Washington State Auditor's Office

Financial Statements Audit Report

Washington Cities Insurance Authority

King County

Audit Period
January 1, 2006 through December 31, 2006

Report No. 73999

Issue Date
February 19, 2008

WASHINGTON
BRIAN SONNTAG
STATE AUDITOR

Washington State Auditor
Brian Sonntag

February 19, 2008

Board of Directors
Washington Cities Insurance Authority
Tukwila, Washington

Report on Financial Statements

Please find attached our report on the Washington Cities Insurance Authority's financial statements.

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

In addition to this work, we look at other areas of our audit client's operations for compliance with state laws and regulations. The results of that audit will be included in a separately issued accountability report.

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR

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King County
January 1, 2006 through December 31, 2006

Independent Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters in Accordance with *Government Auditing Standards*

Washington Cities Insurance Authority
King County
January 1, 2006 through December 31, 2006

Board of Directors
Washington Cities Insurance Authority
Tukwila, Washington

We have audited the basic financial statements of the Washington Cities Insurance Authority, King County, Washington, as of and for the years ended December 31, 2006 and 2005, and have issued our report thereon dated September 5, 2007.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits, we considered the Authority’s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority’s internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Authority's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Authority's financial statements that is more than inconsequential will not be prevented or detected by the Authority's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity’s internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of the Authority'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*.

This report is intended for the information and use of management and the Board of Directors. 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.

BRIAN SONNTAG, CGFM
STATE AUDITOR

September 5, 2007

Independent Auditor's Report on Financial Statements

Washington Cities Insurance Authority
King County
January 1, 2006 through December 31, 2006

Board of Directors
Washington Cities Insurance Authority
Tukwila, Washington

We have audited the accompanying basic financial statements of the Washington Cities Insurance Authority, King County, Washington, as of and for the years ended December 31, 2006 and 2005, as listed on page 5. These financial statements are the responsibility of the Authority's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Washington Cities Insurance Authority, as of December 31, 2006 and 2005, and the changes in financial position and, where applicable, cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report on our consideration of the Authority'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 6 through 7 and risk pool information on pages 21 through 22 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

BRIAN SONNTAG, CGFM
STATE AUDITOR

September 5, 2007

Financial Section

Washington Cities Insurance Authority
King County
January 1, 2006 through December 31, 2006

REQUIRED SUPPLEMENTAL INFORMATION

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BASIC FINANCIAL STATEMENTS

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Statements of Cash Flows – 2006 and 2005
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REQUIRED SUPPLEMENTAL INFORMATION

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Washington Cities Insurance Authority's (WCIA or the Pool) discussion and analysis is designed to assist the reader in focusing on significant financial issues, provide an overview of WCIA's financial activity, identify changes in WCIA's financial position, and identify any material deviations from the financial plan (the approved budget).

Since the Management's Discussion and Analysis (MD&A) is designed to focus on the current years activities, resulting changes and currently known facts, please read it in conjunction with WCIA's financial statements.

HIGHLIGHTS

Financial Highlights

- The Pool's overall financial position has improved from 2006 to 2005 due primarily to the following: WCIA's net assets increased by $9,561,303 or 27.28%. The increase was a result of WCIA's ability to reduce its claims reserves and costs by approximately $2,209,000. Additional increase in member assessments by approximately $1,000,000 assisted as well. Additional factor contributing to increase asset over 2005 were related to the approximately $3,400,000 increase in investment income from interest and dividends as well as market recovery for prior years losses being written down to market value.

- The Pool's actual financial results were comparable to its budgeted amounts, with the exception of a few areas where the budget was exceeded. The areas where the Pool exceeded the budgeted amounts have already been identified in the financial highlights discussions above.

- The Pool does not carry any short or long term debt. The Pool's primary liabilities are for claims reserves. The combined claims reserves for the years ending December 31, 2006, 2005, and 2004 are $62,859,000, $61,573,000, and $58,588,000, respectively.

- Three year comparative summary financial data:

DESCRIPTION	Year 2006	Year 2005	Year 2004
Total Assets – Capital	$5,393,491	$5,295,802	$4,972,231
Total Assets – Other	$104,166,199	$92,849,811	$85,226,064
Total Liabilities	$64,951,108	$63,098,334	$59,942,667
Total Net Assets	$44,608,582	$35,047,279	$30,255,628
OPERATING REVENUES			
Member Assessments	$26,306,649	$25,361,807	$22,637,316
OPERATING EXPENSES			
Loss & Loss Adjustment Expense	$14,494,178	$16,384,032	$9,851,609
Confidence Level Expense	$629,341	$984,200	($225,351)
Insurance Expense	$3,818,873	$2,250,563	$4,908,204
Wages & Benefits	$1,576,832	$1,444,781	$1,368,720
Professional Services	$1,250,536	$1,216,857	$1,006,627
Seminars & Training	$398,329	$378,893	$355,832
Other Expenses	$400,182	$353,157	$354,144
TOTAL OPERATING EXPENSES	$22,568,271	$23,012,483	$17,619,785
OPERATING INCOME (LOSS)	$3,738,378	$2,349,324	$5,017,531
NON-OPERATING REVENUES			
Unrealized Gain(Loss) on Investments	$227,398	($2,555,829)	$128,445
Realized Gain (Loss) on Investments	$282,428	$344,425	($27,812)
Investment Income	$5,355,500	$4,742,563	$4,228,999
Net Profit (Loss) From Building Operations	($42,401)	($88,832)	($29,979)
TOTAL NON-OPERATING REVENUES	$5,8222,925	$2,442,327	$4,299,653
NET INCOME	$9,651,303	$4,791,651	$9,317,184

