

Financial Statements

June 30, 2010 and 2009

(With Independent Auditors' Report Thereon)

June 30, 2010 and 2009

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

Independent Auditors' Report

The Honorable Mayor and Board of Supervisors City and County of San Francisco

We have audited the accompanying financial statements of the San Francisco Water Enterprise (the Enterprise), an enterprise fund of the City and County of San Francisco, California (the City), as of and for the years ended June 30, 2010 and 2009, as listed in the table of contents. These financial statements are the responsibility of the Enterprise's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing the audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Enterprise's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements of the Enterprise are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the City that is attributable to the transactions of the Enterprise. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2010 and 2009, the changes in its financial position, or, where applicable, the cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the San Francisco Water Enterprise of the City and County of San Francisco, California as of June 30, 2010 and 2009, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 24, 2010, on our consideration of the Enterprise's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3 through 17 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



November 24, 2010

Management's Discussion and Analysis

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

This section presents management's analysis of the San Francisco Water Enterprise's (the Enterprise) financial condition and activities as of and for the years ended June 30, 2010 and 2009. Management's Discussion and Analysis (MDA) is intended to serve as an introduction to the Enterprise's financial statements. This information should be read in conjunction with the audited financial statements that follow this section. All amounts, unless otherwise noted, are expressed in thousands of dollars.

The information in this MDA is presented under the following headings:

- Organization and Business
- Overview of the Financial Statements
- Financial Analysis
- Capital Assets and Debt Administration
- Next Year's Rates
- Request for Information

Organization and Business

The San Francisco Public Utilities Commission (SFPUC or the Commission) is an agency of the City and County of San Francisco (the City) that is responsible for the maintenance, operation, and development of three utility enterprises, Wastewater, Hetch Hetchy Water and Power, and Water (the Enterprise). The Water Enterprise collects, transmits, treats, and distributes high-quality drinking water to a total population of approximately 2.4 million people, including retail customers in the City and wholesale customers located in San Mateo, Santa Clara, and Alameda Counties. The Enterprise delivered approximately 80,273 million gallons in the year ended June 30, 2010. Approximately two-thirds of the water delivered by the Enterprise is to wholesale customers. Retail customers are primarily San Francisco consumers and include residential, commercial, industrial, and governmental users. The Enterprise recovers cost of service through user fees. Wholesale customers include cities, water districts, one private utility, and one nonprofit university. Service to these customers is provided pursuant to the new 25-year Water Supply Agreement (WSA) which establishes the basis for determining the costs of wholesale service. The former contract expired June 30, 2009 and the new WSA commenced on July 1, 2009.

Overview of the Financial Statements

The Enterprise's financial statements include:

Statements of Net Assets present information on the Enterprise's assets and liabilities as of year-end, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Enterprise is improving or deteriorating.

While the Statements of Net Assets provide information about the nature and amount of resources and obligations at year-end, the Statements of Revenues, Expenses, and Changes in Net Assets present the results of the Enterprise's operations over the course of the fiscal year and information as to how the net assets changed during

Management's Discussion and Analysis

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(Dollars in thousands, unless otherwise stated)

the year. These statements can be used as an indicator of the extent to which the Enterprise has successfully recovered its costs through user fees and other charges. All changes in net assets are reported during the period in which the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in these statements from some items that will result in cash flows in future fiscal periods, such as delayed collection of operating revenues and the expenses of employee earned but unused vacation leave.

The *Statements of Cash Flows* present changes in cash and cash equivalents resulting from operational, capital, non-capital, and investing activities. These statements summarize the annual flow of cash receipts and cash payments, without consideration of the timing of the event giving rise to the obligation or receipt and exclude non-cash accounting measures of depreciation or amortization of assets.

The *Notes to Financial Statements* provide information that is essential to a full understanding of the financial statements that is not displayed on the face of the financial statements.

Financial Analysis

Financial Highlights for Fiscal Year 2010

- Total assets of the Enterprise exceeded total liabilities by \$415,684.
- Net assets decreased by \$46,616 or 10.1% during the fiscal year.
- Capital assets, net of accumulated depreciation, increased by \$363,093 or 24.2% to \$1,864,353.
- During the fiscal year, charges for services, excluding interest and investment income, rental income, other operating and non-operating revenues, increased by \$705 or 0.3% to \$248,369.
- Operating expenses, excluding interest expense and other non-operating expenses, increased by \$29,655 or 11.9% to \$277,970.

Financial Highlights for Fiscal Year 2009

- Total assets of the Enterprise exceeded total liabilities by \$462,300.
- Net assets increased by \$967 or 0.2% during the fiscal year.
- Capital assets, net of accumulated depreciation, increased by \$233,266 or 18.4 % to \$1,501,260.
- During the fiscal year, charges for services, excluding interest and investment income, rental income, other operating and non-operating revenues, increased by \$30,845 or 14.2% to \$247,664.
- Operating expenses, which exclude interest expense and other non-operating expenses, increased by \$25,263 or 11.3% to \$248,315.

Management's Discussion and Analysis

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(Dollars in thousands, unless otherwise stated)

Financial Position

The following table summarizes changes in the Enterprise's changes in net assets.

Table 1
Comparative Condensed Net Assets

June 30, 2010, 2009, and 2008

		2010	2009	2008	2010 – 2009 change	2009 – 2008 change
Current and other assets Capital assets, net of accumulated	\$	1,136,966	269,975	259,432	866,991	10,543
depreciation	_	1,864,353	1,501,260	1,267,994	363,093	233,266
Total assets		3,001,319	1,771,235	1,527,426	1,230,084	243,809
Revenue and capital appreciation bonds		2,249,179	936,506	961,790	1,312,673	(25,284)
Certificates of participation		122,496	_	_	122,496	
Commercial paper		_	229,600	_	(229,600)	229,600
Other liabilities		213,960	142,829	104,303	71,131	38,526
Total liabilities	_	2,585,635	1,308,935	1,066,093	1,276,700	242,842
Net assets:						
Invested in capital assets, net of						
related debt		319,581	372,421	324,091	(52,840)	48,330
Restricted for debt service		12,073	11,941	27,434	132	(15,493)
Restricted for capital projects		3,868	841	214	3,027	627
Unrestricted		80,162	77,097	109,594	3,065	(32,497)
Total net assets	\$	415,684	462,300	461,333	(46,616)	967

Net Assets, Fiscal Year 2010

For the year ended June 30, 2010, the Enterprise's assets exceeded liabilities by \$415,684, representing a decrease of \$46,616 or 10.1% from the prior year (see Table 1). The decline in net assets was the result of an additional \$1,230,084 in total assets offset by a \$1,276,700 increase in total liabilities. Investment in capital assets, net of related debt, decreased from prior year's \$372,421 to \$319,581 or 14.2% due to the depreciation and repayment of debt.

Current and other assets primarily comprised of restricted and unrestricted balances of cash, receivables for water deliveries and services, interfund receivables due from other governmental agencies, and inventory. This also includes a receivable which represents cumulative amounts due from the wholesale customers to match revenues with the Enterprise's costs of providing service (the "Balancing Account") in accordance with the provisions set forth in the Water Supply Agreement effective July 1, 2009. Balances due are recovered in future year rates.

Management's Discussion and Analysis

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(Dollars in thousands, unless otherwise stated)

During the fiscal year 2010, current and other assets increased by \$866,991 or 321.1%, as a result of \$853,084 increase in restricted cash and investments, and restricted interest receivable from planned bond issuances during the year. The bond issuance costs increased by \$10,537. Unrestricted cash with City Treasury was used to pay down current contractual obligations and other liabilities, thereby resulting in a \$17,455 decline in unrestricted cash balance. Inventories decreased by \$58, and total receivables increased by \$20,830, primarily resulting from \$10,157 net increase in unrestricted interest receivable, due from other funds and advances for the SFPUC headquarters building, \$3,491 increase in receivables for charges for services mainly from City retail ratepayers, net of the current year provision for uncollectible accounts, in part as a result of an average rate adjustment of 15% that went into effect at the beginning of the fiscal year, \$661 receivable increase in due from other governmental agencies from the High Efficiency Toilet Grant, and increase of \$6,521 in receivable from the wholesale customers consistent with the new Water Supply Agreement terms. Wholesale customers are billed based on the estimated costs of service and usage, which are adjusted to actual costs and usage at year end. As of June 30, 2010, the ending balance was \$34,092 owed to the Enterprise. Refer to Note 10, Wholesale Balancing Account, for additional details.

Total liabilities increased by \$1,276,700 or 97.5% primarily due to the issuance of \$1,435,169 in revenue bonds and certificates of participation offset by principal payments, \$34,004 in payables from restricted assets from the Water System Improvement Program and the 525 Golden Gate Avenue Headquarters Project, and \$8,651 in interest payable from new bonds issued, offset by a refunding of \$229,600 in commercial paper through the issuance of new bonds. Other factors contributing to the increase in total liabilities are \$20,099 in damage and claims liability due to updated liability reserve estimates related to pending Federal and State cases regarding breach of contract claims by Mitchell Engineering (see Subsequent Events, note 15(d)), \$14,631 in other post-employment benefits obligation based on actuarial estimates, \$878 in accrued payroll and other liabilities, \$373 in accrued vacation and sick leave due to the wellness program, and \$288 in arbitrage rebate payable due to higher yield, offset by decreases of \$4,617 in accounts payable of operating funds, as project spending this year was more funded with restricted bond funds than with operating funds in comparison to prior fiscal year, \$2,653 in pollution remediation obligation due to liability reduction in the Baylands Peninsula Sportsman Club project as a result of completion of remediation process, and \$523 in workers' compensation.

Net Assets, Fiscal Year 2009

For the year ended June 30, 2009, the Enterprise's assets exceeded liabilities by \$462,300, representing an increase of \$967 or 0.2% from the prior year (see Table 1). The growth in net assets is the result of an additional \$243,809 in total assets offset by a \$242,842 increase in total liabilities. Investment in capital assets, net of related debts, represents the largest portion of the Enterprise's net assets (\$372,421 or 80.6%). The increase of \$48,330 represents the excess of capital asset book values over debt-financed construction and acquisition costs. Unrestricted net assets declined \$32,497 due to higher planned expenses than revenue growth.

Current and other assets is primarily comprised of restricted and unrestricted balances of cash, receivables for water deliveries and services, interfund receivables due from other governmental agencies, and inventory. This section also includes a receivable which represents cumulative amounts due from the Suburban Purchasers to match revenues with the Enterprise's costs of providing service (the "Balancing Account") in accordance with the provisions set forth in the Master Water Sales Agreement which expired on June 30, 2009.

Management's Discussion and Analysis

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(Dollars in thousands, unless otherwise stated)

During the fiscal year 2009, current and other assets increased by \$10,543 or 4.1%, as a result of an \$11,107 increase in current assets, a \$234 decrease in restricted cash and investments due to declining interest rates and lower cash balances and a \$330 decrease in bond issuance costs. Current assets increased mainly due to the increase in accounts receivable from the wholesale customers under the Suburban Water Rate Agreement. Wholesale customers are billed based on the estimated costs of service and usage, which are adjusted to actual costs and usage at year end. The estimates billed for fiscal year 2008 and 2009 were less than actual, resulting in \$13,701 additional due at June 30, 2009. There was also an increase of \$4,608 in receivable balances for charges for services mainly from City retail ratepayers, net of the current year provision for uncollectible accounts, as a result of an average rate adjustment of 15% that went into effect at the beginning of the fiscal year. Part of the receivable increase was \$205 in receivables resulting from an established memorandum of understanding between the Enterprise and the San Francisco Zoological Society for water consumption at its park facility. The increase of \$278 due from other governmental agencies was attributable to an increase in grants receivable. In addition, there was a net increase in other current assets including interest, due from other funds, advances, and inventory of \$247. Cash balances, however, declined by \$7,727 due to a decrease in interest rates and related earnings, and increases in operating expenses.

Total liabilities increased by \$242,842 or 22.8% primarily due to the issuance of \$229,600 in commercial paper. Excluding the change in commercial paper, other current liabilities increased by \$19,956 due to increases in accounts payable of \$6,384 related to large capital projects such as the 525 Golden Gate Avenue Headquarters Project of \$2,600, the SCADA System of \$950, the Noe Valley Trans Line of \$589, and the Ripley Control Distribution Division of \$419. In addition, current liabilities increased by \$13,281 in restricted assets, largely related to increases in payables for the Water System Improvement Program. Long-term liabilities decreased by \$6,714 due to scheduled principal payments on revenue bonds outstanding of \$26,369, decreases in damage and claims liability of \$1,117 and pollution remediation obligation of \$120 related to payment of pollution remediation costs, offset by increases in the liability for other post-employment benefits (OPEB) of \$15,919, arbitrage rebate payable of \$4,265, workers' compensation of \$443, and accrued vacation and sick leave of \$265.

Restricted cash and investments with and outside City Treasury declined by \$234 at the end of the fiscal year 2009, due primarily to declining interest rates and lower cash balances held by City Treasury. Additionally, unrestricted cash with City Treasury was used to pay down current contractual obligations and other liabilities, thereby resulting in \$7,727 decline in unrestricted cash balance.

Management's Discussion and Analysis

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(Dollars in thousands, unless otherwise stated)

Results of Operations

The following table summarizes the Enterprise's revenues, expenses, and changes in net assets.

Table 2

Comparative Condensed Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2010, 2009, and 2008

2010 2000

2000 2000

	2010	2009	2008	2010 – 2009 change	2009 – 2008 change
Revenues:					
Charges for services \$	248,369	247,664	216,819	705	30,845
Rents and concessions	8,584	9,399	9,645	(815)	(246)
Other operating revenues	8,265	8,718	7,752	(453)	966
Interest and investment income	9,823	7,088	12,456	2,735	(5,368)
Other non-operating revenues	5,851	7,202	29,681	(1,351)	(22,479)
Total revenues	280,892	280,071	276,353	821	3,718
Expenses:					
Operating expenses	277,970	248,315	223,052	29,655	25,263
Interest expense	47,272	28,847	29,750	18,425	(903)
Non-operating expenses	1,773	799	792	974	7
Total expenses	327,015	277,961	253,594	49,054	24,367
Income (loss) before transfers	(46,123)	2,110	22,759	(48,233)	(20,649)
Transfers to City and County					
of San Francisco	(493)	(1,143)		650	(1,143)
Changes in net assets	(46,616)	967	22,759	(47,583)	(21,792)
Net assets at beginning of year	462,300	461,333	438,574	967	22,759
Net assets at end of year \$	415,684	462,300	461,333	(46,616)	967

Results of Operations, Fiscal Year 2010

The Enterprise's total revenues for the year of \$280,892 represented an increase of \$821 or 0.3% compared to the prior year (see Table 2). Charges for services increased by \$705 or 0.3%, interest and investment income increased by \$2,735, offset by decreases of \$1,351 in other non-operating revenues, \$815 in rents and concessions, and \$453 in other operating revenues.

