# SOUTH BAYSIDE WASTE MANAGEMENT AUTHORITY

## BASIC FINANCIAL STATEMENTS

## FISCAL YEAR ENDED JUNE 30, 2017

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**SOUTH BAYSIDE WASTE**
**MANAGEMENT AUTHORITY**

**BASIC FINANCIAL STATEMENTS**
**FISCAL YEAR ENDED JUNE 30, 2017**

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# INDEPENDENT AUDITOR'S REPORT

To Members of the Board of Directors of the
South Bayside Waste Management Authority
San Carlos, California

***Report on the Financial Statements***

We have audited the accompanying financial statements of the South Bayside Waste Management Authority (Authority) as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Authority's 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 the financial statements that are free from material misstatement, whether due to fraud or error.

***Auditor's Responsibility***

Our responsibility is to express opinions 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 opinions.

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***Opinions***

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, 2017, and the changes in financial position and, cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Other Matters***

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis as listed in the 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 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.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated November 9, 2017 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.

Maze & Associates

Pleasant Hill, California
November 9, 2017

**SOUTH BAYSIDE WASTE MANAGEMENT AUTHORITY**
**Management's Discussion and Analysis**
**June 30, 2017**

The Management's Discussion and Analysis (MD&A) section presents an overview and analysis of the financial performance of the South Bayside Waste Management Authority (SBWMA) for the fiscal year (FY) ended June 30, 2017. It should be read in conjunction with the audited financial statements that follow this section.

## OVERVIEW OF THE FINANCIAL STATEMENTS

The SBWMA's financial statements include:

*Statement of Net Position* presents information on the SBWMA's assets and liabilities as of year-end, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.

*Statement of Revenues, Expenses, and Changes in Net Position* presents the results of the SBWMA's operations over the course of the fiscal year and information as to how the net position changed during the year. These statements can be used as an indicator of the extent to which the Authority has successfully recovered its costs through user fees and other charges.

*Statement of Cash Flows* presents changes in cash and cash equivalents resulting from operational, capital, non-capital, and investing activities. The statement summarizes the annual flow of cash receipts and cash payments, without consideration of the timing of the event giving rise to the obligation or receipt and exclude non-cash accounting measures of depreciation or amortization of assets.

*Notes to Financial Statements* provide information that is essential to a full understanding of the financial statements that is not displayed on the face of the financial statements.

## FINANCIAL ANALYSIS

The following table summarizes the Authority's change in net position from last year to this year

**Table 1**
**Comparative Net Position**
**June 30, 2017 and 2016**

| | FY 2017 | FY 2016 | $ Change | % Change |
|---|---|---|---|---|
| Current and other assets | $ 26,256,369 | $ 26,613,281 | $ (356,912) | -1.3% |
| Capital assets, net of depreciation | 49,041,382 | 49,811,020 | (769,638) | -1.5% |
| Total assets | 75,297,751 | 76,424,301 | (1,126,550) | -1.5% |
| Long-term debt outstanding | 47,612,247 | 48,929,747 | (1,317,500) | -2.7% |
| Other liabilities | 6,035,240 | 8,661,067 | (2,625,827) | -30.3% |
| Total liabilities | 53,647,487 | 57,590,814 | (3,943,327) | -6.8% |
| Net position: | | | | |
| Net investment in capital assets | 5,562,069 | 5,011,381 | 550,688 | 11.0% |
| Unrestricted | 16,088,195 | 13,822,106 | 2,266,089 | 16.4% |
| Total net position | $ 21,650,264 | $ 18,833,487 | $ 2,816,777 | 15.0% |

***Net Position***

The total net position increased by $2.8 million or 15% from the prior fiscal year. This increase is comprised of a $0.5 million increase in net investment in capital assets and a $2.3 million increase in unrestricted net position.

The total liabilities decreased by $3.9 million or 6.8%. The decrease of $1.3 million or 2.7% in long-term debt is associated with the $1.4 million principal payment made on the 2009A bonds. This change is explained further in the *"Long-term Debt"* section below. The decrease of $2.6 million or 30.3% in other liabilities is related to the timing of payments for the Shoreway operations.

The largest portion of the Authority's assets is its investment in net capital assets totaling $49 million. These assets are comprised of land, buildings, equipment and infrastructure, less accumulated depreciation, and are primarily located at the Shoreway Environmental Center. The actual year-over-year comparison of the capital assets, net of accumulated depreciation, shows a decrease of $0.8 million or 1.5% due to an increase in accumulated depreciation. This decrease is lower than the previous fiscal year due to a large investment in capital assets to repair the Shoreway Center following the fire in September 2016. These changes are explained further in the *"Capital Assets"* section below.

The net investment in capital assets is $5.6 million as of June 30, 2017. It represents the Authority's investment in infrastructure and other capital assets, net of amounts borrowed to finance that investment. It should be noted that these funds are not available for spending because capital assets cannot be used to liquidate these liabilities. Therefore, the resources needed to repay this debt must be provided from other sources. Unrestricted net position totaling $16.1 million represents the part of net position that can be used to finance operations.

### *Results of Operations*

The following table summarizes the Authority's revenues, expenses, and changes in net position.

**Table 2**
**Comparative Revenues, Expenses, and Changes in Net Position**
**For the Years Ended June 30, 2017 and 2016**

| | FY 2017 | FY 2016 | $ Change | % Change |
|---|---|---|---|---|
| Revenues | | | | |
| Charges for services | 38,925,676 | 34,644,943 | 4,280,733 | 12.4% |
| Commodity revenue | 6,939,608 | 8,036,208 | (1,096,600) | -13.6% |
| Other operating revenues | 584,250 | 1,125,875 | (541,625) | -48.1% |
| Net Insurance Proceeds | 7,542,055 | - | 7,542,055 | - |
| Investment Income | 97,176 | 107,925 | (10,749) | -10.0% |
| Total Revenues | 54,088,765 | 43,914,951 | 10,173,814 | 23.2% |
| Expenses | | | | |
| Operating expenses | 43,786,336 | 43,732,674 | 53,662 | 0.1% |
| Fire-related expenses | 4,725,903 | - | 4,725,903 | - |
| Interest expense | 2,759,746 | 2,810,821 | (51,075) | -1.8% |
| Total Expenses | 51,271,985 | 46,543,495 | 4,728,490 | 10.2% |
| Increase (decrease) in net position | 2,816,780 | (2,628,544) | 5,445,324 | 207.2% |
| Beginning net position | 18,833,484 | 21,462,029 | (2,628,545) | -12.2% |
| Restatements | | | - | 100.0% |
| Beginning net position, restated | 18,833,484 | 21,462,029 | (2,628,545) | -12.2% |
| Ending net position | 21,650,264 | 18,833,485 | 2,816,779 | 15.0% |

While the Statement of Net Position (Table 1) shows the change in financial position, the Statement of Activities (Table 2 above) provides answers as to the nature and sources of the changes.

Charges for services, also known as tipping fee revenue, increased by $4.3 million or 12.4%, from $34.6 million in FY16 to $38.9 million in FY17. $1.9 million of the revenue growth was due to an increase in "self-haul" public solid waste, split by $0.9 million due to an increase in volumes and $1.0 million due to a tipping fee increase. The remaining revenue growth of $2.4 million was due to an increase in franchise waste, split by $0.6 million due to an increase in volumes and $1.8 million due to an increase in franchise tip fees. Public revenue is the revenue generated from non-franchised waste that is delivered to the Shoreway facility by members of the public, while franchise revenue is from solid waste and organic materials collected by Recology San Mateo County from customers of SBWMA's member agencies and delivered to the Shoreway facility. Commodity Revenues decreased by $1.1 million in FY17 compared to FY16 due to the fire at the Shoreway Center in September 2016 which caused considerable damage and halted intake of commodities for a four month period. This was offset by insurance proceeds of $1.4m received for lost revenue. The remainder of the $8.9m total insurance proceeds covered cost of repairs to the Center and replacement of damaged capital assets. Other operating revenues decreased by $0.5m largely due to cessation of the Household Hazardous Waste Collection Service in December 2016. Investment income was static compared to FY16 at $0.1m.

The primary component of operating expenses is related to the Shoreway operations that constitute about 84% of non-discretionary, contractually obligated costs incurred to pay the Shoreway operator, and disposal and processing expense. The Shoreway operations expense increased only slightly by $0.4 million in FY17 compared to the prior year.

Table 3 below shows just the operating results of the Authority. It excludes all revenue and expenditure not directly associated with operating activities such as investment income and expense, and depreciation. For the current fiscal year, operating results were $5.6 million compared to $3.4 million for the prior year.

**Table 3**

**Operating Results**

**For the Years Ended June 30, 2017 and 2016**

| | FY 2017 | FY 2016 | $ Change | % Change |
|---|---|---|---|---|
| Operating Revenue | | | | |
| Charges for Services | $ 38,925,676 | $ 34,644,943 | $ 4,280,734 | 12.4% |
| Commodity Fee | 6,939,608 | 8,036,208 | (1,096,600) | -13.6% |
| Other Operating Revenue | 584,250 | 1,125,875 | (541,625) | -48.1% |
| Total Operating Revenue | 46,449,534 | 43,807,025 | 2,642,508 | 6.0% |
| Operating Expense (excl Depn.) | | | | |
| Shoreway Operations | (36,784,182) | (36,344,429) | (439,753) | 1.2% |
| Program Admin | (2,163,289) | (2,430,066) | 266,777 | -11.0% |
| Franchise Fee | (1,853,604) | (1,649,758) | (203,846) | 12.4% |
| Total Operating Expense (excl Depn.) | $ (40,801,075) | $ (40,424,253) | (376,822) | 0.9% |
| Total Operating Results | 5,648,459 | 3,382,772 | 2,265,687 | 67.0% |

## *Reserves*

Table 4 below reflects the amount of reserves that have been designated by the Board in the fiscal years 2017 and 2016.

