

OTAY WATER DISTRICT
FINANCE, ADMINISTRATION AND COMMUNICATIONS
COMMITTEE MEETING
and
SPECIAL MEETING OF THE BOARD OF DIRECTORS

2554 SWEETWATER SPRINGS BOULEVARD
SPRING VALLEY, CALIFORNIA
BOARDROOM

TUESDAY
January 22, 2013
11:30 A.M.

This is a District Committee meeting. This meeting is being posted as a special meeting in order to comply with the Brown Act (Government Code Section §54954.2) in the event that a quorum of the Board is present. Items will be deliberated, however, no formal board actions will be taken at this meeting. The committee makes recommendations to the full board for its consideration and formal action.

AGENDA

1. ROLL CALL
2. PUBLIC PARTICIPATION – OPPORTUNITY FOR MEMBERS OF THE PUBLIC TO SPEAK TO THE BOARD ON ANY SUBJECT MATTER WITHIN THE BOARD'S JURISDICTION BUT NOT AN ITEM ON TODAY'S AGENDA

DISCUSSION ITEMS

3. APPROVE AN ENGAGEMENT LETTER WITH THE AUDITING FIRM OF DIEHL, EVANS & COMPANY, LLP TO PROVIDE AUDIT SERVICES TO THE DISTRICT FOR THE FISCAL YEAR ENDING JUNE 30, 2013 (KOEPPEN) [5 minutes]
4. INFORMATIONAL REPORT ON THE DISTRICT'S WATER AND SEWER COST OF SERVICE STUDY UPDATE (BELL) [5 minutes]
5. INFORMATIONAL REPORT ON THE DISTRICT'S REFINANCING OF THE 2004 CERTIFICATES OF PARTICIPATION (COPS) (KOEPPEN) [5 minutes]
6. INFORMATIONAL REPORT ON THE DISTRICT'S COMPUTER SECURITY STATUS (SEGURA) [5 minutes]
7. ADJOURNMENT



STAFF REPORT

TYPE MEETING: Regular Board

MEETING DATE: February 6, 2013

PROJECT:

DIV. NO. All

SUBMITTED BY: Kevin Koeppen, Finance Manager

APPROVED BY: Joseph R. Beachem, Chief Financial Officer
 German Alvarez, Assistant General Manager
 Mark Watton, General Manager

SUBJECT: Appointment of Auditor for Fiscal Year Ending June 30, 2013

GENERAL MANAGER'S RECOMMENDATION:

That the Board authorize the General Manager to sign the engagement letters from the auditing firm of White Nelson Diehl Evans LLP, to contract for audit services for the 2013 Fiscal Year. The FY-2013 audit is the last year under the 5-year agreement with White Nelson Diehl Evans LLP.

COMMITTEE ACTION:

Please see Attachment A.

PURPOSE:

The District is required to retain the services of an independent accounting firm to perform an audit of the District's financial records each year.

ANALYSIS:

At the Board meeting on March 9, 2009, the Board approved Diehl, Evans & Company, LLP as the District's auditors for a 1-year contract, with four (4) 1-year options, with each option year subject to Board review and approval. The Board subsequently approved contract options in March 2010, February 2011, and March 2012 to perform the respective FY-2010, FY-2011 and FY-2012 audits. In October 2011, Diehl, Evans & Company, LLP merged with the accounting firm White, Nelson & Co., and now operates under the name White Nelson Diehl Evans LLP.

Staff is recommending the appointment of White Nelson Diehl Evans LLP as the District's auditors for FY-2013, in conjunction with the fourth 1-year contract option. This is based on their staff's knowledge of the District's operations and finances, their technical qualifications, and their performance as the District's auditors during the FY-2009 through FY-2012 audits. Also, at the conclusion of these audits, the White Nelson Diehl Evans staff provided significant advice and review of staff's draft Comprehensive Annual Financial Report (CAFR) prior to submission to the Government Finance Officers Association (GFOA) for award consideration.

The following is a tentative planning schedule for the major activities involved in completing the FY-2012 financial audit:

- Apr-2012: Pre-audit (3-4 days)
- Aug-2012: Year-end audit (4-5 days)
- Nov-2012: Board presentation of audited financials
- Dec-2012: Completed CAFR

The audit will consist of four major components: 1) Standard Audit Services, to provide an audit opinion on the District's financial statements; 2) Review of the District's Investment Policy procedures; 3) A State Controllers Report, required by the State of California; and 4) Assistance in preparation of the District's CAFR.

FISCAL IMPACT:

The fee for auditing services for the Fiscal Year ending June 30, 2013, will not exceed \$35,000. This is an increase of \$1,000 over last year's fee, and is the second fee increase since the inception of the contract in 2009.

STRATEGIC GOAL:

The District ensures its continued financial health through long-term financial planning, formalized financial policies, enhanced budget controls, fair pricing, debt planning, and improved financial reporting.

LEGAL IMPACT:

Required by law.

Attachments: Attachment A - Committee Action Form
Attachment B - White Nelson Diehl Evans LLP Audit Engagement Letter
Attachment C - White Nelson Diehl Evans LLP State Controllers Report Engagement Letter
Attachment D - White Nelson Diehl Evans LLP Agreed Upon Procedures Engagement Letter



ATTACHMENT A

SUBJECT/PROJECT:	Appointment of Auditor for Fiscal Year Ending June 30, 2013
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COMMITTEE ACTION:

The Finance, Administration, and Communications Committee supported staff's recommendation to the Board to appoint Diehl, Evans & Company, LLP, as the District's auditors for the fiscal year ending June 30, 2013.

NOTE:

The "Committee Action" is written in anticipation of the Committee moving the item forward for board approval. This report will be sent to the Board as a committee approved item, or modified to reflect any discussion or changes as directed from the committee prior to presentation to the full board.

WHITE NELSON DIEHL EVANS LLP
Certified Public Accountants & Consultants

January 15, 2013

Mr. Joseph R. Beachem
Chief Financial Officer
Otay Water District
2554 Sweetwater Springs Boulevard
Spring Valley, CA 91978-2004

Dear Mr. Beachem:

We are pleased to confirm our understanding of the services we are to provide Otay Water District (the District) for the year ending June 30, 2013. We will audit the financial statements of Otay Water District as of and for the year ending June 30, 2013. Accounting standards generally accepted in the United States of America provide for certain required supplementary information (RSI), such as management's discussion and analysis (MD&A), to supplement Otay Water District's basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. As part of our engagement, we will apply certain limited procedures to the Otay Water District's RSI in accordance with auditing standards generally accepted in the United States of America. These limited procedures will consist of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We will not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance. The following RSI is required by generally accepted principles and will be subjected to certain procedures, but will not be audited:

1. Management's Discussion and Analysis
2. Schedule of Funding Progress for PERS
3. Schedule of Funding Progress for DPHP

If a Single Audit is required, supplementary information other than RSI also would accompany Otay Water District's financial statements. We will subject the following supplementary information to the auditing procedures applied in our audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America and will provide an opinion on it in relation to the financial statements as a whole:

1. Schedule of Expenditures of Federal Awards

The following other information accompanying the financial statements will not be subjected to the auditing procedures applied in our audit of the financial statements, and for which our auditor's report will not provide an opinion or any assurance.

