

Statement of Changes in the Balancing Account

June 30, 2011

(With Independent Auditors' Report Thereon)



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

Independent Auditors' Report

The City and County of San Francisco and the Wholesale Customers:

KPMG LLP has audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of the San Francisco Water Enterprise (Water Enterprise) and Hetch Hetchy Water and Power (Hetch Hetchy) under the jurisdiction of the San Francisco Public Utilities Commission (SFPUC), as of and for the year ended June 30, 2011, and has issued its reports thereon dated October 28, 2011. KPMG LLP and Yano Accountancy Corporation have also audited the Statement of Changes in the Balancing Account of the Water Enterprise for the year ended June 30, 2011, prepared pursuant to Article VII, Section 7.02 of the Water Supply Agreement (WSA), between the City and County of San Francisco (City) and certain Wholesale Customers in the counties of San Mateo, Santa Clara, and Alameda (Wholesale Customers) effective July 1, 2009. The Statement of Changes in the Balancing Account is the responsibility of the management of the SFPUC. Our responsibility is to express an opinion on the Statement of Changes in the Balancing Account based on our audit.

We conducted our audit of the Statement of Changes in the Balancing Account in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Statement of Changes in the Balancing Account is free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Water Enterprise and Hetch Hetchy 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 Statement of Changes in the Balancing Account, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall presentation of the Statement of Changes in the Balancing Account. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the Statement of Changes in the Balancing Account, referred to above, presents fairly, in all material respects, changes in the Balancing Account for the year ended June 30, 2011 in accordance with Article VII, Section 7.02 of the WSA.

This report is intended solely for the information and use of the Mayor, Board of Supervisors, San Francisco Public Utilities Commission, City management, and the Wholesale Customers and is not intended to be and should not be used by anyone other than these specified parties.



San Francisco, California March 14, 2012



Statement of Changes in the Balancing Account

Year ended June 30, 2011

		Total	Amount allocated to the wholesale customers
Wholesale Revenue Requirement:			
Operating and maintenance expenses:			
San Francisco Water Enterprise (Water Enterprise):			
Source of supply	\$	14,511,464	5,839,477
Pumping Treatment		4,509,943	
Transmission and distribution		34,469,720	22,566,433
Customer Accounts		48,206,943 5,987,971	14,349,762 119,759
Total Water Enterprise operating and maintenance expenses	\$_	107,686,041	42,875,431
Hetch Hetchy Water and Power (Hetch Hetchy):	=		
Operating expenses	\$	37,779,643	8,323,145
Maintenance expenses	4	16,599,797	4,098,555
Total Hetch Hetchy operating and maintenance expenses	\$_	54,379,440	12,421,700
Administrative and general (A&G) expenses:	_		
Countywide Cost Allocation Plan:			
Water Enterprise	\$	1,744,791	694,776
Hetch Hetchy		612,875	180,700
San Francisco Public Utilities Commission (Bureaus): Water Enterprise		21 227 224	
Hetch Hetchy		21,287,023	8,869,601
Other A&G – Water Enterprise		9,410,062 21,173,095	1,783,196 5,420,777
Other A&G – Hetch Hetchy		23,518,888	2,810,796
Compliance audit		135,200	67,600
Total administrative and general expenses	\$_	77,881,934	19,827,446
Property taxes (outside City only):			
Water Enterprise	\$	1,492,143	980,040
Hetch Hetchy	_	479,757	141,452
Total property taxes	\$_	1,971,900	1,121,492
Capital cost recovery – existing regional assets:			
Water Enterprise			24,972,661
Hetch Hetchy Capital cost contribution – new regional assets:			3,240,861
Debt-funded capital projects:			
Water Enterprise			19,215,130
Revenue-funded capital projects:			17,213,130
Water Enterprise			8,636,920
Hetch Hetchy			5,343,527
Total Visionals Program Programme			61,409,099
Total Wholesale Revenue Requirement			137,655,168
Balance due from Wholesale Customers, July 1, 2010 Adjustments to July 1, 2010 balance (Note 2a)			15,194,740 374,438
Adjusted balance due from Wholesale Customers, July 1, 2010			15,569,178
Interest on Adjusted Beginning Balance			187,887
Net Wholesale revenues billed (Note 6)			(132,212,624)
Calculated Wholesale Revenue Requirements			137,655,168
1984 balancing account repayment (Note 1d)			5,000,000
Interest on Working Capital Requirement (Note 1h)			113,501
Balancing Account, June 30, 2011			\$ 26,313,110

See accompanying notes to the statement of changes in the balancing account.

