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Report of Independent Accountants

To the Board of Directors and Stockholders
Kentucky-American Water Company

In our opinion, the accompanying balance sheets and the related statements of income, of capitalization, of retained earnings and stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Kentucky-American Water Company (a wholly-owned subsidiary of American Water Works Company, Inc.) at December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 6, 2003

KENTUCKY-AMERICAN WATER COMPANY
Balance Sheet
(Dollars in thousands)

	December 31, 2002	December 31, 2001
Assets		
Property, plant and equipment		
Utility plant - at original cost less accumulated depreciation	$ 206,484	$ 200,792
Utility plant acquisition adjustments, net	450	359
	206,934	201,151
Non utility property	250	250
Current assets		
Cash	699	1,453
Customer accounts receivable	1,799	1,568
Allowance for uncollectible accounts	(67)	(58)
Unbilled revenues	2,118	2,137
Accounts receivable - associated companies	200	72
Materials and supplies	465	361
Deferred vacation pay	320	252
Other	640	215
	6,174	6,000
Regulatory and other long-term assets		
Deferred business service project expense	1,455	1,360
Regulatory asset-income taxes recoverable through rates	4,697	4,523
Debt and preferred stock expense	786	871
Deferred programmed maintenance	2,741	3,193
Preliminary survey and investigation	150	430
Other	8,305	5,802
	18,134	16,179
	$ 231,492	$ 223,580
Capitalization and Liabilities		
Capitalization		
Common stock	$ 36,569	$ 36,569
Paid-in capital	21	21
Retained earnings	25,178	24,407
Total common stockholder's equity	61,768	60,997
Preferred stock		
With mandatory redemption requirements	5,340	5,380
Without mandatory redemption requirements	1,570	1,570
Long-term debt	68,500	44,500
Total capitalization	137,178	112,447
Current liabilities		
Notes payable - associated companies	14,649	24,668
Current portion of long-term debt	-	13,000
Accounts payable	421	998
Accounts payable - associated companies	102	27
Taxes accrued	89	250
Interest accrued	1,457	853
Tax collections payable	315	215
Accrued vacation pay	320	252
Other	1,388	2,035
	18,741	42,298
Regulatory and other long-term liabilities		
Customer advances for construction	11,047	9,365
Deferred income taxes	31,233	28,174
Deferred investment tax credits	1,642	1,726
Accrued pension expense	1,675	1,362
Accrued postretirement benefits expense	299	299
Other	540	392
	46,436	41,318
Contributions in aid of construction	29,137	27,517
Commitments and contingencies	-	-
	$ 231,492	$ 223,580

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

KENTUCKY-AMERICAN WATER COMPANY
Statement of Income
(Dollars in thousands)

	Years Ended December 31, 2002	2001
Operating revenues	$ 43,627	$ 41,478
Operating expenses		
Operation and maintenance	20,046	17,800
Depreciation and amortization	6,373	5,981
General taxes	2,201	1,831
	28,620	25,612
Utility operating income	15,007	15,866
Other income (deductions)		
Allowance for other funds used during construction	441	300
Miscellaneous other income	9	785
Miscellaneous other deductions	(557)	-
Income before interest charges and income taxes	14,900	16,951
Interest charges		
Interest on long-term debt	4,691	4,767
Interest on bank debt	252	486
Amortization of debt expense	87	79
Other interest	14	55
Allowance for borrowed funds used during construction	(211)	(149)
Income before income taxes	10,067	11,713
Provision for income taxes		
Federal income taxes	3,186	3,711
State income taxes	859	992
Net income	6,022	7,010
Dividends on preferred stock	534	537
Net income to common stock	$ 5,488	$ 6,473

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

KENTUCKY-AMERICAN WATER COMPANY
Statement of Cash Flows
(Dollars in thousands)

