

**South County Regional
Wastewater Authority**
(A Component Unit of the City of Gilroy)

Gilroy, California

Annual Financial Report

For the Year Ended June 30, 2022



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(A Component Unit of the City of Gilroy)
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**SOUTH COUNTY REGIONAL
WASTEWATER AUTHORITY**

1500 Southside Drive

Gilroy, California 95020-7042

Telephone (408) 848-0480

Facsimile (408) 842-0873

scrwamail@ci.gilroy.ca.us

March 20, 2023

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

The South County Regional Wastewater Authority (“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, 2022. 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, 2022. The independent auditors’ report is located at the front of the financial section of this report. The MD&A immediately follows the independent auditors’ 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 Authority 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 800-840 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 Authority with the Gilroy City Administrator serving as the Authority's 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 Authority's daily operations are provided under a third-party contract with Jacobs Engineering Group.

Fiscal Year 2022 (FY 22) Financial Results

The Authority ended FY 22 with an operating loss of \$3.4 million, a minor decrease from the prior years' loss of \$3.5 million. Losses are primarily due to depreciation of fixed assets. During the fiscal year, the Authority's total net position increased by \$15.6 million, to \$120.6 million primarily due to the investment in net capital assets. During FY22, the construction commenced on the \$82.0 million treatment facility expansion project. At June 30, 2022, of the total net position, \$9.0 million was unrestricted, while remaining consists of net investment in capital assets.

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 Audit of the Financial Statements

Opinions

We have audited the accompanying 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, 2022, and the related notes to the financial statements, as listed in the table of contents.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Authority, as of June 30, 2022, 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.

Basis for Opinions

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Authority, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Emphasis of Matter

Implementation of New GASB Pronouncements

As discussed in Note 1 to the basic financial statements, the Authority implemented Governmental Accounting Standards Board ("GASB") Statement No. 87, *Leases* during the year. As of July 1, 2021, the Authority Lease Receivable and Deferred Inflows was increased by \$129,917. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the City's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information is the responsibility of management and, 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 required supplementary information 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 our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The combining statements, 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. The 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.

Management is responsible for the other information included in the annual report. The other information comprises the Introductory Section but does not include the basic financial statements and our auditors' report thereon. Our opinions on the basic financial statements do not cover the other information, and we do not express an opinion or any form of assurance thereon.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 20, 2023 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

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

Santa Ana, California
March 20, 2023

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**South County Regional Wastewater Authority
Management's Discussion and Analysis (Unaudited)
For the Year Ended June 30, 2022**

The following discussion and analysis of the financial performance of the South County Regional Wastewater Authority (Authority) provides an overview of the Authority's financial activities for the fiscal year ended June 30, 2022 (FY 22). Please read it in conjunction with the basic financial statements identified in the accompanying table of contents.

Using the Accompanying Basic 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 Authority 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 800-840 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 Authority with the Gilroy City Administrator serving as the Authority's 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 Authority's daily operations are provided under a third-party contract with Jacobs Engineering Group.

ACCOUNTING STANDARDS

The Authority's basic 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, 2022**

FINANCIAL HIGHLIGHTS

The Authority's overall financial position increased by \$15.6 million during Fiscal Year 2022 (FY 22). Total liabilities increased by \$3.6 million to \$5.3 million due to an increase in retentions payable and monies owed to suppliers for goods and services. Total assets increased by \$19.3 million, to \$126.0 million mainly in the capital assets, a result of capital expenditures.

Operating revenues increased by \$0.9 million from FY 21 and operating expenses increased by \$0.8 million, resulting in an operating income of approximately \$0.1 million better than the prior year.

