San Francisco
Water Power Sewer
Services of the San Francisco Public Utilities Commission

525 Golden Gate Avenue, 13th Floor
San Francisco, CA 94102
T 415.934.5707
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Date: November 28, 2023

To: Commissioner Tim Paulson, President
Commissioner Anthony Rivera, Vice President
Commissioner Newsha K. Ajami
Commissioner Sophie Maxwell
Commissioner Kate H. Stacy

Through: Dennis J. Herrera, General Manager

From: Nancy L. Hom, Chief Financial Officer and Assistant General Manager, Business Services

Subject: FY 2023-24 Q1 Audit and Performance Review Report

This memorandum summarizes the San Francisco Public Utilities Commission (SFPUC) Quarterly Audit and Performance Review (QAPR) report for the first quarter of FY 2023-24, ending September 30th, 2023.

I. Completed Audits

There were ten completed audits during the first quarter of FY 2023-24:

1. 2022 Post Audit | July 13, 2023
   Report Link: https://tinyurl.com/2bv2uwnf

   Report Summary: The Controller's Office performs the Post Audit to examine the effectiveness of the design and implementation of each department's accounting and internal control practices and compliance with City laws, regulations, and policies.

   Audit Findings Summary: The post audit highlighted SFPUC's strengths in clearing unidentified receipts and in documentation related to budget entries, journal entries, and processes and procedures. Areas for improvement were identified in the processing of expense reports and purchases and payables. In response to the audit, SFPUC staff will continue to evaluate opportunities to promote and improve compliance with particular focus on areas highlighted in the findings.

2. FY 2022-23 Cybersecurity Maturity Assessment | July 13, 2023
Report is confidential.

Report Summary: The City Services Auditor (CSA) assessed SFPUC's cybersecurity maturity level based on the National Institute of Standards and Technology (NIST) cybersecurity framework. The assessment is mandated by the Committee on Information Technology (COIT) cybersecurity policy.

Audit Findings Summary: SFPUC scored a "3.1" out of a possible "4.0" where a higher score indicates higher maturity. SFPUC continues to improve its cybersecurity program and bolster its cyber infrastructure.

3. Chapter 14B Local Business Enterprise Compliance Audit | August 8, 2023
Report Link: https://tinyurl.com/4u8w5hpn

Report Summary: The Controller's Office engaged Sjoberg Evashenk Consulting, Inc. to assess whether three randomly selected contractors and two joint ventures disclosed all subcontractors, met their LBE participation commitments, submitted all required CMD forms, and whether contracts were adequately monitored for LBE compliance.

Audit Findings Summary: There were no findings related to the administration of SFPUC contracts, and SFPUC's SOLIS system was recognized as a safeguard against Form 7 and Form 9 noncompliance.

4. SFPUC Revenue Bond Programs Audit: Phase II | August 30, 2023
Report Link: https://tinyurl.com/3fpbv7uy

Report Summary: The SFPUC Revenue Bond Oversight Committee (RBOC) engaged HKA Global, Inc. and Yano Accountancy Corporation through the Controller's Office City Services Auditor to audit six bond series subject to their oversight. The objective of the audit was to determine whether revenue bond funds were spent appropriately.

Audit Findings Summary: The two findings involved non-completion of impartiality and confidentiality statements by individuals associated with procurements, and lack of quantification and reporting on overhead rates charged for SFPW sewer engineering activities. Of the three recommendations, SFPUC partially concurred with one and did not concur with the remaining two.

5. Wholesale Revenue Requirement: Statement of Changes in Balancing Account, FY 2020-21 | September 13, 2023
Report Link: https://tinyurl.com/49djfuwf

Report Summary: Third-party auditors KPMG LLP and Yano Accountancy Corporation performed the annual audit, as required by the Water Supply Agreement with Wholesale Water Customers, to review the allocation of operating and capital costs among retail and wholesale water customers.

Audit Findings Summary: The report contains four observations related to misclassified expenditures; the SFPUC concurred and recorded audit adjustments and changed related disclosures.

- The wholesale share of capital cost contribution – new regional assets – debt-funded was not summarized correctly, resulting in a $26,387,000 misstatement in the Balancing Account as of June 30, 2021. SFPUC recorded an audit adjustment to the Balancing Account of $26,387,000 in favor of the Retail Customers.

- The wholesale share of actual revenue-funded capital expenditures was misstated by $1,152,000. SFPUC recorded an audit adjustment of $1,152,000 in favor of the Wholesale Customers.
- The overall wholesale revenue requirement was misstated by $235,000 because SFPUC did not calculate the Proportional Annual Use (PAU) and Adjusted Proportional Annual Use (APAU) percentages correctly. SFPUC and the Wholesale Customers jointly investigated the discrepancy and agreed on adjusted higher PAU and APAU percentages. SFPUC recorded an audit adjustment to the Balancing Account of $235,000 in favor of the Retail Customers.
- The paid time off adjustment was not calculated correctly, resulting in a $34,000 misstatement in the Balancing Account as of June 30, 2021. SFPUC recorded an audit adjustment to the Balancing Account of $34,000 in favor of the Wholesale Customers.

Total audit adjustments recorded by SFPUC were $25,436,000 in favor of the Retail Customers.

The cause of the first, third, and fourth observations was determined to be inadequate controls over spreadsheet calculations to ensure their accuracy, while the cause of the second observation was determined to be inadequate review of the general ledger to determine which amounts should be recorded as revenue-funded capital expenditures.

6-10. FY 2022-23 Warehouse Inventory Counts | September 15, 2023
Report Link: https://tinyurl.com/5t44nzcn

Report Summary: The SFPUC engaged third-party auditor Crowe, LLP (Crowe) to perform FY 2022-23 physical inventory counts at locations in Millbrae, Sunol Yard, Hetchy Power In-City, Moccasin, Wastewater Southeast, City Distribution Division (CDD), and Auxiliary Water Supply System (AWSS).

Audit Findings Summary: The audits found variances between the physical count and the amounts reported in the inventory system (Maximo). The observed variances were attributed primarily to:

- Issues with the automated fuel tracking system
- Miscounts, double counts, or other errors in data entry
- Inventory updates not posted to Maximo in a timely fashion
- Items not labeled or organized in a manner conducive to inventory counting

Management concurred with the recommendations and provided additional detail regarding mitigating actions.

II. Audit Recommendation Status

As of 9/30/23, 23 audit recommendations are open for two audits: the SSIP CS-165 Program Management Contract Audit and the Crystal Springs Golf Partners, LP Revenue Lease Audit.

If you have questions, please contact me at NHom@sfwater.org or Irella Blackwood at iblackwood@sfwater.org.

Attachment: FY 2023-24 Audit Plan, By Status

CC: Ronald P. Flynn, Deputy General Manager
Irella Blackwood, Audit Bureau Director
Sheryl Bregman, SFPUC Counsel, Office of the City Attorney

Quarterly Audit & Performance Review Report
FY 2023-24 Audit Plan, By Status
As of September 30, 2023

San Francisco Water Power Sewer
Services of the San Francisco Public Utilities Commission

Status	
Completed:	10
In Progress:	10
Upcoming:	10
Total:	30

#	Quarter Status	Audit Type	Enterprise / Bureau	Audit Name	Oversight Body
1	**[Updated]** Completed	Financial	Business Services, Finance	Wholesale Revenue Requirement: Statement of Changes in Balancing Account, FY 2020-21	BAWSCA
2	**[Updated]** Completed	Financial	Business Services, Finance	Post Audit, CY 2022	Controller
3-7	**[Updated]** Completed	Financial	Water	Annual Physical Inventory Count, FY 2022-23	SFPUC, Finance
	[Updated] Completed	Financial	Wastewater		
	[Updated] Completed	Financial	Hetch Hetchy Water & Power		
8	**[Updated]** In Progress	Financial	Water	Audited Financial Statements, FY 2022-23	Controller
9	**[Updated]** In Progress	Financial	Wastewater		
10	**[Updated]** In Progress	Financial	Hetch Hetchy Water & Power & CleanPowerSF		
11	**[Updated]** In Progress	Financial	Power	2021 CAPP Audit	CA Community Services Division
12	In Progress	Financial	Business Services, Finance	Wholesale Revenue Requirement: Statement of Changes in Balancing Account, FY 2021-22	BAWSCA
13	**[Updated]** Upcoming	Financial	Business Services, Finance	Wholesale Revenue Requirement: Statement of Changes in Balancing Account, FY 2022-23	BAWSCA
14	**[Updated]** Upcoming	Financial	Business Services, Finance	Annual Comprehensive Financial Report, FY 2022-23	SFPUC
15	**[Updated]** Upcoming	Financial	Business Services, Finance	Single Audit (OMB Circular A-133), FY 2022-23	OMB
16	**[Updated]** Upcoming	Financial	Business Services, Finance	Popular Annual Financial Report, FY 2022-23	SFPUC
17	**[Updated]** Upcoming	Financial	Water	Interim Financial Statements, FY 2023-24	Controller
18	**[Updated]** Upcoming	Financial	Wastewater		
19	**[Updated]** Upcoming	Financial	Hetch Hetchy Water & Power & CleanPowerSF		

#	Quarter Status	Audit Type	Enterprise / Bureau	Audit Name	Oversight Body
20	**[Updated]** Completed	Performance	Contracts Administration Bureau	Chapter 14B LBE Audit	CSA, Controller
21	**[Updated]** Completed	Performance	Business Services, ITS	Cybersecurity Maturity Assessment, FY 2022-23	CSA, Controller
22	**[Updated]** In Progress	Performance	Hetch Hetchy Water & Power	Critical Infrastructure Protection and Operations and Planning Reliability Standards Audit	WECC / NERC
23	**[Updated]** In Progress	Performance	Business Services, ITS	Interconnection Security Agreement, FY 2022-23	CSA, Controller
24	In Progress	Performance	Infrastructure	Public Integrity Assessment: SOLIS Procurement	CSA, Controller
25	In Progress	Performance	All SFPUC	SFPUC Chapter 6 Delegated Authority Audit	BOS
26	In Progress	Performance	All SFPUC	BLA Conflicts of Interest Audit	BOS
27	**[Updated]** Upcoming	Performance	Customer Services Bureau	Customer Assistance Program Post-Enrollment Verification	BOS
28	Upcoming	Concessions, Lease Revenue	Real Estate Services	Revenue Lease Audit: Mission Valley Rock	CSA, Controller
29	**[Updated]** Completed	Revenue Bond Oversight Committee	RBOC	SFPUC Revenue Bond Programs Audit: Phase II	RBOC
30	Upcoming	Revenue Bond Oversight Committee	RBOC	SFPUC Revenue Bond Programs Audit: Phase III	RBOC

CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Todd Rydstrom
Deputy Controller

DATE: July 13, 2023

TO: Dennis Herrera, General Manager, Public Utilities Commission

FROM: Ben Rosenfield, Controller

SUBJECT: **Results of CY2022 Post Audit & Continuous Monitoring Program**

Thank you for your staff's support of the Controller's continuous monitoring and post audit program. This letter summarizes the audit work completed and explains observations that may have been found during that work. We recognize the extra work and resources required to collect the subject documentation, especially under these extraordinary circumstances, and we truly appreciate your department's effort and assistance.

Department Financial Activity Highlights:

Financial Activity	Fiscal Year 2020		Fiscal Year 2021		Fiscal Year 2022	
	Count	Amount	Count	Amount	Count	Amount
Voucher	34,778	1,294,034,712.40	33,409	1,588,215,434.88	33,546	1,622,368,235.70
Expense Report	1,310	570,348.33	994	184,424.25	869	210,397.36
GL Journal	5,038	29,443,732,999.71	5,074	23,145,784,893.40	5,262	30,660,350,651.21
KK Journal	1,678	10,712,127,138.35	1,717	11,736,739,230.79	1,740	12,810,672,792.25
Purchase Order	11,075	181,812,100.90	8,303	160,968,291.09	8,068	270,421,420.00
Accounts Receivable	5,748	668,503,874.43	5,147	1,965,463,122.99	6,812	2,004,061,324.43
Totals	59,627	42,300,781,174.12	54,644	38,597,355,397.41	56,297	47,368,084,820.95

Program Overview

The continuous monitoring and post audit program are designed to help assess each department's accounting and internal control practices and compliance with City laws, regulations, and policies. The monthly monitoring reports that we send you or your staff provide regular feedback about processing in your department. They can help identify areas that are working well and highlight those that may need immediate attention for change and improvement.

Post-Audit Approach

The post audit examines the effectiveness of the design and implementation of each department's internal control. This year, a risk-based approach was used to determine the transaction cycles selected for testing. Each department was assigned a departmental risk level for each transaction cycle based on the materiality of the department's operations to the City's financial reporting objectives. This was done primarily on the magnitude, volume, and complexity of the department's transactions, and adjusted for factors such as separate reporting funds and new systems, personnel, or management. Departments with more transactions, higher dollar amounts, more complex transactions, and separate financial statements were assigned a higher risk. The assessment of inherent risk is used to design audit procedures and is not a reflection on your department's management or performance.

Financial transactions were selected for analysis and testing on a risk basis. Documentation provided by your department as well as preliminary inquiries of key personnel were used to evaluate the adequacy of the design of the controls on selected cycles. Subsequent testing was used to evaluate the adequacy of the implementation of the controls. In all cases, the existence of citywide controls and potential compensating controls are considered in the evaluation.

Procedures

Our audit team:

- Reviewed your response to our internal control questionnaire
- Reviewed your continuous monitoring results
- Reviewed your prior year's post audit results and your response
- Examined your written policies and procedures pertaining to the audit areas
- Interviewed key staff members to understand the design of controls

Strengths

The following areas are highlighted as your strengths. Your cooperation in timely preparation and organization of backup documentation contributed to an efficient post audit. The Controller's Office thanks you for your prompt response to our inquiries throughout the duration of the post audit.

1. **Documentation.** Your department provided processes and procedures for all requested cycles for this post audit. This demonstrates commitment by management to implement an effective system of internal controls.
2. **Promptly Clearing Unidentified Receipts.** Your department has maintained performance with no exception in this area.
3. **Budget Entry Documents.** Your department has maintained performance with no findings in this area.
4. **Journal Entry Documents.** Your department has maintained performance with no findings in this area.

Areas for Improvement

Based on the test work performed, there were certain areas that were found to need improvement or requested documentation was not received. Specific areas include:

1. **Purchasing & Payables Processing.** Ten invoices we reviewed were paid untimely and did not take advantage of the supplier's discount terms resulting in lost discount. Also, two invoices were paid within 30 days from invoice receipt but did not take advantage of the supplier's discount terms. The department should ensure that invoices are processed following City's prompt payment rule of 30 days and within the discount terms. See Appendix A, Transaction Documentation for details.

2. **Expense Reports Processing.** One employee reimbursement for food exceeded Controller's threshold of $200 per single vendor and should have gone through the procurement process. We recommend the department remind employees of the Controller's guidelines to ensure reimbursements fall within the policy. See Appendix A, Transaction Documentation for details.

Summaries of all higher risk findings are presented in **Appendix A: Fieldwork Test Results** on page 4, **Appendix B: Grant Administration** on page 8, and **Appendix C: P Card** on page 9.

Year-End Close

An ongoing goal of the Controller's office is to have a well-managed process for CCSF's Year-End Close. To accomplish this goal, departments must meet the year-end schedule, respond promptly to Controller's request for information and required actions. This ensures that the processes for the issuance of our Annual Comprehensive Financial Report (ACFR) provides financial data integrity, accuracy, and timeliness. Below is your department's last three year's statistics on budget and journal entries submitted after the month 13 deadline and deleted vouchers that were not fully approved by the year-end deadline.

Financial Activity	Fiscal Year 2020		Fiscal Year 2021		Fiscal Year 2022	
	Count	Amount	Count	Amount	Count	Amount
Deleted Vouchers	141	4,873,413.82	32	1,718,100.54	58	2,001,160.95
GL submitted after year-end deadline	4	8,849,379.46	1	18,630,319.28	2	27,906,130.56
KK submitted after year-end deadline	-	-	-	-	2	18,604,087.04

Follow-up

A detailed audit matrix that reflects test work for each area of the Post Audit was provided to the Department's Controller and discussed at the exit conference. We have not removed findings which we believe are valid although your staff may disagree. In those cases, we have communicated our reasons for retaining the finding to your staff and included any comments in the appendices.

By September 15, 2023, please provide us with a response for the observations that were reported above. If you have any questions about the audit or this report, please call Jocelyn Quintos at 415-554-6609 or Lilly Ting at 415-554-7567.

Cc: Nancy Hom, Chief Financial Officer / Assistant General Manager, Business Services
Laura Busch, Acting Deputy Chief Financial Officer
Vivian Chen, Accounting Services Director
Sailaja Kurella, Director, Office of Contract Administration
Jocelyn Quintos, Director of Accounting Operations and Supplier, Controller's Office

Appendix A: Fieldwork Test Results

Overview

Communication, documentation, and monitoring of compliance are critical elements of every sound financial system, and policies and procedures are an essential part of establishing internal controls. For this year's post audit, departments were asked to respond to an internal control questionnaire and submit copies of their policies and procedures for the basic accounting cycles, submit selected transaction documentation for review and to conduct walkthroughs on accounting cycle procedures.

Internal Control

While it was not within the scope of this audit to perform an extensive internal control review, the status of procedure documentation your department has submitted on requested cycles is below.

Cycle	Status
Cash Handling	Received
Revenue and Receivables	Received
Purchasing & Payables	Received
Payroll	Received
Grants	Not Received. Department follows Controller's Policies.
Journal Entries & Financial Closing	Received
Budget Changes	Not Received. Department follows Controller's Policies.
Debt	Received
Fixed Assets	Received
Inventory	Received
Trustee Accounts	Received
Claims	N/A

Transaction Documentation
The following documents were selected for review, document numbers in bold indicate issues found. Please find our observations below.

Purchasing & Payables		Findings and Recommendation
Hetch Hetchy 01942880 02022626 02050328 **02051742** 02126657 02136038 02165311 02187524 02263074 **02302907** **02306785** **02308503** **Water** 01942880 01943848 **01951563** 02021936 02026611 02026635 **02038595** 02086836 02205021 02221130 **02244923** 02251252 **02279319** 02283932 02326283 **CleanPower** 01946750 02128485 02165311	**PUC** 01942880 **02264214** **Wastewater** 01942880 **02045366** 02136038 **02148140** **02264214** 02275477 **02278094** 02304468 02324830	Our review found twelve higher risk items in this category. Ten vouchers we reviewed were paid more than 30 days after the invoices were received. Of the ten vouchers, eight voucher did not take advantage of the suppliers' payment discount terms and resulted in lost discounts due to late payment. We recommend the department review and update their payment procedures to ensure that invoices are paid within the City's prompt payment rule of 30 days. Ten vouchers, including the eight mentioned above failed to obtain the discount allowed from the vendor with total discount loss of $8,237.24. We recommend the department develop a tracking system to track payments with discount terms and to give these payments the priority when processing. Other minor findings related to these transactions were discussed with your staff.

Cash Receipts	Findings and Recommendation
Hetch Hetchy 218689 **252249** **PUC** No samples **Water** 208021 **Wastewater** 208021 **CleanPower** 207191 208215	Our review found one higher risk item in this category. One deposit was not recorded in PeopleSoft within 5 days after the actual deposits were processed to the bank. We recommend the Department to post cash receipts about the same time the money is deposited, at least within 5 calendar days, to ensure it is timely reflected in the financial system.

Journal Entry - Revenue & Receivable	Findings and Recommendation
Hetch Hetchy No samples **PUC** 0000468971 **Water** 0000466091 0000468971 0000483050 **Wastewater** 0000468971 0000483050 **CleanPower** No samples	Our review did not result in any findings for the documents selected.

Journal Entry - Year end	Findings and Recommendation
Hetch Hetchy 0000469999 0000481835 **PUC** No samples **Water** 0000476061 0000481835 **Wastewater** 0000476061 0000481835 **CleanPower** No samples	Our review did not result in any findings for the documents selected

Budget – Non-Year End	Findings and Recommendation
Hetch Hetchy 0000505413 **PUC** 0000426515 **Water** 0000467901 **Wastewater** No samples **CleanPower** No samples	Our review did not result in any findings for the documents selected.

Budget - Financial Closing	Findings and Recommendation
Hetch Hetchy No samples **PUC** No samples **Water** 0000479336 0000480071 **Wastewater** 0000487971 **CleanPower** No samples	Our review did not result in any findings for the documents selected.

Expense	Findings and Recommendation
Hetch Hetchy 0000084719 **PUC** 0000085284 **Water** **0000084912** 0000085870 **Wastewater** 0000089810 **CleanPower** No samples	Our review found one higher risk item in this category. One employee reimbursement was non-compliant with Controller reimbursement guidelines. Per Controller's Employee Reimbursement Guidelines, officers or employees may be reimbursed for reasonable work-related costs, minor and non-recurring goods up to $200 from any single vendor. One reimbursement request we reviewed exceeded the $200 maximum allowable amount. We recommend department to go through the procurement process and to remind employees of the Controller's guidelines to ensure reimbursements fall within the policy and reimburse only for reasonable work-related costs that encompass minor and non-recurring goods.

Appendix B: Grant Administration

The following grants were selected for review, below are our observations.

Grant Code & Title	Findings and Recommendation
CTR00002964 - SRF Headworks - 10015807	Our review did not result in any findings for the grant selected.

Appendix C: Procurement Card (P-Card)

Overview

The City Procurement Card (P-Card) program enables designated City employees to make authorized purchases during declared emergencies and for certain employee reimbursement items. All transactions should comply with both the citywide P-Card policy and your pre-approved departmental policy. P-Card purchases are monitored monthly and quarterly using reports available from PeopleSoft and US Bank. Departments must respond to all inquiries from the P-Card team and/or fund accountant to ensure that transactions are compliant and that any potential violations are reviewed and granted an exception.

Your department did not have any P Card process during our post audit period.

San Francisco
Water Power Sewer
Services of the San Francisco Public Utilities Commission

Financial Services Bureau
525 Golden Gate Avenue, 4th Floor
San Francisco, CA 94102

Date: September 5, 2023

To: Ben Rosenfield, Controller

Through: Dennis Herrera, General Manager

From: Nancy L. Hom, Chief Financial Officer, Assistant General Manager, Business Services

Subject: **Management Response to CY 2022 Post Audit Findings**

Thank you for your Post Audit Report dated July 13, 2023, detailing the results of the Calendar Year 2022 Post Audit & Continuous Monitoring Program. Controller's Office monitoring and review program is beneficial and supports SFPUC's enforcement of adherence and compliance to citywide policies and procedures. We greatly appreciate your highlights of our department's strengths, as well as the insightful observations noted in the report. SFPUC staff will continue to evaluate opportunities to promote and enhance compliance in the monitored areas, with particular emphasis on areas highlighted by recent findings. SFPUC's detailed responses and work plans follow:

A. Purchasing & Payables Processing

Findings	Response/Action Plan
Our review found twelve higher risk items in this category. Ten vouchers we reviewed were paid more than 30 days after the invoices were received. Of the ten vouchers, eight voucher did not take advantage of the suppliers' payment discount terms and resulted in lost discounts due to late payment. We recommend the department review and update their payment procedures to ensure that invoices are paid within the City's prompt payment rule of 30 days. Ten vouchers, including the eight mentioned above failed to obtain the discount allowed from the vendor with total discount loss of \$8,237.24. We recommend the department develop a tracking system to track payments with discount terms and to give these payments the priority when processing. Other minor findings related to these transactions were discussed with your staff.	SFPUC Accounting will continue to provide trainings to divisional purchasing and accounts payable staff of the City's Prompt Payment policy and the requirement to expedite payment processing on discounted invoices. The SFPUC's Accounts Payable GoPaperless system has embedded a systematic tracking of invoices requested to be expedited. Divisional staff are trained to select the checkbox "Expedited" for expeditious processing on discounted invoices. Staff are reminded to take discount whenever possible.

B. Cash Receipts

Findings	Response/Action Plan
Our review found one higher risk item in this category. One deposit was not recorded in PeopleSoft within 5 days after the actual deposits were processed to the bank. We recommend the Department to post cash receipts about the same time the money is deposited, at least within 5 calendar days, to ensure it is timely reflected in the financial system.	SFPUC has strictly followed Controller's Office and departmental policies to post cash receipts within 5 days. This delay is isolated due to staff unfamiliar with adjusting entry made in the newly implemented billing system, C2M, for power utility service. The staff was provided further training on this matter.

C. Expense

Findings	Response/Action Plan
Our review found one higher risk item in this category. One employee reimbursement was non-compliant with Controller reimbursement guidelines. Per Controller's Employee Reimbursement Guidelines, officers or employees may be reimbursed for reasonable work-related costs, minor and non-recurring goods up to $200 from any single vendor. One reimbursement request we reviewed exceeded the $200 maximum allowable amount. We recommend department to go through the procurement process and to remind employees of the Controller's guidelines to ensure reimbursements fall within the policy and reimburse only for reasonable work-related costs that encompass minor and non-recurring goods.	SFPUC will continue to provide trainings to employees to ensure compliance of Controller's Office policies and procedures. The employee and manager were notified to follow proper purchasing guideline for future food purchases.

SFPUC staff will carefully consider all other observations and recommendations for improvement in relation to this post-audit.

cc: Jocelyn Quintos, Director of Accounting Operations and Systems, Controller's Office
Sailaja Kurella, Director of Office of Contract Administration
Ronald P. Flynn, Deputy General Manager
Vivian Aiyi Chen, Deputy Chief Financial Officer
Irella C. Blackwood, Audit Director

Two of the Three Prime Contractors and One of the Two Joint Ventures Audited Did Not Fully Comply With Certain Provisions of Chapter 14B, the Local Business Enterprise Ordinance

Contract Monitoring Division

AUDITS DIVISION

August 8, 2023

City & County of San Francisco
Office of the Controller
City Services Auditor

About the Audits Division

The City Services Auditor (CSA) was created in the Office of the Controller through an amendment to the Charter of the City and County of San Francisco (City) that voters approved in November 2003. Within CSA, the Audits Division ensures the City's financial integrity and promotes efficient, effective, and accountable government by:

- Conducting performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of service delivery and business processes.
- Investigating reports received through its whistleblower hotline of fraud, waste, and abuse of city resources.
- Providing actionable recommendations to city leaders to promote and enhance accountability and improve the overall performance and efficiency of city government.

Team:
Winnie Woo, *Audit Manager*

Consultant:
Sjoberg Evashenk Consulting, Inc.

Mark de la Rosa
Director of Audits
Office of the Controller
City and County of San Francisco
(415) 554-7574

For media inquiries, please contact con.media@sfgov.org.

sf.gov/controller
@sfcontroller
LinkedIn Office of the Controller

Audit Authority

CSA conducted this audit under the authority of the San Francisco Charter, Section 3.105 and Appendix F, which requires that CSA conduct periodic, comprehensive financial and performance audits of city departments, services, and activities.

OFFICE OF THE CONTROLLER
CITY AND COUNTY OF SAN FRANCISCO

Ben Rosenfield
Controller

Todd Rydstrom
Deputy Controller

August 8, 2023

Stephanie Tang, Director
Office of the City Administrator – Contract Monitoring Division
1155 Market Street, 4th Floor
San Francisco, CA 94103

Dear Ms. Tang:

The Office of the Controller (Controller), City Services Auditor (CSA), Audits Division, presents its report on the audit of the contractor compliance with the San Francisco Administrative Code, Chapter 14B, Local Business Enterprise (LBE) Utilization and Non-Discrimination in Contracting Ordinance. The audit, conducted by Sjoberg Evashenk Consulting, Inc., (SEC), meets the ordinance's requirement that the Contract Monitoring Division (CMD) director, in cooperation with the Office of the Controller, randomly audit at least three contractors and 10 percent of joint ventures granted bid discounts in each fiscal year to ensure their compliance with the ordinance. The audit assessed whether the three selected contractors and two joint ventures disclosed all subcontractors, met their LBE participation commitments, submitted all required CMD forms, and whether contracts were adequately monitored for LBE compliance.

The audit found that all prime contractors and subcontractors were appropriately LBE-certified, as applicable, but two of the three prime contractors and one of the two joint ventures in our sample did not fully comply with certain LBE provisions of Administrative Code Chapter 14B. In particular:

- CMD and the Airport could not provide Form 7 or Form 9 payment information submitted on a construction contract and a professional services contract.
- One of the joint ventures did not disclose that non-LBE subconsultants did work under an Airport professional services contract.
- One prime contractor's LBE participation under an Airport construction contract could not be validated due to insufficient evidence of LBE subcontractor effort.
- Another prime contractor's LBE participation under a San Francisco Public Works construction contract could not be validated due to insufficient evidence of LBE subcontractor effort.

The report makes four recommendations for CMD to work with contracting departments to improve compliance with the ordinance. The responses of the departments are attached in the appendix. CSA will work with your department to follow up every six months on the status of the open recommendations made in this report.

CSA and SEC appreciate the assistance and cooperation of all staff involved in this audit. For questions about the report, please contact me at mark.p.delarosa@sfgov.org or 415-554-5393 or CSA at 415-554-7469.

Respectfully,

Mark de la Rosa
Director of Audits

cc: Board of Supervisors
Budget Analyst
Civil Grand Jury
Citizens Audit Review Board
City Attorney
Mayor
Public Library

City and County of San Francisco
Office of the Controller, City Services Auditor

Audit of Contractor Compliance With Chapter 14B-Local Business Enterprise (LBE) and Non-Discrimination in Contracting Ordinance

SJOBERG EVASHENK
CONSULTING, INC

455 Capitol Mall • Suite 700 • Sacramento, California • 95814 • Tel 916.443.1300 • www.secteam.com

Executive Summary

Purpose of the Audit

As required by the San Francisco Administrative Code, Chapter 14B, *Local Business Enterprise (LBE) and Non-Discrimination in Contracting* Ordinance, the Office of the Controller's City Services Auditor assessed whether the three selected contractors disclosed all subcontractors, met their LBE participation goals, and submitted all required Contract Monitoring Division (CMD) forms, and whether contracts were adequately monitored for LBE compliance.

Highlights

Pursuant to the San Francisco Administrative Code, Chapter 14B, the City and County of San Francisco (City) assists small and micro local businesses to increase their ability to compete effectively for the award of city contracts. The Mayor's Office establishes citywide goals for participation by small and micro local businesses in contracting. The City then provides the bid discounts, set-asides, and subcontracting opportunities set forth in the ordinance, information and training, and other assistance to small and micro local businesses that commit to meeting LBE participation goals.

Based on a sample of five contracts, the audit found:

- CMD and the Airport could not provide Form 7 or Form 9 payment information submitted on a construction contract and a professional services contract.
- PGH Wong Engineering, Inc., and MCK Associates Joint Venture did not disclose that non-LBE subconsultants performed work under an Airport professional services contract.
- The LBE participation of Wickman Development & Construction under an Airport construction contract could not be validated due to insufficient evidence of LBE subcontractor effort.
- The LBE participation of Shaw Pipeline, Inc., under a Department of Public Works construction contract could not be validated due to insufficient evidence of LBE subcontractor effort.

Recommendations

The report includes four recommendations for CMD to work with the contracting departments to improve compliance with the provisions of Chapter 14B:

The Contract Monitoring Division should:

1. Work with the relevant departments to develop and implement processes that help ensure prime contractors submit all required CMD forms in a timely manner.
2. Continue efforts to research whether it can assign penalties when contractors certify and submit inaccurate information to CMD.
3. Require departments and prime contractors to indicate on CMD forms, such as forms 7, 8, and 9, if they have knowledge of the major trade partner subcontractors who hire lower-tier subcontractors to perform the subcontracted work.
4. Work with departments at contract closeout to obtain the actual dollar value of non-LBE-eligible work performed to be used in the calculation of final LBE credit to be awarded instead of using the estimated value provided by the contractor from the time of contract award. The new process should include requiring Form 8 information to distinguish between payments received that are associated with LBE-eligible work and those associated with non-LBE-eligible work—for non-LBE-eligible work, require the contractor to specify what portion of the scope of work performed was ineligible.

INTRODUCTION

Audit Authority

The San Francisco Administrative Code (Administrative Code), Section 14B.10, requires the director of the Contract Monitoring Division (CMD), in cooperation with the Office of the Controller (Controller), to randomly audit at least three prime contractors and 10 percent of joint ventures granted bid discounts in each fiscal year to ensure their compliance with the provisions of the *Local Business Enterprise and Non-Discrimination in Contracting* Ordinance. Further, the San Francisco Charter provides the Controller's City Services Audit (CSA) with broad authority to conduct audits. Sjoberg Evashenk Consulting, Inc., conducted this audit on behalf of CSA under these authorities.

Background

Chapter 14B allows the City to help small businesses and prohibit discrimination in the award and administration of city contracts.

The City and County of San Francisco (City) has a long history of working to end discrimination in all aspects of public contracting. In 1984 the City's Board of Supervisors enacted a law (Ordinance No. 139-84) to combat the City's active and passive participation in discrimination against minority- and women-owned businesses, both in its contracting for goods and services and in the private market for such goods and services. However, due to a 2004 court order (*Coral Construction, Inc. v. City and County of San Francisco*), the City was enjoined from enforcing key provisions of that ordinance, codified as Administrative Code Chapter 12D.A, *Minority/Women/Local Business Utilization*. Therefore, in 2006 a replacement ordinance, codified as Administrative Code Chapter 14B, became effective to allow the City to continue to help small businesses and prohibit discrimination in the award and administration of city contracts.

Pursuant to Chapter 14B, the City assists small and micro local businesses to increase their ability to compete effectively for the award of city contracts. The Mayor's Office establishes citywide goals for participation by small and micro local businesses in contracting, then the City provides the bid discounts, set-asides, and subcontracting opportunities set forth in the ordinance, information and training, and other assistance to small and micro local businesses that commit to meeting LBE participation goals. CMD distinguishes between the LBE goal requirement set at the time of bid and the LBE commitment the contractor agrees to achieve during the life of the contract, which may be the same or higher than the set goal.

The certification unit grants three types of certifications.

A business contracting with the City may be eligible for one of three types of certifications:

- Local Business Enterprise (LBE) certification for businesses headquartered in San Francisco,
- Public Utilities Commission Local Business Enterprise (PUC-LBE) certification for businesses headquartered in the "SFPUC Waterway System Area," or

- Nonprofit Enterprise (NPE) certification for nonprofit entities headquartered in San Francisco.

These certifications promote the participation of local businesses in city contracts. Specifically, certified businesses benefit from bid discounts, subcontracting goals, and micro-set asides that are established for most city contracts. To receive these benefits, a business must be certified with the City before the submittal of a bid or proposal. Chapter 14B allows bid discounts to firms certified as a small or micro-LBE: 10 percent bid discount for contracts greater than $10,000 and less than $10 million, and two percent bid discount for contracts greater than $10 million and less than $20 million. Eligible LBEs are granted certification for one year or three years, depending on several factors, and during the certification period the City retains the right to audit a firm's eligibility to remain certified.

Since 2012, the Contract Monitoring Division has administered Chapter 14B. CMD includes a certification unit, which grants various types of certifications to local businesses.

Organizations that receive city contracts are subject to Chapter 14B's Rules and Regulations. Contractors' monthly billings to each contract-awarding department must include various completed forms to document compliance with the rules, such as Form 7 (Progress Payment Form) and Form 9 (Payment Affidavit). With the final Form 7 submitted, the prime contractor and any LBE subcontractors are required to complete Form 8 (Exit Report and Affidavit), on which the LBE subcontractors are to state how much they were paid and if they subcontracted out any of their work to LBEs or non-LBEs.

Further, if the contract-awarding department has modified a contract by more than 20 percent of its original amount, CMD should receive written notification within 10 days of each modification. The prime contractor is to complete Form 10 (Contract Modification Form) when all amendments, modifications, or supplemental change orders cumulatively increase the original amount by more than 20 percent, and for all subsequent modifications.

Under Chapter 14B, failure to submit any contract forms documenting compliance with the ordinance may result in sanctions, including, but not limited to, withholding of progress payments and final payments.

Objectives

The purpose of the audit was to determine whether the contractors selected for audit complied with the provisions of Chapter 14B. Specifically, the audit determined whether the:

1. Prime contractors that received bid discounts and LBE subcontractors were LBE-certified.
2. Prime contractors disclosed all subcontractors and whether all parties performed the work as detailed in CMD forms.
3. Required CMD forms were submitted and LBE commitments were met.

Scope and Methodology

The audit objectives excluded evaluating CMD's monitoring processes.

The audit covered July 1, 2021, through June 30, 2022. Using a list of contracts active during the audit period from CMD, we stratified the list by department and contract size and selected five contracts from different departments. Exhibit 1 shows the five selected contracts: three prime contractors (construction) and two joint ventures (professional services).

Exhibit 1 **The five contracts selected for audit**

Contract Number	Awarding Department	Contract Name	Prime Contractor	Total Contract Payment Amount [a]	LBE Commitment
1000013160	AIR	Materials Testing Lab	Wickman Development & Construction (Wickman)	$5,224,474	26.59%
1000000981	DPW	Masonic Avenue Streetscape Improvement	Shaw Pipeline, Inc. (Shaw)	$17,912,296	40.33%[b]
1000019373	PUC	STS Combined Sewer Discharge	Trinet Construction, Inc.	$3,967,816	14.15%
1000006305	AIR	Project Management Support Services for Airport Hotel Program	PGH Wong-MCK Joint Venture	$14,392,071	22.00%
1000021473	PUC	Construction Management Services for the East Bay Region	Cooper Pugeda Management/CM Pros Joint Venture	$1,238,857	17.00%

Legend: AIR = Airport; DPW = Department of Public Works; PUC = Public Utilities Commission
Notes:
[a] Per department accounting records.
[b] CMD award memo incorrectly reflected a LBE participation commitment of 35.76% for this project.

Where available, we reviewed required CMD forms for documentation of compliance and tested available contractor-submitted invoices for accurate and detailed supporting documentation. To understand the monitoring process, including internal controls over payments, we interviewed the departments' project managers and CMD staff, including the contract compliance officer assigned to those contracts, when available. We reviewed documentation retained by CMD, departments, and contractors, including invoices, receipts, schedule of values, and certified payroll reports, to determine whether the LBE subcontractors performed the work assigned to them. We also reviewed CMD-maintained documentation showing that contractors were certified as LBEs.

