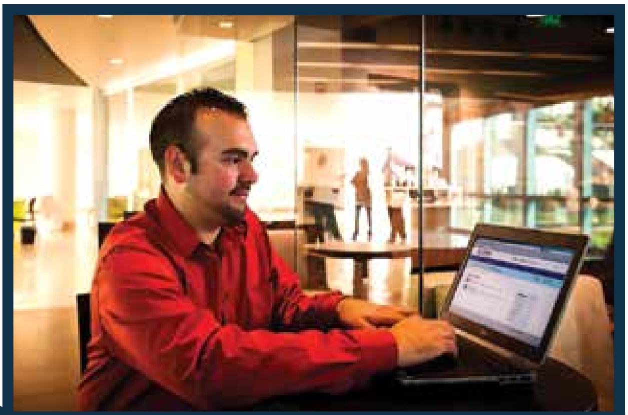
# CITIZENS ENERGY GROUP

# MANAGEMENT DISCUSSION & FINANCIAL REPORT 2014



# CUSTOMER FIRST

# MANAGEMENT DISCUSSION & ANALYSIS

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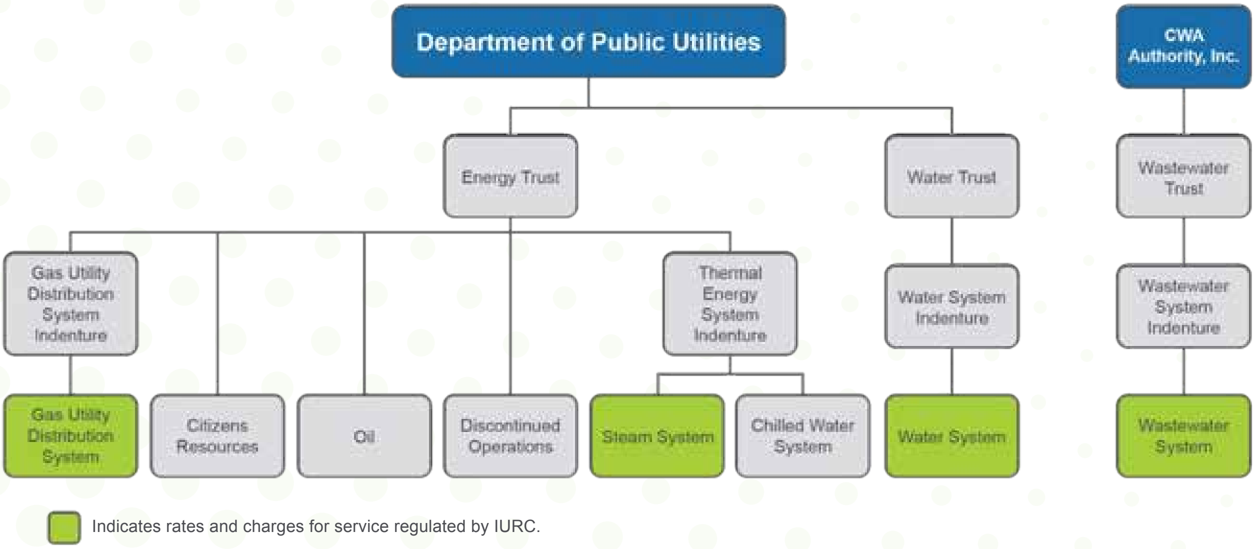
**Forward-looking Statements**
Certain matters discussed in this report, except historical information, include forward-looking statements. The forward-looking statements herein are necessarily based on various assumptions and estimates, are inherently subject to various risks and uncertainties, including risks and uncertainties relating to the possible invalidity of the underlying assumptions and estimates and possible changes or developments in social, economic, business, industry, market, legal and regulatory circumstances and conditions and actions taken or omitted to be taken by third parties, including customers, suppliers, business partners and competitors, and legislative, judicial and other governmental authorities and officials. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and, therefore, there can be no assurance that the forward-looking statements contained in this Management Discussion and Analysis would prove to be accurate.  We do not undertake to update or revise any forward-looking statement as a result of future events, new information, or otherwise.

**Organization Structure**
The chart below provides a diagram of the organization structure of Citizens Energy Group and CWA Authority, Inc. (CWA). The organization structure is further described and explained below the chart.




Citizens Energy Group (Citizens) is the trade name in which the Department of Public Utilities of the City of Indianapolis, Indiana (the Department) acting by and through its Board of Directors (the Board) for Utilities functions. The Department was formed in 1929 pursuant to a state statute (now IC 8-1-11.1, the Act) adopted by the Indiana legislature to provide the governance structure for the City of Indianapolis to act as a successor trustee of a public charitable trust (the Energy Trust) providing natural gas utility services in the City of Indianapolis and to own and operate other utility systems serving areas within and outside the City of Indianapolis. The Department is the governmental entity that owns the Energy Trust and Water Trust assets described below. Each trust is not an entity, but rather defines the nature in which the assets are held by the Department and the obligation imposed upon the Department to manage and operate those assets in accordance with the trust purposes which include the obligations to operate the facilities in public trust for the benefit of the inhabitants of Marion County, free from the influences of partisan political control or private interests. To preserve freedom from partisan political control, the Act creates the Board of Trustees (the Trustees) as a self-perpetuating body entrusted with the power to appoint the members of the Board annually. This two-board structure provides for oversight of the Board by the Trustees. Further, the Act intentionally insulates the Department from political control by isolating the two boards from the Mayor of Indianapolis or the City's legislative bodies.

The Gas Utility Distribution System, the Thermal Energy System, Citizens Resources and certain other properties are subject to the Energy Trust. The Water System is subject to a separate public charitable trust (the Water Trust) that operates in substantially the same manner as the Energy Trust.

The Wastewater System is owned by CWA, a separate non-profit corporation, which, through an interlocal agreement entered into between Citizens and the City of Indianapolis pursuant to Indiana Code 36-1-7, has the power to exercise all rights and powers of the City, except the City’s taxing power, and Citizens in connection with the provision of wastewater utility services. CWA’s board of directors comprises the same individuals who serve on the Board. The Wastewater

System is managed by employees of Citizens under an operating agreement between Citizens and CWA. CWA is subject to a separate public charitable trust (the Wastewater Trust) that operates in substantially the same manner as the Energy Trust and the Water Trust.

Separate indentures exist to issue debt obligations for the Gas Utility Distribution System, the Thermal Energy System, the Water System and the Wastewater System. Each indenture captures only the revenues from the respective System, pays the operating expenses of that System and then debt service on revenue bonds of that System. This structure is designed to achieve the desired separation of each System from other Systems or business segments owned or operated by Citizens and CWA. Each indenture permits Citizens or CWA, as applicable, authority to use residual revenues for other purposes permitted by the language of the respective indenture. Citizens' water indenture and CWA's wastewater indenture, however, permit only the use of the excess revenues for the water and wastewater systems, respectively.

In addition as described above, each trust (i.e., the Energy Trust, the Water Trust and the Wastewater Trust) exists separately from the other trusts. Thus, there are three separate public charitable trusts, each with a governmental entity serving as the trustee (the Energy Trust and the Water Trust assets being owned by the Department and the Wastewater Trust assets being owned by CWA). These separate trusts are designed to insulate one trust from liability for obligations of another trust, based on basic trust principles that two separate trusts do not become jointly liable solely because the same entity is the trustee of both.

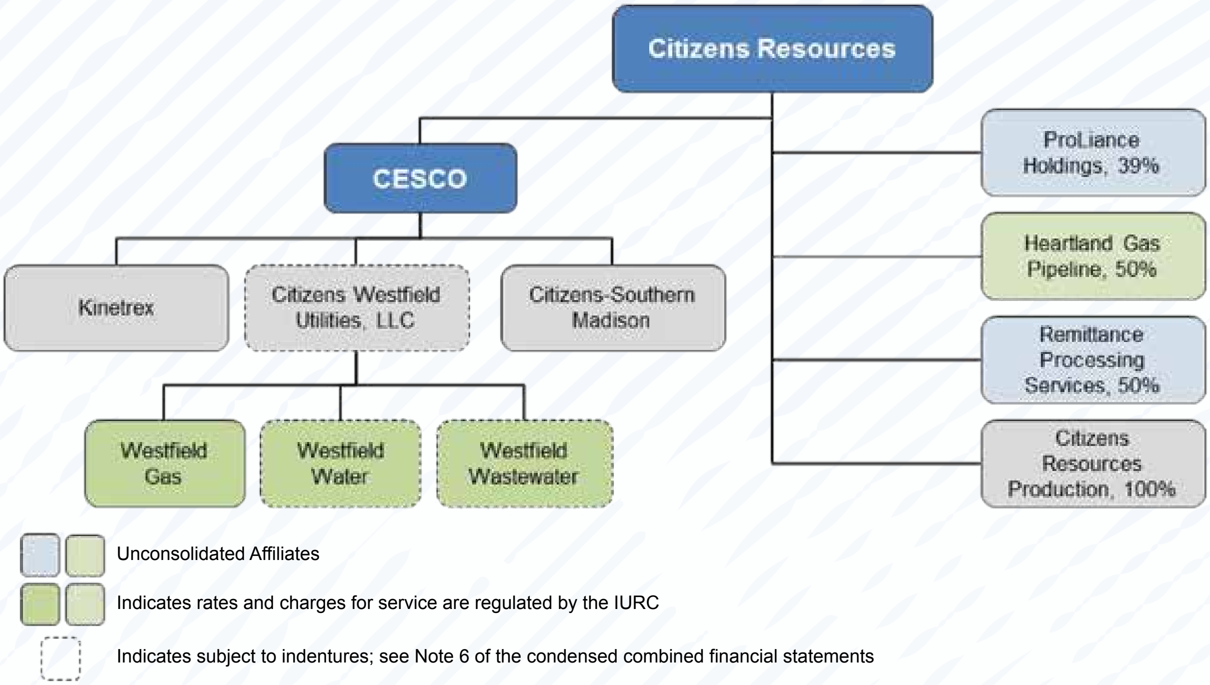
The result of the foregoing is that Citizens and CWA have five distinct cash flow sources in which debt is isolated: (1) the Gas Utility Distribution System and the Gas Utility System;[1] (2) the Thermal Energy System; (3) the Water System; (4) the Wastewater System; (collectively, the four Systems) and (5) Citizens Resources. The cash flow for the four Systems is governed by the respective indentures for each System, which restricts the use of income and revenues of a respective System to the payment of operating expenses and debt service of the respective System before allowing any other use of funds by the System. The fifth source, Citizens Resources is a separate corporation whose stock is owned by the Department in its capacity as trustee of the Energy Trust. The preservation of the corporate organization form of Citizens Resources and its ability to operate for-profit businesses in furtherance of the Energy Trust purposes was specifically authorized by the Act. The assets, liabilities and operations of Citizens Resources are by design isolated within the separate corporate structure of Citizens Resources, as a subsidiary corporation of Citizens, and each of the direct and indirect subsidiaries of Citizens Resources is a limited liability company or corporation designed to limit the liability of the immediate parent to its investment in the subsidiary.[2] Those structures do not insulate the parent from liability for an express assumed contractual liability or guaranty or for the parent's own acts or omissions. In addition to the separate trusts for the Water System and the Wastewater System, those structures along with certain provisions of the Operating Agreements of such subsidiaries of Resources are the primary protection of Citizens' cash flow from any financial losses in Citizens Resources or its subsidiaries and affiliates.[3] Profits of Citizens Resources may roll up to Citizens through dividends declared by the board of Citizens Resources, but Citizens' exposure to liabilities of Citizens Resources should be limited by its corporate structure (and by that of its subsidiaries) and thus not imposed as a burden on the cash flows available in any System. See below for a diagram of Citizens Resources' organizational structure.

[1] The 1986 Gas Utility System (GUS) bonds are debt of the Gas Utility Distribution System (GUDS). Debt service on the GUS bonds is included in the revenue requirements for determining the rates and charges of the GUDS by the IURC. The GUS Indenture is not used for issuance of new debt. The bonds issued under the GUS Indenture are senior to the bonds issued under the GUDS Indenture. Bondholder security for the GUS bonds includes the net revenues after payment of operating expenses of the GUDS, Oil and Discontinued Operations as well as any dividends paid by Citizens Resources for so long as bonds are outstanding under that Indenture. However, as explained below the corporate structure of Citizens Resources should limit the GUS exposure to liabilities of Citizens Resources and its subsidiaries. The final principal payment on the 1986 GUS bonds will occur in 2018 at which point no Indenture of the four Systems will include Oil, Discontinued Operations or Citizens Resources.

[2] Under public policy reflected in state law governing corporations and limited liability companies ("LLCs"), the parent stockholder of a subsidiary corporation or the parent member of a subsidiary LLC is given substantial protection against liability for the acts or debts of the subsidiary, subject to the established inherent limitations of these structures under such applicable state law.

[3] Since Citizens includes the results of operations of Citizens Resources and its subsidiaries and affiliates in its combined financial statements, an accounting loss within Citizens Resources will be reflected in Citizens' combined financial statements. This accounting result, though, does not create the basis upon which the liabilities of Citizens Resources or its subsidiaries or affiliates can be imposed upon Citizens or the cash flows held under any Indentures.

On January 10, 2014, Citizens Westfield Utilities, LLC (CWU) was formed to serve as an intermediate holding company for Westfield Gas (which was transferred to CWU in March, 2014) and for Westfield Water and Westfield Wastewater upon their acquisition, which took place on March 21, 2014 (see Note 4A of the combined financial statements).




## FINANCIAL RESULTS

### Segment Results

The tables below summarize the financial results for each segment (in millions) for the twelve months ended September 30, 2014 and 2013. For a more detailed understanding of these summarized results, see Note 10 of the combined financial statements.

### SHARED SERVICES

| | 2014 | 2013 | Change |
|---|---|---|---|
| Corporate Support Services | $ 78.5 | $ 87.7 | $ (9.2) |
| Shared Field Services | 22.9 | 24.8 | (1.9) |
| Shared Services Expenses | $ 101.4 | $ 112.5 | $ (11.1) |

The variance was primarily driven by:

- A $7.5 million decrease in labor and related costs;
- A $2.2 million decrease in information technology hardware, software and contracted services costs; and
- A $1.6 million decrease in administrative support and fleet fuel expenses.

Partially offset by:

- A $0.7 million increase in depreciation expense.

The costs have been allocated to the appropriate business units and are reflected in the explanations that follow.

## GAS

| | 2014 | 2013 | Change |
|---|---|---|---|
| Operating revenues | $ 319.7 | $ 279.1 | $ 40.6 |
| Cost of goods sold | 177.8 | 141.1 | 36.7 |
| Margin | 141.9 | 138.0 | 3.9 |
| Other operating expenses | 102.9 | 113.4 | (10.5) |
| Operating income | 39.0 | 24.6 | 14.4 |
| Other income (expense), net | (0.7) | (2.3) | 1.6 |
| Interest charges | 15.7 | 16.8 | (1.1) |
| Segment income | $ 22.6 | $ 5.5 | $ 17.1 |
| Volume sales, million Dth | 55.3 | 47.0 | 8.3 |
| Cost of gas sold, per Dth | $ 5.42 | $ 4.89 | $ 0.53 |
| Heating Degree Days | 6,251 | 5,351 | 900 |

**Twelve Months Ended September 30, 2014 as Compared to 2013**

*Margin.* The variance was primarily driven by:

- A $1.4 million increase in revenue components related to gas cost which are largely offset in other operating expenses;
- A $2.4 million increase in billed margin due largely to increased retail sales volume, net of decoupling and Normal Temperature Adjustment (NTA) mechanisms;
- A $1.1 million write-down in 2013 for non-recoverable gas costs; and
- A $1.2 million increase in power generation sales and other fees, including late payment fees.

Partially offset by:

- A $2.2 million decrease in miscellaneous items, including timing of gas cost recovery.

*Other operating expenses.* The variance was primarily driven by:

- A $8.3 million decrease in shared administrative and field services costs; and
- A $3.8 million decrease in labor and labor-related costs.

Partially offset by:

- A $1.5 million increase in property tax and Indiana Utility Receipts Tax (IURT).

*Other income (expense), net.* The variance was primarily driven by:

- A $2.4 million loss in 2013 on the sale of liquefied natural gas inventory to Kinetrex at fair market value.

Partially offset by:

- A $0.8 million contribution to low income assistance plans in the current year.

*Interest charges.* The variance is due to lower interest related to a 2013 refinancing of the 2008A bonds and lower interest related to declining principal amount of outstanding debt.

## STEAM

| | 2014 | 2013 | Change |
|---|---|---|---|
| Operating revenues | $ 81.7 | $ 66.9 | $ 14.8 |
| Cost of goods sold | 47.3 | 37.1 | 10.2 |
| Margin | 34.4 | 29.8 | 4.6 |
| Other operating expenses | 27.7 | 30.0 | (2.3) |
| Operating income (loss) | 6.7 | (0.2) | 6.9 |
| Other income (expense), net | - | - | - |
| Interest charges | 3.3 | 3.0 | 0.3 |
| Segment income (loss) | $ 3.4 | $ (3.2) | $ 6.6 |
| Volume sales, million therms | 67.7 | 64.3 | 3.4 |
| Heating Degree Days | 6,251 | 5,351 | 900 |

**Twelve Months Ended September 30, 2014 as Compared to 2013**

*Margin.* The variance was primarily driven by:

- A $2.6 million increase in margin due to higher volume sales as a result of colder weather and growth; and

- A $1.9 million increase in operating revenues primarily due to a rate increase effective May 30, 2014 (see Note 2M.1 – Citizens Thermal Steam).

*Other operating expenses.* The variance was primarily driven by:

- A $2.4 million decrease mostly due to lower operating and plant maintenance costs resulting from the Natural Gas Conversion (see Note 2M.1 – Citizens Thermal Steam for more information on the conversion of the Perry K plant to natural gas);
- A $1.0 million decrease due to reduced shared administrative and field services costs; and
- A $0.4 million decrease in labor-related costs.

Partially offset by:

- A $1.2 million increase in plant maintenance expenses due to the write-off of obsolete spare part inventory caused by the Natural Gas Conversion (non-cash); and
- A $0.6 million increase in distribution expenses mostly due to a low pressure optimization project.

*Interest charges.* Consistent with prior year.

**CHILLED WATER**

| | 2014 | 2013 | Change |
|---|---|---|---|
| Operating revenues | $ 38.1 | $ 41.9 | $ (3.8) |
| Cost of goods sold | 12.1 | 13.1 | (1.0) |
| Margin | 26.0 | 28.8 | (2.8) |
| Other operating expenses | 19.6 | 17.1 | 2.5 |
| Operating income | 6.4 | 11.7 | (5.3) |
| Other income (expense), net | - | - | - |
| Interest charges | 2.5 | 2.6 | (0.1) |
| Segment income | $ 3.9 | $ 9.1 | $ (5.2) |
| Volume sales, million ton hours | 143.2 | 167.9 | (24.7) |

**Twelve Months Ended September 30, 2014 as Compared to 2013**

*Margin.* The change was primarily driven by:

- A $2.5 million decrease due to lower sales volumes as a result of the sale of the Indianpolis Campus Energy (ICE) plant (see Note 2L of the combined financial statements); and
- A $1.3 million decrease due to the impacts of cooler summer weather.

*Other Operating expenses.* The variance was primarily driven by:

- A $2.8 million net loss incurred on the sale of the ICE plant, of which $2.5 million was non-cash (see Note 2L); and
- A $0.4 million increase in depreciation expense.

Partially offset by:

- A $0.8 million decrease in operating expenses resulting from the sale of the ICE plant;
- A $0.6 million decrease in various operating expenses; and
- A $0.5 million decrease in franchise and property taxes.

*Interest charges.* Consistent with prior year.

**OIL**

| | 2014 | 2013 | Change |
|---|---|---|---|
| Operating revenues | $ 6.6 | $ 6.1 | $ 0.5 |
| Operating expenses | 2.1 | 2.6 | (0.5) |
| Operating income | 4.5 | 3.5 | 1.0 |
| Other income (expense), net | - | - | - |
| Interest charges | - | - | - |
| Segment income | $ 4.5 | $ 3.5 | $ 1.0 |
| Volume sales, thousand barrels | 83.0 | 79.9 | 3.1 |

**Twelve Months Ended September 30, 2014 as Compared to 2013**

Operating revenues. The variance was primarily driven by higher oil prices and increased production.

