

Note: Recology's financial statements do not reflect the same numbers as the rate reports. These differences are due to differences in reported periods covered (the fiscal years do not correspond to the rate years), different treatment for certain items in financial statements and rate reports, and the inclusion in financial statements of expenses for which ratepayers are not charged.

Recology's financial statements were prepared in accordance with U.S. generally accepted accounting principles (GAAP) and cover Recology's fiscal year. For instance, fiscal year 2021 is October 1, 2020 through September 30, 2021. The statements were audited by Recology's independent outside auditor, KPMG LLP, and contain audit opinions that they present fairly, in all material respects, the financial position of Recology Sunset Scavenger, Recology Golden Gate, and/or Recology San Francisco. Statements for fiscal years 2018 and 2019 were prepared for Recology Sunset Scavenger/Recology Golden Gate and, separately, for Recology San Francisco. Statements for fiscal years 2020 and 2021 were prepared on a combined basis (financial results for all three entities), but transactions between Recology Sunset Scavenger/Recology Golden Gate and Recology San Francisco have been eliminated, resulting in revenue and expense figures that are lower than the sum of these amounts in the rate reports. See Schedule 1 for the operating expenses of Recology Sunset Scavenger/Recology Golden Gate and Schedule 2 for the operating expenses of Recology San Francisco.

Rate reports are filed by Recology pursuant to its reporting obligations in the 2017 Rate Application. The rate year begins July 1. Rate Year 2021, for instance, is July 1, 2020 through June 30, 2021. Rate reports are filed on a cumulative basis: the first quarterly report covers the three months from July 1 through September 30; the second quarterly report covers the six months from July 1 through December 31; the third quarterly report covers the nine months from July 1 through March 31; and the annual report covers the twelve months of the rate year ending June 30. Rate reports include projections, which are from the Rate Year 2018 projections in the 2017 Rate Application and are adjusted for COLA in subsequent years. The financial statements do not contain such projections. Rate reports are not prepared entirely on a GAAP basis but rather on the same basis as the rate application projections. Some amounts in the rate application projections and rate reports are reported in a different manner from the audited financial statements, such as pension costs. In addition, rate reporting requires different treatment for certain items, such as the Reserve Fund, Impound, and Zero Waste Incentive ("ZWI") accounts. As an example, the receipt of funds from the ZWI account to offset capital expenditures is reflected as revenue in the audited financial statements and is reported as a negative expense in the rate reports over the same period that the related depreciation and lease expense is recorded. As a result, the same item may be reported differently in a rate report than it is in a financial statement. In addition, the financial statements include balance sheets, statements of stockholder's equity, statements of cash flows, and footnotes, all of which are not required for rate reports.



RECOLOGY SAN FRANCISCO
(An Indirect Wholly Owned Subsidiary of Recology Inc.)
Financial Statements and Supplementary Information
September 30, 2019 and 2018
(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 1400
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report

The Board of Directors
Recology San Francisco:

We have audited the accompanying financial statements of Recology San Francisco (an indirect wholly owned subsidiary of Recology Inc.), which comprise the balance sheets as of September 30, 2019 and 2018, and the related statements of income, stockholder's equity, and cash flows for each of the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; 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 audits. We conducted our audits 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 auditors' 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 financial position of Recology San Francisco as of September 30, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



Other Matters

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplementary information included in Schedule 1 is presented for the purpose of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

KPMG LLP

San Francisco, California
December 6, 2019

RECOLOGY SAN FRANCISCO
(An Indirect Wholly Owned Subsidiary of Recology Inc.)

