



Washington State Auditor's Office

Government that works for citizens

Financial Statements and Federal Single Audit Report

North City Water District

King County

For the period January 1, 2015 through December 31, 2015

Published September 29, 2016

Report No. 1017294





Washington State Auditor's Office

September 29, 2016

Board of Commissioners
North City Water District
Shoreline, Washington

Report on Financial Statements and Federal Single Audit

Please find attached our report on the North City Water District's financial statements and compliance with federal laws and regulations.

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

Sincerely,

A handwritten signature in dark ink that reads "Troy X. Kelley".

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS

**North City Water District
King County
January 1, 2015 through December 31, 2015**

SECTION I – SUMMARY OF AUDITOR’S RESULTS

The results of our audit of the North City Water District are summarized below in accordance with Title 2 *U.S. Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

Financial Statements

We issued an unmodified opinion on the fair presentation of the basic financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP).

Internal Control over Financial Reporting:

- *Significant Deficiencies:* We identified deficiencies in the design or operation of internal control over financial reporting that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified no deficiencies that we consider to be material weaknesses.

We noted no instances of noncompliance that were material to the financial statements of the District.

Federal Awards

Internal Control over Major Programs:

- *Significant Deficiencies:* We identified no deficiencies in the design or operation of internal control over major federal programs that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified no deficiencies that we consider to be material weaknesses.

We issued an unmodified opinion on the District’s compliance with requirements applicable to its major federal program.

Identification of Major Federal Programs:

The following program was selected as a major program in our audit of compliance in accordance with the Uniform Guidance.

| <u>CFDA No.</u> | <u>Program or Cluster Title</u> |
|-----------------|--|
| 66.468 | Capitalization Grants for Drinking Water State Revolving Funds |

The dollar threshold used to distinguish between Type A and Type B programs, as prescribed by the Uniform Guidance, was \$750,000.

The District did not qualify as a low-risk auditee under the Uniform Guidance.

SECTION II – FINANCIAL STATEMENT FINDINGS

See finding 2015-001.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None reported.

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

North City Water District King County January 1, 2015 through December 31, 2015

2015-001 The District's internal controls were inadequate to ensure accurate reporting in its Schedule of Expenditures of Federal Awards.

Background

District management, the state Legislature, state and federal agencies and bondholders rely on the information included in financial statements and supplemental schedules to make decisions. It is the responsibility of District management to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting. Our audit identified a significant deficiency in internal control over financial reporting that affect the District's ability to produce an accurate Schedule of Expenditures of Federal Awards (SEFA).

All local governments in Washington that spend federal funds are required to prepare a Schedule of Expenditures of Federal Awards as part of the annual financial report.

Uniform Administrative Requirements, Cost Principles, and Audit Requirements of Federal Awards requires grantees to identify, in its accounts, all Federal program awards received and expended and to report all Federal program awards expended on the SEFA each fiscal year.

Government Auditing Standards, prescribed by the Comptroller General of the United States, require the auditor to communicate significant deficiencies as defined below in the Applicable Laws and Regulations section, as a finding.

Description of Condition

We identified the following deficiencies in internal control over accounting and financial reporting, that when taken together, represent a significant deficiency:

- To correct prior SEFA issues, the District implemented a coding system to capture all project expenditures. During the preparation of the SEFA, the District relied on this coding system to report all expenditures. However, this resulted in non-federal expenditures being reported, which is not in

accordance with the *Budget, Accounting and Reporting Standards* (BARS) manual or Title 2 *U.S. Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

- Although the District has procedures to perform a review SEFA for accuracy, the review was not adequate to detect and correct errors prior to audit.

Cause of Condition

The District does not regularly receive federal funds; therefore, District staff responsible for preparation of the SEFA were not familiar with the federal reporting requirements.

The District established controls to report Drinking Water State Revolving Funds loans on the SEFA as all expenditures coded to the project in the general ledger, instead of only expenditures that were federally reimbursed as required due to a misunderstanding in accounting requirements.

Effect of Condition

The District reported on its SEFA all expenditures incurred in 2015 on the North City Water District project for \$2,222,470 when only \$1,532,815 of these expenditure were claimed for federal funding and were required to be reported. As a result, the SEFA was overstated by \$689,655 for the Capitalization Grants for Drinking Water State Revolving Funds (CFDA 66.468).

Inaccurate financial reports limit access to financial information used by District officials, the public, state and federal agencies and other interested parties.

Should future errors be made and not identified in a timely manner, the District could miss its federal reporting deadline, jeopardize future federal funding and report its financial information inaccurately to citizens and other governments. Therefore, accurate reporting is an important accountability measure.

The District corrected the misstatement noted above.

Recommendation

We recommend the District strengthen its internal controls over SEFA reporting by ensuring staff responsible for SEFA preparation receive adequate training on the SEFA reporting requirements. We further recommend an effective independent review of the SEFA is performed to ensure federal program expenditures are accurately reported on the SEFA.

District's Response

The single amount of \$1,523,815 on the Schedule of Expenditures of Federal Awards (SEFA) is the amount the finding is referring to. The State Auditor's finding asserts that District staff would have known this was the incorrect number to enter into this field if there had only been more internal controls in place in the form of more comprehensive training for the preparer and/or reviewer; or if the District had invested in an independent review of the schedule. However, the rules governing the required disclosures cannot only be circuitous and ambiguous; they often do not explain what to do when circumstances are outside the norm. In many cases the disclosure rules are completely contrary to what is generally done for GAAP financial statements. This is so much the case that even the "experts" designated to provide training and guidance often do not know quite what to do as well.

District staff was unclear as what to enter on the SEFA for 2015 because to have entered only the amount of expenditures submitted for reimbursement would have been contrary to the advice given to the District by the auditor for the 2014 SEFA, which was to enter all eligible expenditures, whether the expenditures were going to be reimbursed or not. Instead of clarifying this prior to submitting the 2015 financial report, District staff decided to "play it safe" and disclose all that was spent on the project in 2015, \$2,222,818, with the expectation that the amount could simply be changed if, when the auditors were on-site, they clarified it was not the appropriate amount to be disclosed. The District now understands that to wait until the auditors are on site to obtain clarification about the rules governing federal disclosures is not a prudent step to take. The District learned that while the State Auditor's Office has some latitude in this regard with the information contained in the body of the financial statements, they have no latitude when it comes to their audits of federal programs. The SEFA schedule must have the correct amounts entered on the form when the financial statements are submitted to the State Auditor's Office or there will be a finding, even if the amounts are corrected. Consequently, the District will add to the internal control procedures for federal programs a step to obtain all clarifications about disclosure rules from the State Auditor's help desk, in writing and in advance of the audit, to prevent any future findings.

Auditor's Remarks

We appreciate the District's commitment to resolve this finding and thank the District for its cooperation and assistance during the audit. We would like to clarify, however, that we were unable to confirm the District's assertion that it had received prior audit advice to report all expenditures, including non-federal

expenditures, on its SEFA. We will review the corrective action taken during our next regular audit.

Applicable Laws and Regulations

The American Institute of Certified Public Accountants, AU-C Section 265 – Communicating Internal Control Related Matters Identified in an Audit, defines significant deficiencies and material weaknesses as follows:

Material weakness. A deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Significant deficiency. 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.

