**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.

KPMG

# RECOLOGY SAN FRANCISCO

(An Indirect Wholly Owned Subsidiary of Recology Inc.)

Financial Statements and Supplementary Information

September 30, 2016 and 2015

(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, 2016 and 2015, and the related statements of income, changes in stockholder's investment, 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, 2016 and 2015, 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 15, 2016

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

Balance Sheets

September 30, 2016 and 2015

| **Assets** | | **2016** | **2015** |
|---|---|---|---|
| Current assets: | | | |
| Restricted cash | $ | 14,229,975 | 16,743,375 |
| Accounts receivable, less allowance for doubtful accounts of $16,913 and $3,049 in 2016 and 2015, respectively | | 8,429,568 | 4,007,936 |
| Parts and supplies | | 1,394,535 | 1,186,378 |
| Prepaid expenses and other current assets | | 1,355,529 | 1,192,205 |
| Total current assets | | 25,409,607 | 23,129,894 |
| Property and equipment: | | | |
| Land | | 9,301,180 | 9,301,180 |
| Buildings and improvements | | 20,656,262 | 20,370,122 |
| Equipment and furniture | | 18,717,167 | 5,788,227 |
| Vehicles | | 5,809 | 5,809 |
| Construction in progress | | 1,104,001 | 218,769 |
| Total property and equipment | | 49,784,419 | 35,684,107 |
| Less accumulated depreciation | | 20,325,319 | 19,046,562 |
| Property and equipment, net | | 29,459,100 | 16,637,545 |
| Other assets | | 427,682 | 425,303 |
| Total assets | $ | 55,296,389 | 40,192,742 |
| Liabilities and Stockholder’s Investment | | | |
| Current liabilities: | | | |
| Accounts payable | $ | 1,235,800 | 1,019,316 |
| Accrued liabilities: | | | |
| Regulatory and related costs | | — | 137,086 |
| Vacation and sick leave | | 842,137 | 760,451 |
| Payroll and payroll taxes | | 837,367 | 1,662,966 |
| Other accrued expenses | | 5,918,714 | 6,192,421 |
| Zero waste incentive | | 14,229,975 | 16,743,375 |
| Deferred revenue | | 225,589 | 4,536 |
| Total current liabilities | | 23,289,582 | 26,520,151 |
| Other liabilities | | 1,453,736 | 55,774 |
| Total liabilities | | 24,743,318 | 26,575,925 |
| Commitments and contingencies (Note 7) | | | |
| Stockholder’s investment, net | | 30,553,071 | 13,616,817 |
| Total liabilities and stockholder’s investment | $ | 55,296,389 | 40,192,742 |

See accompanying notes to financial statements.

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

Statements of Income

Years ended September 30, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| Revenues: | | |
| Sunset Scavenger Company and | | |
| Golden Gate Disposal & Recycling Company | $ 82,362,000 | 79,845,071 |
| Other affiliates | 32,612 | 72,392 |
| Public disposal | 6,569,976 | 5,309,794 |
| Commercial disposal | 4,085,156 | 4,020,581 |
| Recycling | 44,935,214 | 43,648,703 |
| Rate stabilization revenue | 6,389,383 | — |
| Zero waste incentive revenue | 9,195,322 | — |
| | 153,569,663 | 132,896,541 |
| Less amounts reserved for impound and zero waste incentive accounts | (3,940,487) | (6,097,973) |
| Total operating revenues | 149,629,176 | 126,798,568 |
| Expenses: | | |
| Transfer station | 52,461,475 | 42,340,291 |
| Processing | 36,737,156 | 35,791,806 |
| Truck and garage | 9,594,234 | 9,100,941 |
| Special waste | 3,908,545 | 4,037,086 |
| General recycling | 17,475,990 | 16,797,879 |
| General and administrative | 8,051,810 | 9,823,348 |
| Total operating expenses | 128,229,210 | 117,891,351 |
| Operating income | 21,399,966 | 8,907,217 |
| Other (expense) income: | | |
| Interest expense | (1,679) | (1,264) |
| Rental and other income | 47,164 | 46,624 |
| Net income | $ 21,445,451 | 8,952,577 |

See accompanying notes to financial statements.

