KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 83 of 312

Witness: Michael A. Miller

83. Provide a copy of each adjusting entry proposed by the Company's independent Auditors in the two most recent audits of the Company. Include supporting documentation.

Response:

Please see attached for the adjusting entries made by the Company's independent auditors for the years 2005 and 2006.

For electronic version, refer to KAW_R_AGDR1#83_061807.pdf

PricewaterhouseCoopers LLP

Summary of adjustment proposed and booked by management

Client: Kentucky-American Water Company
Period: December 31, 2006

Prepared by: Iching Su
Date: 23-Mar-07
Date:

Tax Rate 39.00%

Proposed Adjustments

Impact on dr(cr)			BALANCE SHEET					INCOME			
			Assets		Liabilities						
WP Ref		Description	Current	Non-Current	Current	Non-Current	Equity (2)	Known Differences	Projected	Estimate	Total
310011	1	Accounts payable Cash *To reclass cash clearing account to A/P*	(825,408)		825,408						
3400-10	2	Expense Utility Plant, net *To take up true-up of labor overhead capitalized*		38,465				(38,465)			(38,465)
Total Pretax Adjustments			(825,408)	38,465	825,408			(38,465)			(38,465)

PricewaterhouseCoopers LLP

Summary of Unadjusted Differences - Iron Curtain Method

Client: Kentucky-American Water Company
Period: December 31, 2005

Prepared by:
Date:
Date:

Tax Rate 39.00%

Proposed Adjustments

Impact on dr(cr)

WP Ref	SUD #	Description	BALANCE SHEET: Assets Current	Assets Non-Current	Liabilities Current	Liabilities Non-Current	Equity (2)	INCOME: Known Differences	Projected	Estimate	Total
4100	1	Operating expense						12,480			12,480
		Accrued taxes			(12,480)						
		To take up underaccrual of FICA taxes									
3300	2	Prepaid expense	10,055								
		Accrued expenses			(10,055)						
		To reclass accruals booked in prepaid									
4000	3	Operating expense						21,978	59,302		81,280
		Accrued expenses			(81,280)						
		To take up unrecorded liabilities									
4400	4	Other long-term liabilities				112,545					
		Other current liabilities			(112,545)						
		Reclass annual incentive plan liability to current									
4400	5	Other current liabilities			5,174						
		Operating expense						(5,174)			(5,174)
		To adjust annual incentive plan accrual									
Total Pretax Adjustments			10,055		(211,186)	112,545		29,284	59,302		88,586
Pretax Income											8,657,000
Percentage of Total Pretax Adjustments to Pretax Income (7)											1.02%
Tax Effect of Pretax Adjustments											34,549
After Tax Impact of Adjustments			10,055		(211,186)	112,545		29,284	59,302		54,037
Total After Tax Impact of Adjustments on Equity							54,037 (3)				
Financial Statement Amount of Other Comprehensive Income (Net of Tax) for the Period											
Percentage of Total After Tax Adjustments to Other Comprehensive Income (Net of Tax) Amount (7)											
After Tax Impact of Adjustments on Comprehensive Income											
Financial Statement Amounts			5,809,000	258,780,000	18,704,000	182,125,000	63,760,000				5,269,000 (5)
Percentage After Tax Adjustments to Financial Statement Amounts (7)			0.17%	0.00%	-1.13%	0.00%	0.08%				1.03%

Pretax Adjustments Entry Balance Verification (amount should be zero): $0.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 84 of 312

Witness: Michael A. Miller

84. Provide a copy of the Company's two most recent management letters and recommendations received from the Company's independent auditors.

Response:

See the management letters which are attached to this response. For copies of the independent auditors reports please see the Annual Reports provided in Exhibit 28 of the Company's filing.

For electronic version, refer to KAW_R_AGDR1#84_061807.pdf

American Water

April 6, 2006

PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia, PA 19103-7042

Ladies and Gentlemen:

We are providing this letter in connection with your audits of the financial statements of Kentucky-American Water Company (the "Company") as of December 31, 2005 and 2004 and for the years then ended for the purpose of expressing an opinion as to whether such financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of Kentucky-American Water Company in conformity with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the fair presentation in the financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

Certain representations in this letter are described as being limited to those matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, as of March 24, 2006, the date of your report, the following representations made to you during your audit:

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America, and include all disclosures necessary for such fair presentation and disclosures otherwise required to be included therein by the laws and regulations to which the Company is subject.

2. We have made available to you all:

   a. Financial records and related data.

b. Minutes of the board of directors meeting and summaries of actions of recent meetings for which minutes have not yet been prepared. The most recent meeting was held on January 25, 2006.

3. There have been no communications from regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices.

4. There are no material transactions, agreements or accounts that have not been properly recorded in the accounting records underlying the financial statements.

5. We have disclosed to you all deficiencies in the design and operation of internal control over financial reporting of which we are aware.

6. We acknowledge our responsibility for the design and implementation of programs and controls to provide reasonable assurance that fraud is prevented and detected.

7. We have no knowledge of any fraud or suspected fraud affecting the Company involving:

   a. Management,

   b. Employees who have significant roles in internal control over financial reporting, or

   c. Others where the fraud could have a material effect on the financial statements.

8. We have no knowledge of any allegations of fraud or suspected fraud affecting the Company received in communications from employees, former employees, analysts, regulators, short sellers, or others.

   (As to items 6., 7. and 8., we understand the term "fraud" to mean those matters described in Statement on Auditing Standards No. 99).

9. There have been no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.

10. The Company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

11. The following, if material, have been properly recorded or disclosed in the financial statements:

    a. Related-party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.

(We understand the term "related party" to include those entities described in Statement on Auditing Standards No. 45, footnote 1).

b. Guarantees, whether written or oral, under which the Company is contingently liable.

c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties* (Significant estimates are estimates at the balance sheet date that could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year).

12. The Company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral, except as disclosed in the financial statements.

13. The Company has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

14. Receivables recorded in the financial statements represent bona fide claims against debtors for sales or other charges arising on or before the balance sheet dates and are not subject to discount except for normal cash discounts. Receivables classified as current do not include any material amounts which are collectible after one year. All receivables have been appropriately reduced to their estimated net realizable value.

15. Materials and supplies inventory recorded in the financial statements are stated on the average cost basis, with cost being determined on the basis of specific identification consistent with prior year, and due provision was made to reduce all slow-moving, obsolete, or unusable materials and supplies to their estimated useful or scrap values. Materials and supplies inventory quantities at the balance sheet dates were determined from physical counts or from the Company's perpetual inventory records, which have been adjusted on the basis of physical inventories taken by competent employees at various times during the year. Liabilities for amounts unpaid are recorded for all items included in materials and supplies inventories at balance sheet dates and all quantities used for construction, maintenance or operations at those dates are excluded from the materials and supplies inventory balances and have been charged to appropriate utility plant or expense accounts.

16. All liabilities of the Company of which we are aware are included in the financial statements at the balance sheet dates. There are no other liabilities or gain or loss contingencies that are required to be accrued or disclosed by Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies*, and no unasserted claims or assessments that our legal counsel has advised us are probable of assertion and required to be disclosed in accordance with that Statement.

17. The Company has appropriately reconciled its books and records (e.g., general ledger accounts) underlying the financial statements to their related supporting information (e.g., sub ledger or third-party data). All related reconciling items considered to be material were identified and included on the reconciliations and were appropriately adjusted in the financial statements. There were no material unreconciled differences or material general ledger suspense account items that should have been adjusted or reclassified to another account balance. There were no material general ledger suspense account items written off to a balance sheet account, which should have been written off to an income statement account and vice versa. All intracompany accounts have been eliminated or appropriately measured and considered for disclosure in the financial statements.

18. The Company has properly classified as liabilities its mandatorily redeemable preferred stock which are within the scope of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. In addition, the Company has properly disclosed in its financial statements the impact from its adoption of FASB No. 150.

19. All material costs that have been deferred to future periods are probable of recovery. We have reviewed the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, and its applicability to the Company. We believe that the Company qualifies as a regulated enterprise, as set forth in paragraph 5 of SFAS No. 71, and as such, the guidance prescribed in SFAS No. 71 is applicable to the Company. We further believe that recovery through the rate making process of all material regulatory assets which have been established in the financial statements under paragraph 9 of SFAS No. 71 is probable. Further, for regulatory assets for which no specific rate order has been received, we believe these assets are recoverable through the rate making process based on past practice of the regulators.

20. All cash and bank accounts and all other properties and assets of the Company of which we are aware are included in the financial statements at December 31, 2005 and 2004.

21. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, line of credit, or similar arrangements have been properly disclosed.

22. We have had no transactions involving special purpose entities, as defined in FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* or FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, that would require consolidation or disclosure in the financial statements.

23. The cash and cash equivalents amounts reported in the financial statements at December 31, 2005 and 2004 do not include any amounts invested in auction rate securities or other securities with an original maturity date greater than three months from date of purchase.

24. We believe amounts recorded as unbilled revenue appropriately represent services provided, not billed, at December 31, 2005 and 2004.

25. We believe the composite depreciation rates approved by the Kentucky Public Service Commission have been appropriately applied by the Company.

26. We believe the year end accrual methodology appropriately accounts for all material revenue and expense transactions, and assets and liabilities fairly represent the financial position of the Company at December 31, 2005 and 2004

27. Tax-exempt bonds issued have retained their tax-exempt status.

28. The Company has reviewed tangible long-lived assets and other agreements for associated asset retirement obligations, in accordance with FASB Statement No. 143, *Accounting for Asset Retirement Obligations* and has determined that no liabilities are required to be recognized at December 31, 2005 and 2004.

29. We have reviewed long-lived assets to be held and used or to be disposed of by sale for impairment in accordance with FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, whenever events or changes in circumstances have indicated that the carrying amount of assets might not be recoverable, and have determined that no adjustments are necessary at December 31, 2005 and 2004.

30. All borrowings and financial obligations of the Company of which we are aware are included in the financial statements at December 31, 2005 and 2004, as appropriate. We have fully disclosed to you all borrowing arrangements of which we are aware.

31. As of December 31, 2005, the Company has not provided quarterly financial statements for the 2005 calendar year as required under its Indenture of Mortgage dated May 1, 1968 ("Indenture"), which constitutes a covenant violation. The bondholders have not served the Company with a notice of default and therefore, under the terms of the Indenture, this violation does not constitute a default. The Company is currently working to remedy this violation. Except as described herein, the Company has not violated any covenants on long term debt during any of the periods reported. We have fully disclosed to you all covenants and information related to how we determined our compliance with the terms of the covenants.

32. The Company has not received notice from its Trustee signifying an event of default has occurred.

33. We have reviewed the criteria for revenue recognition included in SAB 104, *Revenue Recognition* and are recognizing revenue in accordance with SAB 104.

34. We have reviewed our lease agreements and have determined that we have appropriately accounted for all leases under SFAS No. 13, *Accounting for Leases*.

35. A valuation allowance against the deferred tax assets at December 31, 2005 is not considered necessary because that the deferred tax asset will, more likely than not, be fully realized.

36. Additions to utility plant during the year represent actual costs together with interest and overhead costs allocated on a sound accounting basis consistent with that of the prior year. The original cost estimated, if not known, of property abandoned, retired, or sold is properly charged to accumulated depreciation. Cost of removal, less salvage, has been recorded as operations and maintenance expense, in accordance with FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, for the years ended December 31, 2005 and 2004. The provision for depreciation for the years ended December 31, 2005 and 2004 was made in accordance with the straight-line average remaining life method using annual depreciation rates consistent with the average remaining service lives approved by the appropriate state utility regulatory agencies. In accordance with the applicable provisions of the Uniform System of Accounts, charges for maintenance, repairs and replacement of minor items of property for the years ended December 31, 2005 and 2004 were included in operating expense or clearing accounts. We believe the utility plant in service accounts and accumulated depreciation at December 31, 2005 and 2004 fairly represent the status of existing property in use at those respective dates.

To the best of our knowledge and belief, no events have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

Daniel W. Warnock
Regional President, Southeast Region

Christopher Buls
Director of Finance, Southeast Region

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 84 of 312

Witness: Michael A. Miller

84. Provide a copy of the Company's two most recent management letters and recommendations received from the Company's independent auditors.

Response:

See the management letters which are attached to this response. For copies of the independent auditors reports please see the Annual Reports provided in Exhibit 28 of the Company's filing.

American Water

Southeast Region

March 27, 2007

PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia, PA 19103-7042

We are providing this letter in connection with your audits of the financial statements of Kentucky-American Water Company (the "Company") as of December 31, 2006 and 2005 and for the years then ended for the purpose of expressing an opinion as to whether such financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of Kentucky-American Water Company in conformity with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the fair presentation in the financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

Certain representations in this letter are described as being limited to those matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, as of March 16, 2007, the date of your report, the following representations made to you during your audit:

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America, and include all disclosures necessary for such fair presentation and disclosures otherwise required to be included therein by the laws and regulations to which the Company is subject.

2. We have made available to you all:

    a. Financial records and related data.

    b. Minutes of the board of directors meeting and summaries of actions of recent meetings for which minutes have not yet been prepared. The most recent meeting was held on December 19, 2006.

RWE GROUP

3. There have been no communications from regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices.

4. There are no material transactions, agreements or accounts that have not been properly recorded in the accounting records underlying the financial statements.

5. We have disclosed to you all deficiencies in the design and operation of internal control over financial reporting of which we are aware.

6. We have disclosed to you all deficiencies in the design and operation of internal control over financial reporting that could have a material impact on the financial statements, individually or in the aggregate, which have been identified to the date of this letter, either by the Company or its implementation consultants, during the Company's implementation of the provisions of Section 404 of the Sarbanes-Oxley Act of 2002.

7. We acknowledge our responsibility for the design and implementation of programs and controls to provide reasonable assurance that fraud is prevented and detected.

8. We have no knowledge of any fraud or suspected fraud affecting the Company involving:

   a. Management,

   b. Employees who have significant roles in internal control over financial reporting, or

   c. Others where the fraud could have a material effect on the financial statements.

9. We have no knowledge of any allegations of fraud or suspected fraud affecting the Company received in communications from employees, former employees, analysts, regulators, short sellers, or others.

   (As to items 7., 8., and 9., we understand the term "fraud" to mean those matters described in Statement on Auditing Standards No. 99).

10. There have been no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.

11. The Company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

12. The following, if material, have been properly recorded or disclosed in the financial statements:

    a. Related-party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.

(We understand the term "related party" to include those entities described in Statement on Auditing Standards No. 45, footnote 1).

b. Guarantees, whether written or oral, under which the Company is contingently liable.

c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*. (Significant estimates are estimates at the balance sheet date that could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year).

13. The Company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral, except as disclosed in the financial statements.

14. The Company has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

15. Receivables recorded in the financial statements represent bona fide claims against debtors for sales or other charges arising on or before the balance sheet dates and are not subject to discount. Receivables classified as current do not include any material amounts which are collectible after one year. All receivables have been appropriately reduced to their estimated net realizable value.

16. Materials and supplies inventory recorded in the financial statements are stated on the average cost basis, with cost being determined on the basis of specific identification consistent with prior year, and due provision was made to reduce all slow-moving, obsolete, or unusable materials and supplies to their estimated useful or scrap values. Materials and supplies inventory quantities at the balance sheet dates were determined from physical counts or from the Company's perpetual inventory records, which have been adjusted on the basis of physical inventories taken by competent employees at various times during the year. Liabilities for amounts unpaid are recorded for all items included in materials and supplies inventories at balance sheet dates and all quantities used for construction, maintenance or operations at those dates are excluded from the materials and supplies inventory balances.

17. All liabilities of the Company of which we are aware are included in the financial statements at the balance sheet dates. There are no other liabilities or gain or loss contingencies that are required to be accrued or disclosed by Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies*, and no unasserted claims or assessments that our legal counsel has advised us are probable of assertion and required to be disclosed in accordance with that Statement.

18. The Company has appropriately reconciled its books and records (e.g., general ledger accounts) underlying the financial statements to their related supporting information (e.g., sub ledger or third-party data). All related reconciling items considered to be material were identified and included on the reconciliations and were appropriately adjusted in the financial statements. There were no material unreconciled differences or material general ledger suspense account items that should have been adjusted or reclassified to another account balance. There were no material general ledger suspense account items written off to a balance sheet account, which should have been written off to an income statement account and vice versa. All intracompany accounts have been eliminated or appropriately measured and considered for disclosure in the financial statements.

