Washington State Auditor's Office

Financial Statements Audit Report

Northshore Utility District

King County

Audit Period

January 1, 2011 through December 31, 2011

Report No. 1007604

Issue Date

May 14, 2012

WASHINGTON
BRIAN SONNTAG
STATE AUDITOR

Washington State Auditor
Brian Sonntag

May 14, 2012

Board of Commissioners
Northshore Utility District
Kenmore, Washington

Report on Financial Statements

Please find attached our report on the Northshore Utility District's financial statements.

We are issuing this report in order to provide information on the District's financial condition.

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR

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King County
January 1, 2011 through December 31, 2011

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters in Accordance with *Government Auditing Standards*

Northshore Utility District
King County
January 1, 2011 through December 31, 2011

Board of Commissioners
Northshore Utility District
Kenmore, Washington

We have audited the basic financial statements of the Northshore Utility District, King County, Washington, as of and for the years ended December 31, 2011 and 2010, and have issued our report thereon dated April 30, 2012.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of the District's compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended for the information and use of management and the Board of Commissioners. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

BRIAN SONNTAG, CGFM
STATE AUDITOR

April 30, 2012

Independent Auditor's Report on Financial Statements

Northshore Utility District
King County
January 1, 2011 through December 31, 2011

Board of Commissioners
Northshore Utility District
Kenmore, Washington

We have audited the accompanying basic financial statements of the Northshore Utility District, King County, Washington, as of and for the years ended December 31, 2011 and 2010, as listed on page 5. These financial statements are the responsibility of the District's management. 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Northshore Utility District, as of December 31, 2011 and 2010, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 10 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it tobe an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

BRIAN SONNTAG, CGFM
STATE AUDITOR

April 30, 2012

Financial Section

Northshore Utility District
King County
January 1, 2011 through December 31, 2011

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis – 2011

BASIC FINANCIAL STATEMENTS

Comparative Statement of Net Assets – 2011 and 2010
Comparative Statement of Revenues, Expenses and Changes in Net Assets – 2011 and 2010
Comparative Statement of Cash Flows – 2011 and 2010
Notes to Financial Statements – 2011

MANAGEMENT DISCUSSION AND ANALYSIS

For the Year Ended December 31, 2011

As management of the Northshore Utility District (the District), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended December 31, 2011. We encourage readers to consider the information presented here in conjunction with the District's financial statements, which begin on page 10.

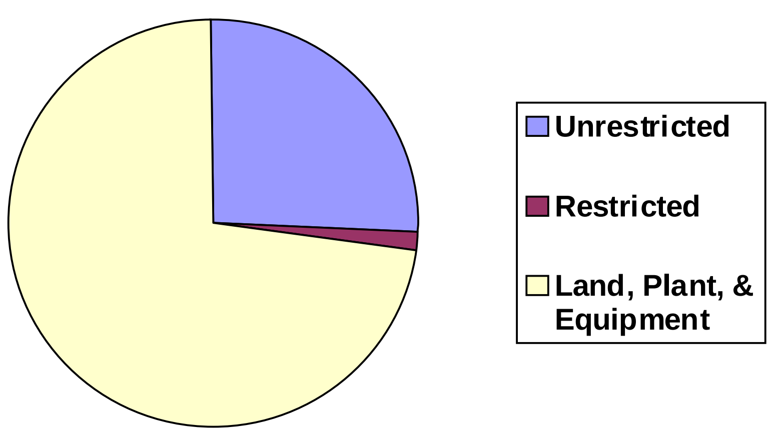
The financial position of the District was mildly affected by the economic downturn and continued slow economic growth in 2011 as noted below:

- The assets of the District exceeded its liabilities creating net assets at the close of the most recent fiscal year in the amount of $157,500,352.

- As of the close of 2011, the District cash balance was $38,466,887, a decrease of $138,145 from December 31, 2010.

- The District had total operating revenues of $31,845,068 and operating expenses of $32,305,125 for the fiscal year ended December 31, 2011.

- A majority of the District's assets are held in land, plant, and equipment. Other assets are categorized as restricted, unrestricted, and other as illustrated below:



Overview of the Financial Statements

The management discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements are comprised of District-wide financial statements and notes to the financial statements. The District began implementing the Governmental Accounting Standards Board (GASB) Statement 34 model of financial reporting in 2003. This statement establishes standards for external financial reporting for all state and local government entities.

DISTRICT FINANCIAL STATEMENTS

The District's financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private sector business.

The *Statement of Net Assets* presents information on all of the District's assets and liabilities, with the difference between the two reported as net assets per GASB 34. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating. Assets are designated as either "Unrestricted" or "Restricted" based upon their purpose. Restricted assets are those subject to constraints that are externally imposed, such as those imposed by creditors through debt covenants. Funds without a designated purpose are called "Unrestricted." The District had assets restricted for construction and debt service of $4,282,015 and $4,571,841 as of December 31, 2011, and 2010, respectively.

The *Statement of Revenues, Expenses, and Changes in Net Assets* presents information showing how the District's position changed during the most recent fiscal year. All changes are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., depreciation as well as earned but unused vacation leave).

The *Statement of Cash Flows* accounts for the net change in cash and cash equivalents by summarizing cash receipts and cash disbursements resulting from operating activities, capital and related financing activities and investment activities. This statement assists the user in determining the source of cash coming into the District, the items for which cash was expended, and the beginning and ending cash balance.

The notes provide additional information that is essential to a full understanding of the data provided in the District's financial statements. The notes to the financial statements can be found on pages 15 through 38 of this report.

FINANCIAL ANALYSIS

The overall financial condition of the District was mildly affected by the economic downturn, but remains strong as indicated by continued increases in net assets over 2010, 2009 and 2008. The most significant financial impact of the recession and slow recovery has been in the area of new housing development and a dramatic reduction in investment income. Most development in the District has ceased. This trend is reflected in the decrease of- facilities benefit charges collected in 2011, 2010, and 2009 when compared to 2008, which was $1,600,372. In addition, 2008 totals had already declined by approximately 33% from 2007 total collections. Investment rate of return began falling in 2007 and in late 2011 reached historical lows of less than 0.6% per annum. The rate had not increased by end of 2011.

