

COVINGTON WATER DISTRICT
Management's Discussion and Analysis (MD&A)
For the year ended December 31, 2017

INTRODUCTION

As management of the Covington Water District (district), we have prepared a narrative overview and analysis of the financial activities of the district for the fiscal year ended December 31, 2017. Please read this in conjunction with the financial statements, including the notes to the financial statements, following this commentary.

FINANCIAL HIGHLIGHTS

- The district's assets and deferred outflows of resources exceed liabilities and deferred inflows of resources by \$124 million as of December 31, 2017.
- The district had a positive change in net position of \$8.3 million for the year ended December 31, 2017.
- The district's required bond debt service coverage ratio was 12.57 as of December 31, 2017. This far exceeds the minimum requirement identified in the bond covenants of 1.25.

OVERVIEW OF THE FINANCIAL STATEMENTS

The discussion and analysis provided here are intended to serve as an introduction to the district's basic financial statements. In accordance with requirements set forth by the Governmental Accounting Standards Board, the district's financial statements employ the accrual basis of accounting in recognizing increases and decreases in economic resources. Accrual accounting recognizes all revenues and expenses during the year, regardless of when cash is received or paid.

The basic financial statements, presented for the year ended December 31, 2017 are comprised of:

- **Statement of Net Position:** The statement of net position provides a record, or snap shot, of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources of the district at the close of the year. It provides information about the nature and amounts of investments in resources (assets) and obligations to district creditors (liabilities). It provides a basis for evaluating the capital structure of the district and assessing its liquidity and financial flexibility.
- **Statement of Revenues, Expenses, and Changes in Fund Net Position:** The statement of revenues, expenses and changes in fund net position presents the results of the district's business activities over the course of the year. This information can be used to determine

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whether the district successfully recovered all its costs through its user fees and other charges, profitability, and credit worthiness.

- **Statement of Cash Flows:** The statement of cash flows reports cash receipts, cash payments and net changes in cash resulting from operating, non-capital financing, capital and related financing, and investing activities over the course of the year. It presents information regarding where cash came from and what it was used for.

The notes to the financial statements, presented at the end of the basic financial statements, are considered an integral part of the district's presentation of financial position, results of operations, and changes in cash flows. The notes provide additional information that is necessary to acquire a full understanding of the data provided in the district's financial statements. The notes can provide useful information regarding the district's significant accounting policies; explain significant account balances and activities, certain material risks, estimates, obligations, commitments, contingencies, and subsequent events, if any.

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CONDENSED COMPARATIVE FINANCIAL DATA**Statement of Net Position**

	2017	2016	Increase (Decrease)	% Change
ASSETS				
Current assets	\$ 32,144,384	\$ 25,054,749	\$ 7,089,635	28.3%
Capital assets, net	142,236,703	142,992,252	(755,549)	(.5)%
Other non-current assets	870,727	944,409	(73,682)	(7.8)%
TOTAL ASSETS	175,251,814	168,991,410	6,260,404	3.7%
TOTAL DEFERRED OUTFLOWS OF RESOURCES	335,905	516,483	(180,578)	(35)%
LIABILITIES				
Current liabilities	4,824,681	3,870,574	954,107	24.7%
Non-current liabilities	43,675,411	47,125,232	(3,449,821)	(7.3)%
TOTAL LIABILITIES	48,500,092	50,995,806	(2,495,714)	(4.9)%
TOTAL DEFERRED INFLOWS OF RESOURCES	2,526,130	2,333,106	193,024	8.3%
NET POSITION				
Net investment in capital assets	95,664,730	93,293,805	2,370,925	2.5%
Restricted	3,293,956	3,277,896	16,060	.5%
Unrestricted	25,602,811	19,607,280	5,995,531	30.6%
TOTAL NET POSITION	\$ 124,561,497	\$ 116,178,981	8,382,516	7.2%

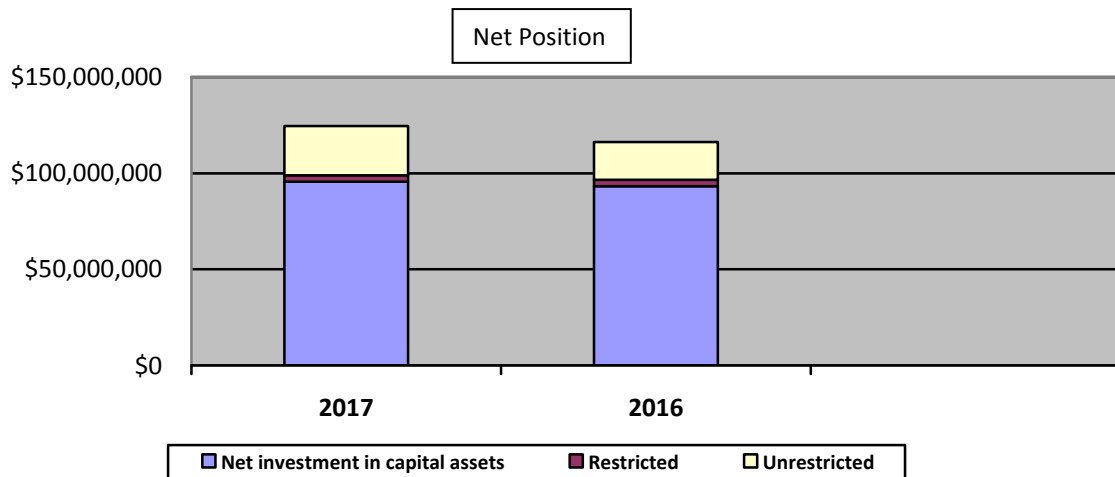
Analysis of the Statement of Net Position

- The increase in current assets of approximately \$7 million, or 28.3%, from 2016 to 2017 is primarily related to an increase in cash on hand.
- Capital assets consist of land, construction work in progress, and property & equipment, less accumulated depreciation. The decrease in net capital assets of \$755,549, which is approximately .5%, is the net effect of positive change in asset additions, negative change in construction work in progress, and increase in accumulated depreciation.
- The decrease in other non-current assets of approximately \$73,682 is related to a combination of the decrease in other accounts receivables and WD#111 receivables, net of current portion in 2017.
- The decrease in deferred outflows of resources of \$180,578 is primarily due to the decrease in deferred outflows related to pensions related to GASB 68.

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- The increase in current liabilities from 2016 to 2017 of \$954,107 or 24.7% is directly related to the increased amount of accounts payable at the financial statement date.
- The decrease in non-current liabilities from 2016 to 2017 of \$3,449,821 or 7.3% is primarily related to the reduction in long term payable portions of debt due to scheduled debt payments in 2017.
- The increase in deferred inflows of resources of \$193,024 is a net result of the increase in deferred inflows related to pensions and the decrease in deferred inflows related to deferred gain on refunding due to regular straight line amortization.
- The district’s net position increased by approximately \$8.3 million from 2016 to 2017 as a direct result of the overall positive net change in position during 2017.

The district shows positive balances in all categories of net position.



Having looked at the Statement of Net Position in detail, another common financial analysis tool is the Quick Ratio which compares the most liquid assets (non-restricted cash and equivalents) to current liabilities in order to assess the organization’s ability to meet obligations. The district’s Quick Ratio is 5.58 (\$26.9M cash/\$4.8M current liabilities) for 2017. While there are no set ‘rules’ regarding Quick Ratios, district management believes this is a very healthy ratio.