Operating expenses. The variance was primarily driven by a decrease in maintenance expenses and damage claims reserve.

**WATER**

| | 2014 | 2013 | Change |
|---|---|---|---|
| Operating revenues | $ 169.2 | $ 163.4 | $ 5.8 |
| Operating expenses | 129.2 | 131.4 | (2.2) |
| Operating income | 40.0 | 32.0 | 8.0 |
| Other income (expense), net | 2.0 | 8.2 | (6.2) |
| Interest charges | 50.7 | 49.0 | 1.7 |
| Segment loss | $ (8.7) | $ (8.8) | $ 0.1 |
| Volume sales, billion gallons | 38.0 | 37.7 | 0.3 |

**Twelve Months Ended September 30, 2014 as Compared to 2013**

Operating revenues. The increase was primarily driven by a rate increase effective April 1, 2014 (see Note 2M.1 – Water). However, Citizens estimates the effect of unseasonably cool and wet weather caused 2014 revenues to be in a range of approximately $10.0 million to $13.7 million less than would have been realized based on historical normal weather averages.

Operating expenses. The variance was primarily driven by:

- A $2.5 million decrease in shared administrative and field services costs;
- A $1.5 million decrease in bad debt expense; and
- A $1.0 million decrease in contract services.

Partially offset by:

- A $2.4 million increase in depreciation; and
- A $0.7 million increase in sludge processing.

Other income (expense), net. The decrease was primarily driven by:

- The 2013 receipt of $3.2 million amounting to Citizens' share of remaining proceeds upon expiration of an escrow account established attendant to the acquisition transaction; and
- The 2013 receipt of $2.8 million for a class action lawsuit settlement relating to the chemical atrazine.

Interest charges. The increase was primarily driven by capitalized interest.

**WASTEWATER**

| | 2014 | 2013 | Change |
|---|---|---|---|
| Operating revenues | $ 187.6 | $ 156.2 | $ 31.4 |
| Operating expenses | 142.2 | 135.8 | 6.4 |
| Operating income | 45.4 | 20.4 | 25.0 |
| Other income (expense), net | 0.2 | 0.3 | (0.1) |
| Interest charges | 49.8 | 49.1 | 0.7 |
| Segment loss | $ (4.2) | $ (28.4) | $ 24.2 |
| Volume billed, billion gallons | 34.1 | 34.6 | (0.5) |
| Strength surchg., million pounds | 44.2 | 41.7 | 2.5 |

**Twelve Months Ended September 30, 2014 as Compared to 2013**

Operating revenues. The variance was primarily driven by a rate increase effective May 1, 2014 (see Note 2M.1 – Wastewater).

Operating expenses. The variance was primarily driven by:

- A $2.0 million increase in contract fees;
- A $1.3 million increase in depreciation expense due an increase in depreciable assets;

- A $1.3 million increase in fuel costs;
- A $1.2 million increase in purchased power; and
- A $1.1 million increase in material and supplies expense.

Partially offset by:

- A $0.8 million decrease in shared administrative and field services costs.

*Other income (expense), net.* Consistent with prior year.

*Interest charges.* Consistent with prior year.

**RESOURCES**

| | 2014 | 2013 | Change |
|---|---|---|---|
| Operating revenues | $ 33.9 | $ 5.0 | $ 28.9 |
| Cost of goods sold | 15.2 | 2.4 | 12.8 |
| Margin | 18.7 | 2.6 | 16.1 |
| Other operating expenses | 17.2 | 7.7 | 9.5 |
| Operating income (loss) | 1.5 | (5.1) | 6.6 |
| Other income (expense), net | 0.2 | 1.3 | (1.1) |
| Equity in loss of affiliates | (2.1) | (38.4) | 36.3 |
| Interest charges | 2.4 | - | 2.4 |
| Segment loss | $ (2.8) | $ (42.2) | $ 39.4 |

**Twelve Months Ended September 30, 2014 as Compared to 2013**

*Margin.* The variance was primarily driven by the activities at Kinetrex, Southern Madison Water, Westfield Water, Westfield Wastewater and oil production at Citizens Resources Production, which either did not exist or had no material activity in the prior year period.

*Operating expenses.* The variance was primarily driven by:

- A $6.0 million increase in operating expenses related to the activities of Kinetrex, Southern Madison Water, Westfield Water, and Westfield Wastewater which either did not exist or had no material activity in the prior year period; and
- A $3.4 million allowance for the value of the uncollectible portion of note principal on a note receivable with ProLiance (see Note 5).

*Other income (expense), net.* The variance was primarily driven by non-recurring miscellaneous income in 2013.

*Equity in affiliates.* The variance was primarily driven by:

- A $36.1 million increase related to ProLiance, mostly driven by the sale of its energy marketing business in June 2013 (see Note 5); and
- A $0.2 million increase related to Heartland and RPS.

*Interest charges.* The variance was primarily driven by new debt issuance related to the acquisition of Westfield Water and Wastewater (See Note 2M.1 – Acquisition of Westfield Water and Wastewater and Note 6).

**OTHER**

| | 2014 | 2013 | Change |
|---|---|---|---|
| Operating revenues | $ - | $ - | $ - |
| Operating expenses | | - | |
| Operating income | - | - | - |
| Other income (expense), net | (2.6) | (5.2) | 2.6 |
| Interest charges | - | - | - |
| Loss from DiscOps | (5.9) | (11.5) | 5.6 |
| Segment loss | $ (8.5) | $ (16.7) | $ 8.2 |

In the table above, Other includes advertising and philanthropic costs that are not recoverable through rates and are funded by contributions from non-regulated segments. The former Manufacturing business segment has been reported as Discontinued Operations and is also included in Other.

### Twelve Months Ended September 30, 2014 as Compared to 2013

Other income (expense), net. The variance was primarily driven by a decrease in brand advertising expenses, energy assistance, community investments and volunteer activities.

Loss from discontinued operations. The variance was primarily driven by an asset retirement obligation re-measurement recorded in 2013 that did not recur in 2014.

## LIQUIDITY AND CAPITAL RESOURCES

### Debt and Liquidity

Please see Notes 6 and 7 of the combined financial statements for information regarding the changes to Citizens' and CWA's outstanding debt obligations and liquidity facilities, respectively.

### Capital Spending

For the twelve months ended September 30, 2014, capital expenditures, on an accrual basis, increased by $44.4 million to $332.6 million from $288.2 million during the same period last year. This increase is summarized as follows (in millions):

| | Citizens Gas | Water | Wastewater | Steam | Chilled Water | Oil | Resources | Other | Total |
|---|---|---|---|---|---|---|---|---|---|
| **2014** | **$ 21.3** | **$ 54.9** | **$ 187.1** | **$ 6.8** | **$ 2.2** | **$ 2.7** | **$ 25.3** | **$ 32.3** | **$ 332.6** |
| 2013 | 20.3 | 58.9 | 170.0 | 9.5 | 2.3 | - | 0.8 | 26.4 | 288.2 |
| Change | $ 1.0 | $ (4.0) | $ 17.1 | $ (2.7) | $ (0.1) | $ 2.7 | $ 24.5 | $ 5.9 | $ 44.4 |

Citizens' and CWA's projected capital spending requirement of $333.2 million for 2015 is summarized as follows (in millions):

| | Citizens Gas | Water | Wastewater | Steam | Chilled Water | Oil | Resources | Other | Total |
|---|---|---|---|---|---|---|---|---|---|
| **2015 Projection** | **$ 21.4** | **$ 54.5** | **$ 216.0** | **$ 2.0** | **$ 3.2** | **$ -** | **$ 19.9** | **$ 16.2** | **$ 333.2** |

Citizens Gas continues to invest in mains and services to maintain its commitment to modernization of its underground gas distribution system. Citizens Gas had cash and cash equivalents of $53.5 million at September 30, 2014. Citizens Gas expects to meet its capital spending requirements in 2015 through cash flows from operations and the temporary seasonal use of its credit lines.

The Water business segment has a capital improvement plan to address system reliability, specific regulatory requirements, and various distribution system and treatment plant upgrades. Water had cash and cash equivalents of $17.0 million at September 30, 2014, including $2.4 million in the construction fund. Water expects to meet its capital spending requirements in 2015 through cash flows from operations and use of its line of credit (see Note 7 of the combined financial statements). See Note 2M.1 – Water for a discussion of the Water rate case Order received on March 19, 2014.

The Wastewater business segment has a capital improvement plan to meet guidelines of the Combined Sewer Overflows and Long-Term Control Plan and the overall needs of the Wastewater System. See Note 13 of the combined financial statements for additional information regarding the Combined Sewer Overflows and Long-Term Control Plan. The capital improvement plan also includes septic tank elimination projects and other improvements to and expansion of the Wastewater System including normal renewals and replacements. Wastewater had cash and cash equivalents of $123.9 million at September 30, 2014, including $85.2 million in the construction fund. Wastewater expects to meet its capital spending requirements in 2015 through a combination of cash flows from operations, its line of credit (see Note 7 of the combined financial statements) and new issuance of long term debt. See Note 2M.1 – Wastewater for a discussion of the Wastewater rate case Order received on April 23, 2014.

Citizens Thermal's Steam business segment continues to invest in distribution assets and production equipment. Additionally, Steam has completed the conversion of two coal fired boilers and two oil fired boilers to natural gas (the Natural Gas Conversion). Chilled Water capital spending plans include investments to increase production capacity. At September 30, 2014, cash and cash equivalents of Steam and Chilled Water amounted to $5.6 million and $24.5 million, respectively. Steam expects to meet its capital spending requirements in 2015 through cash flows from operations and the temporary seasonal use of its credit line while Chilled Water expects to meet its 2015 capital spending requirements through cash flows from operations.  See Note 2M.1 – Citizens Thermal Steam of the combined financial statements for a discussion of the Steam rate case Order received on May 21, 2014.

Resources' capital spending projection for 2015 includes activities at Kinetrex, Citizens Resources Production, Citizens Southern Madison, Westfield Gas,  Westfield Water, and Westfield Wastewater.  Resources expects to meet its capital spending requirements in 2015 through a combination of cash flows from operations, its lines of credit and use of its construction note for Kinetrex.  See Note 6 of the combined financial statements for additional information regarding Kinetrex' construction note and Note 7 of the combined financial statements for additional information on Westfield Water, Westfield Wastewater and Kinetrex' lines of credit.

## DERIVATIVES AND HEDGING

Citizens has entered into certain derivative and hedging transactions in 2014 and 2013, respectively.  These transactions are used by Citizens Gas to hedge natural gas prices.  Through a combination of fixed-price purchases, caps, collars and storage, Citizens Gas hedges approximately 80 percent of its anticipated system supply gas purchases (see Note 12 of the combined financial statements).

See Note 6 of the combined financial statements regarding the issuance of CWU, Westfield Water and Westfield Wastewater revenue bonds.  Concurrent with that issuance, the entities entered into fixed rate pay interest rate swap agreements with PNC Bank, National Association as the counterparty to effectively fix the interest rates through October 1, 2018. See Note 12 of the combined financial statements for additional information about the interest rate swaps.

**Citizens Energy Group and Subsidiary and CWA Authority, Inc.**

**Combined Statements of Operations**
(In Thousands)

| | Fiscal Year Ended September 30, 2014 | 2013 |
|---|---|---|
| Operating revenues | $ 819,226 | $ 711,450 |
| Operating expenses | | |
| Cost of goods sold | 237,815 | 187,833 |
| Operations and maintenance | 261,175 | 268,207 |
| Depreciation and amortization | 134,862 | 127,804 |
| Taxes | 42,452 | 40,887 |
| Total operating expenses | 676,304 | 624,731 |
| Operating Income | 142,922 | 86,719 |
| Other income (expense), net | | |
| Interest income | 2,178 | 2,392 |
| Other | (3,032) | (179) |
| Total other income, net | (854) | 2,213 |
| Income before equity in loss of affiliates and interest charges | 142,068 | 88,932 |
| Equity in loss of affiliates | (2,070) | (38,323) |
| Interest charges | | |
| Interest on long-term debt | 134,548 | 131,750 |
| Other interest including net premium amortization | (10,744) | (11,373) |
| Total interest charges | 123,804 | 120,377 |
| Income (loss) from continuing operations | 16,194 | (69,768) |
| Loss from discontinued operations | (5,853) | (11,501) |
| Net income (loss) | $ 10,341 | $ (81,269) |

The accompanying notes are an integral part of these condensed combined financial statements.

**Citizens Energy Group and Subsidiary and CWA Authority, Inc.**

**Combined Statements of Comprehensive Loss**
(In Thousands)

| | Twelve Months ended September 30, 2014 | 2013 |
|---|---|---|
| **Net Income (Loss)** | **$ 10,341** | **$ (81,269)** |
| | | |
| Other comprehensive income (loss) | | |
| Comprehensive income of unconsolidated investment | 74 | 6,003 |
| | | |
| Retirement benefit liability changes: | | |
| Net gain (loss) arising during period | (60,403) | 61,065 |
| Less: amortization of prior service cost | (455) | (412) |
| Less: amortization of gain | 4,513 | 9,779 |
| Less: amortization of transition obligation | 16 | 588 |
| Total retirement benefit liability changes | (56,329) | 71,020 |
| | | |
| Total other comprehensive income (loss) | (56,255) | 77,023 |
| | | |
| **Total Comprehensive Loss** | **$ (45,914)** | **$ (4,246)** |

The accompanying notes are an integral part of these condensed combined financial statements.

**Citizens Energy Group and Subsidiary and CWA Authority, Inc.**

**Combined Statements of Financial Position**
(In Thousands)

| | At September 30, 2014 | At September 30, 2013 |
|---|---|---|
| **ASSETS** | | |
| Property, plant and equipment | | |
| Plant in service | $ 5,288,097 | $ 4,937,459 |
| Accumulated depreciation | 2,881,170 | 2,743,332 |
| | 2,406,927 | 2,194,127 |
| Construction work in progress | 577,063 | 483,057 |
| Property held for future use | 1,443 | 1,443 |
| Total property, plant and equipment | 2,985,433 | 2,678,627 |
| Intangible assets, net | 92,590 | 92,577 |
| Investments | | |
| Bond restricted funds | 235,482 | 203,787 |
| Investment in affiliates | 15,364 | 18,260 |
| Other | 33,951 | 39,737 |
| Total investments | 284,797 | 261,784 |
| Current assets | | |
| Cash and cash equivalents | 275,300 | 194,825 |
| Short-term investments | - | 1,001 |
| Accounts receivable, less allowance for doubtful accounts of $4,023 and $4,085, repectively | 78,144 | 75,989 |
| Accrued utility revenue | 21,314 | 16,072 |
| Natural gas in storage | 58,253 | 56,667 |
| Materials and supplies | 10,861 | 13,065 |
| Recoverable gas and fuel costs | 5,987 | 7,923 |
| Prepayments and deposits | 3,394 | 4,553 |
| Current assets held for sale and discontinued operations | 337 | 1,328 |
| Total current assets | 453,590 | 371,423 |
| Deferred charges and other non-current assets | | |
| Bond issuance cost, net | 28,054 | 26,438 |
| Other deferred charges | 23,768 | 25,262 |
| Non-current assets held for sale and discontinued operations | 894 | 895 |
| Total deferred charges and other non-current assets | 52,716 | 52,595 |
| **TOTAL ASSETS** | $ 3,869,126 | $ 3,457,006 |
| | | |
| **CAPITALIZATION AND LIABILITIES** | | |
| Capitalization and non-current liabilities | | |
| Retained earnings | $ 199,753 | $ 190,682 |
| Accumulated other comprehensive loss | (139,363) | (83,108) |
| Long-term debt (excluding current maturities) | 3,001,925 | 2,669,904 |
| Retirement benefits | 187,134 | 138,640 |
| Contributions in aid of construction | 135,353 | 89,138 |
| Other long-term liabilities | 25,645 | 23,631 |
| Non-current liabilities directly related to assets held for sale and discontinued operations | 56,533 | 51,411 |
| Total capitalization and non-current liabilities | 3,466,980 | 3,080,298 |
| Current liabilities | | |
| Current maturities of long-term debt | 66,026 | 54,000 |
| Short-term borrowings | 73,500 | 95,285 |
| Accounts payable and accrued expenses | 198,675 | 166,421 |
| Accrued taxes | 46,104 | 45,679 |
| Customer deposits and advance payments | 16,668 | 13,971 |
| Other | 583 | 674 |
| Current liabilities directly related to assets held for sale and discontinued operations | 590 | 678 |
| Total current liabilities | 402,146 | 376,708 |
| Commitments and contingencies (see note 13) | | |
| **TOTAL CAPITALIZATION AND LIABILITIES** | $ 3,869,126 | $ 3,457,006 |

The accompanying notes are an integral part of these condensed combined financial statements.

**Citizens Energy Group and Subsidiary and CWA Authority, Inc.**

**Combined Statements of Cash Flows**
(In Thousands)

| | Fiscal Year Ended September 30, 2014 | 2013 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net income (loss) | $ 10,341 | $ (81,269) |
| Depreciation and amortization | 134,038 | 127,066 |
| Loss on sale or impairment of assets | 6,058 | - |
| Equity in loss of affiliates, net of distributions | 2,970 | 39,081 |
| Allowance for doubtful accounts | 6,503 | 6,819 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable and accrued utility revenue | (12,613) | (15,522) |
| Natural gas in storage | (1,586) | 99 |
| Recoverable/refundable gas and fuel costs | 1,936 | 2,892 |
| Prepayments and deposits | 1,202 | 558 |
| Other current assets | 2,204 | 686 |
| Accounts payable and accrued expenses | 4,176 | (13,258) |
| Retirement benefits | (6,986) | 14,499 |
| Other long-term liabilities | 1,529 | 1,802 |
| Net change in deferred charges | (377) | 8,218 |
| Other operating activities | 1,891 | (246) |
| Change in net liabilites of discontinued operations | 6,026 | 2,562 |
| Net cash provided by operating activities | 157,312 | 93,987 |
| | | |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Construction expenditures | (304,824) | (285,672) |
| Purchase of investment securities | (212,367) | (205,043) |
| Sale and maturity of investment securities | 181,319 | 193,049 |
| Proceeds from sale of assets | 12,000 | - |
| Acquisition of business, net of cash acquired | (89,177) | (3,893) |
| Other investing activities | 1,912 | (4,646) |
| Net cash used by investing activities | (411,137) | (306,205) |
| | | |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Proceeds from bank line of credit | 95,023 | 65,435 |
| Repayment of bank line of credit | (116,613) | (34,150) |
| Proceeds from long-term debt | 485,071 | 49,114 |
| Principal payments of long-term debt and bond refunding | (136,500) | (130,078) |
| Proceeds from bond refunding | | 56,917 |
| Bond issuance costs | (4,261) | (718) |
| Customer benefits arising from nonregulated operations distributable to gas customers | (1,363) | (839) |
| Contributions in aid of construction | 12,943 | 7,373 |
| Net cash provided by financing activities | 334,300 | 13,054 |
| | | |
| Net change in cash and cash equivalents | 80,475 | (199,164) |
| Cash and cash equivalents at beginning of fiscal year | 194,825 | 393,989 |
| Cash and cash equivalents at end of fiscal year | $ 275,300 | $ 194,825 |
| | | |
| Supplemental Cash Flows Information - Interest paid | $ 120,949 | $ 127,555 |
| | | |
| Non-cash Investing and Operating Activities | | |
| Construction work-in-progress accrued at period end | $ 71,120 | $ 28,663 |
| Comprehensive income of unconsolidated investment | $ 74 | $ 6,003 |

The accompanying notes are an integral part of these condensed combined financial statements.

**Citizens Energy Group and Subsidiary and CWA Authority, Inc.**

**Combined Statements of Equity**
(In Thousands)

| | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|
| **Balance at September 30, 2012** | **$ 272,812** | **$ (160,131)** | **$ 112,681** |
| Comprehensive income (loss) | | | |
| Net loss | (81,269) | | (81,269) |
| Comprehensive income of unconsolidated investment | | 6,003 | 6,003 |
| Retirement benefit liability changes | | 71,020 | 71,020 |
| Total comprehensive income (loss) | (81,269) | 77,023 | (4,246) |
| Customer benefit distributions | (861) | | (861) |
| **Balance at September 30, 2013** | **$ 190,682** | **$ (83,108)** | **$ 107,574** |
| Comprehensive income | | | |
| Net income | 10,341 | | 10,341 |
| Comprehensive income of unconsolidated investment | | 74 | 74 |
| Retirement benefit liability changes | | (56,329) | (56,329) |
| Total comprehensive income (loss) | 10,341 | (56,255) | (45,914) |
| Customer benefit distributions | (1,270) | | (1,270) |
| **Balance at September 30, 2014** | **$ 199,753** | **$ (139,363)** | **$ 60,390** |

The accompanying notes are an integral part of these condensed combined financial statements.

