

# Schacht & McElroy

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February 5, 2008

Luly Massaro  
Clerk  
Public Utilities Commission  
89 Jefferson Boulevard  
Warwick, RI 02888

Re: BIPCo Rate Case – Docket No. 3900

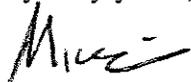
Dear Luly:

As you know, this office represents Block Island Power Company (BIPCo).

Enclosed for filing in this matter are an original and nine copies of BIPCo's financial statements and other financial information for the years ended May 31, 2007 and May 31, 2006. These financial statements were just recently received from BIPCo's auditing firm and are being filed to supplement BIPCo's previous responses to Division data request 1-1 and Town data request 1-1.

If you have any questions, please feel free to call.

Very truly yours,

  
Michael R. McElroy

MRMc:tmg  
BIPCo9:07 Rate-Massaro9  
cc: Service list

**David Bebyn**

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**From:** Sharon Johnson [sjohnson@carluccidugan.com]  
**Sent:** Friday, February 01, 2008 10:04 AM  
**To:** dbebyn@beconsulting.biz  
**Subject:** Block Island Financials  
**Attachments:** Block Island Power-1.pdf

Attached are the financial statements for Block Island Power for the year ended May 31, 2007.

Sharon Johnson  
Certified Bookkeeper  
Carlucci & Dugan  
1525 Old Louisquisset Pike  
Suite B201  
Lincoln, RI 02865  
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**Financial Statements  
and Other Financial Information**

**BLOCK ISLAND POWER COMPANY**

**Years Ended May 31, 2007 and May 31, 2006**

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# CARLUCCI & DUGAN

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
Block Island Power Company  
Block Island, Rhode Island

We have audited the accompanying balance sheet of Block Island Power Company as of May 31, 2007 and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Block Island Power Company as of May 31, 2006, were audited by other auditors whose report dated September 8, 2006, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Block Island Power Company at May 31, 2007, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 14, 2007 on our consideration of Block Island Power Company's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of this audit.

Our audit was performed for the purpose of forming an opinion on the 2007 basic financial statements taken as a whole. The information listed as other financial information in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such 2007 information has been subjected to the auditing procedures applied in the audit of the 2007 basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole. The 2006 other information was audited by other auditors whose report dated September 8, 2006 expressed an unqualified opinion on the 2006 other information.

*Carlucci & Dugan*

December 14, 2007

**BLOCK ISLAND POWER COMPANY**  
**BALANCE SHEETS**  
**May 31, 2007 and 2006**

	<u>2007</u>	<u>2006</u> <u>As Restated</u>
<b>ASSETS</b>		
<b>UTILITY PLANT</b>		
Property, plant and equipment	\$ 8,295,415	\$ 7,803,897
Less accumulated depreciation	<u>3,670,466</u>	<u>3,367,710</u>
<b>NET UTILITY PLANT</b>	4,624,949	4,436,187
<b>CURRENT ASSETS</b>		
Cash	315,143	364,763
Accounts receivable:		
Trade	343,236	338,826
Other	188,929	933,318
Fuel and other inventory	259,214	191,273
Prepaid expenses	11,131	10,895
Deposits	113	113
Current portion of deferred regulatory retirement asset	30,546	11,550
Current portion of deferred regulatory rate asset	61,835	61,835
Deferred regulatory engine and SCR maintenance asset	188,062	68,746
Deferred income tax	<u>—</u>	<u>798</u>
<b>TOTAL CURRENT ASSETS</b>	1,398,209	1,982,117
<b>DEFERRED CHARGES</b>		
Deferred regulatory retirement asset	365,023	332,289
Deferred regulatory rate asset	<u>43,673</u>	<u>105,508</u>
<b>TOTAL DEFERRED CHARGES</b>	408,696	437,797
<b>RESTRICTED ASSETS</b>		
Cash - DSM and IRP surcharges	45,222	54,940
<b>TOTAL ASSETS</b>	<u>\$ 6,477,076</u>	<u>\$ 6,911,041</u>

See accompanying notes.

