

South Orange County Wastewater Authority

Dana Point, California

Financial Statements and Independent Auditor's Report

For the year ended June 30, 2016

SOUTH ORANGE COUNTY WASTEWATER AUTHORITY

Financial Statements

For the year ended June 30, 2016

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The Board of Directors
of the South Orange County Wastewater Authority
Dana Point, California

Independent Auditor's Report

Report on the Financial Statements

We have audited the accompanying financial statements of the South Orange County Wastewater Authority ("the Authority"), as of and for the year ended June 30, 2016, 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity'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 entity'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 qualified opinion.

Basis for Qualified Opinion

We were unable to audit \$23,601,400 of infrastructure capital assets presented in the financial statements. Accounting principles generally accepted in the United States of America require that capital assets records contain sufficient detail by specific asset.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements referred to above present fairly, in all material respects, the financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

During the year ended June 30, 2016, the Authority recorded capitals assets that were constructed or acquired by other agencies and transferred to the Authority upon formation. As a result, the Authority's financial statements include a prior period adjustment in the amount of \$38,882,794 as described further in Note 9 to the financial statements. Our opinion is qualified with respect to this matter as noted in the Basis of Qualified Opinion.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the *management's discussion and analysis* and *required supplementary information related to the pension plan* 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 Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The *other information* is presented for purposes of additional analysis and are not a required part of the basic financial statements. The *other 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 it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 23, 2017 on our consideration of the South Orange County Wastewater Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

A handwritten signature in blue ink that reads "Davis Lee WP". The signature is written in a cursive, flowing style.

Irvine, California

June 23, 2017



South Orange County Wastewater Authority
 1150 Del Obispo Street, Dana Point CA. 92629
 Phone: (949) 234-5400 Fax: (949) 489-0130

MANAGEMENT'S DISCUSSION AND ANALYSIS June 30, 2016

This section of the financial statements of the South Orange County Wastewater Authority (Authority) is management's overview and analysis of the Authority's financial activities for the fiscal year ended June 30, 2016. The information here is to be considered in conjunction with the financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

	Changes in Net Position					
	Year Ended June 30					
	2016	2015	Capital Asset Additions FY 2015	Restated FY 2015	Dollar Change +/-	Percentage Change +/-
Net Position	\$108,610,338	\$53,182,324	\$38,882,794	\$92,065,118	\$16,545,220	18.0%
Construction-in-Progress	28,169,309	10,133,406		10,133,406	17,810,596	178.0%
Capital Assets:						
Land	14,402,224	653,224	13,749,000	14,402,224		0.0%
Other Assets	215,383,339	103,600,794	108,076,158	211,676,952	3,706,387	1.8%
Accumulated Depreciation	(142,697,383)	(54,098,419)	(82,942,364)	(137,040,783)	(5,656,600)	4.1%
Capital Assets Book Value	87,088,180	50,155,599	38,882,794	89,038,393	(1,950,213)	-2.2%
Liabilities:						
Other Post Employment Benefits	745,962	1,083,904		1,083,904	(337,942)	-31.2%
GASB 68-Net Pension Liability	9,054,535	6,794,277		6,794,277	2,260,258	33.3%
GASB 68-Deferred Outflows	(1,712,209)	(813,449)		(813,449)	(898,760)	110.5%
GASB 68-Deferred Inflows	1,315,151	2,409,966		2,409,966	(1,094,815)	-45.4%
Compensated Absences	684,767	644,831		644,831	39,936	6.2%

The Authority's Net Position increased \$16.5 million or 18.0% primarily due to:

- The addition of Capital Assets "held and in-service" but previously not included in the Authority's financial records, an increase in net book value of \$38.9 million which includes:

Land	\$13.7 million
Buildings	\$1.6 million
Infrastructure	\$23.6 million

Notes to historical audited financial statements provide the basis for valuations of infrastructure assets of \$23.6 million. However, there is not sufficient detail to support an unqualified opinion. In Fiscal Year 2017-18, the Authority will pursue further evaluation to obtain supporting detail.



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- Construction-in-Progress increased \$17.8 million primarily due to work at:
JB Latham, PC 2, \$11.8 million
Regional, PC 17, \$ 5.4 million

JB Latham facility projects include significant spending on:

- Aeration/Co-Generation, \$4.4M million
- Co-Generation repair, \$2.3 million
- Digester Gas Systems, \$2.2 million
- West Side Power Upgrade, \$1.7 million.

Regional facility projects include significant spending on:

- Co-Gen System Retrofit, \$3.1 million
- Switchgear Upgrade, \$2.6 million.

- Other Post Employment Benefits liability decreased \$337 thousand primarily due to prefunding of the liability via the PARS Trust Fund.
- GASB 68 Pension entries decreased Net Position by \$267 thousand due to a net pension liability increase of \$2.3 million offset by \$2.0 million change in deferred outflows and inflows.
- Compensated Absences, Vacation and Sick Leave earned but not taken or paid out, increased by \$40 thousand primarily due to revaluation of the liability.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Authority operates as a Joint Powers Authority and is accounted for as an Enterprise Fund, using the full accrual basis of accounting. As an enterprise fund, the Authority's basic financial statements are comprised of two components:

- Financial Statements
- Notes to the Financial Statements.

The report also contains other supplementary information about the Operations and Maintenance (O&M) budgets, in addition to the basic financial statements.

In accordance with GASB Statement No. 34, the Authority's financial statements include:

- Statement of Net Position
- Statement of Revenues, Expenses and Changes in Net Position
- Statement of Cash Flows
- Notes to the Financial Statements.

The statement of revenues, expenses, and changes in net position accounts for the current year's revenues and expenses. This statement reflects the overall activity of the Authority, related to normal operations of all facilities.



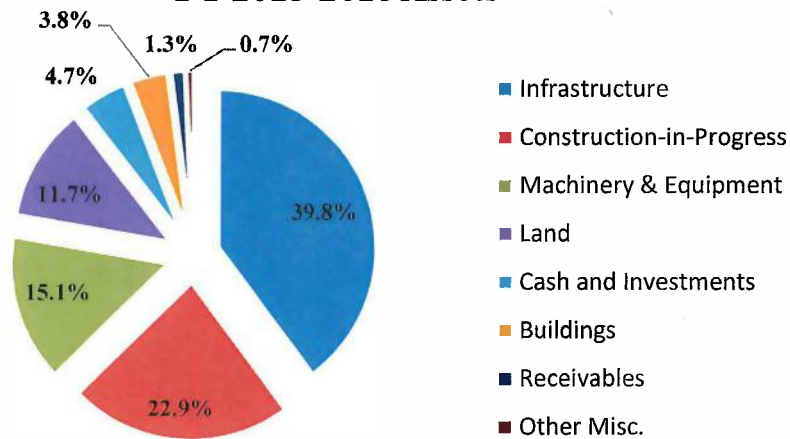
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NET POSITION

To begin our analysis, a summary of the Authority's Statement of Net position is presented as Chart 1, Chart 2, Chart 3, Table 1, Table 2, Table 3, Table 4 and Table 5.

Chart 1

**Composition of Authority's
 FY 2015-2016 Assets**



The Authority's recorded investment in land, buildings and infrastructure increased significantly due to the recording of real properties in service but not previously recorded in the financial records, \$38.9 million.

