



Report of Independent Auditors and
Financial Statements with Required
Supplementary Information and
Supplemental Information for

**Seattle Public Utilities -
Drainage and Wastewater Fund**
(An Enterprise Fund of the City of Seattle)

December 31, 2012 and 2011

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

To the Director of Seattle Public Utilities
Drainage and Wastewater Fund
Seattle, Washington

Report on Financial Statements

We have audited the accompanying financial statements of Seattle Public Utilities -Drainage and Wastewater Fund (the Fund), which comprise the statements of net position as of December 31, 2012 and 2011, and the related statements of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Seattle Public Utilities – Drainage and Wastewater Fund as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matter

The accompanying management discussion and analysis is not part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. This information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The supplemental information following the financial statements is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The supplemental information following the financial statements has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Moss Adams LLP

Seattle, Washington
May 29, 2013

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED DECEMBER 31, 2012 AND 2011**

As management of Seattle Public Utilities ("SPU"), a department of the City of Seattle (the "City"), we offer readers of SPU's financial statements this narrative overview and analysis of the financial activities of the Drainage and Wastewater Fund (the "Fund") for the fiscal years ended December 31, 2012 and 2011. The revenues, expenses, assets, and liabilities of Seattle's drainage and wastewater system are recorded in the Drainage and Wastewater Fund, the functions of which are primarily supported by user fees and charges to customers. The financial situation of other aspects of Seattle City government, including other utility services and general government operations, are reported elsewhere.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Fund's financial statements. The financial statements include Management's Discussion and Analysis and basic financial statements with accompanying notes.

Basic Financial Statements - The basic financial statements of the Fund report information similar to the presentation used by private sector companies. These statements offer short-term and long-term financial information about its activities. The basic financial statements begin on page 14 of this report and are comprised of three components: (1) Statements of Net Position, (2) Statements of Revenues, Expenses, and Changes in Net Position, and (3) Statements of Cash Flows.

The Statements of Net Position present information, as of December 31, 2012 and 2011, on all of the Fund's assets and liabilities, with the difference between the two reported as net position. They also provide information about the nature and amounts of investments in resources (assets), obligations to the Fund's creditors (liabilities), and provide the basis for assessing the liquidity and financial flexibility of the Fund.

The Statements of Revenues, Expenses, and Changes in Net Position present changes in the Fund's net position for the years ended December 31, 2012 and 2011. All changes in net position are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. These statements reflect the results of the Fund's operations for the years identified to provide information about the Fund's credit worthiness and its ability to successfully recover all its costs through service fees and other charges.

The Statements of Cash Flows are required to provide information about the Fund's cash receipts and cash payments during the years ended December 31, 2012 and 2011. To provide answers to questions about sources, uses, and impacts to cash, these statements report cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities for the reporting period.

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OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

Notes to the Financial Statements - The notes are an integral part of the financial statements. They provide additional disclosures that are essential to a full understanding of the data provided in the financial statements, such as for certain estimates and financing details. The notes to the financial statements begin on page 19 of this report.

FINANCIAL ANALYSIS

Increases or decreases in net position may serve over time as a useful indicator of whether the Fund's financial position is improving or deteriorating. At December 31, 2012 and 2011, the Fund's assets exceeded liabilities, resulting in a surplus of total assets of \$271.0 million and \$270.3 million, respectively. In 2012, the Fund's overall position improved, with an increase in net position of \$0.8 million (0.3%) as compared to an increase in net position of \$18.0 million (7.1%) in 2011. The following summary statements of net position present the assets of the Fund and show the mix of liabilities and net position used to acquire these assets:

STATEMENTS OF NET POSITION

	<u>2012</u>	<u>2011</u>	<u>2010</u>
ASSETS			
Current assets	\$ 100,911,336	\$ 71,477,456	\$ 67,258,730
Capital assets, net	699,131,240	663,434,318	628,042,924
Other	<u>178,019,792</u>	<u>107,346,278</u>	<u>143,778,405</u>
Total assets	<u>978,062,368</u>	<u>842,258,052</u>	<u>839,080,059</u>
LIABILITIES			
Current liabilities	59,447,182	55,753,517	58,065,225
Revenue bonds	557,067,691	477,318,769	491,116,902
Other	<u>90,536,749</u>	<u>38,926,782</u>	<u>37,608,873</u>
Total liabilities	<u>707,051,622</u>	<u>571,999,068</u>	<u>586,791,000</u>
NET POSITION			
Net investment in capital assets	230,457,310	223,131,662	216,471,199
Restricted	31,476,172	28,383,412	28,099,086
Unrestricted	<u>9,077,264</u>	<u>18,743,910</u>	<u>7,718,774</u>
TOTAL NET POSITION	<u>\$ 271,010,746</u>	<u>\$ 270,258,984</u>	<u>\$ 252,289,059</u>

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FINANCIAL ANALYSIS (CONTINUED)

2012 Compared to 2011

Assets - Current assets increased \$29.4 million (41.2%) over the prior year primarily due to increases totaling \$34.7 million in operating cash and equity in pooled investments, unbilled revenue, due from other governments, and materials and supplies inventory. These increases were offset by decreases totaling \$5.3 million in restricted cash and equity in pooled investments, due from other funds, and accounts receivable, net from the Combined Customer Service System.

Other assets increased \$70.7 million (65.8%) from 2011. This is mostly attributable to an increase in restricted cash and equity in pooled investments of \$50.1 million resulting from new debt issued in 2012 and spending on construction projects. The environmental costs and recoveries increased \$15.8 million as a result of deferring costs related to cleanup of contamination along the Duwamish River. In addition, other charges increased \$4.8 million mainly due to the Long Term Control Plan. The projects identified in the plan will ultimately enhance the water quality of Ballard, North Union Bay, Interbay, Fremont/Wallingford, Duwamish, West Seattle, Montlake, Leschi, Union Bay, East Waterway, and Lake Union/Portage Bay.

Liabilities - Current liabilities increased \$3.7 million (6.6%) from 2011. This is mostly attributable to increases in accounts payable, interest payable, and revenue bonds due within one year, totaling \$4.7 million, offset by a decrease of \$1.0 million in claims payable.

Other liabilities increased \$51.6 million (132.6%). This is due to an increase in environmental liabilities (see Note 9), offset by a decrease in loans (see Note 10) and a decrease in claims payable.

Net Position - The largest portion of the Fund's net position (\$230.5 million or 85.1%) reflects the Fund's investment in capital assets such as land, buildings, and equipment, less any related outstanding debt used to acquire those assets. The Fund uses these assets to provide services to customers; consequently, these assets are not available for future spending. Although the Fund's investment in its capital assets is reported net of related debt, the resources needed to repay the debt are provided by fees paid by customers for services provided by these assets. In 2012, net investment in capital assets increased \$7.3 million from 2011 due to an increase in capital assets placed in service, net of depreciation offset by the related debt.

The Fund's restricted net position (\$31.5 million or 11.6%) represent resources that are subject to restrictions on how they may be used. This portion of net position increased \$3.1 million from 2011. This change was primarily due to the restriction of 2012 bond proceeds set aside as a bond reserve and an increase in other charges.

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FINANCIAL ANALYSIS (CONTINUED)

The remaining portion of the Fund's net position (\$9.1 million or 3.3%) represent resources that are unrestricted and may be used to meet the Fund's obligations to creditors. Unrestricted net position decreased \$9.7 million from 2011 in part due to a higher percentage of capital projects funded with operating cash as compared to the prior year.

2011 Compared to 2010

Assets - Current assets increased \$4.2 million (6.3%) over the prior year primarily due to increases totaling \$5.9 million in unbilled revenue, due from other governments and accounts receivable, net from the Combined Customer Service System. These increases were offset by decreases totaling \$1.7 million in cash and equity in pooled investments and due from other city funds.

Other assets decreased \$36.4 million (25.3%) due to the spending of \$40.4 million for use toward construction projects, reductions of \$0.7 million in external infrastructure costs and a decrease in vendor deposits, and cash and equity in pooled investments of \$0.5 million. These decreases were impacted by increases totaling \$2.7 million in other restricted accounts, cash and equity in pooled investments mainly due to funding received for work toward the Alaskan Way Viaduct project and in notes and contracts receivable from the Public Infrastructure Agreement with the Seattle Housing Authority (see Note 11). In addition, the Fund experienced increases totaling \$2.6 million in environmental costs and recoveries and other charges, which primarily related to the 2010 Combined Sewer Overflow Plan. The projects identified in the plan will ultimately enhance the water quality of Lake Washington, Puget Sound, Elliot Bay, the Ship Canal, the Duwamish, Longfellow Creek, Lake Union, Union Bay, and Portage Bay.

Liabilities - Current liabilities decreased \$2.3 million (4.0%) from 2010. This is mostly attributable to decreases in credits and other, accounts payable and due to other city funds, totaling \$3.3 million, offset by an increase of \$1.0 million in due to other governments.

Other liabilities increased \$1.3 million (3.5%). This is due to an increase in loans (see Note 10), offset by a decrease in environmental liabilities (see Note 9).

Net Position - The largest portion of the Fund's net position (\$223.1 million or 82.6%) reflects the Fund's investment in capital assets such as land, buildings, and equipment, less any related outstanding debt used to acquire those assets. The Fund uses these assets to provide services to customers; consequently, these assets are not available for future spending. Although the Fund's investment in its capital assets is reported net of related debt, the resources needed to repay the debt are provided by fees paid by customers for services provided by these assets. In 2011, net investment in capital assets increased \$6.7 million from 2010 due to an increase in capital assets placed in service, net of depreciation offset by the related debt.

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FINANCIAL ANALYSIS (CONTINUED)

The Fund's restricted net position (\$28.4 million or 10.5%) represent resources that are subject to restrictions on how they may be used. This portion of net position increased \$0.3 million from 2010. This change was primarily due to an increase in other charges related to the 2010 Combined Sewer Overflow Plan, less related debt.

The remaining portion of the Fund's net position (\$18.7 million or 6.9%) represent resources that are unrestricted and may be used to meet the Fund's obligations to creditors. Unrestricted net position increased \$11.0 million from 2010 in part due to the rate increase effective January 1, 2011.

