



**Office of the Washington State Auditor**  
**Pat McCarthy**

**Financial Statements Audit Report**  
**Alderwood Water and Wastewater**  
**District**

**For the period January 1, 2018 through December 31, 2018**

**Published December 19, 2019**

**Report No. 1025262**





**Office of the Washington State Auditor  
Pat McCarthy**

December 19, 2019

Board of Commissioners  
Alderwood Water and Wastewater District  
Lynnwood, Washington

**Report on Financial Statements**

Please find attached our report on the Alderwood Water and Wastewater District's financial statements.

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

Sincerely,

Pat McCarthy  
State Auditor  
Olympia, WA

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## SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

### Alderwood Water and Wastewater District January 1, 2018 through December 31, 2018

This schedule presents the status of findings reported in prior audit periods.

<b>Audit Period:</b> 2017	<b>Report Ref. No.:</b> 1022085	<b>Finding Ref. No.:</b> 2017-001
<b>Finding Caption:</b> Internal controls over accounting and financial reporting were inadequate to ensure proper valuation and reporting of developer contributions.		
<b>Background:</b> We evaluated the District's internal controls over developer contributions and found that the District did not have written policies or procedures for this process. The District continued to rely on one staff member to enter amounts for developer contributions into an Access database. There was no secondary review of the data to ensure it was entered accurately from source documents, and that total values for each item were calculated correctly. At year-end, the Finance Department used a summary report to create the journal entry to record contributed systems, which did not have enough detailed information to perform an adequate review. The District experienced significant staff turnover in both the Engineering and Development and Finance departments, therefore adequate resources were not assigned to review the calculations for financial reporting purposes.		
<b>Status of Corrective Action: (check one)</b> <input checked="checked" type="checkbox"/> Fully Corrected <input type="checkbox"/> Partially Corrected <input type="checkbox"/> Not Corrected <input type="checkbox"/> Finding is considered no longer valid		
<b>Corrective Action Taken:</b> <i>District staff reviewed the process for accounting for developer contributions and made significant changes to the data entry and review processes. The data entry process was moved from an Access database to an Excel spreadsheet to limit any calculation errors and simplify the entry process. Engineering and Development (E&amp;D) staff do a quarterly review to make sure the spreadsheet reconciles to the individual source documents. At year end, E&amp;D staff review and reconcile at the detail level and the summary level by asset type. This review is approved by the Development Engineer and the Engineering &amp; Development Director before being sent to Finance. Finance staff reconcile the detail, summary, and asset type reports, and samples 10 individual developer extension source documents to verify they reconcile to the detail report. A standard operating procedure was created, and staff was trained on the new process. The District also reviewed and corrected 2017 data.</i>		

**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**

**Alderwood Water and Wastewater District  
January 1, 2018 through December 31, 2018**

Board of Commissioners  
Alderwood Water and Wastewater District  
Lynnwood, 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 Alderwood Water and Wastewater District, as of and for the year ended December 31, 2018, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated June 25, 2019.

**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.

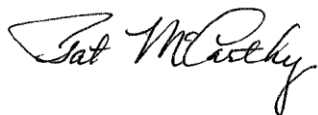
## COMPLIANCE AND OTHER MATTERS

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.



Pat McCarthy  
State Auditor  
Olympia, WA

June 25, 2019

# INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

## **Alderwood Water and Wastewater District January 1, 2018 through December 31, 2018**

Board of Commissioners  
Alderwood Water and Wastewater District  
Lynnwood, Washington

### **REPORT ON THE FINANCIAL STATEMENTS**

We have audited the accompanying financial statements of the Alderwood Water and Wastewater District, as of and for the year ended December 31, 2018, and the related notes to the financial statements, which collectively comprise the District'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 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 Alderwood Water and Wastewater District, as of December 31, 2018, 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.

## **Other Matters**


### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and required supplementary information listed on page 10 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 June 25, 2019 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Pat McCarthy". The signature is written in a cursive, flowing style.

Pat McCarthy  
State Auditor  
Olympia, WA

June 25, 2019

## **FINANCIAL SECTION**

### **Alderwood Water and Wastewater District January 1, 2018 through December 31, 2018**

#### **REQUIRED SUPPLEMENTARY INFORMATION**

Management's Discussion and Analysis – 2018

#### **BASIC FINANCIAL STATEMENTS**

Statement of Net Position – 2018

Statement of Revenues, Expenses and Changes in Net Position – 2018

Statement of Cash Flows – 2018

Notes to Financial Statements – 2018

#### **REQUIRED SUPPLEMENTARY INFORMATION**

Schedule of Proportionate Share of Net Pension Liability – PERS 1, PERS 2/3 – 2018

Schedule of Employer Contributions – PERS 1, PERS 2/3 – 2018

## **Management's Discussion and Analysis**

As management of the District we have prepared a narrative overview and analysis of the financial activities of the District for the fiscal year ending December 31, 2018. This should be read in conjunction with the financial statements, notes to the financial statements, and required supplementary information which follows this discussion.

### **Financial Highlights**

- For the year ending December 31, 2018, the assets and deferred outflows of the District exceeded its liabilities and deferred inflows by \$472.5 million. Of this amount, 21.2% or \$100.2 million is unrestricted net position and may be used to meet the District's ongoing obligations. The remaining net position is invested in capital assets, \$364.4 million or 77.1%, and restricted for debt service payments and reserves, \$7.9 million or 1.7%.
- As of the end of 2018, the District's total net position increased by \$18.6 million or 4.1% from the prior year.
- A 2016 rate study resulted in modest increases in water and wastewater charges, and significant changes to the structure of the District's wastewater rates for single-family residences. The Board of Commissioners adopted annual rate increases of 2% for water and 3.5% for wastewater, for each of the next three years, which become effective on January 1 of 2017, 2018, and 2019. Information regarding the District's water and wastewater rates are available on the District's website - [www.awwd.com](http://www.awwd.com).

### **Overview of the Financial Statements**

The District presents three basic financial statements:

- **Statement of Net Position**
- **Statement of Revenues, Expenses, and Changes in Net Position**
- **Statement of Cash Flows**

The **Statement of Net Position** presents detailed information on all of the District's assets, liabilities, and deferred outflows/inflows of resources. The difference between the sum of total assets and deferred outflows of resources and the sum of total liabilities and deferred inflows of resources is represented as net position. This statement reports all of the District's assets, deferred outflows of resources, liabilities, and deferred inflows of resources as of December 31, 2018. It is like taking a "financial photograph" of the District on December 31, 2018.

The **Statement of Revenues, Expenses, and Changes in Net Position** presents twelve months worth of revenue and expenses beginning January 1, 2018 and ending December 31, 2018. This statement, in part, measures the success of the District's operations to collect enough revenue to pay for the costs of providing water and wastewater services. It also reports other non-operating revenue and expenses such as investment interest income, bond interest expense, and capital contributions.

The **Statement of Cash Flows** reports cash receipts and cash payments in several categories such as cash flows from operations, capital financing, and investing. In total these activities explain the changes that have occurred in the District's cash.

**Notes to the Financial Statements** provide additional information that is essential for a full understanding of the information provided in the financial statements.

### **Other Information**

In addition to the basic financial statements and accompanying notes, this report also presents required supplementary information concerning the District's progress in funding its obligation to provide pension benefits to its employees. The Comprehensive Annual Financial Report (CAFR) also includes a Statistical Section, which provides more details about the District.

