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Office of the Mayor
City of San Diego

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

We have applied the procedures enumerated below to the City of San Diego's proposed wastewater rate increases. These procedures, which were agreed to by the City of San Diego were performed solely to assist the City in evaluating the proposed wastewater rate increases.

This engagement to apply agreed-upon procedures was performed in accordance with 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.

For purposes of comparisons referenced in this report, amounts are considered to be consistent if the difference between the compared amounts is less than $1 million and also less than 15%.

BACKGROUND

The Wastewater rate model was developed by outside consultants. The rate model contains projections of future expected revenues, operating costs, and capital costs. The model requires the rate increases to be sufficient to cover net operating costs and 20% of annual capital costs while not violating certain constraints. The model's constraints include maintaining $10 million in unrestricted, undesignated equity and maintaining a debt coverage ratio of at least 125% through fiscal year ending June 30, 2017. The model projects the following rate increases beginning:

May 1, 2007	8.75%
May 1, 2008	8.75%
May 1, 2009	7%
May 1, 2010	7%

PROCEDURES PERFORMED

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

1. We agreed the beginning unrestricted, undesignated equity balance at June 30, 2006 to unaudited accounting system reports.

   Results: The unaudited accounting system reports supported the amounts included in the rate model.

2. The rate model projects revenues based on historical trends and projections of future demand. The rate model includes the following revenue projections (in thousands):

	Fiscal Year Ending June 30,				
	2007	2008	2009	2010	2011
Service Charge Revenues	$ 238,538	261,769	293,274	316,409	337,207
Sewage Treatment Plant Services	70,389	73,916	77,518	81,142	84,705
Interest Earnings	3,963	4,867	5,358	6,134	6,482
Capacity Charge	14,984	15,139	15,294	15,450	15,607
Other Revenue	17,507	10,794	11,093	11,404	11,728
	$ 345,381	366,485	402,537	430,539	455,729

- We agreed the 2003 to 2006 revenues to unaudited accounting system reports. These revenues are used in the model to calculate historical trends.

  Results: For the years ended June 30, 2003 through 2006, the revenues are consistent with unaudited accounting system reports.

- We agreed the 2007 revenue amounts to the 2007 Annual Budget.

  Results: The 2007 Annual Budget is consistent with the projected revenues used in the rate model calculation.

- For *Service Charge Revenues*, we analytically tested the projected revenues for the years ending June 30, 2007 through 2011 by calculating revenues as a percentage of the sewered population as projected by San Diego Association of Governments. We also reviewed Service Charge Revenues by comparing future increases to historical increases.

  Results: Projected revenues as a percentage of the population are consistent with historical years. Additionally, projected revenues, excluding inflation and projected rate increases, are consistent with historical revenues.

- For *Interest Income*, we calculated the rate of return using unaudited accounting system reports.

  Results: The projected rate of return is consistent with current market interest rates.

- For *Sewage Treatment Plant Services*, *Capacity Charges*, and *Other Revenues* we compared each projected year to the prior year, beginning with the fiscal year ended June 30, 2005.

  Results: Projected revenues did not significantly vary from prior year data except for Other Revenues during 2007 to 2008. This is a result of a one-time refund to the Wastewater Department from the Motive Equipment Fund. The refund is attributed to the Wastewater Department's accumulation of funds in the Motive Equipment Fund which exceeds projected fleet vehicle requirements in operations over a 30-year period. The action is currently in the process of being approved by City Council.

3. The rate model projects other sources of funding based on long-term budgeting expectations. The rate model includes the following projections of other sources (in thousands):

	For the years ended June 30,				
	2007	2008	2009	2010	2011
Bond Proceeds	$ 199,345	80,270	95,590	148,380	147,534
Other Sources	14,435	-	-	-	-
Total	$ 213,780	80,270	95,590	148,380	147,534

- *Bond Proceeds* are issued to fund 80% of expected capital project expenditures. Wastewater revenues are used to fund the remaining 20% of capital projects. We recalculated 80% of the capital project expenditures to determine if the amount of bond proceeds is accurate.

