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-M-E-M-O-R-A-N-D-U-M-

DATE: February 20, 2009
TO: Shannon J. Hudson, Regulatory Analyst IV, Division of Economic Regulation
FROM: Denise N. Vandiver, Chief of Auditing, Division of Regulatory Compliance
RE: Docket No: 080668-SU; Company Name: Fairmount Utilities, the 2nd Inc.;
Audit Purpose: Staff-assisted rate case; Company Code: SU648;
Audit Control No: 08-346-2-1;

Attached is the final audit report for the utility stated above. I am sending the utility a copy of this memo and the audit report. If the utility desires to file a response to the audit report, it should send a response to the Office of the Commission Clerk. There are no confidential work papers associated with this audit.

DNV/tbm

Attachment: Audit Report

CC: Division of Regulatory Compliance (Salak, Mailhot, Harvey,
District Offices, File Folder)
Office of Commission Clerk (2)
General Counsel
Office of Public Counsel

Mr. Roger E. Miller
Fairmount Utilities, the 2nd Inc.
Post Office Box 488
Avon Park, FL 33826-0488

Mike Smallridge
Mike Smallridge Consultant
1645 W. Main Street
Inverness, FL 34450

DOCUMENT NUMBER-DATE

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**FLORIDA PUBLIC SERVICE COMMISSION
DIVISION OF REGULATORY COMPLIANCE
BUREAU OF AUDITING**

Tampa District Office

FAIRMOUNT UTILITIES, THE 2ND, INC.


STAFF ASSISTED RATE CASE

AS OF SEPTEMBER 30, 2008

**DOCKET NO. 080668-SU
AUDIT CONTROL NO. 08-346-2-1**



Daniel Acheampong, Audit Manager



Joseph W. Rohrbacher, District Supervisor

DOCUMENT NUMBER-DATE

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**DIVISION OF REGULATORY COMPLIANCE
AUDITOR'S REPORT**

FEBRUARY 04, 2009

**TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED
PARTIES**

We have performed the procedures described later in this report to meet the agreed upon objectives set forth by the Division of Economic Regulation in its audit service request dated December 10, 2008. We have applied these procedures to the attached schedules prepared by the audit staff in support of Fairmount Utilities, the 2nd Inc.'s request for a Staff Assisted Rate Case in Docket No. 080668-SU.

This audit was performed following general standards and field work standards found in the AICPA Statements on Standards for Attestation Engagements. This report is based on agreed upon procedures and the report is intended only for internal Commission use.

OBJECTIVES AND PROCEDURES

GENERAL

Utility Books and Records

Objective: To determine that the utility maintains its accounts and records in conformity with the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts.

Procedures: We reviewed the utility's accounting system. Audit Finding No. 1 discusses our findings and recommendations for improvements to the utility's accounting system.

RATE BASE

Utility-Plant-in-Service (UPIS)

Objective: To determine that property exists and is owned by the utility. To determine that additions to UPIS are authentic, recorded at original cost, and properly classified in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify that the proper retirements of UPIS were made when a replacement item was put in service.

Procedures: We compiled UPIS additions for the period December 31, 1994 through September 30, 2008 to determine the utility's UPIS balance for this proceeding. We recorded retirements to UPIS when a capital item was removed or replaced. We toured the utility plant sites to observe whether asset additions were completed and to ascertain if asset retirements were needed. Audit Finding No. 2 discusses our findings and recommended UPIS balance as of September 30, 2008.

Land and Land Rights

Objective: To determine that utility land is recorded at original cost and is owned or secured under a long-term lease.

Procedures: We verified that the utility owns the land and determined its cost recorded in the general ledger reconciles with the last rate case Order No. PSC-96-0860-FOF-SU.

Contributions-in-Aid-of-Construction (CIAC)

Objective: To determine that additions to CIAC are properly recorded in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify and insure that all donated property is properly accounted for and recorded as CIAC and UPIS.

Procedures: We compiled CIAC additions for the period December 31, 1994 through September 30, 2008 to determine the utility's CIAC balance for this proceeding. We recorded additions to CIAC when new customers were connected. We scanned the utility's 1995 through 2007 Federal Income Tax returns for unrecorded cash and property contributions. Audit Finding No. 3 discusses our findings and recommended CIAC balance as of September 30, 2008.

