

# **South County Regional Wastewater Authority**

Gilroy, California

## **Annual Financial Report**

*For the Year Ended June 30, 2020*





**South County Regional Wastewater Authority**  
**Annual Financial Report**  
**For the Year Ended June 30, 2020**

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**SOUTH COUNTY REGIONAL  
WASTEWATER AUTHORITY**

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February 1, 2021

To the Honorable Members of the SCRWA Board, and Citizens of Gilroy and Morgan Hill:

The South County Regional Wastewater Authority Joint Powers Agreement requires that the Authority publish a complete set of audited financial statements for each fiscal year. This report is published to fulfill that requirement for the fiscal year ended June 30, 2020. This financial report is submitted for your information and review. The information contained herein has been provided to allow the reader to gain an understanding of the Authority's financial activities. Management assumes full responsibility for the completeness and reliability of the information contained in this report. The Management Discussion and Analysis (MD&A) is included to assist the reader in its review of the Authority's financial statements. It provides a roadmap for the financial statements and related notes.

To provide a reasonable basis for making these representations, management of the Authority has established a comprehensive framework of internal controls that is designed to both protect the Authority's assets from loss, theft or misuse and to compile sufficient reliable information for the preparation of the Authority's financial statements in conformity with U.S. Generally Accepted Accounting Principles (GAAP). Because the cost of internal controls should not outweigh their benefits, the Authority's comprehensive framework of internal controls has been designed to provide reasonable, rather than absolute assurance that the financial statements will be free from material misstatements. Management is committed to maintaining the Authority's internal controls to adequately safeguard assets; and to provide reasonable assurances of proper recording of financial transactions.

The Pun Group LLP, Certified Public Accountants, have issued an unmodified ("clean") opinion on the authority's financial statements for the year ended June 30, 2020. The independent auditor's report is located at the front of the financial section of this report. The MD&A immediately follows the independent auditor's report and provides a narrative introduction, overview, and analysis of the basic financial statements. The MD&A complements this letter of transmittal and should be read in conjunction.

***Profile of the Authority***

The SCRWA is a joint powers authority of the cities of Gilroy and Morgan Hill. Formed in 1992 the Authority serves both cities treating approximately 2.2 - 2.4 billion gallons of wastewater and producing 700-720 million gallons of recycled wastewater each year for use in landscaping, agricultural, industrial and other applications. The Authority is governed by a five (5) member board of directors consisting of city council members from each member agency; three (3) members from the City of Gilroy and two (2) members from the City of Morgan Hill. The City of Gilroy provides administrative oversight and staffing services to the SCRWA with the Gilroy City Administrator serving as the SCRWA General Manager.

General administrative oversight includes, but is not limited to, contract negotiation and administration, financial management, public works services, capital project management, budget preparation, insurance administration, and chemical control services. The SCRWA daily operations are provided under a third- party contract with Jacobs Engineering Group.

### ***Fiscal Year 2020 (FY 20) Financial Results***

The Authority ended FY 20 with an operating loss of \$3.6 million, which is a decrease from the prior years' loss of \$4.0 million. Losses are primarily due to depreciation of fixed assets and an increase in sewage treatment costs. The Authority had some capital projects that were not completed in FY 20 and the expenditures will be carried forward to FY 21.

### ***Acknowledgements***

The preparation of this report would not have been possible without the skill, diligence, and commitment of the entire staff of the City of Gilroy Finance Department, and specifically Finance Manager Rosemary Guerrero. We wish to thank all government departments for their assistance in providing the data necessary to prepare this report. Credit also is due to the Authority Board for their continuing support for maintaining the highest standards of professionalism in the management of Gilroy's finances and prioritizing the goal of financial sustainability.

Respectfully submitted,



Jimmy Forbis  
Authority General Manager



## INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
of the South County Regional Wastewater Authority  
Gilroy, California

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the South County Regional Wastewater Authority (the "Authority"), as of June 30, 2020 and for the year then ended, and the related notes to the basic financial statements as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Authority's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***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, 2020 and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Directors  
of the South County Regional Wastewater Authority  
Gilroy, California  
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***Other Matters***

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis identified as Required Supplementary Information (RSI) in the accompanying table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the RSI in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the RSI because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Other Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Authority's basic financial statements. The introductory section, combining statements and additional schedules, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining statements are fairly stated in all material respects in relation to the basic financial statements as a whole.

The introductory section and additional schedules have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

*The PwC Group, LLP*

Santa Ana, California  
February 1, 2021

**South County Regional Wastewater Authority  
Management's Discussion and Analysis (Unaudited)  
For the Year Ended June 30, 2020**

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The following discussion and analysis of the financial performance of the South County Regional Wastewater Authority (SCRWA) provides an overview of the Authority's financial activities for the fiscal year ended June 30, 2020 (FY 20). Please read it in conjunction with the financial statements identified in the accompanying table of contents.

