CITY OF SAN DIEGO

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

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Office of the Mayor
City of San Diego

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On April 30, 2002, the San Diego City Council adopted resolution number R-296437 authorizing the increase of water sales revenues by 6% per year each year beginning July 1, 2002, for a period of five years through July 1, 2006. We have applied the procedures enumerated below to the City of San Diego's Water rate increases from July 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, 2002 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's *Daily Revenue by Rate* schedule. We also performed analytical procedures on the revenues generated by the rate increase by multiplying the amount of water sales revenue 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, 2003	$11,036
June 30, 2004	25,956
June 30, 2005	42,712
Total	$77,704

3. We reviewed the City Council resolution approving the water rate increases for limitations on the use of the revenues.

   Result: The City Council resolution did not specify the use of the revenues generated by the rate increases.

4. We analytically compared the changes in operations and maintenance expenses to the changes in purchased water for the years ended June 30, 2003 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.

5. We obtained accounting system reports to determine the amount of capital project expenditures in the years ended June 30, 2003 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 water rates and other available water fund resources.

   Results: The following summarizes capital project activity for the years ended June 30, 2003 through 2005:

	2003	2004	2005	Total
Capital projects:				
Internal costs	$ 11,652,495	9,848,359	9,711,925	31,212,779
Payments to 3rd party vendors	90,499,192	94,393,017	94,420,933	279,313,142
Total capital projects	102,151,687	104,241,376	104,132,858	310,525,921
Less: Bond funded projects	(60,423,016)	(62,478,164)	(51,613,495)	(174,514,675)
Projects funded by water revenues	$ 41,728,671	41,763,212	52,519,363	136,011,246

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

   Results: Operating and Capital expenses incurred by the Water Fund exceeded the revenues generated by the rate increase, as demonstrated in the following schedule:

Additional revenues created through rate increases		$ 77,704
Increase in operating expenditures from base year		5,647
Increase in water purchases from base year		10,699
Increase in debt service expenditures from base year		23,303
Capital project expenditures	310,526	
Less: Capital projects funded by bond proceeds	(174,515)	
Capital projects funded by water rates		136,011
Total increase in expenditures from base year		175,660
Excess (deficiency) of revenues from rate increase		$ (97,956)

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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
Water Utility Fund - Analysis of Rate Increase
For the Years Ended June 30 (Unaudited)
(In Thousands)

	2002	2003	2004	2005
Operating Revenues:				
Sale of water	$ 200,033	195,347	197,667	202,574
Sale of water-rate increase		**11,036**	**23,956**	**42,712**
Charges for services	821	887	965	1,027
Revenue from the use of property	3,654	4,074	4,969	4,701
Usage fees	1,304	1,417	1,614	1,987
Other	16,163	9,700	10,362	14,648
Total operating revenues	221,975	222,461	239,533	267,649
Operating Expenses:				
Maintenance, operations and administration	124,950	125,114	130,114	130,597
Cost of water purchased	97,312	100,094	100,445	102,096
Depreciation	17,027	18,457	20,799	25,676
Total operating expenses	239,289	243,665	251,358	258,369
Operating income	(17,314)	(21,204)	(11,825)	9,280
Nonoperating Revenues (Expenses):				
Earnings on investments	11,989	11,848	7,754	7,368
Federal grant assistance	23	565	506	640
Other agency grant assistance	515	1,068	50	694
Gain (loss) on sale of capital assets	130	(1,532)	(1,251)	(24,967)
Debt service interest payments	(18,794)	(24,358)	(26,387)	(27,235)
Other	6	11	(988)	15
Total nonoperating revenues (expenses)	(6,131)	(12,398)	(20,316)	(43,485)
Income (loss) before contributions and transfers	(23,445)	(33,602)	(32,141)	(34,205)
Capital contributions	77,808	98,371	79,055	21,630
Transfers in	-	-	-	1,927
Transfers out	(1,366)	(1,047)	(1,795)	-
Change in net assets	52,997	63,722	45,119	(10,648)
Net assets at beginning of year	961,762	1,014,759	1,078,481	1,123,600
Net assets at end of year	$ 1,014,759	1,078,481	1,123,600	1,112,952