



**SAN FRANCISCO WASTEWATER ENTERPRISE**

Financial Statements

June 30, 2008 and 2007

(With Independent Auditors' Report Thereon)

# SAN FRANCISCO WASTEWATER ENTERPRISE

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KPMG LLP  
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 Wastewater Enterprise (the Enterprise), a department of the City and County of San Francisco, California (the City), as of and for the years ended June 30, 2008 and 2007, 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 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 are 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, 2008 and 2007, the changes in its financial position, or, where applicable, its 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 Enterprise as of June 30, 2008 and 2007, 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 December 5, 2008, 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 11 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.

As discussed in notes 2(o) and 9(b) to the financial statements, the Enterprise adopted the recognition and disclosure provisions of Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as of July 1, 2007.

KPMG LLP

December 5, 2008

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

This section presents management's analysis of the San Francisco Wastewater Enterprise's (the Enterprise) financial condition and activities as of and for the years ended June 30, 2008 and 2007. 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 dollar 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
- Economic Factors and Next Year's Rates
- Request for Information

### **Organization and Business**

The San Francisco Public Utilities Commission (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, including the Enterprise. The Enterprise collects, transmits, treats, and discharges sanitary and stormwater flows generated within the City for the protection of public health and environmental safety. In addition, the Enterprise serves on a contractual basis certain municipal customers located outside of the City limits, including the North San Mateo County Sanitation District, Bayshore Sanitation District, and the City of Brisbane. The Enterprise recovers cost of service through user fees based on the volume and strength of sanitary flow. The Enterprise serves approximately 150,000 residential accounts (representing approximately 350,000 dwelling units), which discharge about 19 million units of sanitary flow per year (measured in hundreds of cubic feet, or ccf) and approximately 22,000 nonresidential accounts, which discharge about 9.4 million units of sanitary flow per year.

### **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. This statement 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.

## SAN FRANCISCO WASTEWATER ENTERPRISE

### Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

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, noncapital, 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 noncash 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

#### *2008 Financial Highlights*

- Total assets of the Enterprise exceeded the total liabilities by \$983,913.
- Net assets increased by \$24,663, or 2.6%, during the fiscal year.
- Capital assets, net of accumulated depreciation, increased by \$25,391, or 1.9%, to \$1,360,861.
- Operating revenue, which excludes interest and investment income and other nonoperating revenue, increased by \$9,138, or 4.7%, to \$202,549.
- Operating expenses, which exclude interest expense and other nonoperating expenses, increased by \$13,645, or 9.0%, to \$165,245

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

**Financial Position**

**Table 1**

Comparative Condensed Net Assets

June 30, 2008, 2007, and 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2008-2007 change</u>	<u>2007-2006 change</u>
Current and other assets	\$ 134,739	172,585	161,028	(37,846)	11,557
Capital assets, net of accumulated depreciation	<u>1,360,861</u>	<u>1,335,470</u>	<u>1,312,827</u>	25,391	22,643
Total assets	<u>1,495,600</u>	<u>1,508,055</u>	<u>1,473,855</u>	(12,455)	34,200
Revenue bonds outstanding	327,473	361,251	393,975	(33,778)	(32,724)
State revolving funds and loans	89,101	102,438	118,868	(13,337)	(16,430)
Commercial paper	50,000	50,000	—	—	50,000
Other liabilities	<u>45,113</u>	<u>35,116</u>	<u>34,635</u>	9,997	481
Total liabilities	<u>511,687</u>	<u>548,805</u>	<u>547,478</u>	(37,118)	1,327
Net assets:					
Invested in capital assets, net of related debt	940,602	901,113	867,257	39,489	33,856
Restricted	1,316	1,107	919	209	188
Unrestricted	<u>41,995</u>	<u>57,030</u>	<u>58,201</u>	(15,035)	(1,171)
Total net assets	<u>\$ 983,913</u>	<u>959,250</u>	<u>926,377</u>	24,663	32,873

**Fiscal Year 2008**

*Net Assets*

For the year ended June 30, 2008, the Enterprise's total net assets increased by \$24,663, or 2.6%. The liabilities decreased by \$37,118 or 6.8% during the year. The net decrease was primarily due to repayment of bonds of \$34,500 and State revolving fund loans of \$13,337, partially offset by the other post employment benefits obligation liability increase of \$5,684 due to the adoption of, Government Accounting Standards Board (GASB) Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, during the fiscal year ended June 30, 2008.

Total capital assets, net of accumulated depreciation, increased by \$25,391 or 1.9%, reflecting an increase in the current year's construction activities. The largest portion of the Enterprise's net assets (\$940,602 or 95.6%) represents investment in capital assets, net of related debt. Unrestricted net assets decreased by \$15,035 due to the use of revenues to fund capital projects and operating expenditures.

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

### *Fiscal Year 2007*

#### *Net Assets*

For the year ended June 30, 2007, the Enterprise's total net assets increased by \$32,873, or 3.5%. The liabilities increased slightly by \$1,327 during the year. The net increase was due to issuance of commercial paper of \$50,000, repayment of State revolving fund loans principal of \$16,430, bond principal payment of \$33,445, and an increase on other liabilities of \$481.

Total capital assets, net of accumulated depreciation, increased by \$22,643, or 1.7%, reflecting an increase in the current year's construction activities. The largest portion of the Enterprise's net assets (\$901,113 or 93.9%) represents investment in capital assets, net of related debt. Restricted net assets increased by \$188. Unrestricted net assets decreased by \$1,171 due to the use of revenues to fund capital projects and operating expenditures.

