

CITY OF SAN JOSE
SOUTH BAY WATER RECYCLING
PROGRAM AND SYSTEM
(A Program of the City of San José, California)

Independent Auditor's Report and
Schedule of Net Operating Revenues

Year Ended June 30, 2024

CITY OF SAN JOSE
SOUTH BAY WATER RECYCLING PROGRAM AND SYSTEM
Independent Auditor's Report and Schedule of Net Operating Revenues
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Independent Auditor's Report

Recycled Water Policy Advisory Committee
City of San José, California

Opinion

We have audited the schedule of net operating revenues (Schedule) of the South Bay Water Recycling Program and System (Program), a program of the City of San José (City), for the year ended June 30, 2024, and the related notes to the Schedule.

In our opinion, the accompanying Schedule referred to above presents fairly, in all material respects, the net operating revenues of the Program for the year ended June 30, 2024 in accordance with the basis of accounting specified in the Recycled Water Facilities and Programs Integration Agreement between the City of San José and the Santa Clara Valley Water District dated March 2, 2010 (Integration Agreement) as described in Note 2 to the Schedule.

Basis for Opinion

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

Emphasis of Matters

As discussed in Note 2 to the Schedule, the Schedule was prepared by the City in accordance with the terms of the Integration Agreement, under a basis of accounting other than accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the Schedule, the Schedule presents only the Program and does not purport to, and does not, present fairly the changes in financial position of the City or the City's Wastewater Treatment System Enterprise Fund for the year ended June 30, 2024 in accordance with accounting principles generally accepted in the United States of America.

Our opinion is not modified with respect to these matters.

Responsibilities of Management for the Schedule

Management is responsible for the preparation and fair presentation of the Schedule in accordance with the terms of the Integration Agreement, and for determining that the accounting method specified in the Integration Agreement referred to above is an acceptable basis for the preparation of the presentation of the

Schedule in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the Schedule that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Schedule

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the Schedule, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the Schedule.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the Schedule.

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

Macias Gini & O'Connell LLP

Walnut Creek, California
November 15, 2024

CITY OF SAN JOSE
SOUTH BAY WATER RECYCLING PROGRAM AND SYSTEM

(A Program of the City of San José, California)

Schedule of Net Operating Revenues

Year Ended June 30, 2024

Revenues:

Wholesale recycled water sales:

City of Santa Clara	\$ 7,005,001
City of Milpitas	1,549,688
San Jose Water Company	4,980,307
San Jose Municipal Water System	7,185,167
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Total revenues	20,720,163
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Expenses:

Program administration, permitting and compliance	9,220,276
System operations and maintenance	3,503,357
Capital planning and engineering (studies)	205,214
Communication and outreach	25,998
Overhead and capitated services	683,310
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Total expenses	13,638,155
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Net operating revenues	\$ 7,082,008
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See accompanying notes to the schedule of net operating revenues.

CITY OF SAN JOSE
SOUTH BAY WATER RECYCLING PROGRAM AND SYSTEM
Notes to the Schedule of Net Operating Revenues
Year Ended June 30, 2024

(1) GENERAL

On March 2, 2010, the City of San José (“City”) and the Santa Clara Valley Water District (“District”) entered into a Recycled Water Facilities and Programs Integration Agreement (“Integration Agreement”).

The City, as the administering agency for the San José/Santa Clara Water Pollution Control Plant (“Plant”), a joint powers agency of the State of California, manages and operates the South Bay Water Recycling Program and System (“Program”).

The District is the primary water management agency for Santa Clara County (County), providing wholesale water supply, groundwater management, and flood management.

In 1990, the City developed the South Bay Action Plan (“Action Plan”), which was designed to reduce flows from the Plant to South San Francisco Bay to avoid converting the salt marsh habitat of two endangered species, the Salt Marsh Harvest Mouse and the California Clapper Rail. The Action Plan had three main components: water recycling, marsh mitigation, and water conservation. It was approved by the San Francisco Bay Regional Water Quality Control Board and adopted by the City in 1991.

In 1997, the Action Plan was revised to call for expansion of the water recycling and conservation programs as well as several new flow reduction programs. The Revised Plan was approved by the Regional Board in 1997 and incorporated into the City’s Plant National Pollutant Discharge Elimination System (NPDES) permit in 1998.

The City began development of the Program in 1994. The Program currently consists of 110 miles of pipe, four pump stations, and three reservoirs and serves nearly 600 customers with an average of approximately 10,000 acre-feet annually of recycled water.

