

JOHN N. HUGHES
ATTORNEY AT LAW
PROFESSIONAL SERVICE CORPORATION
124 WEST TODD STREET
FRANKFORT, KENTUCKY 40601

TELEPHONE: (502) 227-7270

JNHUGHES@fewpb.net

TELEFAX (502) 875-7059

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August 28, 2007

AUG 29 2007

PUBLIC SERVICE
COMMISSION

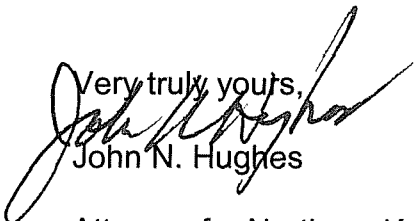
Beth O'Donnell
Executive Director
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40601

Re: Case 2007-00135

Dear Beth:

Northern Kentucky Water District submits its responses to the Attorney General's Supplemental Data request. A copy of these responses has been delivered to the Attorney General.

If there are any questions about this, please contact me.

Very truly yours,

John N. Hughes

Attorney for Northern Kentucky
Water District

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

AUG 29 2007

PUBLIC SERVICE
COMMISSION

In the Matter of:

NORTHERN KENTUCKY WATER DISTRICT'S)
NOTICE OF INTENT TO FILE RATE, FINANCING) Case No. 2007-00135
& CONSTRUCTION APPLICATION BASED ON)
HISTORIC TEST PERIOD)

NORTHERN KENTUCKY WATER DISTRICT RESPONSES TO SECOND
INFORMATION REQUEST FROM THE ATTORNEY GENERAL DATED AUGUST
10, 2007

Q1. Follow-up to AG Q-A1d:

Q1a. Describe anticipated increases in operating and maintenance expenses resulting from each of the two projects discussed in the responses, i.e. electric, maintenance, plant, etc.

A1a. Witness: Harrison. The District cannot quantify the operating and maintenance expenses for GAC at this time. These costs are not known and measurable and have not been included in the District's current rate application. It is anticipated that increased power to operate the GAC treatment process will be necessary. Additional labor to maintain new equipment will be necessary and the largest operation and maintenance expense will be the purchase of carbon to operate the new GAC facility at the Fort Thomas Treatment Plant.

The annual O & M costs are preliminarily estimated to be \$48,000 annually for the UV treatment process. This estimate is for power, materials and labor to

maintain the system on an annual basis. This expense is not included in the District's rate application.

Q1b. Describe the \$821,966 and \$6,843,034 expenditures anticipated to be incurred in 2008 associated with the FTTP Post-Filtration GAC. Also, explain the 1-year gap between expenditures 2008 and 2010.

A1b. Witness: Harrison. These expenses are associated with design of the FTTP Post Filtration GAC project. The preliminary design is currently under way and the final design will be procured in late 2007 or early 2008. The total design is currently estimated to cost \$7,665,000 over the 2007 and 2008 period. The reason there is a two year gap between design and construction is because the design is anticipated to take until late 2009 to complete and construction is not anticipated to commence until 2010 at this time.

Q1c. Demonstrate the impact of each project on : i) debt service, ii) depreciation, and iii) coverage.

A1c. Witness: Bragg. i) The effect on debt service from both projects would increase P & I expense about \$575,000 per year for 20 years, depending on the Bonds issued and that the current market rates do not change. ii) The effect on depreciation would be estimated at about \$155,000 per year over the next fifty (50) years. iii) the effect on coverage is about 21% of the total 20% that is required by the District General Bond Resolution. ($\$575,000/\$2,795,578=21\%$)

Q1d. When will the \$821,966 and \$6,843,034 expenditures be capitalized to plant account 304-0002-000?

A1d. Witness: Bragg. Yes.

- Q2. Follow up to AG Q – A5b1.
- Q2a. What does “IRR” mean?
- A2a. Witness: Bragg. “IRR” stands for Improvement, Repair and Replacement fund.
- Q2b. How do you determine what items are funded by the IRR account versus funding by debt?
- A2b. Witness: Bragg. When the District plans it’s next year budget, small mainline replacement projects that will not require a certificate, (such as Highway Department relocation Project), smaller expenditures such as vehicles, power equipment, plants projects, computer equipment, furniture, backhoes, etc are normally funded by this fund.
- Q2c. How does money flow into and out of the IRR account?
- A2c. The funds that are deposited into this fund are the funds left over from operations per quarter. In other words, revenue received minus expenditures and debt service payments.
- Q2d. Provide all policies, procedures and accounting manuals related to the IRR Account, Debt Service Account and the Debt Service Reserve Account.
- A2d. Witness: Bragg. There is no policy manual on how the IRR fund is budgeted. In regards to Debt Service Account and Debt Service Reserve these are requirements per the District’s adopted General Bond Resolution.
- Q2e. Is any part of the Cost of Service you have filed in this case reflected in or driven by these accounts.
- A2e. Witness: Bragg/McKinely. Yes.

