

CORNING NATURAL GAS CORP  
Form 10-K  
December 19, 2008

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 30, 2008

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number: 0-643

Corning Natural Gas Corporation  
(Exact name of registrant as specified in its charter)

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New York  
(State or other jurisdiction of  
incorporation or organization)

16-0397420  
(I.R.S. employer  
Identification no.)

330 W. William St.  
Corning, New York 14830  
(Address of principal executive offices, including zip code)

(607) 936-3755  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value \$5.00 per share  
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act.  
YES

NO  YES

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. YES

NO  YES

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES [X] NO [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and a "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one):

Large accelerated Filer

[ ] Accelerated Filer [ ] Non-Accelerated Filer [ ] Smaller Reporting Company [X]

Indicate by check mark whether the registrant is a shell company. YES

[ ] NO [X]

The aggregate market value of the 530,934 shares of the Common Stock held by non-affiliates of the Registrant at the \$15.90 average of bid and asked prices as of March 31, 2008 was \$8,441,850.

Number of shares of Common Stock outstanding as of the close of business on December 1, 2008 - 819,550.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of Registrant's Annual Report to Shareholders for the twelve month period ended September 30, 2008, and definitive proxy statement relating to the 2009 annual meeting of shareholders are incorporated by reference into Part III hereof.

Information contained in this Form 10-K and the Annual Report to shareholders for fiscal 2008 period which is incorporated by reference contains certain forward looking comments which may be impacted by factors beyond the control of the Company, including but not limited to natural gas supplies, regulatory actions and customer demand. As a result, actual conditions and results may differ from present expectations.

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For the Fiscal Year Ended September 30, 2008

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PART I

ITEM 1 - BUSINESS

Corning Natural Gas Corporation (the "Company," "we" or "our"), incorporated in 1904, is a natural gas utility. We distribute natural gas through our own distribution and transmission network to residential, commercial, industrial and municipal customers in the Corning, New York area and to two other gas utilities which service the Elmira and Bath, New York areas. We are franchised to supply gas service in all of the political subdivisions in which we operate. We are under the jurisdiction of the Public Service Commission of New York State which oversees and sets rates for New York gas distribution companies.

#### Discontinued Operations

In August 2006, the Company completed agreements for the sale or disposal of all remaining Discontinued Operations.

#### Gas Supply

We have contracted with various sources to provide natural gas to our distribution system. We maintain storage capacity of approximately 586,000 decatherms ("Dth"). We have a contract with Atmos Energy Marketing, LLC to manage our capacity and storage assets. The contract is in place from July 2008 through March 2010.

We have secured the required fixed price and storage gas supply for the 2008-2009 winter season and are managing our forecasting process to assure that we follow our gas supply and acquisition plan. Assuming no extraordinary conditions for the winter season, gas supply, flowing and storage will be adequate to serve our approximately 14,500 customers.

We do not expect a shortage of natural gas to impact our business over the next five to ten years. Natural gas drilling is at record levels and domestic reserves and production are increasing. We likewise anticipate no shortages of the necessary pipes and valves for safe distribution of natural gas, and continue to receive material inventory from various reliable sources.

#### Seasonality

Because our business is highly seasonal in nature, sales for each quarter of the year vary and are not comparable. Sales vary depending on seasonal variations in temperature, although the Company's weather normalization clause serves to stabilize net revenue from the effects of unusual temperature variations. The weather normalization clause allows us to adjust customer billings to partially compensate for changes in net revenue caused by weather.

#### Significant Customers

We have three major customers, Corning Incorporated, New York State Electric & Gas, and Bath Electric, Gas & Water Systems. The loss of any of these customers could have a significant impact on our financial results. We recently extended our principal contract with Corning Inc. through September 30, 2010.

#### Employees

We had 54 employees as of September 30, 2008 and 51 as of September 30, 2007.

#### Competition

Historically, the competition in our residential market has been primarily from electricity for cooking, water heating and clothes drying, and to a very small degree, for heating. The price of gas remains low in comparison to that of

electricity in our service territory and our competitive position in the residential market continues to be very strong. Over 90 percent of our residential customers heat with gas. Relative to attracting new customers beyond our existing mains, our principal competition is oil and propane. Natural gas enjoys a price advantage over these fuels today.

We face limited competition from oil in the industrial market. We have been able to compete successfully through several mechanisms, including providing customers the option of transporting their own gas. We are able to maintain our profit margin in these situations because our transportation rate is equal to the lowest unit rate of the appropriate rate classification, exclusive of gas costs.

#### Environmental Regulation

We believe we are in compliance with present federal, state and local provisions relating to the protection of the environment. We do not expect that continued compliance with these requirements will have any material adverse effect on our capital expenditures, earnings and financial position. The Company has no former manufactured gas plant sites (MGP) and is not a party to any environmental proceedings, litigation or complaints.

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#### ITEM 1A. RISK FACTORS.

Our operations could be adversely affected by fluctuations in the price of natural gas.

Prices for natural gas are subject to volatile fluctuations in response to changes in supply and other market conditions. While these costs are usually passed on to customers pursuant to natural gas adjustment clauses and therefore do not pose a direct risk to earnings, we are unable to predict what effect a sharp increase in natural gas prices may have on our customers' energy consumption or ability to pay. Higher prices to customers can lead to higher bad debt expense and customer conservation. Higher prices may also have an adverse effect on our cash flow as typically we are required to pay for our natural gas prior to receiving payments for the natural gas from our customers.

Operational issues beyond our control could have an adverse effect on our business.

Our ability to provide natural gas depends both on our own operations and facilities and that of third parties, including local gas producers and natural gas pipeline operators from whom we receive our natural gas supply. The loss of use or destruction of our facilities or the facilities of third parties due to extreme weather conditions, breakdowns, war, acts of terrorism or other occurrences could greatly reduce potential earnings and cash flows and increase our costs of repairs and replacement of assets. Although we carry property insurance to protect our assets and have regulatory agreements that provide for the recovery of losses for such incidents, our losses may not be fully recoverable through insurance or customer rates.

Significantly warmer than normal weather conditions may affect the sale of natural gas and adversely impact our financial position and the results of our operations.

The demand for natural gas is directly affected by weather conditions. Significantly warmer than normal weather conditions in our service areas could greatly reduce our earnings and cash flows as a result of lower gas sales levels. Although we mitigate the risk of warmer winter weather through the weather normalization clauses in our tariffs, we may not always be able to fully recover all lost revenues as the weather mitigation rate design provides only partial protection for warmer than normal weather.

There are inherent risks associated with storing and transporting natural gas, which could cause us to incur significant financial losses.

There are inherent hazards and operation risks in gas distribution activities, such as leaks, accidental explosions and mechanical problems that could cause substantial financial losses. These risks could, if they occur, result in the loss of human life, significant damage to property, environmental pollution, impairment of operations and substantial losses to us. The location of pipelines and storage facilities near populated areas, including residential areas, commercial business centers and industrial sites, could increase the level of damages resulting from these risks. These activities may subject us to litigation and administrative proceedings that could result in substantial monetary judgments, fines or penalties against us. To the extent that the occurrence of any of these events is not fully covered by insurance, they could adversely affect our financial position and results of operations.

Changes in regional economic conditions could reduce the demand for natural gas.

Our business follows the economic cycle of the customers in our service regions, Corning, Bath and Hammondsport, New York. A falling, slow or sluggish economy that would reduce the demand for natural gas in the areas in which we are doing business by forcing temporary plant shutdowns, closing operations or slow economic growth would reduce our earnings potential.