The following summary statements of revenues, expenses, and changes in net position present the annual surplus of revenues over expenses (the change in net position):

SUMMARY STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating revenues	\$ 304,001,717	\$ 278,956,907	\$ 249,733,794
Operating expenses	<u>(258,518,280)</u>	<u>(253,071,273)</u>	<u>(230,118,012)</u>
Net operating income	45,483,437	25,885,634	19,615,782
Other income (expenses)	(15,918,029)	(15,929,416)	(15,638,287)
Fees, contributions, and grants and special items	<u>(28,813,646)</u>	<u>8,013,707</u>	<u>1,874,393</u>
Change in net position	<u>\$ 751,762</u>	<u>\$ 17,969,925</u>	<u>\$ 5,851,888</u>

2012 Compared to 2011

Current year operating revenues increased approximately \$25.0 million (9.0%) from 2011. This is primarily due to a \$16.5 million increase in wastewater revenues resulting from an average increase in rates of 3.9% and increase in consumption of 3.6%. Drainage revenue also increased \$7.9 million due to increase in rates.

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FINANCIAL ANALYSIS (CONTINUED)

Operating expenses increased \$5.4 million (2.2%) from 2011. Notable factors affecting this change include increases in city business and occupation and other taxes of \$3.5 million related to the overall increase in revenues. Depreciation and other amortization also increased \$1.3 million due to an increase in depreciable assets. Additional increases to expenses include \$1.0 million in the project delivery branch related to the First Hill Streetcar project, \$0.8 million in customer services branch as a result of federal government drainage levy write-off, \$0.7 million in the utility systems management branch due to increase in mainline inspection and cleaning, and \$0.7 million in the field operations branch as general management and apprenticeship programs increased. These increases were offset by a decrease of \$2.7 million in general and administrative branch as risk financing liabilities decreased and other postemployment benefit liability increased.

Nonoperating revenues (expenses) remained stable at \$15.9 million as compared to 2011. Interest expense increased \$0.6 million, offset by \$0.5 million increase in premium amortization as a result of issuing a new 2012 bond.

Capital contributions and grants increased \$0.8 million mainly due to an increase in grant billings of \$2.7 million for Capital Hill Water Quality Improvements, Midvale Stormwater Facility, and King County Flood Control Meadowbrook projects, offset by a decrease of \$1.9 million in capital contributions. The Fund had an increase in environmental remediation expenses of \$37.6 million.

2011 Compared to 2010

Current year operating revenues increased approximately \$29.2 million (11.7%) from 2010. This is primarily due to a \$20.2 million increase in wastewater revenues resulting from an average increase in rates of 14.5% and a \$9.4 million increase in drainage revenues due to increased rates. These increases were offset by a decrease of \$0.6 million in system usage.

Operating expenses increased \$23.0 million (10.0%) from 2010. Notable factors affecting this change include increases in wastewater treatment of \$14.0 million due to an increase in the treatment rate imposed by King County in 2011. Additional increases to expenses include \$4.9 million in the utility systems management branch related to the abandonment of the Densmore Basin project and the unsuccessful Ballard rain gardens project. Finally, city and other tax expenses increased \$3.8 million related to the overall increase in revenue.

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FINANCIAL ANALYSIS (CONTINUED)

Nonoperating revenues (expenses) increased \$0.3 million from 2010. Factors impacting this change were lower environmental cost recoveries and insurance recoveries totaling \$2.7 million. These factors were offset by an additional \$1.0 million in interest expense for capitalized interest costs related to construction projects and higher Build America Bond interest income of \$0.3 million. In addition, operating grants increased \$1.1 million.

Capital contributions and grants, transfers, and special items increased \$6.1 million due to infrastructure assets donated by the Seattle Department of Transportation, as well as, revenue from the Seattle Housing Authority, Sound Transit and the Alaskan Way Viaduct project. In addition, the Fund had a decrease in environmental remediation expenses.

CAPITAL ASSETS

The following table summarizes capital assets, net of accumulated depreciation, by major asset category:

SUMMARY OF CAPITAL ASSETS, NET OF ACCUMULATED DEPRECIATION

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Land and land rights	\$ 19,583,084	\$ 14,279,516	\$ 14,279,516
Buildings	7,436,540	7,745,381	8,017,345
Structures	117,155,245	114,758,607	101,910,764
Machinery and equipment	460,902,462	450,664,575	424,460,591
Computer systems	9,926,960	12,492,853	13,640,712
Construction in progress	83,224,105	62,822,427	65,071,758
Other property	902,844	670,959	662,238
Capital assets, net of accumulated depreciation	<u>\$ 699,131,240</u>	<u>\$ 663,434,318</u>	<u>\$ 628,042,924</u>

**SEATTLE PUBLIC UTILITIES -
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MANAGEMENT'S DISCUSSION AND ANALYSIS
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CAPITAL ASSETS (CONTINUED)

2012 Compared to 2011

The Fund's investment in capital assets, net of accumulated depreciation, for the year ended December 31, 2012 was \$699.1 million. This represented an increase of approximately \$35.7 million (5.4%) compared to 2011. Highlights of the Fund's major capital assets placed in service during 2012 included the following:

- \$6.2 million for the completion of the Madison Valley Phase II project.
- \$5.3 million to replace sewer pipelines throughout several locations within the city.
- \$3.2 million to build a pump station and a water quality facility near 7th and Riverside in South Park.
- \$1.4 million in emergency rehabilitation work on sewer mainlines.
- \$1.2 million to improve surface water system field equipment.
- \$1.1 million to improve and replace a gate in the Windermere basin.

Highlights of the Fund's major construction projects in progress at the end of 2012 include the following:

- \$23.6 million for improvements to the Windermere combined sewer overflow storage.
- \$11.6 million for improvements to the South Henderson combined sewer overflow storage.
- \$9.8 million for improvements to the South Genesee combined sewer overflow facilities.
- \$7.8 million for a detention project to reduce flooding near North 107th Street and Midvale.
- \$4.9 million for the relocation and replacement of wastewater related facilities in the Mercer Corridor.
- \$4.3 million in Capital Hill water quality improvements.
- \$3.7 million to build a pump station and a water quality facility near 7th and Riverside in South Park.
- \$2.3 million to upgrade the Maximo system.
- \$1.7 million for improvements to the Delridge combined sewer overflow facilities.
- \$1.7 million to develop natural drainage system at Venema Creek.
- \$1.5 million to review conceptual designs, business case development, negotiation of agreements, and project management related to the Alaskan Way Viaduct bored tunnel project.

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CAPITAL ASSETS (CONTINUED)

- \$1.4 million to replace damaged culvert at 35th Avenue Northeast and restore floodplain area at the confluence of Thornton Creek.
- \$1.0 million for major enhancements to the I-SCADA data management program and IMS web site portal application.

2011 Compared to 2010

The Fund's investment in capital assets, net of accumulated depreciation, for the year ended December 31, 2011 was \$663.4 million. This represented an increase of approximately \$35.4 million (5.6%) compared to 2010. Highlights of the Fund's major capital assets placed in service during 2011 included the following:

- \$26.2 million for the completion of the Madison Valley Phase II project.
- \$4.7 million to replace sewer pipelines throughout several locations within the city.
- \$4.2 million in donated sewer and drainage pipes from the Seattle Department of Transportation.
- \$3.1 million in improvements related to stormwater quality conditions in the Norfolk Basin.
- \$1.4 million in emergency rehabilitation work on sewer mainlines.
- \$1.2 million for I-SCADA improvements at wastewater pump stations.
- \$1.2 million to reduce infiltration and enhance the capacity of the sewer at 12th Avenue NW.
- \$1.1 million for the installation of onsite generators at critical wastewater pump stations.

Highlights of the Fund's major construction projects in progress at the end of 2011 include the following:

- \$16.2 million for improvements to the Windermere combined sewer overflow storage.
- \$8.2 million for improvements to the South Henderson combined sewer overflow storage.
- \$5.9 million for a detention project to reduce flooding near North 107th Street and Midvale.
- \$5.9 million to build a pump station and a water quality facility near 7th and Riverside in South Park.
- \$3.8 million for improvements to the South Genesee combined sewer overflow facilities.
- \$3.7 million for the relocation and replacement of wastewater related facilities in the Mercer Corridor.

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CAPITAL ASSETS (CONTINUED)

- \$1.8 million in Capital Hill water quality improvements.
- \$1.1 million to upgrade the Maximo system.
- \$1.1 million to review conceptual designs, business case development, negotiation of agreements, and project management related to the Alaskan Way Viaduct bored tunnel project.

Additional information about the Fund's capital assets can be found in Note 3 of this report.

DEBT ADMINISTRATION

The Fund's debt primarily consists of bonded debt and loans. Bonded debt is secured solely by drainage and wastewater system revenues and provides financing for capital improvements. Loans issued by various Washington State agencies for certain capital improvements are unsecured. The Fund's credit ratings on its bonds were AA+ by Standard and Poor's Rating Service and Aa1 by Moody's Investor Service.

2012 Compared to 2011

At the end of 2012, the Fund had \$540.5 million in bonded debt, as compared to \$486.6 million in 2011, all of which was secured solely by drainage and wastewater system revenues. The key factor in this increase of \$53.9 million was the issuance of \$222.1 million new debt, offset by refunding \$151.9 million of 2001 bond, 2002 bond, and partially 2004 bond and payments of \$16.3 million of debt principal. Additional information about the Fund's long-term debt can be found in Notes 4 and 10.

In 2012, the Fund was approved for a water pollution control revolving fund loan of \$1,857,150 from the Washington State Department of Ecology for design and construction of a stormwater facility in the Capital Hill area of Seattle from which no funds have been drawn. The Fund did not make any additional draws on existing loans in 2012 (see Note 10).

2011 Compared to 2010

At the end of 2011, the Fund had \$486.6 million in bonded debt, as compared to \$499.8 million in 2010, all of which was secured solely by drainage and wastewater system revenues. There were no new bonds issued in 2011. Additional information about the Fund's long-term debt can be found in Notes 4 and 10.

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DEBT ADMINISTRATION (CONTINUED)

During 2011, the Fund made additional draws on loans. The Fund borrowed an additional \$3,574,418 from the Washington State Department of Commerce and the Fund also borrowed \$243,845 from the Washington State Department of Ecology, which was funded by the American Recovery and Reinvestment Act of 2009 ("ARRA") (see Note 10).

REQUESTS FOR INFORMATION

The Fund's financial statements are designed to provide a general overview of the Fund's finances, as well as to demonstrate the Fund's accountability to its customers, investors, creditors, and other interested parties. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Seattle Public Utilities, Finance and Administration Branch, Finance Division, PO Box 34018, Seattle, Washington 98124-4018, telephone: (206) 684-3000.