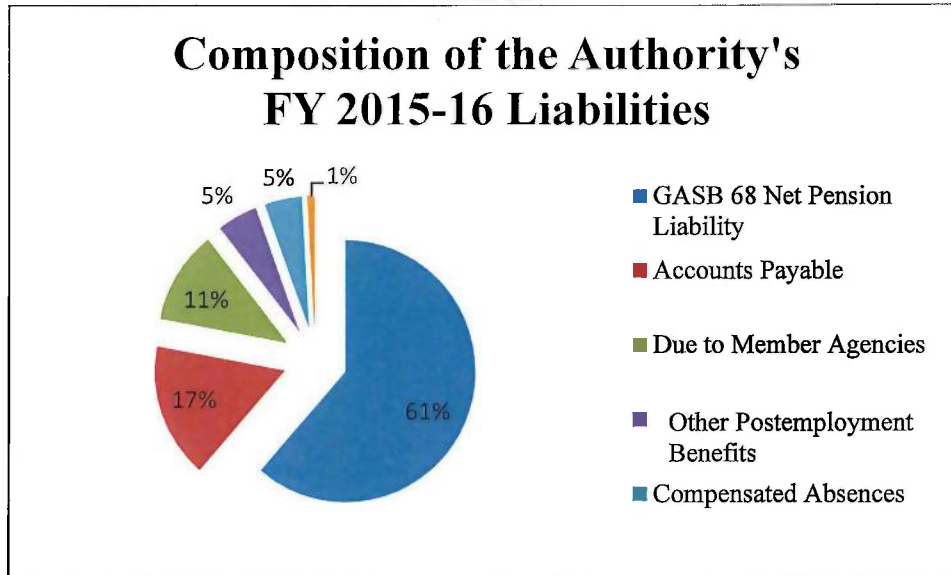
Table 1

SOCWA's Total Assets FY 2015-16		
	\$ Amount	% Total
Infrastructure	48,935,158	39.8%
Construction-in-Progress	28,169,309	22.9%
Machinery & Equipment	18,536,923	15.1%
Land	14,402,224	11.7%
Cash and Investments	5,777,486	4.7%
Buildings	4,636,244	3.8%
Receivables	1,637,961	1.3%
Other Misc.	878,674	0.7%
Total Assets	122,973,979	100.0%



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 31150 Del Obispo Street, Dana Point CA. 92629
 Phone: (949) 234-5400 Fax: (949) 489-0130

Chart 2



The Net Pension Liability continues to account for the lion share, 61.3%, of the Authority's liabilities.

Table 2

SOCWA's Total Liabilities FY 2015-16		
	\$ Amount	% Total
GASB 68 Net Pension Liability	\$9,054,535	61.3%
Accounts Payable	2,453,078	16.6%
Due to Member Agencies	1,692,399	11.5%
Other Postemployment Benefit	745,962	5.1%
Compensated Absences	684,767	4.6%
Accrued Payroll Liabilities	129,958	0.9%
Total Liabilities	\$14,760,699	100.0%



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Table 3
Condensed Statement of Net Position

	Fiscal Year Ending 6/30/2016	Fiscal Year Ending 6/30/2015	Capital Asset Additions 2015	Restated FY 2015	Dollar Change +/-	Percentage Change +/-
Current Assets	\$7,716,490	\$10,463,647		\$10,463,647	(\$2,747,157)	-26.3%
Non-Current Assets:						
Capital Assets not being depreciated	42,571,533	10,786,630	13,749,000	24,535,630	18,035,903	73.5%
Capital Assets net of accum. depreciation	72,685,956	49,502,375	25,133,794	74,636,169	(1,950,213)	-2.6%
Total Assets	122,973,979	70,752,652	38,882,794	109,635,446	13,338,533	12.2%
GASB 68-Deferred Outflows	1,712,209	813,449		813,449	898,760	110.5%
Current Liabilities	4,534,782	7,707,754		7,707,754	(3,172,972)	-41.2%
Non-Current Liabilities	10,225,917	8,266,057		8,266,057	1,959,860	23.7%
Total Liabilities	14,760,699	15,973,811	0	15,973,811	(1,213,112)	-7.6%
GASB 68-Deferred Inflows	1,315,151	2,409,966		2,409,966	(1,094,815)	-45.4%
Net Position:						
Net Investment in Capital Asset	113,998,431	60,289,005	38,882,794	99,171,799	14,826,632	15.0%
Restricted for Project Committees	(5,388,093)	(7,106,681)		(7,106,681)	1,718,588	-24.2%
Total Net Position	\$108,610,338	\$53,182,324	\$38,882,794	\$92,065,118	\$16,545,220	18.0%

Assets

The Authority has total assets of \$123 million as of June 30, 2016. This represents an increase of \$13.4 million or 12.2% over FY 2014-15 restated total assets of \$109.6 million at June 30, 2015.

The increase is primarily due to:

- The addition of Capital Assets “held and in-service” but previously not included in the Authority’s financial records, an increase in net book value of \$38.9 million which includes:
 - Land, \$13.7 million
 - Buildings and Infrastructure, \$25.2 million
- Construction-in-Progress increased \$17.8 million primarily due to work at:
 - JB Latham, PC 2, \$11.8 million
 - Regional, PC 17, \$5.4 million



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JB Latham facility projects include significant spending on Aeration/Co-Generation, \$4.4M million, Co-Generation repair, \$2.3 million, Digester Gas Systems, \$2.2 million and West Side Power Upgrade, \$1.7 million.

Regional facility projects include significant spending on Co-Gen System Retrofit, \$3.1 million and Switchgear Upgrade, \$2.6 million.

The remaining decrease in Capital Assets net of accumulated depreciation is current year depreciation, \$5.8 million, which is \$2.0 million more than assets acquisition, \$3.9 million.

- The change in current assets is a timing difference.

Liabilities

The Authority has \$14.8 million in liabilities as of June 30, 2016, a decrease of \$1.2 million or down 7.6% from June 30, 2015 balance of \$16 million.

The decrease is largely due to change in current liabilities and OPEB:

- Accounts Payable timing difference, a decrease of \$2.4 million
- Amounts owed Member Agencies decrease due to stream lined budgeting, \$527 thousand
- Payroll accrual timing difference, a decrease of \$201 thousand
- OPEB decrease, \$338 thousand, primarily due to prefunding of the liability via a PARS Trust Fund.

Offsetting the above is an increase in Net Pension liability, \$2.3 million.

Deferred Outflows and Deferred Inflows

GASB 68 Deferred Outflows and Inflows change was a positive \$2 million impact on net position.

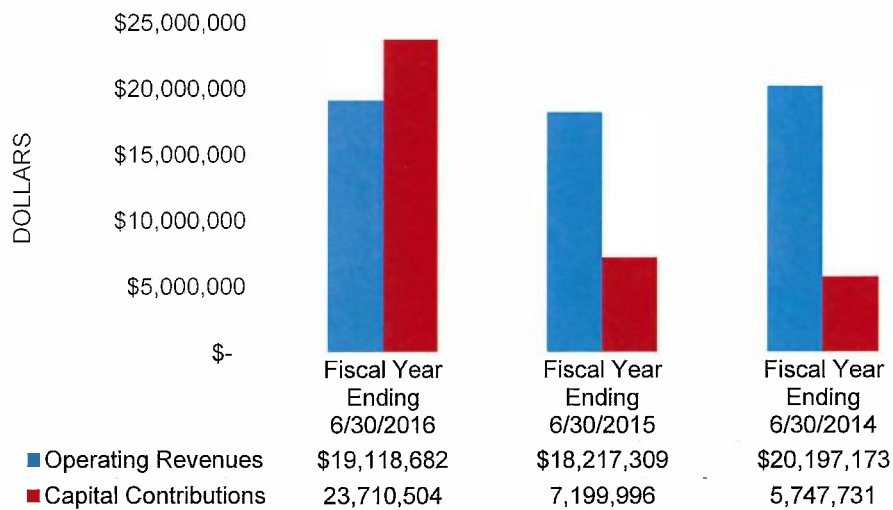


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Chart 3

Statement of Revenues, Expenses and Changes in Net Position

SOCWA O&M Revenue and Capital Contributions



The Authority has maintained a reduction in O&M Revenue requirements consistently for fiscal years 2014-15 and 2015-16.

Capital Contributions have steadily increased due to facility projects at JB Latham and Regional.