Many of our commercial and industrial customers use natural gas in the production of their products. During economic downturns, these customers may see a decrease in demand for their products, which in turn may lead to a decrease in the amount of natural gas they require for production. Two of our larger customers have recently announced reductions in work force at local plants. The Company has not seen any meaningful change in billing to large customers to date.

Our earnings may decrease in the event of adverse regulatory actions.

Our operations are subject to the jurisdiction of the New York Public Service Commission (NYPSC). The NYPSC approves the rates that we may charge to our customers. If we are required in a rate proceeding to reduce the rates we charge our customers, or if we are unable to obtain approval for rate relief from the NYPSC, particularly when necessary to cover increased costs, including costs that may be incurred in connection with mandated infrastructure improvements, our earnings would decrease.

Our success depends in large part upon the continued services of a number of significant employees, the loss of which could adversely affect our business, financial condition and results of operation.

Our success depends in large part upon the continued services of our senior executives and other key employees. Although we have entered into an employment agreement with Michael I. German, our president and chief executive officer, he can terminate his agreement on ninety days notice and other significant employees, who have not entered into employment agreements, may terminate their employment at any time. The loss of the services of any significant employee could have a material adverse effect on our business.

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Concentration of share ownership among our largest shareholders may prevent other shareholders from influencing significant corporate decisions.

Richard M. Osborne, chairman of the board, and Michael I. German, president and chief executive officer, currently own approximately 30% of our outstanding common stock. As a result, these individuals, if they chose to act together, will have the ability to exert substantial influence over all matters requiring approval by our shareholders, including

the election and removal of directors and any proposed merger, consolidation or sale of all or substantially all of our assets and other corporate transactions. This concentration of ownership could be disadvantageous to other shareholders with differing interests from these shareholders.

We will need additional equity or debt financing to meet all of our cash needs.

Although we will have cash resources available for general corporate purposes, we do not generate sufficient cash flows to meet all of our cash needs. Historically, we have made large capital expenditures in order to fund the expansion and upgrading of our distribution system. We have also purchased and will continue to purchase natural gas to store in inventory. The successful continuation of our business will be dependent upon our ability to obtain additional equity or debt financing. The sale of additional equity securities could result in dilution to our shareholders. The incurrence of debt would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. Additional financing may have unacceptable terms or may not be available at all for reasons relating to:

- \* limits placed on us by our current lenders in our loan agreements,
  - \* our future results of operations, financial condition and cash flows,
  - \* our inability to meet our business plan,
  - \* Lenders' or investors' perception of, and demand for, securities of natural gas utilities, and
  - \* conditions of the capital markets in which we may seek to raise funds.

If we cannot raise additional capital on acceptable terms, we may not be able to finance the expansion and upgrading of our distribution system, take advantage of future opportunities or respond to competitive pressures or unanticipated capital requirements.

The Company's profitability may be adversely affected by increased competition.

We are in a geographical area with a number of interstate pipelines and local production sources. If a major customer decided to connect directly to either an interstate pipeline or a local producer, our earnings and revenues would decrease.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not applicable.

#### ITEM 2 - PROPERTIES

The Company's headquarters are located at 330 West William Street, Corning, New York. This structure is physically connected to the operations center.

The Company's pipeline system is thoroughly surveyed each year in compliance with federal and state regulations. Any deficiencies found are corrected as mandated. Approximately 325 miles of distribution main, 15,000 services, and 86 regulating station, along with various other properties are owned by the Company, except for one short section of 10" gas main that is under long term lease and is used primarily to serve Corning Incorporated. All of the property owned by the Company is adequately insured and is subject to the lien of the Company's first mortgage indenture.



### ITEM 3 - LEGAL PROCEEDINGS

The Company is not a party to any material pending legal proceedings, nor is the Company aware of any problems of any consequence which it anticipates may result in legal proceedings. The Company settled three lawsuits in 2007 related to the failed C&T merger. The former Chairman of the Company has filed suit against the Company in the western district of New York relative to certain post-retirement benefits.

### ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 2008.

## PART II

### ITEM 5 - MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The principal market on which the Company's common stock is traded is the Over-the-Counter Bulletin Board, or OTCBB, under the symbol "CNIG". The following table sets forth the high and low closing sale prices as reported on the OTCBB for the Company's common stock for each quarter within the Company's last two fiscal years. Because the Company's stock is traded on the OTCBB, these quotations reflect inter-dealer prices, without retail markup, markdown or commission and may not represent actual transactions. The number of shareholders of record of the Company's common stock was 271 at September 30, 2008.

### DIVIDENDS

Under the terms of a \$4,700,000 senior note issued September 5, 1997, the Company may not declare or pay any dividend, or cause any other payment from retained earnings except to the extent that consolidated tangible net worth of the Company exceeds \$2,000,000. Under the 2007 rate order from NYPSC, the Company may not declare or pay annual dividends and/or buy back its stock until the Company can demonstrate it has sufficiently improved its access to the financial market. On September 16, 2008 we filed a petition with the NYPSC to remove the restriction on us from paying common stock dividend and repurchasing common stock imposed in Case 07-G-0772. We believe that the commission may act on our request in January, 2009.

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**ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Our primary business is natural gas distribution. We serve approximately 14,500 customers through 400 miles of pipeline in the Corning and Hammondsport, New York areas. The market for natural gas in our residential service territory is saturated with little growth potential. However, growth opportunities do exist in extending our mains to areas currently not served, as well as expansion in to the commercial and industrial markets. For example, our largest customer, Corning Inc., has added additional manufacturing capacity in our service area that has increased our revenue and margins. Corning Inc. has announced another expansion that we expect will further increase our revenue and margins. In addition we believe that revenue and margin growth should occur through increasing connection with local gas production sources. For example, we are completing a new pipeline to Marcellus Shale gas in Pennsylvania that is likely to open up new business opportunities. In addition, we continue to focus on improving the efficiency of our operations. We are also in the process of making capital investments to improve our infrastructure including upgrading our distribution system through replacement of distribution mains and customer service lines.

Our key performance indicators are net income and shareholders' equity.

In 2008, our consolidated earnings were \$1,006,349. This was mainly due to operating for the full year under two rate increase orders as well as additional storage carrying cost revenue and recognition of producer's revenue. Effective October 1, 2006, we received an order from the New York Public Service Commission (NYPSC) to increase our rates by \$2.7 million. This was the principal reason we returned to profitability in 2007. At the end of 2007 we received another rate increase that positively impacted 2008 earnings. Earnings in 2008 were also positively impacted by a contribution to one of our construction projects of pipeline valued at \$649,900.

In 2007, our consolidated earnings were \$259,545. Earnings were negatively impacted by residual costs associated with the failed merger with C&T Enterprises, Inc. in 2006 in the amount of \$1.0 million. Our results for 2007 were positively impacted by the NYPSC's October 2006 rate order.

During 2006 several events took place that resulted in our sustaining a loss of approximately \$3.6 million, including rising natural gas prices that resulted in less use per customer, higher pension and interest costs and the loss of revenue from local production. In addition, in 2006 we incurred a number of extraordinary operating expenses including restructuring expenses (in the amount of \$1.9 million which includes legal, investment banking and other expenses associated with the failed merger with C&T Enterprises as well as severance and related costs for our former senior officers, gas cost disallowance in the amount of \$1.4 million), the write off of goodwill associated with the sale of our real estate subsidiary, Corning Realty Associates, LLC, in the amount of \$729,709 and the expense associated with the Deferred New York State Franchise Tax catch-up reconciliation in the amount of \$325,000. Excluding these extraordinary items, we lost \$396,801 in 2006. We have excluded certain expenses from our net income (loss) because we believe that meaningful analysis of our financial performance is enhanced by an understanding of isolated factors underlying that performance.

