



Washington State Auditor's Office

Troy Kelley

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Financial Statements Audit Report

King County Directors Association

For the period January 1, 2013 through December 31, 2013

Published March 12, 2015

Report No. 1013769





Washington State Auditor Troy Kelley

March 12, 2015

Board of Directors
King County Directors Association
Kent, Washington

Report on Financial Statements

Please find attached our report on the King County Directors Association's financial statements.

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

Sincerely,

A handwritten signature in cursive script that reads "Troy X. Kelley".

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

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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*

King County Directors Association January 1, 2013 through December 31, 2013

Board of Directors
King County Directors Association
Kent, 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 King County Directors Association, King County, Washington, as of and for the years ended December 31, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Association's basic financial statements, and have issued our report thereon dated March 6, 2015. As discussed in Note 2 to the financial statements, during the year ended December 31, 2013, the Association implemented Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The Association has omitted the management's discussion and analysis information that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements. Our opinion on the basic financial statements is not affected by this missing information.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits of the financial statements, we considered the Association's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we do not express an opinion on the effectiveness of the Association'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 Association'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 Association's financial statements are free from material misstatement, we performed tests of the Association'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 Association'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 Association's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited.

It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

A handwritten signature in cursive script that reads "Troy X. Kelley". The signature is written in dark ink and is positioned above the printed name.

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

March 6, 2015

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

King County Directors Association January 1, 2013 through December 31, 2013

Board of Directors
King County Directors Association
Kent, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the King County Directors Association, King County, Washington, as of and for the years ended December 31, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Association's basic financial statements as listed on page 10.

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 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 Association'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 Association'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 Directors Association, as of December 31, 2013 and 2012, 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.

Matters of Emphasis

As discussed in Note 2 to the financial statements, in 2013, the Association adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

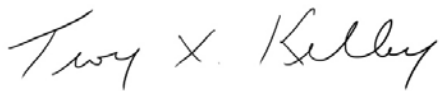
Other Matters

Required Supplementary Information

Management has omitted the management's discussion and analysis information that governmental accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated March 6, 2015 on our consideration of the Association'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 Association's internal control over financial reporting and compliance.



TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

March 6, 2015

FINANCIAL SECTION

King County Directors Association January 1, 2013 through December 31, 2013

BASIC FINANCIAL STATEMENTS

Statement of Net Position – 2013 and 2012

Statement of Revenues, Expenses and Changes in Net Position – 2013 and 2012

Statement of Cash Flows – 2013 and 2012

Notes to Financial Statements – 2013 and 2012

KING COUNTY DIRECTORS' ASSOCIATION
STATEMENT OF NET POSITION
As of December 31, 2013 and 2012

December 31, 2013 December 31, 2012

Assets

CURRENT ASSETS

| | | |
|---------------------------|------------|------------|
| Cash | 1,559,135 | 631,412 |
| Total Accounts Receivable | 9,999,237 | 8,244,611 |
| Inventory | 8,121,235 | 6,332,740 |
| Prepaid Expenses | 168,052 | 140,292 |
| Total Current Assets | 19,847,659 | 15,349,055 |

OTHER ASSETS

| | | |
|-------------------------------|---|---|
| Prepaid Expenses, non-current | 0 | 0 |
|-------------------------------|---|---|

Capital Assets

| | | |
|---------------------------------|---------|---------|
| Nondepreciable Capital Assets | 285,108 | 285,108 |
| Depreciable Capital Assets, Net | 891,429 | 871,094 |

Total Assets

| | |
|------------|------------|
| 21,024,196 | 16,505,257 |
|------------|------------|

Liabilities and Net Position

CURRENT LIABILITIES

| | | |
|---------------------------|------------|-----------|
| Accounts Payable | 3,457,917 | 3,507,168 |
| Note Payable (Net) | 9,000,000 | 4,600,000 |
| Total Current Liabilities | 12,457,917 | 8,107,168 |