19. All material costs that have been deferred to future periods are probable of recovery. We have reviewed the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, and its applicability to the Company. We believe that the Company qualifies as a regulated enterprise, as set forth in paragraph 5 of SFAS No. 71, and as such, the guidance prescribed in SFAS No. 71 is applicable to the Company. We further believe that recovery through the rate making process of all material regulatory assets which have been established in the financial statements under paragraph 9 of SFAS No. 71 is probable. Further, for regulatory assets for which no specific rate order has been received, we believe these assets are recoverable through the rate making process based on past practice of the regulators.

20. All cash and bank accounts and all other properties and assets of the Company of which we are aware are included in the financial statements at December 31, 2006 and 2005.

21. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, line of credit, or similar arrangements have been properly disclosed.

22. We believe amounts recorded as unbilled revenue appropriately represent services provided, not billed, at December 31, 2006 and 2005.

23. We believe the composite depreciation rates approved by the Kentucky Public Service Commission have been appropriately applied by the Company.

24. Tax-exempt bonds issued have retained their tax-exempt status.

25. All borrowings and financial obligations of the Company of which we are aware are included in the financial statements at December 31, 2006 and 2005, as appropriate. We have fully disclosed to you all borrowing arrangements of which we are aware.

26. The Company has not violated any covenants on long term debt during any of the periods reported. We have fully disclosed to you all covenants and information related to how we determined our compliance with the terms of the covenants.

27. We have reviewed our lease agreements and have determined that we have appropriately accounted for all leases under FASB Statement No. 13, *Accounting for Leases*.

28. The Company has reviewed tangible long-lived assets, operating lease agreements that contain provisions that require the leased assets to be returned in the same condition that existed at lease inception and other agreements for associated asset retirement obligations, and concluded that there are no such liabilities.

29. We have reviewed long-lived assets to be held and used or to be disposed of by sale for impairment in accordance with FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* and FASB Statement No. 90, *Regulated Enterprises Accounting for Abandonments and Disallowances of Plant Costs*, whenever events or changes in circumstances have indicated that the carrying amount of assets might not be recoverable, and have determined that no adjustment is necessary.

30. Additions to utility plant during the year represent actual costs together with interest and overhead costs allocated on a reasonable accounting basis. The original cost estimated if not known, of property abandoned, retired, or sold is properly charged to accumulated depreciation. Cost of removal, less salvage, has been recorded as operation and maintenance expense, in accordance with FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, for the years ended December 31, 2006 and 2005. The provision for depreciation for the years ended December 31, 2006 and 2005 was made in accordance with the straight-line average remaining life method using annual depreciation rates consistent with the average remaining service lives approved by the applicable regulatory agencies. We believe the utility plant in service accounts and accumulated depreciation at December 31, 2006 and 2005, fairly represent the status of existing property in use at those respective dates.

31. The Company has appropriately reconciled its deferred tax asset and deferred tax liability books and records underlying the financial statements to their related supporting information. All related reconciling items considered to be material were identified and included on the reconciliations and were appropriately adjusted in the financial statements.

32. A valuation allowance against the deferred tax assets at the balance sheet date is not considered necessary because the deferred tax asset will, more likely than not, be fully realized.

To the best of our knowledge and belief, no events have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

Daniel W. Warnock
Regional President, Southeast Region
American Water Works Company, Inc.

Michael A. Miller

Michael Miller
Treasurer and Comptroller,
Kentucky-American Water Company

Kentucky-American Water Company
Subsequent Events Procedures - 2006 Audit

Year-End Period: December 31, 2006

Date of inquiry: March 27, 2007

	YES	NO
1. Have the 2007 unaudited monthly financial statements been prepared on a basis consistent with the December 31, 2006 financial statements?	☒	☐
2. Has the Company entered into any significant transactions or agreements, including sales or purchases of significant assets, with third parties through the date of inquiry? If yes, please provide explanations.	☐	☒
3. Have any unusual adjustments or reversals of any transactions entered into prior to 12/31/2006 been made during the period from the balance sheet date to the date of inquiry? If yes, please provide explanations.	☐	☒
4. Are you aware of any significant litigation, claims, and assessments through the date of inquiry not presently recorded or properly disclosed in the Company's financial statements in accordance with FAS 5? If yes, please provide explanations.	☐	☒
5. Have there been any resolutions/settlements to known uncertainties or contingent liabilities present at year end? If yes, please provide explanations.	☐	☒
6. Are there any substantial contingent liabilities or commitments that existed at 12/31/2006 or at the date of inquiry? Have there been any development regarding risk areas and contingencies? If yes, please provide explanations.	☐	☒
7. Has the Company entered into any new borrowing or banking arrangements through the date of inquiry? If yes, please provide explanations.	☐	☒
8. Is the Company currently in compliance with all debt covenants? If no, please provide explanations.	☒	☐
9. Have any significant assets been sold? Are you planning to sell any significant asset? If yes, please provide support and explanation.	☐	☒
10. Have there been any significant changes in the capital stock,	☐	☒

Kentucky-American Water Company
Subsequent Events Procedures - 2006 Audit

Year-End Period: December 31, 2006

Date of inquiry: March 27, 2007

	YES	NO
long-term debt, or working capital to the date of inquiry? If yes, please provide support and explanation.		
11. Have there been any significant new policy decisions or significant new laws or regulations affecting the Company's business through the date of inquiry? If yes, please provide explanations.	☐	☒
12. Has the issue of new shares, debentures, or an agreement to merge, acquire, or dispose been made or planned? If yes, please provide explanation.	☐	☒
13. Have there been any rate case (e.g., general, interim and others) settlements subsequent to 12/31/2006? If so, have there been disallowances or adjustments to rate base or deferred expenses? If yes, please provide support and explanation.	☐	☒
14. Have there been any billing changes or adjustments to 2006 billings subsequent to 12/31/2006? If yes, please provide explanation.	☐	☒
15. Have there been adjustments made to significant estimates (e.g. accruals, provisions, etc.) made at the balance sheet date to the date of inquiry? If yes, please provide support and explanation.	☐	☒
16. Are you aware of any other significant events, transactions, or changes from prior year end through the date of inquiry? If yes, please provide explanation.	☐	☒
17. Are you aware of any fraud or suspected affecting the company? If yes, please provide explanation.	☐	☒
18. Has the Company reported any information to an external party since year end?	☐	☒

Michael A. Miller

Michael Miller
Treasurer and Comptroller,
Kentucky-American Water Company

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 85 of 312

Witness: Michael A. Miller

85. List each internal audit completed, scheduled, or in progress at the Company for 2004, 2005, 2006 and 2007. For each, list subject of audit, date of audit, date of report and title of report.

Response:

An internal audit was performed at KAWC in 2005. The scope of the audit included compliance with capital expenditure policies and procedures, compliance with federal and local EPA water quality standards, actual meter reads vs estimates, monitoring of developer deposits, fleet management and vehicle assignment policies and procedures, and employee payroll policies and procedures. The audit was completed December 13, 2005. The audit report was dated January 11, 2006 titled Kentucky –American Water Company REF:A0160/2005/A/26.

For electronic version, refer to KAW_R_AGDR1#85_061807.pdf

American Water

INTERNAL AUDIT SERVICES

To: Nick Rowe
Donna Braxton
Linda Bridwell
Frank Ross
Greg Tomko
Fred White
Rachel Cole

Cc: John Bigelow
Dietrich Firnhaber
Jim McGivern
Jeremy Pelczer
John Young

Internal Audit Services

Name Doneen Hobbs
Phone 856.309.4506
Fax 856.346.8360
E-Mail dhobbs@amwater.com

January 11, 2006

Kentucky - American Water Company: A0160/2005/A/26

Please find attached the final Audit Report and the Audit Status Report arising from the above audit work. The audit results have already been discussed with Donna Braxton, Frank Ross, Greg Tomko, Linda Bridwell, Nick Rowe, and Rachel Cole at an exit meeting held on December 13, 2005. Internal Audit's findings, recommendations and management responses including agreed timescales for clearance are outlined at the back of the report.

It was also agreed at the Exit meeting that Nick Rowe would be responsible for maintaining the Audit Status report and providing Internal Audit (and line management if requested) with the current status of the implementation of the agreed management actions.

In normal circumstances we will contact Nick Rowe for the updated position at the end of each quarter but in certain circumstances he may be asked to provide a more regular update. The memorandum requesting this information will be sent at least two weeks before the due date and the updated Audit Status Report must be provided in response to the request.

Please adhere to the agreed recommendation implementation dates since the Chief Executive has requested details of failures to implement agreed actions to be reported to him in quarterly IA progress reports. In addition, overdue agreed actions are also reported quarterly to RWE via the QRM process.

If you require any further information on the work carried out or the process going forward, please contact either Courtland L. Hines or myself.

Sincerely,

Doneen Hobbs

RWE GROUP

INTERNAL AUDIT SERVICES

Kentucky - American Water Company

REF: A0160/2005/A/26

STATUS: Final

REPORT DATE: 12/13/2005

Vice President Internal Audit:	Doneen Hobbs
Audit Manager:	Courtland Hines
Lead Auditor:	Will Vanjonack

Distribution :	Nick Rowe	Greg Tomko
	Donna Braxton	Fred White
	Linda Bridwell	Rachel Cole
	Frank Ross	
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	Dietrich Firnhaber	John Young
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CONTENTS

1. Introduction
2. Audit Objectives
3. Audit Scope
4. Reporting
5. Conclusion
6. Detailed Recommendations
7. Contact Listing

American Water

1. Introduction

Kentucky-American Water Company (the Company) provides water service to approximately 111,000 customers and wastewater service to approximately 83 customers. These services are provided in 18 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 Kentucky Public Service Commission (the Commission). The Company is a wholly-owned subsidiary of American Water Works Company, Inc. (American). Effective January 10, 2003, American was acquired by Thames Water Aqua US Holdings, Inc, which is a wholly-owned subsidiary of RWE Aktiengesellschaft (RWE)

Business objectives:
To provide quality and reliable water service to its customer at a reasonable price while returning a reasonable profit to the company

2. Audit Objectives

To review and evaluate the adequacy, effectiveness, and efficiency of internal controls and compliance with corporate and regional policies relating to meter reads/billing, payroll, and fleet vehicle management. Additional objectives include a review of management concerns relating to capital expenditures, water quality, and developer deposits.

3. Audit Scope

The scope of the audit will be concentrated on the following functional areas in the Kentucky American Water Central District:

- Compliance with capital expenditure policies and procedures.
- Compliance with federal and local EPA water quality standards.
- Actual meter reads vs. estimates.
- Monitoring of developer deposits.
- Fleet management and vehicle assignment policies and procedures.
- Employee payroll policies and procedures.

4. Reporting

Our report has been prepared on an exception basis, highlighting only those areas where we consider improvement is required.

We will review implementation of all management responses to our recommendations within four months of the date of the report.

5. Conclusion

We have audited the effectiveness of and efficiency of the internal control system of Kentucky American Water based on the scope noted above and identified the following weaknesses in controls:

Meter Reading:

- Inadequate documentation supporting consecutive estimated read billing/reporting

Developer Deposit:

- Inadequate independence disclosure in preferred contractor application

Fleet Management:

- Inadequate vehicle tracking
- Inadequate employee motor vehicle record background checks
- Incomplete and unapproved Fleet Program Governance
- Inadequate corporate analysis performed on lease accounting
- Inadequate tracking of on call employees and emergency response instances
- Inadequate submission and review of mileage tracking for 525a

Our recommendations were discussed with Donna Braxton, Frank Ross, Greg Tomko, Linda Bridwell, Nick Rowe, and Rachel Cole at an exit meeting held on December 13, 2005. Their comments, together with details of management action, are set out in section 6.

6. Detailed Recommendations

Ref	Finding	Risk	Recommendation	Priority	Management Response
01	**Meter Reading** **Consecutive monthly estimated meter read report review is not documented.** It is good business practice to ensure all Kentucky State regulations are met. Kentucky regulations require that no more than two consecutive estimated reads can be used to bill the customer. Testing of the monthly scorecards revealed that Kentucky American Water is meeting the meter read benchmark of 98% however; Kentucky American Water is not documenting the review process used to ensure that a premise does not receive three consecutive estimated reads.	A premise is billed for 3 or more estimated amounts resulting in non-compliance with state regulations.	Kentucky American Water should institute a review process that will provide evidence for the review of the consecutive estimated read reports. The addition of this layer of evidence will ensure that it is completed for every billing cycle.	2	*Comment:* *Previously KAW has reviewed and discarded the related reports. In the future these hard copies will be filed and kept for future reference and ensuring the regulations are being met. This process will be instituted beginning January 3, 2006.* *Responsibility: Fred White & Bill Buckner* *Target Date: Thursday, April 13, 2006*

Ref	Finding	Risk	Recommendation	Priority	Management Response
02	<u>Developer Deposit</u> **Kentucky American Water requires that contractors who perform contract work must be on the approved vendor list. The approved vendor listing does not contain an independence disclosure section. This exclusion allows potential preferential treatment and the exposure that vendors may not be awarded contracts based on quality of service and price.** It is good business practice for Kentucky American Water to have full knowledge of any parties which are contracted to do work on their behalf. Kentucky American Water requires that contractors who perform contract work must be on the approved vendor list. The approved vendor listing does not contain an independence disclosure section. This exclusion allows potential preferential treatment and the exposure that vendors may not be awarded contracts based on quality of service and price.	Award of main extension contracts are not based on competitive price, quality, or other terms resulting in inferior work and higher expense.	An independence disclosure section must be added to the vendor approval application.	2	*Comment:* *Kentucky American Water's New Development Project Manager (Greg Tomko) will work with legal counsel to develop the appropriate language for an independence disclosure section to be added to the vendor approval application. This language will be prepared and added to the application by January 31, 2006.* *Responsibility: Linda Bridwell* *Target Date: Thursday, April 13, 2006*

Ref	Finding	Risk	Recommendation	Priority	Management Response
03	<u>Fleet Management</u> **Kentucky American Water maintains the vehicle tracking spreadsheet, however, the tracking spreadsheet does not track vehicles on the basis of employee responsibility.** It is good business practice to maintain complete records for all fleet and pool vehicles. Each vehicle should be assigned to a supervisor or practice group to ensure that in the event of a loss or an expense incurred, it will be adequately tracked. Kentucky American Water maintains the vehicle tracking spreadsheet; however, the tracking spreadsheet does not track vehicles on the basis of employee responsibility.	Vehicles are not tracked and employees who are responsible for each piece of equipment cannot be identified.	Kentucky American Water should expand the tracking sheet to include all pertinent information on fleet vehicles. Identifying and including the employee responsibility information in the tracking spreadsheet will allow Kentucky American Water to track fleet vehicles more accurately.	2	*Comment:* *Currently, the Distribution department maintains a log of all employees and the vehicle they are driving each day as well as the work location where applicable. This log is updated to reflect when an employee drives a different vehicle. In other departments vehicles are assigned. If for some reason that vehicle is out of service a pool car is requested and that request is logged as well. In addition, a new log will be created for the meter readers.* *Responsibility: Frank Ross* *Target Date: Thursday, April 13, 2006*

Ref	Finding	Risk	Recommendation	Priority	Management Response
04	**Kentucky American Water does not perform yearly reviews of employee motor vehicle records for both validity and infractions to ensure the company does not incur unnecessary legal liability.** It is a good business practice to have an approved and implemented comprehensive Fleet Program Governance to reasonably ensure the organization is not exposed to unnecessary legal liability. Kentucky American Water does not perform yearly reviews of employee motor vehicle records for both validity and infractions to ensure the company does not incur unnecessary legal liability.	Employee motor vehicle records are not searched for infractions and validity at subsequent points during employment.	a. Company should ensure that any employee who requires a company vehicle to perform her/his job duties should have a valid driver's license and a clean driving record prior to gaining access to a company vehicle. b. Driving record of employees who were assigned with a company vehicle should be checked at least once a year. c. A policy should be established to stipulate what will prohibit the employee from driving a company vehicle, the policy should include but not limited to the following incidents: - Convictions, - Failure to appear in court, - Accidents, - Driver license suspensions	2	*Comment:* *We agree that periodic checks to confirm that all drivers have valid licenses need to be done, and will establish a policy/procedure to that effect.* *We are less comfortable with the recommendations related to checking individuals' driving records, as well as the suggested requirements for use of a personal vehicle for company business. We believe these issues need to be reviewed at the corporate level in conjunction with risk management and the legal staff. In the absence of corporate direction, however, we will contact the appropriate areas to formulate a recommendation that spells out the depth to which such inquiries should be made, to appropriately balance the cost, administrative burden and privacy concerns against our*