	Years Ended December 31, 2002	2001
Cash flows from operating activities		
Net income	$ 6,022	$ 7,010
Adjustments:		
Depreciation and amortization	6,373	5,981
Amortization, other	1,840	1,031
Provision for deferred income taxes	3,038	899
Amortization of deferred investment tax credits	(85)	(85)
Provision for losses on accounts receivable	258	200
Allowance for other funds used during construction	(441)	(300)
Pension expense in excess of funding	313	385
Deferred regulatory assets	(95)	(1,212)
Other, net	(2,165)	(3,071)
Changes in current assets and liabilities:		
Accounts receivable	(608)	2
Unbilled revenues	19	(52)
Materials and supplies	(104)	70
Other current assets	(493)	167
Accounts payable	(502)	(795)
Taxes accrued	(161)	69
Interest accrued	604	165
Other current liabilities	(479)	1,352
Net cash provided by operating activities	13,334	11,816
Cash flows from investing activities		
Construction expenditures	(13,904)	(13,794)
Allowance for other funds used during construction	441	300
Cost of removal, net of salvage	(400)	289
Payment for acquisition of public service district assets	-	(1,686)
Net cash used in investing activities	(13,863)	(14,891)
Cash flows from financing activities		
Proceeds from long-term debt issuance	24,000	15,500
Net borrowings (repayments) under line-of-credit agreement	(10,019)	3,837
Repayment of long-term debt	(13,000)	(13,000)
Customer advances and contributions, net of refunds	4,088	2,878
Redemption of preferred stock	(40)	(40)
Dividends paid	(5,251)	(5,333)
Debt issuance cost	(3)	(117)
Net cash provided by financing activities	(225)	3,725
Net increase (decrease) in cash and cash equivalents	(754)	650
Cash and cash equivalents at beginning of year	1,453	803
Cash and cash equivalents at end of year	$ 699	$ 1,453
Cash paid during the year for:		
Interest, net of capitalized amount	$ 4,353	$ 5,144
Income taxes	$ 1,217	$ 3,240

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

KENTUCKY-AMERICAN WATER COMPANY
Statement of Capitalization
(Dollars in thousands, except per share amounts)

	Call Price Per Share	December 31, 2002	2001
Common stockholder's equity			
Common stock - no par value, authorized 2,000,000 shares, issued and outstanding 1,567,391 shares in 2002 and 2001		$ 36,569	$ 36,569
Paid in capital		21	21
Retained earnings		25,178	24,407
		61,768	60,997
Preferred stocks - $100 par value, authorized 25,000 shares			
Without mandatory redemption requirements			
Cumulative preferred stock			
5.75% series, 4,700 shares issued and outstanding	$ 101.00	470	470
5.5% series, 5,000 shares issued and outstanding	$ 100.50	500	500
5.% series, 6,000 shares issued and outstanding	$ 101.00	600	600
		1,570	1,570
With mandatory redemption requirements			
Cumulative preferred stock			
7.9% series, 8,400 and 8,800 shares issued and outstanding in 2002 and 2001, respectively	$ 100.00	840	880
8.47% series, 45,000 shares issued and outstanding	$ 100.00	4,500	4,500
		5,340	5,380
Long-term debt			
General mortgage bonds			
7.21% series due 2002		-	13,000
6.79% series due 2005		5,500	5,500
6.96% series due 2023		7,000	7,000
7.15% series due 2027		7,500	7,500
6.99% series due 2028		9,000	9,000
Notes payable to affiliate			
5.65% series due 2007		24,000	-
6.87% series due 2011		15,500	15,500
		68,500	57,500
Less: Current portion of long-term debt		-	13,000
Long-term debt net of current maturities		68,500	44,500
Total capitalization		$ 137,178	$ 112,447

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

KENTUCKY-AMERICAN WATER COMPANY
Statement of Retained Earnings and Stockholders' Equity
(Dollars in thousands, except per share amounts)