As a regulated utility company, shareholders' equity is an important performance indicator for us. The NYPSC allows us to earn a just and reasonable return on shareholders' equity. Shareholders' equity is therefore a precursor of future earnings potential. Shareholders' equity decreased between 2005 and 2006 as a result of the significant loss in 2006. In 2007, shareholders' equity increased by \$4.5 million due, in part, to a rights offering to holders of our common stock in which we raised \$4.8 million. In 2008 shareholders' equity increased from \$7.2 million to \$7.9 million due to positive earnings. Going forward, we continue to focus on rebuilding shareholders' equity.

Other performance indicators that we track include leak repair, main and service replacements and customer service metrics. During 2006 we made a significant effort to improve our infrastructure and invested more than \$1.6 million in line, meter and service replacement. We repaired 282 leaks and replaced 150 services and three miles of gas main. In 2007, we continued our program to improve infrastructure by investing \$1.8 million in system improvements, repairing 234 leaks, and replacing 147 services and two miles of gas main. In 2008 we improved infrastructure by spending \$4.0 million in our system to make it more reliable. We also repaired 321 leaks and replaced 513 services and over 6 miles of gas main.

Our customer service group has implemented several changes to positively impact our customers. Beginning in 2007, customers have the option of third party payment of their gas bill through their lending institution. This will accelerate payments by saving customers from having to travel to the office to make payments or mail payments. We have also instituted online meter reading. Bill processing has been consolidated to shorten the time between meter readings and mailing, allowing a more direct link between the consumption of gas and the receipt by the customer of their bill. Our principal customer service metric is the number of customer complaints we receive. In 2008, the NYPSC reported 13 complaints against us. This compares to 29 in 2007 and 62 in 2006.

### Earnings

Our continuing operations consist of our utility operations. Corning Realty Associates, LLC sold all of its assets in 2006 for a purchase price of \$825,000. The results of our non-utility operations have been classified as discontinued operations for all periods presented in this report. See Note 10 to the accompanying Consolidated Financial Statement of this Form 10-K.

Earnings (loss) on a consolidated basis was as follows:

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2008 compared with 2007.

We had income of \$1.0 million or \$1.24 per share, in 2008 compared with \$259,545 or \$0.49 per share in 2007, an increase of over 288%. The increase in earnings is primarily due to a rate increase that became effective in December 2007, a contribution in aid of construction of pipeline valued at \$649,900, a \$300,000 loan that was forgiven by Corning Inc., as well as lower interest rates. This was partially offset by a write down of \$575,683 of deferred interest, a Gas Adjustment Clause (GAC) reconciliation of \$175,553 and realized losses in our investment income of \$160,131.

2007 compared with 2006.

We had income of \$259,545 or \$0.49 per share, in 2007 compared to a loss of \$3.6, or \$7.13 per share, in 2006, an increase of \$3.8 million. The increase in earnings is primarily due to a significant reduction in non-recurring expenditures, including a sharp reduction in restructuring expenses from \$1.9 million to \$1.0 million. Earnings also

improved due to a \$2.0 million increase in margins from \$7.5 million to \$9.5 million. Margins increased due to a rate increase authorized by the NYPSC and higher gas usage caused by colder weather. Expenses increased primarily because of an increase in regulatory amortizations (\$714,335) and non-cash pension and welfare expenses (\$1.1 million).

#### Revenue

2008 compared with 2007.

In 2008 our operating revenue increased \$1.3 million, or 5.3%, primarily because of the 2007 rate increase.

2007 compared with 2006.

In 2007 our operating revenue decreased \$2.4 million, or 9%, primarily because of a decline in gas costs, passed through to our customers from \$19.4 million in 2006 to \$14.8 million in 2007.

Our operating revenue by segment was:

Our margin increased by \$1.4 million to 42.99% of revenue in 2008 compared to 39.3% of revenue in 2007 due primarily to the December 2007 rate increase, the contribution to one of our projects of pipeline valued at \$649,900, and colder weather.

Our margin increased by \$2.2 million to 39.3% of revenue in 2007 compared to 27.8% of revenue in 2006 due primarily to colder weather and higher rates.

On October 1, 2006, we implemented a rate increase in the amount of \$2.7 million that positively impacted revenue and margin. Effective December 12, 2007, the NYPSC granted another rate increase that became effective immediately, which will further improve our margins. Finally, our largest customer, Corning Inc., has added additional manufacturing capacity in our service area that has increased our revenue and margins. Corning Inc. has recently announced another major expansion that we believe will increase our revenue and margin as well as enhance the economic vitality of the area.

Looking forward, we anticipate additional margin growth due to the anticipated rate case that we have filed in 2008 with the NYPSC. Our cost of gas should remain stable because of our access to local production and a more favorable gas supply asset management agreement that we entered into with Atmos Energy Marketing LLC in 2008.

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#### Operating Expenses

2008 compared with 2007.

Our operating expenses decreased primarily because of reduction of operating and maintenance cost, from \$6.9 million in 2007 to \$6.4 million in 2008. Depreciation and amortization expenses increased from \$625,498 in 2007 to \$694,251 in 2008 because of increased capital expenditures. Our purchase gas costs remained relatively stable.

2007 compared with 2006.

Our operating expenses decreased primarily because of falling purchase gas costs, from \$19.4 million in 2006 to \$14.8 million in 2007. Our average gas costs decreased from \$12.57 per thousand cubic feet or mcf in 2006 to \$8.11 per mcf in 2007. Other operating and maintenance expenses increased primarily due to higher pension expenses. Depreciation and amortization expenses increased from \$539,127 to \$1.4 million as a result of 2006 rate case that allowed us to implement a \$2.7 million rate increase and increased capital expenditures.

#### Investment Income

Our investment income decreased by \$258,626 to \$9,877 in 2008 compared to \$268,503 in 2007. This was primarily due to realized losses on a trust fund established to fund post-retirement compensations to certain officers. The fund sustained a realized loss of \$24,365 in the third fiscal quarter of this year and additional realized losses of \$135,766 in the fourth quarter.

Our investment income increased by \$63,413 to \$268,503 in 2007 versus \$205,090 in 2006. Our investment income increased by \$117,007 to \$205,090 in 2006 versus \$88,083 in 2005. The increase in 2007 was due to changes in interest bearing gas cost reconciliation amounts due from customers as well as realized gains and losses on a trust fund established to fund post-retirement compensations to certain officers.

#### Effective Tax Rate

Our effective tax rate for the period ending September 30, 2008 decreased to 11.3% instead of the expected rate of 41.1% (34% federal provision and 7.1% New York State provision). This was primarily due to reconciling several years of booked tax to actual federal and New York State taxes paid that resulted in a net benefit to the Company of \$318,950. Taxes paid have also been affected by the amount of Net Operating Loss (NOL) carry forward on both federal and state returns and have positively affected our effective tax rates for the periods ending September 30, 2008

and 2007. In 2007, this carry forward resulted in a 5.8% tax benefit instead of a tax expense. In 2006, the 25.85% tax benefit and effective rate was negatively affected by a reconciliation of prior amounts due to New York State Franchise Tax.

### Liquidity and Capital Resources

Internally generated cash from operating activities consists of net income, adjusted for non-cash expenses and changes in operating assets and liabilities. Non-cash items include depreciation and amortization, gain on sale of securities, deferred income taxes and losses on sale of discontinued operations. Over or under recovered gas costs significantly impact cash flow. In addition, there are significant year-to-year changes in regulatory assets that impact cash flow. Cash flows from investing activities consist primarily of capital expenditures.