MANAGEMENT'S DISCUSSION AND ANALYSIS

Operations Highlights

- The Pool is continuing to provide its members with education workshops in an effort to reduce its and its member's claims exposure. Using the COMPACT, a formal, systematic training program now in its 13th year, education workshops were presented at 178 sites to train 3,162 employees on subjects such as employment practice liability, defensive driving, police professional training and elected official-land use liability.

- The Pool purchased an office building during June 2003. The office building will allow space for future growth of the Pool, as well as providing some net rental income from third party tenants that are renting the remainder of the building. WCIA uses approximately 45% of the building for its office and training space needs.

Financial Statements

WCIA implemented GASB 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* in fiscal year 2003. The Pool has already been reporting it's financial activities in a format now required by GASB 34, so there was not a significant impact on the reporting process, with the exception of descriptions for various financial statements and funds/accounts.

SUMMARY

The insurance industry is currently in a hard insurance marketplace (less competition, higher premiums, lower limits, less capacity, etc.). In order to offset the hard insurance marketplace, the Pool has been using surplus funding to offset the increases in some of the lines of insurance. The insurance market appears to be recovering from the hard market, barring any major disasters, so the Pool will be easing its use of surplus funding. Also, as a result of the insurance market, the Pool continually researches coverage enhancements, changing self-insured retentions, raising/lowering limits, etc. in order to react to the ever changing insurance marketplace. The Pool also has changed property insurance brokers to Marsh USA Inc. (in 2004) to continue to be competitive in the insurance industry and to provide the needed services to our membership. During 2004, the Pool conducted a claims audit to insure proper handling of claims. The Pool is using a variety of risk financing techniques to systematically distance itself from an unstable insurance industry. It has charted a formal 501(c)(3) national purchasing group (NPX) and is a founding member of a captive insurance company, Governmental Entity Mutual, Inc. (GEM). GEM allows each captive member to participate in the profits of an excess layer insurance company as well. It is the Pool's long-term strategy to eliminate use of a private insurance carrier, placing all its excess insurance business with GEM to maximize its potential insurance profits. 2004 claims reserves decreased due to fluctuations in WCIA's participation in the excess layer and lack of excess large loss development.

FINANCIAL CONTACT

The Pool's financial statements are designed to present users (members and or the general public) with a general overview of the Pool's finances and to demonstrate the Pool's accountability. If you have questions about the report or need additional information, contact Lewis Leigh, the Pool's Executive Director, at P.O. Box 88030, Tukwila, WA 98138 (206)575-6046.

WASHINGTON CITIES INSURANCE AUTHORITY
Balance Sheets
As of December 31, 2006 and 2005

ASSETS	2006	2005
Cash and Cash Equivalents	$15,406,510	$12,883,916
Accrued Interest	198,797	191,270
Investments	87,320,032	78,492,230
Investment in GEM	699,299	699,299
Capital Assets	5,944,381	5,684,085
Accumulated Depreciation	(550,890)	(387,283)
Accounts Receivable	(39,282)	46,688
Prepaid Expenses	444,073	535,408
TOTAL ASSETS	$109,422,920	$98,145,613
LIABILITIES AND NET ASSETS		
Accounts Payable	$347,351	$384,417
Accrued Vacation Compensation	69,444	68,126
Deposits Payable	198,856	189,536
Property & Vehicle Claims Reserve	883,255	883,255
Reserve for Claims	48,448,443	48,448,443
Reserve for Increased Confidence Level	13,124,557	13,124,557
TOTAL LIABILITIES	63,071,906	63,098,334
Net Assets-Invested in Capital Assets	5,393,491	5,296,802
Net Assets-Unrestricted	40,957,523	29,750,477
TOTAL NET ASSETS	46,351,014	35,047,279
TOTAL LIABILITIES AND NET ASSETS	$109,422,920	$98,145,613

The accompanying notes are an integral part of this financial statement.

