



Washington State Auditor's Office

Government that works for citizens

Financial Statements Audit Report

Lake Stevens Sewer District

Snohomish County

For the period January 1, 2015 through December 31, 2015

Published December 29, 2016

Report No. 1018255





Washington State Auditor's Office

December 29, 2016

Board of Commissioners
Lake Stevens Sewer District
Lake Stevens, Washington

Report on Financial Statements

Please find attached our report on the Lake Stevens Sewer District's financial statements.

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

Sincerely,

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**

**Lake Stevens Sewer District
Snohomish County
January 1, 2015 through December 31, 2015**

Board of Commissioners
Lake Stevens Sewer District
Lake Stevens, 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 Lake Stevens Sewer District, Snohomish County, Washington, as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated December 9, 2016. As discussed in Note 1 to the financial statements, during the year ended December 31, 2015, the District implemented Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit 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 opinion 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.

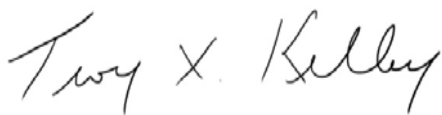
COMPLIANCE AND OTHER MATTERS

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.



TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

December 9, 2016

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Lake Stevens Sewer District Snohomish County January 1, 2015 through December 31, 2015

Board of Commissioners
Lake Stevens Sewer District
Lake Stevens, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of Lake Stevens Sewer District, Snohomish County, Washington, as of and for the year ended December 31, 2015, 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 an opinion on these financial statements based on our audit. We conducted our audit 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lake Stevens Sewer District, as of December 31, 2015, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Matters of Emphasis

As discussed in Note 1 to the financial statements, in 2015, the District adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*. Our opinion is not modified with respect to this matter.

Other Matters

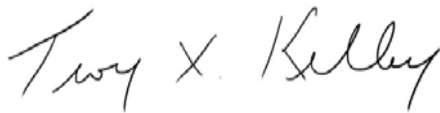
Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 10 through 12 and pension plan information on pages 28 through 31 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 December 9, 2016 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.

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

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

December 9, 2016

FINANCIAL SECTION

**Lake Stevens Sewer District
Snohomish County
January 1, 2015 through December 31, 2015**

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis – 2015

BASIC FINANCIAL STATEMENTS

Statement of Net Position – 2015

Statement of Revenues, Expenses and Changes in Net Position – 2015

Statement of Cash Flows – 2015

Notes to the Financial Statements – 2015

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Proportionate Share of the Net Pension Liability – PERS 1 – 2015

Schedule of Proportionate Share of the Net Pension Liability – PERS 2/3 – 2015

Schedule of Employer Contributions – PERS 1 – 2015

Schedule of Employer Contributions – PERS 2/3 – 2015

Lake Stevens Sewer District Management's Discussion and Analysis For the Year Ended December 31, 2015

The following discussion and analysis of the financial performance of the Lake Stevens Sewer District (the District) provides an overall review of the District's financial activities for the year ended December 31, 2015. This discussion is designed to be read in conjunction with the financial statements and notes to financial statements, which follow this section.

OVERVIEW

The District was incorporated in 1957 and operates under the laws of the State of Washington. All financial reporting is based on twelve months of operations.

In 2015, the District had a positive operating income and met all debt obligations. As of December 31, 2015, the District had a total net position of \$82,852,941.

Highlights of the 2015 year at the District:

- The District hired a new Treatment Plant Manager and Process Analyst for the Waste Water Treatment Plant (WWTP) for the purposes of increasing efficiency and relying on in-house treatment expertise versus using sporadic consultant involvement.
- Invested in \$550,000 of new equipment such as a Closed Circuit TV Camera Inspection Truck and a new Vactor Truck. This equipment will provide the District with full-service Field maintenance and inspection capability for 110 miles of underground pipe and 29 lift stations in the community.
- Re-negotiated a loan with the State Department of Ecology for \$4.9 million to finance the Bio-solids clean-up and decommissioning of the former Lake Stevens Treatment Plant site adjacent to Ebey Slough within a flood plain. Work on this project began in March 2016 and is expected to finish by December 2016.
- Created Development Extension Agreements (DEAs) for more than 300 new housing units to be constructed in Lake Stevens over the next two years.
- Over the past 18 months, completed the District's update to its Comprehensive Plan mandated by the State Growth Management Act. This draft Comp Plan and its associated 7 to 10-year financial analysis of revenues and General Facilities Charges (GFCs) will form the basis of revised policies to consider adopting during the second half of the calendar year 2016. The District's present comprehensive plan was completed in 2007 with a substantial amendment completed in 2010.

FINANCIAL STATEMENTS

This section of the management's discussion and analysis explains the purpose of the District's basic financial statements and the notes to these financial statements.

Basic Financial Statements

The financial statements of the District are designed to provide readers with a broad overview of the District's finances similar to a private-sector business. They have been prepared using the accrual basis of accounting in accordance with generally accepted accounting principles. Under this basis of accounting, revenues are recognized in the period they are earned and expenses are recognized when incurred, regardless of the timing of related cash flows. These statements offer short and long-term financial information about the District's activities.

The Statement of Net Position presents the District's assets and liabilities, with the difference between the two reported as Net Position. The Statement of Net Position provides information about the nature and amount of investments in resources (assets), and deferred outflows, and the obligations to creditors (liabilities) and deferred inflows. Net Position increases when revenues exceed expenses. The Statement of Revenues, Expenses, and Changes in Net Position reports the revenues and expenses during the periods indicated. The Statement of Cash Flows provides information about the District's cash receipts and payments for operations, as well as funds provided and used in investing and financing activities.

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to gain a full understanding of the figures provided in the financial statements.