### *Results of Operations*

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

**Table 2**

Comparative Condensed Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2008, 2007, and 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2008-2007</u> <u>change</u>	<u>2007-2006</u> <u>change</u>
<b>Revenues:</b>					
Charges for services	\$ 187,810	176,344	159,281	11,466	17,063
Other operating revenues	14,739	17,067	5,851	(2,328)	11,216
Interest and investment income	4,099	5,749	5,385	(1,650)	364
Other nonoperating revenues	885	2,986	1,802	(2,101)	1,184
<b>Total revenues</b>	<u>207,533</u>	<u>202,146</u>	<u>172,319</u>	<u>5,387</u>	<u>29,827</u>
<b>Expenses:</b>					
Operating expenses	(165,245)	(151,600)	(140,954)	(13,645)	(10,646)
Interest expense	(17,467)	(17,354)	(19,747)	(113)	2,393
Nonoperating expenses	(158)	(291)	(308)	133	17
<b>Total expenses</b>	<u>(182,870)</u>	<u>(169,245)</u>	<u>(161,009)</u>	<u>(13,625)</u>	<u>(8,236)</u>
<b>Income (loss) before transfers</b>	<u>24,663</u>	<u>32,901</u>	<u>11,310</u>	<u>(8,238)</u>	<u>21,591</u>
Transfers to City	—	(28)	—	28	(28)
<b>Changes in net assets</b>	<u>24,663</u>	<u>32,873</u>	<u>11,310</u>	<u>(8,210)</u>	<u>21,563</u>
Net assets at beginning of year	<u>959,250</u>	<u>926,377</u>	<u>915,067</u>	<u>32,873</u>	<u>11,310</u>
Net assets at end of year	<u>\$ 983,913</u>	<u>959,250</u>	<u>926,377</u>	<u>24,663</u>	<u>32,873</u>

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

### *Rate-Setting Process*

Proposition E, as approved by the Voters on November 5, 2002, amended the City Charter by adding the new Article VIII B, entitled "Public Utilities," which established the Commission's exclusive authority to issue new revenue bonds and set wastewater 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.

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

<b>Historical rate adjustments</b>	
<b>Effective date</b>	<b>Rate</b>
July 1, 2004	11.0%
July 1, 2005	13.0
July 1, 2006	13.0
July 1, 2007	8.0 <sup>1</sup>
July 1, 2008	9.0

<sup>1</sup> Adjustment effective July 14, 2007

### *Fiscal Year 2008*

The Enterprise's total revenue of \$207,533 for the year increased by \$5,387, or 2.7%, over the prior year. Revenue from service charges increased by \$11,466, or 6.5%, primarily due to a rate increase of 8.0% effective July 14, 2007. Other nonoperating revenues decreased by \$2,101, or 70.4%. Interest and investment income decreased by \$1,650, or 28.7%, due to lower average monthly cash balances and lower interest earnings.

Total operating expenses increased by \$13,645 or 9.0% primarily due to, \$4,939 increase in other operating expenses, \$3,646 increase in wages and \$5,684 increase in post employment benefits, due to the adoption of GASB 45, as noted above.

The increase in revenue of \$5,387 combined with an increase in expenses of \$13,625 lead to an increase in total net assets of \$24,663, net of transfers.

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Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

***Fiscal Year 2007***

The Enterprise's total revenue of \$202,146 for the year increased by \$29,827, or 17.3%, over the prior year. Revenue from service charges increased by \$17,063, or 10.7%, primarily due to a rate increase of 13.0% effective July 1, 2006. Other operating revenues increased by \$11,216, or 191.7% after a prior year recast of \$430 capacity charge assessment presented as other non operating revenues in fiscal year 2006. The increase includes \$10,945 from capacity charge assessment as a result of the full implementation of the San Francisco Public Utilities Commission's resolution 05-0045 in 2005. The resolution had an effective date of July 1, 2005, however the Public Utilities Commission was unable to establish an agreement with the Department of Building Inspection and the necessary procedures as a part of the building application process to calculate and collect it until August 2006. The effect of the delay is that \$7,699 of the revenue reported for the year ended June 30, 2007 related to charges for the previous fiscal year. Other nonoperating revenues increased by \$1,184, or 65.7%. Interest and investment income increased by \$364, or 6.8%, due to lower average monthly cash balances with offsetting higher interest earnings.

The increase in revenue of \$29,827 combined with an increase in expenses of \$8,236 lead to an increase in total net assets of \$32,873, net of transfers.

**Capital Assets and Debt Administration**

***Capital Assets***

**Table 3**

Capital Assets, net of Depreciation

Years ended June 30, 2008, 2007, and 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2008-2007 change</u>	<u>2007-2006 change</u>
Facilities, improvements, machinery, and equipment	\$ 1,276,099	1,270,446	1,233,863	5,653	36,583
Land and rights-of-way	21,787	22,168	22,168	(381)	—
Construction work in progress	<u>62,975</u>	<u>42,856</u>	<u>56,796</u>	<u>20,119</u>	<u>(13,940)</u>
Total	<u>\$ 1,360,861</u>	<u>1,335,470</u>	<u>1,312,827</u>	<u>25,391</u>	<u>22,643</u>

***Fiscal Year 2008***

The Enterprise had net capital assets of \$1,360,861 invested in a broad range of utility capital assets as of June 30, 2008. This amount represents an increase of \$25,391, or 1.9%, over the prior fiscal year. The investment in capital assets includes land, buildings, improvements, wastewater treatment plants, sewer pipes and mains, underground transport and storage boxes, pump stations, machinery, and equipment.

## SAN FRANCISCO WASTEWATER ENTERPRISE

### Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

The major additions to construction work in progress during the year ended June 30, 2008 included:

Mission/Mount Vernon Sewer Improvements	\$	9,399
Digester Cover/Mixing Improvements		4,860
Oceanside HVAC Assessment		4,255
Clean Water Master Plan		3,762
Oceanside Pump Station/Westside Bar Screens		2,350
2nd/4th/12th Avenue Sewer Replacement		2,183
Other additions individually below \$2,000		36,506
	\$	<u>63,315</u>

This year's major structures, buildings and equipment additions, including transfers of completed projects from work in progress, include the following:

Mission/Mount Vernon Sewer Improvements	\$	10,749
Oceanside Pump Station/Westside Bar Screens		4,382
2nd/4th/12th Avenue Sewer Replacement		2,525
Brotherhood Way/St. Charles Sewer Replacement		2,360
Mateo Street/Chenery Street/Laidley Street Sewer Replacement		2,031
Other items individually below \$2,000		22,370
	\$	<u>44,417</u>

### *Fiscal Year 2007*

The Enterprise had net capital assets of \$1,335,470 invested in a broad range of utility capital assets as of June 30, 2007. This amount represents an increase of \$22,643, or 1.7%, over the prior fiscal year. The investment in capital assets includes land, buildings, improvements, wastewater treatment plants, sewer pipes and mains, underground transport and storage boxes, pump stations, machinery, and equipment.

