Fiscal Policy

Fiscal Policy Statement	Completed	In Progress	Comments
General Financial Goals			
To maintain a financially viable Sanitation District that can maintain an appropriate level of wastewater treatment services.	✓		
To maintain financial flexibility by adapting to local and regional economic changes.	✓		
To maintain and enhance the sound fiscal condition of the District.	✓		
To ensure that the value added by every program and activity within the District is proportional to its cost; and to eliminate those programs and activities that do not contribute to the District's mission.	✓		
To provide training opportunities to the greatest extent possible for available jobs within the organization for those employees working in programs or activities that have been reduced or eliminated.	✓		
To provide employees with cross-training opportunities in order to achieve multi-tasking capabilities.	✓		
Operating Budget Policies			
The District will adopt a balanced budget by June 30 of each year.	✓		
The budget will be used as a fiscal control device as well as a financial plan.	✓		
Budget preparation and monitoring will be performed by each division within the District, the organizational level of accountability and control.	✓		
The Director of Finance & Administrative Service will prepare a budget calendar no later than January of each year.	✓		
An annual operating budget will be developed by conservatively projecting revenues and expenditures for the current and forthcoming fiscal years.	✓		
During the annual budget development process, the existing programs will be thoroughly examined to assure removal or reduction of any services or programs that could be eliminated or reduced in cost.	✓		

Fiscal Policy Statement	Completed	In Progress	Comments
Current operating revenues will be sufficient to support current operating expenditures.	✓		
Annual budgets including reserves will provide for adequate design, construction, maintenance and replacement of District capital facilities and equipment.	✓		
The District will maintain all physical assets at a level adequate to protect the District's capital investment and to minimize future maintenance and replacement costs.	✓		
The District will project equipment replacement and maintenance needs for the next five years and will update this projection each year. From this projection a maintenance and replacement schedule will be developed and followed.	✓		
The District will avoid budgetary and accounting procedures that balance the current budget at the expense of future budgets.	✓		
The District will forecast its expenditures and revenues for each of the next five years and will update this forecast at least annually.	✓		
Revenue Policies			
Because revenues are sensitive to both local and regional economic conditions, revenue estimates adopted by the Board of Directors must be conservative.	✓		
Staff will estimate annual revenues by an objective, analytical process that utilizes trend, judgmental, and statistical analysis as appropriate.	✓		
Ad valorem property tax revenues of the District will be dedicated to debt service.	✓		
Sewer Service User Fees will be projected for each of the next ten years and this projection will be updated annually.	✓		
Expenditure Policies			
The District will maintain a level of expenditures that provides for the health, safety and welfare of the residents of the community.	✓		

Fiscal Policy Statement	*Completed*	*In Progress*	*Comments*
The District will set fees and user charges at a level that fully supports the total direct and indirect costs of operations, capital improvements, and debt service requirements not covered by reserves.	✓		
Capital Improvement Budget Policies			
The District will make all capital improvements in accordance with an adopted and funded capital improvement program. The adopted capital improvement program will be based on need.	✓		
The District will develop an annual five-year plan for capital improvements, including design, development, implementation, and operating and maintenance costs.	✓		Strategic Plan projects needs through 2020.
All capital improvement projects approved in the annual operating budget are approved at the budgeted amounts through the completion of the project. The Board of Directors approves both the individual project total budget and the projected cash outlays for all capital improvement projects for the current fiscal year.	✓		
Staff will identify the estimated costs, potential funding sources and project schedule for each capital project proposal before it is submitted to the Board of Directors for approval.	✓		
Staff will identify the estimated on-going future Operating and Maintenance costs, as well as staffing requirements upon completion for each capital project proposal before it is submitted to the Board of Directors for approval.		✓	Included in the Asset Management Plan II.
The District will use intergovernmental assistance and other outside resources whenever possible to fund capital improvements providing that these improvements are consistent with the Capital Improvement Plan and the District's priorities, and that the future operating and maintenance costs of these improvements have been included in the budget.	✓		
Staff will coordinate development of the capital improvement budget with the development of the operating budget. All operations and maintenance resources required to implement the CIP have been considered and appropriately reflected in the operating budget for the year the CIP is to be implemented.	✓		
Cost tracking for components of the capital improvement program will be updated quarterly to ensure project completion against budget and established time lines.	✓		

Fiscal Policy Statement	*Completed*	*In Progress*	*Comments*
Asset Management Policy In order to provide for the systematic planning, acquisition, deployment, utilization control, and decommissioning of capital assets, the following policies have been established:			In 2002, the Board approved a Strategic Plan for development of a state-of-the-art Asset Management (AM) Program. In 2004, the Board approved advanced AM practices. In 2007, the Board directed a staff driven approach on all future initiatives of the AM program as opposed to continued reliance on outside consultants.
• The condition, performance, utilization, and cost of assets will be recorded down to the maintenance managed item component level.	✓		
• A detailed, planned maintenance program is in place to ensure that the assets, facilities and systems perform to their design criteria and meet their design lives.		✓	
• A system is in place to blend planned and unplanned activity to optimize the cost against the asset performance requirements.		✓	
• Reliability Centered Maintenance techniques will be used to optimize the maintenance plans and to identify any design alterations that are economically justified.		✓	
• Current levels of asset management service in terms of quantity and quality of service including condition, function/size/type, regulatory requirements, reliability, and repair response times have been determined and documented.		✓	
• The full economic cost is charged on all asset management activities.	✓		
• Asset Management maintains appropriate pricing and funding strategies that match the needs of the business to ensure sustainability.	✓		
• Asset Management considers the real growth of the District's service area and the way in which demands for service will change in the future, including population, unit demand, demographics, changing customer expectations, and changing regulatory requirements.	✓		
• Monitoring and reporting is performed on the condition, performance and functionality of the District's assets against prescribed service levels and regulatory requirements.		✓	
• A condition/function index is linked with customer expectations at a cost that customers are willing to pay.		✓	

Fiscal Policy Statement	*Completed*	*In Progress*	*Comments*
• Future level of service options available and their associated costs are constantly analyzed.	✓		
• An assessment of the relative risks, costs and benefits is derived for all investments in capital works, maintenance, and operations.	✓		
• Individual asset management decisions are made only when the cost of all programs has been analyzed and the funding needs of the whole organization is known together with the knowledge of its impact on rates.	✓		
• Necessary renewal programs to sustain the existing levels of service and condition of assets, as identified through the best appropriate process, is approved ahead of new capital works and services.		✓	
• New capital assets for new works and services are approved only with the commitment of the recurrent (operations and maintenance) funding necessary to sustain the new works and services.		✓	
• The financial, social, and environmental aspects of asset management will be reported on bi-annually.	✓		
Vehicle Replacement Policy			
In order to provide safe, reliable transportation appropriate to the work to be performed, the following policies have been established:			
• The newest vehicles will be used for those purposes requiring the highest annual mileage.	✓		
• Vehicles will be replaced when they are 10 years old or have accumulated 100,000 miles.	✓		
• A vehicle may be replaced in advance of the above criteria if it can be reallocated to a low mileage use between the plants.	✓		
• Electric carts are to be utilized for in-plant only uses.	✓		
• When available, CNG vehicles or bi-fuel vehicles are to be utilized within the County (pump station runs, Source Control inspections, etc).	✓		
• When available, CNG vehicles or bi-fuel vehicles are to be utilized to travel outside of Orange County (e.g., Environmental Compliance Monitoring of biosolids application sites, etc).	✓		