The District Board of Directors is committed to ensuring that the water supply for the County meets or exceeds all applicable water quality regulatory standards. The District, as the groundwater management agency for the County, actively protects the groundwater basins from contamination and the threat of contamination.

On April 7, 1998, the City and the District entered into an agreement titled “South Bay Water Recycling Reimbursement Agreement For Development And Utilization Of Non-potable Recycled Water Between The Santa Clara Valley Water District And City of San José”, providing for payment by the District to the City for water produced and distributed by the Program that offsets District supplies (the “1998 Reimbursement Agreement”). This 1998 Reimbursement Agreement, as extended by the City and the District, expired on June 30, 2009.

In 2000, the City began, and the District participated in, a multi-stakeholder process to develop a long-term master plan for the Program. The findings of that process confirmed the importance of the linkage between the Program and the District’s Integrated Water Resource Plan (“IWRP”) and the need for a long-term collaboration between the City and the District.

CITY OF SAN JOSE
SOUTH BAY WATER RECYCLING PROGRAM AND SYSTEM
Notes to the Schedule of Net Operating Revenues (Continued)
Year Ended June 30, 2024

(1) GENERAL (CONTINUED)

The District completed its second IWRP in 2003. The District Board of Directors adopted new Ends Policies in 2005 following completion of IWRP 2003. Some of these new policies recognized the need for all weather water supplies and placed value on local water supplies.

In 2003, the City and the District began collaborating on design, construction and operation of an advanced treated recycled water facility and related facilities (“AWTF”), to be located on lands owned by the Plant, in order to demonstrate the treatment capability of a local AWTF to produce highly purified water that will be blended with existing recycled water to expand irrigation and industrial uses.

The City and the District desire to financially support the production and use of recycled water in Santa Clara County consistent with each party’s separate and distinct interests: for wastewater treatment and disposal for the City, and water quality and supply for the District, as well as to coordinate and cooperate to achieve the most cost effective, environmentally beneficial utilization of recycled water to meet both water supply and wastewater treatment and disposal needs.

On March 2, 2010, the City and the District entered into the Integration Agreement. The signed Integration Agreement created the Recycled Water Policy Advisory Committee, approved the building of the new AWTF, and increased the use of recycled water in Santa Clara County. The role of the Advisory Committee is to annually make recommendations to the Board of Directors of the District and the City Council of the City on their respective proposed budgets for the ensuing fiscal year for the maintenance, expansion, replacement, improvement and operation of the Program and the AWTF.

The schedule of net operating revenues (Schedule) of Program is presented to comply with the Integration Agreement.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Accounting

The accompanying Schedule is intended to present the Program’s net operating revenues pursuant to the Integration Agreement and is not intended to be a complete presentation of the Program’s changes in financial position. The Program’s transactions are accounted for in accordance with the terms of the Integration Agreement. Revenues are recognized when earned and expenses are recognized when the liability is incurred.

Program Revenues

Program revenues for the year ended June 30, 2024 totaled \$20.7 million. The revenues are from recycled water sales to the following recycled water retailers: (1) the City of Santa Clara Water and Sewer Utility; (2) the City of Milpitas Water and Sewer; (3) the San José Water Company; and (4) the San José Municipal Water System.

CITY OF SAN JOSE
SOUTH BAY WATER RECYCLING PROGRAM AND SYSTEM
Notes to the Schedule of Net Operating Revenues (Continued)
Year Ended June 30, 2024

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Program Expenses

The Program's expenses for the year ended June 30, 2024 totaled \$13.6 million. These expenses mainly included: program administration, permitting and compliance costs and system operations and maintenance costs. The expenses represent the City's allocations of the Wastewater Treatments System Fund's expenses to the Program based on the Environmental Services Department personnel's direct and indirect levels of effort.

(3) RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS

The South Bay Water Recycling Program and System is a program of the City's Wastewater Treatment System Enterprise Fund. Accordingly, the Program revenues and expenses are reported in the City's basic financial statements as part of the Wastewater Treatment System Enterprise Fund, a major enterprise fund. The Schedule is intended to present the net operating revenues of only that portion of the City that is attributable to the transactions of the Program. They do not purport to, and do not, present fairly the changes in the financial position of the City and the City's Wastewater Treatment System Enterprise Fund for the year ended June 30, 2024 in accordance with accounting principles generally accepted in the United States of America.