Statement of Auditing Standards

Sjoberg Evashenk Consulting, Inc., conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

Summary

Although all prime contractors and subcontractors were appropriately LBE-certified as applicable, two of the three prime contractors and one of the two joint ventures in our sample did not fully comply with certain LBE provisions of Administrative Code Chapter 14B. Specifically, we found:

- CMD and the Airport could not provide Form 7 or Form 9 payment information submitted on a construction contract and a professional services contract.
- PGH Wong Engineering, Inc. and MCK Associates Joint Venture did not disclose that non-LBE subconsultants performed some work under an Airport professional services contract.
- The LBE participation of Wickman Development & Construction (Wickman) under an Airport construction contract could not be validated due to insufficient evidence of LBE subcontractor effort.
- The LBE participation of Shaw Pipeline, Inc., (Shaw) under a DPW construction contract could not be validated due to insufficient evidence of LBE subcontractor effort.

Finding 1

CMD and the Airport could not provide Form 7 or Form 9 payment information submitted on a construction contract and a professional services contract.

During the life of a contract, contractors must submit certain payment monitoring forms to the awarding department and CMD:

- Form 7—CMD Progress Payment Request Form. This form requests payment from the department. Prime contractors must complete it and submit it to the department and CMD. The form requires the prime contractor to list the amount that subcontractors invoiced the prime contractor during the reporting period.

- Form 9—CMD Payment Affidavit. This form lists actual payments made to subcontractors during each reporting period. The prime contractor must complete and submit it to the department and CMD within ten days of being paid by the City. The amounts reflected on the Form 9 should match or be reasonably close to the amounts reflected on Form 7 for the relevant reporting period because the amounts the subcontractors invoice should match the payment amounts reflected in the prime contractor's accounting records.

- Form 8—CMD Exit Report and Affidavit. This form summarizes and finalizes the total amounts of progress payments made to the LBE subcontractors. The subcontractor must complete it, and the prime contractor must submit it to the department and CMD. The amounts reflected on the Form 8 should match or be reasonably close to the cumulative amounts reflected on Form 9 as actual payments to the subcontractors and should also match the amounts reflected in the prime contractor's accounting records as paid to the subcontractors.

- Form 10—CMD Contract Modification Form. The prime contractor must complete this form and submit it to CMD when contract amendments, modifications, or change orders cumulatively increase the original contract amount by more than 20 percent.

The three departments we reviewed were able to provide Form 8 and Form 10 information for each project tested, as applicable, but neither CMD nor the Airport could provide Form 7 or Form 9 payment information submitted on two contracts tested, as shown in Exhibit 2.

Exhibit 2. Completeness of Form 7 and Form 9 information by departments reviewed

Contract Number	Awarding Depart-ment	Contract Title	Number of Payments Made to Prime Contractor	Form 7	Form 9
1000013160	AIR	Materials Testing Lab	25	🔴	🔴
1000006305	AIR	Project Management Support Services for The Airport Hotel Program	58	🔴	🔴
1000000981	DPW	Masonic Ave Streetscape Improvement	30	🟡	🟡
1000019373	PUC	STS Combined Sewer Discharge	12	🟢	🟢
1000021473	PUC	Construction Management Services for the East Bay Region	62	🟢	🟢

Legend:
🔴 55% or less of the form information available and complete
🟡 90% of the form information available and complete
🟢 All form information available and complete

The City's financial system, which is used to manage Form 7 and Form 9 submissions, includes a module for prime contractors to directly submit Form 7 and Form 9 payment information and for subcontractors to confirm that payments were received. Before July 2017, when the City's current financial system was implemented, Form 7 and Form 9 payment information was submitted to departments and CMD via paper forms or was entered into the City's Elations system. Although most departments have relied on the City's financial system post go-live, PUC also required its contractors to put the data directly into its contract invoicing and reporting subsystem, SOLIS. This may explain how another department tested, PUC, successfully maintained pre-2018 Form 7 and Form 9 information.

For the remaining department tested, DPW cited technical issues, at the time, with the City's financial system prevented its prime contractors and subcontractors from entering Form 7 or Form 9 payment information directly into the system as envisioned, so had to continue submitting Form 7 and Form 9 payment information to DPW via paper copies with their payment packages. DPW stated that the resulting confusion caused a few of the Form 7 and Form 9 copies for its Masonic Ave Streetscape Improvement contract not to be submitted or to have gone missing.

According to the Airport, timing and technical issues, at the time, with the City's financial system created problems in collecting Form 7 and Form 9 information on the two Airport contracts we tested. Specifically:

- The Airport Hotel contract started several years before the City's current financial system was implemented, and during this time the Airport did not collect Form 7 or Form 9 information because it was collected by CMD through its Elations system processes. However, CMD could not provide any of the missing Form 7 or Form 9 information for the 27 progress payments submitted before the implementation of the City's current financial system. After the system was implemented, the Airport required contractors to submit paper copies of Form 7 and Form 9 due to the same financial system technical issues described by DPW. The Airport was able to provide most, but not all, of Form 7 and Form 9 information beginning with progress payment 30.

- The Materials Testing Lab contract started just after the City's current financial system was implemented, and the Airport required contractors to submit paper copies of Form 7 and Form 9 due to the financial system's technical issues. However, the Airport was only able to provide Form 7 and Form 9 payment information for just a few of the progress payments made under the contract.

If complete Form 7 and Form 9 information is not collected, the awarding departments cannot properly monitor LBE subcontractor payment information to ensure that LBE subcontractors are paid the amounts reflected on payment request forms and subcontractor invoices and are paid within required time limits. Although several representatives of the departments stated that subcontractors alert the departments if they have not been paid, waiting for subcontractors' complaints is a reactive process and defeats the purpose of collecting the information on Form 7 and Form 9 for oversight and monitoring.

Finding 2

PGH Wong Engineering, Inc., and MCK Associates Joint Venture did not disclose that non-LBE subconsultants performed work under the Airport professional services contract.

As shown in Exhibit 3, PGH Wong Engineering, Inc., and MCK Associates Joint Venture (PGH Wong-MCK JV), the prime contractors on the tested Airport's professional services contract, which was executed in June 2015, committed to providing a combined 22 percent of the project work to LBE subcontractors.

Exhibit 3. PGH Wong-MCK JV contract award and LBE Commitment

Prime Contractor / Project	Contract Award	LBE Portion of Contract Award	LBE Commit-ment
PGH Wong-MCK JV – Project Management Support Services for Airport Hotel Program	$2,938,000	$646,360	22%

As shown in Exhibit 4, PGH Wong-MCK JV achieved the 22 percent LBE subcontractor participation commitment set for the project.

Exhibit 4. PGH Wong-MCK JV LBE participation credit

PGH Wong-MCK JV Total Project Payments	CMD Close-Out Memo		Auditor Adjustment	
	Final LBE Participation	Final LBE Participation Credit	Final LBE Participation	Final LBE Participation Credit
$14,392,071	$3,768,652	26.19%	$3,552,444	24.68%

In determining whether PGH Wong-MCK JV met its LBE commitment, CMD's contract close-out memo notes that the joint venture's LBE subcontractors were paid a combined $3,768,652 of the $14,392,071 contract total and awards the joint venture a final LBE participation credit of 26.19 percent. However, auditors reduced the joint venture's final LBE participation by $216,208, bringing it to $3,552,444, which lowered the final LBE participation credit to 24.68 percent—although they still exceeded their LBE participation commitment of 22 percent. The adjustment was necessary for the following reasons:

- **Subcontractor Did Not Disclose That Non-LBE Lower-Tier Subcontractor Performed Some Work.** The final LBE participation credit of 26.19 percent CMD awarded relied on payment information reflected on Form 8, which requires subcontractors to indicate if they further subcontracted out any of their work. For this project, all subcontractors indicated that no work was subcontracted. However, testing of LBE subcontractor invoices to validate that subcontractors and their employees performed work on the project revealed that APEX Testing Laboratories (APEX) did not disclose on its Form 8 that a lower-tier subcontractor, REAX, performed work for which APEX was paid by PGH Wong-MCK JV. Specifically, PGH Wong-MCK JV., paid $92,937 to APEX for the work and the full amount was applied toward the LBE participation credit. Emails suggest the prime contractor and the Airport knew the work was subcontracted, but the Form 8 does not require either the prime contractor or the department to verify the accuracy of the information reported by the subcontractor on the form. No evidence was provided that REAX is an LBE subcontractor whose work would otherwise qualify for LBE participation. Although REAX received only $77,447 of the $92,937 and the remaining $15,490 was APEX's fee for managing the non-LBE eligible work, the full $92,937 should be reduced from the LBE participation of PGH Wong-MCK JV because the work was not performed by a certified LBE.

- **Inaccurate Payment Amount in CMD's LBE Credit Calculation.** CMD calculated the final LBE participation based on APEX's final contract amount of $1,787,261, as reflected on the Form 8, However, APEX was paid a total of only $1,663,990 because the full contract amount was not realized. Thus, $123,271 should be reduced from the LBE participation of PGH Wong-MCK JV.

Also, when the contract was awarded, the joint venture received a 7.5 percent rating bonus for committing to providing the LBE joint venture partner, MCK, 40 percent of the work anticipated to be performed by the joint venture partners. In determining whether the joint venture provided 40 percent of the final contract value to MCK, CMD's contract close-out memo only notes that MCK received 46.15 percent of the joint venture total payments but does not indicate the amount of total joint venture payments received. Thus, it is difficult to understand the memo's percentage calculation. Using the amounts of the payments made to the joint venture shown on the final versions of Form 7 and Form 8, MCK received $4,764,400, or 44.7 percent, of the total $10,657,646 joint venture payments. However, an adjustment was necessary as described in the bullet that follows:

- **MCK Did Not Disclose That Subcontractors Performed Some Work.** On its Form 8, MCK indicates that it did not subcontract any of its work on the project. However, we analyzed MCK's subcontractor invoices to determine whether MCK and its employees performed all the work and found that MCK used one non-LBE firm that hired several estimators to supplement its cost estimation department. Subtracting the $618,914 MCK paid to its non-LBE subcontractors lowers MCK's final share of the joint venture payments to $4,145,486. As a result, MCK's final LBE participation credit was adjusted to 41.08 percent, which still met the 40 percent LBE joint venture partner participation commitment.

CMD relies heavily on the accuracy of information reflected on Form 8s when determining if LBE participation commitments are met. CMD management expressed concern regarding the revelation that there were two instances on this contract where contractors submitted Form 8s with inaccurate LBE payment information and undisclosed subcontractor activity. CMD management indicated that efforts are underway to determine whether CMD can assign penalties when contractors certify and submit inaccurate information.

Finding 3

Wickman's LBE participation under the Airport construction contract could not be validated due to insufficient evidence of LBE subcontractor effort.

As shown in Exhibit 5, Wickman, the prime contractor on the Airport Materials Testing Lab construction contract, which was executed in January 2019, committed to providing a combined 26.27 percent of the project work to LBE subcontractors.

Exhibit 5. Wickman contract award and LBE Commitment

Prime Contractor / Project	Contract Award	LBE Portion of Contract Award	LBE Commit-ment
Wickman—Materials Testing Lab	$4,905,000	$1,288,453	26.27%*

Note: * CMD's award memo incorrectly reflected the LBE commitment as 26.59 percent.

In determining whether Wickman met its LBE commitment, CMD's contract close-out memo notes that Wickman's LBE subcontractors were paid a combined $1,583,217 of the $5,224,474 contract total and awards Wickman a final LBE participation credit of 30.30 percent. However, we were unable to validate Wickman's final LBE participation credit for the following reasons:

- **Insufficient Evidence of LBE Subcontractors' Effort.** To validate that the LBE subcontractors and their employees worked on the project, we asked to review invoices totaling $610,512 for the work performed by five LBE subcontractors associated with 5 of 25 prime contractor payment applications. We also asked to review invoices totaling $168,224 associated with all work performed by a sixth LBE subcontractor. Wickman provided less than half of the requested documentation.

- **San Francisco Office of Labor Standards Enforcement (OLSE) Investigation Remains Unresolved.** In May 2022, OLSE opened an investigation into labor standards concerns on the project associated with one of the LBE subcontractors, TP Windows, Inc., DBA SF Window Factory. Due to the investigation, Wickman did not issue a final payment to the subcontractor of $45,381 although the City had already paid Wickman all amounts due for the subcontractor's efforts. As of April 2023, OLSE indicated the case was administratively closed as it could not be resolved because the subcontractor had not been fully cooperative. The prime contractor indicated that because the investigation was not resolved, the prime contractor has continued to keep the retained funds.

Finding 4 **Shaw's LBE participation under the DPW construction contract could not be validated due to insufficient evidence of LBE subcontractor effort.**

According to CMD's contract award memo, Shaw Pipeline, Inc., the prime contractor on DPW's Masonic Avenue Streetscape Improvement construction contract, which was executed in February 2016, committed to providing a combined 35.76 percent of project work to LBE subcontractors, as shown in Exhibit 6. However, CMD incorrectly calculated Shaw's LBE participation commitment. According to cost proposals submitted when the contract was awarded, Shaw committed to providing a combined 40.33 percent of project work to LBE subcontractors.

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Exhibit 6. Shaw contract award and LBE Commitment

Prime Contractor / Project	Award	CMD Award Memo		Cost Proposals	
		LBE Portion of Contract Award	LBE Commit-ment	LBE Portion of Contract Award	LBE Commit-ment
Shaw – Masonic Avenue Streetscape Improvement	$18,299,035	$6,543,935	35.76%	$7,380,642*	40.33%

Note: * Includes amounts proposed for Esquivel ($2,433,935), M Squared ($3,060,000), Phoenix/Reliance ($1,873,707), and Ron Nelson ($13,000).

In determining whether Shaw met its LBE commitment, CMD's contract close-out memo notes that Shaw's LBE subcontractors were paid a combined $9,818,854 of the $17,912,296 contract total and awards Shaw a final LBE participation credit of 50.21 percent. However, using CMD's prime contractor and subcontractor payment totals, we found the correct calculation is 49.86 percent. Nonetheless, we cannot validate Shaw's final LBE participation credit for the following reasons:

- **Inconsistent LBE Subcontractor Payment Information.** The final LBE participation credit CMD awarded relied on payment information reflected on Form 8, which requires prime and LBE subcontractors to certify total payment amounts made and received. However, we found that the information reflected on the Form 8 submittals was inconsistent with the LBE subcontractor payment information reflected on other CMD forms the prime contractor submitted for the contract. According to DPW, Shaw is no longer in business. Thus, the LBE payment inconsistencies cannot be reconciled. Also, on our behalf, DPW requested information directly from the LBE subcontractors that worked on this project, but they did not respond.

- **LBE Subcontractor Payment Information Does Not Distinguish Ineligible LBE Work.** Form 8 payment information does not clearly distinguish between LBE-eligible work and Non-LBE work. For example, one subcontractor, Phoenix Electric (Phoenix), submitted a proposal that it would perform work totaling $1,700,520[1] on the project, but only about 70 percent of Phoenix's work, or $1,193,307, could be counted toward Phoenix's LBE participation credit. The remaining $507,213 was associated with work Phoenix was not LBE-certified to perform.

  On its Form 8, Phoenix indicated that it received $1,770,040[2] from Shaw for work its employees performed on the project. However, the form does not indicate what portion of the total payment should be reduced for the non-LBE-eligible work Phoenix anticipated performing. Rather than determining the actual value of the work that was ineligible for LBE credit, CMD simply deducted the $507,213 that was initially estimated to be ineligible at the time of the bid award. According to CMD, it would be too difficult to determine the actual value of the non-LBE work performed on the project. However, DPW could require that proposals specify which portion of the scope of work is associated with non-LBE work so that CMD can use the subcontractor's final schedule of values to determine the actual value of the ineligible LBE scope of work.

- **Insufficient Evidence of LBE Subcontractor Effort.** To validate that the LBE subcontractors and their employees performed work on the project, we asked to review all invoices for work performed by LBE subcontractors associated with five of 30 prime contractor payment applications submitted—these tested LBE payments totaled $2,329,209. We also asked to review invoices associated with all work performed by one of the LBE subcontractors totaling $670,200. Although DPW was able to provide most of the requested documentation associated with the $2,999,409 in payments tested, a significant portion of the LBE subcontractor payment support, $926,714, was unavailable because Shaw is no longer in business.

- **Work Performed by Non-LBE Subcontractor Included in LBE Participation Credit.** The final LBE participation credit of 50.21 percent CMD awarded relied on payment information on Form 8, which requires subcontractors to indicate if they subcontracted any of their work. For this project, one subcontractor, Esquivel Grading and Paving (Esquivel), indicated on its Form 8 that a lower-tier non-LBE

[1] The proposal also indicates that an additional $680,400 would be further subcontracted out to Reliance Engineering.
[2] Form 8 also indicates that Phoenix received another $670,200 that it paid to Reliance Engineering for its work.

subcontractor performed $26,270 of the $2,781,248 in work for which Esquivel was paid. However, CMD did not subtract the cost of this non-LBE participation from the LBE credit awarded on this project.

Recommendations

The Contract Monitoring Division should:

1. Work with the relevant departments to develop and implement processes that help ensure prime contractors submit all required CMD forms in a timely manner.

2. Continue efforts to research whether it can assign penalties when contractors certify and submit inaccurate information to CMD.

3. Require departments and prime contractors to indicate on CMD forms, such as forms 7, 8, and 9, if they have knowledge of the major trade partner subcontractors who hire lower-tier subcontractors to perform the subcontracted work.

4. Work with departments at contract closeout to obtain the actual dollar value of non-LBE-eligible work performed to be used in the calculation of final LBE credit to be awarded instead of using the estimated value provided by the contractor from the time of contract award. The new process should include requiring Form 8 information to distinguish between payments received that are associated with LBE-eligible work and those associated with non-LBE-eligible work—for non-LBE-eligible work, require the contractor to specify what portion of the scope of work performed was ineligible.

APPENDIX: DEPARTMENT RESPONSES

Contract Monitoring Division

City & County of San Francisco
London N. Breed, Mayor

Office of the City Administrator
Carmen Chu, City Administrator
Stephanie Tang, Director
Contract Monitoring Division

July 7, 2023

Mark de la Rosa
Department of Audits
City Hall
1 Dr. Carlton B Goodlett Place
San Francisco, CA 94102

Subject: Contract Monitoring Division Response to the Program Audit of Implementation of the Local Business Enterprise Program

Dear Mr. de la Rosa,

Thank you for the opportunity for the Contract Monitoring Division to review the Audit Report and respond to its finding and recommendations.

We appreciate the time and effort spent by the staff of the Sjoberg Evashenk Consulting, Inc. and the City Services Audit Division to learn about the Local Business Enterprise program.

The CMD concurs with the recommendations of the audit. We will be working with the departments, contractors, and Local Business Enterprise community to include these recommendations and to ensure the efficacy of this small business inclusion program.

Please see attached for CMD Recommendation and Response form.

If you have any questions or need additional information, please contact me at 415-581-2310.

Sincerely,

Stephanie Tang

Stephanie Tang
Director

Cc: Rachel Cukierman, Deputy City Administrator

SFGSA.org · 3-1-1

Recommendation and Response

For each recommendation, the responsible agency should indicate in the column labeled ***Agency Response*** whether it concurs, does not concur, or partially concurs and provide a brief explanation. If it concurs with the recommendation, it should indicate the expected implementation date and implementation plan. If the responsible agency does not concur or partially concurs, it should provide an explanation and an alternate plan of action to address the identified issue.

Recommendation	Agency Response	CSA Use Only Status Determination*
The Contract Monitoring Division should:		
1. Work with the relevant departments to develop and implement processes that help ensure prime contractors submit all required CMD forms in a timely manner.	☒ Concur ☐ Do Not Concur ☐ Partially Concur CMD concurs with the recommendation and will complete the following by the end of fiscal year 2023-2024. - At the time of the contract monitoring, CMD will notify all firms of their obligations to complete forms in a timely manner. - Newly executed contracts will require both electronic and paper forms until quality of electronic forms can be verified.	☒ Open ☐ Closed ☐ Contested
2. Continue efforts to research whether it can assign penalties when contractors certify and submit inaccurate information to CMD.	☒ Concur ☐ Do Not Concur ☐ Partially Concur CMD concurs with this recommendation and will complete the following in fiscal year 2023-2024. - In Spring 2023 CMD sent enforcement notices to firms where inaccurate information was submitted to CMD. - CMD will work with the City Attorney's Office to develop a framework for penalties when contractors willfully certify and submit inaccurate information to CMD.	☒ Open ☐ Closed ☐ Contested

Recommendation	Agency Response	CSA Use Only Status Determination*
3. Require departments and prime contractors to indicate on CMD forms, such as forms 7, 8, and 9, if they have knowledge of the major trade partner subcontractors who hire lower-tier subcontractors to perform the subcontracted work.	☒ Concur ☐ Do Not Concur ☐ Partially Concur CMD concurs with this recommendation and will complete the following by the end of fiscal year 2023-2024. - CMD will complete a review of the paper forms 7, 8, 9 and work with the City Attorney's Office to clarify the language on the forms. - CMD will collaborate with the Office of the Controller Systems Team to identify development needs for the CMD module.	☒ Open ☐ Closed ☐ Contested
4. Work with departments at contract closeout to obtain the actual dollar value of non-LBE-eligible work performed to be used in the calculation of final LBE credit to be awarded instead of using the estimated value provided by the contractor from the time of contract award. The new process should include requiring Form 8 information to distinguish between payments received that are associated with LBE-eligible work and those associated with non-LBE-eligible work—for non-LBE-eligible work, require the contractor to specify what portion of the scope of work performed was ineligible.	☒ Concur ☐ Do Not Concur ☐ Partially Concur CMD concurs with this recommendation and will complete the following by the end of the fiscal year 2023-2024. - CMD will develop a procedure to (1) identify contracts where the LBE was credited for less than 100% of the work; (2) review with departments how to validate the exact dollar value for LBE credited and non-credited work; and (3) work with the City Attorney's Office to clarify the language on the form. - CMD will collaborate with the Office of the Controller Systems Team to identify development needs for the CMD module.	☒ Open ☐ Closed ☐ Contested

* Status Determination based on audit team's review of the agency's response and proposed corrective action

San Francisco International Airport

July 17, 2023

Mark de la Rosa
Director of Audits
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Re: Auditor Response to SFO Letter on LBE Audit Report
Two of the Three Prime Contractors and One of Two Joint Ventures Audited Did Not Fully Comply with Certain Provisions of Chapter 14B, the Local Business Enterprise Ordinance

Dear Mr. de la Rosa:

Thank you for the opportunity to review and respond to the Auditor Response to SFO Letter on the LBE Audit Report. We have a few items we would like to respond to, noted in blue text below.

SFO Letter dated June 13, 2023: Airport contracts specify that contractors are required to submit Forms 7 and 9 through a tracking system specified by the Contract Monitoring Division (CMD), and CMD is responsible for reviewing the information. Contractors do not submit these forms to the Airport. The draft audit, in part, appears to focus on requested CMD documentation that the Airport was not able to provide, even though the auditors acknowledge they "excluded evaluating CMD's monitoring process." The Airport has CMD staff dedicated to monitoring Airport contracts and Admin Code Ch. 14B compliance. It is unclear how the audit can perform a comprehensive evaluation of Ch. 14B compliance for Airport contracts without evaluating the monitoring process of CMD staff dedicated to Airport projects.

- Auditor Response: Section 33 (page 13) of this contract requires that the contractor comply with Chapter 14B. Chapter 14B (14.B.10.3) requires the City Administrator (CMD) to "issue forms for the Controller or contract awarding authorities to collect information from contractors as the City Administrator deems necessary to perform its duties under this Chapter." Auditors believe CMD and departments are responsible for collecting information from the contractors. Please note audit recommendations are directed to CMD to improve compliance with the ordinance.

  Reviewing CMD monitoring is not required per 14B.10.B.5 section of the audit provision (see excerpt below). The audit scope is to audit the prime contractors to ensure their compliance with 14B. However, the audit has recommendations for CMD to improve their process as it relates to the prime contractor's findings.

CA > San ... > San Francisco ... > SEC. 14B.10. POWERS AND DUTIES OF THE CITY ADMINIST...

enable the Director to issue reports required by this Chapter to the Mayor and the Board of Supervisors, and otherwise to perform his her duties imposed hereunder.

(B) **CMD Director.** In addition to the duties and powers given to the CMD Director elsewhere, the Director shall:

(1) Levy the same sanctions that a Contract Awarding Authority may levy as specified in Section 14B.17(D).

(2) Ensure that the necessary data concerning LBE, MBE, and OBE availability and participation in City Contracting is collected, analyzed, and included in CMD's annual report required by Section 14B.15(B). The Director shall identify areas of contracting where the City or any of its departments are failing to meet LBE subcontracting requirements or are contracting with MBEs, WBEs, or OBEs at rates less than would be anticipated by the availability data.

(3) Provide information and other assistance to LBEs to increase their ability to compete effectively for the award of City Contracts.

(4) Grant waivers as set forth in Sections 14B.7(J) and 14B.8(A), and disqualify a Bidder or Contractor as set forth in Section 14B.17.

(5) In cooperation with the Controller, randomly audit at least three prime Contractors each fiscal year in order to insure their compliance with the provisions of this Chapter. The Director, in cooperation with the Controller, shall furthermore randomly audit 10 percent (10%) of the Joint Ventures granted Bid Discounts in each fiscal year.

Post Office Box 8097 San Francisco, California 94128 Tel 650.821.5000 Fax 650.821.5005 www.flysfo.com

➢ **SFO Response:** SFO attempted to satisfy 14B.10(3) and the issue raised in this audit finding through its Memorandum of Understanding ("MOU") by which SFO budgeted payment to CMD and through which CMD expressly agreed to: "provide full time staff. . . to handle contract compliance related to Ch. 14B;" to "monitor LBE participation requirements;" and "track and audit contractor compliance to ensure payments are entered into the new Local Business Enterprise Utilization Tracking System (LBETUS) or any (as directed by CMD) successor system...." At no time did CMD inform SFO that CMD failed to fully perform its obligations under the MOU.

SFO appreciates the audit findings and the suggestions to better serve the public. SFO also agrees with the audit's conclusion that 14B.10(B)(5) allows the CMD Director "to audit the prime contractors to ensure their compliance with 14B." However, this item in the audit is not the result of auditing prime contractors. Rather, it arises from an audit of SFO. An audit of contractor records may yield the records this audit states SFO did not possess.

SFO Letter dated June 13, 2023:

1. Report Pages 5-7 (pdf Pages 10-12): Finding 1.
CMD and the Airport could not provide Form 7 or Form 9 payment information submitted on a construction contract and a professional services contract."

PGH Wong-MCK Joint Venture, Project Management Support Services for Airport Hotel Program
As the Report correctly explains, at the time the Airport awarded this Contract, CMD required contractors to submit LBE reporting through LBEUTS, a web-based tracking system. The Report fails to recognize that the Contract did not require that the contractor submit paper copies of Form 7 and Form 9. The Contract clearly states that CMD will monitor compliance with the 14B LBE Ordinance by the information submitted in LBEUTS (AIR-500, Paragraph 33.3). The Airport had no reason to request separate paper copies of Form 7 or 9 when LBEUTS was in use for Payments 1 through 27.

The Airport recommends revising the Finding Title to: "CMD could not provide Form 7 or Form 9 payment information submitted on a construction contract and a professional services contract."

➢ Auditor Response: No change. Section 33 (page 13) of this contract requires that the contractor comply with Chapter 14B. Chapter 14B (14.B.10.3) requires the City Administrator (CMD) to "issue forms for the Controller or contract awarding authorities to collect information from contractors as the City Administrator deems necessary to perform its duties under this Chapter."

https://codelibrary.amlegal.com/codes/san_francisco/latest/sf_admin/0-0-0-9639#JD_14B.10

➢ **SFO Response:** SFO attempted to satisfy 14B.10(3) and the issue raised in this audit finding through its Memorandum of Understanding ("MOU") by which SFO budgeted payment to CMD and through which CMD expressly agreed to: "provide full time staff. . . to handle contract compliance related to Ch. 14B;" to "monitor LBE participation requirements;" and "track and audit contractor compliance to ensure payments are entered into the new Local Business Enterprise Utilization Tracking System (LBETUS) or any (as directed by CMD) successor system...." At no time did CMD inform SFO that CMD failed to fully perform its obligations under the MOU.

SFO Letter dated June 13, 2023:

2. Report Pages 8-9 (pdf Pages 13-14): Finding 2.
"PGH Wong Engineering, Inc. and MCK Associates Joint Venture did not disclose that non-LBE subconsultants performed work under the Airport professional services agreement."

Draft audit Finding 2 acknowledges CMD Form 8 "requires subcontractors to indicate if they further subcontracted out any of their. work" and that "all subcontractors indicated that no work was subcontracted." But the finding continues to summarily conclude that "the Airport appeared to know the work was subcontracted" without stating any factual basis for the Report's conclusion that the Airport knew the submitted Form 8s were inaccurate. Subsequently, the Report appears to excuse CMD's apparent failure to discover the inaccuracies in the submitted Form 8s because "CMD relies heavily on the accuracy of information reflected on Form 8s." It is unclear how the Report reconciles that it is acceptable for CMD to rely upon the information reflected in Form 8, but the Airport is not entitled to the same reliance.

- Auditor Response: Please note audit recommendations are directed to CMD to improve compliance with the ordinance.

- **SFO Response:** SFO acknowledges it knew APEX retained REAX as lower-tier subcontractor and that APEX's Form 8 failed to disclose this. However, SFO was not aware MCK had retained multiple independent contractors and passed off those contractors as MCK employees.

We appreciate the opportunity to review and respond to Auditor Comments to the draft audit report. If you have any questions or require further information regarding the contents of this response, please contact me.

Sincerely,

Mosqueda

Judi Mosqueda
Chief Development Officer
San Francisco International Airport

Cc: Ivar Satero, Kevin Kone

San Francisco
Water Power Sewer
Services of the San Francisco Public Utilities Commission

525 Golden Gate Avenue, 13th Floor
San Francisco, CA 94102
T 415.554.3155
F 415.554.3161
TTY 415.554.3488

June 15, 2023

Mark de la Rosa
Director of Audits
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Subject: Two of the Three Prime Contractors and One of Two Joint Ventures Audited Did Not Fully Comply With Certain Provisions of Chapter 14B, the Local Business Enterprise Ordinance

Dear Mr. de la Rosa,

Thank you for providing us the opportunity to review the audit report, *Two of the Three Prime Contractors and One of Two Joint Ventures Audited Did Not Fully Comply With Certain Provisions of Chapter 14B, the Local Business Enterprise Ordinance*, prepared by the Controller's Office City Services Auditor.

We appreciate the time your staff dedicated to this audit and are pleased that there are no findings related to the administration of SFPUC contracts. We are also pleased that the report recognizes SFPUC's SOLIS system as a safeguard against Form 7 and Form 9 noncompliance.

If there are any questions or additional information is needed, please do not hesitate to contact me at 415-554-1600.

Sincerely,

Dennis Herrera
General Manager

CC: Ronald Flynn, Deputy General Manager
Nancy Hom, AGM Business Services/CFO
Irella Blackwood, Audit Director

OUR MISSION: To provide our customers with high-quality, efficient and reliable water, power and sewer services in a manner that values environmental and community interests and sustains the resources entrusted to our care.

Carla Short, Interim Director | Director's Office
carla.short@sfdpw.org | T. 628.271.3078 | 49 South Van Ness Ave. Suite 1600, San Francisco, CA 94103

June 16, 2023

Mr. Mark de la Rosa
Director of Auditors
City Services Auditor Division
City Hall, Room 382
1 Carlton B. Goodlett Place
San Francisco, CA 94102

Re: Response to Contract Monitoring Division (CMD) Report of Contractor Compliance

Dear Mr. de la Rosa,

Thank you for providing Public Works a draft copy of your report on the audit of the contractor compliance with the San Francisco Administrative Code, Chapter 14B, Local Business Enterprise (LBE) Utilization and Non-Discrimination in Contracting Ordinance. We appreciate the opportunity to review and respond.

The finding on the Public Works contract with Shaw Pipeline is for insufficient evidence of LBE subcontractor effort. The recommendations are directed to the City's Contract Monitoring Division (CMD) to develop and implement processes to ensure prime contractors submit all required CMD forms timely. The process of validating and calculating LBE participation commitment is outside Public Works' area of responsibility and falls under CMD. Public Works will continue to collaborate, provide support and partner with CMD as they implement procedures to address the audit findings and improve LBE tracking and reporting. Public Works has discussed these issues with CMD in the past and our team is looking forward to our continued collaboration to ensure full compliance with Administrative Code 14B.

We appreciate the time spent by your staff and contractor reviewing the CMD and department information regarding Administrative Code 14B requirements. Please feel free to contact Bruce Robertson, Deputy Director of Finance and Administration, should you need additional information.

Respectfully,

DocuSigned by:
073CF73A4EA6486...

Carla Short
Interim Director
San Francisco Public Works

CC: Bruce Robertson, Deputy Director Finance and Administration, San Francisco Public Works
Albert Ko, City Engineer, San Francisco Public Works
Michelle Woo, Project Manager, San Francisco Public Works

KPMG

Yano Accountancy Corporation

SAN FRANCISCO WATER ENTERPRISE AND HETCH HETCHY WATER AND POWER

Statement of Changes in the Balancing Account

June 30, 2021

(With Independent Auditors' Report Thereon)

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

Yano Accountancy Corporation

Independent Auditors' Report

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

Report on the Financial Statement

KPMG LLP and Yano Accountancy Corporation have audited the Statement of Changes in the Balancing Account (the statement) of the San Francisco Water Enterprise (Water Enterprise) and Hetch Hetchy Water and Power (Hetch Hetchy), under the jurisdiction of the San Francisco Public Utilities Commission (SFPUC), for the year ended June 30, 2021, prepared pursuant to Article VII, Section 7.02 of the Water Supply Agreement (WSA), between the City and County of San Francisco (City) and certain Wholesale Customers in the counties of San Mateo, Santa Clara, and Alameda (Wholesale Customers) effective July 1, 2009.

Management's Responsibility for the Financial Statement

Management of the SFPUC is responsible for the preparation and fair presentation of the statement in accordance with Article VII, Section 7.02 of the WSA. Management of the SFPUC is also responsible for the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of the statement that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statement is free from material misstatement.

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

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

Opinion

In our opinion, the Statement of Changes in the Balancing Account, referred to above, presents fairly, in all material respects, changes in the Balancing Account for the year ended June 30, 2021 in accordance with Article VII, Section 7.02 of the WSA.

Yano Accountancy Corporation

Basis of Accounting

We draw attention to note (1)(b) to the statement, which describes the basis of accounting. The statement was prepared by the SFPUC on the basis of the financial reporting provisions of Article VII, Section 7.02 of the WSA, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to comply with the financial reporting provisions of the WSA. Our opinion is not modified with respect to this matter.

Other Matter

KPMG LLP has audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of the San Francisco Water Enterprise and of Hetch Hetchy Water and Power as of and for the year ended June 30, 2021, and our reports thereon, dated January 27, 2022 expressed an unmodified opinion on those financial statements.

Restriction on Use

This report is intended solely for the information and use of the Mayor, Board of Supervisors, San Francisco Public Utilities Commission, City management, and the Wholesale Customers, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP Yano Accountancy Corporation

San Francisco, California
September 13, 2023

SAN FRANCISCO WATER ENTERPRISE AND
HETCH HETCHY WATER AND POWER

Statement of Changes in the Balancing Account

Year ended June 30, 2021

	Totals	Amount Allocated to the Wholesale Customers
Wholesale Revenue Requirement Calculation:		
Operations and Maintenance (O&M) expense:		
San Francisco Water Enterprise (Water Enterprise):		
Source of supply	$ 28,663,810	$ 15,604,478
Pumping	1,694,803	—
Treatment	45,531,738	31,455,230
Transmission and distribution	70,999,619	17,497,220
Customer Accounts	10,816,529	213,835
Total Water Enterprise Operations & Maintenance	157,706,499	64,770,763
Hetch Hetchy Water and Power (Hetch Hetchy):		
Operations & Maintenance	127,100,057	19,208,926
Total Hetch Hetchy Operations & Maintenance	127,100,057	19,208,926
Administrative and general (A&G) expenses:		
COWCAP:		
Water Enterprise	3,105,989	1,275,630
Hetch Hetchy	969,619	304,383
SF Public Utilities Commission (Bureaus):		
Water Enterprise	33,445,580	15,105,992
Hetch Hetchy	17,139,427	3,178,436
Other A&G – Water Enterprise	22,284,639	7,289,701
Other A&G – Hetch Hetchy	32,788,254	3,652,900
Compliance audit	190,020	95,010
Total administrative and general expenses	109,923,528	30,902,052
Property taxes (outside city only):		
Water Enterprise	1,958,673	1,369,896
Hetch Hetchy	582,786	182,948
Total property taxes	2,541,459	1,552,844
Capital cost recovery - existing regional assets:		
K-5:		
Water Enterprise		201,027
Hetch Hetchy		88,788
Capital cost contribution - new regional assets:		
Debt-funded capital projects:		
Water Enterprise		145,834,689
Hetch Hetchy		—
True-Up of Substantially Expended Bonds		(305,643)
Credit for Federal BABs Interest Subsidy		(14,802,217)
Other Debt-Related Costs: Escrow Payments		13,807,831
Revenue-funded capital projects:		
Water Enterprise		9,617,108
Hetch Hetchy		(2,583)
True-Up of Wholesale Capital Fund		(727,181)
Total Capital Cost Recovery		153,711,819
Total Wholesale Revenue Requirement		$ 270,146,404
Balance due from (to) Wholesale Customers, July 1, 2021		$ (63,393,776)
Adjustments to Beginning Balance (FY 18-19 & FY 19-20 7.06 Settlement Agreement)		(136,119)
Adjusted Balance due from (to) Wholesale Customers, July 1, 2021		(63,529,895)
Interest on adjusted beginning balance at 0.68%		(432,003)
Wholesale revenues billed		(275,113,885)
Deposit to / (Transfer from) Wholesale Coverage Reserve		2,431,211
Transfer from Balancing Account for BAWSCA Water Projects		197,000
Transfer from Balancing Account for K-5 Prepayment		4,030,664
Calculated Wholesale Revenue Requirement		270,146,404
FY 19-20 Net Interest on Wholesale Coverage Reserve / Working Capital		(709,172)
Balancing account, June 30, 2021		$ (62,979,676)
Total payable due to Wholesale Customers, June 30, 2021		$ (62,979,676)
Wholesale revenue coverage reserve shortfall (surplus), as of June 30, 2021		$ (1,104,094)

See accompanying notes to the statement of changes in the balancing account.

