Washington State Auditor's Office

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Financial Statements Audit Report

Northshore Utility District

King County

For the period January 1, 2013 through December 31, 2014

Published December 31, 2015

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Washington State Auditor's Office

December 31, 2015

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,

Troy X. Kelley

TROY KELLEY

STATE AUDITOR

OLYMPIA, WA

NOTE 4 – CONSTRUCTION IN PROGRESS (concluded)

PROJECT	2014	2013
CIP: Lift Station 10 Rehab C811	-	$4,285,162
CIP: HQ Improvements	-	2,448,922
CIP: HQ Improvements	-	2,231,597
CIP: Northshore Ridge Combined **SEE ALSO 190-00-C653**	-	482,398
CIP: Northshore Ridge Combined **SEE ALSO 190-00-C653**	-	482,398
CIP: SPWP 68/HPD Geotech C586	-	427,114
CIP: 162/81 Rd Repair & Main Rplcmt	-	331,493
CIP: Truck 97	-	93,518
CIP: 133/88 Water Main Ext.	-	89,625
CIP: 2010 Water Main Replacement Phase 2 C893	-	44,513
CIP: 2010 PRV Rehabilitation C864	-	30,329
Total Construction in Progress	$12,692,624	$18,826,457

NOTE 5 – LEASE COMMITMENTS

The District had no lease commitments for the periods ended December 31, 2014 and 2013.

NOTE 6 – LONG-TERM DEBT

a. Junior Lien Loans

The District had junior lien loans of $4,147,450 as of December 31, 2014 and $4,559,514 as of December 31, 2013 from the Washington Public Works Trust Fund, including current portions of $412,447 for both 2014 and 2013.

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

NOTE 6 – LONG-TERM DEBT (continued)

Year	Term in Years	Interest Rate	Proceeds Received	Loan Balance as of 12/31/14
1995	20	1.0%	$661,138	$34,797
1996	20	1.0%	1,896,300	201,959
2002	20	0.5%	408,000	173,400
2004	20	0.5%	862,570	457,470
2005	20	0.5%	878,454	508,579
2011	20	0.5%	3,105,000	2,771,245
			$7,811,462	$4,147,450
			Less current maturity	(412,447)
			Long-term portion	$3,735,003

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 equal annual installments.

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 (concluded)

b. Long-Term Debt Service Schedule

Year	Public Works Trust Fund Loans Principal	Public Works Trust Fund Loans Interest	Total Cash Flow
2015	412,447	14,993	427,440
2016	377,650	12,659	390,309
2017	276,671	10,674	287,345
2018	276,671	9,698	286,369
2019	276,671	8,722	285,393
2020-2024	1,340,005	29,082	1,369,087
2025-2029	861,307	10,420	871,727
2030-2031	326,028	1,223	327,251
Total	$4,147,450	$97,471	$4,244,921

c. Changes in Long-Term Liabilities

During the years ended December 31, 2014 and 2013 the following changes occurred in long-term liabilities:

	Beginning Balance 1/1/2014	Additions	Reductions	Ending Balance 12/31/2014	Due Within One Year
Public Works Trust Fund Loans	$4,559,514	$0	($412,063)	$4,147,451	$412,447

	Beginning Balance 1/1/2013	Additions	Reductions	Ending Balance 12/31/2013	Due Within One Year
Bonds Payable	$2,705,000	$0	($2,705,000)	$0	$0
Public Works Trust Fund Loans	$4,980,069	$0	($420,555)	$4,559,514	$412,447

NOTE 7 – PENSION PLAN

Substantially all District 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 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 Statements 27, *Accounting for Pensions by State and Local Government Employers* and 50*, Pension Disclosures, an amendment of GASB Statements 25 and 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; employees of legislative committees; employees of district and municipal courts; and employees of local governments. Membership also includes higher education employees not participating in higher education retirement programs. Approximately 49 percent of PERS salaries are accounted for by state employment. PERS retirement benefit provisions are established in Chapters 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 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 Plan 3. The option must be exercised within 90 days of employment. Employees who fail to choose within 90 days default to Plan 3. PERS is comprised of and reported as three separate plans for accounting purposes: Plan 1, Plan 2/3, and Plan 3. Plan 1 accounts for the defined benefits of Plan 1 members. Plan 2/3 accounts for the defined benefits of Plan 2 members, and the defined benefit portion of benefits for Plan 3 members. Plan 3 accounts for the defined contribution portion of benefits for Plan 3 members. Although

NOTE 7 – PENSION PLAN (continued)

members can only be a member of either Plan 2 or Plan 3, the defined benefit portions of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of this Plan 2/3 may legally be used to pay the defined benefits of any of the Plan 2 or Plan 3 members or beneficiaries, as defined by the terms of the plan. Therefore, Plan 2/3 is considered to be a single plan for accounting purposes.

PERS Plan 1 and Plan 2 retirement benefits are financed from a combination of investment earnings and employer and employee contributions. Employee contributions to the PERS Plan 1 and Plan 2 defined benefit plans accrue interest at a rate specified by the Director of DRS. During DRS' Fiscal Year 2013, the rate was five and one-half percent compounded quarterly. Members in PERS Plan 1 and Plan 2 can elect to withdraw total employee contributions and interest thereon, in lieu of any retirement benefit, upon separation from PERS-covered employment. PERS Plan 1 members are vested after the completion of five years of eligible service. PERS Plan 1 members are eligible for retirement from active status at any age with at least 30 years of service, at age 55 with 25 years of service, or at age 60 with at least 5 years of service. Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarially reduced benefits.