Statements of Net Position

	2022	2021	Change
Cash and investments	\$ 10,758,715	\$ 8,893,106	\$ 1,865,609
Current assets	3,691,020	2,779,971	911,049
Capital assets	111,561,190	95,045,017	16,516,173
Total assets	126,010,925	106,718,094	19,292,831
Current liabilities	5,295,425	1,690,428	3,604,997
Noncurrent liabilities	17,764	20,159	(2,395)
Total liabilities	5,313,189	1,710,587	3,602,602
Deferred inflows	111,107	-	111,107
Net Position			
Net investment in capital assets	111,561,190	95,045,017	16,516,173
Unrestricted	9,025,439	9,962,490	(937,051)
Total net position	\$ 120,586,629	\$ 105,007,507	\$ 15,579,122

- In 2022, total assets increased \$19.3 million to \$126.0 million primarily in the capital assets area, a result of capital expenditures in addition to net increase of \$2.8 million in the cash and investments and current assets category.
- Current liabilities increased by \$3.6 million over the prior year to \$5.3 million. Primarily a result of increased retention and accounts payables at June 30, 2022, for the SCRWA Expansion Project.
- At June 30, 2022, the Authority's total net position was \$120.6 million, of which \$9.0 million was unrestricted, and remaining consisted of net investment in capital assets.

**South County Regional Wastewater Authority
Management's Discussion and Analysis (Unaudited) (Continued)
For the Year Ended June 30, 2022**

Statements of Revenues, Expenses, and Changes in Net Position

	<u>2022</u>	<u>2021</u>	<u>Change</u>
OPERATING REVENUES			
Operating contributions from City of Gilroy	6,125,158	6,121,301	3,857
Operating contributions from City of Morgan Hill	4,598,541	3,684,494	914,047
Other charges for services	357,008	346,683	10,325
Other operating revenue	109,598	90,000	19,598
Total operating revenue	<u>11,190,305</u>	<u>10,242,478</u>	<u>947,827</u>
OPERATING EXPENSES			
Sewage treatment	9,218,414	8,407,216	811,198
Pretreatment program	549,898	568,307	(18,409)
Plant operations	331,538	173,030	158,508
Depreciation and amortization	4,443,622	4,551,414	(107,792)
Total operating expenses	<u>14,543,472</u>	<u>13,699,967</u>	<u>843,505</u>
Operating income (loss)	<u>(3,353,167)</u>	<u>(3,457,489)</u>	<u>104,322</u>
NONOPERATING REVENUES (EXPENSES)			
Investment income (loss)	(92,741)	54,929	(147,670)
Miscellaneous income (expense)	(1,939,990)	(10,230)	(1,929,760)
Total nonoperating revenues (expenses)	<u>(2,032,731)</u>	<u>44,699</u>	<u>(2,077,430)</u>
Loss before capital contributions	<u>(5,385,898)</u>	<u>(3,412,790)</u>	<u>(1,973,108)</u>
CAPITAL CONTRIBUTIONS			
Capital contribution from City of Gilroy	12,148,175	1,894,351	10,253,824
Capital contribution from City of Morgan Hill	8,816,845	1,290,343	7,526,502
Total capital contribution	<u>20,965,020</u>	<u>3,184,694</u>	<u>17,780,326</u>
Change in net position	15,579,122	(228,096)	15,807,218
NET POSITION			
Beginning of year	<u>105,007,507</u>	<u>105,235,603</u>	<u>(228,096)</u>
End of year	<u>120,586,629</u>	<u>105,007,507</u>	<u>15,579,122</u>

- Total operating revenues for FY 22 increased by \$0.9 million to \$11.1 million from FY 21.
- Total operating expenses in FY 22 were \$14.5 million, an increase of \$0.8 million from FY 21.
- Current year operating activity produced an operating loss of \$3.4 million, primarily due to annual depreciation expense.
- Total non-operating expenses were \$2.0 million in FY 22, a decrease of \$2.0 million from prior year.
- The Authority's net position increased by \$15.6 million to \$120.6 million from FY21, primarily in investment in net capital assets.

**South County Regional Wastewater Authority
Management's Discussion and Analysis (Unaudited) (Continued)
For the Year Ended June 30, 2022**

Statement of Cash Flows

A summary of the Authority's statements of cash flows for FY 22 is presented below.

