HETCH HETCHY WATER AND POWER

Financial Statements

June 30, 2010 and 2009

(With Independent Auditors' Report Thereon)

HETCH HETCHY WATER AND POWER

Table of Contents

	Page
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Financial Statements:	
Statements of Net Assets	25
Statements of Revenues, Expenses, and Changes in Net Assets	26
Statements of Cash Flows	27
Notes to Financial Statements	29
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*	64

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

Independent Auditors' Report

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

We have audited the accompanying financial statements of the business-type activities and each major fund of the Hetch Hetchy Water and Power (Hetch Hetchy), an enterprise of the City and County of San Francisco, California, (the City), as of and for the year ended June 30, 2010 which collectively comprise the Hetch Hetchy's basic financial statements as listed in the table of contents. We have also audited the accompanying financial statements of the business-type activities of Hetch Hetchy as of and for the year ended June 30, 2009 as listed in the table of contents. These financial statements are the responsibility of Hetch Hetchy's management. Our responsibility is to express opinions 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 audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hetch Hetchy'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 opinions.

As discussed in note 1, the financial statements of Hetch Hetchy 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 Hetch Hetchy. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2010 and 2009, 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 2010 financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and each major fund of Hetch Hetchy Water and Power, as of June 30, 2010 and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the 2009 financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Hetch Hetchy Water and Power, as of June 30, 2009 and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

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

The accompanying financial statements presenting each major fund of Hetch Hetchy as of and for the year ended June 30, 2009 and the 2009 management's discussion and analysis as of for the year ended June 30, 2009, were not audited by us, and accordingly, we do not express an opinion on them.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 9, 2010, on our consideration of the Hetch Hetchy's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis as of and for the year ended June 30, 2010 on pages 3 through 24 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

December 9, 2010

HETCH HETCHY WATER AND POWER

Management's Discussion and Analysis

June 30, 2010 and 2009

(Dollars in thousands)

This section presents management's analysis of the San Francisco Hetch Hetchy Water and Power's (Hetch Hetchy) financial condition and activities as of and for the years ended June 30, 2010 and 2009. Management's Discussion and Analysis (MDA) is intended to serve as an introduction to Hetch Hetchy'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, Wastewater, and Hetch Hetchy Water and Power (Hetch Hetchy). Hetch Hetchy was established as a result of the Raker Act of 1913, which granted water and power resource rights-of-way on the Tuolumne River in Yosemite National Park and the Stanislaus National Forest to the City. Hetch Hetchy operates the Hetch Hetchy Project that provides both electricity generation and upcountry water service. Hetch Hetchy is engaged in the collection and conveyance of approximately 85% of the City's water supply and in the generation and transmission of electricity from that resource.

Approximately 65% of the electricity generated by Hetch Hetchy Power is used to provide electric service to the City's municipal customers (including the San Francisco Municipal Transportation Agency, Recreation and Parks Department, the Port of San Francisco, the San Francisco International Airport and its tenants, San Francisco General Hospital, street lights, Moscone Convention Center, and the Water and Wastewater Enterprises). The majority of the remaining 35% of electricity generated is sold to other publicly owned utilities, such as the Turlock and Modesto Irrigation Districts. The Hetch Hetchy Project includes a system of reservoirs, hydroelectric power plants, aqueducts, pipelines, and transmission lines, carrying water and power more than 165 miles from the Sierra Nevada Mountain Range to customers in the City and portions of the surrounding San Francisco Bay Area.

Hetch Hetchy Water and Power

Hetch Hetchy Water and Power provides reliable, high quality water and electric energy to the City and other customers, protects watershed resources in cooperation with Federal agencies, operates and maintains facilities to a high standard of safety and reliability, and maximizes revenue opportunities within approved levels of risk.

Hetch Hetchy Water and Power also strives to promote diversity and the health, safety and professional development of its employees.

Eighty-five percent of San Francisco's drinking water starts out as snow falling on more than 650 square miles of watershed land in Yosemite National Park and the Stanislaus National Forest. As the snow melts, it collects in Hetch Hetchy's three storage reservoirs. Water flows by gravity through 150 miles of pipelines and tunnels and it turns the turbines in four hydroelectric powerhouses, generating approximately 1.6 billion kilowatt hours of electricity. Over 160 miles of transmission and distribution lines move the electricity from the powerhouses to the San Francisco Bay Area. The majority of the power is used for the City and County of San Francisco offices and services. Surplus power is sold to Central Valley irrigation districts (Turlock and Modesto) and other public agencies.

Hetch Hetchy Water and Power is comprised of two component funds: 1) Hetch Hetchy Water upcountry operations and water system; and 2) Hetch Hetchy Power, also referred to as the Power Enterprise, which is wholly contained within the Hetch Hetchy. A number of the facilities are joint assets and used for both water and power generation.

Hetch Hetchy Water

Hetch Hetchy Water endeavors to operate as an effective, reliable water and power supplier, while managing resources in an environmentally sound manner. Hetch Hetchy Water is responsible for the operation, maintenance and improvement of its water and power facilities to a high standard of safety and reliability while meeting regulatory requirements. Hetch Hetchy Water distributes high quality water to SFPUC customers while optimizing generation from the hydropower facilities. It maintains lands and properties consistent with public health and neighborhood concerns.

Hetch Hetchy Power

The core business of Hetch Hetchy Power, as a municipal agency, is to provide adequate and reliable supplies of electric power to meet the electricity needs of the City's customers and to satisfy the municipal loads and agricultural pumping demands of the Modesto and Turlock Irrigation districts consistent with prescribed contractual obligations and Federal law.

Hetch Hetchy Power's portfolio consists of hydroelectric generation, small on-site solar and third party purchases. Consistent with its commitment to the development of cleaner and greener power, and to address environmental concerns and community objectives, Hetch Hetchy Power continues to evaluate and expand its existing resource base to include additional renewables, distributed generation, demand management and energy efficiency programs.

As part of its mission and core functions, Hetch Hetchy Power aims to provide reliable energy services at reasonable cost to customers, with attention to environmental effects and community concerns.

Hetchy Joint Water and Power

A portion of Hetch Hetchy provides benefit to both Hetch Hetchy Power and Hetch Hetchy Water. Both operating and capital costs that jointly benefit both funds are allocated 55% to the Hetch Hetchy Power and 45% to the Hetch Hetchy Water, as has historically been done by the SFPUC.

Overview of the Financial Statements

Hetch Hetchy's financial statements include:

Statements of Net Assets present information on Hetch Hetchy'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 Hetch Hetchy 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 Hetch Hetchy'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 Hetch Hetchy 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 expense 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 presented on the face of the financial statements.

Financial Analysis

Financial Highlights for Fiscal Year 2010

Hetch Hetchy Water and Power

- Total assets of Hetch Hetchy exceeded total liabilities by $456,370. Net assets increased by $11,993 or 2.7% during the fiscal year. Capital assets, net of accumulated depreciation, increased by $12,131 or 4.4% to $285,770.
- Charges for services, excluding interest and investment income, rental income and other non-operating revenues, increased by $13,317 or 11.6% to $128,345. Operating expenses, excluding interest expense and other non-operating expenses, increased by $22,159 or 23.0% to $118,387, largely due to higher capital project spending costs, capital project write-offs, and a one-time $10,194 of combustion turbine asset write-off as a result of settlement.

Hetch Hetchy Water

- Total assets of Hetch Hetchy Water exceeded total liabilities by $113,149. Net assets decreased by $138 or 0.1% during the fiscal year. Capital assets, net of accumulated depreciation, increased by $3,328 or 4.0% to $86,634.
- Charges for services representing water sales, which excludes interest and investment income, rental income and other non-operating revenues, increased by $6,641 or 27.1 % to $31,109. Operating expenses decreased by $434 or 1.3% to $32,053 mainly due to a decrease of $3,432 in non-capitalized project expenses, offset by increases of $2,030 in taxes, licenses, permits and other general and administrative expenses, $574 in contractual services, $153 in depreciation, $140 in personal services, and $101 in materials and supplies and services provided by other departments.

Hetch Hetchy Power

- Total assets of Hetch Hetchy Power exceeded total liabilities by $343,221. Net assets increased by $12,131 or 3.7% during the fiscal year. Capital assets, net of accumulated depreciation, increased by $8,803 or 4.6% to $199,136.
- Charges for services representing electricity sales, which excludes interest and investment income, rental income and other non-operating revenues, increased by $6,676 or 7.4% to $97,236 mainly due to higher electricity generation and sales. Operating expenses, which exclude other non-operating expenses, increased by $22,593 or 35.4% to $86,334, largely due to higher non-capitalized project expenses, capital project write-offs, and a one-time $10,194 of combustion turbine asset write-off as a result of settlement.

Financial Highlights for Fiscal Year 2009

Hetch Hetchy Water and Power

- Total assets of Hetch Hetchy exceeded the total liabilities by $444,377.
- Net assets increased by $23,221 or 5.5% during the fiscal year.
- Capital assets, net of accumulated depreciation, increased by $14,263 or 5.5% to $273,639.
- During the fiscal year, charges for services, excluding interest and investment income, rental income and other non-operating revenues, decreased by $4,602 or 3.8% to $115,028.
- Operating expenses, which exclude interest expense and other non-operating expenses, decreased by $13,208 or 12.1% to $96,228.

Hetch Hetchy Water

- Total assets of Hetch Hetchy Water exceeded total liabilities by $113,287. Net assets decreased by $7,042 or 5.9% during the fiscal year. Capital assets, net of accumulated depreciation, decreased by $9,168 or 9.9% to $83,306.

- Charges for services representing water sales, excluding interest and investment income, rental income and other non-operating revenues, increased by $2,086 or 9.3% to $24,468. Operating expenses increased by $5,874 or 22.1% to $32,487.

Hetch Hetchy Power

- Total assets of Hetch Hetchy Power exceeded total liabilities by $331,090. Net assets increased by $30,263 or 10.1% during the fiscal year. Capital assets, net of accumulated depreciation, increased by $23,431 or 14.0% to $190,333.
- Charges for services representing electricity sales, excluding interest and investment income, rental income and other non-operating revenues, decreased by $6,688 or 6.9% to $90,560 mainly due to decrease in electricity sales. Operating expenses, excluding other non-operating expenses, decreased by $19,082 or 23.0% to $63,741, largely due to decrease in purchased power and related costs.

Financial Position

The following tables summarize Hetch Hetchy's changes in net assets.

Table 1A: **Consolidated Hetch Hetchy Water and Power Comparative Condensed Net Assets**

Table 1A

Comparative Condensed Net Assets

June 30, 2010, 2009, and 2008

		2010	2009	2008	2010 – 2009 Change	2009 – 2008 Change
Current and other assets	$	232,470	214,759	200,836	17,711	13,923
Capital assets, net of accumulated depreciation		285,770	273,639	259,376	12,131	14,263
Total assets		518,240	488,398	460,212	29,842	28,186
Current liabilities		27,975	22,881	22,209	5,094	672
Long-term liabilities		33,895	21,140	16,847	12,755	4,293
Total liabilities		61,870	44,021	39,056	17,849	4,965
Net assets:						
Invested in capital assets, net of related debt		282,698	273,639	259,376	9,059	14,263
Unrestricted		173,672	170,738	161,780	2,934	8,958
Total net assets	$	456,370	444,377	421,156	11,993	23,221

Table 1B: Hetch Hetchy Water Comparative Condensed Net Assets

Table 1B – Hetch Hetchy Water

Comparative Condensed Net Assets

June 30, 2010, 2009, and 2008

		2010	2009	2008	2010 – 2009 Change	2009 – 2008 Change
Current and other assets	$	34,512	36,530	32,270	(2,018)	4,260
Capital assets, net of accumulated depreciation		86,634	83,306	92,474	3,328	(9,168)
Total assets		121,146	119,836	124,744	1,310	(4,908)
Current liabilities		4,696	4,155	2,853	541	1,302
Long-term liabilities		3,301	2,394	1,562	907	832
Total liabilities		7,997	6,549	4,415	1,448	2,134
Net assets:						
Invested in capital assets, net of related debt		86,634	83,306	92,474	3,328	(9,168)
Unrestricted		26,515	29,981	27,855	(3,466)	2,126
Total net assets	$	113,149	113,287	120,329	(138)	(7,042)

Table 1C: Hetch Hetchy Power Comparative Condensed Net Assets

Table 1C – Hetch Hetchy Power

Comparative Condensed Net Assets

June 30, 2010, 2009, and 2008

		2010	2009	2008	2010 – 2009 Change	2009 – 2008 Change
Current and other assets	$	197,958	178,229	168,566	19,729	9,663
Capital assets, net of accumulated depreciation		199,136	190,333	166,902	8,803	23,431
Total assets		397,094	368,562	335,468	28,532	33,094
Current liabilities		23,279	18,726	19,356	4,553	(630)
Long-term liabilities		30,594	18,746	15,285	11,848	3,461
Total liabilities		53,873	37,472	34,641	16,401	2,831
Net assets:						
Invested in capital assets, net of related debt		196,064	190,333	166,902	5,731	23,431
Unrestricted		147,157	140,757	133,925	6,400	6,832
Total net assets	$	343,221	331,090	300,827	12,131	30,263

Net Assets, Fiscal Year 2010

Hetch Hetchy Water and Power

Hetch Hetchy's net assets increased by $11,993 or 2.7% during the year (see Table 1A). Current and other assets were $232,470, a $17,711 or 8.2% increase from prior year mainly due to the proceeds from the issuance of certificates of participation (COPs) for Hetch Hetchy Power's allocable share of the new 525 Golden Gate Avenue Headquarters Project, offset by a decrease in cash and investments in Hetch Hetchy Water. Total liabilities were $61,870, a $17,849 or 40.5% increase from prior year. The largest portion (61.9%) of Hetch Hetchy's net assets was investment in capital assets, net of related debt, which increased by $9,059 or 3.3 % over the prior year to $282,698.