**SEATTLE PUBLIC UTILITIES -
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STATEMENTS OF NET POSITION
DECEMBER 31, 2012 AND 2011**

ASSETS

	<u>2012</u>	<u>2011</u>
CURRENT ASSETS		
Operating cash and equity in pooled investments	\$ 60,207,512	\$ 29,121,787
Restricted cash and equity in pooled investments	-	1,571,461
Receivables		
Accounts, net of allowance	17,434,638	19,951,276
Interest and dividends	121,609	66,808
Unbilled revenues	16,728,475	15,914,459
Notes, and other contracts	46,815	44,690
Due from other funds	680,374	1,870,874
Due from other governments	4,853,465	2,344,910
Materials and supplies inventory	827,973	570,165
Prepayments and other current assets	10,475	21,026
Total current assets	<u>100,911,336</u>	<u>71,477,456</u>
NONCURRENT ASSETS		
Restricted cash and equity in pooled investments	100,442,808	50,355,493
Unamortized bond issue costs	3,450,269	3,089,486
Notes and contracts receivable	1,259,509	1,306,324
Environmental costs and recoveries	23,189,224	7,398,798
External infrastructure costs	20,223,378	20,577,735
Other charges	29,454,604	24,618,442
Capital assets		
Land and land rights	19,583,084	14,279,516
Plant in service, excluding land	861,228,220	831,908,520
Less accumulated depreciation	(265,807,013)	(246,247,104)
Construction in progress	83,224,105	62,822,427
Other property, net	902,844	670,959
Total noncurrent assets	<u>877,151,032</u>	<u>770,780,596</u>
Total assets	<u>\$ 978,062,368</u>	<u>\$ 842,258,052</u>

**SEATTLE PUBLIC UTILITIES -
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STATEMENTS OF NET POSITION (CONTINUED)
DECEMBER 31, 2012 AND 2011**

LIABILITIES		
	2012	2011
CURRENT LIABILITIES		
Accounts payable	\$ 11,124,890	\$ 8,637,576
Salaries, benefits, and payroll taxes payable	1,703,025	1,401,256
Compensated absences payable	377,496	374,356
Due to other funds	4,858,162	4,696,918
Due to other governments	10,443,300	10,339,097
Interest payable	7,113,121	6,451,933
Taxes payable	288,932	246,344
Revenue bonds due within one year	15,215,000	13,695,000
Claims payable	2,458,707	3,459,286
Environmental liabilities	1,679,343	2,263,979
Loans payable, due within one year	1,085,194	903,774
Credits and other	3,100,012	3,283,998
Total current liabilities	59,447,182	55,753,517
NONCURRENT LIABILITIES		
Compensated absences payable	4,022,592	4,050,598
Claims payable	7,863,341	8,830,523
Environmental liabilities	59,855,766	6,291,846
Loans	16,608,794	17,693,988
Vendor and other deposits payable	33,484	13,611
Unfunded other post employment benefits	1,943,931	1,894,828
Other noncurrent liabilities	208,841	151,388
Revenue bonds	540,495,000	486,610,000
Less bonds due within one year	(15,215,000)	(13,695,000)
Bond discount and premium, net	39,262,092	8,555,708
Loss on advanced refunding	(7,474,401)	(4,151,939)
Total noncurrent liabilities	647,604,440	516,245,551
Total liabilities	707,051,622	571,999,068
NET POSITION		
Net investment in capital assets	230,457,310	223,131,662
Restricted for		
Debt service	14,688,392	12,757,013
External infrastructure costs	6,834,126	7,114,670
Other charges	9,953,654	8,511,729
Unrestricted	9,077,264	18,743,910
Total net position	271,010,746	270,258,984
Total liabilities and net position	\$ 978,062,368	\$ 842,258,052

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
YEARS ENDED DECEMBER 31, 2012 AND 2011**

	<u>2012</u>	<u>2011</u>
OPERATING REVENUES		
Charges for services and other revenues	<u>\$ 304,001,717</u>	<u>\$ 278,956,907</u>
OPERATING EXPENSES		
Planning and development	2,101,137	2,565,065
Utility systems management	17,304,177	16,574,074
Field operations	19,587,958	18,873,873
Project delivery	12,363,376	11,368,181
Customer services	6,055,771	5,207,443
Wastewater treatment	125,743,876	125,251,546
General and administrative	14,658,027	17,367,886
City business and occupation taxes	35,374,947	32,448,908
Other taxes	4,172,248	3,582,168
Depreciation and other amortization	<u>21,156,763</u>	<u>19,832,129</u>
Total operating expenses	<u>258,518,280</u>	<u>253,071,273</u>
OPERATING INCOME	<u>45,483,437</u>	<u>25,885,634</u>
NONOPERATING REVENUES (EXPENSES)		
Investment and interest income	3,269,810	2,820,139
Interest expense	(21,703,780)	(21,129,394)
Amortization of bonds premiums and discounts, net	897,638	376,936
Amortization of refunding loss	(351,384)	(273,803)
Amortization of debt costs	(138,989)	(138,607)
Gain on sale of capital assets	41,000	12,901
Contributions and grants	2,061,760	2,309,750
Others, net	5,916	92,662
Total nonoperating revenues (expenses)	<u>(15,918,029)</u>	<u>(15,929,416)</u>
INCOME BEFORE CAPITAL CONTRIBUTIONS AND GRANTS, TRANSFERS, AND SPECIAL ITEMS	29,565,408	9,956,218
CAPITAL CONTRIBUTIONS AND GRANTS	8,252,261	7,475,683
ENVIRONMENTAL REMEDIATION	<u>(37,065,907)</u>	<u>538,024</u>
CHANGE IN NET POSITION	751,762	17,969,925
NET POSITION		
Beginning of year	<u>270,258,984</u>	<u>252,289,059</u>
End of year	<u>\$ 271,010,746</u>	<u>\$ 270,258,984</u>

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2012 AND 2011**

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	\$ 308,772,630	\$ 272,773,087
Cash paid to suppliers	(148,169,113)	(148,864,899)
Cash paid to employees	(48,798,401)	(49,700,928)
Cash paid for taxes	(39,185,230)	(35,822,166)
Net cash from operating activities	72,619,886	38,385,094
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating grants received	1,702,187	2,204,999
Payments for environmental liabilities	(1,001,459)	(2,848,308)
Net cash from noncapital financing activities	700,728	(643,309)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of bonds and other long-term debt	255,886,458	3,818,263
Principal payments on long-term debt and refunding	(173,901,508)	(14,019,505)
Capital expenditures and other charges paid	(56,117,496)	(49,442,364)
Interest paid on long-term debt	(24,378,191)	(24,307,874)
Capital fees and grants received	3,106,511	2,938,786
Debt issuance costs	(1,573,320)	-
Proceeds from sale of capital assets	43,502	111,858
Net cash from capital and related financing activities	3,065,956	(80,900,836)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of investments	-	24,600,000
Interest received on investments	3,215,009	2,834,772
Net cash from investing activities	3,215,009	27,434,772
NET INCREASE (DECREASE) IN CASH AND EQUITY IN POOLED INVESTMENTS	79,601,579	(15,724,279)
CASH AND EQUITY IN POOLED INVESTMENTS		
Beginning of year	81,048,741	96,773,020
End of year	\$ 160,650,320	\$ 81,048,741
CASH AT THE END OF THE YEAR CONSISTS OF		
Operating cash and equity in pooled investments	\$ 60,207,512	\$ 29,121,787
Current restricted cash and equity in pooled investments	-	1,571,461
Noncurrent restricted cash and equity in pooled investments	100,442,808	50,355,493
Total cash at the end of the year	\$ 160,650,320	\$ 81,048,741

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
STATEMENTS OF CASH FLOWS (CONTINUED)
YEARS ENDED DECEMBER 31, 2012 AND 2011**

	<u>2012</u>	<u>2011</u>
RECONCILIATION OF NET OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income	<u>\$ 45,483,437</u>	<u>\$ 25,885,634</u>
Adjustments to reconcile net operating income to net cash from operating activities		
Depreciation and amortization	21,156,763	19,832,129
Nonoperating revenues and expenses	2,428,678	1,293,235
Changes in operating assets and liabilities		
Accounts receivable	2,516,638	(2,968,296)
Unbilled revenues	(814,016)	(1,688,096)
Other receivables	44,690	(1,351,014)
Due from other funds	1,190,499	539,641
Due from other governments	(190,980)	(984,235)
Materials and supplies inventory	(257,808)	38,358
Accounts payable	2,487,315	(399,418)
Salaries, benefits, and payroll taxes payable	301,769	135,489
Compensated absences payable	(24,866)	142,375
Due to other funds	161,244	(1,906,852)
Due to other governments	104,203	1,086,815
Claims payable	(1,967,761)	(312,025)
Taxes payable	42,587	616
Credits and other	(179,486)	(1,031,700)
Other assets and liabilities	136,980	72,438
Total adjustments	<u>27,136,449</u>	<u>12,499,460</u>
Net cash from operating activities	<u>\$ 72,619,886</u>	<u>\$ 38,385,094</u>
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Fair value adjustment of long-term investments	\$ -	\$ (4,085)
Contributed infrastructure	<u>1,983,248</u>	<u>4,208,974</u>
Total noncash investing, capital, and financing activities	<u>\$ 1,983,248</u>	<u>\$ 4,204,889</u>

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 1 - Operations and Summary of Significant Accounting Policies

Operations - The City of Seattle, Seattle Public Utilities - Drainage and Wastewater Fund (the "Fund") is a public utility enterprise fund of the City of Seattle (the "City"). The Fund was established to account for the drainage and wastewater activities of Seattle Public Utilities ("SPU"). Drainage activities include regulating storm water runoff, alleviating flooding, mitigating water pollution caused by runoff, and responding to federal storm water regulations, in addition to managing drainage utility assets. Wastewater activities consist of managing the City's sewer system, including the operation of sewer utility facilities and pumping stations necessary to collect the sewage of the City and discharge it into the King County Department of Natural Resources Wastewater Treatment System for treatment and disposal.

On January 1, 1997, the City created SPU, which brought together under one administrative umbrella the water, solid waste, and drainage and wastewater functions of the City. The Fund (as well as SPU's other funds) remains separate for accounting purposes.

SPU receives certain services from other departments and agencies of the City, including some that are normally considered to be general and administrative. The Fund is charged a share of these costs and additionally pays a business and occupation tax to the City's General Fund. During 2012 and 2011, the Fund paid \$8,910,471 and \$8,739,578, respectively, to the City for its share of general and administrative services. Additionally, the Fund paid \$35,374,947 and \$32,448,908 to the City for business and occupation utility taxes in 2012 and 2011, respectively.

