

**CITY OF SAN DIEGO PUBLIC
UTILITIES DEPARTMENT**

Schedule of Allocation for Billing to Metropolitan
Wastewater Utility and Independent Auditor's Reports

For the Fiscal Year Ended June 30, 2015



Certified
Public
Accountants

CITY OF SAN DIEGO PUBLIC UTILITIES DEPARTMENT
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and Independent Auditor’s Reports
For the Fiscal Year Ended June 30, 2015

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Independent Auditor's Report on the Schedule of Allocation for Billing to Metropolitan Wastewater Utility

To the Honorable Mayor and City
Council of the City of San Diego
San Diego, California

Report on the Schedule

We have audited the accompanying Schedule of Allocation for Billing to Metropolitan Wastewater Utility (the Schedule) of the City of San Diego Public Utilities Department (PUD), an enterprise fund of the City of San Diego, California (the City) for the fiscal year ended June 30, 2015, and the related notes to the Schedule.

Management's Responsibility for the Schedule

Management is responsible for the preparation and fair presentation of the Schedule in accordance with the modified cash basis of accounting described in Note 3, this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the Schedule in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the Schedule that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the Schedule based on our audit. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Schedule is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Schedule. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Schedule in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the Schedule.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the Schedule referred to above presents fairly, in all material respects, the modified cash basis allocation of billing to the Metropolitan Wastewater Utility of the PUD pursuant to the Regional Wastewater Disposal Agreement (Agreement) between the City and the Participating Agencies in the Metropolitan Wastewater System dated May 18, 1998 and amended on May 15, 2000 and June 3, 2010, for the fiscal year ended June 30, 2015, in accordance with the modified cash basis of accounting described in Note 3.

Basis of Accounting

We draw attention to Note 3 of the Schedule, which describes the basis of accounting. The Schedule is prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 27, 2017 on our consideration of the PUD's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over the Schedule and compliance and the results of that testing, and not to provide an opinion on internal control over the Schedule or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the PUD's internal control over the Schedule and compliance.



San Diego, California
February 27, 2017

CITY OF SAN DIEGO PUBLIC UTILITIES DEPARTMENT
Schedule of Allocation for Billing to Metropolitan Wastewater Utility
For the Fiscal Year Ended June 30, 2015

	Municipal System	Metropolitan System	Total
Transmission			
Main Cleaning	\$ 13,427,224	\$ -	\$ 13,427,224
Sewer Pump Stations.....	5,350,642	-	5,350,642
Other Pump Stations.....	6,276,302	956,471	7,232,773
Pump Station 1.....	-	2,417,436	2,417,436
Pump Station 2.....	-	9,268,862	9,268,862
Other Muni Agencies.....	3,409,824	-	3,409,824
Pipeline Maintenance & Repair.....	10,812,465	272,459	11,084,924
Wastewater Collection (WWC) Engineering & Planning.....	2,411,771	-	2,411,771
Total Transmission.....	41,688,228	12,915,228	54,603,456
Treatment and Disposal			
Point Loma Wastewater Treatment Plan (PTLWWTP).....	-	23,094,771	23,094,771
North City Water Reclamation Plant (NCWRP).....	-	9,282,399	9,282,399
South Bay Water Reclamation Plant (SBWRP).....	-	8,053,400	8,053,400
Metropolitan Biosolids Center (MBC).....	-	15,994,140	15,994,140
Cogeneration Facilities.....	-	314,652	314,652
Gas Utilization Facility (GUF).....	-	1,968,647	1,968,647
Wastewater Treatment and Disposal (WWTD) Plant Engineering.....	-	607,557	607,557
Total Treatment and Disposal.....	-	59,315,566	59,315,566
Quality Control			
Sewage Testing & Control.....	2,555,079	434,786	2,989,865
Marine Biology & Ocean Operations.....	936	5,301,034	5,301,970
Wastewater Chemistry Services.....	20	5,555,336	5,555,356
Industrial Permitting & Compliance.....	3,429,905	-	3,429,905
Total Quality Control.....	5,985,940	11,291,156	17,277,096
Engineering			
Program Management & Review.....	3,670,613	6,156,690	9,827,303
Environmental Support.....	1,622,536	272,640	1,895,176
Total Engineering.....	5,293,149	6,429,330	11,722,479
Operational Support			
Central Support: Clean Water Operations Management Network (Comnet).....	105,430	3,505,550	3,610,980
Operational Support.....	1,470,789	6,424,991	7,895,780
Total Operational Support.....	1,576,219	9,930,541	11,506,760
General & Administrative			
Business Support Admin.....	19,963,565	18,390,969	38,354,534
Operating Division Admin.....	6,601,682	5,765,703	12,367,385
Total General & Administrative.....	26,565,247	24,156,672	50,721,919
TOTAL OPERATING EXPENSES.....	81,108,783	124,038,493	205,147,276
CAPITAL IMPROVEMENT EXPENSE.....	75,690,945	22,262,192	97,953,137
DEBT SERVICE ALLOCATION.....	49,463,726	55,591,786	105,055,512
METROPOLITAN SYSTEM INCOME CREDITS.....			
Operating Revenue.....	-	(6,323,189)	(6,323,189)
CIP - Revenue Bond Issue.....	-	-	-
Operating - Grant Revenue.....	-	-	-
CIP - Grant/SRF Revenue.....	-	(3,696,984)	(3,696,984)
TOTAL METROPOLITAN SYSTEM INCOME CREDITS.....	-	(10,020,173)	(10,020,173)
TOTAL ALLOCATION FOR BILLING PURPOSES.....	\$ 206,263,454	\$ 191,872,298	\$ 398,135,752

