SAN FRANCISCO WASTEWATER ENTERPRISE

Financial Statements

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

SAN FRANCISCO WASTEWATER ENTERPRISE

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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, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the Enterprise's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in note 1, the financial statements of the Enterprise are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the City that is attributable to the transactions of the Enterprise. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2012 and 2011, 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, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2012 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.

KPMG LLP is a Delaware limited liability partnership, the U.S. member firm of KPMG International Cooperative ("KPMG International"), a Swiss entity.

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 15 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

October 25, 2012

SAN FRANCISCO WASTEWATER ENTERPRISE

Management's Discussion and Analysis

June 30, 2012 and 2011

(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, 2012 and 2011. 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
- Next Year's Rates
- Request for Information

Organization and Business

The San Francisco Public Utilities Commission (SFPUC or the Commission) is an agency of the City and County of San Francisco (the City) that is responsible for the maintenance, operation, and development of three utility enterprises: Water, Hetch Hetchy Water and Power, and Wastewater (the Enterprise). The primary responsibility of the Enterprise is to protect the public health and the surrounding bay and ocean receiving waters by collecting, transmitting, treating, and discharging storm and sanitary flows generated in the service area. This includes 993 miles of combined storm and sanitary collection system pipes, sewer mains, transport/storage boxes, other storage structures and tunnels. San Francisco is the only coastal city in California with a combined sewer system that collects both waste water and storm water in the same network of pipes and provides treatment to remove harmful pollutants before discharging into the San Francisco Bay and Pacific Ocean. 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 costs of service through user fees based on the volume and strength of sanitary flow. The Enterprise serves 147,150 residential accounts, which discharge about 18.3 million units of sanitary flow per year (measured in hundreds of cubic feet, or ccf) and 16,166 non-residential accounts, which discharge 8.6 million ccf per year.

The Enterprise also maintains a Water Pollution Prevention Program that works to keep pollutants from entering the City's sewer system and street storm drains. This includes an industrial and commercial pre-treatment program, which monitors individual businesses that have been issued permits to discharge wastewater into the City's sewer system, as well as outreach, education, and a best management practices program for residents, businesses and governments.

Overview of the Financial Statements

The Enterprise's financial statements include:

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

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

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

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

Financial Analysis

Financial Highlights for Fiscal Year 2012

- Total assets of the Enterprise exceeded total liabilities by $1,100,353.
- Net assets increased by $39,072 or 3.7% during the fiscal year.
- Capital assets, net of accumulated depreciation, increased by $93,670 or 6.5% to $1,534,137.
- Operating revenues, excluding interest and investment income and other non-operating revenues, increased by $14,939 or 6.5% to $244,155.
- Operating expenses, excluding interest expenses and non-operating expenses, increased by $16,773 or 9.4% to $195,857.

Financial Highlights for Fiscal Year 2011

- Total assets of the Enterprise exceeded total liabilities by $1,061,281.
- Net assets increased by $35,945 or 3.5% during the fiscal year.
- Capital assets, net of accumulated depreciation, increased by $42,855 or 3.1% to $1,440,467.
- Operating revenues, excluding interest and investment income and other non-operating revenues, increased by $19,373 or 9.2% to $229,216.
- Operating expenses, excluding interest expenses and non-operating expenses, decreased by $6,428 or 3.5% to $179,084.

Financial Position

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

Table 1

Comparative Condensed Net Assets

June 30, 2012, 2011 and 2010

	2012	2011	2010	2012 – 2011 change	2011 – 2010 change
Total assets:					
Current and other assets	$ 184,439	252,736	287,272	(68,297)	(34,536)
Capital assets, net of accumulated depreciation	1,534,137	1,440,467	1,397,612	93,670	42,855
Total assets	1,718,576	1,693,203	1,684,884	25,373	8,319
Current liabilities:					
Revenue bonds	23,095	22,010	26,320	1,085	(4,310)
State revolving fund loans	8,322	9,594	14,648	(1,272)	(5,054)
Certificates of participation	521	—	—	521	—
Other liabilities	55,719	43,524	32,552	12,195	10,972
Subtotal current liabilities	87,657	75,128	73,520	12,529	1,608
Long-term liabilities:					
Revenue bonds	431,029	454,350	476,558	(23,321)	(22,208)
State revolving fund loans	28,576	36,898	46,492	(8,322)	(9,594)
Certificates of participation	31,665	32,289	32,390	(624)	(101)
Other liabilities	39,296	33,257	30,588	6,039	2,669
Subtotal long-term liabilities	530,566	556,794	586,028	(26,228)	(29,234)
Total liabilities:					
Revenue bonds	454,124	476,360	502,878	(22,236)	(26,518)
State revolving fund loans	36,898	46,492	61,140	(9,594)	(14,648)
Certificates of participation	32,186	32,289	32,390	(103)	(101)
Other liabilities	95,015	76,781	63,140	18,234	13,641
Total liabilities	618,223	631,922	659,548	(13,699)	(27,626)
Net assets:					
Invested in capital assets, net of related debt	1,070,097	1,000,242	970,526	69,855	29,716
Restricted for debt service	1,027	935	1,477	92	(542)
Restricted for capital projects	19,787	18,081	25,845	1,706	(7,764)
Unrestricted	9,442	42,023	27,488	(32,581)	14,535
Total net assets	$ 1,100,353	1,061,281	1,025,336	39,072	35,945

(Continued)

Net Assets, Fiscal Year 2012

For the year ended June 30, 2012, the Enterprise's total net assets increased by $39,072 or 3.7% as a result of increases of $69,855 in invested in capital assets, net of related debt, and $1,798 increase to restricted for capital projects and restricted for debt service, offset by a decrease of $32,581 in unrestricted net assets (see Table 1).

Current and other assets decreased by $68,297 or 27.0%. The decreases included $53,911 in cash and investments with City Treasury resulting from increased capital improvement program spending, $18,002 in cash and investments outside City Treasury mainly due to $14,200 expenses pertaining to the 525 Golden Gate Headquarters Project and $9,300 payments to bondholders offset by $4,300 in Internal Revenue Service subsidies, $267 decrease in bond issuance costs and $4 decrease in inventory. The decreases were offset by increases of $2,472 in accounts receivables mainly due to average rate increase of 5%, and $1,415 federal grant due from other governments for Brown Grease Biodiesel Demonstration, Cesar Chavez Improvement and Civic Center Sustainable District Plan projects.

Capital assets, net of accumulated depreciation, increased by $93,670 or 6.5%, reflecting an increase in construction and capital improvement activities. The largest portion of the Enterprise's net assets ($1,070,097 or 97.3%) represents invested in capital assets, net of related debt.

Total liabilities decreased by $13,699 or 2.2% during the year. The decrease in liabilities was mainly due to repayments of $22,236 in revenue bonds and $9,594 in State revolving fund loans. Other decreases in liabilities included $507 in lower interfund payable to Water Enterprise for the 525 Golden Gate Headquarters project, $397 decrease in bond and loan interest payable, $154 in pollution remediation liability, and $103 in Certificates of Participation due to amortization of premium. These decreases were offset by increases of $7,848 in restricted liabilities and accounts payable primarily due to increased sewer construction activity, $5,640 in other post-employment benefits as a result of a higher annual required contribution, $4,189 in deferred liabilities mainly due to a $3,730 custom work deposit from California Pacific Medical Center for the Cesar Chavez sewer project, $1,191 in payroll and accrued vacation and sick leave, $318 in worker's compensation and $106 in damage claims liability based on actuarial estimate.

Net Assets, Fiscal Year 2011

For the year ended June 30, 2011, the Enterprise's total net assets increased by $35,945 or 3.5% as a result of increases of $29,716 in invested in capital assets, net of related debt, and $14,535 in unrestricted net assets, offset by decreases of $7,764 in restricted for capital projects and $542 in restricted for debt service (see Table 1).

