OFFICE OF THE DISTRICT OF COLUMBIA AUDITOR

717 14TH STREET N.W., SUITE 900
WASHINGTON, D.C. 20005
TEL. 202-727-3600 • FAX: 202-724-8814

Deborah K. Nichols
District of Columbia Auditor

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Letter Report: Sufficiency Review of the Water and Sewer Authority's Fiscal Year 2007 Revenue Estimate in Support of $50,000,000 in Commercial Paper Notes

April 3, 2007

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The Honorable Vincent C. Gray, Chairman
and Members of the Council of the District of Columbia
The John A. Wilson Building
1350 Pennsylvania Ave., N.W., Suite 504
Washington, D.C. 20004

Letter Report: Sufficiency Review of the Water and Sewer Authority's Fiscal Year 2007 Revenue Estimate in Support of $50,000,000 in Commercial Paper Notes

Dear Chairman Gray and Members of the Council of the District of Columbia:

Pursuant to D.C. Code, Section 34-2202.09(h), and a February 15, 2007 letter, the General Manager of the District of Columbia Water and Sewer Authority (WASA) requested the District of Columbia Auditor (Auditor) to certify the sufficiency of WASA's fiscal year (FY) 2007 revenue estimate in support of a proposed issuance of $50,000,000 in commercial paper notes. According to WASA officials, the purpose of issuing the commercial paper was to provide interim financing for WASA's $2.2 billion capital improvement program. This report sets forth the results of the Auditor's analysis of WASA's FY 2007 revenue estimate of $305,010,000 in support of its proposed issuance of $50,000,000 in commercial paper notes.

The certification review was conducted in accordance with standards applicable to attestation engagements contained in Government Auditing Standards issued by the Comptroller General of the United States. The review included such tests of the documentation and other procedures as deemed necessary and appropriate under the circumstances. The Auditor believes the procedures used in conducting this examination provided a reasonable basis for certifying WASA's FY 2007 revenue estimate.

BACKGROUND

The Water and Sewer Authority (WASA) was established pursuant to D.C. Law 11-111, effective April 18, 1996. Prior to the establishment of WASA, the Water and Sewer Utility Administration (WASUA), which was under the organizational umbrella of the District's Department of Public Works (DPW), managed the District's water and sewer utility operations. In accordance with D.C. Law 11-111, WASUA was abolished and its functions were transferred from DPW to WASA. D.C. Law 11-111 was amended by D.C. Law 11-184 to clarify WASA's relationship with the District government and provided for the Auditor's analysis of revenues certified by WASA for purposes of borrowing money and incurring debt.

WASA is governed by an 11-member board of directors. The chairperson and five members represent the District and are appointed by the Mayor of the District of Columbia with the advice and consent of the Council of the District of Columbia. The remaining five members represent Prince George's and Montgomery Counties in Maryland, and Fairfax County in Virginia. A General Manager provides day-to-day management of WASA with the assistance of a management team consisting of one Deputy General Manager and two Assistant General Managers.

Auditor's Responsibilities Regarding WASA's Borrowing of Money and Incurring of Debt

D.C. Code, Section 34-2202.09(h) states that:

> During each fiscal year in which debt service on the proposed bonds and outstanding revenue bonds issued by the Authority, and the transfer provided in Section 34-2202.07(f) becomes due and payable, the Authority may not issue bonds, notes, or other obligations or borrow money unless the Authority first certifies, to the reasonable satisfaction of the District of Columbia Auditor, [Auditor's Emphasis] that the revenues of the Authority are sufficient to pay its costs, the principal of and interest on and other requirements pertaining to the proposed bonds and outstanding revenue bonds issued by the Authority, and amounts equal to the debt service payments on District general obligation bonds issued by the District prior to October 1, 1996, which financed Department of Public Works, Water and Sewer Utility Administration capital projects, as such bonds and transfers become due and payable. The Authority's certification shall be supported by expert study and analysis.

WASA's Commercial Paper Program

Commercial paper is a financing vehicle that provides flexible access to the short-term capital markets, taking advantage of lower interest rates that are typically realized in the commercial paper market. Technically, commercial paper is a short-term promissory note with a maximum maturity of not more than 270 days, with typical issuances maturing in 30 to 60 days. Commercial paper is generally backed by a letter of credit issued by a commercial bank.

According to WASA officials, the commercial paper program represents an interim financing plan that will be used to finance some capital construction. This is WASA's second commercial paper issuance. WASA's Board of Directors approved WASA's first commercial paper issuance on November 1, 2001, with Series A and B notes not to exceed $50 million each at any one time. Proceeds from the sale of the notes were used to finance some of WASA's capital improvements. The Series A and B notes were secured by separate letters of credit. The letters of credit expire on November 30, 2015. There was no outstanding commercial paper at the end of FY 2006.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this review was to determine whether WASA's FY 2007 revenue estimate of $305,010,000, as certified by WASA's Chief Financial Officer (CFO) in a signed certificate dated March 12, 2007, was reasonably sufficient to cover WASA's FY 2007 costs, the principal of and interest on outstanding revenue bonds, debt service payments on general obligation bonds issued by the District on behalf of WASUA prior to October 1, 1996, and the proposed issuance of $50,000,000 in commercial paper.

In preparing this certification, the Auditor reviewed WASA's FY 2007 operating and capital budgets, the Comprehensive Annual Financial Reports for fiscal years 2004 through 2006, and an expert study and analysis conducted by PB Consult, Inc., an outside consultant retained by WASA.[1] WASA also provided additional supporting documentation as deemed necessary by the Auditor. Discussions were held with WASA officials, including its CFO, and representatives of PB Consult, the consulting firm which completed the expert study and analysis required by law.