Notes to Statement of Changes in the Balancing Account
June 30, 2011

(1) Summary of Significant Accounting Policies

(a) Water Supply Agreement

The City & County of San Francisco (City) and the Wholesale Customers, represented by the Bay Area Water Supply and Conservation Agency (BAWSCA), entered into the Water Supply Agreement (WSA) on July 1, 2009. The WSA has a twenty-five year term with two options for five-year extensions, and contains provisions on rate-setting, accounting, and dispute resolution, including emergency and drought-pricing adjustment. The WSA has a 184 millions of gallons per day (mgd) Supply Assurance, and no increase in the Supply Assurance will be considered before December 31, 2018. During the period from 2009 to 2018, the WSA limits the quantity of water delivered to the Retail Customers and Wholesale Customers from the watersheds to 81 mgd and 184 mgd; respectively, or a total of 265 mgd.

(b) Basis of Accounting

Pursuant to the terms of the WSA, the accounts of the San Francisco Water Enterprise (Water Enterprise) and Hetch Hetchy Water & Power (Hetch Hetchy) are maintained in conformity with accounting principles generally accepted in the United States of America. The financial activities of the Water and Hetch Hetchy Enterprise Funds are accounted for on a flow of economic resource measurement focus, using the accrual basis of accounting. Under this method, all assets and liabilities associated with its operations are included on the statements of net assets; revenues are recognized when earned, and expenses are recognized when liabilities are incurred. The SFPUC is required to apply all applicable pronouncements of the Governmental Accounting Standards Board (GASB) as well as statements and interpretations of the Financial Accounting Standards Board and Accounting Principles Board opinions issued on or before March 30, 1989, unless those pronouncements or opinions conflict with GASB pronouncements. For copies of the Water Enterprise and Hetch Hetchy audited financial statements for the year ended June 30, 2011, please contact the Chief Financial Officer, San Francisco Public Utilities Commission, 1155 Market Street, 11th Floor, San Francisco, CA 94103.

Under the WSA, current operating expenditures, including debt service on bonds sold to finance regional water system improvements and regional capital projects funded from revenues, are allocated between Retail Customers and the Wholesale Customers on the basis of proportional annual use. The Balancing Account is maintained pursuant to the WSA, and by other provisions that may result from a settlement agreement prescribed in Article V11, Section 7.06 of the WSA.

(c) Balancing Account under the WSA

Pursuant to the terms of the WSA, the SFPUC is required to establish water rates applicable to the Wholesale Customers at the beginning of each fiscal year. The wholesale water rates are based on an estimate of revenues necessary to recover the cost of distributing water to the Wholesale Customers in accordance with the methodology outlined in Articles V and VI of the WSA.

Pursuant to Article VII, Section 7.02 of the WSA, the City is required to prepare the Wholesale Revenue Requirement (WRR) of the Water Enterprise and Hetch Hetchy after the close of each fiscal year based on the actual costs incurred in the delivery of water to the Wholesale Customers.

(Continued)

Notes to Statement of Changes in the Balancing Account
June 30, 2011

The difference between the wholesale revenues billed to the Wholesale Customers during the year and the "actual" WRR is recorded in a separate account (the Balancing Account) and represents the cumulative amount that is either owed to the Wholesale Customers (if wholesale revenues billed exceed the WRR) or owed to the SFPUC (if the WRR exceeds wholesale revenues billed). The Balancing Account is reflected on the Water Enterprise's financial statements as either an asset or a liability depending on the amount due from or owed to the Wholesale Customers.

In accordance with Article VI, Section 6.05B of the WSA, the amount recorded in the Balancing Account will earn interest at a rate equal to the average rate earned on the invested pooled funds of the City Treasurer, and is taken into consideration in the determination of subsequent wholesale water rates.

(d) Balancing Account under 1984 Settlement Agreement

The Agreement includes repayment provisions for the 1984 Balancing Account established under the Master Water Sales Contract (MWSC) and permits the SFPUC to factor these repayments in establishing wholesale rates.

Consistent with Article VI, Section 6.05, the SFPUC assumed a \$5 million repayment of the 1984 Balancing Account in setting fiscal year 2010-11 wholesale rates. In subsequent years, wholesale rate-setting will assume repayments of the 1984 Balancing Account of not less than \$2 million and not more than \$5 million annually until the 1984 Balancing Account is paid in full, including any interest accreting on the unpaid balance.

The amount of the final 1984 Balancing Account (fiscal year 2008-09) has been settled as of January 12, 2012 through a final settlement agreement entered into by the SFPUC and the Wholesale Customers.

