

**CITY OF PALO ALTO
REGIONAL WATER QUALITY
CONTROL PLANT**

Independent Auditor's Report
and Financial Statements

For the Year Ended June 30, 2024



Certified
Public
Accountants

CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT
Independent Auditor's Report and Financial Statements
For the Year Ended June 30, 2024

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Independent Auditor's Report

The Honorable Mayor and Members
of the City Council of the City of Palo Alto
Palo Alto, California

Opinion

We have audited the Statements of Net Expenditures and Quarterly Billings (financial statements) of the City of Palo Alto Regional Water Quality Control Plant (Plant), an enterprise operation of the City of Palo Alto, California (City), for the year ended June 30, 2024, and the related notes to the financial statements, which collectively comprise the Plant's financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the net expenditures and quarterly billings of the Plant for the year ended June 30, 2024, in accordance with the financial reporting provisions of the Basic Agreement between the City of Palo Alto, the City of Mountain View and the City of Los Altos for the Acquisition, Construction and Maintenance of a Joint Sewer System, dated October 10, 1968, as amended by addenda dated December 5, 1977, January 14, 1980, April 9, 1985, May 30, 1991, July 31, 1992, March 16, 1998, April 15, 2009, October 17, 2016, March 4, 2019, and May 17, 2021 (Basic Agreement), as described in Note 2 to the financial statements.

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 Financial Statements section of our report. We are required to be independent of the City and the Plant, and to meet our 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 a Matter

As discussed in Note 2 to the financial statements, the financial statements are prepared in accordance with the financial reporting provisions of the Basic Agreement, which is a basis of accounting other than accounting principles generally accepted in the United States of America and are not intended to be a complete presentation of the Plant's financial position or results of operations. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the financial reporting provisions of the Basic Agreement, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an 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 financial statements.

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

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.

Restriction on Use

This report is intended solely for the information and use of the governing bodies and management of the City of Palo Alto, the City of Mountain View, the City of Los Altos, the East Palo Alto Sanitary District, Stanford University, and the Town of Los Altos Hills, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in blue ink that reads "Macias Gini & O'Connell LLP". The signature is written in a cursive, flowing style.

Walnut Creek, California
November 8, 2024

CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT
Statement of Net Expenditures
For the Year Ended June 30, 2024

	Total	City of Mountain View	City of Los Altos	City of Palo Alto
Direct Expenditures:				
Source control program	\$ 1,312,595	\$ 515,981	\$ 133,097	\$ 663,517
Public outreach	114,429	44,982	11,603	57,844
Permitting and enforcement	1,398,273	400,154	22,124	975,995
Operations and maintenance	19,246,690	7,565,875	1,951,615	9,729,200
System improvement CIP (Note 3)	7,156,302	2,941,799	752,612	3,461,891
Total Direct Expenditures	29,228,289	11,468,791	2,871,051	14,888,447
Indirect Administrative Expenditures (Note 4):				
Source control program	1,133,728	445,668	114,960	573,100
Public outreach	2,024	796	205	1,023
Permitting and enforcement	412,782	369,373	20,422	22,987
Operations and maintenance	4,837,366	1,901,568	490,509	2,445,289
Total Indirect Administrative Expenditures	6,385,900	2,717,405	626,096	3,042,399
Debt Service Expenditures (Note 5):				
Refunding 1990 Series A Bonds	284,111	144,896	22,161	117,054
1999 Wastewater Treatment New Project	541,530	205,186	51,283	285,061
2009 State Water Resource Loan	560,629	212,422	53,092	295,115
2017 State Water Resource Loan	1,090,832	413,316	103,302	574,214
Total Debt Service Expenditures	2,477,102	975,820	229,838	1,271,444
Operational Transfer				
Operational transfer to Technology Fund	16,400	6,447	1,663	8,290
Total Expenditures	38,107,691	15,168,463	3,728,648	19,210,580
Deduct Joint Systems Revenues (Note 6)	(813,615)	(286,939)	(174,125)	(352,551)
Net Expenditures	\$ 37,294,076	\$ 14,881,524	\$ 3,554,523	\$ 18,858,029

See accompanying notes to the financial statements.

CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT
Statement of Quarterly Billings
For the Year Ended June 30, 2024

	<u>City of Mountain View</u>	<u>City of Los Altos</u>
Billings by Quarter, Beginning:		
July 1, 2023	\$ 3,189,611	\$ 672,526
October 1, 2024	3,515,586	952,111
January 1, 2024	3,296,421	897,681
April 1, 2024	<u>6,395,998</u>	<u>1,635,328</u>
Total billings	16,397,616	4,157,646
Less: Advance billings	<u>(1,844,658)</u>	<u>(439,966)</u>
Total net billings	14,552,958	3,717,680
Net expenditures	<u>14,881,524</u>	<u>3,554,523</u>
Excess (deficit) of total billings over (under) net expenditures	<u><u>\$ (328,566)</u></u>	<u><u>\$ 163,157</u></u>

See accompanying notes to the financial statements.

CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT
Notes to the Financial Statements
For the Year Ended June 30, 2024

NOTE 1 – THE REPORTING ENTITY

In 1968, the Cities of Mountain View and Los Altos retired their treatment plants and became partners with the City of Palo Alto (City) to construct a regional treatment plant. Construction started in 1970 and was completed in 1972 at a cost of \$11 million. Since 1972, the Regional Water Quality Control Plant (the Plant) has been treating wastewater, which has significantly reduced the number of pollutants entering the San Francisco Bay.

Initially, the Cities of Mountain View and Los Altos were the only partner agencies participating jointly in the cost of operating and maintaining the Plant. The City's total usage of the treatment plant was not fully utilized and as a result, the City entered into separate subcontracts distributing some of its allocated use to other partner agencies. Currently, the City, the City of Los Altos, the City of Mountain View, and the subcontracting agencies: the East Palo Alto Sanitary District, Stanford University, and the Town of Los Altos Hills (Partner Agencies) share in the proportional operating and maintenance costs of the Plant. These partners regularly work with the City to foster positive relationship and ensure the Plant operates successfully.

The Partner Agencies share the original costs of acquisition and construction of the Plant in the same proportions as the allocation of capacity rights to them. The City of Palo Alto (the City) is the owner and administrator of the Plant. The Cities of Mountain View and Los Altos are entitled to use a portion of the capacity of the Plant, as set forth in the Basic Agreement between the City of Palo Alto, the City of Mountain View and the City of Los Altos for the Acquisition, Construction and Maintenance of a Joint Sewer System dated October 10, 1968, as amended by addenda dated December 5, 1977, January 14, 1980, April 9, 1985, May 30, 1991, July 31, 1992, March 16, 1998, April 15, 2009, October 17, 2016, March 4, 2019, and May 17, 2021 (collectively, the "Basic Agreement"). The Basic Agreement will terminate on December 31, 2060, unless a written notice of withdrawal is tendered ten years preceding the date of withdrawal.

On May 17, 2021, the Partner Agencies approved the construction of a new outfall and related improvements to existing discharge infrastructure and the rehabilitation of the primary sedimentation tanks including electrical upgrades. Each Partner Agency agreed to pay its share of the project costs, in proportion to the capacity it owns in the Joint Sewer System. The Partner Agencies also authorized the City to receive State Revolving Fund Loan from the State Water Resources Control Board (SWRCB) or pursue other project financing to fund the costs of the projects.

In November 2022, the Partner Agencies approved the construction of secondary treatment upgrades (STU). The Partner Agencies also authorized the City to receive State Revolving Fund Loan from the SWRCB to fund the costs of the project. In December 2023, the Partner Agencies approved the construction of the joint intercepting sewer rehabilitation (Phase 1) project. Each Partner Agency agreed to pay fixed cost shares of the project costs. These large capital improvement programs are being implemented to replace aging infrastructure and upgrade treatment systems to comply with the new regulations.

CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT
Notes to the Financial Statements
For the Year Ended June 30, 2024

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Plant is an enterprise that is operated by the City and its operations are accounted for as an enterprise fund in the City's basic financial statements. The financial statements are prepared in accordance with the financial reporting provisions of the Basic Agreement, which is a basis of accounting other than accounting principles generally accepted in the United States of America. The accompanying financial statements are intended to present the Plant's net expenditures and quarterly billings by the Plant to the Cities of Mountain View and Los Altos pursuant to the agreement of the Partner Agencies as described above and are not intended to be a complete presentation of the Plant's financial position or results of operations. Additionally, the capital cost and the outstanding debt of the Plant are not presented in these statements but are presented in the basic financial statements of the City.

