KPMG

Yano Acccountanccy Corpooration

SAN FRANCISCO WATER ENTERPRISE AND HETCH HETCHY WATER AND POWER

Statement of Changes in the Balancing Account

June 30, 2019

(With Independent Auditors' Report Thereon)

Yano Accountancy Corporation

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

Independent Auditors' Report

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

Report on the Financial Statement

KPMG LLP and Yano Accountancy Corporation have audited the Statement of Changes in the Balancing Account (the statement) of the San Francisco Water Enterprise (Water Enterprise) and Hetch Hetchy Water and Power (Hetch Hetchy), under the jurisdiction of the San Francisco Public Utilities Commission (SFPUC), for the year ended June 30, 2019, prepared pursuant to Article VII, Section 7.02 of the Water Supply Agreement (WSA), between the City and County of San Francisco (City) and certain Wholesale Customers in the counties of San Mateo, Santa Clara, and Alameda (Wholesale Customers) effective July 1, 2009.

Management's Responsibility for the Financial Statement

Management of the SFPUC is responsible for the preparation and fair presentation of the statement in accordance with Article VII, Section 7.02 of the WSA. Management of the SFPUC is also responsible for the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of the statement that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the statement. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the Statement of Changes in the Balancing Account, referred to above, presents fairly, in all material respects, changes in the Balancing Account for the year ended June 30, 2019 in accordance with Article VII, Section 7.02 of the WSA.

Basis of Accounting

We draw attention to note 1(b) to the statement, which describes the basis of accounting. The statement was prepared by the SFPUC on the basis of the financial reporting provisions of Article VII, Section 7.02 of the WSA, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to comply with the financial reporting provisions of the WSA. Our opinion is not modified with respect to this matter.

Other Matter

KPMG LLP has audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of the San Francisco Water Enterprise and of Hetch Hetchy Water and Power as of and for the year ended June 30, 2019, and our reports thereon, dated December 9, 2019 and December 23, 2019, respectively, expressed an unmodified opinion on those financial statements.

Restriction on Use

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

KPMG LLP

Yano Accountancy Corporation

San Francisco, California
October 15, 2020

SAN FRANCISCO WATER ENTERPRISE AND
HETCH HETCHY WATER AND POWER

Statement of Changes in the Balancing Account

Year ended June 30, 2019

		Total		Amount allocated to the wholesale customers
Wholesale revenue requirement:				
Operating and maintenance expenses:				
San Francisco Water Enterprise (Water Enterprise):				
Source of supply	$	21,341,502		9,901,861
Pumping		2,275,080		—
Treatment		43,490,088		28,058,303
Transmission and distribution		68,134,713		17,366,034
Customer accounts		9,806,210		193,225
Total Water Enterprise operating and maintenance expenses	$	145,047,593		55,519,423
Hetch Hetchy Water and Power (Hetch Hetchy):				
Operations and maintenance expenses	$	114,288,704		16,444,189
Total Hetch Hetchy operating and maintenance expenses	$	114,288,704		16,444,189
Administrative and general (A&G) expenses:				
Countywide cost allocation plan:				
Water Enterprise	$	3,821,685		1,462,941
Hetch Hetchy		1,404,702		414,162
San Francisco Public Utilities Commission (Bureaus) :				
Water Enterprise		27,884,225		11,674,711
Hetch Hetchy		13,342,687		2,340,188
Other A&G – Water Enterprise		23,302,433		6,524,315
Other A&G – Hetch Hetchy		31,955,995		3,467,146
Compliance audit		175,700		87,850
Total administrative and general expenses	$	101,887,427		25,971,313
Property taxes (outside City only):				
Water Enterprise	$	1,755,370		1,152,927
Hetch Hetchy		550,253		162,237
Total property taxes	$	2,305,623		1,315,164
Capital cost recovery – existing regional assets (K-5):				
Water Enterprise (note 4)				804,106
Hetch Hetchy (note 4)				355,152
Capital cost contribution – new regional assets:				
Debt-funded capital projects:				151,520,781
Water Enterprise (note 5a)				(13,977,545)
Revenue-funded capital projects:				
Water Enterprise (note 5d)				30,272,000
Total capital cost recovery and contribution				168,974,494
Revenue Credit Federal BABs Interest Subsidy				
Total wholesale revenue requirement			$	268,224,583
Balance due to wholesale customers, July 1, 2017			$	(59,781,812)
Adjustments to July 1, 2017 balance (note 2a)				(2,944,639)
Adjusted balance due to wholesale customers, July 1, 2017				(62,726,451)
Interest on adjusted beginning balance				(1,455,254)
Net Wholesale revenue billed (note 6)				(250,454,444)
Calculated wholesale revenue requirement				268,224,583
Interest on wholesale revenue coverage reserve (net of working capital requirement)				(513,712)
Balance due to wholesale customers, June 30, 2019			$	(46,925,278)

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

(1) Summary of Significant Accounting Policies

(a) Water Supply Agreement

The City and County of San Francisco (City), acting by and through its Public Utilities Commission (SFPUC), and the Wholesale Customers, represented by the Bay Area Water Supply and Conservation Agency (BAWSCA), entered into the Water Supply Agreement (WSA) on July 1, 2009. The November 2018 Amended and Restated Wholesale Water Supply Agreement (WSA) was ratified by all BAWSCA member agencies and the SFPUC in April 2019. The WSA has a twenty-five year term with two options for five-year extensions, and contains provisions on rate-setting, accounting, and dispute resolution, including emergency and drought-pricing adjustment. The WSA has a 184 millions of gallons per day (mgd) Supply Assurance. During the period from 2009 to 2028 the WSA limits the quantity of water delivered to the Retail Customers and Wholesale Customers from the watersheds to 81 mgd and 184 mgd, respectively, or a total of 265 mgd.