(e) Basis of Allocating Operating Costs

Pursuant to the terms of the WSA, direct Water Enterprise and specific Hetch Hetchy expenses are allocated to the applicable user. Regional Water Enterprise operating and maintenance expenses related to source of supply, treatment, transmission and distribution are allocated based on proportional annual use.

Two percent of Water Enterprise customer service expenses are allocated to the Wholesale Customers. Water Enterprise administrative and general expenses, including the assigned costs under the City's Countywide Cost Allocation Plan (COWCAP), services provided by other City departments and water administration, are allocated based on the ratio of total allocated wholesale operating and maintenance expenses to total Water Enterprise operating and maintenance expenses. Certain SFPUC bureaus expenses are identified as regional operations and maintenance expenses and allocated to the Wholesale Customers on proportional annual use basis. Remaining SFPUC bureaus expenses are allocated to the Water Enterprise on the basis of labor costs incurred by the various SFPUC enterprises, and then allocated to the Wholesale Customers on the basis of proportional annual use.

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Notes to Statement of Changes in the Balancing Account
June 30, 2011

Water Enterprise property taxes are levied against properties owned by the City in Alameda, San Mateo, and Santa Clara counties, and operated and managed by the SFPUC. Hetch Hetchy property taxes are levied against properties owned by the City in Tuolumne, Stanislaus, San Joaquin, and Alameda counties, and operated and managed by the SFPUC. All property taxes paid, net of (1) reimbursements received from lessees and permit holders and (2) refunds from taxing authorities, are considered regional expenses. The Wholesale Customers are allocated a share of Water Enterprise and Hetch Hetchy property tax expenses on the basis of proportional annual use and adjusted proportional annual use, respectively.

Forty-five percent of joint Hetch Hetchy costs are water-related expenses. The water-related share of joint Hetch Hetchy operating, maintenance, general and administrative expenses are allocated based upon on adjusted proportional annual use.

Fifty percent of the cost of the compliance audit described in Article VII, Section 7.04 is allocated to the Wholesale Customers.

(f) Capital Cost Recovery – Existing Regional Assets

Under Article V, Section 5.03 of the WSA, the SFPUC will recover the wholesale share of capital costs of regional net plant in service and revenue-funded construction work in process existing as of June 30, 2009, the date of expiration of the MWSC, over a twenty-five year period at an interest rate of 5.13%. Direct wholesale and regional capital assets of the Water Enterprise and Hetch Hetchy were allocated 70.1% and 64.2%, respectively to the Wholesale Customers per Article V, Section 5.03D. The WSA permits the Wholesale Customers to apply prepayments of at least \$10 million on the unpaid principal balance at any time, in whole or in part, without penalty or early payment premium, at which time the remaining annual payments will be recalculated.

(g) Capital Cost Contribution – New Regional Assets

The wholesale share of Water Enterprise and Hetch Hetchy capital expenditures incurred during the term of the WSA are allocated on the basis of proportional annual use and adjusted proportional annual use, respectively. These costs include net annual debt service and appropriations for revenue-funded regional capital additions.

Capital expenditures financed by debt are allocated to bond proceeds on a first-in, first-out basis to the extent allowable by law and the terms of the applicable indenture. In accordance with Article V, Section 5.04A of the WSA, the SFPUC issues a certificate on the expected use of bond proceeds within 15 days of issuance (Attachment L-2), and a report on actual expenditures of and earnings on bond proceeds after the proceeds are considered substantially expended (Attachment L-3). The Wholesale Customers' proportionate share of net annual debt service is based on the expected use of bond proceeds on regional projects. Any differences between expected and actual expenditures on regional projects are applied in the year the proceeds are substantially expended. For copies of Attachments L-2 or L-3 previously issued for each indenture, please contact the Chief Financial Officer, San Francisco Public Utilities Commission, 1155 Market Street, 11th Floor, and San Francisco, CA 94103.

Notes to Statement of Changes in the Balancing Account
June 30, 2011

In fiscal year 2009-10, in accordance with Article VII, Section 7.06 of WSA and as referenced in note 8, SFPUC and the Wholesale Customers clarified certain procedures relating to the administration of the accounting, debt administration, and capital cost contribution components of Article V, Section 5.04A. The application of these provisions resulted in the reissuance of L-3 schedules for Bond Series 2006A and Bond Series 2009A. Consequently, the revised L-3 schedules changed the previous percent allocation of debt service between the costs prior to July 1, 2009, the retail, and the regional projects. The revised percent allocation of debt service is shown in note 5a Table 2. For copies of the Settlement Agreement (Article VII, Section 7.06 of WSA) for fiscal year 2009-10, please contact the Chief Financial Officer, San Francisco Public Utilities Commission, 1155 Market Street, 11th Floor, and San Francisco, CA 94103.