Current and other assets decreased by $34,536 or 12.0%. The decreases included $58,246 in restricted assets in cash and investments resulting from increased capital project spending, $164 in amortization of bond issuance costs, which is net of $110 issue cost paid during the year, and $31 in interest receivables. The decreases were offset by increases of $20,152 in unrestricted cash and investments as a result of higher operating revenues, $2,031 in restricted receivables from capacity fees, $1,494 in charges for services receivables, $144 in receivables from other governments, $36 in advances, $25 in receivables from City departments, and $23 in inventory.

Capital assets, net of accumulated depreciation, increased by $42,855 or 3.1%, reflecting an increase in construction and capital improvement activities. The largest portion of the Enterprise's net assets ($1,000,242 or 94.2%) represents invested in capital assets, net of related debt.

Total liabilities decreased by $27,626 or 4.2% during the year. The decrease in liabilities was mainly due to repayments of $26,320 in revenue bonds and $14,648 in State revolving fund loans. Other decreases in liabilities included $2,915 in interfund payable to Water Enterprise for the 525 Golden Gate Headquarters project, $2,677 in claims liability based on actuarial estimates, $1,874 in amortization of premium, $537 in workers' compensation, $223 in deferred revenue and lien payable, and $120 in interfund payable to Hetch Hetchy Water and Power. These decreases were offset by increases of $6,332 in restricted liabilities related to bond-funded and capacity fee-funded capital projects, $5,902 in accounts payable from higher construction, repair and replacement activities, $4,795 in other post-employment benefits obligation as a result of a higher annual required contribution, $1,738 in interest payable, $1,575 in amortization of refunding loss, $996 in payroll and accrued vacation and sick leave, and $350 in pollution remediation liability.

Results of Operations

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

Table 2

Comparative Condensed Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2012, 2011 and 2010

	2012	2011	2010	2012 – 2011 change	2011 – 2010 change
Revenues:					
Charges for services	$ 233,628	220,586	202,363	13,042	18,223
Other operating revenues	10,527	8,630	7,480	1,897	1,150
Interest and investment income	2,975	1,927	2,056	1,048	(129)
Other non-operating revenues	8,498	6,841	4,236	1,657	2,605
Total revenues	255,628	237,984	216,135	17,644	21,849
Expenses:					
Operating expenses	195,857	179,084	185,512	16,773	(6,428)
Interest expense	18,736	22,545	15,891	(3,809)	6,654
Non-operating expenses	1,962	300	—	1,662	300
Total expenses	216,555	201,929	201,403	14,626	526
Income before transfers	39,073	36,055	14,732	3,018	21,323
Transfers to City & County of San Francisco	(1)	(110)	—	109	(110)
Changes in net assets	39,072	35,945	14,732	3,127	21,213
Net assets at beginning of year	1,061,281	1,025,336	1,010,604	35,945	14,732
Net assets at end of year	$ 1,100,353	1,061,281	1,025,336	39,072	35,945

Results of Operations, Fiscal Year 2012

The Enterprise's total revenues of $255,628 for the year increased by $17,644 or 7.4% over the prior year primarily due to increases in charges for services, capacity fee revenues, and grants received from other governments. While sanitary flow of 26.8 million ccf for the year decreased by 0.7%, charges for services increased by $13,042 or 5.9% due to an increase in sewer billing rates of 5% on average. Other operating revenues increased by $1,897 or 22.0% mainly due to an increase of $1,789 in capacity fee revenues from increased applications and capacity fee rates. Interest and investment income increased by $1,048 or 54.4%, mainly due to higher cash balance and higher interest earnings. Other non-operating revenues increased by $1,657 or 24.2% mainly due to the receipt of additional $1,528 in federal grant for Brown Grease Biodiesel Demonstration, Cesar Chavez Improvement and Civic Center Sustainable District Plan projects.

Total expenses increased by $14,626 or 7.2% due to increase of $16,773 in operating expenses offset by a $3,809 decrease in interest expense due to repayments of revenue bonds and State revolving fund loans. The increase in operating expenses is attributable to $9,079 in personal services, mainly due to salaries and fringe benefits, retirement, health care and workers' compensation costs, $2,582 in depreciation due to prior year capital assets being in use, $2,308 in general and administrative expenses mainly due to judgment and claims liability of $2,639 based on actuarial estimate, $938 in other operating expenses due to increased non-capitalized project expenses, $680 in contractual services, $603 in services provided by other departments mainly for legal services, and $583 in materials and supplies, especially in building, construction and equipment maintenance supplies.

During fiscal year 2012, net assets increased by $39,072. This change in net assets was higher than the prior year's increase in net assets by $3,127 or 8.7%.

Results of Operations, Fiscal Year 2011

The Enterprise's total revenues of $237,984 for the year increased by $21,849 or 10.1% over the prior year primarily due to planned rate increases, interest subsidy, and increased capacity fee revenues. Sanitary flow of 27,050,397 ccf for the year decreased by 154,469 ccf or 0.6%. Charges for services increased by $18,223 or 9.0% as a result of an average rate increase of 7.0% effective July 1, 2010. Other operating revenues increased by $1,150 or 15.4% due to an increase of $1,455 in capacity fee revenue from increased applications, offset by $305 reduction in charges to other City departments as a result of reduced usage. Interest and investment income decreased by $129 or 6.3%. The decrease is attributable to $1,360 unrealized loss related to lower market values on cash and investments with City Treasury, offset by increases of $1,051 in interest and investment income from increased cash balance, and $180 in unrealized gain related to higher market values on cash and investment outside City Treasury. Other non-operating revenues increased by $2,605 or 61.5% mainly due to increases of $4,218 in Federal interest subsidy received for certificates of participation 2009 Series D and revenue bond 2010 Series B, and $790 in biofuel revenues and late fee charges, offset by a decrease of $2,403 from prior year's capital assets amortization.

Total expenses increased by $526 or 0.3% due to increases of $6,654 in interest expenses from higher outstanding debt balances, $300 of non-operating expenses for the youth garden and landscaping project, and offset by a decrease of $6,428 in operating expenses. The decrease in operating expenses is attributable to $7,935 in various non-capitalized project expenses and capital project write-offs, $1,993 in general and administrative expenses for judgment and claims, and $1,550 in materials and supplies, especially in chemicals used in various

processes for proper wastewater treatment, city-wide odor control process, and equipment maintenance supplies. The decreases were partially offset by increases of $2,638 in personal services, mainly related to retirement and health care benefit costs, $1,469 in depreciation expense, $559 in contractual services mainly for system consulting services for Maximo software, and $384 in services provided by other City departments, primarily related to city planning and street repair services.

During fiscal year 2011, net assets increased by $35,945. This change in net assets was higher than the prior year's increase in net assets by $21,213 or 144.0%.

Capital Assets and Debt Administration

Capital Assets

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

Table 3

Capital Assets, Net of Depreciation

Years ended June 30, 2012, 2011 and 2010

	2012	2011	2010	2012 – 2011 change	2011 – 2010 change
Facilities, improvements, machinery, and equipment	$ 1,372,629	1,306,288	1,293,342	66,341	12,946
Intangible assets	5,595	5,793	4,587	(198)	1,206
Land and rights-of-way	21,210	21,210	21,210	—	—
Construction work in progress	134,703	107,176	78,473	27,527	28,703
Total	$ 1,534,137	1,440,467	1,397,612	93,670	42,855

Capital Assets, Fiscal Year 2012

The Enterprise has net capital assets of $1,534,137 invested in a broad range of utility capital assets as of June 30, 2012 (see Table 3). This amount represents an increase of $93,670 or 6.5% 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.