Condensed Statement of Net Assets	2011	2010	2009	2011-2010 Change	Change %
Current, Restricted					
and Other Assets	$45,251,627	$44,913,119	$46,923,303	$338,508	0.8%
Capital Assets					
(net of depreciation)	120,511,877	118,222,606	113,654,674	2,289,271	1.9%
Total Assets	165,763,504	163,135,725	160,577,977	2,627,779	1.6%
Non-Current Liabilities	5,760,017	5,146,920	5,780,079	$613,097	11.9%
Current Liabilities	2,503,135	2,329,391	3,668,420	$173,744	7.5%
Total Liabilities	8,263,152	7,476,311	9,448,499	786,841	10.5%
Net Assets					
Invested in capital assets,					
net of related debt	115,552,943	113,075,687	107,874,594	$2,477,256	2.2%
Restricted assets	4,282,015	4,571,841	3,632,746	(289,826)	-6.3%
Unrestricted	37,665,394	38,011,886	39,622,138	(346,492)	-0.9%
Total Net Assets	$157,500,352	$155,659,414	$151,129,478	$1,840,938	1.2%

The net assets of the District increased from $155,659,414 in 2010 to $157,500,352 in 2011, an increase of $1,840,938. In 2008, District net assets were $148,137,901. In 2011, the majority of the District’s revenues (91.7%) was derived from water and wastewater service charges received from its ratepayers. The District also derives cash flows from connection charges (facility benefit charges) and investment earnings.

Additional assets are received from developers in the form of infrastructure donated to the District upon completion of their projects (developer donated plant).

Condensed Statement of Revenues, Expenses and Changes in Net Assets

	2011	2010	2009	2011-2010 Change	Change (%)
Operating Revenues:					
Sewer	$18,393,221	$17,003,151	$15,478,363	$1,390,070	8.2%
Water	13,229,750	12,400,875	12,302,415	828,875	6.7%
Other	1,521,562	1,400,309	1,138,470	121,253	8.7%
Less discounts	(1,299,465)	(1,180,318)	(1,135,100)	(119,147)	10.1%
Non-Operating Revenues:					
Facility benefit charges	927,800	1,078,460	1,069,814	(150,660)	-14.0%
Other	306,067	440,851	787,919	(134,784)	-30.6%
Total Revenues	33,078,935	31,143,328	29,641,881	$1,935,607	6.2%
Operating Expenses	32,305,125	28,322,977	27,649,424	3,982,148	14.1%
Non-Operating Expenses	133,881	176,743	206,524	(42,862)	-24.3%
Total Expenses	32,439,006	28,499,720	27,855,948	3,939,286	13.8%
Excess Before Plant Donation	639,929	2,643,608	1,785,933	(2,003,679)	-75.8%
Developer donated plant	1,201,009	1,886,328	1,205,644	(685,319)	-36.3%
Change in Net Assets	1,840,938	4,529,936	2,991,577	(2,688,998)	-59.4%
Beginning Net Assets	155,659,414	151,129,478	148,137,901	4,529,936	3.0%
Ending Net Assets	$157,500,352	$155,659,414	$151,129,478	1,840,938	1.2%

CAPITAL ASSETS AND DEBT ADMINISTRATION

By far the largest portion of the District's net assets (72.7%) is investment in capital assets (e.g. buildings, land, utility plant, and equipment). The District uses these capital assets to provide water and sewer services to residential and commercial ratepayers in the District. The unrestricted net assets of the District are available for future use to provide utility services.

As of December 31, 2011, the District's investment in capital assets for its activities, shown on the Statement of Net Assets as Capital Assets was $120,511,877 net of depreciation. This is an increase of $2,289,271 since December 31, 2010. Capital assets include land, improvements to land and land rights, buildings, building improvements, vehicles, machinery, equipment, utility plant, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Please refer to Note 3 on page 21.

The municipal construction industry has been hard hit by the recession and the slow recovery. During 2011 and 2010, the District, and other municipalities, received construction bids up to 40% below historical market prices. To take advantage of this trend, the District's Board of Commissioners has instructed staff to accelerate capital improvement construction using the District's accumulated reserves.

LONG-TERM DEBT

The District took advantage of favorable interest rates in 2003 by advance refunding of its outstanding 1995 Revenue Bonds, while at the same time, acquiring $4.2 million in new financing. In preparation for this event, the District made a presentation to Standard & Poors, the credit rating agency, in May 2003 and obtained an improved credit rating of "AA". An advance refunding transaction occurs when the District retires its outstanding bonds ahead of their scheduled due date with a new series of bonds. In most cases, the advance refunding results in lower debt service costs. Revenue bonds offer a number of distinct advantages. Much like a home mortgage, revenue bonds allow the District to spread out payments over 20 years. Instead of burdening today's ratepayers with the total cost of improvements, all users of the system over the next 20 years will shoulder that cost. Please refer to Note 6 of the financial statements on page 23. In 2008, Standard & Poor's updated the District's bond rating from "AA" to "AAA."

The District has historically sought Public Works Trust Fund loans issued by the Washington Public Works Board to finance its water and sewer capital projects. These loans are offered to competing public entities to fund capital projects. In 2010, the District applied for and in 2011 was awarded $3.105 million in State funding to construct a gravity sewer main bypass of the District's lift station 10. This lift station sits on the shores of Lake Washington. It is difficult to access, particularly during inclement weather, and its elimination will greatly reduce the District's environmental exposure should the lift station fail. The current annual interest rate on these loans ranges from 0.5% to 1.0%.

2010 was the last year that the District had revenue bond debt service payments in excess of $1 million. Bond principal payments dropped from $1,360,000 in 2010 to under $300,000 each year beginning in 2011 until the bonds are retired in 2023. In the absence of new debt, the total long-term debt principal outstanding after 2011 will be $2,705,000 for revenue bonds and $3,055,017 for Public Works Trust Fund (PWTF) loans.