The American Institute of Certified Public Accountants, AU-C Section 265 – Communicating Internal Control Related Matters Identified in an Audit, states in part:

.11 The auditor should communicate in writing to those charged with governance on a timely basis significant deficiencies and material weaknesses identified during the audit, including those that were remediated during the audit. (Ref: par. .A15–.A20 and .A28)

.12 The auditor also should communicate to management at an appropriate level of responsibility, on a timely basis (Ref: par. .A21 and .A28) *a.* in writing, significant deficiencies and material weaknesses that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances. (Ref: par. .A16 and .A22–.A23) *b.* in writing or orally, other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention. If other deficiencies in internal control are communicated orally, the auditor should document the communication. (Ref: par. .A24–.A27)

The United States Government Accountability Office Governmental Auditing Standards (Yellow Book), Section 4.23 states:

4.23 When performing GAGAS financial audits, auditors should communicate in the report on internal control over financial reporting and compliance, based upon the work performed, (1) significant deficiencies and material weaknesses in internal control; (2) instances of fraud and noncompliance with provisions of laws or regulations that have a material effect on the audit and any other instances that warrant the attention of those charged with governance; (3) noncompliance with provisions of contracts or grant agreements that has a material effect on the audit; and (4) abuse that has a material effect on the audit.

The United States Government Accountability Office Governmental Auditing Standards (Yellow Book), Section 4.24 states:

4.24 The AICPA requirements to communicate in writing significant deficiencies and material weaknesses identified during an audit⁷⁰ form the basis for reporting significant deficiencies and material weaknesses in the GAGAS report on internal control over financial reporting when deficiencies are identified during the audit.

Title 2 Code of Federal Regulations, PART 200—Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards, Subpart F, §200.502 Basis for determining Federal awards expended.

(a) Determining Federal awards expended. The determination of when a Federal award is expended must be based on when the activity related to the Federal award occurs. Generally, the activity pertains to events that require the non-Federal entity to comply with Federal statutes, regulations, and the terms and conditions of Federal awards, such as: expenditure/expense transactions associated with awards including grants, cost-reimbursement contracts under the FAR, compacts with Indian Tribes, cooperative agreements, and, direct appropriations; the disbursement of funds to subrecipients; the use of loan proceeds under loan and loan guarantee programs; the receipt of property; the receipt of surplus property; the receipt or use of program income; the distribution or use of food commodities; the

disbursement of amounts entitling the non-Federal entity to an interest subsidy; and the period when insurance is in force.

(b) Loan and loan guarantees (loans). Since the Federal Government is at risk for loans until the debt is repaid, the following guidelines must be used to calculate the value of Federal awards expended under loan programs, except as noted in paragraphs (c) and (d) of this section:

- (1) Value of new loans made or received during the audit period; plus
- (2) Beginning of the audit period balance of loans from previous years for which the Federal Government imposes continuing compliance requirements; plus
- (3) Any interest subsidy, cash, or administrative cost allowance received.

(c) Loan and loan guarantees (loans) at IHEs. When loans are made to students of an IHE but the IHE does not make the loans, then only the value of loans made during the audit period must be considered Federal awards expended in that audit period. The balance of loans for previous audit periods is not included as Federal awards expended because the lender accounts for the prior balances.

(d) Prior loan and loan guarantees (loans). Loans, the proceeds of which were received and expended in prior years, are not considered Federal awards expended under this part when the Federal statutes, regulations, and the terms and conditions of Federal awards pertaining to such loans impose no continuing compliance requirements other than to repay the loans.

(e) Endowment funds. The cumulative balance of Federal awards for endowment funds that are federally restricted are considered Federal awards expended in each audit period in which the funds are still restricted.

(f) Free rent. Free rent received by itself is not considered a Federal award expended under this part. However, free rent received as part of a Federal award to carry out a Federal

program must be included in determining Federal awards expended and subject to audit under this part.

(g) Valuing non-cash assistance. Federal non-cash assistance, such as free rent, food commodities, donated property, or donated surplus property, must be valued at fair market value at the time of receipt or the assessed value provided by the Federal agency.

(h) Medicare. Medicare payments to a non-Federal entity for providing patient care services to Medicare-eligible individuals are not considered Federal awards expended under this part.

(i) Medicaid. Medicaid payments to a subrecipient for providing patient care services to Medicaid-eligible individuals are not considered Federal awards expended under this part unless a state requires the funds to be treated as Federal awards expended because reimbursement is on a cost-reimbursement basis.

(j) Certain loans provided by the National Credit Union Administration. For purposes of this part, loans made from the National Credit Union Share Insurance Fund and the Central Liquidity Facility that are funded by contributions from insured non-Federal entities are not considered Federal awards expended.

Title 2 Code of Federal Regulations, PART 200—Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards, Subpart F, §200.510 Financial statements.

(a) Financial statements. The auditee must prepare financial statements that reflect its financial position, results of operations or changes in net assets, and, where appropriate, cash flows for the fiscal year audited. The financial statements must be for the same organizational unit and fiscal year that is chosen to meet the requirements of this part. However, non-Federal entity-wide financial statements may also include departments, agencies, and other organizational units that have separate audits in accordance with §200.514 Scope of audit, paragraph (a) and prepare separate financial statements.

(b) Schedule of expenditures of Federal awards. The auditee must also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements which must include the total Federal awards expended as determined in accordance with §200.502 Basis for determining Federal awards expended. While not required, the auditee may choose to provide information requested by Federal awarding agencies and pass-through entities to make the schedule easier to use. For example, when a Federal program has multiple Federal award years, the auditee may list the amount of Federal awards expended for each Federal award year separately. At a minimum, the schedule must:

- (1) List individual Federal programs by Federal agency. For a cluster of programs, provide the cluster name, list individual Federal programs within the cluster of programs, and provide the applicable Federal agency name. For R&D, total Federal awards expended must be shown either by individual Federal award or by Federal agency and major subdivision within the Federal agency. For example, the National Institutes of Health is a major subdivision in the Department of Health and Human Services.
- (2) For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity must be included.
- (3) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available. For a cluster of programs also provide the total for the cluster.
- (4) Include the total amount provided to subrecipients from each Federal program.
- (5) For loan or loan guarantee programs described in §200.502 Basis for determining Federal awards expended, paragraph (b), identify in the notes to the schedule the balances outstanding at the end of the audit period. This is in addition to including the total Federal awards expended for loan or loan guarantee programs in the schedule.

(6) Include notes that describe that significant accounting policies used in preparing the schedule, and note whether or not the auditee elected to use the 10% de minimis cost rate as covered in §200.414 Indirect (F&A) costs.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

North City Water District King County January 1, 2015 through December 31, 2015

This schedule presents the status of federal findings reported in prior audit periods. The status listed below is the representation of the North City Water District. The State Auditor's Office has reviewed the status as presented by the District.

| | | | |
|--|------------------------------------|--|-------------------------------|
| Audit Period: 1/1/2013 – 12/31/2013 | Report Ref. No.: 1013644 | Finding Ref. No.: 2013-002 | CFDA Number: 66.468 |
| Federal Program Name and Granting Agency: Capitalization Grants for Drinking Water State Revolving Funds U.S. Environmental Protection Agency | | Pass-Through Agency Name: Department of Commerce | |
| Finding Caption: The District's internal controls were inadequate to ensure compliance with Federal Davis-Bacon Act (prevailing wage) and procurement requirements. | | | |
| Background: <p>Federally funded construction projects that exceed \$2,000 require contractors to pay federally prescribed prevailing wages to laborers, per the Davis-Bacon Act. The Act also requires recipients of Federal funds to obtain weekly certified payrolls for all contractors and subcontractors to ensure prevailing wages are paid. The District did not obtain weekly certified payroll for nine out of eleven pay periods for the 615 Zone Expansion Improvements and Water Main Replacement projects. By not obtaining weekly certified payrolls, the District could not ensure, prior to disbursement of loan funds, all contractors and subcontractors were paid prevailing wages as required by Federal law.</p> <p>In addition, the District was not aware of the requirement to competitively bid projects that exceed the Federal simplified acquisition threshold of \$100,000 and therefore used a small works roster to contact contractors instead of sealed bids with formal advertising.</p> | | | |
| Status of Corrective Action: <div style="display: flex; justify-content: space-between;"> <input checked="" type="checkbox"/> Fully Corrected <input type="checkbox"/> Partially Corrected <input type="checkbox"/> No Corrective Action Taken <input type="checkbox"/> Finding is considered no longer valid </div> | | | |
| Corrective Action Taken: <i>The District put the North City Pump Station project out to bid and awarded the project in the spring of 2015. The District's Operation Manager is currently collecting weekly certified payrolls on this project. The result of the prior federal audit was communicated with the Public Works Board, Public Works Board staff and the Department of Health staff, specifically regarding the difference in federal and state small works project bid limits. The District is</i> | | | |

aware of the \$100,000 federal bid limit on this remaining project and does not anticipate awarding any bids under this threshold.