**Table 4**

**Unrestricted Reserves Balances**

| | FY 2017 | FY 2016 |
|---|---|---|
| Rate Stabilization Reserve | $ 4,242,701 | $ 4,174,238 |
| Emergency Reserve | 4,242,701 | 4,174,238 |
| Equipment Replacement | 991,791 | 1,736,098 |
| 2009 A Bond Repayment | 1,137,500 | 1,091,667 |
| Undesignated | 5,473,502 | 2,645,859 |
| Total Unrestricted Reserves | $ 16,088,195 | $ 13,822,103 |

In 2002, the SBWMA Board established a reserve policy to set aside certain portions of unrestricted net position for specific uses in order to protect the short and long-term financial operation of the Authority. In May 2013 the Board revised the Cash Reserve Policy to accomplish the goal of more clearly defining the Reserve accounts. It replaced the existing Operating Reserve with an Emergency Reserve Account. The Emergency Reserve is to address unexpected and sudden capital needs or significant one-time increases in Shoreway operating expenses associated with "damage by natural disasters, acts of war or terrorism, or other community emergency scenarios that are not covered by existing insurance policies". The new Policy also changed the priority order of the accounts so the Rate Stabilization Reserve is first in priority followed by the Emergency Reserve. The Rate Stabilization Reserve & Emergency Reserve is calculated as 10% of Operating expenses. Operating expenses include Shoreway Operations expenses, SBWMA program expenses, 2009A bond interest expense, and franchise fees. Operating expenses exclude depreciation, buyback, and household hazardous waste payments.

## *Capital Assets*

The following table summarizes changes in the Authority's capital assets.

**Table 5**
**Capital Assets, Net of Depreciation**
**For the Years Ended June 30, 2017 and 2016**

| | FY 2017 | FY 2016 | $ Change | % Change |
|---|---|---|---|---|
| Land | $ 14,000,000 | $ 14,000,000 | $ - | - |
| Buildings and systems | 35,679,927 | 35,359,894 | 320,033 | 0.9% |
| Machinery and equipment | 23,439,074 | 22,574,212 | 864,862 | 3.8% |
| Construction in progress | - | 126,347 | (126,347) | -100.0% |
| Total accumulated depreciation | (24,077,619) | (22,249,433) | (1,828,186) | 8.2% |
| Total Net Capital Assets | $ 49,041,382 | $ 49,811,019 | $ (769,637) | -1.5% |

The net capital assets decreased by $0.8 million or 1.5% from $49.8 million in FY16 to $49 million in FY17. This decrease is the net of the annual $3 million increase in accumulated depreciation, a one-off asset write-off (impairment) of $1.3m due to damaged assets caused by the fire, and $3.5m in additional capital expenditure to replace damaged assets and to upgrade various buildings at the Center, as well as retrofit all light installations with LED lighting.

Additional information on the capital assets can be found in Note (4) of the financial statements.

### *Long-term Debt*

At the end of the current fiscal year, the Authority has $47.6 million total debt outstanding.

**Table 6**
**Outstanding Debt, Net of Amortized Costs**
**June 30, 2017 and 2016**

| | FY 2017 | FY 2016 | $ Change | % Change |
|---|---|---|---|---|
| 2009A Revenue Bond | $ 47,470,000 | $ 48,780,000 | $ (1,310,000) | -2.7% |
| Net Premium 2009A | 142,247 | 149,747 | (7,500) | -5.0% |
| Total | $ 47,612,247 | $ 48,929,747 | $ (1,317,500) | -2.7% |

Long-term debt consists of the Revenue Bond Series 2009A that was issued to finance the construction and renovation of a solid waste materials recovery facility and transfer station as well as related equipment.

Additional information on the Authority's long-term debt can be found in Note (5) to the accompanying financial statements.

## CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our member agencies, investors and creditors with a general overview of the Authority's finances and to show the Authority's accountability for the revenues and expenses in the course of doing business. If you have questions about this report or need additional financial information, contact the Executive Director, South Bayside Waste Management Authority, 610 Elm Street, San Carlos, California 94070.

## SOUTH BAYSIDE WASTE MANAGEMENT AUTHORITY

## STATEMENT OF NET POSITION
## JUNE 30, 2017

| | |
|---|---|
| ASSETS | |
| Current Assets: | |
| Cash and investments for operations (Note 2) | $14,861,163 |
| Accounts receivable | 4,615,340 |
| Interest receivable | 36,178 |
| Inventory | 378,709 |
| Prepaid items | 720 |
| Total Current Assets | 19,892,110 |
| Noncurrent Assets: | |
| Cash and investments with fiscal agent (Note 2) | 6,364,259 |
| Capital assets (Note 4): | |
| Land | 14,000,000 |
| Building | 35,679,927 |
| Equipment | 23,439,074 |
| Less Accumulated Depreciation | (24,077,619) |
| Net capital assets | 49,041,382 |
| Total Noncurrent Assets | 55,405,641 |
| Total Assets | 75,297,751 |
| LIABILITIES | |
| Current Liabilities: | |
| Accounts payable | 3,594,995 |
| Accrued liabilities | 186,656 |
| Interest payable | 919,504 |
| Current portion of compensated absences | 75,925 |
| Long-term debt due in one year (Note 5) | 1,365,000 |
| Total Current Liabilities | 6,142,080 |
| Noncurrent Liabilities: | |
| Compensated absences due in more than one year | 24,520 |
| Accrued liabilities (Note 7) | 1,233,640 |
| Long-term debt due in more than one year (Note 5) | 46,247,247 |
| Total Noncurrent Liabilities | 47,505,407 |
| Total Liabilities | 53,647,487 |
| NET POSITION | |
| Net investment in capital assets | 5,562,069 |
| Unrestricted | 16,088,195 |
| Total Net Position | $21,650,264 |

See accompanying notes to the financial statements

## SOUTH BAYSIDE WASTE MANAGEMENT AUTHORITY

## STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION FOR THE YEAR ENDED JUNE 30, 2017

| | |
|---|---|
| OPERATING REVENUES: | |
| Charges for services | $38,925,676 |
| Commodity revenue | 6,939,608 |
| Other | 584,250 |
| Total Operating Revenues | 46,449,534 |
| OPERATING EXPENSES: | |
| Shoreway operations | 36,784,182 |
| SBWMA program administration | 2,163,289 |
| Franchise fee - transfer station | 1,853,604 |
| Depreciation (Note 4) | 2,985,261 |
| Total Operating Expenses | 43,786,336 |
| Operating Income | 2,663,198 |
| NONOPERATING REVENUES (EXPENSES): | |
| Insurance proceeds (Net of Impairment - Note 4) | 7,542,055 |
| Investment income | 97,176 |
| Fire-related expenses | (4,725,903) |
| Interest expense | (2,759,746) |
| Net Nonoperating Revenue (Expense) | 153,582 |
| Change in Net Position | 2,816,780 |
| NET POSITION AT BEGINNING OF YEAR | 18,833,484 |
| NET POSITION AT END OF YEAR | $21,650,264 |

See accompanying notes to the financial statements

**SOUTH BAYSIDE WASTE MANAGEMENT AUTHORITY**

**STATEMENT OF CASH FLOWS**
**FOR THE YEAR ENDED JUNE 30, 2017**

| | |
|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | |
| Cash receipts from customers | $45,967,487 |
| Payments to suppliers | (42,470,796) |
| Payments to employees | (930,339) |
| Inventory | (378,709) |
| Net Cash Flows (used for) Operating Activities | 2,187,643 |
| CASH FLOWS FROM NONCAPITAL AND FINANCING ACTIVITIES | |
| Insurance proceeds | 8,852,902 |
| Fire-related expenses | (4,725,903) |
| Net Cash Flows (used for) Noncapital and Financing Activities | 4,126,999 |
| CASH FLOWS FROM INVESTING ACTIVITIES | |
| Interest received | 84,016 |
| Net Cash Flows from Investing Activities | 84,016 |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | |
| Capital assets additions | (3,535,493) |
| Retirement of long-term debt | (1,310,000) |
| Interest paid | (2,784,713) |
| Net Cash Flows (Used for) Capital and Related Financing Activities | (7,630,206) |
| Net Cash Flows | (1,231,548) |
| Cash and investments for operations - beginning of year | 22,456,970 |
| Cash and investments - end of year | $21,225,422 |
| Reconciliation of operating income to net cash flows from operating activities: | |
| Operating income (loss) | $2,663,198 |
| Adjustments to reconcile operating income to cash flows from operating activities: | |
| Depreciation | 2,985,261 |
| Loss on disposal of capital asset | 9,023 |
| Net change in: | |
| Accounts receivable | (482,047) |
| Prepaids | (720) |
| Inventory | (378,709) |
| Accounts payable | (2,688,304) |
| Accrued liabilities | 30,255 |
| Compensated absences | 49,686 |
| Net Cash Flows from Operating Activities | $2,187,643 |
| NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES: | |
| Amortization related to long-term debt | $7,500 |
| Loss on disposal of capital asset | (9,023) |
| Impairment loss | (1,310,847) |

See accompanying notes to the financial statements

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## Note 1: Summary of Significant Accounting Policies

### a. Organization

The South Bayside Waste Management Authority (the Authority) is a joint powers authority formed on October 13, 1999 for the purpose of joint ownership, financing and administration of the Facilities, currently the Shoreway Environmental Center in San Carlos; and the planning, administration management, review, monitoring, enforcement and reporting of solid waste, recyclable material and plant material collection activities within Authority's service area.