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

Statements of Changes in Stockholder's Investment

Years ended September 30, 2016 and 2015

| | Total stockholder's investment |
|---|---|
| Balances, September 30, 2014 | $ 17,173,988 |
| Net income | 8,952,577 |
| Net distribution to Parent | (12,509,748) |
| Balances, September 30, 2015 | 13,616,817 |
| Net income | 21,445,451 |
| Net distribution to Parent | (4,509,197) |
| Balances, September 30, 2016 | $ 30,553,071 |

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, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net operating income | $ 21,445,451 | 8,952,577 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 1,278,757 | 1,284,234 |
| Provision for bad debts | 158,301 | (24,716) |
| Changes in assets and liabilities: | | |
| Restricted cash | 2,513,400 | (5,883,460) |
| Accounts receivable | (4,579,933) | (464,293) |
| Parts and supplies | (208,157) | 374,967 |
| Prepaid expenses and other assets | (165,703) | (281,008) |
| Accounts payable | 216,484 | (92,220) |
| Accrued liabilities | (1,154,706) | 3,404,707 |
| Zero waste incentive rebate | (2,513,400) | 5,883,460 |
| Deferred revenue and other liabilities | 1,619,015 | 47,720 |
| Net cash provided by operating activities | 18,609,509 | 13,201,968 |
| Cash flows used in financing activities: | | |
| Net distributions to Parent and affiliates | (18,609,509) | (13,201,968) |
| Net change in cash | — | — |
| Cash, beginning of year | — | — |
| Cash, end of year | $ — | — |
| Supplemental disclosures of noncash activities: | | |
| Interest allocation from Parent | $ 1,679 | 1,264 |
| Equipment allocation from Parent or affiliate | 14,100,312 | 692,220 |

See accompanying notes to financial statements.

## (1) Accounting Policies

### *(a) Organization*

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).

### *(b) 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 pension and postretirement obligations, self-insurance reserves, allowances for doubtful accounts, zero waste incentive accounting, 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 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.

### *(d) 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.

### *(e) 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 San Francisco 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 allowance for doubtful 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.

***(f) 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.

***(g) Property and Equipment***

Property and equipment, including major renewals and betterments, 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 $1,278,757 and $1,284,234 for the years ended September 30, 2016 and 2015, 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, 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, 2016 and 2015, no impairment was recorded.

***(i) 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.


(Continued)

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, 2016 and 2015, there were no interest expenses or penalties recorded, because the Company had no uncertain tax positions that met the more-likely than-not threshold.

***(j) Stockholder's Investment***

The Company has 7,500 shares of common stock authorized, issued, and outstanding with no par value as of September 30, 2016 and 2015. Stockholder's investment, net, is comprised of the legal capital plus cumulative contributions net of distributions.

***(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) Reclassifications***

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

**(2) Operations**

In January 2016, the Company's waste Disposal Agreement (the Agreement) with the City and County of San Francisco (the City) and Waste Management Company of Alameda County (WMAC) expired. In July 2011, the San Francisco Board of Supervisors approved the Landfill Disposal and Facilitation Agreements (Landfill Agreement) with Recology San Francisco to commence once the Agreement with WMAC ended. The nine-year agreement provides for solid waste collected in San Francisco to be disposed of at the Recology Hay Road Landfill. On January 15, 2016, the Company began disposing of San Francisco solid waste to the Recology Hay Road Landfill.

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 2013 San Francisco Rate Order (the Rate Order or 2013 Rate Order) was approved in July 2013. The Rate Order approved the rates for the 2014 rate year (Rate Year 2014 began July 1, 2013) and a cost-of-living adjustment (COLA) for up to four years after the first year through and including the rate year ending June 30, 2018. New rates became effective August 1, 2013. A COLA increase was applied to the rates effective July 1, 2016 and 2015. On September 2, 2016, the Company submitted a notice of intent to file a rate application.

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.

## (3) Regulatory and Contractual Obligations

A portion of the amounts received from the disposal and collection of refuse is deposited into the Recology San Francisco Impound Account (Impound Account), which is a restricted bank account held jointly by the Company and the City. The Company, together with Sunset Scavenger Company and Golden Gate Disposal & Recycling Company (Sunset and Golden Gate), deposited cash receipts of $16,556,408 and $18,581,956 into the Impound Account for the years ended September 30, 2016 and 2015, respectively. The funds are required for the City's Solid Waste Program, royalty fee payments to the County of Alameda, and certain other obligations connected with the disposal of the solid waste of the City. While the Company has historically been solely responsible for making monthly deposits into the Impound Account, the 2013 Rate Order reallocated part of the funding requirements to Sunset and Golden Gate effective July 1, 2013. Sunset and Golden Gate are required to make fixed monthly deposits into the Impound Account as established in the Rate Order while the Company will continue to make monthly deposits based on tonnage. Any disbursements from the Impound Account must be authorized by both the Company and the City. These account balances are not included in the Company's financial statements because the Company is the account administrator and does not own the assets. Upon the expiration of the Waste Disposal Agreement with the City and County of San Francisco and WMAC, the Company ceased making monthly deposits.

