



THE GARRARD COUNTY WATER ASSOCIATION, INC.

FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

WITH

INDEPENDENT AUDITORS' REPORT

THE GARRARD COUNTY WATER ASSOCIATION, INC.

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INDEPENDENT AUDITORS' REPORT

Board of Directors
The Garrard County Water Association, Inc.

We have audited the accompanying balance sheets of The Garrard County Water Association, Inc. (a nonprofit organization) as of December 31, 2012 and 2011, and the related statements of income, fund equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility For 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 an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes performing procedures to obtain audit evidence about amounts and disclosures in the financial statements. The procedures selected depend upon 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Garrard County Water Association, Inc. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Robinson, Hughes & Christopher, P.S.C.

ROBINSON, HUGHES & CHRISTOPHER, P.S.C.
Certified Public Accountants

March 7, 2013

THE GARRARD COUNTY WATER ASSOCIATION, INC.
BALANCE SHEETS

	December 31, 2012	December 31, 2011
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash on hand	\$ 300	\$ 300
Cash on deposit	219,950	302,544
Accounts receivable - trade (net of allowances for uncollectible accounts of \$12,662 and \$8,912 respectively)	132,883	124,948
Grant receivable - Kentucky Infrastructure Authority	-	37,172
Line relocation receivable - KY Department of Transportation	5,931	35,406
Other receivable	611	-
Interest receivable	4,127	2,535
Prepaid insurance	12,870	12,530
Total Current Assets	376,672	515,435
INVESTMENTS:		
Certificates of deposit - held to maturity	2,368,000	1,988,000
Mutual fund	428,266	146,861
Total Investments	2,796,266	2,134,861
FIXED ASSETS, LESS DEPRECIATION	8,794,466	9,167,979
TOTAL ASSETS	\$ 11,967,404	\$ 11,818,275
<u>LIABILITIES AND FUND EQUITY</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 79,268	\$ 73,019
Payroll taxes payable	2,439	2,367
Total Current Liabilities	81,707	75,386
FUND EQUITY:		
Contributed capital	8,697,674	8,671,201
Retained earnings	3,188,023	3,071,688
Total Fund Equity	11,885,697	11,742,889
TOTAL LIABILITIES AND FUND EQUITY	\$ 11,967,404	\$ 11,818,275

"See accompanying notes."

THE GARRARD COUNTY WATER ASSOCIATION, INC.

INCOME STATEMENTS

	<u>For The Year Ended December 31,</u>	
	<u>2012</u>	<u>2011</u>
OPERATING REVENUE:		
Water sales - metered	\$ 1,721,839	\$ 1,666,152
Service charges	91,460	90,291
Bulk water sales	3,692	2,804
Machine hire and labor	2,569	26,944
Hydrant fees	1,150	1,150
Miscellaneous	1,042	306
Total Operating Revenue	<u>1,821,752</u>	<u>1,787,647</u>
OPERATING EXPENSES:		
Purchased water	765,057	738,576
Depreciation	396,977	394,565
Salaries (net of capitalized labor)	300,453	297,906
Repairs and maintenance	43,551	58,807
Postage	29,624	30,321
Group insurance	29,089	31,529
Utilities and telephone	25,537	24,394
Payroll taxes	25,265	24,937
Insurance	24,075	25,161
Gas and oil	22,278	21,957
Directors' fees	21,400	16,600
Bad debts	20,753	19,710
Supplies	13,151	16,943
Legal and accounting	12,125	11,785
Pension expense	9,636	9,554
Bill processing fees	6,381	7,039
Water sampling	5,382	3,643
PSC assessment	3,213	2,853
Collection fees - loading stations	1,286	1,264
Other	9,774	9,587
Total Operating Expenses	<u>1,765,007</u>	<u>1,747,131</u>
OPERATING INCOME	56,745	40,516
OTHER INCOME (EXPENSE):		
Interest income	55,939	39,340
Gain on disposition of equipment	1,665	4,930
Unrealized gain (loss) on investments	1,986	(5,374)
NET INCOME	<u><u>\$ 116,335</u></u>	<u><u>\$ 79,412</u></u>

"See accompanying notes."