In 2008 we refinanced our short and long term debts for more favorable rates. We replaced \$4.6 million of long term notes in the rate of 8.25% and 9.83% with a \$6 million note of 5.96% with Manufacturer and Traders Trust Company, or M&T Bank. We also refinanced and increased our term line of credit to \$8.0 million with an interest rate of 1.35 basis points above LIBOR. Great West Life & Annuity Insurance Company, the holder of the Company's \$4.7 million 7.9% Senior Notes dated as of September 1, 1997, believes that the refinancing with M&T Bank may breach the negative covenants contained in the 1997 note agreement. As a result, Great West claims that the note holders are entitled to share in the security interest the Company has granted to M&T Bank. Great West has not called a default under the 1997 note agreement and is currently in discussion with the Company.

During the third quarter of 2007 we conducted a rights offering pursuant to a May 2006 order of the NYPSB that required us to conduct an equity offering and make various capital investments. The rights offering provided holders of our common stock the right to purchase, at the price of \$16.00, one "investment unit" for each share of common stock held. Each investment unit consisted of one share of common stock and one four-year warrant to purchase .7 shares of our common stock at a price of \$19.00. The rights offering also provided shareholders with an over subscription privilege whereby any shareholder fully exercising his/her rights under basic subscription privilege would be entitled to subscribe to additional investment units also at \$16.00 per unit. Through the rights offering, we raised \$4.8 million (\$4.6 million net of costs). We used these funds for capital investments.

Cash flows from financing activities consist of repayment of long-term debt and borrowings and repayments under our lines-of-credit. For our consolidated operations, we had \$8 million during 2008 available through lines of credit at local banks, the terms of which are disclosed in Note 6 to the accompanying consolidated financial statements. The amount outstanding under these lines at September 30, 2008 was \$6.3 million. As security for our line of credit, collateral assignments have been executed which assign to the lender various rights in the investment trust account. In addition, our lender has a purchase money interest in and to all natural gas purchases by debtor utilizing funds advanced by the bank under the line-of-credit agreement and all proceeds of sale thereof and accounts receivable pertaining to such sale. We rely heavily on our credit lines and large portions of them are utilized throughout the entire year.

In 2008 we have \$10.6 million in long term debt outstanding. We repaid \$775,219 in 2008 consistent with the requirements of our debt instruments.

In 2007 we entered in to an asset management agreement with Merrill Lynch Commodities and purchased \$3.8 million of gas by the end of September 2007 that was placed into storage. In 2008 we entered in to a new agreement with Atmos Energy Marketing LLC and have put \$5.2 million in to gas storage for the winter season. As the result of these actions, we anticipate that we will have sufficient gas to supply our customers for the 2008-2009 winter season.

Off Balance Sheet Arrangements

We have no off balance sheet arrangements.

Contractual Obligations

Long-term Debt

The fair market value of our long-term debt is estimated based on quoted market prices of similar issues having the same remaining maturities, redemption terms and credit ratings. Notes payable to banks are stated at cost, which approximates their value due to the short-term maturities of those financial instruments. Based on these criteria, the fair market value of long-term debt, including current portion, was as follows at September 30, 2008, 2007 and 2006:



#### Lines of Credit

The Company has lines of credit with local banks to borrow up to \$8.0 million on a short-term basis. Borrowings outstanding under these lines were \$6.3 million, \$4.5 million, and \$6.6 million at September 30, 2008, 2007 and 2006, respectively. The maximum amount outstanding during the year ended September 30, 2008, 2007 and 2006 was \$6.3 million, \$6.6 million and \$6.6 million respectively. The lines of credit are unsecured and payable on demand with an interest rate of 3.83563% on September 30, 2008. The interest rate formula was changed to 1.35 basis points above 30 days LIBOR and was in place as of March 20, 2008. As security for the Company's line of credit, collateral assignments have been executed which assign to the lender various rights in the investment trust account. In addition, the lender has a purchase money interest in and to all natural gas purchases by debtor utilizing funds advanced by the bank under the line-of-credit agreements and all proceeds of sale thereof and accounts receivable pertaining to such sale. The weighted average interest rates on outstanding borrowings during fiscal 2008, 2007 and 2006 were 4.98%, 8.25%, and 6.49% respectively.

As of September 30, 2008, we believe that cash flow from operating activities, borrowings under our lines of credit and proceeds from the rights offering will be sufficient to satisfy our working capital, capital expenditures, debt requirements and to finance our internal growth needs for the next twelve months.

## Interest Rate Risk

Our exposure to interest rate risk arises from borrowing under short-term debt instruments. At September 30, 2008, these instruments consisted of a bank credit line of \$8 million. The interest rate (prime) on this loan was 3.84% at September 30, 2008. An increase of 1% in the prime rate would increase our interest costs by \$80,000.

## Regulatory Matters

As a regulated public utility, our earnings are primarily determined by a rate of return set by the NYPSC on the investments in our facilities and equipment (i.e., our rate base). On June 28, 2007 the Company filed a rate case with the NYPSC requesting an increase of \$581,038 for rates to become effective June 2008. In November 2007, we amended our June 28, 2007 filing to make the rate case a "mini filing" so that under the NYPSC regulations the Company would be permitted to increase the amount requested to \$681,000 and accelerate the effective date of the increase. On December 12, 2007, the NYPSC granted us a 2.5% (\$681,000) rate increase effective December 17, 2007. In addition, the NYPSC allowed us to retain \$250,000 in revenue from gas producers relevant to producer interconnects with our system. Because the NYPSC imputed \$250,000 in revenue from gas producers interconnected with our system in its determination of the \$681,000 rate relief, the NYPSC allowed us to retain the first \$250,000 of such revenues and 10 percent of any amount above that level.

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On June 23, 2008 the NYPSC issued an order in Case 07-M-0548 Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard ("EEPS"). In that order, as amended on July 3, 2008, the NYPSC determined that a Gas System Benefits Charge ("GSBC") should be established for New York gas utilities that have 14,000 customers or more. As such, Corning will be required to establish a GSBC effective October 1, 2008 and collect from its customers \$148,647 annually until December 31, 2011. One quarter of the annual amount will be collected in the last quarter of 2008. These funds will be used for NYPSC approved energy efficiency initiatives in the Corning franchise area. The funds collected will be reconciled to energy efficiency expenditures annually. Any over or under collection will be included in the GSBC rate determination for the following year. Corning was required to make tariff changes to establish the GSBC by August 22, 2008 to become effective October 1, 2008, as well as filing a plan with the NYPSC that establishes energy efficiency programs consistent with its order in Case 07-M-0548. A review of Corning's (as well as other New York State utilities) energy efficiency plan is currently being conducted by NYPSC Staff. When that review will be completed is not known at this time. The additional revenues collected through the GSBC will not impact income from operations.

On August 22, 2008 in Case 06-G-1266 the NYPSC approved our request filed on October 16, 2006 for deferral of uncollectible cost in excess of the amount allowed in rates for the fiscal year ended September 30, 2006. The deferral authorization was \$271,090. The recovery of this amount will occur over a commission approved recovery plan to be deferred in rate case 08-G-0708. This will have no impact on the Company's earnings.

On August 22, 2008 in Case 06-G-0064 the NYPSC denied our request filed on January 12, 2007 for deferral of interest cost in excess of the amount allowed in rates for the fiscal year ended September 30, 2006. The deferral request was \$573,183. The Company on September 14, 2008 petitioned for re-hearing of the Commission decision in Case 06-G-0064 on the grounds that the Commission erred in its conclusion the interest expense was neither incremental nor extraordinary and therefore did not qualify for deferral and recovery under current Commission guidelines. Action by the Commission on the Company's re-hearing request is still pending and is unknown at this time.

