

**KENTUCKY-AMERICAN WATER COMPANY  
CASE NO. 2004-00103  
FORECASTED TEST PERIOD FILING REQUIREMENTS  
EXHIBIT NO. 31**

**Description of Filing Requirement:**

Monthly Budget Variance Reports for 12 Months Pre-Base Period and as available, for Base Period and Subsequent Months

**Response:**

Please see attached

For the electronic version, refer to the following files:

KAW\_APP\_EX31\_2002\_043004.pdf  
KAW\_APP\_EX31\_2003\_043004.pdf  
KAW\_APP\_EX31\_2004\_043004.pdf

# Operating Unit Managing Director Report



Report Status: Final +3  
Year & Month: 2002 - August  
Operating Unit: Kentucky  
Business Segment: Regulated Subsidiaries

## **1. FINANCIAL PERFORMANCE SUMMARY INPUT**

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### **Financial Results**

Water revenues were over budget \$382,532 for August, due to moderate to severe drought conditions in Central Kentucky. Heavy rainfall earlier in the year providing adequate water levels in the Kentucky River coupled with improvements in permitted treatment plant output, allowed KAWC to manage demand needs and avoid water restrictions. The positive variance brings the actual revenues within 1.76% of the YTD budget. Other expenses negatively impacting the increased revenues for the month, were labor costs exceeding plan by \$34,000, fleet maintenance of \$20,000, sludge removal of \$89,000, and purchased bottled water for area hospitals during city wide boil advisory, of \$16,000.

### **Operations**

#### **Water Supply and Production Facilities to meeting demands:**

Levels of the Kentucky River have remained below average flow for several weeks, approaching 20% of the norm. Demands have fallen off slightly due to recent rains and cooler Fall weather.

During the month of August, Kentucky American saw record pumpage totals. On Monday, August 5, 2002, Kentucky American had a new all-time maximum day pumpage of 71.82 million gallons per day. Operation of the facilities was normal, and water quality was excellent. Meeting this demand without incident confirmed the temporary re-rating of the Kentucky River Station to 45.0 million gallons per day during summer months and the operational capacity of the Kentucky River Station at 48.0 mgd. There were no unusual circumstances that contributed to the max day such as main breaks or a large fire event. The previous max day was June 13, 2000 at 66.37 mgd. Kentucky American followed up this demand with a 70.23 mgd demand on August 9<sup>th</sup>. For the first 11 days of August, demands exceeded 60 mgd. Demands have remained in the upper 50s and low 60s even into early September.

### **Construction**

Total capital expenditures as of the end of August are \$8.7 million below the plan amount of \$11.7 million. This is due primarily to Item-A expenditures, which are \$1,500,000 below plan, and the delay of the Richmond Road Station Hydraulic Improvements due to

a delay in permit receipt from the Division of Water, equating to \$1 million below the planned amount to date. Kentucky American received Certificate of Convenience and Necessity from the PSC and started construction August 13 on the RRS Hydraulic Improvements but the project will now carryover into 2003. Pipeline relocations due to Highway projects will exceed the originally planned amount by year-end due to the accelerated completion of the Paris Pike widening project.

**High profile projects**

As discussed in previous correspondence, the Kentucky Public Service Commission established a proceeding in May 2001 to investigate the source of supply situation of Kentucky-American. The PSC has delayed the proceedings and has not issued a new schedule while the RWE merger case is ongoing although a procedural schedule is expected to be issued in September. The Bluegrass FLOW group has moved to intervene in the water supply case KAWC has petitioned the Commission to deny this intervention based on the belief that FLOW’s concerns were being adequately represented by the Attorney General and the Lexington-Fayette Urban County Government.

The Bluegrass Water Supply Consortium is continuing to move forward with its study after grant money, released in late May, was delayed by the EPA and KY DOW. The Consortium now hopes to have its selected consultant, O’Brien and Gere Engineers, under contract by the end of September. This study will recommend a regional solution to the water treatment capacity deficits of the region, and identify an implementation plan that will include a probable resolution of the source of supply deficit. There have been some minor protests that the Consortium has not been open to the public, and the Consortium has responded with a series of public workshops as part of the study process.

**Health and safety compliance**

During the month of August there were no accidents or claims reported to the insurance carrier.

	Current Year		Prior Year	
	Month	YTD	Month	YTD
Chargeable Vehicle	0	3	0	6
Total Lost Time	0	4	1	1
Public Liability Claims	0	18	1	11

*KRS Power Outage, Distribution Pressure Loss and System Boil Advisory*

Due to a power outage to KRS on July 31<sup>st</sup>, pressure was lost in a significant portion of our distribution system including the University of Kentucky and the heavily developed South end of the city/county. Power was restored within an hour and total pressure soon thereafter. A system wide boil advisory was issued by KAWC until results of samples collected throughout the system were clear (3:40pm August 1<sup>st</sup>). Water Quality worked closely with other KAWC associates and various state and local drinking water and health agencies, and local businesses and institutions, throughout to address concerns during the boil advisory. Telephone service was also interrupted during the first 5 hours





## Operating Unit Managing Director Report



Report Status: Final +3  
Year & Month: 2002 - September  
Operating Unit: Kentucky  
Business Segment: Regulated Subsidiaries

### **Financial Results**

Water revenues were over budget \$295,286 in September, due to moderate to severe drought conditions in Central Kentucky during August. Heavy rainfall earlier in the year providing adequate water levels in the Kentucky River coupled with improvements in permitted treatment plant output, allowed KAWC to manage demand needs and avoid water restrictions. The positive variance brings actual revenues in line with the YTD budget.

### **Operations**

#### **Water Supply and Production Facilities to meet demands:**

Current levels of the Kentucky River are above average flow after heavy rains following two hurricanes in the Gulf of Mexico. Cooler fall water combined with the rain has caused demands to drop to normal levels.

### **Construction**

Total capital expenditures as of the end of September are \$9.7 million and below the original plan amount of \$13.2 million. This is due primarily to Item A expenditures which are \$1,600,000 below plan, and the delay of the Richmond Road Station Hydraulic Improvements by the Division of Water. Kentucky-American received Certificate of Convenience and Necessity from the PSC and started construction August 13 on the RRS Hydraulic Improvements but the project will now carryover into 2003. New services are at 1,861 and are on target for 2,350 by year-end. Additionally, pipe relocations due to Highway projects will exceed the originally planned amount by year-end due to the Paris Pike widening project being completed ahead of our schedule by the Highway Department. A revised IP has been submitted to System Engineering to accommodate increased relocations, which will be offset by the reduced RRS Hydraulic Improvements expenditures, reduced New Columbus expenditures, and an increase in contributions. Kentucky-American continues to operate at the internally generated funds level.

### **High profile projects**

As discussed in previous correspondence, the Kentucky Public Service Commission established a proceeding in May 2001 to investigate the source of supply situation of Kentucky-American. The PSC has delayed the proceedings and has not issued a new schedule while the RWE merger case is ongoing although a procedural schedule was expected to be issued in September. The Bluegrass FLOW group has moved to intervene in the case. KAWC has petitioned the Commission to deny based on the belief that their concerns were adequately represented by the

Attorney General and the Lexington-Fayette Urban County Government. A revised procedural schedule has not been issued yet.