Using the Accompanying Financial Statements

This annual report consists of a series of financial statements. The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position provide information about the activities of the Authority and present a longer-term view of the Authority's finances.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

**BACKGROUND AND OVERVIEW**

The SCRWA is a joint powers authority of the City of Gilroy and City of Morgan Hill. Formed in 1992, the Authority serves both cities treating approximately 2.2 - 2.4 billion gallons of wastewater and producing 700-720 million gallons of recycled wastewater each year for use in landscaping, agricultural, industrial and other applications. The Authority is governed by a five (5) member board of directors consisting of city council members from each member agency; three (3) members from the City of Gilroy and two (2) members from the City of Morgan Hill. The City of Gilroy provides administrative oversight and staffing services to the SCRWA with the Gilroy City Administrator serving as the SCRWA General Manager. General administrative oversight includes, but is not limited to, contract negotiation and administration, financial management, public works services, capital project management, budget preparation, insurance administration, and chemical control services. The SCRWA daily operations are provided under a third-party contract with Jacobs Engineering Group.

**ACCOUNTING STANDARDS**

The Authority's financial statements are prepared in accordance with the accounting principles established by the Government Accounting Standards Board (GASB).

**South County Regional Wastewater Authority  
Management's Discussion and Analysis (Unaudited) (Continued)  
For the Year Ended June 30, 2020**

**FINANCIAL HIGHLIGHTS**

The Authority's overall financial position decreased by \$946K during Fiscal Year 2020 (FY 20). Total liabilities decreased by \$127K to \$2.8 million due to an increase in retentions payable and monies owed to agency members. Total assets decreased by \$1.1 million, providing the Authority with total assets of \$108.0 million.

Operating revenues increased by \$216K from FY 19, while operating expenses increased by \$375K from the prior fiscal year, which resulted in an operating loss of approximately \$159K more than the prior year due to additional amounts of \$346K in sewage treatment costs while offset by an increase in \$216K in operating revenue.

**Statements of Net Position**

	Statement of Net Position		
	2020	2019	Change
Cash and investments	\$ 11,582	\$ 10,875	\$ 707
Capital assets	96,423	98,203	(1,780)
Total assets	<u>108,005</u>	<u>109,078</u>	<u>(1,073)</u>
Long-term liabilities outstanding	2,758	2,885	(127)
Other liabilities	11	11	-
Total liabilities	<u>2,769</u>	<u>2,896</u>	<u>(127)</u>
Net Position			
Investment in capital assets	96,423	98,203	(1,780)
Unrestricted	8,813	7,979	834
Total Net Position	<u>\$ 105,236</u>	<u>\$ 106,182</u>	<u>\$ (946)</u>

- In 2020, total assets decreased \$1.1 million to \$108.0 million. Current assets increased \$707K to a total of \$11.6 million; and capital net assets decreased \$1.8 million to \$96.4 million.
- Current liabilities decreased, \$127K over the prior year to \$2.8 million.
- There was no change in non-current liabilities compared to the prior year.

**South County Regional Wastewater Authority  
Management's Discussion and Analysis (Unaudited) (Continued)  
For the Year Ended June 30, 2020**

**Statements of Revenues, Expenses, and Changes in Net Position**

	<u>2020</u>	<u>2019</u>	<u>Change</u>
<b>OPERATING REVENUES</b>			
Operating contributions from City of Gilroy	\$ 5,507	\$ 5,718	\$ (211)
Operating contributions from City of Morgan Hill	3,438	3,169	269
Other charges for services	340	182	158
Total operating revenue	<u>9,285</u>	<u>9,069</u>	<u>216</u>
<b>OPERATING EXPENSES</b>			
Sewage treatment	8,233	7,887	346
Pretreatment program	616	547	69
Plant operations	182	217	(36)
Depreciation and amortization	4,459	4,464	(5)
Total operating expenses	<u>13,490</u>	<u>13,115</u>	<u>375</u>
Operating income	<u>(4,205)</u>	<u>(4,046)</u>	<u>(159)</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>			
Interest income	175	175	-
Rental income	90	85	5
Miscellaneous expense	304	(220)	524
Total nonoperating revenues (expenses)	<u>569</u>	<u>40</u>	<u>529</u>
Loss before Capital Contributions	<u>(3,636)</u>	<u>(4,006)</u>	<u>370</u>
<b>CAPITAL CONTRIBUTIONS</b>			
Capital contribution from City of Gilroy	1,577	2,788	(1,212)
Capital contribution from City of Morgan Hill	1,113	1,972	(858)
Total Capital Contribution	<u>2,690</u>	<u>4,760</u>	<u>(2,070)</u>
Change in net position	<u>(946)</u>	<u>754</u>	<u>(1,700)</u>
<b>NET POSITION</b>			
Beginning of year	<u>106,182</u>	<u>105,428</u>	<u>754</u>
End of year	<u>\$ 105,236</u>	<u>\$ 106,182</u>	<u>\$ (946)</u>

- Total operating revenues for FY 20 increased \$216K from FY 19 to \$9.3 million.
- Total operating expenses in FY 20 were \$13.5 million, which is an increase of \$375K from FY 19.
- Current year operating activity produced an operating loss of \$3.6 million which is an increase from the prior years' loss of \$4.0 million. Losses are primarily due to an increase in sewage treatment costs.
- Total non-operating revenues were \$569K in FY 20.
- The Authority's decrease in net position was \$946,000 for FY 20, a decrease from \$106.2 million in FY 19 to \$105.2 million in FY 20.

