Report of Independent Auditors and Financial Statements with Required Supplementary Information and Supplemental Information for

King County Water Quality Enterprise Fund (An Enterprise Fund of King County, Washington)

December 31, 2013 and 2012

MOSS-ADAMS LLP

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REPORT OF INDEPENDENT AUDITORS

To the Metropolitan King County Council
Seattle, Washington

Report on Financial Statements

We have audited the accompanying financial statements of the King County Water Quality Enterprise Fund (Water Quality), which comprise the statements of net position as of December 31, 2013 and 2012, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

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 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 audits 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 entity'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 entity'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 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 King County Water Quality Enterprise Fund as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 13 to the financial statements, Water Quality adopted the accounting requirements of Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which resulted in the restatement of previously reported amounts for the year ended December 31, 2012. 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 3 through 12 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on Water Quality's financial statements. The Supplemental Schedule of Net Revenues Available for Debt Service is presented for purposes of additional analysis and is not a required part of the 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 financial statements. The supplemental schedule has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Moss Adams LLP

Seattle, Washington
May 15, 2014

The management of King County Water Quality Enterprise Fund (Water Quality) presents to readers of its financial statements this narrative overview and analysis of its activities and financial performance for the fiscal years ended December 31, 2013 and 2012.

THE SEWER SYSTEM

Water Quality provides regional wastewater treatment services to Western Washington in King County, part of Snohomish County, and part of Pierce County with a service area encompassing over 415 square miles. The major wastewater treatment facilities include three secondary treatment plants at West Point in Seattle, South Plant in Renton and the Brightwater Treatment Plant located near Woodinville and two smaller secondary treatment plants at Vashon Island and Carnation, 391 miles of interceptors, 47 pump stations, and 25 regulator stations. Other facilities include four combined sewer overflow treatment plants (CSO) and 38 CSO control locations. The sewer system collects and treats an average of 177 million gallons per day from approximately 1.5 million residents.

FINANCIAL HIGHLIGHTS

During 2013, Water Quality provided sewage treatment services to 718,160 residential customer equivalents (RCE) compared to 708,900 in 2012 and 707,300 in 2011. An RCE is one single-family residence or an equivalent unit of 750 cubic feet of monthly water consumption for all other customers such as multifamily residential, commercial, and industrial properties. The capacity charge program added 7,224 new connections to its customer billing base in 2013. The program added 7,915 and 5,855 new connections in 2012 and 2011, respectively. The average flow of the five treatment plants was 167 million gallons per day (MGD) with a peak daily flow of 500 MGD. Maximum system capacity remained at 895 MGD in 2013 and 2012 after full implementation of the Brightwater Treatment Plant. The average daily flow fluctuated between a low of 167 MGD in 2013 and a peak of 188 MGD in 2012. The annual fluctuation in flows largely depends on the amount of annual precipitation.

In 2013, Water Quality distributed 115,801 wet tons of biosolids to end users engaged in forestry, agriculture and soil enhancement. Approximately 65 million gallons of Class A reclaimed water was distributed for irrigation, urinals/toilets, municipal purposes, and wetland enhancement and about 607 million gallons of filtered, treated wastewater were used for internal treatment plant processes. The reclaimed water capacity at South Plant is 1.3 MGD and the Brightwater reclaimed water distribution capacity is 7 MGD. Water Quality sold 1.5 million therms of natural gas to Puget Sound Energy from the South Treatment Plant, and produced 6.5 million kilowatt hours of electricity produced from digester gas at the West Point Treatment Plant which was sold to Seattle City Light.

The Industrial Pretreatment Program conducted 363 inspections and took 1610 compliance samples in 2013. The program currently tracks 342 facilities with discharge authorization permits and 121 significant industrial users.

FINANCIAL HIGHLIGHTS (CONTINUED)

Water Quality currently has 38 combined sewer overflow facilities plus 4 CSO treatment facilities. An aggressive effort conducted in concert with the City of Seattle has resulted in a significant reduction in combined sewer overflows from a baseline of 2.3 billion gallons per year in years 1980-1983 to an average of 800 million gallons per year.

In 2012, the Environmental Protection Agency (EPA) entered into a consent decree with Water Quality to reduce CSO overflows over a 25 year period. The consent decree required the payment of a $400 thousand fine for past CSO overflows and the possibility of future fines for CSO overflows exceeding EPA limits. The EPA accepted Water Quality's 2012 Amended Long-term CSO Control Plan as part of the consent decree and has established an option to develop an integrated plan which may reduce CSO's at lower costs than traditional methods. The EPA will monitor Water Quality's progress with CSO control and work closely with the enterprise going forward to achieve acceptable CSO levels.

In 1999, the Metropolitan King County Council adopted the Regional Wastewater Services Plan (RWSP) to construct additional capacity, protect public health and provide for future projected population growth in its service area through 2030. Major RWSP projects include the building of the Brightwater Treatment Plant, improvements to the regional Conveyance system, construction of 21 CSO control projects, and expansion of the South Treatment Plant to 135 million gallons per day capacity by 2029. The RWSP also includes projects to control infiltration and inflow into the Conveyance system, process additional biosolids, and produce additional reclaimed water. Total Water Quality capital program expenditures were $163.5 million for 2013 and $192.4 million for 2012.

Water Quality operating revenues increased by 10.5 percent to $422 million in 2013 from $381.9 million in 2012 while operating expenses before depreciation and amortization increased by 1.9 percent to $117.1 million in 2013 from $114.9 million in 2012.

The monthly sewer rate increased to $39.79 per RCE in 2013. In 2012, it remained unchanged at $36.10. The capacity charge rate increased to $53.50 per RCE in 2013 from $51.95 in 2012. Capacity charge revenues increased 14.2 percent to $58.8 million in 2013 from $51.4 million in 2012. The RCE's billed for sewer treatment services increased to 718,160 in 2013 from 708,900 in 2012. The rate stabilization reserve decreased to $52.3 million in 2013 from $62.6 million in 2012. This decrease of $10.3 million in the reserve balance increases operating revenues for the year and has been included in the calculation of debt service coverage for 2013. Future deposits to the rate stabilization reserve will decrease operating revenues and debt service coverage in the year of the deposit. Withdrawals will have the opposite effect of increasing operating revenues and debt service coverage in the year the rate stabilization reserve is reduced.

The rate stabilization reserve, as mandated by the Metropolitan King County Council as part of its rate setting activities, requires Water Quality to set aside a portion of current revenue for future periods in order to moderate the impact of rate increases over time.

FINANCIAL HIGHLIGHTS (CONTINUED)

Water Quality issued $197.8 million in Sewer Revenue and Refunding Bonds in 2013, including $50 million for new construction and $3 million in additional bond reserves. This resulted in $38 million in savings over the lives of the refunded issues or $24.1 million in present value of debt service savings. This compares to $234.1 million of Revenue and Refunding bonds issued in 2012, including $81.3 million for new construction and $3.6 million for bond reserves, and $100 million in Junior Lien Variable Rate Demand Revenue bond proceeds. Additionally in 2013, $19.6 million in low interest state loans were received at rates between 2.72% and 2.82% compared to $15.3 million received in 2012.

The results of operations for 2013 and 2012 produced a debt service coverage ratio on senior lien debt of 1.42 and 1.37, respectively, exceeding the coverage covenant requirement of 1.15 in both years. The total debt coverage ratio of 1.33 in 2013 and 1.28 in 2012 exceeded the 1.15 policy minimum in both years.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to Water Quality's basic financial statements. The basic financial statements are comprised of the comparative statements of net position, statements of revenues, expenses and changes in net position, statements of cash flows, and the notes to the financial statements, which explain certain elements of the financial statements in greater detail.

REQUIRED FINANCIAL STATEMENTS

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

The comparative statement of net position presents information on all of Water Quality's assets, liabilities and deferred inflows/outflows of resources, with the difference presented as net position as of each year-end. Over time, the statements demonstrate Water Quality's financial health by providing a basis for the reader to evaluate capital structure, liquidity, and financial flexibility.

The two most recent years' operating and non-operating revenues and expenses of Water Quality are accounted for in the statements of revenues, expenses and changes in net position. The statements illustrate the current and prior period results of operations and recovery of costs by receipt of fees, and are instrumental in demonstrating Water Quality's continued creditworthiness. All changes in net position are reported as soon as the underlying event occurs, irrespective of the timing of related cash flows. The receipt of monthly sewage treatment charges provides the principal support for Water Quality's activities. Sewage treatment charges of $353.3 million provided 83.7 percent of operating revenues in 2013 and $321.1 million provided 84.1 percent of operating revenues in 2012. Water Quality is a wholesale provider of sewage treatment services to 34 municipal and 3 non-municipal participants in King, Pierce, and Snohomish counties. The receipt of the monthly payments is governed by service agreements, the majority of which expire in July 2036.

REQUIRED FINANCIAL STATEMENTS (CONTINUED)

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 Water Quality's sources and applications of cash during 2013 and 2012, reasons for differences between operating cash flows and operating income, and the effect on the statements of net position 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.

In the following comparative analysis of the financial statements, percentages and ratios were calculated and rounded using the actual detail from the financial statements. In 2013, Water Quality implemented Government Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Asset and Liabilities,* reclassifying certain items that were previously reported as assets and liabilities to deferred outflows and inflows of resources or to outflows of resources (expense). The analysis below is therefore restated for 2011-12 due to GASB 65's implementation.