With the adoption of GASB Statement 51 in fiscal year 2010, the Enterprise reclassified $4,587 in intangible assets, primarily composed of $3,434 in customer care and billing computer software and $1,153 in easements. In fiscal year 2011, the Enterprise recorded a total of $5,793 of intangible assets, an additional $1,893 in intangible assets primarily composed of sewer easements, offset by $687 in depreciation. The Enterprise recorded a total of $5,595, an additional $497 in intangible assets related in customer care and billing computer software, and $695 in depreciation during fiscal year 2012.

Major additions to construction work in progress during the year ended June 30, 2012 include:

Sunnydale Sewer Improvements	$	25,070
525 Golden Gate Headquarters Building		14,225
Mission/Cesar Chavez Improvements		13,484
Sewer System Improvement Program		9,713
Wastewater Facility Reliability Improvements		7,610
Mariposa/Northshore Reliability		4,576
Spot Sewer Repair		3,866
Channel Pump Station III		3,684
Urban Watershed Assessment Project		3,146
Other items individually below $3,000		53,065
	$	138,439

Major facilities, improvements, machinery, equipment and intangible asset placed in service, including transfers of completed projects from construction work in progress, during the year ended June 30, 2012 include:

Sunnydale Sewer Improvements	$	39,830
525 Golden Gate Headquarters Building		25,411
Spot Sewer Contract and Repair		11,019
Civil Sewer, Hydraulic and Wastewater Repair and Replacement Projects		6,020
Bush Street Sewer Replacement		2,366
Other items individually below $2,000		26,296
	$	110,942

Sewer System Improvement Program

The Commission recently completed a review of the endorsed goals and service levels associated with the Sewer System Improvement Program (SSIP) in August 2012. This program is a multi-year, multi-phase project to meet the SFPUC goals and levels of service for operational reliability, regulatory compliance, effective stormwater management, community benefits, climate change adaptation, economic and environmental sustainability, and ratepayer affordability. The set of system improvement being developed by the Enterprise is the culmination of several years of planning efforts, public meetings, and Commission summer 2012 workshops by City staff. The estimated costs over the next 20 years is projected to total $6.9 billion, of which Phase 1 totals $2.7 billion and is planned over the next 10 years.

The SSIP evaluates the current treatment and collection system and provides a long-term strategy for wastewater and stormwater management to ensure reliability and resilience. The SSIP is based on a comprehensive planning effort that: (1) outlines a long-term strategy for San Francisco's waste water and storm water management; (2) addresses specific system deficiencies, aging infrastructure, and future operational and repair/replacement needs; and (3) provides a roadmap for a future capital improvement programs, ensuring reliable service that meets all regulatory requirements.

525 Golden Gate Avenue Headquarters Building

As of June 30, 2012, the Enterprise has incurred $28,552 in construction costs for the 525 Golden Gate Headquarters project. The building consolidated divisions of the San Francisco Public Utilities Commission that were renting space at multiple locations in the Civic Center. Construction started in January 2010 and SFPUC was in the process of relocation into the headquarters as of June 30, 2012. The entire staff relocation was completed in July 2012.

Capital Assets, Fiscal Year 2011

The Enterprise has net capital assets of $1,440,467 invested in a broad range of utility capital assets as of June 30, 2011 (see Table 3). This amount represents an increase of $42,855 or 3.1% over the prior fiscal year. The investment in capital assets includes land, buildings, improvements, wastewater treatment plants, sewer pipes and mains, underground transport and storage boxes, pump stations, machinery, and equipment.

The Enterprise recorded an additional $1,893 in intangible assets primarily composed of sewer easements, offset by $687 in depreciation during fiscal year 2011. With the adoption of GASB Statement 51 in fiscal year 2010, the Enterprise reclassified $4,587 in intangible assets, primarily composed of $3,434 in customer care and billing computer software and $1,153 in easements.

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

Sunnydale Sewer Improvements	$	28,772
525 Golden Gate Headquarters Building		9,591
Wastewater Master Plan		3,580
Spot Sewer Repair Contract No. 24		3,319
Odor Control Improvements		3,224
Various Sewer Locations No. 1		3,101
Channel Pump Station Improvements Phase 2		2,025
Other additions individually below $2,000		30,999
	$	84,611

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

Channel Pump Station Improvements	$	25,229
Odor Control Improvements		6,931
Spot Sewer Repair Contract No. 24		3,337
Miramar/Ocean/Staples/Various Locations Sewer Replacements		2,839
Brown Grease – Biodiesel Equipment		2,316
Other items individually below $2,000		13,824
	$	54,476

Sewer System Improvement Program

The Commission formally endorsed goals and service levels associated with the Sewer System Improvement Program (SSIP) on July 27, 2010. It is anticipated that the SSIP will cost $6 to $7 billion over 20 to 30 years. The SSIP's objective is to improve and rehabilitate the sewer system consistent with publicly vetted, agreed-upon levels of service to ensure the provision of high quality treatment services, odor and flood control as well as the promotion of green and sustainable best practices. The SFPUC's 10-year Capital Improvement Plan was adopted by the Board of Supervisor's in late fiscal year 2011 and included $4.1 billion of SSIP costs over the next 10 years. In fiscal year 2012, planning and design will begin on a new biosolids facility and furtherance of the urban watershed framework, including flood and odor control projects and other low impact development using a triple bottom line approach. Development of low impact design projects to store or divert storm water for beneficial use and to avoid entry into the sewer collection system where storm water mixes with sewage is being fully investigated as part of the SSIP.

525 Golden Gate Avenue Headquarters Building

As of June 30, 2011, the Enterprise has incurred $15,378 in construction costs for the 525 Golden Gate Headquarters project. The building is intended to consolidate divisions of the San Francisco Public Utilities Commission that are currently renting space at multiple locations in the Civic Center. Construction has started in January 2010 with an expected completion in June 2012.

Debt Administration

As of June 30, 2012 and 2011, the Enterprise's debt from revenue bonds, commercial paper, certificates of participation, and State revolving fund loans outstanding were $523,208 and $555,141, respectively, as shown below in Table 4. More detailed information about the Enterprise's debt activity is presented in notes 6, 7, and 8 to the financial statements.

Table 4

Outstanding Debt
(Net of Unamortized Costs, Discount, and Premium)

Years ended June 30, 2012, 2011 and 2010

		2012	2011	2010	2012 – 2011 change	2011 – 2010 change
Revenue bonds	$	454,124	476,360	502,878	(22,236)	(26,518)
Certificates of participation		32,186	32,289	32,390	(103)	(101)
State revolving fund loans		36,898	46,492	61,140	(9,594)	(14,648)
Total	$	523,208	555,141	596,408	(31,933)	(41,267)

The Enterprise has no commercial paper outstanding at June 30, 2012 and June 30, 2011. Total debt outstanding at June 30, 2012 consisted of $454,124 in revenue bonds, $36,898 in State revolving fund loans, and $32,186 in

Certificates of Participation. The fiscal year 2012 change in total debt outstanding was due to repayment of revenue bonds and State revolving fund loan principal, and amortization of bond premium and refunding loss.

Credit Ratings and Bond Insurance – At June 30, 2012 and June 30, 2011, the Enterprise carried underlying ratings of "Aa3" and "AA-" from Moody's and Standard & Poor's (S&P), respectively.

Debt Service Coverage – Pursuant to the Indenture for the Wastewater bonds, 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 2012 and 2011, 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. The Enterprise is authorized to issue up to $820,566 in revenue bonds to finance various projects as of June 30, 2012 up from $297,756 as of June 30, 2011. The Enterprise is authorized to issue $300,000 in commercial paper, with no commercial paper outstanding as of June 30, 2012 and June 30, 2011.