FINANCIAL ANALYSIS**Condensed Financial**

| | Dec. 31, 2015 | Dec. 31, 2014 |
|----------------------------------------------|----------------------|----------------------|
| Current Assets | \$ 25,583,991 | \$ 25,655,092 |
| Net Capital Assets | 169,709,994 | 174,095,313 |
| Deferred Outflow of Resources | 188,233 | 12,061 |
| Total Assets | \$ 195,482,218 | \$ 199,762,466 |
| Current Liabilities | \$ 6,964,054 | \$ 6,747,990 |
| Long-Term Liabilities | 105,395,612 | 109,711,654 |
| Deferred Inflows of Resources | 269,611 | 62,703 |
| Total Liabilities | \$ 112,629,277 | \$ 116,522,347 |
| Net Investment in Capital Assets | \$ 65,200,709 | \$ 63,878,927 |
| Restricted for Debt Service & Const | 17,045,439 | 17,581,715 |
| Unrestricted | 606,793 | 1,779,477 |
| Total Net Position | \$ 82,852,941 | \$ 83,240,119 |
| Utility Operating Revenue | \$ 11,875,340 | \$ 11,248,502 |
| Non-operating Revenue | 221,391 | 159,487 |
| Total Revenue | 12,096,731 | 11,407,989 |
| Operating Expenses | 11,037,892 | 10,772,037 |
| Non-operating Expenses | 2,721,513 | 2,974,729 |
| Total Expenses | 13,759,405 | 13,746,766 |
| Excess (Deficiency) | (1,662,674) | (2,338,777) |
| Capital Contributions | 2,891,484 | 3,590,795 |
| Change in Net Position | 1,228,810 | 1,252,018 |
| Net Position – Beg of Year | 83,240,119 | 81,988,101 |
| Restatement – Change in Accounting Principle | (1,615,988) | |
| Net Position – End of Year | \$ 82,852,941 | \$ 83,240,119 |

Overview

For the twelve months ending December 31, 2015, the total assets of the District decreased by approximately \$4.3 million or approximately 2.1%, and total liabilities decreased by approximately \$3.9 million or approximately 3.3%. As a result, Net Position decreased approximately \$400,000. This consists of a 1.2 million increase in net position with an offset of a 1.6 million adjustment as a result of implementing GASB 68 Accounting and Financial Reporting for Pensions. The District's overall financial position did not change. The decreases in total assets are primarily due to the increased depreciation costs and the decreases in total liabilities are primarily due to the repayment of debt.

Operating Revenues increased approximately 5.6% as expected due to an increase in District customers during 2015 and the \$3.00 per month, per Equivalent Residential Unit (ERU) rate increase that took effect January 1, 2015. Operating Revenues are expected to increase in 2016 due to a \$3.00 per month, per ERU rate increase, that took effect on January 1, 2016, and an increase in District customers.

Operating Expenses increased only 2.5% due to the salary costs of the General Manager position and the staff operating the District more efficiently.

The District has restrictions on the use of funds which are listed on the previous page.

Capital Assets

The District had a total net Capital Asset Value of \$169,709,994 as of December 31, 2015. This was a decrease of approximately \$4.4 million and is due to the increased STP#2 depreciation expense. Capital Assets consisted of \$1,644,246 in assets not being depreciated including land, and construction in process; \$207,794,194 in depreciable assets with a total accumulated depreciation of \$39,728,446 for a net value of depreciable assets of \$169,709,994.

Please refer to Note 4 to the Financial Statements for more information.

Long-Term Debts

During the year, the District decreased its long-term debt by \$5,707,101, leaving a balance of \$104,509,285, including current portion of long-term debt.

Please refer to Note 5 to the Financial Statements for more information.

REQUESTS FOR INFORMATION

The District's financial statements, notes and management discussion and analysis are designed to provide a general overview of the District's finances. Questions concerning any of the information presented in this report should be directed to the District at:

Lake Stevens Sewer District
1106 Vernon Rd #A
Lake Stevens, WA 98258
(425) 334-8588

MGAG No. 2176
LAKE STEVENS SEWER DISTRICT
STATEMENT OF NET POSITION
DECEMBER 31, 2015

Assets

Current Assets:

| | |
|--------------------------------------|-------------------|
| Cash and Cash Equivalents | \$ 7,980,061 |
| Restricted Cash and Cash Equivalents | 17,045,439 |
| Receivables, net | 368,900 |
| Assessments Receivable | 52,449 |
| Prepayments | 137,142 |
| Total Current Assets | <u>25,583,991</u> |

Noncurrent Assets:

| | |
|--------------------------------------|--------------------|
| Capital Assets Not Being Depreciated | |
| Land | 1,290,722 |
| Construction Works in Progress | 353,524 |
| Capital Assets Being Depreciated | |
| Plant and Buildings | 179,963,745 |
| Machinery, Equipment and Furniture | 27,830,449 |
| | <u>209,438,440</u> |
| Less accumulated depreciation | (39,728,446) |
| Total Noncurrent Assets | <u>169,709,994</u> |
| Total Assets | <u>195,293,985</u> |

Deferred Outflows of Resources

| | |
|----------------------------------------------------------|----------------|
| Deferred Outflows of Resources Related to Bond Refunding | 10,287 |
| Deferred Outflows of Resources Related to Pension | 177,946 |
| Total Deferred Outflows of Resources | <u>188,233</u> |

| | |
|------------------------------------|-----------------------|
| Total Assets and Deferred Outflows | <u>\$ 195,482,218</u> |
|------------------------------------|-----------------------|

Liabilities

Current Liabilities:

| | |
|---------------------------------------------------|------------------|
| Accounts Payable | \$ 662,010 |
| Compensated Absences | 104,438 |
| Developer Extension Deposits | 82,800 |
| Interest Accrued | 379,682 |
| Current Portion of Bonds, Notes and Loans Payable | 5,735,124 |
| Total Current Liabilities | <u>6,964,054</u> |