The major additions to construction work in progress during the year ended June 30, 2007 included:

North Point Plant, 150 Million Gallon Per Day Upgrade	\$	13,113
Clean Water Master Plan		5,425
Vicente Sewer Improvement		3,503
Shotwell Street Sewer		2,911
Oceanside/Westside Bar Screens		2,483
Southeast Water Pollution Control Plant – Aeration Basin Mixer Replacement		2,218
Other additions individually below \$2,000		27,896
	\$	<u>57,549</u>

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

The major items placed in service during the twelve-month period ending June 30, 2007, included:

North Point Plant, 150 Million Gallon Per Day Upgrade	\$	28,120
Shotwell Street Sewer		7,140
Southeast Water Pollution Control Plant Building – Aeration Basin Mixer Replacement		7,613
Vicente Sewer Improvement		4,429
Aeration Tanks		4,363
Other items individually below \$4,000		21,602
	\$	<u>73,267</u>

More detailed information about the Enterprise's capital assets is presented in notes 2(d), 2(e), and 4 to the financial statements.

**Debt Administration**

As of June 30, 2008 and 2007, the Enterprise had total long-term debt and State Revolving Fund Loans outstanding of \$466,574 and \$513,689, respectively, as shown below in Table 4. More detailed information about the Enterprise's debt activity is presented in note 6 to the financial statements.

**Table 4**

Outstanding Debt  
(Net of Amortized Costs)

Years ended June 30, 2008, 2007, and 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2008-2007 change</u>	<u>2007-2006 change</u>
Revenue bonds	\$ 327,473	361,251	393,975	(33,778)	(32,724)
Commercial paper	50,000	50,000	—	—	50,000
State revolving fund loans	89,101	102,438	118,868	(13,337)	(16,430)
Total	\$ <u>466,574</u>	<u>513,689</u>	<u>512,843</u>	<u>(47,115)</u>	<u>846</u>

**Credit Ratings and Bond Insurance** – At June 30, 2008 and 2007, the Enterprise carried underlying ratings of “A2” and “A” from Moody’s and Standard & Poor’s (S&P), respectively. In connection with the sale of the Enterprise’s 2003 Series A Refunding Bonds, municipal bond insurance has been purchased by the Commission and the underwriters from MBIA Insurance (MBIA) to guarantee the payment of principal and interest when due. With the insurance, Moody’s and S&P have assigned their municipal bond ratings of “Aaa” and “AAA”, respectively, to the Enterprise’s insured revenue bonds. The downgrade of various bond insurance companies by credit ratings agencies in 2008 did not cause any change in the Enterprise’s underlying ratings. By November 2008, Moody’s and S&P had downgraded MBIA to “Baa1” and “AA”, respectively.

## SAN FRANCISCO WASTEWATER ENTERPRISE

### Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

**Debt Service Coverage** – Pursuant to the Indenture, the Enterprise covenants to collect sufficient net revenues each fiscal year, together with any Enterprise funds (except Bond Reserve Funds) that 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 2008 and 2007, 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 Indenture.

**Debt Authorization** – Pursuant to the Charter, the Enterprise can incur indebtedness upon two-thirds vote of the Board of Supervisors. At June 30, 2008, the Enterprise had \$150,000 authorized commercial paper program debt, subject to further Commission and Board of Supervisors authorization. As of June 30, 2008, the Enterprise had issued \$50,000 in commercial paper with \$100,000 remaining unissued.

**Cost of Capital** – The interest rates on the Enterprise's outstanding bonds range from 3.00% to 5.25% at June 30, 2008, unchanged from June 30, 2007 with a true interest cost of 3.95%. The outstanding State Revolving Fund Loans carry interest rates from 2.80% to 3.50%.

### **Economic Factors and Next Year's Rates**

The Commission intends to use debt financing as necessary to fund its capital improvement program related to rebuilding various Enterprise assets.

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 will be undertaken in the coming year to examine the future revenue requirements and cost of service of the Enterprise.

The Commission increased wastewater rates 9.0% next year to meet projected costs and coverage requirements.

### **Request for Information**

This report is designed to provide our citizens, customers, investors, and creditors with a general 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, Financial Services, 1155 Market Street, 11th Floor, San Francisco, CA 94103.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Statements of Net Assets

June 30, 2008 and 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
Assets:		
Current assets:		
Cash and investments with City Treasury	\$ 44,361	52,222
Receivables:		
Charges for services (net of allowance for doubtful accounts of \$943 in 2008 and \$823 in 2007)	34,290	30,661
Interest and other	266	705
Total receivables	<u>34,556</u>	<u>31,366</u>
Total current assets	<u>78,917</u>	<u>83,588</u>
Noncurrent assets:		
Restricted assets – cash and investments with City Treasury	52,808	85,005
Restricted assets – cash and investments outside City Treasury	27	15
Restricted assets – interest receivable	252	1,084
Capital assets not being depreciated	84,762	65,024
Capital assets, net of accumulated depreciation	1,276,099	1,270,446
Bond issuance costs, net of accumulated amortization of \$2,348 in 2008 and \$2,190 in 2007	2,735	2,893
Total noncurrent assets	<u>1,416,683</u>	<u>1,424,467</u>
Total assets	<u>1,495,600</u>	<u>1,508,055</u>
Liabilities:		
Current liabilities:		
Accounts payable	7,096	4,493
Accrued payroll	3,296	2,796
Accrued vacation and sick leave, current portion	2,680	2,588
Accrued workers' compensation, current portion	822	804
Damage and claims liability, current portion	2,989	2,136
Bond and loan interest payable	5,626	6,143
Revenue bond, current portion	35,665	34,500
Commercial paper	50,000	50,000
State revolving fund loans, current portion	13,765	13,337
Current liabilities payable from restricted assets	4,605	4,090
Total current liabilities	<u>126,544</u>	<u>120,887</u>
Long-term liabilities:		
Other post employment benefits obligation	5,684	—
Accrued vacation and sick leave, less current portion	2,318	2,142
Accrued workers' compensation, less current portion	3,853	3,340
Damage and claims liability, less current portion	6,055	6,575
Deferred revenue	89	9
Revenue bonds	291,808	326,751
State revolving fund loans, less current portion	75,336	89,101
Total long-term liabilities	<u>385,143</u>	<u>427,918</u>
Total liabilities	<u>511,687</u>	<u>548,805</u>
Net assets:		
Invested in capital assets, net of related debt	940,602	901,113
Restricted for debt service	1,316	1,107
Unrestricted	41,995	57,030
Total net assets	\$ <u>983,913</u>	<u>959,250</u>