The Company is also a joint signatory with the City over disbursements from the Recology San Francisco Special Reserve Joint Bank Account (Special Reserve Joint Bank Account). This account is funded by Sunset and Golden Gate from refuse collection billings to their customers. The amounts in the Special Reserve Joint Bank Account are to be used for extraordinary expenses relating to the Agreement dated November 1, 1988, and to reimburse extraordinary costs incurred by the Company due to regulatory changes until such costs are included in the rates. These account balances are not included in the Company's financial statements because the Company is the account administrator and does not own the assets.

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 will incur as part of the landfill disposal agreement with Recology Hay Road. Reimbursements related to this arrangement are included in rate stabilization revenue and recognized in the period in which the expenses are incurred.

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 (the Companies), 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 2013 Rate Order established new zero waste diversion goals based on disposal tons at four tiers to cover the rate year ended June 30, 2014 through rate year ending June 30, 2021. 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, 2016 and 2015 are included in restricted cash. The portion of the diversion goals achieved are recognized as revenue and the unachieved portion is included in deferred revenue. The Company deposited $2,538,243 and $2,495,882 from cash receipts into the ZWIA for the years ended September 30, 2016 and 2015, respectively.

The Company did not achieve any of the diversion goals for the rate years ended June 30, 2016 and 2015. The Company does not expect to achieve any of incentive goals for the rate year ending. June 30, 2016 and did not recognize any of the corresponding incremental revenue for the period from July 1, 2015 through September 30, 2016.

During 2016, the Company proposed a new diversion program in the form of constructing improvements to the Company’s material recovery facility at Pier 96. The proposal was approved and the construction of the improvements completed. As a result of the completion of the diversion program, the Company recognized $9,195,322 in Zero Waste Incentive revenue during the year.

## (4) 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 Company, or shares, subject to immediate repurchase by the Company. 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 union and nonunion employees. Benefits are based on a formula that includes years of service and average compensation. As of September 30, 2016 and 2015, the Plan, of which the Company's employees are participants, had a projected benefit obligation in excess of plan assets by approximately $143.7 million and $78.6 million, respectively. It is the Parent's current policy to contribute at least the minimum statutory required amount. The Company's financial statements do not reflect the Company's share of the projected benefit obligation in excess of plan assets.

The Company's pension expense under the Plan for the years ended September 30, 2016 and 2015 was $4,178,257 and $3,781,743, respectively, which represents an allocation of approximately 26.3% and 25.9% of the Parent's plan expense for the years ended September 30, 2016 and 2015, respectively.

The weighted average discount rate used by the Parent to determine pension expense under the Plan was 4.9% and 4.75% for the years ended September 30, 2016 and 2015, respectively. The expected long-term rate of return on assets was 7.5% for both years ended September 30, 2016 and 2015. The rate of increase in future compensation levels used in determining the benefit obligations was 3.0% for both years ended September 30, 2016 and 2015. The Company's portion of the actuarially computed value of the vested and nonvested benefits of the Plan and the net assets of the pension funds has 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 September 30, 2016 and 2015 was $1,062,971 and $915,066, 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:

| Pension fund (1)/Employer identification number/ Plan number | Pension Protection Act reported status | | Fund improvement plan/ Rehabilitation plan status | Contributions | | Expiration date of collective bargaining agreement |
|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2016 | 2016 | 2015 | |
| Pension Trust Fund for Operating Engineers/94-6090764/002 | Endangered | Endangered | Implemented | $ 1,062,971 | 915,066 | December 31, 2016 |

(1) The Company paid no surcharges for multiemployer pension funds during the year ended September 30, 2016.

Unless otherwise noted in the table above, the most recent Pension Protection Act zone status available in 2016 and 2015 is for the Plan's year-end at December 31, 2015 and 2014, respectively. 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, 2016 and 2015, the Plan, of which the Company's employees are participants, has a projected benefit obligation of approximately $44.2 million and $42.4 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, 2016 and 2015 was $1,220,844 and $1,093,583, respectively.