	Common Stock		Paid-in	Retained	Stockholders'
	Shares	Par Value	Capital	Earnings	Equity
Balance at December 31, 2000	1,567,391	$ 36,569	$ 21	$ 22,730	$ 59,320
Net income	-	-	-	7,010	7,010
Dividends					
Preferred stock	-	-	-	(537)	(537)
Common stock, $2.60 per share	-	-	-	(4,796)	(4,796)
Balance at December 31, 2001	1,567,391	36,569	21	24,407	60,997
Net income	-	-	-	6,022	6,022
Dividends					
Preferred stock	-	-	-	(534)	(534)
Common stock, $3.06 per share	-	-	-	(4,717)	(4,717)
Balance at December 31, 2002	1,567,391	$ 36,569	$ 21	$ 25,178	$ 61,768

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

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2002 and 2001
(Dollars in thousands)

Note 1 - Organization and Operation

Kentucky-American Water Company (the Company) provides water service to approximately 105,000 customers and wastewater service to approximately 84 customers. These services are provided in 10 communities located in 10 counties in the state of Kentucky. As a public utility operating in Kentucky, the Company functions under rules and regulations prescribed by the Public Service Commission of the Commonwealth of Kentucky (the Commission). The Company is a wholly-owned subsidiary of American Water Works Company, Inc. (American).

Note 2 - Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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 these estimates.

Regulation

The Company has incurred various costs and received various credits, which have been reflected as regulatory assets and liabilities on its balance sheet. Accounting for such costs and credits as regulatory assets and liabilities is in accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71). This statement sets forth the application of generally accepted accounting principles for those companies whose rates are established by or are subject to approval by an independent third-party regulator. Under SFAS No. 71, regulated companies defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be recognized in the rate-making process in a period different from the period in which they would have been reflected in income by an unregulated company. These deferred regulatory assets and liabilities are then reflected in the income statement in the period in which the same amounts are reflected in the rates charged for service.

Note 2 (continued)

Property, Plant and Equipment

Additions to utility plant and replacements of retirement units of property are capitalized. Costs include material, direct labor and such indirect items as engineering and supervision, payroll taxes and benefits, transportation and an allowance for funds used during construction. The costs incurred to acquire and internally develop computer software for internal use are capitalized as a unit of property. Repairs, maintenance and minor replacements of property are charged to current operations. The cost of property units retired in the ordinary course of business plus removal cost (net of salvage) is charged to accumulated depreciation. The cost of property, plant and equipment is depreciated using the straight-line method. The depreciation rates, based on the average balance of depreciable property, were 2.63 % in 2002 and 2.69% in 2001.

In accordance with the Commission's regulations, depreciation on contributed facilities is charged to contributions in aid of construction. Such depreciation amounted to $784 in 2002 and $642 in 2001.

Cash and Cash Equivalents

Substantially all of the Company's cash is invested in interest bearing accounts. The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. There were no cash equivalents held at December 31, 2002 or 2001.

Materials and Supplies

Materials and supplies are stated at average cost.

Regulatory and Long-Term Assets

Deferred business services project expenses consist of reengineering and start-up activities for consolidated customer and shared administrative service centers that are being established by American. These costs are being deferred as it is expected that these costs will be recovered in the rates charged for utility service in the future.

The Company has deferred $1,703 related to the cost of increased security measures that were implemented to secure facilities after the terrorist attacks on September 11, 2001. These costs are being deferred as it is expected that these costs will be recovered in the rates charged for utility service in the future.

The Company has recorded a regulatory asset for the additional revenues expected to be realized as the tax effects of temporary differences previously flowed through to customers reverse. These temporary differences are primarily related to the difference between book and

Note 2 (continued)

tax depreciation on property placed in service before the adoption by the Commission of full normalization for rate-making purposes.

The regulatory asset for income taxes recoverable through rates is net of the reduction expected in future revenues as deferred taxes previously provided, attributable to the difference between the state and federal income tax rates under prior law and the current statutory rates, reverse over the average remaining service lives of the related assets.