Balance Sheets

September 30, 2019 and 2018

Assets	2019	2018
Current assets:		
Restricted cash	\$ 15,074,644	9,321,189
Accounts receivable, less allowance for doubtful accounts of \$37,610 and \$66,279 in 2019 and 2018, respectively	6,836,384	4,659,122
Parts and supplies	1,701,331	1,690,301
Prepaid expenses and other current assets	1,744,793	1,493,967
Total current assets	<u>25,357,152</u>	<u>17,164,579</u>
Property and equipment:		
Land	9,301,180	9,301,181
Buildings and improvements	28,686,576	22,908,114
Equipment and furniture	29,425,279	20,288,425
Vehicles	5,809	5,809
Construction in progress	1,416,072	23,819,894
Total property and equipment	<u>68,834,916</u>	<u>76,323,423</u>
Less accumulated depreciation	<u>29,545,629</u>	<u>26,091,978</u>
Property and equipment, net	39,289,287	50,231,445
Other assets	<u>959,249</u>	<u>567,373</u>
Total assets	<u>\$ 65,605,688</u>	<u>67,963,397</u>
Liabilities and Stockholder's Equity		
Current liabilities:		
Accounts payable	\$ 1,915,501	1,676,613
Accrued liabilities:		
Vacation and sick leave	1,005,105	971,521
Payroll and payroll taxes	1,160,297	1,014,519
Other accrued expenses	6,380,402	6,587,022
Zero waste incentive	15,074,644	9,321,189
Deferred revenue	210,161	206,286
Total current liabilities	<u>25,746,110</u>	<u>19,777,150</u>
Other liabilities	<u>464,831</u>	<u>1,032,182</u>
Total liabilities	26,210,941	20,809,332
Commitments and contingencies		
Stockholder's equity, net	<u>39,394,747</u>	<u>47,154,065</u>
Total liabilities and stockholder's equity	<u>\$ 65,605,688</u>	<u>67,963,397</u>

See accompanying notes to financial statements.

RECOLOGY SAN FRANCISCO
(An Indirect Wholly Owned Subsidiary of Recology Inc.)

Statements of Income

Years ended September 30, 2019 and 2018

	2019	2018
Revenue:		
Sunset Scavenger Company and Golden Gate Disposal & Recycling Company	\$ 100,023,323	94,479,948
Other affiliates	17,695	22,913
Public disposal	9,766,579	10,249,994
Commercial disposal	10,118,383	5,588,545
Recycling	46,524,734	47,833,408
	166,450,714	158,174,808
Less amounts reserved for impound and zero waste incentive accounts	(2,902,289)	(2,791,313)
Total operating revenue	163,548,425	155,383,495
Expense:		
Transfer station	68,135,888	62,307,363
Processing	39,510,032	38,722,482
Truck and garage	13,174,940	11,539,975
Special waste	4,026,759	3,921,865
General recycling	20,977,472	16,820,431
General and administrative	10,611,298	10,778,255
Total operating expense	156,436,389	144,090,371
Operating income	7,112,036	11,293,124
Other (expense) income:		
Interest expense	(1,396)	(1,583)
Rental and other income	45,010	49,759
Net income	\$ 7,155,650	11,341,300

See accompanying notes to financial statements.

RECOLOGY SAN FRANCISCO
(An Indirect Wholly Owned Subsidiary of Recology Inc.)

Statements of Stockholder's Equity

Years ended September 30, 2019 and 2018

	Total stockholder's equity
Balance, September 30, 2017	\$ 32,250,208
Net income	11,341,300
Net contribution from Parent	<u>3,562,557</u>
Balance, September 30, 2018	47,154,065
Net income	7,155,650
Net distribution to Parent	<u>(14,914,968)</u>
Balance, September 30, 2019	<u>\$ 39,394,747</u>

See accompanying notes to financial statements.

RECOLOGY SAN FRANCISCO
(An Indirect Wholly Owned Subsidiary of Recology Inc.)

Statements of Cash Flows

Years ended September 30, 2019 and 2018

	2019	2018
Cash flows from operating activities:		
Net income	\$ 7,155,650	11,341,300
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	3,520,321	2,927,883
Provision for bad debts	(32,293)	94,162
Loss on disposal of fixed assets	139,347	—
Changes in assets and liabilities:		
Accounts receivable	(2,144,969)	3,982,744
Parts and supplies	(11,030)	(394,936)
Prepaid expenses and other assets	(642,702)	125,120
Accounts payable	238,888	(49,207)
Accrued liabilities	(27,258)	695,184
Zero waste incentive rebate	5,753,455	(6,305,286)
Deferred revenue and other liabilities	(563,476)	(692,226)
Net cash provided by operating activities	13,385,933	11,724,738
Cash flows from financing activities:		
Net distributions to Parent and affiliates	(7,632,478)	(18,030,024)
Net increase (decrease) in cash and restricted cash	5,753,455	(6,305,286)
Cash and restricted cash at beginning of year	9,321,189	15,626,475
Cash and restricted cash at end of year	\$ 15,074,644	9,321,189
Supplemental disclosures of noncash activities:		
Interest allocation from Parent	\$ 1,396	1,583
Equipment allocation (to) from Parent or affiliate	(7,282,490)	21,592,581

See accompanying notes to financial statements.