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Table 4				
Condensed Statement of Revenues, Expenses and Changes in Net Position				
	Fiscal Year Ending 6/30/2016	Fiscal Year Ending 6/30/2015	Dollar Change +/-	Percentage Change +/- (%)
Operating Revenues	\$19,118,682	\$18,217,309	\$901,373	4.9%
Operating Expenses	18,873,462	18,891,983	\$18,521	0.1%
Depreciation Expense	5,846,601	4,176,643	\$1,669,958	40.0%
Non-Operating Expenses/(Income)	1,563,903	95,089	\$1,468,814	1544.7%
Total Expenses	26,283,966	23,163,715	3,120,251	13.5%
Capital Contributions	23,710,504	7,199,996	\$16,510,508	229.3%
Current Year Change in Net Position	16,545,220	2,253,590	14,291,630	634.2%
Beginning Net Position	92,065,118	50,928,734	41,136,384	80.8%
Add Current Year Change	16,545,220	2,253,590	14,291,630	634.2%
Net Position before extraordinary items	108,610,338	53,182,324	55,428,014	104.2%
Addition of Capital Assets		38,882,794	(38,882,794)	
Ending Net Position	108,610,338	92,065,118	16,545,220	18.0%

While the Statement of Net Position shows the change in Financial Position, the Statement of Revenue, Expenses and Changes in Net Position provides answers as to the nature and source of these changes.

The Authority's Operating Revenue of \$19.1 million increased by \$0.9 million or 4.9% from FY 2014-15 Operating Revenue of \$18.2 million due to payroll costs inflation with significant offsets from the continuance of Cost Control Measures implemented by the Management Team.

Some of the Cost Control Measurements are:

- hiring of less senior level personnel in all departments,
- combination of positions,
- implementation of 2% @ 62 pension plan tier
- creation of PARS Trust Fund to help contain OPEB increasing costs.



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Capital Contributions increased \$16.5 million or 229.3% primarily due to aggressive Capital Projects work at:

- JBL Latham, PC2, \$11.8 million
- Regional, PC 17, \$5.4 million
- West Side Power System Upgrade, \$1.6 million.

JB Latham facility projects include significant spending on:

- Aeration/Co-Generation, \$4.4M million
- Co-Generation repair, \$2.3 million
- Digester Gas Systems, \$2.2 million
- West Side Power Upgrade, \$1.7 million.

Regional facility projects include significant spending on:

- Co-Gen System Retrofit, \$3.1 million
- Switchgear Upgrade, \$2.6 million.

FY 2015-16 Operating Results contributed \$16.5 million to Net Position.

SUPPLEMENTARY INFORMATION

Capital Assets

The Authority's investment in capital assets increased \$21,890,536, while \$3,854,633 in construction in progress was moved to completed projects during the fiscal year ending June 30, 2016.

The most significant projects work was at the JB Latham and Regional plants as follows:

JB Latham facility projects include significant spending on:

- Aeration/Co-Generation, \$4.4M million
- Co-Generation repair, \$2.3 million
- Digester Gas Systems, \$2.2 million
- West Side Power Upgrade, \$1.7 million.

Regional facility projects include significant spending on:

- Co-Gen System Retrofit, \$3.1 million
- Switchgear Upgrade, \$2.6 million.



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Long Term Debt

Long-term debt for SOCWA consists of three items:

1. Compensated absences as of June 30, 2016:
 - a. Current Portion, payable within one year, \$259,347
 - b. Long Term Portion, future benefit, greater than one year, \$425,420
 - c. Total Liability (Current and Long Term), \$684,767.

SOCWA accrues the liability for unpaid leave that is payable upon an employee's termination. These amounts are adjusted each year.
2. OPEB (Other Post-Employment Benefits)/Retiree Health-ARC as of June 30, 2016:
 - a. The annual required contribution (ARC), \$745,962, consists of two parts;
 - Estimated normal costs, the amount that needs to be set aside and invested in order to fund future retiree health benefits earned during that year by active employees,
 - An amount estimated to be sufficient to retire existing unfunded liabilities over no more than 30 years.

The ARC includes the costs necessary to provide each year's benefits to past Retirees-those benefits are currently funded under the pay-as-you -go system.
 - b. In fiscal year 2015, the Authority Board of Directors approved a \$500 thousand annual contribution to a PARS Retiree Health Trust Fund to cover future retiree health costs. The annual contribution reduced the ARC by \$338 thousand from fiscal year 2015 ARC of \$1.1 million.
 - c. The Authority does not have to fund the ARC each year, but choosing to do so allows the Authority to reduce and perhaps even eliminate unfunded liabilities over the long term (thereby lowering long-term costs).
3. GASB 68 Net Pension Liability as of June 30, 2016:
 - The Net Pension Liability is \$9,054,535, an increase of \$2,260,258 over FY 2015 liability of \$6,794,277 due to changes in actuarial assumptions for discount rates and longevity of retirees.



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- The Authority has three Benefit Levels as follows:

Benefit Levels			
Benefit Level	Enroll Effective Date	Formula	Member Rate
Tier One	1/16/1978	2.5% @55	8.00%
Tier Two	2/13/2011	2% @ 55	7.00%
Tier Three	1/1/2013	2% @ 62	6.25%

Deferred Inflows and Outflows are the changes in the net pension liability not included in pension expense and are required to be reported as deferred outflows of resources or deferred inflows of resources related to pensions.

The balances as of June 30, 2016 are:

- Deferred Outflows, \$1,712,209, an increase of \$898,760 over FY 2015 balance of \$813,449.
- Deferred Inflows, \$1,315,151, a decrease of \$1,094,815 from FY 2015 balance of \$2,409,966.

Requests for Information

The financial report is designed to provide a general overview of the Authority's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed in writing to the General Manager, South Orange County Wastewater Authority, 34156 Del Obispo Street, Dana Point, CA 92629.

South Orange County Wastewater Authority
Statement of Net Position

As of June 30, 2016

ASSETS

Current Assets:

Cash and Investments (note 2)	\$	5,777,486
Receivables, net		
Accounts		316,772
Due from Member Agencies		1,316,255
LAIF Interest Receivable		4,934
Total Receivables, net		1,637,961

Inventories		217,429
Deposits		18,000
Prepaid Items		65,614
Total Current Assets		7,716,490

Noncurrent Assets (note 3):

Capital Assets Not Being Depreciated		42,571,533
Capital Assets, Net of Accumulated Depreciation		72,685,956
Total Noncurrent Assets		115,257,489

Total ASSETS		122,973,979
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DEFERRED OUTFLOWS

Deferred Outflows - Pension Contribution (note 6)		947,627
Deferred Outflows - Actuarial (note 6)		764,582
Total DEFERRED OUTFLOWS		1,712,209

LIABILITIES

Current Liabilities:

Accounts Payable		2,453,078
Due to Member Agencies		1,692,399
Payroll Costs Payable		129,958
Current Portion of Compensated Absences (note 4)		259,347
Total Current Liabilities		4,534,782

Noncurrent Liabilities:

Long-term Portion of Compensated Absences (note 4)		425,420
Net Other Postemployment Benefits (note 5)		745,962
Net Pension Liability (note 6)		9,054,535
Total Noncurrent Liabilities		10,225,917

Total LIABILITIES		14,760,699
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DEFERRED INFLOWS

Deferred Inflows - Actuarial (note 6)		985,126
Deferred Inflows - Additional Deferral (note 6)		330,025
Total DEFERRED INFLOWS		1,315,151

NET POSITION

Net Investment in Capital Assets		113,998,431
Restricted for Project Committees		(5,388,093)
Total NET POSITION		\$ 108,610,338

See Notes to the Financial Statements

South Orange County Wastewater Authority
Statement of Revenues, Expenses and Changes in Net Position
For the year ended June 30, 2016

