

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.



**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**
(Wholly Owned Subsidiaries of Recology Inc.)

Combined Financial Statements and Supplementary Information

September 30, 2018 and 2017

(With Independent Auditors' Report Thereon)



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

Independent Auditors' Report

The Board of Directors
Sunset Scavenger Company and
Golden Gate Disposal & Recycling Company:

We have audited the accompanying combined financial statements of Sunset Scavenger Company and Golden Gate Disposal & Recycling Company (the Company) (wholly owned subsidiaries of Recology Inc.), which comprise the combined balance sheets as of September 30, 2018 and 2017, and the related combined statements of income, changes in stockholder's investment, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined 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 combined 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 combined 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 combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined 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 combined financial statements referred to above present fairly, in all material respects, the financial position of Sunset Scavenger Company and Golden Gate Disposal & Recycling Company as of September 30, 2018 and 2017, and the results of their operations and their 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 combined 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 combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audits of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined 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 combined financial statements as a whole.

KPMG LLP

San Francisco, California
December 5, 2018

**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**
(Wholly Owned Subsidiaries of Recology Inc.)

Combined Balance Sheets

September 30, 2018 and 2017

Assets	2018	2017
Current assets:		
Accounts receivable, less allowance for doubtful accounts of \$205,688 and \$144,764 in 2018 and 2017, respectively	\$ 51,074,398	49,060,459
Parts and supplies	1,919,445	1,499,391
Prepaid expenses and other current assets	<u>1,559,893</u>	<u>1,365,249</u>
Total current assets	<u>54,553,736</u>	<u>51,925,099</u>
Property and equipment:		
Vehicles, containers, and operating equipment	846,001	786,515
Leasehold improvements	11,524,451	9,361,764
Furniture and fixtures	<u>501,677</u>	<u>454,455</u>
Total property and equipment	12,872,129	10,602,734
Less accumulated depreciation and amortization	<u>5,528,397</u>	<u>5,017,154</u>
Property and equipment, net	7,343,732	5,585,580
Permits	50,014,837	50,014,837
Goodwill, net of accumulated amortization of \$9,970 and \$7,976 in 2018 and 2017, respectively	9,970	11,964
Investment in Recology San Francisco	<u>47,154,065</u>	<u>32,250,208</u>
Total assets	<u>\$ 159,076,340</u>	<u>139,787,688</u>
Liabilities and Stockholder's Investment		
Current liabilities:		
Accounts payable	\$ 1,308,287	668,128
Accrued liabilities:		
Vacation and sick leave	1,906,582	1,832,182
Payroll and payroll taxes	1,776,786	1,810,192
Other accrued expenses	2,008,595	1,708,223
Deferred revenues	<u>8,649,554</u>	<u>8,501,504</u>
Total current liabilities	<u>15,649,804</u>	<u>14,520,229</u>
Total liabilities	15,649,804	14,520,229
Commitments and contingencies		
Stockholder's investment, net	<u>143,426,536</u>	<u>125,267,459</u>
Total liabilities and stockholder's investment	<u>\$ 159,076,340</u>	<u>139,787,688</u>

See accompanying notes to combined financial statements.

**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**

(Wholly Owned Subsidiaries of Recology Inc.)

Combined Statements of Income

Years ended September 30, 2018 and 2017

	2018	2017
Revenues:		
Commercial	\$ 214,576,822	186,477,880
Residential	90,260,088	79,345,730
Apartments	74,624,674	63,910,993
Other	3,884,688	1,702,022
Revenue from affiliate	21,698	18,354
	383,367,970	331,454,979
Less amounts reserved for impound and zero waste incentive accounts	(24,390,096)	(20,490,924)
Total operating revenues	358,977,874	310,964,055
Expenses:		
Refuse collection	203,638,324	192,060,713
Truck and garage	29,768,919	27,304,379
Debris box	36,307,984	33,402,970
General and administrative	26,648,856	23,745,463
Total operating expenses	296,364,083	276,513,525
Operating income	62,613,791	34,450,530
Other income:		
Recology San Francisco, net income share	11,341,300	19,225,975
Other	232,955	127,571
Net income	\$ 74,188,046	53,804,076

See accompanying notes to combined financial statements.

