

April 29, 2013

Attn: Mr. Troy Kelley, WA State Auditor
Insurance Building
Capitol Campus
302 Sid Snyder Avenue SW
Olympia, Washington 98504-0021

Dear Mr. Troy Kelley:

I sincerely appreciate your Office's function; your reports are relied upon by countless Citizens, Rate Payers, Investors, Analysts, Insurers, and Rating Agencies.

I am an analyst with experience in Equities, Fixed Income, GAAP Audits and SEC Compliance; I have very little experience with Government Auditing Standards and GASB so I beg your forgiveness if any elements of this request are less than sophisticated. Also, I have no experience in working with the State of Washington's Auditor's Office, but I know you are extremely busy and short on staff so please inform me of necessary protocols so I can save you time. I realize and appreciate that it is impossible for your Office to audit everything, therefore many of my requests may require your judgment as to what issues I highlight merit a closer look by your staff.

Recently I have experienced significant problems with King County Water District #49 (hereinafter, KCWD49) with regards to its management and governance by the elected commissioners. Your department's website has been a valuable source of data. Professionals at King County and the City of Burien have also assisted me to this point so I am copying them as well as my legal counsel on this email so as to insure accountability and for a digital trail of events. I am also copying members of your staff, some residents and rate payers and some political representatives. At this time, I have not copied or contacted the Press and other interested parties on this request for information. Neither your team nor the employees at KCWD49 need to be harassed by the Press when we are trying to solve some major problems.

Please note I have attached four documents for your convenience and reference which I will use throughout this request: 1) a copy of this email in PDF format for readability; 2) Your Office's Report # 1009191 entitled Washington States Auditor's Office, *Accountability Audit Report*, KCWD49, January 18, 2013, hereinafter referred to as "The Accountability Report;" 3) Official Statement made December 12, 2007 for the purposes of selling \$1,565,000 of KCWD49 Revenue Bonds to investors hereinafter referred to as the "Official Statement;" 4) Your Office's Report # 1009191 entitled Washington States Auditor's Office, *Financial Statements Audit Report*, KCWD49, Audit Period January 1, 2011 through December 31, 2011, hereinafter referred to as the "2011 Financial Audit."

As soon as the Financial Statements Audit Report for 2012 is available I would sincerely appreciate a notice from your Office. Additionally, if you have unaudited financial statements for 2012 I would appreciate receiving them.

In reference to the 2011 Financial Audit, please note page 7 in the paragraph entitled **Liabilities** and the sentence “The increase in Purveyor Balance Liabilities is due to a **settlement** with the City of Seattle over the deficit in the City’s Purveyor Balance Account.” Also please see page 25, accompanying notes, specifically NOTE 6c **PURVEYOR ACCOUNT LIABILITY** and page 32, accompanying notes, specifically NOTE 11 **PRIOR PERIOD ADJUSTMENTS**. It seems clear to me that for 28 years there existed this account payable to the City of Seattle as set forth in the 1982 Water Purveyor Contract. Can you forward me a copy of this contract? It seems clear to me that the City of Seattle is by a significant margin the most important and the largest business relationship for the KCWD49; in fact, the KCWD49’s entire business depends on the City of Seattle. It seems clear to me that this account payable to the City of Seattle was never previously properly accounted for by the KCWD49 and then very suddenly a “settlement” was reached for \$510,719 according to NOTE 11 which converted the *deficient past due account payable* into a Note or Short Term Bond according to the terms set forth in NOTE 6 on page 25. What is not clear to me is the use of the term “settlement” which I define as an official agreement designed and intended to resolve a dispute. It is not clear to me how GASB would define “settlement.”

1. What are the specific details of this dispute before the “settlement” was so very suddenly reached? As you know there is a critical period in accounting before a “settlement” is reached. As you know one party has a claim or lien against the second party; usually either the entire claim is disputed by the second party or, at the very least, the amount of the claim or lien is in dispute. Therefore, I am *assuming* the City of Seattle had a claim or lien for an amount greater than \$510,719 against the KCWD49, but I do not know? Or perhaps the City of Seattle demanded just the \$510,719 payment immediately and had some recourse via a lien or shutting off water to the KCWD49’s distribution system? This claim or lien as it existed before the “settlement” was known by someone at KCWD49 and most likely by someone at an outside accounting firm. Therefore this *deficient past due account payable* should have been accounted for as a *contingent liability* in earlier periods since this account existed for 28 years according to the 1982 Purveyor Contract and is the single most important business relationship and the greatest single expense for the KCWD49. At the time of recording (\$510,719) post settlement this very significant material internal accounting event represented an astonishing 21.68% increase to the existing long term debt and it represented 27.16% of the KCWD49’s Unrestricted Assets for the reporting period. This is a very suspicious accounting event and a Red Flag as potentially a cover up or concealment. At the very minimum this very significant material internal accounting event is at least a deficiency in internal control. Respectfully, I think this issue merits a closer look by your team and I realize that when this event occurred it was not on your watch.
2. What are the dates, forms of communication, and who are the parties involved in negotiating this “settlement?” As you know when one party has a claim or lien against the second party and that claim is disputed, there usually is some communication to follow. There must be a trail of communication whether paper or digital necessary to reach a “settlement.” I am especially