The Bluegrass Water Supply Consortium is continuing to move forward with its study. Grant money was finally released in late May, but there seems to be some minor bureaucratic paperwork that continues to delay the start of the study. The DOW, as the grant administrator for the EPA has just this week given the Consortium approval to sign the contract with O'Brien and Gere. The study is expected to take up to nine months to complete, pushed back well into 2003. The public forum was held in Lexington on August 6<sup>th</sup> by the Consortium to begin the public input process for the study. About 200 people attended, though most were interested in the LFUCG Condemnation issue or were local consulting engineers.

The Richmond Road Station hydraulic improvements were under construction in early August after Kentucky-American received a Certificate of Convenience and Necessity application from the Public Service Commission. The regulatory approval delays have caused construction to carry over into the first quarter of 2003, but will be completed well before summer. These improvements will allow Kentucky-American to actually produce up to 30 mgd water during high demand periods, while maintaining EPA Partnership water quality goals.

**Health and safety compliance**

During the month of September there was one lost-time accident and two public liability claims that were submitted to the insurance carrier. A meter reader stepped over a rock and twisted her foot. In the process she broke two bones in her foot. Both general liability claims were related to individuals that alleged they sustained an injury as a result of an unsecured meter box.

	Current Year		Prior Year	
	Month	YTD	Month	YTD
Chargeable Vehicle	0	3	0	6
Total Lost Time	1	5	0	1
Public Liability Claims	2	18	5	10

**Business Growth**

Owenton

We continue to work closely with Mayor Wotier, water and sewer board Chairman Chuck Gill, and County Judge Executive O'Banion toward acquisition of the Owenton water and wastewater systems. Only July 1,2002, the utility board passed a resolution recommending that the City enter into direct negotiations with KAWC for acquisition of the water and wastewater systems. Negotiations are ongoing.

### Martin County

An operations and maintenance agreement with AWS with possible support from KAWC and/or WVAWC via inter-company agreement was reached and will be signed on October 2, 2002. KAWC will continue to provide support to Martin County by (1) supplying a water treatment plant operator and by (2) providing certain advisory services, both of which we are being reimbursed for by Martin County until this date. The utility board has entered into an agreement with AWS. AWS is in the process of transitioning the O&M contract effective October 1, 2002. Representatives of AWS have been on site and are working closely with KAWC in this effort.

### Bluegrass Station

The Commonwealth of Kentucky accepted bids for the O&M of Bluegrass Station Division water, wastewater and storm water systems in September. Per the RFP, they have 30 days in which to make a decision. PDR/CO2 was low bidder at \$145,000 followed by KAWC at \$172,000 and Earth Tech at \$273,000. BSD has not requested additional information or presentations. We should hear something definitive on October 30.

### City of Jackson. KY

Mayor Mike Miller, City of Jackson, sent KAWC some financial and other information some time ago. He stipulated that he did not want to discuss the issues until after the November election. He is interested in any proposals that KAWC can provide that would be of benefit to the city of Jackson. He is most interested in O&M and other service, although he did not shut the door completely to acquisition. The information provided needs to be analyzed and additional research done on the needs of Jackson before proposals can be drafted.

## **Economic Regulation**

### **Regulatory Issues**

The Kentucky Public Service Commission issued an Order on August 15, 2002 in Administrative Case 386, which clearly indicates that the Commission is looking to eliminate the requirement for developer refunds on main extensions. The Commission indicated in the Order that it is their belief that the developers actually recover the cost of the mains twice, first in the price of the home or lot, then in the refund. A number of the smaller utilities in the case expressed concern over this policy. Kentucky-American had responded to the questions posed in the Case, and participated in the hearing on September 23 to discuss changes in the regulation. Kentucky-American has maintained a position that the current system of refunds has not been an administrative burden, reflects the benefit to existing customers through growth, and each utility should develop a policy appropriate for the demographics and economics of its service area to be approved in its tariff. The Kentucky Rural Water Association expressed its position to eliminate all refunds. Representatives of developers, including the Kentucky Homebuilders Association, also presented statements. The PSC regulation now requires a refund in the amount up to the equivalent cost of fifty feet of pipe. There is no indication as to when a new regulation, if any, will be formally proposed.

A motion for modified Order was filed with the PSC to recognize the creation of TWUS as an intermediary holding in order to file consolidated US tax returns. A separate case has been

established for this filing. FLOW has been granted intervenor's status with cautionary language from the PSC that this issue of public ownership is not before the Commission. A Washington-based group, Public Citizen, moved to intervene, but was subsequently denied intervenor status. Public Citizen held a news conference in Lexington on September 17<sup>th</sup> to denounce the RWE acquisition and offer support for LFUCG ownership.

## **Regional Issues**

### **Condemnation**

To date, Kentucky-American has received approximately 10,037 responses in the form of phone calls, reply cards, letters, petitions, and e-mails. Of those responses, 9,626, or 95.9%, oppose a government takeover of Kentucky-American.

### **Conservation Education**

In compliance with a PSC Order, Kentucky-American enhanced consumer awareness of conservation with the launching of a media schedule to raise awareness of the importance of wise water use. The conservation initiatives include: airing of a 30-minute leak detection program on local affiliate stations; 30-second conservation spots featuring home repair expert Lynda Lyday; and radio spots featuring 10-second conservation tips airing during local traffic reports. To increase message frequency, Kentucky-American continues to promote conservation through the positing of outdoor boards and transit signs. Dedication to youth education remains an emphasis of the conservation awareness efforts, and in September, included activities at a local children's museum event.

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American Water Works Company  
Kentucky Total Company - 05 12  
Income Statement Month & YTD  
For the Period Ending September 30, 2002

Kentucky-American Water Co.

