KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

150. Please provide complete copies of all correspondence with the following parties regarding the Company's implementation of FASB Statement No. 143 and FIN:
   a. External auditors and other public accounting firms.
   b. Consultants;
   c. External counsel;
   d. Federal and State regulatory agencies; and
   e. Internal Revenue Service.

Response:

See attached correspondence with External Auditor and Consultants.

For electronic version, refer to KAW_R_AGDR1#150_122308.pdf.

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----- Forwarded by Chuck A Gilbert/PAWC/AWWSC on 01/18/2005 06:02 PM -----

Walter Gauss
01/18/2005 03:50 PM

To: Christopher C Buls/PAWC/AWWSC@AWW, Chuck A Gilbert/PAWC/AWWSC@AWW, Mike Miller/WVAWC/AWWSC@AWW, Tom Bailey/WVAWC/AWWSC@AWW
cc: Edward J Keiffer/ADMIN/CORP/AWWSC@AWW, Tom McKitrick/ADMIN/CORP/AWWSC@AWW, Rod Nevirauskas/SHARSVCS/AWWSC@AWW, Gary Akmentins/SHARSVCS/AWWSC@AWW, Robert D Sievers/ADMIN/CORP/AWWSC@AWW, Thomas C Spitz/SHARSVCS/AWWSC@AWW
Subject: Net Negative Salvage - Southeast Region

Dear All:

2004 US GAAP Audited Financial Statements will require the reclassification of net negative salvage out of depreciation expense to operation and maintenance expense and the reclassification of net negative salvage out of accumulated depreciation to a regulatory liability or asset account. This is in accordance with SFAS 143 "Accounting for Asset Retirement Obligations" as well as SEC guidance.

Please review this analysis carefully. The impact of this disclosure and account reclassification may influence future rates cases as net negative salvage previously embedded within accumulated depreciation will now be subject to examination.

For 2003, net negative salvage included in depreciation was estimated using each company's most recent depreciation study. Net negative salvage included in depreciation was calculated using the percentage factor of net negative salvage as a percent of total gross utility plant in service and net salvage.

For 2004 the same methodology is used, however rather than applying a composite net negative salvage percentage, net negative salvage was calculated on an individual asset class level (schedule attached).

It is proposed that net negative salvage included in accumulated depreciation be estimated in the same way. First the average percentage net increase in accumulated depreciation attributable to net negative salvage over the past 6 years is calculated. This average net negative salvage percentage of accumulated depreciation is then multiplied by the net increase in accumulated depreciation for the period starting when companies began accounting for NNS in depreciation rates and ending 12/31/04.

Proposed SFAS 143, 2004 audited financial statement adjustments:

Kentucky

Operation and Maintenance expense	$1,058,788	
Depreciation Expense		$1,058,788
Accumulated Depreciation	$6,212,492	
Regulatory Liability NNS		$6,212,492

Tennessee

Operation and Maintenance expense	$356,712	
Depreciation Expense		$356,712
Accumulated Depreciation	$1,842,781	
Regulatory Liability NNS		$1,842,781

Virginia

Operation and Maintenance expense	$253,964	
Depreciation Expense		$253,964
Accumulated Depreciation	$173,576	
Regulatory Liability NNS		$173,576

West Virginia

Operation and Maintenance expense	$2,065,405	
Depreciation Expense		$2,065,405
Regulatory Asset NNS	$5,893,470	
Accumulated Depreciation		$5,893,470

The attached schedule contains the detailed calculations used to arrive at these entries. I have also attached a PDF file (information received from your staff) containing the asset class net negative salvage factors from the depreciation study used for the computations.

Mike Miller provided the approximate date that Tennessee and Virginia started including net negative salvage as part of depreciation. West Virginia's 1999 rate case included information that net negative salvage commenced in July 2000. For Kentucky I used a 1/1/1990 start date as this was a reasonable assumption based upon information from other American Water companies and information from Tom McKitrick.

Maryland was not included as it was determined last year that net negative salvage was not included in its depreciation rates.

Pennsylvania was not included as net negative salvage in accumulated depreciation was already reclassed to a regulatory asset account as of 12/31/2003 and the net negative salvage component of depreciation was reclassed to operations and maintenance expense quarterly, in statements sent to security holders during 2004.

For 2005 it may be advisable to record these adjustments on a detailed level through recurring journal entries each month. Gary Akmentins is looking at the feasibility of this approach and has set a target date of March 2005 to automate this process.

Please let me know if you have any questions and if you are in agreement with my calculations by Tuesday 01/25/05. If you know of any other way in which to estimate the amount of net negative salvage included in accumulated depreciation I would appreciate your suggestions.

Walter Gauss

Southeastern 2004 NNS.xls   Tennessee NNS by asset class.pdf   Virginia 1986 NNS by asset class.pdf
Kentuckey NNS by asset class.pdf   West Virginia NNS by asset class.pdf

Net Negative Salvage in Depreciation Expense

Date of Depreciation Study	2004	2003	2002	2001	2000	1999	1998
Kentucky							
Total depr 1995	6,655,435	5,823,490	5,620,415	5,373,898	5,109,380	4,790,793	
% attributable to negative salvage	15.91%	16.88%	16.49%	16.24%	15.99%	15.87%	
Net negative salvage in depreciation	1,058,788	983,054	926,960	872,648	817,048	760,483	
Net removal costs (SD2 2004 -1999)	355,596	330,262	478,771	322,259	258,105	158,529	
Accumulated Depreciation (SD2 2004 -1999)	66,027,848	59,283,172	54,242,814	48,780,792	42,762,017	38,597,521	34,971,660
Year over Year increase in Accumulated Depreciation	6,744,676	5,040,358	5,462,022	6,018,775	4,164,496	3,625,861	
Negative salvage in depr less net removal	703,192	652,792	448,189	550,389	558,943	601,954	
Negative salvage in AD	10.4%	13.0%	8.2%	9.1%	13.4%	16.6%	
6 year average	11.8%		66,027,848	Accumulated Depreciation @ 12/31/04			
Negative salvage in AD	6,212,492		13,342,825	Accumulated Depreciation @ 12/31/89			
Negative salvage in AD Prior Year	5,509,300		52,685,023	Increase in Accumulated Depreciation since beginning of NNS			

Note 2 Property Plant and Equipment

When a unit of property is retired, the recorded value of such unit is credited to the asset account and that value, including the cost of removal, is charged to accumulated depreciation. The Company recovers retirement costs through the depreciation component of customer rates during the life of the associated asset. In accordance with SFAS 143, "Accounting for Asset Retirement Obligations", $6,212 and $5,509 have been reclassified as of December 31, 2004 and 2003, and is reported as a regulatory liability. Prior to the adoption of SFAS 143, these amounts were embedded within accumulated depreciation. Additionally, removal cost (net of salvage) of $1,059 and $983 have been recorded as operation and maintenance expense for the years ended December 31, 2004 and 2003 to remove retirement costs from depreciation expense, where they were previously reported.

