



**SAN FRANCISCO WASTEWATER ENTERPRISE**

Financial Statements

June 30, 2009 and 2008

(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), an enterprise fund of the City and County of San Francisco, California (the City), as of and for the years ended June 30, 2009 and 2008, 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 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 transaction of the Enterprise. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2009 and 2008, 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 Enterprise as of June 30, 2009 and 2008, 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 November 9, 2009, 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 13 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

November 9, 2009

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Management's Discussion and Analysis

June 30, 2009 and 2008

(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, 2009 and 2008. 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, the Water Enterprise, Hetch Hetchy Water and Power, and Wastewater 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 No. 3, Bayshore Sanitary 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, which discharge about 19.0 million units of sanitary flow per year (measured in hundreds of cubic feet, or ccf) and approximately 22,000 non-residential accounts, which discharge about 9.2 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. 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.

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### Management's Discussion and Analysis

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(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, 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

#### *2009 Financial Highlights*

- Total assets of the Enterprise exceeded total liabilities by \$1,010,604
- Net assets increased by \$26,691 or 2.7%, during the fiscal year.
- Capital assets, net of accumulated depreciation, increased by \$34,062 or 2.5%, to \$1,394,923.
- Operating revenues, which exclude interest and investment income and other non-operating revenues, increased by \$6,105 or 3.0%, to \$208,654.
- Operating expenses, which exclude interest and non-operating expenses, increased by \$4,055 or 2.5% to \$169,300.

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Management's Discussion and Analysis

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

### *Financial Position*

**Table 1**

Comparative Condensed Net Assets

June 30, 2009, 2008, and 2007

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2009-2008 change</u>	<u>2008-2007 change</u>
Current and other assets	\$ 139,783	134,739	172,585	5,044	(37,846)
Capital assets, net of accumulated depreciation	<u>1,394,923</u>	<u>1,360,861</u>	<u>1,335,470</u>	<u>34,062</u>	<u>25,391</u>
Total assets	<u>1,534,706</u>	<u>1,495,600</u>	<u>1,508,055</u>	<u>39,106</u>	<u>(12,455)</u>
Revenue bonds	292,529	327,473	361,251	(34,944)	(33,778)
State revolving fund loans	75,339	89,101	102,438	(13,762)	(13,337)
Commercial paper	100,000	50,000	50,000	50,000	—
Other liabilities	<u>56,234</u>	<u>45,113</u>	<u>35,116</u>	<u>11,121</u>	<u>9,997</u>
Total liabilities	<u>524,102</u>	<u>511,687</u>	<u>548,805</u>	<u>12,415</u>	<u>(37,118)</u>
Net assets:					
Invested in capital assets, net of related debt	971,789	940,602	901,113	31,187	39,489
Restricted for debt service	1,360	1,316	1,107	44	209
Restricted for capital projects	11,126	—	—	11,126	—
Unrestricted	<u>26,329</u>	<u>41,995</u>	<u>57,030</u>	<u>(15,666)</u>	<u>(15,035)</u>
Total net assets	<u>\$ 1,010,604</u>	<u>983,913</u>	<u>959,250</u>	<u>26,691</u>	<u>24,663</u>

### *Net Assets Fiscal Year 2009*

For the year ended June 30, 2009, the Enterprise's total net assets increased by \$26,691 or 2.7% as a result of increases of \$31,187 in invested in capital assets, net of related debt, \$11,126 in restricted for capital projects, and \$44 in restricted for debt service, offset by a decrease of \$15,666 in unrestricted net assets (see Table 1).

Current and other assets increased by \$5,044 or 3.7%. The increases include \$3,586 addition to inventory, \$8,642 in restricted assets – cash and investments and \$409 in receivables primarily from the San Francisco Zoological Society. The increases were offset by decreases of \$205 in miscellaneous receivables and \$7,388 in cash and investments as a result of reduction in accounts payable outstanding balance from prior year.

Capital assets, net of accumulated depreciation, increased by \$34,062 or 2.5%, reflecting an increase in construction activities. The largest portion of the Enterprise's net assets (\$971,789 or 96.2%) represents invested in capital assets, net of related debt.

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Total liabilities increased by \$12,415 or 2.4% during the year. The increase in liabilities was due to \$50,000 in commercial paper issuance, increases in interfund payable to Hetch Hetchy Water and Power of \$556, refund payable to Bayshore Sanitary District of \$407, pollution remediation obligation of \$375, accounts payable and payroll related liabilities of \$3,459, damage and claim liability of \$1,316, and other postemployment benefits obligation of \$5,729. These increases were offset by repayments of revenue bonds of \$35,665 and State revolving fund loans of \$13,762.

#### *Net Assets for Fiscal Year 2008*

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, Governmental 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.