	<u>2007</u>	<u>2006</u> <u>As Restated</u>
<b>STOCKHOLDERS' EQUITY AND LIABILITIES</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$25 par value, 8,000 shares authorized, issued and outstanding	\$ 200,000	\$ 200,000
Premium on common stock	13,000	13,000
Retained earnings	<u>799,841</u>	<u>799,216</u>
	1,012,841	1,012,216
Less cost of 180 shares of treasury stock	<u>21,485</u>	<u>21,485</u>
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>991,356</b>	<b>990,731</b>
<b>LIABILITIES</b>		
<b>LONG-TERM LIABILITIES</b>		
Retirement obligation	365,023	332,289
Deferred tower lease revenue	133,331	149,998
Long-term debt, less current portion	<u>3,428,631</u>	<u>3,064,121</u>
<b>TOTAL LONG-TERM LIABILITIES</b>	<b>3,926,985</b>	<b>3,546,408</b>
<b>CURRENT LIABILITIES</b>		
Line-of-credit note payable	75,000	75,000
Accounts payable	684,511	1,031,588
Deferred DSM and IRP surcharge revenues	45,222	54,940
Customer deposits	48,019	46,961
Accrued payroll	20,187	30,037
Accrued other expenses	57,674	60,866
Deferred income taxes	9,652	—
Deferred regulatory engine and SCR maintenance obligation	188,062	68,746
Current portion of retirement obligation	30,546	11,550
Current portion of deferred tower lease revenue	16,667	16,667
Current portion of long-term debt	<u>236,878</u>	<u>824,498</u>
<b>TOTAL CURRENT LIABILITIES</b>	<b>1,412,418</b>	<b>2,220,853</b>
<b>DEFERRED CREDITS</b>		
Deferred income tax	103,475	105,236
Accrued deferred income tax - other	40,842	45,813
Deferred rent payment	<u>2,000</u>	<u>2,000</u>
<b>TOTAL DEFERRED CREDITS</b>	<b>146,317</b>	<b>153,049</b>
<b>TOTAL LIABILITIES</b>	<b>5,485,720</b>	<b>5,920,310</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b><u>\$ 6,477,076</u></b>	<b><u>\$ 6,911,041</u></b>

**BLOCK ISLAND POWER COMPANY**  
**STATEMENTS OF INCOME**  
**Years Ended May 31, 2007 and 2006**

	<u>2007</u>	<u>2006</u> <u>As Restated</u>
<b>OPERATING REVENUES</b>		
Electricity charges	\$ 2,105,245	\$ 2,106,074
Fuel surcharge	<u>2,139,368</u>	<u>1,947,890</u>
<b>TOTAL OPERATING REVENUES</b>	4,244,613	4,053,964
<b>OPERATING EXPENSES</b>		
Operations	3,525,914	3,438,114
Maintenance	200,887	281,096
Taxes	243,412	236,818
Depreciation	<u>302,756</u>	<u>231,104</u>
<b>TOTAL OPERATING EXPENSES</b>	<u>4,272,969</u>	<u>4,187,132</u>
<b>LOSS FROM OPERATIONS</b>	(28,356)	(133,168)
<b>OTHER INCOME</b>		
Rental of utility poles and towers	236,324	181,605
Interest	2,679	1,454
Miscellaneous	22,361	71,628
Gain on sale of property	<u>16,464</u>	<u>828,196</u>
<b>TOTAL OTHER INCOME</b>	277,828	1,082,883
<b>OTHER EXPENSES</b>		
Interest	226,277	201,521
Miscellaneous	551	340
Condominium fees	1,330	1,330
Apartment rental	<u>12,000</u>	<u>16,035</u>
<b>TOTAL OTHER EXPENSES</b>	<u>240,158</u>	<u>219,226</u>
<b>INCOME BEFORE INCOME TAXES</b>	9,314	730,489
Income tax expense	<u>8,689</u>	<u>100,150</u>
<b>NET INCOME</b>	<u>\$ 625</u>	<u>\$ 630,339</u>

See accompanying notes.

**BLOCK ISLAND POWER COMPANY**  
**STATEMENTS OF RETAINED EARNINGS**  
**Years Ended May 31, 2007 and 2006**

	<u>2007</u>	<u>2006</u> <u>As Restated</u>
<b>RETAINED EARNINGS AT BEGINNING OF YEAR</b>		
As previously reported	\$ 753,783	\$ 22,610
Adjustment for overstatement of net deferred tax liabilities	<u>45,433</u>	<u>146,267</u>
Balance at beginning of year, as restated	799,216	168,877
Net income	<u>625</u>	<u>630,339</u>
<b>RETAINED EARNINGS AT END OF YEAR</b>	<u>\$ 799,841</u>	<u>\$ 799,216</u>

See accompanying notes.

