

Washington State Auditor's Office
Financial Statements Audit Report

City of Oak Harbor
Island County

Audit Period
January 1, 2010 through December 31, 2010

Report No. 1007328

Issue Date
March 12, 2012



WASHINGTON
BRIAN SONNTAG
STATE AUDITOR



**Washington State Auditor
Brian Sonntag**

March 12, 2012

Mayor and City Council
City of Oak Harbor
Oak Harbor, Washington

Report on Financial Statements

Please find attached our report on the City of Oak Harbor's financial statements.

We are issuing this report in order to provide information on the City's financial condition.

Sincerely,

A handwritten signature in black ink, appearing to read "Brian Sonntag".

BRIAN SONNTAG, CGFM
STATE AUDITOR

Table of Contents

**City of Oak Harbor
Island County
January 1, 2010 through December 31, 2010**

Schedule of Audit Findings and Responses	1
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters in Accordance with <i>Government Auditing Standards</i>	8
Independent Auditor's Report on Financial Statements.....	10
Financial Section.....	12

Schedule of Audit Findings and Responses

**City of Oak Harbor
Island County
January 1, 2010 through December 31, 2010**

- 1. The City's internal controls are inadequate to ensure accurate accounting and financial reporting, resulting in significant misstatements on its financial statements.**

Background

City management, the state Legislature, state and federal agencies and bondholders rely on financial statement information to reflect the entity's position, enabling accurate decisions to be made. It is the responsibility of City management to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting. Our audit identified a material weakness in controls that affects the City's ability to produce reliable financial statements.

Government Auditing Standards prescribed by the Comptroller General of the United States require the auditor to communicate a material weakness, as defined below in the Applicable Laws and Regulations section, as a finding.

We have communicated recommendations to City management regarding improving internal controls over financial transactions and reporting in six of the seven prior audits.

Description of Condition

We identified the following deficiencies in internal controls that, when taken together, represent a material weakness in the City's controls over financial reporting. The City:

- Does not have adequate processes to ensure it retains documentation to support all reported financial transactions and account balances. We noted it:
 - Does not have a detailed plan for the method used to allocate General Fund and Internal Service Fund costs to other funds. It does not annually re-evaluate these estimated allocations. It made other transfers based on estimates without adequate supporting documentation. The City cannot demonstrate all costs transferred to other funds represent costs incurred by those funds.
 - Does not have supporting documentation for its landfill closure liability. City officials do not annually re-evaluate this liability as required by accounting standards. Additionally, the City did not report a liability for pollution clean-up, but was unable to provide documentation showing how it did not have to report this. As a result, we were not able to determine the accuracy of the landfill liability or whether the City needs to report a pollution clean-up liability.

- Does not have a sufficient review process for financial statements, note disclosures, and management's discussion and analysis (MD&A) to prevent or detect significant reporting errors and omissions.
- Does not reconcile the results of its asset inventory to the capital asset listing used for financial reporting. Also, the asset listing does not contain an adequate level of detail to track all activity from asset acquisition to disposal. The City's capital asset policy does not require a reconciliation of asset inventories to records used for financial reporting. The policy does not adequately address depreciation procedures for additions and improvements to assets, and assigning a useful life to additions and improvements.

Cause of Condition

Although the City has received prior audit recommendations to improve internal controls over financial reporting, it has not adequately addressed them.

The City has not prioritized the necessary staff time to detect presentation errors, and ensure the accuracy and reasonableness of accounting and financial reporting.

Effect of Condition

The City did not comply with state law requiring supporting documentation to prove the validity of all transactions. Our audit identified concerns with the following:

The City's General Fund and Shop Fund may have improperly benefited from other City Funds. The City transferred \$1,251,429 into the General Fund and \$354,830 into the Shop Fund, including a total of \$1,055,985 and \$197,548, respectively, from City utilities and the City Marina, without adequate supporting documentation.

In addition, the Shop Fund reported revenues of \$622,928 received from other funds, based on an allocation that has not been updated since 2000. These revenues were calculated based on Shop Fund costs that did not agree to the general ledger; the costs allocated exceeded the amount reported in the general ledger by \$16,830.

As a result, we will qualify our opinion on the General Fund, Storm Drain Fund, Marina Fund, and aggregate remaining funds because we were not able to audit records supporting the internal cost allocation used to determine the transfers reported on the financial statements.

When the accuracy of costs allocated to City funds cannot be determined, utility ratepayers and Marina users may not have been correctly charged for services.

The City cannot demonstrate that it is accurately reporting its liabilities related to landfill closure costs and pollution cleanup costs. The City may be over-reporting or under-reporting its future obligations related to these activities.

The City's original financial statements, note disclosures and management's discussion and analysis presented for audit contained numerous errors in presentation, including the omission of a required statement, which did not comply with Generally Accepted

Accounting Principles (GAAP) or the *Budgeting, Accounting, and Reporting System (BARS) Manual*. The City subsequently corrected many of these errors.

We identified three land parcels owned by the City that were not reported as part of its Governmental Activities Land balance. Several assets should have been fully depreciated based on the information provided by the City, but were not. We also identified several assets that had not reached the end of their useful life, but the City reported them as fully depreciated. Other asset records did not contain enough information for us to determine whether depreciation was correctly calculated.

Recommendation

We recommend the City:

- Adopt a plan for its allocation of indirect costs that specifies: The specific costs to be allocated; which funds or accounts the costs will be allocated among; the allocation basis used, including how this basis is measured and how it will allow for the equitable distribution of indirect costs; when the allocation will be made; and the specific calculations used to determine the allocation.
- Re-evaluate all assumptions used in accounting estimates and ensure appropriate documentation is available to support those assumptions.
- Establish detailed procedures for oversight of the process of preparing the financial statements and accompanying schedules.
- Revise its capital asset policy to require annual reconciliation of asset inventory results to the capital asset listing used for financial reporting and to provide criteria for assigning a useful life to improvements and additions to asset.
- Establish procedures for ensuring all activity associated with existing capital assets is documented and maintained until assets are disposed.

City's Response

The City appreciates the insights and recommendations of the State Auditor's Office. The City of Oak Harbor places a high degree of importance in the reporting of operational details to its citizens, and in safeguarding City assets. The City's response to the Schedule of Findings is as follows:

Allocation of costs – For several years the City has utilized a methodology for allocating General Fund and Internal Service Fund costs using conservative estimates of time spent by staff in support of the City's Proprietary Funds. Historically, this methodology was considered an acceptable industry practice and one which had been audited in previous years. The City agrees with the State Auditor's Office recommendation that, in order to provide greater precision and a higher level of assurance that allocated costs are appropriately measured, the allocation of costs should utilize methodologies that are based on measurements that are objective, quantifiable, and which utilize processes that minimize any potential subjective influence of cost allocation practices. The City has already initiated the development of a new cost allocation methodology by sending applicable staff to training, by developing objective measurements to be the basis for

cost transfers, and by building supporting documentation systems to support all allocation assumptions. The City anticipates having this process completed for its 2011 fiscal year.

Landfill liability – The City of Oak Harbor estimated its landfill closure liability during the 1990s. The amount of the estimated future cost of closure was calculated at \$800,000 and, accordingly, the liability was recorded on the City’s financial records. Over the subsequent years until such time the landfill was certified closed, the City incurred costs of \$729,843 which were applied against the initial liability on the City’s financial records. To date, the City has taken the conservative position to continue presenting financially the original closure liability, the accumulated closure costs incurred to date, with the net amount \$70,157 being retained as an actual cash reserve against any future post-closure costs. This presentation and cash reserve position have been discussed during the closing of the financial records each fiscal year. The City appreciates the State Auditor’s Office recommendation to review and update this procedure, and will be reviewing its internal processes to provide an updated estimate of future liability, if any, with the process of review being physically documented each year. The City anticipates having this process completed with the resulting changes reflected on its 2011 financial statements.

Finance statement review process – the City will be improving the methods of review of over financial reporting, to include the allocation of the necessary resources to ensure the review process is complete and accurate.

Capital assets – the City will be implementing the policy change suggestions made by the State Auditors Office, and will ensure that the City’s actual physical inventory is compared to the Capital Asset Listing. In addition, the City is looking to migrate its Capital Asset Listing from an electronic spreadsheet format to a standardized fixed asset tracking application. The City anticipates resolving this issue during the coming year.

Auditor’s Remarks

During our prior audit, we determined the City did not have a formal plan for allocating indirect costs among funds and did not have an appropriate mechanism for determining whether the percentages used to allocate General Fund costs were accurate and reasonable. We made recommendations to management to adopt a formal plan for allocating indirect costs among funds and identify an allocation basis that is measurable and allows equitable distribution of indirect costs.

We appreciate the steps the City is taking to resolve these issues. We will review the condition during our next audit.

Applicable Laws and Regulations

Government Auditing Standards, July 2007 Revision – Section 5.11 provides that auditors should report material weaknesses and significant deficiencies in internal control.

The American Institute of Certified Public Accountants, Statement on Auditing Standards No. 115 defines material weaknesses as follows:

Material weakness: A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

RCW 35A.34.205 states:

Administration, oversight, or supervision of utility – Reimbursement from utility budget authorized. Whenever any code city apportions a percentage of the city manager's, administrator's, or supervisor's time, or the time of other management or general government staff, for administration, oversight, or supervision of a utility operated by the city, or to provide services to the utility, the utility budget may identify such services and budget for reimbursement of the city's current expense fund for the value of such services.

RCW 43.09.200 states:

The state auditor shall formulate, prescribe, and install a system of accounting and reporting for all local governments, which shall be uniform for every public institution, and every public office, and every public account of the same class.

The system shall exhibit true accounts and detailed statements of funds collected, received, and expended for account of the public for any purpose whatever, and by all public officers, employees, or other persons.

The accounts shall show the receipt, use, and disposition of all public property, and the income, if any, derived there from; all sources of public income, and the amounts due and received from each source; all receipts, vouchers, and other documents kept, or required to be kept, necessary to isolate and prove the validity of every transaction; all statements and reports made or required to be made, for the internal administration of the office to which they pertain; and all reports published or required to be published, for the information of the people regarding any and all details of the financial administration of public affairs.

RCW 43.09.210 states in part:

Separate accounts shall be kept for every appropriation or fund of a taxing or legislative body showing date and manner of each payment made therefrom, the name, address, and vocation of each person, organization, corporation, or association to whom paid, and for what purpose paid.

Separate accounts shall be kept for each department, public improvement, undertaking, institution, and public service industry under the jurisdiction of every taxing body.

All service rendered by, or property transferred from, one department, public improvement, undertaking, institution, or public service industry to

another, shall be paid for at its true and full value by the department, public improvement, undertaking, institution, or public service industry receiving the same, and no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another.

Budgeting, Accounting and Reporting System (BARS) Manual - Part 3, Accounting, Chapter 1, Accounting Principles and General Procedures, Section C, Internal Control, states in part:

Management and the governing body are responsible for the government's performance, compliance and financial reporting. Therefore, the adequacy of internal control to provide reasonable assurance of achieving these objectives is also the responsibility of management and the governing body. The governing body has *ultimate* responsibility for ensuring adequate controls to achieve objectives, even though *primary* responsibility has been delegated to management

Budgeting, Accounting and Reporting System (BARS) Manual - Part 3, Accounting, Chapter 7, Capital Assets and Internal Service Fund, Section C, Individual Capital Asset Records, states in part:

An adequate capital asset accounting system should enable the government to meet statutory requirements, to produce adequate records and reports, and to safeguard assets properly.

The basis of a capital asset accounting system is the individual capital asset record. It is necessary to apply careful thought to designing the capital asset record so that the government can accumulate the information it will want later on. Generally it is too costly to reconstruct this data at a later date. The sample format illustrated in this chapter has been designed to collect most of the important data about capital assets; however, not all of this information is mandatory. The following minimum information is required for all capital assets.

1. Category of asset, custody and general ledger asset account. (Boxes 1 - 5)
2. Acquisition information, including reference to source documents and acquisition dates. (Boxes 6a - 6c)
3. Changes in custody or use. (Boxes 2 and 6a - 6c)
4. Source of payment (fund, grants, etc.), historical cost, and account numbers. (Boxes 6d - 6f)
5. Description of asset, including legal descriptions where applicable. (Box 7)
6. Disposition information. (Box 14)

Budgeting, Accounting and Reporting System (BARS) Manual - Part 3, Accounting, Chapter 7, Capital Assets and Internal Service Fund, Section E, Updating the Capital Asset System: Physical Inventory, states in part:

Once the physical inventories are complete, they must be reconciled to the individual capital asset records or the listings of small attractive assets. Since the prelistings are generated from these records, the reconciliation is limited to: (1) identifying those assets that were purchased or transferred-in but not added to or changed on the individual capital asset records or listings of small attractive assets, and (2) investigating the disposal or transfer-out of assets not located. There are several other reconciliations that need to be made. See Chapter 7, Section D for a complete list.

Governmental Accounting Standards Board Statement No. 18, paragraph 6, states in part:

After the initial calculation of estimated total current cost of municipal solid waste landfill (MSWLF) closure and postclosure care, current cost should be adjusted each year for the effects of inflation or deflation. In addition, current cost should be adjusted when changes in the closure or postclosure care plan or MSWLF operating conditions increase or decrease estimated costs.

Independent Auditor's Report on Internal
Control over Financial Reporting and on
Compliance and Other Matters in Accordance
with *Government Auditing Standards*

**City of Oak Harbor
Island County
January 1, 2010 through December 31, 2010**

Mayor and City Council
City of Oak Harbor
Oak Harbor, Washington

We have audited the financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Oak Harbor, Island County, Washington, as of and for the year ended December 31, 2010, which collectively comprise the City's basic financial statements, and have issued our report thereon dated February 22, 2012. Our report includes a qualified opinion on the financial statements of the General, Storm Drain and Marina and the aggregate remaining funds information.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Audit Findings and Responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented,

or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Audit Findings and Responses as Finding 1 to be material weaknesses.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of the City's compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The City's response to the finding identified in our audit is described in the accompanying Schedule of Audit Findings and Responses. We did not audit the City's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of management and the Mayor and City Council. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

A handwritten signature in black ink, appearing to read "Brian Sonntag". The signature is fluid and cursive, with the first name "Brian" and last name "Sonntag" clearly distinguishable.

BRIAN SONNTAG, CGFM
STATE AUDITOR

February 22, 2012

Independent Auditor's Report on Financial Statements

City of Oak Harbor Island County January 1, 2010 through December 31, 2010

Mayor and City Council
City of Oak Harbor
Oak Harbor, Washington

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Oak Harbor, Island County, Washington, as of and for the year ended December 31, 2010, which collectively comprise the City's basic financial statements as listed on page 12. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

The City allocated costs of \$1,251,429 and \$354,840, respectively, from the General Fund and aggregate remaining fund to other City funds for internal services provided to those funds. These transfers of costs comprised a significant portion of total expenses in the Storm Drain Fund (\$208,397) and the Marina Fund (\$91,178). The City does not have support for this internal cost allocation, as required by generally accepted accounting principles (GAAP), and therefore we were unable to determine the correct values of the allocated costs.

The City also did not present other inter-fund activity in accordance with GAAP in the financial statements. Transfers between funds included in the aggregate remaining fund information should be eliminated for financial reporting purposes; however, the City did not eliminate these transfers. Therefore, aggregate remaining fund information transfers in and transfers out are overstated by \$340,000.

In our opinion, except for the overstatement of aggregate remaining fund transfers and for the effects of any adjustments that might have been determined had we been able to examine evidence regarding the internal cost allocation between the General, Storm Drain, Marina and aggregate remaining funds information, as described in the preceding paragraphs, the financial statements referred to above present fairly, in all material respects, the respective financial position of the General, Storm Drain, Marina and the aggregate remaining funds information of

the City of Oak Harbor, as of December 31, 2010, and the respective changes in financial position and, where applicable, cash flows thereof, and the budgetary comparison for the General Fund, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, business-type activities, Arterial Fund, Water Fund, Sewer Fund and Solid Waste Fund of the City of Oak Harbor, as of December 31, 2010, and the respective changes in financial position and, where applicable, cash flows thereof, and the budgetary comparison for the Arterial Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 13 through 21 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink, appearing to read "Brian Sonntag". The signature is fluid and cursive, with the first name "Brian" and last name "Sonntag" clearly distinguishable.

BRIAN SONNTAG, CGFM
STATE AUDITOR

February 22, 2012

Financial Section

**City of Oak Harbor
Island County
January 1, 2010 through December 31, 2010**

REQUIRED SUPPLEMENTAL INFORMATION

Management's Discussion and Analysis – 2010

BASIC FINANCIAL STATEMENTS

Statement of Net Assets – 2010

Statement of Activities – 2010

Balance Sheet – Governmental Funds – 2010

Reconciliation of the Balance Sheet of the Governmental Funds to the Statement of Net Assets – 2010

Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds – 2010

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of the Governmental Funds to the Statement of Activities – 2010

Statement of Revenues, Expenditures and Changes in Fund Balances – Budget and Actual – General Fund – 2010

Statement of Revenues, Expenditures and Changes in Fund Balances – Budget and Actual – Arterial Fund – 2010

Statement of Net Assets – Proprietary Funds – 2010

Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Funds – 2010

Statement of Cash Flows – Proprietary Funds – 2010

Notes to Financial Statements – 2010

Management Discussion and Analysis

As management of the City of Oak Harbor, we offer readers of the city's financial statements this narrative overview and analysis of the financial activities of the City of Oak Harbor for the fiscal year ended December 31, 2010. This information is provided in an effort to assist the reader in focusing on significant financial events, to provide an overview of the City's financial activity, to identify changes in the City's financial position, to identify deviations from the City's adopted budget, and to identify individual fund issues and concerns. We encourage readers to consider the information presented here in conjunction with additional information presented in the form of financial statements, footnotes, and other data.

