



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

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

December 31, 2015 and 2014

**MOSS-ADAMS<sub>LLP</sub>**

Certified Public Accountants | Business Consultants

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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, 2015 and 2014, 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 we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the King County Water Quality Enterprise Fund as of December 31, 2015 and 2014, 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 Notes 1 and 14 of the financial statements, in 2015 Water Quality adopted the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – An Amendment of GASB Statement No. 68*. The financial statements have been retroactively restated for all periods presented for this change. 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, the Schedule of the County's Proportionate Share of the Net Pension Liability, Schedule of Contributions, and Schedule of Funding Progress for the Plan be presented to supplement the basic 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 16, 2016

# **KING COUNTY WATER QUALITY ENTERPRISE FUND**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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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, 2015 and 2014.

### **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 424 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 26 regulator stations. Other facilities include four combined sewer overflow (CSO) treatment plants and 38 CSO control locations. The sewer system collected and treated an average of 178 million gallons per day in 2015 from approximately 1.7 million residents.

### **FINANCIAL HIGHLIGHTS**

During 2015, Water Quality provided sewage treatment services to 736,090 residential customer equivalents (RCE) compared to 725,844 in 2014 and 718,160 in 2013. 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 11,676 new connections to its customer billing base in 2015. The program added 10,767 and 7,224 new connections in 2014 and 2013, respectively. In 2015, the average flow of the five treatment plants was 178 million gallons per day (MGD) with a peak daily flow of 556 MGD. Maximum system capacity remained at 895 MGD in 2015 and 2014. The average daily flow fluctuated between a peak of 186 MGD in 2014 and a low of 178 MGD in 2015. The annual fluctuation in flows largely depends on the amount of annual precipitation.

In 2015, Resource Recovery delivered 114,957 tons compared to 119,325 tons in 2014 of Loop® biosolids to customers for use in forest management, agriculture, and composting. Approximately 86 million gallons compared to 75 million gallons in 2014 of Class A reclaimed water was distributed for irrigation, urinals/toilets, municipal purposes, and wetland enhancement and about 762 million gallons of filtered, treated wastewater were used for internal treatment plant processes. The permitted capacity for the South Plant reclaimed water facility is a filter feed loading of 1.3 MGD and the Brightwater permitted reclaimed water treatment capacity is 21 MGD. Water Quality sold 1.8 million therms of natural gas to Puget Sound Energy from the South Treatment Plant, and produced 18 million kilowatt hours of electricity from digester gas at the West Point Treatment Plant, which was sold to Seattle City Light. In 2014, Water Quality sold 1.9 million therms of natural gas to Puget Sound Energy and 16.9 million kilowatt hours of electricity produced from digester gas.

## **KING COUNTY WATER QUALITY ENTERPRISE FUND MANAGEMENT'S DISCUSSION AND ANALYSIS**

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### **FINANCIAL HIGHLIGHTS (CONTINUED)**

The Industrial Pretreatment Program conducted 356 inspections and took 1,570 compliance samples in 2015 compared to 347 inspections and 1,700 compliance samples taken in 2014. The program currently tracks 483 facilities with discharge authorization permits and 116 significant industrial users.

Water Quality currently has 38 combined sewer overflow facilities plus 4 CSO treatment facilities. Past investments conducted in concert with the City of Seattle have 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 at present.

In 2012, the Environmental Protection Agency (EPA) entered into a consent decree with Water Quality to reduce CSO overflows to meet regulator's standards for discharges or treatment by 2030. The consent decree is based on Water Quality's 2012 Amended Long-term CSO Control Plan. The Plan identified 14 additional CSO control projects, five of which are currently underway. A joint project with the City of Seattle is being developed that will address two of the remaining nine projects.

The consent decree includes an option to develop an integrated plan which may result in lower costs to complete the Plan. The EPA and Washington Department of Ecology will monitor Water Quality's progress with CSO control and work closely with the enterprise going forward to meet CSO control requirements. In accordance with the county's National Pollutant Discharge Elimination System permit for the West Point Treatment Plant and the consent decree, an update to the Plan is underway and will be completed by 2018.

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, and construction of 21 CSO control projects. The RWSP also includes projects to control infiltration and inflow into the Conveyance system, process additional biosolids, and produce additional reclaimed water. Total capital program expenditures were \$154.6 million in 2015 and \$155.4 million in 2014.

Water Quality operating revenues decreased by 0.6 percent to \$433.4 million in 2015 from \$435.8 million in 2014 while operating expenses before depreciation and amortization increased by 4.3 percent to \$127.2 million in 2015 from \$122.0 million in 2014.

## **KING COUNTY WATER QUALITY ENTERPRISE FUND MANAGEMENT'S DISCUSSION AND ANALYSIS**

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### **FINANCIAL HIGHLIGHTS (CONTINUED)**

The monthly sewer rate increased to \$42.03 per RCE in 2015. In 2014, it remained unchanged from 2013 at \$39.79. The capacity charge rate increased to \$57.00 per RCE in 2015 from \$55.35 in 2014. Capacity charge revenues increased 4.9 percent to \$62.5 million in 2015 from \$59.6 million in 2014. The RCE's billed for sewer treatment services increased to 736,090 in 2015 from 725,844 in 2014. The rate stabilization reserve increased to \$46.3 million in 2015 from \$34.3 million in 2014. This increase of \$12 million in the reserve balance decreases operating revenues for the year and has been included in the calculation of debt service coverage for 2015. 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.

Water Quality issued \$567.3 million in Sewer Revenue and Refunding Bonds in 2015, which provided \$80.0 million for new construction, including \$3.5 million in reserves and accrued interest from refunded bonds. The enterprise issued \$247.8 million in LTGO refunding bonds. This resulted in \$163.4 million in savings over the lives of the refunded issues or \$90.5 million in present value of debt service savings. In November, 2015 Water Quality issued \$100 million in Junior Lien Sewer Revenue Bonds to redeem its Commercial Paper program and \$31.6 million in low interest state loans at rates between 0.5 and 2.72 percent. This compares to \$267.5 million of Sewer Revenue and Refunding Bonds issued in 2014, including \$5.3 million for new construction and \$22.3 million in low interest state loans.

The results of operations for 2015 and 2014 produced a debt service coverage ratio on senior lien debt of 1.48 and 1.44, respectively, exceeding the coverage covenant requirement of 1.15 in both years. The total debt coverage ratio of 1.36 in 2015 and 1.33 in 2014 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.

# **KING COUNTY WATER QUALITY ENTERPRISE FUND MANAGEMENT'S DISCUSSION AND ANALYSIS**

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## **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 \$359.2 million (net of the rate stabilization transfer) provided 82.9 percent of operating revenues in 2015 and \$364.6 million provided 83.7 percent of operating revenues in 2014. 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.

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 2015 and 2014, 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.



**KING COUNTY WATER QUALITY ENTERPRISE FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

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**FINANCIAL ANALYSIS OF THE STATEMENTS OF NET POSITION**

Comparative data, stated in millions of dollars:

	Years Ended December 31,		
	2015	2014 (As Restated)	2013
Current assets	\$ 431.8	\$ 407.5	\$ 457.9
Noncurrent assets	245.2	216.8	236.0
Capital assets	4,106.5	4,122.9	4,128.4
Other	110.4	97.8	95.9
Total assets	<u>4,893.9</u>	<u>4,845.0</u>	<u>4,918.2</u>
Deferred outflows of resources	184.9	104.0	92.0
Total assets and deferred outflows of resources	<u>5,078.8</u>	<u>4,949.0</u>	<u>5,010.2</u>
Current liabilities	456.5	434.9	435.6
Noncurrent liabilities	4,065.9	3,951.9	3,962.4
Total liabilities	<u>4,522.4</u>	<u>4,386.8</u>	<u>4,398.0</u>
Deferred inflows of resources	53.2	49.6	52.3
Total liabilities and deferred inflows of resources	<u>4,575.6</u>	<u>4,436.4</u>	<u>4,450.3</u>
Net position-net investment in capital assets	191.1	210.4	206.9
Net position-restricted	201.6	205.3	203.3
Net position-unrestricted	<u>110.5</u>	<u>96.9</u>	<u>149.7</u>
Total net position	<u>\$ 503.2</u>	<u>\$ 512.6</u>	<u>\$ 559.9</u>

Net position serves as a useful indicator of Water Quality's financial position. As of December 31, 2015 and 2014, assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by \$503.2 million and \$512.6 million, respectively.

Of the total Water Quality assets and deferred outflows of resources, 80.9 percent or \$4,106.5 million were invested in capital assets such as treatment plants, pumping and regulator stations, interceptors, and other equipment at year-end 2015. For the year-end 2014, 83.3 percent or \$4,122.9 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.

