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**Damon R. Talley**

September 26, 2014

**Attorney At Law**

Mr. Jeff Derouen  
Executive Director  
Public Service Commission  
PO Box 615  
Frankfort, KY 40602

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PUBLIC SERVICE  
COMMISSION

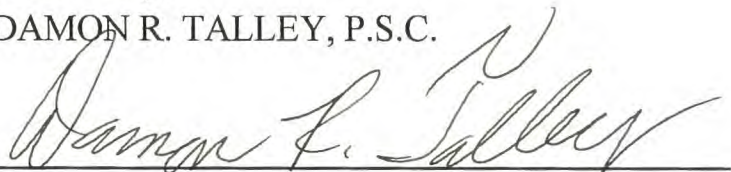
RE: Case No. 2014-00289  
Hardin County Water District No. 2  
Financing – Promissory Note for \$8,000,000

Dear Mr. Derouen:

Enclosed for filing on behalf of Hardin County Water District No. 2 are the original and ten (10) copies of the Applicant's **Supplemental** Response to Commission Staff's First Information Request.

Should you need any additional information, please let me know.

Yours truly,  
DAMON R. TALLEY, P.S.C.



DAMON R. TALLEY, ATTORNEY FOR  
HARDIN COUNTY WATER DISTRICT NO. 2

DRT:ms

Enclosure

cc: Hardin County Water District No. 2

14/HCWD2/Derouen Letter – 9-26-14





26. Provide the journal entry that Hardin County No. 2 will record in its general ledger to report its purchase of Elizabethtown's water assets.

**SUPPLEMENTAL RESPONSE:** The original Response to Question 26 is revised to read as follows:

JOURNAL ENTRY TO RECORD PURCHASE OF ELIZABETHTOWN'S WATER ASSETS AND NOTE PAYABLE

ACCOUNT NUMBER	DESCRIPTION	DEBIT	CREDIT
10103314	TRANSMISSION, DISTRIBUTION & FIRE MAINS	5,775,955.00	
10103344	METER & METER INSTALLATIONS	439,379.03	
10103043	STRUCTURES AND IMPROVEMENTS	4,530,650.33	
10103307	NORTH MULBERRY	30,160.84	
10103308	HELMWOOD	29,522.83	
10103309	SHEPHERDSVILLE	39,209.10	
10103310	SOUTH END	1,200,000.00	
10103311	INDUSTRIAL PARK	139,131.40	
11400000	UTILITY PLANT ACQUISITION	194,607.68	
10813314	A/D - TRANSMISSION, DISTRIBUTION & FIRE		2,947,711.86
10813344	A/D - METER & METER		405,068.30
10813043	A/D - STRUCTURES AND IMPROVEMENTS		1,379,645.68
10313304	A/D - DISTRIBUTION RESERVOIRS & STANDPIPES		552,442.37
23200000	NOTE PAYABLE (FAIR VALUE)		6,093,748.00
43210000	CAPITAL		1,000,000.00 (1)
	TOTAL FOR ENTRY	12,378,616.21	12,378,616.21

(1) THE REVENUE ACCOUNT IS USED IN ORDER TO ACCOUNT FOR THE CAPITAL CONTRIBUTIONS. AMOUNT IS NOT CHARGED DIRECTLY TO NET POSITION, BUT WILL BECOME A COMPONENT NET POSITION IN ACCOUNT 271 AFTER THE CLOSE OF THE DISTRICT'S CALENDAR YEAR.

Hardin County No. 2 proposes to amortize the Acquisition Adjustment shown above in the amount of \$194,607.68 over **20 years**, which is the term of the Promissory Note. It should be noted that the weighted average remaining useful life of the tangible assets being purchased exceeds 20 years.

**WITNESS:** Amber D. Pike, Accounting Manager, Hardin County No. 2.

28. When a note is exchanged for property, goods, or services, Generally Accepted Accounting Principles require that consideration be given to the reasonableness of the note's stated rate of interest when compared to prevailing market conditions. It requires that, when an interest rate is deemed unreasonable, the exchange should be valued at the fair value of the note or the property, goods, or services, whichever is more clearly determinable.<sup>1</sup>

**SUPPLEMENTAL RESPONSE:** The original Response to Question 28 is revised to read as follows:

a. The note payable from Hardin County No. 2 to Elizabethtown has a stated interest rate of zero. State whether Hardin County No. 2 is of the opinion that this rate of interest is reasonable based on current market conditions.