WASHINGTON CITIES INSURANCE AUTHORITY
Statements of Revenues, Expenses
And Changes In Fund Net Assets
For The Years Ended December 31, 2006 and 2005

	2006	2005
Operating Revenues		
Member Assessments - Liability	$20,533,549	$20,447,870
Member Assessments - Property	5,698,585	4,841,272
Member Assessments - Fidelity	74,515	72,665
Total Operating Revenues	$26,306,649	$25,361,807
Operating Expenses		
Loss & Loss Adjustment Expenses	$13,356,243	$16,384,032
Confidence Level Expense	-	948,200
Insurance - Members	3,818,873	2,250,563
Salaries and Wages	1,235,351	1,139,205
Personnel Benefits	341,481	305,576
Professional Services		
Claims Adjusting	433,312	411,420
Pre-Defense Review	533,836	611,712
Consultant	146,190	77,748
Legal	53,621	48,242
Actuarial	25,000	23,500
Audit	34,012	17,202
Financial Services	16,415	19,768
Risk Management Audit	8,150	7,265
Rent	120,000	118,613
Transportation	76,284	70,641
Printing	20,155	20,690
Communications	16,656	17,065
Supplies	40,018	45,066
Dues and Conferences	24,757	26,256
Retreat/Board Meetings	24,575	21,070
Depreciation	43,780	41,274
Miscellaneous	25,427	21,104
Repair and Maintenance	8,530	7,378
Seminars and Training	398,329	378,893
Total Operating Expenses	$20,800,995	$23,012,483

The accompanying notes are an integral part of this financial statement.

WASHINGTON CITIES INSURANCE AUTHORITY
Statements of Revenues, Expenses
And Changes In Fund Net Assets
For The Years Ended December 31, 2006 and 2005

	2006	2005
Operating Income (Loss)	$5,505,654	$2,349,324
Non-Operating Revenue (Loss)		
Unrealized Gain (Loss) on Investments	227,398	(2,555,829)
Realized Gain (Loss) on Investments	257,584	106,752
Income (Loss) from Investment in GEM	-	237,673
Investment Income	5,355,500	4,742,563
Net Profit (Loss) from Building Operations	(42,401)	(88,832)
Total Non-Operating Revenue	$5,798,081	$2,442,327
Income (Loss) Before Member Contributions	$11,303,735	$4,791,651
Net Assets - January 1, as previously reported	35,047,279	31,646,889
Adjustment for overstatement of member assessments in 2004	-	(1,391,261)
Net Assets - January 1, as restated	35,047,279	30,255,628
Assets - December 31	$46,351,014	$35,047,279

The accompanying notes are an integral part of this financial statement.

WASHINGTON CITIES INSURANCE AUTHORITY
Statements of Cash Flows
For the Years Ended December 31, 2006 and 2005

	2006	2005
SH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from members	$26,306,649	$25,361,807
Cash payments for claims	(13,356,243)	(14,540,874)
Cash payments for property & fidelity insurance	(3,818,873)	(704,502)
Cash payments for employee services	(1,575,514)	(1,438,633)
Payments for operating expenses	(1,855,708)	(1,932,032)
Net cash provided (used) by operating activities	$5,700,311	$6,745,766
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition of capital assets	(260,296)	(474,330)
Net cash provided (used) by financing activities	($260,296)	($474,330)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of investment securities	44,360,525	44,969,000
Purchase of investment securities	(52,831,479)	(44,847,717)
Proceeds from rental of office building	75,066	19,653
Interest on investments	5,478,467	4,741,494
Net cash provided (used) by investing activities	(2,917,421)	4,882,430
Net increase in cash and cash equivalents	$2,522,594	$11,153,866
Cash and Cash equivalents beginning of year	12,883,916	1,730,050
ih and cash equivalents end of year	$15,406,510	$12,883,916

Reconciliation of Net Income (Loss) to Net Cash Provided (Used) by Operating Activities:

	2006	2005
Net Income (Loss)	$11,303,735	$4,791,651
Adjustments to reconcile income to net cash provided by operating activities:		
Depreciation	43,780	41,274
Amortization of bond discounts/premiums	130,494	26,259
Interest reserve reported as investing	(5,478,467)	(4,741,494)
(Income) Loss from investment in GEM	-	(237,673)
(Gain) Loss on investments	(257,584)	(106,752)
Unrealized (gains) losses on investments	(227,398)	2,555,829
Net loss from building operations	42,401	88,832
Changes in assets and liabilities:		
Decrease (Increase) in accrued interest	(7,527)	(27,328)
Decrease (Increase) in accounts receivable	85,970	(40,318)
Decrease (Increase) in prepaid expenses	91,335	1,239,819
Increase (Decrease) in payables	(37,066)	349,088
Increase (Decrease) in accrued vacation compensation	1,318	6,146
Increase (Decrease) in security deposits payable	9,320	9,075
Increase (Decrease) in property & vehicle claims reserve	-	(193,642)
'ncrease in claims reserves	-	2,036,800
,ncrease (Decrease) in confidence level reserve	-	948,200
Net Cash Provided (Used) by Operating Activities	$5,700,311	$6,745,766

WASHINGTON CITIES INSURANCE AUTHORITY
Notes To Financial Statements
For The Fiscal Years Ended December 31, 2006 and 2005

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of WCIA conform to generally accepted accounting principles as applicable to proprietary funds of governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The following summary of the significant accounting policies is presented to assist the reader in interpreting the financial statements. The more significant policies are described below.