# KING COUNTY WATER QUALITY ENTERPRISE FUND MANAGEMENT'S DISCUSSION AND ANALYSIS

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## FINANCIAL ANALYSIS OF THE STATEMENTS OF NET POSITION (CONTINUED)

The net position decreased by 1.8 percent or \$9.4 million in 2015 to \$503.2 million from \$512.6 million in 2014. This change includes a \$42.5 million restatement to the net position at 2014 year-end in accordance with the implementation of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*. For more information see Notes 1, 9 and 14 in the Notes to Financial Statements section. Restricted net position decreased by 1.8 percent or \$3.7 million in 2015 to \$201.6 million from \$205.3 million in 2014. The unrestricted net position increased by \$13.6 million in 2015 to \$110.5 million from \$96.9 million in 2014.

The net position decreased by 8.4 percent or \$47.3 million in 2014 from \$559.9 million in 2013. The restricted net position increased by \$2.0 million in 2014 from \$203.3 million in 2013. The unrestricted net position decreased by \$52.8 million in 2014 from \$149.7 million in 2013.

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

Comparative data, stated in millions of dollars:

	Years Ended December 31,		
	2015	2014	2013
		(As Restated)	
Sewage treatment fees	\$ 371.3	\$ 346.6	\$ 342.9
Rate stabilization	(12.0)	18.0	10.4
Capacity charge revenue	62.5	59.5	58.8
Other revenue	11.6	11.7	9.9
Operating revenues	433.4	435.8	422.0
Operating expenses	301.0	288.6	278.2
Operating income	132.4	147.2	143.8
Non operating (expenses)	(142.6)	(149.8)	(145.3)
Grant revenues	0.8	-	0.3
Change in net position	(9.4)	(2.6)	(1.2)
Net position beginning of year (restated)	512.6	515.2	561.1
Net positon end of year	<u>\$ 503.2</u>	<u>\$ 512.6</u>	<u>\$ 559.9</u>

## **KING COUNTY WATER QUALITY ENTERPRISE FUND MANAGEMENT'S DISCUSSION AND ANALYSIS**

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

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 2015, operating revenues decreased by 0.6 percent or \$2.4 million to \$433.4 million from \$435.8 million in 2014. Operating expenses increased by 4.3 percent or \$12.4 million to \$301.0 million in 2015 from \$288.6 million in 2014.

In 2014, operating revenues increased by 3.3 percent or \$13.8 million to \$435.8 million from \$422.0 million in 2013. Operating expenses increased by 3.7 percent or \$10.4 million from \$278.2 million in 2013.

The operating revenues and expenses were driven by:

- Water Quality collected a monthly sewage treatment charge of \$42.03 per RCE in 2015 and \$39.79 in 2014 and 2013. Sewer disposal revenues before rate stabilization increased by 7.1 percent or \$24.7 million in 2015 to \$371.3 million. An increase in RCE's and the 2015 rate increase were the main contributors. Sewer disposal revenues before rate stabilization increased by 1.0 percent or \$3.6 million to \$346.6 million in 2014 from \$343.0 million in 2013.
- Sewer treatment charges, net of rate stabilization reserve, decreased by \$5.4 million in 2015 or 1.5 percent to \$359.2 million from \$364.6 million in 2014. The decrease is due to the rate stabilization reserve increase of \$12 million.
- Other operating revenues, including capacity charges for new customers and other treatment charges, increased by 4.1 percent or \$2.9 million in 2015 to \$74.1 million from \$71.2 million in 2014. These revenues increased by 3.6 percent or \$2.5 million in 2014 to \$71.2 million from \$68.7 million in 2013. Capacity charge early payoff revenues were 28.6 percent or \$17.9 million of total capacity charge revenues in 2015, while in 2014, capacity charge early payoff revenues were 23.5 percent or \$14.0 million of the annual total. Actual new capacity charge connections were 11,676 in 2015 and 10,767 in 2014.
- Net non-operating revenues and expenses decreased by 4.8 percent or \$7.2 million to \$142.6 million in 2015 from \$149.8 million in 2014. The main contributors to changes in the numbers were decreased interest and amortization expense resulting from bond refunding. Net non-operating revenues and expenses increased by 3.1 percent or \$4.5 million to \$149.8 million in 2014 from \$145.3 million in 2013.
- Capital Grant revenues received from federal and state agencies increased by \$766 thousand in 2015 from zero in 2014. No capital grant revenues were received from federal and state agencies in 2014 reflecting a decrease of \$300 thousand from 2013. Low interest loans have largely replaced grants as the primary method of state agency support in recent years.

## **KING COUNTY WATER QUALITY ENTERPRISE FUND MANAGEMENT'S DISCUSSION AND ANALYSIS**

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

- Chemical expenses increased slightly by 2.9 percent or about \$236 thousand in 2015 to \$7.2 million. Chemical expenses decreased by 7.6 percent or about \$573 thousand in 2014 to \$7.0 million.
- Utility and Service expenses increased by 4.6 percent or \$1.3 million to \$29.9 million for 2015 from \$28.6 million in 2014. Utility and Service expenses increased by 1.8 percent or \$517 thousand to \$28.6 million for 2014 from \$28.1 million in 2013. Electricity expense increased by 3.0 percent or \$445 thousand to \$13.9 million in 2015 after increasing by 5.4 percent or \$689 thousand to \$13.5 million in 2014. Electricity usage was driven up in 2015 due to notably warmer than normal wastewater temperatures causing the need for increased aeration. New capital facilities went into service as well, requiring additional electricity for enhanced HVAC/odor control and larger pumps.
- Intergovernmental expenses increased by 8.9 percent or \$2.8 million in 2015 to \$34.4 million from \$31.6 million in 2014. Intergovernmental expenses fell by 5.1 percent or \$1.7 million in 2014 to \$31.6 million from \$33.3 million in 2013. In general, contributors to increases here are reflected in increased surface water management fees as well as central charges relating to support of the 2012 Oracle system conversion, increased Fleet and GIS efforts.

### **CAPITAL ASSETS**

At December 31, 2015, Water Quality's investment in capital assets, net of accumulated depreciation, was \$4,106.5 million, reflecting a decrease of \$16.4 million or 0.4 percent less than the balance at December 31, 2014. This decrease represents plant in service retirements and an increase in depreciation from Brightwater Treatment Plant and Conveyance capitalizations. Capital assets net decrease from December 31, 2013 to December 31, 2014 was \$5.5 million or 0.13 percent.

Large 2015 construction project expenditures include:

- \$16.5 million for North Creek Interceptor
- \$12.4 million for Fremont Siphon Replacement
- \$11.9 million for Magnolia CSO Control & Improvements
- \$9.7 million for Murray CSO Control & Improvements
- \$8.1 million for Georgetown Wet Weather Treatment Station

Large 2014 construction project expenditures include:

- \$20.9 million for Magnolia CSO Control & Improvements
- \$11.3 million for Murray CSO Control & Improvements
- \$9.1 million for West Point Dewatering & Energy Improvements
- \$8.2 million for West Point Influent Screen Improvements
- \$7.5 million for North Beach CSO Control & Improvements

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

# KING COUNTY WATER QUALITY ENTERPRISE FUND MANAGEMENT'S DISCUSSION AND ANALYSIS

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## DEBT ADMINISTRATION

Water Quality issued \$474.0 million of sewer revenue refunding bonds and \$247.8 million of LTGO refunding bonds in February 2015 with an average life of 21.6 years at an average rate of 4.5 percent and an effective rate of 3.6 percent, and \$93.3 million of sewer improvement and refunding revenue bonds in November 2015 with an average life of 14.6 years at an average rate of 4.1 percent and effective rate of 3.4 percent. In November 2015, Water Quality issued \$100.0 million in Junior Lien Sewer Revenue Bonds at a rate of 2.0 percent and an effective rate of 0.5 percent for 1 year. This issue redeemed Water Quality's Commercial Paper debt and will be remarketed on the Long-Term Rate Purchase Date of November 16, 2016.

Water Quality issued \$75.0 million of sewer revenue and refunding bonds in June 2014 with an average life of 30.6 years at a rate of 5.0 percent and an effective rate of 4.2 percent, and \$192.5 million of revenue refunding bonds in August 2014 with an average life of 14.5 years at an average rate of 4.1 percent and effective rate of 3.4 percent.

Water Quality received \$31.6 million in low-interest loans from the State of Washington in 2015 and \$22.3 million in 2014. The new loans carry below-market rates between 0.5 percent and 2.72 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 2015 and had \$2.8 billion outstanding at the end of 2014. 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 2015, Water Quality has \$765.4 million of general obligation bonds and variable rate general obligation bonds outstanding and had \$780.0 million of general obligation bonds and variable rate general obligation bonds outstanding at the end of 2014. While the full faith and credit of King County guarantees repayment of principal and interest on general obligation bonds, they are paid from sewage treatment fees and other income.

