

MOSSES ADAMS

**KING COUNTY WATER QUALITY
ENTERPRISE FUND**
(An Enterprise Fund of
King County, Washington)

**Independent Auditor's Report
and Financial Statements with
Required Supplementary Information
and Supplemental Schedule**

December 31, 2009 and 2008

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INDEPENDENT AUDITOR'S REPORT

To the Metropolitan King County Council
Seattle, Washington

We have audited the accompanying financial statements of the King County Water Quality Enterprise Fund ("Water Quality"), as of and for the year ended December 31, 2009, which collectively comprise Water Quality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Water Quality's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the King County Water Quality Enterprise Fund as of and for the year ended December 31, 2008 prior to restatement, were audited by other auditors, whose report dated October 7, 2009 expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the King County Water Quality Enterprise Fund as of December 31, 2009, and the changes in its financial position and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 15, Water Quality corrected errors related to its accounting for capital assets, amortization of debt related accounts, and classification of net assets accounts and has restated the 2008 financial statements and its net assets as of January 1, 2008, to conform with accounting principles generally accepted in the United States of America. We also audited the adjustments described in Note 15 that were applied to restate the 2008 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

The accompanying management's discussion and analysis on pages 2 through 9 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of Water Quality's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Supplemental Schedule of Net Revenues Available for Debt Service is not a required part of the basic financial statements, but is supplemental information presented for purposes of additional analysis. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Moss Adams LLP

Seattle, Washington
July 6, 2010

**KING COUNTY WATER QUALITY ENTERPRISE FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2009 AND 2008**

The management of King County Water Quality Enterprise Fund ("Water Quality") presents to readers of its financial statements this narrative overview and analysis of its activities and financial performance for the fiscal years ended December 31, 2009 and 2008.

THE SEWER SYSTEM

Water Quality provides wastewater treatment services to King County, part of Snohomish County, and part of Pierce County with a service area encompassing over 420 square miles. The major wastewater treatment facilities include two large secondary treatment plants at West Point in Seattle and South Plant in Renton, two smaller secondary treatment plants at Vashon Island and Carnation, 335 miles of interceptors, 42 pump stations, and 38 combined sewer overflow ("CSO") control locations. The sewer system collects and treats 206 million gallons per day in a normal flow year from approximately 1.5 million residents.

FINANCIAL HIGHLIGHTS

During 2009, Water Quality provided sewage treatment services to 703,795 residential customer equivalents ("RCE") compared to 706,846 in 2008 and 702,946 in 2007. An RCE is one single-family residence or an equivalent unit of 750 cubic feet of monthly water consumption for all other customers such as multifamily residential, commercial, and industrial properties. The capacity charge program added 8,949 new connections to its customer billing base in 2009. The program added 11,331 and 12,271 new connections in 2008 and 2007, respectively. The average flow of the four treatment plants was 169 million gallons per day ("MGD") with a peak daily flow of 525 MGD. Maximum system capacity remained at 767 MGD in 2009. The average daily flow fluctuated between a peak of 178 in 2007, a low of 162 MGD in 2008 and 169 in 2009. The amount of annual precipitation largely determines annual fluctuations in flows, with recent years considered low flow years.

In 2009, Water Quality produced 47,718 wet tons of biosolids at its West Point Treatment Plant and 68,280 wet tons at its South Treatment Plant. The entire system produced 28,287 dry tons of biosolids. About 333 million gallons of reclaimed water were used for landscape irrigation, industrial processes, and for heating and cooling in 2009. Reclaimed water capacity will expand when the Brightwater Treatment Plant begins service in 2011.

The Industrial Pretreatment Program conducted 438 inspections and took 2,650 compliance samples in 2009. The program currently tracks 304 facilities with discharge authorization permits and 130 significant industrial users.

Water Quality currently has 38 combined sewer overflow facilities. An aggressive effort conducted in concert with the City of Seattle has resulted in a significant reduction in combined sewer overflows in years 1980-1983 from a baseline of 2.3 billion gallons per year to 815 million gallons currently.

**KING COUNTY WATER QUALITY ENTERPRISE FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2009 AND 2008**

In 1999, the Metropolitan King County Council adopted the Regional Wastewater Services Plan ("RWSP") to construct additional capacity, protect public health and provide for future projected population growth in its service area through 2030. Major RWSP projects include the building of the Brightwater Treatment Plant, improvements to the regional conveyance system, construction of 21 combined sewer overflow control projects, and expansion of the South Treatment Plant to 135 million gallons per day capacity by 2029. The RWSP also includes projects to control infiltration and inflow into the conveyance system, process additional biosolids, and produce additional reclaimed water. Total Water Quality capital program expenditures were \$470.9 million for 2009 and \$474.1 million for 2008.

Construction continued on the new Brightwater Treatment Plant located in southern Snohomish County and the associated conveyance system. Current cost estimates for the Brightwater project total \$1.8 billion. The \$360.6 million project expenditures in 2009 pushed life to date expenditures to \$1.4 billion. The treatment plant is scheduled for completion and to begin operations in 2011 with the conveyance to be completed in 2012.

Water Quality operating revenues increased by 8.0 percent to \$306.9 million in 2009 from \$284.2 million in 2008. Operating expenses before depreciation increased by 4.8 percent to \$103.1 million in 2009 from \$98.4 million in 2008.

The monthly sewer rate increased to \$31.90 per RCE in 2009 after remaining stable in 2008 at \$27.95. The capacity charge rate increased to \$47.64 per RCE in 2009 from \$46.25 in 2008. Capacity charge revenues increased 16.7 percent to \$40.7 million in 2009 from \$34.9 million in 2008. The RCE billed for sewer treatment services decreased to 703,795 in 2009 from 706,846 in 2008. The rate stabilization reserve was increased by \$15.4 million to \$35.2 million in 2009 from \$19.8 million in 2008. This increase of \$15.4 million in the reserve balance decreases operating revenues for the year and has been excluded from the calculation of debt service coverage for 2009. Future deposits to the rate stabilization reserve will decrease operating revenues and debt service coverage in the year of the deposit. Withdrawals will have the opposite effect of increasing operating revenues and debt service coverage in the year the rate stabilization reserve is reduced.

The rate stabilization reserve, as mandated by the Metropolitan King County Council as part of its rate setting activities, requires Water Quality to set aside a portion of current revenue for future periods in order to moderate the impact of rate increases over time.

Water Quality issued \$300.0 million in new limited tax general obligation bonds in April 2009 and \$250.0 million in new revenue bonds in August 2009 at average coupon rates of 5.12 percent and 5.09 percent, respectively. The King County Metro Transit Vehicle Replacement fund provided a loan to the Water Quality Construction fund as bridge financing from October 2009 until proceeds from a \$100.0 million variable rate bond issue were received in January 2010. The negative unrestricted net assets balance was reduced to (\$88.0) million at December 31, 2009 from (\$176.4) million at December 31, 2008. Water Quality received \$19.2 million of new, low-rate loans from the State of Washington to help fund the capital program at interest rates between 2.7 percent and 3.1 percent.

KING COUNTY WATER QUALITY ENTERPRISE FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2009 AND 2008

In 2008, Water Quality issued \$350.0 million in new revenue bonds, \$237.0 million in limited tax general obligation refunding bonds, and retired \$100.0 million of existing variable rate debt. In addition, surplus King County funds provided a five-year loan of \$100.0 million to be repaid in increments of \$20.0 million annually.

The results of operations for 2009 and 2008 produced a debt service coverage ratio on senior lien debt of 1.44 and 1.41, respectively, exceeding the coverage covenant requirement of 1.15 in both years. The total debt coverage ratio of 1.33 in 2009 and 1.24 in 2008 exceeded the 1.15 policy minimum in both years.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to Water Quality's basic financial statements. The basic financial statements are comprised of the comparative statements of net assets; statements of revenues, expenses and changes in net assets; statements of cash flows, and the notes to the financial statements, which explain certain elements of the financial statements in greater detail.

REQUIRED FINANCIAL STATEMENTS

Water Quality's financial statements provide information with respect to all of its activities using accounting methods similar to those used by private-sector companies. The statements provide both long-term and short-term information about Water Quality's financial status.

The comparative statement of net assets presents information on all of Water Quality's assets and liabilities, with the difference between assets and liabilities presented as net assets as of each year-end. The statement of net assets provides information about the nature and amount of investments in resources (assets) and obligations to creditors (liabilities). Over time, the statements demonstrate Water Quality's financial health by providing a basis for the reader to evaluate capital structure, liquidity, and financial flexibility.

The two most recent years' of Water Quality operating and nonoperating revenues and expenses are accounted for in the statements of revenues, expenses and changes in net assets. The statements illustrate the current and prior period results of operations and recovery of costs by receipt of fees, and are instrumental in demonstrating Water Quality's continued creditworthiness. All changes in net assets are reported as soon as the underlying event occurs, irrespective of the timing of related cash flows. The receipt of monthly sewage treatment charges provides the principal support for Water Quality's activities. Sewage treatment charges provided 83.5 percent of operating revenues in 2009 and 84.5 percent in 2008. Water Quality is a wholesale provider of sewage treatment services to thirty-five municipal and three nonmunicipal participants in King, Pierce, and Snohomish counties. The receipt of the monthly payments is governed by service agreements, the majority of which expire in July 2036.

**KING COUNTY WATER QUALITY ENTERPRISE FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2009 AND 2008**

The statements of cash flows report cash receipts, cash payments, and net changes in cash derived from operations, financing, and investment activities. From the statements, the reader can discern Water Quality's sources and applications of cash during 2009 and 2008, reasons for differences between operating cash flows and operating income, and the effect on the statements of net assets from investing, capital, and financing activities.

The notes to financial statements provide additional information essential to obtain a full understanding of the data provided in the basic statements.

In the following comparative analysis of the financial statements, percentages and ratios were calculated and rounded using the actual detail from the financial statements.