The monthly benefit is 2 percent of the average final compensation (AFC) per year of service, but the benefit may not exceed 60 percent of the AFC. The AFC is the monthly average of the 24 consecutive highest-paid service credit months.

PERS Plan 1 retirement benefits are actuarially reduced to reflect the choice, if made, of a survivor option.

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 for duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity. The benefit amount is $350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any worker's compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60, at which time the benefit is converted to the member's service retirement amount.

A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the benefit 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

NOTE 7 – PENSION PLAN (continued)

reduced to reflect the choice of a survivor option. Plan 1 members may elect to receive an optional COLA amount (based on the Consumer Price Index), capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

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. The AFC is the monthly average of the 60 consecutive highest-paid service months. 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 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, if hired prior to May 1, 2013:

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

PERS Plan 2 members hired on or after May 1, 2013 have the option to retire early by accepting a reduction of 5 percent for each year of retirement before age 65. This option is available only to those who are age 55 or older and have at least 30 years of service.

PERS Plan 2 retirement benefits are actuarially reduced to reflect the choice, if made, of a survivor option.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component and member contributions finance a defined contribution component. As established by Chapter 41.34 RCW, employee contribution rates to the defined contribution component range from 5 percent to 15 percent of salaries, based on member choice. Members who do not choose a contribution rate default to a 5 percent rate. There are currently no requirements for employer contributions to the defined contribution component of PERS Plan 3.

NOTE 7 – PENSION PLAN (continued)

PERS Plan 3 defined contribution retirement benefits are dependent upon the results of investment activities. Members may elect to self-direct the investment of their contributions. Any expenses incurred in conjunction with self-directed investments are paid by members. Absent a member's self-direction, PERS Plan 3 contributions are invested in the Retirement Strategy Fund that assumes the member will retire at age 65.

For DRS' Fiscal Year 2013, PERS Plan 3 employee contributions were $99.0 million, and plan refunds paid out were $69.4 million.

The defined benefit portion of PERS Plan 3 provides members a monthly benefit that is 1 percent of the AFC per year of service. The AFC is the monthly average of the 60 consecutive highest-paid service months. There is no cap on years of service credit, and Plan 3 provides the same cost-of-living allowance as Plan 2.

Effective June 7, 2006, PERS 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 of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 by 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, and were hired before May 1, 2013, 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.
- If they have 30 service credit years, are at least 55 years old, and were hired after May 1, 2013, they have the option to retire early by accepting a reduction of 5 percent for each year before age 65.

PERS Plan 3 benefits are actuarially reduced to reflect the choice, if made, of a survivor option.

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 1 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

NOTE 7 – PENSION PLAN (continued)

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 members meeting specific eligibility requirements have options available to enhance their retirement benefits. Some of these options are available to their survivors.

A one-time duty-related death benefit is provided to the beneficiary or the estate of a PERS member who dies 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 the member's covered employment, if found eligible by the Department of Labor and Industries.

There are 1,176 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2013:

Retirees and Beneficiaries Receiving Benefits	85,328
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	31,047
Active Plan Members Vested	150,706
Active Plan Members Non-Vested	101,191
Total	368,272

Funding Policy

Each biennium, the state Pension Funding Council adopts PERS Plan 1 employer contribution rates, PERS Plan 2 employer and employee contribution rates, and PERS Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6 percent for state agencies and local government unit employees, and at 7.5 percent for state government elected officials. The employer and employee contribution rates for Plan 2 and the employer 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. 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.

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

NOTE 7 – PENSION PLAN (concluded)

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2014 and 2013, are as follows:

2014	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer (a)	9.21% (b)	9.21% (b)	9.21% (c)
Employee	6.00% (d)	4.92% (d)	(e)
2013			
Employer (a)	9.21% (b)	9.21% (b)	9.21% (c)
Employee	6.00% (d)	4.92% (d)	(e)

(a) The employer rates include the employer administrative expense fee currently set at 0.18%.
(b) The employer rate for state elected officials is 13.73% for Plan 1 and 9.21% 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 4.92% 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 ended December 31 were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
2014	$5,588	$329,199	$6,474
2013	$4,912	$282,753	$6,726
2012	$4,557	$238,169	$11,906

NOTE 8 – PRIOR PERIOD ADJUSTMENTS

The District had no prior period adjustments for 2014 or 2013.

NOTE 9 – JOINT VENTURE

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

Until it is determined that this joint venture will ever be used to supply water to the District's customers, all costs incurred are being expensed immediately. There are, however, amounts that have been capitalized over the years. The capitalized amounts on the District's books include land valued at $264,610 and construction in progress of $181,611.

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 162 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, police, public officials' errors or omissions, stop gap, and employee benefits liability. Limits are $4 million per occurrence in the self-insured layer, and $16 million per occurrence in the reinsured 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 sub-limits 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 contracts 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 outlined in the inter-local, 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.

NOTE 10 – RISK MANAGEMENT (concluded)

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.

NOTE 11 – PENDING LITIGATION

There was no pending litigation as of December 31, 2014.

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.

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

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.

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 as well as fraud, state whistleblower and citizen hotline investigations.

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

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

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