King County received ratings of AAA from Standard and Poor's and Aa1 from Moody's Investors Service for the limited tax general obligation bond issued in February 2015. Junior Lien Sewer Revenue Bonds issued in November 2015 were rated MIG 1 and SP-1+ by Moody's Investors Service and Standard & Poor's Rating Services, respectively. At the time of the issuance of the sewer revenue bonds in 2015 and 2014, Water Quality's bond ratings were:

Moody's Investor's Service

Aa2

Standard & Poor's

AA+

# **KING COUNTY WATER QUALITY ENTERPRISE FUND MANAGEMENT'S DISCUSSION AND ANALYSIS**

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## **DEBT ADMINISTRATION (CONTINUED)**

As required by bond covenant, Water Quality maintains a bond reserve account, which is funded by cash balances. At December 31, 2015, the cash balance in the reserve account was \$166.1 million, including \$1.4 million of Junior Lien bonds maturing in November, 2016, and \$174.1 million at the end of 2014. In addition to bond covenant reserves, Water Quality also maintains financial policy reserves. At December 31, 2015 and 2014, the rate stabilization, liquidity, and asset management financial policy reserves totaled \$79.1 million and \$66.7 million, respectively.

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

## **DEBT SERVICE COVERAGE RATIOS**

	<u>FY 2015</u>	<u>FY 2014</u>
Parity Debt	1.48	1.44
Total Debt	1.36	1.33

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, 2015 and 2014. Questions concerning this report or requests for additional information should be addressed to Cheryl Lee, 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,	
	2015	2014
		(As Restated)
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 230,349	\$ 204,064
Restricted cash and cash equivalents	149,403	146,651
Accounts receivable, net	37,018	44,081
Due from other funds	1,224	1,150
Due from other governments, net	5,014	3,782
Inventory of supplies	8,425	7,672
Prepayments	385	85
	<u>431,818</u>	<u>407,485</u>
<b>NONCURRENT ASSETS</b>		
Cash and cash equivalents	<u>245,177</u>	<u>216,868</u>
Capital assets		
Building and land improvements	2,009,486	1,939,307
Artwork	5,645	5,572
Infrastructure and right of way	2,245,766	2,266,997
Plant in service and other equipment	1,107,256	1,074,386
Less accumulated depreciation	<u>(1,849,992)</u>	<u>(1,700,893)</u>
	3,518,161	3,585,369
Land and easements	268,398	254,713
Construction work in progress	<u>319,960</u>	<u>282,785</u>
	<u>4,106,519</u>	<u>4,122,867</u>
Other noncurrent		
Prepayments	81	425
Regulatory assets - environmental remediation	74,616	63,303
Other utility assets, net of amortization	31,816	29,835
Other assets	<u>3,963</u>	<u>4,200</u>
	<u>110,476</u>	<u>97,763</u>
Total assets	<u>4,893,990</u>	<u>4,844,983</u>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>		
Deferred outflows on refunding	179,878	101,942
Deferred outflows on pension	<u>4,987</u>	<u>2,087</u>
Total deferred outflows of resources	<u>184,865</u>	<u>104,029</u>
<b>TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</b>	<u>\$ 5,078,855</u>	<u>\$ 4,949,012</u>

**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**STATEMENTS OF NET POSITION (CONTINUED)**  
**(In Thousands)**

	December 31,	
	2015	2014 (As Restated)
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 37,599	\$ 27,283
Retainage payable	2,766	2,352
Due to other funds	111	-
Interest payable	76,438	79,115
Wages and benefits payable	3,222	2,210
Compensated absences	642	565
Taxes payable	12	17
Unearned revenue	2,067	1,628
Notes payable	-	100,000
State loans payable	12,121	11,133
General obligation bonds payable	9,520	9,000
Revenue bonds payable	156,910	51,615
Environmental remediation costs	8,477	5,632
Deposit and other liability	146,637	144,299
	<u>456,522</u>	<u>434,849</u>
<b>NONCURRENT LIABILITIES</b>		
Compensated absences	10,623	10,919
Other post-employment benefits	1,467	1,351
Net pension liability	38,885	29,193
State loans payable, net	167,267	147,920
General obligation bonds payable, net	828,715	806,567
Revenue bonds payable, net	2,975,124	2,916,797
Environmental remediation costs	43,821	39,168
	<u>4,065,902</u>	<u>3,951,915</u>
Total liabilities	<u>4,522,424</u>	<u>4,386,764</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Regulatory credits - rate stabilization	46,250	34,250
Deferred inflows on pension	6,984	15,368
Total deferred inflows of resources	<u>53,234</u>	<u>49,618</u>
<b>TOTAL LIABILITIES AND DEFERRED INFLOWS OF RESOURCES</b>	<u>4,575,658</u>	<u>4,436,382</u>
<b>NET POSITION</b>		
Net investments in capital assets	191,080	210,360
Restricted for:		
Debt service	175,332	182,618
Regulatory assets and environmental liabilities	26,281	22,704
Unrestricted	110,504	96,948
Total net position	<u>\$ 503,197</u>	<u>\$ 512,630</u>



**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION**  
(In Thousands)

	Years Ended December 31,	
	2015	2014 (As Restated)
<b>OPERATING REVENUES</b>		
Sewage disposal fees	\$ 359,253	\$ 364,591
Other operating revenues	74,153	71,197
Total operating revenues	<u>433,406</u>	<u>435,788</u>
<b>OPERATING EXPENSES</b>		
Sewage treatment, disposal, and transmission	89,715	100,473
General and administrative	37,496	21,541
Environmental related amortization	2,954	2,581
Depreciation and amortization	170,787	163,976
Total operating expenses	<u>300,952</u>	<u>288,571</u>
<b>OPERATING INCOME</b>	<u>132,454</u>	<u>147,217</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Investment earnings	2,231	3,856
Interest expense	(139,980)	(150,007)
Loss on disposal and impairment of capital assets	(5,280)	(3,001)
Other	376	(677)
Total nonoperating expenses	<u>(142,653)</u>	<u>(149,829)</u>
<b>LOSS BEFORE GRANTS AND CONTRIBUTIONS</b>	(10,199)	(2,612)
<b>CAPITAL GRANT REVENUES</b>	<u>766</u>	<u>-</u>
<b>CHANGE IN NET POSITION</b>	(9,433)	(2,612)
<b>NET POSITION</b>		
Beginning of year (restated)	<u>512,630</u>	<u>515,242</u>
End of year	<u>\$ 503,197</u>	<u>\$ 512,630</u>

**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**STATEMENTS OF CASH FLOWS**  
**(In Thousands)**

	Years Ended December 31,	
	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash received from customers	\$ 454,391	\$ 414,909
Cash payments to suppliers for goods and services	(83,417)	(79,950)
Cash payments for employee services	(49,017)	(48,703)
Settlement receipts	2,338	-
Other payments	(6,531)	(5,957)
Net cash provided by operating activities	<u>317,764</u>	<u>280,299</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Operating grant and subsidy received	-	65
Transfers out	(115)	(173)
Assistance to other agencies	(710)	(17)
Net cash used in noncapital financing activities	<u>(825)</u>	<u>(125)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Acquisition of capital and other utility assets	(137,674)	(154,085)
Proceeds from disposal of capital assets	24	23
Principal paid on capital debt	(71,843)	(67,331)
Interest paid on capital debt	(161,183)	(169,072)
Proceeds of new bond issuance	76,523	5,275
Proceeds of state loans	31,563	22,343
Capital grants received	766	-
Net cash used in capital and related financing activities	<u>(261,824)</u>	<u>(362,847)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest on investments	<u>2,231</u>	<u>3,856</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	57,346	(78,817)
<b>CASH AND CASH EQUIVALENTS</b>		
Beginning of year	<u>567,583</u>	<u>646,400</u>
End of year	<u>\$ 624,929</u>	<u>\$ 567,583</u>

**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**STATEMENTS OF CASH FLOWS**  
**(In Thousands)**

	Years Ended December 31,	
	2015	2014 (As Restated)
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 132,454	\$ 147,217
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation and amortization	170,787	163,976
Other nonoperating revenue and expense	1,458	1,646
Changes in assets		
Accounts receivable	7,063	(7,859)
Due from other funds	25	2,892
Inventory of supplies	(753)	(420)
Prepayments	(316)	(40)
Other assets	(5,113)	(3,476)
Changes in deferred outflows of resources		
Deferred outflows on pension	(2,900)	(42)
Changes in liabilities		
Accounts payable	(2,820)	(2,783)
Retainage payable	12	(17)
Due to other funds	111	(5)
Taxes payable	(5)	10
Unearned revenue	440	300
Wages and benefits payable	244	(1,523)
Compensated absences	(220)	172
Other post-employment benefits	116	156
Net pension liability	9,691	(17,513)
Other liabilities	3,874	240
Changes in deferred inflows of resources		
Rate stabilization	12,000	(18,000)
Deferred inflows on pension	(8,384)	15,368
Total adjustments	<u>185,310</u>	<u>133,082</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 317,764</u>	<u>\$ 280,299</u>

**NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:**

Water Quality issued bonds in 2015 to refund debt issued from 1995 to 2010. The \$851.1 million bond proceeds were placed in escrow for the defeasance of \$752.3 million of outstanding revenue and LTGO bond principal and \$124.3 million of interest. There were \$100.0 million of junior lien bonds issued to redeem the 1995 commercial paper program.