FINANCIAL ANALYSIS OF THE STATEMENTS OF NET ASSETS

Comparative data, stated in millions of dollars:

	Years Ended December 31		
	2009	2008 ¹	2007 ¹
Current assets	\$ 227.9	\$ 173.0	\$ 177.4
Noncurrent assets	172.6	142.7	100.2
Capital assets	3,483.1	3,084.7	2,659.4
Other	111.3	80.7	77.4
Total assets	<u>3,994.9</u>	<u>3,481.1</u>	<u>3,014.4</u>
Long term liabilities	3,088.7	2,530.2	2,298.3
Other liabilities	362.4	431.8	231.0
Total liabilities	<u>3,451.1</u>	<u>2,962.0</u>	<u>2,529.3</u>
Net assets invested in capital assets	410.6	521.8	353.3
Net assets-restricted	221.2	173.7	117.2
Net assets-unrestricted	<u>(88.0)</u>	<u>(176.4)</u>	<u>14.6</u>
Total net assets	<u>\$ 543.8</u>	<u>\$ 519.1</u>	<u>\$ 485.1</u>

¹ Prior period amounts have been restated. See Note 15 - Prior Period Adjustments.

Net assets serve as a useful indicator of Water Quality's financial position. As of December 31, 2009 and 2008, assets exceeded liabilities by \$543.8 million and \$519.1 million, respectively.

**KING COUNTY WATER QUALITY ENTERPRISE FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2009 AND 2008**

Of the total assets of Water Quality, 87.2 percent or \$3,483.1 million were invested in capital assets such as treatment plants, pumping and regulator stations, interceptors, and other equipment at year-end 2009. For the year-end 2008, 88.6 percent or \$3,084.7 million were invested in capital assets. Water Quality uses its capital assets to provide wholesale wastewater collection and treatment services in King, Pierce, and Snohomish counties. Current operating and debt service requirements are met by operating and nonoperating revenues composed of monthly sewage treatment charges, a capacity charge for new customers, other special-handling charges, miscellaneous operating revenues, and investment earnings.

Net assets increased by 4.8 percent or \$24.7 million in 2009 to \$543.8 million in 2009 from \$519.1 million in 2008 due to strong operating results. Restricted net assets increased by 27.3 percent or \$47.4 million in 2009 to \$221.1 million in 2009 from \$173.7 million in 2008. Unrestricted net assets increased by 50.1 percent or \$88.4 million in 2009 to (\$88.0) million in 2009 from (\$176.4) million in 2008.

Water Quality reported its investment in capital assets, net of debt related to capital asset acquisition, as \$410.6 million and \$521.8 million at December 31, 2009 and 2008, respectively.

FINANCIAL ANALYSIS OF THE STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Comparative data, stated in millions of dollars:

	Years Ended December 31		
	2009	2008 ¹	2007 ¹
Sewage treatment fees	\$ 271.6	\$ 237.0	\$ 236.0
Rate stabilization	(15.4)	3.0	(8.3)
Capacity charge revenue	40.7	34.9	27.1
Other revenue	10.0	9.3	8.1
Operating revenues	306.9	284.2	262.9
Operating expenses	194.8	180.1	173.9
Operating income	112.1	104.1	89.0
Non operating revenues (expenses)	(89.2)	(72.1)	(94.1)
Grant revenues and transfers	1.8	2.0	1.0
Change in net assets	24.7	34.0	(4.1)
Net assets beginning of year	519.1	485.1	489.2
Net assets end of year	<u>\$ 543.8</u>	<u>\$ 519.1</u>	<u>\$ 485.1</u>

¹ Prior period amounts have been restated. See Note 15 - Prior Period Adjustments.

**KING COUNTY WATER QUALITY ENTERPRISE FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2009 AND 2008**

While the statement of net assets shows changes in assets, liabilities and net assets, the statements of revenues, expenses and changes in net assets provide insight into the source of these changes.

During 2009, operating revenues increased by 8.0 percent or \$22.7 million to \$306.9 million in 2009 from \$284.2 million in 2008. Operating expenses increased by 8.1 percent or \$14.6 million to \$194.7 million in 2009 from \$180.1 million in 2008.

Water Quality collected a monthly sewage treatment charge of \$31.90 per RCE in 2009 and \$27.95 per RCE in 2008. Total sewer disposal revenues before the rate stabilization transfer increased by 14.6 percent or \$34.6 million to \$271.6 million in 2009 from \$237.0 million in 2008.

- Other operating revenues, including capacity charges for new customers and other treatment charges increased by 14.7 percent or \$6.5 million in 2009 to \$50.7 million in 2009 from \$44.2 million in 2008. Capacity charge early payoff revenues were \$10.8 million or 26.5 percent of total capacity charge revenues in 2009 while in 2008, capacity charge early payoff revenues were 29.1 percent or \$10.1 million of the annual total. Actual new capacity charge connections were 8,949 in 2009 and 11,331 in 2008.
- Net nonoperating revenues and expenses increased by 23.7 percent or (\$17.1) million to (\$89.2) million in 2009 from (\$72.1) million in 2008.
- Capital grant revenues and transfers received from federal and state agencies decreased by 18.6 percent or \$0.4 million to \$1.7 million in 2009 from \$2.1 million in 2008. Low interest loans have largely replaced grants as the primary method of state agency support in recent years.

CAPITAL ASSETS

At December 31, 2009, Water Quality's investment in capital assets, net of accumulated depreciation, was \$3.5 billion as compared to \$3.1 billion in 2008. These represent increases of 12.9 percent or \$398.4 million in 2009 and 16.0 percent or \$425.3 million in 2008. The changes are a result of replacement and additions to the interceptor and siphon systems, purchases of land, additional storage capacity, extensions of sewer trunk lines, and continued efforts to control odor and improve sewage-handling technology.

The increases are directly related to continued implementation of Water Quality's Regional Wastewater Services Plan.

Large 2009 construction project expenditures include:

- \$5.6 million for Pipeline Rehabilitation;
- \$6.7 million for the Brightwater Reclaimed Water Pipeline;
- \$6.8 million for the South Plant Control System Replacement;
- \$12.8 million for the North Creek Pipeline;
- \$360.6 million spent toward the Brightwater Treatment Plant and conveyance.

**KING COUNTY WATER QUALITY ENTERPRISE FUND
MANAGEMENT’S DISCUSSION AND ANALYSIS
DECEMBER 31, 2009 AND 2008**

Large 2008 construction project expenditures include:

- \$6.8 million for Juanita Bay Pump Station construction;
- \$6.9 million for the Hidden Lake Pump Station;
- \$7.2 million for the North Creek Pipeline;
- \$9.9 million for the New South Plant Administration Building;
- \$369.8 million spent toward the Brightwater Treatment Plant and conveyance.

For more detailed information on capital assets please refer to the notes to the financial statements.

DEBT ADMINISTRATION

Water Quality issued \$300 million of limited tax general obligation bonds in April 2009 with an average life of 20.0 years at an average coupon rate of 5.12 percent. An additional \$250.0 million in revenue bonds were issued in August 2009, with an average life of 26.8 years at an average coupon rate of 5.09 percent.

Water Quality received \$19.2 million in low-interest loans from the state of Washington in 2009 and \$16.9 million in 2008. The loans carry below-market rates between 0.00 percent and 3.10 percent with repayment terms up to 20 years.

Water Quality has \$2.2 billion of sewer revenue bonds and variable rate revenue bonds outstanding at the end of 2009 and \$1.9 billion outstanding at the end of 2008. Revenue bonds are repaid from and secured by a pledge of earnings, revenues and money received by Water Quality from or on account of operation of the sewer system, to include receipts from sewage treatment fees and other income of Water Quality. Revenue bonds are not guaranteed by the full faith and credit of King County.

Water Quality has \$733.0 million of general obligation bonds outstanding at the end of 2009, and \$437.0 million of general obligation bonds outstanding at the end of 2008. Although repaid from a portion of receipts from sewage treatment fees and other income, the full faith and credit of King County guarantees repayment of principal and interest on general obligation bonds.

King County received a AAA rating from Standard & Poor’s for the limited tax general obligation bond issue refunding issue in April 2009 with ratings of “Aa1” from Moody’s Investor’s Service and “AA+” from Fitch Ratings. At the time of the issuance of the sewer revenue bonds in August 2009, Water Quality’s bond ratings were:

Moody’s Investor’s Service

Aa3

Standard & Poor’s

AA+

**KING COUNTY WATER QUALITY ENTERPRISE FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2009 AND 2008**

As required by bond covenant, Water Quality maintains a bond reserve account, which is funded by cash balances and surety policies. At December 31, 2009, the cash balance in the reserve account was \$113.1 million and \$101.0 million at the end of 2008. In addition to bond covenant reserves, Water Quality also maintains financial policy reserves. At December 31, 2009, the rate stabilization, liquidity, and asset management financial policy reserves totaled \$66.6 million and \$49.9 million at the end of 2008.

For more detailed information on debt please refer to the notes to the financial statements.

DEBT SERVICE COVERAGE RATIOS

	<u>FY 2009</u>	<u>FY 2008</u>
Parity Debt	1.44	1.41
Total Debt	1.33	1.24

Two debt service coverage ratios closely monitored by bond rating agencies are coverage on parity debt and coverage on total debt. By bond ordinance, Water Quality sets sewer rates at a level adequate to provide net revenue equal to at least 1.15 times the annual debt service requirement on parity debt. Water Quality has an adopted policy to achieve a ratio of at least 1.25 on parity debt or 0.10 above the ratio required by bond ordinance. Since 2001, Water Quality established a minimum coverage policy of 1.15 on total debt to further strengthen coverage performance.

REQUESTS FOR INFORMATION

This financial report is designed to provide an overview of Water Quality's financial condition as of the years ended December 31, 2009 and 2008. Questions concerning this report or requests for additional information should be addressed to Pete Anthony, Chief Accountant for King County, 500 Fourth Avenue, Room 653, Seattle, WA 98104.