Revenues from the sale of water to retail customers increased \$3,463 or 3.2% largely attributable to an average 15% increase in retail rates less partially offsetting reduction in consumption, in part due to successful conservation campaign, the economy and weather patterns. There was also a wholesale rate increase of 15.7% that was partially offset by a reduction of 8.9% in consumption due to conservation and economic downturn. The wholesale rates are adopted annually to recover costs. Additionally, sales to suburban non-resale customers

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decreased by \$1,460, while water sales to municipal customers increased by \$274 based on consumption. The Balancing Account due from wholesale customers increased \$6,521 from the prior year, based on the difference between revenues billed and costs of service. Interest and investment income increased by \$2,735 or 38.6% as a result of higher cash balance from the issuance of new revenue bonds and certificates of participation. Other non-operating revenues decreased by \$1,351 or 18.8% primarily due to the \$2,544 gain in the prior year from the sale of surplus land.

The Enterprise's total expenses increased by \$49,054 or 17.6% to \$327,015 over prior year (see Table 2), due to increases of \$29,655 in operating expenses, \$18,425 in interest expense, and \$974 in non-operating expenses primarily attributable to the Water Conservation Rebate Program. Increases in operating expenses were due to increases of \$23,026 in judgments & claims including \$6,736 paid in fiscal year 2010 and \$20,099 of accrual based on updated liability reserve estimates including the pending Federal and State cases regarding breach of contract claims, \$7,471 in services provided by other departments related to Hetch Hetchy water assessment fees and increased billed work orders from City Attorney's Office, \$3,471 in depreciation for additional capital assets, \$1,309 in personal services due to decreases of \$385 in salaries and \$1,694 in retirement and health care costs due to higher required contributions, and \$77 in materials and supplies for various maintenance projects. Increase in interest expense was mainly attributable to an increase of \$1,312,415 in revenue bonds. These increases were offset by decreases of \$4,984 in other operating expenses, \$532 in contractual services from building and structure maintenance, and \$92 in bad debt expense resulting from reclassification of bad debt as a direct write-off of charges for services. Decreases in other operating expenses were mainly due to decreases in non-capitalized project expenses and capital project write-offs and decrease in indirect cost allocation paid to the General Fund (see note 12).

Results of Operations, Fiscal Year 2009

The Enterprise's total revenues for the year of \$280,071 represented an increase of \$3,718 or 1.3% compared to the prior year (see Table 2). Charges for services increased by \$30,845 or 14.2%, other operating revenue increased by \$966, offset by decreases of \$22,479 in non-operating revenues, \$5,368 in interest and investment income, and \$246 in rents and concessions.

Revenues from the sale of water to retail customers increased \$14,564 or 15.6% largely attributable to an average 15.0% increase in retail rates and a slight increase in consumption. Revenues from the sale of water to wholesale or related customers increased by \$15,905 or 13.7%, as revenue collection for wholesale customers increased to \$131,831 from \$115,926 over the prior year. Water sales to suburban non-resale customers increased by \$385, and water sales to municipal customers decreased by \$9. The Balancing Account due from suburban customers increased \$13,701 from the prior year, based on the difference between revenues billed and costs of service. Interest and investment income decreased by \$5,368 or 43.1% as a result of lower average daily cash balances and lower interest rates. Other non-operating revenue decreased by \$22,479 or 92.5% primarily due to the receipt of \$24,335 from the sale of surplus land in the prior year.

The Enterprise's total expenses increased by \$24,367 or 9.6% to \$277,961 over prior year (see Table 2), due to increases of \$25,263 in operating expenses, \$7 in non-operating expenses and decrease of \$903 in interest expense. The change in operating expenses was mainly due to an increase of \$13,727 in other operating expenses such as non-capitalized projects expenses, capital project write-offs, indirect cost reimbursement to the City's general fund, and environmental remediation. Other increases were due to \$5,405 in services provided by other

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(Dollars in thousands, unless otherwise stated)

departments related to Hetch Hetchy water assessment fees and fees paid to the City Attorney, \$4,636 in personal services, due to an increase in work hours in fiscal year 2009 which resulted in a \$2,500 increase in salaries and an increase in health care costs of \$1,400 in fiscal year 2009 compared to fiscal year 2008, \$3,142 in depreciation, \$2,327 in contractual services, \$1,165 in materials and supplies, and \$88 in bad debt expense, offset by a decrease of \$5,227 in general and administrative expenses mainly due to lower judgment and claims. The change in non-operating expenses represents larger investments in various community based organizations (CBOs) of \$299 in support of local water conservation and sustainability programs and interest expense from amortized refunding losses relating to the early retirement of bonds issued in 2002 and 2006.

Capital Assets and Debt Administration

Capital Assets

The following table summarizes changes in the Enterprise's capital assets.

Table 3
Capital Assets, Net of Depreciation

Years ended June 30, 2010, 2009, and 2008

	_	2010	2009	2008	2010 – 2009 change	2009 – 2008 change
Facilities, improvements, machinery,						
and equipment	\$	1,054,627	935,581	827,045	119,046	108,536
Intangible assets		4,652	_		4,652	_
Land and rights-of-way		17,707	18,386	17,886	(679)	500
Construction work in progress	_	787,367	547,293	423,063	240,074	124,230
Total	\$	1,864,353	1,501,260	1,267,994	363,093	233,266

Capital Asset, Fiscal Year 2010

The Enterprise has net capital assets of \$1,864,353 invested in a broad range of utility capital assets as of June 30, 2010 (see Table 3). The investment in capital assets includes land, facilities, improvements, water treatment plants, aqueducts, water transmission, distribution mains, water storage facilities, pump stations, water reclamation facilities, machinery and equipment. The Enterprise's net revenue and long-term debt are used to finance capital investments. Capital assets, net of depreciation, increased from prior year as a result of increases of \$240,074 or 43.9% in construction work in progress, \$123,698 or 13.2% in structures, buildings, equipment and intangible assets, and a decrease of \$679 in land and rights-of-way due to reclassification to intangible assets in fiscal year 2010. The increase in capital assets is consistent with the Enterprise's implementation of the ten-year capital plan, including the WSIP. As of June 30, 2010, the Enterprise has invested \$28,195 in development costs for the headquarters at 525 Golden Gate Avenue. The Enterprise adopted GASB Statement 51, Accounting and Financial Reporting for Intangible Assets, in fiscal year 2010. Intangible assets were separated as a major category in the fiscal year ended June 30, 2010.

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Water System Improvement Program

The Enterprise is in the middle of a multi-billion dollar, multi-year program to upgrade its Regional and Local Water Systems, known as the Water System Improvement Program (WSIP). The WSIP will deliver capital improvements that enhance the Enterprise's ability to provide reliable, affordable, high quality drinking water to its twenty-seven wholesale customers and regional retail customers in Alameda, Santa Clara and San Mateo Counties, and to 800,000 retail customers in the City and County of San Francisco, in an environmentally sustainable manner. The program is structured to cost-effectively meet water quality requirements, improve seismic and delivery reliability, and meet water supply objectives for the year 2030.

The program is on target to achieve an overall completion date of December 2015. The transition of the WSIP's larger regional projects to the construction phase started in early 2009. As of June 30, 2010, there are 2 regional projects in Planning Phase, 7 in Design Phase, 3 in Bid & Award Phase, 14 in Construction phase, 5 in Close-Out phase, 10 regional projects are completed, and 5 regional projects in multiple phases.

The total estimated cost for the WSIP is \$4.6 billion, including \$4.1 billion for capital projects and \$0.5 billion for net financing costs. To date, the entire amount is fully appropriated for the WSIP, of which approximately \$1.1 billion has been expended through fiscal year ending June 30, 2010. To help meet this funding need, additional bonds sales are planned.

Additional details regarding the WSIP are available in the Annual Reports published on the Enterprise's web site at www.sfwater.org.

525 Golden Gate Avenue Headquarters Building

As of June 30, 2010 the Enterprise has incurred its 73% share or \$28,195 in development costs for the project. The building is intended to consolidate divisions of the San Francisco Public Utilities Commission that are currently renting space at multiple locations in the Civic Center. Demolition of the existing site was completed in June 2009. Construction started in January 2010 with an expected completion date of February 2012, followed by an expected occupancy date of April 2012.

Advanced Meter Infrastructure System

Over the next three years, the SFPUC will be in the process of implementing the Advanced Meter Infrastructure System (AMI), which will largely eliminate manual meter reading field visits, improve customers' access to hourly usage information, facilitate the timely detection of tampering, theft, and leaks, while enhancing usage or flow-tracking. The estimated total capital cost of this project is \$64.1 million, with Phase 1 implementation including 57,000 meter replacements throughout fiscal year 2011, and Phase 2 implementation replacing 123,000 meters with a projected completion date of February 2012.

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Major additions to construction work in progress during the year ended June 30, 2010 include:

Tesla Treatment Facility	\$ 58,641
New Crystal Springs Bypass Tunnel	40,551
Bay Division Pipeline (BDPL) Reliability Upgrade - Pipeline	35,054
Irvington Tunnel Alternatives - Alameda Siphon No. 4	21,356
University Mound Reservoir - Upgrade (North Basin)	20,404
San Andreas No. 3 Pipeline Installation	16,695
Lake Merced Pump Station Upgrade	14,580
Bay Division Pipeline (BDPL) Reliability Upgrade - Tunnel	14,316
Harry Tracy Water Treatment Plant Long Term Improvements	14,111
Baden and San Pedro Valve Lot	13,537
Calaveras Dam Replacement	10,628
San Joaquin Pipeline System	10,585
Irvington Tunnel Alternatives - New Irvington Tunnel	9,072
Bay Division Pipeline (BDPL) No. 3 & 4 Cross Connection	8,533
Crystal Springs/San Andreas Transmission Upgrade	7,364
Rehabilitation of Existing San Joaquin Pipelines	7,256
Harry Tracy Water Treatment Plant Short Term Improvement - Phase 3	7,074
525 Golden Gate Avenue Headquarters Building	6,745
Mclaren Park Pump Station Upgrade	6,541
Sunol Valley Water Treatment Plant Expansion & Treated Water Reservoir	5,763
North University Mound System Upgrade	5,027
Other project additions individually below \$5,000	 83,432
	\$ 417,265

Major structures, buildings and equipment, and intangible assets placed in service during the year ended June 30, 2010 include:

Tesla Treatment Facility - Steel Pipes	\$	19,731
Stanford Heights Reservoir - Building/Reservoir		18,872
Harry Tracy Water Treatment Plant - Filters		12,273
Alemany Pump Station Upgrade - Electrical System		10,113
Harry Tracy Water Treatment Plant - Genset		9,893
Harry Tracy Water Treatment Plant - Flocculation Basins		8,153
Alemany Pump Station Upgrade - Mechanical System		7,737
Alemany Pump Station Upgrade - Building		7,631
North University Mound System Upgrade - Pipeline		6,976
Other items individually below \$5,000	_	74,450
	\$	175,829

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Capital Assets, Fiscal Year 2009

The Enterprise had net capital assets of \$1,501,260 invested in a broad range of utility capital assets as of June 30, 2009 (see Table 3). The investment in capital assets includes land, facilities, improvements, water treatment plants, aqueducts, water transmission, and distribution mains, water storage facilities, pump stations, water reclamation facilities, machinery and equipment. This amount includes an increase of \$108,536 or 13.1% over the prior year in structures, buildings and equipment, and an increase of \$124,230 or 29.4% in construction in progress, consistent with the Enterprise's implementation of the ten-year capital plan, including the Water System Improvement Program. The Enterprise's net revenue, commercial paper, and long-term debt are used to finance capital investments. During the fiscal year 2009, as part of a property transfer, the Enterprise has acquired a parcel from BART located in the City of San Bruno, California, with a value of \$500.

As of June 30, 2009, the Enterprise has invested \$12,669 in development costs and \$9,900 in site acquisition for the new headquarters building located at 525 Golden Gate Avenue. The site was acquired by the City from the State of California in 2000, and was transferred to the Enterprise in 2006. The site comprises a 0.5-acre portion of the block bounded by Polk Street, McAllister Street, Golden Gate Avenue and Van Ness Avenue, in the Civic Center district of the City. The Civic Center is home to City, State and Federal government buildings, including City Hall, Civic Center Courthouse, offices of the San Francisco Unified School District, the Philip Burton Federal Building and U.S. Courthouse, the Hiram W. Johnson State Office Building, and City cultural facilities, including the San Francisco Main Public Library, Louise M. Davies Symphony Hall, Bill Graham Civic Auditorium, the War Memorial Opera House and Veterans Building, and the Asian Art Museum of San Francisco.

The principal improvement to the site consists of a new 277,500 square-foot Class A office building containing approximately 257,000 square feet of rentable space across 13 floors plus one basement level. The finished building has been designed to include a 10,000-square-foot child development center, a café, and public art exhibition space. The building design seeks to achieve the Platinum certification standards of the Leadership in Energy and Environmental Design (LEED) Green Building Rating System, the nationally accepted benchmark for the design, construction and operation of high-performance "green" buildings.

The City has received all environmental approvals necessary for construction of the 525 Golden Gate Avenue Headquarters building, and the design development phase is completed. Demolition of the existing site was completed in June 2009, while site improvement phases such as shoring, underpinning and excavation are currently underway. Construction is expected to start in January 2010 with an expected completion date of February 2012, with an expected occupancy date of April 2012.

