KPMG

Yano Accountancy Corporation

SAN FRANCISCO WATER ENTERPRISE AND HETCH HETCHY WATER AND POWER

Statement of Changes in the Balancing Account

June 30, 2020

(With Independent Auditors' Report Thereon)

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

Yano Accountancy Corporation

Independent Auditors' Report

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

KPMG LLP and Yano Accountancy Corporation have audited the accompanying 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, 2020, 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, and the related notes to the statement.

Management's Responsibility for the Statement

Management is responsible for the preparation and fair presentation of the statement in accordance with the financial reporting provisions of Article VII, Section 7.02 of the WSA. Management is also responsible for the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of the statement that is 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, 2020 in accordance with Article VII, Section 7.02 of the WSA.

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Yano Accountancy Corporation

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 U.S. generally accepted accounting principles, to comply with the financial reporting provisions of the WSA referred to above. 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, 2020, and our reports thereon, dated January 22, 2021, 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
August 24, 2021

SAN FRANCISCO WATER ENTERPRISE AND
HETCH HETCHY WATER AND POWER

Statement of Changes in the Balancing Account

Year ended June 30, 2020

	Total	Amount allocated to the wholesale customers
Wholesale revenue requirement:		
Operating and maintenance expenses:		
San Francisco Water Enterprise (Water Enterprise):		
Source of supply	$ 28,079,243	$ 14,369,580
Pumping	2,319,987	—
Treatment	44,909,085	29,734,924
Transmission and distribution	66,814,154	17,170,618
Customer accounts	10,152,123	199,387
Total Water Enterprise operating and maintenance expenses	$ 152,274,592	$ 61,474,509
Hetch Hetchy Water and Power (Hetch Hetchy):		
Operating and maintenance expenses	$ 119,703,961	$ 17,962,206
Total Hetch Hetchy operating and maintenance expenses	$ 119,703,961	$ 17,962,206
Administrative and general (A&G) expenses:		
Countywide cost allocation plan:		
Water Enterprise	$ 2,495,753	$ 1,007,535
Hetch Hetchy	394,287	118,700
San Francisco Public Utilities Commission (Bureaus):		
Water Enterprise	30,681,264	13,402,609
Hetch Hetchy	15,232,032	2,746,769
Other A&G – Water Enterprise	21,307,577	6,912,754
Other A&G – Hetch Hetchy	32,059,833	3,093,421
Compliance audit	184,485	92,243
Total administrative and general expenses	$ 102,355,231	$ 27,374,031
Property taxes (outside City only):		
Water Enterprise	$ 1,960,063	$ 1,313,046
Hetch Hetchy	567,449	170,830
Total property taxes	$ 2,527,512	$ 1,483,876
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:		
Water Enterprise (note 5(a))		140,585,076
Credit for federal BABs interest subsidy		(14,202,492)
Revenue-funded capital projects:		
Water Enterprise (note 5(d))		26,796,000
True-Up of Wholesale Capital Fund		(1,921,189)
Total capital cost recovery and contribution		152,416,653
Total wholesale revenue requirement		$ 260,711,275
Balance due to wholesale customers, July 1, 2019		$ (46,925,278)
Adjustment to July 1, 2019 balance (note 2(b))		(2,323,997)
Adjusted balance due to wholesale customers, July 1, 2019		(49,249,275)
Interest on adjusted beginning balance		(940,660)
Net Wholesale revenue billed (note 6)		(269,506,214)
Transfer from Wholesale Coverage Reserve		(4,358,973)
Transfer from Balancing Account for BAWSCA water projects		805,000
Calculated wholesale revenue requirement		260,711,275
Interest on wholesale revenue coverage reserve (net of working capital requirement) (note 7)		(854,929)
Balance due to wholesale customers, June 30, 2020		$ (63,393,776)

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 or Retail Customers, acting by and through its Public Utilities Commission (SFPUC), and certain Wholesale Customers in the counties of San Mateo, Santa Clara, and Alameda (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, 2020, 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 6.05.B 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, 2020, the City of Mountain View did not meet its minimum purchase requirements. Revenues associated with the shortfall in the amount of $2,578,810 are included as wholesale water revenues, and 1.3 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 must be reflected in a written agreement before they are recorded as adjustments to the beginning Balancing Account with interest from the year of the underlying transaction. If differences cannot be resolved, the dispute shall be submitted to the arbitration in accordance with Article VIII, Section 8.01 of the WSA.