Wastewater disposal services provided to other City departments and agencies are billed at rates prescribed by City ordinances. The Fund collected \$1,911,147 in 2012 and \$1,852,250 in 2011 from the City for wastewater services provided.

The utility billing function is co-managed by both SPU and Seattle City Light ("SCL"). SPU provides customer service through the call center and walk-in center. SCL operates and manages the billing system, Combined Customer Services System ("CCSS"). SPU and SCL bills and reimburses each other for these services. Within SPU, the costs and reimbursements were shared among its three utility funds (Water, Drainage and Wastewater, and Solid Waste). The Fund received reimbursements related to the call center and walk-in center of \$1,470,251 and \$1,396,068 in 2012 and 2011, respectively. The Fund paid \$301,990 and \$384,365 for CCSS services in 2012 and 2011, respectively, which does not include reimbursements to SCL for the Fund's share of capital costs to upgrade the CCSS system.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

The Fund is subject to regulation by the City and the State of Washington. Service rates are authorized by ordinances passed by the City Council. Accounting policies and financial reporting are regulated by the Washington State Auditor's Office, and conform to accounting principles generally accepted in the United States of America as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Basis of Accounting - The Fund is accounted for on a flow of economic resources measurement focus. Its financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to governmental units using the accrual basis of accounting. With the flow of economic resources measurement focus, all assets and liabilities associated with the Fund's operations are included on the Statements of Net Position. The operating statements present increases (revenues) and decreases (expenses) in total net position.

Cash and Equity in Pooled Investments - Cash resources of the Fund are combined with cash resources of the City to form a pool of cash that is managed by the City's Finance and Administration Services Department. Under the City's investment policy, the Finance and Administration Services Department invests all temporary cash surpluses either directly or through a "sweep account." Interest earned on the pooled investments is prorated to individual funds at the end of each month on the basis of their average daily cash balances during the month when interest was earned. The Fund's share of the pool is included in the accompanying Statements of Net Position under the caption "cash and equity in pooled investments." The pool operates like a demand deposit account in that all City departments may deposit cash at any time and can also withdraw cash out of the pool without prior notice or penalty. Accordingly, the Statements of Cash Flows reconcile to cash and equity in pooled investments. Cash and equity in pooled investments are reported at fair value. The restricted cash and equity in pooled investments are comprised of unexpended bond proceeds, a portion of which is scheduled to be spent in 2013.

Receivables and Unbilled Revenues - Customer accounts receivable consist of amounts owed by private individuals and organizations for goods delivered or services rendered in the regular course of business operations. Receivables are shown net of allowances for doubtful accounts. The Fund also accrues an estimated amount for services that have been provided but not billed.

Due From/To Other Funds and Governments - Activity between other funds and governments that is outstanding at the end of the year, not related to the provision of utility services, is reported as due from or due to other funds and governments.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

Allowance for Doubtful Accounts - A reserve has been established for uncollectible accounts receivable based on actual historical write-off trends and knowledge of specific circumstances that indicate collection of an account may be unlikely. As of December 31, 2012 and 2011, the Fund's allowance for doubtful accounts was \$877,428 and \$1,866,543, respectively.

Materials and Supplies Inventory - The Fund values its inventory based on a moving average method. The most recent total cost of an inventory item is divided by the total units of the item that remain in inventory to determine the moving average cost of the item. The moving average cost is then applied to all the units of the inventory item.

Unamortized Bond Issue Costs - Costs associated with the issuance of bonds are amortized to expense over the term of the related debt. Amortization expense is calculated using the straight line method.

Environmental Costs and Recoveries - The Fund is involved in several remediation efforts around the City (see Note 9). When estimated remediation costs are approved to be recovered through rates, the costs, net of recoveries, associated with these efforts are deferred when accrued as a regulatory asset and are amortized over the rate recovery period. Certain environmental remediation costs that are infrequent in occurrence are treated as a special item in the Statements of Revenues, Expenses, and Changes in Net Position.

External Infrastructure Costs - The Fund has contributed \$21,963,686 to a joint project with King County to expand one of their transmission lines to help alleviate sewer overflows in the area. These costs represent the portion of the project that did not result in a capital asset for the Fund. The project was completed in 2005. The Fund has deferred these costs and began amortizing them in 2006 over a 75 year period.

Other Charges - Other charges primarily include costs related to leasehold improvements and plans, such as the Combined Sewer Overflow Update plan and the Comprehensive Ditch and Culvert plan. The Fund amortizes these charges over a 5 to 30 year period.

Capital Assets - Capital assets are stated at cost or, if contributed, at fair value at the date of contribution. Costs include direct material, labor, and indirect costs such as engineering, supervision, payroll taxes, pension benefits, and interest relating to the financing of projects under construction. The cost of current repairs and maintenance is charged to expense, while the cost of additions and improvements is capitalized. SPU's policy is to generally capitalize assets with a cost of \$5,000 or more. The Fund received donated assets, such as sewer and drainage pipes, from developers and other government agencies.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

Construction in Progress - Capitalizable costs incurred on projects which are not in use or ready for use are held in construction in progress. When the asset is ready for use, related costs are transferred to capital assets. Upon determining that a project will be abandoned, the related costs are charged to expense.

Other Property - Other property is stated at cost, or if contributed, the fair value at the date of contribution. Other property includes artwork and property held for future use. The artwork is acquired through the City's "One Percent for Art" program, which supports the City ordinance established to direct the inclusion of works of art in public spaces within the City.

Depreciation - Capital assets in service are depreciated on the straight-line method over estimated useful lives as follows:

Buildings and fixtures	10 - 50 years
Laterals, mains, and outfalls	75 years
Detention structures	50 years
Pumping stations, equipment, and overflow structures	10 to 50 years
Machinery and equipment	3 to 20 years
Computer systems	3 to 10 years

Composite rates based on year of addition are used for depreciating the laterals, mains, and outfalls asset group. For most assets, it is SPU's policy to begin depreciation in the year following acquisition and to record a full year's depreciation in the year of disposition. This does not apply to heavy equipment, for which depreciation begins in the month following the equipment's in-service date to more accurately allocate equipment costs to various activities.

Environmental Liabilities - The Fund has accrued a liability for pollution remediation activities in accordance with GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB 49 outlines five specific obligating events that give rise to estimating expected pollution remediation outlays. These outlays may be accrued as a liability and expensed, or if appropriate, capitalized.

The Fund will accrue a liability if any of the following obligating events occurs:

- The Fund is compelled to take pollution remediation action because of an imminent endangerment.
- The Fund violates a pollution prevention-related permit or license.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

- The Fund is named, or evidence indicates it will be named, by a regulator as a potentially responsible party (“PRP”) for remediation.
- The Fund is named, or evidence indicates that it will be named, in a lawsuit to compel participation in pollution remediation.
- The Fund commences or legally obligates itself to commence pollution remediation.

Most pollution remediation outlays do not qualify for capitalization and the Fund does not anticipate significant capitalized costs in the future. See Note 9 for site descriptions.

Compensated Absences - Employees earn vacation based upon their date of hire and years of service, and may accumulate earned vacation up to a maximum of 480 hours. Unused vacation at retirement or normal termination is considered vested and payable to the employee. Earned but unused vacation is accrued as a liability of the Fund. Employees also earn up to 12 days of sick leave per year and may accumulate sick leave balances without limit.

Employees who submit the required documentation to be represented by the Coalition of City Unions are paid 35% of the value of unused sick leave upon retirement as part of the Health Reimbursement Arrangement – Voluntary Employees’ Beneficiary Association (“HRA-VEBA”) program. If the employee fails to submit the required documentation by their last working day of employment, their sick leave balance is forfeited.

Retiring employees who are not eligible to participate in the HRA-VEBA program may elect to receive 25% of the value of unused sick leave upon retirement or defer receipt of 35% of the value of their sick leave balance to the City’s 457 Plan and Trust, subject to the year-to-date or life-to-date limitations on deferrals and contributions. If the 35% value of the sick leave balance exceeds the maximum amount deferred to the City’s 457 Plan and Trust, the employee shall receive a taxable cash payment equal to the amount by which the 25% value of the sick leave balance exceeds the 35% that was allowed to be deferred. The Fund records a liability for estimated sick leave payments.

Operating Revenues - Wastewater service revenues are recorded through cycle billings rendered to customers monthly or bimonthly. The Fund accrues and records unbilled wastewater service revenues in the financial statements for services provided from the date of the last billing to year end.

Drainage service charges are billed to the City’s drainage residential and nonresidential customers twice a year through the service of King County’s property tax billing system. These charges fund operations and maintenance of, and improvements to, the City’s system of storm and drainage facilities.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

Other operating revenues include revenues generated from wastewater and sewer permits, and engineering services provided to other City funds.

Operating Expenses - Certain expenses of the Fund are reported on the Statement of Revenue, Expenses and Change in Net Position by functional category. The types of work performed within each category are as follows:

- Planning and development - Provides planning services and other related costs prior to the start of capital projects.
- Utility systems management - Accounts for the overall management of the Fund's infrastructure assets, assuring they are properly designed, constructed, operated, and protected.
- Field operations - Operates and maintains the Fund's drainage and wastewater systems.
- Project delivery - Provides project management and engineering services to the Fund and executes the Fund's capital projects from start to completion.
- Customer services - Invoices the Fund's customers for services provided and is the primary point of contact for customers.

Taxes - The Fund is charged a public utility tax by the City at a rate of 12.0% for Wastewater revenues and 11.5% for Drainage revenues, net of certain credits. In addition, the Fund paid a 3.85% public utility tax to the State on a certain portion of revenues identified as sewer collection revenues. The Fund also paid business and occupation tax to the State at the rate of 1.8% on certain other non-utility revenues.

Nonoperating Revenues and Expenses - This includes the non-operating revenues and expenses that arise from transactions not related directly to the major income-earning operations of the Fund and are of a recurring nature. Major items are investment and interest income, interest expense, amortization of debt expenses, and sale of capital assets.

Net Position - The Statement of Net Position reports all financial and capital resources. The difference between assets and liabilities is net position. There are three components of net position: net investment in capital assets, restricted, and unrestricted.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

Net investment in capital assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Net position is restricted when constraints placed on net position use are either: (1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments, or (2) imposed by law through constitutional provisions or enabling legislation. The Fund's restricted net position as of December 31, 2012 and 2011 are related to the bond debt reserve funds and certain other charges.