Condensed Statement of Cash Flows

	2022
Cash flows from operating activities	\$ 1,193,609
Cash flows used for capital and related financing activities	764,848
Cash flows used for investing activities	(92,848)
Net change in cash	1,865,609
Cash and investments - beginning of year	8,893,106
Cash and investments - end of year	\$ 10,758,715

Capital Assets

At the end of FY 22, the Authority had net investment in capital assets of \$111.6 million, an increase of \$16.5 million from FY 21, primarily a result of capital expenditures related to the SCRWA Plant Expansion project.

Long-Term Debt

The Authority possesses no long-term debt as debt for Authority-related activities are obligations of the member agencies and reported in their respective 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, 2022

ASSETS

Current Assets:

Cash and investments	\$ 10,758,715
Accounts receivable, net	244,900
Due from City of Gilroy	1,107,862
Due from City of Morgan Hill	2,185,611
Due from other governments	19,032
Interest receivable	107
Lease receivable - current	89,597
Total current assets	14,405,824

Noncurrent Assets:

Capital assets	
Capital assets - depreciable, net	62,907,676
Capital assets - nondepreciable	48,653,514
Total noncurrent assets:	111,561,190
TOTAL ASSETS	125,967,014

LIABILITIES

Current Liabilities:

Accounts payable and accrued liabilities	5,249,541
Compensated absences, due within one year	1,973
Total current liabilities	5,251,514

Noncurrent Liabilities:

Compensated absences	17,764
Total noncurrent liabilities	17,764
TOTAL LIABILITIES	5,269,278

DEFERRED INFLOWS OF RESOURCES

Deferred lease-related items	111,107
Total deferred inflows of resources	111,107

NET POSITION

Net investment in capital assets	111,561,190
Unrestricted	9,025,439
TOTAL NET POSITION	\$ 120,586,629

South County Regional Wastewater Authority
Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended June 30, 2022

OPERATING REVENUES:

Operating contributions from City of Gilroy	\$ 6,125,158
Operating contributions from City of Morgan Hill	4,598,541
Other charges for services	357,008
Other operating revenue	<u>109,598</u>
Total operating revenue	<u>11,190,305</u>

OPERATING EXPENSES:

Sewage treatment	9,218,414
Pretreatment program	549,898
Plant operations	331,538
Depreciation	<u>4,443,622</u>
Total operating expenses	<u>14,543,472</u>
Operating loss	<u>(3,353,167)</u>

NONOPERATING (EXPENSES):

Investment loss	(92,741)
Miscellaneous expense	<u>(1,939,990)</u>
Total nonoperating (expenses)	<u>(2,032,731)</u>
Loss before capital contributions	<u>(5,385,898)</u>

CAPITAL CONTRIBUTIONS:

Capital contribution from City of Gilroy	12,148,175
Capital contribution from City of Morgan Hill	<u>8,816,845</u>
Total capital contribution	<u>20,965,020</u>
Change in net position	15,579,122

NET POSITION:

Beginning of year	<u>105,007,507</u>
End of year	<u><u>\$ 120,586,629</u></u>

South County Regional Wastewater Authority
Statement of Cash Flows
For the Year Ended June 30, 2022

Cash Flows from Operating Activities:

Cash received from system users	\$ 11,276,321
Cash payments to suppliers for goods and services	(9,988,028)
Cash payments to employees for services	(50,773)
	<u>1,237,520</u>
Net cash provided by operating activities	<u>1,237,520</u>

Cash Flows From Capital and Related Financing Activities:

Cash transferred (paid) for capital assets	(18,152,297)
Capital contributions	18,873,234
	<u>720,937</u>
Net cash provided by capital and related financing activities	<u>720,937</u>

Cash Flows from Investing Activities

Investment loss	(92,848)
	<u>(92,848)</u>
Net cash used in investing activities	<u>(92,848)</u>
Net change in cash and investments	1,865,609

Cash and Investments:

Beginning of year	8,893,106
	<u>8,893,106</u>
End of year	<u>\$ 10,758,715</u>

Reconciliation of Operating Loss to Net Cash Provided by Operating Activities:

Operating loss	\$ (3,353,167)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation	4,443,622
Changes in assets and liabilities:	
(Increase) decrease in accounts receivable	(71,733)
(Increase) decrease in lease receivable	(89,597)
(Increase) decrease in due from City of Gilroy	123,208
(Increase) decrease in due from City of Morgan Hill	24,482
(Increase) decrease in due from other governments	(11,451)
Increase (decrease) in accounts payable	111,822
Increase (decrease) in accrued liabilities	(50,351)
Increase (decrease) in compensated absences	(422)
Increase (decrease) in deferred inflows of resources related to lease	111,107
	<u>4,590,687</u>
Total adjustments	<u>4,590,687</u>
Net cash provided by operating activities	<u>\$ 1,237,520</u>

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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, 2022

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 accounting principles generally accepted in the United States of America (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 and the City of Morgan Hill have a 58.1% and 41.9% capacity interest in the wastewater treatment plant, respectively, which is used to determine the capital contribution amounts by the Member Agencies and the pro-rata share of the Authority's income (loss).

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 component unit 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.

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.

South County Regional Wastewater Authority
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2022

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

C. Measurement Focus and Basis of Accounting (Continued)

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, 2022, the Authority implemented the following new GASB Pronouncement:

GASB Statement No. 87 – In June 2017, GASB issued Statement No. 87, *Leases* (GASB Statement No. 87), to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This statement increases the usefulness of governments’ financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It also establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Implementation of this Statement had a significant effect on the Authority’s financial statements for the fiscal year ended June 30, 2022.

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. All investments of the Authority are uncategorized in the fair value measurement hierarchy.

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.

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 capital construction.

G. Leases

Lessor

The Authority is a lessor for leases of buildings and land and recognizes leases receivable and deferred inflows of resources in the financial statements. Variable payments based on future performance or usage of the underlying asset are not included in the measurement of the lease receivable.

South County Regional Wastewater Authority
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2022

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

G. Leases (Continued)

Lessor (Continued)

At the commencement of a lease, the lease receivable is measured at the present value of payments expected to be received during the lease term. Subsequently, the lease receivable is reduced by the principal portion of lease payments received. The deferred inflows of resources are initially measured as the initial amount of the lease receivable, adjusted for lease payments received at or before the lease commencement date. Subsequently, the deferred inflows of resources are recognized as revenue over the life of the lease term in a systematic and rational method.

Key estimates and judgments include how the Authority determines (1) the discount rate it uses to discount the expected lease receipts to present value, (2) lease term, and (3) lease receipts.

- The Authority uses the average of the LAIF rate and the incremental borrowing rate (IBR) provided by our financial institution at July 1, 2021 for existing leases or the current rate at the time a new lease is executed.
- The lease term includes the noncancelable period of the lease plus any option periods that are likely to be exercised.
- Lease receipts included in the measurement of the lease receivable is composed of fixed payments from the lessee.

The Authority monitors changes in circumstances that would require a remeasurement of its lease and will remeasure the lease receivable and deferred inflows of resources if certain changes occur that are expected to significantly affect the amount of the lease receivable.

H. 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 and improvements	40 years
Office furniture, fixtures and equipment	5 - 25 years
Vehicles	8 years
Treatment plant	40 years
Sewer lines	50 years
Land improvements	50 years

South County Regional Wastewater Authority
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2022

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

I. Compensated Absences

All full-time employees accumulate vacation benefits in varying annual amounts. Sick leave benefits accrue at the rate of one day per month for all full-time employees regardless of their length of service to the Authority. Upon termination or retirement, employees are paid for all unused vacation time and overtime. No cash payment is made for unused sick leave upon termination or retirement.

A liability is recorded for unused vacation and similar compensatory leave balances since the employees' entitlement to these balances are attributable to services already rendered and it is probable that virtually all of these balances will be liquidated by either paid time off or payments upon termination or retirement.

If material, a liability is accrued for all leave benefits relating to the operations of the Authority. All amounts are considered to be current and noncurrent liabilities and will be recorded as fund expenditures in the year in which they are paid or become due. As of June 30, 2022 the Authority had the following activity in compensated absences:

	Balance June 30, 2021	Additions	Deletions	Balance June 30, 2022	Due within One Year
Compensated Absences	\$ 20,159	\$ 17,142	\$ (17,564)	\$ 19,737	1,973

J. Net Position

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

Net 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 net investment in capital assets.