**BLOCK ISLAND POWER COMPANY**  
**STATEMENTS OF CASH FLOWS**  
**Years Ended May 31, 2007 and 2006**

	<u>2007</u>	<u>2006</u> <u>As Restated</u>
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 625	\$ 630,339
Adjustments to reconcile net income to net cash from (used in) operating activities:		
Depreciation	302,756	231,104
Amortization of deferred regulatory rate asset	61,835	61,835
Amortization of deferred tower lease income	(16,667)	(16,667)
Provision for bad debts	3,183	5,026
Deferred income tax expense	8,689	100,150
Gain on sale of property	(16,464)	(828,196)
Changes in operating assets and liabilities:		
Accounts receivable	736,796	(898,467)
Fuel and other inventory	(67,941)	(131,481)
Prepaid expenses	(236)	(376)
Accounts payable	(347,077)	385,213
Deferred DSM and IRP surcharge revenues	(9,718)	54,940
Customer deposits	1,058	1,824
Accrued payroll and other accrued expenses	(13,042)	79
Accrued deferred income tax - other	(4,971)	7,898
<b>NET CASH FROM (USED IN) OPERATING ACTIVITIES</b>	<b>638,826</b>	<b>(396,779)</b>
<b>INVESTING ACTIVITIES</b>		
Purchases of property, plant and equipment	(491,518)	(597,080)
Deferred regulatory rate asset expenditures	—	(22,733)
Proceeds from sale of assets	16,464	828,196
<b>NET CASH FROM (USED IN) INVESTING ACTIVITIES</b>	<b>(475,054)</b>	<b>208,383</b>
<b>FINANCING ACTIVITIES</b>		
Repayment of long-term debt	(223,110)	(209,648)
Proceeds from long-term debt	—	600,000
<b>NET CASH FROM (USED IN) FINANCING ACTIVITIES</b>	<b>(223,110)</b>	<b>390,352</b>
<b>NET INCREASE (DECREASE) IN CASH</b>	<b>(59,338)</b>	<b>201,956</b>
<b>CASH AT BEGINNING OF YEAR</b>	<b>419,703</b>	<b>217,747</b>
<b>CASH AT END OF YEAR</b>	<b>\$ 360,365</b>	<b>\$ 419,703</b>
<b>SUPPLEMENTAL DISCLOSURES</b>		
Interest paid	\$ 227,356	\$ 198,092

See accompanying notes.

**BLOCK ISLAND POWER COMPANY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE A—SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Business:** The Block Island Power Company (Company), a privately held regulated utility entity, provides electricity to users located on Block Island, Rhode Island. The Company conforms to accounting principles generally accepted in the United States (GAAP) which includes the Financial Accounting Standard Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, and, in accordance with SFAS No. 71, the accounting requirement and rate-making practices of the Federal Energy Regulatory Commission (FERC) and the state public utilities commission.

**Use of Estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management's most significant estimates relate to the allowance for doubtful accounts, inventory valuation and depreciable lives of utility plant and equipment.

**Property, Plant and Equipment:** Depreciation is computed using the straight-line method generally for a period of between three (3) and forty (40) years in accordance with the Public Utility Commission guidelines with regard to asset classification and useful life.

**Cash:** The Company considers all highly liquid investments with a maturity of three months or less when purchased are considered to be cash. The Company maintains its cash accounts in one financial institution. The balances are insured by the Federal Deposit Insurance Corporation up to \$100,000. At May 31, 2007 and 2006, the Company's uninsured cash bank balances totaled \$275,415 and \$272,801, respectively.

**Accounts Receivable:** All of the accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides on the trade receivable for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to trade accounts receivable. Based on management's assessment of the other outstanding accounts receivable, it has concluded that realization losses will be immaterial.

**Fuel and Other Inventory:** Fuel and other inventory is valued at the lower of cost or market determined on the first-in, first-out (FIFO) method.

**BLOCK ISLAND POWER COMPANY  
NOTES TO FINANCIAL STATEMENTS**

**Income Taxes:** The Company recognizes income tax expense based on income reported for financial statement purposes. Income tax expense differs from amounts currently payable because of timing differences in the recognition of certain income and expense items, primarily depreciation, tax loss carryforwards, and contributions in aid. For income tax purposes, the Company depreciates newly acquired assets on the accelerated basis. Further, for income tax purposes regulatory commission expense is expensed as incurred. Contributions in aid revenue are taxable in the year received but recorded in part as a reduction of basis in property and equipment and deferred income (Note K) for financial statement purposes.