See accompanying notes to financial statements.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2008 and 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Charges for services	\$ 187,810	176,344
Other revenues	14,739	17,067
Total operating revenues	<u>202,549</u>	<u>193,411</u>
Operating expenses:		
Personal services	69,383	58,789
Contractual services	11,973	11,536
Materials and supplies	9,539	9,526
Depreciation	38,758	36,683
Services provided by other departments	26,021	28,010
General and administrative	1,719	4,143
Other	7,852	2,913
Total operating expenses	<u>165,245</u>	<u>151,600</u>
Operating income	<u>37,304</u>	<u>41,811</u>
Nonoperating revenues (expenses):		
Interest and investment income	4,099	5,749
Interest expense	(17,467)	(17,354)
Other, net	727	2,695
Total nonoperating expenses	<u>(12,641)</u>	<u>(8,910)</u>
Income before transfers	24,663	32,901
Transfers to the City and County of San Francisco	<u>—</u>	<u>(28)</u>
Changes in net assets	24,663	32,873
Net assets at beginning of year	<u>959,250</u>	<u>926,377</u>
Net assets at end of year	\$ <u><u>983,913</u></u>	\$ <u><u>959,250</u></u>

See accompanying notes to financial statements.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Statements of Cash Flows

Years ended June 30, 2008 and 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Cash received from customers, including cash deposits	\$ 198,895	187,337
Cash paid to employees for services	(61,696)	(57,393)
Cash paid to suppliers for goods and services	(51,723)	(52,015)
Cash paid for judgments and claims	(1,554)	(1,118)
Net cash provided by operating activities	<u>83,922</u>	<u>76,811</u>
Cash flows from noncapital and related financing activities:		
Cash paid for operating transfers	—	(28)
Cash received from other nonoperating activities	885	444
Net cash provided by noncapital and related financing activities	<u>885</u>	<u>416</u>
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	—	2,409
Acquisition and construction of capital assets	(62,087)	(58,832)
Interest paid on revenue bonds and state loans	(20,325)	(20,968)
Principal paid on revenue bond	(34,500)	(33,445)
Principal paid on state revolving fund loans	(13,337)	(16,430)
Other financing activities	—	50,000
Net cash used in capital and related financing activities	<u>(130,249)</u>	<u>(77,266)</u>
Cash flows from investing activities:		
Interest income received	5,396	4,790
Net cash provided by investing activities	<u>5,396</u>	<u>4,790</u>
Decrease (increase) in cash and cash equivalents	(40,046)	4,751
Cash and cash equivalents:		
Beginning of year	137,242	132,491
End of year	<u>\$ 97,196</u>	<u>137,242</u>
Reconciliation of cash and cash equivalents to the statements of net assets:		
Cash and investments :		
Unrestricted	\$ 44,361	52,222
Restricted	52,835	85,020
	<u>\$ 97,196</u>	<u>137,242</u>

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Statements of Cash Flows

Years ended June 30, 2008 and 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ <u>37,304</u>	<u>41,811</u>
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation	38,758	36,683
Provision for uncollectible accounts	120	68
Write-off of capital assets	1,517	710
Changes in operating assets and liabilities:		
Receivables – charges for services	(3,775)	(6,074)
Accounts payable	2,602	249
Accrued payroll	500	247
Accrued other post employment benefits obligation	5,684	—
Accrued vacation and sick leave	268	414
Accrued workers' compensation	531	(29)
Damage and claims liability	333	2,732
Deferred credits and other liabilities	<u>80</u>	<u>—</u>
Total adjustments	<u>46,618</u>	<u>35,000</u>
Net cash provided by operating activities	\$ <u><u>83,922</u></u>	<u><u>76,811</u></u>
Noncash transactions:		
Accrued capital asset costs	\$ 4,605	4,090

See accompanying notes to financial statements.

# SAN FRANCISCO WASTEWATER ENTERPRISE

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

## (1) Definition of Reporting Entity

The San Francisco Wastewater Enterprise (the Enterprise), formerly known as, the San Francisco Clean Water Program (the Program) was established in 1977 following the transfer of all sewage-system-related assets and liabilities of the City and County of San Francisco (the City) to the Program.

In 1976, the electorate of the City approved a proposition authorizing the City to issue \$240,000 in revenue bonds pursuant to the Revenue Bond Law of 1941 of the State of California for the purpose of acquiring, constructing, improving, and financing improvements to the City's municipal sewage treatment and disposal system. Since then, the City's Board of Supervisors has adopted resolutions (Wastewater Resolutions) providing for the issuance of various sewer revenue and refunding bond series. The Wastewater Resolutions require the City to keep separate books of records and accounts of the Enterprise.

The Enterprise was placed under the jurisdiction of the San Francisco Public Utilities Commission (the Commission) in 1996. 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 water utilities (i.e., Hetch Hetchy Water and Power [Hetch Hetchy] and the San Francisco Water Enterprise [Water]). 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 the 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 requires the Commission members meet the following qualifications:

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

The amended Charter provides for staggered four-year term for members. Initially, the new members for seats 2 and 4 will serve two years and the new members for seats 1, 3 and 5 will serve for four years.

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

The Commission is a department of the City, and as such, the financial operations of the Enterprise, Hetch Hetchy, and the Water 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 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, specifically an enterprise fund. 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 operations are included on the statements of net assets; revenues are recorded when earned, and expenses are recorded when liabilities are incurred.

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

#### (c) *Investments*

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

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

**(d) Capital Assets**

Capital assets with an original acquisition date prior to July 1, 1977 are recorded in the financial statements at estimated cost, as determined by an independent professional appraisal, or at cost, if known. All subsequent acquisitions have been recorded at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related assets, which range from 3 to 75 years. No depreciation or amortization is recorded in the year of acquisition and a full year's depreciation or amortization is recorded in the year of disposal.

**(e) Construction in Progress**

The cost of acquisition and construction of major plant and equipment is recorded as construction in progress. As facilities are accepted by the Enterprise and become operative, they are transferred to the facilities and improvements or machinery and equipment accounts and depreciated in accordance with the Enterprise's depreciation policies. Costs of construction projects that are discontinued are recorded as expense in the year in which the decision is made to discontinue such projects.