Ref	Finding	Risk	Recommendation	Priority	Management Response
			or revocations, and - Driving under influence (DUI). d. Policy and procedures should be established with sufficient stipulations and restrictions defined to address liability when using a company fleet vehicle and/or a personal vehicle for business purposes. The policy should include but not limited to the following provisions: For Company Fleet Vehicles: - Driver has a valid driver's license and - Driver's license is not suspended or revoked. For Personal Vehicles: - Driver has a valid driver's license, - Valid registration of vehicle, - Vehicle is insured, - Vehicle state and emission inspections are valid, - Driver's license is not suspended or revoked, and - No legal proceedings are currently taken place in regard to DUI, unpaid of		*need to protect the company from liability.* *Responsibility: Frank Ross* *Target Date: Thursday, April 13, 2006*

Ref	Finding	Risk	Recommendation	Priority	Management Response
			tickets, etc. e. A process should be established to ensure that every employee is asked to acknowledge this policy in writing when signing out a company fleet vehicle or driving a personal vehicle for business purposes.		
05	**Incomplete and unapproved Fleet Program Governance.** It is a good business practice to have an approved and implemented comprehensive Fleet Program Governance to reasonably ensure the organization is not exposed to unnecessary legal liability. While the corporation does have a Vehicle Utilization Policy it does not contain all of the key elements to protect the organization from unnecessary legal liability. Note: A comprehensive Corporate Fleet Program Governance is still in the draft stage and awaiting final revision prior to being approved by the Executive Management Team (EMT).	The absence of a Fleet Program Governance may result in exposure to unnecessary legal liability, and increased cost to operations. An approved Fleet Program Governance is necessary to provide guidelines that local offices can use as reference to manage company vehicles.	a. In short of a comprehensive Fleet Program, local management should include, but not be limited to the following key elements as part of their regular review of users operating fleet vehicles: - Registration, titling, and taxation of vehicles; - Fuelling; - Traffic and parking violations; - Vehicle collisions and accidents; - Insurance; - Driver license requirements; - Safety; and - Safeguarding of company	2	*Comment:* *a. SER management agrees that a process should be in place to ensure safeguards such as those listed are addressed. SER anticipates that such a role is best addressed with designated responsibility, and expect to evaluate the elements need to be reviewed, at what intervals, and who (internal vs. external sources) could most efficiently administer this recommendation.* *b. SER Management anticipates a fleet manager role will address the periodic practice requirements referenced.*

Ref	Finding	Risk	Recommendation	Priority	Management Response
			vehicles. b. Corporate Fleet Management should take the necessary steps to put forth a comprehensive Fleet Program Governance to guide local offices on expected and best practices. Included in the Fleet Program should be a requirement that a review be performed on a periodic basis to reasonably ensure the program operates as intended. c. The Tax Department should establish a Corporate Policy that incorporates applicable IRS requirements to provide employees with adequate guidance with regards to IRS rules and regulations. d. The approved policies and procedures should be communicated to all employees.		*c. SER engaged the tax department regarding the issues identified in the audit. The Tax Department (Bill Schiavi and Ben Tartaglia) have indicated a willingness to provide the guidance requested, and ensure the vehicle policy incorporates the tax reporting requirements.* *Responsibility: Nick Rowe* *Target Date: Thursday, April 13, 2006*

Ref	Finding	Risk	Recommendation	Priority	Management Response
06	**The decision to account for vehicle leases as operating leases was not made by financial management.** Sound internal controls require financial reporting decisions to be made by professionals who by experience, education, training, and judgment are well versed in applicable financial accounting standards. During our review, we noted the decision to account for vehicle leases as operating leases was delegated by the Comptroller to Supply Chain Management. American Water entered into a Master Lease Agreement (MLA) with ARI in April of 2003. Lease payments vary based upon depreciation periods, which vary by vehicle type. Vehicles surrendered to ARI prior to the end of the applicable depreciation period result in a lease adjustment equal to the difference between the resale proceeds and the depreciated value of the vehicle. American Water bears the risk of loss and is responsible for insuring the leased vehicles. As of September 30, 2005, the Company leased 1,045 vehicles from ARI with a net capital lease value of $32.7 million. American Water produces its financial statements in accordance with US Generally Accepted Accounting Principles (GAAP). The American Water US GAAP financial statements are converted to those	Inappropriate delegation of financial reporting decisions (1) may result in the issuance of financial statements not prepared in accordance with US GAAP or IFRS applied on a consistent basis, (2) increases the risk of restating previously issued financial statements, (3) may result in violations of applicable securities regulations, and (4) increases the Company's exposure to litigation due to improper financial reporting.	Financial management should evaluate the ARI MLA and determine the appropriate accounting treatment under both US GAAP and IFRS. Additionally, financial reporting decisions should be designated as Finance responsibilities and should not be delegated to other functional areas.	1	*Comment:* *This is a responsibility of corporate accounting provided we are allowed to fill some new technical accounting roles that have been recently discussed. The additional resource will be requested by John Bigelow by January 31, 2006, with John's response by February 28, 2006. If approved, we will go through a normal hiring process. Once the individual is on board, we would target the issue to be addressed within 90 days.* *Responsibility: Robert D. Sievers* *Target Date: Friday, January 13, 2006*

American Water

Ref	Finding	Risk	Recommendation	Priority	Management Response
	based upon International Financial Reporting Standards (IFRS) for RWE consolidation. Leases are classified as operating or capital leases under US GAAP and as operating or financing leases under IFRS. US GAAP and IFRS have different criteria to distinguish the type of leases. It is possible for lease categorization to be different under the above financial reporting standards (e.g., an operating lease under US GAAP could be classified as a financing lease under IFRS). Under US GAAP, the ARI MLA would be classified as a capital lease if it meets one of the following criteria: 1.. The lease term, as specified in FAS13, is more than 75% of the estimated useful life of an asset; 2. The present value of the minimum lease payments, as defined in FAS13, equals or exceeds 90% of the fair market value of the leased asset. IFRS specify finance leases are those that transfer all the risks and rewards incident to ownership to the lessee.				

Ref	Finding	Risk	Recommendation	Priority	Management Response
07	**Kentucky American Water does not maintain an on call log or emergency response log.** It is a good business practice to have an approved and implemented comprehensive Fleet Program Governance to reasonably ensure the organization is not exposed to unnecessary expense. The lack of an on call log and emergency response log does not allow Kentucky American Water to track the usage of company vehicles.	On-call log is not maintained resulting in the inability to track the usage of vehicles for personal vs. business use.	Kentucky American Water should create a tracking log for all vehicles used for emergency calls. Employees should be required to track vehicle usage to ensure that personal mileage can be accurately tracked.	2	*Comment:* *A policy of tracking this personal mileage when an employee is on call will be put in place.* *Responsibility: Donna Braxton & Frank Ross* *Target Date: Thursday, April 13, 2006*

Ref	Finding	Risk	Recommendation	Priority	Management Response
08	**Proper reporting of personal mileage on Form 525a is not tracked or approved.** It is a good business practice to have an approved and implemented comprehensive Fleet Program Governance to reasonably ensure the organization is not exposed to unnecessary legal liability and expense. Kentucky American Water employee's who have been assigned vehicles are not properly reporting personal mileage to the payroll department. The local fleet management team does not monitor or approve employee 525a forms. The corporate payroll team has not received a listing of employee's which have been issued a vehicle which impairs their ability to monitor the receipt of 525a forms. IA reviewed 7 employee 525a submissions for a 3 month period. 2 of 7 employees reported mileage for each of the sampled months. The remaining 5 employee's did not submit 525a forms for multiple reporting periods.	Inappropriate fleet expense may be incurred.	Kentucky American in conjunction with corporate payroll should institute a review function for all employees whom are required to report personal mileage on form 525a. A listing of all employees whom are assigned a pool vehicle should be provided to corporate payroll by the local management. Each reporting period the supervisor approved 525a's should be sent to corporate payroll for inclusion in wage calculations. Lastly, reconciliation should be performed between employees whom are listed to the approved 525a forms received each period.	2	*Comment:* *A policy will be established where the HR department will verify that each employee that drives a company vehicle turns in their 525A form at the end of each month.* *Responsibility: Frank Ross* *Target Date: Thursday, April 13, 2006*

7. Contact Listing

Name	Title
Nick Rowe	President - Kentucky American
Rachel Cole	Financial Analyst
Donna Braxton	Human Resources Manager
Linda Bridwell	Special Delivery and Development Service Manager
Fred White	Operations Superintendent
Greg Tomko	Project Manager
Frank Ross	Loss Control Supervisor

Status Update Report – A0160/2005/A - Kentucky - American Water Company

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
02	<u>DEVELOPER DEPOSIT</u> **KENTUCKY AMERICAN WATER REQUIRES THAT CONTRACTORS WHO PERFORM CONTRACT WORK MUST BE ON THE APPROVED VENDOR LIST. THE APPROVED VENDOR LISTING DOES NOT CONTAIN AN INDEPENDENCE DISCLOSURE SECTION. THIS EXCLUSION ALLOWS POTENTIAL PREFERENTIAL TREATMENT AND THE EXPOSURE THAT VENDORS MAY NOT BE AWARDED CONTRACTS BASED ON QUALITY OF SERVICE AND PRICE.** It is good business practice for Kentucky American Water to have full knowledge of any parties which are contracted to do work on their behalf. Kentucky American Water requires that contractors who perform contract work must be on the approved vendor list. The approved vendor listing does not contain an	Award of main extension contracts are not based on competitive price, quality, or other terms resulting in inferior work and higher expense.	An independence disclosure section must be added to the vendor approval application.	2	*Comment:* *Kentucky American Water's New Development Project Manager (Greg Tomko) will work with legal counsel to develop the appropriate language for an independence disclosure section to be added to the vendor approval application. This language will be prepared and added to the application by January 31, 2006.* *Responsibility: Linda Bridwell* *Target Date: Thursday, April 13, 2006*	Comment: These records are now being maintained in the Network department and are available for reference at any time. Completed by: Fred White Date: January 3, 2006. **OPEN - NOTE: THIS ITEM WILL BE CLOSED UPON VALIDATION BY IA.**

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	independence disclosure section. This exclusion allows potential preferential treatment and the exposure that vendors may not be awarded contracts based on quality of service and price.					
03	<u>FLEET MANAGEMENT</u> **KENTUCKY AMERICAN WATER MAINTAINS THE VEHICLE TRACKING SPREADSHEET, HOWEVER, THE TRACKING SPREADSHEET DOES NOT TRACK VEHICLES ON THE BASIS OF EMPLOYEE RESPONSIBILITY.** It is good business practice to maintain complete records for all fleet and pool vehicles. Each vehicle should be assigned to a supervisor or practice group to ensure that in the event of a loss or an expense incurred, it will be adequately tracked. Kentucky American Water maintains the vehicle tracking spreadsheet; however, the tracking spreadsheet does not track vehicles on the basis of employee responsibility.	Vehicles are not tracked and employees who are responsible for each piece of equipment cannot be identified.	Kentucky American Water should expand the tracking sheet to include all pertinent information on fleet vehicles. Identifying and including the employee responsibility information in the tracking spreadsheet will allow Kentucky American Water to track fleet vehicles more accurately.	2	*Comment:* *Currently, the Distribution department maintains a log of all employees and the vehicle they are driving each day as well as the work location where applicable. This log is updated to reflect when an employee drives a different vehicle. In other departments vehicles are assigned. If for some reason that vehicle is out of service a pool car is requested and that request is logged as well. In addition, a new log will be created for the meter readers.* *Responsibility: Frank Ross* *Target Date: Thursday, April 13, 2006*	Comment: These logs are maintained in the Network department and are available through the dispatcher that is on duty. A new log has been created for the meter readers and is currently in use. Completed by: Frank Ross Date: January 3, 2006 **OPEN - NOTE: THIS ITEM WILL BE CLOSED UPON VALIDATION BY IA.**
04	**KENTUCKY AMERICAN**			2		

American Water

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	WATER DOES NOT PERFORM YEARLY REVIEWS OF EMPLOYEE MOTOR VEHICLE RECORDS FOR BOTH VALIDITY AND INFRACTIONS TO ENSURE THE COMPANY DOES NOT INCUR UNNECESSARY LEGAL LIABILITY. It is a good business practice to have an approved and implemented comprehensive Fleet Program Governance to reasonably ensure the organization is not exposed to unnecessary legal liability. Kentucky American Water does not perform yearly reviews of employee motor vehicle records for both validity and infractions to ensure the company does not incur unnecessary legal liability.	Employee motor vehicle records are not searched for infractions and validity at subsequent points during employment.	a. Company should ensure that any employee who requires a company vehicle to perform her/his job duties should have a valid driver's license and a clean driving record prior to gaining access to a company vehicle. b. Driving record of employees who were assigned with a company vehicle should be checked at least once a year. c. A policy should be established to stipulate what will prohibit the employee from driving a company vehicle, the policy should include but not limited to the following incidents: - Convictions, - Failure to appear in court, - Accidents, - Driver license suspensions or revocations, and - Driving under influence (DUI). d. Policy and procedures		*Comment:* *We agree that periodic checks to confirm that all drivers have valid licenses need to be done, and will establish a policy/procedure to that effect.* *We are less comfortable with the recommendations related to checking individuals' driving records, as well as the suggested requirements for use of a personal vehicle for company business. We believe these issues need to be reviewed at the corporate level in conjunction with risk management and the legal staff. In the absence of corporate direction, however, we will contact the appropriate areas to formulate a recommendation that spells out the depth to which such inquiries should be made, to appropriately balance the cost, administrative burden and privacy concerns against our need to protect the company from liability.* *Responsibility: Frank Ross* *Target Date: Thursday, April 13, 2006*	Comment: We have and will continue to verify all employees have a current driver's license. We will follow any corporate direction regarding checking employees Motor Vehicle Records. Completed by: Frank Ross Date:January 3, 2006 **OPEN**

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
			should be established with sufficient stipulations and restrictions defined to address liability when using a company fleet vehicle and/or a personal vehicle for business purposes. The policy should include but not limited to the following provisions: For Company Fleet Vehicles: - Driver has a valid driver's license and - Driver's license is not suspended or revoked. For Personal Vehicles: - Driver has a valid driver's license, - Valid registration of vehicle, - Vehicle is insured, - Vehicle state and emission inspections are valid, - Driver's license is not suspended or revoked, and - No legal proceedings are currently taken place in regard to DUI, unpaid of tickets, etc.			

