Washington State Auditor's Office

Financial Statements Audit Report

Shoreline Water District
King County

Audit Period
January 1, 2012 through December 31, 2012

Report No. 1010910

Issue Date
December 23, 2013

WASHINGTON
TROY KELLEY
STATE AUDITOR

Washington State Auditor
Troy Kelley

December 23, 2013

Board of Commissioners
Shoreline Water District
Shoreline, Washington

Report on Financial Statements

Please find attached our report on the Shoreline Water 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

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Shoreline Water District
King County
January 1, 2012 through December 31, 2012

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Shoreline Water District
King County
January 1, 2012 through December 31, 2012

Board of Commissioners
Shoreline Water District
Shoreline, Washington

We have audited, 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, the financial statements of the Shoreline Water District, King County, Washington, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated December 10, 2013.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the District's financial statements are free from 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*.

PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. 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.

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

December 10, 2013

Independent Auditor’s Report on Financial Statements

Shoreline Water District
King County
January 1, 2012 through December 31, 2012

Board of Commissioners
Shoreline Water District
Shoreline, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Shoreline Water District, King County, Washington, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District’s basic financial statements as listed on page 5.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Shoreline Water District, as of December 31, 2012, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 8 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 to be 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 our 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.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 2013 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

December 10, 2013

Financial Section

Shoreline Water District
King County
January 1, 2012 through December 31, 2012

REQUIRED SUPPLEMENTARY INFORMATION

BASIC FINANCIAL STATEMENTS

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.

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 Position* presents information on the District's assets and liabilities, with the difference between the two reported as net position per GASB 34. Increases or decreases in net position may serve as an 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. Assets whose use is subject to constraints that are externally imposed, such as those imposed by creditors through debt covenants, are defined as Restricted Assets. Funds without a designated purpose are called Unrestricted.

The *Statement of Revenues, Expenses, and Changes in Net Position* 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 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 the full understanding of the data provided in the District's financial statements. The notes to the financial statements can be found on pages 11 through 20 of this report.

Financial Analysis

The overall financial condition of the District remains strong with an increase in net position of $852,740 in 2012. The increase is almost entirely due to an increase of $870,665 in Total Assets as Total Liabilities remained relatively constant in 2012. The increase in Total Assets is due to an excess of cash operating revenues (from a nearly 15% rate increase) over cash operating expenses. This excess was used to fund the capital costs related to purchasing District assets, reducing debt principal, and funding an escrow account for developer extensions – see Note 8. While the increase of $17,926 in Total Liabilities is relatively small it is comprised of a more significant decrease in long-term liabilities and a similar increase in all other liabilities. Long-term liabilities decreased by $458,214 from the payment of principal on long-term debt, and from a decrease in compensated absences, which occurred with the payment of accrued leave for two retired employees. The decrease in long-term liabilities is offset by an increase in accounts payable for construction activities. Other liabilities increased by $476,140 largely due to deposits received from developers for system expansion.

The amount invested (or equity) in capital assets of $17,466,656 is the net book value of all District assets of $21,766,549 less the amount funded with outstanding debt of $4,299,893 (not shown in the financial statements). Please refer to Note 3 for more information regarding the composition of fixed assets. During a period of construction, which is funded primarily with debt proceeds (currently the case for the District), the amount invested in capital assets is expected to decline if depreciation expense exceeds debt principal payments related to the constructed assets, which it does by $497,935. The restricted position of $3,795,857 is comprised of the District's sinking fund and bond fund reserves. The increase in the restricted position is entirely due to an increase in the sinking fund reserves from a rate funded capital transfer less amounts used to fund escrow accounts for two joint ventures in developer extensions – see Note 8. The unrestricted balance of $3,706,840 represents the assets available for the future use in providing utility service.