Noncurrent Liabilities:

| | |
|--------------------------------------------------------|--------------------|
| Bonds, Notes and Loans Payable, net of current portion | 98,774,161 |
| Accrued STP #1 Remediation Costs | 5,092,667 |
| Net Pension Liability | 1,528,784 |
| Total Noncurrent Liabilities | <u>105,395,612</u> |

| | |
|-------------------|--------------------|
| Total Liabilities | <u>112,359,666</u> |
|-------------------|--------------------|

Deferred Inflows of Resources

| | |
|---------------------------------------------------------|----------------|
| Deferred Inflows of Resources Related to Bond Refunding | 33,882 |
| Deferred Inflows of Resources Related to Pension | 235,729 |
| Total Deferred Inflows of Resources | <u>269,611</u> |

| | |
|----------------------------------------|--------------------|
| Total Liabilities and Deferred Inflows | <u>112,629,277</u> |
|----------------------------------------|--------------------|

Net Position

| | |
|--------------------------------------------|-------------------|
| Net Investment in Capital Assets | 65,200,709 |
| Restricted for Debt Service & Construction | 17,045,439 |
| Unrestricted | 606,793 |
| Total Net Position | <u>82,852,941</u> |

| | |
|------------------------------------|-----------------------|
| Total Liabilities and Net Position | <u>\$ 195,482,218</u> |
|------------------------------------|-----------------------|

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

MGAG No. 2176
LAKE STEVENS SEWER DISTRICT
STATEMENT OF REVENUE, EXPENSES & CHANGES IN
NET POSITION
FOR YEAR ENDED DECEMBER 31, 2015

| | |
|-------------------------------------------------------|-----------------------------|
| Operating Revenue | |
| Utility Revenue | \$ 11,875,340 |
| Total Operating Revenue | <u>11,875,340</u> |
| Operating Expenses: | |
| General Operations | 3,735,565 |
| Maintenance Expense | 571,643 |
| Depreciation Expense | 6,274,899 |
| Taxes | 455,785 |
| Total Operating Expenses | <u>11,037,892</u> |
| Operating Income (Loss) | <u>837,448</u> |
| Nonoperating Revenues (Expenses): | |
| Interest Revenue | 146,407 |
| Interest on Long-Term Debt | (2,694,466) |
| Gain (Loss) on Capital Asset Disposition | 27,743 |
| Net Rental Income | 20,194 |
| Total Nonoperating Revenues (Expenses) | <u>(2,500,122)</u> |
| Income (Loss) Before Capital Contributions | <u>(1,662,674)</u> |
| Capital Contributions: | |
| Developer Donated Facility | 1,343,170 |
| Connection Fees | 1,548,314 |
| Total Capital Contributions | <u>2,891,484</u> |
| Change in Net Position | 1,228,810 |
| Total Net Position, January 1, 2015 - Restated | <u>81,624,131</u> |
| Total Net Position, December 31, 2015 | <u><u>\$ 82,852,941</u></u> |

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

MGAG No. 2176
LAKE STEVENS SEWER DISTRICT
STATEMENT OF CASH FLOWS
FOR YEAR ENDED DECEMBER 31, 2015

Cash Flows from Operating Activities:

| | |
|-------------------------------------------|------------------|
| Receipts from customers | \$ 11,892,174 |
| Payments to suppliers | (2,836,281) |
| Payments to employees | (1,884,091) |
| Net Cash Provided by Operating Activities | <u>7,171,802</u> |

Cash Flows from Capital and Related Financing Activities:

| | |
|-----------------------------------------------------------|--------------------|
| Capital contributions - Connection fees | 1,548,314 |
| Cash purchase of capital assets | (412,979) |
| Principal paid on long-term debt | (5,707,101) |
| Interest paid on long-term debt | (2,880,268) |
| Principal received on ULID assessments | 12,422 |
| Interest received on ULID assessments | 3,067 |
| Net Cash Provided (Used) for Capital Financing Activities | <u>(7,436,545)</u> |

Cash Flows from Investing Activities:

| | |
|--------------------------------------------------|----------------|
| Interest received on investments | 143,340 |
| Proceeds from sale of equipment | 27,743 |
| Net rental income | 20,194 |
| Net Cash Provided (Used) by Investing Activities | <u>191,277</u> |

Net Increase (Decrease) in Cash and Cash Equivalents (73,466)

Cash and Cash Equivalents at January 1, 2015 25,098,966

Cash and Cash Equivalents at December 31, 2015 \$ 25,025,500

Reconciliation of Operating Income to Net Cash provided by Operating Activities:

| | |
|-----------------------------------------------------------------------------------------|------------|
| Operating Income (Loss) | \$ 837,448 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | |
| Depreciation | 6,274,899 |
| Non-Cash Actuarial Pension Adjustment | (29,421) |
| Changes in assets and liabilities: | |
| Decrease (Increase) in accounts receivable | 17,534 |
| Decrease (Increase) in prepayments | (32,007) |
| Increase (Decrease) in operating accounts payable | 244,565 |
| Increase (Decrease) in other current/accrued liabilities | (107,334) |
| Increase (Decrease) in compensated absences | (33,182) |
| Increase (Decrease) in developer deposits | (700) |

Net Cash Provided by Operating Activities \$ 7,171,802

Noncash Investing, Capital, and Financing Activities:

| | |
|----------------------------|--------------|
| Developer donated facility | \$ 1,343,170 |
|----------------------------|--------------|

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

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2015**

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Lake Stevens Sewer District conform to generally accepted accounting principles (GAAP) as applicable to proprietary funds of governments. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. 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 / Nature of Business

The Lake Stevens Sewer District is a municipal corporation governed by a three-member board elected by the voters located in the service area of the Lake Stevens Sewer District. The District provides a sewage system for collection, transportation and treatment of sanitary sewage for the unincorporated area around Lake Stevens, WA and for the City of Lake Stevens. As required by generally accepted accounting principles, management has considered all potential component units in defining the reporting entity. The Lake Stevens Sewer 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 RCW.

The District uses the full accrual basis of accounting where revenues are recognized when earned and expenses are recognized when incurred. Capital asset purchases are capitalized and long-term liabilities are accounted for in the appropriate funds. All activities of the District are accounted for within a single proprietary fund.