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
			e. A process should be established to ensure that every employee is asked to acknowledge this policy in writing when signing out a company fleet vehicle or driving a personal vehicle for business purposes.			
05	**INCOMPLETE AND UNAPPROVED FLEET PROGRAM GOVERNANCE.** It is a good business practice to have an approved and implemented comprehensive Fleet Program Governance to reasonably ensure the organization is not exposed to unnecessary legal liability. While the corporation does have a Vehicle Utilization Policy it does not contain all of the key elements to protect the organization from unnecessary legal liability. Note: A comprehensive Corporate Fleet Program Governance is still in the draft stage and awaiting final revision prior to being approved by the Executive Management Team (EMT).	The absence of a Fleet Program Governance may result in exposure to unnecessary legal liability, and increased cost to operations. An approved Fleet Program Governance is necessary to provide guidelines that local offices can use as reference to manage company vehicles.	a. In short of a comprehensive Fleet Program, local management should include, but not be limited to the following key elements as part of their regular review of users operating fleet vehicles: - Registration, titling, and taxation of vehicles; - Fuelling; - Traffic and parking violations; - Vehicle collisions and accidents; - Insurance; - Driver license requirements; - Safety; and - Safeguarding of company vehicles.	2	*Comment:* *a. SER management agrees that a process should be in place to ensure safeguards such as those listed are addressed. SER anticipates that such a role is best addressed with designated responsibility, and expect to evaluate the elements need to be reviewed, at what intervals, and who (internal vs. external sources) could most efficiently administer this recommendation.* *b. SER Management anticipates a fleet manager role will address the periodic practice requirements referenced.* *c. SER engaged the tax department regarding the issues identified in the audit.*	Comment: Completed by: Date:

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
			b. Corporate Fleet Management should take the necessary steps to put forth a comprehensive Fleet Program Governance to guide local offices on expected and best practices. Included in the Fleet Program should be a requirement that a review be performed on a periodic basis to reasonably ensure the program operates as intended. c. The Tax Department should establish a Corporate Policy that incorporates applicable IRS requirements to provide employees with adequate guidance with regards to IRS rules and regulations. d. The approved policies and procedures should be communicated to all employees.		*The Tax Department (Bill Schiavi and Ben Tartaglia) have indicated a willingness to provide the guidance requested, and ensure the vehicle policy incorporates the tax reporting requirements.* *Responsibility: Nick Rowe* *Target Date: Thursday, April 13, 2006*	
06	**THE DECISION TO ACCOUNT FOR VEHICLE LEASES AS OPERATING LEASES WAS NOT MADE BY FINANCIAL MANAGEMENT.**	Inappropriate delegation of financial reporting decisions (1) may result in the issuance	Financial management should evaluate the ARI MLA and determine the	1	*Comment:* *This is a responsibility of corporate accounting provided we are allowed to fill some*	Comment: Completed by: Date:

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	Sound internal controls require financial reporting decisions to be made by professionals who by experience, education, training, and judgment are well versed in applicable financial accounting standards. During our review, we noted the decision to account for vehicle leases as operating leases was delegated by the Comptroller to Supply Chain Management. American Water entered into a Master Lease Agreement (MLA) with ARI in April of 2003. Lease payments vary based upon depreciation periods, which vary by vehicle type. Vehicles surrendered to ARI prior to the end of the applicable depreciation period result in a lease adjustment equal to the difference between the resale proceeds and the depreciated value of the vehicle. American Water bears the risk of loss and is responsible for insuring the leased vehicles. As of September 30, 2005, the Company leased 1,045 vehicles from ARI with a net capital lease value of $32.7 million. American Water produces its financial statements in	of financial statements not prepared in accordance with US GAAP or IFRS applied on a consistent basis, (2) increases the risk of restating previously issued financial statements, (3) may result in violations of applicable securities regulations, and (4) increases the Company's exposure to litigation due to improper financial reporting.	appropriate accounting treatment under both US GAAP and IFRS. Additionally, financial reporting decisions should be designated as Finance responsibilities and should not be delegated to other functional areas.		*new technical accounting roles that have been recently discussed. The additional resource will be requested by John Bigelow by January 31, 2006, with John's response by February 28, 2006. If approved, we will go through a normal hiring process. Once the individual is on board, we would target the issue to be addressed within 90 days.* *Responsibility: Robert D. Sievers* *Target Date: Friday, January 13, 2006*	

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	accordance with US Generally Accepted Accounting Principles (GAAP). The American Water US GAAP financial statements are converted to those based upon International Financial Reporting Standards (IFRS) for RWE consolidation. Leases are classified as operating or capital leases under US GAAP and as operating or financing leases under IFRS. US GAAP and IFRS have different criteria to distinguish the type of leases. It is possible for lease categorization to be different under the above financial reporting standards (e.g., an operating lease under US GAAP could be classified as a financing lease under IFRS). Under US GAAP, the ARI MLA would be classified as a capital lease if it meets one of the following criteria: 1.. The lease term, as specified in FAS13, is more than 75% of the estimated useful life of an asset; 2. The present value of the minimum lease payments, as defined in FAS13, equals or exceeds 90% of the fair market value of the leased asset.					

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	IFRS specify finance leases are those that transfer all the risks and rewards incident to ownership to the lessee.					
07	**KENTUCKY AMERICAN WATER DOES NOT MAINTAIN AN ON CALL LOG OR EMERGENCY RESPONSE LOG.** It is a good business practice to have an approved and implemented comprehensive Fleet Program Governance to reasonably ensure the organization is not exposed to unnecessary expense. The lack of an on call log and emergency response log does not allow Kentucky American Water to track the usage of company vehicles.	On-call log is not maintained resulting in the inability to track the usage of vehicles for personal vs. business use.	Kentucky American Water should create a tracking log for all vehicles used for emergency calls. Employees should be required to track vehicle usage to ensure that personal mileage can be accurately tracked.	2	*Comment:* *A policy of tracking this personal mileage when an employee is on call will be put in place.* *Responsibility: Donna Braxton & Frank Ross* *Target Date: Thursday, April 13, 2006*	Comment: This policy is currently in place. Completed by: Frank Ross Date: January 3, 2006 **OPEN - NOTE: THIS ITEM WILL BE CLOSED UPON VALIDATION BY IA.**
08	**PROPER REPORTING OF PERSONAL MILEAGE ON FORM 525A IS NOT TRACKED OR APPROVED.** It is a good business practice to have an approved and implemented comprehensive Fleet Program Governance to	Inappropriate fleet expense may be incurred.	Kentucky American in conjunction with corporate payroll should institute a review function for all employees whom are required to report personal mileage on	2	*Comment:* *A policy will be established where the HR department will verify that each employee that drives a company vehicle turns in their 525A form at the end of each month.* *Responsibility: Frank Ross*	Comment: This policy is currently in place. Completed by: Frank Ross Date: January 3, 2006

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	reasonably ensure the organization is not exposed to unnecessary legal liability and expense. Kentucky American Water employee's who have been assigned vehicles are not properly reporting personal mileage to the payroll department. The local fleet management team does not monitor or approve employee 525a forms. The corporate payroll team has not received a listing of employee's which have been issued a vehicle which impairs their ability to monitor the receipt of 525a forms. IA reviewed 7 employee 525a submissions for a 3 month period. 2 of 7 employees reported mileage for each of the sampled months. The remaining 5 employee's did not submit 525a forms for multiple reporting periods.		form 525a. A listing of all employees whom are assigned a pool vehicle should be provided to corporate payroll by the local management. Each reporting period the supervisor approved 525a's should be sent to corporate payroll for inclusion in wage calculations. Lastly, reconciliation should be performed between employees whom are listed to the approved 525a forms received each period.		*Target Date: Thursday, April 13, 2006*	**OPEN - NOTE: THIS ITEM WILL BE CLOSED UPON VALIDATION BY IA.**

American Water

Status Update Report – A0160/2005/A - Kentucky - American Water Company

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
01	<u>METER READING</u> **CONSECUTIVE MONTHLY ESTIMATED METER READ REPORT REVIEW IS NOT DOCUMENTED.** It is good business practice to ensure all Kentucky State regulations are met. Kentucky regulations require that no more than two consecutive estimated reads can be used to bill the customer. Testing of the monthly scorecards revealed that Kentucky American Water is meeting the meter read benchmark of 98% however; Kentucky American Water is not documenting the review process used to ensure that a premise does not receive three consecutive estimated reads.	A premise is billed for 3 or more estimated amounts resulting in non-compliance with state regulations.	Kentucky American Water should institute a review process that will provide evidence for the review of the consecutive estimated read reports. The addition of this layer of evidence will ensure that it is completed for every billing cycle.	2	*Comment:* *Previously KAW has reviewed and discarded the related reports. In the future these hard copies will be filed and kept for future reference and ensuring the regulations are being met. This process will be instituted beginning January 3, 2006.* *Responsibility: Fred White & Bill Buckner* *Target Date: Thursday, April 13, 2006*	Comment: These records are now being maintained in the Network department and are available for reference at any time. Completed by: Fred White Date: January 3, 2006. **CLOSED**
02	<u>DEVELOPER DEPOSIT</u> **KENTUCKY AMERICAN WATER REQUIRES THAT CONTRACTORS WHO PERFORM CONTRACT WORK MUST BE ON THE APPROVED VENDOR LIST. THE**	Award of main extension contracts are not based on competitive price, quality, or other terms resulting in inferior work and higher expense.	An independence disclosure section must be added to the vendor approval application.	2	*Comment:* *Kentucky American Water's New Development Project Manager (Greg Tomko) will work with legal counsel to develop the appropriate*	Comment: Completed by: Greg Tomko Date: : 01/31/06

RWE GROUP

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	APPROVED VENDOR LISTING DOES NOT CONTAIN AN INDEPENDENCE DISCLOSURE SECTION. THIS EXCLUSION ALLOWS POTENTIAL PREFERENTIAL TREATMENT AND THE EXPOSURE THAT VENDORS MAY NOT BE AWARDED CONTRACTS BASED ON QUALITY OF SERVICE AND PRICE. It is good business practice for Kentucky American Water to have full knowledge of any parties which are contracted to do work on their behalf. Kentucky American Water requires that contractors who perform contract work must be on the approved vendor list. The approved vendor listing does not contain an independence disclosure section. This exclusion allows potential preferential treatment and the exposure that vendors may not be awarded contracts based on quality of service and price.				*language for an independence disclosure section to be added to the vendor approval application. This language will be prepared and added to the application by January 31, 2006.* *Responsibility: Linda Bridwell Target Date: Thursday, April 13, 2006*	Update: 3/31/06 These forms were mailed to contractors on 02/08/09 and they were returned to KAW signed. These certifications are filed in the engineering department.
03	**<u>FLEET MANAGEMENT</u>** **KENTUCKY AMERICAN WATER MAINTAINS THE**	Vehicles are not tracked and	Kentucky American	2	*Comment:*	Comment: These logs are

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	VEHICLE TRACKING SPREADSHEET, HOWEVER, THE TRACKING SPREADSHEET DOES NOT TRACK VEHICLES ON THE BASIS OF EMPLOYEE RESPONSIBILITY. It is good business practice to maintain complete records for all fleet and pool vehicles. Each vehicle should be assigned to a supervisor or practice group to ensure that in the event of a loss or an expense incurred, it will be adequately tracked. Kentucky American Water maintains the vehicle tracking spreadsheet; however, the tracking spreadsheet does not track vehicles on the basis of employee responsibility.	employees who are responsible for each piece of equipment cannot be identified.	Water should expand the tracking sheet to include all pertinent information on fleet vehicles. Identifying and including the employee responsibility information in the tracking spreadsheet will allow Kentucky American Water to track fleet vehicles more accurately.		*Currently, the Distribution department maintains a log of all employees and the vehicle they are driving each day as well as the work location where applicable. This log is updated to reflect when an employee drives a different vehicle. In other departments vehicles are assigned. If for some reason that vehicle is out of service a pool car is requested and that request is logged as well. In addition, a new log will be created for the meter readers.* *Responsibility: Frank Ross Target Date: Thursday, April 13, 2006*	maintained in the Network department and are available through the dispatcher that is on duty. A new log has been created for the meter readers and is currently in use. Completed by: Frank Ross Date: January 3, 2006 **CLOSED**
04	**KENTUCKY AMERICAN WATER DOES NOT PERFORM YEARLY REVIEWS OF EMPLOYEE MOTOR VEHICLE RECORDS FOR BOTH VALIDITY AND INFRACTIONS TO ENSURE THE COMPANY DOES NOT INCUR UNNECESSARY LEGAL LIABILITY.** It is a good business practice to	Employee motor vehicle records are not searched for infractions and validity at subsequent points during employment.	a. Company should ensure that any employee who requires a company vehicle to perform her/his job duties should have a valid driver's license and a clean driving record prior to gaining access to a company vehicle.	2	*Comment:* *We agree that periodic checks to confirm that all drivers have valid licenses need to be done, and will establish a policy/procedure to that effect.* *We are less comfortable with the recommendations related to checking individuals' driving records, as well as the suggested requirements for*	Comment: : We have and will continue to verify all employees have a current driver's license. We will follow any corporate direction regarding checking employees Motor Vehicle Records. Completed by: Frank Ross

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	have an approved and implemented comprehensive Fleet Program Governance to reasonably ensure the organization is not exposed to unnecessary legal liability. Kentucky American Water does not perform yearly reviews of employee motor vehicle records for both validity and infractions to ensure the company does not incur unnecessary legal liability.		b. Driving record of employees who were assigned with a company vehicle should be checked at least once a year. c. A policy should be established to stipulate what will prohibit the employee from driving a company vehicle, the policy should include but not limited to the following incidents: - Convictions, - Failure to appear in court, - Accidents, - Driver license suspensions or revocations, and - Driving under influence (DUI). d. Policy and procedures should be established with sufficient stipulations and restrictions defined to address liability when using a company fleet vehicle and/or a personal vehicle for business purposes. The policy should include but not limited to the		*use of a personal vehicle for company business. We believe these issues need to be reviewed at the corporate level in conjunction with risk management and the legal staff. In the absence of corporate direction, however, we will contact the appropriate areas to formulate a recommendation that spells out the depth to which such inquiries should be made, to appropriately balance the cost, administrative burden and privacy concerns against our need to protect the company from liability.* *Responsibility: Frank Ross* *Target Date: Thursday, April 13, 2006*	Date:January 3, 2006 **OPEN** Update Comment: 03/30/06 All driver's licenses are reviewed on a monthly basis to ensure that they are all updated and valid. Reminders are sent to employees with expired licenses and copies of valid licenses are made. Completed: 3/30/06 Donna Braxton

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
			following provisions: For Company Fleet Vehicles: - Driver has a valid driver's license and - Driver's license is not suspended or revoked. For Personal Vehicles: - Driver has a valid driver's license, - Valid registration of vehicle, - Vehicle is insured, - Vehicle state and emission inspections are valid, - Driver's license is not suspended or revoked, and - No legal proceedings are currently taken place in regard to DUI, unpaid of tickets, etc. e. A process should be established to ensure that every employee is asked to acknowledge this policy in writing when signing out a company fleet vehicle or driving a personal vehicle for business purposes.			

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
05	**INCOMPLETE AND UNAPPROVED FLEET PROGRAM GOVERNANCE.** It is a good business practice to have an approved and implemented comprehensive Fleet Program Governance to reasonably ensure the organization is not exposed to unnecessary legal liability. While the corporation does have a Vehicle Utilization Policy it does not contain all of the key elements to protect the organization from unnecessary legal liability. Note: A comprehensive Corporate Fleet Program Governance is still in the draft stage and awaiting final revision prior to being approved by the Executive Management Team (EMT).	The absence of a Fleet Program Governance may result in exposure to unnecessary legal liability, and increased cost to operations. An approved Fleet Program Governance is necessary to provide guidelines that local offices can use as reference to manage company vehicles.	a. In short of a comprehensive Fleet Program, local management should include, but not be limited to the following key elements as part of their regular review of users operating fleet vehicles: - Registration, titling, and taxation of vehicles; - Fuelling; - Traffic and parking violations; - Vehicle collisions and accidents; - Insurance; - Driver license requirements; - Safety; and - Safeguarding of company vehicles. b. Corporate Fleet Management should take the necessary steps to put forth a comprehensive Fleet Program Governance to guide local offices on expected and best practices. Included in the Fleet Program should be a requirement	2	*Comment:* *a. SER management agrees that a process should be in place to ensure safeguards such as those listed are addressed. SER anticipates that such a role is best addressed with designated responsibility, and expect to evaluate the elements need to be reviewed, at what intervals, and who (internal vs. external sources) could most efficiently administer this recommendation.* *b. SER Management anticipates a fleet manager role will address the periodic practice requirements referenced.* *c. SER engaged the tax department regarding the issues identified in the audit. The Tax Department (Bill Schiavi and Ben Tartaglia) have indicated a willingness to provide the guidance requested, and ensure the vehicle policy incorporates the tax reporting requirements.* *Responsibility: Nick Rowe* *Target Date: Thursday, April 13, 2006*	Comment: In progress – will align with the other commitments made in the southeast region. Completed by: Date: a. SER has in place routine reviews of some of the items referenced (i.e., registration, fuel, accidents, etc.) now consolidated within the responsibility of the SER Fleet Manager role. SER will begin regular reviews of other items (i.e., parking & traffic violations) as privacy issues are addressed and Region personnel can align the reviews with proposed fleet governance policy. b. Region personnel met with Rob Allen, corporate fleet manager, to review his draft fleet policy on February 16. At that time, the draft policy only considered vehicle procurement. It was suggested, and agreed to

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
			that a review be performed on a periodic basis to reasonably ensure the program operates as intended. c. The Tax Department should establish a Corporate Policy that incorporates applicable IRS requirements to provide employees with adequate guidance with regards to IRS rules and regulations. d. The approved policies and procedures should be communicated to all employees.			by Rob, to make the draft policy a comprehensive fleet governance policy. Rob agreed to take the lead on this, and has since solicited recommendations and comment from the other regions. Region personnel met with Rob again on March 22 to review progress. Rob indicated that approval and issuance of a Corporate vehicle use governance policy, including tax ramification to employees, is being delayed pending Corporate HR resolution of issues related to the proposed governance policy. Policy anticipated to be completed by May 22, 2006. c. The Tax Department issued a draft policy for taxing personal use of Company vehicles on March 9 and requested SER comments. Region personnel recommended that the other regions be given the opportunity to provide comment to the draft for the purpose of incorporating taxation