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Statement of Revenues, Expenses, and Changes in Fund Net Position

	2017	2016	Increase (Decrease)	% Change
Water service revenues	\$ 13,664,454	\$ 12,422,331	\$1,242,123	10%
Other operating revenues	796,856	738,405	58,451	7.9%
Non-operating revenues	335,206	225,351	109,855	48.7%
TOTAL REVENUES	14,796,516	13,386,087	1,410,429	10.5%
Production, operations, maintenance	2,516,016	2,535,507	(19,491)	(.8)%
Administrative, taxes	4,623,755	4,470,769	152,986	3.4%
Depreciation expense	4,243,739	4,210,438	33,301	.8%
Non-operating expenses	1,330,528	1,176,269	154,259	13.1%
TOTAL EXPENSES	12,714,038	12,392,983	321,055	2.6%
EXCESS (DEFICIENCY) BEFORE CONTRIBUTIONS	2,082,478	993,104	1,089,374	109.7%
Capital contributions	6,300,038	5,025,463	1,274,575	25.4%
CHANGE IN NET POSITION	8,382,516	6,018,567	2,363,949	39.3%
BEGINNING NET POSITION	116,178,981	110,160,414	6,018,567	5.5%
ENDING NET POSITION	\$ 124,561,497	\$ 116,178,981	\$8,382,516	7.2%

Analysis of the Statement of Revenues, Expenses & Changes in Fund Net Position

- Water service revenue increased 10% in 2017, which is a result of weather related increased residential and irrigation water sales as compared to 2016.
- Other operating revenues consist of street lights, late fees and other miscellaneous charges related to water customer accounts. The increase of 7.9% in 2017 is made up of a net in positive change in various accounts and is considered reasonable.
- The increase in non-operating revenues of \$109,855 is a primarily due to an increase in interest income from the prior year.
- Production, operations, and maintenance expenses decreased by a modest .8% in 2017, which fluctuates by nature and is considered reasonable.
- Administrative expenses fluctuate by nature and a modest increase of 3.4% is considered reasonable.

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- Depreciation expense is a non-cash operating expense that systematically allocates the historical cost of a capital asset over its useful life. It is a proxy for the cost of using a capital asset or for the gradual wearing out of a capital asset over time. The district starts charging depreciation expense in the year following the capitalization of an asset. The expense in 2017 is reasonable based on the assets in service.
- The increase in 2017 from 2016 of non-operating expenses of 13.1% is primarily due to an increase in losses of capital asset disposition.
- Capital contributions are comprised of meter installation charges, connection charges, and donated capital assets. There was a net increase from the prior year in total capital contributions of 25.4% in 2017.
 - **Meter installation charges-** The meter installation is the last step in the connection process. Once the meter installation charge has been collected and the meter installed, the customer becomes a part of the utility billing process. Meter installation charges fluctuate by nature from year to year based on development. Meter installations, and therefore charges, increased in 2017 by 11.8%.
 - **Connection charges-** The district collects connection charges in order to ensure that future customers bear most of the burden of growth. Connection charges consist of the Future Facilities Fee (new customers' proportionate share of future facilities needed to serve each new customer); Existing Facilities Fee (new customer proportionate share of existing system general supply and storage facilities) and Existing Distribution Facilities Fee (new customers' proportionate share of existing pipes, hydrants, valves and distribution facilities). Connection charges are collected in stages as the water availability certificate is issued, the system extension application is approved, the completed system is accepted by the district, and the meter application is submitted. The entire process typically extends over several years. The bulk of the facility charge revenue represents a small number of large developer projects – typically only 20 to 25 projects are in process at a time. The timing is not subject to the district's control and the total revenue can substantially vary from year to year with the delay or acceleration of only a few projects. Connection charges received in 2017 were 20% higher than the prior year.
 - **Donated capital assets-** The district also receives additions to the distribution system from developers. Donated capital assets are recognized when the system is completed according to the district's specifications and accepted by the district.

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The timing is not subject to the district's control, and therefore fluctuates by nature from year to year. Donated capital assets increased in 2017 from the prior year by 33.8%.

The district recorded a positive change in Net Position in 2017 of \$8,382,516 as a result of the combination of the items outlined in the bullet points above.

OVERALL ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

The district's overall financial position has improved since the prior year, with a healthy increase in net position for 2017. The district's financial condition remains strong at 2017 year-end with adequate liquid assets, positive operating cash flow, a robust unrestricted net position, reliable plants and systems and favorable debt service coverage ratios.

The district expects to see continued growth in its service area. As a result, operating expenses are expected to continue to increase proportionately due primarily to plant expansion necessary to meet anticipated customer needs, increased depreciation, increased supply costs and increased security requirements. Due to the District's strong financial position at the end of 2017, the District did not increase 2018 water rates.

The expected growth in the service area will also require increased capital investment to meet fire flow requirements of the newer cities in the area, make system improvements concurrent with the cities' road improvements to avoid the cost of resurfacing, and to respond to increased water quality regulations and conservation requirements.

CAPTIAL ASSETS AND LONG-TERM DEBT ACTIVITY

Capital Assets

Capital assets consist of land, construction work in progress, and capital assets such as infrastructure (utility plant), buildings, technology and office equipment, and transportation, machinery and equipment. Capital assets are recorded at cost and depreciated over the estimated useful life of the asset (3 to 100 years) using the straight-line method beginning the year after it is placed in service. A corresponding contra-asset account depicts the accumulated depreciation. The net value of an asset at any point in time consists of the historical cost less the accumulated depreciation. Note that land is not depreciated according to generally accepted accounting principles, therefore land continues to be valued at historical cost over time.

For additional information on capital assets, see Note 3 in the notes to the financial statements.

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The overall net decrease of \$(755,549) in net capital assets consisted of:

Item	Net Increase (Decrease)
Donated assets (infrastructure donated by developers & customers)	\$ 2,678,790
Net book value of asset disposals	(295,100)
Capital asset additions	2,617,191
Construction work in progress	(1,512,691)
Depreciation	(4,243,739)
Net decrease	\$ (755,549)

- The \$2,678,790 in donated assets in 2017 consists of eleven developer extension projects that range in amounts from approximately \$30k to \$641k, in addition to donated meters from customers.
- The \$2,617,191 net increase in capital asset additions is related to the completion and close out of multiple Capital Improvement Projects as well as the purchase of capital assets.
- The \$1,512,691 net decrease of construction work in progress reflects a decrease in the carrying balance of various construction projects in progress that have not been placed into service as of December 31, 2017, in addition to the projects that have been completed and closed out to capital assets.

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Long Term Debt

	Beginning Balance 1/1/2017	Additions	Reductions	Ending Balance 12/31/2017	Due in 1 year	Long term portion
Water Revenue Bonds	\$ 7,150,000	\$ ---	\$ (610,000)	\$ 6,540,000	\$ 630,000	\$ 5,910,000
PWTF/DWSRF loans	20,556,286	169,060	(2,084,177)	18,641,169	1,966,257	16,674,912
SSP Repayment Agreements	19,441,256	---	(266,228)	19,175,028	274,561	18,900,467
TOTALS	\$ 47,147,542	\$ 169,060	\$ (2,960,405)	\$ 44,356,197	\$ 2,870,818	\$ 41,485,379

The district is required to establish, maintain and collect rates and charges for water service (and for all other utility services that may be provided by the System) that will yield net revenues equal to at least 1.25 times the average annual debt service. Although the bond covenant allows the use of connection charge revenue (i.e. cash capital contributions) in the calculation of debt service coverage, the district has adopted a more stringent internal policy of maintaining 2.0 ratio of net revenues to bond debt service, without consideration of connection charge revenue. The board of commissioners debt coverage ratio, without considering connection charge revenue, was 8.14 for the year ended December 31, 2017. This indicates that the district is not only meeting the requirements mandated by the bond covenant, but also meets the more stringent and conservative internal policy. The less stringent calculation required by the bond covenants with connection charge revenue yields a ratio for the year ended December 31, 2017 of 12.57.