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### Management's Discussion and Analysis

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### *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, 2009, 2008, and 2007

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2009-2008 change</u>	<u>2008-2007 change</u>
<b>Revenues:</b>					
Charges for services	\$ 199,332	187,810	176,344	11,522	11,466
Other operating revenues	9,322	14,739	17,067	(5,417)	(2,328)
Interest and investment income	1,992	4,099	5,749	(2,107)	(1,650)
Other nonoperating revenues	1,022	885	2,986	137	(2,101)
Total revenues	<u>211,668</u>	<u>207,533</u>	<u>202,146</u>	<u>4,135</u>	<u>5,387</u>
<b>Expenses:</b>					
Operating expenses	169,300	165,245	151,600	4,055	13,645
Interest expense	15,677	17,467	17,354	(1,790)	113
Nonoperating expenses	—	158	291	(158)	(133)
Total expenses	<u>184,977</u>	<u>182,870</u>	<u>169,245</u>	<u>2,107</u>	<u>13,625</u>
Income (loss) before transfers	26,691	24,663	32,901	2,028	(8,238)
Transfers to City and County of San Francisco	—	—	(28)	—	28
Changes in net assets	26,691	24,663	32,873	2,028	(8,210)
Net assets at beginning of year	<u>983,913</u>	<u>959,250</u>	<u>926,377</u>	<u>24,663</u>	<u>32,873</u>
Net assets at end of year	<u>\$ 1,010,604</u>	<u>983,913</u>	<u>959,250</u>	<u>26,691</u>	<u>24,663</u>

### *Fiscal Year 2009*

The Enterprise's total revenues of \$211,668 for the year increased by \$4,135 or 2.0% over the prior year primarily due to a rate increase partially offset by reduction in usage. Sanitary flow of 27,826 ccf (100 cubic feet) for the year decreased by 531 ccf or 1.9%. Charges for services increased by \$11,522 or 6.1% due to a rate increase of 9.0% effective July 1, 2008. Other operating revenues decreased by \$5,417 or 36.8% due to reduction of \$4,858 in capacity fees revenue related to lower building permits, and \$559 reduction in charges to other City departments. Interest and investment income decreased by \$2,107 or 51.4% due to lower cash balances and interest rates. Other non-operating revenues increased by \$137 or 15.5%.

Total expenses increased by \$2,107 or 1.2% due to increase of \$4,055 in operating expenses, offset by decreases of \$1,790 in interest and \$158 in non-operating expenses. The increase in operating expenses is attributable to:

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increases of \$5,613 in services provided by other City departments, \$1,855 in contractual services, \$583 in general and administrative expenses which include growth in actuarially determined claim liability, \$576 in bad debt expense, and \$57 in depreciation expense. Services provided by the City's Department of Public Works increased \$3,317 for sewer repair, street cleaning, and engineering services. Contractual services increased due to a new sewer pipeline project and other ongoing repair and replacement projects. These increases were offset by decreases in materials and supplies of \$3,785, primarily due to an inventory adjustment of \$3,586, \$602 in other operating expenses, and \$242 in personal services.

Net assets increased by \$26,691 to \$1,010,604 due to revenue growth of \$4,135 offset by increase in expenses of \$2,107.

***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 non-operating 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.

**Capital Assets and Debt Administration**

***Capital Assets***

**Table 3**

Capital Assets, Net of Depreciation

Years ended June 30, 2009, 2008, and 2007

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2009-2008 change</u>	<u>2008-2007 change</u>
Facilities, improvements, machinery, and equipment	\$ 1,295,806	1,276,099	1,270,446	19,707	5,653
Land and rights-of-way	21,787	21,787	22,168	—	(381)
Construction work in progress	<u>77,330</u>	<u>62,975</u>	<u>42,856</u>	<u>14,355</u>	<u>20,119</u>
Total	\$ <u><u>1,394,923</u></u>	<u><u>1,360,861</u></u>	<u><u>1,335,470</u></u>	<u><u>34,062</u></u>	<u><u>25,391</u></u>

***Fiscal Year 2009***

The Enterprise has net capital assets of \$1,394,923 invested in a broad range of utility capital assets as of June 30, 2009 (see Table 3). This amount represents an increase of \$34,062 or 2.5% over the prior fiscal year.

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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.

Major additions to construction work in progress during the year ended June 30, 2009 include:

Oceanside Heating Ventilation, Air Conditioning Assessment	\$	11,994
Channel Pump Station Improvements Phase 2		8,854
Southeast Water Pollution Control Program Digester Cover and Mixing Improvements		5,030
Wastewater Master Plan		2,962
Sewer Spot Replacements No. 21		2,946
Sewer Spot Replacements Job Order Contract 2		2,100
Other additions individually below \$2,000		39,652
	\$	<u>73,538</u>

This year's major facilities, improvements, machinery, and equipment additions, including transfers of completed projects from construction work in progress, include the following:

Southeast Water Pollution Control Program Digester Cover and Mixing Improvements	\$	10,571
Oceanside Heating, Ventilation, Air Conditioning Assessment		9,970
North Point Facilities Wet Weather Improvements-Pumps		3,520
Southeast Community Facilities Deck Waterproofing		2,433
Connecticut Street, 43rd and 46th Avenues Sewer Replacement		2,378
Toland, Hudson and Phelps Streets Sewer Improvements		2,353
Southeast Water Pollution Control Program Gas Handling Improvement Phase 2		2,164
Noe Street, Sanchez Street Sewer Replacement		2,114
Southeast Community Facilities Heating, Ventilation, Air Conditioning and Other Renovations		2,051
Other items individually below \$2,000		20,968
	\$	<u>58,522</u>

### *Fiscal Year 2008*

The Enterprise has 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.