OTHER LIABILITIES

| | | |
|-------------------------------|---|---|
| Accounts Payable: Non-Current | 0 | 0 |
|-------------------------------|---|---|

Total Liabilities

| | |
|------------|-----------|
| 12,457,917 | 8,107,168 |
|------------|-----------|

NET POSITION

| | | |
|----------------------------------|-----------|-----------|
| Net Investment in Capital Assets | 1,176,537 | 1,156,202 |
| Unrestricted | 7,389,742 | 7,241,887 |
| Total Net Position | 8,566,279 | 8,398,089 |

Total Liabilities and Net Position

| | |
|------------|------------|
| 21,024,196 | 16,505,257 |
|------------|------------|

See accompanying notes to financial statements

KING COUNTY DIRECTORS ASSOCIATION
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
Years Ending 12/31/13 and 12/31/12

| | 2013 | 2012 |
|---|---------------|---------------|
| <u>OPERATING REVENUES</u> | | |
| Merchandise Billings - net of discounts | 105,715,536 | 89,080,743 |
| Less Cost of Merchandise Billed | 98,819,947 | 83,189,371 |
| Service Fees - Mdse Billings | 6,895,589 | 5,891,372 |
| Service Fees - Contract Billings | 471,539 | 365,422 |
| Total Operating Revenue | 7,367,128 | 6,256,794 |
| <u>OPERATING EXPENSES</u> | | |
| Salaries | 1,860,619 | 1,652,248 |
| Freight | 2,240,642 | 2,025,515 |
| General Office Expense | 33,219 | 27,298 |
| Printing | 39,071 | 0 |
| Data Processing: Supplies & Services | 382,371 | 269,245 |
| Postage/Mailing Services | 42,322 | 33,432 |
| Telephone Expense | 50,901 | 51,413 |
| Warehouse Labor Expense | 790,162 | 741,768 |
| Warehouse Supplies & Equip. Repair | 151,985 | 135,431 |
| Building Maintenance | 45,268 | 38,571 |
| Utilities | 113,672 | 109,199 |
| Payroll taxes | 253,107 | 235,978 |
| Insurance Expense: Fire/Liability | 49,911 | 48,427 |
| Consulting Expense | 0 | 3,363 |
| Advertisement for Bids | 21,993 | 26,095 |
| Expenses of Executive Council | 1,072 | 796 |
| Professional Fees | 14,178 | 35,661 |
| Other Taxes | 12,883 | 11,888 |
| Auditing Expense | 9,045 | 17,882 |
| Sick Leave/Vacation Expense | (74,247) | (5,177) |
| State Retirement Expense | 187,571 | 156,634 |
| Employee Medical Insurance | 342,876 | 319,964 |
| Depreciation | 229,616 | 239,126 |
| Employee Travel Expense | 78,596 | 66,741 |
| Promotion & Training Expense | 44,650 | 31,537 |
| Loss on Disposal of Capital Assets | 0 | 0 |
| Total Operating Expenses | 6,921,483 | 6,273,033 |
| Operating Income | 445,645 | (16,239) |
| <u>Nonoperating Revenue (Expenses)</u> | | |
| Sublease Income | 0 | 0 |
| Interest Income | 0 | 0 |
| See accompanying notes to financial statements | 6,720 | 0 |
| Interest Expense, Note Payable | (284,175) | (182,708) |
| Total Nonoperating Income | (277,455) | (182,708) |
| Change in Net Position | 168,190 | (198,946) |
| <u>Net Position, Beginning of Year</u> | 8,398,089 | 8,597,035 |
| Less Withdrawal of Ownership Equity | 0 | 0 |
| <u>Net Position, End of Year</u> | 8,566,279 | 8,398,089 |