OPERATING REVENUES	
O & M Member Agency Assessments	
City of Laguna Beach	\$ 2,669,450
City of San Clemente	96,253
City of San Juan Capistrano	1,868,009
Emerald Bay Service District	85,067
El Toro Water District	731,459
Irvine Ranch Water District	127,723
Moulton Niguel Water District	8,393,893
South Coast Water District	3,317,016
Santa Margarita Water District	1,808,872
Trabuco Canyon Water District	20,940
Total O & M Member Agency Assessments	<u>19,118,682</u>
Total OPERATING REVENUES	<u>19,118,682</u>
OPERATING EXPENSES	
O&M, Environmental, Compliance and Safety	16,714,195
Engineering After Capital Transfer	433,685
Administration	1,725,582
Depreciation and Amortization	5,846,601
Total OPERATING EXPENSES	<u>24,720,063</u>
Operating Income/(Loss)	<u>(5,601,381)</u>
NON-OPERATING REVENUES (EXPENSES)	
Interest Income	24,587
Gain on Sale of Capital Assets	18,789
Other Revenues	844,191
Capital Donations to Other Governments	(1,548,438)
Other Expenses	(903,032)
Total NON-OPERATING EXPENSES	<u>(1,563,903)</u>
CAPITAL CONTRIBUTIONS AND TRANSFERS	
Member Agency Assessments	
City of Laguna Beach	1,003,741
City of San Clemente	33,240
City of San Juan Capistrano	4,019,148
Emerald Bay Service District	64,516
El Toro Water District	1,034,636
Irvine Ranch Water District	16,440
Moulton Niguel Water District	9,854,276
South Coast Water District	4,085,001
Santa Margarita Water District	3,599,506
Total Member Agency Assessments	<u>23,710,504</u>
Total CAPITAL CONTRIBUTIONS AND TRANSFERS	<u>23,710,504</u>
Change in Net Position	16,545,220
NET POSITION	
Beginning of Year, As Restated (note 9)	92,065,118
End of Year	<u>\$ 108,610,338</u>

See Notes to the Financial Statements

South Orange County Wastewater Authority
Statement of Cash Flows
For the year ended June 30, 2016

CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash Received From Member Agencies	\$ 17,846,855
Cash Payments to Suppliers for Operations	(9,312,834)
Cash Payments to Employees for Services	(8,842,803)
Cash Payments for General and Administrative Expenses	(775,025)
Net Cash Used For Operating Activities	<u>(1,083,807)</u>
 CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:	
Capital Contributions from Member Agencies	23,394,994
Acquisition of Capital Assets	(25,813,397)
Net Cash Used For Capital and Related Financing Activities	<u>(2,418,403)</u>
 CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest Received	23,218
Net Cash Provided by Investing Activities	<u>23,218</u>
Net Decrease in Cash and Cash Equivalents	(3,478,992)
 CASH AND CASH EQUIVALENTS	
Beginning of Year	9,256,478
End of Year	<u>\$ 5,777,486</u>
 RECONCILIATION OF OPERATING LOSS TO	
NET CASH USED FOR OPERATING ACTIVITIES:	
Operating Loss	\$ (5,601,381)
Adjustments to Reconcile Operating Loss to Net Cash Used For Operating Activities	
Depreciation	5,846,601
Changes in operating assets and liabilities:	
Due From Member Agencies	(744,576)
Inventory	259,196
Prepaid Items	11,583
Deferred Outflows	(898,760)
Accounts Payable	(95,197)
Due to Member Agencies	(527,251)
Accrued Payroll Liabilities	(201,459)
Compensated Absences	39,936
Net Other Postemployment Benefits	(337,942)
Net Pension Liability	2,260,258
Deferred Inflows	(1,094,815)
Net Cash Used For Operating Activities	<u>\$ (1,083,807)</u>

There were no significant noncash capital, investing or financing activities for the year ended June 30, 2016

See Notes to the Financial Statements

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NOTES TO THE FINANCIAL STATEMENTS

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity

Effective July 1, 2001, the Aliso Water Management Agency (“AWMA”), South East Regional Reclamation Authority (“SERRA”), and South Orange County Reclamation Authority (“SOCRA”) were consolidated to form the South Orange County Wastewater Authority (the “Authority”). The Authority was formed as a joint exercise of powers agreement under the laws of the State of California. The member agencies of AWMA, SERRA and SOCRA became member agencies of the Authority. Each member agency appoints one representative to the Authority’s board of directors. The Authority assumed all assets, obligations, agreements and liabilities of AWMA, SERRA, and SOCRA. The accompanying financial statements present the Authority and its component units for which the Authority is considered to be financially accountable, if any. Currently, there are no such component units.

AWMA was created under a joint exercise of powers agreement dated March 1, 1972. AWMA was formed to enable its members to jointly exercise their common powers regarding the treatment and disposal of wastewater to establish a total water management program for their consolidated service areas.

SERRA was formed by a joint exercise of powers agreement on March 9, 1970. SERRA was formed to coordinate regional planning of wastewater disposal and reclamation of wastewater in the San Juan Basin.

SOCRA was created under a joint exercise of powers agreement dated September 5, 1991. SOCRA was formed to enable its members to jointly exercise their common powers regarding the acquisition and holding of a single water reclamation primary user permit for the San Juan, Aliso Valley and other watershed areas within Region 8 and 9 of the California State Water Resources Control Board.

The Authority is comprised of the following ten member agencies:

- City of Laguna Beach (“CLB”)
- City of San Clemente (“CSC”)
- City of San Juan Capistrano (“CSJC”)
- Emerald Bay Service District (“EBSD”)
- El Toro Water District (“ETWD”)
- Irvine Ranch Water District (“IRWD”)
- Moulton Niguel Water District (“MNWD”)
- South Coast Water District (“SCWD”)
- Santa Margarita Water District (“SMWD”)
- Trabuco Canyon Water District (“TCWD”)

The Authority is economically dependent upon assessments from the above member agencies.

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

B. Basis of Accounting and Measurement Focus

The financial statements (i.e., the Statement of Net Position, the Statement of Revenues, Expenses, and Changes in Net Position, and the Statement of Cash Flows) report information on all of the enterprise activities of the Authority.

The financial statements are prepared using the “*economic resources*” measurement focus and the accrual basis of accounting. Accordingly, all assets and liabilities (whether current or noncurrent) are included on the Statement of Net Position. The Statement of Revenues, Expenses, and Changes in Net Position presents increases (revenues) and decreases (expenses) in total Net Position. Under the accrual basis of accounting, revenues are recognized in the period in which they are earned while expenses are recognized in the period in which the liability is incurred.

The Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues consists primarily of member assessments for services. Operating expenses include the cost of services, administrative expenses, and depreciation expense on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

C. Cash, Cash Equivalents and Investments

The Authority’s cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturity of three months or less from the date of acquisition. Cash and cash equivalents are combined with investments and displayed as cash and investments.

Investments are stated at fair value (quoted market price or best available estimate thereof).

Fair value measurements - Certain assets and liabilities are required to be reported at fair value. The fair value framework provides a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of fair value hierarchy are described as follows:

- Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly and fair value is determined through the use of models or other valuation methodologies including:
 - Quoted prices for similar assets or liabilities in active markets;

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

- Quoted prices for identical or similar assets or liabilities in markets that are inactive;
 - Inputs other than quoted prices that are observable for the asset or liability;
 - Inputs that are derived principally from or corroborated by observable market data by correlation or other means.
-
- Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement. These unobservable input reflect the Authority's own assumptions about the inputs market participants would use in pricing the asset or liability (including assumptions about risk). These unobservable inputs are developed based on the best information available in the circumstances and may include the Authority's own data.

D. Inventories

Inventories consist of materials and supplies which are valued at cost on a first-in, first-out basis. Inventories are recorded as an expense when consumed for financial statement purposes but recorded as inventory when purchased for determining member agencies' allocations.

E. Prepaid Items

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

F. Capital Assets

Capital assets are defined by the Authority as assets with an initial, individual cost of more than \$5,000 and an estimated useful of more than three years. The original completed joint construction project costs of all original facilities constructed or acquired by AWMA and SERRA were transferred to SOCWA and are reflected in the accompanying financial statements as capital assets owned by SOCWA.

Capital assets used in operations are depreciated over their estimated useful lives using the straight-line method. The lives used for depreciation purposes are as follows:

Plant equipment	3 to 58 years
Facilities and improvements	5 to 50 years

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

G. Compensated Absences

Employees can accrue vacation leave up to a maximum of 240 hours. Vacation leave accrues at the rate of 96 to 160 a year depending on the number of years of employment. Sick leave accrued at the rate of 8 hours per month up to a maximum of 240 hours. Upon termination, the Authority pays 75% of accumulated sick leave in excess of 176 hours.

All accumulated vacation and vested sick leave pay is recorded as an expense and a liability at the time the benefit is earned.