Fiscal Policy Statement	*Completed*	*In Progress*	*Comments*
Short-Term Debt Policies			
The District may use short-term debt to cover temporary or emergency cash flow shortages. All short-term borrowing will be subject to Board approval by resolution.	✓		
The District may utilize Board approved intra-agency loans rather than outside debt instruments to meet short-term cash needs. Intra-agency loans will be permitted only if an analysis of the affected Revenue Areas indicates funds are available and the use of these funds will not impact current operations. The principal, along with interest at the prevailing rate as established by the District's Treasurer, will be paid to the lending Revenue Area.	✓		
Long-Term Debt Policies			
Proceeds from long-term debt will not be used for current on-going operations.	✓		
Before any new debt is issued, the impact of debt service payments on total annual fixed costs will be analyzed.	✓		
Develop and maintain a board adopted debt policy.	✓		
Accumulated Funds & Reserve Policies			
A cash flow reserve will be established to fund operations, maintenance, and certificates of participation expenses for the first half of the fiscal year, prior to the receipt of the first installment of the property tax allocation and the sewer service user fees which are collected as a separate line item on the property tax bill. The level of this reserve will be established as the sum of an amount equal to six months operations and maintenance expenses and the total of the annual debt (COP) service payments due in August each year.	✓		
An operating contingency reserve will be established to provide for non-recurring expenditures that were not anticipated when the annual budget and sewer service fees were considered and adopted. The level of this reserve will be established at an amount equal to ten percent of the annual operating budget.	✓		

Fiscal Policy Statement	Completed	In Progress	Comments
A capital improvement reserve will be maintained to fund annual increments of the capital improvement program. The long-term target is for one half of the capital improvement program to be funded from borrowing and for one half to be funded from current revenues and reserves. With this program in mind, the target level of this reserve has been established at one half of the average annual capital improvement program through the year 2020. Levels higher and lower than the target can be expected while the long-term financing and capital improvement programs are being finalized.	✓		
A renewal/replacement reserve will be maintained to fund the District's renewal, rehabilitation and replacement requirement costs associated with the District's existing capital plant and collection system over the next twenty years. The reserve was initially set at $50 million in 1998-99 and is annually augmented by interest earnings and a small portion of the annual sewer user fees in order to meet projected needs through the year 2030.	✓		
Catastrophic loss, or self-insurance, reserves will be maintained for property damage including fire, flood, and earthquake; for general liability; and for workers' compensation. These reserves are intended to work with purchased insurance policies, FEMA disaster reimbursements, and State disaster reimbursements. Based on the current infrastructure value of $1.3 billion, the reserve level has been set to fund the District's non-reimbursed costs, estimated to be $57 million.	✓		
Investment Policies			
The District's Treasurer will annually submit an investment policy to the Board of Directors for review and adoption.	✓		
The investment policy will emphasize safety and liquidity before yield.	✓		
Accounting, Auditing, and Financial Reporting			
The District's accounting and financial reporting systems will be maintained in conformance with generally accepted accounting principles and standards promulgated by the Governmental Accounting Standards Board.	✓		

Fiscal Policy Statement	Completed	In Progress	Comments
A capital asset system will be maintained to identify all District assets, their condition, historical cost, replacement value, and useful life.	✓		
Quarterly financial reports will be submitted to the Board of Directors and will be made available to the public.	✓		
Full disclosure will be provided in the general financial statements and bond representations.	✓		
The District will maintain a good credit rating in the financial community.	✓		The District's AA rating was reaffirmed with the COP Series 2007A and 2007B debt issuances.
An annual audit will be performed by an independent public accounting firm with the subsequent issue of an official Comprehensive Annual Financial Report, including an audit opinion and a management letter.	✓		

GFOA Recommended Practices

GFOA Recommended Practice	*Compliance Met*	*Not Applicable*	*In Progress*	*Comments*
Accounting, Auditing, and Financial Reporting Recommended Practices				
Governmental Accounting, Auditing, and Financial Reporting Practice	✓			
Prepare Popular Reports		✓		Not being considered at this time due to other communication efforts.
Competitive Audit Procurement	✓			
Use the Comprehensive Annual Financial Report to Meet SEC Requirements for Periodic Disclosure	✓			
Establish Appropriate Capitalization Thresholds for Tangible Capital Assets	✓			
Internal Audit Function Established	✓			Administrative Committee directs Internal Audits
Audit Committees Established	✓			Administrative Committee serves as an audit committee.
The Need for Periodic Inventories of Capitalized Tangible Assets			✓	
Application of Full-Cost Accounting to Municipal Solid Waste Management Activities		✓		OCSD does not provide solid waste services.
Present Securities Lending Transactions in Financial Statements		✓		OCSD does not have Securities Lending Activities
Technology (Computer) Disaster Recovery Planning			✓	Managed by Information Technology Division
Present Budget to Actual Comparisons Within the Basic Financial Statements		✓		Not required for audited financial statement reports of Enterprise Funds. Budget/actual comparisons are included within unaudited quarterly financial reports.
Use Websites to Improve Access to Budget Documents and Financial Reports	✓			
Use of Trend Data and Comparative Data for Financial Analysis	✓			
Appropriate Level of Unreserved Fund Balance in the General Fund	✓			OCSD only has Proprietary Fund Types - established a formal policy on the level of unrestricted net assets
Document Accounting Policies and Procedures	✓			

GFOA Recommended Practice	Compliance Met	Not Applicable	In Progress	Comments
Establish the Estimated Useful Lives of Capital Assets	✓			
Improve the Effectiveness of Fund Accounting	✓			
Enhance Management Involvement with Internal Control	✓			
Voluntary Presentation of Management's Discussion and Analysis in Departmental Reports	✓			
Auditor Association with Financial Statements Included in Offering Statements or Posted on Websites	✓			
Ensuring Control over Noncapitalized Items	✓			
Considerations on Using the Modified Approach to Account for Infrastructure Assets		✓		OCSD depreciates all capital assets; OCSD has no governmental fund types
Mitigating the negative effects of auditing standard No.112 (communicating internal control related matters identified in an audit)	✓			
Encouraging and facilitating the reporting of fraud and questionable accounting and auditing practices	✓			
Ensuring adequate documentation of costs to support claims for disaster recovery assistance			✓	
Improving the timeliness of financial reports	✓			
<u>Cash Management Recommended Practices</u>				
Collateralization of Public Deposits	✓			
Government Relationships with Securities Dealers	✓			
Use of Various Types of Mutual Funds by Public Cash Managers		✓		Investment Policy does not allow Mutual Fund Investments
Debt Service Payment Settlement Procedures	✓			
Use of Derivatives by State and Local Governments		✓		Investment Policy does not allow Derivative Investments

