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**BUFFALO TRAIL
WATER ASSOCIATION, INC.
Sardis, Kentucky**

**FINANCIAL STATEMENTS
December 31, 2012 and 2011**

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Buffalo Trail Water Association, Inc.
Sardis, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Buffalo Trail Water Association, Inc. (the Association) as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Association's basic financial statements as listed in the table of contents.

Management's 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.

Auditors' Responsibility

Our responsibility is to express opinions 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 and the standards applicable to financial audits contained in **Government Auditing Standards**, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit 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 the 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 opinions.

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Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Buffalo Trail Water Association, Inc., as of December 31, 2012 and 2011, and the respective changes in financial position, and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with ***Government Auditing Standards***, we have also issued our report dated March 27, 2013 on our consideration of the Buffalo Trail Water Association, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with ***Government Auditing Standards*** in considering the Buffalo Trail Water Association, Inc.'s internal control over financial reporting and compliance.

Ray, Foley, Hensley & Company

Ray, Foley, Hensley & Company, PLLC
March 27, 2013

BUFFALO TRAIL WATER ASSOCIATION, INC.
BALANCE SHEETS
DECEMBER 31,

ASSETS	2012	2011
Current assets		
Cash and cash equivalents	\$ 203,227	\$ 172,379
Certificates of deposit	739,691	632,719
Accounts receivable, net	47,244	46,432
Accrued interest receivable	628	1,150
Inventory	<u>15,624</u>	<u>13,906</u>
Total current assets	<u>1,006,414</u>	<u>866,586</u>
Restricted assets		
Cash and cash equivalents	115,561	111,777
Investments	36,024	36,024
Note receivable-Mt Olivet	<u>44,514</u>	<u>50,436</u>
Total restricted assets	<u>196,099</u>	<u>198,237</u>
Plant, property and equipment		
Property, plant and equipment	7,482,902	7,331,648
Less accumulated depreciation	(2,570,040)	(2,401,710)
Construction in progress	<u>-</u>	<u>55,829</u>
Total plant, property and equipment	<u>4,912,862</u>	<u>4,985,767</u>
Other assets		
Unamortized bond costs	<u>3,191</u>	<u>4,491</u>
TOTAL ASSETS	<u>\$ 6,118,566</u>	<u>\$ 6,055,081</u>
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable	\$ 18,721	\$ 20,149
Taxes payable	2,971	3,005
Customer deposits	18,780	15,000
Accrued interest payable	2,492	2,798
Current portion of long term debt	<u>44,693</u>	<u>66,339</u>
Total current liabilities	87,657	107,291
Long-term debt		
Notes payable	681,724	711,005
Bonds payable, net	<u>-</u>	<u>17,000</u>
Total liabilities	<u>769,381</u>	<u>835,296</u>
Equity		
Contributed capital		
Customer contributions	3,108,010	2,957,110
Federal /state grants in aid of construction	2,317,557	2,317,557
Retained earnings	<u>(76,382)</u>	<u>(54,882)</u>
Total equity	<u>5,349,185</u>	<u>5,219,785</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 6,118,566</u>	<u>\$ 6,055,081</u>

The accompanying notes are an integral
part of the financial statements

BUFFALO TRAIL WATER ASSOCIATION, INC.
STATEMENTS OF REVENUES, EXPENSES AND CHANGES
IN RETAINED EARNINGS
for the years ended December 31,

	2012	2011
OPERATING INCOME		
Water sales	\$ 607,378	\$ 655,490
Other revenue	<u>9,691</u>	<u>10,119</u>
Total operating income	<u>617,069</u>	<u>665,609</u>
OPERATING EXPENSES		
Regulatory commission expenses	1,167	964
Salaries and wages	78,764	76,591
Purchased water	186,052	245,435
Materials and supplies	12,414	11,099
Contractual services	146,850	196,091
Utilities and telephone	6,107	6,687
Insurance	8,022	9,583
Bad debt expense	737	679
Miscellaneous	<u>2,833</u>	<u>4,868</u>
Total operating expense	<u>442,946</u>	<u>551,997</u>
Operating income before depreciation	174,123	113,612
Depreciation expense	<u>(168,330)</u>	<u>(168,333)</u>
OPERATING INCOME (LOSS)	5,793	(54,721)
Non-operating income (expenses)		
Interest income	11,782	15,769
Interest expense	<u>(39,075)</u>	<u>(44,067)</u>
NET (LOSS)	(21,500)	(83,019)
Retained earnings, beginning	<u>(54,882)</u>	<u>28,137</u>
RETAINED EARNING, ENDING	<u>\$ (76,382)</u>	<u>\$ (54,882)</u>

The accompanying notes are an integral part of the financial statements.