Members of the Authority currently include the towns of Atherton and Hillsborough, and the cities of Belmont, Burlingame, East Palo Alto, Foster City, Menlo Park, Redwood City, San Carlos, San Mateo, as well as the West Bay Sanitary District and the County of San Mateo.

The Authority is controlled by a twelve member board consisting of one elected representative from each member. None of the member entities exercise specific control over the budgeting and financing of the Authority's activities beyond their representation on the board. Accounting services are provided by the City of San Carlos.

Based on the franchise agreements with each member agency and Recology effective January 1, 2011, the Authority collects service fees from Recology for the processing and disposal of collected materials. The facility operator, South Bay Recycling, also collects fees from public customers which are remitted to the Authority. South Bay Recycling is paid by the Authority to operate the facility and transport materials to disposal and processing facilities on a per ton basis pursuant to the Operations Agreement. The compensation to both contractors is adjusted annually based primarily on various CPI indices. The Authority also directly pays for disposal and processing of solid waste and organics materials to vendors such as BFI/Republic, Recology Grover, Zanker Road, and Bio-Fuel Systems.

### b. Enterprise Fund Accounting

The Authority is a proprietary entity; it uses an enterprise fund format to report its activities for financial statement purposes. Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs and expenses, including depreciation, of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges and the sale of commodities.

**Note 1: Summary of Significant Accounting Policies (Continued)**

An enterprise fund is used to account for activities similar to those in the private sector, where the proper matching of revenues and costs is important and the full accrual basis of accounting is required. With this measurement focus, all assets and all liabilities of the enterprise are recorded on its balance sheet, all revenues are recognized when earned and all expenses, including depreciation, are recognized when incurred. Enterprise fund equity includes retained earnings and contributed capital.

**c. Net Position Flow Policy**

Sometimes the Authority will fund outlays for a particular purpose from both restricted (e.g., restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted – net position and unrestricted – net position in the proprietary fund financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is the Authority's policy to consider restricted – net position to have been depleted before unrestricted – net position is used.

**d. Capital Assets**

All capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Contributed capital assets are valued at their estimated fair market value on the date contributed. Expenditures which materially increase the value or life of capital assets are capitalized and depreciated over the remaining useful life of the asset. The Authority's policy is to capitalize all assets with costs exceeding the $10,000 threshold and a useful life of more than one year.

All capital assets with limited useful lives are depreciated over their estimated useful lives. The purpose of depreciation is to spread the cost of capital assets equitably among all users over the life of these assets. The amount charged to depreciation expense each year represents that year's pro rata share of the cost of capital assets.

Depreciation is provided using the straight line method; meaning the cost of the asset is divided by its expected useful life in years and the result is charged to expense each year until the asset is fully depreciated. The Authority has assigned the useful lives of capital assets by type as listed below:

| | |
|---|---|
| Building | 10 - 40 years |
| Improvements | 5 - 20 years |
| Equipment | 5 - 15 years |

## Note 1: Summary of Significant Accounting Policies (Continued)

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase is reflected in the capitalized value of the asset constructed, net of interest earned on the invested proceeds over the same period.

### e. Compensated Absences

Compensated absences comprise unpaid vacation which is accrued as earned. All employees who hold full-time regular positions are entitled to 15 working days' vacation pay upon successful completion of their first year of continuous service. The accrual rate increases as length of service exceeds 5 years. Maximum accumulation of vacation is two years' vacation accrual. Upon termination or retirement, full-time employees are entitled to receive compensation at their current base salary for all unused vacation and 50% of their sick leave balance. The liability for compensated absences is determined annually.

### f. Retirement and Deferred Compensation Plans

The Authority offers its employees a retirement plan created in accordance with Internal Revenue Code Section 401a. The employer contribution to the 401a is 10% plus a match up to 2% of the employee contribution.

The Authority also offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457b. Pursuant to the IRC subsection (g), all amounts of compensation deferred under the deferred compensation plan, all property, or rights are solely the property and rights of the employee and beneficiaries of the Plan. Deferred compensation funds are not subject to the claims of the Authority's general creditors; consequently, the assets and related liabilities of the plan are not included within the Authority's financial statements.

### g. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position reports a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/ expenditure) until then. The Authority has no items that qualify for reporting in this category.

In addition to liabilities, the statement of financial position reports a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Authority has no items that qualify for reporting in this category.

## Note 1: Summary of Significant Accounting Policies (Continued)

### h. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Authority categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The fair value hierarchy categorizes the inputs to valuation techniques used to measure fair value into three levels based on the extent to which inputs used in measuring fair value are observable in the market.

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 inputs are inputs – other than quoted prices included within level 1 – that are observable for an asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for an asset or liability.

If the fair value of an asset or liability is measured using inputs from more than one level of the fair value hierarchy, the measurement is considered to be based on the lowest priority level input that is significant to the entire measurement.

## Note 2: Cash and Investments

The Authority pools cash from all sources except cash and investments held by fiscal agents so that it can be invested at the maximum yield consistent with safety and liquidity, while individual funds can make expenditures at any time.

### a. Policies

California Law requires banks and savings and loan institutions to pledge government securities with a market value of 110% of the Authority's cash on deposit, or first trust deed mortgage notes with a market value of 150% of the deposit, as collateral for these deposits. Under California Law this collateral is held in a separate investment pool by another institution in the Authority's name and places the Authority ahead of general creditors of the institution. The Authority Treasurer may waive the collateral requirement for deposits that are fully insured up to $250,000 by the FDIC.

The Authority invests in individual investments and in investment pools. Individual investments are evidenced by specific identifiable securities instruments, or by an electronic entry registering the owner in the records of the institution issuing the security, called the book entry system. In order to increase security, the Authority employs the Trust Department of a bank as the custodian of certain Authority managed investments, regardless of their form.

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

The Authority's investments are carried at fair value, as required by generally accepted accounting principles. The Authority adjusts the carrying value of its investments to reflect their fair value at each fiscal year end, and it includes the effects of these adjustments in income for that fiscal year.

**b. Classification**

Cash and investments are classified in the financial statements as shown below, based on whether or not their use is restricted under the terms of Authority debt instruments or agreements.

| Statement of Net Position | | |
|---|---|---|
| Cash and investments for operations | $ | 14,861,163 |
| Cash and investments with fiscal agent | | 6,364,259 |
| Total Cash and Investments | $ | 21,225,422 |

Cash and investments for operations is used in preparing proprietary fund statements of cash flows because these assets are highly liquid and are expended to liquidate liabilities arising during the year.

**c. Investment Authorized by the California Government Code and the Authority's Investment Policy**

The Authority's Investment Policy and the California Government Code allow the Authority to invest in the following, provided the credit ratings of the issuers are acceptable to the Authority; and approved percentages and maturities are not exceeded. The table below also identifies certain provisions of the California Government Code, or the Authority's Investment Policy when the Authority's Investment Policy is more restrictive.

## Note 2: Cash and Investments (Continued)

| Authorized Investment Type | Maximum Maturity | Minimum Credit Quality | Maximum in Portfolio | Maximum Investment In One Issuer |
|---|---|---|---|---|
| State Local Agency Investment Fund | Upon Demand | N/A | 50% to 70% of the investment portfolio, as approved by the SBWMA Board but no more than $65 million permitted by LAIF | $65 million per account |
| San Mateo County Investment Pool | Upon Demand | N/A | 30% to 50% of the investment portfolio, as approved by the SBWMA Board | N/A |
| U.S. Treasury Bonds, Notes and Bills | 5 Years | N/A | 100% | N/A |
| U.S. Government Agency and Federal Agency Securities | 5 Years | N/A | 100% | N/A |
| Bankers Acceptances | 180 Days | N/A | 40% | (A), (B) |
| Commercial Paper | 270 Days | A-1 | 25% | (A), (B) |
| Negotiable Certificates of Deposit | 5 Years | N/A | 30% | (A), (B) |
| Time Certificates of Deposit - Banks or Savings and Loans | 5 Years | N/A | 30% | (A), (B) |
| Medium Term Corporate Notes | 5 Years | A-1 | 30% | (A), (B) |

(A) 5% of outstanding paper of issuing corporation
(B) 5% of the portfolio in one corporation

### d. Investments Authorized by Debt Agreements

The Authority must maintain required amounts of cash and investments with trustees or fiscal agents under the terms of certain debt issues. These funds are unexpended bond proceeds or are pledged reserves to be used if the Authority fails to meet its obligations under these debt issues. The California Government Code requires these funds to be invested in accordance with Authority resolutions, bond indentures or State statutes. The table below identifies the investment types that are authorized for investments held by fiscal agents. The table also identifies certain provisions of these debt agreements:

## Note 2: Cash and Investments (Continued)

| Authorized Investment Type | Minimum Credit Quality |
|---|---|
| Direct obligations of the Department of the Treasury of the United States | None |
| Obligations issued or guaranteed by FMHA, FHA, General Services Administration, GNMA, U.S. Maritime Administration, HUD, and backed by the full faith and credit of the United States of America | None |
| Direct obligations of FHLB, FHLMC, FNMA, REFCORP, Farm Credit Enterprise, Federal Agriculture Mortgage Association, Tennessee Valley Authority | None |
| Money Market Fund | AA |
| U.S. dollar denominated Certificates of Deposit, savings accounts, deposit accounts | None |
| Investment agreements, including GIC's forward purchase agreements and reserve fund put agreements | None |
| Commercial Paper | A-1 |
| General obligations of States or municipalities | AAA |
| Bankers acceptances | A-1+ |
| Medium Term Notes | AAA |
| State of California Local Agency Investment Fund | None |
| San Mateo County Investment Pool | None |

### e. Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Normally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The Authority generally manages its interest rate risk by holding investments to maturity.