The wholesale share of revenue-funded regional capital additions included in SFPUC's budget is based on an annual determination of estimated proportional annual use for the fiscal year. The amounts will be reviewed and administered pursuant to Article VI, Section 6.08 in fiscal year 2014-15.

(h) Wholesale Revenue Coverage Reserve and Working Capital Requirements

Under Article VI, Section 6.06 of the WSA, the SFPUC may require periodic deposits by the Wholesale Customers to fund a debt service coverage reserve account (the Wholesale Revenue Coverage Reserve) established and maintained by the SFPUC to meet debt service and minimum working capital requirements. The WSA sets the formula to calculate the debt service coverage and the working capital requirement. The ceiling of the Wholesale Revenue Coverage Reserve is the highest amount between the required debt service coverage and the working capital. Under Article VI, Section 6.06B of the WSA, any balance in the Wholesale Revenue Coverage Reserve in excess of the actual wholesale coverage requirement may be applied as a credit against wholesale rates in the following fiscal year, unless otherwise instructed by BAWSCA.

The Debt Service Coverage is calculated as the lesser of: (i) 25% of the Wholesale Customers' share of net annual debt service for the applicable fiscal year, or (ii) the amount necessary to meet the Wholesale Customers' proportionate share of debt service coverage, less any credits for previous deposits and interest accruing to the Wholesale Revenue Coverage Reserve.

The working capital requirement prescribed in Article VI, Section 6.07, is one-sixth (2 months) of the annual wholesale allocation of operation and maintenance, administrative and general, and property tax expenses for the Water Enterprise and Hetch Hetchy. If the Wholesale Revenue Coverage Reserve is less than the calculated working capital requirement, the Wholesale Customers are charged interest on the difference. This amount is shown as an adjustment to the Balancing Account in the subsequent fiscal year.

Refer to note 7 for the calculation of the adequacy of debt service coverage and working capital requirement.

Notes to Statement of Changes in the Balancing Account
June 30, 2011

(2) Balancing Account Under the WSA

(a) Balancing Account Activity

The following summarizes Balancing Account under the WSA activity relating to the year ended June 30, 2011.

	As previously reported	Adjustments		Adjusted balance
Balancing account under the WSA, June 30, 2010	\$ 15,194,740	(37,185)		15,157,555
Wholesale revenue coverage reserve credits Interest on settlement agreement	-	406,516		406,516
adjustments		5,107		5,107
Balancing account under the WSA, as adjusted, June 30, 2010 Interest on adjusted beginning balance (net of Sec. 7.06 interest	\$ 15,194,740	374,438	:	15,569,178
adjustment)				187,887
Net wholesale revenues billed Calculated wholesale revenue				(132,212,624)
requirement				137,655,168
1984 Balancing Account repayment				5,000,000
Working capital requirement				113,501
Balancing Account under the WSA, June 30, 2011			\$	26,313,110

(b) Article VII, 7.06 Settlement Agreement – Fiscal Year 2009-10

In accordance with Article VII, Section 7.06 of the WSA, and as referenced in note 8, the SFPUC and the Wholesale Customers have a pending settlement agreement relating to previously disputed costs attributable to the year ended June 30, 2010. In the pending settlement agreement, the parties have reached a resolution on the classification and treatment of these costs. Credits referenced in the settlement agreement have been included as an adjustment to the Balancing Account balance as of July 1, 2010. These credits pertain to a reclassification of certain operations, maintenance, administrative and general costs from the Wholesale to Retail Customers.

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Notes to Statement of Changes in the Balancing Account
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These adjustments are summarized below:

Fiscal year 2009-10 settlement adjustments		Amount
Adjustments to July 1, 2010 beginning balance Settlement agreement – operation expenses Settlement agreement – capital cost contribution – new regional assets Settlement agreement – wholesale revenue – coverage reserve credit	\$	(1,663,247) 1,626,062 406,516
Subtotal		369,331
Interest on adjustments		5,107
Total adjustments for fiscal year 2009-10 included in fiscal year 2010-11	\$_	374,438

In addition to the adjustments of costs identified in the preceding table, the SFPUC and the Wholesale Customers have clarified certain procedures relating to the administration of Section 5.04A of the WSA as referenced in note 1 (g). Details of these procedures are contained in the Settlement Agreement (Section 7.06 of the WSA) for the year ended June 30, 2010 expected to be signed after the issuance of this report. For copies of the Settlement Agreement (Section 7.06 of the WSA) for the year ended June 30, 2010, please contact the Chief Financial Officer, San Francisco Public Utilities Commission, 1155 Market Street, 11th Floor, and San Francisco, CA 94103.