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KING COUNTY WATER QUALITY ENTERPRISE FUND
STATEMENTS OF NET ASSETS
DECEMBER 31, 2009 AND 2008
(in thousands)

	2009	2008
		(As Restated)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 21,625	\$ 19,045
Restricted cash and cash equivalents	169,998	122,881
Accounts receivable, net	25,639	21,564
Inventory of supplies	5,384	5,572
Due from other funds	5,118	3,900
Prepayments	152	117
	<u>227,916</u>	<u>173,079</u>
NONCURRENT ASSETS		
Revenue fund		
Cash and cash equivalents	43,586	28,188
Accounts receivable, net	384	406
Construction fund—cash and cash equivalents	15,560	13,043
Bond fund—cash and cash equivalents	113,051	101,028
	<u>172,581</u>	<u>142,665</u>
Capital assets		
Building and land improvements	2,230,292	2,156,295
Plant in service and other equipment	643,841	611,835
Less accumulated depreciation	(1,151,861)	(1,082,002)
	<u>1,722,272</u>	<u>1,686,128</u>
Land	153,290	152,930
Construction work in progress	1,607,537	1,245,615
	<u>3,483,099</u>	<u>3,084,673</u>
Other noncurrent		
Regulatory assets - environmental remediation	51,946	39,205
Other utility assets	24,360	21,338
Deferred environmental remediation costs	12,393	5,625
Other deferred charges	22,561	14,495
	<u>111,260</u>	<u>80,663</u>
TOTAL ASSETS	<u>\$ 3,994,856</u>	<u>\$ 3,481,080</u>

KING COUNTY WATER QUALITY ENTERPRISE FUND
STATEMENTS OF NET ASSETS (CONTINUED)
DECEMBER 31, 2009 AND 2008
(in thousands)

LIABILITIES AND NET ASSETS	<u>2009</u>	<u>2008</u> (As Restated)
CURRENT LIABILITIES		
Accounts payable	\$ 57,105	\$ 44,370
Interest payable	70,098	55,832
Wages and benefits payable	3,154	2,741
Compensated absences	387	547
Environmental remediation costs—current portion	3,126	-
Notes payable	100,000	100,000
State loans payable	7,771	7,029
Due to other funds	3,502	2,761
Interfund loans payable	82,633	184,041
General obligation bonds payable—current portion	2,530	3,905
Revenue bonds payable—current portion	32,090	30,540
	<u>362,396</u>	<u>431,766</u>
NONCURRENT LIABILITIES		
Retainage payable	15,756	13,043
Compensated absences	9,906	8,824
Other post-employment benefits	503	336
General obligation bonds payable	730,515	433,045
Revenue bonds payable	2,135,275	1,917,365
Deferred bond premium, discount, and refunding losses	(13,298)	(18,474)
Rate stabilization	35,150	19,750
Environmental remediation costs	41,486	34,141
State loans payable	133,394	122,157
	<u>3,088,687</u>	<u>2,530,187</u>
Total liabilities	<u>3,451,083</u>	<u>2,961,953</u>
NET ASSETS		
Invested in capital assets—net of related debt	410,649	521,803
Restricted for		
Debt service	185,242	147,679
Regulatory assets and environmental liabilities	35,870	26,021
Unrestricted	(87,988)	(176,376)
	<u>543,773</u>	<u>519,127</u>
Total net assets	<u>543,773</u>	<u>519,127</u>
TOTAL	<u><u>\$ 3,994,856</u></u>	<u><u>\$ 3,481,080</u></u>

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KING COUNTY WATER QUALITY ENTERPRISE FUND
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2009 AND 2008
(in thousands)

	2009	2008
		(As Restated)
OPERATING REVENUES		
Sewage disposal fees	\$ 256,160	\$ 240,001
Other operating revenues	50,696	44,172
Total operating revenues	306,856	284,173
OPERATING EXPENSES		
Sewage treatment, disposal, and transmission	73,046	68,292
General and administrative	30,072	30,078
Depreciation and amortization	91,595	81,744
Total operating expenses	194,713	180,114
OPERATING INCOME	112,143	104,059
NONOPERATING REVENUES (EXPENSES)		
Investment earnings	4,776	5,066
Interest	(69,893)	(65,578)
Amortization of debt related accounts	(3,196)	(4,049)
Environmental remediation	(1,565)	(724)
Loss on disposal and impairment of capital assets	(19,996)	(7,613)
Other	674	781
Total nonoperating expenses	(89,200)	(72,117)
INCOME BEFORE GRANTS, CONTRIBUTIONS, AND TRANSFERS	22,943	31,942
CAPITAL GRANT REVENUES	1,843	2,311
TRANSFERS	(140)	(219)
	1,703	2,092
CHANGE IN NET ASSETS	24,646	34,034
NET ASSETS		
Beginning of year, as restated	519,127	485,093
End of year	\$ 543,773	\$ 519,127

See accompanying notes.

KING COUNTY WATER QUALITY ENTERPRISE FUND
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2009 AND 2008
(in thousands)

	<u>2009</u>	<u>2008</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	\$ 316,985	\$ 277,877
Cash payments to suppliers for goods and services	(47,458)	(42,609)
Cash payments for employee services	(37,816)	(37,674)
Net cash provided by operating activities	<u>231,711</u>	<u>197,594</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers out	(140)	(219)
Interfund loan principal received	82,633	184,041
Interfund loan principal paid	(184,041)	-
Interest paid on short-term loans	(2,242)	(1,789)
Net cash from noncapital financing activities	<u>(103,790)</u>	<u>182,033</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of capital assets	(450,268)	(460,723)
Principal paid on general obligation bonds	(3,905)	(6,270)
Interest paid on general obligation bonds	(25,342)	(21,194)
Proceeds of new bond issuance	550,000	586,950
Principal paid on bonds by refunding	-	(244,270)
Principal paid on revenue bonds	(30,540)	(126,315)
Interest paid on revenue bonds	(90,789)	(87,364)
Interest paid on notes payable	(853)	(1,863)
Principal paid on state loans	(7,228)	(6,252)
Proceeds of state loans	19,208	16,914
Interest paid on state loans	(2,123)	(2,162)
Capital grants received	1,843	2,311
Payments made on other noncurrent assets	(13,065)	15
Net cash used in capital and related financing activities	<u>(53,062)</u>	<u>(350,223)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest and realized gains	<u>4,776</u>	<u>5,066</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	79,635	34,470
CASH AND CASH EQUIVALENTS		
Beginning of year	<u>284,185</u>	<u>249,715</u>
End of year	<u>\$ 363,820</u>	<u>\$ 284,185</u>

See accompanying notes.

KING COUNTY WATER QUALITY ENTERPRISE FUND
STATEMENTS OF CASH FLOWS (CONTINUED)
YEARS ENDED DECEMBER 31, 2009 AND 2008
(in thousands)

	2009	2008
		(As Restated)
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 112,143	\$ 104,059
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation and amortization	91,595	81,744
Changes in assets		
Accounts receivable	(4,053)	(836)
Due from other funds	(1,218)	(2,460)
Inventory of supplies	188	(323)
Prepayments	(35)	(9)
Changes in liabilities		
Accounts payable	12,735	9,586
Due to other funds	741	(481)
Retainage payable	2,713	8,513
Rate stabilization	15,400	(3,000)
Wages and benefits payable	413	173
Compensated absences	922	426
Other postemployment benefits	167	202
Total adjustments	119,568	93,535
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 231,711	\$ 197,594
SUPPLEMENTAL DISCLOSURE OF NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES		
Contribution of capital assets from government	\$ 632	\$ 211
NON CASH INVESTING ACTIVITIES		
In 2008, Water Quality issued capital bonds to refund debt issued in 1998. The \$249,084 thousand bond proceeds were placed in escrow for the defeasance of the \$244,270 thousand of outstanding bond principal.		
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Changes in fair value of investments (held in investment pool)	\$ 1,333	\$ (2,282)

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KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 1 - Operations and Accounting Policies

Summary of Operations - The King County Water Quality Enterprise Fund (“Water Quality”) is an enterprise fund operated by the King County Department of Natural Resources in accordance with Chapter 35.58 of the Revised Code of Washington (“RCW”) to provide sewage treatment and water pollution abatement services to the urbanized areas of King County, Washington (the “County”).

Water Quality is an integral part of the County reporting entity and is included, as an enterprise fund, in the County’s comprehensive annual financial report. As an enterprise fund, Water Quality is funded and operated separately from other operations of the County. Revenues, bond proceeds, and grants are restricted by purpose. Accordingly, Water Quality maintains separate accounting records and issues stand-alone financial statements.

Water Quality has long-term sewage disposal agreements with the cities and sewer districts that operate sewage collection systems within its service area. The monthly sewage disposal charge to the contracting cities and districts is based on Water Quality’s estimated annual monetary requirements, including operating costs and debt service. Revenues from Water Quality’s largest customer, the City of Seattle (Seattle Public Utilities), represent approximately 40 percent of total sewage disposal fees in 2009 and 41 percent in 2008.

Water Quality purchases goods and services from other County agencies, including reimbursement of the County’s general fund for a share of general government. Expenses incurred in doing business with other County agencies amounted to \$27.2 million and \$29.2 million in 2009 and 2008, respectively.

