SAN FRANCISCO WATER ENTERPRISE

Financial Statements

June 30, 2011 and 2010

(With Independent Auditors' Report Thereon)

SAN FRANCISCO WATER ENTERPRISE

June 30, 2011 and 2010

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KPMG LLP
Suite 1400
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report

The Honorable Mayor and Board of Supervisors
City and County of San Francisco

We have audited the accompanying financial statements of the San Francisco Water Enterprise (the Enterprise), an enterprise fund of the City and County of San Francisco, California (the City), as of and for the years ended June 30, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Enterprise's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing the audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Enterprise's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements of the Enterprise are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the City that is attributable to the transactions of the Enterprise. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2011 and 2010, the changes in its financial position, or, where applicable, the cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the San Francisco Water Enterprise of the City and County of San Francisco, California as of June 30, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2011, on our consideration of the Enterprise's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3 through 19 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

October 28, 2011

This section presents management's analysis of the San Francisco Water Enterprise's (the Enterprise) financial condition and activities as of and for the years ended June 30, 2011 and 2010. Management's Discussion and Analysis (MDA) is intended to serve as an introduction to the Enterprise's financial statements. This information should be read in conjunction with the audited financial statements that follow this section. All amounts, unless otherwise noted, are expressed in thousands of dollars.

The information in this MDA is presented under the following headings:

- Organization and Business
- Overview of the Financial Statements
- Financial Analysis
- Capital Assets and Debt Administration
- Next Year's Rates
- Request for Information

Organization and Business

The San Francisco Public Utilities Commission (SFPUC or the Commission) is an agency of the City and County of San Francisco (the City) that is responsible for the maintenance, operation, and development of three utility enterprises, Wastewater, Hetch Hetchy Water and Power, and Water (the Enterprise). The Water Enterprise collects, transmits, treats, and distributes high-quality drinking water to a total population of approximately 2.5 million people, including retail customers in the City and wholesale customers located in San Mateo, Santa Clara, and Alameda Counties. The Enterprise delivered approximately 218.8 millions of gallons per day of water in the year ended June 30, 2011. Approximately two-thirds of the water delivered by the Enterprise is to wholesale customers. Retail customers are primarily San Francisco consumers and include residential, commercial, industrial, and governmental users. The Enterprise recovers cost of service through user fees. Wholesale customers include cities, water districts, one private utility, and one non-profit university. Service to these customers is provided pursuant to the 25-year Water Supply Agreement (WSA) commencing on July 1, 2009, which establishes the basis for determining the costs of wholesale service.

Overview of the Financial Statements

The Enterprise's financial statements include:

Statements of Net Assets present information on the Enterprise's assets and liabilities as of year-end, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Enterprise is improving or deteriorating.

While the *Statements of Net Assets* provide information about the nature and amount of resources and obligations at year-end, the *Statements of Revenues, Expenses, and Changes in Net Assets* present the results of the Enterprise's operations over the course of the fiscal year and information as to how the net assets changed during the year. These statements can be used as an indicator of the extent to which the Enterprise has successfully recovered its costs through user fees and other charges. All changes in net assets are reported during the period in which the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in these statements from some items that will result in cash flows in future fiscal periods, such as delayed collection of operating revenues and the expenses of employee earned but unused vacation leave.

The *Statements of Cash Flows* present changes in cash and cash equivalents resulting from operational, capital, non-capital, and investing activities. These statements summarize the annual flow of cash receipts and cash payments, without consideration of the timing of the event giving rise to the obligation or receipt and exclude non-cash accounting measures of depreciation or amortization of assets.

The *Notes to Financial Statements* provide information that is essential to a full understanding of the financial statements that is not displayed on the face of the financial statements.

Financial Analysis

Financial Highlights for Fiscal Year 2011

- Total assets of the Enterprise exceeded total liabilities by $396,258.
- Net assets decreased by $19,426 or 4.7% during the fiscal year.
- Capital assets, net of accumulated depreciation, increased by $615,535 or 33.0% to $2,479,888.
- During the fiscal year, charges for services, excluding interest and investment income, rental income, other operating and non-operating revenues, increased by $23,018 or 9.3% to $271,387.
- Operating expenses, excluding interest expense and other non-operating expenses, decreased by $16,043 or 5.8% to $261,927.

Financial Highlights for Fiscal Year 2010

- Total assets of the Enterprise exceeded total liabilities by $415,684.
- Net assets decreased by $46,616 or 10.1% during the fiscal year.
- Capital assets, net of accumulated depreciation, increased by $363,093 or 24.2% to $1,864,353.
- During the fiscal year, charges for services, excluding interest and investment income, rental income, other operating and non-operating revenues, increased by $705 or 0.3% to $248,369.
- Operating expenses, excluding interest expense and other non-operating expenses, increased by $29,655 or 11.9% to $277,970.

(Continued)

(Dollars in thousands, unless otherwise stated)

Financial Position

The following table summarizes changes in the Enterprise's changes in net assets.

Table 1

Comparative Condensed Net Assets

June 30, 2011, 2010, and 2009

	2011	2010	2009	2011 – 2010 change	2010 – 2009 change
Current and other assets	$ 1,661,236	1,136,966	269,975	524,270	866,991
Capital assets, net of accumulated depreciation	2,479,888	1,864,353	1,501,260	615,535	363,093
Total assets	4,141,124	3,001,319	1,771,235	1,139,805	1,230,084
Revenue and capital appreciation bonds	3,189,053	2,249,179	936,506	939,874	1,312,673
Certificates of participation	122,115	122,496	—	(381)	122,496
Commercial paper	150,000	—	229,600	150,000	(229,600)
Other liabilities	283,698	213,960	142,829	69,738	71,131
Total liabilities	3,744,866	2,585,635	1,308,935	1,159,231	1,276,700
Net assets:					
Invested in capital assets, net of related debt	333,386	319,581	372,421	13,805	(52,840)
Restricted for debt service	30,840	12,073	11,941	18,767	132
Restricted for capital projects	19,163	4,346	1,209	14,817	3,137
Unrestricted	12,869	79,684	76,729	(66,815)	2,955
Total net assets	$ 396,258	415,684	462,300	(19,426)	(46,616)

Net Assets, Fiscal Year 2011

For the year ended June 30, 2011, the Enterprise's assets exceeded liabilities by $396,258. Total net assets decreased from prior year by $19,426 or 4.7% (see Table 1). The decline in net assets was the result of $1,139,805 increase in total assets offset by a $1,159,231 increase in total liabilities. Investment in capital assets, net of related debt, increased from the prior year's $319,581 to $333,386 by $13,805 or 4.3% primarily due to the $11,747 transfer of fixed assets from the Fire Department's Auxiliary Water Supply System (AWSS) to the Enterprise.

Current and other assets are primarily comprised of restricted and unrestricted balances of cash, receivables for water deliveries and services, interfund receivables due from other governmental agencies, and inventory. This also includes receivables which represent cumulative amounts due from the wholesale customers to match revenues with the Enterprise's costs of providing service (the "Balancing Account") in accordance with the provisions set forth in the Water Supply Agreement effective July 1, 2009. Balances due are recovered in future year rates.

During the fiscal year 2011, current and other assets increased by $524,270 or 46.1%. The increases included $506,068 in restricted and unrestricted cash and investment from bond issuance of $979,355 and $6,934 in receivables from the wholesale customers that was consistent with the new Water Supply Agreement terms. Wholesale customers are billed based on the estimated costs of service and usage, which are adjusted to actual costs and usage at year end. As of June 30, 2011, the ending balance was $41,026 owed to the Enterprise. Refer to Note 10, Wholesale Balancing Account, for additional details. Inventory increased by $6,158 due to the transfer of AWSS assets from the Fire Department. Other increases included bond issuance costs of $5,210, restricted receivables of $3,920 primarily due to interest subsidies receivables from the Internal Revenue Service on taxable Build America bonds, $3,214 in prepaid expenses was explained by $2,813 for the Pacifica Recycled Water project and $401 for lease agreement with the San Francisco Recreation and Park Commission for the use of Civic Center Garage, and $893 in capacity fee receivables. The increases were offset by decreases of $4,224 in receivables from Wastewater and Hetch Hetchy Enterprises as a result of construction cost reimbursement for 525 Golden Gate Headquarters Building, $3,479 in receivables for charges for services, as a result of unbilled revenue accrual for wholesale customers, $372 from the High Efficiency Toilet Grant and the EPA Contamination Warning System Grant, and $52 in interest receivables from pooled investments.

Total liabilities increased by $1,159,231 or 44.8% primarily due to the issuance of $939,493 in revenue bonds net of principal payment and $150,000 in commercial paper. Increases also included $30,791 in payables from restricted assets for the Water System Improvement Program, the Advanced Meter Infrastructure System, and the 525 Golden Gate Headquarters, $14,716 in other post-employment benefits obligation as a result of a higher annual required contribution, $13,614 in interfund payable which included $13,638 due to Hetch Hetchy Enterprise for water storage and transmission facilities improvements, $12,676 in bond interest payable, $3,459 in deferred credit including $1,100 in grant advance, and $1,800 of rent and utility deposits, $2,480 in accounts payable from higher construction, repair and replacement activities, and $118 in accrued payroll. These increases were offset by decreases of $4,036 in arbitrage liability due to a payment made to the Internal Revenue Service in fiscal year 2011, $2,750 in damage claims liability based on actuarial estimates, $659 reduction in pollution remediation liability for the Baylands Peninsula Sportsman Club project as a result of completion of remediation, $419 in workers' compensation, and $252 in accrued vacation and sick leave.

Net Assets, Fiscal Year 2010

For the year ended June 30, 2010, the Enterprise's assets exceeded liabilities by $415,684, representing a decrease of $46,616 or 10.1% from the prior year (see Table 1). The decline in net assets was the result of an additional $1,230,084 in total assets offset by a $1,276,700 increase in total liabilities. Investment in capital assets, net of related debt, decreased from prior year's $372,421 to $319,581 or 14.2% due to the depreciation and repayment of debt.

Current and other assets primarily comprised of restricted and unrestricted balances of cash, receivables for water deliveries and services, interfund receivables due from other governmental agencies, and inventory. This also includes receivables which represent cumulative amounts due from the wholesale customers to match revenues with the Enterprise's costs of providing service (the "Balancing Account") in accordance with the provisions set forth in the Water Supply Agreement effective July 1, 2009. Balances due are recovered in future year rates.

During the fiscal year 2010, current and other assets increased by $866,991 or 321.1%, as a result of $853,084 increase in restricted cash and investments, and restricted interest receivables from planned bond issuances during the year. The bond issuance costs increased by $10,537. Unrestricted cash with City Treasury was used to pay down current contractual obligations and other liabilities, thereby resulting in a $17,455 decline in unrestricted cash balance. Inventories decreased by $58, and total receivables increased by $20,830, primarily resulting from $10,157 net increase in unrestricted interest receivables, due from other funds and advances for the SFPUC headquarters building, $3,491 increase in receivables for charges for services mainly from City retail ratepayers, net of the current year provision for uncollectible accounts, in part as a result of an average rate adjustment of 15% that went into effect at the beginning of the fiscal year, $661 receivables increase in due from other governmental agencies from the High Efficiency Toilet Grant, and increase of $6,521 in receivables from the wholesale customers consistent with the new Water Supply Agreement terms. Wholesale customers are billed based on the estimated costs of service and usage, which are adjusted to actual costs and usage at year end. As of June 30, 2010, the ending balance was $34,092 owed to the Enterprise. Refer to Note 10, Wholesale Balancing Account, for additional details.

Total liabilities increased by $1,276,700 or 97.5% primarily due to the issuance of $1,435,169 in revenue bonds and certificates of participation offset by principal payments, $34,004 in payables from restricted assets from the Water System Improvement Program and the 525 Golden Gate Avenue Headquarters Project, and $8,651 in interest payable from new bonds issued, offset by a refunding of $229,600 in commercial paper through the issuance of new bonds. Other factors contributing to the increase in total liabilities are $20,099 in damage claims liability due to updated liability reserve estimates related to pending Federal and State cases regarding breach of contract claims by Mitchell Engineering (see Subsequent Events, note 15(d)), $14,631 in other post-employment benefits obligation based on actuarial estimates, $878 in accrued payroll and other liabilities, $373 in accrued vacation and sick leave due to the wellness program, and $288 in arbitrage rebate payable due to higher yield, offset by decreases of $4,617 in accounts payable of operating funds, as project spending this year was more funded with restricted bond funds than with operating funds in comparison to prior fiscal year, $2,653 in pollution remediation obligation due to liability reduction in the Baylands Peninsula Sportsman Club project as a result of completion of remediation process, and $523 in workers’ compensation.

(Dollars in thousands, unless otherwise stated)

Results of Operations

The following table summarizes the Enterprise’s revenues, expenses, and changes in net assets.

Table 2

Comparative Condensed Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2011, 2010, and 2009

	2011	2010	2009	2011 – 2010 change	2010 – 2009 change
Revenues:					
Charges for services	$ 271,387	248,369	247,664	23,018	705
Rents and concessions	9,388	8,584	9,399	804	(815)
Other operating revenues	7,620	8,265	8,718	(645)	(453)
Interest and investment income	17,283	9,823	7,088	7,460	2,735
Other non-operating revenues	31,499	5,851	7,202	25,648	(1,351)
Total revenues	337,177	280,892	280,071	56,285	821
Expenses:					
Operating expenses	261,927	277,970	248,315	(16,043)	29,655
Interest expense	100,875	47,272	28,847	53,603	18,425
Non-operating expenses	2,121	1,773	799	348	974
Total expenses	364,923	327,015	277,961	37,908	49,054
Income (loss) before transfers	(27,746)	(46,123)	2,110	18,377	(48,233)
Capital contribution	26,154	—	—	26,154	—
Transfers to City and County of San Francisco	(17,834)	(493)	(1,143)	(17,341)	650
Changes in net assets	(19,426)	(46,616)	967	27,190	(47,583)
Net assets at beginning of year	415,684	462,300	461,333	(46,616)	967
Net assets at end of year	$ 396,258	415,684	462,300	(19,426)	(46,616)

Results of Operations, Fiscal Year 2011

The Enterprise’s total revenues for the year of $337,177 represented an increase of $56,285 or 20.0% compared to the prior year (see Table 2). Increases included $25,648 from other non-operating revenues, $23,018 from charges for services, $7,460 from interest and investment income, and $804 from rent and concessions, offset by a decrease of $645 in other operating revenues of installation services.