RECOLOGY SAN FRANCISCO
(An Indirect Wholly Owned Subsidiary of Recology Inc.)
Notes to Financial Statements
September 30, 2019 and 2018

(1) Nature of Business

Recology San Francisco (the Company) is owned equally by Golden Gate Disposal & Recycling Company and Sunset Scavenger Company, which are wholly owned subsidiaries of Recology Inc. (the Parent or Recology), which in turn is wholly owned by the Recology Employee Stock Ownership Plan (the ESOP). Amounts due from or payable to the Parent and affiliates are accumulated by the Company during the year, and at year end, the net amount is settled by way of capital contributions from or distributions to the Parent.

The Company's processing rates are set by the Refuse Collection and Disposal Rate Board of the City and County of San Francisco (Rate Board) when a Rate Order is approved. The Company together with Golden Gate Disposal & Recycling and Sunset Scavenger Company filed a rate application with the Department of Public Works on February 13, 2017. On May 12, 2017, the Rate Board approved the 2017 San Francisco Rate Order (the Rate Order or 2017 Rate Order). The Rate Order approved the rates for the 2018 rate year (Rate Year 2018 began July 1, 2017) and an annual cost-of-living adjustment (COLA) after the first year. New rates became effective July 1, 2017. A COLA increase was applied to the rates effective July 1, 2018 and July 1, 2019.

The rates are set to allow the Company to recover its operating costs plus a return on those costs, with certain mandated exceptions. The rate-setting process may result in the disallowance of certain costs and/or delays in cost recovery.

The Company's operating results are affected by variation in its recycling revenue from the sale of recyclable commodities. The Company's recycling revenue can be volatile and fluctuate in accordance with changes in the recycling commodity mix and in the prices of recyclable commodities, which in turn are, in many cases, dependent on changes in worldwide supply of, and demand for, such recyclable commodities.

(2) Summary of Significant Accounting Policies

(a) Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. The more significant estimates requiring the judgment of management include allowances for doubtful accounts, zero waste incentive accounting, and potential litigation, claims, and assessments. Actual results could differ from those estimates.

(b) Fair Value of Financial Instruments

Assets and liabilities that are considered to be financial instruments (such as restricted cash, accounts receivable, accounts payable, and accrued liabilities) are reported in the balance sheets at carrying values that approximate their fair value based upon current market indicators and the short maturity of these instruments.

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(c) Cash Concentration Account and Restricted Cash

The Company's primary bank account is linked to the Parent's concentration account. Cash balances (or deficits) from the primary bank account at the end of each day are automatically transferred to (or from) the concentration account, so that at the end of any particular day, as well as at year-end, the Company's bank account has a zero balance, with related amounts debited or credited to the underlying intercompany account. Restricted cash includes amounts pertaining to incentives for certain waste diversion programs undertaken by the Company's operations.

(d) Revenue Recognition and Accounts Receivable

The Company generally recognizes revenue when services are performed or products are delivered and collectibility is reasonably assured. A significant amount of the Company's revenue is subject to rate regulation in accordance with the Refuse Collection and Disposal Rate Board Resolution adopting the Department of Public Work Director's Recommendation Order (the Rate Order). Revenue recognition related to contractual diversion goals is based on the Company's estimation of the likelihood that it will reach those diversion goals.

The Company's receivables are recorded when billed and represent claims against third parties that will be settled in cash. The carrying value of the Company's receivables, net of the allowance for doubtful accounts, represents their estimated net realizable value. The Company estimates its potentially uncollectible accounts based on several factors, including historical collection trends, type of customer, existing economic conditions, and other factors. Past-due receivable balances are written off when the Company's internal collection efforts have been unsuccessful.

(e) Parts and Supplies

Parts and supplies consist of fuel, oil, tires, tubes, repair parts, and recycling materials, are recorded at average cost and are expensed when utilized.

(f) Property and Equipment

Property and equipment, including capital improvements, are stated at cost. It is the Company's policy to periodically review the estimated useful lives of its property and equipment. Depreciation is calculated on a straight-line basis over the estimated useful lives of assets as follows:

	<u>Estimated useful lives</u>
Buildings	20–40 years
Leasehold improvements	Shorter of lease or useful life
Machinery and equipment	6–8 years
Furniture and fixtures	8 years
Vehicles	9 years
Containers	10 years

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Depreciation expense on the above amounted to \$3,520,321 and \$2,927,883 for the years ended September 30, 2019 and 2018, respectively. The cost of maintenance and repairs is expensed as incurred; significant renewals and betterments are capitalized.

(g) Impairment of Long-Lived Assets

Long-lived assets, such as property, plant, and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. A long-lived asset is considered impaired when the undiscounted cash flow from the asset or asset group is estimated to be less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the long-lived asset. During the years ended September 30, 2019 and 2018, no impairment was recorded.