THE GARRARD COUNTY WATER ASSOCIATION, INC.
STATEMENTS OF FUND EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	<u>Contributed Capital</u>	<u>Retained Earnings</u>	<u>Total Fund Equity</u>
Beginning balance January 1, 2011	\$ 8,391,277	\$ 2,992,276	\$ 11,383,553
CONTRIBUTED CAPITAL:			
Contributions in aid of construction received or credited	46,650		46,650
Refunds to developers for line construction costs	(3,042)		(3,042)
Grants in aid of construction	236,316		236,316
Line relocation costs paid by KY Department of			
NET INCOME FOR THE PERIOD		<u>79,412</u>	<u>79,412</u>
Ending balance December 31, 2011	8,671,201	3,071,688	11,742,889
CONTRIBUTED CAPITAL:			
Contributions in aid of construction received or credited	28,050		28,050
Refunds to developers for line construction costs	(1,577)		(1,577)
NET INCOME FOR THE PERIOD		<u>116,335</u>	<u>116,335</u>
Ending balance December 31, 2012	<u>\$ 8,697,674</u>	<u>\$ 3,188,023</u>	<u>\$ 11,885,697</u>

"See accompanying notes."

THE GARRARD COUNTY WATER ASSOCIATION, INC.

STATEMENTS OF CASH FLOWS

	<u>For The Year Ended December 31,</u>	
	<u>2012</u>	<u>2011</u>
Cash Flows From Operating Activities:		
Net income	\$ 116,335	\$ 79,412
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	396,977	394,565
Gain on disposition of equipment	(1,665)	(4,930)
Unrealized (gain) loss on investments	(1,986)	5,374
Change in:		
Accounts receivable	(7,935)	3,606
Other receivable	(611)	491
Interest receivable	(1,592)	(722)
Prepaid expenses	(340)	(41)
Accounts payable and accrued expenses	6,321	(27,240)
Net Cash Provided By Operating Activities	<u>505,504</u>	<u>450,515</u>
Cash Flows From Investing Activities:		
Fixed assets purchased	(24,570)	(194,509)
Proceeds from sale of fixed assets	2,771	-
Net investments purchased	(659,419)	(557,338)
Net Cash Used In Investing Activities	<u>(681,218)</u>	<u>(751,847)</u>
Cash Flows From Financing Activities:		
Contributions from customers in aid of meter installations	25,550	27,900
Refunds to developers for line construction costs	(1,577)	(3,042)
Change in receivable from the KY Department of Transportation	29,475	(5,904)
Grants in support of extensions	-	236,316
Decrease (increase) in grant receivable	37,172	(37,172)
Customer contributions in aid of extension construction	2,500	18,750
Net Cash Provided By Financing Activities	<u>93,120</u>	<u>236,848</u>
Net increase (decrease) in cash	(82,594)	(64,484)
Cash at beginning of year	<u>302,844</u>	<u>367,328</u>
Cash at end of year	<u>\$ 220,250</u>	<u>\$ 302,844</u>

Supplemental Schedule of Noncash Investing and Financing Activities:

During 2011, a trade-in allowance of \$3,300 was received on the trade of an old truck for a new one.

"See accompanying notes."

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

NOTE I - Nature of Activities and Summary of Significant Accounting Policies

Nature of Activities

The Garrard County Water Association, Inc. (the Association) was incorporated on February 3, 1970. The Association sells water to residential, agricultural, and commercial customers in much of rural Garrard County and parts of Madison, Lincoln, and Rockcastle Counties, Kentucky.

Basis of Accounting

The financial statements of the Association have been prepared in accordance with generally accepted accounting principles (GAAP) and accordingly, reflect all significant receivables, payables and other liabilities.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of the statement of cash flows, all highly liquid debt instruments purchased with a maturity of three months or less are considered to be cash equivalents. Overdrafts are treated as components of cash if the bank has the right of offset against other deposits.

Accounts Receivable - Trade

Receivables for water sales are recorded monthly following the reading of meters and verification of those readings.

On a quarterly basis, the Association's board of directors is provided with a listing of accounts deemed to be uncollectible. Generally, this listing is comprised of customers who have moved without paying their water bill and for which no forwarding address can be found. After reviewing the listing, the board approves charging off the accounts.

The allowance for doubtful accounts is calculated using the percentage of sales charged off over the the most recent five years multiplied by the customer accounts receivable outstanding.

Inventory

Materials and supplies are expensed when purchased with no inventory account being maintained. Management considers such inventories immaterial in relation to the financial statements taken as a whole.

Investments

Investments in debt securities for which the Association has both the intention and ability to hold to maturity (i.e., certificates of deposit and repurchase agreements) are classified as held-to-maturity securities and are reported at cost.