See accompanying notes to financial statements

KING COUNTY DIRECTORS' ASSOCIATION
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2013 and 2012

| | 2013 | 2012 |
|---|---------------|--------------|
| <u>Cash Flows from Operating Activities</u> | | |
| Cash received from customers and other parties | 104,432,449 | 88,104,735 |
| Cash paid to suppliers and employees | (107,377,319) | (88,743,159) |
| Net cash flows from operating activities | (2,944,870) | (638,424) |
| <u>Cash Flows from Non-Capital and Related Financing Activities</u> | | |
| Interest expense | (284,175) | (182,708) |
| Other misc. non-operating income | 6,720 | 0 |
| Repayment of Note Payable (net) | (4,600,000) | (3,400,000) |
| Borrowings on Note Payable (net) | 9,000,000 | 4,600,000 |
| Net cash flows, non-capital and related financing activities | 4,122,545 | 1,017,292 |
| <u>Cash Flows from Capital and Related Financing Activities</u> | | |
| Purchase of capital assets | (229,616) | (71,529) |
| Refund of ownership equity | 0 | 0 |
| Net cash flows, capital and related financing activities | (229,616) | (71,529) |
| <u>Cash Flows from Investing Activities</u> | | |
| Interest income | 0 | 0 |
| Sublease income | 0 | 0 |
| Net cash flows from investing activities | 0 | 0 |
| Net change in cash | 948,058 | 307,340 |
| <u>Reconciliation of Net change in cash</u> | | |
| Cash and cash equivalents, beginning of year | 631,412 | 324,072 |
| Cash and cash equivalents, end of year | 1,559,135 | 631,412 |
| | 927,723 | 307,340 |
| <u>Reconciliation of Operating Income to Net Cash Flows from Operating Activities</u> | | |
| Operating income | 445,645 | (16,239) |
| Adjustments to reconcile operating income to net cash flow from operating activities | | |
| Depreciation | 229,616 | 239,126 |
| Change in operating assets & liab. | | |
| Accounts receivable | (1,754,626) | (1,341,430) |
| Inventory | (1,788,495) | 975,489 |
| See accompanyingi Prepaid expense | (27,760) | (17,538) |
| Loss on sale of capital assets | 0 | 0 |
| Accounts payable | (49,251) | (477,832) |
| Cash flows from operating activities | (2,944,870) | (638,424) |
| See accompanying notes to financial statements | | |

**KING COUNTY DIRECTORS' ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR YEARS ENDED DECEMBER 31, 2013 AND DECEMBER 31, 2012**

NOTE 1 - SCOPE OF REPORTING ENTITY

The King County Directors' Association Purchasing Department (KCDA) was formed by the Washington State public school districts, in accordance with RCW 28A.320.080, and generates all revenues by the billing for goods and services provided to its members. This report covers the source of all revenues, the record of all expenditures and the distribution of surplus.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

KCDA maintains its records in accordance with generally accepted accounting principles. In 2003 KCDA implemented GASB 34, entitled "Basic Financial Statements and Management Discussion and Analysis for State and Local governments", with the exception that management has elected not to present Management Discussion and Analysis. In addition, during 2012 KCDA implemented the provisions of GASB 63 and its impact on basic financial statements. Also, during 2013 all applicable provisions of GASB 65 were implemented. Significant policies are described below.

A. Cash

Cash balances are summarized into one total for each year presented in the balance sheet and the statement of cash flow. Cash includes demand deposits in banks and investments in marketable securities. See "Note 5" regarding investments.

B. Deposits

Cash deposits from members are shown on the balance sheet as current liabilities. In years prior to 2006, KCDA provided a deferred merchandise delivery program for members who wish to order and pay for merchandise according to normal terms and have the goods delivered as needed in the future. Members were billed upon receipt of the merchandise. Deferred merchandise inventory was owned by the member districts and stored in the KCDA warehouse. The deferred inventory was shown on the balance sheet as a current asset, with an offsetting current liability for the same amount. Beginning in 2006, the deferred inventory program was discontinued and is no longer reflected on the balance sheet.