Management's Discussion and Analysis

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

Major additions to construction work in progress during the year ended June 30, 2009 included:

McLaren Park Pump Station Upgrade New Crystal Springs Bypass Tunnel Local Water Main Replacement Program Harry Tracy Water Treatment Plant (HTWTP) Short Term Improvements Phase 3 11,823 San Joaquin Pipeline System 10,916 Stanford Heights Reservoir Rehab/Upgrade Standby Power Facility Various Locations Calaveras Dam Replacement Sunset Reservoir – Upgrade/Rehab North Basin HTWTP Long Term Improvements HTWTP Long Term Improvements Sunol Valley Water Treatment Plant (SVWTP) Expansion/Treated Water Reservoir Sunsion Pipeline (BDPL) Reliability Upgrade – Tunnel Stay Division Pipeline (BDPL) Reliability Upgrade – Tunnel Survington Tunnel Supplied (Source Systal Springs – San Andreas Pipeline Supplied (Source Systal Springs) Supplied (Source Systal Springs) Supplied (Source Systal System) Suppli	Tesla Treatment Facility	\$ 22,314
New Crystal Springs Bypass Tunnel Local Water Main Replacement Program 16,114 Harry Tracy Water Treatment Plant (HTWTP) Short Term Improvements Phase 3 11,823 San Joaquin Pipeline System 10,916 Stanford Heights Reservoir Rehab/Upgrade Standby Power Facility Various Locations Calaveras Dam Replacement 8,774 Sunset Reservoir – Upgrade/Rehab North Basin HTWTP Long Term Improvements 8,404 Sunol Valley Water Treatment Plant (SVWTP) Expansion/Treated Water Reservoir 8,314 Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel Stystal Springs Pump Station & Crystal Springs – San Andreas Pipeline New Irvington Tunnel Ford BDPL Reliability – Pipeline Upgrade East/West Transmission Main 5,694 Irvington Tunnel Alternatives – Alameda Siphon No. 4 4,979 North University Mound System Update 525 Golden Gate 4,184 Seismic Upgrade BDPL at Hayward Fault Forest Knolls Pump Station Upgrade 3,165 Mount Davidson Pump Station Upgrade 3,165 Mount Davidson Pump Station Upgrade 3,106 Rehab Existing San Joaquin Pipelines		19,244
Local Water Main Replacement Program Harry Tracy Water Treatment Plant (HTWTP) Short Term Improvements Phase 3 11,823 San Joaquin Pipeline System 10,916 Stanford Heights Reservoir Rehab/Upgrade 9,738 Standby Power Facility Various Locations 9,032 Calaveras Dam Replacement 8,774 Sunset Reservoir - Upgrade/Rehab North Basin HTWTP Long Term Improvements 8,404 Sunol Valley Water Treatment Plant (SVWTP) Expansion/Treated Water Reservoir 8,314 Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel 8,183 Crystal Springs Pump Station & Crystal Springs – San Andreas Pipeline 8,051 New Irvington Tunnel 7,676 BDPL Reliability – Pipeline Upgrade East/West Transmission Main 5,694 Irvington Tunnel Alternatives – Alameda Siphon No. 4 4,979 North University Mound System Update 525 Golden Gate 4,184 Seismic Upgrade BDPL at Hayward Fault Seismic Upgrade BDPL at Hayward Fault Forest Knolls Pump Station Upgrade Mount Davidson Pump Station Upgrade 8,106 Rehab Existing San Joaquin Pipelines		17,512
Harry Tracy Water Treatment Plant (HTWTP) Short Term Improvements Phase 3 San Joaquin Pipeline System 10,916 Stanford Heights Reservoir Rehab/Upgrade 9,738 Standby Power Facility Various Locations 9,032 Calaveras Dam Replacement 8,774 Sunset Reservoir - Upgrade/Rehab North Basin HTWTP Long Term Improvements 8,404 Sunol Valley Water Treatment Plant (SVWTP) Expansion/Treated Water Reservoir 8,314 Bay Division Pipeline (BDPL) Reliability Upgrade - Tunnel 8,183 Crystal Springs Pump Station & Crystal Springs - San Andreas Pipeline 7,676 BDPL Reliability - Pipeline Upgrade 6,076 East/West Transmission Main 5,694 Irvington Tunnel Alternatives - Alameda Siphon No. 4 4,979 North University Mound System Update 4,184 Seismic Upgrade BDPL at Hayward Fault 3,844 Forest Knolls Pump Station Upgrade 3,165 Mount Davidson Pump Station Upgrade 3,106 Rehab Existing San Joaquin Pipelines 3,075		
San Joaquin Pipeline System Stanford Heights Reservoir Rehab/Upgrade 9,738 Standby Power Facility Various Locations 9,032 Calaveras Dam Replacement 8,774 Sunset Reservoir – Upgrade/Rehab North Basin HTWTP Long Term Improvements 8,404 Sunol Valley Water Treatment Plant (SVWTP) Expansion/Treated Water Reservoir 8,314 Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel 8,183 Crystal Springs Pump Station & Crystal Springs – San Andreas Pipeline New Irvington Tunnel BDPL Reliability – Pipeline Upgrade East/West Transmission Main 15,694 Irvington Tunnel Alternatives – Alameda Siphon No. 4 4,979 North University Mound System Update 525 Golden Gate 8eismic Upgrade BDPL at Hayward Fault Forest Knolls Pump Station Upgrade Mount Davidson Pump Station Upgrade 8ehab Existing San Joaquin Pipelines 3,075		11,823
Stanford Heights Reservoir Rehab/Upgrade Standby Power Facility Various Locations 9,032 Calaveras Dam Replacement 8,774 Sunset Reservoir – Upgrade/Rehab North Basin HTWTP Long Term Improvements 8,404 Sunol Valley Water Treatment Plant (SVWTP) Expansion/Treated Water Reservoir 8,314 Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel 8,183 Crystal Springs Pump Station & Crystal Springs – San Andreas Pipeline New Irvington Tunnel BDPL Reliability – Pipeline Upgrade East/West Transmission Main 15,694 Irvington Tunnel Alternatives – Alameda Siphon No. 4 North University Mound System Update 525 Golden Gate 8eismic Upgrade BDPL at Hayward Fault Forest Knolls Pump Station Upgrade Mount Davidson Pump Station Upgrade Rehab Existing San Joaquin Pipelines 3,075		10,916
Standby Power Facility Various Locations Calaveras Dam Replacement Sunset Reservoir – Upgrade/Rehab North Basin HTWTP Long Term Improvements Sunol Valley Water Treatment Plant (SVWTP) Expansion/Treated Water Reservoir Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel Crystal Springs Pump Station & Crystal Springs – San Andreas Pipeline New Irvington Tunnel Tunnel PDPL Reliability – Pipeline Upgrade East/West Transmission Main Irvington Tunnel Alternatives – Alameda Siphon No. 4 North University Mound System Update Seismic Upgrade BDPL at Hayward Fault Forest Knolls Pump Station Upgrade Mount Davidson Pump Station Upgrade Rehab Existing San Joaquin Pipelines 9,032 8,774 8,7		
Sunset Reservoir – Upgrade/Rehab North Basin HTWTP Long Term Improvements 8,404 Sunol Valley Water Treatment Plant (SVWTP) Expansion/Treated Water Reservoir 8,314 Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel 8,183 Crystal Springs Pump Station & Crystal Springs – San Andreas Pipeline New Irvington Tunnel 8,051 New Irvington Tunnel BDPL Reliability – Pipeline Upgrade 6,076 East/West Transmission Main 5,694 Irvington Tunnel Alternatives – Alameda Siphon No. 4 4,979 North University Mound System Update 525 Golden Gate 8,365 Seismic Upgrade BDPL at Hayward Fault Forest Knolls Pump Station Upgrade Mount Davidson Pump Station Upgrade Rehab Existing San Joaquin Pipelines 3,075		9,032
Sunset Reservoir – Upgrade/Rehab North Basin HTWTP Long Term Improvements 8,404 Sunol Valley Water Treatment Plant (SVWTP) Expansion/Treated Water Reservoir 8,314 Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel 8,183 Crystal Springs Pump Station & Crystal Springs – San Andreas Pipeline New Irvington Tunnel 8,051 New Irvington Tunnel BDPL Reliability – Pipeline Upgrade 6,076 East/West Transmission Main 5,694 Irvington Tunnel Alternatives – Alameda Siphon No. 4 4,979 North University Mound System Update 525 Golden Gate 8,365 Seismic Upgrade BDPL at Hayward Fault Forest Knolls Pump Station Upgrade Mount Davidson Pump Station Upgrade Rehab Existing San Joaquin Pipelines 3,075	Calaveras Dam Replacement	8,774
Sunol Valley Water Treatment Plant (SVWTP) Expansion/Treated Water Reservoir Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel Crystal Springs Pump Station & Crystal Springs – San Andreas Pipeline New Irvington Tunnel BDPL Reliability – Pipeline Upgrade East/West Transmission Main Irvington Tunnel Alternatives – Alameda Siphon No. 4 Irvington Tunnel Alternatives – Alameda Siphon No. 4 North University Mound System Update 525 Golden Gate Seismic Upgrade BDPL at Hayward Fault Forest Knolls Pump Station Upgrade Mount Davidson Pump Station Upgrade Rehab Existing San Joaquin Pipelines 8,314 8,314 8,314 8,314 8,314 8,314 8,314 8,314 8,051 8,051 8,051 8,051 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,076 8,183 8,051 8,		8,591
Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel Crystal Springs Pump Station & Crystal Springs – San Andreas Pipeline New Irvington Tunnel Reliability – Pipeline Upgrade East/West Transmission Main Trvington Tunnel Alternatives – Alameda Siphon No. 4 Irvington Tunnel Alternatives – Alameda Siphon No. 4 Irvington Gate Seismic Upgrade BDPL at Hayward Fault Forest Knolls Pump Station Upgrade Mount Davidson Pump Station Upgrade Rehab Existing San Joaquin Pipelines 8,183 8,051 8,051 8,051 8,076	HTWTP Long Term Improvements	8,404
Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel Crystal Springs Pump Station & Crystal Springs – San Andreas Pipeline New Irvington Tunnel Reliability – Pipeline Upgrade East/West Transmission Main Trvington Tunnel Alternatives – Alameda Siphon No. 4 Irvington Tunnel Alternatives – Alameda Siphon No. 4 Irvington Gate Seismic Upgrade BDPL at Hayward Fault Forest Knolls Pump Station Upgrade Mount Davidson Pump Station Upgrade Rehab Existing San Joaquin Pipelines 8,183 8,051 8,051 8,051 8,076	Sunol Valley Water Treatment Plant (SVWTP) Expansion/Treated Water Reservoir	8,314
New Irvington Tunnel7,676BDPL Reliability – Pipeline Upgrade6,076East/West Transmission Main5,694Irvington Tunnel Alternatives – Alameda Siphon No. 44,979North University Mound System Update4,836525 Golden Gate4,184Seismic Upgrade BDPL at Hayward Fault3,844Forest Knolls Pump Station Upgrade3,165Mount Davidson Pump Station Upgrade3,106Rehab Existing San Joaquin Pipelines3,075	Bay Division Pipeline (BDPL) Reliability Upgrade – Tunnel	8,183
BDPL Reliability – Pipeline Upgrade 6,076 East/West Transmission Main 5,694 Irvington Tunnel Alternatives – Alameda Siphon No. 4 4,979 North University Mound System Update 4,836 525 Golden Gate 4,184 Seismic Upgrade BDPL at Hayward Fault 3,844 Forest Knolls Pump Station Upgrade 3,165 Mount Davidson Pump Station Upgrade 3,106 Rehab Existing San Joaquin Pipelines 3,075	Crystal Springs Pump Station & Crystal Springs – San Andreas Pipeline	8,051
East/West Transmission Main5,694Irvington Tunnel Alternatives – Alameda Siphon No. 44,979North University Mound System Update4,836525 Golden Gate4,184Seismic Upgrade BDPL at Hayward Fault3,844Forest Knolls Pump Station Upgrade3,165Mount Davidson Pump Station Upgrade3,106Rehab Existing San Joaquin Pipelines3,075	New Irvington Tunnel	7,676
Irvington Tunnel Alternatives – Alameda Siphon No. 4 North University Mound System Update 4,836 525 Golden Gate 4,184 Seismic Upgrade BDPL at Hayward Fault 3,844 Forest Knolls Pump Station Upgrade 3,165 Mount Davidson Pump Station Upgrade 3,106 Rehab Existing San Joaquin Pipelines 3,075	BDPL Reliability – Pipeline Upgrade	6,076
North University Mound System Update 4,836 525 Golden Gate 4,184 Seismic Upgrade BDPL at Hayward Fault 3,844 Forest Knolls Pump Station Upgrade 3,165 Mount Davidson Pump Station Upgrade 3,106 Rehab Existing San Joaquin Pipelines 3,075	East/West Transmission Main	5,694
525 Golden Gate4,184Seismic Upgrade BDPL at Hayward Fault3,844Forest Knolls Pump Station Upgrade3,165Mount Davidson Pump Station Upgrade3,106Rehab Existing San Joaquin Pipelines3,075	Irvington Tunnel Alternatives – Alameda Siphon No. 4	4,979
Seismic Upgrade BDPL at Hayward Fault3,844Forest Knolls Pump Station Upgrade3,165Mount Davidson Pump Station Upgrade3,106Rehab Existing San Joaquin Pipelines3,075	North University Mound System Update	4,836
Forest Knolls Pump Station Upgrade 3,165 Mount Davidson Pump Station Upgrade 3,106 Rehab Existing San Joaquin Pipelines 3,075	525 Golden Gate	4,184
Mount Davidson Pump Station Upgrade3,106Rehab Existing San Joaquin Pipelines3,075	Seismic Upgrade BDPL at Hayward Fault	3,844
Rehab Existing San Joaquin Pipelines 3,075	Forest Knolls Pump Station Upgrade	3,165
	Mount Davidson Pump Station Upgrade	3,106
0.1	Rehab Existing San Joaquin Pipelines	3,075
Other project additions individually below \$3,000 69,060	Other project additions individually below \$3,000	 69,060
\$ \$ 282,705		\$ 282,705

Major structures, buildings and equipment placed in service during the year ended June 30, 2009 included:

Sunset Reservoir North Basin Seismic Retrofit Structure	\$ 50,025
East/West Transmission Main	29,754
Water Main Replacement - Bernal/Nebraska	6,647
Other items individually below \$5,000	71,171
	\$ 157,597

Management's Discussion and Analysis

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

Debt Administration

As of June 30, 2010, the Enterprise has \$2,371,675 total debt outstanding, an increase of \$1,205,569 over the prior year, as shown below in Table 4. More detailed information about the Enterprise's debt activity is presented in notes 6, 7, 8 and 9 to the financial statements.

