

Water-Sewer District Audit Planning Guide



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Planning Guide Information

Supersedes previous planning guide dated June 20, 2018. Please direct questions or suggestions to the Water-Sewer District Subject Matter Experts.

Note: This guide is intended for use when auditing a water-sewer district. It may also be useful for auditing water-sewer departments of cities, counties, irrigation districts or PUDs, although some of the information may not apply, such as certain legal compliance requirements. See Appendix 1 for statutes applicable to cities and counties.

Guidance is based on the extensive research, brainstorming and reviews conducted as part of the [planning guide update process](#). Guidance is intended only for internal use to help auditors gain an understanding of water-sewer districts. The guide is intended to enhance planning and risk assessment procedures, not replace them. Information in the guide should therefore be considered along with other planning and risk assessment procedures. While guidance is designed to be as comprehensive as feasible, auditors must be alert for audit issues and situations not specifically addressed.

This guide is used by the State Auditor's Office staff as they plan audit engagements. Information presented in this document does not represent policy or legal guidance. State agencies and local governments should contact their legal counsels with specific questions.

WHAT'S NEW

Auditors should be aware of the following significant updates:

- [Systems development charges](#) – Clarification added that there is no universal operating/nonoperating classification of these revenues. Unless the classification is misleading or contradicts the district's policy/procedure, we would not consider it an error.
- [Public Records Act](#) – The Public Records Act (RCW 42.56.330(2)) has a **special exclusion of records or lists of a public utility** from public disclosure if those documents include the following information about its customers: address, phone number, electronic contact information, usage & billing information. Records obtained from the utility that include this information must be handled by the auditor as **Category 3 confidential information** in accordance with SAO "Security and Privacy Policy for Managing Data".
- [Franchise Fees](#) – Due to a recent court decision, counties may start charging for use of right-of-ways (ROW). If the county and utility cannot agree on an amount, the county may bar the utility from using its ROW and as a result, the district may not be able to legally access their infrastructure.
- [Excise Taxes](#) – There is pending litigation challenging cities' imposition of excise taxes on its water and sewer customers. As of the date of this planning guide, it is legally allowable for cities to charge excise taxes to its water and sewer utility customers.
- [Receiverships](#) – Courts can place failing public water systems in receiverships. The receiver assumes and operates the system, including collecting reasonable charges to recover costs for maintenance, operations and improvements necessary for public health and safety.
- [OPEB Liabilities](#) – A list of known water/sewer districts that participate in health care plans administered by Public Employees Benefit Board (PEBB) has been added.
- [Assessment Audits](#) – Appendix added for guidance on performing assessment audits on small water-sewer districts.
- [COVID-19 Impacts](#) – Appendix added on the impacts of the Governor's Proclamation Orders in regards to policies, customer support programs, deferral of late fees and prohibition of shut-off of services.
- [Water-Sewer District Terms](#) – Appendix added on terms and definitions common to water-sewer districts.

REQUIRED RISKS TO ASSESS

The following risks must be documented as red flags and discussed during brainstorming to ensure sufficient consideration. They should be prioritized for audit to the extent they are applicable and significant to the entity.

EFT Controls

Payroll and vendor EFT cyber related frauds continue to exist. Accordingly, testing EFT controls is a required risk to assess for all entities we audit. The fraud has evolved to changing contact information prior to requesting a change to the existing EFT associated bank account numbers. Under the previous guidance, entities were encouraged to follow up with the contact information known at the time of the request for changes to the bank account information; which led them to the fraudster's contact information. A stronger control is to independently confirm any change to payroll or vendor profile contact information or banking account information. [A testing strategy is available in TeamMate at Accountability | Expenses | EFT Disbursements | Controls over EFTs.](#) Contact Team IT Audit at SAOITAudit@sao.wa.gov for additional clarification or guidance.

Financial Condition

Governments have experienced a wide range of negative economic and operational effects as a result of COVID-19. We would expect that most governments have and will need to cope with reduced and/or delayed revenues and increased expenses. However, these effects may vary widely by government and will depend on a number of factors, including the government's policy or program responses to the pandemic, the extent of any offsetting decreases in other expenses, state or federal relief funding, and the strength of its financial condition to start with. This risk should be assessed for both accountability and financial audits as part of regular planning steps, and especially as part of the risk assessment inquiry. If needed, [auditors may use the](#)

“Financial Condition” step available in TeamMate in the Accountability folder to further evaluate this risk.

Utilities, including water providers, also have been impacted by the governor’s proclamations on deferrals of late payments and prohibitions against shut-off of service, see [Appendix 3 – COVID 19 Impacts](#). As a result of the proclamation, we are aware that many utilities saw increases, sometimes significant, in past due customer accounts. While federal funds under the American Rescue Plan Act (ARPA) may be available to assist with overdue customer accounts, we are unsure at this time how many districts may receive this funding source. Auditors should inquire about the impacts of the COVID-19 pandemic and associated Governor’s proclamation on the financial health of the district. Specifically, audit staff should be alert for large increases in accounts more than 120 days past due, low cash balances and any indications of temporary debt instruments that may be obtained for operational needs. Further, audit staff are encouraged to ensure their analysis also considers current conditions as of the time the audit is conducted. If you are seeing financial condition concerns directly related to the impacts of COVID-19, please consult with the Water/Sewer Program Manager and your assigned Assistant Director. See also [Measurement of Financial Health](#).

Auditors should review [FYI 2020-01](#) COVID-19 Considerations for expected disclosures.

BACKGROUND

There are approximately 187 water and sewer districts¹ established under Title 57 RCW; most of these provide only water. The districts operate under a variety of names including: water district, sewer district, wastewater district, or utility district. All of the districts established under Title 57 RCW have the same statutory powers and requirements, which are to operate water, sewer, drainage, water reclamation, and street lighting systems.

Districts can vary considerably in size. Small districts may only have a single employee handling most functions which requires a higher level of monitoring by management or commissioners.

Industry and Other External Factors

Water and sewer districts are public utilities with a local monopoly of a basic service. Rates are set by the board of commissioners. RCW 57.08.081 requires district rates be sufficient to cover all costs necessary to operate the system and the board of commissioners to enforce collection of charges.