Q2f. Does NKWD have a formula or other mechanical process or procedure to determine the level of funds necessary to be in the IRR regardless of the source of funds? If yes, please explain.

A2f. Witness: Bragg. No. Funds that are left over after all O&M expenses and Principle and Interest payments are met, is deposited into this fund per General Bond Resolution and must be used on capital projects and purchases.

Q2g. Explain how the Debt Service and Debt Service Reserve accounts get funded? In other words, how does NKWD determine the level of funding necessary for the reserves and what is the source of the funding.

A2g. Witness: Bragg. They are funded by the issuance of bonds. The District maintains a five year capital budget which is adjusted at the end of each year. For projects that need to be done for which there are no funds Bonds are issued. The total amount issued in Bonds will determine how much must be borrowed to fund the Debt Service Reserve Account. (Per General Bond Resolution).

Q2h. Describe the type of nature of the capital projects that are funded via IRR.

A2h. Witness: Bragg. The capital items mostly funded by IRR Account are Computer Equipment, Vehicles, Lab and Plant Equipment, Furniture, and small mainline projects. Often the mainline replacements or movement of mainlines funded from this source is requested by Department of Highways. Smaller size mainline replacements not requiring large amount of funding, and Cleaning and Relining of older mains.

Q2i. Does NKWD use the IRR to fund any operation of maintenance expense projects? If yes, describe the types of operation and maintenance expense projects.

- A2i. Witness: Bragg. NO. The IRR per the District Bond Resolution can only be used for capital items. (General Bond Resolution)
- Q2j. Identify what projects in the Asset Management Plan will be funded via IRR.
- A2j. Witness: Bragg. NONE
- Q2k. Are projects funded by IRR ever ultimately consumed by or covered under a BAN or BOND? If yes, please explain and provide examples.
- A2k. Witness: Bragg. NO.
- Q3. Follow-up to AG Q – A9a.
- Q3a. The original question was referring the e”2006 Independent Auditors Report” in Exhibit E and the “2006 Annual USoA Report” in Exhibit C. Please explain why the two reports cannot be reconciled if they are both drawn from the same set of accounts.
- A3a. Witness: Bragg. A schedule that details the reconciliation between the 2006 USOA Report and the 2006 Audit is included in Tab 3. The USOA is compared to the 2006 Audit and any differences are explained and the balance sheet and income statement totals match.
- Q4. Follow-up to AG Q – A10.
- Q4a. NKWD states that is uses the USOA for Class C water companies. Should it now be using the USOA for Class A water companies? Please explain.
- A4a. Witness: Bragg. Yes. The District does use USoA for Class A&B Water District. The response give to AG Q- A10 was in error.
- Q5. Follow-up to AG Q – A13.

Q5a. What types of capital replacement does the cash flow from the depreciation finance if your entire construction program is financed with debt?

A5a. Witness: Bragg. The entire amount of projects and capital items are not all funded by debt. Please refer to the response to A2h.

Q5b. Is there a linkage between depreciation and the IRR fund? If yes, please explain.

A5b. Witness: Bragg. In directly. Since depreciation expense is built into the water rates, the amount of funds left over after all O&M, Principle, and Interest is paid the remaining funds are used for capital projects and purchases.

Q6. Follow-up to AG Q – A16.

Q6a. What alternatives does NKWD currently use in lieu of “No-Dig” alternatives?

A6a. Witness: Harrison. Witness: Harrison NKWD utilizes open trench main replacement in lieu of “No-Dig” alternatives.

Q6b. What are the relative economics of “No-Dig” alternatives to whatever NKWD is using in lieu of “No-Dig”? Provide support for this.

A6b. Witness: Harrison. Witness: Harrison. Cleaning and Lining is initially cheaper than open trench excavation. However, only mains that are structurally sound are good candidates for this method. Many of the older cast iron mains are subject to breakage that makes it questionable to invest about 50 percent of the replacement cost into cleaning and lining. Additionally, the District is not sure how to fund this effort since the Kentucky Public Service Commission has ruled that this process should be capitalized as an asset instead of expensed and may be difficult to secure bond funds for a process that is typically considered to be an expense.