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Major additions to construction work in progress during the year ended June 30, 2008 include:

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>

**Debt Administration**

As of June 30, 2009 and 2008, the Enterprise's debt and State Revolving Fund Loans outstanding are \$467,868 and \$466,574 respectively, as shown below in Table 4. More detailed information about the Enterprise's debt activity is presented in notes 6 and 7 to the financial statements.

**Table 4**

Outstanding Debt  
(Net of Amortized Costs)

Years ended June 30, 2009, 2008, and 2007

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2009-2008 change</u>	<u>2008-2007 change</u>
Revenue bonds	\$ 292,529	327,473	361,251	(34,944)	(33,778)
Commercial paper	100,000	50,000	50,000	50,000	—
State revolving fund loans	75,339	89,101	102,438	(13,762)	(13,337)
Total	\$ <u>467,868</u>	<u>466,574</u>	<u>513,689</u>	<u>1,294</u>	<u>(47,115)</u>

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### Management's Discussion and Analysis

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**Credit Ratings and Bond Insurance** – At June 30, 2009, the Enterprise carried underlying ratings of “A2” and “A+” from Moody’s and Standard & Poor’s (S&P), respectively. At June 30, 2008, 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. In February 2009, MBIA provided further reinsurance on its public finance bond insurance portfolio through its newly created subsidiary, National Public Finance Guarantee Corporation (NPFGC). Moody’s and S&P initially rated NPFGC at “Baa1” and “A,” respectively. By July 2009, Moody’s and S&P had downgraded MBIA to “Ba3” and “BBB”, respectively, but affirmed NPFGC’s rating. On September 28, 2009 S&P downgraded MBIA to “BB+”.

**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 2009 and 2008, 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, 2009, the Enterprise had a \$150,000 authorized commercial paper program, with \$100,000 and \$50,000 in commercial paper outstanding as of June 30, 2009 and 2008 respectively.

**Cost of Debt Capital** – The interest rates on the Enterprise’s outstanding bonds range from 3.00% to 5.25% at June 30, 2009, unchanged from June 30, 2008 with a true interest cost of 3.95%. The outstanding State Revolving Fund Loans carry interest rates from 2.8% to 3.5%. The Enterprise’s short-term debt had interest rates ranging from 0.30% to 2.20% at June 30, 2009 and from 1.52% to 3.62% at June 30, 2008.

More information about the Enterprise’s debt activities is presented in notes 6 and 7 to the financial statements.

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

#### **Rate-Setting Process**

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 completed in the Spring of 2009, which includes examination of future revenue requirements and cost of service of the Enterprise, and was used to set the Enterprise rates for the next five years through fiscal year 2014.

The Commission adopted a five-year rate proposal that includes a 7.0% average increase in wastewater rates effective July 1, 2009 to meet projected costs and coverage requirements, followed by average increases of 7.0%, 5.0%, 5.0%, and 5.0% for fiscal years 2010, 2011, 2012, and 2013, respectively.

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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 approved average rate adjustments since July 1, 2004:

<b>Approved Average 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 %
July 1, 2008	9.0 %
July 1, 2009**	7.0 %
July 1, 2010	7.0 %
July 1, 2011	5.0 %
July 1, 2012	5.0 %
July 1, 2013	5.0 %

\* Adjustment effective July 14, 2007.

\*\* Denotes beginning of five-year rate increase.

### ***Master Plan***

The current Master Plan was finalized in 1974 and brought the City into compliance with Federal and State laws and reduced the number of combined sewer discharges. It resulted in a 25-year capital improvement and construction program that included the construction of the award-winning Oceanside Plant, upgrade of the Southeast Plant to secondary treatment, a new 4.5-mile ocean outfall, and the transport/storage boxes around the city.

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Since 2005, the Sewer System Improvement Program (SSIP) team has collected and analyzed extensive data, including input from the public, and has used it to develop a recommended program of improvements to address infrastructure challenges facing the wastewater system. The team presented these draft improvements at numerous public meetings and has now folded them into a draft Master Plan. Potential costs of the SSIP are estimated at \$3.5 billion. As an interim step, the Enterprise has an interim Capital Improvement Plan (Interim CIP) totaling \$297 million. The SSIP will be further reviewed by the Commission in early 2010.

Environmental review of the SSIP is anticipated to be complete in 2011. This process, led by the San Francisco Planning Department's Major Environmental Analysis division will identify environmental impacts of proposed actions, identify ways to avoid or reduce environmental damage, and enhance public participation in the planning process.