(h) Income Taxes

The Parent is an S corporation with the Company electing to be treated as a Qualified Subchapter S corporation subsidiary. Under S corporation rules, the Parent's taxable income and losses are passed through to the ESOP, the Parent's sole shareholder, which is exempt from income tax, and the Company is treated as a division of the Parent having no separate income tax obligations. The Parent has not allocated the income tax expense to the Company.

The Company recognizes income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that has a greater than 50% likelihood of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company's accounting policy for evaluating uncertain tax positions is to accrue estimated benefits or obligations relating to those positions. The Company records interest related to unrecognized tax benefits as interest expense and penalties as an administrative expense. For the years ended September 30, 2019 and 2018, there were no interest expenses or penalties recorded, because the Company had no uncertain tax positions that met the more-likely than-not threshold.

(i) Environmental Remediation Liabilities

The Company accrues for environmental remediation costs when they become probable and based on its best estimate within a range. If no amount within the range appears to be a better estimate than any other, the low end of such range is used. Remediation costs are estimated by environmental remediation professionals based upon site remediation plans they develop and on their experience working with regulatory agencies and the Company's environmental staff and legal counsel. No environmental remediation liabilities were accrued at September 30, 2019 and 2018.

(j) Stockholder's Equity

The Company has 7,500 shares of common stock authorized, issued, and outstanding with no par value as of September 30, 2019 and 2018. Stockholder's equity, net, is comprised of the legal capital plus cumulative contributions net of distributions.

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Notes to Financial Statements

September 30, 2019 and 2018

(k) Allocations

The Company includes allocated charges from the Parent and affiliates in operating and other expenses. The charges are allocated by applying activity appropriate factors to direct and indirect costs of the Parent and affiliates or based upon established fees.

(l) Adoption of New Accounting Standards

In November 2016, the FASB issued guidance that requires the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Entities are required to reconcile such total to amounts on the balance sheet and disclose the nature of the restrictions. The Company has elected to early adopt the new guidance on October 1, 2018. The prior period has been adjusted to conform to the current period presentation, which resulted in an increase in cash and restricted cash of \$15,074,644 and a decrease in cash and restricted cash of \$9,321,189 for the years ended September 30, 2019 and 2018, respectively.

In May 2014, the Financial Accounting Standards Board (the FASB) issued guidance to provide a single, comprehensive revenue recognition model for all contracts with customers. The revenue guidance contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The Company will adopt the amended guidance using the modified retrospective method as of October 1, 2019. Under the new standard, the Company will record revenue when control is transferred to the customer, generally at the time the Company provides waste collection services. The Company has completed its review of the new standard, and it does not anticipate a significant change to the pattern or timing of revenue recognition as a result of adopting the new standard. While the Company does not expect a significant change to the timing or pattern of revenue recognition, certain consideration payable to customers will be recorded as a reduction of revenue. Upon adoption of the amended guidance, the Company anticipates a reduction in operating revenue and expense of approximately \$1,039,282 with no impact to net income. Additional areas of the amended guidance the Company has evaluated for potential impact include sales incentives, volume discounts, free service periods, and rebates. The Company does not believe changes in these areas will result in a material impact on its consolidated financial statements.

In February 2016, the FASB issued guidance that requires lessees to recognize a right-of-use asset and a lease liability for virtually all leases (other than leases that meet the definition of a short-term lease). The liability will be equal to the present value of lease payments. The asset will be based on the liability, subject to adjustment, such as for initial direct costs. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Operating leases will result in straight-line expense (similar to current operating leases) while finance leases will result in a front-loaded expense pattern (similar to current capital leases). Classification will be based on criteria that are largely similar to those applied in current lease accounting, but without explicit bright lines. The new standard is effective for private companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020, with early adoption permitted. The new standard must be adopted using a modified retrospective transition, and provides for certain practical expedients. Transition will require application of the new guidance at the beginning of the earliest

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comparative period presented. The Company is assessing the potential impact of implementing this new accounting standard on its consolidated financial statements.

(m) Reclassifications

Certain prior year balances have been reclassified to conform to the current year presentation.

(3) Regulatory and Contractual Obligations

The Reserve Fund is a fund to be used for extraordinary expenses relating to the Waste Disposal Agreement between the City and County of San Francisco, Recology San Francisco, and Recology Hay Road. The Company is required to fund this account with \$2,000,000 annual transfers from the Special Reserve Account, with the last of these transfers occurring in the beginning of Rate Year 2020. At the end of Rate Year 2020, any remaining funds in the Special Reserve Account will be transferred to the Reserve Fund. The Company's deposits into the Reserve Fund are not reported as assets or liabilities of the Company.