interested in communication the KCWD49 had with its outside accountant and auditor. Who is their auditor and do they work for other Water Districts which have similar relationships with the City of Seattle to purchase water? As you know, in a GAAP audit or any audit for that matter it is difficult to examine every transaction and account therefore priorities are set based on areas which represent the highest risk such as contracts and accounts with the largest vendor relationship, the single most important strategic partner a business depends upon, the biggest customers, and activities which present the highest risk for concealment, noncompliance, misappropriation, or misuse. I find it difficult to believe that an organization, such as KCWD49, that faces a mandatory *annual* financial audit never had this 1982 Water Purveyor Contract examined, reconciled and checked for accounting compliance. The exception is when someone conceals information and typically shops for a small accounting firm that has little to no experience with the industry, the industry's unique characteristics, and the well known professionals in the industry such as those at the City of Seattle who are involved with Water Purveyor Contracts.

3. Can your team please examine this 1982 Water Purveyor Contract and provide me with a copy? Most all contracts have clauses for past due penalties and the location where notices are to be sent. Where were the notices from the City of Seattle to KCWD49 sent? Were they sent to some employee's attention? Were they perhaps intercepted and not fully disclosed? Is the address current?
4. At what point in time do the minutes of the KCWD49 Commissioners' meetings reflect management discussing this very significant material internal accounting event with the Commissioners? Can you please provide me with those minutes? Does the KCWD49 and its outside accounting firm archive email communication? They should be achieving email communication and all other operational data as set forth in a *Business Continuity Plan*. Are there discussions regarding this settlement and the *deficient past due account payable* with the outside accountant and is there a full, fair and prompt disclosure to the Commissioners? Are there any email communications between management and the commissioners or between management and the outside accountant which recommend having a discussion offline?
5. Can you provide me with curriculum vitae for the three KCWD49 Commissioners? If these commissioners have little or no education in accounting and audit then this is a Red Flag when viewed in conjunction with this very significant material internal accounting event. My hypothesis is that if an employee of KCWD49 were to conceal and cover up material information for the sake of keeping his/her job, then it certainly would be much easier to accomplish this concealment and cover up if the commissioners had no education in accounting and audit.
6. Can you provide me with the KCWD49 management team's curriculum vitae? Do they have an education in accounting and audit? Are there minutes or an employee file which reflect the commissioners negatively reviewing the management team's performance as it relates to this very significant material internal accounting event? What was the management team's

compensation for the year when this event occurred and did that compensation include bonuses? It is critically important to note, the rate payers in KCWD49 were served with a basic rate increase of 12% in 2011 and served again with a shocking 18% increase in 2012 or a 33.33% increase over the 2010 basic rate.

7. What is the compensation and benefits package for the elected commissioners? Did this compensation package change under current KCWD49 management team from the previous KCWD49 management team?

8. On page 3 of your Accountability Report, your Office states under paragraph **Audit History** “We audit the district annually. We have not issued any findings in the last 11 years.” Respectfully, I am curious as to how your Office defines “findings.” Are these “findings” red flags? Are they material events as defined by GASB? As a reminder I have very little experience with GASB and therefore I am not challenging your judgment. Based on my GAAP audit experience, I think this statement stands out and merits a closer look by your team and your consideration for a possible amendment to this statement. Respectfully, I realize that when this very significant material internal accounting event occurred it was not on your watch.

This next series of questions relates to this “settlement” addressed above, the critical accounting period before this very sudden settlement or contingent liability and its impact on the covenants, restrictions and resolutions in the Official Statement associated with the sale, rating, and insurance of the KCWD49 Revenue Bonds and the *continuing disclosure requirement* associated with the Revenue Bonds still outstanding as per the Municipal Securities Rule Making Board; and, as per ethical and professional responsibility of issuers of securities; and, as per commissioner’s oaths of office; and last, as per state fiduciary law of public resources. (See the table below for a list of bonds outstanding).