The District has utilized directional drilling on a limited basis to minimize particularly challenging restoration requirements. This cost between \$200 and \$250 per foot on the couple of projects we utilized this method as compared to an estimated average cost \$175 per foot for open trench replacement. Another challenge with utilizing directional drilling is that it is very difficult to complete in urban areas with numerous underground conflicts such as natural gas, electric, sanitation, storm sewer facilities and other potential conflicts. A clear, well defined corridor is necessary to effectively utilize directional drilling as a no-dig alternative to open trench main replacement. The District works very hard to coordinate its main replacement work with Cities, Counties and the State of Kentucky to minimize restoration costs when possible.

Q6c. Are there any alternative funding sources available for “No-Dig” or other rehabilitation activities? If yes, what are these sources and how could NKWD obtain them.

A6c. Witness: Harrison. The alternative funding sources are the same for No- Dig activities as with open trench main replacement. The District was successful in securing \$3,500,000 in Kentucky Infrastructure Authority funding for main replacement through the 2006 Kentucky General Assembly in Covington and will continue to pursue these types of opportunities.

Q6d. Could the IRR or a similar reserve be used to fund replacement? If no, why not? If yes, provide a description of how NKWD would estimate the annual amount necessary for this approach.

A6d. Witness: Harrison. The District would strongly prefer to utilize the IRR for main replacement funding as opposed to having to borrow funds at a significantly higher overall cost considering interest and coverage costs. However, the current level of IRR for water main replacement is approximately \$1.25 million based upon Fiscal Year 2006. The estimated replacement cost for the District's over 1,100 miles of water main is estimated to be over \$800 million based upon estimates prepared earlier this year. The current District depreciation period for water mains is 99 years. This generates an estimated, minimum annual amount necessary to utilize the IRR as the funding mechanism for main replacement of approximately \$8 million.

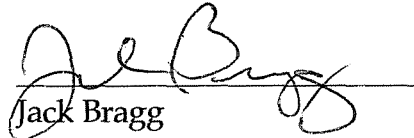
This amount does not take into consideration that the District has taken over numerous systems with infrastructure that has already reached or is nearing its useful life and the District's current depreciation study that seems to indicate a useful life of 99 years may not be appropriate and should be somewhat shorter. Given these factors, the annual level of funding needed for water main replacement could readily exceed \$10 million. This creates a funding gap of approximately \$8 million annually based upon current levels of funding. This is why the District has to utilize bond funding for main replacement as its major source of financing.

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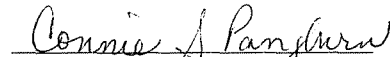
COMMONWEALTH OF KENTUCKY

COUNTY OF KENTON

Affiant, Jack Bragg, appearing personally before me a notary public for and of the Commonwealth of Kentucky and after being first sworn, deposes, states, acknowledges, affirms and declares that he is Vice President - Finance, that he is authorized to submit this Response on behalf of Northern Kentucky Water District, and that the information contained in the Response is true and accurate to the best of his knowledge, information and belief, after a reasonable inquiry, and as to those matters that are based on information provided to him, he believes to be true and correct.


Jack Bragg

This instrument was produced, signed, acknowledged and declared by Jack Bragg to be his act and deed the 27th day of August, 2007.


Notary Public

My Commission expires: May 26, 2009

Attorney General's Supplemental Request for Information to Northern Kentucky Water District Case 2007-00135
Response to Question 3a.

	Annual Report Acct. No.	PSC Annual Report Exhibit C	Audit 12/31/2006 Exhibit E	Difference	Audit Report Description	Explanation
Balance Sheet						
PSC Annual Report Descr.						
Cash	131	\$5,326,214	\$5,326,214	\$0	Cash/Cash Equiv.	
Special Deposits	132	\$13,149,342	\$13,149,342	\$0	Bond Proc. Fund	
A/R Less Accum. Prov.	141-144	\$4,170,658	\$4,170,658	\$0	A/R Customer	
Materials & Supplies	151-153	\$1,245,380	\$1,245,380	\$0	Inv. Supplies for New Install. & Maint. At Cost	
Prepayments	162	\$464,883	\$464,883	\$0	Prepaid Items	
Accrued Utility Revenues	173	\$4,200,000	\$4,200,000	\$0	Unbilled Customers	
Misc. Current & Accr. Assets	174	\$138,527	\$138,527	\$0	A/R Others	Combine these two \$65,519+\$73,008 from audit
Unamortized Debt Discount	181	\$3,135,928	\$0	\$3,135,928	A/R Assessments	Included in Misc. deferred charges in audit
Misc. Deferred Debits	186	\$7,203,743	\$10,339,671	(\$3,135,928)	Misc. Deferred Chg..	Difference is 181 breakout in PSC report
Utility Plant	101-106	\$284,190,587	\$289,706,723	(\$5,516,136)	Total Capital Assets	
Accumulated Depreciation	108-110	(\$56,796,806)	(\$58,245,471)	\$1,448,665	Accum. Depr.	Accum. Acquisition Amort. Included in audit number
Utility Acquisition Adjustments	114-115	\$4,067,471	\$0	\$4,067,471	None	Included in Capital Assets in audit report
Utility Investment	124	\$22,803,162	\$22,803,162	\$0	Debt Service Res. Debt Service Acct.	Combine \$13,157,181+\$7,713,194+\$1,932,787
Other Investments	125	\$3,023,965	\$3,023,965	\$0	Boone Florence Settlement	
Totals		\$296,323,054	\$296,323,054	\$0		