**(f) Capitalization of Interest**

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

**(g) 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.

**(h) 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 nonvesting and may be accumulated up to six months per employee.

**(i) 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.

**(j) Damage and Claims Liability**

The Enterprise is self-insured for general liability and property damage claims. The liability represents an estimate of the cost of all outstanding claims, including adverse loss development and estimated incurred but not reported claims.

**(k) 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

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

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. No arbitrage liability is due as of June 30, 2008 and 2007.

**(l) Refunding of Debt**

Gains or losses occurring from advance refundings 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.

**(m) Income Taxes**

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

**(n) Revenue Recognition**

Sewer service charges are based on water usage as determined by the San Francisco Water Enterprise. In general, 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 receivable on the statements of net assets.

**(o) Effects of New Pronouncements**

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which addresses how state and local governments should account for and report their costs and obligations related to post employment healthcare and other non pension benefits. Collectively, these benefits are commonly referred to as other post employment benefits, or OPEB. The statement generally requires that employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. This statement's provisions may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB transition liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. This statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. As of July 1, 2007, the Enterprise implemented the new reporting requirements in the financial statements and established its OPEB transition liability at zero.

**(p) 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

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**(q) Reclassifications**

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

**(3) Cash, Cash Equivalents and Investments**

The Enterprise’s cash, cash equivalents and investments with the City Treasury are invested pursuant to investment policy guidelines established by the City Treasurer and are treated as cash equivalents for financial reporting purposes. 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 Treasury allocates monthly income from the investment of pooled cash in proportion to the Enterprise’s end-of-month balances.

The restricted asset for bond reserves is held by an independent trustee outside the City investment pool. As of June 30, 2008 and 2007, were \$27 and \$15, respectively.

The primary objectives of the Enterprise’s policy of investment are consistent with the City’s policy.

Funds held by the trustee established under the 2003 Indenture are invested in “Permitted Investments” as defined in the Indenture. “Permitted Investments” include money market funds registered under the Federal Investment Company Act of 1940 and whose shares are 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, 2008 and June 30, 2007 were Aaa by Moody’s and AAAM by Standard & Poor’s.

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

	<u>2008</u>	<u>2007</u>
Current assets:		
Cash and investments with City Treasury	\$ 44,361	52,222
Noncurrent assets – restricted assets:		
Cash and investments with City Treasury	52,808	85,005
Cash and investments outside City Treasury	27	15
Net cash provided by operating activities	<u>\$ 97,196</u>	<u>137,242</u>

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

The following table shows the percentage distribution of the City's pooled investments by maturity as of June 30, 2008:

<b>Investment maturities (in months)</b>			
<b>Under 1</b>	<b>1 to less than 6</b>	<b>6 to less than 12</b>	<b>12 to 36</b>
6.9%	52.7%	11.6%	28.8%

The following table shows the percentage distribution of the City's pooled investments by maturity as of June 30, 2007:

<b>Investment maturities (in months)</b>			
<b>Under 1</b>	<b>1 to less than 6</b>	<b>6 to less than 12</b>	<b>12 to 36</b>
25.9%	43.6%	28.4%	2.1%

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

**(4) Capital Assets**

Capital assets as of June 30, 2008 and 2007, consisted of the following:

	<u>Balance</u> <u>July 1, 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2008</u>
Capital assets not being depreciated:				
Land and rights of way	\$ 22,168	—	(381)	21,787
Construction in progress	<u>42,856</u>	<u>63,315</u>	<u>(43,196)</u>	<u>62,975</u>
Total capital assets not being depreciated	<u>65,024</u>	<u>63,315</u>	<u>(43,577)</u>	<u>84,762</u>
Capital assets being depreciated:				
Facilities and improvements	2,018,942	38,683	—	2,057,625
Machinery and equipment	<u>46,224</u>	<u>5,734</u>	<u>(375)</u>	<u>51,583</u>
Total capital assets being depreciated	<u>2,065,166</u>	<u>44,417</u>	<u>(375)</u>	<u>2,109,208</u>
Less accumulated depreciation for:				
Facilities and improvements	(770,443)	(36,595)	—	(807,038)
Machinery and equipment	<u>(24,277)</u>	<u>(2,163)</u>	<u>369</u>	<u>(26,071)</u>
Total accumulated depreciation	<u>(794,720)</u>	<u>(38,758)</u>	<u>369</u>	<u>(833,109)</u>
Total capital assets being depreciated, net	<u>1,270,446</u>	<u>5,659</u>	<u>(6)</u>	<u>1,276,099</u>
Total capital assets, net	\$ <u><u>1,335,470</u></u>	<u><u>68,974</u></u>	<u><u>(43,583)</u></u>	<u><u>1,360,861</u></u>

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

	<u>Balance</u> <u>July 1, 2006</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2007</u>
Capital assets not being depreciated:				
Land and rights of way	\$ 22,168	—	—	22,168
Construction in progress	<u>56,796</u>	<u>57,549</u>	<u>(71,489)</u>	<u>42,856</u>
Total capital assets not being depreciated	<u>78,964</u>	<u>57,549</u>	<u>(71,489)</u>	<u>65,024</u>
Capital assets being depreciated:				
Facilities and improvements	1,957,165	61,777	—	2,018,942
Machinery and equipment	<u>34,776</u>	<u>11,490</u>	<u>(42)</u>	<u>46,224</u>
Total capital assets being depreciated	<u>1,991,941</u>	<u>73,267</u>	<u>(42)</u>	<u>2,065,166</u>
Less accumulated depreciation for:				
Facilities and improvements	(735,503)	(34,940)	—	(770,443)
Machinery and equipment	<u>(22,575)</u>	<u>(1,743)</u>	<u>41</u>	<u>(24,277)</u>
Total accumulated depreciation	<u>(758,078)</u>	<u>(36,683)</u>	<u>41</u>	<u>(794,720)</u>
Total capital assets being depreciated, net	<u>1,233,863</u>	<u>36,584</u>	<u>(1)</u>	<u>1,270,446</u>
Total capital assets, net	\$ <u><u>1,312,827</u></u>	<u><u>94,133</u></u>	<u><u>(71,490)</u></u>	<u><u>1,335,470</u></u>

Capital assets with a useful life of 50 years or greater include buildings and structures, sewers, waste water treatment plants, pump stations, and other pipelines.