**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**

**North City Water District
King County
January 1, 2015 through December 31, 2015**

Board of Commissioners
North City 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 North City Water District, King County, Washington, as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated September 19, 2016. As discussed in Note 1 to the financial statements, during the year ended December 31, 2015, the District implemented Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*.

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 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Audit Findings and Responses as Finding 2015-001 that we consider to be significant deficiencies.

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*.

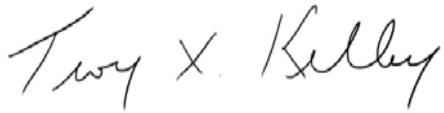
DISTRICT'S RESPONSE TO FINDINGS

The District's response to the findings identified in our audit is described in the accompanying Schedule of Audit Findings and Responses. The District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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.

A handwritten signature in black ink that reads "Troy X. Kelley". The signature is written in a cursive, flowing style.

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

September 19, 2016

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR
EACH MAJOR FEDERAL PROGRAM AND REPORT ON
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE
WITH THE UNIFORM GUIDANCE**

**North City Water District
King County
January 1, 2015 through December 31, 2015**

Board of Commissioners
North City Water District
Shoreline, Washington

**REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL
PROGRAM**

We have audited the compliance of the North City Water District, King County, Washington, with the types of compliance requirements described in the U.S. *Office of Management and Budget (OMB) Compliance Supplement* that could have a direct and material effect on each of the District's major federal programs for the year ended December 31, 2015. The District's major federal programs are identified in the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 *U.S. Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred.

An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. Our audit does not provide a legal determination on the District's compliance.

Opinion on Each Major Federal Program

In our opinion, the District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2015.

REPORT ON INTERNAL CONTROL OVER COMPLIANCE

Management of the District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program in order to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over compliance.

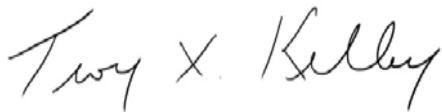
A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore,

material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses.

Purpose of this Report

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report 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.

A handwritten signature in black ink that reads "Troy X. Kelley". The signature is written in a cursive, flowing style.

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

September 19, 2016

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

North City Water District King County January 1, 2015 through December 31, 2015

Board of Commissioners
North City Water District
Shoreline, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the North City Water District, King County, Washington, as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 27.

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 North City Water District, as of December 31, 2015, 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.

Matters of Emphasis

As discussed in Note 1 to the financial statements, in 2015, the District adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*. Our opinion is not modified with respect to this matter.

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 28 through 30 and pension plan information on page 48 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.

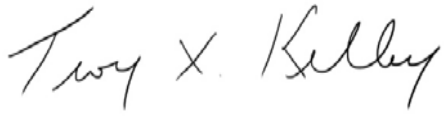
Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the District's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by Title 2 *U.S. Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). This schedule is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated September 19, 2016 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.

A handwritten signature in black ink that reads "Troy X. Kelley". The signature is written in a cursive, flowing style.

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

September 19, 2016

FINANCIAL SECTION

**North City Water District
King County
January 1, 2015 through December 31, 2015**

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis – 2015

BASIC FINANCIAL STATEMENTS

Statement of Net Position – 2015

Statement of Revenues, Expenses and Changes in Net Position – 2015

Statement of Cash Flows – 2015

Notes to Financial Statements – 2015

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Proportionate Share of Net Pension Liability and Schedule of Employer
Contributions and Notes– 2015

SUPPLEMENTARY AND OTHER INFORMATION

Schedule of Expenditures of Federal Awards – 2015

Notes to the Schedule of Expenditures of Federal Awards – 2015

North City Water District
MANAGEMENT DISCUSSION AND ANALYSIS
For the Year Ended December 31, 2015

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, liabilities, deferred inflows and outflow, 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.

Financial Analysis

Condensed Comparative Statement of Net Position

| | 2015 | 2014 | 2013 | 2015-2014 Change |
|--------------------------------|----------------------|----------------------|----------------------|---------------------|
| Current and Other Assets | \$ 5,742,007 | \$ 6,273,441 | \$ 8,939,323 | \$ (531,435) |
| Capital Assets | <u>35,532,505</u> | <u>34,036,003</u> | <u>28,565,079</u> | <u>1,496,502</u> |
| Total Assets | 41,274,511 | 40,309,444 | 37,504,402 | 965,067 |
| Deferred Outflows of Resources | 110,293 | | | 110,293 |
| Long-term Liabilities | 10,254,686 | 10,013,171 | 9,454,141 | 241,515 |
| Other Liabilities | <u>1,505,107</u> | <u>1,252,487</u> | <u>1,109,263</u> | <u>252,620</u> |
| Total Liabilities | 11,759,793 | 11,265,658 | 10,563,404 | 494,135 |
| Deferred Inflows of Resources | 151,058 | | | 151,058 |
| Invested in Capital Assets | 25,817,021 | 23,774,332 | 19,171,063 | 2,042,689 |
| Restricted | 829,109 | 772,147 | 3,968,172 | 56,962 |
| Unrestricted | <u>2,827,824</u> | <u>4,497,307</u> | <u>3,801,764</u> | <u>(1,669,484)</u> |
| Total Net Position | <u>\$ 29,473,953</u> | <u>\$ 29,043,786</u> | <u>\$ 26,940,999</u> | <u>\$ 430,167</u> |

The overall financial condition of the District remains strong with an increase in net position of \$430,167 in 2015. The increase is due to an increase of \$1,075,360 in Total Assets and Deferred Outflows, net of \$645,193 in Total Liabilities and Deferred Inflows. The increase in Total Assets is due to an excess of cash operating revenues over cash operating expenses. This excess was used to fund the capital costs related to purchasing or constructing District assets and for reducing debt principal. Deferred Outflows of Resources was established in 2015 under the new reporting requirements from GASB 68 in the amount of \$110,293 (see Note 6 and Note 7). Total Liabilities increased by \$494,135 with the major items being an increase in Pension Liability of \$931,809 (resulting from the new reporting requirements of GASB 68) and a reduction in bond indebtedness of \$551,765 (see Note 5). Deferred Inflows increased by \$151,058 as a result of the new reporting requirements of GASB 68.

The amount invested (or equity) in capital assets of \$25,817,021 is the net book value of all District assets of \$35,532,505 less the amount funded with outstanding debt of \$9,715,484. Please refer to Note 3 for more information regarding the composition of fixed assets and Note 5 for more information about the District's debt. The restricted position of \$829,109 is the District's bond fund reserves and funds set aside to make bond payments. The unrestricted balance of 2,827,824 represents the assets available for the future use in providing utility service.