In addition, the Company is responsible for administering the Recology San Francisco Zero Waste Incentive Account (ZWIA). In order to help the City meet state-mandated recycling goals, the Company, along with Sunset Scavenger Company and Golden Gate Disposal & Recycling Company, has the opportunity to earn a higher level of profit beyond that normally allowed for in the Rate Order by meeting tonnage goals for diversion of materials. The 2017 Rate Order established new zero waste diversion goals based on disposal tons at four tiers to cover the rate year ended June 30, 2018 through rate year ending June 30, 2022. The revenue collected by the Companies is based on the maximum reward level of profit as stated in the respective Rate Order. The incentive revenue recognized by the Companies is based on the estimate of the level of incentive to be achieved during each respective rate year. The incremental billings generated from the Companies resulting from the additional reward level of profit are deposited on a monthly basis into the ZWIA. If the Companies meet or exceed the diversion goals for the rate year, then the funds deposited into the account may be withdrawn by the Companies as the incentive reward after the conclusion of the rate year. If the goal for the rate year is not achieved, then the funds from that year will remain in the account and will be used to offset future rate increases. The amounts deposited for both rate years ended June 30, 2019 and 2018 are included in restricted cash. The portion of the diversion goals achieved is recognized as revenue and the unachieved portion is included in deferred revenue. The Company deposited \$2,902,289 and \$2,791,313 from cash receipts into the ZWIA for the years ended September 30, 2019 and 2018, respectively.

The Company did not achieve any of the diversion goals for the rate years ended June 30, 2018 or 2019, does not expect to achieve any of the incentive goals for the rate year ending June 30, 2020, and did not recognize any of the corresponding incremental revenue.

(4) Employee Stock Ownership Plan

In 1986, the Parent established the ESOP, which purchased all of the Parent's outstanding stock. The ESOP covers most of the employees of the Company and is noncontributory. Employees, except under certain conditions, become fully vested after a requirement of three years of service. Benefits, in the form of Parent company stock, are allocated to an employee's account based on a number of factors, including contributions, forfeitures, income, and changes in the underlying value of the Parent company stock.

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All benefit distributions are made from the ESOP in cash, which is received from the Parent, or shares, subject to immediate repurchase by the Parent. A participant who is vested is entitled to begin receiving a distribution from his or her ESOP account at a future date following his or her termination of employment. Distributions may be made in a lump sum, equal annual installments over a period generally not to exceed five years or a combination of the foregoing, generally as determined by the ESOP Administrative Committee subject to certain limitations under the ESOP. Each participant who has attained age 55 and has participated in the ESOP for at least 10 years may elect to receive cash distributions for in-service withdrawals attributable to post-1986 shares allocated to his or her account. An eligible participant is entitled to elect payment attributable to as much as 25% of his or her eligible shares during the first five years of election and up to 50% of eligible shares in the sixth year.

Presently, the Parent makes cash contributions to fund certain of the ESOP benefit distributions. Shares attributable to those benefit distributions are reallocated within the ESOP among active participants. The Parent's common stock is not traded on an established market. The fair market value of the shares as of the most recently completed fiscal year-end is used for the next years' ESOP benefit distributions.

(5) Employee Benefit Plans

The Company participates in a noncontributory, funded defined benefit pension plan (the Plan) sponsored by its Parent for the benefit of nonunion employees. Benefits are based on a formula that includes years of service and average compensation. As of September 30, 2019 and 2018, the Plan, of which certain of the Company's employees are participants, had a projected benefit obligation in excess of plan assets by approximately \$115.0 million and \$19.0 million, respectively. The Company's financial statements do not reflect the Company's share of the projected benefit obligation in excess of plan assets. It is the Parent's current policy to contribute at least the minimum statutory required amount.

The Company's pension expense under the Plan for the years ended September 30, 2019 and 2018 was \$3,511,535 and \$5,016,947, respectively, which represents an allocation of approximately 36.7% and 30.1% of the Parent's plan expense for the years ended September 30, 2019 and 2018, respectively.

The weighted average discount rate used by the Parent to determine pension expense under the Plan was 4.55% and 4.10% for the years ended September 30, 2019 and 2018, respectively. The expected long-term rate of return on assets was 7.25% for the both years ended September 30, 2019 and 2018. The rate of increase in future compensation levels used in determining the benefit obligations was 4% for both years ended September 30, 2019 and 2018. The Company's portions of the actuarially computed value of the vested and nonvested benefits of the Plan and the union plan and the net assets of the related pension plan funds have not been determined.

