Office of the Washington State Auditor
Pat McCarthy

Financial Statements Audit Report

Northshore Utility District

For the period January 1, 2016 through December 31, 2017

Published January 14, 2019

Report No. 1023051

Office of the Washington State Auditor
Pat McCarthy

January 14, 2019

Board of Commissioners
Northshore Utility District
Kenmore, Washington

Report on Financial Statements

Please find attached our report on the Northshore Utility District's financial statements.

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

Sincerely,

Pat McCarthy

State Auditor

Olympia, WA

Insurance Building, P.O. Box 40021 • Olympia, Washington 98504-0021 • (360) 902-0370 • Pat.McCarthy@sao.wa.gov

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Northshore Utility District
January 1, 2016 through December 31, 2017

Board of Commissioners
Northshore Utility District
Kenmore, Washington

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the Northshore Utility District, as of and for the years ended December 31, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated January 8, 2019.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the District's financial statements are free from material misstatement, we performed tests of the District's compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

Pat McCarthy

State Auditor

Olympia, WA

January 8, 2019

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Northshore Utility District
January 1, 2016 through December 31, 2017

Board of Commissioners
Northshore Utility District
Kenmore, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Northshore Utility District, as of and for the years ended December 31, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 9.

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 opinions 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Northshore Utility District, as of December 31, 2017 and 2016, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and required supplementary information listed on page 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated January 8, 2019 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Pat McCarthy

State Auditor

Olympia, WA

January 8, 2019

FINANCIAL SECTION

Northshore Utility District
January 1, 2016 through December 31, 2017

REQUIRED SUPPLEMENTARY INFORMATION

Management’s Discussion and Analysis – 2017 and 2016

BASIC FINANCIAL STATEMENTS

Comparative Statement of Net Position – 2017 and 2016
Comparative Statement of Revenues, Expenses and Changes in Net Position – 2017 and 2016
Comparative Statement of Cash Flows – 2017 and 2016
Notes to Financial Statements – 2017 and 2016

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Proportionate Share of Net Pension Liability – PERS Plans 1, PERS Plan 2/3 – 2017 and 2016
Schedule of Employer Contributions – PERS Plans 1, PERS Plan 2/3 – 2017 and 2016

MANAGEMENT DISCUSSION AND ANALYSIS

For the Year Ended December 31, 2017

As management of the Northshore Utility District (the District), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended December 31, 2017. We encourage readers to consider the information presented here in conjunction with the District's financial statements.

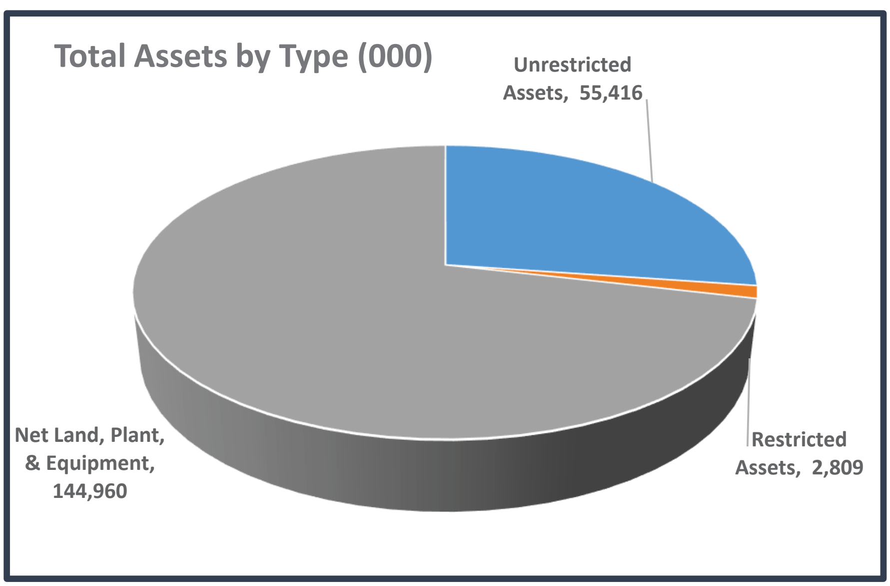
The financial position of the District has improved over prior years, which were mildly affected by an economic downturn and slow economic growth.

- As of the close of 2017, the assets of the District exceeded its liabilities, creating a net position of $192.4 million. This represents an increase of $6.9 million over 2016.

- As of the close of 2017, the District cash balance was $49.9 million, representing an increase of $2.4 million from December 31, 2016.

The District had total operating revenues of $41.2 million and operating expenses of $39.7 million for the fiscal year ended December 31, 2017. This is compared to $41.0 million and $35.2 million in operating revenues and expenses, respectively, for 2016.

The vast majority of the District's assets are held in land, plant, and equipment. Other assets are categorized as restricted or unrestricted, as illustrated below (000):



Overview of the Financial Statements

The management discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements are comprised of District-wide financial statements and notes to the financial statements. The District began implementing the Governmental Accounting Standards Board (GASB) Statement No. 34 (Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments) model of financial reporting in 2003. In 2012, the District implemented GASB Statement No. 63 (Financial Reporting of Deferred Inflows and Outflows of Resources, and Net Position). During 2015, the District implemented GASB Statement No. 68 (Accounting and Financial Reporting for Pensions). These statements establish standards for external financial reporting for all state and local government entities.

DISTRICT FINANCIAL STATEMENTS

The District's financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private sector businesses.

The ***Statement of Net Position*** presents information on all of the District's assets and deferred outflows vs. liabilities and deferred inflows, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the District is improving or deteriorating. Assets are designated as either "Unrestricted" or "Restricted" based upon their purpose. Restricted assets are those subject to constraints that are externally imposed, such as those imposed by creditors through debt covenants. Funds without a designated purpose are referred to as "Unrestricted." The District had assets restricted, primarily for construction and debt service, of $2.8 million and $2.1 million as of December 31, 2017, and 2016, respectively.

Total current assets increased significantly during the year, primarily due to a $2.4 million increase in cash. The details of this increase can be seen in the Comparative Statement of Cash Flows on page 17. There were also increases to inventory and prepaid expenses in the amount of $54K due to the timing of purchases.

Non-current and other assets consist of assessments and contracts receivable. The increase in these accounts is due to an influx of sewer installment contracts during the year.