**South County Regional Wastewater Authority  
Management's Discussion and Analysis (Unaudited) (Continued)  
For the Year Ended June 30, 2020**

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**Statement of Cash Flows**

A summary of the Authority's statements of cash flows for FY 20 is presented below.

	<u>FY 2020</u>
Cash flows from operating activities	\$ 1,407
Cash flows used for capital and related financing activities	181
Cash flows used for investing activities	<u>175</u>
<b>Net change in cash</b>	<b>1,763</b>
Cash and investments - beginning of year	<u>8,172</u>
Cash and investments - end of year	<u><u>\$ 9,935</u></u>

**Capital Assets**

At the end of FY 20, the Authority had investment in capital assets of \$96.4 million, a decrease of \$1.8 million from FY 19.

**Long-Term Debt**

The Authority possesses no long-term debt as debt for SCRWA-related activities are stated as part of each member's financial statements.

**Contacting the Authority's Financial Management**

This financial report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the Authority's finances and to show the Authority's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Authority Treasurer, at the City of Gilroy, 7351 Rosanna Street, Gilroy, California 95020.

## **BASIC FINANCIAL STATEMENTS**

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**South County Regional Wastewater Authority**  
**Statement of Net Position**  
**June 30, 2020**

**ASSETS**

**Current Assets:**

Cash and investments (Note 2)	\$ 9,935,263
Accounts receivable, net	150,566
Due from City of Gilroy	576,445
Due from City of Morgan Hill	399,512
Due from other governments	29,608
	29,608
Total current assets	11,091,394

**Noncurrent Assets:**

**Capital assets (Note 3)**

Buildings and improvements	72,223,230
Land improvements	10,681,371
Infrastructure	35,649,317
Fleet (vehicles)	1,295,492
Office furniture, fixtures and equipment	19,964,163
	19,964,163
Subtotal	139,813,573
Less: accumulated depreciation	(68,497,881)
	71,315,692
Total capital assets being depreciated, net	71,315,692
Land	13,396,202
Construction in progress	11,711,219
	11,711,219
Total capital assets, net	96,423,113
<b>TOTAL ASSETS</b>	<b>107,514,507</b>

**LIABILITIES**

**Current Liabilities:**

Accounts payable and accrued liabilities	583,601
Due to City of Gilroy	1,044,367
Due to City of Morgan Hill	640,096
	640,096
Total current liabilities	2,268,064

**Noncurrent Liabilities:**

Compensated absences, due in more than one year	10,840
	10,840
Total noncurrent liabilities	10,840
<b>TOTAL LIABILITIES</b>	<b>2,278,904</b>

**NET POSITION**

Investment in capital assets	96,423,113
Unrestricted	8,812,490
	8,812,490
<b>TOTAL NET POSITION</b>	<b>\$ 105,235,603</b>

**South County Regional Wastewater Authority**  
**Statement of Revenues, Expenses, and Changes in Net Position**  
**For the Year Ended June 30, 2020**

**OPERATING REVENUES:**

Operating contributions from City of Gilroy	\$ 5,506,763
Operating contributions from City of Morgan Hill	3,438,016
Other charges for services	340,395
	9,285,174
Total operating revenue	9,285,174

**OPERATING EXPENSES:**

Sewage treatment	8,233,254
Pretreatment program	616,405
Plant operations	181,590
Depreciation	4,458,785
	13,490,034
Total operating expenses	13,490,034
Operating (loss)	(4,204,860)

**NONOPERATING REVENUES (EXPENSES):**

Rental income	90,000
Interest income	175,284
Miscellaneous income	303,880
	569,164
Total nonoperating revenues (expenses)	569,164
Loss before Capital Contributions	(3,635,696)

**CAPITAL CONTRIBUTIONS:**

Capital contribution from City of Gilroy	1,576,500
Capital contribution from City of Morgan Hill	1,113,486
	2,689,986
Total Capital Contribution	2,689,986
<b>Change in net position</b>	<b>(945,710)</b>