Water Quality issued bonds in 2014 to refund debt issued from 2004 to 2008. The \$295.1 million proceeds were placed in escrow for the defeasance and purchase of \$270.9 million of outstanding bond principal and \$22.8 million of interest.

# KING COUNTY WATER QUALITY ENTERPRISE FUND

## NOTES TO FINANCIAL STATEMENTS

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### 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 and Parks 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 2015 and in 2014.

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 \$34.4 million and \$31.6 million in 2015 and 2014, 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. **Receivables and Allowance for Doubtful Accounts** – Receivables include charges for services rendered by Water Quality or intergovernmental grants. All unbilled service receivables are recorded at year-end. The provisions for estimated uncollectible receivables are reviewed and updated at year-end. These provisions are estimated based on actual historical write-off trends and knowledge of specific circumstances that indicate collection of an account may be unlikely. As of December 31, 2015 and 2014, Water Quality’s allowance for doubtful accounts was \$6.4 million and \$886 thousand, respectively.

**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 1 – Operations and Accounting Policies (Continued)**

- c. **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.

- d. **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.
- e. **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.
- f. **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 and improvements other than building	10 - 75 years
Cars, vans, and trucks	5 - 10 years
Data processing equipment	3 - 10 years
Heavy equipment	5 - 25 years
Sewer lines	20 - 50 years
Shop equipment	5 - 20 years
Software	3 - 10 years
Intangibles	35 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 \$154.0 million and \$165.5 million, respectively, during the years ended December 31, 2015 and 2014, respectively, of which \$11.3 million and \$11.5 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.

## KING COUNTY WATER QUALITY ENTERPRISE FUND

### NOTES TO FINANCIAL STATEMENTS

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#### Note 1 – Operations and Accounting Policies (Continued)

- g. **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.

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.

- h. **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. Water Quality has no liability as of December 31, 2015 and 2014.
- i. **Deferred Outflows and 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 of resources include deferred losses on the refunding of bonds and certain amounts related to pension accounting. Deferred inflows of resources include certain amounts related to pension accounting and rate stabilization.
- j. **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.

Water Quality provides water treatment services to cities and sewer districts and recognizes revenue when such service is provided. Additionally, the capacity charge revenue is generated from new connections to the sewer system. Both water treatment service and capacity charge rates are authorized by ordinances passed by the King County Council. Water treatment service and capacity charge revenues are recorded through cycle billings rendered to customers monthly. Water Quality accrues and records unbilled water service and capacity charge revenues in the financial statements for services provided from the date of the last billing to year end.

## KING COUNTY WATER QUALITY ENTERPRISE FUND

### NOTES TO FINANCIAL STATEMENTS

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#### Note 1 – Operations and Accounting Policies (Continued)

- k. **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.
- l. **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 \$766 thousand for the year ended December 31, 2015.
- m. **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 and consists of capital assets, net of accumulate depreciation, reduced by the outstanding balances of any bonds, notes, or other borrowings attributable to the acquisition, construction, or improvement of those assets. Any net position not subject to classification as restricted or invested in capital assets are reported as unrestricted.
- n. **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, pension liability and related deferred outflow and inflow of resources, and future interest rates. Actual results could differ from these estimates.
- o. **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 were implemented during the current year.

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, was issued in June 2012. The standard requires governmental employers with employees participating in defined benefit pension plans that are administered through trusts or equivalent arrangements to report their proportionate share of the net pension liability (or net assets, if the plan net position exceeds the total pension liability) on the face of their accrual based financial statements. The statement is effective for periods beginning after June 15, 2014. It was implemented in 2015 by Water Quality.

GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*, addresses an issue regarding application of the transition provisions of GASB Statement No. 68. The issue relates to amounts associated with contributions, if any, made by a state or local government employer to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions of this statement are required to be applied simultaneously with the provisions of GASB Statement No. 68. It was adopted in 2015 by Water Quality.

# KING COUNTY WATER QUALITY ENTERPRISE FUND

## NOTES TO FINANCIAL STATEMENTS

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### 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.

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), which serves the role of the County Finance Committee as defined in RCW 36.48.070.

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 \$624.9 million and \$567.6 million were fully invested in the Pool as of December 31, 2015 and 2014, respectively. The County had demand deposits of \$30.7 million and \$104.1 million as of December 31, 2015 and 2014, respectively, in fully insured and collateralized depository accounts at U.S. Bank and other banks under FDIC and PDPC as set out above.

**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, 2015, 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.



**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 2 – Deposits and Investments (Continued)**

The Pool’s policies limit the maximum amount that can be invested in various securities. At 2015 and 2014 year-end the Pool was in compliance. The Pool’s actual composition, as of December 31, 2015 and 2014, is as follows (in thousands):

Investment Type	2015		2014	
	Fair Value	Allocation Percentage	Fair Value	Allocation Percentage
Repurchase agreements	\$ 175,000	2.83%	\$ 144,000	2.75%
Commercial paper	221,744	3.59%	164,989	3.15%
U.S. agency discount notes	1,120,318	18.15%	559,230	10.67%
Bank notes	732,896	11.87%	169,536	3.23%
Bank notes floating rate	59,952	0.97%	-	0.00%
U.S. treasury notes	2,274,494	36.84%	1,839,864	35.11%
U.S. agency notes	1,250,334	20.25%	1,798,259	34.31%
U.S. agency collateralized mortgage obligations	7,212	0.12%	8,629	0.16%
State treasurer’s investment pool	332,121	5.38%	556,391	10.62%
	<u>\$ 6,174,071</u>	<u>100.00%</u>	<u>\$ 5,240,898</u>	<u>100.00%</u>

**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. Exempt from the DVP policy are Certificates of Deposits (CDs) and funds placed with the State of Washington Local Government Investment Pool.

**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 2015 year-end the Pool had concentrations greater than 5 percent of the total investment pool portfolio in the following issuers: Federal Home Loan Mortgage Corporation, 5.3 percent, Federal National Mortgage Association, 6.5 percent, Federal Home Loan Bank, 10.9 percent, and Federal Farm Credit Bank, 15.8 percent.

The issues with concentrations greater than 5 percent of the pool portfolio at 2014 year-end were as follows: Federal Home Loan Mortgage Corporation, 11.3 percent, Federal National Mortgage Association, 13.1 percent, Federal Home Loan Bank, 13.6 percent, Federal Farm Credit Bank, 7.1 percent and Wells Fargo Bank, 5.0 percent.

# KING COUNTY WATER QUALITY ENTERPRISE FUND

## NOTES TO FINANCIAL STATEMENTS

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### Note 2 – Deposits and Investments (Continued)

**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 0.936 years and 1.261 years at December 31, 2015 and 2014, respectively.

All securities are reported at fair value. Fair value reports are prepared monthly and distributed to all Pool participants. The Pool values participants’ shares using an amortized cost basis. Monthly income is distributed to participants based on their relative participation during the period.

### 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 \$394.6 million at December 31, 2015 and \$363.5 million at December 31, 2014 to comply with bond covenants and other requirements.

Liability amounts payable from restricted assets primarily consist of escrow and in-house retainage payables. These amounted to \$2.8 million and \$2.4 million at December 31, 2015 and 2014, respectively. The details of restricted and unrestricted cash and cash equivalents as of December 31, 2015 and 2014 are as follows (in thousands):

	2015	2014
Unrestricted cash and cash equivalents		
Operating funds	\$ 19,920	\$ 21,411
Construction funds	40,787	11,417
Bond funds	136,749	138,816
Policy reserves	32,893	32,420
Total unrestricted cash and cash equivalents	<u>230,349</u>	<u>204,064</u>
Restricted cash and cash equivalents		
Bond reserves	166,128	174,094
SRF loan reserves	9,204	8,524
Bond proceeds committed to construction	23,595	-
Retainage	2,766	2,352
Rate stabilization reserve	46,250	34,250
Legally restricted funds	146,637	144,299
Total restricted cash and cash equivalents	<u>394,580</u>	<u>363,519</u>
Total cash and cash equivalents	<u>\$ 624,929</u>	<u>\$ 567,583</u>

## KING COUNTY WATER QUALITY ENTERPRISE FUND

### NOTES TO FINANCIAL STATEMENTS

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#### **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 2015 and 2014, Water Quality claims paid by the Insurance Fund of King County were \$130 thousand and \$1.5 million, 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.

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, 2015, bonds outstanding include \$2,930.2 million of serial and term bonds maturing from January 1, 2016 through January 1, 2052, bearing interest at stated rates of 1.00 percent to 5.75 percent per annum.