Unrestricted net position is the portion that is not "net investment in capital assets" or "restricted."

Arbitrage Rebate Requirement - The Fund is subject to the Internal Revenue Code ("IRC"), Section 148(f), related to its tax-exempt revenue bonds. The IRC requires that earnings on gross proceeds of any revenue bonds that are in excess of the amount prescribed be surrendered to the Internal Revenue Service. As such, the Fund would record such a rebate as a liability. The Fund had no liability for arbitrage as of December 31, 2012 and 2011.

Accounting Changes - GASB has issued Statement No. 62, *Codification of Pre-November 30, 1989 FASB Pronouncements*. This statement combines the authoritative accounting and financial reporting of the FASB and the American Institute of Certified Public Accountants ("AICPA"). The statement eliminates the need for financial statement preparers and auditors to determine which FASB and AICPA pronouncement provisions apply to state and local governments. This statement became effective for periods beginning after December 15, 2011 and did not have a significant impact on the Fund's financial statements for 2012 or 2011.

GASB has issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The requirement of this statement standardizes the presentation of deferred inflows and outflows of resources, and their effects on a government's net position. This statement became effective for periods beginning after December 15, 2011. The implementation of this statement to the Fund is limited to renaming of "Net Assets" to "Net Position."

GASB has issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reports as assets and liabilities. The statement is effective for periods beginning after December 15, 2012. The Fund is evaluating the impact of this standard on the financial statements.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 1 - Operations and Summary of Significant Accounting Policies (Continued)

GASB has issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This statement is effective for periods beginning after June 15, 2014. The Fund is evaluating the impact of this standard on the financial statements.

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 amounts reported in the financial statements. Estimates and assumptions are used to record unbilled revenues, allowance for doubtful accounts, accrued sick leave, capitalized interest, depreciation, environmental liabilities, risk liabilities, and other contingencies. Changes in these estimates and assumptions may have a material impact on the financial statements.

Significant Risks and Uncertainties - The Fund is subject to certain business risks that could have a material impact on future operations and financial performance. These risks include, but are not limited to, weather and natural disaster-related disruptions, collective bargaining labor disputes, Environmental Protection Agency regulations, and federal government regulations or orders concerning the operation, maintenance, and licensing of facilities.

Financial Statement Presentation - The Fund made presentation changes to the Statements of Net Position, Statements of Revenues, Expenses, and Changes in Net Position, and Statements of Cash Flows to better correlate with the City of Seattle's Comprehensive Annual Financial Report ("CAFR"). The prior year balances did not change and had no overall effect on the total change in net position.

Note 2 - Cash and Investments

Custodial Credit Risk - Deposits - As of December 31, 2012 and 2011, the City's pool contained cash on deposit with the City's custodial banks in the amounts of \$18,082,491 and \$19,666,051, respectively. The deposits in excess of \$250,000 in both 2012 and 2011 were uninsured and uncollateralized. As such, these deposits were exposed to custodial credit risk, which is the risk that the deposits may not be returned to the City in the event of a bank failure. The City attempts to minimize exposure to custodial credit risk for deposits by requiring the depository bank to have sufficient capital to support the activity of the City. In addition, banks having a deposit relationship with the City are required to provide financial statements for the City's use in reviewing the bank's financial condition.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 2 - Cash and Investments (Continued)

All deposits not covered by FDIC insurance are under the regulation of the Washington State Public Deposit Protection Commission (the "Commission") established in RCW 39.58 for public depository financial institutions. The Commission requires a pledge agreement and a trustee for each public depository financial institution. The trustee ensures eligible collateral defined as securities and designated for the benefit of public depositors, as described in RCW 39.58.050 (5) and (6), are segregated from all other assets. Eligible collateral is utilized by the trustee when the Commission has determined a loss, net of deposit insurance, has been incurred by a public depository financial institution.

Investments - As of December 31, the City's pooled investments were as follows:

	2012		2011	
	City Pool	Weighted Average Maturity (Days)	City Pool	Weighted Average Maturity (Days)
U.S. Government Agencies	\$ 803,856,889	851	\$ 991,128,738	974
State and Local Governments	182,163,719	549	105,403,511	513
Commercial Paper	176,955,311	40	77,494,937	10
Repurchase Agreements	162,390,595	2	66,785,435	3
U.S. Government Obligations	67,448,440	482	37,993,718	816
Total	\$ 1,392,814,954		\$ 1,278,806,339	
Portfolio Weighted Average Maturity		592		823

As of December 31, the Fund's share of the City pool was as follows:

	2012	2011
Operating cash and equity in pooled investments	\$ 60,207,512	\$ 29,121,787
Restricted cash and equity in pooled investments	100,442,808	51,926,954
Total	\$ 160,650,320	\$ 81,048,741
Balance as a percentage of City pool cash and investments	11.5%	6.3%

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 2 - Cash and Investments (Continued)

Interest Rate Risk - Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. In general, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The City manages this risk by limiting the average maturity of investments to five years. However, the Fund's investments are selected for greater liquidity in order to support the Fund's cash flow needs and therefore typically have much shorter average maturities.

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In accordance with the City's investment policy, investments in commercial paper purchased on the secondary market are limited to those with maturities not longer than 180 days from purchase and with the highest rating by at least two nationally recognized statistical rating organizations ("NRSROs"). As of December 31, 2012 and 2011, the City's investments in commercial paper were rated P-1 by Moody's Investors Service and A-1 or A-1+ by Standard & Poor's Rating Service.

The City also purchases obligations of government-sponsored enterprises which are eligible as collateral for advances to member banks as determined by the Board of Governors of the Federal Reserve System. These include, but are not limited to, debt securities of Federal Home Loan Bank, Federal National Mortgage Association, Wells Fargo, and Federal Home Loan Mortgage Corporation. As of December 31, 2012, these investments were rated Aaa, and Aa1 by Moody's Investors Service and AAA and AA+ by Standard & Poor's Rating Service. As of December 31, 2011, these investments were rated Aaa and P-1 by Moody's Investors Service and AAA, AA+, and AA by Standard & Poor's Rating Service.

Concentration of Credit Risk - The City's investment policy limits concentration of credit risk for the City's investments as a whole, inclusive of the Fund's investments. These policy limits vary for each investment category. The City's investments in which five percent or more is invested in any single issuer, as of December 31, are as follows:

Issuer	2012		2011	
	Fair Value	Percent of Total Investments	Fair Value	Percent of Total Investments
Federal Home Loan Bank	\$ 258,633,251	19%	\$ 194,321,359	15%
Federal National Mortgage Association	\$ 243,725,925	18%	\$ 317,039,812	25%
Wells Fargo	\$ 162,390,595	12%	\$ 66,785,435	5%
Federal Home Loan Mortgage Corp	\$ 126,065,840	9%	\$ 395,358,375	31%
Freddie Mac Multifamily Securities	\$ 80,726,450	6%	\$ -	0%
United States Government	\$ 67,448,440	5%	\$ 37,993,718	3%
Washington State	\$ 33,378,424	2%	\$ 68,388,721	5%
Federal Farm Credit Bank	\$ 17,015,980	1%	\$ 83,708,078	7%

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
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NOTES TO FINANCIAL STATEMENTS
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Note 3 - Capital Assets

Capital asset activity consisted of the following for the year ended December 31, 2012:

	Beginning Balance	Additions and Transfers In	Retirements and Transfers Out	Ending Balance
Buildings	\$ 14,099,729	\$ (6,846)	\$ -	\$ 14,092,883
Structures	150,321,057	6,397,104	-	156,718,161
Machinery and equipment	618,945,605	21,646,212	(128,772)	640,463,045
Computer systems	48,542,129	1,412,002	-	49,954,131
Total capital assets, excluding land	831,908,520	29,448,472	(128,772)	861,228,220
Less accumulated depreciation	(246,247,104)	(19,688,681)	128,772	(265,807,013)
	585,661,416	9,759,791	-	595,421,207
Construction in progress	62,822,427	61,887,286	(41,485,608)	83,224,105
Land and land rights	14,279,516	5,303,568	-	19,583,084
Other property	670,959	231,885	-	902,844
Capital assets, net	<u>\$ 663,434,318</u>	<u>\$ 77,182,530</u>	<u>\$ (41,485,608)</u>	<u>\$ 699,131,240</u>

Capital asset activity consisted of the following for the year ended December 31, 2011:

	Beginning Balance	Additions and Transfers In	Retirements and Transfers Out	Ending Balance
Buildings	\$ 14,071,027	\$ 28,702	\$ -	\$ 14,099,729
Structures	133,693,948	16,627,109	-	150,321,057
Machinery and equipment	582,471,588	36,852,622	(378,605)	618,945,605
Computer systems	46,641,633	2,555,206	(654,710)	48,542,129
Total capital assets, excluding land	776,878,196	56,063,639	(1,033,315)	831,908,520
Less accumulated depreciation	(228,848,784)	(18,332,131)	933,811	(246,247,104)
	548,029,412	37,731,508	(99,504)	585,661,416
Construction in progress	65,071,758	57,742,377	(59,991,708)	62,822,427
Land and land rights	14,279,516	-	-	14,279,516
Other property	662,238	8,721	-	670,959
Capital assets, net	<u>\$ 628,042,924</u>	<u>\$ 95,482,606</u>	<u>\$ (60,091,212)</u>	<u>\$ 663,434,318</u>

During 2012 and 2011, the Fund capitalized interest costs relating to construction of \$3,335,599 and \$3,043,269, respectively.

**SEATTLE PUBLIC UTILITIES -
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Note 4 - Revenue Bonds

The Fund issues bonds to provide financing for capital improvements. Payment of debt service on the bonds is derived solely from the revenues generated by the Fund. The Fund has \$14,737,040 in a debt service reserve fund and has obtained reserve insurance policies to meet the remainder of its reserve requirements. The total bonds outstanding as of December 31, 2012 and 2011 were \$540,495,000 and \$486,610,000, respectively.