**NET POSITION:**

Beginning of year	106,181,313
	106,181,313
End of year	\$ 105,235,603

**South County Regional Wastewater Authority**  
**Statement of Cash Flows**  
**For the Year Ended June 30, 2020**

<b>Cash Flows from Operating Activities:</b>	
Cash received from system users	\$ 10,830,145
Rental income received	90,000
Miscellaneous income	303,880
Cash payments to suppliers for goods and services	(9,367,881)
Cash payments to employees for services	(448,702)
	1,407,442
Net cash provided by operating activities	1,407,442
<b>Cash Flows from Noncapital Financing Activities:</b>	
Cash received from other funds	6,533,665
Cash paid to other funds	(6,363,855)
	169,810
Net cash provided by noncapital financing activities	169,810
<b>Cash Flows From Capital and Related Financing Activities:</b>	
Cash transferred (paid) for capital assets	(2,679,252)
Capital contributions	2,689,986
	10,734
Net cash provided by capital and related financing activities	10,734
<b>Cash Flows from Investing Activities</b>	
Interest on investments	175,284
	175,284
Net cash provided by investing activities	175,284
Net change in cash and cash equivalents	1,763,270
<b>Cash and Cash Equivalents:</b>	
Beginning of year	8,171,993
End of year	\$ 9,935,263
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities:</b>	
Operating (loss)	\$ (4,204,860)
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	4,458,785
Rental income	90,000
Miscellaneous income	303,880
Changes in assets and liabilities:	
(Increase) decrease in accounts receivable	(108,400)
(Increase) decrease in due from City of Gilroy	945,716
(Increase) decrease in due from City of Morgan Hill	694,088
(Increase) decrease in due from other governments	13,567
(Increase) decrease in prepaid expenses	1,640
Increase (decrease) in accounts payable	(807,377)
Increase (decrease) in accrued liabilities	20,909
Increase (decrease) in compensated absences	(506)
	5,612,302
Total adjustments	5,612,302
<b>Net cash provided by operating activities</b>	<b>\$ 1,407,442</b>

See accompanying Notes to the Basic Financial Statements.

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**NOTES TO THE BASIC FINANCIAL STATEMENTS**

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**South County Regional Wastewater Authority**  
**Notes to the Basic Financial Statements**  
**For the Year Ended June 30, 2020**

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**Note 1 – Reporting Entity and Significant Accounting Policies**

The financial statements of the South County Regional Wastewater Authority (the Authority) have been prepared in accordance 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.

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. The current agreement terminates the joint power agreement entered into in 1979 (the Agreement of 1979). 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 the Authority 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 Position, the Statement of Revenues, Expenses and Changes in Net Position, the Statement of Cash Flows and the notes to the basic financial statements.

**C. Measurement Focus and Basis of Accounting**

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.

**South County Regional Wastewater Authority**  
**Notes to the Basic Financial Statements (Continued)**  
**For the Year Ended June 30, 2020**

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**Note 1 – Reporting Entity and Significant Accounting Policies (Continued)**

**C. Measurement Focus and Basis of Accounting (Continued)**

The Authority distinguishes operating revenues and expenses from nonoperating 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 contributions from Member Agencies. Operating expenses include cost of services, general and administrative expenses and depreciation of capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Net position of the Authority has been reported as restricted when its use is constrained more narrowly than the reporting unit in which it is reported as a result of state laws governing such use. When both restricted and unrestricted resources are available for use, the Authority uses restricted resources first, then unrestricted 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. Implementation of New GASB Pronouncements**

During fiscal year ended June 30, 2020, the Authority has implemented the following new GASB Pronouncement:

**GASB Statement No. 95** – In May 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*. The primary objective of this Statement is to provide temporary relief to governments and other stakeholders in light of the COVID-19 pandemic. That objective is accomplished by postponing the effective dates of certain provisions in Statements and Implementation Guides that first became effective or are schedule to become effective for periods beginning after June 15, 2018, and later. Application of this statement is effective immediately and did not have a material effect on the Authority's financial statements for the fiscal year ending June 30, 2020

**E. Cash and investments**

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.

Investments are reported in the accompanying Statement of Net Position at fair value.

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. Interest income includes interest earnings and any gains or losses realized upon the liquidation or sale of investments.

**F. Balances Due To/From Member Agencies**

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

**South County Regional Wastewater Authority**  
**Notes to the Basic Financial Statements (Continued)**  
**For the Year Ended June 30, 2020**

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**Note 1 – Reporting Entity and Significant Accounting Policies (Continued)**

**G. Capital Assets**

Property, plant and equipment purchases greater than \$10,000 are capitalized at original acquisition cost or estimated acquisition cost. Donated capital assets are recorded at their estimated fair market value at the date of donation. Capital 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:

Buildings	40 years
Machinery and equipment	5 - 25 years
Furniture and fixtures	10 - 20 years
Vehicles	8 years
Treatment plant	40 years
Sewer lines	50 years
Land improvements	50 years

**H. Net Position**

In the government-wide financial statements and proprietary fund financial statements, net position is classified as follows:

**Investment in Capital Assets** – This component of net position consists of capital assets, net of accumulated depreciation.

**Unrestricted** – This component of net position is the amount of the assets and liabilities that are not included in the determination of investment in capital assets.

**I. 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 nonmember users.

**J. 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.

**K. Use of Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that effect certain reported amounts and disclosures. Accordingly, actual results could differ from the estimates.

**South County Regional Wastewater Authority**  
**Notes to the Basic Financial Statements (Continued)**  
**For the Year Ended June 30, 2020**

**Note 2 – Cash and Investments**

The City maintains a cash and investment pool, which includes cash balances and authorized investments of all funds.

