King County Water Quality Enterprise

Financial Statements and
Supplemental Schedule for the Years Ended
December 31, 2004 and 2003 and
Independent Auditors' Report

KING COUNTY WATER QUALITY ENTERPRISE

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INDEPENDENT AUDITORS' REPORT

To the King County Council
Seattle, Washington:

We have audited the accompanying statements of net assets of King County Water Quality Enterprise (the "Enterprise") as of December 31, 2004 and 2003, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Enterprise's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Enterprise's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Enterprise as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis on pages 2 through 6 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplemental schedule of net revenues available for debt service for the year ended December 31, 2004 is presented as required by bond resolutions and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

Deloitte & Touche LLP

June 17, 2005

KING COUNTY WATER QUALITY ENTERPRISE

MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2004

The management of the King County Water Quality Enterprise ("Water Quality" or the "Enterprise") offers readers of its financial statements this narrative overview and analysis of the financial activities for the fiscal year ended December 31, 2004. It is intended to be viewed in conjunction with the financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

During 2004, Water Quality made significant investments in its continued implementation of the Regional Wastewater Services Plan ("RWSP") and replacement of existing assets. The RWSP is intended to build additional capacity for the Enterprise to meet future projected population growth in its service area. In 2004, work on the Brightwater project continued on schedule with completion of the predesign on the Brightwater facilities in June and the opening of the Brightwater project office in October. The Enterprise made significant progress on two major construction projects designed to control combined sewer overflows. The Denny Way project which will begin operations in mid-2005, and the Henderson/Martin Luther King Way CSO Control Project that will bring the last uncontrolled county CSO into Lake Washington into compliance.

Operations of the Enterprise were stable during 2004, with operating expenses net of depreciation declining $0.1 million between 2003 and 2004 to a total of $82.8 million. The monthly sewer rate was unchanged from 2003 at $23.40. 2004 is the third year of a planned three-year level rate for monthly sewer charges. Total sewer rate revenues rose $1.0 million, reflecting an overall 0.4% increase in the sewer rate customer base. Capacity charge revenues rose $1.2 million, reflecting a higher rate of $18.00, a 40-cent increase over 2003, and the addition of 11,136 new sewer connections. Debt from state loans increased during 2004 as new, low-rate loans were received from the State of Washington to help fund the Enterprise's capital program.

The results of operations for 2004 produced a debt service coverage ratio on senior lien debt of 1.39, in excess of the coverage covenant requirement of 1.15 and the Enterprise's financial policy target of 1.25.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Enterprise's basic financial statements. The basic financial statements comprise the financial statements and the notes to the financial statements, which explain certain elements of the financial statements in greater detail.

REQUIRED FINANCIAL STATEMENTS

The Enterprise's financial statements provide information with respect to all of its activities and use accounting methods similar to those used by private-sector companies. The statements provide both long-term and short-term information about the Enterprise's financial status.

The comparative statements of net assets present information on all of the Enterprise's assets and liabilities, with the difference between assets and liabilities presented as net assets as of each year-end. The statements of net assets provide information about the nature and amount of investments in resources (assets) and obligations to creditors (liabilities).

The two most recent years' operating and nonoperating revenues and expenses of the Enterprise are accounted for in the statements of revenues, expenses, and changes in net assets. The statements illustrate the current and prior period results of operations and recovery of costs by receipt of fees and are instrumental in demonstrating continued creditworthiness. All changes in net assets are reported as soon as the underlying event occurs, irrespective of the timing of related cash flows. Readers should note that the principal support for Water Quality's activities (88.8% of operating revenues in 2004) is receipt of monthly sewage disposal charges. The Enterprise is a wholesale provider of sewage treatment services to 35 municipal and 3 nonmunicipal participants in King and Snohomish counties. The receipt of the monthly payments is governed by service agreements, the earliest of which expires in July 2036.

The statements of cash flows report cash receipts, cash payments, and net changes in cash derived from operations, financing, and investment activities. From the statements, the reader can discern the Enterprise's sources and applications of cash during 2004, reasons for differences between operating cash flows and operating income, and the effect on the statements of net assets from investing, capital, and financing activities.

The notes to financial statements provide additional information essential to obtain a full understanding of the data provided in the basic statements.

FINANCIAL ANALYSIS OF THE STATEMENTS OF NET ASSETS

Comparative data (in millions of dollars):

	2004	2003	Difference	Percentage Change
Capital assets	$ 1,893.1	$ 1,782.9	$ 110.2	6.2 %
Total assets	2,123.8	2,000.5	123.3	6.2
Total liabilities	1,783.8	1,662.8	121.0	7.3
Net assets invested in capital assets	212.1	228.5	(16.4)	(7.2)
Net assets—restricted	95.4	78.4	17.0	21.8
Net assets—unrestricted	32.4	30.8	1.6	5.1
Net assets	339.9	337.7	2.2	0.7

Net assets serve as a useful indicator of the Enterprise's financial position. As of December 31, 2004, assets of the Enterprise exceeded liabilities by $339.9 million.

Of the total assets of the Enterprise, at year-end 2004, 89.1% are invested in capital assets such as treatment plants, pumping and regulator stations, interceptors, and other equipment. The Enterprise uses its capital assets to provide wholesale wastewater collection and treatment services in King and Snohomish counties. Current operating and debt service requirements are met by operating and nonoperating revenues composed of monthly sewage disposal charges, a capacity charge for new customers, other special-handling charges, miscellaneous operating revenues, and investment earnings.

Net assets increased $2.2 million in 2004 compared to a $0.4 million increase in 2003. This relative stability in change of net assets was attributable to stable operating results and offsetting changes in other operating factors.

The Enterprise reports its investment in capital assets, net of debt related to capital asset acquisition, as $212.1 million. Resources of the Enterprise may be restricted for use in construction, to meet debt service requirements, to satisfy bond covenants, or to meet regulatory restrictions. Restricted net assets at year-end 2004 increased $17.0 million (21.8%), as restricted cash balances increased while liabilities payable from restricted assets decreased. Unrestricted net assets increased by $1.6 million (5.1%).