In 2017, the district drew \$169,060 of a Drinking Water State Revolving fund loan that totals \$1.1 million to finance capital improvement projects.

For additional information on long-term debt, see Note 5 in the notes to the financial statements.

COVINGTON WATER DISTRICT

Statement of Net Position

December 31, 2017

	2017
ASSETS	
Current assets:	
Cash and cash equivalents - undesignated	\$ 22,663,991
Cash and cash equivalents - designated	4,264,022
Accounts receivable - customer	581,536
Accrued unbilled water charges	814,937
Accrued interest receivable	25,276
WD #111 Receivable, current portion	36,265
Restricted current assets:	
Rate Stabilization account	2,000,000
Water Revenue Bond account	607,147
Bond Sinking account	683,581
Accrued interest receivable - restricted	3,228
Developer Deposits	161,931
Inventory	202,903
Prepaid expenses	99,567
TOTAL CURRENT ASSETS	<u>32,144,384</u>
Noncurrent assets:	
Other accounts receivable	28,517
WD #111 Receivable, net of current portion	842,210
Capital assets not being depreciated:	
Land and land rights	1,482,399
Construction work in progress	2,302,299
Capital assets being depreciated:	
Utility Plant	184,725,380
Accumulated depreciation	(46,273,375)
TOTAL NONCURRENT ASSETS	<u>143,107,430</u>
TOTAL ASSETS	<u>\$ 175,251,814</u>
DEFERRED OUTFLOWS OF RESOURCES	
Deferred loss on refunding	\$ 16,518
Deferred outflows related to pensions	319,387
TOTAL DEFERRED OUTFLOWS OF RESOURCES	<u>\$ 335,905</u>
LIABILITIES	
Current liabilities:	
Accounts payable and accrued liabilities	\$ 1,381,458
Accrued compensated absences	262,223
Accrued interest on bonds and loans payable	148,251
Water Revenue Bonds, current portion	630,000
PWTF/DWSRF loans, current portion	1,966,257
SSP repayment agreements, current portion	274,561
Developer deposits	161,931
TOTAL CURRENT LIABILITIES	<u>4,824,681</u>
Noncurrent liabilities:	
Water Revenue Bonds, net of current portion	5,910,000
PWTF/DWSRF loans, net of current portion	16,674,911
SSP repayment agreements, net of current portion	18,900,468
Net Pension Liability	2,190,032
TOTAL NONCURRENT LIABILITIES	<u>43,675,411</u>
TOTAL LIABILITIES	<u>\$ 48,500,092</u>
DEFERRED INFLOWS OF RESOURCES	
Deferred gain on refunding	\$ 2,084,043
Deferred inflows related to pensions	442,087
TOTAL DEFERRED INFLOWS OF RESOURCES	<u>\$ 2,526,130</u>
NET POSITION	
Net investment in capital assets	\$ 95,664,730
Restricted	3,293,956
Unrestricted	25,602,811
TOTAL NET POSITION	<u>\$ 124,561,497</u>

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

COVINGTON WATER DISTRICT

Statement of Revenues, Expenses, and Changes in Fund Net Position
For the year ended December 31, 2017

	<u>2017</u>
OPERATING REVENUES	
Water service	\$ 13,664,454
Street light revenue	210,424
Other operating revenue	586,432
TOTAL OPERATING REVENUE	<u>14,461,310</u>
OPERATING EXPENSES	
Total production costs-CWD water	353,512
Total purchased water	708,999
Operations Department	1,453,505
Engineering Department	521,310
Customer Service, Finance, and Information Technology	1,821,167
Administration	1,414,004
Street light expense	174,777
Taxes	692,497
Depreciation expense	4,243,739
TOTAL OPERATING EXPENSES	<u>11,383,510</u>
OPERATING INCOME (LOSS)	3,077,800
NONOPERATING REVENUES (EXPENSES)	
Interest income	314,568
Miscellaneous income	20,638
Gain (Loss) on capital asset disposition	(276,654)
Interest expense on debt financing	(1,046,251)
Amortized debt discounts	(7,623)
TOTAL NONOPERATING REVENUES (EXPENSES)	<u>(995,322)</u>
INCOME BEFORE CONTRIBUTIONS	2,082,478
Capital contributions:	
Meter installation charges	123,328
Connection charges	3,497,920
Donated capital assets	2,678,790
Total capital contributions	<u>6,300,038</u>
CHANGE IN NET POSITION	8,382,516
TOTAL NET POSITION, beginning	116,178,981
TOTAL NET POSITION, ending	<u>\$ 124,561,497</u>

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

COVINGTON WATER DISTRICT

Statement of Cash Flows
For the year ended December 31, 2017

	2017
CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from water customers, net of refunds, etc.	\$ 14,186,950
Receipts from non-water customers	203,238
Payments to suppliers	(2,215,207)
Payments related to employees (non-capitalized)	(4,626,443)
Payments related to business taxes	(692,497)
Other receipts (payments)	20,638
Net cash provided by operating activities	6,876,679
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
	-
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Receipt of connection charges	3,621,244
Miscellaneous receipts (payments)	788,981
Loan proceeds	46,960
Principal and interest payment on PWTF & DWSRF loans	(2,158,822)
Principal and interest payment on Tacoma loans	(1,063,527)
Principal and interest payment on Water Revenue Bond	(817,448)
Purchase of capital assets (CIP)	1,512,691
Purchase of capital assets (CAA)	(2,322,090)
Other receipts	265,351
Net cash provided (used) by capital and related financing activities	(126,660)
CASH FLOWS FROM INVESTING ACTIVITIES	
Interest income	274,924
Net cash provided by investing activities	274,924
Net Increase (Decrease) in Cash	7,024,943
Balance, Beginning of Period	23,355,729
Balance, End of Period	\$ 30,380,672
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Operating income (loss)	\$ 3,077,800
Adjustments to reconcile operating income to net cash provided (used) by operating income:	
Depreciation expense	4,243,739
Other nonoperating receipts (payments)	20,638
Change in assets and liabilities:	
Receivables	33,490
Inventory	(63,065)
Accrued & prepaid income/expenses	(435,923)
Net cash provided by operating activities	\$ 6,876,679
SUPPLEMENTAL SCHEDULE OF SIGNIFICANT NON-CASH CAPITAL AND FINANCING TRANSACTIONS	
Developer contributions to utility plant	\$ 2,678,790

COVINGTON WATER DISTRICT
Notes to the Financial Statements
For the years ended December 31, 2017 and 2016

These notes are an integral part of the accompanying financial statements.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Covington Water District (the District) conform to generally accepted accounting principles (GAAP) as applicable to proprietary funds of governments. The following is a summary of the most significant policies (including identification of those policies which result in material departures from generally accepted accounting principles):

Reporting Entity

The District is a municipal corporation governed by an elected five member board. As required by generally accepted accounting principles, management has considered all potential component units in defining the reporting entity. The District has no component units.

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 Uniform System of Accounts for Class A Water Utilities.

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 accounts.

The District distinguishes between operating revenues and expenses from non-operating ones. Operating revenues and expenses result from providing services and producing and delivering goods in connection with a District's principal ongoing operations. The principal operating revenues of the District are charges to customers for water delivery services. The District also recognizes street light revenue and other operating revenue as operating revenue. Operating expenses for the District include the related costs of water services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. Unbilled utility service receivables are recorded monthly.

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

The District implemented GASB 82, Pension issues. This statement amends GASB statements No. 67, No. 68, and No. 73 to enhance consistency in the application of financial reporting requirements related to certain pension issues. This standard changes how the District reported covered payroll in Required Supplementary Information.

