

Washington State Auditor's Office
Financial Statements Audit Report

City of Oak Harbor
Island County

Audit Period
January 1, 2011 through December 31, 2011

Report No. 1008910

Issue Date
January 7, 2013



WASHINGTON
BRIAN SONNTAG
STATE AUDITOR



**Washington State Auditor
Brian Sonntag**

January 7, 2013

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,

BRIAN SONNTAG, CGFM
STATE AUDITOR

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Island County
January 1, 2011 through December 31, 2011**

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Status of Prior Audit Findings

City of Oak Harbor Island County January 1, 2011 through December 31, 2011

The status of findings contained in the prior years' audit reports of the City of Oak Harbor is provided below:

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

Report No. 1007328, dated March 12, 2012

Background

The audit of fiscal year 2010 identified several deficiencies in internal control over financial reporting that represent a material weakness. These deficiencies include not having a detailed indirect cost allocation plan, inadequate documentation or evaluation to support amounts reported for pollution liability, and an insufficient review process for financial statement preparation, and asset inventory. These deficiencies resulted in significant errors reported in the 2010 financial statements.

Status

The condition reported in 2010 has been resolved. The City has developed an indirect cost allocation plan, evaluated its pollution remediation liability and implemented a review process over financial reporting, and reporting of its capital assets. No material errors or other significant deficiencies were noted during our current audit.

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, 2011 through December 31, 2011**

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, 2011, which collectively comprise the City's basic financial statements, and have issued our report thereon dated December 10, 2012. During the year ended December 31, 2011, the City implemented Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

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.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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*.

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

December 10, 2012

Independent Auditor's Report on Financial Statements

**City of Oak Harbor
Island County
January 1, 2011 through December 31, 2011**

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, 2011, which collectively comprise the City's basic financial statements as listed on page 5. 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Oak Harbor, as of December 31, 2011, and the respective changes in financial position and, where applicable, cash flows thereof, and the respective budgetary comparison for the General and Arterial funds, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1E, during the year ended December 31, 2011, the City implemented Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 23 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

A handwritten signature in black ink, appearing to read "Brian Sonntag". The signature is fluid and cursive, with a large initial "B" and "S".

BRIAN SONNTAG, CGFM
STATE AUDITOR

December 10, 2012

Financial Section

**City of Oak Harbor
Island County
January 1, 2011 through December 31, 2011**

REQUIRED SUPPLEMENTARY INFORMATION

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis (MD&A) of the City of Oak Harbor's financial performance provides an overall review of the City's financial activities for the year ended December 31, 2011. The intent of this discussion and analysis is to look at the City's financial performance as a whole.

This MD&A, combined with the Financial Statements and the Notes to the Financial Statements, represents the complete 2011 financial activities for the City of Oak Harbor. These are all intended to help the reader understand the City's significant financial issues. This MD&A provides an overview of the City's financial records. The data in this financial report also identifies any material deviations from the financial plan and the adopted annual budget. Finally, the intent of the MD&A and other financial information is to isolate and identify individual fund issues or concerns.

FINANCIAL INFORMATION

The City's government-wide financial statements were prepared on the full accrual basis of accounting in conformity with Generally Accepted Accounting Principles (GAAP). The City's fund financial statements for its major and non-major governmental funds were prepared on the modified accrual basis of accounting in conformity with GAAP. The City's major and non-major proprietary funds were accounted for on the full accrual basis of accounting in conformity with GAAP.

The City of Oak Harbor, along with all cities, counties, and other governmental entities in Washington, must comply with the Budgeting, Accounting, and Reporting System (BARS) as defined by the Washington State Auditor's Office (SAO). SAO audits the financial records of all cities and other governmental units within the State. The City of Oak Harbor's financial system integrates financial and administrative controls that ensure the safeguarding of assets and the reliability of financial reports. These controls are designed to provide:

1. reasonable assurance that transactions are executed in accordance to management understanding and approval;
2. reasonable assurance that transactions are executed in accordance to GAAP;
3. accountability for control of assets and obligations; and
4. assurance that sufficient reporting and review exists to provide adequate information for analysis and comparability of data.

Internal control is a high priority for the City. SAO reviews the City's internal controls, and the City receives and takes action on all the recommendations made. The City maintains strong budgetary controls in order to ensure compliance with legal provisions embodied in the biennial appropriated budget as approved by the City Council. The City Council must authorize any budget increase or decrease to any fund.

FINANCIAL HIGHLIGHTS

- The City's overall financial conditioned improved during 2011, as compared to 2010.
- City of Oak Harbor assets exceeded its liabilities at the close of the 2011 fiscal year by \$122.18 million (net position). Of this amount, \$43.92 million (unrestricted net position) may be used to meet the City's ongoing obligations to its citizens and creditors.

- Reported net position increased \$2.32 million. The overall net position of governmental activities decreased \$296,683, or -0.71%, during 2011. Net position of business-type activities increased \$2.62 million, or 3.36%, during 2011.
- Total liabilities increased by \$1.79 million, or 22.76%. This is the net amount of new debt in the form of a Limited Tax General Obligation (LTGO) Bond issued to finance dredging and other capital improvements at the City Marina, existing debt principal payments reducing the amount owed for existing issues, and other changes in compensated absences and accounts payable balances.
- In 2011, the City completed land improvements and construction of the Scenic Heights Trailhead project. This parkland improvement provides additional parking for the City's Waterfront Trail, in addition to providing an anchor at the west end of this scenic trail pathway. The City also completed the Marina Redevelopment Project which involved the dredging of existing waterway channels, improvements to the marina's electrical system, and other dock and float improvements.
- In 2011, the City continued work on improvement of streetscapes and utility infrastructure along Pioneer Way - the City's historic district arterial. This significant project, budgeted at approximately \$8.3 million, offers improved parking, enhanced utilities, and tourist friendly walkways intended to attract visitors to this retail district. During construction, the City discovered ancient archeological resources within the arterial roadway of the project which temporarily halted construction. Through negotiations with Tribal and State organizations, the City has completed construction at the project site, although there still remains final completion of the disposition of the recovered archeological resources.
- Overall, the book value of capital assets increased by \$4.69 million, or 6.29%. Total capital assets from governmental activities increased \$2.32 million or 9.02%. This net increase is primarily due to the capitalization of amounts from the Scenic Heights Trailhead and Pioneer Way Improvement Projects. Capital assets of business-type activities increased \$2.37 million or 4.85%. This is due to the Marina Redevelopment Project, and continued development of the City's utility infrastructure.
- At the close of the 2011, the City's governmental funds reported combined ending fund balances of \$14.41 million. Approximately 79.03% of this total amount, or \$11.39 million, is available for spending at the government's discretion (committed, assigned, and unassigned fund balances). 46.52% or \$6.70 million of the ending fund balances are recorded in the City's Special Revenue and Capital Project funds.
- At the end of the current fiscal year, the ending fund balance for the General Fund was \$7.71 million. Of this amount, 95.77%, or \$7.38 million, is available for spending at the government's discretion. It should also be noted that the City recently adopted a minimum fund balance requirement of 16.67% of annual expenditures.

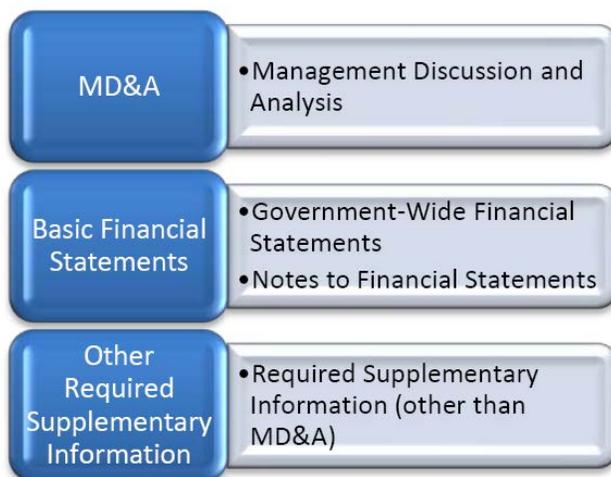
OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis provides an introduction and overview to the City of Oak Harbor's basic financial statements. The basic financial statements are comprised of three components:

1. Government-wide Financial Statements;
2. Fund Financial Statements; and
3. Notes to the Financial Statements.

The graphic representation below illustrates the required components of the City's annual financial report and how the required parts are arranged and relate to one another. This illustration helps explain the City's financial presentation in 2011. This graphic representation should be used in conjunction with the

following explanations to help guide the reader in understanding the financial condition of the City of Oak Harbor.



BASIC FINANCIAL STATEMENTS

Government-wide Financial Statements provide readers with a broad overview of the City of Oak Harbor's finances in a manner similar to a private sector business. They provide both short-term and long-term information about the City's overall financial status. The government-wide statements distinguish between functions of the City that are principally supported by taxes and intergovernmental revenues (referred to as "governmental activities") from functions that are intended to recover all or a significant portion of their costs through user fees and charges (referred to as "business-type activities.") The governmental activities of the City include a full range of local government services provided to the public such as executive, judicial, legal, finance, police and fire protection, road maintenance and construction; community planning and economic development; libraries, parks, and recreational opportunities; and other community services. The business-type activities of the City include the City's water, sewer, solid waste, and storm drain utilities, as well as the city-owned marina.

The Statement of Net Position presents information on all of the City's assets and liabilities with the difference between the two reported as net position. This statement combines and consolidates governmental funds' current financial resources (short term available resources) with capital assets and long-term obligations, which is primarily debt. The Statement of Net Position serves a purpose similar to that of the Balance Sheet of a private-sector business. Over time, increases or decreases in net position may serve as one indicator of whether the financial position of the City is improving or deteriorating. Other indicators to consider when evaluating the financial position of the City includes changes to the property tax base, general economic conditions as demonstrated through business licenses fees or sales tax revenue, and the condition of the City's infrastructure (roads, drainage systems, bridges, and water infrastructure).

The Statement of Activities presents information showing how the City's net position changed during the most recent fiscal year. This statement distinguishes revenue generated by specific functions from revenue provided by taxes and other sources not related to a specific function. The revenue generated by the specific functions (charges for services, grants, and contributions) is compared to the expenses for those functions to show how much each function either supports itself or relies on taxes and other general funding sources for support. All activities on this statement are reported on the accrual basis of accounting, requiring that revenues are reported when they are earned and expenses are reported when they are incurred, regardless of when cash is received or disbursed. Items such as uncollected taxes,

unpaid vendor invoices for goods or services received during the year, and earned but unused vacation leave are included in the statement of activities as revenue and expenses even though no cash has changed hands. The government-wide financial statements can be found immediately following this section (MD&A) of the annual financial report.

In the Statement of Net Position and the Statement of Activities, the City activities are divided into two categories:

- *Governmental Activities* - Most of the City's basic services are reported here, including the police, facilities, parks, planning and general administration. Taxes (property, sales, and utility) and intergovernmental revenues finance most of these activities.
- *Business-Type Activities* - The City charges fees to customers to help cover all or most of the costs of certain services provided, and to recoup the cost of the operations of water, sewer, storm drain, and solid waste utilities, as well as all capital and debt expenses associated with the individual utility, and the marina.

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. Funds are often set up in accordance with special regulations, restrictions, or limitations. The City of Oak Harbor, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The annual financial report includes individual fund financial statements in addition to the government-wide financial statements. While the government-wide statements present the City's finances based on the type of activity, general government versus business-type, the fund financial statements are presented by fund type. All of the City of Oak Harbor's funds can be divided into two categories: twenty individual governmental funds and nine proprietary funds. The City of Oak Harbor does not utilize fiduciary funds.

Traditional users of governmental financial statements will find the fund financial statements presentation more familiar. The focus is on Major Funds rather than types. A Major Fund has three elements as defined by GASB 34:

- Total assets, liabilities, revenues, or expenditures of that individual governmental or enterprise funds are at least ten percent (10%) of the corresponding total (assets, liabilities, etc.) for all funds of that category or type (i.e., governmental, proprietary, or fiduciary); and
- Total assets, liabilities, revenues, or expenditures/expenses of the individual government fund or enterprise funds are at least five percent (5%) of the corresponding total for all governmental and enterprise funds combined; or
- Any other governmental or enterprise fund that the government's officials believe is particularly important.

Governmental funds present most of a government's tax-supported activities. The proprietary funds describe and financially manage the government's business-type activities where all or part of the activities' costs are supported by fees and charges that are paid directly by those who benefit from the activities. Fiduciary funds control resources held by the government as a trustee or agent for parties outside of the government. The resources of fiduciary funds cannot be used to support the government's own programs.

Governmental Funds:

The Governmental Funds Balance Sheet and Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances present separate columns of financial data for the General Fund and Arterial Fund. These two funds comprise the City's major governmental funds. Data from the remaining governmental funds are combined and presented in a single, aggregated column in the fund statements.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. The focus of governmental fund financial statements is on near-term inflows and outflows of available financial resources and on balances of resources available at the end of the fiscal year. Such information is useful in evaluating whether there are more or less financial resources that can be spent in the near future to finance City services.

Because the focus of governmental fund financial statements is a narrower view than that of the government-wide financial statements, it is useful to compare information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. This gives the reader a better understanding of the long-term impact of the government's near-term financing decisions. The Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances provide reconciliation to the governmental activities column in the government-wide statements to facilitate this comparison.

The City maintains budgetary controls over its governmental funds. Budgetary controls ensure compliance with legal provisions embodied in the biennial appropriated budget. Governmental fund budgets are established in accordance with state law and are adopted on a fund level. General Fund budget variances are specifically addressed later in this discussion and analysis.

Proprietary Funds

These types of funds consist of two types of funds: enterprise and internal service funds. They have always been operated as private business activities. Enterprise funds are used to report the same functions as business-type activities in the government-wide financial statements. Internal service funds are used to report activities that provide supplies and services to various City departments and to accumulate and allocate the associated costs of providing these services to the various functions. The revenues and expenses of internal service funds that are duplicated in other funds are eliminated in the government-wide statements. The remaining balances have been allocated to the type of activity, governmental or business-type, that is predominant for each internal service fund.