A significant business risk is the cost of repairing and replacing systems as they age. Districts should address this risk by following a replacement plan and adjusting their rates as needed. Districts may experience financial difficulty when:

- The customer base has significantly declined and is no longer large enough to operate and repair the existing infrastructure without exorbitant rates.
- Existing main lines are too small for current needs. The cost of main line repair and replacement can be higher than the initial investment if other infrastructure, such as roads, has subsequently been built on top of the lines.
- Privately-owned systems are acquired. Many small private systems have not invested in maintenance and cannot keep up with certification or regulatory requirements. The district usually must make substantial upgrades. Over time, the initial outlay is usually recovered from the customers of the system, through connection charges, a surcharge added to the monthly bill, or an ULID assessment. Districts may be able to reduce the costs to the customers through System Acquisition Grants through the State Department of Health.

Water availability is another potential business risk. Districts with little water capacity left in their systems must obtain new water rights, look for new ways to expand, or promote water conservation efforts. Some districts sell reclaimed water from their sewer systems for irrigation use.

¹ Based on the SAO’s review of the Washington Association of Sewer & Water Districts website, MRSC, and the SAO’s EIS system as of spring 2021.

(NEW) Franchise Fees

In December 2019, the Washington State Supreme Court reached a decision that ruled King County has the authority to charge a franchise fee (not a tax) to districts that use King County right-of-ways (ROW) to access utility infrastructure. This ruling overturned a lower court ruling. More information on this decision can be located on King County's website [here](#).

Based on the case, it is possible that other Counties may start charging for use of right-of-ways (ROW). These amounts could potentially be significant. If the county and utility cannot agree on an amount, the county may bar the utility from using its ROW and as a result, the district may not be able to legally access their infrastructure. Any questions from districts on the reasonableness of the amount charged by a County should be referred to the district's legal counsel, however, the district should maintain support for these payments.

(NEW) Excise Taxes

In June 2020, the Washington Supreme Court ruled that the City of Federal Way may lawfully impose a 7.75-percent excise tax on its water and sewer customers. In its decision, the Court sustained an earlier King County Superior Court ruling upholding the City's tax ordinance where the City has the authority to tax water and sewer utilities and that the tax is constitutional. The legality of the earlier King County Superior Court ruling was challenged jointly by the Lakehaven Water and Sewer District, Highline Water District and Midway Water District. The Lakehaven Water and Sewer District also challenged an excise tax ordinance adopted by the City of Edgewood. That challenge remained on hold in Pierce County Superior Court pending the decision in the Federal Way matter. Auditors should be aware that as of the date of this planning guide, it is legally allowable for cities to charge excise taxes to its water/sewer utility customers.

Receiverships

Over time, districts may dissolve entirely, merge with or be assumed by other governments or in some cases, enter what is called "receivership." The secretary of health or a local health officer can petition the court to place a failing public water system in receivership. The petition names a candidate(s) who agrees to assume operation of the water system. The Department of Health (DOH) recommends the court grant the receiver full authority to act in the best interests of the water system customers. This includes reporting recommendations for the system's future operation to the court. The court appoints the county where the water system is located if no other entity is willing, capable or able to act as receiver.

The receiver can't be held personally liable for any good faith, reasonable effort to assume and operate the system in compliance of court order. The receiver is authorized to collect reasonable charges on the water system customers to recover costs for maintenance, operations and improvements necessary for public health and safety. For more information, see RCW 43.70.195 on the statutory requirements for receiverships.

As one example of a current receivership, Pierce County was court-appointed as the receiver of the Kapowsin Water District (KWD) on November 29, 2017. Additional information on this receivership can be viewed [here](#).

Regulatory Environment

Water and sewer operations are highly regulated by Federal and State agencies, primarily the United States Environmental Protection Agency, Washington State Department of Health, and Washington State Department of Ecology. Among other things, these agencies regulate water rights, level of contaminants allowed in drinking water, discharge of wastewater, and certification and ongoing training of operators of water and sewer systems.

Each system has unique characteristics which will affect how they are impacted by new or tighter regulations and the extent to which they may be subject to fines. For example, one water district may be unaffected by changes in the levels of contaminants allowed while another may require a large investment in new treatment equipment.

In most cases, we would not expect any impact to accountability or financial statement audits. However, the auditor should be alert for any material or significant fines that should be reported in the financial statements or disclosed in the notes. The auditor should also consider whether there is any action against the district or

new regulations that significantly impact the district that should be disclosed in the notes to the financial statements.

Measurement of Financial Health

Due to their ability to set rates, unrestricted net position is the best measure of a district's financial health and net income is the best measure of performance. The district should have enough unrestricted net assets to be able to meet current obligations and also address future capital needs. The amount considered adequate will fluctuate with the size and unique needs of each district. Districts should plan and set rates high enough to have a positive net income in all years. See also [Required Risks to Assess](#).

PLANNING & ADMINISTRATION

The standard frequency for accountability and financial audits is described in Audit Policy 1210.

ALERT: The Public Records Act (RCW 42.56.330(2)) has a special exclusion of records or lists of a public utility from public disclosure if those documents include the following information about its customers:

- Addresses,
- Telephone numbers,
- Electronic contact information, and
- Customer-specific utility usage and billing information.

Records obtained from the utility that include this information must be handled by the auditor as **Category 3 confidential information** in accordance with SAO "[Security and Privacy Policy for Managing Data](#)". If auditors have questions on how to handle the data, contact the Team IT Audit Data Analysis Manager, Tara Lindholm.

Training and Additional Resources

The following recorded self-study is available in the training system and may be helpful when auditing water/sewer districts:

- [Know Before You Go: Water-Sewer Districts](#)

Additional resources related to water-sewer districts can be found on the SAO Hub under Audit | Information | Reference Guide | [Miscellaneous Entity Resources](#).

Key Operational Information

Key information about district operations that the auditor should document in the permanent file includes:

- What services are offered (water, sewer, street lighting, etc.)
- Number of customers
- Receipting locations and methods (e.g. online, in person, etc.)
- Whether the customer base is declining or expanding
- Whether the district uses the county treasurer
- Whether the district has adequately segregated duties for revenue and expenditure systems
- Any LIDs or ULIDs administered by the district
- Whether the district is managed or operated by an outside party
- Whether the district manages or operates any outside systems
- Any component units, joint ventures, or related parties
- Any significant business risks (such as aging infrastructure, insufficient water rights or difficulties in meeting water quality or other regulations) applicable to the district and how such risks are being addressed.