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

Cash and Cash Equivalents

For purposes of the statement of cash flows, the District considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

Capital Assets

See Note 3.

Restricted Assets

In accordance with bond resolutions (and certain related agreements) separate restricted accounts are required to be established. The assets held in these accounts are restricted for specific uses described below.

Rate Stabilization Account

The rate stabilization account segregates cash and cash equivalents reserved to prevent occurrence of unexpected revenue shortfalls, thus stabilizing rates regardless of high or low water sales due to fluctuating weather conditions. As consistent with Bond Resolution, the District may transfer funds to the Rate Stabilization account.

Water Revenue Bond Account

The Water Revenue Bond account (Bond account) was created by Board Resolution for the purpose of paying and securing bond principal and interest. Payments from revenues of the District are required to be made to the Bond account in annual amounts sufficient to retire serial bonds on or before maturity and to satisfy the bond account requirements for redemption of term bonds scheduled to mature in 2033.

Bond Sinking Account

The Bond Sinking account was established and fully funded at an amount of \$683,581 as part of the 2013 bond issue to meet the reserve requirement.

Receivables

Receivables consist primarily of amounts due from water customers. All receivables are recorded when earned. There may also be amounts due from developers, other Districts and municipalities. No allowance for uncollectible accounts is provided since the District has the power to record liens for its receivables and generally does not experience significant uncollectible amounts.

Loan Draw Receivables

Loan draw receivables consists of receivables for draws on low interest loan agreements through the Public Works Trust Fund and Drinking Water State Revolving Fund loan programs to fund various capital improvement projects.

Inventories

Inventories are valued at average cost which approximates the market value.

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Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

Prepaid Expenses

Certain invoices paid to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenses. Examples are: property insurance premiums, annual membership dues, and service maintenance agreements.

Deferred Outflows

Deferred outflows consist of deferred losses on refunding that are being amortized over the remaining life of the debt, along with deferred outflows related to pensions.

Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. The District records accrued leave for compensated absences as an expense and liability.

Vacation Leave

Vacation leave, which may be accumulated up to six weeks (240 hours) is payable upon termination, after the first six months of employment have been completed.

Sick Leave

Regular full-time employees accrue sick leave benefits at the rate of eight hours for each calendar month of continuous employment up to a maximum of 320 hours of sick leave. Sick leave accruals for regular part time staff scheduled to work less than 40 hours per week is prorated. Sick leave accruals for temporary/intern/project/contract status employees will accrue sick leave at the rate of one hour for every 40 hours worked up to the maximum of 320 hours of leave.

There is a quarterly cash out of all sick leave into the HRA VEBA Trust which exceeds the following amounts:

Sick leave balance at end of the quarter:	Quarterly accrual cashed to HRA VEBA:
Balance of 100-199 hours	10% of the quarterly accrual (gross)
Balance of 200-319 hours	25% of the quarterly accrual (gross)
Balance of 320+ hours	100% of the quarterly accrual (gross)

Upon voluntary resignation, a portion of accrued sick leave will be cashed out into the HRA VEBA trust. The amount of leave to be cashed out is based upon the following sliding scale:

Years of cumulative service:	Percent of accrued sick hours:
10 years	25%
15 years	50%
20 years	75%
25 years	100%

Deferred Inflows

Deferred inflows of resources consist of deferred gains on refunding that are being amortized over the remaining life of the debt, along with deferred inflows related to pensions.

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Notes to the Financial Statements
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Revenues

Service rates are authorized by resolutions passed by the Board of Commissioners. Billings are made to customers on a bi-monthly cyclical basis. Unbilled revenues for water service to customers between the last billing date and the end of the year are estimated on a pro rata basis and accrued at year-end.

Pensions

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

Reclassifications

Certain 2016 account balances may have been reclassified to conform to the 2017 presentation. Such reclassifications would have no effect on previously reported results of operations and cash flows.

NOTE 2 DEPOSITS AND INVESTMENTS

As provided by state law, the King County Treasurer is the fiscal agent of the District and, as such, receives, disburses and invests funds for the District, at the District's request. All investments are insured, registered or held by the District or by its agent in the District's name. The District is a participant of the County Treasurer's pooled investment program for the purpose of maximizing earnings on investments and at the same time assuring liquidity and safety. Under this program, available funds of the District are mostly invested in securities, bankers' acceptances, commercial paper, and certificates of deposit. Funds in the pooled investment program can be used for disbursements at any time. As of December 31, 2017 the pool's net asset fair value price per share was \$0.9951.

Designated cash and cash equivalents were made up of the following at December 31:

Designated cash & cash equivalents:	12/31/2017
Asset Replacement	\$ 3,764,022
Emergency Operations	500,000
TOTALS	\$ 4,264,022

In accordance with state law, the District's governing body has entered into a formal interlocal agreement with the District's ex officio treasurer, King County, to have all its funds not required for immediate expenditure to be invested in the King County Investment Pool (Pool).

As of December 31, 2017, the District had the following investments:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Effective Duration</u>
King County Investment Pool	\$ 30,175,745	1.02 Years

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

Impaired Investments

As of December 31, 2017, all impaired commercial paper investments have completed enforcement events. The King County impaired investment pool (Impaired Pool) held one commercial paper asset where the Impaired Pool accepted an exchange offer and is receiving the cash flows from the investment's underlying securities. The Impaired Pool also held the residual investments in one commercial paper assets that were part of completed enforcement events, where the Impaired Pool accepted the cash out option. The District's share of the impaired investment pool principal is \$41,979 and the District's fair value of these investments is \$49,438.

Interest Rate Risk

As of December 31, 2017, the Pool's average duration was 1.02 years. As a means of limiting its exposure to rising interest rates, securities purchased in the Pool must have a final maturity, or weighted average life, no longer than five years. While the Pool's market value is calculated on a monthly basis, unrealized gains and losses are not distributed to participants. The Pool distributes earnings monthly using an amortized cost methodology.

Credit Risk

As of December 31, 2017, the District's investment in the Pool was not rated by a nationally recognized statistical rating organization (NRSRO). In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency securities and mortgage-backed securities, corporate note (rated at least "A"), municipal securities (rated at least "A" by two NRSROs), commercial paper (rated at least the equivalent of "A-1" by two NRSRO's), certificates of deposits issued by qualified public depositaries, repurchase agreements, and the Local Government Investment Pool managed by the Washington State Treasurer's office.

NOTE 3 CAPITAL ASSETS

Capital assets are defined by the District as assets with initial individual costs of more than \$5,000, and an estimated useful life in excess of one year. Major expense 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. Capital assets in service are recorded at cost. Donations by developers are recorded at the contract price.