Sub	Description	2004 Dep	NNS%	NNS in Dep	2003 Dep	NNS%	NNS in Dep	2002 Dep	NNS%	NNS in Dep	2001 Dep	NNS%	NNS in Dep	2000 Dep	NNS%	NNS in Dep	1999 Derp	NNS%	NNS in Dep
304100	Struct & Imp SS	23,020	0.00%	0	12,066	0.00%	0	7,061	0.00%	0	3,687	0.00%	0	3,077	0.00%	0	3,077	0.00%	0
304200	Struct & Imp P	102,997	-9.09%	(9,362)	102,997	-9.09%	(9,362)	103,038	-9.09%	(9,366)	102,679	-9.09%	(9,334)	102,803	-9.09%	(9,345)	93,835	-9.09%	(8,530)
304300	Struct & Imp WT	142,873	-9.09%	(12,987)	141,623	-9.09%	(12,874)	138,384	-9.09%	(12,579)	134,750	-9.09%	(12,249)	128,811	-9.09%	(11,709)	122,949	-9.09%	(11,176)
304400	Struct & Imp TD	40,944	0.00%	0	40,944	0.00%	0	40,283	0.00%	0	39,606	0.00%	0	38,706	0.00%	0	36,711	0.00%	0
304600	Struct & Imp Offices	64,684	0.00%	0	65,183	0.00%	0	65,205	0.00%	0	64,540	0.00%	0	64,277	0.00%	0	63,410	0.00%	0
304700	Struct & Imp Store,Shop,Gar	16,345	0.00%	0	16,345	0.00%	0	15,748	0.00%	0	14,924	0.00%	0	14,894	0.00%	0	14,283	0.00%	0
304800	Struct & Imp Misc	31,278	0.00%	0	13,022	0.00%	0	12,037	0.00%	0	10,440	0.00%	0	10,094	0.00%	0	9,914	0.00%	0
305000	Collect & Impounding	23,305	0.00%	0	22,283	0.00%	0	22,292	0.00%	0	22,292	0.00%	0	22,292	0.00%	0	22,292	0.00%	0
306000	Lake, River & Other Intakes	12,507	0.00%	0	12,507	0.00%	0	9,947	0.00%	0	7,270	0.00%	0	7,270	0.00%	0	7,270	0.00%	0
309000	Supply Mains	56,414	-4.76%	(2,685)	56,414	-4.76%	(2,685)	56,356	-4.76%	(2,683)	56,275	-4.76%	(2,679)	56,135	-4.76%	(2,672)	55,995	-4.76%	(2,665)
310100	Power Generation Equip Other	19,164	0.00%	0	18,806	0.00%	0	18,885	0.00%	0	18,755	0.00%	0	18,755	0.00%	0	18,755	0.00%	0
311200	Pump Equip Electric	352,104	-7.41%	(26,091)	350,431	-7.41%	(25,967)	347,736	-7.41%	(25,767)	342,218	-7.41%	(25,358)	335,150	-7.41%	(24,835)	326,234	-7.41%	(24,174)
311300	Pump Equip Diesel	18,304	-7.41%	(1,356)	18,304	-7.41%	(1,356)	18,311	-7.41%	(1,357)	18,311	-7.41%	(1,357)	18,311	-7.41%	(1,357)	18,311	-7.41%	(1,357)
311400	Pump Equip Hydraulic	56	0.00%	0	1	0.00%	0	0	0.00%	0	0	0.00%	0	0	0.00%	0	0	0.00%	0
320100	WT Equip Non-Media	965,143	-16.67%	(160,889)	938,940	-16.67%	(156,521)	901,183	-16.67%	(150,227)	888,766	-16.67%	(148,157)	883,447	-16.67%	(147,271)	869,066	-16.67%	(144,873)
330000	Dist Reservoirs & Standpipes	14,261			0			0			0			0			0		
330100	Elevated Tanks & Standpipes	131,298	-9.09%	(11,935)	131,950	-9.09%	(11,994)	131,254	-9.09%	(11,931)	120,184	-9.09%	(10,925)	109,589	-9.09%	(9,962)	100,669	-9.09%	(9,151)
331001	TD Mains Not Classified by Siz	1,506,247	-3.85%	(57,991)	1,441,897	-3.85%	(55,513)	1,404,734	-3.85%	(54,082)	1,302,645	-3.85%	(50,152)	1,239,423	-3.85%	(47,718)	1,162,411	-3.85%	(44,753)
331100	TD Mains 4in & Less	22,585	-3.85%	(870)	20,982	-3.85%	(808)	21,413	-3.85%	(824)	10,240	-3.85%	(394)	0	-3.85%	0	0	-3.85%	0
331200	TD Mains 6in to 8in	9,308	-3.85%	(358)	8,533	-3.85%	(329)	9,271	-3.85%	(357)	4,616	-3.85%	(178)	0	-3.85%	0	0	-3.85%	0
331300	TD Mains 10in to 16in	57	-3.85%	(2)	52	-3.85%	(2)	29	-3.85%	(1)	0	-3.85%	0	0	-3.85%	0	0	-3.85%	0
333000	Services	1,214,046	-61.39%	(745,303)	1,118,180	-61.39%	(686,451)	1,041,923	-61.39%	(639,637)	962,101	-61.39%	(590,634)	878,827	-61.39%	(539,512)	804,903	-61.39%	(494,130)
334110	Meters Bronze Case	336	13.79%	46	341	13.79%	47	347	13.79%	48	356	13.79%	49	356	13.79%	49	356	13.79%	49
334120	Meters Plastic Case	78,638	0.00%	0	83,592	0.00%	0	87,804	0.00%	0	81,495	0.00%	0	74,624	0.00%	0	76,064	0.00%	0
334130	Meters Other	118,332	13.79%	16,318	95,257	13.79%	13,136	77,716	13.79%	10,717	65,221	13.79%	8,994	40,426	13.79%	5,575	31,970	13.79%	4,409
334200	Meter Installations	317,213	-34.64%	(109,882)	302,322	-34.64%	(104,724)	288,687	-34.64%	(100,001)	275,984	-34.64%	(95,601)	262,511	-34.64%	(90,934)	246,944	-34.64%	(85,541)
335000	Hydrants	213,831	-26.47%	(56,601)	196,666	-26.47%	(52,058)	192,203	-26.47%	(50,876)	175,309	-26.47%	(46,404)	166,878	-26.47%	(44,173)	158,608	-26.47%	(41,984)
339100	Other P/E Intangible	12,958	0.00%	0	12,958	0.00%	0	12,771	0.00%	0	12,579	0.00%	0	524	0.00%	0	0	0.00%	0
339600	Other P/E CPS	47,149	0.00%	0	47,149	0.00%	0	73,939	0.00%	0	47,168	0.00%	0	1,965	0.00%	0	0	0.00%	0
340100	Office Furniture & Equip	27,259	2.91%	793	27,016	2.91%	786	26,960	2.91%	785	26,644	2.91%	775	26,463	2.91%	770	25,830	2.91%	752
340210	Comp & Periph Mainframe	4,115	14.53%	598	4,115	14.53%	598	4,117	14.53%	598	3,688	14.53%	536	3,259	14.53%	474	25,754	14.53%	3,742
340220	Comp & Periph Personal	216,290	14.53%	31,427	241,048	14.53%	35,024	248,302	14.53%	36,078	231,604	14.53%	33,652	218,693	14.53%	31,776	202,973	14.53%	29,492
340230	Comp & Periph Other	45,734	14.53%	6,645	30,825	14.53%	4,479	36,682	14.53%	5,330	34,309	14.53%	4,985	36,350	14.53%	5,282	39,267	14.53%	5,705
340300	Computer Software	827,683	0.00%	0	279,143	0.00%	0	180,450	0.00%	0	180,450	0.00%	0	180,450	0.00%	0	98,140	0.00%	0
340320	Comp Software Personal	149,200	0.00%	0	149,200	0.00%	0	149,260	0.00%	0	149,094	0.00%	0	148,928	0.00%	0	140,565	0.00%	0
340330	Comp Software Other	87,260	0.00%	0	32,973	0.00%	0	27,734	0.00%	0	26,120	0.00%	0	20,382	0.00%	0	16,137	0.00%	0
340500	Other Office Equipment	11,402	2.91%	332	11,402	2.91%	332	11,383	2.91%	331	9,934	2.91%	289	9,733	2.91%	283	9,949	2.91%	290
341100	Trans Equip Lt Duty Trks	187,629	23.08%	43,305	197,371	23.08%	45,553	185,952	23.08%	42,918	173,969	23.08%	40,152	176,297	23.08%	40,689	167,802	23.08%	38,729
341200	Trans Equip Hvy Duty Trks	76,124	20.00%	15,225	76,124	20.00%	15,225	76,154	20.00%	15,231	68,243	20.00%	13,649	61,810	20.00%	12,362	57,956	20.00%	11,591
341300	Trans Equip Autos	32,161	18.70%	6,014	29,898	18.70%	5,591	32,349	18.70%	6,049	32,759	18.70%	6,126	32,759	18.70%	6,126	32,923	18.70%	6,157
341400	Trans Equip Other	7,690	0.00%	0	3,357	0.00%	0	1,663	0.00%	0	589	0.00%	0	409	0.00%	0	409	0.00%	0
342000	Stores Equipment	1,379	0.00%	0	1,379	0.00%	0	1,379	0.00%	0	1,379	0.00%	0	1,379	0.00%	0	1,379	0.00%	0
343000	Tools,Shop,Garage Equip	56,021	-2.91%	(1,630)	56,120	-2.91%	(1,633)	56,281	-2.91%	(1,638)	54,960	-2.91%	(1,599)	52,005	-2.91%	(1,513)	47,227	-2.91%	(1,374)
344000	Laboratory Equipment	95,362	19.35%	18,452	95,362	19.35%	18,452	84,142	19.35%	16,282	68,037	19.35%	13,165	54,601	19.35%	10,565	42,947	19.35%	8,310
345000	Power Operated Equipment	50,012	0.00%	0	49,035	0.00%	0	48,137	0.00%	0	46,010	0.00%	0	44,380	0.00%	0	43,119	0.00%	0
346100	Comm Equip Non-Telephone	88,968	0.00%	0	86,882	0.00%	0	82,072	0.00%	0	76,520	0.00%	0	61,734	0.00%	0	42,045	0.00%	0
347000	Misc Equipment	24,857	0.00%	0	22,430	0.00%	0	18,412	0.00%	0	15,560	0.00%	0	15,300	0.00%	0	13,802	0.00%	0
348000	Other Tangible Property	27,741	0.00%	0	26,766	0.00%	0	26,724	0.00%	0	24,642	0.00%	0	24,642	0.00%	0	24,642	0.00%	0
354200	WW Struct & Imp Coll	1,906	0.00%	0	2,006	0.00%	0	2,006	0.00%	0	2,006	0.00%	0	2,006	0.00%	0	2,006	0.00%	0
371100	WW Pump Equip Elect	535	0.00%	0	535	0.00%	0	535	0.00%	0	535	0.00%	0	535	0.00%	0	535	0.00%	0
CIAC	Contibuted Property	(926,190)	0.00%	0	(876,142)	0.00%	0	(781,809)	0.00%	0		0.00%	0		0.00%	0		0.00%	0
101100	Reg Asset-AFUDC-Debt	6,900	0.00%	0	6,899	0.00%	0	6,900	0.00%	0		0.00%	0		0.00%	0		0.00%	0
	Adjustments (Contributed property)							(3,927)			(635,568)			(541,880)			(488,641)		
	Total	6,655,435		(1,058,788)	5,823,490		(983,054)	5,620,415		(926,960)	5,373,898		(872,648)	5,109,380		(817,048)	4,790,793		(760,483)
	NNS %			-15.91%			-16.88%			-16.49%			-16.24%			-15.99%			-15.87%