**NOTE B—UTILITY PLANT**

The utility plant assets consist of:

	<u>2007</u>	<u>2006</u>
Land and land rights	\$ 79,610	\$ 79,610
Building	507,289	478,015
Machinery and equipment	4,388,017	3,993,137
Furniture and fixtures	89,011	89,011
Distribution system	<u>3,231,488</u>	<u>3,164,124</u>
	<u>\$ 8,295,415</u>	<u>\$ 7,803,897</u>

**NOTE C—DEFERRED REGULATORY RATE ASSET**

On December 17, 2004, the Company filed an application with the Commission of Public Utilities (Commission) to increase its rates above its then authorized rate. In response to the Company's filing, the Commission conducted a standard investigation of the Company's increase request through extensive discovery methods and testimony. The details to this filing and settlement of the increase in rates can be found in the Commission Docket No. 3655. The Company's rate increase became effective for the June 2005 consumption period.

During the fiscal year ended May 31, 2005, the Company incurred various legal and consulting costs during this rate filing process that amounted to \$206,445. The Company in 2006 incurred \$22,733 of additional legal and consulting costs to complete the rate filing process thereby increasing the total rate filing costs to \$229,178. These costs have been amortized beginning June 1, 2005, over a four year period as approved by the Commission. The Commission approved the funding of the rate case expense in the amount of \$61,835 per year for the first three years. The remaining balance of \$43,673 will be amortized during the fourth year. This method properly matches the rate filing expenses incurred with the related future revenues to be recognized through the approved rate increase. As of May 31, 2007 and 2006 \$61,835 is considered current; \$43,673 at May 31, 2007 and \$105,508 at May 31, 2006 is considered non-current.

**BLOCK ISLAND POWER COMPANY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE D—DEFERRED REGULATORY ENGINE AND SCR MAINTENANCE ASSET**

The Company is required to reserve \$210,272 each year, beginning with the fiscal year ended May 31, 2006, to be spent for catalysts for the SCR system, for related SCR work, and for engine maintenance, installation and related work. This requirement is detailed in the Commission of Public Utilities Docket No. 3655 and is a stipulation agreed to by the Company as part of the December 17, 2004 rate increase filing request. The actual cash costs for engine and SCR maintenance, installation and related work are required to be charged to this reserve each year. Any difference between the reserve which has been included in the increased rates and actual costs is required to be addressed in a future proceeding. The actual amount reserved based on the mandated regulatory calculation was \$211,493 in 2007 and \$209,183 in 2006, of which \$92,177 and \$140,436 was actually expended in 2007 and in 2006, respectively. The difference of \$188,062 as of May 31, 2007 and \$68,746 as of May 31, 2006 represents the amount not yet expended on SCR related items and is required to be stated as a deferred regulatory liability with a corresponding deferred regulatory asset.

**NOTE E—ACCOUNTS RECEIVABLE**

Accounts receivable consists of the following:

	<u>2007</u>	<u>2006</u>
Trade receivables	\$ 364,652	\$ 359,185
Less allowance for bad debts	<u>21,416</u>	<u>20,359</u>
	<u>\$ 343,236</u>	<u>\$ 338,826</u>
Other:		
Refundable fuel excise tax	\$ 84,010	\$ 27,004
Advances on Rhode Island gross receipts tax	31,500	30,240
Due from sale of property	16,464	836,437
Rental income	<u>56,955</u>	<u>39,637</u>
	<u>\$ 188,929</u>	<u>\$ 933,318</u>

**NOTE F—RESTRICTED CASH ACCOUNT**

The Company was required to, and did establish, a restricted cash account during the fiscal year ended May 31, 2006, to separately account for revenue required to be reserved for Demand Side Management (DSM) and Integrated Resource Planning (IRP) expenses. The DSM and IRP revenues are derived from a surcharge in the four summer months of \$.01 per kilowatt hour (KWH) for a period of 3 years. This requirement is detailed in the Commission of Public Utilities Docket No. 3655 and is a stipulation agreed to by the Company as part of the December 17, 2004 rate increase filing request. The Company received revenue from this surcharge of \$58,891 in 2007 and \$58,645 in 2006 and incurred DSM and IRP expenses of \$68,609 in 2007 and \$3,705 in 2006. As of May 31, 2007, the restricted cash balance was \$45,222 (\$54,940 at May 31, 2006) which represents deferred surcharge revenues not yet expended on DSM and IRP expenses.