During the years ended June 30, 2008 and 2007, the Enterprise incurred total interest cost of \$20,531 and \$21,291, respectively. Of the total amount of interest cost incurred, \$3,064 and \$3,937 were capitalized into the cost of constructed assets during the years ended June 30, 2008 and 2007, respectively.

During fiscal years 2008 and 2007, the Enterprise expensed \$1,517 and \$710, respectively, related to capitalized design and planning costs on certain projects, which were discontinued. The amount of the write-off was recognized as other operating expense in the accompanying financial statements.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

**(5) Restricted Assets**

The Master Bond Resolution was discharged upon the issuance of the 2003 Refunding Series A Bonds. Pursuant to the Indenture, which became effective with the issuance of the 2003 Refunding Series A Bonds, all net revenues of the Enterprise (except amounts on deposit in the rebate fund) are irrevocably pledged to the punctual payment of debt service on the Wastewater revenue bonds. Accordingly, the net revenues of the Enterprise shall not be used for any other purpose while any of its revenue bonds are outstanding except as expressly permitted by the Indenture. Further, all net revenues shall be deposited by the City Treasurer, by instruction of the Enterprise, in special funds designated as the 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 deposits and investments with the City Treasury. Deposits in the Revenue Fund, including earnings thereon, shall be appropriated, transferred, expended, or used for the following purposes and only in accordance with the following priority:

1. The payment of operation and maintenance costs of the Enterprise
2. The payment of state loans
3. The payment of bonds, parity state loans, policy costs, and amounts due as reimbursement under any letter of credit agreement
4. Any other lawful purpose of the Enterprise

In accordance with the Indenture, the Enterprise maintains certain restricted cash and investment balances in trust. Restricted assets held in trust consisted of the following as of June 30, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Deposits and investments with City Treasury:		
Sewer Bond Construction Fund	\$ 52,808	85,005
Deposits and investments outside City Treasury:		
2003A Clean Water Revenue Refunding Bond Fund	27	15
Interest receivable:		
Sewer Bond Construction Fund	<u>252</u>	<u>1,084</u>
Total restricted assets	<u>\$ 53,087</u>	<u>86,104</u>

Restricted deposits listed above as deposits and investments with the City Treasury are held in subfunds of the Sewer Revenue Fund and the Revenue Fund of the City Treasury.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

**(6) Short-Term Debt**

The Commission and Board of Supervisors have authorized the issuance of up to \$150,000 in commercial paper, under the voter-approved 2002 Proposition E, for the purpose of reconstructing, expanding, repairing or improving the Wastewater Enterprise's facilities. As of June 30, 2008 and 2007, the Enterprise had \$50,000 and \$50,000, respectively, in commercial paper notes outstanding. The commercial paper program is supported by a letter of credit issued by BNP Paribas and is dated as of February 1, 2007 with U.S. Bank Trust N.A. as agent bank. For the year ended June 30, 2008, interest rates on the commercial paper ranged from 1.52% to 3.62%.

	<u>Interest rate</u>	<u>Beginning of the year</u>	<u>Additions</u>	<u>Reductions</u>	<u>End of the year</u>
June 30, 2008	1.52% to 3.62%	\$ 50,000	185,000	185,000	50,000
June 30, 2007	3.59% to 3.70%	—	50,000	—	50,000

Maturity dates of the June 30, 2008 outstanding balance ranged from July 8, 2008 to September 9, 2008.

**(7) Changes in Long-Term Liabilities**

Long-term liability activities for the years ended June 30, 2008 and 2007 were as follows:

	<u>Interest rate</u>	<u>Final maturity date</u>	<u>July 1, 2007</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2008</u>	<u>Due within one year</u>
Revenue bonds (a):							
Revenue Bonds, 2003 Refunding Series A	3.00 to 5.25%	2025	\$ 362,825	—	(34,500)	328,325	35,665
Less deferred amounts:							
For issuance premiums			18,370	—	(1,004)	17,366	—
For refunding loss			(19,944)	—	1,726	(18,218)	—
Total revenue bonds payable			361,251	—	(33,778)	327,473	35,665
State of California revolving loans (b)	2.80 to 3.50%	2021	102,438		(13,337)	89,101	13,765
Other post employment benefits obligations			—	5,684	—	5,684	—
Accrued vacation and sick leave			4,730	2,829	(2,561)	4,998	2,680
Accrued workers' compensation			4,144	1,236	(705)	4,675	822
Damage and claims liability			8,711	1,182	(849)	9,044	2,989
Deferred revenue			9	80	—	89	—
Total long-term liabilities			\$ 481,283	11,011	(51,230)	441,064	55,921

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

	<u>Interest rate</u>	<u>Final maturity date</u>	<u>July 1, 2006</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2007</u>	<u>Due within one year</u>
Revenue bonds (a):							
Revenue Bonds, 2003 Refunding Series A	3.00 to 5.25%	2025	\$ 396,270	—	(33,445)	362,825	34,500
Less deferred amounts:							
For issuance premiums			19,375	—	(1,005)	18,370	—
For refunding loss			(21,670)	—	1,726	(19,944)	—
Total revenue bonds payable			393,975	—	(32,724)	361,251	34,500
State of California revolving loans (b)	2.80 to 3.50%	2021	118,868	—	(16,430)	102,438	13,337
Accrued vacation and sick leave			4,316	3,093	(2,679)	4,730	2,588
Accrued workers' compensation			4,173	735	(764)	4,144	804
Damage and claims liability			5,979	3,086	(354)	8,711	2,136
Deferred revenue			9	—	—	9	—
Total long-term liabilities			\$ <u>527,320</u>	<u>6,914</u>	<u>(52,951)</u>	<u>481,283</u>	<u>53,365</u>

The payments of principal and interest amounts on various bonds are secured by net revenues of the Enterprise.

**(a) Revenue Bonds, 2003 Refunding Series A**

During fiscal year 2003, the Enterprise issued 2003 Refunding Series A Bonds (Refunding Bonds) in the amount of \$396,270 with interest rates ranging from 3.00% to 5.25%.