See Accompanying Notes to the Schedule of Allocation for Billing to Metropolitan Wastewater Utility.

CITY OF SAN DIEGO PUBLIC UTILITIES DEPARTMENT
Notes to the Schedule of Allocation for Billing to Metropolitan Wastewater Utility
For the Fiscal Year Ended June 30, 2015

Note 1 – General

The City of San Diego Public Utilities Department (the PUD) operates and maintains the Metropolitan Wastewater System (the Metropolitan System) and the Municipal Wastewater Collection System (the Municipal System). The Participating Agencies and the City of San Diego (the City) have entered into the Regional Wastewater Disposal Agreement dated May 18, 1998 and amended on May 15, 2000 and June 3, 2010, for their respective share of usage and upkeep of the Metropolitan Wastewater Utility. The accompanying Schedule of Allocation for Billing to Metropolitan Wastewater Utility (the Schedule), represents the allocation of expenses for billing related to the Metropolitan Wastewater Utility of the Participating Agencies.

The Metropolitan System and Municipal System are accounted for as enterprise funds and reported in the Sewer Utility Fund in the City’s Comprehensive Annual Financial Report.

Note 2 – Participating Agencies

The Participating Agencies consist of the following municipalities and districts:

City of Chula Vista	City of National City
City of Coronado	City of Poway
City of Del Mar	Lemon Grove Sanitation District
City of El Cajon	Otay Water District
City of Imperial Beach	Padre Dam Municipal Water District
City of La Mesa	San Diego County Sanitation District

Note 3 – Summary of Significant Accounting Policies

Basis of Presentation

The Schedule has been prepared for the purpose of complying with the Regional Wastewater Disposal Agreement between the City and the Participating Agencies as discussed in Note 1 above, and is presented on a modified cash basis of accounting. As a result, the Schedule is not intended to be a presentation of the changes in the financial position of the City or the PUD in conformity with generally accepted accounting principles. The more significant differences are:

1. Purchases of capital assets are presented as capital improvement expenses.
2. Depreciation expense on capital assets is not reported in the Schedule.
3. Payments of principal and interest related to long-term debt are reported as debt service allocation.
4. Exclusion in the Schedule for unbudgeted expenses related to compensated absences, liability claims, capitalized interest, pollution remediation, other postemployment benefits, net pension obligation, and landfill closure and postclosure care costs.

The preparation of the Schedule requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

CITY OF SAN DIEGO PUBLIC UTILITIES DEPARTMENT

Notes to the Schedule of Allocation for Billing to Metropolitan Wastewater Utility (Continued)
For the Fiscal Year Ended June 30, 2015

Note 4 – Capital Improvement Expense

Construction costs incurred during the fiscal year to maintain and improve the Metropolitan Wastewater Utility and equipment purchases used in the maintenance of the Metropolitan Wastewater Utility are included in capital improvement expense.

Metropolitan Wastewater Utility capital improvement income credits include, if any, contributions-in-aid-of-construction received from Federal and State granting agencies and reimbursements from bond proceeds.