**BLOCK ISLAND POWER COMPANY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE G—RETIREMENT OBLIGATION**

The Company has an agreement with a retired Vice President of the Company to pay him a pension benefit of \$1,000 per month as well as paying his Blue Cross health insurance premiums. The Company also has three agreements with a retired watchman operator, a retired general manager, and retired lineman of the Company to pay each a monthly pension benefit of \$1,000. None of the agreements are part of a qualified plan and the payment will end upon each recipient's death, except for the general manager who will receive payment until age 65.

In accordance with SFAS No. 71, the Company's regulatory agency has authorized the Company to record these obligations as a deferred regulatory asset and amortize them at the same rate as the retirement obligation is reduced.

The present value of these obligations over a life expectancy of 75 years for each recipient, except for the general manager who was calculated to age 65, is \$395,569 at May 31, 2007, of which \$30,546 is considered current and \$365,023 is considered non-current. The interest rate imputed in determining this obligation was 5.0%. The obligation, which is based on the life expectancy of each recipient, is expected to be paid through 2015 for the retired Vice President, through 2018 for the retired watchman operator, through 2013 for the retired general manager, and through 2027 for the retired lineman. The Company also has an agreement with a retired president to pay him a pension benefit of \$2,000 per month. He is currently over 75 years old.

The pension expense charged to operations was \$67,000 for 2007 and \$60,000 for 2006.

**NOTE H—DEFERRED TOWER LEASE REVENUE**

The Company has two agreements with two entities to broadcast from a tower and maintenance building (facility) built on the Company's land by these two entities and donated to the Company. In exchange, these two entities have the right to broadcast from the tower for a fifteen year period expiring in May 2016. The Company capitalized \$250,000 as the estimated cost of the facility with a corresponding deferred credit for the estimated forgone tower lease income that the Company would have received from the entities. Both the cost of the facility and the deferred revenues are being amortized over the term of the agreements. Deferred tower lease revenue is scheduled to be recognized at \$16,667 for each year ending May 31, 2008 through 2016.

**BLOCK ISLAND POWER COMPANY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE I—LONG TERM DEBT**

Long-term debt consists of:

	<u>2007</u>	<u>2006</u>
7.75% note payable to bank in monthly payments of \$11,730 including interest until April 2008, secured by a mortgage on certain real estate located in New Shoreham, RI, a second position security interest in certain property, and a guarantee pledge of 97.75% of the Company's stock.	\$ 132,670	\$ 257,583
Note payable - in June 2000, the Company entered into an agreement with Rural Utilities Service (RUS) to obtain low interest loan advances through the Federal Financing Bank (FFB). The financing was used to improve its generation and distribution systems as well as restructure some of its outstanding debt. RUS has a first position security interest in all assets. There were seven separate advances from August 2000 to March 2003 which total \$3,339,963. The seven individual advances to the Company require quarterly payments totaling \$64,293 including interest, with various fixed rates from 4.392% to 5.915% and final payments in December 2024.	2,932,839	3,031,036
Note payable to bank with interest equal to the bank's prime rate plus 1%, currently 9.25%. In June 2007, this note to the bank was paid from an eighth advance from the RUS funded by FFB with interest at 5.24% and requiring quarterly payments of \$11,138 commencing September 2008. The scheduled final payment is December 2031.	<u>600,000</u>	<u>600,000</u>
	3,665,509	3,888,619
Less current portion	<u>236,878</u>	<u>824,498</u>
	<u>\$ 3,428,631</u>	<u>\$ 3,064,121</u>

**BLOCK ISLAND POWER COMPANY  
NOTES TO FINANCIAL STATEMENTS**

The aggregate annual maturities of the long-term debt are as follows:

Year ending May 31, 2008	\$ 236,878
2009	119,678
2010	129,223
2011	135,979
2012	143,035
Thereafter	<u>2,900,716</u>
	<u>\$ 3,665,509</u>

**NOTE J—INCOME TAX EXPENSE (BENEFIT)**

Income tax expense consists of deferred income taxes of \$8,689 in 2007 and \$100,150 in 2006, as restated.