Condensed Comparative Statement of Net Position

	2012	2011	2010	2012-2011 Change
Current and Other Assets	$ 14,578,020	$ 15,669,688	$ 10,058,983	$ (1,091,667)
Capital Assets	21,766,549	19,804,217	17,212,309	1,962,333
Total Assets	36,344,570	35,473,904	27,271,292	870,665
Long-term Liabilities	9,614,247	10,072,461	1,908,822	(458,214)
Other Liabilities	1,760,970	1,284,830	726,558	476,140
Total Liabilities	11,375,217	11,357,291	2,635,380	17,926
Invested in Capital Assets	17,466,656	17,964,590	15,062,622	(497,935)
Restricted	3,795,857	4,098,582	5,835,422	(302,726)
Unrestricted	3,706,840	2,053,440	3,737,868	1,653,400
Total Net Position	$ 24,969,353	$ 24,116,613	$ 24,635,912	$ 852,740

The majority of the District's revenues are derived from water service charges received from its ratepayers. The District also derives cash flow from connection charges and interest. The significant increase in water service revenues of $739,409 in 2012 over 2011 is due to an increase in water service rates of approximately fifteen percent. Other operating income increased due to higher rental rates for water tower antennas. The increase of $594,259 in operating expenses is driven by the following items: Water purchases increased by nearly twenty percent due to a rate increase from Seattle Public Utilities; Utility taxes increased due to higher revenues; Depreciation expense increased due to the capitalization of a number of Capital Improvement Projects (CIP) in 2011 (depreciation expense is delayed until the year after capitalization); General operations, maintenance, and administration increased from a combination of one-time costs for temporary office space required while the new administrative building is under construction, personnel cost increases, and from higher than normal use of outside consultants for one-time or special projects. Personnel costs were higher due to a cost of living increase in wages, step increases for several employees, and higher health care benefits costs. The projects driving outside consulting costs higher ranged from negotiating a new interlocal agreement with the City of Lake Forest Park, revising and renewing all water tower leases, establishing joint ventures with two local developers (see Note 8), increased regional involvement for legal counsel, and a comprehensive cost-of-service rate study. Non-operating revenues increased from higher interest costs from the 2011 bond issue. Capital contributions remain on par with 2011.

Condensed Comparative Statement of Revenues and Expenses and Changes in Net Position

	2012	2011	2010	2012-2011 Change
Water Service	$ 5,855,780	$ 5,116,371	$ 4,595,157	$ 739,409
Other Operating Revenue	181,876	142,336	251,359	39,540
Facility Benefit Charges	-	-	211,030	-
Other Non-Operating Revenue	98,078	98,804	105,448	(725)
Total Revenues	6,135,734	5,357,511	5,162,994	778,223
Operating Expenses	5,089,904	4,495,645	3,744,852	594,259
Non-Operating Expenses	262,015	114,697	51,659	147,318
Total Expenses	5,351,918	4,610,341	3,796,511	741,577
Excess before Contributions	783,816	747,170	1,366,483	36,646
Capital Contributions	68,924	60,238	-	8,686
Change in Net Position	852,740	807,408	1,366,483	45,332
Beginning Net Position	24,116,613	24,635,912	23,269,429	(519,299)
Prior Period Adjustments	-	(1,326,707)	-	1,326,707
Ending Net Position	$ 24,969,353	$ 24,116,613	$ 24,635,912	$ 852,740

Capital Assets and Debt Administration

The majority of the District's net assets are invested in capital assets (e.g. buildings, land, lines, and equipment). The District uses these capital assets to provide water service to residential and commercial customers in the District.

As of December 31, 2012, the District's investment in capital assets shown on the Statement of Net Position as Capital Assets is $21,766,549 net of depreciation. This is an increase of $1,962,333 since December 31, 2011. Capital assets include land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, infrastructure, 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.

Long-Term Debt

The District uses long-term debt to help fund its capital projects in the form of revenue bonds and, for qualifying projects, low interest loans from the Washington State Department of Commerce.

Bond covenants require the District to fund reserves in its Bond Redemption Fund at a level at least equal to the average amount required in any calendar year to pay the principal of and interest on the outstanding bonds. The District issued revenue bonds in December 2011 – see Note 6.

In 2012, the District was approved to receive Drinking Water State Revolving Fund loan monies for two capital projects totaling approximately $4.4 million. The District expects to expend all available funds in 2013. Due to the amount of the loans, the District will be subject to a Federal audit under the Single Audit Act guidelines.