Districts must create a comprehensive plan under RCW 57.16.010 covering all of their operations. The auditor can get details on a district's current and anticipated activities by reviewing a copy of this plan. Construction, bond issuance and other significant activities can only be accomplished pursuant to the plan.

ACCOUNTABILITY

Although the county is normally the district's treasurer, districts with more than 2,500 water or sewer customers may act as their own treasurer with approval from the county (RCW 57.20.135). The term "customers" is not defined by law. Our Office considers the number of accounts billed as an appropriate measure of customers. Contact an Expert for assistance if districts are using a different measure for "customers" (such as population or equivalent residential units) in order to act as their own treasurer.

In addition to the above, a change in RCW 57.20.028 effective 07/23/17 allows Districts with revenues of five million dollars or more to issue their own warrants. Districts with revenues greater than \$250,000 and less than five million may issue their own warrants upon agreement with the county treasurer and district commission.

Significant Entity Changes

Auditors should consider risks associated with newly created districts, mergers or consolidations, and dissolving districts such as:

- Failing to identify new audits
- Predecessor districts not properly dissolved when a new entity is formed
- Reporting entity not properly defined
- Assets not properly transferred
- Errors in transferring accounting records to new systems
- Errors in combining customer accounts
- Lack of awareness of applicable laws

See the "Formation of Entity" or "Dissolution of Entity" steps available in TeamMate in the Compliance Requirements | Formation, Merger or Dissolution folder for audit and administrative steps to consider.

Contracted Services

Districts sometimes enter into operating agreements with other systems. Such arrangements should have a contract that clearly spells out the responsibilities of each party. Districts providing the services should ensure that they are recovering their costs. Districts contracting out management or operations to another entity are not relieved of their responsibilities and should provide an adequate level of oversight.

Closely-Held Districts

Some districts serve only a few customers. This may result in board members or managers who have a financial interest in the creation and operation of the district. Auditors should be alert for conflicts of interest, such as officials who sell their water rights or private systems to the district. Contact an Expert or Program Manager if such situations are identified.

Revenues

Except in extremely rare circumstances, utility billing should be considered a significant system and should be reviewed at least once every three audits. For multi-year audits, Auditors are encouraged to review utility billing more frequently, as feasible.

Misappropriation of public funds could occur during billing (unmetered or unbilled accounts), receipting (skimming, lapping or check for cash substitution schemes), or in receivables and collections (invalid adjustments, unauthorized write-offs or lack of follow-up on unpaid accounts). We would expect that districts have adopted policies and procedures over utility billings, receipting, and adjustments. The "Utilities" Teammate steps at Accountability | Revenues provide many ideas of areas to consider for testing.

There are various laws governing when a district can shut off service, providing customers with a final bill, and other areas related to utility billing and collection. The MRSC website <http://mrsc.org/Home/Explore-Topics/Public-Works/General-Utility-Topics/Utility-Billing-and-Collection.aspx> is a good resource, including a tool for Utility Liens and Shutoffs.

Recent fraud investigations have identified weaknesses in monitoring unattached receipts for those entities using **Vision software**. Historically, Vision did not have a report available to monitor unattached receipts

from the receipting system and many entities lacked proper monitoring of the system to timely capture frauds using this vulnerability. Vision now has a report that captures any receipt in the cash management module that was not attached to a deposit. Suggested steps to consider and other risks that have been identified are summarized in the Vision [Common System Review](#).

If the district outsources all or part of its cash receipting process, additional risks should be considered. See the “[Third Party Cash Receipting](#)” [TeamMate step at Accountability | Revenues](#) for more details.

The following are some of the types of revenues charged. Some will be processed through the district’s utility billing system and others will be charged separately.

- **Service Charges** – These charges normally constitute the majority of water-sewer district revenue. Services typically include metered water sales, sewer service, unmetered water service, storm water and sanitary sewer services. Some districts also provide street lighting services. Districts may use third-party receipt providers for the collection of revenues.
- **Special Fees & Charges** – These are normally associated with monthly services and could include penalties for late payments, shut off or connection fees. See also [Appendix 3 – COVID-19 Impacts](#) for information on the governor’s proclamations on prohibitions of charges for late payment or reconnection of water service. RCW 57.08.081 limits the amount of penalties water-sewer districts can charge up to 10 percent of the bill.
- **System Development Charges (SDCs)** – SDCs (also known as hook-up, tap or connection fees) can be very large. SDCs are charged to new customers connecting to the existing system. They often exceed the cost to connect the customer to the existing system. The excess represents the new customer’s contribution to the costs of the existing system or the future costs of expanding to meet new demand. SDC revenues may be restricted by entity policy for capital construction or other allowable costs.
- **Special Assessments (LIDs or ULIDs)** – A water-sewer district has authority to set up a Local Improvement District (LID) to pay for the cost of capital improvements benefiting a certain area. Revenues are derived from special assessments levied on property within the LID. Risk associated with this revenue stream depends largely on whether the county handles assessment and collection or whether the district assesses and collects this revenue.
- **Grants and Loans** – There are a variety of grants and loans available from the Public Works Trust Fund, Department of Health, Department of Ecology and other sources. These grants and loans are typically highly competitive.
- **Miscellaneous Revenue** – Common sources of miscellaneous revenue include payments for intergovernmental water sales or services, property rentals or cell phone antenna leases (on water towers). Electricity or methane gas generated as a by-product and treated bio-solids may also be sold.
- **Reimbursements on Final Payments** – When properties are sold, title companies request an estimate of the final bill from districts. If the customer has a credit balance after the final bill has been paid, the refund is owed to the customer and not to the title company under RCW 60.80.020. If the customer’s address is unknown, it should be handled as unclaimed property under Chapter 63.29 RCW.