K. 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.

L. 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 capital contributions.

M. Use of Estimates

The preparation of financial statements in accordance with GAAP 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, 2022

Note 2 – Cash and Investments

The Authority participates in a cash and investment pool maintained by the City, which includes cash balances and authorized investments of all funds and the Local Agency Investment Fund (“LAIF”).

Cash and investments as of June 30, 2022 consists of the following:

Current Assets:

Equity in City of Gilroy investment pool	\$	724,368
Local Agency Investment Fund		10,034,347
Total cash and investments		\$ 10,758,715

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

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.

South County Regional Wastewater Authority
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2022

Note 2 – Cash and Investments (Continued)

B. Disclosures Relating to Interest Rate Risk (Continued)

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, 2022
Equity in City of Gilroy investment pool	\$ 724,368
Local Agency Investment Fund	10,034,347
Total	\$ 10,758,715

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, 2022	Not Rated
Equity in City of Gilroy investment pool	N/A	\$ 724,368	\$ 724,368
Local Agency Investment Fund	N/A	10,034,347	10,034,347
Total		\$ 10,758,715	\$ 10,758,715

D. 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.

South County Regional Wastewater Authority
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2022

Note 2 – Cash and Investments (Continued)

E. 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, 2022 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, 2022, the Authority had \$10,034,347 invested in LAIF, which had invested 1.88% of the pool investment funds in Structured Notes and Asset-Backed Securities.

F. 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, 2022, the Authority had a cash balance of \$724,368.

G. 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.

South County Regional Wastewater Authority
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2022

Note 3 – Lease Receivables

The Authority leases various types of property including land and buildings. Leases receivable consist of agreements with other entities for the “right-to-use” the underlying assets at various locations owned by the Authority. The remaining terms of the agreements are within one year. The interest rates used calculated the net present value of the lease receivable ranged from 1% to 1.5%.

For the fiscal year ended June 30, 2022, the Authority recognized \$68,149 in lease revenue and \$248 in interest revenue.

A summary of changes in lease receivable for the year ended June 30, 2022 is as follows:

Balance July 1, 2021 (as restated)	Additions	Reductions	Balance June 30, 2022	Amounts due within one year	Amounts due in more than one year
\$ 129,917	\$ 49,338	\$ (89,658)	\$ 89,597	\$ 89,597	\$ -

Note 4 – Capital Assets

The following is a summary of changes in capital assets for the year ended June 30, 2022:

	Balance June 30, 2021	Additions	Balance June 30, 2022
<i>Capital assets not being depreciated:</i>			
Land	\$ 13,396,202	\$ -	\$ 13,396,202
Construction in progress	14,415,091	20,842,221	35,257,312
Total capital assets not being depreciated	<u>27,811,293</u>	<u>20,842,221</u>	<u>48,653,514</u>
<i>Capital assets being depreciated:</i>			
Buildings and improvements	72,257,749	-	72,257,749
Land improvements	10,681,371	-	10,681,371
Infrastructure	35,874,535	-	35,874,535
Vehicles	1,505,200	-	1,505,200
Office furniture, fixtures and equipment	19,964,163	117,574	20,081,737
Total capital assets being depreciated	<u>140,283,018</u>	<u>117,574</u>	<u>140,400,592</u>
<i>Less accumulated depreciation for:</i>			
Buildings and improvements	(41,210,706)	(1,663,219)	(42,873,925)
Land improvements	(5,907,921)	(190,342)	(6,098,263)
Infrastructure	(8,786,258)	(1,198,771)	(9,985,029)
Vehicles	(1,139,461)	(34,378)	(1,173,839)
Office furniture, fixtures and equipment	(16,004,948)	(1,356,912)	(17,361,860)
Total accumulated depreciation	<u>(73,049,294)</u>	<u>(4,443,622)</u>	<u>(77,492,916)</u>
Total capital assets being depreciated, net	<u>67,233,724</u>	<u>(4,326,048)</u>	<u>62,907,676</u>
Total capital assets	<u><u>\$ 95,045,017</u></u>	<u><u>\$ 16,516,173</u></u>	<u><u>\$ 111,561,190</u></u>

Depreciation expense was \$4,443,622 for the year ended June 30, 2022.

