



Office of the Washington State Auditor
Pat McCarthy

Financial Statements and Federal Single Audit Report

Lake Stevens Sewer District

Snohomish County

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

Published September 21, 2017

Report No. 1019858





Office of the Washington State Auditor
Pat McCarthy

September 21, 2017

Board of Commissioners
Lake Stevens Sewer District
Lake Stevens, Washington

Report on Financial Statements and Federal Single Audit

Please find attached our report on the Lake Stevens Sewer District's financial statements and compliance with federal laws and regulations.

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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SCHEDULE OF FINDINGS AND QUESTIONED COSTS

**Lake Stevens Sewer District
Snohomish County
January 1, 2016 through December 31, 2016**

SECTION I – SUMMARY OF AUDITOR’S RESULTS

The results of our audit of the Lake Stevens Sewer District are summarized below in accordance with Title 2 *U.S. Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

Financial Statements

We issued an unmodified opinion on the fair presentation of the basic financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP).

Internal Control over Financial Reporting:

- *Significant Deficiencies:* We reported no deficiencies in the design or operation of internal control over financial reporting that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified no deficiencies that we consider to be material weaknesses.

We noted no instances of noncompliance that were material to the financial statements of the District.

Federal Awards

Internal Control over Major Programs:

- *Significant Deficiencies:* We reported no deficiencies in the design or operation of internal control over major federal programs that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified no deficiencies that we consider to be material weaknesses.

We issued an unmodified opinion on the District's compliance with requirements applicable to its major federal program.

We reported no findings that are required to be disclosed in accordance with 2 CFR 200.516(a).

Identification of Major Federal Programs:

The following program was selected as a major program in our audit of compliance in accordance with the Uniform Guidance.

<u>CFDA No.</u>	<u>Program or Cluster Title</u>
66.458	Capitalization Grants for Clean Water State Revolving Funds

The dollar threshold used to distinguish between Type A and Type B programs, as prescribed by the Uniform Guidance, was \$750,000.

The District did not qualify as a low-risk auditee under the Uniform Guidance.

SECTION II – FINANCIAL STATEMENT FINDINGS

None reported.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None reported.

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

**Lake Stevens Sewer District
Snohomish County
January 1, 2016 through December 31, 2016**

Board of Commissioners
Lake Stevens Sewer District
Lake Stevens, Washington

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

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

September 8, 2017

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR
EACH MAJOR FEDERAL PROGRAM AND REPORT ON
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE
WITH THE UNIFORM GUIDANCE**

**Lake Stevens Sewer District
Snohomish County
January 1, 2016 through December 31, 2016**

Board of Commissioners
Lake Stevens Sewer District
Lake Stevens, Washington

**REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL
PROGRAM**

We have audited the compliance of the Lake Stevens Sewer District, Snohomish County, Washington, with the types of compliance requirements described in the U.S. *Office of Management and Budget (OMB) Compliance Supplement* that could have a direct and material effect on each of the District's major federal programs for the year ended December 31, 2016. The District's major federal programs are identified in the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 *U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance

requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. Our audit does not provide a legal determination on the District's compliance.

Opinion on Each Major Federal Program

In our opinion, the District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2016.

REPORT ON INTERNAL CONTROL OVER COMPLIANCE

Management of the District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program in order to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over compliance.

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

Our consideration of internal control over compliance 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. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Purpose of this Report

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

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

Pat McCarthy

State Auditor

Olympia, WA

September 8, 2017

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Lake Stevens Sewer District Snohomish County January 1, 2016 through December 31, 2016

Board of Commissioners
Lake Stevens Sewer District
Lake Stevens, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Lake Stevens Sewer District, Snohomish County, Washington, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 14.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District's preparation and fair presentation of the

financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lake Stevens Sewer District, as of December 31, 2016, 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

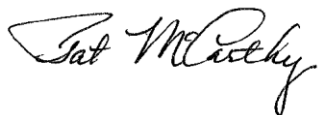
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 15 through 18 and pension plan information on pages 35 through 38 be presented to supplement the basic financial statements. Such information, although not a part of 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.

Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the District's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by Title 2 *U.S. Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). This schedule is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated September 8, 2017 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.



Pat McCarthy

State Auditor

Olympia, WA

September 8, 2017

FINANCIAL SECTION

Lake Stevens Sewer District Snohomish County January 1, 2016 through December 31, 2016

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis – 2016

BASIC FINANCIAL STATEMENTS

Statement of Net Position – 2016

Statement of Revenues, Expenses and Changes in Net Position – 2016

Statement of Cash Flows – 2016

Notes to Financial Statements – 2016

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Proportionate Share of the Net Pension Liability – PERS 1 – 2016

Schedule of Proportionate Share of the Net Pension Liability – PERS 2/3 – 2016

Schedule of Employer Contributions – PERS 1 – 2016

Schedule of Employer Contributions – PERS 2/3 – 2016

SUPPLEMENTARY AND OTHER INFORMATION

Schedule of Expenditures of Federal Awards – 2016

Notes to the Schedule of Expenditures of Federal Awards – 2016

Lake Stevens Sewer District Management's Discussion and Analysis For the Year Ended December 31, 2016

The following discussion and analysis of the financial performance of the Lake Stevens Sewer District (the District) provides an overall review of the District's financial activities for the year ended December 31, 2016. This discussion is designed to be read in conjunction with the financial statements and notes to financial statements, which follow this section.