During fiscal year 2005, the Enterprise substituted cash and equivalents held in the Bond Reserve Fund with a bond reserve fund policy of \$34,199, which was the largest reserve requirement pursuant to the Indenture. The cash released by the substitution will be used for improvements to capital projects within the Enterprise in accordance with the Indenture.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

***Future Annual Debt Service of Refunding Bonds***

The future annual debt service relating to the Refunding Bonds outstanding as of June 30, 2008 is as follows:

	<u>Principal</u>	<u>Interest</u>
Years ending June 30:		
2009	\$ 35,665	14,646
2010	37,130	13,183
2011	26,320	11,827
2012	22,010	10,959
2013	23,095	9,941
2014 – 2018	115,320	31,915
2019 – 2023	62,530	11,677
2024 – 2026	<u>6,255</u>	<u>674</u>
	328,325	\$ <u><u>104,822</u></u>
Less:		
Current portion	(35,665)	
Unamortized bond premiums and refunding loss	<u>(852)</u>	
Long-term portion as of June 30, 2008	\$ <u><u>291,808</u></u>	

As defined in the Indenture, the principal and interest of the Enterprise's Refunding Bonds are payable from its corresponding revenue as well as monies deposited in certain funds and accounts pledged thereto (note 5).

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

**(b) State Revolving Fund Loans**

The Enterprise has entered into several contracts with the State Water Resources Control Board (SWRCB) under which the Enterprise borrowed up to prescribed maximum amounts to finance the construction of certain facilities. Loans outstanding as of June 30, 2008 and 2007, are summarized as follows:

Project	Date of issuance	Maturity date	Interest rate	Loan amount	June 30	
					2008	2007
					Amount outstanding	Amount outstanding
Oceanside	07/25/90	2010	3.4%	\$ 40,000	7,723	10,129
Oceanside	06/10/91	2011	3.5	32,376	6,275	8,227
Oceanside	12/24/93	2013	2.9	14,100	5,142	5,917
Mariposa	01/28/91	2011	3.5	7,624	1,488	1,951
Mariposa	06/24/92	2012	3.1	1,936	487	600
Lake Merced	01/29/92	2012	3.1	21,114	5,303	6,531
Islais Creek	10/08/92	2012	3.0	5,705	1,745	2,064
Islais Creek	09/07/93	2013	3.1	26,800	9,756	11,215
Islais Creek	06/17/94	2014	2.9	15,000	6,378	7,189
Islais Creek	01/09/96	2016	3.4	21,700	11,379	12,599
Islais Creek	08/04/00	2020	2.9	18,026	12,848	13,653
Rankin Pump	12/23/96	2016	2.8	27,000	14,679	16,096
Rankin Pump	01/23/01	2021	2.9	8,274	5,898	6,267
				\$ 239,655	89,101	102,438

The Enterprise is repaying the interest and principal by installments with the final amount due between 15 and 20 years after the first disbursement by SWRCB. Disbursements are made by SWRCB as funds are spent for the projects. The Enterprise is required to comply with applicable federal and state regulations. The future annual debt service relating to the State Revolving Fund Loans outstanding as of June 30, 2008, is as follows:

	Principal	Interest	Total
Years ending June 30:			
2009	\$ 13,765	2,744	16,509
2010	14,198	2,307	16,505
2011	14,650	1,855	16,505
2012	9,594	1,389	10,983
2013	8,322	1,099	9,421
2014 – 2018	23,612	2,354	25,966
2019 – 2022	4,960	291	5,251
	89,101	\$ 12,039	101,140
Less current portion	(13,765)		
Long-term portion as of June 30, 2008	\$ 75,336		

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

### (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 2026. Annual principal and interest payments on the bonds are expected to require less than 27% of future revenues through the year 2026.

The original amount of revenue bonds issued, total principal and interest remaining, principal and interest paid during 2008, and applicable revenues for 2008 are as follows:

	<u>2008</u>
Bonds issued with revenue pledge	\$ 396,270
Principal and interest remaining due at the end of the year	433,147
Principal and interest paid during the year	50,198
Net revenue for the year ended June 30	106,692

### (9) Employee Benefits

#### (a) Retirement Plan

*Plan Description* – The City has a 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. The Retirement System issues a publicly available financial report 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.

*Funding Policy* – Contributions are made to the basic Plan by both the Enterprise and its employees. Employee contributions are mandatory. Employee contribution rates for 2008, 2007 and 2006 were from 5.0% to 8.0% as a percentage of covered payroll. 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 was required to contribute for 2008, 2007 and 2006 at the actuarially determined rate as a percentage of covered payroll of 5.91%, 6.24% and 6.58%, respectively. The Enterprise’s required contribution was approximately \$2,658 in 2008, \$2,605 in 2007 and \$2,936 in 2006.

## SAN FRANCISCO WASTEWATER ENTERPRISE

### Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

**(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 \$6,992 and \$6,364 in fiscal years 2008 and 2007, 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 \$1,834 and \$1,624 for 2008 and 2007, respectively, to provide post retirement benefits for retired employees, on a pay-as-you-go basis.

The City has determined a Citywide Annual Required Contribution (ARC) and OPEB cost based upon an actuarial valuation performed in accordance with GASB 45, by the City's actuaries. The City has allocated \$7,518 of the Citywide ARC and OPEB cost to the Enterprise for the year ended June 30, 2008 based upon its percentage of Citywide payroll costs. The difference between the allocation and the amount paid was \$5,684 which has been recorded as a net OPEB obligation by the Enterprise as of June 30, 2008.

The City issues a publicly available financial report that includes the complete note disclosures and Required Supplementary Information (RSI) 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.

**(c) Wellness Incentive Program**

Effective July 1, 2002, the City established a pilot "Wellness Incentive Program" (the Wellness Program) to promote workforce attendance. Under the Wellness Program, any full-time employee leaving the employment of the City upon service or disability retirement may receive payment of a portion of accrued sick leave credits at the time of separation.

The amount of this payment shall be equal to two and one-half percent of accrued sick leave credits at the time of separation times the number of whole years of continuous employment times an employee's salary rate, exclusive of premiums or supplements, at the time of separation. Vested sick leave credits, as set forth under Civil Service Commission Rules, shall not be included in this computation.

The Wellness Program shall be discontinued upon expiration of current bargaining agreements on June 30, 2010.