### **Financial Position**

The District's overall financial position continues to be strong and provides sufficient liquidity to support stable, ongoing operations. There are no restrictions, commitments, or other limitations that would significantly affect the availability of fund resources for future use. Capital assets have continued to increase as new connections have been added to our water and wastewater systems and significant investments continue to be made to upgrade and replace necessary capital infrastructure and facilities.

### **Alderwood Water and Wastewater District's Net Position**

	2018	Restated 2017	Increase (Decrease)	% Change
Current and other assets	\$ 121,680,206	\$ 134,727,397	\$ (13,047,191)	(9.7)%
Capital assets, net	454,878,839	428,305,994	26,572,845	6.2%
Total assets	576,559,045	563,033,391	13,525,654	2.4%
Total deferred outflows of resources	1,107,352	1,299,602	(192,250)	(14.8)%
Current liabilities	11,558,858	15,329,581	(3,770,723)	(24.6)%
Long-term liabilities	91,546,407	93,890,070	(2,343,663)	(2.5)%
Total liabilities	103,105,265	109,219,651	(6,114,386)	(5.6)%
Total deferred inflows of resources	2,104,581	1,303,732	800,849	61.4%
Net investment in capital assets	364,351,153	337,743,424	26,607,729	7.9%
Restricted for debt service	7,894,003	10,780,866	(2,886,863)	(26.8)%
Unrestricted	100,211,395	105,285,320	(5,073,925)	(4.8)%
Total net position	\$ 472,456,551	\$ 453,809,610	\$ 18,646,941	4.1%

### Analysis of the Statement of Net Position

- Decrease of current assets of approximately \$13.0 million was due to a planned drawdown of cash for capital projects in 2018. The District has three large capital projects under construction: Lift Station 23, D-1 Water Transmission Main, and Picnic Point Wastewater Treatment Facility Membrane Replacements. Expenses for these projects totaled \$20.5 million in 2018.
- Capital assets consist of land; construction in progress, plant; distribution and collection systems; machinery and equipment; and accumulated depreciation. The \$25.6 million increase in net capital assets is primarily due to the increase in construction-in-progress, for the three projects stated above, and \$11.7 million in assets contributed by developers through system extensions.
- The 24.6% decrease in current liabilities was mostly due to the change in accounts payable. This difference was related to timing of board meetings and payment schedules. The first board meeting in 2018 was on January 2<sup>nd</sup> and had a voucher packet of \$4.0 million compared to the first board meeting in 2019, on January 7<sup>th</sup>, which only had a voucher packet of \$722,000.
- Changes in long-term liabilities included the scheduled reduction of debt due to annual principal payments and the additional \$5.3 million of draws on the State Revolving Fund loan for the D-1 Transmission Main project.
- The District's net position increased \$18.6 million from 2017 to 2018 as a direct result of the overall positive net change in 2018.

A common analysis tool to evaluate the overall financial health of the District is the quick ratio which compares non-restricted cash and cash equivalents, investments, and accounts receivable to current liabilities in order to assess the District's ability to meet obligations in the coming year. The District's quick ratio for 2018 is 9.84. Between 2013 and 2017 the District's quick ratio has averaged 8.77. While there are no set 'rules' regarding quick ratios, District management believes this is a very healthy ratio.

**Alderwood Water and Wastewater changes in net position**

	2018	Restated 2017	Increase (Decrease)	% Change
Total operating revenue	\$ 88,760,417	\$ 82,437,982	\$ 6,322,435	7.7%
Interest and investment revenue	2,921,136	1,726,431	1,194,705	69.2%
Other nonoperating revenue	159,922	163,039	(3,117)	(1.9)%
Total revenues	91,841,475	84,327,452	7,514,023	8.9%
Total operating expenses	87,287,676	82,443,041	4,844,635	5.9%
Nonoperating expenses	4,696,185	4,669,849	26,336	0.6%
Total expenses	91,983,861	87,112,890	4,870,971	5.6%
Income before cap. contributions	(142,386)	(2,785,438)	2,643,052	(94.9)%
Capital contributions	18,789,327	17,379,775	1,409,552	8.1%
Change in net position	18,646,941	14,594,337	4,052,604	27.8%
Beginning net position	453,809,610	439,215,273	14,594,337	3.3%
Ending net position	\$ 472,456,551	\$ 453,809,610	\$ 18,646,941	4.1%

**Analysis of the Statement of Revenues, Expenses, and Changes in Net Position**

- Total operating revenue increased by 7.7% in 2018, this is due to a combination of rate increases and higher consumption from both retail and wholesale customers.
- Interest and investment revenue grew by nearly \$1.2 million due to increasing interest rates in 2018.
- \$3.0 million of the \$4.8 million increase in operating expenses is attributable to increased rates and consumption in both purchased water and purchased wastewater treatment. These two categories make up nearly 60% of all operating expenses, purchased water, \$16.5 million, and purchased wastewater treatment, \$28.5 million.
- Capital contributions are general facility charges (GFC) revenue and contributed systems which are assets installed by developers in order to provide service to new areas within the District. These assets are donated to the District once the new development is complete and approved by the District. In 2018 contributed systems included \$9.5 million in depreciable assets such as water and wastewater mains, manholes, and meter services over two inches in size. \$2.2 million in assets that are under the District's \$5,000 asset capitalization threshold were donated. Silver Lake Water and Sewer District (SLWSD) installed and donated a \$350,000 large master meter to the District to provide SLWSD another water connection for redundancy.

### **Alderwood Water and Wastewater District's Capital Assets**

	2018	Restated 2017	Increase (Decrease)	% Change
Land	\$ 1,049,891	\$ 1,049,891	\$ -	-
Construction-in-progress	21,206,547	10,716,669	10,489,878	97.9%
Total plant not depreciated	22,256,438	11,766,560	10,489,878	89.1%
Plant	167,750,540	168,382,220	(631,680)	(0.4)%
Distribution and collection systems	419,974,084	391,830,785	28,143,299	7.2%
Machinery and equipment	29,596,838	26,713,729	2,883,109	10.8%
Total plant being depreciated	617,321,462	586,926,734	30,394,728	5.2%
Less accumulated depreciation	(184,699,061)	(170,387,300)	(14,311,761)	8.4%
Total plant	\$ 454,878,839	\$ 428,305,994	\$ 26,572,845	6.2%

### **Analysis of Changes in Capital Assets**

Capital assets being depreciated increased \$30.4 million from 2017 to 2018. This was mostly made up of:

- \$28.1 net increase to distribution and collection systems. The majority of this is from:
  - \$9.8 million in developer contributions (see the breakdown in the Analysis of the Statement of Revenues, Expenses, & Change in Net Position).
  - Completion of several projects, consisting of the D-1 water transmission line, \$7.3 million, and the Shelby Road water and wastewater main replacement, \$9.7 million.
- Construction-in-progress increased \$10.5 million. This is the combination of completing projects in 2018 and significant work on the Lift Station 23 project, \$7.3 million and the Membrane Replacement Project, \$9.4 million.
- Additional information about asset depreciation and other construction-in-progress capital projects can be found in Notes 1, 3, and 4.

