



December 3, 2018

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

We have audited the financial statements of the South Orange County Wastewater Authority (the “Authority”), which comprise the statement of net position as of June 30, 2018 and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 3, 2018. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated May 21, 2018, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

As part of our audit, we considered the internal control of the Authority. Such considerations are solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we also performed tests of the Authority’s compliance with certain provisions of laws, regulations, contracts, and grants. However, providing an opinion on compliance with those provisions is not an objective of our audit.

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.

Generally accepted accounting principles provide for certain required supplementary information (“RSI”) to supplement the basic financial statements. Our responsibility with respect to the Management’s Discussion and Analysis, Schedule of the Authority’s Proportionate Share of the Net Pension Liability and Related Ratios, Schedule of the Authority’s Contributions - Pensions, the Schedule of Changes in Net OPEB Liability and Related Ratios, and the Schedule of the Authority’s Contribution – OPEB, which supplement the basic financial statements, is to apply certain limited procedures in accordance with generally accepted auditing standards. However, the RSI was not audited and, because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance, we do not express an opinion or provide any assurance on the RSI.

Planned Scope and Timing of the Audit

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit involved judgment about the number of transactions to be examined and the areas to be tested.

Our audit included obtaining an understanding of the entity and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Material misstatements may result from (1) errors, (2) fraudulent financial reporting, (3) misappropriations of assets, or (4) violations of laws or governmental regulations that are attributable to the entity or to acts by management or employees acting on behalf of the entity.

We performed the audit according to the planned scope and timing previously communicated to you.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Authority are described in Note 2 to the basic financial statements.

New Accounting Standards

GASB Statement No. 75 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions.* 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 Plans*, 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. This statement had an impact on the Authority's financial statements for the year ended June 30, 2018.

GASB Statement No. 81, *Irrevocable Split-Interest Agreement.* 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. This statement did not have a significant impact on the Authority's financial statements for the year ended June 30, 2018.

GASB Statement No. 85, *Omnibus 2017.* This Statement addresses 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). This statement did not have a significant impact on the Authority's financial statements for the year ended June 30, 2018.

GASB Statement No. 86, *Certain Debt Extinguishment Issues.* GASB Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt*, requires that debt be considered defeased in substance when the debtor irrevocably places cash or other monetary assets acquired with refunding debt proceeds in a trust to be used solely for satisfying scheduled payments of both principal and interest of the defeased debt. The trust also is required to meet certain conditions for the transaction to qualify as an in-substance defeasance. This Statement establishes essentially the same requirements for when a government places cash and other monetary assets acquired with only existing resources in an irrevocable trust to extinguish the debt. However, in financial statements using the economic resources measurement focus, governments should recognize any difference between the reacquisition price (the amount required to be placed in the trust) and the net carrying amount of the debt defeased in substance using only existing resources as a separately identified gain or loss in the period of the defeasance. This statement did not have a significant impact on the Authority's financial statements for the year ended June 30, 2018.

No other new accounting policies were adopted and the application of existing policies was not changed during 2018. 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 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 estimates affecting the Authority's financial statements were:

- Management's estimate of the investment fair market value is based on information provided by the State of California for its investment in the Local Agency Investment Fund. We evaluated the key factors and assumptions used to develop the investment fair market value in determining that it is reasonable in relation to the financial statements taken as a whole.
- Management's estimate of the depreciation on capital assets is based on the industry standard and past experience on actual useful life of the asset groups. We evaluated the key factors and assumptions used to develop the depreciation on capital assets in determining that it is reasonable in relation to the financial statements taken as a whole.
- Management's estimate of the net other postemployment benefit ("OPEB") liability is based on the actuarial valuation on total OPEB liability and based on audited financial statements for CalPERS plans. We evaluated the key factors and assumptions used to develop the net OPEB liability in determining that it is reasonable in relation to the financial statements taken as a whole.
- Management's estimate of the net pension liabilities is based on the actuarial valuation on total pension liability and based on audited financial statements on fiduciary net position for CalPERS plans. We evaluated the key factors and assumptions used to develop the net pension liability in determining that it is reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

- Note 2 – Summary of Significant Accounting Policies
- Note 4 – Capital Assets
- Note 6 – Other Postemployment Benefits
- Note 7 – Pension Plans
- Note 9 – Commitments and Contingencies
- Note 10 – Prior Period Adjustment

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. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

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 the management representation letter dated December 3, 2018.

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 governmental unit'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 Matters

We applied certain limited procedures to the Management's Discussion and Analysis, Schedule of the Authority's Proportionate Share of the Net Pension Liability and Related Ratios, Schedule of the Authority's Contributions – Pensions, the Schedule of Changes in Net OPEB Liability and Related Ratios, and the Schedule of the Authority's Contribution – OPEB, which is required supplementary information ("RSI") that 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 RSI and do not express an opinion or provide any assurance on the RSI.

The Project Committees, which accompany the financial statements as Other Information, are presented for purposes of additional analysis and are not a required part of the financial statements. The Project Committees information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance to them.

To the Board of Directors
of the South Orange County Wastewater Authority
Dana Point, California
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Restriction on Use

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

Very truly yours,

The Pen Group, LLP

Santa Ana, California

South Orange County Wastewater Authority

Dana Point, California

Financial Statements and Independent Auditors' Report

For the Year Ended June 30, 2018



South Orange County Wastewater Authority

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FINANCIAL SECTION

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INDEPENDENT AUDITORS' REPORT

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

Report on Financial Statements

We have audited the accompanying statement of net position of the South Orange County Wastewater Authority (the "Authority") as of June 30, 2018 and the related statement of revenues, expenses, and change in net position, and cash flows for the year ended June 30, 2018, 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Authority as of June 30, 2018, and the respective changes in financial position, and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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To the Board of Directors
of the South Orange County Wastewater Authority
Dana Point, California
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Emphasis of Matters

Implementation of GASB Statement No. 75

As discussed in Note 2 to the basic financial statements, in 2018, the Authority adopted new accounting guidance, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The adoption of this statement requires retrospective application of previously reported net position at July 1, 2017 as described in Note 6 to the basic financial statements. In addition, Net OPEB Liability is reported in the Statement of Net Position in the amount of \$5,358,998 as of June 30, 2018, the measurement date. This Net OPEB Liability is calculated by actuaries using estimates and actuarial techniques from an actuarial valuation as of January 1, 2017. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, Schedule of the Authority's Proportionate Share of the Net Pension Liability and Related Ratios, Schedule of Contributions - Pensions, Schedule of Changes in Net OPEB Liability and Related Ratios and Schedule of Contributions - OPEB on pages 3 through 17, and 46 through 48 will 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 is 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 them.

The PwC Group, LLP

Santa Ana, California
December 3, 2018



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MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2018

This section of the financial statements of the South Orange County Wastewater Authority (Authority) is management's overview of “Key/Significant” items included in the statements and analysis of the Authority's financial activities for the fiscal year ended June 30, 2018. 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					
	2018	2017	GASB 75 Implementation FY 2017 Impact	Restated FY 2017	Dollar Change +/(-)	Percentage Change +/(-)
Net Position	\$127,152,449	\$130,862,190	(\$4,744,703)	\$126,117,487	\$1,034,962	0.8%
Capital Assets:						
Capital Assets Not Depreciated:						
Construction-in-Progress	20,833,802	27,159,497		27,159,497	(6,325,696)	-23.3%
Land	14,402,224	14,402,224		14,402,224		
Total Capital Assets Not Depreciated	35,236,026	41,561,721		41,561,721	(6,325,696)	-15.2%
Depreciable Capital Assets:						
All Classes of Depreciable Capital Assets	294,970,825	280,203,940		280,203,940	14,766,886	5.3%
Accumulated Depreciation	(198,952,950)	(192,356,990)		(192,356,990)	(6,595,960)	3.4%
Depreciable Capital Assets Net Book Value	96,017,875	87,846,950		87,846,950	8,170,926	9.3%
Total Capital Assets Net Book Value	131,253,901	129,408,671		129,408,671	1,845,231	1.4%
Liabilities:						
GASB 45-Net OPEB Liability Position	-	587,760	(587,760)	-	-	
GASB 75-Net OPEB Liability Position	5,358,998		5,332,463	5,332,463	26,535	0.5%
GASB 68-Net Pension Liability	13,410,437	11,549,944		11,549,944	1,860,493	16.1%
Compensated Absences	620,032	653,282		653,282	(33,250)	-5.1%
Deferred Outflows/(Inflows):						
GASB-68 Deferred Outflows/(Inflows)	3,271,953	2,779,195		2,779,195	492,758	17.7%
GASB-45 Deferred Outflows/(Inflows)	(34,043)				(34,043)	



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The Authority's Net Position increased by only \$1 million or .8 % in comparison to a \$13.1 million or 11.1% increase in FY 2016-17 primarily due to:

- Implementation of GASB 75, Accounting and Financial Reporting for Postemployment Benefits Other than Pensions (OPEB), added \$4.8 million unfunded Retiree Health Liability to move from GASB 45 to GASB 75; total liability is \$5.4 million.
- GASB 68 Net Pension Liability, unfunded, increased \$1.9 million to \$13.4 million.