KENTUCKY AMERICAN
CALCULATION OF NEGATIVE SALVAGE

Account Number	Description	Plant Investment	Accumulated Reserve	Gross Inv.		Percent Net Salvage		Negative Salvage
3031	Other P/E Intangibles	$26,219	$2,616	$28,835				
3036	Other P/E Comprehensive Studies	349,997	59,424	409,421				
311	SS Structures and Improvements	195,204	27,114	222,318		0%		
312	Cull and Impounding Reservoir	1,013,271	198,082	1,211,353		0%		
313	Lake, River, and Other Intakes	338,159	150,794	488,953		0%		
314	Wells and Springs	0	0	0		0%		
316	Supply Mains	5,044,610	619,525	5,664,135	5947342	-5%	4.76	(283,207)
321	Pumping Structures and Improvements	4,478,431	990,152	5,468,583	6015441	-10%	9.09	(546,858)
322	Boiler Plant Equipment	0	0	0		0%		0
323.2	Other Power Production Equipment	559,844	180,195	740,039		0%		0
325	Electric Pumping Equipment	9,122,411	2,760,530	11,882,941	12833576	-8%	7.41	(950,635)
326	Diesel Pumping Equipment	594,512	204,747	799,259		-8%	7.41	(63,941)
328.2	Gasoline Pumping Equipment	0	0	0		0%		0
328.3	Other Pumping Equipment	0	0	0		0%		0
3541	Collecting System Structures - Sewer	40,127	35,046	75,173		0%		0
3711	Electric Pumping Equipment - Sewer	10,708	9,358	20,066		0%		0
331	WT Structures and Improvements	7,006,487	977,200	7,983,687		-10%	9.09	(798,369)
332	Water Treatment Equipment	23,034,953	7,963,615	30,998,568	37198282	-20%	16.67	(6,199,714)
334	Water Treatment -- GAC	0	0	0		0%		0
341	T&D Structures and Improvements	766,565	120,804	887,369		0%		0
342	Distribution Reservoirs and Standpipes	5,016,463	1,365,454	6,381,917		-10%	9.09	(638,192)
343	T&D Mains	97,063,338	13,913,403	110,976,741	115415811	-4%	3.35	(4,439,070)
345	Services	13,257,626	7,971,002	21,228,628	54982147	-159%		(33,753,519)
346	Meters	0	0	0		0%	61.39	0
346.1	Meters- Bronze Case	34,932	8,152	43,084	49977	16%	13.79	6,893
346.2	Meters-Plastic Case	1,866,232	435,500	2,301,732		0%		0
346.3	Meters-Other	1,295,820	302,390	1,598,210		16%	13.79	255,714
347	Meter Installations	11,859,907	2,795,935	14,655,842	22423438	-53%	34.64	(7,767,596)
348	Hydrants	6,177,087	1,497,768	7,674,855	10437803	-36%	26.47	(2,762,948)
390.1	Office Structures	3,891,288	562,588	4,453,876		0%		0
390.2	Stores, Shop & Garage Strum.	902,690	130,508	1,033,198		0%		0
390.3	Misc.. Structures	256,725	37,116	293,841		0%		0
391.1	Office Furniture	659,925	383,850	1,043,775	1075088	3%	2.91	31,313
391.2	Mainframe Computer & Perish Equip.	72,295	42,051	114,346	133785	17%	14.53	19,439
391.21	Personal Computer & Perish Equip.	1,432,139	833,014	2,265,153		17%	14.53	385,076
391.22	Other Office Machines and Equip.	15,000	8,725	23,725		0%		0
391.23	Office Machines and Equipment Software	361,579	210,315	571,894		17%	14.53	97,222
391.25	Mainframe Software	876,835	510,017	1,386,852		0%		0
391.26	Personal Computer Software	678,047	394,391	1,072,438		0%		0
391.28	Other Software	221,222	128,675	349,897		0%		0
391.3	Other Office Equipment	139,656	81,232	220,888		3%	2.91	6,627
392.11	Transportation -- Light Trucks	1,275,652	660,000	1,935,652	2516348	30%	23.08	580,696
392.12	Transportation -- Heavy Trucks	564,715	292,174	856,889	1071111	25%	20.00	214,222
392.2	Transportation -- Cars	161,535	83,575	245,110	301485	23%	18.70	56,375
392.3	Other Transportation Equip.	2,846	1,472	4,318		0%		0
393	Stores Equipment	35,547	22,605	58,152		0%		0
394	Tools, Shop, and Garage Equip.	712,988	315,678	1,028,666		-3%	2.91	(30,860)
395	Laboratory Equipment	675,252	10,011	685,263	849726	24%	19.35	164,463
396	Power Operated Equipment	498,962	237,584	736,546		0%		0
397	Communications Equipment	1,601,524	94,817	1,696,341		0%		0
397.1	Communications Equipment	117,000	6,927	123,927		0%		0
397.2	Communications Equipment	0	0	0		0%		0
398	Misc. Equipment	20,723	(87,005)	(66,282)		0%		0
399	Other Tangible Property	117,960	141,625	259,585		0%		0
	BWA Acquisition	0	447,969	447,969				0
		204,445,008	48,138,720	252,583,728				($56,416,867)
	Percent Attributable to Negative Salvage			309 000 595				-22.34%

	2,002	2003	
Annual Depreciation	$5,624,342 *	$6,699,631 *	18.25
Percent Negative Salvage	22.34%	22.34%	
Negative Salvage Amount	$1,256,478	$1,496,698	

*Doesn't Include Amtz. CIAC Tax

Composite Depreciation Rate	2.33%	2.53%

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FIN 47, Accounting for Conditional Asset Retirement Obligations

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Financial Accounting Series

FASB Interpretation No. 47

Accounting for Conditional Asset Retirement Obligations
an interpretation of FASB Statement No. 143

March 2005

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Summary

This Interpretation clarifies that the term *conditional asset retirement obligation* as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations,* refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional asset retirement obligation should be recognized when incurred--generally upon acquisition, construction, or development and (or) through the normal operation of the asset. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. Statement 143 acknowledges that in some cases, sufficient information may not be available to reasonably estimate the fair value of an asset retirement obligation. This Interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation.

Reason for Issuing This Interpretation

Diverse accounting practices have developed with respect to the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and (or) method of settlement of the obligation are conditional on a future event. For example, some entities recognize the fair value of the obligation prior to the retirement of the asset with the uncertainty about the timing and (or) method of settlement incorporated into the liability's fair value. Other entities recognize the fair value of the obligation only when it is probable the asset will be retired as of a specified date using a specified method or when the asset is actually retired. This Interpretation clarifies that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. Questions also arose about when sufficient information may not be available to make a reasonable estimate of the fair value of an asset retirement obligation. This Interpretation clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation.

How This Interpretation Will Improve Financial Reporting

Application of this Interpretation will result in (a) more consistent recognition of liabilities relating to asset retirement obligations, (b) more information about expected future cash outflows associated with those obligations, and (c) more information about investments in long-lived assets because additional asset retirement costs will be recognized as part of the carrying amounts of the assets.

How the Conclusions in This Interpretation Relate to the Conceptual Framework

FASB Concepts Statement No. 6, *Elements of Financial Statements*, states that "liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events." The Board concluded that asset retirement obligations within the scope of Statement 143 that meet the definition of a liability in Concepts Statement 6 should be recognized as a liability at fair value if fair value can be reasonably estimated. The Board believes that when an existing law, regulation, or contract requires an entity to perform an asset retirement activity, an unambiguous requirement to perform the retirement activity exists, even if that activity can be deferred indefinitely. At some point, deferral is no longer possible, because no tangible asset will last forever (except land). Therefore, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. The use of an expected value technique to measure the fair value of the liability reflects any uncertainty about the amount and timing of future cash outflows. The clarification of when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation should improve the relevance, reliability, and comparability of the amounts recognized in the financial statements.

The Effective Date of This Interpretation

This Interpretation is effective no later than the end of fiscal years ending after December 15, 2005 (December 31, 2005, for calendar-year enterprises). Retrospective application for interim financial information is permitted but is not required. Early adoption of this Interpretation is encouraged.

FASB Interpretation No. 47

Accounting for Conditional Asset Retirement Obligations
an interpretation of FASB Statement No. 143

March 2005

CONTENTS

FASB Interpretation No. 47

Accounting for Conditional Asset Retirement Obligations
an interpretation of FASB Statement No. 143

March 2005

INTRODUCTION

1. Paragraph 3 of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, states, "An entity shall recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made."[1] Diverse accounting practices have developed with respect to the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and (or) method of settlement are conditional on a future event. For example, some entities recognize the fair value of the obligation prior to the retirement of the asset with the uncertainty about the timing and (or) method of settlement incorporated into the liability's fair value. Other entities recognize the fair value of the obligation only when it is probable the asset will be retired as of a specified date using a specified method or when the asset is actually retired. Questions also arose about when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation.

INTERPRETATION

2. Statement 143 applies to legal obligations associated with the retirement of a tangible long-lived asset that result from the acquisition, construction, or development and (or) the normal operation of a long-lived asset, except as explained in paragraph 17 of that Statement for certain obligations of lessees. The term *retirement*[2] encompasses sale, abandonment, recycling, or disposal in some other manner.

3. The term *conditional asset retirement obligation* as used in paragraph A23 of Statement 143 refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Accordingly, an entity shall recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Statement 143 requires an entity to recognize the fair value of a legal obligation to perform asset retirement activities when the obligation is incurred--generally upon acquisition, construction, or development and (or) through the normal operation of the asset.

4. An entity shall identify all its asset retirement obligations. If an entity has sufficient information to reasonably estimate the fair value of an asset retirement obligation, it must recognize a liability at the time the liability is incurred. An asset retirement obligation would be reasonably estimable if (a) it is evident that the fair value of the obligation is embodied in the acquisition price of the asset,[3] (b) an active market exists for the transfer of the obligation, or (c) sufficient information exists to apply an expected present value technique.[4]

An expected present value technique incorporates uncertainty about the timing and method of settlement into the fair value measurement. However, in some cases, sufficient information about the timing and (or) method of settlement may not be available to reasonably estimate fair value. Examples 1 and 2 in Appendix A illustrate the application of this Interpretation when an entity has sufficient information to reasonably estimate the fair value of an asset retirement obligation at the time the obligation is incurred.

5. An entity would have sufficient information to apply an expected present value technique and therefore an asset retirement obligation would be reasonably estimable if either of the following conditions exists:

a. The settlement date and method of settlement for the obligation have been specified by others. For example, the law, regulation, or contract that gives rise to the legal obligation specifies the settlement date and method of settlement. In disposal of the treated poles, the cost to remove the poles is not included in the asset retirement obligation. However, if there was a legal requirement to remove the treated poles, the cost of removal would be included.