Information about the sensitivity of the fair values of the Authority's investments (including investments held by bond trustees) to market interest rate fluctuations is provided by the following table that shows the distribution of the Authority's investments by maturity or earliest call date:

## Note 2: Cash and Investments (Continued)

| Investment Type | 12 Months or less | Total |
|---|---|---|
| California Local Agency Investment Fund | $ 6,836,659 | $ 6,836,659 |
| San Mateo County Investment Pool | 6,814,034 | 6,814,034 |
| Cash and Cash Equivalents with Fiscal Agent: | | |
| Money Market Fund | 6,364,259 | 6,364,259 |
| Total Investments | $ 20,014,952 | 20,014,952 |
| Total Cash in Bank and Cash on Hand | | 1,210,470 |
| Total Cash and Investments | | $ 21,225,422 |

Local Agency Investment Fund

The Authority is a 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 Authority reports its investment in LAIF at the fair value amount provided by LAIF, which is the same as the value of the pool share. The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis. Included in LAIF's investment portfolio are collateralized mortgage obligations, mortgage-backed securities, other asset-backed securities, loans to certain state funds, and floating rate securities issued by federal agencies, government-sponsored enterprises, United States Treasury Notes and Bills, and corporations.

San Mateo County Investment Fund

The Authority is a voluntary participant in the San Mateo County Investment Fund (SMCIF) that is regulated by California Government Code Section 53600 under the oversight of the treasurer of the County of San Mateo. The Authority reports its investment in SMCIF at the fair value amount provided by SMCIF. The balance available for withdrawal is based on the accounting records maintained by SMCIF, which are recorded on an amortized cost basis. Included in SMCIF's investment portfolio are U.S. Treasury Notes, obligations issued by agencies of the U.S. Government, LAIF, corporate notes, commercial paper, collateralized mortgage obligations, mortgage-backed securities, other asset-backed securities, and floating rate securities issued by federal agencies, government-sponsored enterprises, and corporations. The Authority reports its investments in SMCIF at the fair value amounts provided by SMCIF, which is the same as the value of the pool share.

## Note 2: Cash and Investments (Continued)

### f. Credit Risk

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. Investments in California Local Agency Investment Fund and San Mateo County Investment Pool are not rated and therefore no rating is shown.

Presented below is the actual rating as of June 30, 2017, for each investment type as provided by S&P ratings:

| Investment Type | AAAm | Total |
|---|---|---|
| Cash and Cash Equivalents with Fiscal Agent: | | |
| Money Market Fund | $ 6,364,259 | $ 6,364,259 |
| Totals | $ 6,364,259 | 6,364,259 |
| Not rated: | | |
| California Local Agency Investment Fund | | 6,836,659 |
| San Mateo County Investment Pool | | 6,814,034 |
| Total Investments | | 20,014,952 |
| Total Cash in bank and cash on hand | | 1,210,470 |
| Total Cash and Investments | | $ 21,225,422 |

### g. Fair Value Hierarchy

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

## Note 2: Cash and Investments (Continued)

The following is a summary of the fair value hierarchy of the fair value of investments of the Authority as of June 30, 2017:

| Investment Type | Exempt | Total |
|---|---|---|
| **Investments by Fair Value:** | | |
| California Local Agency Investment Fund | $ 6,836,659 | $ 6,836,659 |
| San Mateo County Investment Pool | 6,814,034 | 6,814,034 |
| Total Investments at Fair Value | $ 13,650,693 | 13,650,693 |
| **Investments Measured at Amortized Cost:** | | |
| Money Market Fund | | 6,364,259 |
| Total Investments | | 20,014,952 |
| *Cash in banks* | | 1,210,470 |
| Total Cash and Investments | | $ 21,225,422 |

Both the California Local Agency Investment Fund and the San Mateo County Investment Pool are external investment pools and exempted in the fair value hierarchy, under GASB 72.

### h. Concentration of Credit Risk

The Authority's Investment Policy contains certain limitations on the amount that can be invested in any one issuer. In certain categories, these limitations surpass those required by California Government Code Sections 53600 et seq. Investments in any one issuer, other than U.S. Treasury securities, mutual funds, and external investment pools that represent 5% or more of total Entity-wide investments. There were no such investments at June 30, 2017.

## Note 3: Capital Assets and Facilities Operations

Pursuant to a sales agreement with Republic Services, Inc., the Authority purchased land, and buildings and personal property amounting to $14 million and $5.228 million, respectively. These facilities comprise the Shoreway Environmental Center in San Carlos. The Authority signed an agreement to lease back the facilities to Republic Services, Inc. to operate them. This agreement expired on December 31, 2006 and the Authority had extended the agreement until December 31, 2010. The Authority signed a new agreement effective January 1, 2011 with South Bay Recycling to operate the facility. For the year ended June 30, 2017, the Authority paid $18,518,805 to South Bay Recycling to operate the Facility.

## Note 4: Capital Assets

Changes in capital assets were as follows for fiscal year ended June 30, 2017:

| | Balance at June 30, 2016 | Additions | Retirements | Transfers | Balance at June 30, 2017 |
|---|---|---|---|---|---|
| Capital assets not being depreciated: | | | | | |
| Land | $ 14,000,000 | $ - | $ - | $ - | $ 14,000,000 |
| Construction in Progress | 126,347 | - | - | (126,347) | - |
| Total non-depreciable assets | 14,126,347 | - | - | (126,347) | 14,000,000 |
| Capital assets being depreciated: | | | | | |
| Buildings | 35,359,894 | 250,265 | (56,579) | 126,347 | 35,679,927 |
| Equipment | 22,574,212 | 3,285,227 | (2,420,365) | - | 23,439,074 |
| Total capital assets being depreciated | 57,934,106 | 3,535,492 | (2,476,944) | 126,347 | 59,119,001 |
| Less accumulated depreciation for: | | | | | |
| Buildings | (10,701,382) | (1,277,610) | 47,557 | - | (11,931,435) |
| Equipment | (11,548,051) | (1,707,651) | 1,109,518 | - | (12,146,184) |
| Total accumulated depreciation | (22,249,433) | (2,985,261) | 1,157,075 | - | (24,077,619) |
| Net capital assets being depreciated | 35,684,673 | 550,231 | (1,319,869) | 126,347 | 35,041,382 |
| Capital assets, net | $ 49,811,020 | $ 550,231 | $ (1,319,869) | $ - | $ 49,041,382 |

In September 2016, a Fire at the Shoreway Environmental Center caused considerable damage to the Material Recycling Facility sorting equipment. A calculation was made to determine the impairment required to be made to the damaged sorting system asset. This was calculated to be $1.3m and is treated in the table above and in the financial statements as a proportionate reduction of both the reported value of the asset and accumulated depreciation, based on the notion that the impairment represents the effective retirement of a portion of the asset. It is also shown in the Statement of Revenues, Expenses and Changes in Net Position netted against Insurance Proceeds, the total received of which was $8.8m. Net proceeds after deduction of the impairment were $7.5m.

## Note 5: Revenue Bonds

The Authority's debt issues and transactions are summarized below and discussed in detail thereafter.

| | Balance June 30, 2016 | Retirements | Balance June 30, 2017 | Due Within One Year |
|---|---|---|---|---|
| 2009A Solid Waste System Revenue Bonds | $ 48,780,000 | $ (1,310,000) | $ 47,470,000 | $ 1,365,000 |
| Bond premiums | 149,747 | (7,500) | 142,247 | - |
| | $ 48,929,747 | $ (1,317,500) | $ 47,612,247 | $ 1,365,000 |

### a. Solid Waste Enterprise Revenue Bonds Series 2009A

On September 2, 2009, the Authority issued $53,500,000 of Solid Waste Enterprise Revenue Bonds Series 2009A. The 2009A Bonds were issued to pay for the construction and renovation of a solid waste materials recovery facility and transfer station and related equipment, to fund a Reserve Fund, to fund capitalized interest, and to fund certain working capital and pay other costs, including issuance costs.

The series 2009A bonds are solely payable from and secured by the net revenues and debt service reserve fund held by the Authority's trustee, as defined under the bond indenture. Net Revenues means, for any period, all of the revenues during such period less all of the maintenance and operation costs during such period. Revenues mean all gross income and revenue received or receivable by the Authority.