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

| | 2015 | 2014 | 2013 | 2015-2014 Change |
|-----------------------------|----------------------|----------------------|----------------------|---------------------|
| Water Service | \$ 6,512,408 | \$ 6,165,955 | \$ 6,178,686 | \$ 346,453 |
| Other Operating Revenue | 424,631 | 305,677 | 188,679 | 118,955 |
| Other Non-Operating Revenue | <u>30,390</u> | <u>27,685</u> | <u>89,078</u> | <u>2,704</u> |
| Total Revenues | 6,967,429 | 6,499,317 | 6,456,444 | 468,112 |
| Operating Expenses | 5,783,911 | 5,608,167 | 5,351,915 | 175,744 |
| Non-Operating Expenses | <u>136,204</u> | <u>89,597</u> | <u>77,826</u> | <u>46,607</u> |
| Total Expenses | <u>5,920,115</u> | <u>5,697,764</u> | <u>5,429,741</u> | <u>222,351</u> |
| Excess before Contributions | 1,047,314 | 801,553 | 1,026,703 | 245,761 |
| Capital Contributions | <u>400,913</u> | <u>1,301,234</u> | <u>945,391</u> | <u>(900,322)</u> |
| Change in Net Position | 1,448,226 | 2,102,787 | 1,972,094 | (654,561) |
| Beginning Net Position | 29,043,786 | 26,940,999 | 24,968,905 | 2,102,787 |
| Change in Account Principle | <u>(1,018,060)</u> | <u>-</u> | <u>-</u> | <u>(1,018,060)</u> |
| Ending Net Position | <u>\$ 29,473,953</u> | <u>\$ 29,043,786</u> | <u>\$ 26,940,999</u> | <u>\$ 430,167</u> |

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, antenna rents, and interest. The increase in Water Service Revenue of \$346,453 in 2015 over 2014 is primarily due to a rate increase and higher water usage in 2015. Other Operating Revenue increased by \$118,955 due to higher rental rates for water tower antennas and from rental income for the building located on the site of the District's future maintenance facilities.

The increase of \$175,744 in Operating Expenses is the result of less labor costs being capitalized in 2015 than in 2014, as well as an increase in depreciation expense due to the capitalization of Capital Improvement Projects (CIP) in 2014 (depreciation expense is delayed until the year after capitalization). Capital contributions vary from year to year and were \$900,322 lower in 2015 due to fewer contributions from developers.

The most significant change in net position occurred with the reduction in the beginning balance of Net Position by establishing Pension Liabilities and Assets in the District financial records (per GASB 68).

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, 2015, the District's investment in capital assets shown on the Statement of Net Position and in Note 3: Capital Assets is \$35,532,505 net of depreciation. This is a net increase of \$1,496,502 since December 31, 2014. As part of an in-house effort to reconcile the Fixed Asset schedule more closely to infrastructure reflected in the District's GIS system, many fully depreciated assets that were no longer in-service were removed from the Fixed Asset schedule in 2015. This project will continue through 2016 and 2017. 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 administered through 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 5.

In 2012, the District was approved to receive Drinking Water State Revolving Fund loan monies for two capital projects totaling approximately \$4.3 million. The District completed one project in 2013 and expects to complete the second project in 2016. Due to the amount of the loans, the District is subject to a Federal audit under the Single Audit Act guidelines.

Significant Events

In June 2012, the Governmental Accounting Standards Board (GASB) issued Statement 68, *Accounting and Financial Reporting for Pensions*. The GASB also issued Statement 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date* (amends GASB Statement 68). These statements amend the financial reporting requirements of GASB Statement 27 and are effective for years ending in 2015.

GASB 68 calls for the following key reporting changes, which are reflected in these financial statements (see the Statement of Net Position, the Statement of Revenues and Expenses and Changes in Net Position, Note 1, Note 6, and Note 7):

- Net pension liability (asset) is added to the statement of position.
- Additional balances are introduced for deferred outflows and inflows related to pensions.
- Pension expense is no longer equal to the contributions to the plan.

North City Water District
STATEMENT OF NET POSITION – Page 1
As of December 31, 2015

ASSETS

Current Assets:

| | |
|-------------------------------|-------------------------|
| Cash and Cash Equivalents | |
| Maintenance/Operating Account | \$ 1,341,342 |
| Capital Account | 1,920,865 |
| Vehicle Replacement Account | 116,124 |
| Preservation Account | 50,000 |
| Customer Deposits | 14,607 |
| Accounts Receivable (Net) | 1,152,557 |
| Inventories | 264,814 |
| Prepayments | 52,588 |
| TOTAL CURRENT ASSETS | <u>4,912,898</u> |

Non-Current Assets:

| | |
|--|--------------------------|
| Restricted Assets (<i>Cash & Cash Equivalents</i>) - (NOTE 1)) | |
| Revenue Bond Funds | 829,109 |
| Net Pension Assets | - |
| Capital Assets Not Being Depreciated or Amortized: | |
| Land - (NOTE 3) | 3,496,535 |
| Construction in Progress - (NOTE 4) | 5,077,714 |
| Capital Assets Being Amortized: (NOTE 3) | |
| Intangibles Plant (<i>Net of Amortization</i>) | 305,728 |
| Capital Assets Being Depreciated: (NOTE 3) | |
| Buildings | 4,957,374 |
| Equipment | 1,089,243 |
| Infrastructure | 31,304,301 |
| Vehicles | 916,897 |
| Less Accumulated Depreciation | <u>(11,615,288)</u> |
| Total Capital Assets Being Depreciated (Net) | <u>26,652,527</u> |
| TOTAL NONCURRENT ASSETS | <u>36,361,614</u> |
| TOTAL NET ASSETS | <u>41,274,511</u> |

DEFERRED OUTFLOWS OF RESOURCES

| | |
|---|-----------------------|
| Deferred Outflows Related to Pensions NOTE 7) | <u>110,293</u> |
| TOTAL DEFERRED OUTFLOWS OF RESOURCES | <u>110,293</u> |

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

North City Water District
STATEMENT OF NET POSITION – Page 2
As of December 31, 2015

LIABILITIES

Current Liabilities:

| | |
|--|------------------|
| Accounts Payable - Maint | 376,984 |
| Accounts Payable - Construction | 381,466 |
| Accrued Employee Benefits | 63,537 |
| Other Liabilities | 84,783 |
| Accrued Interest Payable | 58,337 |
| Current Portion of Long-Term Debt - (NOTE 5) | 540,000 |
| TOTAL CURRENT LIABILITIES | 1,505,107 |

Non-Current Liabilities:

| | |
|--|-------------------|
| Compensated Absences | 60,266 |
| Drinking Water State Revolving Fund Loans - (NOTE 5) | 1,885,484 |
| Long-Term Debt - Net of Current Portion - (NOTE 5) | 7,290,000 |
| Bond Premium | 87,127 |
| Net Pension Liability (NOTE 7) | 931,809 |
| TOTAL NONCURRENT LIABILITIES | 10,254,686 |
| TOTAL NET LIABILITIES | 11,759,793 |

DEFERRED INFLOWS OF RESOURCES

| | |
|---|----------------|
| Deferred Inflows Related to Pensions (NOTE 7) | 151,058 |
| TOTAL DEFERRED INFLOWS OF RESOURCES | 151,058 |

NET POSITION

| | |
|--|----------------------|
| Net Investment in Capital Assets | 25,817,021 |
| Restricted for Debt Service and Capital Construction | 829,109 |
| Unrestricted | 2,827,824 |
| TOTAL NET POSITION | \$ 29,473,953 |

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

North City Water District
STATEMENT OF REVENUES, EXPENSES & CHANGES IN NET POSITION
As of December 31, 2015

OPERATING REVENUE

| | |
|--------------------------------|------------------|
| Utility Sales and Service Fees | \$ 6,512,408 |
| Other Operating Revenue | 424,631 |
| Total Operating Income | <u>6,937,039</u> |

OPERATING EXPENSES

| | |
|---------------------------------|------------------|
| Operations: | |
| Water Purchased for Resale | 1,479,224 |
| General Operations | 800,781 |
| Maintenance | 324,663 |
| Customer Service and Billing | 247,192 |
| Administration: | |
| General Administration | 293,875 |
| Planning & Development | 18,838 |
| Public & Regional Involvement | 187,557 |
| Office & Records Management | 420,188 |
| Depreciation and Amortization | 1,320,144 |
| Franchise Fees | 366,929 |
| Property, Excise, and B&O Taxes | 324,520 |
| Total Operating Expenses | <u>5,783,911</u> |