The City uses enterprise funds to account for its water utility, sewer utility, solid waste utility, storm drain utility, and its 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 and equipment, management of technological systems and maintenance of City facilities. Internal service funds benefit both governmental and business-type activities and are allocated accordingly in the government-wide statement of activities.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The City's water utility, sewer utility, solid waste utility, storm drain utility, and marina are presented in separate columns in the proprietary fund financial statements; whereas the internal service funds are combined into a single column. The proprietary fund financial statements are included in the basic financial statements section of this report.

Fiduciary funds are used to account for resources held by the City in a trustee capacity or as an agent for individuals, private organizations, other governments, or other funds. Fiduciary funds are not reflected

in the government-wide financial statements, because the resources of those funds are not available to support the City's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. The City does not utilize fiduciary funds at this time.

Notes to the Financial Statements, located in the basic financial statements section of this report immediately following the financial statements, provide additional information that is essential to a full understanding of the data provided, and are an integral part of 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

The Statement of Net Position can serve as a useful indicator of the City's financial position. The City of Oak Harbor's net position at December 31, 2011, totals \$122.18 million. Following is a condensed version of the government-wide statement of net position comparing fiscal year 2011 to 2010. Unrestricted and restricted net position for 2010 was adjusted for comparable presentation.

	Net Position					
	Governmental		Business-type		Totals	
	Activities		Activities			
	2011	2010	2011	2010	2011	2010
Assets						
Current	\$17,113,049	\$19,203,316	\$35,412,321	\$33,907,380	\$52,525,370	\$53,110,696
Capital assets	28,080,625	25,757,432	51,208,063	48,839,911	79,288,688	74,597,343
Total assets	45,193,674	44,960,748	86,620,384	82,747,291	131,814,058	127,708,039
Liabilities						
Long-term	1,738,679	1,576,510	5,606,031	3,765,610	7,344,710	5,342,120
Other	1,697,340	1,329,900	595,500	1,178,645	2,292,840	2,508,545
Total liabilities	3,436,019	2,906,410	6,201,531	4,944,255	9,637,550	7,850,665
Net Position						
Invested in capital assets net of related debt	28,055,204	25,682,446	45,968,619	45,481,608	74,023,823	71,164,054
Restricted	3,197,279	5,752,590	1,035,281	1,035,281	4,232,560	6,787,871
Unrestricted	10,505,172	10,619,302	33,414,953	31,286,147	43,920,125	41,905,449
Total net position	\$41,757,655	\$42,054,338	\$80,418,853	\$77,803,036	\$122,176,508	\$119,857,374

As of the end of 2011, the largest component of the City's total net position at \$74.02 million, or 60.59%, is its investment in capital assets (e.g., land, buildings, streets, parks, water/sewer infrastructure, and machinery and equipment) less any related outstanding debt issued to acquire those assets. These capital assets are used to provide services to the citizens. Consequently, these assets are not available to sell and convert to cash for future spending. Although the City's investment in 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 pay these liabilities. Roughly \$4.23 million, or 3.46%, of the City's total net position is subject to legal restrictions.

The net position of governmental activities decreased by \$296,683, a change of -0.71%. This change is primarily attributable to the decline in sales tax revenues, thereby reducing the operating margin and ending cash of the General Fund, combined with \$256,323 in invoices payable in the Arterial Fund at December 31 for the Pioneer Way Improvement project. The net position of business-type activities increased \$2.62 million, a change of 3.36%. The increase was primarily in the category of current and

capital assets. This can be attributed to the effect of increased utility rates on cash balances to fund future capital projects established in the long range plans.

At the end of the fiscal year, the City of Oak Harbor reported positive balances in all three categories of net position for the government as a whole as well as for the separate governmental and business-type activities.

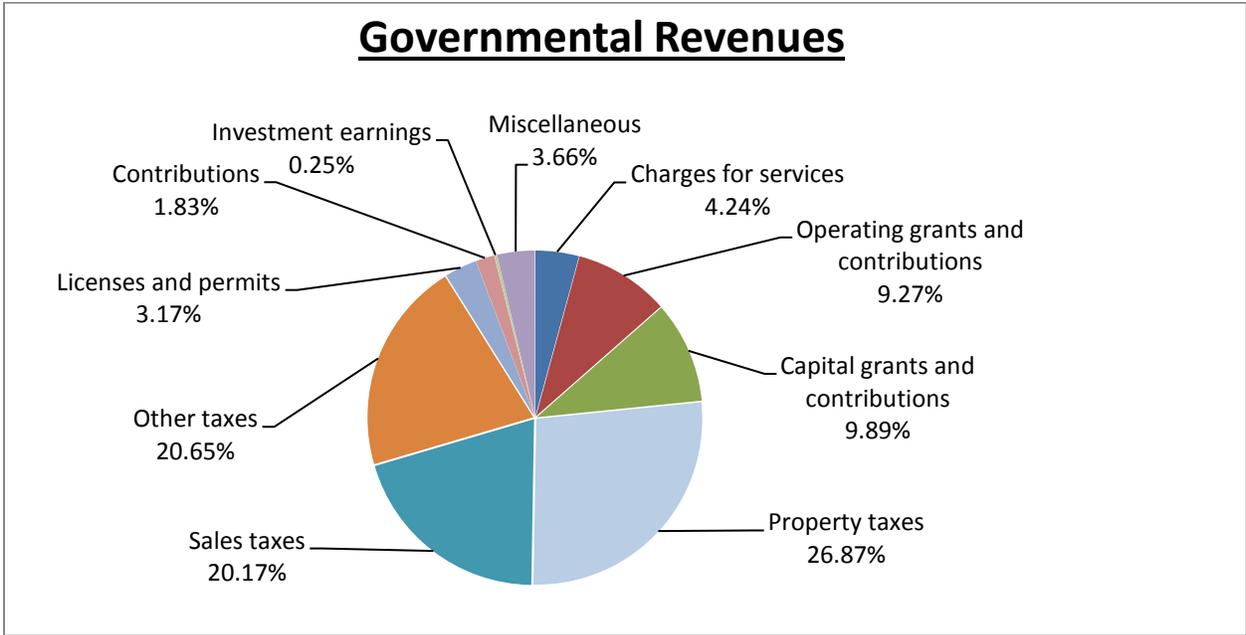
The Statement of Activities can serve as a useful indicator of the results of operations for the City. The following table is a condensed version of the Statement of Activities, illustrating the increases or decreases in net position of the City resulting from its operating activities. The table shows the revenues, expenses, and related changes in net position in tabular form for the governmental activities separate from the business-type activities for 2011 and 2010:

	Changes in Net Position					
	Governmental Activities		Business-type Activities		Totals	
	2011	2010	2011	2010	2011	2010
Revenues						
Program revenues						
Charges for services	\$593,211	\$795,055	\$14,622,585	\$14,384,752	\$15,215,796	\$15,179,807
Operating grants and contributions	1,297,533	1,426,635	5,372	28,966	1,302,905	1,455,601
Capital grants and contributions	1,383,795	630,300	332,206	1,218,255	1,716,001	1,848,555
General revenues						
Property taxes	3,761,165	4,006,062	-	-	3,761,165	4,006,062
Sales and use taxes	2,822,734	2,920,891	-	-	2,822,734	2,920,891
Other taxes	2,890,481	2,875,652	-	-	2,890,481	2,875,652
Other revenues	1,246,287	1,493,792	302,423	371,152	1,548,710	1,864,944
Total revenues	13,995,206	14,148,387	15,262,586	16,003,125	29,257,792	30,151,512
Expenses						
Governmental						
General government	2,133,139	2,598,075	-	-	2,133,139	2,598,075
Judicial	335,526	363,212	-	-	335,526	363,212
Public safety	7,057,955	6,939,632	-	-	7,057,955	6,939,632
Physical environment	316,623	263,007	-	-	316,623	263,007
Transportation	2,196,977	1,480,987	-	-	2,196,977	1,480,987
Health and human services	378,048	410,128	-	-	378,048	410,128
Economic environment	863,684	847,179	-	-	863,684	847,179
Culture and recreation	2,140,181	1,559,296	-	-	2,140,181	1,559,296
Interest on long-term debt	2,146	17,840	-	-	2,146	17,840
Other expenses	-	-	-	-	-	-
Business-type						
Water	-	-	3,464,088	3,527,231	3,464,088	3,527,231
Sewer	-	-	2,985,443	3,067,084	2,985,443	3,067,084
Solid waste	-	-	2,807,781	2,732,853	2,807,781	2,732,853
Storm drain	-	-	1,014,203	1,027,554	1,014,203	1,027,554
Marina	-	-	1,242,864	1,010,019	1,242,864	1,010,019
Total expenses	15,424,279	14,479,356	11,514,379	11,364,741	26,938,658	25,844,097
Change in net position before transfers	(1,429,073)	(330,969)	3,748,207	4,638,384	2,319,134	4,307,415
Transfers	1,132,390	983,712	(1,132,390)	(983,712)	-	-
Change in net position	(296,683)	652,743	2,615,817	3,654,672	2,319,134	4,307,415
Net position - beginning	42,054,338	41,401,595	77,803,036	74,148,364	119,857,374	115,549,959
Net position - ending	\$41,757,655	\$42,054,338	\$80,418,853	\$77,803,036	\$122,176,508	\$119,857,374

In governmental activities, total revenues for 2011 show a slight decrease. This is primarily attributable to a \$235,921 decrease in collected property taxes due to the expiration of the City's 1996 voted property tax levy passed to fund the construction of the City's fire station. Expenses in governmental activities increased, primarily in transportation and culture and recreation, as the Pioneer Way Improvement Project has been in process and the City completed the Scenic Heights Trailhead project. In business-type activities, revenues appear to have decreased. However, this reduction is primarily due higher than average revenues in 2010 due to the receipt of an Island County Economic Development Grant of \$521,693 for the construction of a sewer lift station on Goldie Road, and \$629,490 in 2010 contributions received from developers for donated capital. Expenditures remained at nearly the same levels as 2010.

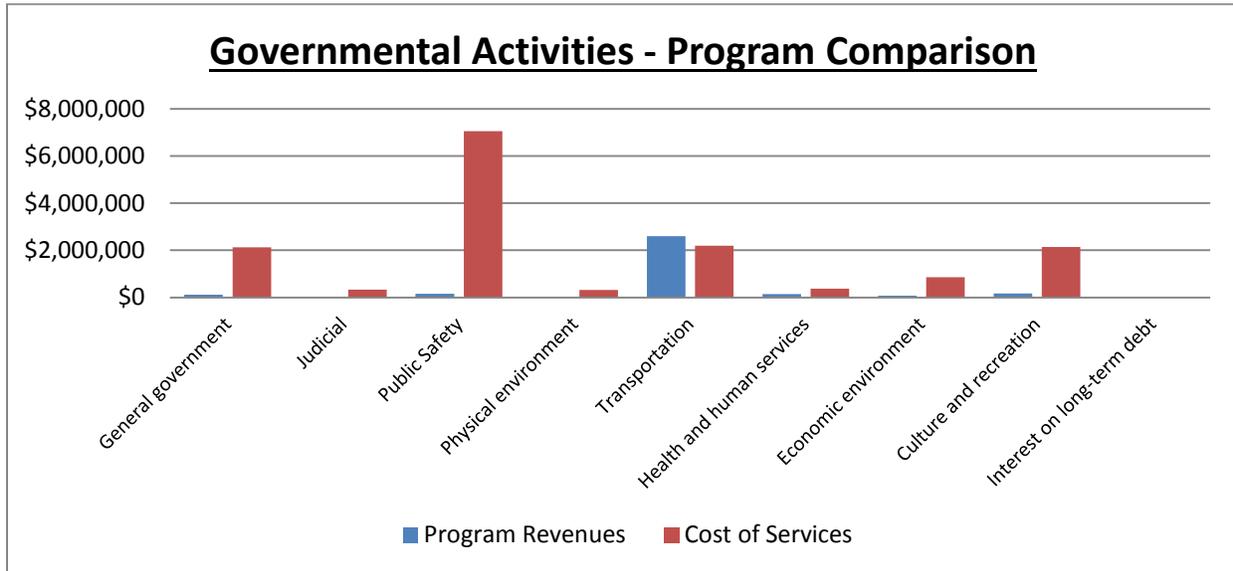
GOVERNMENTAL ACTIVITIES ANALYSIS

Revenues: The following chart illustrates the categorical percentages for each governmental revenue type:



On the Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds, taxes account for the largest revenue category, generating 51.15% of the total revenue. The majority of tax revenue is received in the General Fund accounting for 73.68% of General Fund revenue. Because of this ratio, the category receives the majority of attention during the City's budgeting process. Included in this category are sales, property, utility, criminal justice, and gambling taxes. Governmental fund taxes total \$9.59 million.