On February 18, 2015, the County issued \$474.0 million in sewer revenue bonds, Series A, with an effective interest cost of 3.6 percent to advance refund \$475.3 million of outstanding 2007, 2008, and 2009 sewer revenue bonds with an average coupon interest rate of 5.2 percent. The reacquisition price exceeded the net carrying amount of the old debt by \$54.3 million. This advance refunding was undertaken to reduce total debt service payments by \$127.7 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 \$65.6 million.

## **KING COUNTY WATER QUALITY ENTERPRISE FUND**

### **NOTES TO FINANCIAL STATEMENTS**

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

On November 17, 2015, the County issued \$93.3 million in sewer revenue bonds, Series B, with an effective interest cost of 3.4 percent, to currently refund \$24.1 million of outstanding 2006 sewer revenue bonds with a coupon interest rate of 5.0 percent. The reacquisition price exceeded the net carrying amount of the old debt by \$409 thousand. This current refunding was undertaken to reduce total debt service payments by \$3.8 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 \$3.4 million.

On November 24, 2015, the County issued \$100.0 million in junior lien sewer revenue bonds, Series A and B, maturing on January 1, 2046 to redeem all of its outstanding notes payable from its commercial paper program. The bonds bear interest at a rate of 2.0 percent through November 16, 2016, at which time they are subject to mandatory purchase by the County after which they may be remarketed in weekly or other Interest Rate Modes. The bonds are classified as a current liability as of December 31, 2015.

On July 8, 2014, the County issued \$75.0 million in sewer revenue refunding bonds, 2014A, with an effective interest cost of 4.2 percent to purchase \$75.0 million of outstanding sewer revenue bonds, 2007, with an average coupon interest rate of 5.0 percent. The reacquisition price exceeded the net carrying amount of the old debt by \$3.5 million. The transaction resulted in an economic gain of \$5.3 million, the difference between the present values of the old and new debt service payments and the difference between the issue price of the 2014A bond and the purchase price of the 2007 bond.

On August 12, 2014, the County issued \$192.5 million in sewer revenue bonds, 2014B, with an effective interest cost of 3.4 percent to advance refund \$195.9 million of outstanding 2004B, 2006-1, 2006-2, 2007 and 2008 sewer revenue bonds with an average coupon interest rate of 5.0 percent. The reacquisition price exceeded the net carrying amount of the old debt by \$15.8 million. This advance refunding was undertaken to reduce total debt service payments by \$32.0 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 \$20.1 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 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 to pay interest and 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, 2015, Water Quality is in compliance with the combined amount required for the reserve and surety policies.

**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**NOTES TO FINANCIAL STATEMENTS**

**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, 2015
2001A-B Junior Lien Variable	1/1/32	(variable)	\$ 100,000	\$ 100,000
2006 Refunding	1/1/36	5.00%	124,070	-
2006 (2nd Series) Refunding	1/1/36	3.50-5.00%	193,435	127,035
2007	1/1/47	5.00%	250,000	3,585
2008	1/1/48	5.00-5.75%	350,000	5,550
2009	1/1/42	4.00-5.25%	250,000	215,480
2010	1/1/50	2.00-5.00%	334,365	315,985
2011	1/1/41	5.00-5.125%	175,000	168,495
2011 Series B	1/1/41	1.00-5.00%	494,270	408,615
2011 Series C	1/1/35	3.00-5.00%	32,445	32,445
2011 Sewer Junior 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 Junior Lien Variable	1/1/43	(variable)	100,000	100,000
2013A Refunding	1/1/35	2.00-5.00%	122,895	117,560
2013B Revenue and Refunding	1/1/44	2.00-5.00%	74,930	68,135
2014A Refunding	1/1/47	5.00%	75,000	75,000
2014B Refunding	7/1/35	1.00-5.00%	192,460	190,790
2015 Sewer Junior Lien Variable	11/16/16	2.00%	100,000	100,000
2015A Refunding	7/1/47	3.00-5.00%	474,025	474,025
2015B Refunding	1/1/46	4.00-5.00%	93,345	93,345
			<u>\$ 3,870,360</u>	<u>\$ 2,930,165</u>

**General Obligation Bonds** – As of December 31, 2015, bonds outstanding include \$765.4 million of serial and term bonds maturing January 1, 2016 through 2040, bearing interest at stated rates of 2.00 percent to 5.25 percent per annum.

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

On February 18, 2015, the County issued \$247.8 million in general obligation refunding bonds, Series A, with an effective interest cost of 3.3 percent to advance refund \$252.9 million of 2009 general obligation bonds, with an average coupon interest rate of 5.1 percent. The reacquisition price exceeded the net carrying amount of the old debt by \$36.6 million. This advance refunding was undertaken to reduce total debt service payments by \$31.9 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 \$21.5 million.

# KING COUNTY WATER QUALITY ENTERPRISE FUND

## NOTES TO FINANCIAL STATEMENTS

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### 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, 2015
2008 LTGO	1/1/34	3.25-5.25%	\$ 236,950	\$ 216,540
2009B LTGO	7/1/39	5.00-5.25%	300,000	35,135
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
2015A LTGO	7/1/38	2.00-5.00%	247,825	247,825
			<u>\$ 1,051,310</u>	<u>\$ 765,395</u>

**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 2016 through 2036 and bear interest at stated rates from 0.0 percent to 3.1 percent. As of December 31, 2015, the balance due on all state loans is \$179.4 million. Water Quality maintains separate cash reserves of \$9.2 million as of December 31, 2015. These reserves are treated as restricted, being required under the Revolving Fund Loan Program.

At December 31, 2015, the required principal and interest payments for all classes of long-term debt are as follows (in thousands):

Year(s) Beginning	Revenue Bonds		General Obligation Bonds		State Loans		Total
	Principal	Interest	Principal	Interest	Principal	Interest	
January 1, 2016	\$ 156,910	\$ 130,957	\$ 9,520	\$ 36,771	\$ 12,121	\$ 3,593	\$ 349,872
January 1, 2017	45,965	128,244	21,105	36,033	12,944	3,376	247,667
January 1, 2018	51,785	126,062	22,140	34,952	13,160	3,145	251,244
January 1, 2019	52,690	123,684	23,225	33,820	13,437	2,909	249,765
January 1, 2020	54,980	121,183	32,160	32,632	13,178	2,671	256,804
January 1, 2021–2025	302,500	564,385	144,485	142,052	58,726	9,877	1,222,025
January 1, 2026–2030	388,050	478,761	180,600	102,198	33,835	4,861	1,188,305
January 1, 2031–2035	606,230	354,415	175,780	56,561	21,553	1,222	1,215,761
January 1, 2036–2040	448,415	231,278	156,380	26,896	434	1	863,404
January 1, 2041–2045	588,235	109,894	-	-	-	-	698,129
January 1, 2046–2050	215,145	26,331	-	-	-	-	241,476
January 1, 2051–2052	19,260	975	-	-	-	-	20,235
	<u>\$ 2,930,165</u>	<u>\$ 2,396,169</u>	<u>\$ 765,395</u>	<u>\$ 501,915</u>	<u>\$ 179,388</u>	<u>\$ 31,655</u>	<u>\$ 6,804,687</u>

**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**NOTES TO FINANCIAL STATEMENTS**

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

The future annualized interest payments for the variable rate revenue bonds are based on an interest rate of 4.5 percent in 2015 and 5.40 percent thereafter, which represents 90 percent of the long-term interest rate assumed by the County for financial planning purposes.

**Commercial Paper (Notes Payable)** – On November 24, 2015, Water Quality redeemed all of its outstanding commercial paper from the proceeds of the junior lien sewer revenue bonds, 2015 Series A and B, thereby ending the program. Water Quality initiated the commercial paper program in December 1995, with the ability to issue up to \$100.0 million. The program was supported by an annually renewable line of credit that expired on November 30, 2015. The commercial paper had maturities ranging between 61 and 92 days and was classified as a current liability of Water Quality’s operating fund as of December 31, 2014. Changes in short-term note payables for the years ended December 31, 2015 and 2014 were as follows (in thousands):

	Balance January 1, 2015	Additions	Reductions	Balance December 31, 2015
Commercial paper	\$ 100,000	\$ 621,280	\$ (721,280)	\$ -
	Balance January 1, 2014	Additions	Reductions	Balance December 31, 2014
Commercial paper	\$ 100,000	\$ 411,110	\$ (411,110)	\$ 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 September 30, 2020. The variable rate bonds, 2010 Series A and Series B general obligation bonds are supported by a Standby Bond Purchase Agreement that expires November 3, 2017. The variable rate bonds, 2011, 2012 and fixed rate 2015 Series A and Series B Sewer Jr Lien do not have liquidity facilities.

**Financial Policy Reserves** – In addition to bond reserves related to Sewer Revenue Bonds, Water Quality maintains liquidity and asset management reserves totaling \$32.9 million at December 31, 2015.

**Compliance with Bond Resolutions** – With respect to the year ended December 31, 2015, Water Quality complied with all financial covenants stipulated by its bond resolutions.