The District distinguishes between operating revenues and expenses from non-operating ones. Operating revenues and expenses result from providing services, producing and delivering goods in connection with the District's principal ongoing operations. The principal operating revenues of the district are charges to customers for wastewater treatment. Operating expenses for the District include the cost of maintenance & operations, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

c. Pensions

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.

Effective December 31, 2015, the District implemented Governmental Accounting Standard Series (GASB) Statement No. 68 Accounting and Financial Reporting for Pensions. The District did not adjust the 2014 financial statements, instead the District adjusted the Total Net Position, January 1, 2015.

| | |
|-------------------------------------------------------------|-----------------------------|
| Total Net Position, December 31, 2014 | \$ 83,240,119 |
| Restatement-Change in Accounting Principle, January 1, 2015 | <u>(1,615,988)</u> |
| Total Net Position, January 1, 2015 | <u><u>\$ 81,624,131</u></u> |

All utility services are billed monthly and recorded as revenues.

d. Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the District considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2015**

e. Utility Plant and Depreciation

Utility plant in service and other capital assets are recorded at cost. Donations by developers and customers are recorded at actual construction cost plus engineer estimated allied cost; and depreciated over the appropriate life of the assets.

The original cost of operating property retired, sold, or otherwise disposed of is removed from the utility plant accounts, accumulated depreciation is charged with the accumulated depreciation related to the property sold, and the net gain or loss on disposition is credited or charged to income.

Depreciation is computed on the straight-line method with useful lives of five to fifty years.

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

Please see Note 4.

f. Restricted Cash

In accordance with bond resolutions, (and certain related agreements) separate restricted cash accounts are required to be established. The assets held in these accounts are restricted for specific uses, including construction, debt service, and other special reserve requirements. Restricted accounts at December 31, 2015 include the following:

| | <u>2015</u> |
|-----------------------------|----------------------|
| Bond/Loan Reserve Funds: \$ | 5,299,050 |
| Construction Funds: | 814,509 |
| Debt Service Funds: | <u>10,931,880</u> |
| | <u>\$ 17,045,439</u> |

g. Receivables

Uncollectible accounts are written off to expense; however, few accounts are uncollectible because of the lien and foreclosures rights provided by the Revised Codes of Washington (RCW). Chapters 56.16.100/110 provide that the payment of delinquent charges for service may be enforced by establishing a lien against the property for which the charge is delinquent. If a lien is established against the property in question, such lien would be superior to all other liens except those established for the payment of general taxes and special assessments. Foreclosure rights are by civil action in the Snohomish County Superior Court.

h. Investments

All investments of the District are in the form of time certificates of deposit, U.S. Government Securities, State Treasurer's Investment Pool, and County Treasurer's Investment Pool pursuant to the requirements of Chapter 39.58 RCW. Investments are stated at cost. Interest income is accrued at year-end. As a general policy, investments are held until maturity.

i. Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation pay, holiday pay, comp time, and sick leave. The District accrues unpaid compensated absences as an expense and liability when incurred. The Lake Stevens Sewer District Board of Commissioners adopted Resolution #827 on 1/28/2011, stating that upon termination, 100% of the employee's accrued sick leave is paid out to their VEBA account, previously only 50% of the employee's accrued sick leave was paid out to their VEBA account. Vacation pay, which may be accumulated up to 240 hours; comp time, which may be accumulated up to 40 hours; and holiday pay, which may be accumulated up to 8 hours; are payable upon termination, resignation, retirement or death. The total liability for compensated absences at December 31, 2015 was \$104,438.

j. Accumulated Amortization Debt Discount and Expense

The District implemented GASB 65, Items Previously Reported as Assets and Liabilities. This standard states in part, "Debt issuance costs, except any portion related to prepaid insurance costs, should be recognized as an expense in the period incurred."

k. Deferred Inflows and Outflows

The December 31, 2015 deferred outflows are as follows:

| | |
|---------------------------------------------------|-------------------|
| Debt Discount & Expense | \$ 21,733 |
| Accumulated Amortized Debt Discount & Expense | (11,446) |
| Deferred Outflows of Resources Related to Pension | <u>177,946</u> |
| | <u>\$ 188,233</u> |

The December 31, 2015 deferred inflows are as follows:

| | |
|------------------------------------|-------------------|
| Debt Premium | \$ 180,517 |
| Accumulated Amortized Debt Premium | (146,635) |
| Deferred Pension | <u>235,729</u> |
| | <u>\$ 269,611</u> |

l. Construction contract and financing

In 2014 the District applied for and was approved for a Department of Ecology, State Revolving Fund Loan, in the amount of \$4,025,000, to Decommission Former LSSD WWTP Site: Phase 2A, Biosolids Removal. The loan agreement was signed by Department of Ecology on 3/13/2015. The District went out to bid for the project in June of 2015 and awarded the project to Merrell Bros, Inc. Worked on the project started in March of 2016.

NOTE 2: DEPOSITS AND INVESTMENTS

The District's deposits and certificates of deposits are 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). The District's cash funds and investments are processed or maintained by the Snohomish County Treasurer's Department in the name of the District. Snohomish County has all District deposits and investments in local banks short-term certificates of deposit, the County Treasurer's Investment Pool, or in the State of Washington Treasurer's Investment pool. As of December 31, 2015 the credit rating for the District's investment in the State Pool and County Pool were not available.

As of December 31, 2015 the District had the following deposits and investments:

| | Balance 12/31/2015 |
|---------------------------------|-----------------------|
| Checking and Cash Accounts | \$ 746,479 |
| County Treasury Investment Pool | 18,489,538 |
| State Treasury Investment Pool | <u>5,789,483</u> |
| Total Deposits and Investments | <u>\$ 25,025,500</u> |

Deposits and investments are stated at cost, which approximates fair value, on the statement of net position.

