

SOUTH COUNTY REGIONAL  
WASTEWATER AUTHORITY

Financial Statements and Supplemental Data

For the year ended June 30, 2011

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

Financial Statements and Supplemental Data

For the year ended June 30, 2011

TABLE OF CONTENTS

	<u>Page</u>
FINANCIAL SECTION:	
Independent Auditors' Report	1
Basic Financial Statements:	
Statement of Net Assets	2
Statement of Revenues, Expenses and Changes in Net Assets	4
Statement of Cash Flows	5
Notes to the Basic Financial Statements	7
Supplementary Information:	
Combining Statement of Net Assets	20
Combining Statement of Revenues, Expenses and Changes in Net Assets	21
Combining Statement of Cash Flows	22
Analysis of Available Resources	24
Composition of Available Resources	25



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Board of Directors  
South County Regional Wastewater Authority

## **INDEPENDENT AUDITORS' REPORT**

We have audited the accompanying basic financial statements of the South County Regional Wastewater Authority (Authority) as of and for the year ended June 30, 2011, as listed in the accompanying table of contents. These financial statements are the responsibility of the management of the Authority. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the financial statements of the Authority for the year ended June 30, 2010 and, in our report dated January 18, 2011 we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2011, and the changes in financial position and cash flows of the Authority for the year ended in conformity with accounting principles generally accepted in the United States of America.

The Authority has not presented *management's discussion and analysis*. The Governmental Accounting Standards Board has determined that the aforementioned item is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming an opinion on the financial statements that comprise the Authority's basic financial statements. The supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Mayer Hoffman McCann P.C.*

Irvine, California  
December 21, 2011

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY  
Statement of Net Assets  
June 30, 2011  
(with prior year data for comparison purposes only)

<u>Assets</u>	<u>2011</u>	<u>2010</u>
Current assets:		
Cash held by City of Gilroy (note 2)	\$ 4,662,978	4,931,480
Accounts receivable	18,528	61,678
Due from Gilroy	634,827	110,290
Due from Morgan Hill	457,820	43,326
Due from other governments	185,574	6,160
Installment sale receivable - current (note 4)	<u>1,155,000</u>	<u>1,120,000</u>
Total current assets	<u>7,114,727</u>	<u>6,272,934</u>
Noncurrent assets:		
Restricted assets:		
Investments with fiscal agent (note 2)	1,849,425	1,849,408
Accrued interest on installment sale receivable	<u>280,802</u>	<u>294,802</u>
Total restricted assets	<u>2,130,227</u>	<u>2,144,210</u>
Capital Assets (note 3):		
Buildings	59,467,241	59,467,241
Fleet (vehicles)	954,243	954,192
Office furniture, fixtures and equipment	11,499,006	11,484,485
Infrastructure	9,828,150	5,490,592
Land improvements	<u>10,681,371</u>	<u>10,681,371</u>
Subtotal	92,430,011	88,077,881
Less: accumulated depreciation	<u>(41,350,469)</u>	<u>(39,250,851)</u>
Total capital assets being depreciated, net	51,079,542	48,827,030
Land	13,396,202	13,396,202
Construction in progress	<u>7,753,330</u>	<u>4,562,004</u>
Total capital assets, net	<u>72,229,074</u>	<u>66,785,236</u>
Other assets:		
Installment sale receivable (note 4)	13,975,593	15,130,592
Debt issuance costs	<u>254,760</u>	<u>277,920</u>
Total other assets	<u>14,230,353</u>	<u>15,408,512</u>
Total noncurrent assets	<u>88,589,654</u>	<u>84,337,958</u>
Total assets	<u>\$ 95,704,381</u>	<u>90,610,892</u>

See accompanying notes to basic financial statements.

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY  
Statement of Net Assets  
(Continued)

	2011	2010
<u>Liabilities and Net Assets</u>		
Liabilities:		
Current liabilities:		
Accounts payable	\$ 737,766	231,513
Due to Morgan Hill	498,191	630,156
Due to Gilroy	979,814	802,016
Total current liabilities	2,215,771	1,663,685
Current liabilities payable from restricted assets:		
Accrued interest payable	280,802	294,802
Revenue bonds payable - current (note 4)	1,155,000	1,120,000
Total current liabilities payable from restricted assets	1,435,802	1,414,802
Noncurrent liabilities:		
Compensated absences	28,075	23,369
Revenue bonds payable (note 4)	14,953,310	16,029,066
Total noncurrent liabilities	14,981,385	16,052,435
Total liabilities	18,632,958	19,130,922
Net Assets:		
Investment in capital assets	72,229,074	66,785,236
Unrestricted	4,842,349	4,694,734
Total net assets	\$ 77,071,423	71,479,970

See accompanying notes to basic financial statements.