American Water

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
						issues into a Company-wide, comprehensive fleet governance policy. Once a Corporate policy is established and approved, SER will comply in all respects. In particular, changes in tax implications will be communicated to all affected employees with lease values and consequences explained for all employees that currently use Company vehicles for commuting It is anticipated employees will have an opportunity (i.e., 30-60 days) to make a determination whether to continue taking the vehicle home or to make alternate commuting arrangements. Meeting is set with Rob Allen, Corporate fleet manager, March 22 to review draft Tax opinion for incorporation in Corporate policy. SER anticipates Corporate approvals for Company-wide fleet governance policy to be completed by May 22, 2006. Completed by: Nick Rowe Date: 3/22/06

American Water

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
06	**THE DECISION TO ACCOUNT FOR VEHICLE LEASES AS OPERATING LEASES WAS NOT MADE BY FINANCIAL MANAGEMENT.** Sound internal controls require financial reporting decisions to be made by professionals who by experience, education, training, and judgment are well versed in applicable financial accounting standards. During our review, we noted the decision to account for vehicle leases as operating leases was delegated by the Comptroller to Supply Chain Management. American Water entered into a Master Lease Agreement (MLA) with ARI in April of 2003. Lease payments vary based upon depreciation periods, which vary by vehicle type. Vehicles surrendered to ARI prior to the end of the applicable depreciation period result in a lease adjustment equal to the difference between the resale proceeds and the depreciated value of the vehicle. American Water bears the risk of loss and is responsible for insuring the leased vehicles. As of September 30, 2005, the	Inappropriate delegation of financial reporting decisions (1) may result in the issuance of financial statements not prepared in accordance with US GAAP or IFRS applied on a consistent basis, (2) increases the risk of restating previously issued financial statements, (3) may result in violations of applicable securities regulations, and (4) increases the Company's exposure to litigation due to improper financial reporting.	Financial management should evaluate the ARI MLA and determine the appropriate accounting treatment under both US GAAP and IFRS. Additionally, financial reporting decisions should be designated as Finance responsibilities and should not be delegated to other functional areas.	1	*Comment:* *This is a responsibility of corporate accounting provided we are allowed to fill some new technical accounting roles that have been recently discussed. The additional resource will be requested by John Bigelow by January 31, 2006, with John's response by February 28, 2006. If approved, we will go through a normal hiring process. Once the individual is on board, we would target the issue to be addressed within 90 days.* *Responsibility: Robert D. Sievers* *Target Date: Friday, January 13, 2006*	Comment: As called for in management's response for finding number 6 in the above referenced audit, please see below that we have submitted job descriptions for two technical accounting positions. Filling these role would allow us to do things such as review classification (operating or finance) of master lease agreements at the corporate level. As soon as we receive the go ahead from Mr. MacKenzie we will move forward on filling these positions. Completed by: B. Sievers Date: February 2006 **OPEN – Update received after due date. Cannot be closed until individuals are hired.** Job descriptions for two technical accounting positions have been submitted for approval. Filling these roles would

 RWE GROUP

American Water

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	Company leased 1,045 vehicles from ARI with a net capital lease value of $32.7 million. American Water produces its financial statements in accordance with US Generally Accepted Accounting Principles (GAAP). The American Water US GAAP financial statements are converted to those based upon International Financial Reporting Standards (IFRS) for RWE consolidation. Leases are classified as operating or capital leases under US GAAP and as operating or financing leases under IFRS. US GAAP and IFRS have different criteria to distinguish the type of leases. It is possible for lease categorization to be different under the above financial reporting standards (e.g., an operating lease under US GAAP could be classified as a financing lease under IFRS). Under US GAAP, the ARI MLA would be classified as a capital lease if it meets one of the following criteria: 1.. The lease term, as specified in FAS13, is more than 75% of the estimated useful life of an					allow us to do things such as review classification (operating or finance) of master lease agreements at the corporate level. As soon as we receive the go ahead from Mr. MacKenzie, we will move forward on filling these positions. Completed by: Robert Sievers Date: 2/14/06 Update 3/1/06 - Permission to fill these positions was received

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	asset; 2. The present value of the minimum lease payments, as defined in FAS13, equals or exceeds 90% of the fair market value of the leased asset. IFRS specify finance leases are those that transfer all the risks and rewards incident to ownership to the lessee.					
07	**KENTUCKY AMERICAN WATER DOES NOT MAINTAIN AN ON CALL LOG OR EMERGENCY RESPONSE LOG.** It is a good business practice to have an approved and implemented comprehensive Fleet Program Governance to reasonably ensure the organization is not exposed to unnecessary expense. The lack of an on call log and emergency response log does not allow Kentucky American Water to track the usage of company vehicles.	On-call log is not maintained resulting in the inability to track the usage of vehicles for personal vs. business use.	Kentucky American Water should create a tracking log for all vehicles used for emergency calls. Employees should be required to track vehicle usage to ensure that personal mileage can be accurately tracked.	2	*Comment:* *A policy of tracking this personal mileage when an employee is on call will be put in place.* *Responsibility: Donna Braxton & Frank Ross* *Target Date: Thursday, April 13, 2006*	Comment: This policy is currently in place. Completed by: Frank Ross Date: January 3, 2006 **CLOSED**
08	**PROPER REPORTING OF PERSONAL MILEAGE ON FORM 525A IS NOT TRACKED**	Inappropriate fleet expense may be incurred.	Kentucky American in conjunction with	2	*Comment:* *A policy will be established where the HR department will*	Comment: This policy is currently in place.

Ref	Finding	Risk	Recommendation	Priority	Management Response	Status Update (to be completed by client)
	OR APPROVED. It is a good business practice to have an approved and implemented comprehensive Fleet Program Governance to reasonably ensure the organization is not exposed to unnecessary legal liability and expense. Kentucky American Water employee's who have been assigned vehicles are not properly reporting personal mileage to the payroll department. The local fleet management team does not monitor or approve employee 525a forms. The corporate payroll team has not received a listing of employee's which have been issued a vehicle which impairs their ability to monitor the receipt of 525a forms. IA reviewed 7 employee 525a submissions for a 3 month period. 2 of 7 employees reported mileage for each of the sampled months. The remaining 5 employee's did not submit 525a forms for multiple reporting periods.		corporate payroll should institute a review function for all employees whom are required to report personal mileage on form 525a. A listing of all employees whom are assigned a pool vehicle should be provided to corporate payroll by the local management. Each reporting period the supervisor approved 525a's should be sent to corporate payroll for inclusion in wage calculations. Lastly, reconciliation should be performed between employees whom are listed to the approved 525a forms received each period.		*verify that each employee that drives a company vehicle turns in their 525A form at the end of each month.* *Responsibility: Frank Ross* *Target Date: Thursday, April 13, 2006*	Completed by: Frank Ross Date: January 3, 2006 **CLOSED**

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 86 of 312

Witness: Nick Rowe/Michael A. Miller

86. Provide a copy of the Company's most recent management and operations audit.

Response:

The Management Audit was performed in June, 1991, by Schumaker & Company for the Kentucky Public Service Commission and is titled: COMPREHENSIVE MANAGEMENT and OPERATIONS AUDIT of KENTUCKY-AMERICAN WATER COMPANY. The report contains 464 pages, is available at the Public Service Commission of the Commonwealth of Kentucky and will be made available by Kentucky-American Water Company for inspection by the Attorney General.

For the Operations Audit, please see attached.

For electronic version, refer to KAW_R_AGDR1#86_061807.pdf

Ernie Fletcher
Governor

LaJuana S. Wilcher, Secretary
Environmental and Public
Protection Cabinet

Christopher L. Lilly
Commissioner
Department of Public Protection

Commonwealth of Kentucky
Public Service Commission
211 Sower Blvd.
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Mark David Goss
Chairman

Teresa Hill
Vice-Chairman

Gregory Coker
Commissioner

November 9, 2006

Nick Rowe, President
Kentucky-American Water Company
2300 Richmond Road
Lexington, Kentucky 40502

RE: Periodic Regulatory Compliance Inspection

Dear Mr. Rowe:

On October 19, 2006, Joe Greenwell conducted a periodic regulatory compliance inspection of the Kentucky-American Water Company in Lexington, Kentucky. A copy of the report of that inspection is attached for your review. There were no deficiencies documented during the periodic inspection. The previous inspection of this facility was conducted on September 20, 2005. During that periodic inspection, one deficiency was documented and was corrected in a timely manner.

Please review the attached inspection report. If you have any questions or need additional information, please contact me at (502) 564-3940. We appreciate your continued interest in the safe operation of your facility.

Sincerely,

George W. Wakim

George W. Wakim, P.E., Manager
Water & Sewer Branch
Engineering Division

Attachment: Kentucky-AmericanWC-101906 Inspection Report
C: Julie Roney, Supervisor, Division of Water

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION

UTILITY INSPECTION REPORT

Report Date: 10/20/2006

Report Number: Kentucky-AmericanWC-101906

BRIEF

Inspector:	Joe Greenwell
Inspection Date:	10/19/2006
Type of Inspection:	Periodic Regulatory Compliance Inspection
Type of Facility:	Privately-owned water company
Name of Utility:	Kentucky-American Water Company
Location of Facility:	2300 Richmond Road, Lexington, Kentucky 40502; Attention: Nick Rowe, President
Purpose of Inspection:	Periodic inspection of utility facilities and management practices to verify compliance with PSC regulations
Applicable Regulations	KRS 278 and 807 KAR Chapter 5

INSPECTION

Description of Utility:	Water treatment plant with a capacity of 65 million gallons
Number of Customers:	115000
Area of Operation:	Bourbon, Clark, Fayette, Harrison, Jessamine, Scott, and Woodford Counties
Supply Source:	Kentucky River
Distribution Description:	Average daily consumption of 46 million gallons; 15,400 miles of distribution line (PVC, ductile iron, AC, and cast iron); total storage capacity of 24 million gallons
Workforce Summary:	125 employees: 72 office; 53 field
Utility Reps in Insp:	Dillard Griffin and Joe White
Date of Last Inspection:	9/20/2005
DTR from Last Insp:	1
DTRs not Cleared:	0

Summary of items and facilities Inspected:

Records including, but not limited to, pressure charts; meter testing, reading, and history; flushing; service interruptions; complaints; facilities inspections and procedures; facilities maintenance; safety guidelines; a copy of a water shortage response plan; and the service area map, etc.; high service pumps with intake and output lines at the Kentucky River Station; high service pumps; diesel engine for power outages; clarifier (1 of 8); clearwell (2 million gal); Cox Water Storage Facility; (1 million gal.); and the Cox #2 Water Storage Facility (1 million gal.).

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION

UTILITY INSPECTION REPORT

Report Date: 10/20/2006

Report Number: Kentucky-AmericanWC-101906

FINDINGS

RECOMMENDATIONS

ADDITIONAL INSPECTOR COMMENTS

The district was given a copy of the water utility inspection quick reference, the water utility inspection checklist, the Public Service Commission's water loss monthly report, the water utility inspection procedures outline, the general outline for inspection plans, and the new edition of the laws affecting public utilities.

The deficiency documented in the September 20, 2005 inspection regarding 807 KAR 5:066 Section 6(3) has been corrected. Water loss for 2004 was 15.5 percent; water loss for 2005 was 13 percent; and water loss through September 2006 was 13 percent. (See attachments.)

Kentucky-American Water Company's water storage capacity is approximately 24 million gallons compared to the daily consumption average of 46 million gallons. The company's deviation expired on 12/31/2005, and KAWC has submitted a new request for deviation.

A periodic regulatory compliance inspection will be conducted within a year.

Submitted by

GW Joe Greenwell

Joe Greenwell
Utility Regulatory and Safety Investigator III

Utility Type: Investor-Owned Water Companies Period: 1/1/2005

Kentucky-American Water Company aka Kentucky American Water

- Water Statistics

15800 Kentucky-American Water Company aka Kentucky American Water Water Statistics (Ref Pg. 35)		
	Gallons (Omit 000`s)	**Percent**
1.Water Produced, Purchased and Distributed:		**0**
2. Water Produced	15,897,589	
3. Water Purchased	170,742	
4.Total Produced and Purchased	**16,068,331**	
6.Water Sales:		
7. Residential	6,531,909	
8. Commercial	4,327,340	
9. Industrial	808,195	
10. Bulk Loading Stations	336	
11. Resale	444,438	
12. Other Sales	1,523,764	
13.Total Water Sales	**13,635,982**	
15.Other Water Used:		
16. Utility/water treatment plant		
17. Wastewater plant		
18 System flushing		
19. Fire department		
20. Other	320,982	
21. Total Other Water Used	**320,982**	
23. Water Loss		**0**
24. Tank Overflows		
25. Line Breaks		
26. Line Leaks		
27. Other	2,111,367	
28. Total Line Loss	**2,111,367**	
Note Line 13 + Line 21 + Line 28 Must equal Line 4		**0**
Water Loss Percentage		**0**
33. Line 28 divided by Line 4		**13.1399**

Utility Type: Investor-Owned Water Companies Period: 1/1/2004

Kentucky-American Water Company aka Kentucky American Water

- Water Statistics

15800 Kentucky-American Water Company aka Kentucky American Water Water Statistics (Ref Pg. 35)		
	Gallons (Omit 000`s)	**Percent**
1.Water Produced, Purchased and Distributed:		**0**
2. Water Produced	14,705,442	
3. Water Purchased	225,767	
4.Total Produced and Purchased	**14,931,209**	
6.Water Sales:		
7. Residential	5,729,658	
8. Commercial	4,011,583	
9. Industrial	755,945	
10. Bulk Loading Stations	2,965	
11. Resale	398,383	
12. Other Sales	1,400,619	
13.Total Water Sales	**12,299,153**	
15.Other Water Used:		
16. Utility/water treatment plant		
17. Wastewater plant		
18 System flushing		
19. Fire department		
20. Other	349,226	
21. Total Other Water Used	**349,226**	
23. Water Loss		**0**
24. Tank Overflows	2,308,198	
25. Line Breaks		
26. Line Leaks		
27. Other		
28. Total Line Loss	**2,308,198**	
Note Line 13 + Line 21 + Line 28 Must equal Line 4		**0**
Water Loss Percentage		**0**
33. Line 28 divided by Line 4		**15.5000**

.304 / 1000

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 87 of 312

Witness: Michael A. Miller

87. If applicable, list the expense associated with the most recent management audit. If the Company is amortizing the expense, list the amount of base and test period expense, the unamortized amount at December 31, 2004, 2005, 2006, and 2007 and state when the amortization will end.

Response:

There are no management audit expenses in the case and there are no unamortized deferred management audit expenses on the Company's books.

For electronic version, refer to KAW_R_AGDR1#87_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 88 of 312

Witness: Michael A. Miller

88. List each proposed pro forma entry which was considered in this filing but not made and state the reason(s) why the entry was not made.

Response:

The Company objects to this question because it is vague,; not withstanding the objection, the Company reviewed its historical financial and operational records, base period records, and its Business Plan in the development of its rate filing. From that data and all other more recent data, each element of the rate filing was produced. All known adjustments were included that were not one-time costs, non-recurring costs, or expenses not recoverable in rates.

For electronic version, refer to KAW_R_AGDR1#88_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 89 of 312

Witness:

89. Please provide, in Microsoft Excel or Excel compatible format, the year-end balances from December 31, 2004 through December 31, 2006, July 31, 2007 and the 13-month November 30, 2008 average total jurisdictional balances for the following:

a. Plant in Service (by category, both total and depreciable)
b. CWIP
c. Construction completed not classified
d. Accumulated Depreciation (by categories provided in part a, above)
e. Plant Held for Future Use
f. Customer Contributions in Aid of Construction
g. Customer Advances
h. Prepayments (by type)
i. Materials and Supplies - Operating by category
j. Materials and Supplies - Undistributed Stores Expense
k. Other Current Assets (by type)
l. Other Deferred Charges (by type)
m. Accumulated Deferred Income Taxes - Depreciation
n. Accumulated Deferred Income Taxes - Other (by type)
o. Miscellaneous Reserves (by type)
p. Retirement Work in Progress (by plant category)

Response:

The Company does not have the information available at this time to respond to this question, but will provide a response as soon as possible.