C. Accounts Receivable

Includes all unpaid billings to members. Payment terms for Class 1 Washington public school districts and other types of Washington government agencies were net 40 days. Private school members who have bonds receive those same terms. Class 2 Washington public school districts were net 45 days. Private schools without bonds receive no discounts and must pay invoices before delivery of merchandise. Out-of-state public schools and public agencies have terms of net 40 days. Service charges are levied for accounts over 30 days past due. Due to the rare occurrence of bad debts, KCDA considers all accounts receivable to be collectible and therefore does not include an allowance for doubtful accounts in accounts receivable.

D. Inventory

Inventory consists of merchandise held for future sale to members and is valued at the lower of cost or market. Cost is determined by the average cost method.

E. Capital Assets and Depreciation

Capital assets are stated at cost. Depreciable assets are depreciated on a straight-line basis. The cost of capital assets sold or retired is credited to the asset account and the related depreciation is charged to the accumulated depreciation account. Profit or loss resulting from the sale or retirement is included in income.

F. Vacation and Sick Leave Benefits

Earned, but unused, vacation and sick leave are accrued at 100% and 25% respectively of current pay rates. At December 31, 2013 the balance of accrued vacation and sick leave was \$114,804. At December 31, 2012 the balance of accrued vacation and sick leave was \$189,052.

G. Revenues

Operating revenues are derived primarily from billings to members for goods and services, and from rebates for use of KCDA contracts. Included in each billing is the cost of the product, Washington State sales tax and a service fee to cover the cost of the Association's operation. Additional non-operating revenues are generally received from interest income on investments, short term rental of warehouse space, sale of data processing services, and gain on sale of capital assets. Revenues are classified as operating and non-operating in the statement of revenues, expenses, and changes in net position.

H. Interest Income and Expense

KCDA earns interest income by investing cash balances in the King County investment pool (see Note 5). Normally there are cash balances to invest during its non-peak operating months, October through April. However during the other months, short-term borrowing is needed to fund a cash flow deficit created by the purchase of large quantities of school supplies for summer annual orders. Either commercial paper (CP) is sold or a bank line of credit (LOC) is utilized to borrow these funds (see Note 4). Funds received from accounts receivable collections are deposited daily in the County investment pool. During the non-peak months, KCDA sometimes elects to keep the LOC extended (or CP issued) to re-invest the proceeds at higher interest rates being paid by the County, in a manner that does not trigger the arbitrage rebate requirements of the Internal Revenue Code. Therefore,

KCDA, at times, is borrowing and investing simultaneously. KCDA accounts for interest income and expense by offsetting them. The net amount is classified in the financial statements as operating interest expense in the peak months when the LOC (or CP) interest expense is greater than the interest income, when our operations are being financed by the borrowing. In non-peak months when interest income exceeds LOC (or CP) interest expense, the net amount is classified in the financial statements as other income in the investment interest income account.

I. Reserve Ownership – Net Position

Net position represents the sum of the reserve ownership balances. The reserve ownership is allocated among participating members (Washington public school districts) each year by dividing the year's net income in proportion to the total service fees billed to each district. For 2002 and years thereafter a change was made in that method so as to include rebates earned by each district's purchases in that district's total service fees for the year. The rebates, for goods purchased through KCDA contracts but not billed through KCDA, were not formerly included in each district's annual service fee total. These districts may withdraw from KCDA and receive a refund of their ownership balance in merchandise over 10 years, or in cash over 15 years.

NOTE 3 – CAPITAL ASSETS

The following is a summary of property and equipment at cost:

Non-depreciable Capital Assets:

| Description | 12/31/2012 Balance | Additions | Retirements | 12/31/2013 Balance |
|-------------|-----------------------|-----------|-------------|-----------------------|
| Land | \$ 285,108 | 0 | 0 | \$ 285,108 |
| Description | 12/31/2011 Balance | Additions | Retirements | 12/31/2012 Balance |
| Land | \$ 285,108 | 0 | 0 | \$ 285,108 |