Note 5 – Debt Service Allocation

Debt service allocation represents a portion of the principal and interest payments relating to the Senior Sewer Revenue Bonds Series 2009A, the Senior Sewer Revenue Refunding Bonds Series 2009B and 2010A, and the outstanding State Revolving Fund (SRF) loans from the State of California.

Note 6 – Metropolitan System Income Credits

Metropolitan System income credits are revenues earned by the Metropolitan System for costs incurred during the current or previous fiscal years. The PUD has agreed to share the income credits from the South Bay Water Reclamation Facility in accordance with the 1998 Regional Wastewater Disposal Agreement. An agreement was reached in fiscal year 2015 regarding revenue generated from the South Bay Water Reclamation Facility and revenue sharing payments were issued for the fiscal years from 2006 through 2014 to Participating Agencies. Revenue sharing payments for fiscal year 2015 of approximately \$1.2 million, were transferred from the Water Fund to the Metro Fund in the fiscal year 2016 and are not included in the Schedule.

Note 7 – Total Allocation for Billing Purposes

Costs to be billed to Participating Agencies include all individual construction projects costs and operation and maintenance expenses attributable to the Metropolitan System. Costs are apportioned back to the Participating Agencies based on their percentage of each of the totals of flow, suspended solids and chemical oxygen demand (COD). Each Participating Agency and the City are sampled quarterly, with plants sampled daily. Beginning in fiscal year 2014, the percentages were determined from a new sample data set taken during the fiscal year and annual monitored flow.

For construction projects, percentages were allocated to flow, suspended solids and COD based on each of the project's design and function. The percentages are weighted by total project costs and combined to determine the final three derived percentages. Total annual costs are then allocated based on the three derived percentages and the measured flow, suspended solids and COD of each Participating Agency.

Operation and maintenance (O&M) costs as a percentage of flow, suspended solids and COD are evaluated based on four cost categories: pump stations, plant operations, technical services and cogeneration. These percentages are weighted by the annual O&M costs for each category, and combined to determine a derived percentage for administrative costs. All O&M costs are then allocated based on the measured flow, suspended solids and COD of each Participating Agency.

CITY OF SAN DIEGO PUBLIC UTILITIES DEPARTMENT

Notes to the Schedule of Allocation for Billing to Metropolitan Wastewater Utility (Continued)

For the Fiscal Year Ended June 30, 2015

Note 8 – Administrative Protocol

In May 2010, the City of San Diego and all Participating Agencies signatory to the Regional Wastewater Disposal Agreement established an Administrative Protocol (Protocol) which was effective beginning in fiscal year 2010. The Protocol established a requirement that the Participating Agencies maintain a 1.2 debt service coverage ratio on parity debt, fund a 45-day operating reserve, and earn interest on the operating and unrestricted reserve accounts. All interest earned during fiscal year 2015 was credited to the operating reserve, which ended the fiscal year with a 45-day reserve.



Independent Auditor’s Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Schedule of Allocation for Billing to Metropolitan Wastewater Utility Performed in Accordance with *Government Auditing Standards*

To the Honorable Mayor and City
Council of the City of San Diego
San Diego, California

We have audited, 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, the Schedule of Allocation for Billing to Metropolitan Wastewater Utility (the Schedule) of the City of San Diego Public Utilities Department (PUD), an enterprise fund of the City of San Diego, California (the City), for the fiscal year ended June 30, 2015, and the related notes to the Schedule, and have issued our report thereon dated February 27, 2017. Our report contained an explanatory paragraph indicating that the Schedule was prepared for the purpose of complying with, and in conformity with, the accounting practices prescribed by the Regional Wastewater Disposal Agreement between the City of San Diego and the Participating Agencies in the Metropolitan Wastewater System dated May 18, 1998 and amended on May 15, 2000 and June 3, 2010.

Internal Control over Financial Reporting

In planning and performing our audit of the Schedule, we considered the PUD’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the Schedule, but not for the purpose of expressing an opinion on the effectiveness of the PUD’s internal control. Accordingly, we do not express an opinion on the effectiveness of the PUD’s internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a certain deficiency in internal control, described in the accompanying schedule of finding and response as item 2015-001 that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the PUD's Schedule is free from 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 schedule 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*.