Expenses

Developers will sometimes build excess capacity or will build a water or sewer line past undeveloped areas. The district may have a “latecomers” agreement with the developer whereby if additional connections are made to the developer’s line, the district would charge a late-comers fee. This shows up as a district expense when it passes the fee on to the developer. Latecomer agreements are typically 10-15 years in length.

Other large or unexpected expenses may be the result of regulatory requirements. Please see the “[Regulatory Environment](#)” section of the planning guide for examples.

Assets

Common assets at risk of misappropriation or misuse include:

- **Vehicles** – Most districts own vehicles which are used by staff to read meters and perform maintenance. Vehicles should be clearly marked as belonging to the district (RCW 46.08.065) and be used only for business purposes. Many districts allow vehicles to be taken home, usually for employees on standby for emergencies.
- **Inventories** – Districts maintain inventories including pipe, meters, and other materials for general maintenance purposes. These materials can easily be sold as scrap or to contractors. In addition, recent loss notifications have indicated that unused supplies/materials may not be tracked or monitored to ensure they are used for public purposes, which increases the risk of misappropriation.
- **Small and Attractive Assets** - Small and attractive assets typically consist of normal office equipment and maintenance tools, equipment and supplies used to maintain the water or sewer systems.

Compliance Requirements

General compliance requirements apply to water-sewer districts, including Open Public Meetings Act, expenditure audit and certification, conflict of interest, insurance / bonding requirements and authorized investments.

In addition to the usual conflicts of interest considerations, the auditor should consider the possibility of unmetered or unbilled hook-ups and service provided to employees, officers, friends or family.

Other compliance requirements and risks to be aware of are as follows:

- **Board Member Compensation** - RCW 57.12.010 was modified to allow OFM to increase compensation based on inflation every five years. These increases are automatic during commissioners' current terms. As of July 1, 2013, the compensation was authorized at a rate of \$114 per day up to an annual amount not to exceed \$10,944 (see [OFM 2013 notice](#)). Effective July 1, 2018, the compensation is authorized at a rate of \$128 per day up to an annual amount not to exceed \$12,288 (see [OFM 2018 notice](#)). Districts must pay their commissioners at these rates, unless a commissioner has waived all or a portion of their compensation in writing.
- **Self-Insurance** - Accountability audits of individual health and welfare programs and self-insurance programs must be performed at least every two years (RCW 43.09.260 and Audit Policy 1210). (Note: Self-Insurance will need to be included in every audit for those on a 3-year cycle.) Self-insurance programs include: liability, property, health and welfare, worker's compensation, and unemployment compensation. Auditors should review the "Self-Insurance" section of the [Self Insurance and Risk Pools planning guide](#) for further guidance.
- **Additional Bonding** - If the district has appointed a treasurer other than the county, RCW 57.20.135 requires the treasurer to be bonded for not less than \$25,000.
- **Bid Law** – Due to the nature of district activities, we would expect public works projects (such as painting water tanks) to be occurring at least every couple of years and more frequently in districts experiencing growth. Districts are required to competitively bid public works projects and purchases - see the [Bidding and Procurement](#) guide or RCW 57.08.050 for details.
- **Gift of Public Funds** – There are a few specific concerns for water-sewer districts.
 - *Hook-up Fees* - Properties connecting to the district's system are required to pay a fee. These fees are usually substantial. In some instances, districts have discounted hook-up fees for certain developers below the commissioner-approved fee schedule. In the absence of any additional benefit received from those developers, this would be considered a gift of public funds.
 - *Developer Engineering Fees* - Developers are normally required to construct or expand municipal infrastructure as a condition of building. Some districts have engineering staff that review developer's plans to ensure that they are done according to municipal specifications. A plan review fee is charged for this service. Smaller districts often contract with an engineering firm to review plans. There is no

lending of credit issues if the district pays the engineering firm and is reimbursed by the developer because the district is receiving full value for the cost incurred, there is no “donative intent” and the consideration received is clearly “legally sufficient”. In addition, the district has not financed a private undertaking. Instead, the district has delivered lawfully authorized/required services (plan review) in advance of payment by the developer/applicant. Instead of conducting plan review using district staff, the district has made a business decision to use outside consultants for such review. However, if the district pays an engineering firm to **prepare** designs for the developer, there is a potential lending of credit issue.

- *Side Sewer Improvements* – Districts sometimes make improvements to private side sewers. AGO 2009 No. 5 states “Municipal sewer districts have statutory authority to use public funds to repair or replace side sewers located on private property if doing so will increase sewer capacity by reducing infiltration and inflow. Use of public funds to do so does not constitute an unconstitutional gift or loan of public funds if the district acts without donative intent and can demonstrate that the action will result in significant benefit to the public.” Auditors are not expected to perform test for compliance in this area unless the amount spent on side sewer projects is significant and there is risk of donative intent or no analysis of benefit to the public. Before testing, the auditor should contact the Director of Legal Affairs.
- *Donations* – A 2011 law allows cities and public utility districts to use utility bills to ask for donations for hunger programs. This authority was not given to water-sewer districts and would be considered a gift of public funds.
- **State Grants** – Districts often receive state grants for capital construction. These grants often have allowable cost and matching requirements.
- **Bond Covenants** – Bonds are almost always revenue bonds and usually contain covenants specifying reserve or debt service ratio requirements.
- **Limitation of Indebtedness** – Limitation of indebtedness only applies to general obligation debt, which would be highly unusual for a water-sewer district. If there is general obligation debt, RCW 57.20.110 and .120 specifies a debt limitation specific to water-sewer districts of 0.5% of the value of taxable property within its boundaries, in addition to the constitutional debt limitations.
- **Disposal of property** - RCW 57.08.015-16 requires commissioner approval for all surplus sales, public notice for property valued over \$2,500 and appraisals for all real estate sales.

As a proprietary fund, water-sewer district budgets are not considered to be appropriations. **Therefore, districts are not subject to budgeting requirements.**

Note: Water-sewer departments of cities, counties, irrigation districts or PUDs would be considered a separate “department” under RCW 43.09.210 and would therefore be prohibited from benefiting other funds of the entity. SAO has noted numerous issues statewide where the water-sewer department (which is generally well-funded compared to other programs) is benefiting other funds. This can occur through transfers, interfund loans, over-allocating joint expenses, unequal indirect cost plans, or charging expenses or payroll of other departments to the water-sewer department

FINANCIAL STATEMENTS

Water-sewer districts are considered proprietary-type entities. Districts should follow either the GAAP or the Cash Basis BARS Manual for Cities, Counties and Special Purpose Districts.