Significant Accounting Policies - Water Quality is accounted for using the flow of economic resources measurement focus similar to that of a private enterprise organized for profit. Water Quality’s financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) as applied to governmental units using the accrual basis of accounting. Under this method, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred. Water Quality, regardless of the timing of cash flows, applies all applicable Governmental Accounting Standards Board (“GASB”) pronouncements as well as Financial Accounting Standards Board (“FASB”) Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB Pronouncements. Water Quality, in accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, elected not to apply all statements of the FASB issued subsequent to November 30, 1989.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 1 - Operations and Accounting Policies (Continued)

- a. *Cash and Cash Equivalents* - Water Quality considers as cash and cash equivalents all balances held with the King County Treasurer in the King County Investment Pool (the "Pool"), cash with escrow agents or held in trust, and petty cash. Unrealized gain or loss on Water Quality's proportionate share of the Pool is reported as a component of investment earnings.
- b. *Due to/From Other Funds* - Due to/from other funds consists of current receivables/payables from or to other funds within the King County primary government. These typically arise from exchange transactions, reimbursements, and from authorized transfers to or from the other funds.
- c. *Interfund Loans Payable/Receivable* - Interfund loans consist of authorized short-term borrowing/lending between Water Quality and other funds within the King County primary government.
- d. *Inventory of Supplies* - Inventory is recorded at the lower of cost or market using the weighted-average cost method. Materials and supplies are expensed as consumed. Inventory is written off in the year that it is determined obsolete.
- e. *Restricted Assets* - In accordance with Water Quality's bond resolutions, state law, King County codes, or other agreements, separate restricted assets have been established. These assets are restricted for specific purposes, including debt service payments and funding of capital projects. These funds are maintained in the revenue fund, construction fund, and bond fund on the statements of net assets.
- f. *Capital Assets* - Capital assets are stated at cost, less accumulated depreciation. Water Quality's capitalization threshold was changed in 2008 in accordance with King County's new capitalization policy: equipment at \$5 thousand; software at \$25 thousand, and buildings and improvements at \$50 thousand. Below-threshold equipment and software were removed from capital assets in 2008. For buildings and improvements the new threshold changes were applied prospectively. Provision for depreciation is made on a straight-line basis over the estimated useful lives of Water Quality's capital assets, which range from 3 to 50 years.

Water Quality capitalizes certain interest income and expense related to tax-free borrowings until the assets are ready for their intended use. The amount capitalized is the difference between the interest revenue and interest expense associated with the applicable tax free borrowings. Total interest incurred was \$135.2 million and \$116.9 million during the years ended December 31, 2009 and 2008, respectively, of which \$65.3 million and \$51.3 million, respectively, was capitalized.

Repairs and maintenance are expensed as incurred; major renewals, replacements, and betterments are capitalized.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 1 - Operations and Accounting Policies (Continued)

Water Quality annually reviews long-lived assets for impairment to determine whether any events or circumstances indicate the carrying value of the assets may not be recoverable. The fuel cell demonstration project was deemed impaired in 2009 due to the failure of a vital component and technological obsolescence of the installed model. A charge of \$12.6 million was incurred as a loss on the abandonment of the impaired asset.

- g. *Compensated Absences* - Employees earn vacation based upon their date of hire and years of service. They may accumulate a maximum of 480 hours or as bargained for by represented employees. Unused vacation at retirement or normal termination is considered vested and payable to the employee.

Employees also earn up to 12 days of sick leave per year and may accumulate sick leave balances without limit. Employees or their beneficiaries are paid 35 percent of the accrued unused sick leave upon retirement or death. No amounts are paid for unused sick leave upon termination.

In addition, Water Quality accrues estimated excess compensation liabilities to the Washington State Department of Retirement Systems based on an employee's accrued vacation and sick leave. An excess compensation liability is incurred when an employee whose retirement benefits are based in part on excess compensation receives a termination or severance payment defined by the State as excess compensation. This includes, but is not limited to, a cash-out of unused annual leave in excess of 240 hours and a cash-out of any other form of leave.

- h. *Amortization* - Bond premiums and discounts, refunding losses, as well as issuance costs, are deferred and amortized over the life of the bonds using the outstanding principal balance method. Bonds payable are reported net of the applicable bond premium or discount. Issuance costs are reported as deferred charges and amortized over the term of the related debt.
- i. *Operating and Nonoperating Revenues and Expenses* - Operating revenues result from exchange transactions of Water Quality's activities. Expenses associated with providing wastewater treatment services and operating Water Quality's treatment facilities are considered operating. Nonoperating revenues result from nonexchange transactions such as operating subsidies and investment earnings.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 1 - Operations and Accounting Policies (Continued)

- j. *Deferred Compensation* - The County offers a consolidated deferred compensation plan that complies with Internal Revenue Code Section 457. The plan permits employees to defer a portion of annual compensation until future years. Participation in the plan is voluntary. The assets are not the property of Water Quality and not recorded in the financial statements.
- k. *Use of Estimates* - The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Specific estimates have been made in the areas of allowance for uncollectible accounts, environmental remediation costs, useful lives of capital assets, and future interest rates. Actual results could differ from these estimates.
- l. *Reclassifications* - Certain reclassifications have been made to the prior year statements to conform to the current year presentation (also see Note 15 – Prior Period Adjustments).
- m. *Capital Grant Revenues* - Pursuant to GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, grant revenues are reported separately from operating and nonoperating revenues as capital grant revenues. Water Quality received capital grant revenues of \$1.8 million and \$2.3 million for the years ended December 31, 2009 and 2008, respectively.
- n. *Net Assets* - Pursuant to GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, grant revenues and resources set aside for repayment of bonds, net of related liabilities, are classified as restricted net assets on the statement of net assets, as their use is limited by externally-imposed restrictions. Capital assets, net of related debt, are reported as a separate component of net assets. Any net assets not subject to classification as restricted or invested in capital assets are reported as unrestricted.

New Accounting Standards - GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, established accounting and financial reporting standards for pollution remediation obligations. The requirements of this statement were effective for fiscal periods beginning after December 15, 2007. Water Quality implemented this pronouncement in the 2008 fiscal period.

GASB Statement No. 50, *Pension Disclosure—an amendment of GASB Statements No. 25 and 27*, closely aligns financial reporting requirements for pensions with those for other postemployment benefits (“OPEB”) and, in doing so, enhances information disclosed in notes to financial statements or presented as required supplemental information by pension plans and by employers that provide pension benefits. GASB Statement No. 50 was effective for fiscal periods beginning after June 15, 2007 and was implemented by Water Quality in 2008 without a material impact on its financial position or result of operations.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 1 - Operations and Accounting Policies (Continued)

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. The objective of this statement is to establish accounting and financial reporting requirements for intangible assets, thereby enhancing the comparability of the accounting and financial reporting of such assets among local governments. This statement provides 1) authoritative guidance that specifically addresses the nature of these intangible assets, 2) establishes a specified-conditions approach to recognizing intangible assets that are internally generated, 3) provides guidance on recognizing internally generated computer software as an intangible asset, 4) serves as an application of the specified-conditions approach described above to the development cycle of computer software, and 5) provides guidance on determining the useful life of intangible assets when the length of their life is limited by contractual or legal provisions. The statement is effective for financial statements for periods beginning after June 15, 2009. The provisions of this statement generally are required to be applied retroactively. Water Quality management is currently studying the statement and plans on adoption, as required, for the 2010 financial statements.

GASB has issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which provides guidance for the recognition, measurement and disclosure of activity related to derivative instruments held by state and local governments. This statement becomes effective for the period beginning January 1, 2010. Management is evaluating the impact of this standard on the financial statements.

GASB has issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, to ensure integration of the GAAP hierarchy for state and local governments into GASB literature. This statement has no impact on the financial statement disclosures for 2009 or 2008.

GASB has issued Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statements on Auditing Standards. This statement addresses three issues not included in the authoritative literature that establishes accounting principles: related party transactions, going concern considerations, and subsequent events. This statement was effective immediately upon its issuance. This statement has no impact on the financial statements.

Note 2 - Deposits and Investments

The King County Treasurer is the custodian of Water Quality's cash. Water Quality's cash on deposit with the King County Treasurer is pooled with cash from other County funds and other jurisdictions and either deposited in the County's bank account or invested by the County. The King County Investment Pool (the "Pool") functions essentially as a demand deposit account where Water Quality receives an allocation of its proportionate share of pooled earnings as interest.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 2 - Deposits and Investments (Continued)

The Pool is not registered with the Securities and Exchange Commission as an investment company. Oversight is provided by the King County Executive Finance Committee (“EFC”) pursuant to RCW 36.29.020. The EFC consists of the Chair of the County Council, the County Executive, Chief Budget Officer, and Director of the Finance and Business Operations Division. All investments are subject to written policies and procedures adopted by the EFC. The EFC reviews pool performance monthly.

The County has deposit and investment policies addressing risks that have the potential to result in losses of deposits and investments. All deposits not covered by the Federal Depository Insurance Corporation (“FDIC”) are 100 percent covered by the Public Deposit Protection Commission of the State of Washington (“PDPC”), a statutory authority established under chapter 39.58 RCW. Beginning in July 2009, PDPC requires all banks and thrifts that operate as public depositories to collateralize their uninsured public deposits at 100 percent. The custodial credit risk for deposits is the risk that Water Quality’s deposits may not be returned to it in the event of a bank failure. Assessing Water Quality’s risk exposure, Water Quality’s cash and cash equivalents balance of \$363.8 million was fully insured and collateralized as of December 31, 2009 and \$15.0 of \$284.2 million cash and cash equivalents as of December 31, 2008 was exposed to custodial credit risk as uninsured and uncollateralized.

Statutes permit the Pool to enter into reverse repurchase agreements to enhance yield. The proceeds from these agreements are reinvested in other instruments with the same maturity as the collateral securities resulting in a matched position. County policy sets maturity limits and maximum amounts and prohibits the use of these contracts as borrowing mechanisms. There were no reverse repurchase agreements outstanding as of December 31, 2009 and December 31, 2008.

During the year, the County did not buy, sell, or hold any derivative instrument except for certain US agency collateralized mortgage obligations purchased by the Pool. Although these securities are sensitive to early prepayments by mortgagees, County policies are in place to ensure that only the lowest risk securities of this type are acquired.