Cash and investments as of June 30, 2020 are classified in the accompanying financial statements as follows:

Statement of Net Position:

Current Assets:

Cash and cash equivalents	\$ 9,935,263
Investments	-
Total cash and investments	<u>\$ 9,935,263</u>

Cash and investments as of June 30, 2020 consisted of the following:

Current Assets:

Equity in City of Gilroy investment pool	\$ 71,433
Local Agency Investment Fund	<u>9,863,830</u>
Total cash and investments	<u>\$ 9,935,263</u>

**A. 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.

Investment Type	Authorized Policy	Maximum Maturity*	Maximum Portfolio*	Maximum One Issuer*
Local Agency Bonds	No	5 years	None	None
U.S. Treasury Obligations	Yes	2 years	None	None
U.S. Government Sponsored				
Agency Securities	Yes	5 years	None	None
Banker's Acceptances	Yes	180 days	15%	30%
Commercial Paper	Yes	270 days	10%	10%
Negotiable Certificates of Deposit	Yes	2 years	15%	None
Repurchase Agreements	No	1 year	None	None
Reverse Repurchase Agreements	No	92 days	20% base value	None
Medium-Term Notes	No	5 years	30%	None
Mutual Funds	Yes	N/A	5%	10%
Money Market Mutual Funds	Yes	N/A	5%	10%
Mortgage Pass-Through Securities	No	5 years	20%	None
County Pooled Investment Funds	No	N/A	None	None
Local Agency Investment Fund (LAIF)	Yes	N/A	None	None
JPA Pools (other investment pools)	No	N/A	None	None

Liquidity:

\*Securities or bonds purchased under a prior investment policy may be held or sold but additional purchases shall not be made.

N/A - Not applicable

**South County Regional Wastewater Authority**  
**Notes to the Basic Financial Statements (Continued)**  
**For the Year Ended June 30, 2020**

**Note 2 – Cash and Investments (Continued)**

**B. 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 to market interest rate fluctuations is provided by the following table that shows the distribution of the Authority’s investments by maturity:

Investment Type	Remaining Maturity 12 Months or Less June 30, 2020
Equity in City of Gilroy investment pool	\$ 71,433
Local Agency Investment Fund	9,863,830
Total	\$ 9,935,263

**C. 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, or the Authority’s investment policy, and the actual rating by Standard & Poor’s as of year-end for each investment type.

Investment Type	Minimum Legal Rating	Total as of June 30, 2020	Not Rated
Equity in City of Gilroy investment pool	N/A	\$ 71,433	\$ 71,433
Local Agency Investment Fund	N/A	9,863,830	9,863,830
Total		\$ 9,935,263	\$ 9,935,263

**D. 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. There are no 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.

**South County Regional Wastewater Authority**  
**Notes to the Basic Financial Statements (Continued)**  
**For the Year Ended June 30, 2020**

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**Note 2 – Cash and Investments (Continued)**

***E. 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 Authority deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

***F. Investment in State Investment Pool***

The Authority is a voluntary participant in the Local Agency Investment Fund ("LAIF") that is regulated by California Government Code Section 16429 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. The Authority's investments in LAIF at June 30, 2020 included a portion of pool funds invested in Structured Notes and Asset-Backed Securities.

*Structured Notes:* debt securities (other than asset-backed securities) whose cash flow characteristics (coupon rate, redemption amount, or stated maturity) depend upon one or more indices and/or that have embedded forwards or options.

*Asset-Backed Securities:* generally, mortgage-backed securities that entitle their purchasers to receive a share of the cash flows from a pool of assets such as principal and interest repayments from a pool of mortgages (for example, Collateralized Mortgage Obligations) or credit card receivables.

As of June 30, 2020, the Authority had \$9,863,830 invested in LAIF, which had invested 3.37% of the pool investment funds in Structured Notes and Asset-Backed Securities.

***G. Equity in Cash and Investment Pool of the City of Gilroy***

The Authority does not have a separate bank account; however, the Authority's cash and investments are maintained in an investment pool managed by the City. The Authority is a voluntary participant in that pool. This pool is governed by and under the regulatory oversight of the Investment Policy adopted by the City Council of the City. 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 calculated by the City for the entire City portfolio. The balance available for withdrawal is based on the accounting records maintained by the City, which are recorded on an original cost basis. At June 30, 2020, the Authority had a cash balance of \$71,433.

**South County Regional Wastewater Authority**  
**Notes to the Basic Financial Statements (Continued)**  
**For the Year Ended June 30, 2020**

**Note 2 – Cash and Investments (Continued)**

**H. Fair Value Measurements**

The Authority categorizes its fair value measurement within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the assets. Level 1 inputs are quoted prices in active markets for identical assets, Level 2 inputs are quoted prices for similar assets in active markets (significant other observable inputs) and Level 3 inputs are significant unobservable inputs.

The Authority’s investments in Equity in City of Gilroy investment pool and LAIF are not subject to the fair value measurement hierarchy.