  Results: Bond proceeds reported in 2007 are equal to 60% of eligible capital project expenditures, a reimbursement of 2007 eligible capital project expenditures, and $152 million of proceeds to be used to refund outstanding debt. Bond proceeds reported in 2008 through 2011 are consistent with 80% of eligible capital project expenditures.

- We inquired about significant changes in *Other Sources*.

  Results: The $14 million of Other Sources in 2007 represents known grant funding in 2007 that is unknown for future years.

4. The rate model projects operating expenses based on historical trends and projections of future demand. The rate model includes the following expense projections:

	Fiscal Year Ending June 30,				
	2007	2008	2009	2010	2011
Debt Service	$ 95,947	99,248	105,747	113,477	125,492
Operating & Maintenance	245,158	247,709	265,865	281,359	292,308
	$ 341,105	346,957	371,612	394,836	417,800

- We agreed the 2003 to 2006 expenditures to unaudited accounting system reports. These expenditures are used in the model to calculate historical trends.

  Results: For the years ended June 30, 2003 through 2006, expenditures per the unaudited accounting system reports are consistent with expenditures in the rate model.

- We agreed the 2007 expenditure amounts to the 2007 Annual Budget.

  Results: The 2007 expenditures per the model are consistent with the approved expenses in the 2007 Annual Budget.

- For *Operating & Maintenance Expenditures* we compared each projected year to the prior year starting with the fiscal year ended June 30, 2005. Operating and maintenance expenses did not increase by more than 15% in any year and are consistent with historical amounts. We obtained a detailed listing of what makes up the operating and maintenance expense amounts. For significant fluctuations between fiscal years, we obtained an explanation from management.

  Results: The major changes in Operating & Maintenance Expenditures are as follows:

  - Increase in Pension Contribution – We agreed the increase to projections provided by the Office of the Mayor.
  - Increase in Retirement Heath Benefits – We agreed the increase to projections provided by the Office of the Mayor.
  - Increase in General Government Services – We agreed the increase to detailed reports of the General Governmental Service Allocation.
  - Decrease in use of Service Level Agreements – We agreed the decrease to the Mayor's response to the Grand Jury findings.

- For *Operating & Maintenance Expenditures*, we calculated expenditures as a percentage of flow as reported and projected by the San Diego Association of Governments for both historical and future years.

  The results are as follows:

	For the years ended June 30,				
	2007	2008	2009	2010	2011
Ratio of Flow to Operating & Maintenance Expenditures	0.08%	0.08%	0.07%	0.07%	0.07%

Historical Average for 2003 - 2006 = 0.08%

- For *Debt Service Expenditures*, we agreed principal and interest payments to bond maturity schedules on outstanding debt. We also agreed debt service payments to the City's bond model that projects debt service on bonds that have not yet been issued.

  Results: No exceptions were noted.

5. The rate model projects capital expenditures based on specific project start dates and cost estimates. The capital project expenditures include a 3.5% contingency cost and an inflation factor of 4%. We compared the capital project expenditures in the rate model to the City's Capital Improvement Budget.

   Results: The capital improvement budget included in the 2007-2011 annual budget report totals $979 million. The capital improvement expenses from 2007-2011 in the rate model total $643 million. The variance of $336 million is mainly attributed to management's decision to schedule certain projects in later years than previously budgeted for in the capital projects budget. The modified projects are as follows:

Project Number	Project Name
44-001.0	Annual Allocation - Sewer Main Replacements
46-194.0	Annual Allocation - Trunk Sewer Rehabilitations
46-206.0	Annual Allocation - Accelerated Projects
40-933.0	Annual Allocation - MWWD Trunk Sewers
45-940.0	Wet Weather Storage Facility
42-933.0	NCWRP - Ultrafiltration and EDR Upgrade
41-933.0	Pump Station 2 Screens
42-930.0	SBWRP Demineralization Phase 1 and 2
46-502.0	Pooled Contingency
46-505.0	Annual Allocation - Unscheduled Projects

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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
November 17, 2006