Hetch Hetchy Water

Hetch Hetchy Water's net assets decreased by $138 or 0.1% resulting from an increase in total assets of $1,310 and an increase in total liabilities of $1,448 (see Table 1B). Contributing to the increase in total assets was increases of $3,328 of capital assets and $169 in charges for services receivables and inventories, offset by decreases of $1,737 in unrestricted cash and investment, and $450 in interest receivables and other receivables resulting from decrease in investment earnings. The increase in total liabilities was mainly due to the increase of $851 in other post-employment benefits obligation based on actuarial estimates, $378 in accounts payable related

to various project activities, $112 in payroll related liabilities mainly attributable to higher required contribution to retirement and health care costs, and $107 in damage and claim liability. Hetch Hetchy Water's investment in capital assets, net of related debt, was $86,634 or 76.6% of the total net assets.

Hetch Hetchy Power

Hetch Hetchy Power's net assets increased by $12,131 or 3.7% due to an increase of $28,532 in total assets, partially offset by an increase of $16,401 in total liabilities (see Table 1C). Hetch Hetchy Power's total asset increases were primarily due to increases of $8,803 in capital assets, $5,487 in unrestricted cash and investments, $12,626 in restricted cash and investments related to the issuance of the COPs for the new 525 Golden Gate Avenue Headquarters Project, $4,733 in receivables and other assets. These increases were offset by decreases of $1,701 in interest receivables due to lower investment earnings, $828 in deferred charges and $588 in due from other City departments and governments. Increases in Hetch Hetchy Power's total liabilities were due to the issuance of $16,676 in COPs, increase in accounts payable and liabilities of $2,297, other post-employment benefits obligation of $1,822 based on actuarial estimates, and an interfund payable due to the Water Enterprise of $4,560 for the 525 Golden Gate Avenue Headquarters Project costs incurred through fiscal year-end. These increases were offset by decreases in damage claim liabilities of $8,547 due primarily to settlement of two lawsuits filed by the United States of America on behalf of the U.S. Forest Service related to fires that resulted due to proximity of power lines, and revenue bonds of $407. Hetch Hetchy Power's investment in capital assets, net of related debt, was $196,064 or 57.1% of the total net assets.

Net Assets, Fiscal Year 2009

Hetch Hetchy Water and Power

Hetch Hetchy's net assets increased by $23,221 or 5.5% during the year (see Table 1A). Contributing to this net increase was an addition of $28,186 in total assets offset by an increase in total liabilities of $4,965. The largest portion of Hetch Hetchy's net assets ($273,639 or 61.6%) represents investment in capital assets, net of related debt.

Current and other assets increased by $13,923 or 6.9%, as a result of increases of $7,484 in current assets and $6,439 in other assets (see Table 1A). Current assets increased by $7,484 or 4.1% mainly due to increases in unrestricted cash and investments of $4,265 or 2.6%, accounts receivable of $1,751 or 18.6%, primarily related to sales to the Modesto Irrigation District (MID) and Turlock Irrigation District (TID), deferred charges and other assets of $1,358 or 64.0% due to increased energy banked with PG&E at fiscal year-end, $215 or 195.5% in current portion due from other governmental agencies (Wastewater Enterprise and the Port of San Francisco for lighting retrofit and other energy conservation projects), and other current assets of $29. The increases are partially offset by a decrease in current loan receivable of $134 or 100%. Increase in unrestricted cash and investments is attributable to net cash provided by operating activities of $28,150, cash provided by interest income of $4,167, offset partially by cash used in capital and related financing activities of $21,672 and non-capital financing activities of $289. Other assets increased by $6,439 or 38.7% mainly due to an increase of restricted cash and investments by $6,089 from proceeds from Clean Renewable Energy Bonds (CREBs) issued in November 2008, increases of $496 in non-current portion of the due from other governmental agencies, and $40 of bond issuance costs. These increases are offset by a $188 decrease in non-current loan receivable due to

repayments received and the expiration of the memorandum of understanding between Hetch Hetchy and the San Francisco Housing Authority.

Total liabilities increased by $4,965 or 12.7% primarily due to $5,717 in CREBs issued in November 2008, of which $422 relates to the short-term principal obligation. Accounts payable increased by $2,127 or 16.7% due to higher expenditures compared to prior year. Deposits, advances and other liabilities decreased by $1,331 or 58.3%, mainly due to the allocation of gas settlement proceeds to City departments. Other post-employment benefits obligation increased by $3,076 based on actuarial estimates. Damage and claim liability decreased by $4,990 or 32.6% due to settlement of two lawsuits filed by the U.S. Forest Service related to fires in proximity to Hetch Hetchy power lines. California Energy Commission's loans payable were retired during the fiscal year in the amount of $282 or 100%. Other liabilities of accrued payroll, vacation and sick leave, and workers' compensation increased by $648 or 11.3%.

Hetch Hetchy Water

Hetch Hetchy Water's net assets decreased by $7,042 or 5.9% resulting from a decrease in total assets of $4,908 and an increase in total liabilities of $2,134 (See Table 1B). Contributing to the decrease in total assets was a decrease of $9,168 in investment in capital assets, net of related debt and increase of $2,126 in unrestricted net assets. Current assets increased by $4,260 or 13.2% mainly due to increases in unrestricted cash of $4,213 resulting from net cash provided by operating activities. Total liabilities increased by $2,134 or 48.3% largely due to increase of $1,189 in accounts and vouchers payable related to operating spending activities, $811 in other post-employment benefits obligation based on actuarial study where the annual required contribution exceeded the contribution made, $194 in accrued payroll, vacation and sick leave, as well as workers' compensation, offset by a decrease of $60 in deposits, advances and other liabilities due to the allocation of gas settlement proceeds to City departments.

Hetch Hetchy Power

Total net assets increased by $30,263 or 10.1% during the year (see Table 1C). Contributing to this net increase was an addition of $33,094 in total assets offset by an increase in total liabilities of $2,831. Current assets increased by $3,224 or 2.1% mainly due to increases in accounts receivable of $1,732 or 18.8%, primarily related to sales to the Modesto Irrigation District, deferred charges and other assets of $1,358 or 64.1% due to increased energy banked with PG&E at fiscal year-end, $215 or 195.5% in current portion due from other governmental agencies (Wastewater Enterprise and the Port of San Francisco for lighting retrofit and other energy conservation projects), unrestricted cash of $52 from net cash provided by operating activities, and other current assets of $1, offset by a decrease in current loan receivable of $134 or 100%. Non-current assets increased by $29,870 or 16.3% mainly due to increased capital assets of $23,431, restricted cash by $6,091 of proceeds from Clean Renewable Energy Bonds (CREBs) issued in November 2008, $496 in interfund receivable from other governmental agencies, and $40 of bond issuance costs. These increases are offset by a $188 decrease in loan receivable due to repayments received and the expiration of the memorandum of understanding between Hetch Hetchy and the San Francisco Housing Authority.

Total liabilities increased by $2,831 or 8.2% primarily due to increases of $5,717 in CREBs issued in November 2008, of which $422 relates to the short-term principal obligation, other post-employment benefits obligation of $2,265 based on actuarial study where the annual required contribution exceeded the contribution made, $938 or

8.7% in accounts payable due to higher expenditures compared to prior year, and other liabilities of accrued payroll, vacation and sick leave, and workers compensation increased by $728 or 17.7%. These increases are offset by decreases in damage and claim liability of $4,990 or 32.6%, due to settlement of two lawsuits filed by the U.S. Forest Service related to fires in proximity to Hetch Hetchy power lines, $1,545 or 69.6% in deposits, advances and other liabilities mainly due to the allocation of gas settlement proceeds to City departments, and $282 or 100% in loans payable as the California Energy Commission's loans were retired during the fiscal year.

Results of Operations

The following tables summarize Hetch Hetchy's revenues, expenses, and changes in net assets:

Table 2A: Consolidated Hetch Hetchy Water and Power Revenues, Expenses, and Changes in Net Assets

Table 2A – Consolidated – Hetch Hetchy Water and Power

Comparative Condensed Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2010, 2009, and 2008

	2010	2009	2008	2010 – 2009 Change	2009 – 2008 Change
Revenues:					
Charges for services	$ 128,345	115,028	119,630	13,317	(4,602)
Rents and concessions	245	246	225	(1)	21
Interest and investment income	2,738	4,160	6,420	(1,422)	(2,260)
Other non-operating revenues	6,495	2,705	10,296	3,790	(7,591)
Total revenues	137,823	122,139	136,571	15,684	(14,432)
Expenses:					
Operating expenses	118,387	96,228	109,436	22,159	(13,208)
Other non-operating expenses	6,043	2,389	150	3,654	2,239
Total expenses	124,430	98,617	109,586	25,813	(10,969)
Net income before transfers and special item	13,393	23,522	26,985	(10,129)	(3,463)
Special item:					
Impairment loss	—	—	(41,224)	—	41,224
Income (loss) before transfers	13,393	23,522	(14,239)	(10,129)	37,761
Transfers in/(out)	(1,400)	(301)	(450)	(1,099)	149
Changes in net assets	11,993	23,221	(14,689)	(11,228)	37,910
Net assets at beginning of year	444,377	421,156	435,845	23,221	(14,689)
Net assets at end of year	$ 456,370	444,377	421,156	11,993	23,221

Table 2B: Hetch Hetchy Water Revenues, Expenses, and Changes in Net Asset

Table 2B – Hetch Hetchy Water

Comparative Condensed Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2010, 2009, and 2008

	2010	2009	2008	2010 – 2009 Change	2009 – 2008 Change
Revenues:					
Charges for services	$ 31,109	24,468	22,382	6,641	2,086
Rents and concessions	110	111	101	(1)	10
Interest and investment income	657	874	1,220	(217)	(346)
Other non-operating revenues	39	16	205	23	(189)
Total revenues	31,915	25,469	23,908	6,446	1,561
Expenses:					
Operating expenses	32,053	32,487	26,613	(434)	5,874
Total expenses	32,053	32,487	26,613	(434)	5,874
Income (loss) before transfers	(138)	(7,018)	(2,705)	6,880	(4,313)
Transfers in/(out)	—	(24)	—	24	(24)
Changes in net assets	(138)	(7,042)	(2,705)	6,904	(4,337)
Net assets at beginning of year	113,287	120,329	123,034	(7,042)	(2,705)
Net assets at end of year	$ 113,149	113,287	120,329	(138)	(7,042)

Table 2C: Hetch Hetchy Power Revenues, Expenses, and Changes in Net Assets

Table 2C – Hetch Hetchy Power

Comparative Condensed Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2010, 2009, and 2008

	2010	2009	2008	2010 – 2009 Change	2009 – 2008 Change
Revenues:					
Charges for services	$ 97,236	90,560	97,248	6,676	(6,688)
Rents and concessions	135	135	124	—	11
Interest and investment income	2,081	3,286	5,200	(1,205)	(1,914)
Other non-operating revenues	6,456	2,689	10,091	3,767	(7,402)
Total revenues	105,908	96,670	112,663	9,238	(15,993)
Expenses:					
Operating expenses	86,334	63,741	82,823	22,593	(19,082)
Other non-operating expenses	6,043	2,389	150	3,654	2,239
Total expenses	92,377	66,130	82,973	26,247	(16,843)
Net income before transfers and special item	13,531	30,540	29,690	(17,009)	850
Special item:					
Impairment loss	—	—	(41,224)	—	41,224
Income (loss) before transfers	13,531	30,540	(11,534)	(17,009)	42,074
Transfers in/(out)	(1,400)	(277)	(450)	(1,123)	173
Changes in net assets	12,131	30,263	(11,984)	(18,132)	42,247
Net assets at beginning of year	331,090	300,827	312,811	30,263	(11,984)
Net assets at end of year	$ 343,221	331,090	300,827	12,131	30,263

Results of Operations, Fiscal Year 2010

Hetch Hetchy Water and Power

Hetch Hetchy's total revenues were $137,823, an increase of $15,684 or 12.8% over the prior year. Hetch Hetchy's total expenses were $124,430, an increase of $25,813 or 26.2% over the prior year.