### **Alderwood Water and Wastewater District's Long-term debt**

At the end of the current fiscal year, the District had total long term debt outstanding of \$89.7 million; the net decrease of \$76,047 is a result of normal principal payments and new draws on State Revolving Fund loans. The District is rated by Standard and Poor's (S&P) as "AA+" and Moody's Investors Services Inc. has assigned a rating of "Aa2". In April 2013, S&P affirmed its "AA+" rating for the District. Additional detailed information about the District's long-term debt can be found in Note 6 to the Financial Statements.

	2018	2017
Public Works Trust Fund Loans	\$ 4,136,504	\$ 4,884,506
State Revolving Fund Loans	14,412,233	9,615,280
Bond Obligations	71,175,000	75,300,000
Total	\$ 89,723,737	\$ 89,799,786

### **Requests for Information**

This financial report is designed to provide a general overview of the District's finances for all those with an interest. Questions concerning any of the information provided in the report or requests for additional financial information should be addressed to Alderwood Water and Wastewater District, 3626 – 156<sup>th</sup> St. SW, Lynnwood, WA 98087.



**ALDERWOOD WATER & WASTEWATER DISTRICT**Statement of Net Position  
December 31, 2018**ASSETS**

Current Assets:	
Cash and cash equivalents	\$ 19,061,741
Investments	78,896,410
Receivables, net	13,558,623
Interest receivable	389,208
Inventories	910,553
Prepaid items	576,112
Total current assets	<u>113,392,647</u>
Noncurrent Assets:	
Restricted cash and cash equivalents	7,894,003
Deposits with fiscal agent/trustee	300,121
Assessments receivable	93,435
Capital Assets:	
Land	1,049,891
Construction-in-progress	21,206,547
Plant	167,750,540
Distribution and collection systems	419,974,084
Machinery and equipment	29,596,838
Less accumulated depreciation	(184,699,061)
Total noncurrent assets	<u>463,166,398</u>
Total assets	<u>576,559,045</u>

**DEFERRED OUTFLOWS OF RESOURCES**

Deferred outflows related to pensions	1,107,352
Total deferred outflows of resources	<u>1,107,352</u>

**LIABILITIES**

Current liabilities:	
Accounts payable	3,476,010
Accrued wages and benefits	331,381
Compensated absences	369,832
Customer deposits	1,507,643
Bonds, notes, and loans payable	5,873,992
Total current liabilities	<u>11,558,858</u>
Noncurrent liabilities:	
Bonds, notes, and loans payable	84,653,694
Compensated absences	1,109,494
Accrued interest	397,601
Net pension liability	5,385,618
Total noncurrent liabilities	<u>91,546,407</u>
Total liabilities	<u>103,105,265</u>

**DEFERRED INFLOWS OF RESOURCES**

Deferred inflows related to pensions	2,104,581
Total deferred inflows of resources	<u>2,104,581</u>

**NET POSITION**

Net investment in capital assets	364,351,153
Restricted for debt service	7,894,003
Unrestricted	100,211,395
Total net position	<u>\$ 472,456,551</u>

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

**ALDERWOOD WATER & WASTEWATER DISTRICT**  
Statement of Revenues, Expenses, and Changes in Net Position  
For the year ended December 31, 2018

Operating revenues:	
Water charges for services	\$ 39,002,595
Wastewater charges for services	48,587,537
Other charges for services	1,170,285
Total operating revenues	<u>88,760,417</u>
Operating expenses:	
Personnel services	14,671,125
Supplies and services	10,629,676
Purchased water	16,504,199
Purchased wastewater	28,501,321
Depreciation	15,220,421
Taxes	1,760,934
Total operating expenses	<u>87,287,676</u>
Operating income (loss)	<u>1,472,741</u>
Nonoperating revenues (expenses):	
Investment earnings	2,921,136
Rental income	140,530
Miscellaneous revenue	19,392
Gain (loss) on disposition of asset	(1,058,890)
Interest expense	(3,637,295)
Total nonoperating revenues (expenses)	<u>(1,615,127)</u>
Income before capital contributions	<u>(142,386)</u>
Capital contributions - general facility charges	6,749,297
Capital contributions - developers	<u>12,040,030</u>
Change in net position	18,646,941
Net position-beginning	454,763,965
Prior period adjustment	(954,355)
Restated net position-beginning	<u>453,809,610</u>
Net position-ending	<u>\$ 472,456,551</u>

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

# **ALDERWOOD WATER & WASTEWATER DISTRICT**

## Statement of Cash Flows

For the year ended December 31, 2018

	<b>Total</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
Receipts from customers	\$ 84,625,208
Payments for purchased water	(16,504,199)
Payments for sewage treatment	(28,501,321)
Payments to suppliers and service providers	(16,774,188)
Payments to and for employees salaries and benefits	(15,544,292)
Other operating receipts (payments)	<u>1,170,285</u>
Net cash provided by (used for) operating activities	<u>8,471,493</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>	
Acquisition and construction of capital assets	(31,176,925)
Gain (loss) from sale of assets	20,303
Payments received on ULID assessments	34,983
Proceeds from capital debt	5,346,594
Principal paid on capital debt	(5,422,642)
Interest paid on capital debt	(3,406,892)
Capital contributions	6,749,297
Other capital related receipts (payments)	<u>358,291</u>
Net cash provided by (used for) capital and related financing activities	<u>(27,496,991)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	
Proceeds from sale of investments	38,985,003
Purchase of investments	(39,195,783)
Interest on investments	<u>3,156,327</u>
Net cash provided by investing activities	<u>2,945,547</u>
Net increase (decrease) in cash and cash equivalents	(16,079,950)
Cash and cash equivalents at beginning of year	<u>43,035,694</u>
Cash and cash equivalents at end of year	<u><u>\$ 26,955,744</u></u>
<b>Reconciliation of operating income (loss) to net cash provided by (used for) operating activities:</b>	
Operating income (loss)	<u>\$ 1,472,741</u>
Adjustments to reconcile operating income (loss) to net cash provided by (used for) operating activities:	
Depreciation expense	15,220,421
Decrease (increase) in accounts receivable	(2,964,924)
Decrease (increase) in inventories	(97,001)
Decrease (increase) in prepaid items	(30,228)
Increase (decrease) in accounts payable	(4,256,349)
Increase (decrease) in employee benefits	(873,167)
Total adjustments	<u>6,998,752</u>
Net cash provided by (used for) operating activities	<u><u>\$ 8,471,493</u></u>
<b>Schedule of non-cash capital and related financing activities</b>	
Contributions of capital assets from developers	\$ 12,040,030
Increase (decrease) in fair value of investments	(387,241)
Amortization of bond premium	(172,247)

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

## **ALDERWOOD WATER & WASTEWATER DISTRICT**

Notes to the Financial Statements  
December 31, 2018

### **Note 1: Summary of significant accounting policies**

The financial statements of the District have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The significant accounting policies are described below.

#### **A. Reporting entity**

The District was incorporated in 1931 and operates under the laws of the state of Washington applicable to special purpose districts. It is governed by an elected five-member Board of Commissioners and has no component units.

#### **B. Measurement focus, basis of accounting, and financial statement presentation**

The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Capital asset purchases are capitalized and long-term liabilities are accounted for.

The District distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses result from providing services and 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 water and wastewater services. Operating expenses for the District include the cost of water from the wholesale provider, wastewater treatment costs, administrative services, operating and maintenance costs, depreciation on capital assets and taxes. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Unbilled utility service receivables are recorded at year-end.