1. Introductory Section
2. Statistical Section

Audit Objective

The objective of our audit is the expression of an opinion as to whether your basic financial statements are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America and to report on the fairness of the supplemental information referred to in the second paragraph when considered in relation to the basic financial statements taken as a whole. Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America and will include tests of the accounting records and other procedures we consider necessary to enable us to express such an opinion. If our opinion on the financial statements is other than unqualified, we will discuss the reasons with you in advance. If, for any reason, we are unable to complete the audit or are unable to express an opinion, we may decline to express an opinion or may not issue a report as a result of this engagement.

If the District is subject to a Single Audit the objective of our audit also includes reporting on:

- Internal control related to the financial statements and compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements in accordance with *Government Auditing Standards*.
- Internal control related to major programs and an opinion (or disclaimer of opinion) on compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program in accordance with the Single Audit Act Amendments of 1996 and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

The reports on internal control and compliance will each include a statement that the report is intended solely for the information and use of management, the body or individuals charged with governance, others within the District, specific legislative or regulatory bodies, federal awarding agencies, and if applicable, pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

If the District is subject to a Single Audit, our audit will be conducted in accordance with auditing standards generally accepted in the United States of America; the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; the Single Audit Act Amendments of 1996; and the provisions of OMB Circular A-133, and will include tests of accounting records, a determination of major program(s) in accordance with OMB Circular A-133, and other procedures we consider necessary to enable us to express such opinions and to render the required reports. If our opinions on the financial statements or the Single Audit compliance opinions are other than unqualified, we will discuss the reasons with you in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed opinions, we may decline to express opinions or to issue a report as a result of this engagement.

Management Responsibilities

Management is responsible for the basic financial statements and all accompanying information as well as all representations contained therein. If the District is subject to a Single Audit, management is also responsible for identifying government award programs and understanding and complying with the compliance requirements, and for preparation of the schedule of expenditures of federal awards in accordance with the requirements of OMB Circular A-133. As part of the audit, we will assist with preparation of your financial statements and related notes. You are responsible for making all management decisions and performing all management functions relating to the financial statements and related notes and for accepting full responsibility for such decisions. You will be required to acknowledge in the management representation letter our assistance with preparation of the financial statements and that you have reviewed and approved the financial statements and related notes prior to their issuance and have accepted responsibility for them. Further, you are required to designate an individual with suitable skill, knowledge, or experience to oversee our assistance with the preparation of your financial statements and related notes and any nonaudit services we provide and for evaluating the adequacy and results of those services and accepting responsibility for them.

Management is responsible for establishing and maintaining effective internal controls, including internal controls over compliance, and for evaluating and monitoring ongoing activities, to help ensure that appropriate goals and objectives are met and that there is reasonable assurance that government programs are administered in compliance with compliance requirements. You are also responsible for the selection and application of accounting principles; for the fair presentation in the financial statements of the financial position of the Otay Water District and the respective changes in financial position and, where applicable, cash flows in conformity with U.S. generally accepted accounting principles; and for compliance with applicable laws and regulations and the provisions of contracts and grant agreements.

Management is also responsible for making all financial records and related information available to us and for ensuring that management and financial information is reliable and properly recorded. You are also responsible for providing us with (1) access to all information of which you are aware that is relevant to the preparation and fair presentation of the financial statements, (2) additional information that we may request for the purpose of the audit, and (3) unrestricted access to persons within the District from whom we determine it necessary to obtain audit evidence.

Your responsibilities also include identifying significant vendor relationships in which the vendor has responsibility for program compliance and for the accuracy and completeness of that information. Your responsibilities include adjusting the financial statements to correct material misstatements and confirming to us in the representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

You are responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud or illegal acts affecting the government involving (1) management, (2) employees who have significant roles in internal control, and (3) others where the fraud or illegal acts could have a material effect on the financial statements. Your responsibilities include informing us of your knowledge of any allegations of fraud or suspected fraud affecting the government received in communications from employees, former employees, grantors, regulators, or others. In addition, you are responsible for identifying and ensuring that the District complies with applicable laws, regulations, contracts, agreements, and grants. Additionally, if a Single Audit is required, as required by OMB Circular A-133, it is management's responsibility to follow up and take corrective action on reported audit findings and to prepare a summary schedule of prior audit findings and a corrective action plan.

Management Responsibilities (continued)

Management is responsible for establishing and maintaining a process for tracking the status of audit findings and recommendations. Management is also responsible for identifying for us previous financial audits, attestation engagements, performance audits, or other studies related to the objectives discussed in the Audit Objectives section of this letter. This responsibility includes relaying to us corrective actions taken to address significant findings and recommendations resulting from those audits, attestation engagements, performance audits, or studies. You are also responsible for providing management's views on our current findings, conclusions, and recommendations, as well as your planned corrective actions, for the report, and for the timing and format for providing that information.

Audit Procedures - General

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested. 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 financial statements. We will plan and perform the audit to obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the District or to acts by management or employees acting on behalf of the District. Because the determination of abuse is subjective, *Government Auditing Standards* do not expect auditors to provide reasonable assurance of detecting abuse.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, and because we will not perform a detailed examination of all transactions, there is a risk that material misstatements or noncompliance may exist and not be detected by us, even though the audit is properly planned and performed in accordance with U.S. generally accepted auditing standards and *Government Auditing Standards* (if applicable). In addition, an audit is not designed to detect immaterial misstatements or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements or major programs. However, we will inform you of any material errors and any fraudulent financial reporting or misappropriation of assets that come to our attention. We will also inform you of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential, and of any material abuse that comes to our attention. We will include such matters in the reports required for a Single Audit (if required). Our responsibility as auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, and may include tests of the physical existence of inventories, and direct confirmation of receivables and certain other assets and liabilities by correspondence with selected individuals, funding sources, creditors, and financial institutions. We will request written representations from your attorneys as part of the engagement, and they may bill you for responding to this inquiry. At the conclusion of our audit, we will require certain written representations from you about the financial statements and related matters.