Hetch Hetchy Water

Hetch Hetchy Water's revenues were $31,915, an increase of $6,446 or 25.3% over the prior year, explained by higher water assessment fees from the San Francisco Water Enterprise, primarily to recover upcountry costs of water operations, and other water customers. Total expenses decreased by $434 mainly due to the decrease of $3,432 in non-capitalized project expenses, offset by increases of $882 in taxes, licenses, and permits from payments related to watershed protection and the Don Pedro licenses; $1,124 in judgment and claim expenses, $24 in general and administrative expenses; $574 in contractual services for building maintenance services, $153 in depreciation resulting from increased depreciable capital assets, $140 in personal services due to increased payroll and payroll-related costs, and $93 in materials and supplies of building and construction and equipment maintenance, and safety supplies; and $8 services provided by City department for increased billed work efforts from the City Attorney's Office.

Hetch Hetchy Power

Hetch Hetchy Power's total revenues were $105,908, an increase of $9,238 or 9.6% over the prior year. The majority of this revenue increase resulted from electricity sales of $5,154 and third party sales to other municipalities and governmental agencies under Western System Power Pool (WSPP) agreements. Additionally, Hetch Hetchy Power has revenue increases from Treasure Island Development Authority (TIDA) and City departments totaling $472 due to increase in power usage. Other non-operating revenues increased by $3,767 or 140.1%, which is due primarily to the $2,895 increase in settlement with the State Department of Water Resources (DWR) related to the Combustion Turbine project. This is offset by a $968 decrease in PG&E settlements and a $4 decrease in other miscellaneous items (see Table 2C). There was a decrease in interest and investment income of $1,205. Hetch Hetchy Power's total expenses increased by $26,247 or 39.7%, mainly due to increases in general liability payments of $1,815, write-off of development costs related to the Combustion Turbine project of $10,194 related to the settlement with DWR mentioned previously, $11,687 non-capitalizable in construction related activities, and $2,939 of solar incentive program expenses. The increases were offset by decreases in contractual services.

Results of Operations, Fiscal Year 2009

Hetch Hetchy Water and Power

Hetch Hetchy's total revenues of $122,139 decreased by $14,432 or 10.6% over the prior year (see Table 2A). Revenues from charges for services decreased by $4,602 or 3.8%, attributable to a decrease in electricity sales of $6,648 to Modesto Irrigation District, Turlock Irrigation District, and third party sales to other municipalities and governmental agencies under WSPP agreements, a decrease of $2,636 in revenue from TIDA resulting from the deletion of a $2,028 allowance in fiscal year 2008 per the new service agreement, other Treasure Island customers, the San Francisco Port power customers and other non-City department power customers. The decreases are offset by an increase in power sales of $2,597 to City departments and an increase in water assessment fees of $2,085 to the San Francisco Water Enterprise primarily and other water customers.

Other non-operating revenues decreased by $7,591 or 73.7%, which is attributed primarily to the absence of one-time revenues in prior fiscal year 2008 for combustion turbine project reimbursements of $4,866 and PG&E refunds of $3,361. Other decreases included services to other governmental agencies of $79, sale of fixed assets proceeds, overhead charges and other miscellaneous items of $253, and recognition of natural gas proceeds of

$968 in fiscal year 2009. Investment and interest income decreased by $2,260 or 35.2% mainly due to lower interest rates.

Total operating expenses decreased by $13,208 or 12.1% to $96,228, primarily due to a decrease in purchased power and related costs. Power purchases from the WSPP were lower by $10,082, resulting in lower transmission costs from PG&E. In addition, there was a decrease in general and administrative expenses of $13,650 due to a reduction of estimated liability claims in fiscal year 2009 compared to fiscal year 2008. These decreases are offset by a $4,126 increase in expenses attributable to professional and specialized services of $3,692, and rents and lease services of $402. Other expense increases include services provided by other departments of $776, other operating expenses of $480, personal services of $4,294 due to higher other post-employment benefit obligation actuarial estimates, and depreciation of $848. Non-operating expenses increased by $2,239 mainly due to the implementation of the new San Francisco Go-Solar incentive program, where rebate payments of $2,232 were made in fiscal year 2009. Overall, these changes along with transfers resulted in an increase in net assets of $23,221.

Hetch Hetchy Water

Hetch Hetchy Water's total revenues were $25,469, an increase of $1,561 or 6.5% over the prior year. Total expenses were $32,487, an increase of $5,874 or 22.1% over the prior year. Revenues from charges for services increased by $2,086 or 9.3%, attributable to water assessment fees to the San Francisco Water Enterprise primarily and other water customers, an increase of $10 in rents and concessions revenues, offset by decreases of $346 in interest and investment income mainly due to lower interest rates, and $189 in other non-operating revenues including Federal grants.

Hetch Hetchy Water's total expenses increased by $5,874 as explained by increases of $3,237 of non-capitalized project expense, $1,522 in personal services due to increased payroll and payroll-related costs, $357 in contractual services, $235 of services provided by City departments and overhead charges, $40 in depreciation, $512 in general administrative expense, and offset by a decrease of $29 in materials and supplies.

Hetch Hetchy Power

Hetch Hetchy Power's total revenues were $96,670, a decrease of $15,993 or 14.2% over the prior year. Revenues from charges for services decreased by $6,688 or 6.9%, attributable to a decrease in electricity sales of $6,648 to Modesto Irrigation District, Turlock Irrigation District, and third party sales to other Municipalities and Governmental Agencies under Western System Power Pool agreements.

Hetch Hetchy Power's total expenses decreased by $16,843 or 20.3%, primarily due to a decrease of $12,557 in estimated liability claims, purchased power from the Western System Power Pool of $10,082, resulting in lower transmission costs from PG&E, and materials and supplies of $20. These decreases are offset by increases in professional and specialized services of $3,258, personal services of $2,772 due to higher other post-employment benefit obligation actuarial estimates, depreciation expense of $808, services provided by other departments of $542, rents and lease services of $511. Non-operating expenses increased by $2,239 mainly due to the implementation of the new San Francisco Go-Solar incentive program, where rebate payments of $2,232 were made in fiscal year 2009. Overall, these changes resulted in an increase in net assets of $30,263.

Capital Assets and Debt Administration

Capital Assets

The following tables summarize Hetch Hetchy's changes in capital assets.

Table 3A: Hetch Hetchy Water and Power Consolidated Capital Assets

Table 3A – Consolidated – Hetch Hetchy Water and Power

Capital Assets, Net of Depreciation

Year ended June 30, 2010, 2009, and 2008

		2010	2009	2008	2010 – 2009 Change	2009– 2008 Change
Facilities, improvements, machinery, and equipment	$	215,679	229,998	230,265	(14,319)	(267)
Land and rights-of-way		4,665	4,676	4,594	(11)	82
Intangible assets		30,001	—	—	30,001	—
Construction work in progress		35,425	38,965	24,517	(3,540)	14,448
Total	$	285,770	273,639	259,376	12,131	14,263

Table 3B: Hetch Hetchy Water Capital Assets

Table 3B – Hetch Hetchy Water

Capital Assets, Net of Depreciation

Year ended June 30, 2010, 2009, and 2008

		2010	2009	2008	2010 – 2009 Change	2009– 2008 Change
Facilities, improvements, machinery, and equipment	$	62,429	71,079	85,248	(8,650)	(14,169)
Land and rights-of-way		3,003	3,008	2,932	(5)	76
Intangible assets		12,860	—	—	12,860	—
Construction work in progress		8,342	9,219	4,294	(877)	4,925
Total	$	86,634	83,306	92,474	3,328	(9,168)

Table 3C: Hetch Hetchy Power Capital Assets

Table 3C – Hetch Hetchy Power

Capital Assets, Net of Depreciation

Year ended June 30, 2010, 2009, and 2008

		2010	2009	2008	2010 – 2009 Change	2009– 2008 Change
Facilities, improvements, machinery, and equipment	$	153,250	158,919	145,017	(5,669)	13,902
Land and rights-of-way		1,662	1,668	1,662	(6)	6
Intangible assets		17,141	—	—	17,141	—
Construction work in progress		27,083	29,746	20,223	(2,663)	9,523
Total	$	199,136	190,333	166,902	8,803	23,431

Capital Assets, Fiscal Year 2010

Hetch Hetchy Water and Power

Hetch Hetchy has net capital assets of $285,770 invested in both water and power utility capital assets as of June 30, 2010 (see Table 3A). This amount represents an increase of $12,131 or 4.4%, resulting from a decrease of $14,319 in facilities, improvements, machinery and equipment, net of depreciation, partly as a result of reclassification of $30,001 in intangible assets of water rights and emission reduction credits and a $11 decrease in land and rights-of-way. Construction work in progress decreased by $3,540.

The investment in capital assets includes land, buildings, improvements, hydropower facilities, dams, transmission lines, machinery, and equipment.

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

Table 3D-1 Hetch Hetchy Water and Power

Major Additions to Construction Work in Progress

Year ended June 30, 2010

		Hetch Hetchy Water	Hetch Hetchy Power	Total 2010 Hetch Hetchy Water & Power
525 Golden Gate Avenue Headquarters Building	$	—	4,629	4,629
Fiber/Communication System Upgrades		1,440	1,761	3,201
San Joaquin Pipeline Rehabilitation		2,166	—	2,166
Penstock Renovations		876	1,071	1,947
Kirkwood Powerhouse Project		—	1,436	1,436
San Francisco Electrical Reliability Power Project		—	1,426	1,426
Shore Power for Cruise Ships		—	1,340	1,340
Switchyard Upgrades		—	1,305	1,305
Other project additions below $1,000		3,222	12,907	16,129
	$	7,704	25,875	33,579

Major depreciable facilities, improvements, intangible assets, machinery and equipment placed in service during the year ended June 30, 2010 include:

Table 3D-2 Hetch Hetchy Water and Power

Major Facilities, Improvements, Intangible Assets, Machinery and Equipment Placed in Service

Year ended June 30, 2010

		Hetch Hetchy Water	Hetch Hetchy Power	Total 2010 Hetch Hetchy Water & Power	
Water Rights	$	20,522	25,082	45,604	*
Hetchy Microwave Replacement		2,069	2,528	4,597	
Fiber Optic Cable from Moccasin to Early Intake		1,558	1,904	3,462	
Kirkwood Powerhouse Project		1,412	4,971	6,383	
Moscone Center Solar Energy System		—	2,365	2,365	
Governor at Moccasin Powerhouse Unit 2		—	1,799	1,799	
Moccasin Roads Rebuilding		544	665	1,209	
Other project additions below $1,000		2,717	4,351	7,068	
	$	28,822	43,665	72,487	

* Intangible assets reclassification

Hetch Hetchy Water

Hetch Hetchy Water has net capital assets of $86,634 invested in a broad range of utility capital assets as of June 30, 2010 (see Table 3B). This amount represents an increase of $3,328 or 4.0%, primarily due to an increase in facilities and equipment. A reclassification of $12,860 of water rights in intangible assets from facilities, improvements, machinery and equipment was also made.

For the year ended June 30, 2010, Hetch Hetchy Water's major additions to construction work in progress totaled $7,704 (see Table 3D-1). Major depreciable facilities, improvements, intangible assets, machinery and equipment placed in service totaled $28,822 (see Table 3D-2).

Hetch Hetchy Power

Hetch Hetchy Power has net capital assets of $199,136 invested in power utility capital assets as of June 30, 2010 (see Table 3C). This amount represents an increase of $8,803 or 4.6%, attributable to a reclassification of $17,141 from facilities, improvements, machinery and equipment to intangible assets and a decrease of $2,663 in construction in progress.

For the year ended June 30, 2010, Hetch Hetchy Power's major additions to construction work in progress totaled $25,875 (see Table 3D-1), and major depreciable facilities, improvements, intangible assets, machinery and equipment placed in service totaled $43,665 (see Table 3D-2).