A reconciliation of expected income tax expense calculated by applying the statutory federal tax rate to pretax income is as follows:

	<u>2007</u>	<u>2006</u> <u>As Restated</u>
Expected income tax expense	\$ 1,397	\$ 109,573
Tax depreciation in excess of book depreciation	15,767	1,203
Change in collection of fuel excise tax	8,551	(4,950)
Amortization of deferred regulatory rate asset	(9,275)	(9,275)
Change in allowance for doubtful accounts	(158)	(687)
Net operating loss utilization (carryover)	(8,338)	5,471
Other	<u>745</u>	<u>(1,185)</u>
<b>Income Tax Expense</b>	<u>\$ 8,689</u>	<u>\$ 100,150</u>

The Company has a net operating loss of \$464,832 which expires in May 2025.

**BLOCK ISLAND POWER COMPANY  
NOTES TO FINANCIAL STATEMENTS**

The tax effect of significant temporary differences that result in deferred tax assets and liabilities are as follows:

	<u>2007</u>	<u>2006</u> <u>As Restated</u>
Deferred tax assets:		
Utility plant basis	\$ 28,036	\$ 32,595
Net operating loss carryover	69,725	62,784
Allowance for bad debts	3,212	3,054
Aid-In-Construction contribution	<u>6,127</u>	<u>6,872</u>
	107,100	105,305
Deferred tax liabilities:		
Utility plant basis	(191,800)	(180,591)
Deferred regulatory rate asset	(15,826)	(25,101)
Accounts receivable fuel excise	<u>(12,601)</u>	<u>(4,051)</u>
	<u>(220,227)</u>	<u>(209,743)</u>
	<u>\$ (113,127)</u>	<u>\$ (104,438)</u>

The components of deferred tax assets and liabilities are as follows:

	<u>2007</u>	<u>2006</u> <u>As Restated</u>
Current assets	\$ 12,225	\$ 14,124
Current liabilities	<u>(21,877)</u>	<u>(13,326)</u>
<b>Net current deferred tax assets (liabilities)</b>	<u>\$ (9,652)</u>	<u>\$ 798</u>
Non-current assets	\$ 94,876	\$ 91,181
Non-current liabilities	<u>(198,351)</u>	<u>(196,417)</u>
<b>Net non-current deferred tax liabilities</b>	<u>\$ (103,475)</u>	<u>\$ (105,236)</u>

**NOTE K-ACCRUED DEFERRED INCOME TAX - OTHER**

The Company collects an amount in excess of the dollars necessary to construct utility assets funded by contributions in aid to construction. This "gross up" amount represents the difference between the cost of paying federal income taxes in the year the contribution in aid is received and the present value of the future depreciation stream allowed for federal income tax purposes.

Each year's gross up amount is amortized over 15 years (tax useful life) and charged against interest expense. The amount amortized against interest expense was \$6,502 in 2007 and \$7,480 in 2006. In order to properly reflect the utility plant assets, the accrued deferred income tax - other account was established. This presentation is consistent with the Uniform System of Accounts for Class A and B Electric Utilities promulgated by the National Associations of Regulatory Utility Commissioners.

**BLOCK ISLAND POWER COMPANY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE L—COMMITMENTS AND CONTINGENCIES**

**Litigation:** During the ordinary course of business, the Company is a party to various claims, legal actions and complaints. In the opinion of management and legal counsel, these matters are not anticipated to have a material financial impact on the Company.

**Commitments**

The Company has a credit agreement with the Washington Trust Company that requires the submission of audited financial statements for each fiscal year through April 1, 2008.

The Company has complied with this requirement for the fiscal years ended May 31, 2007 and 2006.

The Company has a credit agreement with the U.S. Department of Agriculture Rural Utilities Service Guaranteed Loan Program that requires the submission of information regarding net worth, current ratio, cash flow coverage, and earnings for each fiscal year through December 31, 2024.

The Company did not meet two of the four required minimum credit agreement financial ratio standards for the calendar year ended December 31, 2006, but did meet all the standards for the calendar year ended December 31, 2005. For the fiscal year ended May 31, 2007, the Company was not in default of this debt; however, two consecutive years of below standard reporting would constitute noncompliance with the debt covenants which may result in default of this debt.

**NOTE M—LEASES**

The Company leases certain vehicles which are used by management and staff. The leases, which are for 36 to 39 month periods and which expire in March 2010, are classified as operating leases. The leases stipulate the company pay for certain costs such as taxes, maintenance and insurance. In addition, the leases require contingent rentals based on mileage in excess of specified minimums. Future minimum payments for the years ending May 31, 2008 and 2009 is \$23,588 and May 31, 2010 is \$19,740 for a total of \$67,116.