Description	September Actual	September Plan	September Variance	September Prior Year	Yr to Date September Actual	Yr to Date September Plan	Yr to Date September Variance	Yr to Date September Prior Year
1 OPERATING REVENUES								
2 Water	4,176,671	3,881,385	295,286	3,536,241	32,370,463	32,405,447	34,984-	30,542,909
3 Sewer	2,316	1,698	618	2,013	23,832	22,482	544	22,550
4 Other	88,937	86,653	2,284	85,209	852,691	819,483	33,168	768,029
5 Management								
6 Total Revenues	4,267,924	3,969,736	298,188	3,623,463	33,246,950	33,248,222	1,272-	31,333,488
7 OPERATIONS & MAINTENANCE EXPENSE								
8 Labor	484,372	467,306	17,066	459,483	4,487,599	4,285,447	202,152	4,257,637
9 Purchased Water	35,067	30,682	4,385	23,293	281,844	235,700	46,144	135,620
10 Fuel & Power	167,827	157,772	10,055	158,479	1,205,507	1,238,700	29,772	1,382,784
11 Chemicals	87,836	102,371	(14,535)	98,252	926,037	838,066	87,971	983,051
12 Waste Disposal	28,182	19,300	8,882	16,889	249,327	108,278	169,049	105,028
13 Management Fees	167,462	163,264	4,198	167,201	1,805,288	1,508,200	297,088	983,852
14 Group Insurance	14,322	12,920	1,402	10,398	112,331	117,668	(5,337)	999,647
15 Pensions	57,752	41,775	14,006	28,846	328,267	328,894	(627)	252,572
16 Regulatory Expense	24,077	20,790	3,287	21,888	198,690	177,110	21,580	187,295
17 Insurance Other than Group	43,153	34,639	8,514	30,138	102,221	107,110	(4,889)	258,298
18 Customer Accounting	83,960	70,305	13,655	87,166	314,451	314,451	91,880	649,710
19 Rents	3,496	7,476	(3,980)	4,193	64,278	65,043	(765)	57,165
20 General Office Expense	11,068	33,684	(22,616)	22,873	321,089	281,617	39,472	327,056
21 Miscellaneous	265,427	184,552	80,875	181,312	2,321,382	1,661,107	660,275	1,778,168
25 Other Maintenance	90,284	95,940	(5,656)	92,289	771,799	868,349	(96,550)	950,045
Total Maintenance & Operations Expense	1,632,575	1,547,077	85,498	1,461,464	15,442,000	14,210,293	1,231,707	13,313,937
27 Depreciation								
28 Amortization	476,548	467,327	9,221	461,637	4,179,029	4,126,026	53,003	3,993,515
29 General Taxes	57,580	50,477	7,103	50,477	1,584,003	1,524,338	59,665	1,455,312
30 State Income Taxes	127,639	172,180	(44,541)	160,816	1,591,718	1,374,160	217,558	1,464,569
31 Federal Income Taxes	164,646	118,062	46,584	98,329	621,216	817,160	(195,944)	707,539
32 Tax Savings Acquisition Adjustment	455,707	440,907	14,800	333,530	2,463,506	3,053,972	(590,466)	2,638,494
33 Total Operating Expenses	2,944,691	2,796,080	148,611	2,558,251	24,914,732	24,246,002	668,730	22,573,359
34 Utility Operating Income	1,323,233	1,173,656	149,577	1,065,212	8,332,218	9,002,220	(670,002)	8,760,129
35 OTHER INCOME & DEDUCTIONS								
36 Non-Operating Rental Income								
37 Dividend Income-Common								
38 Dividend Income-Preferred								
39 Interest Income	2,871		2,871	391	3,116		3,116	9,078
40 AFUDC Equity	44,019	50,355	(6,336)	22,070	295,218	304,782	(9,564)	213,739
42 M & J Miscellaneous Income	992		992	50	20,412		20,412	250,000
43 Gain(Loss)on Disposition								
45 Total Other Income	45,895	50,355	(4,460)	22,511	318,746	304,782	13,964	470,156
Miscellaneous Amortizat								
Max Savings Acquisition	64	65	(1)	64	1,304	1,304		1,304
Miscellaneous Deductions								
General Taxes	23,946	21,671	2,275	8,144	487,181	284,220	202,961	593,556
0 State Income Taxes	1,606	1,783	(177)	634	9,433	23,358	(13,925)	70,363
1 Federal Income Taxes	16,623	6,940	9,683	2,466	24,103	90,922	(66,819)	273,884
52 Total Other Deductions	42,239	13,013	29,226	5,108	454,949	171,244	283,705	248,005
53 Total Other Income	3,656	37,342	(33,686)	17,403	136,203	133,538	2,665	718,161
54 income Before Interest Charges	1,326,889	1,210,998	115,891	1,082,615	8,196,015	9,135,758	(939,743)	9,478,290
55 INTEREST CHARGES								
56 Interest on Long-Term Debt	448,679	335,681	112,998	426,246	3,422,805	3,021,117	401,688	3,578,874
57 Amortization and Debt Expense	7,201	7,171	30	6,657	67,807	67,530	277	55,699
58 Interest-Short Term Bank Debt		69,808	(69,808)	15,818	237,303	570,524	(333,221)	401,774
59 Other Interest Expense	19	4,617	(4,598)	6,690	13,188	571,244	(258,056)	42,093
60 AFUDC-Debt	21,007	24,020	(3,013)	10,529	148,387	145,387	2,999	108,068
61 Total Interest Charges	434,892	393,257	41,635	446,182	3,589,196	3,552,366	36,830	3,970,374
62 Net Income	891,927	817,741	74,186	636,433	4,606,819	5,583,392	(976,573)	5,507,216
64 Preferred Dividend Declared	44,336	12,837	31,499	44,600	400,606	147,296	253,310	402,979
65 Net Income to Common stock	847,661	804,904	42,757	591,833	4,206,213	5,436,096	(1,229,883)	5,104,937

There was no  
Operating Unit Managing Directors Report  
generated for

October 2002

Due to preparation for Board of Directors Meeting

# Operating Unit Managing Director Report



Report Status: Final '+3'  
 Year & Month: 2002 - November  
 Operating Unit: KAWC  
 Business Segment: Regulated Subsidiaries

## 1. FINANCIAL PERFORMANCE SUMMARY REPORT

The following table indicates the results for November compared to the Plan and the Forecast provided at the October Board Meeting, and the results for year-to-date through November again compared to the Plan and the Forecast supplied in October. Earnings for the month are under Plan \$226,000 and under the Forecast by \$161,000. For the eleven months ended November, the earnings are \$1,343 million under Plan and \$271,000 under the previous Forecast. For the year 2002, the Company is forecasting earnings of \$5,531,000, which is under Plan \$1,342,000, and a reduction of \$185,000 from the forecasted earnings provided to the Board in October. The commentary following the financial table will provide details of significant variances from Plan and efforts by the Company to offset items that have negatively impacted earnings in 2002.

Month of <b>November</b>					
Item	Actual Results	Plan	Variance vs. Plan	Most Recent Forecast	Variance vs. Forecast
Revenues	\$40,422	\$40,461	\$-39	\$40,612	\$-390
Operating Result (EBITA)	\$13,926	\$15,706	\$-1,780	\$14,403	\$-477
PBT (Pre-Tax Income)	\$9,467	\$11,194	\$-1,727	\$9,923	\$-456
Distributable Profit (Net to Common)	\$5,176	\$6,519	\$-1,343	\$5,447	\$-271
Capital Expenditures	\$12,755	\$15,720	\$-2,965	\$12,841	\$-86
Year to Date					
Item	Actual Results	Plan	Variance vs. Plan	Most Recent Forecast	Variance vs. Forecast
Revenues	\$40,422	\$40,461	\$-39	\$40,812	\$-390
Operating Result (EBITA)	\$13,926	\$15,706	\$-1,780	\$14,403	\$-477
PBT (Pre-Tax Income)	\$9,467	\$11,194	\$-1,727	\$9,923	\$-456
Distributable Profit (Net to Common)	\$5,176	\$6,519	\$-1,343	\$5,447	\$-271
Capital Expenditures	\$12,755	\$15,720	\$-2,965	\$12,841	\$-86

**Comments:**

Revenues are \$142,000 under Plan, and \$178,000 under the Forecast previously supplied for the month of November. Above normal rainfall in October and November have caused pumpage and water sales in all classes to decline from both the Plan and previous Forecast.

Year to date revenues are \$39,000 under Plan, and \$390,000 below the previous Forecast. The decrease from Forecast occurred in both October and November due to reduced sales related to weather that were not expected at the time the Forecast was prepared. The Company has thoroughly reviewed its system delivery levels and unbilled revenue calculations for December, and is currently forecasting a positive impact on revenues of \$86,000 in December.

Operating Result is \$353,000 below Plan and \$280,000 below Forecast for November due to the previously mentioned reduction in revenues. In addition, the Company experienced increased chemical cost due to the wet weather's impact on turbidity, increased general taxes related to an increased property tax assessment, and paid a bonus related to its "world class" designation in the most recent customer satisfaction survey.