#### **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, 2009 and 2008

(In thousands)

	<u>2009</u>	<u>2008</u>
Assets:		
Current assets:		
Cash and investments with City Treasury	\$ 36,968	44,361
Cash and investments outside City Treasury	5	—
Receivables:		
Charges for services (net of allowance for doubtful accounts of \$1,486 in 2009 and \$943 in 2008)	34,699	34,290
Due from other governments	106	—
Due from other city departments	31	25
Interest	169	241
Advances	3	—
Total receivables	<u>35,008</u>	<u>34,556</u>
Inventories	<u>3,586</u>	<u>—</u>
Total current assets	<u>75,567</u>	<u>78,917</u>
Noncurrent assets:		
Restricted assets – cash and investments with City Treasury	61,477	52,808
Restricted assets – cash and investments outside City Treasury	—	27
Restricted assets – interest receivable	163	252
Capital assets not being depreciated	99,117	84,762
Capital assets, net of accumulated depreciation	1,295,806	1,276,099
Bond issuance costs (net of accumulated amortization of \$2,506 in 2009 and \$2,348 in 2008)	2,576	2,735
Total noncurrent assets	<u>1,459,139</u>	<u>1,416,683</u>
Total assets	<u>1,534,706</u>	<u>1,495,600</u>
Liabilities:		
Current liabilities:		
Accounts payable	7,891	7,096
Accrued payroll	3,498	3,296
Accrued vacation and sick leave, current portion	2,770	2,680
Accrued workers' compensation, current portion	774	822
Due to other city departments	556	—
Damage and claim liability, current portion	1,861	2,989
Bond and loan interest payable	5,108	5,626
Revenue bonds, current portion	37,130	35,665
Commercial paper	100,000	50,000
Loans payable, current portion	14,199	13,765
Current liabilities payable from restricted assets	6,998	4,605
Total current liabilities	<u>180,785</u>	<u>126,544</u>
Long-term liabilities:		
Other postemployment benefits obligation	11,413	5,684
Accrued vacation and sick leave, less current portion	2,308	2,318
Accrued workers' compensation, less current portion	3,639	3,853
Damage and claim liability, less current portion	8,499	6,055
Deferred revenue, refunds and other liabilities	544	89
Revenue bonds	255,399	291,808
Loans payable, less current portion	61,140	75,336
Pollution remediation obligation	375	—
Total long-term liabilities	<u>343,317</u>	<u>385,143</u>
Total liabilities	<u>524,102</u>	<u>511,687</u>
Net assets:		
Invested in capital assets, net of related debt	971,789	940,602
Restricted for debt service	1,360	1,316
Restricted for capital projects	11,126	—
Unrestricted	26,329	41,995
Total net assets	<u>\$ 1,010,604</u>	<u>983,913</u>

See accompanying notes to financial statements.



**SAN FRANCISCO WASTEWATER ENTERPRISE**

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2009 and 2008

(In thousands)

	<u>2009</u>	<u>2008</u>
Operating revenues:		
Charges for services	\$ 199,332	187,810
Other revenues	9,322	14,739
Total operating revenues	<u>208,654</u>	<u>202,549</u>
Operating expenses:		
Personal services	69,141	69,383
Contractual services	13,828	11,973
Materials and supplies	5,754	9,539
Depreciation	38,815	38,758
Services provided by other departments	31,634	26,021
Bad debt expense	576	—
General and administrative	2,302	1,719
Other	7,250	7,852
Total operating expenses	<u>169,300</u>	<u>165,245</u>
Operating income	<u>39,354</u>	<u>37,304</u>
Nonoperating revenues (expenses):		
Federal and state grants	224	—
Interest and investment income	1,992	4,099
Interest expense	(15,677)	(17,467)
Other, net	798	727
Total nonoperating expenses	<u>(12,663)</u>	<u>(12,641)</u>
Changes in net assets	26,691	24,663
Net assets at beginning of year	<u>983,913</u>	<u>959,250</u>
Net assets at end of year	\$ <u><u>1,010,604</u></u>	\$ <u><u>983,913</u></u>

See accompanying notes to financial statements.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Statements of Cash Flows

Years ended June 30, 2009 and 2008

(In thousands)

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Cash received from customers, including cash deposits	\$ 208,067	198,895
Cash paid to employees for services	(62,702)	(61,696)
Cash paid to suppliers for goods and services	(59,424)	(51,723)
Cash paid for judgments and claim	(459)	(1,554)
Net cash provided by operating activities	<u>85,482</u>	<u>83,922</u>
Cash flows from noncapital and related financing activities:		
Cash received for operating grants	118	—
Cash received from other nonoperating activities	798	885
Net cash provided by noncapital and related financing activities	<u>916</u>	<u>885</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(69,911)	(62,087)
Interest paid on revenue bonds and state loans	(17,959)	(20,325)
Principal paid on revenue bond	(35,665)	(34,500)
Principal paid on state revolving fund loans	(13,762)	(13,337)
Proceeds from issuance of commercial paper	227,500	185,000
Payments on commercial paper	(177,500)	(185,000)
Net cash used in capital and related financing activities	<u>(87,297)</u>	<u>(130,249)</u>
Cash flows from investing activities:		
Interest income received	2,153	5,396
Net cash provided by investing activities	<u>2,153</u>	<u>5,396</u>
Increase (decrease) in cash and cash equivalents	1,254	(40,046)
Cash and cash equivalents:		
Beginning of year	97,196	137,242
End of year	<u>\$ 98,450</u>	<u>97,196</u>
Reconciliation of cash and cash equivalents to the statements of net assets:		
Cash and investments :		
Unrestricted	\$ 36,973	44,361
Restricted	61,477	52,835
	<u>\$ 98,450</u>	<u>97,196</u>

