

CITY AND COUNTY



OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET ANALYST

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September 27, 2004

Honorable Chris Daly, Chair of the Finance and Audits Committee
And Members of the Board of Supervisors
City and County of San Francisco
Room 244, City Hall
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-4689

Dear Supervisor Daly and Members of the Board of Supervisors:

The Budget Analyst is pleased to submit this *Phase I Management Audit of the Public Utilities Commission, Clean Water Enterprise Fund*. On May 18, 2004, the Board of Supervisors adopted a motion directing the Budget Analyst to conduct a management audit of the San Francisco Public Utilities Commission, pursuant to its powers of inquiry defined in Charter Section 16.114 (Motion No. M04-57). Subsequently, on June 29, 2004, the Board of Supervisors adopted a motion directing the Budget Analyst to prioritize an analysis of sewer service charges, as part of the management audit of the Public Utilities Commission. The purpose of the management audit has been to (i) evaluate the economy, efficiency and effectiveness of the Public Utilities Commission's programs, activities, and functions and the Public Utilities Commission's compliance with applicable State and Federal laws, local ordinances, and City policies and procedures; and (ii) assess the appropriateness of established goals and objectives, strategies and plans to accomplish such goals and objectives, the degree to which such goals and objectives are being accomplished, and the appropriateness of controls established to provide reasonable assurance that such goals and objectives will be accomplished. The scope of the management audit includes all of the Public Utilities Commission's programs, activities, and functions.

The results of the management audit will be presented in four phases. Phase I is a review of the programs, activities, and functions of the Clean Water Enterprise program, including an evaluation of sewer service charges, budgetary controls, financial status, organizational structure,

maintenance management, interdepartmental relationship with the Department of Public Works, and the capital program planning process, including public outreach and participation. Phase II of the management audit will be a review of the programs, activities, and functions of the Hetch Hetchy Enterprise program and Phase III will be a review of the programs, activities, and functions of the Water Enterprise program. Phase IV will review all programs, activities, and functions that cross the Public Utilities Commission as a whole, including common functions of the three enterprises, such as maintenance and asset management practices, and administrative overhead functions.

The management audit is conducted in accordance with *Government Auditing Standards, 2003 Revision*, issued by the Comptroller General of the United States, U.S. General Accounting Office. As part of the management audit, the Budget Analyst interviewed the senior management and other Public Utilities Commission staff; representatives from other City and County departments; advisory committee and community organization representatives; and management staff from other clean water agencies and representative organizations, including the Association of Metropolitan Sewerage Agencies and the State Water Resources Control Board. Additionally, the management audit staff reviewed various State statutes and local codes; examined various documents, reports and work products prepared by the Public Utilities Commission; reviewed the Clean Water Enterprise Fund's audited financial statements and reports prepared by various consultants; obtained and analyzed various data and financial reports; and evaluated the effectiveness of the various tools used by Public Utilities Commission management to oversee the activities of the Clean Water Enterprise program.

This management audit report of the Clean Water Enterprise program includes 10 findings and 63 related recommendations prepared by the Budget Analyst, that encompass major areas of the Clean Water Enterprise program's operations. A list of the management audit recommendations are shown in the Attachment to this transmittal letter. Included are findings and recommendations related to the Clean Water Enterprise program's organization, strategic and capital planning, financial management, budgetary controls, internal controls over the Clean Water Enterprise program's processes, and management of the Clean Water Enterprise's maintenance activities. The management audit also reviewed and reported on the Clean Water Enterprise's financial condition, sewer service charges, and the capacity of sewer service charge revenues to meet the Clean Water Enterprise's operating, maintenance, and capital revenue requirements.

Implementation of the Budget Analyst's recommendations would result in savings of an estimated \$1.1 million, resulting from savings in salaries and mandatory fringe benefits, administrative overhead, and power costs. The following sections summarize our findings and recommendations.

Assessment of the Sewer Service Charges and Financial Needs of the Clean Water Enterprise

As noted above, the Board of Supervisors adopted a motion directing the Budget Analyst to analyze the sewer service charges approved by the Public Utilities Commission, which became effective July 15, 2005 (Motion No. M04-77). The Public Utilities Commission approved a sewer service charge increase in FY 2004-2005 to meet an 11 percent increase in FY 2004-2005 Clean Water Enterprise revenue requirements. As discussed in Section 6 of the management audit report, the Budget Analyst found that, even with the sewer service charge increase in FY 2004-2005 to meet an 11 percent increase in FY 2004-2005 Clean Water Enterprise revenue requirements, and with proposed sewer service charge increases in FY 2005-2006 and FY 2006-2007, the Clean Water Enterprise would have insufficient revenues to meet both its operating, maintenance, and capital requirements and the Public Utilities Commission's policy of maintaining operating reserves equal to 25 percent of operating and maintenance expenditures.