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

Capital asset activity for the year ended December 31, 2017 was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
CAPITAL ASSETS, NOT BEING DEPRECIATED:				
Land and land rights	\$ 1,482,399	\$ ---	\$ ---	\$ 1,482,399
Construction in progress	3,814,990	838,955	(2,351,646)	2,302,299
TOTAL CAPITAL ASSETS, NOT BEING DEPRECIATED	5,297,389	838,955	(2,351,646)	3,784,698
CAPITAL ASSETS, BEING DEPRECIATED:				
Utility plant	162,889,632	3,956,670	(535,365)	166,310,937
Buildings and improvements	11,492,213	512,452	(15,294)	11,989,371
Technology and office equipment	4,404,525	755,251	(178,925)	4,980,851
Transportation, machinery, and equipment	1,454,159	71,914	(81,852)	1,444,221
TOTAL CAPITAL ASSETS, BEING DEPRECIATED	180,240,529	5,296,287	(811,436)	184,725,380
LESS ACCUMULATED DEPRECIATION FOR:				
Utility plant	(32,969,088)	(3,090,677)	252,339	(35,807,426)
Buildings and improvements	(6,367,558)	(556,356)	15,294	(6,908,620)
Technology and office equipment	(2,057,623)	(494,065)	181,965	(2,369,723)
Transportation, machinery, and equipment	(1,151,397)	(102,641)	66,432	(1,187,606)
TOTAL ACCUMULATED DEPRECIATION	(42,545,666)	(4,243,739)	516,030	(46,273,375)
TOTAL CAPITAL ASSETS, BEING DEPRECIATED, NET	137,694,863	1,052,548	(295,406)	138,452,005
TOTAL CAPITAL ASSETS, NET	\$ 142,992,252	\$ 1,891,503	\$ (2,647,052)	\$ 142,236,703

At such time as property is retired and removed from service, the original cost of the property is removed from the capital asset accounts, accumulated depreciation related to the retired or sold property is charged, and the net gain or loss on disposition is credited or charged to income.

During 2017, the District capitalized interest costs for funds borrowed to finance the construction/acquisition of capital assets. The total interest expense incurred by the District during 2017 was \$1,046,251. Of this amount, none was included as part of the cost of capital assets under construction.

Preliminary costs incurred for Capital Improvement Projects are deferred pending construction of the facility. Costs relating to projects ultimately constructed are transferred to utility plant accounts and depreciation starts in the subsequent year. Charges related to abandoned projects are expensed. Initial depreciation of other capital assets not related to projects is recorded in the year subsequent to purchase.

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

Asset:	Years:
Information Technology	3-20
Land improvements	10-20
Security	5-15
Structures & Improvements	20
Tools, Furniture & Equipment	3-10
Vehicles	5
Utility Plant	10-100

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

The District has undivided interests in projects with another utility district. Each District was responsible for financing its share of construction. Each District is responsible for its proportionate share of on-going maintenance and operating costs. The following schedule shows the District's portion in each capital asset as included in the Statement of Net Position as of December 31, 2017:

Project	Ownership Interest	Completed Project
Covington Water District and Cedar River Water and Sewer District		
Four million gallon water storage tank, transmission mains, pumps and SCADA	67.2%	\$ 1,781,736
Less: accumulated depreciation		(830,822)
Net book value		<u>\$ 950,914</u>
Covington Water District and Cedar River Water and Sewer District		
West Intertie Vault-transmission mains and vault	50.0%	\$ 22,266
Less: accumulated depreciation		(12,587)
Net book value		<u>\$ 9,679</u>
Total Project Costs (Net Book Value)		<u>\$ 960,593</u>

NOTE 4 CONSTRUCTION WORK-IN-PROGRESS

Construction Work-in-Progress represents expenses to date on projects whose authorizations total \$7,765,771.

Construction Work-in-Progress is composed of the following at December 31, 2017:

	Project Authorization	Expended to 12/31/17	Committed	Required Future Financing
Capital Projects In Process	\$ 7,765,771	\$ 2,302,299	\$ 5,463,472	\$ ---

NOTE 5 LONG-TERM DEBT**Water Revenue Bonds**

In 2013, the District issued water revenue bonds that are secured by, and payable solely from the Net Revenues of the District, as defined in the revenue bond agreement. The bonds have a principal amount of \$8,865,000 and interest rates ranging from 2% to 4%, of which, \$2,660,000 was used to refund the District's outstanding 2001 Bonds with interest rates ranging from 4.75% to 5.125%. The remaining \$6,205,000 Revenue Bonds were issued to fund the District's Capital Improvement Projects. The 2013 bond issue resulted in a bond premium of \$331,605 which is shown as a deferred inflow of resources on the Statement of Net Position and is being amortized over the life of the bonds.

This advance refunding was undertaken to reduce total debt service payments over the next 8 years by \$337,631 and resulted in an economic gain (difference between the present value of the old and new debt service payments) of \$292,030.

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

In February 2014, Moody's Investors Service confirmed the Aa3 rating on the District's 2013 bonds, removing the negative outlook that was given with the previous rating in December 2012.

The District has covenants to establish, maintain and collect such rates and charges for water service (and for all other utility services that may be provided by the System) which, together with collections of assessments, are available for the payment of the principal and interest on the Bonds and any Future Parity Bonds at an amount equal to at least 1.25 times the Average Debt Service. There are other limitations and restrictions contained in the bond indenture. The District is in compliance with all significant limitations and restrictions including compliance with federal arbitrage requirements.

Water Revenue bonds currently outstanding are as follows:

Name of Bond Issue	Purpose/ Original Issue Amount	Date of Original Issue	Date of Maturity	Interest Rate	Beginning Outstanding Debt 1/1/17	Amount Issued in 2017	Amount Redeemed in 2017	Ending Outstanding Debt 12/31/17
2013 Bonds	Capital Improvements & Refunding 2001 Water Revenue Bonds / \$8,865,000	2013	2033	2-4%	\$ 7,150,000	\$ ---	\$ (610,000)	\$ 6,540,000
	TOTALS				\$ 7,150,000	\$ ---	\$ (610,000)	\$ 6,540,000

Water Revenue Bond debt service requirements to maturity are as follows:

	Principal	Interest	Total
2018	\$ 630,000	\$ 188,848	\$ 818,848
2019	650,000	172,148	822,148
2020	665,000	154,923	819,923
2021	290,000	141,504	431,504
2022	300,000	133,560	433,560
2023-2027	1,650,000	505,725	2,155,725
2028-2032	1,930,000	222,505	2,152,505
2033-2037	425,000	6,798	431,798
TOTAL	\$ 6,540,000	\$ 1,526,011	\$ 8,066,011

COVINGTON WATER DISTRICT
Notes to the Financial Statements
For the years ended December 31, 2017 and 2016

Bond Covenant calculation for the year 2017:

Operating revenues	\$ 14,461,310
Operating expenses*	(8,079,872)
Interest income (excluding restricted funds)	252,436
Miscellaneous income	20,638
Meter installation charges	123,324
Facility charges	3,497,920
Balance available for debt service	\$ 10,275,756
Debt service	\$ 817,448
Debt service ratio (minimum 1.25)	12.57

*Operating expenses for the purpose of this calculation exclude depreciation and include principal and interest paid on the City of Tacoma loans related to the second supply project.

Public Works Trust Fund (PWTF) and Drinking Water State Revolving Fund (DWSRF) loans

The District has entered into loan agreements through the Public Works Trust Fund and Drinking Water State Revolving Fund loan programs to fund various capital improvement projects.