Table 4
Outstanding Debt, Net of Amortized Costs

June 30, 2010, 2009, and 2008

	_	2010	2009	2008	2010 – 2009 change	2009 – 2008 change
Revenue bonds	\$	2,245,301	932,886	958,410	1,312,415	(25,524)
Capital appreciation bonds		3,878	3,620	3,380	258	240
Commercial paper		_	229,600	_	(229,600)	229,600
Certificates of participation		122,496			122,496	
Total	\$	2,371,675	1,166,106	961,790	1,205,569	204,316

The Enterprise has no commercial paper notes outstanding at June 30, 2010 and \$229,600 in the previous year. Total debt outstanding at June 30, 2010 consisted of \$2,245,301 in fixed-rate long-term revenue bonds, \$3,878 (accreted value) in capital appreciation bonds, and \$122,496 in certificates of participation. The change in total debt outstanding was due to the issuance of new bonds and certificates of participation, refunding of commercial paper, retirement of revenue bond principal, and a change in the accreted value of all capital appreciation bonds, amortization of bond discounts, bond premium, and refunding loss. See notes 7 and 9 for more detail.

As of June 30, 2009, the Enterprise has \$1,166,106 total debt outstanding, an increase of \$204,316 over the prior year (see Table 4). The Enterprise has commercial paper notes outstanding of \$229,600 at June 30, 2009 and none in the previous year. Total debt outstanding at June 30, 2009 consisted of \$932,886 in fixed-rate long-term revenue bonds and \$3,620 (accreted value) in capital appreciation bonds. The change in total debt outstanding was due to the retirement of revenue bond principal, and a change in the accreted value of all capital appreciation bonds, amortization of bond discounts, bond premium, and refunding loss.

Credit Ratings and Bond Insurance – At June 30, 2010, the Enterprise carried underlying ratings of "Aa2" and "AA-" from Moody's and Standard & Poor's (S&P), respectively. At June 30, 2009, the Enterprise carried underlying ratings of "A1" and "AA-" from Moody's and Standard & Poor's (S&P), respectively.

Debt Service Coverage – Pursuant to the Amended and Restated Indenture, the Enterprise is required to collect sufficient net revenues each fiscal year, together with any Enterprise funds (except Bond Reserve Funds) which are available for payment of debt service and are not budgeted to be expended, at least equal to 1.25 times annual debt service for said fiscal year. During fiscal years 2010 and 2009, the Enterprise's net revenues, together with fund balances available to pay debt service and not budgeted to be expended, were sufficient to meet the rate covenant requirements under the Enterprise's Amended and Restated Indenture.

Management's Discussion and Analysis
June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

Debt Authorization – Pursuant to the Charter, the Enterprise can incur indebtedness upon two-thirds vote of the Board of Supervisors, as approved by voters in Proposition E in November 2002. As of June 30, 2010, the Board of Supervisors has authorized the issuance of \$3,048,031 in revenue bonds under Prop E with \$474,665 issued to date against this authorization. The Enterprise can also incur indebtedness of up to \$1,628,000 for improvements to the water system pursuant to Proposition A that was approved by the voters in November 2002. As of June 30, 2010, \$1,331,815 of the \$1,628,000 Proposition A authorized bonds was issued. The Enterprise is also authorized to issue up to \$500,000 in commercial paper. As of June 30, 2010, there was no commercial paper outstanding. In August 2010, the Enterprise sold \$25,000 in taxable commercial paper. Under existing Proposition E authority, Series 2010 DE was issued on August 4, 2010 with a par value of \$415,560.

Cost of Debt Capital – The Enterprise's outstanding long-term debt has coupon interest rates ranging from 2.0% to 6.0% as of June 30, 2010 and ranged from 2.5% to 7% as of June 30, 2009. The Enterprise's short-term debt has interest rates ranging from 0.3% to 0.5% during fiscal year 2010. In the prior year, the Enterprise's short-term debt has interest rates ranging from 0.3% to 0.8%. More information about the Enterprise's debt activities is presented in notes 6, 7, 8, and 9 to the financial statements.

Next Year's Rates

Retail water rate increases of 15.0%, 15.0%, 12.5%, 12.5%, 6.5% have been approved for fiscal years ending June 30, 2010 through 2014, respectively. Wholesale water rates are adopted annually.

Rate Setting Process

Proposition E, as approved by the Voters in November 2002, amended the City Charter by adding the new Article VIIIB, entitled "Public Utilities," which changed the Commission's ability to issue new revenue bonds and set retail water rates. The Commission is required to:

- Establish rates, fees, and charges based on cost of service;
- Retain an independent rate consultant to conduct cost of service studies at least every five years;
- Consider establishing new connection fees;
- Consider conservation incentives and lifeline rates;
- Adopt a rolling five-year forecast annually; and
- Establish a Rate Fairness Board.

Wholesale customer rates were set pursuant to the Master Water Sales Contract, through June 30, 2009 when the contract expired. A new agreement was negotiated between the Commission and the Wholesale Customers represented by the Bay Area Water Supply and Conservation Agency (BAWSCA). The term of the new Water Supply Agreement (WSA) began on July 1, 2009 and shall end on June 30, 2034. Two 5-year extension options are also available.

Management's Discussion and Analysis

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

The following table is the Enterprise's average rate adjustments since July 1, 2004:

Approved average rate adjustments

	Tute uajustinents		
	Retail	Wholesale	
Effective date:			
July 1, 2004	0.0 %	2.7 %	
July 1, 2005	15.0	$(9.7)^{1}$	
July 1, 2006	15.0	18.8	
July 1, 2007	15.0 ²	6.3	
July 1, 2008	15.0	10.0	
July 1, 2009 ³	15.0	15.7	
July 1, 2010	15.0	15.2	
July 1, 2011 ⁴	12.5	10.2	
July 1, 2012 ⁴	12.5	29.2	
July 1, 2013 ⁴	6.5	5.3	

¹ Adjustment effective April 1, 2005

Pursuant to the City and County of San Francisco Charter Section 8B.125, an independent rate study is performed at least once every five years. A rate study was undertaken in fiscal year 2009 to examine the future revenue requirements and cost of service of the Enterprise. This resulted in an approved 5-year rate schedule through fiscal year 2014.

Request for Information

This report is designed to provide our citizens, customers, investors, and creditors with an overview of the Enterprise's finances and to demonstrate the Enterprise's accountability for the money it receives. Questions regarding any of the information provided in this report or requests for additional financial information should be addressed to San Francisco Public Utilities Commission, Chief Financial Officer, 1155 Market Street, 11th Floor, San Francisco, CA 94103.

² Adjustment effective July 14, 2007

³ July 1, 2009 was the first year of the new twenty-five year agreement

⁴ Wholesale rates are adopted annually, pursuant to the 25-year WSA. These are estimates.

Statements of Net Assets June 30, 2010 and 2009 (In thousands)

	_	2010	2009
Assets:			
Current assets:	\$	113,472	130,927
Cash and investments with City Treasury Cash and investments outside City Treasury	Ф	113,472 89	36
Receivables:			
Charges for services (net of allowance for doubtful accounts			
of \$2,021 in 2010 and \$1,187 in 2009)		41,789	38,298
Wholesale balancing account Due from other funds		19,231 10,346	— 197
Due from other governments		998	337
Interest		52	321
Advances and other		1,065	788
Total receivables	-	73,481	39,941
Inventories		1,791	1,849
Restricted assets – investments outside City Treasury	-	43,866	
Total current assets	-	232,699	172,753
Non-current assets: Wholesale balancing account receivable		14,861	27,571
Restricted assets – cash and investments with City Treasury		620,347	21,726
Restricted assets – cash and investments outside City Treasury		251,415	40,974
Restricted assets – interest receivable		273	117
Capital assets not being depreciated Capital assets, net of accumulated depreciation		805,753 1,058,600	565,679 935,581
Bond issuance costs (net of accumulated amortization		1,030,000	755,561
of \$4,408 in 2010 and \$3,302 in 2009)		17,371	6,834
Total non-current assets	_	2,768,620	1,598,482
Total assets		3,001,319	1,771,235
Liabilities:		_	
Current liabilities:			4.4.550
Accounts payable Accrued payroll		10,161 7,560	14,778 6,846
Accrued payron Accrued vacation and sick leave, current portion		6,366	6,071
Accrued workers' compensation, current portion		1,468	1,551
Due to other funds		24	23
Damage and claims liability, current portion Deposits, advances, and other liabilities		8,719 5,066	2,515 4,903
Bond and loan interest payable		16,071	7,420
Pollution remediation obligation, current portion		499	3,077
Revenue bonds, current portion Commercial paper		27,795	26,605 229,600
Current liabilities payable from restricted assets		74,607	40,603
Total current liabilities	-	158,336	343,992
Long-term liabilities:	-		
Arbitrage rebate		4,553	4,265
Other post-employment benefits obligations		45,598	30,967
Accrued vacation and sick leave, less current portion Accrued workers' compensation, less current portion		5,461 6,626	5,383 7,066
Damage and claims liability, less current portion		21,021	7,126
Revenue bonds, less current portion		2,217,506	906,281
Capital appreciation bonds		3,878	3,620
Certificates of participation Pollution remediation obligation, less current portion		122,496 160	235
Total long-term liabilities	-	2,427,299	964,943
Total liabilities	-	2,585,635	1,308,935
Net assets:	-	2,363,633	1,300,733
Invested in capital assets, net of related debt		319,581	372,421
Restricted for debt service		12,073	11,941
Restricted for capital projects		3,868	841
Unrestricted Total not assets	\$	80,162	77,097
Total net assets	Ф	415,684	462,300

See accompanying notes to financial statements.

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2010 and 2009

(In thousands)

	 2010	2009
Operating revenues: Charges for services Rents and concessions Capacity fees Other revenues	\$ 248,369 8,584 610 7,655	247,664 9,399 626 8,092
Total operating revenues	 265,218	265,781
Operating expenses: Personal services Contractual services Materials and supplies Depreciation Services provided by other departments Bad debt expense General and administrative Other	 108,178 13,087 12,748 52,571 47,574 — 25,917 17,895	106,869 13,619 12,671 49,100 40,103 92 2,982 22,879
Total operating expenses	 277,970	248,315
Operating income (loss)	 (12,752)	17,466
Non-operating revenues (expenses): Federal and State grants Interest and investment income Interest expense Net gain (loss) from sale of land Other non-operating revenues Other non-operating expenses	 1,506 9,823 (47,272) (178) 4,523 (1,773)	1,784 7,088 (28,847) 2,587 2,831 (799)
Net non-operating revenues (expenses)	(33,371)	(15,356)
Income before transfers	(46,123)	2,110
Transfers to the City and County of San Francisco	 (493)	(1,143)
Changes in net assets	(46,616)	967
Net assets at beginning of year	 462,300	461,333
Net assets at end of year	\$ 415,684	462,300

See accompanying notes to financial statements.

Statements of Cash Flows

Years ended June 30, 2010 and 2009

(In thousands)

	_	2010	2009
Cash flows from operating activities:			
Cash received from customers, including cash deposits	\$	246,684	235,841
Cash received from tenants for rent Cash paid to employees for services		8,584 (91,035)	9,069 (88,027)
Cash paid to suppliers for goods and services		(94,430)	(78,888)
Cash paid for judgments and claims	_	(4,787)	(4,126)
Net cash provided by operating activities	_	65,016	73,869
Cash flows from non-capital and related financing activities:			
Transfers out		(493)	(1,143)
Operating grants	_	845	
Net cash provided by (used in) non-capital			
financing activities	_	352	(1,143)
Cash flows from capital and related financing activities:			
Proceeds from sale of capital assets		23	2,601
Proceeds from bond issuance, net of discounts and issuance costs		1,355,644	
Proceeds from certificate of participation issuance, net of discounts		1,333,044	_
and issuance costs		122,755	_
Proceeds from commercial paper issuance		_	890,500
Payments on commercial paper		(229,600)	(660,900)
Principal paid on long-term debt Interest paid on long-term debt		(41,005) (74,131)	(25,520) (44,065)
Interest paid on commercial paper		(337)	(2,104)
Issuance costs paid on long-term debt		(12,759)	
Interfund loans		(10,346)	<u> </u>
Acquisition and construction of capital assets Capital grants	_	(352,805)	(251,671) 1,506
Net cash provided by (used in) capital and related financing			
activities	_	757,439	(89,653)
Cash flows from investing activities:			
Interest income received		9,936	7,576
Proceeds from sale of investments outside City Treasury		252,781 (340,412)	70,388 (70,311)
Purchases of investments outside City Treasury Other investing activities		2,783	1,533
Net cash (used in) provided by investing activities	_	(74,912)	9,186
Increase (decrease) in cash and cash equivalents	_	747,895	(7,741)
Cash and cash equivalents:			
Beginning of year	_	152,689	160,430
End of year	\$ _	900,584	152,689
Reconciliation of cash and cash equivalents to the statement of net assets:			
Cash and investments with City Treasury:			
Unrestricted	\$	96,050	130,927
Restricted Cash and investments outside City Treasury:		637,769	21,726
Unrestricted		89	36
Restricted	_	166,676	
Cash and cash equivalents at end of year on	_		
statements of cash flows	\$ =	900,584	152,689
			(Continued)

Statements of Cash Flows

Years ended June 30, 2010 and 2009

(In thousands)

		2010	2009
Reconciliation of operating income to net cash provided by			
operating activities:			
Operating income	\$	(12,752)	17,466
Adjustment to reconcile operating income to net cash			
provided by operating activities:			
Depreciation		52,571	49,100
Provision for uncollectible accounts		834	(252)
Write-off of capital assets and other non-cash items		7,043	5,207
Changes in operating assets and liabilities:			
Receivables:			
Charges for services		(4,325)	(4,356)
Wholesale water rate agreement receivable		(6,521)	(13,701)
Due from other City departments		197	53
Interest and other		(277)	(666)
Inventories		58	23
Accounts payable		(4,617)	6,209
Accrued payroll		714	837
Accrued other post-employment benefit liability		14,631	15,919
Accrued vacation and sick leave		373	598
Accrued workers' compensation		(523)	482
Due to other funds		1	23
Pollution remediation obligation		(2,653)	618
Damage and claims liability		20,099	(1,613)
Deposits, advances, and other liabilities		163	(2,078)
Total adjustments		77,768	56,403
Net cash provided by operating activities	\$	65,016	73,869
Noncash transactions:			
Accrued capital asset costs	\$	74,607	40,603
Land acquired through real property exchange	Ψ		500
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See accompanying notes to financial statements.

Notes to Financial Statements

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

(1) Definition of Reporting Entity

The San Francisco Water Enterprise (the Enterprise) was established in 1930 under the provisions of the Charter of the City and County of San Francisco. The Enterprise acquired the fully developed, mature water works for San Francisco on March 3, 1930. Since then, the City and County of San Francisco (the City) has operated and maintained the water works as the San Francisco Water Enterprise. The Board of Supervisors of the City has adopted resolutions (the Water Resolutions) providing for the issuance of various water revenue and refunding bond series. The Enterprise, which consists of a system of reservoirs, storage tanks, water treatment plants, pump stations, and pipelines, is engaged in the distribution of water to San Francisco and certain suburban areas. In fiscal year 2010, the Enterprise delivered approximately 80,273 million gallons of water to nearly 2.4 million people within San Francisco and certain suburban areas.