FINANCIAL ANALYSIS OF THE STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Comparative data (in millions of dollars):

	2004	2003	Difference	Percentage Change
Operating revenues	$ 217.3	$ 214.2	$ 3.1	1.5 %
Operating expenses	171.2	170.6	0.6	0.3
Operating income	46.1	43.5	2.6	5.8
Nonoperating revenues (expenses)	(59.5)	(52.1)	(7.4)	14.4
Grant revenues	15.9	11.4	4.5	39.2
Change in net assets	2.2	0.4	1.8	408.4

While the statements of net assets show changes in assets, liabilities, and net assets, the statements of revenues, expenses, and changes in net assets provide insight into the source of these changes. During 2004, the statements report that operating revenues increased by $3.1 million (1.5%) and operating expenses increased by $0.6 million (0.3%). These changes were influenced by several factors:

- The Enterprise collected a monthly sewage disposal charge of $23.40 (per month, per residential customer equivalent) in 2004, which is unchanged from 2003. Total sewage disposal fees increased by $1.0 million (0.5%) in 2004 from 2003 as the number of customers increased by 0.4%.

- Other operating revenues, including capacity charge for new customers and other treatment charges, rose $2.1 million (9.6%), reflecting the addition of new connections and an increase in the per-month capacity charge from $17.60 in 2003 to $18.00 in 2004 (2.3%) and increases in other charges.

- Nondepreciation-related operating expenses decreased $0.1 million (0.1%).

Nonoperating revenues and expenses (net expenses) increased between 2003 and 2004, with expenses increasing $7.4 million (14.4%).

The statements also report comparative amounts of capital grant revenues for 2004 and 2003:

- Capital grant revenues derived from federal and state agencies increased $4.5 million in 2004, as additional federal funding was received for the Enterprise's Denny Way and Renton projects, which are approaching completion of grant-funded portions.

CAPITAL ASSETS

At December 31, 2004, the Enterprise's investment in capital assets, net of accumulated depreciation, is $1.9 billion. This is an increase of $110.2 million (6.2%) over the year-end 2003 investment in capital assets, net of accumulated depreciation. The change is a result of replacement and additions to the interceptor and siphon systems, purchases of land, additional storage capacity, extensions of sewer trunk lines, and continued efforts to control odor and improve sewage-handling technology.

The increase is directly related to continued implementation of the Enterprise's Regional Wastewater Services Plan. Large 2004 construction project expenditures include:

- $18.3 million added to the Denny Way Combined Sewer Overflow project, a joint venture with Seattle Public Utilities, also partially funded by federal grants;
- $7.3 million to replace dewatering equipment at the South Treatment Plant;
- $11.0 million for the Henderson/Martin Luther King Way Combined Sewer Overflow project;
- $9.4 million construction of cogeneration facility at South Treatment Plant;
- $82.7 million spent toward the Brightwater treatment plant and conveyance.

DEBT ADMINISTRATION

During 2004, the Enterprise benefited from declining interest rates. Rates paid on commercial paper and variable rate debt were substantially below amounts projected in setting the 2004 sewer rate. In March 2004, proceeds from issuance of Sewer Revenue Refunding Bonds, Series 2004B, were used for advance refunding of existing debt. The transaction will reduce aggregate debt service payments by $7.2 million over the life of the bonds. The present value of the reduction of aggregate Enterprise debt service was $4.1 million. In March 2004, the Enterprise also issued Sewer Revenue Bonds, Series 2004A, proceeds of which were used to repay construction-related short-term debt and to fund construction activities of the Enterprise.

During 2004, the Enterprise received new loans from agencies of the state of Washington totaling $9.1 million. The loans carry below-market interest rates of 0.5% to 1.5% and repayment terms up to 20 years.

The Enterprise has $1.2 billion of sewer revenue bonds outstanding. Revenue bonds are repaid from and secured by a pledge of earnings, revenues, and money received by the Enterprise from or on account of operation of the sewer system, to include receipts from sewage disposal fees and other income of the Enterprise. Revenue bonds are not guaranteed by the full faith and credit of King County.

The Enterprise has $356.0 million of general obligation bonds outstanding. Although repaid from a portion of receipts from sewage disposal fees and other income, the full faith and credit of King County guarantees repayment of principal and interest on general obligation bonds. At time of the issuance of the Sewer Revenue Bonds, Series 2004A, the Enterprise's bond ratings, as conditioned upon the delivery of an accompanying municipal bond insurance policy, are:

Moody's Investors Service	**Standard & Poor's**
Aaa	AAA

Underlying ratings (those assigned by the ratings services without benefit of an accompanying municipal bond insurance policy) are "A1" for Moody's Investors Service and "AA-" for Standard & Poor's.

As required by bond covenant, the Enterprise maintains a bond reserve account, which is funded by cash balances and surety policies. At December 31, 2004, the cash balance in the reserve account was $67.1 million. In addition to bond covenant reserves, the Enterprise also maintains financial policy reserves. At December 31, 2004, the liquidity and asset management financial policy reserves totaled $21.6 million.

REQUESTS FOR INFORMATION

This financial report is designed to provide an overview of the Enterprise's financial condition at December 31, 2004, and results for the period then ended. Questions concerning this report or requests for additional information should be addressed to Chief Accountant for King County, 500 Fourth Avenue, Room 653, Seattle, Washington 98104.