Name of Debt	Purpose/ Original Issue Amount	Date of Original Issue	Date of Maturity	Interest Rate	Beginning Outstanding Debt 1/1/17	Amount Issued in 2017	Amount Redeemed in 2017	Ending Outstanding Debt 12/31/17
PWTF-Corrosion Control	Capital Improvements / \$1,436,400	1997	2017	1%	\$ 65,596	\$ ---	\$ (65,596)	\$ ---
PWTF-Timberlane Main Replacement	Capital Improvements / \$1,250,550	1997	2017	1%	55,222	---	(55,222)	---
SSP	Capital Improvements / \$7,000,000	2000	2020	1%	1,491,022	---	(372,755)	1,118,267
SSP	Capital Improvements / \$10,000,000	2002	2022	0.50%	3,187,500	---	(531,250)	2,656,250
DWSRF-264 th Well	Capital Improvements / \$2,322,163	2002	2023	1.50%	1,015,946	---	(145,135)	870,811
DWSRF-Tank 5 Rechlorination	Capital Improvements / \$548,250	2002	2023	1.50%	239,859	---	(34,266)	205,593
PWTF-Filtration	Capital Improvements / \$10,000,000	2011	2031	0.50%	8,109,064	---	(540,604)	7,568,460
DWSRF-Filtration	Capital Improvements / \$2,020,000	2011	2035	1.50%	1,893,494	---	(99,658)	1,793,836
DWSRF-222 nd	Capital Improvements / \$1,100,000	2012	2036	1.50%	999,900	111,100	(55,550)	1,055,450
DWSRF-Filtration	Capital Improvements / \$6,060,000	2012	2036	1.50%	3,498,683	---	(184,141)	3,314,542
DWSRF-Tank 1 Main	Capital Improvements / \$1,100,000	2013	2037	1.50%	---	57,960	(---	57,960
	TOTALS				\$ 20,556,286	\$ 169,060	\$ (2,084,177)	\$ 18,641,169

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

Annual debt service requirements to maturity for the PWTF/DWSRF loans are as follows:

	Principal	Interest	Total
2018	\$ 1,966,257	\$ 170,888	\$ 2,137,145
2019	1,966,257	153,168	2,119,425
2020	1,966,259	136,540	2,102,799
2021	1,593,502	119,712	1,713,214
2022	1,593,502	106,611	1,700,113
2023-2027	4,593,654	379,250	4,972,904
2028-2032	3,873,655	182,728	4,056,383
2033-2037	1,088,083	33,693	1,121,776
TOTAL	\$ 18,641,169	\$ 1,282,590	\$ 19,923,759

Tacoma Repayment Agreement loans

Please see Note 9 Regional Water Supply System (RWSS) for a description of the RWSS and Second Supply Project.

2002 Second Supply Project Bond Issue

In 2002, the City of Tacoma issued \$82,700,000 of Regional Water Supply System (RWSS) Revenue Bonds for the construction of a portion of the Second Supply Project. The District entered into a repayment agreement with the City in the amount of \$17,822,335 to finance its share of construction costs. The District is obligated to pay debt service on the agreement in an amount that is consistent with 22.67% of Tacoma's debt service on the bonds, excluding the capitalized interest, under the terms of the Second Supply Project Agreements. The District's portion of the debt service related to the Tacoma bond was capitalized while the project was still in construction and has been expensed thereafter. The District's total project costs of \$46 million were capitalized and are being amortized over the assets useful life.

In 2013, the City of Tacoma refinanced the 2002 RWSS bonds, which resulted in a bond premium. The District's share of the premium was \$2,416,133, which is shown as a deferred inflow of resources on the Statement of Net Position and is being amortized over the remaining life of the debt.

2010 Second Supply Project Bond Issue

In 2010, the City of Tacoma issued \$44,245,000 of Regional Water Supply System (RWSS) Revenue Bonds to finance a portion of the costs of the Filtration Treatment Project for the Second Supply Project. The 2010 bonds issued are Build America Bonds with a 35% government interest subsidy option. The District entered into a repayment agreement with the City of Tacoma in 2010 in the amount of \$11,595,000 to fund a portion of its share of costs related to the project. The federal government budget sequestration cuts reduced the BABS subsidy through the year 2023. Amounts reflected for interest in the table below are net of the 35% government interest subsidy, with a reduction of 7.2% of the 35% subsidy through 2023.

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

Subsequent to the 2010 repayment agreement with the City of Tacoma, the District received additional DWSRF and PWTf low interest loans for use in funding its portion of the Filtration Treatment project. Therefore, the 2010 repayment agreement with the City of Tacoma was amended in 2013 to allocate \$8,080,000 of the District's bond proceeds back to Tacoma to be used toward their portion of the project funding.

2011 Filtration Loan

In 2010 the City of Tacoma was awarded a \$6,060,000 loan for use in funding the Filtration Treatment project through the Drinking Water State Revolving Fund loan program. The District entered into a repayment agreement with the City of Tacoma in 2011 for an amount up to \$3,030,000 to fund a portion of its share of costs related to the project. The District ended up using \$2,727,000 of this loan. In 2016 the repayment agreement with Tacoma was amended to show the loan allocation to Covington Water District of \$2,727,000.

Name of Debt	Purpose/ Original Issue Amount	Date of Original Issue	Date of Maturity	Interest Rate	Beginning Outstanding Debt 1/1/17	Amount Issued in 2017	Amount Redeemed in 2017	Ending Outstanding Debt 12/31/17
City of Tacoma SSP Repayment Agreement	Capital Improvements / \$17,822,335	2002	2032	4%-5%	\$13,459,167	\$ ---	\$ (129,167)	\$13,330,000
City of Tacoma SSP Repayment Agreement	Capital Improvements / \$3,515,000	2010	2040	5.62%	3,515,000	---	---	3,515,000
City of Tacoma Filtration Loan	Capital Improvements / \$2,727,000	2011	2034	1.50%	2,467,089	---	(137,061)	2,330,028
TOTALS					\$19,441,256	\$ ---	\$ (266,228)	\$19,175,028

Annual debt service requirements to maturity for the SSP Repayment Agreements are as follows:

	Principal	Interest	Total
2018	\$ 274,561	\$ 792,005	\$ 1,066,566
2019	468,728	783,075	1,251,803
2020	488,311	764,436	1,252,747
2021	503,311	744,817	1,248,128
2022	518,727	724,449	1,243,176
2023-2027	5,662,387	3,059,716	8,722,103
2028-2032	7,469,883	1,551,641	9,021,524
2033-2037	2,349,120	502,150	2,851,270
2038-2042	1,440,000	106,318	1,546,318
TOTAL	\$ 19,175,028	\$ 9,028,607	\$ 28,203,635

Changes in Long-Term Liabilities

During the year ended December 31, 2017, the following changes occurred in long-term liabilities:

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

ID No.	Description	Beginning Balance 1/1/17	Additions	Reductions	Ending Balance 12/31/17	Due within one year
252.11	Water Revenue Bonds	\$ 7,150,000	\$ ---	\$ (610,000)	\$ 6,540,000	\$ 630,000
263.82	PWTF/DWSRF loans	20,556,286	169,060	(2,084,177)	18,641,169	1,966,257
263.82	SSP Repayment Agreements	19,441,256	---	(266,228)	19,175,028	274,561
	TOTALS	\$47,147,542	\$ 169,060	\$(2,960,405)	\$44,356,197	\$ 2,870,818

The annual debt service requirements to maturity on all debts outstanding as of December 31, 2017 including interest are as follows:

Year	Principal	Interest	Total
2018	\$ 2,870,818	\$ 1,151,741	\$ 4,022,559
2019	3,084,985	1,108,391	4,193,376
2020	3,119,570	1,055,899	4,175,469
2021	2,386,813	1,006,033	3,392,846
2022	2,412,229	964,620	3,376,849
2023-2027	11,906,041	3,944,691	15,850,732
2028-2032	13,273,538	1,956,874	15,230,412
2033-2037	3,862,203	542,641	4,404,844
2038-2042	1,440,000	106,318	1,546,318
TOTALS	\$44,356,197	\$11,837,208	\$56,193,405

NOTE 6 RESTRICTED COMPONENT OF NET POSITION

The District’s Statement of Net Position reports a restricted component of net position, which is restricted by enabling legislation for the following purposes as of December 31:

	12/31/17
Debt service	\$ 1,291,942
Rate stabilization	2,002,014
TOTAL	\$ 3,293,956

NOTE 7 PENSION PLAN

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 2017:

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

Aggregate Pension Amounts – All Plans	
Pension liabilities	\$ (2,190,032)
Pension assets	---
Deferred outflows of resources	319,387
Deferred inflows of resources	(442,087)
Pension expense/expenditures	132,411

State Sponsored Pension Plans

Substantially all 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 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.