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

### (10) Related Parties

Various common costs incurred by the Commission are allocated pro-ratably between the Enterprise, Hetch Hetchy, and Water. 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 department and the information available. For the years ended June 30, 2008 and 2007, the Commission allocated \$16,666 and \$15,135, respectively, in administrative costs to the Enterprise, which is included in these statements under various expense categories.

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 \$1,894 and \$1,658 for the years ended June 30, 2008 and 2007, respectively, and is included in other operating expenses in the accompanying financial statements.

The Enterprise purchases electricity from Hetch Hetchy at market rates. This amount, totaling \$7,672 and \$7,744 for the years ended June 30, 2008 and 2007, respectively, has been included in services provided by other departments in the accompanying financial statements.

The Enterprise provides sewer services to other City departments at the nonresidential rates established by the Enterprise.

The Water Enterprise bills and collects sewer service charges on behalf of the Wastewater Enterprise.

The City's Department of Public Works (DPW) provides certain engineering and other services to the Enterprise and charges amounts designed to recover its costs. This amount totaling approximately \$12,685 and \$14,920 for the years ended June 30, 2008 and 2007, respectively, has been included in services provided by other departments in the accompanying financial statements.

A variety of other City departments provide services such as purchasing, legal, data processing, telecommunications, and human resources to the Enterprise and charge amounts designed to recover those departments' costs. These charges totaling approximately \$5,663 and \$5,344 for the years ended June 30, 2008 and 2007, respectively, have been included in services provided by other departments in the accompanying financial statements.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

**(11) Risk Management**

The Enterprise’s risk management program encompasses both self-insured and insured coverage. Risk assessments and coverage are coordinated by the City Office of Risk Management. With certain exceptions, the City and the Enterprise’s general policy is to first evaluate self-insurance for the risk of loss to which it is exposed. Based on this analysis, mitigating risk through a ‘self-retention’ mechanism is more economical as it manages risks internally and 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.

<b>Primary risks</b>	<b>Typical coverage approach</b>
General liability	Self-insure
Property	Purchase insurance and self-insure
Workers’ compensation	Self-insure through citywide pool
<b>Other risks</b>	<b>Typical coverage approach</b>
Surety bonds	Purchased and contractually transferred
Professional liability	Combination of self-insure, purchased insurance and contractual risk transfer
Errors and omissions	Combination of self-insure, purchased insurance and contractual risk transfer
Builders risk	Purchased insurance and contractual risk transfer

**(a) Damage and 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.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

**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, owner-controlled insurance programs (OCIPs) or other alternative insurance programs. Under the latter two approaches, the insurance program usually provides coverage for the entire construction project, along with multiple risk coverages, 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, and 3) mandated coverage to meet statutory requirements for bonding of various public officials.

The changes for the Damage and Claims Liabilities for the years ended June 30, 2008 and 2007 are as follows:

	<u>Beginning of year</u>	<u>Claims and changes in estimates</u>	<u>Claims paid</u>	<u>End of year</u>
2006 – 2007	\$ 5,979	3,086	(354)	8,711
2007 – 2008	8,711	1,182	(849)	9,044

**(b) 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.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

The changes in the liabilities for Worker’s Compensation for the years ended June 30, 2008 and 2007 are as follows:

	<u>Beginning of year</u>	<u>Claims and changes in estimates</u>	<u>Claims paid</u>	<u>End of year</u>
2006 – 2007	\$ 4,173	735	(764)	4,144
2007 – 2008	4,144	1,236	(705)	4,675

(c) ***Surety Bonds***

Bonds are required in most phases of the public works 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. Additionally, all public officials with financial oversight responsibilities are bonded, including Commission members, the General Manager and the Chief Financial Officer.

(d) ***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 coverages described are engineers, architects, design professionals and other licensed or certified professional service providers.

(e) ***Builders Risk***

Builder’s Risk policies of insurance are required to be provided either through OCIP or the contractor on all construction projects for the full value of the construction.

**(12) Commitments and Litigation**

(a) ***Commitments***

As of June 30, 2008 and 2007, the Enterprise has outstanding commitments with third parties of \$33,882 and \$37,545, 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.

## **SAN FRANCISCO WASTEWATER ENTERPRISE**

### Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise stated)

**(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 these 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.

**(13) Subsequent Event**

The Enterprise had \$50,000 in commercial paper (CP) outstanding at June 30, 2008, \$14,500 of which matured on various dates between September 30 and October 8, 2008. The reissue of the \$14,500 was delayed until November 25, 2008 due to market conditions.



KPMG LLP  
55 Second Street  
San Francisco, CA 94105

**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 Wastewater Enterprise (the Enterprise), a department of the City and County of San Francisco, California (the City), as of and for the year ended June 30, 2008, and have issued our report thereon, dated December 5, 2008. Our audit report included an explanatory paragraph related to the Enterprise's adoption of the provisions of Governmental Accounting Standards Board GASB 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as of July 1, 2007. 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 an 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control over financial reporting. We consider the deficiency described in the accompanying schedule of findings and responses as 08-01, to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

### **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*.

The Enterprise's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Enterprise's response and, accordingly, we express no opinion on it.

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

**KPMG LLP**

December 5, 2008

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Schedule of Findings and Responses

Year ended June 30, 2008

**2008-1 Lack of Control over the Review of the Cash Flow Statement Presentation of Acquisition and Construction of Capital Assets and Cash Paid to Suppliers for Goods and Services**

***Criteria***

A control deficiency 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 misstatements on a timely basis.

***Condition and Context***

Noncapitalizable costs of approximately \$3.7 million were included as additions to construction in progress and as deletions to construction in progress. This impacted the cash flow statement causing an overstatement of acquisition and construction of capital assets and an understatement of cash paid to suppliers for goods and services. This also resulted in a gross up of additions and deletions in note 4 of the financial statements.

***Cause***

The Wastewater Enterprise has a process in place to capitalize all costs to construction in progress. Noncapitalizable costs are then removed as deletions as part of the year end reporting process.

***Recommendation***

Management should ensure that the statement of cash flows and the notes to the financial statements are appropriately adjusted to correct this gross up.

***Management Response***

Management concurs. Processes that are in place have been communicated to staff and an additional level of review has been added to ensure that capital asset additions are properly reported.