(1) Summary of Significant Accounting Policies

(a) Water Supply Agreement

The City and County of San Francisco (City), acting by and through its Public Utilities Commission (SFPUC), and the Wholesale Customers, represented by the Bay Area Water Supply and Conservation Agency (BAWSCA), entered into the Water Supply Agreement (WSA) on July 1, 2009. The November 2018 Amended and Restated Wholesale Water Supply Agreement (WSA) was ratified by all BAWSCA member agencies and the SFPUC in April 2019. The WSA has a twenty-five year term with two options for five-year extensions, and contains provisions on rate-setting, accounting, and dispute resolution, including emergency and drought-pricing adjustment. The WSA has a 184 millions of gallons per day (mgd) Supply Assurance. During the period from 2009 to 2028 the WSA limits the quantity of water delivered to the Retail Customers and Wholesale Customers from the watersheds to 81 mgd and 184 mgd, respectively, or a total of 265 mgd.

(b) Basis of Accounting

Pursuant to the terms of the WSA, the accounts of the San Francisco Water Enterprise (Water Enterprise) and Hetch Hetchy Water and Power (Hetch Hetchy), are maintained in conformity with accounting principles generally accepted in the United States of America. The financial activities of the Water Enterprise and Hetch Hetchy Funds are accounted for on a flow of economic resource measurement focus, using the accrual basis of accounting. Under this method, all assets and liabilities associated with its operations are included on the statements of net assets; revenues are recognized when earned, and expenses are recognized when liabilities are incurred. The SFPUC applies all applicable Governmental Accounting Standards Board pronouncements. For copies of the Water Enterprise and Hetch Hetchy audited financial statements for the year ended June 30, 2021, please contact the Chief Financial Officer, San Francisco Public Utilities Commission, 525 Golden Gate Avenue, 13th Floor, San Francisco, California 94102.

Under the WSA, current operating expenditures, including regional revenue-funded capital projects and debt service on bonds sold to finance regional water system improvements, are allocated between Retail Customers and the Wholesale Customers on the basis of Proportional Annual Use. The Balancing Account is maintained pursuant to the WSA, and by other provisions that may result from a settlement agreement prescribed in Article VII, Section 7.06 of the WSA.

(c) Balancing Account under the WSA

Pursuant to the terms of the WSA, the SFPUC is required to establish water rates applicable to the Wholesale Customers at the beginning of each fiscal year. The wholesale water rates are based on an estimate of revenues necessary to recover the cost of distributing water to the Wholesale Customers in accordance with the methodology outlined in Articles V and VI of the WSA.

Pursuant to Article VII, Section 7.02 of the WSA, the City is required to prepare the Wholesale Revenue Requirement (WRR) of the Water Enterprise and Hetch Hetchy after the close of each fiscal year based on the actual costs incurred in the delivery of water to the Wholesale Customers. The difference between the wholesale revenue billed to the Wholesale Customers during the year and the “actual” WRR is recorded in a separate account (the Balancing Account) and represents the cumulative amount that is either owed to the Wholesale Customers (if wholesale revenue billed exceed the WRR) or owed to the SFPUC (if the WRR exceeds wholesale revenues billed). The Balancing Account is reflected on the Water Enterprise’s financial statements as either an asset or a liability depending on the amount due from or owed to the Wholesale Customers.

In accordance with Article VI, Section 6.05B of the WSA, the amount recorded in the Balancing Account will earn interest at a rate equal to the average rate earned on the invested pooled funds of the City Treasurer, and is taken into consideration in the determination of subsequent wholesale water rates.

(d) Proportional Annual Use and Adjusted Proportional Annual Use

The WSA states that the Wholesale Customers will pay their share of expenses incurred by the SFPUC in delivering water on the basis of Proportional Annual Use unless otherwise indicated in the WSA. WSA Attachment J prescribes the calculation methodology to determine Proportional Annual Use. At the end of each fiscal year, as specified in WSA Attachment J, the SFPUC and BAWSCA sign off on Table J-1, which memorializes the annual water deliveries to Retail and Wholesale Customers. The information in the Table J-1 is the basis for the Proportional Annual Use calculation.

The Proportional Annual Use is defined as the share of deliveries from the Regional Water System used by City Retail Customers and by the Wholesale Customers in a fiscal year, expressed as a percentage. The Adjusted Proportional Annual Use is defined as the respective percentages of annual water use, as adjusted to reflect deliveries of water by Hetch Hetchy to Retail Customers outside of the city limits of the City and County of San Francisco.

(e) Minimum Annual Purchases

Alameda County Water District and the cities of Milpitas, Mountain View, and Sunnyvale have agreed to a minimum annual purchases requirement, which requires each to purchase a minimum annual quantity of water from the SFPUC. These minimum quantities are included in the Individual Water Sales Contracts between SFPUC and each of these four Wholesale Customers reference to Article III, Section 3.07.C of the WSA, and WSA Attachment E.

These Wholesale Customers are billed for minimum quantities only if minimum annual purchase quantities have not been met in any fiscal year. Minimum annual purchase payments are considered wholesale water revenues. Additionally, the Proportional Annual Use is based on minimum quantities for each of these four customers if minimum annual purchase quantities are not met. Any differences between minimum quantities and below-minimum actuals are referred to as imputed water sales.

During the year ended June 30, 2021, the city of Mountain View did not meet its minimum purchase requirements. Revenues associated with the shortfall in the amount of $2,055,966 are included as wholesale water revenues, and 1.0 mgd of imputed water sales was added to the wholesale usage used to calculate Proportional Annual Use.

(f) Basis of Allocating Operating Expenses

Pursuant to the terms of the WSA, direct Water Enterprise and specific Hetch Hetchy expenses are allocated to the applicable user. Regional Water Enterprise operating and maintenance expenses related to source of supply, treatment, transmission and distribution are allocated based on Proportional Annual Use.

Two percent of Water Enterprise customer service expenses are allocated to the Wholesale Customers. Water Enterprise administrative and general expenses, including the assigned costs under the City's Countywide Cost Allocation Plan, services provided by other City departments and water administration, are allocated based on the ratio of total allocated wholesale operating and maintenance expenses to total Water Enterprise operating and maintenance expenses. Certain SFPUC bureau expenses are identified as regional operations and maintenance expenses and allocated to the Wholesale Customers on Proportional Annual Use basis. Remaining SFPUC bureau expenses are allocated to the Water Enterprise on the basis of labor costs incurred by the various SFPUC enterprises, and then allocated to the Wholesale Customers on the basis of Proportional Annual Use.

Water Enterprise property taxes are levied against properties owned by the City in Alameda, San Mateo, and Santa Clara counties, and operated and managed by the SFPUC. Hetch Hetchy property taxes are levied against properties owned by the City in Tuolumne, Stanislaus, San Joaquin, and Alameda counties, and operated and managed by the SFPUC. All property taxes paid, net of (1) reimbursements received from lessees and permit holders and (2) refunds from taxing authorities, are considered Water Enterprise regional expenses or joint Hetch Hetchy expenses. The Wholesale Customers are allocated a share of Water Enterprise and Hetch Hetchy property tax expenses on the basis of Proportional Annual Use and Adjusted Proportional Annual Use, respectively.

Forty-five percent of joint Hetch Hetchy expenses are water-related expenses. The water-related share of joint Hetch Hetchy operating, maintenance, and administrative and general expenses is allocated based upon on Adjusted Proportional Annual Use.

Fifty percent of the cost of the compliance audit described in Article VII, Section 7.04 of the WSA is allocated to the Wholesale Customers.

(g) Wholesale Customers Review

Article VII, Section 7.06 of the WSA provides the Wholesale Customers the right to conduct a review of the SFPUC's calculation of the annual Wholesale Revenue Requirement and changes in the Balancing Account. The review shall be completed within 60 days after the date of the compliance auditor's report is issued. At the conclusion of the review, representatives of SFPUC and BAWSCA meet to discuss any differences noted. Adjustments agreed by both parties are adjusted to the Balancing Account. If differences cannot be resolved, the dispute shall be submitted to the arbitration in accordance with Article VIII, Section 8.01 of the WSA.

(Continued)

(h) Capital Cost Recovery – Existing Regional Assets

The SFPUC previously appropriated funds, advanced through rates charged to Retail Customers, for construction of capital projects. The unexpended balances of these appropriated funds were not included in construction work in progress as listed on WSA Attachment K-1 and K-2 as of June 30, 2009. These projects, and their associated balances, are shown on WSA Attachment K-5. Expenditures of funds from these balances from July 1, 2009 to June 30, 2014 are allocated to the Wholesale Customers based on Proportional Annual Use and amortized over ten years at an interest rate of 4%. Fiscal year 2020-21 is the seventh year for capital cost recovery through Schedule K-5. The Wholesale Customers are allowed, under Section 6.05.B.2 of the WSA to use Balancing Account amounts due to them to pay all or a portion of the remaining K-5 principal balance. On September 18, 2020, the Wholesale Customers elected to prepay the full remaining balance of $4,030,664 as of September 30, 2020.

(i) Capital Cost Contribution – New Regional Assets

The wholesale share of Water Enterprise and Hetch Hetchy capital expenditures incurred during the term of the WSA are allocated on the basis of Proportional Annual Use and Adjusted Proportional Annual Use, respectively. These costs include net annual debt service and appropriations for revenue-funded regional capital additions.

Capital expenditures financed by debt are allocated to bond proceeds on a first-in, first-out basis to the extent allowable by law and the terms of the applicable indenture. In accordance with Article V, Section 5.04A of the WSA, the SFPUC issues a certificate on the expected use of bond proceeds within 15 days of issuance (WSA Attachment L-2), and a report on actual expenditures of and earnings on bond proceeds after the proceeds are considered substantially expended (WSA Attachment L-3). The Wholesale Customers' proportionate share of net annual debt service is based on the expected use of bond proceeds on regional projects. Any differences between expected and actual expenditures on regional projects are applied in the year the proceeds are substantially expended. For copies of WSA Attachments L-2 or L-3 previously issued for each indenture, please contact the Chief Financial Officer, San Francisco Public Utilities Commission, 525 Golden Gate Avenue, 13th Floor, San Francisco, California 94102.

SFPUC and the Wholesale Customers clarified certain procedures relating to the administration of the accounting, debt administration, and capital cost contribution components of Article V, Section 5.04A as part of the Settlement Agreement (Article VII, Section 7.06 of the WSA) for the year ended June 30, 2010. For copies of the Settlement Agreement (Article VII, Section 7.06 of the WSA) for the year ended June 30, 2010, please contact the Chief Financial Officer, San Francisco Public Utilities Commission, 525 Golden Gate Avenue, 13th Floor, San Francisco, California 94102.

The regional share of appropriations for revenue-funded regional asset expenditures are allocated to the Water Enterprise and Hetch Hetchy on the basis of Proportional Annual Use and Adjusted Proportional Annual Use, respectively. Adjustments to reflect actual vs. appropriated expenditures are made in accordance with Article VI, Section 6.08 of the WSA, which was amended in May 2019.

(j) Allocation of 525 Golden Gate Avenue Expenses

525 Golden Gate Avenue is the headquarters of the SFPUC as of July 2012. This building consolidated divisions of the SFPUC that were renting space at multiple locations in the Civic Center area, and consists of a new 277,500 square-foot Class A office building that spans 13 floors plus a basement level. In allocating 525 Golden Gate Avenue costs, building tenants occupy 10,709 square feet (3.9% of total building square footage), which reduces the costs allocated to the Wholesale Customers.

Certificates of Participation, 2009 Series C and D, were issued by the City in October 2009 to fund the SFPUC headquarters building at 525 Golden Gate Avenue.

Operating, maintenance, capital expenses, and debt service payments pertaining to 525 Golden Gate Avenue are classified as Administrative and General expenses and are allocated to the three enterprises (Water, Hetch Hetchy, and Wastewater) based on square footage occupied by each enterprise based at 525 Golden Gate Avenue.

(k) Interest Earnings and Excess Funds Related to Bond Issuance

Interest earnings and excess funds available from funds associated with regional bonds – including Debt Service Reserves and Capital Projects Funds – are allocated between the Wholesale and Retail Customers based on the debt service allocation of the underlying bond series (see Note (5)(a)).

All interest earnings on Debt Reserve Funds are accounted for as credits against gross debt service in determining the net debt service amounts. Interest earnings from unexpended bond proceeds in the Capital Projects Funds are treated as additional funds available for project expenditures.

(l) Grants

The Wholesale Customers are allocated a proportional benefit from funds received by the SFPUC from (a) governmental grants, rebates, reimbursements, or other subventions or (b) private-sector grants for Regional capital or operating purposes. The Wholesale Customers' allocated benefit is based on any excess of grant revenues over expenses.

Bonds 2010 Series B, 2010 Series E, and 2010 Series G were issued as Build America Bonds, with the Federal government subsidizing a portion of the annual interest payments. The subsidy amount changes based on the Federal government's budget, and per agreement between the parties in the Fiscal Year 2015-16 Settlement Agreement, the cash receipts in a Fiscal Year are credited proportionally to the Wholesale Customers based on the underlying debt service allocation of each series. Beginning in Fiscal Year 2016-17, per the advice of the SFPUC's bond counsel, interest rebates from the taxable federal Build America Bonds are no longer credited against gross debt service due to federal sequestration. Instead, they are reflected as a governmental revenue credit; the impact on the Balancing Account from both treatments is the same.

(m) Wholesale Revenue Coverage Reserve and Working Capital Requirements

Under Article VI, Section 6.06 of the WSA, the SFPUC may require periodic deposits by the Wholesale Customers to fund a debt service coverage reserve account (the Wholesale Revenue Coverage Reserve) established and maintained by the SFPUC to meet debt service and minimum working capital requirements. The WSA sets the formula to calculate the debt service coverage and the working capital requirement. The ceiling of the Wholesale Revenue Coverage Reserve is the greater amount between the required debt service coverage and the working capital. Under Article VI, Section 6.06B of the WSA, any balance in the Wholesale Revenue Coverage Reserve in excess of the actual wholesale coverage requirement may be applied as a credit against wholesale rates in the following fiscal year, unless otherwise instructed by BAWSCA.

The Debt Service Coverage is calculated as the lesser of: (i) 25% of the Wholesale Customers' share of net annual debt service for the applicable fiscal year or (ii) the amount necessary to meet the Wholesale Customers' proportionate share of debt service coverage, less any credits for previous deposits and interest accruing to the Wholesale Revenue Coverage Reserve.

The working capital requirement prescribed in Article VI, Section 6.07 of the WSA is one-sixth (two months) of the annual wholesale allocation of operation and maintenance, administrative and general, and property tax expenses for the Water Enterprise and Hetch Hetchy.

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

(Continued)

(2) Balancing Account under the WSA

(a) Balancing Account Activity

The following summarizes activity in the Balancing Account under the WSA for the year ended June 30, 2021:

Table 2.1. Activity in the Balancing Account

		As previously reported	Adjustments		Adjusted balance
Balancing account under the WSA, June 30, 2021	$	(63,393,776)	—		(63,393,776)
Fiscal Year 2018-19 & Fiscal Year 2019-20 settlement agreement (note 2b)		—	(139,021)		(139,021)
Interest on Fiscal Year 2018-19 & Fiscal Year 2019-20 settlement agreement (note 2b)		—	2,902		2,902
Balancing account under the WSA, as adjusted, June 30, 2021	$	(63,393,776)	(136,119)		(63,529,895)
Interest on adjusted beginning balance at 0.68%					(432,003)
Net wholesale revenue billed (note 6)					(275,113,885)
Transfer from Wholesale Coverage Reserve					2,431,211
Transfer for BAWSCA water projects (note 2c)					197,000
Transfer from Balancing Account for K-5 Prepayment					4,030,664
Calculated wholesale revenue requirement					270,146,404
Interest on wholesale coverage reserve excess (note 2b)					(709,172)
Balancing account under the WSA, June 30, 2021				$	(62,979,676)

(b) *Article VII, 7.06 Settlement Agreement – Fiscal Year 2018-19 and Fiscal Year 2019-20*

In accordance with Article VII, Section 7.06 of the WSA, the SFPUC and the Wholesale Customers reached a settlement agreement on November 19, 2021, relating to costs attributable to the fiscal year ended June 30, 2019, and a settlement agreement on July 25, 2022, relating to costs attributable to the fiscal year ended June 30, 2020. The following are adjustments to the June 30, 2020 beginning Balancing Account agreed to by both parties to the WSA.

Table 2.2. Settlement Agreements

		Amount
Adjustments to June 30, 2020 beginning balance:		
Fiscal Year 2018-19 settlement adjustments:		
Settlement agreement – Minimum Purchase Payment	$	245,247
Settlement agreement – SF Lands Manager		(88,749)
Settlement agreement – CDD Buildings & Grounds		(4,595)
Subtotal Fiscal Year 2018-19 settlement adjustments – due (to)/from wholesale customers		151,903
Fiscal Year 2019-20 settlement adjustments:		
Settlement agreement – CDD Personnel		(111,104)
Settlement agreement – Staff Loan to Juvenile Probation Center		(23,337)
Settlement agreement – CDD Telephone Expenses		(184,136)
Settlement agreement – Landscape Maintenance on SFPUC Watershed Properties		(2,128)
Settlement agreement – Infrastructure Division COVID-19 Work		29,781
Subtotal Fiscal Year 2019-20 settlement adjustments – due (to)/from wholesale customers		(290,924)
Subtotal settlement adjustments – due (to)/from wholesale customers		(139,021)
Interest on adjustments:		
FY 2019-20 interest at 1.91%		2,902
Subtotal interest on settlement adjustments – due (to)/from wholesale customers		2,902
Total Fiscal Year 2018-19, Fiscal Year 2019-20 settlement adjustments – due (to)/from wholesale customers	$	(136,119)

(c) *Application of Balancing Account for Water Supply Projects*

In July 2020, $197,000 from the Balancing Account was transferred to BAWSCA to support water supply projects, as authorized by WSA Section 6.05.B.2. This amount is deducted during the fiscal year, and reflected in the Balancing Account as of June 30, 2021.

(3) Proportional Annual Use and Adjusted Proportional Annual Use

The Proportional Annual Use and the Adjusted Proportional Annual Use for the Wholesale and Retail Customers since the inception of the WSA in Fiscal Year 2009–10 are summarized below:

Table 3.1. Proportional Annual Use and Adjusted Proportional Annual Use

	Proportional annual use		Adjusted proportional annual use	
Fiscal year	Wholesale	Retail	Wholesale	Retail
2009-10	66.67 %	33.33 %	66.48 %	33.52 %
2010-11*	65.86	34.14	65.70	34.30
2011-12*	65.83	34.17	65.72	34.28
2012-13	66.56	33.44	66.43	33.57
2013-14	67.63	35.37	67.52	32.48
2014-15	65.67	34.33	65.56	34.44
2015-16	63.28	36.72	63.15	36.85
2016-17	64.27	35.73	64.12	35.88
2017-18*	66.04	33.96	65.91	34.09
2018-19*	65.68	34.32	65.52	34.48
2019-20*	66.99	33.01	66.90	33.10
2020-21*	69.94	30.06	69.76	30.24

*adjusted for imputed water sales

(4) Capital Cost Contribution – Existing Regional Assets (WSA Attachment K-5)

WSA Attachment K-5 represents projects of previously appropriated funds, which are summarized on the following table, advanced through rates charged to Retail Customers, for construction of capital projects. From July 1, 2009 to June 30, 2015, the Water Enterprise incurred total expenditures of $9,599,442 including interest through June 30, 2015, of which $6,618,478 is the Wholesale share and $12,385,482 for Hetch Hetchy including interest through June 30, 2015, of which $2,923,204 is the Wholesale share. Based on the WSA Section 5.03, these expenditures were amortized over ten years at an interest rate at 4%. The wholesale share is based on Proportional Annual Use for Water Enterprise and Adjusted Proportional Annual Use for Hetch Hetchy. Fiscal year 2020-21 is the seventh of ten annual cost recoveries for WSA Attachment K-5 capital projects.

The Wholesale Customers are allowed by Section 6.05.B.2 of the WSA to use Balancing Account amounts due to them to pay all or a portion of the remaining K-5 principal balance. On September 18, 2020, the Wholesale Customers elected to prepay the full remaining balance of $4,030,664. As a result, the payment for the fiscal year ended June 30, 2021 represents principal and interest through September 30, 2020.

Table 4.1. Capital Cost Contribution

		Water Enterprise	Hetch Hetchy	Total
Total expenditures of previously appropriated funds – July 1, 2009 to June 30, 2015	$	9,599,442	12,385,482	21,984,924
Wholesale share of expenditures		6,393,692	2,812,954	9,206,646
Interest on wholesale share of expenditures		224,786	110,250	335,036
Total amount due from Wholesale Customers	$	6,618,478	2,923,204	9,541,682
Interest rate		4%	4%	
Term (years)		10	10	
Annual payment due from Wholesale Customers	$	201,027	88,788	289,815

The activity in the liability account for K-5 projects for the fiscal year ended June 30, 2021 is summarized below.

Table 4.2. WSA Attachment K-5 Payments

		Water Enterprise	Hetch Hetchy	Total
Principal balance as of June 30, 2020	$	2,967,745	1,310,773	4,278,518
Principal payment		(171,921)	(75,933)	(247,854)
Prepayment		(2,795,824)	(1,234,840)	(4,030,664)
Principal balance as of June 30, 2021	$	—	—	—
Cumulative payments received through June 30, 2021:				
Applied to principal	$	3,822,654	1,688,363	5,511,017
Applied to interest		1,203,011	531,338	1,734,349
Total	$	5,025,665	2,219,701	7,245,366

(5) Capital Cost Contribution – New Regional Assets

(a) Debt-Funded Capital Projects

The Water Enterprise has previously issued revenue bonds to fund the construction of new regional capital assets. As of June 30, 2021, outstanding debt related to the construction of new regional capital assets included 11 different Water Revenue Bond Series, as well as 10 different Water Revenue Bond Series refunding all or a portion of other bonds. When a bond refunds more than one underlying bond series, the debt service is split out and allocated to the Wholesale Customers proportionally based on the allocation of the underlying bond. Bond 2020 Series A, 2020 Series B and 2020 Series D had no debt service payments during Fiscal Year 2020-21 because although they were issued during the fiscal year, they were structured for the first debt service payment to occur during Fiscal Year 2021-22. The following tables summarize the net debt service expenditures on outstanding debt related to the construction of new regional assets that was determined to be allocable to the Retail and Wholesale Customers.

The Water Enterprise paid $246,047,420 in gross debt service on the bonds listed in the table below during the year ended June 30, 2021. The net debt service is decreased to $245,986,083 when other interest earnings and other cash on hand of $61,337 are applied against the gross debt service payments.

Table 5.1. Debt Service Expenditures – New Regional Assets

	Principal	Net interest	Total
2010 Series B	$ 11,920,000	$ 21,645,037	$ 33,565,037
2010 Series E	—	20,059,169	20,059,169
2010 Series G	—	24,424,704	24,424,704
2011 Series B	730,000	44,773	774,773
2015 Series A/2006 Series A Refunding	14,635,000	17,279,332	31,914,332
2015 Series A/2009 Series A Refunding	—	1,844,220	1,844,220
2016 Series A/2009 Series A Refunding	9,980,000	13,370,248	23,350,248
2016 Series A/2009 Series B Refunding	9,725,000	15,051,123	24,776,123
2016 Series A/2010 Series F Refunding	250,000	6,838,750	7,088,750
2016 Series C	5,705,000	8,866,135	14,571,135
2017 Series A	—	987,335	987,335
2017 Series B	—	277,653	277,653
2017 Series C	—	787,430	787,430
2017 Series D/2011 Series A Refunding	890,000	11,174,411	12,064,411
2017 Series D/2012 Series A Refunding	—	6,114,401	6,114,401
2017 Series F/2011 Series B Refunding	—	435,250	435,250
2017 Series G/2011 Series A Refunding	500,000	903,553	1,403,553
2019 Series A/2010 Series F Refunding	3,280,000	312,919	3,592,919
2019 Series A/2011 Series A Refunding	3,575,000	14,236,302	17,811,302
2019 Series A/2012 Series A Refunding	—	11,486,406	11,486,406
2019 Series B/2011 Series B Refunding	—	729,955	729,955
2020 Series A	—	—	—
2020 Series B	—	—	—
2020 Series D	—	—	—
2020 Series E/2010 Series D Refunding	—	79,469	79,469
2020 Series E/2012 Series A Refunding	—	3,337,606	3,337,606
2020 Series E/2017 Series A Refunding	—	1,699,850	1,699,850
2020 Series F/2017 Series B Refunding	—	1,900,664	1,900,664
2020 Series H/2017 Series C Refunding	—	909,388	909,388
	$ 61,190,000	$ 184,796,083	$ 245,986,083

The following table shows the allocation of each bond series to retail and regional projects, as well as the Fiscal Year during which each bond reached substantially expended. Bond 2016 Series C reached substantially expended during the year ended June 30, 2021.

Table 5.2. Wholesale Customers Debt Service Allocation (%)

	Excluded costs	Retail projects	Regional projects	Total	Substantially expended fiscal year	Allocation adjusted fiscal year
2010 Series B	0.02	7.13	92.85	100.00	FY 10-11	FY 15-16 7.06
2010 Series E	—	3.17	96.83	100.00	FY 15-16	FY 15-16 7.06
2010 Series G	—	—	100.00	100.00	FY 14-15	
2011 Series B	—	0.53	99.47	100.00	FY 18-19	
2012 Series A	—	8.83	91.17	100.00	FY 18-19	
2015 Series A/ 2006 Series A Refunding	33.71	13.10	53.19	100.00	FY 09-10 7.06	
2015 Series A/ 2009 Series A Refunding	31.65	10.43	57.92	100.00	FY 09-10 7.06	
2016 Series A/ 2009 Series A Refunding	31.65	10.43	57.92	100.00	FY 09-10 7.06	
2016 Series A/ 2009 Series B Refunding	0.85	12.51	86.64	100.00	FY 10-11	FY 15-16 7.06
2016 Series A/ 2010 Series F Refunding	—	—	100.00	100.00	FY 14-15	
2016 Series C	—	0.98	99.02	100.00	FY 20-21	
2017 Series A	—	0.54	99.46	100.00	FY 18-19	
2017 Series B*	—	70.40	29.60	100.00		
2017 Series C	—	—	100.00	100.00	FY 18-19	
2017 Series D/ 2011 Series A Refunding	—	6.47	93.53	100.00	FY 14-15	
2017 Series D/ 2012 Series A Refunding	—	8.83	91.17	100.00	FY 18-19	
2017 Series F/ 2011 Series B Refunding	—	0.53	99.47	100.00	FY 18-19	
2017 Series G/ 2011 Series A Refunding	—	6.47	93.53	100.00	FY 14-15	
2019 Series A/ 2010 Series F Refunding	—	—	100.00	100.00	FY 14-15	
2019 Series A/ 2011 Series A Refunding	—	6.47	93.53	100.00	FY 14-15	
2019 Series A/ 2012 Series A Refunding	—	8.83	91.17	100.00	FY 18-19	
2019 Series B/ 2011 Series B Refunding	—	0.53	99.47	100.00	FY 18-19	
2020 Series A*	—	2.04	97.96	100.00		
2020 Series B*	—	—	100.00	100.00		
2020 Series D*	—	—	100.00	100.00		
2020 Series E/ 2010 Series D Refunding	—	2.77	97.23	100.00	FY 11-12	
2020 Series E/ 2012 Series A Refunding	—	8.83	91.17	100.00	FY 18-19	
2020 Series E/ 2017 Series A Refunding	—	0.54	99.46	100.00	FY 18-19	
2020 Series F/ 2017 Series B Refunding	—	70.40	29.60	100.00		
2020 Series H/ 2017 Series C Refunding	—	—	100.00	100.00	FY 18-19	

* Expected allocation to be trued up w hen bond reaches Substantially Expended status (note 5a)

The table below shows the allocation of the net debt service in Table 5.1 using the percentages from Table 5.2. The regional share of all bonds except for 2011 Series B, 2017 Series C, and 2020 Series D is allocated based on Proportional Annual Use. Because 2011 Series B, 2017 Series C, and 2020 Series D fund Hetch Hetchy water-related capital project expenditures, the Wholesale share of the debt on these series for the year ended June 30, 2021 was allocated using the Adjusted Proportional Annual Use percentage of 69.76%.

In total, $145,834,621 in net debt service is allocated to the Wholesale Customers.

Table 5.3. Wholesale Customers Debt Service Allocation ($)

	Excluded costs	Retail projects	Regional projects	Total	Proportional annual use	Total wholesale debt service
2010 Series B	$ 6,713	$ 2,393,187	$ 31,165,137	$ 33,565,037	69.94%	$ 21,796,897
2010 Series E	—	635,876	19,423,293	20,059,169	69.94%	13,584,651
2010 Series G	—	—	24,424,704	24,424,704	69.94%	17,082,638
2011 Series B	—	4,106	770,667	774,773	69.76% *	537,617
2015 Series A/ 2006 Series A Refunding	10,758,321	4,180,777	16,975,233	31,914,332	69.94%	11,872,478
2015 Series A/ 2009 Series A Refunding	583,696	192,352	1,068,172	1,844,220	69.94%	747,080
2016 Series A/ 2009 Series A Refunding	7,390,353	2,435,431	13,524,464	23,350,248	69.94%	9,459,010
2016 Series A/ 2009 Series B Refunding	210,597	3,099,493	21,466,033	24,776,123	69.94%	15,013,343
2016 Series A/ 2010 Series F Refunding	—	—	7,088,750	7,088,750	69.94%	4,957,872
2016 Series C	—	142,797	14,428,338	14,571,135	69.94%	10,091,180
2017 Series A	—	5,332	982,003	987,335	69.94%	686,813
2017 Series B	—	195,468	82,185	277,653	69.94%	57,480
2017 Series C	—	—	787,430	787,430	69.76% *	549,311
2017 Series D/ 2011 Series A Refunding	—	780,567	11,283,844	12,064,411	69.94%	7,891,920
2017 Series D/ 2012 Series A Refunding	—	539,902	5,574,499	6,114,401	69.94%	3,898,805
2017 Series F/ 2011 Series B Refunding	—	2,307	432,943	435,250	69.76% *	302,021
2017 Series G/ 2011 Series A Refunding	—	90,810	1,312,743	1,403,553	69.94%	918,133
2019 Series A/ 2010 Series F Refunding	—	—	3,592,919	3,592,919	69.94%	2,512,888
2019 Series A/ 2011 Series A Refunding	—	1,152,391	16,658,911	17,811,302	69.94%	11,651,242
2019 Series A/ 2011 Series B Refunding	—	1,014,250	10,472,156	11,486,406	69.94%	7,324,226
2019 Series B/ 2012 Series A Refunding	—	3,869	726,086	729,955	69.76% *	506,518
2020 Series A	—	—	—	—	69.94%	—
2020 Series B	—	—	—	—	69.94%	—
2020 Series D	—	—	—	—	69.76% *	—
2020 Series E/ 2010 Series D Refunding	—	2,201	77,268	79,469	69.94%	54,041
2020 Series E/ 2012 Series A Refunding	—	294,711	3,042,895	3,337,606	69.94%	2,128,201
2020 Series E/ 2017 Series A Refunding	—	9,179	1,690,671	1,699,850	69.94%	1,182,455
2020 Series F/ 2017 Series B Refunding	—	1,338,067	562,597	1,900,664	69.94%	393,480
2020 Series F/ 2017 Series C Refunding	—	—	909,388	909,388	69.76% *	634,389
	$ 18,949,680	$ 18,513,073	$ 208,523,329	$ 245,986,083		$ 145,834,689

* Adjusted Proportional Annual Use (note 5b)

(b) Build America Bonds Federal Interest Subsidy

2010 Series B, 2010 Series E and 2010 Series G are Federally taxable bonds with Build America Bonds Subsidy (BABS) revenues. The following table shows total BABS revenues received of $21,886,851 and wholesale shares credited to the Wholesale Customers of $14,802,218.

Table 5.4. Build America Bonds Federal Interest Subsidy

Bond Series	Total BABs Subsidy	% of Regional Projects	Proportional Annual Use	Wholesale Share
2010 Series B	$ (7,162,914)	92.85 %	69.94 %	$ (4,651,545)
2010 Series E	(6,641,546)	96.83 %	69.94 %	(4,497,848)
2010 Series G	(8,082,391)	100.00 %	69.94 %	(5,652,824)
	$ (21,886,851)			$ (14,802,217)

(c) True-Up of Substantially Expended Bonds

Article V, Section 5.04 of the WSA requires the revised allocation factor be used in the year when a bond series becomes substantially expended and thereafter. The difference between the amount of net debt service paid by the Wholesale Customers prior to the year that the bond series became substantially expended and the amount of the net debt service that they should have paid will be included in the calculation of the Balancing Account in the year the bond series becomes substantially expended. Table 2 shows the Fiscal Year during which each bond reached substantially expended. As of June 30, 2021, Bond 2016 Series C reached substantially expended status. A true-up of $305,643 is included in Fiscal Year 2020-21 WRR to account for the change from the estimated allocation of 100% regional projects to the final allocation of 99.02% regional projects.

(d) Use of Escrow Funds for Bond-Funded Capital Expenditures

Bonds 2010 Series D, 2012 Series A, 2017 Series A, and 2017 Series C were partially or fully refunded by 2020 Series E, 2020 Series F, and 2020 Series H during Fiscal Year 2020-21. Debt service payments for the underlying series already been made to the trustee during Fiscal Year 2020-21 were instead applied to pay for the cost of issuance or respective escrow accounts for their refunding bonds. These amounts are not considered debt service for the year, but are included as "other costs of debt" as authorized by WSA Section 5.04 (A)(6), since they represent actual payments made to support Water Revenue Bonds that are not accounted for elsewhere in the Wholesale Revenue Requirement. Their allocation to the Wholesale Customers is proportional to the allocation of each underlying bond series. The following table shows the total payments to refunding escrows included in the Fiscal Year 2020-21 Wholesale Revenue Requirement.

Table 5.5. Payments for Refunding Escrow Funds

Bond Series		Total Refunding Escrow	Allocation % Regional for the Bond	Proportional annual use (PAU) or Adjusted PAU		Total Allocated to Wholesale
2010 Series D	$	12,427,875	97.23 %	69.94 %	$	8,451,286
2012 Series A		4,330,000	91.17 %	69.94 %		2,761,504
2017 Series A		2,353,500	99.46 %	69.94 %		1,637,149
2017 Series C		1,373,125	100.00 %	69.76 %		957,892
					$	13,807,831

(e) Revenue-Funded Capital Projects – Water Enterprise

The following is a summary of the wholesale share of appropriations for regional revenue-funded capital projects under the Water Enterprise for the year ended June 30, 2021.

Table 5.6. Revenue-Funded Capital Projects – Water Enterprise

Project Description		Appropriations	Allocation %		Wholesale share
Buildings & Grounds	$	(567,375)	69.94%	$	(396,822)
Water Transmission		(4,717,212)	69.94%		(3,299,218)
Water Treatment		(651,830)	69.94%		(455,890)
Watershed & Land Management		19,713,316	69.94%		13,787,493
525 Golden Gate - Water Enterprise Share		(26,079)	69.94%		(18,240)
525 Golden Gate - Direct Wholesale Share		(215)	100.00%		(215)
Fiscal Year 2020-21 Total	$	13,750,605		$	9,617,108

(f) Revenue-Funded Capital Projects – Hetch Hetchy Share

The following is a summary of the wholesale share of appropriations for Hetch Hetchy Water revenue-funded capital projects for the year ended June 30, 2021.

Table 5.7. Revenue-Funded Capital Projects – Hetch Hetchy Share

Project Description	Appropriations	Allocation %	Wholesale Share
525 Golden Gate - Hetchy Water Share	$ (3,703)	69.76 %	$ (2,583)
Fiscal Year 2020-21 Total	$ (3,703)		$ (2,583)

(g) Excess Accumulation of Unexpended and Unencumbered Appropriation

Collections for revenue-funded regional capital assets are based on appropriation rather than actual expenditures. To prevent excess accumulation of unexpended and unencumbered appropriation, WSA Section 6.08 requires a review and adjustment of the Wholesale Revenue-Funded Capital Fund balance.

As of June 30, 2021, the Wholesale Revenue-Funded Capital Fund balance is $727,181 more than the target amount based on cumulative annual appropriations and expenditures. This excess balance is transferred to the Balancing Account. Activity in the Wholesale Revenue Funded Capital Fund is shown in the table below.

Table 5.8. Annual Activity in Wholesale Capital Fund

	FY 2021-22
Beginning Wholesale Capital Fund Balance:	$ 62,212,090
Annual Appropriation	9,614,525
Annual Expenditures	(14,865,227)
Interest Earnings	405,190
Subtotal Balance Before Transfers	57,366,578
Amount Encumbered as of June 30, 2021	(17,785,484)
Unencumbered Balance Before Transfers	$ 39,581,094

Table 5.9. True-Up of Balance in Wholesale Capital Fund

Lesser of		
Target Balance, or	$ 38,853,912	
Cumulative Unspent Wholesale Capital Fund	58,813,986	
Target Balance		38,853,912
(Less) Unencumbered Balance Before Transfer		(39,581,093)
Deficiency/(Excess) in Reserve		(727,181)
Lesser of		
$4,000,000 or	$ 4,000,000	
Calculated Reserve Deficiency	(727,181)	
Wholesale Capital Fund, Before Adjustments		57,366,578
Transfer From/(To) Balancing Account		(727,181)
Ending Total Balance		56,639,397

(6) Wholesale Revenue Billings

During the year ended June 30, 2021, the SFPUC billed a total of $275,113,886 (net of amounts remitted to BAWSCA) in wholesale revenue for costs of service associated with deliveries from the regional water system. This total includes $2,055,966 in wholesale revenue billings associated with customers who did not meet their minimum purchase requirements (note (1)(e)). As applicable, a portion of these billings relate to deposits by the Wholesale Customers to meet their Wholesale Revenue Coverage Reserve and Working Capital Reserve requirements per Article VI, Section 6.06 and Section 6.07 of the WSA, respectively. For the year ended June 30, 2021, the balance in the Wholesale Revenue Coverage Reserve was lower than required, and so $2,431,211 was transferred to the Wholesale Revenue Coverage Reserve and Working Capital Reserve from the Balancing Account, decreasing total revenues for the Fiscal Year. The net amount billed after transfer from the Coverage Reserve, and which is applied to the revenue requirement, is $272,682,675.

Gross and net wholesale revenue billings are summarized below:

Table 6.1. Wholesale Revenue Billings

Gross wholesale amounts billed – net of adjustments	$ 273,057,919
Imputed water sales from minimum purchase requirements	2,055,966
Subtotal	275,113,885
Transfer from wholesale revenue coverage reserve	(2,431,211)
Net wholesale revenues billed	$ 272,682,674

(7) Wholesale Revenue Coverage Reserve

(a) Activity in the Wholesale Revenue Coverage Reserve During the Year Ended June 30, 2021

During the year ended June 30, 2021, $2,431,211 was transferred to the Wholesale Revenue Coverage Reserve in accordance with Article VI, Section 6.06 of the WSA. As of June 30, 2021, the Wholesale Revenue Coverage Reserve balance was $37,562,766, representing total deposits since July 1, 2009.