November year-to date operating result is \$1.781 million under Plan and \$477,000 under the previous Forecast. The variance from the previous forecast relates to weather related revenue reductions in October and November, and the bonus payment in November. The variance from Plan results from labor costs associated with overtime to cover extended illness, a manager for the Pineville contract (reimbursed), the Martin County interim contract and the customer service bonus (\$291,000); production costs for chemicals and waste disposal associated with turbidity levels much higher than historical levels in the first half due to excessive rainfall, higher power cost in the third quarter due to increased water sales during the very hot, dry period, and in October and November due to high rain related turbidities (\$332,000); insurance costs related to current liability market conditions (\$103,000); correcting the amortization of the Source of Supply cost from the previous year (\$144,000); and charging to income deferred expenses from prior years where future rate recovery now appears unlikely (\$223,000).

The Company has been able to offset only a portion of these factors negatively impacting earnings through cutting measures for travel, maintenance, and capital spending (\$145,000).

## **2. OPERATIONAL ISSUES**

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KAWC remained in compliance with all applicable drinking water and environmental regulations through November and expects to continue through year-end. KAWC water sources were ample in quantity in November and are expected to remain that way through next spring based on recent rainfall levels.

KAWC received an overall utility value rating of 79.03% in third quarter customer survey results, which was below the 2002 goal of 82.4%, but was the highest ranking among American Water subsidiaries. KAWC does not expect these results to change in the fourth quarter.

Security efforts are at a heightened state of alert. Access to facilities continues to be minimized while appropriate intrusion and security devices have been installed. No significant capital expenditures are expected during the remainder of the year or in 2003 for security efforts. Ongoing O&M cost for security is approximately \$1.0 million per year. The Company will seek rate coverage for both its ongoing and deferred security cost in the rate case expected to be filed in March 2004 as ordered in the RWE case.

The current 12-month sales to delivery ratio is 86.0%. More effort is being directed toward our Central Kentucky operation by our leak detection crew(s) to elevate this percentage.

KAWC continues to be an active participant in the Bluegrass Water Supply Consortium in its efforts to resolve the water supply deficit. On October 15, the Consortium executed its agreement to begin a 10-month study of alternatives for a regional water supply. The Kentucky River Authority hosted a public meeting on November 21 to present preliminary environmental findings by the US Army Corps of Engineers to stabilize and raise Dam 10, which is directly upstream of KAWC's intake. The Public Service Commission had established an investigative proceeding to review KAWC's efforts in resolving the deficit in March 2001, but the case has been delayed by the PSC pending the proceedings ongoing in the RWE case. A schedule for continued investigation including a hearing has not been set by the PSC.

Hydraulic improvements to the Richmond Road Station treatment plant were initially delayed by the Division of Water review process, but are currently underway and should be completed by March 2003, increasing production capability at the Richmond

Road Station during a peak day event. While these improvements do not expand the reliable rated capacity of the treatment facilities, they do provide the operational ability to exceed the rated capacity, if needed to meet peak day demands. This project will reduce the risk of the vulnerability identified with the treatment capacity deficit in the short term.

KAWC's capital expenditures through the end of November are projected to be \$2,965,000 below planned amounts due to a decrease in developer main extensions of \$1.8 million below Plan. Additionally, the delay in the Richmond Road Station Hydraulic Improvements has caused a decrease of \$700,000. These decreases are not expected to be made up by year-end. The 2002 capital expenditures are projected to be below internally generated fund levels.

#### LEGAL

Condemnation of KAWC continues to be an issue. The LFUCG has hired Raftelis Financial to conduct a valuation of KAWC as the first step to condemnation. The local newspaper has supported condemnation and has provided extensive coverage on the issue. The Public Service Commission excluded this issue from its consideration of the RWE/Thames/TWUS merger case.

The citizens group, For Local Ownership of Water ("FLOW), challenged the validity of KAWC's franchise from the LFUCG, but lost at the trial court level. The case is on appeal to the Kentucky Court of Appeals, but no hearing date has been set.

#### REGULATORY

KAWC is under an Agreed Order to decommission its Boonesboro package sewer plant and connect the small sewer distribution system to the Winchester municipal system. All parties, including the Commonwealth of Kentucky, have agreed to an extension of time to implement a revised plan. The plant has stayed in compliance with discharge requirements while operating during the process.

On October 31, the PSC issued an order denying the motions of the Attorney General and the LFUCG to have the PSC reconsider its ruling on the limitation of the scope of the TWUS application. However, the PSC amended its previous ruling to clarify that the Commission may consider any change in circumstances since the May 30 order. The TWUS hearing is scheduled for November 21. FLOW filed testimony from two witnesses against the purchase by RWE.

The PSC hearing was held on November 21st. The scope of the hearing included why the change in control to TWUS is in the public interest as well as examine any material changes that have occurred since the May 30th approval order that might affect the transaction.

The Commonwealth of Kentucky awarded KAWC the operating contract for a governmental/commercial development called Bluegrass Station. Under the two-year arrangement, KAWC will operate the water, sewer and storm water systems and will receive \$86,000 per year. An O&M contract will have to be negotiated.

### **3. MANAGEMENT FOCUS**

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KAWC is a member of the Bluegrass Water Supply Consortium, which is pursuing a regional solution to the water supply deficits in Central Kentucky. KAWC is the largest water utility in the region and will have an opportunity to distribute water to other Consortium members once the preferred operational solution is identified, designed and implemented. Additionally, KAWC will have the opportunity to serve as a financing partner to the Consortium. This project provides the opportunity to solve the source of supply deficit projected for KAWC in a manner that creates consensus with the surrounding public water providers and political entities.

KAWC exceeded its rated treatment capacity of 70 mgd on August 5, 2002 with system delivery of 718.2 mgd during a moderately hot, dry period. Because resolution of the treatment capacity deficit is integrally fixed in the resolution of the source of supply deficit, the preferred solution for resolving the treatment capacity deficit will be delayed until a long-term water supply solution is identified. KAWC is completing a project that will increase the operational capability during a peak day event, but will not expand reliable treatment capacity. Until long-term solutions for source of supply and treatment capacity are identified and

implemented, KAWC is at risk of going to mandatory restrictions during periods of extreme hot, dry weather or periods of prolonged drought conditions.

The Kentucky PSC ordered KAWC on November 27, 2000 that it should formally apply to the Commission for approval to defer expenses as a regulatory asset. KAWC has requested PSC approval to defer expenses associated with security improvements, and the allocated costs of the transition to the call center and the shared services operation. To date, there has been no response from the PSC. These costs are projected to exceed \$3.16 million by the end of 2002. Since the PSC ordered on May 30, 2002 that KAWC address the security costs in the next rate case, KAWC believes that deferral of \$17 million will be approved. The Company is currently amortizing the transition costs of the shared services operations based on the savings experienced in on-going expenses and expects to do the same for the call center costs once the Company makes the move to the call center next year. The Company will then seek rate recognition of the unamortized portion of the transition cost as part of its 2004 rate filing. The Company believes that rate recovery of these three items will occur.