**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**
(Wholly Owned Subsidiaries of Recology Inc.)

Combined Statements of Changes in Stockholder's Investment

Years ended September 30, 2018 and 2017

	Total stockholder's investment
Balances, September 30, 2016	\$ 107,321,844
Net income	53,804,076
Net distribution to Parent	<u>(35,858,461)</u>
Balances, September 30, 2017	125,267,459
Net income	74,188,046
Net distribution to Parent and affiliates	<u>(56,028,969)</u>
Balances, September 30, 2018	<u>\$ 143,426,536</u>

See accompanying notes to combined financial statements.

**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**
(Wholly Owned Subsidiaries of Recology Inc.)

Combined Statements of Cash Flows

Years ended September 30, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Net income	\$ 74,188,046	53,804,076
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	513,237	464,487
Provision for bad debts	311,486	222,277
Loss on disposal of assets	—	—
Share of income of Recology San Francisco	(11,341,300)	(19,225,975)
Changes in assets and liabilities:		
Accounts receivable	(2,325,425)	(15,184,341)
Parts and supplies	(420,054)	(26,119)
Prepaid expenses and other current assets	(194,644)	(28,771)
Deferred revenues	148,050	1,276,668
Accounts payable	640,159	(38,448)
Accrued liabilities	341,366	(922,538)
Net cash provided by operating activities	61,860,921	20,341,316
Cash flows used in financing activities:		
Net distributions to Parent and affiliates	(61,860,921)	(20,341,316)
Net change in cash	—	—
Cash, beginning of year	—	—
Cash, end of year	\$ —	—
Supplemental disclosure of noncash activities:		
Contribution to (distribution from) Recology San Francisco	\$ 3,562,557	(17,528,838)
Additions to property and equipment funded by Parent	2,269,395	2,011,693

See accompanying notes to combined financial statements.

**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**
(Wholly Owned Subsidiaries of Recology Inc.)

Notes to Combined Financial Statements

September 30, 2018 and 2017

(1) Accounting Policies

(a) Organization

The accompanying financial statements are the combined statements of Sunset Scavenger Company and Golden Gate Disposal & Recycling Company (the 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). The Company eliminates intercompany transactions between the combined companies and combines their individual ownership interests in the unconsolidated subsidiary (note 3). 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 or distributions by the Parent. The Parent has the ability and intent to continue to support the Company's operations, as needed.

(b) Use of Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these combined financial statements in conformity with accounting principles generally accepted in the United States of America. The more significant estimates requiring the judgment of management include pension and postretirement obligations, valuation of intangible assets, self-insurance reserves, allowances for accounts receivable, zero waste incentive accounting (note 4), and potential litigation, claims, and assessments. Actual results could differ from those estimates.

(c) Fair Value of Financial Instruments

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

(d) Cash Concentration Account

The Company's bank accounts are linked to the Parent's concentration account. Cash balances (or deficits) 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 accounts have a zero balance, with related amounts debited or credited to the underlying intercompany account.

(e) Revenue Recognition and Accounts Receivable

The Company generally recognizes revenue when services are performed or products are delivered and collectibility is reasonably assured. Deferred revenue primarily consists of revenue billed in advance that is recorded as revenue in the period in which the related services are rendered. A significant amount of the Company's revenue is subject to rate regulation and adjustment 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.

**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**
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Notes to Combined Financial Statements

September 30, 2018 and 2017

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 potentially uncollectible accounts based on several factors, including historical collection trends, existing economic conditions, and other factors. In certain instances, the Company can collect receivables through a lien process. Past-due receivable balances not subject to a lien process are written-off when the Company's internal collection efforts have been unsuccessful.

(f) Parts and Supplies

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

(g) Property and Equipment

Property and equipment, including major 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:

	Estimated useful lives
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

Depreciation expense on the above amounted to \$511,243 and \$462,493 for the years ended September 30, 2018 and 2017, respectively. The cost of maintenance and repairs is expensed as incurred; significant renewals and betterments are capitalized.

(h) Impairment of Long-Lived Assets

Long-lived assets, such as property 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 flows 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, 2018 and 2017, no impairment was recorded.

**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**
(Wholly Owned Subsidiaries of Recology Inc.)

Notes to Combined Financial Statements

September 30, 2018 and 2017

(i) Goodwill, Permits and Intangible Assets

The Company performs an assessment of the fair value of permits for impairment at least annually. The Company's annual assessments indicated that there was no impairment to the permit values.

The Company amortizes goodwill on a straight-line basis over 10 years. The Company performs an assessment for impairment at the entity level if an event occurs or circumstances change that indicate that the fair value of the entity may be below its carrying amount.