Cost of Debt Capital – The interest rates on the Enterprise's outstanding revenue bonds ranged from 3.0% to 5.8%, with a blended true interest cost of 3.8%, after factoring in Federal interest subsidy receipts on Build America Bonds at June 30, 2012 and June 30, 2011. The outstanding State revolving fund loans carried interest rates from 2.8% to 3.5% during fiscal years 2012 and 2011. The 2009 Series C certificates carried interest rates ranging from 2.0% to 5.0%. The 2009 Series D certificates carried interest rates ranging from 6.4% to 6.5%. After adjusting for the Federal interest subsidy, the true interest cost averaged 3.4% to 4.3% for Series C and D, respectively**.**

Next Year's Rates

Rate-Setting Process

Proposition E, as approved by the Voters in November 2002, amended the City Charter by adding the new Article VIIIB, entitled "Public Utilities," which established the Commission's 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.

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 included examination of future revenue requirements and costs of service of the Enterprise, and was used to set the Enterprise rates through fiscal year 2014. Based on this study, the Commission adopted a five-year rate proposal in 2009 that includes increases sufficient to meet project costs and debt coverage requirements. The approved average rate adjustments are shown below:

Approved Average Rate Adjustments

Effective Date	Rate	
July 1, 2004	11.0%	
July 1, 2005	13.0%	
July 1, 2006	13.0%	
July 1, 2007	8.0 %	[1]
July 1, 2008	9.0 %	
July 1, 2009	7.0 %	[2]
July 1, 2010	7.0 %	[2]
July 1, 2011	5.0 %	[2]
July 1, 2012	5.0 %	[2]
July 1, 2013	5.0 %	[2]

[1] Adjustment effective July 14, 2007.

[2] Adjustment effective annually from July 1, 2009 through the fiscal year beginning July 1, 2013.

Request for Information

This report is designed to provide our citizens, customers, investors, and creditors with an overview of the Enterprise's finances and to demonstrate the Enterprise's accountability for the money it receives. Questions regarding any of the information provided in this report or requests for additional financial information should be addressed to San Francisco Public Utilities Commission, Chief Financial Officer, Financial Services, 525 Golden Gate Avenue, 13th Floor, San Francisco, CA 94102.

SAN FRANCISCO WASTEWATER ENTERPRISE

Statements of Net Assets

June 30, 2012 and 2011

(In thousands)

	2012	2011
Assets:		
Current assets:		
Cash and investments with City Treasury	55,586	70,143
Cash and investments outside City Treasury	204	—
Receivables:		
Charges for services (net of allowance for doubtful accounts of $2,383 in 2012 and $2,962 in 2011)	35,642	33,737
Due from other governments	1,693	245
Due from other City departments	28	61
Interest	412	—
Advances and other	143	36
Total receivables	37,918	34,079
Inventories	3,265	3,269
Total current assets	96,973	107,491
Non-current assets:		
Restricted assets – cash and investments with City Treasury	54,102	93,456
Restricted assets – cash and investments outside City Treasury	23,348	41,554
Restricted assets – interest and other receivable	5,201	5,153
Capital assets not being depreciated	158,959	131,432
Capital assets, net of accumulated depreciation	1,375,178	1,309,035
Bond issuance costs (net of accumulated amortization of $3,238 in 2012 and $2,971 in 2011)	4,815	5,082
Total non-current assets	1,621,603	1,585,712
Total assets	1,718,576	1,693,203
Liabilities:		
Current liabilities:		
Accounts payable	21,490	9,814
Accrued payroll	5,323	4,634
Accrued vacation and sick leave, current portion	2,986	2,730
Accrued workers' compensation, current portion	734	645
Due to other City departments	3,057	3,564
Damage claims liability, current portion	2,231	2,203
Deferred revenue, refunds and other liabilities, current portion	5,468	1,279
Bond and loan interest payable	6,946	7,343
Revenue bonds, current portion	23,095	22,010
Loans payable, current portion	8,322	9,594
Certificates of participation, current portion	521	—
Current liabilities payable from restricted assets	7,484	11,312
Total current liabilities	87,657	75,128
Long-term liabilities:		
Other post-employment benefits obligation	26,513	20,873
Accrued vacation and sick leave, less current portion	2,712	2,466
Accrued workers' compensation, less current portion	3,193	2,964
Damage claims liability, less current portion	6,307	6,229
Revenue bonds, less current portion	431,029	454,350
Loans payable, less current portion	28,576	36,898
Certificates of participation, less current portion	31,665	32,289
Pollution remediation obligation	571	725
Total long-term liabilities	530,566	556,794
Total liabilities	618,223	631,922
Net assets:		
Invested in capital assets, net of related debt	1,070,097	1,000,242
Restricted for debt service	1,027	935
Restricted for capital projects	19,787	18,081
Unrestricted	9,442	42,023
Total net assets	$ 1,100,353	1,061,281

See accompanying notes to financial statements.

SAN FRANCISCO WASTEWATER ENTERPRISE

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2012 and 2011

(In thousands)

		2012	2011
Operating revenues:			
Charges for services	$	233,628	220,586
Other revenues		10,527	8,630
Total operating revenues		244,155	229,216
Operating expenses:			
Personnel services		82,709	73,630
Contractual services		13,257	12,577
Materials and supplies		8,921	8,338
Depreciation		44,799	42,217
Services provided by other departments		33,292	32,689
General and administrative and other		12,879	9,633
Total operating expenses		195,857	179,084
Operating income		48,298	50,132
Non-operating revenues (expenses):			
Federal and State grants		1,979	482
Interest and investment income		2,975	1,927
Interest expense		(18,736)	(22,545)
Other non-operating revenues		6,519	6,359
Other non-operating expenses		(1,962)	(300)
Net non-operating expenses		(9,225)	(14,077)
Income before transfers		39,073	36,055
Transfers to the City and County of San Francisco		(1)	(110)
Changes in net assets		39,072	35,945
Net assets at beginning of year		1,061,281	1,025,336
Net assets at end of year	$	1,100,353	1,061,281

See accompanying notes to financial statements.

SAN FRANCISCO WASTEWATER ENTERPRISE

Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

		2012	2011
Cash flows from operating activities:			
Cash received from customers, including cash deposits	$	245,837	226,067
Cash received from tenants for rent		806	755
Cash received from settlements		2	141
Cash received from miscellaneous revenues		1,327	946
Cash paid to employees for services		(74,338)	(66,721)
Cash paid to suppliers for goods and services		(54,022)	(53,310)
Cash paid for judgments and claims		(3,195)	(6,053)
Cash paid for rebates and program incentives		(300)	(300)
Net cash provided by operating activities		116,117	101,525
Cash flows from non-capital financing activities:			
Transfer out		(1)	(110)
Cash received for operating grants		531	338
Net cash provided by non-capital financing activities		530	228
Cash flows from capital and related financing activities:			
Principal paid on revenue bonds		(22,010)	(26,320)
Principal paid on State revolving fund loans		(9,594)	(14,648)
Interest paid on long-term debt		(27,250)	(26,180)
Issuance costs paid on long-term debt		—	(110)
Acquisition and construction of capital assets		(136,674)	(78,220)
Federal interest income subsidy for Build America Bonds		4,292	3,596
Net cash used in capital and related financing activities		(191,236)	(141,882)
Cash flows from investing activities:			
Interest income received		2,676	2,035
Proceeds from sale of investments outside City Treasury		127,427	122,384
Purchase of investments outside City Treasury		(115,502)	(145,021)
Net cash provided by (used in) investing activities		14,601	(20,602)
Decrease in cash and cash equivalents		(59,988)	(60,731)
Cash and cash equivalents:			
Beginning of year		174,153	234,884
End of year	$	114,165	174,153
Reconciliation of cash and cash equivalents to the statements of net assets:			
Cash and investments with City Treasury:			
Unrestricted	$	55,586	70,143
Restricted		54,102	93,456
Cash and investments outside City Treasury:			
Unrestricted			
Restricted		204	—
Less: Restricted (with maturity more than 90 days – see table in note 3)		23,348	41,554
		(19,075)	(31,000)
Cash and cash equivalents at the end of year on statements of cash flows	$	114,165	174,153