## NOTES TO COMBINED FINANCIAL STATEMENTS

*Citizens Energy Group and Subsidiary and CWA Authority, Inc.*

### 1. NATURE OF OPERATIONS AND PRESENTATION

**A. Nature of Operations**

Operations of Citizens Energy Group and Subsidiary (Citizens) include activities in six business segments: Citizens Gas, Water, Steam, Chilled Water, Oil and Citizens Resources (Resources). Steam and Chilled Water comprise the Thermal Energy System (Citizens Thermal or Thermal). Operations of CWA Authority, Inc. (CWA) include activities for the Wastewater business segment. Resources includes affiliate joint venture interests as well as several wholly owned subsidiaries, the most significant of which is Citizens Energy Services Corporation LLC (CESCO) which serves as a holding company for several subsidiaries, including Citizens Westfield Utilities, LLC (CWU) and LNG Indy, LLC, d/b/a Kinetrex Energy, LLC (Kinetrex), which operates as a provider of liquefied natural gas (LNG) for use as transportation and industrial fuel.

CWU serves as a holding company for the gas, water, and wastewater utilities for the Westfield service area which include Westfield Gas Corporation (Westfield Gas) which is operated as a regulated investor-owned natural gas distribution utility, Citizens Water of Westfield, LLC (Westfield Water) which is operated as a regulated investor-owned water utility, and Citizens Wastewater of Westfield, LLC (Westfield Wastewater) which is operated as a regulated investor-owned wastewater utility. The rates and charges for gas, steam, water and wastewater services are regulated by the Indiana Utility Regulatory Commission (IURC).

**B. Basis of Presentation**

The accompanying financial statements reflect the combined operations of commonly controlled entities, including Citizens, CWA and certain non-profit instrumentalities. The accounting records conform to the accounting standards prescribed by the Federal Energy Regulatory Commission, National Association of Regulatory Utility Commissioners and accounting principles generally accepted in the United States of America (GAAP). The effects of all intercompany transactions have been eliminated.

**C. Reclassifications**

Certain reclassifications have been made to the combined financial statements of the prior period to conform to the current period presentation.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**A. Use of Estimates**

The presentation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from those estimates. The most significant of such estimates include accrued utility revenue, Thermal contract useful lives, allowance for doubtful accounts, allowance for ProLiance Note Receivable (See Note 2D), impairment charges (See Note 5), asset retirement obligation (Discontinued Operations, see Note 11), the fair value of assets and liabilities acquired as part of the Westfield Water and Wastewater acquisitions, and assumptions underlying the actuarial calculations for pension and post-retirement liabilities.

**B. Property, Plant and Equipment, Depreciation and Maintenance**

Construction costs include costs directly incurred plus overhead allocation relating to payroll, administrative and general costs, and, for certain utility plant, capitalized interest. Depreciation on plant for regulated utilities is computed on a straight-line basis using rates approved by the IURC. Depreciation on Chilled Water and Kinetrex plant is computed on a straight-line basis over the estimated remaining useful lives of the various classes of depreciable plant in service. Depreciation on Oil plant is computed on a straight-line basis over the projected productive lives of the oil wells. Periodic depreciation rate studies include a review of depreciable plant remaining useful lives. Maintenance and repairs of property units are charged to expense as incurred. Citizens and CWA utilize the composite method of depreciation. Accordingly, the original cost of depreciable property and equipment retired or replaced and the cost of removal, less salvage, are charged to accumulated depreciation.

Plant in service at September 30:

| | (In Thousands) 2014 | 2013 | Useful Lives |
|---|---|---|---|
| Distribution | $ **1,886,353** | $ 1,800,676 | 15 – 65 years |
| Treatment | **1,429,664** | 1,366,181 | 40 – 50 years |
| Collection | **1,250,212** | 1,120,696 | 40 – 50 years |
| Source of supply | **221,270** | 199,020 | 40 – 50 years |
| Pumping | **136,512** | 132,133 | 40 – 50 years |
| Production | **123,655** | 93,699 | 5 – 75 years |
| General plant | **98,470** | 94,719 | 5 – 50 years |
| Gas storage | **87,429** | 78,554 | 33 – 60 years |
| Transmission | **54,532** | 51,781 | 22 – 60 years |
| | $ **5,288,097** | $ 4,937,459 | |

Depreciation expense was $130.3 million and $116.1 million for the twelve months ended September 30, 2014 and 2013, respectively.

Interest capitalized represents the cost of borrowed funds used for construction purposes and is charged to major construction projects during the construction period with a corresponding credit to Other Interest Charges. The total amount of interest capitalized was $10.2 million and $10.5 million for the twelve months ended September 30, 2014 and 2013, respectively.

As part of the original Water asset purchase agreement with the City of Indianapolis, an option was included that allowed for the future re-purchase by the City of the former Water headquarters building and certain property located in Indianapolis, Indiana. Based on discussions with the City, Citizens anticipates the City may exercise this option in fiscal year 2015. The negotiated purchase price specified in the option agreement is $6.5 million. The assets relating to this potential sale have an approximate carrying value of $6.5 million, which approximates fair value.

**C. Revenue Recognition**

Revenue is recorded when earned, either when the product is delivered or when services are performed. Citizens Gas, Water and Wastewater customer billings are rendered on a cycle basis on each working day throughout the month. Westfield Gas customer billings for all rate classes are billed near the end of the calendar month. Westfield Water and Westfield Wastewater customer billings are rendered near the middle of the calendar month. The estimated revenue for gas, water delivered, and wastewater service since the last customer billing dates to month-end is accrued based on actual demand data for the calendar month. The accrual for unbilled revenues is reversed in the subsequent accounting period when meters are actually read and customers are billed. Meter readings are taken as of month-end for Steam and Chilled Water customers, with billings rendered as of month-end for all such customers. Revenue at Kinetrex is recognized in the period LNG is delivered to the customer.

**D. Credit Quality and Allowance for Credit Losses of Notes Receivable**

Citizens and CWA monitor credit quality and associated risks of notes receivable on an individual basis based on criteria such as financial stability of the party, strength of Citizens' and CWA's contractual position, value and existence of collateral, and collection experience in conjunction with general economic and market conditions. The note receivable from ProLiance was reviewed for collectability in September of 2014. The note was found to be partially recoverable and a loss allowance of $3.4 million was recorded for the estimated uncollectible amount of the note. Interest received on the ProLiance note was $0.2 million and $0.1 million in 2014 and 2013, respectively. The note receivable relating to the City of Carmel was acquired as part of the water system acquisition on August 26, 2011. The original principal was $22.2 million and is to be paid back by December 30, 2025. The City of Carmel makes semi-annual payments on this note at an imputed interest rate of 4.88% annually. The following table presents Citizens' notes receivable, which are recorded in Other Investments on the statements of financial position, whose carrying value approximates fair value, as of September 30, 2014 and 2013 (in thousands):

| | **Notes Receivable at September 30, 2014** | | |
|---|---|---|---|
| Description | Unpaid Balance | Related Allowance | Receivable Net of Allowance |
| Note Receivable from City of Carmel | **$15,699** | **$ -** | **$15,699** |
| Note Receivable from ProLiance | **6,474** | **3,431** | **3,043** |
| | **$22,173** | **$ 3,431** | **$18,742** |

| Description | Notes Receivable at September 30, 2013<br>Unpaid Balance | Related Allowance | Receivable Net of Allowance |
|---|---|---|---|
| Note Receivable from City of Carmel | $16,900 | $ - | $16,900 |
| Note Receivable from ProLiance | 6,474 | - | 6,474 |
| | $23,374 | $ - | $23,374 |

**E. Inventory**

Material and supplies, maintained at average cost, are recorded as inventory when received and subsequently charged to expense or capitalized to plant when installed. Natural gas in storage is recoverable through gas cost adjustments (see note 2G) and maintained at the weighted average cost of gas. LNG in storage for Kinetrex is maintained at the lower of weighted average cost of gas or market. There were no lower of cost or market adjustments in 2014 and 2013.

**F. Taxes**

Citizens and CWA are generally subject to payroll, property (in the case of Citizens and its affiliates), payment in lieu of taxes (PILOT) (in the case of CWA), utility receipts (in the case of Citizens), and other miscellaneous taxes. In general, Citizens and CWA are exempt from federal, state and local income taxes as either political subdivisions of the State of Indiana or pursuant to Internal Revenue Code section 115 as applicable. Utility receipts taxes are included in rates charged to customers in all rate regulated business units except Wastewater, which is exempt from utility receipts taxes pursuant to Indiana law.

**G. Recoverable (Refundable) Gas and Fuel Costs**

The difference between actual gas costs, including unrealized gains and losses and settled amounts associated with Citizens' Price Volatility Mitigation Policy (see Note 12), and the amounts of gas costs recovered by Citizens Gas and Westfield Gas through rates is deferred and recovered (or refunded) through gas cost adjustments (GCA) permitted by the IURC. Citizens Gas is authorized to change its GCA factors quarterly as a result of changes in market prices. Citizens Gas is authorized to utilize a flex mechanism in its quarterly filings to change its GCA factors within a fixed, known and measurable range, on a monthly basis, through a Monthly Price Update as a result of changes in market prices. Westfield Gas is authorized to change its GCA factors quarterly as a result of changes in market prices. The difference between actual fuel costs and the amounts of fuel costs recovered by Steam through rates is deferred and recovered (or refunded) through the fuel adjustment clause (FAC) permitted by the IURC. Steam is authorized to change its FAC factors each quarter as a result of changes in market prices.

**H. Bond Issuance Costs**

Bond premiums and discounts, debt issuance costs, and retirement gains and losses are amortized over the lives of the respective issues through the effective interest method. For regulated business segments, the unamortized portion of bond issuance costs of the refunded bonds is amortized over the life of the refunding bond issue.

**I. Cash and Cash Equivalents**

For purposes of the Combined Statements of Financial Position and Cash Flows, Citizens and CWA consider investments purchased with a maturity of three months or less to be cash equivalents. The carrying value equals fair value for these financial instruments. Included in cash and cash equivalents on the Combined Statements of Financial Position are money market funds of $141.4 million and $88.4 million at September 30, 2014 and 2013, respectively. Approximately $87.6 million of cash and cash equivalents have been designated by management as construction funds and will be used to fund capital expenditures.

**J. Fair Value Measurements**

In accordance with Financial Accounting Standards Board (FASB) guidance related to fair value measurements and disclosures, Citizens' and CWA's financial assets and liabilities have been categorized, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy as set forth below.

The following table presents the financial assets and liabilities measured at fair value on a recurring basis, based on the hierarchy, as of September 30, 2014 and 2013 (in thousands):

| Description | 2014 Fair Value Measurements Using | | |
|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Financial Assets: | | | |
| Cash equivalents | **$ 141,409** | **$ -** | **$ -** |
| Bond restricted funds | **235,482** | **-** | **-** |
| Derivative Assets | **760** | **-** | **-** |
| | **-** | **-** | |
| Total financial assets measured at fair value | **$377,651** | **$ -** | **$ -** |
| Financial Liabilities: | | | |
| Derivative Liabilities | **$ -** | **$ 518** | **$ -** |

| Description | 2013 Fair Value Measurements Using | | |
|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Financial Assets: | | | |
| Cash equivalents | $ 88,351 | $ - | $ - |
| Bond restricted funds | 203,788 | - | - |
| Derivative Assets | 536 | - | - |
| Total financial assets measured at fair value | $292,675 | $ - | $ - |
| Financial Liabilities: | | | |
| Derivative Liabilities | $ 153 | $ - | $ - |

The fair values of the bond restricted funds and commodity contracts have been determined using quoted prices in an active market. The fair value of derivatives at September 30, 2014 was $0.8 million. The fair value of derivatives at September 30, 2013 was $0.4 million. The fair value of the interest rate swaps are determined by significant other observable inputs. Gains/losses and fees associated with the commodity based derivatives, when realized, are recoverable through the Gas Cost Adjustment tracker. There were no transfers between levels during 2014.

Management has estimated the fair value of the outstanding debt securities based on the coupons of the outstanding bonds and the current market yields. These are level 2 fair value measurements. Management established the corresponding price to the call date as well as the price to maturity. The fair value was determined based on the lower of these two prices. For Resources, the carrying value approximates fair value. Using this method, the estimated fair value of the debt is $3.3 billion and $2.8 billion at September 30, 2014 and 2013, respectively, versus carrying value of $3.1 billion and $2.7 billion at September 30, 2014 and 2013, respectively.

Held-to-maturity short-term investments are held at a carrying value of $0.0 million and $1.0 million as of September 30, 2014 and 2013, respectively, which approximated fair value.

The following table presents financial assets measured at fair value on a nonrecurring basis, using Level 3 inputs, as of September 30, 2014 (in thousands):

| Quantitative Information about Level 3 Fair Value Measurements | | | |
|---|---|---|---|
| | Fair Value at September 30, 2014 | Valuation Technique | Unobservable Inputs |
| Resources' Investment in ProLiance | $ 11,202 | Discounted Cash Flow | Discount Rates<br>Terminal Values |

The nonrecurring fair value measurement of Resources' investment in ProLiance has been calculated using an income approach, which requires the use of subjective assumptions that are considered level 3 inputs. Fair value has been estimated by discounting the cash flows expected to be received from ProLiance's investments in natural gas midstream assets, using a discount rate based on observable market data for companies that participate in the natural gas midstream sector, adjusted for size discrepancy between ProLiance and the guideline companies. The discount rate used was 7.2%. Critical assumptions used in the fair value measurement primarily include the amount and timing of cash inflows, including a terminal amount (perpetuity), the discount rate and the amount of future investment necessary to achieve the projected results. A change in these assumptions could result in a significantly higher or lower fair value measurement, which could result in additional loss during the period in which the assumption changes. A 100 basis point change in the discount rate used would have changed the fair value of Resources' share of its investment in ProLiance by approximately $4.5 million as of September 30, 2014. Similarly, a change in the projected gas storage rates for the underlying operating assets or project configuration would have a significant impact on the projected cash flows and the resulting valuation. As a result of this evaluation, Resources recorded a $2.3 million reduction to its investment in ProLiance (see Note 5).

**K. Asset Impairment**
Long-lived assets and certain amortizing intangible assets held and used by Citizens and CWA are reviewed for impairment using undiscounted cash flows, whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. Resources' investment in ProLiance is also reviewed for impairment annually using accounting guidance for equity method investments, which requires use of discounted cash flows. Measurement of an impairment loss is based on the discounted value cash flows related to these specific assets or asset group. See additional disclosure at Note 2L. An impairment of Resources' investment in ProLiance was recorded in 2014 (See Note 5).

**L. Intangible Assets**
Intangible assets at September 30, 2014 consist of $16.2 million of intangible assets acquired in the Westfield Water and Wastewater acquisitions (see note 4) and $76.4 million of Thermal customer contracts. As the purchase price allocation is preliminary the nature of the acquired intangibles has not yet been determined. The customer contracts intangible assets are finite lived and amortized on a straight-line basis over their expected useful lives which range from 20 to 30 years. Gross carrying values of intangible customer contracts were $104.5 million and $120.1 million as of September 30, 2014 and 2013, respectively. Accumulated amortization for all intangible customer contracts was $28.1 million and $27.5 million at September 30, 2014 and 2013, respectively. Amortization expense of such assets was $3.8 million and $4.2 million in the years ended September 30, 2014 and 2013, respectively. Estimated aggregate amortization expenses for each of the five succeeding fiscal years are as follows:

| | (In Thousands) |
|---|---|
| 2015 | $ 3,703 |
| 2016 | 3,703 |
| 2017 | 3,703 |
| 2018 | 3,703 |
| 2019 | 3,703 |

**Disposal of Indianapolis Campus Energy**
On December 12, 2013, the Chilled Water business unit sold its Indianapolis Campus Energy plant (ICE) to the company being exclusively served by that plant for $12.0 million in cash. As part of this transaction, Citizens Thermal recorded a write-off of the remaining ICE customer contract intangible asset balance of $12.4 million in December 2013. This transaction resulted in a $2.8 million loss, which is recorded in Operations and Maintenance Expense.

**M. Regulatory Developments, Assets and Liabilities**

*M.1 Regulatory Developments*

*Citizens Gas*
Citizens Gas' most recent rate order became effective in September 2011.

In 2011, Citizens Gas and Citizens Gas of Westfield filed a joint petition with the IURC requesting approval to extend the provision of energy efficiency programs and continue rate adjustment mechanisms that had been approved in prior rate cases, including a rider that provides for the recovery of costs incurred in connection with the energy efficiency programs as well as a decoupling mechanism that is designed to allow Citizens Gas to recover the non-gas costs authorized for recovery in the utility's most recent base rate case order. In the testimony it filed, the Indiana Office of Utility Consumer Counselor (OUCC), among other things, recommended the Commission not approve continuation of the decoupling mechanism in its present form. In 2013, the Commission issued an order authorizing the extension of certain energy efficiency programs and approving the continuation of Citizens Gas's decoupling mechanism through December 30, 2015. The Commission directed Citizens Gas and the OUCC to engage in discussions regarding appropriate caps on the amount of revenues that can be recovered through the decoupling mechanism and amounts that can be deferred for future recovery for revenues that exceed such caps. On June 10, 2013, Citizens Gas and the OUCC entered into an agreement on the cap and future revenue recovery issues for both Citizens Gas and Citizens Gas of Westfield. The agreement included capping margin differences at 4% (Citizens Gas) and 8% (Citizens Gas of Westfield) of adjusted order granted margin for eligible rate classes, beginning with the twelve month period ended December 31, 2013. The actual margin differences in excess of 4% (Citizens Gas) and 8% (Citizens Gas of Westfield) will be eligible for deferral for future recovery either in a future decoupling filing, still subject to the annual cap, or in a future rate case. The total amounts that may be deferred for recovery in future rate cases may not exceed $2.5 million and $1.0 million for Citizens Gas and Citizens Gas of Westfield, respectively.

In December 2012, Citizens and Kinetrex filed a joint petition with the IURC seeking certain approvals in connection with the creation and proposed operations of Kinetrex, a transportation and industrial fueling business utilizing LNG to serve the needs of customers throughout the Midwest. Kinetrex markets and sells LNG as a competitive alternative to diesel fuel for use in heavy-duty vehicles or off road applications such as drilling rigs and rail applications. Citizens, Kinetrex and the OUCC entered into a settlement agreement that facilitated the proposed LNG initiative upon the IURC's approval. The IURC issued an order on June 26, 2013 approving terms of the settlement agreement set forth regarding the operation of LNG Indy, its purchases of natural gas, provision of LNG to Citizens Gas for peaking and balancing purposes and reporting requirements. The IURC declined to regulate Kinetrex' rates and charges. On July 5, 2013, Kinetrex Energy began operations. In August 2013, Citizens Gas transferred its decommissioned LNG South plant to Kinetrex at Citizens Gas net book value. An Asset Contribution Agreement was filed with the IURC on the same day. Kinetrex also purchased the LNG inventory in both the LNG North and LNG South plants during the fourth quarter of 2013 at fair market value from Citizens Gas.

*Westfield Gas*
Westfield Gas' most recent rate order became effective in 2010. In September 2012, Westfield Gas filed a quarterly gas cost adjustment application with the IURC. In that proceeding, the OUCC recommended that Westfield Gas file a revision to its tariff to account for the federal and state income taxes Westfield Gas will no longer be required to pay as a result of its conversion to a limited liability company, which became effective September 30, 2012. Westfield Gas argued, among other things, the OUCC's recommendation ignored the one-time state and federal tax payments made by Westfield Gas to effect the conversion and that the recommendation runs counter to the IURC's policy against single issue ratemaking. The IURC established a subdocket to address the issue raised by the OUCC. In October 2013, the IURC issued an order that closed the subdocket and ruled in favor of Westfield Gas, finding that the utility does not need to file a revision of its rates as a result of its conversion to a limited liability company.

*Citizens Thermal Steam*
The schedule of rates and charges in effect for Citizens Thermal Steam prior to May 2014 became effective May 2010.