KING COUNTY WATER QUALITY ENTERPRISE

STATEMENTS OF NET ASSETS
DECEMBER 31, 2004 AND 2003

ASSETS	2004	2003
CURRENT ASSETS:		
Cash and cash equivalents	$ 8,831,534	$ 10,055,566
Accounts receivable	14,355,486	13,885,039
Inventory of supplies	4,676,047	4,319,347
	27,863,067	28,259,952
NONCURRENT ASSETS:		
Revenue fund—cash and cash equivalents	24,711,357	21,829,755
Accounts receivable	501,755	
Construction fund:		
Cash and cash equivalents	14,830,778	9,076,990
Grants receivable	5,777,297	1,800,466
Accounts receivable	861,317	4,288,082
Due from other funds	403,937	278,644
Due from other governments	41,937	52,198
Bond fund—cash and cash equivalents	138,569,406	136,402,049
	185,697,784	173,728,184
CAPITAL ASSETS:		
Building and land improvements	1,310,940,771	1,293,312,594
Plant in service and other equipment	851,212,490	847,931,526
Less accumulated depreciation	(944,387,304)	(862,711,327)
	1,217,765,957	1,278,532,793
Land	67,979,536	50,073,118
Construction work in progress	607,311,853	454,297,338
	1,893,057,346	1,782,903,249
OTHER:		
Deferred environmental remediation costs	6,573,945	6,811,322
Other deferred charges	10,561,085	8,807,142
	17,135,030	15,618,464
TOTAL	$2,123,753,227	$2,000,509,849

(Continued)

KING COUNTY WATER QUALITY ENTERPRISE

STATEMENTS OF NET ASSETS
DECEMBER 31, 2004 AND 2003

LIABILITIES AND NET ASSETS	2004	2003
CURRENT LIABILITIES:		
Accounts payable	$ 3,118,470	$ 2,532,580
Interest payable	1,375,028	550,057
Wages and benefits payable	9,707,919	9,883,170
Notes payable	100,000,000	100,000,000
Obligations under reverse repurchase agreements	1,620,013	434,035
State loans payable	2,292,796	2,079,187
Due to other funds	772,689	2,219,513
Estimated claims settlement	106	2,103,607
Environmental remediation costs	1,205,909	
	120,092,930	119,802,149
CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS:		
Loan from King County Pool		44,967,935
Accounts payable	24,147,148	28,847,427
Interest payable	36,988,590	33,691,551
Wages and benefits payable	374,122	256,728
Obligations under reverse repurchase agreements	4,504,092	5,510,284
General obligation bonds payable—current portion	7,970,000	6,950,000
Revenue bonds payable—current portion	20,585,000	20,700,000
Estimated claims settlement		6,662,042
	94,568,952	147,585,967
COMMITMENTS AND CONTINGENCIES (Note 8)		
NONCURRENT LIABILITIES:		
General obligation bonds payable	348,090,000	356,060,000
Revenue bonds payable	1,189,755,000	1,017,355,000
Deferred bond premium, discount, and refunding losses	(63,143,814)	(62,324,720)
Environmental remediation costs	3,268,436	
State loans payable	91,172,446	84,311,900
	1,569,142,068	1,395,402,180
Total liabilities	1,783,803,950	1,662,790,296
NET ASSETS:		
Invested in capital assets—net of related debt	212,106,246	228,500,258
Restricted	95,437,565	78,383,158
Unrestricted	32,405,466	30,836,137
Total net assets	339,949,277	337,719,553
TOTAL	$2,123,753,227	$2,000,509,849

See notes to financial statements. (Concluded)

KING COUNTY WATER QUALITY ENTERPRISE

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2004 AND 2003

	2004	2003
OPERATING REVENUES:		
Sewage disposal fees	$ 192,911,760	$ 191,919,371
Other operating revenues	24,363,455	22,238,333
Total operating revenues	217,275,215	214,157,704
OPERATING EXPENSES:		
Sewage treatment, disposal, and transmission	71,438,381	71,704,414
General and administrative	11,339,723	11,182,789
Depreciation and amortization	88,421,735	87,722,739
Total operating expenses	171,199,839	170,609,942
OPERATING INCOME	46,075,376	43,547,762
NON-OPERATING REVENUES (EXPENSES):		
Investment earnings	2,662,424	1,918,279
Interest	(56,016,231)	(52,712,603)
Amortization of bond premium, discount, and issuance costs	(5,650,538)	(5,275,865)
Loss on disposal of fixed assets and environmental remediation	(5,733,514)	(686,278)
Other	5,190,918	4,702,364
Total non-operating expenses	(59,546,941)	(52,054,103)
LOSS BEFORE GRANTS, CONTRIBUTIONS, AND TRANSFERS	(13,471,565)	(8,506,341)
GRANT REVENUES	15,921,336	11,438,426
CAPITAL CONTRIBUTIONS		544,470
TRANSFERS—Net	(220,047)	(3,037,980)
CHANGE IN NET ASSETS	2,229,724	438,575
NET ASSETS—Beginning of year	337,719,553	337,280,978
NET ASSETS—End of year	$ 339,949,277	$ 337,719,553

See notes to financial statements.

KING COUNTY WATER QUALITY ENTERPRISE

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2004 AND 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers	$ 219,740,040	$ 209,828,378
Cash payments to suppliers for goods and services	(56,389,465)	(51,841,197)
Cash payments for employee services	(32,489,701)	(31,929,069)
Net cash provided by operating activities	130,860,874	126,058,112
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Operating transfers out	(220,047)	(2,493,510)
Interest paid on short-term loans		(748,503)
Net cash used in noncapital financing activities	(220,047)	(3,242,013)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition of capital assets	(221,512,835)	(170,942,771)
Principal paid on general obligation bonds	(6,950,000)	(6,605,000)
Interest paid on general obligation bonds	(18,411,743)	(21,428,391)
Proceeds of new bond issuance	246,760,000	96,470,000
Principal paid on bonds by refunding	(53,775,000)	(87,460,000)
Principal paid on revenue bonds	(20,700,000)	(10,835,000)
Interest paid on revenue bonds	(51,165,230)	(41,191,747)
Principal paid on notes payable		6,700,000
Interest paid on notes payable	(1,400,151)	(1,197,481)
Issuance costs of bonds and notes payable	(8,223,578)	(8,993,616)
Principal paid on state loans	(2,071,562)	(1,341,273)
Proceeds of state loans	9,145,717	49,536,529
Interest paid on state loans	(878,879)	(432,396)
Capital grants received	5,282,463	11,051,902
Environmental remediation and amortization of deferred charges	(3,525)	(166,636)
Net cash used in capital and related financing activities	(123,904,323)	(186,835,880)
CASH FLOWS FROM INVESTING ACTIVITIES—Interest, other gains on investments and changes in reverse repurchase obligations	2,842,210	4,070,222
Net cash provided by investing activities	2,842,210	4,070,222

(Continued)