(3) Balancing Account under 1984 Settlement Agreement

(a) 1984 Balancing Account Activity

As referenced in note 1(d), the 1984 Balancing Account balance was finalized on January 12, 2012 when the fiscal year 2008-09 Settlement Agreement was executed. Under the settlement agreement, no further adjustments are permitted for fiscal year 2008-09.

Notes to Statement of Changes in the Balancing Account
June 30, 2011

The following summarizes 1984 Balancing Account activity relating to the years ended June 30, 2011:

	As previously reported	Adjustments	_	Adjusted balance
1984 Balancing Account, July 1, 2009 Interest on adjusted beginning	\$ 21,358,347	(970,070)		20,388,277
balance Other adjustments for existing capital	295,386	(38,327)		257,059
costs	70,623			70,623
1984 Balancing Account credits (note 1d)	(2,000,000)		_	(2,000,000)
1984 Balancing Account, June 30, 2010	\$ 19,724,356	(1,008,397)	=	18,715,959
Interest on adjusted beginning balance 1984 Balancing Account credits				224,592
(note 1d)				(5,000,000)
1984 Balancing Account, June 30, 2011			\$	13,940,551

(b) Adjustments to the 1984 Balancing Account as of July 1, 2009

Credits referenced in the settlement agreement have been included as an adjustment to the July 1, 2010 Balancing Account. These credits pertain to a reclassification of certain operations, maintenance, administrative and general costs from the Wholesale to Retail Customers.

These adjustments are summarized below:

Fiscal year 2008-09 Settlement Adjustments		Amount
Adjustments to July 1, 2009 beginning balance: Operating and maintenance costs – water enterprise Administrative and general costs – water enterprise Joint bureau expense	\$	(846,977) (66,623) (56,470)
Subtotal		(970,070)
Interest on adjustments	_	(38,327)
Total adjustments for fiscal year 2008-09 included in fiscal year 2010-11	\$_	(1,008,397)

Notes to Statement of Changes in the Balancing Account
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(4) Capital Cost Recovery - Existing Regional Assets

Attachments K-1 through K-4

In accordance with procedures mutually agreed upon between the SFPUC and BAWSCA, acting on behalf of the Wholesale Customers, the net book values of existing capital assets per Revised Attachments K-1 through K-4 were reconciled to the audited financial statements of the Water Enterprise and Hetch Hetchy as of fiscal year ending June 30, 2009. For copies of the audited financial statements for the Water Enterprise and Hetch Hetchy for the year ended June 30, 2009 or the report on agreed-upon procedures applied to Revised Attachments K-1 through K-4, please contact the Chief Financial Officer, San Francisco Public Utilities Commission, 1155 Market Street, 11th Floor, and San Francisco, CA 94103.

The net book values as of June 30, 2009 and the annual wholesale revenue requirement referenced in Attachment K, as approved by the SFPUC and BAWSCA, acting on behalf of the Wholesale Customers, are summarized below:

		Net book values as of June 30, 2009				
		Water Enterprise	Hetch Hetchy	Total		
Regional System Net Plant Add Construction Work in Progress	\$	485,580,249	63,528,861	549,109,110		
(CWIP)	_	35,072,164	7,507,984	42,580,148		
Total Regional Net Plant and CWIP	\$	520,652,413	71,036,845	591,689,258		
Wholesale Share of Net Plant Wholesale Share of CWIP	\$ _	340,391,755 11,025,550	40,785,529 4,820,126	381,177,284 15,845,676		
Total wholesale share	\$_	351,417,305	45,605,655	397,022,960		
Interest rate Term (Years) Total, due from Wholesale Customers	\$	5.13% 25 24,972,661	5.13% 25	5.13%		
rotal, due nom wholesale Customers	Ф	44,912,001	3,240,861	28,213,522		

Notes to Statement of Changes in the Balancing Account
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The activity in the liability account for existing regional assets for the year ended June 30, 2011 is summarized below. Between July 1, 2009 and June 30, 2011, the Wholesale Customers have applied \$14,594,665 and \$1,894,042 in payments on the outstanding principal balances attributable to the Water Enterprise and Hetch Hetchy, respectively. Twenty three annual payments remain.