FINANCIAL ANALYSIS OF THE STATEMENTS OF NET POSITION

Comparative data, stated in millions of dollars:

	Years Ended December 31,		
	2013	2012 (As Restated)	2011 (As Restated)
Current assets	$ 457.9	$ 304.8	$ 281.7
Noncurrent assets	236.0	249.7	231.2
Capital assets	4,128.4	4,141.2	4,062.1
Other	95.9	82.3	88.7
Total assets	4,918.2	4,778.0	4,663.7
Deferred outflows of resources	92.0	94.4	71.4
Total assets and deferred outflows of resources	5,010.2	4,872.4	4,735.1
Current liabilities	435.6	295.9	307.8
Long term liabilities	3,962.4	3,952.8	3,782.9
Total liabilities	4,398.0	4,248.7	4,090.7
Deferred inflows of resources	52.3	62.6	76.5
Total liabilities and deferred inflows of resources	4,450.3	4,311.3	4,167.2
Net position-net investment in capital assets	206.9	200.1	276.4
Net position-restricted	203.3	254.8	297.3
Net positon-unrestricted	149.7	106.2	(5.8)
Total net position	$ 559.9	$ 561.1	$ 567.9

FINANCIAL ANALYSIS OF THE STATEMENTS OF NET POSITION (CONTINUED)

Net position serves as a useful indicator of Water Quality's financial position. As of December 31, 2013 and 2012, assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by $559.9 million and $561.1 million, respectively.

Of the total Water Quality assets, 82.4 percent or $4,128.4 million were invested in capital assets such as treatment plants, pumping and regulator stations, interceptors, and other equipment at year-end 2013. For the year-end 2012, 85 percent or $4,141.2 million were invested in capital assets. Water Quality uses its capital assets to provide wholesale wastewater collection and treatment services in King, Pierce, and Snohomish counties. Current operating and debt service requirements are met by operating and non-operating revenues composed of monthly sewage treatment charges, a capacity charge for new customers, other special-handling charges, miscellaneous operating revenues, and investment earnings.

The net position decreased by 0.2 percent or $1.2 million in 2013 to $559.9 million from $561.1 million in 2012 as shown in the financial analysis of net changes discussion. The reduction in construction work in progress increased the value of plant in service and depreciation. Restricted net position decreased by 20 percent or $51.5 million in 2013 to $203.3 million from $254.8 million in 2012. The unrestricted net position increased by $43.5 million in 2013 to $149.7 million from $106.2 million in 2012. The decrease in restricted net position and increase in unrestricted net position resulted primarily from changes in reserve requirements.

The net position decreased by 1.2 percent or $6.8 million in 2012 from $567.9 million in 2011. The restricted net position decreased by $42.5 million in 2012 from $297.3 million in 2011. The unrestricted net position increased by $112 million in 2012 from $(5.8) million in 2011.

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

Comparative data, stated in millions of dollars:

	Years Ended December 31,		
	2013	2012 (As Restated)	2011 (As Restated)
Sewage treatment fees	$ 343.0	$ 307.2	$ 306.4
Rate stabilization	10.3	13.9	(25.5)
Capacity charge revenue	58.8	51.4	48.7
Other revenue	9.9	9.4	7.8
Operating revenues	422.0	381.9	337.4
Operating expenses	278.2	252.4	214.7
Operating income	143.8	129.5	122.7
Non operating (expenses)	(145.3)	(136.3)	(107.3)
Grant revenues	0.3	-	7.3
Change in net position	(1.2)	(6.8)	22.7
Net position beginning of year (restated)	561.1	567.9	545.2
Net positon end of year	$ 559.9	$ 561.1	$ 567.9

While the statements of net position show changes in assets, liabilities, deferred inflows/outflows of resources and net position, the statements of revenues, expenses and changes in net position provide insight into the source of these changes.

During 2013, operating revenues increased by 10.5 percent or $40.1 million to $422 million from $381.9 million in 2012. Operating expenses increased by 10.2 percent or $25.8 million to $278.2 million in 2013 from $252.4 million in 2012.

In 2012, operating revenues increased by 13.2 percent or $44.5 million to $381.9 million from $337.4 million in 2011. Operating expenses increased by 17.6 percent or $37.7 million from $214.7 million in 2011.

The operating expenses and revenues were driven by:

- Chemical expenses increased by 14.5 percent or about $1 million in 2013 to $7.5 million primarily due to price and volume increases in polymers, caustic soda, sodium hypochlorite, and carbon. Chemical expenses increased by 31.9 percent or about $1.6 million in 2012 to $6.6 million.

FINANCIAL ANALYSIS OF THE STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION (CONTINUED)

- Service expenses decreased by 0.4 percent or $994 thousand to $28.1 million for 2013 from $28.2 million in 2012 mainly due to a 5.1 percent decrease in electricity expense. Electricity usage fell in 2013 reflecting lower rainfall amounts by 34% in 2013 compared to 2012. Service expenses increased by 3.5 percent or $943 thousand to $28.2 million for 2012 from $27.2 million in 2011.

- Intergovernmental expenses for the entire Water Quality Enterprise increased by 5.0 percent or $1.2 million in 2013 to $33.3 million from $31.8 million in 2012. Intergovernmental expenses for the entire Water Quality Enterprise increased by 8.6 percent or $4.1 million 2012 to $3.18 million from $29.2 million in 2011. Of these amounts, $3.2 million in 2013, and $3.6 million in 2012 of intergovernmental expenses were capitalized as support to capital projects. IT services and communications was the primary source of the increase in both years due to the implementation of a new IT support model and the new Countywide financial system. Fleet services costs also increased due to the acquisition of new Loop biosolids hauling trucks and trailers or fuel efficient non-revenue vehicles.

- Water Quality collected a monthly sewage treatment charge of $39.79 per RCE in 2013, and $36.10 in 2012 and 2011. Sewer disposal revenues before rate stabilization increased by 11.6 percent or $35.6 million in 2013 to $343.0 million. Sewer disposal revenues before rate stabilization increased by 0.3 percent or $800 thousand to $307.2 million in 2012 from $306.4 million in 2011.

- Other operating revenues, including capacity charges for new customers and other treatment charges, increased by 13 percent or $7.9 million in 2013 to $68.7 million from $60.8 million in 2012. These revenues increased by 7.6 percent or $4.3 million in 2012 to $60.8 million from $56.5 million in 2011. Capacity charge early payoff revenues were 30.9 percent or $18.1 million of total capacity charge revenues in 2013, while in 2012, capacity charge early payoff revenues were 25.3 percent or $13 million of the annual total. Actual new capacity charge connections were 7,224 in 2013 and 7,915 in 2012.

- Net non-operating expenses increased by 6.6 percent or $9 million to $145.3 million in 2013 from $136.3 million in 2012 due to an increase in interest expense from long-term debt. Net non-operating expenses increased by 27 percent or $29 million to $136.3 million in 2012 from $107.3 in 2011.

- Capital grant revenues received from federal and state agencies increased $300 thousand in 2013 from zero in 2012. Capital grant revenues received from federal and state agencies decreased by $7.3 million to zero in 2012 from $7.3 million in 2011. Low interest loans have largely replaced grants as the primary method of state agency support in recent years.

- Depreciation and amortization expense increased by 17.4 percent or about $23.6 million in 2013 primarily due to incurring a complete year of depreciation expense for the Brightwater Treatment Plant and Conveyance which was placed in service in late 2012.

CAPITAL ASSETS

At December 31, 2013, Water Quality's investment in capital assets, net of accumulated depreciation, was $4.13 billion, a decrease of $12.8 million or 0.3 percent under the balance at December 31, 2012. This decrease is reflective of the 2011-12 Brightwater Treatment Plant and Conveyance capitalizations which increased capital assets in 2011-12. Capital expenditures have leveled as a result. Capital assets net increase from December 31, 2011 to December 31, 2012 was $79.1 million or 1.9 percent. This increase was a result of the Brightwater Treatment Plant and Conveyance project, replacement and additions to the interceptor and siphon systems, purchases of land, additional storage capacity, extension of sewer trunk lines, and continued efforts to control odor and improved sewage-handling technology.

The increases in net capital assets are directly related to continued implementation of Water Quality's Regional Wastewater Services Plan.

Large 2013 construction project expenditures include:

- $6.2 million for West Point Liquids Control System Replacement
- $7.7 million for West Point Influent Screen Improvements
- $11.2 million for Barton Pump Station Upgrade
- $16.3 million for Ballard Siphon Replacement
- $19.8 million spent toward the Brightwater Conveyance project

Large 2012 construction project expenditures include:

- $5.1 million for the Interbay Pumping Station;
- $6.3 million for the Murray CSO;
- $7.1 million for the Kirkland Pumping Station;
- $21.3 million for the Ballard Siphon;
- $82.4 million spent toward the Brightwater Treatment Plant and Conveyance projects

For more detailed information on capital assets, refer to Note 6 in the financial statements.

DEBT ADMINISTRATION

Water Quality issued $122.9 million of revenue refunding bonds in April 2013 with an average life of 12.8 years at an average rate of 4.97 percent and an effective rate of 3.3 percent, and $74.9 million of revenue and refunding bonds in October 2013 with an average life of 14.6 years at an average rate of 4.91 percent and effective rate of 4.05 percent.

Water Quality issued $104.4 million of revenue and refunding bonds and $68.4 million of LTGO refunding bonds in April 2012 with an average life of 21.7 years at an average rate of 4.98 percent and an effective rate of 4.0 percent, $64.3 million of revenue refunding bonds and $41.7 million of LGTO refunding bonds in August 2012 with an average life of 16.7 years at an average rate of 4.86 percent and effective rate of 3.66 percent, and $65.4 million of revenue refunding bonds and $53.4 million in LTGO refunding bonds in September 2012 with an average life of 17.4 years at an average rate of 4.91 percent and an effective rate of 3.62 percent. In December 2012, Water Quality issued $100 million in variable rate revenue bonds.

Water Quality received $19.6 million in low-interest loans from the State of Washington in 2013 and $15.3 million in 2012. The loans carry below-market rates between 0.5 percent and 3.1 percent with repayment terms up to 20 years.