Audit Procedures - Internal Controls

Our audit will include obtaining an understanding of the District and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Tests of controls may be performed to test the effectiveness of certain controls that we consider relevant to preventing and detecting errors and fraud that are material to the financial statements and to preventing and detecting misstatements resulting from illegal acts and other noncompliance matters that have a direct and material effect on the financial statements. Our tests, if performed, will be less in scope than would be necessary to render an opinion on internal control and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to *Government Auditing Standards*.

If a Single Audit is required, as required by OMB Circular A-133, we will perform tests of controls over compliance to evaluate the effectiveness of the design and operation of controls that we consider relevant to preventing or detecting material noncompliance with compliance requirements applicable to each major federal award program. However, our tests will be less in scope than would be necessary to render an opinion on those controls and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to OMB Circular A-133.

Management is responsible for establishing and maintaining a process for tracking the status of audit findings and recommendations. Management is also responsible for identifying for us previous financial audits, attestation engagements, performance audits, or other studies related to the objectives discussed in the Audit Objectives section of this letter. This responsibility includes relaying to us corrective actions taken to address significant findings and recommendations resulting from those audits, attestation engagements, performance audits, or studies. You are also responsible for providing management's views on our current findings, conclusions, and recommendations, as well as your planned corrective actions, for the report, and for the timing and format for providing that information.

An audit is not designed to provide assurance on internal control or to identify significant deficiencies. However, during the audit, we will communicate to management and those charged with governance internal control related matters that are required to be communicated under AICPA professional standards, *Government Auditing Standards*, and OMB Circular A-133.

Audit Procedures - Compliance

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of the District's compliance with applicable laws and regulations and the provisions of contracts and agreements, including grant agreements. However, the objective of those procedures will not be to provide an opinion on overall compliance and we will not express such an opinion in our report on compliance issued pursuant to *Government Auditing Standards*.

OMB Circular A-133 requires that we also plan and perform the audit to obtain reasonable assurance about whether the auditee has complied with applicable laws and regulations and the provisions of contracts and grant agreements applicable to major programs. Our procedures will consist of tests of transactions and other applicable procedures described in the *OMB Circular A-133 Compliance Supplement* and related addenda for the types of compliance requirements that could have a direct and material effect on each of the District's major programs. The purpose of these procedures will be to express an opinion on the District's compliance with requirements applicable to each of its major programs in our report on compliance issued pursuant to OMB Circular A-133.

Audit Administration Fees, and Other

Noted below is a listing of work required by District staff to assist in the audit.

1. Preparation of trial balances for all funds, after posting of all year end journal entries.
2. Preparation of schedules supporting all major balance sheet accounts, and selected revenue and expense accounts.
3. Typing of all confirmation requests.
4. Pulling and refiling of all supporting documents required for audit verification.
5. Preparation of the Management's Discussion and Analysis.

The workpapers for this engagement are the property of White Nelson Diehl Evans LLP and constitute confidential information. However, we may be requested to make certain workpapers available to grantor agencies pursuant to authority given to it by law or regulation. If requested, access to such workpapers will be provided under the supervision of our personnel. Furthermore, upon request, we may provide photocopies of selected workpapers to the grantor agencies. The grantor agencies may intend, or decide, to distribute the photocopies or information contained therein to others, including other governmental agencies.

In accordance with our firm's current record retention policy, all of your original records will be returned to you at the conclusion of this engagement. Our accounting workpaper files will be kept for a period of seven years. All other files will be kept for as long as you retain us as your accountants. However, upon termination of our service, all records will be destroyed after a period of seven years. Physical deterioration or catastrophic events may further shorten the life of these records. The working papers and files of our firm are not a substitute for your original records.

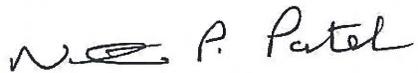
We expect to begin our audit on approximately August 1, 2013 and to issue our reports no later than October 31, 2013. Nitin Patel is the engagement partner and is responsible for supervising the engagement and signing the report or authorizing another individual to sign them. Our fee for these services will be at our standard hourly rates plus out-of-pocket costs (such as report reproduction, word processing, postage, travel, copies, telephone, etc.) except that we agree that our gross fee, including expenses, for the year ending June 30, 2013 will not exceed \$35,000. Our standard hourly rates vary according to the degree of responsibility involved and the experience level of the personnel assigned to your audit. Our invoices for these fees will be rendered each month as work progresses and are payable on presentation. In accordance with our firm policies, work may be suspended if your account becomes 60 days or more overdue and may not be resumed until your account is paid in full. If we elect to terminate our services for nonpayment, our engagement will be deemed to have been completed upon written notification of termination, even if we have not completed our report. You will be obligated to compensate us for all time expended and to reimburse us for all out-of-pocket costs through the date of termination. The above fee is based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered during the audit. If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs.

Mr. Joseph R. Beachem, CFO
Otay Water District
January 15, 2013
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Government Auditing Standards require that we provide you with a copy of our most recent external peer review report and any letter of comment, and any subsequent peer review reports and letters of comment received during the period of the contract. Our peer review reports accompany this letter.

We appreciate the opportunity to be of service to the Otay Water District and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us.

Very truly yours,



Nitin P. Patel, CPA
Engagement Partner

RESPONSE:

This letter correctly sets forth the understanding of the Otay Water District

By: _____

Title: _____

Date: _____

System Review Report

August 3, 2012

To the Owners of
White Nelson Diehl Evans, LLP
and the Peer Review Committee of the CA Society of CPAs

We have reviewed the system of quality control for the accounting and auditing practice of White Nelson Diehl Evans, LLP (the firm) in effect for the year ended March 31, 2012. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

As required by the standards, engagements selected for review included engagements performed under the *Government Auditing Standards* and audits of employee benefit plans.

In our opinion, the system of quality control for the accounting and auditing practice of White Nelson Diehl Evans, LLP in effect for the year ended March 31, 2012, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)* or *fail*. White Nelson Diehl Evans, LLP has received a peer review rating of *pass*.

Heidenreich & Heidenreich

Heidenreich & Heidenreich, CPAs, PLLC

WHITE NELSON DIEHL EVANS LLP
Certified Public Accountants & Consultants

January 15, 2013

Mr. Joseph R. Beachem
Chief Financial Officer
Otay Water District
2554 Sweetwater Springs Blvd.
Spring Valley, CA 91978-2004

Dear Mr. Beachem:

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services that we will provide.