Due to Proposition H, approved by the voters in November of 1998, there were no increases in sewer service charges for the eight year period between FY 1996-1997 through FY 2003-2004. During that period and as discussed in Section 6 of this management audit report, the financial condition of the Clean Water Enterprise program deteriorated and two credit rating agencies, Standard and Poors and Moody's, issued a negative outlook for the Clean Water Enterprise Fund. After approval of Proposition E by the voters in November of 2002, the credit rating agencies changed their outlook from "negative" to "stable."

The Public Utilities Commission refunded Clean Water Enterprise Fund outstanding revenue bonds in January of 2003 and restructured the annual debt payments to reduce payments through FY 2005-2006. Consequently, the Clean Water Enterprise Fund will have a large increase in annual debt service payments in FY 2006-2007, as shown in Table 6.1 of Section 6. When the Public Utilities Commission Financial Services staff analyzed potential sewer service charge increases to meet revenue requirements, they evaluated the need for sewer service charge increases to meet FY 2006-2007 revenue requirements, when annual debt service payments increase from \$37.3 million in FY 2005-2006 to \$70.3 million in FY 2006-2007. After FY 2006-2007, annual debt service payments on existing debt will gradually decrease each year, as shown in Table 6.1 of Section 6.

The Public Utilities Commission has entered into a capital planning process to develop a Clean Water Master Plan. The Clean Water Master Plan is expected to be completed in the fall of 2007 and construction of Clean Water Master Plan projects is expected to begin in FY 2009-2010 at the earliest. Prior to construction of Clean Water Master Plan projects, the Clean Water Enterprise Fund has interim capital needs, estimated by the Clean Water Enterprise program to cost approximately \$100 million to \$150 million. The Clean Water Enterprise Fund may therefore need sewer service charge increases beyond the proposed sewer service charge

increases in FY 2005-2006 and FY 2006-2007 to fund interim capital needs prior to commencement of construction of Clean Water Master Plan projects.

The Budget Analyst has reviewed alternative sewer service charge rate structures that would provide stable revenues to the Clean Water Enterprise Fund, promote water conservation, and lessen the overall impact of the sewer service charge increases on the combined water and sewer service bill. Section 1 of the management audit report discusses these alternative sewer service charge rate structures. In Section 6 of the management audit report, the Budget Analyst has found that annual incremental sewer service charge increases compared to larger periodic sewer service charge increases could provide stable future revenues to the Clean Water Enterprise Fund while lessening the overall impact to the ratepayer. However, because of the eight year rate freeze from 1996 until 2004, the Clean Water Enterprise Fund will require sufficient increases in the sewer service charge in FY 2005-2006 and FY 2006-2007 to meet its operating, maintenance, and capital needs and to maintain an operating reserve equal to 25 percent of operating and maintenance expenditures.

Section 1. Designing the Sewer Service Charge

The Public Utilities Commission adopted sewer service charge increases in FY 2004-2005 to meet an 11 percent increase in FY 2004-2005 Clean Water Enterprise Fund revenue requirements. The Public Utilities Commission will have to consider additional sewer service charge increases in the coming fiscal years to pay for projected increases in Clean Water Enterprise Fund operating and maintenance expenses, debt service payments, and interim capital needs.

In FY 2004-2005, the Rate Fairness Board and the Public Utilities Commission are considering both the need for sewer service charge increases to meet Clean Water Enterprise Fund revenue requirements in the coming fiscal years and alternative sewer service charge rate structures. The Rate Fairness Board is considering the elimination of the residential lifeline, or base, rate, which is applied to the first three units of service, because the lifeline rate neither recovers the costs of providing service nor meets the Rate Fairness Board's policy goal of providing income-based rates for low-income residential customers.

In considering alternative sewer service charge rate structures, the Rate Fairness Board and the Public Utilities Commission need to consider how the alternative rate structures impact the stable flow of revenues to the Clean Water Enterprise Fund, promote water conservation, and overall impact the combined water and sewer service bill of residential customers. Projected increases in both water and sewer service charges in the next few fiscal years to pay for necessary capital improvements to water and clean water facilities and increased revenue requirements will have a large impact on the combined monthly water and sewer bill for residential customers.

Costs and Benefits

The Budget Analyst's recommendations concerning these findings are attached to this transmittal letter. There would be no new direct costs associated with these recommendations, which can all be accomplished in-house without additional staff. The Public Utilities Commission Financial Services staff would continue to analyze and present sewer service charge alternatives and impacts to the Rate Fairness Board and the Public Utilities Commission. The Public Utilities Commission would continue to have necessary information to assess alternative sewer service charge rate structures that address the goals of (a) providing stable revenue to the Clean Water Enterprise Fund, (b) equitably distributing the costs of sewer services to the users of the system, and (c) promoting conservation.

