

SKEETERS, BENNETT AND WILSON, PLC

ATTORNEYS AT LAW
550 W. LINCOLN TRAIL BLVD.
P.O. BOX 610
RADCLIFF, KENTUCKY 40160

RECEIVED

JUN 24 2005

PUBLIC SERVICE
COMMTEL (270) 351-4404

DONALD E. SKEETERS
R. TERRY BENNETT
DAVID T. WILSON II
MICHAEL A. PIKE
JEREMY S. ALDRIDGE

June 23, 2005

FAX: (270) 352-4626

REAL ESTATE DEPT:

TEL: (270) 352-4406

FAX: (270) 352-4421

Beth O'Donnell
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, Ky 40602

Re: Hardin County Water District No. 1 Contract with Fort Knox Regarding
Wastewater Treatment; Case No. 2004-00422

Dear Ms. O'Donnell:

Attached hereto are documents pertaining to the accounting allocation procedures which Hardin County Water District No. 1 proposes to use in order to allocate assets, liabilities, revenues and expenses between the wastewater treatment services to be provided by the District and the other Water District related services.

I trust these documents will be self-explanatory. If, however, you wish to discuss them please do not hesitate to contact me.

Sincerely,

SKEETERS, BENNETT & WILSON PLC



David T. Wilson II

DTW:dnt
cc: Jerry Wuetcher
Jim Bruce

Hardin County Water District No. 1

Serving Radcliff and Hardin County for Over 50 Years

1400 Rogersville Road
Radcliff, KY. 40160

MEMORANDUM

Hardin County Water District No. 1

DATE: May 26, 2005

TO: All HCWD1 Employees
Karen Brown, HCWD1 Accounting Specialist
Copy to: Kentucky Public Service Commission

FROM: Jim Bruce, HCWD1 General Manager

SUBJECT: Accounting Allocation Procedure for Water & Sewer Utilities

As required in our order from the Kentucky Public Service Commission (order dated December 1, 2004, case no. 2004-00422), we will need to begin to properly account for revenues and expenses between our water and sewer utility. Please review the following procedures and plan to implement and use after July 1 when we take over operations of the Ft. Knox Sewer Systems. If you have any questions, please contact Karen or myself;

1. Purpose of process / procedures
 - a. Beginning in 2005, the District became owner and began operating the Ft. Knox Sewer Utilities (FKSU) in response to a bid award by the United States Government (Government). The PSC issued an order dated December 1, 2004 (Case No. 2004-00422) approving the District beginning operations as a sewer utility, and also approved its tariff and fees which it will charge to the Government. As part of the PSC's order, the District must develop procedures to be used for the allocation of joint and common costs, and unique costs (including revenues) between its water, sanitary sewer and storm sewer operations.
 - b. By correctly allocating costs using NARUC, UsaA (Uniform System of Accounts), the District is able to make certain that customers of the different utilities are not being charged for operating costs from another utility of which they are not a customer and receive no benefit. Revenues must also be debited to the proper utility so that funds are available for operations derived from that utilities customers, and a utility is not using revenues from other customers.

- c. Also, as some of the District's employees, equipment and resources may be used for more than one of these operations, a process must be in place to allocate a single resource, to multiple accounts or utilities.
2. Chart of Accounts
 - a. The District has developed a separate chart of accounts, including balance sheet, for its Water and Sewer Utilities. The accounting system (inHance) also is able to use separate funds for two distinct operations or utilities. As storm water is not a regulated utility by the PSC, separate balance sheet and operating statement (revenue and expense) accounts are maintained for both the sanitary and storm sewer utilities
3. Methods of Allocation
 - a. Direct / Actual: This is used when there is no question or sharing of revenue or expenses between utilities. The charge is put 100% to the cost center or division that has created the need for the expense, or the revenue center for which utility created the sales or service. Example; A hand tool that will only be used at the wastewater treatment plant would be charged to Wastewater Treatment, Sanitary Sewer Utility
 - b. Measured Allocation between two or more cost centers: If a resource will be used or benefitting two or more utilities, and actual measurement is possible or available. Example; An employee works 10 hours at the sewer plant, and 30 hours at the water plant in a week. Their time sheet would *measure* the allocation and the single week would be allocated to both utilities based on known and measured time working for each. Other measurement methods could be miles driven or hours / weeks that equipment is used at different sites.
 - c. Calculated Estimates based on Test Period: For an allocation that will be routine or repetitive, a test period can be used to measure the split and then that allocation used in future until re-testing is needed or allocation changes significantly. Example; If an employee makes a weekly check or rounds between the utilities they could keep track of how much time is spent at each for a month, or several months. After the test period, it may be found that each week it takes 5 hours to complete the sewer work, and the remaining 35 weeks is at water. For that 40 hour work week, 13% of the employees time was spent on sewer and 87% on water. Those percentages would then be used to allocate wages, benefits, and other payroll to the two utilities.