#### **4. NEW BUSINESS**

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##### **Acquisition Activity**

Status	Project Name:	Date	Cust. #	Empl. #	Price
Completed	Elk Lake Property Owners Assoc.	07/19/02	310	0	\$89
Written offers made	City of Owenton	02/01/02	1700	10	\$3.200
Written offers made	South Shore Water Company	09/01/00	2315	6	1,450

1. Elk Lake Water Company – KAWC completed the acquisition of this system and has successfully transitioned it into the operations of the Tri-Village District in Owen County without any operational issues.
2. Martin County Water District – KAWC assisted in the operations of this troubled water system through an interim contract for several months this year. Effective October 1, AWS began operating under a 5-year agreement for an initial contract price that produces \$850,000 of revenue per year. The Kentucky Division of Water and the Public Service Commission have both commended KAWC for its efforts in Martin County.
3. City of Pineville – KAWC is completing the first year of a 5-year O & M contract to operate the water and waste water systems. The contract generates \$12 million of revenue annually. Because of the success of this contract, two other area systems have approached KAWC about possible contracts for operations or purchase agreements.
4. Kentucky River Authority Leak Detection Services – KAWC was successfully awarded the contract to provide leak detection services for the second consecutive year. The contract can produce up to \$80,000 of revenue per year. This contract allows the Authority to pay KAWC to provide services to water utilities within the Kentucky River basin. This contract has provided an opportunity to demonstrate KAWC's professionalism and to open doors for new potential business opportunities. KAWC expects to pursue bidding the contract in 2003.
5. City of Owenton – Proposals have been made to the City for consideration of purchase of the water and waste water systems. The water system has experienced some source of supply and water quality problems. The City has recently been awarded a grant to partially fund improvements for water supply problems. The City is the supplier for the majority of water for the Tri-Village operations owned by the Company, and would be a strategic expansion for KAWC. The Mayor and County Judge Executive strongly support the proposal. KAWC will meet again with the city council on December 3, 2002.
6. South Shore Water Company – KAWC negotiated a preliminary contract, but further due diligence indicated more capital improvements than originally anticipated were necessary. The Company is currently renegotiating the preliminary purchase price.

7. Bluegrass Station – On October 31, KAWC was notified that it was the successful bidder on an O & M contract for water, storm water and waste water services to the former Army Depot located within Lexington-Fayette County. The Lexington-Fayette Urban County Government formerly held the contract. The contract is expected to be executed on February 1, 2003 and will produce \$86,000 of revenue annually.

8. City of Jackson – The Mayor of the City of Jackson has approached KAWC about presenting a proposal for a potential purchase of the water system or long-term O & M contract, but asked that efforts be delayed until after the November 2002 election. The contact was a direct result of the KRA leak detection contract.

9. City of Stamping Ground in western Scott County - KAWC has been approached about a possible purchase of its water system. A preliminary financial review has indicated that an agreement may not be possible with the City's current rate structure.

## **5. HUMAN RESOURCES**

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The labor contract with the customer service employees expires June 16, 2003. This covers 16 employees in the Lexington office. Negotiations are expected to begin in early Spring 2003.

There are currently seven vacancies at KAWC. Several of these positions have been posted on the System Network. Several good candidates have applied and it is expected that the Company will be able to fill the positions in a timely manner.

The NLRB ruled in favor of KAWC concerning the unit clarification issue filed by the Fireman and Oilers Union. The hearing officer ruled that the time had lapsed for the issue to be filed. The union may pursue the unit clarification issue during the next negotiations, which are scheduled for September 2004.

The Company has contacted Prime Directive Consulting to review the preliminary work of the SE Region regarding its Diversity Plan. The Company is currently developing the guidelines for a SE Region Diversity Council, and a diversity training program for the work force to be rolled out in 2003.

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Amer Water Works Company  
Kentucky-American Water Co 12  
Total Company (USGAAP)  
Income Statement Month & YTD  
For the Period Ending November 30, 2002

Kentucky-American Water Co.

Description	November Actual	November Plan	November Variance	November Prior Year	Yr. to Date November Actual	Yr. to Date November Plan	Yr. to Date November Variance	Yr. to Date November Prior Year
1 OPERATING REVENUES								
2 Water	3,223,159	3,358,629	135,470-	3,030,690	39,311,125	39,418,306	107,181-	37,146,628
3 Sewer	2,023	2,440	394-	2,196	29,166	28,720	446	28,451
4 Other	80,619	86,785	6,166-	85,046	1,081,565	1,013,987	67,578	936,291
5 Management								
6 Total Revenues	3,305,824	3,447,854	142,030-	3,117,932	40,421,856	40,461,013	39,157-	38,111,370
7 OPERATIONS & MAINTENANCE EXPENSE								
8 Labor	589,953	480,094	109,859	478,024	5,561,524	5,270,407	291,117	5,344,909
9 Purchased Water	22,223	24,785	2,562-	22,975	229,769	219,007	10,762	202,072
10 Fuel & Power	161,375	131,452	29,923	115,067	1,513,572	1,288,008	225,564	1,666,664
11 Chemicals	17,704	84,386	66,682-	92,037	1,013,895	1,037,159	23,264-	1,138,565
12 Waste Disposal	18,478	11,800	7,678	10,375	134,309	107,366	26,943	1,241,095
13 Management Fees	183,200	194,434	11,234-	136,391	1,729,086	1,824,201	95,115-	1,888,251
14 Group Insurance	27,524	124,863	97,339-	112,347	1,160,100	1,378,801	218,701-	1,326,985
15 Regulations	63,348	41,775	21,573	26,734	288,173	278,801	9,372	326,985
16 Regulatory Expense	56,071	20,790	35,281	21,909	249,873	226,269	23,604	230,969
17 Insurance Other Than Group	38,678	34,239	4,439	21,454	289,827	286,620	3,207	312,368
18 Customer Accounting	89,478	70,530	18,948	82,609	788,095	794,222	6,127-	804,928
19 Rents	21,509	6,876	14,633	8,958	77,732	71,732	6,000	70,277
20 General Office Expense	27,637	25,159	2,478	4,974	303,742	284,846	18,896	410,901
21 Miscellaneous	24,214	196,325	172,111-	205,333	350,208	350,208		410,901
22 Other Maintenance	81,005	75,425	5,580	56,785	2,920,479	2,416,604	503,875	2,127,488
23 Total Maintenance & Operations Expense	1,653,960	1,493,630	160,330	1,449,022	18,570,571	17,312,431	1,258,140	16,400,682
24 Depreciation	422,822	478,064	55,242-	479,452	5,143,667	5,084,422	59,245	4,922,897
25 Amortization	57,580	50,477	7,103	7,103	87,165	55,241	31,924	55,241
26 General Taxes	202,571	170,885	31,686	172,755	1,874,248	1,917,333	43,085-	1,799,599
27 State Income Taxes	67,627	72,136	4,509-	68,760	852,636	979,123	126,487-	835,972
28 Federal Income Taxes	226,496	269,320	42,824-	177,060	3,087,064	3,646,956	559,892-	3,111,848
29 Tax Savings Acquisition Adjustment								
30 Total Operating Expenses	2,704,056	2,534,512	169,544	2,376,926	30,310,649	29,492,912	817,737	27,627,262
31 Utility Operating Income	601,768	913,342	311,574-	741,006	10,111,207	10,968,101	856,894-	10,484,108
32 OTHER INCOME & DEDUCTIONS								
33 Non-Operating Rental Income								
34 Dividend Income-Common								
35 Dividend Income-Preferred								
36 Interest Income	3,755		3,755		10,305		10,305	9,593
37 AFUDC Equity	61,634	56,601	5,033	28,076	404,112	416,085	11,973-	266,220
38 M & J Miscellaneous Income	1,268		1,268	3,394	21,516		20,122	7,590
39 Gain(Loss)on Disposition								250,000
40 Total Other Income	64,121	56,601	7,520	24,955	433,934	416,085	17,849	521,243
41 Misc Savings Amortization	64	64		64	1,433	1,432	1	1,433
42 Misc. Other Acquisition Adjustment								
43 General Tax Reductions	9,464	7,671	1,793	15,726	540,467	299,517	240,950	570,975-
44 State Income Taxes	23,923	628	23,295-	1,552	33,356	24,610	8,746	68,418
45 Federal Income Taxes	62,992	2,444	60,548-	6,039	87,099	95,796	8,697-	266,313
46 Total Other Deductions	77,387	4,663	82,050-	8,199	421,449	180,543	240,906	234,811-
47 Total Other Income	141,508	51,938	89,570	16,756	12,485	235,542	223,057-	756,054
48 Income Before interest Charges	743,276	965,280	222,004-	757,762	10,123,692	11,203,643	1,079,951-	11,240,162
49 INTEREST CHARGES								
50 Interest on Long-Term Debt	448,679	468,388	19,709-	426,246	4,320,164	3,957,892	362,272	4,431,365
51 Amortization and Debt Expense	7,304	7,213	91	8,117	79,312	82,965	3,653-	72,055
52 Interest-Short Term Bank Debt		7,178	7,178-	14,234	237,303	618,889	381,586	433,733
53 Other Interest Expense	143	4,817	4,674-	7,172	13,600	50,787	37,187-	48,178
54 AFUDC-Debt	21,629	26,999	5,370-	13,835	192,137	198,479	6,342	133,097-
55 Total Interest Charges	434,497	462,397	27,900-	439,200	4,458,242	4,512,054	53,812-	4,852,532
56 Net Income	308,779	502,883	194,104-	318,562	5,665,450	6,691,589	1,026,139-	6,387,630
57 Preferred Dividend Declared	44,336	12,574	31,762	44,600	489,279	172,444	316,835	492,178
58 Net Income to Common Stock	264,443	490,309	225,866-	273,962	5,176,171	6,519,145	1,342,974-	5,895,452