The San Francisco Public Utilities Commission (the Commission), established in 1932, is responsible for providing operational oversight of the public utility enterprises of the City, which include the Enterprise along with the City's power and sewer utilities (i.e. Hetch Hetchy Water and Power, of which the Power Enterprise is a component, and the San Francisco Wastewater Enterprise). The Commission is responsible for determining such matters as the rates and charges for services, approval of contracts, and organizational policy.

Until August 1, 2008, the Commission consisted of five members, all appointed by the Mayor. Proposition E, a City and County of San Francisco Charter amendment approved by the voters in the June 3, 2008 election, terminated the terms of all five existing members of the Commission, changed the process for appointing new members, and set qualifications for all members. Under the amended Charter, the Mayor continues to nominate candidates to the Commission, but nominees do not take office until the Board of Supervisors votes to approve their appointments by a majority (at least six members). The amended Charter requires the Commission members meet the following qualifications:

- Seat 1 must have experience in environmental policy and an understanding of environmental justice issues.
- Seat 2 must have experience in ratepayer or consumer advocacy.
- Seat 3 must have experience in project finance.
- Seat 4 must have expertise in water systems, power systems, or public utility management.
- Seat 5 is an at-large member.

The amended Charter provides for staggered four-year term for members. Initially, the new members for seats 2 and 4 served two years and the new members for seats 1, 3 and 5 served for four years.

The Commission is a department of the City, and as such, the financial operations of the Enterprise, Hetch Hetchy Water and Power, and the Wastewater Enterprise are included in the Comprehensive Annual Financial Report of the City as enterprise funds. These financial statements present only the financial operations of the Enterprise alone and are not intended to present the financial position of the City as a

Notes to Financial Statements
June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

whole or the consolidated entity, the changes in its financial position, and the cash flows of its proprietary funds in conformity with U.S. generally accepted accounting principles.

(2) Significant Accounting Policies

(a) Basis of Accounting and Measurement Focus

The accounts of the Enterprise are organized on the basis of a proprietary fund type and are included as an enterprise fund of the City and County of San Francisco, California. The activities of this Enterprise are accounted for with a separate set of self-balancing accounts that comprise the Enterprise's assets, liabilities, net assets, revenues, and expenses. Enterprise funds account for activities (i) that are financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; or (ii) that are required by laws or regulations that the activity's costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues; or (iii) that the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

The financial activities of the Enterprise are accounted for on a flow of economic resources 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 recorded when earned, and expenses are recorded when liabilities are incurred. Operating revenues are defined as charges to customers, rental income and capacity fees.

The Enterprise does not apply Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989. The Enterprise applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, as well as statements and interpretations of the FASB, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

(b) Cash and Cash Equivalents

The Enterprise considers its pooled cash and investments held with the City Treasury to be demand deposits and, therefore, cash equivalents for financial reporting. The City also holds non-pooled cash and investments for the Enterprise. Non-pooled restricted deposits and investments held outside the City Treasury with maturities of three months or less are also considered to be cash equivalents.

(c) Investments

Money market funds are carried at cost. All other investments are stated at fair value based on quoted market prices. Changes in fair value are recognized as investment gains or losses.

(d) Inventory

Inventory consists primarily of construction materials and maintenance supplies, and is valued at average cost. Inventory is expensed as it is consumed.

Notes to Financial Statements June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

(e) Capital Assets

Capital assets are stated at cost. Depreciation and amortization are computed using the straight-line method based on the estimated useful lives of the related assets, which range from 3 to 75 years for equipment and 3 to 175 years for buildings, structures, and improvements. No depreciation or amortization is recorded in the year of acquisition, and a full year's depreciation is recorded in the year of disposal.

(f) Intangible Assets

As of July 1, 2009, the Enterprise has adopted GASB Statement 51, *Accounting and Financial Reporting for Intangible Assets*. Generally, the Enterprise capitalizes intangible assets providing a benefit extending beyond one reporting period, and amortizes the asset over the useful life. Intangible assets with an indefinite useful life are not amortized. The capitalization threshold of the Enterprise is \$100.

(g) Construction in Progress

The cost of acquisition and construction of major plant and equipment is recorded as construction in progress. Costs of discontinued construction projects are recorded as an expense in the year in which the decision is made to discontinue such projects.

(h) Capitalization of Interest

A portion of the interest cost incurred on capital projects is capitalized for assets that require a period of time to construct or to otherwise prepare them for their intended use. Such amounts are amortized over the useful lives of the assets.

(i) Bond Discount, Premium, and Issuance Costs

Bond discount, premium, and issuance costs are amortized over the term of the related bonds on a method which approximates the effective interest method basis.

(j) Accrued Vacation and Sick Leave

Accrued vacation pay, which may be accumulated up to ten weeks per employee, is charged to expense as earned. Sick leave earned subsequent to December 6, 1978 is non-vesting and may be accumulated up to six months per employee.

(k) Workers' Compensation

The Enterprise is self-insured for workers' compensation claims and accrues the estimated cost of those claims, including the estimated cost of incurred but not reported claims.

(l) Damage and Claims Liability

The Enterprise is self-insured for general liability and uninsurable property damage claims. Commercially uninsurable property includes assets that are underground or provide transmission and distribution. Maintained commercial coverage does not cover claims attributed to loss from

Notes to Financial Statements June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

earthquake, contamination, pollution remediation efforts and other specific naturally occurring contaminants such as mold. The liability represents an estimate of the cost of all outstanding claims, including adverse loss development, and estimated incurred but not reported claims.

(m) Arbitrage Rebate Payable

Certain bonds are subject to arbitrage rebate requirements in accordance with regulations issued by the U.S. Treasury Department. The requirements generally stipulate that earnings from the investment of the tax-exempt bond proceeds that exceed related interest costs on the bonds must be remitted to the federal government on every fifth anniversary of each bond issue. The liability for arbitrage rebate was \$4,553 and \$4,265 at June 30, 2010 and June 30, 2009, respectively.

(n) Refunding of Debt

Gains or losses occurring from advance refunding of debt are deferred and amortized into interest expense over the remaining life of the old bonds or the life of the new bonds, whichever is shorter.

(o) Income Taxes

As a government agency, the Enterprise is exempt from both Federal income taxes and California State franchise taxes.

(p) Revenue Recognition

Water service charges are based on water usage as determined by the Enterprise. Generally, customers are billed on a cyclical basis with large commercial and industrial customers billed monthly, and all other customers bi-monthly. Revenues earned but unbilled are accrued as charges for services receivable on the statements of net assets.

(a) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(r) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to current year presentation.

(s) Accounting and Financial Reporting for Pollution Remediation Obligations

The Enterprise adopted GASB Statement 49, Accounting and Financial Reporting for Pollution Remediation Obligations, in fiscal year 2009. To provide governments with better accounting guidance and consistency, GASB Statement 49, Accounting and Financial Reporting for Pollution

Notes to Financial Statements

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

Remediation Obligations, identifies the circumstances under which a governmental entity would be required to report a liability related to pollution remediation.

According to the standard, a government would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem;
- A government has violated a pollution prevention-related permit or license;
- A regulator has identified (or evidence indicates it will identify) a government as responsible (or
 potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the
 clean up;
- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution; or
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

As a part of ongoing operations, situations may occur requiring the removal of pollution or other hazardous material. These situations typically arise in the process of acquiring an asset, preparing an asset for its intended use, or during the Design Phase of projects under review by the Project Managers. Other times, pollution may arise during the implementation and construction of a major or minor capital project. Examples of pollution may include, but are not limited to: asbestos or lead paint removal; leaking of sewage in underground pipes or neighboring areas; chemical spills; removal and disposal of known toxic waste; harmful biological and chemical pollution of water; or contamination of surrounding soils by underground storage tanks (UST).

The Enterprise recorded \$659 and \$3,312 in pollution remediation liability as of June 30, 2010 and 2009, respectively.

(t) Effects of New Pronouncements

Governmental Accounting Standards Board Statement 51, Accounting and Financial Reporting for Intangible Assets

As of July 1, 2009, the Enterprise has adopted GASB Statement 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement 51 provides governmental entities with guidance on how to properly identify, account for and report intangible assets, requiring capitalization of the asset and amortization over its useful life.

Under GASB Statement 51, intangible assets are defined as identifiable, non-financial assets capable of being separated, sold, transferred, or licensed, and include contractual or legal rights. Examples of intangible assets include rights-of-way easements, land use rights, water rights, licenses, and permits.

Notes to Financial Statements

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

The accounting pronouncement also provides guidance on the capitalization of internally generated intangible assets, such as the development and installation of computer software by or on behalf of the reporting entity.

According to the standard, the Enterprise is required to capitalize intangible assets with a useful life extending beyond one reporting period. Effective July 1, 2009, the Enterprise has established a capitalization threshold of \$100. GASB Statement 51 also requires amortization of intangible asset over the benefit period, except for certain assets having an indefinite useful life. Assets with an indefinite useful life generally provide a benefit that is not constrained by legal or contractual limitations or any other external factor, and therefore, are not amortized.

As a result of the adoption of GASB Statement 51, the Enterprise reclassified \$4,652 in intangible assets as of June 30, 2010, primarily composed of \$3,973 of Customer Care & Billing computer software and \$679 of easements.

(3) Cash, Cash Equivalents and Investments

The Enterprise's cash, cash equivalents and investments with the City Treasury are invested in an unrated City pool pursuant to investment policy guidelines established by the City Treasurer. The objectives of the policy guidelines are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The City Treasurer allocates income from the investment of pooled cash at month end in proportion to the Enterprise's average daily cash balances. The primary objectives of the Enterprise's investment policy are consistent with the City's policy.

Restricted assets are held by an independent trustee outside the City's investment pool. The assets are held for the purpose of paying future interest and principal on the bonds and for eligible capital project expenditures. The balances as of June 30, 2010 and 2009 were \$295,281 and \$40,974, respectively. The Enterprise held all investments in guaranteed investment contracts, Treasury and Government Obligations, and money market mutual funds consisting of Treasury and Government Obligations.

Notes to Financial Statements
June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

Restricted Cash and Investments outside City Treasury

	Credit Ratings	June 30, 2010			
Investments	(S&P/Moody's)	Maturities	Fair Value		
U.S. Treasury Notes	Not applicable	November 1, 2010	\$ 26,763		
U.S. Treasury Notes	Not applicable	May 1, 2011	27,648		
U.S. Treasury Notes	Not applicable	November 1, 2011	18,225		
U.S. Treasury Notes	Not applicable	May 1, 2012	5,036		
U.S. Treasury Notes	Not applicable	November 1, 2012	4,448		
U.S. Treasury Notes	Not applicable	May 1, 2013	3,489		
Guaranteed Investment Contract	AA-/Aa2	March 16, 2013	15,958		
U.S. Treasury Bonds & Notes	Not applicable	August 31, 2016	27,038		
U.S. Treasury Money Market Funds	Not applicable	< 90 days	45,490		
U.S. Treasury Bills	Not applicable	< 90 days	121,186		
Total			\$ 295,281		

Funds held by the trustee established under the 2002 amended and restated Indentures agreements are invested in "Permitted Investments," as defined in the agreement, which includes money market funds and investment agreements. The agreement permits investment in money market funds registered under the Federal Investment Company Act of 1940 and whose shares are also registered under the Federal Securities Act of 1933 and having a rating by Standard & Poor's of "AAAm-G," "AAAm" or "AAm" and a rating by Moody's of "Aaa," "Aa1" or "Aa2." Investment agreements must be with a U.S. bank or trust company having a rating by Moody's and S&P of "A" or higher, or are guaranteed by any entity with a rating of "A" or higher, at the time the agreement is entered into.

Additional cash outside of the investment pool includes \$89 at June 30, 2010 and \$36 at June 30, 2009, which is held in a commercial bank in non-interest bearing checking accounts which are covered by Federal Deposit Insurance Corporation (FDIC) depository insurance. These accounts were established as provided by the City's Administrative Code for revolving fund needs.

Notes to Financial Statements

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

The Enterprise's cash, cash equivalents and investments are shown on the accompanying statements of net assets as follows:

		2010	2009
Current assets:			
Cash and investments with City Treasury	\$	96,050	130,927
Cash and investments outside City Treasury		89	36
Restricted cash and investments outside City Treasury	_	43,866	
Non-current assets:			
Restricted cash and investments with City Treasury		637,769	21,726
Restricted cash and investments outside City Treasury		251,415	40,974
Total cash, cash equivalents and investments	\$	1,029,189	193,663

The following table shows the percentage distribution of the City's pooled investments by maturity as of June 30, 2010:

Investment maturities (in months)

Under 1	1 to less than 6	6 to less than 12	12 to 60
0.0%	2.9%	16.6%	80.5%

The following table shows the percentage distribution of the City's pooled investments by maturity as of June 30, 2009:

Under 1	1 to less than 6	6 to less than 12	12 to 60
9.9%	27.0%	8.8%	54.3%

Notes to Financial Statements June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

(4) Capital Assets

Capital assets as of June 30, 2010 and 2009 consist of the following:

	,	Balance June 30, 2009	Increases	Decreases	Balance June 30, 2010
Capital assets not being depreciated: Land and rights-of-way Intangible assets-non depreciable Construction in progress	\$	18,386 — 547,293	679 417,265	(679) — (177,191)	17,707 679 787,367
Total capital assets not being depreciated	į	565,679	417,944	(177,870)	805,753
Capital assets being depreciated: Facilities and improvements Intangible assets-depreciable Machinery and equipment	·	1,426,180 — 146,788	123,062 3,973 49,456	(667) — (605)	1,548,575 3,973 195,639
Total capital assets being depreciated	·	1,572,968	176,491	(1,272)	1,748,187
Less accumulated depreciation for: Facilities and improvements Machinery and equipment Intangible assets		(537,920) (99,467)	(46,940) (5,631)	371	(584,860) (104,727)
Total accumulated depreciation	,	(637,387)	(52,571)	371	(689,587)
Total capital assets being depreciated, net		935,581	123,920	(901)	1,058,600
Total capital assets, net	\$	1,501,260	541,864	(178,771)	1,864,353

Notes to Financial Statements June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

	-	Balance June 30, 2008	Increases	Decreases	Balance June 30, 2009
Capital assets not being depreciated: Land and rights-of-way Construction in progress	\$	17,886 423,063	500 282,705	(158,475)	18,386 547,293
Total capital assets not being depreciated	_	440,949	283,205	(158,475)	565,679
Capital assets being depreciated: Facilities and improvements Machinery and equipment	_	1,287,404 128,758	138,776 18,821	<u>(791)</u>	1,426,180 146,788
Total capital assets being depreciated	_	1,416,162	157,597	(791)	1,572,968
Less accumulated depreciation for: Facilities and improvements Machinery and equipment	_	(496,886) (92,231)	(41,085) (8,015)	51 779	(537,920) (99,467)
Total accumulated depreciation	_	(589,117)	(49,100)	830	(637,387)
Total capital assets being depreciated, net	_	827,045	108,497	39	935,581
Total capital assets, net	\$	1,267,994	391,702	(158,436)	1,501,260

Capital assets with a useful life of 50 years or greater include buildings and structures, reservoirs, dams, treatment plants, pump stations, certain water mains and pipelines, sewer systems, tunnels, and bridges.