- d. Estimated pro-forma method: If an operation or process of sharing resources has not been measured or established before, it may be necessary to allocate costs based on an estimate or which would be applied for a period until actual data or measurement can be used to compare to the estimated method. A year end adjustment may be needed to correct from the pro-forma amounts used. Example; A new piece of lab equipment is purchased which can do sewer and water analysis and tests. If it is unknown how much time each test will take, or the amount of tests in a year for each utility, an estimate would be used to allocate the purchase cost of the equipment between the utilities.
 - e. Revenue or Asset Value Allocation: Some resources could be allocated based on the percentage of revenues or plant asset value between two utilities. If the item could increase sales or revenues for both utilities, the purchase cost of that item could be based on the percent difference of added revenues, or current revenues. The same method could be used based on assets. Example; If a rate study were being completed by a consultant for both utilities, there charge could be allocated by 60% to water and 40% to sewer, assuming of the combined revenues for both utilities, 60% were water.
4. Records and Transaction Documents
- a. Expenses: The normal stamp used on all invoices has a place for multiple account numbers to be used. The amount of allocation should use one of the methods above. If an employee is uncertain of the allocation amount, they will ask the Accounting Specialist or General Manager. Expense allocation could be for materials, supplies or services.
 - b. Revenues: Revenues are normally "hard coded" in the accounting system and when they are posted, the revenues go to the correct account numbers. If a revenue needs to be split, the entry will have to be done manually by the Accounting Specialist.
 - c. Payroll / Benefits: Non-exempt employees will use their time-sheet and department numbers or CIP / Work Order numbers to show time they worked on different utility projects. Exempt or salary employees should keep a log of time worked on different utility issues or projects, and periodically report to Accounting Specialist how many hours to allocate for their time. Accounting Specialist may use a journal entry to credit and debit wage and benefit value from one utility to another for salaried time allocations. Annually, an final adjusting journal entry will also be made to adjust any salaried personnel time between utilities based on time spent on different projects.

- d. Capital Purchases: Some capital equipment or vehicles can also be allocated or used between utilities. When the expense or purchase is made, the most accurate allocation method should be used to determine how much to make to each utility. Example; A pick-up truck a supervisor would use and drive between both utility sites. If the supervisor has accurate records of time or mileage spent between the sites, that same percentage could be used for expensing the vehicle.
 - e. Depreciation of Fixed Assets: When a capital asset is purchased that will be shared between utilities, (such as truck example above), that asset total acquisition cost should be shown on each utility's Depreciation Schedule or Fixed Asset list, showing only the portion of the asset charged to that utility. The regular estimated life years would be used to divide the cost to determine annual depreciation amount. Any sold asset which is on the depreciation list should also split the sale proceeds by the same percentage as was split when the item was purchased.
5. Annual Budgeting
- a. During the annual budget process, the General Manager and supervisors will determine which resources, requests and capital projects / purchase may benefit multiple utilities. The requested revenue estimates, expense line accounts and capital purchases shall be split on the budget forms based on the percentage approved by the General Manager. A budget will be presented to the Board for each utility, however a single capital request list will be used, showing how much of a single request will be charged to each utility. Upon Board approval of the final list, the allocated amount will be added to the appropriate capital or operating budget line accounts.
6. Frequency of Allocation Review / Auditing
- a. During year end closing and the audit, the Accounting Specialist and auditors will review any allocated costs between utilities for accuracy and correctness. Year end adjustment entries may be needed to transfer charges or revenues between utilities. Expenses that may be paid once annually (CPA expense for annual report, liability insurance, amortized expenses) may also require a single journal entry at year end.
 - b. Any year that a rate design is completed for a utility, an additional effort will be made by staff or the consultant to ensure that test year data for the utility which the rates are being designed do not include amounts that should be credited from or debited to another utility. This adjustment may also include checking

previous assumptions or allocation percentages previously being used, to make sure that are still correct and accurate.