All activities of the District are reported within a single enterprise fund.

#### **C. Assets, liabilities, deferred outflows/inflows of resources, and net position**

##### **1. Cash and cash equivalents**

The District's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

For the purpose of the Statement of Cash Flows, the District considers all highly liquid investments, (including restricted assets) with maturity of three months or less when purchased, to be cash equivalents.

##### **2. Investments**

Investments are reported at fair value except for investments in the Washington State Local Government Investment Pool which are reported at amortized cost. The District is limited, by State law, to purchasing investments in U.S. Treasury and Agency Securities, Certificates of

Deposit with Washington State depositories that participate in the State Insurance Pool, bankers acceptances, the State Investment Pool, and in other investments authorized by law. District policy requires that all investments be purchased DVP (delivery vs. payment), which means cash payments for securities are made at the same time as, or after, the delivery of the security. Securities are held in safekeeping by a third-party custodian. Additional detailed information on investments can be found in Note 2.

### **3. Receivables, net**

The District uses the allowance method of accounting for doubtful accounts. Uncollectible accounts are written off to expense; however, few accounts are uncollectible because of the lien, foreclosure, and water shutoff rights provided by RCW 57.08.081.

### **4. Inventories and prepaid items**

Inventories are valued using the first in first out (FIFO) method. The cost of inventory is recorded as expense when consumed, rather than when purchased.

Certain payments to vendors such as insurance and maintenance agreements, reflect costs applicable to future accounting periods and are recorded as prepaid items in the financial statements. The cost of prepaid items is recorded as expenses when consumed rather than when purchased.

### **5. Restricted cash and cash equivalents**

In accordance with bond resolutions (and certain related agreements), separate restricted reserves are required to be established. The assets held in these reserves are restricted for specific uses, including debt service and other special reserve requirements.

### **6. Capital assets**

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., mains, valves, and similar items), are reported in the financial statements. Capital assets are defined by the District as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at acquisition value at the date of donation.

Costs for additions or improvements to capital assets are capitalized when they increase the effectiveness or efficiency, or extend the useful life of the asset.

The costs for normal maintenance and repairs are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are completed.

Land and construction-in-progress are not depreciated. Other property, plant, and equipment of the District are depreciated using the straight-line method over the following estimated useful lives:

<b>Capital asset classes</b>	<b>Useful Life</b>
Building	40 - 50
Building Improvements	25
Vehicles	7
Equipment	3 - 10
Reservoirs	75
Water Pipes	75
Wastewater Pipes	50

Additional detailed information on capital assets can be found in Note 3.

#### **7. Deferred outflows/inflows of resources**

Deferred outflows of resources represent a consumption of net position that applies to future periods and will not be recognized as an outflow of resources (expense) until that time. Deferred inflows of resources represent an acquisition of net assets that is applicable to a future reporting period. The District records deferred outflows/inflows of resources related to their participation in Washington State pension programs.

#### **8. Compensated absences**

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. All vacation and sick pay is accrued when incurred.

Vacation pay, which may be accumulated up to 240 hours per employee, is payable upon resignation, retirement, or death. Employees may sell back to the District accrued but unused vacation benefits with certain restrictions, up to a maximum of 80 hours for non-represented staff and 40 hours for represented staff.

Sick leave may accumulate indefinitely and is payable in part upon separation, retirement or death. For non-represented staff, and represented staff hired after January 1, 2014, upon voluntary separation, the employee will receive 25% of the accrued and unused sick leave after 10 years of service or 50% after 20 years of service. For represented staff hired before this date, the employee will receive 50% of the accrued and unused sick leave after 10 years of service. Upon death of an employee, his/her beneficiary will receive 50% of the accrued and unused sick leave. Annually an employee may sell back to the District accrued sick leave in excess of 384 hours at 50% of the current hourly rate.

Vacation benefits are accrued for all eligible employees. Sick leave benefit amounts for represented and non-represented employees are accrued for employees with 10 or more years of service.

#### **9. 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.

#### **D. Revenues and expenses**

##### **1. Other charges for services**

Other charges include preliminary engineering charges, water use permits, side sewer permits, industrial waste surcharges, and sales of supplies and materials.

#### **Note 2: Deposits and Investments**

##### **A. Cash on hand and deposits with financial institutions**

The District's bank deposits are covered by the Federal Deposit Insurance Corporation (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC). All deposits not covered by the FDIC are covered by the PDPC. Cash on hand at December 31, 2018 was \$3,200 and the bank balance was \$7,127,183 .

##### **B. Investments**

All surplus cash is invested in accordance with an investment policy approved by the District's Board of Commissioners. State law defines eligible investments to only those securities and deposits authorized by statute (RCW 39.58, 39.59, 43.250, and 43.84.080).

The Washington State Local Government Investment Pool (LGIP) is managed and operated by the Washington Office of the State Treasurer (OST). The OST is responsible for establishing the investment policy for the pool and reviews it annually. Any proposed changes are reviewed by the LGIP Advisory Committee.

Investments in the LGIP, a qualified external investment pool, are reported at amortized cost which approximates fair value. The LGIP is an unrated external investment pool. The pool portfolio is invested in a manner that meets the maturity, quality, diversification and liquidity requirements set forth by the GASBS 79 for external investments pools that elect to measure, for financial reporting purposes, investments at amortized cost. The LGIP does not have any legally binding guarantees of share values. The LGIP does not impose liquidity fees or redemption gates on participant withdrawals. The Office of the State Treasurer prepares a stand-alone LGIP financial report. A copy of the report is available from the Office of the State Treasurer, PO Box 40200, Olympia, Washington 98504-0200, online at <http://www.tre.wa.gov>. As of December 31, 2018, the District held \$20,085,880 in LGIP investments.

All investments are subject to the following risks.

*Interest rate risk* is the risk that the District may face should interest rate variances affect the value of investments. As a means of limiting its exposure to fair value losses caused by a rise in interest rates, the District's policy limits investments in securities to those maturing no more

than five years from the date of purchase and limits the average weighted maturity for the portfolio to two years. The portfolio weighted maturity at year end was 1.905 years.

The Washington State Local Government Investment Pool is an unrated 2a7-like pool as defined by GASB 31, accordingly, participants' balances are not subject to interest rate risk as the weighted average maturity of the portfolio will not exceed 90 days.

The following schedule presents the investments and related maturities as of December 31, 2018:

Investment Type	Investment Maturities (in years)		
	Fair Value	Less than 1 year	1-5 year
U.S. Treasury Notes	\$ 14,953,110	\$ 14,953,110	\$ -
Government Sponsored Enterprises	63,943,300	21,876,627	42,066,673
<b>Total</b>	<b>\$ 78,896,410</b>	<b>\$ 36,829,737</b>	<b>\$ 42,066,673</b>

*Credit risk* is the chance that an issuer or other counterparty to an investment will not fulfill its obligations. The District's investment policy applies the prudent person standard; investments will be made with judgment and care, under circumstances then prevailing, which a person of prudence, discretion and intelligence would use in the management of their own affairs, not for speculation, but for investment purposes. All of the District's investments are held in organizations with a Moody's rating of Aaa, excluding investments with The Washington State Local Government Investment Pool which is a 2a7-like pool and is unrated.

