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NATURAL ENERGY UTILITY CORPORATION

**INDEPENDENT AUDITOR'S REPORT
AND
FINANCIAL STATEMENTS**

DECEMBER 31, 2013 AND 2012

**Smith, Goolsby
Artis & Reams P.S.C.**

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Natural Energy Utility Corporation
Ashland, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Natural Energy Utility Corporation which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of income, stockholders' equity, and cash flows for the years ended, and the related notes to the financial statements.

Managements Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the 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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 financial statements referred to above present fairly, in all material respects, the financial position of Natural Energy Utility Corporation as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Smith, Goolsby, Artis & Reams, P.S.C.

Ashland, Kentucky
February 12, 2014

**NATURAL ENERGY UTILITY CORPORATION
BALANCE SHEETS
DECEMBER 31, 2013 AND 2012**

ASSETS	<u>2013</u>	<u>2012</u>
CURRENT ASSETS		
Cash in bank	\$ 87,211	\$ 76,372
Accounts receivable, net of allowance for doubtful accounts of \$1,500 and \$1,000 respectively	375,118	286,089
Prepaid expenses	37,367	46,742
Supplies inventory	<u>5,000</u>	<u>5,000</u>
TOTAL CURRENT ASSETS	504,696	414,203
PROPERTY AND EQUIPMENT, NET	408,352	511,045
OTHER ASSETS		
Advances to shareholders	<u>7,195</u>	<u>18,165</u>
TOTAL OTHER ASSETS	<u>7,195</u>	<u>18,165</u>
TOTAL ASSETS	<u>\$ 920,243</u>	<u>\$ 943,413</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Line of credit	\$ 231,000	\$ 299,892
Accounts payable	83,258	85,642
Accrued liabilities	93,165	46,577
Customer deposits	15,873	14,678
Gas imbalance payable	<u>12,445</u>	<u>-</u>
TOTAL CURRENT LIABILITIES	435,741	446,789
STOCKHOLDERS' EQUITY		
Common stock, \$1 par; 1,000 shares authorized, issued and outstanding	1,000	1,000
Additional paid-in capital	320,000	320,000
Retained earnings	<u>163,502</u>	<u>175,624</u>
TOTAL STOCKHOLDERS' EQUITY	<u>484,502</u>	<u>496,624</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 920,243</u>	<u>\$ 943,413</u>

NATURAL ENERGY UTILITY CORPORATION
STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
REVENUES		
Gas sales and transportation income	\$ 3,201,454	\$ 2,874,095
Other income	<u>14,918</u>	<u>17,968</u>
TOTAL REVENUES	<u>3,216,372</u>	<u>2,892,063</u>
 COST OF SALES		
Gas purchases	427,031	301,245
Transportation costs	<u>30,194</u>	<u>20,910</u>
TOTAL COST OF SALES	<u>457,225</u>	<u>322,155</u>
GROSS PROFIT	<u>2,759,147</u>	<u>2,569,908</u>
 OPERATING EXPENSES		
Salaries and wages	1,846,970	1,666,067
Employee retirement plan contributions	21,682	20,303
Depreciation	184,932	204,029
Operations expense	119,146	80,570
Professional fees	49,259	51,255
Taxes and licenses	54,663	82,291
Employee insurance	77,234	71,969
Travel expenses	27,174	28,518
Payroll tax expense	57,233	52,780
Other insurance	64,174	46,255
Rent and lease expense	10,532	10,609
Telephone and communications	24,870	26,460
Repairs and maintenance	20,665	20,343
Bad debt provision	1,817	3,534
Office supplies and expense	5,076	5,914
Postage and shipping	8,658	6,771
Miscellaneous expenses	6,948	6,617
Utilities	7,085	6,386
Advertising	<u>2,541</u>	<u>2,033</u>
TOTAL OPERATING EXPENSES	<u>2,590,659</u>	<u>2,392,704</u>
NET OPERATING INCOME	<u>168,488</u>	<u>177,204</u>
 OTHER INCOME (EXPENSE)		
Gain on sale of property and equipment	27,709	-
Interest expense, net of interest income of \$215 and \$228 respectively	<u>(3,610)</u>	<u>(10,983)</u>
TOTAL OTHER INCOME (EXPENSE)	<u>24,099</u>	<u>(10,983)</u>
NET INCOME	<u>\$ 192,587</u>	<u>\$ 166,221</u>

**NATURAL ENERGY UTILITY CORPORATION
 STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
 YEARS ENDED DECEMBER 31, 2013 AND 2012**

	<u>COMMON STOCK</u>	<u>ADDITIONAL PAID IN CAPITAL</u>	<u>RETAINED EARNINGS</u>	<u>TOTAL</u>
BALANCE, JANUARY 1, 2012	\$ 1,000	\$ 320,000	\$ 400,213	\$ 721,213
Net income	-	-	166,221	166,221
Distribution to stockholders	-	-	(390,810)	(390,810)
BALANCE, DECEMBER 31, 2012	1,000	320,000	175,624	496,624
Net income	-	-	192,587	192,587
Distributions to stockholders	-	-	(204,709)	(204,709)
BALANCE, DECEMBER 31, 2013	<u>\$ 1,000</u>	<u>\$ 320,000</u>	<u>\$ 163,502</u>	<u>\$ 484,502</u>