Financial Highlights

- The City's overall financial condition improved in 2010, as compared to 2009.
- Total City's net assets on a consolidated basis equal \$119,857,374, representing the net difference between assets and liabilities. This balance is comprised of \$71,239,040 invested in net capital assets, net of related debt, \$16,641,401 in restricted net assets for capital projects, \$953,353 in restricted assets for debt service, and \$31,023,580 in unrestricted net assets.
- As shown on the Statement of Net Assets, fiscal year December 31, 2010, the City ended with an Unrestricted Net Asset Balance of \$10,544,316 in Governmental Activities. These monies are intended to provide a cushion against significant downturns in revenues and to maintain sufficient working capital and cash flow to meet daily financial needs. Other reserves have been designated by management to address annual budget amendments, vehicle and equipment replacements, major building repairs, and future facility improvements.
- Total Change in Net Assets, as found on the Statement of Activities, from Governmental activities and Business-type activities is \$652,743 and \$3,654,672, respectively.

Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to the City of Oak Harbor's basic financial statements. The City of Oak Harbor's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves. The City of Oak Harbor has adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments* as of January 1, 2002.

Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the City of Oak Harbor's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *Statement of Activities* presents information showing how the City's net assets changed during the most recent fiscal year. All changes in the net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash

flows. Thus, revenues and expenses are reported in the statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City of Oak Harbor that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City of Oak Harbor include general government, judicial, public safety, highways and streets, economic development, senior services, and culture and recreation. The business-type activities of the City include water, sewer, solid waste, and storm water utilities, and a municipal marina as well.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Oak Harbor, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statement, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of the governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City of Oak Harbor maintains 21 individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund and the Arterial Fund, as they are considered to be major funds. Data from the remaining governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of combining statements in the city's full report, which is available upon request.

The City of Oak Harbor adopts a biennial appropriated budget for its General Fund and Arterial Fund. A budgetary comparison statement has been provided for the General Fund and the Arterial Fund to demonstrate compliance with this budget.

Proprietary funds. The City of Oak Harbor maintains two types of proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for its Water, Sewer, Solid Waste, and Storm Drainage Utilities and Municipal Marina. Internal service funds are an accounting device used to accumulate and allocate costs internally among the City's

various functions. The City uses internal service funds to account for its fleet of vehicles, central stores, labor pool, technology assets, and for facilities maintenance.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Water, Sewer, Solid Waste, Storm Drainage Utilities and the Municipal Marina as all are considered, or have been designated to be major funds of the City. The internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data is provided in the form of combining statements in the city's full report, which is available upon request.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary are consolidate into the government-wide financial statements because the resources of those funds are available to support the City of Oak Harbor's programs. The City does not utilize Fiduciary funds at this time.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Other information. In addition to the basic financial statements and accompanying notes, required supplementary information presents a budgetary comparison schedule for the General Fund and the Arterial Fund to demonstrate compliance with the budget.

Government-wide Financial Analysis

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City of Oak Harbor, assets exceeded liabilities by \$119,857,374. The largest portion of the City's net assets (59.4%) reflects its investment in capital assets (land, buildings, machinery, and equipment), less related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

	Net Assets					
	Governmental		Business-type		Totals	
	Activities		Activities			
Assets	2010	2009	2010	2009	2010	2009
Current	\$19,203,316	\$20,511,238	\$33,907,380	\$32,694,517	\$53,110,696	\$53,205,755
Capital assets	25,757,432	23,570,936	48,839,911	46,656,605	74,597,343	70,227,541
Total assets	44,960,748	44,082,174	82,747,291	79,351,122	127,708,039	123,433,296
Liabilities						
Long-term	1,576,510	1,698,415	3,765,610	4,269,874	5,342,120	5,968,289
Other	1,329,900	982,164	1,178,645	932,884	2,508,545	1,915,048
Total liabilities	2,906,410	2,680,579	4,944,255	5,202,758	7,850,665	7,883,337
Net Assets						
Invested in capital assets						
net of related debt	25,757,432	23,570,936	45,481,608	42,762,613	71,239,040	66,333,549
Restricted	5,752,590	6,156,440	11,842,164	11,397,043	17,594,754	17,553,483
Unrestricted	10,544,316	11,674,219	20,479,264	19,988,708	31,023,580	31,662,927
Total net assets	42,054,338	41,401,595	77,803,036	74,148,364	119,857,374	115,549,959

A portion of the City's net assets (14.7%) represent resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets (25.9%) may be used to meet the city's ongoing obligations to citizens and creditors.

At the end of the current fiscal year, the City is able to report positive balances in all three categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities. The same situation was true of the prior year.

Changes in Net Assets

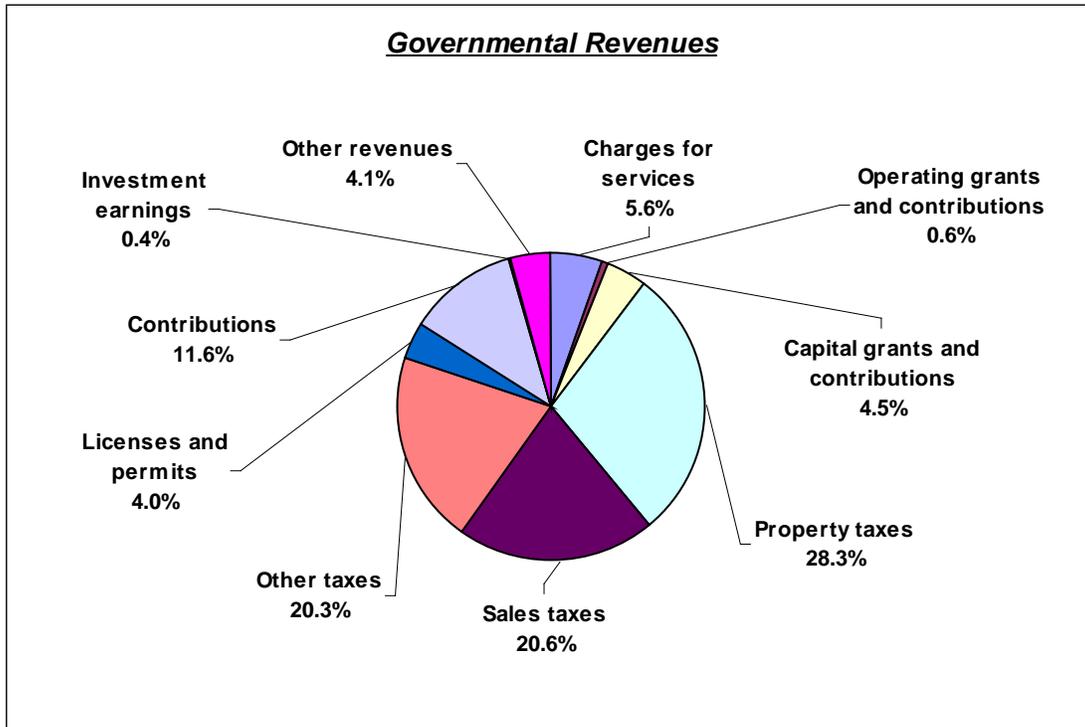
The changes in net assets table illustrates the increases or decreases in net assets of the City resulting from its operating activities. The table shows the revenues, expenses, and related changes in net assets in tabular form for the governmental activities separate from the business-type activities for 2010 and 2009.

	Changes in Net Assets					
	Governmental Activities		Business-type Activities		Totals	
	2010	2009	2010	2009	2010	2009
Revenues						
Program revenues						
Charges for services	\$795,055	\$806,610	\$14,384,752	\$14,378,114	\$15,179,807	\$15,184,724
Operating grants and contributions	87,486	127,696	28,966	30,565	116,452	158,261
Capital grants and contributions	630,300	20,240	1,218,255	1,236,923	1,848,555	1,257,163
General revenues						
Property taxes	4,006,062	3,983,435	-	-	4,006,062	3,983,435
Sales and use taxes	2,920,891	3,276,747	-	-	2,920,891	3,276,747
Other taxes	2,875,652	3,139,412	-	-	2,875,652	3,139,412
Other revenues	2,832,941	3,061,958	371,152	523,330	3,204,093	3,585,288
Total revenues	14,148,387	14,416,098	16,003,125	16,168,932	30,151,512	30,585,030
Expenses						
Governmental						
General government	2,598,075	2,526,182	-	-	2,598,075	2,526,182
Judicial	363,212	418,655	-	-	363,212	418,655
Public safety	6,939,632	6,643,759	-	-	6,939,632	6,643,759
Physical environment	263,007	179,089	-	-	263,007	179,089
Transportation	1,480,987	1,136,291	-	-	1,480,987	1,136,291
Health and human services	410,128	445,042	-	-	410,128	445,042
Economic environment	847,179	921,456	-	-	847,179	921,456
Culture and recreation	1,559,296	1,422,123	-	-	1,559,296	1,422,123
Interest on long-term debt	17,840	32,198	-	-	17,840	32,198
Other expenses	-	-	-	-	-	-
Business-type						
Water	-	-	3,527,231	3,426,584	3,527,231	3,426,584
Sewer	-	-	3,067,084	3,073,823	3,067,084	3,073,823
Solid waste	-	-	2,732,853	2,752,195	2,732,853	2,752,195
Storm drain	-	-	1,027,554	1,030,034	1,027,554	1,030,034
Marina	-	-	1,010,019	997,785	1,010,019	997,785
Total expenses	14,479,356	13,724,795	11,364,741	11,280,421	25,844,097	25,005,216
Change in net assets before transfers	(330,969)	691,303	4,638,384	4,888,511	4,307,415	5,579,814
Transfers	983,712	950,122	(983,712)	(950,122)	-	-
Change in net assets	652,743	1,641,425	3,654,672	3,938,389	4,307,415	5,579,814
Net assets - beginning	41,401,595	39,760,170	74,148,364	70,209,975	115,549,959	109,970,145
Net assets - ending	42,054,338	41,401,595	77,803,036	74,148,364	\$119,857,374	\$115,549,959

Revenues by Source

Governmental activities contributed \$652,743 of the total change in net assets of \$4,307,415. The increase in net assets in 2010 was lower than the increase in net assets for 2009 by \$988,682. The key element of this decrease is as follows:

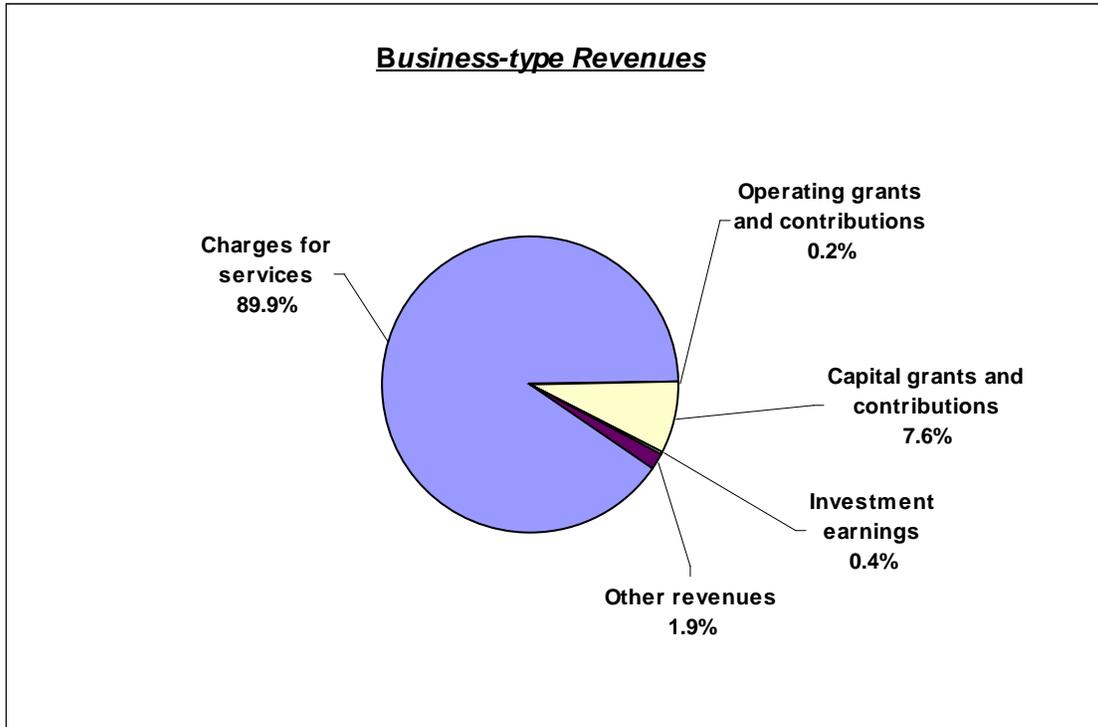
During 2010, the City experienced a downturn in sales and utility tax revenues as a result of the current economic recession. Accordingly, total governmental activities revenue is 1.9% less than total governmental revenues in 2009. In addition, public safety costs increased during 2010, primarily due to increased personnel expenditures, with an increase also experienced in transportation expenses due to a number of capital outlay expenditures during the year.



The above chart includes debt service, but excludes net transfers.

Business-type activities increased the City of Oak Harbor's net assets by \$3,654,672 or 84.8% of the total change of net assets of \$4,307,415. Business-type activities accounts for 64.9% of the City's net assets. Key reasons for this increase include:

- The City is adjusting its utility rate structure to begin accumulating fund balances reserves in advance of a number of significant sewage treatment, storm water drainage, and water treatment infrastructure upgrades.
- A financially secure rate structure.
- The continued accumulation of system development fees, service revenue, and other funding sources for capital projects scheduled for future years.



The above chart excludes net transfers.

Financial Analysis of the City's Funds

As noted earlier, the City of Oak Harbor uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of the city's net resources available for spending at the end of a fiscal year.

As of the end of 2010, the City's governmental funds reported combined ending fund balances of \$17,865,763. Nearly all of this constitutes unreserved fund balance, which is available for spending at the city's discretion. While none of these funds are restricted by legislation or ordinance, portions of the unreserved fund balance are used to pay debt service and for other specific uses.

The general fund is the chief operating fund of the City. At the end of 2010, unreserved fund balance of the general fund was \$6,659,979. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. The general fund unreserved fund balance represents 100.0% of total General Fund net assets.

The fund balance of the City of Oak Harbor's general fund decreased by \$267,330 during 2010. Key factors include:

- A decrease in the sales tax and utility tax revenue.
- An increase in employee compensation from labor union agreements.
- Increased medical benefit costs.

Proprietary Funds

The City of Oak Harbor's enterprise funds are all presented as major funds for purposes of this report. As a result, all statements related to the enterprise funds are presented at the entity-wide level. The City does have Internal Service funds which are reported in the fund statements.

General Fund Budgetary Highlights

For 2010, the adopted general fund budget for expenditures, net of ending fund balance, was \$13,129,006, the final budget was \$12,749,105, and the actual expenditures were \$12,645,657. Amendments to the City budget are made for the following purposes:

- Reallocating fund resources between various line items within the General Fund.
- To record the award of a \$27,000 Homeland Security Grant for the fire department.
- To adjust the budget for the move of the Engineering Department from City Hall to the Public Works Facility, and to transfer the appropriation authority for the department to Fund #510 Facility Fund.
- To increase the budget for the newly acquired Whidbey Island Marathon.
- To carryover unexpended appropriations expiring on December 31, 2009 to the actual beginning fund balances as of January 1, 2010.

Actual revenues were \$319,830 less than the final budget, or 97.5%. Actual expenditures are \$103,448 lower than final budget amounts, net of budgeted ending fund balance, or 99.2%. See below for the primary contributing factors:

- Sales taxes were less than projections by \$191,620.
- Utility taxes were less than projections by 52,841.
- Property taxes were less than projections by \$110,500.
- Actual budgetary expenditures were less than projections due to conservative cost monitoring, and by the vacancy of various staff positions within the General Fund.

Capital Assets and Debt Administration

Capital Assets

The City of Oak Harbor's investment in non-current and capital assets for its governmental and business type activities as of December 31, 2010, amounts to \$74,597,343 (net of accumulated depreciation). This investment in capital assets includes land, buildings and system, improvements, machinery and equipment, and park facilities. The City has completed its inventory and analysis of its roads, highways, and bridges as capital assets of the city.

Capital assets, net of accumulated depreciation, in governmental activities increased from \$23,570,936 in 2009 to \$25,757,432 in 2010 primarily due to the renovation of North Oak Harbor Street. Capital assets in business-type activities increased from \$46,656,605 in 2009 to

\$48,839,911 in 2010. This increase is primarily due to upgrades to the City's utility infrastructure and Marina, and donated capital infrastructure received from developers.

Non-current Liabilities

At the end of 2010, the City of Oak Harbor had total non-current liabilities consisting of outstanding bonded debt, PWTF loans, and other long-term liabilities as reflected on the Statement of Net Assets, of \$5,342,120.

Economic Factors and the Next Year's Budgets and Rates

The city continues to recover from the effects of the slow economy and changes in state laws as it develops its budgets and financial plans for the future.

Slow Economy

The local economy has experienced some of the deceleration that other communities have felt since the events of September 11, 2001. On a national level, the effects of this event, combined with the economic impacts of the banking insolvencies, real estate devaluations, and declines in equity markets on a national level, the costs of energy, and the negative effects of the sub-prime market continue to be apparent. From a local perspective, sales taxes represent a significant revenue component and a barometer of the local economy. Sales tax receipts were approximately 10.9% lower than the previous year. Most of this was due to the loss of two major car dealerships. Accordingly, it is anticipated that sales tax receipts in 2011 will be less than 2010.

The City continues to experience a moderate demand for single family housing. There remain several undeveloped parcels within the City limits that are scheduled for development over the next 24 to 36 months. The eventual development will result in increased property tax receipts, however the sales tax receipts as a result of construction will begin to decrease as the inventory of available parcels of property becomes smaller. As always, the outcome will be determined on the general economy and improved consumer confidence.