(Continued)

SAN FRANCISCO WASTEWATER ENTERPRISE

Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

		2012	2011
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	48,298	50,132
Adjustment to reconcile operating income to net cash provided by operating activities:			
Depreciation		44,799	42,217
Provision for uncollectible accounts		(579)	102
Write-off of capital assets		2,051	1,913
Settlements		2	141
Rebates and program incentives		(300)	(300)
Miscellaneous revenues		471	946
Changes in operating assets and liabilities:			
Receivable charges for services, net		(1,395)	(2,028)
Inventories		4	(23)
Accounts payable		11,676	5,902
Due from other City departments		33	(25)
Advances and other		(107)	(36)
Accrued payroll		689	859
Accrued other post-employment benefits obligation		5,640	4,795
Accrued vacation and sick leave		502	137
Accrued workers' compensation		318	(537)
Due from other funds		(126)	(120)
Pollution remediation obligation		(154)	350
Damage claims liability		106	(2,677)
Deposits, advances and other liabilities		4,189	(223)
Total adjustments		67,819	51,393
Net cash provided by operating activities	$	116,117	101,525
Noncash transactions:			
Accrued capital asset costs	$	7,484	11,312
Interfund loans payable		2,492	2,872

See accompanying notes to financial statements.

(1) Description 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, of which the Power Enterprise is a component, and the San Francisco Water Enterprise). The Commission is responsible for determining such matters as the rates and charges for services, approval of contracts, and organizational policy.

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

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

The Commission is a department of the City, and as such, the financial operations of the Enterprise, Hetch Hetchy Water and Power, and the Water Enterprises are included in the Comprehensive Annual Financial Report of the City as enterprise funds. These financial statements are intended to present only the financial position, and the changes in financial position and cash flows of only that portion of the City that is attributable to the transactions of the Enterprise. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2012 and 2011, 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.

(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 recognized when earned, and expenses are recognized when liabilities are incurred. Operating revenues are defined as charges to customers, rental income, and capacity fees.

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

(b) Cash and Cash Equivalents

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

(c) Investments

Money market funds are carried at cost, which approximates fair value. All other investments are stated at fair value based upon quoted market prices. Changes in fair value are recognized as investment gains or losses and are recorded as a component of non-operating revenue.

(d) Inventory

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

(e) Capital Assets

Capital assets are defined as assets with an initial individual cost of more than $5 and an estimated useful life in excess of one year. 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. All donated capital assets are valued at estimated fair value at the time of donation. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related assets, which range from 1 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) Intangible Assets

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

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

As of June 30, 2012 and 2011, the Enterprise recorded intangible assets of $5,595 and $5,793, respectively.

(g) Construction Work in Progress

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

(h) Capitalization of Interest

A portion of the interest cost incurred on capital projects is capitalized 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.

(i) Bond Discount, Premium, and Issuance Costs

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

(j) Accrued Vacation and Sick Leave

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

(k) Workers' Compensation

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

(l) Damage Claims Liability

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

(m) Arbitrage Rebate Payable

Certain bonds are subject to arbitrage rebate requirements in accordance with regulations issued by the U.S. Treasury Department. The requirements generally stipulate that earnings from the investment of the tax-exempt bond proceeds that exceed related interest costs on the bonds must be remitted to the Federal government on every fifth anniversary of each bond issue. No arbitrage liability is due as of June 30, 2012 and 2011.

(n) Refunding of Debt

Gains or losses occurring from refunding of debt prior to maturity 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.

(o) Income Taxes

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

(p) Revenue Recognition

Sewer service charges are based on water usage as determined by the San Francisco Water Enterprise. In general, residential customers are billed on a bi-monthly basis and commercial customers on a

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

(q) Use of Estimates

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

(r) Reclassifications

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

(s) Accounting and Financial Reporting for Pollution Remediation Obligations

According to GASB Statement 49, *Accounting and Financial Reporting for Pollution Remediation Obligations,* 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 cleanup;
- 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.

The Enterprise recorded $571 and $725 in pollution remediation liability as of June 30, 2012 and 2011, respectively.

(3) Cash, Cash Equivalents and Investments

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

The following table presents the restricted cash and investments outside City Treasury as of June 30, 2012.

Restricted Cash and Investment outside City Treasury

Investments	Credit Ratings (S&P/Moody's)	June 30, 2012 Maturities	Fair Value
U.S. Agencies	AAA/Aaa	April 18, 2016	$ 16,152
U.S. Agencies	AA+/Aaa	August 20, 2015	1,868
U.S. Treasury Notes - State and Local Government Series	Not Applicable	October 1, 2013	129
U.S. Treasury Notes - State and Local Government Series	Not Applicable	April 1, 2013	393
U.S. Agencies	Not Applicable	October 9, 2012	105
U.S. Treasury Notes - State and Local Government Series	Not Applicable	October 1, 2012	428
Money Market Funds	Not Applicable	<90 days	1,121
U.S. Treasury Money Market Funds	Not Applicable	<90 days	3,152
Total			$ 23,348

The following table presents the restricted cash and investments outside City Treasury as of June 30, 2011.

Restricted Cash and Investment outside City Treasury

Investments	Credit Ratings (S&P/Moody's)	June 30, 2011 Maturities	Fair Value
U.S. Agencies	AAA/Aaa	April 18, 2016	$ 15,894
U.S. Agencies	AAA/Aaa	August 20, 2015	1,868
U.S. Treasury Notes - State and Local Government Series	Not Applicable	October 1, 2013	129
U.S. Treasury Notes - State and Local Government Series	Not Applicable	April 1, 2013	393
U.S. Treasury Notes - State and Local Government Series	Not Applicable	October 1, 2012	428
U.S. Treasury Notes - State and Local Government Series	Not Applicable	April 1, 2012	1,576
U.S. Treasury Notes	AAA/Aaa	December 15, 2011	4,883
U.S. Agencies	AAA/Aaa	December 14, 2011	3,774
U.S. Treasury Notes - State and Local Government Series	Not Applicable	October 1, 2011	2,055
U.S. Agencies	AAA/Aaa	<90 days	5,983
U.S. Treasury Money Market Funds	AAA/Aaa	<90 days	2,428
Corporate Notes	AAA/Aaa	<90 days	1,743
Money Market Fund	AAA/Aaa	<90 days	400
Total			$ 41,554

The restricted asset for bond reserves is held by an independent trustee outside the City investment pool. The balances as of June 30, 2012 and 2011 were $23,348 and $41,554, 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 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 restricted cash and investment outside City Treasury as of June 30, 2012 and 2011 included $437 and $180 unrealized gain due to increases in fair values on U.S. Agencies, respectively.