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Statements of Cash Flows

Years ended June 30, 2009 and 2008

(In thousands)

	<u>2009</u>	<u>2008</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ <u>39,354</u>	<u>37,304</u>
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation	38,815	38,758
Provision for uncollectible accounts	543	120
Write-off and loss on disposal of capital assets	2,071	1,517
Changes in operating assets and liabilities:		
Accounts receivable	(952)	(3,775)
Due from other city departments	(6)	—
Advances	(3)	—
Inventories	(3,586)	—
Accounts payable	795	2,602
Accrued payroll	202	500
Accrued other postemployment benefits	5,729	5,684
Accrued vacation and sick leave	80	268
Accrued workers' compensation	(262)	531
Due to other funds	556	—
Pollution remediation obligation	375	—
Damage and claim liability	1,316	333
Deferred credits and other liabilities	455	80
Total adjustments	<u>46,128</u>	<u>46,618</u>
Net cash provided by operating activities	\$ <u><u>85,482</u></u>	<u><u>83,922</u></u>
Noncash transactions:		
Accrued capital asset costs	\$ 6,998	4,605

See accompanying notes to financial statements.

# SAN FRANCISCO WASTEWATER ENTERPRISE

Notes to Financial Statements

June 30, 2009 and 2008

(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, 2009 and 2008

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

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

**(c) Investments**

Investments include money market funds, which 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.

**(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 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 100 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.

**(f) Construction in Progress**

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

**(g) 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.

**(h) 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.

**(i) 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.

**(j) 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.

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

**(k) *Damage and 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.

**(l) *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. No arbitrage liability is due as of June 30, 2009 and 2008.

**(m) *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.

**(n) *Income Taxes***

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

**(o) *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 bi-monthly basis.

Revenues earned but unbilled are accrued as charges for services receivable on the statements of net assets.

**(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 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.

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

(r) ***Postemployment Benefits Other Than Pensions***

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 postemployment 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. The 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.

(s) ***Effects of New Pronouncements***

**Governmental Accounting Standards Board 49, *Accounting and Financial Reporting for Pollution Remediation Obligations***

For fiscal year ending June 30, 2009, the Enterprise has adopted GASB Statement 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. More detailed information about the Enterprise's environmental pollution remediation obligations is presented in note 12(d) to the financial statements.

To provide governments with better accounting guidance and consistency, GASB Statement 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, 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;



## SAN FRANCISCO WASTEWATER ENTERPRISE

### Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

- 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)

Due to the implementation of GASB 49, the Enterprise recorded \$375 and \$0 in pollution remediation costs as of June 30, 2009 and 2008, respectively.

### (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 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.

The restricted asset for bond reserves is held by an independent trustee outside the City investment pool. The balances as of June 30, 2009 and 2008 were \$0 and \$27, respectively.

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

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

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, 2009 and June 30, 2008 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>2009</u>	<u>2008</u>
Current assets:		
Cash and investments with City Treasury	\$ 36,968	44,361
Cash and investments outside City Treasury	5	—
Noncurrent assets – restricted assets:		
Cash and investments with City Treasury	61,477	52,808
Cash and investments outside City Treasury	—	27
Net cash provided by operating activities	<u>\$ 98,450</u>	<u>97,196</u>

The following table shows the percentage distribution of the City's pooled investments by maturity as of June 30, 2009:

<u>Investment maturities (in months)</u>			
<u>Under 1</u>	<u>1 to less than 6</u>	<u>6 to less than 12</u>	<u>12 to 60</u>
9.9%	27.0%	8.8%	54.3%

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

<u>Investment maturities (in months)</u>			
<u>Under 1</u>	<u>1 to less than 6</u>	<u>6 to less than 12</u>	<u>12 to 60</u>
6.9%	52.7%	11.6%	28.8%

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

**(4) Capital Assets**

Capital assets as of June 30, 2009 and 2008 consisted of the following:

	<u>Balance</u> <u>July 1, 2008</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2009</u>
Capital assets not being depreciated:				
Land and rights of way	\$ 21,787	—	—	21,787
Construction in progress	<u>62,975</u>	<u>73,538</u>	<u>(59,183)</u>	<u>77,330</u>
Total capital assets not being depreciated	<u>84,762</u>	<u>73,538</u>	<u>(59,183)</u>	<u>99,117</u>
Capital assets being depreciated:				
Facilities and improvements	2,057,625	51,757	—	2,109,382
Machinery and equipment	<u>51,583</u>	<u>6,765</u>	<u>(335)</u>	<u>58,013</u>
Total capital assets being depreciated	<u>2,109,208</u>	<u>58,522</u>	<u>(335)</u>	<u>2,167,395</u>
Less accumulated depreciation for:				
Facilities and improvements	(807,038)	(36,368)	—	(843,406)
Machinery and equipment	<u>(26,071)</u>	<u>(2,447)</u>	<u>335</u>	<u>(28,183)</u>
Total accumulated depreciation	<u>(833,109)</u>	<u>(38,815)</u>	<u>335</u>	<u>(871,589)</u>
Total capital assets being depreciated, net	<u>1,276,099</u>	<u>19,707</u>	<u>—</u>	<u>1,295,806</u>
Total capital assets, net	\$ <u><u>1,360,861</u></u>	<u><u>93,245</u></u>	<u><u>(59,183)</u></u>	<u><u>1,394,923</u></u>

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

	<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	42,856	63,315	(43,196)	62,975
	<u>65,024</u>	<u>63,315</u>	<u>(43,577)</u>	<u>84,762</u>
Total capital assets not being depreciated				
Capital assets being depreciated:				
Facilities and improvements	2,018,942	38,683	—	2,057,625
Machinery and equipment	46,224	5,734	(375)	51,583
	<u>2,065,166</u>	<u>44,417</u>	<u>(375)</u>	<u>2,109,208</u>
Total capital assets being depreciated				
Less accumulated depreciation for:				
Facilities and improvements	(770,443)	(36,595)	—	(807,038)
Machinery and equipment	(24,277)	(2,163)	369	(26,071)
	<u>(794,720)</u>	<u>(38,758)</u>	<u>369</u>	<u>(833,109)</u>
Total accumulated depreciation				
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>1,335,470</u>	<u>68,974</u>	<u>(43,583)</u>	<u>1,360,861</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.

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, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Interest expensed	\$ 15,677	17,467
Interest included in construction in progress	2,644	3,064
	<u>\$ 18,321</u>	<u>20,531</u>

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

During fiscal years ending in 2009 and 2008, the Enterprise expensed \$2,071 and \$1,517, 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**

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, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Deposits and investments with City Treasury:		
Sewer Bond Construction Fund	\$ 61,477	52,808
Deposits and investments outside City Treasury:		
2003A Clean Water Revenue Refunding Bond Fund	—	27
Interest receivable:		
Sewer Bond Construction Fund	<u>163</u>	<u>252</u>
Total restricted assets	<u>\$ 61,640</u>	<u>53,087</u>

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

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2009 and 2008

(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, 2009 and 2008, the Enterprise had \$100,000 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. The letter of credit will expire on February 13, 2012. For the year ended June 30, 2009, interest rates on the commercial paper ranged from 0.30% to 2.20% with due dates ranging from July 8, 2008 to October 8, 2009.

	<u>Interest rate</u>	<u>Beginning of the year</u>	<u>Additions</u>	<u>Reductions</u>	<u>End of the year</u>
June 30, 2009	0.30% to 2.20%	\$ 50,000	227,500	(177,500)	100,000
June 30, 2008	1.52% to 3.62%	50,000	185,000	(185,000)	50,000

Maturity dates of the June 30, 2009 outstanding balance ranged from July 16, 2009 to October 8, 2009.

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

Long-term liability activities for the years ended June 30, 2009 and 2008 were as follows:

	<u>Interest rate</u>	<u>Final maturity date</u>	<u>July 1, 2008</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2009</u>	<u>Due within one year</u>
Revenue bonds:							
Revenue Bonds, 2003 Refunding Series A	3.00 to 5.25%	2025	\$ 328,325	—	(35,665)	292,660	37,130
Less deferred amounts:							
For issuance premiums			17,366	—	(1,006)	16,360	—
For refunding loss			(18,218)	—	1,727	(16,491)	—
Total revenue bonds payable			327,473	—	(34,944)	292,529	37,130
State of California revolving loans	2.80 to 3.50%	2021	89,101	—	(13,762)	75,339	14,199
Other post employment benefits obligations			5,684	5,729	—	11,413	—
Accrued vacation and sick leave			4,998	2,904	(2,824)	5,078	2,770
Accrued workers' compensation			4,675	428	(690)	4,413	774
Damage and claims liability			9,044	1,460	(144)	10,360	1,861
Deferred revenue			89	535	(80)	544	—
Pollution remediation obligation			—	375	—	375	—
Total			\$ 441,064	11,431	(52,444)	400,051	56,734