Construction-in-Progress (CIP) decreased \$6.3 million primarily due to \$14.8 million in capital assets placed in service as follows:

Treatment Facility	Acquisition Amount
PC 2, JB Latham Plant	8,984,088
PC 17, Joint Regional Reclamation Plant	2,330,348
PC 23, North Coast Interceptor	1,735,552
PC 15, Coastal Treatment Plant	1,635,214
IT	81,684
Total Acquisitions	14,766,886

The Acquisition Assets categories are:

Asset Category	Acquisition Amount
Machinery and Equipment	9,358,209
Infrastructure	3,281,240
Building Improvements	1,463,184
Computer Hardware	235,258
Buildings	194,074
Vehicles	116,778
Computer Software	95,466
Furniture and Fixtures	22,677
Total Acquisitions	14,766,886

Construction-in-Progress additions were \$8.4 million as follows:

Treatment Facility	CIP Additions Amount
PC 2, JB Latham Plant	\$2.1 million
PC 15, Coastal Treatment Plant	\$2.5 million
PC 17, Joint Regional Reclamation Plant	\$3.8 million
Total CIP Additions	\$8.4 million



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Significant CIP Projects were:

FY 2017-18 Significant Capital Projects	CIP Addition Amount
PC 2, JB Latham Plant:	
Facility Improvements B - Basin Upgrades (2018)	568,041
Facility Improvements B - DAFT and Ancillary Solids Improvement	287,349
Facility Improvements - Solids Area (2015)	162,656
Aeration/Cogeneration Design/Construction (2009)	85,007
PC 15, Coastal Treatment Plant:	
Facility Improvements Project Design (2018)	651,114
Export Sludge Pump Addition (2017)	253,685
AWT Backwash Pump Replacement (2016)	169,400
Stanley Expansion	123,339
East Primary/Aeration Grating Rebate and Concrete Repair Basins Between HW Bldg. and Primary Basin Grating Rebate	119,735
Applied Water Pump System Replacement (AWT) (2017)	115,877
Export Sludge System (1997)	113,089
Applied Water VFD Pump Panel and Electrical (AWT) (2018)	86,643
	82,823
PC 17, Joint Regional Reclamation Plant	
Co-Gen Sys Retrofit (formerly Siloxane) (2015)	1,112,726
Influent Junction Structure Gate Replacement (2016)	371,598
Influent Manholes 1 and 2 and Sewer Rehabilitation (2016)	367,154
Switchgear Upgrade (2006)	247,956
Grit Basin Drop Gate and Weir Replacement (2016)	158,344
Primary Inlet Drop Gate Replacement (2016)	150,637
Stanley Expansion	143,072
Develop Buried Piping Reconstruction Master Plan (2017)	108,425
SCADA Improvements (2017)	95,817
AWT No.2 Upgrade Design (2017)	81,713
Various PC's and Capital Projects	2,784,993
Total CIP Additions	8,441,192



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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.

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 and Table 4.



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The Authority's recorded investment in capital assets increased \$14.8 million (as detailed in above schedules). Total capital assets by category are as follows:

Table 1

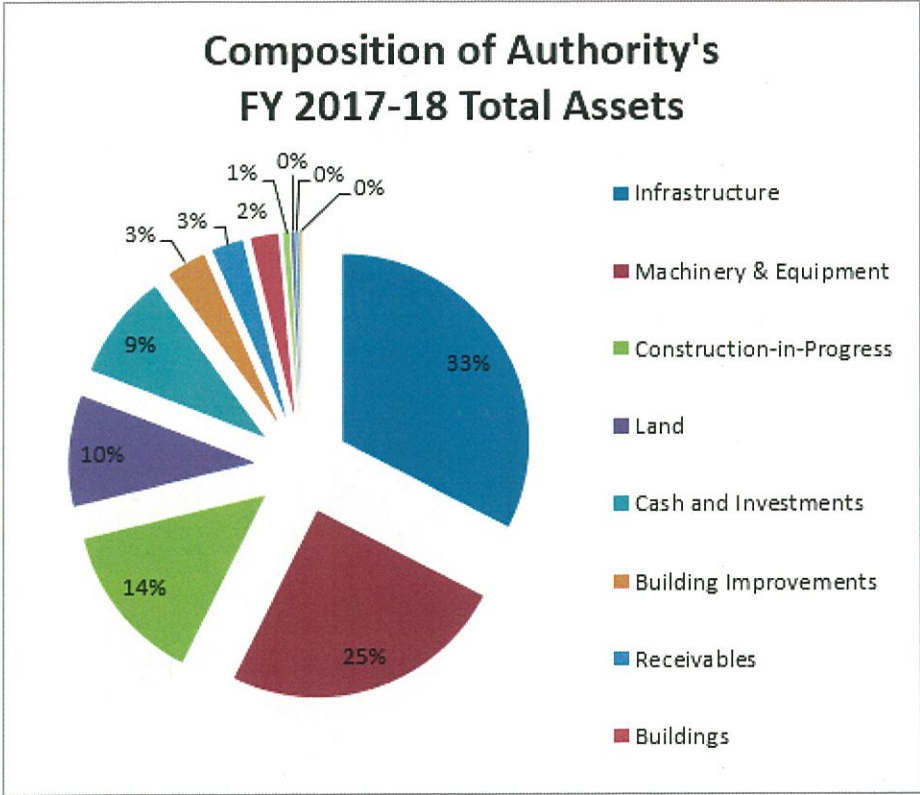
SOCWA's Total Capital Assets FY 2017-18		
Asset Category	\$ Amount	% Total
Infrastructure	48,779,298	37.2%
Machinery & Equipment	37,055,331	28.2%
Construction-in-Progress	20,833,802	15.9%
Land	14,402,224	11.0%
Building Improvements	5,179,648	3.9%
Buildings	3,673,353	2.8%
Computer Hardware	730,665	0.6%
Vehicles	406,343	0.3%
Computer Software	154,691	0.1%
Furniture and Fixtures	38,547	0.0%
Total Capital Assets	131,253,901	100.0%

The above assets are Net Book Value (net of accumulated depreciation) for depreciable capital assets.



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Chart 1



90% of the Authority's assets are as follows:

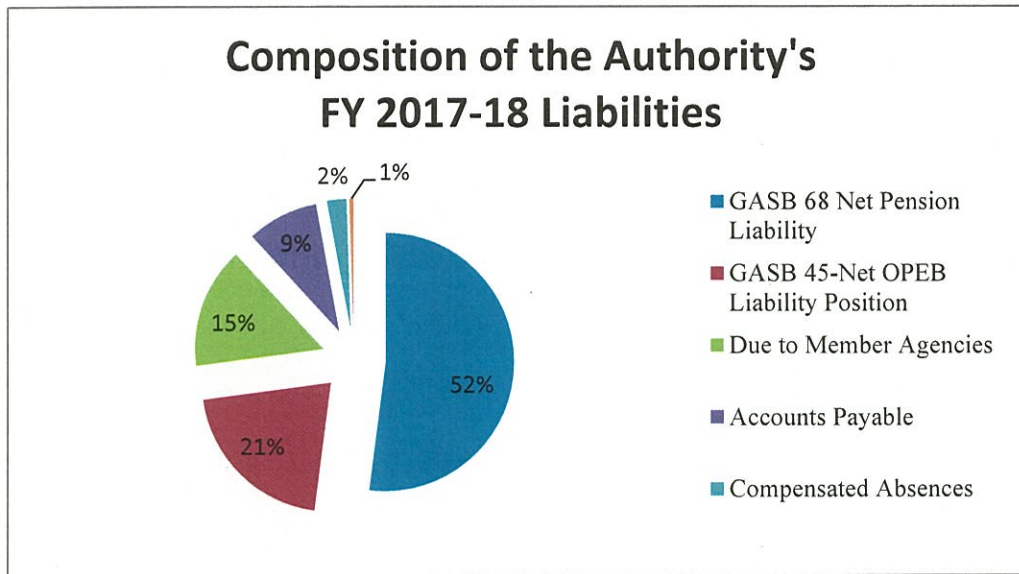
Major Assets	% Mix
Infrastructure	32.6%
Machinery & Equipment	24.8%
Construction-in-Progress	13.9%
Land	9.6%
Cash and Investments	9.1%
Total	90.0%



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Table 2		
SOCWA's Total Liabilities FY 2017-18		
Liability Type	\$ Amount	% Total
GASB 68 Net Pension Liability	\$13,410,437	52.1%
GASB 75-Net OPEB Liability Position	5,358,998	20.8%
Due to Member Agencies	3,910,599	15.2%
Accounts Payable	2,314,106	9.0%
Compensated Absences	620,032	2.4%
Accrued Payroll Liabilities	127,396	0.5%
Total Liabilities	\$25,741,567	100.0%

Chart 2



SOCWA's liabilities increased \$4.1 million or 19% from \$21.7 million in FY 2016-17 to \$25.7 million in FY 2017-18 primarily due to:

- GASB 75, retiree health, implementation, \$4.8 million
- GASB 68, net pension liability, change primarily due to CalPERS lowering the discount rate, \$1.9 million.