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

	2012	2011
Current assets:		
Cash and investments with City Treasury	$ 55,586	70,143
Cash and investments outside City Treasury	204	—
Non-current assets – restricted:		
Cash and investments with City Treasury	54,102	93,456
Restricted cash and investments outside City Treasury	23,348	41,554
Total cash, cash equivalents and investments	$ 133,240	205,153

The following table shows the percentage distribution of the City's pooled investments by maturity as of June 30, 2012:

Investment maturities (in months)			
Under 1	**1 to less than 6**	**6 to less than 12**	**12 to 60**
1.9%	11.1%	8.0%	79.0%

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

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

(4) Capital Assets

Capital assets as of June 30, 2012 and 2011 consisted of the following:

	Balance July 1, 2011	Increases	Decreases	Balance June 30, 2012
Capital assets not being depreciated:				
Land and rights-of-way	$ 21,210	—	—	21,210
Construction work in progress	107,176	138,439	(110,912) *	134,703
Intangible assets	3,046	—	—	3,046
Total capital assets not being depreciated	131,432	138,439	(110,912)	158,959
Capital assets being depreciated:				
Facilities and improvements	2,192,198	102,138	—	2,294,336
Machinery and equipment	63,244	8,307	(286)	71,265
Intangible assets	3,434	497	—	3,931
Total capital assets being depreciated	2,258,876	110,942	(286)	2,369,532
Less accumulated depreciation for:				
Facilities and improvements	(917,690)	(40,182)	—	(957,872)
Machinery and equipment	(31,464)	(3,922)	286	(35,100)
Intangible assets	(687)	(695)	—	(1,382)
Total accumulated depreciation	(949,841)	(44,799)	286	(994,354)
Total capital assets being depreciated, net	1,309,035	66,143	—	1,375,178
Total capital assets, net	$ 1,440,467	204,582	(110,912)	1,534,137

* Includes $2,051 in capital project write-offs, mainly related to the Brown Grease to Biofuel Demonstration Project, the Wastewater Mechanical and Electrical Upgrade Project, the Oceanside Plan Digester Coasting Project, the Odor Control Unit Media Replacement Project, the South West Ocean Outfall Stablization Emergency Work Project, and the Treatment Plan Equipment Replacement Project.

	Balance July 1, 2010	Increases	Decreases	Balance June 30, 2011
Capital assets not being depreciated:				
Land and rights-of-way	$ 21,210	—	—	21,210
Construction work in progress	78,473	84,611	(55,908) *	107,176
Intangible assets	1,153	1,893	—	3,046
Total capital assets not being depreciated	100,836	86,504	(55,908)	131,432
Capital assets being depreciated:				
Facilities and improvements	2,143,113	49,085	—	2,192,198
Machinery and equipment	57,876	5,391	(23)	63,244
Intangible assets	3,434	—	—	3,434
Total capital assets being depreciated	2,204,423	54,476	(23)	2,258,876
Less accumulated depreciation for:				
Facilities and improvements	(879,091)	(38,599)	—	(917,690)
Machinery and equipment	(28,556)	(2,931)	23	(31,464)
Intangible assets	—	(687)	—	(687)
Total accumulated depreciation	(907,647)	(42,217)	23	(949,841)
Total capital assets being depreciated, net	1,296,776	12,259	—	1,309,035
Total capital assets, net	$ 1,397,612	98,763	(55,908)	1,440,467

* Includes $1,913 in capital project write-offs, mainly related to the Improvement Project, the South East Water Pollution Control Plant Corrosion Repair Project, and the Grease Recovery/Biofuel Production Project.

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 work in progress and total interest expense incurred during the years ended June 30, 2012 and 2011 are as follows:

		2012	2011
Interest expensed	$	18,736	22,545
Interest included in construction work in progress		8,055	5,348
Total interest incurred	$	26,791	27,893

During fiscal years ending in 2012 and 2011, the Enterprise expensed $2,051 and $1,913, 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 cash 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 revolving fund loans;

3. The payment of bonds, parity State revolving fund loans, policy costs, and amounts due as reimbursement under any letter of credit agreement; and

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, 2012 and 2011:

		2012	2011
Cash and investments with City Treasury:			
Wastewater revenue bond construction fund	$	54,102	93,456
Cash and investments outside City Treasury:			
2010A Wastewater revenue bond fund		3,449	3,256
2010B Wastewater revenue bond fund		16,804	19,646
2009C Certificates of Participation - 525 Golden Gate		598	4,823
2009D Certificates of Participation - 525 Golden Gate		2,497	13,829
Total cash and investments outside City Treasury		23,348	41,554
Interest receivable:			
Wastewater revenue bond construction fund		5,201	5,153
Total restricted assets	$	82,651	140,163

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

(6) Short-Term Debt

The Commission and Board of Supervisors have authorized the issuance of up to $300,000 in commercial paper, under the voter-approved 2002 Proposition E, for the purpose of reconstructing, expanding, repairing or improving the Wastewater Enterprise's facilities. The Enterprise has no commercial paper outstanding on June 30, 2012 and 2011, and did not have any commercial paper related activities during fiscal year 2012.

(7) Changes in Long-Term Liabilities

Long-term liability activities for the years ended June 30, 2012 and 2011 are as follows:

	Interest rate*	Final maturity date	July 1, 2011	Additions	Reductions	June 30, 2012	Due within on year
Revenue Bonds:							
2003 refunding Series A	3.00 to 5.25%	2025	229,210	—	(22,010)	207,200	23,095
2010A	4.00 to 5.00%	2021	47,050	—	—	47,050	—
2010B (Build America)	4.65 to 5.82%	2040	192,515	—	—	192,515	—
Less deferred amounts:							
For issuance premiums			20,774	—	(1,747)	19,027	—
For refunding loss			(13,189)	—	1,521	(11,668)	—
Total revenue bonds payable			476,360	—	(22,236)	454,124	23,095
State of California revolving fund loans	2.80 to 3.40%	2021	46,492	—	(9,594)	36,898	8,322
2009C certificates of participation (COPs)	2.00 to 5.00%	2022	7,197	—	—	7,197	521
2009C COPs issuance premiums			634	—	(103)	531	—
2009D COPs (Build America)	6.36 to 6.49%	2041	24,458	—	—	24,458	—
Other post-employment benefits obligation			20,873	7,974	(2,334)	26,513	—
Accrued vacation and sick leave			5,196	3,035	(2,533)	5,698	2,986
Accrued workers' compensation			3,609	1,858	(1,540)	3,927	734
Damage claims liability			8,432	2,021	(1,915)	8,538	2,231
Pollution remediation obligation			725	196	(350)	571	—
Total			$ 593,976	15,084	(40,605)	568,455	37,889

* After adjusting for Federal interest subsidy, the true interest costs for revenue bond 2010 Series B and certificates of participation 2009 Series D, both issued as Build America Bonds, are 3.7% and 4.3%, respectively.

	Interest rate*	Final maturity date	July 1, 2010	Additions	Reductions	June 30, 2011	Due within on year
Revenue Bonds:							
2003 refunding Series A	3.00 to 5.25%	2025	255,530	—	(26,320)	229,210	22,010
2010A	4.00 to 5.00%	2021	47,050	—	—	47,050	—
2010B (Build America)	4.65 to 5.82%	2040	192,515	—	—	192,515	—
Less deferred amounts:							
For issuance premiums			22,547	—	(1,773)	20,774	—
For refunding loss			(14,764)	—	1,575	(13,189)	—
Total revenue bonds payable			502,878	—	(26,518)	476,360	22,010
State of California revolving fund loans	2.80 to 3.50%	2021	61,140	—	(14,648)	46,492	9,594
2009C certificates of participation (COPs)	2.00 to 5.00%	2022	7,197	—	—	7,197	—
2009C COPs issuance premiums			735	—	(101)	634	—
2009D COPs (Build America)	6.36 to 6.49%	2041	24,458	—	—	24,458	—
Other post-employment benefits obligation			16,078	7,215	(2,420)	20,873	—
Accrued vacation and sick leave			5,059	2,703	(2,566)	5,196	2,730
Accrued workers' compensation			4,146	581	(1,118)	3,609	645
Damage claims liability			11,109	—	(2,677)	8,432	2,203
Pollution remediation obligation			375	350	—	725	—
Total			$ 633,175	10,849	(50,048)	593,976	37,182

* After adjusting for Federal interest subsidy, the true interest costs for revenue bond 2010 Series B and certificates of participation 2009 Series D, both issued as Build America Bonds, are 3.7% and 4.3%, respectively.

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

(a) Wastewater Revenue Bonds 2003 Refunding Series A

During fiscal year 2003, the Enterprise issued 2003 refunding Series A bonds in the amount of $396,270 with interest rates ranging from 3.0% to 5.3%. 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 "B3" and "B" by Moody's and Standard & Poor's (S&P), respectively as of June 30, 2012. This policy is further reinsured by the National Public Finance Corporation, which is currently rated "Baa2" and "BBB" 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. Bonds mature through October 1, 2025.