Shoreline Water District
STATEMENT OF NET POSITION
As of December 31, 2012

ASSETS	
Current Assets:	
Cash and Cash Equivalents	$ 703,131
Accounts Receivable (Net)	1,103,654
Inventories	281,165
Prepayments	79,641
TOTAL CURRENT ASSETS	2,167,591
Non-Current Assets:	
Deferred Charges - (NOTE 10)	416,010
Restricted Assets (*Cash & Cash Equivalents*) - (NOTE 1))	
Public Works Trust Fund	42,345
Revenue Bond Fund	772,148
Sinking Fund	2,981,364
Construction Fund	8,183,975
Customer Deposits	14,588
Capital Assets Not Being Depreciated:	
Land - (NOTE 3)	936,244
Construction in Progress - (NOTE 4)	2,703,194
Capital Assets Being Depreciated: (NOTE 3)	
Buildings	512,669
Equipment	1,547,182
Infrastructure	25,895,269
Vehicles	682,614
Intangibles *(Amortized)*	298,819
Less Accumulated Depreciation	(10,809,443)
Total Capital Assets (Net)	21,766,549
TOTAL NONCURRENT ASSETS	34,176,978
TOTAL ASSETS	36,344,570
LIABILITIES	
Current Liabilities:	
Accounts Payable - Maint	610,639
Accrued Employee Benefits	48,032
Other Liabilities	444,322
Accrued Interest Payable	65,433
Current Portion of Public Works Trust Fund Loans - (NOTE 6)	82,545
Current Portion of Long-Term Debt - (NOTE 6)	510,000
TOTAL CURRENT LIABILITIES	1,760,970
Non-Current Liabilities:	
Accounts Payable - Construction	493,259
Compensated Absences	92,987
Public Works Trust Fund Loans - Net of Current Portion - (NOTE 6)	49,537
Long-Term Debt - Net of Current Portion - (NOTE 6)	8,875,000
Bond Premium	103,463
TOTAL NONCURRENT LIABILITIES	9,614,247
TOTAL LIABILITIES	11,375,217
NET POSITION	
Net Investment in Capital Assets	17,466,656
Restricted for Debt Service and Capital Construction	3,795,857
Unrestricted	3,706,840
TOTAL NET POSITION	**$ 24,969,353**

The notes to the financial statement are an integral part of this statement.

Shoreline Water District

STATEMENT OF REVENUES, EXPENSES & CHANGES IN NET POSITION

As of December 31, 2012

OPERATING REVENUE	
Utility Sales and Service Fees	$ 5,855,780
Other Operating Revenue	181,876
Total Operating Income	6,037,656
OPERATING EXPENSES	
Operations:	
Water Purchased for Resale	1,325,316
Adjustment on Utility Sales	5,233
General Operations	815,840
Maintenance	189,576
Customer Service	162,141
Administration:	
General Administration	1,046,318
Planning, Conservation, Research & Development	202,653
Depreciation and Amortization	765,333
Francise Fees	309,088
Property, Excise, and B&O Taxes	268,407
Total Operating Expenses	5,089,904
OPERATING INCOME	**947,752**
NON-OPERATING REVENUES (EXPENSES)	
Investment Interest Income	98,078
Bond and Loan Interest Expense	(262,074)
Other Non-Operating Expense	59
Total Non-Operating Revenues (Expenses)	(163,936)
Capital Contributions	68,924
CHANGE IN NET POSITION	852,740
TOTAL NET POSITION, January 1	24,116,613
TOTAL NET POSITION, December 31	**$ 24,969,353**

The notes to the financial statement are an integral part of this statement.