OVERVIEW

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

In 2016, the District had a positive operating income and met all debt obligations. As of December 31, 2016, the District had a total net position of \$84,622,900.

Highlights of the 2016 year at the District:

- The District successfully completed 80% of the bio-solids removal at our Old Treatment Plant in preparation for the decommissioning and Plant closure process starting in 2017.
- At the end of 2016, the Sewer District hired two highly-skilled employees to assist with Collection System operations and maintenance which includes the ability to deploy a Vactor Truck for full-service sewer maintenance capability.
- Created Development Extension Agreements (DEAs) for more than 300 new housing units to be constructed in Lake Stevens over the next two to three years.
- Completed the update of the District's Comprehensive Plan which was approved by Snohomish County in December 2016.
- Modified \$20 million of Public Works Trust Fund (PWTF) loans with the State Department of Commerce, thereby reducing the District's annual debt payments by \$500,000.
- Participated with the City of Lake Stevens on evaluating potential expansion of the City boundary via Annexations into unincorporated County land areas to the northeast and southeast of the City.
- Submitted a new Permit Application to the Department of Ecology for the next 5-years of operation at the Wastewater Treatment Plant, which was commissioned in 2012.
- Received a request by our Field and Treatment Plant employees to form a Bargaining Unit. The employees are represented by American Federation of State, County and Municipal Employees (AFSCME) out of the Everett, WA office and as such, the District management team began negotiations to create a Labor Contract estimated to be finalized in the summer of 2017.
- Scheduled a 60th Anniversary celebration and Open House for the Sewer District in June 2017.
- Signed an agreement with Snohomish County Public Utility District (PUD) to be a part of a 2-year Energy Conservation monitoring and incentive program sponsored by the Bonneville Power Administration (BPA).

FINANCIAL STATEMENTS

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

Basic Financial Statements

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

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

Notes to the Financial Statements

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

FINANCIAL ANALYSIS

Condensed Financial Information for Years Ending

	Dec. 31, 2016	Dec. 31, 2015
Current Assets	\$ 27,833,643	\$ 25,583,991
Net Capital Assets	163,442,598	169,709,994
Deferred Outflow of Resources	<u>315,523</u>	<u>188,233</u>
Total Assets & Deferred Outflows of Resources	191,591,764	195,482,218
Current Liabilities	6,756,380	6,964,054
Non-Current Liabilities	100,136,725	105,395,612
Deferred Inflows of Resources	<u>75,759</u>	<u>269,611</u>
Total Liabilities & Deferred Inflows of Resources	106,968,864	112,629,277
Net Investment in Capital Assets	60,824,357	65,200,709
Restricted for Debt Service & Const	15,805,150	17,045,439
Unrestricted	<u>7,993,393</u>	<u>606,793</u>
Total Net Position	\$ <u><u>84,622,900</u></u>	\$ <u><u>82,852,941</u></u>
Utility Operating Revenue	\$ 12,731,317	\$ 11,875,340
Non-operating Revenue	<u>202,903</u>	<u>221,391</u>
Total Revenue	12,934,220	12,096,731
Operating Expenses	11,060,741	11,037,892
Non-operating Expenses	<u>3,987,733</u>	<u>2,721,513</u>
Total Expenses	<u>15,048,474</u>	<u>13,759,405</u>
Excess (Deficiency)	(2,114,254)	(1,662,674)
Capital Contributions	<u>3,884,213</u>	<u>2,891,484</u>
Change in Net Position	1,769,959	1,228,810
Net Position – Beg of Year	82,852,941	83,240,119
Restatement – Change in Accounting Principle	<u>0</u>	<u>(1,615,988)</u>
Net Position – End of Year	\$ <u><u>84,622,900</u></u>	\$ <u><u>82,852,941</u></u>

Overview

For the twelve months ending December 31, 2016, the total assets of the District decreased by approximately \$3.9 million or approximately 2.0%, and total liabilities decreased by approximately \$5.7 million or approximately 5.0%. Net Position increased approximately \$1.8 million. The District's overall financial position improved. The decreases in total assets are primarily due to the increased depreciation costs and the decreases in total liabilities are primarily due to the repayment of debt.

Operating Revenues increased approximately 7.2% as expected due to an increase in District customers during 2016 and the \$3.00 per month, per Equivalent Residential Unit (ERU) rate increase that took effect January 1, 2016. Operating Revenues are expected to increase in 2017 due to a \$3.00 per month, per ERU rate increase, that took effect on January 1, 2017, and an increase in District customers.

Operating Expenses increased only 0.2% due to the staff operating the District more efficiently.