(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 2019–20 is the sixth 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 April 2019.

(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 5(a)).

All interest earnings on Debt Reserve Funds are accounted for as credits against gross debt service in determining the net debt service amounts. 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.

Bonds 2010 Series B, 2010 Series E, and 2010 Series G were issued as Build America Bonds, with the Federal government subsidizing a portion of the annual interest payments. The subsidy amount changes based on the Federal government's budget, and per agreement between the parties in the FY 2015-16 Settlement Agreement, the cash receipts in a Fiscal Year are credited proportionally to the Wholesale Customers based on the underlying debt service allocation of each series. 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.

Interest on the Wholesale Coverage Reserve is included as an adjustment to the Balancing Account based on the Wholesale Coverage Reserve balances, calculated working capital requirement and the City's pooled fund rate from the prior fiscal year. The entire Wholesale Coverage Reserve accrues interest at the City's pooled funds rate. If the average monthly Wholesale Coverage reserve balance is less than the calculated working capital requirement, interest on the Wholesale Coverage Reserve is reduced by calculated interest on the difference between the balance and the calculated working capital requirement.

(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, 2020:

	As previously reported	Adjustments	Adjusted balance
Balancing account under the WSA, June 30, 2019	$ (46,925,278)	$ —	$ (46,925,278)
Fiscal Year 2017-18 settlement agreement (note 2(b))	—	(2,264,918)	(2,264,918)
Interest on Fiscal Year 2017-18 settlement agreement (note 2(b))	—	(59,079)	(59,079)
Balancing account under the WSA, as adjusted, June 30, 2019	$ (46,925,278)	$ (2,323,997)	$ (49,249,275)
Interest on adjusted beginning balance at 1.91%			$ (940,660)
Net wholesale revenue billed (note 6)			(269,506,214)
Transfer from Wholesale Coverage Reserve			(4,358,973)
Transfer for BAWSCA water projects (note 2(c))			805,000
Calculated wholesale revenue requirement			260,711,275
Interest on wholesale coverage reserve excess (note 2(b))			(854,929)
Balancing account under the WSA, June 30, 2020			$ (63,393,776)

(b) Article VII, 7.06 Settlement Agreement – Fiscal Year 2015-16, Fiscal Year 2016-17, and Fiscal Year 2017-18 (note 9)

In accordance with Article VII, Section 7.06 of the WSA, the SFPUC and the Wholesale Customers reached a settlement agreement on June 9, 2021 relating to costs attributable to the fiscal years ended June 30, 2016, June 30, 2017, and June 30, 2018 (see note 1(g)). The following are adjustments to the June 30, 2019 beginning Balancing Account agreed to by both parties to the WSA.

		Amount
Adjustments to June 30, 2019 beginning balance:		
Fiscal Year 2015-16 settlement adjustments:		
Settlement agreement – work order funds	$	(133,931)
Fiscal Year 2016-17 settlement adjustments:		
Settlement agreement – work order funds		(180,095)
Fiscal Year 2017-18 settlement adjustments:		
Settlement agreement – WSIP financing costs		(132,719)
Settlement agreement – CDD Buildings & Grounds		(9,573)
Settlement agreement – work order funds		(78,192)
Settlement agreement – paid time off adjustment		(1,808,316)
Settlement agreement – inventories		95,790
Settlement agreement – retail groundwater monitoring		(17,882)
Subtotal Fiscal Year 2017-18 settlement adjustments – due (to)/from wholesale customers		(1,950,892)
Total adjustments		(2,264,918)
Interest on adjustments:		
FY 2016-17 interest computed at 0.93%		(1,246)
FY 2017-18 interest at 1.63%		(5,139)
FY 2018-19 interest at 2.32%		(52,694)
Subtotal interest on settlement adjustments due (to)/from wholesale customers		(59,079)
Total Fiscal Year 2015-16, Fiscal Year 2016-17, and Fiscal Year 2017-18 settlement adjustments – due (to)/from wholesale customers	$	(2,323,997)