Shoreline Water District

STATEMENT OFCASH FLOWS

As of December 31, 2012

CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash Received from Customers	$	5,863,290
Cash Payments to Suppliers for Goods & Services		(3,083,414)
Cash Payments for Payroll and Related Costs		(1,399,717)
NET CASH PROVIDED BY OPERATING ACTIVITIES		**1,380,159**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Capital Contributions		68,924
Developer Deposits (Net of Costs)		360,591
Contributions to WSEA Escrow Accounts		(416,010)
Cash Payments for Capital Construction & Acquisition		(2,498,354)
Bond Issue Cost Refund		3,000
Principal Paid on Revenue Bonds		(480,000)
Interest Paid on Revenue Bonds		(201,014)
Principal Paid on Public Works Trust Fund Loan		(82,545)
Interest Paid on Public Works Trust Fund Loan		(2,146)
TOTAL CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		**(3,247,553)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received on Investments (Net of Fees)		100,939
CASH FLOWS FROM INVESTING ACTIVITIES		**100,939**
NET INCREASE (DECREASE IN CASH AND CASH EQUIVALENTS		**(1,766,455)**
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR		14,463,833
CASH AND CASH EQUIVALENTS - END OF YEAR		**12,697,378**
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
OPERATING INCOME (LOSS)	**$**	**959,992**
ADJUSTMENTS TO RECONCILE NET OPERAING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATIONS:		
Depreciation & Amortization Expense	$	765,333
Decrease (Increase) in Inventory		(62,751)
Decrease (Increase) in Accounts Receivable		(174,366)
Decrease (Increase) in Prepaid Expense		(24,816)
Increase (Decrease) in Other Payables		(109,291)
Increase (Decrease) in Maintenance Accounts Payable		(81,376)
Accrued Non-Metered Water Costs - (NOTE 8)		107,433
NET CASH PROVIDED BY OPERATING ACTIVITIES	**$**	**1,380,159**

The accompanying notes are an integral part of these statements.

Shoreline Water District
NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the District conform to generally accepted accounting principles (GAAP) as applicable to proprietary funds of governments. GASB is the accepted standard setting body for establishing governmental accounting and financial reporting principles. In June 1999, GASB approved Statement 34, *Basic Financial Statements – and Management Discussion and Analysis – for State and Local Governments.* This and consecutive statements are reflected in the accompanying financial statements (including notes to the financial statements). The following is a summary for the most significant policies (including identification of those policies, which result in material departures from GAAP:

a. Reporting Entity

The District is a municipal corporation governed by an elected three-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. Unbilled utility service receivables are recorded at year-end. Operating income includes gains and losses from the disposal of utility plant.

New Accounting Standards - For the year ended December 31, 2012, the District implemented GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position.

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. All District deposits are covered by Federal Depository Insurance Corporation (FDIC) and are selected through the contracting of treasurer services through King County.

d. Capital Assets – See Note 3

e. Restricted Funds

In accordance with bond resolutions (and certain related agreements) separate restricted funds are required to be established. The assets held in these funds are restricted for specific uses, including construction, debt service and other special reserve requirements. Restricted funds as of December 31, 2012 include the following:

PWTF Debt Fund	$ 42,345
Bond Fund	772,148
Sinking Fund	2,981,364
Construction Fund	8,183,975
Deposits	14,588

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.

e. Receivables

The District records receivables when billing takes place. The District takes advantage of its authority to lien properties with delinquent utility balances. Such liens are recorded with King County 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.

f. Inventories

Inventory is valued at the average acquisition cost, which approximates the market value. All items are physically counted at year-end.

g. 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 13.

h. 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 360 hours, is payable upon resignation, retirement or death. Sick leave may accumulate up to 520 hours as of December 31 of each calendar year. With the exception of the District Manager, accumulated sick leave is not paid upon termination of employment.

i. Revenues and Expenses

OPERATING REVENUE is defined as those revenues generated from the sale of utility services and all associated administrative charges directly connected to those services. Non-operating revenues are defined as those revenues not meeting the definition of operating revenue.

OPERATING EXPENSES are those direct costs necessary for providing water services. Non-operating expenses are all other expenses not meeting the definition of an operating expense.

j. Unamortized Debt Expenses

Costs relating to the sale of bonds are deferred and amortized over the life of the bond issue.

k. Construction Financing

The District has issued revenue bonds for long-term financing of capital improvements. The District also takes advantage of Public Works Trust Fund Loans made available through the Washington State Department of Commerce for public works projects. See Note No. 6 on page 15 for additional information. Developers also build regular system extensions. Upon the completion of the project, the developer donates those main lines to the District.