All entities are required to file their annual financial reports with our Office and are encouraged to file them online using the SAO’s website. Auditors can find this information on the intranet under Auditor Resources | LGCS reports. For districts reporting on the cash basis, rather than requesting the financial reports from the

district for audit, auditors should download the statements from LGCS and confirm with the district that these are the final versions for audit.

GAAP Reporting Changes

All new GASBs are identified and evaluated by the Financial Audit Committee (FAC), as summarized on the [GASB Tracker](#) available on the FAC Sharepoint page. When evaluating implementation of new GASBs for Water and Sewer Districts, auditors should specifically consider:

GASB Statement No. 83: Asset Retirement Obligations (AROs)

original implementation effective FYE 2019, new implementation effective FYE 2020

An asset retirement obligation (ARO) is a legally enforceable liability associated with the retirement of a tangible capital asset. Water Sewer Districts might have AROs associated with water or sewer treatment plants (where applicable). See the Center's [Identifying Asset Retirement Obligations](#) for additional guidance. [A TeamMate testing strategy workpaper is available at Financial Statement | GAAP | Workpapers.](#)

GASB Statement No. 87: Leases

original implementation effective FYE 2020, new implementation effective FYE 2022

We expect this to have an impact on Water Sewer Districts and require re-evaluating and changes to reporting for leases. We would not expect any early adoption of this GASB. [A TeamMate testing strategy workpaper is available in Financial Statement | GAAP | Workpapers.](#)

Question: How will GASB Statement No. 87 impact the accounting for cell tower leases common to water and sewer districts?

Answer: If the cell tower lease meets the definition of a lease under GASB Statement No. 87, it should be accounted for under the requirements of GASB 87. Auditors can inquire if there is a contract (doesn't have to be written) that conveys control of the right to use another entity's nonfinancial asset (the cell tower – note that it doesn't have to be exclusive use; more than one entity can use the underlying asset at the same time), for a period of time (excludes month-to-month leases because there is no lease term) in an exchange or exchange-like transaction (note that non-cash doesn't mean non-exchange)?

Note: If the cell tower leases were month-to-month, and they could make the users remove their equipment at any time, then there would be no "lease term" and the District wouldn't need to record a lease receivable and deferred inflow. The District would still need to have note disclosures describing the arrangement, there just wouldn't be a balance sheet effect.

GASB 95, issued May 8, 2020, delayed the implementation date of certain new standards. Entities have the option to decide whether or not to delay implementation. During planning, as part of [Understanding the Entity & Environment](#), auditors should inquire with the entity and confirm the entity's implementation decisions.

OPEB Liabilities

The following water/sewer districts participate in health care plans administered by Public Employees Benefit Board (PEBB). If a District is not listed below, auditors should still inquire with the District as these are the ones we are currently aware of, plus they may have Other Post-Employment Benefit (OPEB) liabilities that are not through PEBB to report in accordance with GASB 75. In some cases the amount may be material. Auditors should evaluate if these districts are reporting their liability correctly. For **GAAP** basis entities, [auditors should use the GASB 75 testing strategy available in Financial Statements | GAAP | Work Papers folder.](#) For **cash** basis entities, [auditors will use the OPEB Liability testing strategy available in BARS Cash Basis Statements | Baseline Testing.](#)

Team	MCAG	Legal Name	*PEBB Subscriber Count	**OPEB Reported in FY19 Sch09?	Includes Financial Audit?
Bellingham	2328	Birch Bay Water and Sewer District	18	Yes	Yes
Bellingham	2302	Eastsound Sewer/Water District	5	Yes	No
Bellingham	2836	Columbia Valley Water District (formerly called Evergreen Water Sewer District)	3	No	No
Bellingham	2330	Lake Whatcom Water and Sewer Dist	20	Yes	Yes
Bellingham	2325	Point Roberts Water District #4	4	No	No
Everett	2210	Clinton Water District	5	No	No
Everett	2678	Holmes Harbor Sewer District	6	No	No
Everett	2314	Olympic View Water & Sewer District*	4	No	Yes
Everett	2308	Silver Lake Water and Sewer District*	29	No	Yes
Everett	0727	Cross Valley Water District*	14	Yes	CPA
LGS	2721	Glacier Water District	3	No	No
LGS	0728	Coalition for Clean Water	2	No (Schedule 09 Not Filed)	No
North King County	2685	Coal Creek Utility District*	26	Yes	Yes
North King County	0385	Fall City Water District	3	No	No
North King County	2247	Lake Forest Park Water District (formerly King Co. Water District 83)	4	No	No
North King County	2691	King County Water District 119	3	Yes	No
North King County	2252	King County Water District 90	17	Yes	Yes
North King County	2140	Northshore Utility District	75	Yes	Yes
North King County	2702	North City Water District (formerly Shoreline Water District)	16	Yes	Yes
Olympia	2207	Grays Harbor County Water District #2	2	No (Schedule 09 Not Filed)	No
Olympia	2206	Grays Harbor Water District #1	2	No	No
Olympia	2294	Willapa Valley Water District	6	No	No
Port Orchard	2946	West Sound Utility District No. 1	31	No	Yes
Port Orchard	2292	Belfair Water District No. 1	4	Yes	No
Port Orchard	2965	Hartstene Pointe Water-Sewer Dist	4	No	No
Port Orchard	2277	Manchester Water District	9	No	No
Port Orchard	2267	North Perry Avenue Water District	18	Yes	Yes
Port Orchard	2280	Silverdale Water District 16	29	Yes	Yes
Port Orchard	0493	Sunland Water District	8	No	No
Port Orchard	2698	Vashon Island Water District #19	6	No	No
Port Orchard	2148	Vason Sewer District	1	No	No