Total gross capital assets increased by $9.2 million. Notwithstanding the impact of depreciation and the sale of surplus capital assets, this increase was due to the following significant changes during the year:

- CIP increasing by $1.4 million during the year
- Water and sewer plants increasing $7.5 million

Total current liabilities increased by $315K during the year. Payables increased $281K during the current year, primarily due to simple timing differences.

The ***Statement of Revenues, Expenses, and Changes in Net Position*** presents information showing how the District's financial position changed during the most recent fiscal year. All changes are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., depreciation as well as earned but unused vacation leave).

Gross utility revenues increased $122K during the year (0.3%) as expected. There was no rate increase for either water or sewer in 2017. Any increases in service revenues were due to additional connections and/or usage.

Total operating expenses increased $3.9 million during the year, primarily due to a $3.3 million increase in Maintenance Expenses. This increase was due to a reclassification from Administrative and General Expenses which was made last year. There was also an error correction in 2016 related to Maintenance expenses. Wholesale costs for water and sewer (Seattle Public Utilities and King County) increased by $1.3 million.

The ***Statement of Cash Flows*** accounts for the net change in cash and cash equivalents by summarizing cash receipts and cash disbursements resulting from operating activities, capital, and related financing and investment activities. This statement assists the user in determining the source of cash coming into the District, the items for which cash was expended, and the beginning and ending cash balance.

The notes provide additional information which are essential to a full understanding of the data provided in the District's financial statements.

The overall financial condition of the District continues to improve, as indicated by continued increases in net position over 2017 and 2016. Development in the District continues to show strength. Facilities benefit charges, increased $1.4 million in 2017, primarily due to connection charges in the Totem Lake Village re-development project. Average investment rates of return moved up strongly from .84% in 2016 to 1.14% in 2017. This resulted in investment income of $554K in 2017, compared with $372K in 2016.

The net position of the District increased $7.1 million from $185.5 million in 2016 to $192.6 million in 2017. In 2015, the District's net position was $175.5 million.

In 2017, the majority of the District's gross income (89.5%) was derived from water and wastewater service charges received from its ratepayers. The District also derives cash flows from street light service, connection charges (facility benefit charges) and investment earnings.

Additional assets are received from developers in the form of infrastructure donated to the District upon completion of their projects (developer donated plant).

Condensed Statements of Net Position

	2017	2016	2015	2017-2016 Change	Change %
Current, Restricted and Other Assets	$57,695,729	$55,396,540	$47,679,091	$2,299,189	4.2%
Capital Assets (net of depreciation)	144,960,190	140,401,037	137,718,221	4,559,153	3.2%
Total Assets	$202,655,919	$195,797,577	$185,397,312	$6,858,342	3.5%
Total Deferred Outflows	$529,592	$655,030	$260,655	($125,438)	N/A
Current Liabilities	$4,233,350	$3,918,641	$3,095,149	$314,709	8.0%
Non-Current Liabilities	5,897,569	6,896,600	6,578,244	(999,031)	-14.5%
Total Liabilities	$10,130,919	$10,815,241	$9,673,393	($684,322)	-6.3%
Total Deferred Inflows	$470,904	$159,318	$489,219	$311,586	N/A
Net Position:					
Net Investment in Capital Assets less Debt	$141,872,099	$137,035,892	$133,975,448	$4,836,208	3.5%
Restricted Net Position	2,279,832	1,409,770	1,267,720	870,061	61.7%
Unrestricted Net Position	48,431,757	47,032,386	40,252,187	1,399,371	3.0%
Total Net Position	$192,583,688	$185,478,048	$175,495,355	$7,105,640	3.8%

Condensed Statement of Revenues, Expenses and Changes in Net Position

	2017	2016	2015	2016-2015 Change	Change (%)
Operating Revenues:					
Sewer	$25,180,987	$25,164,732	$23,901,107	$16,255	0.1%
Water	16,105,350	15,999,460	15,936,172	105,890	0.7%
Other	1,652,034	1,535,181	1,523,413	116,853	7.6%
Less discounts	(1,750,449)	(1,688,773)	(1,652,309)	(61,676)	3.7%
Non-Operating Revenues:					
Facility benefit charges	2,616,599	1,250,284	1,505,329	1,366,315	109.3%
Other	576,702	1,481,746	272,720	(905,044)	-61.1%
Total Revenues	$44,381,224	$43,742,630	$41,486,432	$638,594	1.5%
Operating Expenses	$39,380,761	$35,472,008	$36,027,113	$3,908,754	11.0%
Non-Operating Expenses	9,745	11,630	21,540	(1,885)	-16.2%
Total Expenses	$39,390,506	$35,483,637	$36,048,653	$3,906,869	11.0%
Income Before Plant Donation	$4,990,718	$8,258,993	$5,437,779	($3,268,275)	-39.6%
Developer donated plant	2,114,923	1,723,701	2,002,411	391,222	22.7%
Change in Net Position	$7,105,640	$9,982,693	$7,440,190	($2,877,053)	-28.8%
Beginning Net Position	185,478,049	175,495,356	171,789,375	9,982,693	5.7%
Change in Accounting Principle	-		(3,734,209)	-	N/A
Ending Net Position	$192,583,690	$185,478,049	$175,495,356	$7,105,640	3.8%

CAPITAL ASSETS AND DEBT ADMINISTRATION

By far the largest portion of the District's total assets (71.4%) is its investment in capital assets net of accumulated depreciation. The District uses these capital assets to provide water and sewer services to residential and commercial ratepayers in the District. The unrestricted net position of the District represents assets that are available for future use to provide utility services.

As of December 31, 2017, the District's capital assets shown on the Statement of Net Position was $145 million net of accumulated depreciation. This is an increase of $4.6 million (3.2%) from December 31, 2016. Capital assets include land, improvements to land and land rights, buildings, building improvements, vehicles, machinery, equipment, utility plant, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Please refer to Note 3.

LONG-TERM DEBT

The District took advantage of favorable interest rates in 2003 by advance refunding of its outstanding 1995 Revenue Bonds, while at the same time acquiring $4.2 million in new financing. In preparation for this event, the District made a presentation to Standard & Poors, the credit rating agency in May 2003, and obtained an improved credit rating of "AA". An advance refunding transaction occurs when the District retires its outstanding bonds ahead of their scheduled due date with a new series of bonds. In most cases, the advance refunding results in lower debt service costs. Revenue bonds offer a number of distinct advantages. Much like a home mortgage, revenue bonds allow the District to spread out payments over twenty years. Instead of burdening today's ratepayers with the total cost of improvements, all users of the system over the next twenty years will shoulder that cost. 2013 was the last year that the District had revenue bond debt service payments in excess of $1 million. Bond principal payments dropped from $1,360,000 in 2010 to under $300,000 each year beginning in 2011. During 2012 the District decided to call all remaining 2003 revenue bonds on May 1, 2013. In 2008, Standard & Poor's updated the District's bond rating from "AA" to "AAA". Please refer to Note 5 of the financial statements.