Changes in State Law

Washington has seen a wave of initiatives and anti-tax measures over the past several years. The most significant changes are the elimination of the motor vehicle excise tax, the elimination of a motor vehicle license fee and the imposition of a one-percent limit to increases in the property tax.

In 1999, the City of Oak Harbor received in excess of \$800,000 per year from the State Motor Vehicle Excise tax, representing approximately 9% of the General Fund. This tax was eliminated in 2000 by the State Legislature which enacted the change after an initiative was approved by the voters; even though the initiative was reversed by the courts as unconstitutional. For a brief time, the state provided "back fill" money to help offset the losses to cities and counties. This amounted to about \$140,000 annually in Oak Harbor. However, the state discontinued the backfill to Oak Harbor in 2004.

In 2001 the voters approved an initiative which reduced the permitted increase in property taxes from six percent to one percent each year. The property tax laws are quite complicated and there is a provision whereby the City of Oak Harbor has "banked" past capacity. However, the various legislative bodies, including the Oak Harbor City Council are very mindful of the voter's interests in keeping taxes and fees at a minimum.

During 2008, the State of Washington implemented the Streamlined Sales tax (SST) program of distributing sales tax receipts to local cities. Sales taxes on remote sales now are distributed to

the receiving location rather than the location where the remote sale was originated. It is anticipated that the During 2009, the City received a higher allocation of sales tax receipts from this change as the mix of light manufacturing and order receiving entities is smaller in size than many communities. This increase in allocation is expected to continue in the future.

Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Director, City of Oak Harbor, 865 SE Barrington Drive, Oak Harbor, WA 98277.

**City of Oak Harbor
Statement of Net Assets
December 31, 2010**

	Primary Government		
	Governmental Activities	Business-type Activities	Total
Assets			
Cash & cash equivalents	\$ 16,782,864	\$ 25,308,037	\$ 42,090,901
Receivables (net)	537,614	1,219,679	1,757,293
Internal balances	94,559	(94,559)	-
Due from other governments	1,102,575	9,341	1,111,916
Inventories	-	72,945	72,945
Bond issue cost net of accumulated amortization	-	50,925	50,925
Restricted assets:			
Cash & cash equivalents	685,704	7,341,012	8,026,716
Capital assets not being depreciated:			
Land	8,650,562	1,333,347	9,983,909
Construction in progress	1,651,776	2,306,247	3,958,023
Intangible assets	26,000	-	26,000
Capital assets net of accumulated depreciation:			
Buildings and system	4,305,839	4,816,241	9,122,080
Improvements other than buildings	261,410	35,992,893	36,254,303
Machinery and equipment	979,852	4,391,183	5,371,035
Infrastructure	9,881,993	-	9,881,993
Total assets	\$ 44,960,748	\$ 82,747,291	\$ 127,708,039
Liabilities			
Accounts payable	\$ 716,393	\$ 917,932	\$ 1,634,325
Accrued interest payable	-	39,653	39,653
Other current liabilities	279,889	197,348	477,237
Deferred revenue	333,618	23,712	357,330
Noncurrent liabilities:			
Due within one year:			
Compensated absences	454,202	134,860	589,062
Other long-term liabilities	-	51,344	51,344
Bonds payable, net	49,565	500,000	549,565
Due in more than one year:			
Compensated absences	681,303	202,290	883,593
Other long-term liabilities	366,019	817,341	1,183,360
Bonds payable, net	25,421	2,059,775	2,085,196
Total liabilities	2,906,410	4,944,255	7,850,665
Net Assets			
Invested in capital assets net of related debt	25,682,446	45,481,608	71,164,054
Restricted for:			
Capital projects	5,752,590	10,888,811	16,641,401
Debt service	-	953,353	953,353
Unrestricted	10,619,302	20,479,264	31,098,566
Total net assets	\$ 42,054,338	\$ 77,803,036	\$ 119,857,374

The accompanying notes are an integral part of this statement.

**City of Oak Harbor
Statement of Activities
For the Year Ended December 31, 2010**

Function/Program	Program Revenues			Net (Expense) Revenue and Changes in Net Assets			
	Expenses	Charges for Services	Capital Contributions	Changes in Net Assets			
				Operating Grants and Contributions	Governmental Activities	Business-type Activities	Total
Primary government							
Governmental activities:							
General government	\$ 2,598,075	\$ 92,010	\$ -	\$ -	\$ (2,506,065)	\$ -	\$ (2,506,065)
Judicial	363,212	-	-	-	(363,212)	-	(363,212)
Public safety	6,939,632	54,109	115,543	23,783	(6,746,197)	-	(6,746,197)
Physical environment	263,007	20	641	-	(262,346)	-	(262,346)
Transportation	1,480,987	67,102	1,191,554	477,722	255,391	-	255,391
Health and human services	410,128	171,544	101,820	-	(136,764)	-	(136,764)
Economic environment	847,179	65,685	17,077	-	(764,417)	-	(764,417)
Culture and recreation	1,559,296	344,585	-	128,795	(1,085,916)	-	(1,085,916)
Interest on long-term debt	17,840	-	-	-	(17,840)	-	(17,840)
Total governmental activities	14,479,356	795,055	1,426,635	630,300	(11,627,366)	-	(11,627,366)
Business-type activities:							
Water	3,527,231	4,371,591	-	151,419	-	995,779	995,779
Sewer	3,067,084	4,380,429	4,294	937,994	-	2,255,633	2,255,633
Solid waste	2,732,853	3,083,072	-	-	-	350,219	350,219
Storm drain	1,027,554	1,278,710	12,834	111,769	-	375,759	375,759
Marina	1,010,019	1,270,950	11,838	17,073	-	289,842	289,842
Total business-type activities	11,364,741	14,384,752	28,966	1,218,255	-	4,267,232	4,267,232
Total primary government	\$ 25,844,097	\$ 15,179,807	\$ 1,455,601	\$ 1,848,555	(11,627,366)	4,267,232	(7,360,134)

General revenues:

Property taxes	4,006,062	-	4,006,062
Sales and use taxes	2,920,891	-	2,920,891
Business, occupancy and other taxes	2,875,652	-	2,875,652
Licenses and permits	562,699	-	562,699
Grants and other contributions not restricted to specific programs	298,712	21,164	319,876
Unrestricted investment earnings	56,349	68,991	125,340
Miscellaneous	576,032	268,497	844,529
Gain (loss) on sale of assets	-	12,500	12,500
Transfers	983,712	(983,712)	-
Total general revenues and transfers	12,280,109	(612,560)	11,667,549
Change in net assets	652,743	3,654,672	4,307,415
Net assets - beginning	41,401,595	74,148,364	115,549,959
Net assets - ending	\$ 42,054,338	\$ 77,803,036	\$ 119,857,374

The accompanying notes are an integral part of this statement.

**City of Oak Harbor
Balance Sheet
Governmental Funds
December 31, 2010**

	General Fund	Arterial Fund	Other Governmental Funds	Total Governmental Funds
Assets				
Cash & cash equivalents	\$ 7,061,797	\$ 940,268	\$ 8,780,799	\$ 16,782,864
Accounts receivables (net)	502,198	-	35,416	537,614
Due from other funds	42,266	-	-	42,266
Due from other governments	15,554	-	128,795	144,349
Restricted cash	59,400	-	299,270	358,670
Total assets	\$ 7,681,215	\$ 940,268	\$ 9,244,280	\$ 17,865,763
Liabilities and Fund Balances				
Liabilities				
Accounts payable	\$ 164,978	\$ 226,897	\$ 134,429	\$ 526,304
Deposits	134,637	78,785	66,467	279,889
Due to other funds	580	7,045	2,807	10,432
Deferred revenue	298,664	-	34,954	333,618
Compensated absences	422,377	-	31,825	454,202
Total liabilities	1,021,236	312,727	270,482	1,604,445
Fund balances				
Unreserved, reported in:				
General fund	6,659,979	-	-	6,659,979
Special revenue funds	-	627,541	3,221,208	3,848,749
Capital project funds	-	-	5,752,590	5,752,590
Total fund balance	6,659,979	627,541	8,973,798	16,261,318
Total liabilities and fund balances	\$ 7,681,215	\$ 940,268	\$ 9,244,280	\$ 17,865,763

The accompanying notes are an integral part of this statement.

**City of Oak Harbor
Reconciliation of the Balance Sheet
of the Governmental Funds
to the Statement of Net Assets
December 31, 2010**

Total fund balances—governmental funds \$ 16,261,318

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and are not reported in funds:

Historical cost of assets not being depreciated	\$ 10,328,338	
Historical cost of assets being depreciated	39,143,489	
Accumulated depreciation	<u>(24,026,470)</u>	25,445,357

Long-term assets not available to pay for current period expenditures and therefore deferred	958,226
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Internal service funds are used by management to charge the costs of fleet management, shop facilities and information systems to individual funds. The assets and liabilities of the internal service funds are included in the governmental activities in the statement of net assets.	670,602
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Some liabilities are not due and payable in the current period and therefore are not reported in the funds, including:

Accounts payable	\$ (158,857)	
Compensated absences	(681,303)	
Bonds and interest payable	(74,986)	
Other post-employment benefit liabilities	<u>(366,019)</u>	(1,281,165)

Net assets of governmental activities	\$ 42,054,338
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The accompanying notes are an integral part of this statement.

City of Oak Harbor
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
For the Year Ended December 31, 2010

	General Fund	Arterial Fund	Other Governmental Funds	Total Governmental Funds
Revenues				
Taxes	\$ 9,244,655	\$ -	\$ 505,412	\$ 9,750,067
Licenses and permits	558,541	-	4,158	562,699
Intergovernmental	462,115	616,993	1,280,713	2,359,821
Charges for services	508,827	-	286,228	795,055
Fines and forfeits	146,812	-	-	146,812
Interest revenue	28,606	3,057	24,686	56,349
Miscellaneous	177,342	6,906	245,753	430,001
Total revenues	11,126,898	626,956	2,346,950	14,100,804
Expenditures				
Current:				
General government	2,517,209	-	-	2,517,209
Judicial	364,853	-	-	364,853
Public safety	6,730,425	-	-	6,730,425
Physical environment	248,727	-	-	248,727
Transportation	-	143,099	928,337	1,071,436
Health and human services	27,711	-	368,831	396,542
Economic environment	841,533	-	-	841,533
Culture and recreation	1,305,925	-	145,517	1,451,442
Debt Service:				
Principal	-	-	287,911	287,911
Interest	-	-	17,840	17,840
Capital outlay	20,066	2,579,427	260,087	2,859,580
Total expenditures	12,056,449	2,722,526	2,008,523	16,787,498
Excess (deficiency) of revenues over (under) expenditures	(929,551)	(2,095,570)	338,427	(2,686,694)
Other Financing Sources (Uses)				
Transfers in	1,251,429	700,000	538,321	2,489,750
Transfers out	(589,208)	(88,767)	(883,683)	(1,561,658)
Total other financing sources (uses)	662,221	611,233	(345,362)	928,092
Net change in fund balances	(267,330)	(1,484,337)	(6,935)	(1,758,602)
Fund balances - beginning	6,927,309	2,111,878	8,980,733	18,019,920
Fund balances - ending	\$ 6,659,979	\$ 627,541	\$ 8,973,798	\$ 16,261,318

The accompanying notes are an integral part of this statement.

City of Oak Harbor
Reconciliation of the Statement of Revenues
Expenditures, and Changes in Fund Balances of the Governmental Funds
to the Statement of Activities
For the Year Ended December 31, 2010

Net change in fund balances—governmental funds \$ (1,758,602)

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as outlays exceeded depreciation in the current period:

Capital outlay	\$ 2,859,580	
Depreciation	<u>(1,020,081)</u>	1,839,499

Donated capital increases net assets in the statement of activities, but does not appear in the governmental funds because it is not a financial resource. 358,892

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds. 47,583

Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets and does not effect the statement of activities 287,911

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds, including:

Change in accounts payable	\$ (45,921)	
Change in compensated absences	(32,795)	
Other post-employment benefit expense	<u>(111,347)</u>	(190,063)

Internal service funds are used by management to charge the costs of fleet management, shop facilities and information systems to individual funds. The net revenues and expenses of the internal service funds are reported with governmental activities in the statement of activities. 67,523

Change in net assets of governmental activities \$ 652,743

The accompanying notes are an integral part of this statement.

City of Oak Harbor
Statement of Revenues, Expenditures, and Changes in Fund Balances — Budget and Actual
General Fund
For the Year Ended December 31, 2010

	Budgeted Amounts		Actual Amounts	Total Variance with Final Budget
	Original	Final		
Revenues				
Taxes	\$ 9,605,349	\$ 9,605,349	\$ 9,244,655	\$ (360,694)
Licenses and permits	491,650	491,650	558,541	66,891
Intergovernmental	396,000	423,000	462,115	39,115
Charges for services	470,700	590,300	508,827	(81,473)
Fines and forfeits	173,000	173,000	146,812	(26,188)
Interest revenue	162,000	162,000	28,606	(133,394)
Miscellaneous	68,550	83,550	177,342	93,792
Total revenues	11,367,249	11,528,849	11,126,898	(401,951)
Expenditures				
Current:				
General government	2,476,029	2,527,920	2,517,209	10,711
Judicial	419,250	419,250	364,853	54,397
Public safety	6,733,369	6,848,637	6,730,425	118,212
Physical environment	1,007,473	290,158	248,727	41,431
Health and human services	24,000	26,400	27,711	(1,311)
Economic environment	790,919	805,264	841,533	(36,269)
Culture and recreation	1,153,434	1,257,084	1,305,925	(48,841)
Capital outlay	20,700	70,560	20,066	50,494
Total expenditures	12,625,174	12,245,273	12,056,449	188,824
Excess (deficiency) of revenues over (under) expenditures	(1,257,925)	(716,424)	(929,551)	(213,127)
Other Financing Sources (Uses)				
Transfers in	1,871,163	1,169,308	1,251,429	82,121
Transfers out	(503,832)	(503,832)	(589,208)	(85,376)
Total other financing sources (uses)	1,367,331	665,476	662,221	(3,255)
Net change in fund balances	109,406	(50,948)	(267,330)	(216,382)
Fund balances - beginning	2,765,347	3,765,659	6,927,309	3,161,650
Fund balances - ending	\$ 2,874,753	\$ 3,714,711	\$ 6,659,979	\$ 2,945,268

The accompanying notes are an integral part of this statement.

City of Oak Harbor
Statement of Revenues, Expenditures, and Changes in Fund Balances — Budget and Actual
Arterial Fund
For the Year Ended December 31, 2010

	Budgeted Amounts		Actual Amounts	Total Variance with Final Budget
	Original	Final		
Revenues				
Intergovernmental	\$ 1,135,000	\$ 1,135,000	\$ 616,993	\$ (518,007)
Interest revenue	45,000	45,000	3,057	(41,943)
Miscellaneous	-	-	6,906	6,906
Total revenues	1,180,000	1,180,000	626,956	(553,044)
Expenditures				
Current:				
Transportation	-	80,339	143,099	(62,760)
Capital outlay	4,150,000	2,650,000	2,579,427	70,573
Total expenditures	4,150,000	2,730,339	2,722,526	7,813
Excess (deficiency) of revenues over (under) expenditures				
	(2,970,000)	(1,550,339)	(2,095,570)	(545,231)
Other Financing Sources (Uses)				
Transfers in	3,200,000	3,200,000	700,000	(2,500,000)
Transfers out	(155,631)	(79,555)	(88,767)	(9,212)
Total other financing sources (uses)	3,044,369	3,120,445	611,233	(2,509,212)
Net change in fund balances	74,369	1,570,106	(1,484,337)	(3,054,443)
Fund balances - beginning	2,622,523	2,111,877	2,111,878	1
Fund balances - ending	\$ 2,696,892	\$ 3,681,983	\$ 627,541	\$ (3,054,442)

The accompanying notes are an integral part of this statement.

City of Oak Harbor
Statement of Net Assets
Proprietary Funds
December 31, 2010

	Business-Type Activities							Internal Service Funds
	Water and Water Reserve Fund	Sewer and Sewer Reserve Fund	Solid Waste Reserve Fund	Storm Drain and Storm Drain Reserve Fund	Marina and Marina Reserve Fund	Total		
Assets								
Current assets:								
Cash & cash equivalents	\$ 9,101,706	\$ 11,404,183	\$ 2,795,837	\$ 1,032,902	\$ 812,557	\$ 25,147,185	\$ 160,852	
Accounts receivables (net)	354,846	405,539	280,343	138,835	40,116	1,219,679	-	
Due from other funds	-	-	-	-	-	-	428	
Due from other governments	-	-	-	-	9,341	9,341	-	
Inventories	-	-	-	-	41,582	41,582	-	
Bond issue cost net of accumulated amortization	-	50,925	-	-	-	50,925	-	
Total current assets	9,456,552	11,860,647	3,076,180	1,171,737	903,596	26,468,712	192,643	
Noncurrent assets:								
Restricted cash	455,852	593,123	74,856	48,000	64,070	1,235,901	6,432,145	
Capital assets net of accumulated depreciation:								
Land	99,589	4,200	201,810	-	1,027,748	1,333,347	-	
Construction in progress	83,825	185,990	-	1,924	1,593,551	1,865,290	440,957	
Buildings and system	201,629	711,417	-	-	453,509	1,366,555	3,449,686	
Improvements other than buildings	14,713,576	19,064,667	103,996	1,375,499	695,285	35,953,023	301,280	
Machinery and equipment	1,024,574	1,422,330	24,043	10,725	8,883	2,490,555	1,951,293	
Total noncurrent assets	16,579,045	21,981,727	404,705	1,436,148	3,843,046	44,244,671	12,575,361	
Total assets	\$ 26,035,597	\$ 33,842,374	\$ 3,480,885	\$ 2,607,885	\$ 4,746,642	\$ 70,713,383	\$ 12,768,004	

The accompanying notes are an integral part of this statement.