	_	Water Enterprise	Hetch Hetchy
Principal balance as of July 1, 2010 Principal payments	\$	344,306,710 7,484,069	44,682,868 971,255
Principal balance as of June 30, 2011	\$ _	336,822,641	43,711,613
Number of annual payments remaining		23	23
Payments received from Wholesale Customers: Applied to principal Applied to interest	\$	7,484,069 17,488,592	971,255 2,269,606
Total	\$	24,972,661	3,240,861

(5) Capital Cost Contribution – New Regional Assets

(a) Debt-funded Capital Projects – Water Enterprise

The Water Enterprise has previously issued revenue bonds to fund the construction of new regional capital assets. As of June 30, 2011, outstanding debt related to the construction of new regional capital assets included Water Revenue Bonds 2006 Series A, 2009 Series A, 2009 Series B, 2010 Series B, 2010 Series E, 2010 Series F and 2010 Series G. For fiscal year ended June 30, 2011, the Water Enterprise paid \$127,305,580 in debt service. The debt service is reduced to \$47,270,936 when capitalized interest and other interest earnings are applied against the gross debt service payments.

Notes to Statement of Changes in the Balancing Account
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The following tables summarize debt service expenditures on outstanding debt related to the construction of new regional assets that was determined to be allocable to the Retail and Wholesale Customers:

Table 1 - Debt Service Expenditures - New Regional Assets

	_	Principal	Net interest	Total
2006 Series A	\$	9,198,333	22,153,142	31,351,475
2009 Series A		4,306,667	1,424,952	5,731,619
2009 Series B		4,406,667	465,325	4,871,992
2010 Series B		_	2,471,517	2,471,517
2010 Series D		_	94,953	94,953
2010 Series E		_	1,551,962	1,551,962
2010 Series F			(77,591)	(77,591)
2010 Series G	_		1,275,009	1,275,009
	\$_	17,911,667	29,359,269	47,270,936

Table 2 - Wholesale Customers Debt Service Allocation (%)

	Costs prior to July 1, 2009	Retail projects	Regional projects	Total
2006 Series A	33.71%	13.10%	53.19%	100.00%
2009 Series A	31.65	10.43	57.92	100.00
2009 Series B	_	12.63	87.37	100.00
2010 Series B		8.23	91.77	100.00
2010 Series D	_	6.62	93.38	100.00
2010 Series E		6.62	93.38	100.00
2010 Series F		_	100.00	100.00
2010 Series G	_	-	100.00	100.00

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Table 3 - Wholesale Customers Debt Service Allocation (\$)

	Costs prior to July 1, 2009	Retail projects	Regional projects	Total	Proportional annual use	Total wholesale debt service
2006 Series A	\$ 10,568,582	4,107,043	16,675,850	31,351,475	65.68% \$	10,952,698
2009 Series A	1,814,057	597,808	3,319,754	5,731,619	65.68	2,180,414
2009 Series B	· · · · —	615,333	4,256,659	4,871,992	65.68	2,795,774
2010 Series B	_	203,406	2,268,111	2,471,517	65.68	1,489,695
2010 Series D		6,286	88,667	94,953	65.68	58,236
2010 Series E	_	102,740	1,449,222	1,551,962	65.68	951,849
2010 Series F	_	_	(77,591)	(77,591)	65.68	(50,962)
2010 Series G		() =11	1,275,009	1,275,009	65.68	837,426
	\$12,382,639	5,632,616	29,255,681	47,270,936	\$	19,215,130

(b) Debt-funded Capital Projects - Hetch Hetchy

The Wholesale Customers are allocated a share of water-related costs on the basis of adjusted proportional annual use. Joint assets are allocated 45% to water-related activities.

Hetch Hetchy had no water-related debt outstanding at June 30, 2011. Therefore, no debt service has been allocated to the Wholesale Customers.

(c) Revenue-funded Capital Projects – Water Enterprise

The following is a summary of the wholesale share of appropriations for regional revenue-funded capital projects under the Water Enterprise for the year ended June 30, 2011:

Project #	Project	FY 2010-11 appropriations	Allocation%	Wholesale share
CUW262	R&R – Treatment Facilities	\$ 3,200,000	65.68% \$	2,101,760
CUW263	R&R – Conveyance & Transmission	5,850,000	65.68	3,842,280
CUW264	Watersheds & Right of Way	500,000	65.68	328,400
FUW100	Regional Facilities Maintenance	3,600,000	65.68	2,364,480
	Total	\$ 13,150,000	\$_	8,636,920

(d) Revenue-Funded Capital Projects – Hetch Hetchy

The Wholesale Customers are allocated a share of water-related costs on the basis of adjusted proportional annual use. Joint assets are allocated 45% to water-related activities.