The District has historically sought Public Works Trust Fund (PWTF) loans issued by the Washington Public Works Board to finance its water and sewer capital projects. These loans are offered to competing public entities to fund capital projects. The current annual interest rate on these loans ranges from 0.25% to 1.0%. The total debt principal outstanding as of December 31, 2017 was $3.1 million consisting solely of PWTF loans. See additional information in Note 5.

Comparative Statement of Net Position
As of December 31, 2017 and 2016

	2017	2016
ASSETS		
Current Assets:		
Cash and cash equivalents	$47,632,464	$46,062,575
Accounts receivable	4,255,342	3,873,247
Estimated unbilled service revenue	2,374,876	2,995,876
Restricted Assets:		
Construction Fund:		
Cash and cash equivalents	1,977,019	1,146,040
Revenue Bond Fund:		
Cash and cash equivalents	302,812	263,730
Inventory	611,486	583,853
Other current assets - prepaid items	234,009	207,947
TOTAL CURRENT ASSETS	$57,388,009	$55,133,268
Non-current and Other Assets:		
Assessments receivable	$80,195	$109,260
Installment contracts receivable	227,525	154,012
TOTAL NON-CURRENT AND OTHER ASSETS	$307,720	$263,272
Capital Assets:		
Non-depreciable - Land and land rights	$2,723,067	$2,719,890
Non-depreciable - Construction in progress	8,018,949	6,591,439
Depreciable assets:		
Buildings	14,525,839	14,520,010
Data processing and office equipment	2,021,956	1,982,620
Engineering equipment and vehicles	5,596,136	5,356,305
Sewer utility plant	102,998,466	100,157,830
Water utility plant	106,060,977	101,415,672
Less: Accumulated depreciation	(96,985,201)	(92,342,729)
Total Capital Assets	$144,960,190	$140,401,037
TOTAL NON-CURRENT AND OTHER ASSETS	$145,267,910	$140,664,309
TOTAL ASSETS	$202,655,919	$ 195,797,577
DEFERRED OUTFLOWS OF RESOURCES		
TOTAL DEFERRED OUTFLOWS OF RESOURCES	$529,592	$655,030
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	$203,185,511	$196,452,607

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

Comparative Statement of Net Position
As of December 31, 2017 and 2016

	2017	2016
LIABILITIES		
Current Liabilities:		
Accounts payable	$2,977,656	$2,730,352
Accrued employee benefits	401,606	369,479
Other liabilities	82,460	81,030
Current portion of State Public		
Trust Fund Loans	276,648	276,648
Payables from Restricted Assets:		
Accounts payable	489,655	455,285
Accrued interest payable	5,324	5,846
TOTAL CURRENT LIABILITIES	$4,233,350	$3,918,641
Non-current Liabilities:		
State Public Trust Fund Loans	$2,811,442	$3,088,497
TOTAL NON-CURRENT LIABILITIES	$2,811,442	$3,088,497
Net Pension Liability	$3,086,127	$3,808,103
TOTAL LIABILITIES	$10,130,919	$10,815,241
DEFERRED INFLOWS OF RESOURCES		
Deferred Inflows Related to Pensions	$470,904	$159,318
TOTAL DEFERRED INFLOWS OF RESOURCES	$470,904	$159,318
NET POSITION		
Net investment in capital assets	$141,872,099	$137,035,892
Restricted net position	2,279,832	1,409,770
Unrestricted net position	48,431,757	47,032,386
TOTAL NET POSITION	$192,583,688	$185,478,048
TOTAL LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION	$203,185,511	$196,452,607

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

Comparative Statement of Revenues, Expenses, and Changes in Net Position
For the Years Ended December 31, 2017 and 2016

	2017	2016
OPERATING REVENUES		
Utility Sales - Sewer service	$25,180,987	$25,164,732
Utility Sales - Water service	16,105,350	15,999,460
Utility Sales - Street light service	211,797	211,197
Less: Discounts and adjustments	(1,750,449)	(1,688,773)
Net Utility Sales	$39,747,685	$39,686,615
Other Operating Revenue	$1,440,238	$1,323,984
Total Operating Income	$41,187,923	$41,010,599
OPERATING EXPENSES		
Sewage treatment charges	$15,932,348	$15,100,035
Water purchased for resale	5,953,939	5,495,418
Cost of street lighting	119,763	132,031
Maintenance	5,511,135	2,253,631
Administration - General	6,066,835	6,921,623
Depreciation	4,687,273	4,518,589
Property, Excise, and B&O Tax	1,109,469	1,050,681
Total Operating Expenses	$39,380,761	$35,472,008
OPERATING INCOME (LOSS)	$1,807,161	$5,538,592
NON-OPERATING REVENUES (EXPENSES)		
Connection fees	$2,616,599	$1,250,284
Assessment interest income	19,983	25,532
Investment interest income	554,231	372,212
Gain (loss) from disposition of assets	2,488	1,084,003
Loan interest expense	(9,745)	(11,630)
Total Non-operating Revenues	$3,183,557	$2,720,401
Income Before Capital Contributions	$4,990,718	$8,258,993
Capital Contributions - Developer donated plant	2,114,923	1,723,701
INCREASE IN NET POSITION	$7,105,640	$9,982,693
TOTAL NET POSITION, January 1, 2016	185,478,046	175,495,353
CHANGE IN ACCOUNTING PRINCIPLE (SEE NOTE 7)		
TOTAL NET POSITION, December 31, 2016	$192,583,687	$185,478,046