525 Golden Gate Avenue Headquarters Building

As of June 30, 2010, the Power Enterprise has incurred its 12% share or $4,629 in development costs for the project. The building is intended to consolidate divisions of the San Francisco Public Utilities Commission that are currently renting space at multiple locations in the Civic Center. Demolition of the existing site was completed in June 2009. Construction started in January 2010 with an expected completion in February 2012, followed by an expected occupancy in April 2012.

Capital Assets, Fiscal Year 2009

Hetch Hetchy has net capital assets of $273,639 invested in water and power utility capital assets as of June 30, 2009 (see Table 3A). This amount represents an increase of $14,263 or 5.5%, attributable to a $267 decrease in facilities, improvements, machinery and equipment offset by a $14,448 net increase in construction work in progress and $82 of additions in land and rights-of-way.

The investment in capital assets includes land, buildings, improvements, hydropower facilities, dams, transmission lines, machinery, and equipment.

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

Table 3E-1 Hetch Hetchy Water and Power

Major Additions to Construction in Progress and Equipment Placed in Service

Year ended June 30, 2009

		Hetch Hetchy Water	Hetch Hetchy Power	Total 2009 Hetch Hetchy Water & Power
Street Light Underground Utilities	$	—	3,173	3,173
San Joaquin Pipeline Rehabilitation		2,327	—	2,327
Hunter's Point Municipal Power		—	1,329	1,329
Kirkwood Powerhouse Project		1,141	2,615	3,756
Replacement of Microwave Communication Device		450	550	1,000
Other project additions individually below $1,000		2,960	9,097	12,057
	$	6,878	16,764	23,642

Major facilities, improvements, machinery and equipment placed in service during the year ended June 30, 2009 included:

Table 3E-2 Hetch Hetchy Water and Power

Major Facilities, Improvements, Machinery and Equipment Placed in Service

Year ended June 30, 2009

		Hetch Hetchy Water	Hetch Hetchy Power	Total 2009 Hetch Hetchy Water & Power
Street Lights	$	—	3,138	3,138
Moccasin Powerhouse 1 New Governor Unit		—	1,004	1,004
Other additions below $1,000		3,427	4,036	7,463
	$	3,427	8,178	11,605

Debt Administration

Hetch Hetchy Water and Power

As of June 30, 2010, Hetch Hetchy Water and Power has outstanding certificates of participation and Clean Renewable Energy Bonds (CREBs). See Hetch Hetchy Power section below for more details.

Hetch Hetchy Water

Hetch Hetchy Water did not have any debt outstanding in the fiscal years 2010 and 2009.

Hetch Hetchy Power

As of June 30, 2010 and 2009, Hetch Hetchy Power has outstanding debt of $21,986 and $5,717, respectively, as shown in Table 4. The change in total debt outstanding was due to issuance of the certificates of participation (COPs) Series 2009C and 2009D in October 2009 for the construction of the SFPUC headquarters building at 525 Golden Gate Avenue. The total amount of COPs issued was $167,700 and Hetch Hetchy Power's share was 9.72% or $16,711, including premium of $413.

Hetch Hetchy Power issued $6,325 of CREBs in accordance with the Energy Tax Incentives Act of 2005 to fund solar photovoltaic projects in November 2008. The qualified bonds carry no interest costs and have a term of fifteen years. Annual payments in the amount of $422 are due on December 15th beginning in 2008.

The California Energy Commission (CEC) loan, issued in November 2002, was retired in April 2009.

Table 4 – Consolidated Hetch Hetchy Water and Power

Outstanding Debt, Net of Unamortized Costs and Premium

June 30, 2010, 2009, and 2008

		2010	2009	2008	2010 – 2009 Change	2009 – 2008 Change
State of California CEC loan	$	—	—	282	—	(282)
Clean renewable energy bonds		5,310	5,717	—	(407)	5,717
Certificates of participation Series 2009C		4,083	—	—	4,083	—
Certificates of participation Series 2009D (BABs)		12,593	—	—	12,593	—
Total	$	21,986	5,717	282	16,269	5,435

Total debt outstanding at June 30, 2010 consisted of $5,310 in CREBs and $16,676 in certificates of participation. The change in total debt outstanding was due to the issuance of certificates of participation, retirement of CEC loan, and amortization of bond premium and discount.

More detailed information on Hetch Hetchy Power's long-term liabilities is presented in Note 6 to the financial statements.

Next Year's Rates

Hetch Hetchy Water

Assessment fees to the Water Enterprise will increase to $29.7 million as reflected in the FY 2011 adopted budget. Other upcountry retail rates are increasing 15% effective July 1, 2010 as adopted by the Commission as part of the five-year retail rates plan in May 2009.

Hetch Hetchy Power

Hetch Hetchy Power's electric revenue requirement model was completed in September 2009. The electric retail rate setting process will occur during fiscal year 2011 in conjunction with an independent rate study as required by City Charter. Currently, Hetch Hetchy Power charges the general fund City departments $0.0375 per kilowatt hours (kWh) and other City enterprise departments are charged at the PG&E scheduled rates. For fiscal year 2010, the MID and TID class one rates were $0.02472 kWh and $0.02193 kWh, respectively. MID/TID rates get trued up every year based on actuals. Under an existing development agreement, Hetch Hetchy will construct, own and operate the electric distribution infrastructure required to provide retail electric service to residential and commercial customers in Parcel "A" of the former Hunter's Point Shipyard. To date, Hetch Hetchy has prepared service standards, developed system plans and specifications, acquired materials and equipment, and initiated construction of primary distribution facilities.

Request for Information

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

HETCH HETCHY WATER AND POWER

Statements of Net Assets

June 30, 2010 and 2009

(In thousands)

	Hetch Hetchy Water	Hetch Hetchy Power	2010 Total	Hetch Hetchy Water	Hetch Hetchy Power	2009 Total
Assets:						
Current assets:						
Cash and investments with City Treasury	$ 33,986	139,875	173,861	35,723	134,388	170,111
Cash and investments outside City Treasury	2	8	10	2	8	10
Receivables:						
Charges for services (net of allowance for doubtful accounts of $0 in 2010 and 2009)	364	12,734	13,098	207	10,968	11,175
Due from other City departments, current portion	—	1,113	1,113	—	325	325
Due from other governments	—	170	170	—	—	—
Interest receivables	25	78	103	473	1,779	2,252
Other receivables	1	6,869	6,870	3	4,081	4,084
Total receivables	390	20,964	21,354	683	17,153	17,836
Deferred charges and other assets	—	2,650	2,650	—	3,478	3,478
Inventories	134	153	287	122	139	261
Total current assets	34,512	163,650	198,162	36,530	155,166	191,696
Non-current assets:						
Restricted assets – cash and investments outside City Treasury	—	18,717	18,717	—	6,091	6,091
Capital assets not being depreciated	11,351	30,176	41,527	12,227	31,414	43,641
Capital assets, net of accumulated depreciation	75,283	168,960	244,243	71,079	158,919	229,998
Due from other City departments	—	15,386	15,386	—	16,932	16,932
Bond issuance costs, net of accumulated amortization of $19 in 2010 and $2 in 2009	—	205	205	—	40	40
Total non-current assets	86,634	233,444	320,078	83,306	213,396	296,702
Total assets	121,146	397,094	518,240	119,836	368,562	488,398
Liabilities:						
Current liabilities:						
Accounts payable	3,528	13,725	17,253	3,150	11,703	14,853
Accrued payroll	595	1,479	2,074	496	1,322	1,818
Accrued vacation and sick leave, current portion	436	1,084	1,520	396	1,058	1,454
Accrued workers' compensation, current portion	109	271	380	110	295	405
Due to other funds	—	4,560	4,560	—	—	—
Damage and claim liability, current portion	25	734	759	—	3,251	3,251
Deposits, advances, and other liabilities	3	840	843	3	675	678
Bond and loan interest payable	—	164	164	—	—	—
Revenue bonds, current portion	—	422	422	—	422	422
Total current liabilities	4,696	23,279	27,975	4,155	18,726	22,881
Long-term liabilities:						
Other post-employment benefits obligation	2,431	6,041	8,472	1,580	4,219	5,799
Accrued vacation and sick leave, less current portion	304	755	1,059	296	790	1,086
Accrued workers' compensation, less current portion	484	1,204	1,688	518	1,382	1,900
Damage and claim liability, less current portion	82	1,030	1,112	—	7,060	7,060
Revenue bonds, less current portion	—	4,888	4,888	—	5,295	5,295
Certificates of participation	—	16,676	16,676	—	—	—
Total long-term liabilities	3,301	30,594	33,895	2,394	18,746	21,140
Total liabilities	7,997	53,873	61,870	6,549	37,472	44,021
Net assets:						
Invested in capital assets, net of related debt	86,634	196,064	282,698	83,306	190,333	273,639
Unrestricted	26,515	147,157	173,672	29,981	140,757	170,738
Total net assets	$ 113,149	343,221	456,370	113,287	331,090	444,377

See accompanying notes to financial statements.

HETCH HETCHY WATER AND POWER

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2010 and 2009

(In thousands)

	Hetch Hetchy Water	Hetch Hetchy Power	2010 Total	Hetch Hetchy Water	Hetch Hetchy Power	2009 Total
Operating revenues:						
Charges for services	$ 31,109	97,236	128,345	24,468	90,560	115,028
Rents and concessions	110	135	245	111	135	246
Total operating revenues	31,219	97,371	128,590	24,579	90,695	115,274
Operating expenses:						
Personal services	10,770	25,755	36,525	10,630	25,839	36,469
Contractual services	1,457	5,627	7,084	883	7,215	8,098
Transmission/distribution and other power costs	—	17,398	17,398	—	18,466	18,466
Purchased electricity	—	328	328	—	—	—
Materials and supplies	970	1,540	2,510	877	1,366	2,243
Depreciation	4,092	8,539	12,631	3,939	7,930	11,869
Services provided by other departments and general and administrative	12,185	4,018	16,203	10,147	1,677	11,824
Other	2,579	23,129	25,708	6,011	1,248	7,259
Total operating expenses	32,053	86,334	118,387	32,487	63,741	96,228
Operating income (loss)	(834)	11,037	10,203	(7,908)	26,954	19,046
Non-operating revenues (expenses):						
Federal grants	—	197	197	—	—	—
Interest and investment income	657	2,081	2,738	874	3,286	4,160
Other non-operating revenues	39	6,259	6,298	16	2,689	2,705
Interest expense	—	(722)	(722)	—	(7)	(7)
Other non-operating expense	—	(5,321)	(5,321)	—	(2,382)	(2,382)
Net non-operating revenues	696	2,494	3,190	890	3,586	4,476
Net income (loss) before transfers	(138)	13,531	13,393	(7,018)	30,540	23,522
Transfers in/(out)	—	(1,400)	(1,400)	(24)	(277)	(301)
Changes in net assets	(138)	12,131	11,993	(7,042)	30,263	23,221
Net assets at beginning of year	113,287	331,090	444,377	120,329	300,827	421,156
Net assets at end of year	$ 113,149	343,221	456,370	113,287	331,090	444,377

See accompanying notes to financial statements.