Section 2. Allocating Costs of Sewer Services to Customer Classes

Residential and nonresidential sewer service customers are billed based upon wastewater volume and the expected concentration (or strength) of pollutants in their wastewater discharge. All residential customers are billed for a standard domestic wastewater strength. Nonresidential customers are either billed (i) for their actual wastewater strength, if they discharge high volumes of wastewater or the wastewater discharge has high concentration of pollutants, or (ii) on the expected wastewater strength of their assigned Standard Industrial Classification code if they are minor industrial or commercial users.

According to the Wastewater Rate Study, the measured amount (or loadings) of wastewater pollutants at the wastewater treatment plants do not match the calculated wastewater loadings, based on customer service billing records. The Public Utilities Commission is currently implementing work plans to (i) sample and test wastewater loadings at the treatment plants and (ii) identify correct nonresidential property uses from Tax Collector and other documents to ensure that nonresidential properties are assigned the correct Standard Industrial Classification codes and wastewater strength in the Customer Services billing system.

The management audit review of Customer Services billing data found discrepancies between the Schedule of Sewer Service Charges and Customer Services billing records. For example, the Schedule of Sewer Service Charges lists 44 Standard Industrial Classification codes and the Customer Services billing system lists 83. Of the 44 Standard Industrial Classification codes listed in the Schedule of Sewer Service Charges, only 22 correspond with the Standard Industrial Classification codes listed in the Customer Services billing system. The Public Utilities Commission Business Services Division should streamline the list of Standard Industrial Classification codes and reconcile the Customer Services billing system with the Schedule of Sewer Service Charges.

Costs and Benefits

The Budget Analyst's recommendations concerning these findings are attached to this transmittal letter. There would be no new direct costs associated with these recommendations, which can all be accomplished in-house without additional staff. Implementation of these recommendations would allow the Public Utilities Commission to correctly identify and bill for residential and nonresidential customers wastewater strengths.

Section 3. Opportunities to Improve Management Control of Clean Water Enterprise Fund Expenditures

The Clean Water Enterprise program's expenditures for providing sewer collection and wastewater treatment services have increased by approximately 18 percent between FY 1998-1999 and FY 2002-2003. The Clean Water Enterprise program's operating costs for chemicals and electricity have increased at a higher rate than other costs. Electricity costs have increased by approximately 44 percent and chemical costs have increased by 49.7 percent.

One of the main increases in expenditures has been administrative overhead. Budgeted overhead expenditures for Public Utilities Administration increased by 47.8 percent between FY 2001-2002 and FY 2004-2005.

The Public Utilities Commission Financial Services section, in conjunction with the Clean Water Enterprise program management, should implement budgetary benchmarks and performance matrices for administrative functions, and should assess potential cost savings for electricity and chemical purchases.

Developing performance standards for Administration functions are a concern for all three Public Utilities Commission enterprises. Administrative overhead costs, including implementation of service measures and cost controls, will be evaluated further in Phases II through IV of the management audit.

Costs and Benefits

The Budget Analyst's recommendations concerning these findings are attached to this transmittal letter. These recommendations are intended to increase the level of budgetary controls for Clean Water Enterprise Fund expenditures. Decreasing electricity costs by 1.0 percent would result in annual savings of \$122,380 and decreasing administrative overhead by 5.0 percent would result in annual savings of \$917,060, for total cost savings of \$1,039,440.

Section 4. Clean Water Capital Improvement Planning

There are a number of urgently required clean water capital improvement projects which are either on hold or proceeding incrementally through the insufficiently funded annual clean water repair and replacement program.

Since the 1990s, there has been extensive clean water capital planning, but the overall planning process has not been particularly coherent, particularly given the former General Manager's elimination in 2002 of clean water projects from the Department's long-term capital improvement program without consultation with the Water Pollution Control Division.

Based on comments from Department interviewees, the Budget Analyst concludes that the former General Manager severed clean water from the long-term capital improvement program due to her assessment that (a) the planning process had been inadequate, (b) opposition from the Southeast community and the Mayor's Public Utilities Infrastructure Task Force might undermine politician and voter support for the water system projects, (c) voters might not support the total cost, and (d) the proposed odor control plans for the Southeast Water Pollution Control Plant might not be effective. The former General Manager publicly stated that there was no clean water master plan and that the Department would start clean water planning from scratch using a community consultation process which examined all available options. The former General Manager's actions and statements were regarded by long-term clean water staff as dispiriting given the amount of clean water capital planning which had taken place since the 1990s, and the third party vetting of the long-term capital improvement program's proposed clean water projects and their funding.