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

Comparative Statement of Cash Flows
For the Years Ended December 31, 2017 and 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts for utility services	$41,354,746	$39,849,494
Payments to wholesale service providers	(21,722,946)	(19,831,329)
Payments for state and local taxes	(1,109,469)	(1,050,681)
Payments for payroll and related costs	(6,156,033)	(4,808,112)
Payments for administration and operations	(5,700,824)	(3,001,661)
Net cash provided by operating activities	$6,665,474	$11,157,710
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
(Purchase)/sale of capital assets - equipment	($1,751,479)	($330,084)
Purchase or reclassification of system expansion	(5,371,019)	(7,271,257)
(Purchase)/sale of land rights	(9,007)	639,085
Receipts from connection fees	2,616,599	1,250,284
Principal paid on capital debt	(277,055)	(377,628)
Interest paid on capital debt	(10,267)	(12,658)
Net receipts on disposal of capital assets	2,488	1,084,003
Net cash used in capital and related financing activities	($4,799,740)	($5,018,255)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest on investments	$554,231	$372,212
Interest on contracts	19,983	25,532
Net cash provided by investing activities	$574,214	$397,744
Net (decrease) increase in cash and cash equivalents	$2,439,948	$6,537,199
Cash balance - beginning of year	47,472,345	40,935,146
Cash balance - end of year	$49,912,293	$47,472,345
NON-CASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:		
Contribution of capital assets from developers *	$2,114,923	$1,723,701

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

Comparative Statement of Cash Flows
For the Years Ended December 31, 2017 and 2016

	2017	2016
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income	**$1,807,161**	**$5,538,592**
Adjustments to reconcile operating income to net cash Provided by operating activities:		
Depreciation expense	4,687,273	4,518,589
GASB 68 pension expense not impacting cash	(284,952)	(129,272)
Correction of error in current year	-	1,484,553
Changes in assets and liabilities		
(Increase)/Decrease in accounts receivable	238,905	(1,186,186)
(Increase)/Decrease in inventory	(27,633)	(86,046)
(Increase)/Decrease in other current assets	(70,510)	91,981
Increase/(Decrease) in accounts payable	281,674	889,626
Increase/(Decrease) in accrued payroll benefits	32,127	29,345
Increase/(Decrease) in other current liabilities	1,430	6,529
Net cash provided by operating activities	**$6,665,474**	**$11,157,711**

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

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Northshore Utility District conform to generally accepted accounting principles (GAAP) as applicable to proprietary funds of governments. The following is a summary of the most significant policies (including identification of those policies which result in material departures from generally accepted accounting principles):

a. Reporting Entity

Northshore Utility District is a municipal corporation governed by an elected five-member board. As required by generally accepted accounting principles, management has considered all potential component units in defining the reporting entity. The District has no component units.

b. Basis of Accounting and Presentation

The accounting records of the District are maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09 of the Revised Code of Washington (RCW).

The District uses the full-accrual basis of accounting where revenues are recognized when earned and expenses are recognized when incurred. An exception to full accrual is that interest on assessments is recorded when received. Capital asset purchases are capitalized and long-term liabilities are accounted for in the appropriate funds.

The District distinguishes between operating revenues and expenses from non-operating. Operating revenues and expenses result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. The principle operating revenues of the District are charges to ratepayers for water, sewer and streetlight services. Unbilled utility service receivables are recorded at year-end. Operating expenses of the District include the cost of sales and services, administration expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

The District implemented the Governmental Accounting Standards Board (GASB) Statement No. 34 in 2003, Statement No. 63 in 2013 and Statement No. 68 in 2016. These statements establish standards for external financial reporting for all state and local government entities.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

c. Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the District considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents. The District maintains a deposit relationship with a local commercial bank, which was selected through the contracting of treasury services provided by King County, the *ex officio* Treasurer for the District.

d. Capital Assets

See Note 3

e. Restricted Funds

In accordance with bond resolutions (and certain related agreements) separate restricted depository accounts are required to be established. These depository accounts are with King County. King County refers to these depository accounts as “funds.” The assets held in these “funds” are restricted for specific uses, including construction, debt service, and other special reserve requirements. As of December 31, 2017 restricted “funds” included the following:

Water Construction Fund	$1,007,473
Sewer Construction Fund	$969,546
Bond Reserve Fund	$9,782
Debt Service Fund	$293,030

f. Receivables

The District records receivables when billing takes place. The District takes advantage of its authority to file liens against properties with delinquent utility charge balances. Such liens are recorded with the King County Recorder’s office and are maintained until the balances are paid in full. Interest is assessed on these accounts until paid. For this reason, there is not an allowance for bad debts.

g. Inventory

Inventory is valued at the average acquisition cost, which approximates the market value. The District performs an annual physical inventory count.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

h. Investments

District funds not required for immediate expenditure are invested via King County in the King County Investment Pool. Investments are stated at cost. For various risks related to the investments, see Deposits and Investments Note No. 2.

i. Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. The District records unused/accrued leaves for compensated absences as an expense and liability when incurred.

Vacation pay, which may be accumulated up to 240 hours, is payable upon resignation, retirement or death. Sick leave may accumulate indefinitely and is payable upon the following conditions:

- The District will pay 100% of accrued and unused sick leave upon the death of an active employee.
- The District allows all employees to cash out accrued sick leave hours credited during the preceding calendar year, less any sick leave used during the same calendar year, up to a maximum of 56 hours if the employee has a balance of 224 hours in unused/accrued sick leave before cash-out.
- The District does not pay for unused sick leave upon termination of employment.

j. Unamortized Debt Expenses

Costs relating to the sale of bonds are expensed in the year of bond issuance. The District currently has no bonds outstanding.

k. Construction Financing

The District issued revenue bonds for long-term financing of capital improvements. These bonds were paid off entirely during 2013. See Note No. 5.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (concluded)

In 1985, the District started a series of public works projects to replace aging components of the District's sewer and water systems. The District also funds these select capital improvements of the District's sewer and water systems from accumulated reserves. Where applicable, property owners connecting to these facilities in the future will reimburse the District for the cost of these projects plus interest. In some instances, the District has started these projects in response to customers' needs, such as failed septic systems. In other instances, the District has tried to install facilities prior to major street resurfacing projects by King County and other municipalities for cost savings.

Developers also build regular system extensions. Upon the completion of the project, the developer donates those installed facilities to the District as system extensions. Developer donations are recorded at the developer's cost of the improvements.

NOTE 2 – DEPOSITS AND INVESTMENTS

a. Deposits

The District's deposits are entirely covered by federal depository insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC).

b. Investments

In accordance with State law, the District's governing body has entered into a formal interlocal agreement with King County, to have all its funds not required for immediate expenditure to be invested in the King County Investment Pool (Pool). As of December 31, 2017 and 2016, the District had the following investments:

Year	Investment Type	Fair Value	Average Duration
2017	King County Investment Pool	$49,248,955	1.0 Years
2016	King County Investment Pool	$47,167,018	1.1 Years

Impaired Investments. As of December 31, 2017, all impaired commercial paper investments have completed enforcement events. The King County impaired investment pool (Impaired Pool) held one commercial paper asset where the Impaired Pool accepted an exchange offer and is receiving the cash flows from the investment's underlying securities. The Impaired Pool also held

NOTE 2 – DEPOSITS AND INVESTMENTS (concluded)

the residual investments in one commercial paper assets that were part of completed enforcement events, where the Impaired Pool accepted the cash-out

option. The District's share of the impaired investment pool principal is $75,285 and its fair value of these investments is $50,755.