Lease expense was \$24,407 for 2007 and \$24,513 for 2006.

**NOTE N—PENSION PLAN**

The Company maintains a qualified defined contribution plan which covers all employees that meet the Plan's eligibility requirements. The contribution for each fiscal year is an amount determined by vote of the directors and communicated to the participants on or before the end of each year. Contributions charged to operations were \$13,271 in 2007 and \$13,450 in 2006.

**BLOCK ISLAND POWER COMPANY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE O-RELATED PARTY TRANSACTIONS**

During 2007 and 2006, the following related party transactions occurred:

- a.) The Company receives fuel deliveries from IFR Trucking which is owned by a stockholder of the Company. The total delivery expense was \$27,407 for 2007 and \$26,000 for 2006.
- b.) The Company rented a garage, an apartment, and land to the Ballard Oil Company. The Ballard Oil Company is owned by a son of the Vice President of Plant Operations. The total related rental income for 2007 was \$0 and \$7,200 for 2006.
- c.) The Company purchases heating oil from the Ballard Oil Company. The Ballard Oil Company is owned by a son of the Vice President of Plant Operations. The total related oil expense for 2007 was \$7,296 and \$8,238 for 2006.
- d.) The Company rented space on its utility poles to the Block Island Cable Company. The Block Island Cable Company is owned by the Vice President of Plant Operations. The total related income for 2007 was \$3,249 and \$1,703 for 2006. In October 2007, Block Island Cable Company removed its cable lines and is no longer renting the poles from the Company.
- e.) The Company rents an oil storage tank to the Ballard Oil Company. The Ballard Oil Company is owned by a son of the Vice President of Plant Operations. The total related income for 2007 was \$6,680 and \$7,560 for 2006.
- f.) The Company provides free electricity to its President and Vice President of Operations. The total value of the related free electricity based on usage for 2007 was \$7,625 and \$7,260 for 2006.

**NOTE P-PRIOR PERIOD ADJUSTMENT**

Certain errors resulting in an overstatement of the previously reported net deferred income tax liability were discovered during the 2007 year. Accordingly, adjustments were made during 2007 to reduce net deferred taxes as of the beginning of 2007 for \$45,433 and 2006 for \$145,267. Corresponding entries were made to increase previously reported retained earnings by similar amounts. As a result of these adjustment the 2006 financial statements were restated as follows:

- The 2006 income tax expense was increased and net income was reduced by \$100,834.
- Total 2006 deferred income tax liability was reduced by \$60,698 and deferred income tax asset was decreased by \$15,265.

**BLOCK ISLAND POWER COMPANY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE Q—SUBSEQUENT EVENTS**

On November 9, 2007, the Company filed an application with the Rhode Island Public Utilities Commission (Commission) to increase its rates. The Company is seeking a rate increase of approximately 8.9% over test year May 31, 2007 revenues. The new rates were proposed to take effect on December 9, 2007. However, the Commission can suspend the effective date of the proposed rates up to six months. No rate change will take effect until the Commission has conducted a full investigation into the proposal.

**OTHER FINANCIAL INFORMATION**

**BLOCK ISLAND POWER COMPANY**  
**SUPPLEMENTAL SCHEDULES OF EXPENSES**  
**Years Ended May 31, 2007 and 2006**

	<u>2007</u>	<u>2006</u>
<b>OPERATIONS</b>		
<b>POWER PRODUCTION EXPENSES</b>		
Supervision	\$ 22,232	\$ 26,086
Fuel purchases	1,926,580	1,773,519
Fuel handling	807	7,184
Fuel procurement	107,078	115,444
Watchman	107,957	111,527
Lubrication	24,747	22,586
Freight	86	1,092
Inside maintenance	73,100	81,760
Automobile repair	5,463	11,041
Purchased power	3,740	1,093
Miscellaneous costs (includes inventory change)	<u>1,938</u>	<u>3,620</u>
<b>TOTAL POWER PRODUCTION EXPENSES</b>	<b>2,273,728</b>	<b>2,154,952</b>
<b>DISTRIBUTION EXPENSES</b>		
Supervision	23,005	26,407
Overhead lines	45,365	12,958
Underground lines (PR)	38	—
Meters	1,927	179
Customer installation	376	39
Lease motor vehicle	24,407	24,513
Outside lineman services	51,074	134,728
Miscellaneous	<u>6,256</u>	<u>591</u>
<b>TOTAL DISTRIBUTION EXPENSES</b>	<b>152,448</b>	<b>199,415</b>
<b>CUSTOMER ACCOUNT EXPENSES</b>		
Meter reading	9,236	8,981
Records and collection	<u>17,610</u>	<u>16,816</u>
<b>TOTAL CUSTOMER ACCOUNT EXPENSES</b>	<b>26,846</b>	<b>25,797</b>
<b>ADMINISTRATIVE AND GENERAL EXPENSES</b>		
Office salaries	16,930	17,073
Vacation pay	23,474	19,690
Holiday pay	5,765	3,530
Holiday not worked	10,692	7,466
Sick leave pay	6,044	4,309
Personal days	3,227	2,021
Office supplies	37,083	57,697
Outside services	<u>152,572</u>	<u>235,162</u>