NOTE 3: CONSTRUCTION IN PROGRESS

Construction in progress is composed of the following at December 31, 2015:

| <u>Project Name</u> | <u>Project Authorization</u> | <u>Expended 12/31/2015</u> | <u>Committed</u> | <u>Required Future Financing</u> |
|--------------------------------|----------------------------------|--------------------------------|---------------------|------------------------------------------|
| Miscellaneous Capital Projects | \$ 406,418 | \$ 9,674 | \$ 396,744 | \$ None |
| LS 17 Force Main | 630,000 | 0 | 630,000 | None |
| Downtown Regional Lift Station | 40,000 | 26,773 | 13,227 | None |
| Comprehensive Plan | 416,650 | 317,077 | 99,573 | None |
| Capital Computer Systems | 30,324 | 0 | 30,324 | None |
| | <u>\$ 1,523,392</u> | <u>\$ 353,524</u> | <u>\$ 1,169,868</u> | <u>\$ None</u> |

NOTE 4: 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 of five years or more.

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

Utility plant in service and other capital assets are recorded at cost. Donations by developers and customers are recorded at actual construction cost plus engineer estimated allied cost; and depreciated over the appropriate life of the assets.

Utility plant activity for the year ended December 31, 2015 was as follows:

| | <u>Balance 1/1/2015</u> | <u>Increase</u> | <u>Decrease</u> | <u>Balance 12/31/2015</u> |
|-------------------------------------|-----------------------------|---------------------|-----------------------|-------------------------------|
| Utility plant not being depreciated | | | | |
| Land | \$ 1,290,722 | \$ 0 | \$ 0 | \$ 1,290,722 |
| Construction in progress | <u>1,338,830</u> | <u>653,742</u> | <u>(1,639,048)</u> | <u>353,524</u> |
| Total plant not being depreciated | 2,629,552 | 653,742 | (1,639,048) | 1,644,246 |
| Utility plant being depreciated | | | | |
| Plant in service | 176,726,152 | 2,471,618 | (2,687) | 179,195,083 |
| Buildings | 768,662 | 0 | 0 | 768,662 |
| Machinery, equipment & furniture | <u>27,487,076</u> | <u>403,268</u> | <u>(59,895)</u> | <u>27,830,449</u> |
| Total plant being depreciated | 204,981,890 | 2,874,886 | (62,582) | 207,794,194 |
| Plant in service | (28,175,182) | 2,687 | (4,408,791) | (32,581,286) |
| Buildings | (209,926) | 0 | (18,345) | (228,271) |
| Machinery, equipment & furniture | <u>(5,131,021)</u> | <u>59,895</u> | <u>(1,847,763)</u> | <u>(6,918,889)</u> |
| Total accumulated depreciation | <u>(33,516,129)</u> | <u>62,582</u> | <u>(6,274,899)</u> | <u>(39,728,446)</u> |
| Total plant being depreciated, net | 171,465,761 | 2,937,468 | (6,337,481) | 168,065,748 |
| Total utility plant, net | <u>\$ 174,095,313</u> | <u>\$ 3,591,210</u> | <u>\$ (7,976,529)</u> | <u>\$ 169,709,994</u> |

Capital assets are depreciated over the straight-line method over the following estimated lives:

| <u>Assets</u> | <u>Years</u> |
|-----------------------|--------------|
| Buildings | 20-50 |
| Building Improvements | 20-50 |
| Vehicles | 5-7 |
| Equipment | 5-20 |
| Utility Plant | 5-50 |

NOTE 5: LONG-TERM DEBT

As security for Sewer Revenue Bonds and Debt, the District is required to maintain a reserve account and pledge gross revenue less operation and maintenance expenses for payment of these debts. The revenue debt reserve at December 31, 2015 was \$5,299,050.

Construction loan (PWTF & SRF) agreements require that borrowed funds be used for the construction of designated construction projects.

The VBC / Office Building mortgage is secured by the administrative building used by the District.

There are a number of other limitations and restrictions contained in the various debt indentures. The District is in compliance with all significant limitations and restrictions.

General obligation debt currently outstanding are as follows:

| Description / Purpose | Maturity Range | Interest Rate | Original Amount | 12/31/2015 Balance | Current Portion |
|-----------------------|----------------|---------------|---------------------|---------------------|-------------------|
| 2008 City GO Bonds | 2008-2022 | 3% - 4% | \$ 1,508,553 | \$ 815,677 | \$ 100,268 |
| VBC / Office Bldg | 2002-2021 | 4.50% | 700,000 | 245,325 | 50,924 |
| | | | <u>\$ 2,208,553</u> | <u>\$ 1,061,002</u> | <u>\$ 151,192</u> |

Revenue debt currently outstanding are as follows:

| Description / Purpose | Maturity Range | Interest Rate | Original Amount | 12/31/2015 Balance | Current Portion |
|-------------------------------|----------------|---------------|-----------------------|-----------------------|---------------------|
| 2010A Bonds / STP2 | 2011-2039 | 4.2 % - 7.0% | \$ 30,595,000 | \$ 30,595,000 | \$ 0 |
| 2010B Bonds / STP2 | 2011-2016 | 2% - 3% | 4,520,000 | 905,000 | 905,000 |
| PWTF Loan / STP1 Design | 1999-2018 | 1.00% | 236,250 | 51,200 | 17,067 |
| PWTF Loan / STP1 Const | 2001-2020 | 1.00% | 3,288,600 | 800,303 | 160,060 |
| PWTF Loan / City 2002 Cap Imp | 2003-2022 | 0.50% | 1,608,255 | 599,838 | 85,691 |
| PWTF Loan / Lundeen Bypass | 2003-2022 | 0.50% | 4,083,400 | 1,518,514 | 216,931 |
| PWTF Loan / STP2 Design | 2006-2025 | 0.50% | 1,000,000 | 526,316 | 52,632 |
| PWTF Loan / City STP2 Design | 2006-2025 | 0.50% | 1,000,000 | 526,316 | 52,632 |
| PWTF Loan / STP2 Design | 2006-2025 | 2.00% | 1,000,000 | 533,626 | 53,362 |
| PWTF Loan / STP2 Design | 2009-2028 | 0.50% | 1,000,000 | 684,211 | 52,632 |
| PWTF Loan / STP2 Const | 2007-2026 | 0.50% | 7,000,000 | 4,740,062 | 395,005 |
| PWTF Loan / City STP2 Const | 2008-2027 | 0.50% | 7,000,000 | 4,504,934 | 409,539 |
| PWTF Loan / City STP2 Const | 2009-2028 | 0.50% | 10,000,000 | 7,191,338 | 553,180 |
| PWTF Loan / STP2 Const | 2009-2028 | 0.50% | 10,000,000 | 7,191,338 | 553,180 |
| SRF Loan / STP2 Const | 2013-2032 | 3.10% | 13,969,445 | 13,802,830 | 651,006 |
| SRF Loan / STP2 Const | 2013-2032 | 2.70% | 25,970,567 | 24,523,249 | 1,196,067 |
| SRF Loan / STP2 Const | 2013-2032 | 2.80% | 5,262,417 | 4,754,208 | 229,948 |
| | | | <u>\$ 127,533,934</u> | <u>\$ 103,448,283</u> | <u>\$ 5,583,932</u> |
| | | | <u>\$ 129,742,487</u> | <u>\$ 104,509,285</u> | <u>\$ 5,735,124</u> |

The annual debt service requirements for general obligation and revenue debts at 12/31/15, are as follows:

| Ending December | General Obligation Debt | | Revenue Debt | | Total Debt | |
|--------------------|-------------------------|------------|----------------|---------------|----------------|---------------|
| | Principle | Interest | Principle | Interest | Principle | Interest |
| 2016 \$ | 151,192 | 43,528 | 5,583,932 | 3,375,653 | 5,735,124 | 3,419,181 |
| 2017 | 159,703 | 36,397 | 5,588,621 | 3,274,130 | 5,748,324 | 3,310,527 |
| 2018 | 171,789 | 29,687 | 5,675,032 | 3,162,570 | 5,846,821 | 3,192,257 |
| 2019 | 174,399 | 22,478 | 5,746,148 | 3,046,291 | 5,920,547 | 3,068,769 |
| 2020 | 143,919 | 15,523 | 5,841,156 | 2,923,201 | 5,985,075 | 2,938,724 |
| 2021-2025 | 260,000 | 15,600 | 29,075,341 | 12,536,755 | 29,335,341 | 12,552,355 |
| 2026-2030 | 0 | 0 | 25,621,845 | 8,586,338 | 25,621,845 | 8,586,338 |
| 2031-2035 | 0 | 0 | 12,656,208 | 4,494,917 | 12,656,208 | 4,494,917 |
| 2036-2040 | 0 | 0 | 7,660,000 | 1,363,203 | 7,660,000 | 1,363,203 |
| Totals | \$ 1,061,002 | \$ 163,213 | \$ 103,448,283 | \$ 42,763,058 | \$ 104,509,285 | \$ 42,926,271 |

NOTE 6: CHANGES IN LONG-TERM LIABILITIES

During the year ended December 31, 2015, the following changes occurred in long-term liabilities:

| | Balance 1/1/2015 | Additions | Reductions | Balance 12/31/2015 | Due Within One Year |
|-------------------------|---------------------|------------|--------------|-----------------------|------------------------|
| City 2008 GO Bonds | \$ 910,798 | \$ 0 | \$ 95,121 | \$ 815,677 | \$ 100,268 |
| Revenue Bonds | 1,785,000 | 0 | 880,000 | 905,000 | 905,000 |
| Build America Bonds | 30,595,000 | 0 | 0 | 30,595,000 | 0 |
| State Revolving Fund | 45,099,295 | 0 | 2,019,006 | 43,080,289 | 2,077,021 |
| City Public Works Trust | 13,923,468 | 0 | 1,101,042 | 12,822,426 | 1,101,042 |
| Public Works Trust | 17,607,677 | 0 | 1,562,109 | 16,045,568 | 1,500,869 |
| Vernon Business Center | 295,148 | 0 | 49,823 | 245,325 | 50,924 |
| Net Pension Liability | 1,176,577 | 352,207 | | 1,528,784 | |
| | \$ 111,392,963 | \$ 352,207 | \$ 5,707,101 | \$ 106,038,069 | \$ 5,735,124 |

NOTE 7: PENSION PLAN

On October 9, 2003, the District's Board of Commissioners passed a resolution authorizing and approving participation in the Washington Public Employees Retirement System (PERS). Membership in PERS commenced on January 1, 2004.

Substantially all Lake Stevens Sewer 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 retirement plans. 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 98504-8380; or it may be downloaded from the DRS website at www.drs.wa.gov.

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 2015:

| Aggregate Pension Amounts – All Plans | |
|---------------------------------------|-------------|
| Pension liabilities | \$8,620,986 |
| Deferred outflows of resources | \$ 177,946 |
| Deferred inflows of resources | \$ 235,729 |
| Pension expenses | \$ 141,950 |

State Sponsored Pension Plans

Substantially all Lake Stevens Sewer District'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, 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

Or the DRS CAFR may be downloaded from the DRS website at www.drs.wa.gov.

Public Employees' Retirement Systems (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 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 2015 were as follows:

| PERS Plan 1 | | |
|-----------------------------------|-----------------|-----------------|
| Actual Contribution Rates: | Employer | Employee |
| January through June 2015 | 9.21% | 6.00% |
| July through December 2015 | 11.18% | 6.00% |

The Lake Stevens Sewer District's actual contributions to the plan were \$74,823 for the year ended December 31, 2015.

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.