Certain of the Company's union employees are participants in a union-sponsored multiemployer defined-benefit pension plan. The risks of participating in this multiemployer plan are different from single-employer plans in that (i) assets contributed to a multiemployer plan by one employer may be used to provide benefits to employees of other participating employers; (ii) if a participating employer stops contributing to the Plan, the unfunded obligations of the Plan may be required to be assumed by the remaining participating employers; and (iii) if the Company chooses to stop participating in any of the multiemployer plans, the Company may be required to pay those plans a withdrawal amount on the underfunded status of the Plan. Pension cost charged to expense under these plans for the years ended

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Notes to Financial Statements

September 30, 2019 and 2018

September 30, 2019 and 2018 was \$1,191,085 and \$1,150,628, respectively. The Company's portion of the actuarially computed value of the vested and nonvested benefits of the plans and the net assets of the pension funds has not been determined.

The following table outlines the Company's participation in multiemployer plans:

<u>Pension fund (l)/Employer Identification number/plan number</u>	<u>Pension protection act reported status</u>	<u>Fund Improvement plan/ rehabilitation plan status</u>	<u>Contributions (in millions)</u>		<u>Expiration date of collective bargaining agreement</u>
			<u>2019</u>	<u>2018</u>	
Pension Trust Fund for Operating Engineers/94-6090764/001	Endangered	Implemented \$	1,191,085	1,150,628	Various through December 31, 2021

(1) The Company paid no surcharges for multi-employer pension funds during year ended September 30, 2019.

The most recent Pension Protection Act zone status available as of September 30, 2019 is for the Plan's year-end at December 31, 2018. The zone status is based on information that the Company received from the Plan and is certified by the Plan's actuary. As defined in the Pension Protection Act of 2006, among other factors, plans reported as critical are generally less than 65% funded, plans seriously endangered are less than 80% funded and have an accumulated funding deficiency for the current plan year or a projected accumulated funding deficiency for any of the next six years, and plans reported as endangered are generally less than 80% funded.

In connection with the ESOP's purchase of stock from certain former employee-shareholders, the Parent has agreed to provide those former employee-shareholders with lifetime postretirement medical benefits subject to certain conditions. In addition, certain union employees are eligible for postretirement medical benefits as part of an early retirement program when they reach certain eligibility criteria.

Recology recognizes postretirement medical benefits in the financial statements over the term of the affected employee's service with Recology. The postretirement medical benefit plan is unfunded. As of September 30, 2019 and 2018, the Plan, of which the Company's employees are participants, has a projected benefit obligation of approximately \$36.6 million and \$36.1 million, respectively. The Company's financial statements do not reflect the Company's share of the projected benefit obligation.

The Company's postretirement medical income for the years ended September 30, 2019 and 2018 was \$1,370,670 and \$1,313,134, respectively.

The weighted average discount rate used by the Parent to determine postretirement medical expense was 4.50% and 4.15% for the years ended September 30, 2019 and 2018, respectively. The Parent expects its healthcare cost trend for postretirement medical benefits to decrease from 6.50% in 2019 to 5.00% in 2025, after which the rate is expected to stabilize.

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The Company agreed to allow certain union employees to participate in a multiemployer union-sponsored postretirement medical plan. The Company contributed \$3,341,459 and \$3,109,344 into the multiemployer union postretirement plan during the years ended September 30, 2019 and 2018, respectively.

The Company also sponsors a defined-contribution plan, the Recology 401(k) Plan, for certain eligible employees of the Company and its participating subsidiaries. The Company made matching contributions equal to a specified percentage of each participant's annual contributions, amounting to \$83,057 and \$64,319 for the years ended September 30, 2019 and 2018, respectively.

(6) Self-Insurance

The Company, through plans managed by the Parent, is self-insured for various risks of loss related to general liability, automobile liability, property damage, employee, and certain retiree healthcare and workers' compensation. The Parent establishes a reserve for self-insured claims based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. Adjustments to the reserve are charged or credited to the Parent's expense in the periods in which they are determined to be necessary. The Parent also purchases commercial insurance on behalf of the Company and other subsidiaries to cover risks above set limits. The Company was allocated expenses of \$13,853,438 and \$13,434,778 for the years ended September 30, 2019 and 2018, respectively, for the cost of self-insured programs, including certain reserve adjustments. The Company's share of the self-insurance reserve is ultimately reflected as a liability of the Parent.