**BLOCK ISLAND POWER COMPANY**  
**SUPPLEMENTAL SCHEDULES OF EXPENSES—Continued**  
**Years Ended May 31, 2007 and 2006**

	<u>2007</u>	<u>2006</u>
Employees private pension	67,000	60,000
Profit sharing	13,271	13,450
Insurance	119,548	117,153
Accounting	74,868	34,915
Travel	5,564	2,043
Employees benefits	139,193	132,040
Employee bonus	9,490	8,952
Regulatory commission	71,342	71,229
Provision for bad debts	3,183	5,026
Officers' salaries	168,000	133,000
Directors' meetings	7,950	2,500
Clean air compliance	60,822	71,227
Environmental	66,567	49,702
Underground cable project	—	350
Trash disposal	<u>10,307</u>	<u>9,415</u>
<b>TOTAL ADMINISTRATIVE AND GENERAL EXPENSES</b>	<u>1,072,892</u>	<u>1,057,950</u>
<b>TOTAL OPERATIONS</b>	<u>\$ 3,525,914</u>	<u>\$ 3,438,114</u>
<b>MAINTENANCE</b>		
<b>GENERATION OF ELECTRICAL PLANT EXPENSES</b>		
Supervision	\$ 21,702	\$ 25,765
Gasoline	17,747	—
Miscellaneous	<u>174</u>	<u>395</u>
<b>TOTAL GENERATION OF ELECTRICAL PLANT EXPENSES</b>	39,623	26,160
<b>DISTRIBUTION EXPENSES</b>		
Supervision	22,050	25,846
Overhead lines	9,107	18,787
Small station equipment	—	8,456
Line transformers	—	233
Street light and signals	139	39
Meter maintenance	<u>429</u>	<u>2,973</u>
<b>TOTAL DISTRIBUTION EXPENSES</b>	31,725	56,334

**BLOCK ISLAND POWER COMPANY**  
**SUPPLEMENTAL SCHEDULES OF EXPENSES—Continued**  
**Years Ended May 31, 2007 and 2006**

	<u>2007</u>	<u>2006</u>
<b>GENERAL PLANT EXPENSES</b>		
Small tools	—	2,996
Tank testing	—	1,250
Generator and general plant maintenance	116,140	180,026
Hazardous removal	13,399	12,036
Uniforms	—	2,294
	<u>129,539</u>	<u>198,602</u>
<b>TOTAL GENERAL PLANT EXPENSES</b>	<u>129,539</u>	<u>198,602</u>
<b>TOTAL MAINTENANCE</b>	<u>\$ 200,887</u>	<u>\$ 281,096</u>
<b>TAXES</b>		
Payroll	\$ 38,313	\$ 38,132
Registrations	1,792	1,884
Sales	3,730	4,539
Rhode Island gross earnings tax	184,452	175,035
Property tax	15,125	17,228
	<u>243,412</u>	<u>236,818</u>
<b>TOTAL TAXES</b>	<u>\$ 243,412</u>	<u>\$ 236,818</u>

# CARLUCCI & DUGAN

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## **INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

To the Board of Directors  
Block Island Power Company  
Block Island, Rhode Island

We have audited the financial statements of the Block Island Power Company (the Company), as of and for the year ended May 31, 2007, and have issued our report thereon dated December 14, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Company's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

## Compliance

As part of obtaining reasonable assurance about whether the Company's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, management, and federal awarding agencies, and is not intended to be, and should not be used by anyone other than these specified parties.

*Carlucci & Dugan*

December 14, 2007