H. Net Position

Sometimes the government 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 a flow assumption must be made about the order in which the resources are considered to be applied.

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed.

I. Basis for Member Assessments

Member assessments are determined based on each member's participation in project committee costs, Costs are allocated to member agencies based on usage.

J. Use of Estimates

The preparation of the basic financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions. These estimates and assumptions affect certain reported amounts and disclosures. Accordingly, actual results could differ from these estimates and assumptions.

The accompanying basic financial statements reflect management's best estimate of balances pertaining to capital costs due to/from member agencies for various capital projects. Periodically, this information is subjected to further reconciliation. Adjustments pertaining to the accounting estimates associated with capital costs received from member agencies are recognized as the information for such adjustments becomes available.

K. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will sometimes report 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

**South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

not be recognized as an outflow of resources (expense/ expenditure) until then. The government has two items that qualify for reporting in this category, deferred outflows on pension contributions and deferred outflows - actuarial.

In addition to liabilities, the statement of net position will sometimes report 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 government has two items that qualify for reporting in this category. The deferred inflow – actuarial and additional deferral.

L. Pensions

For purposes of measuring the net pension liability, deferred outflows and inflows of resources related to pensions, and pension expense, information about the fiduciary net position and additions to/deductions from the fiduciary net position have been determined on the same basis as they are reported by the CalPERS Financial Office. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. Investments are reported at fair value. CalPERS audited financial statements are publicly available reports that can be obtained at CalPERS’ website under Forms and Publications.

GASB 68 requires that the reported results must pertain to liability and asset information within certain defined timeframes. For this report, the following timeframes are used:

Valuation Date (VD)	June 30, 2014
Measurement Date (MD)	June 30, 2015
Measurement Period (MP)	June 30, 2014 to June 30, 2015

2. CASH AND INVESTMENTS

The Authority’s cash and investments were comprised of the following at June 30, 2016:

Petty cash	\$	1,600
Demand deposits		983,539
Local Agency Investments Fund		<u>4,792,347</u>
 Total cash and investments		 <u>\$ 5,777,486</u>

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

2. CASH AND INVESTMENTS, Continued

A. Cash Deposits

The carrying amounts of the Authority's demand deposits were \$983,539 at June 30, 2016.

B. Investments

The table below identifies the investment types that are authorized for the Authority by the California Government Code and the Authority's investment policy. The table also identifies certain provisions of the California Government Code (or the Authority's investment policy, if more restrictive) that addresses interest rate risk and concentration of credit risk.

Authorized Investment Type	Maximum Maturity*	Maximum Percentage of Portfolio*	Maximum Investments In One Issuer*
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Banker's Acceptances	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20%	None
Medium-term Notes	5 years	30%	None
Mutual Funds	N/A	20%	10%
Time Certificates of Deposit	5 years	25%	None
Money Market Mutual Funds	N/A	15%	10%
Mortgage Pass-Through Securities	5 years	20%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund ("LAIF")	N/A	None	None
JPA Pools	N/A	None	None

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

C. Investment in Local Agency Investment Fund

The Authority is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the Authority's investment in this pool is reported in the accompanying financial statements at amounts based upon the Authority's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis that approximates fair value.

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

2. CASH AND INVESTMENTS, Continued

C. Risk Disclosures

Interest Rate Risk

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

Information about the sensitivity of the fair values of the Authority's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the Authority's investments by maturity.

Investment Type	Fair Value	Investment Maturities (In Years) Less than 1
Local Agency Investment Fund	\$ 4,792,347	4,792,347
Total	\$ 4,792,347	4,792,347

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. As of June 30, 2016, the Authority's investment portfolio consisted of \$4,792,347 invested in the State of California Local Agency Investment Fund, which is not rated.

Investment in State Investment Pool

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

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

2. CASH AND INVESTMENTS, Continued

Custodial Credit Risk

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

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

3. CAPITAL ASSETS

The summary of changes in the capital assets for the year ended June 30, 2016 was as follows:

	Balance June 30, 2015 <u>As Restated</u>	<u>Additions</u>	<u>Deletions</u>	Balance June 30, 2016
Capital assets not being depreciated:				
Land	\$ 14,402,224	-	-	14,402,224
Construction-in-progress	10,133,406	21,890,536	(3,854,633)	28,169,309
Total capital assets not being depreciated	<u>24,535,630</u>	<u>21,890,536</u>	<u>(3,854,633)</u>	<u>42,571,533</u>
Capital assets being depreciated:				
Buildings	7,921,504	-	-	7,921,504
Building Improvements	9,908,499	133,780	-	10,042,279
Computer Hardware	2,218,833	150,417	-	2,369,250
Computer Software	93,265	16,449	-	109,714
Furniture and Fixtures	116,326	-	-	116,326
Infrastructure	134,267,564	1,330,421	(190,000)	135,407,985
Machinery and Equipment	56,652,574	2,098,005	-	58,750,579
Vehicles	498,387	167,315	-	665,702
Total capital assets being depreciated	<u>211,676,952</u>	<u>3,896,387</u>	<u>(190,000)</u>	<u>215,383,339</u>
Less accumulated depreciation:				
Buildings	(5,567,723)	(201,697)	-	(5,769,420)
Building Improvements	(7,053,182)	(504,937)	-	(7,558,119)
Computer Hardware	(1,915,433)	(81,089)	-	(1,996,522)
Computer Software	(70,243)	(12,765)	-	(83,008)
Furniture and Fixtures	(116,011)	(315)	-	(116,326)
Infrastructure	(83,318,554)	(3,344,273)	190,000	(86,472,827)
Machinery and Equipment	(38,517,680)	(1,695,976)	-	(40,213,656)
Vehicles	(481,956)	(5,549)	-	(487,505)
Total accumulated depreciation	<u>(137,040,782)</u>	<u>(5,846,601)</u>	<u>190,000</u>	<u>(142,697,383)</u>
Total capital assets being depreciated, net	<u>74,636,170</u>	<u>(1,950,214)</u>	<u>-</u>	<u>72,685,956</u>
Total capital assets, net	<u>\$ 99,171,800</u>	<u>19,940,322</u>	<u>(3,854,633)</u>	<u>115,257,489</u>

Depreciation expense for the fiscal year ended June 30, 2016 was \$5,846,601.

The June 30, 2015 balances were restated as discussed further in note 9.

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

4. LONG-TERM LIABILITIES

The following is a summary of changes in long-term liabilities for the year ended June 30, 2016:

	Balance			Balance June 30, 2016	Classification	
	July 1, 2015	Additions	Deletions		Current	Long-term
Compensated absences	\$ 644,830	661,249	(621,312)	684,767	259,347	425,420
Net OPEB obligation	<u>1,083,904</u>	<u>633,850</u>	<u>(971,792)</u>	<u>745,962</u>	<u>-</u>	<u>745,962</u>
Total	<u>\$ 1,728,734</u>	<u>1,295,099</u>	<u>(1,593,104)</u>	<u>1,430,729</u>	<u>259,347</u>	<u>1,171,382</u>

5. POST-RETIREMENT HEALTH CARE BENEFITS

Plan Description and Eligibility

The Authority provides post-retirement health care benefits to employees who retire from PERS on or after age 50 with at least 5 years of service with the Authority and PERS. The Authority's plan is a single employer plan that provides post-retirement health care benefits in accordance with the Public Employee's Medical and Hospital Care Act through the PERS health program. The Authority's contribution for each retiree is the amount necessary to pay the cost of his/her enrollment per month in the health benefits plan up to a maximum of the average of all plans available, plus administrative fees and Contingency Reserve Fund assessments. The Authority's contribution for each annuitant will be from 84% to 100% based on the health plan selected by the employee.

For the fiscal year ended June 30, 2016, the total contribution made was \$971,792, which was comprised of \$694,403 contributed to the Public Agency Retirement Services ("PARS") irrevocable trust and \$277,389 on the pay-as-you-go basis. There were 18 retired employees who received health care benefits during the fiscal year.

Annual OPEB Cost and Net OPEB Obligation

The Authority's annual Other Postemployment Benefits ("OPEB") cost (expense) is calculated based on the *Annual Required Contribution of the Employer* ("ARC"), an amount actuarially determined. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excesses) over a period not to exceed thirty years.