(c) Application of Balancing Account for Water Supply Projects

In July 2019, $805,000 from the Balancing Account was transferred to BAWSCA to support water supply projects, as authorized by Article VI, Section 6.05.B.2 of the WSA. This transfer is reflected in the Balancing Account as of June 30, 2020.

(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
FY 2019-20*	66.99	33.01	66.90	33.10

*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 2019-20 is the sixth 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	
Net wholesale revenue billed (note 6)			
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, 2020 is summarized below.

		Water Enterprise		Hetch Hetchy		Total
Principal balance as of June 30, 2019	$	3,638,519	$	1,607,036	$	5,245,555
Principal payment		(670,775)		(296,263)		(967,038)
Principal balance as of June 30, 2020	$	2,967,744	$	1,310,773	$	4,278,517
Number of annual payments remaining (see Note 11a)		4		4		
Cumulative payments received through June 30, 2020:						
Applied to principal	$	3,650,733	$	1,612,431	$	5,263,164
Applied to interest		1,173,906		518,483		1,692,389
Total	$	4,824,639	$	2,130,914	$	6,955,553

The Wholesale Customers are allowed, under Article VI, 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. In September 2020, the Wholesale Customers elected to prepay the full remaining balance; see Note 11(a).

(5) Capital Cost Contribution – New Regional Assets

(a) Debt-Funded Capital Projects

SFPUC has issued water revenue bonds to fund the construction of new regional capital assets. As of June 30, 2020, outstanding debt related to the construction of new regional capital assets included 14 different Water Revenue Bond Series, as well as 7 different Water Revenue Bond Series refunding all or a portion of other bonds. When a bond refunds more than one underlying bond series, the debt service is split out and allocated to the Wholesale Customers proportionally based on the allocation of the underlying bond. 2017 Series A and 2017 Series B bonds had no net debt service payments during FY 2019-20, as they were in the capitalized interest period. 2019 Series A and 2019 Series B bonds had no debt service payments during FY 2019-20 because although they were issued during the fiscal year, they were structured for the first debt service payment to occur during FY 2020-21. 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.

SFPUC paid $245,785,084 in gross debt service on the bonds listed in Table 1 below during the year ended June 30, 2020. The net debt service is reduced to $245,421,991 when other interest earnings and other cash on hand of $363,093 are applied against the gross debt service payments.

Table 1 – Debt Service Expenditures – New Regional Assets

	Principal	Net interest	Total
2009 Series A	$ 9,635,000	$ 192,686	9,827,686
2009 Series B	9,635,000	240,859	9,875,859
2010 Series B	11,555,000	22,139,153	33,694,153
2010 Series D	11,430,000	1,111,395	12,541,395
2010 Series E	—	19,989,277	19,989,277
2010 Series F	5,175,000	546,441	5,721,441
2010 Series G	—	24,354,828	24,354,828
2011 Series A	—	7,785,354	7,785,354
2011 Series B	700,000	459,040	1,159,040
2012 Series A	—	14,732,826	14,732,826
2015 Series A/2006 Series A Refunding	14,000,000	17,911,290	31,911,290
2015 Series A/2009 Series A Refunding	—	1,844,178	1,844,178
2016 Series A/2009 Series A Refunding	—	13,618,838	13,618,838
2016 Series A/2009 Series B Refunding	—	15,293,226	15,293,226
2016 Series A/2010 Series F Refunding	—	6,844,542	6,844,542
2016 Series C	5,605,000	8,966,163	14,571,163
2017 Series A	—	—	—
2017 Series B	—	—	—
2017 Series C	—	1,627,721	1,627,721
2017 Series D/2011 Series A Refunding	860,000	11,205,016	12,065,016
2017 Series D/2012 Series A Refunding	—	6,114,353	6,114,353
2017 Series F/2011 Series B Refunding	—	435,220	435,220
2017 Series G/2011 Series A Refunding	500,000	914,585	1,414,585
2019 Series A/2010 Series F Refunding	—	—	—
2019 Series A/2011 Series A Refunding	—	—	—
2019 Series B/2011 Series B Refunding	—	—	—
2019 Series B/2012 Series A Refunding	—	—	—
	$ 69,095,000	$ 176,326,991	$ 245,421,991