*Custodial credit risk* is the risk that, in the event of the failure of the counterparty, the District would not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The District's Investment Policy requires that all security transactions entered into by the District will be conducted on a DVP basis and will be held in safekeeping by a third party custodian. All of the District's securities at year end were held in safekeeping by a third party custodian and are not exposed to custodial credit risk.

*Concentration of credit risk* is the risk associated with a lack of diversification or having too much invested in a few individual issues. It is the District's policy to diversify its investments by security type and institution. The District's policy is to assure that no single institution or security is invested to such an extent that a delay of liquidation at maturity is likely to cause a current cash flow emergency. With the exception of U.S. Treasury securities and authorized pools, no more than 35% of the entity's total investment portfolio will be invested in a single security type, issuer or financial institution. Detail information on concentration risk is covered in the District Investment Policy.

*Fair Value Hierarchy.* Securities classified as Level 1 in the fair value hierarchy are valued using prices quoted in active markets for identical securities, Level 2 securities are valued using observable inputs, and Level 3 securities are valued using unobservable inputs. U.S. Treasury securities classified in Level 1 are valued using quoted prices in an active market for identical assets. Government Sponsored Enterprise (GSE) Securities classified in Level 2 are valued using quoted prices for similar securities and interest rates. The level of fair value measurement is based on the lowest level of significant input for the security type in its entirety. There are no Level 3 security classifications to report.



Investment Type	Fair Value	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury Notes	\$ 14,953,110	\$ 14,953,110	\$ -	\$ -
Government Sponsored Enterprises	63,943,300	-	63,943,300	-
<b>Total</b>	<b>\$ 78,896,410</b>	<b>\$ 14,953,110</b>	<b>\$ 63,943,300</b>	<b>\$ -</b>

### Note 3: Utility plant and depreciation

Capital asset activity for the year ended December 31, 2018 was as follows:

	Restated Balance December 31, 2017	Increases	Decreases	Balance December 31, 2018
Capital assets, not being depreciated:				
Land	\$ 1,049,891	\$ -	\$ -	\$ 1,049,891
Construction-in-progress	10,716,670	32,456,414	(21,966,537)	21,206,547
Total capital assets, not being depreciated	11,766,561	32,456,414	(21,966,537)	22,256,438
Capital assets, being depreciated:				
Plant	168,382,220	301,594	(933,274)	167,750,540
Distribution and collection systems	391,830,785	28,842,859	(699,560)	419,974,084
Machinery and equipment	26,713,729	3,238,305	(355,196)	29,596,838
Total capital assets, being depreciated	586,926,734	32,382,758	(1,988,030)	617,321,461
Less accumulated depreciation for:				
Plant	(46,681,501)	(6,371,703)	240,104	(52,813,100)
Distribution and collection systems	(109,841,500)	(7,241,074)	314,083	(116,768,492)
Machinery and equipment	(13,864,300)	(1,607,644)	354,474	(15,117,469)
Total accumulated depreciation	(170,387,301)	(15,220,421)	908,661	(184,699,061)
Total capital assets being depreciated, net	416,539,433	17,162,337	(1,079,369)	432,622,401
Capital assets, net	\$ 428,305,994	\$ 49,618,751	\$ (23,045,906)	\$ 454,878,839

#### Note 4: Significant Construction Commitments

The District had the following significant construction projects in progress as of December 31, 2018. Project budgets include District staff labor:

Project Name	Expended to Date	Remaining Budget
PPWWTF Membrane Upgrades	\$9,424,784	\$8,639,216
Lift Station 23	7,271,240	1,082,011
Reservoir #2 & #3 Coatings	282,459	4,365,526
660/520/340 Water Pressure Zones (D-1,2,3 & V-1,2,3)	404,059	4,012,453
Trans Mains 1 and 2 Air-Vac and Blowoff Replacement	157,128	4,199,718
35th Ave and 180th Capacity Upgrade	9,272	2,223,858
East Side Pressure Reduction - Phase 1	395,085	1,654,300
Water Main Looping	13,212	1,576,788
Reservoir 1 and 2 Sodium Hypochlorite System Upgrade	1,672	1,148,328
	<u>\$17,958,911</u>	<u>\$28,902,198</u>

#### Note 5: Pension plans

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 2018:

Aggregate Pension Amounts – All Plans	
Pension liabilities	\$5,385,618
Pension assets	\$0
Deferred outflows of resources	\$1,107,352
Deferred inflows of resources	\$2,104,581
Pension expense/expenditures	\$148,208

#### State Sponsored Pension Plans

Substantially all the 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](http://www.drs.wa.gov).

## Public Employees' Retirement System (PERS)

PERS members include elected officials; state employees; employees of the Supreme, Appeals and Superior Courts; employees of the legislature; employees of district and municipal courts; employees of local governments; and higher 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 2% 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%. 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%. 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 2018 were as follows:

<b>PERS Plan 1</b>		
<b>Actual Contribution Rates</b>	<b>Employer</b>	<b>Employee</b>
January - August 2018:		
PERS Plan 1	7.49%	6.00%
PERS Plan 1 UAAL	5.03%	
Administrative Fee	0.18%	
<b>Total</b>	<b>12.70%</b>	<b>6.00%</b>
September - December 2018:		
PERS Plan 1	7.52%	6.00%
PERS Plan 1 UAAL	5.13%	
Administrative Fee	0.18%	
<b>Total</b>	<b>12.83%</b>	<b>6.00%</b>

**PERS Plan 2/3** provides retirement, disability and death benefits. Retirement benefits are determined as 2% of the member's average final compensation (AFC) times the member's years of service for Plan 2 and 1% 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 3% 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 5% 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 6% 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% and escalate to 15% 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 Unfunded Actuarial Accrued Liability (UAAL) and an administrative expense that is currently set at 0.18%. 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 2018 were as follows:

<b>PERS Plan 2/3</b>		
<b>Actual Contribution Rates</b>	<b>Employer 2/3</b>	<b>Employee 2</b>
January - August 2018:		
PERS Plan 2/3	7.49%	7.38%
PERS Plan 1 UAAL	5.03%	
Administrative Fee	0.18%	
Employee PERS Plan 3		varies
<b>Total</b>	<b>12.70%</b>	<b>7.38%</b>
September - December 2018:		
PERS Plan 2/3	7.52%	7.41%
PERS Plan 1 UAAL	5.13%	
Administrative Fee	0.18%	
Employee PERS Plan 3		Varies
<b>Total</b>	<b>12.83%</b>	<b>7.41%</b>

The District's actual PERS plan contributions were \$571,908 to PERS Plan 1 and \$802,909 to PERS Plan 2/3 for the year ended December 31, 2018.

### **Actuarial Assumptions**

The total pension liability (TPL) for each of the DRS plans was determined using the most recent actuarial valuation completed in 2018 with a valuation date of June 30, 2017. The actuarial assumptions used in the valuation were based on the results of the Office of the State Actuary's (OSA) *2007-2012 Experience Study* and the *2017 Economic Experience Study*.

Additional assumptions for subsequent events and law changes are current as of the 2017 actuarial valuation report. The TPL was calculated as of the valuation date and rolled forward to the measurement date of June 30, 2018. Plan liabilities were rolled forward from June 30, 2017, to June 30, 2018, reflecting each plan's normal cost (using the entry-age cost method), assumed interest and actual benefit payments.