Water Quality has $2.9 billion of sewer revenue bonds and variable rate revenue bonds outstanding at the end of 2013 and $2.8 billion outstanding at the end of 2012. Revenue bonds are repaid from and secured by a pledge of earnings, revenues and money received by Water Quality from or on account of operation of the sewer system, including receipts from sewage treatment fees, and other income of Water Quality. Revenue bonds are not guaranteed by the full faith and credit of King County.

At the end of 2013, Water Quality has $788 million of general obligation bonds and variable rate general obligation bonds outstanding and $821 million of general obligation bonds and variable rate general obligation bonds outstanding at the end of 2012. Although repaid from a portion of receipts from sewage treatment fees and other income, the full faith and credit of King County guarantees repayment of principal and interest on general obligation bonds.

King County received long-term ratings of AAA from Standard and Poor's for the multimodal limited tax general obligation bond issued in January 2010 and "Aa1" from Moody's Investor's with short-term ratings of "VMIG 1" and "A-1+". At the time of the issuance of the sewer revenue bonds in 2013 and 2012, Water Quality's bond ratings were:

Moody's Investor's Service	Standard & Poor's
Aa2	AA+

DEBT ADMINISTRATION (CONTINUED)

As required by bond covenant, Water Quality maintains a bond reserve account, which is funded by cash balances. At December 31, 2013, the cash balance in the reserve account was $175.5 million and $172.6 million at the end of 2012. In addition to bond covenant reserves, Water Quality also maintains financial policy reserves. At December 31, 2013 and 2012, respectively, the rate stabilization, liquidity, and asset management financial policy reserves totaled $84.3 million and $94.2 million.

For more detailed information on debt, refer to the notes to the financial statements.

DEBT SERVICE COVERAGE RATIOS

	FY 2013	FY 2012
Parity Debt	1.42	1.37
Total Debt	1.33	1.28

Two debt service coverage ratios closely monitored by bond rating agencies are coverage on parity debt and coverage on total debt. By bond ordinance, Water Quality sets sewer rates at a level adequate to provide net revenue equal to at least 1.15 times the annual debt service requirement on parity debt. Water Quality has an adopted policy to achieve a ratio of at least 1.25 on parity debt or 0.10 above the ratio required by bond ordinance. Since 2001, Water Quality established a minimum coverage policy of 1.15 on total debt to further strengthen coverage performance.

REQUESTS FOR INFORMATION

This financial report is designed to provide an overview of Water Quality's financial condition as of the years ended December 31, 2013 and 2012. Questions concerning this report or requests for additional information should be addressed to Pete Anthony, Chief Accountant for King County, 500 Fourth Avenue, Room 653, Seattle, WA 98104.

KING COUNTY WATER QUALITY ENTERPRISE FUND
STATEMENTS OF NET POSITION
(in thousands)

	December 31, 2013	December 31, 2012 (As Restated)
CURRENT ASSETS		
Cash and cash equivalents	$ 262,151	$ 116,800
Restricted cash and cash equivalents	148,177	135,449
Accounts receivable, net	36,222	42,569
Due from other funds	3,994	2,321
Inventory of supplies	7,252	6,972
Prepayments	59	614
	457,855	304,725
NONCURRENT ASSETS		
Restricted cash and cash equivalents	236,072	249,459
Accounts receivable, net	-	325
	236,072	249,784
Capital assets		
Building and land improvements	1,895,310	1,872,943
Artwork	5,579	5,520
Infrastructure and right of way	2,154,089	2,131,466
Plant in service and other equipment	1,081,146	1,018,686
Less accumulated depreciation	(1,575,767)	(1,423,889)
	3,560,357	3,604,726
Land and easements	251,860	244,663
Construction work in progress	316,142	291,826
	4,128,359	4,141,215
Other noncurrent		
Prepayments	863	905
Regulatory assets - environmental remediation	59,591	46,918
Other utility assets, net of amortization	31,001	29,731
Other assets	4,438	4,675
	95,893	82,229
Total assets	4,918,179	4,777,953
DEFERRED OUTFLOWS OF RESOURCES		
Deferred amount on refunding	92,008	94,429
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	$ 5,010,187	$ 4,872,382

See accompanying notes.

KING COUNTY WATER QUALITY ENTERPRISE FUND
STATEMENTS OF NET POSITION (CONTINUED)
(in thousands)

	December 31, 2013	December 31, 2012 (As Restated)
CURRENT LIABILITIES		
Accounts payable	$ 30,204	$ 30,254
Retainage payable	881	365
Due to other funds	5	851
Interest payable	81,418	80,520
Wages and benefits payable	4,256	4,471
Compensated absences	572	617
Taxes payable	7	4
Unearned revenue	1,328	865
Interfund loans payable	-	20,158
Notes payable	100,000	100,000
State loans payable	9,323	8,841
General obligation bonds payable	8,750	3,435
Revenue bonds payable	48,880	39,290
Environmental remediation costs	5,715	6,246
Deposit and other liability	144,302	-
	435,641	295,917
NONCURRENT LIABILITIES		
Compensated absences	10,740	10,632
Other post-employment benefits	1,195	1,040
State loans payable	137,349	127,161
General obligation bonds payable	779,505	817,180
Revenue bonds payable	2,817,205	2,802,465
Unamortized bond premium and discount	177,554	165,306
Environmental remediation costs	38,845	28,955
	3,962,393	3,952,739
Total liabilities	4,398,034	4,248,656
DEFERRED INFLOWS OF RESOURCES		
Regulatory credit - rate stabilization	52,250	62,600
TOTAL LIABILITIES AND DEFERRED INFLOWS OF RESOURCES	4,450,284	4,311,256
NET POSITION		
Net investments in capital assets	206,943	200,082
Restricted for		
Debt service	183,822	221,825
Regulatory assets and environmental liabilities	19,469	32,992
Unrestricted	149,669	106,227
Total net position	$ 559,903	$ 561,126

KING COUNTY WATER QUALITY ENTERPRISE FUND
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
(in thousands)

	Years Ended December 31, 2013	2012 (As Restated)
OPERATING REVENUES		
Sewage disposal fees	$ 353,200	$ 321,066
Other operating revenues	68,786	60,809
Total operating revenues	421,986	381,875
OPERATING EXPENSES		
Sewage treatment, disposal, and transmission	94,081	92,595
General and administrative	23,102	22,344
Environmental related amortization	2,041	2,035
Depreciation and amortization	158,947	135,391
Total operating expenses	278,171	252,365
OPERATING INCOME	143,815	129,510
NONOPERATING REVENUES (EXPENSES)		
Investment earnings	272	2,141
Interest	(154,357)	(140,153)
Amortization of debt related accounts	3,651	1,107
Loss on disposal and impairment of capital assets	(792)	(1,556)
Other	5,928	2,156
Total nonoperating expenses	(145,298)	(136,305)
LOSS BEFORE GRANTS AND CONTRIBUTIONS	(1,483)	(6,795)
CAPITAL GRANT REVENUES	260	-
CHANGE IN NET POSITION	(1,223)	(6,795)
NET POSITION		
Beginning of year	561,126	567,921
End of year	$ 559,903	$ 561,126

See accompanying notes.

KING COUNTY WATER QUALITY ENTERPRISE FUND
STATEMENTS OF CASH FLOWS
(in thousands)

	Years Ended December 31, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	$ 423,020	$ 368,413
Cash payments to suppliers for goods and services	(81,251)	(71,257)
Cash payments for employee services	(38,836)	(39,541)
Settlement receipts	144,299	-
Other payments	(5,117)	(2,401)
Net cash provided by operating activities	442,115	255,214
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating grant and subsidy received	72	190
Transfers out	(70)	(275)
Interfund loan principal received	-	20,158
Interfund loan principal paid	(20,158)	(39,583)
Assistance to other agencies	(103)	(130)
Net cash used in noncapital financing activities	(20,259)	(19,640)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of capital and other utility assets	(134,409)	(198,764)
Proceeds from disposal of capital assets	19	36
Principal paid on capital debt	(51,593)	(50,388)
Interest paid on capital debt	(164,300)	(159,750)
Proceeds of new bond issuance	52,990	187,915
Proceeds of state loans	19,597	15,325
Capital grants received	260	-
Net cash used in capital and related financing activities	(277,436)	(205,626)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest on investments	272	2,141
NET INCREASE IN CASH AND CASH EQUIVALENTS	144,692	32,089
CASH AND CASH EQUIVALENTS		
Beginning of year	501,708	469,619
End of year	$ 646,400	$ 501,708

See accompanying notes.

KING COUNTY WATER QUALITY ENTERPRISE FUND
STATEMENTS OF CASH FLOWS (CONTINUED)
(in thousands)

	Years Ended December 31, 2013	2012
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	$ 143,815	$ 129,510
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation and amortization	158,947	135,391
Other nonoperating revenue	6,279	8,734
Changes in assets		
Accounts receivable	6,670	(9,177)
Due from other funds	(2,027)	15
Inventory of supplies	(280)	(640)
Prepayments	127	(68)
Other assets	(12,435)	1,854
Changes in liabilities		
Accounts payable	(1,944)	2,855
Retainage payable	(36)	19
Due to other funds	(844)	849
Taxes payable	4	(31)
Unearned revenue	463	865
Wages and benefits payable	(150)	928
Compensated absences	63	45
Other post-employment benefits	155	184
Other liabilities	153,658	(2,220)
Changes in deferred inflows of resources		
Rate stabilization	(10,350)	(13,899)
Total adjustments	298,300	125,704
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 442,115	$ 255,214

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:

Water Quality issued bonds in 2013 to refund debt issued from 2003 to 2006. The $171.2 million proceeds were placed in escrow for the defeasance of $163.1 million of outstanding bond principal and $8.1 million of interest.