(7) Commitments and Contingencies

Substantially all of the assets of the Company are pledged to secure the obligations of the Parent. The Company, along with the Parent and the Parent's wholly owned subsidiaries, has guaranteed the repayment, on a joint and several basis, of any and all obligations under the Parent's Revolving Credit Agreement. The Company could be required to honor the guarantee upon an uncured default event, as defined in the Parent's Revolving Credit Agreement. The Parent's Revolving Credit Agreement expires on April 21, 2022. At September 30, 2019, there was an outstanding balance of \$142.5 million on the Parent's Revolving Credit Agreement and there were standby letters of credit issued for \$254.9 million. The Parent has represented to the Company that it is in compliance with all covenants of the Revolving Credit Agreement.

The Company, along with the Parent and the Parent's wholly owned subsidiaries, has guaranteed the payment of amounts owed to unrelated third parties, which provided the equipment financing to affiliates of the Company. The affiliates are obligated to the unrelated third parties with various expiration dates through August 2025. At September 30, 2019, the outstanding principal on the financed equipment recorded by the affiliates was \$49.2 million.

The book value of the equipment financed by an affiliate and utilized by the Company at September 30, 2019 was \$3.4 million.

Approximately 89.5% of the Company's employees are subject to collective bargaining agreements. The Company contracts with Local 350 and Local 3 expire on December 31, 2021.

RECOLOGY SAN FRANCISCO
(An Indirect Wholly Owned Subsidiary of Recology Inc.)

Notes to Financial Statements

September 30, 2019 and 2018

The Parent and its subsidiaries, including the Company, are subject to various laws and regulations relating to the protection of the environment. It is not possible to quantify with certainty the potential impact of actions regarding environmental matters, particularly any future remediation and other compliance efforts. The Parent has environmental impairment liability insurance, which covers the sudden or gradual onset of environmental damage to third parties, on all owned and operated facilities. In the opinion of management, compliance with present environmental protection laws will not have a material adverse effect on the results of operations of the Company provided costs are substantially covered in the Company's rates on a timely basis.

The Company and the Parent are involved in various legal actions in the normal course of business. It is the Company's opinion that these matters are adequately provided for or that the resolution of such matters will not have a material adverse impact on the financial position or results of operations of the Company or the Parent.

(8) Equipment and Property Obligations

The Company has cancelable operating lease agreements with an affiliate, whereby it pays for the use of certain operating equipment and property. The Company leases two facilities from an unrelated entity for a portion of the Company's operations. The annual rent for the first facility, effective January 1, 2012, is \$1,824,160, and the lease expires on July 31, 2023. The annual rent for the second facility, effective August 1, 2012, is \$578,328 and the lease expired on July 31, 2019. Future payments for continued use of equipment and property, by year and in aggregate, as of September 30, 2019 are as follows:

	<u>Equipment</u>	<u>Real property</u>	<u>Total</u>
Year ending September 30:			
2020	\$ 5,899,252	4,284,154	10,183,406
2021	5,556,600	4,284,154	9,840,754
2022	4,872,571	4,284,154	9,156,725
2023	3,500,519	2,856,950	6,357,469
2024	1,921,804	—	1,921,804
Thereafter	<u>2,137,563</u>	<u>—</u>	<u>2,137,563</u>
Total payments	<u>\$ 23,888,309</u>	<u>15,709,412</u>	<u>39,597,721</u>

The Company's rental expense for the years ended September 30, 2019 and 2018 was \$14,570,486 and \$11,268,237, respectively, including amounts under short-term rental agreements with third parties.

Under the terms of the agreements with an affiliate, and in accordance with existing rate policies, the Company may continue to use certain equipment currently under operating leases without a related payment once the affiliates' equipment cost and related interest have been funded through operating lease payments.

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Notes to Financial Statements

September 30, 2019 and 2018

(9) Transactions with Related Parties

During the years ended September 30, 2019 and 2018, operating and other expenses of the Company included the following charges by the Parent and affiliates. Such charges are based upon the direct and indirect costs of the Parent and affiliates or established fees, and are allocated based on the specific activities. The allocated charges were as follows:

	<u>2019</u>	<u>2018</u>
Parent:		
Health insurance	\$ 9,866,631	9,574,671
Workers' compensation	2,731,474	2,718,898
Pension	3,511,535	5,016,947
Postretirement medical income	(1,370,670)	(1,313,134)
General and vehicle insurance	1,255,332	1,141,208
Corporate services	41,511	770,003
Information technology services	28,507	955,260
	<u>16,064,320</u>	<u>18,863,853</u>
Affiliates:		
Property rental	1,844,980	855,814
Equipment rental	5,084,190	4,883,450
Disposal/organics processing	29,870,042	28,385,217
	<u>36,799,212</u>	<u>34,124,481</u>
	<u>\$ 52,863,532</u>	<u>52,988,334</u>

Amounts settled by way of capital distributions to or contributions from Parent and affiliates are presented as financing activities in the statements of cash flows, except those relating to expenditures attributable to property and equipment, which are reported as investing activities.