# Operating Unit Managing Director Report



Report Status: Final '+3'  
 Year & Month: 2002 - December  
 Operating Unit: Kentucky  
 Business Segment: Regulated Subsidiaries

## 1. FINANCIAL PERFORMANCE SUMMARY REPORT

The following table indicates the results for December compared to the Plan and the Forecast provided at the October Board Meeting, and the results for year-to-date through December again compared to the Plan and the Forecast supplied in October. Earnings for the month are \$42,000 under Plan and \$44,000 over Forecast. For the year 2002, the Company is forecasting earnings of \$5,488,000, which is under Plan \$1,385,000, and \$227,000 under forecasted earnings provided to the Board in October. The commentary following the financial table will provide details of significant variances from Plan and efforts by the Company to offset items that have negatively impacted earnings in 2002.

Month of December					
Item	Actual Results	Plan	Variance vs. Plan	Most Recent Forecast	Variance vs. Forecast
Revenues	\$3,205	\$3,158	\$47	\$3,164	\$41
Operating Result (EBITA)	\$974	\$1,021	\$-47	\$915	\$59
PBT (Pre-Tax Income)	\$599	\$613	\$-14	\$523	\$76
Distributable Profit (Net to Common)	\$312	\$354	\$-42	\$268	\$44
Capital Expenditures	\$1,239	\$613	\$626	\$1,162	\$77
Year to Date					
Item	Actual Results	Plan	Variance vs. Plan	Most Recent Forecast	Variance vs. Forecast
Revenues	\$43,627	\$43,619	\$8	\$43,976	\$-349
Operating Result (EBITA)	\$14,900	\$16,727	\$-1,827	\$15,318	\$-418
PBT (Pre-Tax Income)	\$10,066	\$11,807	\$-1,741	\$10,446	\$-380
Distributable Profit (Net to Common)	\$5,488	\$6,873	\$-1,385	\$5,715	\$-227
Capital Expenditures	\$13,994	\$16,333	\$-2,339	\$14,003	\$-9

**Comments:**

Revenues are \$47,000 over Plan, and \$41,000 over the Forecast previously supplied for the month of December

Year to date revenues are \$8,000 over Plan, and \$349,000 under the previous Forecast. Heavy rain fall in October and November led to the decrease from Forecast.

Operating Result is \$47,000 under Plan and \$59,000 over the previous Forecast for December. The variance from Plan is primarily driven increased chemical cost due to the wet weather's impact on turbidity and the increased general taxes related to an increased property tax assessment.

December year-to date operating result is \$1.827 million under Plan and \$418,000 under the previous Forecast. The variance from Plan results from labor costs associated with overtime to cover extended illness, a manager for the Pineville contract (reimbursed), and the Martin County interim contract and the customer service bonus (\$291,000); production costs for chemicals and waste disposal associated with turbidity levels much higher than historical levels in the first half due to excessive rainfall, higher power cost in the third quarter due to increased water sales during the very hot, dry period, and in October and November due to high rain related turbidities (\$336,000); insurance costs related to current liability market conditions (\$103,000); correcting the amortization of the Source of Supply cost from the previous year (\$150,000); and charging to income deferred expenses from prior years where future rate recovery now appears unlikely (\$223,000).

The Company has been able to offset only a portion of these factors negatively impacting earnings through cost cutting measures for travel, maintenance, and capital spending (\$183,000).

## 2. OPERATIONAL ISSUES

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KAWC remained in compliance with all applicable drinking water and environmental regulations through December. KAWC water sources were ample in quantity in December and are expected to remain that way through next spring based on recent rainfall levels.

KAWC received an overall satisfaction with American Water System rating of 86.20% for the fourth quarter customer survey results, which attained "world class" levels. KAWC received a 2002 total of 86.85% which was above the 2002 goal of 85.24% and was the highest ranking among American Water subsidiaries.

Security efforts are at a heightened state of alert. Access to facilities continues to be minimized while appropriate intrusion and security devices have been installed. No significant capital expenditures are expected during the remainder of the year or in 2003 for security efforts. Ongoing O&M cost for security is approximately \$1.0 million per year. The Company will seek rate coverage for both its ongoing and deferred security cost in the rate case expected to be filed in March 2004 as ordered in the RWE case.

The current 12-month sales to delivery ratio is 85.2%. More effort is being directed toward our Central Kentucky operation by our leak detection crew(s) to elevate this percentage.

KAWC continues to be an active participant in the Bluegrass Water Supply Consortium in its efforts to resolve the water supply deficit. On October 15, the Consortium executed its agreement to begin a 10-month study of alternatives for a regional water supply. The Kentucky River Authority, following its public meeting on November 21, voted on December 11 to direct the U.S. Army Corps of Engineers to raise Dam 10 permanently by six feet with an attached cellular dam and close the lock structure. Dam 10 is directly upstream of KAWC's intake. The Public Service Commission had established an investigative proceeding to review KAWC's efforts in resolving the deficit in March 2001, but the case has been delayed by the PSC pending the proceedings ongoing in the RWE case. A schedule for continued investigation including a hearing has not been set by the PSC.