City of Oak Harbor
Statement of Net Assets
Proprietary Funds
December 31, 2010
(Continued)

	Business-Type Activities						Total	Internal Service Funds
	Water and Water Reserve Fund	Sewer and Sewer Reserve Fund	Solid Waste and Solid Waste Reserve Fund	Storm Drain and Storm Drain Reserve Fund	Marina and Marina Reserve Fund			
Liabilities								
Current liabilities:								
Accounts payable	\$ 138,817	\$ 176,493	\$ 103,939	\$ 5,781	\$ 424,591	\$ 849,621	\$ 99,543	
Deposits	13,695	-	4,700	48,000	64,069	130,464	-	
Retainage	-	-	-	-	57,736	57,736	9,148	
Due to other funds	7,834	11,911	5,454	1,809	2,240	29,248	3,014	
Interest payable	1,996	37,657	-	-	-	39,653	-	
Deferred revenue	18,672	5,040	-	-	-	23,712	-	
Compensated absences	26,177	8,207	15,630	16,781	6,501	73,296	61,564	
Due to other governments	51,344	-	-	-	-	51,344	-	
Bonds payable, net	-	500,000	-	-	-	500,000	-	
Total current liabilities	258,535	739,308	129,723	72,371	555,137	1,755,074	173,269	
Noncurrent liabilities:								
Compensated absences	39,265	12,310	23,445	25,172	9,752	109,944	92,346	
Due to other governments	747,184	-	-	-	-	747,184	-	
Bonds payable, net	-	2,059,775	-	-	-	2,059,775	-	
Landfill closure	-	-	70,157	-	-	70,157	-	
Total noncurrent liabilities	786,449	2,072,085	93,602	25,172	9,752	2,987,060	92,346	
Total liabilities	1,044,984	2,811,393	223,325	97,543	564,889	4,742,134	265,615	
Net Assets								
Invested in capital assets								
net of related debt	15,324,665	18,828,829	329,849	1,388,148	3,778,976	39,650,467	6,143,216	
Restricted for:								
Capital projects	5,596,647	4,765,569	115,777	410,818	-	10,888,811	-	
Debt service	360,230	593,123	-	-	-	953,353	-	
Unrestricted	3,709,071	6,843,460	2,811,934	711,376	402,777	14,478,618	6,359,173	
Total net assets	\$ 24,990,613	\$ 31,030,981	\$ 3,257,560	\$ 2,510,342	\$ 4,181,753	\$ 65,971,249	\$ 12,502,389	

Amounts reported for business-type activities in the statement of net assets are different because:
Adjustments to reflect consolidation of internal service fund activities related to enterprise funds.
Net assets of business type activities

11,831,787
\$ 77,803,036

The accompanying notes are an integral part of this statement.

City of Oak Harbor
Statement of Revenues, Expenses, and Changes in Fund Net Assets
Proprietary Funds
For the Year Ended December 31, 2010

	Business-Type Activities						Internal Service Funds
	Water and Water Reserve Fund	Sewer and Sewer Reserve Fund	Solid Waste Reserve Fund	Storm Drain and Storm Drain Reserve Fund	Marina and Marina Reserve Fund	Total	
Operating Revenues							
Charges for services	\$ 4,109,400	\$ 4,260,004	\$ 3,083,067	\$ 1,275,029	\$ 391,565	\$ 13,119,065	\$ 1,752,340
System development revenue	260,345	118,235	-	-	-	378,580	-
Other operating revenues	1,829	2,177	-	3,674	879,381	887,061	1,788,511
Total operating revenues	4,371,574	4,380,416	3,083,067	1,278,703	1,270,946	14,384,706	3,540,851
Operating Expenses							
Cost of sales and service	1,755,967	692,503	535,923	498,902	659,059	4,142,354	1,870,027
Contractual services	31,207	64,187	18,490	31,951	7,750	153,585	238,275
Utilities	12,852	185,599	1,079,190	2,295	84,729	1,364,665	61,699
Taxes	477,874	366,199	366,930	103,189	-	1,314,192	-
Repairs and maintenance	91,928	128,868	244,904	56,608	33,395	555,703	159,416
Other operating expenses	447,938	559,290	459,368	236,628	52,978	1,756,202	459,683
Insurance claims and expenses	26,939	51,170	24,432	8,413	24,862	135,816	27,175
Depreciation	733,789	928,305	21,457	114,006	161,006	1,958,563	568,849
Total operating expenses	3,578,494	2,976,121	2,750,694	1,051,992	1,023,779	11,381,080	3,385,124
Operating income (loss)	793,080	1,404,295	332,373	226,711	247,167	3,003,626	155,727
Nonoperating Revenues (Expenses)							
Interest revenue	22,718	28,083	9,263	2,706	2,430	65,200	3,792
External subsidies	-	525,986	-	12,834	28,911	567,731	54,000
Other nonoperating revenues	75,788	38	11,970	81,691	90,921	260,408	17,716
Gain (loss) on sale of fixed assets	-	-	-	-	-	-	12,500
Interest expense	(4,132)	(132,935)	-	-	-	(137,067)	-
Total nonoperating revenues (expenses)	94,374	421,172	21,233	97,231	122,262	756,272	88,008
Net income (loss) before contributions and transfers	887,454	1,825,467	353,606	323,942	369,429	3,759,898	243,735
Capital contributions	151,419	366,302	-	111,769	-	629,490	17,164
Transfers in	24,000	-	-	25,000	25,000	74,000	715,450
Transfers out	(409,931)	(342,783)	(235,244)	(233,397)	(116,178)	(1,337,533)	(380,009)
Change in net assets	652,942	1,848,986	118,362	227,314	278,251	3,125,855	596,340
Net assets - beginning	24,337,671	29,181,995	3,139,198	2,283,028	3,903,502	62,845,394	11,906,049
Net assets - ending	\$ 24,990,613	\$ 31,030,981	\$ 3,257,560	\$ 2,510,342	\$ 4,181,753	\$ 65,971,249	\$ 12,502,389

Amounts reported for business-type activities in the statement of activities are different because:

Change in net assets	\$ 3,125,855
Adjustments to reflect consolidation of internal service fund activities related to enterprise funds.	528,817
Change in net assets of business-type activities	<u>\$ 3,654,672</u>

The accompanying notes are an integral part of this statement.

City of Oak Harbor
Statement of Cash Flows
Proprietary Funds
For the Year Ended December 31, 2010

	Business-Type Activities							Internal Service Funds
	Water and Water Reserve Fund	Sewer and Sewer Reserve Fund	Solid Waste and Solid Waste Reserve Fund	Storm Drain and Storm Drain Reserve Fund	Marina and Marina Reserve Fund	Total		
Cash Flows From Operating Activities								
Receipts from customers and users	\$ 4,555,620	\$ 4,554,460	\$ 3,244,935	\$ 1,349,728	\$ 1,239,365	\$ 14,944,108	\$	46
Payments from interfund services provided	(2,177,518)	(931,968)	(1,693,120)	(351,425)	(159,379)	(5,313,410)		3,540,805
Payments to suppliers	(432,856)	(446,441)	(350,615)	(334,365)	(286,799)	(1,851,076)		(1,403,583)
Payments to employees	(458,939)	(584,155)	(682,240)	(257,713)	(14,835)	(1,997,882)		(924,184)
Payments for interfund services used								(471,683)
Net cash provided by operating activities	1,486,307	2,591,896	518,960	406,225	778,352	5,781,740		741,401
Cash Flows From Noncapital Financing Activities								
Transfers from other funds	24,000	-	-	25,000	25,000	74,000		715,450
Transfers to other funds	(409,931)	(342,783)	(235,244)	(233,397)	(116,178)	(1,337,533)		(380,009)
Receipts from miscellaneous revenues	75,788	4,331	11,970	94,525	90,259	276,873		21,716
Contributions and deposits	-	-	-	-	12,500	12,500		-
Net cash provided (used) by noncapital financing activities	(310,143)	(338,452)	(223,274)	(113,872)	11,581	(974,160)		357,157
Cash Flows From Capital and Related Financing Activities								
Principal paid on capital debt	(55,905)	(479,784)	-	-	-	(535,689)		-
Interest paid on capital debt	(4,272)	(138,400)	-	-	-	(142,672)		-
Purchases of capital assets	(989,072)	(1,205,436)	-	-	(1,215,716)	(3,410,224)		(641,945)
Proceeds from sales of capital assets	-	-	-	-	-	-		12,500
Capital grants and contributions	-	521,693	-	-	17,073	538,766		50,000
Net cash provided (used) by capital and related financing activities	(1,049,249)	(1,301,927)	-	-	(1,198,643)	(3,549,819)		(579,445)

The accompanying notes are an integral part of this statement.

City of Oak Harbor
Statement of Cash Flows
Proprietary Funds
For the Year Ended December 31, 2010
(Continued)

	Business-Type Activities							Internal Service Funds
	Water and Water Reserve Fund	Sewer and Sewer Reserve Fund	Solid Waste Reserve Fund	Storm Drain Reserve Fund	Marina and Marina Reserve Fund	Total		
Cash Flows From Investing Activities								
Interest and dividends received	22,718	28,083	9,263	2,706	2,430	65,200	3,792	
Net cash provided (used) by investing activities	22,718	28,083	9,263	2,706	2,430	65,200	3,792	
Net increase (decrease) in cash and cash equivalents	149,633	979,600	304,949	295,059	(406,280)	1,322,961	522,905	
Cash and cash equivalents - beginning of year	9,407,925	11,017,706	2,565,744	785,843	1,282,907	25,060,125	6,070,092	
Cash and cash equivalents - end of year	\$ 9,557,558	\$ 11,997,306	\$ 2,870,693	\$ 1,080,902	\$ 876,627	\$ 26,383,086	\$ 6,592,997	
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities:								
Operating income (loss)	\$ 793,080	\$ 1,404,295	\$ 332,373	\$ 226,711	\$ 247,167	\$ 3,003,626	\$ 155,727	
Adjustments to reconcile operating income to net cash provided (used) by operating activities:								
Depreciation expense	733,789	928,305	21,457	114,006	161,006	1,958,563	568,849	
(Increase) decrease in accounts receivable	177,045	179,870	157,868	69,419	(883)	583,319	-	
(Increase) decrease in due from other funds	-	-	-	-	-	-	(428)	
(Increase) decrease in due from other governments	-	-	-	1,606	(646)	960	-	
(Increase) decrease in inventories	-	-	-	-	(17,030)	(17,030)	(22,440)	
(Increase) decrease in prepaids	-	4,613	-	-	6,061	10,674	-	
Increase (decrease) in accounts payable	(227,050)	79,624	(918)	(6,515)	354,664	199,805	20,372	
Increase (decrease) in deposits	3,201	(134)	4,000	-	(30,052)	(22,985)	-	
Increase (decrease) in retainage	-	-	-	-	50,570	50,570	9,148	
Increase (decrease) in due to other funds	(2,034)	(2,061)	(282)	173	(661)	(4,865)	(257)	
Increase (decrease) in deferred revenue	3,800	(5,692)	-	-	-	(1,892)	-	
Increase (decrease) in compensated absences payable	4,476	3,076	4,462	825	8,156	20,995	10,430	
Net cash provided (used) by operating activities	\$ 1,486,307	\$ 2,591,896	\$ 518,960	\$ 406,225	\$ 778,352	\$ 5,781,740	\$ 741,401	
Noncash Activities:								
Contributions of capital Assets from developer construction	\$ 151,419	\$ 366,302	\$ -	\$ 111,769	\$ -	\$ 629,490	\$ 17,164	

The accompanying notes are an integral part of this statement.

Notes to Financial Statements

Note 1 – Summary of Significant Accounting Policies

The financial statements of the City of Oak Harbor have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. GAAP statements include all relevant Governmental Accounting Standards Board (GASB) pronouncements. GASB is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The financial statements have incorporated all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on accounting procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

A. Reporting Entity

The City of Oak Harbor was incorporated on May 14, 1915 and operates under the laws of the state of Washington applicable to an optional code city with a Mayor-Council form of government. The governing body consists of eight elected officials, the mayor and seven council members. The mayor and council members are each elected to serve a four-year term. The City Manager administers policies and coordinates the activities of the City. The heads of the various departments, formed to provide various services, are under the direct supervision of the City Manager.

The City's Annual Financial Report includes all funds and organizations that are controlled by or dependent on the City. Control by the City was determined on the basis of budget adoption, taxing authority, and resource allocation criteria. Dependence on the City was determined by the City's obligation to redeem the organization's debts, to finance the organization's deficits, and the extent to which subsidies from the City constitute a major portion of the organization's total resources. Applying these criteria, as outlined in GASB Statement 1, the combined financial statements do not include the financial position or results of operation for:

The Oak Harbor Library - Although the City has a contract with the Sno-Isle Library System that obligates the City to provide a portion of the insurance and intergovernmental charges for services, the Sno-Isle Library is a separate municipal corporation and is not a component unit of the City.

North Whidbey Park District - The North Whidbey Park and Recreation District is a separate corporation with an independently elected Board of Directors.

B. Government-wide and Fund Financial Statements

Basic financial statements are presented at both the government-wide and fund financial level. Both levels of statements categorize primary activities as either governmental or business-type.

Government-wide financial statements display information about the reporting government as a whole. These statements focus on the sustainability of the City as an entity and the change in aggregate financial position resulting from the activities of the fiscal period. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. These aggregated statements consist of the Statement of Net Assets and the Statement of Activities.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services or privileges provided by a given function or segment, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Fund financial statements display information at the individual fund level. Each fund is considered to be a separate accounting entity. Funds are classified and summarized as governmental, proprietary, and fiduciary even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements. Non-major funds are consolidated into a single column within each fund type in the financial section of the basic financial statements and are detailed in the supplemental information.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule include charges between the City's business-type activities/enterprise funds, as well as some special revenue funds, and the General Fund. The City allocates charges as reimbursement for services provided by the General Fund in support of those functions based on levels of service provided. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Basis of Presentation

Financial transactions of the City are recorded in individual funds. Each fund is accounted for by providing a separate set of self-balancing accounts that comprises its assets, liabilities, reserves, fund equity, revenues and expenses/expenditures. The various funds are reported by generic classification within the financial statements.

The GASB 34 model sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses of either fund category or the governmental and enterprise combined) for the determination of major funds. The City reports the General Fund, the Arterial Fund and all Proprietary funds as major funds. Non-major funds are combined in a column in the fund financial statements.

General Fund

This is the City's primary operating fund. It accounts for all the financial operations of the City except those that are required to be accounted for in another fund. Principal sources of revenue are property taxes, licenses and permits, state and county shared revenues and charges for administrative services from other funds. Primary expenditures are for general government, police and fire protection and culture and recreation.

Major Governmental Funds

Major funds are funds whose revenues, expenditures, assets, or liabilities (excluding extraordinary items) are at least 10 percent of corresponding element totals for all funds of that type and at least five percent of the corresponding element total for all governmental or enterprise funds combined. The City reports the following as major governmental funds:

The *Arterial Street fund #104* receives State-shared restricted gasoline tax revenues and State grants for capital improvements to the City's arterial street system.

Other Governmental Funds

Additionally, the City reports non-major funds within the governmental fund type. These funds account for revenues derived from specific taxes, grants, or other sources that are designated to finance particular activities of the City.

- Ø Special Revenue funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes.
- Ø Debt Service funds account for the accumulation of resources to pay principal, interest and related costs on (certain) general long-term (bonded) debt.
- Ø Capital Projects funds account for financial resources used for the acquisition or construction of major capital facilities (other than those financed by Business or Proprietary Funds).

The City's Special Revenue funds include the following entities:

The *Street fund #101* receives State-shared unrestricted gasoline tax revenues and Capron funds. Capron funds are State-shared revenues comprised of gasoline taxes and motor vehicle license fees. Island and San Juan Counties and municipalities within these counties are the only recipients of Capron funds. Revenues are used for maintenance of the City streets.

The *Transportation Capital Improvement fund #105* collects revenues on development activity and grants to be used for expenditures on improvements to public streets and roads.

The *Paths & Trails fund #106* accounts for ½ of 1% of the Motor Vehicle Fuel Tax. These taxes are dedicated for the construction of pedestrian/bicycle paths and trails within the City.

The *Cumulative Street Reserve fund #110* reserves matching funds for grant requirements and as a contingency reserve for unanticipated expenditures.

The *Arts Acquisition and Maintenance fund #115* collects ¼% of the 6¼% utility tax to foster the creative arts in the City.

The *Civic Improvement (2%) fund #116* receives hotel/motel tax revenues for expenditure on the promotion of tourism. The City receives both the basic 2% and the additional 2% lodging taxes.

The *Park Improvement - Neighborhood Parks fund #125* receives revenue from developers for constructing and maintaining new and established neighborhood parks.

The *Park Improvement - Community Parks fund #126* receives revenue from developers for constructing and maintaining new and established larger scale community parks.

The *Senior Center fund #129* receives participant fees, grant revenues, and contributions from The City's General Fund and Island County for expenditures associated with providing services and activities for the senior citizens in Oak Harbor and Island County.

The City's Debt Service funds include the following accounting entities:

1996 \$2,680,000 Unlimited Tax General Obligation Refunding Bond - Public Safety and Fire Station fund #201 accounts for the advance refunding of the callable portion of the City's 1987 \$1,065,000 G.O. Bond and advance refunding of the City's 1991 \$2,672,000 G.O. Bond.

2008 \$192,000 LOCAL Bond - Fire Equipment fund #230 accounts for the debt service payment on the financing for two new fire engines.