Table 7.1. Wholesale Revenue Coverage Reserve

		Wholesale revenue coverage reserve
Balance, June 30, 2020	$	35,131,555
Deposits to wholesale revenue coverage reserve (note 2a)		2,431,211
Balance, June 30, 2021	$	37,562,766

(b) Net Interest on Wholesale Coverage Reserve

As of July 1, 2020, the Wholesale Revenue Coverage Reserve amount exceeded the Working Capital Requirement of 60 days of the wholesale share of Operations and Maintenance, Administrative and General, and Property Taxes, as shown in the below table. Net interest of $709,172, calculated as the annual interest on the Wholesale Revenue Coverage Reserve less any Working Capital Requirement not met, is credited to the Balancing Account in favor of the Wholesale Customers during the year ended June 30, 2021, in accordance with Article VI, Section 6.06 of the WSA.

Table 7.2. Net Interest on Wholesale Coverage Reserve

		Debt service coverage requirement	Working capital coverage requirement	Net interest
Calculation of adequacy of reserve requirement				
Wholesale revenue coverage reserve balance, July 1, 2020	$	35,131,555	35,131,555	
Coverage reserve requirement, July 1, 2020		(35,146,269)	(18,049,104)	
Coverage reserve excess (deficiency)	$	(14,714)	17,082,451	
Net interest due (to) from Wholesale Customers				(709,172)

(8) 2013 Rim Fire

In August 2013, the SFPUC's Hetch Hetchy Water and Power was challenged by the third largest fire in California history, the Rim Fire, in Stanislaus National Forest and Yosemite National Park, which burned over 250,000 acres. Through the U.S. Department of Homeland Security Federal Emergency Management Agency and the State of California Office of Emergency Services, federal and state funding is available on a cost-sharing basis to the City to help offset the costs of emergency work and the repair or replacement of facilities damaged by the Rim Fire. Additionally, many of the SFPUC assets impacted by the Rim Fire were insured.

For the fiscal year ending June 30, 2021, Hetch Hetchy incurred expenses of approximately $0.1 million, bringing cumulative total expenses related to facilities and infrastructure damage, and costs related to emergency response to approximately $24.9 million. Reimbursements to-date from insurance and federal and state grants totals approximately $13.2 million. The WRRs for the years ended June 30, 2014 through June 30, 2021 did not include complete allocation of the Rim Fire related costs because insurance reimbursements, government grants, and expenditures have not been finalized. SFPUC will finalize the allocation of Rim Fire related costs to Wholesale Customers once final expense amounts and related cost reimbursements are known. That allocation will include a proportional allocation of all reimbursements, and account for debt service already paid by the Wholesale Customers on any projects funded by bond series. An estimate of $2.3 million may be due from the Wholesale Customers.

(9) Wholesale Customer Review of Fiscal Years 2018-19 and 2019-20 Wholesale Revenue Requirement

Article VII, Section 7.06 of the WSA provides the Wholesale Customers the right to conduct a review of the SFPUC's calculation of the annual changes in the Balancing Account.

The Wholesale Customers and SFPUC entered into a settlement agreement on November 19, 2021, to resolve issues pertaining to the calculation of changes to the Balancing Account for Fiscal Year 2018-19, and on July 25, 2022, to resolve issues pertaining to the calculation of changes in the Balancing Account for Fiscal Year 2019-20. These settlement agreements resulted in adjustments described Statement to the Changes in the Balancing Account June 30, 2021 in Note (2)(b). This settlement agreement closed all outstanding issues from Fiscal Year 2018-19 and Fiscal Year 2019-20, with the exception of the items listed in note (10) below.

(10) Other Items Under Discussion

The following are items that are under discussion between the Wholesale Customers and the SFPUC. The discussion of these items and the path to resolution may have an impact on the calculation of the Wholesale Revenue Requirement.

(a) Implementation of WSA Asset Classification Amendment

Timing for implementation of the SFPUC adopted December 11, 2018 WSA amendments directly affecting the calculation of the Wholesale Revenue Requirement is still to be discussed and agreed upon. The SFPUC will share a plan for implementation of these amendments with Wholesale Customers before proceeding with implementation. While the other amendments which impact the WRR have been implemented, a true-up of expenditures relating to Hetch Hetchy Water asset classification remains outstanding as of Fiscal Year 2020-21.

WSA section 5.11 and definitions, section 5.12, and Attachment R were amended to clarify the classification of Hetch Hetchy Water assets. For the assets shown in the table below, the classification of operating expenses will remain as shown in the "Asset Classification" column, but specific capital project expenses, going forward and retroactively to the date shown in the table, will be reclassified. The methodology for implementing these changes, especially the required retroactive adjustment, will be discussed between the SFPUC and Wholesale Customers. Adjustments to the Balancing Account to reflect the revised capital classification will be incorporated as expediently as possible; the amount of adjustments is not known at this time.

Table 10.1. Capital Project Expenses Classification

Asset	Asset Classification	Project Classification
Lower Cherry Aqueduct	Joint	Water
Mountain Tunnel Interim Work	Joint	Water
Mountain Tunnel Long Term Repairs	Joint	Water
Mountain Tunnel Flow Control Facility	Joint	Joint
Kirkwood Penstock	Power	Joint
Moccasin Penstock	Power	Joint
Moccasin Lower Dam	Water	Joint

(b) True-up of Debt Service Allocation of WSIP Bonds

In the Fiscal Year 2009-10 7.06 Settlement Agreement, the parties agreed that the debt service allocation on bonds related to the Water System Improvement Project (WSIP) may need to be adjusted to properly reflect the final use of proceeds. This adjustment, which would impact the allocation of debt service beginning in Fiscal Year 2009-10, is to occur at or near the completion of WSIP. As WSIP is over 98% complete by dollar value as of Fiscal Year 2020-21, the SFPUC expects to incorporate this adjustment in the Fiscal Year 2021-22 Wholesale Revenue Requirement. This adjustment is expected to change the allocation of bonds 2009 Series B and 2010 Series E, and is estimated at $3,549,471 owed by the wholesale customers.

KPMG

Yano Accountancy Corporation

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

September 13, 2023

To the Honorable Mayor, Members of the Board of Supervisors,
and Management of the City and County of San Francisco,
and the Wholesale Customers:

In planning and performing our audit of the Statement of Changes in the Balancing Account (the statement) of the San Francisco Water Enterprise (Water Enterprise) and Hetch Hetchy Water and Power (Hetch Hetchy), under the jurisdiction of the San Francisco Public Utilities Commission (SFPUC), for the year ended June 30, 2021, in accordance with auditing standards generally accepted in the United States of America, we considered SFPUC's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the SFPUC's internal control. Accordingly, we do not express an opinion on the effectiveness of the SFPUC's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a combination of deficiencies in internal control that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency described in Finding 2021-1 to be a material weakness.

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

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

Restriction on Use

This communication is intended solely for the information and use of the Mayor, Board of Supervisors, San Francisco Public Utilities Commission, City Management, and the Wholesale Customers, and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

Yano Accountancy Corporation

Finding 2021-1

Criterion

Water Supply Agreement Article V, Section 5.02E describes two general principles of allocating costs to the Wholesale Customers, and states in part that "…(1) the Wholesale Customers should not pay for expenses of SFPUC operations from which they receive no benefit and (2) the Wholesale Customers should pay their share of expenses incurred by the SFPUC in delivering water to them…"

Observations and Effects

We observed the following during the audit of the Balancing Account. SFPUC management agreed with these observations, and accordingly recorded audit adjustments and changed related disclosures.

1. The wholesale share of capital cost contribution – new regional assets – debt-funded was not summarized correctly, resulting in a $26,387,000 misstatement in the Balancing Account as of June 30, 2021. SFPUC recorded an audit adjustment to the Balancing Account of $26,387,000 in favor of the Retail Customers.

2. The wholesale share of actual revenue-funded capital expenditures was misstated by $1,152,000. SFPUC recorded an audit adjustment of $1,152,000 in favor of the Wholesale Customers.

3. The overall wholesale revenue requirement was misstated by $235,000 because SFPUC did not calculate the Proportional Annual Use (PAU) and Adjusted Proportional Annual Use (APAU) percentages correctly. SFPUC and the Wholesale Customers jointly investigated the discrepancy and agreed on adjusted higher PAU and APAU percentages. SFPUC recorded an audit adjustment to the Balancing Account of $235,000 in favor of the Retail Customers.

4. The paid time off adjustment was not calculated correctly, resulting in a $34,000 misstatement in the Balancing Account as of June 30, 2021. SFPUC recorded an audit adjustment to the Balancing Account of $34,000 in favor of the Wholesale Customers.

Total audit adjustments recorded by SFPUC were $25,436,000 in favor of the Retail Customers.

Cause

The cause of the first, third, and fourth observations was inadequate controls over spreadsheet calculations to ensure their accuracy. The cause of the second observation was inadequate review of the general ledger to determine which amounts should be recorded as revenue-funded capital expenditures.

Recommendation

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

Views of SFPUC Management

SFPUC management concurs with the findings. To prevent items 1, 3, and 4 in the future, the SFPUC has already implemented additional controls in the spreadsheets used to calculate the Wholesale Revenue Requirement to check for or automatically correct these specific errors and is adding similar checks to other portions of the calculation as appropriate. To prevent item 2, the SFPUC is providing additional training for staff who prepare these schedules and performing additional cross-checks to alternative data sources for quality control.

The San Francisco Public Utilities Commission Spent Revenue Bond Funds for Allowable Purposes but Should Strengthen Its Compliance and Monitoring Controls

San Francisco Public Utilities Commission

AUDITS DIVISION

August 30, 2023

City & County of San Francisco
Office of the Controller
City Services Auditor

About the Audits Division

The City Services Auditor (CSA) was created in the Office of the Controller through an amendment to the Charter of the City and County of San Francisco (City) that voters approved in November 2003. Within CSA, the Audits Division ensures the City's financial integrity and promotes efficient, effective, and accountable government by:

- Conducting performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of service delivery and business processes.
- Investigating reports received through its whistleblower hotline of fraud, waste, and abuse of city resources.
- Providing actionable recommendations to city leaders to promote and enhance accountability and improve the overall performance and efficiency of city government.

Team:
Massanda D'Johns, *Lead Audit Manager*
Hunter Wang, *Audit Manager*
Jeancarlos Santos Palacios, *Audit Intern*

Consultants:
HKA Global, Inc.
Yano Accountancy Corporation

Mark de la Rosa
Director of Audits
Office of the Controller
City and County of San Francisco
(415) 554-7574

For media inquiries, please contact con.media@sfgov.org.

sf.gov/controller
@sfcontroller
LinkedIn Office of the Controller

Audit Authority

This audit was conducted under the authority of the San Francisco Charter, Section 3.105, and Appendix F, which requires that CSA conduct periodic, comprehensive financial and performance audits of city departments, services, and activities.

OFFICE OF THE CONTROLLER
CITY AND COUNTY OF SAN FRANCISCO

Ben Rosenfield
Controller

Todd Rydstrom
Deputy Controller

August 30, 2023

Public Utilities Revenue Bond Oversight Committee
San Francisco Public Utilities Commission
525 Golden Gate Avenue, 2nd Floor
San Francisco, CA 94102

San Francisco Public Utilities Commission
525 Golden Gate Avenue, 13th Floor
San Francisco, CA 94102

Dennis Herrera
General Manager
San Francisco Public Utilities Commission
525 Golden Gate Avenue, 13th Floor
San Francisco, CA 94102

Dear Committee Members, Commissioners, and General Manager Herrera:

The Office of the Controller (Controller), City Services Auditor (CSA), Audits Division, presents its audit report of the revenue bond program administered by the San Francisco Public Utilities Commission (SFPUC). The Public Utilities Revenue Bond Oversight Committee (RBOC) engaged CSA, which, in turn, engaged HKA Global, Inc. (HKA) and, as its subcontractor, Yano Accountancy Corporation (YAC), to conduct the audit. The audit had as its objectives to determine whether revenue bond funds were spent in accordance with the stated purposes and permissible use of such bonds.

The audit concluded that nearly all revenue bond expenditures were spent appropriately. However, the audit identified $15.36 million in questionable expenditures related to internal control weaknesses over SFPUC's control environment and monitoring of its procurement policies and procedures. We recommend that SFPUC improve documentation controls over its procurement solicitation requirements. We also recommend that SFPUC coordinate with RBOC to strengthen its monitoring activities of overhead rates on capital projects funded with revenue bond proceeds. The department's response is attached as Appendix B. CSA will work with the department to follow up every six months on the status of the open recommendations made in this report.

CSA, HKA, and YAC appreciate the assistance and cooperation of all staff involved in this audit. For questions about the report, please contact me at mark.p.delarosa@sfgov.org or 415-554-7574 or CSA at 415-554-7469.

Respectfully,

Mark de la Rosa
Director of Audits

cc: Board of Supervisors
Budget Analyst
Citizens Audit Review Board
City Attorney
Civil Grand Jury
Mayor
Public Library

REVENUE BOND OVERSIGHT COMMITTEE

San Francisco Public Utilities Commission

PERFORMANCE AUDIT OF SELECT REVENUE BOND EXPENDITURES

PHASE II

August 30, 2023

HKA

Yano Accountancy Corporation

CONTENTS

1. EXECUTIVE SUMMARY

Introduction

The San Francisco Public Utilities Commission ("SFPUC"), a department of the City and County of San Francisco ("City"), has embarked on multiple construction programs in its Water, Wastewater, and Power enterprises. The voters approved Proposition A and Proposition E in 2002, which authorized SFPUC to issue bonds to fund the costs of the construction programs, which currently have total forecasted expenditures of approximately $17 billion; actual program expenditures through June 30, 2022, are $8.8 billion. Funding of the expenditures through June 30, 2022, includes roughly $6.7 billion in bond proceeds from bond issuances authorized by Propositions A and E. The remaining $2.1 billion is funded by a combination of investment earnings on unexpended proceeds, Federal and state loans and grants, commercial paper, and SFPUC revenues.

The voters also passed Proposition P in 2002, which created City Administrative Code Section 5A.30-5A.36, which in turn authorized the establishment of the Public Utilities Revenue Bond Oversight Committee ("RBOC"). RBOC's authorities under City Administrative Code 5A.31(b)(6) include the *"…independent review and evaluation of the disbursement and expenditure of the proceeds of such revenue bonds by accessing any funds set aside for this purpose…to retain outside auditors, inspectors and necessary experts to conduct such independent review…."* RBOC retained the Office of the Controller's City Services Auditor ("CSA") to conduct a performance audit of bond-funded expenditures to determine whether expenditures were allowable under bond resolutions, properly supported, and assigned or allocated to the correct project(s) within bond series, and to evaluate the effectiveness of internal control over the allowability, and assignment of expenditures.

CSA engaged HKA Global, Inc. ("HKA") and Yano Accountancy Corporation ("YAC" collectively referred to as the "Audit Team") to conduct a performance audit of six SFPUC bond series subject to RBOC oversight. This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Summary of Findings and Recommendations

We found two contracts in which SFPUC did not comply with established internal control guidance and preferred procurement practices. The non-compliance with preferred procurement practices also increased the risk environment for waste and/or abuse. Total expenditures on these two contracts subject to RBOC oversight was $15.36 million.

SFPUC is not quantifying or reporting the monetary impact of SFPW's overhead rates on total sewer engineering direct labor and benefits to the RBOC. Since future Wastewater project expenditures subject to RBOC oversight are expected to be in the billions of dollars, substantial SFPW sewer engineering overhead on direct labor and benefits are expected to be in such expenditures.

Summary of Our Findings and Recommendations	
Non-Completion of Impartiality and Confidentiality Statements by All Individuals Associated with Procurements	SFPUC did not comply with established internal control guidance and City preferred procurement practices by not obtaining signed impartiality and conflict of interest statements from all individuals participating in procurement solicitations. This pervasive internal control design deficiency existed during the procurement process for a contract awarded to an entity controlled by an individual who had a joint investment with the former SFPUC Assistant General Manager – Infrastructure (and later, SFPUC General Manager). The circumstances surrounding the timing of the sale of the individual's share of the investment to the then Assistant General Manager – Infrastructure increased the risk environment for waste and abuse. We questioned a total of $15.36 million of expenditures subject to RBOC oversight.
SFPUC Should Quantify and Report on Overhead Rates Charged for SFPW Sewer Engineering Activities	See Finding No. 1 in Section 5. SFPUC is not quantifying or reporting the monetary impact of SFPW's overhead rates on total sewer engineering direct labor and benefits to the RBOC. The RBOC accordingly cannot discharge its oversight responsibilities on SFPW overhead expenditures charged on sewer engineering direct labor and benefits. Since future expenditures subject to RBOC oversight on Wastewater projects are expected to be in the billions of dollars, it is expected that substantial SFPW sewer engineering direct labor, benefits and related overhead will be included in such expenditures. See Finding No. 2 in Section 5.

Restriction on Use

The purpose of this performance audit is solely to evaluate SFPUC's compliance with and internal control over the allowability of expenditures under bond provisions, support for expenditures, assignment, or allocation of expenditures to correct projects within a bond series. Accordingly, this performance audit is not suitable for any other purpose.

List of Acronyms

SFPUC	San Francisco Public Utilities Commission
City	City and County of San Francisco
RBOC	Revenue Bond Oversight Committee
CSA	Office of the Controller's City Services Auditor
HKA	HKA Global, LLC
YAC	Yano Accountancy Corporation
Audit Team	HKA and YAC
SFPW	San Francisco Public Works
GM	General Manager
AGM	Assistant General Manager
Wastewater Enterprise	San Francisco Wastewater Enterprise
SEP	Southeast Water Pollution Control Plant
OSP	Oceanside Water Pollution Control Plant
mgd	million gallons per day
Water Enterprise	San Francisco Water Enterprise
HHWP	Hetch Hetchy Water and Power
Power Enterprise	Hetchy Water & Hetchy Power projects in the Hetch Hetchy Program
Infrastructure	SFPUC Infrastructure Division
SSIP	Sewer System Improvement Program
R&R	Wastewater Renewal & Replacement Program
FIP	Wastewater Facilities & Infrastructure Program
SSIP Phase 1	SSIP Phase 1 projects
Other SSIP	Projects not in SSIP Phase 1
WSIP	Water System Improvement Program
WECIP	Water Enterprise Capital Improvement Program
Regional WECIP	WECIP sub-program for the Regional Capital Improvement Program
Local WECIP	WECIP sub-program for the Local Capital Improvement Program
HCIP	Hetchy Capital Improvement Projects program
HCIP Water	Water projects of the HCIP Program
HCIP Power	Power projects of the HCIP Program
HCIP Joint	Joint Water and Power projects of the HCIP program
FIFO	First-in, First-out
Government Awards	Federal and State grants and loans
COSO Framework	COSO Internal Control-Integrated Framework
PD	Project Design Procedures
PM	Project Management Procedures
CM	Construction Management Procedures
HydraSection	SFPW's Hydraulic Section activities
SFMTA	San Francisco Municipal Transit Authority
MOU	Memorandum of Understanding
CMGC	Construction Manager / General Contractor
OCA	Office of Contract Administration
RFP	Request for Proposal
SOW	Scope of Work
BDF	Biosolids Digester Facilities
OLSE	Office of Labor Standards Enforcement

Acknowledgement	City Solicitation/Contract Participation Acknowledgement form
I/CS	Impartiality/Confidentiality Statement form
mlok	mlok Consulting, Inc.
City Attorney	Office of the City Attorney
CAR	Corrective Action Plan

2. SAN FRANCISCO PUBLIC UTILITIES COMMISSION

SFPUC is a department of the City responsible for the maintenance, operation, and development of the Wastewater, Water, and Power utility enterprises. SFPUC, led by the General Manager ("GM"), operates and manages the enterprises as separate financial entities with different enterprise funds, and each enterprise is led by an Assistant General Manager ("AGM").

- The Wastewater Enterprise provides wastewater and stormwater collection, treatment, and disposal services for the City.
- The Water Enterprise provides drinking water to Retail Customers in the City, specific Retail Customers outside the City, and Wholesale Customers in three other Bay Area counties.
- The Power Enterprise provides hydroelectric and solar-generated electricity to municipal and public infrastructure, and other facilities in the City.

Enterprise and Support Bureau Descriptions

Wastewater Enterprise

The San Francisco Wastewater Enterprise ("Wastewater Enterprise") provides collection, treatment, and disposal services to residential, commercial, and industrial customers in the City limits and three municipal sewer service providers for residents and businesses in northern San Mateo County.

The City's collection system is a network of sewers that collect and transport both sanitary flow and stormwater runoff – commonly referred to as wastewater. Ninety-two percent of San Francisco is served by a combined sanitary and stormwater wastewater system comprising 24,800 manholes, 25,000 catch basins, 27 pump stations, and approximately 1,000 miles of sewers ranging from 8-inch diameter pipes to large transport structures measuring up to 45 feet deep by 25 feet wide.

Flows are conveyed from the collection system through the transport/storage boxes to two centralized all-weather treatment plans, the Southeast Water Pollution Control Plant ("SEP") and the Oceanside Water Pollution Control Plant ("OSP"). These are respectively located in the southeast and southwest sections of the City. During wet weather, additional flows are conveyed to the North Point Wet-Weather Facility, located in the northeast section of the City. The collection system storage capacity is over 200 million gallons, comprised of predominantly grey infrastructure. The maximum treatment capacity of the existing system is 575 million gallons per day ("mgd") or 40 billion gallons annually.

Figure 2.1.1

Water Enterprise

The San Francisco Water Enterprise ("Water Enterprise") operates the Hetch Hetchy Regional Water System, consisting of over 389 miles of pipeline, 74 miles of tunnels, 11 reservoirs, 13 groundwater wells, 5 pump stations, and 3 water treatment plants located outside the City limits. The Water Enterprise also operates over 1,235 miles of pipeline, 11 reservoirs, six groundwater wells, 8 storage tanks, 24 pump stations, 8 hydropneumatic stations, and 17 chlorination stations located within the City limits.

The Water Enterprise serves as the retail water supplier for the City and is responsible for water deliveries to residents and institutions within the City limits and several retail accounts outside City limits. In addition, the Water Enterprise sells water to 27 Wholesale Customer entities in San Mateo, Alameda, and Santa Clara counties. Altogether, nearly 2.7 million people rely on water supplied by the Water Enterprise.

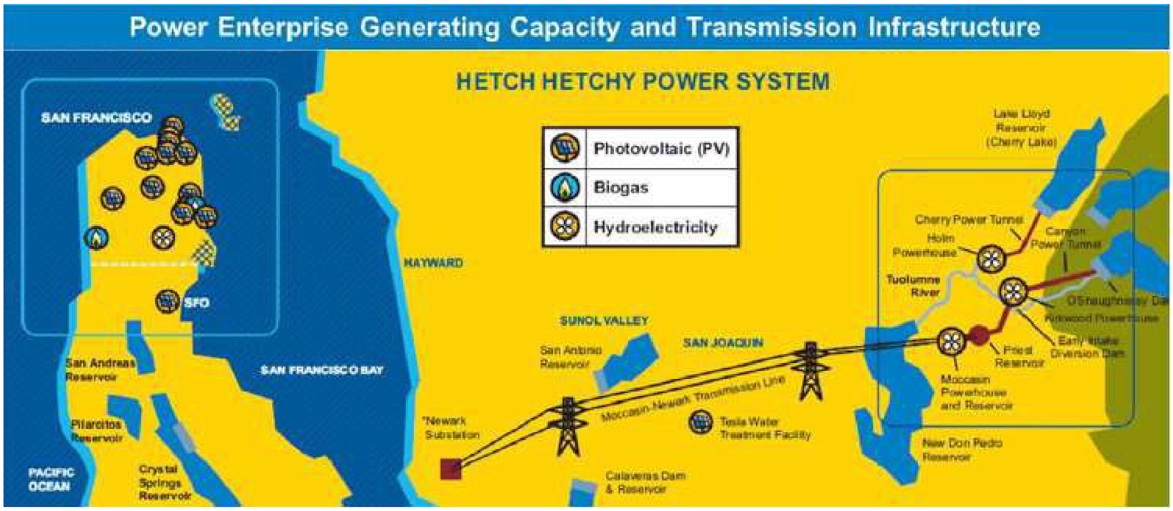
Figure 2.1.2

Power Enterprise

Hetch Hetchy Water and Power ("HHWP") operates the Hetch Hetchy Project, which consists of Hetchy Water and Hetchy Power projects (collectively referred to as the "Power Enterprise"). Hetchy Water collects, stores, purifies, and delivers water between the Sierra mountains to the eastern Alameda County, where it connects with the Water Enterprise. Hetch Hetchy Power operates the Power Enterprise, which generates, schedules, purchases, sells, and distributes electricity to meet the needs of approximately 2,400 customers, including 17% of the total electricity consumed within the City. The Power Enterprise's capacities consist of 385MW of greenhouse gas-free hydroelectric generation, 8.5MW of solar generation, and 160 miles of energy transmission lines from Yosemite to the Bay Area.

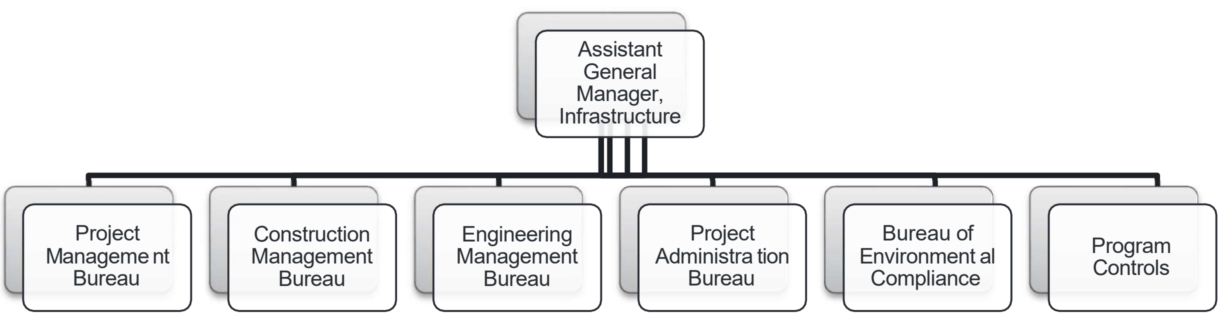
Power Enterprise customers include all municipal departments, tenants in City-owned properties, including the Port and SFO, Phase I of the Hunters Point Shipyard redevelopment projects, and tenants of the Treasure Island Development Authority on Treasure Island and Yerba Buena Island. 385,000 Power Enterprise customers have chosen to have at least 50% of their electricity usage sources from renewable sources through Clean Power San Francisco.

Figure 2.1.3



Support Divisions and Bureaus

In addition to the three AGMs who oversees the three enterprises, three AGMs oversee the support divisions and bureaus. One AGM leads SFPUC's Infrastructure Division ("Infrastructure"), responsible for management of all SFPUC construction programs. The following is a summary of Infrastructure's organization:



Another AGM oversees SFPUC's External Affairs, and the third AGM oversees department-wide business services, such as finance, human resources, information technology and customer service.

Enterprise Construction Programs

Historically, the SFPUC recognized that major wastewater, water, and power construction programs were necessary to upgrade existing facilities due to age and changing regulatory requirements. The City's voters recognized this with the passage of Propositions A and E in 2002, authorizing SFPUC to issue revenue bonds to fund the costs of major construction programs. SFPUC is also authorized to issue commercial paper for interim funding of programs – and multiple bond series have identified all or part of the bond proceeds to defease commercial paper used for interim funding. Bond proceeds available for expenditure also include investment earnings on unexpended bond proceeds and post-issuance releases of debt service reserves. Construction program expenditures also receive funding from revenues, and loans and grants from Federal and state agencies.

The following summarizes cumulative program budget and expenditures from all funding sources subject and not subject to RBOC oversight, and related cumulative bond funding as of June 30, 2022:

Table 2.2.1
Construction Program Expenditures and Program Funding
Program Inception to June 30, 2022
($000)

SFPUC Enterprise	Current Approved Budget	Program Forecast Cost	Expenditures to Date	Bond Proceeds at Issuance
Wastewater	$ 6,614,210	$ 7,998,460	$ 2,973,481	$ 1,837,773
Water	8,080,850	8,753,880	5,745,650	4,674,443
Power	225,133	225,133	85,293	195,761
TOTAL	**$ 14,920,193**	**$ 16,977,473**	**$ 8,804,424**	**$ 6,707,977**

Source: SFPUC Quarterly Construction Reports as of June 30, 2022, Bond Series Official Statements.

Enterprise Construction Reporting

As a result of commission approvals, SFPUC modified the construction program reporting for each of the three enterprises. In general, SFPUC's reporting is representative of the program's baseline for project scope, budget, and schedule according to the commission's approved ten-year capital plan, as established every two years.

The following subsections summarize the construction programs of Wastewater, Water and Hetchy Water, and Power.

Wastewater Construction Programs

The Wastewater Enterprise construction program consists of three capital programs: the Sewer System Improvement Program (“SSIP”), Renewal & Replacement Program (“R&R”) and Facilities & Infrastructure Program (“FIP”).

Sewer System Improvement Program

The SSIP is a City-wide investment to upgrade SFPUC’s aging infrastructure to ensure a reliable, sustainable, and seismically safe sewer system. It contains a series of major capital improvement projects necessary to bring the City's wastewater and stormwater system into a state of good repair and meet the Commission-endorsed goals and levels of service.

In fiscal year 2022, the SSIP program transitioned from its original intent of three distinct SSIP phases spanning over a 20-year period, to implementing capital improvement projects as part of a rolling ten-year capital plan. The Commission authorized the 2020 SSIP baseline, where a selection of high-priority projects identified initially in phases 2 and 3 were initiated. SSIP projects are now reported within either phase 1 (“SSIP Phase 1”) or other (“Other SSIP”). As of June 2022, SSIP Phase 1 has 70 projects in various construction stages and is approximately 52% complete, and Other SSIP includes 35 projects in different construction stages and is about 3% complete.

The Wastewater Enterprise SSIP construction program consists of four sub-programs: Treatment Facility Projects, Collection Systems, Land Reuse, and SSIP Program Management. The Treatment Facilities and Collection Systems sub-programs are further broken down into categories, with numerous construction projects in each category.

Repair and Replacement Program

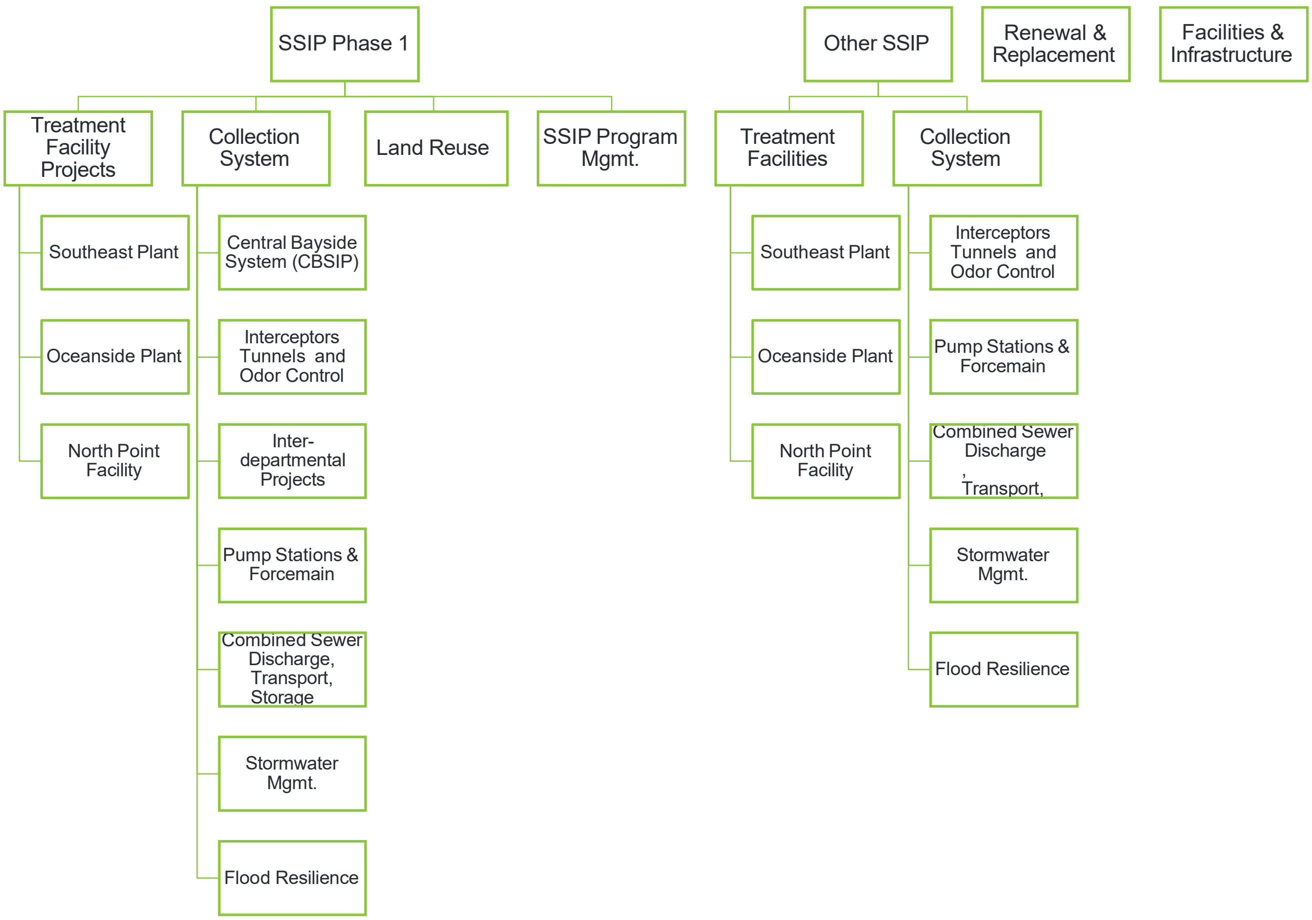
R&R is a continual program that addresses deficiencies in the R&R collection system (29 projects) and R&R treatment facilities (9 projects). The R&R program seeks to comply with State-mandated requirements and to meet the endorsed levels of service goals, regulatory permit compliance, system reliability and functionality, and sustainable operation of the City’s sewer system. Capital projects that fall outside of the SSIP and R&R programs are addressed by the Facilities and Infrastructure program.

Facilities and Infrastructure Program

The Facilities and Infrastructure program (5 projects) provides upgrades to aging facilities to maintain their intended functions.

Figure 2.2.1 below shows the hierarchy of the Wastewater Enterprise Construction Program.

Figure 2.2.1
Wastewater Construction Program Hierarchy[1]



[1] SFPUC FY 2021-22 Q4 Report

The following table identifies the Wastewater Enterprise construction programs, including forecast costs and expenditures for each as of June 2022:

Table 2.2.2
Wastewater Construction Program
Budget, Forecast, and Expenditures
Program Inception to June 30, 2022
($000)

Wastewater Enterprise	Current Approved Budget	Program Forecast Cost	Expenditures to Date
SSIP			
Phase 1	$ 3,655,300	$ 4,852,500	$ 1,949,000
Other SSIP	1,197,300	1,381,600	25,800
Subtotal SSIP	**4,852,600**	**6,234,100**	**1,974,800**
Non-SSIP			
Renewal and Replacement	1,099,000	1,088,800	810,811
Facilities and Infrastructure	662,610	675,560	187,870
Subtotal Non-SSIP	**1,761,610**	**1,764,360**	**998,681**
TOTAL WASTEWATER	$ **6,614,210**	**$ 7,998,460**	**$ 2,973,481**

Note: Program Budget and Forecast Costs are unaudited.
Source: Wastewater Enterprise Construction Program Reports as of June 30, 2022

Water and Hetch Hetchy Water Construction Programs

The Water Enterprise construction program is driven by the fact that certain of its facilities are near the end of their useful life. Long-lived facilities result in decreased reliability due to unplanned outages and place a greater maintenance burden on SFPUC operations. The Water Enterprise construction program consists of the Water System Improvement Program ("WSIP"), which is ~99% complete, and the Water Enterprise Capital Improvement Program (“WECIP”). WECIP consists of two sub-programs. The Regional Capital Improvement Program (“Regional WECIP”) includes 25 projects in various construction stages, and the Local Capital Improvement Program (“Local WECIP”) includes 7 groups of projects in different construction stages.

In addition to WSIP and WECIP, the Water Enterprise construction program also includes water-related projects of Hetch Hetchy Water and Power (“HHWP”), which is responsible for operating, managing, and maintaining the upcountry HHP system and facilities. The HHWP capital improvement programs are divided into two programs: the Renewal and Replacement program and the Hetchy Capital Improvement Projects (“HCIP”) program.

Water renewal and replacement projects are completed and closed out and, therefore, are not included in SFPUC’s construction reports.

The scope of HCIP is divided into three major sub-programs: water (“HCIP Water”), power (“HCIP Power”), and joint (“HCIP Joint”).