**Note 3 – Capital Assets**

The following is a summary of changes in capital assets for the governmental activities for the year ended June 30, 2020:

	Balance July 1, 2019	Additions	Deletions	Reclassification	Balance June 30, 2020
<i>Capital assets not being depreciated:</i>					
Land	\$ 13,396,202	\$ -	\$ -	\$ -	\$ 13,396,202
Construction in progress	13,791,603	2,647,983	-	(4,728,367)	11,711,219
Total capital assets not being depreciated	<u>27,187,805</u>	<u>2,647,983</u>	<u>-</u>	<u>(4,728,367)</u>	<u>25,107,421</u>
<i>Capital assets being depreciated:</i>					
Buildings and improvements	67,494,863	-	-	4,728,367	72,223,230
Land improvements	10,681,371	-	-	-	10,681,371
Infrastructure	35,618,048	31,269	-	-	35,649,317
Fleet (Vehicles)	1,295,492	-	-	-	1,295,492
Office furniture, fixtures and equipment	19,964,163	-	-	-	19,964,163
Total capital assets being depreciated	<u>135,053,937</u>	<u>31,269</u>	<u>-</u>	<u>4,728,367</u>	<u>139,813,573</u>
<i>Less accumulated depreciation for:</i>					
Buildings and improvements	(37,924,692)	(1,595,406)	-	-	(39,520,098)
Land improvements	(5,527,237)	(190,342)	-	-	(5,717,579)
Infrastructure	(6,147,129)	(1,639,300)	-	-	(7,786,429)
Fleet (Vehicles)	(1,073,365)	(34,759)	-	-	(1,108,124)
Office furniture, fixtures and equipment	(13,366,673)	(998,978)	-	-	(14,365,651)
Total accumulated depreciation	<u>(64,039,096)</u>	<u>(4,458,785)</u>	<u>-</u>	<u>-</u>	<u>(68,497,881)</u>
Total capital assets being depreciated, net	<u>71,014,841</u>	<u>(4,427,516)</u>	<u>-</u>	<u>4,728,367</u>	<u>71,315,692</u>
<b>Total capital assets</b>	<u>\$ 98,202,646</u>	<u>\$ (1,779,533)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 96,423,113</u>

Depreciation expense was \$4,458,785 for the year ended June 30, 2020.

**South County Regional Wastewater Authority**  
**Notes to the Basic Financial Statements (Continued)**  
**For the Year Ended June 30, 2020**

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**Note 4 – Commitments and Contingencies**

*Litigation*

Legal claims and lawsuits arise from time to time in the normal course of business which, in the opinion of management, will have no material effect on the Authority's financial position.

*COVID-19*

In December 2019, a novel strain of coronavirus has spread around the world resulting in business and social disruption. The coronavirus was declared a Public Health Emergency of International Concern by the World Health Organization on January 30, 2020. The operations and business results of the Fund could potentially be adversely affected by this global pandemic. The extent to which the coronavirus may impact business activity or investment results will depend on future developments, which are highly uncertain and cannot be predicted, including new information which may emerge concerning the severity of the coronavirus and the actions required to contain the coronavirus. The ultimate financial impact and duration cannot be estimated at this time.

**Note 5 – Insurance**

The Authority is owned by the City of Gilroy and the City of Morgan Hill, but operated by a third-party contractor, currently CH2MHill. The contract for services with CH2MHill requires that CH2MHill provide general liability (\$5M per occurrence), auto liability (\$5M per accident), employer's liability (\$5M per accident) professional liability/errors and omissions (\$5M per occurrence), pollution/environmental impairment liability insurance (\$5M per occurrence) and workers' compensation coverage (State of CA mandated coverage) for the operation of the facility. The City of Gilroy, through its coverage with the Municipal Pooling Authority, purchases property coverage for the SCRWA facility. Property coverage is through Alliant Property Insurance Program (APIP). Appraisals of the SCRWA facility were completed in March 2018 to document the property values. The general property insurance coverage amount is \$1B per occurrence up to the insurable value. The flood limit is \$25M. Business interruption coverage is \$100M.

Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three years.

**SUPPLEMENTARY INFORMATION**

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**South County Regional Wastewater Authority**  
**Combining Statement of Net Position**  
**June 30, 2020**