BUFFALO TRAIL WATER ASSOCIATION, INC.
STATEMENTS OF CASH FLOWS
for the years ended December 31,

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	\$ 620,037	\$ 671,241
Payments to suppliers	(367,328)	(484,695)
Payments for employee services and benefits	<u>(78,798)</u>	<u>(76,670)</u>
Net cash provided by operating activities	<u>173,911</u>	<u>109,876</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Customer contributions	150,900	12,000
Purchases of capital assets	(95,425)	(107,905)
Interest paid	(38,081)	(43,069)
Principal paid	(67,927)	(66,580)
Receipts from note receivable	<u>5,922</u>	<u>4,080</u>
Net cash provided by (used in) financing activities	<u>(44,611)</u>	<u>(201,474)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Redemption (purchase) of certificates of deposit	(106,972)	100,000
Interest income	<u>12,304</u>	<u>8,093</u>
Net cash provided by (used in) investing activities	<u>(94,668)</u>	<u>108,093</u>
NET INCREASE IN CASH	34,632	16,495
Cash and cash equivalents, beginning of year	<u>284,156</u>	<u>267,661</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 318,788</u>	<u>\$ 284,156</u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:		
Operating income (loss)	\$ 5,793	\$ (54,721)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation expense	168,330	168,333
Change in assets and liabilities:		
(Increase) decrease in accounts receivable	(812)	4,642
(Increase) decrease in inventory	(1,718)	(960)
Increase (decrease) in accounts payable	(1,428)	(8,329)
Increase (decrease) in taxes payable	(34)	(79)
Increase (decrease) in customer deposits	<u>3,780</u>	<u>990</u>
Net cash provided by operating activities	<u>\$ 173,911</u>	<u>\$ 109,876</u>

The accompanying notes are an integral part of the financial statements.

BUFFALO TRAIL WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

1. ORGANIZATION AND ACCOUNTING POLICIES

The Buffalo Trail Water Association, Inc. (the Association) distributes and sells water to approximately 1,500 members. The Association primarily serves Bracken, Harrison, Mason, Nicholas, Pendleton, and Robertson Counties. Its suppliers of water are Maysville Utilities and Western Fleming.

Reporting Entity

The Buffalo Trail Water Association, Inc. was created and organized as a non-profit association and is exempt from income tax under Section 501(c)12 of the Internal Revenue Code.

Basis of Accounting

The Association maintains its accounting records on the cash basis during the year. Adjustments are made to convert to the accrual basis from memorandum records at year end.

The Association records revenue as billed to its customers based upon monthly meter reading cycles. At the end of each year, water service which has been rendered from the latest date of each meter reading to December 31, is unbilled.

The statements of revenues, expenses and changes in retained earnings reports all revenues and expenses as operating, except interest income, interest expense, and amortization.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Association defines cash and cash equivalents to include cash on hand, cash in bank, and certificates of deposit with original maturities of 90 days or less.

Accounts Receivable

The reserve for accounts receivable represents accounts past due in excess of thirty days that are thought to be uncollectible. The reserve for accounts receivable at December 31, 2012 and 2011 was \$9,489.

Inventory

The Association's inventory is maintained at lower of cost (first-in, first-out method) or market.