In June 2013, Citizens filed a petition with the IURC requesting approval to increase its rates and charges for steam service and for certain revisions to its terms and conditions for steam service. The final requested amount of the rate increase was $7.9 million or 11.97%. On May 21, 2014, the IURC, in its order for Cause No. 44349 (the "2014 Steam Order"), approved an 11.43% overall increase in rates, representing an increase in revenues of approximately $7.6 million. Recovery of debt service on the Thermal Series 2014A Bonds was included in the 2014 Steam Order (see also the discussion of Thermal long-term debt in Note 6). Further, the IURC found that the changes Citizens proposed to its terms and conditions for steam service, which include changes to the meter testing period and deposit rules for non-residential customers, were non-discriminatory, reasonable and just. Under the terms of a settlement agreement in IURC Cause No. 44149, Citizens agreed to implement an Operating Expense Rate Adjustment (OPERA) mechanism to track savings related to the conversion of the Perry K plant to natural gas. In this rate case, Citizens was required to propose a baseline for operations and maintenance (O&M) expenses in order to administer a tracking mechanism for O&M savings achieved as a result of the Perry K natural gas conversion. Citizens' proposed baseline was approved. The new schedule of rates and charges was implemented effective May 30, 2014. The OPERA mechanism will begin returning savings to customers in fiscal year 2015.

*Water*
In the IURC's July 2011 Order approving Citizens' acquisition of the water utility, the IURC authorized Citizens to adopt the rates and charges the prior owner of the utility had in effect at the time of closing, which had been previously approved by the IURC. Those rates became effective for Citizens from the date of closing (August 26, 2011) and remained in effect through March 2014.

In February 2013, Citizens filed testimony with the IURC for a general rate increase of Water rates and charges. The final requested amount of the rate increase was $24.1 million or 13.91%. On March 19, 2014, in Cause No. 44306 (the 2014 Water Order), the IURC authorized an annual revenue increase of $15.7 million or 8.98%. Recovery of debt service on all the outstanding long-term debt of the Water System plus the Water 2014A First Lien Bonds and the Water 2014B Second Lien Bonds was included in the 2014 Water Order (see also the discussion of Water long-term debt in Note 6). The rate structure approved in the 2014 Water Order is intended to provide annual funding of $42.0 million of extensions and replacements through rates (paygo) representing approximately 75% of annual capital needs. Due to a variety of factors including but not limited to the possibility that actual sales volume and actual operating expenses could be materially different than assumed in the rate structure, there can be no assurance that actual results will meet the intention of the rate structure in the 2014 Water Order. The new schedule of rates and charges was implemented effective March 24, 2014.

*Wastewater*
The wastewater rates in effect through April 2014 were approved pursuant to the IURC July 2011 Order approving the wastewater utility acquisition that authorized CWA to adopt the rates and charges approved by the City-County Council of Indianapolis and Marion County in effect at the time of closing the acquisition which included implementation of rate increases of 10.75% on each of January 1, 2012 and 2013.

In February, 2013, CWA filed testimony with the IURC for a general rate increase in two steps. On October 11, 2013, the OUCC and CWA filed a Stipulation and Settlement Agreement on Revenue Requirements (the "Revenue Requirements Agreement") resolving issues between the parties related to revenue requirement and the stipulated step 1 and step 2 increases. Additionally, in October 2013, the OUCC and Industrial Group filed a Stipulation and Settlement Agreement on Allocation Issues (the "Allocation Agreement") resolving issues related to the allocation of costs among customer classes. On April 23, 2014 the IURC issued its order in Cause No. 44305 (the 2014 Wastewater Order). In the 2014 Wastewater Order the IURC approved a rate increase in two steps, the material aspects of the Revenue Requirements Agreement making minor adjustments to the amounts of the stipulated step 1 and step 2 increases and the Allocation Agreement. The IURC authorized the step 1 rate increase of 21.08% or $38.3 million annual revenue increase and authorized the step 2 rate increase of 5.61% or $12.3 million annual revenue increase with a rate structure intended to provide funding of $46.0 million of annual extensions and replacements through rates (paygo). Due to a variety of factors including but not limited to the possibility that actual treatment volume and actual operating expenses could be materially different than assumed in the rate structure, there can be no assurance that actual results will meet the intention of the rate structure in the 2014 Wastewater Order. Recovery of debt service on all the outstanding long-term debt of the Wastewater System plus the CWA 2014A First Lien Bonds was included in the step 1 increase in the 2014 Wastewater Order and debt service on additional CWA long-term debt expected to be issued in fiscal year 2015 was included in the step 2 increase in the 2014 Wastewater Order (see also the discussion of Wastewater long-term debt in Note 6). The phase 1 rate increase was implemented effective May 1, 2014 and was reduced by $1.5 million annually effective October 1, 2014 since the actual debt service on the CWA 2014A First Lien Bonds was $1.5 million less than the amount assumed in the 2014 Wastewater Order. The phase 2 increase went into effect on October 1, 2014. In the 2014 Wastewater Order, the IURC approved the continued funding of the Septic Tank Elimination Program (STEP) for fiscal years 2014 and 2015. The IURC also ordered CWA to pursue all possible means to renegotiate customer contracts with neighboring wastewater districts (Satellites) to increase cost recovery from these customers to be more reflective of their actual cost of service.

*Investigation Proceeding*
In March 2014, the IURC initiated an investigation, including an investigation of billing practices for the gas, water, and wastewater utilities owned and operated by Citizens, and their compliance with IURC approved rules, regulations, and tariffs. Management expects the investigation proceeding will conclude in early 2015. The hearing in the investigation proceeding was completed in September 2014. Citizens filed its proposed order on October 24, 2014. The OUCC filed its proposed order on November 21, 2014, and Citizens filed its reply brief on December 5, 2014. Citizens cannot predict the outcome of the investigation, but does not expect that the outcome will have a material adverse effect on Citizens' operations or financial position.

*Acquisition of Westfield Water and Wastewater*
In November 2012, Westfield Water and Westfield Wastewater, two indirect subsidiaries of Resources, entered into separate asset purchase agreements with the City of Westfield for the purchase of Westfield's water and wastewater utility assets. The aggregate purchase price under the agreements was $91 million for the purchase of both the water utility assets and the wastewater utility assets. In November 2012, the City of Westfield, Westfield Water and Westfield Wastewater filed a joint petition with the IURC seeking approval of the proposed acquisitions. The Commission held hearings on the acquisition proposal in June 2013. A settlement agreement among the two Resources indirect subsidiaries, the City of Westfield, and the OUCC was reached and filed with the IURC in October 2013. The IURC issued an Order approving the acquisitions and the settlement agreement in November 2013. The acquisitions closed in March 2014. After purchase price adjustments, the combined actual purchase price for both utilities was $89.4 million. See also Note 4A.

*M.2 Regulatory Assets and Liabilities*

Citizens' and CWA's rates are designed to recover the costs of providing service, thus certain items that would normally be reflected in the Combined Statements of Operations are deferred on the Combined Statements of Financial Position. Regulatory assets represent probable future revenues associated with certain incurred costs, which will be recovered from customers through the rate-making process. Regulatory assets are charged to earnings as collection of the cost in rates is recognized or when future recovery is no longer probable. Conversely, regulatory liabilities represent future reductions in revenues associated with amounts that are to be credited to expense through the rate-making process. Citizens and CWA continuously monitor changes in market and regulatory conditions and consider the effects of any changes in assessing the continual applicability of the FASB guidance related to regulated entities.

Regulatory assets were comprised of the following at September 30, 2014 and 2013 (in thousands):

| | 2014 | 2013 | Recovery Period | Statement of Financial Position Location |
|---|---|---|---|---|
| Deferred Acquisition Transaction Costs | **$ 10,105** | $ 10,819 | 29 – 30 years | Other deferred charges |
| Decoupled Sales Component | **2,119** | 4,575 | 1 – 15 months | Other deferred charges |
| Deferred Post-Retirement Benefit Costs | **-** | 451 | through 2014 | Other deferred charges |
| Deferred Regulatory Proceeding Costs | **1,458** | 1,233 | 1 – 9 years | Other deferred charges |
| Price Volatility Mitigation Program | **255** | 628 | 1 – 13 months | Recoverable gas and fuel costs |
| Deferred Remediation Costs | **3,628** | 2,735 | Not yet recovered | Other deferred charges |
| Deferred Fuel Tracking Adjustments | **5,732** | 7,295 | 1 – 18 months | Recoverable gas and fuel costs |
| Other | **-** | 1 | Various | Other deferred charges |
| Total Regulatory Assets | **$ 23,297** | $ 27,737 | | |

Regulatory liabilities were comprised of the following at September 30, 2014 and 2013 (in thousands):

| | 2014 | 2013 | Refund Period | Statement of Financial Position Location |
|---|---|---|---|---|
| Contributions in Aid of Construction | **$ 135,353** | $ 89,138 | 40 – 50 years | Contributions in aid of construction |
| Regulatory Credit for Remediation | **5,819** | 5,779 | Not yet refunded | Other long-term liabilities |
| Deferred Water Rights | **694** | 811 | 10 – 11 years | Other long-term liabilities |
| Other | **3,984** | 3,448 | Various | Accounts payable and accrued expenses |
| Total Regulatory Liabilities | **$ 145,850** | $ 99,176 | | |

**N. Software Developed for Internal Use**

Internal and external costs incurred during the preliminary project stage associated with the development of internal use software are expensed as incurred. External direct costs of materials and services, internal direct payroll and payroll-related costs, and interest costs for the use of funds incurred during the application development stage associated with developing or obtaining internal use software are capitalized. Capitalized software costs were $2.3 million and $11.7 million in 2014 and 2013, respectively. Internal and external training and maintenance costs incurred during the post-implementation stage associated with the development of internal use software are expensed as incurred.

**O. Comprehensive Income (Loss)**

Comprehensive income (loss) is primarily a measure of all changes in equity of an enterprise which result from the transactions or other economic events during the period. This information is reported in the Combined Statements of Comprehensive Income. Citizens' components of accumulated other comprehensive income (loss) include the impact of pension and other post-retirement benefits and its share of ProLiance and Heartland Gas Pipeline, LLC (Heartland) other comprehensive income. Citizens records its portion of ProLiance's and Heartland's other comprehensive income as increases or decreases to the investment account with a corresponding adjustment to other comprehensive income.

The following table presents changes in accumulated other comprehensive income (loss) (AOCI) by component for the twelve months ended September 30, 2014 and 2013 (in Thousands):

| | Pension Plan | Other Postretirement Benefits | Other | Total |
|---|---|---|---|---|
| Accumulated other comprehensive (loss) as of September 30, 2012 | $ (147,317) | $ (6,855) | $ (5,959) | $ (160,131) |
| Other comprehensive income before reclassifications | 54,772 | 6,247 | 6,049 | 67,068 |
| Amounts reclassified from accumulated other comprehensive income | 8,956 | 999 | - | 9,955 |
| Net current-period other comprehensive income | 63,728 | 7,246 | 6,049 | 77,023 |
| Accumulated other comprehensive income (loss) as of September 30, 2013 | $ (83,589) | $ 391 | $ 90 | $ (83,108) |
| Other comprehensive income (loss) before reclassifications | (35,337) | (25,242) | 250 | (60,329) |
| Amounts reclassified from accumulated other comprehensive income (loss) | 4,683 | (609) | - | 4,074 |
| Net current-period other comprehensive income (loss) | (30,654) | (25,851) | 250 | (56,255) |
| Accumulated other comprehensive income (loss) as of September 30, 2014 | $ (114,243) | $ (25,460) | $ 340 | $ (139,363) |

P. Advances and Contributions in Aid of Construction (CIAC)

The Company may receive advances and contributions from customers, home builders and real estate developers to fund construction necessary to extend service to new areas. Water advances for construction are refundable for up to ten years as new customers begin to receive service or other contractual obligations are fulfilled. Advances not refunded within 10 years are transferred to CIAC. The balance of advances for construction are reported in the Statement of Financial Position in Other long-term liabilities, and are $15.4 million and $16.0 million at September 30, 2014 and 2013, respectively.

Contributions in aid of construction are permanent collections of plant assets or cash for a particular construction project. The IURC requires the water and wastewater utilities of Citizens and Resources to record CIAC as a deferred credit. Utility plant funded by contributions is depreciated and contribution balances are amortized as a reduction to depreciation expense. The values of CIAC, net of amortization, recorded at September 30, 2014 for Water, Wastewater, and Resources are $62.7 million, $41.8 million, and $30.8 million, respectively, versus the values at September 30, 2013 for Water, Wastewater, and Resources of $57.1 million, $32.0 million, and $0 million, respectively.

Q. New Accounting Guidance

The FASB issued guidance amending the disclosures about offsetting assets and liabilities. This guidance will impact entities that have financial and derivative instruments that are either offset in accordance with certain sections of the guidance, or are subject to an enforceable master netting arrangement or similar agreement. This guidance is applicable to Citizens and CWA beginning in fiscal year 2014. The FASB issued clarifications regarding the scope of the disclosures about offsetting assets and liabilities in January 2013. Citizens and CWA adopted this guidance, as amended for quarterly reporting, for fiscal year 2014. The adoption of this guidance did not have a material impact on its financial position, results of operations, or cash flows.

In February 2013, the FASB issued accounting guidance that revised the accounting for providing information about the amounts reclassified out of accumulated other comprehensive income (AOCI). The guidance became effective for fiscal years beginning after December 15, 2012. Citizens and CWA adopted this guidance, as amended, on October 1, 2013. The adoption of this guidance did not have a material impact on its financial position, results of operations, or cash flows. See footnote 2.O for implementation of this accounting pronouncement.

In May 2014, the FASB issued guidance revisiting the principles and standards for revenue recognition. The standard creates a framework for recognizing revenue to improve comparability of revenue recognition practices across entities and industries. The guidance is effective for Citizens' and CWA's quarterly report ending December 31, 2017. Citizens and CWA are evaluating the methods of adoption allowed by the new standard and the effect the standard is expected to have on its financial position, results of operations, cash flows, or disclosures.

## 3. BOND RESTRICTED FUNDS

Under the terms of various trust indentures, Citizens and CWA are required to maintain bond restricted funds. These bond restricted funds are invested in short-term securities, commercial paper, and cash equivalents. Due to the nature of these investments, cost approximates fair market value of $235.5 million and $203.8 million at September 30, 2014 and 2013, respectively. Gross deposits to the bond restricted fund investments during 2014 and 2013 were $179.9 million and $178.1 million, respectively.

## 4. ACQUISITIONS

A. Westfield Water and Westfield Wastewater

On March 21, 2014, Westfield Water and Westfield Wastewater, subsidiaries of CWU, closed on Asset Purchase Agreements with the City of Westfield to purchase the water and wastewater system assets and operating rights to the water and wastewater utilities of the City of Westfield, Indiana, respectively. Major assets acquired included underground mains and services, treatment and production plant, wells, and the accounts receivable. Significant excluded assets include the City of Westfield's stormwater system assets (unless the assets are used jointly by the wastewater system), and the Westfield Public Works building.

The benefits to Citizens include opportunities for growth in sales and revenues; improved access to water supply; improved water transmission in the northern part of the existing Citizens Water service territory; and opportunities to improve regional water quality through management of the Westfield wastewater treatment plant.

*Consideration Transferred*

Westfield Water and Westfield Wastewater acquired the water and wastewater system assets for a cash purchase price of $29.5 million and $59.9 million, respectively. See also Note 6 for additional information on debt issued relating to the acquisitions. The acquisition was approved by the IURC on November 25, 2013. Rates and charges will be regulated by the IURC. The utilities are operated as investor-owned utilities. Westfield Water and Westfield Wastewater assumed the rate schedules in place for the systems' customers at the acquisition date which include rate increases of 5%, 3%, and 5% on January 1, 2014, 2015 and 2016, respectively, for Westfield Water and 4%, 3%, and 2% on January 1, 2014, 2015, and 2016, respectively, for Westfield Wastewater. Westfield Water and Westfield Wastewater agreed that such rates shall remain in effect through December 31, 2016 (subject to unforeseen emergency rate relief needs). The acquisitions have been accounted for as business combinations.

The following table (in thousands) summarizes the preliminary purchase price allocation to assets acquired and liabilities assumed as of September 30, 2014:

| Water | Preliminary allocation as of March 31, 2014 | Adjustments to allocation during reporting period | Preliminary allocation as of September 30, 2014 |
|---|---|---|---|
| Property, Plant, Equipment | $ 40,548 | $ (7,526) | $ 33,022 |
| Intangible Assets | - | 8,375 | 8,375 |
| Current Assets | 575 | - | 575 |
| Total Assets Acquired | 41,123 | 849 | 41,972 |
| Current Liabilities | 42 | - | 42 |
| Contributions in Aid of Construction | 11,579 | 849 | 12,428 |
| Total Liabilities Assumed | 11,621 | 849 | 12,470 |
| Net Assets Acquired | $ 29,502 | $ - | $ 29,502 |

| Wastewater | Preliminary allocation as of March 31, 2014 | Adjustments to allocation during reporting period | Preliminary allocation as of September 30, 2014 |
|---|---|---|---|
| Property, Plant, Equipment | $ 74,053 | $ (4,814) | $ 69,239 |
| Intangible Assets | - | 7,805 | 7,805 |
| Current Assets | 1,015 | - | 1,015 |
| Total Assets Acquired | 75,068 | 2,991 | 78,059 |
| Current Liabilities | 163 | - | 163 |
| Contributions in Aid of Construction | 15,042 | 2,991 | 18,033 |
| Total Liabilities Assumed | 15,205 | 2,991 | 18,196 |
| Net Assets Acquired | $ 59,863 | $ - | $ 59,863 |

The allocation of purchase price in the table shown above is preliminary, as Citizens will obtain additional information regarding the fair value of property, plant, and equipment and intangible assets acquired. Based on preliminary allocations, the purchase prices for the acquisitions of Westfield Water and Westfield Wastewater exceeded the estimated fair value of net assets acquired by $8.4 million and $7.8 million, respectively, and have been reflected as Intangible Assets in the Statements of Financial Position. Adjustments to the allocation of purchase price recorded in 2015 will be recorded retroactively and could impact 2014 reported balances and net income. Regulatory accounting standards require that utility plant acquired be recorded at its original cost. To the extent there is a difference between original cost of utility plant and its estimated fair value, it will be recorded as an acquisition adjustment and reflected in Property, Plant, and Equipment for financial reporting purposes.

*Acquisition Costs*
Acquisition costs included those incurred to bring about the acquisition transaction (Transactional costs), those incurred to acquire the financing (Financing costs), and those incurred to bring about the integration of the utilities into Citizens (Integration costs). Transactional and Integration costs incurred in 2014 and 2013 were $0.3 million and $1.0 million, respectively, and were expensed as incurred. Financing costs were $2.0 million through September 30, 2014 and were recorded as deferred charges.

**B. Southern Madison Utilities, LLC**
In March 2013, CESCO acquired Southern Madison Utilities, LLC (SMU). SMU is a small unregulated water utility serving 28 retail customers in Madison County, Indiana, and a small portion of Hamilton County, Indiana. The utility also supplies wholesale water supplies to the Town of Pendleton, Indiana. The utility now operates under the Citizens Southern Madison (CSM) brand. The acquisition was attractive because it improves water supply diversity in order to ensure reliable water service to customers in the rapidly growing Fishers area and the northeast perimeter of the Citizens

Water service territory. The capacity of CSM is about 1.5 million gallons per day of water supply. CSM is operated as an unregulated, for-profit entity of CESCO.