Despite delays in moving the Clean Water Master Planning process forward, the process has now begun. The advantages of the master planning approach outweigh the disadvantages. This is primarily because the comprehensiveness of this type of planning process, and the level of stakeholder involvement woven into the entire process, will provide the public with a meaningful opportunity to provide input into policy and planning decisions and will protect the Department from future criticism that it did not consider all the options and work closely with affected communities. Nevertheless, the disadvantages are both real and serious, and need to be carefully managed.

An interim five year capital improvement program would usefully bridge the five to seven year gap before Clean Water Master Plan construction can commence.

Costs and Benefits

The Budget Analyst's recommendations concerning these findings are attached to this transmittal letter. As of the writing of this report, in order to develop a Clean Water Master Plan, the Department is planning to invest \$15,750,000 in consultant services and internal City resources. The Budget Analyst considers that this will be a worthwhile investment if it completes a Clean

Water Master Plan with widespread stakeholder support that facilitates the financing and construction of necessary capital improvements in a timely fashion.

Section 5. Public Participation in Clean Water Policy and Planning

The Public Utilities Commission failed to provide for public participation in clean water policy and planning and to conduct adequate public outreach prior to the introduction of the clean water projects in the proposed integrated long-term capital improvement program in 2002. As a result, the public received inconsistent and vague information, which fueled the public perception that Public Utilities Commission staff were not listening. It is unclear whether public concerns were consistently conveyed to decision-makers and whether the recommendations of established community and technical advisory groups influenced the selection of the 2002 clean water projects. The Department did not (a) utilize its internal Communications Department to do public outreach work, (b) evaluate or implement consultant recommendations to improve public outreach, (c) create a forum for public input into policy and planning, or (d) fully utilize established community and technical advisory groups.

The Public Utilities Commission staff's failure to provide for public participation in clean water policy and planning and to conduct adequate public outreach prior to the introduction of the integrated long-term capital improvement program in 2002 will result in delays to necessary capital improvements. The Clean Water Master Planning process should address a majority of the problems of the earlier process and give the public a meaningful opportunity to provide input into policy and planning decisions.

The incoming General Manager should ensure that a public participation program for the Clean Water Master Planning Process is carefully managed so that this effort provides the public with a meaningful opportunity to give input into policy and planning decisions and results in widespread stakeholder support of a clean water capital improvement program.

Costs and Benefits

The Budget Analyst's recommendations concerning these findings are attached to this transmittal letter. As of the writing of this report, in order to develop the proposed public participation component of the Clean Water Master Planning process, the Department is planning to invest \$2,750,000, of which \$750,000 will be for staff costs and \$2,000,000 will be for consultant services. The Budget Analyst's recommendations could result in a larger share of resources for the internal Communications Division staff, and a reduction in the consultant contract, if the Department determines that such changes reflect the appropriate mix of internal and contractual resources for public outreach. The Budget Analyst considers that this public participation process will be a worthwhile investment if it provides the public with a meaningful opportunity to give input into policy and planning decisions and results in widespread stakeholder support of a clean water capital improvement program. Close management of this departmental contract is necessary to ensure that the problems of earlier outreach efforts are not repeated.

Section 6. Managing Debt and Funding Future Capital Projects

According to the Public Utilities Commission's Financial Services 10-year financial projections, even with the sewer service charge increase to meet an 11 percent increase in FY 2004-2005 revenue requirements and the recommended sewer service charge increases in FY 2005-2006 and FY 2006-2007 to meet 11 percent increases in annual revenue requirements, projected Clean Water Enterprise Fund operating reserves in most years would still be less than the Public Utilities Commission's policy of maintaining a reserve equal to 25 percent of operating and maintenance costs. The Budget Analyst has reviewed these projections and finds them to be reasonable. The Clean Water Enterprise Fund may need sewer service charge increases beyond the proposed FY 2005-2006 and FY 2006-2007 sewer service charge increases to fund interim capital needs prior to commencement of construction of Clean Water Master Plan Capital Improvement Program projects in FY 2009-2010 at the earliest.

Both water and sewer service charges will need to increase to pay for Water and Clean Water Master Plan Capital Improvement Program projects over the coming fiscal years. Because construction of improvements to water and clean water infrastructure will impact all San Francisco rate payers, the Public Utilities Commission needs to assess the alternatives of annual incremental sewer service charge increases compared to larger periodic sewer service charge increases to meet ongoing operating and capital needs. The advantage of such an approach would be to reduce the risk of sudden large rate increases in future years and to meet current revenue needs. Annual incremental rate increases would stabilize revenues and better match operating revenues to meet operating needs.

