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NATURAL ENERGY UTILITY CORPORATION

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

DECEMBER 31, 2012 AND 2011

**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 sheet as of December 31, 2012 and 2011, and the related statements of income, retained earnings, 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, 2012 and 2011, 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 13, 2013

NATURAL ENERGY UTILITY CORPORATION
BALANCE SHEETS
DECEMBER 31, 2012 AND 2011

| ASSETS | <u>2012</u> | <u>2011</u> |
|--|--------------------|---------------------|
| CURRENT ASSETS | | |
| Cash in bank | \$ 76,372 | \$ 61,955 |
| Accounts receivable, net of allowance for doubtful accounts of \$1,000 and \$1,600 respectively | 286,089 | 283,050 |
| Prepaid expenses | 46,742 | 61,485 |
| Supplies inventory | <u>5,000</u> | <u>5,000</u> |
| TOTAL CURRENT ASSETS | <u>414,203</u> | <u>411,490</u> |
| PROPERTY AND EQUIPMENT, NET | 511,045 | 659,731 |
| OTHER ASSETS | | |
| Advances to shareholders | <u>18,165</u> | <u>379,365</u> |
| TOTAL OTHER ASSETS | <u>18,165</u> | <u>379,365</u> |
| TOTAL ASSETS | <u>\$ 943,413</u> | <u>\$ 1,450,586</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Line of credit | \$ 299,892 | \$ 500,000 |
| Accounts payable | 85,642 | 119,253 |
| Accrued liabilities | 46,577 | 95,743 |
| Customer deposits | 14,678 | 13,412 |
| Gas imbalance payable | <u>-</u> | <u>965</u> |
| TOTAL CURRENT LIABILITIES | 446,789 | 729,373 |
| 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>175,624</u> | <u>400,213</u> |
| TOTAL STOCKHOLDERS' EQUITY | <u>496,624</u> | <u>721,213</u> |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | <u>\$ 943,413</u> | <u>\$ 1,450,586</u> |

**NATURAL ENERGY UTILITY CORPORATION
STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2012 AND 2011**

| | <u>2012</u> | <u>2011</u> |
|---|-------------------|-------------------|
| REVENUES | | |
| Gas sales and transportation income | \$ 2,874,095 | \$ 2,879,649 |
| Other income | 17,968 | 16,048 |
| TOTAL REVENUES | <u>2,892,063</u> | <u>2,895,697</u> |
| COST OF SALES | | |
| Gas purchases | 301,245 | 178,528 |
| Transportation costs | 20,910 | 18,151 |
| TOTAL COST OF SALES | <u>322,155</u> | <u>196,679</u> |
| GROSS PROFIT | <u>2,569,908</u> | <u>2,699,018</u> |
| OPERATING EXPENSES | | |
| Salaries and wages | 1,666,067 | 1,695,318 |
| Employee retirement plan contributions | 20,303 | 20,859 |
| Depreciation | 204,029 | 217,763 |
| Operations expense | 80,570 | 91,019 |
| Professional fees | 51,255 | 43,429 |
| Taxes and licenses | 82,291 | 89,786 |
| Employee insurance | 71,969 | 70,850 |
| Travel expenses | 28,518 | 33,024 |
| Payroll tax expense | 52,780 | 53,610 |
| Other insurance | 46,255 | 44,884 |
| Rent and lease expense | 10,609 | 10,985 |
| Telephone and communications | 26,460 | 23,304 |
| Repairs and maintenance | 20,343 | 21,834 |
| Bad debt provision | 3,534 | 1,817 |
| Office supplies and expense | 5,914 | 5,800 |
| Postage and shipping | 6,771 | 8,507 |
| Miscellaneous expenses | 6,617 | 8,189 |
| Utilities | 6,386 | 6,424 |
| Advertising | 2,033 | 1,414 |
| TOTAL OPERATING EXPENSES | <u>2,392,704</u> | <u>2,448,816</u> |
| NET OPERATING INCOME | <u>177,204</u> | <u>250,202</u> |
| OTHER INCOME (EXPENSE) | | |
| Other income | - | 262 |
| Interest expense, net of interest income of \$228 and \$665 respectively | (10,983) | (12,831) |
| TOTAL OTHER INCOME (EXPENSE) | <u>(10,983)</u> | <u>(12,569)</u> |
| NET INCOME | <u>\$ 166,221</u> | <u>\$ 237,633</u> |

**NATURAL ENERGY UTILITY CORPORATION
 STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
 YEARS ENDED DECEMBER 31, 2012 AND 2011**

| | <u>COMMON STOCK</u> | <u>ADDITIONAL PAID IN CAPITAL</u> | <u>RETAINED EARNINGS</u> | <u>TOTAL</u> |
|-----------------------------------|-------------------------|---|------------------------------|-------------------|
| BALANCE, JANUARY 1, 2011 | \$ 1,000 | \$ 320,000 | \$ 162,580 | \$ 483,580 |
| Net income | <u>-</u> | <u>-</u> | <u>237,633</u> | <u>237,633</u> |
| BALANCE, DECEMBER 31, 2011 | 1,000 | 320,000 | 400,213 | 721,213 |
| Net income | - | - | 166,221 | 166,221 |
| Distributions to stockholders | <u>-</u> | <u>-</u> | <u>(390,810)</u> | <u>(390,810)</u> |
| BALANCE, DECEMBER 31, 2012 | <u>\$ 1,000</u> | <u>\$ 320,000</u> | <u>\$ 175,624</u> | <u>\$ 496,624</u> |

