TO: HONORABLE CITY COUNCIL
FROM: CITY MANAGER DEPARTMENT: UTILITIES
DATE: JANUARY 18, 2011 CMR: 109:11
REPORT TYPE: INFORMATIONAL
SUBJECT: Report of City Manager Action Pursuant to the City’s Water Contract with San Francisco on the Initiation of a Review of the Fiscal Year 2008-09 Audit of the Suburban Revenue Requirement

This report is for the Council’s information only. No action is required.

DISCUSSION
On December 12, 2005, the Council delegated to the City Manager the authority to execute certain documents for the City of Palo Alto when the City acts as a Suburban Representative under the Settlement Agreement and Master Water Sales Contract (Contract) with San Francisco [CMR 434:05]. The delegation required staff to report to the Council whenever the City Manager acted under the delegated authority. The City Manager exercised that authority when he signed a Memorandum of Understanding on November 18, 2009 with the San Francisco Public Utilities Commission (SFPUC) describing how the annual audit of the calculation of the Suburban Revenue Requirement for FY 2008-09 shall be conducted. That action was reported to the Council on January 25, 2010 [CMR: 106:10]. The City Manager exercised that authority again when he signed a letter on December 2, 2010 advising the SFPUC that the suburban representatives intend to review the calculations made to determine the costs allocated to the suburban customers for FY 2008-09.

The Suburban Revenue Requirement is the amount the Contract allows San Francisco to collect from the Suburban Purchasers, the group of agencies that purchase water wholesale from the San Francisco regional water system. These same agencies comprise the membership of the Bay Area Water Supply and Conservation Agency (BAWSCA). The City of Palo Alto is one of the five Suburban Representatives of the BAWSCA member agencies for the Contract administration. The Contract requires that a “compliance audit” be performed on San Francisco’s calculation of the Suburban Revenue Requirement each fiscal year. Each year, the Suburban Representatives may choose to conduct a “suburban review” of the compliance audit.

BAWSCA staff reviewed the FY 2008-09 compliance audit and recommended that the Suburban Representatives initiate a review of the audit for the FY 2008-09 Suburban Revenue
Requirement. BAWSCA staff identified eight issues but expect that they can be dealt with without resorting to arbitration. Additionally, ten issues that were identified last year in the audit review for FY 2007-08 also impact FY 2008-09. The issues are described in the attachment and include the classification of expenses for several projects and programs, explanation of certain expenses, errors, costs and transfers, and classification of a judgment from a lawsuit.

**RESOURCE IMPACT**
Resolution of the issues identified may result in a change to the Suburban Revenue Requirement that the Suburban Purchasers are obligated to pay. Resolution of the Suburban Review of the audit will be reported, as appropriate, to the City Council.

**POLICY IMPLICATIONS**
The attached letter was executed in accordance with Council authority delegated to the City Manager. If the issues raised by the audit cannot be resolved without going to arbitration, the Council will be asked to approve that action.

**ATTACHMENT**
A. December 6, 2010 letter to Todd Rydstrom, SFPUC Assistant General Manager, from John Ummel, BAWSCA Senior Administrative Analyst re: FY 2008-09 Suburban Revenue Requirement; Section 6.06

**PREPARED BY:**

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Utilities Assistant Director, Resource Management

**DEPARTMENT HEAD:**

VALERIE O. PONG
Director of Utilities

**CITY MANAGER APPROVAL:**

JAMES KEENE
City Manager
December 6, 2010

Mr. Todd Rydstrom, Assistant General Manager  
San Francisco Public Utilities Commission  
1155 Market Street, 11th Floor  
San Francisco, CA 94103

Subject: FY 2008-09 Suburban Revenue Requirement; Section 6.06

Dear Todd:

Pursuant to Section 6.06 of the 1984 Settlement Agreement and Master Water Sales Contract, the Suburban Representatives have the prerogative to conduct a "suburban review" of the FY08-09 compliance audit provided the SFPUC is notified of this intent within three months of having received the auditor's compliance audit report. The report was received in the BAWSCA offices on September 9, 2010; hence, the deadline for initiating a suburban review is on or about December 9, 2010.

The Suburban Representatives have designated the staff of the Bay Area Water Supply and Conservation Agency to conduct this review. Portions of the compliance audit designated for review are listed on the attached though the scope of the review may be expanded - as provided in the Agreement - to include other portions beyond those initially designated.

In order that the review proceeds in a constructive and timely fashion, BAWSCA is authorized to act on behalf of the Suburban Representatives. I will oversee the review and serve as liaison to the Suburban Representatives. In the past, I have worked with Bill Laws, Senior Rate Administrator for the SFPUC, on these reviews. Given Bill's departure, however, I intend to work with Charles Perl, Deputy Chief Financial Officer, unless you instruct otherwise.

If the SFPUC or compliance auditor wishes to contact us during the course of the suburban review, all such communications should be channeled through me.

