



OFFICE OF THE DISTRICT OF COLUMBIA AUDITOR

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**Sufficiency Review of the Water and Sewer Authority's
Fiscal Year 2004 Revenue Estimate in Support of
the Issuance of \$280 Million in Revenue Bonds**

July 12, 2004



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The Honorable Linda W. Cropp, Chairman
and Members
Council of the District of Columbia
1350 Pennsylvania Ave., NW, Suite 504
Washington, D.C. 20004

Letter Report: Sufficiency Review of the Water and Sewer
Authority's Fiscal Year 2004 Revenue Estimate in Support
of the Issuance of \$280 Million in Revenue Bonds

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

Pursuant to D.C. Code, Section 34-2202.09(h), the District of Columbia Auditor certified the sufficiency of the Water and Sewer Authority's (WASA) fiscal year (FY) 2004 revenue estimate in support of a proposed \$280 million in Public Utility Subordinated Lien Revenue Bonds, Series 2004, at the request of WASA's General Manager.

D.C. Code, Section 34-2202.09(h), sets forth the Auditor's responsibilities with regard to the borrowing of money and issuance of bonds, notes or other obligations by WASA as stated below:

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, 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.

The objective of this analysis was to determine whether the fiscal year 2004 revenue estimate of \$261.5 million, as certified by WASA's Chief Financial Officer (CFO) in a signed certificate dated June 29, 2004, was reasonably sufficient to cover WASA's fiscal year 2004 costs¹, the principal of and interest on the proposed bonds and other requirements, outstanding revenue bonds, and the debt service payments on general obligation bonds issued by the District on behalf of the Department of Public Works' Water and Sewer Utility Administration prior to October 1, 1996.

In January 2004, a public health crisis emerged regarding the presence of elevated lead levels in water supplied to approximately 23,000 WASA customers' homes in the District of Columbia. WASA began to implement actions aimed at addressing the public's concerns and informational needs regarding this public health crisis. Reportedly, the initiatives included distributing water filters and lead test kits to WASA customers, establishing a lead command call center exclusively to handle calls related to lead, conducting lead tests of certain District residents through the District's Department of Health, developing solutions to reduce lead levels in the water supply, and formulating a program to replace lead meter service lines. All of these initiatives may potentially impact WASA's revenues and expenditures in fiscal year 2004 and beyond.

Information upon which WASA's revenue estimates were based can 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 changes to the revenue estimate that differ significantly from the estimate certified by the Auditor. Thus, the Auditor has determined that, at the time of certification, WASA's revenue estimate for fiscal year 2004 appeared reasonable, sufficiently supported, and achievable.

Based upon a review of the expert study and analysis and other information provided by WASA in support of the bond financing and our independent evaluation and assessment of revenues and expenditures, the District of Columbia Auditor certified that the Authority's fiscal year 2004 revenue estimate of \$261.5 million, as presented in WASA's certificate, appeared to be sufficient to pay its fiscal year 2004 costs; the principal, interest, and other requirements pertaining to the proposed and outstanding bonds; and debt service payments on District general obligation bonds issued prior to October 1, 1996 which financed Water and Sewer Utility Administration capital projects. Table I presents WASA's fiscal year 2004 projected revenue estimate.

¹According to WASA's Cash Flow Summary Statement through May 31, 2004, operating disbursements are projected at \$258,436,000 for fiscal year 2004.

TABLE I
Water and Sewer Authority's Fiscal Year 2004
Revenue Estimate²
(\$000's)

Account Type

Retail

Residential and Commercial	
Federal Government	
District of Columbia Government	
D.C. Housing Authority	
Groundwater	
Metering Fee	
Total Retail	\$185,433

Wholesale

IMA Wastewater Charges	
Potomac Interceptor Wastewater Charges	
Total Wholesale	49,621

Other

District Stormwater Revenue	
Misc. Rev (e.g., Tap installation fees, etc.)	
Washington Aqueduct Debt Service Revenue	
Interest Income	
Right of Way Fee	
Total Other	<u>26,480</u>

WASA's FY 2004 Revenue Estimate	<u>\$261,534</u>
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Source: District of Columbia Water and Sewer Authority Revised FY 2004 and Proposed FY 2005 Operating Budgets and Supporting Schedules dated October 16, 2003, and Cash Flow Statement dated May 2004

²Rounding may affect some calculations presented in this report.