Example 2

A6. An entity recently purchased several kilns lined with a special type of brick. As of the date of purchase, the kilns had not yet been used in any smelting processes. The kilns have a long useful life, but the bricks are replaced periodically. Because the bricks become contaminated with hazardous chemicals while the kiln is operated, a state law requires that when the bricks are removed, they must be disposed of at a special hazardous waste site. The entity has the information to estimate a range of potential settlement dates, the method of settlement, and the probabilities associated with the potential settlement dates based on its past practice of replacing the bricks to maintain the efficient operation of the kiln. Therefore, at the date the bricks become contaminated because of the operation of the kiln, the entity is able to estimate the fair value of the liability for the required disposal procedures using an expected present value technique.

A7. Although performance of the asset retirement activity is conditional on removing the bricks from the kiln, existing legislation creates a duty or responsibility for the entity to dispose of the bricks at a special hazardous waste site, and the obligating event occurs when the entity contaminates the bricks. As of the purchase date, the kilns have not yet been used in any smelting processes, and the bricks have not yet been contaminated. Therefore, at the date of purchase, no obligation exists because the bricks have not been contaminated and could be disposed of without performing any special disposal activities.

A8. The fair value of the asset retirement obligation should be recognized once the kilns have been placed into operation and the bricks are contaminated. Although the entity may decide not to remove the bricks from the kiln and thereby defer settlement of the obligation, the ability to defer settlement does not relieve the entity of the obligation. The contaminated bricks will eventually need to be removed and disposed of at a special hazardous waste site, because a kiln will not last forever. Therefore, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing of settlement. An asset retirement obligation should be recognized once the kilns have been placed into operation and the bricks are contaminated because the entity has sufficient information to estimate the fair value of the asset retirement obligation. The asset retirement obligation is the requirement to dispose of the contaminated bricks at a special hazardous waste site. The cost to remove the bricks is not part of the obligation and should be accounted for as a maintenance or replacement activity.

Example 3

A9. An entity acquires a factory that contains asbestos. After the acquisition date, regulations are put in place that require the entity to handle and dispose of this type of asbestos in a special manner if the factory undergoes major renovations or is demolished. Otherwise, the entity is not required to remove the asbestos from the factory. The entity has several options to retire the factory in the future including demolishing, selling, or abandoning it. The entity believes it does not have sufficient information to estimate the fair value of the asset retirement obligation because the settlement date or the range of potential settlement dates has not been specified by others and information is not available to apply an expected present value technique. For example, there are no plans or expectation of plans to undertake a major renovation that would require removal of the asbestos or demolition of the factory. The factory is expected to be maintained by repairs and maintenance activities that would not involve the removal of the asbestos. Also, the need for major renovations caused by technology changes, operational changes, or other factors has not been identified.

A10. Although the timing of the performance of the asset retirement activity is conditional on the factory undergoing major renovations or being demolished, existing regulations create a duty or responsibility for the entity to remove and dispose of asbestos in a special manner, and the obligating event occurs when the regulations are put in place. Therefore, an asset retirement obligation should be recognized when regulations are put in place if the entity can reasonably estimate the fair value of the liability. In this example, the entity believes that there is an indeterminate settlement date for the asset retirement obligation because the range of time over which the entity may settle the obligation is unknown or cannot be estimated. Therefore, the entity cannot reasonably estimate the fair value of the liability. Accordingly, the entity would not recognize a liability for the asset retirement obligation when regulations are put in place, but it should disclose (a) a description of the obligation, (b) the fact that a liability has not been recognized because the fair value cannot be reasonably estimated, and (c) the reasons why fair value cannot be reasonably estimated. The company would recognize a liability in the period in which sufficient information is available to reasonably estimate its fair value.

Example 4

A11. An entity acquires a factory that contains asbestos. At the acquisition date, regulations are in place that require the entity to handle and dispose of this type of asbestos in a special manner if the factory undergoes major renovations or is demolished. Otherwise, the entity is not required to remove the asbestos from the factory. The entity has several options to retire the factory in the future including demolishing, selling, or abandoning it. At the acquisition date, it is not evident that the fair value of the obligation is embodied in the acquisition price of the factory because both the seller and the buyer of the factory believed the obligation had an indeterminate settlement date, an active market does not exist for the transfer of the obligation, and sufficient information does not exist to apply an expected present value technique. Ten years after the acquisition date, the entity obtains additional information based on changes in demand for the products manufactured at that factory. At that time, the entity has the information to estimate a range of potential settlement dates, the potential methods of settlement, and the probabilities associated with the potential settlement dates and potential methods of settlement. Therefore, at that time the entity is able to estimate the fair value of the liability for the special handling of the asbestos using an expected present value technique.

A12. Although timing of the performance of the asset retirement activity is conditional on the factory undergoing major renovations or being demolished, existing regulations create a duty or responsibility for the entity to remove and dispose of asbestos in a special manner, and the obligating event occurs when the entity acquires the factory.[11] Although the entity may decide to abandon the factory and thereby defer settlement of the obligation for the foreseeable future, the ability to defer settlement does not relieve the entity of the obligation. The asbestos will eventually need to be removed and disposed of in a special manner, because no building will last forever. Additionally, the ability of the entity to sell the factory does not relieve the entity of its present duty or responsibility to settle the obligation. The sale of the asset would transfer the obligation to another entity and that transfer would affect the selling price. Therefore, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and method of settlement.

A13. In this example, an asset retirement obligation is not recognized when the entity acquires the factory because the entity does not have sufficient information to estimate the fair value of the obligation. The entity would disclose (a) a description of the obligation, (b) the fact that a liability has not been recognized because the fair value cannot be reasonably estimated, and (c) the reasons why fair value cannot be reasonably estimated. An asset retirement obligation would be recognized by this entity 10 years after the acquisition date because that is when the entity has sufficient information to estimate the fair value of the asset retirement obligation.

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[11] In this example, regulations are in place at the date of acquisition that require the entity to handle and dispose of the asbestos in a special manner. Therefore, the obligating event is the acquisition of the factory. If regulations were enacted after the date of acquisition, the obligating event would be the enactment of the regulations. Refer to Example 3.

Appendix B

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

CONTENTS	Paragraph Numbers

Appendix B

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

B1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Interpretation. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background

B2. Diverse accounting practices have developed with respect to the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. Some entities recognize the fair value of the obligation prior to the retirement of the asset with the uncertainty about the timing and (or) method of settlement incorporated into the liability's fair value. Other entities recognize the fair value of the obligation only when it is probable the asset will be retired as of a specified date using a specified method or when the asset is actually retired.

B3. The FASB staff issued a proposed FASB Staff Position (FSP) FAS 143-x, "Applicability of FASB Statement No. 143, *Accounting for Asset Retirement Obligations,* to Legislative Requirements on Property Owners to Remove and Dispose of Asbestos or Asbestos-Containing Materials," in July 2003. That proposed FSP concluded:

a. The enactment or existence of asbestos legislation creates a duty or responsibility to remove and dispose of asbestos.

b. If such legislation already exists, the obligating event is the acquisition (or construction) of the asset, or if the asset is owned when that legislation is enacted, then the enactment of the legislation is the obligating event.

c. An entity should recognize a liability for this obligation when the obligating event occurs.

B4. The FASB staff evaluated the comment letters received on that proposed FSP. Because of the diverse views expressed and constituents' concerns that there is a broader issue underlying the issue addressed in the proposed FSP, the FASB staff withdrew that proposed FSP. The FASB staff confirmed the diversity in practice with a questionnaire to selected constituents. Because of the diversity in practice and constituents'concern about the broader nature of this issue, the Board added a project to its agenda to address the issue of whether Statement 143 requires an entity to recognize a liability for a legal obligation to perform asset retirement activities when the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity and, if so, the timing of that recognition.

B5. On June 17, 2004, the Board issued an Exposure Draft, *Accounting for Conditional Asset Retirement Obligations.* The Board received 34 comment letters on the Exposure Draft. The Board considered all comments and concerns raised by respondents and constituents during its redeliberations of the issues addressed by the Exposure Draft in a public meeting in August 2004. This Interpretation reflects the results of those deliberations. The Board received comments requesting that the Board reconsider Statement 143 in its entirety. At a public meeting in January 2005, the Board decided not to reconsider Statement 143. The Board decided to provide additional guidance for evaluating whether sufficient information is available to reasonably estimate the fair value of an asset retirement obligation.

Objective of This Interpretation

B6. The objective of this Interpretation is to clarify that the term *conditional asset retirement obligation* as used in Statement 143 refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. In this situation, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Accordingly, an entity should recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the fair value of the liability can be reasonably estimated. This Interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation.

Scope

B7. Statement 143 applies to legal obligations associated with the retirement of a tangible long-lived asset that result from the acquisition, construction, or development and (or) the normal operation of a long-lived asset, except as explained in paragraph 17 of Statement 143. As used in Statement 143, a legal obligation is an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel. As discussed in paragraphs A2--A5 of Statement 143, whether a legal obligation exists will usually be unambiguous. However, questions arose about whether a liability should be recognized when a legal obligation exists but the timing and (or) method of settlement are conditional on future events. Based on diversity in practice and the broad nature of this issue, the Board decided that this Interpretation should apply to all entities that have legal obligations to perform asset retirement activities in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity.

B8. During the redeliberations of this Interpretation, questions also arose about when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. Paragraph A20 of Statement 143 states that "it is expected that uncertainties about the amount and timing of future cash flows can be accommodated by using the expected cash flow technique and therefore will not prevent the determination of a reasonable estimate of fair value." Some constituents believe paragraph A20 contradicts paragraph 3 of Statement 143, which states that "if a reasonable estimate of fair value cannot be made in the period the asset retirement obligation is incurred, the liability shall be recognized when a reasonable estimate of fair value can be made." As a result, the Board decided that this Interpretation should clarify that uncertainties about the amount and timing of future cash flows can be accommodated by using the expected cash flow technique when sufficient information exists. The Board decided to provide additional guidance in this Interpretation for evaluating whether sufficient information is available to reasonably estimate the fair value of an asset retirement obligation.