Investments in mutual funds, are reported at fair value on the balance sheet. GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

NOTE I - Nature of Activities and Summary of Significant Accounting Policies (continued)

Investments (continued)

transaction between market participants at the measurement date. GAAP establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value. The fair values of equity securities and equity mutual funds held by the Association are measured using the highest level of inputs in the fair value hierarchy, quoted prices in active markets for identical assets or liabilities.

Fixed Assets

Fixed assets purchased by the Association are recorded at cost. New line additions received from subdivision developers and others are recorded at the cost incurred to construct the additions. Fixed asset additions costing less than \$500 are charged to expense as purchases are made. Fixed assets are reported on the financial statements net of an allowance for depreciation. Depreciation expense has been calculated on the straight-line basis over the estimated useful lives of the assets.

Contributed Capital

Customer connection fees received for existing lines, grants received, and service lines contributed by others have been accorded the same treatment in these statements as that required by the Public Service Commission. This policy results in such amounts being credited directly to contributed capital rather than being recorded as income. Connection fees received for new lines are recorded as liabilities until construction is completed.

Reimbursements to developers for partial cost of line additions are offset against contributed capital.

Income Taxes

The Association has been classified as exempt from income taxes under IRC Section 501(c)(12) and will retain this exemption as long as at least 85% of its gross income consists of amounts collected from members for the sole purpose of meeting losses and expenses. Management monitors to make certain that the 85% test described above is met and that all income not collected from members is excluded from tax under IRC Sections 512, 513, or 514. Accordingly, management has determined that no provision for income taxes is needed and that no significant exposure to risk of assessment of income or excise taxes currently exists.

NOTE II - Deposits

A. Accounts Maintained

The Association maintains the following accounts - Revenue Funds, Operation and Maintenance and Depreciation Reserve.

All income collected, with the exception of interest credited to other interest bearing checking accounts, is deposited to the Revenue Funds Account.

An amount sufficient to pay reasonable and necessary current expenses is to be maintained in the Operation and Maintenance Account. The Association transfers funds from the Revenue Funds Account at the beginning of each month in order to meet these expenses.

The Association has also established a Depreciation Reserve Account to be drawn against for large and non-recurring expenditures.

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

NOTE II - Deposits (continued)

B. Summary of Account Balances

	Cash on Deposit			Certificates of Deposit Included in Investments	Total Deposits
	Non-Interest Bearing	Interest Bearing	Total		
Revenue Funds	\$ 25,000	\$ 100,553	\$ 125,553	\$ -	\$ 125,553
Operations and Maintenance	42,774	646	43,420		43,420
Depreciation Reserve		50,977	50,977	2,368,000	2,418,977
Total deposits	<u>\$ 67,774</u>	<u>\$ 152,176</u>	<u>\$ 219,950</u>	<u>\$ 2,368,000</u>	<u>\$ 2,587,950</u>

C. Deposit Security

The Association maintains its deposits with various banks. At December 31, 2012, \$2,421,848 of the balance was covered by standard federal depository insurance, \$69,046 was covered by federal depository insurance under the FDIC's Transaction Account Guarantee Program, and \$97,056 was secured by securities under a repurchase agreement described below.

Pursuant to a sweep account agreement with a local bank, a balance of \$25,000 is maintained in a non-interest bearing checking account. On a daily basis, funds are either swept out of or into the account as necessary to maintain the \$25,000 balance. The funds in excess of \$25,000 are placed in retail repurchase agreements (Repos): the Repos evidence a borrowing by the bank to be fully collateralized by securities which are the direct obligation of, or the principal and interest of which are fully guaranteed by, the United States, one of its agencies, or investment grade securities or investment grade corporate bonds. All securities which are part of the repurchase agreement are held by a third party custodian which serves as agent for the Association.

D. Maturities - Certificates of Deposit

A breakdown of certificates of deposit by year of maturity is as follows:

2013	\$ 225,000
2014	245,000
2015	249,000
2016	849,000
2017	800,000
	<u>\$ 2,368,000</u>

E. Restricted Cash

The Association requires developers of new subdivisions and others desiring to add privately sponsored extensions to make deposits to an Extension Escrow Account to cover the cost of waterline extensions. The waterline construction costs are then paid from the Escrow Account as incurred. Any deposits remaining at the end of the construction are refunded to the sponsor of the extension.

There was no restricted cash under such agreements at December 31, 2012 or 2011.