KING COUNTY WATER QUALITY ENTERPRISE

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2004 AND 2003

	2004	2003
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	$ 9,578,715	$ (59,949,559)
CASH AND CASH EQUIVALENTS—Beginning of year	177,364,360	237,313,919
CASH AND CASH EQUIVALENTS—End of year	$ 186,943,075	$ 177,364,360
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$ 46,075,376	$ 43,547,762
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	88,421,736	87,722,739
Changes in assets:		
Accounts receivable	2,454,564	(4,467,869)
Inventory of supplies	(356,700)	(86,914)
Due from other governments	10,262	138,544
Changes in liabilities:		
Accounts payable	(4,114,388)	1,482,001
Wages and benefits payable	(57,859)	(1,114,533)
Due to other funds	(1,572,117)	(1,163,618)
Total adjustments	84,785,498	82,510,350
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 130,860,874	$ 126,058,112
SUPPLEMENTAL DISCLOSURE OF NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES—Contribution of capital assets from government	$ 169,859	$ 544,470
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES—Changes in fair value of investments	$ (1,009,316)	$ (1,001,813)

See notes to financial statements.

(Concluded)

1. OPERATIONS AND ACCOUNTING POLICIES

Summary of Operations—The King County Water Quality Enterprise (the "Enterprise") is an enterprise fund operated by the King County Department of Natural Resources in accordance with Chapter 35.58 of the Revised Code of Washington ("RCW") to provide water pollution abatement services to the urbanized areas of King County, Washington (the "County").

The Enterprise is an integral part of the County reporting entity and is included, as an enterprise fund, in the County's comprehensive annual financial report.

As an enterprise fund, the Enterprise is funded and operated separately from other operations of the County. Revenues, bond proceeds, and grants-in-aid are restricted by purpose. Accordingly, the Enterprise has separate accounting records and financial statements.

The Enterprise has long-term sewage disposal agreements with the cities and sewer districts that operate sewage collection systems within its service area. The monthly sewage disposal charge to the contracting cities and districts is based on the Enterprise's estimated annual monetary requirements, including operating costs and debt service. Revenues from the Enterprise's largest customer, the City of Seattle ("Seattle Public Utilities"), represent approximately 42.5% and 43.5% of total sewage disposal fees in 2004 and 2003, respectively.

The Enterprise purchases goods and services from other County agencies, including reimbursement of the County's General Fund for a share of general government. Expenses incurred in doing business with other County agencies amounted to $25,477,000 and $28,327,000 in 2004 and 2003, respectively.

Significant Accounting Policies—The Enterprise is accounted for on a flow of economic resources measurement focus similar to that of a private enterprise organized for profit. The Enterprise's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to governmental units using the accrual basis of accounting. Under this method, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred. The Enterprise, in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, elected not to apply all statements of the Financial Accounting Standards Board issued subsequent to November 30, 1989.

a. *Cash and Cash Equivalents*—The Enterprise considers as cash and cash equivalents all balances held with the King County Treasurer in the King County Investment Pool (the "Pool") and petty cash. Unrealized gain or loss on the Enterprise's proportionate share of the Pool is reported as a component of investment earnings.

b. *Due to/from Other County Funds*—Due to/from other funds consists of payments for goods and services or advances provided to or by other funds and for cash collected on behalf of or due from another fund.

c. *Inventory of Supplies*—Inventory is recorded at the lower of cost or market using the weighted-average cost method. Inventory is written off in the year that it is determined obsolete.

d. *Restricted Assets*—In accordance with the Enterprise's bond resolutions, state law, or other agreements, separate restricted assets have been established. These assets are restricted for specific purposes, including debt service payments and funding of capital projects. These funds are maintained in the revenue fund, construction fund, and bond fund on the statements of net assets.

e. *Capital Assets*—The provision for depreciation is made on a straight-line basis over the estimated useful lives of the Enterprise's capital assets, which range from 2 to 50 years.

Total interest incurred was $76,244,155 and $69,743,823 during the years ended December 31, 2004 and 2003, respectively, of which $20,227,924 and $17,031,220, respectively, was capitalized.

Repairs and maintenance are expensed as incurred; major renewals, replacements, and betterments are capitalized.

The Enterprise periodically reviews long-lived assets for impairment to determine whether any events or circumstances indicate the carrying value of the assets may not be recoverable. No impairment was identified in 2004 or 2003.

f. *Environmental and Property Remediation Costs*—In prior years, the Enterprise settled lawsuits related to certain environmentally damaged sites. In these settlements, the Enterprise agreed to pay its portion of remediation and cleanup costs.

The Enterprise funds the majority of its environmental expenditures with debt proceeds. The Enterprise also receives grant funding to offset a portion of these costs. The initial settlement costs, net of the partial grant funding and other recoveries, are deferred and are being amortized over 40 years as revenues are collected from the Enterprise's customers. Current remediation activities are expensed in the year incurred. Previously, the Enterprise agreed to pay a portion of remediation costs to clean up contaminated sediments and restore aquatic habitats in Elliott Bay and the Lower Duwamish River. Although the Department of Ecology has not mandated remediation of any of these sites, the Enterprise has conducted a review and has identified seven areas near combined sewer overflows that may require sediment remediation. Due to the high level of regulatory review, approval requirements, and the environmental permitting associated with these projects, and the uncertainty related to the particular remediation alternative for each project, the schedule of required remediation and costs of remediation has not been fully determined. However, the Enterprise has accrued $2.4 million for the sediment remediation plan as of December 31, 2004.

Compensated Absences—Employees earn vacation based upon their date of hire and years of service. They may accumulate a maximum of 480 hours. Unused vacation at retirement or normal termination is considered vested and payable to the employee.

Employees also earn up to 12 days of sick leave per year and may accumulate sick leave balances without limit. Employees or their beneficiaries are paid 35% of the accrued unused sick leave upon retirement or death. No amounts are paid for unused sick leave upon termination.

The Enterprise records additions to wages and benefits payable for accrued and unused vacation and sick leave in the period earned.

g. *Amortization*—Bond issue costs and discounts are amortized to interest expense using the effective interest rate method over the term of the bonds.