City of San Diego Public Utility Department's Response to Finding

The PUD's response to the finding identified in our audit is described in the accompanying schedule of finding and response. The PUD's response was not subjected to the auditing procedures applied in the audit of the schedule and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Macias Gini & O'Connell LLP". The signature is written in a cursive, slightly slanted style.

San Diego, California
February 27, 2017

CITY OF SAN DIEGO PUBLIC UTILITIES DEPARTMENT

Schedule of Finding and Response
For the Fiscal Year Ended June 30, 2015

2015-001 Preparation of Schedule of Allocation for Billing to the Metropolitan System (Schedule)

Criteria

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Condition

To substantiate the completeness and accuracy of the Schedule, we performed a reconciliation of the total operating expenses recorded in the Sewer Fund as reported in the City's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2015, to the expenses reported in the Schedule, and noted a reconciling item relating to the State Revolving Fund (SRF) loan payment transfer in the amount of \$7,609,804 that was erroneously included in the Schedule.

The inclusion of the SRF loan payment transfer transaction in the Schedule resulted in amounts, as originally reported, for "Total Allocation for Billing Purposes" of \$207,814,043 for the Municipal System and \$197,931,513 for the Metropolitan System.

Cause

In fiscal year 2015, the Office of the City Comptroller (Comptroller's Office) implemented new procedures related to debt service payments recorded in the Sewer Fund for financial reporting preparation. The new procedure requires the elimination of account numbers associated with the transfer of SRF loan payments in the process of preparing the Schedule.

Elimination of SRF loan payment transfer recorded in account numbers 516032 and 516033 was overlooked during the preparation of the Schedule.

Effect

Due to the inclusion of the SRF loan payment transfer transactions, amounts originally reported as "Total Allocation for Billing Purposes" in the Schedule were overstated by \$7,609,804, and as a result the Schedule reflected that the participating agencies had underpaid by \$391,628 for the fiscal year ended June 30, 2015.

However, after the adjustment to the Schedule eliminating the recording and effect of the SRF loan payment transfer, the final "Total Allocation for Billing Purposes" amounts reported were \$206,263,454 for the Municipal System and \$191,872,298 for the Metropolitan System, resulting in an overpayment by the participating agencies of \$1,169,021 for the fiscal year ended June 30, 2015.

Recommendation

We recommend that the Comptroller's Office and PUD collaborate and improve upon their established review procedures of all financial schedules generated from the SAP financial accounting system used in the preparation of the Schedule. Procedures and processes should be re-evaluated to determine whether changes are necessary which provide greater assurance that errors, which could be material to the Schedule, are prevented, or detected and corrected.

CITY OF SAN DIEGO PUBLIC UTILITIES DEPARTMENT

Schedule of Finding and Response (Continued)

For the Fiscal Year Ended June 30, 2015

Furthermore, there could be improved communication between the Comptroller's Office and PUD regarding the completeness and accuracy of the Schedule, as well as high-level analytical review by responsible management concerning the overall reasonableness of the Schedule.

Management Response

The Comptroller's Office and PUD agree with the recommendations. The audit finding by MGO occurred during the PUD and Comptroller's Office continuing review of Exhibit E billing allocation. PUD and the Comptroller's Office provided MGO with the annual schedule of applicable costs; however, PUD and Comptroller's Office management subsequently identified a potential issue as anticipated billings did not match with actual calculations. PUD and the Comptroller's Office were continuing to research the cause when MGO identified the issue regarding the SRF loan payment that had been included erroneously. Both PUD and the Comptroller's Office have identified process improvements and internal controls that help address this specific issue that occurred in the FY 2015 Exhibit E preparation in addition to other internal controls improvement; including:

- PUD and Comptroller's Office Deputy Director or appropriate level designee review and approve prior to submitting finalized information to MGO;
- Greater collaboration among Comptroller's Office and PUD staff responsible for Exhibit E preparation, to include monthly onsite staffing by the Comptroller's Office at PUD's main facility at a minimum;
- Improved timeline clarity between PUD / Comptroller's Office / MGO as to specific deliverables, timelines, review period, etc.
- Documentation of significant process workflows through a series of work instructions, with an annual review to identify any changes to the procedures.

The establishment of these additional controls will specifically address process workflow and improvement between PUD and the Comptroller's Office, in addition to aiding MGO in finalizing the audited review of fiscal year information.