The Affordable Care Act, which was passed by Congress and signed into law in March 2010, imposes an excise tax on high-value health plans (often referred to as Cadillac plans) in addition to other requirements. It is anticipated that these law changes will not have a material impact upon the Company's total cost of retiree medical coverage.

The weighted average discount rate used by the Parent to determine postretirement medical expense was 4.8% and 4.6% for the years ended September 30, 2016 and 2015, respectively. The Parent expects its healthcare cost trend for postretirement medical benefits to decrease from 7.25% in 2016 to 5.0% in 2025, 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 $2,568,124 and $2,378,569 into the multiemployer union postretirement plan during 2016 and 2015, 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 $32,509 and $25,013 for the years ended September 30, 2016 and 2015, 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 $13,672,912 and $12,672,206 for the years ended September 30, 2016 and 2015, 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 12, 2018. At September 30, 2016, $23 million outstanding on the Parent's Revolving Credit Agreement, and there were standby letters of credit issued for $182.4 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. These obligations expire at various dates through June 2024. At September 30, 2016, the outstanding principal on the financed equipment recorded by the affiliates was $59.9 million.

The book value of the equipment financed by an affiliate and utilized by the Company at September 30, 2016 was $4.1 million.

Approximately 89.9% of the Company's employees are subject to collective bargaining agreements, which expire on December 31, 2016 for both Local 3 and Local 350. The Company is in ongoing negotiations and expect to renew the contract prior to expiration.


(Continued)

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 expires on July 31, 2019. Future payments for continued use of equipment and property, by year and in aggregate, as of September 30, 2016 are as follows:

| | | Equipment | Real property | Total |
|---|---|---|---|---|
| Year ending September 30: | | | | |
| 2017 | $ | 4,840,970 | 4,794,032 | 9,635,002 |
| 2018 | | 4,346,161 | 5,233,778 | 9,579,939 |
| 2019 | | 3,925,904 | 5,095,194 | 9,021,098 |
| 2020 | | 3,722,715 | 4,284,159 | 8,006,874 |
| 2021 | | 3,378,310 | 4,284,159 | 7,662,469 |
| Thereafter | | 4,023,078 | 6,285,300 | 10,308,378 |
| Total payments | $ | 24,237,138 | 29,976,622 | 54,213,760 |

The Company's rental expense for the years ended September 30, 2016 and 2015 was $9,156,513 and $9,094,206, 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.

### (9) Transactions with Related Parties

During the years ended September 30, 2016 and 2015, 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:

| | | 2016 | 2015 |
|---|---|---|---|
| Parent: | | | |
| Health insurance | $ | 9,841,125 | 8,151,633 |
| Workers' compensation | | 3,003,302 | 3,733,653 |
| Pension | | 4,178,257 | 3,781,743 |
| Postretirement medical income | | (1,220,844) | (1,093,583) |
| General and vehicle insurance | | 828,485 | 786,920 |
| Corporate services | | 786,558 | 923,247 |
| Information technology services | | 735,526 | 827,821 |
| | | 18,152,409 | 17,111,434 |
| Affiliates: | | | |
| Property rental | | 855,814 | 831,130 |
| Equipment rental | | 4,954,666 | 5,056,401 |
| Disposal/organics processing | | 22,424,424 | 10,081,204 |
| | | 28,234,904 | 15,968,735 |
| Total | $ | 46,387,313 | 33,080,169 |

Amounts due from or payable to Parent and affiliates are accumulated by the Company during the year, and, at year-end, may be settled by way of capital distributions or contributions by the Parent. Changes in amounts due from or payable to Parent and affiliates are presented as operating activities, and amounts settled by way of capital distributions or contributions 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 (53.6% and 60.1% in 2016 and 2015, 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, 49.2% and 49.7% in 2016 and 2015, respectively, were received from affiliates.

### (10) Subsequent Events

The Company has evaluated its subsequent events through December 15, 2016, which is the date the financial statements were available for issuance.