On September 16, 2008 we filed a petition with the NYPSC to remove the restriction on Corning from paying common stock dividends and repurchasing common stock imposed in Case 07-G-0772. We believe that the Commission may act on its request in January 2009.

On September 17, 2008 in Case 08-G-0708 the NYPSC approved our petition to issue long term indebtedness in the principal amount of \$6,000,000 for the purpose of refunding existing obligations and financing new construction.

On September 24, 2008, we filed a rate case with the NYPSC requesting the approval of a rate increase of approximately 7% in 2009. As an alternative to the rate case increase, we offered to recover the cost of incremental investment via a surcharge. We intend to use the proposed rate increase to continue its improvement program which includes the replacement of miles of gas pipeline. We are also pursuing additional connections to local gas producers and storage in an effort to reduce the cost of gas to our customers.

### Critical Accounting Policies

Our significant accounting policies are described in the notes to the accompanying Consolidated Financial Statements of this Form 10-K. The application of generally accepted accounting principles involve certain assumptions, judgments and estimates that affect reported amounts of assets, liabilities, revenues and expenses. Thus, the application of these principles can result in varying results from company to company. The principles and policies that most significantly impact us are discussed below.

### Accounting for Utility Revenue and Cost of Gas Recognition

We record revenues from residential and commercial customers based on meters read on a cycle basis throughout each month, while certain large industrial and utility customers' meters are read at the end of each month. We do not accrue revenue for gas delivered but not yet billed, as the NYPSC requires that such accounting be adopted during a rate proceeding, which we have not done. Currently we do not anticipate adopting unbilled revenue recognition nor do we believe it would have a material impact on our financial results. Our tariffs contain mechanisms that provide for the recovery of the cost of gas applicable to firm customers, which includes estimates. Under these mechanisms, we periodically adjust rates to reflect increases and decreases in the cost of gas. Annually, we reconcile the difference between the total gas costs collected from customers and the cost of gas. We defer any excess or deficiency and subsequently either recover it from, or refund it to, customers over the following twelve-month period. To the extent estimates are inaccurate; a regulatory asset on the balance sheet is increased or decreased.

### Accounting for Regulated Operations - Regulatory Assets and Liabilities

All of our business is subject to regulation by NYPSC. We record the results of our regulated activities in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, Accounting for the Effects of Certain Types of Regulation, which results in differences in the application of generally, accepted accounting principles between regulated and non-regulated businesses. SFAS No. 71 requires the recording of regulatory assets and liabilities for certain transactions that would have been treated as revenue and expense in non-regulated businesses. In certain circumstances, SFAS No. 71 allows entities whose rates are determined by third-party regulators to defer costs as "regulatory" assets in the balance sheet to the extent that the entity expects to recover these costs in future rates. Management believes that currently available facts support the continued application of SFAS No. 71 and that all regulatory assets and liabilities are recoverable or refundable through the regulatory environment.

### Pension and Post-Retirement Benefits

The amounts reported in our financial statements related to pension and other post-retirement benefits are determined on an actuarial basis, which requires the use of many assumptions in the calculation of such amounts. These assumptions include the discount rate, the expected return on plan assets, the rate of compensation increase and, for

other post-retirement benefits, the expected annual rate of increase in per capita cost of covered medical and prescription benefits. Changes in actuarial assumptions and actuarial experience could have a material impact on the amount of our pension and post-retirement benefit costs and funding requirements. However, we expect to recover substantially all of our net periodic pension and other post-retirement benefit costs attributed to employees in accordance with NYPSIC authorization. For financial reporting purposes, the difference between the amounts of such costs as determined under applicable accounting principles is recorded as either a regulatory asset or liability.

#### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This report contains statements which, to the extent they are not recitations of historical facts, constitute "forward-looking statements" within the meaning of the Securities Litigation Reform Act of 1995 (Reform Act). In this respect, the words "estimate", "project", "anticipate", "expect", "intend", "believe" and similar expressions are intended to identify forward-looking statements. All such forward-looking statements are intended to be subject to the safe harbor protection provided by the Reform Act. Although we believe that the expectations reflected in these forward-looking statements are based on reasonable assumptions, we can give no assurance that our expectations will be achieved. As forward looking statements, these statements involve risks, uncertainties and other factors that could cause actual results to differ materially from the expected results. Accordingly, actual result may differ materially from those expressed in any forward looking statements. Factors that could cause results to differ materially from our management's expectations include, but are not limited to, those listed under Item 1A - "Risk Factors" of this Form 10-K in addition to:

- \* the effect of any interruption in our supply of natural gas or a substantial increase in the price of natural gas,
- \* our ability to successfully negotiate new supply agreements for natural gas as they expire, on terms favorable to us, or at all,
- \* the effect on our operations of weather conditions and conservation efforts by our customers,
- \* the effect on our operations of any action by the New York Public Service Commission,
- \* the effect on our operations of unexpected changes in any other applicable legal or regulatory requirements,
- \* our ability to obtain additional equity or debt financing,
- \* our ability to retain the services of our senior executives and other key employees, and
- \* our vulnerability to adverse general economic and industry conditions and competition.

Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update any forward-looking statement in light of new information or future events.

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#### ITEM 7A - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

##### Interest Rate Risk

The Company's exposure to interest rate risk arises from borrowing under short-term debt instruments. At September 30, 2008, these instruments consisted of bank credit line borrowings outstanding of \$6,322,974. The interest rate (1.35 basis points above 30 days LIBOR) on this line was 3.84% during September 2008. The annual impact of a 1% rate

increase would be \$80,000.

#### ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following financial statements are filed with this Form 10-K:

Reports of Rotenberg & Co. LLP, Independent Registered Public Accounting Firm

Consolidated Financial Statements:

Balance Sheets as September 30, 2008 and 2007

Statements of Income for the years ended September 30, 2008, 2007 and 2006

Statements of Stockholders' Equity for the years ended September 30, 2008, 2007 and 2006

Statements of Cash Flows for the years ended September 30, 2008, 2007 and 2006

Notes to Consolidated Financial Statements

#### ITEM 9 - CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

#### ITEM 9A(T) - CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

As of September 30, 2008, the Company's management, with the participation of the Company's chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Based upon the Company's evaluation, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective as of September 30, 2008.

##### Management's Report on Internal Control over Financial Reporting

The management of the Company is responsible for establishing and maintaining an adequate system of internal control over financial reporting as such term is defined in Exchange Act Rule 13a-15(f) and 15d-15(f). The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the consolidated financial statements. Our internal control over financial reporting is supported by a program of internal audits and appropriate reviews by management, written policies and guidelines, careful selection and training of qualified personnel, and a written Code of Conduct adopted by our Company's Board of Directors, applicable to all Company Directors and all officers and employees of our company.

The Audit Committee of our Company's Board of Directors meets with the independent public accountants and management periodically to discuss internal control over financial reporting and auditing and financial reporting matters. The Audit Committee reviews with the independent public accountants the scope and results of the audit effort. The Audit Committee's Report will be reported in the Proxy Statement issued in connection with the Company's 2009 Annual Meeting of Shareholders.

The Company's management, including the Company's chief executive officer and chief financial officer, assessed the effectiveness of the Company's internal control over financial reporting as of September 30, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework*. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of September 30, 2008.

#### Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that was conducted during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### Inherent Limitations on Effectiveness of Controls

The Company's management, including our chief executive officer and chief financial officer, do not expect that our disclosure controls or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

#### Attestation Report of Independent Registered Public Accounting Firm

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting, Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

#### ITEM 9B - OTHER INFORMATION

None

#### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 is incorporated herein by reference to the Registrant's definitive Proxy Statement relating to its 2009 Annual Meeting of Shareholders (the "Proxy Statement"), under the captions "Board of Directors,"

"Executive Officers," "Section 16(a) Beneficial Ownership Reporting Compliance" and "Code of Business Conduct and Ethics." The Proxy Statement will be filed with the SEC prior to January 28, 2009.

#### ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is contained under the caption "Executive Compensation" in the Proxy Statement and is incorporated herein by reference. The Proxy Statement will be filed with the SEC prior to January 28, 2009.

#### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required with respect to security ownership of certain beneficial owners is set forth under the caption "Principal Shareholders" and "Equity Compensation Plan Information" at September 30, 2008" in the Proxy Statement and is incorporated herein by reference. The Proxy Statement will be filed with the SEC prior to January 28, 2009.

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 is contained under the caption "Certain Relationships and Related Transactions" and "Director Independence" in the Proxy Statement and is incorporated herein by reference. The Proxy Statement will be filed with the SEC prior to January 28, 2009.

#### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 is contained under the caption "Audit Committee Report - Principal Accountant Fees and Services" in the Proxy Statement and is incorporated herein by reference. The Proxy Statement will be filed with the SEC prior to January 28, 2009.









\*\* Filed herewith

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SIGNATURES

In accordance with the requirements of Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CORNING NATURAL GAS CORPORATION (Registrant)

Date: December 18, 2008     /s/ Michael I. German

Michael I. German

President and Chief Executive Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

























CORNING NATURAL GAS CORPORATION AND SUBSIDIARY Notes to Consolidated Financial Statements for the Years Ended September 30, 2008, 2007 and 2006

(1) Summary of Significant Accounting Policies

Corning Natural Gas Corporation (the Company) is a gas distribution company providing gas on a commodity and transportation basis to its customers in the Southern Tier of New York State. The Company follows the Uniform System of Accounts prescribed by the Public Service Commission of the State of New York (PSC) which has jurisdiction over and sets rates for New York State gas distribution companies. The Company's regulated operations meet the criteria and accordingly, follow the accounting and reporting of Statement of Financial Accounting Standards No. 71 (SFAS No. 71) *Accounting for the Effects of Certain Types of Regulation*. The Company's consolidated financial statements contain the use of estimates and assumptions for reporting certain assets, liabilities, revenue and expenses and actual results could differ from the estimates. The more significant accounting policies of the Company are summarized below.

(a) Principles of Consolidation and Presentation

The consolidated financial statements include the Company and its wholly owned subsidiary, the Corning Natural Gas Appliance Corporation. The Corning Natural Gas Appliance Corporation owned two businesses, which were sold in August 2006, which have been established as New York State limited liability subsidiary companies, as follows: Corning Realty Associates, LLC and Corning Mortgage, LLC. Hereinafter the Appliance Corporation and its limited liability subsidiary companies are collectively referred to as "Appliance Corporation". All significant inter-company accounts and transactions have been eliminated in consolidation. The results of the Appliance Corporation are reported separately as discontinued operations in the consolidated statements of income. Shared expenses are allocated to the Appliance Corporation.

It is the Company's policy to reclassify amounts in the prior year financial statements to conform with the current year presentation.

(b) Cash and Cash Equivalents

Cash and cash equivalents include time deposits, certificates of deposit, and all highly liquid debt instruments with original maturities of three months or less. Cash and cash equivalents at financial institutions may periodically exceed federally insured limits.

(c) Accounts Receivable

Accounts receivable are stated net of an allowance for doubtful accounts. The Company estimates the allowance based on its analysis of specific balances, taking into consideration the age of past due accounts.

(d) Debt Issuance Costs

Costs associated with the issuance of debt by the Company are deferred and amortized over the lives of the related debt.

(e) Property, Plant and Equipment

Utility plant is stated at the historical cost of construction. Those costs include payroll, fringe benefits, materials and supplies and transportation costs. The Company charges normal repairs to maintenance expense.

(f) Depreciation

The Company provides for depreciation for accounting purposes using a straight-line method based on the estimated economic lives of property, which ranges from 3 to 55 years for all assets except utility plant. The depreciation rate used for utility plant, expressed as an annual percentage of depreciable property was 2.1% in 2008, 2.2% in 2007, and 2.3% in 2006. At the time utility properties are retired, the original cost plus costs of removal less salvage are charged to accumulated depreciation.

(g) Revenue and Natural Gas Purchased

The Company records revenues from residential and commercial customers based on meters read on a cycle basis throughout each month, while certain large industrial and utility customers' meters are read at the end of each month. The Company does not accrue revenue for gas delivered but not yet billed, as the New York PSC requires that such accounting must be adopted during a rate proceeding, which the Company has not done. Pursuant to the most recent rate order, starting January 1, 2008 capacity assignment revenue is recorded at a rate of 15% of the amount received from released capacity and is recognized upon notification of capacity release from the pipeline company while the remaining 85% is returned to customers through reduced gas cost. The Company operates a weather normalization clause as protection against severe weather fluctuations. This affects space heating customers and is activated when degree days are 2.2% greater or less than a 30 year average. As a result, the effect on revenue fluctuations in weather related gas sales is somewhat moderated.

Gas purchases are recorded on readings of suppliers' meters as of the end of the month. The Company's rate tariffs include a Gas Adjustment Clause (GAC) which adjusts rates to reflect changes in gas costs from levels established in the rate setting process. In order to match such costs and revenue, the PSC has provided for an annual reconciliation of recoverable GAC costs with applicable revenue billed. Any excess or deficiency in GAC revenue billed is deferred and the balance at the reconciliation date is either refunded to or recovered from customers over a subsequent 12-month period.

(h) Marketable Securities

Marketable securities, which are intended to fund the Company's deferred compensation plan, are classified as available for sale. Such securities are reported at fair value based on quoted market prices, with unrealized gains and losses, net of the related income tax effect, excluded from income, and reported as a component of accumulated other comprehensive income in stockholders' equity until realized. The cost of securities sold was determined using the specific identification method. For all investments in the unrealized loss portion, none have been in an unrealized loss position for more than 12 months. None are other than temporary impairments based on management's analysis of available market research. In 2008, 2007 and 2006, the Company sold equity securities for gains (losses) of (\$140,675), \$258,700, and \$246,200 respectively.

A summary of the marketable securities at September 30, 2008, 2007 and 2006 is as follows:





(i) Discontinued Operations

The non utility operations were sold in fiscal year ending September 2006 and the results are included in Discontinued Operation section.

(j) Inventories

Inventories are stated at the lower of cost or market, cost being determined on a first-in, first-out basis.

(k) Federal Income Tax

The Company uses the asset and liability method to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled. In addition, such deferred tax assets and liabilities will be adjusted for the effects of enacted changes in tax laws and rates.

(l) Dividends

Dividends are accrued when declared by the Board of Directors.

Under the 2007 rate order from NYPSC, the Company may not declare or pay annual dividends and/or buy back its stock until the Company can demonstrate it has sufficiently improved its access to the financial market.

(m) Accounting for Impairment

Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"), *Accounting for the Impairment or Disposal of Long-Lived Assets* establishes accounting standards to account for the impairment of long-lived assets, and certain identifiable intangibles. Under SFAS No. 144 the Company reviews assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. SFAS No. 144 also requires that a rate regulated enterprise recognize an impairment when regulatory assets are no longer probable of recovery. No impairment losses were incurred for the years ended September 30, 2008, 2007, and 2006.

(n) New Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value at specified election dates. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ended September 30, 2009. The Company is currently evaluating the impact of SFAS 159 on its consolidated financial statements

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133*. This new standard requires enhanced disclosures for derivative instruments, including those used in hedging activities. It is effective for fiscal years and interim periods beginning after November 15, 2008, and will be applicable to the Company in the first quarter of fiscal 2009. The Company is assessing the potential impact that the adoption of SFAS 161 may have on its financial statements.