Other non-operating revenues increased by $25,648 or 438.4% primarily due to interest subsidies of $21,647 from the Internal Revenue Service for Build America bonds issued during the year in connection with the 2010 Series B and Series E. Charges for services increased by $23,018 or 9.3% due to increased revenues from an average 15% of planned retail rate increase along with an average 15.2% of planned wholesale rate increase, offset by reduced consumption and a decrease in unbilled revenue accrual from wholesale customers. Interest and investment income increased by $7,460 or 75.9% as a result of higher cash balance from the issuance of revenue bonds and commercial paper during the year.

The Enterprise's total expenses increased by $37,908 or 11.6% to $364,923 over the prior year (see Table 2), due to increases of $53,603 in interest expense as a result of the issuance of revenue bonds and commercial paper, $348 in non-operating expenses mainly for the Water Conservation Rebate Program, offset by a decrease of $16,043 in operating expenses. The decrease of $16,043 in operating expenses were due to decreases of $19,460 in judgments & claims based on actuarial estimate, $8,127 in non-capitalized project expenses, $1,266 in services provided by other departments, and $146 in general and administrative expenses. These decreases were offset by increases of $6,181 in depreciation, $3,185 in personal services due to a decrease of $1,194 in salaries offset by an increase of $4,379 in retirement and health care costs and contributions, $2,499 in contractual services primarily for building and structure maintenance, and $1,091 in materials and supplies for various maintenance projects.

The total transfers out has increased by $17,341 mainly due to a $13,638 transfer to the Hetch Hetchy Enterprise for certain up-country water storage and transmission facilities improvements. The Enterprise also transferred $2,643 to the Recreation and Park and the Department of Public Works for the Enterprise's landscape and irrigation projects.

Results of Operations, Fiscal Year 2010

The Enterprise's total revenues for the year of $280,892 represented an increase of $821 or 0.3% compared to the prior year (see Table 2). Charges for services increased by $705 or 0.3%, interest and investment income increased by $2,735, offset by decreases of $1,351 in other non-operating revenues, $815 in rents and concessions, and $453 in other operating revenues.

Revenues from the sale of water to retail customers increased $3,463 or 3.2% largely attributable to an average 15% increase in retail rates less partially offsetting reduction in consumption, in part due to successful conservation campaign, the economy and weather patterns. There was also a wholesale rate increase of 15.7% that was partially offset by a reduction of 8.9% in consumption due to conservation and economic downturn. The wholesale rates are adopted annually to recover costs. Additionally, sales to suburban non-resale customers decreased by $1,460, while water sales to municipal customers increased by $274 based on consumption. The Balancing Account due from wholesale customers increased $6,521 from the prior year, based on the difference between revenues billed and costs of service. Interest and investment income increased by $2,735 or 38.6% as a result of higher cash balance from the issuance of new revenue bonds and certificates of participation. Other non-operating revenues decreased by $1,351 or 18.8% primarily due to the $2,544 gain in the prior year from the sale of surplus land.

The Enterprise's total expenses increased by $49,054 or 17.6% to $327,015 over prior year (see Table 2), due to increases of $29,655 in operating expenses, $18,425 in interest expense, and $974 in non-operating expenses primarily attributable to the Water Conservation Rebate Program. Increases in operating expenses were due to increases of $23,026 in judgments & claims including $6,736 paid in fiscal year 2010 and $20,099 of accrual based on updated liability reserve estimates including the pending Federal and State cases regarding breach of contract claims, $7,471 in services provided by other departments related to Hetch Hetchy water assessment fees and increased billed work orders from City Attorney's Office, $3,471 in depreciation for additional capital assets, $1,309 in personal services due to decreases of $385 in salaries and $1,694 in retirement and health care costs due to higher required contributions, and $77 in materials and supplies for various maintenance projects. Increase in interest expense was mainly attributable to an increase of $1,312,415 in revenue bonds. These increases were offset by decreases of $4,984 in other operating expenses, $532 in contractual services from building and structure maintenance, and $92 in bad debt expense resulting from reclassification of bad debt as a direct write-off of charges for services. Decreases in other operating expenses were mainly due to decreases in non-capitalized project expenses and capital project write-offs and decrease in indirect cost allocation paid to the General Fund (see note 12).

(Dollars in thousands, unless otherwise stated)

Capital Assets and Debt Administration

Capital Assets

The following table summarizes changes in the Enterprise's capital assets.

Table 3

Capital Assets, Net of Depreciation

Years ended June 30, 2011, 2010, and 2009

		2011	2010	2009	2011 – 2010 change	2010 – 2009 change
Facilities, improvements, machinery, and equipment	$	1,223,311	1,054,627	935,581	168,684	119,046
Intangible assets		9,191	4,652	—	4,539	4,652
Land		18,812	17,707	18,386	1,105	(679)
Construction work in progress		1,228,574	787,367	547,293	441,207	240,074
Total	$	2,479,888	1,864,353	1,501,260	615,535	363,093

Capital Assets, Fiscal Year 2011

The Enterprise has net capital assets of $2,479,888 invested in a broad range of utility capital assets as of June 30, 2011 (see Table 3). The investment in capital assets includes land, facilities, improvements, water treatment plants, aqueducts, water transmission, distribution mains, water storage facilities, pump stations, water reclamation facilities, machinery and equipment. The Enterprise's net revenue and long-term debt are used to finance capital investments. Capital assets, net of depreciation, increased by $615,535 from prior year as a result of increases of $441,207 or 56.0% in construction in progress, $168,684 or 16.0% in structures, buildings and equipment, $4,539 or 97.6% in intangible assets, and an increase of $1,105 for purchase of land. The increase in capital assets is consistent with the Enterprise's implementation of the ten-year capital plan, including the Water System Improvement Program (WSIP).

The Enterprise recorded $5,512 in intangible assets and $973 in intangible assets related depreciation during the fiscal year. The intangible assets addition composed of $5,017 in Supervisory Control & Data Acquisition (SCADA) System software and $495 in San Francisco Online Invoicing System software. With the adoption of

(Dollars in thousands, unless otherwise stated)

GASB Statement 51, the Enterprise reclassified $4,652 in intangible assets as of June 30, 2010, composed of $3,973 in Customer Care & Billing computer software and $679 in easements.

In May 2010, the City and County of San Francisco Board of Supervisors and Mayor approved the transfer of costs of operating, maintaining and improving the auxiliary water supply system (AWSS) from the Fire Department to the Enterprise. In the fiscal year 2011, the Fire Department transferred $11,747 in AWSS capital assets to the Enterprise comprising of cisterns, pump stations, storage tanks, valves and vaults.

Major additions to construction work in progress during the year ended June 30, 2011 include:

Bay Division Pipeline (BDPL) Reliability Upgrade	$ 101,469
New Irvington Tunnel	62,068
525 Golden Gate Headquarters	61,519
Bay Division Pipeline Reliability Upgrade - Tunnel	58,096
Sunol Valley Water Treatment Plant Expansion & Treated Water Reservoir	46,638
San Joaquin Pipeline System	27,691
Irvington Tunnel Alternatives - Alameda Siphon #4	24,812
Tesla Treatment Facility	23,768
Lake Merced Pump Station Upgrade	19,711
New Crystal Springs Bypass Tunnel	19,023
University Mound Reservoir - Upgrade (North Basin)	18,420
Crystal Springs/San Andreas Transmission Upgrade	17,397
Advanced Meter Infrastructure System	17,344
Calaveras Dam Replacement	16,803
Pulgas Balancing Reservoir Rehab - Pulgas Phase 3	15,202
Harry Tracy Water Treatment Plant Long Term Improvements	13,981
San Antonio Pump Station Upgrade	7,405
Crystal Springs pipeline #2 Replacement	6,838
Baden and San Pedro Valve Lot	6,574
San Andreas #3 Pipeline Installation	5,861
Lower Crystal Springs Dam Improvements	5,803
Environmental Impact Project - Habitat Restoration Program	5,187
Other project additions individually below $5,000	77,477
	$ 659,087

(Dollars in thousands, unless otherwise stated)

Major facilities, improvements, intangible assets, machinery and equipment placed in service, including transfers of completed projects from construction work in progress, during the year ended June 30, 2011 include:

Tesla Treatment Facility - UV Building	$	31,662
San Andreas Pipeline #3		28,334
Tesla Treatment Facility - Steel Pipes		21,996
San Joaquin Pipeline Rehab		15,440
Tesla Treatment Facility - UV Reactor & Valve Vault Valves		12,441
Auxiliary Water Supply System Infrastructure		11,744
Tesla Treatment Facility - Chemical Building		10,457
Baden Pump Station - Pumps, Motors, Drives and Vibration Monitoring System		9,912
Tesla Treatment Facility - San Joaquin pipeline Valves & Vault		7,797
SCADA Software & Hardware		5,018
Other project additions individually below $5,000		77,174
	$	231,975

Water System Improvement Program

As of June 30, 2011, the SFPUC's Water Enterprise is half-way completed with its multi-billion dollar, multi-year program to upgrade the Hetch Hetchy Regional and Local Water Systems, known as the Water System Improvement Program (WSIP). The WSIP delivers capital improvements that enhance the Enterprise's ability to provide reliable, affordable, high quality drinking water to its twenty-seven wholesale customers and regional retail customers in Alameda, Santa Clara and San Mateo Counties, collectively serving some 1.7 million people outside of San Francisco, as well as another 800,000 retail customers in San Francisco, in an environmentally sustainable manner. The program is structured to cost effectively meet water quality requirements, improve seismic and delivery reliability, and meet long-term water supply objectives.

The program is on target to achieve an overall completion date of December 2015, with construction phase started in early 2009. As of June 30, 2011, there are 2 regional projects in Planning Phase, 5 in Design Phase, 1 in Bid & Award Phase, 20 in Construction phase, 4 in Close-Out phase, and 14 regional projects are completed.

Total cost included $4.1 billion for capital projects and $0.5 billion for net financing costs. To date, the entire amount is fully appropriated for the WSIP, of which approximately $1.6 billion of project appropriations have been expended through fiscal year ended June 30, 2011. To help meet this funding need, additional bonds sales are planned. Additional details regarding the WSIP are available on the Enterprise's web site at www.sfwater.org.

525 Golden Gate Avenue Headquarters Building

As of June 30, 2011 the Enterprise has incurred $80,933 in construction costs for the 525 Golden Gate Avenue Headquarters project. The building is intended to consolidate divisions of the San Francisco Public Utilities Commission that are currently renting space at multiple locations in the Civic Center. Demolition of the existing site was completed in June 2009. Construction started in January 2010 with an expected completion date of June 2012.

Advanced Meter Infrastructure System

The SFPUC is implementing the Advanced Meter Infrastructure System (AMI), which will largely eliminate manual meter reading field visits, improve customers' access to hourly usage information, facilitate the timely detection of tampering, theft and leaks, while enhancing usage or flow-tracking. The estimated total capital cost of this project is $64,100, with Phase 1 implementation including 58,006 meter replacements throughout fiscal year 2010, and Phase 2 implementation replacing 120,000 meters with a projected completion date of December 2012.

Capital Assets, Fiscal Year 2010

The Enterprise has net capital assets of $1,864,353 invested in a broad range of utility capital assets as of June 30, 2010 (see Table 3). The investment in capital assets includes land, facilities, improvements, water treatment plants, aqueducts, water transmission, distribution mains, water storage facilities, pump stations, water reclamation facilities, machinery and equipment. The Enterprise's net revenue and long-term debt are used to finance capital investments. Capital assets, net of depreciation, increased from prior year as a result of increases of $240,074 or 43.9% in construction work in progress, $123,698 or 13.2% in structures, buildings, equipment and intangible assets, and a decrease of $679 in land and rights-of-way due to reclassification to intangible assets in fiscal year 2010. The increase in capital assets is consistent with the Enterprise's implementation of the ten-year capital plan, including the WSIP. As of June 30, 2010, the Enterprise has invested $28,195 in construction costs for the headquarters at 525 Golden Gate Avenue. The Enterprise adopted GASB Statement 51, *Accounting and Financial Reporting for Intangible Assets*, in fiscal year 2010. Intangible assets were separated as a major category in the fiscal year ended June 30, 2010.

(Dollars in thousands, unless otherwise stated)

Major additions to construction work in progress during the year ended June 30, 2010 include:

Tesla Treatment Facility	$	58,641
New Crystal Springs Bypass Tunnel		40,551
Bay Division Pipeline (BDPL) Reliability Upgrade - Pipeline		35,054
Irvington Tunnel Alternatives - Alameda Siphon No. 4		21,356
University Mound Reservoir - Upgrade (North Basin)		20,404
San Andreas No. 3 Pipeline Installation		16,695
Lake Merced Pump Station Upgrade		14,580
Bay Division Pipeline (BDPL) Reliability Upgrade - Tunnel		14,316
Harry Tracy Water Treatment Plant Long Term Improvements		14,111
Baden and San Pedro Valve Lot		13,537
Calaveras Dam Replacement		10,628
San Joaquin Pipeline System		10,585
Irvington Tunnel Alternatives - New Irvington Tunnel		9,072
Bay Division Pipeline (BDPL) No. 3 & 4 Cross Connection		8,533
Crystal Springs/San Andreas Transmission Upgrade		7,364
Rehabilitation of Existing San Joaquin Pipelines		7,256
Harry Tracy Water Treatment Plant Short Term Improvement - Phase 3		7,074
525 Golden Gate Avenue Headquarters Building		6,745
Mclaren Park Pump Station Upgrade		6,541
Sunol Valley Water Treatment Plant Expansion & Treated Water Reservoir		5,763
North University Mound System Upgrade		5,027
Other project additions individually below $5,000		83,432
	$	417,265

Major structures, buildings and equipment, and intangible assets placed in service during the year ended June 30, 2010 include:

Tesla Treatment Facility - Steel Pipes	$	19,731
Stanford Heights Reservoir - Building/Reservoir		18,872
Harry Tracy Water Treatment Plant - Filters		12,273
Alemany Pump Station Upgrade - Electrical System		10,113
Harry Tracy Water Treatment Plant - Genset		9,893
Harry Tracy Water Treatment Plant - Flocculation Basins		8,153
Alemany Pump Station Upgrade - Mechanical System		7,737
Alemany Pump Station Upgrade - Building		7,631
North University Mound System Upgrade - Pipeline		6,976
Other items individually below $5,000		74,450
	$	175,829

Water System Improvement Program

The Enterprise is in the middle of a multi-billion dollar, multi-year program to upgrade its Regional and Local Water Systems, known as the Water System Improvement Program (WSIP). The WSIP will deliver capital improvements that enhance the Enterprise's ability to provide reliable, affordable, high quality drinking water to its twenty-seven wholesale customers and regional retail customers in Alameda, Santa Clara and San Mateo Counties, and to 800,000 retail customers in the City and County of San Francisco, in an environmentally sustainable manner. The program is structured to cost-effectively meet water quality requirements, improve seismic and delivery reliability, and meet water supply objectives for the year 2030.