At the start of 2008, the Pool held four commercial paper securities that were impaired and were part of an enforcement event. The County completed the restructuring of three of the four securities in 2008 and completed the restructuring of the fourth security in 2009. The Pool has suspended investments in commercial paper securities since 2007. Water Quality’s share of the unrealized loss from the Pool’s impaired investments was \$2.0 million at December 31, 2009 and \$3.1 million at December 31, 2008. Losses from impaired investments are offset against other investment earnings.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 3 - Restricted Assets

A significant portion of Water Quality's assets is restricted as to use by legal and contractual provisions and by fiscal management policy. Restricted assets comprise \$342.6 million in 2009 and \$265.5 million in 2008 to pay for debt service and to comply with bond reserve requirements.

Note 4 - Risk Management

Water Quality is exposed to a wide range of risks of loss, including those related to tort; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees, and natural disasters.

Water Quality participates in three County internal service funds to account for and finance its (1) property/casualty, (2) workers' compensation and (3) employee medical and dental benefits, through self-insurance programs. The County contracts with a plan administrator to process medical and dental claims. County fund/claims managers, together with the Civil Division of the King County Prosecuting Attorney's Office, are responsible for processing all tort and workers' compensation claims.

Claims settlements and loss expenses are accrued in the three internal service funds for the estimated settlement value of both reported and unreported claims. These funds are responsible for collecting interfund premiums from insured funds and departments, for paying claim settlements, and for purchasing certain policies. The County's internal service funds assess premiums attributable to Water Quality on the basis of claims experience, actuarial evaluation of future claims risk, and adequacy of available reserves. Premiums are recorded as an expense in the year paid or accrued.

Water Quality retains all risk associated with environmental claims.

Note 5 - Long-Term Liabilities and Notes Payable

Sewer Revenue Bonds - As of December 31, 2009, bonds outstanding include \$798.7 million of serial bonds maturing from January 1, 2010 through 2034, bearing interest at stated rates of 3.00 percent to 5.50 percent per annum, and \$1,368.6 million of term bonds maturing on January 1 in the years 2024 through 2048, bearing interest at stated rates of 4.38 percent to 5.75 percent per annum.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 5 - Long-Term Liabilities and Notes Payable (Continued)

In 2009, Water Quality issued \$250.0 million of Sewer Revenue Bonds maturing from January 1, 2013 to 2048. The new issues include \$48.0 million of serial bonds maturing from January 1, 2017 through 2034, bearing interest at stated rate between 4.00 percent and 5.00 percent, and \$202.0 million of term bonds, maturing in the years 2039 through 2042, bearing interest at stated rates between 5.00 percent and 5.25 percent.

In 2008, Water Quality issued \$350.0 million of Sewer Revenue Bonds maturing from January 1, 2017 to 2048. The new issues includes \$45.8 million of serial bonds maturing from January 1, 2017 through 2033, bearing interest at stated rate of 5.50 percent, and \$304.2 million of term bonds, maturing in the years 2038 through 2048, bearing interest at stated rates between 5.00 percent and 5.75 percent.

Bond issues provide funding for Water Quality's construction plan. Certain serial bonds may not be redeemed prior to maturity; other bonds may be redeemed at declining premiums after the lapse of specific periods of time. Amounts from the sewer revenue bond fund may be used to purchase term bonds prior to maturity.

The bonds are secured by a pledge of the revenue of the sewer system subject to payment of all operating and maintenance expenses of the sewer system. Payments from revenues of Water Quality are required to be made to the sewer revenue bond fund in annual amounts sufficient to retire serial or term bonds on or before maturity. At December 31, 2009, Water Quality restricted cash balances in the amount of \$82.7 million to repay principal and interest due on revenue bonds on January 1, 2010. Annual principal and interest payments on the bonds are expected to require less than 74 percent of net revenues. Principal and interest incurred in the current year and total customer net revenues were \$150.6 million and \$203.7 million, respectively.

Additional amounts of \$113.1 million and \$101.0 million held in the bond fund as bond reserves, as of December 31, 2009 and 2008, respectively, have been designated as net assets restricted for future debt service. Water Quality met additional reserve requirements required by the issuance of Sewer Revenue Bonds, Series 2009, by depositing \$11.9 million to the bond reserve account for this issue. The amount required in the cash reserves and surety policies are based on the highest year of debt service over the life of all outstanding revenue bonds. As of December 31, 2009, Water Quality is in compliance with the combined amount required for the reserve and surety policies.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 5 - Long-Term Liabilities and Notes Payable (Continued)

The following table summarizes Water Quality's revenue bonds (in thousands):

	Final Maturity	Interest Rates	Original Issue Amount	Outstanding at December 31, 2009
2001A-B Jr. lien var. rate	1/1/32	(variable)	\$ 100,000	\$ 100,000
2001 Refunding	1/1/35	5.00-5.25%	270,060	223,375
2002A	1/1/35	5.00-5.50%	100,000	94,960
2002B Refunding	1/1/33	4.00-5.50%	346,130	249,350
2003A Refunding	1/1/35	3.00-5.50%	96,470	91,625
2004A	1/1/35	4.50-4.75%	185,000	185,000
2004B Refunding	1/1/35	3.00-5.00%	61,760	58,900
2006 Refunding	1/1/36	5.00%	124,070	124,070
2006 (2nd Series) Refunding	1/1/36	3.50-5.00%	193,435	190,085
2007	1/1/47	5.00%	250,000	250,000
2008	1/1/48	5.00-5.75%	350,000	350,000
2009	1/1/42	4.00-5.25%	250,000	250,000
			<u>\$ 2,326,925</u>	<u>\$ 2,167,365</u>

General Obligation Bonds - As of December 31, 2009, bonds outstanding include \$438.2 million of serial bonds maturing January 1, 2009 through 2031, bearing interest at stated rates of 3.25 percent to 5.25 percent per annum. General Obligation Bonds outstanding also include \$294.8 million of term bonds maturing on January 1, 2033 through 2039, bearing interest at stated rates of 4.60 percent to 5.25 percent.

In 2009, Water Quality issued \$300.0 million of Limited Tax General Obligation ("LTGO") Bonds maturing from January 1, 2014 to 2039. The new issues included \$150.1 million of serial bonds maturing from January 1, 2014 through 2030, bearing interest at stated rate of 5.00 percent, and \$149.9 million of term bonds, maturing in the years 2033 through 2039, bearing interest at stated rates between 5.13 percent and 5.25 percent.

The bonds were issued to provide funding for Water Quality's construction plan. Certain serial bonds cannot be redeemed prior to maturity; other bonds may be redeemed at declining premiums after the lapse of specific periods of time.

In 2008, Water Quality issued \$237.0 million of Limited Tax General Obligation (Sewer Revenue) Refunding Bonds maturing from 2009 to 2034, bearing interest at stated rates of 3.25 percent to 5.25 percent. This issue fully refunded the 1998 Series B LTGO Bonds.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 5 - Long-Term Liabilities and Notes Payable (Continued)

The economic gain resulting from the refunding transaction was \$13.0 million. The difference between the cash flows required to service the outstanding bonds and the cash flows required to service the new debt was a gain of \$15.6 million.

The following table summarizes Water Quality's general obligation bonds (in thousands):

	Final Maturity	Interest Rates	Original Issue Amount	Outstanding at December 31, 2009
2005 LTGO	1/1/35	4.50-5.00%	\$ 200,000	\$ 200,000
2008 LTGO	1/1/34	3.25-5.25%	236,950	233,045
2009B LTGO	7/1/39	5.00-5.25%	300,000	300,000
			<u>\$ 736,950</u>	<u>\$ 733,045</u>

State Loans - Water Quality has received loans from the Washington Department of Ecology under the Water Pollution Control State Revolving Fund Loan Program and the Washington Public Works Trust Fund. The loans require annual payments of principal and interest from 2010 through 2031 and bear interest at stated rates from 0.00 percent and 3.10 percent. As of December 31, 2009, the balance due on all state loans is \$141.2 million. Water Quality maintains separate cash reserves of \$8.4 million. These reserves are treated as restricted, being required under the Revolving Fund Loan Program.

At December 31, 2009, the required principal and interest payments for all classes of long-term debt are as follows (in thousands):

Year(s) Beginning	Revenue Bonds		Variable Rate Revenue Bonds	
	Principal	Interest	Principal	Interest
January 1, 2010	\$ 32,090	\$ 96,370	\$ -	\$ 5,625
January 1, 2011	33,710	102,516	-	5,625
January 1, 2012	35,395	100,845	-	5,625
January 1, 2013	38,185	99,404	-	5,625
January 1, 2014	40,165	97,445	-	5,625
January 1, 2015—2019	198,475	455,187	-	28,125
January 1, 2020—2024	226,890	404,512	-	28,125
January 1, 2025—2029	289,685	342,610	-	28,125
January 1, 2030—2034	368,930	263,395	100,000	11,250
January 1, 2035—2039	324,235	172,060	-	-
January 1, 2040—2044	298,240	90,499	-	-
January 1, 2045—2049	181,365	22,255	-	-
	<u>\$ 2,067,365</u>	<u>\$ 2,247,098</u>	<u>\$ 100,000</u>	<u>\$ 123,750</u>

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 5 - Long-Term Liabilities and Notes Payable (Continued)

Year(s) Beginning	General Obligation Bonds		State Loans		Total
	Principal	Interest	Principal	Interest	
January 1, 2010	\$ 2,530	\$ 32,430	\$ 7,771	\$ 2,145	\$ 178,961
January 1, 2011	2,630	36,416	8,142	2,040	191,079
January 1, 2012	2,730	36,284	8,527	1,921	191,327
January 1, 2013	2,795	36,195	8,642	1,797	192,643
January 1, 2014	8,750	36,104	8,760	1,672	198,521
January 1, 2015—2019	85,685	172,005	45,425	6,399	991,301
January 1, 2020—2024	136,025	144,121	39,346	3,115	982,134
January 1, 2025—2029	172,990	106,402	13,619	702	954,133
January 1, 2030—2034	211,265	59,390	933	12	1,015,175
January 1, 2035—2039	107,645	15,682	-	-	619,622
January 1, 2040—2044	-	-	-	-	388,739
January 1, 2045—2049	-	-	-	-	203,620
	<u>\$ 733,045</u>	<u>\$ 675,029</u>	<u>\$ 141,165</u>	<u>\$ 19,803</u>	<u>\$ 6,107,255</u>

The future annualized interest payments for the variable rate revenue bonds are based on an interest rate of 5.625 percent, which represents 90 percent of the Revenue Bond Index assumed by the County for financial planning purposes.