The Budget Analyst's analysis suggests that annual incremental sewer service charge increases would yield the same total revenues to the Clean Water Enterprise over time as less frequent but larger periodic sewer service charge increases. The Clean Water Enterprise Fund would receive a stable increase in annual revenues to meet operating, maintenance, and ongoing capital needs, but the rate payer would not be confronted all at once with large increases in the monthly sewer service bill. For example, annual incremental sewer service charge increases of 1.25 percent annually from FY 1997-1998 through FY 2005-2006 would have yielded the same total revenues over ten years as sewer service charges with no increases from FY 1997-1999 through FY 2003-2004 and three annual increases of 11 percent from FY 2004-2005 through FY 2006-2007.

Implementing annual incremental sewer service charge increases results in lower cumulative sewer service charges for the rate payer also. If the sewer service charges increased incrementally by 1.25 percent annually over ten years, the cumulative sewer service charge increase to the rate payer over ten years would be 13.2 percent, but if sewer service charges did not increase for seven years and then increased by 11 percent annually for three years, the cumulative increase to the rate payer over ten years would be 36.9 percent. In comparing the two scenarios, rate payers who had received incremental rate increases of 1.25 percent between FY 1997-1998 and FY 2006-2007 would pay FY 2006-2007 rates that were 17.3 lower than the FY

2006-2007 rates of rate payers who had received three larger rate increases of 11 percent in FY 2004-2005 through FY 2006-2007.

Currently, Public Utilities Commission Financial Services staff prepare a long range financial plan, presenting ten-year financial projections that include estimates of operation and maintenance expenses, repair and replacement costs, debt costs and rate increase requirements to the Public Utilities Commission, pursuant to Proposition E. The General Manager of the Public Utilities Commission should present this annual report to the Board of Supervisors prior to May 31 each year, including (i) current Clean Water Enterprise program revenue and expenditure projections, (ii) the projected need for sewer service charge increases, the impact of smaller incremental sewer service charge increases compared to larger periodic increases, and the impact of combined water and sewer service charge increases, (iii) the status of implementation of the asset management program and an evaluation of the asset management program's effectiveness, and (iv) the status of the capital planning process and proposed funding for both interim capital projects and Clean Water Capital Improvement Program projects.

Costs and Benefits

The Budget Analyst's recommendations concerning these findings are attached to this transmittal letter. There would be no new direct costs associated with these recommendations, which can all be accomplished in-house without additional staff. The benefit of this recommendation is to provide the Public Utilities Commission with sufficient information to improve the Clean Water Enterprise Fund's financial condition, assess the Clean Water Enterprise Fund's interim capital needs, project ongoing revenue requirements, and analyze and recommend sewer service charges to meet the Clean Water Enterprise Fund's ongoing maintenance, operating, and capital needs, including maintaining an operating reserve fund equal to 25 percent of annual operating and maintenance expenditures.

Section 7. Water Pollution Control Division's Personnel and Maintenance Management

The Water Pollution Control Division of the Public Utilities Commission Clean Water Enterprise program needs to better manage employee performance, update written policies and procedures, and improve accountability over tools and equipment.

Although the Water Pollution Control Division was transferred from the Department of Public Works to the Public Utilities Commission in 1996, and the Division's Policies and Procedures Manual was last revised as recently as October of 2003, the manual continues to cite the Director of the Department of Public Works and the Department of Public Works Employee Reference Guide as policy authorities in several instances. Other Policies and Procedures Manuals, such as the Maintenance Management and Materials Management Manuals, which have been minimally revised since the Water Pollution Control Division's transfer to the Public Utilities Commission, also contain Department of Public Works references. It is clear, therefore, that critical

documents that are supposed to communicate policies and procedures from management to all employees have not been comprehensively reviewed or updated in at least eight years.

The Policies and Procedures Manual requires that Water Pollution Control Division employees receive an annual performance evaluation. Although Division management is currently making a significant effort to have all performance evaluations completed for the period ended June 30, 2004, our review of the performance evaluation files revealed that numerous Division employees did not receive an annual performance evaluation for previous periods.

The administrative Policies and Procedures Manual contains (a) an *Entrance – Exit Policy* that is designed to track and control equipment and tools assigned to employees, and to track and control information, such as computer access codes, provided during each employee's tenure, and (b) a provision requiring that the Water Pollution Control Division conduct an exit interview of employees who are separating from the Division and that an Exit Interview Form is completed. Although a total of 66 Water Pollution Control Division employees have separated from the Public Utilities Commission since January of 2003, the Bureau of Human Resources had received a total of only 19 Equipment Processing and Exit Interview Forms for all years.

The Water Pollution Control Division does not currently exclude pre-scheduled overtime hours from its calculation of overtime usage.