The program is on target to achieve an overall completion date of December 2015. The transition of the WSIP's larger regional projects to the construction phase started in early 2009. As of June 30, 2010, there are 2 regional projects in Planning Phase, 7 in Design Phase, 3 in Bid & Award Phase, 14 in Construction phase, 5 in Close-Out phase, 10 regional projects are completed, and 5 regional projects in multiple phases.

The total estimated cost for the WSIP is $4.6 billion, including $4.1 billion for capital projects and $0.5 billion for net financing costs. To date, the entire amount is fully appropriated for the WSIP, of which approximately $1.1 billion of project appropriations have been expended through fiscal year ended June 30, 2010. To help meet this funding need, additional bonds sales are planned.

Additional details regarding the WSIP are available in the Annual Reports published on the Enterprise's web site at www.sfwater.org.

525 Golden Gate Avenue Headquarters Building

As of June 30, 2010 the Enterprise has incurred its 73% share or $28,195 in construction costs for the 525 Golden Gate Avenue Headquarters project. The building is intended to consolidate divisions of the San Francisco Public Utilities Commission that are currently renting space at multiple locations in the Civic Center. Demolition of the existing site was completed in June 2009. Construction started in January 2010 with an expected completion date of June 2012.

Advanced Meter Infrastructure System

Over the next three years, the SFPUC will be in the process of implementing the Advanced Meter Infrastructure System (AMI), which will largely eliminate manual meter reading field visits, improve customers' access to hourly usage information, facilitate the timely detection of tampering, theft and leaks, while enhancing usage or flow-tracking. The estimated total capital cost of this project is $64.1 million, with Phase 1 implementation including 57,000 meter replacements throughout fiscal year 2010, and Phase 2 implementation replacing 123,000 meters with a projected completion date of February 2012, as of year-end close June 30, 2010.

(Dollars in thousands, unless otherwise stated)

Debt Administration

As of June 30, 2011, the Enterprise has $3,461,168 total debt outstanding, an increase of $1,089,493 over the prior year, as shown below in Table 4. More detailed information about the Enterprise's debt activity is presented in notes 6, 7, 8 and 9 to the financial statements.

Table 4

Outstanding Debt, Net of Amortized Costs

June 30, 2011, 2010, and 2009

		2011	2010	2009	2011 – 2010 change	2010 – 2009 change
Revenue bonds	$	3,184,898	2,245,301	932,886	939,597	1,312,415
Capital appreciation bonds		4,155	3,878	3,620	277	258
Commercial paper		150,000	—	229,600	150,000	(229,600)
Certificates of participation		122,115	122,496	—	(381)	122,496
Total	$	3,461,168	2,371,675	1,166,106	1,089,493	1,205,569

The Enterprise has commercial paper notes of $150,000 outstanding at June 30, 2011 and none in the previous year. Total debt outstanding at June 30, 2011 consisted of $3,184,898 in fixed-rate long-term revenue bonds, $4,155 (accreted value) in capital appreciation bonds, and $122,115 in certificates of participation. The change in total debt outstanding was due to issuance of $979,355 in revenue bonds and $150,000 commercial paper, retirement of revenue bond principal, accretion of capital appreciation bonds, and amortization of bond discounts, bond premium and refunding loss. See notes 7 and 9 for more details.

***Credit Ratings and Bond Insurance* –** The Enterprise carried underlying ratings of "Aa2" and "AA-" from Moody's and Standard & Poor's (S&P) at June 30, 2011 and 2010, respectively.

Debt Service Coverage – Pursuant to the Amended and Restated Indenture, the Enterprise is required to collect sufficient net revenues each fiscal year, together with any Enterprise funds (except Bond Reserve Funds) which are available for payment of debt service and are not budgeted to be expended, at least equal to 1.25 times annual debt service for said fiscal year. During fiscal years 2011 and 2010, the Enterprise's net revenues, together with fund balances available to pay debt service and not budgeted to be expended, were sufficient to meet the rate covenant requirements under the Enterprise's Amended and Restated Indenture.

Debt Authorization – Pursuant to the Charter, the Enterprise can incur indebtedness upon two-thirds vote of the Board of Supervisors, as approved by voters in Proposition E in November 2002. As of June 30, 2011, the Board of Supervisors has authorized the issuance of $3,097,131 in revenue bonds under Proposition E with $1,422,655 issued against this authorization. The Enterprise can also incur indebtedness of up to $1,628,000 for improvements to the water system pursuant to Proposition A that was approved by the voters in November 2002. As of June 30, 2011, $1,331,815 of the $1,628,000 Proposition A authorized bonds was issued. The Enterprise is also authorized to issue up to $500,000 in commercial paper. As of June 30, 2011, there was $150,000 in taxable commercial paper outstanding, and as of June 30, 2010, there was no commercial paper outstanding.

Cost of Debt Capital – The Enterprise's outstanding long-term debt has coupon interest rates ranging from 2.0% to 6.9% as of June 30, 2011 and ranged from 2.0% to 6.0% as of June 30, 2010. The Enterprise's short-term debt has interest rates ranging from 0.2% to 0.4% during fiscal year 2011. In the prior year, the Enterprise's short-term debt has interest rates ranging from 0.3% to 0.5%. More information about the Enterprise's debt activities is presented in notes 6, 7, 8, and 9 to the financial statements.

Next Year's Rates

Retail water rate increases of 15.0%, 12.5%, 12.5%, 6.5% have been approved for fiscal years ending June 30, 2011 through 2014, respectively. Wholesale water rates are adopted annually; Commission approved a 15.2% increase for the fiscal year ended June 30, 2011 on April 13, 2010. The Commission also approved a 38.4% increase for the fiscal year ending June 30, 2012 on May 10, 2011.

Rate Setting Process

Proposition E, as approved by the Voters in November 2002, amended the City Charter by adding the new Article VIIIB, entitled "Public Utilities," which changed the Commission's ability to issue new revenue bonds and set retail water rates. The Commission is required to:

- Establish rates, fees, and charges based on cost of service;
- Retain an independent rate consultant to conduct cost of service studies at least every five years;
- Consider establishing new connection fees;
- Consider conservation incentives and lifeline rates;
- Adopt a rolling five-year forecast annually; and
- Establish a Rate Fairness Board.

Wholesale customer rates were set pursuant to the Master Water Sales Contract through June 30, 2009 when the contract expired. A new agreement was negotiated between the Commission and the wholesale customers represented by the Bay Area Water Supply and Conservation Agency (BAWSCA). The term of the new Water Supply Agreement (WSA) began on July 1, 2009 and shall end on June 30, 2034. Two 5-year extension options are also available.

(Dollars in thousands, unless otherwise stated)

The following table is the Enterprise's average rate adjustments since July 1, 2004:

	Approved average rate adjustments	
	Retail	**Wholesale**
Effective date:		
July 1, 2004	0.0 %	2.7 %
July 1, 2005	15.0	(9.7) [1]
July 1, 2006	15.0	18.8
July 1, 2007	15.0 [2]	6.3
July 1, 2008	15.0	10.0
July 1, 2009 [3]	15.0 [4]	15.7
July 1, 2010	15.0 [4]	15.2
July 1, 2011	12.5 [4]	38.4
July 1, 2012	12.5 [4]	9.5 [5]
July 1, 2013	6.5 [4]	13.3 [5]

[1] Adjustment effective April 1, 2005

[2] Adjustment effective July 14, 2007

[3] July 1, 2009 was the first year of the new twenty-five year agreement

[4] Adjustment effective July 1, 2009 through the fiscal year beginning July 1, 2013

[5] Wholesale rates are adopted annually, pursuant to the 25-year WSA. July 1, 2012 and July 1, 2013 rates are estimates.

Pursuant to the City and County of San Francisco Charter Section 8B.125, an independent rate study is performed at least once every five years. A rate study was undertaken in fiscal year 2009 to examine the future revenue requirements and cost of service of the Enterprise. This resulted in an approved 5-year rate schedule through fiscal year 2013-14.

Forward Looking Information

On July 18, 2011, Moody's Investors Service, Inc. lowered its municipal bond rating on all outstanding Water Revenue Bonds from "Aa2" to "Aa3" with a stable outlook while S&P maintained its rating on all outstanding Water Revenue Bonds at "AA-" with a stable outlook. The ratings assigned by Moody's express only the views of such rating agency, and is based upon its own investigations, studies, and assumptions. Any such downward revision or withdrawal of the rating may have an adverse effect on the market price of the Bonds. The SFPUC undertakes no responsibility to maintain its current ratings on the Bonds or to oppose any such downward revision, suspension or withdrawal.

In July 2011, $720,750 in Water Revenue Bonds were issued as 2011 Series ABCD for the ongoing multi-billion dollar, multi-year WSIP programs and for the refunding of a portion of the 2001 Series A and the 2002 Series A Water Revenue Bonds. This refunding resulted in $3,311, or 5.8%, in net present value savings. An additional $24,000 in taxable commercial paper was issued for the WSIP programs. Another $61,000 in taxable commercial paper was issued to refund outstanding commercial paper maturing on August 1, 2011 and August 3, 2011.

On September 27, 2011, the Board of Supervisors authorized the settlement of claims arising out of nine lawsuits involving Mitchell Engineering, and the issuance of settlement bonds of $14,080.

Request for Information

This report is designed to provide our citizens, customers, investors, and creditors with an overview of the Enterprise's finances and to demonstrate the Enterprise's accountability for the money it receives. Questions regarding any of the information provided in this report or requests for additional financial information should be addressed to San Francisco Public Utilities Commission, Chief Financial Officer, 1155 Market Street, 11th Floor, San Francisco, CA 94103.

SAN FRANCISCO WATER ENTERPRISE

Statements of Net Assets

June 30, 2011 and 2010

(In thousands)

		2011	2010
Assets:			
Current assets:			
Cash and investments with City Treasury	$	83,410	113,472
Cash and investments outside City Treasury		253	89
Receivables:			
Charges for services (net of allowance for doubtful accounts of $2,765 in 2011 and $2,021 in 2010)		38,310	41,789
Wholesale balancing account		26,029	19,231
Due from other funds		6,122	10,346
Due from other governments		626	998
Interest		—	52
Advances and other		4,694	587
Total current receivables		75,781	73,003
Inventories		7,949	1,791
Restricted assets – cash and investments outside City Treasury		72,797	43,866
Total current assets		240,190	232,221
Non-current assets:			
Wholesale balancing account receivable		14,997	14,861
Restricted assets – cash and investments with City Treasury		1,093,431	620,347
Restricted assets – cash and investments outside City Treasury		285,366	251,415
Restricted assets – interest and other receivable		4,671	751
Capital assets not being depreciated		1,248,065	805,753
Capital assets, net of accumulated depreciation		1,231,823	1,058,600
Bond issuance costs (net of accumulated amortization of $5,400 in 2011 and $4,408 in 2010)		22,581	17,371
Total non-current assets		3,900,934	2,769,098
Total assets		4,141,124	3,001,319
Liabilities:			
Current liabilities:			
Accounts payable		12,641	10,161
Accrued payroll		7,678	7,560
Accrued vacation and sick leave, current portion		5,764	6,366
Accrued workers' compensation, current portion		1,324	1,468
Due to other funds		13,638	24
Damage claims liability, current portion		8,603	8,719
Deposits, advances, and other liabilities		8,525	5,066
Bond and loan interest payable		28,747	16,071
Pollution remediation obligation, current portion		—	499
Revenue bonds, current portion		44,050	27,795
Commercial paper		150,000	—
Current liabilities payable from restricted assets		105,398	74,607
Total current liabilities		386,368	158,336
Long-term liabilities:			
Arbitrage rebate		517	4,553
Other post-employment benefits obligations		60,314	45,598
Accrued vacation and sick leave, less current portion		5,811	5,461
Accrued workers' compensation, less current portion		6,351	6,626
Damage claims liability, less current portion		18,387	21,021
Revenue bonds, less current portion		3,140,848	2,217,506
Capital appreciation bonds		4,155	3,878
Certificates of participation		122,115	122,496
Pollution remediation obligation, less current portion		—	160
Total long-term liabilities		3,358,498	2,427,299
Total liabilities		3,744,866	2,585,635
Net assets:			
Invested in capital assets, net of related debt		333,386	319,581
Restricted for debt service		30,840	12,073
Restricted for capital projects		19,163	4,346
Unrestricted		12,869	79,684
Total net assets	$	396,258	415,684

See accompanying notes to financial statements.

SAN FRANCISCO WATER ENTERPRISE

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2011 and 2010

(In thousands)

		2011	2010
Operating revenues:			
Charges for services	$	271,387	248,369
Rents and concessions		9,388	8,584
Capacity fees		869	610
Other revenues		6,751	7,655
Total operating revenues		288,395	265,218
Operating expenses:			
Personal services		111,363	108,178
Contractual services		15,586	13,087
Materials and supplies		13,839	12,748
Depreciation		58,752	52,571
Services provided by other departments		46,308	47,574
General and administrative		6,311	25,917
Other		9,768	17,895
Total operating expenses		261,927	277,970
Operating income (loss)		26,468	(12,752)
Non-operating revenues (expenses):			
Federal and State grants		1,810	1,506
Interest and investment income		17,283	9,823
Interest expense		(100,875)	(47,272)
Net gain (loss) from sale of assets		39	(178)
Other non-operating revenues		29,650	4,523
Other non-operating expenses		(2,121)	(1,773)
Net non-operating expenses		(54,214)	(33,371)
Income before transfers		(27,746)	(46,123)
Capital contribution		26,154	—
Transfers to the City and County of San Francisco		(17,834)	(493)
Net capital contribution and transfers		8,320	(493)
Changes in net assets		(19,426)	(46,616)
Net assets at beginning of year		415,684	462,300
Net assets at end of year	$	396,258	415,684

See accompanying notes to financial statements.