Debt expense is amortized over the lives of the respective issues. Call premiums on the redemption of long-term debt, as well as unamortized debt expense, are deferred and amortized to the extent they will be recovered through future service rates. Expenses of preferred stock issues without sinking fund provisions are amortized over 30 years from the date of issue; expenses of issues with sinking fund provisions are charged to operations as shares are retired.

Preliminary survey and investigation charges generally relate to future construction projects. Management believes these costs will ultimately be recovered through rates.

Programmed maintenance costs are deferred and amortized to current operations on a straight-line basis over a period ranging between five and fifteen years, as authorized by the Commission in their determination of rates charged for service.

Other Current Liabilities

Other current liabilities at December 31, 2002 and 2001 include payables of $600 and $929, respectively, which represent checks issued but not presented to the bank for payment.

Advances and Contributions in Aid of Construction

The Company may receive advances and contributions to fund construction necessary to extend service to new areas. As determined by the Commission, advances for construction are refundable for limited periods of time as new customers begin to receive service. Amounts which are no longer refundable are reclassified to contributions in aid of construction.

Utility plant funded by advances and contributions is excluded from rate base and is not depreciated for rate-making purposes. Generally, advances and contributions received during the period of January 1, 1987 through June 12, 1996 have been included in taxable income and the related property is depreciable for tax purposes. As a result of a tax law change, advances and contributions received subsequent to June 12, 1996 are excluded from taxable income and the related property is not depreciable for tax purposes.

Note 2 (continued)

On January 11, 2001 the Internal Revenue Service issued regulations that excluded lateral service lines from its definition of contributions in aid of construction that are not included in taxable income. These customer connection fees are defined as the cost of installing a connection or service line from the Company's main lines to the lines owned by the customer. The regulations were effective immediately, but the Company does not have customer connection fees.

Recognition of Revenues

Water service revenues for financial reporting purposes include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the latest meter reading to the end of the accounting period.

Income Taxes

The Company, its parent and affiliates participate in a consolidated federal income tax return. Federal income tax expense for financial reporting purposes is provided on a separate return basis, except that the federal income tax rate applicable to the consolidated group is applied to separate company taxable income and the benefit of net operating losses, if any, is recognized currently.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. Deferred income taxes have been provided on the difference between the tax bases of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates anticipated to be in effect when such temporary differences are expected to reverse. Regulatory assets and liabilities are recognized for the effect on revenues expected to be realized as the tax effects of temporary differences previously flowed through to customers reverse.

Investment tax credits have been deferred and are being amortized to income over the average estimated service lives of the related assets.

Allowance for Funds Used During Construction (AFUDC)

AFUDC is a non-cash adjustment to income with a corresponding charge to utility plant, which represents the cost of borrowed funds and a return on equity funds devoted to plant under construction. AFUDC is recorded to the extent permitted by the Commission.

(Dollars in thousands)

Note 2 (continued)

Environmental Costs

Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. There were no remediation costs accrued at December 31, 2002 and 2001.

Asset Impairment

Long-lived assets and certain identifiable intangible assets held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets, on a separate entity basis, may not be recoverable. If the sum of the future cash flows expected to result from the use of the assets and their eventual disposition is less than the carrying amount of the assets, an impairment loss is recognized. Measurement of an impairment loss would be based on the fair value of the assets. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

Reclassifications

Certain reclassifications have been made to conform previously reported data to the current presentation.

Note 3 - Utility Plant

The components of utility plant at December 31 are as follows:

	2002	2001
Water plant		
Sources of supply	$ 7,344	$ 6,926
Treatment and pumping	45,561	45,017
Transmission and distribution	133,231	125,485
Services, meters, and fire hydrants	50,763	47,024
General structures and equipment	16,605	16,167
Construction work in progress	7,223	8,954
	260,727	249,573
Less - accumulated depreciation	(54,243)	(48,781)
	$206,484	$200,792

Note 3 (continued)

Depreciation expense amounted to $5,620 in 2002 and $5,374 in 2001.