- c. Any split allocations, especially non-routine or large extra-ordinary expenses, should have noted on the source document what method was used for the allocation percentage, and any other explanation or why a certain allocation method was used. These notes or records may be needed to show the PSC during a rate case, especially if a customer challenges the their new calculated rate and is able to review actual expense and purchase records.

7. Annual Reporting Requirements

- a. The Annual Financial Report & Audit will show columns for the two main utilities, with a column for consolidated amounts for the District as a whole. Storm Sewer will not be shown as a distinct enterprise, but separate lines will be shown under the "Sewer Utility" column.
- b. Two separate annual PSC reports will be required for Water and Sewer (NARUC classifies our Sewer operation as a Class A). Storm water amounts will be excluded from either report (based on PSC written order) as these amounts are not considered "regulated" by the PSC. The District's CPA and PSC will determine if any notes and reference to Storm Water financial entries should be shown on either the annual PSC water or sewer report.
- c. Bond Documents / Official Statements: If any future bonds are sold for sewer capital projects, the CPA and bond counsel will determine if both storm and sanitary revenues and expenses can be combined for stating the "sewer" financial position of the District, and for calculating bond coverage or other requirements.

HARDIN COUNTY WATER DISTRICT #1
UNIFORM SYSTEM OF ACCOUNTS
CLASS A - SEWER UTILITY

BALANCE SHEET ACCOUNTS

Assets and Other Debits

Utility Plant

20.00.1010000	Utility Plant in Service
20.00.1010100	Lift Station Facilities
20.00.1010300	Wastewater Assets - Unclassified
20.00.1010500	Storm Water Assets - Unclassified
20.00.1050000	Construction Work in Progress
20.00.1080000	Accumulated Depreciation
20.00.1140000	Utility Plant Acquisition Adjustments

Other Property and Investments

20.00.1240000	Utility Investments
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Current and Accrued Assets

20.00.1310000	Unrestricted Cash
20.00.1410000	Accounts Receivable
20.00.1510000	Plant Material & Supplies
20.00.1620000	Prepaid Expenses
20.00.1710000	Accrued Interest & Dividends

Deferred Debits

20.00.1810000	Unamortized Debt Discount & Expenses
20.00.1860000	Miscellaneous Deferred Debits

Equity Capital & Liabilities

20.00.2150000	Retained Earnings
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Current and Accrued Liabilities

20.00.2310000 Accounts Payable
20.00.2320000 Notes Payable
20.00.2370100 Accrued Interest on Long-Term Debt

Contributions in Aid of Construction

20.00.2710000 Contributions in Aid of Construction

Wastewater Utility Plant Accounts

20.00.3890000 Other Plant and Misc. Equipment
20.00.3900000 Office Furniture and Equipment
20.00.3940000 Laboratory Equipment

INCOME ACCOUNTS

Utility Operating Income

20.00.4030000 Depreciation Expense
20.00.4140000 Gain/Loss Sale of Assets

Other Income and Deductions

20.00.4190000 Interest and Dividend Income
20.00.4210000 Non-utility Income

WASTEWATER OPERATING REVENUE ACCOUNTS

Wastewater Sales

20.00.5210400 Fort Knox Sanitary Sewer Revenue
20.00.5210500 Fort Knox Storm Water Revenue
20.00.5230000 Muldraugh Sales

Other Wastewater Revenues

20.00.5360100 Fort Knox CIP Surcharge Revenue
20.00.5360200 Miscellaneous Revenue
20.00.5360300 Labor Revenue - Miscellaneous Statements

WASTEWATER OPERATION AND MAINTENANCE EXPENSE ACCOUNTS

20.00.7010000	Allocated Salaries and Wages
20.00.7030000	Allocated Commissioner Salaries
20.00.7310000	Professional Services - Engineering
20.00.7320000	Professional Services - Accounting
20.00.7330000	Professional Services - Legal
20.00.7360000	Contractual Operations Expense
20.00.7500000	Transportation Fuel & Repairs
20.00.7570000	Insurance - General Liability
20.00.7670000	Regulatory Commission Expense
20.00.7750000	Miscellaneous Allocated Expense
20.00.7750100	Travel & Lodging
20.00.7750200	Education & Conferences