HETCH HETCHY WATER AND POWER

Statements of Cash Flows

Years ended June 30, 2010 and 2009

(In thousands)

	Hetch Hetchy Water	Hetch Hetchy Power	2010 Total	Hetch Hetchy Water	Hetch Hetchy Power	2009 Total
Cash flows from operating activities:						
Cash received from customers, including cash deposits	$ 30,954	93,599	124,553	24,453	86,986	111,439
Cash received from tenants for rent	110	141	251	111	135	246
Cash paid to employees for services	(9,625)	(23,583)	(33,208)	(9,472)	(22,850)	(32,322)
Cash paid to suppliers for goods and services	(14,414)	(39,087)	(53,501)	(17,003)	(32,592)	(49,595)
Cash from miscellaneous revenues	26	239	265	4	281	285
Cash paid for judgments and claims	(1,269)	(7,452)	(8,721)	(218)	(1,685)	(1,903)
Net cash provided by operating activities	5,782	23,857	29,639	(2,125)	30,275	28,150
Cash flows from non-capital and related financing activities:						
Federal and State grants	—	27	27	—	—	—
Cash received from settlements	2	4,653	4,655	—	1,246	1,246
Rebates and program incentives paid	—	(5,332)	(5,332)	—	(2,401)	(2,401)
License fees received	—	1,361	1,361	—	1,167	1,167
Transfers in	—	300	300	—	—	—
Transfers (out)	—	(1,700)	(1,700)	(24)	(277)	(301)
Net cash provided by (used in) non-capital financing activities	2	(691)	(689)	(24)	(265)	(289)
Cash flows from capital and related financing activities:						
Acquisition and construction of capital assets	(8,637)	(24,396)	(33,033)	5,518	(32,593)	(27,075)
Proceeds from sale of capital assets	11	15	26	12	13	25
Issuance costs paid on long-term debt	—	(150)	(150)	—	6,089	6,089
Principal payments on bond debt	—	(422)	(422)	—	(422)	(422)
Principal payments on loans payable	—	—	—	—	(282)	(282)
Proceeds from certificates of participation	—	16,711	16,711	—	—	—
Interest paid on loans payable	—	(593)	(593)	—	(7)	(7)
Net cash (used in) provided by capital and related financing activities	(8,626)	(8,835)	(17,461)	5,530	(27,202)	(21,672)
Cash flows from investing activities:						
Interest income received	1,105	3,782	4,887	830	3,337	4,167
Proceeds from sale of investments outside City Treasury	—	4,218	4,218	—	—	—
Purchases of investments outside City Treasury	—	(4,218)	(4,218)	—	—	—
Net cash provided by investing activities	1,105	3,782	4,887	830	3,337	4,167
(Decrease) increase in cash and cash equivalents	(1,737)	18,113	16,376	4,211	6,145	10,356
Cash and cash equivalents:						
Beginning of year	35,725	140,487	176,212	31,512	134,344	165,856
End of year	$ 33,988	158,600	192,588	35,723	140,489	176,212
Reconciliation of cash and cash equivalents to the statements of net assets:						
Cash and investments with City Treasury	$ 33,986	139,875	173,861	35,723	134,388	170,111
Cash and investments outside City Treasury	2	18,725	18,727	2	6,099	6,101
Total cash and investments	$ 33,988	158,600	192,588	35,725	140,487	176,212

(Continued)

HETCH HETCHY WATER AND POWER

Statements of Cash Flows

Years ended June 30, 2010 and 2009

(In thousands)

	Hetch Hetchy Water	Hetch Hetchy Power	2010 Total	Hetch Hetchy Water	Hetch Hetchy Power	2009 Total
Reconciliation of operating income to net cash provided by operating activities:						
Operating income	$ (834)	11,037	10,203	(7,908)	26,954	19,046
Adjustment to reconcile operating income to net cash provided by operating activities:						
Depreciation	4,092	8,539	12,631	3,939	7,930	11,869
Write-off of capital assets	810	11,645	12,455	—	349	349
Amortization of bond discount and issuance cost	—	—	—	—	10	10
Cash from other sources	26	239	265	4	281	285
Changes in operating assets and liabilities:						
Receivables:						
Charges for services	(157)	(1,766)	(1,923)	(19)	(1,732)	(1,751)
Due from other City departments	—	758	758	—	(711)	(711)
Other receivable	2	(2,788)	(2,786)	—	(71)	(71)
Loans receivable	—	—	—	—	322	322
Deferred charges and other assets	—	828	828	—	(1,358)	(1,358)
Inventories	(12)	(14)	(26)	16	19	35
Accounts payable	785	1,993	2,778	899	1,821	2,720
Accrued payroll	99	157	256	85	286	371
Accrued other post-employment benefits obligation	851	1,822	2,673	811	2,265	3,076
Accrued vacation and sick leave	48	(9)	39	22	147	169
Accrued workers' compensation	(35)	(202)	(237)	22	136	158
Damage and claim liability	107	(8,547)	(8,440)	—	(4,990)	(4,990)
Deposits, advances, and other liabilities	—	165	165	4	(1,383)	(1,379)
Total adjustments	6,616	12,820	19,436	5,783	3,321	9,104
Net cash provided by operating activities	$ 5,782	23,857	29,639	(2,125)	30,275	28,150
Noncash transaction:						
Accrued capital asset costs	$ 917	5,009	5,926	1,324	4,980	6,304
Interfund loan	—	4,560	4,560	—	—	—

See accompanying notes to financial statements.

(1) Definition of Reporting Entity

Hetch Hetchy was established as a result of the Raker Act of 1913, which granted water and power resources rights-of-way on the Tuolumne River in Yosemite National Park and Stanislaus National Forest to the City. Hetch Hetchy is a stand-alone enterprise comprised of two funds, Hetch Hetchy Power (AKA the Power Enterprise) and Hetch Hetchy Water, a portion of the Water Enterprise's operations, specifically the upcountry water supply and transmission service for the latter. Hetch Hetchy accounts for the activities of the Hetch Hetchy Water and Power and is engaged in the collection and conveyance of approximately 85% of the City's water supply and in the generation and transmission of electricity from that resource.

Approximately 65% of the electricity generated by Hetch Hetchy Power is used to provide electric service to the City's municipal customers (including the San Francisco Municipal Transportation Agency, Recreation and Parks Department, the Port of San Francisco, the San Francisco International Airport and its tenants, San Francisco General Hospital, street lights, Moscone Convention Center, and the Water and Wastewater Enterprises). The balance of electricity is sold to other utility districts, such as the Turlock and Modesto Irrigation Districts. As a result of the 1913 Raker Act, energy produced above the City's Municipal Load is sold first to Modesto and Turlock Irrigation Districts (the Districts) to cover their pumping and municipal load needs and any remaining energy is either sold to other municipalities and/or government agencies (not for resale) or deposited into an energy bank account under the City's agreement with PG&E. Hetch Hetchy consists of a system of reservoirs, hydroelectric power plants, aqueducts, pipelines, and transmission lines. This system carries water and power more than 165 miles from the Sierra Nevada to customers in the City and portions of the surrounding San Francisco Bay Area.

Hetch Hetchy also purchases wholesale electric power from various energy providers that are used in conjunction with owned hydro resources to meet the power requirements of its customers. Operations and business decisions can be greatly influenced by market conditions, State and Federal power matters before the California Public Utilities Commission (CPUC), the California Independent System Operator (CAISO), and the Federal Energy Regulatory Commission (FERC). Therefore, Hetch Hetchy serves as the City's representative at CPUC, CAISO and FERC forums and continues to monitor regulatory proceedings.

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

The Commission is a department of the City, and as such, the financial operations of Hetch Hetchy, Wastewater, 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 the financial position and the changes in financial position and cash flows of only the portion of the City that is attributable to the transactions of Hetchy Hetchy. The do not purport to, and do not present fairly the financial position of the City as of June 30, 2010, and the changes in financial position, or, where applicable, the cash flows in conformity with U.S. generally accepted accounting principles.

(2) Significant Accounting Policies

(a) Basis of Accounting and Measurement Focus

The accounts of Hetch Hetchy are organized on the basis of a proprietary fund types and are included as enterprise funds of the City. The activities of Hetch Hetchy and each fund are accounted for with a separate set of self-balancing accounts that comprise Hetch Hetchy's and each fund'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 Hetch Hetchy are accounted for on a flow of economic resources measurement focus, using the accrual basis of accounting. Under this method, all assets and liabilities associated with operations are included on the statements of net assets; revenues are recorded when earned, and expenses are recorded when liabilities are incurred. Operating revenues are defined as charges to customers and rental income.

Hetch Hetchy does not apply Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989. Hetch Hetchy applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, as well as statements and interpretations of 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

Hetch Hetchy considers its pooled deposits and investments held with the City Treasury to be demand deposits and therefore cash equivalents for financial reporting. Non-pooled restricted

deposits and restricted deposits and investments held outside the City Treasury with maturities of three months or less are considered to be cash equivalents.

(c) Investments

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

(d) Deferred Charges

Deferred charges consist of costs incurred to generate the power that has been placed in the Municipal Deviation and Deferred Delivery Accounts under the provisions of the interconnection agreement with PG&E (see note 12(a)).

(e) Inventory

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

(f) 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. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related assets, which range from 3 to 100 years. No depreciation or amortization is recorded in the year of acquisition, and a full year's depreciation or amortization is recorded in the year of disposal.

(g) Intangible Assets

As of July 1, 2009, the Enterprise has adopted GASB Statement 51, *Accounting and Financial Reporting for Intangible Assets*. Generally, the Enterprise capitalizes intangible assets providing a benefit extending beyond one reporting period, and amortizes the asset over the useful life. Intangible assets with an indefinite useful life are not amortized. The capitalization threshold of Hetch Hetchy is $100. The adoption of this standard had no impact on net assets.

(h) Construction in Progress

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

(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

Hetch Hetchy 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 and Claim Liability

Hetch Hetchy 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 Requirement

Certain bonds are subject to arbitrage rebate requirements in accordance with regulations issued by the U.S. Treasury Department. The requirements of the Clean Renewable Energy Bonds stipulate that the first payment of excess investment earnings if any, is required to be rebated to the Federal government, no later than sixty days after the end of the fifth bond year of the agreement. Hetch Hetchy's arbitrage liability was zero as of June 30, 2010 and 2009.

(n) Income Taxes

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

(o) Revenue Recognition

Water and power revenues are based on water and power consumption and billing rates. Generally, customers are billed monthly. Revenues earned but unbilled are accrued as charges for services receivable on the statements of net assets.

(p) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts

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

(q) Reclassifications

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

(r) Accounting and Financial Reporting for Pollution Remediation Obligations

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

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

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

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

As of June 30, 2010 and 2009, the pollution remediation obligation reported in the accompanying statements of net assets is $0.

(s) Effects of New Pronouncements

Governmental Accounting Standards Board Statement 51, Accounting and Financial Reporting for Intangible Assets

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

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

According to the standard, Hetch Hetchy is required to capitalize intangible assets with a useful life extending beyond one reporting period. Effective July 1, 2009, Hetch Hetchy has established a capitalization threshold of $100. GASB Statement 51 also requires amortization of intangible assets 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 a result of the adoption of GASB Statement 51, Hetch Hetchy reclassified $45,616 of water rights and easements, and recorded $1,425 of emission reduction credits for a total of $47,041 in intangible assets as of June 30, 2010, $20,528 in Hetch Hetchy Water and $26,513 in Hetch Hetchy Power.

(3) Cash, Cash Equivalents and Investments

Hetch Hetchy's cash, cash equivalents and investments with the City Treasury are invested 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 Hetch Hetchy's average daily cash balances.

The primary objectives of Hetch Hetchy's investment policy are consistent with the City's policy.

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

		Hetch Hetchy Water	Hetch Hetchy Power	Total 2010 Hetch Hetchy Water & Power
Current and non-current assets:				
Pooled cash and investments with City Treasury	$	33,986	139,875	173,861
Nonpooled cash and investments outside City Treasury		2	18,725	18,727
Total cash, cash equivalents, and investments	$	33,988	158,600	192,588

		Hetch Hetchy Water	Hetch Hetchy Power	Total 2009 Hetch Hetchy Water & Power
Current and non-current assets:				
Pooled cash and investments with City Treasury	$	35,723	134,388	170,111
Nonpooled cash and investments outside City Treasury		2	6,099	6,101
Total cash, cash equivalents, and investments	$	35,725	140,487	176,212

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

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

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

Investment maturities (in months)			
Under 1	**1 to less than 6**	**6 to less than 12**	**12 – 60**
9.9%	27.0%	8.8%	54.3%

Non-pooled cash outside of the investment pool is $18,727 and $6,101 at June 30, 2010 and 2009, respectively. Balances include CREBs proceeds of $2,589 deposited into a Federal Deposit Insurance Corporation (FDIC) insured money market fund with a weighted average maturity of 34 days, and $10 held at a commercial bank in a non-interest bearing checking account that is covered by depository insurance. The account was established as provided by the City's Administrative Code. The credit ratings of the money market funds invested in as of June 30, 2010 and June 30, 2009 were "Aaa" by Moody's and "AAAm" by Standard & Poor's. Proceeds from the certificates of participation in the amount of $16,128 are held with an outside trustee and are invested in the US Treasury Bills with maturities from July 1, 2010 through September 23, 2010. The credit ratings of the Treasury Bills as of June 30, 2010 were "Aaa" by Moody's and "AAA" by Standard & Poor's.