The City's Capital Projects funds include the following entities:

The *Cumulative Reserve 1st ¼% Real Estate Excise Tax fund #311* collects the first ¼% excise tax on the sales price from the exchange of all real estate. These funds are deposited into this fund and must be used for capital-type projects necessary to implement Growth Management Act-related improvements.

The *Cumulative Reserve 2nd ¼% Real Estate Excise Tax fund #312* collects the second ¼% excise tax on the sales price on the exchange of all real estate. These funds are deposited into this fund and must be used for capital projects identified in the City's Capital Facilities Plan.

The *Construction – Municipal Pier Project fund #320* is one of the City's Capital Projects funds. This fund accounts for the construction activity related to the Municipal Pier Project.

The *Waterfront Redevelopment fund #325* receives funding from various grant, lodging tax, and subsidy sources to be used in the redevelopment of Windjammer Park project.

The *Scenic Heights LID fund #361* is another of the City's Capital Projects Funds. This fund accounts for the financial activity related to the Scenic Heights LID project.

The *Sewer Bond Construction fund #362* will be used to account for various sewer fund related capital construction projects.

The *Bayshore LID fund #2007-1 #363* accounts for the financial activity related to Bayshore LID project.

Proprietary Funds

The City electively reports all of its five enterprise funds as major funds for specific community focus. These funds are used to account for the acquisition, operation, and maintenance of water, sewer, solid waste, storm drain, and marina facilities.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's five enterprise funds are collected primarily through user charges. Operating expenses for enterprise funds and internal service funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Ø *Enterprise funds* operate in a manner similar to private business enterprises where the intent is to provide goods or services to the general public and be reimbursed primarily

through user charges. An enterprise fund may also be established when the governing body decides that periodic determination of net income is needed.

- Ø *Internal Service funds* account for operations that provide goods or services to other departments or funds of the city on a cost-reimbursement basis.

The City reports the following enterprise funds:

The *Water fund #401 and Water Cumulative Reserve fund #411* accounts for the operations and capital planning of the City-owned water utility. The water department maintains three storage tanks, approximately 103 miles of water mains, three booster pumps and associated appurtenances. The distribution system serves the City of Oak Harbor and supplies water to the U.S. Naval Air Station at Whidbey Island.

The *Sewer fund #402 and Sewer Cumulative Reserve fund #412* accounts for the operations and capital planning of the City-owned sanitary sewer utility. The City's sewer treatment plant and sewer treatment lagoons provide secondary treatment. The sewer department maintains approximately 70 miles of sanitary sewer mains, 11 remote lift stations and associated appurtenances. The collection and treatment system serves the City of Oak Harbor and a portion of the U.S. Naval Air Station at Whidbey Island.

The *Solid Waste fund #403 and Solid Waste Cumulative Reserve fund #413* accounts for the operations of the City-owned solid waste utility. The solid waste utility provides full service solid waste, recycling and yard waste. This utility serves the City of Oak Harbor.

The *Storm Drain fund #404 and Storm Drain Cumulative Reserve fund #414* accounts for the operations and capital planning of the City-owned storm drain utility. The storm drain utility consists of 10 City-owned detention facilities and control structures and maintains approximately 49 miles of storm drain pipe, roadside ditches and bio-swales. This utility serves the City of Oak Harbor.

The *Marina fund #410 and Marina Cumulative Reserve fund #420* accounts for the operations of the City-owned Marina. This full-service marina has moorage berths, dry storage sheds and dry landing storage. Other services provided are: temporary moorage, electricity, fuel, boat dolly, grid and launcher.

Additionally, the City reports its four internal service funds that provide goods and services to other departments or agencies of the City on a cost-reimbursement basis.

The *Equipment Repair fund #501* accounts for the motor-pool operations of the City. Maintenance, operation, and depreciation costs are charged to each user department on a monthly basis.

The *Equipment Replacement fund #502* accumulates funds for future purchases of vehicles and equipment. Cash reserves or "sinking funds" are established to fully fund vehicle and major equipment needs at the time of purchase.

The *Technology fund #505* accounts for the purchase and acquisition of technologically oriented equipment such as computers and other technical equipment.

The *Shop Facility fund #510* accounts for the cost of operating the Public Works Facility Campus and supervision of the various Public Works divisions. Each division that is housed at the facility is charged space rent, with the annual proceeds used to pay maintenance, and the overhead.

The City does not currently have Trust or Agency funds.

C. Measurement Focus and Basis of Accounting

Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus.

The Government-wide Financial Statements and the Proprietary Funds Financial Statements are presented on a *full accrual* basis of accounting with an *economic resource* measurement focus. An economic resource focus concentrates on an entity or fund's net assets. All transactions and events that affect the total economic resources (net assets) during the period are reported. An economic resources measurement focus is inextricably connected with full accrual accounting. Under the full accrual basis of accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of related cash inflows and outflows.

Governmental Funds Financial Statements are presented on a *modified accrual* basis of accounting with a *current financial resource* measurement focus. This measurement focus concentrates on the fund's resources available for spending in the near future. Only transactions and events affecting the fund's current financial resources during the period are reported. Similar to the connection between an economic resource measurement focus and full accrual accounting, a current financial resource measurement focus is inseparable from a modified accrual basis of accounting. Under modified accrual accounting, revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. BARS allows for the recognition of revenues to no more than 60 days however, since the City is not always able to obtain timely information to estimate the accrued amounts it chooses not to accrue taxes received in January or February in order to remain consistent with prior years. Expenditures generally are recorded when a liability is incurred, as under accrual accounting.

A deferred revenue liability arises in the Governmental Funds Balance Sheet when potential revenue does not meet both the *measurable* and *available* criteria for recognition in the current period. This *unavailable* deferred revenue consists primarily of uncollected property taxes and assessments not deemed available to finance operation of the current period. In the Government-wide Statement of Net Assets, with a full accrual basis of accounting, revenue must be recognized as soon as it is earned regardless of its availability. Thus, the liability created on the Governmental Fund Balance Sheet for unavailable deferred revenue is eliminated. Note that deferred revenues also arise outside the scope of measurement focus and basis of accounting, such as when the City receives resources before it has a legal claim to them. For instance, when grant monies are received prior to the incurrence of qualifying expenditures.

Similar to the way its revenues are recorded, governmental funds only record those expenditures that affect current financial resources. Principal and interest on general long-term debt are recorded as fund liabilities only when due, or when amounts have been accumulated in the debt service fund for payments to be made early in the following year. Vested compensated absences are recorded as expenditures only to the extent that they are expected to be liquidated with expendable financial resources. In the Government-wide Financial Statements, however, with a full accrual basis of accounting, all expenditures affecting the economic resource status of the government must be recognized. Thus, the expense and related accrued liability for long term portions of debt and compensated absences must be included.

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements' governmental column, a reconciliation is necessary to explain the adjustments needed to transform the fund based financial statements into the governmental column of the government-wide presentation. This reconciliation is part of the financial statements.

D. Budgetary Information

Biennial appropriated budgets are adopted for the General Fund, Special Revenue funds, Debt Service funds, Capital Projects funds, and Proprietary funds. For governmental funds, there are no differences between the budgetary basis and generally accepted accounting principles. Budgetary accounts are integrated in fund ledgers for all budgeted funds, but the financial statements include budgetary comparisons for annually budgeted governmental funds only.

Biennial appropriated budgets are adopted at the level of the fund and the budget constitutes the legal authority for expenditure at that level. Subsidiary revenue and expenditure ledgers are used to compare the budgeted amounts with actual revenues and expenditures. As a management control device, the subsidiary ledgers monitor expenditures for individual functions and activities by object class.

Appropriations for general and special revenue funds lapse at the end of the second year of the fiscal biennium (except for appropriations for capital outlays, which are carried forward from year to year until fully expended or the purpose of the appropriations has been accomplished or abandoned).

Procedures For Adopting the Original Budget

The City's biennial budget procedures are mandated by RCW 35A.34. The process under which the budget is adopted is described in the following paragraphs.

Prior to the first Tuesday in November the Finance Director submits a proposed budget to the Mayor and City Council. This budget is based on priorities established by the Council and estimates provided by City departments during the preceding months, and balanced with revenue estimates made by the Finance Director.

During the months of November and December, the Council conducts public hearings on the proposed budget for the purpose of obtaining citizens' comments. The Council makes its adjustments and adopts by ordinance a final balanced budget no later than December 31. Within 30 days of adoption, the final budget is available to the public.

Mid-biennial Review and Modification

A mid-biennial review and modification of the biennial budget occurs no sooner than eight months after the start nor later than the conclusion of the first year of the fiscal biennium. The Finance Director prepares the proposed budget modification and provides for publication of notice of hearings consistent with publication of notices for adoption of other City ordinances. Copies of the proposed modification are distributed to members of the City Council. Copies of the proposed modification are available to the public at the office of the City Clerk and at public hearings thereon.

Immediately following the preparation of the proposed budget modification by the Mayor, public hearings on the proposed budget modification are held. The City Clerk publishes a notice once each week for two consecutive weeks stating that the budget modification has been proposed, and a copy thereof will be furnished to any member of the public who will call at the Clerk's office, and that the City Council will meet on or before the first Monday of the month next

preceding the beginning of the second year of the fiscal biennium, but not before September 1 of the first year of the fiscal biennium, for the purpose of fixing the budget for the second year of the fiscal biennium, designating the date, time and place of the City Council meeting and that any taxpayer may appear there at and be heard for or against any part of the proposed budget modification. The publication of the notice is made in the official newspaper of the City. The budget modification, if any, is approved in the same manner as other ordinances of the City.

The budget amounts shown in the financial statements do not represent total appropriations for the entire biennial budget period. The budget amounts shown represent appropriations for a single calendar year within the biennial budget.

Amending the Budget

The Finance Director is authorized to transfer budgeted amounts between object classes within departments; however, any revisions that alter the total expenditures of a fund, or that affect the number of authorized employee positions, salary ranges, hours, or other conditions of employment must be approved by the City Council.

When the City Council determines that it is in the best interest of the City to increase or decrease the appropriation for a particular fund, it may do so by ordinance approved by one or more than the majority after holding public hearing(s).

The budget amounts shown in the financial statements are the final authorized amounts as revised during the year.

The financial statements contain the original and final budget information. The original budget is the first complete appropriated budget. The final budget is the original budget adjusted by all reserves, transfers, allocations, supplemental appropriations, and other legally authorized changes applicable for the fiscal year.

Deficit Fund Equity

As of December 31, 2010, the City has no funds reflecting a deficit fund balance.

E. Assets, Liabilities, and Equities

Cash and Investments

It is the City's policy to invest all temporary cash surpluses. As of December 31, 2010, the Treasurer was holding \$16,782,864 in short-term residual investments of surplus cash. This amount is included in the amount classified on the balance sheet as cash and cash equivalents in various funds. The interest on these investments is prorated to the various funds based upon the fund's average daily cash balance. For purposes of the Statement of Cash Flows, the City considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

Receivables

Taxes receivable consists of property taxes and related interest and penalties (see Property Taxes Note No. 5). Accrued interest receivable consists of amounts earned on investments, notes, and contracts at the end of the year.

Customer accounts receivable consist of amounts owed from private individuals or organizations for goods and services including amounts owed for which billings have not been prepared. Notes and contracts receivable consist of amounts owed on open account from private individuals or organizations for goods and services rendered.

Amounts Due To and From Other Funds and Governmental Units, Interfund Loans and Advances Receivable

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either “interfund loans receivable/payable” or “advances to/from other funds.” All other outstanding balances between funds are reported as “due to/from other funds.” A separate schedule of interfund loans receivable and payable is furnished in Note No. 15 Interfund Balances and Transfers.

Advances between funds, as reported in the fund financial statements, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

Inventories

Inventories in governmental funds consist of expendable supplies held for consumption. The cost is recorded as an expenditure at the time individual inventory items are purchased. The reserve for inventory is equal to the ending amount of inventory to indicate that a portion of the fund balance is not available for future expenditures. A comparison to market value is not considered necessary.

Inventories in proprietary funds are valued by the FIFO method (which approximates the market value).

Restricted Assets and Liabilities

These accounts contain resources for a 24” waterline reserve, certain customer deposits, debt service, equipment replacement, impact fees and land fill closure requirements. Specific debt service reserve requirements are described in Note No. 10 Long-term Debt.

The restricted cash of the City is composed of the following:

	Governmental	Business-type
Capital projects	\$269,397	\$129,928
Customer deposits	300	82,464
Debt service	-	953,352
Equipment replacement	327,034	6,105,111
Fire fees	59,400	-
Landfill closure	-	70,157
Park impact fees	29,573	-
Total restricted cash	\$685,704	\$7,341,012

Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure (e.g. roads, pathways, street lights) are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the City as assets with an initial, individual cost of \$5,000 or more, and an estimated useful life of greater than five years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated assets are recorded at estimated fair market value as of the date of the donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of the capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. In governmental and similar trust funds, compensated absences that are expected to be liquidated with expendable available financial resources are reported as expenditures and fund liability in the fund that will pay for them. The remainder of the compensated absences liability is reported in the General Long-term Debt Account Group. In proprietary funds, compensated absences are recorded as an expense and liability of the fund that will pay for them.

City employees accumulate vacation and sick leave on a monthly basis. Employees earn vacation at a rate of a certain number of hours per year. The number of hours per year depends upon length of service. Annual vacation may be accumulated to a maximum of two years accrual. Sick leave for all employees is earned at a rate of one day per month. A maximum of 180 days sick leave may be accumulated.

At termination of employment, employees with required length of service may receive cash payment for accumulated vacation and a percentage of sick leave with five (5) or more years of service. The payment is based on current wages at the time of termination of service.

Long-term Debt

(See Long-term Debt Note No.10)

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type Statement of Net Assets. Bond premiums and discounts are deferred and amortized over the life of the bonds. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are treated as period costs in the year of issue and are shown as other financing uses.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Deferred Revenues

This account includes amounts recognized as receivables but not revenues in governmental funds because the revenue recognition criteria have not been met.

Fund Reserves and Designations

Tentative plans for utilization of fund balances in future periods are recorded as designations of fund balance in the fund-level financial statements. Planned expenditures include future capital projects, debt service, equipment reserves and other commitments for which fund balances have not been appropriated or specifically segregated.

Note 2 – Reconciliation of Government-wide and Fund Financial Statements

Explanation of Certain Differences Between the Governmental Funds Balance Sheet and the Government-wide Statement of Net Assets

The governmental funds' Balance Sheet includes a reconciliation between fund balance – total governmental funds and net assets – governmental activities as reported in the government-wide Statement of Net Assets. The following represent the reconciling items:

Capital assets used in governmental activities are not financial resources and are not reported in funds:		
Historical cost of assets not being depreciated	\$ 10,328,338	
Historical cost of assets being depreciated	39,143,489	
Accumulated depreciation	<u>(24,026,470)</u>	\$ 25,445,357
Long-term assets not available to pay for current period expenditures and therefore deferred		958,226
Internal service funds are used by management to charge the costs of fleet management, shop facilities and information systems to individual funds. The assets and liabilities of the internal service funds are included in the governmental activities in the Statement of Net Assets.		670,602
Some liabilities are not due and payable in the current period and therefore are not reported in the funds, including:		
Accounts payable	\$ (158,857)	
Compensated absences	(681,303)	
Bonds and interest payable	(74,986)	
Other post-employment benefit liabilities	<u>(366,019)</u>	(1,281,165)
Net adjustment to increase <i>fund balance - total governmental funds</i> to arrive at <i>net assets - governmental activities</i> .		<u><u>\$ 25,793,020</u></u>

Explanation of Certain Differences Between the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances and the Government-wide Statement of Activities

The governmental funds' Statement of Revenues, Expenditures, and Changes in Fund Balances includes a reconciliation between *net changes in fund balances – total governmental funds* and *changes in net assets of governmental activities* as reported in the government-wide Statement of Activities. Elements of the reconciliation include the net increase in governmental net assets, increases in long-term debt or other long-term liabilities, and certain activities of internal service funds that are allocated to governmental activities outside of the funds themselves. The following represent the reconciling items:

Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as outlays exceeded depreciation in the current period:

Capital outlay	\$ 2,859,580	
Depreciation	<u>(1,020,081)</u>	\$ 1,839,499

Donated capital increases net assets in the statement of activities, but does not appear in the governmental funds because it is not a financial resource. 358,892

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds. 47,583

Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets and does not effect the Statement of Activities 287,911

Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds, including:

Change in accounts payable	\$ (45,921)	
Change in compensated absences	(32,795)	
Other post-employment benefit expense	<u>(111,347)</u>	(190,063)

Internal service funds are used by management to charge the costs of fleet management, shop facilities and information systems to individual funds. The net revenues and expenses of the internal service funds are reported with governmental activities in the Statement of Activities. 67,523

Net adjustment to increase *net changes in fund balance - total governmental funds* to arrive at *changes in net assets of governmental activities* . \$ 2,411,345

Internal service funds may be reported as governmental activities or business activities based on the predominate function of the fund. The City reports Technology Fund as a governmental activity and the Equipment Repair, Equipment Replacement and Shop Funds as business activities.

Note 3 – Stewardship, Compliance, and Accountability

None of the City’s funds exceeded its authorized appropriation authority for 2010.

Note 4 – Deposits and Investments

As required by state law, all investments and deposits of the City's funds are obligations of the U.S. Government, the State Treasurer’s Investment Pool, bankers’ acceptances, deposits with Washington State banks and savings and loan institutions.