Comparative Statement of Net Assets
As of December 31, 2011 and 2010

	2011	2010
ASSETS		
Current assets		
Cash and cash equivalents	$ 34,184,872	$ 34,033,191
Accounts receivable	3,430,438	3,284,178
Estimated unbilled service revenue	1,648,096	1,719,176
Restricted Assets:		
Construction Fund:		
Cash and cash equivalents	2,961,812	3,284,644
Revenue Bond Fund:		
Cash and cash equivalents	1,320,203	1,287,197
Inventory	775,316	233,586
Other current assets - prepaid items	129,807	127,185
TOTAL CURRENT ASSETS	44,450,544	43,969,157
Non-current & Other Assets		
Assessments receivable	354,116	457,266
Installment contracts receivable	397,710	432,658
Unamortized bond discount & issuance costs	49,257	53,613
Other restricted assets	-	425
Capital Assets		
Non-depreciable - land & land rights	2,633,577	2,633,577
Depreciable assets:		
Buildings	9,478,659	8,478,242
Data processing and office equipment	1,711,263	1,713,653
Engineering equipment and vehicles	4,526,732	4,208,927
Sewer utility plant	85,076,803	82,931,628
Water utility plant	80,543,940	77,794,354
Less: Accumulated depreciation	(71,474,367)	(67,500,493)
Construction in progress	8,015,270	7,962,718
Total Capital Assets	120,511,877	118,222,606
TOTAL NON-CURRENT & OTHER ASSETS	121,312,960	119,166,568
TOTAL ASSETS	$ 165,763,504	$ 163,135,725

The notes to these financial statements are an integral part of this statement

Comparative Statement of Net Assets
As of December 31, 2011 and 2010

	2011	2010
LIABILITIES		
Current liabilities		
Accounts payable	$ 1,137,234	$ 818,498
Accrued employee benefits	257,712	262,392
Other liabilities	22,879	73,025
Current portion of State Public Trust Fund Loans	366,850	443,160
Payables from Restricted Assets		
Accounts payable	501,793	523,243
Accrued interest payable	16,667	19,073
Current portion of Revenue Bonds	200,000	190,000
TOTAL CURRENT LIABILITIES	2,503,135	2,329,391
Non-current Liabilities:		
State Public Trust Fund Loans	3,055,017	2,241,920
Payables from Restricted Assets:		
Revenue Bonds	2,705,000	2,905,000
TOTAL PAYABLES - RESTRICTED ASSETS	5,760,017	5,146,920
TOTAL LIABILITIES	8,263,152	7,476,311
NET ASSETS		
Invested in capital assets, net of related debt	115,552,943	113,075,687
Restricted assets - facilities construction and debt service	4,282,015	4,571,841
Unrestricted	37,665,394	38,011,886
TOTAL NET ASSETS	157,500,352	155,659,414
TOTAL LIABILITIES AND NET ASSETS	$ 165,763,504	$ 163,135,725

The notes to these financial statements are an integral part of this statement

Comparative Statement of Revenues, Expenses, and Changes in Net Assets
For the Years Ended December 31, 2011 and 2010

	2011	2010
OPERATING REVENUES		
Utility Sales - Sewer service	$ 18,393,221	$ 17,003,151
Utility Sales - Water service	13,229,750	12,400,875
Utility Sales - Street light service	417,755	423,416
Less discounts and adjustments	(1,299,465)	(1,180,318)
Net Utility Sales	30,741,261	28,647,124
Other Operating Revenue	1,103,807	976,893
Total Operating Income	31,845,068	29,624,017
OPERATING EXPENSES		
Sewage treatment charge	12,363,771	10,955,777
Water purchased for resale	4,743,305	5,080,848
Cost of street lighting	311,767	312,452
Maintenance	4,462,101	3,167,656
Administration - General	5,525,341	4,240,254
Depreciation	4,054,495	3,820,044
Property, Excise, and B&O Tax	844,345	745,946
Total Operating Expenses	32,305,125	28,322,977
OPERATING INCOME (LOSS)	(460,057)	1,301,040
NON-OPERATING REVENUES (EXPENSES)		
Connection fees	927,800	1,078,460
Assessment interest income	64,678	62,918
Investment interest income	233,839	374,474
Gain from disposition of assets	7,550	3,459
Reimbursement agreement costs	-	(18,270)
Bond and loan interest expense	(129,221)	(153,813)
Bond discount, issuance, and registration costs	(4,660)	(4,660)
Total Non-operating Revenues	1,099,986	1,342,568
Income Before Extraordinary Items and Capital Contributions	639,929	2,643,608
Capital Contributions - Developer donated plant	1,201,009	1,886,328
CHANGE IN NET ASSETS	1,840,938	4,529,936
TOTAL NET ASSETS, January 1	155,659,414	151,129,478
TOTAL NET ASSETS, December 31	$ 157,500,352	$ 155,659,414

The notes to these financial statements are an integral part of this statement

Comparative Statement of Cash Flows
For the Years Ended December 31, 2011 and 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts for utility services	$ 31,836,906	$ 30,696,131
Payments to wholesale service providers	(17,665,997)	(16,458,687)
Payments for state and local taxes	(844,345)	(745,946)
Payments for payroll & related costs	(3,945,517)	(3,930,257)
Payments for administration & operations	(6,048,802)	(3,476,397)
Net cash provided by operating activities	3,332,245	6,084,844
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of capital assets - equipment	(1,396,454)	(1,201,781)
Purchase of system expansion	(3,675,223)	(5,544,368)
Receipts from connection fees	927,800	1,060,190
Principal paid on capital debt	546,787	(1,884,429)
Interest paid on capital debt	(179,367)	(105,602)
Net receipts on disposal of capital assets	7,550	3,459
Net cash used in capital and related financing activities	(3,768,907)	(7,672,531)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest on investments	233,839	374,474
Interest on contracts	25,223	29,252
Interest on assessments	39,455	33,666
Net cash provided by investing activities	298,517	437,392
Net decrease in cash and cash equivalents	(138,145)	(1,150,295)
Cash balance - beginning of year	38,605,032	39,755,327
Cash balance - end of year	$ 38,466,887	$ 38,605,032
NON-CASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:		
Contribution of capital assets from developers *	$ 1,201,009	$ 1,886,328

* Utility plant donated by developers is recorded at the contract price paid by the developer for the facilities accepted by the district.

The notes to these financial statements are an integral part of this statement

Comparative Statement of Cash Flows
For the Years Ended December 31, 2011 and 2010

	2011	2010
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income	$ (460,057)	$ 1,301,040
Adjustments to reconcile operating income to net cash Provided by operating activities:		
Depreciation expense	4,054,495	3,820,044
Changes in assets and liabilities		
Increase (decrease) in accounts receivable	(8,162)	1,072,114
(Increase) decrease in inventory	(541,730)	37,244
Increase in other current assets	(2,501)	(9,628)
(Decrease)/increase in accounts payable	297,286	(94,889)
(Decrease)/increase in accrued payroll benefits	(4,680)	10,580
Decrease in other current liabilities	(2,406)	(51,661)
Net cash provided by operating activities	$ 3,332,245	$ 6,084,844

The notes to these financial statements are an integral part of this statement

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Northshore Utility District conform to generally accepted accounting principals (GAAP) as applicable to proprietary funds of governments. The following is a summary of the most significant policies (including identification of those policies which result in material departures from generally accepted accounting principles):

a. Reporting Entity

Northshore Utility District is a municipal corporation governed by an elected five-member board. As required by generally accepted accounting principles, management has considered all potential component units in defining the reporting entity. The District has no component units.

b. Basis of Accounting and Presentation

The accounting records of the District are maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09 RCW.