Goodwill was \$9,970 and \$11,964 at September 30, 2018 and 2017, respectively. During the years ended September 30, 2018 and 2017, the Company recognized amortization expense of \$1,994. The Company did not recognize any impairment charges for goodwill during the years ended September 30, 2018 and 2017.

(j) Income Taxes

Effective October 1, 1998, the Parent elected to become 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, 2018 and 2017, there were no interest expenses or penalties recorded, because the Company had no uncertain tax positions that met the more-likely than-not threshold.

(k) 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, 2018 and 2017.

(l) Stockholder's Investment

The Company has 30,000 shares of common stock authorized and 12,304 shares issued and outstanding with no par value as of September 30, 2018 and 2017. Stockholder's investment, net, is comprised of the legal capital plus cumulative contributions net of distributions.

**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**
(Wholly Owned Subsidiaries of Recology Inc.)

Notes to Combined Financial Statements

September 30, 2018 and 2017

(m) Allocations

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

(2) Operations

The Company provides solid waste, recyclables, and organics collection services in San Francisco. The Company's collection rates for residences and apartments are set by the Refuse Collection and Disposal Rate Board of the City and County of San Francisco (the Rate Board). The rates are set to allow the Company to recover its operating costs plus a return on those costs, with certain mandated exceptions. This rate-setting process may result in the disallowance of certain costs and/or delays in cost recovery.

The Company together with Recology San Francisco filed a rate application to 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 adjustments (COLA) after the first year. The Rate Order includes the City's adoption of new rate structures for residential and apartment customers. New rates became effective July 1, 2017. The residential rate structure includes separate identification of fixed charges and volumetric charges on recycling and composting service. The apartment rate structure includes a fixed charge and a variable charge based on total service volume, with incentives to participate in recycling and composting collection programs. As a result of the Rate Order, the recycling incentive program for commercial customers was modified whereby 100% of the charges for containerized services are eligible for a diversion discount, equal to the percentage of recycling and compostable service volume to total service volume in excess of 25%, up to a maximum discount of 100%. The new rate structure for commercial customers became effective July 1, 2017.

(3) Investment in Recology San Francisco

Sunset Scavenger Company and Golden Gate Disposal & Recycling Company each has a 50% ownership interest in Recology San Francisco. The investment in Recology San Francisco is accounted for under the equity method of accounting.

**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**
(Wholly Owned Subsidiaries of Recology Inc.)

Notes to Combined Financial Statements

September 30, 2018 and 2017

Summarized financial information of Recology San Francisco as of September 30 is as follows:

	2018	2017
Financial position:		
Current assets	\$ 17,164,579	27,414,431
Current liabilities	(19,777,150)	(25,443,985)
	(2,612,571)	1,970,446
Long-term liabilities	(1,032,182)	(1,716,882)
Property and equipment, net and non current and other	50,798,818	31,996,644
Stockholder's investment	\$ 47,154,065	32,250,208
Operations:		
Revenue	\$ 155,383,495	159,574,921
Expenses, net of other expense and income	(144,042,195)	(140,348,946)
Net income	\$ 11,341,300	19,225,975

Recology San Francisco's operating results were affected by variations in its recycling revenue and expenses from the sale of recyclable commodities. Recology San Francisco's recycling revenue and expenses can be volatile and fluctuate in accordance with changes in the recycling commodity mix and in the prices of recyclable commodities, which may be dependent on changes in worldwide supply of, and demand for, such recyclable commodities.

(4) Regulatory and Contractual Obligations

Historically, the Company was required to deposit funds on a monthly basis into the Recology San Francisco Special Reserve Fund (Special Reserve Fund) from refuse collection billings. The dollar amount deposited represented a 1.3% surcharge of certain volume-related billings to the Company's customers, as approved by the Rate Board and collected by the Company.

On October 8, 2010, the Rate Board issued an order that reallocated the proceeds from the surcharge related to the Special Reserve Fund to the Impound Account for Department of Public Works' use to offset the costs of recycling and waste management. The Company deposited cash receipts of \$2,253,604 to the Impound Account that represents the surcharge related to the rate year ended June 30, 2013. As a result of the 2013 Rate Order, the surcharge for the Special Reserve Fund was discontinued effective July 1, 2013.

The Special Reserve Fund was to be used for extraordinary expenses relating to the Waste Disposal Agreement dated November 1, 1988, between the City and County of San Francisco, Recology San Francisco, and Waste Management Company of Alameda County.