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY  
Statement of Revenues, Expenses and Changes in Net Assets  
Year ended June 30, 2011  
(with prior year data for comparison purposes only)

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Operating contributions from Gilroy	\$ 3,577,243	3,445,217
Operating contributions from Morgan Hill	2,801,316	2,697,581
Other charges for services	<u>66,027</u>	<u>113,120</u>
Total operating revenues	<u>6,444,586</u>	<u>6,255,918</u>
Operating expenses:		
Sewage treatment	5,684,378	5,574,637
Chemical control	447,660	433,408
Plant operations	154,271	109,249
Depreciation	<u>2,099,617</u>	<u>2,342,425</u>
Total operating expenses	<u>8,385,926</u>	<u>8,459,719</u>
Operating income (loss)	<u>(1,941,340)</u>	<u>(2,203,801)</u>
Nonoperating revenues (expenses):		
Interest contributions from Morgan Hill	676,724	706,741
Interest contributions from Gilroy	-	545,026
Rental income	83,975	87,741
Interest income	32,741	219,463
Miscellaneous income (expense)	109,152	(195,559)
Interest expense and related fees	<u>(509,885)</u>	<u>(1,787,760)</u>
Total nonoperating revenues (expenses)	<u>392,707</u>	<u>(424,348)</u>
Income (loss) before operating transfers and capital contributions	(1,548,633)	(2,628,149)
Loss on settlement of debt	-	(2,211,630)
Capital contributions - Gilroy	4,148,390	385,493
Capital contributions - Morgan Hill	<u>2,991,696</u>	<u>278,008</u>
Change in net assets	5,591,453	(4,176,278)
Net assets at beginning of year	<u>71,479,970</u>	<u>75,656,248</u>
Net assets at end of year	<u>\$ 77,071,423</u>	<u>71,479,970</u>

See accompanying notes to basic financial statements.

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY  
Statement of Cash Flows  
Year ended June 30, 2011  
(with prior year data for comparison purposes only)

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Cash received from system users	\$ 6,468,322	6,320,974
Rental income received	83,975	87,741
Miscellaneous income (expense)	109,152	(195,559)
Cash payments to suppliers for goods and services	(5,813,503)	(5,678,574)
Cash payments to employees for services	<u>(399,696)</u>	<u>(390,281)</u>
Net cash provided by (used for) operating activities	<u>448,250</u>	<u>144,301</u>
Cash flows from capital and related activities:		
Cash paid for fixed assets	(7,263,771)	(503,291)
Member contributions toward interest	641,724	2,531,767
Member contributions toward principal	1,154,999	26,490,000
Capital contributions	6,524,741	590,287
Cash paid for settlement of debt	-	(2,211,630)
Interest paid on bonds	(780,414)	(2,062,099)
Principal paid on bonds	<u>(1,040,756)</u>	<u>(28,098,754)</u>
Net cash provided by (used for) capital and related financing activities	<u>(763,477)</u>	<u>(3,263,720)</u>
Cash flows from investing activities:		
Purchase of investments	(17)	-
Proceeds from sale of investments	-	2,687,112
Interest received on investments	<u>46,742</u>	<u>754,593</u>
Net cash provided by (used for) investing activities	<u>46,725</u>	<u>3,441,705</u>
Net increase (decrease) in cash and cash equivalents	(268,502)	322,286
Cash and cash equivalents at beginning of year	<u>4,931,480</u>	<u>4,609,194</u>
Cash and cash equivalents at end of year (note 1-l)	<u>\$ 4,662,978</u>	<u>4,931,480</u>

(Continued)

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY  
Statement of Cash Flows  
(Continued)

	2011	2010
Reconciliation of operating income to net cash provided by operating activities:		
Operating income (loss)	\$ (1,941,340)	(2,203,801)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	2,099,617	2,342,425
Rental income	83,975	87,741
Miscellaneous income	109,152	(195,559)
(Increase) decrease in due from other governments	(19,414)	9,348
(Increase) decrease in accounts receivable	43,151	55,708
Increase (decrease) in accounts payable	22,570	7,038
Increase (decrease) in compensated absences	4,706	4,502
Increase (decrease) in due to Morgan Hill	(131,965)	5,131
Increase (decrease) in due to Gilroy	177,798	31,768
Total cash provided by (used for) operating activities	\$ 448,250	144,301

There were no significant noncash financing, capital or investing transactions for the year ended June 30, 2011.

See accompanying notes to basic financial statements.

# SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

## Notes to the Basic Financial Statements

For the year ended June 30, 2011

### (1) Summary of Significant Accounting Policies

The financial statements of the South County Regional Wastewater Authority (SCRWA or Authority) have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to local governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The significant accounting policies of the Authority are described below.

#### (a) Description of Reporting Entity

The Authority was created on July 1, 1992 by the City of Morgan Hill and the City of Gilroy (Member Agencies). The purpose of the Authority is to plan and implement regional solutions to the wastewater treatment and management problems resulting from the generation of wastewater within the service areas of the Member Agencies. To achieve this purpose, the Authority constructs, maintains and operates facilities for sewage treatment and wastewater reclamation. The City of Gilroy has a 58.1% ownership interest in the Authority. The City of Morgan Hill has a 41.9% ownership interest in the Authority. This agreement terminates the joint power agreement entered into in 1979 (the Agreement of 1979).