(b) Wastewater Revenue Bonds 2010 Series A

During fiscal year 2010, the Enterprise issued revenue bonds 2010 Series A in the amount of $47,050 with interest rates ranging from 4.0% to 5.0%. Proceeds from the bonds were used to redeem $50,000 in outstanding commercial paper notes, fund a cash debt service reserve fund and pay the costs of issuing the bonds. The bonds were rated "Aa3" and "AA-" by Moody's and S&P, respectively. Bonds mature through October 1, 2021. The true interest cost is 2.9%.

(c) Wastewater Revenue Bonds 2010 Series B

During fiscal year 2010, the Enterprise issued revenue bonds 2010 Series B (Federally Taxable – Build America Bonds – Direct Payment) in the amount of $192,515 with interest rates ranging from 4.7% to 5.8%. Proceeds from the bonds were used to redeem $53,500 in outstanding commercial paper notes, provide funding for capital projects in the amount of $112,429, fund a cash debt service reserve fund, and pay financing costs for the bonds. The bonds were rated "Aa3" and "AA-" by Moody's and S&P, respectively. Bonds mature through October 1, 2040. The true interest cost is 3.7%.

(d) Future Annual Debt Service of Revenue and Refunding Bonds

The following table presents the future annual debt service relating to the revenue and refunding bonds outstanding as of June 30, 2012. The interest before subsidy amounts include the interest for the revenue bonds 2003 refunding Series A, 2010 Series A, and 2010 Series B. The Federal interest subsidy amounts represent 35% of the interest for the 2010 Series B revenue bonds.

		Principal	Interest before subsidy	Federal interest subsidy	Interest net of subsidy
Years ending June 30:					
2013	$	23,095	22,902	(3,740)	19,162
2014		24,395	21,715	(3,740)	17,975
2015		25,790	20,428	(3,740)	16,688
2016		27,325	19,034	(3,740)	15,294
2017		18,855	17,890	(3,740)	14,150
2018-2022		110,920	73,919	(18,700)	55,219
2023-2027		62,670	50,358	(17,109)	33,249
2028-2032		45,995	37,822	(13,238)	24,584
2033-2037		55,315	23,478	(8,216)	15,262
2038-2041		52,405	6,245	(2,187)	4,058
	$	446,765	293,791	(78,150)	215,641
Less: Current portion		(23,095)			
Add: Unamortized bond premiums and refunding loss		7,359			
Long-term portion as of June 30, 2012	$	431,029			

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).

(e) 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, 2012 and 2011 are summarized as follows:

						June 30	
						2012	2011
Project	Date of issuance	Date of 1st disbursement	Maturity date	Interest rate	Loan amount	Amount outstanding	Amount outstanding
Mariposa	09/27/91	06/24/92	2012	3.1%	$ 1,936	—	128
Islais Creek	06/12/92	10/08/92	2012	3.0	5,706	370	729
Lake Merced	11/14/91	01/29/92	2012	3.1	21,114	—	1,387
Oceanside	11/02/93	12/24/93	2013	2.9	14,102	1,813	2,681
Islais Creek	04/26/93	09/07/93	2013	3.1	26,800	3,452	5,101
Islais Creek	10/01/93	06/17/94	2014	2.9	15,105	2,890	3,800
Islais Creek	10/20/95	01/09/96	2016	3.4	21,720	6,070	7,464
Rankin Pump	05/31/96	12/23/96	2016	2.8	27,000	8,603	10,185
Islais Creek	02/16/00	08/04/00	2020	2.9	18,026	9,390	10,292
Rankin Pump	02/16/00	01/23/01	2021	2.9	8,274	4,310	4,725
		Total			$ 159,783	36,898	46,492

The Enterprise is repaying the interest and principal by installments with the final amount due between 15 and 20 years after loan disbursement by SWRCB. 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, 2012 is as follows:

		Principal	Interest	Total
Years ending June 30:				
2013	$	8,322	1,099	9,421
2014		8,192	848	9,040
2015		5,686	602	6,288
2016		4,837	431	5,268
2017		3,335	284	3,619
2018 – 2021		6,526	480	7,006
		36,898	3,744	40,642
Less: Current portion		(8,322)		
Long-term portion as of June 30, 2012	$	28,576		

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

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

Under the terms of a Memorandum of Understanding between the City and the SFPUC dated October 1, 2009, the City conveyed the real property to the Trustee, the Bank of New York Mellon Trust Company, N.A., under a property lease in exchange for the proceeds of the sale of the certificates. The Trustee has leased the property back to the City for the City's use under a Project Lease. The City will be obligated under the Project Lease to pay base rental payments and other payments to the Trustee each year during the thirty-two year term of the Project Lease. The Commission will make annual base rental payments to the City for the building equal to annual debt service on the certificates. It is anticipated that these lease costs will be offset with reductions in costs associated with current office rental expense.

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

The future annual debt services relating to the certificates of participation 2009 Series C and D outstanding as of June 30, 2012 are as follows:

Certificates of participation 2009 Series C (Tax Exempt)		**Principal**	**Interest**	**Total**
Years ending June 30:				
2013	$	521	326	847
2014		538	308	846
2015		557	289	846
2016		581	265	846
2017		612	235	847
2018 – 2022		3,562	668	4,230
2023		826	20	846
		7,197	2,111	9,308
Less: Current portion		(521)		
Add: Unamortized bond premiums		531		
Long-term portion as of June 30, 2012	$	7,207		

Certificates of participation 2009 Series D (Taxable)	Principal	Interest before subsidy	Federal interest subsidy	Interest net of subsidy
Years ending June 30:				
2013	$ —	1,578	(552)	1,026
2014	—	1,578	(552)	1,026
2015	—	1,578	(552)	1,026
2016	—	1,578	(552)	1,026
2017	—	1,578	(552)	1,026
2018 – 2022	—	7,890	(2,762)	5,128
2023 – 2027	3,677	7,435	(2,602)	4,833
2028 – 2032	5,540	5,867	(2,054)	3,813
2033 – 2037	6,825	3,873	(1,356)	2,517
2038 – 2042	8,416	1,410	(494)	916
	24,458	34,365	(12,028)	22,337
Less: Current portion	—			
Add: Unamortized bond premiums	—			
Long-term portion as of June 30, 2012	$ 24,458			

(9) 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 2041.

The original amount of revenue bonds issued, total principal and interest remaining, principal and interest paid during 2012 and 2011, and applicable revenues for 2012 and 2011 are as follows:

	2012	2011	
Bonds issued with revenue pledge	$ 635,835	635,835	
Principal and interest remaining due at the end of the year	740,556	786,487	
Principal and interest paid during the year	42,190	41,839	*
Net revenue for the year ended June 30	107,637	85,529	
Funds available for bond debt service	158,398	108,298	

*Adjustment to reflect springing amendment related to federal bond interest subsidy.

(10) Employee Benefits

(a) *Retirement Plan*

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

Funding Policy – Contributions to the basic Plan are made by both the Enterprise and its employees. Employee contributions are mandatory. Employee contribution rates for fiscal years 2012, 2011, and 2010 varied from 7.5% to 8.0% as a percentage of covered payroll. In addition, the Enterprise was required to contribute for the fiscal years ended June 30, 2012, 2011, and 2010 at an actuarially determined contribution rate as a percentage of covered payroll of 18.09%, 13.6%, and 9.5%, respectively. The Enterprise's required and actual contributions were approximately $8,393 in 2012, $5,884 in 2011, and $4,233 in 2010.