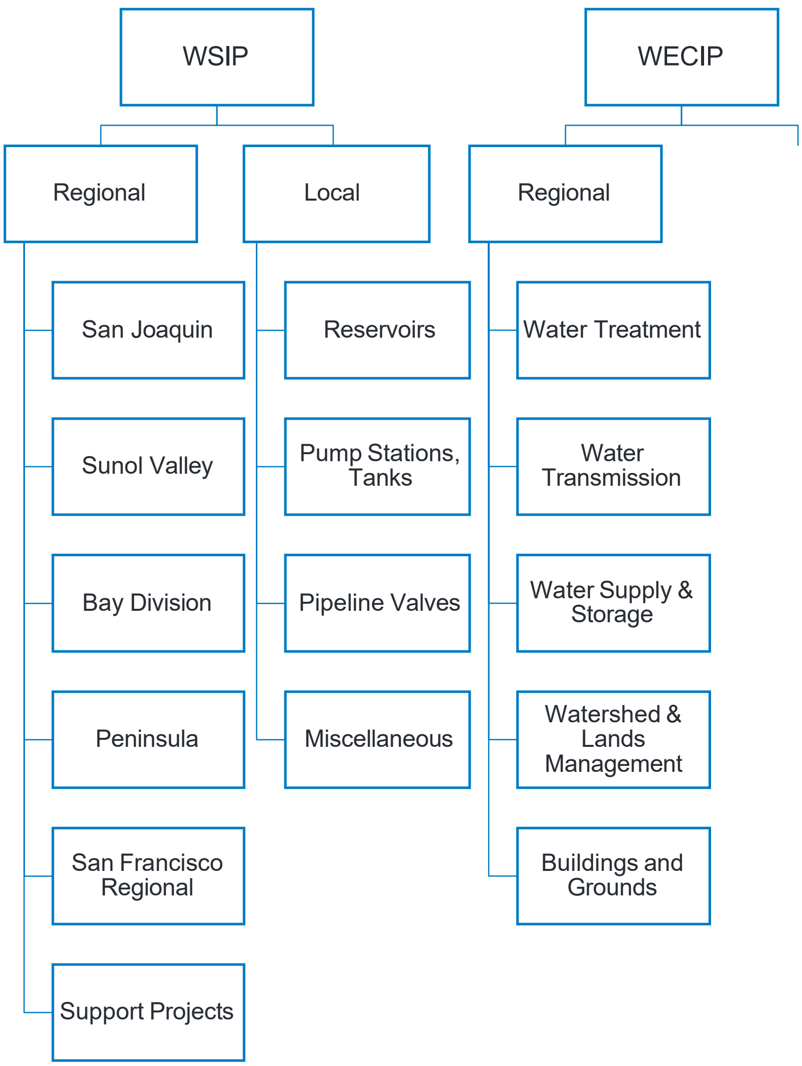
- HCIP Water sub-program includes only asset improvements benefitting the SFPUC’s water customers.
- HCIP Power sub-program includes only asset improvements used to generate environmentally friendly hydroelectric energy.

- HCIP Joint sub-program includes projects for assets used for both water delivery and power generation.

Other water expenditures are related to litigation settlement expenditures funded by proceeds from water 2012 Series B bonds. Water renewal and replacement projects are completed and closed out and, therefore, are not included in SFPUC's construction reports.

Figure 2.2.2 below is the hierarchy of the WSIP and WECIP programs and the project groups included within each sub-program. HCIP Water and Joint programs are shown in the following HCIP section.

Figure 2.2.2
Water Construction Program Hierarchy[2]



[2] WSIP Regional Projects Quarterly Report, 4th Quarter/Fiscal Year 2021-22

The following table identifies the Water programs for WSIP, WECIP, HCIP Water, and HCIP Joint sub-programs, including the current approved budget, forecast costs, and expenditures from all funding sources subject and not subject to RBOC oversight as of June 30, 2022:

Table 2.2.3
Water Construction Program
Budget, Forecast, and Expenditures
Program Inception to June 30, 2022
($000)

Water Enterprise	Current Approved	Program Forecast Cost	Expenditures to Date
WSIP			
Regional	$ 3,803,100	$ 3,803,100	$ 3,708,300
Local	331,900	331,900	331,900
Local Water Supply	280,900	280,900	220,400
Financing	372,000	372,000	372,000
Subtotal WSIP	**$ 4,787,900**	**$ 4,787,900**	**$ 4,632,600**
WECIP			
Regional	918,790	1,030,280	194,520
Local	1,755,360	2,271,390	792,670
Subtotal WECIP	**$ 2,674,150**	**$ 3,301,670**	**$ 987,190**
HCIP Water & Joint			
HCIP Water	109,530	153,270	11,100
HCIP Joint	493,520	495,290	99,010
Subtotal HCIP Water & Joint	**603,050**	**648,560**	**110,110**
Mitchell Engineering Litigation Settlement	15,750	15,750	15,750
TOTAL WATER	**$ 8,080,850**	**$ 8,753,880**	**$ 5,745,650**

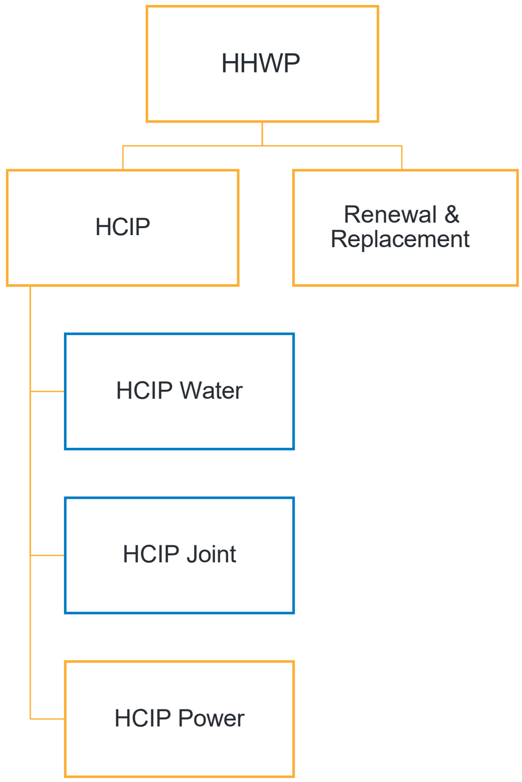
Source: Water Enterprise Construction and Hetch Hetchy Construction Program Reports as of June 30, 2022
Note: Program Budget and Forecast Costs are unaudited. The WSIP Local Water Supply projects underwent a September 2013 re-baseline. Only the original WSIP portion of the re-baselined costs are reported in WSIP. The remaining budget is funded under the WECIP Local and is managed outside the purview of the WSIP.

Hetchy Capital Improvement Program

The HCIP includes both Power and Water sub-programs. The HCIP Power sub-program includes only asset improvements used to generate environmentally friendly hydroelectric energy. HCIP Power's sub-program consists of powerhouses that convey water through hydroelectric turbines to generate electricity, power substation transformers, and transformation lines that convey electricity generated by power assets. Other project expenditures are related to non-programmatic capital projects with funding subject to RBOC oversight. As a result of SFPUC's changes in reporting, completed projects are no longer included in quarterly status reports.

Figure 2.2.3 below shows the hierarchy of the Hetchy Capital Improvement Program, which shows the HCIP Water and HCIP Joint sub-programs that are included within the Water Enterprise, and HCIP Power sub-program that is included in the Power Enterprise.

Figure 2.2.3
Power Construction Program Hierarchy[3]



The following table identifies the HCIP Power sub-program, including the current approved budget, forecast costs, and expenditures from all funding sources subject and not subject to RBOC oversight as of June 30, 2022:

Table 2.2.4
Power Construction Programs
Budget, Forecast, and Expenditures
Program Inception to June 30, 2022
($000)

Power Enterprise	Current Approved Budget	Program Forecast Cost	Expenditures to Date
Power			
HCIP Power	$ 204,240	$ 204,240	$ 64,400
Other Projects	20,893	20,893	20,893
TOTAL POWER	**$ 225,133**	**$ 225,133**	**$ 85,293**

Note: Program Budget and Forecast Costs are unaudited.
Source: Hetch Hetchy Construction Program Reports as of June 30, 2022, and SFPUC Finance.

[3] Hetch Hetchy Capital Improvement Program Quarterly Report, 4th Quarter / Fiscal Year 2021-2022

3. PARTIES INVOLVED WITH THE PERFORMANCE AUDIT

In addition to SFPUC as auditee, RBOC, CSA, and the team of HKA and YAC (referred to as the "Audit Team") all have significant roles and responsibilities in the performance audit.

Revenue Bond Oversight Committee

The City's voters approved Propositions A, E, and P in 2002. Propositions A and E gave SFPUC the authority to issue revenue bonds to fund construction programs. Proposition P created Administrative Code Section 5A.30-36 and authorized the establishment of RBOC. Administrative Code Section 5A.36 charges RBOC with providing independent oversight of the expenditure of public utility revenue bond proceeds issued under the authority of Proposition A or E for capital improvements. RBOC helps ensure an uninterrupted supply of water, power, and wastewater treatment services by SFPUC to its customers. Further, RBOC helps ensure public dollars are spent according to the authorizing bond resolution and applicable laws.

RBOC engaged CSA to oversee the performance audit to determine whether SFPUC expenditures of bond proceeds were in accordance with bond provisions, adequately supported, and properly assigned or allocated to project(s) within a bond series and evaluate internal control over these expenditures.

City Services Auditor – Audits Division

The CSA - Audits Division is the City's internal auditor, providing performance, financial, and compliance auditing and managing the City's whistleblower, public integrity, and cybersecurity programs. The CSA – Audits Division produces a wide range of audit reports and performance reports relating to the City's revenue, spending, service delivery, and outcomes. RBOC has contracted with the CSA – Audits Division to oversee this performance audit, which in turn has contracted with HKA with YAC as a subcontractor to conduct the Revenue Bond Performance Audit.

The Audit Team

HKA is a global consultancy company with over 40 years of experience and has completed numerous performance audits on some of the largest and most complex programs/projects in the world. YAC is a regional CPA and consulting firm and has worked directly with the City and County of San Francisco and the San Francisco Public Utilities Commission for over 27 years, performing audits per GAGAS and other relevant auditing and assurance standards. The principals from HKA and YAC, who are ultimately responsible for the quality of the performance audit, worked together for several years at one of the "Big Four" audit and consulting firms.

4. THE PERFORMANCE AUDIT

Scope and Objectives

The Audit Team conducted a performance audit of capital expenditures funded by proceeds from public utility revenue bonds. Forty revenue bonds subject to RBOC oversight have funded expenditures from March 1, 2006, to June 30, 2022.

The objectives of this performance audit were to determine whether expenditures from project funds were:

- Allowable under the bond resolutions, laws, and regulations,
- Properly supported,
- Assigned or allocated to the correct project(s) within a bond series, and
- Subjected to appropriate cost control measures.

Statement of Compliance with Generally Accepted Government Auditing Standards

We conducted this performance audit under generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe we have obtained sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions.

Information Not Subject to Any Performance Audit Procedures

We were not engaged to perform, and did not perform, any performance audit procedures on any budgeted or forecasted information included in this report. Such information is identified as unaudited. Accordingly, our audit conclusions do not extend to such information.

Overall Methodology

The Audit Team approached the audit in three separate stages, enabling us to develop our findings and recommendations to the RBOC. These three stages encompass a high-level evaluation of each of the audit planning and survey, fieldwork, and reporting stages.

Stage 1 – Audit Planning and Survey Phase

Upon receiving notice to proceed for Phase 2, the Audit Team conducted an entrance meeting with RBOC and CSA to initiate the audit engagement. From this meeting, we established the audit objectives, methodology, information needs, and engagement timeline.

Next, the Audit Team performed a preliminary assessment on all revenue bonds subject to RBOC oversight. This assessment included an analysis of capital project expenditures funded by the various bond proceeds for the Wastewater, Water, and Power. The Audit Team used this information to identify six bonds to include within the Phase 2 audit scope.

The Audit Team presented the preliminary bond assessment to CSA, including the six bonds selected that address the performance audit's scope and objectives.

Stage 2 – Audit Fieldwork

The Audit Team developed an audit plan using information obtained during the audit planning and survey stage. This plan served as our framework and approach for completing the audit fieldwork. The Audit Team engaged multiple SFPUC Infrastructure and SFPUC Financial Services departments to request bond documentation, capital project files, and other related documentation. Additionally, we held discussions with SFPUC department relevant to our scope and objectives.

The Audit Team's fieldwork yielded the audit evidence used to formulate our findings, conclusions, and ultimately our recommendations to the RBOC.

Stage 3 - Reporting

Based upon the information collected during our fieldwork, the Audit Team developed a preliminary list of observations and distributed this information for SFPUC comment. We revised our initial observations and held follow-up meetings with each department to confirm our understanding of the information further provided to us.

The Audit Team periodically met with CSA to provide progress updates and coordinate audit fieldwork. Also, the Audit Team provided updates to RBOC during their monthly public meetings. The culmination of our audit fieldwork is represented throughout this performance audit report, including the Audit Team's findings and recommendations to the RBOC.

Performance Audit Risk Assessment

SFPUC Finance provided the Audit Team with schedules for Water, Wastewater, and Power showing expenditures by bond series. The Audit Team used these schedules, along with SFPUC's general ledger, to summarize all debt-funded expenditures by project for Water and Wastewater. The Audit Team then analyzed this information to identify bonds that fit within RBOC's scope and objectives.

	Attributes
Revenue Bonds	• Large net proceeds available for capital expenditures • Funds used to defease commercial paper • Bonds associated with historically high-risk projects • Large spend across many projects • Significant spend on two or three projects
Capital Programs and Projects	• Inherent project complexities (e.g., heavy civil construction and non-typical projects) • Projects with forecasted costs above baseline budgets • Projects with numerous construction schedule delays • Projects managed by other City agencies

Bond Series Selected for the Performance Audit

The Audit Team selected six bond series for our performance audit from the 40-bond series subject to RBOC oversight as of June 30, 2022 – three from Wastewater, two from Water, and one from Power.

- The three-bond series from Wastewater represented three high-dollar bond series after 2016 Series A, the most recent bond series subject to our performance audit in Phase 1.
- The two-bond series from Water represented two high-dollar bond series used to fund the water-related expenditures on Hetchy Water projects.
- The Power bond series was the larger of the two Power bond series subject to RBOC oversight.

Table 4.4.1
Bonds Selected for Phase II of the Performance Audit

Wastewater	Water	Power
2018 Series A	2016 Series C	2015 Series A
2018 Series C	2017 Series C	
2021 Series A		

The total available proceeds and expenditures from each of these bond series are in the tables 4.4.2 through 4.4.4.

Refer to Section 8.2 for a complete list of revenue bonds subject to RBOC oversight as of June 30, 2022.

The Official Statement for each bonds series identifies the amounts deposited to SFPUC's capital projects fund and the defeasance of commercial paper issued to fund capital expenditures temporarily. Amounts in the Official Statement are adjusted for investment earnings on unexpended proceeds and other adjustments (typically adjustments to bond issuance and underwriter's fees, and transfers to RBOC) to determine total available proceeds.

The following table summarizes the total available proceeds, expenditures, and unexpended proceeds by bond series for the three Wastewater bond series subject to the performance audit.

Table 4.4.2
Available Proceeds, Expenditures
and Unexpended Proceeds by Wastewater Bond Series
($000)

Wastewater	2018 Series A	2018 Series C	2021 Series A	Total
Proceeds from Official Statements				
Capital projects fund	$ 215,997	$ 170,720	$ -	$ 386,717
Commercial paper defeased	25,016	-	296,000	321,016
Subtotal proceeds from Official Statements	241,013	170,720	296,000	707,733
Post-issuance adjustments				
Investment earnings	5	-	-	5
Other adjustments	-	-	-	-
Subtotal post-issuance adjustments	5	-	-	5
TOTAL AVAILABLE PROCEEDS	241,018	170,720	296,000	707,738
EXPENDITURES	(241,018)	(170,720)	(296,000)	(707,738)
UNEXPENDED PROCEEDS	**$ -**	**$ -**	**$ -**	**$ -**

Source: SFPUC General Ledger and Bond Series Official Statements

The following table summarizes the total available proceeds, expenditures, and unexpended proceeds by bond series for the two Water bond series subject to the performance audit.

Table 4.4.3
Available Proceeds, Expenditures
and Unexpended Bond Proceeds by Water Bond Series
($000)

Water	2016 Series C	2017 Series C	Total
Proceeds from Official Statements			
Capital projects fund	$ 19,975	$ 15,000	$ 34,975
Commercial paper defeased	236,847	60,265	297,112
Subtotal proceeds from Official Statements	256,822	75,265	332,087
Post-issuance adjustments			
Investment earnings	394	126	520
Other adjustments	268	-	268
Subtotal post-issuance adjustments	662	126	788
TOTAL AVAILABLE PROCEEDS	257,483	75,392	332,875
EXPENDITURES	(255,697)	(75,265)	(332,619)
UNEXPENDED PROCEEDS	**$ 1,786**	**$ 126**	**$ 256**

Source: SFPUC General Ledger and Bond Series Official Statements

The following table summarizes the total available proceeds, expenditures, and unexpended proceeds by bond series for the Power bond series subject to the performance audit.

Table 4.4.4
Available Proceeds, Expenditures
and Unexpended Bond Proceeds by Power Bond Series
($000)

Power	2015 Series A
Proceeds from Official Statements	
Capital projects fund	$ 30,200
Commercial paper defeased	-
Subtotal proceeds from Official Statements	30,200
Post-issuance adjustments	
Investment earnings	-
Other adjustments	-
Subtotal post-issuance adjustments:	-
TOTAL AVAILABLE PROCEEDS	30,200
EXPENDITURES	(28,641)
UNEXPENDED PROCEEDS	**$ 1,559**

Source: SFPUC General Ledger and Bond Series Official Statements

Regarding 2015 Series A post-issuance adjustments, SFPUC did not allocate investment earnings on unexpended bond proceeds to Power 2015 Series A and 2015 Series B bonds. The Official Statement for Power 2015 Series A and B stated that investment earnings are considered revenues and are not restricted for use on capital projects, green or non-green.

Bond Expenditure Categories and Assignment to Bonds

SFPUC establishes project categories for bond-funded expenditures. Water bond-funded project categories are classified as WSIP regional, WSIP regional (green), WSIP local, non-WSIP regional, and non-WSIP local. Wastewater project categories are SSIP, SSIP (green), non-SSIP and non-SSIP (non-green). Power bond-funded project categories are green and non-green.

SFPUC's general rule is to assign funding for expenditures within any project category with the available cash deposited on the earliest date into the City's treasury accounts (referred to as the first-in, first-out or “FIFO”). Bond proceeds that defeased outstanding commercial paper are deemed to have the deposit date of the original commercial paper issuance.

This general rule is modified for restrictions of specific bond series. Certain Water and Wastewater bond series are identified as green bonds and can only fund green projects. Other bond series are designated to fund specific project expenditures. Water 2016 Series C bonds are designated as green bonds to fund environmentally beneficial projects.

Accordingly, the FIFO by expenditure category method often results in proceeds from later bonds being expended while proceeds from earlier bond series are still available. An example is Water 2010 Series A bonds which are designated solely to local projects and Water 2010 Series C bonds, which are designated solely for regional projects. Water 2010 Series A and 2010 Series C simultaneously funded local and regional projects, respectively. All Water 2010 Series C bond proceeds were expended before Water 2010 Series A. Water 2010 Series D and later bonds funded regional expenditures while Water 2010 Series A continued to fund local projects.

Another example is Wastewater 2013 Series A and 2016 Series B bonds. Wastewater 2016 Series A bonds were designated for SSIP projects. Proceeds from Wastewater 2013 Series B bonds funded both non-SSIP and SSIP projects until the issuance of Wastewater 2016 Series A bonds. After the issuance of Wastewater 2016 Series A bonds, Wastewater 2013 Series B bonds funded only non-SSIP projects. Wastewater 2016 Series B bond proceeds were not expended until all 2013 Series B bond proceeds were expended.

This general rule is also modified for federal and state grants and loans ("Government Awards"), which fund specific expenditures. Depending on the award agreement, expenditures initially funded by bonds can have their funding source(s) changed to Government Awards. When such funding changes occur, bond proceeds from earlier bond issuances become available after a future series has been used to fund expenditures. Such newly available bond proceeds keep their original deposit date.

Bond Funded Expenditures

As part of the audit risk analysis procedures, we summarized bond-funded expenditures by cost category identified and described below:

Table 4.4.5

Expenditure Category	Description
Labor-related	Labor and benefits charged by CCSF employees and related overhead on labor.
Consultants	Expenditures to consultants such as program management, project management, construction management, environmental services, specialty inspection services, systems consulting, other management consulting services.
Construction contracts	Expenditures to contractors for construction labor and materials.
Land acquisition	Expenditures for additional land.
Fees, licenses, and permits	Expenditures to Federal, state, and local government agencies to comply with regulatory and other requirements.
Construction materials	Construction materials purchased directly by SFPUC.
Other allocations	Allocations from within SFPUC that are not based on labor expenditures.
Legal and related	Expenditures under the control of the Office of the City Attorney.
Commercial paper-related	Expenditures for commercial paper fees and interest.
Intra-City charges	Expenditures to other City departments other than labor, benefits and related overhead, and expenditures to the Office of the City Attorney.
Transfers	Expenditures for land and buildings from other City agencies for use on SFPUC projects.
All other	All other non-labor expenditures not classified above.

We were provided with copies of journal entries to support entries to support all Wastewater expenditures. These entries were provided by fiscal year and transaction date, starting in fiscal year 2017-18. Transactions for fiscal years 2009-10 through 2016-17 did not have transaction dates. Also, transactions funded by commercial paper were assigned to commercial paper did not have their funding sources changed to the ultimate funding source when commercial paper was defeased by bonds.

Accordingly, to ensure that we included at least all Wastewater expenditures subject to the performance audit, our summarization includes expenditures funded by revenue bonds other than those subject to the performance audit. The following table summarizes, by auditor-selected periods, Wastewater bond-funded expenditures by expenditure classification for the periods that funded Wastewater expenditures funded by bonds subject to the performance audit.

Table 4.4.6
Wastewater Bond-Funded Expenditures
by Expenditure Classification
($000)

Expenditure Classification	Nov2016 - Jun 2018	Jul 2018 - Sep 2019	Oct 2019 - Oct 2020	Total
Labor-related and consultants				
Labor-related	$ 48,616	$ 36,692	$ 38,413	$ 123,721
Consultants	63,541	75,479	68,031	207,051
Subtotal Labor-related and consultants	112,157	112,171	106,444	330,772
Construction contracts	74,454	44,124	187,582	306,160
Subtotal labor-related, consultants, and construction contracts	186,611	156,295	294,026	636,932
Other expenditures				
Land acquisition	-	-	-	-
Fees, licenses, and permits	150	58	47	255
Construction materials	3	-	1	4
Other allocations	-	-	-	-
Legal and related	778	219		997
Commercial paper related	-	-	-	-
Intra-CCSF charges	1,047	131	65	1,243
Fund transfers	56,788	5,810	-	62,598
All other	5,365	11,520	3,400	20,285
Subtotal other expenditures	64,131	17,738	3,513	85,382
TOTAL EXPENDITURES	**$ 250,742**	**$ 174,033**	**$ 297,539**	**$ 722,314**
Number of months in the period	20	15	13	48

Source: SFPUC General Ledger

The $722.3 million of total expenditures shown is $14.6 million greater than the $707.7 million bond-funded expenditures in Table 4.4.2. This is because funding sources could change during the middle of a month. Therefore, identifying expenditures to specific funding sources is impracticable.

Transfers to the City's general fund are for the transfer of the 1800 Jerrold property to SFPUC, and construction of a replacement facility for the City's Office of Contract Administration. These are classified as transfers in the City's accounting system since the property transfers involved only City agencies and no outside parties.

Sixty-one percent (61%) of the construction expenditures occurred in the final 13 months of this 48-month period. This reflects the substantial completion of design and engineering activities on certain projects during the first 35 months, while design and engineering activities occurred on other projects during the final 13 months of the 48-month period.

The following table summarizes Wastewater bond-funded expenditures by expenditure classification as a percentage of total expenditures (also known as "common size"):

Table 4.4.7
Wastewater Bond-Funded Expenditures by Expenditure Classification as a Percentage of Total Expenditures
($000)

Expenditure Classification	Nov2016 - Jun 2018	Jul 2018 - Sep 2019	Oct 2019 - Oct 2020	Total
Labor-related and consultants				
Labor-related	19.39%	21.08%	12.91%	17.13%
Consultants	25.34	43.37	22.86	28.66
Subtotal Labor-related and consultants	44.73	64.45	35.77	45.79
Construction contracts	29.69	25.35	63.05	42.39
Subtotal labor-related, consultants, and construction contracts	74.42	89.80	98.82	88.18
Other expenditures				
Land acquisition	-	-	-	-
Fees, licenses, and permits	0.06	0.03	0.02	0.04
Construction materials	0.00	-	0.00	0.00
Other allocations	-	-	-	-
Legal and related	0.31	0.13	-	0.14
Commercial paper related	-	-	-	-
Intra-CCSF charges	0.42	0.08	0.02	0.17
Fund transfers	22.65	3.34	-	8.67
All other	2.14	6.62	1.14	2.81
Subtotal other expenditures	25.58	10.19	1.18	11.82
TOTAL EXPENDITURES	**100.00%**	**100.00%**	**100.00%**	**100.00%**
Number of months in the period	20	15	13	48

Source: SFPUC General Ledger

As indicated above, the timing of certain projects resulted in higher construction expenditures between October 2019 and October 2020 than in the other two periods.

The percentage of fund transfers funded by Water 2018 Series A bonds is consistent with the timing of the transfer of the 1800 Jerrold property from the City's General Fund to SFPUC.

The following table summarizes the journal entries to transfer expenditures from the Water expenditure pool to reflect amounts funded by Water bonds subject to the performance audit:

Table 4.4.8
Water Bond-Funded Expenditures by Expenditure Classification
($000)

Expenditure Classification	2016 Series C	2017 Series C	Total
Labor-related and consultants			
Labor-related	$ 15,069	$ 16,039	$ 31,108
Consultants	21,383	26,587	47,970
Subtotal Labor-related and consultants	36,452	42,626	79,078
Construction contracts	142,746	31,733	174,479
Subtotal labor-related, consultants, and construction contracts	179,198	74,359	253,557
Other expenditures			
Land acquisition	4,962	-	4,962
Fees, licenses, and permits	8,392	146	8,538
Construction materials	672	97	769
Other allocations	-	-	-
Legal and related	533	-	533
Commercial paper related	-	-	-
Intra-CCSF charges	2,923	66	2,989
Habitat preserve	12,000	-	12,000
All other	326	913	1,239
Subtotal other expenditures	29,808	1,222	31,030
TOTAL EXPENDITURES	**$ 209,006**	**$ 75,581**	**$ 284,587**
Transfers from 2006A and 2009A	46,691	-	46,691

Source: SFPUC General Ledger

The amounts in Table 4.4.3 for Water 2017 Series C bonds do not reconcile directly to specific expenditures recorded in the general ledger, because funding sources could change during the middle of a month. Therefore, identifying expenditures to specific funding sources is impracticable.

The first expenditures funded by these bonds were $46.7 million of transfers of expenditures originally funded by Water 2006 Series A and 2009 Series A bonds. The proceeds from these bond series were deemed to be substantially expended by June 30, 2008, and June 30, 2010, respectively. SFPUC was also required to establish a Habitat Preservation Reserve Fund, of which $12 million was funded by Water 2016 Series C bond proceeds.

The following table summarizes Water bond-funded expenditures by expenditure classification as a percentage of total expenditures:

Table 4.4.9
Water Bond-Funded Expenditures by Expenditure Classification as a Percentage of Total Expenditures

Expenditure Classification	2016 Series C	2017 Series C	Total
Labor-related and consultants			
Labor-related	7.21%	21.22%	10.93%
Consultants	10.23	35.18	16.86
Subtotal Labor-related and consultants	17.44	56.40	27.79
Construction contracts	68.30	41.99	61.31
Subtotal labor-related, consultants, and construction contracts	85.74	98.38	89.10
Other expenditures			
Land acquisition	2.37	-	1.74
Fees, licenses, and permits	4.02	0.19	3.00
Construction materials	0.32	0.13	0.27
Other allocations	-	-	-
Legal and related	0.26	-	0.19
Commercial paper related	-	-	-
Intra-CCSF charges	1.4	0.09	1.05
Habitat preserve	5.74	-	4.22
All other	0.13	1.21	0.44
Subtotal other expenditures	14.26	1.62	11.10
TOTAL EXPENDITURES	**100.00%**	**100.00%**	**100.00%**

Source: SFPUC General Ledger

The high percentage of construction contract costs funded by Water 2016 Series C bonds reflects that such expenditures were made during the latter stages of the WSIP. Total proceeds from Water 2016 Series C were expended on Hetch Water projects, which were started later than WSIP projects, and accordingly would be expected to have a lower percentage of construction costs.

Table 4.4.10
Power Bond-Funded Expenditures
by Expenditure Classification

Expenditure Classification		2015 Series A ($000)	% Of Total
Labor-related and consultants			
Labor-related	$	4,227	14.76%
Consultants		9,449	32.99
Subtotal Labor-related and consultants		13,676	47.75
Construction contracts		14,731	51.43
Subtotal labor-related, consultants, and construction contracts		28,407	99.18
Other expenditures			
Land acquisition		-	-
Fees, licenses, and permits			-
Construction materials		17	0.06
Other allocations		-	-
Legal and related		-	-
Commercial paper related		-	-
Intra-CCSF charges		9	0.03
All other		208	0.73
Subtotal other expenditures		234	0.82
TOTAL EXPENDITURES	**$**	**28,641**	**100.00%**

Source: SFPUC General Ledger

We note that labor-related, consultant and construction expenditures were more than 99% of total bond-funded expenditures. The relatively high percentage of labor-related and consultant expenditures to total expenditures reflects the early phases of the power bond-funded projects.

Internal Controls Significant to the Audit Objectives

GAGAS requires the identification and evaluation of internal controls that are significant to the audit objectives. The City uses the *COSO Internal Control – Integrated Framework* ("COSO Framework") as its internal control framework,[4] an acceptable framework under GAGAS for our consideration of internal control.[5] We therefore used the COSO Framework as a benchmark to evaluate the SFPUC's design and operating effectiveness of relevant internal controls.

The original COSO Framework was originally published in 1992 and updated in 2013. We applied the original 1992 COSO Framework to activities and transactions occurring until May 31, 2013, and the 2013 update to activities and transactions after that date. The five interrelated components of internal control

[4] City and County of San Francisco, Accounting Policies and Procedures Manual, August 2020 update, §1.7
[5] GAGAS July 2018 Revision, ¶8.130.

remained substantively the same between the 1992 original and 2013 update, and are:

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring (1992) or Monitoring Activities (2013)

City Requirement to Establish and Maintain Effective Internal Control Systems

The City requires that all departments *"…establish and maintain effective internal control systems as an integral part of their management practices…"*[6] SFPUC establishes and maintains department-specific internal controls[7] and is required to comply with City-wide internal controls established by City offices, including but not limited to, the Controller, Contract Administration, City Attorney, and Labor Standards Enforcement. Implementation of COSO Framework guidance is also part of effective internal control.

[6] City and County of San Francisco, Accounting Policies and Procedures Manual, August 2020 update, §1.7.

[7] SFPUC Infrastructure Construction Management Procedures, Procedure No:001, Preparation and Control of Construction Management Procedures, June 7, 2019

Identification of Internal Control Significant to the Audit Objectives

We identified the following elements of SFPUC's system of internal controls to be significant to our audit objectives. We, therefore, evaluated these elements to the extent necessary to meet our performance audit objectives:

- Control Environment
  - Design and implementation of policies and procedures to promote ethical behavior
  - "Tone From the Top" – behavior of senior management having a pervasive impact on internal control
- Control Activities
  - Contractor/consultant/vendor selection, including bid advertisement, acceptance and evaluation, and contract award procedures
  - Project cost control
  - Claims and change order control process
  - Allocation of program management costs to projects
  - Assignment of project costs to bond series

Material Weakness Identified by Other Auditors

GAGAS requires auditors to consider findings from prior audit projects as part of performance audit risk assessment procedures and their effect on planned performance audit procedures.

The United States Attorney in San Francisco announced on July 17, 2023, that a Federal jury convicted SFPUC's former General manager (GM) of multiple felonies. Relevant convictions include one count of conspiracy to commit honest services wire fraud and one count of honest services wire fraud. The former GM resigned from the SFPUC in November 2020 upon his indictment on charges for which he was convicted.

Evidence presented at trial showed, among other things, that the former GM "…had access to confidential information about city contract bidding processes, and the ability to influence the awarding of some city contracts…"[8] The city contracts referred to in the United States Attorney's announcement were specifically SFPUC contracts.

The former GM's conviction for such conduct on any SFPUC contract is deemed to be a material weakness relevant to our performance audit, as the former GM did not demonstrate ethical behavior and management integrity, a key component of the control environment. The CEO (in this case, the GM) of any organization individually often sets its ethical tone.[9] The ethical tone set by the former GM increased the risk of waste and abuse during his time as AGM of Infrastructure and later, GM.

All contracts awarded between June 2003 (the earliest date of expenditures subject to RBOC oversight) to November 2020 were under the control of the former AGM of Infrastructure/GM. Also, expenditures on these contracts occurred after November 2020.

[8] https://www.justice.gov/usao-ndca/pr/jury-convicts-former-san-francisco-public-utilities-commission-general-manager-0.

[9] Committee of Sponsoring Organizations of the Treadway Commission; *Internal Control – Integrated Framework: Framework*; September 1992, page 20.

Evaluation of SFPUC Infrastructure

SFPUC’s Infrastructure Division is responsible for various aspects of the capital process, including but not limited to engineering & design, environmental compliance, project & construction management, and cost control functions.

SFPUC Infrastructure Division Procedures Manual

The Infrastructure Division provided us with current Project Design (“PD”), Project Management ("PM"), and Construction Management ("CM") procedures. We evaluated certain procedures to understand their design and implementation by the Infrastructure Division staff.

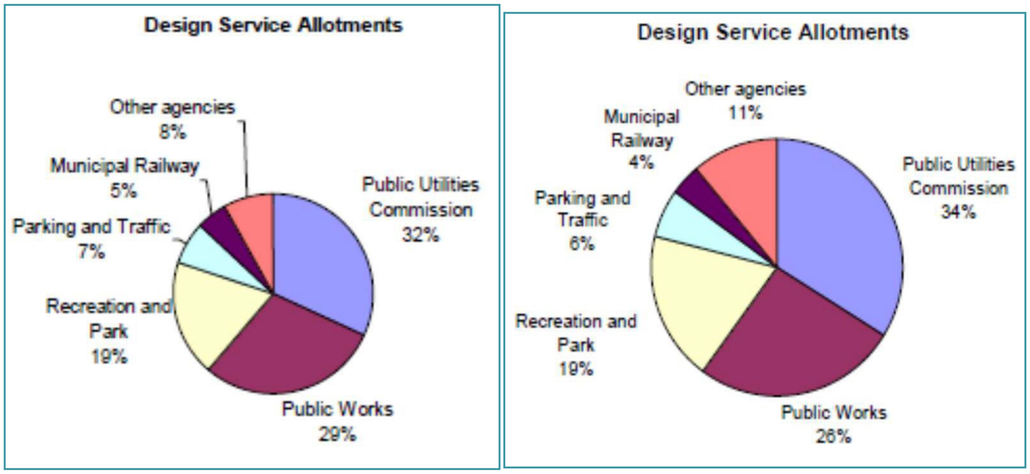
SFPUC's procedures are prepared to provide guidance and expectations for the various construction functions and the roles and responsibilities of consultants and SFPUC staff for the three Water, Wastewater, and Power Enterprises. PM and CM procedures are designed as a roadmap so that a consistent approach is implemented across the broader construction program.

The Audit Team evaluated project documentation contemporaneously prepared and memorialized throughout the construction process. Such documentation included but was not limited to risk management plans, pay applications, change orders, consultant monitoring reports, construction progress reports, lessons learned, and contract closeout packages for Wastewater, Water, and Power. The Audit Team analyzed these documents against the deliverables according to applicable PM and CM procedures.

Services Performed by San Francisco Public Works

San Francisco Public Works’ Hydraulic Section’s (“HydraSection”) activities of project management, design, engineering, and construction management are almost exclusively for SFPUC sewer-related work. Our conversations with SFPUC Infrastructure in November 2022 gave us the impression that HydraSection’s functions have not changed significantly since 2002. According to SFPW’s 2002-03 and 2005-06 annual reports, the last two annual reports that show engineering expenditures by benefitting City agency, show approximately 33% of total SFPW engineering expenditures benefitted SFPUC, which was higher than any other percentage, including work that benefitted SFPW. The following graphs in Figure 4.5.1 were obtained from SFPW annual reports:

Figure 4.5.1
San Francisco Public Works
Design Service Allotments
Fiscal Years 2002-03 and 2005-06



Source: SFPW (fka SFDPW) Annual Reports

We note that the HydraSection remained at SFPW when all other Wastewater divisions and functions were transferred from SFPW to SFPUC.

Refer to Section 5 for a finding and recommendation to SFPUC related to the SFPW Hydraulic Section.

Capital Projects Managed by Other City Agencies

During the risk assessment stage of the performance audit, we identified two Wastewater projects that are managed by the San Francisco Municipal Transportation Agency ("SFMTA"): Van Ness BRT Sewer Improvement and L Taraval Sewer Improvement. SFPUC informed us that SFMTA is responsible for retaining project documentation since SFMTA is designated as the lead City agency.

SFPUC provided us with a written narrative describing SFPUC's framework for its participation on capital projects managed by other City agencies. SFPUC also provided a response along with memorandums of understanding ("MOUs") and the most recent pay application for both projects.

SFPUC is primarily involved during the initial phase of project development up to the point when the MOU is executed. During this time, SFPUC's activities include assessing infrastructure assets, developing alternative construction solutions, and budget negotiations. SFPW is responsible for the planning, design, and engineering aspects of the project. After the MOU is executed and construction begins, SFPW performs ongoing engineering, inspection, and other construction management activities. SFPUC project managers perform oversight activities to ensure SFPW is delivering on the requirements that SFPUC negotiated with SFMTA.

Wastewater, Water, and Power Competitive Bid Analysis

The Audit Team requested and received bid tabulation summaries for each project identified during the risk analysis. We combined contractor bidding information with the ending change order values and compared this total to the SFPUC's engineering estimate.

As a follow-up to the two projects with cost overruns, we received supplementary documentation and held discussions with the relevant SFPUC personnel to understand the driving force behind variances. Based on our follow-up evaluation, we did not have any reportable findings with these two cost variations. This information is summarized in the following table:

Table 4.5.1
Competitive Bid Analysis
($000)

SFPUC Enterprise	Winning Bid Value	Total Change Order Value	Total Project Value	Engineer's Estimate (EE)	Variance Total Project Value & EE
Wastewater	$ 129,334	$ 8,840	$ 138,174	$ 122,688	$ (15,486)
Water	832,449	392,760	1,228,918	1,018,129	(207,110)
Power	11,225	1,695	12,640	10,420	(2,220)
TOTAL	**$ 973,008**	**$ 403,295**	**$ 1,379,732**	**1,151,237**	**$ (224,816)**

Refer to appendix 8.4 for competitive bids by project.

Construction Manager / General Contractor

SFPUC adopted a Construction Manager / General Contractor ("CMGC") contracting method for the New Headworks Facility and Biosolids Digester projects. The contractor with the highest score was awarded the CMGC contract on each of these projects.

SFPUC used a panel of experienced in-house construction professionals to score each contractor based on their responses to the CMGC bid package. Panelists' raw scores are averaged and then weighted based on each category's maximum value. The Audit Team evaluated each of the panelists' score sheets and had no audit findings because of our evaluation. See appendix 8.4 for CMGC bids by project.