Contributions

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

| PERS Plan 2/3 | | |
|-----------------------------------|---------------------|-------------------|
| Actual Contribution Rates: | Employer 2/3 | Employee 2 |
| January through June 2015 | 9.21% | 4.92% |
| July through December 2015 | 11.18% | 6.12% |
| Employee PERS Plan 3 | | varies |

The Lake Stevens Sewer District's actual contributions to the plan were \$96,027 for the year ended December 31, 2015.

Actuarial Assumptions

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

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

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

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

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

- The OSA updated demographic assumptions, consistent with the changes from the *2007-2012 Experience Study Report*, used when valuing the PERS 1 and TERS 1 Basic Minimum COLA.
- The OSA corrected how valuation software calculates a member's entry age under the entry age normal actuarial cost method. Previously, the funding age was rounded, resulting in an entry age one year higher in some cases.

- For purposes of calculating the Plan 2/3 Entry Age Normal Cost contribution rates, the OSA now uses the current blend of Plan 2 and Plan 3 salaries rather than using a long-term membership assumption of two-thirds Plan 2 members and one-third Plan 3 members.
- The OSA changed the way it applies salary limits, as described in the *2007-2012 Experience Study Report*.

Discount Rate

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

To determine that rate, an asset sufficiency test included an assumed 7.7 percent long-term discount rate to determine funding liabilities for calculating future contribution rate requirements. (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. The Washington State Investment Board (WSIB) used a best estimate of expected future rates of return (expected returns, net of pension plan investment expense, including inflation) to develop each major asset class. Those expected returns make up one component of WSIB's capital market assumptions. The WSIB uses the capital market assumptions and their target asset allocation to simulate future investment returns at various future times. The long-term expected rate of return of 7.5 percent approximately equals the median of the simulated investment returns over a 50-year time horizon.

Estimated Rates of Return by Asset Class

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

| Asset Class | Target Allocation | % Long-Term Expected Real Rate of Return Arithmetic |
|-----------------|-------------------|-----------------------------------------------------|
| Fixed Income | 20% | 1.70% |
| Tangible Assets | 5% | 4.40% |
| Real Estate | 15% | 5.80% |
| Global Equity | 37% | 6.60% |
| Private Equity | 23% | 9.60% |
| | 100% | |

Sensitivity of NPL

The table below presents the Lake Stevens Sewer District's proportionate share* of the net pension liability calculated using the discount rate of 7.5 percent, as well as what the Lake Stevens Sewer 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.

| | 1% Decrease (6.5%) | Current Discount Rate (7.5%) | 1% Increase (8.5%) |
|----------|--------------------|------------------------------|--------------------|
| PERS 1 | \$988,864 | \$812,207 | \$660,298 |
| PERS 2/3 | \$2,095,307 | \$716,577 | (\$339,066) |

Pension Plan Fiduciary Net Position

Detailed information about the State's pension plans' fiduciary net position is available in the separately issued DRS financial report.

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

At June 30, 2015, the Lake Stevens Sewer District reported a total pension liability of \$1,528,784 for its proportionate share of the net pension liabilities as follows:

| | Liability (or Asset) |
|----------|----------------------|
| PERS 1 | \$812,207 |
| PERS 2/3 | \$716,577 |
| | |

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

| | Proportionate Share 6/30/14 | Proportionate Share 6/30/15 | Change in Proportion |
|----------|-----------------------------|-----------------------------|----------------------|
| PERS 1 | % 0.015400 | % 0.015527 | % 0.000127 |
| PERS 2/3 | % 0.019828 | % 0.020055 | % 0.000227 |
| | | | |

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

Pension Expense

For the year ended December 31, 2015, the Lake Stevens Sewer District recognized pension expense as follows:

| | Pension Expense |
|----------|-----------------|
| PERS 1 | \$ 62,166 |
| PERS 2/3 | \$ 79,784 |
| TOTAL | \$141,950 |

Deferred Outflows of Resources and Deferred Inflows of Resources

At December 31, 2015, the Lake Stevens Sewer 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 | | \$44,437 |
| Changes of assumptions | | |
| Changes in proportion and differences between contributions and proportionate share of contributions | | |
| Contributions subsequent to the measurement date | \$40,477 | |
| TOTAL | \$40,477 | \$44,437 |

| PERS 2/3 | Deferred Outflows of Resources | Deferred Inflows of Resources |
|------------------------------------------------------------------------------------------------------|-------------------------------------------|------------------------------------------|
| Differences between expected and actual experience | \$ 76,172 | |
| Net difference between projected and actual investment earnings on pension plan investments | 3,759 | \$191,292 |
| Changes of assumptions | 1,155 | |
| Changes in proportion and differences between contributions and proportionate share of contributions | 3,545 | |
| Contributions subsequent to the measurement date | 52,838 | |
| TOTAL | \$137,469 | \$191,292 |

| | | |
|----------------------------------------|------------------|------------------|
| Grand Total PERS 1 and PERS 2/3 | \$177,946 | \$235,729 |
|----------------------------------------|------------------|------------------|

Deferred outflows of resources related to pensions resulting from the Lake Stevens Sewer 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, 2016. 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 1 |
|------------------------------------|---------------|
| 2016 | \$0.00 |
| 2017 | \$0.00 |
| 2018 | \$0.00 |
| 2019 | \$0.00 |
| 2020 | \$0.00 |
| Thereafter | \$0.00 |

| Year ended December 31: | PERS 2/3 |
|------------------------------------|-----------------|
| 2016 | \$2,148 |
| 2017 | \$2,148 |
| 2018 | \$2,148 |
| 2019 | \$ 860 |
| 2020 | \$ 0 |
| Thereafter | \$ 0 |

NOTE 8: RISK MANAGEMENT

In August of 2014, the Lake Stevens Sewer District changed to Travelers for its insurance coverage. There was a significant premium savings with Travelers over Enduris, so the District chose not to renew their membership in the Enduris Insurance Risk Pool.

Travelers Insurance is the market leader in public entity property and liability insurance. Since 1991, Travelers Insurance Public Sector Services business group has been dedicated exclusively to addressing the needs of local governments.