Revenue bonds outstanding as of December 31, 2012 and 2011 consisted of the following Municipal Drainage and Wastewater bonds:

<u>Name of Issue</u>	<u>Issuance Date</u>	<u>Maturity Years</u>	<u>Interest Rates</u>	<u>Original Issue Amount</u>	<u>Bonds Outstanding, 2012</u>	<u>Bonds Outstanding, 2011</u>
2001 parity bonds	7/3/01	2002-2031	4.25-5.25%	\$ 60,680,000	\$ -	\$ 48,880,000
2002 parity refunding bonds	12/17/02	2003-2032	3.0-5.25%	78,550,000	-	62,675,000
2004 parity bonds	10/28/04	2005-2034	2.25-5.125%	62,010,000	10,260,000	54,140,000
2006 parity refunding bonds	11/1/06	2007-2037	4.0-5.0%	121,765,000	104,205,000	108,100,000
2008 parity bonds	4/16/08	2009-2038	4.0-5.0%	84,645,000	78,935,000	80,450,000
2009A parity bonds	12/17/09	2017-2039	4.2-5.5%	102,535,000	102,535,000	102,535,000
2009B parity revenue bonds	12/17/09	2010-2027	2.0-4.0%	36,680,000	26,585,000	29,830,000
2012 parity refunding bonds	6/27/12	2012-2042	2.0-5.0%	222,090,000	217,975,000	-
				<u>\$ 768,955,000</u>	<u>\$ 540,495,000</u>	<u>\$ 486,610,000</u>

Minimum debt service requirements to maturity on revenue bonds are as follows:

<u>Years Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 15,215,000	\$ 25,837,203	\$ 41,052,203
2014	15,825,000	25,282,453	41,107,453
2015	16,415,000	24,619,803	41,034,803
2016	17,220,000	23,898,828	41,118,828
2017	18,070,000	23,123,578	41,193,578
2018 - 2022	100,670,000	101,742,648	202,412,648
2023 - 2027	111,550,000	76,203,716	187,753,716
2028 - 2032	113,995,000	47,587,050	161,582,050
2033 - 2037	90,210,000	21,795,882	112,005,882
2038 - 2042	41,325,000	4,074,455	45,399,455
	<u>\$ 540,495,000</u>	<u>\$ 374,165,616</u>	<u>\$ 914,660,616</u>

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 4 - Revenue Bonds (Continued)

The following table shows the revenue bond activity during the year ended December 31, 2012:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable					
Revenue bonds	\$ 486,610,000	\$ 222,090,000	\$ (168,205,000)	\$ 540,495,000	\$ 15,215,000
Add (deduct) deferred amounts:					
Issuance premiums	9,633,210	33,796,457	(3,549,804)	39,879,863	-
Issuance discounts	(1,077,502)	-	459,731	(617,771)	-
Loss on refunding	(4,151,939)	(4,138,094)	815,632	(7,474,401)	-
Total bonds payable	<u>\$ 491,013,769</u>	<u>\$ 251,748,363</u>	<u>\$ (170,479,441)</u>	<u>\$ 572,282,691</u>	<u>\$ 15,215,000</u>

The following table shows the revenue bond activity during the year ended December 31, 2011:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable					
Revenue bonds	\$ 499,785,000	\$ -	\$ (13,175,000)	\$ 486,610,000	\$ 13,695,000
Add (deduct) deferred amounts:					
Issuance premiums	10,055,705	-	(422,495)	9,633,210	-
Issuance discounts	(1,123,061)	-	45,559	(1,077,502)	-
Loss on refunding	(4,425,742)	-	273,803	(4,151,939)	-
Total bonds payable	<u>\$ 504,291,902</u>	<u>\$ -</u>	<u>\$ (13,278,133)</u>	<u>\$ 491,013,769</u>	<u>\$ 13,695,000</u>

Defeasance of Debt - The Fund defeases certain obligations by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. As a result, the old bonds are considered defeased, and the corresponding liabilities and trust account assets are not included in the Statement of Net Position. In 2012, \$151,860,000 bonds were defeased of which \$109,320,000 were redeemed, as shown below:

	Amount Outstanding at December 31, 2011	Additions	Redemptions	Amount Outstanding at December 31, 2012
Bonds issued				
2001 Parity	\$ -	\$ 48,880,000	\$ (48,880,000)	\$ -
2002 Parity				
Refunding	-	60,440,000	(60,440,000)	-
2004 Parity	-	42,540,000	-	42,540,000
	<u>\$ -</u>	<u>\$ 151,860,000</u>	<u>\$ (109,320,000)</u>	<u>\$ 42,540,000</u>

**SEATTLE PUBLIC UTILITIES -
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(An Enterprise Fund of the City of Seattle)
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Note 4 - Revenue Bonds (Continued)

In June 2012, the Fund issued \$222,090,000 of Drainage and Wastewater Improvement and Refunding Revenue Bonds with varying annual principal payments due beginning 2012 and ending in 2042, at interest rates ranging from 2.0 percent and 5.0 percent. A portion of the proceeds were used to fully refund 2001 and 2002 bonds and partially refund 2004 bonds. As a result of the refunding, the Fund reduced total debt service requirements by \$32.3 million resulting in an economic gain (difference between the present value of the debt service payments on the old and new debts) of \$24.3 million.

Debt Service Coverage - The revenue bonds contain certain financial covenants, the most significant of which requires the Fund to maintain net revenue available for debt service of at least equal to 125% of average annual debt service. For 2012, net revenue available for debt service, as defined by the bond covenants, was 342% of average annual debt service. For 2011, net revenue available for debt service, as defined by the bond covenants, was 280% of average annual debt service.

Net revenue available for debt service for the years ended December 31, is determined as follows:

	<u>2012</u>	<u>2011</u>
Net operating income	\$ 45,483,437	\$ 25,885,634
Add:		
City taxes	35,374,947	32,448,908
Depreciation and amortization	21,156,763	19,832,129
Investment income	3,269,810	2,820,139
Claims expense	<u>(875,251)</u>	<u>1,515,945</u>
Adjusted net revenue available for debt service	<u>\$ 104,409,706</u>	<u>\$ 82,502,755</u>
Debt service requirement	\$ 30,488,687	\$ 29,507,563
Coverage	342%	280%

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 5 - Leases

The Fund has non-cancelable operating lease commitments for real and personal property, with payments of \$110,248 and \$108,115 in 2012 and 2011, respectively. Rents are paid as they become due and payable. Minimum lease payments under the leases as of December 31, 2012 are as follows:

2013	\$	69,707
2014		59,568
2015		61,611
2016		52,760
		<hr/>
	\$	<u>243,646</u>

Note 6 - Retirement and Other Postemployment Benefit Plans

Pension Costs - All permanent Fund employees are eligible to participate in the Seattle City Employees' Retirement System (the "System"), a cost-sharing public employee retirement system operated by the City. Benefits vest after five years of covered service. City employees may retire after 30 years of service regardless of age; after age 52, with 20 or more years of service; after age 57, with 10 or more years of service, and after age 62, with five or more years of service. The System also provides death and disability benefits. These benefit provisions and all other requirements are established by City ordinances.

City employees are required to contribute 10.03% of their annual base salaries to the System. The City's contribution rate increased to 11.01% for 2012 from 9.03% in 2011. Employer rates are established by the City Council on a biannual basis. The Fund's contributions to the System for the years ended December 31, 2012, 2011 and 2010, were \$4,323,607, \$3,465,961, and \$2,910,580, respectively. The Fund's contribution in 2012 represents its full liability to the System.

The System issues stand-alone financial statements, which may be obtained by writing to the Seattle City Employees' Retirement System, 720 Third Avenue, Suite 900, Seattle, Washington, 98104, telephone: (206) 386-1293, or www.seattle.gov/retirement/annual_report.htm.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 6 - Retirement and Other Postemployment Benefit Plans (Continued)

Employer contributions for the City are as follows (dollars in millions):

Year Ended December 31,	City Required Contribution	City Actual Contribution	Percentage Contributed
2010	\$ 45.2	\$ 45.2	100%
2011	\$ 50.2	\$ 50.2	100%
2012	\$ 62.4	\$ 62.4	100%

Actuarial data and assumptions

Valuation date	January 1, 2012
Actuarial cost method	Entry age
Amortization method	Level percent
Remaining amortization period	30 years, open
Asset valuation method	5-Year Smoothing Method
Investment rate of return	7.75%
Projected general wage inflation	4.0%
Postretirement benefit increases	1.5%

Schedules of funding progress are as follows (dollars in millions):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liabilities (AAL) Entry Age ¹ (b)	Unfunded AAL (UAAL) ² (b-a)	Funded Ratio (a/b)	Covered Payroll ³ (c)	UAAL as a % of Covered Payroll ((b-a)/c)
January 1, 2010	\$ 1,645.3	\$ 2,653.8	\$ 1,008.5	62.0%	\$ 580.9	173.6%
January 1, 2011	\$ 2,013.7	\$ 2,709.0	\$ 695.4	74.3%	\$ 563.2	123.5%
January 1, 2012	\$ 1,954.3	\$ 2,859.3	\$ 905.0	68.3%	\$ 557.0	162.5%

- 1 Actuarial present value of benefits less actuarial present value of future normal costs based on entry age actuarial cost method.
- 2 Actuarial accrued liabilities less actuarial value of assets.
- 3 Covered payroll includes compensation paid to all active employees on which contributions are calculated.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 6 - Retirement and Other Postemployment Benefit Plans (Continued)

Deferred Compensation - The City offers all of its employees a deferred compensation plan (the "Plan") created in accordance with Internal Revenue Code ("IRC") Section 457. The Plan permits employees to defer a portion of their salaries until future years. The deferred compensation is paid to employees upon termination, retirement, death, or unforeseen emergency.

The Plan is an eligible deferred compensation plan under Section 457 of the IRC of 1986, as amended, and a trust exempt from tax under IRC Sections 457(g) and 501(a). The Plan is operated for the exclusive benefit of participants and their beneficiaries. No part of the corpus or income of the Plan shall revert to the City or be used for, or diverted to, purposes other than the exclusive benefit of participants and their beneficiaries. The Plan is not reported in the financial statements of the City or the Fund.

It is the opinion of the City's legal counsel that the City has no liability for investment losses under the Plan. Under the Plan, participants select investments from alternatives offered by the Plan Administrator, who is under contract with the City to manage the Plan. Investment selection by a participant may be changed from time to time. The City does not manage any of the investment selections. By making the selection, participants accept and assume all risks inherent in the Plan and its administration.

Other Postemployment Benefits - Health care plans for active and retired employees are administered by the City as single-employer defined benefit public employee health care plans.

Eligible retirees (younger than age 65) may contribute to the medical plan and any additional health care programs contemplated or amended by ordinance of the Seattle City Council and as provided in Seattle Municipal Code 4.50.020.