South County Regional Wastewater Authority
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2022

Note 5 – Related Party

Member Agencies contributed amount of \$10,723,699 to the Authority for the Authority’s daily operation during the fiscal year ended June 30, 2022, and member agencies contributed amount of \$20,965,020 to the Authority for the capital projects during the fiscal year ended June 30, 2020. As of June 30, 2022, the balance due from the City of Gilroy was \$1,107,862 and the balance due from the City of Morgan Hill was \$2,185,611.

Note 6 – 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.

Commitments

The Authority had the following commitments outstanding as of June 30, 2022:

Name of Project	Outstanding Amount
Treatment Plant Expansion Project	\$ 40,900,000
Maintenance Building Upgrades	1,700,000
	\$ 42,600,000

Note 7 – 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 (\$5 million per occurrence), auto liability (\$5M per accident), employer’s liability (\$5 million per accident) professional liability/errors and omissions (\$5 million per occurrence), pollution/environmental impairment liability insurance (\$5 million 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 \$1billion per occurrence up to the insurable value. The flood limit is \$25 million. Business interruption coverage is \$100 million.

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

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SUPPLEMENTARY INFORMATION

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South County Regional Wastewater Authority
Combining Statement of Net Position
June 30, 2022

	Plant Construction	Sewage Treatment Operations	Totals
ASSETS			
Current assets:			
Cash and investments	\$ -	\$ 10,758,715	\$ 10,758,715
Accounts receivable, net	-	244,900	244,900
Interest receivable	-	107	107
Lease receivable - current	-	89,597	89,597
Due from City of Gilroy	821,288	286,574	1,107,862
Due from City of Morgan Hill	1,969,428	216,183	2,185,611
Due from other governments	-	19,032	19,032
Total current assets	2,790,716	11,615,108	14,405,824
Noncurrent Assets:			
Capital assets - depreciable, net	-	62,907,676	62,907,676
Capital assets - nondepreciable	30,435,167	18,218,347	48,653,514
Total noncurrent assets:	30,435,167	81,126,023	111,561,190
TOTAL ASSETS	33,225,883	92,741,131	125,967,014
LIABILITIES			
Current Liabilities:			
Accounts payable and accrued liabilities	4,747,488	502,053	5,249,541
Compensated absences, due within one year	-	1,973	1,973
Total current liabilities	4,747,488	504,026	5,251,514
Noncurrent Liabilities:			
Compensated absences	-	17,764	17,764
Total noncurrent liabilities	-	17,764	17,764
TOTAL LIABILITIES	4,747,488	521,790	5,269,278
DEFERRED INFLOWS OF RESOURCES			
Deferred lease-related items	-	111,107	111,107
Total deferred inflows of resources	-	111,107	111,107
NET POSITION			
Net investment in capital assets	30,435,167	81,126,023	111,561,190
Unrestricted (deficit)	(1,956,772)	10,982,211	9,025,439
TOTAL NET POSITION	\$ 28,478,395	\$ 92,108,234	\$ 120,586,629

South County Regional Wastewater Authority
Combining Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended June 30, 2022