Principal payments are payable annually on September 1, commencing September 1, 2012. The bond bears interest at 3.5%-6.0% which is payable semi-annually on September 1 and March 1, commencing on March 1, 2010.

### b. Revenue Pledge

The bonds are secured by a pledge of the Authority’s Net Revenue as defined under the bond indenture. For the 2009A bonds, the pledge of future net revenue ends upon repayment of the 2009A bonds in the amount of $87.1 million in remaining debt service on the bonds which is scheduled to occur in fiscal year 2037.

According to the Rate Covenant in the 2009A Bond Indenture, the Authority will maintain a Net Revenue to Debt Service coverage ratio of 1.40. As of the Fiscal Year 2016, the Net Revenues to Debt Service Coverage ratio was 1.47 .

## Note 5: Revenue Bonds (Continued)

### c. Debt Service Requirements

Annual debt service requirements on the bonds are shown below with specified repayment terms:

| For the Year Ending June 30 | Principal | Interest | Total |
|---|---|---|---|
| 2018 | $ 1,365,000 | $ 2,729,506 | $ 4,094,506 |
| 2019 | 1,420,000 | 2,665,000 | 4,085,000 |
| 2020 | 1,495,000 | 2,592,125 | 4,087,125 |
| 2021 | 1,570,000 | 2,554,750 | 4,124,750 |
| 2022 | 1,650,000 | 2,554,750 | 4,204,750 |
| 2023 - 2027 | 9,665,000 | 11,630,563 | 21,295,563 |
| 2028 - 2032 | 12,940,000 | 8,695,188 | 21,635,188 |
| 2033 - 2037 | 17,365,000 | 6,212,700 | 23,577,700 |
| Total | $ 47,470,000 | $ 39,634,582 | $ 87,104,582 |

## Note 6: Insurance

The Authority purchases commercial insurance policies to protect itself from claims arising from the following types of losses:

| Type of Coverage | Coverage Limits |
|---|---|
| General Aggregate Limit | $ 2,000,000 |
| General Liability deductible | 2,500 SIR |
| Environmental Impact Liability aggregate | 2,000,000 |
| Environmental Liability deductible | 25,000 SIR |
| Hired & Non-Owned Auto Limit | 1,000,000 |
| Employee Benefits Liability | 1,000,000 |
| Excess Liability | 10,000,000 |

**Note 7: Pollution Remediation**

In 2000 the South Bay Waste Management Authority (SBWMA) purchased the property located at 225/333 Shoreway Road in San Carlos. The property had pre-existing ground water contamination issues and the former property owner Allied Waste (now Republic Services) was identified as the responsible party. The ground water contamination is the result of hydrocarbon and petroleum products. Both Allied Waste and the SBWMA have managed a remediation effort under supervision from the County of San Mateo Department of Environmental Health.

The San Mateo County Health System (SMCHS) and the California Regional Water Quality Control Board (RWQCB) have reviewed and approved the SBWMA's "Closure Report" submitted on January 29, 2013 to close the Shoreway Environmental Center ("Shoreway") groundwater remediation project and issued a NOTICE OF CASE CLOSURE on April 29, 2014. This case closure letter is the final step in the Shoreway remediation closure and "no further remediation action" is required at the Shoreway facility. While no further remediation effort was deemed necessary, due to concerns about potential residual contamination, the property has a deed restriction requiring it to remain industrially zoned.

In March of 2010, the SBWMA received a lump sum settlement payment of $1,500,000 from Republic Services (formerly Allied Waste and BFI). This money was deposited into a SBWMA account dedicated to the ongoing clean-up efforts at Shoreway (the remediation cost estimate was negotiated with Allied per methods approved by County regulators and based on input from environmental engineers). At the close of remediation efforts on April 29, 2014 the Shoreway Remediation Fund had an unspent balance of $1,239,826. The unspent balance as of June 30, 2017 is $1,233,640 and is reported as accrued liabilities.

**Note 8: Net Position**

Designations

The Authority has designated $10,614,693 of the unrestricted net position for several reserves which include: $4,242,701 for rate stabilization, $4,242,701 for emergency reserve, 991,791 for equipment replacement, $1,137,500 for the payment of 2009A bonds. These designations may be modified, amended or removed by Authority Board action.

**Note 9: Commitments and Contingent Liabilities**

Litigation

SBWMA is subject to litigation arising in the normal course of business. In the opinion of legal counsel there is no pending litigation, which is likely to have a material adverse effect on the financial position of SBWMA.

Construction Commitments

There are no significant construction commitments as of June 30, 2017.

**INDEPENDENT AUDITOR'S 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***

To the Honorable Members of the Board of Directors
South Bayside Waste Management Authority
San Carlos, 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 basic financial statements of the South Bayside Waste Management Authority (Authority), as of and for the year ended June 30, 2017, and have issued our report thereon dated November 9, 2017.

***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 have not been identified.

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### *Compliance and Other Matters*

As part of obtaining reasonable assurance about whether the Authority's financial statements are free from 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 that are required to be reported under *Government Auditing Standards*.

We have also issued a separate Memorandum on Internal Control dated November 9, 2017 which is an integral part of our audit and should be read in conjunction with this report.

### *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.

Maze & Associates

Pleasant Hill, California
November 9, 2017

# SOUTH BAYSIDE WASTE
# MANAGEMENT AUTHORITY
# MEMORANDUM ON INTERNAL CONTROL
# AND
# REQUIRED COMMUNICATIONS

## FOR THE YEAR ENDED JUNE 30, 2017

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**SOUTH BAYSIDE WASTE
MANAGEMENT AUTHORITY
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

**For The Year Ended June 30, 2017**

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# MEMORANDUM ON INTERNAL CONTROL

To the Members of the Board of Directors of the
South Bayside Waste Management Authority
San Carlos, California

In planning and performing our audit of the basic financial statements of the South Bayside Waste Management Authority (Authority) as of and for the year ended June 30, 2017, in accordance with auditing standards generally accepted in the United States of America, we considered the Authority's internal control over financial reporting (internal control) as a basis for designing our 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.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. 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 have not been identified.

This communication is intended solely for the information and use of management, Board of Directors, others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Maze & Associates

Pleasant Hill, California
November 9, 2017

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**REQUIRED COMMUNICATIONS**

To the Members of the Board of Directors of the
South Bayside Waste Management Authority
San Carlos, California

We have audited the basic financial statements of the South Bayside Waste Management Authority (Authority) for the year ended June 30, 2017. Professional standards require that we communicate to you the following information related to our audit under generally accepted auditing standards and *Government Auditing Standards*.

## Significant Audit Findings

### *Accounting Policies*

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Authority are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year.

### *Unusual Transactions, Controversial or Emerging Areas*

We noted no transactions entered into by the Authority during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

### *Accounting Estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate(s) affecting the Authority's financial statements were):

> *Estimated Fair Value of Investments:* As of June 30, 2017, the Authority held approximately $14.9 million of cash and investments as measured by fair value as disclosed in Note 2 to the financial statements. Fair value is essentially market pricing in effect as of June 30, 2017. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2017.

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*Estimate of Depreciation:* Management's estimate of the depreciation is based on useful lives determined by management. These lives have been determined by management based on the expected useful life of assets as disclosed in Note 1 to the financial statements. We evaluated the key factors and assumptions used to develop the depreciation estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

*Estimate of Compensated Absences:* Accrued compensated absences which are comprised of accrued vacation, holiday, and certain other compensating time is estimated using accumulated unpaid leave hours and hourly pay rates in effect at the end of the fiscal year as disclosed in Note 1e to the financial statements. We evaluated the key factors and assumptions used to develop the accrued compensated absences and determined that it is reasonable in relation to the basic financial statements taken as a whole.

***Disclosures***

The financial statement disclosures are neutral, consistent, and clear.

***Difficulties Encountered in Performing the Audit***

We encountered no significant difficulties in dealing with management in performing and completing our audit.

***Corrected and Uncorrected Misstatements***

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. We did not propose any audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the Authority's financial reporting process.

Professional standards require us to accumulate all known and likely uncorrected misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the Authority Board.

***Disagreements with Management***

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

***Management Representations***

We have requested certain representations from management that are included in a management representation letter dated November 9, 2017.

### *Management Consultations with Other Independent Accountants*

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Authority's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

### *Other Audit Findings or Issues*

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Authority's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

## Other Information Accompanying the Financial Statements

We applied certain limited procedures to the required supplementary information that accompanies and supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the required supplementary information and do not express an opinion or provide any assurance on the required supplementary information.

******

This information is intended solely for the use of the Board of Directors and management and is not intended to be, and should not be, used by anyone other than these specified parties.

Maze & Associates

Pleasant Hill, California
November 9, 2017

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# CITY OF SAN CARLOS, CALIFORNIA
# MEMORANDUM ON INTERNAL CONTROL
# AND
# REQUIRED COMMUNICATIONS

## FOR THE YEAR ENDED JUNE 30, 2017

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**CITY OF SAN CARLOS, CALIFORNIA**
**MEMORANDUM ON INTERNAL CONTROL**
**AND**
**REQUIRED COMMUNICATIONS**

**For The Year Ended June 30, 2017**

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# MEMORANDUM ON INTERNAL CONTROL

To the City Council of
The City of San Carlos, California

In planning and performing our audit of the basic financial statements of the City of San Carlos (City) as of and for the year ended June 30, 2017, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our 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 City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City'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 City's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. 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 have not been identified.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe are opportunities for strengthening internal controls and operating efficiency.