- **Inflation:** 2.75% total economic inflation; 3.50% salary inflation.
- **Salary increases:** In addition to the base 3.50% salary inflation assumption, salaries are also expected to grow by promotions and longevity.
- **Investment rate of return:** 7.4%.

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% Scale BB. Mortality rates are applied on a generational basis; meaning, each member is assumed to receive additional mortality improvements in each future year throughout his or her lifetime.

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

- Lowered the valuation interest rate from 7.70% to 7.50%
- Lowered the assumed general salary growth from 3.75% to 3.50% for all systems.
- Lowered assumed inflation from 3.00% to 2.75% for all systems.

### Discount Rate

The discount rate used to measure the total pension liability for all DRS plans was 7.4%.

To determine that rate, an asset sufficiency test included an assumed 7.5% long-term discount rate to determine funding liabilities for calculating future contribution rate requirements. Consistent with the long-term expected rate of return, a 7.4% 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 7.4% 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 7.4% was determined using a building-block-method. In selecting this assumption, the Office of the State Actuary (OSA) reviewed the historical experience data, considered the historical conditions that produced past annual investment returns, and considered capital market assumptions and simulated expected investment returns provided by the Washington State Investment Board (WSIB). The WSIB uses the capital market assumptions and their target asset allocation to simulate future investment returns over various time horizons.

### Estimated Rates of Return by Asset Class

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2018, are summarized in the table below. The inflation component used to create the table is 2.2% 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	7%	4.90%
Real Estate	18%	5.80%
Global Equity	32%	6.30%
Private Equity	23%	9.30%
	<b>100%</b>	

### Sensitivity of the Net Pension Liability/(Asset)

The table below presents the District's proportionate share\* of the net pension liability calculated using the discount rate of 7.4%, as well as what the District's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.4%) or 1-percentage point higher (8.4%) than the current rate.

	1% Decrease (6.4%)	Current Discount Rate (7.4%)	1% Increase (8.4%)
PERS 1	\$4,506,040	\$3,666,614	\$2,939,502
PERS 2/3	7,862,766	1,719,004	(3,318,195)

### 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, 2018, the District reported a total pension liability of \$5,385,618 for its proportionate share of the net pension liabilities as follows:

	Liability (or Asset)
PERS 1	\$3,666,614
PERS 2/3	1,719,004

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

	Proportionate Share 6/30/17	Proportionate Share 6/30/18	Change in Proportion
PERS 1	0.085174%	0.082100%	(0.003074%)
PERS 2/3	0.102567%	0.100679%	(0.001888%)

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

The collective net pension liability (asset) was measured as of June 30, 2018, and the actuarial valuation date on which the total pension liability (asset) is based was as of June 30, 2017, with update procedures used to roll forward the total pension liability to the measurement date.

## Pension Expense

For the year ended December 31, 2018, the District recognized pension expense as follows:

	Pension Expense
PERS 1	\$168,706
PERS 2/3	(20,498)
TOTAL	\$148,208

## Deferred Outflows of Resources and Deferred Inflows of Resources

At December 31, 2018, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

PERS Plan 1	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$0	\$0
Net difference between projected and actual investment earnings on pension plan investments	0	(145,709)
Changes of assumptions	0	0
Changes in proportion and differences between contributions and proportionate share of contributions	0	0
Contributions subsequent to the measurement date	289,437	0
TOTAL	\$289,437	(\$145,709)

PERS Plan 2/3	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$210,705	(\$300,965)
Net difference between projected and actual investment earnings on pension plan investments	0	(1,054,861)
Changes of assumptions	20,109	(489,215)
Changes in proportion and differences between contributions and proportionate share of contributions	184,524	(113,831)
Contributions subsequent to the measurement date	402,577	0
TOTAL	\$817,915	(\$1,958,872)



<b>All Plans</b>	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Differences between expected and actual experience	\$210,705	(\$300,965)
Net difference between projected and actual investment earnings on pension plan investments	0	(1,200,570)
Changes of assumptions	20,109	(489,215)
Changes in proportion and differences between contributions and proportionate share of contributions	184,524	(113,831)
Contributions subsequent to the measurement date	692,014	0
<b>TOTAL</b>	<b>\$1,107,352</b>	<b>(\$2,104,581)</b>

Deferred outflows of resources related to pensions resulting from the District's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2019. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

<b>Year ended December 31:</b>	<b>PERS Plan 1</b>
2019	\$6,375
2020	(31,853)
2021	(95,581)
2022	(24,650)
2023	0
Thereafter	0
<b>Total</b>	<b>(\$145,709)</b>

<b>Year ended December 31:</b>	<b>PERS Plan 2/3</b>
2019	(\$170,152)
2020	(335,929)
2021	(622,128)
2022	(215,553)
2023	(64,954)
Thereafter	(134,818)
<b>Total</b>	<b>(\$1,543,534)</b>

## Note 6: Long-term Liabilities

### Loans Payable

The Districts long-term loan debt is comprised of the following:

Public Works Trust Fund Loans	Original Issue	Original Borrowing	Interest Rates to Maturity	Maturity Date	Outstanding 12/31/2018
99-791-001 Water Reservoir No 1 Cover	1999	\$ 3,420,060	1.000%	2019	\$ 182,121
00-691-001 Water Low Pressure Area Improvements	2000	1,402,800	1.000%	2020	155,553
05-691-PRE-108 Wastewater Facility Upgrade	2005	1,000,000	0.500%	2025	368,421
05-691-PRE-126 Wastewater Facility Upgrade	2005	1,000,000	0.500%	2025	373,538
06-962-001 Wastewater Facility Upgrade	2006	7,000,000	0.500%	2026	3,056,871
					<u>\$ 4,136,504</u>

State Revolving Fund Loans	Original Issue	Original Borrowing	Interest Rates to Maturity	Maturity Date	Outstanding 12/31/2018
L0900006 Wastewater Facility Upgrade	2011	\$ 9,308,953	2.700%	2031	\$ 6,474,419
DM-12-952-098 Water Pump Station & High Tank Upgrade	2012	2,663,943	1.500%	2034	2,144,434
DM-13-952-125 660/520/340 Water Pressure Zones	2013	5,793,380	1.500%	2038	5,793,380
					<u>\$ 14,412,233</u>

The State of Washington has a low-cost financing program that allows public entities to borrow funds to finance public works projects. This program is administered by the State of Washington Public Works Trust Fund (PWTF) Board. The State Revolving Fund program administered by the State of Washington also provides lower-cost financing to public projects that meet certain requirements.

In 2000, the District partially funded construction of improvements to the Northeast pressure zone with PWTF loans. Construction of a cover for Reservoir No. 1, which has a capacity of 28,000,000 gallons, was also funded in part by a PWTF loan during 1999. A total of \$9,000,000 in PWTF loans were used to fund construction of the Picnic Point Wastewater Facility upgrade and improvement project beginning in 2005. \$7,000,000 of these funds were used for pre-construction design and planning activities. Each of these loans will be repaid over a period not to exceed 20 years at the interest rates stated above.