The District has restrictions on the use of Restricted for Debt Service & Const funds which are listed on the previous page.

Capital Assets

The District had a total net Capital Asset Value of \$163,442,598 as of December 31, 2016. This was a decrease of approximately \$6.3 million and is due to the increased STP#2 depreciation expense. Capital Assets consisted of \$1,120,936 in assets not being depreciated including land, and construction in process; \$207,808,262 in depreciable assets with a total accumulated depreciation of \$45,486,600 for a net value of depreciable assets of \$162,321,662.

Please refer to Note 3 and 4 to the Financial Statements for more information.

Long-Term Debts

During the year, the District decreased its long-term debt by \$5,736,310, leaving a balance of \$102,618,241, including current portion of long-term debt.

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

REQUESTS FOR INFORMATION

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

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

MGAG No. 2176
LAKE STEVENS SEWER DISTRICT
STATEMENT OF NET POSITION
DECEMBER 31, 2016

Assets

Current Assets:

Cash and Cash Equivalents	\$ 11,487,227
Restricted Cash and Cash Equivalents	15,805,150
Receivables, net	358,468
Assessments Receivable	48,388
Prepayments	134,410
Total Current Assets	<u>27,833,643</u>

Noncurrent Assets:

Capital Assets Not Being Depreciated

Land	1,052,474
Construction Works in Progress	68,462

Capital Assets Being Depreciated

Plant and Buildings	179,537,251
Machinery, Equipment and Furniture	28,271,011

208,929,198

(45,486,600)

Total Noncurrent Assets 163,442,598

Total Assets 191,276,241

Deferred Outflows of Resources

Deferred Outflows of Resources Related to Bond Refunding 8,513

Deferred Outflows of Resources Related to Pension 307,010

Total Deferred Outflows of Resources 315,523

Total Assets and Deferred Outflows \$ 191,591,764

Liabilities

Current Liabilities:

Accounts Payable	\$ 858,786
Compensated Absences	143,810
Developer Extension Deposits	98,200
Interest Accrued	410,151
Current Portion of Bonds, Notes and Loans Payable	5,245,433
Total Current Liabilities	<u>6,756,380</u>

Noncurrent Liabilities:

Bonds, Notes and Loans Payable, net of current portion 97,372,808

Accrued STP #1 Remediation Costs 1,027,801

Net Pension Liability 1,736,116

Total Noncurrent Liabilities 100,136,725

Total Liabilities 106,893,105

Deferred Inflows of Resources

Deferred Inflows of Resources Related to Bond Refunding 5,062

Deferred Inflows of Resources Related to Pension 70,697

Total Deferred Inflows of Resources 75,759

Total Liabilities and Deferred Inflows 106,968,864

Net Position

Net Investment in Capital Assets 60,824,357

Restricted for Debt Service & Construction 15,805,150

Unrestricted 7,993,393

Total Net Position 84,622,900

Total Liabilities and Net Position \$ 191,591,764

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

MGAG No. 2176
LAKE STEVENS SEWER DISTRICT
STATEMENT OF REVENUE, EXPENSES & CHANGES IN
NET POSITION
FOR YEAR ENDED DECEMBER 31, 2016

Operating Revenue	
Utility Revenue	\$ 12,731,317
Total Operating Revenue	<u>12,731,317</u>
Operating Expenses:	
General Operations	3,958,725
Maintenance Expense	555,114
Depreciation Expense	6,049,617
Taxes	497,285
Total Operating Expenses	<u>11,060,741</u>
Operating Income (Loss)	<u>1,670,576</u>
Nonoperating Revenues (Expenses):	
Interest Revenue	181,674
Interest on Long-Term Debt	(2,777,093)
Gain (Loss) on Capital Asset Disposition	(1,210,640)
Net Rental Income	21,229
Total Nonoperating Revenues (Expenses)	<u>(3,784,830)</u>
Income (Loss) Before Capital Contributions	<u>(2,114,254)</u>
Capital Contributions:	
Developer Donated Facility	713,323
Connection Fees	3,170,890
Total Capital Contributions	<u>3,884,213</u>
Change in Net Position	1,769,959
Total Net Position, January 1, 2016	<u>82,852,941</u>
Total Net Position, December 31, 2016	<u>\$ 84,622,900</u>

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

MGAG No. 2176
LAKE STEVENS SEWER DISTRICT
STATEMENT OF CASH FLOWS
FOR YEAR ENDED DECEMBER 31, 2016

Cash Flows from Operating Activities:

Receipts from customers	\$ 12,757,149
Payments to suppliers	(2,469,220)
Payments to employees	(1,935,583)
Net Cash Provided by Operating Activities	<u>8,352,346</u>

Cash Flows from Capital and Related Financing Activities:

Capital contributions - Connection fees	3,170,890
Cash purchase of capital assets	(733,744)
Proceeds from long-term debt	3,845,268
Principal paid on long-term debt	(5,736,310)
Interest paid on long-term debt	(2,773,671)
Payments on accrued STP#1 Remediation cost	(4,064,866)
Principal received on ULID assessments	4,061
Interest received on ULID assessments	2,003
Net Cash Provided (Used) for Capital Financing Activities	<u>(6,286,369)</u>