The District uses the full-accrual basis of accounting where revenues are recognized when earned and expenses are recognized when incurred. An exception to full accrual is that interest on assessments is recorded when received. Capital asset purchases are capitalized and long-term liabilities are accounted for in the appropriate funds.

The District distinguishes between operating revenues and expenses from non-operating ones. Operating revenues and expenses result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. The principle operating revenues of the District are charges to ratepayers for water and sewer services. Operating expenses of the District include the cost of sales and services, administration expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Unbilled utility service receivables are recorded at year-end. Operating income includes gains and losses from the disposal of capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

c. Cash and Cash Equivalents

For purposes of the statement of cash flows, the District considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents. The District maintains a deposit relationship with a local commercial bank, which was selected through the contracting of treasury services provided by King County.

d. Capital Assets

See Note 3

e. Restricted Funds

In accordance with bond resolutions (and certain related agreements) separate restricted depository accounts are required to be established. These depository accounts are with King County, the *ex-officio* Treasurer for the District. King County refers to these depository accounts as "funds." The assets held in these "funds" are restricted for specific uses, including construction, debt service, and other special reserve requirements. Restricted "funds" currently include the following:

Water Construction Fund	$ 1,651,609
Sewer Construction Fund	1,310,203
Bond Reserve Fund	970,791
Debt Service	349,412

Assets and liabilities shown as current in the accompanying statement of net assets exclude current maturities on revenue bonds and accrued interest thereon because debt service funds are provided for their payment.

f. Receivables

The District records receivables when billing takes place. The District takes advantage of its authority to lien properties with delinquent utility charge balances. Such liens are recorded with the appropriate County Recorder and are maintained until the balances are paid in full. Interest is assessed on these liens until paid. For this reason, there is not an allowance for bad debts.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

g. Inventory

Inventory is valued at the average acquisition cost, which approximates the market value. The District performs an annual physical inventory count.

h. Investments

District funds not required for immediate expenditure are invested via King County, the District's *ex-officio* treasurer, in the King County Investment Pool (Pool). Investments are stated at cost. For various risks related to the investments, see Deposits and Investments Note No. 2 on page 19.

i. Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. The District records unpaid leave for compensated absences as an expense and liability when incurred.

Vacation pay, which may be accumulated up to 240 hours, is payable upon resignation, retirement or death. Sick leave may accumulate indefinitely and is payable upon the following conditions:

- The District will pay 100% of accrued and unused sick leave upon the death of an active employee.
- The District allows supervisors, confidential employees and management employees to cash-out up to 56 hours of accrued and unused sick leave per year only if the employee still has 200 hours or more of unused sick leave after the cash-out.
- The District allows all other employees to convert into vacation up to 48 hours of accrued and unused sick leave per year only if the employee still has 200 hours or more of unused sick leave prior to the conversion.
- The employee may only cash out or convert accrued sick leave hours credited during the preceding calendar year less any sick leave used during the same calendar year.
- The District does not pay for unused sick leave upon termination of employment.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (concluded)

j. Unamortized Debt Expenses

Costs relating to the sale of bonds are deferred and amortized over the lives of the respective bond issues.

k. Construction Financing

The District has issued revenue bonds for long-term financing of capital improvements. See Note No. 6 on page 23.

In 1985, the District started a series of public works projects to replace aging components of District's sewer and water systems. The District also funds these select capital improvements of the District's sewer and water systems from accumulated reserves. Where applicable, property owners connecting to these facilities in the future will reimburse the District for the cost of these projects plus interest. In some instances, the District has started these projects in response to customer's needs, such as failed septic systems. In other instances, the District has tried to install facilities prior to major street resurfacing projects by King County and other municipalities for cost savings.

Developers also build regular system extensions. Upon the completion of the project, the developer donates those installed facilities to the District. Developer donations are recorded at the developer's cost of the improvements.

l. Financial Statement Reclassifications

Certain reclassifications were made to the 2010 financial statement presentation to conform with the 2011 financial statement presentation.

NOTE 2 – DEPOSITS AND INVESTMENTS

a. Deposits

The District's deposits are entirely covered by federal depository insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC).

b. Investments

In accordance with State law, the District's governing body has entered into a formal interlocal agreement with the District's *ex officio* treasurer, King County, to have all its funds not required for immediate expenditure invested in the King County Investment Pool (Pool). As of December 31, 2011, the District had the following investments:

Year	Investment Type	Fair Value	Effective Duration
2011	King County Investment Pool	$38,563,054	0.72 Years
2010	King County Investment Pool	$38,716,987	0.71 Years

Impaired Investments. As of December 31, 2011, all impaired commercial paper investments have completed enforcement events. The King County impaired investment pool (Impaired Pool) held one commercial paper asset where the Impaired Pool accepted an exchange offer and is receiving the cash flows from the investment's underlying securities. The Impaired Pool also held the residual investments in four commercial paper assets that were part of completed enforcement events, where the Impaired Pool accepted the cash-out option. The District's share of the impaired investment pool is $289,534 and the districts unrealized loss for these investments is $162,869.

Interest Rate Risk. As of December 31, 2011, the Pool's average duration to maturity was 0.72 years. As a means of limiting its exposure to rising interest rates, securities purchased in the Pool must have a final maturity, or weighted average life, no longer than five years. While the Pool's market value is calculated on a monthly basis, unrealized gains and losses are not distributed to participants. The Pool distributes earnings monthly using an amortized cost methodology.

Credit risk. As of December 31, 2011, the District's investment in the Pool was not rated by a nationally recognized statistical rating organization (NRSRO). In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency securities, and mortgage-backed securities,

NOTE 2 – DEPOSITS AND INVESTMENTS (concluded)

municipal securities (rated at least “A” by two NRSROs), commercial paper (rated at least the equivalent of “A” by two NRSROs), commercial paper (rated at least the equivalent of “A-1” by two NRSROs), certificates of deposits issued by qualified public depositories, repurchase agreements, and the Local Government Investment Pool managed by the Washington State Treasurer’s Office.