A. Reporting Entity

The Washington Cities Insurance Authority (WCIA) is a municipal organization of cities, towns, and interlocal entities in Washington State that join together for the purpose of providing liability protection to its member entities. WCIA was created by interlocal agreement on January 1, 1981, pursuant to RCW Chapters 48.62 and 39.34. WCIA was organized to provide members with comprehensive and economical liability coverage, such as auto, general, police, public officials & errors & omissions, and property coverages, to reduce the amount and frequency of member losses and to decrease the cost incurred by members in the handling and litigation of claims.

Insurance lines of coverage are provided by the Authority to members for auto & general liability, police liability, public officials liability, and employee benefit liability.

An auto physical damage and property insurance program was established by WCIA on behalf of participating members. WCIA also formed a group purchase fidelity insurance program to provide public employee dishonesty coverage and optional forgery or alteration coverage. The program is optional to member entities.

Member entities in 2006 were ARCH, Aberdeen, Anacortes, Arlington, Auburn, Bainbridge Island, Battle Ground, Benton County Emergency Services, Benton City, Bonney Lake, Bothell, Burien, Camas, Centralia, Cashmere, Chehalis, Chelan, Cheney, Clarkston, Clark Regional Wastewater, Cle Elum, Clyde Hill, Coupeville, Covington, Des Moines, Eastside Public Safety Communications, Edgewood, Edmonds, Elma, Emergency Services Coordinating Agency, Enumclaw, e City Gov Alliance, Fife, George, Goldendale, Grandview, Grays Harbor Communications 911, Hoquiam, Issaquah, Kelso, Kent, Kenmore, Kirkland, La Conner, Lacey, Lake Forest Park, Lake Stevens, Leavenworth, Long Beach, Longview, LOTT, Mabton, Maple Valley, Marysville, Marysville Fire District, McCleary, Medical Lake, Medina, Mercer Island, Metro Park Dist. Of Tacoma, Mill Creek, Milton, Monroe, Monroe Fire District, Montesano, Moses Lake, Mount Vernon, Mountlake Terrace, Mukilteo, Newcastle, Normandy Park, North Bonneville, North Shore Utility District Oak Harbor, Ocean Shores, Olympia, Othello, Pasco, PENCOM, Port Angeles, Port Townsend, Pullman, Pullman Moscow Regional Airport, Puyallup, Renton, Richland, Ridgefield, Sammamish, Shelton, Shoreline, Skagit 911, SNOCOM, Snohomish, SNOPAC, Snohomish County Dept. of Emergency Management, Snohomish County Emergency Radio System, Snoqualmie, Soap Lake, Spokane Valley, Stanwood, Steilacoom, Sumner, Three Rivers Regional Wastewater, Thurston Regional Planning Commission, Toppenish, Tukwila, Tumwater, Union Gap, University Place, Valley Communications, Walla Walla, Warden, Washougal, Water Operating Board, Westport, Whitcom 911, Woodinville, Woodway, Yakima Valley Conference of Governments, Yarrow Point, and Zillah.

B. **Basis Of Accounting And Presentation**

The accounting records of WCIA are maintained in accordance with methods prescribed by the State Auditor's Office under the authority of Chapter 43.09 RCW. WCIA also follows the accounting standards established by the Governmental Accounting Standards Board (GASB) Statement 10, *Accounting And Financial Reporting For Risk Financing And Related Insurance Issues*, as amended by the GASB Statement 30, *Risk Financing Omnibus* and GASB 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Funds.*

WCIA uses the full-accrual basis of accounting where revenues are recognized when earned and expenses are recognized when incurred. Fixed asset purchases are capitalized and long-term liabilities are accounted for in the appropriate fund.

C. **Assets, Liabilities, and Equities**

1. **Cash and Cash Equivalents**

It is WCIA's policy to invest all temporary cash surpluses. At December 31, 2006, WCIA was holding $15,406,510 in short-term residual investments of surplus cash. This amount is classified on the balance sheet as cash and cash equivalents.

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

2. **Investments** - See Note 2.

3. **Fixed Assets and Depreciation** - See Note 6.

4. **Restricted Funds**

In accordance with state statutes, separate restricted/designated funds are required to be established. The assets held in these funds are restricted for specific uses, such as claims expense. WCIA established such accounts for funds received by member entities for the payment of claims.

5. **Compensated Absences**

Compensated absences are absences for which employees will be paid, such as vacation leave. WCIA records compensated absences as an expense and liability when earned.

As of December 31, 2006 and 2005, Accrued Vacation Compensation was estimated at $69,444 and $68,126, respectively. Vacation pay, which may be accumulated up to two hundred and forty (240) hours, is payable upon resignation, retirement or death.

6. **Unpaid Claims Liabilities**

WCIA establishes claims liabilities based on estimates of the ultimate cost of claims, including future claim adjustment expenses, that have been reported but not settled, and claims that have been incurred but not reported. The length of time for which such costs must be estimated varies depending on the coverage involved. Estimated amounts of salvage and subrogation and purchased excess coverages involved are considered in determining the liability for unpaid claims. Because actual claims costs depend on such complex factors as inflation, changes in doctrines of legal liability, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made.