Note 4 - Preferred Stocks

Preferred stock agreements have annual minimum sinking fund payments of $40 in 2003 through 2007. The 7.9% series sinking fund payment of $40 is at the option of the Company.

Note 5 - Long-Term Debt

Maturities of long-term debt will amount to $0 in 2003 and 2004, $5,500 in 2005, $0 in 2006 and $24,000 in 2007.

The general mortgage bond indentures, as supplemented, contain clauses restricting the declaration of common stock dividends and other distributions on capital stock if common stockholder's equity falls below a specified amount. There were no restrictions at December 31, 2002.

The general mortgage bonds are issuable in series. No bonds senior to the general mortgage bonds may be issued so long as the general mortgage bonds are outstanding. The amount of bonds authorized is unlimited as long as long-term debt does not exceed 65% of capitalization. Long-term debt is secured by utility plant.

The senior notes are unsecured and were issued to American Water Capital Corp. (AWCC) for the principal amount. AWCC provided the funding for this note by itself issuing senior notes to institutional investors at a price equal to the principal amount.

Note 6 - Affiliate Borrowings

During 2002, the Company maintained a line of credit through AWCC, an affiliate (see Note 12). AWCC has a 364-day $500 million revolving credit agreement with a group of 11 domestic and international banks. No compensating balances are required under the agreement. AWCC also issues commercial paper, and the revolving credit agreement also supports these borrowings.

At December 31, 2002 and 2001, there were $14,649 and $24,668 of short-term borrowings outstanding, respectively. The weighted average annual interest rate on these

(Dollars in thousands)

Note 6 (continued)

borrowings was 2.27% and 5.60% respectively. The unused line of credit at December 31, 2002 was $7,851.

Note 7 - General Taxes

Components of general tax expense for the years presented in the statement of income are as follows:

	2002	2001
Gross receipts and franchise	$ 75	$ 74
Property and capital stock	1,685	1,313
Payroll	441	444
	$2,201	$1,831

Note 8 - Income Taxes

Components of income tax expense for the years presented in the statement of income are as follows:

	2002	2001
State income taxes:		
Current	$ 407	$ 782
Deferred		
Non-current	452	210
	$ 859	$ 992
Federal income taxes:		
Current	$ 685	$3,107
Deferred		
Non-current	2,586	689
Amortization of deferred investment tax credits	(85)	(85)
	$3,186	$3,711

(Dollars in thousands)

Note 8 (continued)

A reconciliation of income tax expense at the statutory federal income tax rate to the actual income tax expense is as follows:

	2002	2001
Income tax at statutory rate of 35%	$3,523	$4,100
Increases (decreases) resulting from -		
State taxes, net of federal income taxes	558	645
Flow through differences	10	72
Amortization of investment tax credits	(85)	(85)
Other, net	39	(29)
Actual income tax expense	$4,045	$4,703

The following table provides the components of the net deferred tax liability at December 31:

	2002	2001
Deferred tax assets:		
Advances and contributions	$ 4,038	$ 3,927
Deferred investment credits	662	731
Deferred OPEB	121	121
Other - Pension	676	550
Other	1,111	2,164
	6,608	7,493
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	31,571	29,342
Utility plant acquisition adustments	182	145
Income taxes recoverable through rates	1,031	1,013
Deferred security costs	687	120
Deferred financial and customer service costs	222	184
Other	4,148	4,863
	37,841	35,667
Net deferred tax liability	$ 31,233	$28,174

No valuation allowances were required on deferred tax assets at December 31, 2002 and 2001, as management believes it is more likely than not that these assets will be realized.

(Dollars in thousands)

Note 9 - Rate Matters

As necessary, the Company applies to the Commission for changes in the rates charged for service. The rate increase request is based on the level of operating expenses and capital costs that are expected to be in effect when the rates become effective. The revenues requested are based on forecasted sales, operating expenses and investments for the test year selected by the Company.