This communication is intended solely for the information and use of management, City Council, others within the organization, and agencies and pass-through entities requiring compliance with *Government Audit Standards*, and is not intended to be and should not be used by anyone other than these specified parties.

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## MEMORANDUM ON INTERNAL CONTROL

## SCHEDULE OF OTHER MATTERS

**NEW GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE**

**EFFECTIVE FISCAL YEAR 2017/18:**

**GASB 75 – *Accounting and Financial Reporting for Post-employment Benefits Other Than Pensions***

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for post-employment benefits other than pensions (other post-employment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all post-employment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

This Statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plan*s, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans.

The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed.

In addition, this Statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB. This Statement also addresses certain circumstances in which a nonemployer entity provides financial support for OPEB of employees of another entity.

In this Statement, distinctions are made regarding the particular requirements depending upon whether the OPEB plans through which the benefits are provided are administered through trusts that meet the following criteria:

- Contributions from employers and nonemployer contributing entities to the OPEB plan and earnings on those contributions are irrevocable.

- OPEB plan assets are dedicated to providing OPEB to plan members in accordance with the benefit terms.
- OPEB plan assets are legally protected from the creditors of employers, nonemployer contributing entities, the OPEB plan administrator, and the plan members.

## MEMORANDUM ON INTERNAL CONTROL

## SCHEDULE OF OTHER MATTERS

**DEFINED BENEFIT OPEB**

Defined Benefit OPEB That Is Provided through OPEB Plans That Are Administered through Trusts That Meet the Specified Criteria

For OPEB that is administered through a trust that meets the specified criteria, requirements differ based on the number of employers whose employees are provided with OPEB through the OPEB plan and whether OPEB obligations and OPEB plan assets are shared by the employers. Employers are classified in one of the following categories for purposes of this Statement:

- Single employers are those whose employees are provided with defined benefit OPEB through single-employer OPEB plans—OPEB plans in which OPEB is provided to the employees of only one employer (as defined in this Statement).

- Agent employers are those whose employees are provided with defined benefit OPEB through agent multiple-employer OPEB plans—OPEB plans in which plan assets are pooled for investment purposes but separate accounts are maintained for each individual employer so that each employer's share of the pooled assets is legally available to pay the benefits of only its employees.

- Cost-sharing employers are those whose employees are provided with defined benefit OPEB through cost-sharing multiple-employer OPEB plans—OPEB plans in which the OPEB obligations to the employees of more than one employer are pooled and plan assets can be used to pay the benefits of the employees of any employer that provides OPEB through the OPEB plan.

Measurement of the OPEB Liability to Employees for Benefits

This Statement requires the liability of employers and nonemployer contributing entities to employees for defined benefit OPEB (net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position.

The total OPEB liability generally is required to be determined through an actuarial valuation. However, if fewer than 100 employees (active and inactive) are provided with OPEB through the plan, use of a specified alternative measurement method in place of an actuarial valuation is permitted. An actuarial valuation or a calculation using the specified alternative measurement method of the total OPEB liability is required to be performed at least every two years, with more frequent valuations or calculations encouraged. If an actuarial valuation or a calculation using the alternative measurement method is not performed as of the measurement date, the total OPEB liability is required to be based on update procedures to roll forward amounts from an earlier actuarial valuation or alternative measurement method calculation (performed as of a date no more than 30 months and 1 day prior to the employer's most recent fiscal year-end). Unless otherwise specified by this Statement, all assumptions underlying the determination of the total OPEB liability and related measures set forth by this Statement are required to be made in conformity with Actuarial Standards of Practice issued by the Actuarial Standards Board.

Projections of benefit payments are required to be based on claims costs, or age-adjusted premiums approximating claims costs, and the benefit terms and legal agreements existing at the measurement date. For purposes of evaluating the benefit terms, consideration is required to be given to the written plan document, as well as other information, including other communications between the employer and employees and an established pattern of practice with regard to the sharing of benefit-related costs with inactive employees. Certain legal or contractual caps on benefit payments to be provided are required to be considered in projections of benefit payments.

This Statement requires that projections of benefit payments incorporate the effects of projected salary changes (if the OPEB formula incorporates future compensation levels) and service credits (if the OPEB formula incorporates periods of service), as well as projected automatic postemployment benefit changes, including automatic cost-of-living-adjustments (COLAs). The effects of ad hoc postemployment benefit changes (including ad hoc COLAs), if they are considered to be substantively automatic, also are required to be included in the projections. This Statement also requires that projections of benefit payments include certain taxes or other assessments expected to be imposed on the benefit payments.

Projected benefit payments are required to be discounted to their actuarial present value using the single rate that reflects (1) a long-term expected rate of return on OPEB plan investments to the extent that the OPEB plan's fiduciary net position is projected to be sufficient to make projected benefit payments and OPEB plan assets are expected to be invested using a strategy to achieve that return and (2) a tax-exempt, high-quality municipal bond rate to the extent that the conditions for use of the long-term expected rate of return are not met.

This Statement requires that the actuarial present value of projected benefit payments be attributed to periods of employee service using the entry age actuarial cost method with each period's service cost determined as a level percentage of pay. The actuarial present value is required to be attributed for each employee individually, from the first period in which the employee provides service under the benefit terms, through the period in which the employee exits active service.

**Alternative Measurement Method**

This Statement includes an option for the use of a specified alternative measurement method in place of an actuarial valuation for purposes of determining the total OPEB liability for benefits provided through an OPEB plan in which fewer than 100 employees (active and inactive) are provided with OPEB through the plan. The alternative measurement method is an approach that includes the same broad measurement steps as an actuarial valuation (projecting benefit payments, discounting projected benefit payments to a present value, and attributing the present value of projected benefit payments to periods using an actuarial cost method). However, it permits simplification of certain assumptions.

**SINGLE AND AGENT EMPLOYERS**

In financial statements prepared using the economic resources measurement focus and accrual basis of accounting, a single or agent employer that does not have a special funding situation is required to recognize a liability equal to the net OPEB liability. The net OPEB liability is required to be measured as of a date no earlier than the end of the employer's prior fiscal year and no later than the end of the employer's current fiscal year (the measurement date), consistently applied from period to period.

The OPEB expense and deferred outflows of resources and deferred inflows of resources related to OPEB that are required to be reported by an employer primarily result from changes in the components of the net OPEB liability—that is, changes in the total OPEB liability and in the OPEB plan's fiduciary net position.

This Statement requires that most changes in the net OPEB liability be included in OPEB expense in the period of the change. For example, changes in the total OPEB liability resulting from current-period service cost, interest on the total OPEB liability, and changes of benefit terms are required to be included in OPEB expense immediately. Projected earnings on the OPEB plan's investments also are required to be included in the determination of OPEB expense immediately.

In circumstances in which the net OPEB liability is determined based on the results of an actuarial valuation, the effects of certain other changes in the net OPEB liability are required to be included in OPEB expense over the current and future periods. The effects on the total OPEB liability of (1) changes of economic and demographic assumptions or of other inputs and (2) differences between expected and actual experience are required to be included in OPEB expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all employees that are provided with benefits through the OPEB plan (active employees and inactive employees), beginning in the current period.

Under all means of determining the net OPEB liability, the effect on the net OPEB liability of differences between the projected earnings on OPEB plan investments and actual experience with regard to those earnings is required to be included in OPEB expense in a systematic and rational manner over a closed period of five years, beginning in the current period.

Changes in the net OPEB liability that have not been included in OPEB expense are required to be reported as deferred outflows of resources or deferred inflows of resources related to OPEB.

Employer contributions subsequent to the measurement date of the net OPEB liability are required to be reported as deferred outflows of resources.

In governmental fund financial statements, a net OPEB liability is required to be recognized to the extent the liability is normally expected to be liquidated with expendable available financial resources. OPEB expenditures are required to be recognized equal to the total of (1) amounts paid by the employer to the OPEB plan, including amounts paid for OPEB as the benefits come due, and (2) the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources.

**Notes to Financial Statements**

This Statement requires that notes to financial statements of single and agent employers include descriptive information, such as the types of benefits provided and the number and classes of employees covered by the benefit terms. Single and agent employers also are required to disclose information that includes the following, as applicable:

- For the current year, sources of changes in the net OPEB liability

- Significant assumptions and other inputs used to calculate the total OPEB liability, including those about inflation, the healthcare cost trend rate, salary changes, ad hoc postemployment benefit changes (including ad hoc COLAs), and inputs to the discount rate, as well as certain information about mortality assumptions and the dates of experience studies

- The date of the actuarial valuation or calculation using the alternative measurement method used to determine the total OPEB liability, information about changes of assumptions or other inputs and benefit terms, the basis for determining employer contributions to the OPEB plan, and information about the purchase of allocated insurance contracts, if any.

**Required Supplementary Information**

This Statement requires single and agent employers to present in required supplementary information the following information, determined as of the measurement date, for each of the 10 most recent fiscal years:

- Sources of changes in the net OPEB liability

- The components of the net OPEB liability and related ratios, including the OPEB plan's fiduciary net position as a percentage of the total OPEB liability, and the net OPEB liability as a percentage of covered-employee payroll.