**South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016**

5. POST-RETIREMENT HEALTH CARE BENEFITS, Continued

The following table shows the components of the Authority's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the Authority's net OPEB obligation to the plan:

Annual required contribution	\$ 617,912
Interest on net OPEB obligation	75,873
Adjustment to annual required contribution	<u>(59,935)</u>
Annual OPEB cost (expense)	633,850
Contributions made to trust	(694,403)
Benefit payments	<u>(277,389)</u>
Increase in net OPEB obligation	(337,942)
Net OPEB obligation - beginning of year	<u>1,083,904</u>
Net OPEB obligation - end of year	<u><u>\$ 745,962</u></u>

The Authority's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2016 and the two preceding years were as follows:

Fiscal Year Ended	Annual OPEB Cost	Annual Contribution	% of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2014	\$ 606,675	601,800	99.20%	1,052,319
6/30/2015	633,385	601,800	95.01%	1,083,904
6/30/2016	633,850	971,792	153.32%	745,962

Funded Status and Funding Progress

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts, and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan, and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress presented below presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time related to the actuarial accrued liabilities for benefits.

**South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016**

5. POST-RETIREMENT HEALTH CARE BENEFITS, Continued

Actuarial Valuation Date	Actuarial Value of Assets	Entry Age Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Annual Covered Payroll	Unfunded Actuarial Liability as Percentage of Covered Payroll
1/1/2008	\$ -	8,899,197	8,899,197	0.00%	4,956,000	179.56%
1/1/2010	212,094	6,973,032	6,760,938	3.04%	5,269,432	128.30%
1/1/2013	1,337,155	8,184,615	6,847,460	16.34%	4,873,758	140.50%

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members), and include the types of benefits provided at the time of each valuation, and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, and are consistent with the long-term perspective of the calculations.

In the January 1, 2013 actuarial valuation, the entry age normal cost method was used. The actuarial assumptions include a 6.0% investment rate of return which is based on the expected return on funds invested by the Authority, and an annual healthcare cost trend rates of 7.0% initially and reduced to an ultimate rate of 5.0% thereafter. An aggregate payroll increase of 3.25% was used in the actuarial valuation. The UAAL is being amortized as level percentage of projected payroll over a 30 year closed period. The remaining amortization period at January 1, 2013 was 25 years.

6. PENSION PLAN

Plan Description – All qualified permanent and probationary employees are eligible to participate in the Authority’s separate Miscellaneous Employee Pension Plan, cost-sharing multiple employer defined benefit pension plan administered by the California Public Employees’ Retirement System (CalPERS). Benefit provisions under the Plans are established by State statute and Local Government resolution. CalPERS issues publicly available reports that include a full description of the pension plans regarding benefits provisions, assumptions and membership information that can be found on the CalPERS website.

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

6. PENSION PLAN, Continued

Benefits Provided

CalPERS provides service retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. Benefits are based on years of credited service, equal to one year of full time employment. The Plans' provisions and benefits in effect at June 30, 2016, are summarized as follows:

	Miscellaneous		
	Tier 1	Tier 2	Tier 3
Hire date	Prior to January 1, 2013	On or after January 1, 2013	On or after January 1, 2013
Benefit formula	2% @ 55	2% @ 55	2% @ 62
Benefit vesting schedule	5 years service	5 years service	5 years of service
Benefit payments	monthly for life	monthly for life	monthly for life
Retirement age	50-55	50-55	52-67
Monthly benefits, as a % of eligible compensation	2.0%	2.0%	1.0% to 2.5%
Required employee contribution rates	8%	7%	6.237%
Required employer contribution rates	9.671%	8.512%	6.237%

Contribution Description

Section 20814(c) of the California Public Employees' Retirement Law (PERL) requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. The total plan contributions are determined through the CalPERS' annual actuarial valuation process. For public agency cost-sharing plans covered by the Miscellaneous risk pool, the Plan's actuarially determined rate is based on the estimated amount necessary to pay the Plan's allocated share of the risk pool's costs of benefits earned by employees during the year, and any unfunded accrued liability. The employer is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. For the measurement period ended June 30, 2015 (the measurement date), the active employee contribution rate is 7.942 percent of annual pay, and the average employer's contribution rate is 20.052 percent of annual payroll. Employer contributions rates may change if plan contracts are amended. It is the responsibility of the employer to make necessary accounting adjustments to reflect the impact due to any Employer Paid Member Contributions or situations where members are paying a portion of the employer contribution.

**South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016**

6. PENSION PLAN, Continued

Actuarial Methods and Assumptions used to determine Total Pension Liability

For the measurement period ending June 30, 2015 (the measurement date), the total pension liability was determined by rolling forward the June 30, 2014 total pension liability determined in the June 30, 2014 actuarial valuation. The June 30, 2015 total pension liability was based on the following actuarial methods and assumptions:

Actuarial Cost Method	Entry Age Normal in accordance with the requirements of GASB Statement No. 68
Actuarial Assumptions	
Discount Rate	7.65%
Inflation	2.75%
Salary Increases	Varies by Entry Age and Service
Mortality Rate Table	Derived using CalPERS' Membership Data for all funds
Post Retirement Benefit Increase	Contract COLA up to 2.75% until Purchasing Power Protection Allowance Floor on Purchasing Power applies, 2.75% thereafter

All other actuarial assumptions used in the June 30, 2014 valuation were based on the results of an actuarial experience study for the fiscal years 1997 to 2011, including updates to salary increase, mortality and retirement rates. The Experience Study report can be obtained at CalPERS' website under Forms and Publications.

Change of Assumption

GASB 68, paragraph 68 states that the long-term expected rate of return should be determined net of pension plan investment expense but without reduction for pension plan investment expense and pension plan administrative expense. The discount rate was changed from 7.50 percent (net of administrative expense in 2014) to 7.65 percent as of the June 30, 2015 measurement date to correct the adjustment which previously reduced the discount rate for administrative expense.

Discount Rate

The discount rate used to measure the total pension liability was 7.65 percent. To determine whether the municipal bond rate should be used in the calculation of a discount rate for each plan, CalPERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. Based on the testing of the plans, the test revealed that the assets would not run out. Therefore, the current 7.65 percent discount rate is appropriate and

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

6. PENSION PLAN, Continued

the use of the municipal bond rate calculation is not deemed necessary. The long-term expected discount rate of 7.65 percent is applied to all plans in the Public Employees Retirement Fund. The stress test results are presented in a detailed report called “GASB Crossover Testing Report” that can be obtained on CalPERS’ website under the GASB 68 section.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, staff took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Such cash flows were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years. Using historical returns of all the funds’ asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

The table below reflects long-term expected real rate of return by asset class.

Asset Class	New Strategic Allocation	Real Return Years 1 – 10(1)	Real Return Years 11+2 (2)
Global Equity	51.0%	5.25%	5.71%
Global Fixed Income	19.0	0.99	2.43
Inflation Sensitive	6.0	0.45	3.36
Private Equity	10.0	6.83	6.95
Real Estate	10.0	4.50	5.13
Infrastructure and Forestland	2.0	4.50	5.09
Liquidity	2.0	(0.55)	(1.05)

(1) An expected inflation of 2.5% used for this period

(2) An expected inflation of 3.0% used for this period

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

6. PENSION PLAN, Continued

Allocation of Net Pension Liability and Pension Expense to Individual Employers

The following table shows the Authority's proportionate share of the net pension liability over the measurement period:

	Increase (Decrease)		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (c) = (a) - (b)
Balance at: 6/30/2014	\$40,034,045	33,239,766	6,794,279
Balance at: 6/30/2015	41,977,344	32,922,809	9,054,535
Net Changes during 2014-15	\$1,943,299	(316,957)	2,260,256

The net pension liability of the plan is measured as of June 30, 2015, and the total pension liability for the plan used to calculate the net pension liability was determined by an actuarial valuation of June 30, 2014 rolled forward to June 30, 2015 using standard update procedures. The proportion of the net pension liability was based on a projection of the Authority's long term share of contributions to the pension plans relative to the projected contributions of all participating employers, actuarially determined. The Authority's proportionate share of the net pension liability for the plan as of June 30, 2014 and 2015 was as follows:

	Miscellaneous Plan Tier 1	Miscellaneous Plan Tier 2
Proportion – June 30, 2014	.27451%	.00040%
Proportion – June 30, 2015	.30648%	.00114%
Change – Increase (Decrease)	.03197%	.00074%

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the Plan as of the Measurement Date, calculated using the discount rate of 7.65 percent, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.65 percent) or 1 percentage-point higher (8.65 percent) than the current rate:

	Discount Rate – 1% (6.65%)	Current Discount Rate (7.65%)	Discount Rate + 1% (8.65%)
Plan's Net Pension Liability	\$14,771,290	9,054,535	4,334,690

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

6. PENSION PLAN, Continued

Amortization of Deferred Outflows and Deferred Inflows of Resources

Under GASB 68, actuarial gains and losses related to changes in total pension liability and fiduciary net position are recognized in pension expense systematically over time.