Commercial Paper (Notes Payable) - In December 1995, Water Quality initiated a commercial paper program that gives Water Quality the ability to issue up to \$100.0 million. The program is supported by an annually renewable line of credit that expires November 30, 2015. As of December 31, 2009, \$100.0 million was issued and outstanding under this program. The commercial paper has maturities ranging between 11 and 63 days and is classified as a current liability of Water Quality's operating fund.

Variable Rate Revenue Bonds - The variable rate bonds are supported by an annually renewable letter of credit that expires December 31, 2015.

Financial Policy Reserves - In addition to bond reserves related to Sewer Revenue Bonds, Water Quality maintains liquidity and asset management reserves totaling \$30.3 million at December 31, 2009.

Compliance with Bond Resolutions - With respect to the year ended December 31, 2009, Water Quality complied with all covenants stipulated by its bond resolutions.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 5 - Long-Term Liabilities and Notes Payable (Continued)

Changes in Long-Term Liabilities - Long-term liability activity for the years ended December 31, 2009 and 2008 was as follows (in thousands):

	Balance January 1, 2009	Additions	Reductions	Balance December 31, 2009	Due Within One Year
Bonds payable	\$ 2,384,855	\$ 550,000	\$ (34,445)	\$ 2,900,410	\$ 34,620
Bond premiums	46,626	3,344	(3,474)	46,496	3,345
Refunding losses	(65,100)	-	5,307	(59,793)	(5,223)
Total bonds payable	2,366,381	553,344	(32,612)	2,887,113	32,742
Retainage payable	17,027	4,336	(140)	21,223	5,467
State loans	129,186	19,207	(7,228)	141,165	7,771
Compensated absences	9,371	922	-	10,293	387
Other post-employment benefits	336	167	-	503	-
Environmental remediation	34,141	14,152	(3,681)	44,612	3,126
Rate stabilization	19,750	15,400	-	35,150	-
Total long-term liabilities	<u>\$ 2,576,192</u>	<u>\$ 607,528</u>	<u>\$ (43,661)</u>	<u>\$ 3,140,059</u>	<u>\$ 49,493</u>

The current portion of retainage payable in the amount of \$5,467 thousand and \$3,984 thousand for 2009 and 2008, respectively, is classified in Accounts Payable.

	Balance January 1, 2008	Additions	Reductions	Balance December 31, 2008 (as restated)	Due Within One Year
Bonds payable	\$ 2,174,760	\$ 350,000	\$ (139,905)	\$ 2,384,855	\$ 34,445
Bond premiums	35,071	14,872	(3,317)	46,626	2,434
Refunding losses	(66,419)	(4,376)	5,695	(65,100)	(5,404)
Total bonds payable	2,143,412	360,496	(137,527)	2,366,381	31,475
Retainage payable	4,530	13,014	(517)	17,027	3,984
State loans	118,524	16,915	(6,253)	129,186	7,029
Compensated absences	8,811	560	-	9,371	547
Other post-employment benefits	134	202	-	336	-
Environmental remediation	39,669	-	(5,528)	34,141	-
Rate stabilization	22,750	-	(3,000)	19,750	-
Total long-term liabilities	<u>\$ 2,337,830</u>	<u>\$ 391,187</u>	<u>\$ (152,825)</u>	<u>\$ 2,576,192</u>	<u>\$ 43,035</u>

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 6 - Changes in Capital Assets

Changes in capital assets for the years ended December 31, 2009 and 2008 are shown in the following table (in thousands):

	Balance January 1, 2009	Increases	Decreases	Balance December 31, 2009
Land	\$ 152,930	\$ 360	\$ -	\$ 153,290
Construction work in progress	1,245,615	533,779	(171,857)	1,607,537
Total nondepreciable assets	<u>1,398,545</u>	<u>534,139</u>	<u>(171,857)</u>	<u>1,760,827</u>
Building and land improvements	2,156,295	89,601	(15,604)	2,230,292
Major equipment and vehicles	9,195	601	(210)	9,586
Shop and other equipment	592,194	45,455	(11,172)	626,477
Software development	10,446	2,056	(4,724)	7,778
Total depreciable assets	<u>2,768,130</u>	<u>137,713</u>	<u>(31,710)</u>	<u>2,874,133</u>
Accumulated depreciation and amortization:				
Building and land improvements	(694,914)	(49,564)	3,752	(740,726)
Major equipment and vehicles	(6,748)	(849)	188	(7,409)
Shop and other equipment	(372,077)	(38,285)	10,698	(399,664)
Software development	(8,263)	(523)	4,724	(4,062)
Total depreciation and amortization	<u>(1,082,002)</u>	<u>(89,221)</u>	<u>19,362</u>	<u>(1,151,861)</u>
Depreciable assets - net	<u>1,686,128</u>	<u>48,492</u>	<u>(12,348)</u>	<u>1,722,272</u>
Total capital assets - net	<u>\$ 3,084,673</u>	<u>\$ 582,631</u>	<u>\$ (184,205)</u>	<u>\$ 3,483,099</u>

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 6 - Changes in Capital Assets (Continued)

	Balance January 1, 2008 <u>(as restated)</u>	<u>Increases</u>	<u>Decreases</u>	Balance December 31, 2008 <u>(as restated)</u>
Land	\$ 149,997	\$ 2,933	\$ -	\$ 152,930
Construction work in progress	982,726	450,799	(187,910)	1,245,615
Total nondepreciable assets	<u>1,132,723</u>	<u>453,732</u>	<u>(187,910)</u>	<u>1,398,545</u>
Building and land improvements	2,033,287	123,377	(369)	2,156,295
Major equipment and vehicles	8,917	421	(143)	9,195
Shop and other equipment	514,329	77,912	(47)	592,194
Software development	9,310	1,136	-	10,446
Total depreciable assets	<u>2,565,843</u>	<u>202,846</u>	<u>(559)</u>	<u>2,768,130</u>
Accumulated depreciation and amortization:				
Building and land improvements	(652,074)	(45,558)	2,718	(694,914)
Major equipment and vehicles	(6,099)	(792)	143	(6,748)
Shop and other equipment	(343,670)	(32,730)	4,323	(372,077)
Software development	(7,983)	(251)	(29)	(8,263)
Total depreciation and amortization	<u>(1,009,826)</u>	<u>(79,331)</u>	<u>7,155</u>	<u>(1,082,002)</u>
Depreciable assets - net	<u>1,556,017</u>	<u>123,515</u>	<u>6,596</u>	<u>1,686,128</u>
Total capital assets - net	<u>\$ 2,688,740</u>	<u>\$ 577,247</u>	<u>\$ (181,314)</u>	<u>\$ 3,084,673</u>

Note 7 - Environmental Remediation

Water Quality operations are subject to rules and regulations enacted by the Washington State Department of Ecology (“DOE”) and the U.S. Environmental Protection Agency (“EPA”). In years prior to 2008, Water Quality evaluated and accrued for environmental remediation based on engineering studies and estimates of future potential costs. Water Quality settled lawsuits related to certain environmentally damaged sites and agreed to pay its portion of remediation and cleanup costs. The initial settlement costs were capitalized as deferred environmental remediation costs and are being amortized over 40 years as offsetting revenues are collected from Water Quality’s customers.

In 2008, Water Quality implemented GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, (“GASB 49”) which mandates the disclosure of “obligations to address current or potential detrimental effects of existing pollution by participating in pollution remediation activities.” GASB 49 establishes five events, any one of which obligates Water Quality to record a liability for pollution remediation expenditures. Liabilities are related to ongoing projects, which include the sediment management of aquatic habitats along Elliot Bay and the clean-up of certain sites along the Lower Duwamish Waterway.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 7 - Environmental Remediation (Continued)

The sediment management project has been approved by the Metropolitan King County Council as a self obligated pollution remediation program. The Lower Duwamish Waterway project became a Water Quality obligation when King County entered into an Administrative Order on Consent (“AOC”) with the DOE and EPA. This AOC also includes The Boeing Company, the City of Seattle and the Port of Seattle as parties to the cleanup. Each party has agreed to pay one fourth of the cleanup costs.

Both projects may result in additional cleanup efforts as a result of additional regulatory orders. Additionally, the U.S. Environmental Protection Agency has announced its intention to negotiate an agreement with local governments, including King County, and other Potentially Responsible Parties (“PRP”) for the remediation of Combined Sewer Overflows which may result in Water Quality recording additional pollution remediation liabilities in the future. These potential cleanup liabilities cannot be currently estimated. Ongoing, regulatory action may identify other PRP’s for the Lower Duwamish Waterway cleanup.

There are no estimated recoveries at this time that will reduce the amount of Water Quality’s pollution remediation obligations. However, the State of Washington has indicated that it intends to fund grants in support of Water Quality’s Lower Duwamish Waterway cleanup. These amounts are forecast at \$1.2 million over the period 2010 to 2016.

The implementation of GASB 49 resulted in a 2007 restatement of \$27.9 million added to the estimated remediation liability being carried forward to subsequent years. The total liability at December 31, 2009 stands at \$44.6 million.