NATURAL ENERGY UTILITY CORPORATION
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 192,587	\$ 166,221
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	184,932	204,029
Provision for bad debts	1,817	3,534
Gain on sale of property and equipment	(27,709)	-
Net changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(90,846)	(6,573)
Prepaid expenses	9,375	14,743
(Decrease) increase in:		
Accounts payable	(2,384)	(33,611)
Accrued liabilities	46,588	(49,166)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>314,360</u>	<u>299,177</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of property and equipment	37,000	-
Purchases of property and equipment	(91,530)	(55,343)
Decrease in advances to shareholders	10,970	361,200
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	<u>(43,560)</u>	<u>305,857</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Net change line of credit	(68,892)	(200,108)
Distributions to shareholders	(204,709)	(390,810)
Gas imbalance repayments	12,445	(965)
Increase in customer deposits	1,195	1,266
NET CASH USED BY FINANCING ACTIVITIES	<u>(259,961)</u>	<u>(590,617)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	10,839	14,417
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>76,372</u>	<u>61,955</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 87,211</u>	<u>\$ 76,372</u>
SUPPLEMENTAL INFORMATION:		
Cash paid during the year for interest	\$ 3,848	\$ 11,211

NATURAL ENERGY UTILITY CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 AND 2012

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Date of Management Review

Subsequent events have been evaluated through February 12, 2014, which is the date the financial statements were available to be issued.

Nature of Operations

Natural Energy Utility Corporation (the Corporation) owns and operates a natural gas pipeline in Boyd, Carter and Greenup County, Kentucky. The Corporation provides transportation services and sells natural gas to governmental, industrial and residential customers in its market area consisting primarily of Boyd, Carter and Greenup County, Kentucky. The Corporation is subject to regulation by the Kentucky Public Service Commission.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

For the purposes of the statements of cash flows, the Corporation considers cash on deposit with banks and all highly liquid debt instruments, purchased with an original maturity of three months or less to be cash equivalents.

Income Taxes

The Corporation, with the consent of its shareholders, has elected under the Internal Revenue Code to be an S-Corporation. In lieu of corporation income taxes, the shareholders of an S Corporation are taxed on their proportionate share of the Corporation's taxable income. Therefore, no provision or liability for federal or state income taxes has been included in the financial statements.

Management believes its tax returns prior to 2010 are no longer subject to examination by the Internal Revenue Service.

Accounts Receivable

Accounts receivable are uncollateralized customer obligations due under normal trade terms requiring payment within 30 days from the invoice date.

Trade accounts receivable are stated at the contractual amount billed to the customer. Customer account balances with invoices dated over 30 days old are considered past due. The Company allocates customer payments of accounts receivable to the specific invoices identified on the customer's remittance advice or, if unspecified, the Company apply the payment to the oldest unpaid invoices.

NATURAL ENERGY UTILITY CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 AND 2012

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Company reduces the carrying amount of trade accounts receivable by an allowance for credit losses that reflects its best estimate of the amounts that will not be collected. The Company reviews each customer balance where all or a portion of the balance exceeds 30 days from the invoice date. Based on the Company's assessment of the customer's current creditworthiness, management estimates the portion, if any, of the balance that will not be collected. The Company writes off receivables as a charge to the allowance for credit losses when, in the Company's estimation, it is probable that the receivable is worthless.

Property and Equipment

Land is carried at cost. Property, furniture and equipment are carried at cost less accumulated depreciation computed principally by the straight-line method over the estimated useful lives of the assets. Expenditures for maintenance, repairs and improvements which do not materially extend the useful lives of the assets are charged to operations in the periods incurred.

Advertising

Advertising costs are expensed when incurred.

NOTE B: PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2013 and 2012, by major classifications are as follows:

	<u>2013</u>	<u>2012</u>
Land	\$ 5,000	\$ 5,000
Buildings and improvements	74,553	74,553
Furniture, fixtures & equipment	166,278	166,278
Autos and trucks	247,212	259,896
Pipelines and projects	<u>2,885,208</u>	<u>2,885,208</u>
	3,378,251	3,390,935
Accumulated depreciation	<u>(2,969,899)</u>	<u>(2,879,890)</u>
	<u>\$ 408,352</u>	<u>\$ 511,045</u>

Depreciation expense charged to operations for the years ended December 31, 2013 and 2012 totaled \$184,932 and \$204,029, respectively.

NOTE C: LINE OF CREDIT

The Corporation has available a \$850,000 line of credit expiring August 5, 2014, interest to be paid monthly at the Wall Street prime interest rate, secured by all the Corporation's assets and personal guarantee of the principal shareholder. There was \$231,000 outstanding on this line of credit as of December 31, 2013 and \$299,892 at December 31, 2012.

NATURAL ENERGY UTILITY CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 AND 2012

NOTE D: CONCENTRATIONS

Major Customers

Three major customers accounted for 75.49% of total sales for 2013. Accounts receivable from these three customers comprised 70.43% of total accounts receivable at December 31, 2013. The same three major customers accounted for 78.41% of total sales for 2012. Accounts receivable from these three customers comprised 88.26% of total accounts receivable at December 31, 2012.

NOTE E: RETIREMENT PLAN

Effective October 1, 2007, the Corporation adopted a 401-K retirement plan covering all eligible employees. The Corporation has elected to make safe harbor contributions of 3.0% of all qualifying employee compensation. Contributions to the plan totaled \$21,682 and \$20,303 for the years ended December 31, 2013 and 2012, respectively.