CUSIP	MATURITY	COUPON	PRINCIPAL
495322AL3	4/1/2014	3.55	80,000
495322AM1	4/1/2015	3.65	80,000
495322AN9	4/1/2016	3.75	85,000
495322AP4	4/1/2017	3.85	85,000
495322AQ2	4/1/2022	4	490,000
495322AR0	4/1/2027	4.25	600,000

1. Please refer to page #6 in the Official Statement under the covenant, restriction and resolution **Future Parity Bonds**. According to the “settlement” above, doesn’t this suspicious conversion of this City of Seattle Account Payable or Purveyor Balance Liability or Contingent Liability into long term debt as per the terms in NOTE 6, page 25, of the 2011 Financial Audit fall under the definition of a Bond, or a Note which is just a short term bond? This meets my definition of a

bond. At times I function as an expert witness on fixed income issues and I have done so in Federal Court. The Revenue Bond is not registered with the SEC; nor is this Purveyor Bond; the only difference is an underwriter was involved in the unregistered Revenue Bond. I think this violates covenant, restriction and resolution (d) of **Future Parity Bonds**, page 7, in that neither Moody's nor Standard & Poor's would rate the KCWD49 in at least one of the two highest rating categories as per the resolution. I see no evidence from the KCWD49 disclosing this to anyone. Can you provide me with any disclosures that KCWD49 made to investors, the underwriter, rating agencies, the insurer of the Revenue Bonds (FSA), the Municipal Securities Rule Making Board, the Securities and Exchange Commission, the transfer agent, Depository Trust Company, the Registrar or even the Bond Counsel Foster Pepper of Seattle?

2. Please refer to the **flow of funds** covenant, restriction and resolution as stated on Page 6 of the Official Statement it clearly states order of priority. It would appear to me according to this order of priority that the Purveyor Balance Liability Note or the Purveyor Bond as per the "settlement" is senior to this Revenue Bond and not a subordinate lien and therefore in direct violation of the covenants, restrictions and resolutions according the **Future Parity Bonds**, on pages 7 & 8 in the Official Statement. Respectfully, I think this issue merits a closer look by your team. I see no evidence from the KCWD49 disclosing this to anyone: investors, the underwriter, rating agencies, insurer of the Revenue Bonds, the Municipal Securities Rule Making Board, the Securities and Exchange Commission, the transfer agent, Depository Trust Company, the Registrar or even the Bond Counsel Foster Pepper of Seattle.
3. Continuing with the covenant, restriction and resolution **Future Parity Bonds** as per (f) page #7, can your Office provide me with certificates attesting to the terms of this resolution for the years 2008-2012 as both unadjusted and also adjusted for the "settlement" or the Purveyor Bond?
4. As requested above, if you can provide me with the 1982 Water Purveyor Contract and other information on the "settlement" I can assist in calculating the Contingent Liability at the time of the Offering, which *maybe* will amount to several hundred thousand dollars if I understand the notes for the "settlement" correctly. It is probable the revenue bonds ratings on a standalone basis without the FSA insurance would drop from the A+ rating at the time of the offering.
5. Please refer to covenant, restriction and resolution **Liens upon the System** on Page 9 of the Official Statement. It would appear to me that either this *deficient past due account payable* or the conversion of this *deficient past due account payable* into a Purveyor Bond would establish a legal right to the holder of the Purveyor Bond against the Gross Revenue of the System operated by KCWD49 thereby in direct violation of the covenant, restrictions and resolutions of this Bond Offering. Respectfully, I think this merits a closer look by your team.
6. Please refer to covenant, restriction and resolution **Auditing of District Finances**, page 14, of the Official Statement. In light of this very significant material internal accounting event and after

your team takes a closer look at some of the information I request, respectfully, can you attest to KCWD49's complying with the Laws and Constitution of the State of Washington? In light of this very significant material internal accounting event and after your team takes a closer look at some of the information I request, respectfully, can you further attest to the accuracy of KCWD49's accounts and reports?

This next series of questions relates to the tremendous amount of data your office collects and how your team may analyze, infer, enhance, rank, and draw correlations and conclusions as to assist in the efficient and effective use of public resources.