GFOA Recommended Practices

GFOA Recommended Practice	*Compliance Met*	*Not Applicable*	*In Progress*	*Comments*
Market Risk (Volatility) Ratings	✓			Managed by PIMCO
Master, Trust, Custodial, and Safekeeping Security Lending Programs	✓			
Use and Application of Voluntary Agreements and Guidelines for Cash Management	✓			
Diversification of Investments in a Portfolio	✓			
Managing Market Risk in a Portfolio	✓			
Electronic Commerce	✓			
Procurement of Banking Services	✓			
Purchasing Card Programs	✓			
Acceptance of Credit and Debit Cards		✓		OCSD does not have sufficient transactions to offer the use of credit cards
Frequency of Purchased Securities Valuation in Repurchase Agreements	✓			
Selection of Investment Advisors for Non-Pension Fund Assets	✓			
Mark-to-Market Reporting Practices	✓			
Repurchase Agreements and Reverse Repurchase Agreements	✓			
Use of Lockbox Services		✓		OCSD does not have sufficient cash related transactions to use Lockbox services. The majority of revenues are collected on the property tax roll.
Commercial Paper	✓			
Revenue Policy: Cash Receipts Controls	✓			
Revenue Policy: Accounts Receivable Controls	✓			
Use of Cash Flow Forecasts in Operations	✓			
Bank Accountant Fraud Prevention	✓			

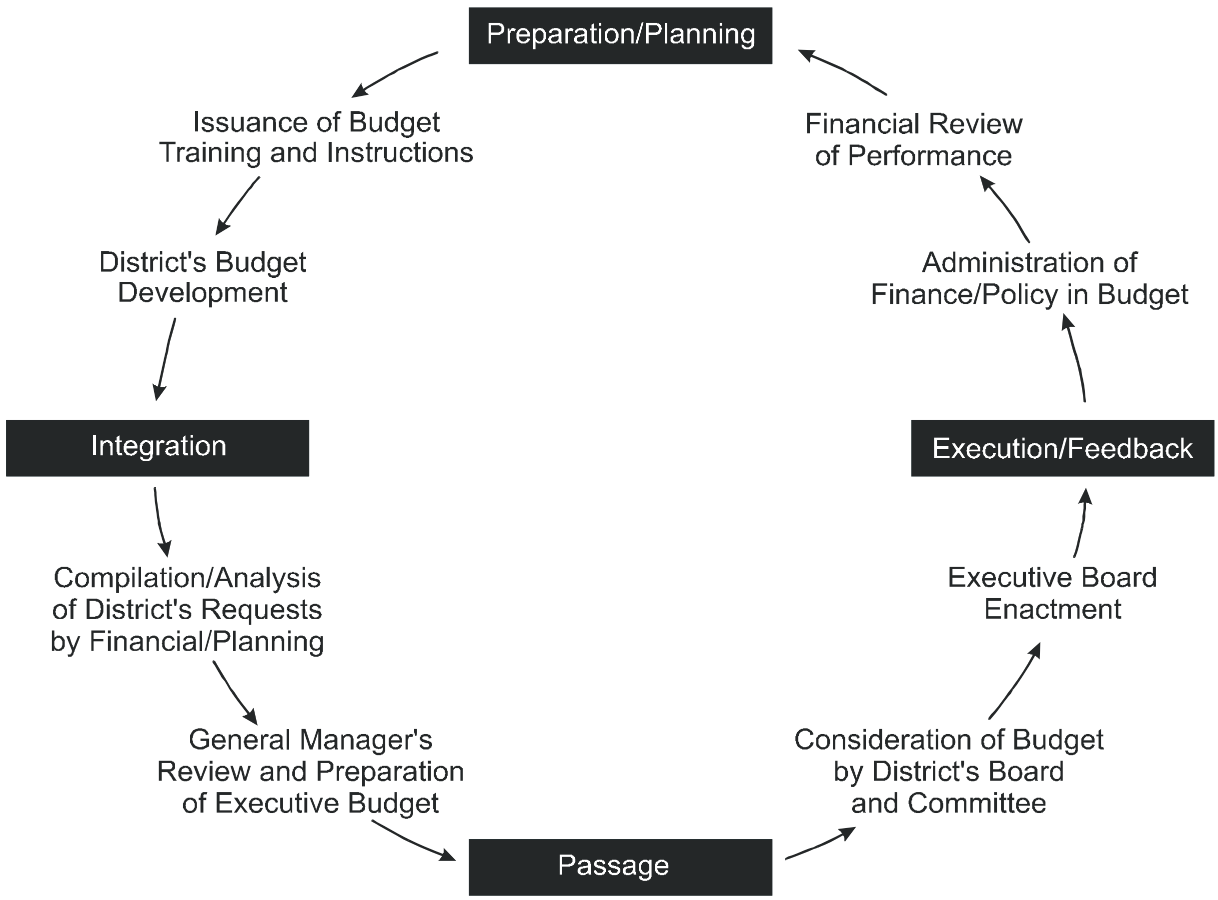
GFOA Recommended Practice	*Compliance Met*	*Not Applicable*	*In Progress*	*Comments*
Use of Local Government Investment Pools	✓			
Revenue Control and Management Policy	✓			
Payment Consolidation Services		✓		
Budgeting and Fiscal Policy Recommended Practices				
Economic Development Incentives	✓			
Use of Performance Measurement for Decision Making	✓			
Providing a Concise Summary of the Budget	✓			
Setting of Government Charges and Fees	✓			
Recommended Budget Practices of the National Advisory Council on State and Local Budgeting (NACSLB)	✓			
Financial Forecasting in the Budget Preparation Process	✓			
Relationships Between Budgetary and Financial Statement Information	✓			
Use of Financial Status in the Budgeting Process	✓			
Adoption of Financial Policies	✓			
Appropriate Level of Unreserved Fund Balance in the General Fund	✓			OCSD only has Proprietary Fund Types - established a formal policy on the level of unrestricted net assets
Include Sustainability as a Core Value in Setting Organizational Policy and in Establishing Business Practices	✓			
Establish Strategic Plans	✓			
Measuring the Cost of Government Services	✓			
Using Websites to Improve Access to Budget Documents and Financial Reports	✓			
Business Preparedness and Continuity Guidelines	✓			