Schedule 1

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

Schedule of Operating Expenses

Year ended September 30, 2016

| | Transfer station | Processing | Truck and garage | Special waste | General recycling | General and administrative | Total |
|---|---|---|---|---|---|---|---|
| Operating expenses: | | | | | | | |
| Salaries and wages | $ 14,628,007 | 12,677,713 | 2,595,889 | 1,564,458 | 7,326,176 | 1,925,859 | 40,718,102 |
| Payroll taxes | 1,039,250 | 1,011,337 | 202,911 | 125,992 | 575,744 | 206,913 | 3,162,147 |
| Health insurance | 3,058,887 | 3,660,536 | 649,853 | 489,894 | 1,843,065 | 357,706 | 10,059,941 |
| Workers' compensation | 1,018,730 | 1,135,423 | 182,044 | 117,660 | 539,422 | 10,020 | 3,003,299 |
| Pension and 401(k) | 1,883,913 | 1,444,945 | 560,631 | 185,254 | 1,008,171 | 190,821 | 5,273,735 |
| Postretirement medical benefit | 600,318 | 938,258 | 6,033 | 95,926 | 455,195 | (748,452) | 1,347,278 |
| Provision for bad debt | — | — | — | — | — | 158,300 | 158,300 |
| Advertising and promotion, donations, dues and subscriptions | — | — | — | 17 | — | 7,650 | 7,667 |
| Buildings and facilities | 166,513 | 291,634 | 189,842 | 1,080 | 91,010 | 16,599 | 756,678 |
| Business meals, travel and entertainment | 1,341 | 4,637 | — | 945 | 6,600 | 24,131 | 37,654 |
| Corporate management fees | — | — | — | — | — | 1,522,083 | 1,522,083 |
| Depreciation & depletion | 464,215 | 555,756 | 27,900 | 52,833 | 33,635 | 144,414 | 1,278,753 |
| Disposal charges | 22,387,874 | 170,058 | 54,211 | 770,316 | 1,814,464 | 4,776 | 25,201,699 |
| Equipment rental | 1,984,450 | 1,442,322 | 339,236 | 22,588 | 1,391,507 | 8,529 | 5,188,632 |
| Freight | (888,510) | 2,465,689 | 17,456 | 2,609 | — | 3,567 | 1,600,811 |
| Fuel and oil | 2,933 | 170,799 | 2,604,794 | — | 30,767 | 1,107 | 2,810,400 |
| General and vehicle insurance | 621,242 | — | 78,219 | 122,613 | — | 6,410 | 828,484 |
| Licenses and permits | 2,341,227 | 46,026 | 26,980 | 4,050 | 15,328 | 35,914 | 2,469,525 |
| Office expenses | 34,565 | 72,153 | 11,044 | 18,631 | 3,435 | 81,054 | 220,882 |
| Other expense | 1,235,355 | 25,004 | 1,110 | 4,456 | 1,687 | 239,647 | 1,507,259 |
| Parts, tires, and tubes | 4,129 | 653,957 | 1,345,537 | — | 7,011 | 11,853 | 2,022,487 |
| Professional services | 15,000 | 86,800 | — | 5,552 | 16,721 | 1,664,976 | 1,789,049 |
| Projects | — | — | — | — | — | 128,487 | 128,487 |
| Property rental | 335,876 | 2,294,852 | 66,246 | — | 978,634 | 292,269 | 3,967,877 |
| Recycling processing | — | 5,094,056 | — | — | — | — | 5,094,056 |
| Regional management expense | — | — | — | — | 282,119 | 122,879 | 404,998 |
| Repairs expense | 220,311 | 306,999 | 275,971 | 7,071 | 7,890 | 15,706 | 833,948 |
| Security and janitorial | 4,994 | 238,638 | 11,570 | 789 | 74,758 | 300,123 | 630,872 |
| Supplies | 508,096 | 633,009 | 305,172 | 270,569 | 654,564 | 43,648 | 2,415,058 |
| Taxes | 1,825 | 658,766 | — | — | 36,076 | 1,042,844 | 1,739,511 |
| Telephone | 24,024 | 20,195 | 11,440 | 18,143 | 7,089 | 180,337 | 261,228 |
| Temporary labor and subcontractor costs | 153,844 | 34,034 | 977 | — | 53,021 | 25,763 | 267,639 |
| Utilities | 613,066 | 603,560 | 29,168 | 27,099 | 221,901 | 25,877 | 1,520,671 |
| Total operating expenses | $ 52,461,475 | 36,737,156 | 9,594,234 | 3,908,545 | 17,475,990 | 8,051,810 | 128,229,210 |

See accompanying independent auditors' report.