For electronic version, refer to KAW_R_AGDR1#89_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 90 of 312

Witness: Michael A. Miller

90. Please provide an explanation of all items included in the following accounts (by subaccount if any) and provide the appropriate jurisdictional amounts for the year ended December 31, 2004, December 31, 2005, December 31, 2006 and July 31, 2007:

a. Other Accounts Receivable
b. Accrued Utility Revenues
c. Miscellaneous Deferred Debits
d. Miscellaneous current and accrued liabilities
e. Other Deferred Credits

Response:

See attached schedule. The July 31, 2007 information will be provided when it is available.

For electronic version, refer to KAW_R_AGDR1#90_061807.pdf

Kentucky-American Water Company
Explanation of items AGDR1#90

Desc		December 2004	December 2005	December 2006
Accrued Utility Revenue				
144000	Accrued Utility Revenue	4,429,251.42	4,529,611.79	2,510,264.49
Miscellaneous Receivables				
146100	Misc A/R-System	398,808.20	444,827.60	541,006.77
146100.001	Misc A/R-Manual	224,480.74	145,748.82	45,154.49
146115	Misc A/R-Medicare Subsidy	0.00	0.00	20,476.31
146370	Accum prov-uncoll misc a/r	0.00	0.00	-3,657.57
146500.AW02	A/R Assoc Cos-AW02	0.00	0.00	146.79
146500.AW12	A/R Assoc Cos-AW12	0.00	0.00	-146.79
Miscellaneous Receivables		623,288.94	590,576.42	602,980.00
Other Deferred Debits				
184100	Eng Clearing Dist OH	24,604.45	270.20	0.00
184102	Mngmt Studu - AMR	0.00	35.46	0.00
184103	Mngmt Study - Pipe Assmnt	0.00	32.60	0.00
185125	RWIP Permits, Fees & Premiums	9.75	9.75	9.75
185150	RWIP M & S and Purchases	6,757.19	6,689.86	8,239.81
185200	RWIP Co Labor	166,286.39	188,966.56	234,315.42
185250	RWIP Co Labor OH	58,386.99	87,726.96	119,080.00
185275	RWIP Contracted Services	1,583,269.72	1,713,965.27	1,847,899.15
185280	RWIP Retainage	5,093.07	5,093.07	5,093.07
185315	RWIP Salvage	-51,871.00	-52,371.00	-67,062.60
185322	RWIP Scrap Misc	-780.00	-780.00	-780.00
185999	RWIP Clear Removal & Salvage	-1,169,149.95	-1,948,700.47	-2,139,192.95
186401	DDA-Programmed Maint	2,139,855.26	1,761,135.68	1,468,485.47
186405	DDA-RIA Software Licen	0.00	0.03	0.00
186426	DDA-FAS 112 Costs	6,278.00	6,278.00	61,130.00
186432	DDA-Cost of Service Study	24,555.86	8,569.71	0.00
186444	DDA-Waste Disposal	0.00	70,323.15	194,062.50
186492	DDA-Add'l Security Costs	287.49	0.00	15.10
186598	DDA-Oth Reg Assets	4,590,277.53	3,800,210.59	3,361,153.63
186703	DDN-Prelim Financing E	0.00	0.00	14,124.92
186704	DDN-Undistributed Items	-239,927.25	2,635.18	0.00
186704.2	DDN-Undist SC Bill	1,723.29	0.00	0.00
186705	DDN-IC Rec/Pay Clearing	-42,613.42	-274,629.58	0.00
186707	DDN-Ins Oth Than Grp Reg	-8,714.34	-37,411.26	2,916.10
186711	DDN-Acquisition Costs	38,593.40	19,296.78	0.33
186750	DDN-Engineering Studie	0.00	0.00	0.00
186898	DDN-Oth LT Assets	17,095.78	0.02	0.00
186898	DDN-Oth LT Assets			
Other Deferred Debits		7,150,018.21	5,357,346.56	5,109,489.70
Misc Current Liabilities				
241100	Accrued Vacation Pay	-81,851.24	-23,199.99	-24,138.25
241201	Accr Water Purchases	-42,005.86	-13,891.76	-33,268.16
241202	Accr Power	-97,000.00	-107,000.00	-273,336.96

241203	Accr Legal	0.00	0.00	-21,805.70
241204	Accr Audit	0.00	0.00	-1,055.00
241206	Accr Wages	-356,132.52	-327,816.00	-205,867.00
241207	Accr Insurance	0.00	-114.67	-1.06
241208	Accr Rents	-12,000.00	-12,000.00	-30,624.97
241210	Accr Waste Disposal	0.00	0.00	-120,218.18
241211	Accr Retiree Medical Reimb	0.00	0.00	-3,500.00
241212	Accr DCP Contribution	0.00	0.00	-5,238.53
241213	Accr EIP Contribution	-11,579.62	-10,141.63	0.00
241214	Accr Bank Fees	0.00	0.00	-34,155.52
241220.001	WH PR-Union Dues	-1,433.00	-1,457.93	0.00
241220.002	WH PR-Charity Contribution	2.00	2.00	0.00
241220.005	WH PR-Flex Spending Account	-157.31	-713.65	-1,774.37
241220.006	WH PR-401k Contribution	-3,952.12	-6,665.75	-30,824.08
241220.009	WH PR-EIP	-1,170.19	-56.22	0.00
241220.010	WH PR-Tax Coll Pay FIT	-23,478.06	-29,690.66	0.00
241220.011	WH PR-Tax Coll Pay SIT	-10,450.47	-11,959.74	0.00
241220.012	WH PR-Tax Coll Pay LIT	-8,463.72	-13,882.65	-16,375.66
241220.013	WH PR-Tax Coll Pay FICA	-16,028.78	-18,369.12	0.00
241220.999	WH PR-Miscellaneous	-36,827.78	-3,148.60	0.00
241225	Refund Rates Under Bonds	-76,654.00	0.00	0.00
241227	Accr Employer 401k Match	-24,250.93	-36,301.81	-10,510.05
241228	Accrued PFD Div Requirements	-20,832.08	-19,682.33	-19,460.10
241228.001	Accr PFD Div w/ mand	-31,762.50	0.00	0.00
241229	Accr Construction Costs Pay	0.00	-200,463.28	-57,053.20
241230	Unclaimed Credits Pay	-33,395.55	-26,056.57	-52,620.93
241234	Unclaimed Ext Dep Refund Pay	-6,158.93	-4,598.15	-4,598.15
241236	Unbilled Items-System	-9,897.46	-53,865.36	-28,771.29
241237	Unbilled Stock C-System	-37,620.92	-100,558.58	-66,572.45
241238	Unbilled Stock E-System	-18,299.56	-281,019.75	-113,168.22
241241.005	CFO-Cust Asst NonPledged	-165.00	-144.00	-226.00
241241.006	CFO-Cust Asst Pledged	-23.85	-92.00	-124.00
241244	CFO-Sales Tax	-637,662.06	-298,168.55	-370,382.05
241246	CFO-Gross Rcts Tax	-423,269.88	-200,303.95	38,041.80
241248	CFO-Mun Tax	194,711.03	-4,000.37	-1,367.80
241248.001	CFO-MC/Swr Rev/Cash	-1,749,831.86	-2,766,843.21	-2,418,632.52
241248.002	CFO-MC/Swr A/R	1,939,876.63	2,113,980.71	1,610,263.89
241248.004	CFO-MC/Swr ChgOff	343,416.46	417,258.51	644,337.60
241250	A/P Check Clearing	-911,365.05	-3,013,144.70	-3,375,861.04
241251	P/R Check Clearing	-134,566.42	-161,634.54	-1,492.71
241998	Other Curr Liab Analyzed	-369,831.05	-810,289.39	-668,941.13
Misc Current Liabilities		-2,710,111.65	-6,026,033.69	-5,699,321.79
Other Deferred Credits				
262110	DCA-Pension Liab AWWS	-582,877.10	-714,406.14	0.00
262120	DCA-Pension Pymt Op Co	-2,609,295.24	-2,965,911.20	-2,381,721.20
262210	DCA-Accr OPEB	-299,737.00	-299,737.00	-299,736.96
262215	DCA-Accr OPEB Med Subsidy	0.00	0.00	-42,980.00
262313	DCA-FAS 112 Costs	-6,278.00	-6,278.00	-61,130.00
262317	DCA-Def Comp Costs	-13,939.13	19,669.92	31,657.20
262318	DCA-Inc Plan Stock	11,987.28	11,987.28	0.00
262321	DCA-Inc Plan Cash LT	-1,621.50	0.00	0.00

262322 DCA-Inc Plan Cash Annual	-153,407.89	-107,545.42	-213,721.81
262401 DCN-Ins Other Than Grp Reg	8,714.17	37,410.57	-30,765.92
Other Deferred Credits	-3,646,454.41	-4,024,809.99	-2,998,398.69

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 91 of 312

Witness: Linda Bridwell

91. Please provide a comparison by month, or if not available, by quarter, of budgeted versus actual retirements for each month of 2004, 2005, 2006 and 2007. Please explain any significant variations.

Response:

See attached list of actual retirement amounts by month. No detailed utility plant retirement budget is performed.

For electronic version, refer to KAW_R_AGDR1#91_061807.pdf

Kentucky-American Water Company
Case # 2007-00143
Data Request - Item 91 of 312
Actual Cost of Retirements

Year	January	February	March	April	May	June	July	August	September	October	November	December	Grand Total
2004	(3,624.23)	(14,985.32)	(5,682.83)		(27,211.03)	(6,145.27)	(37,529.72)	(8,077.59)	(157.09)	(193,227.57)	(36,896.30)	(147,814.54)	(481,351.49)
2005		(1,947.04)	(12,695.83)			(49,278.81)	(104,431.61)	(63,673.91)	(11,510.72)	(7,194.94)	(17,586.15)	(280,536.40)	(548,855.41)
2006		(1,083.18)	(17,979.47)	(15,298.12)	(10,573.34)	(35,456.54)	(75,125.71)	(13,147.85)	(56,908.35)	(66,000.00)	(270,676.25)	(111,246.67)	(673,495.48)
2007	(55,945.66)	(4,917.17)	(51,848.34)										(112,711.17)

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 92 of 312

Witness: Michael A. Miller

92. Indicate the treatment of customer discounts for prompt payment of bills and budget billing accounts interest payments or income in the revenue portion of the cash working capital calculation.

Response:

The Company does not have a discount for prompt payment of bills.

For electronic version, refer to KAW_R_AGDR1#92_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 93 of 312

Witness: Sheila Miller/Michael Miller

93. Indicate whether and how check-clearing time was included in the revenue or expense lag calculations in the lead-lag study. If included in the study, indicate the number of days it added to the lead or lag by category.

Response:

Check-clearing is not included in the lead-lag study.

For electronic version, refer to KAW_R_AGDR1#93_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 94 of 312

Witness: Michael A. Miller/Sheila Miller

94. If check-clearing time was not included in the revenue or expense lag calculations in the lead-lag study, indicate the number of days between the receipt of a customer's payment and the time the Company has use of the funds. Also, provide an estimate of the number of days after a check mailed to a vendor is reduced from the Company's bank account. If the number of days varies by type of expense or vendor, indicate those differences if known. Indicate any payments made by wire (in total by expense category).

Response:

Check clearing time was not included in the original lead-lag study. The Company has the use of funds for one day after receipt of the customer payment. On average, Company checks that are mailed (incl. payroll checks) clear the bank account in approximately 9.4 days. This can vary by expense and/or vendor, but the level of variance is unknown. Payments that are made through the Automated Clearing House (ACH) clear the bank in one day. Following are the details by category of payments made by wire in 2006:

Power bills	$2,566,000
Interest payments	$5,925,000
Flexible spending withholding	$17,000
Audit fees	$38,000
OPEB costs	$812,000
Group insurance payments	$1,397,000
Pension payments	$1,359,000

For electronic version, refer to KAW_R_AGDR1#94_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 95 of 312

Witness: Sheila Miller/Michael A. Miller

95. Indicate whether tax payment lead days are calculated on actual or statutory percentages and payment dates in the cash working capital calculation.

Response:

The attached schedule reflects the income tax payment dates approved by this Commission in the Company's last rate case.

For electronic version, refer to KAW_R_AGDR1#95_061807.pdf

AG 1st set of Request for Information # 95

KENTUCKY AMERICAN WATER
2003 LEAD/LAG STUDY

FEDERAL INCOME TAXES

Payment Date	From	Thru	Avg Service Period	Lag (Lead)	Annual Payment	
3/15/2003	12/31/2002	3/31/2003	45.00	29	25%	7.25
6/15/2003	3/31/2003	6/30/2003	45.50	30.5	25%	7.63
9/15/2003	6/30/2003	9/30/2003	46.00	31	25%	7.75
12/15/2003	9/30/2003	12/31/2003	46.00	30	25%	7.50
	Total			**120.5**		

Average Lag for Federal Income Tax **30.13**

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 96 of 312

Witness: Michael A. Miller/Sheila Miller

96. Indicate whether in the cash working capital calculation, the payroll expense lead day result is based upon a composite of the separate net wage lag and withholding deposit period lag, or whether it is based on the single lag associated with gross wages (i.e., middle of pay period to payroll date).

Response:

Payroll expense is based on the single lag associated with gross wages (i.e., middle of pay period to payroll date.) This method was approved by the Commission in the last rate case.

For electronic version, refer to KAW_R_AGDR1#96_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 97 of 312

Witness: Sheila Miller/ Michael A. Miller

97. Indicate the average period of time between rendering of service to customers to meter reading date (by type of customer if different), meter reading to billing date, and billing date to receipt of payment for Kentucky jurisdictional customers, if known; otherwise for total company if known.

Response:

See KAW_APP_EX37B_043007, Page 98 of 108.

For electronic version, refer to KAW_R_AGDR1#97_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 98 of 312

Witness: Michael A. Miller

98. Provide for each month from December 2005 to the present, the following by customer class on a jurisdictional basis (if not available by class, provide on a total jurisdictional basis):

    a. monthly revenues

    b. accounts receivable (aging and amounts) net of uncollectibles

Response:

See attached.