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	Fiscal Year Ending 6/30/2018	Fiscal Year Ending 6/30/2017	GASB 75 Implementation FY 2017 Impact	Restated FY 2017	Dollar Change + / (-)	Percentage Change + / (-)
Current Assets	\$18,402,205	\$15,609,499		\$15,609,499	\$2,792,706	17.9%
Non-Current Assets:						
Capital Assets not being depreciated	35,236,026	41,561,721		41,561,721	(6,325,696)	-15.2%
Capital Assets net of accum. depreciation	96,017,875	87,846,950		87,846,950	8,170,926	9.3%
Total Capital Assets	131,253,901	129,408,671		129,408,671	1,845,230	
Total Assets	149,656,106	145,018,170		145,018,170	4,637,936	3.2%
GASB 68-Deferred Outflows	4,069,991	3,321,291		3,321,291	748,700	22.5%
Current Liabilities	6,746,223	4,458,739		4,458,739	2,287,484	51.3%
Non-Current Liabilities	18,995,344	12,476,437	4,744,703	17,221,140	1,774,204	10.3%
Total Liabilities	25,741,567	16,935,176	4,744,703	21,679,879	4,061,688	18.7%
GASB 68-Deferred Inflows	798,038	542,096		542,096	255,942	47.2%
GASB 45-Deferred Inflows	34,043				34,043	
Net Position:						
Net Investment in Capital Asset	131,253,901	129,408,671		129,408,671	1,845,230	1.4%
Restricted for Project Committees	(4,101,452)	1,453,519		(3,291,184)	(810,268)	24.6%
Total Net Position	\$127,152,449	\$130,862,189	\$0	\$126,117,487	\$1,034,962	0.8%

The Authority has total assets of \$150 million as of June 30, 2018. This represents an increase of \$4.7 million or 3.2% over FY 2016-17 total assets of \$145 million as of June 30, 2017.

The increase is primarily due to the Authority's continued investment in Capital Improvement Projects, \$8.4 million, as discussed above.

Current assets change is a timing difference.

Deferred Outflows and Deferred Inflows

GASB 68, net pension liability, Deferred Outflows and Inflows change is a positive \$493 thousand impact on net position.

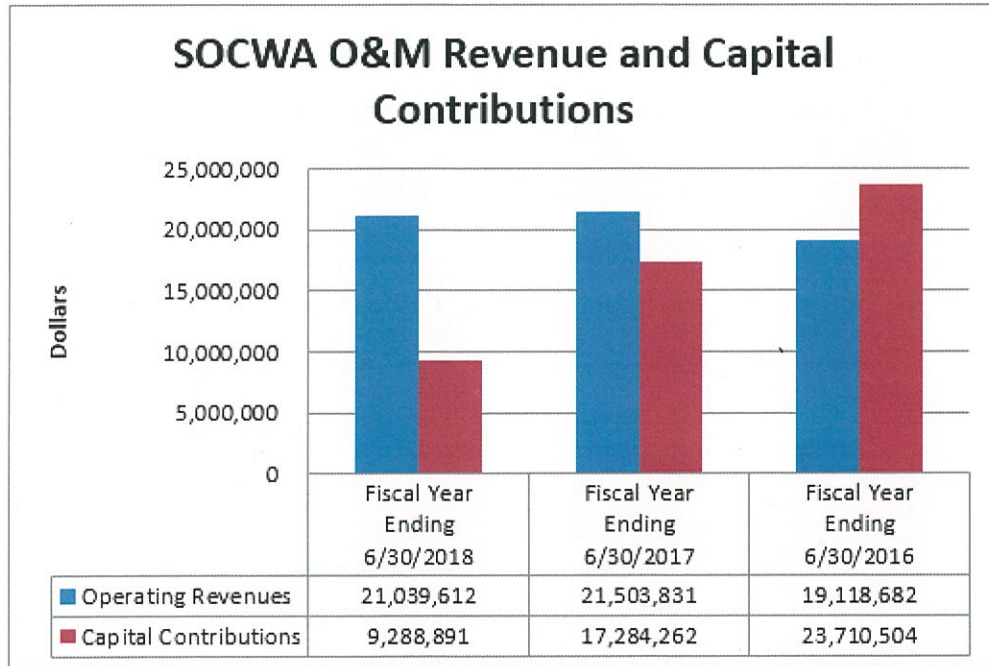
GASB 75, retiree health liability, Deferred Inflows is a \$34 thousand reduction in net position.



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Chart 3

Statement of Revenues, Expenses and Changes in Net Position



O&M revenue requirements decreased \$0.5 million to \$21 million from FY 2016-17 revenue of \$21.5 million, a -2.2% change, primarily due to cost control measures.

Capital Contributions declined in FY 2017-18, \$8 million, a 46.3% decline due to a multiyear large capital project completion at JBL, Aeration/Cogeneration/Construction (2009).



South Orange County Wastewater Authority
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 Phone: (949) 234-5400 Fax: (949) 489-0130

Table 4 Condensed Statement of Revenues, Expenses and Changes in Net Position						
	Fiscal Year Ending 6/30/2018	Fiscal Year Ending 6/30/2017	GASB 75 Implementation FY 2017 Impact	Restated FY 2017	Dollar Change +/-	Percentage Change +/-
Operating Revenues	\$21,039,612	\$21,503,831		\$21,503,831	(\$464,219)	-2.2%
Operating Expenses	23,017,491	19,302,692	4,744,703	24,047,395	(1,029,904)	-4.3%
Depreciation Expense	6,595,960	6,291,302		6,291,302	304,658	4.8%
Non-Operating Expenses/(Income)	(319,910)	113,220		113,220	(433,130)	-382.6%
Total Expenses	29,293,541	25,707,214	4,744,703	30,451,917	(1,158,376)	-3.8%
Capital Contributions	9,288,891	17,284,262		17,284,262	(7,995,371)	-46.3%
Current Year Change in Net Position	1,034,962	13,080,879	(4,744,703)	8,336,176	(7,301,214)	-87.6%
Beginning Net Position (Restated)	\$126,117,487	\$117,781,310		\$117,781,310	\$8,336,176	7.1%
Add Current Year Change	1,034,962	13,080,879	(4,744,703)	8,336,176	(7,301,214)	-55.8%
Net Position before extraordinary items	127,152,449	130,862,189	(4,744,703)	126,117,487	1,034,962	0.8%
Ending Net Position	127,152,449	130,862,189	(4,744,703)	126,117,487	1,034,962	0.8%

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 \$21 million decreased \$464 thousand or 2% primarily due to cost control measures.

The Authority continues to follow 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.

Capital Contributions declined in FY 2017-18, \$8 million, a 46.3% decline due to a multiyear large capital project completion at JBL, Aeration/Cogeneration/Construction (2009).

FY 2017-18 Operating Results contributed \$1 million to Net Position due to Capital Contributions from Member Agencies; O&M Operating Revenue is equal to Operating Expenses, therefore, no contribution to Net Position.



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SUPPLEMENTARY INFORMATION

Capital Assets

The Authority's investment in capital assets increased \$8.4 million, while \$14.8 million capital assets were placed in service and moved from construction in progress to fixed assets during the fiscal year ending June 30, 2018.

Long-Term Debt

Long-term debt for SOCWA consists of three items:

1. Compensated absences as of June 30, 2018:
 - a. Current Portion, payable within one year, \$394,123
 - b. Long Term Portion, future benefit, greater than one year, \$225,909
 - c. Total Liability (Current and Long Term), \$620,032.