Notes to Statement of Changes in the Balancing Account
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The following is a summary of the wholesale share of Hetch Hetchy water-related revenue-funded capital projects based on adjusted proportional annual use for the year ended June 30, 2011:

Project #	Project		FY 2010-11 appropriations	Water related	Allocation%	Wholesale share
CUH975 CUH977	R&R – Infrastructure R&R – Facilities	\$	2,898,971	45.00%	65.52% \$	854,733
CUH975	Maintenance R&R – Infrastructure	_	10,000,000 2,351,029	45.00 100.00	65.52 65.52	2,948,400 1,540,394
	Total	\$_	15,250,000		\$_	5,343,527

(6) Wholesale Revenue Billings

During fiscal year 2010-11, the SFPUC billed a total of \$135,234,294 in wholesale revenue for costs of service associated with deliveries from the regional water system. A portion of these billings relate to deposits by the Wholesale Customers to meet their Wholesale Coverage and Working Capital Reserve requirements per Article VI, Section 6.06 and Section 6.07 of the WSA, respectively, which reduced total wholesale revenue billings.

Gross and net wholesale revenue billings are summarized below:

Gross wholesale revenues billed	\$	135,234,294
Deposits to wholesale revenue		
coverage reserve	_	(3,021,670)
Net wholesale revenues billed	\$_	132,212,624

(7) Wholesale Revenue Coverage Reserve

During the year ended June 30, 2011, \$3,021,670 in deposits to the Wholesale Revenue Coverage Reserve account were made in accordance with Article VI, Section 6.06 of the WSA. An amount of \$406,516 was added to the wholesale revenue coverage reserve as an outcome of a settlement agreement in fiscal year 2009-10 as referenced in note 2(a). As of June 30, 2011, the Wholesale Revenue Coverage Reserve balance was \$7,916,419, representing total deposits and settlement agreement adjustment in fiscal year 2009-10.

The Debt Service Coverage Requirement was determined to be \$4,803,783, resulting in a coverage reserve excess of \$3,112,636 when compared to the Wholesale Revenue Coverage Reserve balance.

Notes to Statement of Changes in the Balancing Account
June 30, 2011

The Working Capital Coverage Requirement as of June 30, 2011 was \$12,707,678, while the Wholesale Revenue Coverage Reserve balance was \$7,916,419; deficient by \$4,791,259 in order to meet the Wholesale Customers' proportionate share of the working capital requirement. An adjustment of \$4,835 for accrued interest on the working capital requirement not met will be made to the Balancing Account in the subsequent fiscal year.

	_	Wholesale revenue coverage reserve		Debt service coverage requirement	Working capital coverage requirement
Balance, June 30, 2010	\$	4,488,233			
Adjustment due to settlement agreement (note 2b) Deposits to wholesale revenue		406,516			
coverage reserve	_	3,021,670	-		
Balance, June 30, 2011	\$ _	7,916,419	=		
Calculation of adequacy of reserve requirement: Coverage reserve requirement, June 30, 2011 Wholesale revenue coverage reserve balance, June 30, 2011			\$	(4,803,783) 7,916,419	(12,707,678) 7,916,419
Coverage reserve – excess (deficiency)			\$	3,112,636	(4,791,259)
Interest due to (from) wholesale customers	\$	(4,835)		76,370	(81,205)

(8) Subsequent Events – Fiscal Year 2009–10 Settlement Agreement

In accordance with Article VII, Section 7.06 of the WSA, SFPUC and the Wholesale Customers have a pending settlement agreement for fiscal year 2009-10. Provisions of this pending agreement have financial impacts in the calculation of the Balancing Account under the WSA in the fiscal year 2009-10 and the fiscal year 2010-11. The financial impacts of this pending agreement are included in this report, and are referenced in note 1(g), note 2(a) and note 2(b). SFPUC and the Wholesale Customers do not anticipate significant changes in the pending agreement from the date of issuance of this report.



March 29, 2012

The Honorable Mayor and Board of Supervisors City and County of San Francisco, and the Wholesale Customers

Ladies and Gentlemen:

KPMG LLP has audited the financial statements of the San Francisco Water Enterprise ("Water Enterprise") and Hetch Hetchy Water and Power Enterprise ("Hetch Hetchy"), under the jurisdiction of the San Francisco Public Utilities Commission (SFPUC) as of and for the year ended June 30, 2011, and has issued its reports thereon dated October 28, 2011. KPMG LLP and Yano Accountancy Corporation have also audited the Statement of Changes in the Balancing Account of the Water Enterprise and Hetch Hetchy for the year ended June 30, 2011, and issued our report on the Statement of Changes in the Balancing Account, dated March 14, 2012.