The Authority is governed by a Board of Directors which consists of three members from the Gilroy City Council and two members from the Morgan Hill City Council.

The Authority is classified as a joint venture with respect to the two member agencies. Although the City of Gilroy controls three of the five members of the Board of Directors, the City of Gilroy does not have the ability to impose its will on the Authority beyond its representation on the Board. The Authority's budget and member contribution requirements are approved by the Board of Directors of the Authority. Although the City of Gilroy provides accounting services, engineering services, and administrative support to the Authority, day-to-day operations associated with SCRWA have been contracted directly by the Authority to a private provider of services for wastewater management and operations.

#### (b) Basic Financial Statements

The basic financial statements are comprised of the Statement of Net Assets, the Statement of Revenues, Expenses and Changes in Net Assets, the Statement of Cash Flows and the notes to the basic financial statements.

# SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

## Notes to the Basic Financial Statements

(Continued)

### (1) Summary of Significant Accounting Policies, (Continued)

#### (c) Measurement Focus, Basis of Accounting and Financial Statement Presentation, (Continued)

The Authority is accounted for as an enterprise fund (proprietary fund type). A fund is an accounting entity with a self-balancing set of accounts established to record the financial position and results of operations of a specific governmental activity. The activities of enterprise funds closely resemble those of ongoing businesses in which the purpose is to conserve and add to basic resources while meeting operating expenses from current revenues. Enterprise funds account for operations that provide services on a continuous basis and are substantially financed by revenues derived from user charges. The Authority utilizes the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized as they are incurred. Internal activity has been eliminated in the accompanying financial statements.

The Authority applies all applicable GASB pronouncements in accounting and reporting for proprietary operations as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB's) of the Committee on Accounting Procedure.

The Authority distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with sewer operations. The principal operating revenues of the Authority are charges to customers for sales and services. Operating expenses include cost of sales and services, general and administrative expenses and depreciation of capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Net assets of the Authority have been reported as restricted when their use is constrained more narrowly than the reporting unit in which they are reported as a result of state laws governing such use. When both restricted and unrestricted resources are available for use, the Authority uses unrestricted resources first, then restricted resources as they are needed. For capital expenditures, legally available restricted bond proceeds are used first, then other restricted resources, then unrestricted resources are used if needed.

#### (d) Operating Contributions

Operating contributions from the members are recognized when the related operating costs are incurred. Members are billed amounts equal to the actual operating expenses incurred less other revenues including contributions from non-member users.

# SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

## Notes to the Basic Financial Statements

(Continued)

### (1) Summary of Significant Accounting Policies, (Continued)

#### (e) Capital Contributions

In accordance with generally accepted accounting principles for local governmental units, the Authority has recorded the following transactions as capital contributions:

- Capital grants and other contributions from third parties restricted for property, plant, and equipment.
- Cash contributed from members for property, plant, and equipment.

#### (f) Capitalization of Interest

Interest paid on bonds (net of interest earnings on the investment of unexpended bond proceeds) is capitalized as a cost of property, plant and equipment until the assets constructed with bond proceeds are ready for their intended use.

During the period of construction, member cash contributions toward capitalized interest increase the members' investment in the joint venture and are recorded by the Authority as capital contributions.

#### (g) Unamortized Debt Issuance Expense

Direct expenses incurred in obtaining financing are capitalized and amortized over the lives of the respective borrowings.

#### (h) Balances Due To/Due From Member Agencies

Balances shown as due to/from agencies represent each member's over/under payment towards the funding of current year operations.

#### (i) Installment Sales Receivable

The Authority has recorded an installment sales receivable for capacity rights sold to member agencies under installment purchase agreements. Capacity rights are sold to members in return for member contributions toward (and ownership in) the facilities of the Authority. The members' obligation has been valued at the amount of principal payments agreed to be made by the members under the terms of the installment purchase agreements.

# SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

## Notes to the Basic Financial Statements

(Continued)

### (1) Summary of Significant Accounting Policies, (Continued)

#### (j) Capital Assets

Property, plant and equipment purchases greater than \$10,000 are capitalized at original acquisition cost or estimated acquisition cost. Donated fixed assets are recorded at their estimated fair market value at the date of donation. Fixed assets acquired under capital leases are recorded at the net present value of the total lease payments. Depreciation is charged to operations, using a straight-line method, based on the estimated useful life of the assets. The estimated useful lives of the assets are as follows:

Furniture and fixtures	5 years
Vehicles	5 years
Machinery and equipment	5-25 years
Treatment plant	40 years
Buildings	40 years
Sewer lines	50 years
Land improvements	50 years

#### (k) Investments

Investments are reported in the accompanying Statement of Net Assets at fair value, except for certain certificates of deposit and investment contracts that are reported at cost because they are not transferable and they have terms that are not affected by changes in market interest rates.