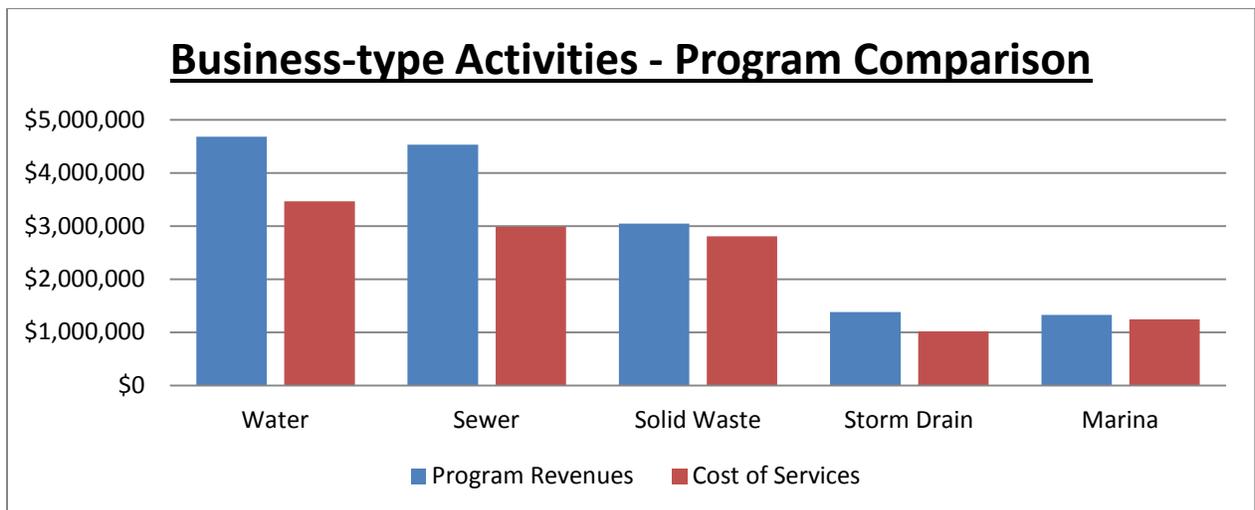
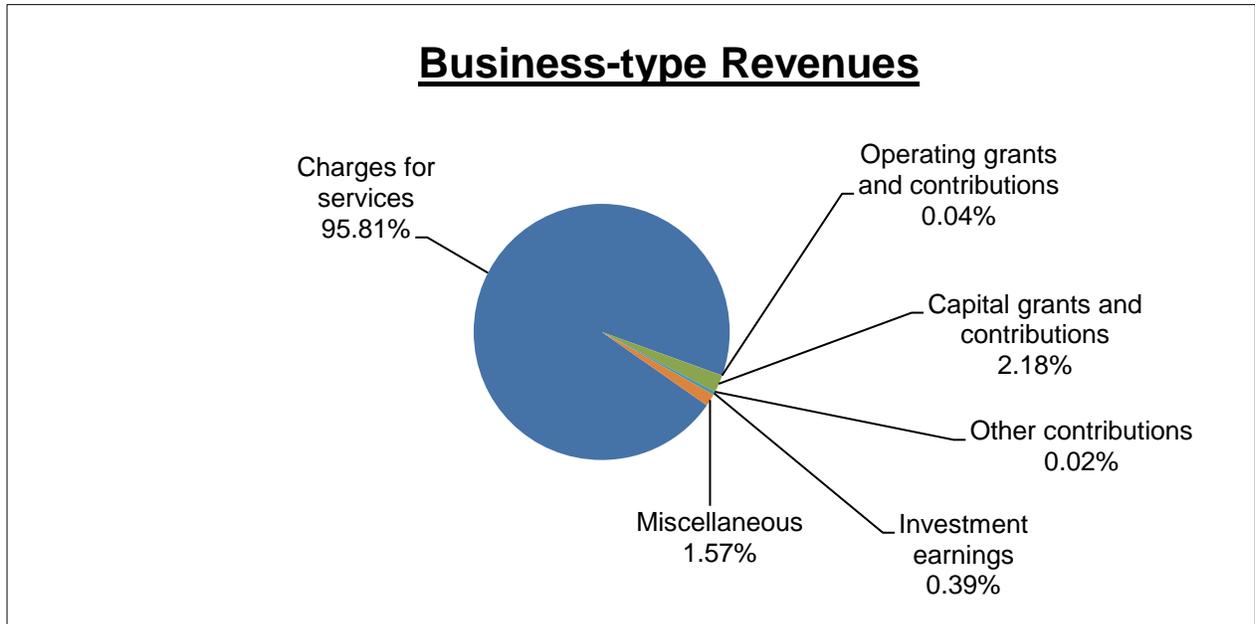
Expenses: The following comparative graph illustrates governmental program revenues to program expenses, net of general revenues and transfers:



General government services encompass a variety of services including executive, financial, legal, judicial, development services, parks, personnel, building maintenance, and audit/risk management. Security of persons and property services are provided by the City's Police Department who works to provide professional law enforcement services to keep our citizens and their property safe. Special emphasis is placed on community-oriented programs that will prevent crime and forge a partnership between the officers and the citizens they serve. Utility and environment services create a satisfactory living environment for the City's residents. Inspection of private construction projects and coordinating the design of city projects are two examples of physical environment activities. Transportation services provide maintenance of the City's streets, sidewalks, paths and traffic control signs/signals. Economic environment services include land use planning, zoning and community development. Health and human services include the City's support for the county's substance abuse program. The City is required by State law to commit 2% of our revenues from liquor profits and liquor tax to this program. The City has a contract with the Island County Health Department, which uses a formula based on population and assessed value to determine the City's level of subsidy.

BUSINESS-TYPE ACTIVITIES ANALYSIS

Revenues: The following graphs illustrate the division of business-type revenues, and the comparison of program revenues to program expenses, net of general revenues and transfers:



Enterprise Funds

The City of Oak Harbor owns and fully operates five enterprise funds, which are accounted for separately as part of the City's fund structure and operations. The five funds are as follows:

- Water and Water Reserve Fund:** The City's water utility is solely supported by its customers, and revenue is generally derived from three sources: 1) monthly service charges, 2) system connection fees, and 3) miscellaneous revenues. The majority of revenue comes from monthly service charges. The 2011 revenue was slightly lower than 2010 as the City has been marketing water conservation measures with City customers, thereby lowering consumption during the summer months. It is anticipated that Water

and Water Reserve Fund revenues will increase in future years due to the moderate rate increases implemented in advance of a number of significant improvements to the City's water infrastructure, including the construction of a new water storage tank on the north side of the City and the City's portion of the costs of upgrading the Anacortes water treatment facility.

• **Sewer and Sewer Reserve Fund:** In 2010, a new rate structure was put into place incorporating steady rate increases over a five year period. This steady increase in sewer rates is implemented in advance of the City's considering the replacement of its sewage treatment facility currently located at Windjammer Park. Site selection and construction of the new facility is anticipated to begin within the next three years. The City's sewer utility is also solely supported by its users and revenue is generally derived from three sources: 1) monthly service charges, 2) system connection fees, and 3) miscellaneous revenues. The majority of revenue comes from monthly service charges.

• **Solid Waste and Solid Waste Reserve Fund:** The solid waste utility is supported by its users and revenue is generally derived from service charges for scheduled residential and commercial solid waste pickup. The City also receives fees for the collection of compostable green waste, and for regular dumpster garbage collection. The City's recycle program is included within the service charge fee structure. The majority of revenue comes from monthly service charges. There was no cost inflator for the rates in 2011 keeping the revenues fairly consistent with previous years.

• **Storm Drain and Storm Drain Reserve Fund:** The City's storm drain utility is supported by its users and revenue is generally derived from monthly service charges. Rates are charged to residential and commercial customers by the area of equivalent residential units (ERU). The rate structure provides funding for many of the storm water projects identified in the City's Comprehensive Storm Water Management Plan. In 2010, a new rate structure was put into place incorporating steady rate increases over a five year period, and a reallocation of service costs between different classes of customers. This steady increase in storm drain rates is being implemented in advance of the several storm drain infrastructure to include replacement of the City's 42-inch outfall. Accordingly, revenues in the Storm Drain and Storm Drain Reserve Fund are projected to increase in future years as the new rate structure takes effect. In 2012, City Council will be considering the implementation of a storm drain system development fee as a funding source for future system expansion requirements.

• **Marina and Marina Reserve Fund:** This fund is supported primarily through user fees charged to customers using the marina facility. Fees are charged for overnight transient rental of slips, longer term leases for boat owners mooring their vessels, and for the sale of fuel and other products to marina customers. The City completed the Marina Redevelopment Project which included the dredging of waterways to and around the marina, electrical system upgrades, and other dock enhancements. During 2011, the marina rate structure was increased to fund both the debt service incurred by the issuance of a \$2,570,000 Limited Tax General Obligation (LTGO) bond utilized to finance the extensive improvements, and to fund continued operations of the marina facility. Marina revenues have recently been at or below historical averages due to the effect of the slower economy on the boating industry.

The City seeks to supplement business activities, as well as governmental activities, through the prudent application of third party funding sources in the form of grants wherever possible. During 2011, business activity program revenues exceeded expenditures because rates were set to accommodate future capital improvements for a fully functioning system. Recently all utilities either implemented or updated their functional plans to evaluate future improvements and operating costs. Rates have been set to reflect these plans. It is anticipated that a joint project with the Whidbey Island Naval Air Station to upgrade the sewer's processing plant will require replacement in the near future, which is why the sewer revenue has a larger variance between revenues and expenditures than the other utilities.

Internal Service Funds:

The City of Oak Harbor also has four internal service funds. These account for the goods and services provided to other units of the entity. Payment by the benefiting unit is intended to fund the costs of providing such service. The four funds that fall into this category are: Equipment Repair Fund, Equipment Replacement Fund, Technology Reserve Fund, and the Shop Facility Fund.

- **Equipment Repair Fund:** The Equipment Repair Fund is an internal service fund that provides the City with in-house mechanic services. The service is responsible for both major and minor repairs of all mechanical equipment used in the business activity funds including cars, trucks, heavy equipment, portable pumps and generators, and small engines. All general governmental department vehicles and equipment for police, fire, building inspection, and parks are serviced by these in-house services. Funding is derived from charges for parts, labor, and overhead. This allows the mechanic shop to be fully self-sufficient. No other funding is used to support this operation.

- **Equipment Replacement Fund:** The Equipment Replacement Fund is an internal service fund to accumulate resources for the future purchase of vehicles and equipment. The objectives of this fund are to cooperate with State and local agencies to establish cooperative purchasing agreements that will reduce costs and improve efficiency and effectiveness, to maintain a fleet replacement program that adequately funds vehicle replacement without having to borrow funds, and to oversee the City auction and sale of City assets in accordance with RCW 39.

- **Technology Reserve Fund:** The Technology Reserve Fund is an internal service fund established to pay for computers, licensing, and other assets of a high tech nature. Individual departments contribute towards future purchases over time in order to have adequate cash to fully purchase the asset with no short term borrowing. The cost of technological assets are charged directly to those departments receiving the purchased goods. The costs of licensing and software are allocated to departments based on the number of computers residing in each area of responsibility.

- **Shop Facility Fund:** The Shop Facility Fund is an internal service support fund responsible for the overall maintenance of City owned buildings, and for the supervision and administration of the Public Works Divisions. The Shop Facility Fund is supported by those divisions, which include the Streets, Water, Sewer, Solid Waste, Storm Drain, Engineering, Parks, and Development Services. Expenses incurred for the Public Works complex are allocated based on a percentage of square footage space utilized by each department.

MAJOR FUND ANALYSIS

The City, in accordance with GASB 34, performed the major fund calculation and determined that the Arterial Fund and the General Fund, met the requirements to qualify as major funds. These funds are accounted for using the modified accrual basis of accounting. As reported on the Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds, total revenues equal \$18.74 million and with total expenditures equaling \$20.59 million.

- **General Fund:** The General Fund accounts for the main operating revenues and expenditures of the City's governmental functions. Revenues and expenditures related to Executive, Judicial, Finance, Legal, Public Safety, Building Inspection and Planning and Park operations are some of the primary functions of the general government accounted for in General Fund. The majority of tax revenues are receipted into the General Fund supporting the governmental functions of the City. The fund balance for the General Fund has increased \$1.05 million, or 15.72%. This is primarily due to the cost savings experienced in the Municipal Court (Judicial) department of \$76,994, savings due to a number of vacant positions within the General Fund, and the economic impact of changing the presentation of the accrued liability for

compensated absences from the Balance Sheet - Governmental to the entity-wide Statement of Net Position. For several years, actual revenues received were consistently higher than actual expenditures which allowed the City to build its fund balance position. With the declining economy consistently following the national trend, current revenues are primarily at or slightly below projected figures. During 2011, most revenues stayed at approximately the same levels as 2010 with the exception of sales taxes, investment earnings and development fees. Expenditures stayed fairly consistent in comparison to previous years.

- **Arterial Fund:** The Arterial Fund accounts for major capital improvements to city arterial roadway transportation projects. In 2011, the City began construction on the Pioneer Way Improvement Project. The budgeted revenues and capital outlay expenditures for this project, totaling approximately \$8.3 million, are higher than the historical expenditure average for this fund. Accordingly, the Arterial Fund qualified to be considered a major fund for 2011.

- **Enterprise Funds:** The City elects to report its four utilities and marina as major funds. In previous years, the marina and storm drain utility have not always met the technical requirements needed to be reported as major funds. However, the City elects to treat both funds as major funds due to the public interest in these operations, and due to the desire to provide a consistent presentation of financial information from year to year. The funds are reported on a full-accrual basis - accounting for all assets and liabilities. Fund balances remained fairly consistent with the prior year. The City anticipates fund balances will slightly increase in future years as the City implements steady and consistent rate increases in anticipation of several long-term capital projects.

BUDGETARY HIGHLIGHTS

General Fund and Arterial Fund Budget Analysis: The following is a brief review of the budgeting changes from the adopted to the amended final budget for both the General Fund and Arterial Fund (a major special revenue fund). Please note that budget to actual comparisons are provided for both funds in the financial statements. The significant budgetary changes in the General and Arterial Funds include:

- Budgeted General Fund revenues and expenditures increased \$126,294, or 0.78%, as the result of an amendment to adjust beginning and ending fund balances to actual resources on hand at January 1, 2011. Some adjustments were made between budgeted expenditure line items within departments of the General Fund, with none of these adjustments impacting total the adopted fund appropriation.

- Budgeted Arterial Fund revenues and expenditures increased \$99,556, or 1.22%, as the result of an amendment to adjust beginning and ending fund balances to actual resources on hand at January 1, 2011.

CASH MANAGEMENT

Aggressive efforts to maximize interest earnings of temporary cash reserves have been as successful as the economy allows. The City manages cash accounts by the pooled cash management concept and plans investment maturities to coincide with cash needs. The pool concept provides for investing greater amounts of money at more favorable interest rates. The City has a Financial Management Policy with recommended levels of cash and reserves. These balances are regularly monitored to assure compliance with the requirements of the policy.

DEBT ADMINISTRATION

The City participates in various forms of debt at the end of 2011: general obligation debt, revenue debt, and debt issued by the Washington Public Works Trust Fund. In governmental activities, the City has one LOCAL program general obligation bond outstanding in the amount of \$25,421 which is being retired with tax revenues from the General Fund. In business-type activities, the City has one outstanding LTGO bond issue in the amount of \$2,445,000 being retired by revenues pledged from the Marina and Marina Reserve Fund, two Public Works Trust Fund Loans for a combined amount of \$747,183 which are being retired by revenues pledged from the Water and Water Reserve Fund, and sewer revenue bonds outstanding in the amount of \$2,060,000, which are being retired from revenues pledged from the City's Sewer and Sewer Reserve Fund.