*Consideration Transferred*

SMU was acquired through a cash payment of $3.9 million. An appraisal of the system was conducted which found that the fair value of the system was equal to the cash purchase price. The following table (in thousands) summarizes the final purchase price allocation to assets acquired and liabilities assumed:

| | Preliminary purchase price allocation as of March 31, 2013 | Adjustments made to finalize purchase price allocation | Final purchase price allocation as of March 31, 2014 |
|---|---|---|---|
| Property, Plant, Equipment | $ 3,897 | $ 1,358 | $ 5,255 |
| Current Assets | 82 | (72) | 10 |
| Total Assets Acquired | 3,979 | 1,286 | 5,265 |
| Current Liabilities | 86 | 437 | 523 |
| Contributions in Aid of Construction | - | 841 | 841 |
| Total Liabilities Assumed | 86 | 1,278 | 1,364 |
| Net Assets Acquired | $ 3,893 | $ 8 | $ 3,901 |

## 5. INVESTMENT IN UNCONSOLIDATED AFFILIATES

Unconsolidated affiliates include ProLiance, a jointly-owned affiliate of Resources (39%) and Vectren Energy Marketing & Services, Inc., (61%); Heartland Gas Pipeline, LLC (Heartland), an affiliation of equal ownership between Resources and ProLiance; and RPS, an affiliation of equal ownership between Resources and IPALCO Enterprises, Inc. A Condensed Statement of Operations of unconsolidated affiliates is presented below for the twelve months ended September 30, 2014 and 2013. A Condensed Statement of Financial Position for unconsolidated affiliates for the periods as of September 30, 2014 and 2013 follows. Both statements are presented in thousands.

| | For the twelve months ended September 30, **2014** | 2013 |
|---|---|---|
| Condensed Statements of Operation: | | |
| Revenues | $ **4,794** | $ 7,883 |
| Operating income (loss) | **1,597** | 1,155 |
| Net income (loss) from continuing operations | **882** | (339) |
| Discontinued operations | **(685)** | (98,174) |
| Net income (loss) | $ **197** | $ (98,512) |

| | As of September 30, **2014** | 2013 |
|---|---|---|
| Condensed Statements of Financial Position: | | |
| Current assets | $ **10,654** | $ 14,914 |
| Non-current assets | **59,953** | 65,493 |
| Total Assets | **70,607** | 80,407 |
| Current Liabilities | **1,523** | 6,364 |
| Non-current Liabilities | **20,903** | 24,446 |
| Equity | **48,181** | 49,597 |
| Total Capitalization and Liabilities | $ **70,607** | $ 80,407 |

In June 2013, ProLiance disposed of certain of the net assets, along with the long term pipeline and storage commitments of its wholesale natural gas marketing subsidiary, ProLiance Energy, LLC (PLE), through a sale transaction with a subsidiary of Energy Transfer Partners (ETP), ETC Marketing, Ltd. (ETC). As a result of this transaction, ProLiance recorded a loss of $64.1 million. Resources' share of the net loss was $25.0 million, consistent with its ownership share. ProLiance is accounted for under the equity method. This loss was reflected in the September 30, 2013 Combined Financial statements as a component of equity in loss of affiliates. To a great extent, the loss reflects the loss of prior earnings recognized since the original investment of $0.5 million made in 1996.

In addition, in connection with the PLE disposition, Citizens and Vectren issued a guarantee to ETC. The guarantee issued by the partners was a backup guarantee to the $50.0 million guarantee issued by ProLiance to ETC. The partners were released from the guarantee in September 2014.

ProLiance's remaining assets include investments in physical storage, pipeline assets, and a non-controlling interest in LA Storage, LLC (LA Storage), a development project in Louisiana for a salt-cavern natural gas storage facility. Certain of the remaining assets of ProLiance are owned through its investment in Heartland. Heartland, a joint venture between Resources and ProLiance, owns and operates an intrastate natural gas pipeline regulated by the IURC and is an affiliation of equal ownership between Resources and ProLiance. Operating services for Heartland are provided by Citizens. Citizens received storage rental fees from Heartland of $0.6 million in 2014 and 2013. Heartland is accounted for under the equity method.

On November 6, 2013, ProLiance Transportation & Storage, a wholly owned subsidiary of ProLiance, sold its wholly owned subsidiary Northern Storage to Ameren for $4.0 million.

On March 19, 2014, Exelon Corporation announced it had reached an agreement to purchase ETC ProLiance Energy from ETC. As a result of the transaction, ETC ProLiance has become a part of the Exelon subsidiary Constellation, a competitive retail supplier of power, natural gas and energy products and services for homes and businesses. This development is not expected to have a material impact on the operations of Citizens Gas, or its access to competitively priced gas supplies. The transaction closed in April, 2014. Under Constellation's ownership, Citizens' gas utility customers continue to receive the benefits of the portfolio administration services that were provided previously by PLE and ETC.

**Impairment Analysis - Investment in ProLiance and Note Receivable**
Investments in unconsolidated affiliates are reviewed for impairment whenever events or circumstances indicate that a loss in the value of the investment may have occurred which is other than temporary. Evidences of a loss in value might include, but are not limited to, the absence of an ability to recover the carrying amount of the investment or inability of the investee to sustain an earnings capacity that would justify the carrying amount of the investment.

Resources conducted an impairment review of its investment in ProLiance in September 2014. The fair value was estimated by discounting the cash flows expected to be received from ProLiance's investments in natural gas midstream assets, plus available cash. Resources determined the fair value of its investment in ProLiance to be $11.2 million (see Note 2J). The carrying value of Resources' investment in ProLiance at September 30, 2014 is $16.9 million, which includes both the investment in ProLiance and a Note Receivable due from ProLiance (see below). An impairment of $5.7 million reflects the amount by which the total carrying value of the investment exceeds its estimated fair value. This amount was recorded as described below.

As part of the sale of PLE, Resources provided a loan to ProLiance of $6.5 million. The loan is interest bearing and matures on June 24, 2018. The loan is secured by the remaining assets of ProLiance, which has been making interest payments on the note since inception. Interest income received through September 30, 2014 and September 30, 2013, was $0.2 million and less than $0.1 million respectively.

As part of the impairment analysis described above, the loan was tested for recoverability, using estimated cash available at ProLiance to repay the loan on its maturity date. This analysis indicated that ProLiance will not have sufficient resources to repay the loan at the maturity date. Accordingly, an allowance for the value of the uncollectible portion of the note principal ($3.4 million) was recorded in September 2014. The remaining amount of the total impairment ($2.3 million) was recorded to Resources' investment in ProLiance also in September 2014.

The activity for fiscal year 2014 for the investment in affiliates asset is as follows:

| | (In Thousands) | |
|---|---|---|
| Investment in affiliates as of September 30, 2012 | $ | 51,338 |
| ProLiance | | (33,001) |
| Heartland | | 525 |
| Other | | (602) |
| Investment in affiliates as of September 30, 2013 | $ | 18,260 |
| ProLiance | | (2,754) |
| Heartland | | (137) |
| Other | | (5) |
| Investment in affiliates as of September 30, 2014 | $ | 15,364 |

## 6. LONG-TERM DEBT

Long-term debt consisted of the following:

| | (In Thousands) | |
|---|---|---|
| | **September 30, 2014** | September 30, 2013 |
| **Citizens Gas** | | |
| Gas Utility System Series 1986B, Revenue Refunding Bonds, 3.50% to 4.00%, due 2015 to 2018 | **$ 41,920** | $ 51,420 |
| Gas Utility Distribution System Series 2008B, Second Lien Multi-Mode Revenue Bonds, 5.25%, due 2025 to 2027 | **55,855** | 55,855 |
| Gas Utility Distribution System Series 2008C, Second Lien Multi-Mode Revenue Bonds, 5.00% to 5.25%, due 2015 to 2021 | **54,435** | 57,180 |
| Gas Utility Distribution System Series 2009A, Second Lien Revenue Refunding Bonds, 3.50% to 5.00%, due 2015 to 2018 | **12,265** | 12,450 |
| Gas Utility Distribution System Series 2010A, Second Lien Revenue Refunding Bonds, 4.00% to 5.00%, due 2019 to 2024 | **59,975** | 59,975 |
| Gas Utility Distribution System Series 2013A, Second Lien Revenue Refunding Bonds, 4.125% to 5.250%, due 2027 to 2030 | **54,465** | 54,465 |
| Net Unamortized Bond Premiums and Discounts | **6,296** | 6,304 |
| Current Maturities | **(12,955)** | (12,430) |
| Subtotal Citizens Gas Long-Term Debt | **272,256** | 285,219 |
| **Water** | | |
| Water Utility Net Revenue Bonds Series 2011A, 4.375% to 5.500%, due 2011 to 2014 | **-** | 4,410 |
| Water Utility Net Revenue Bonds Series 2011B, 4.00% to 5.00%, due 2015 to 2029 | **64,690** | 69,705 |
| Water Utility Net Revenue Bonds Series 2011C, 5.50%, due 2016 to 2022 | **77,830** | 77,830 |
| Water Utility Net Revenue Bonds Series 2011D, 5.25%, due 2022 to 2025 | **70,410** | 70,410 |
| Water Utility Net Revenue Bonds Series 2011E, 4.50% to 5.25%, due 2015 to 2038 | **94,440** | 96,955 |
| Water Utility Net Revenue Bonds Series 2011F, 3.25% to 5.75%, due 2015 to 2038 | **539,310** | 545,845 |
| Water Utility Net Revenue Bonds Series 2011G, 3.25% to 5.125%, due 2015 to 2041 | **56,120** | 57,170 |
| Water Utility Net Revenue Bonds Series 2011B, Second Lien, 3.00%, due 2014 | **-** | 42,905 |
| Water Utility Net Revenue Bonds Series 2014A, 2.00% to 5.00%, due 2016 to 2045 | **27,170** | - |
| Water Utility Net Revenue Bonds Series 2014B, Second Lien, 2.95%, due 2023 | **43,595** | - |
| Net Unamortized Bond Premiums | **1,887** | 594 |
| Current Maturities | **(17,495)** | (19,525) |
| Subtotal Water Long-Term Debt | **957,957** | 946,299 |
| **Wastewater** | | |
| CWA Wastewater Utility Revenue Bonds Series 2011A, 2.50% to 5.25%, due 2015 to 2041 | **664,070** | 672,540 |

(In Thousands)

| | **September 30, 2014** | September 30, 2013 |
|---|---|---|
| CWA Wastewater Utility Revenue Bonds Series 2011B, Second Lien, 5.00% to 5.25%, due 2015 to 2041 | **268,015** | 268,015 |
| CWA Wastewater Utility Revenue Bonds Series 2011C, Second Lien, 3.00%, due 2016 | **45,990** | 45,990 |
| CWA Wastewater Utility Revenue Bonds Series 2012A, 2.75% to 5.00%, due 2015 to 2042 | **192,125** | 192,125 |
| CWA Wastewater Utility Revenue Bonds Series 2014A, 3.00% to 5.00%, due 2016 to 2045 | **236,990** | - |
| Obligation to reimburse City for debt service on Sanitary District General Obligation Bonds, see table below | **28,345** | 35,425 |
| Net Unamortized Bond Premiums | **88,433** | 67,038 |
| Current Maturities | **(26,539)** | (15,195) |
| Subtotal Wastewater Long-Term Debt | **1,497,429** | 1,265,938 |
| **Thermal** | | |
| Thermal Energy System Series 2008, Multi-Mode Revenue Bonds, 5.00%, due 2022 to 2026 | **50,070** | 50,070 |
| Thermal Energy System Revenue Refunding Bonds Series 2010A, 3.00% to 5.00%, due 2015 to 2029 | **9,440** | 9,845 |
| Thermal Energy System Revenue Refunding Bonds Series 2010B, 4.00% to 5.00%, due 2015 to 2021 | **59,060** | 65,505 |
| Thermal Energy System Revenue Bonds Series 2013A, 3.00% to 5.00% due 2015 to 2033 | **8,585** | 8,585 |
| Thermal Energy System Revenue Bonds Series 2013B Put Bonds, 0.73%, due 2015 to 2034 | **-** | 39,240 |
| Thermal Energy System Revenue Bonds Series 2014A, 2.00% to 5.00%, due 2016 to 2035 | **35,265** | - |
| Net Unamortized Bond Premiums and Discounts | **8,915** | 6,053 |
| Current Maturities | **(7,310)** | (6,850) |
| Subtotal Thermal Long-Term Debt | **164,025** | 172,448 |
| **Resources** | | |
| Citizens Westfield Utilities Revenue Bonds Series 2014A, 74% of 3-month LIBOR +2.20% with a swap to effectively fix 80% of bonds at 3.56% (see below and note 12); due 2015 to 2019 | **69,090** | - |
| Citizens Westfield Water Revenue Bonds Series 2014A, 74% of 1-month LIBOR + 1.60% with a swap to effectively fix the rate at 2.89% (see below and note 12); due 2019 | **8,365** | - |
| Citizens Westfield Wastewater Revenue Bonds Series 2014A, 74% of1-month LIBOR + 1.60% with a swap to effectively fix the rate at 2.89% (see below and note 12); due 2019 | **15,270** | - |
| Kinetrex Energy Construction Loan | **19,260** | |
| Current Maturities | **(1,727)** | - |
| Subtotal Resources Long-Term Debt | **110,258** | - |
| Total Long-Term Bonds Outstanding | **$3,001,925** | $ 2,669,904 |

Principal maturities of long-term debt for the next five fiscal years and thereafter are as follows:

| | (In Thousands) |
|---|---|
| 2015 | $ 66,026 |
| 2016 | 83,252 |
| 2017 | 130,386 |
| 2018 | 99,218 |
| 2019 | 165,811 |
| Thereafter | 2,417,727 |
| Total principal maturities | $2,962,420 |

*Citizens Gas*
The Gas Utility System (GUS) revenue refunding bonds were issued pursuant to a trust indenture dated as of July 1, 1986. These bonds are secured by and payable from the income and revenues of the Citizens Gas, Oil, Discontinued Operations and Citizens Resources segments. The Gas Utility Distribution System (GUDS) Second Lien Revenue Refunding Bonds, Series 2008B, Series 2008C, Series 2009A and Series 2010A and Series 2013A are secured by and payable from the income and revenues of the GUDS as provided for in the respective trust indentures. The GUDS Second Lien Multi-Mode Revenue Bonds, Series 2008B and Series 2008C were issued on April 10, 2008 (Series A&B) and June 10, 2008 (Series C) in conjunction with the refunding of the Series 2001 and Series 2003A bonds. The Series 2009A bonds were issued on February 17, 2009 in conjunction with a partial refunding of the Series 1998A bonds. The Series 2010A bonds were issued on March 12, 2010 in conjunction with the refunding of the remaining Series 1998A bonds. The Series 2013A bonds were issued on July 16, 2013 in conjunction with the refunding of the series 2008A bonds. All of the Second Lien bonds are subordinate to the bonds issued under the 1986 trust indenture.

*Water*
The bonds issued in connection with the acquisition of the Water System are governed by bond indentures dated as of August 1, 2011. These bonds are secured by and payable from the net revenues of the Water System. Upon acquisition of the Water System on August 26, 2011, Citizens also succeeded to the obligations of the Indianapolis Waterworks Department with respect to the $958.3 million of Bond Bank bonds supported by the net revenues of the Water System and $0.3 million of District Subordinate Taxable Notes. The Indianapolis Local Public Improvement Bond Bank (Bond Bank) agreed to exchange its Department of Waterworks Bonds for identical bonds of Citizens. The Bond Bank debt included seven series of bonds (Series 2011 A through G, respectively), issued between 2002 and 2011. Maturity dates, at the time of closing, ranged from 2012 to 2041 and coupon rates ranged from 2.0 percent to 5.75 percent.

On August 26, 2011, the Water business segment also issued $42.9 million of Second Lien Water Utility Revenue Bonds, Series 2011B, due 2014. The Second Lien bonds are secured and payable from the net revenues of the Water System as provided in the respective bond indenture dated August 26, 2011. The series was issued at a premium of $1.8 million. The new debt was issued as three-year fixed rate bonds with a bullet maturity on October 1, 2014. The coupon rate was 3 percent. The proceeds of this series were used to fund capital improvements, working capital and the initial start-up costs related to the acquisition and operation of the Water System. The second lien bonds are subordinate to the first lien bonds.

On July 16, 2014 Citizens Water issued $27.2 million of First Lien Water Utility Revenue Bonds, Series 2014A and $43.6 million of Second Lien Water Utility Revenue Bonds, Series 2014B. The Series 2014A first lien bonds were issued at a premium of $1.9 million and have principal maturities due between 2015 and 2044 with coupons ranging from 2.0% to 5.0%. The bonds were issued to fund a portion of 2013 and 2014 capital expenditures including repaying $15 million on the PNC line of credit. The Series 2014B second lien bonds were issued to refund the Series 2011B second lien bonds due October 1, 2014 and have a principal maturity date of October 01, 2022 with a coupon of 2.95%.

*Wastewater*
The bonds issued to fund the acquisition, start-up expenses, and capital expenditures of the Wastewater System were pursuant to Trust indentures dated as of August 1, 2011. The First Lien and Second Lien bonds are secured by and payable from the net revenues of the Wastewater System. The second lien bonds are subordinate to the first lien bonds. On August 26, 2011, CWA issued $992.5 million of Wastewater Utility Revenue Bonds. The First Lien Wastewater Utility Revenue Bonds, Series A, were issued in the amount of $678.5 million. The series was issued at a premium of $38.5 million. The debt was issued as fixed rate serial and term bonds maturing between 2012 and 2041, with coupon rates ranging from 2 percent to 5.25 percent. The proceeds from the 2011A Series were used to fund a portion of the acquisition of the Wastewater System, to fund the debt service reserve fund for the 2011A Series and to fund capital improvements for the Wastewater System. The Second Lien Wastewater Utility Revenue Bonds, Series 2011B, were issued in the amount of $268.0 million. The series was issued at a premium of $8.2 million. The debt was issued as fixed rate serial and term bonds maturing between 2014 and 2041, with coupon rates ranging from 5 percent to 5.25 percent. The proceeds from the 2011B Series were used to provide a portion of the funding for the acquisition of the Wastewater System and to fund a debt service reserve for the series. The Second Lien Wastewater Utility Revenue Bonds, Series 2011C, were issued in the amount of $46.0 million. The series was issued at a premium of $2.3 million. The debt was issued as a five-year fixed rate bond with a bullet maturity of October 1, 2016. The coupon rate is 3 percent. The proceeds of this series have been used to fund capital improvements, working capital and the initial start-

up costs related to the acquisition and operation of the Wastewater System. On September 19, 2012, CWA issued $192.1 million of First Lien Wastewater Utility Revenue Bonds. The Series 2012A Series bonds were issued at a premium of $21.6 million and have principal maturities due between 2014 and 2042 with coupons ranging from 2.75% to 5.00%. The bonds were issued to fund capital expenditures on the Wastewater System.

On July 16, 2014 CWA issued $237.0 million of First Lien Wastewater Utility Revenue Bonds, Series 2014A. The Series 2014A bonds were issued at a premium of $24.2 million and have principal maturities due between 2015 and 2044 with coupons ranging from 3.0% to 5.0%. The bonds were issued to fund a portion of 2013 and 2014 capital expenditures including repaying $100 million on the Wells Fargo line of credit.

Upon acquisition, CWA also agreed to make payments to the City in order to satisfy the annual debt service payments on the outstanding principal amount of the General Obligation Sanitary District Bonds listed below. The principal amounts outstanding at September 30 are as follows:

| | (In Thousands) | |
|---|---|---|
| | **2014** | 2013 |
| Wastewater General Obligation Bonds Series 2003A, 5.25%, due 2012 to 2018 | **$ -** | $ 5,840 |
| Wastewater General Obligation Bonds Series 2007C, 5.00%, due 2015 to 2018 | **23,395** | 28,570 |
| Wastewater General Obligation Bonds Series 2009A, 2.75% to 4.00%, due 2015 | **515** | 1,015 |
| Wastewater General Obligation Bonds Series 2013A, 5.25%, due 2015 to 2018 | **4,435** | - |
| Total Wastewater General Obligation Bond Debt | **$ 28,345** | $ 35,425 |

*Thermal*

The Thermal Energy System Revenue Bonds, Series 2001A and 2001B were issued pursuant to a Thermal Energy System trust indenture dated January 1, 2001. The Thermal Energy System Revenue Bonds, Series 2008 and Series 2010B were issued on April 10, 2008 (Series 2008) and October 28, 2010 (Series 2010B) in conjunction with the refunding of the Series 2001B and Series 2001A bonds, respectively. The Series 2010A bonds were issued on March 12, 2010 in order to refund approximately $10.0 million of interim indebtedness incurred by the Steam business segment. The bonds issued under the Thermal Energy System trust indenture are secured by and payable from all income and revenues of the Thermal Energy System provided for in the Thermal Energy System trust indenture.