We will compile and provide the Special Districts Financial Transaction Report and Supplement to the Annual Report of the Otay Water District (District) for the year ending June 30, 2013 to be included in the form prescribed by the California State Controller's Office. Our report is presently expected to read:

"We have compiled the accompanying Annual Report of Financial Transactions of Otay Water District for the year ending June 30, 2013, included in the accompanying prescribed form and as filed electronically with the California State Controller's Office, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

Our compilation was limited to presenting in the form prescribed by the California State Controller information that is the representation of management. We have not audited or reviewed the financial statements referred to above and, accordingly, do not express an opinion or any other form of assurance on them.

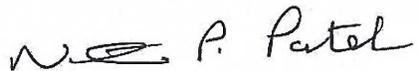
These financial statements are presented in accordance with the requirements of the State Controller of California, which differ from generally accepted accounting principles. These financial statements omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the District's financial position and results of operations. Accordingly, these financial statements are not designed for those who are not informed about such matters."

Mr. Joseph R. Beachem, CFO
January 15, 2013
Otay Water District
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Our fee to prepare the report is included in the \$35,000 maximum fee quoted in the engagement letter to conduct the June 30, 2013 financial audit of the District dated January 15, 2013. This fee contemplates that conditions satisfactory to the normal progress and completion of the Report will be encountered and that the District personnel will furnish assistance in connection with the Report preparation.

We appreciate the opportunity to be of service to the Otay Water District and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us.

Very truly yours,



Nitin P. Patel, CPA
Engagement Partner

RESPONSE:

This letter correctly sets forth the understanding
of the Otay Water District.

By _____

Title _____

| Date _____

WHITE NELSON DIEHL EVANS LLP
Certified Public Accountants & Consultants

January 15, 2013

Mr. Joseph R. Beachem
Chief Financial Officer
Otay Water District
2554 Sweetwater Springs Blvd.
Spring Valley, CA 91978-2004

Dear Mr. Beachem:

We are pleased to confirm our understanding of the nature and limitations of the services we are to provide for the Otay Water District.

We will apply the agreed-upon procedures which the District's senior management has specified, listed in Attachment A solely to assist the District's senior management in evaluating the investments of the District for the fiscal year ending June 30, 2013. Our engagement to apply agreed-upon procedures will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described in the attached schedule either for the purpose for which this report has been requested or for any other purpose. If, for any reason, we are unable to complete the procedures, we will describe any restrictions on the performance of the procedures in our report, or will not issue a report as a result of this engagement.

Because the agreed-upon procedures listed in the attached schedule do not constitute an examination, we will not express an opinion on the evaluation of the investments of the District. In addition, we have no obligation to perform any procedures beyond those listed in Attachment A.

We will submit a report listing the procedures performed and our findings. This report is intended solely for the use of District senior management, and should not be used by anyone other than these specified parties. Our report will contain a paragraph indicating that had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

You are responsible for the presentation of the evaluation of the investments of the District; and for selecting the criteria and determining that such criteria are appropriate for your purposes. You are also responsible for making all management decisions and performing all management functions; and for evaluating the adequacy and results of those services and accepting responsibility for them.

Mr. Joseph R. Beachem, CFO
Otay Water District
January 15, 2013
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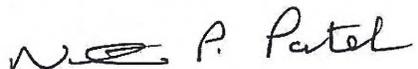
Nitin P. Patel, CPA is the engagement partner and is responsible for supervising the engagement and signing the report or authorizing another individual to sign it.

We plan to begin our procedures on approximately August 1, 2013 and, unless unforeseeable problems are encountered, the engagement should be completed by October 31, 2013. At the conclusion of our engagement, we will require a representation letter from management that, among other things, will confirm management's responsibility for the presentation of the evaluation of the investment of the District.

Our fee to prepare the report is included in the \$35,000 maximum fee quoted in the engagement letter to conduct the June 30, 2013 financial audit of the District dated January 15, 2013. If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs. Our invoices for these fees will be rendered each month as work progresses and are payable on presentation.

We appreciate the opportunity to assist you and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us. If the need for additional procedures arises, our agreement with you will need to be revised. It is customary for us to enumerate these revisions in an addendum to this letter. If additional specified parties of the report are added, we will require that they acknowledge in writing their responsibility for the sufficiency of procedures.

Very truly yours,



Nitin P. Patel CPA
Engagement Partner

RESPONSE:

This letter correctly sets forth the understanding
of the Otay Water District.

By _____

Title _____

Date _____

Attachment A

Agreed Upon Procedures

1. Obtain a copy of the District's investment policy and determine that it is in effect for the time period under review.
2. Select 4 investments held at year end and determine if they are allowable investments under the District's Investment Policy.
3. For the four investments selected in #2 above, determine if they are held by a third party custodian designated by the District.
4. Confirm the par or original investment amount and market value for the four investments selected above with the custodian or issuer of the investments.
5. Select two investment earnings transactions that took place during the year and recompute the earnings to determine if the proper amount was received.
6. Trace amounts received for transactions selected at #5 above into the District's bank accounts.
7. Select five investment transactions (buy, sell, trade or maturity) occurring during the year under review and determine that the transactions are permissible under the District's investment policy.
8. Review the supporting documents for the five investments selected at #7 above to determine if the transactions were appropriately recorded in the District's general ledger.



STAFF REPORT

TYPE MEETING:	Regular Board	MEETING DATE:	February 6, 2013
SUBMITTED BY:	Rita Bell, Finance Manager	PROJECT:	DIV. NO. All
APPROVED BY:	<input checked="" type="checkbox"/> Joseph R. Beachem, Chief Financial Officer <input checked="" type="checkbox"/> German Alvarez, Assistant General Manager <input checked="" type="checkbox"/> Mark Watton, General Manager		
SUBJECT:	Water and Sewer Cost of Service Study Update		

GENERAL MANAGER'S RECOMMENDATION:

This is an informational item only.

COMMITTEE ACTION: _____

Please see Attachment A.

PURPOSE:

To inform the Board of the potential changes in the rate structure currently being examined, in the water and sewer cost of service study performed by Karyn Keese of Atkins Global.

BACKGROUND:

On January 8, 2013, staff discussed the current cost of service study being performed. This informational item is to inform the Board of the changes being considered in this study. In March 2013, the final recommendations will be brought forward for the Board's consideration.

Typically, rate studies are performed every three to five years depending on changes in economic factors; price increases; water use patterns; regulations; infrastructure; and other cost driver changes. It has been four years since the District's last water and sewer rate study. The cost of service study is an important tool when setting retail rates because as water use and cost drivers change over time, imbalances may occur in the equity of how various customer classes pay for water.

Another factor to consider is the requirements of Proposition 218, whereby changes to the rate structure require a public hearing and the protest procedures must be followed. The cost of the notice requirements for the public hearing can be minimized by having a

five-year rate increase notice and schedule. For this reason, and the timing of the rate study, staff will be proposing a fair number of changes at this time. These changes are based on the findings of the rate study. These periodic updates also give stability in the rate structure.