The first amortized amounts are recognized in pension expense for the year the gain or loss occurs. The remaining amounts are categorized as deferred inflows and deferred outflows to be recognized in future pension expense.

The amortization period differs depending on the source of the gain or loss:

Net difference between projected and actual earnings on pension plan investments	5 year straight-line amortization
All other amounts	Straight-line amortization over the expected average remaining service lifetime (EARSL) of all members that are provided with pensions (active, inactive, and retired) as of the beginning of the measurement period

The Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments is amortized over a five-year period on a straight-line basis. One-fifth is recognized in pension expense during the measurement period, and the remaining Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments at the measurement date is to be amortized over the remaining four-year period. The Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments in the Schedule of Collective Pension Amounts represents the unamortized balance relating to the current measurement period and the prior measurement period on a net basis.

Deferred outflows of resources and deferred inflows of resources relating to Differences Between Expected and Actual Experience, Changes of Assumptions and employer-specific amounts should be amortized over the EARSL of members provided with pensions through the Plan. The EARSL for the Plan for the June 30, 2015 measurement date is 3.8 years, which was obtained by dividing the total services years by the total number of participants (active, inactive, and retired) in the Plan. Inactive employees and retirees have remaining service lifetimes equal to 0. Total future service is based on the members' probability of decrementing due to an event other than receiving a cash refund.

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

6. PENSION PLAN, Continued

Pension Expense and Deferred Outflows and Deferred Inflows of Resources Related to Pensions

For the year ended June 30, 2016, the Authority recognized a pension expense of \$1,214,309 for the Plan. As of June 30, 2016, the Authority reports deferred outflows of resources and deferred inflows of resources related to pensions as follows:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension contributions subsequent to the measurement date	\$ 947,627	-
Additional deferral	-	330,025
Changes of assumptions	-	475,226
Net difference between projected and actual earnings on pension plan investments	50,232	494,301
Adjustment due to differences in proportions	714,350	15,599
Total	\$1,712,209	1,315,151

\$947,627 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows and deferred inflows of resources in the previous chart will be recognized in future pension expense as follows:

Measurement Period Ended June 30:	Deferred Outflows/(Inflows) of Resources
2016	\$(298,321)
2017	(291,629)
2018	(265,141)
2019	304,523
2020	-
Thereafter	-

Subsequent Events

In December 2016, the CalPERS Board of Administration voted to lower the discount rate from 7.5 percent to 7.0 percent over the next three years. For public agencies, the discount rate changes approved by the Board for the next three fiscal years ending June 30, 2019, 2020, and 2021 are 7.375%, 7.25%, and 7.00%, respectively.

South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016

7. RISK MANAGEMENT

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Authority has joined the California Sanitation Risk Management Authority (“CSRMA”), a public entity risk pool currently operating as a common risk management and insurance program for 62 member sanitation districts. The Authority pays an annual premium to CSRMA for its general insurance coverage. The agreement for formation of the CSRMA provides that CSRMA will be self-sustaining through member premiums and will provide specific excess insurance through commercial companies. The CSRMA is allowed to make additional assessments to its members based on a retrospective premium adjustment process.

At June 30, 2016, the Authority’s participation in the self-insurance programs of the CSRMA was as follows:

- Workers’ Compensation – the Authority is self-insured through the CSRMA up to \$750,000 with a \$0 deductible. Excess insurance up to the statutory limits per occurrence has been purchased. Excess insurance of \$1,000,000 for employer’s liability has also been purchased.
- General Liability (including errors and omissions (“E&O”) and employment practices liability (“EPL”)) – the Authority is self-insured through the CSRMA for up to \$500,000 (\$100,000 for EPL) with a \$25,000 deductible (\$2,500 for E&O). Excess insurance of \$15,000,000 per occurrence has also been purchased.

In addition to the above, the Authority has also purchased insurance coverage for property loss including auto, employees’ dishonesty bonds, pollution and remediation liability and employee health and accident. The Authority is not insured against earthquake damage.

Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. The premiums paid during the fiscal year were \$332,423. There were no accrued claims liabilities at June 30, 2016.

8. CONTINGENCIES AND COMMITMENTS

A. Lawsuits

In the ordinary course of business, the Authority is subject to various claims, investigations, proceedings, tax assessments, and legal actions from time to time arising out of the conduct of the Authority’s business. Management believes that, based on current knowledge, the outcome of any such pending matters will not have a material adverse effect on the Authority’s financial position.

**South Orange County Wastewater Authority
Notes to the Financial Statements
For the year ended June 30, 2016**

8. CONTINGENCIES AND COMMITMENTS, Continued

B. Construction Commitments

The Authority has active construction projects as of June 30, 2016. At year-end, the Authority's commitments with contractors are as follows:

PC 2	JB Latham Treatment Plant Improvements	\$ 5,240,843
PC 17	Regional Treatment Cogeneration and Switchgear Upgrade	\$ 1,832,907
PC 17	Regional Treatment Plant Miscellaneous Improvements	\$ 720,499

9. RESTATEMENT OF NET POSITION

Net Position at July 1, 2015 was restated as follows:

Net Position, July 1, 2015, as originally reported	\$ 53,182,324
Adjustment for capital assets that were not previously recorded	<u>38,882,794</u>
Net Position, July 1, 2015, as restated	<u>\$ 92,065,118</u>

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REQUIRED SUPPLEMENTARY INFORMATION

South Orange County Wastewater Authority
Schedule of the Plan's Proportionate Share of the Net Pension Liability
*Last Ten Years**

	Measurement Date	Measurement Date
	6/30/2015	6/30/2014
Proportion of the Collective Net Pension Liability	0.30215%	0.10903%
Proportionate Share of the Collective Net Pension Liability	\$ 9,054,535	\$ 6,794,277
Covered-Employee Payroll	\$ 4,981,141	\$ 5,148,701
Proportionate Share of the Collective Net Pension Liability as percentage of covered-employee payroll	181.78%	131.96%
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	78.43%	83.03%

Notes to Schedule:

Benefit changes. The figures above do not include any liability impact that may have resulted from plan changes which occurred after the June 30, 2014 valuation date. This applies for voluntary benefit changes as well as any offers of Two Years Additional Service Credit (aka Golden Handshakes).

Changes in assumptions. The discount rate was changed from 7.5 percent (net of administrative expense) to 7.65 percent to correct for an adjustment to exclude administrative expense.

**Fiscal year 2015 was the first year of implementation, therefore only two years are shown.*

South Orange County Wastewater Authority
Schedule of Plan Contributions
*Last Ten Years**

	Fiscal Year 2015-16	Fiscal Year 2014-15	Fiscal Year 2013-14
Actuarially Determined Contribution	\$ 947,627	\$ 780,373	\$ 759,739
Contributions in Relation to the Actuarially Determined Contribution	(947,627)	(780,373)	(759,739)
Contribution Deficiency (Excess)	\$ 0	\$ 0	\$ 0
Covered Payroll	\$ 5,428,132	\$ 5,402,930	\$ 5,272,545
Contributions as a Percentage of Covered-Employee Payroll	9.067%	8.896%	9.671%

Notes to Schedule

Fiscal Year End: 6/30/2016
Valuation Date: 6/30/2014

Methods and assumptions used to determine contribution rates:

Actuarial Cost Method	Entry Age
Amortization Method	Level Percent of Payroll
Asset Valuation Method	Market Value
Discount Rate	7.50%
Projected Salary Increase	3.30% to 14.20% depending on Age, Service, and type of employment
Inflation	2.75%
Payroll Growth	3.00%
Individual Salary Growth	A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 2.75% and an annual production growth of 0.25%.