For the electronic version see KAW_R_AGDR1#98 _061807.pdf

Kentucky American Water Company
AG DR 1 Question 98
A. Monthly Revenues

2005

District Name	Object Account	Account Description	January	February	March	April	May	June	July	August	September	October	Nonember	December	Total
KY-Lexington Water	401110	Res Sales Billed												$1,395,175.17	$1,395,175.17
	401210	Com Sales Billed												$622,756.76	$622,756.76
	401310	Ind Sales Billed												$98,762.22	$98,762.22
	401410	Pub Fire Billed												$178,501.29	$178,501.29
	401450	Priv Fire Billed												$87,959.55	$87,959.55
	401510	Pub Auth Billed												$239,913.35	$239,913.35
	401610	SFR Billed												$68,027.98	$68,027.98
	401710	Misc Sales Billed												($2.28)	($2.28)
	KY-Lexington Water Total													$2,691,094.04	$2,691,094.04
KY-Tri Village	401110	Res Sales Billed												$42,900.87	$42,900.87
	401210	Com Sales Billed												$1,268.06	$1,268.06
	KY-Tri Village Total													$44,168.93	$44,168.93
	Total Revenues													$2,735,262.97	$2,735,262.97

2006

District Name	Object Account	Account Description	January	February	March	April	May	June	July	August	September	October	Nonember	December	Total
KY-Lexington Water	401110	Res Sales Billed	$2,466,173.05	$1,858,963.17	$2,340,516.99	$1,454,985.65	$2,667,805.06	$2,189,312.39	$2,101,218.70	$2,295,430.46	$2,631,179.30	$1,916,727.66	$2,192,213.90	$1,828,958.85	$25,942,485.18
	401210	Com Sales Billed	$1,126,348.17	$786,791.57	$1,084,405.62	$751,939.91	$1,082,323.24	$1,004,754.78	$1,080,496.81	$1,083,885.40	$1,237,491.72	$956,933.51	$990,833.33	$851,118.80	$12,037,322.86
	401310	Ind Sales Billed	$135,440.06	$105,239.60	$114,177.34	$117,193.02	$111,543.34	$128,115.72	$144,788.20	$121,160.57	$153,135.23	$99,279.07	$113,225.78	$101,055.62	$1,444,353.55
	401410	Pub Fire Billed	$178,249.71	$189,633.44	$173,313.09	$180,300.12	$184,567.75	$180,335.31	$184,337.06	$182,009.99	$181,638.81	$182,108.07	$182,103.51	$183,776.55	$2,182,373.41
	401450	Priv Fire Billed	$84,945.90	$84,190.94	$84,583.15	$88,492.23	$86,880.36	$87,220.53	$88,603.82	$85,076.64	$88,087.39	$90,126.94	$89,790.07	$94,103.06	$1,052,101.03
	401510	Pub Auth Billed	$325,088.28	$232,725.40	$252,312.45	$260,061.40	$253,528.68	$297,562.50	$370,823.63	$366,621.55	$340,912.64	$324,792.38	$273,228.31	$249,179.51	$3,546,836.73
	401610	SFR Billed	$72,744.56	$57,808.24	$55,188.50	$63,771.79	$60,822.98	$86,132.89	$85,860.94	$94,813.80	$104,622.20	$69,158.74	$65,720.60	$65,659.71	$882,304.95
	401710	Misc Sales Billed	($4.56)	($4.56)	$3,608.88	$636.74	($195.69)	($78.28)	$236.69	$6,888.42	($5,364.45)	$2,838.52	$89.72	$372.26	$9,023.69
	KY-Lexington Water Total		$4,388,985.17	$3,315,347.80	$4,108,106.02	$2,917,380.86	$4,447,275.72	$3,973,355.84	$4,056,365.85	$4,235,886.83	$4,731,702.84	$3,640,964.89	$3,907,205.22	$3,374,224.36	$47,096,801.40
KY-Tri Village	401110	Res Sales Billed	$102,521.20	$67,735.06	$79,143.58	$73,515.61	$68,812.32	$79,495.84	$85,404.29	$76,458.96	$81,724.35	$69,787.33	$69,386.28	$73,050.99	$927,035.81
	401210	Com Sales Billed	$2,143.77	$1,952.83	$3,083.24	$2,348.61	$2,767.16	$2,316.81	$2,276.89	$2,016.52	$1,757.60	$1,642.42	$1,622.10	$1,596.37	$25,524.32
	401510	Pub Auth Billed	$2,434.13	$1,305.28	$901.37	$1,341.27	$1,624.31	$1,334.81	$1,335.27	$656.01	$2,128.32	$1,992.10	$1,496.48	$1,869.23	$18,418.58
	KY-Tri Village Total		$107,099.10	$70,993.17	$83,128.19	$77,205.49	$73,203.79	$83,147.46	$89,016.45	$79,131.49	$85,610.27	$73,421.85	$72,504.86	$76,516.59	$970,978.71
KY-Owenton Water	401110	Res Sales Billed	$55,664.28	$30,413.14	$38,680.29	$31,815.83	$26,743.13	$29,035.20	$31,886.34	$30,540.51	$33,898.52	$26,139.54	$28,526.26	$29,822.22	$393,165.26
	401210	Com Sales Billed	$0.00	$1,461.00	$11,782.06	$9,737.21	$7,413.35	$6,884.67	$7,649.30	$7,173.70	$7,774.27	$7,445.84	$6,614.67	$6,201.37	$80,157.44
	401310	Ind Sales Billed	$0.00	$11.80	$50.31	$27.95	$33.54	$35.09	$35.09	$0.00	$0.00	$0.00	$0.00	$0.00	$193.78
	401610	SFR Billed	$0.00	$23,206.88	$21,510.93	$20,773.44	$23,917.11	$18,834.13	$16,892.33	$17,928.31	$16,739.55	$20,991.28	$23,595.30	$22,698.67	$227,087.93
	401710	Misc Sales Billed	$0.00	$0.00	$690.00	($120.00)	$0.00	($92.85)	$0.00	$9,734.43	($170.55)	($3.13)	$0.96	$450.00	$10,488.86
	KY-Owenton Water Total		$55,664.28	$55,112.82	$72,713.59	$62,234.43	$58,107.13	$54,696.24	$56,463.06	$65,376.95	$58,241.79	$54,573.53	$58,737.19	$59,172.26	$711,093.27
	Total Revenues		$4,551,748.55	$3,441,453.79	$4,263,947.80	$3,056,820.78	$4,578,586.64	$4,111,199.54	$4,201,845.36	$4,380,395.27	$4,875,554.90	$3,768,960.27	$4,038,447.27	$3,509,913.21	$48,778,873.38

2007

District Name	Object Account	Account Description	January	February	March	April	May	June	July	August	September	October	Nonember	December	Total
KY-Lexington Water	401110	Res Sales Billed	$1,997,688.19	$1,861,240.15	$2,006,252.66	$1,938,541.58	$1,973,338.98								$9,777,061.56
	401210	Com Sales Billed	$867,556.16	$879,988.30	$873,641.40	$933,349.50	$912,115.83								$4,466,651.19
	401310	Ind Sales Billed	$97,741.16	$117,599.97	$103,475.97	$140,682.81	$120,965.12								$580,465.03
	401410	Pub Fire Billed	$183,385.50	$183,620.13	$183,932.97	$183,929.55	$183,894.28								$918,762.43
	401450	Priv Fire Billed	$90,185.38	$100,353.00	$93,425.04	$94,386.76	$92,667.21								$471,017.39
	401510	Pub Auth Billed	$226,741.90	$237,299.56	$244,797.14	$275,556.34	$266,897.21								$1,251,292.15
	401610	SFR Billed	$63,626.24	$72,842.58	$56,111.72	$67,266.08	$70,114.72								$329,961.34
	401710	Misc Sales Billed	$195.41	$40.59	($24.51)	$0.00	$515.82								$727.31
	KY-Lexington Water Total		$3,527,119.94	$3,452,984.28	$3,561,612.39	$3,633,712.62	$3,620,509.17	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$17,795,938.40
KY-Tri Village	401110	Res Sales Billed	$72,834.41	$74,209.03	$77,072.24	$81,617.44	$73,830.56								$379,563.68
	401210	Com Sales Billed	$1,661.77	$1,530.83	$32,037.73	$4,262.64	$3,503.32								$42,996.29
	401510	Pub Auth Billed	$1,140.25	$1,305.28	$1,407.16	$1,657.69	$1,509.15								$7,019.53
	KY-Tri Village Total		$75,636.43	$77,045.14	$110,517.13	$87,537.77	$78,843.03	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$429,579.50
KY-Owenton Water	401110	Res Sales Billed	$27,943.10	$26,891.20	$29,538.57	$30,891.40	$29,211.85								$144,476.12
	401210	Com Sales Billed	$7,907.17	$7,273.79	$9,273.01	$7,624.30	$7,100.57								$39,178.84
	401610	SFR Billed	$21,907.63	$24,098.60	$22,381.12	$23,477.48	$41,670.39								$133,535.22
	KY-Owenton Water Total		$57,757.90	$58,263.59	$61,192.70	$61,993.18	$77,982.81	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$317,190.18
	Total Revenues		$3,660,514.27	$3,588,293.01	$3,733,322.22	$3,783,243.57	$3,777,335.01	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$18,542,708.08

Kentucky American Water
AR Aging for December 2005 to May 2007 by month
AG #98b

Accounts Receivable (per Aging Summary Report)

Kentucky

	12 / 09 / 05		01 / 20 / 06		02 / 17 / 06		03 / 24 / 06		04 / 21 / 06		05 / 26 / 06		06 / 30 / 06		07 / 28 / 06		08 / 25 / 06	
0 - 30	2,455,937	74.7%	1,832,812	69.9%	1,905,737	73.4%	1,906,310	73.6%	1,983,442	74.7%	1,722,257	72.0%	1,687,512	73.6%	2,656,214	79.2%	2,166,392	76.1%
31 - 60	358,229	10.9%	296,629	11.3%	262,457	10.1%	268,657	10.4%	282,701	10.6%	295,917	12.4%	262,016	11.4%	328,565	9.8%	305,292	10.7%
61 - 90	178,451	5.4%	136,583	5.2%	115,116	4.4%	102,975	4.0%	119,310	4.5%	115,268	4.8%	121,944	5.3%	137,355	4.1%	143,448	5.0%
> - 90	296,359	9.0%	356,258	13.6%	312,057	12.0%	310,885	12.0%	270,819	10.2%	257,616	10.8%	222,767	9.7%	232,765	7.0%	229,995	8.1%
	3,288,976	100.0%	2,622,282	100.0%	2,595,367	100.0%	2,588,827	100.0%	2,656,272	100.0%	2,391,058	100.0%	2,294,239	100.0%	3,354,899	100.0%	2,845,127	100.0%

	09 / 29 / 06		10 / 27 / 06		12 / 01 / 06		12 / 29 / 06		01 / 31 / 07		02 / 28 / 07		03 / 31 / 07		04 / 30 / 07		05 / 31 / 07	
0 - 30	2,368,953	75.5%	2,149,775	73.7%	1,547,260	66.6%	1,655,069	67.5%	1,422,045	67.5%	1,525,273	71.0%	1,558,969	69.7%	1,778,909	71.1%	1,513,488	70.4%
31 - 60	351,185	11.2%	366,652	12.6%	340,660	14.7%	362,989	14.8%	300,550	14.3%	284,872	13.3%	331,656	14.8%	351,095	14.0%	282,218	13.1%
61 - 90	139,806	4.5%	162,214	5.6%	189,650	8.2%	173,927	7.1%	134,160	6.4%	124,441	5.8%	125,322	5.6%	148,181	5.9%	130,926	6.1%
> - 90	277,706	8.9%	239,014	8.2%	245,159	10.6%	261,496	10.7%	250,199	11.9%	213,674	10.0%	221,471	9.9%	224,191	9.0%	224,062	10.4%
	3,137,650	100.0%	2,917,655	100.0%	2,322,729	100.0%	2,453,481	100.0%	2,106,954	100.0%	2,148,260	100.0%	2,237,418	100.0%	2,502,376	100.0%	2,150,694	100.0%

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 99 of 312

Witness: Michael A. Miller

99. Provide for each year 2005, 2006 and 2007 the total dollar write-offs to uncollectibles reserve with and without subsequent recoveries.

Response:

Year	Write-Offs	Recoveries of Write-Offs
2005	$447,408.67	$49,300.58
2006	$445,454.26	$61,136.63
Through 5/2007	$163,704.60	$20,135.38

For electronic version, refer to KAW_R_AGDR1#99_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 100 of 312

Witness: Linda C. Bridwell

100. Indicate any contractor retentions being held by the Company or for the Company during 2005, 2006 and 2007 in relation to a major construction project or acquisition.

Response:

The total retentions held at year-end were:

YEAR	YEAR-END RETENTION AMOUNT
2004	$103,006.21
2005	$560,668.09
2006	$1,065,820.82
April 30, 2007	$381,495.07

KAW has one account during this period for contractor retentions on a project in excess of $1.9 million. Sludge Handling Improvements at Richmond Road Station for Herrick Company has a balance of $7,000.00 as of the end of April, 2007.

For electronic version, refer to KAW_R_AGDR1#100_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 101 of 312

Witness: Michael A. Miller/Sheila Miller

101. Customer Advances.

a. What is the ratemaking treatment for customer advances proposed by the Company in its filing? Where is such proposal found in the filing?

b. Provide the monthly level of customer advances for the period December 2005 thru July 2007.

c. Provide the monthly interest expense paid by the Company on customer advances for the same period.

Response:

a. Customer advances are a reduction to rate base as shown on Schedule B-1.

b.

MONTH	YEAR	Deposits
12	2005	571,654.28
1	2006	815,904.91
2	2006	987,108.75
3	2006	739,059.82
4	2006	297,913.70
5	2006	607,547.88
6	2006	382,489.13
7	2006	75,134.80
8	2006	390,768.24
9	2006	378,893.50
10	2006	102,125.37
11	2006	680,131.47
12	2006	101,409.30
1	2007	368,866.40
2	2007	728,987.11
3	2007	193,807.82
4	2007	205,020.00
5	2007	211,621.96

c. None.

For electronic version, refer to KAW_R_AGDR1#101_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 102 of 312

Witness: Sheila Miller

102. Customer Deposits.

a. What is the ratemaking treatment for customer deposits proposed by the Company? Where is such proposal found in the filing?

b. Provide the monthly level of customer deposits for the period December 2005 thru July 2007.

c. Provide the monthly interest expense paid by the Company on customer deposits for the same period.

Response:

Kentucky American Water stopped collecting customer deposits in 2003.

For electronic version, refer to KAW_R_AGDR1#102_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 103 of 312

Witness: Sheila Miller

103. Customer Deposits.

a. What is the contractual interest rate on customer deposits?

b. Identify the tariff or statute that establishes the interest rate.

c. Does the Company accrue interest on inactive customer deposits?

d. How often is interest on customer deposits paid?

e. Is interest on customer deposits paid by check, in the form of a bill credit, or credited as an addition to the customer deposit balance?

f. What is the Company's policy on customer deposits for collection, refund, and use as an offset against an uncollectible balance?

g. Provide a copy of the Company's policy(s) relating to customer deposits

Response:

See response to AGDR1 Question 102.

For electronic version, refer to KAW_R_AGDR1#103_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 104 of 312

Witness: Linda C. Bridwell

104. For the base year and the preceding two years, has the Company sold any property which had formerly been included in Plant Held for Future Use or devoted to utility service? If so, for each sale, describe the property sold; state whether, when and in what manner it had been included in rate base; show the details of how the gain or loss was calculated; indicate when the sale occurred; explain how and whether the Company is amortizing such gain or loss; and show how such amortization was computed.

Response:

No.

For electronic version, refer to KAW_R_AGDR1#104_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 105 of 312

Witness: Sheila Miller

105. The following questions are related to the Company's policies regarding accounting for CWIP, plant in service and depreciation:

a. For each item of CWIP which the Company has transferred into utility plant in service for purposes of this filing, has a full 12 months of depreciation expense been included in the cost of service?

b. For each item of CWIP which the company has transferred into utility plant in service for the purposes of this filing, has an amount representing a full 12 months of depreciation expense been added to the total accumulated depreciation by which rate base is reduced?

c. Provide the same information as requested in subsection b. above for the deferred taxes related to the depreciation timing differences

<u>Response</u>:

a. No. The forecasted period depreciation expense is based on thirteen month average as shown on KAW_R_RSCDR1#1a_WP4_052107 pages 10 thru 13 for each district.
b. No. The 13 month average depreciation expense was used to determine accumulated depreciation.
c. See KAW_R_PSCDR1#1a_WP6_052107, Page 2 of 28.

For the electronic version refer to KAW_R_AGDR1#105_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 106 of 312

Witness: Linda C. Bridwell

106. For major plant construction projects representing plant additions costing more than $5 million added during 2005, 2006 and 2007 to date please state the following:

a. Description of project.

b. Any economic feasibility studies done in a relationship to the project.

c. Any related cost savings achieved as a result of adding the addition.

d. Whether the project was for replacement, for new growth, environmental, or other.

e. Description of why the project was necessary.

Response:

No plant additions have been completed or will be completed in 2007 costing more than $5 million.

For electronic version, refer to KAW_R_AGDR1#106_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 107 of 312

Witness: Michael A. Miller

107. Explain in detail the Company's procedure for accruing AFUDC and provide examples of AFUDC accrued during 2005, 2006 and 2007. Discuss specifically how the Company computes the AFUDC rate, computes AFUDC monthly, adjusts AFUDC for the impact of the Alternative Minimum Tax and for interest that is capitalized for federal income tax purposes. Show examples of each calculation. Also provide references to PSC Orders which authorize or approve the calculation methods used by the Company.

Response:

Please see the attached procedure. The Company is not aware of any Commission Order specifically addressing its AFUDC procedure. The Company has consistently used this method in all recent rate filings.

For electronic version, refer to KAW_R_AGDR1#107_061807.pdf

American Water

AFUDC Accounting Policy

Allowance for Funds Used During Construction

Policy Number:

POLICY STATEMENT

- Business Objective: The management of American Water Works Company, Inc. (the Company) recognizes the impact *Allowance for Funds Used During Construction (AFUDC)* transactions have on the Company's balance sheet and income statement. Management considers it a business priority to accurately report the value of AFUDC to its stakeholders and regulatory agencies.

- Statement: This policy is intended to provide a sufficient level of control over the transactions associated with the Company's AFUDC balance and to serve as the authoritative document for the proper accounting treatment of AFUDC, in accordance with the United States' Generally Accepted Accounting Principles (GAAP).