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 (GASB 75) as of June 30, 2018, the Net OPEB liability is \$5,358,998.
3. GASB 68 Net Pension Liability as of June 30, 2018:
 - The Net Pension Liability is \$13,410,437, an increase of \$1,860,493 or 16%, over FY 2017 liability of \$11,549,444 primarily due to CalPERS reduction in their discount rate.
 - 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%

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FINANCIAL STATEMENTS

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South Orange County Wastewater Authority
Statement of Net Position
June 30, 2018

ASSETS

Current assets:

Cash and investments (Note 3)	\$ 13,557,237
Receivables:	
Accounts	1,660,444
Due from Member Agencies	2,433,322
Interest	52,302
Total receivable, net	4,146,068
Inventories	494,032
Deposits	-
Prepaid items	204,868
Total current assets	18,402,205

Noncurrent asset (Note 4):

Capital assets, nondepreciable	35,236,026
Capital assets, depreciable, net	96,017,875
Total current assets	131,253,901
Total assets	149,656,106

DEFERRED OUTFLOWS OF RESOURCES

Pensions related deferred outflows of resources	4,069,991
Total deferred outflows of resources	4,069,991

LIABILITIES

Current liabilities:

Accounts payable	2,314,106
Due to Member Agencies	3,910,599
Accrued payroll and related liabilities	127,395
Compensated absences - due within one year (Note 5)	394,123
Total current liabilities	6,746,223

Noncurrent liabilities:

Compensated absences - due in more than one year (Note 5)	225,909
Net OPEB liability	5,358,998
Net pension liability	13,410,437
Total noncurrent liabilities	18,995,344
Total liabilities	25,741,567

DEFERRED INFLOWS OF RESOURCES

Pensions related deferred inflows of resources	798,038
OPEB related deferred inflows of resources	34,043
Total deferred inflows of resources	832,081

NET POSITION

Investment in capital assets	131,253,901
Unrestricted (deficit)	(4,101,452)
Total net position	\$ 127,152,449

South Orange County Wastewater Authority
Statement of Revenues, Expenses, and Change in Net Position
For the Year Ended June 30, 2018

OPERATING REVENUES:

O&M Member Agency Assessments :	
City of Laguna Beach	\$ 3,777,716
City of San Clemente	156,322
City of San Juan Capistrano	2,158,791
Emerald Bay Service District	125,522
El Toro Water District	804,371
Irvine Ranch Water District	167,911
Moulton Niguel Water District	8,501,212
South Coast Water District	3,394,390
Santa Margarita Water District	1,897,223
Trabuco Canyon Water District	56,154
Total O&M Member Agency Assessments	<u>21,039,612</u>
Total Operating Revenues	<u>21,039,612</u>

OPERATING EXPENSES:

O&M, Environmental, Compliance and Safety	18,118,149
Engineering after capital transfer	414,966
Administration	2,400,967
Unallocated portion of pension and OPEB expense	1,428,313
Other expense	655,096
Depreciation and amortization	6,595,960
Total Operating Expenses	<u>29,613,451</u>
Operating (Loss)	<u>(8,573,839)</u>

NON-OPERATING REVENUES (EXPENSES):

Interest income	166,452
Other revenues	153,458
Total Non-Operating Expenses	<u>319,910</u>

CAPITAL CONTRIBUTIONS FROM MEMBER AGENCIES:

Member Agency Assessments:	
City of Laguna Beach	1,221,424
City of San Clemente	2,556
City of San Juan Capistrano	973,822
Emerald Bay Service District	93,615
El Toro Water District	266,044
Irvine Ranch Water District	83,500
Moulton Niguel Water District	3,825,793
South Coast Water District	2,119,393
Santa Margarita Water District	702,744
Total Member Agency Assessments	<u>9,288,891</u>
Total Capital Contributions from Member Agencies	<u>9,288,891</u>
Change in Net Position	1,034,962

NET POSITION:

Beginning of year, as restated (Note 10)	<u>126,117,487</u>
End of year	<u>\$ 127,152,449</u>

See accompanying Notes to the Financial Statements.

South Orange County Wastewater Authority
Statement of Cash Flows
For the Year Ended June 30, 2018

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash receipts from Member Agencies	\$ 19,104,447
Cash payments to vendors and suppliers for operations	(11,948,482)
Cash payments to employees for services	(7,688,988)
Net cash (used in) operating activities	<u>(533,023)</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

Other miscellaneous revenue	153,461
Net cash provided by noncapital financing activities	<u>153,461</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Capital contributions from Member Agencies	9,288,891
Acquisition of capital assets	(8,441,192)
Net cash provided by capital and related financing activities	<u>847,699</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Interest received	139,406
Net cash provided by investing activities	<u>139,406</u>
Net change in cash and cash equivalents	607,543

CASH AND CASH EQUIVALENTS:

Beginning of year	12,949,694
End of year	<u>\$ 13,557,237</u>

**RECONCILIATION OF NET OPERATING (LOSS) TO
NET CASH PROVIDED BY OPERATING ACTIVITIES:**

Operating (Loss)	\$ (8,573,839)
Adjustments to reconcile operating (loss) to net cash (used in) operating activities:	
Depreciation	6,595,960
Changes in operating assets and liabilities:	
Accounts receivable	(591,162)
Due from Member Agencies	(1,363,503)
Inventory	(83,166)
Deposits	19,500
Prepaid items	(139,786)
Pensions related deferred outflows of resources	(748,700)
Accounts payable	(368,582)
Due to Member Agencies	2,551,758
Accrued payroll liabilities	24,734
Compensated absences	(33,250)
Net OPEB liability	26,535
Net pension liability	1,860,493
Pensions related deferred inflows of resources	255,942
OPEB related deferred inflows of resources	34,043
Net cash (used in) operating activities	<u>\$ (533,023)</u>

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NOTES TO THE FINANCIAL STATEMENTS

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South Orange County Wastewater Authority
Notes to the Financial Statements
For the Year Ended June 30, 2018

Note 1 – 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.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation

Financial statement presentation follows the recommendations promulgated by the Governmental Accounting Standards Board ("GASB") commonly referred to as accounting principles generally accepted in the United States of America ("U.S. GAAP"). GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting standards.

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 2 – Summary of Significant Accounting Policies (Continued)

Deferred Outflows/Inflows of Resources

The Statement of Net Position reports separate sections for Deferred Outflows of Resources, and Deferred Inflows of Resources, when applicable.

Deferred Outflows of Resources represent outflows of resources (consumption of net position) that apply to future periods and that, therefore, will not be recognized as an expense until that time.

Deferred Inflows of Resources represent inflows of resources (acquisition of net position) that apply to future periods and that, therefore, are not recognized as revenue until that time.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

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 activities of the Authority. The Authority accounts for its operations (a) that are financed and operated in a manner similar to private business enterprises – where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

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), and deferred outflows and inflows of resources 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.

Operating revenues are those revenues that are generated from the primary operations of the Authority. The Authority reports a measure of operations by presenting the change in net position from operations as "Net Surplus/(Deficit)" in the statement of revenues, expenses, and changes in net position. Operating activities are defined by the Authority as all activities other than financing and investing activities (interest expense and investment income), grants and subsidies, settlement receivable allowance, and other infrequently occurring transactions of a non-operating nature. Operating revenues consists primarily of member assessments for services. Operating expenses are those expenses that are essential to the primary operations of the Authority. 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.

Cash, Cash Equivalents, and Investments

Cash and cash equivalents include all highly liquid investments with original maturities of 90 days or less and are carried at cost, which approximates fair value. Investments are reported at fair value. Changes in fair value that occur during the fiscal year are recognized as investment income for that fiscal year.

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 2 – Summary of Significant Accounting Policies (Continued)

Cash, Cash Equivalents, and Investments (Continued)

The Authority participates in an investment pool managed by the State of California titled Local Agency Investment Fund (“LAIF”), which has invested a portion of the pooled funds in structured notes and asset-backed securities. LAIF’s investments are subject to credit risk with the full faith and credit of the State of California collateralizing these investments. In addition, these structured notes and asset-backed securities are subject to market risk and to change in interest rates. The reported value, which is the net asset value, of the pool approximates the fair value of the pool shares.

Receivables and Allowance For Doubtful Accounts

Accounts receivable consist of amounts owed by member agencies rendered in the regular course of business operations. Receivables are shown net of allowances for doubtful accounts. Uncollectable accounts are based on prior experience and management’s assessment of the collectability of existing accounts.

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.

Prepaid Items

Payments made to vendors for services that will benefit periods beyond the fiscal year ended are recorded as prepaid items.

Capital Assets

Capital assets are valued at historical cost, or estimated historical cost, if actual historical cost was not available. Donated capital assets are valued at their estimated acquisition value on the date donated. The Authority policy has set the capitalization threshold for reporting capital assets at \$5,000, all of which must have an estimated useful life in excess of three years. The original completed joint construction project costs of all original facilities constructed or acquired by AWMA and SERRA were transferred to the Authority and are reflected in the accompanying financial statements as capital assets owned by the Authority. Depreciation is recorded on a straight-line basis over estimated useful lives of the assets as follows:

Machinery and Equipment	3 to 50 years
Buildings and Building improvements	5 to 50 years
Furniture and Fixtures	5 to 10 years
Infrastructure	3 to 80 years

Capital expenditures are recorded as construction-in-process (CIP) and capitalized as a Capital Asset once all costs have been recorded and the asset has been placed in service. Repairs and maintenance costs are expensed. Interest accrued during capital assets construction, if any, is capitalized as part of the asset cost, net of interest income on construction bond proceeds.