Changes in fair value that occur during the fiscal year are recognized as *increase (decrease) in fair value of investments* reported for that fiscal year. *Investment income* includes interest earnings, and any gains or losses realized upon the liquidation or sale of investments.

#### (l) Cash Equivalents

For purposes of the statement of cash flows, cash represents funds that effectively may be withdrawn at any time without prior notice of penalty (such as demand deposits and mutual funds). Cash equivalents are investments that are short-term and highly liquid and that are both readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Cash equivalents have an original maturity date of three months or less from the date of purchase. A reconciliation of cash and cash equivalents to amount reported on the combined statement of net assets is as follows:

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

Notes to the Basic Financial Statements

(Continued)

(1) Summary of Significant Accounting Policies, (Continued)

(l) Cash Equivalents, (Continued)

For the year ended June 30, 2011:

	<u>Cash and Cash Equivalents</u>	<u>Investments</u>	<u>Total</u>
Cash held by City of Gilroy	\$ 40,765	-	40,765
LAIF	4,622,213	-	4,622,213
Money market funds	<u>-</u>	<u>1,849,425</u>	<u>1,849,425</u>
	<u>\$4,662,978</u>	<u>1,849,425</u>	<u>6,512,403</u>

(m) Prior Year Information

Selected information regarding the prior year has been included in the accompanying financial statements. This information had been included for comparison purposes only and does not represent a complete presentation in accordance with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the government's prior year financial statements, from which this selected financial data was derived.

(2) Cash and Investments

Cash and investments as of June 30, 2011 are classified in the accompanying financial statements as follows:

Statement of net assets:	
Cash and investments	\$ 4,662,978
Cash and investments with fiscal agent	<u>1,849,425</u>
Total cash and investments	<u>\$ 6,512,403</u>

Cash and investments as of June 30, 2011 consist of the following:

Investments	\$ 6,512,403
Total investments	<u>\$ 6,512,403</u>

# SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

## Notes to the Basic Financial Statements

(Continued)

### (2) Cash and Investments, (Continued)

#### Investments Authorized by the California Government Code and the Authority's Investment Policy

The table below identifies the investment types that are authorized for the Authority by the California Government Code and the Authority's investment policy. The table also identifies certain provisions of the California Government Code (or the Authority's investment policy, if more restrictive) that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investments of debt proceeds with fiscal agent that are governed by the provisions of debt agreements of the Authority, rather than the general provisions of the California Government Code or the Authority's investment policy.

<u>Investment Types Authorized by State Law</u>	<u>Authorized by Investment Policy</u>	<u>Maximum Maturity*</u>	<u>Maximum Percentage of Portfolio*</u>	<u>Maximum Investment In One Issuer*</u>
Local Authority Bonds	Yes	5 years	None	None
U.S. Treasury Obligations	Yes	2 years	None	None
U.S. Authority Securities	Yes	5 years	None	None
Banker's Acceptances	No	180 days	40%	30%
Commercial Paper	No	270 days	25%	10%
Negotiable Certificates of Deposit	Yes	2 years	30%	None
Repurchase Agreements	No	1 year	None	None
Reverse Repurchase Agreements	No	92 days	20% of base value	None
Medium-Term Notes	No	5 years	30%	None
Mutual Funds	Yes	N/A	20%	10%
Money Market Mutual Funds	Yes	N/A	20%	10%
Mortgage Pass-Through Securities	Yes	5 years	20%	None
County Pooled Investment Funds	Yes	N/A	None	None
Local Authority Investment Fund	Yes	N/A	None	None
JPA Pools (other investment pools)	Yes	N/A	None	None

\* Based on state law requirements or investment policy requirements, whichever is more restrictive.

#### Investments Authorized by Debt Agreements

Investment of debt proceeds with fiscal agent are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Authority's investment policy. The table below identifies the investment types that are authorized for investments with fiscal agent. The table also identifies certain provisions of these debt agreements that address interest rate risk, credit risk, and concentration of credit risk.

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

Notes to the Basic Financial Statements

(Continued)

(2) Cash and Investments, (Continued)

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Allowed</u>	<u>Maximum Investment In One Issuer</u>
U.S. Treasury Obligations	None	None	None
U.S. Authority Securities	None	None	None
Banker's Acceptances	365 days	None	None
Commercial Paper	270 days	None	None
Money Market Mutual Funds	N/A	None	None
Repurchase Agreements	180 days	None	None
Investment Contracts	N/A	None	None

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Authority manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Information about the sensitivity of the fair values of the Authority's investments (including investments with fiscal agent) to market interest rate fluctuations is provided by the following table that shows the distribution of the Authority's investments by maturity:

<u>Investment Type</u>	<u>Total</u>	<u>Remaining Maturity (in Months)</u>			
		<u>12 Months Or Less</u>	<u>13 to 24 Months</u>	<u>25-60 Months</u>	<u>More Than 60 Months</u>
Equity in City of Gilroy investment pool	\$ 40,765	40,765	-	-	-
LAIF	4,622,213	4,622,213	-	-	-
With fiscal agent:					
Money market funds	<u>1,849,425</u>	-	-	-	<u>1,849,425</u>
Total	<u>\$ 6,512,403</u>	<u>4,662,978</u>	<u>-</u>	<u>-</u>	<u>1,849,425</u>

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

Notes to the Basic Financial Statements

(Continued)

(2) Cash and Investments, (Continued)

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the Authority's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

<u>Investment Type</u>	<u>Total</u>	<u>Minimum Legal Rating</u>	<u>Rating as of Year End</u>		
			<u>AAA</u>	<u>Aa</u>	<u>Not Rated</u>
Equity in City of Gilroy investment pool	\$ 40,765	N/A	-	-	40,765
LAIF	4,622,213	N/A	-	-	4,622,213
With fiscal agent:					
Money market funds	<u>1,849,425</u>	A	<u>1,849,425</u>	-	-
<b>Total</b>	<b><u>\$6,512,403</u></b>		<b><u>1,849,425</u></b>	<b><u>-</u></b>	<b><u>4,662,978</u></b>

Concentration of Credit Risk

The investment policy of the Authority contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of total Authority investments are as follows:

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>
Blackrock	Money market fund (with fiscal agent)	\$ 1,849,425

# SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

## Notes to the Basic Financial Statements

(Continued)

### (2) Cash and Investments, (Continued)

#### Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Authority's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

For investments identified herein as with fiscal agent, the bond trustee selects the investment under the terms of the applicable trust agreement, acquires the investment, and holds the investment on behalf of the reporting government.

#### Investment in State Investment Pool

The Authority is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the Authority's investment in this pool is reported in the accompanying financial statements at amounts based upon the Authority's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis. LAIF is not rated.

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

Notes to the Basic Financial Statements

(Continued)

(3) Capital Assets

Capital asset activity for the year ended June 30, 2011 is as follows:

	<u>Balance at July 1, 2010</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at June 30, 2011</u>
Buildings	\$59,467,241	-	-	59,467,241
Fleet (vehicles)	954,192	51	-	954,243
Office furniture and equipment	11,484,485	14,521	-	11,499,006
Infrastructure	5,490,592	4,337,558	-	9,828,150
Land improvements	<u>10,681,371</u>	<u>-</u>	<u>-</u>	<u>10,681,371</u>
Subtotal	<u>88,077,881</u>	<u>4,352,130</u>	<u>-</u>	<u>92,430,011</u>
Less accumulated depreciation:				
Buildings	(23,343,250)	(1,460,834)	-	(24,804,084)
Fleet (vehicles)	(674,640)	(49,950)	-	(724,590)
Office furniture and equipment	(9,483,633)	(162,922)	-	(9,646,555)
Infrastructure	(2,483,990)	(113,612)	-	(2,597,602)
Land improvements	<u>(3,265,338)</u>	<u>(312,300)</u>	<u>-</u>	<u>(3,577,638)</u>
Total accumulated depreciation	<u>(39,250,851)</u>	<u>(2,099,618)</u>	<u>-</u>	<u>(41,350,469)</u>
Net depreciable assets	48,827,030	2,252,512	-	51,079,542
Capital assets, not depreciated:				
Land	13,396,202	-	-	13,396,202
Construction in progress	<u>4,562,004</u>	<u>7,528,897</u>	<u>(4,337,571)</u>	<u>7,753,330</u>
Capital Assets, net	<u>\$66,785,236</u>	<u>9,678,589</u>	<u>(4,337,571)</u>	<u>72,229,074</u>

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

Notes to the Basic Financial Statements

(Continued)

(4) Long-Term Liabilities

Long-term liability activity for the year ended June 30, 2011 is as follows:

	<u>Balance at July 1, 2010</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at June 30, 2011</u>	<u>Due Within One Year</u>
Bonds payable:					
2002 Series Bonds	<u>\$ 18,100,000</u>	<u>-</u>	<u>1,120,000</u>	<u>16,980,000</u>	<u>1,155,000</u>

(a) Morgan Hill Series 2002

The Authority issued refunding revenue bonds on October 3, 2002 in the amount of \$25,390,000. Interest is payable at rates ranging from 2.0% to 4.5%. The bonds mature in annual principal installments on August 1 of each year beginning in 2003. The outstanding balance at June 30, 2011 was \$16,980,000.

The bonds are secured by an assignment and pledge of installment payments to be made by the City of Morgan Hill pursuant to the Second Amended and Restated Installment Purchase Agreement relating to capacity rights in regional wastewater facilities.