A reconciliation of cash, cash equivalents (including pooled investments) and investments as shown in the government-wide and fund financial statements is as follows:

Notes	
Investments	\$ 24,040,824
Deposits	26,076,793
Total	\$ 50,117,617
Governmental Financial Statements	
Governmental funds - cash and cash equivalents	\$ 16,782,864
Governmental funds - restricted cash	358,670
Proprietary funds - cash and cash equivalents	25,147,185
Proprietary-type funds - restricted cash	1,235,901
Internal service funds - cash and cash equivalents	160,852
Internal service funds - restricted cash	6,432,145
Total	\$ 50,117,617

Internal service fund assets and liabilities are allocated between governmental and business-type activities for government-wide financial reporting purposes. Accordingly, the following schedule represents the allocation of internal service fund deposits and investments between the two fund types for the purpose of providing reconciliation between governmental fund balances and the balances appearing on the Statement of Net Assets:

Reconciliation of governmental deposits and investments to government-wide deposits and investments	
Governmental funds - cash and cash equivalents	\$ 16,782,864
Allocated internal service fund - cash and cash equivalents	-
Governmental Activities - cash and cash equivalents	16,782,864
Governmental funds - restricted cash	358,670
Allocated internal service fund - restricted cash	327,034
Governmental Activities - restricted cash	685,704
Proprietary-type funds - cash and cash equivalents	25,147,185
Allocated internal service fund - cash and cash equivalents	160,852
Business-type activities - cash and cash equivalents	25,308,037
Proprietary-type funds - restricted cash	1,235,901
Allocated internal service fund - restricted cash	6,105,111
Business-type activities - restricted cash	7,341,012
Total	\$ 50,117,617

Deposits

On December 31, 2010 the carrying amount of the City's cash demand deposits, including money market accounts was \$26,076,793 and the bank balance with US Bank of Washington was \$26,396,928. Petty cash on hand totaled \$7,559. The FDIC insures fully the City's noninterest-bearing demand deposits, and separately insures the first \$250,000 in the aggregate of the City's time deposits and interest-bearing deposits. The remaining deposit balances are insured by the Washington Public Deposit Protection Commission (WPDPC) Act of 1969. The WPDPC is a multiple financial institution collateral pool. State statute permits additional amounts to be assessed on a pro rata basis to members of the pool in the event the pool's collateral should be insufficient to cover a loss.

Investments

The City has \$24,040,824 in the State’s Local Government Investment Pool (LGIP) which is managed by the Washington State Treasurer’s Office. The LGIP is not SEC registered but has oversight provided by the following sources: 1) annually audited by the Office of the State Auditor; 2) annually audited by an outside, independent auditor; 3) an Advisory Committee meets quarterly to advise the State Treasurer on issues regarding the LGIP; 4) monthly statement enclosures detailing portfolio breakdown and earnings information sent to participants; and, 5) quarterly newsletters that include a compliance report and quarterly financials. Financial reports are available at the State Treasurers Office, P.O. Box 40200, Olympia, Washington, 98504-2000.

Investments are reported within Cash and Cash Equivalents. As of December 31, 2010, the City had the following investments:

Investments	Fair Value	Weighted Average Maturity (Months)
Washington State Investment Pool (LGIP)	\$ 24,040,824	1.81
Total fair value	\$ 24,040,824	
Portfolio weighted average maturity		1.81

Interest Rate Risk: In accordance with its investment policy, the City manages its exposure to fair value losses arising from increasing interest rates by limiting the weighted average maturity of its investment portfolio to less than 12 months.

Custodial Credit Risk-investments: This is the risk that, in event of a failure of the counterparty to an investment transaction, the City would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of December 31, 2010, the City did not have any investments that are subject to the custodial credit risk.

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The LGIP, a 2a7-like pool, as defined by GASB Statement 31, is unrated. The policy of the LGIP is to invest in securities and instruments that are rated A-1 by Standard and Poor’s Corporation and P-1 by Moody’s Investors Services, Inc.

To limit risk, state law does not allow general governments such as the City to invest in corporate debt. However, the Pension fund is not restricted by state law to invest in corporate debt with ratings equivalent or above the single “A” rating by nationally recognized statistical rating organizations. The ratings of debt securities as of December 31, 2010 are:

Debt Security
The City has no debt securities at this time

Concentration of Credit Risk: City of Oak Harbor diversifies its investments by security type and institution. With the exception of U.S. Treasury securities and authorized pools, the City’s investment policy does not allow for an investment in any one issuer that is in excess of 50% of the City’s total investment portfolio.

Note 5 – Property Taxes

The County Treasurer acts as an agent to collect property taxes levied in the County for all taxing authorities.

Property Tax Calendar	
January 1	Taxes are levied and become an enforceable lien against properties.
February 14	Tax bills are mailed
April 30	First of two equal installment payments are due.
May 31	Assessed value of property established for next year's levy at 100 percent of market value.
October 31	Second installment is due.

Property taxes are recorded as a receivable and revenue when levied. Property taxes collected in advance of the fiscal year to which they apply are recorded as deferred revenue and recognized as revenue of the period to which they apply. No allowance for uncollectible taxes is established because delinquent taxes are considered fully collectible. Prior year tax levies were recorded using the same principal and delinquent taxes are evaluated annually.

The City is permitted by law to levy up to \$2.975 minus the Sno-Isle Library rate of \$0.40 per \$1,000 of assessed valuation for general governmental services, subject to two limitations:

1. Washington State law in RCW 84.55.010 limits the growth of regular property taxes to the lower of the Implicit Price Deflator or 1%, before adjustments for new construction. If the assessed valuation increases by more than 6% due to revaluation, the levy rate will be decreased.
2. The Washington State Constitution limits the regular (non-voted) combined property tax rate applied to an individual's property to 1% (\$10 per \$1,000) of the market valuation. If the taxes of all districts exceed this amount, each is proportionately reduced until the total is at or below the 1% limit.

The City's regular levy for 2010 was \$2.04457 per \$1,000 on an assessed valuation of \$1,832,165,652 for a regular levy of \$3,745,985.

The City's general obligation bond levy for 2010 was \$0.13969 per \$1,000 on an assessed valuation of \$1,818,600,667 for a total bond levy of \$254, 040.

Note 6 – Capital Assets and Depreciation

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g. roads, pathways, street lights, etc.) are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. In the governmental fund statements, capital assets are charged to expenditures as purchased, and capitalized in the proprietary fund statements. Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated assets are recorded at estimated fair market value as of the date of the donation.

Capital assets are defined by the City as assets with an initial, individual cost of \$5,000 or more, and an estimated useful life of greater than five years. Additions or improvements and other capital outlays that significantly extend the useful life of an asset, or that significantly increase the capacity of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation on exhaustible assets is recorded as an allocated expense

in the Statement of Activities with accumulated depreciation reflected in the Statement of Net Assets and is provided using the straight-line method over the following estimated useful lives:

Asset	Years
Buildings and improvements	20-50
Improvements other than buildings	10-20
Machinery and equipment	5-10
Vehicles	5-10
Utility systems	20-40
Infrastructure	20-40

Governmental-type capital assets activity for the year ended December 31, 2010 was as follows:

Governmental Activities:	Beginning Balance			Ending Balance
	1/1/2010	Increases	Decreases	12/31/2010
Capital assets not being depreciated:				
Land	\$ 1,895,664	\$ 153,203	\$ -	\$ 2,048,867
Recreation areas	6,581,039	20,656	-	6,601,695
Construction in progress	1,268,443	2,821,476	(2,438,143)	1,651,776
Intangible assets	13,000	13,000	-	26,000
Total assets not depreciated:	\$ 9,758,146	\$ 3,008,335	\$ (2,438,143)	\$ 10,328,338
Assets depreciated:				
Buildings	\$ 8,296,033	\$ -	\$ -	\$ 8,296,033
Capital lease	138,572	-	-	138,572
Improvements	352,552	-	-	352,552
Machinery & equipment	2,153,365	17,871	-	2,171,236
Infrastructure	26,036,216	2,637,834	-	28,674,050
Total assets depreciated:	\$ 36,976,738	\$ 2,655,705	\$ -	\$ 39,632,443
Less accumulated depreciation:				
Buildings depreciation	\$ (3,821,354)	\$ (168,840)	\$ -	\$ (3,990,194)
Capital lease depreciation	(138,572)	-	-	(138,572)
Improvements depreciation	(85,764)	(5,378)	-	(91,142)
Machinery & equipment depreciation	(1,038,722)	(152,662)	-	(1,191,384)
Infrastructure depreciation	(18,079,536)	(712,521)	-	(18,792,057)
Total accumulated depreciation:	\$ (23,163,948)	\$ (1,039,401)	\$ -	\$ (24,203,349)
Total assets depreciated (net):	\$ 13,812,790	\$ 1,616,304	\$ -	\$ 15,429,094
Governmental activities				
total capital assets (net):	\$ 23,570,936	\$ 4,624,639	\$ (2,438,143)	\$ 25,757,432

The City purchased The Whidbey Island Marathon, an intangible asset in 2009. The cost of the Marathon is \$50,000 and will be made in 4 annual payments.

Depreciation expense for the various components of governmental activities is as follows:

Governmental Activities:	
General governmental	\$ 53,437
Public safety	95,187
Physical environment	20,976
Transportation	716,404
Mental and physical health	15,044
Cultural and recreational	119,033
Internal service fund capital assets are charged to the various functions based on their usage of the asset	19,320
Total depreciation expense - governmental activities	\$ 1,039,401

Business-type capital assets activity for the year ended December 31, 2010 was as follows:

Business-type Activities:	Beginning Balance			Ending Balance
	1/1/2010	Increases	Decreases	12/31/2010
Capital assets not being depreciated:				
Land	\$ 1,333,347	\$ -	\$ -	\$ 1,333,347
Construction in progress	1,477,924	2,300,513	(1,472,190)	2,306,247
Total capital assets not depreciated:	\$ 2,811,271	\$ 2,300,513	\$ (1,472,190)	\$ 3,639,594
Capital assets being depreciated:				
Buildings	\$ 8,817,513	\$ 130,843	\$ -	\$ 8,948,356
Improvements other than buildings	53,978,955	3,090,896	-	57,069,851
Machinery & equipment	13,038,915	641,334	(308,588)	13,371,661
Total assets depreciated:	\$ 75,835,383	\$ 3,863,073	\$ (308,588)	\$ 79,389,868
Less accumulated depreciation:				
Buildings depreciation	\$ (3,918,049)	\$ (214,066)	\$ -	\$ (4,132,115)
Improvements other than buildings	(19,568,515)	(1,508,443)	-	(21,076,958)
Machinery & equipment depreciation	(8,503,485)	(785,581)	308,588	(8,980,478)
Total accumulated depreciation:	\$ (31,990,049)	\$ (2,508,090)	\$ 308,588	\$ (34,189,551)
Total assets depreciated (net):	\$ 43,845,334	\$ 1,354,983	\$ -	\$ 45,200,317
Business-type activities total capital assets (net):	\$ 46,656,605	\$ 3,655,496	\$ (1,472,190)	\$ 48,839,911

Depreciation expense for the various components of governmental activities is as follows:

Business-type Activities:	
Water	\$ 733,789
Sewer	928,305
Solid waste	21,457
Storm drain	114,006
Marina	161,006
Internal service	549,529
Total depreciation expense - business-type activities	\$ 2,508,092

The City has active construction projects as of December 31, 2010. The projects include street improvements, redevelopment of the Marina, design of a multimodal facility and waste water treatment plant, construction of a new water reservoir and trail head.

At year end, the government's commitments with contractors are as follows:

Project	Spent to Date	Remaining Commitment
SE Pioneer Way street improvements	\$ 669,418	\$ 123,974
Marina redevelopment	1,340,188	1,414,828
Multimodal facility	90,863	31,625
Gun Club Road water reservoir	83,688	149,746
Wastewater treatment plant	83,564	1,005,997
Scenic Heights trail head	128,795	104,589
Marina dock roof repair	-	29,000
Total	\$ 2,396,516	\$ 2,859,759

Note 7 – Pension Plans

Substantially all City of Oak Harbor full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380; or it may be downloaded from the DRS website at www.drs.wa.gov. The following disclosures are made pursuant to GASB Statements No. 27, *Accounting for Pensions by State and Local Government Employers* and No. 50, *Pension Disclosures, an Amendment of GASB Statements No. 25 and No. 27*.

Public Employees' Retirement System (PERS) Plans 1, 2 and 3

Plan Description

PERS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a defined benefit plan with a defined contribution component.

Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts (other than judges in a judicial retirement system); employees of legislative committees; community and technical colleges, college and university employees not participating in national higher education retirement programs; judges of district and municipal courts; and employees of local governments.

PERS members who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977 and by either, February 28, 2002 for state and higher education employees, or August 31, 2002 for local government employees, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS members joining the system on or after March 1, 2002 for state and higher education employees, or September 1, 2002 for local government employees have the irrevocable option of choosing membership in

either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. Notwithstanding, PERS Plan 2 and Plan 3 members may opt out of plan membership if terminally ill, with less than five years to live.

PERS Plan 1 and Plan 2 defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PERS retirement benefit provisions are established in Chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

PERS Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, or at age 60 with five years of service, or at the age of 55 with 25 years of service. The monthly benefit is 2 percent of the average final compensation (AFC) per year of service. (AFC is the monthly average of the 24 consecutive highest-paid service credit months.) The retirement benefit may not exceed 60 percent of AFC. The monthly benefit is subject to a minimum for PERS Plan 1 retirees who have 25 years of service and have been retired 20 years, or who have 20 years of service and have been retired 25 years. Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarially reduced benefits. If a survivor option is chosen, the benefit is further reduced. A cost-of living allowance (COLA) is granted at age 66 based upon years of service times the COLA amount, which is increased 3 percent annually. Plan 1 members may also elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at three percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity payable to the age of 60. The allowance amount is \$350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any workers' compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60. A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the allowance amount is 2 percent of the AFC for each year of service reduced by 2 percent for each year that the member's age is less than 55. The total benefit is limited to 60 percent of the AFC and is actuarially reduced to reflect the choice of a survivor option. A cost-of living allowance is granted at age 66 based upon years of service times the COLA amount (based on the consumer Price Index), capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 members can receive credit for military service while actively serving in the military, if such credit makes them eligible to retire. Members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years of service. The monthly benefit is 2 percent of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

PERS Plan 2 members who have at least 20 years of service credit and are 55 years of age or older are eligible for early retirement with a reduced benefit. The benefit is reduced by an early retirement factor (ERF) that varies according to age, for each year before age 65.

PERS Plan 2 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions:

- With a benefit that is reduced by 3 percent for each year before age 65.
- With a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules.

PERS Plan 2 retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit; and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at 3 percent annually.

The surviving spouse or eligible child or children of a PERS Plan 2 member who dies after leaving eligible employment having earned ten years of service credit may request a refund of the member's accumulated contributions. Effective July 22, 2007, said refund (adjusted as needed for specified legal reductions) is increased from 100 percent to 200 percent of the accumulated contributions if the member's death occurs in the uniformed service to the United States while participating in *Operation Enduring Freedom* or *Persian Gulf*, *Operation Iraqi Freedom*.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component and member contributions finance a defined contribution component. The defined benefit portion provides a monthly benefit that is 1 percent of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

Effective June 7, 2006, PERS Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service, if twelve months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

Vested Plan 3 members are eligible for normal retirement at age 65, or they may retire early with the following conditions and benefits:

- If they have at least ten service credit years and are 55 years old, the benefit is reduced by an ERF that varies with age, for each year before age 65.
- If they have 30 service credit years and are at least 55 years old, they have the choice of a benefit that is reduced by 3 percent for each year before age 65; or a benefit with a smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.

PERS Plan 3 defined benefit retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit and Plan 3 provides the same cost-of-living allowance as Plan 2.

PERS Plan 3 defined contribution retirement benefits are solely dependent upon the results of investment activities.

The defined contribution portion can be distributed in accordance with an option selected by the member, either as a lump sum or pursuant to other options authorized by the Director of the Department of Retirement Systems.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2 percent of the AFC per year of service. For Plan 3, the monthly benefit amount is 1 percent of the AFC per year of service.

These disability benefit amounts are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option. There is no cap on years of service credit, and a cost-of-living allowance is granted (based on the Consumer Price Index) capped at 3 percent annually.

PERS Plan 2 and Plan 3 members may have up to ten years of interruptive military service credit; five years at no cost and five years that may be purchased by paying the required contributions. Effective July 24, 2005, a member who becomes totally incapacitated for continued employment while serving the uniformed services, or a surviving spouse or eligible children, may apply for interruptive military service credit. Additionally, PERS Plan 2 and Plan 3 members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS members may also purchase up to five years of additional service credit once eligible for retirement. This credit can only be purchased at the time of retirement and can be used only to provide the member with a monthly annuity that is paid in addition to the member's retirement benefit.

Beneficiaries of a PERS Plan 2 or Plan 3 member with ten years of service who is killed in the course of employment receive retirement benefits without actuarial reduction, if the member was not at normal retirement age at death. This provision applies to any member killed in the course of employment, on or after June 10, 2004, if found eligible by the Department of Labor and Industries.

A one-time duty-related death benefit is provided to the estate (or duly designated nominee) of a PERS member who dies in the line of service as a result of injuries sustained in the course of employment, or if the death resulted from an occupational disease or infection that arose naturally and proximately out of said member's covered employment, if found eligible by the Department of Labor and Industries.

There are 1,189 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2009:

Type of Members	Number of Participants
Retirees and Beneficiaries Receiving Benefits	74,857
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	28,074
Active Plan Members Vested	105,339
Active Plan Members Non-vested	53,896
Total	262,166

Funding Policy

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6 percent for state agencies and local government unit employees, and 7.5 percent for state government elected officials.

The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan and member contributions finance the defined contribution portion. The Director of the Department of Retirement Systems sets Plan 3 employee contribution rates. Six rate options are available ranging from 5 percent to 15 percent; two of the options are graduated rates dependent on the employee's age. The methods used to determine the contribution requirements are established under state statute in accordance with chapters 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2010, are as follows:

Contributer	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer*	5.31%	5.31%	5.31%**
Employee	6.00%	3.90%	***

*The employer rates include the employer administrative expense fee currently set at 0.16%.