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

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 2017 were as follows:

PERS Plan 1		
Actual Contribution Rates	Employer	Employee*
January-June 2017:		
PERS Plan 1	6.23%	6.00%
PERS Plan 1 UAAL	4.77%	
Administrative Fee	0.18%	
TOTAL	11.18%	6.00%
July-December 2017:		
PERS Plan 1	7.49%	6.00%
PERS Plan 1 UAAL	5.03%	
Administrative Fee	0.18%	
TOTAL	12.70%	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.

COVINGTON WATER DISTRICT

Notes to the Financial Statements

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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 2017 were as follows:

PERS Plan 2/3		
Actual Contribution Rates	Employer 2/3	Employee 2*
January-June 2017:		
PERS Plan 2/3	6.23%	6.12%
PERS Plan 1 UAAL	4.77%	
Administrative Fee	0.18%	
Employee PERS Plan 3		varies
TOTALS	11.18%	6.12%
July-December 2017:		
PERS Plan 2/3	7.49%	7.38%
PERS Plan 1 UAAL	5.03%	
Administrative Fee	0.18%	
Employee PERS Plan 3		varies
TOTALS	12.70%	7.38%

* For employees participating in JBM, the contribution rate was 15.30% for January-June 2017 and 18.45% for July-December 2017.

The District's actual PERS plan contributions were \$153,948 to PERS Plan 1 and \$215,555 to PERS Plan 2/3 for the year ended December 31, 2017.

Actuarial Assumptions

The total pension liability (TPL) for each of the DRS plans was determined using the most recent actuarial valuation completed in 2017 with a valuation date of June 30, 2016. The actuarial assumptions used in the valuation were based on the results of the Office of the State Actuary's (OSA) 2007-2012 Experience Study and the 2015 Economic Experience Study.

Additional assumptions for subsequent events and law changes are current as of the 2016 actuarial valuation report. The TPL was calculated as of the valuation date and rolled forward to the measurement date of June 30, 2017. Plan liabilities were rolled forward from June 30, 2016, to

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

June 30, 2017, reflecting each plan's normal cost (using the entry-age cost method), assumed interest and actual benefit payments.

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

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

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

- For all plans except LEOFF Plan 1, how terminated and vested member benefits are valued was corrected.
- How the basic minimum COLA in PERS Plan 1 is valued for legal order payees was improved.
- For all plans, the average expected remaining service lives calculation was revised.

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. In selecting this assumption, the Office of the State Actuary (OSA) reviewed the historical experience data, considered the historical conditions that produced past annual investment returns, and considered capital market assumptions and

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

simulated expected investment returns provided by the Washington State Investment Board (WSIB). The WSIB uses the capital market assumptions and their target asset allocation to simulate future investment returns at various future time horizons.

Estimated Rates of Return by Asset Class

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2017, 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%	4.90%
Real Estate	15%	5.80%
Global Equity	37%	6.30%
Private Equity	23%	9.30%
	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	\$ 1,374,640	\$ 1,128,427	\$ 915,154
PERS 2/3	2,860,076	1,061,605	(411,975)

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, 2017, the District reported a total pension liability of \$2,190,032 for its proportionate share of the net pension liabilities as follows:

	Liability (or Asset)
PERS 1	\$ 1,128,427
PERS 2/3	1,061,605

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

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

	Proportionate Share 6/30/16	Proportionate Share 6/30/17	Change in Proportion
PERS 1	.024848%	.023781%	(.001067%)
PERS 2/3	.031740%	.030554%	(.001186%)

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

The collective net pension liability (asset) was measured as of June 30, 2017, and the actuarial valuation date on which the total pension liability (asset) is based was as of June 30, 2016, with update procedures used to roll forward the total pension liability to the measurement date.

Pension Expense

For the year ended December 31, 2017, the District recognized pension expense as follows:

	Pension Expense
PERS 1	\$ 13,096
PERS 2/3	119,315
TOTAL	\$ 132,411

Deferred Outflows of Resources and Deferred Inflows of Resources

At December 31, 2017, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

COVINGTON WATER DISTRICT

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For the years ended December 31, 2017 and 2016

Plan Name	Deferred Outflows of Resources			Deferred Inflows of Resources		
	PERS 1	PERS 2/3	Total	PERS 1	PERS 2/3	Total
Differences between expected and actual experience	\$ ---	\$ 107,566	\$ 107,566	\$ ---	\$ 34,914	\$ 34,914
Net difference between projected and actual investment earnings on pension plan investments	---	---	---	42,110	282,998	325,108
Changes of assumptions	---	11,276	11,276	---	---	---
Changes in proportion and differences between contributions and proportionate share of contributions	---	---	---	---	82,065	82,065
Contributions subsequent to the measurement date	80,673	119,872	200,545	---	---	---
TOTAL	\$ 80,673	\$ 238,714	\$ 319,387	\$ 42,110	\$ 399,977	\$ 442,087

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, 2018. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:	PERS 1	PERS 2/3	Total
2018	\$ (28,463)	\$ (138,150)	\$ (166,613)
2019	8,986	6,380	15,366
2020	(2,087)	(34,673)	(36,760)
2021	(20,546)	(120,752)	(141,298)
2022	---	2,635	2,635
Thereafter	---	3,426	3,426

NOTE 8 DEFERRED COMPENSATION PLAN

The District offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. This plan is with the State of Washington Deferred Compensation Program. The plan is available to eligible employees and permits them to defer a portion of their salary until future years. Participation in the plan is optional. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

The Deferred Compensation Plan provides for a maximum annual contribution of \$18,000. In addition, participants may be eligible for a Catch-Up contribution which would increase the maximum to \$24,000. The District employees' total deferred compensation plan contribution for the year 2017 was \$96,142. Total employees' actual deferred contribution since joining the plan is \$1,086,652.

COVINGTON WATER DISTRICT

Notes to the Financial Statements

For the years ended December 31, 2017 and 2016

NOTE 9 REGIONAL WATER SUPPLY SYSTEM

The Regional Water Supply System (RWSS) is a partnership formed by Covington Water District, City of Tacoma, City of Kent, and Lakehaven Water and Sewer District (the "Participants") to provide them with additional water supply on a long term basis. The Participants have rights and obligations consistent with the following fractional shares: City of Tacoma – 15/36; City of Kent – 7/36; Covington Water District – 7/36; Lakehaven Water and Sewer District – 7/36 ("Participant Shares"). Each Participant has a right, among others, to receive Second Diversion Water and Storage, and each has an obligation to pay its Participant Share of the costs of the Project ("Project Costs"). Project costs include fixed and variable operation and maintenance costs, initial project construction costs and capital expenditures. The City of Tacoma, consistent with the project agreement, is the owner and operator of the Second Supply Project.

The Regional Water Supply System (RWSS) completed construction of a filtration plant in 2015 as part of the Second Supply Project (SSP) to meet an Environmental Protection Agency mandate. For this project only, the District's share of cost was only 11.7%, as the City of Tacoma has a higher share of costs for additional usage of the filtration plant.

Information about current debt related to the District's participation in the RWSS can be found in Note 5 Long-Term Debt.