Financial Accounting Standards Board (FASB) Statement 34, Capitalization of Interest Costs, requires that interest expense incurred during construction of assets be capitalized. Interest included in the construction in progress and total interest expense incurred during the years ended June 30, 2010 and 2009 are as follows:

	 2010	2009
Interest expensed	\$ 47,272	28,847
Interest included in construction in progress	 36,131	22,135
	\$ 83,403	50,982

During fiscal years ending in 2010 and 2009, the Enterprise expensed \$7,037 and \$5,207, respectively, related to capitalized design and planning costs on certain projects. The amounts of the write-offs were recognized as other operating expenses in the accompanying statements of revenues, expenses, and changes in net assets.

31 (Continued)

2010

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Notes to Financial Statements

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

(5) Restricted Assets

Pursuant to the Indentures, all revenues of the Enterprise (except amounts on deposit in the rebate fund) are irrevocably pledged to the punctual payment of debt service on the Water Revenue and Refunding Bonds. Accordingly, the revenues of the Enterprise shall not be used for any other purpose while any of its Water Revenue and Refunding Bonds are outstanding, except as expressly permitted by the Indentures. Further, all revenues shall be deposited by the City Treasurer, by instruction of the Enterprise, in special funds designated as the Water Enterprise Revenue Fund (the Water Revenue Fund), which must be maintained in the City Treasury. These funds, held at the City Treasury, are recorded in the statements of net assets of the Enterprise as cash and investments with the City Treasury. Deposits in the Water Revenue Fund, including earnings thereon, shall be appropriated, transferred, expended, or used for the following purposes pertaining to the financing, maintenance, and operation of the Enterprise in accordance with the following priority:

- 1. The payment of operation and maintenance expenses for such utility and related facilities;
- 2. The payment of pension charges and proportionate payments to such compensation and other insurance or outside reserve funds as the Enterprise may establish or the Board of Supervisors may require with respect to employees of the Enterprise;
- 3. The payment of principal, interest, reserve, sinking fund, and other mandatory funds created to secure Revenue Bonds issued by the Enterprise for the acquisition, construction, or extension of facilities owned, operated, or controlled by the Enterprise;
- 4. The payment of principal and interest on General Obligation Bonds issued by the City for the Enterprise's purposes;
- 5. Reconstruction and replacement as determined by the Enterprise or as required by any of the Enterprise's Revenue Bond ordinances duly adopted and approved; and
- 6. The acquisition of land, real property, or interest in real property for, and the acquisition, construction, enlargement, and improvement of, new and existing buildings, structures, facilities, equipment, appliances, and other property necessary or convenient to the development or improvement of such utility owned, controlled, or operated by the Enterprise; and for any other lawful purpose of the Enterprise, including the transfer of surplus funds pursuant to Section 6.407(e) of the City's Charter.

Notes to Financial Statements

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

In accordance with the Indenture, the Program maintains certain restricted cash and investment balances in trust. Restricted assets held in trust consisted of the following as of June 30, 2010 and 2009:

	 2010	2009
Cash and investments with City Treasury:		
Water revenue bond construction fund	\$ 637,769	21,726
Cash and investments outside City Treasury:		
1991 Capital Appreciation Bond	15	15
2001A Water revenue bond fund	2,545	2,611
2002A Water revenue bond fund	3,451	3,363
2002B Water revenue bond fund	4,790	4,647
2006A Water revenue bond fund	25,761	25,564
2006B Water revenue bond fund	2,945	2,869
2006C Water revenue bond fund	1,952	1,905
2009A Water revenue bond fund	38,675	
2009B Water revenue bond fund	41,190	
2010ABC Water revenue bond fund	52,771	
2009C Certificates of participation – 525 Golden Gate	29,291	
2009D Certificates of participation – 525 Golden Gate	 91,895	
Total cash and investments outside		
City Treasury	 295,281	40,974
Interest receivable:		
Water bond construction fund	 273	117
Total restricted assets	\$ 933,323	62,817

Restricted assets listed above as cash and investments with City Treasury are held in sub-funds of the Water Revenue Fund.

(6) Short-Term Debt

The Commission and Board of Supervisors have authorized the issuance of up to \$500,000 in commercial paper. During the fiscal year 2010, \$229,600 in outstanding commercial paper was refunded as a part of the 2009A Series Water revenue bond issuance. The Enterprise has no commercial paper notes outstanding at June 30, 2010 as follows:

	 Amount
Balance, beginning of year	\$ 229,600
Additions Reductions (Refunding)	(229,600)
Balance, end of year	\$

Notes to Financial Statements June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

(7) Changes in Long-Term Liabilities

Long-term liability activities for the years ended June 30, 2010 and 2009 are as follows:

	Coupon	Final					Due
	interest	maturity	July 1,			June 30,	within
	rate	date	2009	Additions	Reductions	2010	one year
Revenue Bonds:							
2001A revenue bonds	4.0 - 5.0%	2031	77,580	_	(17,345)	60,235	3,065
2002A revenue bonds	2.5 - 5.0	2032	147,520	_	(3,260)	144,260	3,425
2002B revenue refunding bonds	3.1 - 5.0	2015	51,425	_	(6,375)	45,050	6,640
2006A revenue bonds	4.0 - 5.0	2036	497,060	_	(8,505)	488,555	8,895
2006B revenue refunding bonds	4.0 - 5.0	2026	104,245	_	(3,145)	101,100	3,300
2006C revenue refunding bonds	4.0 - 5.0	2026	43,560	_	(2,375)	41,185	2,470
2009A revenue bonds	4.0 - 5.3	2039	_	412,000	_	412,000	_
2009B revenue refunding bonds	4.0 - 5.0	2039	_	412,000	_	412,000	_
2010A revenue bonds	2.0 - 5.0	2030	_	56,945	_	56,945	_
2010B revenue bonds	4.0 - 6.0	2040	_	417,720	_	417,720	_
2010C revenue refunding bonds	5.0	2015	_	14,040	_	14,040	_
Less deferred amounts:							
For issuance premiums			24,929	42,939	(3,753)	64,115	_
For refunding loss			(13,433)		1,529	(11,904)	
Total revenue bonds payable			932,886	1,355,644	(43,229)	2,245,301	27,795
1991 capital appreciation bonds	0.00	2019	3,620	258	_	3,878	_
2009C certificates of participatation (COPs)	2.0 - 5.0	2023	_	27,218	_	27,218	_
Issuance premiums-COPs (2009C)			_	3,038	(259)	2,779	_
2009D certificates of participtation	6.36 - 6.49	2042	_	92,499	_	92,499	_
Other post-employment benefits							
obligation			30,967	19,073	(4,442)	45,598	_
Arbitrage rebate payable			4,265	288	_	4,553	_
Accrued vacation and sick leave			11,454	8,380	(8,007)	11,827	6,366
Accrued workers' compensation			8,617	1,624	(2,147)	8,094	1,468
Damage and claims liability			9,641	26,835	(6,736)	29,740	8,719
Pollution remediation obligation			3,312		(2,653)	659	499
Total			\$ 1,004,762	1,534,857	(67,473)	2,472,146	44,847

Notes to Financial Statements

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

	Coupon interest	Final maturity	7	July 1,			June 30,	Due within
	rate	date	,	2008	Additions	Reductions	2009	one year
Revenue Bonds:								
2001A revenue bonds	4.0 - 5.0%	2031	\$	80,410	_	(2,830)	77,580	2,945
2002A revenue bonds	2.5 - 5.0	2032		150,620	_	(3,100)	147,520	3,260
2002B revenue refunding bonds	3.0 - 5.0	2015		57,580	_	(6,155)	51,425	6,375
2006A revenue bonds	4.0 - 5.0	2036		505,230	_	(8,170)	497,060	8,505
2006B revenue refunding bonds	4.0 - 5.0	2026		107,230	_	(2,985)	104,245	3,145
2006C revenue refunding bonds Less deferred amounts:	4.0 - 5.0	2026		45,840	_	(2,280)	43,560	2,375
For issuance premiums				25,952	_	(1,023)	24,929	_
For refunding loss			_	(14,452)		1,019	(13,433)	
Total revenue bonds payable	;			958,410	_	(25,524)	932,886	26,605
Capital appreciation bonds Other post-employment benefits	0.00	2019		3,380	240	_	3,620	_
obligation				15,048	15,919	_	30,967	_
Arbitrage rebate payable				_	4,265	_	4,265	_
Accrued vacation and sick leave				10,856	8,715	(8,117)	11,454	6,071
Accrued workers' compensation				8,135	2,195	(1,713)	8,617	1,551
Damage and claims liability				11,254	7,946	(9,559)	9,641	2,515
Pollution remediation obligation			_	2,694	1,700	(1,082)	3,312	3,077
Total			\$	1,009,777	40,980	(45,995)	1,004,762	39,819

(a) Capital Appreciation Bonds

The capital appreciation bonds mature from November 1, 2018 through November 1, 2019. The bonds were insured by MBIA and carried "Aaa" and "AAA" ratings from Moody's and Standard & Poor's (S&P), respectively. In February 2009, the bonds were further reinsured by NPFGC and carried "Baal" and "A" ratings from Moody's and S&P, respectively. As of June 30, 2010, MBIA was rated "B3" and "BB+" by Moody's and S&P, respectively, while NPFGC has affirmed ratings of "Baal" and "A" from Moody's and S&P, respectively. Interest on the capital appreciation bonds is due upon maturity and is recognized as annual interest expense over the life of the bonds using the interest method. The Enterprise has recognized \$3,878 and \$3,620 of unpaid principal and interest on the capital appreciation bonds as of June 30, 2010 and 2009, respectively, and has reported it as capital appreciation bonds in the accompanying statements of net assets.

(b) Water Revenue Bonds Series 2001A

During fiscal year 2002, the Enterprise issued \$140,000 of revenue bonds 2001 Series A. The bonds were insured by FSA and carried "Aaa" and "AAA" ratings from Moody's and Standard & Poor's, respectively. As of June 30, 2010, FSA was rated "Aa3" and "AAA" by Moody's and S&P, respectively. The revenue bonds include current interest serial and term bonds with interest rates varying from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2021 and the current interest term bonds mature on November 1, 2024, 2027, and 2031. In March 2006, \$45,630 of the 2001A serial and term bonds with maturities of November 2016 to November 2024 were refunded by the 2006 refunding Series B revenue bonds.

Notes to Financial Statements June 30, 2010 and 2009

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On June 17, 2010, the Enterprise issued \$14,040 of the 2010 Sub-Series C revenue bonds for the purpose of refunding \$14,400 of then-outstanding 2001 Series A revenue bonds. The 2010 bonds bear a coupon rate of 5.0% and mature serially from 2012 to 2015. The refunded Series 2001A bonds carried a coupon rate of 5.0% and also matured between 2012 and 2015. The unamortized issuance costs related to the refunded portion of the Series 2001A bonds were \$126 at the date of the refunding.

A portion of the proceeds on the 2010 Sub-Series C revenue bonds was deposited with the trustee, acting as escrow agent under the irrevocable Escrow Agreement, dated June 1, 2010, to refund and legally defease a portion of the outstanding 2001 Series A bonds. This deposit, together with certain other available moneys was held by the escrow agent under the Escrow Agreement and invested in non-callable Federal Securities consisting of United States Treasury Securities-State and Local Government Series (SLGS). The principal and interest on monies held by the escrow agent will be sufficient to redeem the Refunded 2001 Series A bonds on November 1, 2011 by optional redemption on that date.

As of June 30, 2010, the 2001 Series A bonds still outstanding totals \$60,235. Although the refunding resulted in the recognition of a deferred accounting loss of \$1,044, the Enterprise achieved net present value debt service savings of \$919 or 6.4% of the refunded principal.

(c) Water Revenue Bonds Series 2002A

During fiscal year 2003, the Enterprise issued \$164,000 of revenue bonds 2002 Series A. The bonds were insured by MBIA and carried "Aaa" and "AAA" ratings from Moody's and Standard & Poor's, respectively. In February 2009, the bonds were further reinsured by NPFGC and carried "Baal" and "A" ratings from Moody's and S&P, respectively. As of June 30, 2010, MBIA was rated "B3" and "BB+" by Moody's and S&P, respectively, while NPFGC carried "Baal" and "A" ratings from Moody's and S&P, respectively. The revenue bonds include interest and serial and term bonds with interest rates varying from 2.5% to 5.0%. The current interest serial bonds mature through November 1, 2026, and the current interest term bonds mature on November 1, 2025 and 2032.

(d) Water Revenue Refunding Bonds Series 2002B

During fiscal year 2003, the Enterprise issued 2002 revenue refunding bonds, Series B in the amount of \$85,260 with interest rates ranging from 3.0% to 5.0%. The bonds were insured by MBIA and carried "Aaa" and "AAA" ratings from Moody's and Standard & Poor's, respectively. In February 2009, the bonds were further reinsured by NPFGC and carried "Baal" and "A" ratings from Moody's and S&P, respectively. As of June 30, 2010, MBIA was rated "B3" and "BB+" by Moody's and S&P, respectively, while NPFGC has affirmed ratings of "Baal" and "A" from Moody's and S&P, respectively. The current interest serial bonds mature through November 1, 2015.

(e) Water Revenue Bonds Series 2006A

During fiscal year 2006, the Enterprise issued 2006 revenue bonds, Series A in the amount of \$507,815. The purpose of the bonds is to finance improvements to the City's water systems pursuant to Proposition A and to retire commercial paper outstanding. The bonds were insured by FSA and

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carried "Aaa" and "AAA" ratings from Moody's and Standard & Poor's, respectively. As of June 30, 2010, FSA was rated "Aa3" and "AAA" by Moody's and S&P, respectively. The 2006 Series A bonds include current interest and serial and term bonds with interest rates ranging from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2027 and the current interest term bonds mature on November 1, 2031 and 2033 and 2036.