Depreciable Capital Assets:

| | 12/31/2012 | | | 12/31/2013 |
|----------------------------------|--------------|--------------|-------------|------------|
| Description | Balance | Additions | Retirements | Balance |
| Building | 2,066,713 | 38,733 | 0 | 2,105,446 |
| Office equipment | 2,856,912 | 146,785 | 310,598 | 2,693,099 |
| Office systems under development | 0 | 0 | 0 | 0 |
| Warehouse Equipment | 2,156,408 | 64,433 | 0 | 2,220,841 |
| Total Cost | 7,080,033 | 249,951 | 310,598 | 7,019,386 |
| Accumulated Depreciation | | | | |
| Building | 1,793,421 | 62,389 | 0 | 1,855,810 |
| Office equipment | 2,465,325 | 117,148 | 310,598 | 2,271,875 |
| Warehouse equipment | 1,950,193 | 50,079 | 0 | 2,000,272 |
| Total accumulated depreciation | 6,208,939 | 229,616 | 310,598 | 6,127,957 |
| Net property & equipment | \$ 871,094 | \$ 20,335 | \$ - | \$ 891,429 |
| | | | | |
| | 12/31/2011 | | | 12/31/2012 |
| Description | Balance | Additions | Retirements | Balance |
| Building | 2,062,059 | 4,654 | 0 | 2,066,713 |
| Office equipment | 2,794,165 | 62,747 | 0 | 2,856,912 |
| Office systems under development | 0 | 0 | 0 | 0 |
| Warehouse Equipment | 2,152,280 | 4,128 | 0 | 2,156,408 |
| Total Cost | 7,008,504 | 71,529 | 0 | 7,080,033 |
| Accumulated Depreciation | | | | |
| Building | 1,731,598 | 61,823 | 0 | 1,793,421 |
| Office equipment | 2,344,199 | 121,125 | 0 | 2,465,325 |
| Warehouse equipment | 1,894,015 | 56,178 | 0 | 1,950,193 |
| Total accumulated depreciation | 5,969,812 | 239,126 | 0 | 6,208,939 |
| Net property & equipment | \$ 1,038,692 | \$ (167,597) | \$ - | \$ 871,094 |

NOTE 4 – SHORT-TERM BORROWING PROGRAM

In April of 2005, KCDA initiated a \$10 million bank line of credit through Key Bank. Washington State law provides the authority for this program. That same program was renewed in 2012, and again in 2013, though, with an increase in the line of credit to \$12 million. The balance of the bank line of credit outstanding at 12/31/12 was \$4,600,000, with the balance being \$9,000,000, as of 12/31/13.

NOTE 5 - INVESTMENTS

On October 1, 1995, KCDA joined the King County investment pool, which includes the County's own funds as well as those of approximately 100 independent government agencies. Those funds are co-mingled and then invested by the County's cash management department in accordance with Washington State law which regulates the types of investment vehicles that government entities may own. At December 31, 2013 the Pool's holdings totaled approximately \$5.1 billion with an average portfolio maturity of 1.28 years. KCDA's investments in the Pool as of December 31, 2013, and December 31, 2012 are as follows:

As of December 31, 2013

| <u>Investment Type</u> | <u>Fair Value</u> | <u>Effective Duration</u> |
|-----------------------------|-------------------|---------------------------|
| King County Investment Pool | \$3,101,642 | 1.28 Years |

As of December 31, 2012

| <u>Investment Type</u> | <u>Fair Value</u> | <u>Effective Duration</u> |
|-----------------------------|-------------------|---------------------------|
| King County Investment Pool | \$ 674,283 | 1.36 Years |

Interest Rate Risk. As of December 31, 2013, the Pool's average duration was 1.28 years. As of December 31, 2012, the Pool's average duration was 1.36 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 both December 31, 2013, and December 31, 2012, the district's investment in the Pool was not rated by a nationally recognized statistical rating organization (NRSRO). In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency securities and mortgage-backed securities, municipal securities (rated at least "A" by two NRSROs), commercial paper (rated at least the equivalent of "A-1" by two NRSROs), certificates of deposits issued by qualified public depositories, repurchase agreements, and the Local Government Investment Pool managed by the Washington State Treasurer's office.