The Travelers Insurance policy provides liability coverage of \$1,000,000, per occurrence, \$2,000,000 aggregate limit. The Property coverage is written on a blanket basis using current Statement of Values with a \$1,000 deductible.

Insurance coverage exceeded settlements paid in the years ended December 31, 2015, 2014 and 2013.

NOTE 9: CITY OF LAKE STEVENS AGREEMENT

The City of Lake Stevens and the Lake Stevens Sewer District entered into a Unified Sewer Services and Annexation Agreement on the 23rd day of May, 2005 that was subsequently implemented January 1, 2006. This agreement called for a transfer of the City System to the District after which the District shall own, operate and maintain the entire wastewater collection conveyance, treatment and discharge system in the UGA (the Urban Growth Area). The agreement also provides for the ultimate transfer of the Unified Sewer System from the District to the City.

As part of this agreement, the District agreed to transfer to the City all funds necessary for the Public Work Trust Fund Loan No. PW-02-691-029 and the City Sewer utility's share of the 1997 General Obligation Bonds. The City has refunded these bonds with the City 2008 GO Bonds.

The agreement also calls for certain payments from the District for a Franchise Fee and a Utility Agreement Fee for the City liabilities or costs associated with the implementation and maintenance of the Agreement. As of the preparation of these financial statements, the District has not yet been charged a Franchise Fee, and the Utility Agreement Fee amounted to \$77,040 for the year ended December 31, 2015.

The effect of the transfer of assets and obligations are as follows:

| | | |
|--------------------------------------|----|--------------------|
| City - Utility Plant in Service | \$ | 12,192,905 |
| City - Sewer Equipment | | 139,000 |
| Less Accumulated Depreciation | | (2,885,908) |
| Cash from City Sewer Reserve Funds | | 808,218 |
| Assumption of City 2002 Cap Imp Debt | | (1,456,750) |
| Assumption of City 1997 GO Bonds | | <u>(1,545,000)</u> |
| | \$ | <u>7,252,465</u> |

Lake Stevens Sewer District
Schedule of Proportionate Share of the Net Pension Liability
PERS 1
As of June 30
Last 10 Fiscal Years*

| | 2015 | 20XX | 20XX | 20XX | 20XX | 20XX | 20XX | 20XX | 20XX |
|---------------------------------------------------------------------------------------------------------|------|-----------|------|------|------|------|------|------|------|
| Employer's proportion of the net pension liability (asset) | % | 0.015527 | | | | | | | |
| Employer's proportionate share of the net pension liability | \$ | 812,207 | | | | | | | |
| Employer's covered employee payroll | \$ | 1,709,572 | | | | | | | |
| Employer's proportionate share of the net pension liability as a percentage of covered employee payroll | % | 49.9800 | | | | | | | |
| Plan fiduciary net position as a percentage of the total pension liability | % | 59.1000 | | | | | | | |

* Until a full 10-year trend is compiled, governments should present information only for those years for which information is available.

Lake Stevens Sewer District
Schedule of Proportionate Share of the Net Pension Liability
PERS 2/3
As of June 30
Last 10 Fiscal Years*

| | 2015 | 20XX | 20XX | 20XX | 20XX | 20XX | 20XX | 20XX | 20XX |
|---------------------------------------------------------------------------------------------------------|------|-----------|------|------|------|------|------|------|------|
| Employer's proportion of the net pension liability (asset) | % | 0.020055 | | | | | | | |
| Employer's proportionate share of the net pension liability | \$ | 716,577 | | | | | | | |
| Employer's covered employee payroll | \$ | 1,709,572 | | | | | | | |
| Employer's proportionate share of the net pension liability as a percentage of covered employee payroll | % | 44.1000 | | | | | | | |
| Plan fiduciary net position as a percentage of the total pension liability | % | 89.2000 | | | | | | | |

* Until a full 10-year trend is compiled, governments should present information only for those years for which information is available.

Lake Stevens Sewer District
Schedule of Employer Contributions
PERS 1

As of December 31, 2015
Last 10 Fiscal Years*

| | 2015 | 2014 | 2013 | 20XX | 20XX | 20XX | 20XX | 20XX | 20XX |
|--------------------------------------------------------------------------------------|--------------|-----------|-----------|------|------|------|------|------|------|
| Statutorily or contractually required contributions | \$ 74,823 | 72,116 | 56,032 | | | | | | |
| Contributions in relation to the statutorily or contractually required contributions | \$ (74,823) | (72,116) | (56,032) | | | | | | |
| Contribution deficiency (excess) | \$ 0 | 0 | 0 | | | | | | |
| Covered employer payroll | \$ 1,709,572 | 1,788,182 | 1,778,324 | | | | | | |
| Contributions as a percentage of covered employee payroll | % 4.38% | 4.03% | 3.15% | | | | | | |

* Until a full 10-year trend is compiled, governments should present information only for those years for which information is available.

Lake Stevens Sewer District
Schedule of Employer Contributions
PERS 2/3
As of December 31, 2015
Last 10 Fiscal Years*

| | 2015 | 2014 | 2013 | 20XX | 20XX | 20XX | 20XX | 20XX | 20XX |
|--------------------------------------------------------------------------------------|--------------|-----------|-----------|------|------|------|------|------|------|
| Statutorily or contractually required contributions | \$ 99,105 | 92,548 | 88,633 | | | | | | |
| Contributions in relation to the statutorily or contractually required contributions | \$ (99,105) | (92,548) | (88,633) | | | | | | |
| Contribution deficiency (excess) | \$ 0 | 0 | 0 | | | | | | |
| Covered employer payroll | \$ 1,709,572 | 1,788,182 | 1,778,324 | | | | | | |
| Contributions as a percentage of covered employee payroll | % 5.80% | 5.18% | 4.98% | | | | | | |

* Until a full 10-year trend is compiled, governments should present information only for those years for 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 |