Water Quality issued bonds in 2012 to refund debt issued in 2004 and 2005. The $371.4 million proceeds were placed in escrow for the defeasance of $334.2 million of outstanding bond principal and $37.3 million of interest.

Note 1 - Operations and Accounting Policies

Summary of Operations - The King County Water Quality Enterprise Fund (Water Quality) 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 sewage treatment and water pollution abatement services to the urbanized areas of King County, Washington (the County).

Water Quality 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, Water Quality is funded and operated separately from other operations of the County. Revenues, bond proceeds, and grants are restricted by purpose. Accordingly, Water Quality maintains separate accounting records and issues stand-alone financial statements.

Water Quality 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 Water Quality's estimated annual monetary requirements, including operating costs and debt service. Revenues from Water Quality's largest customer, the City of Seattle (Seattle Public Utilities), represent approximately 40 percent of total sewage disposal fees in 2013 and in 2012.

Water Quality 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 $33.3 million and $31.5 million in 2013 and 2012, respectively.

Significant Accounting Policies - Water Quality is accounted for using the flow of economic resources measurement focus similar to that of a private enterprise organized for profit. Water Quality's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) 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. Water Quality, regardless of the timing of cash flows, applies all applicable Governmental Accounting Standards Board (GASB) pronouncements.

a. *Cash and Cash Equivalents* - Water Quality considers as cash and cash equivalents all balances held with the King County Treasurer in the King County Investment Pool (the Pool), cash with escrow agents or held in trust, and petty cash. Unrealized gain or loss on Water Quality's proportionate share of the Pool is reported as a component of investment earnings.

b. *Due From and To Other Funds, Interfund Loans and Advances* - Due from and to other funds consists of current receivables and payables from or to other funds within the County. They typically arise from interfund goods and service transactions and reimbursements.

   Interfund loans receivable and payable or advances from and to other funds represent authorized short-term and long-term, respectively, lending and borrowing arrangements within the County.

Note 1 - Operations and Accounting Policies (Continued)

c. *Inventory of Supplies* - Inventory is recorded at the lower of cost or market using the weighted-average cost method. Materials and supplies are expensed as consumed. Inventory is written off in the year that it is determined obsolete.

d. *Restricted Assets* - In accordance with Water Quality's bond resolutions, state law, King County codes, or other agreements, separate restricted assets have been established. These assets are restricted for specific purposes, including bond and state loan reserves.

e. *Capital Assets* - Capital assets are stated at cost, less accumulated depreciation and amortization. Water Quality's capitalization threshold is: equipment at $5 thousand; software and intangible assets at $500 thousand, and buildings and improvements at $100 thousand. Provision for depreciation and amortization are made on a straight-line basis over the estimated useful lives of Water Quality's capital assets as follows:

Description	Estimated Useful Life
Buildings	10 - 75 years
Cars, vans, and trucks	5 - 8 years
Data processing equipment	3 - 10 years
Heavy equipment	7 - 15 years
Sewer lines	50 years
Shop equipment	5 - 20 years

Water Quality capitalizes certain interest income and expense related to borrowings until the assets are ready for their intended use. The amount capitalized is the difference between the interest revenue and interest expense associated with the applicable tax free borrowings. Total interest incurred was $165.7 million each during the years ended December 31, 2013 and 2012, respectively, of which $11.3 million and $25.5 million, respectively, was capitalized.

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

Water Quality annually reviews long-lived assets for impairment to determine whether any events or circumstances indicate the carrying value of the assets may not be recoverable.

f. *Compensated Absences* - Employees earn vacation based upon their date of hire and years of service. They may accumulate a maximum of 480 hours or as bargained for by represented employees. 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 percent of the accrued unused sick leave upon retirement or death. No amounts are paid for unused sick leave upon termination. Vacation pay and a portion of sick leave liabilities, including payroll taxes, are accrued.

Note 1 - Operations and Accounting Policies (Continued)

Water Quality accrues estimated excess compensation liabilities to the Washington State Department of Retirement Systems based on an employee's accrued vacation and sick leave. An excess compensation liability is incurred when an employee whose retirement benefits are based in part on excess compensation receives a termination or severance payment defined by the State as excess compensation. This includes, but is not limited to, a cash-out of unused annual leave in excess of 240 hours and a cash-out of any other form of leave.

g. *Rebatable Arbitrage* - Water Quality's tax-exempt debt is subject to arbitrage restrictions as defined by the Internal Revenue Code. Arbitrage occurs when the funds borrowed at tax-exempt rates of interest are invested in higher yielding taxable securities. These interest earnings in excess of interest expense must be remitted to the federal government except when spending exceptions rules are met. The liability is recognized during the period the excess interest is earned.

h. *Deferred Outflows and Deferred Inflows of Resources* - Deferred outflows of resources represent consumption of resources that is applicable to future reporting periods and deferred inflows of resources represent acquisition of resources that is applicable to future reporting periods. Deferred outflows and inflows should only be used as specifically required in authoritative GASB pronouncements.

i. *Operating and Nonoperating Revenues and Expenses* - Operating revenues result from exchange transactions of Water Quality's activities. Expenses associated with providing wastewater treatment services and operating Water Quality's treatment facilities are considered operating. Nonoperating revenues result from nonexchange transactions such as operating subsidies and investment earnings.

j. *Debt-related Amortization* - Bond premiums, discounts and refunding losses and gains are amortized over the life of the bonds using the outstanding principal balance method. Debt issuance costs are expense in the period of issuance.

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. Water Quality received capital grant revenues of $260 thousand for the year ended December 31, 2013.

l. *Net Position* - Resources set aside for debt services and other obligations, net of related liabilities, are classified as restricted net position on the statements of net position as their use is limited by externally-imposed restrictions. Net investments in capital assets are reported as a separate component of net position. Any net position not subject to classification as restricted or invested in capital assets are reported as unrestricted.

Note 1 - Operations and Accounting Policies (Continued)

m. *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.

n. *Reclassification* - Certain reclassifications have been made to the prior year statements to conform to the current year presentation.

New Accounting Standards - The following GASB pronouncements are effective for 2013 financial reporting of Water Quality.

GASB Statement No. 65, *Items Previously Reported as Asset and Liabilities*, was issued in March 2012. This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2012. Water Quality adopted the standard in 2013 and restated its prior financial statements to comply with the requirements (see Note 13.)

GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Guarantees,* was issued in April 2013. The standard provides guidance on accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. GASB 70 is effective for periods beginning after June 15, 2013. It was early adopted in 2013 and had no impact on Water Quality's financial statements.

Note 2 - Deposits and Investments

The King County Treasurer is the custodian of Water Quality's cash. Water Quality's cash on deposit with the King County Treasurer is pooled with cash from other County funds and other jurisdictions and are either deposited in the County's bank account or invested by the County. The King County Investment Pool (the Pool) functions essentially as a demand deposit account where Water Quality receives an allocation of its proportionate share of pooled earnings as interest.

Note 2 - Deposits and Investments (Continued)

The Pool is administered by the King County Treasury Operations Section and is not registered with the Securities and Exchange Commission (SEC) as an investment company. Oversight is provided by the King County Executive Finance Committee (EFC) pursuant to RCW 36.29.020. The EFC consists of the Chair of the County Council, the County Executive, the Director of Office of Performance, Strategy and Budget, and the Director of the Finance and Business Operations Division, or their designees. All investments are subject to written policies adopted by the EFC. The EFC reviews Pool performance monthly.

The County has deposit and investment policies addressing risks that have the potential to result in losses of deposits and investments. All deposits not insured by the Federal Depository Insurance Corporation (FDIC) are fully collateralized by the Public Deposit Protection Commission of the State of Washington (PDPC), a statutory authority established under chapter 39.58 RCW that governs public depositaries and provides that "All public funds deposited in public depositaries, including investment deposits and accrued interest thereon, shall be protected against loss, as provided in the chapter." Effective July 1, 2009, all public depositaries were required to pledge securities at 100% of their public deposits not covered by FDIC insurance. The PDPC constitutes a multiple financial institution collateral pool that can make pro rata assessments to all public depositaries within the state for their public deposits. PDPC protection is of the nature of collateral, not of insurance. The custodial credit risk for deposits is the risk that Water Quality's deposits may not be returned to it in the event of a bank failure. Assessing Water Quality's risk exposure, Water Quality's cash and cash equivalents balance of $646.4 million and $501.7 million were fully insured and collateralized as of December 31, 2013 and 2012, respectively.

Credit Risk - Investments: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. As of December 31, 2013, 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 deposit issued by qualified public depositaries, repurchase agreements, and the Local Government Investment Pool managed by the Washington State Treasurer's office. The main Pool's policies limit the maximum amount that can be invested in various securities. At 2013 and 2012 year-end the Pool was in compliance. The Pool's actual composition, as of December 31, 2013, consisted of Repurchase Agreements, 0.9 percent, Commercial Paper, 0.5 percent, U.S. Agency Discount Notes, 7.5 percent, U.S. Treasury Notes, 21.5 percent, U.S. Treasury Zero Coupon Notes, 0.5 percent, U.S. Agency Notes, 50.6 percent, U.S. Agency Collateralized Mortgage Obligations, 0.2 percent, and the State Treasurer's Investment Pool, 18.3 percent. The December 31, 2012 composition comprised Repurchase Agreements, 3.2 percent, U.S. Agency Discount Notes, 8.5 percent, U.S. Treasury Notes, 36.1 percent, U.S. Agency Notes, 34.8 percent, U.S. Agency Mortgage Backed Securities, 0.4 percent, and the State Treasury's Investment Pool, 17.0 percent.