Hydraulic improvements to the Richmond Road Station treatment plant were initially delayed by the Division of Water review process, but are currently underway and should be completed by March 2003, increasing production capability at the Richmond Road Station during a peak day event. While these improvements do not expand the reliable rated capacity of the treatment facilities, they do provide the operational ability to exceed the rated capacity, if needed to meet peak day demands. This project will reduce the risk of the vulnerability identified with the treatment capacity deficit in the short term.

KAWC's capital expenditures through year-end are \$2,339,000 below planned amounts due to a decrease in developer main extensions of \$1.5 million below Plan. Additionally, the delay in the Richmond Road Station Hydraulic Improvements has caused a decrease of \$530,000. The 2002 capital expenditures are below internally generated fund levels.

#### LEGAL

The Rafeelis Report on valuation of KAWC is expected by the end of February 2003. At that time, the Urban County Council will consider whether to make an offer to the Company, and, in the event of declination, vote on whether to file condemnation proceedings. The Public Service Commission excluded this issue (local government ownership) from its consideration of the RWE/Thames/TWUS ("TWUS) merger case. The Kentucky Public Service Commission is expected to rule on the TWUS case by its deadline of December 20, 2002.

The citizens group, For Local Ownership of Water ("FLOW), challenged the validity of KAWC's franchise from the LFUCG, but lost at the trial court level. The case is on appeal to the Kentucky Court of Appeals, but no hearing date has been set. KAWC has a strong position in its case and there is only a small chance the original verdict would be overturned on appeal.

#### REGULATORY

KAWC is under an Agreed Order to decommission its Boonesboro package sewer plant and connect the small sewer distribution system to the Winchester municipal system. All parties, including the Commonwealth of Kentucky, have agreed to an extension of time to implement a revised plan. The plant has stayed in compliance with discharge requirements while operating during the process.

On October 31, the PSC issued an order denying the motions of the Attorney General and the LFUCG to have the PSC reconsider its ruling on the limitation of the scope of the TWUS application. However, the PSC amended its previous ruling to clarify that the Commission may consider any change in circumstances since the May 30 order. The TWUS hearing was November 21 and Order was issued late December.

The PSC hearing was held on November 21st. The scope of the hearing included why the change in control to TWUS is in the public interest as well as examine any material changes that have occurred since the May 30th approval order that might affect the transaction.

The Commonwealth of Kentucky awarded KAWC the operating contract for a governmental/commercial development called Bluegrass Station. Under the two-year arrangement, KAWC will operate the water, sewer and storm water systems and will receive \$86,000 per year. An O&M contract will have to be negotiated.

### **3. MANAGEMENT FOCUS**

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KAWC is a member of the Bluegrass Water Supply Consortium, which is pursuing a regional solution to the water supply deficits in Central Kentucky. KAWC is the largest water utility in the region and will have an opportunity to distribute water to other Consortium members once the preferred operational solution is identified, designed and implemented. Additionally, KAWC will have the opportunity to serve as a financing partner to the Consortium. This project provides the opportunity to solve the source of supply deficit projected for KAWC in a manner that creates consensus with the surrounding public water providers and political entities.

KAWC exceeded its rated treatment capacity of 70 mgd on August 5, 2002 with system delivery of 71.82 mgd during a moderately hot, dry period. Because resolution of the treatment capacity deficit is integrally fixed in the resolution of the source of supply deficit, the preferred solution for resolving the treatment capacity deficit will be delayed until a long-term water supply solution is identified. KAWC is completing a project that will increase the operational capability during a peak day event, but will not expand reliable treatment capacity. Until long-term solutions for source of supply and treatment capacity are identified and implemented, KAWC is at risk of going to mandatory restrictions during periods of extreme hot, dry weather or periods of prolonged drought conditions.

The Kentucky PSC ordered KAWC on November 27, 2000 that it should formally apply to the Commission for approval to defer expenses as a regulatory asset. At the time of the Order, KAWC was already deferring costs for the shared services operation and the call center. KAWC has requested PSC approval to defer expenses associated with security improvements, and the allocated costs of the transition to the call center and the shared services operation. To date, there has been no response from the PSC. Since the PSC ordered on May 30, 2002 that KAWC address the security costs in the next rate case, KAWC believes that deferral of \$1.7 million will be approved. The Company is currently amortizing the transition costs of the shared services operations based on the savings experienced in on-going expenses and expects to do the same for the call center costs once the Company makes the move to the call center next year. The Company will then seek rate recognition of the unamortized portion of the transition cost as part of its 2004 rate filing.

#### **4. NEW BUSINESS**

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1. Elk Lake Water Company – KAWC completed the acquisition of this system and has successfully transitioned it into the operations of the Tri-Village District in Owen County without any operational issues.
2. Martin County Water District – KAWC assisted in the operations of this troubled water system through an interim contract for several months this year. Effective October 1, AWS began operating under a 5-year agreement for an initial contract price that produces \$850,000 of revenue per year. The Kentucky Division of Water and the Public Service Commission have both commended KAWC for its efforts in Martin County.
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4. Kentucky River Authority Leak Detection Services – KAWC was awarded the contract to provide leak detection services for the second consecutive year. The contract can produce up to \$80,000 of revenue per year. This contract allows the Authority to reimburse KAWC for services to water utilities within the Kentucky River basin. This contract has provided an opportunity to demonstrate KAWC's professionalism and to open doors for new potential business opportunities. KAWC expects to pursue bidding the contract in 2003.
5. City of Owenton – Proposals have been made to the City for consideration of purchase of the water and waste water systems. The water system has experienced some source of supply and water quality problems. The City has recently been awarded a grant to partially fund improvements for water supply problems. The City is the supplier for the majority of water for the Tri-Village operations owned by the Company, and would be a strategic expansion for KAWC. The Mayor and County Judge Executive strongly support the proposal. KAWC met again with the city council on December 3, 2002. KAWC will make a formal proposal to the City Council in February 2003.
6. South Shore Water Company – KAWC negotiated a preliminary contract, but further due diligence indicated more capital improvements than originally anticipated were necessary. The Company is currently renegotiating the preliminary purchase price.
7. Bluegrass Station – On October 31, KAWC was notified that it was the successful bidder on an O & M contract for water, storm water and waste water services to the former Army Depot located within Lexington-Fayette County. The Lexington-Fayette Urban County Government formerly held the contract. The contract is expected to be executed on February 1, 2003 and will produce \$86,000 of revenue annually.
8. City of Jackson – The Mayor of the City of Jackson has approached KAWC about presenting a proposal for a potential purchase of the water system or long-term O & M contract, but asked that efforts be delayed until after the November 2002 election, which was successful for the Mayor. The contact was a direct result of the KRA leak detection contract and detailed discussions will begin in January 2003.

9. City of Stamping Ground in western Scott County - KAWC has been approached about a possible purchase of its water system. A preliminary financial review has indicated that an agreement may not be possible with the City's current rate structure.

10. Green Hills Water District - The District approached KAWC to tour the facilities on November 18 and expressed interest in selling the assets based on the contract with the City of Pineville, As of December 31, 2001, the District served 500 customers and had \$147,480 in water operating revenues which did not cover expenses. The District is currently preparing for a rate increase. On evaluation, the best alternative appears to be for the Pineville Utilities Commission to purchase the assets and extend the O&M contract to KAWC. On December 16, KAWC met again with the District manager and will begin detailed discussions in January 2003.