(b) Basis of Accounting

Pursuant to the terms of the WSA, the accounts of the San Francisco Water Enterprise (Water Enterprise) and Hetch Hetchy Water and Power (Hetch Hetchy), are maintained in conformity with accounting principles generally accepted in the United States of America. The financial activities of the Water Enterprise and Hetch Hetchy Funds are accounted for on a flow of economic resource measurement focus, using the accrual basis of accounting. Under this method, all assets and liabilities associated with its operations are included on the statements of net assets; revenues are recognized when earned, and expenses are recognized when liabilities are incurred. The SFPUC applies all applicable Governmental Accounting Standards Board pronouncements. For copies of the Water Enterprise and Hetch Hetchy audited financial statements for the year ended June 30, 2019, please contact the Chief Financial Officer, San Francisco Public Utilities Commission, 525 Golden Gate Avenue, 13th Floor, San Francisco, California 94102.

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

(c) Balancing Account under the WSA

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

Pursuant to Article VII, Section 7.02 of the WSA, the City is required to prepare the Wholesale Revenue Requirement (WRR) of the Water Enterprise and Hetch Hetchy after the close of each fiscal year based on the actual costs incurred in the delivery of water to the Wholesale Customers. The difference between the wholesale revenue billed to the Wholesale Customers during the year and the “actual” WRR is recorded in a separate account (the Balancing Account) and represents the cumulative amount that is either owed to the Wholesale Customers (if wholesale revenue billed exceed the WRR) or owed to the SFPUC (if the WRR exceeds wholesale revenues billed). The Balancing Account is reflected on the Water Enterprise's financial statements as either an asset or a liability depending on the amount due from or owed to the Wholesale Customers.

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

(d) Proportional Annual Use and Adjusted Proportional Annual Use

The WSA states that the Wholesale Customers will pay their share of expenses incurred by the SFPUC in delivering water on the basis of Proportional Annual Use unless otherwise indicated in the WSA. WSA Attachment J prescribes the calculation methodology to determine Proportional Annual Use. At the end of each fiscal year, as specified in WSA Attachment J, the SFPUC and BAWSCA sign off on Table J-1, which memorializes the annual water deliveries to Retail and Wholesale Customers. The information in the Table J-1 is the basis for the Proportional Annual Use calculation.

The Proportional Annual Use is defined as the share of deliveries from the Regional Water System used by City Retail Customers and by the Wholesale Customers in a fiscal year, expressed as a percentage. The Adjusted Proportional Annual Use is defined as the respective percentages of annual water use, as adjusted to reflect deliveries of water by Hetch Hetchy to Retail Customers outside of the city limits of the City and County of San Francisco.

(e) Minimum Annual Purchases

Alameda County Water District and the cities of Milpitas, Mountain View, and Sunnyvale have agreed to a minimum annual purchases requirement, which requires each to purchase a minimum annual quantity of water from the SFPUC. These minimum quantities are included in the Individual Water Sales Contracts between SFPUC and each of these four Wholesale Customers reference to Article III, Section 3.07.C of the WSA, and WSA Attachment E.

These Wholesale Customers are billed for minimum quantities only if minimum annual purchase quantities have not been met in any fiscal year. Minimum annual purchase payments are considered wholesale water revenues. Additionally, the Proportional Annual Use is based on minimum quantities for each of these four customers if minimum annual purchase quantities are not met. Any differences between minimum quantities and below-minimum actuals are referred to as imputed water sales.

During the year ended June 30, 2019, the cities of Mountain View and Milpitas did not meet their minimum purchase requirements. Revenues associated with the shortfall in the amount of $3,454,951 are included as wholesale water revenues, and 1.7 mgd of imputed water sales was added to the wholesale usage used to calculate Proportional Annual Use.

(f) Basis of Allocating Operating Expenses

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

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

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

Forty-five percent of joint Hetch Hetchy expenses are water-related expenses. The water-related share of joint Hetch Hetchy operating, maintenance, and administrative and general expenses is allocated based upon on Adjusted Proportional Annual Use.

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

(g) Wholesale Customers Review

Article VII, Section 7.06 of the WSA provides the Wholesale Customers the right to conduct a review of the SFPUC's calculation of the annual Wholesale Revenue Requirement and changes in the Balancing Account. The review shall be completed within 60 days after the date of the compliance auditor's report is issued. At the conclusion of the review, representatives of SFPUC and BAWSCA meet to discuss any differences noted. Adjustments agreed by both parties are adjusted to the Balancing Account. If differences cannot be resolved, the dispute shall be submitted to the arbitration in accordance with Article VIII, Section 8.01 of the WSA.

(Continued)

(h) Capital Cost Recovery – Existing Regional Assets

The SFPUC previously appropriated funds, advanced through rates charged to Retail Customers, for construction of capital projects. The unexpended balances of these appropriated funds were not included in construction work in progress as listed on WSA Attachment K-1 and K-2 as of June 30, 2009. These projects, and their associated balances, are shown on WSA Attachment K-5. Expenditures of funds from these balances from July 1, 2009 to June 30, 2014 are allocated to the Wholesale Customers based on Proportional Annual Use and amortized over ten years at an interest rate of 4%. Fiscal year 2018–19 is the fifth year for capital cost recovery through Schedule K-5.

(i) Capital Cost Contribution – New Regional Assets

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

Capital expenditures financed by debt are allocated to bond proceeds on a first-in, first-out basis to the extent allowable by law and the terms of the applicable indenture. In accordance with Article V, Section 5.04A of the WSA, the SFPUC issues a certificate on the expected use of bond proceeds within 15 days of issuance (WSA Attachment L-2), and a report on actual expenditures of and earnings on bond proceeds after the proceeds are considered substantially expended (WSA Attachment L-3). The Wholesale Customers' proportionate share of net annual debt service is based on the expected use of bond proceeds on regional projects. Any differences between expected and actual expenditures on regional projects are applied in the year the proceeds are substantially expended. For copies of WSA Attachments L-2 or L-3 previously issued for each indenture, please contact the Chief Financial Officer, San Francisco Public Utilities Commission, 525 Golden Gate Avenue, 13th Floor, San Francisco, California 94102.

SFPUC and the Wholesale Customers clarified certain procedures relating to the administration of the accounting, debt administration, and capital cost contribution components of Article V, Section 5.04A as part of the Settlement Agreement (Article VII, Section 7.06 of the WSA) for the year ended June 30, 2010. For copies of the Settlement Agreement (Article VII, Section 7.06 of the WSA) for the year ended June 30, 2010, please contact the Chief Financial Officer, San Francisco Public Utilities Commission, 525 Golden Gate Avenue, 13th Floor, San Francisco, California 94102.