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 2 – Summary of Significant Accounting Policies (Continued)

Compensated Absences

Employees can accrue vacation leave up to a maximum of 240 hours. Vacation leave accrues at the rate of 80 to 160 a year depending on the number of years of employment. Sick leave accrues at the rate of 80 to 96 hours per year depending on the number of years of employment. When an employee terminates and provides a two weeks' notice, 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.

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the plans and additions to/deductions from the plans' fiduciary net position have been determined on the same basis as they are reported by the plans (Note 7). For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. Investments are reported at fair value. The following timeframes are used for pension reporting:

For the Year Ended	June 30, 2018
Valuation Date	June 30, 2016
Measurement Date	June 30, 2017
Measurement Period	July 1, 2016 to June 30, 2017

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 outflows and deferred inflows of resources related to pensions and are to be recognized in future pension expense. The amortization period differs depending on the source of the gain or loss. The difference between projected and actual earnings is amortized using the straight-line method over five (5) years. All other amounts are amortized straight-line over the average expected remaining service lives of all members that are provided with benefits (active, inactive, and retired) as of the beginning of the measurement period.

Other Postemployment Benefits ("OPEB")

For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the Authority's Retiree Benefits Plan ("OPEB Plan") and additions to/deductions from OPEB Plan's fiduciary net position have been determined on the same basis as they are reported by the Plan (Note 6). For this purpose, the OPEB Plan recognizes benefit payments when due and payable in accordance with the benefit terms. Investments are reported at fair value, except for money market investments, which are reported at amortized cost.

The following timeframes are used for OPEB reporting:

For the Year Ended	June 30, 2018
Valuation Date	January 1, 2017
Measurement Date	June 30, 2018
Measurement Period	July 1, 2017 to June 30, 2018

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 2 – Summary of Significant Accounting Policies (Continued)

Other Postemployment Benefits (“OPEB”) (continued)

Gains and losses related to changes in total OPEB liability and fiduciary net position are recognized in OPEB expense systematically over time. The first amortized amounts are recognized in OPEB expense for the year the gain or loss occurs. The remaining amounts are categorized as deferred outflows and deferred inflows of resources related to OPEB and are to be recognized in future OPEB expense. The amortization period differs depending on the source of gain or loss. The difference between projected and actual earnings is amortized on a straight-line basis over 5 years. All other amounts are amortized on a straight-line basis over the average expected remaining service lives of all members that are provided with benefits (active, inactive, and retired) at the beginning of the measurement period.

Net Position

Net position represents the difference between all other elements in the statement of net position and should be displayed in the following three components:

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

Restricted – This component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets.

Unrestricted – This component of net position is the amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

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

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.

Use of Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the certain reported amounts and disclosure. Accordingly, actual results could differ from those estimates.

Implementation of New GASB Pronouncements

GASB Statement No. 75 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (GASB 75). 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 Plans*, 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. This statement had an impact on the Authority's financial statements for the year ended June 30, 2018.

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 2 – Summary of Significant Accounting Policies (Continued)

Implementation of New GASB Pronouncements (Continued)

GASB Statement No. 81, *Irrevocable Split-Interest Agreement* (GASB 81) 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. This statement did not have a significant impact on the Authority’s financial statements for the year ended June 30, 2018.

GASB Statement NO. 85, *Omnibus 2017* (GASB 85). This Statement addresses 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). This statement did not have a significant impact on the Authority’s financial statements for the year ended June 30, 2018.

GASB Statement No. 86, *Certain Debt Extinguishment Issues* (GASB 86). Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt*, requires that debt be considered defeased in substance when the debtor irrevocably places cash or other monetary assets acquired with refunding debt proceeds in a trust to be used solely for satisfying scheduled payments of both principal and interest of the defeased debt. The trust also is required to meet certain conditions for the transaction to qualify as an in-substance defeasance. This Statement establishes essentially the same requirements for when a government places cash and other monetary assets acquired with only existing resources in an irrevocable trust to extinguish the debt. However, in financial statements using the economic resources measurement focus, governments should recognize any difference between the reacquisition price (the amount required to be placed in the trust) and the net carrying amount of the debt defeased in substance using only existing resources as a separately identified gain or loss in the period of the defeasance. This statement did not have a significant impact on the Authority’s financial statements for the year ended June 30, 2018.

Note 3 – Cash and Investments

At June 30, 2018, the Authority’s cash and investments were comprised of the following:

Petty cash	\$	1,600
Demand deposits		1,379,677
Local Agency Investments Fund		12,175,960
Total cash and investments	\$	13,557,237

A. Demand Deposits

At June 30, 2018, the carrying amount of cash deposit was \$1,379,677 at June 30, 2018. Bank balances at that date were \$1,374,748, the total amount of which was fully insured and/or collateralized with securities held by the pledging financial institutions in the Authority’s name as discussed below.

The California Government Code requires California banks and savings and loan associations to secure the Authority’s cash deposits by pledging securities as collateral. This Code states that collateral pledged in this manner shall have the effect of perfecting a security interest in such collateral superior to those of a general creditor. Thus, collateral for cash deposits is considered to be held in the Authority’s name.

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 3 – Cash and Investments (Continued)

A. Demand Deposits (Continued)

The fair value of pledged securities must equal at least 110% of the Authority's cash deposits. California law also allows institutions to secure the Authority's deposits by pledging first trust deed mortgage notes having a value of 150% of the Authority's total cash deposits. The Authority may waive collateral requirements for cash deposits, which are fully insured up to \$250,000 by the Federal Deposit Insurance Corporation. The Authority, however, has not waived the collateralization requirements.

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*
U.S. Treasury Obligations	5 years	None	None
Negotiable Certificates of Deposit	5 years	30%	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's investments with Local Agency Investment Fund (LAIF) include a portion of the pooled funds invested in Structured Notes and Asset-Backed Securities. These investments include the following:

- **Government Securities Structured Notes** – debt securities (other than asset-backed securities) whose cash flow characteristics (coupon rate, redemption amount, or stated maturity) depend upon one or more indices and/or that have embedded forwards or options.
- **Asset-Backed Securities** – the bulk of which are mortgage-backed securities, entitle their purchasers to receive a share of the cash flows from a pool of assets such as principal and interest repayments from a pool of mortgages (such as CMO's) or credit card receivables.

LAIF is overseen by the Local Agency Investment Advisory Board, which consists of five members, in accordance with State statute. The fair value of the Authority's position in the pool is the same as the value of the pool shares.

As of June 30, 2018, the Authority had \$12,175,960 invested in LAIF, which had invested 2.48% of the pool investment funds in Government Securities Structured Notes and Asset-Backed Securities. LAIF determines fair value on its investment portfolio based on market quotations for those securities where market quotations are readily available and based on amortized cost or best estimate for those securities where market value is not readily available. The credit quality rating of LAIF is unrated as of June 30, 2018

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 3 – Cash and Investments (Continued)

D. Fair Value Measurement

The Authority categorizes its fair value measurements within the fair value hierarchy established by U.S. GAAP. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. As of June 30, 2018, the Authority's investment portfolio consisted of \$12,175,960 invested in the State of California Local Agency Investment Fund, which is "uncategorized" under the fair value hierarchy.

E. Risk Disclosures

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity 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 placing all deposits of member agency funds in passbook savings account demand deposits that are federally insured and additionally in the State of California Local Agency Investment Fund ("LAIF") for deposits up to \$40 million where investments may be made by the State Treasurer in accordance with the above guidelines. For any held funds over \$40 million, investments may be made in negotiable certificates of deposits, U.S. Treasury Notes and other JPA Investment Programs allowable under State statute.

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.

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. As of June 30, 2018, the Authority's investment portfolio consisted of \$12,175,960 invested in the State of California Local Agency Investment Fund, which is not rated.

Disclosures Relating to Custodial Credit Risk

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Authority's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for investments. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF).