NOTE 3 – CAPITAL ASSETS

Capital assets are defined by the District as assets with initial individual cost of more than $5,000 and an estimated useful life in excess of one year.

Major expenses for capital assets such as major repairs that increase useful lives are capitalized. Maintenance, repairs, and minor renewals are accounted for as expenses when incurred.

Utility plants in service and other capital assets are recorded at cost. Donations by developers are recorded at the developer’s cost.

Capital asset activity for the year ended December 31, 2011, was as follows:

2011

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not being depreciated:				
Land & land rights	$ 2,633,577	$ -	$ -	$ 2,633,577
Construction in progress	7,962,718	5,527,964	(5,475,412)	8,015,270
Total capital assets not being depreciated	10,596,295	5,527,964	(5,475,412)	10,648,847
Capital assets being depreciated:				
Buildings	8,478,242	1,000,417	-	9,478,659
Data processing and office equipment	1,713,653	-	(2,390)	1,711,263
Engineering equipment and vehicles	4,208,927	396,036	(78,231)	4,526,732
Sewer utility plants	82,931,628	2,145,175	-	85,076,803
Water utility plants	77,794,354	2,749,586	-	80,543,940
Total capital assets being depreciated	175,126,804	6,291,214	(80,621)	181,337,397
Less accumulated depreciation for:				
Buildings	(3,278,792)	(304,469)	-	(3,583,261)
Equipment and vehicles	(4,509,592)	(481,114)	80,621	(4,910,085)
Sewer utility plants	(25,282,413)	(1,633,363)	-	(26,915,776)
Water utility plants	(34,429,696)	(1,635,549)	-	(36,065,245)
Total accumulated depreciation	(67,500,493)	(4,054,495)	80,621	(71,474,367)
Total Capital Assets, net	$ 118,222,606	$ 7,764,683	$ (5,475,412)	$ 120,511,877

NOTE 3 – CAPITAL ASSETS (continued)

2010

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not being depreciated:				
Land & land rights	$ 2,633,577	$ -	$ -	$ 2,633,577
Construction in progress	7,499,226	6,587,571	(6,124,079)	7,962,718
Total capital assets not being depreciated	10,132,803	6,587,571	(6,124,079)	10,596,295
Capital assets being depreciated:				
Buildings	8,343,169	135,073	-	8,478,242
Data processing and office equipment	1,683,021	32,628	(1,996)	1,713,653
Engineering equipment and vehicles	3,337,092	1,030,621	(158,786)	4,208,927
Sewer utility plants	80,589,334	2,956,408	(614,114)	82,931,628
Water utility plants	73,276,153	5,109,732	(591,531)	77,794,354
Total capital assets being depreciated	167,228,769	9,264,462	(1,366,427)	175,126,804
Less accumulated depreciation for:				
Buildings	(2,976,473)	(302,319)	-	(3,278,792)
Equipment and vehicles	(4,201,205)	(334,836)	26,449	(4,509,592)
Sewer utility plants	(23,661,839)	(1,620,574)	-	(25,282,413)
Water utility plants	(32,867,381)	(1,562,315)	-	(34,429,696)
Total accumulated depreciation	(63,706,898)	(3,820,044)	26,449	(67,500,493)
Total Capital Assets, net	$ 113,654,674	$ 12,031,989	$ (7,464,057)	$ 118,222,606

The original cost of operating property retired or otherwise disposed of and the cost of installation, less salvage, is charged to accumulated depreciation. However, in the case of the sale of a significant operating unit or system, the original cost is removed from the utility plant accounts, accumulated depreciation related to the property sold is charged, and the net gain or loss on disposition is credited or charged to income.

Capital assets are depreciated using straight-line method of depreciation over the following estimated useful lives:

Buildings	20 to 30 years
Vehicles	3 to 10 years
Office and Engineering Equipment	3 to 10 years
Utility Plants	10 to 50 years

NOTE 3 – CAPITAL ASSETS (concluded)

Preliminary costs incurred for proposed projects are deferred pending construction of the facility. Costs relating to projects ultimately constructed are transferred to utility plant; charges that relate to abandoned projects are expensed.

NOTE 4 – CONSTRUCTION IN PROGRESS

Construction in progress represents expenses to date on capital projects, which were $8,015,270 in 2011 and $7,962,718 in 2010. Project details as of December 31, 2011, and 2010, were as follows:

PROJECT	2011	2010
2010 CIPP Rehabilitation	$ -	$ 115,544
PRV Rehabilitation	51,124	46,161
Inglemoor Pump House Improvement	462,521	273,955
Inglemoor Transmission Main	23,511	-
SR 522 Phase I Water Main	119,852	119,852
SR 522 Phase II Water Main	1,573,719	1,573,719
SR 522 West Phase Water Main	23,194	23,194
2010 Water Main Replacement Phase 1 &2	44,513	81,482
Lift Station 10 Rehabilitation	1,723,847	321,234
Lift Station 19 Improvements	65,431	65,431
Other Miscellaneous Projects	1,492,608	1,059,457
Regional Water Authority (RWA)	507,352	497,107
116/80 Water Main Extension	295,497	-
116/98 Ave NE Waterman Replacement	-	1,456,127
193/49 Sewer Extension	-	148,470
Northshore Ridge	960,097	960,097
NUD headquarters building HVAC control	-	671,915
Decant Facility	672,004	548,973
Total Construction in Progress	$ 8,015,270	$ 7,962,718

NOTE 5 – LEASE COMMITMENTS

The District had no lease commitments for the periods ended December 31, 2011, and 2010.

NOTE 6 – LONG-TERM DEBT

a. Revenue Bonds

The annual requirements to amortize the 2003 Revenue Bonds outstanding as of December 31, 2011, including interest rates are as follows:

Payment Date	2003 Revenue Bonds	Interest Rate
May 1, 2012 *	200,000	3.20%
May 1, 2013	205,000	3.40%
May 1, 2014	210,000	3.40%
May 1, 2015	215,000	3.55%
May 1, 2016	225,000	3.55%
May 1, 2017	235,000	3.80%
May 1, 2018	245,000	3.80%
May 1, 2019	250,000	4.00%
May 1, 2020	265,000	4.00%
May 1, 2021	275,000	4.00%
May 1, 2022	285,000	4.10%
May 1, 2023	295,000	4.15%
	$2,905,000	

* 2012 maturing bond was reclassified as current portion of long-term debt in 2011 reporting.