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

Note III - Investments - Bond Mutual Fund

In addition to investments in certificates of deposit described in Note II, the Association has invested in a mutual fund that invests primarily in senior floating rate loans made by banks to corporations. Senior floating rate (variable) loans are senior to other debt securities a corporation may issue and are usually secured by specific collateral. Because the interest rates on floating rate loans are reset periodically, they are typically less sensitive to changes in interest rates than fixed rate securities of similar securities. However, the mutual fund is subject to some degree of market value fluctuation. The December 31, 2012, market value of this investment was \$428,266 and the original cost of the investment was \$432,761.

NOTE IV - Accounts Receivable - Trade

As of December 31, 2012, the outstanding trade accounts receivable consisted of the following.

	Period Since Due Date				Total
	Current	31-59 Days	60-89 Days	90 Days and Over	
Customers	\$ 121,247	\$ 14,427	\$ 2,538	\$ 7,333	\$ 145,545
Miscellaneous	-				-
Total	\$ 121,247	\$ 14,427	\$ 2,538	\$ 7,333	\$ 145,545

NOTE V - Fixed Assets

Fixed assets consisted of the following at December 31, 2012 and 2011:

	Depreciable Lives -Years	Historical Cost Basis	
		2012	2011
Land and land rights	N/A	\$ 123,911	\$ 123,911
Distribution reservoirs and standpipes	40 - 50	1,176,467	1,174,467
Transmission and distribution mains	40 - 50	11,894,433	11,894,433
Fire mains	50	6,803	6,803
Meters and meter installations	40 -50	1,487,930	1,463,589
Hydrants	40 -50	8,859	8,859
Maintenance equipment	5 - 10	188,197	188,197
Loading station equipment	10	2,750	2,750
Buildings	20 - 25	119,671	119,671
Office equipment	5	46,030	55,708
Total		15,055,051	15,038,388
Less: Accumulated depreciation		6,260,585	5,870,409
Total Fixed Assets		\$ 8,794,466	\$ 9,167,979

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

NOTE VI - Pension Expense

The Association provides pension benefits to eligible employees through a 401-K plan. Employees must be age 21 or over with one year of service as of either of the plan entrance dates of January 1 and July 1 to be eligible to participate. Employee participation is elective. Employees under age 50 may elect to contribute up to \$17,000 annually. Employees age 50 or over may elect to contribute up to \$22,500 annually. Employee elective contributions are matched by the employer up to 5% of employee compensation.

Under the plan, employees are immediately vested in the contributions made by the employee and are vested in the employer contributions over a five year period beginning with the date of employment as follows:

0 - 1 year	0%	3 years	60%
1 year	20%	4 years	80%
2 years	40%	5 years	100%

The Association's policy is to fund the pension expense as the liability accrues.

NOTE VII - Insurance In Force

In order to secure itself against various unexpected losses and to comply with various loan requirements, the Association maintains insurance coverage as described below:

<u>Description</u>	<u>Amount</u>
Workers compensation	Statutory Limit
Kentucky Association of Counties All Lines Fund	
General liability	\$ 3,000,000
Real and personal property	15,000,000
Public officials	3,000,000
Auto liability	3,000,000
Auto comprehensive and collision	ACV
Public officials and employee fidelity	150,000
ERISA bond	100,000

NOTE VIII - Commitments and Contingencies

In connection with the construction of additional water lines, the Association has received various grants. Terms of the grants include repayment of the grant funds in the event of the Association's default on its representations and warranties as specified in the grant agreements.

NOTE IX - Source of Water Supply

The Association purchases most of its water (67.3% during 2011) from the City of Lancaster under a contract dated March 25, 1970. It is, therefore, dependent upon the continuing ability of the City of Lancaster to provide a sufficient supply of treated water.

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

NOTE X - Concentration of Credit Risk

The Association is subject the credit risks associated with selling water to residential, agricultural, and commercial customers in an area where the economy is largely agricultural based.

NOTE XI- Subsequent Events

Events subsequent to December 31, 2012 have been evaluated to determine their potential impact on the financial statements. Events through March 7, 2013, the date the financial statements were available to be issued, were considered.

There were no events occurring during this period requiring disclosure in the financial statements.

NOTE XII - Water Losses

During 2012, the Association incurred the following water loss:

	Gallons (1,000's)	Percent
Water purchased	390,172	100.00 %
Less: metered sales to customers	(304,437)	(78.03)
unmetered sales to customers (loading stations)	(841)	(0.22)
water used by Association	(1,270)	(0.32)
Water loss	<u>83,624</u>	<u>21.43 %</u>

Breakdown of water loss:

Line leaks	75,444	19.33 %
Line breaks	8,070	2.07
Tank overflows	110	0.03
Total water loss	<u>83,624</u>	<u>21.43 %</u>