On October 28, 2010, Thermal issued $78.1 million of Thermal Energy System, First Lien Revenue Refunding Bonds, Series 2010B, due 2011 to 2021. This series was issued at a premium of $9.3 million. The new debt was issued as fixed rate serial bonds ranging from a coupon rate of 1.5 percent for bonds maturing in 2011, increasing to 3 percent for bonds maturing through 2013, 4 percent for bonds maturing in 2014 and 5 percent for maturities thereafter. The proceeds of this series were used to refund the remaining Thermal Energy System Revenue Bonds, Series 2001A in the aggregate principal amount of $81.2 million.

Thermal entered into a $30.0 million, 2 year, variable interest construction loan during 2010 with J.P. Morgan Chase, the proceeds of which were used for construction of steam and chilled water facilities at the new Eskenazi Hospital (the Wishard Construction Loan). The loan was paid in full in September 2013.

On August 20, 2013, Citizens issued the Thermal Energy System First Lien Revenue Bonds, Series 2013A and B in the amount of $8.6 million and $39.2 million, respectively. The proceeds from the Series A bonds were used to pay back the Steam portion of the Wishard Construction Loan. These bonds have maturities from 2014 to 2033, with coupons ranging from 3.00% to 5.00%. The bonds were issued with a premium of $0.2 million. The proceeds from the Series B bonds met several needs of the Steam system, including repayment of its $20 million line of credit (see Note 7), funding for the Steam system conversion to natural gas boilers (see Note 2M.1 – Citizens Thermal Steam), and funding for other capital needs. The Series B bonds were issued at par and were subject to a mandatory tender for purchase (put) on August 1, 2014.

On July 23, 2014 the Thermal Energy System issued $35.3 million of First Lien Revenue Refunding Bonds, Series 2014A. The Series 2014A bonds were issued at a premium of $4.1 million and have principal maturities due between 2015 and 2034 with coupons ranging from 2.0% to 5.0%. The bonds were issued to refund the $39.2 million Series 2013B Put Bonds.

*Resources*
The CWU revenue bonds were issued to provide capital for investment in subsidiaries pursuant to a CWU indenture dated March 1, 2014. The bonds are secured by an assignment of certain interests in the ownership rights of the CWU subsidiaries and payable with funds from dividends of the CWU subsidiaries. The bonds were purchased by a syndicate of banks (the Lenders) under a Continuing Covenant Agreement dated March 21, 2014. PNC Bank, National Association served as administrative agent for the Lenders. The bonds amortize on a 30-year level principal amortization schedule beginning December 31, 2014 and are subject to a mandatory tender by the Lenders on March 20, 2019. Interest on the bonds is at a floating rate of 74 percent of 3-month LIBOR plus 2.2 percent; however, the interest on 80 percent of the bonds was effectively fixed at a rate of approximately 3.56% through October 1, 2018 by means of an interest rate swap with PNC Bank, National Association as the counterparty (see Note 12).

The Westfield Water revenue bonds were issued pursuant to a Westfield Water indenture dated March 1, 2014 to fund a portion of the $29.5 million acquisition price of the assets and operating rights to the water utility of the City of Westfield, Indiana (see also Note 4A), as well as to provide $1.1 million to fund a portion of future capital expenditures for the water utility. The Westfield Water bonds are secured by and payable from the net revenues of Westfield Water. Secondarily, the bonds are collateralized by certain non-operating assets of the utility. The bonds were purchased by a syndicate of banks (the Lenders) under a Continuing Covenant Agreement dated March 21, 2014. PNC Bank, National Association served as administrative agent for the Lenders. The bonds are subject to a mandatory tender by the Lenders on March 20, 2019. Interest on the bonds is a floating rate of 74 percent of 1-month LIBOR plus 1.6 percent effectively fixed at a rate of approximately 2.89% through October 1, 2018 by means of an interest rate swap with PNC Bank, National Association as the counterparty (see Note 12).

The Westfield Wastewater revenue bonds were issued pursuant to a Westfield Wastewater indenture dated March 1, 2014 to fund a portion of the $59.9 million acquisition price of the assets and operating rights to the water utility of the City of Westfield, Indiana (see also Note 4A), as well as to provide $0.5 million to fund a portion of future capital expenditures for the wastewater utility. The Westfield Wastewater bonds are secured by and payable from the net revenues of Westfield Wastewater. Secondarily, the bonds are collateralized by certain non-operating assets of the utility. The bonds were purchased by a syndicate of banks (the Lenders) under a Continuing Covenant Agreement dated March 21, 2014. PNC Bank, National Association served as administrative agent for the Lenders. The bonds are subject to a mandatory tender by the Lenders on March 20, 2019. Interest on the bonds is a floating rate of 74 percent of 1-month LIBOR plus 1.6 percent effectively fixed at a rate of approximately 2.89% through October 1, 2018 by means of an interest rate swap with PNC Bank, National Association as the counterparty (see Note 12).

On August 28, 2013, Kinetrex closed on a construction note of $14.0 million. The note matures on the earlier of 24 months from closing or when the $14.0 million is fully drawn. On January, 15, 2014, the capacity of the note was increased to $24 million. Kinetrex may elect to convert the construction note to a five-year term loan at any time up to the date of maturity, August 28, 2015. The current interest rate on the note is LIBOR plus 1.9 percent. As of September 30, 2014, $19.3 million had been drawn on the construction note versus $0.2 million as of September 30, 2013.

*Rate Covenants*
Citizens and CWA are obligated to satisfy certain covenants, including meeting certain minimum rate covenant debt service coverage requirements for each bond issue which are generally calculated as earnings before interest, taxes, depreciation and amortization, including certain adjustments, divided by the relevant debt service.

In addition, Citizens and CWA have covenants specifying in the event that debt service covenants cannot be met, Citizens and CWA shall take any appropriate action under the law and within its power, to generate income and revenues of the GUS, GUDS, Water System, Wastewater System and Thermal Energy System, respectively, in the amounts required to satisfy the covenants for subsequent fiscal years. These actions include, but are not limited to, the filing of a proceeding seeking additional revenues or other relief before the IURC.

Citizens' and CWA's rate covenant debt service coverage ratios, as defined by each indenture, are summarized as follows for 2014:

| | Minimum Covenant Requirement | 2014 Actual |
|---|---|---|
| GUS Revenue Refunding Bonds Series 1986B | 1.4 | 5.68 |
| GUDS Revenue Refunding Bonds Series 2008B, Series 2008C, Series 2009A, Series 2010A, and Series 2013A Second Lien Multi-Mode Revenue and Revenue Refunding Bonds | 1.0 | 2.29 |

| | Minimum Covenant Requirement | 2014 Actual |
|---|---|---|
| Water Utility Net Revenue Bonds Series 2011A-2011G, Series 2014A | 1.2 | 1.27 |
| Water Utility Net Revenue Second Lien Bonds Series 2011B and Series 2014B | 1.1 | 1.25 |
| CWA Wastewater Utility Revenue Bonds Series 2011A, Series 2012A, and Series 2014A | 1.2 | 2.13 |
| CWA Wastewater Utility Revenue Second Lien Bonds Series 2011B and 2011C | 1.1 | 1.61 |
| Thermal Energy System Revenue Bonds Series 2008, Series 2010A and 2010B, and Series 2013A and 2013B and Series 2014A | 1.0 | 1.88 |
| Westfield Wastewater Utility Revenue Bonds Series 2014A | 3.5 | 11.28 |
| Westfield Water Utility Revenue Bonds Series 2014A | 3.5 | 17.89 |
| Citizens Westfield Utility LLC Revenue Bonds Series 2014A | 2.0 | 4.11 |

As of September 30, 2014, the Water System maintains $6.9 million in the Rate Stabilization Fund. For purposes of satisfying its rate covenant, per the Water System indenture, Citizens may transfer funds from the Rate Stabilization Fund to revenues in any fiscal year, so long as the funds were not transferred to the Rate Stabilization Fund during such fiscal year. These funds were transferred to the Rate Stabilization Fund in fiscal 2012 and continue to be available to support net revenues of the Water System in future years.

## 7. SHORT-TERM AND OTHER BORROWINGS

*Citizens Gas*

Citizens Gas had $50.0 million in commercial paper outstanding at September 30, 2014 and 2013. The commercial paper has a maximum maturity of 270 days. It was last remarketed in September 2014 and will next remarket in December 2014. The seasonal nature of Citizens Gas creates short-term working capital needs to fund gas inventory purchases and accounts receivable during the heating season. Citizens Gas has two working capital lines of credit amounting to $50.0 million available on an annual basis to fund such needs. As of September 30, 2014, Citizens Gas had no amount outstanding under such lines of credit, so the entire amount remained available as specified above. One of the $25.0 million lines of credit was renewed for a three year term in July 2013 with an interest rate of LIBOR plus 1.125 percent. This line of credit is with PNC Bank, N.A (PNC). The other $25.0 million line of credit, with J.P. Morgan Chase, was renewed for a three-year term in August 2012 with an interest rate of LIBOR plus 1.30 percent.

*Water*

In August 2012, Citizens executed a $50.0 million line of credit with PNC to support capital expenditures for the water utility. The line of credit was scheduled to terminate on August 17, 2015 but has been expanded and extended as discussed below. As of September 30, 2014 and 2013, $21.5 million and $15.0 million was outstanding on the line, respectively. On December 9, 2014 Citizens closed on an expansion of the capital expenditure line of credit to $100 million and extended the termination date to December 8, 2017 with a syndicate led by PNC. Interest rates are based on the S&P and Fitch ratings of the 2014B Second Lien Water System Revenue Bonds; at the time of close the interest rate is 68.50 percent of LIBOR plus 0.80 percent with a commitment fee of 0.20 percent.

In April 2013, Citizens executed a $30.0 million line of credit with BMO Harris Bank NA for working capital which matures in April 2015 and has an interest rate of LIBOR plus 0.92 percent. There were no draws on the facility during 2014 or 2013.

*Wastewater*

Concurrent with the acquisition of the Wastewater System on August 26, 2011, CWA established a line of credit. The line of credit has a capacity of $145.0 million and is intended to be used to fund Wastewater capital expenditures. As of September 30, 2013, $30.0 million was outstanding on the line. The line of credit was renewed with a syndicate of JP Morgan Chase and Wells Fargo, each with equal participation and with JP Morgan Chase acting as Administrative Agent, on September 30, 2014 at an interest rate of 72 percent of LIBOR plus 0.84 percent and a commitment fee of 0.22

percent. This line will mature on September 30, 2017. As of September 30, 2014, no amounts were outstanding on the line.

*Thermal*
On June 10, 2014 the Thermal Energy System closed on the second supplemental credit agreement with JP Morgan Chase extending a $20.0 million line of credit to a June 21, 2017 maturity date. The proceeds can be used for both operating expenses and capital expenditures. The commitment fee on the line is 0.25 percent and the applicable interest rate is LIBOR plus 1.25 percent. As of September 30, 2014, no amounts were outstanding.

*Resources*
Concurrent with the acquisition of Westfield Water and Wastewater on March 21, 2014, both utilities established lines of credit. The Westfield Water line of credit has a capacity of $10.3 million and is intended to fund working capital and capital expenditures. As of September 30, 2014 $1.0 million was outstanding on the line. The Westfield Wastewater line of credit has a capacity of $11.0 million and is intended to fund working capital and capital expenditures. As of September 30, 2014, $1.0 million was outstanding on the line. The interest rate on these lines is LIBOR plus 2.40 percent with a commitment fee of 0.175 percent.

On August 28, 2013, Kinetrex closed on a line of credit. The current interest rate on the line of credit is LIBOR plus 1.90 percent. The line of credit has a capacity of $3.0 million for working capital needs and matures three years from the closing date. As of September 30, 2014, no amounts were outstanding. As of September 30, 2013 less than $0.1 million was outstanding.

## 8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses as shown in the accompanying Combined Statements of Financial Position are comprised of the following components at September 30:

| | (In Thousands) | |
|---|---|---|
| | **2014** | 2013 |
| Accounts payable | **$ 109,680** | $ 77,784 |
| Accrued interest | **51,818** | 49,838 |
| Customer credit balances | **12,325** | 15,124 |
| Salaries and employee benefits | **15,512** | 16,699 |
| Post-retirement benefits | **4,873** | 3,553 |
| Other | **4,467** | 3,423 |
| Total accounts payable and accrued expenses | **$ 198,675** | $166,421 |

## 9. RETIREMENT PLANS

Citizens has a non-contributory defined benefit pension plan covering substantially all full-time employees. The policy of Citizens is to fund amounts necessary to maintain the plan on an actuarially sound basis. Contributions are intended to provide not only benefits attributed to service-to-date but also for benefits expected to be earned in the future. Citizens also has a defined-benefit pension plan for certain Water bargaining employees. Citizens elected to freeze the plan as of September 30, 2011, and the participants are no longer accruing benefits.

In addition to providing defined benefit pension plan benefits, Citizens also offers other retirement benefits to eligible employees including a pension restoration plan, a supplemental benefits plan, thrift savings plans and post-retirement health care and life insurance benefits. The pension restoration plan provides retirement benefits for employees whose retirement benefit exceeds the maximum allowable benefit under the Internal Revenue Code for qualified pension plans and thrift plans. The supplemental benefit plan covers certain former employees of Indianapolis Water Company.

The thrift savings plans are defined contribution plans covering most employees. Citizens matches a portion of the contributions made by the employees to the savings plans. The cost to Citizens for its matching portion was $1.6 million and $1.7 million in 2014 and 2013, respectively.

Citizens provides post-retirement health and dental benefits to eligible retirees, which includes payment of up to 80 percent of single and dependent coverage premiums until age 65. Certain active non-bargaining employees, previously on the legacy Water post-retirement health plan, will receive benefits for life upon retirement. The percentage of premiums paid by Citizens is dependent upon the age and years of service at the date the employee retires. The post-retirement benefit plans are unfunded. Citizens accrues the expected cost of post-retirement health benefits during the years in which employees render service. Between 1994 and 2002, in accordance with an IURC order permitting the deferral and subsequent recovery of costs in excess of pay as you go, Citizens had been deferring such post-retirement benefit costs of Citizens Gas amounting to $5.4 million. Since 2002, Citizens Gas has recovered, through its rates, $5.4 million and $4.9 million through September 30, 2014 and 2013, respectively, leaving no deferred balance as of

September 30, 2014 and $0.5 million as of September 30, 2013. Post-retirement benefit costs applicable to the Water, Thermal, Manufacturing and Oil segments have not been deferred.

Citizens also assumed responsibility for benefits of the legacy Water plan with respect to employees that were retired (as well as eligible dependents) as of the date of acquisition of the water utility. These benefits continue for the life of the participants. A restricted funds trust (Grantor Trust) had been established by previous owners of the Water operations to fund retiree medical benefit obligations of the legacy Water plan. Contributions to the trust had been made periodically by the previous owners. Citizens acquired the Grantor Trust as part of the acquisition and continues to make contributions to the trust from operating revenues of the Water System as authorized by the IURC. Benefits are paid from the Grantor Trust.

The following table sets forth the funded status of the defined benefit pension and other post-retirement benefit plans as of the measurement date, reconciled with the amount reported in Citizens' and CWA's Combined Statements of Financial Position at September 30, 2014 and 2013:

| | Defined Benefit Pension (In Thousands) | | Other Benefits (In Thousands) | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| Projected Benefit Obligation (PBO) | **$ 360,209** | $ 310,871 | **$ 99,359** | $ 72,353 |
| Plan assets at fair value | **261,899** | 238,466 | **–** | – |
| Funded status | **$ (98,310)** | $ (72,405) | **$ (99,359)** | $ (72,353) |
| Amounts recognized in the Consolidated Statements of Financial Position consist of: | | | | |
| Current liability | **$ –** | $ – | **$ (4,873)** | $ (3,957) |
| Non-current liability | **(98,310)** | (72,405) | **(94,486)** | (68,396) |
| Net amounts recognized | **$ (98,310)** | $ (72,405) | **$ (99,359)** | $ (72,353) |
| Amounts in Accumulated Other Comprehensive Income (AOCI) not in costs*: | | | | |
| Unrecognized transition obligation | **$ –** | $ – | **$ –** | $ 16 |
| Unrecognized prior service cost | **1,724** | 2,085 | **(8,876)** | (9,692) |
| Unrecognized actuarial loss | **112,519** | 81,504 | **34,494** | 9,285 |
| Total Amounts in AOCI | **$ 114,243** | $ 83,589 | **$ 25,618** | $ (391) |

* The amounts expected to be recognized in 2015 out of AOCI, are $6.9 million for the defined benefit pension plan and $(1.1) million for the other benefits.

The net periodic benefit cost for these plans included the following components:

| | Defined Benefit Pension (In Thousands) | | Other Benefits (In Thousands) | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| Service cost-benefits attributed to service during the period | **$ 8,904** | $ 10,784 | **$ 3,957** | $ 3,360 |
| Interest cost | **14,003** | 12,334 | **3,043** | 2,518 |
| Actual (gain) on assets | **(18,494)** | (25,445) | **–** | – |
| Amortization of transition obligation | **–** | – | **16** | 588 |
| Amortization of prior service cost | **361** | 361 | **(816)** | (773) |
| Amortization of loss | **4,322** | 8,595 | **191** | 1,184 |
| Deferred actuarial (loss) gain | **3,959** | 11,901 | **–** | – |
| Net periodic benefit cost | **13,055** | 18,530 | **6,391** | 6,877 |
| Settlement expense (gain) loss | **–** | (76) | **–** | – |
| Total expense for the year | **$ 13,055** | $ 18,454 | **$ 6,391** | $ 6,877 |

Assumptions used to determine benefit obligations at September 30 were as follows:

| | Citizens Defined Benefit Pension | | Citizens Other Benefits | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| Average discount rate | **4.15%** | 4.65% | **3.96%** | 4.32% |
| Rate of increase in future compensation levels | **3.50%** | 3.50% | – | – |

| | Water Defined Benefit Pension | |
|---|---|---|
| | **2014** | 2013 |
| Average discount rate | **3.63%** | 4.00% |
| Rate of increase in future compensation levels | – | - |

Assumptions used to determine net periodic benefit cost at September 30 were as follows:

| | Citizens Defined Benefit Pension | | Citizens Other Benefits | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| Average discount rate | **4.65%** | 3.70% | **4.32%** | 3.38% |
| Rate of increase in future compensation levels | **3.50%** | 3.50% | – | – |
| Expected long-term rate of return on assets | **6.04%** | 6.37% | – | – |

| | Water Defined Benefit Pension | |
|---|---|---|
| | **2014** | 2013 |
| Average discount rate | **4.00%** | 3.19% |
| Rate of increase in future compensation levels | – | – |
| Expected long-term rate of return on assets | **6.04%** | 6.37% |

Assumed health care cost trend rates at September 30 were as follows:

| | Citizens Other Benefits | |
|---|---|---|
| | **2014** | 2013 |
| Health care cost trend rate assumed for next year | **8.0%** | 8.5% |
| Rate to which the cost trend rate is assumed to decline | **5.0%** | 5.0% |
| Year that the rate reaches the ultimate trend rate | **2021** | 2020 |

To calculate the expected long-term rate of return on assets, Citizens used the plan assets fair market value and an expected long-term rate of return, based on a targeted 60 percent equity and 40 percent debt allocation for the plan.

Assets of the defined benefit pension plan consist principally of investments in long-term and intermediate-term fixed income securities and common stocks. The measurement date of September 30 was used to determine the pension cost for the years 2014 and 2013.

The following table presents the pension assets measured at fair value on a recurring basis, based on the hierarchy as of September 30, 2014 and 2013 (in thousands):

| | **2014 Fair Value Measurements Using** | | |
|---|---|---|---|
| Description | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Pension Assets: | | | |
| Cash equivalents | **$ 8,008** | **$ -** | **$ -** |
| Equities | **163,816** | **-** | **-** |
| Fixed income | **90,075** | **-** | **-** |
| Total pension assets measured at fair value | **$ 261,899** | **$ -** | **$ -** |

| | 2013 Fair Value Measurements Using | | |
|---|---|---|---|
| Description | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Pension Assets: | | | |
| Cash equivalents | $ 3,889 | $ - | $ - |
| Equities | 140,759 | 8,989 | - |
| Fixed income | 84,819 | - | - |
| Total pension assets measured at fair value | $ 229,467 | $ 8,989 | $ - |

See Note 2J for additional guidance on fair value measurement.