The City's debt obligations are well within the statutory limits for debt capacity. There are three types of statutory limits on general obligation debt capacity:

1. The first limit is on the amount of general obligation debt that can be incurred without a vote of the people. For this type of debt, a city is limited to 1.5% of its assessed value (\$1,640,900,593), or \$24,613,509. The City currently has \$2,470,421 in outstanding general obligation debt originated without a public vote.
2. The second statutory limit is the amount of general obligation debt a city may incur for general governmental purposes with a vote of the people. This limit is 2.5% of the assessed value (\$1,640,900,593). For 2011, the City's limit is \$41,022,515, less any amount issued as non-voted debt. At this time the City does not have any voted debt.
3. The third limit is also calculated as a percentage of assessed value. This statutory limit allows a City to incur general obligation debt of up to an additional 2.5% of its assessed value for bond issues approved by the voters for the purpose of utility improvements and an additional 2.5% for parks or open space development.

CAPITAL EQUIPMENT AND UPGRADING CAPITAL FACILITIES

The City continues to provide for replacement of capital items of \$5,000 or more, such as motor vehicles and public works equipment, as well as other miscellaneous equipment through the utilization of the equipment replacement fund. These replacements are funded with transfers from participating funds to the Equipment Replacement Fund. The City's budget continues to primarily focus on operation and maintenance costs. Annually the City updates the City Improvement Plan (CIP) to prioritize and establish funding sources for capital outlay costs to maintain and upgrade the existing infrastructure. With revenue streams continually being challenged, the City has had the fortune of securing grants for many of the transportation projects. The City continues to allocate funds for pavement. These funds have normally been incorporated into larger projects to complete the restoration and receive the biggest benefit for the dollars.

It has become apparent that the City must continue to direct more efforts to building maintenance programs and begin to plan for future renovation and replacement. The City continues to look for energy savings measures and revenue streams to support ongoing maintenance of City facilities.

ECONOMIC FACTORS AND OAK HARBOR IN 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 3.36% lower than the previous year. Most of this decrease is the residual effect of the loss of three major car dealerships, the completion of a large renovation of the Oak Harbor High School campus during 2010, and a general downturn in consumer spending. 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. Their 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.

Naval Air Station Whidbey Island (NASWI)

NASWI is located immediately adjacent to the City of Oak Harbor. This economic position and activities of this military facility, and its accompanying staff and military dependents, are tied closely to the economic vitality of the City of Oak Harbor. Changes in staffing levels, adjustments to the type of aircraft platforms deployed at the base, variances in the year to year level of construction activity on facility structures, and the level of activity at the Base Realignment and Closure Commission (BRAC) have a direct correlation to the future economic outlook for the City. The City proactively works to diversify its economy with other non-military dependent activities, and to market the viability and military value of the base with Department of Defense officials.

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. Potential budget reductions at the state level and how these changes might affect state shared revenues such as liquor excise tax revenues, and the availability of Public Works Trust Fund financing funds, are continually monitored by the City.

The State of Washington does not have a state personal income tax and therefore the state operates primarily using property, sales, utility, and motor vehicle fuel taxes. The City relies on sales, property and utility taxes and a limited array of permitted other taxes, fees, and state and federal grants to support governmental activities. For the business-type and certain governmental activities (permitting, recreation programs, etc.) the user pays a related fee or associated charge.

According to the U.S. Census Bureau, the City's population has grown 11.5% over the last ten years. The daytime population will continue to grow as Oak Harbor becomes a destination for many county residents to shop, conduct medical treatments and send students to school for all grade levels including attendance at Skagit Valley College.

The City Council continues to be proactive with other agencies to monitor and lobby for regulations to minimize the impact to the City and provide funds for City services. The City continues to support a

possible street utility to provide funding to maintain streets and pay for growing electricity charges related to street lights. The City will continue to work with these surrounding agencies for sharing of services opportunities, to minimize expenses.

The level of taxes, fees and charges for services (including development related mitigation fees) will have a bearing on the City's competitive ability to encourage retail, office, residential, and industrial development to locate in their jurisdiction. The City places significant emphasis on encouraging economic development to attract family wage paying jobs, and as an incentive does not assess a business and occupation tax.

Request for Financial Information

This financial report is designed to provide our citizens, taxpayers, creditors and investors with a general overview of the City's finances and to show the City's accountability for the monies it receives. Any questions about this report or requests for additional financial information should be addressed to the Finance Department, City of Oak Harbor, 865 SE Barrington Drive, Oak Harbor, Washington, 98277.

**City of Oak Harbor
Statement of Net Position
December 31, 2011**

	Primary Government		
	Governmental Activities	Business-type Activities	Total
Assets			
Cash & cash equivalents	\$ 15,073,865	\$ 26,606,787	\$ 41,680,652
Receivables (net)	434,735	1,455,958	1,890,693
Internal balances	96,527	(96,527)	-
Due from other governments	659,318	629	659,947
Inventories	-	55,459	55,459
Prepays	382,422	303	382,725
Bond issue cost net of accumulated amortization	-	99,708	99,708
Restricted assets:			
Cash & cash equivalents	466,182	7,290,004	7,756,186
Capital assets not being depreciated:			
Land	8,994,397	3,481,020	12,475,417
Construction in progress	4,551,520	2,800,925	7,352,445
Intangible assets	38,000	-	38,000
Capital assets net of accumulated depreciation:			
Buildings and systems	4,136,998	5,612,601	9,749,599
Improvements other than buildings	9,508,885	34,891,824	44,400,709
Machinery and equipment	850,825	4,421,693	5,272,518
Total assets	\$ 45,193,674	\$ 86,620,384	\$ 131,814,058
Liabilities			
Accounts payable	\$ 1,147,232	\$ 425,880	\$ 1,573,112
Accrued interest payable	-	37,799	37,799
Other current liabilities	489,991	112,920	602,911
Deferred revenue	60,117	18,901	79,018
Noncurrent liabilities:			
Due within one year:			
Compensated absences	115,188	14,256	129,444
Other long-term liabilities	-	51,344	51,344
Bonds payable, net	25,421	225,000	250,421
Due in more than one year:			
Compensated absences	1,114,323	352,331	1,466,654
Other long-term liabilities	483,747	695,839	1,179,586
Bonds payable, net	-	4,267,261	4,267,261
Total liabilities	3,436,019	6,201,531	9,637,550
Net Position			
Invested in capital assets net of related debt	28,055,204	45,968,619	74,023,823
Restricted for:			
Capital projects	3,197,279	81,928	3,279,207
Debt service	-	953,353	953,353
Unrestricted	10,505,172	33,414,953	43,920,125
Total net position	\$ 41,757,655	\$ 80,418,853	\$ 122,176,508

The accompanying notes are an integral part of this statement.

**City of Oak Harbor
Statement of Activities
For the Year Ended December 31, 2011**

<u>Function/Program</u>	Program Revenues			Net (Expense) Revenue and Changes in Net position			
	Expenses	Charges for Services	Operating	Capital Grants and Contributions	Governmental Activities	Business-type Activities	Total
			Grants and Contributions				
Primary government							
Governmental activities:							
General government	\$ 2,133,139	\$ 116,053	\$ -	\$ -	\$ (2,017,086)	\$ -	\$ (2,017,086)
Judicial	335,526	17,263	-	-	(318,263)	-	(318,263)
Public safety	7,057,955	54,568	97,388	-	(6,905,999)	-	(6,905,999)
Physical environment	316,623	-	-	-	(316,623)	-	(316,623)
Transportation	2,196,977	76,471	1,146,499	1,383,795	409,788	-	409,788
Health and human services	378,048	134,476	3,235	-	(240,337)	-	(240,337)
Economic environment	863,684	18,280	50,411	-	(794,993)	-	(794,993)
Culture and recreation	2,140,181	176,100	-	-	(1,964,081)	-	(1,964,081)
Interest on long-term debt	2,146	-	-	-	(2,146)	-	(2,146)
Total governmental activities	15,424,279	593,211	1,297,533	1,383,795	(12,149,740)	-	(12,149,740)
Business-type activities:							
Water	3,464,088	4,567,850	-	110,219	-	1,213,981	1,213,981
Sewer	2,985,443	4,438,848	-	93,209	-	1,546,614	1,546,614
Solid waste	2,807,781	3,044,306	-	-	-	236,525	236,525
Storm drain	1,014,203	1,337,120	-	40,815	-	363,732	363,732
Marina	1,242,864	1,234,461	5,372	87,963	-	84,932	84,932
Total business-type activities	11,514,379	14,622,585	5,372	332,206	-	3,445,784	3,445,784
Total primary government	\$ 26,938,658	\$ 15,215,796	\$ 1,302,905	\$ 1,716,001	(12,149,740)	3,445,784	(8,703,956)

General revenues:

Property taxes	3,761,165	-	3,761,165
Sales and use taxes	2,822,734	-	2,822,734
Business, occupancy and other taxes	2,890,481	-	2,890,481
Licenses and permits	443,130	-	443,130
Grants and other contributions not restricted to specific programs	255,680	3,671	259,351
Unrestricted investment earnings	35,203	59,102	94,305
Miscellaneous	512,274	239,650	751,924
Transfers	1,132,390	(1,132,390)	-
Total general revenues and transfers	11,853,057	(829,967)	11,023,090
Change in net position	(296,683)	2,615,817	2,319,134
Net position - beginning	42,054,338	77,803,036	119,857,374
Net position - ending	\$ 41,757,655	\$ 80,418,853	\$ 122,176,508

The accompanying notes are an integral part of this statement.

**City of Oak Harbor
Balance Sheet
Governmental Funds
December 31, 2011**

	General Fund	Arterial Fund	Other Governmental Funds	Total Governmental Funds
Assets				
Cash & cash equivalents	\$ 7,715,863	\$ 687,127	\$ 6,653,735	\$ 15,056,725
Accounts receivables (net)	401,998	593	32,144	434,735
Due from other governments	1,497	-	-	1,497
Prepays	316,407	141	-	316,548
Restricted cash	64,200	-	48,957	113,157
Total assets	\$ 8,499,965	\$ 687,861	\$ 6,734,836	\$ 15,922,662
Liabilities and Fund Balances				
Liabilities				
Accounts payable	\$ 450,589	\$ 256,323	\$ 79,473	\$ 786,385
Deposits	139,433	282,655	67,903	489,991
Deferred revenue	203,195	-	31,784	234,979
Total liabilities	793,217	538,978	179,160	1,511,355
Fund balances				
Nonspendable	316,407	141	-	316,548
Restricted	9,513	148,742	2,547,557	2,705,812
Committed	-	-	4,008,119	4,008,119
Assigned	1,766,500	-	-	1,766,500
Unassigned	5,614,328	-	-	5,614,328
Total fund balance	7,706,748	148,883	6,555,676	14,411,307
Total liabilities and fund balances	\$ 8,499,965	\$ 687,861	\$ 6,734,836	\$ 15,922,662

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 Position
December 31, 2011**

Total fund balances—governmental funds \$ 14,411,307

Amounts reported for governmental activities in the statement of net position 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	\$ 13,583,917	
Historical cost of assets being depreciated	39,364,065	
Accumulated depreciation	<u>(25,148,778)</u>	27,799,204

Investments are adjusted to market value 17,140

Long-term assets not available to pay for current period expenditures and therefore deferred

Deferred revenue	\$ 174,862	
Other long-term assets	<u>657,821</u>	832,683

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 position. 728,591

Some liabilities are not due and payable in the current period and therefore are not reported in the funds, including:

Accounts payable	\$ (292,591)	
Compensated absences	(1,229,511)	
Bonds and interest payable	(25,421)	
Other post-employment benefit liabilities	<u>(483,747)</u>	(2,031,270)

Net position of governmental activities

\$ 41,757,655

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, 2011

	General Fund	Arterial Fund	Other Governmental Funds	Total Governmental Funds
Revenues				
Taxes	\$ 9,144,459	\$ -	\$ 443,451	\$ 9,587,910
Licenses and permits	437,150	-	5,980	443,130
Intergovernmental	418,586	1,488,365	1,041,929	2,948,880
Charges for services	339,868	-	253,343	593,211
Fines and forfeits	128,746	-	-	128,746
Interest revenue	19,324	834	15,045	35,203
Miscellaneous	262,147	-	102,999	365,146
Total revenues	10,750,280	1,489,199	1,862,747	14,102,226
Expenditures				
Current:				
General government	1,953,944	-	-	1,953,944
Judicial	337,756	-	-	337,756
Public safety	6,468,031	-	-	6,468,031
Physical environment	302,010	-	-	302,010
Transportation	-	591,636	854,492	1,446,128
Health and human services	24,412	-	338,159	362,571
Economic environment	835,409	-	-	835,409
Culture and recreation	1,261,422	-	194,281	1,455,703
Debt Service:				
Principal	-	-	49,565	49,565
Interest	-	-	2,146	2,146
Capital outlay	12,764	3,626,008	232,592	3,871,364
Total expenditures	11,195,748	4,217,644	1,671,235	17,084,627
Excess (deficiency) of revenues over (under) expenditures	(445,468)	(2,728,445)	191,512	(2,982,401)
Other Financing Sources (Uses)				
Transfers in	1,660,948	2,752,000	228,711	4,641,659
Transfers out	(168,711)	(502,213)	(2,838,345)	(3,509,269)
Total other financing sources (uses)	1,492,237	2,249,787	(2,609,634)	1,132,390
Net change in fund balances	1,046,769	(478,658)	(2,418,122)	(1,850,011)
Fund balances - beginning	6,659,979	627,541	8,973,798	16,261,318
Fund balances - ending	\$ 7,706,748	\$ 148,883	\$ 6,555,676	\$ 14,411,307

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, 2011

Net change in fund balances—governmental funds \$ (1,850,011)

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	\$ 3,871,364	
Depreciation	<u>(1,122,557)</u>	2,748,807

The effect of various miscellaneous transactions involving capital assets not reported in governmental funds:

Contributions of capital assets	144,389	
Construction projects that did not become a capital asset	<u>(539,349)</u>	(394,960)

Some revenues in the statement of activities do not provide current financial resources and, therefore, are not reported as revenues in the funds:

Change in current assets	(283,265)	
Deferred property tax	<u>174,862</u>	(108,403)

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

49,565

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	\$ (133,734)	
Change in compensated absences	(548,208)	
Other post-employment benefit expense	<u>(117,728)</u>	(799,670)

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.