Recognition of a Liability for a Conditional Asset Retirement Obligation

Characteristics of a Liability

B9. FASB Concepts Statement No. 6, *Elements of Financial Statements,* defines *liabilities* as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events." *Probable* is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, *Accounting for Contingencies*), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved. Its inclusion in the definition is intended to acknowledge that business and other economic activities occur in an environment characterized by uncertainty. The Board concluded that all asset retirement obligations within the scope of Statement 143 that meet the definition of a liability in Concepts Statement 6 should be recognized as liabilities if the fair value of the liabilities can be reasonably estimated.

B10. Concepts Statement 6 states that a liability has three essential characteristics. The first characteristic of a liability is that an entity has a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. A duty or responsibility becomes a present duty or responsibility when an obligating event occurs that leaves the entity little or no discretion to avoid a future transfer or use of assets. A present duty or responsibility does not mean that the obligation must be satisfied immediately. Rather, if events or circumstances have occurred that give an entity little or no discretion to avoid a future transfer or use of assets, that entity has a present duty or responsibility. If an entity is required by current laws, regulations, or contracts to settle an asset retirement obligation upon retirement of the asset, that requirement imposes a present duty.

B11. The second characteristic of a liability is that the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice. The ability of an entity to indefinitely defer settlement of an asset retirement obligation does not provide the entity discretion to avoid the future sacrifice, nor does it relieve the entity of the obligation. Implicit in this conclusion is the belief that no tangible asset will last forever (except land) and, accordingly, the asset retirement activities will eventually be performed. Furthermore, the ability of an entity to sell the asset prior to its disposal does not relieve the entity of its present duty or responsibility to settle the obligation. In paragraph B47 of Statement 143, the Board noted that "if the asset for which there is an associated asset retirement obligation were to be sold, the price a buyer would consent to pay for that asset would reflect an estimate of the fair value of the asset retirement obligation. Because that asset retirement obligation meets the definition of a liability, however, the Board believes that reporting it as a liability with a corresponding increase in the carrying amount of the asset for the asset retirement costs, which has the same net effect as incorporating the fair value of the costs to settle the liability in the valuation of the asset, is more representationally faithful and in concert with Concepts Statement 6."

B12. The third characteristic of a liability is that the event obligating the entity has already occurred. The definition of a liability distinguishes between present obligations and future obligations. Only present obligations are liabilities under the definition, and they are liabilities of a particular entity as a result of the occurrence of transactions or other events affecting the entity. Identifying the obligating event may be difficult in situations that involve a series of transactions or other events affecting the entity. For example, in the case of an asset retirement obligation, a law or an entity's promise may create a duty or responsibility, but that law or promise in and of itself may not be the obligating event that results in an entity having little or no discretion to avoid a future transfer or use of assets. Statement 143 states that the obligating event is the acquisition, construction, or development and (or) the normal operation of the long-lived asset when a law or promise exists that creates a duty or responsibility relating to the retirement of the asset. At this point, the obligation cannot be realistically avoided if the asset is operated for its intended use. The obligating event does not depend on the ultimate retirement of the asset.

B13. A number of respondents to the Exposure Draft questioned the view that conditional asset retirement obligations require "probable future sacrifices of economic benefits." Although Concepts Statement 6 does not use the Statement 5 definition of probable in its definition of a liability (as discussed in paragraph 5 of Statement 143), these respondents suggested that a Statement 5 definition be used for evaluating when an asset retirement obligation should be recognized. The Board considered this issue in both its deliberations and its redeliberations of Statement 143 and decided not to use the Statement 5 definition for the same reasons discussed in paragraph B17 of this Interpretation. In addition, in developing Statement 143, the Board decided that incorporating uncertainty in the measurement attribute (fair value) results in higher quality financial reporting than incorporating uncertainty into the timing of the recognition of the asset retirement obligation, if sufficient information exists to develop a reasonable estimate of fair value.

B14. Other respondents suggested that the obligating event, and therefore the recognition of a conditional asset retirement obligation, occurs when a decision or event provides more certainty about the timing and method of settlement of the obligation. In deliberating Statement 143, the Board considered the following alternatives for the obligating event: (a) the existence of law or an entity's promise to do something, (b) the creation of the situation that the law or promise relates to (for example, contamination or acquisition of the asset), and (c) events that would trigger the settlement of the obligation (for example, demolishment). The Board decided that the existence of a law or promise, combined with the creation of the situation that the law or promise relates to, provides the obligating event as described in paragraph B31 of Statement 143. Thus, if sufficient information exists, any uncertainty about the timing of the event that would trigger the settlement of the obligation should affect the measurement of the liability rather than the timing of recognition of the obligation. Although the timing and (or) method of settlement of the asset retirement obligation may depend on events that will occur after the obligating event has occurred, an obligation still exists. Therefore, conditional asset retirement obligations are within the scope of Statement 143 as discussed in paragraphs A17 and A18 of Statement 143, and a liability must be recognized before the event that requires performance occurs. This Interpretation clarifies that point.

Uncertainty and the Fair Value Measurement Objective

B15. This Interpretation is consistent with the fair value measurement objective of Statement 143. During the deliberations of Statement 143, the Board concluded that the initial measurement objective for an asset retirement obligation is fair value. The Board acknowledged that liability recognition under a fair value measurement objective differs from recognition under Statement 5, which requires an entity to consider uncertainty in its determination of whether to recognize a liability. In contrast, Statement 143 requires an entity to consider uncertainty in its fair value measurement of the liability when sufficient information exists to develop a reasonable estimate. Because of the Board's decision that the initial measurement objective is fair value and, therefore, uncertainty is considered in the measurement of the liability, the guidance in Statement 5 is not applicable.

B16. To assist in understanding the differences between the fair value approach and the Statement 5 approach, the Board provided the following explanation in paragraph B36 of Statement 143:

> The objective of recognizing the fair value of an asset retirement obligation will result in recognition of some asset retirement obligations for which the likelihood of future settlement, although more than zero, is less than probable from a Statement 5 perspective. A third party would charge a price to assume an uncertain liability even though the likelihood of a future sacrifice is less than probable.... Thus, this Statement does not retain the criterion... that a future transfer of

assets associated with the obligation is probable for recognition purposes. [Footnote reference omitted.]

B17. Additionally, the Board specifically addressed conditional obligations in paragraph A17 of the implementation guidance for Statement 143 and concluded, consistent with the fair value measurement objective, that an entity should recognize a liability for a legal obligation to perform asset retirement activities in which the timing and (or) method of settlement are conditional on a future event. The implementation guidance for Statement 143 also provides an example in which a third party has the right to require an entity to perform asset retirement activities; however, uncertainty exists as to whether the third party will require performance. Some have interpreted that example to mean that the Board intended for conditional obligations to be recognized only when a third party could require performance, not when the timing and method of settlement are at least partly under the control of the entity. However, the Board concluded that although the timing and method of settlement of the retirement obligation may depend on future events that may or may not be within the control of the entity, a legal obligation to stand ready to perform retirement activities still exists. The entity should consider the uncertainty about the timing and method of settlement in the measurement of the liability, consistent with a fair value measurement objective, regardless of whether the event that will trigger the settlement is partially or wholly under the control of the entity.

B18. A number of respondents questioned why the Board believes that financial reporting is improved by incorporating uncertainty in measurement by recording the liability initially at fair value, rather than by using as the recognition trigger a high probability that a transfer or use of assets will occur, combined with the ability to measure the ultimate settlement amount of the retirement obligation. Fair value is not an estimate of the ultimate settlement amount or the present value of an estimate of the ultimate settlement amount. Paragraph 7 of Statement 143 states that "the fair value of a liability for an asset retirement obligation is the amount at which that liability could be settled in a current transaction between willing parties, that is, other than in a forced or liquidation transaction." Fair value reflects uncertainty, as of the initial recognition date, about the timing, method, and ultimate amount of the asset retirement settlement. A single best estimate of the settlement outcome, or the bottom of a range of possible ultimate settlement outcomes as required by Statement 5 and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss,* does not reflect that uncertainty. Using a higher level of certainty as to the ultimate settlement amount as a trigger for recognition in the balance sheet (and consequently in the income statement) would delay recognition of the asset retirement obligation, and thereby reduce the information content of the financial statements. Uncertainty about the timing and method of settling the existing obligation is information that should be reflected in the amounts recognized in the financial statements. In developing Statement 143, the Board concluded that not recognizing the liability and providing the Statement 5 disclosures for a contingent loss is not an adequate substitute for recognizing the fair value of the obligation.

Uncertainty about the Timing and Method of Settlement

B19. Some respondents to the Exposure Draft of Statement 143 questioned whether asset retirement obligations with indeterminate settlement dates or asset retirement obligations with multiple methods of settlement are within the scope of the Statement. In developing Statement 143, the Board decided that uncertainty about the timing and (or) method of settlement does not change the fact that an entity has a legal obligation. The Board acknowledged in paragraph A16 of Statement 143 that measurement of an existing obligation might not be possible if insufficient information exists about the timing and method of settlement of that obligation. However, information about the timing and method of settlement of an asset retirement obligation will become available as time goes by. The Board decided that an entity should measure and recognize the fair value of an asset retirement obligation when enough information is available to develop assumptions about the potential timing and amounts of cash flows.

B20. Some respondents to the Exposure Draft of the Interpretation requested specific criteria for determining when it would not be possible to reasonably estimate the fair value of an asset retirement obligation. The Board decided to provide general guidelines rather than specific criteria because the determination of whether a reasonable estimate can be made is a matter of judgment. Additionally, each situation is unique and providing specific criteria would not encompass all possible situations. The Board discussed situations that might lead to a conclusion that sufficient information does not exist to estimate the fair value of an asset retirement obligation.