**SUPPLEMENTAL RESPONSE:** A zero interest rate promissory note is not reasonable based on current market conditions.

After additional research, Hardin County No. 2 has determined that GASB Statement 62 does **not** preclude reporting the Promissory Note at its fair value. Therefore, Hardin County No. 2 plans to impute interest on the Promissory Note and report it at its fair value.

b. If Hardin County No. 2's opinion is that the stated rate of interest is reasonable, explain and discuss Hardin County No. 2's reasoning and rationale.

**SUPPLEMENTAL RESPONSE:** N/A

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<sup>1</sup> Financial Account Standards Board, Accounting Standards Codification 835.

c. If Hardin County No. 2 is of the opinion that the stated rate of interest is unreasonable, state the fair value it will assign to the note payable for reporting purposes and explain how the fair value was determined.

**SUPPLEMENTAL RESPONSE:** \$6,093,748.00

d. Hardin County No. 2's most recent bond issuance occurred in 2012. Hardin County No. 2 reported the average rate of interest for these bonds to be 2.745 percent in its 2013 Annual Report that it filed with the Commission. Explain whether Hardin County No. 2 agrees that current market conditions are not materially different than when it issued the 2012 bonds.

**SUPPLEMENTAL RESPONSE:** Yes.

**[The Remainder of This Page Intentionally Left Blank]**



e. Explain whether Hardin County No. 2 agrees that it would be appropriate to calculate the fair value of the note payable for reporting purposes by discounting the note's \$400,000, 20-year annual payment using as the discount factor the average interest rate of Hardin County No. 2's 2012 Revenues Bonds.<sup>2</sup> As shown in the amortization schedule below, this method results in a fair value of \$6,093,748.

Payment Number	Payment Amount	Imputed Interest at 2.745 Percent	Principal Reduction	Principal Balance Outstanding
				\$6,093,748
1	\$400,000	\$167,273	\$232,727	5,861,021
2	400,000	160,885	239,115	5,621,906
3	400,000	154,321	245,679	5,376,228
4	400,000	147,577	252,423	5,123,805
5	400,000	140,648	259,352	4,864,454
6	400,000	133,529	266,471	4,597,983
7	400,000	126,215	273,785	4,324,197
8	400,000	118,699	281,301	4,042,897
9	400,000	110,978	289,022	3,753,874
10	400,000	103,044	296,956	3,456,918
11	400,000	94,892	305,108	3,151,810
12	400,000	86,517	313,483	2,838,328
13	400,000	77,912	322,088	2,516,240
14	400,000	69,071	330,929	2,185,310
15	400,000	59,987	340,013	1,845,297
16	400,000	50,653	349,347	1,495,951
17	400,000	41,064	358,936	1,137,015
18	400,000	31,211	368,789	768,226
19	400,000	21,088	378,912	389,313
20	400,000	10,687	389,313	-

**SUPPLEMENTAL RESPONSE:** Yes. \$6,093,748.00 is the fair value.

<sup>2</sup> Hardin District's 2013 Annual Financial and Statistical Report at 49.

f. Confirm that Hardin County No. 2 understands that, based on the information provided in Hardin County No. 2's application, accounting for the note payable at a fair value of \$6,093,748 would result in the recording of a negative acquisition adjustment in the amount of \$805,392<sup>3</sup> and that, while a negative acquisition adjustment is not subject to the Commission's aforementioned five-part Delta test, the Commission may require that the benefit of the acquisition adjustment's amortization be passed through to Hardin County No. 2's customers in Hardin County No. 2's next application for a general rate adjustment unless Hardin County No. 2 can demonstrate that such a pass-through is unreasonable.

**SUPPLEMENTAL RESPONSE:** In light of the \$1,000,000.00 state grant utilized by Elizabethtown to pay a portion of the costs of the City Springs WTP Renovation Project (see information provided in the original Response to Question 33 of Commission Staff's First Information Request), the Net Book Value of Water Assets to be Purchased is \$5,899,140.00. If the note payable is recorded at its fair value of \$6,093,748.00, there will **not** be a negative acquisition adjustment.

**WITNESS:** James R. Jeffries, General Manager, Hardin County Water District No. 2

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Net Book Value of Water Assets Purchased	\$	6,899,140
Less: Fair Value of Note Payable to Elizabethtown		<u>(6,093,748)</u>
Acquisition Adjustment	\$	805,392