Impaired Investments. As of December 31, 2013, 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; and the residual investments in four commercial paper assets that were part of completed enforcement events, where the Impaired Pool accepted the cash out option. King County Directors Association's share of the impaired investment pool principle is \$17,257 and its fair value of these investments is \$10,221.

As of September 1, 2008, impaired commercial paper assets were removed from the main King County Investment Pool and placed into an impaired investment pool. As of December 31, 2008, the King County impaired investment pool held one commercial paper asset that is impaired and part of an enforcement event where a trustee or receiver is appointed to determine the best options for selling assets and/or restructuring the portfolio; and the residual investments in four commercial paper assets that were part of completed enforcement events. KCDA's share of the impaired investment pool is \$44,585 (Maximum Loss Exposure) and KCDA's unrealized loss exposure for these investments is \$38,459 as of 12/31/08. During 2008, KCDA's share of realized losses from previously impaired investments was \$31,700. This amount plus the estimated future unrealized loss exposure of \$38,459, totals a combine realized/unrealized loss of \$70,158. In 2007 KCDA reflected a Generally Accepted Accounting Principles (GAAP) adjustment to its year-end financial statements of \$46,569, to reflect the fair value of investments at year end. In 2008, KCDA made an additional adjustment of \$23,589 (to bring the total to \$70,158), which resulted in a further decrease in cash on the balance sheet and a corresponding decrease in interest income on the income statement. In 2012 a \$17,050 adjustment was made to cash. Due to the positive cash flows from and overall assessment of the final impaired asset (Victoria), no adjustment was made in 2013.

All temporary investments are stated at cost, which approximates market value. Other property and investments are shown on the balance sheet at cost, net of amortized premium or discount.

NOTE 6 - PENSION PLANS

Substantially all of the King County Directors Association's 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 (DRS), under cost-sharing multiple-employer defined benefit and defined contribution retirement plans. 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. The DRS CAFR may be obtained by writing to: DRS, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380. The following disclosures are made pursuant to GASB Statement 27, *Accounting for Pensions by State and Local Government Employers*.

Description of Plan

PERS is a cost sharing multiple employer, retirement system comprised of three separate plans for membership purposes: plans 1 and 2 are defined benefit plans and plan 3 is a combination defined benefit/defined contribution plan. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals and Superior courts (other than judges in a judicial retirement system); employees of legislative committees; community and technical colleges, college and university employees (not in national higher education retirement programs); judges of district and municipal courts; and employees of local governments. Participants who joined the system by 9/30/77 are plan 1 members. Those who joined on or after 10/1/77 and by either 2/28/02 for state and higher education employees, or 8/31/02 for local government employees, are plan 2 members unless they exercise an option to transfer their membership to plan 3. Participants joining the system on or after 3/1/02 for state and higher education employees, or 9/1/02 for local government employees have the option of choosing membership in either plan 2 or plan 3. The option must be exercised within 90 days of employment. An employee is reported in plan 2 until a choice is made. Employees who fail to choose within 90 days default to plan 3. Defined benefit retirement benefits are financed from a combination of employee and employer contributions and investment earnings. Retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

Retirement benefits in both plans 1 and plan 2 are vested after completion of 5 years of eligible service. Plan 1 members are eligible for retirement at any age after 30 years of service, or at the age of 60 with 5 years of service, or at the age of 55 with 25 years of service. The annual pension is 2% of the final average compensation per year of service, capped at 60%. The average final compensation is based on the greatest compensation during any 24 eligible consecutive compensation months.

If qualified, after reaching age 66 a cost-of-living allowance is granted based on years of service credit and capped at 3 percent annually. Plan 2 members may retire at the age of 65 with 5 years of service, or at 55 with 20 years of service, with an allowance of 2% per year of service of the average final compensation. The average final compensation is based on the greatest compensation during any eligible consecutive 60 month period. Plan 2 retirements prior to age 65 receive reduced benefits. If retirement is at age 55 with at least 30 years of service, a 3% per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit, and a cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index), capped at 3% annually.

Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. The defined benefit portion provides a benefit calculated at 1% of the average final compensation per year of service. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period. Plan 3 members become eligible for retirement if they have: at least 10 years of service; or five years including 12 months that were earned after age 54; or 5 service credit years earned in plan 2 prior to 6/1/03. Plan 3 retirements prior to age 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a 3% per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit, and plan 3 provides the same cost-of-living allowance as plan 2. The defined contribution portion can be distributed in accordance with an option selected by the member, either as a lump sum or pursuant to other options authorized by the Employee Benefits Board.

There are 1,316 participating employers in the Washington State retirement system. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of 6/30/12:

| | |
|--|----------------|
| Retirees and Beneficiaries Receiving Benefits | 82,242 |
| Terminated Plan Members Entitled To but Not Yet Receiving Benefits | 30,515 |
| Active Plan Members Vested | 106,317 |
| Active Plan Members Nonvested | <u>44,273</u> |
| Total | 263,347 |

Funding Policy

Each biennium the state Pension Funding Council adopts plan 1 employer contribution rates, and plan 2 employer and employee contribution rates, and plan 3 employer contribution rates. Employee contribution rates for plan 1 are established by statute at 6% and do not vary from year to year. The employer and employee contribution rates for plan 2 and the employer contribution rate for plan 3 are developed by the Office of the State Actuary to fully fund plan 2 and the defined benefit portion of plan 3. All employers are required to contribute at the level established by the Legislature. PERS plan 3 defined contribution is a non-contributing plan for employers. Employees who participate in the defined contribution portion of PERS plan 3 do not contribute to the defined benefit portion of PERS plan 3. The Employee Retirement Benefits Board sets plan 3 employee contribution rates. Six rate options are available ranging for 5 to 15%; two of the options are graduated rates dependent on the employee's age. The methods used to determine the contribution requirements are established under state statute in accordance with Chapters 41.40 and 41.45 RCW.

Contributions Made

The required contribution rates expressed as a percentage of current year covered payroll as of December 31, 2013 were:

| | PERS Plan 1 | PERS Plan 2 | PERS Plan 3 |
|-----------|--------------------|--------------------|--------------------|
| Employer* | 9.21% | 9.21% | 9.21%** |
| Employee | 6.00% | 4.92% | *** |

The required contribution rates expressed as a percentage of current year covered payroll as of December 31, 2012 were:

| | PERS Plan 1 | PERS Plan 2 | PERS Plan 3 |
|-----------|--------------------|--------------------|--------------------|
| Employer* | 7.08% | 7.08% | 7.08%** |
| Employee | 6.00% | 4.64% | *** |

- * The employer rates include the employer administrative expense fee of 0.18%
- ** Plan 3 defined benefit portion only.
- *** Variable from 5 to 15% maximum based on rate selected by the PERS 3 member.

Both King County Directors Association and the employees made the required contributions. KCDA's required contributions for the year ended December 31, 2012 and 2013 were:

| | PERS Plan 1 | PERS Plan 2 |
|------|--------------------|--------------------|
| 2012 | \$ 8,238 | \$ 94,408 |
| 2013 | \$11,670 | \$175,215 |

NOTE 7 – RISK MANAGEMENT

KCDA carries insurance to protect its physical property and to insure against various types of risk. During both 2012 and 2013, the following insurance was in force: Building - \$10,000,000; Inventory – At current reportable cost; Equipment - \$3,715,000; business income - \$2,185,000; general liability - \$2,000,000 and directors and officers - \$3,000,000.

NOTE 8 – CONTINGENCIES AND LITIGATION

The KCDA insurance coverage is adequate to insure against any and all known claims pending against the Association.

ABOUT THE STATE AUDITOR'S OFFICE

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

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

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

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

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

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

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

| Contact information for the State Auditor's Office | |
|--|--|
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