Other Current Assets – Pre-paid items

Prepaid expenses are those costs which are paid up front for short term future use. One such prepaid item is insurance. As noted in Note 11, the District carries insurance through the Washington Governmental Entities Pool and pays for this coverage bi-annually. Since the monies are paid in advance of the coverage, the amount allocated to future periods is noted as a pre-paid expense. The District also includes applies funds toward its postage meter and postage permit.

l. Intangible Assets

The District defers costs for intangible assets for a period of time equal to its estimated useful life. As of December 31, 2012, the District's intangible assets $298,819. See Note 3.

NOTE 2 – DEPOSITS AND INVESTMENTS

a. Deposits

The District's deposits are covered by federal depository insurance (FDIC). The Public Deposit Protection Commission of the State of Washington (PDPC) also provides limited coverage of the Districts funds held by King County. The PDPC is a statutory authority which constitutes a multiple financial institution collateral pool that can make pro rata assessments to all public depositories within the state of up to ten percent (10%) of all their public deposits. For more information, please refer to Note 2 of these financial statements.

b. Investments

In accordance with state investment laws, the District's governing body has entered into a formal interlocal agreement with King County, its *ex officio* treasurer, to have all funds not required for immediate expenditure invested in the King County Investment Pool (Pool). As of December 31, 2012, the District had the following investments:

Investment Type	Fair Value	Effective Duration
King County Investment Pool	$12,635,281	.72 Years

Impaired Investments: As of December 31, 2012, 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 principle is $47,110.72.

Interest Rate Risk. As of December 31, 2012, the Pool's average duration 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 2012, 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, municipal securities (rated at least "A" by two NRSROs), commercial paper (rated at least the equivalent of "A-1" by tow 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. Capital assets for the year ended December 31, 2012 were as shown in the following table:

	2012 Beg Bal	2012 Activity Increase	2012 Activity Decrease / Adjustment	2012 End Bal
UTILITY PLANT NOT BEING DEPRECIATED				
Land	$ 936,244	$ -	$ -	936,244
Construction-in-Progress	2,469,731	2,687,812	(2,454,348)	2,703,194
TOTAL UTILITY PLANT NOT BEING DEPRECIATED	**$ 3,405,975**	**$ 2,687,812**	**$ (2,454,348)**	**$ 3,639,438**
UTILITY PLANT BEING DEPRECIATED/AMORTIZED				
Building & Structures	$ 512,669	$ -	$ -	$ 512,669
Machinery & Equipment	1,507,328	39,854	-	1,547,182
Vehicles	682,614	-	-	682,614
Infrastructure	23,565,940	2,454,348	(125,019)	25,895,269
Intangibles *(Amortized)*	358,583	-	(59,764)	298,819
TOTAL UTILITY PLANT BEING DEPRECIATED	**$ 26,627,135**	**$ 2,494,203**	**$ (184,783)**	**$ 28,936,554**
LESS ACCUMULATED DEPRECIATION FOR:				
Building & Structures	$ (287,293)	$ (1,388)	$ -	$ (288,681)
Machinery & Equipment	(857,565)	(46,367)	-	(903,932)
Vehicles	(315,861)	(30,026)	-	(345,887)
Infrastructure	(8,768,174)	(627,788)	125,019	(9,270,943)
TOTAL ACCUMULATED DEPRECIATION	**$ (10,228,893)**	**$ (705,569)**	**$ 125,019**	**$ (10,809,443)**
UTILITY PLANT BEING DEPRECIATED (NET)	**$ 16,398,242**	**$ 1,788,633**	**$ (59,764)**	**$ 18,127,111**
TOTAL UTILITY PLANT, NET	**$ 19,804,217**	**$ 4,476,445**	**$ (2,514,112)**	**$ 21,766,549**

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
Equipment	3 to 10 years
Infrastructure	10 to 50 years
Vehicles	3 to 10 years

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. The construction in progress as of December 31, 2012 was as follows:

CONSTRUCTION IN PROGRESS *As of December 31, 2012*		
Telemetry Upgrades	$	27,590
NE 185th/187th (#30)		78,945
3.7MG Reservoir Exterior recoat		94,614
Pump Station Pre-Design		498,192
Space Needs		1,746,219
Shop Building		7,500
Comprehensive Plan		250,134
TOTAL	**$**	**2,703,194**

NOTE 5 – LEASE COMMITMENTS

In February 2012 the District entered into a one-year lease, at $5,500 a month, for temporary office space during the construction of a new administration building. The lease has a provision to extend the lease month-to-month after January of 2012, if needed. The District expects to use the leased space until the fall of 2013.