The regional share of appropriations for revenue-funded regional asset expenditures are allocated to the Water Enterprise and Hetch Hetchy on the basis of Proportional Annual Use and Adjusted Proportional Annual Use, respectively. Adjustments to reflect actual vs. appropriated expenditures are made in accordance with Article VI, Section 6.08 of the WSA, which was amended in 2018. FY 2018-19 is the first year of the amended methodology (see Note 5e).

(j) Allocation of 525 Golden Gate Avenue Expenses

525 Golden Gate Avenue is the headquarters of the SFPUC as of July 2012. This building consolidated divisions of the SFPUC that were renting space at multiple locations in the Civic Center area, and consists of a new 277,500 square-foot Class A office building that spans 13 floors plus a basement level. In allocating 525 Golden Gate Avenue costs, building tenants occupy 10,709 square feet (3.9% of total building square footage), which reduces the costs allocated to the Wholesale Customers.

Certificates of Participation, 2009 Series C and D, were issued by the City in October 2009 to fund the SFPUC headquarters building at 525 Golden Gate Avenue.

Operating, maintenance, capital expenses, and debt service payments pertaining to 525 Golden Gate Avenue are classified as Administrative and General expenses and are allocated to the three enterprises (Water, Hetch Hetchy, and Wastewater) based on square footage occupied by each enterprise based at 525 Golden Gate Avenue.

(k) Interest Earnings and Excess Funds Related to Bond Issuance

Interest earnings and excess funds available from funds associated with regional bonds – including Debt Service Reserves and Capital Projects Funds – are allocated between the Wholesale and Retail Customers based on the debt service allocation of the underlying bond series (see Note 5a).

All interest earnings on Debt Reserve Funds are accounted for as credits against gross debt service in determining the net debt service amounts. In FY 2018-19, excess funds from the Debt Service Reserves of bond Series 2010B, 2010D, and 2010E were also credited against gross debt service. Interest earnings from unexpended bond proceeds in the Capital Projects Funds are treated as additional funds available for project expenditures.

(l) Grants

The Wholesale Customers are allocated a proportional benefit from funds received by the SFPUC from (a) governmental grants, rebates, reimbursements, or other subventions or (b) private-sector grants for Regional capital or operating purposes. The Wholesale Customers' allocated benefit is based on any excess of grant revenues over expenses. Beginning in FY 2016-17, per the advice of the SFPUC's bond counsel, interest rebates from the taxable federal Build America Bonds are no longer credited against gross debt service due to federal sequestration. Instead, they are reflected as a governmental revenue credit; the impact on the Balancing Account from both treatments is the same.

(m) Wholesale Revenue Coverage Reserve and Working Capital Requirements

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

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

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

(2) Balancing Account under the WSA

(a) Balancing Account Activity

The following summarizes activity in the Balancing Account under the WSA for the year ended June 30, 2019:

	As previously reported	Adjustments	Adjusted balance
Balancing account under the WSA, June 30, 2018	$ (59,781,812)	—	(59,781,812)
Fiscal Year 2015-16 settlement agreement on operating expenses (note 2b)	—	(2,756,834)	(2,756,834)
Fiscal Year 2016-17 settlement agreement on operating expenses (note 2b)	—	(95,408)	(95,408)
Interest on Fiscal Year 2015-16 and Fiscal Year 2016-17 settlement agreements (note 2b)	—	(92,397)	(92,397)
Balancing account under the WSA, as adjusted, June 30, 2018	$ (59,781,812)	(2,944,639)	(62,726,451)
Interest on adjusted beginning balance at 2.32%			(1,455,254)
Net wholesale revenue billed (note 6)			(250,454,444)
Calculated wholesale revenue requirement			268,224,583
Interest on wholesale revenue coverage reserve (net of working capital requirement not met) (note 2b)			(513,712)
Balancing account under the WSA, June 30, 2019			$ (46,925,278)

(b) Article VII, 7.06 Settlement Agreement – Fiscal Year 2015-16 and Fiscal Year 2016-17

In accordance with Article VII, Section 7.06 of the WSA, the SFPUC and the Wholesale Customers reached a settlement agreement on January 31, 2020 relating to costs attributable to the fiscal years ended June 30, 2016 and June 30, 2017. The following are adjustments to the fiscal year 2017-18 Balancing Account agreed to by both parties to the WSA.

	Amount
Adjustments to June 30, 2018 beginning balance:	
Fiscal Year 2015-16 settlement adjustments:	
Settlement agreement – Build America Bond series subsidy	$ (2,135,194)
Settlement agreement – WSIP financing costs	(621,640)
Subotal Fiscal Year 2015-16 settlement adjustments – due (to)/from wholesale customers	(2,756,834)
Fiscal Year 2016-17 settlement adjustments:	
Settlement agreement – WSIP financing costs	(95,408)
Interest on adjustments	
FY 2015-16 interest computed at 0.67%	(18,471)
FY 2016-17 interest computed at 0.93%	(26,698)
FY 2017-18 interest at 1.63%	(47,228)
Subotal interest on settlement adjustments – due (to)/from wholesale customers	(92,397)
Total Fiscal Year 2015-16 and Fiscal Year 2016-17 settlement adjustments – due (to)/from wholesale customers	$ (2,944,639)

(3) Proportional Annual Use and Adjusted Proportional Annual Use

The Proportional Annual Use and the Adjusted Proportional Annual Use for the Wholesale and Retail Customers since the inception of the WSA in FY 2009–10 are summarized below:

	Proportional annual use		Adjusted proportional annual use	
Fiscal year	**Wholesale**	**Retail**	**Wholesale**	**Retail**
FY 2009-10	66.67%	33.33%	66.48%	33.52%
FY 2010-11*	65.86	34.14	65.70	34.30
FY 2011-12*	65.83	34.17	65.72	34.28
FY 2012-13	66.56	33.44	66.43	33.57
FY 2013-14	67.63	35.37	67.52	32.48
FY 2014-15	65.67	34.33	65.56	34.44
FY 2015-16	63.28	36.72	63.15	36.85
FY 2016-17	64.27	35.73	64.12	35.88
FY 2017-18*	66.04	33.96	65.91	34.09
FY 2018-19*	65.68	34.32	65.52	34.48