(4) Capital Assets

(a) Hetch Hetchy Water and Power

Hetch Hetchy Water and Power capital assets as of June 30, 2010 and 2009 consist of the following:

	Balance June 30, 2009	Increases	Decreases	Balance June 30, 2010
Capital assets not being depreciated:				
Land and rights-of-way	$ 4,676	—	(11)	4,665
Intangible assets	—	1,437	—	1,437
Construction in progress	38,965	33,579	(37,119)	35,425
Total capital assets not being depreciated	43,641	35,016	(37,130)	41,527
Capital assets being depreciated:				
Facilities and improvements	489,342	11,938	(45,604)	455,676
Intangible assets	—	45,604	—	45,604
Machinery and equipment	55,162	14,945	(177)	69,930
Total capital assets being depreciated	544,504	72,487	(45,781)	571,210
Less accumulated depreciation for:				
Facilities and improvements	(280,866)	(10,057)	15,283	(275,640)
Intangible assets	—	(17,040)	—	(17,040)
Machinery and equipment	(33,640)	(2,574)	1,927	(34,287)
Total accumulated depreciation	(314,506)	(29,671)	17,210	(326,967)
Total capital assets being depreciated, net	229,998	42,816	(28,571)	244,243
Total capital assets, net	$ 273,639	77,832	(65,701)	285,770

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2010 and 2009

(Dollars in thousands)

	Balance June 30, 2008	Increases	Decreases	Balance June 30, 2009
Capital assets not being depreciated:				
Land and rights-of-way	$ 4,594	82	—	4,676
Construction in progress	24,517	23,642	(9,194)	38,965
Total capital assets not being depreciated	29,111	23,724	(9,194)	43,641
Capital assets being depreciated:				
Facilities and improvements	484,567	4,775	—	489,342
Machinery and equipment	48,501	6,830	(169)	55,162
Total capital assets being depreciated	533,068	11,605	(169)	544,504
Less accumulated depreciation for:				
Facilities and improvements	(270,951)	(9,915)	—	(280,866)
Machinery and equipment	(31,852)	(1,954)	166	(33,640)
Total accumulated depreciation	(302,803)	(11,869)	166	(314,506)
Total capital assets being depreciated, net	230,265	(264)	(3)	229,998
Total capital assets, net	$ 259,376	23,460	(9,197)	273,639

(Continued)

(b) Hetch Hetchy Water

Hetch Hetchy Water capital assets as of June 30, 2010 and 2009 consist of the following:

	Balance June 30, 2009	Increases	Decreases	Balance June 30, 2010
Capital assets not being depreciated:				
Land and rights-of-way	$ 3,008	—	(5)	3,003
Intangible assets	—	6	—	6
Construction in progress	9,219	7,704	(8,581)	8,342
Total capital assets not being depreciated	12,227	7,710	(8,586)	11,351
Capital assets being depreciated:				
Facilities and improvements	210,300	2,250	(20,522)	192,028
Intangible assets	—	20,522	—	20,522
Machinery and equipment	11,450	6,050	(80)	17,420
Total capital assets being depreciated	221,750	28,822	(20,602)	229,970
Less accumulated depreciation for:				
Facilities and improvements	(143,063)	(3,521)	7,668	(138,916)
Intangible assets	—	(7,668)	—	(7,668)
Machinery and equipment	(7,608)	(571)	76	(8,103)
Total accumulated depreciation	(150,671)	(11,760)	7,744	(154,687)
Total capital assets being depreciated, net	71,079	17,062	(12,858)	75,283
Total capital assets, net	$ 83,306	24,772	(21,444)	86,634

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2010 and 2009

(Dollars in thousands)

	Balance June 30, 2008	Increases	Decreases	Balance June 30, 2009
Capital assets not being depreciated:				
Land and rights-of-way	$ 2,932	76	—	3,008
Construction in progress	4,294	6,878	(1,953)	9,219
Total capital assets not being depreciated	7,226	6,954	(1,953)	12,227
Capital assets being depreciated:				
Facilities and improvements	221,587	2,369	(13,656)	210,300
Machinery and equipment	10,468	1,058	(76)	11,450
Total capital assets being depreciated	232,055	3,427	(13,732)	221,750
Less accumulated depreciation for:				
Facilities and improvements	(139,541)	(3,522)	—	(143,063)
Machinery and equipment	(7,266)	(417)	75	(7,608)
Total accumulated depreciation	(146,807)	(3,939)	75	(150,671)
Total capital assets being depreciated, net	85,248	(512)	(13,657)	71,079
Total capital assets, net	$ 92,474	6,442	(15,610)	83,306

(Continued)

(c) Hetch Hetchy Power

Hetch Hetchy Power capital assets as of June 30, 2010 and 2009 consist of the following:

	Balance June 30, 2009	Increases	Decreases	Balance June 30, 2010
Capital assets not being depreciated:				
Land and rights-of-way	$ 1,668	—	(6)	1,662
Intangible assets	—	1,431	—	1,431
Construction in progress	29,746	25,875	(28,538)	27,083
Total capital assets not being depreciated	31,414	27,306	(28,544)	30,176
Capital assets being depreciated:				
Facilities and improvements	279,042	9,688	(25,082)	263,648
Intangible assets	—	25,082	—	25,082
Machinery and equipment	43,712	8,895	(97)	52,510
Total capital assets being depreciated	322,754	43,665	(25,179)	341,240
Less accumulated depreciation for:				
Facilities and improvements	(137,803)	(6,536)	7,615	(136,724)
Intangible assets	—	(9,372)	—	(9,372)
Machinery and equipment	(26,032)	(2,003)	1,851	(26,184)
Total accumulated depreciation	(163,835)	(17,911)	9,466	(172,280)
Total capital assets being depreciated, net	158,919	25,754	(15,713)	168,960
Total capital assets, net	$ 190,333	53,060	(44,257)	199,136

	Balance June 30, 2008	Increases	Decreases	Balance June 30, 2009
Capital assets not being depreciated:				
Land and rights-of-way	$ 1,662	6	—	1,668
Construction in progress	20,223	16,764	(7,241)	29,746
Total capital assets not being depreciated	21,885	16,770	(7,241)	31,414
Capital assets being depreciated:				
Facilities and improvements	262,980	2,406	13,656	279,042
Machinery and equipment	38,033	5,772	(93)	43,712
Total capital assets being depreciated	301,013	8,178	13,563	322,754
Less accumulated depreciation for:				
Facilities and improvements	(131,410)	(6,393)	—	(137,803)
Machinery and equipment	(24,586)	(1,537)	91	(26,032)
Total accumulated depreciation	(155,996)	(7,930)	91	(163,835)
Total capital assets being depreciated, net	145,017	248	13,654	158,919
Total capital assets, net	$ 166,902	17,018	6,413	190,333

(5) Restricted Assets

Pursuant to the Master Lease/Purchase Agreement (Agreement), net power revenues of Hetch Hetchy are irrevocably pledged to the punctual payment of debt service on the Clean Renewable Energy Bonds (CREBs). Accordingly, pledged power revenue shall not be used for any other purpose while any of its CREBs are outstanding, except as expressly permitted by the Agreement. Further, all revenues shall be deposited by the City Treasurer, by instruction of Hetch Hetchy, in special funds designated as the Hetch Hetchy Water and Power Revenue Fund (the Power 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 Hetch Hetchy as deposits and investments with the City Treasury.

Deposits in the Power Revenue Fund, including earnings thereon, shall be appropriated, transferred, expended, or used for the following purposes pertaining the financing, maintenance, and operation of Hetch Hetchy in accordance with the following priority:

1. The payment of operation and maintenance expenses for such utility and related facilities;

2. The payment of pension charges and proportionate payments to such compensation and other insurance or outside reserve funds as Hetch Hetchy may establish or the Board of Supervisors may require with respect to employees of Hetch Hetchy;
3. The payment of principal, interest, reserve, sinking fund, or other mandatory funds created to secure long-term financing issued by Hetch Hetchy for the acquisition, construction, or extension of facilities owned, operated, or controlled by Hetch Hetchy;
4. Reconstruction and replacement as determined by Hetch Hetchy or as required by any of Hetch Hetchy's financing ordinances duly adopted and approved; and
5. The acquisition of land, real property, or interest in real property for, and the acquisition, construction, enlargement, and improvement of, new and existing buildings, structures, facilities, equipment, appliances, and other property necessary or convenient to the development or improvement of such utility owned, controlled, or operated by Hetch Hetchy; and for any other lawful purpose of Hetch Hetchy, including the transfer of surplus funds pursuant to Section 6.407(e) of the City's Charter.

In accordance with the Agreement, Hetch Hetchy maintains certain restricted cash and investment balances in trust. Restricted assets held in trust consist of the following as of June 30, 2010 and 2009:

(a) Hetch Hetchy Water

Hetch Hetchy Water did not have any restricted assets held in trust as of June 30, 2010 and 2009.

(b) Hetch Hetchy Power

Hetch Hetchy Power has the following restricted assets held in trust as of June 30, 2010 and 2009:

	Hetch Hetchy Water	Hetch Hetchy Power	Total 2010 Hetch Hetchy Water & Power
Restricted cash and investments outside City Treasury:			
2008 Clean Renewable Energy Bond Fund	$ —	2,589	2,589
Certificates of participation – 525 Golden Gate Headquarters	—	16,128	16,128
	$ —	18,717	18,717

	Hetch Hetchy Water	Hetch Hetchy Power	Total 2009 Hetch Hetchy Water & Power
Restricted cash and investments outside City Treasury:			
2008 Clean Renewable Energy Bond Fund	$ —	6,091	6,091
	$ —	6,091	6,091

(6) Changes in Long-Term Liabilities

Total Hetch Hetchy Water and Power long-term liability activities for the years ended June 30, 2010 and 2009 are as follows:

	Coupon interest rate	Final maturity date	July 1, 2009	Additions	Reductions	June 30, 2010	Due within on year
Clean Renewable Energy Bonds	0%	2022	$ 5,903	—	(422)	5,481	422
Less bond discount			(186)	—	15	(171)	—
Certificates of participation Series 2009C	2.00 to 5.00%	2023	—	3,705	—	3,705	—
Add bond premium			—	413	(35)	378	—
Certificates of participation Series 2009D (BABs)	6.36 to 6.49%	2042	—	12,593	—	12,593	—
Total revenue bonds and certificates of participation payable			5,717	16,711	(442)	21,986	422
Other post-employment benefits obligation			5,799	3,843	(1,170)	8,472	—
Accrued vacation and sick leave			2,540	1,460	(1,421)	2,579	1,520
Accrued workers' compensation			2,305	349	(586)	2,068	380
Damage and claim liability			10,311	332	(8,772)	1,871	759
Total			$ 26,672	22,695	(12,391)	36,976	3,081

	Coupon interest rate	Final maturity date	July 1, 2008	Additions	Reductions	June 30, 2009	Due within on year
California Energy Commission Loan	0%	2010	$ 282	—	(282)	—	—
Clean Renewable Energy Bonds	0%	2022	—	6,325	(422)	5,903	422
Less bond discount			—	(194)	8	(186)	—
Total loan and revenue bonds			282	6,131	(696)	5,717	422
Other post-employment benefits obligation			2,723	4,026	(950)	5,799	—
Accrued vacation and sick leave			2,371	1,476	(1,307)	2,540	1,454
Accrued workers' compensation			2,147	533	(375)	2,305	405
Damage and claim liability			15,301	(3,400)	(1,590)	10,311	3,251
Total			$ 22,824	8,766	(4,918)	26,672	5,532

a) Hetch Hetchy Water's long-term liability activities for the years ended June 30, 2010 and 2009 are as follows:

	July 1, 2009	Additions	Reductions	June 30, 2010	Due within one year
Other post-employment benefits obligation	$ 1,580	1,187	(336)	2,431	—
Accrued vacation and sick leave	692	460	(412)	740	436
Accrued workers' compensation	628	218	(253)	593	109
Damage and claim liability	—	107	—	107	25
Total	$ 2,900	1,972	(1,001)	3,871	570

	July 1, 2008	Additions	Reductions	June 30, 2009	Due within one year
Other post-employment benefits obligation	$ 742	1,097	(259)	1,580	—
Accrued vacation and sick leave	670	375	(353)	692	396
Accrued workers' compensation	606	191	(169)	628	110
Total	$ 2,018	1,663	(781)	2,900	506

b) Hetch Hetchy Power's long-term liability activities for the years ended June 30, 2010 and 2009 are as follows:

	July 1, 2009	Additions	Reductions	June 30, 2010	Due within one year
Clean Renewable Energy Bonds	$ 5,903	—	(422)	5,481	422
Less bond discount	(186)	—	15	(171)	—
Certificates of participation Series 2009C	—	3,705	—	3,705	—
Add bond premium	—	413	(35)	378	—
Certificates of participation Series 2009D (BABs)	—	12,593	—	12,593	—
Total revenue bonds and certificates of participation payable	5,717	16,711	(442)	21,986	422
Other post-employment benefits obligation	4,219	2,656	(834)	6,041	—
Accrued vacation and sick leave	1,848	1,000	(1,009)	1,839	1,084
Accrued workers' compensation	1,677	130	(332)	1,475	271
Damage and claim liability	10,311	225	(8,772)	1,764	734
Total	$ 23,772	20,722	(11,389)	33,105	2,511

	July 1, 2008	Additions	Reductions	June 30, 2009	Due within one year
California Energy Commission Loan	$ 282	—	(282)	—	—
Clean Renewable Energy Bonds	—	6,325	(422)	5,903	422
Less bond discount	—	(194)	8	(186)	—
Total loan and revenue bonds	282	6,131	(696)	5,717	422
Other post-employment benefits obligation	1,981	2,929	(691)	4,219	—
Accrued vacation and sick leave	1,701	1,101	(954)	1,848	1,058
Accrued workers' compensation	1,541	342	(206)	1,677	295
Damage and claim liability	15,301	(3,400)	(1,590)	10,311	3,251
Total	$ 20,806	7,103	(4,137)	23,772	5,026

(a) State of California Energy Commission (CEC) Loan

In November 2002, Hetch Hetchy Power received a $971 loan from the California Energy Commission. The loan had a final maturity date of December 22, 2010; however, the loan was retired early in April 2009.