The majority of the rate increase will be for the pass-through cost increases from our providers. These pass-through costs had no limitations within the prior 218 process, while the internal causes of the rate increases were set at a "not to exceed" percentage based on the rate model projections.

For significant changes to the rate structure, the District has the option of phasing in changes over time and incorporating the "phase-in" into the Proposition 218 notice and hearing.

There are several purposes of performing a rate study. The first is to maintain equity among the customer classes based on the cost of service study. The second is to bring financial stability to the agency by balancing fixed and variable charges so it can survive swings in water sales volume. Lastly, is to encourage conservation by adjusting both the tiered water rate structure and the strength and flow rate structure for sewer customers.

The current rate study will examine equity and assign costs to the various customer types. Financial stability will be a factor in setting fixed and variable charges as well as best management practices.

For the water cost of service study the following changes are being considered:

1. Create a Recycled Commercial Rate for future customers.
2. Update the fire service fee to ensure equity among customers.
3. Examine master meter/irrigation and commercial/irrigation customers to determine if they belong in a separate customer class because of their mixed use meter.
4. Re-examine the tiers for all customer types to ensure they match current consumption.
5. Examine the energy charge to ensure customers that cause a higher energy cost pay a higher energy charge.
6. Evaluate water meter equivalencies using AWWA hydraulic capacity factors for water customers.

For the sewer cost of service study the following changes are being considered:

1. Eliminate the Assigned Service Unit (ASU) calculation for commercial accounts. This would include the creation of a system fee by water meter size plus the annual average water consumption for the usage charge.
2. Adjust commercial sewer strengths to current industry standards.
3. Ensure water meter equivalencies used for sewer base fees are consistent with AWWA water meter equivalencies. (See No. 6 above.)
4. For multi-residential, charge the system fee on meter size instead of the current $\frac{3}{4}$ " system fee per dwelling unit.
5. Make the monthly base fee for SFR the same regardless of meter size ($\frac{3}{4}$ " vs. 1").
6. Eliminate the special formulas for schools and churches and charge them on the same proposed basis of other commercial accounts.

In addition to the changes being proposed in the water and sewer cost of service study, staff will be requesting the Board to consider an additional change. Since this change requires a Proposition 218 hearing it will be presented with the study findings. The change is to detach and attach Improvement Districts (ID) 25 to ID 20 and ID 19 to ID 22. The fees are identical for customers in the IDs being combined and would allow the District to eliminate two IDs that are no longer needed. Also, it would simplify the accounting and administration currently required for these IDs.

In March 2013, staff plans to bring the findings and recommendations to the Board, asking to incorporate these changes into the FY 2014 rate model. With the Board's direction, staff will then incorporate these recommendations into the FY 2014 rate model and budget. In May of 2013, staff will request the Board to approve the budget and to move forward with the Proposition 218 process. Only after the Proposition 218 hearing is completed can the Board approve the rates and rate structure changes.

FISCAL IMPACT: _____

This is an informational item only and has no fiscal impact.

STRATEGIC GOAL:

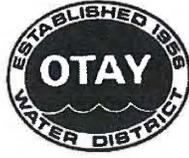
The District ensures its continued financial health through sound policies and procedures.

LEGAL IMPACT: _____

None.

Attachments:

- A) Committee Action Form
- B) Presentation



ATTACHMENT A

SUBJECT/PROJECT:	Water and Sewer Cost of Service Study Update
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COMMITTEE ACTION:

This is an informational item only.

NOTE:

The "Committee Action" is written in anticipation of the Committee moving the item forward for board approval. This report will be sent to the Board as a committee approved item, or modified to reflect any discussion or changes as directed from the committee prior to presentation to the full board.

Water and Sewer Cost of Service Study Update

Informational Item

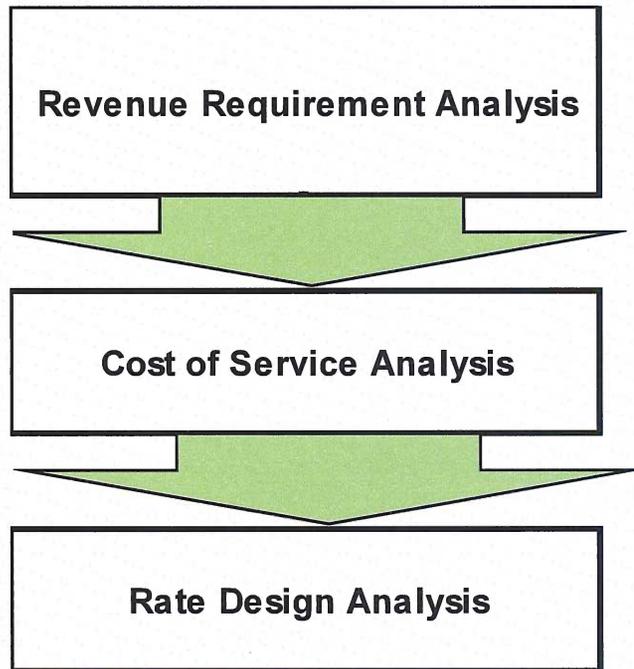
February 6, 2013



Introduction & Purpose

- Introduced water and sewer cost of service study to the Board on January 8, 2013 and discussed reasons to reexamine the rate structure every 3 to 5 years
 - Economic Factors, Price Increases (elasticity), Environmental Changes and Regulatory Changes
- Purpose
 - Bring equity between customer classes based on cost of service
 - Financial stability (fixed vs. variable charges)
 - Encourage conservation
 - Tiered rate structure for water
 - Strength and flow rate structure for sewer

Overview of Rate Study Analysis



Compares the sources of funds (revenue) to the expenses of the utility to determine the overall rate adjustment required