The District was granted a State Revolving Fund (SRF) loan by the Washington State Department of Commerce in 2011 to finance a portion of construction of the liquids facility as part of the Picnic Point Wastewater Facility upgrade and improvement project. The District was granted a second State Revolving Fund loan in 2012 for \$2,663,943 to finance a portion of the improvements to Pump Station 2 and the 724 Zone Booster Pump Station. The District began paying back the loan in October 2015. Additionally, the District was granted a third SRF loan in 2013 for the D-1 Transmission Main Project. The final draw on the loan was completed in 2018, resulting in a total of \$5,793,380 million with the first payment beginning in 2019.

## Bonds

The District's long-term bond debt is composed of the following bond issues:

Bond Obligations	Original Issue	Original Borrowing	Interest Rates to Maturity	Maturity Date	Outstanding 12/31/2018
2009 State Revenue Bond	2009	\$ 23,885,000	3.000% - 4.000%	2018	\$ -
2010 State Revenue Bond - Series B	2010	49,325,000	4.200% - 5.500%	2029	48,365,000
2013 State Revenue Bond	2013	25,000,000	2.000% - 4.625%	2043	22,810,000
					<u>\$ 71,175,000</u>

The District issued revenue bonds in December 2009 in the amount of \$23,885,000 to provide for a current refunding of all of the District's outstanding revenue bonds, 1998, and Water and Sewer Revenue bonds, 1999. An arbitrage rebate calculation was completed in January of 2019 and no rebate liability exists from issuance through December 1, 2018. As of December 31, 2018 the 2009 revenue bond was paid in full.

In February 2010 the District issued \$53 million in new Water and Sewer Revenue bonds to finance the continuing construction of the Picnic Point Wastewater Treatment Facility and other water system improvements. These bonds were issued as Build America Bonds – direct payment and were split into Series A and Series B. Series A totaled \$3.675 million and has been paid in full. The District has contracted with the Bank of New York, Mellon, the current fiscal agent, to prepare the IRS form 8038-CP for District signature to ensure that the 35% Federal interest payment subsidy is received by the District in a timely manner. As of December 31, 2012, all of the 2010 bond proceeds were fully drawn and expended.

In October 2013, the District issued \$25,000,000 in revenue bonds to finance upcoming wastewater capital improvement projects. As of December 31, 2014, all of the 2013 Revenue Bond proceeds were fully drawn and expended.

All bond debt is secured by the District revenues. Restricted net position as of December 31, 2018 is \$7,894,003. This represents debt service funds and reserve requirements as contained in the various bond indentures. Per bond resolutions, ULID assessments are dedicated to the payment of debt service.

The debt service requirements for the District's loans and bonds are as follows for the years ending December 31:

Year	Principal	Interest
2019	\$ 5,841,727	\$ 3,747,221
2020	5,812,258	3,536,849
2021	5,897,548	3,377,943
2022	6,056,037	3,214,607
2023	6,229,962	2,837,340
2024-2028	32,922,451	10,150,814
2029-2033	13,160,981	3,935,686
2034-2038	7,092,773	2,385,303
2039-2043	6,710,000	958,763
	<u>\$89,723,737</u>	<u>\$34,144,526</u>

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

Changes in the District's long-term liabilities for the year ended December 31, 2018 are as follows:

	Balance 12/31/2017	Additions	Reductions	Balance 12/31/2018	Due with one year
Public Works Trust Fund loans	\$ 4,884,505	\$ -	\$ (748,001)	\$ 4,136,504	\$ 748,000
State Revolving Fund loans	9,615,280	5,346,594	(549,641)	14,412,233	813,727
Bond obligations	75,300,000	-	(4,125,000)	71,175,000	4,280,000
Bond premium	976,197	-	(172,248)	803,949	32,265
Pension obligation	7,605,286	1,374,817	(3,594,485)	5,385,618	-
Compensated absences	1,091,586	1,574,499	(1,186,759)	1,479,326	369,832
	<u>\$99,472,854</u>	<u>\$ 8,295,910</u>	<u>\$ (10,376,134)</u>	<u>\$97,392,630</u>	<u>\$ 6,243,824</u>

## Note 7: Risk Management

### Unemployment

The District is a reimbursable employer with the Washington State Employment Security Department, therefore it is self-insured for unemployment. Claims are processed by the State and paid by the District. Below is an analysis of claims activity for the two year period ended December 31, 2018:

	2017	2018
Liability - beginning	\$ 5,035	\$ 319
Claims incurred	17,378	4,429
Claim payments	(22,093)	(1,011)
Liability - ending	<u>\$ 319</u>	<u>\$ 3,738</u>

### Water and Sewer Risk Management Pool

The District is a member of the Water and Sewer Risk Management Pool (Pool). Chapter 48.62 RCW authorizes the governing body of any one or more governmental entities to form together into or join a pool or organization for the joint purchasing of insurance, and/or joint self-insuring, and/or joint hiring or contracting for risk management services to the same extent that they may individually purchase insurance, self-insurance, or hire or contract for risk management services. An agreement to form a pooling arrangement was made pursuant to the provisions of Chapter 39.34 RCW, the Interlocal Cooperation Act. The Pool was formed in November 1987 when water and sewer districts in the State of Washington joined together by signing an Interlocal Governmental Agreement to pool their self-insured losses and jointly purchase insurance and administrative services. The Pool currently has 66 members. The Pool's fiscal year is November 1<sup>st</sup> through October 31<sup>st</sup>.

The Pool allows members to jointly purchase insurance coverage, establish a plan of self-insurance coverage, and provide related services, such as risk management and loss prevention. The Pool provides the following forms of group purchased insurance coverage for its members: Property (including Building, Electronic Data Processing, Boiler and Machinery, and Mobile Equipment); General Liability; Automotive Liability; Excess Liability, Crime; Public Officials Liability; Identity Fraud Reimbursement Program; and bonds of various types. All coverages are on an "occurrence" basis.

Members make an annual premium contribution to fund the Pool. The Pool purchases insurance policies from unrelated underwriters as follows:

TYPE OF COVERAGE	MEMBER DEDUCTIBLE	SELF-INSURED RETENTION/GROUP	EXCESS LIMITS
<b>Property Loss:</b>			
Buildings and Contents	\$1,000 - \$25,000 and See (C) below	\$25,000	\$1,000,000,000
Flood	See (A) below	See (A) below	\$50,000,000
Earthquake	See (B) below	See (B) below	\$110,000,000 (\$75,000,000 shared by all members, \$25,000,000 dedicated to Alderwood, \$5,000,000 dedicated to Sammamish Plateau, and \$5,000,000 dedicated to Cascade Water Alliance)
Terrorism	\$1,000 - \$25,000	\$25,000 Primary layer	\$100,000,000 Primary layer
Boiler & Machinery	\$1,000 - \$350,000 depending on object	\$25,000 - \$350,000 depending on object	\$100,000,000
Auto - Physical Damage	\$1,000-\$25,000	\$25,000	\$10,000,000
<b>Liability:</b>			
Commercial General Liability	\$1,000 - \$25,000	\$200,000	\$10,000,000
Auto Liability	\$1,000 - \$25,000	\$200,000	\$10,000,000
Public Officials Errors and Omissions	\$1,000 - \$25,000	\$200,000	\$10,000,000
Employment Practices	\$1,000 - \$25,000	\$200,000	\$10,000,000
<b>Other:</b>			
Public Officials Bonds	Various	N/A	Various
Crime	\$1,000 - \$25,000	\$25,000	\$2,000,000
Identity Fraud	\$0	\$0	\$25,000
A. \$100,000 member deductibles, per occurrence, in Flood zones except Zones A&V; \$250,000 member deductible per occurrence, in Flood Zones A&V.			
B. Member deductible for earthquakes is 5% subject to \$100,000 minimum Earthquake Shock. The deductible will apply per occurrence on a per unit basis, as defined in the policy form, subject to the stated minimum.			
C. Member deductible for Cyber liability is \$100,000 and where applicable the dollar amount of the business interruption loss during the policy's required 8 hour waiting period.			