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

	<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:							
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			<u>(19,944)</u>	<u>—</u>	<u>1,726</u>	<u>(18,218)</u>	<u>—</u>
Total revenue bonds payable			361,251	—	(33,778)	327,473	35,665
State of California revolving loans	2.80 to 3.50%	2021	102,438	—	(13,337)	89,101	13,765
Other postemployment 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 claim liability			8,711	1,182	(849)	9,044	2,989
Deferred revenue			<u>9</u>	<u>80</u>	<u>—</u>	<u>89</u>	<u>—</u>
Total			\$ <u>481,283</u>	<u>11,011</u>	<u>(51,230)</u>	<u>441,064</u>	<u>55,921</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 surety bond policy was issued by MBIA, which is currently rated "BB+" and "Ba3" by S&P and Moody's, respectively as of September 25, 2009. This policy is further reinsured by the National Public Finance Corporation, which is currently rated "Baal" and "A" by Moody's and S&P, respectively. 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, 2009 and 2008

(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, 2009 is as follows:

	<u>Principal</u>	<u>Interest</u>
Years ending June 30:		
2010	\$ 37,130	13,183
2011	26,320	11,827
2012	22,010	10,959
2013	23,095	9,941
2014	24,395	8,754
2015 – 2019	90,925	27,001
2020 – 2024	62,530	8,197
2025 – 2026	<u>6,255</u>	<u>315</u>
	292,660	\$ <u><u>90,177</u></u>
Less:		
Current portion	(37,130)	
Unamortized bond premiums and refunding loss	<u>(131)</u>	
Long-term portion as of June 30, 2009	\$ <u><u>255,399</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, 2009 and 2008

(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, 2009 and 2008 are summarized as follows:

Project	Date of issuance	Maturity date	Interest rate	Loan amount	June 30	
					2009	2008
					Amount outstanding	Amount outstanding
Oceanside	07/25/90	2010	3.4%	\$ 40,000	5,233	7,723
Oceanside	06/13/91	2011	3.5	32,376	4,255	6,275
Oceanside	12/24/93	2013	2.9	14,102	4,345	5,142
Mariposa	01/28/91	2011	3.5	7,624	1,009	1,488
Mariposa	06/24/92	2012	3.1	1,936	371	487
Lake Merced	01/29/92	2012	3.1	21,114	4,038	5,303
Islais Creek	10/08/92	2012	3.0	5,706	1,416	1,745
Islais Creek	09/07/93	2013	3.1	26,800	8,251	9,756
Islais Creek	06/17/94	2014	2.9	15,105	5,543	6,378
Islais Creek	01/09/96	2016	3.4	21,720	10,118	11,379
Islais Creek	08/04/00	2020	2.9	18,026	12,020	12,848
Rankin Pump	12/23/96	2016	2.8	27,000	13,222	14,679
Rankin Pump	01/23/01	2021	2.9	8,274	5,518	5,898
				\$ 239,783	75,339	89,101

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, 2009 is as follows:

	Principal	Interest	Total
Years ending June 30:			
2010	\$ 14,199	2,307	16,506
2011	14,648	1,855	16,503
2012	9,594	1,389	10,983
2013	8,322	1,099	9,421
2014	8,192	848	9,040
2015 – 2019	17,028	1,649	18,677
2020 – 2021	3,356	147	3,503
	75,339	\$ 9,294	84,633
Less current portion	(14,199)		
Long-term portion as of June 30, 2009	\$ 61,140		

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2009 and 2008

(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 2009 and 2008, and applicable revenues for 2009 and 2008 are as follows:

	<b>2009</b>	<b>2008</b>
Bonds issued with revenue pledge	\$ 396,270	396,270
Principal and interest remaining due at the end of the year	382,837	433,147
Principal and interest paid during the year	50,311	50,198
Net revenue for the year ended June 30	71,130	106,692

**(9) 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 2009, 2008 and 2007 varied 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 the fiscal years ended June 30, 2009, 2008 and 2007 at an actuarially determined contribution rate as a percentage of covers payroll of 4.99%, 5.91% and 6.24%, respectively. The Enterprise’s required and actual contributions were approximately \$2,320 in 2009, \$2,658 in 2008, and \$2,605 in 2007.

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.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2009 and 2008

(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 \$7,382 and \$6,992 in fiscal years 2009 and 2008, respectively, is determined by a charter provision based on similar contributions made by the 10 most populous counties in California.

Included in these amounts are \$1,862 and \$1,761 for 2009 and 2008, respectively, to provide postretirement benefits for retired employees, on a pay-as-you-go basis. In addition, the City allocated an additional \$55 and \$73 to the Enterprise's contribution allocation for payments made from the Health Service System for postretirement health benefits in 2009 and 2008, respectively.

The City has determined a City-wide Annual Required Contribution (ARC), interest on net Other postemployment 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 City's allocation of the OPEB related costs to the Enterprise for the year ended June 30, 2009 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 ending June 30, 2009 and 2008, for the amount contributed to the plan, and changes in the City's net OPEB obligation (dollar amount in thousands):

	<u>2009</u>	<u>2008</u>
Annual required contribution	\$ 7,585	7,518
Interest on net OPEB Obligation	235	—
Adjustment to ARC	<u>(174)</u>	<u>—</u>
Annual OPEB cost (expense)	7,646	7,518
Contribution made	<u>(1,917)</u>	<u>(1,834)</u>
Increase in net OPEB obligation	5,729	5,684
Net OPEB obligation – beginning of year	<u>5,684</u>	<u>—</u>
Net OPEB obligation – end of year	<u>\$ 11,413</u>	<u>5,684</u>

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.