Accumulated Depreciation

Objective: To determine that accruals to accumulated depreciation are properly recorded in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify that depreciation expense accruals are calculated using the Commission's authorized rates and that retirements are properly recorded.

Procedures: We compiled accumulated depreciation accruals for the period December 31, 1994 through September 30, 2008 to determine the utility's accumulated depreciation balance for this proceeding. We recorded retirements to accumulated depreciation when a capital item was removed or replaced. Audit Finding No. 2 discusses our findings and recommended accumulated depreciation balance as of September 30, 2008.

Accumulated Amortization of CIAC

Objective: To determine that accruals to accumulated amortization of CIAC are properly recorded in compliance with Commission rules and the NARUC Uniform System of Accounts.

Procedures: We compiled accumulated amortization of CIAC for the period December 31, 1994 through September 30, 2008 to determine the utility's accumulated amortization of CIAC balance for this proceeding. Audit Finding No. 3 discusses our findings and recommended accumulated amortization of CIAC balance as of September 30, 2008.

Working Capital

Objective: To determine that the utility's working capital balance is properly calculated in compliance with Commission rules.

Procedures: We calculated the utility's working capital balance as of September 30, 2008, using 1/8th of operation and maintenance expense as required by Commission rule 25-30.433(2), Florida Administration Code. Audit Finding No. 5 discusses our recommended working capital balance as of September 30, 2008.

NET OPERATING INCOME

Revenues

Objective: To determine that revenues are properly recorded in compliance with Commission rules and are based on the utility's Commission approved tariff rates.

Procedures: We recalculated revenues for the 12-month period ended September 30, 2008 from meter readings obtained from City of Sebring and the Commission approved tariff rate. Audit Finding No. 4 discusses our findings and recommended revenue balance for the 12-month period ended September 30, 2008.

Operation and Maintenance Expenses (O&M)

Objective: To determine that operation and maintenance expenses are properly recorded in compliance with Commission rules and were reasonable and prudent for ongoing utility operations.

Procedures: We compiled O&M expense items from the utility's available invoices and compared current amounts to those allowed in the last rate case order. We reviewed all utility invoices for proper amount, period, classification, NARUC account and recurring nature. We determined the proper allocation of invoices and expenses that included services for non-utility operations. Audit Finding No. 5 discusses our findings and recommended O&M expense balance for the 12-month period ended September 30, 2008.

Taxes-Other-Than-Income (TOTI)

Objective: To determine that taxes other than income tax expense is properly recorded in compliance with Commission rules and was reasonable and prudent for ongoing utility operations.

Procedures: We compiled TOTI expense items from the utility's available records, recalculated payroll taxes based on the salaries from O&M. We reviewed all utility tax invoices for proper amount, period, classification, NARUC account and recurring nature. We determined the proper allocation of all tax expenses that included services for non-utility operations. Audit Finding No. 6 discusses our findings and recommended TOTI expense balance for the 12-month period ended September 30, 2008.

Depreciation Expense

Objective: To determine that depreciation expense is properly recorded in compliance with Commission rules and that it accurately represents the depreciation of UPIS assets and amortization of CIAC assets for ongoing utility operations.

Procedures: We calculated depreciation expense and CIAC amortization expense balances using UPIS and CIAC balances that we determined above. Audit Finding Nos. 2 and 3 discuss our findings and recommended depreciation expense and CIAC amortization expense balances for the 12-month period ended September 30, 2008.

CAPITAL STRUCTURE

General

Objective: To determine that the components of the utility's capital structure and the respective cost rates used to arrive at the overall weighted cost of capital are properly recorded in compliance with Commission rules and that they accurately represent ongoing utility operations.

Procedures: We determined that the utility's capital structure is made up of long term debt and equity. We reconciled the long-term debt and equity balance to the net rate base balance we determined in our procedures listed above. Audit Finding No. 7 discusses our findings and recommended capital structure balance for the 12-month period ended September 30, 2008.