Cash Flows from Investing Activities:

Interest received on investments	179,671
Net rental income	21,229
Net Cash Provided (Used) by Investing Activities	<u>200,900</u>

Net Increase (Decrease) in Cash and Cash Equivalents 2,266,877

Cash and Cash Equivalents at January 1, 2016 25,025,500

Cash and Cash Equivalents at December 31, 2016 \$ 27,292,377

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

Operating Income (Loss)	\$ 1,670,576
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	6,049,617
Non-Cash Actuarial Pension Adjustment	78,263
Changes in assets and liabilities:	
Decrease (Increase) in accounts receivable	10,432
Decrease (Increase) in prepayments	2,732
Increase (Decrease) in operating accounts payable	485,955
Increase (Decrease) in compensated absences	39,371
Increase (Decrease) in developer deposits	15,400

Net Cash Provided by Operating Activities \$ 8,352,346

Noncash Investing, Capital, and Financing Activities:

Developer donated facility	\$ 713,323
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The notes to the financial statements are an integral part of this statement

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

a. Reporting Entity / Nature of Business

The Lake Stevens Sewer District is a municipal corporation governed by a three-member board elected by the voters located in the service area of the Lake Stevens Sewer District. The District provides a sewage system for collection, transportation and treatment of sanitary sewage for the unincorporated area around Lake Stevens, WA and for the City of Lake Stevens. As required by generally accepted accounting principles, management has considered all potential component units in defining the reporting entity. The Lake Stevens Sewer District has no component units.

b. Basis of Accounting and Presentation

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

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

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

All utility services are billed monthly and recorded as revenues.

c. Pensions

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

d. Cash and Cash Equivalents

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

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

e. Utility Plant and Depreciation

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

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

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

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

Please see Note 4.

f. Restricted Cash

In accordance with bond resolutions, (and certain related agreements) separate restricted cash accounts are required to be established. The assets held in these accounts are restricted for specific uses, including construction, debt service, and other special reserve requirements. Restricted accounts at December 31, 2016 include the following:

Bond/Loan Reserve Funds:	\$	5,587,052
Debt Service Funds:		<u>10,218,098</u>
	\$	<u><u>15,805,150</u></u>

g. Receivables

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

h. Investments

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

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

i. Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation pay, holiday pay, comp time, and sick leave. The District accrues unpaid compensated absences as an expense and liability when incurred. The Lake Stevens Sewer District policy states that upon termination, 100% of the employee's accrued sick leave is paid out to their Voluntary Employee Beneficiary Association (VEBA) account. Vacation pay, which may be accumulated up to 240 hours; comp time, which may be accumulated up to 40 hours; and holiday pay, which may be accumulated up to 8 hours; are payable upon termination, resignation, retirement or death. The Districts treats all accrued compensated absences as current liabilities. The total liability for compensated absences at December 31, 2016 was \$143,810.

j. Accumulated Amortization Debt Discount and Expense

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

k. Deferred Inflows and Outflows

The December 31, 2016 deferred outflows are as follows:

Debt Discount & Expense	\$ 21,733
Amortized Debt Discount & Expense	(13,220)
Deferred Outflows of Resources Related to Pension	<u>307,010</u>
	<u>\$ 315,523</u>

The December 31, 2016 deferred inflows are as follows:

Debt Premium	\$ 180,517
Amortized Debt Premium	(175,455)
Deferred Inflows of Resources Related to Pension	<u>70,697</u>
	<u>\$ 75,759</u>

l. Construction Contract and Financing

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

	Maximum Loan Amount	Advances through 12/31/2016	Available Funds at 12/31/2016
State of Washington Revolving Fund	\$ <u>4,025,000</u>	<u>3,845,268</u>	<u>179,732</u>

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 2: DEPOSITS AND INVESTMENTS

The District's deposits and certificates of deposits are covered by Federal Depository Insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC). The District's cash funds and investments are processed or maintained by the Snohomish County Treasurer's Department in the name of the District. Snohomish County has all District deposits and investments in local banks short-term certificates of deposit, the County Treasurer's Investment Pool, or in the State of Washington Treasurer's Investment pool. As of December 31, 2016, the credit rating for the District's investment in the State Pool and County Pool were not available.

As of December 31, 2016, the District had the following deposits and investments:

Checking and Cash Accounts	\$ 785,340
County Treasury Investment Pool	17,777,540
State Treasury Investment Pool	<u>8,729,497</u>
	<u>\$ 27,292,377</u>

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

NOTE 3: CONSTRUCTION IN PROGRESS

Construction in progress is composed of the following at December 31, 2016:

<u>Project Name</u>	<u>Project Authorization</u>	<u>Expended 12/31/2016</u>	<u>Committed</u>	<u>Required Future Financing</u>
Other Capital Projects	\$ 125,510	\$ 0	\$ 125,510	None
LS 17 Force Main	630,000	32,285	597,715	None
LS 17 Upgrade	51,770	9,404	42,366	None
Downtown Regional Lift Station	<u>40,000</u>	<u>26,773</u>	<u>13,227</u>	<u>None</u>
	<u>\$ 847,280</u>	<u>\$ 68,462</u>	<u>\$ 778,818</u>	<u>\$ None</u>

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 4: CAPITAL ASSETS

Capital assets are defined by the District as assets with initial individual cost of more than \$5,000 and an estimated useful life of five years or more.