*adjusted for imputed water sales

(4) Capital Cost Contribution – Existing Regional Assets (WSA Attachment K-5)

WSA Attachment K-5 represents projects of previously appropriated funds, which are summarized on the following table, advanced through rates charged to Retail Customers, for construction of capital projects. From July 1, 2009 to June 30, 2015, the Water Enterprise incurred total expenditures of $9,599,442 including interest through June 30, 2015, of which $6,618,478 is the Wholesale share and $12,385,482 for Hetch Hetchy including interest through June 30, 2015, of which $2,923,204 is the Wholesale share. Based on the WSA Section 5.03, these expenditures were amortized over ten years at an interest rate at 4%. The wholesale share is based on Proportional Annual Use for Water Enterprise and Adjusted Proportional Annual Use for Hetch Hetchy. Fiscal year 2018-19 is the fifth of ten annual cost recoveries for WSA Attachment K-5 capital projects.

	Water Enterprise	Hetch Hetchy	Total
Total expenditures of previously appropriated funds – July 1, 2009 to June 30, 2015	$ 9,599,442	12,385,482	21,984,924
Wholesale share of expenditures	$ 6,393,692	2,812,954	9,206,646
Interest on wholesale share of expenditures	224,786	110,250	335,036
Total amount due from Wholesale Customers	$ 6,618,478	2,923,204	9,541,682
Interest rate	4%	4%	
Term (years)	10	10	
Annual payment due from Wholesale Customers	$ 804,106	355,152	1,159,258

The activity in the liability account for K-5 projects for the fiscal year ended June 30, 2019 is summarized below.

	Water Enterprise	Hetch Hetchy	Total
Principal balance as of June 30, 2018	$ 4,902,321	2,165,223	7,067,544
Principal payment	(619,285)	(273,522)	(892,807)
Principal balance as of June 30, 2019	$ 4,283,035	1,891,701	6,174,737
Number of annual payments remaining (see note 10c)	5	5	
Cumulative payments received through June 30, 2019:			
Applied to principal	$ 2,979,959	1,316,168	4,296,126
Applied to interest	1,040,574	459,593	1,500,167
Total	$ 4,020,532	1,775,761	5,796,293

The Wholesale Customers are allowed, under Section 6.05.B.2 of the WSA to use Balancing Account amounts due to them to pay all or a portion of the remaining K-5 principal balance.

(5) Capital Cost Contribution – New Regional Assets

(a) Debt-Funded Capital Projects – Water Enterprise

The Water Enterprise has previously issued revenue bonds to fund the construction of new regional capital assets. As of June 30, 2019, outstanding debt related to the construction of new regional capital assets included Water Revenue Bonds, 2009 Series A, 2009 Series B, 2010 Series B, 2010 Series D, 2010 Series E, 2010 Series F, 2010 Series G, 2011 Series A, 2011 Series B, 2012 Series A, 2015 Series A (which refunded all of 2006 Series A and a portion of 2009 Series A), 2016 Series A (which refunded portions of 2009 Series A, 2009 Series B and 2010 Series F), 2016 Series C, 2017 Series A, 2017 Series B, 2017 Series C, 2017 Series D (which refunded a portion of 2011 Series A and a portion of 2012 Series A), 2017 Series F (which refunded a portion of 2011 Series B), and 2017 Series G (which refunded a portion of 2011 Series A). Bond 2017 Series A, 2017 Series B, and 2017 Series C had no net debt service payments during FY 2018-19, as they were in the capitalized interest period.

The Water Enterprise paid $248,128,011 in gross debt service during the year ended June 30, 2019. The net debt service is reduced to $241,626,974 when other interest earnings and other cash on hand of $6,501,037 are applied against the gross debt service payments. The following tables summarize the net debt service expenditures on outstanding debt related to the construction of new regional assets that was determined to be allocable to the Retail and Wholesale Customers:

Table 1 – Debt Service Expenditures – New Regional Assets

	Principal	Net interest	Total
2009 Series A	$ 9,160,000	567,780	9,727,780
2009 Series B	9,165,000	710,242	9,875,242
2010 Series B	11,215,000	21,058,942	32,273,942
2010 Series D	10,875,000	1,067,668	11,942,668
2010 Series E	—	16,051,811	16,051,811
2010 Series F	4,745,000	1,187,587	5,932,587
2010 Series G	—	24,363,127	24,363,127
2011 Series A	—	15,569,301	15,569,301
2011 Series B	675,000	870,449	1,545,449
2012 Series A	—	20,723,277	20,723,277
2015 Series A/2006 Series A Refunding	3,220,000	18,248,312	21,468,312
2015 Series A/2009 Series A Refunding	—	1,844,032	1,844,032
2016 Series A/2009 Series A Refunding	—	13,618,086	13,618,086
2016 Series A/2009 Series B Refunding	—	15,292,381	15,292,381
2016 Series A/2010 Series F Refunding	—	6,844,164	6,844,164
2016 Series C	5,525,000	9,045,963	14,570,963
2017 Series A	—	—	—
2017 Series B	—	—	—
2017 Series C	—	—	—
2017 Series D/2011 Series A Refunding	835,000	11,200,538	12,035,538
2017 Series D/2012 Series A Refunding	—	6,101,310	6,101,310
2017 Series F/2011 Series B Refunding	—	428,176	428,176
2017 Series G/2011 Series A Refunding	500,000	918,828	1,418,828
	$ 55,915,000	185,711,974	241,626,974

Table 2 – Wholesale Customers Debt Service Allocation (%)