Pool members are responsible for a deductible on each coverage and the Pool is responsible for the remainder of the self-insured retention listed in the table above except where noted as

follows. The insurance carriers then cover the loss to the maximum limit of the policy. Each member is responsible for the full deductible applicable to the perils of earthquake and flood (the Pool is not responsible for any deductible or self-insured retention for earthquake and flood claims). Each member is also responsible for the full deductible applicable to the Cyber Liability, and that part of a Boiler & Machinery deductible, which exceeds \$25,000.

Upon joining, the members contract to remain in the Pool for one full policy period. Following completion of one full policy period, members must give six months notice before terminating participation (e.g., to withdraw from the Pool on November 1, 2019, written notice must be in possession of the Pool by April 30, 2019). The Interlocal Governmental Agreement is renewed automatically each year. Even after termination of relationship with the Pool, a member is still responsible for contributions to the Pool for any unresolved, unreported, and in process claims, for the period that the District was a signatory to the Interlocal Governmental Agreement.

The Pool is fully funded by its member participants. Claims are filed by members with the Pool who determines coverage and performs claims adjustment in consultation with Arcadia Claims Services and Adjusters Northwest.

The Pool is governed by a Board of Directors, which is comprised of one designated representative from each participating member. An Executive Committee is elected at the annual meeting, and is responsible for overseeing the business affairs of the Pool and providing policy direction to the Pool's Executive Director.

#### **Note 8: Other Parties**

##### **Clearview Water Supply Agency**

During 2004, the District negotiated a 50 year supply contract for water with the Clearview Water Supply Agency (CWSA). The purpose of CWSA is to provide water to the members and maintain and operate certain facilities. CWSA currently has no plant and equipment; the member districts jointly own the facilities. The District has been contracted to maintain and operate the facilities as well as provide administrative support for CWSA.

CWSA purchases all of its water from the District at the District's cost, which includes the wholesale cost of water from the City of Everett and the associated pumping costs. The members are responsible for all expenses based on metered water use and an agreed upon expense allocation formula. In order to ensure that revenues are sufficient to meet the expenses, monthly charges to the three members are equal to the monthly expenses.

In 2018, the Board of Commissioners of the (CWSA) adopted a resolution clarifying that CWSA is not a joint venture under Governmental Accounting Standards Board (GASB) Statement No. 14 but is a jointly governed organization under Chapter 39.34 RCW. The CWSA is comprised of three Special Purpose Districts: Alderwood Water & Wastewater District, Cross Valley Water District, and Silver Lake Water & Sewer District. The CWSA Board's action was the result of discussions between representatives of the Washington State Auditor's Office (SAO) and the representatives for the three member districts of CWSA as to how to clarify the nature of CWSA's relationship with its three member districts.

Annual financial statements are available by contacting Clearview Water Supply Agency at 3626 – 156<sup>th</sup> St. SW, Lynnwood, WA 98087 or by calling (425) 743-4605.

## **Note 9: Other Disclosures**

### **Prior Period Adjustments**

During review of capital assets in January 2019, there were assets found that did not meet the District's capital asset threshold policy or were no longer in service as of January 1, 2018. These errors resulted in a reduction of net position of \$553,940. In addition, the District identified previous calculation errors of construction-in-progress that resulted in a reduction of net position of \$400,414. The total prior period adjustment recorded by the District was a \$954,355 reduction in net position.

**Required Supplementary Information**

**Alderwood Water & Wastewater District  
Schedule of Proportionate Share of the Net Pension Liability  
PERS 1  
As of June 30, 2018  
Last Ten Fiscal Years\***

	2018	2017	2016	2015
Employer's proportion of the net pension liability (asset)	0.082100%	0.085174%	0.081201%	0.083423%
Employer's proportionate share of the net pension liability	\$3,666,614	\$4,041,573	\$4,360,876	\$4,363,799
Covered payroll	\$10,611,754	\$9,983,247	\$9,383,256	\$9,264,779
Employer's proportionate share of the net pension liability as a percentage of covered payroll	34.55%	40.48%	46.48%	47.10%
Plan fiduciary net position as a percentage of the total pension liability	63.22%	61.24%	57.03%	59.10%

**Alderwood Water & Wastewater District  
Schedule of Employer Contributions  
PERS 1  
As of December 31, 2018  
Last Ten Years\***

	2018	2017	2016	2015
Statutorily or contractually required contributions	\$ 571,908	\$ 519,497	\$ 475,623	\$ 423,748
Contributions in relation to the statutorily or contractually required contributions*	\$ (571,908)	\$ (519,497)	\$ (475,623)	\$ (423,748)
Contribution deficiency (excess)	\$ -	\$ -	\$ -	\$ -
Covered payroll	\$10,945,922	\$10,278,440	\$9,604,515	9,366,709
Contributions as a percentage of covered payroll	5.22%	5.05%	4.95%	4.52%

\* Until a full 10-year trend is compiled, information is presented only for those years for which information is available.



**Required Supplementary Information**

**Alderwood Water & Wastewater District  
Schedule of Proportionate Share of the Net Pension Liability  
PERS 2/3  
As of June 30, 2018  
Last Ten Fiscal Years\***

	2018	2017	2016	2015
Employer's proportion of the net pension liability (asset)	0.100679%	0.102567%	0.097145%	0.101096%
Employer's proportionate share of the net pension liability	\$ 1,719,004	\$ 3,563,713	\$ 4,891,174	\$3,612,218
Covered payroll	\$10,404,020	\$ 9,696,517	\$ 9,103,079	\$8,991,768
Employer's proportionate share of the net pension liability as a percentage of covered payroll	16.52%	36.75%	53.73%	40.17%
Plan fiduciary net position as a percentage of the total pension liability	95.77%	90.97%	85.82%	89.20%

**Alderwood Water & Wastewater District  
Schedule of Employer Contributions  
PERS 2/3  
As of December 31, 2018  
Last Ten Fiscal Years\***

	2018	2017	2016	2015
Statutorily or contractually required contributions	\$ 802,909	\$ 686,573	\$ 580,842	\$509,457
Contributions in relation to the statutorily or contractually required contributions	\$(802,909)	\$(686,573)	\$(580,842)	\$(509,457)
Contribution deficiency (excess)	\$ -	\$ -	\$ -	\$ -
Covered payroll	\$10,706,558	\$10,035,870	\$9,323,549	\$9,089,093
Contributions as a percentage of covered payroll	7.50%	6.84%	6.23%	5.61%

\* Until a full 10-year trend is compiled, information is presented 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.

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Contact information for the State Auditor's Office	
Public Records requests	<a href="mailto:PublicRecords@sao.wa.gov">PublicRecords@sao.wa.gov</a>
Main telephone	(360) 902-0370
Toll-free Citizen Hotline	(866) 902-3900
Website	<a href="http://www.sao.wa.gov">www.sao.wa.gov</a>