If an actuarially determined contribution is calculated for a single or agent employer, the employer is required to present in required supplementary information a schedule covering each of the 10 most recent fiscal years that includes information about the actuarially determined contribution, contributions to the OPEB plan, and related ratios. If a single or agent employer does not have information about an actuarially determined contribution but has a contribution requirement that is established by statute or contract, the employer is required to present a schedule covering each of the 10 most recent fiscal years that includes information about the statutorily or contractually required contribution rates, contributions to the OPEB plan, and related ratios.

Significant methods and assumptions used in calculating the actuarially determined contributions, if applicable, are required to be presented as notes to required supplementary information. In addition, the employer is required to explain certain factors that significantly affect trends in the amounts reported in the schedules.

**Cost-Sharing Employers**

In financial statements prepared using the economic resources measurement focus and accrual basis of accounting, a cost-sharing employer that does not have a special funding situation is required to recognize a liability for its proportionate share of the net OPEB liability (of all employers for benefits provided through the OPEB plan)—the collective net OPEB liability. An employer's proportion is required to be determined on a basis that is consistent with the manner in which contributions to the OPEB plan are determined. The use of the employer's projected long-term contribution effort as compared to the total projected long-term contribution effort of all employers as the basis for determining an employer's proportion is encouraged.

A cost-sharing employer is required to recognize OPEB expense and report deferred outflows of resources and deferred inflows of resources related to OPEB for its proportionate shares of collective OPEB expense and collective deferred outflows of resources and deferred inflows of resources related to OPEB.

In addition, the effects of (1) a change in the employer's proportion of the collective net OPEB liability and (2) differences during the measurement period between certain of the employer's contributions and its proportionate share of the total of certain contributions from employers included in the collective net

OPEB liability are required to be determined. These effects are required to be recognized in the employer's OPEB expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all employees that are provided with OPEB through the OPEB plan (active employees and inactive employees). The portions of the effects not recognized in the employer's OPEB expense are required to be reported as deferred outflows of resources or deferred inflows of resources related to OPEB. Employer contributions to the OPEB plan subsequent to the measurement date of the collective net OPEB liability also are required to be reported as deferred outflows of resources related to OPEB.

In governmental fund financial statements, the cost-sharing employer's proportionate share of the collective net OPEB liability is required to be recognized to the extent the liability is normally expected to be liquidated with expendable available financial resources. OPEB expenditures are required to be recognized equal to the total of (1) amounts paid by the employer to the OPEB plan, including amounts paid for OPEB as the benefits come due, and (2) the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources.

This Statement requires that notes to financial statements of cost-sharing employers include descriptive information about the OPEB plans through which the OPEB is provided. Cost-sharing employers are required to identify the discount rate and assumptions made in the measurement of their proportionate shares of net OPEB liabilities, similar to the disclosures about those items that should be made by single and agent employers. Cost-sharing employers, like single and agent employers, also are required to disclose information about how their contributions to the OPEB plan are determined.

This Statement requires cost-sharing employers to present in required supplementary information 10-year schedules containing (1) the net OPEB liability and certain related ratios and (2) if applicable, information about statutorily or contractually required contributions, contributions to the OPEB plan, and related ratios.

Defined Benefit OPEB That Is Provided through OPEB Plans That Are Not Administered through Trusts That Meet the Specified Criteria

For employers that provide insured benefits—defined benefit OPEB through an arrangement whereby premiums are paid or other payments are made to an insurance company while employees are in active service, in return for which the insurance company unconditionally undertakes an obligation to pay the OPEB of those employees—this Statement requires recognition of OPEB expense/expenditures equal to the amount of premiums or other payments required in accordance with their agreement with the insurance company. In addition to the amount of OPEB expense/expenditures recognized in the current period, a brief description of the benefits provided through the arrangement is required to be disclosed.

For defined benefit OPEB, other than insured benefits, that are provided through OPEB plans that are not administered through trusts that meet the specified criteria, this Statement requires an approach to measurement of OPEB liabilities, OPEB expense, and deferred outflows of resources and deferred inflows of resources related to OPEB parallel to that which is required for OPEB provided through OPEB plans that are administered through trusts that meet the specified criteria. Similar note disclosures and required supplementary information are required to be presented. However, the requirements incorporate modifications to reflect the absence of OPEB plan assets for financial reporting purposes.

## DEFINED CONTRIBUTION OPEB

This Statement requires an employer whose employees are provided with defined contribution OPEB to recognize OPEB expense for the amount of contributions or credits to employees' accounts that are defined by the benefit terms as attributable to employees' services in the period, net of forfeited amounts that are removed from employees' accounts. A change in the OPEB liability is required to be recognized for the difference between amounts recognized in expense and amounts paid by the employer to (or benefit payments through) a defined contribution OPEB plan. In governmental fund financial statements, OPEB expenditures are required to be recognized equal to the total of (1) amounts paid by the employer to (or benefit payments through) an OPEB plan and (2) the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources. An OPEB liability is required to be recognized to the extent the liability is normally expected to be liquidated with expendable available financial resources. Notes to financial statements of an employer with a defined contribution plan are required to include descriptive information about the OPEB plan and benefit terms, contribution rates and how they are determined, and amounts attributed to employee service and forfeitures in the current period.

## SPECIAL FUNDING SITUATIONS

In this Statement, special funding situations are defined as circumstances in which a nonemployer entity is legally responsible for providing certain forms of financial support for OPEB of the employees of another entity. Relevant forms of financial support are contributions directly to an OPEB plan that is administered through a trust that meets the specified criteria, including benefit payments as OPEB comes due for OPEB provided through such a plan, or making benefit payments directly as the OPEB comes due in circumstances in which OPEB is provided through an OPEB plan that is not administered through a trust that meets the specified criteria. Such support is a special funding situation if either (1) the amount of contributions or benefit payments, as applicable, for which the nonemployer entity legally is responsible is not dependent upon one or more events unrelated to the OPEB or (2) the nonemployer entity is the only entity with a legal obligation to make contributions directly to an OPEB plan or to make benefit payments as OPEB comes due, as applicable.

This Statement requires an employer that has a special funding situation for defined benefit OPEB to recognize an OPEB liability and deferred outflows of resources and deferred inflows of resources related to OPEB with adjustments for the involvement of nonemployer contributing entities. The employer is required to recognize its proportionate share of the collective OPEB expense, as well as additional OPEB expense and revenue for the OPEB support of the nonemployer contributing entities. This Statement requires that the employer disclose in notes to financial statements information about the amount of support provided by nonemployer contributing entities and present similar information about the involvement of those entities in 10-year schedules of required supplementary information.

The approach that is required by this Statement for measurement and recognition of liabilities, deferred outflows of resources and deferred inflows of resources, and expense by a governmental nonemployer contributing entity in a special funding situation for defined benefit OPEB is similar to the approach required for cost-sharing employers.

The information that is required to be disclosed in notes to financial statements and presented in required supplementary information of a governmental nonemployer contributing entity in a special funding situation depends on the proportion of the collective net OPEB liability that it recognizes. In circumstances in which a governmental nonemployer contributing entity recognizes a substantial proportion of the collective net OPEB liability, requirements for note disclosures and required supplementary information are similar to those for cost-sharing employers. Reduced note disclosures and required supplementary information are required for governmental nonemployer contributing entities that recognize a less-than-substantial portion of the collective net OPEB liability.

This Statement also establishes requirements related to special funding situations for defined contribution OPEB.

***Effective Date***

This Statement is effective for fiscal years beginning after June 15, 2017.

***How the Changes in This Statement Improve Financial Reporting***

The requirements of this Statement will improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire OPEB liability and a more comprehensive measure of OPEB expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information, as follows:

- More robust disclosures of assumptions will allow for better informed assessments of the reasonableness of OPEB measurements.
- Explanations of how and why the OPEB liability changed from year to year will improve transparency.
- The summary OPEB liability information, including ratios, will offer an indication of the extent to which the total OPEB liability is covered by resources held by the OPEB plan, if any.
- For employers that provide benefits through OPEB plans that are administered through trusts that meet the specified criteria, the contribution schedules will provide measures to evaluate decisions related to contributions.

The consistency, comparability, and transparency of the information reported by employers and governmental nonemployer contributing entities about OPEB transactions will be improved by requiring:

- The use of a discount rate that considers the availability of the OPEB plan's fiduciary net position associated with the OPEB of current active and inactive employees and the investment horizon of those resources, rather than utilizing only the long-term expected rate of return regardless of whether the OPEB plan's fiduciary net position is projected to be sufficient to make projected benefit payments and is expected to be invested using a strategy to achieve that return
- A single method of attributing the actuarial present value of projected benefit payments to periods of employee service, rather than allowing a choice among six methods with additional variations
- Immediate recognition in OPEB expense, rather than a choice of recognition periods, of the effects of changes of benefit terms

- Recognition of OPEB expense that incorporates deferred outflows of resources and deferred inflows of resources related to OPEB over a defined, closed period, rather than a choice between an open or closed period.

**GASB 81 – *Irrevocable Split-Interest Agreements***

The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.

Split-interest agreements are a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments. Split-interest agreements can be created through trusts—or other legally enforceable agreements with characteristics that are equivalent to split-interest agreements—in which a donor transfers resources to an intermediary to hold and administer for the benefit of a government and at least one other beneficiary. Examples of these types of agreements include charitable lead trusts, charitable remainder trusts, and life-interests in real estate.

