CITY OF SAN DIEGO

Independent Accountant's Report on
Agreed-Upon Procedures
Applied to Wastewater Fund Rate Increases

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Office of the Mayor
City of San Diego

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On October 16, 2001, the San Diego City Council adopted resolution number R-295587 authorizing the increase of sewer service charges by 7.5% per year each year beginning March 1, 2002, for a period of four years through February 28, 2006. We have applied the procedures enumerated below to the City of San Diego's sewer service charge increases from March 1, 2002 through June 30, 2005. These procedures, which were agreed to by the City of San Diego were performed solely to assist the City in determining the uses of the revenue generated by the rate increases.

This engagement to apply agreed-upon procedures was performed in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the specified users of the report. Consequently, we make no representations regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures performed and the results of those procedures were as follows:

1. We obtained a summary of revenues and expenses for the fiscal years ended June 30, 2001 through 2005. We traced the revenues and expenses schedules to the City's accounting system to verify accuracy of the reports.

   Results: The summary of revenue and expenses are presented in *Schedule 1*.

2. We obtained a calculation of revenues generated by the rate increase. We recalculated the rate increase schedule and traced the total revenues presented on the schedule to the billing system *Detailed Revenue by Rate* schedule. We also performed analytical procedures on the revenues generated by the rate increase by multiplying the amount of annual sewer revenues in *Schedule 1* by the compounded effect of the rate increases.

   Results: The revenues generated by the rate increase were as follows for the years ended (in thousands):

June 30, 2002	$ 4,517
June 30, 2003	17,540
June 30, 2004	34,983
June 30, 2005	51,388
Total	$108,428

3. We reviewed the City Council resolution approving the sewer service charge increases for limitations on the use of the revenues.

   Result: The City Council resolution specifies that a minimum of 2.5% of the annual sewer rate increase be used for sewer and pipe replacement and rehabilitation.

4. Generally, there is a relationship between sewer system uses and water consumption. Accordingly, we analytically compared the changes in operations and maintenance expenses to the changes in purchased water for the years ended June 30, 2002 through 2005.

   Results: The increases and decreases in operations and maintenance expenses were materially consistent with the increases and decreases in purchased water for all years tested, except for fiscal years ended June 30, 2002 and 2003. For the year ended June 30, 2002, purchased water costs increased 3% while operations and maintenance costs increased 20%. As a result, additional procedures were performed, as set forth in procedure number five below.

5. We compared individual expenses accounts that make up "operations and maintenance" for the years ended June 30, 2002 and 2003 to identify significant fluctuations. We obtained explanations and supporting documentation to verify that the change between fiscal years did not represent a material misstatement.

   Results: Significant fluctuations between the fiscal years ended June 30, 2002 and 2003 were as follows:

   - Retirement expenses increased from $3.5 million to almost $5.5 million as a result of a 21% increase in salaries due to added staff and salary increases and an increase in the required retirement contribution rate from 6.68% of salaries to 10.94% of salaries.
   - Engineering department charges related to Service Level Agreements increased from $5.5 million to $7.2 million due an increased effort to reduce sewer spills. City Council requested the Metropolitan Wastewater Department to replace 45 miles of sewer main per year starting in the fiscal year ending June 30, 2003. The previous average was only 15 miles per year. City Council approved a 30% increase in staffing for the Wastewater Collection Division to attain this goal.
   - Chemical purchases increased from $5.9 million to $7.7 million primarily as a result of cost increases in the ferric chloride used to treat wastewater at the Point Loma Wastewater Treatment Plant.
   - Equipment repairs and maintenance increased from $2.8 million to $3.8 million. Maintenance and minor repairs vary from year to year. In 2003, contractual welding services increased at Pump Station 2 due to increased efforts to prevent sewage spills.

- Fire insurance costs increased from almost $1 million to $2.2 million because of post 911 increases in insurance premiums, increased premiums in earthquake insurance, and the addition of new Metropolitan Wastewater Department facilities.