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(o) Revenue Taxes

The Company collects state revenue taxes on a gross basis. The amount included in Utility Operating Revenue and Taxes other than Federal Income Taxes was \$113,120, \$77,357, and \$128,463 in 2008, 2007, and 2006 respectively.

(p) Stock Based Compensation

The Company accounts for stock based awards in accordance with SFAS No. 123(R). During fiscal 2008, the Company granted 94,000 options. The fair value of each option issued during these periods was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

The weighted average fair value of options granted during 2008 was \$5.85 with an aggregate value of \$549,900.

There were no dividends. Forfeitures are recognized as they occur.

(q) Earnings Per Common Share

Basic earnings per common share is computed by dividing income available for common stock by the weighted average number of common shares outstanding for the period. Diluted earnings per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The only potentially dilutive securities the Company has outstanding are stock options and warrants. The diluted weighted average shares outstanding shown on the Consolidated Statements of Income reflects the potential dilution as a result of these stock options and warrants as determined using the Treasury Stock Method. Stock options and warrants that are antidilutive are excluded from the calculation of diluted earnings per common share. For 2007 and 2008, 211,842 warrants were excluded as being antidilutive. For 2006, no stock options or warrants were excluded as being antidilutive.

(r) Debt Forgiveness

In 2005 the Company had signed a contract with Corning Inc. to make improvements to our Coopers Regulator Station to accommodate Corning Inc. for their gas needs of the new diesel plant facility. Corning Inc. agreed to pay for the entire project except for \$300,000. In June of 2008, after negotiations, our responsibility for the entire

\$300,000 was forgiven and as such was recognized as income.

(s) Other Matters

The former Chairman of the Company has filed suit against the Company in the Western District of New York relative to certain post-retirement benefits. We have reserved \$236,700 to cover the benefits related to the surrender of a key man life insurance policy while this matter is in litigation.

(2) Information About Operating Segments

The Company's reportable segments have been determined based upon the nature of the products and services offered, customer base, availability of discrete internal financial information, homogeneity of products, delivery channel and other factors.

The Corning Natural Gas Corporation (the Gas Company) is a gas distribution company providing gas on a commodity and transportation basis to its customers in the Southern Tier of New York State. The Appliance Corporation, Corning Realty and Corning Mortgage have discontinued operations as discussed in Note 10.

The following table reflects the results of the segments consistent with the Company's internal financial reporting process. The following results are used in part, by management, both in evaluating the performance of, and in allocating resources to, each of the segments.

(1) The Appliance Corporation discontinued operations in September 2003.

The Company presents revenue, net income and interest income for the Appliance Corporation in 2006 due to deferred revenue on the installment sale of these assets.

(2) Corning Realty and Corning Mortgage discontinued operations in August 2006.

Interest income and expense have been displayed in the segment in which it has been earned or incurred. Segment interest expense other than the Gas Company is included within discontinued operations in the consolidated statements of income.

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### (3) Major Customers

The Company has three major customers, Corning Incorporated, New York State Electric & Gas (NYSEG) and Bath Electric Gas & Water Systems (BEGWS). The loss of any of these customers could have a significant impact on the Company's financial results. Total revenue and deliveries to these customers were as follows:

### (4) Regulatory Matters

Certain costs are deferred and recognized as expenses when they are reflected in rates and recovered from customers as permitted by SFAS No. 71. These costs are shown as deferred debits and other assets. Such costs arise from the traditional cost-of-service rate setting approach whereby all prudently incurred costs are generally recoverable through rates. Deferral of these costs is appropriate while the Company's rates are regulated under a cost-of-service approach.

In a purely competitive environment, such costs might not have been incurred or deferred. Accordingly, if the Company's rate setting were changed from a cost-of-service approach and it was no longer allowed to defer these costs under SFAS No. 71, certain of these assets may not be fully recoverable. However, the Company cannot predict the impact, if any, of competition and continues to operate in a cost-of-service based regulatory environment. Accordingly, the Company believes that accounting under SFAS No. 71 is still appropriate.

Below is a summarization of the Company's regulatory assets as of September 30, 2008, 2007 and 2006:

Unrecovered gas costs.

These costs are recoverable over future years and arise from an annual reconciliation of certain gas revenue and costs (as described in Note 1).

The Company expects that regulatory assets other than deferred unrecovered gas costs will be fully recoverable from customers by the end of its next rate case.

Although the Company recovers the cost of its regulatory assets, it does not earn a return on them.

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(5) Long-term Debt

The fair market value of the Company's long-term debt is estimated based on quoted market prices of similar issues having the same remaining maturities, redemption terms and credit ratings. Notes payable to banks are stated at cost, which approximates their value due to the short-term maturities of those financial instruments. Based on these criteria, the fair market value of long-term debt, including current portion, was as follows at September 30, 2008, 2007 and 2006:





(6) Lines of Credit

The Company has lines of credit with local banks to borrow up to \$8,000,000 on a short-term basis. Borrowings outstanding under these lines were \$6,322,974, \$4,515,000, and \$6,550,000 at September 30, 2008, 2007 and 2006, respectively. The maximum amount outstanding during the year ended September 30, 2008, 2007 and 2006 was \$6,322,974, \$6,600,000 and \$6,600,000 respectively. The lines of credit are unsecured and payable on demand with an interest rate of 3.83563% on September 30, 2008. The interest rate formula was changed to 1.35 basis points above 30 days LIBOR and was in place as of March 20th of 2008. As security for the Company's line of credit, collateral assignments have been executed which assign to the lender various rights in the investment trust account. In addition, the lender has a purchase money interest in and to all natural gas purchases by debtor utilizing funds advanced by the bank under the line-of-credit agreements and all proceeds of sale thereof and accounts receivable pertaining to such sale. The weighted average interest rates on outstanding borrowings during fiscal 2008, 2007 and 2006 were 4.98%, 8.25%, and 6.49% respectively.

(7) Income Taxes

The tax effects of temporary differences that result in deferred income tax assets and liabilities at September 30 are as follows:

The Company has net operating loss carryforwards available of approximately \$4,500,000 as of September 30, 2008 that begin to expire at the end of 2019.

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(8) Pension and Other Post-retirement Benefit Plans

In 1997, the Company established a trust to fund a deferred compensation plan for certain officers. The fair market value of assets in the trust was \$2,318,636 (plus \$51,185 in additional stock), \$1,922,411, and \$2,662,009 at September 30, 2008, 2007 and 2006, respectively, and the plan liability, which is labeled as deferred compensation on the balance sheet, was \$2,181,212, \$2,170,965, and \$2,157,407 at September 30, 2008, 2007 and 2006, respectively. The assets of the trust are available to general creditors in the event of insolvency.

The Company has defined benefit pension plans covering substantially all of its employees. The benefits are based on years of service and the employee's highest average compensation during a specified period. The Company makes annual contributions to the plans equal to amounts determined in accordance with the

funding requirements of the Employee Retirement Security Act of 1974. Contributions are intended to provide for benefits attributed for service to date, and those expected to be earned in the future.

In addition to the Company's defined benefit pension plans, the Company offers post-retirement benefits comprised of medical and life coverages to its employees who meet certain age and service criteria. Currently, the retirees under age 65 pay 60% of their health care premium until Medicare benefits commence at age 65. After age 65, Medicare supplemental coverage is offered with Company payment of the premium. For union participants who retire on or after September 2, 1992, the Company cost, as stated above, shall not exceed \$150 per month. The monthly benefit for all non-union employees, regardless of retirement date, shall not exceed \$150. In addition, the Company offers limited life insurance coverage to active employees and retirees. The post-retirement benefit plan is not funded. The Company accrues the cost of providing post-retirement benefits during the active service period of the employee.