11. Berea College Water Utility Department - The City of Berea is 40 miles south of Lexington adjacent to Interstate 75. Berea College privately owns both the water and electric companies that serve the City and has recently expressed interest in selling both utilities. KAWC has been in contact with the manager, who indicates a plan to issue an RFP in January 2003, and has asked KAWC to assist in the design of the RFP. On December 9, KAWC sent an initial due diligence list to Berea. The District serves 3,834 customers and had annual water operating revenues of \$2,244,791, which provided an appropriate return on investment. A significant portion of their revenues is derived from one wholesale customer, Southern Madison Water District.

### Acquisition Activity

Status	Project Name:	Date	Cust. #	Empl. #	Price
Completed	Elk Lake Property Owners Assoc.	07/19/02	310	0	\$89
Written offers made	City of Owenton	02/01/02	1700	10	\$3,200
Written offers made	South Shore Water Company	09/01/00	2315	6	1,450

## 5. HUMAN RESOURCES

---

The labor contract with the customer service employees expires June 16, 2003. This covers 16 employees in the Lexington office. Negotiations are expected to begin in early Spring 2003.

There are currently four vacancies at KAWC. Several good candidates have applied and it is expected that the Company will be able to fill the positions in a timely manner.

The World Class Customer Service Award criteria were achieved by KAWC. This accomplishment allowed 143 associates to be recognized for achievement.

The Company has contacted Prime Directive Consulting to review the preliminary work regarding the Southeast Region's Diversity Plan. The Company is currently developing guidelines for a Southeast Region Diversity Council, and a diversity training program for the work force to be rolled out in 2003.

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American Water Works Company  
Kentucky-American Water-06 12  
Total Company (USGAAP)  
Income Statement (Month, & YTD)  
For the Period Ending December 31, 2002

Kentucky-American Water Co.

Description	December Actual	December Plan	December Variance	December Prior Year	Yr to Date Actual	Yr to Date Plan	Yr to Date Variance	Yr to Date Prior Year
1 OPERATING REVENUES								
2 Water	3,106,994	3,068,642	38,262	3,287,972	42,418,029	42,486,948	68,919	40,434,600
3 Sewer	95,698	86,851	9,071	75,790	1,174,487	1,100,838	76,649	1,012,081
4 Other								
5 Management								
6 Total Revenues	3,205,094	3,158,003	47,091	3,366,457	43,626,950	43,619,016	7,934	41,477,827
7 OPERATIONS & MAINTENANCE EXPENSE								
8 Fuel/Gas/Water	324,794	491,405	166,811	305,800	5,886,318	5,762,012	124,306	5,650,700
9 Electric Power	135,683	135,166	517	122,439	2,242,266	2,174,472	67,794	1,850,702
10 Chemicals	106,638	106,126	512	104,320	1,311,472	1,311,472		1,311,472
11 Waste Disposal	13,070	129,800	116,730	98,720	1,324,832	1,179,288	145,544	1,179,288
12 Management Fees	198,496	179,878	18,618	179,878	2,149,100	2,149,100		2,149,100
13 Group Insurance	108,076	123,888	15,812	110,228	1,278,080	1,278,080		1,278,080
14 Pensions	26,793	41,774	14,981	26,793	1,202,680	1,202,680		1,202,680
15 Regulatory Expense	36,344	74,044	37,700	36,344	1,202,680	1,202,680		1,202,680
16 Insurance Other Than Group	37,111	70,835	33,724	37,111	1,202,680	1,202,680		1,202,680
17 Customer Accounting	37,111	70,835	33,724	37,111	1,202,680	1,202,680		1,202,680
18 Rents	37,111	70,835	33,724	37,111	1,202,680	1,202,680		1,202,680
19 General Office Expense	37,111	70,835	33,724	37,111	1,202,680	1,202,680		1,202,680
20 Miscellaneous	23,025	122,008	98,983	23,025	1,202,680	1,202,680		1,202,680
21 Other Maintenance	128,989	196,603	67,614	157,567	1,049,468	1,049,468		1,049,468
22 Total Maintenance & Operations Expense	1,475,259	1,474,571	688	1,399,335	20,045,831	18,787,002	1,258,829	17,800,018
23 Depreciation	476,748	475,746	1,002	450,001	5,629,475	5,600,168	29,307	5,373,828
24 Amortization	23,195	50,477	27,282	23,195	2,500,342	2,500,342		2,500,342
25 State Income Taxes	286,350	171,390	114,960	286,350	2,600,222	2,089,123	511,100	1,830,775
26 Federal Income Taxes	10,000	52,683	42,683	10,000	3,267,960	3,267,960		3,267,960
27 Tax Savings Acquisition Adjustment	180,896	196,712	15,816	343,691	3,267,960	3,843,668	575,708	3,456,937
28 Total Operating Expenses	2,482,823	2,421,579	61,044	2,368,364	32,793,274	31,914,491	878,783	29,995,626
29 Utility Operating Income	722,471	736,424	13,953	998,093	10,833,676	11,704,525	870,849	11,482,201
30 OTHER INCOME & DEDUCTIONS								
31 Non-Operating Rental Income		43,138	43,138	43,138	43,138	43,138		43,138
32 Dividend Income-Common		65	65	64	64	64		64
33 Dividend Income-Preferred								
34 Interest Income								
35 Other Equity								
36 Gain/Loss on Disposition								
37 Total Other Income	15,694	43,138	27,444	29,126	449,628	459,223	9,595	550,371
38 Miscellaneous Amortization	64	65	1	64	1,497	1,497		1,497
39 Tax Savings Acquisition Adjustment								
40 General Taxes	15,556	7,171	8,385	34,991	556,022	306,688	249,334	535,983
41 State Income Taxes	12,686	587	12,099	7,772	46,942	58,080	11,138	65,138
42 Federal Income Taxes	4,912	2,584	2,328	12,765	82,383	98,197	15,814	253,138
43 Total Other Deductions	7,646	4,365	3,281	19,011	429,094	184,908	244,186	215,799
44 Total Other Income	8,048	38,773	30,725	10,115	20,534	274,315	253,781	766,170
45 Income Before Interest Charges	730,519	775,197	44,678	1,008,208	10,854,210	11,978,840	1,124,630	12,248,371
46 INTEREST CHARGES								
47 Interest on Long-Term Debt	370,571	390,279	19,708	335,679	4,690,735	4,368,171	342,564	4,767,045
48 Amortization and Debt	15,082	26,001	10,919	52,501	252,385	674,860	392,208	797,236
49 Interest-Short Term Bank	18,789	20,577	1,788	6,930	65,520	65,520	39,208	485,792
50 Other Interest Expense								
51 AFUDC-Debt	374,199	408,827	34,628	16,251	210,630	219,056	4,812	149,344
52 Total Interest Charges	374,199	408,827	34,628	385,618	4,832,441	4,920,881	88,440	5,238,152
53 Net Income	356,320	366,370	10,050	622,590	6,021,769	7,057,959	1,036,190	7,010,219
54 Preferred Dividend Declared	44,336	44,336		44,336	533,615	185,018	1,348,597	7,518,778
55 Net Income to Common Stock	311,984	353,796	41,812	577,990	5,488,154	6,872,941	1,384,787	6,473,441