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

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

Utility plant activity for the year ended December 31, 2016 was as follows:

	Balance 1/1/2016	Increase	Decrease	Balance 12/31/2016
Utility plant not being depreciated				
Land	\$ 1,290,722	\$ 0	\$ (238,248)	\$ 1,052,474
Construction in progress	353,524	511,053	(796,115)	68,462
Total plant not being depreciated	1,644,246	511,053	(1,034,363)	1,120,936
Utility plant being depreciated				
Plant in service	179,195,083	1,065,572	(1,492,066)	178,768,589
Buildings	768,662	0	0	768,662
Machinery, equipment & furniture	27,830,449	440,562	0	28,271,011
Total plant being depreciated	207,794,194	1,506,134	(1,492,066)	207,808,262
Plant in service	(32,581,286)	291,637	(4,177,829)	(36,467,478)
Buildings	(228,271)	34,349	(45,314)	(239,236)
Machinery, equipment & furniture	(6,918,889)	0	(1,860,997)	(8,779,886)
Total accumulated depreciation	(39,728,446)	325,986	(6,084,140)	(45,486,600)
Total plant being depreciated, net	168,065,748	1,832,120	(7,576,206)	162,321,662
Total utility plant, net	\$ 169,709,994	\$ 2,343,173	\$ (8,610,569)	\$ 163,442,598

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

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

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 5: LONG-TERM DEBT

As security for Sewer Revenue Bonds and Debt, the District is required to maintain a reserve account and pledge gross revenue less operation and maintenance expenses for payment of these debts. The revenue debt reserve at December 31, 2016 was \$5,587,052.

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

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

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

General obligation debt currently outstanding are as follows:

Description / Purpose	Maturity Range	Interest Rate	Original Amount	12/31/2016 Balance	Current Portion
2008 City GO Bonds	2008-2022	3% - 4%	\$ 1,508,553	\$ 715,408	\$ 105,408
VBC / Office Bldg	2002-2021	4.50%	700,000	193,213	54,295
			<u>\$ 2,208,553</u>	<u>\$ 908,621</u>	<u>\$ 159,703</u>

Revenue debt currently outstanding are as follows:

Description	Maturity Range	Interest Rate	Original Amount	12/31/2016 Balance	Current Portion
		4.2 % -			
2010A Bonds / STP2	2017-2039	7.0%	\$ 30,595,000	\$ 30,595,000	\$ 850,000
PWTF Loan / STP1 Design	1999-2018	1.00%	236,250	34,133	17,067
PWTF Loan / STP1 Const	2001-2020	1.00%	3,288,600	640,242	160,061
PWTF Loan / City 2002 Cap Imp	2003-2022	0.50%	1,608,255	514,147	85,691
PWTF Loan / Lundeen Bypass	2003-2022	0.50%	4,083,400	1,301,584	216,931
PWTF Loan / STP2 Design	2006-2025	0.50%	1,000,000	473,684	52,632
PWTF Loan / City STP2 Design	2006-2025	0.50%	1,000,000	473,684	52,632
PWTF Loan / STP2 Design	2006-2025	2.00%	1,000,000	480,263	53,362
PWTF Loan / STP2 Design	2009-2028	0.50%	1,000,000	631,579	52,632
PWTF Loan / STP2 Const	2007-2026	0.50%	7,000,000	4,345,057	395,005
PWTF Loan / City STP2 Const	2008-2027	0.50%	7,000,000	4,095,395	409,539
PWTF Loan / City STP2 Const	2009-2028	0.50%	10,000,000	6,638,158	301,734
PWTF Loan / STP2 Const	2009-2028	0.50%	10,000,000	6,638,158	301,734
SRF Loan / STP2 Const	2018-2029	2.80%	3,845,268	3,845,268	0
SRF Loan / STP2 Const	2013-2032	3.10%	13,969,445	13,151,825	671,476
SRF Loan / STP2 Const	2013-2032	2.70%	25,970,567	23,327,182	1,228,764
SRF Loan / STP2 Const	2013-2032	2.80%	5,262,417	4,524,261	236,470
			<u>\$ 131,379,202</u>	<u>\$ 101,709,620</u>	<u>\$ 5,085,730</u>
			<u>\$ 133,587,755</u>	<u>\$ 102,618,241</u>	<u>\$ 5,245,433</u>

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 5: LONG-TERM DEBT (continued)

The annual debt service requirements for general obligation and revenue debts at 12/31/16, are as follows:

Year Ending December 31,	General Obligation Debt		Revenue Debt		Total Debt	
	Principle	Interest	Principle	Interest	Principle	Interest
2017	\$ 159,703	\$ 36,397	\$ 5,085,730	\$ 3,274,130	\$ 5,245,433	\$ 3,310,527
2018	171,789	29,687	5,356,774	3,235,330	5,528,563	3,265,017
2019	174,398	22,478	5,396,705	3,152,751	5,571,103	3,175,229
2020	142,731	16,711	5,496,040	3,027,849	5,638,771	3,044,560
2021	130,000	10,400	5,437,311	2,898,100	5,567,311	2,908,500
2022-2026	130,000	5,200	27,551,525	12,276,421	27,681,525	12,281,621
2027-2031	0	0	26,167,214	8,121,178	26,167,214	8,121,178
2032-2036	0	0	14,015,704	4,017,823	14,015,704	4,017,823
2037-2041	0	0	7,202,617	840,572	7,202,617	840,572
	<u>\$ 908,621</u>	<u>\$ 120,873</u>	<u>\$ 101,709,620</u>	<u>\$ 40,844,154</u>	<u>\$ 102,618,241</u>	<u>\$ 40,965,027</u>

NOTE 6: CHANGES IN NON-CURRENT LIABILITIES

During the year ended December 31, 2016, the following changes occurred in non-current liabilities:

	Balance 1/1/2016	Additions	Reductions	Balance 12/31/2016	Due Within One Year
-					
Build America Bonds	\$ 30,595,000	\$ 0	\$ 0	\$ 30,595,000	\$ 850,000
Revenue Bonds	905,000	0	905,000	0	0
City 2008 GO Bonds	815,677	0	100,268	715,409	105,408
State Revolving Fund	43,080,289	3,845,268	2,077,022	44,848,535	2,136,710
City Public Works Trust	12,822,426	0	1,101,042	11,721,384	849,596
Public Works Trust	16,045,568	0	1,500,869	14,544,699	1,249,424
Vernon Business Center	245,325	0	52,111	193,214	54,295
Net Pension Liability	1,528,784	207,332	0	1,736,116	0
Accrued STP1 Cost	5,092,667	0	4,064,866	1,027,801	0
	<u>\$ 111,130,736</u>	<u>\$ 4,052,600</u>	<u>\$ 9,801,178</u>	<u>\$ 105,382,158</u>	<u>\$ 5,245,433</u>

NOTE 7: PENSION PLAN

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

Substantially all Lake Stevens Sewer District full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380; or it may be downloaded from the DRS website at www.drs.wa.gov.

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 7: PENSION PLAN (continued)

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 2016:

Aggregate Pension Amounts – All Plans	
Pension liabilities	\$1,736,116
Deferred outflows of resources	\$ 307,010
Deferred inflows of resources	\$ 70,697
Pension expense	\$ 123,369

State Sponsored Pension Plans

Substantially all of 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.

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

Contributions

The **PERS Plan 1** member contribution rate is established by State statute at 6 percent. The employer contribution rate is developed by the Office of the State Actuary and includes an administrative expense component that is currently set at 0.18 percent. Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates. The PERS Plan 1 required contribution rates (expressed as a percentage of covered payroll) for 2016 were as follows:

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 7: PENSION PLAN (continued)

PERS Plan 1		
Actual Contribution Rates:	Employer	Employee*
PERS Plan 1	6.23%	6.00%
PERS Plan 1 UAAL	4.77%	6.00%
Administrative Fee	0.18%	
Total	11.18%	6.00%

* For employees participating in JBM, the contribution rate was 12.26%.

PERS Plan 2/3 provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the member's average final compensation (AFC) times the member's years of service for Plan 2 and 1 percent of AFC for Plan 3. The AFC is the average of the member's 60 highest-paid consecutive service months. There is no cap on years of service credit. Members are eligible for retirement with a full benefit at 65 with at least five years of service credit. Retirement before age 65 is considered an early retirement. PERS Plan 2/3 members who have at least 20 years of service credit and are 55 years of age or older, are eligible for early retirement with a benefit that is reduced by a factor that varies according to age for each year before age 65. PERS Plan 2/3 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions:

- With a benefit that is reduced by three percent for each year before age 65; or
- With a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules.

PERS Plan 2/3 members hired on or after May 1, 2013 have the option to retire early by accepting a reduction of five percent for each year of retirement before age 65. This option is available only to those who are age 55 or older and have at least 30 years of service credit. PERS Plan 2/3 retirement benefits are also actuarially reduced to reflect the choice of a survivor benefit. Other PERS Plan 2/3 benefits include duty and non-duty disability payments, a cost-of-living allowance (based on the CPI), capped at three percent annually and a one-time duty related death benefit, if found eligible by the Department of Labor and Industries. PERS 2 members are vested after completing five years of eligible service. Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service if 12 months of that service are earned after age 44.