57,989

Change in net position of governmental activities	<u><u>\$ (296,683)</u></u>
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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 — Budget and Actual
General Fund
For the Year Ended December 31, 2011

	Budgeted Amounts		Actual Amounts
	Original	Final	
Revenues			
Taxes	\$ 9,322,568	\$ 9,322,568	\$ 9,144,459
Licenses and permits	405,900	405,900	437,150
Intergovernmental	490,750	490,750	418,586
Charges for services	385,350	385,350	339,868
Fines and forfeits	230,500	230,500	128,746
Interest revenue	58,600	58,600	19,324
Miscellaneous	197,650	197,650	262,147
Total revenues	11,091,318	11,091,318	10,750,280
Expenditures			
Current:			
General government	2,487,685	2,495,300	1,953,944
Judicial	414,750	414,750	337,756
Public safety	6,970,888	6,970,888	6,468,031
Physical environment	244,159	244,159	302,010
Health and human services	26,400	26,400	24,412
Economic environment	905,889	926,889	835,409
Culture and recreation	1,273,922	1,273,922	1,261,422
Capital outlay	130,374	130,374	12,764
Total expenditures	12,454,067	12,482,682	11,195,748
Excess (deficiency) of revenues over (under) expenditures	(1,362,749)	(1,391,364)	(445,468)
Other Financing Sources (Uses)			
Transfers in	1,415,763	1,415,763	1,660,948
Transfers out	(248,823)	(248,823)	(168,711)
Total other financing sources (uses)	1,166,940	1,166,940	1,492,237
Net change in fund balances	(195,809)	(224,424)	1,046,769
Fund balances - beginning	3,631,007	3,757,301	6,659,979
Fund balances - ending	\$ 3,435,198	\$ 3,532,877	\$ 7,706,748

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, 2011

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>
	<u>Original</u>	<u>Final</u>	
Revenues			
Intergovernmental	\$ 1,123,244	\$ 1,123,244	\$ 1,488,365
Interest revenue	-	-	834
Miscellaneous	1,800	1,800	-
Total revenues	1,125,044	1,125,044	1,489,199
Expenditures			
Current:			
Transportation	113,217	113,217	591,636
Capital outlay	7,725,000	7,725,000	3,626,008
Total expenditures	7,838,217	7,838,217	4,217,644
Excess (deficiency) of revenues over (under) expenditures	(6,713,173)	(6,713,173)	(2,728,445)
Other Financing Sources (Uses)			
Transfers in	6,520,000	6,520,000	2,752,000
Transfers out	(89,245)	(89,245)	(502,213)
Total other financing sources (uses)	6,430,755	6,430,755	2,249,787
Net change in fund balances	(282,418)	(282,418)	(478,658)
Fund balances - beginning	527,984	627,540	627,541
Fund balances - ending	\$ 245,566	\$ 345,122	\$ 148,883

The accompanying notes are an integral part of this statement.

City of Oak Harbor
Statement of Net Position
Proprietary Funds
December 31, 2011

	Business-Type Activities							Internal Service Funds
	Water and Water Reserve Fund	Sewer and Sewer Reserve Fund	Solid Waste Solid Waste Reserve Fund	Storm Drain and Storm Drain Reserve Fund	Marina and Marina Reserve Fund	Total		
Assets								
Current assets:								
Cash & cash equivalents	\$ 9,912,209	\$ 12,043,599	\$ 2,916,845	\$ 442,939	\$ 917,771	\$ 26,233,363	\$ 373,424	
Accounts receivables (net)	449,903	447,973	337,056	170,859	50,167	1,455,958	-	
Due from other governments	-	-	-	-	629	629	-	
Inventories	-	-	-	-	29,994	29,994	25,465	
Prepays	-	-	-	-	303	303	65,874	
Bond issue cost net of accumulated amortization	-	47,859	-	-	51,849	99,708	-	
Total current assets	10,362,112	12,539,431	3,253,901	613,798	1,050,713	27,819,955	464,763	
Noncurrent assets:								
Restricted cash	445,057	593,122	700	48,000	57,070	1,143,949	6,499,080	
Capital assets net of accumulated depreciation:								
Land	99,589	4,200	201,810	-	3,175,421	3,481,020	-	
Construction in progress	705,763	1,065,274	-	887,803	78,234	2,737,074	63,851	
Buildings and systems	164,654	659,083	-	-	1,429,988	2,253,725	3,358,876	
Improvements and infrastructure	14,094,201	18,408,434	93,596	1,313,125	602,880	34,512,236	622,415	
Machinery and equipment	1,042,940	1,218,022	25,415	16,001	89,918	2,392,296	2,067,991	
Total noncurrent assets	16,552,204	21,948,135	321,521	2,264,929	5,433,511	46,520,300	12,612,213	
Total assets	\$ 26,914,316	\$ 34,487,566	\$ 3,575,422	\$ 2,878,727	\$ 6,484,224	\$ 74,340,255	\$ 13,076,976	

The accompanying notes are an integral part of this statement.

City of Oak Harbor
Statement of Net Position
Proprietary Funds
December 31, 2011
(Continued)

	Business-Type Activities					Internal Service Funds
	Water and Water Reserve Fund	Sewer and Sewer Reserve Fund	Solid Waste Solid Waste Reserve Fund	Storm Drain and Storm Drain Reserve Fund	Marina and Marina Reserve Fund	
Liabilities						
Current liabilities:						
Accounts payable	\$ 152,735	\$ 60,563	\$ 98,734	\$ 5,840	\$ 42,216	\$ 360,088
Deposits	2,900	-	700	48,000	57,070	108,670
Retainage	-	-	-	1,941	2,309	4,250
Interest payable	1,868	28,843	-	-	7,088	37,799
Deferred revenue	15,541	3,360	-	-	-	18,901
Compensated absences	2,272	936	2,658	2,055	414	8,335
Due to other governments	51,344	-	-	-	-	51,344
Bonds payable, net	-	125,000	-	-	100,000	225,000
Total current liabilities	226,660	218,702	102,092	57,836	209,097	814,387
Noncurrent liabilities:						
Compensated absences	61,361	25,224	39,190	55,497	11,157	192,429
Due to other governments	695,839	-	-	-	-	695,839
Bonds payable, net	-	1,935,000	-	-	2,332,261	4,267,261
Total noncurrent liabilities	757,200	1,960,224	39,190	55,497	2,343,418	5,155,529
Total liabilities	983,860	2,178,926	141,282	113,333	2,552,515	5,969,916
Net Position						
Invested in capital assets						
net of related debt	15,359,964	19,295,013	320,821	2,216,929	2,944,180	40,136,907
Restricted for:						
Capital projects	81,928	-	-	-	-	81,928
Debt service	360,230	593,123	-	-	-	953,353
Unrestricted	10,128,334	12,420,504	3,113,319	548,465	987,529	27,198,151
Total net position	\$ 25,930,456	\$ 32,308,640	\$ 3,434,140	\$ 2,765,394	\$ 3,931,709	\$ 68,370,339
						\$ 12,777,105

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

12,048,514
\$ 80,418,853

The accompanying notes are an integral part of this statement.

City of Oak Harbor
Statement of Revenues, Expenses, and Changes in Fund Net Position
Proprietary Funds
For the Year Ended December 31, 2011

	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	
Operating Revenues							
Charges for services	\$ 4,436,567	\$ 4,354,313	\$ 3,044,305	\$ 1,334,783	\$ 1,234,460	\$ 14,404,428	\$ 2,488,415
System development revenue	129,403	84,119	-	-	-	213,522	-
Other operating revenues	1,878	415	-	2,336	-	4,629	1,409,578
Total operating revenues	4,567,848	4,438,847	3,044,305	1,337,119	1,234,460	14,622,579	3,897,993
Operating Expenses							
Cost of sales and service	1,609,646	740,276	581,513	480,558	631,291	4,043,284	2,132,091
Contractual services	27,457	48,400	9,221	31,749	40,773	157,600	247,320
Utilities	15,339	216,192	1,048,076	5,467	82,749	1,367,823	65,153
Taxes	490,868	367,572	348,933	103,996	-	1,311,369	-
Repairs and maintenance	59,930	129,479	346,801	53,834	51,260	641,304	163,416
Other operating expenses	557,963	438,296	460,063	258,139	175,802	1,890,263	400,274
Insurance claims and expenses	34,962	35,227	21,625	12,889	20,658	125,361	25,313
Depreciation	757,417	960,739	19,191	117,827	190,702	2,045,876	590,764
Total operating expenses	3,553,582	2,936,181	2,835,423	1,064,459	1,193,235	11,582,880	3,624,331
Operating income (loss)	1,014,266	1,502,666	208,882	272,660	41,225	3,039,699	273,662
Nonoperating Revenues (Expenses)							
Interest revenue	15,621	30,429	5,918	1,810	2,106	55,884	3,217
External subsidies	-	75,009	-	-	93,335	168,344	3,670
Other nonoperating revenues	41,544	4,369	84,400	64,851	32,766	227,930	46,211
Interest expense	(3,864)	(107,448)	-	-	(70,343)	(181,655)	-
Other nonoperating expenses	-	-	-	-	-	-	-
Total nonoperating revenues (expenses)	53,301	2,359	90,318	66,661	57,864	270,503	53,098
Net income (loss) before contributions and transfers	1,067,567	1,505,025	299,200	339,321	99,089	3,310,202	326,760
Capital contributions	110,219	18,200	-	40,815	-	169,234	-
Transfers in	-	-	-	-	-	-	2,500
Transfers out	(237,943)	(245,566)	(122,620)	(125,084)	(349,133)	(1,080,346)	(54,544)
Change in net position	939,843	1,277,659	176,580	255,052	(250,044)	2,399,090	274,716
Net position - beginning	24,990,613	31,030,981	3,257,560	2,510,342	4,181,753	65,971,249	12,502,389
Net position - ending	\$ 25,930,456	\$ 32,308,640	\$ 3,434,140	\$ 2,765,394	\$ 3,931,709	\$ 68,370,339	\$ 12,777,105

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

Change in net position	\$ 2,399,090
Adjustments to reflect consolidation of internal service fund activities related to enterprise funds.	216,727
Change in net assets of business-type activities	<u>\$ 2,615,817</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, 2011

	Business-Type Activities							Internal Service Funds
	Water and Water Reserve Fund	Sewer and Sewer Reserve Fund	Solid Waste Solid Waste Reserve Fund	Storm Drain Storm Drain Reserve Fund	Marina and Marina Reserve Fund	Total		
Cash Flows From								
Operating Activities								
Receipts from customers and users	\$ 4,458,865	\$ 4,394,733	\$ 2,983,592	\$ 1,305,095	\$ 1,226,122	\$ 14,368,407	\$	7
Receipts from interfund services provided	-	-	-	-	-	-	-	3,897,986
Payments to suppliers	(1,859,987)	(1,170,221)	(1,661,907)	(377,299)	(1,022,239)	(6,091,653)		(1,457,795)
Payments to employees	(369,655)	(466,804)	(384,559)	(298,804)	(274,070)	(1,793,892)		(1,109,828)
Payments for interfund services used	(562,248)	(460,615)	(777,652)	(254,739)	(139,663)	(2,194,917)		(491,236)
Net cash provided by operating activities	1,666,975	2,297,093	159,474	374,253	(209,850)	4,287,945		839,134
Cash Flows From Noncapital								
Financing Activities								
Transfers from other funds	-	-	-	-	-	-	-	2,500
Transfers to other funds	(237,943)	(245,566)	(122,620)	(125,084)	(349,133)	(1,080,346)		(54,544)
Receipts from miscellaneous revenues	41,544	4,369	14,243	64,851	36,588	161,595		46,211
Contributions and deposits	-	-	-	-	1,550	1,550		-
Net cash provided (used) by noncapital financing activities	(196,399)	(241,197)	(108,377)	(60,233)	(310,995)	(917,201)		(5,833)
Cash Flows From Capital and Related Financing Activities								
Principal paid on capital debt	(51,345)	(499,775)	-	-	2,432,261	1,881,141		-
Interest paid on capital debt	(3,992)	(113,196)	-	-	(115,104)	(232,292)		-
Purchases of capital assets	(631,152)	(908,948)	(10,163)	(905,793)	(1,788,167)	(4,244,223)		(560,681)
Capital grants and contributions	-	75,009	-	-	87,963	162,972		3,670
Net cash provided (used) by capital and related financing activities	(686,489)	(1,446,910)	(10,163)	(905,793)	616,953	(2,432,402)		(557,011)

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, 2011
(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	15,621	30,429	5,918	1,810	2,106			3,217
Net cash provided (used) by investing activities	15,621	30,429	5,918	1,810	2,106			3,217
Net increase (decrease) in cash and cash equivalents	799,708	639,415	46,852	(589,963)	98,214			279,507
Cash and cash equivalents - beginning of year	9,557,558	11,997,306	2,870,693	1,080,902	876,627			6,592,997
Cash and cash equivalents - end of year	\$ 10,357,266	\$ 12,636,721	\$ 2,917,545	\$ 490,939	\$ 974,841			\$ 6,872,504

Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities:

Operating income (loss)	\$ 1,014,266	\$ 1,502,666	\$ 208,882	\$ 272,660	\$ 41,225	\$ 3,039,699	\$ 273,662
Adjustments to reconcile operating income to net cash provided (used) by operating activities:							
Depreciation expense	757,417	960,739	19,191	117,827	190,702	2,045,876	590,764
(Increase) decrease in accounts receivable	(95,057)	(42,434)	(56,713)	(32,024)	(10,051)	(236,279)	-
(Increase) decrease in due from other funds	-	-	-	-	-	-	428
(Increase) decrease in due from other governments	-	-	-	-	8,712	8,712	-
(Increase) decrease in inventories	-	-	-	-	11,588	11,588	5,898
(Increase) decrease in prepaids	-	-	-	-	(303)	(303)	(65,874)
Increase (decrease) in accounts payable	13,918	(115,930)	(5,205)	59	(382,375)	(489,533)	34,505
Increase (decrease) in deposits	(10,795)	-	(4,000)	-	(6,999)	(21,794)	-
Increase (decrease) in Retainage	-	-	-	1,941	(55,427)	(53,486)	(9,148)
Increase (decrease) in due to other funds	(7,834)	(11,911)	(5,454)	(1,809)	(2,240)	(29,248)	(3,014)
Increase (decrease) in deferred revenue	(3,131)	(1,680)	-	-	-	(4,811)	-
Increase (decrease) in compensated absences payable	(1,809)	5,643	2,773	15,599	(4,682)	17,524	11,913
Net cash provided (used) by operating activities	\$ 1,666,975	\$ 2,297,093	\$ 159,474	\$ 374,253	\$ (209,850)	\$ 4,287,945	\$ 839,134

Noncash Activities:

Contributions of capital Assets from developer construction	\$ 110,219	\$ 18,200	\$ -	\$ 40,815	\$ -	\$ 169,234	\$ -
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The accompanying notes are an integral part of this statement.