In its expert study, PB Consult reported that WASA made reasonable revenue projections in that WASA: (1) provided adequate documentation of the principal assumptions underlying the forecast; (2) developed the forecast using the most current information available; (3) thoroughly understood and considered the risk factors inherent in the forecast; and (4) computed projections accurately. PB Consult concluded that WASA's FY 2007 revenue estimate had been reasonably developed and was attainable. The Auditor relied, in part, on representations contained in PB Consult's expert study and analysis as well as additional information obtained directly from WASA to support the certification of the revenue estimate.

Information upon which WASA's revenue estimate is based can, and often does, change rapidly. Further, relative uncertainty in the overall revenue estimating process and unforeseen national and local events may substantially change WASA's economic outlook and result in significant changes to the revenue estimate certified by the Auditor. Thus, the Auditor determined that, at the time of the examination and certification, WASA's estimate appeared sufficiently supported and achievable.

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[1] *See* Review of Projected FY 2007 and FY 2008 Revenues for the District of Columbia Water and Sewer Authority, dated February 15, 2007, issued by PB Consult, Inc.

Based upon a review of the expert study and analysis and examination of other information provided by WASA personnel in support of the commercial paper issuance, it appeared that the revenue estimate of $305,010,000 would be sufficient to cover WASA's FY 2007 costs and other obligations. Therefore, with regard to WASA's planned $50,000,000 commercial paper issuance, the Auditor certified WASA's FY 2007 revenue estimate of $305,010,000.

RESULTS OF ANALYSIS

WASA'S BOARD OF DIRECTORS APPROVED REVISED RATES AND FEE STRUCTURE

The achievement of WASA's FY 2007 revenue estimate of $305,010,000 is based, in part, on a revised rates and fee structure which was adopted by WASA's Board of Directors on January 5, 2006 and became effective October 1, 2006. According to WASA's budget and Board Resolution #06-13, adopted January 5, 2006, the revised rates and fee structure, which affects both commercial and residential customers, would increase overall retail revenue by approximately $10.8 million. Based on WASA's analysis of the proposed rates and fee structure, the overall increase in residential water bills was estimated to be $2.25 per month per customer.[2] Thus, revenues from WASA's 102,655 residential customers should increase by approximately $2.8 million and revenues from WASA's 18,443 commercial customers should increase by approximately $8 million. Therefore, commercial water bills may increase by as much as $36.28 per month per customer.

Based upon the Auditor's review of the revised rates and fee structure, other information submitted by WASA, and information contained in the expert study and analysis, the Auditor was reasonably satisfied that WASA's FY 2007 revenue estimate of $305,010,000 was sufficient to cover its FY 2007 costs, including costs associated with the planned issuance of $50,000,000 in commercial paper, outstanding revenue bonds, and the debt service payments on general obligation bonds issued by the District on behalf of WASUA prior to October 1, 1996. Table 1 presents WASA's FY 2007 revenue estimate.

[2] *See* WASA's Revised FY 2007 and Proposed FY 2008 Operating Budgets, Section IV, Rates and Revenue, page IV-6. WASA calculated this increase as follows: $42.40 *(FY 2007 Retail Rate)* + $2.01 *(WASA Metering Fee)* + $3.67 *(Right-of-Way/Payment in Lieu of Taxes Fee)* +$0.58 *(Stormwater Fee)* = $48.66 *(Typical Residential Customer Monthly Bill in FY 2007)*. The typical monthly bill for residential customers for FY 2007 of $48.66 was then compared to the typical bill for FY 2006 of $46.41 to derive a difference of $2.25 per month.

Table I[3]
Water and Sewer Authority's
Fiscal Year 2007 Revenue Estimate
(Dollars in 000s)

Account Type		
Residential	$44,274	
Commercial	71,888	
Multi-family	46,009	
Subtotal Residential, Commercial, and Multi-family	162,171	
Federal Government	29,246	
District of Columbia Government	7,167	
D.C. Housing Authority	6,607	
Transfer from Rate Stabilization Fund[4]	2,500	
Metering Fee[5]	5,300	
Total Retail		**$212,991**
IMA Wastewater Charges	50,851	
Potomac Interceptor Wastewater Charges	4,927	
Total Wholesale		**55,778**
District Stormwater Revenue	1,712	
Miscellaneous Revenue (e.g. water tap installation, fire hydrant usage, etc.)	8,924	
Washington Aqueduct Debt Service Revenue	787	
Interest Income	7,304	
Right of Way Fee/Payment in Lieu of Taxes Fee	17,514	
Total Other		**36,241**
WASA's FY 2007 Revenue Estimate		**$305,010**

Source: District of Columbia Water and Sewer Authority Revised FY 2007 and Proposed FY 2008 Operating Budgets, dated October 26, 2006.

[3]Table may contain minor differences due to rounding.

[4]WASA periodically transfers monies from the Rate Stabilization Fund to reduce the impact of required rate increases on its customers. Consistent with Board policy, such transfers are made when needed rate increases are not gradual and predictable.

[5]WASA assesses metering fees to cover the costs of installing, operating, and maintaining meters and installing the Automated Meter Reading (AMR) system. Metering fees range from $2.01 to $181.76 per month depending upon the type of meter at the customer's location.

CONCLUSION

Based on the analysis of all information presented by WASA, and other sources of relevant information, the Auditor was reasonably satisfied that WASA's FY 2007 revenue estimate of $305,010,000 would be sufficient to support its FY 2007 costs, the principal of and interest on outstanding revenue bonds, the $50,000,000 in commercial paper notes, and debt service payments.

Should you have any questions or need additional information regarding this matter, please do not hesitate to contact me at (202) 727-3600.

Respectfully submitted,

Deborah K. Nichols
District of Columbia Auditor