This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period.

***Effective Date***

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2016, and should be applied retroactively.

***How the Changes in This Statement Improve Financial Reporting***

This Statement enhances the comparability of financial statements by providing accounting and financial reporting guidance for irrevocable split-interest agreements in which a government is a beneficiary. This Statement also enhances the decision-usefulness of general purpose external financial reports, and their value for assessing accountability, by more clearly identifying the resources that are available for the government to carry out its mission.

**GASB 85 – *Omnibus 2017***

The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). Specifically, this Statement addresses the following topics:

- Blending a component unit in circumstances in which the primary government is a business-type activity that reports in a single column for financial statement presentation

- Reporting amounts previously reported as goodwill and “negative” goodwill
- Classifying real estate held by insurance entities
- Measuring certain money market investments and participating interest-earning investment contracts at amortized cost
- Timing of the measurement of pension or OPEB liabilities and expenditures recognized in financial statements prepared using the current financial resources measurement focus
- Recognizing on-behalf payments for pensions or OPEB in employer financial statements
- Presenting payroll-related measures in required supplementary information for purposes of reporting by OPEB plans and employers that provide OPEB
- Classifying employer-paid member contributions for OPEB
- Simplifying certain aspects of the alternative measurement method for OPEB
- Accounting and financial reporting for OPEB provided through certain multiple-employer defined benefit OPEB plans.

***Effective Date***

The requirements of this Statement are effective for reporting periods beginning after June 15, 2017.

***How the Changes in This Statement Improve Financial Reporting***

The requirements of this Statement will enhance consistency in the application of accounting and financial reporting requirements. Consistent reporting will improve the usefulness of information for users of state and local government financial statements.

**EFFECTIVE FISCAL YEAR 2018/19:**

**GASB 83 – *Certain Asset Retirement Obligations***

This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement.

This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates a government to perform asset retirement activities. Laws and regulations may require governments to take specific actions to retire certain tangible capital assets at the end of the useful lives of those capital assets, such as decommissioning nuclear reactors and dismantling and removing sewage treatment plants. Other obligations to retire tangible capital assets may arise from contracts or court judgments. Internal obligating events include the occurrence of contamination, placing into operation a tangible capital asset that is required to be retired, abandoning a tangible capital asset before it is placed into operation, or acquiring a tangible capital asset that has an existing ARO.

This Statement requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred. The best estimate should include probability weighting of all potential outcomes, when such information is available or can be obtained at reasonable cost. If probability weighting is not feasible at reasonable cost, the most likely amount should be used. This Statement requires that a deferred outflow of resources associated with an ARO be measured at the amount of the corresponding liability upon initial measurement.

This Statement requires the current value of a government's AROs to be adjusted for the effects of general inflation or deflation at least annually. In addition, it requires a government to evaluate all relevant factors at least annually to determine whether the effects of one or more of the factors are expected to significantly change the estimated asset retirement outlays. A government should remeasure an ARO only when the result of the evaluation indicates there is a significant change in the estimated outlays. The deferred outflows of resources should be reduced and recognized as outflows of resources (for example, as an expense) in a systematic and rational manner over the estimated useful life of the tangible capital asset.

A government may have a minority share (less than 50 percent) of ownership interest in a jointly owned tangible capital asset in which a nongovernmental entity is the majority owner and reports its ARO in accordance with the guidance of another recognized accounting standards setter. Additionally, a government may have a minority share of ownership interest in a jointly owned tangible capital asset in which no joint owner has a majority ownership, and a nongovernmental joint owner that has operational responsibility for the jointly owned tangible capital asset reports the associated ARO in accordance with the guidance of another recognized accounting standards setter. In both situations, the government's minority share of an ARO should be reported using the measurement produced by the nongovernmental majority owner or the nongovernmental minority owner that has operational responsibility, without adjustment to conform to the liability measurement and recognition requirements of this Statement.

In some cases, governments are legally required to provide funding or other financial assurance for their performance of asset retirement activities. This Statement requires disclosure of how those funding and assurance requirements are being met by a government, as well as the amount of any assets restricted for payment of the government's AROs, if not separately displayed in the financial statements.

This Statement also requires disclosure of information about the nature of a government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets. If an ARO (or portions thereof) has been incurred by a government but is not yet recognized because it is not reasonably estimable, the government is required to disclose that fact and the reasons therefor. This Statement requires similar disclosures for a government's minority shares of AROs.

***Effective Date***

The requirements of this Statement are effective for reporting periods beginning after June 15, 2018.

### *How the Changes in This Statement Will Improve Financial Reporting*

This Statement will enhance comparability of financial statements among governments by establishing uniform criteria for governments to recognize and measure certain AROs, including obligations that may not have been previously reported. This Statement also will enhance the decision-usefulness of the information provided to financial statement users by requiring disclosures related to those AROs.

## EFFECTIVE FISCAL YEAR 2019/20:

### GASB 84 – ***Fiduciary Activities***

The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities.

An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. An exception to that requirement is provided for a business-type activity that normally expects to hold custodial assets for three months or less.

This Statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

A fiduciary component unit, when reported in the fiduciary fund financial statements of a primary government, should combine its information with its component units that are fiduciary component units and aggregate that combined information with the primary government's fiduciary funds.

This Statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Events that compel a government to disburse fiduciary resources occur when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets.

### *Effective Date*

The requirements of this Statement are effective for reporting periods beginning after December 15, 2018.

## MEMORANDUM ON INTERNAL CONTROL

## SCHEDULE OF OTHER MATTERS

***How the Changes in This Statement Will Improve Financial Reporting***

The requirements of this Statement will enhance consistency and comparability by (1) establishing specific criteria for identifying activities that should be reported as fiduciary activities and (2) clarifying whether and how business-type activities should report their fiduciary activities. Greater consistency and comparability enhances the value provided by the information reported in financial statements for assessing government accountability and stewardship.

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## REQUIRED COMMUNICATIONS

To the City Council of
The City of San Carlos, California

We have audited the basic financial statements of the City of San Carlos for the year ended June 30, 2017. Professional standards require that we communicate to you the following information related to our audit under generally accepted auditing standards and *Government Auditing Standards*.

**Significant Audit Findings**

***Accounting Policies***

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year, except as follows:

**GASB 82 – *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73***

> The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, Financial Reporting for Pension Plans, No. 68, Accounting and Financial Reporting for Pensions, and No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.
>
> The pronouncement became effective, but did not have a material effect on the financial statements or the footnotes. It only affected the Pension-related Required Supplementary Information.

***Unusual Transactions, Controversial or Emerging Areas***

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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***Accounting Estimates***

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate(s) affecting the City's financial statements were:

> *Estimated Net Pension Liabilities and Pension-Related Deferred Outflows and Inflows of Resources:* Management's estimate of the net pension assets and liabilities and deferred outflows/inflows of resources are disclosed in Note 10 to the financial statements and are based on actuarial studies determined by a consultant, which are based on the experience of the City. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.
>
> *Estimated Net OPEB Asset:* Management's estimate of the net OPEB Asset is disclosed in Note 11 to the financial statements and is based on actuarial study determined by a consultant, which is based on the experience of the City. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.
>
> *Estimated Fair Value of Investments:* As of June 30, 2017, the City held approximately $132.1 million of cash and investments as measured by fair value as disclosed in Note 2 to the financial statements. Fair value is essentially market pricing in effect as of June 30, 2017. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2017.
>
> *Estimate of Depreciation:* Management's estimate of the depreciation is based on useful lives determined by management. These lives have been determined by management based on the expected useful life of assets as disclosed in Note 1 to the financial statements. We evaluated the key factors and assumptions used to develop the depreciation estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.
>
> *Estimate of Compensated Absences:* Accrued compensated absences which are comprised of accrued vacation, holiday, and certain other compensating time is estimated using accumulated unpaid leave hours and hourly pay rates in effect at the end of the fiscal year as disclosed in Note 8 to the financial statements. We evaluated the key factors and assumptions used to develop the accrued compensated absences and determined that it is reasonable in relation to the basic financial statements taken as a whole.

*Estimated Claims Liabilities:* Management's estimate of the claims liabilities payable is disclosed in Note 12 to the financial statements and is based on the claims experience of the City. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

***Disclosures***

The financial statement disclosures are neutral, consistent, and clear.

***Difficulties Encountered in Performing the Audit***

We encountered no significant difficulties in dealing with management in performing and completing our audit.

***Corrected and Uncorrected Misstatements***

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. We did not propose any audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the City's financial reporting process.

Professional standards require us to accumulate all known and likely uncorrected misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the City Council.

***Disagreements with Management***

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

***Management Representations***

We have requested certain representations from management that are included in a management representation letter dated October 26, 2017.

***Management Consultations with Other Independent Accountants***

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

***Other Audit Findings or Issues***

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

**Other Information Accompanying the Financial Statements**

We applied certain limited procedures to the required supplementary information that accompanies and supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the required supplementary information and do not express an opinion or provide any assurance on the required supplementary information.

We were engaged to report on the supplementary information which accompany the financial statements, but are not required supplementary information. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the Introductory and Statistical Sections which accompany the financial statements, but are not required supplementary information. Such information has 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.

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This information is intended solely for the use of City Council and management and is not intended to be, and should not be, used by anyone other than these specified parties.

Maze & Associates

Pleasant Hill, California
October 26, 2017