Note 2 - Deposits and Investments (Continued)

Custodial Credit Risk - Investments: Custodial credit risk is the risk that in the event of the failure of the counterparty, the County will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. County policy mandates that all security transactions, including repurchase agreements, are settled "delivery versus payment." This means that payment is made simultaneously with the receipt of the security. These securities are delivered to the County's safekeeping bank or its tri-party custodian banks.

Concentration of Credit Risk - Investments: Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issue. At 2013 year-end the Pool had concentrations greater than 5 percent of the total investment pool portfolio in the following issues: Federal Home Loan Mortgage Corporation–14.7 percent, Federal National Mortgage Association–13.7 percent, Federal Home Loan Bank–20.5 percent, and Federal Farm Credit Bank–9.3 percent. The issues with concentrations greater than 5 percent of the pool portfolio at 2012 year-end were as follows: Federal Home Loan Mortgage Corporation–15.2 percent, Federal National Mortgage Association–13.6 percent, Federal Home Loan Bank–5.8 percent, and Federal Farm Credit Bank–9.0 percent.

Interest Rate Risk - Investments: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Through its investment policy, the County manages its exposure to fair value losses arising from increasing interest rates by setting maturity and effective duration limits for the Pool. The policy limit for the Pool's maximum effective duration is 1.5 years, and 40 percent of the Pool's total value in securities must have a maturity of 12 months or fewer. Securities in the portfolio cannot have an average life greater than five years at purchase. The combined effective duration of the liquidity and core portfolios was 1.299 years and 1.357 years, respectively, at December 31, 2013 and 2012.

The Pool has four impaired commercial paper investments which have completed enforcement events. The County completed the restructuring of three of the four securities in 2008 and completed the restructuring of the fourth security in 2009. Between 2008 and 2010, the County initiated lawsuits seeking recovery for losses associated with all four of the impaired investments. In 2012, the County settled the litigation concerning Mainsail and Victoria, and executed a settlement with three of the defendants in the lawsuits concerning Rhinebridge. The net settlement payments have been distributed to each pool participant. In 2013, the County received final settlement payments for the litigation concerning Rhinebridge and Cheyne and has distributed the net settlement payments to each pool participant.

Water Quality's share of the unrealized loss from the Pool's impaired investments was $609 thousand at December 31, 2013 and $880 thousand at December 31, 2012. Losses from impaired investments are offset against other investment earnings.

Note 3 - Restricted Assets

A significant portion of Water Quality's assets is restricted as to use by legal and contractual provisions and by fiscal management policy. Restricted assets comprise $384.2 million at December 31, 2013 and $385.2 million at December 31, 2012 to comply with bond covenants and other requirements.

The details of restricted and unrestricted cash and cash equivalents as of December 31, 2013 and 2012 are as follows (in thousands):

	2013	2012
Unrestricted Cash and Cash Equivalents		
Operating Funds	$ 21,545	$ (18)
Construction Funds	35,901	4,352
Bond Proceeds Committed to Construction	35,753	96,210
Bond Funds	136,808	1,256
Policy Reserves	32,144	15,000
Total Unrestricted Cash and Cash Equivalents	262,151	116,800
Restricted Cash and Cash Equivilents		
Bond Reserves	175,547	172,557
SRF Loan Reserves	8,275	8,275
Retainage	881	365
Rate Stabilization Reserve	52,250	62,600
Legally Restricted Funds	147,296	141,111
Total Restricted Cash and Cash Equivalents	384,249	384,908
Total Cash and Cash Equivalents	$ 646,400	$ 501,708

Note 4 - Risk Management

Water Quality 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.

Water Quality participates in three County internal service funds to account for and finance its (1) property/casualty, (2) workers' compensation, and (3) employee medical and dental benefits, through 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.

During 2013 and 2012, Water Quality claims paid by the Insurance Fund of King County were $1.0 million and $293 thousand, respectively. In the past three years there was no occurrence that resulted in payment in excess of the self-insured retention of $7.5 million.

Note 4 - Risk Management (Continued)

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 interfund 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 Water Quality 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.

Water Quality retains all risk associated with environmental claims.

Note 5 - Long-Term Liabilities and Notes Payable

Sewer Revenue Bonds - As of December 31, 2013, bonds outstanding include $2,866.1 million of serial and term bonds maturing from January 1, 2014 through January 1, 2052, bearing interest at stated rates of 1.00 percent to 5.75 percent per annum.

On April 9, 2013, Water Quality issued $122.9 million in sewer revenue refunding bonds, Series A, with an effective interest rate of 3.3 percent to advance refund $107.0 million of outstanding sewer revenue bonds, Series 2003 and 2006, and $28.9 million of limited tax GO (Sewer Revenue) bonds, Series 2005A, with an effective interest rate of 4.9 percent. The reacquisition price exceeded the net carrying amount of the old debt by $5.0 million. This advance refunding was undertaken to reduce total debt service payments by $35.3 million over the life of the bonds, resulting in an economic gain (difference between the present values of the old and new debt service payments) of $21.8 million.

On October 29, 2013, Water Quality issued $74.9 million in sewer revenue bonds, Series B, of which $25.5M was refunding, with an effective interest rate of 2.6 percent to refund $27.2 million of outstanding sewer revenue bonds, Series 2004B, with an effective interest rate of 4.4 percent. The reacquisition price exceeded the net carrying amount of the old debt by $437 thousand. This advance refunding was undertaken to reduce total debt service payments by $2.7 million over the life of the bonds, resulting in an economic gain (difference between the present values of the old and new debt service payments) of $2.3 million.

On April 18, 2012, Water Quality issued $104.4 million in sewer revenue and refunding bonds and $68.4 million in limited tax GO refunding bonds (payable from sewer revenues), Series A, with an effective interest cost of 2.7 percent to advance refund $26.1 million of outstanding sewer revenue bonds, 2004A, and $71.7 million of limited tax GO bond (sewer revenues) bonds, 2005A, with an effective interest rate of 4.8 percent. The reacquisition price exceeded the net carrying amount of the old debt by $10.7 million. This advance refunding was undertaken to reduce total debt service payments by $8.2 million over the life of the bonds, resulting in an economic gain (difference between the present values of the old and new debt service payments) of $6.8 million.

Note 5 - Long-Term Liabilities and Notes Payable (Continued)

On August 8, 2012, Water Quality issued $64.3 million in sewer revenue refunding bonds and $41.7 million in limited tax GO refunding bonds (payable from sewer revenues), Series B, with an effective interest cost of 3.7 percent to advance refund $67.9 million of outstanding sewer revenue bonds, 2004A, and $43.8 million of limited tax GO bond (sewer revenues) bonds, 2005A, with an effective interest rate of 4.8 percent. The reacquisition price exceeded the net carrying amount of the old debt by $8.8 million. This advance refunding was undertaken to reduce total debt service payments by $10.2 million over the life of the bonds, resulting in an economic gain (difference between the present values of the old and new debt service payments) of $7.0 million.

On September 19, 2012, Water Quality issued $65.4 million in sewer revenue refunding bonds and $53.4 million in limited tax GO refunding bonds (payable from sewer revenues), Series C, with an effective interest cost of 3.6 percent to advance refund $69.1 million of outstanding sewer revenue bonds, 2004A and 2006, and $55.6 million of limited tax GO bond (sewer revenues) bonds, 2005A, with an effective interest rate of 4.8 percent. The reacquisition price exceeded the net carrying amount of the old debt by $11.6 million. This advance refunding was undertaken to reduce total debt service payments by $10.8 million over the life of the bonds, resulting in an economic gain (difference between the present values of the old and new debt service payments) of $7.5 million.

Bond issues provide funding for Water Quality's construction plan. 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. Amounts from the sewer revenue bond fund may be used to purchase term bonds prior to maturity.

The bonds are secured by a pledge of the revenue of the sewer system subject to payment of all operating and maintenance expenses of the sewer system. Payments from revenues of Water Quality 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. 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, 2013, Water Quality is in compliance with the combined amount required for the reserve and surety policies.

Note 5 - Long-Term Liabilities and Notes Payable (Continued)

The following table summarizes Water Quality's revenue bonds (in thousands):

	Final Maturity	Interest Rates	Original Issue Amount	Outstanding at December 31, 2013
2001A-B Jr Lien Variable	1/1/32	(variable)	$ 100,000	$ 100,000
2004B Refunding	1/1/35	2.00-5.00%	61,760	23,855
2006 Refunding	1/1/36	5.00%	124,070	84,520
2006 (2nd Series) Refunding	1/1/36	3.50-5.00%	193,435	176,185
2007	1/1/47	5.00%	250,000	250,000
2008	1/1/48	5.00-5.75%	350,000	350,000
2009	1/1/42	4.00-5.25%	250,000	248,670
2010	1/1/50	2.00-5.00%	334,365	330,435
2011	1/1/41	5.00-5.125%	175,000	175,000
2011 Series B	1/1/41	1.00-5.00%	494,270	463,030
2011 Series C	1/1/35	3.00-5.00%	32,445	32,445
2011 Sewer Jr Lien Variable	1/1/42	(variable)	100,000	100,000
2012A Refunding	1/1/52	5.00%	104,445	104,445
2012B Refunding	1/1/35	4.00-5.00%	64,260	64,260
2012C Refunding	1/4/33	2.50-5.00%	65,415	65,415
2012 Sewer Jr Lien Variable	1/1/43	(variable)	100,000	100,000
2013A Refunding	1/1/35	2.00-5.00%	122,895	122,895
2013B Revenue and Refunding	1/1/44	2.00-5.00%	74,930	74,930
			$ 2,997,290	$ 2,866,085

General Obligation Bonds - As of December 31, 2013, bonds outstanding include $788.3 million of serial and term bonds maturing January 1, 2014 through 2040, bearing interest at stated rates of 2.20 percent to 5.25 percent per annum.