GFOA Recommended Practice	Compliance Met	Not Applicable	In Progress	Comments
Statistical/Supplemental Section of the Budget Document	✓			
Budgeting for Results and Outcomes	✓			
Capital Project Budget	✓			
Alternative Service Delivery: Shared Services	✓			
Long-Term Financial Planning	✓			
Debt Management Recommended Practices				
Select and Manage the Method of Sale of State and Local Government Bonds	✓			
Analyze an Advance Refunding	✓			
Develop a Debt Management Policy	✓			Board approved Debt Policy completed in 2001-02.
Investment of Bond Proceeds	✓			Included in Trustee Documents
Use of Debt-Related Derivatives Products and Development of Derivatives Policy		✓		No Derivative Products
Maintain an Investor Relations Program	✓			
Payment of the Expense Component of Underwriters' Discount	✓			
Securitization of Tax-Exempt Obligations	✓			Meet qualifications of arbitrage
Prepare RFPs to Select Financial Advisors and Underwriters	✓			
Evaluate the Use of Pension Obligation Bonds		✓		OCSD does not manage pension fund
Sale and Securitization of Property Tax Liens		✓		
Use Variable Rate Debt Instruments	✓			
Issuer's Role in Selection of Underwriter's Counsel	✓			
Issuing Taxable Debt by U.S. State and Local Governments		✓		OCSD does not have plans to issue taxable debt

GFOA Recommended Practice	Compliance Met	Not Applicable	In Progress	Comments
Select Bond Counsel	✓			
Price Bonds in a Negotiated Sale	✓			
Underwriter Disclaimers in Official Statements	✓			
Use a Web Site for Disclosure	✓			
Tax Increment Financing as a Fiscal Tool		✓		
Caution in Regard to OPEB Bonds		✓		Pay-As-You-Go funding, no plan on issuing bond
<u>Retirement and Benefits Administration Recommended Practices</u>				
Public Employee Retirement System Investments		✓		Managed by OCERS
Funding of Public Employee Retirement Systems		✓		Managed by OCERS
Employee Involvement in Retiree Health Plan Changes	✓			
Preparing an Effective Summary Plan Description		✓		Managed by OCERS
Retirement and Financial Planning Services		✓		Managed by OCERS
Directed Brokerage Programs		✓		OCERS manages all “soft dollar” transactions
A Policy for Public Retirement Plan Design Option	✓			
Asset Allocation – Guidance for Defined Benefit Plans		✓		Managed by OCERS
Asset Allocation - Guidance for Defined Contribution Plans		✓		OCERS is a defined benefit plan.
Alternative Investment Policy for Public Employee Retirement Systems (PERS)		✓		Managed by OCERS
Pension Investment Policy		✓		Managed by OCERS
Selection of Investment Advisors for Pension Fund Assets		✓		Managed by OCERS
Brokerage Window Options for Defined Contribution Retirement Plans		✓		Managed by OCERS

GFOA Recommended Practice	Compliance Met	Not Applicable	In Progress	Comments
Framework for Understanding Pension Fund Risk		✓		Managed by OCERS
Investment Policies Governing Assets in a Deferred Compensation Plan			✓	Managed by the plan sponsors
Health Care Cost Containment	✓			
Evaluating Use of Early Retirement Incentives	✓			
Deferred Retirement Option Plans (DROPs)		✓		
A Policy to Participate in Securities Litigation Class Actions		✓		Managed by OCERS
Ensuring the Sustainability of Other Postemployment Benefits	✓			Pay-As-You-Go funding
Design Elements of Defined Benefit Retirement Plans		✓		Managed by OCERS
Design Elements of Defined Contribution Plans as the Primary Retirement Plan		✓		
Design Elements of Hybrid Retirement Plans		✓		
Monitoring and Disclosure of Fees for Defined Contribution Plans		✓		
Economic Development and Capital Planning				
Multi-Year Capital Planning	✓			
The Role of the Finance Officer in Economic Development	✓			
Public-Private Partnerships for Economic Development		✓		
Capital Project Monitoring and Reporting	✓			
Capital Maintenance and Replacement			✓	Will develop a complete inventory of all capital assets
The Role of Master Plans in Capital Improvement Planning	✓			

2008-09 & 2009-10 Budget



Budget Process:

Two years ago, the District prepared its first complete budget document covering two years instead of one. Last year a smaller budget update document was prepared to summarize revisions to the second year of the previously adopted two-year budget period. This two-year cycle approach to budget preparation is expected to continue.

This change has not caused any modification to the previously established stages of the annual budget process except with regard to the level of detail which is provided. The timing of all stages of the budget process remains consistent from year to year. In the second year of a two-year cycle, however, the focus is on any changes that need to be made to the upcoming year's budget relative to what was previously submitted, reviewed, and approved for that budget during the prior year.

The District's annual budget preparation process begins in January of each year and concludes in June upon its adoption. However, the entire budget process extends beyond one year and overlaps with the preceding budget and the subsequent budget. As shown in the chart above, the budget process consists of four major parts. These parts occur at various stages throughout the year as follows:

- Preparation/Planning - takes place from January through March.
- Integration - runs from March through May.
- Passage - adoption of the budget usually occurs in June of each year.
- Execution - starts from the first day of the budget year, July 1, through the entire budget year and beyond into November with the presentation of the annual audit report.

Team Approach

As identified by one of the fiscal policies, the budget preparation process originates at the division level, the organizational level of accountability and control. Budget coordinators are established to represent each operating division. A comprehensive budget manual is prepared and used as the training manual during a training session with the budget coordinators.

After the initial divisional budgets are prepared, budget review sessions are scheduled for each division with the General Manager. It is during these sessions that all proposed staffing levels, programs, and line item expenses are justified. Next senior management representatives from each department analyze opportunities for consolidating programs and eliminating unnecessary requests. Guidance is also sought and utilized from District's committees on various issues that affect budget development.

The Process

The budget preparation process begins in January with the distribution of the budget manual, budget preparation training, and issuance of personnel budget and justification forms, and equipment budget forms to all of the Divisions.

In March, the Administrative Services Department develops divisional level budgets based on the request forms received from the various divisions. These divisional budgets are then reviewed in mid-March by the General Manager along with the Department and Divisional managers for each program request and for new, additional, or reduced services, positions, and capital outlay.

The Capital Improvement Program requests are prepared from October through March and are reviewed by Engineering and Department and Divisional managers prior to being submitted to the General Manager for review and evaluation as part of the budget process.

In determining recommended allocation levels, the General Manager takes into consideration the projected amount of available resources, direction provided by the Directors, the District's fiscal policies, and how to best provide the most cost-effective and efficient service levels to the public. After a final review of the operating budgets by the General Manager, the proposed annual budgets are finalized in late May and then distributed to the Directors for consideration.

The General Manager presents the proposed budget to the various Directors' Committees for deliberations throughout the month of June. The proposed budget is scheduled for adoption, along with any revisions by the Board, at the Board of Directors meeting in June.