**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**NOTES TO FINANCIAL STATEMENTS**

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

**Changes in Long-Term Liabilities** – Long-term liability activity for the years ended December 31, 2015 and 2014 was as follows (in thousands):

	Balance January 1, 2015	Additions	Reductions	Balance December 31, 2015	Due Within One Year
Bonds payable	\$ 3,593,310	\$ 915,195	\$ (812,945)	\$ 3,695,560	\$ 166,430
Bond premiums and discounts	190,669	103,237	(19,197)	274,709	-
Total bonds payable	<u>3,783,979</u>	<u>1,018,432</u>	<u>(832,142)</u>	<u>3,970,269</u>	<u>166,430</u>
State loans	159,053	31,563	(11,228)	179,388	12,121
Compensated absences	11,484	10,208	(10,427)	11,265	642
Other post-employment benefits	1,351	190	(74)	1,467	-
Net pension liability	29,193	25,796	(16,104)	38,885	-
Environmental remediation	44,800	13,241	(5,743)	52,298	8,477
Total long-term liabilities	<u>\$ 4,029,860</u>	<u>\$ 1,099,430</u>	<u>\$ (875,718)</u>	<u>\$ 4,253,572</u>	<u>\$ 187,670</u>

	Balance January 1, 2014 (As Restated)	Additions	Reductions	Balance December 31, 2014 (As Restated)	Due Within One Year
Bonds payable	\$ 3,654,340	\$ 267,460	\$ (328,490)	\$ 3,593,310	\$ 60,615
Bond premiums and discounts	177,554	33,209	(20,094)	190,669	-
Total bonds payable	<u>3,831,894</u>	<u>300,669</u>	<u>(348,584)</u>	<u>3,783,979</u>	<u>60,615</u>
State loans	146,672	22,343	(9,962)	159,053	11,133
Compensated absences	11,312	10,465	(10,293)	11,484	565
Other post-employment benefits	1,195	219	(63)	1,351	-
Net pension liability	46,706	21,820	(39,333)	29,193	-
Environmental remediation	44,560	5,180	(4,940)	44,800	5,632
Total long-term liabilities	<u>\$ 4,082,339</u>	<u>\$ 360,696</u>	<u>\$ (413,175)</u>	<u>\$ 4,029,860</u>	<u>\$ 77,945</u>



**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 6 – Changes in Capital Assets**

Changes in capital assets for the years ended December 31, 2015 and 2014 are shown in the following table (in thousands):

	Balance January 1, 2015	Increases	Decreases	Balance December 31, 2015
Land	\$ 242,993	\$ 10,542	\$ -	\$ 253,535
Easements	11,720	3,143	-	14,863
Construction work in progress	282,785	138,085	(100,910)	319,960
Total nondepreciable assets	<u>537,498</u>	<u>151,770</u>	<u>(100,910)</u>	<u>588,358</u>
Buildings	1,871,986	45,676	(2,422)	1,915,240
Improvements other than building	67,321	26,925	-	94,246
Artwork	5,572	73	-	5,645
Right of way	7,635	-	-	7,635
Infrastructure	2,259,362	-	(21,231)	2,238,131
Equipment	1,038,783	46,142	(13,283)	1,071,642
Software development	35,603	11	-	35,614
Total depreciable assets	<u>5,286,262</u>	<u>118,827</u>	<u>(36,936)</u>	<u>5,368,153</u>
Accumulated depreciation and amortization				
Building	(606,698)	(50,901)	2,025	(655,574)
Improvements other than building	(23,263)	(2,730)	-	(25,993)
Artwork	(668)	(206)	-	(874)
Right of way	(709)	(218)	-	(927)
Infrastructure	(483,397)	(47,367)	114	(530,650)
Equipment	(560,247)	(58,569)	12,716	(606,100)
Software development	(25,911)	(3,963)	-	(29,874)
Total depreciation and amortization	<u>(1,700,893)</u>	<u>(163,954)</u>	<u>14,855</u>	<u>(1,849,992)</u>
Depreciable assets - net	<u>3,585,369</u>	<u>(45,127)</u>	<u>(22,081)</u>	<u>3,518,161</u>
Total capital assets - net	<u>\$ 4,122,867</u>	<u>\$ 106,643</u>	<u>\$ (122,991)</u>	<u>\$ 4,106,519</u>

# KING COUNTY WATER QUALITY ENTERPRISE FUND

## NOTES TO FINANCIAL STATEMENTS

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### Note 6 – Changes in Capital Assets (Continued)

	Balance January 1, 2014	Increases	Decreases	Balance December 31, 2014
Land	\$ 240,391	\$ 2,602	\$ -	\$ 242,993
Easements	11,469	251	-	11,720
Construction work in progress	316,142	141,595	(174,952)	282,785
Total nondepreciable assets	<u>568,002</u>	<u>144,448</u>	<u>(174,952)</u>	<u>537,498</u>
Building	1,829,718	42,268	-	1,871,986
Improvements other than building	65,593	1,728	-	67,321
Artwork	5,579	52	(59)	5,572
Right of way	7,635	-	-	7,635
Infrastructure	2,146,454	112,908	-	2,259,362
Equipment	1,047,837	24,772	(33,826)	1,038,783
Software development	33,308	2,295	-	35,603
Total depreciable assets	<u>5,136,124</u>	<u>184,023</u>	<u>(33,885)</u>	<u>5,286,262</u>
Accumulated depreciation and amortization				
Building	(557,275)	(49,423)	-	(606,698)
Improvements other than building	(20,830)	(2,433)	-	(23,263)
Artwork	(512)	(156)	-	(668)
Right of way	(491)	(218)	-	(709)
Infrastructure	(437,331)	(46,066)	-	(483,397)
Equipment	(536,948)	(55,549)	32,250	(560,247)
Software development	(22,380)	(3,531)	-	(25,911)
Total depreciation and amortization	<u>(1,575,767)</u>	<u>(157,376)</u>	<u>32,250</u>	<u>(1,700,893)</u>
Depreciable assets - net	<u>3,560,357</u>	<u>26,647</u>	<u>(1,635)</u>	<u>3,585,369</u>
Total capital assets - net	<u>\$ 4,128,359</u>	<u>\$ 171,095</u>	<u>\$ (176,587)</u>	<u>\$ 4,122,867</u>

### 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.

## KING COUNTY WATER QUALITY ENTERPRISE FUND NOTES TO FINANCIAL STATEMENTS

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### **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. The total environmental remediation liability at December 31, 2015 stands at \$52.3 million and \$44.8 million in 2014.

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.

**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 \$34.3 million in 2014 and increased by \$12.0 million to \$46.3 million in 2015.

# KING COUNTY WATER QUALITY ENTERPRISE FUND

## NOTES TO FINANCIAL STATEMENTS

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### Note 8 – Regulatory Assets and Credits (Continued)

**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 seven years.

### Note 9 – Employee Benefit Plans

The County implemented GASB Statement No. 68, Accounting and Financial Reporting for Pension, for the year 2015. In accordance with the statement, the County elected to use June 30, 2015 as the measurement date for reporting net pension liability.

The following table represents the aggregate pension amounts allocated to Water Quality for all pension plans subject to the requirements of GASB Statement No. 68 (in thousands):

<u>Aggregate Pension Amounts - All Plans</u>	
Pension liabilities	\$ 38,885
Deferred outflows of resources	\$ 4,987
Deferred inflows of resources	\$ 6,984
Pension expense/expenditures	\$ 4,190

**Pension Plans** – Substantially all full-time and qualifying part-time employees of Water Quality participate in one of the following retirement plans: Public Employees’ Retirement System (PERS) Plan 1, 2 and 3.

PERS is administered by the Washington State Department of Retirement Systems (DRS) under cost-sharing, multiple-employer public employee defined benefit and defined contribution retirement plans. The state Legislature establishes, and amends, laws pertaining to the creation and administration of all statewide public retirement systems.

The 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.

**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 9 – Employee Benefit Plans (Continued)**

The DRS CAFR may be obtained by writing to:

Department of Retirement Systems  
Communications Unit  
P.O. Box 48380  
Olympia, WA 98540-838

Or the DRS CAFR may be downloaded from the DRS website at [www.drs.wa.gov](http://www.drs.wa.gov).