Professional Services Contracts

The City's Office of Contract Administration ("OCA") promulgates the procurement policies and procedures for all professional services contracts for all City departments, including SFPUC. SFPUC has the authority to procure professional services directly; however, the resulting contract must go through all standard City approvals and be approved by OCA.

In the project planning phase, SFPUC project engineers are responsible for initiating Requests for Proposals ("RFP") according to the special or unique project requirements. The RFP document contains pertinent information such as the scope of work ("SOW"), required qualifications, and the criteria for scoring each bid received.

Unlike construction contract RFPs that are evaluated based on a competitive bidding process or a CMGC evaluation process, the evaluation process for professional services is designed based on each project's unique needs. Furthermore, the criteria and evaluator scoring process can also vary depending on the professional services solicited by an RFP.

In general, professional service RFPs contain two main reviews: minimum qualification and qualitative evaluation of a written proposal and an oral presentation. Each of these categories includes multiple subsections based on the RFP criteria. In addition to the minimum qualifications and qualitative evaluation, the RFP may contain other evaluation sections, such as community benefits and/or fee for services. The minimum qualifications review is a pass/fail evaluation performed by procurement specialists and technical experts. Scores assigned by the SFPUC evaluation panel are weighted based on the percentages assigned to each category. Written and oral categories are weighted more than other categories. The following table is a summary of the professional services contracts awarded by enterprise and project:

Table 4.5.2
Professional Services Contract Award Summary

Professional Services Description	Agreement No. Awarded	Contract Not-to-Exceed Value ($000)	Contract Duration	Total No. Bids Evaluated	PUC Enterprise	Project
HSIP Professional and Engineering Services	CS-296B	$9,500	5 years	Evaluated: 6 Awarded: 5	Water	San Joaquin Pipeline Rehabilitation
HSIP Professional and Engineering Services	CS-296D	$9,500	5 years	Evaluated: 6 Awarded: 5	Power	Moccasin Penstock Rehabilitation
Planning and Design Services	CS-249	$21,000	10 years	Evaluated: 3 Awarded: 1	Water	Mountain Tunnel Improvement Project
HHWP Civil and Geotechnical Services	CS-943	$7,000	6 years	Evaluated: 2 Awarded: 1	Water & Power	Mountain Tunnel Lining Rehabilitation
SSIP Program Management Services	CS-165	$150,000	6 years	Evaluated: 3 Awarded: 1	Wastewater	All SSIP Projects
Tunnel Technical Advisory Services	PRO.0137C	$200	4 years	Evaluated: 3 Awarded: 1	Wastewater	Folsom Area Stormwater Detention Project
Planning & Engineering Services	CS-235	$80,000	10 years	Evaluated: 1 Awarded: 1	Wastewater	SEWPCP Biosolids Digester Facilities
System Integration and Support Services – Related to Project Controls	CS-224A CS-224B	$4,500 $4,500	6 years	Evaluated: 2 Awarded: 2	All Three Enterprises	All Construction Projects

During our analysis of the scoring and evaluation process, we noted that the winning bid was primarily determined by the score received for the written and oral categories. Other categories, with weightings less than the written and oral categories, did not materially affect the award's outcome.

The planning & engineering services RFP for the Biosolids Digester Facilities ("BDF") project received only one qualified bidder. SFPUC determined to award the contract, despite only receiving one qualified bid, because the qualified bidder had the unique project experience required, including the unique experience from the sub-consultants included within their bid. We analyzed the evaluation process and did not have any audit findings because of this analysis.

SFPUC did not obtain written confirmations on impartiality and conflicts of interest from all individuals involved in the procurement of the two System Integration and Support Services – Related to Project Controls contracts. Refer to Finding #1 in Section 5 for a finding related to the procurement of certain systems integration and support services. Prevailing Wage Compliance

The City's Office of Labor Standards Enforcement ("OLSE") is responsible, among other things, for monitoring and enforcing prevailing wage compliance on all City construction contracts, including, but not limited to, SFPUC, SFPW, SFMTA, San Francisco International Airport and Port of San Francisco. We obtained an understanding of OLSE activities to monitor City-wide prevailing wage compliance and related follow-up on potential non-compliance. We also performed tests of OLSE's monitoring and follow-up activities. Table 4.5.3 summarizes prevailing wage restitution resulting from OLSE's enforcement efforts for Fiscal Years 2018-19 through 2020-21.

Table 4.5.3
Prevailing Wage Restitutions Recovered by OLSE
($000)

Fiscal Year	Prevailing Wage Restitutions	Total Restitutions	Prevailing Wage as a Percent of Total Restitutions
2018-19	$ 2,334	$ 13,349	17.5%
2019-20	1,706	13,796	12.4%
2020-21	656	10,053	6.5%
TOTAL	**$ 4,696**	**$ 37,198**	**12.6%**

Source: OLSE Annual Reports

The City-wide $4.7 million of restitution for prevailing wage non-compliance during the three-year year period ended June 30, 2021, is deemed to be insignificant when considering that restitution includes numerous SFPUC, SFPW, San Francisco International Airport, and Port of San Francisco, among other projects, that are not subject to RBOC oversight.

Accounting for Expenditures

Implementation of Accounting for Expenditures

Water primarily used Proposition A and Proposition E funds (which were deemed fungible with each other) to accumulate all project expenditures funded by bonds and other specific funding sources. Periodic summary journal entries transferred the costs incurred by bond series, project, and account from the two fungible funds to the ultimate funding sources.

Wastewater implemented different approaches from Water and Power in documenting how costs are ultimately assigned to bond funding sources. Wastewater's use of "funds" in the general ledger is different than what is used by Water. Expenditures by each project are summarized, analyzed, and then assigned to the eventual bond or other funding sources. These analyses are not reflected in Excel spreadsheet files, and not recorded in the general ledger.

Matching Specific Debt-Funded Expenditures to Funding Sources

Matching specific expenditures to ultimate funding sources is a multi-step process. Specific expenditures must be compared to total expenditures by each project by period to determine the project's ultimate funding source(s).

Table 4.6.1
Water Expenditures by Funding Source
($000)

Water Projects	2016 Series C	2017 Series C	Total
Cherry Dam Outlet Works	$ -	$ 3,897	$ 3,897
Hetch Hetchy Facilities New Const.	-	9,741	9,741
Hetch Hetchy Facilities Upgrades	-	5,330	5,330
Mtn Tunnel Inspection & Repairs	-	5,458	5,458
Mtn Tunnel Access/Ad Improvement	-	4,399	4,399
San Joaquin Pipeline Rehab	-	15,109	15,109
Lower Cherry Aqueduct	-	7,530	7,530
Mtn Tunnel Access/Ad Imp	-	3,631	3,631
Mtn Tunnel Lining	-	3,072	3,072
BDPL Reliability Upgrade –Tunnel	81,725	-	81,725
BDPL Reliability –Pipeline	42,027	-	42,027
HTWTP Long-Term Improvements	33,505	-	33,505
Calaveras Dam Replacement	22,222	-	22,222
Alameda Siphon #4	19,471	-	19,471
Habitat Reserve Program	19,104	-	19,401
Regional Ground Water Storage	13,501	-	13,501
Bond/Commercial Paper Expense	8,607	-	8,607
All Other Projects	15,532	16,189	31,721
TOTAL	**$ 255,694**	**$ 74,356**	**$ 330,347**

Source: 2016C - Green Bond Report; 2017C - SFPUC General Ledger.

Yano Accountancy Corporation

Table 4.6.2
Wastewater Expenditures by Funding Source
$(000)

Wastewater Projects	2018 Series A	2018 Series C	2021 Series A	Total
Collection System Improvement	$ 37,584	$ 28,560	$ 30,796	$ 96,940
Central Bayside System Improvement	9,029	838	633	10,500
Biosolids Digester	55,960	79,104	150,495	285,559
Stormwater Management	7,283	3,565	12,342	23,190
Flood Resilience	268	-	2,582	2,850
Northshore To Channel Force Main	3,277	974	-	4,251
Program Wide Management	43,382	4,042	14,874	62,298
Treatment Plant Improvement Projects	83,182	53,637	80,813	217,632
Urban Watershed Assessment	1,052	-	22	1,074
TOTAL	**$ 241,017**	**$ 170,720**	**$ 292,557**	**$ 704,294**
Number of months in the period	20	15	13	48

Source: 2018 A & C - Green Bond Report; 2021A - SFPUC General Ledger

Table 4.6.3
Power Expenditures by Funding Source
($000)

Power Projects	2015 Series A
Holm Powerhouse Refurbishment & Kirkwood Powerhouse Oil Containment	$ 12,928
Mountain Tunnel Interim Repairs – 2017 & 2018	10,847
Kirkwood Penstock Short-Term Risk Reduction Measures	1,790
Moccasin Penstock Rehabilitation	2,232
All Other Projects	844
TOTAL	**$ 28,641**

Source: Green Bond Report

Labor, Benefits, and Related Overhead Expenditures

We took an overall approach to test labor and benefits because of the labor detail information available. We reconciled 100% of SFPUC labor details and selected SFPW labor details for fiscal years 2016-17 through 2020-21 to the payroll general ledger entries. Preliminary differences were deemed insignificant and not investigated.

We performed computer matching of pay rates by job classification and benefits (medical and dental) to published pay and benefit rates. We also calculated and evaluated the reasonableness of the employer retirement contributions and payroll taxes. Significant preliminary differences were explained to our satisfaction.

We were provided with copies of journal entries to support entries to support all Wastewater expenditures. These entries were provided by fiscal year and transaction date, starting in fiscal year 2017-18. Transactions for fiscal years 2009-10 through 2016-17 did not have transaction dates. Also, transactions funded by commercial paper were assigned to commercial paper did not have their funding sources changed to the ultimate funding source when commercial paper was defeased by bonds.

Accordingly, to ensure that we included at least all Wastewater expenditures subject to the performance audit, our summarization includes expenditures funded by bonds other than those subject to the performance audit. The following table summarizes, by auditor-selected periods, Wastewater bond-funded labor-related expenditures by expenditure classification for the FAMIS sub-funds.

Table 4.6.4
Direct Labor, Benefits and Overhead
Wastewater Revenue Bonds
($000)

Expenditure Classification	Nov2016 - Jun 2018	Jul 2018 - Sep 2019	Oct 2019 - Oct 2020	Total
Direct labor	$ 17,716	$ 13,618	$ 14,013	$ 45,347
Benefits on direct labor	6,701	5,353	5,829	17,883
Subtotal direct labor and benefits	24,417	18,971	19,842	63,230
Overhead	24,199	28,832	18,571	71,602
TOTAL	**$ 48,616**	**$ 47,803**	**$ 38,413**	**$ 134,832**
Number of months in the period	20	15	13	48

Source: SFPUC General Ledger.

The following summarizes labor, benefits, and overhead for the Water bond series subject to our performance audit:

Table 4.6.5
Direct Labor, Benefits, and Overhead
Water Revenue Bonds
($000)

Expenditure Classification	2016 Series C	2017 Series C	Total
Direct labor	$ 5,768	$ 6,570	$ 12,338
Benefits on direct labor	2,352	3,026	5,378
Subtotal direct labor and benefits	8,120	9,596	17,716
Overhead	6,949	6,443	13,392
TOTAL	**$ 15,069**	**$ 16,039**	**$ 31,108**

Source: SFPUC General Ledger.

The following summarizes labor, benefits, and overhead for the Power bond series subject to our performance audit:

Table 4.6.6
Direct Labor, Benefits, and Overhead
Power Revenue Bonds
($000)

Expenditure Classification		2015 Series A
Direct labor	$	1,707
Benefits on direct labor		835
Subtotal direct labor and benefits		2,542
Overhead		1,685
TOTAL	**$**	**4,227**

Labor-Related Expenditures by City Department

From July 1, 2013, to June 30, 2021, 97.2% of total labor, benefits, and overhead were charged by SFPUC and SFPW to projects funded by all bonds subject to RBOC oversight. The remaining 2.8% charged by all other City departments and agencies is deemed insignificant.

Table 4.6.6 summarizes total labor, benefits, and overhead dollars by City department or agency funded by bonds subject to RBOC oversight from July 1, 2013, to June 30, 2021:

Table 4.6.7
Comparative Labor, Benefits, and Overhead Dollars
All Bonds Subject to RBOC Oversight
July 2013 to June 2021
($000)

Classification	SFPUC	SFPW	Total SFPUC and SFPW	Other	Total
Direct labor and benefits	$ 225,718	$ 73,220	$ 298,938	$ 8,483	$ 307,421
Overhead	174,389	74,662	249,051	7,203	256,254
TOTAL	**$ 400,107**	**$ 147,882**	**$ 547,989**	**$ 15,686**	**$ 563,675**
TOTAL as a %	**70.99%**	**26.24%**	**97.22%**	**2.78%**	**100.00%**

Table 4.6.7 summarizes overhead as a percentage of direct labor and benefit dollars by City department or agency funded by bonds subject to RBOC oversight from July 1, 2013, to June 30, 2021:

Table 4.6.8
Comparative Overhead as a
Percentage of Direct Labor and Benefits
All Bonds Subject to RBOC Oversight
July 2013 to June 2021

	SFPUC	SFPW	Other
Overhead as a percentage of labor and benefits	**77.35%**	**101.97%**	**84.91%**
Difference using SFPUC's overhead rate as the benchmark	**N/A**	**24.62%**	**7.56%**

From July 1, 2013, to June 30, 2021, SFPW's overhead charged to all projects subject to RBOC oversight was 24.62% higher than SFPUC's. Using SFPUC's overhead rates in place of SFPW's reduces bond-funded expenditures, subject to RBOC oversight, by $18.0 million. As shown above, direct labor, benefits and overhead charged by other departments was insignificant, so the 7.56% overhead rate difference was not investigated further.

SFPW Labor Through June 30, 2017

SFPW labor through June 30, 2017, was controlled only at the funding level, not at the project level. Accordingly, SFPUC is not able to assert that SFPW labor through June 30, 2017, was charged to the correct project. SFPUC informed us that this pervasive system-level internal control deficiency was corrected upon the implementation of PeopleSoft on July 1, 2017.

5. FINDINGS APPLICABLE TO ALL BOND SERIES

We have two findings applicable to all bond series, not just the six-bond series subjected to Phase 2 performance audit procedures. One finding results from a pervasive internal control deficiency related to confidentiality and conflicts of interest during procurement solicitations. The second finding relates to the effects of not transferring SFPW's Hydraulics Section to SFPUC along with the rest of what is now known as the Wastewater Enterprise, even though this Section almost exclusively provides sewer-related project management, design, engineering, and construction management services.

Finding No. 1: Non-Completion of Impartiality and Confidentiality Statements by All Individuals Associated with Procurements

Summary	SFPUC did not comply with COSO Framework guidance and City preferred procurement practices by not obtaining signed impartiality and conflict of interest statements from all individuals participating in procurement solicitations, including those performing minimum qualifications review, creating a heightened risk for impropriety. This pervasive internal control deficiency existed during the procurement process for a contract awarded to an entity controlled by an individual who had a joint investment with the former SFPUC AGM-Infrastructure (and later, SFPUC General Manager). The circumstances surrounding the timing of the sale of the individual's share of the investment to the former AGM-Infrastructure increased the risk environment for waste and abuse with respect to this contract award. We questioned a total of $15.36 million of expenditures.
Criteria	The City requires all departments to establish and maintain effective internal control systems and uses the COSO Framework as its internal control framework. The guidance in the COSO Framework is therefore an appropriate benchmark for evaluating SFPUC's establishment and maintenance of effective internal control systems. Further, the COSO Framework should be applied at various levels of the organizational structure from functional to entity-wide level across the 5 components and 17 underlining principles. Absent any citywide policy, SFPUC as an organization has the responsibility to establish and maintain effective internal control systems for its organization. Specifically, the operating controls over the *control environment* and *monitoring activities* are the relevant criterion identified under the COSO Framework. COSO Framework Evaluation Tools[10] for the control environment, page 5, includes a section on the "…[e]xistence and implementation of codes of conduct and other policies regarding acceptable business practice, conflicts of interest, and ethical and moral behavior…" The evaluation of the codes of conduct and other policies include, but not limited to, consideration of whether they are: • Comprehensive; and • Periodically acknowledged by all employees.

[10] Committee of Sponsoring Organizations of the Treadway Commission; *Internal Control – Integrated Framework: Evaluation Tools*; September 1992, page 5.

Also, the COSO Framework Evaluation Tools for monitoring activities states that, "internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved…including those showing deficiencies and recommendations reported by auditors and others who evaluate agencies' operations.

The SFPUC Statement of Incompatible Activities, Section III. A. 3. states in part that "…[N]o officer or employee may knowingly provide selective assistance (i.e., assistance that is not generally available to all competitors) to individuals or entities in a manner that confers a competitive advantage on a bidder or proposer who is competing for a City contract…" We consider this part of the existence and comprehensiveness of relevant policies and procedures.

The City Controller's Office developed a City Solicitation/Contract Participation Acknowledgement form ("Acknowledgement", and since superseded by the Impartiality/Confidentiality Statement "I/CS"). The Acknowledgement or I/CS must be completed and signed by all individuals associated with procurement, from the development of the solicitation to the evaluation and selection of vendors, consultants, or contractors. The Acknowledgement or I/CS requires the signer to acknowledge, among other things, that:

1. All information concerning the solicitation is of a highly confidential nature.
2. The evaluator must give each entity fair and independent consideration.
3. Although an evaluator may listen to the views of other participants, the comments and decisions must reflect the evaluator's own impartial judgment on the entity's proposal/bid.
4. The evaluator should not participate in the evaluation process if (s)he has any conflict of interest that would prevent an impartial judgment as to each entity.

SFPUC issued *Guidance for Obtaining Professional Services Agreements 9/2/09* ("Procurement Guidance"). Under this Procurement Guidance, the originator of the Request for Proposal "…[r]eviews each proposal package for responsiveness to the RFP requirements and specifically whether consultant meets the qualifications criteria…"

This Procurement Guidance also requires evaluation panelists to complete conflict of interest statements, but no such requirement exists for individuals evaluating proposal packages for responsiveness to RFP requirements. Impartiality and lack of conflict of interest is as important for the individuals evaluating proposal packages for responsiveness to the RFP requirements as they are for panelists.

GAGAS paragraph 8.121b states in part that an example of waste, depending on the facts and circumstances, includes:

> *"[m]aking procurement or vendor selections that are contrary to existing policies..."*

GAGAS paragraph 8.123c states in part that an example of abuse, depending on the facts and circumstances, includes:

> *"[m]isusing the official's position for personal gain (including actions that could be perceived by an objective third party with knowledge of the relevant information as improperly benefiting an official's personal financial interests or those of an immediate or close family member..."*

Observations	SFPUC neither required nor obtained completed Acknowledgement or I/CS forms from SFPUC staff who evaluated proposal packages for responsiveness to the RFP requirements and specifically whether consultants met the qualifications criteria. We specifically observed the non-completion of I/CS forms by the qualitative review panel during the evaluation of the January-August 2012 RFP process that resulted in contract CS-224A awarded to mlok Consulting, Inc. (“mlok”) and contract CS-224B awarded to Westland Management Solutions, Inc. We inspected an Acknowledgement form signed by an SFPUC employee on September 8, 2011, so the existence of the Acknowledgement form was known within SFPUC no later than this date. We also observed that the president of mlok had a joint investment with the former SFPUC AGM-Infrastructure from December 6, 2002, to December 30, 2011. The president of mlok sold their share of the investment to the former SFPUC AGM- Infrastructure 21 days before the RFP for contract C-224A was issued on January 20, 2012. The former AGM-Infrastructure, who was GM from September 2012 to November 2020, was convicted of felonies in July 2023 for, among other things, having the ability to influence the awarding of some city contracts. The Audit Team has been informed that the City Attorney is conducting confidential investigations of SFPUC, which could include an evaluation of contract C-224A. SFPUC informed the Audit Team that procedures are undergoing revisions to require the use of evaluation panels on all procurements above $500,000. The revised procedures also allow SFPUC divisions to use evaluation panels on procurements of less than $500,000.

Effect

The following table summarizes CS-224A and CS-224B contract expenditures subject to RBOC oversight from fiscal year 2012-13 to 2020-21:

Contract Number	Consultant	Expenditures ($000)
CS-224A	mlok Consulting, Inc.	$ 7,100
CS-224B	Westland Management Solutions, Inc.	8,260
Total Expenditures:		**$ 15,360**

The amounts summarized above include expenditures funded by all bond series subject to RBOC oversight and exclude amounts funded by other sources not subject to RBOC oversight.

SFPUC did not obtain adequate evidence that individuals evaluating proposal packages for responsiveness to the RFP requirements and specifically whether consultant met the qualifications criteria complied with SFPUC impartiality and conflict of interest requirements. This increased the risk environment for waste on contract CS-224A and CS-224B.

The combination of not requiring acknowledgement of impartiality and conflict of interest policies, and the facts and circumstances of the mlok President's joint ownership of property with the former SFPUC AGM Infrastructure, and the related sale of her share of the property, resulted in an increased risk environment for abuse as well as waste on contract CS-224A.

Because of the increased risk environment for waste and abuse, we question whether the $15.36 million of expenditures was a proper use of bond proceeds.

Cause

SFPUC not requiring the Acknowledgement or I/CS forms from individuals evaluating proposal packages for responsiveness to the RFP requirements is a pervasive internal control deficiency, as periodic acknowledgements of conflict of interest and other relevant policies is a specific component of the COSO Framework control environment.

SFPUC asserts that then-extant City policy did not require the completion of Acknowledgement or I/CS from individuals evaluating proposal packages for responsiveness to the RFP requirements. Impartiality and lack of conflict of interest of the individuals evaluating proposal packages for responsiveness to the RFP requirements is important enough that a specific City-wide policy including such individuals as being subject to completion of Acknowledgement or I/CS forms should not be necessary for SFPUC to have included and implemented such a requirement for completion.

Recommendations

SFPUC should follow the guidance in the COSO Framework for control environment, and monitoring controls with the following:

- require the completion of I/CS forms on all procurements above $500,000, and for those procurements where SFPUC deems appropriate to further strengthen its control environment.
- request all publicly available information from the City Attorney on its investigations of SFPUC procurement practices and periodically report such publicly available information to the RBOC, where procurement practices impact revenue bond expenditures to further strengthen monitoring activities.

Finding No. 2: SFPUC Should Quantify and Report on Overhead Rates Charged for SFPW Sewer Engineering Activities

Summary	SFPUC is not quantifying or reporting the monetary impact of SFPW's overhead rates on total sewer engineering direct labor and benefits to the RBOC. The RBOC accordingly cannot discharge its oversight responsibilities on these additional expenditures. Since future expenditures subject to RBOC oversight on Wastewater projects are expected to be in the billions of dollars, it is expected that substantial SFPW sewer engineering direct labor, benefits and related overhead will be included in such expenditures.
Criteria	San Francisco Administration Code Section 5A.31(c)(5), states in part that the purpose of the RBOC includes: *"Reviewing efforts by the City to maximize bond proceeds by implementing cost- saving measures, including, but not limited to, all of the following: (i) mechanisms designed to reduce the costs of professional, consulting and similar fees and expenses related to site preparation and project design…"* Since the legislation states *"…including, but not limited to…"*, we interpret this provision to include mechanisms to reduce the costs of all bond-funded expenditures.
Observation	SFPUC is not quantifying or reporting the monetary impact of SFPW's overhead rates on total sewer engineering direct labor and benefits. We recognize that SFPW, as a government fund department, has a different overhead rate recovery structure than SFPUC, a proprietary/enterprise fund department. SFPUC, as a matter of policy and in accordance with an MOU, gives SFPW the right of first refusal to provide sewer engineering services on SFPUC projects if SFPUC has the capability, but not capacity, to provide such services. This observation does not apply to any additional street repair or replacement expenditures made necessary by SFPUC water, power and/or sewer projects. The following shows the allocation of SFPW's engineering expenditures spent on department projects in fiscal years 2021 and 2022. Analysis based on publicly available data. • 32 to 34 percent on SFPUC projects • 26 to 29 percent on SFPW projects • 19 percent on Parks and Recreation projects • 20 to 21 percent on all other City projects, with no department exceeding 11 percent.
Effect	The RBOC does not have adequate visibility of the financial impact of using SFPW sewer engineering services, and therefore cannot exercise proper oversight of these expenditures that are funded with revenue bonds. Specifically, SFPUC submitting project budgets to RBOC without quantifying these effects is not sufficient for RBOC to have adequate information on the mechanisms designed to reduce the costs of projects funded with revenue bond proceeds. Since future expenditures subject to RBOC oversight on Wastewater projects are expected to be in the billions of dollars, it is expected that substantial SFPW sewer engineering direct labor, benefits and related overhead will be included in such expenditures.

Cause	SFPUC budgetary procedures do not include the requirement to communicate these fiscal effects of SFPW sewer engineering costs to RBOC.
Recommendation	SFPUC should coordinate with RBOC and SFPW to quantify, evaluate, and report on the monetary impacts of SFPW's overhead rates charged on total direct labor and benefit expenditures subject to RBOC oversight, so that the RBOC can exercise proper oversight over such overhead expenditures.

6. CONCLUSION

We met our audit objectives for the Phase 2 performance audit of capital expenditures funded by proceeds from public utility revenue bonds subject to RBOC oversight. Except as described in Section 5 of this report, we found no instances in which expenses were not adequately supported or were not assigned or allocated to the correct project(s) within a bond series.

We also found that a previously reported material weakness in internal control over financial reporting was also a deficiency in internal control significant to our audit objectives over the allowability of expenditures, and assignment or allocation of expenditures to project(s) within a bond series. Even though SFPUC has taken steps to rectify the internal control deficiencies identified in Finding 1, SFPUC determined that it was impracticable to rectify the deficiencies on a retrospective basis back to fiscal 2010-11.

7. FOLLOW-UP ON PREVIOUSLY ISSUED FINDINGS

GAGAS requires that auditors follow up on the findings of previous audit recommendations. This section includes our recommendations from Phase 1 of our performance audit and our observations on the implementation of our recommendations.

CSA informed us that it is responsible for follow-up on previously issued findings and will follow up with SFPUC at the appropriate time.

Follow-Up on Phase 1, Finding 1

Phase 1 Report: Finding 1 Recommendation	The SFPUC should coordinate with RBOC to provide a comprehensive report of project expenditures by each funding source to facilitate compliance with Administrative Code Sections 5A.30-5A.36: a. revenue bonds by bond series, b. federal and state grants and loans, c. commercial paper to be refinanced, and d. other funding sources. The amounts should reconcile to the Estimated Uses of Bond Proceeds included in each bond series' Official Statement. In addition, SFPUC should coordinate with RBOC to provide a report showing the uses of bond proceeds for each bond series, including: a. amounts deposited into capital project funds, b. commercial paper defeased, c. Debt Service Reserve (DSR) releases (included with either the original bond series or as separately identified bond proceeds), d. investment earnings on unexpended bond proceeds used for capital expenditures, and e. other uses of bond proceeds.
Current Status	SFPUC's reporting of expenditures by project and funding source does not include funding sources not subject to RBOC oversight, whereas Infrastructure reports only total expenditures by project from all funding sources. Because Infrastructure reports total project expenditure amounts to RBOC, RBOC cannot discharge its responsibilities without a reconciliation of expenditures subject to RBOC oversight to total expenditures. We also observed the following during our follow-up on this prior recommendation: • Total available expenditures for multiple Water bond series do not include amounts used to defease commercial paper. This is inconsistent with other Water bond series and all Wastewater bond series, which include commercial paper defeasances in total available proceeds. • All Wastewater investment earnings on unexpended bond proceeds are included as one total amount, as are total investment earnings for Power 2015 Series A and B bonds. This is inconsistent with the Water bond series, which summarize investment earnings by bond series.

Current Recommendation	SFPUC should ensure that annual reports provided to RBOC of expenditures by bond series include all funding sources. This information is crucial so the annual RBOC reports can be reconciled to other reports issued to the public that contain total expenditures by project regardless of funding source, and Green Bond reports that contain total expenditures by bond series and project.

Follow-Up on Phase 1, Finding 2

Phase 1 Report: Finding 2 Recommendation	SFPUC should comply with the existing PM Procedure, 6.02 Quality Assurance Audits, to perform Quality Assurance Audits during the four main phases of a project's lifecycle.
Current Status	The implementation of this recommendation is in process, as the implementation cycle for this recommendation is multiple years. We have no further observations on the implementation to date of this recommendation. We note that the AGM Infrastructure updated the RBOC regarding steps to improve the QA audit function in September 2022 and May 2023. These steps included re-organizing the project controls group under the project management bureau to better align with other PM functions, and steps to replace the quality assurance manager position that was vacated in June 2022. Further, project management procedure 6.02, titled "Quality Assurance Audits," was revised to increase the AGM's latitude for prioritizing projects that require QA involvement, such as the project's size, type, or complexity. SFPUC performed four QA audits after the Phase 1 report, with more QA audits planned in the future months. Findings from these QA audits were categorized by the project management or engineering management processes. The responsible project managers are required to complete a corrective action plan ("CAR") describing the underlying cause, remedial (short-term) actions, and proposed corrective (long-term) actions taken related to each QA finding.
Current Recommendation	SFPUC should continue its process to re-implement the QA audit function, including the evaluation of CARs as applicable.

8. APPENDIX A

Previously Issued Reports Relevant to the Performance Audit

Report Date	Report Title	Prepared by
December 23, 2021	*Performance Audit of Select Revenue Bond Expenditures*	HKA Global, Inc. Yano Accountancy Corporation
February 26, 2021	*San Francisco Public Utilities Commission – Independent Auditors' 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*	KPMG LLP
October 22, 2015	*Construction Management Services - RBOC Evaluation of Lessons Learned Water System Improvement Program (WSIP) Project CS-363 Final Report*	RW Block Consulting, Inc.
May 9, 2013	*Evaluation of the Water System Improvement Program (WSIP) Project CS-254*	RW Block Consulting, Inc.
January 19, 2012	*Review of the Independent Review Panel's Final Report dated December 28, 2011*	Professor William Ibbs
December 28, 2011	*Independent Review of the Water System Improvement Project (WSIP) Construction Management Program*	Gary Griggs, MSCE., PE, Panel Chair Glenn Singley, PE, Panel Member Don Russell, CCM., FCMAA, Panel Member Galyn Rippentrop, Panel Member
December 10, 2009	*Review of Sunset Reservoir - North Basin Project - Final Report to the Public Utilities Revenue Bond Oversight Committee*	Robert Kuo Consulting, RW Block Consulting, Lawrence Doyle
November 21, 2007	*Financial Review of Aspects of the Water System Improvement Program*	Robert Kuo Consulting, LLC with Lawrence Doyle, Shannon Gaffney Consulting, EPC Consultants, Inc.
July 17, 2006	*Review of Water System Improvement Program Expenditures Under* SFPUC's *Commercial Paper Program*	Robert Kuo Consulting, LLC & Lawrence Doyle

Bonds Subject to RBOC Oversight

SFPUC Enterprise		Official Statement Proceeds ($000)
Water and Hetchy Water	$	4,674,443
Wastewater		1,837,773
Power		195,761
TOTAL	**$**	**6,707,977**

	Water and Hetchy Water		Official Statement Proceeds ($000)
	Water		
1	2006 Series A	$	459,223
2	2009 Series A		369,073
3	2009 Series B		377,778
4	2010 Series A		58,748
5	2010 Series B		364,757
6	2010 Series D		72,243
7	2010 Series E		300,446
8	2010 Series F		149,728
9	2010 Series G		288,252
10	2011 Series A		525,000
11	2011 Series C		33,772
12	2012 Series A		530,000
13	2012 Series B		15,750
14	2016 Series C		256,822
15	2017 Series A		125,765
16	2017 Series B		150,000
17	2020 Series A		180,000
18	2020 Series B		69,644
19	2020 Series C		94,988
	Subtotal Original Issue		**4,421,989**
	Debt Service Reserve Releases		99,709
	Subtotal Water	**$**	**4,521,698**
	Hetchy Water		
20	2011 Series B		27,710
21	2017 Series C		75,265
22	2020 Series D		49,770
	Subtotal Hetchy Water		**152,745**
	Subtotal Water and Hetchy Water	**$**	**4,674,443**

Source: Official Statements.
Proceeds at Issuance may not include all adjustments to the Official Statement amounts, investment earnings, or post-issuance debt service reserve releases.

	Wastewater Enterprise	Official Statement Proceeds ($000)
23	2010 Series A	$ 50,000
24	2010 Series B	165,929
25	2013 Series B	337,610
26	2016 Series A	258,563
27	2016 Series B	72,891
28	2018 Series A	241,013
29	2018 Series B	201,047
30	2018 Series C	170,720
31	2021 Series A	296,000
32	2021 Series B	44,000
	Subtotal Wastewater	**$ 1,837,773**

Source: Official Statements.
Proceeds at Issuance may not include all adjustments to the Official Statement amounts, investment earnings, or post-issuance debt service reserve releases.

	Power Enterprise	Official Statement Proceeds ($000)
33	2008 CREB	$ 5,885
34	2011 QECB	8,217
35	2012 NCREB	3,711
36	2015 NCREB	2,933
37	2015 Series A	30,200
38	2015 Series B	7,100
39	2021 Series A	82,710
40	2021 Series B	55,005
	Subtotal Power	**$ 195,761**

Source: Official Statements.
Proceeds at Issuance may not include all adjustments to the Official Statement amounts, investment earnings, or post-issuance debt service reserve releases.

Phase 2 Bonds - Project Index

Table 8.3.1
Wastewater 2018 A&C and 2021A Projects

Project	Program	Contract No.	FAMIS Project Code	PS Project Code
Treatment Facilities				
Southeast Plant Improvements				
Biosolids Digester Facilities Project – Planning & Engineering, Pre-Construction & Construction Services	SSIP Phase 1	CS-235 WW-647R	CWWSIPDP01	10015796
New Headworks Grit Replacement	SSIP Phase 1	CS-389	CWWSIPSE02	10015807
Oceanside Plant (OSP) Improvements				
Oceanside Pollution Control Plant Digester Gas Handling Utilization Upgrades	SSIP Phase 1	WW-639	CWWSIPTPOP03	10029737
North Point Facility (NFP) Improvements				
Northpoint Outfall Rehabilitation	SSIP Phase 1	WW-614R2	CWWSIPTPNP01	10026821
Collection System				
Interceptors / Tunnels and Odor Control				
Drumm & Jackson St. Sewer Improvements	SSIP Phase 1	WW-657R	CWWSIPCSSR09	10002689
Interdepartmental Projects				
Van Ness BRT Sewer Improvements	SSIP Phase 1	1289 (SFMTA)	CWWSIPCSSR04	10002664
Geary BRT Sewer Improvements	SSIP Phase 1	WW-674R	CWWSIPCSSR06	10002670
L Taraval Sewer Improvements	SSIP Phase 1	1308R (SFMTA)	CWWSIPCSSR13	10002776
Pump Stations and Force Main Improvements				
Mariposa Pump Station & Force Main	SSIP Phase 1	WW-667	CWWSIPCSPS03	10026828
Marin St. Sewer Replacement	SSIP Phase 1	WW-653	CWWSIPCSPS05	10002465
Griffith Pump Station Improvements	SSIP Phase 1	WW-651	CWWSIPCSPS06	10002485
Combined Sewer Discharge, Transport/Storage Structures				
Jackson, Griffith, & Pierce St. Sewer Discharge Rehabilitation & Backflow Prevention	SSIP Phase 1	WW-702R	CWWSIPCSCD04	10002344
Sansome, 5th & 6th North, & Division St., Sewer Discharge Rehabilitation & Backflow Prevention	SSIP Phase 1	WW-683R	CWWSIPCSCD05	10002378
Stormwater Management				
Sunset Blvd. Greenway Phase II Irving to Ulloa	SSIP Phase 1	WW-691	CWWSIPFCDB01	10026805
Lake Merced, Holloway Green St. Stormwater Imp.	SSIP Phase 1	WW-609R	CWWSIPFCDB03	10026807
Richmond, Baker Beach Green Streets Early Improvement	SSIP Phase 1	WW-627R	CWWSIPFCDB05	10026809
Flood Resilience				
Folsom Area Stormwater Detention Project -Tunnel Technical Advisory Panel Services	SSIP Phase 1	PRO.0137C	CWWSIPFCDB14	10026818
SSIP Program Management				
Program Wide Management Services	SSIP Phase 1	CS-165	CWWSIPPRPL01	10029732

Table 8.3.2
Water 2016C and 2017C Projects

Projects	Program	Contract No.	FAMIS Project Code	PS Project Code
Sunol Valley				
Calaveras Dam Upgrade	WSIP Regional	WD-2551	CUW37401	10015317
Alameda Siphon No. 4	WSIP Regional	WD-2552	CUW35902	10015291
Bay Division				
BDPL Reliability Upgrade – Bay Tunnel	WSIP Regional	WD-2531	CUW36801	10015308
BDPL Reliability Upgrade – Pipeline No. 5 East Bay Reaches	WSIP Regional	WD-2541	CUW36802	10015309
Peninsula				
Harry Tracy Water Treatment Plant (HTWTP) Long-Term Improvements	WSIP Regional	WD-2596	CUW36701	10015306
San Francisco Regional				
Regional Ground Water Storage & Recovery	WSIP Regional	WD-2668	CUW30103	10015241
Support Projects				
Bioregional Habitat Restoration – San Antonio Creek	WSIP Regional	WD-2652	CUW38802	10015335
Mountain Tunnel Lining Rehabilitation	WSIP	CS-943 (Task 7)	CUH10002	10014067
HHWP Renewal & Replacement				
San Joaquin Pipeline No. 1 In-line Inspection	R&R	CS-296B	CUH10001	10014066
HCIP Water				
Cherry Dam Outlet Works Rehabilitation	HCIP Water	HH-983	CUH10216	10014109
Moccasin Shops / Office Building & Materials Bins	HCIP Water	HH-982	CUH10214	10014107
Mountain Tunnel Access & Adit Improvement	HCIP Water	HH-981	CUH10219	10014112
Moccasin Control & Server Building	HCIP Water	HH-963R	CUH10202	10014095
HCIP Joint				
Lower Cherry Aqueduct Emergency Rehabilitation	HCIP Joint	HH-974E	CUH10003	10014068
Mountain Tunnel Inspection & Repair 2017	HCIP Joint	HH-986	CUH10220	10014113
Mountain Tunnel Inspection & Repair 2018	HCIP Joint	HH-991 CS-249	CUH10221	10014114

Power 2015A Projects	Program	Contract No.	FAMIS Project Code	PS Project Code
HCIP Power				
Holm Powerhouse Refurbishment & Kirkwood Powerhouse Oil Containment	HCIP Power	HH-989	CUH10102	10014075
Kirkwood Penstock Short-Term Risk Reduction Measures	HCIP Power	HH-988R	CUH10113	10014085
Moccasin Penstock Rehabilitation	HCIP Power	CS-296D	CUH10116	10014088

Procurement Analysis

Table 8.4.1
Wastewater Projects Value Variance Analysis
($000)

Project	No. of Bids	Winning Bid Value	Total Change Order Value	Total Project Value	Engineer's Estimate (EE)	Variance Total Project Value & EE
SSIP Oceanside Pollution Control Plant Digester Gas Handling Utilization Upgrades	5	$ 38,449	$ 2,064	$ 40,513	$ 36,300	$ (4,213)
Sansome, 5th & 6th North, & Division St., Sewer Discharge Rehabilitation & Backflow Prevention	3	$ 4,907	$ 1,705	$ 6,612	$ 5,036	$ (1,576)
Jackson, Griffith, & Pierce St. Sewer Discharge Rehabilitation & Backflow Prevention	3	3,886	-	3,886	4,970	1,084
Mariposa Pump Station & Force Main	5	17,031	1,008	18,039	16,400	(1,639)
Geary Blvd. Sewer & Water Imp.	3	16,247	240	16,487	16,000	(487)
Griffith Pump Station Imp.	3	10,941	1,036	11,977	10,123	(1,854)
Northpoint Outfall Rehabilitation	2	12,486	419	12,905	10,300	(2,605)
Baker Beach Green Streets Early Imp.	4	7,122	1,209	8,331	6,961	(1,370)
Holloway Green St. Stormwater Imp.	2	5,592	288	5,880	5,797	(83)
Drumm & Jackson St. Sewer Imp.	3	5,241	477	5,718	4,810	(908)
Marin St. Sewer Replacement	4	4,860	139	4,999	3,700	(1,299)
Sunset Blvd. Greenway Phase II Irving to Ulloa (Stormwater)	2	2,572	255	2,827	2,291	(536)
TOTAL		**$ 129,334**	**$ 8,840**	**$ 138,174**	**$ 122,688**	**$ (15,486)**

Source: Bid Tabulations, Award Resolutions, and Payment Applications.