Notes to the Basic 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. The Governmental Accounting Standards Board (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, located in Island County, Washington, was incorporated on May 14, 1915. The City 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 Administrator 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 Administrator. The City provides what are considered general government services including public safety, streets, parks and recreation, planning and zoning, permits and inspection, general administrative, water, sanitary sewer collection, solid waste collection and storm drainage services.

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 financial accountability, 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. 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 Position and the Statement of Activities.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule include indirect cost allocation charges between the City's business-type activities, as well as certain 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.

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.

The Statement of Net Position presents the financial condition of the City's governmental and business-type activities of the year end. It reports all financial and capital assets including infrastructure and all liabilities, including current and long-term.

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.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of 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. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, licenses, and interest associated within the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessment receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the City.

The City reports the following major governmental funds:

The *General Fund* is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The *Arterial Fund* was established to make improvements to the City's arterial transportation system. Funding is from various grant sources, motor vehicle fuel tax, and operating transfers.

The City reports the following major proprietary funds:

The *Water and Water Reserve Fund* accounts for providing water services. Its revenues are mostly received from service charges and system connection charges. Expenses are for maintenance and operations of a water supply, storage and distribution system. This fund also reflects the operation of revenue bonds outstanding, the funds available for redemption of bonds, cumulative reserve and construction funds.

The *Sewer and Sewer Reserve Fund* accounts for providing sewer services. Its revenues are mostly received from service charges and system connection charges. Expenses are for maintenance and extensions of drainage, sewer service facilities, maintaining sewer collection and transmission systems. This fund also reflects the operation of revenue bonds outstanding, the funds available for redemption of bonds, cumulative reserve and construction funds.

The *Solid Waste and Solid Waste Reserve Fund* accounts for operations of the collection and transportation of solid waste. Its revenues are received from service charges. Expenses are made up of the cost of collection and disposal of solid waste.

The *Storm Drain and Storm Drain Reserve Fund* accounts for the operation, construction, and maintenance of the storm water management system.

The *Marina and Marina Reserve Fund* accounts for the operation, construction, and maintenance of the municipal marina. Revenues consist of service and rental fee income received from visiting boaters and permanent tenants who live onboard moored vessels, in addition to operating transfers. Expenses are for operations, maintenance and repairs of marina infrastructure, and capital upgrades such as dredging and dock replacement. This fund also reflects the operation of general obligation bonds outstanding, the funds available for redemption of bonds, cumulative reserve and construction funds.

Additionally, the City reports the following fund types:

Special Revenue Funds account for the proceeds of specific revenue sources to finance specific activities as required by law or administration regulation. Their revenues are earmarked to finance certain activities or functions.

Debt Service Funds account for resources accumulated and payment made for principal and interest on the general government except those required to be accounted for in another fund.

Capital Project Funds account for the acquisition or development of capital facilities for governmental activities. The major sources of revenue are real estate excise taxes, proceeds from general obligation bonds, grants, and contributions from other funds.

Internal Service Funds account for the financing of goods and services provided by one City department or agency to another City department or agency on a cost reimbursement basis. The City has four *Internal Service Funds*:

The *Equipment Repair Fund* 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* 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 Reserve Fund* accounts for the purchase and acquisition of technologically oriented equipment such as computers, television programming, and other technical equipment.

The *Shop Facility Fund* 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 utilize Trust, Agency, or Permanent funds.

Private sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the GASB. Governments also have the option of following subsequent private sector guidance for the business-type activities and enterprise funds, subject to the same limitation. The City has elected not to follow subsequent private-sector guidance.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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 proprietary funds are charges for goods and services. Operating expenses for enterprise funds and internal service funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as non-operating revenues and expenses.

D. Budgetary Information

Scope of Budget

The City prepares an biennial budget in accordance with the Revised Code of Washington (RCW) 35A.34 that is on a basis consistent with accounting principles generally accepted in the United States of America. In compliance with the code, budgets for all funds are established. Budgets established for the proprietary funds are considered "management budgets," and as such, are not required to be reported in the Annual Financial Report.

The budget, as adopted, constitutes the legal authority for expenditures. Appropriations are authorized individually for each of the two years of the biennial budget, but must be reviewed by the City Council at the midpoint of the biennial period. The City's budget is adopted at the fund level, so that expenditures may not legally exceed appropriations at the fund level of detail. Transfers or revisions between departments or line items within a fund is allowed, but supplemental or additional appropriations to the adopted fund total must be approved by the legislative authority. All appropriations, except for capital projects, lapse at the end of each year within the biennial period. Unexpended resources must be re-appropriated in the subsequent period.

Amending the Budget

The Finance Director is authorized to transfer budgeted amounts between departments or line items within any fund; however, any revisions that alter the total expenditures of a fund, or that affect the number of authorized employee positions, must be approved by the City Council.

When 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 more than the majority after holding a public hearing.

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.

Budgetary Compliance

In 2011, there were no City funds that reported actual expenditures above budgeted appropriations. Though specific line items may be exceeded, no fund's appropriation total can be legally exceeded. It should be noted, however, that the "Statement of Revenues, Expenditures and Changes in Fund Balances" including the comparisons of "Budget and Actual," could be misinterpreted due to its format and, by so doing, lead one to believe that budgeted expenditures have been exceeded. The City budgets not only expenditures but also the full amount of "Beginning Fund Balances" so as to maintain a budget balance between receipts and disbursements. In addition, the City does not budget for depreciation of fixed assets due to the non-cash nature of this expense. By increasing or decreasing expenditure appropriations by the budget values for these items, it can be seen that no City fund has exceeded its legally established appropriation.

Deficit Fund Equity

The City had no funds with deficit fund equity.

E. Assets, Liabilities, and Equities

Cash and Investments

It is the City's policy to invest all temporary cash surpluses (see Deposits and Investments Note No.4). As of December 31, 2011, the Finance Director was holding \$49,436,838 in short-term residual investments of surplus cash. This amount is 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.

In accordance with GASB 31, investments included in cash and cash equivalents are stated at fair value. The City uses quoted market prices at December 31 to establish the fair market value of investments and adjusts the carrying value accordingly. The City also invest funds with the Washington State Local Government Investment Pool (LGIP). The fair value of the City's position in the LGIP is the same as the value of the pool shares.

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.

The City has established an allowance for doubtful accounts for receivables originating from the City's contracted municipal court operations. This allowance is determined by an analysis of historical collectability, with a multi-year average being applied to the total outstanding balance of municipal court receivables.

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." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as *internal balances*. 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 construction and debt service, including current and delinquent special assessments receivable, if any, in enterprise funds. These accounts contain resources for a 24" waterline reserve, certain customer deposits, debt service, equipment replacement, and impact fees. 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	\$48,657	\$129,926
Customer deposits	300	60,670
Debt service	-	953,353
Equipment replacement	353,025	6,146,055
Fire fees	64,200	-
Total restricted cash	\$466,182	\$7,290,004

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.

Costs for additions or improvements to capital assets are capitalized when they increase the effectiveness or efficiency of the asset.

The costs for normal maintenance and repairs 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

Property, plant, and equipment of the primary government, as well as the component units, is depreciated using the straight-line method over the following estimated useful lives:

Asset	Years
Buildings and improvements	15-50
Improvements other than buildings	10-20
Machinery and equipment	5-20
Vehicles	5-10
Utility systems	20-40
Infrastructure	20-40

Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. All vacation and sick pay is accrued when incurred in the government-wide, proprietary, and fiduciary fund financial statements. In governmental 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.

At termination of employment, certain 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

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 Position. 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 (see Long-term Debt Note No.10).

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.

Other Post Employment Benefits

Lifetime full medical coverage is provided to uniformed Police and Fire personnel who became members of the Law Enforcement Officers and Fire Fighters (LEOFF 1) retirement system prior to October 1, 1977. A liability for the accumulated unfunded actuarially required contribution is reported in the Statement of Net Position. The actual medical costs are reported as expenditures in the year they are incurred.

Custodial Accounts

These accounts reflect the liability for net monetary assets being held by the City in its trustee or agency capacity.

Accrued Liabilities and Long-term Obligations

All payables, accrued liabilities and long-term obligations are reported in the government-wide financial statements. Also, all payables, accrued liabilities and long-term obligations payable from proprietary funds are reported on the proprietary fund financial statements.

In general, governmental fund payables and accrued liabilities, those once incurred, are paid in a timely manner and in full from current financial resources, are reported as obligations of the funds. When due, bonds, capital leases and long-term loans are recognized as a liability on the governmental fund financial statements.

Deferred Revenues

Deferred revenues consist of amounts recognized as receivables but not revenues in governmental funds because the revenue recognition criteria have not been met.

Fund Balance Classification Policies and Procedures

Fund balance equals the difference between the assets and liabilities reported in a governmental fund. Implemented by the City by ordinance in 2011, GASB Statement No. 54 eliminates the current use of the terms “reserved” and “designated” in the reporting of fund balance, and replaces those terms with five new categories for classifying fund balance as follows:

Nonspendable Fund Balance — Includes amounts either not in spendable form, or legally or contractually required to be maintained intact. This would include inventory, prepaids, and non-current receivables.

Restricted Fund Balance — Reflects the same definition as restricted net position: constraints placed on the use of amounts are either externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or imposed by law through constitutional provisions or enabling legislation. This would generally include amounts in bonded capital projects funds, debt service funds, and program funds funded with federal program dollars.

Committed Balance — The City considers committed fund balances to be those amounts that are committed for specific purposes by the adoption of an ordinance by City Council. Amounts classified as “committed” are not subject to legal enforceability like restricted fund balance; however, those amounts cannot be used for any other purpose unless the City Council removes or changes the limitation by adoption of an ordinance. Action to constrain resources must occur prior to year end; however, the amount can be determined in the subsequent period.

Assigned Fund Balance — The City considers amounts that are intended by the city to be used for specific purposes, but are neither restricted nor limited, to be reported as assigned fund balance. The City Council, via its adopted policy, delegates the authority to assign amounts to be used for specific purposes to the Finance Director for the purpose of reporting these amounts in the annual financial statements

Assigned fund balance includes:

- a. For the General Fund, these are the amounts assigned by the Finance Director intended to be used for specific purposes. The amounts reported as assigned do not result in a deficit in unassigned fund balance.
- b. For all governmental funds (other than General Fund), these are all remaining positive amounts (except for negative balances) that are not classified as nonspendable and are neither restricted nor committed. However, if there is a negative balance after classifying amounts as nonspendable, restricted or committed, the fund would report a negative amount as unassigned and zero to be reported as assigned.

Minimum Fund Balance Policy for the General Fund

It is the goal of the City to achieve and maintain an unrestricted fund balance in the General Fund equal to 16.67% of regular operating expenditures. The unrestricted fund balance may only be reduced below the goal level for non-routine circumstances, such as severe economic downturns or other unanticipated budget shortfalls. In the event that the General Fund's unrestricted fund balance becomes less than the policy goal, the City shall plan to adjust budget resources in the subsequent years to restore the balance.