Interest Rate Risk. As of December 31, 2017, the Pool's average duration was 1.02 years. As a means of limiting its exposure to rising interest rates, securities purchased in the Pool must have a final maturity, or weighted average life, no longer than five years. While the Pool's market value is calculated on a monthly basis, unrealized gains and losses are not distributed to participants. The Pool distributes earnings monthly using an amortized cost methodology.

Credit Risk. As of December 31, 2017, the District's investment in the Pool was not rated by a nationally recognized statistical rating organization (NRSRO). In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency securities and mortgage-backed securities, corporate note (rated at least "A"), municipal securities (rated at least "A" by two NRSROs), commercial paper (rated at least the equivalent of "A-1" by two NRSROs), certificates of deposits issued by qualified public depositaries, repurchase agreements, and the Local Government Investment Pool managed by the Washington State Treasurer's office.

NOTE 3 – CAPITAL ASSETS

Capital assets are defined by the District as assets with initial individual cost of more than $5,000 and an estimated useful life in excess of one year.

Major expenses for capital assets, such as major repairs which increase useful lives, are capitalized. Maintenance, repairs, and minor renewals are accounted for as expenses when incurred.

Utility plants in service and other capital assets are recorded at cost. Donations by developers are recorded at the developer's cost.

NOTE 3 – CAPITAL ASSETS (continued)

Capital asset activity for the year ended December 31, 2017 was as follows:

	2017 Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not being depreciated:				
Land & land rights	$2,719,890	$5,000	($1,823)	$2,723,067
Construction in progress	6,591,439	7,227,740	(5,800,229)	8,018,950
Total non-depreciable assets	$9,311,329	$7,232,740	($5,802,052)	$10,742,017
Capital assets being depreciated:				
Buildings	$14,520,009	$5,829	-	$14,525,838
Data processing and office equipment	1,982,620	63,697	($24,362)	2,021,956
Engineering equipment and vehicles	5,356,305	277,447	(37,615)	5,596,136
Sewer utility plants	100,157,830	2,840,636	-	102,998,466
Water utility plants	101,415,672	4,645,305	-	106,060,977
Total depreciable assets	$223,432,436	$7,832,913	($61,977)	$231,203,372
Less accumulated depreciation for:				
Buildings	($5,370,912)	-	($417,364)	($5,788,276)
Equipment and vehicles	(6,411,718)	$44,801	(341,779)	(6,708,696)
Sewer utility plants	(36,142,083)	-	(2,028,983)	(38,171,066)
Water utility plants	(44,418,016)	-	(1,899,146)	(46,317,162)
Total accumulated depreciation	($92,342,729)	$44,801	($4,687,273)	($96,985,200)
Total Capital Assets, net	$140,401,036	$15,110,454	($10,551,301)	$144,960,189

NOTE 3 – CAPITAL ASSETS (concluded)

Capital asset activity for the year ended December 31, 2016 was as follows:

2016	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not being depreciated:				
Land & land rights	$2,715,838	$4,052	-	$2,719,890
Construction in progress	7,718,244	6,261,178	($7,387,982)	6,591,439
Total non-depreciable assets	$10,434,082	$6,265,230	($7,387,982)	$9,311,329
Capital assets being depreciated:				
Buildings	$14,128,765	$391,244	-	$14,520,009
Data processing and office equipment	1,935,578	47,042	-	1,982,620
Engineering equipment and vehicles	5,058,492	375,465	($77,652)	5,356,305
Sewer utility plants	97,393,353	2,764,477	-	100,157,830
Water utility plants	96,669,744	4,745,928	-	101,415,672
Total depreciable assets	$215,185,932	$8,324,156	($77,652)	$223,432,436
Less accumulated depreciation for:				
Buildings	($4,959,433)	$34,297	($445,776)	($5,370,912)
Equipment and vehicles	(6,213,186)	101,632	(300,164)	(6,411,718)
Sewer utility plants	(34,170,602)	164,543	(2,136,024)	(36,142,083)
Water utility plants	(42,558,572)	154,535	(2,013,979)	(44,418,016)
Total accumulated depreciation	($87,901,793)	$455,007	($4,895,943)	($92,342,729)
Total Capital Assets, net	$137,718,221	$15,044,393	($12,361,577)	$140,401,036

The original cost of operating property retired or otherwise disposed of and the cost of installation, less salvage, is charged to accumulated depreciation. However, in the case of the sale of a significant operating unit or system, the original cost is removed from the utility plant accounts, accumulated depreciation related to the property sold is charged, and the net gain or loss on disposition is credited or charged to income.

Capital assets are depreciated using straight-line method of depreciation over the following estimated useful lives:

Buildings	20 to 30 years
Vehicles	3 to 10 years
Office and Engineering Equipment	3 to 10 years
Utility Plants	10 to 50 years

Preliminary costs incurred for proposed projects are deferred pending construction of the facility. Costs relating to projects ultimately constructed are transferred to utility plant; charges that relate to abandoned projects are expensed.

NOTE 4 – CONSTRUCTION IN PROGRESS

Construction in progress represents expenditures to date on capital projects, which totaled $8.0 million as of December 31, 2017 and $6.6 million as of December 31, 2016. Costs are accumulated for each project and transferred to the relevant capital asset upon completion. Depreciation does not commence until the project is completed. Project details as of December 31, 2017, and 2016, were as follows:

PROJECT	2017	2016
CIP: Norway Hill Reservoir Recoating Project	$1,805,075	$16,328
CIP: 2015 Sewer Main CIPP Rehabilitation	1,213,688	43,860
CIP: Lift Station No. 3 Rehabilitation C879	769,792	144,257
CIP: Lift Station #15 Rehab.	635,267	72,662
CIP: 182/64 AC Water Main Replacement	599,209	80,909
CIP: 152/61 Water Main Replacement	450,113	44,537
CIP: 140/84 Water Main Replacement	344,724	20,816
CIP: Totem Lake Sewer Trunk CIPP	309,815	-
CIP: 164/112 Water Main Replacement	236,698	25,485
CIP: PP&S: W-RWA New	181,612	181,612
CIP: Totem Lake Blvd/120 Sewer Extension	167,989	-
CIP: District HQ Bldg A & B Roof Repairs and Other Improvements	158,736	158,736
CIP: 125/HPD Sewer Extension	122,868	82,499
CIP: LS#19 Emergency Generator	109,869	4,614
CIP: Holems PT Dr Water Main Replacement	96,597	94,828
CIP: Water Spaghetti Line Project	93,786	93,786
CIP: Slough/68 Sewer Bypass	87,014	-
CIP: 01 450/425 Pressure Zone Conversion	81,654	80,602
CIP: 141/111 Kirkland Culvert & NUD W&S Project	81,595	-
CIP: Lake Forest Park Reservoir and Pump House Improvements	53,779	39,369
CIP: Totem Lake Regional Improvements	50,227	20,574
Other Miscellaneous Projects	368,843	5,385,966
Total Construction in Progress	$8,018,949	$6,591,439

NOTE 5 – LONG-TERM DEBT

a. Junior Lien Loans

The District had junior lien loans of $3,088,497 as of December 31, 2017 and $3,365,145 as of December 31, 2016 from the Washington Public Works Trust Fund, including current portions of $276,648 for 2017 and $276,648 for 2016.

The District has five loans currently outstanding from the Washington State Public Works Trust Fund.

Year	Term in Years	Interest Rate	Proceeds Received	Loan Balance as of 12/31/17
2002	20	0.5%	$408,000	$108,375
2004	20	0.5%	862,570	320,229
2005	20	0.5%	878,454	369,875
2011	20	0.5%	3,105,000	2,289,612
			$5,254,024	$3,088,091
			Less current maturity	(276,648)
			Long-term portion	$2,811,443

The proceeds from these low interest 20-year loans are used for water main replacement and sewer main extension programs. The principal is repaid in up to twenty equal annual installments.

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

NOTE 5 – LONG-TERM DEBT (concluded)

b. Long-Term Debt Service Schedule

	Public Works Trust Fund Loans		
Year	Principal	Interest	Total Cash Flow
2018	$276,648	$9,697	$286,345
2019	276,648	8,721	285,370
2020	276,648	7,746	284,394
2021	276,648	6,770	283,418
2022	276,648	5,794	282,442
2023-2027	1,044,751	16,335	1,061,086
2028-2031	660,098	4,075	664,173
Total	$3,088,091	$59,138	$3,147,229

c. Changes in Long-Term Liabilities

During the years ended December 31, 2017 and 2016 the following changes occurred in long-term liabilities:

	Beginning Balance 1/1/2017	Additions	Reductions	Ending Balance 12/31/2017	Due Within One Year
Public Works Trust Fund Loans	$3,365,145	$0	($277,054)	$3,088,091	$276,648

	Beginning Balance 1/1/2016	Additions	Reductions	Ending Balance 12/31/2016	Due Within One Year
Public Works Trust Fund Loans	$3,735,003	$0	($369,858)	$3,365,145	$276,648

NOTE 6 – PENSION PLAN

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

The following table represents the aggregate pension amounts for all plans subject to the requirements of the GASB Statement 68, *Accounting and Financial Reporting for Pensions* for the year 2017:

Aggregate Pension Amounts – All Plans	
Net Pension Liability	$3,086,127
Deferred Outflows of Resources	$529,592
Deferred Inflows of Resources	($470,904)
Pension Expense	$241,242

State Sponsored Pension Plans

Substantially all District full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing, multiple-employer public employee defined benefit and defined contribution retirement plans. The state Legislature establishes, and amends, laws pertaining to the creation and administration of all public retirement systems.

The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98540-8380. The DRS CAFR may also be downloaded from the DRS website at www.drs.wa.gov.

Public Employees' Retirement System (PERS)

PERS members include elected officials; state employees; employees of the Supreme, Appeals and Superior Courts; employees of the legislature; employees of district and municipal courts; employees of local governments; and higher

NOTE 6 – PENSION PLAN (continued)

education employees not participating in higher education retirement programs. PERS is comprised of three separate pension plans for membership purposes. PERS plans 1 and 2 are defined benefit plans, and PERS plan 3 is a defined benefit plan with a defined contribution component.

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

Contributions

The **PERS Plan 1** member contribution rate is established by State statute at 6 percent. The employer contribution rate is developed by the Office of the State Actuary and includes an administrative expense component that is currently set at 0.18 percent. Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates. The PERS Plan 1 required contribution rates (expressed as a percentage of covered payroll) for 2017 were as follows:

PERS Plan 1		
Actual Contribution Rates	**Employer**	**Employee**
January - June 2017:		
PERS Plan 1	6.23%	6.00%
PERS Plan 1 UAAL	4.77%	
Administrative Fee	0.18%	
Total	**11.18%**	**6.00%**
July - December 2017:		
PERS Plan 1	7.49%	6.00%
PERS Plan 1 UAAL	5.03%	
Administrative Fee	0.18%	
Total	**12.70%**	**6.00%**

NOTE 6 – PENSION PLAN (continued)

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.

<u>Contributions</u>

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

NOTE 6 – PENSION PLAN (continued)

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 2017 were as follows:

PERS Plan 2/3		
Actual Contribution Rates	**Employer 2/3**	**Employee 2**
January – June 2017:		
PERS Plan 2/3	6.23%	6.12%
PERS Plan 1 UAAL	4.77%	
Administrative Fee	0.18%	
Employee PERS Plan 3		varies
Total	**11.18%**	**6.12%**
July – December 2017:		
PERS Plan 2/3	7.49%	7.38%
PERS Plan 1 UAAL	5.03%	
Administrative Fee	0,18%	
Employee PERS Plan 3		Varies
Total	**12.70%**	**7.38%**

The District actual PERS plan contributions were $0 to PERS Plan 1 and $526,167 to PERS Plan 2/3 for the year ended December 31, 2017.

Actuarial Assumptions

The total pension liability (TPL) for each of the DRS plans was determined using the most recent actuarial valuation completed in 2017 with a valuation date of June 30, 2016. 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* and the *2015 Economic Experience Study*.

Additional assumptions for subsequent events and law changes are current as of the 2016 actuarial valuation report. The TPL was calculated as of the valuation date and rolled forward to the measurement date of June 30, 2017. Plan liabilities were rolled forward from June 30, 2016, to June 30, 2017, reflecting each plan's normal cost (using the entry-age cost method), assumed interest and actual benefit payments.