**SUNSET SCAVENGER COMPANY AND
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Notes to Combined Financial Statements

September 30, 2018 and 2017

On December 16, 2015, the Rate Board approved the creation of a new reserve fund (the Reserve Fund) in connection with the landfill disposal agreement with Recology Hay Road. The funding of the Reserve Fund includes an initial transfer of \$13,250,000 from the Special Reserve Fund, of which \$1,250,000 is considered an initial deposit to meet the Company's obligation to reach \$10,000,000 by January 15, 2020, and \$12,000,000 to cover the anticipated additional transportation and disposal expenses the Company incurs as part of the landfill disposal agreement with Recology Hay Road.

The 2018 Rate Order required the transfer of surplus funds from the Special Reserve Fund. Beginning in Rate Year 2018 and continuing through Rate Year 2020, \$2,000,000 annually will be transferred from the Special Reserve Fund to the Reserve Fund. Also, beginning in the first quarter of Rate Year 2018 and continuing quarterly thereafter until the end of Rate Year 2020, \$625,000 will be transferred from the Special Reserve Fund to Recology to offset the rate increase. Any funds remaining in the Special Reserve Fund at the end of Rate Year 2020 shall be transferred to the New Reserve.

The Impound Account is a restricted bank account held jointly by Recology San Francisco and the City and County of San Francisco and used by the City and County to cover certain waste management and diversion expenses. While Recology San Francisco has historically been responsible for making monthly deposits into the Impound Account, the 2013 Rate Order reallocated part of the funding requirements to the Company. The Company is required to make fixed monthly deposits into the Impound Account as established in the 2013 Rate Order while Recology San Francisco was required to make monthly deposits based on tonnage. The amount deposited during the year ended September 30, 2018 was \$19,848,390 that represents the nine-month deposits of \$1,641,068 per month for the rate year ended June 30, 2018, the two-month deposits of \$1,641,068 per month and the one-month deposit of \$1,692,926 for rate year beginning on July 1, 2018 with a catch-up payment of \$103,716. The amount deposited during the year ended September 30, 2017 was \$16,423,827 that represents the nine-month deposits of \$1,277,847 per month for the rate year ended June 30, 2017 and the three-month deposits of \$1,641,068 per month for rate year beginning on July 1, 2017. The Company's deposits into the Special Reserve Fund or the Impound Account are not reported as assets or liabilities of the Company.

In order to provide the Company incentive to help the City meet recycling goals, the Company has the opportunity to generate additional earnings beyond the historically allowed profit by meeting goals for diversion of materials from landfill. The 2013 and 2017 Rate Orders established new zero waste diversion goals based on disposal tons at four tiers. The rates billed and collected by the Company are based on the maximum reward level of profit. The incentive revenue recognized by the Company is based on the estimate of the level of incentive to be achieved during each respective rate year. The incremental billings generated by the Company resulting from the additional reward levels of profit are deposited on a monthly basis into the Recology San Francisco zero waste incentive account (ZWIA), which Recology San Francisco is responsible for administering based on the 2001 Rate Order. If the Company meets or exceeds the diversion goals for the rate year, then the funds deposited into the account may be withdrawn by the Company. 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 Company deposited \$4,541,706 and \$4,067,097 from cash receipts into the ZWIA for the years ended September 30, 2018 and 2017, respectively.

**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**
(Wholly Owned Subsidiaries of Recology Inc.)

Notes to Combined Financial Statements

September 30, 2018 and 2017

The Company did not achieve any of the diversion goals for the rate year ended June 30, 2017. The Company did not withdraw any incentive rewards during each of the years ended September 30, 2018 and 2017.

The Company does not expect to achieve any of the incentive goals for the rate year ending June 30, 2018 and did not recognize any of the corresponding incremental revenue for the period from July 1, 2017 through September 30, 2018.

The Company withdrew \$2,900,000 from the ZWIA in Rate Year 2018. The funds were used to offset the rate increase effective on July 1, 2017.

(5) Employee Stock Ownership Plan

In 1986, the Parent established an 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.

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.

(6) Employee Benefit Plans

The Company participates in a noncontributory, funded defined-benefit pension plan (the Plan) sponsored by its Parent for the benefit of union and nonunion employees. Benefits are based on a formula, which includes years of service and average compensation. As of September 30, 2018, and 2017, the Plan had a projected benefit obligation in excess of plan assets by approximately \$19.0 million and \$90.1 million, respectively. It is the Parent's current policy to contribute at least the minimum statutory required amount. The Company's combined financial statements do not reflect the Company's share of the projected benefit obligation in excess of plan assets.