Level of Control and Amendments to the Budget

Budgetary control, the level at which expenses cannot legally exceed the appropriated amount, is exercised at the individual Department level. Administrative policies provide guidelines on budget transfers and the authorization necessary to implement transfers. Generally, there are two types of budget transfers:

1. Budget Adjustment

This is a transfer which does not change the total appropriated amount and does not require Board action. Depending on the budget category affected by the transfer, approval may be granted at the General Manager or Department Head level as follows:

Department Heads have discretion to reapportion funds between certain line items within a division but may not exceed total appropriated amounts for each department. They also may transfer staff across divisional lines within their department. The General Manager and Board of Directors must approve additional capital outlay items. Funds appropriated for salaries and benefits may not be expended for any other purpose unless approved by the Board. The General Manager may transfer operating funds within and between divisions and departments. The General Manager may also transfer staff positions between departments.

2. Budget Amendment:

This is an adjustment to the total appropriated amount, which was not included in the original budget. These supplemental appropriations require formal action by the Board of Directors. Types of modifications can be categorized as follows:

> Prior year reserves or fund balances may be appropriated to fund items not previously included in the adopted budget.
>
> Reserves/fund balances exceeding minimum amounts required by fiscal policy may be appropriated if it is determined to be in the best interest of the District. Directors may also appropriate reserves in case of emergencies or unusual circumstances.

Transfers between Revenue Areas require formal action by the Board of Directors.

Unexpended appropriations automatically lapse at the end of the fiscal year and are included in the ending equity balances.

2008-09 & 2009-10 Proposed Budget Assumptions

Economic Assumptions

- Inflation for Orange County in FY 2008-09 is projected to be 2.4 percent based on the 2008 projected percentage change in the consumer price index obtained from the December 2007 Economic Forecast Report prepared by Chapman University. A 2.4 percent inflation factor will also be used for FY 2009-10.

Revenue Assumptions

- Years 1 and 2 of the five-year Proposed Sewer Service Fee Rate Schedule will be ratified by the Board.

- For FY 2008-09 & FY 2009-10 the district-wide rate for a single-family residence (SFR) will increase by approximately 10.4 and 10.0 percent to $201.00 and $221.00, respectively.

- A Proposition 218 rate increase notification is required to be mailed to the Consolidated Revenue Area but not RA 14. Note that each $1 increase in rates generates approximately $900,000 in annual revenue.

- The connection fees, or capital facilities capacity charges, that were adopted in March 2004 will capture only those infrastructure costs that relate to additional capacity. Other infrastructure costs such as improved treatment, rehabilitation, refurbishment, and replacement, will be supported through user fees.

- A rate study for all existing revenue programs was completed in February 2008. The rate study verified the appropriateness of the allocation of costs for operating, maintaining, refurbishing and replacing facilities to serve existing wastewater dischargers and the appropriateness of the allocation of costs for expanding and building of new facilities necessary to provide additional wastewater treatment capacity. The rate study also verified: that the cost of providing the service and the allocation of these costs among fee payers is adequately based on appropriate cost of service principles and applicable legal standards, the appropriate allocation of costs between and among pollutants (BOD, SS, and Flow, including the basis for allocation of non-assignable costs), and the appropriate amount of charges and the allocation of those charges among fee payers for the added costs of providing (i) full secondary treatment and (ii) the ground water replenishment system.

- Capital Facilities Capacity Charges will increase 3.41 percent in accordance with the Engineering News Record (ENR) Construction Cost Index as of December 2007.

- Revenues will be budgeted to reflect 4,000 Equivalent Dwelling Unit (EDU) connections, the average of the past ten years.

- Permit User Rates for Flow and BOD will increase 9.32% and 14.86% respectively, while rates for TSS will decrease 18.44% in accordance with the rate study completed in February 2008.

- The annexation fees, effective as of March 2004, capture both the net current assets and the equivalent property tax allocations totaling $4,235 per acre. Annexable property is minimal in the District's service area sphere of influence, so no annexation fee revenue is budgeted.

- Property tax revenues in FY 2008-09 and 2009-10 are being budgeted with a conservative 5.0 percent increase. A 2.0 percent annual increase in assessed value authorized by the state constitution, is regarded as being somewhat automatic, and is included in the 5.0 percent increase noted above. The additional 3.0 percent increase in assessed value is from authorized increases up to market value when property is sold at a higher value. A 5.0 percent increase represents approximately $3.3 million in additional property taxes.

- Each year, earnings on the investment of the District's operating cash and reserves will be budgeted at 4.0 percent, the same as the current year estimate. Staff has consulted with PIMCO to get estimates for the next year's rate of return on investments.

- A $220 million COP debt issuance is scheduled for FY 2008-09 in order to assist in the funding of the $374 million CIP outlay scheduled for FY 2008-09.

- A $150 million COP debt issuance is scheduled for FY 2009-10 in order to assist in the funding of the $229 million CIP outlay scheduled for FY 2009-10.

Level of Treatment Issues

- In July 2002 the Board decided not to apply for a renewal of the 301(h) NPDES permit. This decision and its impacts on future capital and operating budgets will be reflected in the FY 2008-09 and future budgets.

- All existing and operational secondary treatment facilities will be operated and maintained at full capacity during FY 2008-09 and 2009-10 (approx 200 mgd).

- Interim short-term disinfection facilities will continue to be operated and maintained at existing levels and cost.

- Ten-year cash flow projections will be prepared considering the District's desire to reach secondary treatment standards as quickly as possible.

Operating Assumptions

- Operating, maintenance, and administration cost estimates for FY 2008-09 and 2009-10 are expected to increase. Increases, anticipated as a result of general inflation and as a result of usage variances, are anticipated in personnel salaries, natural gas, chemicals, and biosolids management.

- The operating budget will include costs by division for all collection, treatment, and disposal or reuse costs. The cost per million gallons will include all the components of operations and maintenance.

- Dry weather urban run off will continue to be treated for free up to 4 mgd with a 10 mgd maximum.

- Average daily flow for FY 2008-09 and FY 2009-10 is projected to be 230 million gallons per day (mgd). This is 38 mgd below the Interim Strategic Plan Update projection, but is 6 mgd above the actual for the first 5 months of the current year. The final actual flow for FY 2006-07 was 229 mgd.

- The cost to collect, treat, and dispose of 1 million gallons of wastewater is estimated to increase from the FY 2007-08 budget of $1,478.08 per million gallons, due to an increase in costs and the decrease in estimated flows.

- The total authorized staffing for FY 2008-09 and 2009-10 will increase by approximately 1 percent per year to 641.0 and 648.0 full-time equivalents, respectively.

- MOUs for OCEA, Local 501, and SPMT were completed in FY 2006-07 and will be considered in the FY 2008-09 and 2009-10 budgets. Salary adjustments based on the

MOUs include a range adjustment of 4% that will be effective for all employees as of the first pay period beginning in July each year. Additionally, all employees not already at the top step will be budgeted to receive a 5.0 percent step (merit) increase.

- A vacancy factor of 5 percent will be budgeted for all authorized positions to account for time spent for recruitment and turnover.

- Employee benefits and insurances, other than OCERS, will be budgeted to increase 10.0 percent in total in FY 2008-09 and another 10.0 percent in total in FY 2009-10.

- OCERS will be budgeted to be 21.34 percent of eligible salaries each fiscal year. In addition, the District pays 3.5 percent of employees' required contribution.