SAN FRANCISCO WATER ENTERPRISE

Statements of Cash Flows

Years ended June 30, 2011 and 2010

(In thousands)

		2011	2010
Cash flows from operating activities:			
Cash received from customers, including cash deposits	$	273,675	246,684
Cash received from tenants for rent		8,853	8,584
Cash paid to employees for services		(94,332)	(91,035)
Cash paid to suppliers for goods and services		(64,874)	(94,430)
Cash paid for judgments and claims		(15,183)	(4,787)
Other operating revenues		5,883	—
Net cash provided by operating activities		114,022	65,016
Cash flows from non-capital and related financing activities:			
Transfers out		(17,834)	(493)
Operating grants		3,280	845
Net cash (used in) provided by non-capital financing activities		(14,554)	352
Cash flows from capital and related financing activities:			
Proceeds from sale of capital assets		39	23
Proceeds from bond issuance, net of discounts and issuance costs		1,002,870	1,355,644
Proceeds from certificate of participation issuance		—	122,755
Proceeds from commercial paper borrowings		150,000	—
Payments on commercial paper		—	(229,600)
Principal paid on long-term debt		(59,365)	(41,005)
Interest paid on long-term debt		(145,906)	(74,131)
Interest paid on commercial paper		(250)	(337)
Issuance costs paid on long-term debt		(6,202)	(12,759)
Interfund loans		4,224	(10,346)
Acquisition and construction of capital assets		(581,973)	(352,805)
Capital contribution		7,897	—
Federal interest income subsidy from Build America Bonds		17,658	1,184
Net cash provided by capital and related financing activities		388,992	758,623
Cash flows from investing activities:			
Interest income received		17,608	9,936
Proceeds from sale of investments outside City Treasury		527,561	252,781
Purchases of investments outside City Treasury		(667,310)	(340,412)
Other investing activities		—	1,599
Net cash used in investing activities		(122,141)	(76,096)
Increase in cash and cash equivalents		366,319	747,895
Cash and cash equivalents:			
Beginning of year		900,584	152,689
End of year	$	1,266,903	900,584
Reconciliation of cash and cash equivalents to the statement of net assets:			
Cash and investments with City Treasury:			
Unrestricted	$	83,410	113,472
Restricted		1,093,431	620,347
Cash and investments outside City Treasury:			
Unrestricted		253	89
Restricted (with maturity 90 days or less – see table in note 3)		89,809	166,676
Cash and cash equivalents at end of year on statements of cash flows	$	1,266,903	900,584

(Continued)

SAN FRANCISCO WATER ENTERPRISE

Statements of Cash Flows

Years ended June 30, 2011 and 2010

(In thousands)

		2011	2010
Reconciliation of operating income (loss) to net cash provided by operating activities:			
Operating income (loss)	$	26,468	(12,752)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:			
Depreciation		58,752	52,571
Provision for uncollectible accounts		744	834
Write-off of capital assets and other non-cash items		1,123	7,043
Changes in operating assets and liabilities:			
Receivables:			
Charges for services		2,734	(4,325)
Wholesale balancing account		(6,934)	(6,521)
Interest and other		1,571	(277)
Inventories		355	58
Accounts payable		2,480	(4,617)
Due to other City departments		13,614	198
Accrued payroll		118	714
Accrued other post-employment benefit liability		14,716	14,631
Accrued vacation and sick leave		(252)	373
Accrued workers' compensation		(419)	(523)
Pollution remediation obligation		(659)	(2,653)
Damage claims liability		(2,750)	20,099
Deposits, advances, and other liabilities		2,361	163
Total adjustments		87,554	77,768
Net cash provided by operating activities	$	114,022	65,016
Noncash transactions:			
Accrued capital asset costs	$	105,398	74,607
Capital contribution		18,257	—

See accompanying notes to financial statements.

(1) Definition of Reporting Entity

The San Francisco Water Enterprise (the Enterprise) was established in 1930 under the provisions of the Charter of the City and County of San Francisco. The Enterprise acquired the fully developed, mature water works for San Francisco on March 3, 1930. Since then, the City and County of San Francisco (the City) has operated and maintained the water works as the San Francisco Water Enterprise. The Board of Supervisors of the City has adopted resolutions (the Water Resolutions) providing for the issuance of various water revenue and refunding bond series. The Enterprise, which consists of a system of reservoirs, storage tanks, water treatment plants, pump stations, and pipelines, is engaged in the distribution of water to San Francisco and certain suburban areas. In fiscal year 2011, the Enterprise delivered approximately 78,016 million gallons of water to nearly 2.5 million people within San Francisco and certain suburban areas.

The San Francisco Public Utilities Commission (the Commission), established in 1932, is responsible for providing operational oversight of the public utility enterprises of the City, which include the Enterprise along with the City's power and sewer utilities (i.e. Hetch Hetchy Water and Power, of which the Power Enterprise is a component, and the San Francisco Wastewater Enterprise). The Commission is responsible for determining such matters as the rates and charges for services, approval of contracts, and organizational policy.

Until August 1, 2008, the Commission consisted of five members, all appointed by the Mayor. Proposition E, a City and County of San Francisco Charter amendment approved by the voters in the June 3, 2008 election, terminated the terms of all five existing members of the Commission, changed the process for appointing new members, and set qualifications for all members. Under the amended Charter, the Mayor continues to nominate candidates to the Commission, but nominees do not take office until the Board of Supervisors votes to approve their appointments by a majority (at least six members). The amended Charter provides for staggered four-year terms for the Commission members and requires them to meet the following qualifications:

- Seat 1 must have experience in environmental policy and an understanding of environmental justice issues.
- Seat 2 must have experience in ratepayer or consumer advocacy.
- Seat 3 must have experience in project finance.
- Seat 4 must have expertise in water systems, power systems, or public utility management.
- Seat 5 is an at-large member.

The Commission is a department of the City, and as such, the financial operations of the Enterprise, Hetch Hetchy Water and Power, and the Wastewater Enterprises are included in the Comprehensive Annual Financial Report of the City as enterprise funds. These financial statements present only the financial operations of the Enterprise alone and are not intended to present the financial position of the City as a whole or the consolidated entity, the changes in its financial position, and the cash flows of its proprietary funds in conformity with U.S. generally accepted accounting principles.

(2) Significant Accounting Policies

(a) Basis of Accounting and Measurement Focus

The accounts of the Enterprise are organized on the basis of a proprietary fund type and are included as an enterprise fund of the City and County of San Francisco, California. The activities of this Enterprise are accounted for with a separate set of self-balancing accounts that comprise the Enterprise's assets, liabilities, net assets, revenues, and expenses. Enterprise funds account for activities (i) that are financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; or (ii) that are required by laws or regulations that the activity's costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues; or (iii) that the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

The financial activities of the Enterprise are accounted for on a flow of economic resources measurement focus, using the accrual basis of accounting. Under this method, all assets and liabilities associated with its operations are included on the statements of net assets; revenues are recognized when earned, and expenses are recognized when liabilities are incurred. Operating revenues are defined as charges to customers, rental income and capacity fees.

The Enterprise does not apply Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989. The Enterprise applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, as well as statements and interpretations of the FASB, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

(b) Cash and Cash Equivalents

The Enterprise considers its pooled cash and investments held with the City Treasury to be demand deposits and, therefore, cash and cash equivalents for financial reporting. The City also holds non-pooled cash and investments for the Enterprise. Non-pooled restricted deposits and investments held outside the City Treasury with maturities of three months or less are also considered to be cash equivalents.

(c) Investments

Money market funds are carried at cost, which approximates fair value. All other investments are stated at fair value based on quoted market prices. Changes in fair value are recognized as investment gains or losses.

(d) Inventory

Inventory consists primarily of construction materials and maintenance supplies and is valued at average cost. Inventory is expensed as it is consumed.

(e) Capital Assets

Capital assets are stated at cost. Depreciation and amortization are computed using the straight-line method based on the estimated useful lives of the related assets, which range from 3 to 75 years for equipment and 3 to 175 years for buildings, structures, and improvements. All donated capital assets are valued at estimated fair value at the time of donation. No depreciation or amortization is recorded in the year of acquisition, and a full year's depreciation is recorded in the year of disposal.

(f) Intangible Assets

As of July 1, 2009, the Enterprise has adopted GASB Statement 51, *Accounting and Financial Reporting for Intangible Assets.* GASB Statement 51 provides governmental entities with guidance on how to properly identify, account for and report intangible assets, requiring capitalization of the asset and amortization over its useful life.

Under GASB Statement 51, intangible assets are defined as identifiable, non-financial assets capable of being separated, sold, transferred, or licensed, and include contractual or legal rights. Examples of intangible assets include rights-of-way easements, land use rights, water rights, licenses, and permits. The accounting pronouncement also provides guidance on the capitalization of internally generated intangible assets, such as the development and installation of computer software by or on behalf of the reporting entity.

According to the standard, the Enterprise is required to capitalize intangible assets with a useful life extending beyond one reporting period. Effective July 1, 2009, the Enterprise has established a capitalization threshold of $100. GASB Statement 51 also requires amortization of intangible asset over the benefit period, except for certain assets having an indefinite useful life. Assets with an indefinite useful life generally provide a benefit that is not constrained by legal or contractual limitations or any other external factor, and therefore, are not amortized.

With the adoption of GASB Statement 51, the Enterprise reclassified $4,652 in intangible assets as of June 30, 2010, primarily composed of $3,973 in Customer Care & Billing computer software and $679 in easements.

(g) Construction in Progress

The cost of acquisition and construction of major plant and equipment is recorded as construction in progress. Costs of discontinued construction projects are recorded as an expense in the year in which the decision is made to discontinue such projects.

(h) Capitalization of Interest

A portion of the interest cost incurred on capital projects is capitalized for assets that require a period of time to construct or to otherwise prepare them for their intended use. Such amounts are amortized over the useful lives of the assets.

(i) Bond Discount, Premium, and Issuance Costs

Bond discount, premium, and issuance costs are amortized over the term of the related bonds on a method which approximates the effective interest method basis.

(j) Accrued Vacation and Sick Leave

Accrued vacation pay, which may be accumulated up to ten weeks per employee, is charged to expense as earned. Sick leave earned subsequent to December 6, 1978 is non-vesting and may be accumulated up to six months per employee.

(k) Workers' Compensation

The Enterprise is self-insured for workers' compensation claims and accrues the estimated cost of those claims, including the estimated cost of incurred but not reported claims.

(l) Damage Claims Liability

The Enterprise is self-insured for general liability and uninsurable property damage claims. Commercially uninsurable property includes assets that are underground or provide transmission and distribution. Maintained commercial coverage does not cover claims attributed to loss from earthquake, contamination, pollution remediation efforts and other specific naturally occurring contaminants such as mold. The liability represents an estimate of the cost of all outstanding claims, including adverse loss development, and estimated incurred but not reported claims.

(m) Arbitrage Rebate Payable

Certain bonds are subject to arbitrage rebate requirements in accordance with regulations issued by the U.S. Treasury Department. The requirements generally stipulate that earnings from the investment of the tax-exempt bond proceeds that exceed related interest costs on the bonds must be remitted to the federal government on every fifth anniversary of each bond issue. During fiscal year 2011, the enterprise paid $4,256 to the Internal Revenue Service, representing 90% of the outstanding arbitrage liability to be paid by April 1, 2011. The liability for arbitrage rebate was $517 and $4,553 at June 30, 2011 and 2010, respectively.

(n) Refunding of Debt

Gains or losses occurring from advance refunding of debt are deferred and amortized into interest expense over the remaining life of the old bonds or the life of the new bonds, whichever is shorter.

(Continued)

(o) Income Taxes

As a government agency, the Enterprise is exempt from both Federal income taxes and California State franchise taxes.

(p) Revenue Recognition

Water service charges are based on water usage as determined by the Enterprise. Generally, customers are billed on a cyclical basis with large commercial and industrial customers billed monthly, and all other customers bi-monthly. Revenues earned but unbilled are accrued as charges for services receivables on the statements of net assets.

(q) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(r) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to current year presentation.

(s) Accounting and Financial Reporting for Pollution Remediation Obligations

The Enterprise adopted GASB Statement 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, in fiscal year 2009. To provide governments with better accounting guidance and consistency, GASB Statement 49, identifies the circumstances under which a governmental entity would be required to report a liability related to pollution remediation.

According to the standard, a government would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem;
- A government has violated a pollution prevention-related permit or license;
- A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up;
- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution; or

- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

As a part of ongoing operations, situations may occur requiring the removal of pollution or other hazardous material. These situations typically arise in the process of acquiring an asset, preparing an asset for its intended use, or during the design phase of projects under review by the Project Managers. Other times, pollution may arise during the implementation and construction of a major or minor capital project. Examples of pollution may include, but are not limited to: asbestos or lead paint removal; leaking of sewage in underground pipes or neighboring areas; chemical spills; removal and disposal of known toxic waste; harmful biological and chemical pollution of water; or contamination of surrounding soils by underground storage tanks (UST).

The Enterprise did not have any pollution remediation liability as of June 30, 2011 and recorded $659 in pollution remediation liability as of June 30, 2010.

(3) Cash, Cash Equivalents and Investments

The Enterprise's cash, cash equivalents and investments with the City Treasury are invested in an unrated City pool pursuant to investment policy guidelines established by the City Treasurer. The objectives of the policy guidelines are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The City Treasurer allocates income from the investment of pooled cash at month end in proportion to the Enterprise's average daily cash balances. The primary objectives of the Enterprise's investment policy are consistent with the City's policy.

Restricted assets are held by an independent trustee outside the City's investment pool. The assets are held for the purpose of paying future interest and principal on the bonds and for eligible capital project expenditures. The balances as of June 30, 2011 and 2010 were $358,163 and $295,281, respectively. The Enterprise held all investments in guaranteed investment contracts, Treasury and Government Obligations, Commercial Paper, Corporate Bonds and Notes, as well as money market mutual funds consisting of Treasury and Government Obligations.

(Dollars in thousands, unless otherwise stated)

The following tables present the restricted cash and investments outside City Treasury as of June 30, 2011 and 2010.