**Plan 3 defined benefit portion only.

***Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

Both the City of Oak Harbor and the employees made the required contributions. The overall required contributions for the years ended December 31 were as follows:

Year	PERS Plan 1	PERS Plan 2	PERS Plan 3
2010	\$18,761	\$343,978	\$269,292
2009	20,791	405,154	308,250
2008	20,568	403,608	304,888

Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF) Plans 1 and 2

Plan Description

LEOFF is a cost-sharing multiple-employer retirement system comprised of two separate defined benefit plans. LEOFF members who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977 are Plan 2 members. Membership in the system includes all full-time, fully compensated, local law enforcement commissioned officers, firefighters and, as of July 24, 2005, those emergency medical technicians who were given the option and chose LEOFF Plan 2 membership. LEOFF membership is comprised primarily of non-state employees, with Department of Fish and Wildlife enforcement officers, who were first included prospectively effective July 27, 2003, being an exception.

Effective July 1, 2003, the LEOFF Plan 2 Retirement Board was established by Initiative 790 to provide governance of LEOFF Plan 2. The Board's duties include adopting contribution rates and recommending policy changes to the Legislature for the LEOFF Plan 2 retirement plan.

LEOFF defined benefit retirement benefits are financed from a combination of investment earnings, employer and employee contributions, and a special funding situation in which the state pays through state legislative appropriations. LEOFF retirement benefit provisions are established in Chapter 41.26 RCW and may be amended only by the State Legislature.

LEOFF Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement with five years of service at the age of 50.

The benefit per year of service calculated as a percent of final average salary (FAS) is as follows:

Term of Service	Percent of Final Average Salary
20 or more years	2.00%
10 but less than 20 years	1.50%
5 but less than 10 years	1.00%

The FAS is the basic monthly salary received at the time of retirement, provided a member has held the same position or rank for 12 months preceding the date of retirement. Otherwise, it is the average of the highest consecutive 24 months' salary within the last 10 years of service. A cost-of-living allowance is granted (based on the Consumer Price Index).

LEOFF Plan 1 provides death and disability benefits. Death benefits for survivors of Plan 1 members on active duty consist of the following: (1) If eligible spouse, 50 percent of the FAS, plus 5 percent of FAS for each eligible surviving child, with a limitation on the combined allowances of 60 percent of the FAS; or (2) If no eligible spouse, eligible children receive 30 percent of FAS for the first child plus 10 percent for each additional child, subject to a 60 percent limitation of FAS, divided equally.

A one-time duty-related death benefit is provided to the estate (or duly designated nominee) of a LEOFF Plan 1 member who dies as a result of injuries or illness sustained in the course of employment, if found eligible by the Department of Labor and Industries.

The LEOFF Plan 1 disability allowance is 50 percent of the FAS plus 5 percent for each child up to a maximum of 60 percent. Upon recovery from disability before the age of 50, a member is restored to service with full credit for service while disabled. Upon recovery after the age of 50, the benefit continues as the greater of the member's disability allowance or service retirement allowance.

LEOFF Plan 1 members may purchase up to five years of additional service credit once eligible for retirement. This credit can only be purchased at the time of retirement and can be used only to provide the member with a monthly annuity that is paid in addition to the member's allowance.

LEOFF Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members may retire at the age of 50 with 20 years of service, or at the age of 53 with five years of service, with an allowance of 2 percent of the FAS per year of service. (FAS is based on the highest consecutive 60 months.) Plan 2 members who retire prior to the age of 53 receive reduced benefits. Benefits are actuarially reduced for each year that the benefit commences prior to age 53 and to reflect the choice of a survivor option. If the member has at least 20 years of service and is age 50, the reduction is 3 percent for each year prior to age 53. A cost-of-living allowance is granted (based on the Consumer Price Index), capped at 3 percent annually.

LEOFF Plan 2 provides disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 allowance amount is 2 percent of the FAS for each year of service. Benefits are actuarially reduced for each year that the member's age is less than 53, unless the disability is duty-related, and to reflect the choice of a survivor option. If the member has at least 20 years of service and is age 50, the reduction is 3 percent for each year prior to age 53. A catastrophic disability benefit equal to 70 percent of their FAS, subject to offsets for workers' compensation and Social Security disability benefits received, is also available to those LEOFF Plan 2 members who are severely disabled in the line of duty and incapable of future substantial gainful employment in any capacity.

Effective June 2010, benefits to LEOFF Plan 2 members who are catastrophically disabled include payment of eligible health care insurance premiums.

Members of LEOFF Plan 2 who leave service because of a line of duty disability are allowed to withdraw 150 percent of accumulated member contributions. This withdrawal benefit is not subject to federal income tax. Alternatively, members of LEOFF Plan 2 who leave service because of a line of duty disability may be eligible to receive a retirement allowance of at least 10 percent of FAS and 2 percent per year of service beyond five years. The first 10 percent of the FAS is not subject to federal income tax.

LEOFF Plan 2 retirees may return to work in an eligible position covered by another retirement system, choose membership in that system and suspend their pension benefits, or not choose membership and continue receiving pension benefits without interruption.

LEOFF Plan 2 members who apply for retirement may purchase up to five years of additional service credit. The cost of this credit is the actuarial equivalent of the resulting increase in the member's benefit.

LEOFF Plan 2 members can purchase service credit for military service that interrupts employment. Additionally, LEOFF Plan 2 members who become totally incapacitated for continued employment while servicing in the uniformed services may apply for interruptive military service credit. Should any such member die during this active duty, the member's surviving spouse or eligible child(ren) may purchase service credit on behalf of the deceased member.

LEOFF Plan 2 members may also purchase up to 24 consecutive months of service credit for each period of temporary duty disability.

Beneficiaries of a LEOFF Plan 2 member who is killed in the course of employment receive retirement benefits without actuarial reduction, if found eligible by the Director of the Department of Labor and Industries.

Benefits to eligible surviving spouses and dependent children of LEOFF Plan 2 members killed in the course of employment include the payment of on-going health care insurance premiums paid to the Washington state Health Care Authority.

A one-time duty-related death benefit is provided to the estate (or duly designated nominee) of a LEOFF Plan 2 member who dies as a result of injuries or illness sustained in the course of employment, if found eligible by the Department of Labor and Industries.

There are 372 participating employers in LEOFF. Membership in LEOFF consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2009:

Type of Members	Number of Participants
Retirees and Beneficiaries Receiving Benefits	9,454
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	674
Active Plan Members Vested	13,363
Active Plan Members Non-vested	3,944
Total	27,435

Funding Policy

Starting on July 1, 2000, LEOFF Plan 1 employers and employees contribute zero percent as long as the plan remains fully funded. Employer and employee contribution rates are developed by the Office of the State Actuary to fully fund the plan. LEOFF Plan 2 employers and employees are required to pay at the level adopted by the LEOFF Plan 2 Retirement Board. All employers are required to contribute at the level required by state law. The Legislature, by means of a special funding arrangement, appropriated money from the state General Fund to supplement the current service liability and fund the prior service costs of LEOFF Plan 2 in accordance with the requirements of the Pension Funding Council and the LEOFF Plan 2 Retirement Board. However, this special funding situation is not mandated by the state constitution and this funding requirement could be returned to the employers by a change of statute.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2010, are as follows:

Contributer	LEOFF Plan 1	LEOFF Plan 2
Employer*	0.16%	5.24%**
Employee	0.00%	8.46%
State	N/A	3.38%

*The employer rates include the employer administrative expense fee currently set at 0.16%.

**The employer rate for ports and universities is 8.62%.

Both the City of Oak Harbor and the employees made the required contributions. The overall required contributions for the years ended December 31 were as follows:

Year	LEOFF Plan 1	LEOFF Plan 2
2010	\$304	\$376,225
2009	298	367,366
2008	289	350,492

Public Safety Employees' Retirement System (PSERS) Plan 2

Plan Description

PSERS is a cost-sharing multiple-employer retirement system comprised of a single defined benefit plan, PSERS Plan 2. PSERS was created by the 2004 Legislature and became effective July 1, 2006.

PSERS Plan 2 membership includes full-time employees of a covered employer on or before July 1, 2006, who met at least one of the PSERS eligibility criteria, and elected membership during the election period of July 1, 2006 to September 30, 2006; and those full-time employees, hired on or after July 1, 2006 by a covered employer, that meet at least one of the PSERS eligibility criteria.

A *covered employer* is one that participates in PSERS. Covered employers include the following: state of Washington agencies: Department of Corrections, Department of Natural Resources, Parks and Recreation Commission, Gambling Commission, Washington State Patrol, and Liquor Control Board; Washington State counties; Washington State cities except for Seattle, Tacoma and Spokane.

To be eligible for PSERS, an employee must work on a full-time basis and have one of the following:

- Completed a certified criminal justice training course with authority to arrest, conduct criminal investigations, enforce the criminal laws of Washington, and carry a firearm as part of the job.
- Primary responsibility to ensure the custody and security of incarcerated or probationary individuals.
- Limited authority to function as a Washington peace officer, as defined in RCW 10.93.020.
- Primary responsibility to supervise eligible members who meet the above criteria.

PSERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PSERS retirement benefit provisions are established in Chapter 41.37 RCW and may be amended only by the State Legislature.

PSERS Plan 2 members are vested after the completion of five years of eligible service. PSERS Plan 2 members may retire at the age of 65 with five years of service, or at the age of 60 with at least 10 years of PSERS service credit, with an allowance of 2 percent of the average final compensation (AFC) per year of service. The AFC is the monthly average of the member's 60 consecutive highest-paid service credit months, excluding any severance pay such as lump-sum payments for deferred sick leave, vacation or annual leave. Plan 2 members who retire prior to the age of 60 receive reduced benefits. If retirement is at age 53 or older with at least 20 years of service, a 3 percent per year reduction for each year between the age at retirement and age 60 applies. There is no cap on years of service credit; and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at 3 percent annually.

PSERS Plan 2 provides disability benefits. There is no minimum amount of service credit required for eligibility. Eligibility is based on the member being totally incapacitated for continued employment with a PSERS employer and leaving that employment as a result of the disability. The disability allowance is 2 percent of the average final compensation (AFC) for each year of service. AFC is based on the member's 60 consecutive highest creditable months of service. Service credit is the total years and months of service credit at the time the member

separates from employment. Benefits are actuarially reduced for each year that the member's age is less than 60 with ten or more service credit years in PSERS), or less than 65 (with fewer than ten service credit years).

PSERS Plan 2 members can purchase service credit for military service that interrupts employment. Additionally, PSERS members who become totally incapacitated for continued employment while serving in the uniformed services, may apply for interruptive military service credit. Should any such member die during this active duty, the member's surviving spouse or eligible child(ren) may purchase service credit on behalf of the deceased member.

PSERS members may also purchase up to 24 consecutive months of service credit for each period of temporary duty disability.

Beneficiaries of a PSERS Plan 2 member with ten years of service who is killed in the course of employment receive retirement benefits without actuarial reduction, if the member was not at normal retirement age at death. This provision applies to any member killed in the course of employment, if found eligible by the Director of the Department of Labor and Industries.

A one-time duty-related death benefit is provided to the estate (or duly designated nominee) of a PSERS member who dies as a result of injuries or illness sustained in the course of employment, if found eligible by the Department of Labor and Industries.

There are 73 participating employers in PSERS. Membership in PSERS consisted of the following as of the latest actuarial valuation date for the plan of June 30, 2009:

Type of Members	Number of Participants
Retirees and Beneficiaries Receiving Benefits	2
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	-
Active Plan Members Vested	-
Active Plan Members Non-vested	4,340
Total	4,342

Funding Policy

Each biennium, the state Pension Funding Council adopts PSERS Plan 2 employer and employee contribution rates. The employer and employee contribution rates for Plan 2 are developed by the Office of the State Actuary to fully fund Plan 2. All employers are required to contribute at the level established by the Legislature. The methods used to determine the contribution requirements are established under state statute in accordance with chapters 41.37 and 41.45 RCW.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2010 are as follows:

Contributer	PSERS Plan 2
Employer*	7.85%
Employee	6.55%

*The employer rate includes an employer administrative expense fee of 0.16%.

Both the City of Oak Harbor and the employees made the required contributions. The overall required contributions for the years ending December 31 were as follows:

Year	PSERS Plan 2
2010	\$15,402
2009	12,070
2008	8,545

Other Retirement Systems - Volunteer Fire Fighters’ Relief and Pension Fund

The Washington State Board for Volunteer Firefighters and Reserve Officers administers the Volunteer Firefighters’ and Reserve Officers’ Relief and Pension Act; a cost-sharing multiple-employer retirement system created by the Legislature in 1945 under Chapter 41.24 RCW. It provides pension, disability and survivor benefits. Membership in the system requires service with a fire department of an electing municipality of Washington State except those covered by LEOFF. The system is funded through municipal or member pension contributions of \$60 per year; employer disability fee of \$30 per year; 40 percent of the Fire Insurance Premium Tax; and earnings from the investment of money by the Washington State Investment Board. However, members may elect to withdraw their contributions upon termination.

Note 8 – Risk Management

The City of Oak Harbor is a member of the Washington Cities Insurance Authority. Chapter 48.62 authorizes the governing body of any one or more governmental entities to form together into or join a pool or organization for the joint purchasing of insurance, and/or joint self-insuring, and/or joint hiring or contracting for risk management services to the same extent that they may individually purchase insurance, self-insure, or hire or contract for risk management services. An agreement to form a pooling arrangement was made pursuant to the provisions of Chapter 39.34 RCW, the Interlocal Cooperation Act. The pool was formed January 1, 1981 when cities in the State of Washington joined together by signing an Interlocal Governmental Agreement to pool their self-insured losses and jointly purchase insurance and administrative services.

The pool allows members to jointly purchase insurance coverage, provide related services, such as administration, risk management, claims administration, etc. Coverage for Public Officials Liability and all other coverages are on an “occurrence basis”. The Pool maintains a self-insurance layer limit of \$3,000,000 per occurrence, with a reinsured excess layer limit of \$12,000,000 per occurrence. Coverage includes general liability, automobile liability, stop-gap coverage, errors or omissions liability, and employee benefits liability. Claims deductibles run in levels of \$1,000 for property, and \$1,000 for automobile physical damage.

The City proactively participates in on-going training for staff regarding current practices and risk mitigation procedures in order to effectively limit claims loss exposure. Insurance coverage has been greater than claims and settlements for each of the last three years.

Note 9 – Short-term Debt

The City has no outstanding anticipation notes (other than bond anticipation notes that are accounted for as long-term debt), interest-bearing (registered or revenue) warrants, or similar contractual debt in 2010 nor were any issued during the year.

Note 10 – Long-term Debt

The City of Oak Harbor has issued general obligation and revenue bonds to finance the purchase of fire trucks and capital improvements to the sewer infrastructure. Bonded indebtedness has also been entered into in prior years to advance refund revenue bonds. General obligation bonds have been issued for general government and activities and are being repaid from the applicable resources. The revenue bonds are repaid by income received from proprietary fund earnings. The City of Oak Harbor is also liable for balances due to other governments for Public Works Trust Fund (“PWTF”) loans entered into for the replacement of the City’s water transmission line, as required by the Washington State Department of Transportation.

General obligation debt currently outstanding is as follows:

Purpose	Maturity Range	Interest Rate	Original Amount	Amount of Installments
2008 OAK0361-1-1 LOCAL Bond	2012	3.42%	\$192,000	\$74,986

The annual debt service requirements to maturity for general obligation bonds are as follows:

Year Ending December 31,	Governmental Activities		Business-type Activities	
	Principal	Interest	Principal	Interest
2011	49,565	2,145	-	-
2012	25,421	435	-	-
Total	\$74,986	\$2,580	\$ -	\$ -

The revenue bonds currently outstanding are as follows:

Purpose	Maturity Range	Interest Rate	Original Amount	Amount of Installments
1996 Water & Sanitary Sewer Revenue Refunding Bonds	2011	5.90%	\$3,495,000	\$380,000
2004 Water & Sewer Revenue Bonds	2024	3.35% - 4.55%	\$2,865,000	\$2,180,000

Revenue bond debt service requirements to maturity are as follows:

Year Ending December 31,	Principal	Interest
2011	\$500,000	\$112,970
2012	125,000	86,530
2013	130,000	82,155
2014	135,000	77,410
2015	140,000	72,347
2016-2020	780,000	273,428
2021-2024	750,000	87,133
Total	\$2,560,000	\$791,973

Balances due to other governments currently outstanding are as follows:

Purpose	Maturity Range	Interest Rate	Original Amount	Amount of Installments
PW-05-691-042 Public Works Trust Fund Loan	2025	0.50%	\$834,700	\$344,717
PW-05-691-031 Public Works Trust Fund Loan	2026	0.50%	\$2,694,500	\$453,811

Balances due to other governments debt service requirements to maturity are as follows:

Year Ending December 31,	Principal	Interest
2011	\$51,344	\$3,992
2012	51,344	3,736
2013	51,344	3,479
2014	51,344	3,223
2015	51,344	2,966
2016-2020	256,722	10,978
2021-2025	256,722	4,560
2026	28,364	142
Total	\$798,528	\$33,076

In proprietary funds, unamortized debt issue costs are recorded as deferred charges and bonds are displayed net of premium or discount; annual interest expense is decreased by amortization of debt premium and increased by the amortization of debt issue costs and discount. Restricted assets in proprietary funds contain \$953,353 in reserves as required by bond indentures.

The City has pledged net revenues of the sewer utility to repay the revenue bonds. Proceeds from the bonds provided financing for capital improvements to the sewer infrastructure. The bonds are payable from revenues generated by the City's Sewer fund. Net revenues are expected to be 1.25 times the annual debt service requirement. The total principal and interest remaining to be paid on the bonds is \$3,351,943. Principal and interest paid for the current year and net sewer revenue were \$618,185 and \$1,848,986, respectively.