OPERATING INCOME **1,153,128**

NON-OPERATING REVENUES (EXPENSES)

| | |
|--|------------------|
| Investment Interest Income | 33,892 |
| Bond and Loan Interest Expense (Net of Capitalization) | (136,204) |
| Other Non-Operating Revenue | (3,502) |
| Total Non-Operating Revenues (Expenses) | <u>(105,815)</u> |

| | |
|-----------------------|----------------|
| Capital Contributions | <u>400,913</u> |
|-----------------------|----------------|

CHANGE IN NET POSITION **1,448,226**

TOTAL NET POSITION, January 1 **29,043,786**

| | |
|--|-------------|
| Change in Account Principle - GASB 68 - (NOTE 6) | (1,018,060) |
|--|-------------|

TOTAL NET POSITION, December 31 **\$ 29,473,953**

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

North City Water District
STATEMENT OF CASH FLOWS
As of December 31, 2015

| | |
|--|----------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | |
| Cash Received from Customers | \$ 7,009,626 |
| Cash Payments to Suppliers for Goods & Services | (3,057,354) |
| Cash Payments for Payroll and Related Costs | (1,443,447) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | <u>2,508,825</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES: | |
| Capital Contributions | 400,913 |
| Change in Non-Operating Expense/Income | (3,502) |
| Developer Costs (Net of Deposits) | (82,744) |
| Cash Payments for Capital Construction & Acquisition | (2,453,696) |
| DWSRF Loan Proceeds | 5,577 |
| Principal Paid on Revenue Bonds | (525,000) |
| Interest Paid on Revenue Bonds | (235,222) |
| Principal Paid on DWSRF Loan | (26,765) |
| Interest Paid on DWSRF Loan | (11,129) |
| TOTAL CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | <u>(2,931,568)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | |
| Interest Received on Investments (Net of Fees) | 33,892 |
| CASH FLOWS FROM INVESTING ACTIVITIES | <u>33,892</u> |
| NET INCREASE (DECREASE IN CASH AND CASH EQUIVALENTS) | (388,851) |
| CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD | 4,660,898 |
| CASH AND CASH EQUIVALENTS - END OF PERIOD | 4,272,047 |
| RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES | |
| OPERATING INCOME (LOSS) | \$ 1,153,128 |
| ADJUSTMENTS TO RECONCILE NET OPERAING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATIONS: | |
| Depreciation & Amortization Expense | \$ 1,320,144 |
| Decrease (Increase) in Inventory | 31,368 |
| Decrease (Increase) in Accounts Receivable | 72,587 |
| Decrease (Increase) in Prepaid Expense | 38,629 |
| Increase (Decrease) in Other Payables | 28,050 |
| Increase (Decrease) in Maintenance Accounts Payable | (89,595) |
| Increase (Decrease) by Net Pensions Adjustments | (45,485) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | <u>\$ 2,508,825</u> |

The accompanying notes are an integral part of these statements.

North City 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, 2015, the District implemented Governmental Accounting Standards Board (GASB) Statement 68, *Accounting and Financial Reporting for Pensions*. See Note 6 and Note 7.

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, 2015 include the Revenue Bond funds totaling \$829,109.

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 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.

g. Inventories

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

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

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 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.

j. 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.

k. Construction Financing

The District has issued revenue bonds for long-term financing of capital improvements. The District also takes advantage of Drinking Water State Revolving Fund Loans made available through the Washington State Department of Commerce for public works projects. See Note No. 5 for additional information. Developers also build regular system extensions. Upon the completion of the project, the developer donates those main lines to the District.

l. 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 9, 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.

m. Intangible Assets

The District defers costs for intangible assets for a period of time equal to its estimated useful life. As of December 31, 2015, the District's intangible assets \$305,728. See Note 3.

n. Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the pension plan and additions to/deductions from the plan's fiduciary net position have been determined on the same basis as they are reported by the plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

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 District's 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.

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, 2015, the District had the following investments:

| <u>Investment Type</u> | <u>Fair Value</u> | <u>Effective Duration</u> |
|-----------------------------|-------------------|---------------------------|
| King County Investment Pool | \$4,195,604 | .93 Years |

Impaired Investments: As of December 31, 2015, 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 principal is \$26,309 and the District's fair value of these investments is \$16,512.

Interest Rate Risk. As of December 31, 2015, the Pool's average duration was .93 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 2015, 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 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. Capital assets for the year ended December 31, 2015 were as shown in the following table:

| | 2015 | 2015 Activity | | 2015 |
|--|------------------------|-----------------------|--------------------------|------------------------|
| | Beg Bal | Increase | Decrease / Adjustment | End Bal |
| UTILITY PLANT NOT BEING DEPRECIATED OR AMORTIZED | | | | |
| Land | \$ 3,496,535 | \$ - | \$ - | 3,496,535 |
| Construction-in-Progress | 2,820,711 | 2,257,003 | - | 5,077,714 |
| TOTAL UTILITY PLANT NOT BEING DEPRECIATED | \$ 6,317,247 | \$ 2,257,003 | \$ - | \$ 8,574,250 |
| UTILITY PLANT BEING AMORTIZED - NET OF AMORTIZATION | | | | |
| Intangible Plant | \$ 412,042 | \$ - | \$ (106,314) | \$ 305,728 |
| TOTAL UTILITY PLANT BEING AMORTIZED | \$ 412,042 | \$ - | \$ (106,314) | \$ 305,728 |
| UTILITY PLANT BEING DEPRECIATED | | | | |
| Building & Structures | \$ 5,054,307 | \$ - | \$ (96,933) | \$ 4,957,374 |
| Machinery & Equipment | 1,578,166 | 25,818 | (514,740) | 1,089,243 |
| Vehicles | 779,984 | 136,913 | - | 916,897 |
| Infrastructure | 31,612,492 | 420,771 | (728,962) | 31,304,301 |
| TOTAL UTILITY PLANT BEING DEPRECIATED | \$ 39,024,949 | \$ 583,501 | \$ (1,340,636) | \$ 38,267,815 |
| LESS ACCUMULATED DEPRECIATION FOR: | | | | |
| Building & Structures | \$ (320,133) | \$ (127,682) | \$ 84,549 | \$ (363,266) |
| Machinery & Equipment | (1,099,523) | (91,960) | 511,336 | (680,146) |
| Vehicles | (436,434) | (63,223) | - | (499,657) |
| Infrastructure | (9,862,145) | (971,692) | 761,618 | (10,072,219) |
| TOTAL ACCUMULATED DEPRECIATION | \$ (11,718,235) | \$ (1,254,557) | \$ 1,357,504 | \$ (11,615,288) |
| UTILITY PLANT BEING DEPRECIATED (NET) | \$ 27,306,715 | \$ (671,056) | \$ 16,868 | \$ 26,652,527 |
| TOTAL UTILITY PLANT, NET | \$ 34,036,003 | \$ 1,585,947 | \$ (89,446) | \$ 35,532,505 |

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, 2015 was as follows:

| CONSTRUCTION IN PROGRESS | |
|---|---------------------|
| <i>As of December 31, 2015</i> | |
| McAleer Creek Culvert - 178th LFP | 48,025 |
| GIS Project | 1,233 |
| NCPS (Pump Station) Design and Construction | 3,611,733 |
| Main Replacement at 15th and 24th (CIP #4) | 254,559 |
| Maintenance Building | 1,162,164 |
| TOTAL | \$ 5,077,714 |

NOTE 5 - LONG-TERM DEBT

a. Revenue Bonds

The District issued Water Revenue Bonds in December 31, 2011 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. The outstanding balance as 12/31/2015 is:

\$ 7,830,000

Total Bond Restricted Debt

\$ 7,830,000

b. Junior Lien Loans

Drinking Water State Revolving Fund (DWSRF) Loan

Shoreline Water District entered into two loan agreements with the Department of Commerce in 2012. Both loans are for 24 years including 4 years from the contract execution date to the project completion date with a 1.5% interest rate. The first project will allow the District to accelerate the replacement of cast iron water mains. The second project will install upgrades to the North City pump station make it more efficient.