- The proposed operating budget will continue to reflect an emphasis on safety, technical, and management training. The proposed FY 2008-09 and 2009-10 budgets will include a budget for training that is equal to 2 percent of regular salaries and wages.

- An amount equal to approximately half of one percent of the operating materials and supplies budget, will be a contingency for prior year re-appropriations. Since the current year's budget lapses on June 30, a contingency is needed in the succeeding budget year for goods or services ordered at the end of one budget year but not delivered until the following year.

- An amount equal to approximately half of one percent of the operating materials and supplies budget, will be the General Manager's contingency budget. These funds will be allocated to appropriate line items during the year once requests and justifications for unanticipated needs have been approved by the General Manager.

Capital Improvement Program Assumptions

- The FY 2008-09 and 2009-10 treatment plant and collection system capital improvement program budgets are the amounts based on the current validated Capital Improvement Program (CIP).

- The 2008-09 CIP cashflow budget includes 114 projects in the following categories:

	Total (in millions)
Planning	$ 9.2
Design	$ 25.4
Construction	$337.1
Capital Equipment	$ 2.0
Total	$373.7

- The District's 5-year Strategic Plan, as validated in preparation for the FY 2008-09 budget process, is the basis for the FY 2008-09 and 2009-10 CIP cashflow budget. The FY 2008-09 and 2009-10 CIP budgets will increase only for critical projects that were not previously identified in the Strategic Plan Update.

- The FY 2008-09 CIP budget will not exceed $373.7 million. The FY 2009-10 CIP budget will not exceed $228.9 million.

Debt Financing

- The District will issue new debt as Certificates of Participation for the Capital Improvement Program as needed to fund the CIP and to maintain reserves. Debt financing issuance of $220 and $150 million is projected for FY 2008-09 and 2009-10 respectively to assist in the funding of the CIP outlay scheduled for the year.

- Debt will only be used for CIP, not for operating expenses.

- Capital financing plans which include fewer borrowings and higher user fees after FY 2009-10 will be considered.

- Borrowing is proposed only for facilities which do not add capacity and that are funded by all users for replacement, rehabilitation, and improved treatment.

Reserve Assumptions

- The current reserve policy was reviewed by Public Resources Advisory Group (PRAG) and the Board during FY 2003-04. No changes were proposed and direction was given to continue to maintain reserve levels at a level that is adequate to offset exposure to variable rate COPs due to interest rate increases. The reserve policy is presented in the Fiscal Policy which is located in the budget book at the beginning of Section 3.

- Reserves must be no less than 95 percent of the policy during the five-year planning period. The year-end reserve balances are expected to be within the Board's policy level for the five-year period of FY 2008-09 through FY 2012-13.

Accounting System and Budgetary Control

Fund Accounting & Proprietary Funds

The accounts of the District are organized within one Enterprise Fund, a Proprietary Fund Type. The District's Enterprise Fund is comprised of two Revenue Areas which are identified as Revenue Area 14 and the Consolidated Revenue Area (Revenue Area 15). Each Revenue Area includes a share of capital outlay activities, self-insurance activities, debt service activities, and operating activities. These activities are allocated to each Revenue Area based on sewage flows, location, or level of participation in specific programs.

Enterprise Funds are used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis are financed or recovered through user charges.

Basis of Accounting

Basis of accounting refers to the point at which revenues and expenses are recognized in the accounts and reported in the financial statements. Enterprise funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. In an enterprise fund, revenues are recognized when earned and expenses are recognized when incurred, regardless of the timing of related cash flows.

Budgetary Basis of Accounting

The operating budget for the Enterprise Fund is adopted on a basis consistent with generally accepted accounting principles. Except as noted in the following paragraph, the basis of accounting and the budgetary basis of accounting are the same. Budgeted amounts are as originally adopted and as further amended by Board action of the District.

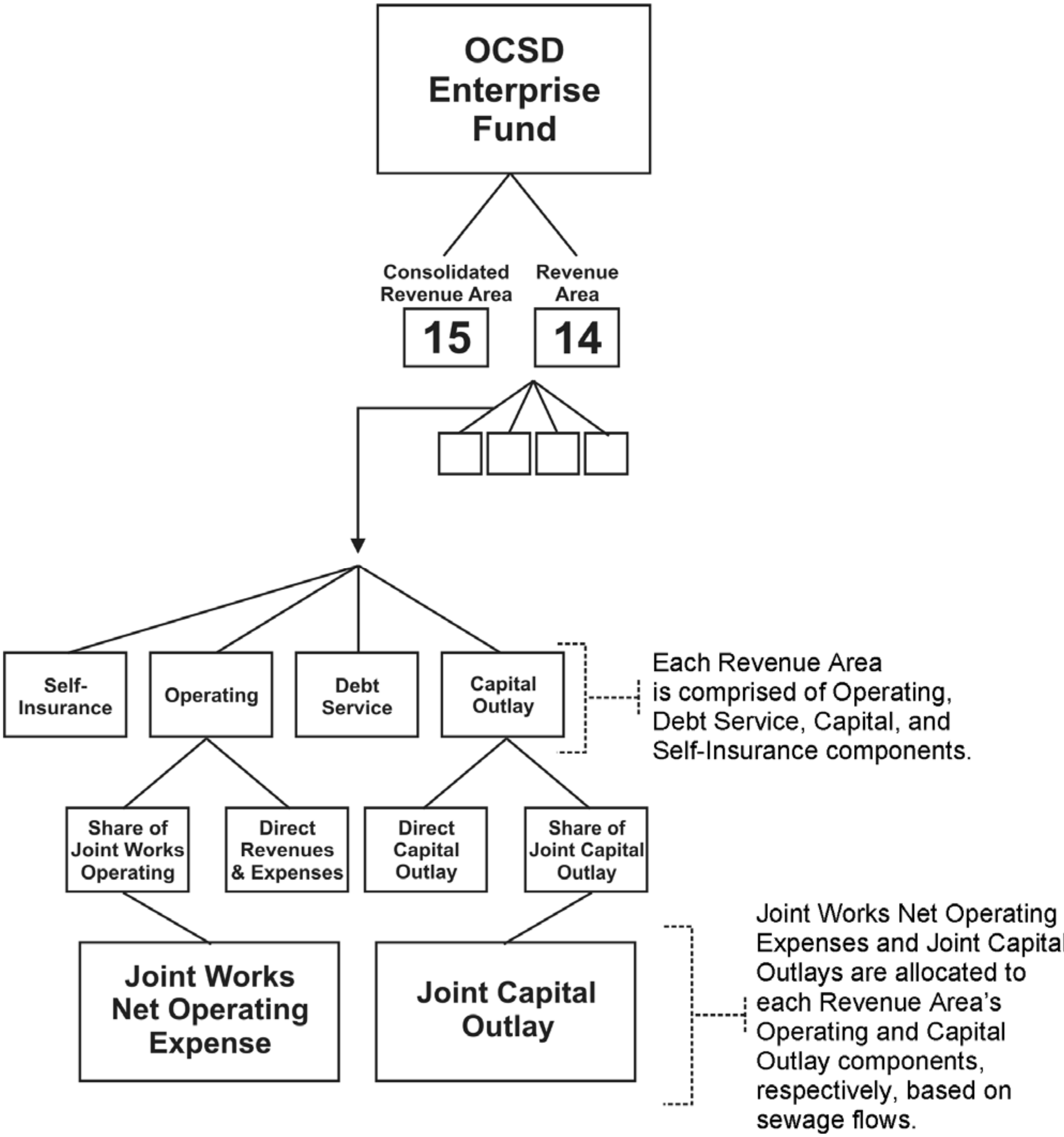
Although the District does budget for capital improvement projects, the related capital outlays are recorded as increases in Property, Plant, and Equipment on the balance sheet of the Enterprise Fund. Similarly, the District budgets for the retirement of debt. However, the principal payments on debt are recorded as reductions in the current portion of long-term debt on the balance sheet of the Enterprise Fund.