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

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

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

PERS Plan 1		
Actual contribution rates:	Employer	Employee
January through June 2015	9.21%	6.00%
July through December 2015	11.18%	6.00%

# KING COUNTY WATER QUALITY ENTERPRISE FUND

## NOTES TO FINANCIAL STATEMENTS

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### Note 9 – Employee Benefit Plans (Continued)

Water Quality’s actual contributions to the plan were as follows for the years ended December 31 (in thousands):

	<u>PERS Plan 1</u>
2015	\$ 78
2014	\$ 88

PERS Plan 2/3 provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the member’s average final compensation (AFC) times the member’s years of service for Plan 2 and 1 percent of AFC for Plan 3. The AFC is the average of the member’s 60 highest-paid consecutive service months. There is no cap on years of service credit. Members are eligible for retirement with a full benefit at 65 with at least five years of service credit. Retirement before age 65 is considered an early retirement. PERS Plan 2/3 members who have at least 20 years of service credit and are 55 years of age or older, are eligible for early retirement with a benefit that is reduced by a factor that varies according to age for each year before age 65. PERS Plan 2/3 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions:

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

PERS Plan 2/3 members hired on or after May 1, 2013 have the option to retire early by accepting a reduction of five percent for each year of retirement before age 65. This option is available only to those who are age 55 or older and have at least 30 years of service credit. PERS Plan 2/3 retirement benefits are also actuarially reduced to reflect the choice of a survivor benefit. Other PERS Plan 2/3 benefits include duty and non-duty disability payments, a cost-of-living allowance (based on the CPI), capped at three percent annually and a one-time duty related death benefit, if found eligible by the Department of Labor and Industries. PERS 2 members are vested after completing five years of eligible service. Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service if 12 months of that service are earned after age 44.

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

**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 9 – Employee Benefit Plans (Continued)**

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

PERS Plan 2/3		
Actual contribution rates:	Employer 2/3	Employee 2
January through June 2015	9.21%	6.00%
July through December 2015	11.18%	6.00%
Employee PERS Plan 3		Varies

Water Quality’s actual contributions to the plan were as follows for the years ended December 31 (in thousands):

PERS Plans 2/3	
2015	\$ 5,705
2014	\$ 5,020

**Actuarial Assumptions** – The total pension liability (TPL) for each of the DRS plans was determined using the most recent actuarial valuation completed in 2015 with a valuation date of June 30, 2014. The actuarial assumptions used in the valuation were based on the results of the Office of the State Actuary’s (OSA) 2007-2012 Experience Study.

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

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

## KING COUNTY WATER QUALITY ENTERPRISE FUND

### NOTES TO FINANCIAL STATEMENTS

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#### Note 9 – Employee Benefit Plans (Continued)

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

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

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

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

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

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



**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 9 – Employee Benefit Plans (Continued)**

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

Asset Class	Target Allocation	% Long-Term Expected Real Rate of Return Arithmetic
Fixed income	20.00%	1.70%
Tangible assets	5.00%	4.40%
Real estate	15.00%	5.80%
Global equity	37.00%	6.60%
Private equity	23.00%	9.60%
	<b>100.00%</b>	

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

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
PERS 1	\$ 20,644	\$ 16,956	\$ 13,785
PERS 2/3	\$ 64,119	\$ 21,929	\$ (10,376)

**Pension Plan Fiduciary Net Position** – Detailed information about the State’s pension plans’ fiduciary net position is available in the separately issued DRS financial report.

**Pension Liabilities (Assets), Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions** – At June 30, 2015, Water Quality reported a total pension liability of \$38.9 million for its proportionate share of the net pension liabilities as follows (in thousands):

	Liability
PERS 1	\$ 16,956
PERS 2/3	\$ 21,929

# KING COUNTY WATER QUALITY ENTERPRISE FUND

## NOTES TO FINANCIAL STATEMENTS

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### Note 9 – Employee Benefit Plans (Continued)

At June 30, Water Quality’s proportionate share of the collective net pension liabilities was as follows:

	Proportionate Share 6/30/14	Proportionate Share 6/30/15	Change in Proportion
PERS 1	0.33%	0.32%	-0.01%
PERS 2/3	0.62%	0.61%	-0.01%

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

The collective net pension liability (asset) was measured as of June 30, 2015, and the actuarial valuation date on which the total pension liability (asset) is based was as of June 30, 2014, with update procedures used to roll forward the total pension liability to the measurement date.

**Pension Expense** – For the year ended December 31, 2015, Water Quality recognized pension expense as follows (in thousands):

	Pension Expense
PERS 1	\$ (945)
PERS 2/3	5,135
Total	\$ 4,190

**Deferred Outflows of Resources and Deferred Inflows of Resources** – At December 31, 2015, Water Quality reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (in thousands):

	Deferred Outflows of Resources	Deferred Inflows of Resources
PERS 1		
Net difference between projected and actual investment earnings on pension plan investments.	\$ -	\$ 928
Contributions subsequent to the measurement date.	901	-
Total	\$ 901	\$ 928

**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 9 – Employee Benefit Plans (Continued)**

<u>PERS 2/3</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between expected and actual experience.	\$ 2,331	\$ -
Net difference between projected and actual investment earnings on pension plan investments.	35	5,854
Changes in proportion and differences between contributions and proportionate share of contributions.	-	202
Contributions subsequent to the measurement date.	<u>1,720</u>	<u>-</u>
Total	<u>\$ 4,086</u>	<u>\$ 6,056</u>

Deferred outflows of resources related to pensions resulting from Water Quality’s contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2016. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows (in thousands):

<u>Year Ending December 31,</u>	<u>PERS 1</u>	<u>PERS 2/3</u>
2016	\$ (360)	\$ (1,649)
2017	\$ (360)	\$ (1,649)
2018	\$ (360)	\$ (1,649)
2019	\$ 152	\$ 1,257

**Note 10 – Other Post-Employment Benefits**

GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension, 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.

# KING COUNTY WATER QUALITY ENTERPRISE FUND

## NOTES TO FINANCIAL STATEMENTS

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### Note 10 – Other Post-Employment Benefits (Continued)

**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 \$74 thousand and \$63 thousand to the Health Plan during both 2015 and 2014, 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, 2015 and 2014 were as follows (in thousands):

	<u>2015</u>	<u>2014</u>
Normal cost - Unit Credit Method	\$ 165	\$ 193
Amortization of unfunded actuarial accrued liability (UAAL)	<u>32</u>	<u>32</u>
Annual Required Contribution (ARC)	197	225
Interest on net OPEB obligation	5	4
Adjustment to annual required contribution	<u>(12)</u>	<u>(10)</u>
Annual OPEB cost (expense)	190	219
Contributions made	<u>(74)</u>	<u>(63)</u>
Increase in net OPEB obligation	116	156
Net OPEB obligation - beginning of year	<u>1,351</u>	<u>1,195</u>
Net OPEB obligation - end of year	<u><u>\$ 1,467</u></u>	<u><u>\$ 1,351</u></u>

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):

<u>Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
12/31/2015	\$ 190	38.9%	\$ 1,467
12/31/2014	\$ 219	29.0%	\$ 1,351
12/31/2013	\$ 219	29.2%	\$ 1,195

## KING COUNTY WATER QUALITY ENTERPRISE FUND NOTES TO FINANCIAL STATEMENTS

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### **Note 10 – Other Post-Employment Benefits (Continued)**

**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, 2015 valuation used the projected unit credit actuarial cost method. The actuarial assumptions included a 2.5 percent investment rate of return (net of administrative expenses) and an initial annual health care cost trend rate of 7.0 percent for KingCare medical, 9.0 percent for KingCare pharmacy, and 7.0 percent for HMO medical/pharmacy, each reduced by decrements to an ultimate rate of 3.8 percent after 59 years and 7 years for medical and pharmacy, respectively. The Medicare Premium trend rate is 6.0 percent, for all years. All trend rates include a 3.0 percent inflation assumption. The UAAL is recalculated each year and amortized as a level dollar amount on an open basis over 22 years.

### **Note 11 – Interfund Balances and Transfers**

Water Quality is an enterprise fund of the County and reports in its financial statements interfund balances and transfers as a result of intracounty activity with other County agencies.

**Interfund Balances** – The balances result from the time lag between the dates when interfund goods and services were provided or reimbursable expenditures incurred and when interfund payments were made, Water Quality reported total due from other funds of \$1.2 million and due to other funds of \$111 thousand at December 31, 2015. Water Quality had \$1.2 million due from other funds at December 31, 2014.

**Interfund Transfers** – The King County Council approves ordinances and/or motions authorizing Water Quality to contribute and receive amounts to and from various County funds. During 2015 and 2014, the transfers from Water Quality to other funds were \$115 thousand and \$173 thousand, respectively.

### **Note 12 – 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 \$70.9 million on active construction contracts as of December 31, 2015.