The majority (60.1% and 59.7% in 2019 and 2018, respectively) of the Company's gross revenue is disposal revenue received from Sunset and Golden Gate, which are the principal refuse collectors in the City. Of the Company's recycling revenue, 60.3% and 56.4% in 2019 and 2018, respectively, was received from affiliates.

(10) Subsequent Events

The Company has evaluated its subsequent events through December 6, 2019, which is the date the financial statements were available to be issued, and determined there were no items to be disclosed.

RECOLOGY SAN FRANCISCO
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Schedule of Operating Expenses

Year ended September 30, 2019

	Transfer station	Processing	Truck and garage	Special waste	General recycling	General and administrative	Total
Operating expenses:							
Salaries and wages	\$ 19,841,295	15,626,425	3,452,619	1,811,828	5,531,235	1,590,340	47,853,742
Payroll taxes	1,375,612	1,221,715	240,492	144,631	447,185	127,371	3,557,006
Health insurance	3,668,901	3,589,388	738,487	460,038	1,321,623	349,267	10,127,704
Workers' compensation	1,020,093	1,106,569	177,973	101,113	307,034	18,692	2,731,474
Pension and 401(k)	1,933,013	1,308,552	646,988	154,386	623,859	118,879	4,785,677
Postretirement medical benefit	—	—	—	—	—	1,970,789	1,970,789
Provision for bad debt	—	—	—	—	—	(32,293)	(32,293)
Advertising and promotion, donations, dues and subscriptions	—	405	—	—	—	9,608	10,013
Buildings and facilities	239,188	993,726	904,706	13,279	197,430	164,395	2,512,724
Business meals, travel and entertainment	3,336	22,991	386	4,061	39,934	33,808	104,516
Corporate management fees	—	—	—	—	—	70,018	70,018
Depreciation	743,583	2,436,254	39,053	33,771	46,601	221,059	3,520,321
Disposal charges	27,957,217	6,756	60,275	803,259	4,148,802	—	32,976,309
Equipment rental	2,229,867	1,319,234	729,475	19,111	3,485,647	36,047	7,819,381
Freight	3,786	43,796	20,918	1,646	1,494,966	811	1,565,923
Fuel and oil	153	171,737	3,432,117	—	19,684	15	3,623,706
General and vehicle insurance	923,230	—	106,908	182,216	—	42,978	1,255,332
Licenses and permits	4,187,973	81,844	42,473	5,134	20,618	5,884	4,343,926
Loss on sale	—	—	—	—	—	139,347	139,347
Office expenses	29,734	71,606	15,873	18,791	11,206	170,567	317,777
Other expense	1,289,595	61,109	709	2,600	2,911	205,935	1,562,859
Parts, tires, and tubes	5,472	733,539	1,753,002	—	4,888	(487)	2,496,414
Professional services	164,147	82,467	625	3,048	556,536	966,595	1,773,418
Projects	—	—	—	—	—	1,058,542	1,058,542
Property rental	1,308,282	3,843,940	66,246	—	1,221,743	310,894	6,751,105
Recycling processing	—	3,380,450	—	—	—	—	3,380,450
Regional management expense	—	—	—	—	207,082	236,886	443,968
Repairs expense	125,226	217,777	329,603	2,273	71,102	5,241	751,222
Security and janitorial	6,024	371,373	4,582	876	86,715	556,753	1,026,323
Supplies	523,043	1,009,159	364,576	207,328	814,706	39,839	2,958,651
Taxes	10,330	974,039	—	—	34,095	1,885,307	2,903,771
Telephone	16,058	28,872	12,893	18,481	5,293	179,885	261,482
Temporary labor and subcontractor costs	—	6,782	—	436	11,325	67,621	86,164
Utilities	530,730	799,527	33,961	38,453	265,252	60,705	1,728,628
Total operating expenses	\$ 68,135,888	39,510,032	13,174,940	4,026,759	20,977,472	10,611,298	156,436,389

See accompanying independent auditors' report.