In 2012, Water Quality issued $3.0 million of Limited Tax General Obligation (LTGO) bonds maturing December 31, 2022. The bonds were issued to provide funding for Water Quality's construction plan.

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.

Note 5 - Long-Term Liabilities and Notes Payable (Continued)

The following table summarizes Water Quality’s general obligation bonds (in thousands):

	Final Maturity	Interest Rates	Original Issue Amount	Outstanding at December 31, 2013
2008 LTGO	1/1/34	3.25-5.25%	$ 236,950	$ 222,360
2009B LTGO	7/1/39	5.00-5.25%	300,000	300,000
2010A-B Multi-Modal LTGO	1/1/40	(variable)	100,000	100,000
2012A LTGO	1/1/25	2.00-5.00%	68,395	67,755
2012B LTGO	1/1/29	5.00%	41,725	41,725
2012C LTGO	1/1/34	5.00%	53,405	53,405
2012F LTGO	12/1/22	2.20%	3,010	3,010
			$ 803,485	$ 788,255

State Loans - Water Quality 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 2014 through 2034 and bear interest at stated rates from 0.00 percent to 3.10 percent. As of December 31, 2013, the balance due on all state loans is $146.7 million. Water Quality maintains separate cash reserves of $8.3 million. These reserves are treated as restricted, being required under the Revolving Fund Loan Program.

At December 31, 2013, the required principal and interest payments for all classes of long-term debt are as follows (in thousands):

	Revenue Bonds		General Obligation Bonds		State Loans		
Year(s) Beginning	Principal	Interest	Principal	Interest	Principal	Interest	Total
January 1, 2014	$ 48,880	$ 139,573	$ 8,750	$ 39,336	$ 9,323	$ 2,655	$ 248,517
January 1, 2015	49,945	140,073	9,000	38,893	10,425	2,508	250,844
January 1, 2016	52,110	137,825	9,420	38,455	10,590	2,339	250,739
January 1, 2017	43,895	135,806	21,000	37,718	10,684	2,167	251,270
January 1, 2018	45,945	133,663	22,030	36,642	10,857	1,991	251,128
January 1, 2019—2023	264,930	632,388	130,460	165,019	50,753	7,289	1,250,839
January 1, 2024—2028	337,335	558,598	162,370	128,490	30,196	3,336	1,220,325
January 1, 2029—2033	531,605	457,489	193,945	84,532	13,091	933	1,281,595
January 1, 2034—2038	448,450	323,684	110,965	43,602	753	11	927,465
January 1, 2039—2043	636,035	206,397	120,315	10,883	-	-	973,630
January 1, 2044—2048	336,940	61,714	-	-	-	-	398,654
January 1, 2049—2052	70,015	5,469	-	-	-	-	75,484
	$ 2,866,085	$ 2,932,679	$ 788,255	$ 623,570	$ 146,672	$ 23,229	$ 7,380,490

The future annualized interest payments for the variable rate revenue bonds are based on an interest rate of 5.175 percent, which represents 90 percent of the Revenue Bond Index assumed by the County for long-term financial planning purposes.

Note 5 - Long-Term Liabilities and Notes Payable (Continued)

Commercial Paper (Notes Payable) - In December 1995, Water Quality initiated a commercial paper program that gives Water Quality the ability to issue up to $100.0 million. The program is supported by an annually renewable line of credit that expires November 30, 2015. As of December 31, 2013, $100.0 million was issued and outstanding under this program. The commercial paper has maturities ranging between 62 and 94 days and is classified as a current liability of Water Quality's operating fund. Changes in short-term note payables for the year ended December 31, 2013 and 2012 were as follows (in thousands):

	Balance January 1, 2013	Additions	Reductions	Balance December 31, 2013
Commercial paper	$ 100,000	$ 544,440	$ (544,440)	$ 100,000

	Balance January 1, 2012	Additions	Reductions	Balance December 31, 2012
Commercial paper	$ 100,000	$ 1,173,650	$ (1,173,650)	$ 100,000

Variable Rate General Obligation and Revenue Bonds - The variable rate bonds, 2001 Series A and Series B revenue bonds are supported by a periodically renewable letter of credit that expires December 31, 2015. The variable rate bonds, 2010 Series A and Series B general obligation bonds are supported by a Standby Bond Purchase Agreement that expires January 21, 2015. The variable rate bonds, 2011 and 2012 Sewer Jr Lien VRDM bonds, do not have a liquidity facility.

Financial Policy Reserves - In addition to bond reserves related to Sewer Revenue Bonds, Water Quality maintains liquidity and asset management reserves totaling $32.1 million at December 31, 2013.

Compliance with Bond Resolutions - With respect to the year ended December 31, 2013, Water Quality complied with all financial covenants stipulated by its bond resolutions.

Note 5 - Long-Term Liabilities and Notes Payable (Continued)

Changes in Long-Term Liabilities - Long-term liability activity for the years ended December 31, 2013 and 2012 was as follows (in thousands):

	Balance January 1, 2013	Additions	Reductions	Balance December 31, 2013	Due Within One Year
Bonds payable	$ 3,662,370	$ 34,695	$ (42,725)	$ 3,654,340	$ 57,630
Bond premiums and discounts	165,306	24,970	(12,722)	177,554	-
Total bonds payable	3,827,676	59,665	(55,447)	3,831,894	57,630
State loans	136,002	19,269	(8,599)	146,672	9,323
Compensated absences	11,249	9,985	(9,922)	11,312	572
Other post-employment benefits	1,040	219	(64)	1,195	-
Environmental remediation	35,201	13,952	(4,593)	44,560	5,715
Total long-term liabilities	$ 4,011,168	$ 103,090	$ (78,625)	$ 4,035,633	$ 73,240

	Balance January 1, 2012	Additions	Reductions	Balance December 31, 2012	Due Within One Year
Bonds payable	$ 3,537,600	$ 500,655	$ (375,885)	$ 3,662,370	$ 42,725
Bond premiums and discounts	122,365	52,891	(9,950)	165,306	-
Total bonds payable	3,659,965	553,546	(385,835)	3,827,676	42,725
State loans	129,276	15,325	(8,599)	136,002	8,841
Compensated absences	11,204	744	(699)	11,249	617
Other post-employment benefits	856	246	(62)	1,040	-
Environmental remediation	37,422	180	(2,401)	35,201	6,246
Total long-term liabilities	$ 3,838,723	$ 570,041	$ (397,596)	$ 4,011,168	$ 58,429

Note 6 - Changes in Capital Assets

Changes in capital assets for the years ended December 31, 2013 and 2012 are shown in the following table (in thousands):

	Balance January 1, 2013	Increases	Decreases	Balance December 31, 2013
Land	$ 233,194	$ 7,197	$ -	$ 240,391
Easements	11,469	-	-	11,469
Construction work in progress	291,826	149,371	(125,055)	316,142
Total nondepreciable assets	536,489	156,568	(125,055)	568,002
Buildings	1,808,253	22,101	(636)	1,829,718
Improvements other than building	64,690	903	-	65,593
Artwork	5,520	59	-	5,579
Right of way	7,635	-	-	7,635
Infrastructure	2,123,831	22,683	(60)	2,146,454
Equipment	985,447	65,031	(2,641)	1,047,837
Software development	33,239	69	-	33,308
Total depreciable assets	5,028,615	110,846	(3,337)	5,136,124
Accumulated depreciation and amortization:				
Building	(511,896)	(45,586)	207	(557,275)
Improvements other than building	(18,457)	(2,373)	-	(20,830)
Artwork	(334)	(178)	-	(512)
Right of way	(273)	(218)	-	(491)
Infrastructure	(391,112)	(46,219)	-	(437,331)
Equipment	(482,972)	(55,098)	1,122	(536,948)
Software development	(18,845)	(3,535)	-	(22,380)
Total depreciation and amortization	(1,423,889)	(153,207)	1,329	(1,575,767)
Depreciable assets - net	3,604,726	(42,361)	(2,008)	3,560,357
Total capital assets - net	$ 4,141,215	$ 114,207	$ (127,063)	$ 4,128,359

Note 6 - Changes in Capital Assets (Continued)

	Balance January 1, 2012	Increases	Decreases	Balance December 31, 2012
Land	$ 218,461	$ 14,734	$ (1)	$ 233,194
Easements	11,469	-	-	11,469
Construction work in progress	1,072,858	164,276	(945,308)	291,826
Total nondepreciable assets	1,302,788	179,010	(945,309)	536,489
Building	1,671,702	144,069	(7,518)	1,808,253
Improvements other than building	58,860	6,383	(553)	64,690
Artwork	4,817	703	-	5,520
Right of way	7,635	-	-	7,635
Infrastructure	1,346,355	777,924	(448)	2,123,831
Equipment	936,987	56,825	(8,365)	985,447
Software development	32,668	2,967	(2,396)	33,239
Total depreciable assets	4,059,024	988,871	(19,280)	5,028,615
Accumulated depreciation and amortization:				
Building	(464,351)	(48,045)	500	(511,896)
Improvements other than building	(16,068)	(2,389)	-	(18,457)
Artwork	(157)	(177)	-	(334)
Right of way	(55)	(473)	255	(273)
Infrastructure	(360,756)	(30,413)	57	(391,112)
Equipment	(440,503)	(45,486)	3,017	(482,972)
Software development	(17,868)	(3,252)	2,275	(18,845)
Total depreciation and amortization	(1,299,758)	(130,235)	6,104	(1,423,889)
Depreciable assets - net	2,759,266	858,636	(13,176)	3,604,726
Total capital assets - net	$ 4,062,054	$ 1,037,646	$ (958,485)	$ 4,141,215

Note 7 - Environmental Remediation

Water Quality operations are subject to rules and regulations enacted by the Washington State Department of Ecology (DOE) and the U.S. Environmental Protection Agency (EPA).