# KING COUNTY WATER QUALITY ENTERPRISE FUND

## NOTES TO FINANCIAL STATEMENTS

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### Note 12 – Commitments and Contingencies (Continued)

**Contingencies and Claims** – 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 issued by the Environmental Protection Agency (EPA) that required King County, the City of Seattle, Boeing, and the Port of Seattle to conduct studies to determine the nature and extent of contamination in the Lower Duwamish Waterway. The County and the other three parties recently agreed with EPA to amend the administrative order and to conduct additional studies pursuant to the amendment. The Feasibility Study, which discusses the remediation alternatives, has been issued in final form by EPA. EPA issued a Record of Decision (ROD) in the latter part of 2014. The ROD contains EPA's final plan for cleanup of the Lower Duwamish Waterway. King County and a number of other parties are participating in an alternative dispute resolution process, called an allocation, to determine shares of liability for the costs of the cleanup. If parties that participate in the allocation accept their allotted shares, they then expect to enter into a settlement agreement and to negotiate a consent decree with EPA to implement the cleanup. Due to the fact that the parties do yet know their respective shares of cleanup costs and no consent decree has been negotiated with EPA, the County is unable to determine the schedule or cost of any required remediation. In addition, the County is unable to determine the extent to which King County and the Wastewater Treatment Division (WTD) or Water Quality will be responsible for the cost of such remediation.
- A potential requirement for more cleanup in the area contaminated when the Denny Way combined sewer outflow was replaced in 2005. Water Quality has already performed interim cleanup costing \$3.6 million to comply with a formal agreement with the Washington State Department of Ecology (DOE). There are no current plans underway for additional cleanup; however, under WAC 173-204, monitoring will be implemented at the site. DOE has reserved the right to require additional or different remedial actions at the site. The County is unable to determine an amount, if any, for which Water Quality may be responsible.
- 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 City of Seattle, Port of Seattle and King County intend to negotiate the amount, if any, that the City and the County will contribute. This is an extremely complex negotiation for which the County is unable to determine an amount that Water Quality may be responsible for, if any. The parties have also agreed to share the cost of a supplemental investigation and feasibility study required by the EPA. The agreement states that Water Quality has only a one-third pro rata share of the study costs although that portion may still be reallocated among the parties or with other Potentially Responsible Parties (PRP) who may agree to participate in the study. The parties may also seek contribution from other PRP's for the cost of the study. The EPA will not determine if, or the nature of, any additional remediation until the study is completed by the several potentially responsible parties. Further remediation costs cannot be reasonably estimated until the study has been completed.

## KING COUNTY WATER QUALITY ENTERPRISE FUND NOTES TO FINANCIAL STATEMENTS

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### **Note 12 – Commitments and Contingencies (Continued)**

- Water Quality has undertaken a capital project to replace a major sewer pipe running under the Ship Canal between Fremont and Queen Anne. The contractor has submitted a claim to perform the south shaft excavation for the exit shaft for the tunnel boring machine that will bore under the Ship Canal from Fremont across the canal to Queen Anne, in the vicinity of Seattle Pacific University and the King County Laboratory. The amount the contractor claims for itself and the subcontractor is \$1.4 million.
  
- 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. 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. The rulings also awarded the County additional \$14.7 million for its legal costs. While the contractor has paid the net judgment amount, it continued to appeal the judgment to the Court of Appeals who affirmed the superior court decision. On January 28, 2016, the contractor petitioned the Washington Supreme Court for review of the defective specification ruling, and the surety defendants petitioned for review of the attorney fees award. The County answered the petition advocating denial of review because the trial court rulings on both issues are consistent with Washington precedent.
  
- A claim submitted by a contractor against Water Quality over the project to repair and replace two miles of pipeline serving the rapidly developing area in the vicinity of Canyon Park. The project is subject to an agreement with DOE that mandates a bypass system be constructed if this capital project is not completed by the onset of the 2016 wet season. The contractor has submitted a request for change order based on its assertion that the design of the rammed pipe alignment is defective. The amount claimed for costs for additional work at this time is approximately \$1.5 million.

### **Note 13 – Subsequent Event**

In February 2016, Water Quality issued \$281.5 million of sewer revenue refunding bonds, 2016 series A, to advance refund \$278.8 million of outstanding 2007, 2008, 2009 and 2010 sewer revenue bonds with an average coupon interest rate of 5.1 percent. This advance refunding was undertaken to reduce total debt service payments by \$65.0 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 \$39.6 million.

**KING COUNTY WATER QUALITY ENTERPRISE FUND**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 14 – Restatement of Beginning Balances**

Due to Water Quality's adoption of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*, the 2014 financial statements and its net position as of January 1, 2014 were restated to conform with the reporting requirements.

Revised balances are shown in the following schedule (in thousands):

	<u>As Previously Reported</u>	<u>Effect of Restatement</u>	<u>As Restated</u>
<b>STATEMENT OF NET POSITION</b>			
DEFERRED OUTFLOWS OF RESOURCES			
Deferred outflows of pension	\$ -	\$ 2,087	\$ 2,087
NONCURRENT LIABILITIES			
Net pension liability	\$ -	\$ (29,193)	\$ (29,193)
DEFERRED INFLOWS OF RESOURCES			
Deferred inflows on pension	\$ -	\$ (15,368)	\$ (15,368)
NET POSITION - December 31, 2014	\$ 555,104	\$ (42,474)	\$ 512,630
<b>STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION</b>			
OPERATING EXPENSES			
General and administrative	\$ 23,728	\$ (2,187)	\$ 21,541
NET POSITION			
Beginning of the year	\$ 559,903	\$ (44,661)	\$ 515,242



**REQUIRED SUPPLEMENTARY INFORMATION**

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**KING COUNTY WATER QUALITY ENTERPRISE FUND  
REQUIRED SUPPLEMENTARY INFORMATION  
PENSION PLAN INFORMATION**

<b>Schedule of the County's Proportionate Share of the Net Pension Liability Public Employees' Retirement System (PERS) Plan 1 Measurement Date of June 30* (dollars in thousands)</b>		
		2015
County's proportion of the net pension liability/(asset)		8.76%
County's proportionate share of the net pension liability/(asset)	\$	458,477
County's covered-employee payroll	\$	20,440
County's proportionate share of the net pension liability/(asset) as a percentage of covered-employee payroll		2243.04%
Plan fiduciary net position as a percentage of the total pension liability/(asset)		59.10%
*This schedule is to be built prospectively until it contains ten years of data.		

<b>Schedule of the County's Proportionate Share of the Net Pension Liability Public Employees' Retirement System (PERS) Plan 2/3 Measurement Date of June 30* (dollars in thousands)</b>		
		2015
County's proportion of the net pension liability/(asset)		10.36%
County's proportionate share of the net pension liability/(asset)	\$	370,294
County's covered-employee payroll	\$	933,304
County's proportionate share of the net pension liability/(asset) as a percentage of covered-employee payroll		39.68%
Plan fiduciary net position as a percentage of the total pension liability/(asset)		89.20%
*This schedule is to be built prospectively until it contains ten years of data.		

**KING COUNTY WATER QUALITY ENTERPRISE FUND  
 REQUIRED SUPPLEMENTARY INFORMATION  
 PENSION PLAN INFORMATION (CONTINUED)**

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<b>Schedule of Contributions</b> <b>Public Employees' Retirement System (PERS) Plan 1</b> <b>Fiscal Year Ended December 31, 2015</b> (dollars in thousands)	
Contractually required contribution	\$ 2,076
Contributions in relation to the contractually required contribution	<u>2,076</u>
Contribution deficiency (excess)	<u>\$ -</u>
Covered-employee payroll	\$ 20,440
Contributions as a percentage of covered-employee payroll	10.16%

\*This schedule is to be built prospectively until it contains ten years of data.

<b>Schedule of Contributions</b> <b>Public Employees' Retirement System (PERS) Plan 2/3</b> <b>Fiscal Year Ended December 31, 2015</b> (dollars in thousands)	
Contractually required contribution	\$ 95,176
Contributions in relation to the contractually required contribution	<u>95,176</u>
Contribution deficiency (excess)	<u>\$ -</u>
Covered-employee payroll	\$ 933,304
Contributions as a percentage of covered-employee payroll	10.20%

\*This schedule is to be built prospectively until it contains ten years of data.

**KING COUNTY WATER QUALITY ENTERPRISE FUND  
REQUIRED SUPPLEMENTARY INFORMATION  
POSTEMPLOYMENT HEALTH CARE PLAN**

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**Schedule of Funding Progress for the Plan**  
(in thousands)

Year	Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Unit Credit (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a ÷ b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) ÷ c)
2013	12/31/2013	\$ -	\$ 167,420	\$ 167,420	0.0%	\$ 1,000,353	16.7%
2014	12/31/2014	\$ -	\$ 167,420	\$ 167,420	0.0%	\$ 1,073,511	15.6%
2015	12/31/2015	\$ -	\$ 167,417	\$ 167,417	0.0%	\$ 1,076,068	15.6%

**OTHER INFORMATION**

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**KING COUNTY WATER QUALITY ENTERPRISE FUND  
SUPPLEMENTAL INFORMATION  
SUPPLEMENTAL SCHEDULE OF NET REVENUES  
AVAILABLE FOR DEBT SERVICE (UNAUDITED)  
YEAR ENDED DECEMBER 31, 2015**

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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) 1.48

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) 1.36

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) 1.28

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 \$100M of Junior Lien Variable Rate Demand Sewer Revenue Bonds which incorporate the identical requirement as Junior Lien obligations. In 2015, Water Quality issued \$100M of Junior Lien Fixed Rate Sewer Revenue Bonds which incorporate the identical requirement as Junior Lien obligations.

Coverage (1.10 required by covenant) 36.33