Citizens' pension plan weighted-average asset allocation as of September 30, 2014 and 2013, by asset category is as follows:

| | **2014** | 2013 |
|---|---|---|
| Equity securities | **62%** | 61% |
| Debt securities | **35%** | 38% |
| Cash & cash equivalents | **3%** | 1% |
| Total | **100%** | 100% |

The primary investment objective of the retirement funds is to earn a reasonable rate of return over a market cycle within a prudent level of risk. These investment objectives are long-term in nature.

Employer contribution, participant contributions and benefits paid during the year:

| | Defined Benefit Pension (In Thousands) | | Other Benefits (In Thousands) | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| Employer contributions (net of participant contributions) | **$ 17,804** | $ 14,069 | **$ 5,232** | $ 3,810 |
| Benefits paid | **13,065** | 13,058 | **5,232** | 3,810 |

Citizens expects to contribute, at a minimum, $17.8 million to the pension plans for 2015. The following retirement benefit payments, which reflect future service, as appropriate, are expected to be paid:

| | Defined Benefit Pension (In Thousands) | Other Benefits (In Thousands) |
|---|---|---|
| 2015 | $ 15,124 | $ 5,224 |
| 2016 | 15,668 | 5,413 |
| 2017 | 16,682 | 5,894 |
| 2018 | 16,969 | 6,281 |
| 2019 | 17,775 | 6,716 |
| Years 2020-2024 | 101,700 | 38,247 |

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percentage increase in assumed health care cost trend rates would have the following effects:

| | (In Thousands) | |
|---|---|---|
| | **2014** | 2013 |
| Effect on total of service and interest cost | **$ 949** | $ 752 |
| Effect on post-retirement benefit obligation | **8,591** | 7,640 |

## 10. FINANCIAL SEGMENT INFORMATION

Operations of Citizens include activities in six reportable segments: Citizens Gas, Water, Steam, Chilled Water, Oil and Resources. In addition to these business segments, Other is utilized to capture non-revenue generating segment costs (see discussion below). Operations of CWA include activities for the Wastewater business segment. The Chief Executive Officer is the chief operating decision maker for Citizens and CWA.

Citizens Gas activities include purchasing natural gas; operating underground natural gas storage and liquefied natural gas storage facilities in Indiana; and distributing natural gas to residential, commercial and industrial customers located in Marion County, Indiana.

Water activities include the treatment and distribution of drinking water to residential, commercial and industrial customers located in and around Marion County, Indiana.

Wastewater activities include wastewater collection and treatment services for residential, commercial and industrial customers located in and around Marion County, Indiana.

Steam activities include the production, purchase and distribution of steam for use in industrial processes and heating buildings in the downtown Indianapolis area.

Chilled Water activities include the production and distribution of chilled water for use in cooling buildings in the central downtown area.

Oil activities include the production and sale of crude oil from reserves in southern Indiana.

Resources conducts for-profit business activities in order to ultimately provide enhanced benefits to Citizens' beneficiaries. Resources includes affiliate joint venture interests of $15.4 million and $18.3 million at September 30, 2014 and 2013, respectively, including ProLiance and Heartland. In June 2013, ProLiance sold certain net assets and pipeline and storage commitments of its subsidiary, ProLiance Energy, LLC (see Note 5). In September 2014, Resources recorded an impairment to its investment in ProLiance (see Note 5). Resources also includes several wholly owned subsidiaries under CESCO which serves as a holding company for several LLC subsidiaries. CESCO subsidiaries include: Citizens Westfield Utilities, which is the holding company for the three utilities serving Westfield (Westfield Gas, Westfield Water, and Westfield Wastewater); Kinetrex, a provider of LNG for use as transportation and industrial fuel; and CSM, a small unregulated water utility. See also Note 4 regarding the acquisitions of Westfield Water and Westfield Wastewater.

In the table below, Other includes certain non-profit instrumentalities, as well as advertising and philanthropic costs that are not recoverable through rates and are funded by contributions from non-regulated segments. Other also includes shared services comprised of various administrative and operational departments that provide support services to each of Citizens and CWA business segments, certain affiliates and the combined enterprise as a whole, and allocates the associated cost of the services to the appropriate segment. Management reviews the allocation methodology for shared services on a regular basis and refines the methodology as necessary. The former Manufacturing business segment has been reported as Discontinued Operations and is also included in Other. To the extent certain business segments purchase services from one another, these amounts have been eliminated on the face of the financial statements, however are reported gross for segment presentation, with eliminating entries reported as Eliminations.

Operating revenues and operating expenses are set forth in the Combined Statements of Operations. Operating income represents operating revenues less operating expenses directly attributable to the segments and an allocation of certain operating expenses benefiting each.

Segment information as of and for the years ended September 30, 2014 and 2013 is summarized as follows:

## Segment Footnote - Combined Statement of Operations

***Citizens Energy Group and Subsidiary and CWA Authority, Inc., Indianapolis, Indiana***
***(In Thousands)***
***For the Twelve Months Ended September 30, 2014***

| | Citizens Gas | Water | Waste-water | Steam | Chilled Water | Oil | Resources | Other | Elimin-ations | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Operating revenues | | | | | | | | | | |
| Customer revenues | $313,562 | $168,157 | $186,576 | $78,138 | $38,077 | $6,646 | $ 28,070 | $ - | $ - | **$819,226** |
| Intercompany revenues | 6,124 | 1,077 | 1,012 | 3,581 | - | - | 5,849 | - | (17,643) | **-** |
| Gross operating revenues | 319,686 | 169,234 | 187,588 | 81,719 | 38,077 | 6,646 | 33,919 | - | (17,643) | **819,226** |
| Operating expenses: | | | | | | | | | | |
| Cost of goods sold | 177,827 | - | - | 47,334 | 12,078 | - | 15,182 | - | (14,606) | **237,815** |
| Operations and maintenance | 69,519 | 76,246 | 70,072 | 21,352 | 10,876 | 1,817 | 13,770 | 519 | (2,996) | **261,175** |
| Depreciation and amortization | 23,271 | 39,883 | 57,596 | 4,763 | 6,496 | 149 | 2,704 | - | | **134,862** |
| Taxes | 10,150 | 13,065 | 14,491 | 1,547 | 2,257 | 126 | 658 | 158 | - | **42,452** |
| Total operating expenses | 280,767 | 129,194 | 142,159 | 74,996 | 31,707 | 2,092 | 32,314 | 677 | (17,602) | **676,304** |
| Total operating income (loss) | 38,919 | 40,040 | 45,429 | 6,723 | 6,370 | 4,554 | 1,605 | (677) | (41) | **142,922** |
| Other income (expense)-net: | | | | | | | | | | |
| Interest income | 24 | 1,749 | 111 | 4 | 12 | - | 278 | 3 | (3) | **2,178** |
| Other | (761) | 230 | 108 | - | - | (7) | (51) | (2,551) | | **(3,032)** |
| Total other income (expense) | (737) | 1,979 | 219 | 4 | 12 | (7) | 227 | (2,548) | (3) | **(854)** |
| Income (loss) before equity in earnings of affiliates and interest charges | 38,182 | 42,019 | 45,648 | 6,727 | 6,382 | 4,547 | 1,832 | (3,225) | (44) | **142,068** |
| Equity in loss of affiliates | - | - | - | - | - | - | (2,070) | - | - | **(2,070)** |
| Interest charges: | | | | | | | | | | |
| Interest on long-term debt | 13,869 | 50,282 | 61,335 | 3,677 | 3,050 | - | 2,335 | 3 | (3) | **134,548** |
| Other interest including net premium (discount) amortization | 1,855 | 408 | (11,511) | (426) | (536) | - | 75 | (609) | - | **(10,744)** |
| Total interest charges | 15,724 | 50,690 | 49,824 | 3,251 | 2,514 | - | 2,410 | (606) | (3) | **123,804** |
| Income (loss) from continuing operations | 22,458 | (8,671) | (4,176) | 3,476 | 3,868 | 4,547 | (2,648) | (2,619) | (41) | **16,194** |
| Loss from discontinued operations | - | - | - | - | - | - | - | (5,894) | 41 | **(5,853)** |
| Net income (loss) | $ 22,458 | $ (8,671) | $ (4,176) | $ 3,476 | $ 3,868 | $4,547 | $ (2,648) | $ (8,513) | $ - | **$ 10,341** |

## Segment Footnote - Combined Statement of Operations

***Citizens Energy Group and Subsidiary and CWA Authority, Inc., Indianapolis, Indiana***
***(In Thousands)***
***For the Twelve Months Ended September 30, 2013***

| | Citizens Gas | Water | Waste-water | Steam | Chilled Water | Oil | Resources | Other | Elimin-ations | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Operating revenues | | | | | | | | | | |
| Customer revenues | $277,852 | $161,873 | $154,952 | $63,737 | $41,911 | $6,142 | $ 4,983 | $ - | $ - | **$711,450** |
| Intercompany revenues | 1,188 | 1,589 | 1,212 | 3,222 | | | | | (7,211) | **-** |
| Gross operating revenues | 279,040 | 163,462 | 156,164 | 66,959 | 41,911 | 6,142 | 4,983 | - | (7,211) | **711,450** |
| Operating expenses: | | | | | | | | | | |
| Cost of goods sold | 141,109 | - | - | 37,123 | 13,075 | - | 2,406 | - | (5,880) | **187,833** |
| Operations and maintenance | 81,802 | 80,868 | 64,861 | 24,195 | 8,929 | 2,211 | 6,743 | (98) | (1,304) | **268,207** |
| Depreciation and amortization | 22,952 | 37,516 | 56,043 | 4,391 | 6,122 | 233 | 547 | - | | **127,804** |
| Taxes | 8,735 | 12,973 | 14,875 | 1,373 | 2,037 | 143 | 376 | 375 | | **40,887** |
| Total operating expenses | 254,598 | 131,357 | 135,779 | 67,082 | 30,163 | 2,587 | 10,072 | 277 | (7,184) | **624,731** |
| Total operating income (loss) | 24,442 | 32,105 | 20,385 | (123) | 11,748 | 3,555 | (5,089) | (277) | (27) | **86,719** |
| Other income (expense)-net: | | | | | | | | | | |
| Interest income | 42 | 1,894 | 316 | - | 8 | - | 104 | 28 | - | **2,392** |
| Other | (2,340) | 6,293 | (1) | - | 12 | - | 1,250 | (5,393) | - | **(179)** |
| Total other income (expense) | (2,298) | 8,187 | 315 | - | 20 | - | 1,354 | (5,365) | - | **2,213** |
| Income (loss) before equity in loss of affiliates and interest charges | 22,144 | 40,292 | 20,700 | (123) | 11,768 | 3,555 | (3,735) | (5,642) | (27) | **88,932** |
| Equity in loss of affiliates | - | - | - | - | - | - | (38,323) | - | - | **(38,323)** |
| Interest charges: | | | | | | | | | | |
| Interest on long-term debt | 14,942 | 50,755 | 59,918 | 2,975 | 3,160 | - | - | - | - | **131,750** |
| Other interest including net premium (discount) amortization | 1,872 | (1,715) | (10,766) | (15) | (546) | - | - | (203) | - | **(11,373)** |
| Total interest charges | 16,814 | 49,040 | 49,152 | 2,960 | 2,614 | - | - | (203) | - | **120,377** |
| Income (loss) from continuing operations | 5,330 | (8,748) | (28,452) | (3,083) | 9,154 | 3,555 | (42,058) | (5,439) | (27) | **(69,768)** |
| Loss from discontinued operations | - | - | - | - | - | - | - | (11,528) | 27 | **(11,501)** |
| Net income (loss) | $ 5,330 | $ (8,748) | $ (28,452) | $ (3,083) | $ 9,154 | $3,555 | $ (42,058) | $ (16,967) | $ - | **$ (81,269)** |

## Segment Footnote - Combined Statement of Financial Position

***Citizens Energy Group and Subsidiary and CWA Authority, Inc., Indianapolis, Indiana***
***(In Thousands)***
***At September 30, 2014***

| | Citizens Gas | Water | Waste-Water | Steam | Chilled Water | Oil | Resources | Other | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | | |
| Property, Plant and Equipment | $ 304,749 | $ 1,062,422 | $ 1,307,680 | $ 73,038 | $ 65,265 | $ 2,807 | $ 145,455 | $ 24,017 | **$ 2,985,433** |
| Intangibles | - | - | - | 20,104 | 56,306 | - | 16,180 | - | **92,590** |
| Investments | 18,936 | 88,895 | 141,866 | 9,968 | 5,284 | - | 19,500 | 348 | **284,797** |
| Cash and Cash Equivalents | 53,531 | 17,042 | 123,882 | 5,569 | 24,538 | 2,992 | 18,041 | 29,705 | **275,300** |
| Other Current Assets | 91,030 | 34,859 | 37,667 | 15,257 | 8,046 | 921 | 9,210 | (18,700) | **178,290** |
| Deferred Charges and Other Non-Current Assets | 18,551 | 8,160 | 15,829 | 2,822 | 790 | 15 | 2,490 | 4,059 | **52,716** |
| Total Assets | $ 486,797 | $ 1,211,378 | $ 1,626,924 | $ 126,758 | $ 160,229 | $ 6,735 | $ 210,876 | $ 39,429 | **$ 3,869,126** |
| **Capitalization and Liabilities** | | | | | | | | | |
| Retained Earnings and Accumulated OCI | $ 38,926 | $ 21,168 | $ (48,296) | $ 3,962 | $ 88,437 | $ 4,539 | $ 50,522 | $ (98,868) | **$ 60,390** |
| Long-Term Debt | 272,256 | 957,956 | 1,497,429 | 103,498 | 60,528 | - | 110,258 | - | **3,001,925** |
| Retirement Benefit and Other Long-Term Liabilities | 46,060 | 136,691 | 43,550 | 7,632 | 2,442 | 578 | 38,531 | 129,181 | **404,665** |
| Current Maturities of Long-Term Debt | 12,955 | 17,495 | 26,539 | 3,553 | 3,757 | - | 1,727 | - | **66,026** |
| Short-Term Borrowings | 50,000 | 21,500 | - | - | - | - | 2,000 | - | **73,500** |
| Current Liabilities | 66,600 | 56,568 | 107,702 | 8,113 | 5,065 | 1,618 | 7,838 | 9,116 | **262,620** |
| Total Capitalization and Liabilities | $ 486,797 | $ 1,211,378 | $ 1,626,924 | $ 126,758 | $ 160,229 | $ 6,735 | $ 210,876 | $ 39,429 | **$ 3,869,126** |

## Segment Footnote - Combined Statement of Financial Position

***Citizens Energy Group and Subsidiary and CWA Authority, Inc., Indianapolis, Indiana***
***(In Thousands)***
***At September 30, 2013***

| | Citizens Gas | Water | Waste-Water | Steam | Chilled Water | Oil | Resources | Other | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | | |
| Property, Plant and Equipment | $ 296,226 | $ 1,037,140 | $ 1,165,139 | $ 68,922 | $ 68,523 | $ 292 | $ 18,608 | $ 23,777 | **$ 2,678,627** |
| Intangibles | - | - | - | 21,087 | 71,490 | - | - | - | **92,577** |
| Investments | 18,584 | 87,662 | 114,099 | 9,334 | 5,227 | - | 26,480 | 398 | **261,784** |
| Cash and Cash Equivalents | 54,392 | 22,011 | 59,451 | 8,868 | 2,902 | 4,224 | 10,031 | 32,946 | **194,825** |
| Other Current Assets | 86,970 | 32,457 | 27,974 | 16,594 | 13,637 | 738 | 9,941 | (11,713) | **176,598** |
| Deferred Charges and Other Non-Current Assets | 21,026 | 8,053 | 14,855 | 2,509 | 862 | 15 | 909 | 4,366 | **52,595** |
| Total Assets | $ 477,198 | $ 1,187,323 | $ 1,381,518 | $ 127,314 | $ 162,641 | $ 5,269 | $ 65,969 | $ 49,774 | **$ 3,457,006** |
| **Capitalization and Liabilities** | | | | | | | | | |
| Retained Earnings and Accumulated OCI | $ 26,607 | $ 53,708 | $ (44,119) | $ 1,121 | $ 85,052 | $ 4,381 | $ 54,289 | $ (73,465) | **$ 107,574** |
| Long-Term Debt | 285,219 | 946,299 | 1,265,938 | 107,492 | 64,956 | - | - | - | **2,669,904** |
| Retirement Benefit and Other Long-Term Liabilities | 43,725 | 111,006 | 33,040 | 6,902 | 1,957 | 467 | 8 | 105,715 | **302,820** |
| Current Maturities of Long-Term Debt | 12,430 | 19,525 | 15,195 | 3,203 | 3,647 | - | - | - | **54,000** |
| Short-Term Borrowings | 50,000 | 15,000 | 30,000 | - | - | - | 285 | - | **95,285** |
| Current Liabilities | 59,217 | 41,785 | 81,464 | 8,596 | 7,029 | 421 | 11,387 | 17,524 | **227,423** |
| Total Capitalization and Liabilities | $ 477,198 | $ 1,187,323 | $ 1,381,518 | $ 127,314 | $ 162,641 | $ 5,269 | $ 65,969 | $ 49,774 | **$ 3,457,006** |

**Capital Expenditures – Accrual Basis**

Certain accrued capital expenditures, including all capitalized interest, have been included in Other for segment presentation of Capitalized Expenditures, while the capitalized amounts on the segmented statements of financial position are reflected as Property, Plant and Equipment in their respective segments.

| | Capital Expenditures (In Thousands) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Citizens Gas | Water | Wastewater | Steam | Chilled Water | Oil | Resources | Other | Total |
| **2014** | **$21,317** | **$54,906** | **$187,066** | **$6,827** | **$2,166** | **$2,662** | **$25,296** | **$32,374** | **$332,614** |
| 2013 | 20,337 | 58,916 | 170,032 | 9,459 | 2,261 | - | 796 | 26,442 | 288,243 |

**Additional Thermal Financial Information**

Additional Thermal financial information for the years ended September 30, 2014 and 2013 is summarized as follows:

| | (In Thousands) | |
|---|---|---|
| | **2014** | 2013 |
| Net Income | **$ 7,344** | $ 6,071 |
| Total Liabilities | **194,588** | 203,782 |
| Equity | **92,399** | 86,173 |
| Interest Charges on Long-Term Debt | **6,727** | 6,135 |
| | | |
| Cash Flow Information: | | |
| Cash and Cash Equivalents, Beginning of Fiscal Year | **$ 11,770** | $ 16,029 |
| Cash Provided by Operating Activities | **24,383** | 2,752 |
| Cash Provided by Investing Activities | **1,063** | (10,591) |
| Cash Used in Financing Activities | **(7,109)** | 3,579 |
| Cash and Cash Equivalents, End of Fiscal Year | **$ 30,107** | $ 11,769 |

## 11. MANUFACTURING DISCONTINUATION OF PRODUCTION AND RELATED ASSET RETIREMENT OBLIGATIONS

The Manufacturing segment, d/b/a Indianapolis Coke, ceased operations on July 13, 2007. Manufacturing (reported as Discontinued Operations) plant assets were $0.9 million at September 30, 2014 and 2013, representing the estimated remaining salvage value of the plant. Final costs relating to the closure, including liquidation of inventories, plant demolition and environmental remediation are reflected in the accompanying combined financial statements in accordance with FASB guidance related to exit or disposal cost obligations. The costs of demolition and remediation will continue for several years. Current estimates of these costs are included in the combined financial statements as part of the asset retirement obligation. The major classes of assets and liabilities of the Manufacturing segment (reported as Discontinued Operations in Other) as of September 30, 2014 and 2013 are as follows:

| | (In Thousands) | |
|---|---|---|
| | **2014** | 2013 |
| Current Assets | **$ 337** | $ 1,328 |
| Deferred Charges and Other Non-Current Assets | **894** | 895 |
| Total Assets | **$ 1,231** | $ 2,223 |
| | | |
| Retained earnings and AOCI | **$ (55,836)** | $ (49,889) |
| Retirement Benefit and Other Long-Term Liabilities | **56,533** | 51,411 |
| Current Liabilities | **534** | 701 |
| Total Capitalization and Liabilities | **$ 1,231** | $ 2,223 |

For the twelve months ended September 30, 2014 and 2013, Discontinued Operations operating expenses were $5.9 million and $11.5 million, respectively.