NOTE 6 – LONG-TERM DEBT (continued)

The 2003 issue was a combination refunding and new financing revenue bond and was rated as "AA" by Standard & Poor's. Of the bond proceeds, $4,665,000 was used to finance capital projects and $5,335,000 was used to redeem the 1995 bonds at par on May 15, 2003. This issue consists of term bonds maturing from 2004 to 2023. The bonds maturing in years 2004 through 2013 are not subject to optional redemption prior to maturity. Bonds maturing on or after May 1, 2014, are subject to redemption at the option of the District, in whole or in part (and, if in part, with maturities to be selected by the District) on any date, on or after May 1, 2013, at the price of par plus accrued interest, if any, to the date of redemption.

The District set aside $1,320,203 in restricted assets exclusively for debt purposes. These represent sinking funds and reserve requirements as contained in the bond indenture.

There are other limitations and restrictions contained in the bond indenture. The District is in compliance with all significant limitations and restrictions.

The District has one outstanding bond issue:

Revenue Bond	**Date of Issue**	**Maturity Date**	**Amount of Original Issue**	**Outstanding as of 12/31/11**
2003 Revenue Bonds	05/15/03	05/01/23	$ 10,000,000	$ 2,905,000
Total:	Revenue Bonds	Outstanding	$ 10,000,000	$ 2,905,000

NOTE 6 – LONG-TERM DEBT (continued)

b. Junior Lien Loans

The District had junior lien loans of $3,421,867 as of December 31, 2011, and $2,685,080 as of December 31, 2010, from the Washington Public Works Trust Fund, including current portions of $366,850 for 2011 and $443,160 for 2010.

The District has seven loans currently outstanding from the Washington State Public Works Trust Fund.

Year	Term in Years	Interest Rate	Received Proceeds	Loan Balance as of 12/31/11
1992	20	1.0%	$ 2,205,000	$ 117,418
1995	20	1.0%	661,138	139,187
1996	20	1.0%	1,896,300	504,897
2002	20	0.5%	408,000	238,425
2004	20	0.5%	862,570	594,711
2005	20	0.5%	878,454	647,281
2011	20	0.5%	1,179,948	1,179,948
			$ 8,091,410	$ 3,421,867
Less current maturity				(366,850)
Long-term portion				$ 3,055,017

The proceeds from these low interest 20-year loans are used for water main replacement and sewer main extension programs. The principal is repaid in up to twenty-five equal annual installments. In 2011, the District was awarded another low interest loan. As of December 31, 2011, $1,179,948 of the proceeds have been drawn. The total proceeds awarded are $3,105,000. The remaining proceeds are expected to come in 2012. Payments will start in 2013. At year-end 2011, $366,850 of the $3,055,017 loans outstanding was reclassified as a current liability.

The District has not obtained short-term debt in the past. It does not anticipate obtaining short-term debt in the future.

NOTE 6 – LONG-TERM DEBT (continued)

c. Combined Long-Term Debt Service Schedule

	2003 Revenue Bond Issuance		Public Works Trust Fund Loans		Total
Year	Principal	Interest	Principal	Interest	Cash Flow
2012	$ 200,000	$ 106,698	$ 366,850	$ 17,967	$ 691,515
2013	205,000	100,013	311,535	17,817	634,365
2014	210,000	92,958	311,535	15,580	630,073
2015	215,000	85,571	311,535	13,344	625,450
2016-2020	1,220,000	298,001	979,775	42,708	2,540,484
2021-2031	855,000	37,434	1,140,638	26,103	2,059,175
Total	$2,905,000	$720,675	$3,421,868	$133,519	$7,181,062

d. Changes in Long-Term Liabilities

During the year ended December 31, 2011, the following changes occurred in long-term liabilities:

	Beginning Balance 01/01/11	Additions	Reductions	Ending Balance 12/31/11	Due Within One Year
Bonds Payable	$3,095,000	$ -	($190,000)	$2,905,000	$ 200,000
Public Works Trust Fund Loans	$2,685,080	$1,179,948	($443,160)	$ 3,421,868	$366,850

	Beginning Balance 01/01/10	Additions	Reductions	Ending Balance 12/31/10	Due Within One Year
Bonds Payable	$4,455,000	$ -	($1,360,000)	$3,095,000	$190,000
Public Works Trust Fund Loans	$3,209,509	$ -	($ 524,429)	$2,685,080	$443,159

NOTE 6 – LONG-TERM DEBT (continued)

Debt service coverage requirements as determined by the 2003 bond covenants are as follows:

	2011 District Total	2010 District Total
Net Service Revenue	$ 31,845,068	$ 29,624,017
Cost of service	(17,418,843)	(16,349,077)
Net operating & administrative expense	(14,886,282)	(11,973,900)
Net operating income (loss)	(460,057)	1,301,040
Interest / Investment income:		
From assessments	64,678	62,918
From investments	233,839	374,474
Gain from asset sale	7,550	3,458
Total Interest / Investment income	306,067	440,850
Income available for debt service	(153,990)	1,741,890
Other source of funds:		
Matured assessments	103,149	111,122
Facility benefit charges	927,800	1,078,460
Total Other sources	1,030,949	1,189,582
Total available for debt service	876,959	2,931,472
Debt service coverage required	(566,850)	(633,160)
Excess (deficit) coverage requirement	$ 310,109	$ 2,298,312

NOTE 6 – LONG-TERM DEBT (continued)

The reserve balances required by the covenants of the 2003 revenue bond issue are:

2011

Debt service reserve:

Average annual debt service	$303,489
Applicable coverage factor per bond covenants	1.25
Lesser of:	
(A) Average annual debt service times coverage factor	379,361
(B) Maximum annual debt service	306,698
(C) 10% of bonds outstanding	290,500
Debt service reserve required by bond covenants:	290,500
Actual reserve balance:	
Cash	970,791
Balance in excess of requirement	$680,291

NOTE 6 – LONG-TERM DEBT (concluded)

2010

Debt service reserve:

Average annual debt service	$303,432
Applicable coverage factor per bond covenants	1.25
Lesser of:	
(A) Average annual debt service times coverage factor	379,290
(B) Maximum annual debt service	306,698
(C) 10% of bonds outstanding	309,500
2003 Debt service reserve requirement by bond covenants:	306,698
Actual reserve balance:	
Cash	964,974
Balance in excess of requirement	$658,276

NOTE 7 – PENSION PLAN

Substantially all of the District's full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380 or it may be downloaded from the DRS website at www.drs.wa.gov. The following disclosures are made pursuant to GASB Statement No. 27 *Accounting for Pensions by State and Local Government Employers* and Statement No. 50, *Pension Disclosures, an Amendment of GASB Statements No. 25 and No. 27.*

Public Employees' Retirement System (PERS) Plans 1, 2, and 3

Plan Description

The Legislature established PERS in 1947. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts (other than judges currently in the Judicial Retirement System); employees of legislative committees; community and technical colleges, college and university employees not participating in higher education retirement programs; judges of district and municipal courts; and employees of local governments. PERS retirement benefit provisions are established in Chapter 41.34 and 41.40 RCW and may be amended only by the State Legislature.