Plant expenditures, joint system revenues, debt service and industrial waste compliance expenditures are shared by the Members based on agreed upon allocation percentages. The expenditures, including indirect administrative expenditures (see Note 4), are allocated to each of the Members based primarily on their respective percentages of the annual sewage flow and treatment needed for suspended solids, chemical oxygen demand and ammonia. Revenues from services, fines and penalties are allocated to each of the Members in the same proportions as those of expenditures. Debt service payments are allocated based on percentages established at the time of bond issuance. Industrial waste compliance (public outreach and permitting and enforcement) charges are allocated to Members primarily based on upon the number of industries and efforts required to maintain compliance with sewage use ordinances and other regulations from Environmental Protection Agency.

The percentages used for the year ended June 30, 2024 to allocate expenditures and revenues were as follows:

	<u>City of Mountain View</u>	<u>City of Los Altos</u>	<u>City of Palo Alto</u>
Public outreach, source control program, operations and maintenance, system improvement CIP and joint system revenues	39.31%	10.14%	50.55%
Joint intercepting sewer rehabilitation costs	62.50%	15.00%	22.50%
Permitting and enforcement	42.49%	2.35%	55.16%
Debt services expenditures:			
Refunding 1990 Series A Bonds	51.00%	7.80%	41.20%
1999 Wastewater Treatment New Project	37.89%	9.47%	52.64%
2009 State Water Resources Loan	37.89%	9.47%	52.64%
2017 State Water Resources Loan	37.89%	9.47%	52.64%

CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT
Notes to the Financial Statements
For the Year Ended June 30, 2024

The City is allocated 50.55% of total usage of the treatment plant. The City does not fully utilize its percentage allocation. Therefore, the City has entered into separate contracts to allocate portions of its excess to other entities. Fiscal year 2024 allocations are as follows:

East Palo Alto Sanitary District	5.56%
Stanford University	6.35%
Town of Los Altos Hills	1.98%
Remaining City percentages	<u>36.66%</u>
Total	<u><u>50.55%</u></u>

The agreement the City has with the above entities has no effect on the partnership agreement between the Members.

Billings are made in advance and are based on projects for the plant and estimated sewage flow. Excess (deficit) billings over (under) net expenditures are offset against the payments during the second quarter of the subsequent fiscal year.

NOTE 3 – SYSTEM IMPROVEMENT CAPITAL IMPROVEMENTS PROGRAM (CIP)

The basic agreement between the Members, dated October 10, 1968, provides that the administrator of the Plant is responsible for capital additions. These capital additions should be for the replacement of obsolete or worn-out units, or minor capital additions to improve the efficiency of the Plant's operations. Per the addendum to the agreement dated March 16, 1998, the Members agreed that capital additions should not exceed \$1.9 million in 1998-99 (base year). For future years, the base year amount will be adjusted annually based on increases to the Consumer Price Index-Urban Wage Earners and Clerical Workers for the San Francisco-Oakland-San Jose area. Unused authorized amount will be carried forward to future years. For fiscal year 2024, the adjusted pay-as-you-go capital additions (minor capital) authorized is \$3,903,738. Actual minor capital additions amounted to \$6,129,596 for fiscal year 2024. As of June 30, 2024, the commitments for minor capital additions, including unspent capital additions, is \$15,935,953, of which encumbrances in the amount of \$6,077,703 have been carried forward to fiscal year 2025.

NOTE 4 – INDIRECT ADMINISTRATIVE EXPENDITURES

Indirect expenditures include those costs allocated from the City's General Fund administrative services, which supports all operating departments of the City. Other indirect expenses are administrative charges from the City's Internal Services Funds. These allocations are applied on a uniform basis throughout the City. The allocations are applied in accordance with the subsequent letter of agreement dated April 9, 1985.

CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT
Notes to the Financial Statements
For the Year Ended June 30, 2024

NOTE 5 – DEBT SERVICE EXPENDITURES

Debt service expenditures include principal repayments, interest expense and amortization of bond discount reduced by any interest income earned from investments with the fiscal agent, related to the 1999 Series A Bonds (split for the portions used for the “New Project” and refunding of the 1990 Series A Bonds) and the 2009 and 2017 State Water Resources loans.