Internal Controls

The District is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the government are protected from loss, theft, or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived and that the valuation of costs and benefits requires estimates and judgments by management.

Budgetary Control

Budgetary controls are maintained to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the Board of Directors. The budgetary level of control, the level at which operating expenses cannot legally exceed the appropriated amount, is exercised at the department level.


OCSD Enterprise Fund
Consolidated Revenue Area
15
Revenue Area
14
Self-Insurance
Operating
Debt Service
Capital Outlay
Share of Joint Works Operating
Direct Revenues & Expenses
Direct Capital Outlay
Share of Joint Capital Outlay
Joint Works Net Operating Expense
Joint Capital Outlay
Each Revenue Area is comprised of Operating, Debt Service, Capital, and Self-Insurance components.
Joint Works Net Operating Expenses and Joint Capital Outlays are allocated to each Revenue Area's Operating and Capital Outlay components, respectively, based on sewage flows.

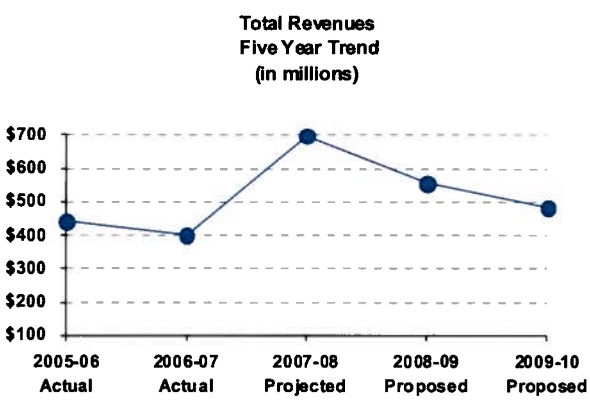
Revenue Sources

The District has a variety of revenue sources available for operating and capital expenses. The major revenue sources are as follows:

- Property Taxes
- Capital Facilities Capacity Charges
- User Fees
- Industrial Waste Permit User Fees
- Interest Earnings
- Debt Proceeds

These sources have generally accounted for more than 90 percent of the total revenue to the District.

The following graph summarizes revenues from all sources for the District as a whole over the past two fiscal years, the current year, and through the following two proposed budget years:



Total revenues decreased from $442.0 million in FY 2005-06 to $399.9 million in FY 2006-07. The lower revenues in FY 2006-07 were primarily due to the issuance of $200 million in certificates of participation (COP) debt issuance in the FY 2005-06 versus only $95.2 million in FY 2006-07. This reduction in revenues was partially offset by the $13.5 million generated from the $14.80 increase in the annual single family residential user fee, the underlying basis used in calculating all user fees. Total projected revenues for FY 2007-08 are expected to increase to $698.7 million due to the new debt issuances of $378.7 million and the $15.8 million that is expected to be generated from the increase of $16.20 in the annual single family residence user fee.

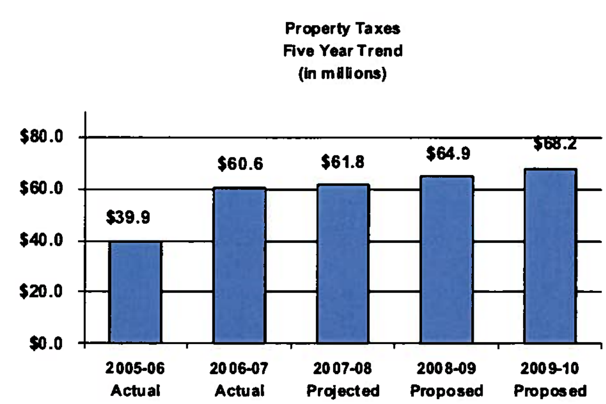
In FY 2008-09, revenues are being proposed at $556.0 million, a decrease of 142.7 million, or 20.4 percent over the prior year. This decrease is primarily attributable to a reduction in new debt issuances from $378.7 million debt issuances in FY 2007-08 to a proposed debt issuance in FY 2008-09 of $200 million. This decrease in overall revenues is being partially being offset by the $25.2 million that is expected to be generated from the flat 10.5 percent increase in all user fees.

In FY 2009-10, revenues are being proposed at $483.9 million, a decrease of $72.1 million, or 13.0 percent over the prior year. This decrease is primarily attributable to the $80 million reduction in new debt financings proposed in FY 2009-10 totaling $120 million as opposed to the total of $200 million proposed for FY 2008-09. This decrease in proposed revenues is more than offset by the additional $20 million proposed increase in user fees of 10.0 percent.

The new money debt financings of $200 million in FY 2008-09 and $120 million in FY 2009-10 are necessary to assist in funding of the current $2.0 billion ten-year capital improvement program.

Property Taxes

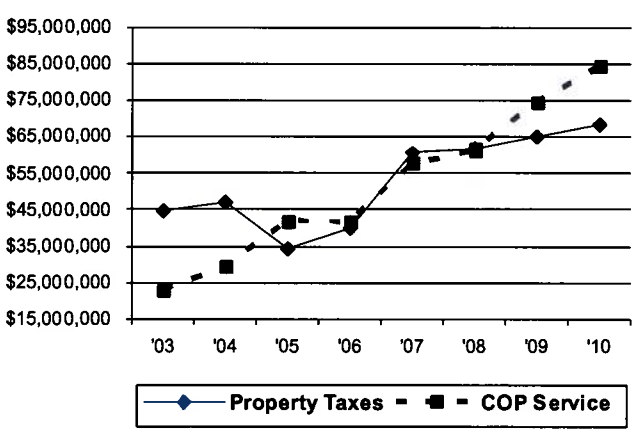
The County is permitted by State law (Proposition 13) to levy taxes at 1 percent of full market value (at time of purchase) and can increase the assessed value no more than two percent per year. The District receives a share of this basic levy proportionate to what was received in the 1976 to 1978 period less $3.5 million, the amount that represents the State's permanent annual diversion from special districts to school districts that began in 1992-93. The District's share of the one percent ad valorem property tax levy is dedicated for the payment of COP debt service. The apportionment of the ad valorem tax is pursuant to the Revenue Program adopted in April 1979 to comply with regulations of the Environmental Protection Agency and the State Water Resources Control Board and in accordance with COP documents and Board policy.