(b) Clean Renewable Energy Bonds

Hetch Hetchy Power issued $6,325 in Clean Renewable Energy Bonds (CREBs) on November 7, 2008 to finance the installation of solar energy equipment on City-owned facilities, including Chinatown Branch Library, Maxine Hall Medical Center, City Distribution Division Warehouse, North Point Wastewater, Chinatown Public Health Center, Municipal Transportation Agency Woods Facility, and Solar Energy Facility. Hetch Hetchy Power has not previously issued debt and has instead up to this point relied on revenue from ratepayers to fund renewable energy projects. CREBs provide the Commission with low-cost access to capital to further its green power objectives.

Hetch Hetchy Power began making principal payments in the amount of $422 on December 15, 2008 and will continue annual payments for fifteen years until December 15, 2022. Funding for these payments will be guaranteed by net power revenues. Interest payments are not required, since the effective equivalent of interest on the bonds is paid in the form of federal tax credits in lieu of interest paid by the issuer.

The future annual debt service relating to the CREBs outstanding as of June 30, 2010 is as follows:

	Clean Renewable Energy Bonds		
	Hetch Hetchy Water	**Hetch Hetchy Power**	**Hetch Hetchy Water & Power Total**
Fiscal years ending June 30:			
2011	$ —	422	422
2012	—	422	422
2013	—	422	422
2014	—	422	422
2015	—	422	422
2016 – 2020	—	2,110	2,110
2021 – 2023	—	1,261	1,261
	—	5,481	5,481
Less: current portion	—	(422)	(422)
Less: unamortized discount	—	(171)	(171)
Long-term portion as of June 30, 2010	$ —	4,888	4,888

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

In October 2009, the City & County of San Francisco issued $167,670 in certificates of participation to fund construction of the future headquarters of the San Francisco Public Utilities Commission (SFPUC) at 525 Golden Gate Avenue. The 2009 Series C were issued for $38,120 and 2009

Series D for $129,550 as "Build America Bonds" (BABs) on a taxable basis under the 2009 American Recovery and Reinvestment Act. The 2009 Series C certificates carry interest rates ranging from 2.0% to 5.0% and mature on November 1, 2022. The 2009 Series D certificates carry interest rates ranging from 6.4% to 6.5% and mature on November 1, 2041, after adjusting for the Federal interest subsidy, the true interest cost averages 3.4% and 4.3% for Series C and D, respectively.

Under the terms of a Memorandum of Understanding between the City and the SFPUC dated October 1, 2009, the City conveyed the real property to the Trustee 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 service relating to the certificates of participation 2009 Series C outstanding as of June 30, 2010 is as follows:

		Certificates of participation 2009 Series C (tax exempt)		
		Hetch Hetchy Power Principal	**Hetch Hetchy Power Interest**	**Hetch Hetchy Power Total**
Fiscal years ending June 30:				
2011	$	—	172	172
2012		—	172	172
2013		268	168	436
2014		277	158	435
2015		287	149	436
2016 – 2020		1,659	519	2,178
2021 – 2023		1,214	93	1,307
		3,705	1,431	5,136
Less: current portion		—	—	—
Add: unamortized bond premium		378	—	378
Long-term portion as of June 30, 2010	$	4,083	1,431	5,514

The following table presents the future annual debt service relating to the certificates of participation 2009 Series D outstanding as of June 30, 2010. The Federal interest subsidy represents 35% of the interest:

	Certificates of participation 2009 Series D (Taxable BABs)			
	Principal	**Interest before subsidy**	**Federal interest subsidy**	**Interest net of subsidy**
Fiscal years ending June 30:				
2011	$ —	812	(284)	528
2012	—	812	(284)	528
2013	—	812	(284)	528
2014	—	812	(284)	528
2015	—	812	(284)	528
2016 – 2020	—	4,063	(1,422)	2,641
2021 – 2025	908	4,006	(1,402)	2,604
2026 – 2030	2,625	3,370	(1,180)	2,190
2031 – 2035	3,232	2,432	(852)	1,580
2036 – 2040	3,985	1,266	(443)	823
2041 – 2042	1,843	121	(42)	79
	12,593	19,318	(6,761)	12,557
Less: current portion	—			
Less: unamortized discount	—			
Long-term portion as of June 30, 2010	$ 12,593			

(7) Revenue Pledge

Hetch Hetchy Power has pledged future power revenues to repay Clean Renewable Energy Bonds which were issued in fiscal year 2009. Proceeds from the bonds provided financing for various capital construction projects. The bonds are payable solely from net power revenues of Hetch Hetchy Power and are payable through the year ending 2022.

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

Hetch Hetchy Power

	Total 2010	Total 2009
Bonds issued with revenue pledge	$ 6,325	6,325
Principal and interest remaining due at the end of the year	5,481	5,903
Principal and interest paid during the year	422	422
Net revenue for the year ended June 30	33,898	36,301

(8) Other Revenue – Trans Bay Cable Construction and Licensing Fees

On August 7, 2007, San Francisco Mayor Gavin Newsom and the Board of Supervisors approved and adopted Resolution No. 070315, two non-exclusive licenses to the Trans Bay Cable LLC (the "Licensee") for the "Trans Bay Cable Project".

The Trans Bay Cable LLC proposes to install, operate and maintain approximately 53 miles of high voltage direct current ("HVDC") PLUS transmission cable bundle of approximately 10 inches in diameter running from the City of Pittsburg to the City of San Francisco. Approximately 9.4 miles of the cable are in submerged lands, a small portion of shoreline, and on a portion of a street that are under San Francisco Port Commission jurisdiction (the "License Area").

The first license is a Construction License, San Francisco Port Commission License No. 14324, a non-exclusive license to install a 400 MW high voltage transmission line, with a four (4) year term. The "Licensee" will pay the Port of San Francisco under this license and Hetch Hetchy Power $3,500 in 36 annual installments of $97 as the "Renewable Energy, Transmission and Grid Reliability Payment."

The second license is an Operational License, San Francisco Port Commission License No. 14325, a non-exclusive license for operation of the transmission line with twenty-five (25) year term with an option to renew for ten (10) years. The "Licensee" will pay Hetch Hetchy Power in excess of $20,000 in 10 separate installments of $2,000 annually with adjustments for inflation, as the "San Francisco Electric Reliability Payment" to implement, advance, promote or enhance policies and projects consistent with City Energy Policies. Once the project is on line, which is currently scheduled in 2010, Hetch Hetchy Power will receive the first installment of $2,000.

For fiscal years ending June 30, 2010 and 2009, $1,458 and $1,069, respectively, of Construction License revenue have been included in revenue related to this project, and are restricted for purposes designated by the San Francisco Board of Supervisors under the agreement.

(9) Employee Benefits

(a) Retirement Plan

Plan Description – Hetch Hetchy 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 Hetch Hetchy 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 Hetch Hetchy and its employees. Employee contributions are mandatory. Employee contribution rates for 2010, 2009 and 2008 varied from 7.5% to 8.0% as a percentage of covered payrolls. Due to certain bargaining agreements, Hetch Hetchy contributed from 0.5% to 8.0% of covered payroll on behalf of some employees. In addition, Hetch Hetchy was required to contribute for the fiscal years ended June 30, 2010, 2009, and 2008 at an actuarially determined contribution rate as a percentage of covered payrolls of 9.5%, 5.0%, and 5.9%, respectively. Hetch Hetchy contributed 100% of its required contribution of $2,417 in 2010, $1,231 in 2009, and $1,326 in 2008. Hetch Hetchy Water's share of the contribution for the fiscal year 2010 was $1,088 or 45% and Hetch Hetchy Power's share of the contribution was $1,329 or 55%.

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

(b) Health Care Benefits

Health care benefits of Hetch Hetchy 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). Hetch Hetchy's annual contribution, which amounted to approximately $4,572 and $3,929 in fiscal years 2010 and 2009, respectively, is determined by a San Francisco Charter provision based on similar contributions made by the 10 most populous counties in California.

Included in these amounts are $1,170 and $921 for 2010 and 2009, respectively, to provide post-retirement benefits for retired employees, on a pay-as-you-go basis. In addition, the City allocated an additional $0 and $29 to Hetch Hetchy's contribution allocation for payments made from the Health Service System for post-retirement health benefits in 2010 and 2009, respectively.

The City has determined a City-wide Annual Required Contribution (ARC), interest on net other post-employment benefits other than pensions (OPEB) obligation, ARC adjustment, and OPEB cost based upon an actuarial valuation performed in accordance with GASB 45, by the City's actuaries.

The City's allocation of the OPEB related costs to Hetch Hetchy for the year ended June 30, 2010 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 Hetch Hetchy for the years ending June 30, 2010 and 2009, for the amount contributed to the plan, and changes in the City's net OPEB obligation:

		Hetch Hetchy Water	Hetch Hetchy Power	Total 2010 Hetch Hetchy Water & Power
Annual required contribution	$	1,170	2,616	3,786
Interest on net OPEB obligation		76	188	264
Adjustment to ARC		(59)	(148)	(207)
Annual OPEB cost (expense)		1,187	2,656	3,843
Contribution made		(336)	(834)	(1,170)
Increase in net OPEB obligation		851	1,822	2,673
Net OPEB obligation – beginning of year		1,580	4,219	5,799
Net OPEB obligation – end of year	$	2,431	6,041	8,472

		Hetch Hetchy Water	Hetch Hetchy Power	Total 2009 Hetch Hetchy Water & Power
Annual required contribution	$	1,088	2,905	3,993
Interest on net OPEB obligation		34	91	125
Adjustment to ARC		(25)	(67)	(92)
Annual OPEB cost (expense)		1,097	2,929	4,026
Contribution made		(259)	(691)	(950)
Increase in net OPEB obligation		838	2,238	3,076
Net OPEB obligation – beginning of year		742	1,981	2,723
Net OPEB obligation – end of year	$	1,580	4,219	5,799

The City issues a publicly available financial report that includes the complete note disclosures and Required Supplementary Information (RSI) related to the City's post-retirement health care

obligations. The report may be obtained by writing to the City and County of San Francisco, Office of the Controller, 1 Dr. Carlton B. Goodlett Place, Room 316, San Francisco, CA 94102, or by calling (415) 554-7500.

(c) Wellness Incentive Program

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

The amount of this payment shall be equal to 2.5% of accrued sick leave credits at the time of separation times the number of whole years of continuous employment times an employee's salary rate, exclusive of premiums or supplements, at the time of separation. Vested sick leave credits, as set forth under Civil Service Commission Rules, shall not be included in this computation. The Wellness Program has been discontinued as current bargaining agreements expired on June 30, 2010.

(10) Related Parties

(a) Hetch Hetchy Water and Power

Various common costs incurred by the Commission are allocated proratably among Hetch Hetchy, the Water Enterprise, and the Wastewater Enterprise. The allocations are based on the Commission management's best estimate and may change from year to year depending on the activities incurred by each department and the information available. For the years ended June 30, 2010 and 2009, the Commission allocated $9,165 and $12,081, respectively, in administrative costs to Hetch Hetchy, which is included in the financial statements under various expense categories. These costs are then allocated to Hetch Hetchy Water and Hetch Hetchy Power in the Hetch Hetchy financial statements, using the periodically reviewed department overhead allocation model.

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 Hetch Hetchy was $269 and $933 for the years ended June 30, 2010 and 2009, respectively, and is included in other operating expenses in the accompanying financial statements.

A variety of City departments provide direct services such as engineering, purchasing, legal, data processing, telecommunication, and human resources to Hetch Hetchy and charge amounts designed to recover those departments' costs. These charges totaling approximately $5,011 and $4,477 for the years ended June 30, 2010 and 2009, respectively, have been included in services provided by other departments in the accompanying financial statements.

(b) Hetch Hetchy Water

The Water Enterprise purchases water from Hetch Hetchy Water. Included in the operating revenues are the water assessment fees totaling $29,747 and $23,000 for the years ended June 30, 2010 and 2009, respectively.