The explanations provided for significant fluctuations are reasonable.

6. We obtained accounting system reports to determine the amount of capital project expenditures in the years ended June 30, 2002 through 2005. We also obtained accounting system reports to determine the amount of capital project expenditures that were funded by bond proceeds. The difference between these reports represents the amount of capital project expenditures that were funded by sewer rates and other available wastewater fund resources.

   Results: The following summarizes capital project activity for the years ended June 30, 2002 through 2005:

	2002	2003	2004	2005	Total
Capital projects:					
Internal costs	$ 18,954,555	20,837,702	22,862,691	11,519,719	74,174,667
Payments to 3rd party vendors	105,398,310	114,009,703	112,718,735	96,442,906	428,569,654
Total capital projects	124,352,865	134,847,405	135,581,426	107,962,625	502,744,321
Less: Bond funded projects	-	-	(121,735,724)	(30,483,308)	(152,219,032)
Projects funded by water revenues	$ 124,352,865	134,847,405	13,845,702	77,479,317	350,525,289

7. We compared the revenues generated by the rate increases to the increase in expenditure activity.

   Results: Operating and Capital expenses incurred by the Wastewater Fund exceeded the revenues generated by the rate increase, as demonstrated in the following schedule. Additionally, at least 2.5% of the rate increase was spent on capital improvement projects, as required by the City Council Resolution.

Additional revenues created through rate increases		$ 108,428
Increase in operating expenditures from base year		90,459
Increase in debt service expenditures from base year		8,633
Capital project expenditures	502,744	
Less: Capital projects funded by bond proceeds	(152,219)	
Capital projects not funded by bond proceeds		350,525
Total increase in expenditures from base year		449,617
Excess (deficiency) of revenues from rate increase		$ (341,189)

* * * * *

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the subject matter. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of the City of San Diego, California and is not intended to be and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes.

Mayer Hoffman McCann P.C.

Irvine, California
August 2, 2006

CITY OF SAN DIEGO
Wastewater Utility Fund - Analysis of Rate Increases
For the Years Ended June 30 (Unaudited)
(In Thousands)

	2001	2002	2003	2004	2005
Operating Revenues:					
Charges for services	$ 212,386	247,130	235,895	226,897	232,344
Charges for services-rate increase	**-**	**4,517**	**17,540**	**34,983**	**51,388**
Other	2,045	5,085	3,511	4,621	2,833
Total operating revenues	214,431	256,732	256,946	266,501	286,565
Operating Expenses:					
Maintenance, operations and admin	168,027	170,461	197,391	195,572	199,143
Depreciation	37,776	51,328	59,559	59,409	72,835
Total operating expenses	205,803	221,789	256,950	254,981	271,978
Operating income	8,628	34,943	(4)	11,520	14,587
Nonoperating Revenues (Expenses):					
Earnings on investments	29,059	18,634	17,021	2,463	7,193
Grant assistance	199	4,431	1,173	687	3
Gain (loss) on sale of capital assets	(2,937)	(272)	(1,801)	(2,692)	(13,413)
Debt service interest payments	(54,605)	(55,013)	(54,531)	(52,997)	(54,917)
Other	5,258	841	5,390	2,888	7,403
Total nonoperating revenues (expenses)	(23,026)	(31,379)	(32,748)	(49,651)	(53,731)
Income (loss) before contributions and transfers	(14,398)	3,564	(32,752)	(38,131)	(39,144)
Capital contributions	-	100,614	58,034	62,794	21,017
Transfers in	134	-	130	-	-
Transfers out	(960)	(5,167)	(3,959)	(1,900)	(1,592)
Change in net assets	(15,224)	99,011	21,453	22,763	(19,719)
Net assets at beginning of year	720,510	705,286	1,710,039	1,731,492	1,754,255
Prior period adjustment	-	905,742	-	-	-
Net assets at end of year	$ 705,286	1,710,039	1,731,492	1,754,255	1,734,536