The District expects to finalize the water main project and withdraw all the remaining funds in 2015. The funds drawn in 2015 were \$5,277. The pump station project started construction in May 2015 and will be completed in 2016. See Schedule 16.

The District was required to have Federal Audits for both loans for 2013 and a single federal audit for 2015 for the pump station loan.

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 | DWSRF Loan Principal | DWSRF Loan Interest | COMBINED ANNUAL DEBT SERVICE |
|-----------|-----------------------------------|----------------------------------|-------------------------|------------------------|------------------------------------|
| 2016 | \$ 540,000 | \$ 225,348 | \$ 26,765 | \$ 7,628 | \$ 799,740 |
| 2017 | 555,000 | 214,548 | 26,765 | 7,226 | 803,539 |
| 2018 | 565,000 | 203,448 | 26,765 | 6,825 | 802,037 |
| 2019 | 580,000 | 192,148 | 26,765 | 5,621 | 804,533 |
| 2020-2025 | 2,540,000 | 911,474 | 160,587 | 30,110 | 3,642,171 |
| 2026-2031 | 3,050,000 | 400,665 | 240,881 | 18,066 | 3,709,612 |
| | \$ 7,830,000 | \$ 2,147,631 | \$ 508,526 | \$ 75,476 | \$ 10,561,633 |

(1) Debt Service payment are not determined until the end of the construction period.

Changes in Long-Term Liabilities

During the year ended December 31, 2015, 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 1i for more information regarding compensated absences. This liability decreased from \$60,708 at year end 2014 to \$60,266 at December 31, 2015.

| | Beginning Balance 1/1/2015 | Additions | Reductions | Ending Balance 12/31/2015 | Due Within One Year |
|-----------------------------|----------------------------------|-----------------|---------------------|---------------------------------|---------------------------|
| Revenue Bonds Payable | \$ 8,355,000 | \$ - | \$ (525,000) | \$ 7,830,000 | \$ 540,000 |
| Compensated Absences | \$ 60,708 | \$ (443) | | \$ 60,266 | n/a |
| DWSRF Loans | \$ 1,906,672 | \$ 5,577 | \$ (26,765) | \$ 1,885,484 | \$ - |
| Total LT Liabilities | \$ 10,322,380 | \$ 5,135 | \$ (551,765) | \$ 9,775,750 | \$ 540,000 |

NOTE 6 – ACCOUNTING AND REPORTING CHANGES

In June 2012, the Governmental Accounting Standards Board (GASB) issued Statement 68, *Accounting and Financial Reporting for Pensions*. The GASB also issued Statement 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date* (amends GASB Statement 68). These statements amend the financial reporting requirements of GASB Statement 27 and are effective for years ending in 2015.

GASB 68 calls for the following key reporting changes:

- Net pension liability (asset) is added to the statement of position
- Additional balances will be introduced for deferred outflows and inflows related to pensions
- Pension expense is no longer equal to the contributions to the plan

The resulting changes in accounting principle reduced the beginning balance in Net Position by \$1,018,060.

NOTE 7– PENSION PLAN

The following table represents the aggregate pension amounts for all plans subject to the requirements of the GASB Statement 68, *Accounting and Financial Reporting for Pensions* for the year 2015:

| Aggregate Pension Amounts – All Plans | |
|--|-----------|
| Pension liabilities | \$931,809 |
| Pension assets | \$ 0 |
| Deferred outflows of resources | \$110,293 |
| Deferred inflows of resources | \$151,058 |
| Pension expense/expenditures | \$ 69,152 |

State Sponsored Pension Plans

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 and defined contribution retirement plans. The state Legislature establishes, and amends, laws pertaining to the creation and administration of all public retirement systems.

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 98540-8380/

Or the DRS CAFR may be downloaded from the DRS website at www.drs.wa.gov.

Public Employees' Retirement System (PERS)

PERS members include elected officials; state employees; employees of the Supreme, Appeals and Superior Courts; employees of the legislature; employees of district and municipal courts; employees of local governments; and higher education employees not participating in higher education retirement programs. PERS is comprised of three separate pension plans for membership purposes. PERS plans 1 and 2 are defined benefit plans, and PERS plan 3 is a defined benefit plan with a defined contribution component.

PERS Plan 1 provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the member's average final compensation (AFC) times the member's years of service. The AFC is the average of the member's 24 highest consecutive service months. Members are eligible for retirement from active status at any age with at least 30 years of service, at age 55 with at least 25 years of service, or at age 60 with at least five years of service. Members retiring from active status prior to the age of 65 may receive actuarially reduced benefits. Retirement benefits are actuarially reduced to reflect the choice of a survivor benefit. Other benefits include duty and non-duty disability payments, an optional cost-of-living adjustment (COLA), and a one-time duty-related death benefit, if found eligible by the Department of Labor and Industries. PERS 1 members were vested after the completion of five years of eligible service. The plan was closed to new entrants on September 30, 1977.

Contributions

The **PERS Plan 1** member contribution rate is established by State statute at 6 percent. The employer contribution rate is developed by the Office of the State Actuary and includes an administrative expense component that is currently set at 0.18 percent. Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates. The PERS Plan 1 required contribution rates (expressed as a percentage of covered payroll) for 2015 were as follows:

| PERS Plan 1 | | |
|-----------------------------------|-----------------|------------------|
| Actual Contribution Rates: | Employer | Employee* |
| January through June 2015 | 9.21% | 6.00% |
| July through December 2015 | 11.18% | 6.00% |

* For employees participating in JBM, the contribution rate was 12.26%

The District's actual contributions to the plan were \$49,305 for the year ended December 31, 2015.

PERS Plan 2/3 provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the member's average final compensation (AFC) times the member's years of service for Plan 2 and 1 percent of AFC for Plan 3. The AFC is the average of the member's 60 highest-paid consecutive service months. There is no cap on years of service credit. Members are eligible for retirement with a full benefit at 65 with at least five years of service credit. Retirement before age 65 is considered an early retirement. PERS Plan 2/3 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 benefit that is reduced by a factor that varies according to age for each year before age 65. PERS Plan 2/3 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 three 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 2/3 members hired on or after May 1, 2013 have the option to retire early by accepting a reduction of five 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 credit. PERS Plan 2/3 retirement benefits are also actuarially reduced to reflect the choice of a survivor benefit. Other PERS Plan 2/3 benefits include duty and non-duty disability payments, a cost-of-living allowance (based on the CPI), capped at three percent annually and a one-time duty related death benefit, if found eligible by the Department of Labor and Industries. PERS 2 members are vested after completing five years of eligible service. 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 12 months of that service are earned after age 44.

PERS Plan 3 defined contribution benefits are totally dependent on employee contributions and investment earnings on those contributions. PERS Plan 3 members choose their contribution rate upon joining membership and have a chance to change rates upon changing employers. As established by statute, Plan 3 required defined contribution rates are set at a minimum of 5 percent and escalate to 15 percent with a choice of six options. Employers do not contribute to the defined contribution benefits. PERS Plan 3 members are immediately vested in the defined contribution portion of their plan.