Fund Balance Spending Order

When both restricted and unrestricted fund balance is available for an expenditure to be incurred for a certain purpose, unless legal requirements disallow it, the City will spend the most restricted dollars before less restricted in the following order:

1. Nonspendable – if the funds become spendable
2. Restricted
3. Committed
4. Assigned
5. Unassigned

Details of Fund Balance Classification

The City has elected to present the components of fund balance, in aggregate, on the face of the financial statements. Information for all detailed components of fund balance reflecting specific purpose information, including the separate presentation of nonspendable fund balance is as follows:

	General Fund	Major Special Revenue Fund Arterial Fund	Other Funds	Total
Fund Balances:				
Nonspendable:				
Amounts not in spendable form - Prepaids	\$ 316,407	\$ 141	\$ -	\$ 316,548
Amounts legally or contractually required	-	-	-	-
Restricted for:				
Employee Medical Reimbursement Program	1,683	-	-	1,683
Drug Seizure Program	6,334	-	-	6,334
Citizens Against Domestic Abuse Grant Program	1,497	-	-	1,497
Arterial Traffic Improvements	-	148,741	-	148,741
Street Surface Improvements	-	-	1,107,196	1,107,196
Paths And Trails Improvements	-	-	19,873	19,873
Tourism Promotion	-	-	362,676	362,676
Capital Facilities Plan	-	-	1,057,813	1,057,813
Committed to:				
Street Surface Improvements	-	-	180,000	180,000
Transportation Capital Improvements	-	-	1,071,984	1,071,984
Community Art Acquisition and Maintenance	-	-	47,311	47,311
Senior Services Program	-	-	181,097	181,097
Park Improvement Programs	-	-	388,260	388,260
Pioneer Way Improvement Project	-	-	1,500,000	1,500,000
Municipal Pier Capital Project	-	-	163,689	163,689
Waterfront Redevelopment Fund	-	-	475,778	475,778
Assigned to:				
Strategic Fiscal Planning (Minimum Fund Balance)	-	-	-	-
Council Project Listing	1,390,238	-	-	1,390,238
Department Purchasing Accounts	6,584	-	-	6,584
Whidbey Marathon Operating Funds	162,497	-	-	162,497
Municipal Court	207,181	-	-	207,181
Unassigned:	5,614,328	-	-	5,614,328
Total Fund Balances	\$ 7,706,748	\$ 148,882	\$ 6,555,676	\$ 14,411,307

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 Position

The governmental funds' Balance Sheet includes a reconciliation between fund balance - total governmental funds, and the net position - governmental activities as reported in the government-wide Statement of Net Position. 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	\$13,583,917	
Historical cost of assets being depreciated	39,364,065	
Accumulated depreciation	<u>(25,148,778)</u>	\$27,799,204

Investments are adjusted to market value \$ 17,140

Long-term assets not available to pay for current period expenditures and therefore deferred		
Deferred revenue	\$ 174,862	
Other long-term assets	<u>657,821</u>	832,683

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 position 728,591

Some liabilities are not due and payable in the current period and therefore are not reported in the funds, including:

Accounts payable	\$ (292,591)	
Compensated absences	(1,229,511)	
Bonds and interest payable	(25,421)	
Other post-employment benefit liabilities	<u>(483,747)</u>	(2,031,270)

Net adjustment to increase *fund balance - total governmental funds* to arrive at *net position - governmental activities* . \$27,346,348

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 position of governmental activities* as reported in the government-wide Statement of Activities. 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	\$ 3,871,364	
Depreciation	<u>(1,122,557)</u>	\$ 2,748,807

The effect of various miscellaneous transactions involving capital assets not reported in governmental funds:

Contributions of capital assets	\$ 144,389	
Construction projects that did not become a capital asset	<u>(539,349)</u>	(394,960)

Some revenues in the statement of activities do not provide current financial resources and, therefore, are not reported as revenues in the funds:

Change in current assets	\$ (283,265)	
Deferred property tax	<u>174,862</u>	(108,403)

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

49,565

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	\$ (133,734)	
Change in compensated absences	(548,208)	
Other post-employment benefit expense	<u>(117,728)</u>	(799,670)

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.

57,989

Net adjustment to increase *net changes in fund balance - total governmental funds* to arrive at *changes in net position of governmental activities* .

\$ 1,553,328

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

Note 3 – Stewardship, Compliance, and Accountability

There have been no material violations of finance-related legal or contractual provisions

Note 4 – Deposits and Investments

The City of Oak Harbor's deposits are entirely covered by federal depository insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington State Public Deposit Protection Commission (WPDPC). The FDIC insures the first \$250,000 of the City's deposits. The deposit balances over \$250,000 are collateralized by the WPDPC. State statute permits additional amounts to be assessed on a pro rata basis to members of the WPDPC pool in the event the pool's collateral should be insufficient to cover a loss.

All surplus cash is invested in accordance with an investment policy approved by Oak Harbor City Council. The investment policy has been certified by the Municipal Treasurer's Association and is in compliance with state law. Qualifying investments include obligations of the United States government, Treasury and Agency securities, bankers' acceptances, certificates of deposit and repurchase agreements.

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

Type	Fair Value	Investment Maturities (In Months)				% of Portfolio
		0 to 6	7 to 12	13 to 18	19 to 24	
Deposits						
FDIC or PDPC insured bank deposits	\$19,442,700	\$19,442,700	\$ -	\$ -	\$ -	39.33%
In-transit items	(286,102)	(286,102)	-	-	-	-0.58%
Petty Cash on hand	7,359	7,359	-	-	-	0.01%
Total deposits	19,163,957	19,163,957	-	-	-	38.76%
Investments						
Federal Home Loan Bank	4,076,207	1,003,839	2,024,411	-	1,047,957	8.25%
Federal Home Loan Mortgage Corporation	2,109,172	-	-	1,044,757	1,064,415	4.27%
Washington State Local Government Inv. Pool	24,087,502	24,087,502	-	-	-	48.72%
Total investments	30,272,881	25,091,341	2,024,411	1,044,757	2,112,372	61.24%
Total cash & cash equivalents	\$49,436,838	\$44,255,298	\$2,024,411	\$1,044,757	\$2,112,372	100.00%

The Washington State Local Government Investment Pool (LGIP) which is managed by the Washington State Treasurer's Office. The LGIP is an unrated 2a-7 like pool, as defined by GASB 31. Accordingly, participants' balances in the LGIP are not subject to interest rate risk, as the weighted average maturity of the portfolio will not exceed 60 days. Per GASB 40 guidelines the balances are also not subject to custodial credit risk. The credit risk of the LGIP is limited as most investments are either obligations of the US government, government sponsored enterprises, or insured demand deposit accounts and certificates of deposit. Investments or deposits held by the LGIP are either insured or held by a third-party custody provider in the LGIP's name. The fair value of the City's pool investments is determined by the pool's share price. The City has no regulatory oversight responsibility for the LGIP which is governed by the Washington State Finance Committee and is administered by the State Treasurer. The LGIP is audited annually by the Office of the State Auditor, an independently elected public official, an Advisory Committee meets quarterly to advise the State Treasurer on issues regarding the LGIP, monthly statement enclosures detailing portfolio breakdown and earnings information sent to participants, and quarterly newsletters that include a compliance report and quarterly financials. Financial reports are available at the State Treasurer's Office, P.O. Box 40200, Olympia, Washington, 98504-2000. The City includes the LGIP as an investment for internal tracking, but it is disclosed on the financial statements as a cash equivalent.

Interest Rate Risk. As a means of limiting its exposure to interest rate risk, the City's policy requires that it diversifies its investments by security type and institution, and limits holdings in any one type of investment with any one issuer. The City coordinates its investment maturities to closely match cash flow needs and restricts the maximum investment term to less than five years from the purchase date. The

Washington State Local Government Investment Pool is an unrated 2a-7 like pool as defined by GASB 31, accordingly participants balances are not subject to interest rate risk as the weighted average maturity of the portfolio will not exceed 90 days.

Credit Risk. Credit risk is the chance that an issuer will fail to pay principal or interest in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause the price of the investment to decline. The City's investment policy applies the prudent person standard; Investments will be made with judgment and care, under circumstances then prevailing, which a person of prudence, discretion and intelligence would use in the management of their own affairs, not for speculation, but for investment purposes. The credit ratings on securities held by the City on December 31, 2011 are listed below:

Debt Security	S&P Rating
Federal Home Loan Bank	AA+
Federal Home Loan Mortgage Corp.	AA+

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the City of Oak Harbor would not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The City's Investment Policy requires that all security transactions entered into by the City of Oak Harbor will be conducted on a delivery-versus-payment (DVP) basis. Securities will be held in safekeeping by a third party custodian. All of the City's securities at year end were held in safekeeping by a third party custodian.

Concentration of Credit Risk. The City diversifies its investments by security type and institution. 100% of the City's portfolio may be invested in US Treasury Notes, Bonds or Certificates, US Government Sponsored Corporations, or the State Investment Pool. 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.

Exposure to Foreign Currency Risk. The City does not invest in any form of foreign currency denomination. While the City does have customers who pay invoices to the city in foreign funds, these transactions are translated and converted into U.S dollars in an amount equal to the original invoice price prior to being received by the City. Accordingly, the City has no exposure to foreign currency risk.

Note 5 – Property Taxes

The Island 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 tax 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 \$3.60 per \$1,000 of assessed valuation for general governmental services. The City of Oak Harbor's maximum property tax levy rate has been reduced from \$3.60 to \$3.1494 - the amount of this reduction directed to supporting the Sno-Isle regional library.

Washington State Constitution and Washington State law, RCW 84.55.010, limit the rate.

The City's regular levy for 2011 was \$2.2853 per \$1,000 on an assessed valuation of \$1,640,900,593 for a regular levy of \$3,749,999. During 2011, the City did not have any special levies.

Note 6 – Capital Assets and Depreciation

Governmental-type capital assets activity for the year ended December 31, 2011 was as follows:

Governmental Activities:	Beginning Balance			Ending Balance
	1/1/2011	Increases	Decreases	
Capital assets not being depreciated:				
Land	\$ 2,048,867	\$ 49,749	\$ -	\$ 2,098,616
Recreation areas	6,601,695	294,086	-	6,895,781
Construction in progress	1,651,776	3,826,632	(926,888)	4,551,520
Intangible assets	26,000	12,000	-	38,000
Total assets not depreciated:	\$ 10,328,338	\$ 4,182,467	\$ (926,888)	\$ 13,583,917
Assets depreciated:				
Buildings	\$ 8,296,033	\$ -	\$ -	\$ 8,296,033
Capital lease	138,572	-	-	138,572
Improvements & infrastructure	29,026,602	201,538	-	29,228,140
Machinery & equipment	2,171,236	21,239	-	2,192,475
Total assets depreciated:	\$ 39,632,443	\$ 222,777	\$ -	\$ 39,855,220
Less accumulated depreciation:				
Buildings	\$ (3,990,194)	\$ (168,841)	\$ -	\$ (4,159,035)
Capital lease	(138,572)	-	-	(138,572)
Improvements & infrastructure	(18,883,199)	(836,056)	-	(19,719,255)
Machinery & equipment	(1,191,384)	(150,266)	-	(1,341,650)
Total accumulated depreciation:	\$ (24,203,349)	\$ (1,155,163)	\$ -	\$ (25,358,512)
Total assets depreciated (net):	\$ 15,429,094	\$ (932,386)	\$ -	\$ 14,496,708
Governmental activities				
total capital assets (net):	\$ 25,757,432	\$ 3,250,081	\$ (926,888)	\$ 28,080,625

In 2011, infrastructure and improvements were combined for reporting purposes.

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	\$ 54,247
Public safety	92,191
Physical environment	20,976
Transportation	819,388
Mental and physical health	15,045
Cultural and recreational	120,460
Internal service fund capital assets are charged to the various functions based on their usage of the asset	32,856
Total depreciation expense - governmental activities	\$ 1,155,163

Business-type capital assets activity for the year ended December 31, 2011 was as follows:

Business-type Activities:	Beginning Balance			Ending Balance
	1/1/2011	Increases	Decreases	
Capital assets not being depreciated:				12/31/2011
Land	\$ 1,333,347	\$ 2,147,673	\$ -	\$ 3,481,020
Construction in progress	2,306,247	4,068,800	(3,574,122)	2,800,925
Total capital assets not depreciated:	\$ 3,639,594	\$ 6,216,473	\$(3,574,122)	\$ 6,281,945
Capital assets being depreciated:				
Buildings	\$ 8,948,356	\$ 1,067,849	\$ (8,800)	\$ 10,007,405
Improvements	57,069,851	567,477	(117,978)	57,519,350
Machinery & equipment	13,371,661	821,037	-	14,192,698
Total assets depreciated:	\$ 79,389,868	\$ 2,456,363	\$(126,778)	\$ 81,719,453
Less accumulated depreciation:				
Buildings	\$ (4,132,115)	\$ (267,969)	\$ 5,280	\$ (4,394,804)
Improvements	(21,076,958)	(1,550,568)	-	(22,627,526)
Machinery & equipment	(8,980,478)	(790,527)	-	(9,771,005)
Total accumulated depreciation:	\$ (34,189,551)	\$(2,609,064)	\$ 5,280	\$ (36,793,335)
Total assets depreciated (net):	\$ 45,200,317	\$ (152,701)	\$(121,498)	\$ 44,926,118
Business-type activities total capital assets (net):	\$ 48,839,911	\$ 6,063,772	\$(3,695,620)	\$ 51,208,063

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

Business-type Activities:	
Water	\$ 757,417
Sewer	960,739
Solid waste	19,191
Storm drain	117,827
Marina	190,702
Internal service	557,908
Total depreciation expense - business-type activities	\$ 2,603,784

The City has active construction projects as of December 31, 2011. The projects include street and sidewalk improvements, construction of a new water reservoir, design of a wastewater treatment plant, and installation of a heating, vacuum, and air conditioning (HVAC) unit.

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

Project	Spent to Date	Remaining Commitment
SE Pioneer Way street improvements	\$ 4,748,887	\$ 518,327
Gun Club Road water reservoir	215,243	32,744
Wastewater treatment plant	425,738	663,823
HVAC installation	38,825	36,175
Safe Routes to Schools sidewalk improvements	-	3,000
Total	\$ 5,428,693	\$ 1,254,069

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 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

The Legislature established PERS in 1947. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts (other than judges currently in the Judicial Retirement System); employees of legislative committees; community and technical colleges, college and university employees not participating in higher education retirement programs; judges of district and municipal courts; and employees of local governments. PERS retirement benefit provisions are established in Chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

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.

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 exercised 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 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 two 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. This benefit was eliminated by the Legislature, effective July 1, 2011. Plan 1 members may 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 two percent of the AFC for each year of service reduced by two 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. This benefit was eliminated by the Legislature, effective July 1, 2011. Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is 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. 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 two 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 three 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.

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 one 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 contributions and 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 two percent of the AFC per year of service. For Plan 3, the monthly benefit amount is one 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 1,197 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2010:

Type of Members	Number of Participants
Retirees and Beneficiaries Receiving Benefits	76,899
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	28,860
Active Plan Members Vested	105,521
Active Plan Members Nonvested	51,005
Total	262,285

Funding Policy

Each biennium, the state Pension Funding Council adopts PERS Plan 1 employer contribution rates, PERS Plan 2 employer and employee contribution rates, and PERS Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at six 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 Plan 3 employee contribution rates range from 5 percent to 15 percent, based on member choice. 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, 2011, are as follows:

Contributer	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer*	7.25%	7.25%	7.25%**
Employee	6.00%	4.64%	***

*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
2011	\$28,940	\$392,669	\$276,838
2010	18,761	343,978	269,292
2009	20,791	405,154	308,250

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

Plan Description

The Legislature established LEOFF in 1970. Membership in the system includes all full-time, fully compensated, local law enforcement commissioned officers, firefighters and, as of July 24, 2005, emergency medical technicians. 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. LEOFF retirement benefit provisions are established in Chapter 41.26 RCW and may be amended only by the State Legislature.