Pullman	0666	Spokane County Water District 3	20	Yes	Yes
South King County	2139	Lakehaven Water & Sewer District	142	Yes	CPA
South King County	2130	Skyway Water and Sewer District	12	Yes	Yes
South King County	2686	Cedar River Water and Sewer District	18	Yes	Yes
South King County	2684	Covington Water District	42	Yes	Yes
South King County	2240	Highline Water District	44	Yes	Yes
South King County	2705	King Co Water Dist 49	9	Yes	CPA
South King County	2687	King Co. Water District 111	17	Yes	Yes
South King County	2682	King Co. Water District 125	15	Yes	Yes
South King County	2699	King Co. Water District 20	17	No	Yes
South King County	2706	King County Water District 54	3	Yes	Yes
South King County	2133	Midway Sewer District	39	Yes	CPA
South King County	0607	Soos Creek Water and Sewer District	39	Yes	Yes
South King County	2144	Southwest Suburban Sewer District	37	No	Yes
Spokane	0476	Loon Lake Sewer District 4	4	No	No
Vancouver	0273	Clark Regional Wastewater District	71	Yes	Yes
Wenatchee	1157	Malaga Water District	3	No	No
Wenatchee	2156	Stevens Pass Sewer District	3	Yes	Yes
Yakima	2162	Snoqualmie Pass Utility District	6	Yes	No

* Count as of July 2020 – see also List of PEBB Member Employers in the [Pension & OPEB Resources](#)

****For GAAP Districts, liabilities are reported in the Notes to the Financial Statements and on the face of the statements themselves. As the Schedule 09 is not a required schedule for audit purposes at a GAAP District, care should be taken to ensure the liabilities were correctly reported within the financial statements before determining an error is present.**

Regulatory Accounting

A utility may elect (optional but not required) to use regulatory accounting allowed by GASB 62. While widely used by PUDs, water and sewer utilities often do not use it or are unaware of their ability to do. Also, utilities operated as a stand-alone fund by a city or county are also allowed to use regulatory accounting if they meet the criteria in GASB 62. There are instances when we might suggest an entity consider using regulatory accounting such as: 1) if a utility is raising rates merely to comply with debt service coverage ratios and not because it needs the additional revenue; 2) if it is incurring costs that it would like to capitalize (that would not otherwise qualify for capitalization) that it plans to recover with future rates.

What is regulatory accounting? In short, its FASB 71 guidance that was brought into GASB with the implementation of GASB 62. Some utilities (mainly PUDs) have used it for many, many years. It allows for some expenses or revenues to be deferred (put on the balance sheet) to be recognized at a later time that coincides with rate development. For example, an entity may incur severe damage from a storm in December, if using regulatory accounting, the utility could capitalize these costs and recognize them as expenses in future years when the rates will be raised to recover those costs.

If the utility uses regulatory accounting, auditors should ensure they are familiar with guidance in the [Public Utility Districts planning guide](#) about regulatory accounting. The PUD guide includes audit considerations within the financial section, and additional information in Appendix B.

The National Association of Regulatory Utility Commissioners (NARUC) publishes a suggested chart of accounts for water and wastewater utilities. NARUC also publishes accounting guidance and answers to accounting and reporting questions. This chart of accounts and accounting guidance is suggested only and is not required to be used. If the district chooses to use NARUC, they are still required to file financial information in accordance with the BARS manual. Links to the NARUC documents can be found under Water-Sewer Districts on the [Miscellaneous Entities Resource page](#).

Jointly Operated Facilities

Districts may operate treatment plants or other facilities jointly with other entities (Chapter 39.34 RCW). Each agreement should be reviewed to determine the appropriate reporting treatment (component unit, joint venture, etc.).

Systems Development Charges

Systems development charges (also known as hook-up fees, tap fees or connection fees) are often charged to new customers in order to hook-up to the existing system. These charges should be developed taking into account the estimated costs of connecting customers to the existing system and past or future capital needs.

There is no universal operating/nonoperating classification of these revenues. Entities should establish a policy or procedure that defines operating revenues and expenses. The district may distinctly track and classify the portion of the customer charge which pays for the cost performing the hook-up service, and amounts which are in excess of that cost. These revenues could be used to fund current operations (i.e. operating revenues) or be committed to capital improvements (i.e. capital contribution or nonoperating revenue). Or a district may choose to record the entire amount of the charges as either operating, non-operating, or capital, based on whether the predominate purpose is to recover actual costs or fund capital activity.

Unless the classification is misleading (such as if the funds were committed to a particular purpose and then not reported that way) or contradicts the district's policy/procedure (defining operating and nonoperating revenues), we would not consider it an error.

Capital Contributions

As a condition of building, developers are normally required to construct or expand municipal infrastructure. This infrastructure is subsequently turned over to the municipality for upkeep and operation. If reporting on the GAAP basis, the district would increase its capital assets and record a capital contribution for such donated water-sewer infrastructure.

Allowance for Doubtful Accounts

Allowance for Doubtful Accounts is an estimated contra-asset representing the amount of Accounts Receivable that is not collectable. Most districts do not record an allowance, since the district assumes that it will collect everything. Any actual losses are written off to bad debt expense as they occur. This is an allowable practice so long as it is disclosed in the Summary of Significant Accounting Policies note disclosure (Note 1) and it doesn't result in a significant variance from the correct method. If the district is pursuing collections and shutting-off services for non-payers, we would not expect the variance to be significant.

To evaluate this assertion (or the valuation of any allowance reported), we need to analyze the collectability of accounts receivable, such as with a review of aged receivables or other test. Shutting-off water services is a relatively simple process and we would expect that the district have a fairly aggressive policy of shutting-off water services to delinquent accounts. However, shutting-off sewer services would require the district to dig up and cap the sewer line, which is an expensive process and would not be done nearly as frequently. We would expect districts to place property liens on delinquent accounts to increase collectability and for districts that provide both water and sewer services to have a policy stating that payments will be applied first to sewer, then water (which will allow water to be shut off for any non-payment).