The methodology for estimating liabilities continues to be based on Water Quality engineering analysis, program experience and cost projections for the remediation activities scheduled to be undertaken in future years as programmed under Water Quality’s Regional Wastewater Services Plan. Certain costs were developed by consulting engineers. Costs were estimated using the expected cash flow method set out by GASB 49. A weighted average cost estimate was not employed because the remaining work is well-defined and negates the utility of multiple estimates. The cost estimates continue to be re-measured as succeeding benchmarks are reached or when cost assumptions are modified. Beginning in 2006, all pollution remediation obligations are being deferred as permitted by regulatory accounting standards (see Note 8 - Regulatory Deferrals.)

Note 8 - Regulatory Deferrals

The King County Council has taken various regulatory actions resulting in differences between the recognition of revenues for rate-making purposes and their treatment under generally accepted accounting principles for nonregulated entities. Changes to these balances and their inclusion in rates may occur only at the direction of the Council.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 8 - Regulatory Deferrals (Continued)

Rate Stabilization - In 2005, pursuant to regulatory accounting standards, the Council established a Rate Stabilization Reserve. This action created a regulatory liability which deferred \$14.5 million from 2005 operating revenue to be set aside in a reserve and recognized in subsequent years to maintain stable sewer rates. This was increased in 2007 by an additional \$8.3 million. In 2008, the liability was reduced by \$3 million to realize matching revenues against allowable costs in the current year. In 2009, the liability was increased by \$15.4 million to \$35.2 million.

Pollution Remediation - In 2006, the Council approved the application of regulatory accounting to treat pollution remediation obligations as regulatory assets to allow for cost recovery through future rate increases. The amount of the regulatory assets capitalized during 2006 and 2007 were revised in 2008 to account for an increase in the estimated liability with the implementation of GASB Statement No. 49 (see Note 7 - Environmental Remediation). The portion of regulatory asset costs that have been paid out is being amortized over a recovery period of 30 years.

Note 9 - Employee Benefit Plans

Defined Benefit Pension Plans - Substantially all full-time and qualifying part-time employees of Water Quality participate in either the Public Employees' Retirement System ("PERS") or the Seattle City Employees' Retirement System ("SCERS"). PERS is a statewide governmental retirement system administered by the State of Washington's Department of Retirement Systems.

Historical trend and other information regarding PERS are presented in the State of Washington Department of Retirement Systems' 2009 Comprehensive Annual Financial Report. A copy of this report may be obtained from the Department of Retirement Systems, PO Box 48380, Olympia, WA 98504-8380.

Historical trend and other information regarding SCERS are presented in the Seattle City Employees' Retirement System's 2009 Comprehensive Annual Financial Report. A copy of this report may be obtained from the Seattle City Employees' Retirement System, 801 Third Avenue, Suite 300, Seattle, WA 98104.

Public Employees Retirement System - The Washington State Legislature (the "Legislature") established PERS in 1947 under RCW chapter 41.40. PERS is a cost-sharing, multiple-employer defined benefit system.

The PERS plan contains three tiers. Participants who joined the system by September 30, 1977 are Plan I members. Those joining thereafter are enrolled in Plan II, unless the employee chooses Plan III. Retirement benefits for all plans are financed from employee and employer contributions and investment earnings. Retirement benefits are vested after various minimum periods of eligible service.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 9 - Employee Benefit Plans (Continued)

Plan I members are eligible for retirement after 30 years of service or at the age of 60 with 5 years of service, or at the age of 55 with 25 years of service. The annual pension is 2 percent of the final average salary per year of service, capped at 60 percent. If qualified, after reaching age 66, a limited cost of living allowance is granted.

Plan II members may retire at the age of 65 with 5 years of service or at 55 with 20 years of service, with an allowance of 2 percent per year of service of the final average salary. Plan II retirements prior to the age of 65 are actuarially reduced. There is no cap on years-of-service credit and a limited cost-of-living allowance is granted.

Plan III members may retire with ten years of service or with 5 service years, including one year earned after age 54 and five service years under Plan II prior to transfer to Plan III. Plan III retirements prior to age 65 are actuarially reduced. With respect to the defined benefit portion of Plan III, there is no cap on years-of-service credit, and a limited cost of living allowance is granted.

Each biennium, the Legislature establishes Plan I employer contribution rates, Plan II employer and employee contribution rates and Plan III employer contribution rates. Employee contribution rates for Plan I are not necessarily adequate to fully fund the system. The employer and employee contribution rates for Plan II and the employer contribution rates for Plan III are developed by the Office of the State Actuary to fully fund future pension obligations. All employers are required to contribute at the level established by the Legislature.

Water Quality's contribution rates expressed as a percentage of covered payrolls as of December 31, 2009 were as follows:

	PERS					
	Plan I		Plan II		Plan III	
	January 1 to June 30, 2009	July 1 to December 31, 2009	January 1 to June 30, 2009	July 1 to December 31, 2009	January 1 to June 30, 2009	July 1 to December 31, 2009
Employer	8.31%	5.29% - 5.31%	8.31%	5.29% - 5.31%	8.31%	5.29% - 5.31%
Employee	6.00%	6.00%	5.45%	3.89% - 3.90%	5% - 15%	5% - 15%

Employer contributions to Plan III are the same as those required for Plan II. Employee contributions to Plan III are made to a separate defined contribution account and may vary from 5 percent to 15 percent.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 9 - Employee Benefit Plans (Continued)

Water Quality's required employer contributions for the years ended December 31 were (in thousands):

	PERS	
	Plan I	Plans II and III
2009	\$ 157	\$ 3,628
2008	169	3,824
2007	163	2,975

Seattle City Employees' Retirement System ("SCERS") - SCERS is a cost-sharing, multiple-employer retirement plan administered in accordance with the Seattle Municipal Code Chapter 4.36. Water Quality employees who are former employees of Seattle Transit are covered by SCERS. SCERS provides retirement, death, and disability benefits.

Employees covered by this plan may retire after 30 years of service regardless of age, after age 52 with 20 years or more of service, after age 57 with 10 or more years of service and after age 62 with 5 or more years of service. Disability retirement is available after ten years of service. The unmodified monthly retirement allowance is based on a percentage of average salary for every year of service to a maximum of 60 percent. The average salary for this plan is defined as the highest consecutive 24-month average rate of pay. The percentage for each year of service used to compute the retirement benefit depends on the age at retirement and the years of service and ranges from 1.2 percent at age 52 with 20 years of service to a maximum of 2.0 percent for each year of service. The maximum allowance a member can receive is the unmodified plan, which has no provision for a beneficiary, and under which all payments stop at the member's death. Several optional retirement benefit formulas exist that make provisions for beneficiaries with reduced monthly allowances.

Within SCERS, there were no material changes in benefit provisions in 2009.

The SCERS member contribution rate is 8.03 percent of compensation, except for members qualifying prior to June 1972 for lower rates. Water Quality is required to contribute at an actuarially determined rate. The current rate is 8.03 percent of annual covered payroll. The contribution requirements of plan members and Water Quality are established and may be amended by the Board of Administration. Both Water Quality and the employees made the required contributions.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 10 - Operating Subsidies and Grant Revenues

Various federal and state government agencies make grants to Water Quality to aid in financing construction costs (capital grants), including those on various projects included in the comprehensive plan, and for operating costs (operating subsidies). Operating subsidies are recorded as revenues in the statements of revenues, expenses, and changes in net assets. Capital grants amounted to \$1.8 million and \$2.3 million for the years ended December 31, 2009 and 2008, respectively.

Note 11 - Other Post-Employment Benefits

In 2007, the County implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension*, which requires the County to accrue other post-employment benefits expenses related to its post-retirement healthcare plan based on a computed annual required contribution that includes the current period's service cost and an amount to amortize unfunded accrued liabilities. The liability is included in noncurrent liabilities on the statements of net assets for Water Quality.

Plan Description - The King County Health Plan (the "Health Plan") is a single-employer defined benefit healthcare plan administered by the County. The Health Plan provides medical, prescription drug, vision, and other unreimbursed medical benefits to eligible employees. The Health Plan's actuary is Healthcare Actuaries and it does not issue a separate stand-alone financial report.

Funding Policy - Law Enforcement Officers' and Fire Fighters' Retirement System Plan ("LEOFF") 1 retirees are not required to contribute to the Health Plan. All other retirees are required to pay the COBRA rate associated with the elected plan. During 2009, Water Quality contributed an estimated \$80 thousand to the Health Plan. The contribution was entirely to fund "pay-as-you-go" costs and not to advance fund the cost of benefits.

Annual OPEB and Net OPEB Obligation - Water Quality's allocated annual OPEB costs, the percentage of annual OPEB cost contributed to the Health Plan, and the net OPEB obligation for the years ended December 31, 2009 and 2008 were as follows (in thousands):

	2009	2008
Net OPEB Obligation at January 1	\$ 336	\$ 134
Annual OPEB Cost	247	208
Contributions Made	(80)	(6)
Net OPEB Obligation at December 31	\$ 503	\$ 336
Percentage of annual OPEB cost contributed	32.4%	2.9%

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 11 - Other Post-Employment Benefits (Continued)

Funded Status and Funding Progress - The funded status of the Health Plan as of December 31, 2009 and 2008 was as follows (in thousands):

	2009	2008
Actuarial Value of Plan Assets	\$ -	\$ -
Actuarial Accrued Liability (AAL)	149,390	145,393
Unfunded Actuarial Accrued Liability (UAAL)	\$ 149,390	\$ 145,393
Funded Ratio (actuarial value assets / AAL)	0%	0%
Covered Payroll (active plan members)	\$ 947,530	\$ 890,310
UAAL as a percentage of covered payroll	15.8%	16.3%

The December 31, 2009 valuation used the unit credit actuarial cost method. The actuarial assumption included a 4.00 percent investment rate of return (net of administrative expenses) and an initial healthcare cost trend rate of 11.0 percent for KingCare medical, 8.5 percent for KingCare Rx, and 11.0 percent for HMO medical/Rx, each reduced by decrements to an ultimate rate of 5.2 percent after 71 years and 12 years for medical and pharmacy, respectively. The vision trend rate is 1.0 percent, the miscellaneous trend rate is 7.0 percent, and the Medicare premium trend rate is 8.5 percent, for all years. All trend rates include a 3.0 percent inflation assumption, with the exception of vision trends. The amortization of UAAL at transition uses a level dollar amount on a closed basis. The remaining amortization period at December 31, 2009 was 27.0 years. The UAAL is recalculated each year and amortized as a level dollar amount on an open basis over 30 years.