B21. The Board believes that an entity would have sufficient information to apply a present value technique if the timing and method of settlement are specified by others. In these situations, the only uncertainty is whether performance will be required. As explained in paragraphs A17 and A18 of Statement 143, uncertainty about whether performance will be required does not defer the recognition of an asset retirement obligation because a legal obligation to stand ready to perform the retirement activities still exists, and that uncertainty does not prevent the determination of a reasonable estimate of fair value.

B22. For situations where the timing and method of settlement are not specified by others, the Board decided that an asset retirement obligation would be reasonably estimable if information is available to estimate the settlement date or the range of potential settlement dates, the method of settlement or potential methods of settlement, and the probabilities associated with the potential settlement dates and methods of settlement. Judgment is involved in determining whether uncertainties about the timing and method of settlement would prevent an entity from reasonably estimating the fair value of an asset retirement obligation. The Board believes that uncertainty about future methods of settlement that have yet to be developed should not prevent an entity from reasonably estimating fair value because methods may change as time goes by. The Board does not believe it is appropriate to delay recognition until all potential methods of settlement are known. This Interpretation provides examples of information (some of which are based on entity-specific assumptions) that is expected to provide a basis for forming expectations about the potential settlement dates, potential methods of settlement, and associated probabilities. The Board believes that entity-specific assumptions may be used in the absence of information that a marketplace participant would use about the timing and method of settlement of the asset retirement obligation as long as no contrary data indicates that marketplace participants would use different assumptions. If such data exist, the entity must adjust its assumptions to incorporate that market information.

B23. The Board also discussed whether sufficient information might not be available to estimate a range of potential cash flows associated with the potential methods of settlement that are currently available to the entity. The Board concluded that an entity would generally have the ability to estimate a range of potential cash flows based on the current costs to perform the asset retirement activities under different methods of settlement that are currently available to the entity.

B24. Some respondents to FSP FAS 143-x questioned whether an obligation to perform asset retirement activities is within the scope of Statement 143 if an entity has alternatives to retiring the asset without settling the obligation. This Interpretation reiterates the conclusions reached during the deliberations of Statement 143:

> ...an unambiguous requirement that gives rise to an asset retirement obligation coupled with a low likelihood of required performance still requires recognition of a liability. Uncertainty about the conditional outcome of the obligation is incorporated into the measurement of the fair value of that liability, not the recognition decision. [Statement 143, paragraph A24]

The Board believes that if a current law, regulation, or contract requires an entity to perform an asset retirement activity when an asset is dismantled or demolished, there is an unambiguous requirement to perform the retirement activity even if that activity can be indefinitely deferred. At some time deferral will no longer be possible, because no tangible asset will last forever (except land). Therefore, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement.

B25. If an entity entered into a contract to pay another entity to assume the asset retirement obligation, there would be little dispute that the contract provides the measurement of the obligation that should be reported in the financial statements, even if the cash payment to the other entity had not been made at the reporting date. Also, the amount demanded by the other entity would incorporate uncertainty about the timing, method, and ultimate amount of the settlement. Statement 143 requires that the asset retirement obligation be recognized and measured in the financial statements using the perspective of participants currently negotiating such a hypothetical contract.

B26. A number of respondents stated that an entity should recognize a liability for a legal obligation when it can reasonably estimate the fair value of the asset retirement obligation and that fair value cannot be reasonably estimated unless it is probable the entity will have to perform the asset retirement activities as of a specific time. The Board believes that an inability to reasonably estimate the fair value of the liability is a measurement issue rather than a recognition issue. When there is an unambiguous requirement to perform asset retirement activities upon the removal of a long-lived asset from service, an asset retirement obligation exists.

B27. As stated in paragraph B19 of Statement 143, the Board decided that asset retirement obligations with indeterminate settlement dates should be included within the scope of Statement 143. Uncertainty about the timing of the settlement date does not change the fact that an entity has a legal obligation. The Board acknowledged that although there is an obligation, measurement of that obligation might not be possible if insufficient information exists about the timing of settlement. However, information about the timing of the settlement of a retirement obligation will become available as time goes by. The Board decided that an entity should measure and recognize the fair value of an obligation when information is available to develop various assumptions about the potential timing of cash flows.

Effective Date and Transition

B28. The Board decided that this Interpretation should be effective no later than the end of fiscal years ending after December 15, 2005 (December 31, 2005, for calendar-year enterprises). The Board considered four alternatives for the effective date of this Interpretation. The three other alternatives were for financial statements issued for fiscal years

(a) ending after December 15, 2004,

(b) beginning after December 15, 2004, and

(c) beginning after December 15, 2005. During its deliberations of the effective date requirements, the Board weighed the need to provide entities with sufficient time to make the necessary measurements with the need to provide investors, creditors, and others with information that is relevant to the assessment of the effects of asset retirement obligations.

B29. Some respondents expressed concern over the effective date requirements in the Exposure Draft. Specifically, they stated that retrospective application promotes inconsistent treatment of interim financial information. The Board agreed with those respondents and decided to permit, but not require, retrospective application of interim financial information during any period of adoption. Early adoption of the Interpretation is encouraged.

B30. While deliberating the transition provisions for Statement 143, the Board reasoned that although some entities may have access to data and assumptions related to measurements that are already being made (for example, under the provisions of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*), they may not have access to sufficient information to retroactively apply the fair value measurement approach required by Statement 143. Furthermore, while deliberating the transition provisions for this Interpretation, the Board acknowledged that some entities that are required to apply the provisions of Statement 143 have not been accounting for conditional asset retirement obligations. The Board concluded that it would be costly and difficult, if not impossible, to reconstruct historical data and assumptions without incorporating the benefit of hindsight.

B31. The Board decided that the provisions for recognition of transition amounts of this Interpretation should be consistent with the recognition provisions of Statement 143. While deliberating the transition provisions for Statement 143, the Board discussed whether a cumulative-effect approach and retrospective application provide equally useful financial statement information. The Board acknowledged that retrospective application would provide more useful information because prior-period balance sheet amounts and prior-period income statement amounts would be restated to reflect the provisions of Statement 143. However, during the deliberations of Statement 143, some rate-regulated entities expressed concern that if retrospective application resulted in recognition of additional expenses in prior periods, those expenses might not be recovered in current or future rates. The Board decided for this Interpretation that a cumulative-effect approach would provide sufficient information if, in addition to disclosing the pro forma income statement amounts, an entity also disclosed on a pro forma basis, for the beginning of the earliest year presented and for the ends of all years presented, the balance sheet amounts for the liability for asset retirement obligations as if this Interpretation had been applied during all periods affected.

Benefits and Costs

B32. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including preparers, auditors, and users of financial information. In fulfilling that mission, the Board endeavors to determine that a standard will fill a significant need and that the costs imposed to apply that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Although the costs to implement a new standard may not be borne evenly, investors and creditors--both present and potential--and other users of financial information benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

B33. The Board's assessment of the benefits and costs of clarifying Statement 143 was based on discussions with preparers and auditors of financial statements and on consideration of the needs of users for more consistent application of that Statement. The Board acknowledges that this Interpretation may increase the costs of applying Statement 143. The expected benefit of this Interpretation is improved financial reporting resulting from a more consistent application of Statement 143 to conditional asset retirement obligations. Financial statements of different entities will be more comparable because all asset retirement obligations that are within the scope of this Interpretation and their related asset retirement costs will be recognized using a clearer threshold. Asset retirement obligations in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity will be recognized as liabilities when they are incurred if the fair value of the liabilities can be reasonably estimated. Application of this Interpretation will result in (a) more consistent recognition of liabilities for asset retirement obligations, (b) more information about expected future cash outflows associated with those obligations, and (c) more information about investments in long-lived assets because additional asset retirement costs will be recognized as part of the carrying amounts of the assets.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

151. Regarding FASB Statement No. 143 and FIN 47, on a plant account-by-plant account basis, please identify any and all "legal obligations" associated with the retirement of the assets contained in the account that result from the acquisition, construction, development and (or) the normal operation of the assets in the account. For the purposes of this question, please use the definition of a "legal obligation" provided in FASB Statement No. 143: "an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract under the doctrine of promissory estoppel."

Response:

None.

For electronic version, refer to KAW_R_AGDR1#151_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

152. For any asset retirement obligations identified above, please provide the "fair value" of the obligation. For the purposes of the question, fair value means "the amount at which that liability could be settled in a current [not future] transaction between willing parties, that is, other than in a forced or liquidation transaction." Please provide all assumptions and calculations underlying these amounts.

Response:

See response to AGDR1#151.

For electronic version, refer to KAW_R_AGDR1#152_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

153. Please provide the “credit adjusted risk free rate” used for any and all ARO calculations under FASB Statement No. 143 and FIN 47 to date.

Response:

None.

For the electronic version, refer to KAW_R_AGDR1#_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

154. Please provide complete copies of all Board of Director’s minutes and internal management meeting minutes during the past five years in which any or all of the following subjects were discussed: the Company’s depreciation rates; retirement unit costs; SFAS No. 143; and, FIN 47.

Response:

None.

For electronic version, refer to KAW_R_AGDR1#154_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

155. Please provide the accounting entries (debits and credits) used to implement SFAS No. 143 and FIN 47, along with all workpapers supporting those entries. Please provide all these workpapers and calculations in electronic format (Excel) with all formulae intact.

Response:

Please refer to electronic file named KAW_R_AGDR1#155_122308.xls for requested information.

For electronic version of this document, refer to KAW_R_AGDR1#155_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

156. Please refer to page 2 of KY American Water Company's ("KAWC's") December 31, 2007 and 2006 Financial Statements provided as Application Exhibit 28. Provide the workpapers supporting the calculation of the $8.44 million (2007) and $7.597 million (2006) regulatory liabilities for cost of removal. Please provide all of these workpapers and calculations in electronic format (Excel) with all formulae intact, showing amounts by plant account. Show all parameters used to make the calculation. If the amounts are calculated on a total company basis and allocated to KY, please provide the workpapers showing the allocation.