- **Inflation:** 3.0% total economic inflation; 3.75% salary inflation

NOTE 6 – PENSION PLAN (continued)

- **Salary increases**: In addition to the base 3.75% salary inflation assumption, salaries are also expected to grow by promotions and longevity.

- **Investment rate of return:** 7.5%

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

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

- For all plans except LEOFF Plan 1, how terminated and vested member benefits are valued was corrected.
- How the basic minimum COLA in PERS Plan 1 is valued for legal order payees was improved.
- For all plans, the average expected remaining service lives calculation was revised.

Discount Rate

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

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

Long-Term Expected Rate of Return

The long-term expected rate of return on the DRS pension plan investments of 7.5 percent was determined using a building-block-method. In selecting this assumption, the Office of the State Actuary (OSA) reviewed the historical

experience data, considered the historical conditions that produced past annual investment returns, and considered capital market assumptions and simulated expected investment returns provided by the Washington State Investment Board

(WSIB). The WSIB uses the capital market assumptions and their target asset allocation to simulate future investment returns over various time horizons.

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, 2017, are summarized in the table below. The inflation component used to create the table is 2.2 percent and represents the WSIB's most recent long-term estimate of broad economic inflation.

Asset Class	Target Allocation	% Long-Term Expected Real Rate of Return Arithmetic
Fixed Income	20%	1.70%
Tangible Assets	5%	4.90%
Real Estate	15%	5.80%
Global Equity	37%	6.30%
Private Equity	23%	9.30%
	100%	

Sensitivity of the Net Pension Liability/(Asset)

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

Plan	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
PERS 1	$1,936,033	$1,589,269	$1,288,897
PERS 2/3	$4,032,694	$1,496,859	($580,882)

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.

NOTE 6 – PENSION PLAN (continued)

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

At June 30, 2017, the District reported a total pension liability of $3,086,127 for its proportionate share of the net pension liabilities as follows:

Plan	Liability
PERS 1	$1,589,269
PERS 2/3	$1,496,858
Total	$3,086,127

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

Plan	Proportionate Share 6/30/16	Proportionate Share 6/30/17	Change in Proportion
PERS 1	0.032558%	0.033493%	0.000935%
PERS 2/3	0.040906%	0.043081%	0.002175%

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 Non-employer Allocations for all plans except LEOFF 1.

The collective net pension liability (asset) was measured as of June 30, 2017, and the actuarial valuation date on which the total pension liability (asset) is based was as of June 30, 2016, with update procedures used to roll forward the total pension liability to the measurement date.

Pension Expense

For the year ended December 31, 2017, the District recognized pension expense as follows:

Plan	Pension Expense
PERS 1	$112,929
PERS 2/3	$128,313
TOTAL	**$241,242**

NOTE 6 – PENSION PLAN (continued)

Deferred Outflows of Resources and Deferred Inflows of Resources

At December 31, 2017, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

PERS 1	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	-	-
Net difference between projected and actual investment earnings on pension plan investments	-	($59,307)
Changes of assumptions	-	-
Changes in proportion and differences between contributions and proportionate share of contributions	-	-
Contributions subsequent to the measurement date	-	-
TOTAL	**-**	**($59,307)**

PERS 2/3	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$151,667	($49,229)
Net difference between projected and actual investment earnings on pension plan investments	-	($399,027)
Changes of assumptions	$15,899	-
Changes in proportion and differences between contributions and proportionate share of contributions	$80,054	($54,670)
Contributions subsequent to the measurement date	$281,971	$0
Prior year adjustment	-	$91,329
TOTAL PERS 2/3	**$529,591**	**($411,597)**
TOTAL PERS 1 and PERS 2/3	**$529,591**	**($470,904)**

NOTE 6 – PENSION PLAN (continued)

Deferred outflows of resources related to pensions resulting from the District's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2018. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:	**PERS 2/3**
2018	($182,943)
2019	$37,999
2020	($22,821)
2021	($147,783)
2022	$26,193
Thereafter	$34,050
Total	**($255,305)**

The following plan is not administered by DRS. Individual municipalities' proportionate share of the net pension liability/(asset) is available at www.bvff.wa.gov. The following disclosures should be combined with those above in a manner that avoids unnecessary duplication.

Actuarial Assumptions

The total pension liability (TPL) for each of the DRS plans was determined using the most recent actuarial valuation completed in 2016 with a valuation date of June 30, 2015. The actuarial assumptions used in the valuation were based on the results of the Office of the State Actuary's (OSA) *2007-2012 Experience Study*.

Additional assumptions for subsequent events and law changes are current as of the 2015 actuarial valuation report. The TPL was calculated as of the valuation date and rolled forward to the measurement date of June 30, 2016. Plan liabilities were rolled forward from June 30, 2015, to June 30, 2016, reflecting each plan's normal cost (using the entry-age cost method), assumed interest and actual benefit payments.

- **Inflation:** 3.0% 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%

NOTE 6 – PENSION PLAN (concluded)

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.

Required Supplementary Information (RSI) - all cost-sharing employers

Under GASB Statement 68, local governments that participate in one or more of the State's cost-sharing, multiple employer pension plans (PERS, SERS, PSERS, TRS, and LEOFF) must present as RSI:

- Schedule of Proportionate Share of the Net Pension Liability
- Schedule of Employer Contributions

This RSI is included on pages 43 and 44 of this report.

NOTE 7 – JOINT VENTURE

Snohomish River Regional Water Authority (SRRWA)
From the early 1950s to 1992, the Weyerhaeuser Company (Weyco) owned and operated a pulp mill in Everett, Washington, using a water right that allowed up to 36 million gallons per day (mgd) to be drawn from the adjacent Snohomish River for industrial use. Although Weyco closed the mill, it kept the 36 mgd water right.

In 1996, three public water utilities; The City of Everett, the Northshore Utility District (Northshore), and Woodinville Water District (Woodinville) formed the SRRWA, and acquired Weyerhaeuser's water right to help meet water demands projected for the SRRWA service area. The Washington State Department of Ecology approved the water right transfer, with an instantaneous withdrawal rate of 36 mgd and an annual quantity of 23.7 mgd. Following completion of the water right change process and related litigation, the SRRWA has engaged in strategic planning, preliminary engineering, and costing work to assess capital project development and operational path issues. This work is ongoing and projected to achieve initial beneficial use of the SRRWA water right by 2021, unless an extension is requested and granted.