The excess costs incurred over the carrying value of bonds refunded on early extinguishment of debt are amortized as a component of interest expense over the shorter of the remaining term of the refunded bond or the term of the new bond.

h. *Deferred Compensation*—The County offers a consolidated deferred compensation plan that complies with Internal Revenue Code Section 457. The plan permits employees to defer a portion of annual compensation until future years. Participation in the plan is voluntary. No amounts related to these obligations are recorded in the financial statements.

i. *Use of Estimates*—The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Specific estimates have been made in the areas of allowance for uncollectible accounts, environmental remediation costs, useful lives of capital assets, and future interest rates. Actual results could differ from these estimates.

j. *Reclassifications*—Certain reclassifications have been made to the prior year statements to conform to the current year presentation.

k. *Capital Grant Revenues*—Pursuant to GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, grant revenues are reported separately from operating and nonoperating revenues as capital grant revenues. The Enterprise received capital grant revenues of $15,921,336 and $11,438,428 for the years ended December 31, 2004 and 2003, respectively.

l. *Net Assets*—Pursuant to GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, grant revenues and resources set aside for repayment of bonds, net of related liabilities, are classified as restricted net assets on the statement of net assets, as their use is limited by externally-imposed restrictions. Capital assets are reported as a separate component of net assets, net of related debt. Any net assets not subject to classification as restricted or invested in capital assets are reported as unrestricted.

New Accounting Standards Adopted—In 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures*. This statement establishes and modifies disclosure requirements related to investment risks: credit risk (including custodial credit risk and concentrations of credit risk), interest rate risk, and foreign currency risk. This statement also establishes and modifies disclosure requirements for deposit risks: custodial credit risk and foreign currency risk. The requirements of this statement are effective for the Enterprise's financial statements for periods beginning after June 15, 2004 (January 1, 2005). The Enterprise does not anticipate that the adoption of this standard will have a material impact on its financial position or results of operations.

In 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries.* This statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This statement also clarifies and establishes accounting requirements for insurance recoveries. The Enterprise will adopt this statement effective January 1, 2005; however, the Enterprise does not expect a material impact on its financial position or results of operations.

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Statement No. 45 establishes accounting and financial reporting standards for benefits that are earned during an employee's active service, but will not be paid until after the employee retires. GASB Statement No. 45 is effective for the Enterprise beginning in fiscal year 2007. Enterprise management is currently evaluating the potential impact of GASB Statement No. 45.

2. CASH AND INVESTMENTS

The King County Treasurer is the custodian of the Enterprise's cash and investments. Prior to October 2002, most Enterprise funds were invested solely in direct obligations of the U.S. Treasury. A refunding of bonds, which were issued with various restrictive covenants, has removed this investment restriction and enabled the Enterprise to invest all its funds in the Pool. Enterprise cash on deposit with the King County Treasurer is pooled with cash from other County funds and other jurisdictions and either deposited in the County's bank account or invested by the County. The County's pooled deposits and investments are categorized by risk into three basic categories. Risk Category 1 includes deposits insured or collateralized with securities held by the entity or by its agent in the entity's name. Risk Category 2 includes deposits collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name. Risk Category 3 includes deposits that are uncollateralized, including any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in the entity's name. At year-end 2004, all of the County's pooled deposits are in Risk Category 1.

Statutes permit the Pool to enter into reverse repurchase agreements. The Enterprise has been allocated a proportionate share of the pooled investments and liabilities associated with reverse repurchase agreements based on total equity in the Pool. Reverse repurchase agreements are recorded as an increase to assets and an offsetting increase to liabilities. The Enterprise's share of the reverse repurchase agreements was $6,124,105 and $5,944,319 as of December 31, 2004 and 2003, respectively. The proceeds from the repurchase agreements are reinvested in other instruments with the same maturity as the collateral securities, resulting in a matched position.

The amount of cash received in reverse repurchase agreements is normally less than the market value of the underlying security. Should a third-party default on their obligations to resell these securities to the County, the County would be faced with an economic loss equal to the difference between the market value of the underlying securities and the agreement obligation. During the fiscal years ended December 31, 2004 and 2003, no losses were incurred as a result of default.

3. RISK MANAGEMENT

The Enterprise is exposed to a wide range of risks of loss, including those related to tort; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters.

The Enterprise participates in three County internal service funds to account for and finance property/casualty, workers' compensation and employee medical and dental benefits self-insurance programs. The County contracts with a plan administrator to process medical and dental claims. County fund/claims managers, together with the Civil Division of the King County Prosecuting Attorney's Office, are responsible for processing all tort and workers' compensation claims.

Claims settlements and loss expenses are accrued in the three internal service funds for the estimated settlement value of both reported and unreported claims. These funds are responsible for collecting inter-fund premiums from insured funds and departments, for paying claim settlements, and for purchasing certain policies. The County's internal service funds assess premiums attributable to the Enterprise on the basis of claims experience, actuarial evaluation of future claims risk, and adequacy of available reserves. Premiums are recorded as an expense in the year paid or accrued.

The Enterprise retains all risk associated with environmental claims.

4. LONG-TERM LIABILITIES AND NOTES PAYABLE

Sewer Revenue Bonds—As of December 31, 2004, bonds outstanding include $662,075,000 of serial bonds maturing from January 1, 2005 through 2033, bearing interest at stated rates of 2% to 6.25% per annum, and $548,265,000 of term bonds maturing on January 1 in the years 2024 through 2035, bearing interest at stated rates of 5% to 5.5% per annum.

In March 2004, the Enterprise issued $246,760,000 of sewer revenue bonds maturing from January 1, 2005 to 2035. The issue includes $174,660,000 of serial bonds maturing from January 1, 2005 through 2030, bearing interest at stated rates of 2% to 5%, and $72,100,000 of term bonds, maturing 2030 through 2035, bearing interest at stated rates of 4.5% to 5%.

Certain serial bonds may not be redeemed prior to maturity; other bonds may be redeemed at declining premiums after the lapse of specific periods of time. Monies in the sewer revenue bond fund may be used to purchase term bonds prior to maturity.

Payments from revenues of the Enterprise are required to be made to the sewer revenue bond fund in annual amounts sufficient to retire serial or term bonds on or before maturity. At December 31, 2004, the Enterprise designated restricted cash balances of $48,464,974 as amounts to repay principal and interest due on revenue bonds on January 1, 2005.