Note 12 - Interfund Borrowing and Transfers

At December 31, 2009, Water Quality had outstanding interfund short-term loans in the amount of \$82.6 million borrowed from the King County Public Transportation Enterprise as authorized by the King County Executive Finance Committee. The loan proceeds were used to: 1) reimburse the operating fund that financed the early retirement of certain sewer revenue bonds, and 2) reimburse the construction fund for capital expenses incurred in anticipation of bond issuance in 2010.

The King County Council approves ordinances and/or motions authorizing Water Quality to contribute and receive amounts to and from various County funds. These net amounts are reported as transfers on the statements of revenues, expenses, and changes in net assets. During 2009 and 2008, the net cash transfers to other funds from Water Quality were \$140 thousand and \$219 thousand, respectively.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 13 - Net Assets Deficit

The deficits in unrestricted net assets of \$88.0 and \$176.4 million in 2009 and 2008 respectively are the result of short term borrowings by Water Quality from other County funds (see Note 12 - Interfund Borrowing and Transfers). Water Quality general obligation bonds were issued in the subsequent fiscal years to cover the capital construction loans.

Note 14 - Commitments and Contingencies

Contingencies and Claims - There is no litigation or claim currently pending against the King County Water Quality Enterprise Fund in which, to our knowledge, the likelihood of an unfavorable outcome with material damages assessed against the enterprise is considered “probable.”

The following litigation, or potential litigation, may involve claims for material damages against the King County Water Quality Enterprise Fund for which the Water Quality is unable to provide an opinion as to the ultimate outcome or the amount of damages that may be found:

- Claims for unspecified damages filed by two sewer districts who allege that certain expenditures of the King County Wastewater Treatment Division (“WTD”) constitute a breach of contract and a violation of the King County Charter and a local government accounting statute. The County is vigorously defending the claim. The court has ruled in favor of the County on two of the five motions filed for partial summary judgment. Trial on the remaining issues is set for October 4, 2010.
- An administrative order from the Environmental Protection Agency that requires the County, the City of Seattle, the Boeing Company, and the Port of Seattle to conduct a feasibility study to determine the nature and extent of the contamination in the Lower Duwamish Waterway. Potentially, upon completion of the study, additional remediation may be required.
- A potential requirement for more cleanups in the area contaminated when the Denny Way combined sewer outflow was replaced in 2005. The WTD has already performed interim cleanup costing \$3.6 million to comply with a formal agreement with Washington State Department of Ecology. The DOE reserves its rights to require additional remediation.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 14 - Commitments and Contingencies (Continued)

- Potential claims for past and future cleanup costs at the Harbor Island Superfund Site. Certain removal costs already incurred by the Port of Seattle are expected to be defrayed by the County and the City of Seattle. The parties have also agreed to share the cost of a supplemental investigation and feasibility study required by the EPA. The agreement states that the WTD has only a one-third pro rata share of the study costs and that portion is still potentially allocable among the several potentially responsible parties. Further remediation costs cannot be reasonably estimated until the studies are completed.
- A contractor's request for adjustment for termination costs, in the amount of \$5.2 million, over a \$34 million sewer project owned by the County and under management by an independent local wastewater agency. At issue is whether the law pertaining to payment of reasonable costs on a termination for convenience allows the owner to reassess contract payments that may have been made. The local agency is negotiating settlement within parameters set by the County.
- A claim in the amount of \$3.7 million filed by the contractor for the Juanita Bay Pump Station Replacement project alleging defective specifications. Contract requires mediation and the County is vigorously defending the claim.
- Three separate contract claims arising out of the Brightwater project: 1) a series of requests for change orders (currently in the amount of \$75 million) from the prime contractor for the Central conveyance system alleging differing site conditions and defective specifications (a new contractor has since been engaged and the County has filed suit alleging contract default by the previous contractor); 2) demands for additional money and time totaling about \$9 million from the contractor for the East conveyance system, and 3) a claim for additional compensation of approximately \$427 thousand to cover unexpected tariff increases on imported construction materials. The claims are in various stages of the contract dispute process.

Office Facilities - Water Quality currently rents office space from the Department of Executive Services - Facilities Management Division of King County. Water Quality has not entered into a formalized legal contract for the use of these spaces but is expecting to continue to rent office space for future years. Rent expenses incurred in 2009 and 2008 were approximately \$1.3 million for each year.

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 15 - Prior Period Adjustments

Errors related to prior periods were corrected and the 2008 financial statements and its net assets as of January 1, 2008 were restated to conform with accounting principles generally accepted in the United States of America.

A comprehensive analysis of construction work in progress, bond accounts and net assets resulted in adjustment of amounts related to prior periods. Total assets at December 31, 2008 were restated in the amount of \$59.3 million from \$3,540.4 million as originally reported to \$3,481.1 million as restated. Total net assets at December 31, 2008 were restated from \$577.2 million to \$519.1 million for a total impact of \$58.1 million. These changes impacted each of the financial statements and are displayed with the original and restated balances, by line item, in the following schedule.

The impact of the restatement to periods prior to 2008 was \$53.6 million and is reflected in the restatement of beginning of year net assets for 2008.

Revised balances are shown in the following schedule (in thousands):

STATEMENT/ACCOUNT TITLE	Balances As Revised Dec. 31, 2008	Balances As Issued Dec. 31, 2008	Net Change
STATEMENT OF NET ASSETS			
Capital assets:			
Building and land improvements	\$ 2,156,295	\$ 2,113,091	\$ 43,204
Plant in service and other equipment	611,835	584,447	27,388
Less accumulated depreciation	(1,082,002)	(1,077,580)	(4,422)
Land	152,930	152,498	432
Construction work in progress	1,245,615	1,394,646	(149,031)
Other noncurrent:			
Regulatory assets - environmental remediation	39,205	39,506	(301)
Other utility assets	21,338	-	21,338
Other deferred charges	14,495	12,456	2,039
			<u>\$ (59,353)</u>
NET CHANGE TO TOTAL ASSETS			
Noncurrent liabilities:			
Deferred bond premium, discount, and refunding losses	18,474	17,245	1,229
Net assets:			
Invested in capital assets—net of related debt	(521,803)	(582,761)	60,958
Restricted for debt service	(147,679)	(34,825)	(112,854)
Restricted for regulatory assets and environmental liabilities	(26,021)	(10,990)	(15,031)
Unrestricted	176,376	51,325	125,051
			<u>\$ 59,353</u>
NET CHANGE TO TOTAL LIABILITIES AND NET ASSETS			

KING COUNTY WATER QUALITY ENTERPRISE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Note 15 - Prior Period Adjustments (Continued)

STATEMENT/ACCOUNT TITLE	Balances As Revised Dec. 31, 2008	Balances As Issued Dec. 31, 2008	Net Change
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS			
Operating Expenses:			
Depreciation and amortization	\$ (81,744)	\$ (76,399)	\$ (5,345)
Nonoperating Expenses:			
Interest	(65,578)	(63,594)	(1,984)
Amortization of debt related accounts	(4,049)	(7,319)	3,270
Loss on disposal and impairment of capital assets	(7,613)	(7,114)	<u>(499)</u>
NET CHANGE TO CHANGE IN NET ASSETS			<u>\$ (4,558)</u>
NET ASSETS - Beginning of year	(485,093)	(538,659)	53,566
NET ASSETS - End of year	(519,127)	(577,251)	58,124

The impact of these restatements on the Statement of Cash Flows was within the reconciliation of operating income to net cash provided by operating activities. Operating income decreased and depreciation and amortization increased by \$5.3 million.

Note 16 - Subsequent Event

Water Quality issued \$100.0 million of Limited Tax General Obligation multi-modal revenue bonds in January 2010. These bonds will be used to finance capital construction and improvements to the sewer system.

SUPPLEMENTAL INFORMATION (UNAUDITED)

**KING COUNTY WATER QUALITY ENTERPRISE FUND
SUPPLEMENTAL SCHEDULE OF NET REVENUES AVAILABLE FOR DEBT SERVICE
(UNAUDITED)
YEAR ENDED DECEMBER 31, 2009**

Water Quality is obligated by applicable bond ordinances to set sewage disposal rates at a level adequate to provide net revenue equal to at least 1.15 times the annual debt service requirements for sewer revenue and general obligation bonds payable from revenues of Water Quality. It is an adopted policy of Water Quality to achieve a debt service coverage ratio of 1.25.

Coverage (1.15 required by covenant, adopted policy 1.25) 1.44

In 2001, Water Quality adopted a new debt service target of 1.15 times the annual debt service for bonds, obligations, notes, and loans of Water Quality.

Coverage (1.15 adopted target) 1.33

Water Quality is required to generate revenues sufficient to pay all costs of operation of the sewage treatment system and debt service on obligations of Water Quality.

Coverage (1.00 required by covenant) 1.24

In 2001, Water Quality issued an additional tier of revenue bonds. The bond covenants of the Junior Lien Variable Rate Demand Sewer Revenue Bonds, Series 2001A and Series 2001B, require that sewage disposal rates provide net revenue equal to at least 1.10 times the annual debt service requirements for all Junior Lien obligations after payment of senior lien requirements.

Coverage (1.10 required by covenant) 87.49