PERS Plan 3 defined contribution benefits are totally dependent on employee contributions and investment earnings on those contributions. PERS Plan 3 members choose their contribution rate upon joining membership and have a chance to change rates upon changing employers. As established by statute, Plan 3 required defined contribution rates are set at a minimum of 5 percent and escalate to 15 percent with a choice of six options. Employers do not contribute to the defined contribution benefits. PERS Plan 3 members are immediately vested in the defined contribution portion of their plan.

Contributions

The **PERS Plan 2/3** employer and employee contribution rates are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. The Plan 2/3 employer rates include a component to address the PERS Plan 1 UAAL and an administrative expense that is currently set at 0.18 percent. Each biennium, the state Pension Funding Council adopts Plan 2 employer and employee contribution rates and Plan 3 contribution rates. The PERS Plan 2/3 required contribution rates (expressed as a percentage of covered payroll) for 2016 were as follows:

PERS Plan 2/3		
Actual Contribution Rates:	Employer 2/3	Employee 2*
PERS Plan 2/3	6.23%	6.12%
PERS Plan 1 UAAL	4.77%	
Administrative Fee	0.18%	
Employee PERS Plan 3		varies
Total	11.18%	6.12%

* For employees participating in JBM, the contribution rate was 15.30%.

The District's actual PERS plan contributions were \$90,631 to PERS Plan 1 and \$121,795 to PERS Plan 2/3 for the year ended December 31, 2016.

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 7: PENSION PLAN (continued)

Actuarial Assumptions

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

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

- **Inflation:** 3.0% total economic inflation; 3.75% salary inflation
- **Salary increases:** In addition to the base 3.75% salary inflation assumption, salaries are also expected to grow by promotions and longevity.
- **Investment rate of return:** 7.5%

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

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

- For all systems, except LEOFF Plan 2, the assumed valuation interest rate was lowered from 7.8% to 7.7%. Assumed administrative factors were updated.
- Valuation software was corrected on how the nonduty disability benefits for LEOFF Plan 2 active members is calculated.
- New LEOFF Plan 2 benefit definitions were added within the OSA valuation software to model legislation signed into law during the 2015 legislative session.

Discount Rate

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

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

Long-Term Expected Rate of Return

The long-term expected rate of return on the DRS pension plan investments of 7.5 percent was determined using a building-block-method. The Washington State Investment Board (WSIB) used a best estimate of expected future rates of return (expected returns, net of pension plan investment expense, including inflation) to develop each major asset class. Those expected returns make up one component of WSIB's capital market assumptions. The WSIB uses the capital market assumptions and their target asset allocation to simulate future investment returns at various future times. The long-term expected rate of return of 7.5 percent approximately equals the median of the simulated investment returns over a 50-year time horizon.

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 7: PENSION PLAN (continued)

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, 2016, are summarized in the table below. The inflation component used to create the table is 2.2 percent and represents the WSIB's most recent long-term estimate of broad economic inflation.

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

Sensitivity of the Net Pension Liability/(Asset)

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

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
PERS 1	\$ 951,814	\$ 789,299	\$ 649,443
PERS 2/3	\$1,743,260	\$ 946,817	\$ (492,873)

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, 2016, the District reported a total pension liability of \$1,736,116 for its proportionate share of the net pension liabilities as follows:

	Liability (or Asset)
PERS 1	\$789,299
PERS 2/3	\$946,817

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

	Proportionate Share 6/30/15	Proportionate Share 6/30/16	Change in Proportion
PERS 1	% 0.015527	% 0.014697	% 0.000830
PERS 2/3	% 0.020055	% 0.018805	% 0.001250

The collective net pension liability (asset) was measured as of June 30, 2016, and the actuarial valuation date on which the total pension liability (asset) is based was as of June 30, 2015, with update procedures used to roll forward the total pension liability to the measurement date.

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 7: PENSION PLAN (continued)

Pension Expense

For the year ended December 31, 2016, the District recognized pension expense as follows:

	Pension Expense
PERS 1	\$ (2039)
PERS 2/3	\$124,280

Deferred Outflows of Resources and Deferred Inflows of Resources

At December 31, 2016, 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		
Net difference between projected and actual investment earnings on pension plan investments	\$ 19,873	
Changes of assumptions		
Changes in proportion and differences between contributions and proportionate share of contributions		
Contributions subsequent to the measurement date	45,929	
TOTAL	\$ 65,802	

PERS Plan 2/3	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 50,417	\$31,254
Net difference between projected and actual investment earnings on pension plan investments	115,863	
Changes of assumptions	9,786	
Changes in proportion and differences between contributions and proportionate share of contributions	5,156	39,443
Contributions subsequent to the measurement date	59,986	
TOTAL	\$241,208	\$70,697

Grand Total PERS 1 and PERS 2/3	\$307,010	\$70,697
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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, 2017. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:	PERS Plan 2/3
2017	\$ (9,523)
2018	\$ (9,523)
2019	\$ 77,124
2020	\$ 52,447
2021	\$ 0
Thereafter	\$ 0

**LAKE STEVENS SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDING DECEMBER 31, 2016**

NOTE 8: RISK MANAGEMENT

The Lake Stevens Sewer District uses Travelers Insurance Company for its insurance coverage. Travelers Insurance is the market leader in public entity property and liability insurance. Since 1991, Travelers Insurance Public Sector Services business group has been dedicated exclusively to addressing the needs of local governments.