	Excluded Costs	Retail projects	Regional projects	Total	Substantially expended fiscal year	Allocation adjusted fiscal year
2009 Series A	31.65	10.43	57.92	100.00	FY 09-10 7.06	
2009 Series B	0.84	12.52	86.64	100.00	FY 10-11	FY 15-16 7.06
2010 Series B	0.02	7.13	92.85	100.00	FY 10-11	FY 15-16 7.06
2010 Series D	—	2.77	97.23	100.00	FY 11-12	FY 15-16 7.06
2010 Series E	—	3.17	96.83	100.00	FY 15-16	FY 15-16 7.06
2010 Series F	—	—	100.00	100.00	FY 14-15	
2010 Series G	—	—	100.00	100.00	FY 14-15	
2011 Series A	—	6.47	93.53	100.00	FY 14-15	
2011 Series B	—	0.53	99.47	100.00	FY 18-19	
2012 Series A	—	8.83	91.17	100.00	FY 18-19	
2015 Series A/ 2006 Series A Refunding	33.71	13.10	53.19	100.00	FY 09-10 7.06	
2015 Series A/ 2009 Series A Refunding	31.65	10.43	57.92	100.00	FY 09-10 7.06	
2016 Series A/ 2009 Series A Refunding	31.65	10.43	57.92	100.00	FY 09-10 7.06	
2016 Series A/ 2009 Series B Refunding	0.84	12.52	86.64	100.00	FY 10-11	FY 15-16 7.06
2016 Series A/ 2010 Series F Refunding	—	—	100.00	100.00	FY 14-15	
2016 Series C*	—	—	100.00	100.00		
2017 Series A	—	0.54	99.46	100.00	FY 18-19	
2017 Series B*	—	70.40	29.60	100.00		
2017 Series C*	—	—	100.00	100.00		
2017 Series D/ 2011 Series A Refunding	—	6.47	93.53	100.00	FY 14-15	
2017 Series D/ 2012 Series A Refunding	—	8.83	91.17	100.00	FY 18-19	
2017 Series F/ 2011 Series B Refunding	—	0.53	99.47	100.00	FY 18-19	
2017 Series G/ 2011 Series A Refunding	—	6.47	93.53	100.00	FY 14-15	

* Expected allocation to be trued up when bond reaches Substantially Expended status (note 5b)

Table 3 – Wholesale Customers Debt Service Allocation ($)

	Excluded Costs	Retail projects	Regional projects	Total	Proportional annual use	Total wholesale debt service
2009 Series A	$ 3,078,842	1,014,607	5,634,330	9,727,780	65.68%	3,700,628
2009 Series B	82,952	1,236,380	8,555,910	9,875,242	65.68%	5,619,522
2010 Series B	6,455	2,301,132	29,966,355	32,273,942	65.68%	19,681,903
2010 Series D	—	330,812	11,611,856	11,942,668	65.68%	7,626,668
2010 Series E	—	508,842	15,542,969	16,051,811	65.68%	10,208,622
2010 Series F	—	—	5,932,587	5,932,587	65.68%	3,896,523
2010 Series G	—	—	24,363,127	24,363,127	65.68%	16,001,702
2011 Series A	—	1,007,334	14,561,967	15,569,301	65.68%	9,564,300
2011 Series B	—	8,191	1,537,258	1,545,449	65.52% *	1,007,212
2012 Series A	—	1,829,865	18,893,412	20,723,277	65.68%	12,409,193
2015 Series A/ 2006 Series A Refunding	7,236,968	2,812,349	11,418,995	21,468,312	65.68%	7,499,996
2015 Series A/ 2009 Series A Refunding	583,636	192,333	1,068,063	1,844,032	65.68%	701,504
2016 Series A/ 2009 Series A Refunding	4,310,124	1,420,366	7,887,595	13,618,086	65.68%	5,180,572
2016 Series A/ 2009 Series B Refunding	128,456	1,914,606	13,249,319	15,292,381	65.68%	8,702,153
2016 Series A/ 2010 Series F Refunding	—	—	6,844,164	6,844,164	65.68%	4,495,247
2016 Series C	—	—	14,570,963	14,570,963	65.68%	9,570,208
2017 Series A	—	—	—	—	65.68%	—
2017 Series B	—	—	—	—	65.68%	—
2017 Series C	—	—	—	—	65.52% *	—
2017 Series D/ 2011 Series A Refunding	—	778,699	11,256,839	12,035,538	65.68%	7,393,492
2017 Series D/ 2012 Series A Refunding	—	538,746	5,562,564	6,101,310	65.68%	3,653,492
2017 Series F/ 2011 Series B Refunding	—	2,269	425,907	428,176	65.52% *	279,054
2017 Series G/ 2011 Series A Refunding	—	91,798	1,327,030	1,418,828	65.68%	871,593
	$ 15,427,434	15,988,331	210,211,210	241,626,974		138,063,584
Adjustment for Substantially Expended 2011 Series B						81,634
Adjsutment for Substantially Expended 2012 Series A						13,375,563
						$ 151,520,781

*Adjusted Proportional Annual Use (note 5c)

(b) *Substantially Expended Bond Series*

Article V, Section 5.04 of the WSA requires the revised allocation factor be used in the year when the bond series became substantially expended and thereafter. The difference between the amount of net debt service paid by the Wholesale Customers prior to the year that the bond series became substantially expended and the amount of the net debt service that they should have paid will be taken into account in the calculation of the Balancing Account in the year the bond series became substantially expended. Table 2 shows the Fiscal Year during which each bond reached substantially expended.

As of June 30, 2019, bond Series 2011B, 2012A, 2017A, and 2017C reached substantially expended status during the year. The revised allocation percentages also apply to the debt service on Series 2017D refunding of 2011A and Series 2017F refunding of 2012A. The true-up of debt service due to the change from expected to actual percentage allocations resulted in an increase in the Wholesale Customer share of debt service of $13,457,197.

(c) Debt-Funded Capital Projects – Hetch Hetchy

The Wholesale Customers are allocated a share of water-related costs on the basis of Adjusted Proportional Annual Use. Joint assets are allocated 45% to water-related activities.

2011 Series B and 2017 Series C were issued as Water Revenue Bond Series to fund the Hetch Hetchy water-related capital project expenditures. Wholesale share of the debt on these series for the year ended June 30, 2019 was allocated using the Adjusted Proportional Annual Use percentage of 65.52%.