In planning and performing our audit of the Statement of Changes in the Balancing Account of the Water Enterprise and Hetch Hetchy, as of and for the year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the SFPUC's internal control over financial reporting ("internal control") as a basis for designing our auditing procedures for the purpose of expressing our opinion Statement of Changes in the Balancing Account, but not for the purpose of expressing an opinion on the effectiveness of the SFPUC's internal control. Accordingly, we do not express an opinion on the effectiveness of the SFPUC's internal control.

A deficiency in internal control 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 a combination of deficiencies, in internal control, 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 was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. We consider the deficiency in the SFPUC's internal control as Finding 2011-01 to be a material weakness. We did not audit the views of SFPUC management and, accordingly, express no opinion on them.

The Honorable Mayor and Board of Supervisors City and County of San Francisco, and the Wholesale Customers March 29, 2012 Page 2 of 2

This communication is intended solely for the information and use of the Mayor, Board of Supervisors, the San Francisco Public Utilities Commission, City management, and the Wholesale Customers and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

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FINDING 2011-01: CONTROLS OVER PROPER CLASSIFICATION OF EXPENDITURES

Background

SFPUC prepares Water Supply Agreement ("WSA") Attachment N2 (the Wholesale Revenue Requirement or "WRR") together with a number of supporting schedules. Controls over the completeness and accuracy of WRR preparation include ensuring that: 1) all schedules are mathematically correct; 2) all required account-level adjustments are recorded in the schedules; and 3) all significant account balances and contracts are evaluated for proper classification.

Article VII Section 7.06 of the Water Supply Agreement (WSA) allows the Wholesale Customers to review the calculation of the annual Wholesale Revenue Requirement (WRR) and the changes in the balancing account. Wholesale Customers commence its review at the end of each fiscal year when the SFPUC issues the compliance audit report. Although articles 5 and 6 of the WSA provide guidance in the calculation of the WRR, differences of interpretation arise between the Wholesale Customers and SFPUC. These differences, or adjustments, are formalized through a settlement agreement. The financial impact of the 7.06 Settlement Agreement Adjustments results in an adjustment to the balancing account.

Observations

We observed the following during our fiscal year 2011 audit procedures:

- An Attachment to the N2 schedule had a mathematical error that was not detected by management.
- A manual adjustment to reclassify certain account balances was not calculated correctly. This is a repeat finding from last year involving the same account.
- Several invoices were not classified correctly. We requested SFPUC to evaluate the classification of one index code/sub-object account balance. The resulting evaluation resulted in the reclassification of more than 50% of the account balance in both 2011 and 2010 to Water Enterprise ("WTR") Operations & Maintenance ("O&M") Retail from WTR O&M Regional.

Each of the above resulted in proposed adjustments. Management agreed with all of the proposed adjustments and reflected them in the Statement of Changes in the Balancing Account. The 2010 adjustment was included in the WSA §7.06 Settlement Agreement, which adjusted the Balancing Account Balance under the WSA as of July 1, 2010.

In addition, SFPUC management has informed us of certain contract interpretations affecting the fiscal year 2012 balancing account in which the underlying transactions occurred before our fiscal 2011 audit procedures.

Recommendation

We recommend SFPUC ensure that proper controls are implemented to ensure the proper review of classification of account balances and significant transactions within accounts and WSA reports. We also recommend that SFPUC evaluate its policies and procedures for identifying, communicating and resolving potential differences of interpretation and application of WSA provisions, particularly when activities occur that are unforeseen by the WSA.

Views of SFPUC Management

Management concurs with the findings.

Fiscal year 2010-11 is the second year of the WSA. Since the start of this agreement, SFPUC management has taken steps to improve internal controls through accounting and monitoring procedures related to WSA provisions. In addition, management continues to seek areas of improvement in WSA implementation by updating process narratives for the WRR calculation, budget instructions, debt issuance, and other areas that impact the WSA. These process narratives identify staff responsible for each process and result in greater accountability.

Regarding the cell calculation error in the N2 schedule, management recognizes the importance of accuracy and will improve the review process. The second and third noted observations are attributed to erroneous index-code/subobject-code classification. Prior to the first year of WSA implementation, the SFPUC initiated an index code mapping process in accordance with the WSA. This review and mapping has provided clarification to personnel using these codes. Management will revisit the review once again to ensure all codes are properly mapped and used. This review is expected to be completed within 6 months.

Regarding charges from other City departments, management will continue to be proactive and work closely with other departments to ensure proper classification of interdepartmental expenditures and avoid further manual reclassifications.

Management recognizes the importance of good internal controls and is committed to continuous improvement in its stewardship of the WSA particularly as it relates to the Statement of Changes in the Balancing Account.