PERS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a combined defined benefit plan with a defined contribution component.

PERS members who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977 and by either, February 28, 2002 for state and higher education employees, or August 31, 2002 for local government employees, are Plan 2 members unless they exercised an option to transfer their membership to Plan 3. PERS members joining the system on or after March 1, 2002 for state and higher education employees, or September 1, 2002 for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or PERS

NOTE 7 – PENSION PLAN (continued)

Plan 3. The option must be exercised within 90 days of employment. An employee is reported in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. Notwithstanding, PERS Plan 2 and Plan 3 members may opt out of plan membership if terminally ill, with less than five years to live.

PERS Plan 1 and Plan 2 defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions.

PERS Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The monthly benefit is 2 percent of the average final compensation (AFC) per year of service. (AFC is the monthly average of the 24 consecutive highest-paid service credit months.) The retirement benefit may not exceed 60 percent of AFC. The monthly benefit is subject to a minimum for PERS Plan 1 retirees who have 25 years of service and have been retired 20 years, or who have 20 years of service and have been retired 25 years. Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarially reduced benefits. If a survivor option is chosen, the benefit is further reduced. A cost-of-living allowance (COLA) was granted at age 66 based upon years of service times the COLA amount. This benefit was eliminated by the Legislature, effective July 1, 2011. Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity payable to the age of 60. The allowance amount is $350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any workers' compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60. A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the allowance amount is 2 percent of the AFC for each year of service reduced by 2 percent for each year that the member's age is less than 55. The total benefit is limited to 60 percent of the AFC and is actuarially reduced to reflect the choice of a survivor option. A cost-of-living allowance was granted at age 66 based upon years of service times the COLA amount. This benefit was eliminated by the Legislature, effective July 1, 2011. Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the

NOTE 7 – PENSION PLAN (continued)

Consumer Price Index. The adjustment is capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 members can receive credit for military service. Members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years of service. The monthly benefit is 2 percent of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

PERS Plan 2 members who have at least 20 years of service credit and are 55 years of age or older are eligible for early retirement with a reduced benefit. The benefit is reduced by an early retirement factor (ERF) that varies according to age, for each year before age 65.

PERS Plan 2 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions:

- With a benefit that is reduced by 3 percent for each year before age 65.
- With a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return to work rules.

PERS Plan 2 retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit; and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at 3 percent annually.

The surviving spouse or eligible child or children of a PERS 2 Plan member who dies after leaving eligible employment having earned ten years of service credit may request a refund of the member’s accumulated contributions.

Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. The defined benefit portion provides a monthly benefit that is 1 percent of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

Effective June 7, 2006, Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service, if twelve months

NOTE 7 – PENSION PLAN (continued)

of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

Vested Plan 3 members are eligible for normal retirement at age 65, or they may retire early with the following conditions and benefits:

- If they have at least ten service credit years and are 55 years old, the benefit is reduced by an ERF that varies with age, for each year before age 65.

- If they have 30 service credit years and are at least 55 years old, they have the choice of a benefit that is reduced by 3 percent for each year before age 65; or a benefit with a smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.

PERS Plan 3 defined benefit retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit and Plan 3 provides the same cost-of- living allowance as Plan 2.

PERS Plan 3 defined contribution retirement benefits are solely dependent upon contributions and the results of investment activities.

The Defined contribution portion can be distributed in accordance with an option selected by the member, either as a lump sum or pursuant to other options authorized by the Director of the Department of Retirement Systems.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2 percent of the AFC per year of service. For Plan 3, the monthly benefit amount is one percent of the AFC per year of service.

These disability benefit amounts are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option. There is no cap on years of service credit, and a cost-of-living allowance is granted (based on the Consumer Price Index) capped at 3 percent annually.

PERS Plan 2 and Plan 3 members may have up to ten years of interruptive military service credit; five years at no cost and five years that may be purchased by paying the required contributions. Effective July 24, 2005, a member who becomes totally incapacitated for continued employment while serving the

NOTE 7 – PENSION PLAN (continued)

uniformed services or a surviving spouse or eligible children, may apply for interruptive military service credit. Additionally, PERS Plan 2 and Plan 3 members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS members may also purchase up to five years of additional service credit once eligible for retirement. This credit can only be purchased at the time of retirement and can be used only to provide the member with a monthly annuity that is paid in addition to the member's retirement benefit.

Beneficiaries of a PERS Plan 2 or Plan 3 member with ten years of service who is killed in the course of employment receive retirement benefits without actuarial reduction, if the member was not at normal retirement age at death. This provision applies to any member killed in the course of employment, on or after June 10, 2004, if found eligible by the Department of Labor and Industries.

A one-time duty-related death benefit is provided to the estate (or duly designated nominee) of a PERS member who dies in the line of service as a result of injuries sustained in the course of employment, or if the death resulted from an occupational disease or infection that arose naturally and proximately out of said member's covered employment, if found eligible by the Department of Labor and Industries.

There are 1,197 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2010:

Retirees and Beneficiaries Receiving Benefits	$76,899
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	28,860
Active Plan Members Vested	105,521
Active Plan Members Non-vested	51,005
Total	**$262,285**

Funding Policy

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at six percent for state agencies and local government unit employees, and seven and a half percent for state government elected officials. The employer and employee contribution rates for Plan 2 and the employer

NOTE 7 – PENSION PLAN (continued)

contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan and member contributions finance the defined contribution portion. The Plan 3 employee contribution rates range from 5 percent to 15 percent, based on member choice. Two of the options are graduated rates dependent on the employee's age. As a result of the implementation of the Judicial Benefit Multiplier Program in January 2007, a second tier of employer and employee rates was developed to fund, along with investment earnings, the increased retirement benefits of those justices and judges that participate in the program.