(d) Revenue-Funded Capital Projects – Water Enterprise

The following is a summary of the wholesale share of appropriations for regional revenue-funded capital projects under the Water Enterprise for the year ended June 30, 2019:

Project Description	Appropriations	Allocation %	Wholesale share
Communications & Monitoring	$ 950,000	65.68%	623,960
Water Supply & Storage	15,382,000	65.68	10,102,898
Water Transmission	12,592,000	65.68	8,270,426
Watershed & Land Management	11,076,000	65.68	7,274,717
Fiscal Year 2018-19 Total	$ 40,000,000		$ 26,272,000

(e) Excess Accumulation of Unexpended and Unencumbered Appropriation

Collections for revenue-funded regional capital assets are based on appropriation rather than actual expenditures. To prevent excess accumulation of unexpended and unencumbered appropriation, WSA Section 6.08 requires a review and adjustment of the Wholesale Revenue-Funded Capital Fund balance. This review previously occurred every five years; the first review was completed in FY 2014–15 for the period of FY 2009–10 through FY 2013–14, and an adjustment of $20,274,453 was credited to the benefit of the Wholesale Customers.

Amendments to the WSA ratified in 2019 changed both the methodology for calculating the true-up and shifted to an annual review. The Fiscal Year 2018-19 WRR incorporates the new methodology, including a review of appropriations and expenditures from FY 2014-15 through FY 2018-19. As of June 30, 2019, the Wholesale Revenue-Funded Capital Fund balance is $10,588,448 less than the target amount based on cumulative annual appropriations and expenditures. With the cap in annual transfers from the Balancing Account applied, the Wholesale Customers must deposit an additional

$4,000,000 in the fund. Activity in the Wholesale Revenue Funded Capital Fund is shown in the table below.

Table 4 - Annual Activity in Wholesale Capital Fund

	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19
Beginning Wholesale Capital Fund Balance	$ 9,084,751	17,303,649	32,208,524	28,772,663	31,112,950
Annual Appropriation	15,432,450	21,011,349	10,220,215	18,378,932	26,272,000
Annual Expenditures	(7,312,139)	(6,272,209)	(13,938,327)	(16,522,767)	(10,822,225)
Interest Earnings	98,587	165,735	282,250	484,122	901,038
Subtotal Balance Before Transfers	17,303,649	32,208,524	28,772,663	31,112,950	47,463,763
Amount Encumbered as of June 30, 2019					(14,749,841)
Unencumbered Balance Before Transfers					32,713,922

Table 5 - True-Up of Balance in Wholesale Capital Fund

Lesser of		
Target Balance, or	43,302,370	
Cumulative Unspent Wholesale Capital Fund	55,524,325	
Target Balance		43,302,370
(Less) Unencumbered Balance Before Transfer		(32,713,922)
Deficiency/(Excess) in Reserve		10,588,448
Lesser of		
$4,000,000 or	4,000,000	
Calculated Reserve Deficiency	10,588,448	
Wholesale Capital Fund, Before Adjustments		47,463,763
Transfer From/(To) Balancing Account		4,000,000
Ending Total Balance		51,463,763

(6) Wholesale Revenue Billings

During the year ended June 30, 2019, the SFPUC billed a total of $256,214,784 (net of amounts remitted to BAWSCA) in wholesale revenue for costs of service associated with deliveries from the regional water system. This total includes $3,454,951 in minimum purchase billings associated with customers who did not meet their minimum purchase requirements (note 1e). As applicable, a portion of these billings relate to deposits by the Wholesale Customers to meet their Wholesale Revenue Coverage Reserve and Working Capital Reserve requirements per Article VI, Section 6.06 and Section 6.07 of the WSA, respectively, which reduced total wholesale revenue billings. For the year ended June 30, 2019, $5,760,340 was deposited to Wholesale Revenue Coverage Reserve and Working Capital Reserve. The net amount billed after deposits to the Coverage Reserve, and which is applied to the revenue requirement, is $250,454,444.

Gross and net wholesale revenue billings are summarized below:

Gross wholesale amounts billed – net of adjustments	$ 252,759,833
Imputed water sales from minimum purchase requirements	3,454,951
Subtotal	256,214,784
Deposits to wholesale revenue coverage reserve	(5,760,340)
Net wholesale revenues billed	$ 250,454,444

(7) Wholesale Revenue Coverage Reserve

During the year ended June 30, 2019, $5,760,340 in deposits to the Wholesale Revenue Coverage Reserve account were made from the Balancing Account in accordance with Article VI, Section 6.06 of the WSA. As of June 30, 2019, the Wholesale Revenue Coverage Reserve balance was $39,490,528, representing total deposits since July 1, 2009.

As of June 30, 2019, the Wholesale Revenue Coverage Reserve amount exceeded the Working Capital Requirement of 60 days of the wholesale share of Operations and Maintenance, Administrative and General, and Property Taxes, as shown in the below table:

	Wholesale revenue coverage reserve	Debt service coverage requirement	Working capital coverage requirement	Net interest
Balance, June 30, 2018	$ 33,730,188			
Deposits to wholesale revenue coverage reserve (note 2a)	5,760,340			
Balance, June 30, 2019	$ 39,490,528			
Calculation of adequacy of reserve requirement:				
Wholesale revenue coverage reserve balance, June 30, 2019		$ 39,490,528	39,490,528	
Coverage reserve requirement, June 30, 2019		(34,515,896)	(16,541,682)	
Coverage reserve excess/(deficiency)		$ 4,974,632	22,948,847	
Net interest due to (from) Wholesale Customers	$ 854,929			854,929

Net interest of $854,929, calculated as the annual interest on the Wholesale Revenue Coverage Reserve less any Working Capital Requirement not met, will be made to the Balancing Account in favor of the Wholesale Customers during the year ended June 30, 2020, in accordance with Article VI, Section 6.06 of the WSA.

(8) 2013 Rim Fire

In August 2013, the SFPUC's Hetch Hetchy Water and Power was challenged by the third largest fire in California history, the Rim Fire, in Stanislaus National Forest and Yosemite National Park, which burned over 250,000 acres.