Contributions

The **PERS Plan 2/3** employer and employee contribution rates are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. The Plan 2/3 employer rates include a component to address the PERS Plan 1 UAAL and an administrative expense that is currently set at 0.18 percent. Each biennium, the state Pension Funding Council adopts Plan 2 employer and employee contribution rates and Plan 3 contribution rates. The PERS Plan 2/3 required contribution rates (expressed as a percentage of covered payroll) for 2015 were as follows:

| PERS Plan 2/3 | | |
|-----------------------------------|---------------------|--------------------|
| Actual Contribution Rates: | Employer 2/3 | Employee 2* |
| January through June 2015 | 9.21% | 4.92% |
| July through December 2015 | 11.18% | 6.12% |
| Employee PERS Plan 3 | | varies |

* For employees participating in JBM, the contribution rate was 15.30%

The District's actual contributions to the plan were \$65,333 for the year ended December 31, 2015.

Actuarial Assumptions

The total pension liability (TPL) for each of the DRS plans was determined using the most recent actuarial valuation completed in 2015 with a valuation date of June 30, 2015. The actuarial assumptions used in the valuation were based on the results of the Office of the State Actuary's (OSA) *2007-2012 Experience Study*.

Additional assumptions for subsequent events and law changes are current as of the 2014 actuarial valuation report. The TPL was calculated as of the valuation date and rolled forward to the measurement date of June 30, 2015. Plan liabilities were rolled forward from June 30, 2014, to June 30, 2015, reflecting each plan's normal cost (using the entry-age cost method), assumed interest and actual benefit payments.

- **Inflation:** 3% total economic inflation; 3.75% salary inflation
- **Salary increases:** In addition to the base 3.75% salary inflation assumption, salaries are also expected to grow by promotions and longevity.
- **Investment rate of return:** 7.5%

Mortality rates were based on the RP-2000 report's Combined Healthy Table and Combined Disabled Table, published by the Society of Actuaries. The OSA applied offsets to the base table and recognized future improvements in mortality by projecting the mortality rates using 100 percent Scale BB. Mortality rates are applied on a generational basis; meaning, each member is assumed to receive additional mortality improvements in each future year throughout his or her lifetime.

There were minor changes in methods and assumptions since the last valuation.

- The OSA updated demographic assumptions, consistent with the changes from the *2007-2012 Experience Study Report*, used when valuing the PERS 1 and TERS 1 Basic Minimum COLA.
- The OSA corrected how valuation software calculates a member's entry age under the entry age normal actuarial cost method. Previously, the funding age was rounded, resulting in an entry age one year higher in some cases.
- For purposes of calculating the Plan 2/3 Entry Age Normal Cost contribution rates, the OSA now uses the current blend of Plan 2 and Plan 3 salaries rather than using a long-term membership assumption of two-thirds Plan 2 members and one-third Plan 3 members.
- The OSA changed the way it applies salary limits, as described in the *2007-2012 Experience Study Report*.

Discount Rate

The discount rate used to measure the total pension liability for all DRS plans was 7.5 percent.

To determine that rate, an asset sufficiency test included an assumed 7.7 percent long-term discount rate to determine funding liabilities for calculating future contribution rate requirements. (All plans use 7.7 percent except LEOFF 2, which has assumed 7.5 percent). Consistent with the long-term expected rate of return, a 7.5 percent future investment rate of return on invested assets was assumed for the test. Contributions from plan members and employers are assumed to continue being made at contractually required rates (including PERS 2/3, PSERS 2, SERS 2/3, and TRS 2/3 employers, whose rates include a component for the PERS 1, and TRS 1 plan liabilities). Based on these assumptions, the pension plans' fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return of 7.5 percent was used to determine the total liability.

Long-Term Expected Rate of Return

The long-term expected rate of return on the DRS pension plan investments of 7.5 percent was determined using a building-block-method. The Washington State Investment Board (WSIB) used a best estimate of expected future rates of return (expected returns, net of pension plan investment expense, including inflation) to develop each major asset class. Those expected returns make up one component of WSIB's capital market assumptions. The WSIB uses the capital market assumptions and their target asset allocation to simulate future investment returns at various future times. The long-term expected rate of return of 7.5 percent approximately equals the median of the simulated investment returns over a 50-year time horizon.

Estimated Rates of Return by Asset Class

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2015, are summarized in the table below. The inflation component used to create the table is 2.2 percent and represents the WSIB's most recent long-term estimate of broad economic inflation.

| Asset Class | Target Allocation | % Long-Term Expected Real Rate of Return Arithmetic |
|-----------------|-------------------|---|
| Fixed Income | 20% | 1.70% |
| Tangible Assets | 5% | 4.40% |
| Real Estate | 15% | 5.80% |
| Global Equity | 37% | 6.60% |
| Private Equity | 23% | 9.60% |
| | 100% | |

Sensitivity of NPL

The table below presents the District's proportionate share* of the net pension liability calculated using the discount rate of 7.5 percent, as well as what the District's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.5 percent) or 1-percentage point higher (8.5 percent) than the current rate.

| | 1% Decrease (6.5%) | Current Discount Rate (7.5%) | 1% Increase (8.5%) |
|----------|-----------------------|------------------------------------|-----------------------|
| PERS 1 | \$ 602,667 | \$495,003 | \$ 402,421 |
| PERS 2/3 | \$1,277,244 | \$436,806 | \$-206,686 |

Pension Plan Fiduciary Net Position

Detailed information about the State's pension plans' fiduciary net position is available in the separately issued DRS financial report.

Pension Liabilities (Assets), Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At June 30, 2015, the District reported a total pension liability of \$931,809 for its proportionate share of the net pension liabilities as follows:

| | Liability (or Asset) |
|----------|----------------------|
| PERS 1 | \$495,003 |
| PERS 2/3 | \$436,806 |
| TOTAL | \$931,809 |

At June 30, the District's proportionate share of the collective net pension liabilities was as follows:

| | Proportionate Share 6/30/14 | Proportionate Share 6/30/15 | Change in Proportion |
|----------|-----------------------------|-----------------------------|----------------------|
| PERS 1 | 0.009673% | 0.009463% | -0.000210% |
| PERS 2/3 | 0.012454% | 0.012225% | -0.000229% |

Employer contribution transmittals received and processed by the DRS for the fiscal year ended June 30 are used as the basis for determining each employer's proportionate share of the collective pension amounts reported by the DRS in the *Schedules of Employer and Nonemployer Allocations* for all plans except LEOFF 1.

The collective net pension liability (asset) was measured as of June 30, 2015, and the actuarial valuation date on which the total pension liability (asset) is based was as of June 30, 2015, with update procedures used to roll forward the total pension liability to the measurement date.

Pension Expense

For the year ended December 31, 2015, the District recognized pension expense as follows:

| | Pension Expense |
|----------|-----------------|
| PERS 1 | \$17,495 |
| PERS 2/3 | \$51,658 |
| TOTAL | \$69,153 |

Deferred Outflows of Resources and Deferred Inflows of Resources

At December 31, 2015, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| PERS 1 | Deferred Outflows of Resources | Deferred Inflows of Resources |
|--|--------------------------------|-------------------------------|
| Differences between expected and actual experience | | |
| Net difference between projected and actual investment earnings on pension plan investments | \$ | \$27,082 |
| Changes of assumptions | \$ | \$ |
| Changes in proportion and differences between contributions and proportionate share of contributions | \$ | \$ |
| Contributions subsequent to the measurement date | \$26,946 | \$ |
| TOTAL | \$26,946 | \$27,082 |

| PERS 2/3 | Deferred Outflows of Resources | Deferred Inflows of Resources |
|--|--------------------------------|-------------------------------|
| Differences between expected and actual experience | \$46,433 | \$ |
| Net difference between projected and actual investment earnings on pension plan investments | \$ | \$116,607 |
| Changes of assumptions | \$704 | \$ |
| Changes in proportion and differences between contributions and proportionate share of contributions | \$ | \$7,369 |
| Contributions subsequent to the measurement date | \$36,210 | \$ |
| TOTAL | \$83,347 | \$123,976 |

Deferred outflows of resources of \$63,156 (\$26,946 for PERS 1 and \$36,210 for PERS 2/3) related to pensions resulting from the District's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2016. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

| Year ended December 31: | PERS 1 | PERS 2/3 |
|------------------------------------|---------------|-----------------|
| 2016 | -\$5,416 | -\$14,775 |
| 2017 | -\$5,416 | -\$14,775 |
| 2018 | -\$5,416 | -\$14,775 |
| 2019 | -\$5,416 | -\$19,904 |
| Thereafter | | |

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 2015 of \$1,479,224.