NOTE 6 - LONG-TERM DEBT

a. Revenue Bonds

The District issued Water Revenue Bonds in December 31, 2012 in the amount of $9,865,000. These bonds bear interest rates ranging from 2.0% to 4.0% and are payable semi-annually each April 1 and October 1. A portion of the bond principle matures each October 1 beginning in the year 2012 through 2031.	$ 9,385,000
Total Bond Restricted Debt	$ 9,385,000

b. Junior Lien Loans

The District had junior lien loans of $214,628 as of December 31, 2012 from the Washington Public Works Trust Fund.

1993	PWTF Loan	$ 33,008
1994	PWTF Loan	99,074
	Total PWTF long-term debt	132,082
	Less current portion	(82,545)
	Net long-term PWTF Debt	$ 49,537

The proceeds from these low interest 20-year loans are used for water main replacement programs. The principal will be repaid in equal annual installments. As of December 31, 2012, the District has drawn all available proceeds of all approved loans. At year-end 2012, $82,545 of the $132,082 in loans outstanding was reclassified as a current liability.

c. Short-term Debt

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

Combined Long Term Debt Service Schedule

	2011 Revenue Bond Principal	2011 Revenue Bond Interest	PWTF Loan Principal	PWTF Loan Interest	COMBINED ANNUAL DEBT SERVICE
2013	$ 510,000	$ 256,448	$ 82,545	$ 991	$ 849,984
2014	520,000	246,248	49,536	495	816,279
2015	525,000	235,848			760,848
2016	540,000	225,348			765,348
2017	555,000	214,548			769,548
2018	565,000	203,448			768,448
2019	580,000	192,148			772,148
2020-2025	2,540,000	911,474			3,451,474
2026-2031	3,050,000	400,665			3,450,665
	$ 9,385,000	**$ 2,886,175**	**$ 132,082**	**$ 1,486**	**$ 12,404,743**

Changes in Long-Term Liabilities

During the year ended December 31, 2010, the following changes occurred in long-term liabilities: The District's compensated absence liability represents the amount owed to District employees upon separation from District employment. See Note 1h for more information regarding compensated absences. This liability decreased from $185,171 at year end 2011 to $92,987 at December 31, 2012.

	Beginning Balance 1/1/2012	Additions	Reductions	Ending Balance 12/31/2012	Due Within One Year
Revenue Bonds Payable	$ 9,865,000	$ -	$ (480,000)	$ 9,385,000	$ 510,000
PWTF Loans	214,626	-	(82,545)	132,082	82,545
Total LT Liabilities	$ 10,079,626	$ -	$ (562,545)	$ 9,517,082	$ 592,545

NOTE 7– PENSION PLAN

Substantially all 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 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 the GASB Statement 27, *Accounting for Pensions by State and Local Government Employers* and the GASB Statement 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

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/defined contribution plan. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts (other than judges currently in a judicial retirement system); employees of legislative committees, community and technical colleges, college and university employees (not in national higher education retirement programs); judges of district and municipal courts, and employees of local governments. PERS participants 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 exercise an option to transfer their membership to Plan 3. PERS participants 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 choice of joining PERS 2 or the irrevocable option of choosing membership in PERS 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 with in 90 days default into PERS Plan 3. PERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PERS retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

PERS Plan 1 retirement benefits are vested after an employee completes five years of eligible service. Plan 1 members are eligible for retirement at any age 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 annual benefit is two percent of the average final compensation per year of service capped at 60 percent. The average final compensation is based on the greatest compensation during any 24 eligible consecutive compensation months. If qualified, after reaching the age of 66, a cost-of-living allowance is granted based on years of service credit and is capped at three percent annually. Plan 1 members may also elect to receive an optional cost of living allowance amount that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at three percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

Plan 2 retirement benefits are vested after an employee completes five years of eligible service. Plan 2 members may retire at the age of 65 with five years of service, or at the age of 55 with 20 years of service, with an allowance of two percent of the average final compensation per year of service. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period. Plan 2 retirements prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a three percent per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit; and a cost-of-living allowance is granted (indexed to the Consumer Price Index – U, Seattle), capped at three percent annually.