AUDIT FINDING NO. 1

SUBJECT: UTILITY BOOKS AND RECORDS

AUDIT ANALYSIS: Fairmount Utilities, the 2nd Inc.'s last application for a staff-assisted rate case was reviewed in Docket No. 950967-SU. Since that review, the utility has implemented a 1999 Price Index and Pass-Through, a 2006 Price Index and a 2007 Price Index.

Commission Rule 25-30.115, Florida Administrative Code, requires that all water and wastewater utilities maintain their accounts and records in conformity with 1996 NARUC Uniform Systems of Accounts adopted by the National Association of Regulatory Utility Commissioners (NARUC USOA). Commission order No. PSC-96-0860-FOF-SU, issued July 2, 1996 in Docket No. 950967-SU allowed an annual amount of \$675 for accounting services. The order also specifically required the utility to comply with the NARUC USOA.

The utility currently has a contract for accounting services with Ledgerplus Accounting Services. The utility's current chart of accounts is not in compliance with NARUC USOA. The utility presently uses a cash basis accounting in recording its daily operations. The utility's current accounting system is not in full compliance with the Commission order referenced above. However, its underlying records were accessible and sufficient for the audit staff to substantially complete its assigned objectives in this proceeding.

Our recommendation is for the utility to create a subsidiary ledger that would comply with NARUC USOA. We also recommend that the company be required to convert from its present cash basis to an accrual basis method of accounting for future reporting periods.

EFFECT ON GENERAL LEDGER: None.

EFFECT ON FILING: Informational

AUDIT FINDING NO. 2

SUBJECT: UTILITY PLANT IN SERVICE AND ACCUMULATED DEPRECIATION

AUDIT ANALYSIS: Utility plant in service (UPIS) and accumulated depreciation balances are \$216,427 and \$189,390, respectively, as of September 30, 2008, based on our audit.

The utility's 2007 Annual Report filed with the Commission reflects UPIS and accumulated depreciation balances of \$217,604 and \$185,460 respectively. There were neither additions nor retirements on the annual report. The utility's 2007 federal income tax return indicates total UPIS of \$326,928 and accumulated depreciation of \$205,881. The federal income tax amounts do not reflect the commission adjustments in the last rate case.

We compiled UPIS additions for the period December 31, 1994 through September 30, 2008 to determine the utility's UPIS balance as of September 30, 2008. We recorded additions and retirements to UPIS when a capital item was removed or replaced. We toured the utility plant site to observe whether asset additions were completed and to ascertain if asset retirements were needed.

We compiled accumulated depreciation accruals for the period December 31, 1994 through September 30, 2008 to determine the utility's accumulated depreciation balance as of September 30, 2008. We recorded retirements to accumulated depreciation when a capital item was removed or replaced. We depreciated all UPIS assets at the rates established by PSC Rule 25-30.140, F.A.C.

Additionally, we calculated a balance of \$8,443 for UPIS depreciation expense for the 12-month period ended September 30, 2008. This amount is included in the \$189,390 stated above. The utility's UPIS, accumulated depreciation and depreciation expense balances by NARUC sub-account are displayed on the following schedule.

EFFECT ON GENERAL LEDGER IF FINDING IS ACCEPTED:

215 Retained Earnings	\$1,177	
101 UPIS		\$1,177
215 Retained Earnings	\$3,930	
108 Accumulated Depreciation		\$3,930

EFFECT ON FILING IF FINDING IS ACCEPTED: UPIS is decreased by \$1,177 and accumulated depreciation is increased by \$3,930.

UPIS ADJUSTMENTS

Acct. No.	Account Description	UPIS PER	AUDIT	UPIS PER
		BOOKS	ADJUSTMENTS	AUDIT
354.00	Land and Land Rights	1,750	(\$1,750)	0
354.00	Structures & Improvements	\$0	\$3,884	\$3,884
354.10	Structures & Improvements	29,563	(\$1,784)	27,779
360.00	Collection - Sewers Forced	1,478	\$8,030	9,508
361.00	Collection - Sewers Gravity	54,339	\$0	54,339
362.00	Special Collecting Structures	24,260	\$0	24,260
363.00	Services to Customers	20,251	\$0	20,251
380.00	Treatment & Disposal Equipment-Ponds	85,118	(\$49,432)	35,686
380.10	Treatment & Disposal Equipment-Blower	-	\$7,963	7,963
380.20	Treatment & Disposal Equipment-Other	-	\$32,269	32,269
390.00	Office Furniture & Equipment	845	(\$357)	488
TOTALS		\$217,604	(\$1,177)	\$216,427