The Bureau of Human Resources processed a total of 40 Equal Employment Opportunity complaints from Water Pollution Control Division employees between February of 2000 and August of 2004. The results of the 40 complaint investigations are as follows: (1) 16 complaints were dismissed after an investigation showed insufficient evidence of discrimination; (2) seven complaints were closed after mediation or other mutual agreement among the parties; (3) eight complaints were closed after an investigation disclosed no factual evidence to identify a responsible person or other inconclusive outcome; (4) two complaints resulted in disciplinary actions; and (5) seven complaints were closed due to there not being sufficient evidence to support that the issue was concerned with equal employment opportunity.

The former General Manager of the Public Utilities Commission met with a group of approximately 20 African-American female employees of the Water Pollution Control Division in February of 2004 to hear complaints of alleged unfair treatment. According to reports from some of those in attendance at the meeting, follow up actions have not been taken.

According to the Section Chief who has been assigned responsibility for maintaining tools and equipment not issued to individual crews, there has not been an inventory of the tools and equipment in the tool rooms or storage containers since sometime in 2001. Using an inventory list provided by the Section Chief, we located some of the tools and equipment in the tool rooms but could not locate many other of the items. Tool and equipment accountability is weak within the Maintenance Division.

Costs and Benefits

The Budget Analyst's recommendations concerning these findings are attached to this transmittal letter. The Water Pollution Control Division could achieve approximately \$100,000 in cost savings from obtaining more economical call-taking services for Sewer Operations. The Budget Analyst's other recommendations can be accomplished with existing staff in-house. The benefits of the recommendations would include a more efficient water pollution control operation, with personnel better supported by the administrative staff, and the Operations Division better supported by the Maintenance Division.

Section 8. Managing the Interface Between the Public Utilities Commission and the Department of Public Works

Both Public Utilities Commission staff and Red Oak Consulting have identified deficiencies in the management information provided to the Public Utilities Commission by the Department of Public Works. However, the Budget Analyst notes that considerable amounts of data are already gathered by the Department of Public Works and the Public Utilities Commission through a number of protocols, regular reports and meetings, and databases. This data should be shared more effectively between the two departments to improve reporting on the actual work performed.

Useful management information would also be provided by (a) a comparative analysis of the cost of sewer repair services provided by the Bureau of Street and Sewer Repair and third party contractors, and (b) a joint space needs analysis of the City and County of San Francisco Yard and adjacent Public Utilities Commission space to ensure the two departments' optimal usage of those sites, and to clarify property ownership issues within the City and County of San Francisco Yard.

Costs and Benefits

The Budget Analyst's recommendations concerning these findings are attached to this transmittal letter. There may be information technology costs associated with the recommended reporting enhancements between the Public Utilities Commission and the Department of Public Works, but they cannot be estimated until the scope of required work between the two departments has been defined. In both departments, however, the base software is already in place. The most important benefit of the recommended reporting enhancements would be the improved reporting on the actual work performed by the Department of Public Works for the Public Utilities Commission, and that work's actual cost.

Section 9. The Clean Water Enterprise's Organizational Structure

The structural disaggregation of clean water functions creates a number of deficiencies, most notably a lack of a unified business identity, inadequate advocacy at the executive management team, dispersal of functional responsibilities, and inadequate integration into the Public Utilities Commission as a whole.

Approximately 90 percent of the workload of the Department of Public Works' Hydraulic Section is related to Public Utilities Commission clean water work orders. Its current location within the Department of Public Works is a legacy of a former organizational structure.

Consolidation of the Water Pollution Control Division, the Pretreatment, Pollution Prevention and Storm Water Program, clean water planning staff, and the Department of Public Works' Hydraulic Section, and potentially the Southeast and Oceanside Water Pollution Control Plant Laboratories (subject to further review in Phase III of the management audit), could address these deficiencies.

The Public Utilities Commission and the Department of Public Works will always have to manage the problematic interface between the needs of the sewer system, with its average 80 year life span, and the street system's 25 year repaving cycle. Given this disparity in the life spans of the two systems, managing the interface poses challenges. Due to the shorter life span of roadways in comparison with sewers, and the pronounced public interest in the physically more obvious benefits of roadway maintenance and repair, there is a strong argument for the performance of sewer repair and replacement work impacting the right-of-way to remain within the purview of the Department of Public Works. However, the Budget Analyst will comment on this more definitively once Phase III of the management audit has reviewed the interface between the Public Utilities Commission and the Bureau of Street and Sewer Repair in relation to water main repair and replacement within the right-of-way, and the possibility of greater coordination of the sewer and water main repair and replacement programs.