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.

North City Water District is a member of Enduris. Chapter 48.62 RCW provides the exclusive source of local government entity authority to individually or jointly self-insure risks, jointly purchase insurance or reinsurance, and to contract for risk management, claims, and administrative services. Enduris was formed July 10, 1987 pursuant to the provisions of Chapter 48.62 RCW, Chapter 200-100 WAC, and Chapter 39.34 RCW. Two (2) counties and two (2) cities in the State of Washington joined together by signing an interlocal governmental agreement to fund their self-insured losses and jointly purchase insurance and administrative services. As of August 31, 2015, there are 507 Enduris members representing a broad array of special purpose districts throughout the state. Enduris provides property and liability coverage as well as risk management services and other related administrative services.

Members make an annual contribution to fund Enduris and share in the self-insured retention of the jointly purchased excess and/or reinsurance coverage. The self-insured retention is:

- \$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 a 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 a property loss.
- Enduris is responsible for the \$4,000 deductible on boiler and machinery loss.

Enduris acquires reinsurance from unrelated insurance companies on a "per occurrence" basis to cover all losses over the deductibles as shown on the policy maximum limits. Liability coverage is for all lines of liability coverage including Public Official's Liability. The Property coverage is written on an "all risk", blanket basis using current Statement of Values. The Property coverage includes but is not limited to mobile equipment, boiler and machinery, electronic data processing equipment, business interruption, course of construction and additions, property in transit, fine arts, and automobile physical damage to insured vehicles. Liability coverage limit is \$10 million per occurrence and property coverage limit is \$1 billion per occurrence. Enduris offers crime coverage up to a limit of \$1 million per occurrence.

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.

REQUIRED SUPPLEMENT INFORMATION

| Schedule of Proportionate Share of Net Pension Liability | |
|--|-------------|
| Plan PERS 1 | |
| As of June 30: | 2015 |
| Employer's proportion of the net pension liability (asset) | 0.009463% |
| Employer's proportionate share of the net pension liability | \$ 495,003 |
| Employer's covered employee payroll | \$ - |
| Employer's proportionate share of the net pension liability as a percentage of covered payroll | 0.0% |
| Plan fiduciary net position as percentage of the total pension liability | 59.1% |

| Schedule of Proportionate Share of Net Pension Liability | |
|--|--------------|
| Plan PERS 2/3 | |
| As of June 30: | 2015 |
| Employer's proportion of the net pension liability (asset) | 0.012225% |
| Employer's proportionate share of the net pension liability | \$ 436,806 |
| Employer's covered employee payroll | \$ 1,124,803 |
| Employer's proportionate share of the net pension liability as a percentage of covered payroll | 38.8% |
| Plan fiduciary net position as percentage of the total pension liability | 89.2% |

| Schedule of Employer Contributions | |
|--|-------------|
| Plan PERS 1 | |
| As of December 31: | 2015 |
| Statutorily or contractually required contributions | \$ 49,305 |
| Contributions in relation to the statutorily or contractually required contributions | \$ (49,305) |
| Contribution deficiency (excess) | \$ - |
| Covered employer payroll | \$ - |
| Contributions as a percentage of covered employee payroll | 0.00% |

| Schedule of Employer Contributions | |
|--|--------------|
| Plan PERS 2/3 | |
| As of December 31: | 2015 |
| Statutorily or contractually required contributions | \$ 65,333 |
| Contributions in relation to the statutorily or contractually required contributions | \$ (65,333) |
| Contribution deficiency (excess) | \$ - |
| Covered employer payroll | \$ 1,161,510 |
| Contributions as a percentage of covered employee payroll | 5.62% |

NOTES TO SCHEDULES

Note 1

These schedules will be built prospectively until they contain ten years of data.

Note 2: Changes of Benefit Terms

There were no changes of benefits for the Pension Plans.

Note 3: Changes of Assumptions

There were no changes for the Pension Plans.

North City Water District
Schedule of Expenditures of Federal Awards
For the Year Ended December 31, 2015

| | | | Expenditures | | | | Passed through to Subrecipients | Note |
|---|--|--|----------------|-----------------------|---------------------------------|-----------------------|------------------------------------|------|
| | | | CFDA Number | Other Award Number | From Pass- Through Awards | From Direct Awards | Total | |
| Federal Agency (Pass-Through Agency) | Federal Program | Drinking Water State Revolving Fund Cluster | | | | | | |
| Office Of Water, Environmental Protection Agency (via Department of Commerce) | Capitalization Grants for Drinking Water State Revolving Funds | | 66.468 | DM12 952-131 | 1,523,815 | - | 1,523,815 | 2 |
| Total Drinking Water State Revolving Fund Cluster: | | | | | <u>1,523,815</u> | <u>-</u> | <u>1,523,815</u> | |
| Total Federal Awards Expended: | | | | | <u>1,523,815</u> | <u>-</u> | <u>1,523,815</u> | |

North City Water District
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year ended December 31, 2015

NOTE 1 – BASIS OF ACCOUNTING

This schedule is prepared on the same basis of accounting as North City Water District's financial statements. North City Water 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.

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.

NOTE 2 – PROGRAM COSTS

The amounts shown as current year expenditures represent only the federal grant portion of the program costs. Entire program costs, including the District's portion, are more than shown.

NOTE 3 – FEDERAL LOANS

North City Water District was approved by the EPA to receive two loans totaling \$4,259,000 to improve its drinking water system. The amount listed for these loans includes the proceeds used during the year.

Both the current and prior year loans are also reported on the District's Schedule of Liabilities.

The capital project funded by Loan DM12 962-112 was substantively complete by year-end 2014, with the final payment request submitted to the Drinking Water State Revolving Fund in March of 2015.

The final request for payment was made in early 2016 for the capital project funded by Loan DM12 962-131. However, the project itself will not be complete until late 2016 or early 2017.

CORRECTIVE ACTION PLAN FOR FINDINGS REPORTED UNDER UNIFORM GUIDANCE

**North City Water District
King County
January 1, 2015 through December 31, 2015**

This schedule presents the corrective action planned by the auditee for findings reported in this report in accordance with Title 2 *U.S. Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). The information in this schedule is the representation of the North City Water District.

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| Finding ref number: 2015-001 | Finding caption: The District's internal controls were inadequate to ensure accurate reporting in its Schedule of Expenditures of Federal Awards. |
| Name, address, and telephone of auditee contact person: Barbara Shosten 1519 N.E. 177th Street Shoreline, WA 98155 (206) 362-8100 | |
| Corrective action the auditee plans to take in response to the finding: <i>The District will add a step to the internal control procedures for the preparation of schedule 16 to obtain a written response from State Auditor's help desk to all inquires about what should be included on the schedule ahead of submitting the annual financial statements to the State Auditor's Office.</i> | |
| Anticipated date to complete the corrective action: January 31, 2017 | |

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.

| Contact information for the State Auditor's Office | |
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| Public Records requests | PublicRecords@sao.wa.gov |
| Main telephone | (360) 902-0370 |
| Toll-free Citizen Hotline | (866) 902-3900 |
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