Accounts Receivable and Customer Assistance Program Financial Reporting

As described in Appendix 3 – [COVID-19 impacts](#), many Districts are seeing an increase in overdue customer utility accounts as a result of the Governor’s proclamations prohibiting the shut off of essential services or charging of fees for late payment/reconnection. In a recent customer debt survey conducted by the Washington Association of Sewer and Water Districts (WASWD), 35 of the WASWD’s 105 members responded and reported total amount of accounts more than 120 days outstanding was about \$2.75 million. This compares to about \$1 million at the same time in 2019. Similarly, the survey reported about 6,800 accounts with outstanding balances of more than 120 days, compared to about 2,300 in 2019. As a result, we expect that districts will report increased outstanding customer accounts receivable balances beginning with the 2020 reporting year. At this time, we don’t expect these balances to also result in higher uncollectible accounts as the Governor’s proclamation only suspends, not relieves, the customer from the obligation to pay for utility services. Once lifted, we expect districts to be able to resume their authority to collect outstanding balances through the use of lien, foreclosure, and water shutoff rights provided by RCW 57.08.081. However, completing these procedures may be extended as districts are encouraged to work with customers facing hardship.

Auditors should consider reviewing the district’s controls for monitoring its aging of accounts receivable accounts and ensuring these are valid accounts. A growing receivable balance could make it easier to conceal fraudulent activity. If the district does not have strong controls, consider testing receivable balances to ensure they are valid.

With respect to financial reporting, in general, we are not expecting a change in how districts report outstanding accounts receivable. However, auditors should consult the GAAP and CASH BARS manuals for general accounting and reporting criteria. If specific questions arise, auditors (or the audit client) should submit a helpdesk question where individualized research and answers can be shared.

Finally, as utilities were directly impacted by the Governor’s proclamation, we would expect that districts are disclosing the impacts of the COVID-19 pandemic (specific to utility billings) within the Notes to the Financial Statements. Auditors should remain alert to information disclosed on accounts receivable and allowance for doubtful accounts to ensure it is consistent with your understanding of the district’s operations. In addition, auditors should review FYI 2020-01 COVID-19 Considerations for expected note disclosures.

SINGLE AUDIT

Auditors should ask if the district has applied for any federal grants or loans and remind them of the Single Audit requirements. Auditors should review the [Single Audit](#) planning guide for additional guidance.

COVID-19 Funding Availability: Districts may be eligible for federal assistance related to the COVID-19 pandemic.

- The Department of Health published information on potential federal assistance that may be available to water systems in response to impacts of the COVID-19 pandemic in its [Federal Assistance for Utility Payments 331-671](#) resource.
- In addition, state and local governments may receive funds through the American Rescue Plan Act (APPA). These funds can be used to assist utility customers with arrearages on past due bills, for renters and homeowners. In addition to state and local funds, the APPA provides \$500 million additional funding for low-income water and wastewater ratepayer assistance.

Appendix 1: Assessment Audits

Below is a summary of information specific to small water/sewer districts where an assessment audit is performed. Additional risk factors and activity less common for small districts can be found in the guide. See also the [Small Government Assessment Audits](#) planning guide.

As with most water/sewer districts, a significant business risk for smaller districts is the cost of repairing and replacing systems as they age. Districts should address this risk by following a replacement plan and adjusting their rates as needed. Water availability is another potential business risk. See [Industry and Other External Factors](#) in the Background section for additional information and risks.

Closely-Held Districts

Some districts serve only a few customers. This may result in board members or managers who have a financial interest in the creation and operation of the district. Auditors should be alert for conflicts of interest, and segregation of duties such as officials who sell their water rights or private systems to the district.

Revenues

- **Cash Receipting** – For smaller districts the county is normally the district’s treasurer, however districts with more than \$250,000 in revenues or 2,500 customers may act as their own treasurer with approval from the county. Smaller districts may have low staffing levels that represent a segregation of duties risk for cash receipting.
- **Charges for Services** - These charges normally constitute the majority of water-sewer district revenue. Districts may use third-party service providers for the collection of revenues, however for our smaller districts these charges are generally billed and receipted by the district prior to deposit with the county treasurer. Due to the small nature of these governments and limited accounting software availability, these districts have an increased risk of inadequate segregation of duties increasing the risk of cash receipts being misappropriated.

Expenditures

- **Contracted Services** - Smaller districts that may not have the staffing levels to meet the daily operational needs may contract for general services. General services may be general bookkeeping, repairs, or billing needs. Districts contracting out management or operations to another entity are not relieved of their responsibilities and should provide an adequate level of oversight.

Compliance Requirements

- **Bid Law** – Due to the nature of district activities, we would expect public works projects (such as painting water tanks) to be occurring at least every couple of years. Districts are required to competitively bid public works projects and purchases - see the Bid Law guidance or RCW 57.08.050 for details.
- **Disposal of Property** - RCW 57.08.015-16 requires commissioner approval for all surplus sales, public notice for property valued over \$2,500 and appraisals for all real estate sales.

Appendix 2: Relevant Statutes

Relevant statutes for water and sewer activities include:

- Chapter 35.67 RCW Sewerage Systems – Refuse Collection and Disposal (Cities and Towns)
- Chapter 35.92 RCW Municipal Utilities (Cities and Towns)
- Chapter 35A.80 RCW Public Utilities (Optional Municipal Code)
- Chapter 36.94 RCW Sewerage, water, and drainage systems (Counties)
- Chapter 54 RCW Public Utility Districts
- Chapter 57 RCW Water-Sewer Districts
- Chapter 60.80 RCW Lien for Unrecorded Utility Charges (requirements related to final billing when properties are sold)
- Chapter 70A RCW Environmental Health & Safety (various sections relate to water or sewer systems)
- RCW 74.38.070 Provides for governments providing utility services to offer reduced utility rates for low-income senior citizens and other low-income citizens
- Chapter 90 RCW Water Rights - Environment

Appendix 3: COVID-19 Impacts

Policies for deferrals of late payments, prohibitions against shut-off of service due to COVID-19

Effective March 23, 2020, the Governor issued Proclamation 20-23 prohibiting “all energy, telecommunications, and water providers in Washington State from conducting the following activities:

- (1) Disconnecting any residential customers from energy, telecommunications, or water service due to nonpayment on an active account, except at the request of the customer.
- (2) Refusing to reconnect any residential customer who has been disconnected due to nonpayment;
- (3) Charging fees for late payment or reconnection of energy, telecommunications, or water service; and
- (4) Disconnecting service to any residential customer who has contacted the utility to request assistance from the utility’s COVID-19 Customer Support Program.