(c) Hetch Hetchy Power

During 2010 and 2009, Hetch Hetchy Power delivered power and gas without charge to certain City departments, which amounted to $2,825 and $3,764, respectively, based on metered usage and what would otherwise be the applicable power rates. These amounts were excluded from operating revenues in the accompanying financial statements.

Included in 2010 and 2009 operating revenues are sales of power to departments within the City of $60,322 and $61,067, respectively, excluding free power noted above.

The Water Enterprise also purchases electricity from Hetch Hetchy Power. This amount totaled $6,723 and $5,504 for the years ended June 30, 2010 and 2009, respectively.

The Wastewater Enterprise purchases electricity from Hetch Hetchy Power. This amount totaled $8,708 and $8,613 for the years ended June 30, 2010 and 2009, respectively.

Hetch Hetchy Power facilitates all electric and gas service connections between Pacific Gas and Electric Company (PG&E) and City departments. In this capacity, Hetch Hetchy Power facilitates and coordinates the terms and payment for the service connections that are performed by PG&E. As of June 30, 2010 and 2009, there were no outstanding amounts due from City departments related to this work. In the event Hetch Hetchy Power received money from PG&E after project completion, monies are to be refunded back to the City departments for their respective credits.

Hetch Hetchy Power serves as the City's agency for energy efficiency projects and maintains the Sustainable Energy Account (SEA) (formerly known as the Mayor's Energy Conservation Account (MECA)) fund to sponsor and financially support such projects at various City departments. In this role, Hetch Hetchy Power may secure low-interest financing to supplement funds available in the SEA fund. At June 30, 2010 and 2009, projects completed or underway throughout the City amounted to $13,900 and $14,658, respectively, and are recorded as due from other governmental agencies.

Besides funding the SEA projects, in 2010 Hetch Hetchy funded a project for the Treasure Island Development Authority (TIDA) and recorded as due from other governmental agencies. Hetch Hetchy Power and the Moscone Center have renegotiated the memoranda of understanding to extend the payment terms of the receivable, to match the useful life of underlying assets.

Details of these projects are as follows:

		2010	2009
Moscone Center	$	10,125	10,700
San Francisco General Hospital		1,411	1,645
San Francisco Department of Public Health		881	1,003
San Francisco Department of Public Works		—	18
Port of San Francisco		671	736
Wastewater		812	556
Total SEA related projects		13,900	14,658
Treasure Island Development Authority		2,599	2,599
Total due from other governmental agencies		16,499	17,257
Less current portion		(1,113)	(325)
Long-term portion as of June 30	$	15,386	16,932

As of June 30, 2010, the Hetch Hetchy Power has a payable in the amount of $4,560 due to the Water Enterprise for its allocable share of costs associated with the construction costs of the future SFPUC headquarters building located at 525 Golden Gate Avenue.

(11) Risk Management

Hetch Hetchy's risk management program encompasses both self-insured and insured coverage. Risk assessments and coverage are coordinated by the City's Office of Risk Management. With certain exceptions, the City and Hetch Hetchy's general policy is to first evaluate self-insurance for the risk of loss to which it is exposed. Based on this analysis, mitigating risk through a 'self-retention' mechanism is more economical as it manages risks internally and administers, adjusts, settles, defends, and pays claims from budgeted resources (i.e. *pay-as-you-go* fund). When economically more viable or when required by debt financing covenants, Hetch Hetchy obtains commercial insurance. At least annually, the City actuarially determines general liability and workers' compensation risk exposures. Hetch Hetchy 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-Insure
Property	Purchase Insurance and Self-Insure
Workers' compensation	Self-Insure through Citywide Pool

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

(a) Damage and Claim Liability

Through coordination with the Controller and the City Attorney's Office, the general liability risk exposure is actuarially determined and is addressed through pay-as-you-go funding as part of the budgetary process. Associated costs are also booked as expenses as required under Generally Accepted Accounting Principles (GAAP) for financial statement purposes for both Hetch Hetchy 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.

Hetch Hetchy Water and Power

Hetch Hetchy Water and Power's damage and claim liabilities changes for the years ended June 30, 2010 and 2009 are as follows:

	Beginning of year	Claims and changes in estimates	Claims paid	End of year
2008 – 2009	$ 15,301	(3,400)	(1,590)	10,311
2009 – 2010	10,311	332	(8,772)	1,871

Hetch Hetchy Water – The changes for the damage and claims liabilities for the years ended June 30, 2010 and 2009 are as follows:

	Beginning of year	Claims and changes in estimates	Claims paid	End of year
2008 – 2009	$ —	—	—	—
2009 – 2010	—	107	—	107

Hetch Hetchy Power – The changes for the damage and claims liabilities for the years ended June 30, 2010 and 2009 are as follows:

	Beginning of year	Claims and changes in estimates	Claims paid	End of year
2008 – 2009	$ 15,301	(3,400)	(1,590)	10,311
2009 – 2010	10,311	225	(8,772)	1,764

(b) Property

Hetch Hetchy'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, Hetch Hetchy 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, Hetch Hetchy requires each contractor to provide its own insurance, while ensuring that the full scope of work be covered with satisfactory levels to limit Hetch Hetchy'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 Hetch Hetchy 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 Hetch Hetchy'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 worker's compensation for the years ended June 30, 2010 and 2009 are as follows:

Hetch Hetchy Water and Power

The changes for the workers' compensation liabilities for the years ended June 30, 2010 and 2009 are as follows:

	Beginning of year	Claims and changes in estimates	Claims paid	End of year
2008 – 2009	$ 2,147	533	(375)	2,305
2009 – 2010	2,305	349	(586)	2,068

Hetch Hetchy Water

The changes for the workers' compensation liabilities for the years ended June 30, 2010 and 2009 are as follows:

	Beginning of year	Claims and changes in estimates	Claims paid	End of year
2008 – 2009	$ 606	191	(169)	628
2009 – 2010	628	218	(253)	593

Hetch Hetchy Power

The changes for the workers' compensation liabilities for the years ended June 30, 2010 and 2009 are as follows:

	Beginning of year	Claims and changes in estimates	Claims paid	End of year
2008 – 2009	$ 1,541	342	(206)	1,677
2009 – 2010	1,677	130	(332)	1,475

(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. Additionally, all public officials with financial oversight responsibilities are provided liability coverage through a commercial Public Official Liability policy, including the Commission members, the General Manager, and the Chief Financial Officer. Hetch Hetchy also maintains a commercial crime policy in lieu of bonding its employees.

(e) Professional Liability, Errors and Omissions

Professional liability policies are either directly purchased insurance on behalf of Hetch Hetchy, 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

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

(12) Commitments and Litigation

(a) Commitments

As of June 30, 2010 and 2009, Hetch Hetchy Water and Power has outstanding commitments with third parties of $29,661 and $22,346, respectively, for various capital projects and other purchase agreements for materials and services.

Hetch Hetchy Water

To meet certain requirements of the Don Pedro Reservoir operating license, the City entered into an agreement with the Districts in which the Districts would be responsible for an increase in water

flow releases from the reservoir in exchange for annual payments from the City, which are included in Hetch Hetchy Water's operating expenses. The payment amounts were $4,646 and $4,250 in fiscal years 2010 and 2009, respectively. The payments are to be made for the duration of the license, but may be terminated with one year's prior written notice after 2001. The City and the Districts have also agreed to monitor the fisheries in the lower Tuolumne River for the duration of the license. A maximum monitoring expense of $1,400 is to be shared between the City and the Districts over the term of the license. The City's share of the monitoring costs is 52%, while the Districts are responsible for 48% of the costs.

Hetch Hetchy Power

In April 1988, Hetch Hetchy Power entered into a long-term power sales agreement (the Agreement) with the Districts. In June 2003, Hetch Hetchy Power amended the terms of the Agreement with the Modesto Irrigation District (MID). Under the terms of the amended and restated long-term power sales agreement, which became effective on January 1, 2003, the expiration date was shortened to December 31, 2007. The agreement with MID was renegotiated and became effective January 1, 2008 which removed Hetch Hetchy's obligation to provide firm power and eliminated MID's rights to excess energy from the Project. This agreement expires on June 30, 2015. In April 2005, Hetch Hetchy Power amended the terms of the Agreement with Turlock Irrigation District (TID). The settlement agreement between the Commission and TID restates and amends the power sales agreement and terminates Hetch Hetchy Power's obligation to provide firm power at below market costs to TID to the end of the agreements term on June 30, 2015**.** The Commission will continue to comply with the Raker Act by making Hetch Hetchy generated hydropower available at cost to MID and TID for its agricultural pumping and municipal loads as energy is available. For fiscal years 2010 and 2009, energy sales to the Districts totaled 286,980 MWh or $7,530 and 258,268 MWh or $6,450, respectively.

Effective September 2007, the City renegotiated the Interconnection Agreement (agreement) with PG&E to provide transmission and distribution services on PG&E's system where needed to deliver Hetch Hetchy's power to its customers. In addition, agreement provides supplemental power and energy banking and other support services to Hetch Hetchy Power. The agreement provides audit rights to review past billings paid by Hetch Hetchy Power and to retroactively (up to two years) adjust these payments as determined necessary. During fiscal years 2010 and 2009, Hetch Hetchy Power purchased $12,906 and $13,264, respectively, of transmission, distribution services, and other support services from PG&E under the terms of the agreement.

The City's Interconnection Agreement with PG&E contains a contractual provision allowing it to bank excess power produced, with a maximum of 110,000 Megawatt hours (MWh). During fiscal year 2010, Hetch Hetchy Power generated 1,453,158 MWh of power, banked (deposited) in the Deferred Delivery Account (DDA) 104,321 MWh and used (withdrew) 115,630 MWh. At June 30, 2010 and 2009, the balance in the bank was 92,854 MWH or $2,650 and 104,172 MWh or $2,719, respectively.

Hetch Hetchy Power may purchase or sell energy with different market entities through the Western System Power Pool (WSPP). During fiscal year 2010, Hetch Hetchy Power purchased $328.2 of power. Sales of excess power, after meeting Hetch Hetchy's obligations, were 298,549 MWh, or $10,106. During fiscal year 2009, Hetch Hetchy Power did not purchase any power and sales of excess power were 217,792 MWh, or $6,162.

(b) Energy Risk Management

Hetch Hetchy is exposed to risks that could negatively impact its ability to generate net revenues to fund operating and capital investment activities. Hydroelectric generation facilities in the Sierra Nevada are the primary source of electricity for Hetch Hetchy. For this reason, the financial results of Hetch Hetchy are sensitive to variability in watershed hydrology and market prices for energy.

(c) Litigation

Hetch Hetchy 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 Hetch Hetchy.

(13) Subsequent Events

(a) Hetch Hetchy Water's New Memorandum of Agreement between the National Park Service (NPS) and the SFPUC

In October 2010, the Board of Supervisors approved the resolution to grant a new Memorandum of Agreement between the National Park Service (NPS) and the SFPUC for the NPS to provide watershed management services for the PUC within Yosemite National Park for a five year term retroactive from July 1, 2010 to June 30, 2015. The SFPUC will pay NPS the capped amount of $27,486 for the watershed management services to be provided by the NPS within Yosemite National Park.

(b) Hetch Hetchy Power's Implementation Agreement with the Attorney General of the State of California, the California Consumer Power and Conservation Financing Authority, and the California Department of Water Resources (DWR)

Resolution has been reached on August 6, 2010 to conclude the Implementation Agreement the City entered into in January 2003 with the Attorney General of the State of California, the California Consumer Power and Conservation Financing Authority, and the California Department of Water Resources (DWR). On March 11, 2010, pursuant to section 4.02(a) of the Implementation Agreement, the City sold the four combustion turbines for $44,000; some of these proceeds were distributed to the Enterprise and DWR accordingly; with the remaining funds placed in a holding escrow account, pending resolution between the City and DWR. Under the terms of the resolution, Hetch Hetchy Power is to be reimbursed $6,264 of expenses, and has recorded as receivable accordingly. In September, 2010, Hetch Hetchy Power received the State's warrant in the amount of $2,667 to be applied to the receivable. Remaining receivable amount will be subsequently drawn from escrow accounts. The total settlement amount was approximately $21,000 to offset expenses, including write-off of assets.

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

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

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

We have audited the financial statements of the business-type activities and each major fund of Hetch Hetchy Water and Power (Hetch Hetchy), an enterprise fund of the City and County of San Francisco, California (the City) as of and for the year ended June 30, 2010, which collectively comprise Hetch Hetchy's basic financial statements and have issued our report thereon dated December 9, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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

provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

KPMG LLP

December 9, 2010