Restricted Cash and Investments outside City Treasury

Investments	Credit Ratings (S&P/Moody's)	June 30, 2011 Maturities	Fair Value
U.S. Treasury Notes	Not applicable	August 31, 2016	$ 28,635
U.S. Agencies	AAA/Aaa	April 18, 2016	62,424
U.S. Agencies	AAA/Aaa	August 20, 2015	7,066
U.S. Agencies	AAA/Aaa	April 2, 2014	3,472
U.S. Agencies	AAA/Aaa	October 28, 2013	12,537
U.S. Treasury Notes - State and Local Government Series	Not applicable	May 1, 2013	8,584
U.S. Agencies	AAA/Aaa	April 15, 2013	12,416
Guaranteed Investment Contracts	A+/Aa3	March 16, 2013	15,958
U.S. Treasury Notes - State and Local Government Series	Not applicable	November 1, 2012	10,402
U.S. Agencies	AAA/Aaa	October 30, 2012	12,459
U.S. Treasury Notes - State and Local Government Series	Not applicable	May 1, 2012	11,677
Corporate Bonds & Notes	AAA/Aaa	April 30, 2012	12,090
U.S. Treasury Notes	AAA/Aaa	December 15, 2011	18,467
U.S. Agencies	AAA/Aaa	December 14, 2011	14,271
U.S. Treasury Notes - State and Local Government Series	Not applicable	November 1, 2011	25,451
Commercial Paper	Not applicable	November 1, 2011	12,445
U.S. Treasury Money Market Funds	AAA/Aaa	< 90 days	60,585
U.S. Agencies	AAA/Aaa	< 90 days	22,632
Corporate Bonds & Notes	AAA/Aaa	< 90 days	6,592
Total			$ 358,163

(Dollars in thousands, unless otherwise stated)

Restricted Cash and Investments outside City Treasury

Investments	Credit Ratings (S&P/Moody's)	June 30, 2010 Maturities	Fair Value
U.S. Treasury Bonds & Notes	Not applicable	August 31, 2016	$ 27,038
Guaranteed Investment Contract	AA-/Aa2	March 16, 2013	15,958
U.S. Treasury Notes	Not applicable	May 1, 2013	3,489
U.S. Treasury Notes	Not applicable	November 1, 2012	4,448
U.S. Treasury Notes	Not applicable	May 1, 2012	5,036
U.S. Treasury Notes	Not applicable	November 1, 2011	18,225
U.S. Treasury Notes	Not applicable	May 1, 2011	27,648
U.S. Treasury Notes	Not applicable	November 1, 2010	26,763
US Treasury Money Market Fund	Not applicable	< 90 days	45,490
US Treasury Bills	Not applicable	< 90 days	121,186
Total			$ 295,281

The restricted cash and investments outside City Treasury as of June 30, 2011 included a $2,507 unrealized gain due to increases in fair values on U.S. Treasury Notes and U.S. Agencies from June 30, 2010.

Funds held by the trustee established under the 2002 Amended and Restated Indentures agreements are invested in “Permitted Investments,” as defined in the agreement, which includes money market funds and investment agreements. The agreement permits investment in money market funds registered under the Federal Investment Company Act of 1940 and whose shares are also registered under the Federal Securities Act of 1933 and having a rating by Standard & Poor’s of “AAAm-G,” “AAAm” or “AAm” and a rating by Moody’s of “Aaa,” “Aa1” or “Aa2.” The credit ratings of the money market funds invested in as of June 30, 2011 and June 30, 2010 were “Aaa” by Moody’s and “AAA” by Standard & Poor’s. Investment agreements must be with a U.S. bank or trust company having a rating by Moody’s and S&P of “A” or higher, or are guaranteed by any entity with a rating of “A” or higher, at the time the agreement is entered into.

Additional cash outside of the investment pool included revolving fund and cash in transit. The revolving fund has a balance of $33 at June 30, 2011 and 2010, which is held in a commercial bank in non-interest bearing checking accounts covered by Federal Deposit Insurance Corporation depository insurance. These accounts were established as provided by the City’s Administrative Code for revolving fund needs. The cash in transit was $220 at June 30, 2011 and $56 at June 30, 2010.

(Dollars in thousands, unless otherwise stated)

The Enterprise's cash, cash equivalents and investments are shown on the accompanying statements of net assets as follows:

		2011	2010
Current assets:			
Cash and investments with City Treasury	$	83,410	113,472
Cash and investments outside City Treasury		253	89
Restricted cash and investments outside City Treasury		72,797	43,866
Non-current assets:			
Restricted cash and investments with City Treasury		1,093,431	620,347
Restricted cash and investments outside City Treasury		285,366	251,415
Total cash, cash equivalents and investments	$	1,535,257	1,029,189

The following table shows the percentage distribution of the City's pooled investments by maturity as of June 30, 2011:

Investment maturities (in months)			
Under 1	**1 to less than 6**	**6 to less than 12**	**12 to 60**
1.3%	13.2%	13.4%	72.1%

The following table shows the percentage distribution of the City's pooled investments by maturity as of June 30, 2010:

Investment maturities (in months)			
Under 1	**1 to less than 6**	**6 to less than 12**	**12 to 60**
0.0%	2.9%	16.6%	80.5%

(Dollars in thousands, unless otherwise stated)

(4) Capital Assets

Capital assets as of June 30, 2011 and 2010 consist of the following:

	Balance June 30, 2010	Increases	Decreases		Balance June 30, 2011
Capital assets not being depreciated:					
Land	$ 17,707	1,105	—		18,812
Intangible assets	679	—	—		679
Construction in progress	787,367	659,087	(217,880)	*	1,228,574
Total capital assets not being depreciated	805,753	660,192	(217,880)		1,248,065
Capital assets being depreciated:					
Facilities and improvements	1,548,575	196,524	—		1,745,099
Intangible assets	3,973	5,512	—		9,485
Machinery and equipment	195,639	29,939	(5,658)		219,920
Total capital assets being depreciated	1,748,187	231,975	(5,658)		1,974,504
Less accumulated depreciation for:					
Facilities and improvements	(584,860)	(46,552)	—		(631,412)
Intangible assets	—	(973)	—		(973)
Machinery and equipment	(104,727)	(11,227)	5,658		(110,296)
Total accumulated depreciation	(689,587)	(58,752)	5,658		(742,681)
Total capital assets being depreciated, net	1,058,600	173,223	—		1,231,823
Total capital assets, net	$ 1,864,353	833,415	(217,880)		2,479,888

* Includes $1,123 in capital project write-offs mainly relating to Thomas Shaft Disinfection Station and Access Road Improvements, and San Joaquin Pipeline Demolition.

(Continued)

(Dollars in thousands, unless otherwise stated)

	Balance June 30, 2009	Increases	Decreases		Balance June 30, 2010
Capital assets not being depreciated:					
Land and rights-of-way	$ 18,386	—	(679)		17,707
Intangible assets	—	679	—		679
Construction in progress	547,293	417,265	(177,191)	*	787,367
Total capital assets not being depreciated	565,679	417,944	(177,870)		805,753
Capital assets being depreciated:					
Facilities and improvements	1,426,180	123,062	(667)		1,548,575
Intangible assets	—	3,973	—		3,973
Machinery and equipment	146,788	49,456	(605)		195,639
Total capital assets being depreciated	1,572,968	176,491	(1,272)		1,748,187
Less accumulated depreciation for:					
Facilities and improvements	(537,920)	(46,940)	—		(584,860)
Machinery and equipment	(99,467)	(5,631)	371		(104,727)
Intangible assets	—	—	—		—
Total accumulated depreciation	(637,387)	(52,571)	371		(689,587)
Total capital assets being depreciated, net	935,581	123,920	(901)		1,058,600
Total capital assets, net	$ 1,501,260	541,864	(178,771)		1,864,353

* Includes $7,037 in capital project write-offs mainly relating to Harry Tracy Water Treatment Plant Demolition, Watershed and Facilities Fence Projects, and Balboa/Francisco Reservoirs Study.

Capital assets with a useful life of 50 years or greater include buildings and structures, reservoirs, dams, treatment plants, pump stations, certain water mains and pipelines, sewer systems, tunnels, and bridges.

(Dollars in thousands, unless otherwise stated)

Financial Accounting Standards Board (FASB) Statement 34, *Capitalization of Interest Costs*, requires that interest expense incurred during construction of assets be capitalized. Interest included in the construction in progress and total interest expense incurred during the years ended June 30, 2011 and 2010 are as follows:

		2011	2010
Interest expensed	$	100,875	47,272
Interest included in construction in progress		50,901	36,131
Total interest incurred	$	151,776	83,403

During fiscal years ending in 2011 and 2010, the Enterprise expensed $1,123 and $7,037, respectively, related to capitalized design and planning costs on certain projects. The amounts of the write-offs were recognized as other operating expenses in the accompanying statements of revenues, expenses, and changes in net assets.

(5) Restricted Assets

Pursuant to the Indentures, all revenues of the Enterprise (except amounts on deposit in the rebate fund) are irrevocably pledged to the punctual payment of debt service on the Water Revenue and Refunding Bonds. Accordingly, the revenues of the Enterprise shall not be used for any other purpose while any of its Water Revenue and Refunding Bonds are outstanding, except as expressly permitted by the Indentures. Further, all revenues shall be deposited by the City Treasurer, by instruction of the Enterprise, in special funds designated as the Water Enterprise Revenue Fund (the Water Revenue Fund), which must be maintained in the City Treasury. These funds, held at the City Treasury, are recorded in the statements of net assets of the Enterprise as cash and investments with the City Treasury. Deposits in the Water Revenue Fund, including earnings thereon, shall be appropriated, transferred, expended, or used for the following purposes pertaining to the financing, maintenance, and operation of the Enterprise in accordance with the following priority:

1. The payment of operation and maintenance expenses for such utility and related facilities;
2. The payment of pension charges and proportionate payments to such compensation and other insurance or outside reserve funds as the Enterprise may establish or the Board of Supervisors may require with respect to employees of the Enterprise;
3. The payment of principal, interest, reserve, sinking fund, and other mandatory funds created to secure Revenue Bonds issued by the Enterprise for the acquisition, construction, or extension of facilities owned, operated, or controlled by the Enterprise;
4. The payment of principal and interest on General Obligation Bonds issued by the City for the Enterprise’s purposes;

(Dollars in thousands, unless otherwise stated)

5. Reconstruction and replacement as determined by the Enterprise or as required by any of the Enterprise's Revenue Bond ordinances duly adopted and approved; and

6. The acquisition of land, real property, or interest in real property for, and the acquisition, construction, enlargement, and improvement of, new and existing buildings, structures, facilities, equipment, appliances, and other property necessary or convenient to the development or improvement of such utility owned, controlled, or operated by the Enterprise; and for any other lawful purpose of the Enterprise, including the transfer of surplus funds pursuant to Section 6.407(e) of the City's Charter.

In accordance with the Indenture, the Program maintains certain restricted cash and investment balances in trust. Restricted assets held in trust consisted of the following as of June 30, 2011 and 2010:

		2011	2010
Cash and investments with City Treasury:			
Water revenue bond construction fund	$	1,093,431	620,347
Cash and investments outside City Treasury:			
1991 Capital Appreciation Bond		15	15
2001A Water revenue bond fund		2,606	2,545
2002A Water revenue bond fund		3,285	3,451
2002B Water revenue bond fund		4,965	4,790
2006A Water revenue bond fund		26,392	25,761
2006B Water revenue bond fund		3,028	2,945
2006C Water revenue bond fund		2,013	1,952
2009A Water revenue bond fund		25,818	38,675
2009B Water revenue bond fund		27,482	41,190
2010ABC Water revenue bond fund		45,383	52,771
2010D Water revenue bond fund		10,061	—
2010E Water revenue bond fund		38,690	—
2010F Water revenue bond fund		32,281	—
2010G Water revenue bond fund		62,887	—
2009C Certificates of participation – 525 Golden Gate		18,241	29,291
2009D Certificates of participation – 525 Golden Gate		55,016	91,895
Total cash and investments outside City Treasury		358,163	295,281
Interest receivable:			
Water bond construction fund		—	273
Total restricted assets	$	1,451,594	915,901

Restricted assets listed above as cash and investments with City Treasury are held in sub-funds of the Water Revenue Fund.

(6) Short-Term Debt

The Commission and the Board of Supervisors have authorized the issuance of up to $250,000 in commercial paper pursuant to the voter-approved 2002 Proposition E. As of June 30, 2011, $150,000 in short-term commercial paper was outstanding. The short-term commercial paper interest rates ranged from 0.2% to 0.4%.

With maturities up to 270 days, the Enterprise intends to maintain the program by remarketing the commercial paper upon maturity over the next five years, at which time outstanding commercial paper will be refunded with long-term revenue bonds. This is being done to take advantage of the continued low interest rate environment. If the commercial paper interest rates rise to a level that exceeds these benefits, the Enterprise will refinance the commercial paper with the long-term fixed rate debts.