Table 8.4.2
Wastewater Project Bid Scoring Summary

Project	No. of Bids	Maximum Score Value (Points)	Winning Score (Points)	2nd Highest Score (Points)	3rd Highest Score (Points)
SEWPCP - New Headworks Grit Replacement	2	1,000	873.5	771.6	n/a
SEWPCP Biosolids Digester Project – Pre-Construction & Construction Services	2	1,000	1,000	906.26	n/a

Source: Bid Tabulations

Table 8.4.3
Water Projects Value Variance Analysis
($000)

Project	No. of Bids	Winning Bid Value	Total Change Order Value	Total Project Value	Engineer's Estimate (EE)	Variance Total Project Value & EE
Calaveras Dam Upgrade	5	$ 259,572	$ 308,209	$ 567,780	$ 295,000	$ (272,780)
BDPL Upgrade – Bay Tunnel	4	215,295	2,325	217,619	250,343	32,724
BDPL Upgrade– Pipeline No. 5 Easy Bay Reach	8	61,558	22,212	83,800	97,771	13,971
HTWTP – Long-Term Improvements	5	174,197	22,288	196,485	235,250	38,765
Regional Ground Water Storage & Recovery	4	42,980	20,327	63,307	50,025	(13,282)
Alameda Siphon No. 4	4	31,933	6,802	38,736	41,410	2,674
Bioregional Habitat Restoration – San Antonio Creek	4	12,947	3,211	16,158	13,000	(3,158)
Cherry Dam Outlet Works Rehabilitation	6	3,063	3,866	6,930	4,500	(2,430)
Lower Cherry Aqueduct*	n/a	n/a	n/a	3,679	n/a	n/a
Moccasin Shops / Office Building & Materials Bins	2	9,171	551	9,722	9,430	(292)
Moccasin Control & Server Building	8	6,611	419	7,030	4,700	(2,330)
Mountain Tunnel Access & Adit Improvement	2	4,287	961	5,248	5,000	(248)
Mountain Tunnel Inspection & Repair 2017	6	4,960	651	5,611	5,500	(111)
Mountain Tunnel Inspection & Repair 2018	4	5,875	938	6,813	6,200	(613)
TOTAL		**$ 832,449**	**$ 392,760**	**$ 1,228,918**	**$ 1,018,129**	**$ (207,110)**

Source: Bid Tabulations, Award Resolutions, and Payment Applications.
The Lower Cherry Aqueduct is an emergency project; thus, normal procurement procedures did not apply.

Table 8.4.4
Power Projects Value Variance Analysis
($000)

Project	No. of Bids	Winning Bid Value	Total Change Order Value	Total Project Value	Engineer's Estimate (EE)	Variance Total Project Value & EE
Holm Powerhouse Refurb. & Kirkwood Powerhouse Oil Containment	2	$ 9,948	$ 1,894	$ 11,482	$ 9,200	$ (2,282)
Kirkwood Penstock Short-Term Risk Reduction	3	1,277	(199)	1,158	1,220	62
TOTAL		**$ 11,225**	**$ 1,695**	**$ 12,640**	**$ 10,420**	**$ (2,220)**

Source: Bid Tabulations, Award Resolutions, and Payment Applications.

Appendix B: Department Response

San Francisco
Water Power Sewer
Services of the San Francisco Public Utilities Commission

525 Golden Gate Avenue, 13th Floor
San Francisco, CA 94102
T 415.554.3155
F 415.554.3161
TTY 415.554.3488

August 11, 2023

Mark de la Rosa
Director of Audits
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Subject: The San Francisco Public Utilities Commission Spent Revenue Bond Funds for Allowable Purposes but Should Strengthen Its Compliance and Monitoring Controls

Dear Mr. de la Rosa,

Thank you for providing us the opportunity to review the audit report, *The San Francisco Public Utilities Commission Spent Revenue Bond Funds for Allowable Purposes but Should Strengthen Its Compliance and Monitoring Controls*, prepared by the Controller's Office City Services Auditor.

We appreciate the time your staff dedicated to this audit. We agreed with the report where we could and, where we could not agree, provided details. Since becoming General Manager, I have sought to strengthen our internal processes and controls. Our team will continue to comply with all applicable laws, policies, and procedures. We respectfully disagree with the fundamental premises of this audit, as stated in the opening letter, and numerous statements and conclusions in the audit. The SFPUC has strong processes and procedures in place and professional staff who work hard to implement the same. What is meant by "coordination" with the Revenue Bond Oversight Committee is unclear – by law, the RBOC is an oversight and reporting body, it is not involved in government decisions. Other statements throughout the report raise concerns: the auditors' late inclusion of the "COSO Framework," which as an internal control framework is not a contracting standard, unsupported assumptions about all contracts between June 2003 and November 2020 (p. 35), and speculative statements about confidential investigations (p. 45). As a result, we cannot agree with a number of the auditors' conclusions.

OUR MISSION: To provide our customers with high-quality, efficient and reliable water, power and sewer services in a manner that values environmental and community interests and sustains the resources entrusted to our care.

We look forward to continuing to work with the Controller's office to provide the public as much information as possible and maintain our transparency.

If there are any questions or additional information is needed, please do not hesitate to contact me at 415-554-1600.

Sincerely,

For Dennis Herrera

Dennis Herrera
General Manager

CC: Ronald Flynn, Deputy General Manager
Stephen Robinson, AGM Infrastructure
Nancy Hom, AGM Business Services/CFO
Irella Blackwood, Audit Director

Recommendations and Responses

For each recommendation, the responsible agency should indicate in the column labeled Agency Response whether it concurs, does not concur, or partially concurs and provide a brief explanation. If it concurs with the recommendation, it should indicate the expected implementation date and implementation plan. If the responsible agency does not concur or partially concurs, it should provide an explanation and an alternate plan of action to address the identified issue.

Recommendation	Agency Response	CSA Use Only Status Determination*
The San Francisco Utilities Commission should:		
1. Follow the guidance in the COSO Framework for control environment and require the completion of I/CS forms on all procurements above $500,000, and for those procurements where SFPUC deems appropriate to further strengthen its control environment.	☐ Concur ☐ Do Not Concur ☒ Partially Concur The SFPUC is pleased to note that we are in compliance with applicable city laws, policies and practices. The SFPUC will continue to look to the City and County of San Francisco for guidance in contracting. The department has a multi-prong approach to maintaining the integrity of the procurement process which includes education, training and acknowledgement. In 2021, the SFPUC formally approved the Competitive Selection Process Communications Policy, which governs communications that may confer a competitive advantage. Additionally, all Contract Administration Bureau staff and other SFPUC staff involved in the solicitation review process sign SFPUC Solicitation Conflict of Interest Statement and Confidentiality Agreement. All SFPUC employees participating as panelist during solicitation evaluation sign a Panelist Acknowledgement Form. With respect to the wording of the recommendation, the SFPUC assumed the auditors intended “all procurements” to mean professional services since that was the topic throughout the fieldwork stage. It is unclear how the $500,000 was calculated or what it is rooted in. The SFPUC respectfully departs from several conclusions drawn in this report. We’d like to highlight a few things: 1. SFPUC staff were never asked about the COSO Framework during the fieldwork stage, and it is not a standard in PUC contracting. The auditor inserted this criterion between the first and second draft reports.	☒ Open ☐ Closed ☐ Contested

Recommendation	Agency Response	CSA Use Only Status Determination*
	2. SFPUC staff communicated to the auditor several times that the PUC was not obligated to form a technical panel for CS-224A and CS-224B and the report provides no evidence to the contrary. We disagree with questioning of the $15.360 in expenditures. 3. Page 30 alleges that "all contracts" covering nearly a twenty-year period were under the former GM's "control" and as such "…deemed to be a material weakness… as the former GM did not demonstrate ethical behavior and management integrity…" and that "The ethical tone set by the former GM increased the risk of waste and abuse during his time as AGM of Infrastructure and later, GM." – but provides no evidence to show that. The former General Manager of course had authority over and access to information throughout the department. But it was SFPUC staff who diligently managed the day-to-day contracting processes in conformance with applicable law and policies. 4. The report states the former General Manager was convicted of "having the ability to influence the awarding some city contracts" – but that does not appear to be the wording from the Department of Justice. The auditor also details a "joint investment" between mLok and the former General Manager but provides no causal link between this, the COSO Framework and how I/CS forms would have affected the joint investment. 5. The report includes a statement that contract C-224A "could" be under a confidential investigation. The auditor provides no evidence of this and it appears misplaced in a report abiding by auditing standards. The report also noted that the auditor "inspected an Acknowledgement form signed by an SFPUC Employee on September 8, 2011," – the SFPUC never received a copy of this form, despite requests, and we disagree that its existence means I/CS forms should have been signed for the CS-224A and CS-224B solicitations.	

Recommendation	Agency Response	CSA Use Only Status Determination*
2. Follow the guidance in the COSO Framework for monitoring activities and request all publicly available information from the City Attorney on its investigations of SFPUC procurement practices and periodically report such publicly available information to the RBOC, where procurement practices impact revenue bond expenditures to further strengthen monitoring activities.	☐ Concur ☒ Do Not Concur ☐ Partially Concur In 2020, the City Attorney and Controller launched a joint investigation into public corruption identified in the criminal complaint. While the City Attorney focused on employee and contractor wrongdoing across multiple departments, the Controller undertook a Public Integrity review of city contracts, purchase orders, and grants to identify red flags possibly indicating process failures. We are advised that the work of the City Attorney is privileged and confidential and is not public. We are also advised that the City Attorney works with and advises other City departments, including the Controller's Office and its City Services Auditor, concerning public integrity and government contract processes. The Controller has issued several public reports with the information sought by this request, with another public integrity assessment forthcoming on the procurement processes at issue in the federal criminal investigation of Harlan Kelly.	☐ Open ☐ Closed ☒ Contested
3. Coordinate with RBOC and SFPW to quantify, evaluate, and report on the monetary impacts of SFPW's overhead rates charged on total direct labor and benefit expenditures subject to RBOC oversight, so that the RBOC can exercise proper oversight over such overhead expenditures.	☐ Concur ☒ Do Not Concur ☐ Partially Concur The RBOC oversees the SFPUC, as an independent oversight body; we would not 'coordinate' with them to "quantify, evaluate, and report" on any matter. The SFPUC routinely provides detailed information and updates to the RBOC to fulfill its oversight role upon their request. We will continue to respond to all reasonable RBOC requests for relevant information available to our staff. Regarding the SFPW rates, we would like to highlight that SFPW works closely with the Controller's Office to set those rates and those rates do not vary by city department. This recommendation would also have broader implications; as noted in the observation 32-34% of projects are for the SFPUC. Other departments would also be subject to a recommendation such as this. SFPW's overhead rate information is already publicly available. Lastly, under the right of first refusal in accordance with an MOU, the SFPUC is obligated to offer work to the SFPW – and only if SFPW declines can the work be offered up outside of SFPW. We did note this to the auditors during the fieldwork stage and it is stated in the report observation.	☐ Open ☐ Closed ☒ Contested

* Status Determination based on audit team's review of the agency's response and proposed corrective action.

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September 15, 2023

To: Barbara Hale, Assistant General Manager, Power
Ramon Abueg, Deputy Manager, Power Operations
Richard Stephens, Utility Services Manager
David Carter, Materials Coordinator
Bart Murphy, Materials Coordinator

Cc: Ronald P. Flynn, Deputy General Manager
Nancy L. Hom, Assistant General Manager, Business Services and Chief Financial Officer
Vivian Chen, Deputy Chief Financial Officer
Laura Busch, Acting Deputy Chief Financial Officer, Budget Director
Irella Blackwood, Audit Director
Jennifer Hopkins, Information Technology Services Director

Subject: Fiscal Year End 2022-2023
Inventory Count – Hetch Hetchy Enterprise, Hetchy Power In-City Warehouse

Dear Ms. Hale, Mr. Abueg, Mr. Stephens, Mr. Carter, and Mr. Murphy:

The San Francisco Public Utilities Commission (SFPUC) engaged Crowe LLP (Crowe) to perform full inventory count services for three enterprise funds including the Wastewater Enterprise, Water Enterprise, and Hetch Hetchy Enterprise.[1] This report represents results of Crowe's full count of the Hetch Hetchy Enterprise – Hetchy Power In-City inventory.

A. Scope of Inventory Work

The SFPUC requested Crowe to perform an annual full inventory count of these enterprises to test whether significant variances exist between the physical count and the records in the SFPUC's Maximo Inventory Tracking System (Maximo), to determine the cause of variances, and to determine amounts that need to be adjusted in Maximo. The SFPUC requested reporting of the analysis, findings, and recommendations consistent with the format requested by SFPUC's Financial Services Bureau.

B. Warehouse Locations

The locations for the Hetchy Power In-City physical inventory were:

Hetchy Power In-City Warehouse
Pier 23
San Francisco, California 94111

Treasure Island
Lot 69 (End of Avenue M)
San Francisco, California 94130

[1] Note that some of the enterprises have multiple warehouse locations.

On June 20 and June 21, 2023, Crowe visited the locations above and conducted the FY 2022-2023 full inventory count that is the subject of this report. The last full inventory count of the locations above was performed by Crowe for FY 2021-2022 on June 21, 2022. In **Table 1** below, we provide key data[2,3] from both full inventory counts.

Table 1
San Francisco Public Utilities Commission
Hetchy Power In-City Warehouse Inventory Count
Comparison with Prior Physical Inventory Counts[4]
(As of June 21, 2023)

Description	FY 2022-2023		FY 2021-2022	
	Items	Value	Items	Value
Total Inventory (per Maximo)	1,318	$ 1,372,997	1,364	$ 1,439,946
Total Inventory Variance (per Crowe's Count)	475	(75,192)	570	(80,224)
Total Inventory Variance (as a percentage of Total Inventory)	36.0%	(5.5%)	41.8%	(5.6%)

Results

As indicated in Table 1, variances were identified between Crowe's full inventory count and the count reported in the Maximo system. The two findings that follow explain the variances in counts and the difficulty in locating inventory items. Crowe's recommendations related to those findings are also included. Management responses to each finding were provided by the Hetchy Power In-City management team on August 31, 2023.

Finding #1 – Physical Inventory Counts Differed from Maximo Counts

Condition:

Of the 1,318 items we counted, 475 items, or 36.0%, had a variance between their physical count and their count in Maximo. This is a recurring finding. Based on the physical count, and using the average cost in Maximo, we determined that the total value of the variances in the Hetchy Power In-City inventory was ($75,192), or (5.5%) of the total inventory value of $1,372,997 in Maximo.[5]

We found 188 positive variances (where the physical count was greater than the Maximo inventory count) which totaled $88,878. We found 287 negative variances (where the physical count was less than the Maximo inventory count) which totaled ($164,071). In **Table 2** below we list 27 items with variances that are either above $2,000 or below ($2,000). Together, these 27 items represented ($53,001), or about 70% of the total variance of ($75,192).

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[2] In this report, percentages are rounded to one decimal place. Monetary values are rounded to the nearest whole dollar unless doing so would obscure the data, in which case they are presented without rounding.
[3] Crowe did not perform any procedures related to the assigned value in the Maximo system.
[4] The signs of both Total Inventory Variance (per Crowe's Count) and Total Inventory Variance (as a percentage of Total Inventory) in Table 1 are presented in a different fashion than in the prior year's report, where they are called Count Discrepancies and Percentage of Discrepancies respectively. In Table 1 of the FY 2021-2022 report, in the FY 2021-2022 Value column, both figures were shown as positive values. Table 1 of this report clarifies this data by presenting the FY 2021-2022 figures as negative inventory adjustments.
[5] The ($75,192) variance is the difference between $676,374.40, which is the total value of the 475 items with variances using Crowe's physical count for each item, and $751,566.85, which is the total value of the 475 items with variances using the Maximo count for each item.

Table 2
San Francisco Public Utilities Commission
Hetchy Power In-City Warehouse Inventory Count
List of Items with Variance Above $2,000 or Below ($2,000)

Item Number	Description	Item Code	Maximo 6.16.23	Crowe 6.21.23	Variance	Average Cost	Cost of Variance
1	BUSS FUSEHOLDER, HEX-AA	PE-10-0067	137	233	96	$ 121.99	$ 11,711.51
2	STEEL POLE, 25.FT, SINGLE ARM	PE-10-0480	11	24	13	750.00	9,750.00
3	4M /66R BULB, PHILIPS, PS40 LAMP	PE-10-1876	46	748	702	12.00	8,424.00
4	BUSS FUSEHOLDER, HEX-BB	PE-10-1414	89	306	217	19.21	4,167.96
5	Bolt Everdur 4" x 1/2"	PE-10-1032	77	329	252	14.04	3,538.41
6	60 AMP FUSES	PE-10-0083	119	430	311	11.21	3,486.09
7	6 FOOT ROUND BASE, ARM ASSEMBLY AMERON #3ST6A	PE-10-0365	11	19	8	395.05	3,160.41
8	STEEL POLE, 33 FT, DOUBLE ARM	PE-10-0488	5	8	3	1,050.00	3,150.00
9	LED PEs	PE-10-0029	202	286	84	28.17	2,366.04
10	N16 STREET LIGHTING CHRISTY BOX LID OLD	PE-10-0351	1,204	1,119	(85)	24.50	(2,082.50)
11	POLES, WOOD 50"	PE-10-0771	11	9	(2)	1,059.30	(2,118.60)
12	POLE, CONCRETE, 28FT, ROUND POE, BASE PLATE, P/N 1C3-28	PE-10-0511	11	10	(1)	2,124.65	(2,124.65)
13	POLE, CONCRETE, 26 FT, OCTAGONAL, DECORATIVE BASE, P/N 5B1-26 (55D)	PE-10-0526	19	18	(1)	2,223.73	(2,223.73)
14	Strain Clamp, Side-Opening-Wedge Deadend 4 Strand Al. to 4/0 Al.	PE-10-0925	30	3	(27)	82.50	(2,227.50)
15	MVR 175/V/BU/PA LAMP	PE-10-0639	110	101	(9)	250.00	(2,250.00)
16	200W INSTANT RESTRIKE LAMP	PE-10-0623	58	0	(58)	39.18	(2,272.27)
17	1000MCMCOP2H LUG PG&E #303461	PE-5935-303461	100	0	(100)	28.55	(2,855.00)
18	High Voltage Sign (Stencil)	PE-10-0959	350	69	(281)	10.20	(2,866.20)
19	Reducing Tap/Stud 15Kv 600/200A PGE 303593	PE-10-1829	25	0	(25)	121.23	(3,030.75)
20	STEEL POLE, 33 FT, SINGLE ARM	PE-10-0487	17	14	(3)	1,050.00	(3,150.00)
21	8 FOOT ROUND BASE, ARM ASSEMBLY, AMERON #3ST8A	PE-10-0364	6	0	(6)	694.26	(4,165.55)
22	STEEL POLE, 28.6, SINGLE ARM	PE-10-0484	7	0	(7)	885.70	(6,199.92)
23	1100 MCM Straight Splice PGE 301434	PE-10-1925	15	0	(15)	556.18	(8,342.70)
24	BUSS FUSEHOLDER , HEJ-BB	PE-10-1394	284	36	(248)	36.43	(9,034.04)
25	POLE, CONCRETE, 29 FT OCTAGONAL, DECORITIVE BASE, P/N 5B129 (56D)	PE-10-0503	22	18	(4)	2,470.61	(9,882.44)
26	6M/66G 6.6A LAMP PS35 LAMP	PE-10-0594	576	46	(530)	30.00	(15,900.00)
27	Tie, Lashing, Nylon	PE-10-1168	569	81	(488)	45.14	(22,029.74)
	Subtotal of Variances Above $2,000 or Below ($2,000)						**$ (53,001.17)**
	All Other Variances						(22,191.29)
						Total	**$ (75,192.46)**

Criteria:

Chapter 6 of the City and County of San Francisco Office of the Controller's Accounting Policies and Procedures identifies that Departments shall conduct a physical inventory at least annually and ensure that the inventory management system records accurately reflect inventory on hand. Additionally, Section 6.1 (Policy Guidelines) indicates that inventory system records must be promptly adjusted for any discrepancies identified in the physical counts, Departments must periodically review the inventory records for reasonableness and appropriateness of any changes to inventory unit cost, inventory valuation, and unit of measure, and Departments must periodically review the inventory for obsolescence and reasonableness of inventory classification. The Policy Guidelines also indicate that Departments should investigate significant discrepancies between the physical count, the inventory system records, and the accounting records; document the reasons for discrepancy; and take corrective actions to reduce future discrepancies.

Cause:

Hetchy Power In-City warehouse staff identified the following reasons for the differences in this physical count compared to the count in Maximo:

- The warehouse staff conducted a full inventory count three weeks prior to Crowe's full count and identified discrepancies but did not finish correcting them in Maximo. Other than validating counts of items on the weekly Re-Order report, warehouse staff do not typically conduct counts on a continuous or recurring basis.
- System posting errors, by the individual entering the data, where the quantity entered, unit of measure, or unit cost was incorrect.[6] Warehouse staff do not periodically review inventory records for changes to unit cost or unit of measure; rather, they address these issues as they are discovered.
- As of June 16, 2023, there were 532 items with a current balance of zero in Maximo. Of these, 428 are items which were moved from one location to another and have two Maximo entries, one for each location, but the Maximo entry for the old location was edited to have a zero balance instead of being deleted. The remaining 104 items are either duplicates, obsolete, or stock. Warehouse staff purposely retains obsolete parts in Maximo as they are occasionally reactivated to be issued out for projects that involve repairs of older equipment.
- Some inventory items were used on a project, and updates for these items were not reflected in Maximo.
- Some items were issued for a project, partially used or consumed, and then returned to the warehouse but not re-added to inventory (trucks were cleaned out, resulting in stock returning to the warehouse).
- During the atmospheric storms which caused extensive damage, many items were taken for emergencies during off hours and not documented for warehouse staff to issue out.
- The warehouse is using a contractor crew to do some work and there have been occasions where the contractor crew has taken items without checking with the warehouse.

Effect:

The Hetchy Power In-City inventory value in the Maximo system is overstated by $75,192.

Recommendation:

Hetchy Power In-City warehouse staff should update the asset inventory counts in Maximo after management approval. The SFPUC Financial Reporting and Analysis division should adjust the General Ledger to reflect the actual cost of inventory on hand. Hetchy Power In-City should investigate the significant discrepancies between the physical counts noted in Tables 1 and 2, the Maximo system records, and the accounting records; document the reasons for discrepancies; and implement corrective actions to reduce future discrepancies. Warehouse staff should periodically review the inventory records to remove duplicate and obsolete items and to ensure the reasonableness and appropriateness of inventory unit cost and unit of measure. Finally, warehouse staff should conduct regular physical inventory cycle counts and compare results with those in Maximo to ensure Maximo data is up-to-date and accurate.

Management Response:

Management concurs with the findings. The warehouse team is implementing various cycle counts. These counts will be based on re-order reports on a weekly basis and routine counts (monthly) based on items usage and value. Warehouse team will also perform reconciliation and consolidate storerooms in the Maximo system, review and reconcile stock versus non-stock items.

[6] Subsequent to Crowe's inventory count, warehouse staff identified that the average cost reported for item 27 in **Table 2**, PE-10-1168, Nylon Lashing Tie, was incorrectly reported as $48.14 when it should have been $0.50 (the unit cost on the last purchase order for that item).

Crowe

Finding #2 – Some Inventory Was Difficult to Locate

Condition:

While performing the physical count, we had difficulty locating some of the inventory items identified in the Maximo system. Some of the items were located behind other items and recessed which limited access. Other items were not clearly marked with their item numbers or were in a different bin location than the one noted in Maximo.

Criteria:

Chapter 6 of the City and County of San Francisco Office of the Controller's Accounting Policies and Procedures identifies that Department's should prepare and organize storage for the inventory count.

Cause:

Hetchy Power In-City moved relatively recently to Pier 23 and has been transitioning its entire inventory to this new storage facility. Additionally, several items that were recently determined to be obsolete were commingled with the current inventory items in Maximo (e.g., significant quantities of light bulbs).

Effect:

A third-party cannot easily perform the full inventory counts without the assistance of storekeeper staff. There also is the potential for some inventory items not to be identified.

Recommendation:

For the next annual inventory, Hetchy Power In-City should clearly label and organize all its inventory, particularly the items outside of the storage shelves, so that a third party can easily identify and count the inventory.

Management Response:

Due to the nature of the parts we carry, differentiated by style, by size, and by primary metal type, there will be some difficulties in identification; we are working on other ways to store materials to be ID'd correctly and consistent in storage structure. There will always be a need for staff to assist with the complex nature of Stock items.

Other Matters

This full inventory count did not constitute an audit, examination, review, or compilation of the historical and prospective financial information conducted in accordance with generally accepted auditing standards or with other standards established by the AICPA. Accordingly, Crowe is unable to express an opinion or any other form of assurance with respect to any of the historical or prospective financial information. Crowe did not perform any procedures to verify the Management Responses and Crowe does not provide any assurance regarding the accuracy or completeness of the responses. Any and all amounts referred to in this letter are preliminary and could change should additional procedures be performed. Additionally, issues that are not mentioned here could develop subsequent to the date of this letter that may have impacted Crowe's analysis or that Crowe may cite should additional procedures be performed.

The inventory services did not contemplate obtaining the understanding of internal controls or assessing control risk, tests of accounting records and responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit or examination. Thus, this engagement did not provide assurance that we became aware of significant matters that would be disclosed in an audit or examination.

As part of this inventory, the SFPUC agreed to be responsible to make all management decisions and perform all management functions; designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management to oversee our services; evaluate the adequacy and results of the services performed; accept responsibility for the results of the services; and establish and maintain internal controls, including monitoring ongoing activities. The SFPUC has ultimate authority for making changes to inventory reported in its Maximo system and on its financial statements.

Crowe's fees are not dependent upon the outcome of this report and Crowe is independent with respect to any other economic interests.

We appreciate the contribution of SFPUC management and your input and direction on this project. We also thank Hetchy Power In-City management and staff for assisting providing access to the inventory and for timely responses to our requests.

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September 15, 2023

To: Joel Prather, Acting Assistant General Manager, Wastewater Enterprise
Steve Jones, Acting Maintenance Manager
Christian Losno, Materials Coordinator
Jorge Gonzalez, Assistant Supervisor of Stores & Equipment

Cc: Ronald P. Flynn, Deputy General Manager
Nancy L. Hom, Assistant General Manager Business Services and Chief Financial Officer
Vivian Chen, Deputy Chief Financial Officer
Laura Busch, Acting Deputy Chief Financial Officer, Budget Director
Irella Blackwood, Audit Director
Jennifer Hopkins, Information Technology Services Director

Subject: Fiscal Year End 2022-2023
Inventory Count – Wastewater Enterprise Warehouse

Dear Mr. Prather, Jones, Losno, and Gonzalez:

The San Francisco Public Utilities Commission (SFPUC) engaged Crowe LLP (Crowe) to perform full inventory count services for three enterprise funds including the Wastewater Enterprise, Water Enterprise, and Hetch Hetchy Enterprise.[1] This report represents results of Crowe's full count of the Wastewater Enterprise inventory (Inventory).

A. Scope of Inventory Work

The SFPUC requested Crowe to perform an annual full inventory count of these enterprises to test whether significant variances exist between the physical count and the records in the SFPUC's Maximo Inventory Tracking System (Maximo), to determine the cause of variances, and to determine amounts that need to be adjusted in Maximo. The SFPUC requested reporting of the analysis findings, and recommendations consistent with the format requested by SFPUC's Financial Services Bureau.

B. Warehouse Location

The location for the Wastewater Enterprise physical inventory was:

2725 Oakdale Avenue
San Francisco, California 94124

On June 28 and June 29, 2023, Crowe visited the location above and conducted the FY 2022-2023 full inventory count that is the subject of this report. The last full inventory count of the location above was

[1] Note that some of the enterprises have multiple warehouse locations.

performed by Crowe for FY 2021-2022 on June 23, 2022. In **Table 1** below, we provide key data[2,3] from both full inventory counts.

Table 1
San Francisco Public Utilities Commission
Wastewater Inventory Count
Comparison with Prior Physical Inventory Counts[4]
(As of June 29, 2023)

Description	FY 2022-2023		FY 2021-2022	
	Items	Value	Items	Value
Total Inventory (per Maximo)	3,757	$ 3,356,658	3,871	$ 2,957,510
Total Inventory Variance (per Crowe's Count)	13	(2,048)	109	(22,955)
Total Inventory Variance (as a percentage of Total Inventory)	0.3%	(0.1%)	2.8%	(0.8%)

Results

As indicated in Table 1, variances were identified between Crowe's full inventory count and the count reported in the Maximo system. The following finding explains the variances in counts. Crowe's recommendation related to this finding is also included. A management response was provided by the Wastewater management team on September 11, 2023.

Finding #1 – Physical Inventory Counts Differed from Maximo Report Counts

Condition:

Of the 3,757 items we counted, 13, or 0.3%, had a variance between their physical count and their count in Maximo.[5] Based on the physical count, and using the average cost in Maximo, we determined that the total value of the variances in the Wastewater Enterprise inventory was ($2,048), or (0.1%) of the total inventory value of $3,356,658 in Maximo.[6]

We found 3 positive variances (where the physical count was greater than the Maximo inventory count) which totaled $121. We found 10 negative variances (where the physical count was less than the Maximo inventory count) which totaled ($2,168).[7,8] In **Table 2** below we list the 13 items with variances from the Maximo count.

[2] In this report, percentages are rounded to one decimal place. Monetary values are rounded to the nearest whole dollar unless doing so would obscure the data, in which case they are presented without rounding.
[3] Crowe did not perform any procedures related to the assigned value in the Maximo system.
[4] The signs of both Total Inventory Variance (per Crowe's Count) and Total Inventory Variance (as a percentage of Total Inventory) in Table 1 are presented in a different fashion than in the prior year's report, where they are called Count Discrepancies and Percentage of Discrepancies respectively. In Table 1 of the FY 2021-2022 report, in the FY 2021-2022 Value column, both figures were shown as positive values. Table 1 of this report clarifies this data by presenting the FY 2021-2022 figures as negative inventory adjustments.
[5] Of the 13 items with a difference between the physical count and the count in Maximo, 8 are non-stock items which should not have been in Maximo. If the total variance in the number of items counted is adjusted to exclude the eight non-stock items, it falls from 0.3% (13 items divided by 3,757 items) to 0.1% (5 items divided by 3,757 items).
[6] The ($2,048) variance is the difference between $1,933, which is the total value of the 13 items with variances using Crowe's physical count for each item, and $3,981, which is the total value of the 13 items with variances using the Maximo count for each item.
[7] The positive variance of $121 and the negative variance of ($2,168) are rounded figures which sum to ($2,047). If the unrounded variances are summed and then rounded, the total is ($2,048) as shown in Table 1.
[8] If the negative variance amount is adjusted to exclude the 8 non-stock items, it changes from ($2,168) to ($9).

Crowe

Table 2
San Francisco Public Utilities Commission
Wastewater Inventory Count
List of All Items with Variances

Item Number	Description	Non-stock Item	Item Code	Issue Unit	Maximo Count	Crowe Count	Variance	Average Cost	Variance
1	GLOVES, LATEX, YELLOW, 5280P, MEDIUM	No	ASFTP-0760	PR	216	217	1	$ 1.90	$ 1.90
2	TAG (WITH GROMMET), LOCKOUT (DANGER-DO NOT OPERATE-MY LIFE IS ON THE LINE), RED	No	ASFTS-1011	EA	1025	1050	25	1.12	28.07
3	BOTTLE, PLASTIC; "TOLCO"; SPRAY, 32 OZ; MAX ISSUE: 2 EA	No	JSUPP-BT32	EA	80	79	-1	0.56	(0.56)
4	SOAP,HAND,POWDERED,WHITE,W/BORAX,8/5LB BX/CS	No	JSUPP-SP01	EA	16	26	10	9.09	90.89
5	JUG, 1 GALLON, W/ HANDLE AND CAP, TRANSLUCENT PLASTIC, " ULINE" PN: S-10746, 12/CASE	No	JSUPP-JG10	EA	16	14	-2	4.44	(8.88)
6	Discrete Output module, "Modicon", BMXDAO1605, M340	Yes	SMODI-0001	EA	1	0	-1	425.37	(425.37)
7	GASKET, BUSH CAP, ALFA LAVAL, PD434951	Yes	GGSKT-0273	EA	10	0	-10	7.20	(72.02)
8	BEARING, FAG, 22215 15EAS.MK.C3	Yes	GBRNG-0565	EA	3	0	-3	86.45	(259.35)
9	BEARING, ROLLER, NSK, 6206ZC3E	Yes	ABRG1-1981	EA	3	0	-3	6.24	(18.72)
10	BEARING, SKF, 22207	Yes	GBRNG-0567	EA	2	0	-2	101.57	(203.14)
11	BEARING, 1-15/16 IN	Yes	GBRNG-0572	EA	2	0	-2	180.00	(360.00)
12	BEARING, EXPANSION STEERING	Yes	GBRNG-0573	EA	2	0	-2	270.00	(540.00)
13	REBUILD KIT, ACTUATOR (ST-600), "JAMESBURY" PN: RKT-43	Yes	GACTU-0009	EA	1	0	-1	280.43	(280.43)
									$ (2,047.61)

Criteria:

Chapter 6 of the City and County of San Francisco Office of the Controller's Accounting Policies and Procedures identifies that Departments shall conduct a physical inventory at least annually and ensure that the inventory management system records accurately reflect inventory on hand. Additionally, Section 6.1 (Policy Guidelines) indicates that inventory system records must be promptly adjusted for any discrepancies identified in the physical counts, Departments must periodically review the inventory records for reasonableness and appropriateness of any changes to inventory unit cost, inventory valuation, and unit of measure, and Departments must periodically review the inventory for obsolescence and reasonableness of inventory classification. The Policy Guidelines also indicate that Departments should investigate significant discrepancies between the physical count, the inventory system records, and the accounting records; document the reasons for discrepancy; and take corrective actions to reduce future discrepancies.

Cause:

Variations were caused by minor miscounts during periodic cycle counts and non-stock items which were classified as inventory items in Maximo.

Effect:

The Wastewater Enterprise inventory value in the Maximo system is overstated by $2,048.

Recommendation:

The Wastewater warehouse staff should update the asset inventory counts in Maximo system after management approval. The SFPUC Financial Reporting and Analysis division should adjust the General Ledger to reflect the actual cost of inventory on hand. The Wastewater Enterprise should investigate the discrepancies between the physical counts noted in Tables 1 and 2, the Maximo system records, and the accounting records; document the reasons for discrepancies; and implement corrective actions to reduce future discrepancies.

Management Response:

WWE concurs with the findings presented in this report and we are pleased to see a marked improvement from last year. One of our goals over the past year was to improve our cycle count processes, with particular focus on high dollar items. We feel that we succeeded here and look forward to continuing our improvements across all WWE warehouse functions.

Other Matters

This full inventory count did not constitute an audit, examination, review, or compilation of the historical and prospective financial information conducted in accordance with generally accepted auditing standards or with other standards established by the AICPA. Accordingly, Crowe is unable to express an opinion or any other form of assurance with respect to any of the historical or prospective financial information. Crowe did not perform any procedures to verify the Management Responses and Crowe does not provide any assurance regarding the accuracy or completeness of the responses. Any and all amounts referred to in this letter are preliminary and could change should additional procedures be performed. Additionally, issues that are not mentioned here could develop subsequent to the date of this letter that may have impacted Crowe's analysis or that Crowe may cite should additional procedures be performed.

The inventory services did not contemplate obtaining the understanding of internal controls or assessing control risk, tests of accounting records and responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit or examination. Thus, this engagement did not provide assurance that we became aware of significant matters that would be disclosed in an audit or examination.

As part of this inventory, the SFPUC agreed to be responsible to: make all management decisions and perform all management functions; designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management to oversee our services; evaluate the adequacy and results of the services performed; accept responsibility for the results of the services; and establish and maintain internal controls, including monitoring ongoing activities. The SFPUC has ultimate authority for making changes to inventory reported in its Maximo system and on its financial statements.

Crowe's fees are not dependent upon the outcome of this report and Crowe is independent with respect to any other economic interests.

We appreciate the contribution of SFPUC management and your input and direction on this project. We also thank Wastewater Enterprise management and staff for assisting providing access to the inventory and for timely responses to our requests.