Table 2 below shows the allocation of each bond series to retail and regional projects, as well as the Fiscal Year during which each bond reached substantially expended. No bonds reached substantially expended during the year ended June 30, 2020.

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 10-12	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/ 2012 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	
2019 Series A/ 2010 Series F Refunding	—	—	100.00	100.00	FY 14-15	
2019 Series A/ 2011 Series A Refunding	—	6.47	93.53	100.00	FY 14-15	
2019 Series B/ 2011 Series B Refunding	—	0.53	99.47	100.00	FY 18-19	
2019 Series B/ 2012 Series A Refunding	—	8.83	91.17	100.00	FY 18-19	

Table 3 shows the allocation of the net debt service in Table 1 using the percentages from Table 2. The regional share of all bonds except for 2011 Series B and 2017 Series C is allocated based on Proportional Annual Use. Because 2011 Series B and 2017 Series C fund Hetch Hetchy water-related capital project expenditures, the Wholesale share of the debt on these series for the year ended June 30, 2020 was allocated using the Adjusted Proportional Annual Use percentage of 66.90%.

In total, $140,585,076 in net debt service is allocated to the Wholesale Customers.

Table 3 – Wholesale Customers Debt Service Allocation ($)

	Excluded costs	Retail projects	Regional projects	Total	Proportional annual use	Total wholesale debt service
2009 Series A	$ 3,110,463	$ 1,025,028	$ 5,692,196	$ 9,827,687	66.99%	$ 3,813,202
2009 Series B	82,957	1,236,458	8,556,444	9,875,859	66.99%	5,731,962
2010 Series B	6,739	2,402,393	31,285,021	33,694,153	66.99%	20,957,836
2010 Series D	—	347,397	12,193,998	12,541,395	66.99%	8,168,759
2010 Series E	—	633,660	19,355,617	19,989,277	66.99%	12,966,328
2010 Series F	—	—	5,721,441	5,721,441	66.99%	3,832,793
2010 Series G	—	—	24,354,828	24,354,828	66.99%	16,315,299
2011 Series A	—	503,712	7,281,642	7,785,354	66.99%	4,877,972
2011 Series B	—	6,143	1,152,897	1,159,040	66.90% *	771,288
2012 Series A	—	1,300,909	13,431,917	14,732,826	66.99%	8,998,041
2015 Series A/						
2006 Series A Refunding	10,757,296	4,180,379	16,973,615	31,911,290	66.99%	11,370,625
2015 Series A/				—		
2009 Series A Refunding	583,682	192,348	1,068,148	1,844,178	66.99%	715,552
2016 Series A/				—		
2009 Series A Refunding	4,310,362	1,420,445	7,888,031	13,618,838	66.99%	5,284,192
2016 Series A/						
2009 Series B Refunding	128,463	1,914,712	13,250,051	15,293,226	66.99%	8,876,209
2016 Series A/						
2010 Series F Refunding	—	—	6,844,542	6,844,542	66.99%	4,585,159
2016 Series C	—	—	14,571,163	14,571,163	66.99%	9,761,222
2017 Series A	—	—	—	—	66.99%	—
2017 Series B	—	—	—	—	66.99%	—
2017 Series C	—	—	1,627,721	1,627,721	66.90%	1,088,945

Table 3 – Wholesale Customers Debt Service Allocation ($)