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 4 – Capital Assets

The summary of changes in capital assets for the year ended June 30, 2018 was as follows:

	Balance July 1, 2017	Additions	Deletions	Balance June 30, 2018
Capital assets, not depreciated				
Land	\$ 14,402,224	\$ -	\$ -	\$ 14,402,224
Construction in progress	27,159,497	8,441,192	(14,766,887)	20,833,802
Total capital assets, not depreciated	41,561,721	8,441,192	(14,766,887)	35,236,026
Capital assets, being depreciated				
Buildings	10,533,051	194,074	-	10,727,125
Buildings Improvements	6,908,104	1,463,184	-	8,371,288
Computer Hardware	1,180,952	235,258	-	1,416,210
Computer Software	164,445	95,466	-	259,911
Furniture and Fixtures	137,359	22,677	-	160,036
Infrastructure	155,899,047	3,241,235	-	159,140,282
Machinery and Equipment	104,364,362	9,373,494	-	113,737,856
Vehicles	1,016,620	141,497	-	1,158,117
Total capital assets, being depreciated	280,203,940	14,766,885	-	294,970,825
Less accumulated depreciation				
Buildings	(6,883,006)	(170,766)	-	(7,053,772)
Buildings Improvements	(2,891,271)	(300,369)	-	(3,191,640)
Computer Hardware	(539,272)	(146,272)	-	(685,544)
Computer Software	(96,251)	(8,969)	-	(105,220)
Furniture and Fixtures	(117,307)	(4,183)	-	(121,490)
Infrastructure	(107,461,582)	(2,930,683)	-	(110,392,265)
Machinery and Equipment	(73,693,613)	(2,964,581)	-	(76,658,194)
Vehicles	(674,688)	(70,137)	-	(744,825)
Total accumulated depreciation	(192,356,990)	(6,595,960)	-	(198,952,950)
Total capital assets, being depreciated, net	87,846,950	8,170,925	-	96,017,875
Total capital assets, net	\$ 129,408,671	\$ 16,612,117	\$ (14,766,887)	\$ 131,253,901

Depreciation expense for the year ended June 30, 2018 was \$6,595,960.

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 5 – Compensated Absences

The summary of changes in compensated absences for the year ended June 30, 2018 was as follows:

	Balance			Balance June 30, 2018	Classification	
	July 1, 2017	Additions	Deletions		Current	Long-term
Compensated absences	\$ 653,282	\$ 2,342,647	\$ (2,375,897)	\$ 620,032	\$ 394,123	\$ 225,909

Note 6 – Other Postemployment Benefits

At June 30, 2018, net OPEB liabilities and related deferred inflows of resources are as follows:

Net OPEB Liabilities	<u>\$ 5,358,998</u>
Deferred Inflows of Resources:	
Difference between projected and actual investment earnings on plan assets	<u>\$ 34,043</u>

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, 2018, the total contribution made was \$564,582, which was comprised of \$210,000 contributed to the Public Agency Retirement Services ("PARS") irrevocable trust and \$354,582 on the pay-as-you-go basis. There were 31 retired employees who received health care benefits during the fiscal year.

Employees Covered

As of January 1, 2017 actuarial valuation, the following current and former employees were covered by the benefit terms under the OPEB Plan:

Active employees	58
Inactive employees or beneficiaries currently receiving benefits	31
Inactive employees entitled to, but not yet receiving benefits	-
	<u>89</u>

OPEB Plan Fiduciary Net Position

Detailed information about the OPEB plan's fiduciary net position is available in the separately issued plan financial report and may be obtained on CalPERS' website. www.calpers.ca.gov.

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 6 – Other Postemployment Benefits (Continued)

Net OPEB Liability

The Authority’s net OPEB liability was measured as of June 30, 2018, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of June 30, 2017 that was rolled forward to determine the June 30, 2018 total OPEB liability.

Actuarial Assumptions

The total OPEB liability in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified:

Discount Rate	7.00% Based on the current funding practice and the actuarial assumptions used.
Inflation	2.75% per annum
Salary increases	3.00% per annum, in aggregate
Expected Long-Term Investment Rate of Return	7.00% per year based on building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of OPEB plan investment expense and inflation) are developed for each major asset class.
Pre-retirement Turnover	According to termination rates under the most recent CalPERS pension plan valuation
Pre-retirement and Post-retirement Mortality; Retirement	According to pre-retirement and post-retirement mortality rates and retirement rates under the most recent CalPERS pension plan valuation.
ACA Excise Tax	Based upon loading health care trend rates by 1.21% in fiscal years 2031 and beyond for 2017, and 0.99% in fiscal years 2029 and beyond 2018.
Healthcare Tread Rate	2017 - PPO: Actual; HMO: Actual
	2018 - PPO: 7.0%; HMO: 6.5%
	2019 - PPO: 6.5%; HMO: 6.0%

The actuarial assumptions used in the January 1, 2017 valuation were based on the results of an actuarial experience study for the period July 1, 2017 through June 30, 2018.

The long-term expected rate of return on OPEB 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 OPEB plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-term Expected Real Rate of Return</u>
Fixed Income	35%	1.50%
Equities	60%	5.75%
Cash	5%	0.00%
Total	<u>100%</u>	

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 6 – Other Postemployment Benefits (Continued)

Net OPEB Liability (Continued)

Discount Rate

The discount rate used to measure the total OPEB liability was 7.00 percent. The actuarial assumptions used to determine the discount rate was based on the current funding practice and assumed the fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

Change in the Net OPEB Liability

	Increase (Decrease)		
	Total OPEB Liability	Plan Fiduciary Net Position	Net OPEB Liability
Balance at June 30, 2017	\$ 9,602,387	\$ 4,269,924	\$ 5,332,463
Changes Recognized for the Measurement Period:			
Service Cost	256,866	-	256,866
Interest on the total OPEB liability	677,737	-	677,737
Changes in benefit terms	-	-	-
Difference between expected and actual experience	-	-	-
Changes in assumptions	-	-	-
Contribution from the employer	-	585,582	(585,582)
Net investment income	-	348,619	(348,619)
Administrative expenses	-	(26,133)	26,133
Benefit payments	(354,582)	(354,582)	-
Net changes during July 1, 2017 to June 30, 2018	580,021	553,486	26,535
Balance at June 30, 2018	<u>\$ 10,182,408</u>	<u>\$ 4,823,410</u>	<u>\$ 5,358,998</u>

Sensitivity of the Net OPEB Liability to Changes in Discount Rate

The following presents the net OPEB liability of the Authority, as well as what the Authority's net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.00 percent) or 1-percentage-point higher (8.00 percent) than the current discount rate:

Plan's Net OPEB Liability		
Discount Rate -1% (6.00%)	Current Discount Rate (7.00%)	Discount Rate +1% (8.00%)
\$ 6,645,325	\$ 5,358,998	\$ 4,296,424

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 6 – Other Postemployment Benefits (Continued)

Net OPEB Liability (Continued)

Sensitivity of the Net OPEB Liability to Changes in Health Care Cost Trend Rates

The following presents the net OPEB liability of the Authority, as well as what the Authority's net OPEB liability would be if it were calculated using healthcare cost trend rates that are 1-percentage-point lower (5.5 percent for HMO plans and 6.0 percent for PPO plans) or 1-percentage-point higher (7.5 percent for HMO plans and 8.0 percent for PPO plans) than the current healthcare cost trend rates:

Plan's Net OPEB Liability		
Discount Rate -1%	Healthcare Cost	Discount Rate +1%
5.5% HMO/6.0% PPO	6.5% HMO/7.0% PPO	7.5% HMO/8.0% PPO
decreasing to	decreasing to	decreasing to
4.0% HMO/4.0% PPO	5.0% HMO/5.0% PPO	6.0% HMO/6.0% PPO
\$ 4,098,627	\$ 5,358,998	\$ 6,897,590

OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

For the fiscal year ended June 30, 2018, the Authority recognized OPEB expense of \$646,160. At June 30, 2018, the District reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following source(s):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between projected and actual earnings on OPEB plan investments	\$ -	\$ (34,043)

The difference between projected OPEB plan investment earnings and actual earnings is amortized over a five-year period. The remaining gains and losses are amortized over the expected average remaining service life. The expected average remaining service life is 12.8 years, which was determined as of June 30, 2017, the beginning of the measurement period, for employees covered by the OPEB plan benefit terms as of the valuation date. Amount reported as deferred inflows of resources related to OPEB will be recognized as future OPEB expense as follows:

Year Ending June 30	Amount
2019	\$ (8,511)
2020	(8,511)
2021	(8,511)
2022	(8,510)
2023	-
Thereafter	-
Total	\$ (34,043)

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 7 – Defined Benefit Pension Plan

At June 30, 2017, net pension liabilities and related deferred outflows/inflows of resources are as follows:

	<u>Miscellaneous Plan</u>
Deferred outflows of resources:	
Pension contribution after measurement date	\$ 1,094,606
Difference between expected and actual experience	16,806
Changes of assumptions	2,085,275
Difference between projected and actual earning on pension plan investments	471,603
Adjustment due to differences in proportions	401,701
Total deferred outflows of resources	\$ 4,069,991
 Aggregate Net pension liabilities:	
Miscellaneous plan	\$ 13,410,437
Total net pension liabilities	\$ 13,410,437
 Deferred inflows of Resources:	
Difference between expected and actual experience	\$ 240,782
Changes of assumptions	159,004
Difference between actual contributions and proportionate share of contributions	398,252
Total deferred inflows of Resources	\$ 798,038
 Pension expenses:	 \$ 2,462,341

General Information about the Pension Plan

Plan Description

The Authority contributes to the California Public Employees’ Retirement System (“CalPERS”), a cost-sharing multiple-employer defined benefit pension plan. CalPERS acts as a common investment and administrative agent for participating public entities within the State of California. A full description of the pension plan, benefit provisions, assumptions (for funding, but not accounting purposes), and membership information are listed in the June 30, 2016 Annual Actuarial Valuation Report. This report and CalPERS’ audited financial statements are publicly available reports that can be obtained at CalPERS’ website under Forms and Publications.