Additional amounts of $67,122,000, held in the bond fund as bond reserves, as of both December 31, 2004 and 2003 have been designated as net assets restricted for future debt service. The Enterprise met additional reserve requirements required by the issuance of Sewer Revenue Bonds, Series 2004A, and Sewer Revenue Refunding Bonds, Series 2004B, by purchase of a surety policy issued by a private insurer. The amount required in the cash reserves and surety policies are based on the highest year of debt service over the life of all outstanding revenue bonds. As of December 31, 2004, the combined amount in the reserve and the surety policies was $87,277 less than needed. This small shortage was corrected in February 2005.

Defeased Debt—In March 2004, the Enterprise issued $61,760,000 of Sewer Revenue Refunding Bonds, Series 2004B. Bond proceeds were used for advance refunding of existing general obligation debt and to pay costs of issuance, bond insurance, and underwriter's discount. The loss recognized on defeasance was $8,662,168, which will be amortized over the life of the old bonds. The transaction will reduce aggregate debt service payments by $7,195,082 over the life of the bonds. The present value of the reduction of aggregate debt service is $4,069,301.

The Sewer Revenue Bonds, 1999 (Second Series), in the amount of $53,775,000, were considered defeased as of December 31, 2004.

At the time of defeasance, amounts are placed in irrevocable escrow accounts to provide for all future debt service on the defeased bonds. As a result, the bonds are considered to be defeased and are not included in the Enterprise's financial statements.

General Obligation Bonds—As of December 31, 2004, bonds outstanding include $95,180,000 of serial bonds maturing January 1, 2005 through 2018, bearing interest at stated rates of 4.75% to 5.5% per annum. General Obligation Bonds outstanding also include $260,880,000 of term bonds maturing on January 1, 2017 through 2034, bearing interest at stated rates of 4.75% to 6.25%.

Certain serial bonds cannot be redeemed prior to maturity; other bonds may be redeemed at declining premiums after the lapse of specific periods of time.

State Loans—The Enterprise has received loans from the Washington Department of Ecology under the Water Pollution Control State Revolving Fund Loan Program and the Washington Public Works Trust Fund. The loans require annual payments of principal and interest from 2005 through 2024 and bear interest at stated rates from 0.5% and 1.5%. As of December 31, 2004, the balance due on all state loans is $93,465,242. As required by loan covenants, the Enterprise maintains separate cash reserves of $1,681,774 with respect to the loans from the Revolving Fund Loan Program.

Maturities of Long-Term Liabilities—As of December 31, 2004, required principal and interest payments are as follows:

	Revenue Bonds		Variable Rate Revenue Bonds	
Year(s) Beginning	Principal	Interest	Principal	Interest
January 1, 2005	$ 20,585,000	$ 53,070,570	$ -	$ 4,725,000
January 1, 2006	23,115,000	54,469,486		4,725,000
January 1, 2007	24,885,000	53,341,936		4,725,000
January 1, 2008	26,095,000	52,166,161		4,725,000
January 1, 2009	27,410,000	50,831,354		4,725,000
January 1, 2010–2014	161,280,000	232,166,021		23,625,000
January 1, 2015–2019	157,715,000	187,682,078		23,625,000
January 1, 2020–2024	157,050,000	150,453,551		23,625,000
January 1, 2025–2029	199,740,000	107,758,435	100,000,000	23,625,000
January 1, 2030–2034	253,905,000	53,601,481		14,175,000
January 1, 2035	58,560,000	2,938,550		
	$1,110,340,000	$ 998,479,623	$ 100,000,000	$ 132,300,000

	General Obligation Bonds		State Loans		
Year(s) Beginning	Principal	Interest	Principal	Interest	Total
January 1, 2005	$ 7,970,000	$ 18,225,200	$ 2,292,796	$ 438,062	107,306,628
January 1, 2006	6,215,000	17,821,763	4,789,882	1,223,731	112,359,862
January 1, 2007	6,005,000	17,511,850	4,846,829	1,160,919	112,476,534
January 1, 2008	6,270,000	17,213,638	4,717,145	1,097,248	112,284,192
January 1, 2009	6,600,000	16,902,163	4,775,832	1,033,645	112,277,994
January 1, 2010–2014	35,870,000	79,260,513	24,783,235	4,185,542	561,170,311
January 1, 2015–2019	44,875,000	70,244,225	26,381,131	2,483,581	513,006,015
January 1, 2020–2024	63,435,000	57,056,588	20,878,392	778,176	473,276,707
January 1, 2025–2029	79,985,000	39,463,863			550,572,298
January 1, 2030–2034	98,835,000	14,650,425			435,166,906
January 1, 2035					61,498,550
	$ 356,060,000	$ 348,350,228	$ 93,465,242	$ 12,400,904	$3,151,395,997

The future annualized interest payments for the variable rate revenue bonds are estimated based on conversion to long-term bonds at 90% of the current long-term bond rate of 5.25%.

Changes in Long-Term Liabilities—Long-term liability activity was as follows for the years ended December 31:

	Revenue Bonds Payable	General Obligation Bonds Payable	State Loans Payable
January 1, 2003	$ 952,420,000	$457,075,000	$ 38,195,831
Additions	96,470,000		49,536,529
Reductions	(10,835,000)	(94,065,000)	(1,341,273)
December 31, 2003	1,038,055,000	363,010,000	86,391,087
Additions	246,760,000		9,145,717
Reductions	(74,475,000)	(6,950,000)	(2,071,562)
December 31, 2004	$1,210,340,000	$356,060,000	$ 93,465,242
Due within one year	$ 20,585,000	$ 7,970,000	$ 2,292,796

Commercial Paper (Notes Payable)—In December 1995, the Enterprise initiated a commercial paper program that gives the Enterprise the ability to issue up to $100,000,000. The program is supported by an annually renewable line of credit that expires November 30, 2015. As of December 31, 2004, $100,000,000 was issued and outstanding under this program. The commercial paper has maturities ranging between 30 and 154 days and is classified as a current liability of the Enterprise's operating fund.

Variable Rate Revenue Bonds—The variable rate bonds are supported by an annually renewable letter of credit that expires December 31, 2015.