Acct. No.	Account Description	ACC/DEP PER	AUDIT	ACC/DEPR
		BOOKS	ADJUSTMENTS	PERAUDIT
354.00	Structures & Improvements	-	(1,110)	(\$1,110)
354.10	Structures & Improvements	(26,739)	(8,673)	(35,412)
360.00	Collection - Sewers Forced	(1,478)	1,478	-
361.00	Collection - Sewers Gravity	(47,069)	569	(46,500)
362.00	Special Collecting Structures	(23,288)	(77)	(23,365)
363.00	Services to Customers	(19,435)	231	(19,204)
380.00	Treatment & Disposal Equipment-Ponds	(66,982)	38,027	(28,955)
380.10	Treatment & Disposal Equipment-Blower		(4,853)	(4,853)
380.20	Treatment & Disposal Equipment-Other		(29,933)	(29,933)
390.00	Office Furniture & Equipment	(469)	411	(58)
TOTALS		(\$185,460)	(\$3,930)	(\$189,390)

Acct. No.	Account Description	UPIS	Acc/Dep	Dep. Exp.
354.00	Structures & Improvements	\$3,884	(\$1,110)	\$144
354.10	Structures & Improvements	27,779	(35,412)	1,635
360.00	Collection - Sewers Forced	9,508	-	339
361.00	Collection - Sewers Gravity	54,339	(46,500)	1,359
362.00	Special Collecting Structures	24,260	(23,365)	656
363.00	Services to Customers	20,251	(19,204)	579
380.00	Treatment & Disposal Equipment-Ponds	35,686	(28,955)	2,378
380.10	Treatment & Disposal Equipment-Blower	7,963	(4,853)	249
380.20	Treatment & Disposal Equipment-Other	32,269	(29,933)	1,072
390.00	Office Furniture & Equipment	488	(58)	32
TOTALS		<u>\$216,427</u>	<u>(\$189,390)</u>	<u>\$8,443</u>

AUDIT FINDING NO. 3

SUBJECT: CONTRIBUTIONS IN AID OF CONSTRUCTION AND ACCUMULATED AMORTIZATION OF CIAC

AUDIT ANALYSIS: Contributions in Aid of Construction (CIAC) and accumulated amortization of CIAC balances are \$2,508 and \$2,508, respectively, as of September 30, 2008 based on our findings discussed below.

The utility's 2007 Annual Report filed with the Commission indicates a net CIAC of \$459 balance as of December 31, 2007.

We compiled CIAC additions for the period December 31, 1994 through September 30, 2008 to determine the utility's CIAC balance as of September 30, 2008. We determined there was a \$45 contribution in the year 2005. We determined the proper CIAC balance is \$2,508. The net CIAC as of September 30, 2008, should be zero.

We compiled accumulated amortization of CIAC accruals for the period December 31, 1994 through September 30, 2008 to determine the utility's accumulated amortization of CIAC balance as of September 30, 2008. We used the composite depreciation rates established by PSC Rule 25-30.140, F.A.C. We determined CIAC was fully amortized. There was no CIAC expense for the twelve months ended September 30, 2008. The utility's CIAC, accumulated amortization of CIAC and CIAC amortization expense balances by NARUC sub-account are displayed on the following schedule.

<u>Acct. No.</u>	<u>Account Description</u>	<u>@09/30/2008</u>
271.00	Contributions in Aid of Construction	(\$2,508)
272.00	Amortization of CIAC	\$2,508
403.00	CIAC Amortization Expense	\$0

EFFECT ON GENERAL LEDGER IF FINDING IS ACCEPTED:

272 Accumulated Amortization of CIAC	\$504	
215 Retained Earnings		\$459
271 CIAC		\$45

EFFECT ON FILING IF FINDING IS ACCEPTED: There is no net effect on rate base. However, the CIAC balance needs to be increased by \$45 and Accumulated CIAC balance needs to be increased by \$504.