Governor Brown declared a state of emergency for San Francisco on August 23, 2013 and President Obama followed with a federal state of emergency declaration. Through the U.S. Department of Homeland Security Federal Emergency Management Agency and the State of California Office of Emergency Services, federal and state funding is available on a cost-sharing basis to the City to help offset the costs of emergency work and the repair or replacement of facilities damaged by the Rim Fire. Additionally, many of the SFPUC assets impacted by the Rim Fire were insured.

For the fiscal year ending June 30, 2019, Hetch Hetchy incurred expenses of approximately $0.3 million bringing cumulative total expenses related to facilities and infrastructure damage, and costs related to emergency response to approximately $24.6 million. Reimbursements to date from insurance and federal and state grants totals approximately $13.5 million. An expense and reimbursement summary is shown in the following table.

2013 Rim Fire Expense and Reimbursement Summary

(in millions)	Hetch Hetchy Power	Hetch Hetchy Water	Hetch Hetchy Joint	Total
Actual expenditures:				
Cumulative through Fiscal Year 2017-18	$ 11.1	1.0	12.2	24.3
Fiscal Year 2018-19	(0.2)	0.0	0.6	0.3
Cumulative actual expenditures	10.8	1.0	12.8	24.6
Less reimbursements:				
Insurance				
Cumulative through Fiscal Year 2017-18	(3.7)	(0.3)	(2.6)	(6.6)
Fiscal Year 2018-19	(0.7)	-	-	(0.7)
Cumulative insurance	(4.4)	(0.3)	(2.6)	(7.3)
Federal/state grant				
Cumulative through Fiscal Year 2017-18	(3.2)	-	(2.7)	(5.9)
Fiscal Year 2018-19	-	(0.3)	-	(0.3)
Cumulative federal/state grant	(3.2)	(0.3)	(2.7)	(6.1)
Net expenditures:				
Cumulative through Fiscal Year 2017-18	4.1	0.7	6.9	11.8
Fiscal Year 2018-19	(0.9)	(0.3)	0.6	(0.6)
Cumulative net expenditures	$ 3.2	0.5	7.5	11.1
Joint allocation percentage			45%	
Adjusted proportional share of water deliveries Fiscal Year 2018-19		65.58%	65.58%	
Potential wholesale customer share:				
Cumulative through Fiscal Year 2017-18	$ -	0.5	2.0	2.5
Fiscal Year 2018-19	-	(0.2)	0.2	(0.0)
Cumulative potential wholesale customer share	$ -	0.3	2.2	2.5

The WRRs for the years ended June 30, 2014 through June 30, 2019 did not include allocation of the Rim Fire related costs because insurance reimbursements, government grants, and expenditures have not been finalized. SFPUC will allocate Rim Fire related costs to Wholesale Customers once final expense amounts and related cost reimbursements are known.

(9) Wholesale Customer Review of Fiscal Year 2015-16, Fiscal Year 2016-17, and Fiscal Year 2017-18 Balancing Account

Article VII, Section 7.06 of the WSA provides the Wholesale Customers the right to conduct a review of the SFPUC's calculation of the annual changes in the Balancing Account.

The Wholesale Customers and SFPUC entered into a settlement agreement on January 31, 2020 to resolve issues pertaining to the calculation of changes in the Balancing Account for Fiscal Year 2015-16 and Fiscal Year 2016-17. This settlement agreement resulted in adjustments described Statement to the Changes in the Balancing Account June 30, 2018 in Note 2(b). In addition, Wholesale Customer review of the Fiscal Year 2017-18 WRR is still ongoing, and may result in additional adjustments not listed below.

There are three outstanding issues related to settlement agreements which are expected to have an impact on the balancing account.

(a) Water System Improvement Program (WSIP) Financing Costs (Fiscal Year 2017-18)

The January 31, 2020 settlement agreement resolved a dispute over the allocation of certain intermediate WSIP financing costs (project CUW300) included in the WSA Attachment L-3 schedules of bond series 2009B, 2010B, 2010D, 2010E, 2011A and 2012A. The agreed-upon methodology for allocating these expenses was implemented through Fiscal Year 2016-17, and is reflected in the adjustments to the Balancing Account described in Note 2(b). However, the debt service allocation in Fiscal Year 2017-18 has not been adjusted. This change will be included in the Settlement Agreement for the FY 2017-18 WRR. The impact is estimated to be an $133,000 increase due to the Wholesale Customers as of June 30, 2018.

(b) Paid Time Off Adjustment Methodology (Fiscal Year 2017-18)

Since FY 2012-13, the Balancing Account has included a paid time off (PTO) adjustment to account for differences in the allocation of employees' work time and time off (including sick leave, vacation, etc.). While employees typically record work time to various specific charts of accounts, which are then classified for the WRR, PTO expenses are generally recorded to a default chart of accounts for each employee. The purpose of the PTO adjustment is to allocate PTO time consistently with work time.

During the FY 2017-18 audit, the SFPUC proposed a revision to the existing methodology that would address identified issues related to shifts across enterprises (i.e., shifting costs from Hetch Hetchy Water and Power to the Water Enterprise). The SFPUC's proposed methodology change would result in an estimated Balancing Account impact for FY 2017-18 of approximately $1.7 million due to the Wholesale Customers; the proposed methodology has already been incorporated into the FY 2018-19 WRR.

(c) Work Order Fund Salaries and Direct Salaries Charges to Other City Departments (Non SFPUC Departments) (Fiscal Years 2015-16 through 2017-18)

WSA section 5.06.B requires that SFPUC Bureau expenses be allocated among SFPUC enterprises on the basis of the actual salaries of employees in each enterprise, as illustrated on the WSA Attachment N-2, Schedule 7 and Schedule 7.1. The SFPUC and Wholesale Customers are in discussion regarding the inclusion of certain salaries related to SFPUC staff performing work for other City departments. For the FY 2017-18 and FY 2018-19 WRRs, these “work order” salaries have been included, where appropriate under the terms of the WSA, in Retail Water and Power salaries, which are used to allocate Bureau expenses. If accepted by the Wholesale Customers, the same methodology will be applied to the FY 2015-16 and FY 2016-17 WRRs. The potential adjustments are unknown at this time. The Wholesale Customers and SFPUC have agreed to resolve this issue during the Wholesale Customer Section 7.06 review of the Balancing Account activity for Fiscal Year 2017-18.