Property and Equipment

Fixed assets are stated at cost. Interest costs incurred during construction are capitalized as a cost of the project. Depreciation has been provided using the straight-line method with the economic lives determined using the following guidelines:

Asset Class	Life
Vehicles & Equipment	5-10
Meters & Pipes	25
Buildings	40
Water & Sewer Systems	50

Restricted Assets

The Board of Directors makes a determination whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

BUFFALO TRAIL WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

1. ORGANIZATION AND ACCOUNTING POLICIES, continued

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 period. Actual results could differ from those estimates.

2. CASH AND CASH EQUIVALENTS

The Association's deposits at December 31, 2012 and 2011 covered by either Federal Depository Insurance or by collateral held by the custodial banks in the Association's name totaled \$1,102,742 and \$952,859, respectively. There were no uninsured deposits at December 31, 2012 and 2011.

Statement of Cash Flows

The statements of cash flows include the following as cash and cash equivalents:

	2012	2011
Cash	\$ 203,227	\$ 172,379
Cash-restricted	<u>115,561</u>	<u>111,777</u>
Total	<u>\$ 318,788</u>	<u>\$ 284,156</u>

3. CAPITAL ASSETS

A summary of capital asset activity during the fiscal year follows:

	Balance Dec. 31, 2011	Additions	Disposals	Balance Dec. 31, 2012
Capital assets not depreciated:				
Land & land rights	\$ 9,778	\$ -	\$ -	\$ 9,778
Construction in process	<u>55,829</u>	<u>-</u>	<u>(55,829)</u>	<u>-</u>
Total not depreciated	<u>65,607</u>	<u>-</u>	<u>(55,829)</u>	<u>9,778</u>
Capital assets that are depreciated:				
Plant & equipment	7,321,870	151,254	-	7,473,124
Less: Accumulated depreciation	<u>(2,401,710)</u>	<u>(168,330)</u>	<u>-</u>	<u>(2,570,040)</u>
Total depreciated	<u>4,920,160</u>	<u>(17,076)</u>	<u>-</u>	<u>4,903,084</u>
Capital assets, net	<u>\$ 4,985,767</u>	<u>\$ (17,076)</u>	<u>\$ (55,829)</u>	<u>\$ 4,912,862</u>

BUFFALO TRAIL WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

4. NOTE RECEIVABLE

The Association entered into an agreement with the City of Mt. Olivet to help pay a debt incurred in 1980 to connect to the West Fleming Water District. The City of Mt. Olivet agreed to pay \$648 per month for a total of \$7,772 per year. This represents 35% of the annual payment of \$22,008 due on the Farmers Home Loan. The receivable represents 40% of the outstanding debt at year end. The debt at December 31, 2012 was \$111,110 with the receivable of \$44,514. The debt at year end December 31, 2011 was \$127,126 with the receivable of \$50,436.

5. LONG-TERM DEBT

The following is a summary of the notes outstanding for the Association for the years ended December 31:

	Outstanding 2012	Outstanding 2011
Notes-Farmers Home Administration		
Loan - \$364,000, dated 5/12/80, payable in annual installments of \$21,588 through 2020, bearing interest at a rate of 5%	\$ 111,110	\$ 127,126
Loan - \$347,000, date 8/6/99, payable in annual installments of \$20,400 through 2040, bearing interest at a rate of 4.75%	281,665	288,510
Loan - \$347,000, dated 5/14/3, payable in annual installments of \$19,394 through 2040, bearing interest at a rate of 4.5%	316,642	321,708
Bonds- Robertson County - \$540,000 dated 12/01/93, payable in variable annual installments through 2013, bearing interest at rates of 4% to 6.4%	<u>17,000</u>	<u>57,000</u>
Total debt	726,417	794,344
Less: current portion	<u>(44,693)</u>	<u>(66,339)</u>
Long-term portion	<u>\$ 681,724</u>	<u>\$ 728,005</u>

The annual requirements to amortize all bonds and loans outstanding at December 31, 2012, are as follows:

Year Ending December 31	Principal	Interest	Total
2013	\$ 44,693	\$ 34,271	\$ 78,964
2014	29,035	31,841	60,876
2015	30,443	30,433	60,876
2016	31,919	28,957	60,876
2017	33,467	27,409	60,876
2018-2022	102,771	117,418	220,189
2023-2027	100,684	95,756	196,440
2028-2032	126,324	70,116	196,440
2033-2037	139,732	37,941	177,673
2038-2042	84,595	12,375	96,970
2043	<u>2,754</u>	<u>124</u>	<u>2,878</u>
	<u>\$ 726,417</u>	<u>\$ 486,641</u>	<u>\$ 1,213,058</u>