In December 2004, the District signed a fixed quantity long-term supply agreement with Seattle Public Utilities (SPU). The supply quantity in the 60-year agreement is sufficient to supply the District for the duration of the agreement. This gives the District ample time to develop the Weyco source for the future. The District's goal is to have supply from both regional systems (Seattle and Everett) for added

NOTE 7 – JOINT VENTURE (concluded)

reliability. Since the cost for planning is not significant, the partners have agreed to explore all possible ways to develop the new source over the coming years. Transmission systems would need to be built to deliver the water to Northshore and/or Woodinville. Portions of the existing transmission systems might be utilized, including the new Clearview pipeline and reservoir. However, additional new pipelines would still be needed to extend from Clearview to Northshore and

Woodinville. Any use of the Clearview pipeline and reservoir would need to be negotiated with the Clearview Water Supply Agency, which owns those facilities.

Until it is determined that this joint venture will ever be used to supply water to the District's customers, all costs incurred are being expensed immediately. There are, however, amounts that have been capitalized over the years. The capitalized amounts on the District's books include land valued at $264,610 and construction in progress of $181,611.

NOTE 8 – RISK MANAGEMENT

The District is a member of the Washington Cities Insurance Authority (WCIA).

Utilizing Chapter 48.62 RCW (self-insurance regulation) and Chapter 39.34 RCW (Interlocal Cooperation Act), nine cities originally formed WCIA on January 1, 1981. WCIA was created for the purpose of providing a pooling mechanism for jointly purchasing insurance, jointly self-insuring, and / or jointly contracting for risk management services. WCIA has a total of 161 members.

New members initially contract for a three-year term, and thereafter automatically renew on an annual basis. A one-year withdrawal notice is required before membership can be terminated. Termination does not relieve a former member from its unresolved loss history incurred during membership.

Liability coverage is written on an occurrence basis, without deductibles [1]. Coverage includes general, automobile, police, errors or omissions, stop gap, employment practices and employee benefits liability. Limits are $4 million per occurrence in the self-insured layer, and $21 million in limits above the self-insured layer is provided by reinsurance. Total limits are $25 million per occurrence subject to aggregates and sub-limits. The Board of Directors determines the limits and terms of coverage annually.

Insurance for property, automobile physical damage, fidelity, inland marine, and boiler and machinery coverage are purchased on a group basis. Various deductibles apply by type of coverage. Property coverage is self-funded from the members' deductible to $750,000, for all perils other than flood and earthquake,

NOTE 8 – RISK MANAGEMENT (concluded)

and insured above that to $300 million per occurrence subject to aggregates and sub-limits. Automobile physical damage coverage is self-funded from the members' deductible to $250,000 and insured above that to $100 million per occurrence subject to aggregates and sub-limits.

In-house services include risk management consultation, loss control field services, and claims and litigation administration. WCIA contracts for certain claims investigations, consultants for personnel and land use issues, insurance brokerage, actuarial, and lobbyist services.

WCIA is fully funded by its members, who make annual assessments on a prospectively rated basis, as determined by an outside, independent actuary. The assessment covers loss, loss adjustment, reinsurance and other administrative expenses. As outlined in the interlocal, WCIA retains the right to additionally assess the membership for any funding shortfall.

An investment committee, using investment brokers, produces additional revenue by investment of WCIA's assets in financial instruments which comply with all State guidelines.

A Board of Directors governs WCIA, which is comprised of one designated representative from each member. The Board elects an Executive Committee and appoints a Treasurer to provide general policy direction for the organization. The WCIA Executive Director reports to the Executive Committee and is responsible for conducting the day to day operations of WCIA.

REQUIRED SUPPLEMENTAL INFORMATION

The Northshore Utility District is presenting Required Supplemental Information (RSI) to meet minimum financial reporting requirements. This RSI, generally composed of schedules, statistical data and other information, is an integral part of the accompanying financial statements.

Northshore Utility District
Schedule of Proportionate Share of the Net Pension Liability
As of June 30, 2017
Last 10 Fiscal Years Beginning 6/30/2015

PERS PLAN 1	2017	2016	2015
Employer's proportion of the net pension liability (asset)	0.033493%	0.032558%	0.033194%
Employer's proportionate share of the net pension liability	$1,589,269	$1,748,518	$1,736,355
Covered payroll	$4,223,694	$3,831,649	$3,728,275
Employer's proportionate share of the net pension liability as a percentage of covered payroll	37.63%	45.63%	46.57%
Plan fiduciary net position as a percentage of the total pension liability	61.24%	57.03%	59.10%

PERS PLAN 2/3	2017	2016	2015
Employer's proportion of the net pension liability (asset)	0.043081%	0.040906%	0.041330%
Employer's proportionate share of the net pension liability	$1,496,859	$2,059,585	$1,476,744
Covered payroll*	$4,223,694	$3,799,961	$3,667,507
Employer's proportionate share of the net pension liability as a percentage of covered payroll	35.44%	54.20%	40.27%
Plan fiduciary net position as a percentage of the total pension liability	90.97%	85.82%	89.20%

*Until a full 10-year trend is compiled, the District is presenting information only for those years which information is available.

REQUIRED SUPPLEMENTAL INFORMATION (concluded)

Northshore Utility District
Schedule of Employer Contributions
For the year ended December 31, 2017
Last 10 Fiscal Years

PERS PLAN 1	2017	2016	2015
Statutorily or contractually required contributions	$219,176	$192,746	$168,908
Contributions in relation to the statutorily or contractually required contributions*	-$219,176	-$192,746	-$168,908
Contribution deficiency (excess)	$0	$0	$0
Covered payroll*	$4,404,467	$3,967,876	$3,740,398
Contributions as a percentage of covered payroll	5.0%	4.9%	4.5%

PERS PLAN 2/3	2017	2016	2015
Statutorily or contractually required contributions	$306,991	$251,428	$212,022
Contributions in relation to the statutorily or contractually required contributions*	-$306,991	-$251,428	-$212,022
Contribution deficiency (excess)	$0	$0	$0
Covered payroll*	$4,404,467	$3,967,920	$3,678,234
Contributions as a percentage of covered payroll	7.0%	6.3%	5.8%

*Until a full 10-year trend is compiled, the District is presenting information only for those years which information is available.

ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments as well as fraud, state whistleblower and citizen hotline investigations.

The results of our work are widely distributed through a variety of reports, which are available on our website and through our free, electronic subscription service.

We take our role as partners in accountability seriously, and provide training and technical assistance to governments, and have an extensive quality assurance program.

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