The Seattle City Council authorizes the obligations of the plan members and the City as employer by passing ordinances and amendments regarding contributions to the plans. Eligible retirees self-pay 100% of the premiums based on blended rates which were established by including the experience of retirees with the experience of active employees for underwriting purposes. The plan is financed on a pay-as-you-go basis, and the City was required to contribute \$2.4 million in 2012 and \$3.9 million in 2011.

**SEATTLE PUBLIC UTILITIES -
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 6 - Retirement and Other Postemployment Benefit Plans (Continued)

The table below summarizes the City's annual cost, expected contributions to the plan, and changes in the net OPEB obligation for fiscal year ended December 31, 2012 and 2011. These calculations are based on the most recent actuarial valuation data available, dated January 1, 2012. The Fund has accrued \$1,943,931 to the plan as of December 31, 2012, as a reasonable estimate of expected contributions.

	2012	2011
Annual required contribution	\$ 8,064,000	\$ 11,286,000
Interest on net OPEB obligation	1,340,000	1,212,000
Adjustment to annual required contribution	<u>(1,969,000)</u>	<u>(1,673,000)</u>
Annual OPEB cost (expense)	7,435,000	10,825,000
Expected contribution (employer-paid benefits)	<u>(2,441,000)</u>	<u>(3,889,000)</u>
Increase in net OPEB obligation	4,994,000	6,936,000
Net OPEB obligation, beginning of year	<u>34,548,000</u>	<u>27,612,000</u>
Net OPEB obligation, end of year	<u><u>\$ 39,542,000</u></u>	<u><u>\$ 34,548,000</u></u>
Fund's allocated share of city liability	<u><u>\$ 1,943,931</u></u>	<u><u>\$ 1,894,828</u></u>

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially-determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Actuarial calculations are based on the types of benefits provided under the terms of the plan and on the pattern of shared costs between the employer and plan members, at the time of each valuation. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future. Actuarial calculations reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

**SEATTLE PUBLIC UTILITIES -
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NOTES TO FINANCIAL STATEMENTS
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Note 6 - Retirement and Other Postemployment Benefit Plans (Continued)

Significant methods and assumptions are as follows:

Actuarial data and assumptions

Valuation date	January 1, 2012
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	30 years, open
Discount rate	3.88%
Health care cost trend rates - medical	Traditional and Preventive Plans: 9.0%, decreasing by 0.5% for each year for 4 years Group Health Standard and Deductible Plans: 8.5%, decreasing by 0.5% for each year for 7 years
Participation	40% of Active Employees who retire participate.
Mortality	General Service Actives based on the RP-2000 Employees Tables for Males and Females, with ages set back three years and General Service Retirees based on the RP-2000 Combined Healthy Males and Females, with ages set back one year.
Marital status	60% of members electing coverage are assumed to be married or to have a registered domestic partner. Male spouses two years older than their female spouses.
Morbidity factors	Morbidity rate ranges for ages 50 through 64: 87.09% to 172.99% for retirees, and 101.19% to 172.99% for spouses. Retirees' spouses pay a lower premium than retirees.
Other considerations	Active employees with current spousal and/or dependent coverage are assumed to elect same plan and coverage after retirement.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
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Note 6 - Retirement and Other Postemployment Benefit Plans (Continued)

Schedules of funding progress are as follows (dollars in millions):

Actuarial Valuation Date	Actuarial Value of Assets (a)	AAL Entry Age (b)	UAAL (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percent of Covered Payroll ((b-a)/c)
January 1, 2010	\$ -	\$ 93.5	\$ 93.5	0.0%	\$ 869.1	10.8%
January 1, 2011	\$ -	\$ 99.4	\$ 99.4	0.0%	\$ 866.2	11.5%
January 1, 2012	\$ -	\$ 74.7	\$ 74.7	0.0%	NA	NA

The Health Care Subfund of the General Fund is reported in the City's Comprehensive Annual Financial Report which can be obtained by writing the Department of Finance, City of Seattle, PO Box 94747, Seattle, WA 98124-4747 or www.seattle.gov/cafrs/.

Note 7 - Claims Payable

The City and the Fund are self-insured for certain losses arising from personal and property damage claims by third parties and for casualty losses to the Fund's property. Liabilities for identified claims and claims incurred but not reported have been recorded by the Fund.

For 2012 and 2011, liabilities for workers' compensation claims, as well as other claims, are discounted over a 15-year period at the City's rate of return on investments, 0.784% and 0.824%, respectively. Claims expected to be paid within one year were \$2,458,707 and \$3,459,286 as of December 31, 2012 and 2011, respectively. The schedules below present the changes in the liability for workers' compensation claims and other claims (risk financing liabilities) as of December 31:

	2012	2011
Beginning liability, undiscounted	\$ 12,605,951	\$ 13,011,297
Payments	(1,092,510)	(1,827,970)
Incurred claims and change in estimate	(878,746)	1,422,624
Ending liability, undiscounted	<u>\$ 10,634,695</u>	<u>\$ 12,605,951</u>
Ending liability, discounted (recorded balance at December 31)	<u>\$ 10,322,048</u>	<u>\$ 12,289,809</u>

The Fund is involved in litigation from time to time as a result of operations.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 8 - Compensated Absences

The Fund has recorded a liability for earned but unused holiday, compensatory, merit, and vacation leave, as well as estimated sick leave payments calculated based on the termination payment method. The schedules below show the compensated absences activity during the years ended December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Beginning liability	\$ 4,424,954	\$ 4,282,579
Additions	2,949,988	3,475,788
Reductions	<u>(2,974,854)</u>	<u>(3,333,413)</u>
Ending liability	<u>\$ 4,400,088</u>	<u>\$ 4,424,954</u>

Note 9 - Environmental Liabilities

Following is a brief description of the significant sites that require environmental remediation:

Duwamish Sites - The U.S. Environmental Protection Agency (“EPA”) has indicated that it will require the clean-up and remediation of certain Duwamish sites under its Superfund authority. No specific requirements for remediation by potentially responsible parties (“PRPs”) have been decided by the EPA as of the date of this report, except related to specific “early action sites” which are or have been under Administrative Orders on Consent (“AOC”). In order to manage the liability, the City has worked with the EPA and other PRPs on a Remedial Investigation (“RI”) and Feasibility Study (“FS”) to evaluate the risk to human health and the environment within the six mile superfund area, identify the possible early action clean-up sites, and generally evaluate the feasibility of clean-up options for use in the ultimate remedial actions that the EPA will require. The RI and FS are complete. On November 2, 2012, the EPA and Ecology approved the Lower Duwamish Waterway Group’s FS which provides sufficient information to support selection of a remedy for this Site. The regulators recommended an option and the fund recorded an estimate of its share of the estimated total cost. The EPA announced their proposed cleanup plan in February 2013 for public comment. EPA is expected to issue a Record of Decision in 2014.

The Fund, together with other PRPs, has voluntarily agreed to initiate clean-up of two early action sites identified during the RI under EPA issued AOC: Slip 4 and T-117.

**SEATTLE PUBLIC UTILITIES -
DRAINAGE AND WASTEWATER FUND
(An Enterprise Fund of the City of Seattle)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011**

Note 9 - Environmental Liabilities (Continued)

East Waterway Site - In 2006 the EPA issued an AOC for a Supplemental RI and FS for the East Waterway, an operable unit of the Harbor Island Superfund Site. Subsequent to an agreement between the EPA, the Port of Seattle ("Port"), King County and the City, the Port alone signed the order. Both the City and King County signed a Memorandum of Agreement with the Port to participate as cost share partners in the work required by the EPA. No specific requirements for remediation by PRPs have been made by the EPA as of the date of this report. The RI and FS are anticipated to be completed by 2014.

Gas Works Park Sediment Site - In April 2002, the Department of Ecology ("DOE") named the City and another party, Puget Sound Energy, as PRPs for contamination at the Gas Works Sediments Site in North Lake Union. The City and Puget Sound Energy signed an Agreed Order with the DOE in 2005 to initiate two RIs and FSs for the sediment site - one in the western portion of the site led by the City, and another in the eastern portion of the site led by Puget Sound Energy. Subsequently, in fall of 2012, the City and Puget Sound Energy entered into a Settlement, Release, and Cost Allocation Agreement that puts Puget Sound Energy in the lead for all additional cleanup work at the site; the east-west split is no longer in place. Based on the 2012 Agreement, the City pays for 20% of the Shared Costs incurred by Puget Sound Energy for the cleanup work. The RI and FS include an evaluation of the nature and extent of contamination on the site, an evaluation of multiple alternatives for remediating the sediments and a recommended preferred alternative. Recently the EPA has begun in-depth discussions with DOE and Puget Sound Energy is collecting additional site data. As a result, a Clean-up Action Plan is expected from the Department of Ecology in about 2016.

North Boeing Field/Georgetown Steam Plant - The City, King County and Boeing have signed an Administrative Order with the DOE requiring them to investigate and possibly remove contamination in an area that encompasses North Boeing Field, the Georgetown Steam Plant, and the King County Airport.

7th Avenue South Pump Station - The City acquired land in the South Park area of Seattle to construct the 7th Ave South Pump Station. The land was determined to be contaminated subsequent to the purchase. The Fund has voluntarily agreed to clean up the contamination in order to continue with the planned construction of the pump station. The cleanup was completed in 2012.

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Note 9 - Environmental Liabilities (Continued)

The Fund has included in its estimated liability those portions of the environmental remediation work that are currently deemed to be reasonably estimable. Cost estimates were developed using the expected cash flow technique in accordance with GASB 49. Estimated outlays were based on current cost and no adjustments were made for discounting or inflation. Cost scenarios were developed for a given site based on data available at the time of estimation and will be adjusted for changes in circumstance. Scenarios consider the relevant potential requirements and are adjusted when benchmarks are met or when new information revises estimated outlays, such as changes in the remediation plan or operating conditions. Costs were calculated on a weighted average that was based on the probabilities of each scenario being selected and reflected cost-sharing agreements in effect. In addition, certain estimates were derived from independent engineers and consultants. The estimates were made with the latest information available; however, as new information becomes available, estimates may vary significantly due to price fluctuations, technological advances, or applicable laws or regulations.

The Fund is aggressively pursuing other third parties that may have contributed to the contamination of the sites noted. The Fund's estimate for not yet realized recoveries from other parties for their share of remediation work that offset the Fund's estimated environmental liability was \$4.9 million and \$6.3 million, as of December 31, 2012 and 2011, respectively. During 2012, the Fund received an environmental cost recovery of \$1.6 million from Seattle City Light related to the Duwamish and East Waterway Sites. No cost recovery funds were received in 2011.