Under terms of the Installment Purchase Agreement, the City of Morgan Hill has incurred an obligation of \$29,904,000 in return for acquiring 41.9% of the capacity rights for the constructed assets.

Covenants within the Installment Purchase Agreement require the City of Morgan Hill to, among other things, maintain insurance on the facility, establish wastewater rates which are sufficient to pay the operating costs and debt service on the bonds and to provide net revenues equal to at least 1.15 times the annual installment payments due. The Authority must maintain a reserve equal to \$1,849,400. As of June 30, 2011, the reserve account balance was \$1,849,425.

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

Notes to the Basic Financial Statements

(Continued)

(4) Long-Term Liabilities, (Continued)

(b) Summary and Reconciliation to Statement of Net Assets

The aforementioned revenue bonds are presented in the accompanying financial statements as follows:

Gross bonds payable	\$16,980,000
Plus unamortized bond premium, net	114,882
Less deferred refunding charge, net	<u>(986,572)</u>
Net bonds payable (total)	16,108,310
Less current principal outstanding	<u>(1,155,000)</u>
Long-term principal outstanding	<u>\$ 14,953,310</u>

(c) Debt Service Requirements to Maturity

Debt service requirements to maturity (including sinking fund installments) on the bonds for future fiscal years are as follows:

<u>Year ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 1,155,000	655,156	1,810,156
2013	1,190,000	617,050	1,807,050
2014	1,235,000	576,100	1,811,100
2015	1,275,000	532,175	1,807,175
2016	1,320,000	483,463	1,803,463
2017	1,375,000	431,281	1,806,281
2018	1,430,000	376,900	1,806,900
2019	1,495,000	316,531	1,811,531
2020	1,560,000	251,613	1,811,613
2021	1,625,000	183,931	1,808,931
2022	1,700,000	111,150	1,811,150
2023	<u>1,620,000</u>	<u>36,450</u>	<u>1,656,450</u>
	<u>\$16,980,000</u>	<u>4,571,800</u>	<u>21,551,800</u>

SUPPLEMENTARY INFORMATION

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY  
Combining Statement of Net Assets  
June 30, 2011

	<u>Debt Service</u>	<u>Plant Construction</u>	<u>Sewage Treatment Operations</u>	<u>Totals</u>	
				<u>2011</u>	<u>2010</u>
<u>Assets</u>					
Current assets:					
Cash held by City of Gilroy	\$ -	-	4,662,978	4,662,978	4,931,480
Accounts receivable	-	-	18,528	18,528	61,678
Due from Gilroy	-	634,827	-	634,827	110,290
Due from Morgan Hill	-	457,820	-	457,820	43,326
Due from other governments	-	160,000	25,574	185,574	6,160
Due from other funds	-	-	722,609	722,609	143,479
Restricted assets:					
Investments - debt service reserve	1,849,425	-	-	1,849,425	1,849,408
Accrued interest on installment sale receivable	280,802	-	-	280,802	294,802
Installment sale receivable - current	1,155,000	-	-	1,155,000	1,120,000
Property, plant and equipment - net	-	7,753,330	64,475,744	72,229,074	66,785,236
Other assets:					
Installment sale receivable	13,975,593	-	-	13,975,593	15,130,592
Debt issuance costs	254,760	-	-	254,760	277,920
Total assets	17,515,580	9,005,977	69,905,433	96,426,990	90,754,371
<u>Liabilities and Equity</u>					
Liabilities:					
Current liabilities:					
Accounts payable	-	530,358	207,408	737,766	231,513
Due to Morgan Hill	-	-	498,191	498,191	630,156
Due to Gilroy	-	-	979,814	979,814	802,016
Due to other funds	-	722,609	-	722,609	143,479
Current liabilities payable from restricted assets:					
Accrued interest payable	280,802	-	-	280,802	294,802
Revenue bonds payable - current	1,155,000	-	-	1,155,000	1,120,000
Noncurrent liabilities:					
Compensated absences	-	-	28,075	28,075	23,369
Revenue bonds payable	14,953,310	-	-	14,953,310	16,029,066
Total liabilities	16,389,112	1,252,967	1,713,488	19,355,567	19,274,401
Net Assets:					
Invested in capital assets	-	7,753,330	64,475,744	72,229,074	66,785,236
Unrestricted	1,126,468	(320)	3,716,201	4,842,349	4,694,734
Total net assets	\$ 1,126,468	7,753,010	68,191,945	77,071,423	71,479,970

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY  
Combining Statement of Revenues, Expenses and Changes in Net Assets  
Year ended June 30, 2011