# SAN FRANCISCO WASTEWATER ENTERPRISE

## Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

**(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 (2.5%) 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 as current bargaining agreements expire on June 30, 2010.

**(10) Related Parties**

Various common costs incurred by the Commission are allocated pro-ratably between the Enterprise, Hetch Hetchy Water and Power, and the Water 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 department and the information available. For the years ended June 30, 2009 and 2008, the Commission allocated \$18,884 and \$16,666, respectively, in administrative costs to the Enterprise, which is included in the financial 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 is \$2,258 and \$1,894 for the years ended June 30, 2009 and 2008 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 \$8,613 and \$7,672 for the years ended June 30, 2009 and 2008 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 non-residential rates established by the Enterprise.

The Water Enterprise, through the Customer Services Department, bills and collects sewer service charges on behalf of the Wastewater Enterprise.

The City’s Department of Public Works provides certain engineering and other services to the Enterprise and charges amounts designed to recover its costs. These services are primarily related to street cleaning, engineering, building repair, and sewer repair. This amount totaling approximately \$16,002 and \$12,685 for the years ended June 30, 2009 and 2008, respectively, has been included in services provided by other departments in the accompanying financial statements.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

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 \$7,019 and \$5,663 for the years ended June 30, 2009 and 2008, respectively, have been included in services provided by other departments in the accompanying financial statements.

**(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's 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 Claim 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, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

The changes for the damage and claim liabilities for the years ended June 30, 2009 and 2008 are as follows:

	<u>Beginning of year</u>	<u>Claims and changes in estimates</u>	<u>Claims paid</u>	<u>End of year</u>
2007 – 2008	\$ 8,711	1,182	(849)	9,044
2008 – 2009	9,044	1,460	(144)	10,360

**(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 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.

**(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.

**SAN FRANCISCO WASTEWATER ENTERPRISE**

Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

The changes in the liabilities for workers' compensation for the years ended June 30, 2009 and 2008 are as follows:

	<u>Beginning of year</u>	<u>Claims and changes in estimates</u>	<u>Claims paid</u>	<u>End of year</u>
2007 – 2008	\$ 4,144	1,236	(705)	4,675
2008 – 2009	4,675	428	(690)	4,413

**(d) Surety Bonds**

Bonds are required in most all 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. Additionally, all public officials with financial oversight responsibilities are provided liability coverage through a commercial Public Official Liability policy; including the Commission members, the General Manager, and the Chief Financial Officer. 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 coverages described are engineers, architects, design professionals and other licensed or certified professional service providers.

**(f) Builders' Risk**

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

**(g) Owner Controlled Insurance Program**

As of June 30, 2009, the Enterprise completed the final close out of its OCIP program. No further obligation for claims funding will continue in future years.

For more information about how the Enterprise's risk management program consolidates into and is coordinated with the City's, please see the City's CAFR.

**(12) Commitments and Litigation**

**(a) Commitments**

As of June 30, 2009, the Enterprise has outstanding commitments with third parties of \$23,879 for various capital projects and other purchase agreements for materials and services.

## SAN FRANCISCO WASTEWATER ENTERPRISE

### Notes to Financial Statements

June 30, 2009 and 2008

(Dollars in thousands, unless otherwise stated)

**(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 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.

**(d) Environmental Issue**

The City and County of San Francisco and the Enterprise have been listed as potentially responsible parties in the clean-up effort of Yosemite Creek due to the Enterprise's role in conveying contaminated flows to the receiving waters through the sewerage system. Yosemite Creek has been identified as having toxic sediments, primarily polychlorinated biphenyls. The U.S. Environmental Protection Agency is moving forward with a clean-up plan for these sediments. Contaminated flows emanating from a local industrial discharger in the drainage areas to Yosemite Creek is the likely responsible source of the contamination. As of June 30, 2009 the pollution remediation obligation reported in the accompanying statements of net assets is \$375, based on estimated contractual costs.

**(13) Subsequent Events**

***525 Golden Gate Avenue***

The City & County of San Francisco issued \$167.7 million in Certificates of Participation Series 2009 C and D on September 23, 2009 to fund the future headquarters of the San Francisco Public Utilities Commission (SFPUC) at 525 Golden Gate Avenue. The 2009 C series were issued for \$38.1 million on a tax-exempt basis, and the 2009 D series were issued for \$129.6 million as "Build America Bonds" on a taxable basis under the 2009 American Recovery and Reinvestment Act.

The City conveyed the real property to the Trustee 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 SFPUC is obligated to pay the City the lease costs, with each of its enterprise operations responsible for their respective proportional usage share of that cost. It is anticipated that these lease costs will be offset with reductions in costs associated with current SFPUC office rental expense.





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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 Wastewater 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, 2009, and have issued our report thereon dated November 9, 2009. 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 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

November 9, 2009