7. **Member Assessments**

Member assessments are collected and recognized as revenue in the period for which insurance protection is provided. The assessment is calculated based on the development of the estimated discounted premium by member, based on an experience rating program which considers both loss experience and exposure to loss of the individual member entity.

8. **Claims Reserves**

Claims are charged to expense as incurred. Claim reserves represent the accumulation of estimates for reported, unpaid claims, plus a provision for claims incurred, but not reported. These estimates are continually reviewed and updated, and any resulting adjustments are reflected in current earnings.

9. **Reserve For Unallocated Loss Adjustment Expenses**

The reserve for unallocated loss adjustment expenses represents the estimated cost to be incurred with respect to the settlement of claims in process and claims incurred but not reported. The actuary estimates this liability at the end of each year based upon estimated costs provided by the third party administrator. The change in the liability each year is reflected in current earnings.

D. **Exemption From Federal And State Taxes**

Pursuant to revenue ruling number 90-74, income of Municipal Risk Pools is excluded from taxation under Internal Revenue Code Section 115(1).

Chapter 48.62 RCW exempts the pool from insurance premium taxes, and business and occupation taxes imposed pursuant to Chapter 82.04 RCW.

E. **Leases**

WCIA's only lease is for office space. In October 2004 WCIA purchased a building and is charging itself rent of $10,000 per month. The future operating lease obligations for the next five years are as follows:

2007	120,000
2008	120,000
2009	120,000
2010	120,000
2011	120,000

NOTE 2 - DEPOSITS AND INVESTMENTS

As required by state law, all deposits and investments of WCIA's funds are obligations of the U.S. Government, the State Treasurer's Investment Pool (deemed a cash equivalent), deposits with Washington State banks and savings and loan institutions, or other investments allowed by Chapter 39.59 RCW, such as, insured municipal bonds, mortgaged backed securities, and collateralized mortgage obligations. WCIA has recorded all its investments at fair market value, as required by GASB 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Funds*. The difference between fair market value and cost adjusted for amortized premiums and discounts is reflected in the Statements of Revenues, Expenses And Changes In Members' Reserves as an unrealized gain (loss) on investments.

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

WCIA's investments are categorized to give an indication of the risk assumed at year-end. The following summary shows WCIA's investments at year-end categorized by risk. Category 1 includes investments that are either insured, registered or held by WCIA or its agent in WCIA's name. Category 2 includes uninsured and unregistered investments that are held by the counter party's trust department or agent in WCIA's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counter party, or its trust department or agent but not in WCIA's name.

	Category			Cost	Market
	1	2	3	Amount	Value
U. S. Government Securities or Equivalents	$90,454,820	$ -0-	$ -0-	$90,454,820	$87,320,032

The investment portfolio of WCIA is designed to attain a high market rate of return throughout budgetary and economic cycles, while preserving and protecting capital and meeting daily cash flow needs, as outlined in the Investment Policy.

It is WCIA's policy and part of the investment process to use asset allocation. Asset allocation is a decision regarding the best use of financial resources at any given moment. This decision typically takes the form of whether to invest for a short term, intermediate term, or long term. WCIA takes into consideration the opportunities, risks and assumptions made regarding the market and WCIA's business. WCIA balances all considerations with a goal of achieving good returns while at the same time maintaining the necessary liquidity to pay claims.

The following is a summary of the investment holdings of WCIA at December 31, 2006:

Investment	Market Value	Percentage
Collaterlized Mortgage Obligations (CMO)	$ 68,602,583	78.56%
Ginnie Mae Investments	14,083,875	16.13%
Govt. Bonds & Medium Term Notes	4,633,574	5.31%
Total	$ 87,320,032	100.0%

DERIVATIVES AND SIMILAR TRANSACTIONS

WCIA's investments include certain derivative instruments which derive their value from securities. Such investments are governed by WCIA's policy. CMO's are used by WCIA in order to take advantage of pricing inefficiencies or to enhance returns.

CMO's may carry credit risk, which varies according to the nature of the underlying collateral and the credit rating. Of the CMO's in WCIA's portfolio, 100% have underlying government agency collateral, and therefore carry an agency rating. In addition, Standard and Poors and Moodys have recognized the mortgage backed securities that underlie the CMOs as triple A quality.

The CMOs are obligations of US sponsored agencies which play key roles in regulating or assisting the economy. Given such roles and the importance of these public bodies, it is unlikely that the federal government would ever permit them to default on outstanding securities.

CMOs may also carry prepayment risk, which varies according to the nature of the CMO. Of the CMOs in WCIA's portfolio at December 31, 2005, all are designed to have very stable average lives and yields over a wider range of prepayment rates on the underlying mortgages.

The investments described in this footnote are recorded in the financial statements and valued consistently within the overall investment portfolio.

All investments made by WCIA are in accordance with the investment laws of the State of Washington and WCIA's internal investment policies.

NOTE 3 - SELF-INSURED RETENTION

WCIA and its members assume liability for the first $3,000,000 of each claim, called the primary loss layer. Total self-insurance is $3,000,000 per loss.