On July 2, 2021, this proclamation was extended through September 30, 2021; the Governor indicated that this will be the final extension.

In addition, under the Governor’s Proclamation 20-23 et al, utilities providing energy, telecommunications and water services in Washington State are required to develop COVID-19 Customer Support Programs. We would expect utilities covered by this guidance to have reviewed their existing policies concerning disconnection of service, reconnection of service, payment arrangements and suspension of other fees or charges and update those policies as appropriate and necessary.

To ensure that customers maintain access to essential services during the effective dates of the Governor’s Proclamation, utilities likely will offer long-term payment arrangements for those directly affected by COVID-19, which could be six to 18 months or longer (as recommended by the Governor’s COVID Utility Customer Support Program Guidance).

Any audits should focus on an entity’s compliance with their own policy and risks of fraud, loss or abuse and not the entity’s compliance with the Proclamations or *Customer Support Program Guidance*, published by the Governor’s Office.

Audit considerations in reviewing the entity’s policy and controls over monitoring of accounts:

- How does the District verify and review to ensure only eligible customer accounts are adjusted, deferred or written off?
- How does the District ensure the adjustments, deferrals or write offs are allowable, correctly calculated, and are properly reviewed and approved?

Additional risks for auditor consideration:

- Cash receipting risk – fraudulent write off of cash receipts
- Accounts receivable risk - improper or fraudulent write off of balances owed
- Financial statement analytics – expect an increase in aged accounts receivable, however a growing receivable balance could make it easier to conceal fraudulent activity

Appendix 4: Glossary of Water-Sewer District Terms

- **Aeration/Aeration basin** - A pond where air is pumped in to increase microbes in the wastewater. The microbes feed on the organic material.
- **Anaerobic digestion** - The use of bacteria to break down organic matter without oxygen is the most common method of treating sludge. This process generates biogas.
- **Aquifers** - An underground layer of rock or sediment that is filled with water that can be removed using a well.
- **Biogas** - Mixture of gases (primarily methane and carbon dioxide) produced by the breakdown of organic matter in the absence of oxygen (anaerobic digestion). The methane can be separated and sold.
- **Biomass** - The solids separated from liquids in the sewer treatment process.
- **Biosolids** - are treated **Biomass** that can be used as fertilizer.
- **Bugs** - bacteria or microbes that feed on organic material.
- **Cake** - Solids separated from liquid waste using a centrifuge.
- **Centrifuge** - Equipment that uses rapid rotation to separate solid waste from liquid during the Primary Wastewater Treatment phase.
- **Clarifier** – There are a variety of different types of clarifiers, which use different methods to remove solids from wastewater.
- **Digestate** - The material that results when the solids that have been separate from liquids in the sewer treatment process are heated and react with naturally occurring micro-organisms and bacteria.
- **Effluent ponds** - large ponds where bacteria consume the organic materials and nutrients in wastewater.
- **Grinder Pump Station** - Waste is collected in the tank, when it rises to a certain level, the pump turns on and grinds the waste and pumps it into sewer mains.
- **Leachate** - runoff from a landfill that can be a significant threat to surface water or groundwater. Landfills collect the contaminated water and usually truck it to a sewer facility where it has a contract for processing.
- **Lift stations** - pump sewage uphill.
- **Primary Clarifiers** - Tanks into which filtered sewage flows during the Primary phase of treatment. Paddles on the floor and surface of the tanks remove materials, leaving liquid.
- **Pump Stations** - pump water uphill
- **Purple Pipe** - This is the color of the pipe used to move reclaimed or recycled water for irrigation use.
- **Reclaimed or Recycled Water** - Water separated and treated in the sewer treatment process and used for irrigation.

- **Sewer lagoons** - large ponds where bacteria consume the organic materials and nutrients in wastewater.
- **Sewer mains** - Pipes used to move sewage from customers to a Wastewater Treatment Plant.
- **Telemetry** - An automated system that collects information from remote locations and transmits it to receiving equipment for monitoring. Important applications include automatic meter reading, groundwater monitoring, leak detection in distribution pipes and monitoring equipment. Telemetry control allows employees to perform certain tasks remotely, such as turning pumps on or off.
- **Wastewater** - any water contaminated by human use
- **Wastewater Treatment Plants** - Treat wastewater so that it is safe for discharge. A plant may have between one to three stages. No matter how many stages the plant uses, at the end of the process, water is chlorinated to kill remaining bacteria and discharged. The three stages are:
 - **Primary** - The primary stage of treatment consists of first separating the solids and liquids. Screens are used to remove materials that can't be processed. These include objects not intended to entered the system, but were flushed down the toilet either in carelessness, ignorance or childish glee and items collected through storm drains. Filtered sewage flow into **Primary Clarifiers**, where paddles on the floor and surface of the tanks remove materials, leaving liquid. A **centrifuge** can also be used. This uses rapid rotation to separate solid from liquid more quickly and removes more water, producing a drier material known as "cake".

The solids removed at this stage may be disposed of at a landfill, incinerated, or further treated. One type of treatment you might see is called **anaerobic digestion**. The **digester** is a large, sealed tank with no oxygen. The solids or **biomass** are heated and react with naturally occurring micro-organisms and bacteria. The end result is that **biogas** is emitted and a material called **digestate** is left behind.
 - **Secondary** - In the secondary stage of treatment, liquids flow to large ponds called **sewer lagoons, effluent ponds, or aeration basins** where bacteria consume organic materials and nutrients. Adding air or aeration helps the bugs thrive. The wastewater is then sent to **secondary clarifiers** that work just like the primary clarifiers, with the material sinking or floating being removed.
 - **Tertiary** - In the third or tertiary stage other types of treatment may be used such as chemicals or filters to remove contaminants or **reverse osmosis**, which filters using membranes and can produce water clean enough to be sold for nonpotable or non-drinking purposes.
- **Water mains** - Pipes used to move water through the water system to the customer
- **Water purification facilities** (aka water treatment plants) - facilities where water is processed to remove impurities and add chemicals as needed
- **Water wheeling** - The process of moving water from one entity to another through a series of pipes.