Activity for the twelve months ending September 30, 2014 and 2013, for the asset retirement obligation liability is as follows:

| | (In Thousands) |
|---|---|
| Asset retirement obligation as of September 30, 2012 | $37,232 |
| Accretion expense | 5,118 |
| Demolition liabilities settled | (965) |
| Remediation liabilities settled | (1,737) |
| Change in cash flows (September, 2013) | 5,561 |
| Asset retirement obligation as of September 30, 2013 | $45,209 |
| Accretion expense | 6,189 |
| Demolition liabilities settled | (527) |
| Remediation liabilities settled | (1,802) |
| Asset retirement obligation as of September 30, 2014 | $49,069 |

## 12. DERIVATIVES AND HEDGING

**Commodity Contracts**

Citizens' Price Volatility Mitigation Policy sets guidelines for using selected financial derivative products to support prudent risk management strategies within designated parameters. Citizens' objectives for using derivatives are to decrease the volatility associated with fluctuating natural gas prices. Citizens enters into natural gas options purchased and sold on the New York Mercantile Exchange. These instruments, in conjunction with physical gas supply contracts, are designated to cover estimated gas customer requirements. Such energy contracts, to the extent they are not considered "normal" as defined by FASB guidance, are recognized at fair value as derivative assets or liabilities on the Combined Statements of Financial Position. Gains/losses and fees associated with these derivatives, when realized, are recoverable through the Gas Cost Adjustment tracker. Accordingly, the offset to the change in fair value of these derivatives is recorded as a regulatory asset or liability.

**Interest Rate Swaps**

Concurrent with the CWU revenue bonds described in Note 6, CWU entered into a fixed rate pay interest rate swap agreement with PNC Bank, National Association as the counterparty through October 1, 2018. The notional value of the swap was $55.27 million as of September 30, 2014, representing 80 percent of the bond issuance. Under the terms of the swap agreement CWU pays a quarterly fixed rate of approximately 1.36 percent of the notional amount to the swap provider and receives a quarterly variable rate payment equal to 74 percent of the average three month LIBOR rate for each quarterly period. The variable rate received from the counterparty approximates the variable rate paid to the bondholders on the CWU bonds. At September 30, 2014, the market value of the interest rate swap derivative for CWU was $0.37 million.

Concurrent with the Westfield Water and Westfield Wastewater revenue bonds described in Note 6, the utilities entered into fixed rate pay interest rate swap agreements with PNC Bank, National Association as the counterparty through October 1, 2018. The notional values of the swaps were $8.3 million and $15.3 million, respectively, as of September 30, 2014. Under the terms of the swap agreement Westfield Water and Westfield Wastewater pay a monthly fixed rate of approximately 1.29 percent of the notional amount to the swap provider and receive a monthly variable rate payment equal to 74 percent of the average one month LIBOR rate for each period. The variable rate received from the counterparty approximates the variable rate paid to the bondholders on the Westfield Water and Westfield Wastewater bonds. At September 30, 2014, the market value of the interest rate swap derivatives for Westfield Water and Westfield Wastewater was less than $0.15 million.

The following tables present information about Citizens' derivative instruments and hedge activities. The first table provides a financial position overview of Citizens' Derivative Assets and Liabilities as of September 30, 2014 and 2013, while the latter table provides a breakdown of the related impact on the results of operations for the twelve months ended September 30, 2014 and 2013. Citizens recovers derivative costs related to commodity contracts through its regulatory mechanism for gas cost adjustments.

**Fair Value of Derivative Instruments (in Thousands)**

| | | | **September 30, 2014** | | September 30, 2013 | |
|---|---|---|---|---|---|---|
| Derivative instrument | Derivative Designation | Statement of Financial Position Location | Derivative Assets Fair Value | Derivative Liabilities Fair Value | Derivative Assets Fair Value | Derivative Liabilities Fair Value |
| Commodity contracts | Not accounted for as a hedge (1)(2) | Other Investments | **$760** | **($0)** | $536 | ($153) |
| Interest rate swaps | Not accounted for as a hedge (3) | Non-Current Liabilities | **$0** | **($518)** | $0 | ($0) |

(1) Commodity contracts represent exchange-traded options. These contracts qualify for net presentation on the Combined Statements of Financial Position.
(2) The fair value shown for the commodity contracts is comprised of derivative volumes totaling 4.6 million and 7.2 million dekatherms at September 30, 2014 and 2013, respectively. These volumes are disclosed in absolute terms, not net.
(3) The fair value shown for the fixed rate interest swap agreements with the bank effective March 21, 2014 to fix the interest rate through October 1, 2018 is determined by using the contractual fixed rate less the LIBOR rate at the time of the interest payment times a multiplier of 0.74. The result is the settlement rate. The outstanding loan balance is multiplied by the settlement rate less a discount factor as provided by the bank.

Unrealized gains and losses and settled amounts related to commodity contracts are initially recognized on the Combined Statements of Financial Position as a deferred recoverable cost, a regulatory asset or liability, and ultimately recognized on the Combined Statements of Operations as Cost of Goods Sold when those costs are recovered through gas rate adjustments. The amount of realized loss included in recoverable gas costs was $0.3 million at September 30, 2014 and the amount of realized loss included in recoverable gas costs was $0.6 million at September 30, 2013. The margin asset was $0.8 million and $0.4 million at September 30, 2014 and 2013, respectively.

**Derivative Impact on Statement of Operations (in Thousands)**

| Derivative instrument | Derivative Designation | Statement of Operations Location | **September 30, 2014** | September 30, 2013 |
|---|---|---|---|---|
| Commodity contracts | Not accounted for as a hedge | Gain in Cost of Goods Sold | **$256** | $781 |
| Interest rate swaps | Not accounted for as a hedge | Interest Expense | **$518** | $0 |

The derivative impact in cost of goods sold is recovered through regulatory gas rate adjustments in subsequent months, which is reflected in operating revenue. The impact of the commodity contracts on the statements of cash flows for the years ended September 30, 2014 and 2013 was an increase of $0.3 million and $0.5 million, respectively. The impact of the interest rate swaps on the statements of cash flows was immaterial for the year ended September 30, 2014.

## 13. COMMITMENTS AND CONTINGENCIES

### A. Environmental Commitments and Contingencies

Citizens and CWA are subject to various environmental laws and regulations and believe they are in material compliance with existing federal, state and local statutes, ordinances, rules and regulations governing environmental matters. Citizens and CWA have no way of estimating the enactment or promulgation of future environmental laws and regulations.

**Langsdale Environmental Remediation**

Citizens operated a gas manufacturing plant (the Langsdale Facility) at Citizens' Langsdale property from 1931 until 1952. Available records indicate the plant was out of service from 1931 until 1943, at which time the U.S. Department of Defense ordered that the plant be recommissioned to support domestic production associated with World War II. Over the course of its operation, the Langsdale Facility produced manufactured gas which was distributed to gas customers through the Citizens gas utility distribution system. The Langsdale Facility also produced metallurgical coke and other by-products. Citizens enrolled this facility in the Indiana Department of Environmental Management (IDEM) Voluntary remediation Program (VRP) in 2005 to address historical environmental impacts associated with these operations. However, because the full nature and extent of the environmental impacts has not yet been determined, Citizens cannot estimate the costs associated with environmental remediation of this site.

**Water System**

The Water System is currently in compliance with the requirements of the Clean Water Act, the Safe Drinking Water Act, the Disinfectants and Disinfection Byproducts Rule, the Enhanced Surface Water Treatment Rule, the Radon Rule and other applicable laws, except to the extent that such non-compliance would not have a material adverse effect on the Water System.

**Wastewater System**

The Wastewater System is subject to wastewater collection and treatment requirements under both federal and state law. Those requirements are contained in a National Pollutant Discharge Elimination System (NPDES) permit. Both United States Environmental Protection Agency (EPA) and Indiana Department of Environmental Management have jurisdiction over the Wastewater System. As authorized by the Clean Water Act, the NPDES permit program controls water pollution by regulating point sources that discharge pollutants into water of the United States.

**Combined Sewer Overflows and Long-Term Control Plan**: As was the common engineering practice during the early 1900's, the older portion of the Wastewater System was designed to carry both stormwater and sanitary waste. In times of wet weather, the capacity of the combined portion of the System can be overloaded. Combined sewer overflow (CSO) outfalls that discharge to various Indianapolis waterways were constructed as relief points to prevent combined stormwater and sewage from backing up into homes, businesses and streets. The EPA requires communities to implement specific minimum controls and to develop and implement long-term control plans (LTCPs) to reduce CSOs by separating sewers and maximizing the capacity to treat stormwater and wastewater. The City, EPA, and the U. S. District Court entered into a Consent Decree in 2006 that established a long-term control plan to address the system's overloaded combined sewer overflows. The plan established a twenty year schedule for the required Wastewater System improvements, including the Deep Rock Tunnel Project. Upon acquisition of the Wastewater System, CWA assumed the obligations under the Consent Decree. When expressed in 2012 dollars, CWA estimates that the projected cost of the Consent Decree, including capital and operation and maintenance costs, is approximately $1.9 billion.

**Septic Tank Elimination Projects**: As part of the Wastewater System acquisition, CWA agreed to finance, construct, implement and complete certain Septic Tank Elimination Program (STEP) Projects to provide for the extension of sanitary sewers into certain specific unsewered areas in Indianapolis with a remaining planned capital cost of $0.3 million as of September 30, 2014.

## B. Legal Contingencies

*B.1 Legal Contingencies*
Citizens and CWA are party to litigation in the normal course of business in which the payments for damages may be substantial but cannot be determined. Management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. Management believes that these matters ultimately will be resolved in a manner which will not materially adversely affect the financial position, operations, equity or cash flows of Citizens and CWA.

**Richmond Hill Incident**
On November 10, 2012, a home in the Richmond Hill neighborhood of Indianapolis was destroyed by explosion and fire. The incident resulted in two fatalities, personal injuries and substantial property damage. The cause of the incident was investigated by various agencies, including the Indianapolis Fire Department, the Indianapolis Metropolitan Police Department and the Marion County Prosecutor's Office. Citizens Gas cooperated fully with the investigation and found no evidence of leaks in the gas pipelines serving the home or neighborhood. On December 21, 2012, three individuals were arrested and charged with murder and multiple other felony counts for having deliberately planned and caused this explosion. A northern Indiana judge has set a June, 2015 trial date for one of the three suspects.

Citizens and other governmental entities received tort claim notices from homeowners allegedly affected by the incident. The statute of limitations for filing a civil suit against Citizens seeking damages as a result of the fatalities, personal injuries or property damage caused by the incident expired November 10, 2014. Citizens has not received service of any such suit and is not aware of any such suit having been timely filed. While Citizens cannot predict the potential for other future litigation or the outcome of any such litigation related to this incident, management does not anticipate any material adverse effect as a result of the incident.

**Deep Rock Tunnel Incident**
On June 13, 2014, an employee of Shea-Kiewit Joint Venture, a contractor engaged by the wastewater utility as part of the Deep Rock Tunnel project being completed in compliance with a federal consent decree to address combined sewer overflows, died while inside the tunnel. A partial safety inspection was subsequently conducted by the Indiana Occupational Safety and Health Administration. On August 21, 2014, the Indiana Department of Labor notified Shea-Kiewit that this inspection resulted in no violations being noted and no safety order was issued. While Citizens cannot predict the possibility of other claim(s), no material adverse effect to CWA Authority, Inc. or Citizens Energy Group is anticipated as a result of the incident.

*B.2 Contractual Commitments*

**Consent Decree**
In connection with the Wastewater System acquisition transaction in August 2011, CWA assumed the City's obligations under the order of the United States District Court for the Southern District of Indiana (the Court) dated December 19, 2006, among the EPA, Indiana Department of Environmental Management (IDEM), and the City, as amended (the Consent Decree). CWA has a Capital Improvement Plan to meet guidelines of the Consent Decree and the overall needs of the Wastewater System. The improvements related to the Consent Decree and the Long Term Control Plan (LTCP) have been planned and scheduled out through 2025. The Deep Rock Tunnel system, the most significant element of the Consent Decree, is the largest sewer infrastructure project in the City's history. The Deep Rock Tunnel Connector (DRTC) is the first segment of a 250' deep, 25 mile underground tunnel system designed to store 250 million gallons of raw sewage during a rain event to prevent overflows from entering area rivers and streams. The stored flows will eventually be pumped to the Southport Treatment plant which is also undergoing significant expansion as a part of this Consent Decree. During fiscal year 2014, mining of the 7.8 mile Deep Rock Tunnel Connector was completed. As part of the DRTC project, approximately 1.9 miles of additional deep tunnel will be mined for the Eagle Creek tunnel extension in FY 2015.

**United Water Management Contract**
In connection with the Wastewater System acquisition, CWA entered into an Assignment and Assumption Agreement with the City whereby CWA assumed all of the rights and obligations of the City under the Management Agreement between the City and United Water Services Indiana LLC, as assignee from White River Environmental Partnership, an Indiana general partnership, d/b/a United Water Services Indiana (United Water), dated as of October 11, 2007 (Management Agreement), pursuant to which United Water manages the Wastewater System and the stormwater system for the City of Indianapolis. Management and incentive fees with United Water were $40.2 million and $38.5 million for the twelve months ending September 30, 2014 and 2013 respectively. This included $4.9 million for stormwater management in 2014 and $4.8 million in 2013. It is anticipated that management and incentive fees for fiscal year 2015 will be $41.5 million, including $5.0 million for stormwater management. The contract is currently set to expire on January 1, 2017.

**Stormwater Management Agreement**
Also in connection with the Wastewater System acquisition, the City retained ownership of its stormwater system; however, the stormwater system was managed and operated under the Management Agreement between the City and United Water, which agreement CWA assumed at the closing of that transaction. CWA and the City entered into a Stormwater Management Agreement and Plan of Cooperation whereby CWA manages and operates the stormwater system through United Water. The City compensates CWA approximately $5.4 million annually, including up to $0.5 million in capital improvements, of which approximately $4.9 million is the amount CWA is obligated to compensate United for services rendered for the stormwater system under the Management Agreement. The remainder is for miscellaneous stormwater system-related services CWA provides to the City.

**C. Lease Contractual Commitments**
Citizens and CWA have entered into operating leases for storage of natural gas at various sites and for miscellaneous equipment. Lease expenses were $11.7 million and $11.6 million for the years ended September 30, 2014 and 2013, respectively. Future minimum lease payments under noncancelable operating leases as of September 30, 2014 are as follows:

| | (In Thousands) |
|---|---|
| 2015 | $10,536 |
| 2016 | 5,753 |
| 2017 | 423 |
| 2018 | 311 |
| 2019 | 311 |
| Thereafter | - |
| Total minimum lease payments | $17,334 |

## 14. SUBSEQUENT EVENTS

Management has considered the impact of subsequent events through December 12, 2014, the date at which these combined financial statements were available to be issued.

## INDEPENDENT AUDITORS' REPORT

To the Boards of Directors for
Citizens Energy Group and Subsidiary and CWA Authority, Inc.

We have audited the accompanying combined financial statements of Citizens Energy Group and Subsidiary and CWA Authority, Inc., both of which are under common ownership and common management, which comprise the combined statements of financial position as of September 30, 2014 and 2013, and the related combined statements of operations, comprehensive income (loss), equity and cash flows for the years then ended, and the related notes to the combined financial statements.

### Management's Responsibility for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the companies' preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the companies' internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Citizens Energy Group and Subsidiary and CWA Authority, Inc. as of September 30, 2014 and 2013, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Indianapolis, Indiana
December 12, 2014

**REPORT OF MANAGEMENT**

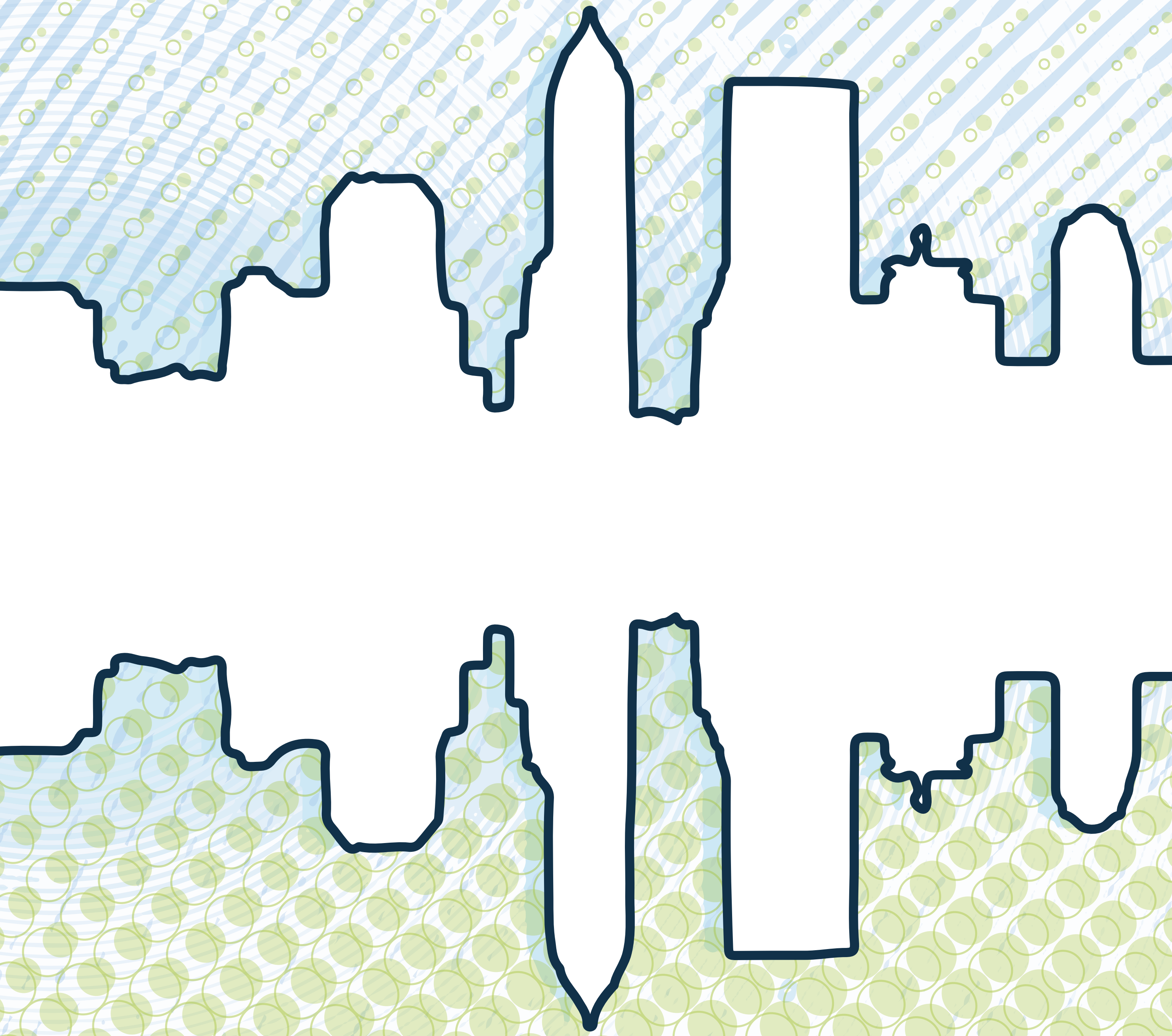
Citizens and CWA have prepared the financial statements and related financial information included in this report. Management has the primary responsibility for the integrity of the financial statements and other financial information included therein, and for ascertaining that the data accurately reflect the financial position and results of operations of Citizens and CWA. The financial statements were prepared in accordance with generally accepted accounting principles and necessarily included estimates and judgments with appropriate consideration to materiality. Financial information included elsewhere in this annual report is consistent with the financial statements.

Citizens and CWA maintain a system of internal accounting controls to provide reasonable assurance that assets are safe-guarded and that the books and records reflect the authorized transactions of Citizens and CWA. Limitations exist in any system of internal control based upon the recognition that the cost of the system should not exceed the benefits derived. Management believes its system of internal accounting controls, augmented by its internal auditing function, appropriately balances the cost/benefit relationship.

The Audit and Risk Committee of the Board of Directors is comprised of four Directors, none of whom is an employee of Citizens and CWA. The committee meets periodically with management, the internal auditors and the independent auditors in connection with its review of matters pertaining to Citizens' and CWA's combined financial statements, the internal audit program, and the services of the independent auditors.

We believe that these policies and procedures provide reasonable assurance that our operations are conducted in conformity with appropriate statutory requirements and with a high standard of business conduct.

John R. Brehm
Senior Vice President & Chief Financial Officer



citizens energy group

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