**NATURAL ENERGY UTILITY CORPORATION
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2012 AND 2011**

| CASH FLOWS FROM OPERATING ACTIVITIES | <u>2012</u> | <u>2011</u> |
|--|--------------------|--------------------|
| Net income | \$ 166,221 | \$ 237,633 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 204,029 | 217,763 |
| Provision for bad debts | 3,534 | 1,817 |
| Realized (gain) on trading securities | - | (262) |
| Proceeds from sales of trading securities | - | 10,188 |
| Net changes in operating assets and liabilities: | | |
| (Increase) decrease in: | | |
| Accounts receivable | (6,573) | 90,740 |
| Prepaid expenses | 14,743 | (16,960) |
| (Decrease) increase in: | | |
| Accounts payable | (33,611) | 21,792 |
| Accrued liabilities | <u>(49,166)</u> | <u>(17,683)</u> |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | <u>299,177</u> | <u>545,028</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchases of property and equipment | (55,343) | (10,720) |
| Decrease (increase) in notes receivable - shareholders | <u>361,200</u> | <u>(342,365)</u> |
| NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES | <u>305,857</u> | <u>(353,085)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from long-term debt | - | 642,636 |
| Payments of long-term debt | - | (1,362,565) |
| Net change line of credit | (200,108) | 500,000 |
| Distributions to shareholders | (390,810) | - |
| Gas imbalance repayments | (965) | (22,611) |
| Increase (decrease) in customer deposits | <u>1,266</u> | <u>(261)</u> |
| NET CASH USED BY FINANCING ACTIVITIES | <u>(590,617)</u> | <u>(242,801)</u> |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 14,417 | (50,858) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | <u>61,955</u> | <u>112,813</u> |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | <u>\$ 76,372</u> | <u>\$ 61,955</u> |
| SUPPLEMENTAL INFORMATION: | | |
| Cash paid during the year for interest | \$ 11,211 | \$ 13,526 |

NATURAL ENERGY UTILITY CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 AND 2011

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Date of Management Review

Subsequent events have been evaluated through February 13, 2013, 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 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 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 income taxes has been included in the financial statements.

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.

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

NATURAL ENERGY UTILITY CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 AND 2011

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2012 and 2011, by major classifications are as follows:

| | <u>2012</u> | <u>2011</u> |
|---------------------------------|--------------------|--------------------|
| Land | \$ 5,000 | \$ 5,000 |
| Buildings and improvements | 74,553 | 74,553 |
| Furniture, fixtures & equipment | 166,278 | 166,278 |
| Autos and trucks | 259,896 | 259,896 |
| Pipelines and projects | <u>2,885,208</u> | <u>2,829,865</u> |
| | 3,390,935 | 3,335,592 |
| Accumulated depreciation | <u>(2,879,890)</u> | <u>(2,675,861)</u> |
| | <u>\$ 511,045</u> | <u>\$ 659,731</u> |

Depreciation expense charged to operations for the years ended December 31, 2012 and 2011 totaled \$204,029 and \$217,763, respectively.

NOTE C: LINE OF CREDIT

The Corporation has available a \$850,000 line of credit expiring August 5, 2013, interest to be paid monthly at the Wall Street prime interest rate, secured by all the Corporation's assets and a personal guarantee by the principal shareholder. There was \$299,892 outstanding on this line of credit as of December 31, 2012 and \$500,000 at December 31, 2011.

NATURAL ENERGY UTILITY CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 AND 2011

NOTE D: CONCENTRATIONS

Cash Balance

The Corporation maintains its cash in bank deposit accounts. The Corporation's depository institution, in accordance with a repurchase agreement, sweeps excess cash into an interest-bearing account that matures daily. The sweeps account is collateralized with investment securities of the depository institution.

Major Customers

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. The same three major customers accounted for 78.63% of total sales for 2011. Accounts receivable from these three customers comprised 86.33% of total accounts receivable at December 31, 2011.

NOTE E: OPERATING LEASES

The Corporation entered into a lease agreement for a vehicle under an operating lease which expires at July 2014. The following table summarizes minimum payments due under the lease agreement by year:

| | |
|---------|------------------|
| Due in: | |
| 2013 | \$ 8,202 |
| 2014 | 4,785 |
| | <u>\$ 12,987</u> |

Total rental expense under operating leases was \$8,734 and \$9,110 for the years ended December 31, 2012 and 2011 respectively.

NOTE F: 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 \$20,303 and \$20,859 for the years ended December 31, 2012 and 2011, respectively.