Refunded Debt

The City of Oak Harbor issued a general obligation refunding bond in 1996. Proceeds of the issue were used to perform an advance refunding of \$680,000 of the City's 1987 Unlimited Tax General Obligation Bonds; to perform an advance refunding of \$1,790,000 of the City's 1991 Unlimited Tax General Obligation Bonds; and to pay the costs of issuance of the bonds. This bond was paid off in 2010.

Note 11 – Leases and Contract Obligations

Operating Leases

The City of Oak Harbor leases office equipment with Xerox under non-cancelable operating leases. Total cost for such leases was \$54,822 for the year ending December 31, 2010. The future minimum lease payments for these leases are as follows:

Year Ending December 31	Amount
2011	33,874
2012	30,276
2013	30,276
2014	22,499
2015	8,132
Total	\$ 125,057

Capital Leases

The City has no capital lease agreements and did not enter into any capital lease agreements during 2010.

Contracts

The City of Oak Harbor entered into a 6-year agreement with Island Thrift, a local non-profit charitable organization for the use of a modular building. This agreement has subsequently been extended for 6 addition years. Island Thrift donated \$125,000 to the City of Oak Harbor, \$105,000 of which was to be put towards the purchase of a modular home. In exchange for the payment, the City purchased a modular for the use of its Adult Day Care Respite program. During the 12-year period under contract, the modular will be kept on City property at 917 East Whidbey Avenue, Oak Harbor, WA, and both Island Thrift and the City of Oak Harbor hold title. At the end of the 12-year period, November 6, 2013, the City will immediately convey the modular to Island Thrift at which time Island Thrift will have 180 days to remove the modular from City property and title to the modular will be conveyed to Island Thrift.

Although the City makes no monthly or annual payments for the modular, the City has chosen to treat this agreement as capital rent for accounting purposes. The modular has been recorded at its total value and expensed over the 6-years of the original agreement.

The asset acquired through this agreement is as follows:

Asset	Governmental Activities
Respite modular	\$ 138,572
Less rent expense	(138,572)
Total	\$ -

Note 12 – Changes in Long-term Liabilities

During the year ended December 31, 2010, the following changes occurred in long-term liabilities (inclusive of both portions due within one year and due in more than one year):

	Beginning Balance 1/1/2010	Additions	Reductions	Ending Balance 12/31/2010	Due Within One Year
Governmental Activities:					
Bonds payable:					
General obligation	\$ 362,897	\$ -	\$ (287,911)	\$ 74,986	\$ 49,565
Less deferred amounts:					
For issuance discounts on refunding	-	-	-	-	-
Total bonds payable:	362,897	-	(287,911)	74,986	49,565
OPEB payable	254,672	164,055	(52,708)	366,019	-
Compensated absences	1,080,846	54,659	-	1,135,505	454,202
Government activity long-term liabilities:	\$ 1,698,415	\$ 218,714	\$ (340,619)	\$ 1,576,510	\$ 503,767
Business-type Activities:					
Bonds payable:					
Revenue bonds	\$ 3,040,000	\$ -	\$ (480,000)	\$ 2,560,000	\$ 500,000
Less deferred amounts:					
For issuance discounts on refunding	(441)	-	216	(225)	-
Total bonds payable:	3,039,559	-	(479,784)	2,559,775	500,000
Due to other governments - PWTF loans	854,433	-	(55,905)	798,528	51,344
Payable from restricted assets (landfill closure)	70,157	-	-	70,157	-
Compensated absences	305,725	31,425	-	337,150	134,860
Business-type activity long-term liabilities	\$ 4,269,874	\$ 31,425	\$ (535,689)	\$ 3,765,610	\$ 686,204

The City of Oak Harbor’s internal service funds serve both governmental and enterprise funds. Accordingly, long-term liabilities for them are included as part of the above totals for both governmental and business-type activities, based on the internal service fund’s predominant customer. At year end, there were no internal service funds bonds, notes and loans payable outstanding. However, \$153,910 of internal service funds compensated absences are included in the above business-type amounts. Also, for the governmental activities, claims and judgments and compensated absences are generally liquidated by the general fund.

Note 13 – Contingencies and Litigations

The City of Oak Harbor has recorded in its financial statements all material liabilities, including an estimate for situations that have not yet resolved but where, based on available information, management believes it is probable that the City of Oak Harbor will have to make payment. In the opinion of management, the City of Oak Harbor’s insurance policies and/or self-insurance reserves are adequate to pay all known or pending claims.

As discussed in Note No.10 (Long-term Debt), the City of Oak Harbor is contingently liable for repayment of refunded debt.

The City of Oak Harbor participates in a number of federal-assisted and state-assisted programs. These grants are subject to audit by the grantors or their representatives. Such audits could result in requests for reimbursement to grantor agencies for expenditures disallowed under the terms of the grants. Other than the instances described above, City of Oak Harbor management believes that such disallowances, if any, will be immaterial.

Note 14 – Restricted Net Assets

The government-wide Statement of Net Assets reports \$17,594,754 of restricted net assets, of which \$17,594,754 is restricted by enabling legislation.

Note 15 – Interfund Balances and Transfers

Interfund Balances

Due to other funds and due from other funds results from goods issued, work performed, or services rendered to or for the benefit of another fund when cash is not immediately moved between the funds. Interfund balances at December 31, 2010 were as follows:

	Due To	Due From
General	\$580	\$42,266
Arterial	7,045	-
Nonmajor		
governmental	2,807	-
Water	7,834	-
Sewer	11,911	-
Solid waste	5,454	-
Storm drain	1,809	-
Marina	2,240	-
Internal service	3,014	428
Total	\$42,694	\$42,694

Interfund Transfers

The primary purpose of interfund transfers is to support the operations of other funds and contribution for capital projects. Interfund transfers at December 31, 2010 were as follows:

Transfers Out	Transfers In							Total
	General	Arterial	Nonmajor Governmental	Water Reserve	Storm Drain Reserve	Marina Reserve	Internal Service	
General	\$ -	\$ -	\$493,321	\$ -	\$ -	\$ -	\$95,887	\$589,208
Arterial	88,767	-	-	-	-	-	-	88,767
Nonmajor								
governmental	71,935	700,000	35,000	-	-	-	76,748	883,683
Water	299,183	-	10,000	24,000	-	-	76,748	409,931
Sewer	302,295	-	-	-	-	-	40,488	342,783
Solid Waste	195,199	-	-	-	-	-	40,045	235,244
Storm drain	168,130	-	-	-	25,000	-	40,267	233,397
Marina	91,178	-	-	-	-	25,000	-	116,178
Internal service	34,742	-	-	-	-	-	345,267	380,009
Total	\$1,251,429	\$700,000	\$538,321	\$24,000	\$25,000	\$25,000	\$715,450	\$3,279,200

Interfund Loan Activity

There were no interfund loans during 2010.

Note 16 – Receivable Balances

Major receivables of the City’s governmental and enterprise funds come from the State, Island County, and local taxpayers. Total receivables coincide with the following balance sheet line items: “Receivable (net)” and “Due from other governments”.

Receivables at December 31, 2010 were as follows:

Receivables:	General	Nonmajor Governmental	Water	Sewer	Solid Waste	Storm Drain	Marina	Total
Taxes	\$277,249	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$277,249
Municipal court	1,573,472	-	-	-	-	-	-	1,573,472
Accounts	100	35,416	354,846	405,539	280,343	138,835	40,116	1,255,195
Due from other governments	973,780	128,795	-	-	-	-	9,341	1,111,916
Gross receivables	2,824,601	164,211	354,846	405,539	280,343	138,835	49,457	4,217,832
Less: allowance for uncollectible	(1,348,623)	-	-	-	-	-	-	(1,348,623)
Net total receivables	\$ 1,475,978	\$ 164,211	\$ 354,846	\$ 405,539	\$ 280,343	\$ 138,835	\$ 49,457	\$ 2,869,209

Total governmental activities receivables were \$1,640,189 and business-type activities receivables were \$1,229,020.

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received but not yet earned. Total governmental activities deferred revenue at December 31, 2010 was \$333,618 and business-type activities deferred revenue was \$23,712.

Note 17 – Post-retirement Benefits Other Than Pension Benefits

Other Post-employment Benefits (OPEB)

Plan Description

As required by the Revised Code of Washington (RCW) Chapter 41.26, the City provides lifetime medical care for members of the Law Enforcement Officers and Firefighters (LEOFF) retirement system hired before October 1, 1977 under a defined benefit healthcare plan administered by the City. The members necessary hospital, medical, and nursing care expenses not payable by worker’s compensation, social security, insurance provided by another employer, other pension plan, or any other similar source are covered. Most medical coverage for eligible retirees is provided by the City’s employee medical insurance program. Under the authorization of the LEOFF Disability Board, direct payment is made for other retiree medical expenses not covered by standard medical plan benefit provisions. Financial reporting for the LEOFF retiree healthcare plan is included in the City’s Comprehensive Annual Financial Report. The City currently has five participants in the LEOFF 1 system consisting of two actively employed and three retired individuals.

Funding Policy

Funding for LEOFF retiree healthcare costs is provided entirely by the City as required by RCW. The City’s funding policy is based upon pay-as-you-go financing requirements.

Annual OPEB Cost and Net OPEB Obligation

The City’s annual other post employment benefit cost is calculated based upon the annual required contribution (ARC), an amount determined using an alternative measurement method

permitted under GASB Statement 45. A single retirement age of 56.24 was assumed for all active members for the purpose of determining the actuarial accrued liability (AAL) and normal cost. Retirement, disablement, termination, and mortality rates were assumed to follow the LEOFF 1 rates used in the June 30, 2007 actuarial valuation report issued by the Office of the State Actuary (SOA). Healthcare costs and trends were determined by Milliman and used by SOA in the state-wide LEOFF 1 medical study performed in 2007. The results were based on grouped data with four active groupings and four inactive groupings. The actuarial cost method used to determine the AAL was Projected Unit Credit. The AAL and net OPEB obligation (NOO) are amortized on an open basis as a level dollar over 15 years. These assumptions are individually and collectively reasonable for the purposes of this valuation.

The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities over a period of 30 years as of January 1, 2007. The following table shows the components of the City's annual OPEB cost and the change in the City NOO. The NOO of \$366,019 is included as a noncurrent liability on the Statement of Net Assets.

Fiscal Year Ending 12/31/2010	
Determination of annual required contribution	
Normal costs at year end	\$18,359
Amortization of unfunded actuarial accrued liabilities (UAAL)	134,236
Annual required contribution (ARC)	\$152,595
Determination of net OPEB obligation (NOO)	
Annual required contribution	\$152,595
Interest on NOO	11,460
Adjustments to ARC	(23,713)
Annual OPEB cost	140,342
Contribution	(28,995)
Increase (decrease) in NOO	111,347
NOO - beginning	254,672
NOO - ending	\$366,019

Funded Status and Funding Progress

The City's OPEB cost, the percentage of OPEB cost contributed to the plan and the net OPEB obligation were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligations
12/31/2010	140,342	20.66%	\$366,019
12/31/2009	159,184	17.46%	254,672
12/31/2008	169,592	27.30%	123,289

As of January 1, 2010, the most recent calculation date, the plan was 0% funded. The City's actuarial value of assets, accrued liability, UAAL, covered payroll and UAAL as a percentage of covered payroll was as follows:

Fiscal Year Ended	Actuarial Value of Assets	Actuarial Accrued Liability	UAAL	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
12/31/2010	\$ -	\$1,441,638	\$1,441,638	0.00%	\$189,153	762.15%
12/31/2009	-	1,551,851	1,551,851	0.00%	185,436	836.87%
12/31/2008	-	1,600,503	1,600,503	0.00%	181,843	880.16%

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information that shows whether the actuarial value of the plan assets is increasing or decreasing over time relative to the actuarial liabilities for benefits.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

In the January 1, 2008 actuarial valuation, the entry age normal actuarial cost method was used. The actuarial assumptions used included a 5.50% discount rate, which is based upon the long-term investment yield on the investments that are expected to be used to finance payment of benefits. A medical inflation rate of 9%, graded to 5% over eight years was used along with a long term care inflation rate of 4.5%. The UAAL is being amortized over a thirty year period on a closed basis at the assumed discount rate.

Note 18 – Closure and Post Closure Care Costs

The City landfill ceased to receive solid waste as of 1980. As required by the Island County Health Department, the City Engineering Department has conducted extensive monitoring of ground water and gas expulsion from 1980 to present. The City has prepared a landfill closure plan, conducted Phase I during 1993, and successive Phases implemented throughout 2003. In compliance with GASB Statement 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, the City of Oak Harbor has identified its remaining landfill closure liability to be approximately \$70,157 (the total estimated liability of \$800,000 less accumulated closure costs of \$729,843). This represents an estimate of the expected liability. Inflation, changes in technology, and closure regulations may affect this estimate.

Note 19 – Pollution Remediation Obligations

GASB Statements 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, was issued on November 30, 2006. This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations,

which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups.

Per GASB 49, once any one of five specified obligating events occurs, a government entity is required to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as a liability or, if appropriate, capitalized when goods and services are acquired. Obligating events include the following:

- The government is compelled to take pollution remediation action because of an imminent endangerment.
- The government violates a pollution prevention–related permit or license.
- The government is named, or evidence indicates that it will be named, by a regulator as a responsible party or potentially responsible party (PRP) for remediation, or as a government responsible for sharing costs.
- The government is named, or evidence indicates that it will be named, in a lawsuit to compel participation in pollution remediation.
- The government commences or legally obligates itself to commence pollution remediation.

The City has above-ground fuel tanks at Public Works and the Marina and utilizes Veeder Root, a monitoring system. This system performs a series of daily tests on the fuel tanks and reports, among other things, any leaks in the tanks. The system has not indicated any leaks or contamination.

Note 20 – Other Disclosures

Accounting and Reporting Changes

There are no accounting or reporting changes for 2010.

Subsequent Events

In 1987, the City entered into a 50-year license agreement with the U.S. Navy to utilize certain sanitary sewer treatment facilities located on Navy property. During 2002, the Department of Defense entered in negotiations with the City of Oak Harbor to privatize the treatment of its sewer system aboard the Whidbey Island Naval Air Station. Discussion is still on-going in 2010 regarding sewage treatment options for military infrastructure.

On February 1, 2011 a contract was awarded to Strider Construction for the Pioneer Way Reconstruction project. The final amount of the contract, including change orders was 4,252,554.76.

On February 17, 2011 an interfund loan was entered into between the Equipment Replacement fund and the Marina Fund not to exceed \$2,560,000. The purpose of this loan was to pay invoices related to the Marina redevelopment project that would be due before the bond proceeds would be available. Draws were authorized in the exact amount of invoices due and totaled \$768,039.22. This interfund loan was repaid to the Equipment Replace Fund on March 23, 2011 from the proceeds of the LTGO Bond issued by the Marina Fund. The repayment included interest calculated at a rate one percent (1%) per annum.

On March 23, 2011 the City issued a Limited Tax General Obligation (“LTGO”) Bond in the amount of \$2,570,000 as funding sources for the Marina redevelopment project. The bonds mature over 20 years and have interest rates from 0.75% to 4.0%.

On July 25, 2011, the City's application for a \$1,600,000 Public Works Trust Fund loan was approved. The purpose of this loan is to provide financing for the City's 42-inch Outfall line project. This project is intended to replace a large eroded section of storm water line infrastructure which distributes storm water runoff into Oak Harbor Bay. The City has completed, signed, and submitted the required documents to obtain the proceeds of the loan. However, the documents have not been completed by the State of Washington at this time. The City anticipates the completion of the loan agreement in October of 2012.

On September 20, 2011 passed a resolution to withdraw the Shoreline Substantial Development Permit for the Multimodal Facility, to request that the Federal Transit Administration withdraw the grant funds of \$836,000 and to remove the Multimodal project from the 2011-2016 Capital improvement Plan, the 2012-2017 Transportation Improvement Plan, The Comprehensive Plan, the Transportation Plan and the Parks, Recreation and Open Space Plan. In conjunction with the resolution to withdraw the FTA grant funds, the City presented a request to the Washington State Department of Transportation (WSDOT) to rescind the repayment of three FHWA Ferry Boat Discretionary Fund Grants, awarded in the aggregate amount of \$528,000, taking the position that after completion of the preliminary design work, a National Environmental Policy Act (NEPA) permit review would result in significant adverse affects to the environments. Given the potential for adverse affects if the project were to continue, it would not reasonable to require the City to proceed with the project and therefore under 23 CFR 630.112 the City should not be required to repay any expended funds. On January 24, 2012, the City received notice from WSDOT that FHWA has expressed its support for their rescinding the grants as requested. The City anticipates the formal approval for rescinding the grants will occur mid-year 2012.

During 2011, the City of Oak Harbor initiated a significant project to upgrade utilities and street infrastructure along Pioneer Way, an arterial located in the City's historical business area. During construction, the City discovered the remains of a Native American burial site. This discovery has resulted in the need for significant archeological analysis and the subsequent relocation of archeological resources.

On July 29, 2011, a contract for \$30,000 was signed with SWCA Environmental Consultants for archeological services related to the Pioneer Way project. On August 18, 2011 a second SWCA Environmental Consultants contract was entered into for an additional \$150,000. On September 29, 2011 that contract was amended to \$290,000. To date, the cost of the archeological services is \$319,922.33. On January 23, 2012, the City Council authorized an additional \$175,000 for anticipated remaining work.

In addition, site security costs were \$84,589.29 and change orders to the Strider contract totaling \$165,722.10 can be attributed to the discovery of the remains. The City has one remaining site to be excavated where the probability of finding additional remains is likely. However, an estimate of the cost of the excavation cannot be determined until further review of the site is completed.



ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

Our mission is to work with our audit clients and citizens as an advocate for government accountability. As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

The State Auditor's Office employees are located around the state to deliver services effectively and efficiently.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments and fraud, whistleblower and citizen hotline investigations.

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