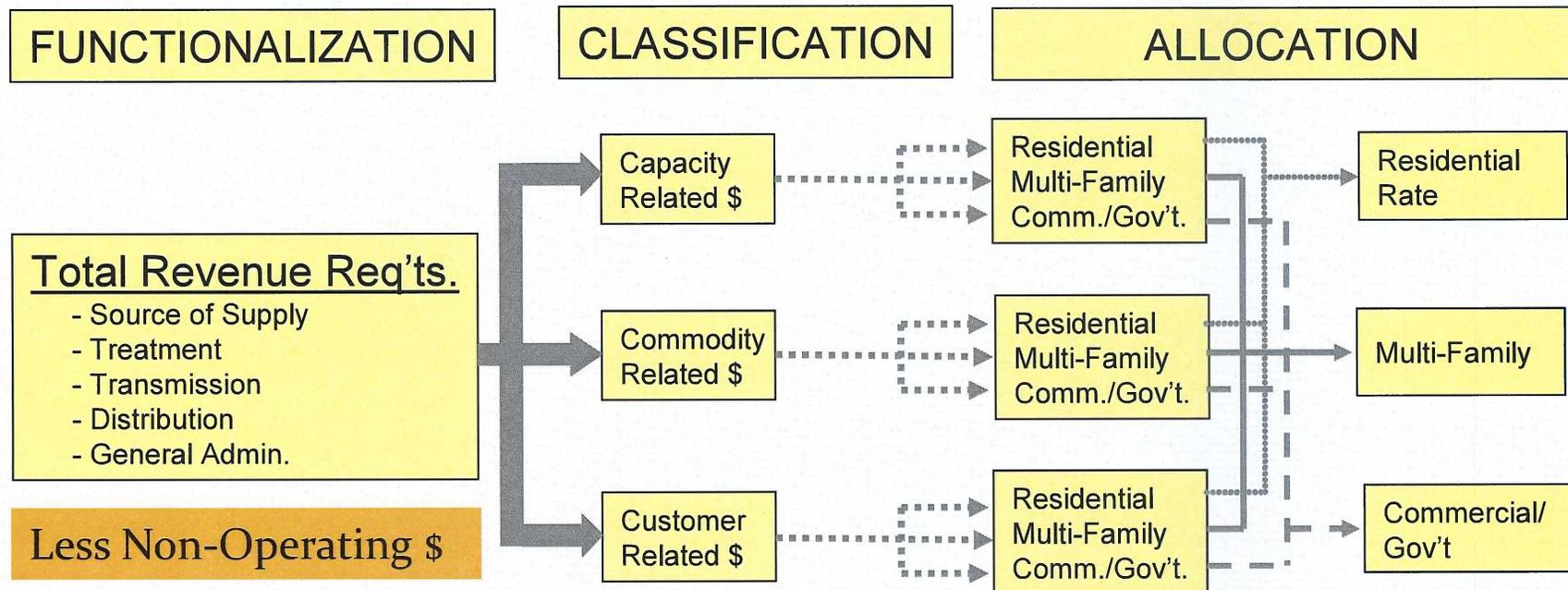
Allocates the revenue requirements to the various customer classes of service in a "fair and equitable manner"

Considers both the level and structure of the rate design to collect the target level of service

Establishing a Revenue Requirement

+ Operations and Maintenance
+ Transfer Payments
+ Capital Projects Based on Rates
= Total Revenue Requirement
- Miscellaneous Revenues
= Net Revenue Requirement from Rates

Cost of Service



Customer Related Costs – Billing, Collecting, Meter Maintenance, any costs that exist due to adding a customer.

Commodity Related Costs – Purchased water, power, and employee costs to provide potable water to customers.

Capacity Related Costs – Fixed costs such as debt service, MWD fixed charges, and actuarial pension obligations.

Terminology of a Cost of Service Analysis

Terminology of a Cost of Service Analysis

Functionalization – The arrangement of the cost data by functional category (e.g. treatment, collection etc.)

Allocation – Allocating the classified costs to each class of service based upon each class's proportional contribution to that specific cost component.

Commodity Costs – Costs that are classified as commodity related vary with the total flow of water (e.g. chemical use at a treatment plant).

Strength Costs – Costs classified as strength related refer to the wastewater treatment function. Typically, strength-related costs are further defined as biochemical oxygen demand (BOD) and total suspended solids (TSS).

Customer Costs – Costs classified as customer related vary with the number of customers on the system, e.g. billing costs.

Capacity Costs – If all customers used the utility in the same way over time (average annual daily volume flows), capacity costs would not need to be recognized. However various customer classes' peaks are realized throughout the year and even throughout the day. Residential customers peak during weekday mornings and commercial accounts tend to peak seasonally due to visitors (conventions or summer visitors). The costs associated with peaking (capacity) are allocated to these customers through the recognition of capacity costs. WW treatment plants and sewers are designed with peak flows in mind and thus a portion of O&M costs can also be attributed to peak flows (using the design basis cost allocation). Capacity cost can be more important when assigning capital costs to volume or capacity since sewers and treatment plants are designed with capacity in mind.

Direct Assignment – Costs that can be clearly identified as belonging to a specific customer group or group of customers.

Fire Protection Costs – Costs that are related to fire protection services (e.g. fire hydrants)

Customer Classes of Service – The grouping of customers into similar groups based usage characteristics and/or facility requirements



Proposition 218 and “Phase-in” Option

- Requirement of a public hearing and protest procedures
 - Additional cost of a 218 process
 - Recommended rate structure changes considered every 3 to 5 years with a rate study
 - Brings rate stability inline with rate setting methodology
 - Majority of rate increase is pass-through from providers
 - Internal rate increase will be set as “not to exceed” percentage based on reasonable rate model projections
- For significant changes to the rate structure a “phase-in” approach may be used to spread the impact over multiple years. This must be included in the Proposition 218 notice.



Water Rate Structure Changes being Considered



Recycled Commercial Rate

- Currently all recycled water is used for irrigation
- Anticipation of new commercial customers such as power plant and conversion of irrigation, laundry and toilet flushing at prisons
- Ensures compliance with CWA Recycled Credits Agreement
- Encourages use of recycled water
- Ensures equity between user classes
 - Peaking factor for indoor use is much lower than peaking factor for irrigation



Fire Service

- Used for sprinkler systems in homes and buildings
- Update the fire service fee to ensure equity among customers
- Examine mixed-use meters
 - Upsizing of the meter for fire service
 - Combined mixed use indoor/irrigation/fire



Mixed Use Meters

- Examine the mixed use meters to determine if they belong in a separate class of customers
 - Commercial/Irrigation
 - Multi-Residential/Irrigation



Re-examine Tiers

- Ensure they match current consumption
 - Industry standard uses winter and summer flows to determine tier break points
- Ensures equity among customer classes
- Retain tiers for commercial classes
 - This allows the District to easily implement drought rates if necessary



Energy Charges

- Examine the way energy charges get allocated to pressure zones
- Ensures those customers causing higher energy costs to pay higher energy charges



Water Meter Equivalencies

- Used to allocate fixed costs driven by capacity
- Ensure compliance with AWWA hydraulic capacity factors
- Ensure equity among customer classes