The Company has received approval from the Commission to increase its rates for service as follows:

Effective Dates	Requested Annual Effect on Revenues	Estimated Annual Effect on Revenues Granted	Estimated Revenue Realized in 2001
05/09/01	$4,685	$2,568	$2,368

On April 28, 2000, the Company filed a rate application with the Commission, requesting $5.034 million in additional annual revenues that was subsequently revised to $4.685 million or 11.69%.

On December 12, 2000, the Commission issued an Order adjusting its original Order dated November 27, 2000. The adjusted order corrected errors in the initial ruling and reduced the allowed revenue increase from $2.518 million to $2.171 million to be effective for service rendered on and after November 27, 2000.

On May 9, 2001, a final decision was issued which addressed appeals from reconsideration made by the Company and the State Attorney General. The final decision adjusted the authorized revenue increase from $2.171 to $2.568 million or 6.42% of total operating revenues.

Note 10 - Employee Benefit Plans

Employees' Stock Ownership Plan

The Company participates in an Employees' Stock Ownership Plan sponsored by American, which provides for beneficial ownership of American common stock by all associates who are not included in a bargaining unit. Each participating associate can elect to contribute an amount that does not exceed 2% of their wages. In addition to the associate's participation, the Company makes a contribution equivalent to ½% of each participant's qualified compensation,

Note 10 (continued)

and matches 100% of the contribution by each participant. The Company expensed contributions of $59 for 2002 and $62 for 2001 that it made to the plan. See Note 16 regarding the sale of American's common stock.

Savings Plan for Employees

The Company participates in a 401(k) Savings Plan for Employees sponsored by American. All Associates can make contributions that are invested at their direction in one or more funds including a fund consisting entirely of American common stock. The Company matches 50% of the first 4% of each associate's wages contributed to the plan. The Company expensed matching contributions to the plan totaling $93 for 2002 and $85 for 2001. All of the Company's matching contributions are invested in the fund of American common stock. See Note 16 regarding the sale of American's common stock.

Note 11 - Postretirement Benefits

Pension Benefits

The Company participates in a noncontributory defined benefit pension plan sponsored by American covering substantially all associates. Benefits under the plan are based on the associate's years of service and average annual compensation for those 60 consecutive months of employment, which yield the highest average. Pension cost of the Company is based on an allocation from American of the total cost related to the plan. Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level. The Company's funding policy is to contribute at least the minimum amount required under the Employee Retirement Income Security Act of 1974. The Company made contributions to the plan of $216 in 2002 and no contributions in 2001.

Postretirement Benefits Other Than Pensions

The Company participates in an American plan that provides certain life insurance benefits for retired associates and certain health care benefits for retired associates and their dependents. Substantially all associates may become eligible for these benefits if they reach retirement age while still working for the Company. Retirees and their dependents under age 65 are covered by a point-of-service managed care plan that requires co-payments or an HMO. Associates who elect to retire prior to attaining age 65 are generally required to make contributions towards their medical coverage until attaining age 65. Retirees and their dependents age 65 and over are covered by a Medicare supplement plan. Costs of the Company are based on an allocation from American of the total cost related to the plan.

(Dollars in thousands)

Note 11 (continued)

Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level. The Company made contributions to trust funds established for these postretirement benefits of $560 in 2002 and $561 in 2001. The Company's policy is to fund postretirement benefits costs accrued.

Note 12 - Related Party Transactions

American Water Works Service Company, Inc. (AWWS), an affiliate, provides certain management services to the Company (administration, accounting, data processing, engineering, etc.) and other operating water companies in the American Water Works System on an at-cost, not-for-profit basis in accordance with a management and service agreement. Purchases of such services by the Company were accounted for as follows:

	2002	2001
Included in operation and maintenance expense as a charge against income	$2,532	$1,535
Capitalized in various balance sheet accounts	654	765
	$3,186	$2,300

The Company provided workspace and information system support for associates of the Southeast Region of AWWS. Charges for direct costs and indirect overhead costs associated with these associates are billed to AWWS on an at-cost, not for profit basis, which amounted to $15 in 2002 and $43 in 2001. At December 31, 2002, there was no outstanding receivable from this affiliate for these services.