AUDIT FINDING NO. 4

SUBJECT: REVENUES

AUDIT ANALYSIS: The utility's revenues are \$109,062 for the 12-month period ended September 30, 2008. The utility's customer base included 401 residential and 5 general service customers during the 12-month period ended September 30, 2008. The utility charges were based on Commission approved charges.

We recalculated the utility's residential and general wastewater revenues to be \$109,062 for the 12-month period ended September 30, 2008. The utility general ledger recorded \$109,794. These revenues were on a cash basis. Based on our calculations, we have determined an adjustment of \$732, needs to be made to the utility books.

EFFECT ON GENERAL LEDGER IF FINDING IS ACCEPTED:

400 Wastewater Service Revenue	\$732	
141 Account Receivable		\$732

EFFECT ON FILING IF FINDING IS ACCEPTED: Wastewater service revenues should be decreased by \$732.

AUDIT FINDING NO. 5

SUBJECT: OPERATION AND MAINTENANCE EXPENSE

AUDIT ANALYSIS: The utility's operation and maintenance (O&M) expenses are \$95,242, for the 12-month period ended September 30, 2008. The utility general ledger was on a cash basis. We reconstructed the utility expenses based on the available supporting documentation. We posted all direct expenses incurred by the utility and we included the following allocated expense categories for the 12-month period ended September 30, 2008 that were posted to the utility's disbursement ledger that benefited utility operations.

- 1) **Salary Expense:** The utility has two full time employees who serve as its office manager and operations manager. The utility general ledger does not reflect the salaries for these employees. The operation and office manager's salaries have not been paid for the test year period. The utility representative stated they are unable to make these payments now. The office manager duties include bookkeeping, billing and collection, paying vendors, customer contact and the overall management of the company's day-to-day activities. The operations manager, who is the brother and son of the owners, mainly works on the sewer plant and light maintenance work. We reviewed the salaries authorized by the last rate case order (PSC-96-0860-FOF-SU). We used the approved amount and the annual Commission approved index to update salary expense. We determined the office manager salary to be \$16,328 and operations manager salary to be \$22,255.
- 2) The utility recorded \$33,609 as officer salary. The officer is also the office manager. She provided a single list of duties to the auditor. These indicate a reasonable allocation of a salary between employees and officer salary. We determined the officer salary should be \$8,906 based on the approved amount for officer salary in the last rate case and indexed to reflect current officer salary.
- 3) The utility's operations manager owns a related party construction firm, Highlands Construction. This firm supplies chlorine and lime to the utility. We obtained comparable prices from a third party, Pugh Utilities Service Inc. We determined prices for the chemical supplies were reasonable and we removed \$664 for out-of-period expenses.
- 4) **Contractual Services:** Highland Construction also provided other maintenance and mowing services to the utility. These charges total \$6,749. There were no readily available prices for comparison to make a determination of reasonableness. Pugh Utilities Service Inc. provided contracted services in the amount of \$5,824. This amount was reclassified from materials and supplies account to contractual services-other.
- 5) **Rent Expense:** The utility office is located in a building owned by Christopher Miller, a related party and shared by Sebring Ridge Utilities and Highland Construction.

The utility recorded an annual rental fee of \$2,782. This amount was approved in the last rate case. The square footage occupied by the utility remains the same as in the last rate case. We used this amount and indexed it to reflect current annual rent charges of \$3,209.

- 6) Transportation Expense: The utility did not record any transportation expenses. The traveling requirements have not significantly changed from last rate case. We used the approved mileage in the last rate case and the current Internal Revenue approved mileage rates to arrive at \$2,718.
- 7) Miscellaneous Expense: We included actual telephone expense, bank charges, postal services and stationary to calculate miscellaneous expense of \$4,289.
- 8) We included actual purchased power, insurance, contractual services-billing and testing invoices to calculate expenses of \$6,133, \$1,066, \$1,229 and \$1,750 respectively.
- 9) We reclassified \$19,181 from materials and supplies to contractual services-other, \$10,974 and \$8,207 to plant in service. The \$8,207 is embedded in different accounts in the plant in service.

Additionally, we calculated a working capital balance of \$11,905 to be added to the utility's rate base based on $1/8^{\text{th}}$ of the O&M expense balance determined above. (\$95,242 / 8)

The utility's O&M expense balances by NARUC sub-account are displayed on the following schedule.