Attorney General's Supplemental Request for Information to Northern Kentucky Water District Case 2007-00135						
Response to Question 3a.						
	Annual Report Acct. No.	PSC Annual Report Exhibit C	Audit 12/31/2006 Exhibit E	Difference	Audit Report Description	Explanation
Balance Sheet						
PSC Annual Report Descr.						
Appropriated Retained Earnings	214	\$28,239,310	\$35,269,670	(\$7,030,360)	Restrict. Net of debt	These items are classified differently in each of
R/E from Income Before Contrib.	215.1	\$38,975,466	\$22,822,788	\$16,152,678	Unrestricted	the reports in the Equity Capital/Net Assets between the
Donated Capital	215.2	\$46,968,934	\$56,091,252	(\$9,122,318)	Invest Capital Assets	reports but the total is \$114,183,710
Bonds	221	\$173,145,000	\$173,145,000	\$0	Bond Indebtedness Bond Indebtedness	Current portion Current Liabilities section \$5,017,000 Long Term \$168,128,000
Other Long Term Debt	224	\$2,125,000	\$1,975,000	\$150,000	Notes Payable	Difference \$100,000 to CC Fiscal Court & Taylor Mill See 232 Below
Accounts Payable	231	\$1,977,170	\$3,637,370	(\$1,660,200)		
Notes Payable	232	\$100,000	\$250,000	(\$150,000)	Notes Payable	In current liabilities section audit audit Taylor Mill Pymnt See 224 above
Customer Deposits	235	\$4,051	\$0	\$4,051		Classified in A/P in audit
Accrued Interest	237	\$2,944,301	\$2,944,301	\$0	Acc. Interest Pay.	
Misc. Current & Accrued Liab.	242	\$1,789,801	\$187,673	\$1,602,128	Other Acc. Liab.	Remainder classified in A/P of audit report
Unamortized Premium Debt	251	\$54,021	\$0	\$54,021		Classified in A/P in audit
Totals		\$296,323,054	\$296,323,054	\$0		

Attorney General's Supplemental Request for Information to Northern Kentucky Water District Case 2007-00135

Response to Question 3a.	Annual Report Acct. No.	PSC Annual Report Exhibit C	Audit 12/31/2006 Exhibit E	Difference	Audit Report Description	Explanation
Income Statement						
PSC Annual Report Descr.						
Operating Revenues	400	\$34,120,264	\$34,120,264	\$0	Total Operating Revenues	
Operating Expenses	401	\$20,284,389	\$20,831,914	(\$547,525)	O&M Expense	Includes taxes other
Depreciation Expense	403	\$5,613,452	\$5,814,572	(\$201,120)	Depr. Expense	Difference Acquisition Adjustment included in audit
Amort. Utility Acq. Cost	406	\$201,120	\$0	\$201,120	None	See previous line item
Amortization Expense	407	\$378,962	\$0	\$378,962	None	See Amortization Audit report below
Taxes Other than Income	408.1	\$547,525	\$0	\$547,525	None	See O&M expenses
Gains (Losses) from Disposition	414	(\$528,022)	\$0	(\$528,022)	None	Included in Non Utility Income
Interest & Dividend Income	419	\$2,227,971	\$2,227,971	\$0	Investment Income	
Non Utility Income	421	\$159,198	(\$368,821)	\$528,019		Includes Gains/Losses Disposition
Interest Expense	427	\$6,404,374	\$6,404,374	\$0	Other Acc. Liab.	Remainder classified in A/P of audit report
Amortization Debt Discount	428	\$211,308	\$585,345	(\$374,037)	Amort. Debt Disc. & Expense	All amortizations netted
Amortization of Premium	429	\$4,928	\$0	\$4,928	None	Included in Amortization
Totals		\$2,343,209	\$2,343,209	\$0		