(Continued)

(Dollars in thousands, unless otherwise stated)

(7) Changes in Long-Term Liabilities

Long-term liability activities for the years ended June 30, 2011 and 2010 are as follows:

	Coupon interest rate*	Final maturity date	July 1, 2010	Additions	Reductions	June 30, 2011	Due within one year
Revenue Bonds:							
2001A revenue bonds	4.0 – 5.0%	2031	$ 60,235	-	(3,065)	57,170	3,195
2002A revenue bonds	2.5 – 5.0	2032	144,260	-	(34,995)	109,265	3,605
2002B revenue refunding bonds	3.0 – 5.0	2015	45,050	-	(6,640)	38,410	6,985
2006A revenue bonds	4.0 – 5.0	2036	488,555	-	(8,895)	479,660	9,350
2006B revenue refunding bonds	4.0 – 5.0	2026	101,100	-	(3,300)	97,800	3,465
2006C revenue refunding bonds	4.0 – 5.0	2026	41,185	-	(2,470)	38,715	2,590
2009A revenue bonds	4.0 – 5.3	2039	412,000	-	-	412,000	6,460
2009B revenue bonds	4.0 – 5.0	2039	412,000	-	-	412,000	6,610
2010A revenue bonds	2.0 – 5.0	2030	56,945	-	-	56,945	1,790
2010B revenue bonds	4.0 – 6.0	2040	417,720	-	-	417,720	-
2010C revenue refunding bonds	5.0	2015	14,040	-	-	14,040	-
2010D revenue and refunding bonds	3.0 – 5.0	2021	-	102,725	-	102,725	-
2010E revenue bonds	4.9 – 6.0	2040	-	344,200	-	344,200	-
2010F revenue bonds	3.0 – 5.5	2030	-	180,960	-	180,960	-
2010G revenue bonds	6.9	2050	-	351,470	-	351,470	-
Less deferred amounts:							
For issuance premiums			64,115	26,920	(5,625)	85,410	-
For refunding loss			(11,904)	(3,405)	1,717	(13,592)	-
Total revenue bonds payable			2,245,301	1,002,870	(63,273)	3,184,898	44,050
1991 capital appreciation bonds	0.00	2019	3,878	277	-	4,155	-
2009C certificates of participtation (COPs)	2.0 – 5.0	2022	27,218	-	-	27,218	-
Issuance premiums - COPs (2009C)			2,779	-	(381)	2,398	-
2009D certificates of participtation (COPs)	6.36 – 6.49	2041	92,499	-	-	92,499	-
Other post-employment benefits obligation			45,598	19,930	(5,214)	60,314	-
Arbitrage rebate payable			4,553	221	(4,257)	517	-
Accrued vacation and sick leave			11,827	7,269	(7,521)	11,575	5,764
Accrued workers' compensation			8,094	2,030	(2,449)	7,675	1,324
Damage claims liability			29,740	6,815	(9,565)	26,990	8,603
Pollution remediation obligation			659	-	(659)	-	-
Total			$ 2,472,146	1,039,412	(93,319)	3,418,239	59,741

* After adjusting for the Federal interest subsidy, the true interest costs for revenue bonds 2010 Sub-Series B, Sub-Series E and Sub-Series G, all issued as Build America Bonds, are 3.9%, 3.8%, and 4.5%, respectively. After adjusting for the Federal interest subsidy, the true interest cost for the certificates of participation 2009 Series D, also issued as Build America Bonds, is 4.3%.

(Dollars in thousands, unless otherwise stated)

	Coupon interest rate*	Final maturity date	July 1, 2009	Additions	Reductions	June 30, 2010	Due within one year
Revenue Bonds:							
2001A revenue bonds	4.0 – 5.0%	2031	$ 77,580	-	(17,345)	60,235	3,065
2002A revenue bonds	2.5 – 5.0	2032	147,520	-	(3,260)	144,260	3,425
2002B revenue refunding bonds	3.0 – 5.0	2015	51,425	-	(6,375)	45,050	6,640
2006A revenue bonds	4.0 – 5.0	2036	497,060	-	(8,505)	488,555	8,895
2006B revenue refunding bonds	4.0 – 5.0	2026	104,245	-	(3,145)	101,100	3,300
2006C revenue refunding bonds	4.0 – 5.0	2026	43,560	-	(2,375)	41,185	2,470
2009A revenue bonds	4.0 – 5.3	2039	-	412,000	-	412,000	-
2009B revenue bonds	4.0 – 5.0	2039	-	412,000	-	412,000	-
2010A revenue bonds	2.0 – 5.0	2030	-	56,945	-	56,945	-
2010B revenue bonds	4.0 – 6.0	2040	-	417,720	-	417,720	-
2010C revenue refunding bonds	5.0	2015	-	14,040	-	14,040	-
Less deferred amounts:							
For issuance premiums			24,929	42,939	(3,753)	64,115	-
For refunding loss			(13,433)	-	1,529	(11,904)	-
Total revenue bonds payable			932,886	1,355,644	(43,229)	2,245,301	27,795
1991 capital appreciation bonds	0.00	2019	3,620	258	-	3,878	-
2009C certificates of participtation (COPs)	2.0 – 5.0	2022	-	27,218	-	27,218	-
Issuance premiums-COPs (2009C)			-	3,038	(259)	2,779	-
2009D certificates of participtation (COPs)	6.36 – 6.49	2042	-	92,499	-	92,499	-
Other post-employment benefits obligation			30,967	19,073	(4,442)	45,598	-
Arbitrage rebate payable			4,265	288	-	4,553	-
Accrued vacation and sick leave			11,454	8,380	(8,007)	11,827	6,366
Accrued workers' compensation			8,617	1,624	(2,147)	8,094	1,468
Damage claims liability			9,641	26,835	(6,736)	29,740	8,719
Pollution remediation obligation			3,312	-	(2,653)	659	499
Total			$ 1,004,762	1,534,857	(67,473)	2,472,146	44,847

* After adjusting for the Federal interest subsidy, the true interest costs for revenue bond 2010 Sub-Series B and the certificates of participation 2009 Series D, both issued as Build America Bonds, are 3.9% and 4.3%, respectively.

(a) Capital Appreciation Bonds

The capital appreciation bonds mature from November 1, 2018 through November 1, 2019. The bonds were insured by MBIA and carried "Aaa" and "AAA" ratings from Moody's and Standard & Poor's (S&P), respectively. In February 2009, the bonds were further reinsured by NPFGC and carried "Baa1" and "A" ratings from Moody's and S&P, respectively. As of June 30, 2011, MBIA was rated "B3" and "B" by Moody's and S&P, respectively, while NPFGC has affirmed ratings of "Baa1" and "BBB" from Moody's and S&P, respectively. Interest on the capital appreciation bonds is due upon maturity and is recognized as annual interest expense over the life of the bonds using the interest method. The Enterprise has recognized $4,155 and $3,878 of unpaid principal and interest on the capital appreciation bonds as of June 30, 2011 and 2010, respectively, and has reported it as capital appreciation bonds in the accompanying statements of net assets.

(b) Water Revenue Bonds Series 2001A

During fiscal year 2002, the Enterprise issued $140,000 of 2001 Series A revenue bonds. The bonds were insured by Assured Guaranty (formerly FSA) and carried "Aaa" and "AAA" ratings from

Moody's and S&P, respectively. As of June 30, 2011, Assured Guaranty was rated "Aa3" and "AA+" by Moody's and S&P, respectively. The revenue bonds include current interest serial and term bonds with interest rates varying from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2021 and the current interest term bonds mature on November 1, 2024, 2027, and 2031. In March 2006, $45,630 of the 2001A serial and term bonds with maturities of November 2016 to November 2024 were refunded by the 2006 refunding Series B revenue bonds.

On June 17, 2010, the Enterprise issued $14,040 of the 2010 Sub-Series C revenue bonds for the purpose of refunding $14,400 of then-outstanding 2001 Series A revenue bonds. The 2010 bonds bear a coupon rate of 5.0% and mature serially from 2012 to 2015. The refunded Series 2001A bonds carried a coupon rate of 5.0% and also matured between 2012 and 2015. Unamortized Series 2001A bond issuance costs were $126 at the date of the refunding. Although the refunding resulted in the recognition of a deferred accounting loss of $1,044, the Enterprise achieved net present value debt service savings of $919 or 6.4% of the refunded principal.

A portion of the proceeds on the 2010 Sub-Series C revenue bonds was deposited with the trustee, acting as escrow agent under the irrevocable Escrow Agreement, dated June 1, 2010, to refund and legally defease a portion of the outstanding 2001 Series A bonds. This deposit, together with certain other available moneys was held by the escrow agent under the Escrow Agreement and invested in non-callable Federal Securities consisting of United States Treasury Securities - State and Local Government Series (SLGS). The principal and interest on monies held by the escrow agent will be sufficient to redeem the refunded 2001 Series A bonds on November 1, 2011 by optional redemption on that date. As of June 30, 2011, the outstanding amount of 2001 Series A bonds was $57,170.

(c) Water Revenue Bonds Series 2002A

During fiscal year 2003, the Enterprise issued $164,000 of revenue bonds 2002 Series A. The bonds were insured by MBIA and carried "Aaa" and "AAA" ratings from Moody's and S&P, respectively. In February 2009, the bonds were further reinsured by NPFGC and carried "Baa1" and "A" ratings from Moody's and S&P, respectively. As of June 30, 2011, MBIA was rated "B3" and "B" by Moody's and S&P, respectively, while NPFGC carried "Baa1" and "BBB" ratings from Moody's and S& P, respectively. The revenue bonds include interest and serial and term bonds with interest rates varying from 2.5% to 5.0%. The current interest serial bonds mature through November 1, 2026, and the current interest term bonds mature on November 1, 2025 and 2032.

In August 2010, the Enterprise issued $102,725 of the 2010 Sub-Series D revenue bonds for the purpose of refunding $31,570 of then-outstanding 2002 Series A revenue bonds, providing $72,243 in new money for WSIP implementation, funding the debt service reserve and capitalized interest funds and paying the costs of issuing the bonds. The 2010 bonds bear coupon rates of 3.0% to 5.0% and mature serially from 2015 to 2021. The refunded Series 2002A bonds carried a coupon rate of 5.0% and will mature between 2016 and 2021. Unamortized Series 2002A bond issuance costs were $208 at the date of the refunding.

A portion of the proceeds on the 2010 Sub-Series D revenue bonds was deposited with the trustee, acting as escrow agent under the irrevocable Escrow Agreement, dated August 1, 2010, to refund and legally defease a portion of the outstanding 2002 Series A bonds. This deposit, together with certain other available moneys, was held by the escrow agent under the Escrow Agreement and invested in non-callable Federal Securities consisting of United States Treasury Securities-State and Local Government Series (SLGS). The principal and interest on monies held by the escrow agent will be sufficient to redeem the refunded 2002 Series A bonds on August 1, 2012 by optional redemption.

As of June 30, 2011, the 2002 Series A bonds outstanding was $109,265. Although the refunding resulted in the recognition of a deferred accounting loss of $3,405, the Enterprise achieved net present value debt service savings of $2,703 or 8.6% of the refunded principal.

(d) Water Revenue Refunding Bonds Series 2002B

During fiscal year 2003, the Enterprise issued revenue refunding bonds, 2002 Series B in the amount of $85,260 with interest rates ranging from 3.0% to 5.0%. The bonds were insured by MBIA and carried “Aaa” and “AAA” ratings from Moody’s and S&P, respectively. In February 2009, the bonds were further reinsured by NPFGC and carried “Baa1” and “A” ratings from Moody’s and S&P, respectively. As of June 30, 2011, MBIA was rated “B3” and “B” by Moody’s and S&P, respectively, while NPFGC has ratings of “Baa1” and “BBB” from Moody’s and S&P, respectively. The current interest serial bonds mature through November 1, 2015.

(e) Water Revenue Bonds Series 2006A

During fiscal year 2006, the Enterprise issued revenue bonds, 2006 Series A in the amount of $507,815. The purpose of the bonds is to finance improvements to the City’s water systems pursuant to Proposition A and to retire commercial paper outstanding. The bonds were insured by Assured (formerly FSA) and carried “Aaa” and “AAA” ratings from Moody’s and S&P, respectively. As of June 30, 2011, Assured was rated “Aa3” and “AA+” by Moody’s and S&P, respectively. The 2006 Series A bonds include current interest and serial and term bonds with interest rates ranging from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2027 and the current interest term bonds mature on November 1, 2031 and 2033 and 2036.

(f) Water Revenue Refunding Bonds Series 2006B

During fiscal year 2006, the Enterprise issued revenue refunding bonds, 2006 Series B in the amount of $110,065. The purpose of the bonds is to refund a portion of the 1996A Series A bonds and the 2001 Series A bonds. The bonds were insured by Syncora (formerly XL) and carried “Aaa” and “AAA” ratings from Moody’s and S&P, respectively. As of June 30, 2011, Syncora was rated “Ca” and “NR” by Moody’s and S&P, respectively. The 2006B refunding bonds include serial bonds with interest rates varying from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2026.

(g) Water Revenue Refunding Bonds Series 2006C

During fiscal year 2007, the Enterprise issued revenue refunding bonds, 2006 Series C in the amount of $48,730 for the purpose of refunding the remaining portion of the outstanding 1996 Series A bonds maturing on and after November 1, 2007 (the Refunded 1996 Series A Bonds). The bonds were insured by Syncora (formerly XL) and carried “Aaa” and “AAA” ratings from Moody’s and S&P, respectively. As of June 30, 2011, Syncora was rated “Ca” and “NR” by Moody’s and S&P, respectively. The 2006 Series C refunding bonds include serial bonds with interest rates varying from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2026.

(h) Water Revenue Bonds Series 2009A

During fiscal year 2010, the Enterprise issued revenue bonds, 2009 Series A in the amount of $412,000. The purpose of the bonds is to refund $229,600 of outstanding Proposition A commercial paper notes and to provide $139,218 in new money for WSIP capital projects, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated “AA-” and “A1” from S&P and Moody’s, respectively. The bonds include serial and term bonds with interest rates varying from 4.0% to 5.3%. The bonds mature through November 1, 2039. The 2009 Series A bonds have a true interest cost of 4.8%.

(i) Water Revenue Bonds Series 2009B

During fiscal year 2010, the Enterprise issued revenue bonds, 2009 Series B in the amount of $412,000. The purpose of the bonds is to provide $377,778 in new money for WSIP capital projects, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated “AA-” and “A1” from S&P and Moody’s, respectively. The bonds include serial and term bonds with interest rates varying from 4.0% to 5.0%. The bonds mature through November 1, 2039. The 2009 Series B bonds have a true interest cost of 4.5%.

(j) Water Revenue Bonds Series 2010 ABC

During fiscal year 2010, the Enterprise issued its revenue bonds, 2010 Series ABC in the combined principal amount of $488,705. The purpose of the bonds is to refund $14,400 of outstanding 2001 Series A revenue bonds, to provide $58,748 in proceeds for the AMI Project and to provide $364,757 in new money for WSIP capital projects, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated “AA-” and “Aa2” from S&P and Moody’s, respectively. The bonds included serial and term bonds with interest rates varying from 2.0% to 6.0%.

The $56,945 Sub-Series A bonds were issued as tax-exempt bonds to provide funds for the AMI Project as well as financing costs. The Sub-Series A bonds were issued as serial bonds with coupons ranging from 2.0% to 5.0% and have a final maturity of 2030. The sub-series A bonds have a true interest cost of 3.8%.

The $417,720 Sub-Series B bonds were issued as taxable Build America Bonds (with Direct Pay Subsidy) to provide $364,757 in new money for WSIP capital projects as well as to pay financing costs. The Sub-Series B bonds were issued as serial and term bonds with coupons ranging from 4.0% to 6.0% and have a final maturity of 2040. The Sub-Series B bonds have a true interest cost (net of federal subsidy) of 3.9%.