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 benefit calculated at 1 percent of the average final compensation per year of service. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period. Plan 3 members become eligible for retirement if they have: at least ten years of service; or five years including twelve months that were earned after age 54; or five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 retirees prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a three percent per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit; and Plan 3 provides the same cost-of-living allowance as Plan 2. 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 Employee Retirement Benefits Board.

There are 1,184 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2012:

Retirees and Beneficiaries Receiving Benefits	79,363
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	29,925
Active Plan Members	105,578
Active Plan Members Non-Vested	46,839

Funding Policy

Each biennium, the state Pension Funding Council adopts Plan 1 and Plan 3 employer contributions rates, and Plan 2 employer and employee 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 officers. 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. All employers are required to contribute at the level established by the Legislature. PERS Plan 3 defined contribution is a non-contributing plan for employers. Employees who participate in the defined contribution portion of PERS Plan 3 do not contribute to the defined benefit portion of PERS Plan 3. The Employee Retirement Benefits Board sets Plan 3 employee contribution rates. Six rate options are available ranging from five to fifteen percent; two of the options are graduated rates dependent on the employee's age. The methods used to determine the contribution requirements are established under state statute in accordance with chapters 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current-year covered payrolls, as of December 31, 2012, were as follows:

	Plan I		**Plan II**		**Plan III**	
	Required	Actual	Required	Actual	Required	Actual
Employer	7.21%	7.21%	7.21%	7.21%	7.21%%	7.21%
Employee	6.00%	6.00%	4.64%	4.64%	5% to15%	5% to15%
Total	13.21%	13.21%	11.85%	11.85%	Up to 22.21%	Up to 22.21%

The employer rates include the employer administrative expense fee of 0.16%.

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

	PERS Plan 1	**PERS Plan 2**	**PERS Plan 3**
2012	0	$ 50,012	$ 17,546
2011	0	$ 52,259	$ 8,457
2010	0	$ 40,547	$ 8,918

NOTE 8 – JOINT VENTURES

The District has a long-term supply agreement with Seattle Public Utilities (SPU). SPU provides the District with all of its water. The supply quantity in the agreement is sufficient to supply the District for at least three decades. The District made direct water purchases from SPU in 2012 of $1,217,883, plus recorded an additional liability for unmetered water usage of $117,433. It is a long-standing policy of SPU to back-bill for unmetered water resulting from under-functioning meters. The total liability for unmetered water at December 31, 2012 was $383,930. The outstanding liability for unmetered water at December 31, 2011 was negotiated and paid in 2013.

During 2012 the District entered into two public-private partnerships with local developers - Development Services of America for a project adjacent to I-5, and the Inland Group for rebuilding the old YMCA into a new apartment complex in the North City area. In both cases additional fire flow was needed to support the development activity. Since the District had identified capital projects designed to increase the fire flow to these two areas within the next eight to ten years, they agreed to complete the projects early if the developers contributed approximately one-half of the project costs. Both developers agreed to these terms. The total savings to the District will be nearly $500,000.

NOTE 9 – RISK MANAGEMENT

The District is exposed to the risk of loss from torts, theft of or damage to assets, natural disasters, workers compensation, errors and omissions, and other general liabilities. .