The methods used to determine the contribution requirements are established under state statute in accordance with Chapter 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2011, and 2010, were as follows:

2011	**PERS Plan I**	**PERS Plan II**	**PERS Plan III**
Employer (a)	7.25% (b)	7.25% (b)	7.25% (c)
Employee	6.00% (d)	4.64% (d)	(e)

2010	**PERS Plan I**	**PERS Plan II**	**PERS Plan III**
Employer (a)	5.31% (b)	5.31% (b)	5.31% (c)
Employee	6.00% (d)	3.90% (d)	(e)

(a) The employer rates include the employer administrative expense fee currently set at 0.16%.

(b) The employer rate for state elected officials is 10.80% for Plan 1 and 7.25% for Plan 2 and Plan 3.

(c) Plan 3 defined benefit portion only.

(d) The employee rate for state elected officials is 7.50% for Plan 1 and 4.64% for Plan 2.

(e) Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

Both the District and the employees made the required contributions. The District's required contributions for the years ending December 31 were as follows:

NOTE 7 – PENSION PLAN (concluded)

	PERS Plan 1	PERS Plan 2	PERS Plan 3
2011	$ 5,150	$ 194,274	$ 9,914
2010	$ 7,746	$ 163,191	$ 7,967
2009	$ 9,864	$ 205,371	$ 5,376

NOTE 8 – PRIOR PERIOD ADJUSTMENTS

The District had no prior period adjustments for 2011 and 2010.

NOTE 9 – JOINT VENTURES

Snohomish River Regional Water Authority (SRRWA)

From the early 1950s to 1992, the Weyerhaeuser Company (Weyco) owned and operated a pulp mill in Everett, Washington, using a water right that allowed up to 36 million gallons per day (mgd) to be drawn from the adjacent Snohomish River for industrial use. Although Weyco closed the mill, it kept the 36 mgd water right.

In 1996, three public water utilities – The City of Everett, the Northshore Utility District (Northshore), and Woodinville Water District (Woodinville) – formed the SRRWA, and acquired Weyerhaeuser's water right to help meet water demands projected for the SRRWA service area. The Washington State Department of Ecology approved the water right transfer, with an instantaneous withdrawal rate of 36 mgd and an annual quantity of 23.7 mgd. Following completion of the water right change process and related litigation, the SRRWA has engaged in strategic planning, preliminary engineering, and costing work to assess capital project development and operational path issues. This work is ongoing and projected to achieve initial beneficial use of the SRRWA water right by 2021, unless an extension is requested and granted.

In December 2004, the District signed a fixed quantity long-term supply agreement with Seattle Public Utilities (SPU). The supply quantity in the 60-year agreement is sufficient to supply the District for the duration of the agreement. This gives the District ample time to develop the Weyco source for the future. The District's goal is to have supply from both regional systems (Seattle and Everett) for added reliability. Since the cost for planning is not significant, the partners have agreed to explore all possible ways to develop the new source over the coming years. Transmission systems would need to be built to deliver the water to Northshore and/or Woodinville. Portions of the existing transmission systems might be utilized, including the new Clearview pipeline and reservoir. However, additional new pipelines would still be needed to extend from Clearview to Northshore and

NOTE 9 – JOINT VENTURES (concluded)

Woodinville. Any use of the Clearview pipeline and reservoir would need to be negotiated with the Clearview Water Supply Agency, which owns those facilities.

NOTE 10 – RISK MANAGEMENT

The District is a member of the Washington Cities Insurance Authority (WCIA).

Utilizing Chapter 48.62 RCW (self-insurance regulation) and Chapter 39.34 RCW (Interlocal Cooperation Act), nine cities originally formed WCIA on January 1, 1981. WCIA was created for the purpose of providing a pooling mechanism for jointly purchasing insurance, jointly self-insuring, and / or jointly contracting for risk management services. WCIA has a total of 153 Members.

New members initially contract for a three-year term, and thereafter automatically renew on an annual basis. A one-year withdrawal notice is required before membership can be terminated. Termination does not relieve a former member from its unresolved loss history incurred during membership.

Liability coverage is written on an occurrence basis, without deductibles. Coverage includes general, automobile, public officials' errors or omissions, stop gap, and employee benefits liability. Limits are $4 million per occurrence self-insured layer, and $16 million per occurrence in the re-insured excess layer. The excess layer is insured by the purchase of reinsurance and insurance and is subject to aggregate limits. Total limits are $20 million per occurrence subject to aggregate sublimits in the excess layers. The Board of Directors determines the limits and terms of coverage annually.

Insurance coverage for property, automobile physical damage, fidelity, inland marine, and boiler and machinery are purchased on a group basis. Various deductibles apply by type of coverage. Property insurance and auto physical damage are self-funded from the members' deductible to $750,000, for all perils other than flood and earthquake, and insured above that amount by the purchase of insurance.

In-house services include risk management consultation, loss control field services, claims and litigation administration, and loss analyses. WCIA contract for the claims investigation consultants for personnel issues and land use problems, insurance brokerage, and lobbyist services.

WCIA is fully funded by its members, who make annual assessments on a prospectively rated basis, as determined by an outside, independent actuary. The assessment covers loss, loss adjustment, and administrative expenses. As

NOTE 10 – RISK MANAGEMENT (concluded)

outlined in the interlocal agreement, WCIA retains the right to additionally assess the membership for any funding shortfall.

An investment committee, using investment brokers, produces additional revenue by investment of WCIA's assets in financial instruments which comply with all State guidelines. These revenues directly offset portions of the membership's annual assessment.

A Board of Directors governs WCIA, which is comprised of one designated representative from each member. The Board elects an Executive Committee and appoints a Treasurer to provide general policy direction for the organization. The WCIA Executive Director reports to the Executive Committee and is responsible for conducting the day to day operations of WCIA.

ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

Our mission is to work with our audit clients and citizens as an advocate for government accountability. As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

The State Auditor's Office employees are located around the state to deliver services effectively and efficiently.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments and fraud, whistleblower and citizen hotline investigations.

The results of our work are widely distributed through a variety of reports, which are available on our Web site and through our free, electronic subscription service.

We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive quality assurance program.

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