NOTE 10 RISK MANAGEMENT

The District is exposed to various risks including, but not limited to, damage to personal and real property, general liability, automotive liability, theft, public officials' errors and omissions, and natural disasters. To protect itself against these risks, the District is a member of the Water and Sewer Risk Management Pool (Pool). Chapter 48.62 RCW authorizes the governing body of any one or more governmental entities to form together into or join a pool or organization for the joint purchasing of insurance, and/or joint self-insuring, and/or joint hiring or contracting for risk management services to the same extent that they may individually purchase insurance, self-insurance, or hire or contract for risk management services. An agreement to form a pooling arrangement was made pursuant to the provisions of Chapter 39.34 RCW, the Interlocal Cooperation Act. The Pool was formed in November 1987 when water and sewer Districts in the State of Washington joined together by signing an Interlocal Governmental Agreement to pool their self-insured losses and jointly purchase insurance and administrative services. The Pool currently has 62 members. The Pool's fiscal year is November 1st through October 31st.

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

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

COVINGTON WATER DISTRICT
Notes to the Financial Statements
For the years ended December 31, 2017 and 2016

TYPE OF COVERAGE	MEMBER DEDUCTIBLE	SELF-INSURED RETENTION/GROUP	EXCESS LIMITS
Property Loss:			
Buildings and Contents	\$1,000 - \$25,000 and See (C) below	\$25,000	\$1,000,000,000 (D)
Flood	See (A) below	See (A) below	\$50,000,000
Earthquake	See (B) below	See (B) below	\$110,000,000 (\$75,000,000 shared by all members, \$25,000,000 dedicated to Alderwood, \$5,000,000 dedicated to Sammamish Plateau, and \$5,000,000 dedicated to Cascade Water Alliance)
Terrorism	\$1,000 - \$25,000	\$25,000 Primary layer	\$100,000,000 Primary layer
Boiler & Machinery	\$1,000 - \$350,000 depending on object	\$25,000 - \$350,000 depending on object	\$100,000,000
Auto - Physical Damage	\$1,000-\$25,000	\$25,000	\$10,000,000
Liability:			
Commercial General Liability	\$1,000 - \$25,000	\$200,000	\$10,000,000
Auto Liability	\$1,000 - \$25,000	\$200,000	\$10,000,000
Public Officials Errors and Omissions	\$1,000 - \$25,000	\$200,000	\$10,000,000
Employment Practices	\$1,000 - \$25,000	\$200,000	\$10,000,000
Other:			
Public Officials Bonds	Various	N/A	Various
Crime	\$1,000 - \$25,000	\$25,000	\$2,000,000
Identity Fraud	\$0	\$0	\$25,000
A. \$100,000 member deductibles, per occurrence, in Flood zones except Zones A&V; \$250,000 member deductible per occurrence, in Flood Zones A&V.			
B. Member deductible for earthquakes is 5% subject to \$100,000 minimum Earthquake Shock. The deductible will apply per occurrence on a per unit basis, as defined in the policy form, subject to the stated minimum.			
C. Member deductible for Cyber liability is \$100,000 and where applicable the dollar amount of the business interruption loss during the policy's required 8 hour waiting period			
D. In 2017 Covington Water District secured property insurance coverage specific to certain underground segments of pipes with a total insurable value of approximately \$3.78M.			

Pool members are responsible for a deductible on each coverage and the Pool is responsible for the remainder of the self-insured retention listed in the table above except where noted as follows. The insurance carriers then cover the loss to the maximum limit of the policy. Each member is responsible for the full deductible applicable to the perils of earthquake and flood (the Pool is not responsible for any deductible or self-insured retention for earthquake and flood claims). Each member is also responsible for the full deductible applicable to the Cyber Liability, and that part of a Boiler & Machinery deductible, which exceeds \$25,000.

Upon joining, the members contract to remain in the Pool for one full policy period. Following completion of one full policy period, members must give six months notice before terminating participation (e.g. to withdraw from the Pool on November 1, 2018, written notice must be in possession of the Pool by April 30, 2018). The Interlocal Governmental Agreement is renewed automatically each year. Even after termination of relationship with the Pool, a member is still responsible for contributions to the Pool for any unresolved, unreported, and in process claims, for the period that the District was a signatory to the Interlocal Governmental Agreement.

COVINGTON WATER DISTRICT
Notes to the Financial Statements
For the years ended December 31, 2017 and 2016

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

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

There were no settlements in excess of the insurance coverage in any of the three prior fiscal years.

COVINGTON WATER DISTRICT
 Schedule of State Financial Assistance (Schedule 15)
 For the year ended December 31, 2017

Grantor	Program Title	Identification Number	Amount
Washington State Department of Commerce-Public Works Board			
	Capitalization Grants for Drinking Water State Revolving Fund	DM13-952-187	\$ 46,960
		Sub-total	\$ 46,960
		Grand total	\$ 46,960

COVINGTON WATER DISTRICT
REQUIRED SUPPLEMENTARY INFORMATION
 Schedule of Proportionate Share of the Net Pension Liability
 As of June 30, 2017

Public Employees' Retirement System Plan 1

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Employer's proportion of the net pension liability (asset)	% 0.023781%	0.024848%	0.027160%
Employer's proportionate share of the net pension liability	\$ 1,128,427	1,334,455	1,420,721
Covered payroll	\$ 3,004,802	2,965,587	3,027,537
Employer's proportionate share of the net pension liability as a percentage of covered payroll	% 37.55%	45.00%	46.93%
Plan fiduciary net position as a percentage of the total pension liability	% 61.24%	57.03%	59.10%

Public Employees' Retirement System Plan 2/3

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Employer's proportion of the net pension liability (asset)	% 0.030554%	0.031740%	0.033333%
Employer's proportionate share of the net pension liability	\$ 1,061,605	1,598,084	1,191,007
Covered payroll	\$ 3,002,180	2,962,053	2,960,140
Employer's proportionate share of the net pension liability as a percentage of covered payroll	% 35.36%	53.95%	40.23%
Plan fiduciary net position as a percentage of the total pension liability	% 90.97%	85.82%	89.20%

Notes to schedule:

1. Until a full 10-year trend is compiled, governments should present information only for those years for which information is available. GASB 68 was implemented for the year ended December 31, 2015, therefore there is no data available for years prior to 2014.
2. Covered payroll is the payroll on which contributions to a pension plan are based (GASB 82, par. 5).

COVINGTON WATER DISTRICT
REQUIRED SUPPLEMENTARY INFORMATION
 Schedule of Employer Contributions
 As of December 31, 2017

Public Employees' Retirement System Plan 1

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Statutorily or contractually required contributions	\$ 153,948	140,442	130,198
Contributions in relation to the statutorily or contractually required contributions	\$ <u>(153,948)</u>	<u>(140,442)</u>	<u>(130,198)</u>
Contribution deficiency (excess)	\$ <u>0</u>	<u>0</u>	<u>0</u>
Covered payroll	\$ 3,137,785	2,940,565	2,961,043
Contributions as a percentage of covered payroll	% 4.91%	4.78%	4.40%

Public Employees' Retirement System Plan 2/3

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Statutorily or contractually required contributions	\$ 215,555	183,020	166,612
Contributions in relation to the statutorily or contractually required contributions	\$ <u>(215,555)</u>	<u>(183,020)</u>	<u>(166,612)</u>
Contribution deficiency (excess)	\$ <u>0</u>	<u>0</u>	<u>0</u>
Covered payroll	\$ 3,135,049	2,937,715	2,956,465
Contributions as a percentage of covered payroll	% 6.88%	6.23%	5.64%

Notes to schedule:

1. Until a full 10-year trend is compiled, governments should present information only for those years for which information is available. GASB 68 was implemented for the year ended December 31, 2015, therefore there is no data available for years prior to 2014.
2. Covered payroll is the payroll on which contributions to a pension plan are based (GASB 82, par. 5).
3. Contributions are actual employer contributions to the plan. For PERS 1 this includes the portion of PERS 2/3 contributions that fund PERS 1 UAAL. Contributions do not include employer-paid member contributions (GASB 82, par .8).