Shoreline Water District is a member of Enduris. Chapter 48.62 RCW authorizes the governing body of any one or more governmental entity to form together into or join a pool or organization for the joint purchasing of insurance, and/or joint self-insuring, and/or joint hiring or contracting for risk management services to the same extent that they may individually purchase insurance, self-insure, or hire or contract for risk management services. An agreement to form a pooling arrangement was made pursuant to the provisions of Chapter 39.34 RCW, the Interlocal Cooperation Act. Enduris was formed July 10, 1987, when two (2) counties and two (2) cities in the State of Washington joined together by signing an Interlocal Governmental Agreement to pool their self-insured losses and jointly purchase insurance and administrative services. As of August 31, 2012, there are 468 Enduris members representing a broad range of special purpose districts.

Enduris allows members to jointly purchase excess insurance coverage, share in the self-insured retention, establish a plan for total self-insurance, and provide excellent risk management services and other related services. Enduris provides “occurrence” policies for all lines of liability coverage including Public Official’s Liability. The Property coverage is written on an “all risk” basis blanket form using current Statement of Values. The Property coverage includes mobile equipment, electronic data processing equipment, valuable papers, building ordinance coverage, property in transit, extra expense, consequential loss, accounts receivable, fine arts, inventory or appraisal cost, automobile physical damage to insured vehicles. Boiler and machinery coverage is included on a blanket limit of $100 million for all members. Enduris offers employee dishonesty coverage up to a liability limit of $1,000,000.

Members make an annual contribution to fund Enduris. Enduris acquires insurance from unrelated insurance companies that is subject to a “per occurrence”:

- $1,000,000 deductible on liability loss - the member is responsible for the first $1,000 of the deductible amount of each claim, while Enduris is responsible for the remaining $999,000 on liability loss;

- $250,000 deductible on property loss - the member is responsible for the first $1,000 of the deductible amount of each claim, while Enduris is responsible for the remaining $249,000 on property loss. Enduris is responsible for the $4,000 deductible on boiler and machinery loss.

Insurance carriers cover all losses over the deductibles as shown to the policy maximum limits. Since Enduris is a cooperative program, there is a joint liability among the participating members.

The contract requires members to continue membership for a period of not less than one (1) year and must give notice 60 days before terminating participation. The Master Agreement (Intergovernmental Contract) is automatically renewed after the initial one (1) full fiscal year commitment. Even after termination, a member is still responsible for contribution to Enduris for any unresolved, unreported and in-process claims for the period they were a signatory to the Master Agreement.

Enduris is fully funded by its member participants. Claims are filed by members with Enduris and are administered in house.

A Board of Directors consisting of seven (7) board members governs Enduris. Its members elect the Board and the positions are filled on a rotating basis. The Board meets quarterly and is responsible for conducting the business affairs of Enduris.

NOTE 10 – DEFERRED CHARGES

During 2012 the District entered into two public-private partnerships with local developers - Development Services of America for a project adjacent to I-5, and the Inland Group for rebuilding the old YMCA into a new apartment complex in the North City area. In both cases additional fire flow was needed to support the development activity. Since the District had identified capital projects designed to increase the fire flow to these two areas within the next eight to ten years, they agreed to complete the projects early if the developers contributed approximately one-half of the project costs. Both developers agreed to these terms. The total savings to the District will be nearly $500,000.

The District contributed 49% [$77,910] of the total expected cost for the YMCA apartment renovation project to an escrow account. The developer contributed 51% [$81,090] to the same escrow account. When the project is completed in 2013, the costs contributed by both the District and the developer will be reclassified as capital assets. Similarly, the District contributed 49% [$338,100] and the developer contributed 51% [$351,900] to an escrow account for the project adjacent to I-5.

NOTE 11 – SUBSEQUENT EVENTS

During 2013 the District purchased property adjacent to the administrative building for additional parking for $211,000. Also in 2013, the District entered into a purchase and sales agreement to acquire property for a new maintenance facility for $3,300,000. The purchase is expected to close by December 2013. It is located at 15555 15th Avenue NE, Shoreline, WA. The property that houses the current maintenance facility will be sold in 2014 or 2015 to offset the cost of new property.

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 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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Chief of Staff	**Doug Cochran**
Director of Performance and State Audit	**Chuck Pfeil, CPA**
Director of Local Audit	**Kelly Collins, CPA**
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Deputy Director of Communications	**Thomas Shapley**
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