Employees Covered by Benefit Terms

At June 30, 2016 valuation date, the following employees were covered by the benefit terms:

	<u>Miscellaneous Plans</u>		
	<u>Tier 1</u>	<u>Tier 2</u>	<u>PEPRA</u>
Active employees	36	7	17
Transferred and terminated employees	44	1	1
Separated	18	0	3
Retired Employees and Beneficiaries	57	0	0
Total	155	8	21

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 7 – Defined Benefit Pension Plan (Continued)

Benefit 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	PEPRA
Hire date	Prior to January 1, 2013	On or after January 1, 2013	On or after January 1, 2013
Benefit Formula	2.5% @ 55	2.0% @ 55	2.0% @ 62
Benefit vesting schedule	5 years of service	5 years of 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	2.000%	2.000%	1.000 % to 2.500%
Require employee contribution rates	8.000%	7.000%	6.250%
Required employer contribution rates	9.671%	8.512%	6.237%

Contributions

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 CalPERS' annual actuarial valuation process. The Public agency cost-sharing plans covered by the miscellaneous risk pools, 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.

Pension Liabilities, Pension Expenses, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pension

Actuarial Methods and Assumptions Used to Determine Total Pension Liability

The June 30, 2016 valuation was rolled forward to determine June 30, 2016 (measurement date) total pension liability based on the following actuarial methods and assumptions:

Actuarial Cost Method	Entry Age Normal
Actuarial Assumption:	
Discount Rate	7.15%
Inflation	2.75%
Salary Increase	Varies by Entry Age and Service
Mortality Rate Table ¹	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

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 7 – Defined Benefit Pension Plan (Continued)

Pension Liabilities, Pension Expenses, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pension (Continued)

Actuarial Methods and Assumptions Used to Determine Total Pension Liability (Continued)

¹The mortality table used was developed based on CalPERS' specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on this table, please refer to 2014 experience study report.

All other actuarial assumptions used in the June 30, 2015 valuation were based on the results of an actuarial experience study for the period from 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

For the June 30, 2017 measurement date, the accounting discount rate was reduced from 7.65 percent to 7.15 percent.

Discount Rate

The discount rate used to measure the total pension liability was 7.15 percent. To determine whether the municipal bond rate should be used in the calculation of the 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. The tests revealed the assets would not run out. Therefore, the current 7.15 percent discount rate is appropriate and the use of the municipal bond rate calculation is not deemed necessary. The long-term expected discount rate of 7.15 percent is applied to all plans in the Public Employees' Retirement Fund ("PERF"). The cash flows used in the testing were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years. The stress test results are presented in a detailed report called "GASB Crossover Testing Report" that can be obtained at 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 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, CalPERS took into account both short-term and long-term market return expectations as well as the expected PERF pension fund cash flows. Taking into account historical returns of all the Public Employees Retirement Funds' asset classes (which includes the agent plan and two cost-sharing plans or PERF A, B, and C funds), 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 PERF 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 equal to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 7 – Defined Benefit Pension Plan (Continued)

Pension Liabilities, Pension Expenses, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pension (Continued)

Discount Rate (Continued)

The table below reflects long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. The target allocation shown was adopted by the Board effective on July 1, 2015.

Asset Class	New Strategic Allocation	Real Return Years 1-10 ⁽¹⁾	Real Return Years 11+ ⁽²⁾
Global Equity	51.00%	5.25%	5.71%
Global Fixed Income	19.00%	0.99%	2.43%
Inflation Sensitive	6.00%	45.00%	3.36%
Private Equity	10.00%	6.83%	6.95%
Real Estate	10.00%	4.50%	5.13%
Infrastructure and Foresland	2.00%	4.50%	5.09%
Liquidity	2.00%	-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

Sensitivity of the Authority's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the Authority's proportionate share of the net pension liability of the Plan as of the measurement date at June 30, 2017, calculated using the discount rate of 7.65%, as well as what the Authority's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.65%) or 1 percentage-point higher (8.65%) than the current rate:

Measurement Date	Discount Rate		
	-1% (6.15%)	Current (7.15%)	+1% (8.15%)
June 30, 2017	\$ 20,284,099	\$ 13,410,437	\$ 7,717,545

Pension Plan Fiduciary Net Position

Detail information about the plan's fiduciary net position is available in the separately issued CalPERS financial report and can be obtained from CalPERS' website under Forms and Publications.

Proportionate Share of Net Pension Liability and Pension Expense

The following table shows the plan's proportionate share of the risk pool collective net pension liability over the measurement period:

	Increase (Decrease)		
	Plan Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability/(Asset)
Miscellaneous			
Balance at: 6/30/16 (Valuation date)	\$ 44,672,109	\$ 33,122,165	\$ 11,549,944
Balance at: 6/30/17 (Measurement date)	49,973,230	36,562,793	13,410,437
Net Changes during 2016-2017	5,301,121	3,440,628	1,860,493

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 7 – Defined Benefit Pension Plan (Continued)

Pension Liabilities, Pension Expenses, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pension (Continued)

Proportionate Share of Net Pension Liability and Pension Expense (Continued)

The following is the approach established by the plan actuary to allocate the net pension liability and pension expense to the individual employers within the risk pool for the measurement period ended June 30, 2017, respectively.

- (1) In determining a cost-sharing plan’s proportionate share, total amounts of liabilities and assets are first calculated for the risk pool as a whole on the valuation date (June 30, 2016). The risk pool’s fiduciary net position (“FNP”) subtracted from its total pension liability (“TPL”) determines the net pension liability (“NPL”) at the valuation date.
- (2) Using standard actuarial roll forward methods, the risk pool TPL is then computed at the measurement date (June 30, 2016). Risk pool FNP at the measurement date is then subtracted from this number to compute the NPL for the risk pool at the measurement date. For purposes of FNP in this step and any later reference thereto, the risk pool’s FNP at the measurement date denotes the aggregate risk pool’s FNP at June 30, 2016 less the sum of all additional side fund (or unfunded liability) contributions made by all employers during the measurement period (2016-2017).
- (3) The individual plan’s TPL, FNP and NPL are also calculated at the valuation date. TPL is allocated based on the rate plan’s share of the actuarial accrued liability. FNP is allocated based on the rate plan’s share of the market value assets.
- (4) Two ratios are created by dividing the plan’s individual TPL and FNP as of the valuation date from (3) by the amounts in step (1), the risk pool’s total TPL and FNP, respectively.
- (5) The plan’s TPL as of the measurement date is equal to the risk pool TPL generated in (2) multiplied by the TPL ratio generated in (4). The plan’s FNP as of the Measurement Date is equal to the FNP generated in (2) multiplied by the FNP ratio generated in (4) plus any additional side fund (or unfunded liability) contributions made by the employer on behalf of the plan during the measurement period.
- (6) The plan’s NPL at the measurement date is the difference between the TPL and FNP calculated in (5).

Deferred outflows of resources, deferred inflows of resources, and pension expense is allocate based on the Authority’s share of contributions during measurement period.

The Authority’s proportionate share of the net pension liability was as follows:

	Miscellaneous
Proportion - June 30, 2016	0.13348%
Proportion - June 30, 2017	0.13522%
Change - Increase (Decrease)	0.00175%

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 7 – Defined Benefit Pension Plan (Continued)

Pension Liabilities, Pension Expenses, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pension (Continued)

Proportionate Share of Net Pension Liability and Pension Expense (Continued)

For the year ended June 30, 2018, the Authority recognized pension expense in the amounts of \$2,294,957.

The amortization period differs depending on the source of the gain or loss. The difference between projected and actual earnings is amortized over 5-years straight line. All other amounts are amortized straight-line over the average expected remaining service lives of all members that are provided with benefits (active, inactive and retired) as of the beginning of the measurement period.