1. There are 27 (please confirm) Water Districts similar to KCWD49 in King County that purchase water from the City of Seattle and subsequently resell it to customers within their Districts; given your data do you rank these Water Districts based on efficiency and effectiveness? Where would KCWD49 rank? For example in my own random sample of 6 Water Districts (from your website) and reviewing their 2011 Financial Audits I looked at the relationship between employee cost to the number of customers served and I arrived at the following conclusion: KCWD49 ranked at the bottom of this random sample of 6 and by this measure is substantially more inefficient based on this employee cost analysis per customer served. In this simple analysis there are many unknown quantities which may scientifically explain my conclusion, but I would infer that 50% of these unknown quantities are attributed to decisions by the Management team and the Commissioners of these Water Districts. For example, KCWD49 has no solution for electronic billing, statements and payments. In a very environmentally unfriendly use of natural resources and in a very economically imprudent process, 6 times per year KCWD49 has employees or vendors purchases paper and envelopes, then subsequently stuff 4000 statements into those envelopes and then, presumably lick those 4000 envelopes, then pay expensive postage for those 4000 envelopes. In addition to the waste of money, natural resources and human resources, 4 days of KCWD49 cash flow cycle or cash conversion cycle are wasted just waiting for the mail to be delivered (per each billing period).
2. Do you have information on the safety record of the Water Districts as it relates to injuries and accidents at construction sites? Where would KCWD49 rank? Can you audit KCWD49's insurance policies (accounts) for Errors & Omissions insurance and general liability insurance? Are these accounts deficient? Can the State of Washington Auditors Office be placed as a *party of interest* on these insurance accounts so that you will be notified in the event they are deficient and past due as occurred in the Purveyor Account debacle?
3. Do you have information on the effectiveness of project management as it relates to the Water Districts performance record in meeting construction schedules and staying

within budget on projects? Where would KCWD49 rank? Can you provide me with any performance audits of the KCDW49?

This next series of questions relates to construction work-in-progress which is referenced in the 2011 Financial Audit of KCWD49, page 23, specifically referred to in the table as **8th PL SW** with a Project Authorization of \$600,000.

1. Can you provide me with all minutes referencing this project? Can you provide me any 2012 and 2013 financial data associated with this project even if it is (obviously) unaudited? Rate payers are extremely concerned about this project and KCWD49's mismanagement of this project; and, the inability of the commissioners to manage the manager of this project; and, the inability of the manager to manage the contractor of this project. Rate payers in the vicinity of this project were told work would begin the first week of **September 2012** (as it did) and be completed the first week of **December 2012**. As of this writing **April 29th, 2013** the project is not complete and does not appear to be anywhere near completion. As you might imagine, in addition to the unsightly mess, the dust, the torn up driveways & right-of-ways, the bumpy uneven road, the safety hazard, the inconvenience, the noise, the storage of construction equipment in front of homes, *the portable toilets in front of homes*, the road closures, the parking, and the travel delays, ***rate payers are extremely concerned that they will face yet another increase to the basic water rate they pay to the KCWD49 because of the mismanagement of this 8th PL SW project.***
2. Can you please provide me with the Contract the KCWD49 has with the Contractor associated with this 8th Ave PL project? Can you help me determine if any penalties which may exist in the contract for delays in the completion of this project are being enforced by the KCWD49, its management and the commissioners? Can you help me determine if there are any *veiled* financial incentives for the contractor in the contract to extend or delay the completion of this projects such as extra time and materials? Can you help me determine if the contractor received a significant *upfront payment* for the project which would reduce her/his incentive to complete the project in a timely fashion in order to get paid; and, also increase her/his incentive to seek other contracts with other clients since she/he has already received a big *upfront payment* from KCWD49? Can you help me determined if the awarding of this contract to the contractor was an arm's length transaction and in compliance with the Laws and the Constitution of the State of Washington?
3. Is there a tipping point or status assessment with regards to work-in-progress construction projects using *public resources* in the State of Washington where the State of Washington could step in and assist with expertise and project management experience for the benefit of the public? It is extremely important to note, the City of

Burien has been extraordinarily responsive and diligent with regards to public safety and the traffic hazard the KCWD49 and the contractor have created on the 8th AVE PL project, especially at the intersection of 8th AVE PL and Sylvester Road. For the public record, in the very unfortunate event of a personal injury on or near the 8th AVE PL and the Sylvester Road, the City of Burien and its employees have responded immediately with skill and care with public safety as their number one priority.

In closing, I would like to reiterate my sincere appreciation for your help and the utmost respect I have for the function of audit and your office. I understand your department has so much work to do with very limited staff and financial resources. I am willing to help. With accountability, fiscal integrity and openness we can hopefully stop this cycle of mismanagement of public resources and unrelenting water rate increases.

Respectfully,

Thomas Evankovich, CFA