Additionally WCIA is fully self-insured for unemployment benefits for its employees. No provision is made for estimated future claims, which are not considered significant to the financial position of WCIA.

NOTE 4 - INSURANCE CONTRACTS

From its inception on January 1, 1981, WCIA used re-insurance agreements of varying levels to reduce its exposure to large losses on all types of insured events. Purchasing insurance permits recovery of a portion of losses from reinsurer, and discharges the primary liability of WCIA as a direct insurer of the risks reinsured, above the combined $3,000,000 self-insured layer. WCIA does not report risks covered by re-insurance as liabilities.

WCIA's insurance coverage is provided in primary and excess layers. Limits for each layer by accident period are as follows:

Accident Period	Excess Layer(s)	Self-Insured Retention
01/01/97 - 12/31/97	10,000,000	4,000,000
01/01/98 – 12/31/98	11,000,000	3,000,000
01/01/99 – 12/31/99	11,000,000	3,000,000
01/01/00 – 12/31/00	11,000,000	3,000,000
01/01/01 – 12/31/01	11,000,000	3,000,000
01/01/02 – 12/31/02	11,000,000	3,000,000
01/01/03 – 12/31/03	11,000,000	3,000,000
01/01/04 – 12/31/04	11,000,000	3,000,000
01/01/05 – 12/31/05	11,000,000	3,000,000
01/01/06 – 12/31/06	12,000,000	3,000,000

NOTE 5 - MEMBERS' SUPPLEMENTAL ASSESSMENTS AND CREDITS

The Interlocal Governmental Agreement provides for supplemental assessments to members based on actual claim experience. During fiscal years 2006 and 2005, WCIA did not make supplemental assessments.

NOTE 6 - PROPERTY AND EQUIPMENT

Capital assets (and other fixed assets) are recorded at historical cost net of accumulated depreciation.

Depreciation is computed using the straight-line method over the estimated useful life of the asset. Initial depreciation on capital assets is recorded on a prorated basis in the year of purchase. Maintenance and repairs are expended as incurred. When assets are retired or otherwise disposed of, the cost and accumulated depreciation is removed from the accounts, and any resulting gain or loss on disposal is reflected as other income.

Property and equipment consisted of the following at December 31, 2006 and 2005:

	2006	2005
Property, Office Furnishings and Equipment	$5,944,381	$5,684,085
Less Accumulated Depreciation	(550,890)	(387,283)
Net Property and Equipment	$5,393,491	$5,296,802

NOTE 7 - UNPAID CLAIMS LIABILITIES

As discussed in Note 1, WCIA establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities for WCIA during the current and previous year:

	2006	2005
Unpaid Claims and Claim Adjustment Expenses at Beginning of Year	$48,448,443	$46,411,643
Incurred Claims and Claim Adjustment Expenses:		
Provision for Insured Events of the Current Year	14,660,434	15,370,281
Increases(Decreases) in Provision for Insured Events of Prior Years	1,516,601	1,576,135
Total Incurred Claims and Claim Adjustment Expenses:	$64,625,478	$63,358,059
Payments:		
Claims and Claim Adjustment Expenses Attributable to Insured Events of the Current Year	2,418,416	29,055
Claims and Claim Adjustment Expenses Attributable to Insured Events of Prior Years	13,101,960	14,880,561
Total Payments	15,520,376	14.909,616
Total Unpaid Claims and Claim Adjustment Expenses at End of the Year	$49,105,102	$48,448,443

NOTE 8 - PENSION PLANS

Substantially all of WCIA's full-time and qualifying part-time employees participate in the Public Employees' Retirement System (PERS). This is a statewide local government retirement system administered by the Washington State Department of Retirement Systems, under a cost-sharing multiple-employer defined benefit public employee retirement system. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a comprehensive annual financial report containing historical trend information and may be obtained from the Department of Retirement Systems, Administrative Services Division, P.O. Box 48380, Olympia, WA 98504-8380. The following disclosures are made pursuant to GASB Statement 27, *Accounting for Pensions by State and Local Government Employers.*

Public Employees' Retirement System (PERS) Plan 1, 2, and 3

Plan Description

PERS is a cost-sharing multiple employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a combination defined benefit/defined contribution plan. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts (other than judges in a judicial retirement system); employees of legislative committees; community and technical colleges, college and university employees (not in national higher education retirement programs); judges of district and municipal courts; and employees of local governments. PERS participants who joined the system by September 30, 1997, are Plan I members. Those who joined on or after October 1, 1977 and by either, February 28, 2002 for state and higher education employees, or August 31, 2002 for local government employees, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS participants joining the system on or after March 1, 2002 for state and higher education employees, or September 1, 2002 for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported under Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. PERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PERS retirement benefit provisions are established in state statue and may be amended only by the State Legislature.