	Plant Construction	Sewage Treatment Operations	Totals
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash and investments	\$ -	\$ 9,935,263	\$ 9,935,263
Accounts receivable, net	-	150,566	150,566
Due from City of Gilroy	426,788	149,657	576,445
Due from City of Morgan Hill	307,787	91,725	399,512
Due from other governments	-	29,608	29,608
Due from other fund	-	490,148	490,148
Total current assets	<u>734,575</u>	<u>10,846,967</u>	<u>11,581,542</u>
<b>Noncurrent Assets:</b>			
Capital assets			
Buildings and improvements	-	72,223,230	72,223,230
Land improvements	-	10,681,371	10,681,371
Infrastructure	-	35,649,317	35,649,317
Fleet (vehicles)	-	1,295,492	1,295,492
Office furniture, fixtures and equipment	-	19,964,163	19,964,163
Subtotal	-	139,813,573	139,813,573
Less: accumulated depreciation	-	(68,497,881)	(68,497,881)
Total capital assets being depreciated, net	-	71,315,692	71,315,692
Land	-	13,396,202	13,396,202
Construction in progress	10,415,322	1,295,897	11,711,219
<b>Total capital assets, net</b>	<u>10,415,322</u>	<u>86,007,791</u>	<u>96,423,113</u>
<b>TOTAL ASSETS</b>	<u>11,149,897</u>	<u>96,854,758</u>	<u>108,004,655</u>
<b>LIABILITIES</b>			
<b>Current Liabilities:</b>			
Accounts payable and accrued liabilities	266,434	317,167	583,601
Due to City of Gilroy	-	1,044,367	1,044,367
Due to City of Morgan Hill	-	640,096	640,096
Due to other funds	490,148	-	490,148
Total current liabilities	<u>756,582</u>	<u>2,001,630</u>	<u>2,758,212</u>
<b>Noncurrent Liabilities:</b>			
Compensated absences, due in more than one year	-	10,840	10,840
Total noncurrent liabilities	-	10,840	10,840
<b>TOTAL LIABILITIES</b>	<u>756,582</u>	<u>2,012,470</u>	<u>2,769,052</u>
<b>NET POSITION</b>			
Investment in capital assets	10,415,322	86,007,791	96,423,113
Unrestricted (deficit)	(22,007)	8,834,497	8,812,490
<b>TOTAL NET POSITION</b>	<u>\$ 10,393,315</u>	<u>\$ 94,842,288</u>	<u>\$ 105,235,603</u>

**South County Regional Wastewater Authority**  
**Combining Statement of Revenues, Expenses, and Changes in Net Position**  
**For the Year Ended June 30, 2020**

	Plant Construction	Sewage Treatment Operations	Totals
<b>OPERATING REVENUES</b>			
Operating contributions from City of Gilroy	\$ -	\$ 5,506,763	\$ 5,506,763
Operating contributions from City of Morgan Hill	-	3,438,016	3,438,016
Other charges for services	-	340,395	340,395
Total operating revenue	-	9,285,174	9,285,174
<b>OPERATING EXPENSES</b>			
Sewage treatment	-	8,233,254	8,233,254
Pretreatment program	-	616,405	616,405
Plant operations	-	181,590	181,590
Depreciation	-	4,458,785	4,458,785
Total operating expenses	-	13,490,034	13,490,034
Operating loss	-	(4,204,860)	(4,204,860)
<b>NONOPERATING REVENUES (EXPENSES)</b>			
Interest income	-	175,284	175,284
Rental income	-	90,000	90,000
Miscellaneous income	172,264	131,616	303,880
Total nonoperating revenues (expenses)	172,264	396,900	569,164
Loss before Capital Contributions	172,264	(3,807,960)	(3,635,696)
<b>CAPITAL CONTRIBUTIONS</b>			
Capital contribution from City of Gilroy	1,360,010	216,490	1,576,500
Capital contribution from City of Morgan Hill	980,799	132,687	1,113,486
Transfers in	-	4,759,635	4,759,635
Transfers out	(4,759,635)	-	(4,759,635)
Total Capital Contribution	(2,418,826)	5,108,812	2,689,986
Change in net position	(2,246,562)	1,300,852	(945,710)
<b>NET POSITION</b>			
Beginning of year	12,639,877	93,541,436	106,181,313
End of year	\$ 10,393,315	\$ 94,842,288	\$ 105,235,603

**South County Regional Wastewater Authority**  
**Combining Statement of Cash Flows**  
**For the Year Ended June 30, 2020**

	Plant Construction	Sewage Treatment Operations	Totals
<b>Cash Flows from Operating Activities:</b>			
Cash received from system users	\$ 1,846,343	\$ 8,983,802	\$ 10,830,145
Rental income received	-	90,000	90,000
Miscellaneous income (expense)	172,264	131,616	303,880
Cash payments to suppliers for goods and services	(425,122)	(8,942,759)	(9,367,881)
Cash payments to employees for services	-	(448,702)	(448,702)
Net cash provided by (used in) operating activities	<u>1,593,485</u>	<u>(186,043)</u>	<u>1,407,442</u>
<b>Cash Flows from Noncapital Financing Activities:</b>			
Cash received from other funds	-	6,533,665	6,533,665
Cash paid to other funds	(6,363,855)	-	(6,363,855)
Net cash provided by (used in) noncapital financing activities	<u>(6,363,855)</u>	<u>6,533,665</u>	<u>169,810</u>
<b>Cash Flows From Capital and Related Financing Activities:</b>			
Cash transferred (paid) for capital assets	2,429,561	(5,108,813)	(2,679,252)
Capital contributions	2,340,809	349,177	2,689,986
Net cash provided by (used in) capital and related financing activities	<u>4,770,370</u>	<u>(4,759,636)</u>	<u>10,734</u>
<b>Cash Flows from Investing Activities</b>			
Interest on investments	-	175,284	175,284
Net cash provided by investing activities	<u>-</u>	<u>175,284</u>	<u>175,284</u>
<b>Net change in cash and cash equivalents</b>	<u>-</u>	<u>1,763,270</u>	<u>1,763,270</u>
<b>Cash and Cash Equivalents:</b>			
Beginning of year	-	8,171,993	8,171,993
End of year	<u>\$ -</u>	<u>\$ 9,935,263</u>	<u>\$ 9,935,263</u>
<b>Reconciliation of Operating (loss) to Net Cash Provided by (Used in) Operating Activities:</b>			
Operating (loss)	\$ -	\$ (4,204,860)	\$ (4,204,860)
Adjustments to reconcile operating (loss) to net cash provided (used in) by operating activities:			
Depreciation	-	4,458,785	4,458,785
Rental income	-	90,000	90,000
Miscellaneous income	172,264	131,616	303,880
Changes in assets and liabilities:			
(Increase) decrease in accounts receivable	-	(108,400)	(108,400)
(Increase) decrease in due from City of Gilroy	1,072,725	(127,009)	945,716
(Increase) decrease in due from City of Morgan Hill	773,618	(79,530)	694,088
(Increase) decrease in due from other governments	-	13,567	13,567
(Increase) decrease in prepaid expenses	-	1,640	1,640
Increase (decrease) in accounts payable	(425,122)	(382,255)	(807,377)
Increase (decrease) in accrued liabilities	-	20,909	20,909
Increase (decrease) in compensated absences	-	(506)	(506)
Total adjustments	<u>1,593,485</u>	<u>4,018,817</u>	<u>5,612,302</u>
<b>Net cash provided by (used in) operating activities</b>	<u>\$ 1,593,485</u>	<u>\$ (186,043)</u>	<u>\$ 1,407,442</u>