The following table shows reconciliations of the Company's pension and post-retirement plan benefits as of September 30:



For measurement purposes, a 12% annual rate of increase in the per capita cost of covered benefits (health care cost trend rate) was assumed for 2008. The rate is assumed to decrease gradually to 5% by the year 2012 and remain at that level thereafter. A 1% increase in the actual health care cost trend would result in approximately a 4.1% increase in the service and interest cost components of the annual net periodic post-retirement benefit cost and a 4.1% increase in the accumulated post-retirement benefit obligation. A 1% decrease in the actual health care cost trend would result in approximately a 3.6% decrease in the service and interest cost components of the annual net periodic post-retirement benefit cost and a 3.6% decrease in the accumulated post-retirement benefit obligation.

The expected returns on plan assets of the Retirement Plan and Post-Retirement Plan are applied to the market-related value of plan assets of the respective plans. For the Retirement Plan, the market-related value of assets recognizes the performance of its portfolio over five years and reduces the effects of short-term market fluctuations. The market-related value of Post-Retirement Plan assets is set equal to market value.

For ratemaking and financial statement purposes, pension expense represents the amount approved by the PSC in the Company's most recently approved rate case. Pension expense (benefit) for ratemaking and financial statement purposes was approximately \$730,000, \$777,858 and \$368,542 for the years ended September 30, 2008, 2007 and 2006 respectively. The difference between the pension expense (benefit) for ratemaking and financial statement purposes, and the amount computed above has been deferred and is not included in the prepaid pension cost noted above. Such balances equal \$1,978,701, \$1,562,301, and \$2,143,324 as of September 30, 2008, 2007 and 2006 respectively.

The NYPSC has allowed the Company to recover incremental cost associated with post-retirement benefits through rates on a current basis. Due to the timing differences between the Company's rate case filings and financial reporting period, a regulatory receivable (liability) of \$24,911, (\$41,020) and \$45,977 has been recognized at September 30, 2008, 2007 and 2006 respectively.

The Company also maintains the Corning Natural Gas Corporation Employee Savings Plan (the "Savings Plan"). All employees of the Company who work for more than 1,000 hours per year and who have completed one year of service may enroll in the Savings Plan at the beginning of each calendar quarter. Under the Savings Plan, participants may contribute up to 50% of their wages. For all employees, the Company will match one-half of the participant's contribution up to a total of 2% of the participant's wages for the period December 29, 2005 through October 29, 2006, 50% of the participant's contribution up to a total of 4% of the participant's wages for the period October 30, 2006 through November 04, 2007, and 50% of the participant's contribution up to a total of 6% of the participant's wages for the period through September 30, 2008. The plan is subject to the federal limitation. The Company contribution to the plan was \$62,280 in 2008, \$49,976 in 2007 and \$42,850 in 2006.

In September 2006, the FASB issued SFAS 158, an amendment of SFAS 87, SFAS 88, SFAS 106, and SFAS 132R. SFAS 158 requires that companies recognize a net liability or asset to report the under funded or over funded status of their defined benefit pension and other post-retirement benefit plans on their balance sheets, as well as recognize changes in the funded status of a defined benefit post-retirement plan in the year in which the changes occur through comprehensive income. The pronouncement also specifies that a plants assets and obligations that determine its funded status be measured as of the end of Company's fiscal year, with limited exceptions. Under SFAS 158, certain previously unrecognized actuarial gains and losses and previously unrecognized prior service costs for both the pension and other post-retirement benefit plans as well as a previously unrecognized transition obligation for the other post-retirement benefit plan are required to be recognized. These amounts were not required to be recorded on the Company's Consolidated Balance Sheet before the adoption of SFAS 158, but were instead amortized over a period of time. In accordance with SFAS 158, the Company initially recognized the funded status of its benefit plans and implemented the disclosure requirements of SFAS 158 at September 30, 2007. The requirement to measure the plan assets and benefit obligations as of the Company's fiscal year-end date will be adopted by the Company by the end of fiscal 2009. Currently, the Company measures its plan assets and benefit obligations using a June 30th measurement date. The incremental effects of adopting the provisions of SFAS 158 on the Company's Consolidated Balance Sheet at September 30, 2007 are presented in the table below:

(9) Stock Options

On November 5, 2007, the Board of Directors granted stock options totaling 75,000 shares. 25,000 of the stock options are vested immediately and 25,000 additional options vest on each of the 1<sup>st</sup> and 2<sup>nd</sup> anniversary of the grant date. On September 23, 2008, the Board of Directors approved performance based stock options totaling 19,000 shares to be vested on the 1<sup>st</sup> anniversary of the grant date.

A summary of all stock option activity and information related to all options outstanding follows:

An additional 5,000 shares were exercised in October 2008 as part of the total of 25,000 shares vested as of November 5, 2007.



During the third quarter of 2007 we conducted a rights offering pursuant to a May 2006 order of the NYPSB that required us to conduct an equity offering and make various capital investments. The rights offering provided holders of our common stock with the right to purchase, at the price of \$16.00, one "investment unit" for each share of common stock held. Each investment unit consisted of one share of common stock and one four-year warrant to purchase .7 shares of our common stock at a price of \$19.00. The rights offering resulted in warrants being issued for 211,842 shares.

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#### (10) Commitments

The Company is a local distribution company and has contracted for gas supply from various sources to provide the commodity to the city gates. The Company maintains storage capacity of approximately 586,000 Dth. In 2008 we entered in to an asset management agreement with Atmos Energy Marketing, LLC and purchased \$5.2 million of gas by the end of September 2008 that was placed into storage. As the result of these actions, we anticipate that we will have sufficient gas to supply our customers for the 2008-2009 winter season.

The Company has secured the required fixed price and storage gas supply for the winter season and is managing our forecasting process to assure that we follow our gas supply and acquisition plan. Assuming no extraordinary conditions for the winter season, gas supply, flowing and storage will be adequate to serve our, approximately 14,500 customers.

#### (11) Discontinued Operations

In August 2006, the Appliance Corporation executed an asset purchase agreement to transfer ownership of the Prudential Ambrose & Shoemaker Real Estate Company (the "Real Estate Company") to Better Living, Inc. The sale of the Real Estate Company was the result of long negotiations between the Company and two other potential buyers. The final agreement with Better Living was determined to be in the best interest of the Company when considering the restrictions placed on the Company.

The sale of the Real Estate Company resulted in all of the assets, furniture, fixtures, receivables and pending contracts being transferred to the new owner, which continues to operate the Real Estate Company as a Prudential franchise. The sale price for the Real Estate Company was \$825,000 in cash.

During the negotiations for the sale of the Real Estate Company, the successful buyer expressed no interest in ownership of the Corning Mortgage Company, which was a mortgage banking company owned by the Appliance Corporation as a subsidiary. Since the mortgage company was not currently conducting any business and existed in name only, it was determined to have no value in the sale and was excluded from the transaction, and has been dissolved as a company.



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders Corning Natural Gas Corporation and Subsidiary Corning, New York

We have audited the accompanying consolidated balance sheets of Corning Natural Gas Corporation and Subsidiary as of September 30, 2008 and 2007, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended September 30, 2008. Corning Natural Gas Corporation and Subsidiary's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Corning Natural Gas Corporation and Subsidiary as of September 30, 2008 and 2007, and the results of its operations and its cash flows for each of the years in the three-year period ended September 30, 2008 in conformity with accounting principles generally accepted in the United States of America.