	Excluded costs	Retail projects	Regional projects	Total	Proportional annual use	Total wholesale debt service
2017 Series D/ 2012 Series A Refunding	—	780,607	11,284,409	12,065,016	66.99%	7,559,426
2017 Series D/ 2012 Series A Refunding	—	539,897	5,574,456	6,114,353	66.99%	3,734,328
2017 Series F/ 2011 Series B Refunding	—	2,307	432,913	435,220	66.90% *	289,619
2017 Series G/ 2011 Series A Refunding	—	91,524	1,323,061	1,414,585	66.99%	886,319
2019 Series A/ 2010 Series F Refunding	—	—	—	—	66.99%	—
2019 Series A/ 2011 Series A Refunding	—	—	—	—	66.99%	—
2019 Series B/ 2011 Series B Refunding	—	—	—	—	66.90% *	—
2019 Series B/ 2012 Series A Refunding	—	—	—	—	66.99%	—
	$ 18,979,962	$ 16,577,919	$ 209,864,111	$ 245,421,992		$ 140,585,076

* Adjusted Proportional Annual Use

(b) Build America Bonds Federal Interest Subsidy

2010 Series B, 2010 Series E and 2010 Series G are Federally taxable bonds with Build America Bonds Subsidy (BABS) revenues. The following table shows total BABS revenues received of $21,932,218 and wholesale shares credited to the Wholesale Customers of $14,202,492.

Bond Series	Total BABS Revenues	Wholesale share
2010 Series B	$ 7,303,397	4,542,729
2010 Series E	6,596,558	4,278,951
2010 Series G	8,032,263	5,380,812
	$ 21,932,218	14,202,492

(c) 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, 2020:

Project Description	Appropriations	Allocation %	Wholesale share
Communications & Monitoring	$ 500,000	66.99%	$ 334,950
Water Supply & Storage	7,050,000	66.99	4,722,795
Water Transmission	19,929,000	66.99	13,350,437
Watershed & Land Management	12,521,000	66.99	8,387,818
Fiscal Year 2019-20 Total	$ 40,000,000		$ 26,796,000

(d) 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.

As of June 30, 2020, the Wholesale Revenue-Funded Capital Fund balance is $1,921,189 more than the target amount based on cumulative annual appropriations and expenditures. This excess balance is transferred to the Balancing Account. Activity in the Wholesale Revenue Funded Capital Fund is shown in the table below.

Table 4 – Annual Activity in Wholesale Capital Fund

	FY 2019-20
Beginning Wholesale Capital Fund Balance	$ 51,463,763
Annual Appropriation	26,796,000
Annual Expenditures	(15,219,993)
Interest Earnings	1,093,509
Subtotal Balance Before Transfers	64,133,279
Amount Encumbered as of June 30, 2020	(13,695,564)
Unencumbered Balance Before Transfers	$ 50,437,715

(Continued)

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

Lesser of			
Target Balance, or	$	48,516,526	
Cumulative Unspent Wholesale Capital Fund		68,154,609	
Target Balance			48,516,526
(Less) Unencumbered Balance Before Transfer			(50,437,715)
Deficiency/(Excess) in Reserve			(1,921,189)
Lesser of			
$4,000,000 or	$	4,000,000	
Calculated Reserve Deficiency		(1,921,189)	
Wholesale Capital Fund, Before Adjustments			64,133,279
Transfer From/(To) Balancing Account			(1,921,189)
Ending Total Balance			62,212,090

(6) Wholesale Revenue Billings

During the year ended June 30, 2020, the SFPUC billed a total of $269,506,214 (net of amounts remitted to BAWSCA) in wholesale revenue for costs of service associated with deliveries from the regional water system. This total includes $2,578,810 in wholesale revenue billings associated with a customer who did not meet its minimum purchase requirements note 1(e)). 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. For the year ended June 30, 2020, the balance in the Wholesale Revenue Coverage Reserve was higher than required, and so $4,358,973 was transferred from the Wholesale Revenue Coverage Reserve and Working Capital Reserve to the Balancing Account, increasing total revenues for the Fiscal Year. The net amount billed after transfer from the Coverage Reserve, and which is applied to the revenue requirement, is $273,865,187.