Water Quality follows GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB 49), which mandates the disclosure of "obligations to address current or potential detrimental effects of existing pollution by participating in pollution remediation activities." GASB 49 establishes five events, any one of which obligates Water Quality to record a liability for pollution remediation expenditures. Liabilities are related to ongoing projects, which include the sediment management of aquatic habitats along Elliot Bay and the clean-up of certain sites along the Lower Duwamish Waterway (LDW). Environmental remediation costs that incurred prior to implementation of GASB 49 were capitalized and amortized over 40 years.

Note 7 - Environmental Remediation (Continued)

The Sediment Management Project has been approved by the Metropolitan King County Council as a self-obligated pollution remediation program. The LDW project became a Water Quality obligation when King County entered into an Administrative Order on Consent (AOC) with the DOE and EPA. This AOC also includes The Boeing Company, the City of Seattle and the Port of Seattle as parties conduct the studies on which to base the cleanup decision. Each party has agreed to pay one fourth of the costs under the AOC.

Both projects may result in additional cleanup efforts as a result of future regulatory orders. These potential cleanup liabilities cannot be currently estimated. Ongoing, regulatory action may identify other Potentially Responsible Parties (PRP) for the LDW cleanup.

There are no estimated recoveries at this time that will reduce the amount of Water Quality's pollution remediation obligations. However, the State of Washington has indicated that it intends to fund grants in support of the LDW cleanup. The total environmental remediation liability at December 31, 2013 stands at $44.6 million and $35.2 million in 2012.

The pollution remediation obligation is an estimate and subject to changes resulting from price increases or reductions, technology, or changes in applicable laws or regulations.

The methodology for estimating liabilities continues to be based on Water Quality engineering analysis, program experience and cost estimates for the remediation activities scheduled to be undertaken in future years as programmed under Water Quality's Regional Wastewater Services Plan. Certain costs were developed by consulting engineers. Costs were estimated using the expected cash flow method set out by GASB 49. For the LDW project, a weighted average method is used to calculate the liability. The Sediment Management Plan does not employ weighted average cost estimation because the remaining work is well-defined and negates the utility of multiple estimates. The cost estimates continue to be re-measured as succeeding benchmarks are reached or when cost assumptions are modified. All pollution remediation obligations are being deferred as permitted by regulatory accounting standards (see Note 8 - Regulatory Assets and Credits).

Note 8 - Regulatory Assets and Credits

The King County Council has taken various regulatory actions resulting in differences between the recognition of revenues for rate-making purposes and their treatment under generally accepted accounting principles for nonregulated entities. Changes to these balances and their inclusion in rates may occur only at the direction of the Council.

Note 8 - Regulatory Assets and Credits (Continued)

Regulatory Credit - Rate Stabilization - In 2005, the Council established a Rate Stabilization Reserve. This action created a deferred inflow of resource which deferred operating revenue to be set aside in a reserve and recognized in subsequent years to maintain stable sewer rates. The reserve was $62.6 million in 2012 and decreased by $10.3 million to $52.3 million in 2013.

Pollution Remediation - In 2006, the Council approved the application of regulatory accounting to treat pollution remediation obligations as regulatory assets to allow for cost recovery through future rate increases. The portion of regulatory asset costs that have been accrued is being amortized over a recovery period of 30 years.

Rainwise Program - In 2013, the Council approved the application of regulatory accounting to treat program payments to Rainwise participants as regulatory assets to allow for cost recovery through future rate increases. The portion of regulatory asset costs that have been accrued is being amortized over a recovery period of 5 years.

Note 9 - Employee Benefit Plans

Defined Benefit Pension Plans - All full-time and qualifying part-time employees of Water Quality participate in the Public Employees' Retirement System (PERS). PERS is a statewide governmental retirement system administered by the State of Washington's Department of 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, PO Box 48380, Olympia, WA 98504-8380; or it may be downloaded from the DRS website at www.drs.wa.gov.

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

Note 9 - Employee Benefit Plans (Continued)

PERS is a cost-sharing, multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a defined benefit plan with a defined contribution component. PERS members who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977 and by either February 28, 2002, for state and higher education employees, or August 31, 2002, for local government employees, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS participants joining the system on or after March 1, 2002, for state and higher education employees, or September 1, 2002, for local government employees, have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. Employees who fail to choose within 90 days default to PERS Plan 3. PERS Plan 2 and Plan 3 members may opt out of plan membership if terminally ill with less than five years to live.

PERS Plan 1 and Plan 2 defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PERS retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

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

PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity payable to the age of 60. The allowance amount is $350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any workers' compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60. A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the allowance amount is 2 percent of the AFC for each year of service reduced by 2 percent for each year that the member's age is less than 55. The total benefit is limited to 60 percent of the AFC and is actuarially reduced to reflect the choice of a survivor option. A cost-of-living allowance was granted at age 66 based upon years of service times the COLA amount. This benefit was eliminated by the Legislature, effective July 1, 2011. Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

Note 9 - Employee Benefit Plans (Continued)

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

PERS Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members may retire at the age of 65 with five years of service with an allowance of two percent of the AFC per year of service. (The AFC is based on the greatest compensation during any eligible consecutive 60-month period.)

Plan 2 members who have at least 20 years of service credit and are 55 years of age or older are eligible for early retirement with a reduced benefit. The benefit is reduced by an early retirement factor (ERF) that varies according to age for each year before age 65. PERS plan 2 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions: with a benefit that is reduced by 3 percent for each year before age 65; or with a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules.

PERS Plan 2 retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at 3 percent annually. The surviving spouse or eligible child or children of a PERS Plan 2 member who dies after leaving eligible employment having earned ten years of service credit may request a refund of the member's accumulated contributions.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. The defined benefit portion provides a benefit calculated at one percent of the AFC per year of service. (The AFC is based on the greatest compensation during any eligible consecutive 60-month period.) Effective June 7, 2006, PERS Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service, if twelve months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

Vested Plan 3 members are eligible for normal retirement at age 65 or they may retire early with the following conditions and benefits: If they have at least ten service credit years and are 55 years old, the benefit is reduced by an ERF that varies with age for each year before age 65; if they have 30 service credit years and at least 55 years old, they have the choice of a benefit that is reduced by 3 percent for each year before age 65 or a benefit with a smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.

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

Note 9 - Employee Benefit Plans (Continued)

PERS Plan 3 defined contribution retirement benefits are solely dependent upon the results of investment activities. The defined contribution portion can be distributed in accordance with an option selected by the member, either as a lump sum or pursuant to other options authorized by the Director of the Department of Retirement Systems.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2 percent of the AFC per year of service. For Plan 3, the monthly benefit amount is 1 percent of the AFC per year of service. These disability benefit amounts are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option. There is no cap on years of service credit, and a cost-of-living allowance is granted (based on the Consumer Price Index) capped at 3 percent annually.

PERS Plan 2 and Plan 3 members may have up to ten years of interruptive military service credit; five years at no cost and five years that may be purchased by paying the required contributions. Effective July 24, 2005, a member who becomes totally incapacitated for continued employment while serving the uniformed services, or a surviving spouse or eligible children, may apply for interruptive military service credit. Additionally, PERS Plan 2 and Plan 3 members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

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

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

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

Note 9 - Employee Benefit Plans (Continued)

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6.0 percent for state agencies and local government unit employees, and at 7.5 percent for state government elected officials. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan, and member contributions finance the defined contribution portion. The Employee Retirement Benefits Board sets Plan 3 employee contribution rates. Six rate options are available ranging from 5 to 15 percent; two of the options are graduated rates dependent on the employee's age. The methods used to determine the contribution requirements are established under state statute in accordance with Chapters 41.40 and 41.45 RCW.

Water Quality's contribution rates expressed as a percentage of covered payrolls as of December 31, 2013 were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer	9.21%	9.21%	9.21%
Employee	6.00%	4.92%	5.00%-15.00%

The employer rates include the employer administrative expense fee currently set at 0.18 percent. PERS Plan 3 is the defined benefit portion only. The employee rates for PERS Plan 3 may vary from 5 percent to 15 percent based on the rate selected by the PERS 3 member.

Water Quality's required employer contributions for the years ended December 31 were (in thousands):

	PERS	
	Plan 1	Plans 2 and 3
2013	$ 93	$ 4,353
2012	$ 98	$ 3,657
2011	$ 124	$ 3,665

Note 10 - Operating Subsidies and Grant Revenue

Various federal and state government agencies make grants to Water Quality 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 nonoperating revenue in the statements of revenues, expenses, and changes in net position. Capital grants amounted to $260 thousand for the year ended December 31, 2013.

Note 11 - Other Post-Employment Benefits

In 2007, the County implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension*, which requires the County to accrue other post-employment benefits (OPEB) expenses related to its post-retirement healthcare plan based on a computed annual required contribution (ARC) that includes the current period's service cost and an amount to amortize unfunded accrued liabilities. The liability is included in noncurrent liabilities on the statements of net position for Water Quality.

Plan Description - The King County Health Plan (the Health Plan) is a single-employer defined benefit healthcare plan administered by the County. The Health Plan provides medical, prescription drug, vision, and other unreimbursed medical benefits to eligible employees. The Health Plan's actuary is Healthcare Actuaries and it does not issue a separate stand-alone financial report.

Funding Policy - Law Enforcement Officers' and Fire Fighters' Retirement System Plan (LEOFF) 1 retirees are not required to contribute to the Health Plan. All other retirees are required to pay the COBRA rate associated with the elected plan. Water Quality contributed an estimated $64 thousand and $62 thousand to the Health Plan during both 2013 and 2012, respectively. The contribution was entirely to fund "pay-as-you-go" costs under the Health Plan and not to advance fund the cost of benefits.