The $14,040 Sub-Series C bonds were issued to advance refund $14,400 of outstanding revenue bonds, 2001 Series A and to pay financing costs. The Sub-Series C bonds were issued as serial bonds with 5.0% coupons and a final maturity of 2015, and have a true interest cost of 1.6%.

(k) Water Revenue Bonds Series 2010 DE

In July 2010, the Enterprise issued revenue bonds 2010 Series DE in the combined principal amount of $446,925. The Sub-Series D bonds were issued as tax-exempt bonds, while the Sub-Series E bonds were issued as Build America Bonds with a Direct Pay Subsidy. The $102,725 Sub-Series D bonds provided $72,243 in new money for WSIP implementation and also provided $35,080 to advance refund a portion of the SFPUC's Water Revenue Bonds, Series 2002 A bonds, as well as providing funds for financing costs. The $344,200 Sub-Series E bonds provided $300,446 in new money for WSIP projects, with the balance applied to financing costs. The bonds included serial and term bonds with interest rates varying from 3% to 6%, and mature through November 1, 2040. (refer to note (c) Water Revenue Bond Series 2002A in relation to the refunding).

(l) Water Revenue Bonds Series 2010FG

In December 2010, the Enterprise issued revenue bonds 2010 Series FG in the combined principal amount of $532,430. The Sub-Series F bonds were issued as tax-exempt bonds, while the Sub-Series G bonds were issued as Build America Bonds with a Direct Pay Subsidy. The $180,960 Sub-Series F bonds provided $149,728 in new money for WSIP. The $351,470 Sub-Series G bonds provided $288,252 in new money for WSIP projects, with the balance applied to financing costs. The bonds included serial and term bonds with interest rates varying from 3% to 6.9%, and mature through November 1, 2050.

(Dollars in thousands, unless otherwise stated)

(m) Future Annual Debt Service of Revenue Bonds

The following table presents the future annual debt service relating to the revenue and refunding bonds outstanding as of June 30, 2011. The interest before subsidy amounts include the interest for the revenue bonds 2001 Series A, 2002 Series A, 2002 refunding Series B, 2006 Series A, 2006 refunding Series B and C, 2009 Series A and B, 2010 Series ABC, 2010 Series DE, and 2010 Series FG. The Federal interest subsidy amounts represent 35% of the interest for the revenue bond 2010 Sub-Series B, Sub-Series E and Sub-Series G.

		Principal	Interest before subsidy	Federal interest subsidy	Interest net of subsidy
Years ending June 30:					
2012	$	44,050	164,100	(23,921)	140,179
2013		45,965	162,039	(23,921)	138,118
2014		48,130	159,887	(23,921)	135,966
2015		50,485	157,583	(23,921)	133,662
2016		62,940	154,839	(23,921)	130,918
2017 – 2021		383,200	723,772	(117,560)	606,212
2022 – 2026		493,195	618,737	(110,283)	508,454
2027 – 2031		619,255	478,532	(96,145)	382,387
2032 – 2036		613,615	312,093	(74,231)	237,862
2037 – 2041		537,475	145,771	(43,597)	102,174
2042 – 2046		95,305	58,671	(20,535)	38,136
2047 – 2051		119,465	21,507	(7,527)	13,980
		3,113,080	3,157,531	(589,483)	2,568,048
Less current portion		(44,050)			
Add unamortized bond premium, net of discount and refunding loss		71,818			
Long-term portion as of June 30, 2011	$	3,140,848			

As defined in the Indentures, the principal and interest of the Enterprise's revenue and refunding bonds are payable from its revenues, as well as monies deposited in certain funds and accounts pledged thereto (note 5).

(n) Proposition A

On November 5, 2002, the San Francisco voters passed Proposition A, which provides for the issuance of revenue bonds and/or other forms of indebtedness by the Commission in a principal amount not to exceed $1,628,000 to finance the acquisition and construction of improvements to the City's Water System. As of June 30, 2011, there was no commercial paper outstanding pursuant to this authorization and $1,331,815 of bonds had been issued in fiscal years 2006 and 2010 against this authorization.

(Dollars in thousands, unless otherwise stated)

(o) Proposition E

On November 5, 2002, the San Francisco voters passed Proposition E, which authorizes the Board of Supervisors' approval of the issuance of revenue bonds and/or other forms of indebtedness by the Commission to finance costs for the Commission's capital programs, including WSIP. As of June 30, 2011, the Board of Supervisors has authorized the issuance of $3,097,131 in revenue bonds with $1,422,655 issued against this authorization. Additionally, $150,000 in commercial paper was outstanding pursuant to this authorization as of June 30, 2011.

(8) Revenue Pledge

The Enterprise has pledged future revenues to repay various revenue bonds. Proceeds from the revenue bonds provided financing for various capital construction projects, and to refund previously issued bonds. The bonds are payable solely from revenues of the Enterprise and are payable through the year ending 2051.

The original amount of revenue bonds issued, total principal and interest remaining, principal and interest paid during 2011 and 2010, and applicable revenues for 2011 and 2010 are as follows:

		2011	2010
Bonds issued with revenue pledge	$	3,400,560	2,421,205
Principal and interest remaining due at the end of the year		6,270,611	4,091,947
Principal and interest paid during the year		118,124	69,621
Net revenue for the year ended June 30		125,747	77,735
Funds available for revenue bond debt service		169,877	138,686

(9) Certificates of Participation Issued for the 525 Golden Gate Avenue Headquarters Building

In October 2009, the City & County of San Francisco issued $167,670 in certificates of participation to fund the future headquarters building of the San Francisco Public Utilities Commission (SFPUC) at 525 Golden Gate Avenue. The 2009 Series C were issued for $38,120 and 2009 Series D for $129,550 as "Build America Bonds" on a taxable basis under the 2009 American Recovery and Reinvestment Act. The 2009 Series C certificates carry interest rates ranging from 2.0% to 5.0% and mature on November 1, 2022. The 2009 Series D certificates carry interest rates ranging from 6.4% to 6.5% and mature on November 1, 2041, after adjusting for the Federal interest subsidy the true interest cost averages 3.4% and 4.3% for Series C & D, respectively.

Under the terms of a memorandum of understanding between the City and the SFPUC dated October 1, 2009, the City conveyed the real property to the Trustee, the Bank of New York Mellon Trust Company, N.A., under a property lease in exchange for the proceeds of the sale of the certificates. The Trustee has leased the property back to the City for the City's use under a Project Lease. The City will be obligated under the Project Lease to pay base rental payments and other payments to the Trustee each year during the thirty-two year term of the Project Lease. The Commission will make annual base rental payments to the

(Dollars in thousands, unless otherwise stated)

City for the building equal to annual debt service on the certificates. It is anticipated that these lease costs will be offset with reductions in costs associated with current office rental expense.

Each of the three Enterprises has an ownership interest in the building equal to their projected usage of space as follows: Water (73%), Wastewater (15%) and Power (12%). Similarly, each Enterprise is responsible for a portion of the annual Base Rental Payment based on their ownership percentages less contributed equity. The percentage share of Base Rental Payments for the Enterprises is as follows: Water (71.4%), Wastewater (18.9%), and Power (9.7%).

Certificates of Participation 2009 Series C (tax-exempt)

		Principal	Interest
Years ending June 30:			
2012	$	—	1,263
2013		1,971	1,231
2014		2,035	1,164
2015		2,106	1,092
2016		2,199	1,000
2017 – 2021		12,813	3,189
2022 – 2023		6,094	309
		27,218	9,248
Less: Current portion		—	
Add: Unamortized bond premium		2,398	
Long-term portion as of June 30, 2011	$	29,616	

(Dollars in thousands, unless otherwise stated)

Certificates of Participation 2009 Series D (taxable)

		Principal	Interest before subsidy	Federal interest subsidy	Interest net of subsidy
Fiscal years ending June 30:					
2012	$	—	5,968	(2,089)	3,879
2013		—	5,968	(2,089)	3,879
2014		—	5,968	(2,089)	3,879
2015		—	5,968	(2,089)	3,879
2016		—	5,968	(2,089)	3,879
2017 – 2021		—	29,839	(10,445)	19,394
2022 – 2026		10,214	28,883	(10,109)	18,774
2027 – 2031		20,099	23,497	(8,223)	15,274
2032 – 2036		24,751	16,291	(5,702)	10,589
2037 – 2041		30,524	7,358	(2,575)	4,783
2042		6,911	224	(78)	146
		92,499	135,932	(47,577)	88,355
Less: Current portion		—			
Less: Unamortized bond premium		—			
Long-term portion as of June 30, 2011	$	92,499			

(10) Wholesale Balancing Account

From 1984-2009, the Water Enterprise provided water service pursuant to the terms of the 1984 Settlement Agreement and Master Water Sales Contract, which establishes the basis for water rates to be charged to those customers (Wholesale Customers). The Master Water Sales Contract expired on June 30, 2009. The Commission and the Wholesale Customers approved a new Water Supply Agreement ("WSA") of a twenty-five year term with two options for five-year extensions. The existing 184 millions of gallons per day (mgd) Supply Assurance continues under the WSA and no increase in the Supply Assurance will be considered before December 31, 2018. During the period from 2009 to 2018, the WSA limits the quantity of water delivered to Retail Customers and Wholesale Customers for the watersheds to 265 mgd. Under the WSA, annual operating expenses including debt service on bonds sold to finance regional system improvements and regional capital projects funded from revenues will be allocated between Retail Customers and Wholesale Customers on the basis of proportionate annual water use. The Wholesale Customers' share of net book value of existing regional assets as of June 30, 2009 will be recovered on level annual payment over the twenty-five year term of the WSA at an interest rate of 5.13%. The WSA continues much of the rate setting, accounting, and dispute resolution provisions contained in the expired Contract, and has emergency and drought-pricing adjustment provisions.

Pursuant to the terms of the WSA, the City is required to establish water rates applicable to the Wholesale Customers annually. The wholesale water rates are based on an estimate of the level of revenues necessary to recoup the cost of distributing water to the Wholesale Customers in accordance with the methodology outlined in Article V of the WSA (the Wholesale Revenue Requirement (WRR), previously known as the Suburban Revenue Requirement). During fiscal years ending in 2011 and 2010, the WRR, net of adjustments, charged to such suburban customers was $142,201 and $129,203, respectively. Such amounts are subject to final review by the Wholesale Customers, along with a trailing wholesale balancing account compliance audit of the Wholesale Revenue Requirement calculation.

Pursuant to Article VII, Section 7.02 of the WSA, the City is required to re-compute the WRR after the close of each fiscal year based on the actual costs incurred in the delivery of water to the Wholesale Customers. The difference between the wholesale revenues earned during the year and the “actual” WRR is recorded in a separate account (the Balancing Account) and represents the cumulative amount that is either owed to the Wholesale Customers (if the wholesale revenues exceed the WRR) or owed to the City (if the WRR exceeds the wholesale revenues paid). In accordance with Article VI of the WSA, the amount recorded in the Balancing Account shall earn interest at a rate equal to the average rate received by the City during the year on the invested pooled funds of the City Treasurer, and shall be taken into consideration in the determination of subsequent wholesale water rates. As of June 30, 2011 and 2010, the Wholesale Customers owed the Enterprise $41,026 and $34,092, respectively, under the terms of the WSA. Subsequently, the June 30, 2010 amount was revised to a total of $34,919, including $15,195 under the new WSA and $19,724 related to the prior contract, based on the audited final balancing account statement dated March 31, 2011.

Pursuant to Section 5.03 of the Water Supply Agreement, the Wholesale Customers agree that SFPUC previously advanced funds to acquire or construct Existing Assets used and useful in the delivery of water to both Wholesale Customers and Retail Customers. As of the expiration of the 1984 Agreement on June 30, 2009, the Wholesale Customers collectively owed the SFPUC $397,023 for the pre-2009 water-related capital costs that have been and will be used to deliver water services to the Wholesale Customers. The balance due was $380,535 and $388,990, respectively as of June 30, 2011 and 2010. The WSA requires a 25-year repayment term, with level annual payments of $28,214 which includes both principal and interest calculated at 5.13% annually. Pursuant to Section 5.03(F) of the WSA, the Wholesale Customers also have the option to prepay the entire amount owed or make partial prepayments of at least equal to $10,000 or greater at any time during the 25-year term. Additionally, the SFPUC has previously appropriated funds, advanced through rates charged to Retail Customers, for construction of capital projects that were not yet placed into service as of June 30, 2009. The Wholesale Customers’ share of these Construction Work In Progress costs will be calculated in accordance with the provisions in the WSA including a 10-year repayment term, which is required to begin in fiscal year 2014-15. The WSA also requires level annual principal and annual interest calculated at 4.00%. The final balance due and the associated 10-year amortization schedule will be determined as part of the fiscal year 2012-13 Wholesale Revenue audit.

(11) Employee Benefits

(a) Retirement Plan

Plan Description – The Enterprise participates in the City’s single-employer defined benefit retirement plan (the Plan) which is administered by the San Francisco City and County Employees’ Retirement System (the Retirement System). The Plan covers substantially all full-time employees of the Enterprise along with other employees of the City. The Plan provides basic service retirement, disability, and death benefits based on specified percentages of final average salary, and provides cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to qualified survivors. The San Francisco City and County Charter and Administrative Code are the authority which establishes and amends the benefit provisions and employer obligations of the Plan.

Funding Policy – Contributions to the basic plan are made by both the Enterprise and its employees. Employee contributions are mandatory. Employee contribution rates for fiscal years 2011, 2010 and 2009 varied from 7.5% to 8.0% as a percentage of covered payrolls. Due to certain bargaining agreements, the Enterprise contributed from 0.5% to 8.0% of covered payroll on behalf of some employees. In addition, the Enterprise is required to contribute for 2011, 2010, and 2009 at an actuarially determined rate as a percentage of covered payroll of 13.6%, 9.5%, and 5.0%, respectively. The Enterprise contributed 100% of its required contribution of $16,453 in 2011, $12,283 in 2010 and $6,946 in 2009.

The Retirement System issues a publicly available financial report for Citywide level that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees' Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, CA 94102, or by calling (415) 487-7020.