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

Insurance coverage exceeded settlements paid in the years ended December 31, 2016, 2015 and 2014.

NOTE 9: CITY OF LAKE STEVENS AGREEMENT

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

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

The agreement also calls for certain payments from the District for a Franchise Fee and a Utility Agreement Fee for the City liabilities or costs associated with the implementation and maintenance of the Agreement. As of the preparation of these financial statements, the District has not yet been charged a Franchise Fee, and the Utility Agreement Fee amounted to \$77,040 for the year ended December 31, 2016.

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

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

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

		<u>2016</u>	<u>2015</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>
Employer's proportion of the net pension liability (asset)	%	0.014697	0.015527							
Employer's proportionate share of the net pension liability	\$	789,299	812,207							
Employer's covered employee payroll	\$	1,900,131	1,709,572							
Employer's proportionate share of the net pension liability as a percentage of covered employee payroll	%	41.54%	47.51%							
Plan fiduciary net position as a percentage of the total pension liability	%	57.03%	59.10%							

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

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

		<u>2016</u>	<u>2015</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>
Employer's proportion of the net pension liability (asset)	%	0.018805	0.020055								
Employer's proportionate share of the net pension liability	\$	946,817	716,577								
Employer's covered employee payroll	\$	1,900,131	1,709,572								
Employer's proportionate share of the net pension liability as a percentage of covered employee payroll	%	49.83%	41.92%								
Plan fiduciary net position as a percentage of the total pension liability	%	85.82%	89.20%								

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

Lake Stevens Sewer District
Schedule of Employer Contributions
PERS 1
As of December 31, 2016
Last 10 Fiscal Years*

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>
<u>Statutorily or contractually required contributions</u> \$	90,631	74,823	72,116	56,032						
<u>Contributions in relation to the statutorily or contractually required contributions</u> \$	<u>(90,631)</u>	<u>(74,823)</u>	<u>(72,116)</u>	<u>(56,032)</u>						
<u>Contribution deficiency (excess)</u> \$	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>						
<u>Covered employer payroll</u> \$	1,900,131	1,709,572	1,788,182	1,778,324						
<u>Contributions as a percentage of covered employee payroll</u> %	4.77%	4.38%	4.03%	3.15%						

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

Lake Stevens Sewer District
Schedule of Employer Contributions
PERS 2/3
As of December 31, 2016
Last 10 Fiscal Years*

	2016	2015	2014	2013	20XX	20XX	20XX	20XX	20XX	20XX
<u>Statutorily or contractually required contributions</u> \$	121,795	99,105	92,548	88,633						
<u>Contributions in relation to the statutorily or contractually required contributions</u> \$	(121,795)	(99,105)	(92,548)	(88,633)						
<u>Contribution deficiency (excess)</u> \$	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>						
<u>Covered employer payroll</u> \$	1,900,131	1,709,572	1,788,182	1,778,324						
<u>Contributions as a percentage of covered employee payroll</u> %	6.41%	5.80%	5.18%	4.98%						

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

Lake Stevens Sewer District
Schedule of Expenditures of Federal Awards
For the Year Ended December 31, 2016

Federal Agency Name					Expenditures		Passed Through to Subrecipients	Note
Pass-Through Agency	Federal Program	CFDA Number	Other Award Number	From Pass- Through Awards	From Direct Awards	Total		
Environmental Protection Agency Washington State Department of Ecology	Capitalization							
	Grants for Clean							
	Water State							
	Revolving Funds	66.458	EL150112	3,204,262	-	<u>3,204,262</u>	-	1,2,3,4
	Total Capitalization Grants for Clean Water State Revolving Funds					<u>3,204,262</u>		
				Total Federal Awards Expended		<u>3,204,262</u>		

The accompanying notes are an integral part of this Schedule

Notes to the Schedule of Expenditures of Federal Awards

For the Year Ended December 31, 2016

NOTE 1: BASIS OF ACCOUNTING

This schedule is prepared on the same basis of accounting as the District's financial statements. The District uses the accrual basis of accounting.

NOTE 2: PROGRAM COSTS

The amounts shown as expenditures represent only the federal portion of the old plant decommissioning costs. The entire decommissioning costs, including the District's portion, are more than shown.

NOTE 3: FEDERAL LOANS

The District was approved by the Washington State Department of Ecology to receive a loan totaling \$4,025,000 for phase I of the decommissioning of the old treatment plant. The Federal portion of loan proceeds for year 2016 amounted to \$3,204,262. The actual loan proceeds received are also reported on the District's Schedule of Long-Term Debt.

NOTE 4: INDIRECT COST RATE

The District has not elected to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance.

ABOUT THE STATE AUDITOR'S OFFICE

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

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

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

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

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

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

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

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