Annual OPEB and Net OPEB Obligation - The basis of the County's annual OPEB cost (expense) is the ARC. The ARC represents a level of funding that, if paid on an ongoing basis, the actuary projects will cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Water Quality's allocated annual OPEB costs, the percentage of annual OPEB cost contributed to the Health Plan, and the net OPEB obligation for the years ended December 31, 2013 and 2012 were as follows (in thousands):

	2013	2012
Normal cost - Unit Credit Method	$ 193	$ 216
Amortization of unfunded actuarial accrued liability (UAAL)	32	33
Annual Required Contribution (ARC)	225	249
Interest on net OPEB obligation	4	3
Adjustment to annual required contribution	(9)	(6)
Annual OPEB cost (expense)	219	246
Contributions made	(64)	(62)
Increase in net OPEB obligation	155	184
Net OPEB obligation - beginning of year	1,040	856
Net OPEB obligation - end of year	$ 1,195	$ 1,040

Note 11 - Other Post-Employment Benefits (Continued)

Water Quality's allocated annual OPEB costs, the percentage of annual OPEB costs contributed to the Health Plan, and the net OPEB obligation were as follows (in thousands):

Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
12/31/2013	$ 219	29.2%	$ 1,195
12/31/2012	$ 246	25.2%	$ 1,040
12/31/2011	$ 245	25.3%	$ 856

Required Supplementary Information: Funded Status and Funding Progress - The funded status of the Health Plan as of December 31, 2013 and 2012 was as follows (in thousands):

	2013	2012	2011
Actuarial Value of Plan Assets	$ -	$ -	$ -
Actuarial Accrued Liability (AAL)	167,420	178,502	178,502
Unfunded Actuarial Accrued Liability (UAAL)	$ 167,420	$ 178,502	$ 178,502
Funded Ratio (actuarial value assets/AAL)	0%	0%	0%
Covered Payroll (active plan members)	$ 1,000,353	$ 961,982	$ 969,750
UAAL as a percentage of covered payroll (AAL less actuarial value of assets/UAAL)	16.7%	18.6%	18.4%

Actuarial Methods and Assumptions - The basis of projections of benefits for financial reporting purposes is the substantive plan (the Health Plan as understood by the County and members of the Health Plan) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the County and Members of the Health Plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The December 31, 2013 valuation used the projected unit credit actuarial cost method. The actuarial assumption included a 2.29 percent investment rate of return (net of administrative expenses) and an initial healthcare cost trend rate of 8.0 percent for KingCare medical, 7.0 percent for KingCare pharmacy, and 8.0 percent for HMO medical/pharmacy, each reduced by decrements to an ultimate rate of 4.2 percent after 70 years and 7 years for medical and pharmacy, respectively. The miscellaneous trend rate is 7.0 percent, and the Medicare premium trend rate is 6.0 percent, for all years. All trend rates include a 3.0 percent inflation assumption. The amortization of the UAAL at transition uses a level dollar amount on an open basis. The UAAL is recalculated each year and amortized as a level dollar amount on an open basis over 24 years.

Note 12 - Interfund Borrowing and Transfers

At December 31, 2012, Water Quality had an outstanding interfund short-term loan of $20.2 million, borrowed from the King County Public Transportation Enterprise as authorized by the King County Executive Finance Committee. The loan proceeds were used to: 1) reimburse the operating fund that financed the early retirement of certain sewer revenue bonds, and 2) reimburse the construction fund for capital expenses incurred in anticipation of bond issuance in 2013. This loan was repaid in 2013.

The King County Council approves ordinances and/or motions authorizing Water Quality to contribute and receive amounts to and from various County funds. During 2013 and 2012, the transfers to other funds from Water Quality were $70 thousand and $275 thousand, respectively.

Note 13 - Prior Period Adjustments

Due to Water Quality's adoption of GASB Statement 65, *Items Previously Reported as Assets and Liabilities*, the 2012 financial statements and its net position as of January 1, 2012 were restated to conform with the reporting requirements. Revised balances are shown in the following schedule (in thousands):

Statement/Account Title	Balances As Revised December 31, 2012	Balances As Previously Reported December 31, 2012	Net Change
STATEMENT OF NET POSITION			
CURRENT ASSETS			
Prepayments	$ 614	$ 144	$ 470
NONCURRENT ASSETS			
Other noncurrent			
Prepayments	905	-	905
Other deferred charges	-	21,145	(21,145)
DEFERRED OUTFLOWS OF RESOURCES			
Deferred amount on refunding	94,429	-	94,429
Net change to total assets and deferred outflows of resources			$ 74,659

Note 13 - Prior Period Adjustments (Continued)

Statement/Account Title	Balances As Revised December 31, 2012	Balances As Previously Reported December 31, 2012	Net Change
STATEMENT OF NET POSITION (CONTINUED)			
NONCURRENT LIABILITIES			
Deferred bond premium, discount and refunding losses	$ -	$ 70,877	$ (70,877)
Unamortized bond premium and discount	165,306	-	165,306
Rate stabilization	-	62,600	(62,600)
DEFERRED INFLOWS OF RESOURCES			
Rate stabilization	62,600	-	62,600
NET POSITION			
Net investments in capital assets	200,082	221,227	(21,145)
Unrestricted	106,227	104,852	1,375
Net change to total liabilities, deferred inflows of resources and net position			$ 74,659
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION			
NONOPERATING REVENUES (EXPENSES)			
Amortization of debt related accounts	$ 1,107	$ 739	$ 368
Net change to change in net position			368
NET POSITION - Beginning of year	567,921	588,059	(20,138)
NET POSITION - End of year			$ (19,770)

Note 14 - Commitments and Contingencies

Construction and Maintenance Programs - To ensure the continued operation, reliability, and compliance with regulatory standards of existing wastewater treatment facilities, Water Quality is committed to expending approximately $108.9 million on active construction contracts as of December 31, 2013.

Contingencies and Claims - There is no litigation or claim currently pending against the King County Water Quality Enterprise Fund in which, to management's knowledge, the likelihood of an unfavorable outcome with material damages assessed against the enterprise is considered "probable."

Note 14 - Commitments and Contingencies (Continued)

The following litigation, or potential litigation, may involve claims for material damages against the King County Water Quality Enterprise Fund for which Water Quality is unable to provide an opinion as to the ultimate outcome or the amount of damages that may be found:

- An administrative order from the EPA that requires the County, the City of Seattle, the Boeing Company, and the Port of Seattle to conduct a feasibility study to determine the nature and extent of the contamination in the Lower Duwamish Waterway. The feasibility study has been issued in final form by EPA. The proposed plan is subject to public comment and may be changed by EPA as a result. EPA has stated that it will issue a Record of Decision (ROD) in the later part of 2014. Due to the high level of regulatory review, the County is unable to determine the particular remediation alternative that may be required, the schedule and cost of any required remediation, or the extent of County responsibility.

- A potential requirement for more cleanup in the area contaminated when the Denny Way combined sewer outflow was replaced in 2005. The King County Wastewater Treatment Division (WTD) has already performed interim cleanup costing $3.6 million to comply with a formal agreement with the Washington State Department of Ecology, who reserves its rights to require additional remediation.

- Potential claims for past and future cleanup costs at the Harbor Island Superfund Site. Certain removal costs already incurred by the Port of Seattle are expected to be defrayed by the County and the City of Seattle. The parties have also agreed to share the cost of a supplemental investigation and feasibility study required by the EPA. The agreement states that WTD has only a one-third pro rata share of the study costs and that portion is still potentially allocable among the several potentially responsible parties. Further remediation costs cannot be reasonably estimated until the study is completed.

- A series of requests for change orders and claims for damages from the prime contractor for the Brightwater Treatment Plant central conveyance system alleging differing site conditions and defective specifications. The County vigorously defended against the claims and filed suit alleging contract default by the contractor for failure to complete the contract work within time limits. Contractor asserted damages of approximately $66 million. The County estimated its damages at $158 million. The County received a jury verdict of $155 million on December 21, 2012. The contractor received a verdict of $26.2 million. Rulings on post-trial motions were issued on April 19, 2013, leaving in place the verdict amounts. In addition, the rulings awarded the County additional $14.7 million for its legal costs. The contractor has paid the net judgment amount and filed the appeal. The cash received has been set aside and a liability recorded by Water Quality until the appeal is completed.

- A contractor for the Brightwater Influent Pump Station project filed a change order appeal totaling approximately $4.0 million. The appeal has been denied by the County and a mediation of the dispute is being scheduled.

Note 15 - Subsequent Event

The County prevailed in the matter of Cedar River vs King County and approximately $3.0 million was returned from Water Quality to the King County General Fund which an appellate court had ordered payment into the Water Quality Operating Fund pending appeal to the Washington State Supreme Court. The funds were transferred on April 1, 2014.

KING COUNTY WATER QUALITY ENTERPRISE FUND
SUPPLEMENTAL INFORMATION
SUPPLEMENTAL SCHEDULE OF NET REVENUES AVAILABLE FOR DEBT SERVICE (UNAUDITED)
YEAR ENDED DECEMBER 31, 2013

Water Quality 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 Water Quality. It is an adopted policy of Water Quality to achieve a debt service coverage ratio of 1.25.

Coverage (1.15 required by covenant, adopted policy 1.25)	1.42

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

Coverage (1.15 adopted target)	1.33

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

Coverage (1.00 required by covenant)	1.25

In 2001, Water Quality 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. In 2010, Water Quality issued Multi-Modal Limited Tax General Obligation Sewer Revenue Bonds, series 2010A and 2010B, which incorporate the identical requirement as Junior Lien obligations. In 2011 and 2012, Water Quality issued $100 million of Junior Lien Variable Rate Demand Sewer Revenue Bonds with incorporate the identical requirement as Junior Lien Obligations

Coverage (1.10 required by covenant)	31.03