**Fiscal year 2015 was the first year of implementation; therefore, only three years are shown.*

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OTHER INFORMATION

South Orange County Wastewater Authority
Other Information
For the year ended June 30, 2016

PROJECT COMMITTEES

The following is a description of Project Committee (“PC”) activity during the fiscal year ended June 30, 2016:

Project Committee No. 2 (“PC 2”) and Project Committee No. 2 Rehabilitation (“PC 2R”)

PC 2 was formed for the acquisition, use, operation, maintenance and expansion of the J.B. Latham Sewage Treatment Plant. Operations and maintenance expenses are allocated to participating member agencies on the basis of ownership and usage of the facilities. Standby charges are based on unused capacity. On June 30, 2016, the capacity ownership of the PC 2 members in the J.B Latham Sewage Treatment Plant, excluding the Advanced Wastewater Treatment (“AWT”) project, was as follows:

Members	Liquid Capacity		Solids Handling Capacity	
	(MGD)	Percentage	(MGD)	Percentage
CSJC	4.00	30.77%	5.55	30.00%
MNWD	3.00	23.08%	4.00	21.62%
SCWD	3.75	28.84%	3.70	20.00%
SMWD	2.25	17.31%	5.25	28.38%
Total	13.00	100.00%	18.50	100.00%

MGD = Million gallons per day average dry weather flow rate

On June 29, 2000, the members entered into Amendment 2 to the PC 2 agreement to provide for the design and construction of the AWT project at the J.B. Latham Sewage Treatment Plant. The PC 2 members who funded, and therefore have capacity interest in the AWT project, are CSJC, MNWD, and SCWD.

Project Committee No. 2(SO) (“PC 2(SO)”)

PC 2(SO) was formed in order to obtain a permit to discharge reclaimed water. The Authority is to hold a single producer/primary user permit and maintain waste discharge permit requirements for the production, distribution and use of reclaimed water. A portion of the costs are split equally among each member agency, part of the costs are allocated to member agencies based on non-potable water production in Region 9, and permit costs are allocated based on region. CSJC, ETWD, IRWD, MNWD, SCWD, SMWD, and TCWD are members of PC 2(SO).

Project Committee No. 3A (“PC 3A”) and Project Committee No. 3A Rehabilitation (“PC 3A(R)”)

The Authority provides contract operation and maintenance services for the PC 3A wastewater treatment plant and related reclamation facilities for the benefit of MNWD and SMWD. An amendment to the original agreement extended the contract to the fiscal year ending June 30, 2012. The agreement provides for subsequent extensions.

South Orange County Wastewater Authority
Other Information, Continued
For the year ended June 30, 2016

PROJECT COMMITTEES, Continued

Project Committee No. 5 ("PC 5")

PC 5 was formed for the purpose of planning, designing, constructing, operating and maintaining the San Juan Creek Ocean Outfall. On June 30, 2016, the capacity ownership of the PC 5 members in the San Juan Creek Ocean Outfall was as follows:

<u>Members</u>	<u>MGD</u>	<u>Percentage</u>
CSC	13.30	16.62%
CSJC	8.86	11.08%
MNWD	12.41	15.51%
SCWD	9.97	12.47%
SMWD	35.46	44.32%
Total	80.00	100.00%

MGD = Million gallons per day peak flow rate

Project Committee No. 15 ("PC 15") and Project Committee No. 15 Rehabilitation ("PC 15R")

PC 15 caused construction of facilities known as the Coastal Wastewater Treatment Facility to receive and treat wastewater. Operations and maintenance expenses are allocated to participating member agencies on the basis of ownership and usage of the facilities. PC 15R is used to account for rehabilitation and construction projects for the Coastal Treatment Plant. On June 30, 2015, the capacity ownership of the PC 15 members in the Coastal Treatment Plant was as follows:

<u>Members</u>	<u>MGD</u>	<u>Percentage</u>
CLB	2.54	37.91%
EBSD	0.20	2.99%
SCWD	2.00	29.85%
MNWD	1.96	29.25%
Total	6.70	100.00%

MGD = Million gallons per day average dry weather flow rate

**South Orange County Wastewater Authority
Other Information, Continued
For the year ended June 30, 2016**

PROJECT COMMITTEES, Continued

Project Committee No. 17 ("PC 17") and Project Committee No. 17 Rehabilitation ("PC 17(R"))

PC 17 is for the operations and maintenance of the facilities known as the Regional Wastewater Treatment, Reclamation and Solids Handling Facilities ("Joint Regional Treatment Plant"). The Joint Regional Treatment Plant treats and reclaims wastewater and handles solid waste. Operations and maintenance expenses are allocated to participating member agencies on the basis of ownership and of usage of the facilities. PC 17(R) is used to account for rehabilitation and construction projects for the Joint Regional Treatment Plant. On June 30, 2016, the capacity ownership of the PC 17 members in the Joint Regional Treatment Plant was as follows:

Members	Liquid Capacity		Solids Handling Capacity	
	(MGD)	Percentage	Pounds	Percentage
CLB	-	0.00%	5,605	11.22%
EBSB	-	0.00%	295	0.59%
ETWD	-	0.00%	10,200	20.41%
MNWD	12.00	100.00%	29,395	58.82%
SCWD	-	0.00%	4,480	8.96%
Total	12.00	100.00%	49,975	100.00%

MGD = Million gallons per day average dry weather flow rate

Pounds = Loadings are shown in pounds per day

Project Committee No. 21 ("PC 21")

PC 21 is for the operation and maintenance of the Effluent Transmission Main. Expenses are allocated to participating members on the basis of ownership of the facilities as follows:

Members	Reach B/C	Reach D	Reach E
ETWD	50.00%	50.00%	23.29%
IRWD	50.00%	50.00%	23.29%
MNWD	0.00%	0.00%	53.42%
Total	100.00%	100.00%	100.00%

On October 7, 1999, the title to Reach A of the Effluent Transmission Main was transferred to Los Aliso Water District (now part of IRWD) and the El Toro Pump Station was transferred to ETWD. The Alicia Parkway Pump Station is owned and operated by MNWD.

PROJECT COMMITTEES, Continued

Project Committee No. 23 ("PC 23")

PC 23 is for the operations and maintenance of the North Coast Interceptor and the Laguna Beach and Bluebird pump stations. Operations and maintenance expenses are allocated to participating member agencies on the basis of ownership and usage of the facilities. The City of Laguna Beach operates and maintains the facility. Ownership of the facilities at June 30, 2016 was as follows:

South Orange County Wastewater Authority
Other Information, Continued
For the year ended June 30, 2016

Members	Percentage
CLB	95.88%
EBSD	4.12%
Total	100.00%

Project Committee No. 24 ("PC 24")

PC 24 is for the operations and maintenance of the facilities known as the Aliso Creek Land and Ocean Outfall which disposes of treated wastewater. Operations and maintenance expenses are allocated to participating member agencies on the basis of ownership and usage of the facilities. On June 30, 2016, the capacity ownership in the Aliso Creek Ocean Outfall was as follows:

Members	MGD	Percentage
CLB	5.50	11.00%
EBSD	0.39	0.78%
ETWD	8.15	16.30%
IRWD	7.88	15.76%
MNWD	21.92	43.85%
SCWD	6.16	12.31%
Total	50.00	100.00%

MGD = Million gallons per day peak flow rate

Pre-Treatment Program

The Pre-Treatment Program was established in compliance with the Environmental Protection Agency ("EPA") to monitor the contents of industrial waste flowing from industries within the areas served by several of the member agencies.