Financial Policy Reserves—In addition to bond reserves related to Sewer Revenue Bonds, the Enterprise maintains liquidity and asset management reserves in noncurrent assets totaling $21,617,289 at December 31, 2004.

Compliance with Bond Resolutions—With respect to the year ended December 31, 2004, the Enterprise complied with all covenants stipulated by its bond resolutions, except for providing audited financial statements and a consulting engineer's report within 120 days of year-end and a minor shortfall in bond reserves. The Enterprise has six months beyond the 120 days to comply with the reporting covenants. It is management's intention to remedy noncompliance within the applicable six-month period. The minor shortfall in the bond reserves was corrected in February 2005.

5. CHANGES IN CAPITAL ASSETS

Changes in capital assets are shown in the following tables for the years ended December 31:

	January 1, 2003	Increases	Retirements and Dispositions	December 31, 2003
Building and land improvements	$1,231,387,503	$ 61,925,091	$ -	$1,293,312,594
Major equipment and vehicles	7,869,760	310,867	(7,697)	8,172,930
Shop and other equipment	819,693,790	12,341,591	(694,018)	831,341,363
Software development	8,426,223		(8,990)	8,417,233
Land	35,185,252	14,887,866		50,073,118
Work in progress	305,523,698	240,471,599	(91,697,959)	454,297,338
	2,408,086,226	329,937,014	(92,408,664)	2,645,614,576
Less accumulated depreciation and amortization:				
Building and land improvements	(394,668,163)	(29,857,617)		(424,525,780)
Major equipment and vehicles	(2,437,384)	(708,109)	7,898	(3,137,595)
Shop and other equipment	(370,531,909)	(56,715,501)	613,397	(426,634,013)
Software development	(8,422,515)	(412)	8,988	(8,413,939)
	(776,059,971)	(87,281,639)	630,283	(862,711,327)
	$1,632,026,255	$242,655,375	$ (91,778,381)	$1,782,903,249

	January 1, 2004	Increases	Retirements and Dispositions	December 31, 2004
Building and land improvements	$1,293,312,594	$ 19,538,369	$ (1,910,192)	$1,310,940,771
Major equipment and vehicles	8,172,930	245,430		8,418,360
Shop and other equipment	831,341,363	8,331,415	(4,597,472)	835,075,306
Software development	8,417,233		(698,409)	7,718,824
Land	50,073,118	17,906,418		67,979,536
Work in progress	454,297,338	211,602,928	(58,588,413)	607,311,853
	2,645,614,576	257,624,560	(65,794,486)	2,837,444,650
Less accumulated depreciation and amortization:				
Building and land improvements	(424,525,780)	(31,609,540)	1,710,911	(454,424,409)
Major equipment and vehicles	(3,137,595)	(720,893)		(3,858,488)
Shot and other equipment	(426,634,013)	(56,127,661)	4,373,209	(478,388,465)
Software development	(8,413,939)	(412)	698,409	(7,715,942)
	(862,711,327)	(88,458,506)	6,782,529	(944,387,304)
	$1,782,903,249	$169,166,054	$ (59,011,957)	$1,893,057,346

6. EMPLOYEE BENEFIT PLANS

Defined Benefit Pension Plans—Substantially all full-time and qualifying part-time employees of the Enterprise participate in either the Public Employees' Retirement System ("PERS") or the Seattle City Employees' Retirement System ("SCERS"). PERS is a statewide governmental retirement system administered by the State of Washington's Department of Retirement Systems.

Historical trend and other information regarding PERS are presented in the State of Washington Department of Retirement Systems' 2004 Comprehensive Annual Financial Report. A copy of this report may be obtained from the Department of Retirement Systems, P.O. Box 48380, Olympia, Washington, 98504-8380.

Historical trend and other information regarding SCERS are presented in the Seattle City Employees' Retirement System's 2004 Comprehensive Annual Financial Report. A copy of this report may be obtained from the Seattle City Employees' Retirement System, 801 Third Avenue, Suite 300, Seattle, Washington, 98104.

Public Employees Retirement System—The Washington State Legislature (the "Legislature") established PERS in 1947 under RCW chapter 41.40. PERS is a cost-sharing, multiple-employer defined benefit system.

The PERS plan contains three tiers. Participants who joined the system by September 30, 1977 are Plan I members. Those joining thereafter are enrolled in Plan II, unless the employee chooses Plan III. Retirement benefits for all plans are financed from employee and employer contributions and investment earnings. Retirement benefits are vested after various minimum periods of eligible service.

Plan I members are eligible for retirement after 30 years of service or at the age of 60 with 5 years of service, or at the age of 55 with 25 years of service. The annual pension is 2% of the final average salary per year of service, capped at 60%. If qualified, after reaching age 66, a limited cost of living allowance is granted.

Plan II members may retire at the age of 65 with 5 years of service or at 55 with 20 years of service, with an allowance of 2% per year of service of the final average salary. Plan II retirements prior to the age of 65 are actuarially reduced. There is no cap on years-of-service credit and a limited cost-of-living allowance is granted.

Plan III commenced September 1, 2002. Plan III members may retire with 10 years of service or with 5 service years, including one year earned after age 54 and 5 service years under Plan II prior to transfer to Plan III. Plan III retirements prior to age 65 are actuarially reduced. With respect to the defined benefit portion of Plan III, there is no cap on years-of-service credit, and a limited cost of living allowance is granted.

Each biennium, the Legislature establishes Plan I employer contribution rates, Plan II employer and employee contribution rates and Plan III employer contribution rates. Employee contribution rates for Plan I are not necessarily adequate to fully fund the system. The employer and employee contribution rates for Plan II and the employer contribution rates for Plan III are developed by the Office of the State Actuary to fully fund future pension obligations. All employers are required to contribute at the level established by the Legislature.