Gross and net wholesale revenue billings are summarized below:

Gross wholesale amounts billed – net of adjustments	$	266,927,404
Imputed water sales from minimum purchase requirements		2,578,810
Subtotal		269,506,214
Transfer from wholesale revenue coverage reserve		4,358,973
Net wholesale revenues billed	$	273,865,187

(7) Wholesale Revenue Coverage Reserve

(a) Activity in the Wholesale Revenue Coverage Reserve During the Year Ended June 30, 2020

During the year ended June 30, 2020, $4,358,973 was transferred from the Wholesale Revenue Coverage Reserve to the Balancing Account in accordance with Article VI, Section 6.06 of the WSA. As of June 30, 2020, the Wholesale Revenue Coverage Reserve balance was $35,131,555, representing total deposits since July 1, 2009.

		Wholesale revenue coverage reserve
Balance, June 30, 2019	$	39,490,528
(Transfer to) Balancing Account from wholesale revenue coverage reserve (note 2a)		(4,358,973)
Balance, June 30, 2020	$	35,131,555

(b) Net Interest on Wholesale Coverage Reserve

As of July 1, 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. Net interest of $(854,929), calculated as the annual interest on the Wholesale Revenue Coverage Reserve less any Working Capital Requirement not met, is credited 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.

		Debt service coverage requirement	Working capital coverage requirement	Net interest
Calculation of adequacy of reserve requirement				
Wholesale revenue coverage reserve balance, July 1, 2019	$	39,490,528	39,490,528	
Coverage reserve requirement, July 1, 2019		(34,515,896)	(16,541,682)	
Coverage reserve excess (deficiency)	$	4,974,632	22,948,846	
Net interest due to (from) Wholesale Customers				(854,929)

(8) 2013 Rim Fire

In August 2013, the SFPUC's Hetch Hetchy Water and Power was challenged by what was then the third largest fire in California history, the Rim Fire, in Stanislaus National Forest and Yosemite National Park, which burned over 250,000 acres. 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, 2020, Hetch Hetchy incurred expenses of approximately $0.2 million, bringing cumulative total expenses related to facilities and infrastructure damage, and costs related to emergency response to approximately $24.8 million. Reimbursements to date from insurance and federal and state grants totals approximately $14.9 million. The WRRs for the years ended June 30, 2014 through June 30, 2020 did not include complete allocation of the Rim Fire-related costs because insurance reimbursements, government grants, and expenditures have not been finalized. SFPUC will finalize the allocation of Rim Fire related costs to Wholesale Customers once final expense amounts and related cost reimbursements are known. That allocation will include a proportional allocation of all reimbursements, and account for debt service already paid by the Wholesale Customers on any projects funded by bond series. An estimate of $1.9 million may be due from the Wholesale Customers.

(9) Wholesale Customer Review of Fiscal Year 2015--16, Fiscal Year 2016-17, Fiscal Year 2017-18, and Fiscal Year 2018-19 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 June 9, 2021 to resolve issues pertaining to the calculation of changes in the Balancing Account for Fiscal Year 2015--16, Fiscal Year 2016-17, and Fiscal Year 2017-18. This settlement agreement resulted in adjustments described Statement to the Changes in the Balancing Account June 30, 2020 in note 2(b). This settlement agreement closed all outstanding issues from Fiscal Years 2015-16, Fiscal Year 2016-17 and Fiscal Year 2017-18. Wholesale Customer review of the Fiscal Year 2018-19 WRR is still ongoing, and may result in additional adjustments to the Balancing Account.

(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 increase the debt service coverage reserve requirement.

(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 ended June 30, 2020.