Care will need to be taken to ensure that a new Clean Water Enterprise does not operate as a stand-alone entity when, in fact, it needs to be coordinating with the Department's other enterprises and its central policy and planning coordination function.

Costs and Benefits

The Budget Analyst's recommendations concerning these findings are attached to this transmittal letter. The transfer of the Department of Public Works' Hydraulic Section to the Public Utilities Commission would incur the following costs or cost shifts:

- A transfer of \$2,330,641 in Hydraulic Section staff salaries and operating costs from the Department of Public Works to the Public Utilities Commission.
- Due to the loss of direct labor, the overhead rate for the Department of Public Works' Bureaus of Architecture, Engineering, and Construction Management would increase by an estimated 5 percent, from 168 percent to 173 percent. Redistribution of the Department of Public Works' overhead expenditures would increase the burden to the General Fund by an estimated \$98,900. These full cost impacts would occur only if the Department of Public Works makes no reductions to its administrative overhead expenses. However, this reduction in administrative overhead should be made to correspond with the transfer of operating responsibilities.
- Relocation costs if the Hydraulic Section staff were physically moved, or a shift in the lease costs between the two departments if the Hydraulic Section remained in its current accommodation.

All the other staffing changes would result in cost neutral transfers of salary dollars within the Public Utilities Commission's existing clean water personnel budget.

Elimination of the vacant Classification 5620 Regulatory Specialist, Clean Water Regulatory Compliance, position in the Planning Bureau would save between \$66,920 and \$81,354, plus mandatory fringe benefits, for a total savings of up to \$101,286 annually. Further salary savings may accrue from rationalizing administrative support positions.

Consolidation of clean water functions would foster a unified business identity for clean water staff characterized by shared goals, shared long-term planning capacity, functional coordination, and efficiency. It will improve decision-making among staff working on clean water issues, and ensure clear accountability lines. Therefore, the proposed structural changes would facilitate important cultural changes.

Section 10. Assistant General Manager, Clean Water

There is inadequate clean water representation at the executive management team because no one executive management team member has a holistic view of clean water or has responsibility for all clean water operations, planning, and financial management.

As explained in Section 9, the consolidation of clean water functions would result in a new Clean Water Enterprise of up to 507.51 FTE positions and an annual operating budget of up to \$154,126,839. An organization of this scope would justify management by a Classification 5166 Assistant General Manager, PUC position. This position should ultimately be a direct report to the General Manager.

An Assistant General Manager, Clean Water should be an highly qualified industry specialist with a high level of policy, regulatory, financial, and management skills.

The Budget Analyst is cognizant that the Public Utilities Commission's recently appointed General Manager is actively looking at reorganizing the Department, with the ultimate goal of reorganizing the Department into its three business enterprises. To achieve that, the General Manager has appointed new senior personnel, including a Deputy General Manager, to assist her to coordinate across the existing divisions on key issues. During this transition period, the General Manager does not support the flat organizational structure being recommended by the Budget Analyst, whereby an Assistant General Manager, Clean Water would report directly to the General Manager. However, the General Manager has indicated that she is prepared to examine a flatter management structure in the medium term. Therefore, if the Board of Supervisors approves the Budget Analyst's recommendations, the Budget Analyst would assess, in the medium term, the Department's progress towards the recommended organizational structure. While the Budget Analyst acknowledges that, in the short-term, the Department's budget will be accommodating senior personnel to manage the transition period, the Budget Analyst will be reviewing their justification in the medium term.

Costs and Benefits

The Budget Analyst's recommendations concerning these findings are attached to this transmittal letter. The costs of these recommendations include (a) the annual salary for the new Classification 5166 Assistant General Manager, PUC position for the Assistant General Manager, Clean Water of between \$121,678 and \$147,909, plus mandatory fringe benefits, for a total cost of up to \$184,147 annually, and (b) the estimated one-time cost of up to \$50,000 for an extensive internal and external recruitment process.

The benefits of implementing these recommendations include improved clean water representation at the executive management team and an appropriate level of top management for the new Clean Water Enterprise.

Department's Response

The Public Utilities Commission General Manager's response to this management audit report was delivered to the Budget Analyst on September 23, 2004, and is included in this management audit report, beginning on page 128. The Public Utilities Commission's written response agrees with 50, or approximately 79.4 percent, of our 63 specific recommendations, and is actively considering ten recommendations. The Public Utilities Commission disagrees with three of the four specific recommendations in Section 3 of the management audit report to improve management control of Clean Water Enterprise Fund Expenditures.

- Recommendation 3.2 recommends that the Director of Financial Services in conjunction with the Water Pollution Control Division Manager, assess the options for reducing or limiting increases in chemical costs, such as revised vendor contracts, prior to the Public Utilities Commission's FY 2005-2006 budget preparation and review.