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## **ADDITIONAL SCHEDULES**

**South County Regional Wastewater Authority**  
**Analysis of Available Resources**  
**For the Year Ended June 30, 2020**

	Plant Construction	Sewage Treatment Operations	Totals
<b>BEGINNING RESOURCES AVAILABLE:</b>			
Operating revenue	\$ (205,006)	\$ 8,195,019	\$ 7,990,013
<b>Total beginning resources</b>	<b>(205,006)</b>	<b>8,195,019</b>	<b>7,990,013</b>
<b>Source of Funds:</b>			
Revenues	-	9,285,174	9,285,174
Rental income	-	90,000	90,000
Miscellaneous income	-	131,616	131,616
Investment income	-	175,284	175,284
Member capital contributions	(2,418,826)	5,108,812	2,689,986
<b>Total sources</b>	<b>(2,418,826)</b>	<b>14,790,886</b>	<b>12,372,060</b>
<b>Use of Funds:</b>			
Expenses (excluding depreciation)	(172,264)	9,031,249	8,858,985
Capital expenditures incurred	-	5,108,813	5,108,813
<b>Total uses</b>	<b>(172,264)</b>	<b>14,140,062</b>	<b>13,967,798</b>
<b>Adjustments:</b>			
Adjustments for other assets and liabilities	-	-	-
<b>Total adjustments</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total changes in resources</b>	<b>(2,246,562)</b>	<b>650,824</b>	<b>(1,595,738)</b>
<b>Ending resources available</b>	<b>\$ (2,451,568)</b>	<b>\$ 8,845,843</b>	<b>\$ 6,394,275</b>
<b>RECAP RESOURCES AVAILABLE:</b>			
Operating reserve	\$ (22,007)	\$ 8,355,189	\$ 8,333,182
<b>Total ending resources</b>	<b>\$ (22,007)</b>	<b>\$ 8,355,189</b>	<b>\$ 8,333,182</b>

**South County Regional Wastewater Authority**  
**Composition of Available Resources**  
**For the Year Ended June 30, 2020**

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	Plant Construction	Sewage Treatment Operations	Totals
<b>BEGINNING RESOURCES AVAILABLE:</b>			
Cash	\$ -	\$ 8,171,993	\$ 8,171,993
Receivables	2,580,918	2,216,192	4,797,110
Payables	(2,785,924)	(2,193,166)	(4,979,090)
<b>Total beginning resources</b>	<u>\$ (205,006)</u>	<u>\$ 8,195,019</u>	<u>\$ 7,990,013</u>
<b>ENDING RESOURCES AVAILABLE:</b>			
Cash	\$ -	\$ 9,935,263	\$ 9,935,263
Receivables	734,575	421,556	1,156,131
Payables	(756,582)	(2,001,630)	(2,758,212)
<b>Total ending resources</b>	<u>\$ (22,007)</u>	<u>\$ 8,355,189</u>	<u>\$ 8,333,182</u>

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND  
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

***Independent Auditors' Report***

To the Board of Directors  
of the South County Regional Wastewater Authority  
Gilroy, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the South County Regional Wastewater Authority (the "Authority"), a component unit of the City of Gilroy, California (the "City"), as of and for the year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated February 1, 2021.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Authority's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Authority's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that were not identified.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

To the Board of Directors  
of the South County Regional Wastewater Authority  
Gilroy, California  
Page 2

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Authority's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "The Per Group, LLP". The signature is written in a cursive, flowing style.

Santa Ana, California  
February 1, 2021