Sewer Rate Structure Changes being Considered



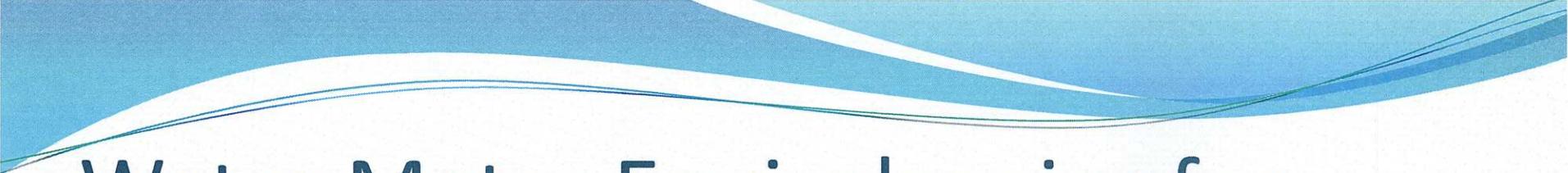
Commercial Accounts

- Eliminate the ASU calculation for commercial accounts
 - Create a system fee by water meter size
 - Use annual average water consumption for the usage charge
 - More fairly allocates costs based on usage
 - Accounts with less than 1 ASU could see lower sewer bills



Adjust Sewer Strength Factors

- Update strength factors using current industry standards
- Brings equity among user classes
- High strength commercial users could see an increase in their volumetric rate per HCF



Water Meter Equivalencies for Sewer Base Charges

- Ensure consistency with water meter equivalencies for the purpose of allocating fixed charges based on capacity
- Brings consistency between water and sewer
- Brings current rate structure to industry standard



Multi-Residential

- Charge system fee based on meter size instead of number of dwelling units
- Brings equity among user classes
- Multi-residential may see a decrease in the system fee



System Fee for Single-Family

- Make monthly base fee for $\frac{3}{4}$ " and 1" single-family accounts the same
- Meter size does not play a large role in sewer rates for single-family
- Simplifies rate structure



Schools and Churches

- Eliminate the special formulas for schools and churches based on attendance
- Simplifies rate structure
- Brings current structure into industry standard
- Many will see their sewer bill reduced



Other Changes

- Detach and attach Improvement District (ID) 25 to ID 20 and ID 19 to ID 22
 - The fees are identical for these customers
 - This allows the District to eliminate two IDs



Next Steps

- Continue to review preliminary findings with consultant
- Determine staff recommendations
- Bring recommended rate structure changes to the Board
- Incorporate new rate structure into FY2014 Rate Model
- Adopt FY2014 Budget
- Bring new rates and charges to Proposition 218 hearing
- Adopt a five-year Proposition 218 set of rates and charges
- Adopt the FY2014 rate increases



Questions???



STAFF REPORT

TYPE MEETING:	Regular Board	MEETING DATE:	February 6, 2013
		PROJECT:	DIV. NO. All
SUBMITTED BY:	Kevin Koeppen, Finance Manager		
APPROVED BY:	<input checked="" type="checkbox"/> Joseph R. Beachem, Chief Financial Officer <input checked="" type="checkbox"/> German Alvarez, Assistant General Manager <input checked="" type="checkbox"/> Mark Watton, General Manager		
SUBJECT:	Refinancing the 2004 Certificates of Participation (COPS)		

GENERAL MANAGER'S RECOMMENDATION:

Informational report only. No action required.

COMMITTEE ACTION:

See Attachment A.

PURPOSE:

This is an information only item to inform the Board of Directors of the potential savings from refinancing the 2004 COPS. The staff is currently working on Requests for Proposals (RFPs) seeking proposals for Financial Advisor, Bond Counsel, and Disclosure Counsel related to the refinancing.

BACKGROUND:

In 2004 the District issued Certificates of Participation and received proceeds of \$12,270,000. The proceeds of the 2004 COPS were used to redeem the 1993 COPS, which were originally used for reservoirs, pump stations and 50,000 feet of pipeline. The amount of the 2004 COPS currently outstanding is \$8,100,000 and is scheduled to be paid-off in FY-2024. The amount to be refinanced would include the current amount outstanding, plus any issuance costs.

The District's Debt Policy (Policy 45) states, "the District may commence the refinancing process if a minimum five percent (5%) present value savings, net of issuance costs, and any cash

contributions can be demonstrated. Beginning the process with at least a 5% savings should provide the District with some level of protection that it can achieve a minimum of three percent (3%) net present value savings of refinancing the bonds when and if the debt is issued." Staff estimates the value savings would meet the 5% requirement.

ANALYSIS:

Based on current interest rates, it is estimated that the District will save \$550,000-\$600,000 over the remaining life of the debt. Staff is evaluating alternatives to calculate the final savings. The staff is not considering any options that would change the debts duration or structure, meaning any refinancing would maintain the maturity and fixed interest aspects of the current debt.

The duration of the refinance process is estimated to be approximately three months.

Conclusions:

This is an information only item to inform the Board of Directors of the potential savings from refinancing the 2004 COPs. To further evaluate and confirm the savings, staff is working on RFPs seeking proposals for Financial Advisor, Bond Counsel, and Disclosure Counsel.

FISCAL IMPACT: Joe Beachem, Chief Financial Officer

A preliminary estimated savings of \$550,000-\$600,000 over the remaining life of the debt is expected, which meets the 5% required by the policy to commence the refinancing process. The exact amount will be determined when the proposed costs are finalized.

STRATEGIC GOAL:

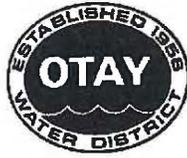
The District ensures its continued financial health through long-term financial planning and debt planning.

LEGAL IMPACT:

None.

Attachments:

Attachment A - Committee Action Form



ATTACHMENT A

SUBJECT/PROJECT:	Refinancing the 2004 Certificates of Participation (COPS)
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COMMITTEE ACTION:

Informational report only. No action required.

NOTE:

The "Committee Action" is written in anticipation of the Committee moving the item forward for board approval. This report will be sent to the Board as a committee approved item, or modified to reflect any discussion or changes as directed from the committee prior to presentation to the full board.

AGENDA ITEM 6



STAFF REPORT

TYPE MEETING:	Regular Board	MEETING DATE:	February 6, 2013
		PROJECT:	Various DIV. NO. ALL
SUBMITTED BY:	Adolfo Segura, IT Manager		
REVIEWED BY:	<input checked="" type="checkbox"/> Geoff Stevens, Chief Information Officer		
APPROVED BY:	<input checked="" type="checkbox"/> German Alvarez, Assistant General Manager		
	<input checked="" type="checkbox"/> Mark Watton, General Manager		
SUBJECT:	DISTRICT COMPUTER SECURITY STATUS		

GENERAL MANAGER'S RECOMMENDATION:

No recommendation. This is an informational item.