The Expected Average Remaining Service Lifetime (“EARSL”) is calculated by dividing the total future service years by the total number of plan participants (active, inactive, and retired) in the risk pool. The EARSL for risk pool for the measurement date ended June 30, 2017 are 3.7, which was obtained by dividing the total service year of 475,689 (the sum of remaining service lifetimes of the active employees) by 127,009 (the total number of participants: active, inactive, and retired).

At June 30, 2018, the Authority reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Miscellaneous	
	Deferred outflows of Resources	Deferred inflows of Resources
Pension contribution after measurement date	\$ 1,094,606	\$ -
Difference between expected and actual experience	16,806	(240,782)
Changes of assumptions	2,085,275	(159,004)
Difference between projected and actual earning on pension plan investments	471,603	-
Adjustment due to differences in proportions	401,701	-
Difference between actual contributions and proportionate share of contributions	-	(398,252)
Total	\$ 4,069,991	\$ (798,038)

Deferred outflows of resources related to pensions resulting from the Authority’s contributions made 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 of resources and deferred inflows of resources related to pension will be recognized in pension expense as follows:

Measurement Period Ended June 30,	Deferred Outflows/ (Inflows) of Resources Miscellaneous
2019	\$ 598,727
2020	1,183,322
2021	675,298
2022	(280,000)
2023	-
Thereafter	-
	\$ 2,177,347

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 8 – 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, 2018, 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 \$174,167. There were no accrued claims liabilities at June 30, 2017.

Note 9 – Commitment and Contingencies

A. Commitments

The Authority had several outstanding or planned construction and other projects as of June 30, 2018. These projects are evidenced by contractual commitments within engineering related services and the outstanding balance as of June 30, 2018 was \$1,429,214.

B. Contingencies

The Authority is a defendant in a number of lawsuits, which have arisen in the normal course of business. While substantial damages are alleged in some of these actions, their outcome cannot be predicted with certainty.

South Orange County Wastewater Authority
Notes to the Financial Statements (Continued)
For the Year Ended June 30, 2018

Note 10 – Prior Period Adjustment

For the year ended June 30 2018, the Authority is required to implement GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The adoption of this statement requires retrospective application of previously reported net position at July 1, 2017. Accordingly, net position as of July 1, 2017 was restated as follows:

Beginning net position, as previously reported	\$ 130,862,190
Prior period adjustments:	
GASB 75, OPEB (Retiree Health) Implementation	<u>(4,744,703)</u>
Beginning net position, as restated	<u>\$ 126,117,487</u>

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**REQUIRED SUPPLEMENTARY INFORMATION
(UNAUDITED)**

South Orange County Wastewater Authority
Required Supplementary Information (Unaudited)
Schedule of the Authority's Proportionate Share of the Net Pension Liability and Related Ratios
For the Year Ended June 30, 2018

Last Ten Fiscal Years

California Public Employees' Retirement System ("CalPERS") Miscellaneous Plan

	June 30, 2014	June 30, 2015 ¹	June 30, 2016	June 30, 2017
Authority's proportion of the net pension liability/(asset)	0.10903%	0.13190%	0.13350%	0.13520%
Authority's proportionate share of the net pension liability/(asset)	\$ 6,794,277	\$ 9,054,535	\$ 11,549,944	\$ 13,410,437
Authority's covered payroll	\$ 5,215,673	\$ 5,452,666	\$ 5,616,113	\$ 5,784,596
Authority's proportionate share of the net pension liability/(asset) as a percentage of covered employee payroll	130.27%	166.06%	205.66%	231.83%
Plan's proportionate share of the fiduciary net position as a percentage of the total pension liability	83.03%	78.43%	74.15%	73.31%

¹ Historical information is required only for measurement periods for which GASB 68 is applicable.

South Orange County Wastewater Authority
Required Supplementary Information (Unaudited)
Schedule of the Authority's Contributions
For the Year Ended June 30, 2018

Last Ten Fiscal Years

California Public Employees' Retirement System ("CalPERS") Miscellaneous Plan

	2014-15 ¹	2015-16	2016-17	2017-18
Actuarially determined contribution ²	\$ 780,373	\$ 495,877	\$ 521,940	\$ 1,094,606
Contribution in relation to the actuarially determined contribution ²	(780,373)	(1,121,220)	(1,019,645)	(1,094,606)
Contribution deficiency/(excess)	\$ -	\$ (625,343)	\$ (497,705)	\$ -
Authority's covered payroll	\$ 5,452,666	\$ 5,616,113	\$ 5,784,596	\$ 6,083,399
Contributions as a percentage of covered payroll	14.31%	19.96%	17.63%	17.99%

¹ Historical information is required only for measurement periods for which GASB 68 is applicable.

² Employers are assumed to make contributions equal to the actuarially determined contributions. However, some employers may choose to make additional contributions towards their side fund or their unfunded liability. Employer contributions for such plans exceed the actuarially determined contributions. CalPERS has determined that employer obligations referred to as "side funds" are not considered separately financed specific liabilities.

Notes to Schedule

Change in Benefit Terms: The figures above do not include any liability impact that may have resulted from plan changes which occurred after the June 30, 2016 valuation date. This applies for voluntary benefit changes as well as any offers of Two Years Additional Service Credit (a.k.a. Golden Handshakes).

Changes of Assumptions: No changes were noted.

South Orange County Wastewater Authority
Required Supplementary Information (Unaudited)
Schedule of Changes in Net OPEB Liability and Related Ratios
For the Year Ended June 30, 2018

	2018
Total OPEB Liability:	
Service Cost	\$ 256,866
Interest	677,737
Changes of benefit terms	-
Differences between expected and actual experience	-
Changes of assumptions	-
Benefit payments, including refunds of member contributions	(354,582)
Net change in Total OPEB Liability	580,021
Beginning of Year	9,602,387
End of Year	\$ 10,182,408
 Plan Fiduciary Net Position:	
Employer contribution	\$ 585,582
Employee contributions	-
Contributions - nonemployer contributing member	-
Net investment income	348,619
Benefit payments	(354,582)
Administrative expenses	(26,133)
Other	-
Net changes in Fiduciary Net Position	553,486
Beginning of Year	4,269,924
End of Year	\$ 4,823,410
 Net OPEB Liability	 \$ 5,358,998
Fiduciary Net Position as a % of Total OPEB Liability	47.37%
Covered Payroll	\$ 6,264,606
Net OPEB Liability as a % of Payroll	85.54%

* Since it is the first year of implementation, there is only one year available for the required 10-year schedule.

South Orange County Wastewater Authority
Required Supplementary Information (Unaudited)
Schedule of the Authority's Contributions - OPEB
For the Year Ended June 30, 2018

	<u>2018</u>
Actuarilly Determined Employer Contribution	\$ 585,582
Actual Employer Contribution	<u>-</u>
Contribution deficiency (excess)	<u>\$ 585,582</u>
Contribution as a % of payroll	9.35%

* Since it is the first year of implementation, there is only one year available for the required 10-year schedule.

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OTHER INFORMATION

South Orange County Wastewater Authority
Other Information
Project Committees
For the Year Ended June 30, 2018

The following is a description of Project Committee ("PC") activity during the fiscal year ended June 30, 2018:

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, 2018, 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(S0) ("PC 2(S0)")

PC 2(S0) 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(S0).

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.

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, 2017, the capacity ownership of the PC 5 members in the San Juan Creek Ocean Outfall was as follows:

Members	MGD	Percentage
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 average dry weather flow rate

South Orange County Wastewater Authority
Other Information
Project Committees (Continued)
For the Year Ended June 30, 2018

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, 2018, the capacity ownership of the PC 15 members in the Coastal Treatment Plant was as follows:

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

MGD = Million gallons per day average dry weather flow rate

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, 2018, 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	<u>12.00</u>	<u>100.00%</u>	<u>49,975</u>	<u>100.00%</u>

MGD = Million gallons per day average dry weather flow rate

Pounds = Loadings are shown in pounds per day

South Orange County Wastewater Authority
Other Information
Project Committees (Continued)
For the Year Ended June 30, 2018

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:

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

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 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, 2017 was as follows:

<u>Members</u>	<u>Percentage</u>
CLB	95.88%
EBSB	4.12%
Total	<u>100.00%</u>

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, 2018, the capacity ownership in the Aliso Creek Ocean Outfall was as follows:

<u>Members</u>	<u>MGD</u>	<u>Percentage</u>
CLB	5.50	11.00%
EBSB	0.39	0.78%
ETWD	8.15	16.30%
IRWD	7.88	15.76%
MNWD	21.92	43.85%
SMWD	6.16	12.31%
Total	<u>50.00</u>	<u>100.00%</u>

MGD = Million gallons per day average dry weather flow rate

South Orange County Wastewater Authority
Other Information
Project Committees (Continued)
For the Year Ended June 30, 2018

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.