RESULTS OF ANALYSIS

WASA ESTIMATES ITS REVENUES WILL BE SUFFICIENT TO COVER COSTS IN FISCAL YEAR 2004

WASA's fiscal year 2004 revenue estimate is \$261.5 million. This estimate is supported by an expert study and analysis completed by a consultant, PB Consult, Inc., which was hired by WASA. The expert study and analysis is required by D.C. Code, Section 34-2202.09(h). PB Consult, Inc. made the following observations in its expert study and analysis of WASA's fiscal year 2004 revenue estimate:

1. Adequacy of supporting documentation - In addition to interviews and timely response to requests for information, the Authority provided sufficient documentation from which to verify their projections.
2. Best available information - The Authority was deemed to have used the most current information available to prepare its forecasts.
3. Accurate computation - All projections were found to have been accurately computed in all material respects.
4. Reasonableness of assumptions - The Authority was deemed to have given appropriate consideration to the risks that would affect forecast values.

PB Consult, Inc. further reported that: (1) WASA was found to have "made reasonable revenue projections;" (2) that WASA's year-to-date revenues were substantially on target; and (3) that year end projections were "achievable."

The Auditor found that the fiscal year 2004 revenue estimate reflects a 2.5% water and sewer rate increase that was approved October 1, 2003. We also found that the fiscal year 2004 revenue estimate of \$261.5 million was approximately \$6 million, or 2.4%, above WASA's actual revenue of \$255.5 million for fiscal year 2003.

WASA Established Reserve Accounts

WASA's financial position is strengthened by several reserve accounts approved by WASA's Board of Directors. Two of the reserve accounts represent Board established reserves and one represents a supplement to a reserve that was required by the 1998 Master Indenture of Trust.³ The reserve accounts consist of: (1) an operating reserve equal to six months of operating and maintenance expenses (the master indenture of trust only required WASA to maintain a balance equal to 60 days operating and maintenance expenses); (2) a rate stabilization reserve fund which consists of WASA's excess operating cash after funding the operating reserve at its required level; and (3) an undesignated reserve established to handle contingencies.

WASA Quantified Costs Associated with Elevated Lead Levels

WASA projects its fiscal year 2004 costs will total approximately \$258 million, including the costs related to addressing elevated lead levels in water supplied to District households. As previously noted, the crisis first surfaced in January 2004 requiring WASA to implement a series of initiatives to address this public health crisis. When the Auditor began the certification review, WASA had not fully quantified these costs or determined its overall impact on revenues for fiscal year 2004. Subsequently, WASA estimated costs of \$13.3 million to cover these initiatives and has requested supplemental budget authority of \$13.3 million for fiscal year 2004.⁴ WASA estimates, however, that the actual costs based on year-to-date spending through May 31, 2004, will be slightly less due to a substantial decline in lead related activities such as requests for test kits and a significant reduction in call volume at the call command center.

Based upon the Auditor's review of information contained in the expert study and analysis, the established reserves, estimated costs associated with addressing elevated lead levels, and other information submitted by WASA, the Auditor was reasonably satisfied that WASA's fiscal year

³According to information contained in the Fifth Supplemental Indenture of Trust, the Master Indenture of Trust initially dated April 1, 1998, (supplemented and amended by a first through fifth supplemental indenture) was established to provide financing or refinancing for the acquisition, construction, operation, maintenance and extension of the System (as defined in the Master Indenture) by the issuance of bonds, notes and other obligations payable solely from Net Revenues (as defined in the Master Indenture)... System is defined as all plants, systems, facilities, equipment, real and personal property and tangible and intangible property...and the supply, treatment, storage and distribution of water.

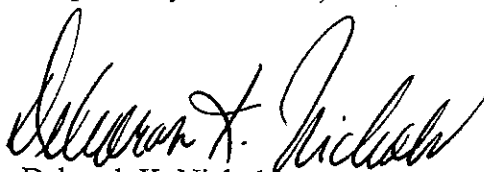
⁴WASA is requesting budget authority to increase its spending by \$13.3 million for fiscal year 2004.

2004 revenue estimate of \$261.5 million was sufficient to cover WASA's fiscal year 2004 costs, the principal of and interest on the proposed bonds and other requirements, outstanding revenue bonds, and the debt service payments on general obligation bonds issued by the District on behalf of the Water and Sewer Utility Administration prior to October 1, 1996.

CONCLUSION

The Auditor certified to the sufficiency of WASA's fiscal year 2004 revenue estimate of \$261.5 million in support of the \$280 million in Public Utility Subordinated Lien Revenue Bonds, Series 2004. Based on the Auditor's analysis of all information presented and provided by WASA, the revenue estimate of \$261.5 million appears sufficient to cover WASA's projected fiscal year 2004 expenses.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Deborah K. Nichols".

Deborah K. Nichols

District of Columbia Auditor