Proposition B, a City Charter Amendment Changing Qualifications for Retiree Health and Pension Benefits and Establishing a Retiree Health Care Trust Fund, was passed by voters on June 3, 2008, and increased the years of service required to qualify for employer-funded retiree health benefits for City employees who retire under the San Francisco Employees Retirement System and were hired on or after January 10, 2009. Employees hired before January 10, 2009, became eligible to participate in the retirement health care system after 5 years of service and the employer paid 100% of the contribution. Proposition B also stated that a separate Retiree Health Care Trust Fund would be created to pay for the City's future costs related to retiree health care. This trust fund will be funded by employer and employee contributions for employees hired on or after January 10, 2009. These new employees would contribute up to 2% of their pre-tax pay and employers would contribute 1%.

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

(b) Health Care Benefits

Health care benefits of the Enterprise employees, retired employees and surviving spouses are financed by beneficiaries and by the City through the City and County of San Francisco Health Service System (the Health Service System). The Enterprise's annual contribution, which amounted to approximately $9,426 and $8,488 in fiscal years 2012 and 2011, 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 $2,334 and $2,420 for 2012 and 2011, respectively, to provide post-retirement benefits for retired employees, on a pay-as-you-go basis. There was no additional City allocation to the Enterprise's contribution payments made from the Health Service System for post-retirement health benefits in 2012 and 2011.

The City has determined a City-wide Annual Required Contribution (ARC), interest on net other post-employment benefits other than pensions (OPEB) obligation, ARC adjustment, and OPEB cost based upon an actuarial valuation performed in accordance with GASB 45, by the City's actuaries. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost of each year and any unfunded actuarial liabilities (or funding excess) amortized over thirty years. The City's allocation of the OPEB related costs to the Enterprise for the year ended June 30, 2012 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, 2012 and 2011, for the amount contributed to the plan, and changes in the City's net OPEB obligation:

		2012	2011
Annual required contribution	$	7,817	7,071
Interest on net OPEB obligation		918	667
Adjustment to ARC		(761)	(523)
Annual OPEB cost (expense)		7,974	7,215
Contribution made		(2,334)	(2,420)
Increase in net OPEB obligation		5,640	4,795
Net OPEB obligation – beginning of year		20,873	16,078
Net OPEB obligation – end of year	$	26,513	20,873

The City issues a publicly available financial report for City-wide level 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.

(11) Related Parties

Various common costs incurred by the Commission are allocated proratably among 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, 2012 and 2011, the Commission allocated $21,843 and $21,354, 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 $1,338 and $1,238 for the years ended June 30, 2012 and 2011, respectively, and is included in other operating expenses in the accompanying financial statements.

The Enterprise purchases electricity from Hetch Hetchy Power at market rates. This amount, totaling $8,618 and $8,959 for the years ended June 30, 2012 and 2011, 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 Commission.

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 $15,029 and $15,102 for the years ended June 30, 2012 and 2011, respectively, has been included in services provided by other departments in the accompanying financial statements.

A variety of other City departments provide services such as purchasing, legal, data processing, telecommunications, and human resources to the Enterprise and charge amounts designed to recover those departments' costs. These charges totaling approximately $9,645 and $8,628 for the years ended June 30, 2012 and 2011, respectively, have been included in services provided by other departments in the accompanying financial statements.

As of June 30, 2012, the Enterprise has payables in the amount of $2,491 associated with the SFPUC headquarters building located at 525 Golden Gate Avenue, of which $2,011 to Hetch Hetchy Water and Power Enterprise for information technology equipment and living machine system, $267 to Arts Commission for artworks, and $213 to Water Enterprise for its respective allocable share of costs.

SFPUC entered into a seventy-five year lease agreement with the San Francisco Recreation and Park Commission for the use of parking spaces at the parking garage located at 355 McAllister Street beneath Civic Center Plaza which is in closer proximity to SFPUC's new headquarters at 525 Golden Gate Avenue. The term of the agreement commenced on February 1, 2011, with 40 parking spaces allocated to SFPUC. As of April 1, 2012, SFPUC had the rights to an additional 20 parking spaces. As of June 30, 2012, SFPUC exercised four of the additional 20 parking spaces for a total of 44 parking spaces. The total payment under this agreement is $6,274 and the first payment in the amount of $1,500 was made in the fiscal year 2011. Of this $1,500, SFPUC recognized $40 as expenses for the 40 parking spaces rented between February and June, 2011. The remaining $1,460 was recorded as prepaid. Of the second payment in the amount of $1,500 made in the fiscal year ending June 30, 2012, SFPUC recognized $84 as expenses and the remaining $1,416 was recorded as prepaid. The expenses and prepayment were prorated and allocated

among the three SFPUC Enterprises based on the use of parking spaces. The total remaining payments that will be allocated to the 3 enterprises will be made as follows:

		Amount
Fiscal years ending June 30:		
2013	$	1,500
2014		1,500
2015		274
Total	$	3,274

In fiscal year 2012, the Wastewater Enterprise's allocable share of the expenses and prepayment was $6 and $143, respectively. In fiscal year 2011, the Wastewater Enterprise's allocable share of the expenses and prepayment was $1 and $37, respectively.

(12) Risk Management

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

Primary risks	Typical coverage approach
General liability	Self-Insured
Property	Purchased Insurance and Self-Insured
Workers' compensation	Self-Insured through Citywide Pool

Other risks	Typical coverage approach
Surety bonds	Purchased and Contractually Transferred
Professional liability	Combination of Self-Insured, Purchased Insurance and Contractual Risk Transfer
Errors and omissions	Combination of Self-Insured, Purchased Insurance and Contractual Risk Transfer
Builders' risk	Purchased Insurance and Contractual Risk Transfer
Public Officials Liability	Purchased Insurance

(a) Damage Claims Liability

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

The changes for the damage claims liability for the years ended June 30, 2012 and 2011 are as follows:

	Beginning of year	Claims and changes in estimates	Claims paid	End of year
2010 – 2011	$ 11,109	(606)	(2,071)	8,432
2011 – 2012	8,432	2,021	(1,915)	8,538

(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, or 3) mandated coverage to meet statutory requirements for bonding of various public officials.

(c) Workers' Compensation

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

duty modification for injured employees with medical restrictions so return to work can occur as soon as possible.

The changes in the liabilities for workers' compensation for the years ended June 30, 2012 and 2011 are as follows:

	Beginning of year	Claims and changes in estimates	Claims paid	End of year
2010 – 2011	$ 4,146	581	(1,118)	3,609
2011 – 2012	3,609	1,858	(1,540)	3,927

(d) Surety Bonds and Public Official Liability

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

(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.

(13) Commitments and Litigation

(a) Commitments

As of June 30, 2012, the Enterprise has outstanding commitments with third parties of $81,890 for various capital projects and other purchase agreements for materials and services.

(b) Grants

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

(c) Litigation

The Enterprise is a defendant in various legal actions and claims that arise during the normal course of business. The final disposition of 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. The pollution remediation obligation reported in the accompanying statements of net assets is based on estimated contractual costs. The balance as of June 30, 2012 and 2011 was $571 and $725, respectively. The fiscal year 2012 liability of $571 is for the clean-up effort of Yosemite Creek. Prior year's liability for the Sunnydale Auxiliary Sewer project has been cleared.

(14) Subsequent Event

Bayshore Sanitary District agreement

The City and County of San Francisco and the Bayshore Sanitary District entered into a Joint Exercise of Powers Agreement on the 1st day of October 2012. According to this agreement, the City, through the SFPUC's Wastewater Enterprise, will accept, treat and dispose of the District's wastewater flows. This Agreement is similar to a 1995 agreement which expired on September 30, 2012. The new agreement shall be in effect through July 31, 2025 and is estimated to generate approximately $800 in revenue in fiscal year 2013.

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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, 2012, and have issued our report thereon dated October 25, 2012. 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

Management of the Enterprise is responsible for establishing and maintaining effective 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*.

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

KPMG LLP

October 25, 2012