Crowe LLP

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San Francisco Public Utilities Commission
525 Golden Gate Avenue, 13th Floor
San Francisco, CA 94102

September 15, 2023

To: Steve Ritchie, Assistant General Manager, Water Enterprise
Margaret Hannaford, Division Manager, Hetch Hetchy Water/Moccasin
Cheryl Sperry, Administrative Services Manager
Ray Emerald, Assistant Materials Coordinator

Cc: Ronald P. Flynn, Deputy General Manager
Nancy L. Hom, Assistant General Manager, Business Services and Chief Financial Officer
Vivian Chen, Deputy Chief Financial Officer
Laura Busch, Acting Deputy Chief Financial Officer, Budget Director
Irella Blackwood, Audit Director
Jennifer Hopkins, Information Technology Services Director

Subject: Fiscal Year End 2022-2023
Inventory Count – Hetch Hetchy Enterprise, Moccasin Warehouse

Dear Mr. Ritchie, Ms. Hannaford, Ms. Sperry, and Mr. Emerald:

The San Francisco Public Utilities Commission (SFPUC) engaged Crowe LLP (Crowe) to perform full inventory count services for three enterprise funds including the Wastewater Enterprise, Water Enterprise, and Hetch Hetchy Enterprise.[1] This report represents results of Crowe's full count of the Hetch Hetchy Enterprise – Moccasin Warehouse inventory.

A. Scope of Inventory Work

The SFPUC requested Crowe to perform an annual full inventory count of these enterprises to test whether significant variances exist between the physical count and the records in the SFPUC's Maximo Inventory Tracking System (Maximo), to determine the cause of variances, and to determine amounts that need to be adjusted in Maximo. The SFPUC requested reporting of the analysis, findings, and recommendations consistent with the format requested by SFPUC's Financial Services Bureau.

B. Warehouse Location

The location for the Hetch Hetchy Enterprise physical inventory was:

Moccasin Warehouse
10390 Moccasin Switchback Road
Moccasin, CA 95347

On June 22, 2023, Crowe visited the location above and conducted the FY 2022-2023 full inventory count that is the subject of this report. The last full inventory count of the location above was performed by

[1] Note that some of the enterprises have multiple warehouse locations.

Crowe for FY 2021-2022 on June 28, 2022. In **Table 1** below, we provide key data[2,3] from both full inventory counts.

Table 1
San Francisco Public Utilities Commission
Hetch Hetchy Moccasin Warehouse Inventory Count
Comparison with Prior Physical Inventory Counts[4]
(As of June 22, 2023)

Description	FY 2022-2023		FY 2021-2022	
	Items	Value	Items	Value
Total Inventory (per Maximo)	2,339	$ 470,945	2,370	$ 422,044
Total Inventory Variance (per Crowe's Count)	34	(220)	20	85
Total Inventory Variance (as a percentage of Total Inventory)	1.5%	(0.05%)	0.8%	0.02%

Results

As indicated in Table 1, minor variances were identified between Crowe's full inventory count and the count reported in the Maximo system. The following observation explains the variances in counts. Crowe's recommendation related to this observation is also included. A management response was provided by the Moccasin management team on August 28, 2023.

Observation #1 – Physical Inventory Counts Differed from Maximo Report Counts

Condition:

Of the 2,339 items we counted, 34, or 1.5%, had a variance between their physical count and their count in Maximo. Based on the physical count, and using the average cost in Maximo, we determined that the total value of the variances in the Moccasin Warehouse inventory was ($220), or (0.05%) of the total inventory value of $470,945 in Maximo.[5]

We found 15 positive variances (where the physical count was greater than the Maximo inventory count) which totaled $412. We found 19 negative variances (where the physical count was less than the Maximo inventory count) which totaled ($632). In **Table 2** below we provide a summary of variances.

[2] In this report, percentages are rounded to one decimal place unless they would round to 0.0%, in which case they are rounded to two decimal places. Monetary values are rounded to the nearest whole dollar unless doing so would obscure the data, in which case they are presented without rounding.
[3] Crowe did not perform any procedures related to the assigned value in the Maximo system.
[4] The signs of both Total Inventory Variance (per Crowe's Count) and Total Inventory Variance (as a percentage of Total Inventory) in Table 1 are presented in a different fashion than in the prior year's report, where they are called Count Discrepancies and Percentage of Discrepancies respectively. In Table 1 of the FY 2021-2022 report, in the FY 2021-2022 Value column, both figures were shown as negative values. Table 1 of this report clarifies this data by presenting the FY 2021-2022 figures as positive inventory adjustments.
[5] The ($220) variance is the difference between $35,478.49, which is the total value of the 34 items with variances using Crowe's physical count for each item, and $35,698.74, which is the total value of the 34 items with variances using the Maximo count for each item.

Table 2
San Francisco Public Utilities Commission
Hetch Hetchy Moccasin Warehouse Inventory Count
Summary of Variances

Description	Item Count	Amount
Fuel Variances		
Positive	4	$ 344
Negative	2	(380)
Total Fuel Variance	6	$ (36)
Other Variances		
Positive	11	68
Negative	17	(252)
Total Other Variances	28	$ (184)
Total Variance	**34**	**$ (220)**

As shown in **Table 3** below, based on the fuel dip procedures Crowe performed for this physical count, we found the actual quantities of fuel contained in the eleven tanks varied slightly, or by ($36), from those in the Maximo system. **Table 4** provides the other ($184) in non-fuel count variances.

Table 3
San Francisco Public Utilities Commission
Hetch Hetchy Moccasin Warehouse Inventory Count
Summary of Fuel Count Variances

Item Number	Description	Item Code	Issue Unit	Maximo 6.22.23	Crowe 6.22.23	Variance	Average Cost	Cost of Variance
1	GASOLINE,unlead,EARLY INTAKE,#05	091-30-3212	GAL	2,414	2,458	44	$ 4.35	$ 191.47
2	GASOLINE, UNLEADED, MOCCASIN,#01.-2	091-30-3270	GAL	2,321	2,256	(65)	4.34	(280.16)
3	GASOLINE, MOCCASIN , # 4-5 tanks	091-30-3271	GAL	1,887	1,898	11	4.44	49.33
4	GASOLINE, UNLEADED, O'S,#04	091-30-3180	GAL	414	429	15	4.47	67.12
5	GASOLINE,UNLEAD,SOUTH FORK,#09.	091-30-3239	GAL	268	246	(22)	4.55	(99.99)
6	FUEL, RENEWABLE DIESEL,SOUTH FORK,#10 (CHANGED FROM #2 DIESEL 4/12/16)	091-40-3150	GAL	377	385	8	4.47	35.74
							Total	**$ (36.49)**

Table 4
San Francisco Public Utilities Commission
Hetch Hetchy Moccasin Warehouse Inventory Count
Summary of Non-Fuel Count Variances

Item Number	Description	Item Code	Maximo 6.22.23	Crowe 6.22.23	Variance	Average Cost	Cost of Variance
1	KNIFE,PLASTIC,HVY.,	085-50-8847	1	2	1	$ 42.00	42
2	BAG, BURLAP, CLOSE WEAVE, (100 LB SACK)	081-05-0535	340	345	5	3.16	16
3	UTILITY KNIFE BLADE, LENNOX GOLD # 5C, 5/PK,(3KJC7)	051-10-5000	4	5	1	4.29	4
4	Nuts, Bolts, Screws, and Washers with Positive Variances (8 Items)	Various	1,014	1,100	86	0.07	6
5	Nuts, Bolts, Screws, and Washers with Negative Variances (14 Items)	Various	1,275	1,213	(62)	0.26	(16)
6	14x20x1 PLEATED HVAC FILTER (MERV 8) 6B970	066-01-1420	14	11	(3)	4.61	(14)
7	HVAC FILTER, 10X20X1, MERV 13, ADMIN (785TK1)	066-01-102013	12	-	(12)	7.36	(88)
8	TIE, CABLE, NYLON, 15" (36J166)	059-78-3998X	9	4	(5)	26.85	(134)
						Total	**$ (184)**

Criteria:

Chapter 6 of the City and County of San Francisco Office of the Controller's Accounting Policies and Procedures identifies that Departments shall conduct a physical inventory at least annually and ensure that the inventory management system records accurately reflect inventory on hand. Additionally, Section 6.1 (Policy Guidelines) indicates that inventory system records must be promptly adjusted for any discrepancies identified in the physical counts, Departments must periodically review the inventory records for reasonableness and appropriateness of any changes to inventory unit cost, inventory valuation, and unit of measure, and Departments must periodically review the inventory for obsolescence and reasonableness of inventory classification. The Policy Guidelines also indicate that Departments should investigate significant discrepancies between the physical count, the inventory system records, and the accounting records; document the reasons for discrepancy; and take corrective actions to reduce future discrepancies.

Cause:

Moccasin Warehouse staff indicated several reasons for the differences in this physical count compared to the count in Maximo, including miscounting, data entry errors, and small variances due to weighing nuts and bolts with a scale instead of individually counting them.

Regarding the fuel volumes variance valued at ($36), we determined that the Moccasin Warehouse uses the automated fuel tracking information system, E.J. Ward, to record fuel usage. The SFPUC information technology department developed an interface designed to periodically upload the fuel usage data to the Maximo system. There may be delays in updating data because of poor network communication systems. The small variances from the quantities we observed during our physical count and those current in Maximo were caused by rounding errors as a result of using a manual dip process and a conversion formula to determine fuel quantities.

Effect:

The Moccasin Warehouse inventory value in the Maximo system is overstated by $220.

Recommendation:

The Moccasin warehouse staff should update the asset inventory counts in Maximo after management approval. The SFPUC Financial Services Unit should adjust the General Ledger to reflect the actual cost of inventory on hand.

Management Response:

Hetch Hetchy Water concurs with the recommendation, and we have made the corresponding adjustments.

Other Matters

This full inventory count did not constitute an audit, examination, review, or compilation of the historical and prospective financial information conducted in accordance with generally accepted auditing standards or with other standards established by the AICPA. Accordingly, Crowe is unable to express an opinion or any other form of assurance with respect to any of the historical or prospective financial information. Crowe did not perform any procedures to verify the Management Responses and Crowe does not provide any assurance regarding the accuracy or completeness of the responses. Any and all amounts referred to in this letter are preliminary and could change should additional procedures be performed. Additionally, issues that are not mentioned here could develop subsequent to the date of this letter that may have impacted Crowe's analysis or that Crowe may cite should additional procedures be performed.

The inventory services did not contemplate obtaining the understanding of internal controls or assessing control risk, tests of accounting records and responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit or examination. Thus, this engagement did not provide assurance that we became aware of significant matters that would be disclosed in an audit or examination.

As part of this inventory, the SFPUC agreed to be responsible to make all management decisions and perform all management functions; designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management to oversee our services; evaluate the adequacy and results of the services performed; accept responsibility for the results of the services; and establish and maintain internal controls, including monitoring ongoing activities. The SFPUC has ultimate authority for making changes to inventory reported in its Maximo system and on its financial statements.

Crowe's fees are not dependent upon the outcome of this report and Crowe is independent with respect to any other economic interests.

We appreciate the contribution of SFPUC management and your input and direction on this project. We also thank Moccasin Warehouse management and staff for providing access to the inventory and for timely responses to our requests.

Crowe LLP

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San Francisco Public Utilities Commission
525 Golden Gate Avenue, 13th Floor
San Francisco, CA 94102

September 15, 2023

To: Steven Ritchie, Assistant General Manager, Water Enterprise
Ellen Levin, Deputy Assistant General Manager, Water
Angela Cheung, Water Supply & Treatment Manager
Annette Devincenzi, Warehouse Manager

Cc: Ronald P. Flynn, Deputy General Manager
Nancy L. Hom, Assistant General Manager, Business Services and Chief Financial Officer
Vivian Chen, Deputy Chief Financial Officer
Irella Blackwood, Audit Director
Laura Busch, Acting Deputy Chief Financial Officer, Budget Director
Jennifer Hopkins, Information Technology Services Director

Subject: Fiscal Year End 2022-2023
Inventory Count – Water Enterprise, Millbrae Warehouse and Sunol Yard Fuel Station

Dear Mr. Ritchie, Ms. Levin, Ms. Cheung, and Ms. Devincenzi:

The San Francisco Public Utilities Commission (SFPUC) engaged Crowe LLP (Crowe) to perform full inventory count services for three enterprise funds including the Wastewater Enterprise, Water Enterprise, and Hetch Hetchy Enterprise.[1] This report represents results of Crowe's full count of the inventory at the Water Enterprise's Millbrae warehouse and fuel inventory at the Millbrae and Sunol Yards.

A. Scope of Inventory Work

The SFPUC requested Crowe to perform an annual full inventory count of these enterprises to test whether significant variances exist between the physical count and the records in the SFPUC's Maximo Inventory Tracking System (Maximo), to determine the cause of variances, and to determine amounts that need to be adjusted in Maximo. The SFPUC requested reporting of the analysis, findings, and recommendations consistent with the format requested by SFPUC's Financial Services Bureau.

B. Warehouse Locations

The locations for the Water Enterprise physical inventory were:

Millbrae Warehouse
1000 El Camino Real
Millbrae, CA 94030

Sunol Yard
505 Paloma Way
Sunol, CA 94586

[1] Note that some of the enterprises have multiple warehouse locations.

On June 27, 2023, Crowe visited the above sites and conducted the inventory observation that is the subject of this report. The last full inventory count was performed by Crowe for Post FY 2021-2022 on June 30, 2022, at the above identified sites. In **Table 1** below, we provide key data[2,3] from both full inventory counts.

Table 1
San Francisco Public Utilities Commission
Water – Millbrae Warehouse and Sunol Yard Inventory Count
Comparison with Prior Physical Inventory Counts[4]
(As of June 27, 2023)

Description	FY 2022-2023		FY 2021-2022	
	Items	Value	Items	Value
Total Inventory (per Maximo)	1,132	$ 642,514	1,117	$ 581,378
Total Inventory Variance (per Crowe's Count)	15	(6,839)	13	441
Total Inventory Variance (as a percentage of Total Inventory)	1.3%	(1.1%)	1.2%	0.1%

Results

As indicated in Table 1, variances were identified between Crowe's full inventory count and the count reported in the Maximo system. The following observation explains the variances in counts. Crowe's recommendation related to this observation is also included. A management response was provided by the Millbrae Warehouse and Sunol Yard management team on August 28, 2023.

Observation #1 – Physical Inventory Counts Differed from Maximo Counts

Condition:

Of the 1,132 items we counted, 15, or 1.3%, had a variance between their physical count and their count in Maximo. Based on the physical count, and using the average cost in Maximo, we determined that the total value of the combined variances in the Millbrae Warehouse and Sunol Yard inventories was ($6,839), or (1.1%) of the total inventory value of $642,514 in Maximo.[5]

We found 6 positive variances (where the physical count was greater than the Maximo inventory count) which totaled $129. We found 9 negative variances (where the physical count was less than the Maximo inventory count) which totaled ($6,968). In **Table 2** below we provide a summary of variances which shows that most of the variance dollar amount is fuel related.

[2] In this report, percentages are rounded to one decimal place. Monetary values are rounded to the nearest whole dollar unless doing so would obscure the data, in which case they are presented without rounding.
[3] Crowe did not perform any procedures related to the assigned value in the Maximo system.
[4] The signs of both Total Inventory Variance (per Crowe's Count) and Total Inventory Variance (as a percentage of Total Inventory) in Table 1 are presented in a different fashion than in the prior year's report, where they are called Count Discrepancies and Percentage of Discrepancies respectively. In Table 1 of the FY 2021-2022 report, in the FY 2021-2022 Value column, both figures were shown as negative values. Table 1 of this report clarifies this data by presenting the FY 2021-2022 figures as positive inventory adjustments.
[5] The ($6,839) variance is the difference between $41,804, which is the total value of the 15 items with variances using Crowe's physical count for each item, and $48,643, which is the total value of the 15 items with variances using the Maximo count for each item.

Table 2
San Francisco Public Utilities Commission
Water – Millbrae Warehouse and Sunol Yard Inventory Count
Summary of Variances

Description	Item Count	Amount
Fuel Variances		
Positive	0	$ -
Negative	4	(5,515)
Total Fuel Variance	4	$ (5,515)
Other Variances		
Positive	6	129
Negative	5	(1,453)
Total Other Variances	11	$ (1,324)
Total Variance	**15**	**$ (6,839)**

As shown in **Table 3** below, based on the fuel dip procedures Crowe performed for this physical count, we found the actual quantities of fuel contained in the four tanks varied from those in the Maximo system. We believe that the quantities we observed during our physical count using a manual dip process and a conversion formula were reasonably accurate as they closely matched quantities registered by an electronic measurement system contained in the fuel tanks that the Water Enterprise generated that day (referred to as the System Status Report). **Table 4** provides the other ($1,324) in non-fuel count variances.

Table 3
San Francisco Public Utilities Commission
Water – Millbrae Warehouse and Sunol Yard Fuel Inventory
Summary of Fuel Gallon and Cost Variances

Item Number	Description	Item Code	Unit	CURBAL 6.26.23	Crowe 6.27.23	Variance	Average Cost	Variance
1	GASOLINE, AUTO, UNLEADED, SUNOL	091-30-3260	GAL	1,966	1,647	(319)	$ 4.17	$ (1,331)
2	GASOLINE, DIESEL, SUNOL	091-40-3147	GAL	1,254	1,167	(87)	4.22	(366)
3	GASOLINE, AUTO, UNLEADED, MILLBRAE	091-30-3255	GAL	5,300	4,609	(691)	4.04	(2,794)
4	GASOLINE, DIESEL FUEL, MILLBRAE	091-40-3146	GAL	2,518	2,257	(261)	3.93	(1,024)
							Total	**$ (5,515)**

Table 4
San Francisco Public Utilities Commission
Water – Millbrae Warehouse and Sunol Yard Fuel Inventory
Summary of Non-Fuel Count Variances

Item Number	Description	Item Code	Unit	Maximo 6.26.23	Crowe 6.27.23	Variance	Average Cost	Cost of Variance
1	VALVE, BALL, 3/4", NIBCO S-685-80-LF	048-22-1004	EA	14	16	2	$ 52.62	$ 105.24
2	BOLT, HEX, STEEL, N.C., 5/8"X 4-1/2"	053-06-4467	EA	214	223	9	0.99	8.91
3	SCRUB, POISON IVY , TECHNU EXTREME - 144/CASE	065-75-1612	EA	47	50	3	1.90	5.70
4	MORTAR, MASON MIX, QUICKCRETE, #3002, 60 LB. BAG	080-30-7950	EA	54	55	1	5.48	5.48
5	NUT, PLN, NC, THRD, 1/4"	053-10-2089	HUN	1	1.7	0.7	4.62	3.23
6	BOLT, HEX, STL., GR-5, NC, 1/2" X 3-1/2"	053-00-3598	EA	248	249	1	0.74	0.74
7	CHAIN, WELDED, PROOF COIL, 3/16"	040-10-1650	FT	75	73	(2)	2.12	(4.24)
8	CHAIN, WELDED, COIL, GALV, 1/4 IN	040-10-1540	FT	180	178	(2)	2.16	(4.31)
9	STEEL BAR, 5/8" ROUND, HOT ROLLED, 20FT.	095-10-8358	EA	8	7	(1)	23.53	(23.53)
10	JACKET, RAIN, YELLOW (XXX LARGE)	084-05-3668	EA	9	-	(9)	54.04	(486.40)
11	POLY, POLY CLEAN, HAND CLEANER	072-00-1006	TUB	106	15	(91)	10.27	(934.41)
							Total	**$ (1,323.59)**

Criteria:

Chapter 6 of the City and County of San Francisco Office of the Controller's Accounting Policies and Procedures identifies that Departments shall conduct a physical inventory at least annually and ensure that the inventory management system records accurately reflect inventory on hand. Additionally, Section 6.1 (Policy Guidelines) indicates that inventory system records must be promptly adjusted for any discrepancies identified in the physical counts, Departments must periodically review the inventory records for reasonableness and appropriateness of any changes to inventory unit cost, inventory valuation, and unit of measure, and Departments must periodically review the inventory for obsolescence and reasonableness of inventory classification. The Policy Guidelines also indicate that Departments should investigate significant discrepancies between the physical count, the inventory system records, and the accounting records; document the reasons for discrepancy and take corrective actions to reduce future discrepancies.

Cause:

Non-fuel variances were primarily caused by minor miscounts during periodic cycle counts and occasional system posting manual errors by the individual entering the quantity or unit of measure. Regarding the fuel variances observed, we determined that the Water Enterprise uses the automated fuel tracking information system, E.J. Ward, to capture fuel usage and the SFPUC Information Technology Services Bureau has developed an interface designed to periodically upload the E.J. Ward fuel usage data to the Maximo system. However, based on problems with the system interface between the E.J. Ward system and the Maximo system, actual Water Enterprise fuel usage data was not consistently and accurately uploaded into Maximo causing the variances.

Effect:

The combined Millbrae and Sunol inventory value in the Maximo system is overstated by $6,839. Regarding the fuel usage discrepancies, absent periodic monitoring of the fuel levels, the Millbrae Warehouse and Sunol Yard will have difficultly reconciling future inventories and identifying variances that are the result of missing fuel (e.g., theft), delivery errors, data entry errors, tank leaks, or shrinkage.

Recommendation:

The Millbrae Warehouse staff should update the asset inventory counts in Maximo after management approval. The SFPUC's Financial Services Bureau should adjust the General Ledger to reflect the actual cost of inventory on hand. The SFPUC Information Technology Services Bureau and warehouse staff should work together to make the EJ Ward system and Maximo interface correctly to minimize discrepancies.

Management Response:

The audit recommendation has been implemented at the SFPUC Millbrae Warehouse regarding updated inventory. All inventory items are updated on a regular basis. A quarterly report is issued from SFPUC Financial Services Bureau reflecting any changes and a response is submitted reflecting the nature of the adjustments. The EJ Ward system is outdated; other options are being explored by the SFPUC.

Other Matters

This full inventory count did not constitute an audit, examination, review, or compilation of the historical and prospective financial information conducted in accordance with generally accepted auditing standards or with other standards established by the AICPA. Accordingly, Crowe is unable to express an opinion or any other form of assurance with respect to any of the historical or prospective financial information. Crowe did not perform any procedures to verify the Management Responses and Crowe does not provide any assurance regarding the accuracy or completeness of the responses. Any and all amounts referred to in this letter are preliminary and could change should additional procedures be performed. Additionally, issues that are not mentioned here could develop subsequent to the date of this letter that may have impacted Crowe's analysis or that Crowe may cite should additional procedures be performed.

The inventory services did not contemplate obtaining the understanding of internal controls or assessing control risk, tests of accounting records and responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit or examination. Thus, this engagement did not provide assurance that we became aware of significant matters that would be disclosed in an audit or examination.

As part of this inventory, the SFPUC agreed to be responsible to: make all management decisions and perform all management functions; designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management to oversee our services; evaluate the adequacy and results of the services performed; accept responsibility for the results of the services; and establish and maintain internal controls, including monitoring ongoing activities. The SFPUC has ultimate authority for making changes to inventory reported in its Maximo system and on its financial statements.

Crowe's fees are not dependent upon the outcome of this report and Crowe is independent with respect to any other economic interests.

We appreciate the contribution of SFPUC management and your input and direction on this project. We also thank Millbrae Warehouse and Sunol Yard management and staff for providing access to the inventory and for timely responses to our requests.

Crowe LLP

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San Francisco Public Utilities Commission
525 Golden Gate Avenue, 13th Floor
San Francisco, CA 94102

September 15, 2023

To: Steve Ritchie, Assistant General Manager, Water Enterprise
Ellen Levin, Deputy Assistant General Manager, Water Enterprise
William Teahan, CDD Division Manager
William Toman, CDD Materials Coordinator
Andy O'Brien, CDD Materials Coordinator

Cc: Ronald P. Flynn, Deputy General Manager
Nancy L. Hom, Assistant General Manager Business Services and Chief Financial Officer
Vivian Chen, Deputy Chief Financial Officer
Laura Busch, Acting Deputy Chief Financial Officer, Budget Director
Irella Blackwood, Audit Director
Jennifer Hopkins, Information Technology Services Director

Subject: Fiscal Year End 2022-2023
Inventory Count – Water Enterprise, CDD Main Warehouse, AWSS Warehouse, and
6 Satellite Warehouses (Auto, Carpentry, Electrical, Ground, LMPS, and Machine Shops)

Dear Mr. Ritchie, Ms. Levin, Mr. Teahan, Mr. Toman and Mr. O'Brien:

The San Francisco Public Utilities Commission (SFPUC) engaged Crowe LLP (Crowe) to perform full inventory count services for three enterprise funds including the Wastewater Enterprise, Water Enterprise, and Hetch Hetchy Enterprise.[1] This report represents results of Crowe's full count of the Water Enterprise inventory at the CDD Main and AWSS Warehouses and 6 Satellite Warehouses but excluding the Millbrae Warehouse and Sunol Yard, which are addressed in a separate report.

A. Scope of Inventory Work

The SFPUC requested Crowe to perform an annual physical inventory of these enterprises to test whether significant variances exist between the physical count and the records in the SFPUC's Maximo Inventory Tracking System (Maximo), to determine the cause of variances, and to determine amounts that need to be adjusted in Maximo. The SFPUC requested reporting of the analysis, findings, and recommendations consistent with the format requested by SFPUC's Financial Services Bureau.

B. Warehouse Locations

The locations for the Water Enterprise physical inventory were:

CDD Main (and 6 Satellites)
1990 Newcomb Ave
San Francisco, California 94124

[1] Note that some of the enterprises have multiple warehouse locations.

AWSS
1980 Oakdale Ave
Twin Peaks Reservoir
San Francisco, California 94124

LPMS Satellite
991 Lake Merced Blvd.
San Francisco, California 94132

From June 12 through June 14, 2023, Crowe visited the locations above and conducted the full inventory count that is the subject of this report. The last full inventory count of the locations above was performed by Crowe for FY 2021-2022 between June 7 and June 9, 2022. In **Table 1** below, we provide key data[2,3] from both full inventory counts.

Table 1
San Francisco Public Utilities Commission
Water CDD (MAIN, AWSS, and 6 Satellite Shops) Inventory Count
Comparison with Prior Physical Inventory Counts[4]
(As of June 14, 2023)

Description	FY 2022-2023		FY 2021-2022	
	Items	Value	Items	Value
Total Inventory (per Maximo)	1,648	$ 7,271,844	2,030	$ 5,859,909
Total Inventory Variance (per Crowe's Count)	253	(153,390)	472	235,043
Total Inventory Variance (as a percentage of Total Inventory)	15.4%	(2.1%)	23.3%	4.0%

Results

As indicated in Table 1, variances were identified between Crowe's full inventory count and the count reported in the Maximo system. The following finding explains the variances in counts. Crowe's recommendation related to this finding is also included. A management response to the finding was provided by the Water Enterprise management team on August 25, 2023.

Finding #1 – Physical Inventory Counts Differed from Maximo Counts

Condition:

Of the 1,648 items we counted, 253, or 15.4%, had a variance between their physical count and their count in Maximo. This is a recurring finding. Based on the physical count, and using the average cost in Maximo, we determined that the total value of the variances in the Water Enterprise inventory locations specified above was ($153,390), or (2.1%) of the total inventory value of $7,271,844 in Maximo.[5]

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[2] In this report, percentages are rounded to one decimal place. Monetary values are rounded to the nearest whole dollar unless doing so would obscure the data, in which case they are presented without rounding.

[3] Crowe did not perform any procedures related to the assigned value in the Maximo system.

[4] In the FY2021-2022 report, the Table 1 value for Count with No Discrepancies for FY2021-2022 was shown as $5,624,865 (Total Inventory Counted – Count Discrepancies). The last sentence on the bottom of page 2 in the FY2021-2022 report shows the total value of the inventory was equal to $5,859,909 (Total Inventory Counted) + $235,043 (Count Discrepancies), or $6,094,952. Total Inventory Counted and Count Discrepancies in the FY2021-2022 report correspond to Total Inventory (per Maximo) and Total Inventory Variance (per Crowe's count) respectively in this report.

[5] The ($153,390) variance is the difference between $1,281,257, which is the total value of the 253 items with variances using Crowe's physical count for each item, and $1,434,647, which is the total value of the 253 items with variances using the Maximo count for each item.

We found 125 positive variances (where the physical count was greater than the Maximo inventory count) which totaled $41,760. We found 128 negative variances (where the physical count was less than the Maximo inventory count) which totaled ($195,149). In **Table 2** below we list 6 items with variances that are either above $5,000 or below ($5,000). Together, these 6 items sum to ($137,196), or about 89.4% of the total variance of ($153,390).

Table 2
San Francisco Public Utilities Commission
Water (CDD and AWSS and 6 Satellite Shops) Inventory Count
List of Items with Variances Above $5,000 or Below ($5,000)

Item Number	Description	Shop	Item Code	Unit	Maximo 6.9.23	Crowe 6.14.23	Variance	Average Cost	Cost of Variance
1	PIPE, D.I., CLASS 53, BELL & SPIGOT, TYPE 2, 16" PUSH ON, ZINC COATING	CD-MAIN	047-10-4571	FT	171	234	63	$ 94.47	$ 5,951.69
2	FLANGE, COMPANION SCREWED, BRONZE, 2", 150#	CD-MAIN	047-31-8240	EA	52	20	(32)	171.74	(5,495.82)
3	TEE, 14" MJB X MJB BELL 10"	AWSS	047-34-6414	EA	2	1	(1)	5,552.35	(5,552.35)
4	PLYWOOD, DOUGLAS FIR, 4' X 8' X 1 1/8", CDX	CARP	055-30-4046	EA	124	18	(106)	72.67	(7,703.38)
5	GASOLINE, AUTO, UNLEADED, C.D.D.	CD-MAIN	091-30-3250	GAL	23,207	5,511	(17,696)	3.97	(70,215.38)
6	DIESEL, RENEWABLE (99%)	CD-MAIN	091-40-3151	GAL	15,357	2,237	(13,120)	4.13	(54,181.20)
7	**Subtotal of Variances Above $5,000 or Below ($5,000)**								**$ (137,196.44)**
8	All Other Variances								(16,193.17)
								Total	**$ (153,389.61)**

As shown in **Table 3** below, based on the fuel dip procedures Crowe performed for this physical count, we found the actual quantities of fuel contained in the two tanks varied from those in the Maximo system. We believe that the quantities we observed during our physical count using a manual dip process and a conversion formula were reasonably accurate as they closely matched quantities registered by an electronic measurement system contained in the fuel tanks that the Water Enterprise generated that day (referred to as the System Status Report).

Table 3
San Francisco Public Utilities Commission
Water (CDD and AWSS and 6 Satellite Shops) Inventory Count
Summary of Fuel Gallon and Cost Variances

Item Number	Description	Shop	Item Code	Unit	Maximo 6.9.23	Crowe 6.14.23	Variance	Average Cost	Cost of Variance
1	GASOLINE, AUTO, UNLEADED, C.D.D.	CD-MAIN	091-30-3250	GAL	23,207	5,511	(17,696)	$ 3.97	$ (70,215.38)
2	DIESEL, RENEWABLE (99%)	CD-MAIN	091-40-3151	GAL	15,357	2,237	(13,120)	4.13	(54,181.20)
								Total	**$ (124,396.58)**

Examples of errors identified in our assessment of a sample of recent E.J. Ward fuel transaction data include the following:

- Transactions where a vehicle had the same odometer reading as the previous transaction for the same vehicle and fuel card.
- Duplicate vehicles identified within the system.
- Multiple vehicles with the same make and model sometimes resulted in fuel transactions assigned to the wrong vehicle.
- Vehicles without a specific year, make, or model identified in the system.

Criteria:

Chapter 6 of the City and County of San Francisco Office of the Controller's Accounting Policies and Procedures identifies that Departments shall conduct a physical inventory at least annually and ensure that the inventory management system records accurately reflect inventory on hand. Additionally, Section 6.1 (Policy Guidelines) indicates that inventory system records must be promptly adjusted for any discrepancies identified in the physical counts, Departments must periodically review the inventory records for reasonableness and appropriateness of any changes to inventory unit cost, inventory valuation, and unit of measure, and Departments must periodically review the inventory for obsolescence and reasonableness of inventory classification. The Policy Guidelines also indicate that Departments should investigate significant discrepancies between the physical count, the inventory system records, and the accounting records; document the reasons for discrepancy; and take corrective actions to reduce future discrepancies.

Cause:

The Water Enterprise identified several reasons for the differences in this physical count compared to the count in Maximo, including:

- Occasional manual system posting errors by the individual entering the quantity or unit of measure.
- Miscounted items from periodic cycle counts, including use of different counting methods and items not being fully separated to make accurate counts.
- For some Satellite shop counts, e.g., the Carpentry shop, the inventory users had not submitted issue tags to warehouse management when items were used.
- Fuel variances, which are further explained below.

The Water Enterprise uses the automated fuel tracking information system, E.J. Ward, to capture fuel usage and the SFPUC information technology department has developed an interface designed to periodically upload the E.J. Ward fuel usage data to the Maximo system. However, based on problems with the interface between the E.J. Ward system and the Maximo system, actual Water Enterprise fuel usage data is not consistently and accurately uploaded into Maximo. In addition, between Crowe's FY 2021-22 and FY 2022-23 inventory counts, warehouse staff only adjusted the Maximo fuel balances once, after a physical fuel dip on October 27, 2022.

Effect:

The Water Enterprise inventory value in the Maximo system is overstated by $153,390. Regarding the fuel usage discrepancies, absent periodic monitoring of the fuel levels, the Water Enterprise will have difficulty reconciling future inventories and identifying variances that are the result of missing fuel (e.g., theft), delivery errors, data entry errors, unrecorded transactions, tank leaks, or shrinkage.

Recommendation:

The Water warehouse staff should update the asset inventory counts in Maximo after management approval. The SFPUC Financial Reporting and Analysis division should adjust the General Ledger to reflect the actual cost of inventory on hand. The Water Enterprise should investigate the significant discrepancies between the physical counts noted in Tables 1 and 2, the Maximo system records, and the accounting records; document the reasons for discrepancies; and implement corrective actions to reduce future discrepancies.

If the E.J. Ward system cannot be made to work consistently it should be replaced or upgraded. The E.J. Ward system is not currently capable of accurately recording all fuel transactions. Examples of potential solutions include:

- Add an in-tank fuel level monitoring system with a satellite interface which could transmit timestamped fuel tank level data. Warehouse staff could then accurately monitor fuel variances at the transaction level and validate exact fuel delivery amounts, both of which are not possible with the current system.

- Purchase additional hardware or reconfigure the existing system to automatically record mileage[6] from vehicle odometers instead of requiring employees to enter the odometer reading and vehicle ID manually as part of the fueling process. This upgrade would reduce instances of data entry errors and fuel transactions associated with incorrect vehicles.

If SFPUC cannot replace or upgrade the E.J. Ward system, the Water Enterprise and the SFPUC Information Technology Services bureau should work toward fixing the fuel usage interface between the E.J. Ward system and the Maximo system such that manual reconciliations are not necessary. SFPUC staff also should frequently review the vehicle data in the Fuel View / E.J. Ward software to remove duplicate entries and ensure the make, model, and year fields are populated for all vehicles. In addition, SFPUC should minimize use of the manual override process, or site card S-51, if possible, as it can lead to data entry errors and fuel transactions associated with incorrect vehicles.

Finally, until the system matters are resolved, Water warehouse staff should begin tracking fuel tank levels and fuel usage for gasoline and diesel using a weekly process similar to the following:

- Process all outstanding fuel invoices in Maximo and determine the week-over-week fuel level change for both fuel types (i.e., fuel level increase from deliveries/inflows).
- Perform a weekly fuel dip for each tank and determine the week-over-week fuel level change for both fuel types (i.e., net change in fuel level).
- Determine the total amount of fuel dispensed per E.J. Ward system data and paper logs, including cross-referencing the two to remove any duplicate transactions.
- Compare the fuel level change based on fuel dips with the net fuel level change per Maximo, E.J. Ward, and paper logs, calculated as Maximo balance change (inflows) minus total fuel dispensed per E.J. Ward and paper logs (outflows).
- Attempt to determine the cause of any variances greater than the margin of error associated with the fuel dip conversion formula.

Management Response:

The CDD Warehouse team concurs with these findings and commits to taking corrective actions to reduce future discrepancies. The CDD Warehouse Team will be extra careful in observing unit of measure discrepancies and correcting the conversions in the Maximo system before issue transactions post. Satellite shop supervisors will begin to conduct cycle counts in their respective areas. The CDD Warehouse Team will work with Satellite Shop Supervisors on having shop employees submit issue tags in a timely manner and on a consistent basis to accurately reflect the inventory that has been removed from the respective storage bins. Finally, fuel variances will be addressed by collaborative efforts between the CDD Management Team, the CDD Warehouse, and the Maximo IT Team.

Other Matters

This full inventory count did not constitute an audit, examination, review, or compilation of the historical and prospective financial information conducted in accordance with generally accepted auditing standards or with other standards established by the AICPA. Accordingly, Crowe is unable to express an opinion or any other form of assurance with respect to any of the historical or prospective financial information. Crowe did not perform any procedures to verify the Management Responses and Crowe does not provide any assurance regarding the accuracy or completeness of the responses. Any and all amounts referred to in this letter are preliminary and could change should additional procedures be performed. Additionally, issues that are not mentioned here could develop subsequent to the date of this letter that may have impacted Crowe's analysis or that Crowe may cite should additional procedures be performed.

The inventory services did not contemplate obtaining the understanding of internal controls or assessing control risk, tests of accounting records and responses to inquiries by obtaining corroborating evidential

[6] The E.J. Ward CANceiver, which is installed on numerous CDD vehicles, is capable of wirelessly transmitting vehicle odometer data and appears to be doing so for some CDD vehicles; however, per the E.J. Ward website, this and other features may not be compatible with all vehicles, particularly older ones.

matter, and certain other procedures ordinarily performed during an audit or examination. Thus, this engagement did not provide assurance that we became aware of significant matters that would be disclosed in an audit or examination.

As part of this inventory, the SFPUC agreed to be responsible to make all management decisions and perform all management functions; designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management to oversee our services; evaluate the adequacy and results of the services performed; accept responsibility for the results of the services; and establish and maintain internal controls, including monitoring ongoing activities. The SFPUC has ultimate authority for making changes to inventory reported in its Maximo system and on its financial statements.

Crowe's fees are not dependent upon the outcome of this report and Crowe is independent with respect to any other economic interests.

We appreciate the contribution of SFPUC management and your input and direction on this project. We also thank Water Enterprise management and staff for assisting providing access to the inventory and for timely responses to our requests.

Crowe LLP

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