Plan 1 retirement benefits are vested after an employee completes five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The annual pension is 2 percent of the average final compensation per year of service, capped at 60 percent. The average final compensation is based on the greatest compensation during any 24 eligible consecutive compensation months. If qualified, after reaching age 66 a cost-of-living allowance is granted based on years of service credit and is capped at 3 percent annually

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

Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. The defined benefit portion provides a benefit calculated at 1 percent of the average final compensation per year of service. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period. Plan 3 members become eligible for retirement if they have: at least ten years of service; or five years including twelve months that were earned after age 54; or five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 retirements prior to the age of 65 receive reduced benefits. If the retirement is at age 55 or older with at least 30 years of service, a 3 percent per year reduction applies; otherwise and actuarial reduction will apply.

There is no cap on years of service credit; and Plan 3 provides the same cost-of-living allowance as Plan 2. The defined contribution portion can be distributed in accordance with an option selected by the member, either as a lump sum or pursuant to other options authorized by the Employee Retirement Benefits Board.

There are 1, 167 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of September 30, 2002:

Retirees and Beneficiaries Receiving Benefits	63,756
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	19,152
Active Plan Members Vested	98,994
Active Plan Members Nonvested	55,191
TOTAL	237,093

Funding Policy

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statue at 6 percent for state agencies and local government unit employees, and 7.5 percent for state government elected officials. The employer and employee contribution rates for Plan 2 and the contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. PERS Plan 3 defined contribution is a non-contributing plan for employers. Employees who participate in the defined contribution portion of PERS Plan 3 do not contribute to the defined benefit portion of PERS Plan 3. The Employee Retirement Benefits Board sets Plan 3 employee contribution rates. Six rate options are available ranging from 5 to 15 percent; two of the options are graduated rates dependent on the employee's age. The methods used to determine the contribution requirements are established under state stature in accordance with chapters 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current year covered payroll, as of December 31, 2005 were:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer*	3.69%	3.69%	3.69%**
Employee	6.00%	3.50%	***

* The employer rates include the employer administrative expense fee currently set at 0.18%.
** Plan 3 defined benefit portion only.
*** Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

WCIA's contribution for the three plans for employer and employee for the year ended December 31, 2006 and 2005 was $88,964 and $59,162, respectively.

NOTE 9 – INVESTMENT IN GEM

Governmental Entities Mutual, Inc. (GEM)

Governmental Entities Mutual, Inc. (GEM) is a captive insurance company, formed by eleven municipal risk pools across the nation. Its sole purpose is to ensure the availability, cost and quality of excess or reinsurance layers necessary for pool operation during difficult phases of insurance market cycles.

GEM is licensed to provide liability, property and workers' compensation reinsurance for public entity pools and self-insured local governments. It performs traditional functions such as marketing, underwriting, financial and regulatory administration, claims and litigation management and risk management through staff or vendors. GEM is managed by a CEO proficient in standard insurance principles, captive operation and pooling administration, directed by an elected Board from the membership.

GEM is domiciled in Washington D.C. pursuant to their Nonprofit Corporation Laws and the Captive Insurance Company Act. It has met and exceeded the capitalization and administrative requirements to act as an authorized, admitted, reinsurer. WCIA is one of eleven founding members providing the initial capitalization and enjoys benefits of that unique status, and has been elected to serve on the Board of Directors.

WCIA has contributed an initial, minimum, surplus contribution of $500,000. $50,000 of the $500,000 surplus contribution was made in December 2002, and has been included on the balance sheet in the "Prepaid Expenses & Deposit" account. The remaining $450,000 of surplus contribution was made in January 2003. Additional surplus requirements have been established to recognize proportionate member growth or expansion of GEM operations. A surplus account for each member has been established consisting of the initial surplus contribution, additional contributions, dividends and allocations of net income. Washington Cities Insurance Authority surplus account balance at 12/31/2006 was $724,143.

Other considerations within the Agreement between GEM and its Members include undesignated member equity, return of member equity, member and policyholder dividends, premium determination, accounting and audits, member obligations and non-compliance, underwriting and rating, and a liquidation and dissolution plan.

The WCIA Executive Committee and Full Board, its Corporate Counsel, State Risk Manager and State Auditor have approved WCIA ability to enter into membership of this private nonprofit corporation.

NOTE 10 – PRIOR PERIOD ADJUSTMENT

During December 2004 WCIA invoiced several members for their 2005 assessments and recorded the revenue in error in 2004. The amount which should have been reported in 2005 was $1,391,261. The financial statements (Member Assessments) have been restated for 2004 to report the amount in 2005 and Net Assets at the beginning of 2005 were also restated.

WASHINGTON CITIES INSURANCE AUTHORITY
Required Supplementary Information
January 1, 2006 Through December 31, 2006

This required supplementary information is an integral part of the accompanying financial statements.

1. Ten-Year Claims Development Information

The table below illustrates how the Authority's earned revenues and investment income compare to related costs of loss and other expenses assumed by WCIA as of the end of each of the last ten (10) years. The rows of the table are defined as follows:

1. This line shows the number of member cities at the end of the year.

2. This line shows the total of each year's earned contribution revenues and investment revenues.

3. This line shows each year's other operating cost of WCIA including overhead and claims expense not allocable to indvidual claims.

4. This line shows WCIA's incurred claims and allocated claim adjustment expense (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year).