COMMITTEE ACTION:

Please see "Attachment A".

PURPOSE:

To brief the Board on the current state of computer security at the Otay Water District.

ANALYSIS:

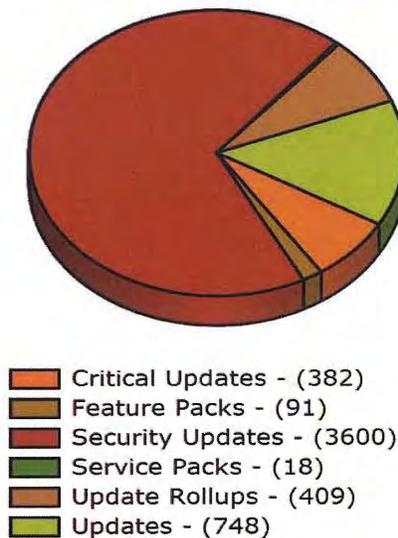
The District follows technology security best practices and implements, with the help of key vendors and IT support staff, a comprehensive and layered approach to operations and system security. Staff has always placed a very high priority on security of our computer systems. With the assistance of excellent consultants, we implemented a high level of security in the original design and all subsequent upgrades. Staff has worked with external agencies, such as the FBI and security testing firms, and as a result has made additional changes (e.g., a revision of our procedure for Virtual Private Network [VPN] access following our last security audit). We have also been recognized by the Municipal Information Systems Association of California (MISAC) and received "Excellence in Operations" awards in 2010 and 2011, which includes an audit of our

published security policies and procedures. While one can never be completely free of risk, the District has systematically been proactive in implementing appropriate security improvements and when we have learned of threats or weaknesses, we have been aggressive in making changes. Specific areas of concentration are:

Desktops/Laptops: The District operates a combination 150 Intel based desktops and laptops, with the vast majority operating on a Windows 7 operating system and a small number running XP. For activity protection, all desktops and laptops run the Symantec Antivirus/Antispyware solution and are updated daily. In addition, via Microsoft subscription service, IT staff routinely monitors for the availability of required operating systems and security patches.

Business Servers: The District operates approximately 70 physical and virtual servers. These servers run our financials, computerized maintenance work order system, website, SCADA, phone system, work group databases, network file & print and general user connectivity. These servers are supported by IT staff and vendor support agreements. For activity protection, all servers run the Symantec Antivirus/Antispyware solution and are updated daily. In addition, via Microsoft subscription service and vendor maintenance agreements, IT staff routinely monitors for the availability of required operating system and application patches. Our internet access is also controlled by Websense software that blocks sites that are known security risks or contain inappropriate content. As an additional precaution, we use a third party credit card validation vendor that allows us to not keep our customers credit card numbers. Likewise, there are extra levels of protection for internal data, such as employee social security numbers, that are restricted from access without approval.

12-Month Otay Server Patch Summary: Report Generated 12/21/2012



Data Center and Network: The District operates one small data center and five satellite communication rooms, which facilitate LAN and remote site connectivity. These computer rooms are physically protected behind door, lock/key and remote card, or FOB access. These rooms are environmentally protected and contain fire suppression systems and/or monitoring agents.

The District operates Cisco networking technology. The networking equipment is supported by IT staff and service providers. Data Center services and general network activity is monitored 24/7 via a remote service provider (RMS). The RMS vendor assists with preventive monitoring, patch deployment and technical support.

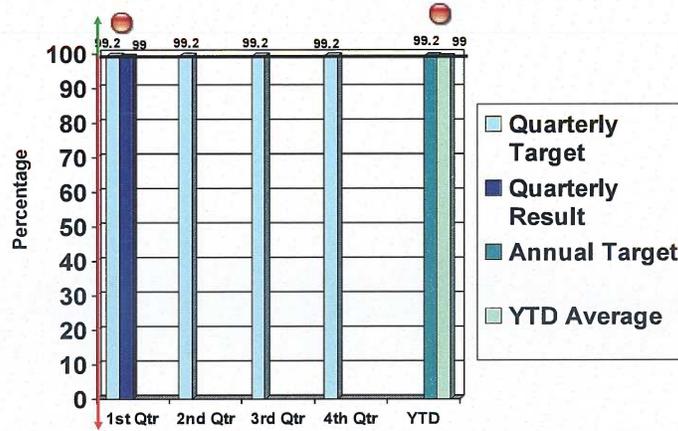
Security: Overall District computing security is layered from desktop level to physical access. This layer strategy includes operating system and database security patching, email anti-virus/anti-spyware, web content filtering for Internet exploit protection, Cisco firewalls for network and intrusion protection, and physical security components to protect District technology assets. In the wireless system that is under deployment, we use fully encrypted point-to-point protocols that cannot be accessed by an unauthorized party. When transmitting sensitive data, for example to PERS or the IRS, we also employ high level encryption for data. We have also outsourced our email system, which removes a lot of risky access to our internal servers and are doing the same for our external web site. **To date, there has been zero network, operating system, or application security breaches. In January 2013, via security vendor Symantec, the District's website was rated as "Very Secure".**

The District did experience an unauthorized access of phone voice mailboxes in November 2012. While no access to our internal systems or data was obtained, the intruders did gain access to a long-distance line. Staff is working with AT&T's Fraud Prevention Unit and should not be liable for these charges. To mitigate this incident, passwords were changed, longer password strings enforced, and a number of non-essential phone functions were disabled.

IT Operations: To enhance the stability and security of the District's computing environment, the IT team routinely meets internally, and with key vendors, to review and apply functional and security updates. Exercising planned Change and Control Management best practices, the IT team has been able to provide computing services at 99.99% up-time, which exceeds our Strategic Plan Measure 4.3.401 target rate of 99.2% (refer to graph on the following page). This means that system downtime is limited to scheduled after-hours maintenance windows.

Network Availability

4.3.401



Measure 4.3.401, Network Availability, aims to be above all set targets in order to have an average of no less than 99.2% network availability per quarter in a single year.

FISCAL IMPACT:

Joe Beachem, Chief Financial Officer

None.

STRATEGIC GOAL:

This report is a requested deliverable under item 3.1.2.10, Streamline and Improve Data Center Processes.

LEGAL IMPACT:

None.

Attachments:

Attachment A - Committee Action Report



ATTACHMENT A

SUBJECT/PROJECT:	DISTRICT COMPUTER SECURITY STATUS
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COMMITTEE ACTION:

The Finance, Administration and Communications Committee reviewed this item at a meeting held on January 22, 2013, and the following comments were made:

As this is an informational item, no approval was required and the Committee recommended that this report be presented to the Board as an informational item at the February 6th Board meeting.