Article V, Section 5.11 of the WSA and WSA Attachments A and 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 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) True-up of Debt Service Allocation of WSIP Bonds

In the FY 2009-10 Settlement Agreement under Article VII, Section 7.06 of the WSA, 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 2019-20, the SFPUC has determined that this true-up should be completed soon. Based on early analysis, this adjustment is expected to change the debt service on 2009 Series B and 2010 Series E bonds. The expected adjustment is unknown at this time.

(11) Subsequent Changes to the Balancing Account

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

On September 18, 2020, the Wholesale Customers elected 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), as authorized by Article VI, Section 6.05.B.2 of the WSA. This prepayment will be reflected in the FY 2020-21 WRR. The prepayment will reduce the amount due to the Wholesale Customers by approximately $4 million, and no further payments would be needed on the Attachment K-5 balance.

(Continued)

(b) Application of Balancing Account for Water Supply Projects

On May 26, 2021, the Wholesale Customers requested a transfer of \$197,000 from the Balancing Account to support water supply projects, as authorized by Article VI, Section 6.05.B.2 of the WSA. This transfer is to be reflected in the FY 2020-21 WRR.

KPMG

Yano Accountancy Corporation

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

August 24, 2021

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, 2020, 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 a material weakness or significant deficiency.

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. We consider the deficiency described in Finding 2020-1 to be a material weakness.

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 deficiency described in Finding 2020-2 to be a significant deficiency.

SFPUC's written responses to the material weakness and significant deficiency were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 2020-1: Inappropriate Tone at the Top – Repeat Finding from KPMG LLP's Report on Internal Control, Compliance and Other Matters Issued on February 26, 2021

An entity must establish and maintain an effective control environment (tone at the top) over compliance with laws, regulations, contracts and grant agreements that have a material effect on the financial statements. The control environment, which is the responsibility of executive management, helps set the tone of the organization and includes commitment towards openness, honesty, integrity, and ethical behavior, and may influence its management and employees. SFPUC management and employees are required to adhere to the ethical standards as governed in the City's code of conduct. Subsequent to SFPUC's June 30, 2020 fiscal year-end, but prior to the date of our report, a criminal Federal complaint was filed against SFPUC's general manager for honest services wire fraud. These alleged criminal actions against an individual responsible for compliance with laws and regulations constituted a deficiency in the control environment because they failed to set an appropriate tone at the top and demonstrated a lack of integrity and ethical values as set forth in the City's code of conduct. Although management has deemed no financial statement impact resulting from these actions, because the alleged criminal actions occurred at the executive management level, the potential for a material misstatement is more than remote. Accordingly, this deficiency constitutes a material weakness.

SFPUC's Repeat Response to Findings in Report on Internal Control, Compliance and Other Matters Issued on February 26, 2021

Management acknowledges the identified internal control deficiency.

The former general manager of SFPUC is no longer employed with the entity or City. The Office of the City Attorney and Controller's Office have set forth a series of investigations and audits related to Public Integrity, addressing organizational functions and processes identified in the alleged criminal actions of the individual. SFPUC has also planned a near-term series of internal assessments for organizational areas, programs and processes related to the investigations to identify areas requiring further improvements over internal control.

Finding 2020-2: Misclassified Expenditures

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. The costs of the 311 call center were classified as A&G Regional instead of A&G Retail in the Balancing Account. The resulting correction to the Balancing Account resulted in an increase due to the Wholesale Customers of approximately $119,000.

2. 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 $117,000.

Cause

The cause of the first observation was inadequate review and approval of the classification of the new general ledger account. The cause of the second observation was inadequate review and approval over the classification of employee costs in the Balancing Account, which we also found to be a recurring deficiency.

Recommendation

SFPUC should improve its review and evaluation practices to ensure that account balances and expenditure summaries are properly classified in the Balancing Account.

SFPUC's Response to Findings

Management concurs with the findings.

To prevent reoccurrence of these issues, the SFPUC will expand its review of new chart of accounts fields to include the account field, ensuring that any new accounts are classified appropriately. 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, with a particular focus on employees and divisions who have previously had misclassified expenditures.