The Enterprise's contribution rates expressed as a percentage of covered payrolls were as follows as of December 31, 2004:

	PERS Plan I 1/1–6/30	PERS Plan I 7/1–12/31	PERS Plan II 1/1–6/30	PERS Plan II 7/1–12/31	PERS Plan III 1/1–6/30	PERS Plan III 7/1–12/31
Employer	1.40 %	1.38 %	1.40 %	1.38 %	1.40 %	1.38 %
Employee	6.00	6.00	1.18	1.18	5%–15%	5%–15%
	7.40 %	7.38 %	2.58 %	2.56 %	6.40%–16.40%	6.38%–16.38%

Employer contributions to Plan III are the same as those required for Plan II. Employee contributions to Plan III are made to a separate defined contribution account and may vary from 5% to 15%.

The Enterprise's required employer contributions for the years ended December 31 were:

	PERS Plan I	PERS Plans II and III
2004	$ 51,875	$ 525,580
2003	55,405	455,416
2002	63,944	452,925

Seattle City Employees' Retirement System ("SCERS")—SCERS is a cost-sharing, multiple-employer retirement plan administered in accordance with the Seattle Municipal Code Chapter 4.36. Enterprise employees who are former employees of Seattle Transit are covered by SCERS. SCERS provides retirement, death, and disability benefits.

Employees covered by this plan may retire after 30 years of service regardless of age, after age 52 with 20 years or more of service, after age 57 with 10 or more years of service and after age 62 with five or more years of service. Disability retirement is available after 10 years of service. The unmodified monthly retirement allowance is based on a percentage of average salary for every year of service to a maximum of 60%. The average salary for this plan is defined as the highest consecutive 24-month average rate of pay. The percentage for each year of service used to compute the retirement benefit depends on the age at retirement and the years of service and ranges from 1.2% at age 52 with 20 years of service to a maximum of 2% for each year of service. The maximum allowance a member can receive is the unmodified plan, which has no provision for a beneficiary, and under which all payments stop at the member's death. Several optional retirement benefit formulas exist that make provisions for beneficiaries with reduced monthly allowances.

Within SCERS, there were no material changes in benefit provisions in 2004.

The SCERS member contribution rate is 8.03% of compensation, except for members qualifying prior to June 1972 for lower rates. The Enterprise is required to contribute at an actuarially determined rate. The current rate is 8.03% of annual covered payroll. The contribution requirements of plan members and the Enterprise are established and may be amended by the Board of Administration. Both the Enterprise and the employees made the required contributions. The Enterprise's required employer contributions for the years ended 2004, 2003, and 2002 were $175, $631, and $5,149, respectively.

7. OPERATING SUBSIDIES AND GRANT REVENUES

Various federal and state government agencies make grants to the Enterprise to aid in financing construction costs (capital grants), including those on various projects included in the comprehensive plan, and for operating costs (operating subsidies). Operating subsidies are recorded as revenues in the statements of revenues, expenses, and changes in net assets. Capital grants amounted to $15,921,336 and $11,438,426 for the years ended December 31, 2004 and 2003, respectively.

8. COMMITMENTS AND CONTINGENCIES

Construction Program—The Federal Water Pollution Control Act requires that municipal sewage be subjected to secondary treatment. Major facilities have been included in the Enterprise's construction plan to meet this requirement, including five treatment plants that are being improved or modified to provide secondary treatment under compliance schedules that have been or will be established by permit, by court-approved consent decree, or by administrative order.

The Enterprise is continuing to design, acquire, and construct treatment facilities and conveyance lines within the guidelines of the construction plan. As of December 31, 2004, the Enterprise plans to expend approximately $1,880,241,000 through 2010 to complete the requirements of the construction plan. The majority of the expenditures will be used for construction of secondary treatment facilities (including an additional sewage treatment plant) and combined sewer overflow control facilities.

Contingencies and Claims—The Enterprise has received claims from contractors involved in construction projects. The contractors have claimed amounts in excess of the original contract sums. The Enterprise intends to defend its case in these actions and cannot assess the likelihood of an adverse outcome; however, management believes any adverse outcomes would not have a material impact on the Enterprise.

Office Facilities—The Enterprise currently rents office space from the Department of Construction and Facilities Maintenance of King County. The Enterprise has not entered into a formalized legal contract for the use of these spaces but is expected to continue to rent office space for future years. Rent expenses incurred in 2004 and 2003 were approximately $1,289,000 and $1,282,000, respectively.

9. TRANSFERS AND CAPITAL CONTRIBUTIONS

The King County Council approves ordinances and/or motions authorizing the Enterprise to contribute and receive amounts to and from various County funds. These net amounts are reported as transfers on the statements of revenues, expenses, and changes in net assets. During 2004 and 2003, the net cash transfers to other funds from the Enterprise were $220,047 and $3,037,980, respectively.

10. SUBSEQUENT EVENT

In April 2005, the Enterprise issued $200,000,000 of Limited Tax General Obligation Bonds. The proceeds of the bonds were used to repay short-term indebtedness and to fund the Enterprise's ongoing program to improve and maintain the sewer system.

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SUPPLEMENTAL SCHEDULE

KING COUNTY WATER QUALITY ENTERPRISE

SUPPLEMENTAL SCHEDULE OF NET REVENUES AVAILABLE FOR DEBT SERVICE YEAR ENDED DECEMBER 31, 2004

The Enterprise is obligated by applicable bond ordinances to set sewage disposal rates at a level adequate to provide net revenue equal to at least 1.15 times the annual debt service requirements for sewer revenue and general obligation bonds payable from revenues of the Enterprise. It is adopted policy of the Enterprise to achieve a debt service coverage ratio of 1.25.

Coverage (1.15 required by covenant, adopted policy 1.25)	1.39

In 2001, the Enterprise adopted a new debt service target of 1.15 times the annual debt service for bonds, obligations, notes, and loans of the Enterprise.

Coverage (1.15 adopted target)	1.30

The Enterprise is required to generate revenues sufficient to pay all costs of operation of the sewage treatment system and debt service on obligations of the Enterprise.

Coverage (1.00 required by covenant)	1.19

In 2001, the Enterprise issued an additional tier of revenue bonds. The bond covenants of the Junior Lien Variable Rate Demand Sewer Revenue Bonds, Series 2001A and Series 2001B, require that sewage disposal rates provide net revenue equal to at least 1.10 times the annual debt service requirements for all Junior Lien obligations after payment of senior lien requirements.

Coverage (1.10 required by covenant)	24.09