Response:

Please see response to AGDR1#155.

For electronic version of this document, refer to KAW_R_AGDR1#156_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller/John Spanos

157. Describe all favorable and unfavorable consequences to KAWC if the Commission were to require reclassification of the Company's asset removal costs from accumulated depreciation to a regulatory liability account for regulatory reporting purposes.

Response:

The Company's current and former depreciation rates approved by the Commission include a component for net negative salvage. For rate making purposes the Company has continued to record depreciation expense using the Commission approved depreciation rates, and thus accumulated depreciation includes the net negative salvage component. The Accumulated Depreciation balance is reduced from rate base.

On its books and records the Company simply reclassifies the net negative salvage component of depreciation expense to maintenance expense, and reclassifies the accumulated depreciation component of net negative salvage to a regulatory liability.

The Company believes the depreciation expense and accumulated depreciation for rate making purposes should be reflected consistent with the depreciation expense approved by the Commission which includes net negative salvage in the depreciation expense. The inclusion of net negative salvage in accumulated depreciation for ratemaking purposes is also consistent with the NARUC Uniform System of Accounts related to accumulated depreciation.

The reclassification of net negative salvage on the Company's books has neither favorable or unfavorable impacts on the Company from a rate making or U.S. GAAP financial statement perspective.

For electronic version, refer to KAW_R_AGDR1#157_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

158. What impact, if any, did the application of FIN 47 have upon the proposed depreciation rates and expense in this rate case? Provide all workpapers supporting the answer. If the application of FIN 47 had no impact please explain why not.

Response:

None. Neither the depreciation rates of the Company nor the depreciation expense in this case are determined by SFAS 143 or FIN 47. The Company depreciation rates are determined by the Commission. Please see the response to KAW_R_AGDR1#157.

For electronic version, refer to KAW_R_AGDR1#158_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

159. Provide an analysis of the regulatory liability for accrued asset removal costs since inception identifying and explaining each debit and credit entry and amount. Also, provide the copies of the pages from each of KAWC's SEC Form 10Ks, Form 10Qs and Annual Reports in which SFAS No. 143 was ever mentioned, whether or not the Company had quantified an amount of the regulatory liability at the time. Specify the exact date each of these reports was issued and released to the public.

Response:

Please refer to electronic file named KAW_R_AGDR1#155_122308.xls

For electronic version of this document, refer to KAW_R_AGDR1#159_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

160. Provide KAWC's projection of the annual year-end balance in the regulatory liability for cost of removal obligations for KAWC, for the next 20 years. If not available for the next twenty years provide for as many years into the future that the projection is available. If this projection has not been made, please explain why not. Provide in electronic format (Excel) with all formulae intact.
    a. For this projection use the same depreciation rates used to calculate the depreciation expense in this rate case.
    b. Explain all other assumptions used to make this projection.

Response:

The Company does not have projections of the regulatory liability. It reclassified the regulatory liability at July 2008 to accumulated depreciation (the method approved by the Commission in establishing the current depreciation rates) for ratemaking purposes.

For electronic version, refer to KAW_R_AGDR1#160_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

161. For all accounts for which KAWC has collected non-legal AROs, but instead recorded a regulatory liability (regulatory liability for cost of removal), please provide the fair value of the related asset retirement cost as of December 31, 2003; December 31, 2004; December 31, 2005, December 31, 2006 and December 31, 2007. For the purposes of this question, assume that KAWC has legal AROs for these accounts.

Response:

The Company objects to this question on the grounds that it seeks information which it does not have, is not required to generate by U.S. GAAP, and would be extremely burdensome to produce. Notwithstanding the objection the Company responds that the Company simply reclassifies the net negative salvage approved in its depreciation rates by the Commission on its U.S. GAAP financial statements to a regulatory liability account in order to recognize the timing difference between the amount of net negative salvage recovered in rates which the Company will record as a cost of removal net of salvage at a future date when the asset is retired. The inclusion of the future net negative salvage in current depreciation rates properly matches the full cost of the asset to those customers receiving the service provided by that asset. In addition, please see the response to KAW_R_AGDR1#157.

For electronic version, refer to KAW_R_AGDR1#161_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: John J. Spanos

162. Provide the calculation of the annual amount of future gross salvage, cost of removal and net salvage incorporated into KAWC’s depreciation rates by account. If any of the amounts are reduced by the total amount of non-legal AROs included in year-end accumulated depreciation, show that calculation.

Response:

The attached schedule sets forth the annual amount of net salvage calculated for 2007 assuming the current net salvage parameter and the proposed net salvage parameter. It is not possible to accurately segregate the current depreciation rates, therefore, the calculation is performed as a ratio of the current rate and proposed rate which does not consider the remaining life rate.

For electronic version, refer to KAW_R_AGDR1#162_122308.pdf.

KENTUCKY AMERICAN WATER COMPANY

ESTIMATED ANNUAL NET SALVAGE FOR 2007 USING PROPOSED AND CURRENT ANNUAL ACCRUAL RATES

			PROPOSED			CURRENT		
	DEPRECIABLE GROUP	ORIGINAL COST AT DECEMBER 31, 2006	ANNUAL ACCRUAL RATE	NET SALVAGE	ESTIMATED 2007 NET SALVAGE	ANNUAL ACCRUAL RATE	NET SALVAGE	ESTIMATED 2007 NET SALVAGE
	STRUCTURES & IMPROVEMENTS							
304.10	SOURCE OF SUPPLY	2,568,387.51	3.06	(5)	3,743	3.14	0	0
304.20	POWER & PUMPING STRUCTURES	4,800,062.05	2.01	(20)	16,080	2.32	(10)	10,124
304.30	WATER TREATMENT	8,962,557.44	1.96	(20)	29,278	1.79	(10)	14,585
304.40	TRANSMISSION & DISTRIBUTION	825,967.62	4.63	0	0	5.65	0	0
304.60	OFFICE BUILDINGS	3,991,281.60	2.10	(5)	3,991	1.68	0	0
304.70	STORE, SHOP & GARAGE STRUCTURES	1,018,770.93	2.42	0	0	1.65	0	0
304.80	MISCELLANEOUS STRUCTURES	1,563,838.35	4.38	0	0	3.97	0	0
	TOTAL ACCOUNT 304	23,730,865.50			53,092			24,709
305.00	COLLECTING AND IMPOUNDING RESERVOIRS	1,016,553.24	1.67	0	0	2.20	0	0
306.00	LAKE, RIVER AND OTHER INTAKES	561,429.96	2.52	0	0	2.15	0	0
309.00	SUPPLY MAINS	5,084,342.14	1.93	(10)	8,921	1.11	(5)	2,687
310.10	OTHER POWER GENERATION EQUIPMENT	572,453.97	3.40	0	0	3.35	0	0
	PUMPING EQUIPMENT							
311.20	ELECTRIC	9,600,980.00	2.58	(15)	32,309	3.71	(8)	26,385
311.30	DIESEL	724,441.60	2.62	(15)	2,476	3.08	(8)	1,653
311.40	HYDRAULIC	61,581.87	2.31	(15)	186			
	TOTAL ACCOUNT 311	10,387,003.47			34,971			28,038
320.10	PURIFICATION SYSTEM - EQUIPMENT	26,461,236.62	2.31	(15)	79,729	4.03	(20)	177,731
330.10	DISTRIBUTION RESERVOIRS AND STANDPIPES	11,813,469.44	2.32	(30)	63,247	2.20	(10)	23,627
331.00	MAINS & ACCESSORIES	151,503,649.02	1.70	(20)	429,260	1.18	(4)	68,759
333.00	SERVICES	35,325,950.03	3.32	(120)	639,721	4.23	(159)	917,343
	METERS							
334.10	METERS	90,962.25	2.81	(10)	232	1.02	16	(177)
334.11	BRONZE CASE	45,063.51	2.94	(10)	120	2.35	16	(202)
334.12	PLASTIC CASE	1,444,409.44	2.96	(10)	3,887	4.97	0	0
334.13	OTHER	6,870,500.64	2.85	(10)	17,801	1.02	0	0
	TOTAL ACCOUNT 334.1	8,450,935.84	2.87		22,040			(379)
334.20	METER INSTALLATIONS	15,249,739.68	3.07	(10)	42,561	2.44	(53)	128,895
335.00	FIRE HYDRANTS	10,147,784.89	1.77	(25)	35,923	2.58	(36)	69,303
339.10	OTHER SOURCE OF SUPPLY PLANT	3,838.00	28.14	0	0			
	OFFICE FURNITURE & EQUIPMENT							
340.10	FURNITURE	701,103.19	10.43	0	0	4.05	3	(878)
340.21	MAINFRAME	50,239.84	9.49	0	0	11.94	17	(1,229)
340.22	PERSONAL COMPUTERS	1,509,960.66	14.31	0	0	16.73	17	(51,741)