Very truly yours,

[Signature]
John Ummel
Senior Administrative Analyst
SUBURBAN REPRESENTATIVES

Alameda County Water District

City of Palo Alto

City of Redwood City

California Water Service

City of Hayward

12/1/10

Date

12/1/10

Date

12/1/10

Date

12/3/10

Date

Dec. 2, 2010

Date

Attachment

Cc:

Art Jensen, BAWSCA GM/CEO
Allison Schutte, Hanson-Bridgett
Ed Harrington, SFPUC GM
Charles Perl, Deputy Chief Financial Officer – SFPUC
Eugene Yano, Auditor, Yano and Associates

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Portions of the FY 2008-09 Compliance Audit Initially Designated For Suburban Review

1. Clarification Regarding the Allocation of Costs for 525 Golden Gate. This $150M project is under way and some minor preliminary expenses for the above project have begun to show up in the wholesale revenue requirement. For example, $5,209 in index code 326108 was classified as Joint A&G for FY 08-09. It is not clear from the new or old agreement how expenses for this project should be allocated.

According to the Commission memorandum of January 22, 2008, this project will be funded from Certificates of Participation (COPS) that will obligate the SFPUC to make annual lease payments. Presumably, each enterprise/bureau will budget its share of lease payments and associated operating costs based on how much space they utilize. This is not unlike the current arrangement for allocating rental costs at 1155 Market.

The SFPUC should 1) review the preliminary expense noted above and determine whether this expenses has been appropriately classified per the old contract; 2) indicate how it intends to classify future “pre-COP” expenses under the new agreement (if different), and finally; 3) confirm how it intends to classify and allocate the COP lease payments once they begin.

2. Clarification of Expenses Related to Pacifica Recycled Water Project. In Water, a transfer to expense of $458,513 was made to index code 473101 (Joint Source of Supply) for Project 695, Pacifica Recycled Water. (You may recall that in the settlement agreement of February 26, 2010, the SFPUC reversed charges for the Pacifica Recycled Water project from Joint to City-only and credited the wholesale customers accordingly.) Please confirm whether this expense is related to the same project within WSIP (Project 302.2) - also named Pacifica Recycled Water -and whether the expense has been appropriately classified.

3. Explanation of Various Expenses in the 743 Report. A) The 743 report cites $416,935 in expense occurring in 505021 (Pooled Resource Plan) and shows the classification as SOS-Joint. What is the nature of this expense? B) The 743 Report also shows an increase (from $31k to $500k) in 400220/2722 (Finance). What was the cause of the increase? C) There are two new index codes (477019 and 477020) whose only identification is “suburban administration,” showing expenses of $348,351 and 346,970 respectively. What are these charges for?
4. **SCADA/Claims Accrual.** Is the judgment for the SCADA (Transdyn) lawsuit factored into the FY 08-09 SRR? Where? What accounts for the large increase in claims accrual in 477903? When will the actual expense be recognized?

5. **Explanations of Transfers to Expense.** A) In Water, a transfer to expense of $45,000 was made from 502661, Water Resources Education, to 470101 (A&G Joint). What is the nature of this expense? B) Also in Water, a transfer to expense of $100,000 was made from 730301, Construction CDD, to 470101 (A&G Joint). What is the nature of this expense? Should this be A&G City?

6. **Allocation of City Attorney Costs to GM Office.** City Attorney charges expensed in the GM’s office totaled about $1.5M. Traditionally, because attorney charges are specifically accounted for, the SFPUC scrutinizes these charges so they can be directly reassigned. For example, if attorney time was specific to Waste Water activities, those charges would be reassigned from the GM’s Office to Waste Water (i.e., removed from the wholesale revenue requirement). If detailed records are kept concerning where attorneys charge their time, why is it that of the $1.5M in attorney time charged to the GM’s office, $1.1M was deemed to be unassignable on a direct basis?

7. **Clarification of Audit Errors.** The auditor’s FY08-09 management letter states that four Hetchy expenses were charged to the wrong sub-activity. By sub-activity, are you referring to divisional or sectional activities within HH, index codes, or the actual classification (joint, power, or water). Please explain. What did these expenses entail, how was the mistake detected, and was the mistake confined to one index code or several? What procedures has the SFPUC taken to prevent this from occurring in the future?

8. **Clarification of PEIR Expenses.** Prior correspondence with Bill Laws indicated that the cost of the PEIR would be expensed for FY 2008-09 rather than allocated among various WSIP projects and repaid through our share of debt service. According to SFPUC documents, the PEIR was completed on June 30, 2009 at a cost of $10,732,619 yet it would appear this expense was not included in the wholesale revenue requirement for FY 2008-09. Please confirm whether the expense has been included or not. If included, how was it classified/allocated? If not included, how and when does the SFPUC intend to allocate PEIR costs?

In addition to the eight items mentioned above, the following ten issues were previously brought to the attention of the SFPUC in connection with FY2007-08 that also impacted FY2008-09. Except for item #14, the SFPUC has previously indicated that these
expenses were classified in error and an adjustment would be calculated. With respect to item #14, BAWSCA maintains that the inclusion of any costs in the wholesale revenue requirement for the City’s 311 service is cost that should be borne by in-City retail customers only.

9. Westside Groundwater Basin/Lake Merced Management expenses
10. Water Audit expenses for SF’s Park and Recreation Department
11. Training monies for City Water Audit Program
12. Expenses for maintaining the City’s steam system
13. Expenses for backflow prevention for city fire hydrants
14. Expenses related to San Francisco’s 311 services
15. Expenses related to City’s Greening Director
16. Expenses related to SF School District Climate Change Manager
17. Expenses related to SF School District Director of Environmental Initiatives
18. Expenses related to Urban Forestry Program