BUFFALO TRAIL WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

5. LONG-TERM DEBT, continued

	December 31, 2011	Additions	Retirements	December 31, 2012	Due Within One Year
Long-term debt	<u>\$ 794,344</u>	<u>\$ -</u>	<u>\$ (67,927)</u>	<u>\$ 726,417</u>	<u>\$ 44,693</u>

6. COMPLIANCE WITH LOAN AGREEMENT

The loan agreement between the County of Robertson, Kentucky and Buffalo Trail Water Association, Inc. (nonprofit organization) concerning the "County of Robertson, Kentucky, Industrial Building Revenue Bonds, Series 1993" requires certain reserves be created and maintained as follows:

Bond and interest reserve - This reserve is required to maintain a balance of \$34,500. The balance at December 31, 2012 and 2011, totaled \$36,024.

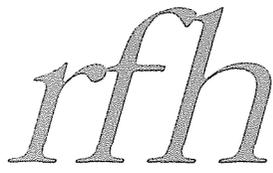
Depreciation reserve - This reserve is required to maintain a balance of \$50,000. The balance of this reserve totaled \$73,648 and \$73,640 at December 31, 2012 and 2011, respectively.

7. RISK MANAGEMENT

The Association is exposed to various risks of loss related torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. In addition to its general liability insurance, the Association also carries commercial insurance for all other risks of loss such as worker's compensation and employee health and accident coverage. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

8. SUBSEQUENT EVENTS

The Association has evaluated and considered the need to recognize or disclose subsequent events through March 27, 2013; which represents the date that these financial statements were available for issuance. Subsequent events past this date, as they pertain to the fiscal year ended December 31, 2012, have not been evaluated by the Association.



Ray, Foley, Hensley & Company, PLLC

Certified Public Accountants and Consultants

**BUFFALO TRAIL WATER ASSOCIATION, INC.
REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Buffalo Trail Water Association, Inc.
Sardis, Kentucky

We have audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in **Government Auditing Standards** issued by the Comptroller General of the United States, the financial statements of the business-type activities of the Buffalo Trail Water Association, Inc. (the Association) as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Buffalo Trail Water Association, Inc.'s basic financial statements, and have issued our report thereon dated March 27, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Association's internal control over financial reporting (internal control) to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be a material weakness.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses to be a material weakness (2012-1).

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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**BUFFALO TRAIL WATER ASSOCIATION, INC.
REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*, continued**

Compliance and Other Matters

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

The Buffalo Trail Water Association, Inc.'s Response to Findings

The Buffalo Trail Water Association, Inc.'s response to the findings identified in our audit is described in the accompanying schedule of findings and responses. The Association's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ray, Foley, Hensley & Company
Ray, Foley, Hensley & Company, PLLC
March 27, 2013

BUFFALO TRAIL WATER ASSOCIATION, INC.
SCHEDULE OF FINDINGS AND RESPONSES
December 31, 2012

FINDING:

2012-1

The Association is required to have internal controls in place that enable it to prepare complete financial statements, including note disclosures, in compliance with generally accepted accounting principles.

The Association lacks personnel with the expertise to apply generally accepted accounting principles in preparing its financial statements including note disclosures and thus, does not have the internal control procedures required to take responsibility for the financial statements in conformity with generally accepted accounting principles.

Management engaged the auditor to prepare draft financial statements, including the related notes to the financial statements. Management reviewed, approved and accepted responsibility for the financial statements prior to their issuance.

We recommend management review the costs and benefits involved to retain a consultant with the required expertise to prepare the financial statements or review the financial statements as prepared by the auditor for compliance with generally accepted accounting principles.

RESPONSE:

This is an ongoing finding. Management has determined that it is more cost effective to continue to engage the auditor to draft the financial statements and related notes.