Acct. Nos.	Acct. Description	PER BOOKS	ADJUSTMENTS	PER AUDIT
701.00	Salaries & Wages - Employees	\$0	\$38,583	\$38,583
703.00	Salaries & Wages - Officers	33,609	(24,703)	8,906
711.00	Sludge Hauling	3,150	-	3,150
715.00	Purchased Power	5,786	347	6,133
718.00	Chemicals	8,539	(664)	7,875
720.00	Materials & Supplies	19,866	(19,181)	685
730.00	Contractual Services - Billing	-	1,229	1,229
732.00	Contractual Services - Accounting	3,460	(385)	3,075
735.00	Contractual Services - Testing	1,500	250	1,750
736.00	Contractual Services - Other	1,600	10,974	12,574
740.00	Rent	2,782	427	3,209
750.00	Transportation Expense	-	2,718	2,718
759.00	Insurance - Other	1,127	(60)	1,066
775.00	Miscellaneous Expense	6,917	(2,628)	4,289
	<u>Subtotal</u>	<u>\$88,336</u>	<u>\$6,906</u>	<u>\$95,242</u>
	<u>Reclassification</u>			
	Payroll Taxes	9,889	(9,889)	-
	Loan Payments	6,097	(6,097)	-
765.00	Regulatory Commission expense	250	(250)	-
766.00	Regulatory Assessment Fees	5,204	(5,204)	-
	Taxes	2,561	(2,561)	-
	Licenses & Fees	300	(300)	-
		<u>\$112,636</u>	<u>(\$17,395)</u>	<u>\$95,242</u>

EFFECT ON GENERAL LEDGER IF FINDING IS ACCEPTED:

701	Salary Expense-Office and Operations	\$38,583	
231.2	Salary Payable-Officer	\$24,703	
715	Purchase Power	\$ 347	
730	Contractual Services-Billing	\$ 1,229	
735	Contractual Services-Testing	\$ 250	
736	Contractual Services-other	\$10,974	
740	Rent Expense	\$ 427	
750	Transportation Expense	\$ 2,718	
231	Account Payable	\$ 6,973	
	231.3 Salary Payable-Office & Operations		\$38,583
	703 Salary Expense-Officer		\$24,703
	718 Chemicals		\$ 664
	720 Materials and Supplies		\$19,181
	732 Contractual Services-accounting		\$ 385
	759 Insurance Expense		\$ 60
	775 Miscellaneous Expense		\$ 2,628

EFFECT ON FILING IF FINDING IS ACCEPTED: If the salary calculation is accepted, utility should record a total of office and operations salary expense of \$38,583. Officer Salary needs to be decreased by \$24,703. There should be an increase in rent expense by \$427. The utility's transportation expense needs to be increased by \$2,718. Contractual services-billing and contractual services-testing expenses need to be increased by \$1,229 and \$250 respectively. Purchase power needs to be increased by \$347 and contractual services-other will also increase by \$10,974. The utility's insurance expense needs to be decreased by \$60, as well as the contractual services-accounting by \$385. Chemical expense needs to be reduced by \$664. Miscellaneous expense and materials and supplies expense need to be decreased by \$2,628 and 19,181 respectively.

AUDIT FINDING NO. 6

SUBJECT: TAXES OTHER THAN INCOME

AUDIT ANALYSIS: The utility's taxes other than income (TOTI) expense is \$11,072 for the 12-month period ended September 30, 2008. The utility recorded \$15,290 as TOTI. We recalculated the payroll tax expenses based on the staff calculated salary and Internal Revenue Service rates. We obtained the utility's unemployment rates from the utility's quarterly unemployment return (UCT-6) to recalculate the payroll taxes. We recalculated the Regulatory Assessment Fees based on the test year revenue (4.5% x 109,062). We determined utility's TOTI is \$11,072.

The utility's TOTI expense balance by NARUC sub-account is displayed below.