**SUNSET SCAVENGER COMPANY AND
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(Wholly Owned Subsidiaries of Recology Inc.)

Notes to Combined Financial Statements

September 30, 2018 and 2017

The Company's pension expense under the Plan for the years ended September 30, 2018 and 2017 was \$8,751,799 and \$11,552,391, respectively, which represents an allocation of approximately 52.5% and 54.1% of the Parent's plan expense for the years ended September 30, 2018 and 2017, respectively.

The weighted average discount rate used by the Parent to determine pension expense under the Plan was 4.10% and 3.95% for the years ended September 30, 2018 and 2017, respectively. The expected long-term rate of return on assets was 7.25% for both of the years ended September 30, 2018 and 2017. The rate of increase in future compensation levels used in determining the benefit obligations was 4% for both of the years ended September 30, 2018 and 2017. 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.

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 combined financial statements over the term of the affected employee's service with Recology. The postretirement medical benefit plan is unfunded. As of September 30, 2018, and 2017, the Plan, of which the Company's employees are participants, has a projected benefit obligation of approximately \$36.1 million and \$39.7 million, respectively. The Company's combined 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, 2018 and 2017 was \$2.7 million and \$2.4 million, respectively.

The weighted average discount rate used by the Parent to determine postretirement medical expense was 4.15% and 3.95% for the years ended September 30, 2018 and 2017, respectively. The Parent expects its healthcare cost trend for postretirement medical benefits to decrease from 6.75% in 2018 to 5.00% in 2026, after which the rate is expected to stabilize.

The Company agreed to allow certain union employees to participate in a multiemployer union-sponsored postretirement medical plan. The Company contributed \$4,628,443 and \$4,350,389 into the multiemployer union postretirement plan during the years ended September 30, 2018 and 2017, respectively.

The Company, through plans managed by the Parent, also sponsors a defined-contribution plan, the Recology 401(k) Plan, for certain eligible employees of the Company. The Company made matching contributions equal to a specified percentage of each participant's annual contributions amounting to \$157,360 and \$79,981 for the years ended September 30, 2018 and 2017, respectively.

**SUNSET SCAVENGER COMPANY AND
GOLDEN GATE DISPOSAL & RECYCLING COMPANY**
(Wholly Owned Subsidiaries of Recology Inc.)

Notes to Combined Financial Statements

September 30, 2018 and 2017

(7) 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 on 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 \$28,416,583 and \$28,051,596 for the years ended September 30, 2018 and 2017, 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.

(8) 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, 2018, there was an outstanding balance of \$131.5 million on the Parent's Revolving Credit Agreement and there were standby letters of credit issued for \$284.5 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, 2018, the outstanding principal on the financed equipment recorded by the affiliates was \$63.4 million.

The book value of the equipment financed by an affiliate and utilized by the Company at September 30, 2018 was \$17.0 million.

As of September 30, 2018, approximately 82.9% of the Company's employees were subject to collective bargaining agreements, which expire on December 31, 2021.

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 that costs are substantially covered in the Company's rates on a timely basis.

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The Company and the Parent are involved in various legal actions arising 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.

(9) Equipment and Property Obligations

The Company has cancelable operating lease agreements with affiliates whereby it pays for use of certain operating equipment and property. In addition, the Company has a noncancelable building operating lease with an unrelated third party. Future payments for continued use of the equipment and property, by year-end and in aggregate, as of September 30, 2018 are as follows:

	<u>Equipment</u>	<u>Real property</u>	<u>Total</u>
Year ending September 30:			
2019	\$ 11,027,875	1,841,958	12,869,833
2020	9,616,393	1,498,854	11,115,247
2021	8,633,591	1,320,902	9,954,493
2022	6,896,314	—	6,896,314
2023	5,303,688	—	5,303,688
Thereafter	<u>5,675,878</u>	<u>—</u>	<u>5,675,878</u>
Total payments	<u>\$ 47,153,739</u>	<u>4,661,714</u>	<u>51,815,453</u>

The Company's rent expense for the years ended September 30, 2018 and 2017 was \$13,839,962 and \$14,639,969, 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 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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September 30, 2018 and 2017

(10) Transactions with Related Parties

During the years ended September 30, 2018 and 2017, operating and other expenses of the Company included the following charges by or (to) the Parent and its affiliates. Such charges are based on the direct and indirect costs of the Parent and its affiliates, or established fees, and are allocated using factors based on specific activities. The allocated charges were as follows:

	<u>2018</u>	<u>2017</u>
Parent:		
Health insurance	\$ 14,979,274	16,057,526
Workers' compensation	9,878,058	8,888,557
Pension	8,751,799	11,552,391
Postretirement medical income	(1,642,077)	(1,411,873)
General and vehicle insurance	3,559,251	3,105,513
Corporate services	6,969,335	6,270,456
Information technology services	3,043,637	2,609,646
	<u>45,539,277</u>	<u>47,072,216</u>
Affiliates:		
Property rental	1,320,902	1,320,902
Equipment rental	11,921,564	12,784,560
Disposal/organics processing	94,502,059	85,396,558
Recycling processing fees	26,280,788	23,288,939
	<u>134,025,313</u>	<u>122,790,959</u>
Total	<u>\$ 179,564,590</u>	<u>169,863,175</u>

Changes in amounts due from or payable to Parent and its affiliates are presented as a financing activity in the combined statements of cash flows, except expenditures attributable to property and equipment, which are presented as supplemental noncash investing activities.

(11) Subsequent Events

The Company has evaluated its subsequent events through December 5, 2018, which is the date the combined financial statements were available for issuance.

SUNSET SCAVENGER COMPANY
GOLDEN GATE DISPOSAL and RECYCLING COMPANY
(Wholly Owned Subsidiaries of Recology Inc.)

Combined Schedule of Operating Expenses

Year ended September 30, 2018

	<u>Refuse collection</u>	<u>Truck and garage</u>	<u>Debris box</u>	<u>General and administrative</u>	<u>Total</u>
Operating expenses:					
Salaries and wages	\$ 56,060,157	10,512,944	7,379,734	3,140,550	77,093,385
Payroll taxes	4,321,065	668,860	538,346	345,831	5,874,102
Pension and 401(k)	6,709,898	1,106,840	851,433	240,988	8,909,159
Health insurance	11,571,467	1,594,402	1,334,640	478,766	14,979,275
Workers' compensation	7,636,310	1,283,359	902,592	55,797	9,878,058
O/S Postretirement benefit	3,646,619	546,931	426,386	8,507	4,628,443
Temporary labor and subcontractor costs	1,468,423	—	60,291	79,485	1,608,199
General and vehicle insurance	13,684	1,588,936	—	1,956,631	3,559,251
Disposal charges	73,051,958	47,955	21,438,336	—	94,538,249
Equipment rental	10,246,777	480,643	1,300,115	83,012	12,110,547
Property rental	—	235,675	—	1,493,739	1,729,414
Supplies	436,030	1,269,233	1,027,193	381,934	3,114,390
Repairs expense	55,592	1,219,306	527,257	33,929	1,836,084
Parts, tires, and tubes	79	3,605,272	—	—	3,605,351
Fuel and oil	—	4,317,128	—	—	4,317,128
Buildings and facilities	29,685	145,798	17,038	85,186	277,707
Security and janitorial	58,881	75,130	—	349,044	483,055
Licenses and permits	1,442,292	100,506	406,697	26,847	1,976,342
Utilities	—	476,762	—	364,522	841,284
Freight	4,306	60,515	2,633	1,837	69,291
Recycling processing	26,280,788	—	—	—	26,280,788
Professional services	47,018	16,031	36,649	803,533	903,231
Provision for bad debt	92,102	—	—	219,384	311,486
Business meals, travel and entertainment	34,053	1,703	8,591	65,930	110,277
Office expense	270,332	47,504	33,430	258,095	609,361
Telephone	65,866	35,095	11,731	362,793	475,485
Dues and subscriptions	245	1,022	—	138,400	139,667
Postage	74	—	—	316,702	316,776
Projects	—	—	—	49,683	49,683
Taxes	—	4,394	—	2,572,807	2,577,201
Corporate management fees	—	—	—	10,012,972	10,012,972
Post-retirement benefit	—	—	—	(1,642,077)	(1,642,077)
Other expense	80,148	2,662	963	4,193,510	4,277,283
Depreciation	14,475	324,313	3,929	168,525	511,242
Amortization expense	—	—	—	1,994	1,994
Total operating expenses	<u>\$ 203,638,324</u>	<u>29,768,919</u>	<u>36,307,984</u>	<u>26,648,856</u>	<u>296,364,083</u>

See accompanying notes to combined financial statements.