Some of the Company's associates have performed services at cost to AWWS relating to the establishment by American of consolidated customer and shared administrative service centers. The total amount of these services was $148 in 2002 and $217 in 2001. At December 31, 2002, net amounts receivable from this affiliate for these services were $47.

The Company has three operating agreements with American Water Services, Inc. (AWS), an affiliate, for the lease of granular activated carbon at one of the Company's water treatment plants. The agreements provide for AWS to regenerate the spent material and return it to the water treatment plant where it originated. Under the terms of the agreements, AWS will provide carbon for a period of thirty-six months beginning in each of March 1999, 2000, and

(Dollars in thousands)

Note 12 (continued)

2001. The carbon is scheduled for replacement at thirty-six month intervals and is warranted to perform to specific standards during that period. The Company paid $87 in 2002 and $82 in 2001 to AWS under these agreements.

The Company maintains a line of credit through AWCC, an affiliate. The company paid AWCC fees of $61 in 2002 and $47 in 2001, preliminary costs of long-term financings of $3 in 2002 and $117 in 2001 and interest on borrowings of $252 in 2002 and $486 in 2001.

Note 13 - Fair Values of Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Current assets and current liabilities: The carrying amount reported in the balance sheet for current assets and current liabilities approximates their fair value.

Preferred stocks with mandatory redemption requirements and long-term debt: The fair values of the Company's preferred stocks with mandatory redemption requirements and long-term debt are estimated using discounted cash flow analyses based on the Company's current incremental financing rates for similar types of securities.

The carrying amounts and fair values of the Company's financial instruments at December 31 are as follows:

	2002		2001	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Preferred stock with mandatory redemption requirements	$ 5,340	$ 5,287	$ 5,380	$ 5,805
Long-term debt, including current maturities	68,500	69,256	57,500	55,961

Note 14 - Operating Leases

The Company has entered into operating leases involving certain facilities and equipment. Rental expenses under operating leases were $176 in 2002 and $134 in 2001. The operating leases for their equipment expire over the next six years.

Note 14 (continued)

At December 31, 2002, the minimum annual future rental commitments under operating leases that have initial or remaining non-cancellable lease terms in excess of one year are $120 in 2004, $81 in 2005, $38 in 2006 and $22 in 2007.

Note 15 - Commitments and Contingencies

The Company's construction program for 2003 is estimated to cost approximately $13,123. Commitments have been made in connection with certain projects included in this program.

In connection with the merger of American with RWE Aktiengesellschaft (RWE, see Note 16), the Company is subject to an order from the Commission that requires that no rate filings will be submitted until March 2004.

The Company is routinely involved in legal actions. In the opinion of management, none of these matters will have a material adverse effect, if any, on the financial position or results of operations of the Company.

Note 16 - Subsequent Event - Merger with RWE Aktiengesellschaft

On September 16, 2001, American entered into an Agreement and Plan of Merger (the Agreement) with RWE and Thames Water Aqua Holdings GmbH (Thames), which is RWE's holding company for its global water business, to merge with a subsidiary of RWE and become a wholly owned indirect subsidiary of RWE. The transaction was approved at a special meeting of the stockholders of American on January 17, 2002. On January 10, 2003, Apollo Acquisition Company, a Delaware corporation, merged (the Merger) with and into American, pursuant to the Agreement, with American surviving the Merger. Pursuant to the Agreement, each issued and outstanding share of common stock, par value $1.25 per share, of American has been canceled and converted into the right to receive $46.00 in cash without interest, plus a stub period dividend of $0.2153333 per share. As a result of the Merger, American became a wholly owned subsidiary of Thames Water Aqua US Holdings, Inc., a wholly owned subsidiary of Thames.