As shown in the graph above, property tax revenues increased from a low in FY 2005-06 of $39.9 million to $60.6 million in FY 2006-07. This increase is due to the end of the State's recent $1.3 billion property tax shift in FY 2004-05 and FY 2005-06 from non-education local governments to solve their fiscal crisis back in 2004. Of this $1.3 billion shift for FY 2004-05 and FY 2005-06, $350 million a year was projected to be contributed from independent special districts, an amount equal to 40 percent of secured property taxes. The overall reduction on total property tax revenue received by the District was minimized to 23.7 percent in FY 2004-05 and 18.6 percent in FY 2005-06 due to the steady increase attributed to the home sales market and the corresponding increase in home values.

Historically the District's property tax revenues were at a level where they could support the District's debt service obligations. However, future capital improvement needs averaging $200.0 million a year over the next ten years will require new COP debt issuances that will eventually increase future debt service payments above the ability to be funded solely from property tax revenues.

COP Funding Requirements vs. Property Tax Funding Source



User Fees

User fees are ongoing fees for service paid by customers connected to the sewer system. A property owner, or user, does not pay user fees until connected to the sewer system and receiving services. Once connected, a user is responsible for his share of the system's costs, both fixed and variable, in proportion to his demand on the system.

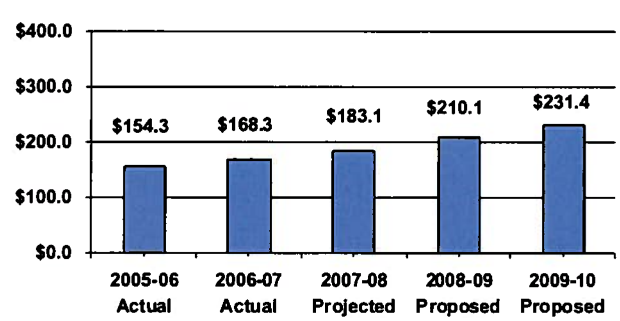
In addition, the Consolidated Revenue Area charges industrial and commercial user fees to customers discharging high-strength or high-volume wastes into the sewer systems. Revenue Area No. 14 need's are funded by Irvine Ranch Water District.

Up until seven years ago, the District had been able to avoid or minimize user fee increases by reducing operational costs through reorganizing and streamlining District operations. As a result of the capital improvement program expansion, the District's debt service obligations continue to increase beyond the level of its primary funding source, property tax revenues. Thus, annual increases in user fees have become a requirement.

In the Fall of 2007, District staff conducted strategic planning workshops with the Board of Directors to layout a capital program to deliver the levels of service desired by the Board of Directors. These levels of service and resulting capital projects are included in the District's 5-year Strategic Plan. This includes approximately $50 million of new CIP projects over the next 10 years. In addition, District staff has reviewed each CIP project to ensure that the scope of the project was appropriate, and that the cost estimates were accurate. The validated CIP includes 86 large capital projects and 28 special projects with a 15-year expenditure of $1.47 billion. This total represents a $149 million increase from the 2007-08 CIP estimate. This increase includes $50 million from the District's 5-year Strategic Plan, $28 million in newly identified rehabilitation and renewal needs, and $71 million in project budget revisions for on-going projects.

In February of 2008, the Board approved rate increases for each year over the next five years. These increases are necessary for compliance with the District's debt fiscal policy of balancing the funding of new capital improvements with current revenues and new debt, and to minimize rate increases over an extended period of time.

Net User Fees (in millions)

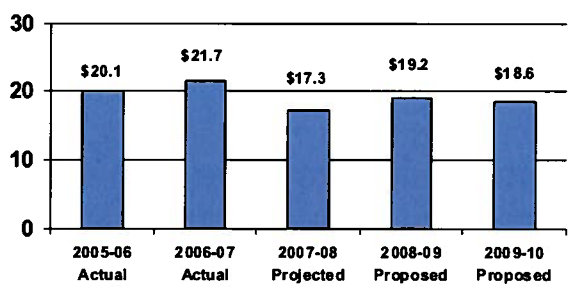


The impact of this five-year sewer fee schedule has increased the single family residence user fee rate of $182.00 in FY 2007-08 to $201 in FY 2008-09, to $221 in FY 2009-10, to $244 in FY 2010-11, to $267 in 2011-12, and to $294 in FY 2012-13. These rate increases by the District are still well below the average annual sewer rate of $406 currently being charged throughout the State according to the 2008 California Wastewater Charge Survey of 726 agencies conducted by the State Water Resources Control Board encompassing all 58 counties in California.

Interest Earnings
Interest earnings are generated from the investment of accumulated reserves consisting of a cash flow/contingency, a capital improvement, a renewal/replacement, and a self-insurance reserve, all projected to total $512.3 million at July 1, 2008.

The District's reserves are invested in accordance with the District's investment policy and the State Government Code through an outside money manager, and an independent custodian bank.

Interest Eamings
(in millions)



Interest earnings fluctuate from year-to-year based on the timing of CIP outlays and debt issuances, which impact the available balance in reserves for investing, and in the rise and fall of fixed-income investment market yields.

The District's investment policy is structured conservatively towards liquidity to avoid having to sell investments at a loss and having unrealized losses become realized losses.

Total projected cash balances reached a high of 489.8 million at July 1, 2006 and a low of $371.9 million at June 30, 2007 as no new money debt issuances occurred during the year and cash balances were brought down to fund current year CIP. However, interest earnings of $21.7 million were attributable to higher yields earned on investments, as investments earnings yielded 5.5 percent, an increase from the prior year earnings rate of 2.4 percent.

Although the yield through the third quarter of FY 2007-08 was only at 2.8 percent, investment earnings are projected to rise to $17.3 million due to the high average cash balances for the year as the as the $300 million debt issuance occurred prior to the third quarter.

The District is proposing an interest earnings rate of 4.0 percent in FY 2008-09 and FY 2009-10 to generate earnings of $19.2 million and $18.6 million, on investment portfolio projections of $460.9 million and $479.0 million at June 30, 2009 and 2010, respectively.

Debt Proceeds
Over the next ten years, the District is projecting an additional $2.0 billion in future treatment plant and collection system capital improvements. In order to minimize future annual sewer rate increases, a total of $550 million in certificates of participation debt is being proposed over the next five years.

In FY 2008-09 and FY 2009-10, new certificates of participation debt issuances are being proposed in the amounts of $200 million and $120 million, respectively. These debt issuances will assist in the funding of the proposed CIP budgeted cash outlays of $373.7 million and $228.9 million accordingly within these two fiscal years.