(b) Health Care Benefits

Health care benefits of the Enterprise employees, retired employees and surviving spouses are financed by beneficiaries and by the City through the City and County of San Francisco Health Service System (the Health Service System). The Enterprise's annual contribution, which amounted to approximately $20,952 and $19,347 in fiscal years 2011 and 2010, respectively, is determined by a San Francisco Charter provision based on similar contributions made by the 10 most populous counties in California.

Included in these amounts are $5,214 and $4,442 for 2011 and 2010, respectively, to provide post-retirement benefits for retired employees, on a pay-as-you-go basis. There was no additional City allocation to the Enterprise's contribution allocation for payments made from the Health Service System for post-retirement health benefits in 2011 and 2010, respectively.

The City has determined a City-wide Annual Required Contribution (ARC), interest on net other post-employment benefits other than pensions (OPEB) obligation, ARC adjustment, and OPEB cost based upon an actuarial valuation performed in accordance with GASB 45, by the City's actuaries. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost of each year and any unfunded actuarial liabilities (or funding excess) amortized over thirty years. The City's allocation of the OPEB related costs to the Enterprise for the year ended June 30, 2011 based upon its percentage of City-wide payroll costs is presented below.

The following table shows the components of the City's annual OPEB allocations for the Enterprise for the years ended June 30, 2011 and 2010, for the amount contributed to the plan, and changes in the City's net OPEB obligation (dollar amount in thousands):

		2011	2010
Annual required contribution	$	19,533	18,790
Interest on net OPEB Obligation		1,842	1,312
Adjustment to ARC		(1,445)	(1,029)
Annual OPEB cost (expense)		19,930	19,073
Contribution made		(5,214)	(4,442)
Increase in net OPEB obligation		14,716	14,631
Net OPEB obligation – beginning of year		45,598	30,967
Net OPEB obligation – end of year	$	60,314	45,598

The City issues a publicly available financial report for Citywide level that includes the complete note disclosures and required supplementary information related to the City's post retirement health care obligations. The report may be obtained by writing to the City and County of San Francisco, Office of the Controller, 1 Dr. Carlton B. Goodlett Place, Room 316, San Francisco, CA 94102, or by calling (415) 554-7500.

(12) Related Parties

Various common costs incurred by the Commission are allocated proratably between the Enterprise, Hetch Hetchy, and the Wastewater Enterprise. The allocations are based on the Commission management's best estimate and may change from year to year depending on the activities incurred by each Enterprise and the information available. The Commission allocated $35,912 and $32,508 in administrative costs to the Enterprise for the years ended June 30, 2011 and 2010, respectively.

The City performs certain administrative services such as maintenance of accounting records and investment of cash for all fund groups within the City. The various funds are charged for these services based on the City's indirect cost allocation plan. The overhead allocation paid to the General Fund of the City by the Enterprise was $2,122 and $1,007 for the years ended June 30, 2011 and 2010, respectively, and is included in other operating expenses in the accompanying financial statements.

The Enterprise purchases water from Hetch Hetchy Water. This amount, totaling $29,747 for each of the years ended June 30, 2011 and 2010, has been included in the services provided by other departments in the accompanying financial statements.

The Enterprise purchases electricity from Hetch Hetchy Power at market rates. This amount, totaling $6,591 and $6,723 for the years ended June 30, 2011 and 2010, respectively, has been included in services provided by other departments in the accompanying financial statements.

(Continued)

Since fiscal year 2008, the Enterprise has charged all City departments for water with the exception of fire hydrants for public safety purpose. In fiscal year 2011, the Enterprise delivered water for fire hydrant purposes totaling $4, based on metered usage and applicable water rates, and the amount has been excluded from operating revenues in the accompanying financial statements.

A variety of City departments provide services such as engineering, purchasing, legal, data processing, telecommunications, and human resources to the Enterprise and charge amounts designed to recover those departments' costs. These charges, totaling $9,971 and $11,105 for the years ended June 30, 2011 and 2010, respectively, have been included in services provided by other departments in the accompanying financial statements.

During the fiscal year ending June 30, 2011, $17,834 was transferred to other City departments, including $13,638 to Hetch Hetchy Enterprise to finance improvements to certain up-country water storage and transmission facilities, $2,643 to the Recreation and Park and Department of Public Works for landscape and irrigation project performed for the Water Enterprise, and $1,080 transferred to special revenue fund for the surety bond program.

As of June 30, 2011, the Enterprise has receivables in the amount of $6,122 due from the Wastewater Enterprise and Hetch Hetchy Enterprise for their respective allocable share of costs associated with the construction of the future SFPUC headquarters building located at 525 Golden Gate Avenue.

In May 2010, the City and County of San Francisco Board of Supervisors and Mayor approved the transfer of costs of operating, maintaining and improving the auxiliary water supply system (AWSS) from the Fire Department to the Enterprise. In June 2010, the voters of the City & County of San Francisco also approved Proposition B which authorizes a general obligation bond to implement improvements for fire, earthquake and emergency response and to ensure a reliable water supply for fires and disasters. The transfer of assets as well as AWSS operations was completed in the fiscal year 2011. The Fire Department has transferred $6,510 in AWSS inventory and $11,747 in capital assets to the Enterprise. In return, the Enterprise has transferred $500 to the Fire Department. Additionally, the Enterprise has received $8,397 of the general obligation bond proceeds for the improvements of the AWSS. The net total of these transfers and proceeds are reported as capital contributions in the Enterprise's financial statements.

(Dollars in thousands, unless otherwise stated)

SFPUC entered into a seventy-five year lease agreement with the San Francisco Recreation and Park Commission for the use of parking spaces at the parking garage located at 355 McAllister Street beneath Civic Center Plaza which is in closer proximity to SFPUC's new headquarters at 525 Golden Gate Avenue. The term of the agreement commenced on February 1, 2011 with 40 parking spaces allocated to SFPUC. On or about April 1, 2012, SFPUC will have the right to an additional 20 parking spaces. The total payment under this agreement is $6,274 and the first payment in the amount of $1,500 was made in the fiscal year ending June 30, 2011. Of this $1,500, SFPUC recognized $40 as expenses for the 40 parking spaces rented between February and June, 2011 at $8 per month. The remaining $1,460 was recognized as prepaid. The expenses and prepayment were prorated and allocated among the three SFPUC Enterprises based on the use of parking spaces. The remaining payments will be made as follows:

		Amount
Fiscal years ending June 30:		
2012	$	1,500
2013		1,500
2014		1,500
2015		274
Total	$	4,774

In fiscal year ending June 30, 2010-11, the Water Enterprise's allocable share of expenses and prepayment was $39 and $401, respectively.

(13) Risk Management

The Enterprise's risk management program includes both self-insured and insured exposures at risk. Risk assessments and purchasing of insurance coverage are collaboratively coordinated by SFPUC Risk Management and the City's Office of Risk Management. With certain exceptions, the City and the Enterprise's general policy is to first evaluate the exposure at risk for self-insurance. Based on this analysis, internal mitigation strategies and financing through a 'self-retention' mechanism is generally more economical as the SFPUC administers, adjusts, settles, defends, and pays claims from budgeted resources (i.e. pay-as-you-go fund). When economically more viable or when required by debt financing covenants, the Enterprise obtains commercial insurance. At least annually, the City actuarially determines general liability and workers' compensation risk exposures. The Enterprise does not maintain commercial earthquake coverage, with certain minor exceptions, such as a sub-limit for fire-sprinkler leakage due to earthquake under the Property Insurance program.

Primary risks	**Typical coverage approach**
General Liability	Self-Insured
Property	Purchased Insurance and Self-Insured
Workers' Compensation	Self-Insured through Citywide Pool
Other risks	**Typical coverage approach**
Surety Bonds	Purchased and Contractually Transferred
Professional Liability	Combination of Self-Insured, Purchased Insurance and Contractual Risk Transfer
Errors & Omissions	Combination of Self-Insured, Purchased Insurance and Contractual Risk Transfer
Builders' Risk	Purchased Insurance and Contractual Risk Transfer
Public Officials Liability	Purchased Insurance

(a) Damage Claims Liability

Through coordination with the Controller and the City Attorney's Office, the general liability risk exposure is actuarially determined and is addressed through pay-as-you-go funding as part of the budgetary process. Associated costs are also booked as expenses as required under Generally Accepted Accounting Principles (GAAP) for financial statement purposes for both the Enterprise and the City and County of San Francisco's Comprehensive Annual Financial Report (CAFR). The claim expense allocations are determined based on actuarially determined anticipated claim payments and the projected timing of disbursement.

(Continued)

(Dollars in thousands, unless otherwise stated)

The changes for the damage claims liabilities for the years ended June 30, 2011 and 2010 are as follows:

	Beginning of year	Claims and changes in estimates	Claims paid	End of year
2009 – 2010	$ 9,641	26,835	(6,736)	29,740
2010 – 2011	29,740	6,815	(9,565)	26,990

(b) ***Property***

The Enterprise's property risk management approach varies depending on whether the facility is currently under construction, or if the property is part of revenue-generating operations. For new construction projects, the Enterprise has utilized traditional insurance, or other alternative insurance programs. Under the latter approach, the insurance program usually provides coverage for the entire construction project, along with multiple risk coverage, such as for general liability, property damage and workers' compensation, for example. When a traditional insurance program is used for property risks, the Enterprise requires each contractor to provide its own insurance, while ensuring that the full scope of work be covered with satisfactory levels to limit the Enterprise's risk exposure. The majority of purchased insurance program is for either: 1) revenue-generating facilities, 2) debt-financed facilities, or 3) mandated coverage to meet statutory requirements for bonding of various public officials.

(c) Workers' Compensation

The City actuarially determines and allocates workers' compensation costs to the Enterprise according to a formula based on the following: (i) the dollar amount of claims; (ii) yearly projections of payments based on historical experience; and (iii) the size of the Enterprise's payroll. The administration of workers' compensation claims and payouts are handled by the Workers' Compensation Division of the City's Department of Human Resources. Statewide workers' compensation reforms have resulted in budgetary savings in recent years. The City continues to develop and implement improved programs, such as return-to-work programs, to lower or mitigate the growth of workers' compensation costs. Programs include: accident prevention, investigation and duty modification for injured employees with medical restrictions so return to work can occur as soon as possible.

(Dollars in thousands, unless otherwise stated)

The changes in the liabilities for workers' compensation for the years ended June 30, 2011 and 2010 are as follows:

		Beginning of year	Claims and changes in estimates	Claims paid	End of year
2009 – 2010	$	8,617	1,624	(2,147)	8,094
2010 – 2011		8,094	2,030	(2,449)	7,675

(d) Surety Bonds and Public Official Liability

Bonds are required in most phases of the public utilities construction contracting process for such phases as bid, performance, and payment or maintenance. Additionally, bonds may be required in other contracts where goods or services are provided to ensure compliance with applicable terms and conditions such as warranty. All public officials with financial oversight responsibilities are provided coverage through a commercial Public Official Liability policy. The Enterprise also maintains a commercial crime policy in lieu of bonding its employees.

(e) Professional Liability, Errors and Omissions

Professional liability policies are either directly purchased insurance on behalf of the Enterprise, transferred through contract to the contracted professional, or retained through self-insurance on a case by case basis depending on the size, complexity or scope of construction or professional service contracts. Examples of contracts providing any form of the coverage described are engineers, architects, design professionals and other licensed or certified professional service providers.

(f) Builders' Risk

Builder's risk policies of insurance are required to be provided by the contractor on all construction projects for the full value of construction.

(14) Commitments and Litigation

(a) Commitments

As of June 30, 2011 and 2010, the Enterprise has outstanding commitments with third parties of $1,168,888, and $913,560, respectively, for various capital projects and other purchase agreements for materials and services.

(b) Grants

Grants that the Enterprise receives are subject to audit and final acceptance by the granting agency. Current and prior year costs of such grants are subject to adjustment upon audit.

(c) Litigation

The Enterprise is a defendant in various legal actions and claims that arise during the normal course of business. The final disposition of those legal actions and claims is not determinable. However, in the opinion of management, the outcome of any litigation of these matters will not have a material effect on the financial position or changes in net assets of the Enterprise.

(15) Subsequent Events

(a) Credit Rating Change

On July 18, 2011, Moody's Investors Service, Inc., lowered its municipal bond rating on all outstanding Water Revenue Bonds from "Aa2" to "Aa3" with a stable outlook while S&P maintained its rating on all outstanding Water Revenue Bonds at "AA-" with a stable outlook.

The explanation of the significance of Moody's rating, and any outlook associated with this rating, may be obtained from Moody's Investors Service, Inc. The ratings assigned by Moody's express only the views of such rating agency, and is based upon its own investigations, studies, and assumptions. There is no assurance such ratings will continue for any given period or that such ratings will not be revised downward or withdrawn entirely by such rating agency, if in its judgment, circumstances so warrant. Any such downward revision or withdrawal of the rating may have an adverse effect on the market price of the Bonds. The SFPUC undertakes no responsibility to maintain its current ratings on the Bonds or to oppose any such downward revision, suspension or withdrawal.

(b) Water Revenue Bonds Series 2011 ABCD

On July 21, 2011, $720,750 in Water Revenue Bonds were issued as 2011 Series ABCD. This transaction closed on August 4, 2011. Of this amount, $55,465 were refunding bonds issued as 2011 Sub Series D, which refunded a portion of 2001 Series A and 2002 Series A Water Revenue Bonds. This refunding resulted in $3,311, or 5.8%, in net present value savings.

(c) Commercial Paper

An additional $24,000 in taxable commercial paper was issued on July 27, 2011. On July 28, 2011, $61,000 in taxable commercial paper was issued to refund $61,000 of outstanding commercial paper maturing on August 1, 2011 and August 3, 2011.

(d) Litigation

On September 27, 2011, the Board of Supervisors authorized the settlement of claims arising out of nine lawsuits involving Mitchell Engineering, and the issuance of settlement bonds of $14,080.

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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Honorable Mayor and Board of Supervisors
City and County of San Francisco, California:

We have audited the financial statements of the San Francisco Water Enterprise (the Enterprise), an enterprise fund of the City and County of San Francisco, California (the City) as of and for the year ended June 30, 2011, and have issued our report thereon dated October 28, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Enterprise's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Enterprise's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Enterprise's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Enterprise's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the City and County of San Francisco Government Audit and Oversight Committee, the Commission, and others within the entities, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 28, 2011