KENTUCKY AMERICAN WATER COMPANY

ESTIMATED ANNUAL NET SALVAGE FOR 2007 USING PROPOSED AND CURRENT ANNUAL ACCRUAL RATES

			PROPOSED			CURRENT		
	DEPRECIABLE GROUP	ORIGINAL COST AT DECEMBER 31, 2006	ANNUAL ACCRUAL RATE	NET SALVAGE	ESTIMATED 2007 NET SALVAGE	ANNUAL ACCRUAL RATE	NET SALVAGE	ESTIMATED 2007 NET SALVAGE
340.23	PERIPHERAL-OTHER	497,999.21	25.39	0	0	11.81	17	(12,046)
340.30	COMPUTER SOFTWARE	4,551,309.57	10.33	0	0	21.06	0	0
340.32	COMPUTER SOFTWARE-PERSONAL	638,669.14	-	0	0	22.20	0	0
340.33	COMPUTER SOFTWARE-OTHER	528,219.88	26.38	0	0	21.15	0	0
340.50	OTHER	178,703.11	9.77	0	0	6.95	3	(384)
	TOTAL ACCOUNT 340	8,656,204.60			0			(66,278)
	TRANSPORTATION EQUIPMENT							
341.10	LIGHT DUTY TRUCKS	1,718,376.55	8.10	20	(34,797)	14.16	30	(104,281)
341.20	HEAVY DUTY TRUCKS	783,375.60	7.17	15	(9,912)	12.59	25	(32,876)
341.30	AUTOS	180,201.94	13.58	15	(4,318)	20.28	23	(10,916)
341.40	OTHER	135,681.17	6.51	0	0	14.37	0	0
	TOTAL ACCOUNT 341	2,817,635.26			(49,027)			(148,073)
342.00	STORES EQUIPMENT	35,546.95	6.51	0	0	3.88	0	0
343.00	TOOLS, SHOP AND GARAGE EQUIPMENT	1,421,289.04	6.43	0	0	7.10	0	0
344.00	LABORATORY EQUIPMENT	843,098.99	8.06	0	0	10.94	(3)	2,686
345.00	POWER OPERATED EQUIPMENT	1,589,810.84	4.68	25	(24,801)	9.13	24	(45,837)
346.10	COMMUNICATION EQUIPMENT - NON-TELEPHONE	1,931,144.48	6.91	0	0	4.79	0	0
347.00	MISCELLANEOUS EQUIPMENT	1,262,276.87	5.61	0	0	4.71	0	0
348.00	OTHER TANGIBLE PROPERTY	138,484.58	6.00	0	0	20.89	0	0
	TOTAL DEPRECIABLE PLANT	319,004,743.41	2.58		1,335,637			1,183,211

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

163. Are the amounts of cost of removal and gross salvage incorporated into the depreciation rates the same as they would have been in the absence of SFAS No. 143 and FIN 47? Please explain.

Response:

The amounts of cost of removal and gross salvage incorporated into the existing and proposed depreciation rates are the same as they would have been in the absence of SFAS No. 143 and FIN 47.

All of the cost of removal and gross salvage recorded on the books and developed into the rates are costs associated with doing normal business in the water industry.

For the electronic version, refer to KAW_R_AGDR1#163_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller/John J. Spanos

164. With respect to the Regulatory Liability relating to cost of removal obligations which KAWC reclassified out of accumulated depreciation:

a. Do you agree that this constitutes a regulatory liability for regulatory purposes in Kentucky? If not, please explain why not.
b. Do you agree that this amount is a refundable obligation to ratepayers until it is spent on its intended purpose (cost of removal)? If not, why not?
c. Please explain the repayment provisions associated with this regulatory liability.
d. Please explain when you expect to spend this money for cost of removal.
e. Please explain what you have done with this money as you have collected it. If you say that you have spent it on plant additions, please prove it.
f. Identify and explain all other similar examples of KAWC's advance collections of estimated future costs for which it does not have a legal obligation.
g. Does KAWC agree that the KPSC will never know whether or not KAWC will actually spend all of this money for cost of removal until and if the Company goes out of business? If not, why not?
h. Does KAWC believe that amounts recoded in accumulated depreciation represent capital recovery? If not, why not?
i. Whose capital is reflected in accumulated depreciation – shareholders' or ratepayers'?

Response:

a. No. The Commission has recognized net negative salvage as a component of current depreciation expense and accumulation of net negative salvage recovered through depreciation is properly reflected as accumulated depreciation for rate making purposes.
b. No. KAWC's current depreciation rates as approved by the Commission recognize the net negative salvage over the remaining lives of the utility plant.
c. Not applicable to KAWC's current depreciation rates approved by the Commission with net negative salvage recovered over the remaining life. Any adjustment necessary to the accumulated depreciation reserve will be corrected with regular depreciation studies reviewed before the

Commission and recognition of the required adjustments to those depreciation rates.

d. When each asset is retired.
e. Depreciation expense is a form of internal cash that is utilized to fund cash requirements of the Company including capital improvements to the extent those capital improvements exceed internal cash generated within the business. Kentucky's capital improvement plan has been in excess of internal cash at least since I have been involved with financial matters and rate cases beginning in 2000. This will certainly be the case over the upcoming five year period as KAWC moves forward with the major project to solve the source of supply deficit. That project alone is expected to cost approximately $162 million. The proof of this can be demonstrated by the fact that KAWC's utility plant increase net of CIAC since 2000 significantly exceeds the increase in capital invested.
f. Pensions and other post employment benefits are recognized for ratemaking purposes using FAS 87 and FAS106. Both FAS 87 and FAS 106 utilize the accrual method to recognize the cost of future obligations in current expense and are recognized for rate recovery by the Commission.
g. No. Regular updates to depreciation rates through depreciation studies will properly adjust the reserve through known and measurable adjustments to the estimates for net negative salvage.
h. Capital recovery is one element of the accumulated depreciation.
i. The shareholders' investment in utility plant is recovered over the expected life of the property, including the recovery in rates of the cost to retire that plant under the remaining life method currently approved by the Commission in establishing KAWC's current depreciation rates. The rate base of a utility is reduced by that return of investment recovered through depreciation expense and no return on that capital investment is provided once the investor's capital is returned though depreciation of that plant.

For electronic version, refer to KAW_R_AGDR1#164_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

165. Does KAWC promise to remove each asset for which it is collecting cost of removal and does it promise to spend all of the money it is collecting for cost of removal, on cost of removal? If the answer is yes, explain why KAWC does not have legal AROs under the principal of promissory estoppel. Please explain.

Response:

KAW anticipates that it will remove the assets for which it is collecting costs of removal. Beyond that, KAW objects to this question because it calls for a legal conclusion and misconstrues and misapplies the legal concept of promissory estoppel.

For the electronic version, refer to KAW_R_AGDR1#165_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

166. Does KAWC consider that it is bound by SEC regulations to record accruals for future costs of removal as regulatory liabilities?
   a. If so, please provide a record of those accruals in as much account detail as is available along with the workpapers used to develop those accruals.
   b. If not, please explain why not.
   c. State whether the Company proposes to separate retirement cost accounting from depreciation accounting, with separate rates and reserves. If the Company does not propose such separation, please state fully the reasons for not doing so.

Response:

a. The Company believes it is required to present its financial statements in conformance with U.S. GAAP. The Company's interpretation of U.S. GAAP and FAS 71 have led the Company to believe that the net negative salvage included in depreciation expense for rate recovery requires reclassification of that timing difference as a regulatory liability for financial statement presentation purposes. The Company believes that the depreciation rates approved for the Company by the Commission include an element for future net negative salvage costs and for regulatory (rate case) presentation, that element of net negative salvage should be reflected as depreciation expense as approved by the Commission.
b. See answer to part a.
c. No. See the response to part a.

For the electronic version, refer to KAW_R_AGDR1#166_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
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ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

167. Please identify and describe the level of detail, e.g. by account, functional category, at which the Company computes the depreciation expense for purposes of financial reporting, Commission reporting, and ratemaking. Explain fully any differences among these three depreciation calculations.

Response:

The Company records depreciation expense by the detailed 300 series NARUC account numbers for Utility Plant using the latest Commission approved depreciation rates for each 300 series account. The calculation is consistent for financial reporting, Commission reporting and ratemaking. For financial reporting purposes the Company then reclassifies the portion of the depreciation expense related to net negative salvage to maintenance expense to conform to U.S. GAAP requirements for financial reporting.

For the electronic version, refer to KAW_R_AGDR1#167_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

168. State whether the Company has forecast any non-legal removal costs that it does not regard as regulatory liabilities. Please describe these costs in detail, state fully the reason(s) for your belief that such forecast costs are not regulatory liabilities, and identify the forecast amounts of such removal costs in as much detail as is available. Provide the supporting documentation for each forecast amount.

Response:

The Company has not forecast any non-legal removal costs that it does not regard as regulatory liabilities.

For the electronic version, refer to KAW_R_AGDR1#168_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

169. Please provide and describe the calculation of the depreciation rates AWW recently implemented in New Jersey and Tennessee. Provide all calculations in Excel format with all formulae intact.

Response:

AWW does not implement depreciation rates, depreciation rates are established by regulatory commissions. The Company does not believe the depreciation rates established in New Jersey or Tennessee are relevant to this proceeding. Each regulated entity prepares depreciation studies specific to their utility plant assets, asset lives and other matters related to plant in service. Those rates are set by the Commission or by settlement based on the factors and issues specific to each regulated entity. Kentucky filed a depreciation study specific to its depreciation matters in case number 2007-00143.

For the electronic version, refer to KAW_R_AGDR1#169_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Patrick Baryenbruch

170. Re. Baryenbruch Direct Testimony. Please provide all workpapers and analyses supporting Exhibit PLB-1.

Response:

Please refer to the following electronic documents:

KAW_R_AGDR1#170_Part1(a through f)_122308.pdf
(Workpapers for Testable Service Company Charge Detail)

KAW_R_AGDR1#170_Part2_122308.pdf
(Workpapers for Estimated Kentucky Legal Hourly Billing Rate)

KAW_R_AGDR1#170_Part3_122308.pdf
(Workpapers for Consultant Hourly Billing Rate)

KAW_R_AGDR1#170_Part4_122308.pdf
(Workpapers for Kentucky CPA Hourly Billing Rate)

KAW_R_AGDR1#170_Part5_122308.pdf
(Workpapers for Kentucky Professional Engineer Hourly Billing Rate)

KAW_R_AGDR1#170_Part6_122308.pdf
(Workpapers for Belleville Lab Unit Cost Survey)

KAW_R_AGDR1#170_Part7_122308.pdf
(Workpapers for KAWC/Service Company Customer Accounts Service Cost)

KAW_R_AGDR1#170_Part8_122308.pdf
(Workpapers for FERC Form 60 Service Company Cost Per Customer)

For the electronic version of this document, refer to KAW_R_AGDR1#170_122308.pdf.