	Debt Service	Plant Construction	Sewage Treatment Operations	Totals	
				2011	2010
Operating revenues:					
Operating contributions from Gilroy	\$ -	-	3,577,243	3,577,243	3,445,217
Operating contributions from Morgan Hill	-	-	2,801,316	2,801,316	2,697,581
Other charges for services	-	-	66,027	66,027	113,120
<b>Total operating revenues</b>	<b>-</b>	<b>-</b>	<b>6,444,586</b>	<b>6,444,586</b>	<b>6,255,918</b>
Operating expenses:					
Sewage treatment	-	-	5,684,378	5,684,378	5,574,637
Chemical control	-	-	447,660	447,660	433,408
Plant operations	-	-	154,271	154,271	109,249
Depreciation	-	-	2,099,617	2,099,617	2,342,425
<b>Total operating expenses</b>	<b>-</b>	<b>-</b>	<b>8,385,926</b>	<b>8,385,926</b>	<b>8,459,719</b>
<b>Operating income (loss)</b>	<b>-</b>	<b>-</b>	<b>(1,941,340)</b>	<b>(1,941,340)</b>	<b>(2,203,801)</b>
Nonoperating revenues (expenses):					
Interest contributions from Morgan Hill	676,724	-	-	676,724	706,741
Interest contributions from Gilroy	-	-	-	-	545,026
Rental income	-	-	83,975	83,975	87,741
Interest income	10,463	-	22,278	32,741	219,463
Miscellaneous income (loss)	-	109,125	27	109,152	(195,559)
Interest expense and related fees	(509,885)	-	-	(509,885)	(1,787,760)
<b>Total nonoperating revenues (expenses)</b>	<b>177,302</b>	<b>109,125</b>	<b>106,280</b>	<b>392,707</b>	<b>(424,348)</b>
<b>Income (loss) before transfers and capital contributions</b>	<b>177,302</b>	<b>109,125</b>	<b>(1,835,060)</b>	<b>(1,548,633)</b>	<b>(2,628,149)</b>
Interfund transfers and capital contributions:					
Transfers in	-	176,868	4,337,571	4,514,439	324,758
Transfers out	(279,688)	(4,234,751)	-	(4,514,439)	(324,758)
Loss on settlement of debt	-	-	-	-	(2,211,630)
Capital contributions - Gilroy	-	4,148,390	-	4,148,390	385,493
Capital contributions - Morgan Hill	-	2,991,696	-	2,991,696	278,008
<b>Change in net assets</b>	<b>(102,386)</b>	<b>3,191,328</b>	<b>2,502,511</b>	<b>5,591,453</b>	<b>(4,176,278)</b>
<b>Net assets at beginning of year</b>	<b>1,228,854</b>	<b>4,561,682</b>	<b>65,689,434</b>	<b>71,479,970</b>	<b>75,656,248</b>
<b>Net assets at end of year</b>	<b>\$ 1,126,468</b>	<b>7,753,010</b>	<b>68,191,945</b>	<b>77,071,423</b>	<b>71,479,970</b>

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY  
Combining Statement of Cash Flows  
Year ended June 30, 2011

	Debt Service	Plant Construction	Sewage Treatment Operations	Totals	
				2011	2010
Cash flows from operating activities:					
Cash received from system users	\$ -	36,213	6,432,109	6,468,322	6,320,974
Rental income received	-	-	83,975	83,975	87,741
Miscellaneous income (expense)	-	109,125	27	109,152	(195,559)
Cash payments to suppliers for goods and services	-	-	(5,813,503)	(5,813,503)	(5,678,574)
Cash payments to employees for services	-	-	(399,696)	(399,696)	(390,281)
Net cash provided by (used for) operating activities	-	145,338	302,912	448,250	144,301
Cash flows from noncapital financing activities:					
Cash received from other funds	-	-	3,655,621	3,655,621	334,646
Cash paid to other funds	-	(3,655,621)	-	(3,655,621)	(334,646)
Net cash provided by (used for) noncapital financing activities	-	(3,655,621)	3,655,621	-	-
Cash flows from capital and related activities:					
Cash paid for fixed assets	-	(3,014,458)	(4,249,313)	(7,263,771)	(503,291)
Member contributions toward interest	641,724	-	-	641,724	2,531,767
Member contributions toward principal	1,154,999	-	-	1,154,999	26,490,000
Capital contributions	-	6,524,741	-	6,524,741	590,287
Cash paid for settlement of debt	-	-	-	-	(2,211,630)
Interest paid on bonds	(780,414)	-	-	(780,414)	(2,062,099)
Principal paid on bonds	(1,040,756)	-	-	(1,040,756)	(28,098,754)
Net cash provided by (used for) capital and related financing activities	(24,447)	3,510,283	(4,249,313)	(763,477)	(3,263,720)
Cash flows from investing activities:					
Purchase of investments	(17)	-	-	(17)	-
Proceeds from sale of investments	-	-	-	-	2,687,112
Interest received on investments	24,464	-	22,278	46,742	754,593
Net cash provided by (used for) investing activities	24,447	-	22,278	46,725	3,441,705
Net increase (decrease) in cash and cash equivalents	-	-	(268,502)	(268,502)	322,286
Cash and cash equivalents at beginning of year	-	-	4,931,480	4,931,480	4,609,194
Cash and cash equivalents at end of year	\$ -	-	4,662,978	4,662,978	4,931,480