SCOPE

This policy is applicable to all business units, regions and subsidiaries of the Company. Subsidiaries that represent investments the Company has made in joint ventures, partnerships or any other forms of joint ownership should be governed by the accounting policy(s) established for each such arrangement. Waivers to be granted under this policy will be authorized, at the discretion of, the Vice President and Controller of the Company or the Senior Vice President and Chief Financial Officer of the Company.

POLICY

In certain jurisdictions, rate regulators recognize the investment burden faced by a utility in financing its *Construction Work in Progress (CWIP)* and permit the utility to earn a current, cash return on a portion of, or all of, it's CWIP. This return is achieved via the inclusion of CWIP in a utility's *Rate Base*. In doing so, a utility benefits from higher customer rates and increased cash flows, compensating them for the carrying costs (borrowed and equity funds) associated with financing their CWIP.

In most jurisdictions, however, rate regulators elect to exclude CWIP from a utility's rate base. From a utility's perspective, an investment in CWIP is no different than any other investment in a "recoverable" asset and, therefore, merits a return. Financial Accounting Standards Board (FASB) Statement No. 71, *Accounting for the Effects of Certain Types of Regulation* (FAS 71), recognizes that a utility has sacrificed alternative uses of the funds they invest in CWIP and, in response, allows utilities to capitalize, as a cost of construction, an estimated return on its investment in CWIP. This estimated return is known as an *Allowance for Funds Used During Construction (AFUDC)*.

Statement of Financial Accounting Standards (SFAS) No. 90, *Regulated Enterprises – Accounting for Abandonments and Disallowances of Plant Costs (SFAS 90)*, restricts FAS 71 by specifying that AFUDC may be capitalized only if its subsequent inclusion in allowable costs for rate-making purposes (rate base) is "probable" (likely to occur). If it is not "probable" that a rate regulator will allow for AFUDC in rate base, then AFUDC should not be capitalized during the construction of a capital asset. SFAS 90 further limits the capitalization of AFUDC to the time frame when a capital asset is being constructed or is part of a qualifying "phase-in" plan. AFUDC should be accrued on an asset until it is placed into service and previously-accrued AFUDC should be written-off if the capital project is scrapped. The accruing of AFUDC should be halted in situations where a capital project is suspended or put on-hold. If a utility is permitted to earn a current return on a portion of its CWIP, it is not permitted to recognize AFUDC on that portion. Specifically, for rate-making purposes, no AFUDC is recognized on the portion of CWIP that is included in rate base while the asset is under construction (only the portion excluded from rate base). See practice for activities occurring on capital projects which are subject to/excluded from AFUDC consideration.

MONITORING
The responsibility of monitoring the compliance with and the consistent application of the subject matter set forth within this policy, will be assigned to the Corporate Controller's group, the Fixed Asset team within the Shared Services Center and the *Regional Finance Teams*. The means used to monitor the compliance with and the consistent application of this policy, will be determined at the discretion of each of the above mentioned groups/teams.

REPORTING/METRICS
The reporting metrics used to evaluate the activity regarding the Company's AFUDC balance will be determined at the discretion of the Corporate Controller's group, the Fixed Asset team within the Shared Services Center and the regional Finance teams.

CONSEQUENCE OF NON-COMPLIANCE
In situations of non-compliance (behavior in violation of the subject matter set forth within this policy), corrective and disciplinary action (if necessary) will be taken against the violating party, at the discretion of the Vice President and Controller of the Company, the Vice President of the Shared Services Center or regional management.

REFERENCES
The following references are in support of the subject matter set forth within this policy:
- Financial Accounting Standards Board (FASB) Statement No. 71, *Accounting for the Effects of Certain Types of Regulation* (FAS 71)
- Statement of Financial Accounting Standards (SFAS) No. 90, *Regulated Enterprises – Accounting for Abandonments and Disallowances of Plant Costs (SFAS 90)*

DEFINITIONS
- ***Allowance for Funds Used During Construction (AFUDC)*** --- A non-cash credit to income and a corresponding debit to Utility Plant, resulting in current-period income and representing the cost of borrowed funds and a return on equity funds, devoted to a utility's investment in *CWIP*.
- ***Construction Work in Progress (CWIP)*** --- A temporary holding account used to collect expenditures incurred during the design and construction of components of property, plant and equipment (PP&E). CWIP expenditures are eventually capitalized and then depreciated, once the capital asset is placed into service.
- ***Rate Base*** --- A utility's total investment in those facilities used and useful in providing service. A rate of return is applied to a utility's rate base to obtain the level of earnings at which a utility should be able to operate successfully. Components of rate base include

American Water

Utility Plant in Service (net of accumulated depreciation), *AFUDC* or *CWIP* (depending on the rate regulator), etc.

- ***Regional Finance Teams*** --- Includes the finance departments for each of the four regions of the Company and the finance department for American Water Enterprises, Inc. (AWE).

REVIEW/UPDATE

This policy will be reviewed every two years by the Corporate Controller's group, upon the anniversary of its implementation.

Approved by:

Area	Name	Functional Area	Approved
Central Region	James Jenkins	Regional Finance	☐
Northeast Region	James McCabe	Regional Finance	☐
Southeast & Western Regions	Christopher Buls	Regional Finance	☐
Business Center	Doneen Hobbs	SSC Finance	☐
Business Center	Bob Sievers	Corporate Finance	☐

Original Adopted: ____________________

Revised Adopted: ____________________

Date of Last Review: ________________

Effective Date: ______________________

Prepared By: Fixed Assets DMAT Team (sponsored by James McCabe)

Disclaimer

American Water reserves the right to change, revise or discontinue this Policy for any reason whatsoever. No employee, manager or other agent of American Water, other than the Service Company Board (or its direct executive membership) has the authority to enter into any agreement contrary to this Policy.

This Policy supersedes and voids all previous policies and practices, which may be inconsistent in any way with that stated herein.

American Water

AFUDC Accounting Practice

Allowance for Funds Used During Construction

Practice Number:

PURPOSE

The management of American Water Works Company, Inc. (the Company) recognizes the impact *Allowance for Funds Used During Construction (AFUDC)* transactions have on the Company's balance sheet and income statement. Management considers it a business priority to accurately report the value of AFUDC to its stakeholders and regulatory agencies. This practice is intended to provide a sufficient level of control over the transactions associated with the calculation and the recording of the Company's AFUDC rates and balances.

This practice is applicable in those jurisdictions where rate regulators have elected to exclude *Construction Work in Progress (CWIP)* from a utility's rate base and permit for the recognition of AFUDC (in accordance with Financial Accounting Standards Board (FASB) Statement No. 71, *Accounting for the Effects of Certain Types of Regulation* (FAS 71)). FASB Statement No. 34, *Capitalization of Interest Costs (FAS 34)* should be followed in those jurisdictions where AFUDC is disallowed by the rate regulator.

This practice is applicable to all business units, regions and subsidiaries of the Company. Subsidiaries that represent investments the Company has made in joint ventures, partnerships or any other forms of joint ownership should be governed by the accounting practice(s) established for each such arrangement.

APPLICABILITY

This practice is intended to complement the Company's *AFUDC Accounting Policy* and serves as the authoritative document for the calculation and recording of the Company's AFUDC rates and balances.

PRACTICE

Allowance for Funds Used During Construction (AFUDC) is recorded with: 1) a non-cash adjustment to income (leading to the recognition of current-period income) and 2) a corresponding debit to Utility Plant, representing the cost of borrowed funds and a return on equity funds devoted to *Construction Work in Progress (CWIP)*. The AFUDC accumulated on an asset while under construction, later becomes a component of the total cost of the asset, once it is placed into service and capitalized. After capitalization, an asset will be included in *Rate Base* and utilities will begin recovering the total cost of the asset, including the AFUDC, via depreciation charges, identified as operating expenses and recoverable, through customer rates, over the *Useful Life* of the asset. AFUDC will be accrued on an asset until it is placed into service and should be halted on an asset that is being constructed for capital project that has been suspended.

If a utility is permitted to include a portion of its CWIP in rate base, then AFUDC is not permitted to be recognized on that portion (AFUDC will continue to be accrued on that portion of CWIP not considered in rate base). To properly account for these situations, separate work orders are required and the regional Rates and Regulation departments are responsible for notifying the Shared Services Center (SSC) Fixed Assets department. Special financing secured for a capital project (e.g. a tax-free loan), may impact whether or not AFUDC can be recognized on the assets associated with the project. The regional Rates and Regulation departments are responsible for notifying the SSC Fixed Assets department of these situations.

American Water

The AFUDC process begins at the work order level, where project managers determine if AFUDC recognition on work orders is appropriate (based on the work order type selected within the system). Activities occurring on capital projects are subject to/excluded from AFUDC consideration as follows:

- Construction activities financed from internally-generated funds (e.g. earnings retained within the business) or from funds provided by other external sources (e.g. short-term or long-term debt), are generally subject to AFUDC.
- Construction activities paid for by a third-party (e.g. customer advances and contributions), are generally not subject to AFUDC.
- Expenditures incurred during the Preliminary Stage of a capital project (e.g. feasibility studies), are generally not subject to AFUDC.
- Expenditures incurred during the Pre-Acquisition/Pre-Construction Stage of a capital project (e.g. engineering and design studies, preliminary surveys and investigation studies (PSI) and comprehensive planning studies (CPS)), are generally subject to AFUDC.
- Expenditures incurred during the Acquisition/Construction Stage of a capital project (e.g. capital asset costs, labor charges, payroll charges, third-party contractor fees), are generally subject to AFUDC.
- Expenditures incurred during the In-Service Stage of a capital project (e.g. recurring and periodic repairs and maintenance), are generally not subject to AFUDC.
- Expenditures incurred for the purchase of land, on which a capital project will be executed on, is generally subject to AFUDC. The work order created for the purchase of land will remain open and will continue to accrue AFUDC until the capital project is completed and assets are placed into service.
- Third-party expenditures, incurred for requested upgrades to new facilities, are generally subject to AFUDC (accomplished through the use of a second work order, used to capture the Company's share of the costs).
- Blanket work orders, retirement work orders, maintenance of M&J work orders and expenditures for capital assets not requiring installation, are generally not subject to AFUDC.

The rate to be applied to a qualified capital expenditure, as a charge for AFUDC, will be based upon: 1) the weighted cost of capital, determined by the rate regulator in the most recent rate order or 2) another method identified by the regulator (e.g. short-term debt). In jurisdictions where the rate is based upon the weighted cost of capital, the regional Rates and Regulation department will use the approved rate order to calculate the AFUDC percentage and communicate it to both the SSC Fixed Assets department and the SSC Rates and Regulation department. The SSC Rates and Regulation department is responsible for inputting the calculated AFUDC rate into the system. The SSC Fixed Assets department is responsible for verifying that the AFUDC rate is placed into the system in the same month the rate order was approved and for maintaining the required SOX documentation related to the AFUDC rate change. This rate will remain in effect until superseded by a subsequent rate order or changes are made to the tax rates. In jurisdictions where the AFUDC rate is based upon another method identified by the rate regulator (other than that identified in the most recent rate order), the calculation of the rate will be performed by the SSC Fixed Assets department, in conjunction with information provided by the regional Rates and Regulation department. The calculation will be reviewed and approved by the regional Rates and Regulation department and the rate will be updated in the system by the SSC Rates and Regulation department. The required SOX documentation related to the AFUDC rate change will be maintained by the SSC Fixed Asset department.

In some jurisdictions, the equity component of AFUDC is grossed-up for income tax purposes (both federal and state, as applicable). The regional Rates and Regulation department is responsible for informing both the SSC Fixed Assets and the SSC Rates and Regulation

American Water

departments of any tax rate changes. The SSC Rates and Regulation department will make any necessary updates to the tax rates in the system and the SSC Fixed Assets department will subsequently adjust the AFUDC and maintain the required SOX documentation related to the tax rate changes.

ORGANIZATIONAL RESPONSIBILITIES

The regional Rates and Regulation departments are responsible for providing the updated AFUDC rate information to both the SSC Fixed Assets department and the SSC Rates and Regulation department. The SSC Rates and Regulation department is responsible for updating the AFUDC rates in the system and the SSC Fixed Assets department is responsible for maintaining the required SOX documentation related to AFUDC rate changes and for calculating and posting AFUDC charges to the ledgers.

REPORTING / METRICS

The reporting metrics used to evaluate the activity regarding the Company's AFUDC balance will be determined at the discretion of the Corporate Controller's group, the SSC Fixed Assets department and the regional Finance departments.

REFERENCES

The following references are in support of the subject matter set forth within this practice:

- Financial Accounting Standards Board (FASB) Statement No. 71, *Accounting for the Effects of Certain Types of Regulation* (FAS 71)
- Statement of Financial Accounting Standards (SFAS) No. 90, *Regulated Enterprises – Accounting for Abandonments and Disallowances of Plant Costs (SFAS 90)*

DEFINITIONS

- ***Allowance for Funds Used During Construction (AFUDC)*** --- A non-cash credit to income and a corresponding debit to Utility Plant, resulting in current-period income and representing the cost of borrowed funds and a return on equity funds, devoted to a utility's investment in *CWIP*.
- ***Construction Work in Progress (CWIP)*** --- A temporary holding account used to collect expenditures incurred during the design and construction of capital assets. CWIP expenditures are eventually capitalized and then depreciated, once the asset is placed into service.
- ***Rate Base*** --- A utility's total investment in those facilities used and useful in providing service. A rate of return is applied to a utility's rate base to obtain the level of earnings at which the utility should be able to operate successfully. Main components of rate base include Utility Plant (net of accumulated depreciation) and *AFUDC* or *CWIP*, depending on the jurisdiction and the rate regulator.
- ***Useful Life*** --- An estimated period of time over which a capital asset is expected to be productive (providing economic benefits to the Company) and in use. Useful lives are generally established by state, public utility commissions, under the rules and regulations prescribed for ratemaking purposes.

REVIEW/UPDATE

This practice will be reviewed by the Corporate Controller's group along with the SSC Fixed Assets department, every two years, upon the anniversary of its implementation.

Practice Development Team: (Add additional lines as needed.)

Role	Name	Functional Area	Business Location

American Water

Sponsor	James McCabe	Regional Finance	Northeast Region
Co-Lead	Angela Sedlacek	Regional Finance	Northeast Region
Co-Lead	Michael McKeever	Regional Finance	Northeast Region
Member			
Member			

Functional Reviewers:

Area	Name	Functional Area	Business Location	Approved
Central	Mark Shaeffer	Regional Finance	Central Region	☐
Northeast	Angela Sedlacek	Regional Finance	Northeast Region	☐
Southeast	Chuck Gilbert	Regional Finance	Southeast Region	☐
Western	Joe Harris	Regional Finance	Western Region	☐
Bus. Center	Gary Akmentins	SSC Finance	SSC	☐
Bus. Center	Beth Scalese	Corporate Finance	Corporate	☐

Approvers:

Area	Name	Functional Area	Business Location	Approved
Central	James Jenkins	Regional Finance	Central Region	☐
Northeast	James McCabe	Regional Finance	Northeast Region	☐
Southeast	Chris Buls	Regional Finance	Southeast Region	☐
Western	Chris Buls	Regional Finance	Western Region	☐
Bus. Center	Doneen Hobbs	SSC Finance	SSC	☐
Bus. Center	Bob Sievers	Corporate Finance	Corporate	☐

Original Adopted: ____________________

Revised Adopted: ____________________

Date of Last Review: __________________

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 108 of 312

Witness: Michael A. Miller

108. List all revenue, expense and rate base amounts by account included in the test year relating to any Company owned or leased airport, airplane and helicopter facilities, if applicable.

Response:

None.

For electronic version, refer to KAW_R_AGDR1#108_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 109 of 312

Witness: Sheila Miller/Michael A. Miller

109. Identify how much of the Company's materials and supplies balance at December 31, 2005, December 31, 2006 and 2007 to date is related to construction activities.

Response:

Materials ordered specifically for a large construction project are charged directly to capital. The Company does not maintain its materials and supplies records between capital and O & M but charges them out to each job as they are used.

For electronic version refer to KAW_R_AGDR1#109_061807.pdf

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2007-00143

ATTORNEY GENERAL'S REQUEST FOR INFORMATION

Item 110 of 312

Witness: Michael A. Miller

110. Please provide a copy of the corporate federal tax returns and supporting “M”schedules for 2004, 2005 and 2006.

<u>Response</u>:

Please refer to response AGDR1#111.

For electronic version, refer to KAW_R_AGDR1#110_061807.pdf