In June 1999, the City, City of Mountain View, City of Los Altos, Town of Los Altos Hills, East Palo Alto Sanitary District, and Stanford University agreed to issue bonds (1999 Series A Bonds) to finance the rehabilitation of the Wastewater Treatment System’s two sludge incinerators and to refund the 1990 Series A Bonds. The 1999 Series A Bonds matured on June 1, 2024.

In October 2009, the City and the SWRCB executed an agreement for the 2009 State Water Resources Loan to finance the Ultraviolet Disinfection Project.

In June 2017, the City and the SWRCB executed an agreement for a State Water Resources Loan for an award up to \$30 million, 30 years at 1.8% to finance the project replacing the sewage sludge “bio-solids” incinerators at the Plant. On September 13, 2017, the City and the SWRCB amended the original agreement of the 2017 SRF loan to lower the total amount to \$29.7 million and the due date of the last debt service payment be May 31, 2049. Under the terms of the amended agreement, a portion of the loan amount, \$4.0 million, is federally funded and the obligation balance was adjusted.

The new facility will dewater the bio-solids and allow it to be loaded onto trucks and taken offsite for further treatment until further treatment units can be built onsite. The Plant provides treatment and disposal for wastewater for the City, City of Mountain View, City of Los Altos, Town of Los Altos Hills, East Palo Alto Sanitary District, and Stanford University. Though the City is the recipient of the loan, the City’s agreement with the partner agencies oblige them to pay their proportionate share of the principal and interest of this loan. The City’s share of the loan payment is 38.2% with the partner agencies paying 61.8%.

In July 2021, the SWRCB and the City executed a direct loan agreement for an award up to \$17.5 million to finance the rehabilitate and upgrade the Plant’s primary sedimentation tanks and ancillary systems. During the year ended June 30, 2023, the approved loan amount was increased to \$19.4 million. Per the SWRCB agreement, the first debt service payment of this loan is estimated to be due on July 31, 2025. At June 30, 2024, the outstanding 2021 State water resources loan was \$14.0 million.

In May 2022, the SWRCB and the City executed a direct loan agreement for an award up to \$168.7 million to finance the Secondary Treatment Upgrades project to produce treated effluent with reduced total nitrogen content, increase treatment capacity, and rehabilitate aging infrastructure. In August 2024, the approved loan amount was increased to \$192.8 million. Per the SWRCB agreement, the first debt service payment of this loan is estimated to be due on July 28, 2029. At June 30, 2024, the outstanding 2022 State water resources loan was \$60.4 million.

CITY OF PALO ALTO
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Notes to the Financial Statements
For the Year Ended June 30, 2024

NOTE 5 – DEBT SERVICE EXPENDITURES (Continued)

The principal amount of the debt outstanding as of June 30, 2024, excluding 2021 and 2022 State water resources loans, are allocated as follows:

	2009 State Water Resources Loan	2017 State Water Resources Loan	Total
City of Palo Alto	\$ 1,341,375	\$ 8,328,804	\$ 9,670,179
City of Mountain View	1,331,883	8,269,874	9,601,757
City of Los Altos	332,883	2,066,923	2,399,806
East Palo Alto Sanitary District	268,556	1,667,507	1,936,063
Stanford University	184,896	1,148,048	1,332,944
Town of Los Altos Hills	55,539	344,851	400,390
Total	<u>\$ 3,515,132</u>	<u>\$ 21,826,007</u>	<u>\$ 25,341,139</u>

NOTE 6 – JOINT SYSTEM REVENUES

The Plant's joint system revenues for the year ended June 30, 2024 total \$813,615 which consisted of the following:

Septic hauling services	\$ 307,020
Valley Water	229,865
Other miscellaneous revenues	182,506
Salt water marsh services	7,500
Utility service to other utility funds	83,983
Others	2,741
	<u>\$ 813,615</u>

NOTE 7 – RELATED PARTY TRANSACTIONS

During fiscal year 2024, the Plant paid the City \$2,785,779 for utility costs. Such costs are included in the Statement of Net Expenditures as source control program, permitting and enforcement, and operations and maintenance expenditures. Vehicle replacement charges of \$306,112 were paid to the City's Vehicle Replacement and Maintenance Internal Services Fund, which is included in the Statement of Net Expenditures as operations and maintenance expenditures.

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