(10) Other Items Under Discussion

The following are items that are under discussion between the Wholesale Customers and the SFPUC. The discussion of these items and the path to resolution may have an impact on the calculation of the Wholesale Revenue Requirement.

(a) Article VI, Section 6.06 – Debt Service Coverage Reserve (Note 7)

SFPUC implemented a revised debt service coverage policy on March 28, 2017 (Resolution 17-0060). Under the revised policy the indenture debt service coverage ratio increased by 10 basis points from 1.25x to 1.35x. The Wholesale Customers and SFPUC are in discussion regarding the implementation of this new policy, following the procedures outlined in Article VII, Section 6.06 of the WSA. If agreed to by the Wholesale Customers, the revised policy will materially increase the debt service coverage reserve.

(b) Implementation of WSA Asset Classification Amendment

Timing for implementation of the SFPUC adopted December 11, 2018 WSA amendments directly affecting the calculation of the Wholesale Revenue Requirement is still to be discussed and agreed upon. The SFPUC will share a plan for implementation of these amendments with Wholesale Customers before proceeding with implementation. While the other amendments which impact the WRR have been implemented, a true-up of expenditures relating to Hetch Hetchy Water asset classification remains outstanding as of Fiscal Year 2018-19.

WSA section 5.11 and definitions, section 5.12, and Attachment R were amended to clarify the classification of Hetch Hetchy Water assets. For the assets shown in the table below, the classification of operating expenses will remain as shown in the “Asset Classification” column, but specific capital project expenses, going forward and retroactively to the date shown in the table, will be reclassified. The methodology for implementing these changes, especially the required retroactive adjustment, will be discussed between the SFPUC and Wholesale Customers. Adjustments to the Balancing Account to reflect the revised capital classification will be incorporated as expediently as possible; the amount of adjustments is not known at this time.

Asset	Asset Classification	Project Classification
Lower Cherry Aqueduct	Joint	Water
Mountain Tunnel Interim Work	Joint	Water
Mountain Tunnel Long Term Repairs	Joint	Water
Mountain Tunnel Flow Control Facility	Joint	Joint
Kirkwood Penstock	Power	Joint
Moccasin Penstock	Power	Joint
Moccasin Lower Dam	Water	Joint

(c) Prepayment of Attachment K-5 Revenue Funded Capital Balance

The Wholesale Customers have informed the SFPUC that they intend to apply a portion of the Balancing Account to prepay the outstanding principal balance on the Attachment K-5 payments for revenue-funded capital (Note 4). This prepayment is expected to occur in September 2020, and will be reflected in the FY 2020-21 WRR. The expected prepayment would reduce the balancing account by approximately $4 million, and no further payments would be needed on the Attachment K-5 balance.

(d) True-up of Debt Service Allocation of WSIP Bonds

In the FY 2009-10 7.06 Settlement Agreement, the parties agreed that the debt service allocation on bonds related to the Water System Improvement Project (WSIP) may need to be adjusted to properly reflect the final use of proceeds. This adjustment, which would impact the allocation of debt service beginning in Fiscal Year 2009-10, is to occur at or near the completion of WSIP. As WSIP is over 98% complete by dollar value as of FY 2018-19, the SFPUC has determined that this true-up should be completed soon. Based on early analysis, this adjustment is expected to change the allocation of bond series 2009B and 2010E. The expected adjustment is unknown at this time.

KPMG

Yano Accountancy Corporation

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

To the Honorable Mayor, Members of the Board of Supervisors,
and Management of the City and County of San Francisco,
and the Wholesale Customers:

In planning and performing our audit of the Statement of Changes in the Balancing Account (the statement) of the San Francisco Water Enterprise (Water Enterprise) and Hetch Hetchy Water and Power (Hetch Hetchy), under the jurisdiction of the San Francisco Public Utilities Commission (SFPUC), for the year ended June 30, 2019, in accordance with auditing standards generally accepted in the United States of America, we considered SFPUC's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the SFPUC's internal control. Accordingly, we do not express an opinion on the effectiveness of the SFPUC's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance. We consider the combination of deficiencies described in Finding 2019-1 to be a significant deficiency.

Restriction on Use

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

Very truly yours,

KPMG LLP

Yano Accountancy Corporation

Finding 2019-1 – Classification of Operations and Maintenance, and Property Tax Expenses

Criterion

Water Supply Agreement Article V, Section 5.02E describes two general principles of allocating costs to the Wholesale Customers, and states in part that "…(1) the Wholesale Customers should not pay for expenses of SFPUC operations from which they receive no benefit and (2) the Wholesale Customers should pay their share of expenses incurred by the SFPUC in delivering water to them…"

Observations and Effects

We observed the following during the audit of the Balancing Account. SFPUC management agreed with these observations, and accordingly corrected the Balancing Account.

1. One employee's costs were classified as O&M Regional instead of O&M Retail in the Balancing Account. The resulting correction to the Balancing Account resulted in an increase due to the Wholesale Customers of approximately $208,000.

2. Gross debt service on 2010 Series F bonds was not correct. The resulting correction to the Balancing Account resulted in an increase due to the Wholesale Customers of approximately $109,000.

Cause

The cause of the first condition was inadequate review and approval over the classification of employee costs in the Balancing Account, which we also found to be a recurring deficiency. The cause of the second condition was inadequate review and approval of the amounts input into Attachment N2, Schedule 2.

Recommendation

SFPUC should improve its review and evaluation practices to: 1) ensure that account balances and expenditure summaries are properly classified in the Balancing Account; and 2) ensure that the proper amounts are included in allocation calculations.

Views of SFPUC Management

Management concurs with the findings.

To prevent re-occurrence of these issues, the SFPUC will ensure that the N-2 schedules are reviewed by multiple staff, especially for highly material schedules such as debt service. In addition, staff will identify new employees during review of payroll data to ensure that their expenditures are classified properly according to their job title and duties.