The Public Utilities Commission General Manager's response states on page 132 of the management audit report states that "we are deeply committed to odor control and that is the primary reason for budget increases" in chemical costs. The Budget Analyst acknowledges in the management audit report that the Clean Water Enterprise program's increases in chemical costs resulted from both operational needs and industry increases in chemical costs. The Budget Analyst's recommendation is to assess options for reducing or limiting increases in chemical costs by assessing options such as revised vendor contracts. Although the General Manager stated in the response that, "We monitor chemical expenses closely and have been very aggressive on this issue over the years, finding creative ways to reduce annual expenses", discussions with Public Utilities Commission staff suggest further opportunities for cost savings, such as entering into group purchasing agreements to increase the power of the purchaser in negotiating vendor contracts.

- Recommendation 3.3 recommends that the Director of Financial Services, in conjunction with the Water Pollution Control Division Manager, evaluate the feasibility of operating the treatment plants during off-peak hours, which includes an assessment of storage capacity and odor control at different levels of storage and off-peak operations and the potential associated cost savings. This analysis should be part of the FY 2005-2006 budget preparation and review.

As noted in the Public Utilities Commission General Manager's response, on page 132 of the management audit report, the "shutdown of these facilities could not be done daily without increasing odors in the collection system". However, according to Water Pollution Control Division staff, the Southeast Water Pollution Control Plant periodically operates during off-peak hours to achieve power savings. The Budget Analyst's recommendation is intended to analyze the feasibility of cost savings of scheduling treatment plant operations during off-peak hours, especially during dry weather when the system does not contain storm water,

while maintaining the Water Pollution Control Division's standards for odor control. Further, although the Water Pollution Control Division would pay a peak demand charge if the Southeast Water Pollution Control Plant operated during peak hours on any day of the month, there could still be some cost savings in actual off peak energy use because the energy charges during off peak hours are less than during on peak hours. Potentially, the savings in off peak energy charges could exceed the cost of the peak demand charge.

- Recommendation 3.4 recommends that the Director of Financial Services, in conjunction with the Water Pollution Control Division Manager, the Pretreatment, Pollution Prevention, and Storm Water Manager, and the Water Quality Bureau Laboratories Manager, develop budgetary benchmarks for the Clean Water Enterprise Fund. According to the Public Utilities Commission General Manager's response on page 133 of the management audit report, "performance measures are submitted to the Controller's Office as part of the annual efficiency plan and budget process". The Budget Analyst's recommendation would establish budgetary benchmarks commonly used by clean water agencies. These benchmarks compare the costs of sewer services to the millions of gallons discharge annually, allowing the Clean Water Enterprise programs to evaluate the costs of providing service per gallon of discharge. These are internal benchmarks, providing a year-to-year comparison of the Clean Water Enterprise program's budgetary performance. The Budget Analyst will assess the Public Utilities Commission's performance measures submitted annually to the Controller's Office during Phase IV of the management audit.

Finally, on page 136 of the Public Utilities Commission's General Manager's response to the management audit, the General Manager states, "While we do not disagree with the idea of small, regular increases, the audit implies that such increases are a possibility right now, which they are not. Eleven percent increases will not bring the department to proper reserve levels, and we may need more funds for maintenance and capital projects".

The management audit does not imply that such increases are a possibility right now. In Section 6, page ____, of the management audit report, the Budget Analyst states, "Even with the sewer service charge increase to meet an 11 percent increase in FY 2004-2005 revenue requirements and the recommended sewer service charge increases in FY 2005-2006 and FY 2006-2007 to meet 11 percent increases in annual revenue requirements, projected Clean Water Enterprise Fund operating reserves in most years would still be less than the Public Utilities Commission's policy of maintaining a reserve equal to 25 percent of operating and maintenance costs. The Clean Water Enterprise Fund may need sewer service charge increases beyond the proposed FY 2005-2006 and FY 2006-2007 sewer service charge increases to fund interim capital needs prior to commencement of construction of Clean Water Master Plan Capital Improvement Program projects in FY 2009-2010 at the earliest." The Budget Analyst's analysis of annual incremental sewer service charge increases is intended to provide direction to the Public Utilities Commission going forward in setting annual sewer service charges to meet operating, maintenance, and capital requirements with the lowest impact to the rate payer.

Memo to Honorable Chris Daly, Chair of the Finance and Audits Committee
and Members of the Board of Supervisors
Management Audit of the Public Utilities Commission Clean Water Enterprise Fund
September 27, 2004
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We would like to thank the General Manager of the Public Utilities Commission, her staff and various representatives from City departments for their cooperation and assistance throughout this management audit.

Respectfully submitted,

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