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY  
Combining Statement of Cash Flows  
(Continued)

	<u>Debt Service</u>	<u>Plant Construction</u>	<u>Sewage Treatment Operations</u>	<u>Totals</u>	
				<u>2011</u>	<u>2010</u>
Reconciliation of operating income to net cash provided by operating activities:					
Operating income (loss)	\$ -	-	(1,941,340)	(1,941,340)	(2,203,801)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:					
Depreciation	-	-	2,099,617	2,099,617	2,342,425
Rental income	-	-	83,975	83,975	87,741
Miscellaneous income (loss)	-	109,125	27	109,152	(195,559)
(Increase) decrease in due from other governments	-	-	(19,414)	(19,414)	9,348
(Increase) decrease in accounts receivable	-	36,213	6,938	43,151	55,708
Increase (decrease) in accounts payable	-	-	22,570	22,570	7,038
Increase (decrease) in compensated absences	-	-	4,706	4,706	4,502
Increase (decrease) in due to Morgan Hill	-	-	(131,965)	(131,965)	5,131
Increase (decrease) in due to Gilroy	-	-	177,798	177,798	31,768
	<u>-</u>	<u>-</u>	<u>177,798</u>	<u>177,798</u>	<u>31,768</u>
Total cash provided by (used for) operating activities	<u>\$ -</u>	<u>145,338</u>	<u>302,912</u>	<u>448,250</u>	<u>144,301</u>

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY

Analysis of Available Resources

Year ended June 30, 2011

	<u>Debt Service</u>	<u>Construction</u>	<u>Operations</u>	<u>Totals</u>
Beginning resources available:				
Debt service reserve	\$ 1,849,408	-	-	1,849,408
Operating reserve	-	(10,459)	3,346,092	3,335,633
	<u>1,849,408</u>	<u>(10,459)</u>	<u>3,346,092</u>	<u>5,185,041</u>
Source of funds (working capital):				
Revenues	-	145,338	6,528,561	6,673,899
Interest	10,463	-	22,278	32,741
Member capital contributions	-	7,140,086	-	7,140,086
Member interest contributions	641,724	-	-	641,724
Member principal contributions	1,154,999	-	-	1,154,999
Transfers in	-	-	4,234,751	4,234,751
	<u>1,807,186</u>	<u>7,285,424</u>	<u>10,785,590</u>	<u>19,878,200</u>
Use of funds (working capital):				
Expenses (excluding depreciation)	-	-	6,286,309	6,286,309
Interest incurred	780,414	-	-	780,414
Principal paid	1,040,756	-	-	1,040,756
Capital expenditures incurred	-	3,014,458	4,249,313	7,263,771
Transfers out	-	4,234,751	-	4,234,751
	<u>1,821,170</u>	<u>7,249,209</u>	<u>10,535,622</u>	<u>19,606,001</u>
Adjustments:				
Adjustments for other assets and liabilities (bond discount, etc.)	14,001	(396,114)	(574,393)	(956,506)
	<u>14,001</u>	<u>(396,114)</u>	<u>(574,393)</u>	<u>(956,506)</u>
	<u>17</u>	<u>(359,899)</u>	<u>(324,425)</u>	<u>(684,307)</u>
Ending resources available	<u>\$ 1,849,425</u>	<u>(370,358)</u>	<u>3,021,667</u>	<u>4,500,734</u>
Recap of ending resources:				
Debt service reserve	\$ 1,849,425	-	-	1,849,425
Operating reserve	-	(370,358)	3,021,667	2,651,309
	<u>\$ 1,849,425</u>	<u>(370,358)</u>	<u>3,021,667</u>	<u>4,500,734</u>

SOUTH COUNTY REGIONAL WASTEWATER AUTHORITY  
Composition of Available Resources  
June 30, 2011

	<u>Debt Service</u>	<u>Construction</u>	<u>Sewage Treatment Operations</u>	<u>Totals</u>
Beginning resources available:				
Cash	\$ 1,849,408	-	4,931,480	6,780,888
Receivables	1,414,802	36,213	31,625	1,482,640
Payables	<u>(1,414,802)</u>	<u>(46,672)</u>	<u>(1,617,013)</u>	<u>(3,078,487)</u>
Total beginning resources	<u>\$ 1,849,408</u>	<u>(10,459)</u>	<u>3,346,092</u>	<u>5,185,041</u>
Ending resources available:				
Cash	\$ 1,849,425	-	4,662,978	6,512,403
Receivables	1,435,802	160,000	44,102	1,639,904
Payables	<u>(1,435,802)</u>	<u>(530,358)</u>	<u>(1,685,413)</u>	<u>(3,651,573)</u>
Total ending resources	<u>\$ 1,849,425</u>	<u>(370,358)</u>	<u>3,021,667</u>	<u>4,500,734</u>