The following changes in the provision for environmental liabilities at December 31 are:

	<u>2012</u>	<u>2011</u>
Beginning environmental liability, net of recovery	\$ 8,555,825	\$ 10,599,933
Payments or amortization	(2,617,893)	(2,848,308)
Incurred environmental liability	<u>55,597,177</u>	<u>804,200</u>
Ending environmental liability, net of recovery	<u><u>\$ 61,535,109</u></u>	<u><u>\$ 8,555,825</u></u>

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Note 9 - Environmental Liabilities (Continued)

The provision for environmental liabilities included in current and non-current liabilities at December 31 are:

	<u>2012</u>	<u>2011</u>
Environmental liability, current	\$ 1,679,343	\$ 2,263,979
Environmental liability, noncurrent	<u>59,855,766</u>	<u>6,291,846</u>
Ending liability	<u>\$ 61,535,109</u>	<u>\$ 8,555,825</u>

Note 10 - Loans

The Fund has various construction projects that are financed by low interest loans issued by the State of Washington. The loan agreements require that the Fund finance a portion of these projects from other sources. These loans have been used to enhance the drainage system. The fund also financed the purchase of land with a small loan in the amount of \$161,000 from a private party.

In 2011, the Fund was approved for a public works trust fund loan of \$4,000,000 from the Washington State Department of Commerce for construction and site improvements in the Midvale area of Seattle. As of December 31, 2012, \$3,574,418 has been borrowed under this agreement at 0.5% per annum to be repaid by June 2032. More draw downs are expected in 2013.

In addition, the Fund made an additional draw of \$457,364 in 2011 on a clean water state revolving fund loan from the Washington State Department of Ecology for Ballard rain garden project. This loan is funded with resources from the American Recovery and Reinvestment Act of 2009 ("ARRA"), which provides a 50% forgivable provision. As of December 31, 2012, the fund borrowed \$1,191,254, with accrued interest, of which \$588,045 is forgivable.

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DECEMBER 31, 2012 AND 2011**

Note 10 - Loans (Continued)

Loans outstanding as of December 31, 2012 and 2011 are as follows:

Description	Maturity Years	Interest Rate	Amount Borrowed	Loans Outstanding 2012	Loans Outstanding 2011
Private Loan	1999-2013	7.0%	\$ 161,100	\$ 10,276	\$ 26,134
Midvale	2013-2032	0.5%	3,574,418	3,574,418	3,574,418
Thornton Creek Natural Drainage Systems	2006-2024	0.5%	3,700,000	2,350,588	2,546,471
High Point Natural Drainage Systems	2010-2029	1.5%	2,679,413	2,299,445	2,421,364
South Park Flood Control and Local Drainage Program	2007-2025	0.5%	3,400,000	2,562,596	2,759,719
Ballard Green Streets ARRA Project	2011-2020	2.9%	603,209	516,059	572,558
Thornton Creek Water Quality Project	2011-2030	1.5%	6,983,021	6,380,606	6,697,098
			<u>\$ 21,101,161</u>	<u>\$ 17,693,988</u>	<u>\$ 18,597,762</u>

Minimum debt service requirements to maturity on long term loans are as follows:

Years Ending December 31,	Principal	Interest	Total
2013	\$ 1,085,194	\$ 186,014	\$ 1,271,208
2014	1,083,349	174,724	1,258,073
2015	1,091,932	163,283	1,255,215
2016	1,100,669	151,687	1,252,356
2017	1,109,564	139,933	1,249,497
2018-2022	5,538,190	520,829	6,059,019
2023-2027	4,541,040	250,159	4,791,199
2028-2032	2,144,050	39,995	2,184,045
	<u>\$ 17,693,988</u>	<u>\$ 1,626,624</u>	<u>\$ 19,320,612</u>

The following table shows the loan activity during the years ended December 31:

	2012	2011
Net loans, beginning of year	\$ 18,597,762	\$ 15,624,004
Loan proceeds	-	3,818,263
Principal payments	(903,774)	(844,505)
Net loans, end of year	<u>\$ 17,693,988</u>	<u>\$ 18,597,762</u>
Loans due within one year	<u>\$ 1,085,194</u>	<u>\$ 903,774</u>
Loans, noncurrent	<u>\$ 16,608,794</u>	<u>\$ 17,693,988</u>

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Note 11 - Notes and Contracts Receivable

The Fund has an agreement with the Seattle Housing Authority for the recovery of the remaining unreimbursed cost of the Fund's contributions of public infrastructure to the New Holly redevelopment project. As of December 31, 2012, the Seattle Housing Authority receivable was \$1,298,008.

In April 2011, the Fund entered into an agreement with private individuals for a sewer connection charge contract. The receivable was \$8,316 at year end 2012.

Notes and contracts receivable are composed of the following as of December 31:

	<u>2012</u>	<u>2011</u>
Seattle Housing Authority receivable	\$ 1,298,008	\$ 1,341,705
Dalcerro receivable	8,316	9,309
Total notes and contracts receivable	<u>1,306,324</u>	<u>1,351,014</u>
Due within one year	<u>(46,815)</u>	<u>(44,690)</u>
Total non-current notes and contracts receivable	<u><u>\$ 1,259,509</u></u>	<u><u>\$ 1,306,324</u></u>

Note 12 - Wastewater Disposal Agreement

The Fund has a wastewater disposal agreement with the King County Department of Natural Resources Wastewater Treatment Division (the "Division"), which expires in 2036. The monthly wastewater disposal charge paid to the Division is based on the Division's budgeted cost for providing the service. The charges are determined by water consumption and the number of single-family residences as reported by SPU and other component agencies. Payments made by the Fund were \$124,513,897 and \$123,702,566 for fiscal years 2012 and 2011, respectively.

SUPPLEMENTAL INFORMATION

**SEATTLE PUBLIC UTILITIES -
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SUPPLEMENTAL INFORMATION**

Statistics Required for Revenue Bond Continuing Disclosure

Wastewater System Operating Statistics

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Population Served	592,800	602,000	612,000	612,100	616,500
Billed Wastewater Revenues	\$ 163,418	\$ 184,332	\$ 185,237	\$ 202,885	\$ 220,059
Billed Wastewater Volume (MG)					
Residential	6,235	6,239	6,165	5,539	5,764
Commercial	10,230	10,076	9,896	10,065	10,414
Total	<u>16,465</u>	<u>16,315</u>	<u>16,061</u>	<u>15,604</u>	<u>16,178</u>
Gallons Used per Day per Capita	76.1	74.3	71.9	69.8	71.9

Drainage and Wastewater - 2012 Accounts and Billed Revenues

	<u>Drainage</u>	<u>Wastewater</u>
Customer Accounts		
Residential	136,860	152,872
Commercial	<u>75,857</u>	<u>19,660</u>
Total	<u><u>212,717</u></u>	<u><u>172,532</u></u>
Billed Revenue		
Residential	\$ 36,590,424	\$ 80,724,147
Commercial	<u>39,837,801</u>	<u>139,335,326</u>
Total	<u><u>\$ 76,428,225</u></u>	<u><u>\$ 220,059,473</u></u>

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Major Wastewater Customers - 2012 Annual Billed Revenues and Volumes

<u>Name</u>	<u>Revenue</u>	<u>Volume</u>
University of Washington	\$ 6,322,126	665,255
Seattle Housing Authority	\$ 3,015,672	285,384
City of Seattle	\$ 1,778,216	197,721
King County	\$ 1,335,031	125,204
Port of Seattle	\$ 1,065,051	148,372
Darigold	\$ 991,680	77,224
Swedish Medical Center	\$ 820,573	87,440
Harborview Medical Center	\$ 814,359	82,835
Virginia Mason	\$ 809,756	76,150
Seattle Public Schools	\$ 745,122	77,858

Major Drainage Customers - 2012 Annual Billed Revenues and Acreage

<u>Name</u>	<u>Revenue</u>	<u>Acres</u>
City of Seattle	\$ 4,936,578	5,060
Port of Seattle	\$ 3,093,379	998
Seattle Public Schools	\$ 1,476,045	684
King County	\$ 1,461,998	621
BNSF Rwy Co.	\$ 1,101,794	417
University of Washington	\$ 1,234,012	571
United States Government	\$ 658,862	300
Seattle Housing Authority	\$ 650,877	334
Union Pacific Railroad Co.	\$ 457,112	154
Seattle Community Colleges	\$ 257,350	158

**SEATTLE PUBLIC UTILITIES -
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Wastewater Rates

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
Volume rate per ccf	\$ 7.75	\$ 8.89	\$ 8.98	\$ 10.28	\$ 10.68	\$ 11.65

Note: 1 CCF equals 748 gallons. Wastewater rate increased 3.9% and 14.5% in 2012 and 2011, respectively.

Drainage Rates

Flat Rate per Parcel	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	% Impervious Space
Single Family Residential*						
< 3,000 sq. ft.	\$ 102.90	\$ 104.90	\$ 134.06	\$ 149.33	\$ 164.05	
3,000 - 4,999 sq. ft.	\$ 149.56	\$ 152.46	\$ 173.10	\$ 192.79	\$ 212.92	
5,000 - 6,999 sq. ft.	\$ 202.17	\$ 206.09	\$ 234.94	\$ 261.66	\$ 289.11	
7,000 - 9,999 sq. ft.	\$ 256.38	\$ 261.35	\$ 298.32	\$ 332.23	\$ 365.97	
Rate per 1,000 sq. ft.						
Undeveloped						0 - 15%
Regular	\$ 16.85	\$ 17.18	\$ 19.72	\$ 21.96	\$ 23.31	
Low Impact	\$ 10.19	\$ 10.39	\$ 12.35	\$ 13.76	\$ 13.65	
Light						16 - 35%
Regular	\$ 25.20	\$ 25.69	\$ 29.62	\$ 32.98	\$ 36.05	
Low Impact	\$ 18.98	\$ 19.35	\$ 23.47	\$ 24.14	\$ 28.35	
Medium						36 - 65%
Regular	\$ 36.61	\$ 37.32	\$ 42.89	\$ 47.76	\$ 52.35	
Low Impact	\$ 29.70	\$ 30.28	\$ 34.43	\$ 38.35	\$ 42.11	
High	\$ 47.34	\$ 48.26	\$ 56.57	\$ 63.01	\$ 70.23	66 - 85%
Very High	\$ 56.23	\$ 57.32	\$ 66.90	\$ 74.49	\$ 83.08	86 - 100%

* SFR parcels more than 10,000 sq. ft. are billed under the commercial rate structure.