	Plant Construction	Sewage Treatment Operations	Totals
OPERATING REVENUES			
Operating contributions from City of Gilroy	\$ -	\$ 6,125,158	\$ 6,125,158
Operating contributions from City of Morgan Hill	-	4,598,541	4,598,541
Other charges for services	-	357,008	357,008
Other operating revenue	-	109,598	109,598
Total operating revenue	-	11,190,305	11,190,305
OPERATING EXPENSES			
Sewage treatment	-	9,218,414	9,218,414
Pretreatment program	-	549,898	549,898
Plant operations	-	331,538	331,538
Depreciation	-	4,443,622	4,443,622
Total operating expenses	-	14,543,472	14,543,472
Operating loss	-	(3,353,167)	(3,353,167)
NONOPERATING EXPENSES			
Investment loss	-	(92,741)	(92,741)
Miscellaneous expense	(1,939,990)	-	(1,939,990)
Total nonoperating expenses	(1,939,990)	(92,741)	(2,032,731)
Income (loss) before capital contributions	(1,939,990)	(3,445,908)	(5,385,898)
CAPITAL CONTRIBUTIONS			
Capital contribution from City of Gilroy	10,464,011	1,684,164	12,148,175
Capital contribution from City of Morgan Hill	7,546,335	1,270,510	8,816,845
Total capital contribution	18,010,346	2,954,674	20,965,020
Change in net position	16,070,356	(491,234)	15,579,122
NET POSITION			
Beginning of year	12,408,039	92,599,468	105,007,507
End of year	\$ 28,478,395	\$ 92,108,234	\$ 120,586,629

South County Regional Wastewater Authority
Combining Statement of Cash Flows
For the Year Ended June 30, 2022

	Plant Construction	Sewage Treatment Operations	Eliminations	Totals
Cash Flows from Operating Activities:				
Cash received from system users	\$ -	\$ 11,276,321	\$ -	\$ 11,276,321
Cash payments to suppliers for goods and services	-	(9,988,028)	-	(9,988,028)
Cash payments to employees for services	-	(50,773)	-	(50,773)
Net cash provided by operating activities	-	1,237,520	-	1,237,520
Cash Flows from Noncapital Financing Activities:				
Cash received from other funds	-	1,970,782	(1,970,782)	-
Cash paid to other funds	(1,970,782)	-	1,970,782	-
Net cash (used in) provided by noncapital financing activities	(1,970,782)	1,970,782	-	-
Cash Flows From Capital and Related Financing Activities:				
Cash transferred (paid) for capital assets	(15,197,624)	(2,954,673)	-	(18,152,297)
Capital contributions	17,168,406	1,704,828	-	18,873,234
Net cash provided by capital and related financing activities	1,970,782	(1,249,845)	-	720,937
Cash Flows from Investing Activities				
Investment loss	-	(92,848)	-	(92,848)
Net cash (used in) investing activities	-	(92,848)	-	(92,848)
Net change in cash and investments	-	1,865,609	-	1,865,609
Cash and Investments:				
Beginning of year	-	8,893,106	-	8,893,106
End of year	\$ -	\$ 10,758,715	\$ -	\$ 10,758,715
Reconciliation of Operating (loss) to Net Cash Provided by (Used in)				
Operating Activities:				
Operating loss	\$ -	\$ (3,353,167)	\$ -	\$ (3,353,167)
Adjustments to reconcile operating (loss) to net cash provided (used in) by operating activities:				
Depreciation	-	4,443,622	-	4,443,622
Changes in assets and liabilities:				
(Increase) decrease in accounts receivable	-	(71,733)	-	(71,733)
(Increase) decrease in lease receivable	-	(89,597)	-	(89,597)
(Increase) decrease in due from City of Gilroy	-	123,208	-	123,208
(Increase) decrease in due from City of Morgan Hill	-	24,482	-	24,482
(Increase) decrease in due from other governments	-	(11,451)	-	(11,451)
Increase (decrease) in accounts payable	-	111,822	-	111,822
Increase (decrease) in accrued liabilities	-	(50,351)	-	(50,351)
Increase (decrease) in compensated absences	-	(422)	-	(422)
Increase (decrease) in deferred inflows of resources related to lease	-	111,107	-	111,107
Total adjustments	-	4,590,687	-	4,590,687
Net cash provided by operating activities	\$ -	\$ 1,237,520	\$ -	\$ 1,237,520

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND REPORT 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, 2022, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated March XX, 2023.

Report on 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 or significant deficiencies may exist that have not been identified.

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

Report on 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 statements. 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 require to be reported under *Government Auditing Standards*.

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 PwC Group, LLP". The signature is written in a cursive, flowing style.

Santa Ana, California
March 20, 2023