Tax Authority	Utility		Audited
	Amount	Adjustments	Amount
Payroll Tax	7,375	(3,720)	3,656
Property Tax	2,561	(203)	2,359
Regulatory Assessment Fees	5,204	(296)	4,908
Corporate Renewal	150	-	150
Totals	15,290	(4,218)	11,072

EFFECT ON GENERAL LEDGER IF FINDING IS ACCEPTED:

131 Account Receivable	\$4,218
408 Taxes Other Than Income	\$4,218

EFFECT ON FILING IF FINDING IS ACCEPTED: Taxes Other Than Income should be decreased by \$4,218.

AUDIT FINDING NO. 7

SUBJECT: CAPITAL STRUCTURE

AUDIT ANALYSIS: The utility's capital structure includes two debt issues and negative retained earnings. The long term debt from an officer has an outstanding balance at September 30, 2008 of \$179,085. We determined the utility has made neither principal nor interest payments on the loan. We have treated this as equity in the Capital Structure schedule

The second debt issue is to Heartland Bank and the balance at September 30, 2008 is \$38,236 and the test year average balance is \$39,116. The interest rate on this debit is 7.25%

EFFECT ON GENERAL LEDGER IF FINDING IS ACCEPTED: None.

EFFECT ON FILING IF FINDING IS ACCEPTED: None

EXHIBIT 1

**FAIRMOUNT UTILITIES, THE 2ND, INC.
WASTEWATER RATE BASE
AS OF SEPTEMBER 30, 2008
DOCKET NO. 080668-SU**

DESCRIPTION	PER COMPANY @09/30/2008 (a)	AUDIT ADJUSTMENTS	PER AUDIT @09/30/2008
UTILITY PLANT IN SERVICE	\$217,604	(\$1,177)	\$216,427
LAND AND LAND RIGHTS	\$0	\$1,750	\$1,750
CONTRIBUTIONS IN AID OF CONSTRUCTION	(\$2,463)	(\$45)	(\$2,508)
AMORTIZATION OF CIAC	\$2,004	\$504	\$2,508
ACCUMULATED DEPRECIATION	(\$185,460)	(\$3,930)	(\$189,390)
WORKING CAPITAL	\$0	\$11,905	\$11,905
NET RATE BASE	\$31,685	\$9,007	\$40,692

Working capital is calculated as 1/8th of the utility's test year O&M expenses.

EXHIBIT 2

**FAIRMOUNT UTILITIES, THE 2ND, INC.
WASTEWATER NET OPERATING INCOME
FOR THE 12-MONTH PERIOD ENDING SEPTEMBER 30, 2008
DOCKET NO. 080668-SU**

DESCRIPTION	PER COMPANY 9/30/2008	AUDIT ADJUSTMENTS	PER AUDIT 9/30/2008
REVENUES	\$109,794	(\$732)	\$109,062
OPERATION AND MAINTENANCE EXPENSE	\$112,637	(\$17,395)	\$95,242
DEPRECIATION EXPENSE	\$0	\$8,443	\$8,443
CIAC AMORTIZATION EXPENSE	\$0	\$0	\$0
TAXES OTHER THAN INCOME EXPENSE	\$15,290	(\$4,218)	\$11,072
PROVISION FOR INCOME TAX EXPENSE (b)	\$0	\$0	\$0
OPERATING EXPENSE	\$127,927	(\$13,170)	\$114,757
NET OPERATING INCOME (c)	(\$18,133)	\$12,438	(\$5,695)

Notes to above schedule:

- a) The company's books were not finalized by the completion of audit staff's fieldwork.
- b) Income is taxed at the shareholder level because the company is a 1120 S-Corporation for federal income tax purposes.
- c) All amounts are rounded to the nearest whole dollar.

EXHIBIT 3

FAIRMOUNT UTILITIES, THE 2ND, INC.
 CAPITAL STRUCTURE
 AS OF SEPTEMBER 30, 2008

DESCRIPTION	BALANCE	AUDIT	BALANCE	COST
	PER T/B @ 09/30/08	ADJUSTMENTS	PER AUDIT @ 09/30/08	RATE
COMMON STOCK	(1,000)	-	(1,000)	0.00%
RETAINED EARNINGS	429,553	384,592	44,961	0.00%
PAID IN CAPITAL	(46,418)	-	(46,418)	0.00%
LONG-TERM DEBIT	(39,996)	(1,760)	(38,236)	7.25%
TOTAL	342,139	382,832	(40,693)	0