(f) Water Revenue Refunding Bonds Series 2006B

During fiscal year 2006, the Enterprise issued 2006 revenue refunding bonds, Series B in the amount of \$110,065. The purpose of the bonds is to refund a portion of the 1996A Series A bonds and the 2001 Series A bonds. The bonds were insured by Syncora (formerly XL) and carried "Aaa" and "AAA" ratings from Moody's and Standard & Poor's, respectively. As of June 30, 2010, Syncora was rated "Ca" and "NR" by Moody's and S&P, respectively. The 2006B refunding bonds include serial bonds with interest rates varying from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2026.

(g) Water Revenue Refunding Bonds Series 2006C

During fiscal year 2007, the Enterprise issued 2006 revenue refunding bonds, Series C in the amount of \$48,730 for the purpose of refunding the remaining portion of the outstanding 1996 Series A bonds maturing on and after November 1, 2007 (the Refunded 1996 Series A Bonds). The bonds were insured by Syncora (formerly XL) and carried "Aaa" and "AAA" ratings from Moody's and Standard & Poor's, respectively. As of June 30, 2010, Syncora was rated "Ca" and "NR" by Moody's and S&P, respectively. The 2006C refunding bonds include serial bonds with interest rates varying from 4.0% to 5.0%. The current interest serial bonds mature through November 1, 2026.

(h) Water Revenue Bonds Series 2009A

During fiscal year 2010, the Enterprise issued its revenue bonds, 2009 Series A in the amount of \$412,000. The purpose of the bonds is to refund \$229,600 of outstanding Proposition A commercial paper notes and to provide \$139,218 in new money for WSIP capital projects, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated "AA-" and "A1" from Standard & Poor's and Moody's, respectively. The bonds include serial and term bonds with interest rates varying from 4.0% to 5.3%. The bonds mature through November 1, 2039. The 2009 Series A bonds have a true interest cost of 4.8%.

(i) Water Revenue Bonds Series 2009 B

During fiscal year 2010, the Enterprise issued its revenue bonds, 2009 Series B in the amount of \$412,000. The purpose of the bonds is to provide \$377,778 in new money for WSIP capital project, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated "AA-" and "A1" from Standard & Poor's and Moody's, respectively. The bonds include serial and term bonds with interest rates varying from 4.0% to 5.0%. The bonds mature through November 1, 2039. The 2009 Series B bonds have a true interest cost of 4.5%.

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(j) Water Revenue Bonds Series 2010 ABC

During fiscal year 2010, the Enterprise issued its revenue bonds, 2010 Series ABC in the combined principal amount of \$488,705. The purpose of the bonds is to refund \$14,400 of outstanding 2001 Series A, revenue bonds, to provide \$58,748 in proceeds for the AMI Project and to provide \$364,757 in new money for WSIP capital projects, with the balance applied to financing costs and a cash-funded debt service reserve. The bonds were rated "AA-" and "Aa2" from Standard & Poor's and Moody's, respectively. The bonds included serial and term bonds with interest rates varying from 2.0% to 6.0%.

The \$56,945 Sub-Series A bonds were issued as traditional tax-exempt bonds to provide funds for the AMI Project as well as financing costs. The Sub-Series A bonds were issued as serial bonds with coupons ranging from 2.0% to 5.0% and have a final maturity of 2030. The sub-series A bonds have a true interest cost of 3.8%.

The \$417,720 Sub-Series B bonds were issued as Federally taxable Build America Bonds (Direct Payment) to provide \$364,757 in new money for WSIP capital projects as well as to pay financing costs. The Sub-Series B bonds were issued as serial and term bonds with coupons ranging from 4.0% to 6.0% and have a final maturity of 2040. The Sub-Series B bonds have a true interest cost (net of subsidy) of 3.9%.

The \$14,040 Sub-Series C bonds were issued to advance refund \$14,400 of outstanding revenue bonds, 2001 Series A and to pay financing costs. The Sub-Series C bonds were issued as serial bonds with 5.0% coupons and a final maturity of 2015, and have a true interest cost of 1.6%.

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(k) Future Annual Debt Service of Revenue Bonds

The following table presents the future annual debt service relating to the Revenue and Refunding Bonds outstanding as of June 30, 2010. The interest before subsidy amounts include the interest for the revenue bonds 2001 Series A, 2002 Series A, 2002 Refunding Series B, 2006 Series A, 2006 Refunding Series B and C, 2009 Series A and B, and 2010 Series ABC. The Federal interest subsidy amounts represent 35% of the interest for the revenue bond 2010 Sub-Series B.

			Interest before	Federal Interest	Interest Net
	_	Principal	subsidy	subsidy	of subsidy
Years ending June 30:					
2011	\$	27,795	106,244	(7,283)	98,961
2012		44,050	108,029	(8,350)	99,679
2013		45,965	105,884	(8,350)	97,534
2014		48,130	103,561	(8,350)	95,211
2015		50,485	101,078	(8,350)	92,728
2016 - 2020		293,500	464,301	(40,479)	423,822
2021 - 2025		355,275	386,459	(35,518)	350,941
2026 - 2030		428,735	289,123	(28,564)	260,559
2031 – 2035		460,125	173,803	(19,661)	154,142
2036 - 2040	_	439,030	60,375	(9,092)	51,283
		2,193,090	1,898,857	(173,997)	1,724,860
Less current portion		(27,795)			
Add unamortized bond premium, net of discount and refunding loss	_	52,211			
Long-term portion as of June 30, 2010	\$ _	2,217,506			

As defined in the Indentures, the principal and interest of the Enterprise's revenue and refunding bonds are payable from its corresponding revenue, as well as monies deposited in certain funds and accounts pledged thereto (note 5).

(l) Proposition A

On November 5, 2002, the San Francisco voters passed Proposition A, which provides for the issuance of revenue bonds and/or other forms of indebtedness by the Commission in a principal amount not to exceed \$1,628,000 to finance the acquisition and construction of improvements to the City's Water System. As of June 30, 2010, there was no commercial paper outstanding pursuant to this authorization and \$1,331,815 of bonds had been issued in fiscal years 2006 and 2010 against this authorization.

(m) Proposition E

On November 5, 2002, the San Francisco voters passed Proposition E, which authorizes the Board of Supervisors' approval of the issuance of revenue bonds and/or other forms of indebtedness by the Commission to finance costs for the Commission's capital programs, including WSIP. As of June 30,

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2010, the Board of Supervisors has authorized the issuance of \$3,048,031 in revenue bonds with \$474,665 issued against this authorization. No commercial paper was outstanding pursuant to this authorization as of June 30, 2010.

(8) Revenue Pledge

The Enterprise has pledged future revenues to repay various revenue bonds. Proceeds from the revenue bonds provided financing for various capital construction projects, and to refund previously issued bonds. The bonds are payable solely from revenues of the Enterprise and are payable through the year ending 2040.

The original amount of revenue bonds issued, total principal and interest remaining, principal and interest paid during 2010, and applicable revenues for 2010 and 2009 are as follows:

	 2010	2009
Bonds issued with revenue pledge	\$ 2,421,205	1,108,500
Principal and interest remaining due at the end of the year	4,091,947	1,549,883
Principal and interest paid during the year	69,621	69,585
Net revenue for the year ended June 30	77,735	82,978
Funds available for revenue bond debt service	138,686	146,622

(9) Certificates of Participation Issued for the 525 Golden Gate Avenue Headquarters Building

In October 2009, the City & County of San Francisco issued \$167,670 in certificates of participation to fund the future headquarters building of the San Francisco Public Utilities Commission (SFPUC) at 525 Golden Gate Avenue. The 2009 Series C were issued for \$38,120 and 2009 Series D for \$129,550 as "Build America Bonds" on a taxable basis under the 2009 American Recovery and Reinvestment Act. The 2009 Series C certificates carry interest rates ranging from 2.0% to 5.0% and mature on November 1, 2022. The 2009 Series D certificates carry interest rates ranging from 6.4% to 6.5% and mature on November 1, 2041, after adjusting for the Federal interest subsidy the true interest cost averages 3.4% and 4.3% for Series C & D, respectively.

Under the terms of a Memorandum of Understanding between the City and the SFPUC dated October 1, 2009, the City conveyed the real property to the Trustee under a property lease in exchange for the proceeds of the sale of the certificates. The Trustee has leased the property back to the City for the City's use under a Project Lease. The City will be obligated under the Project Lease to pay base rental payments and other payments to the Trustee each year during the thirty-two year term of the Project Lease. The Commission will make annual base rental payments to the City for the building equal to annual debt service on the certificates. It is anticipated that these lease costs will be offset with reductions in costs associated with current office rental expense.

Each of the three Enterprises has an ownership interest in the building equal to their projected usage of space as follows: Water (73%), Wastewater (15%) and Power (12%). Similarly, each Enterprise is responsible for a portion of the annual Base Rental Payment based on their ownership percentages less

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contributed equity. The percentage share of Base Rental Payments for the Enterprises is as follows: Water (71.4%), Wastewater (18.9%), and Power (9.7%).

		Certificates of Participation 2009 Series C (tax-exempt)		
		Principal	Interest	
Years ending June 30:				
2011	\$		1,263	
2012			1,263	
2013		1,971	1,231	
2014		2,035	1,164	
2015		2,106	1,092	
2016 - 2020		12,188	3,814	
2021 - 2023	_	8,918	684	
		27,218	10,511	
Less: Current portion				
Add: Unamortized bond premium	_	2,779		
Long-term portion as of June 30, 2010	\$ _	29,997		

		Certifica	tes of Participation	n 2009 Series D (ta	axable)
	_	Principal	Interest before subsidy	Federal interest subsidy	Interest net of subsidy
Fiscal years ending June 30:					
2011	\$	_	5,968	(2,089)	3,879
2012		_	5,968	(2,089)	3,879
2013		_	5,968	(2,089)	3,879
2014		_	5,968	(2,089)	3,879
2015		_	5,968	(2,089)	3,879
2016 - 2020		_	29,840	(10,444)	19,396
2021 - 2025		6,669	29,420	(10,297)	19,123
2026 - 2030		19,285	24,752	(8,663)	16,089
2031 - 2035		23,737	17,863	(6,252)	11,611
2036 - 2040		29,271	9,297	(3,254)	6,043
2041 - 2042	_	13,537	887	(311)	576
		92,499	141,899	(49,666)	92,233
Less: Current portion		_			_
Less: Unamortized bond premium	_				
Long-term portion as of June 30, 2010	\$_	92,499			

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(10) Wholesale Balancing Account

During 1984, the Water Enterprise provided water service pursuant to the terms of the 1984 Settlement Agreement and Master Water Sales Contract, which establishes the basis for water rates to be charged to those customers (wholesale customers). The Master Water Sales Contract expired on June 30, 2009. The Commission and the Wholesale Customers approved a new Water Supply Agreement ("WSA") of a twenty-five year term with two options for five-year extensions. The existing 184 millions of gallons per day (mgd) Supply Assurance continues under the WSA and no increase in the Supply Assurance will be considered before December 31, 2018. During the period from 2009 to 2018, the WSA limits the quantity of water delivered to Retail Customers and Wholesale Customers for the watersheds to 265 mgd. Under the WSA, annual operating expenses including debt service on bonds sold to finance regional system improvements and regional capital projects funded from revenues will be allocated between Retail Customers and Wholesale Customers on the basis of proportionate annual water use. The Wholesale Customers' share of net book value of existing regional assets as of June 30, 2009 will be recovered on level annual payment over the twenty-five year term of the WSA at an interest rate of 5.1%. The WSA continues much of the rate setting, accounting, and dispute resolution provisions contained in the expired Contract, and has emergency and drought-pricing adjustment provisions.

Pursuant to the terms of the WSA, the City is required to establish water rates applicable to the wholesale customers annually. The wholesale water rates are based on an estimate of the level of revenues necessary to recoup the cost of distributing water to the wholesale customers in accordance with the methodology outlined in Article V of the WSA (the Wholesale Revenue Requirement (WRR), previously known as the Suburban Revenue Requirement). During fiscal years ending in 2010 and 2009, the Wholesale Revenue Requirement, net of adjustments, charged to such suburban customers was \$129,203 and \$131,831, respectively. Such amounts are subject to final review by the wholesale customers, along with a trailing wholesale balancing account compliance audit of the Wholesale Revenue Requirement calculation.

Pursuant to Article VII, Section 7.02 of the WSA, the City is required to re-compute the WRR 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 revenues earned during the year and the "actual" Wholesale Revenue Requirement is recorded in a separate account (the Balancing Account) and represents the cumulative amount that is either owed to the wholesale customers (if the wholesale revenues exceed the Wholesale Revenue Requirement) or owed to the City (if the Wholesale Revenue Requirement exceeds the wholesale revenues paid). In accordance with Article VI of the WSA, the amount recorded in the Balancing Account shall earn interest at a rate equal to the average rate received by the City during the year on the invested pooled funds of the City Treasurer, and shall be taken into consideration in the determination of subsequent wholesale water rates. As of June 30, 2010 and 2009, the Suburban Purchasers owed the Enterprise \$34,092 and \$27,571, respectively, under the terms of the Wholesale Water Rate Agreement. Subsequently, the June 30, 2009 amount was revised to \$21,861, based on the audited final balancing account statement dated August 20, 2010.

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(11) Employee Benefits

(a) Retirement Plan

Plan Description – The Enterprise participates in the City's single-employer defined benefit retirement plan (the Plan) which is administered by the San Francisco City and County Employees' Retirement System (the Retirement System). The Plan covers substantially all full-time employees of the Enterprise along with other employees of the City. The Plan provides basic service retirement, disability, and death benefits based on specified percentages of final average salary, and provides cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to qualified survivors. The San Francisco City and County Charter and Administrative Code are the authority which establishes and amends the benefit provisions and employer obligations of the Plan.

Funding Policy – Contributions to the basic plan are made by both the Enterprise and its employees. Employee contributions are mandatory. Employee contribution rates for 2010, 2009 and 2008 varied from 7.5% to 8.0% as a percentage of covered payrolls. Due to certain bargaining agreements, the Enterprise contributed from 0.5% to 8.0% of covered payroll on behalf of some employees. In addition, the Enterprise is required to contribute for 2010, 2009, and 2008 at an actuarially determined rate as a percentage of covered payroll of 9.5%, 5.0%, and 6.0%, respectively. The Enterprise contributed 100% of its required contribution of \$12,283 in 2010, \$6,946 in 2009, and \$7,694 in 2008.

The Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees' Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, CA 94102, or by calling (415) 487-7020.

(b) Health Care Benefits

Health care benefits of the Enterprise employees, retired employees and surviving spouses are financed by beneficiaries and by the City through the City and County of San Francisco Health Service System (the Health Service System). The Enterprise's annual contribution, which amounted to approximately \$19,347 and \$19,982 in fiscal years 2010 and 2009, respectively, is determined by a San Francisco Charter provision based on similar contributions made by the 10 most populous counties in California.

Included in these amounts are \$4,442 and \$5,621 for 2010 and 2009, respectively, to provide post-retirement benefits for retired employees, on a pay-as-you-go basis. In addition, the City allocated an additional \$0 and \$155 to the Enterprise's contribution allocation for payments made from the Health Service System for post-retirement health benefits in 2010 and 2009, respectively.

The City has determined a City-wide Annual Required Contribution (ARC), interest on net other post-employment benefits other than pensions (OPEB) obligation, ARC adjustment, and OPEB cost based upon an actuarial valuation performed in accordance with GASB 45, by the City's actuaries. The City's allocation of the OPEB related costs to the Enterprise for the year ended June 30, 2010 based upon its percentage of City-wide payroll costs is presented below.

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The following table shows the components of the City's annual OPEB allocations for the Enterprise for the years ended June 30, 2010 and 2009, for the amount contributed to the plan, and changes in the City's net OPEB obligation (dollar amount in thousands):

	 2010	2009
Annual required contribution Interest on net OPEB Obligation Adjustment to ARC	\$ 18,790 1,312 (1,029)	21,522 667 (494)
Annual OPEB cost (expense)	19,073	21,695
Contribution made	(4,442)	(5,776)
Increase in net OPEB obligation	14,631	15,919
Net OPEB obligation – beginning of year	 30,967	15,048
Net OPEB obligation – end of year	\$ 45,598	30,967

The City issues a publicly available financial report that includes the complete note disclosures and Required Supplementary Information (RSI) related to the City's post retirement health care obligations. The report may be obtained by writing to the City and County of San Francisco, Office of the Controller, 1 Dr. Carlton B. Goodlett Place, Room 316, San Francisco, CA 94102, or by calling (415) 554-7500.

(c) Wellness Incentive Program

Effective July 1, 2002, the City established a pilot "Wellness Incentive Program" (the Wellness Program) to promote workforce attendance. Under the Wellness Program, any full-time employee leaving the employment of the City upon service or disability retirement may receive payment of a portion of accrued sick leave credits at the time of separation.

The amount of this payment shall be equal to 2.5% of accrued sick leave credits at the time of separation times the number of whole years of continuous employment times an employee's salary rate, exclusive of premiums or supplements, at the time of separation. Vested sick leave credits, as set forth under Civil Service Commission Rules, shall not be included in this computation. The Wellness Program has been discontinued, as current bargaining agreements expired on June 30, 2010.

(12) Related Parties

Various common costs incurred by the Commission are allocated proratably between the Enterprise, Hetch Hetchy, and the Wastewater Enterprise. The allocations are based on the Commission management's best estimate and may change from year to year depending on the activities incurred by each Enterprise and the information available. For the year ended June 30, 2010, the Commission allocated \$32,508 in administrative costs to the Enterprise. For the year ended June 30, 2009, the Commission allocated \$32,163 in administrative costs to the Enterprise.

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The City performs certain administrative services such as maintenance of accounting records and investment of cash for all fund groups within the City. The various funds are charged for these services based on the City's indirect cost allocation plan. The overhead allocation paid to the General Fund of the City by the Enterprise was \$1,007 and \$2,574 for the years ended June 30, 2010 and 2009, respectively, and is included in other operating expenses in the accompanying financial statements.

The Enterprise purchases water from Hetch Hetchy Water. This amount, totaling \$29,746 and \$23,000 for the years ended June 30, 2010 and 2009, respectively, has been included in the services provided by other departments in the accompanying financial statements.

The Enterprise purchases electricity from Hetch Hetchy Power at market rates. This amount, totaling \$6,723 and \$5,504 for the years ended June 30, 2010 and 2009, respectively, has been included in services provided by other departments in the accompanying financial statements.

Since fiscal year 2008, the Enterprise has charged all City departments for water with the exception of fire hydrants. In fiscal year 2010, the Enterprise delivered water for fire hydrant purposes totaling \$3, based on metered usage and applicable water rates, and the amount has been excluded from operating revenues in the accompanying financial statements.

A variety of City departments provide services such as engineering, purchasing, legal, data processing, telecommunications, and human resources to the Enterprise and charge amounts designed to recover those departments' costs. These charges, totaling \$11,105 and \$11,599 for the years ended June 30, 2010 and 2009, respectively, have been included in services provided by other departments in the accompanying financial statements.

During the fiscal year ending June 30, 2010, \$493 was transferred to other City departments, including \$385 to the Arts Commission representing payment based on a percentage of construction contracts.

As of June 30, 2010, the Enterprise has a receivable in the amount of \$10,346 due from the Wastewater Enterprise and Hetch Hetchy's Power Enterprise for their respective allocable share of costs associated with the construction of the future SFPUC headquarters building located at 525 Golden Gate Avenue.

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(13) Risk Management

The Enterprise's risk management program encompasses both self-insured and insured coverage. Risk assessments and coverage are coordinated by the City's Office of Risk Management. With certain exceptions, the City and the Enterprise's general policy is to first evaluate self-insurance for the risk of loss to which it is exposed. Based on this analysis, mitigating risk through a 'self-retention' mechanism is more economical as it manages risks internally and administers, adjusts, settles, defends, and pays claims from budgeted resources (i.e. *pay-as-you-go* fund). When economically more viable or when required by debt financing covenants, the Enterprise obtains commercial insurance. At least annually, the City actuarially determines general liability and workers' compensation risk exposures. The Enterprise does not maintain commercial earthquake coverage, with certain minor exceptions, such as a sub-limit for fire-sprinkler leakage due to earthquake under the Property Insurance program.

Primary risks	Typical coverage approach
General Liability	Self-Insure
Property	Purchased Insurance and Self-Insure
Workers' Compensation	Self-Insure through Citywide Pool
Other risks	Typical coverage approach
Surety Bonds	Purchased and Contractually Transferred
Professional Liability	Combination of Self-Insure, Purchased Insurance and Contractual Risk Transfer
Errors & Omissions	Combination of Self-Insure, Purchased Insurance and Contractual Risk Transfer
Builders' Risk	Purchased Insurance and Contractual Risk Transfer
Public Officials Liability	Purchased Insurance

(a) Damage and Claims Liability

Through coordination with the Controller and the City Attorney's Office, the general liability risk exposure is actuarially determined and is addressed through pay-as-you-go funding as part of the budgetary process. Associated costs are also booked as expenses as required under Generally Accepted Accounting Principles (GAAP) for financial statement purposes for both the Enterprise and the City and County of San Francisco's Comprehensive Annual Financial Report (CAFR). The claim expense allocations are determined based on actuarially determined anticipated claim payments and the projected timing of disbursement.

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The changes for the damage and claims liabilities for the years ended June 30, 2010 and 2009 are as follows:

]	Beginning of year	Claims and changes in estimates	Claims paid	End of year	
2008 - 2009	\$	11,254	7,946	(9,559)	9,641	
2009 - 2010		9,641	26,835	(6,736)	29,740	

(b) Property

The Enterprise's property risk management approach varies depending on whether the facility is currently under construction, or if the property is part of revenue-generating operations. For new construction projects, the Enterprise has utilized traditional insurance, or other alternative insurance programs. Under the latter approach, the insurance program usually provides coverage for the entire construction project, along with multiple risk coverage, such as for general liability, property damage and workers compensation, for example. When a traditional insurance program is used for property risks, the Enterprise requires each contractor to provide its own insurance, while ensuring that the full scope of work be covered with satisfactory levels to limit the Enterprise's risk exposure. The majority of purchased insurance program is for either: 1) revenue-generating facilities, 2) debt-financed facilities, or 3) mandated coverage to meet statutory requirements for bonding of various public officials.

(c) Workers' Compensation

The City actuarially determines and allocates workers' compensation costs to the Enterprise according to a formula based on the following: (i) the dollar amount of claims; (ii) yearly projections of payments based on historical experience; and (iii) the size of the Enterprise's payroll. The administration of workers' compensation claims and payouts are handled by the Workers' Compensation Division of the City's Department of Human Resources. Statewide workers' compensation reforms have resulted in budgetary savings in recent years. The City continues to develop and implement improved programs, such as return-to-work programs, to lower or mitigate the growth of workers' compensation costs. Programs include: accident prevention, investigation and duty modification for injured employees with medical restrictions so return to work can occur as soon as possible.

The changes in the liabilities for workers' compensation for the years ended June 30, 2010 and 2009 are as follows:

	В	eginning of year	Claims and changes in estimates	Claims paid	End of year
2008 – 2009	\$	8,135	2,195	(1,713)	8,617
2009 - 2010		8,617	1,624	(2,147)	8,094

Notes to Financial Statements
June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

(d) Surety Bonds and Public Official Liability

Bonds are required in most phases of the public utilities construction contracting process for such phases, as bid, performance, and payment or maintenance. Additionally, bonds may be required in other contracts where goods or services are provided to ensure compliance with applicable terms and conditions such as warranty. Additionally, all public officials with financial oversight responsibilities are provided liability coverage through a commercial Public Official Liability policy, including the Commission members, the General Manager and the Chief Financial Officer. The Enterprise also maintains a commercial crime policy in lieu of bonding its employees.

(e) Professional Liability, Errors and Omissions

Professional liability policies are either directly purchased insurance on behalf of the Enterprise, transferred through contract to the contracted professional, or retained through self-insurance on a case by case basis depending on the size, complexity or scope of construction or professional service contracts. Examples of contracts providing any form of the coverage described are engineers, architects, design professionals and other licensed or certified professional service providers.

(f) Builders' Risk

Builder's risk policies of insurance are required to be provided by the contractor on all construction projects for the full value of construction.

(14) Commitments and Litigation

(a) Commitments

As of June 30, 2010 and 2009, the Enterprise has outstanding commitments with third parties of \$913,560 and \$303,373, respectively, for various capital projects and other purchase agreements for materials and services.

(b) Grants

Grants that the Enterprise receives are subject to audit and final acceptance by the granting agency. Current and prior year costs of such grants are subject to adjustment upon audit.

(c) Litigation

The Enterprise is a defendant in various legal actions and claims that arise during the normal course of business. The final disposition of those legal actions and claims is not determinable. However, in the opinion of management, the outcome of any litigation of these matters will not have a material effect on the financial position or changes in net assets of the Enterprise.

Notes to Financial Statements
June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

(15) Subsequent Events

(a) Debt Issuance

Water Revenue Bonds Series 2010 DE

In July 2010, the Enterprise issued revenue bonds Series DE in the combined principal amount of \$446,925. The Sub-Series D Bonds were issued as traditional tax-exempt bonds, while the Sub-Series E Bonds were issued as Build America Bonds with a Direct Pay Subsidy. The \$102,725 Sub-Series D Bonds provided \$72,243 in new money for WSIP implementation and also provided \$35,080 to advance refund a portion of the SFPUC's Water Revenue Bonds, Series 2002 A Bonds, as well as providing funds for financing costs. The \$344,200 Sub-Series E Bonds provided \$300,446 in new money for WSIP projects, with the balance applied to financing costs. The bonds included serial and term bonds with interest rates varying from 3% to 6%, and mature through November 1, 2040.

Commercial Paper

In August 2010, the Water Enterprise sold \$25 million in taxable commercial paper with the proceeds used to exclusively fund Regional Projects under WSIP. The Enterprise expects to refinance the commercial paper notes with an intermediate-term debt issuance in the winter of 2010.

(b) Possible Pollution Remediation Liability at Bay Division Pipeline No. 5

In August 2010, the Enterprise noted the possible presence of groundwater contamination at the construction site of Bay Division Pipeline #5 as a result of being alerted to the presence of soil contaminants in neighboring properties, not owned by the City, currently undergoing remediation. The potential liability cannot be reasonably estimated under the standards set forth by GASB Statement 49. The extent of the pollution is currently unknown to the Enterprise, pending the results of scientific testing that will not be available for evaluation until fiscal year 2011. Based on the results of the testing, the Enterprise may consider alternative courses of action to complete the project, and may be able to partially offset the costs of any remediation effort through the pursuit of legal claims.

(c) Transfer of the San Francisco Fire Department's Auxiliary Water Supply System

In May 2010, the City and County of San Francisco Board of Supervisors and Mayor approved the transfer of costs of operating, maintaining and improving the auxiliary water supply system (AWSS) from the Fire Department to the Enterprise. In June 2010, the voters of the City & County of San Francisco also approved Proposition B which authorizes a general obligation bond to implement improvements for fire, earthquake and emergency response and to ensure a reliable water supply for fires and disasters. The transfer of assets as well as AWSS operations is planned to occur during the next fiscal year.

Notes to Financial Statements

June 30, 2010 and 2009

(Dollars in thousands, unless otherwise stated)

(d) Litigation

In October 2010, a federal jury rejected First Amendment retaliation claims that SFPUC retaliated against Mitchell Engineering for engaging in speech protected by the First Amendment. However, the jury found for Mitchell Engineering on the due process claim related to contract termination. Mitchell was awarded \$3.6 million, and will be entitled to attorneys' fees and costs under the federal statute. The SFPUC is appealing the verdict. On a related note, this federal case is separate from the pending state cases between the SFPUC and Mitchell, each of which involves cross-allegations of breach of contract. Estimated costs for both the federal and state cases have been reflected in the financial statements.



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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Honorable Mayor and Board of Supervisors City and County of San Francisco, California:

We have audited the financial statements of the San Francisco Water Enterprise (the Enterprise), an enterprise fund of the City and County of San Francisco, California (the City) as of and for the year ended June 30, 2010, and have issued our report thereon dated November 24, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Enterprise's internal control over financial reporting as a basis for designing our auditing procedures 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 Enterprise's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Enterprise's internal control over financial reporting.

A deficiency in internal control over financial reporting 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 combination of deficiencies, in internal control over financial reporting, 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Enterprise's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the City and County of San Francisco Government Audit and Oversight Committee, the Commission, and others within the entities, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 24, 2010