5. This section of ten (10) rows shows the cumulative amounts paid as of the end of successive years for each policy year.

6. This section of ten (10) rows shows how each policy year's incurred claims increased or decreased as of the end of successive years. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known.

7. This line compares the latest reestimated incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature policy years. The columns of the table show data for successive policy years.

WASHINGTON CITIES INSURANCE AUTHORITY
Claims Development Information
For The Ten Fiscal Years Ended December 31, 2006

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
1. Member Cities	87	92	96	99	103	103	106	106	113	114	124
2. Net earned required contribution and investment revenue	$13,941,025	$15,118,154	$15,485,629	$16,401,286	$18,222,486	$19,523,001	$20,380,001	$20,194,056	$22,664,965	$25,190,433	$25,889,049
3. Unallocated Expenses	1,837,520	1,853,156	2,017,589	2,289,745	2,483,260	2,685,023	2,913,526	2,913,526	3,065,323	3,429,668	3,625,679
4. Estimated incurred claims and expense end of year	11,500,000	10,400,000	11,700,000	13,700,000	16,500,000	15,500,000	17,600,000	20,500,000	18,000,000	17,000,000	16,500,000
5. Paid (cumulative) as of:											
End of year	2,671,153	1,064,039	1,223,403	1,138,358	1,776,527	1,244,210	1,957,122	1,651,450	2,126,559	1,878,844	1,606,040
One year later	4,492,596	2,375,349	2,959,308	3,429,569	4,127,359	2,991,956	4,546,564	4,315,339	4,231,644	4,478,073	
Two years later	6,444,998	5,463,973	5,810,009	5,039,393	5,455,565	5,554,332	8,300,565	6,929,513	5,606,475		
Three years later	8,862,513	7,973,945	7,901,506	6,286,164	7,234,371	8,488,627	11,036,022	9,949,495			
Four years later	10,649,052	8,713,829	11,082,233	7,324,386	9,719,769	11,640,105	13,110,529				
Five years later	12,274,824	9,654,559	12,175,817	7,765,819	10,161,162	12,514,483					
Six years later	13,735,014	9,753,006	12,457,912	8,617,777	10,676,640						
Seven years later	17,343,327	9,863,222	12,693,496	8,648,127							
Eight years later	17,834,647	9,885,841	13,116,697								
Nine years later	18,094,522	9,924,302									
Ten years later	18,201,106										
6. Reestimated incurred claims and expense:											
End of policy year	11,500,000	10,400,000	11,700,000	13,700,000	16,500,000	15,500,000	17,600,000	20,500,000	18,000,000	17,000,000	16,500,000
One year later	11,700,000	10,900,000	13,200,000	13,000,000	14,800,000	13,500,000	19,000,000	16,500,000	15,000,000	15,000,000	
Two years later	12,000,000	12,500,000	13,200,000	12,500,000	13,000,000	15,500,000	17,500,000	15,200,000	12,500,000		
Three years later	14,500,000	11,800,000	14,500,000	9,900,000	13,000,000	13,500,000	17,000,000	15,400,000			
Four years later	14,500,000	12,000,000	16,300,000	9,500,000	12,000,000	14,000,000	16,900,000				
Five years later	16,500,000	10,600,000	13,300,000	9,200,000	11,400,000	16,000,000					
Six years later	18,600,000	10,400,000	13,200,000	9,250,000	11,200,000						
Seven years later	19,160,000	10,200,000	13,300,000	9,100,000							
Eight years later	19,148,131	10,100,000	13,550,000								
Nine years later	19,332,407	9,947,261									
Ten years later	19,321,441										
7. Increase (decrease) in estimated incurred claims from end of policy year	7,821,441	(452,719)	1,850,000	(4,600,000)	(5,300,000)	500,000	(700,000)	(5,100,000)	(6,500,000)	(2,000,000.00)	-

This Information Is Required By The Governmental Accounting Standards Board.

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.

Our mission is to work in cooperation with our audit clients and citizens as an advocate for government accountability. 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.

The State Auditor's Office has 300 employees who are located around the state to deliver our services effectively and efficiently. Approximately 65 percent of our staff are certified public accountants or hold other certifications and advanced degrees.

Our regular 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. We also perform fraud and whistleblower investigations. In addition, we have the authority to conduct performance audits of state agencies and local governments.

The results of our audits are widely distributed through a variety of reports, which are available on our Web site. We continue to refine our reporting efforts to ensure the results of our audits are useful and understandable.

We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive program to coordinate audit efficiency and to ensure high-quality audits.

State Auditor	**Brian Sonntag, CGFM**
Chief of Staff	**Ted Rutt**
Chief Policy Advisor	**Jerry Pugnetti**
Director of Administration	**Doug Cochran**
Director of Audit	**Chuck Pfeil, CPA**
Director of Performance Audit	**Linda Long, CPA, CGFM**
Director of Special Investigations	**Jim Brittain, CPA**
Director for Legal Affairs	**Jan Jutte**
Local Government Liaison	**Mike Murphy**
Communications Director	**Mindy Chambers**
Public Records Officer	**Mary Leider**
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