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.

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.

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 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 two 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 three 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 two 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 three 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 ten percent of FAS and two percent per year of service beyond five years. The first ten 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 receive 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 request 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 374 participating employers in LEOFF. Membership in LEOFF consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2010:

Type of Members	Number of Participants
Retirees and Beneficiaries Receiving Benefits	9,647
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	782
Active Plan Members Vested	13,420
Active Plan Members Nonvested	3,656
Total	27,505

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. 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, 2011, 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
2011	\$305	\$366,903
2010	304	376,225
2009	298	367,366

Public Safety Employees' Retirement System (PSERS) Plan 2

Plan Description

The Legislature created PSERS in 2004 and the system 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. PSERS retirement benefit provisions are established in chapter 41.37 RCW and may be amended only by the State Legislature.

PSERS is a cost-sharing multiple-employer retirement system comprised of a single defined benefit plan, PSERS Plan 2.

PSERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions.

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, Gambling Commission, Liquor Control Board, Parks and Recreation Commission, and Washington State Patrol;
- Corrections departments of Washington State counties;
- Corrections departments of Washington State cities except for Seattle, Tacoma and Spokane; and
- Interlocal corrections agencies.

To be eligible for PSERS, an employee must work on a full-time basis and:

- Have 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; or
- Have primary responsibility to ensure the custody and security of incarcerated or probationary individuals; or
- Function as a Washington peace officer, as defined in RCW 10.93.020; or
- Have primary responsibility to supervise eligible members who meet the above criteria.

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 two 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 three 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 three 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 two 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 receive 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 request 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 76 participating employers in PSERS. Membership in PSERS consisted of the following as of the latest actuarial valuation date for the plan of June 30, 2010:

Type of Members	Number of Participants
Retirees and Beneficiaries Receiving Benefits	7
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	-
Active Plan Members Vested	-
Active Plan Members Nonvested	4,210
Total	4,217

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, 2011 are as follows:

Contributer	PSERS Plan 2
Employer*	8.86%
Employee	6.36%

*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
2011	\$16,460
2010	15,402
2009	12,070

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, if applicable; and earnings from the investment of money by the Washington State Investment Board. However, members may elect to withdraw their contributions upon termination. Currently, the City of Oak Harbor pays the premiums for participating members.

Note 8 – Risk Management

The City of Oak Harbor is a member of the Washington Cities Insurance Authority (WCIA). Utilizing Chapter 48.62 RCW (self-insurance regulation) and Chapter 39.34 RCW (Interlocal Cooperation Act), nine cities originally formed WCIA on January 1, 1981. WCIA was created for the purpose of providing a pooling mechanism for jointly purchasing insurance, jointly self-insuring, and/or jointly contracting for risk management services. WCIA has a total of 150 Members.

New members initially contract for a three-year term, and thereafter automatically renew on an annual basis. A one-year withdrawal notice is required before membership can be terminated. Termination does not relieve a former member from its unresolved loss history incurred during membership.

Liability coverage is written on an occurrence basis, without deductibles. Coverage includes general, automobile, police, public officials' errors or omissions, stop gap, and employee benefits liability. Limits are \$4 million per occurrence self insured layer, and \$16 million per occurrence in the re-insured excess layer. The excess layer is insured by the purchase of reinsurance and insurance and is subject to aggregate limits. Total limits are \$20 million per occurrence subject to aggregate sub-limits in the excess layers. The Board of Directors determines the limits and terms of coverage annually.

Insurance coverage for property, automobile physical damage, fidelity, inland marine, and boiler and machinery are purchased on a group basis. Various deductibles apply by type of coverage. Property insurance and auto physical damage are self-funded from the members' deductible to \$500,000 for all perils other than flood and earthquake, and insured above that amount by the purchase of insurance.

In-house services include risk management consultation, loss control field services, claims and litigation administration, and loss analyses. WCIA contracts for the claims investigation consultants for personnel issues and land use problems, insurance brokerage, and lobbyist services.

WCIA is fully funded by its members, who make annual assessments on a prospectively rated basis, as determined by an outside, independent actuary. The assessment covers loss, loss adjustment, and administrative expenses. As outlined in the interlocal, WCIA retains the right to additionally assess the membership for any funding shortfall.

A Board of Directors governs WCIA, which is comprised of one designated representative from each member. The Board elects an Executive Committee and appoints a Treasurer to provide general policy

direction for the organization. The WCIA Executive Director reports to the Executive Committee and is responsible for conducting the day to day operations of WCIA.

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. No claims in any of the past three years exceeded the City's insurance coverage. None of the current claims or lawsuits made or expected to be made against the City appear to have any reasonable likelihood of significantly affecting the City's financial situation for 2011.

Note 9 – Short-term Debt

The City has no outstanding anticipation notes (including anticipation notes that are accounted for as long-term debt), interest-bearing (registered or revenue) warrants, or similar contractual debt in 2011 nor were any issued during the year.

Note 10 – Long-term Debt

In recent years, the City of Oak Harbor has issued general obligation and revenue bonds to finance the purchase of fire suppression vehicles, capital improvements to the marina, and sewer infrastructure. General obligation bonds have been issued for both general government activities and business-type activities and are being repaid from the applicable resources. The City's Limited Tax General Obligation (LTGO) bonds outstanding include amounts issued to fund dredging, capital improvements, and other components of the Marina Revitalization Plan - the repayment of which comes specifically from marina revenues. Revenue bonds are repaid by income received from proprietary fund earnings.

General Obligation Bonds

General obligation bonds are direct obligations of the City for which its full faith and credit are pledged. Debt service is paid from the Debt Service and Marina and Marina Reserve Funds. Any debt service for voter approved issues is funded with special property tax levies. Debt service for City Council authorized or councilmanic issues is funded from regular property taxes and other general government revenues.

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	\$25,421
2011 OAKLTGO11 Marina Bond	2030	1.00% - 4.40%	\$2,570,000	\$2,445,000

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
2012	25,421	435	100,000	85,052
2013	0	0	100,000	84,053
2014	0	0	100,000	82,902
2015	0	0	105,000	81,403
2016	0	0	105,000	79,040
2017-2021	0	0	580,000	348,914
2022-2026	0	0	695,000	234,000
2027-2030	0	0	660,000	74,140
Total	\$25,421	\$435	\$ 2,445,000	\$ 1,069,504

Revenue Bonds

Revenue bond indebtedness issued to fund proprietary activities is recorded in the proprietary fund. Debt service payments are made from revenues generated by the proprietary fund.

Revenue bonds currently outstanding are as follows:

Purpose	Maturity Range	Interest Rate	Original Amount	Amount of Installments
2004 Water & Sewer Revenue Bonds	2024	3.50% - 4.55%	\$2,865,000	\$2,060,000

Revenue bond debt service requirements to maturity are as follows:

Year Ending December 31,	Principal	Interest
2012	\$125,000	\$86,530
2013	130,000	82,155
2014	135,000	77,410
2015	140,000	72,347
2016	145,000	66,888
2017-2021	810,000	240,665
2022-2024	575,000	53,007
Total	\$2,060,000	\$679,002

The City has pledged net revenues of the Sewer and Sewer Reserve Fund to repay the revenue bonds. Proceeds from the bonds provided financing for capital improvements to the sewer infrastructure. 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 \$2,739,002. Principal and interest paid for the current year and net sewer revenue were \$612,970 and \$1,277,659, respectively

Other Debt - Public Works Trust Fund Loans

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. The City currently has two PWTF loans with principal outstanding of \$747,183. This debt will be repaid from Water and Water Reserve Fund revenues.

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	\$321,736
PW-05-691-031 Public Works Trust Fund Loan	2026	0.50%	\$2,694,500	\$425,447

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

Year Ending December 31,	Principal	Interest
2012	\$51,344	\$3,736
2013	51,344	3,479
2014	51,344	3,223
2015	51,344	2,966
2016	51,344	2,709
2017-2021	256,722	9,695
2022-2026	233,741	3,276
Total	\$747,183	\$29,084

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. At December 31, 2011, the City has restricted assets in proprietary funds containing \$953,353 in reserves as required by bond indentures.

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 \$53,875 for the year ending December 31, 2011. The future minimum lease payments for these leases are as follows:

Year Ending December 31	Amount
2012	35,626
2013	35,626
2014	27,849
2015	13,481
2016	1,601
Total	\$114,183

Capital Leases

The City has no capital lease agreements and did not enter into any capital lease agreements during 2011.

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, 2011, 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 1/1/2011	Additions	Reductions	Ending Balance 12/31/2011	Due Within One Year
Governmental Activities:					
Bonds payable:					
General obligation bonds	\$ 74,986	\$ -	\$ (49,565)	\$ 25,421	\$ 25,421
Issuance premiums/discounts	-	-	-	-	-
Total bonds payable:	74,986	-	(49,565)	25,421	25,421
OPEB payable	366,019	155,238	(37,510)	483,747	-
Compensated absences	1,135,505	94,006	-	1,229,511	115,188
Government activity long-term liabilities:	\$ 1,576,510	\$ 249,244	\$ (87,075)	\$ 1,738,679	\$ 140,609
Business-type Activities:					
Bonds payable:					
General obligation bonds	\$ -	\$ 2,570,000	\$ (125,000)	\$ 2,445,000	\$ 100,000
Revenue bonds	2,560,000	-	(500,000)	2,060,000	125,000
Issuance premiums/discounts	(225)	(13,390)	876	(12,739)	-
Total bonds payable:	2,559,775	2,556,610	(624,124)	4,492,261	225,000
Due to other governments:					
PWTF loans	798,528	-	(51,345)	747,183	51,344
Payable from restricted assets (landfill closure)	70,157	-	(70,157)	-	-
Compensated absences	337,150	29,437	-	366,587	14,256
Business-type activity long-term liabilities	\$ 3,765,610	\$ 2,586,047	\$ (745,626)	\$ 5,606,031	\$ 290,600

The City of Oak Harbor's internal service funds serve both governmental and enterprise funds. Accordingly, long-term liabilities for these funds 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, \$165,823 of internal service fund's compensated absences are included in the above business-type amounts. 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.

In 2011, the City continued work on improvement of streetscapes and utility infrastructure along Pioneer Way - the City's historic district arterial. During construction, the City discovered ancient archeological resources within the arterial roadway of the project which temporarily halted construction. In addition, some of the archeological remains were transported to an off-site location at Pitt Road in Island County. Through negotiations with Tribal and State organizations, the City has completed construction at the actual project site. However, there still remains final completion of the disposition of potentially recovered archeological resources at the Pitt Road site. In March of 2012, the City has entered into a contract with Equinox Research and Consulting International (ERCI) to complete, submit, and finalize a permit application to Washington State Department of Archaeology and Historic Preservation (DAHP) which would define the methodological protocols for the recovery effort. The initial analysis provided by ERCI of the potential cost of recovering all archeological resources falls within a range of \$1.02 million to \$1.93 million. The City feels that it is probable the potential costs might fall within this range, however the true amount of the potential loss is not subject to reasonable estimation until further testing and analysis is performed.

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 position reports \$4,232,560 of restricted components of net position, of which \$4,232,560 is restricted by statute or 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. There were no interfund balances at December 31, 2011.

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, 2011 were as follows:

Transfers Out	Transfers In				Total
	General Fund	Arterial Fund	Nonmajor Governmental Funds	Internal Service Funds	
General fund	\$ -	\$ -	\$ 168,711	\$ -	\$ 168,711
Arterial fund	502,213	-	-	-	502,213
Nonmajor governmental funds	58,845	2,752,000	25,000	2,500	2,838,345
Water fund	237,943	-	-	-	237,943
Sewer fund	245,566	-	-	-	245,566
Solid waste fund	122,620	-	-	-	122,620
Storm drain fund	125,084	-	-	-	125,084
Marina fund	349,133	-	-	-	349,133
Internal service funds	19,544	-	35,000	-	54,544
Total	\$1,660,948	\$2,752,000	\$228,711	\$2,500	\$4,644,159

Interfund Loan Activity

In February, an interfund loan was entered into between the Equipment Replacement Fund and the Marina and Marina Reserve 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. This interfund loan was repaid to the Equipment Replace Fund in March from the proceeds of the LTGO Bond issued by the Marina and Marina Reserve Fund. The repayment included interest calculated at a rate one percent (1%) per annum.

Note 16 – Receivable and Payables Balances

Major receivables of the City’s governmental activities come from the State, Island County, and local taxpayers. Major business-type receivables comes from utility and marina customer billings. Total receivables coincide with the following statement of net position line items: “Receivable (net)” and “Due from other governments”.

Receivables at December 31, 2011 were as follows:

Receivables:	General Fund	Arterial Fund	Nonmajor Governmental Funds	Water Fund	Sewer Fund	Solid Waste Fund	Storm Drain Fund	Marina Fund	Total
Property taxes	\$191,042	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$191,042
Municipal court	\$1,603,568	-	-	-	-	-	-	-	1,603,568
Customer accounts	-	-	-	449,903	447,973	337,056	170,859	49,234	1,455,025
Special assessments	-	-	31,784	-	-	-	-	-	31,784
Other accounts	3,775	593	360	-	-	-	-	933	5,661
Other taxes	657,821	-	-	-	-	-	-	629	658,450
Grants	1,497	-	-	-	-	-	-	-	1,497
Gross receivables	2,457,703	593	32,144	449,903	447,973	337,056	170,859	50,796	\$3,947,027
Less: allowance for uncollectible	(1,396,387)	-	-	-	-	-	-	-	(1,396,387)
Net total receivables	\$1,061,316	\$ 593	\$ 32,144	\$449,903	\$447,973	\$337,056	\$ 170,859	\$50,796	\$2,550,640

Total governmental activities receivables were \$1,094,053 and business-type activities receivables were \$1,456,587.

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, 2011 was \$60,117 and business-type activities deferred revenue was \$18,901.

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 OPEB cost is calculated based upon the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. 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, 2008. The following table shows the components of the City's annual OPEB cost and the change in the City NOO. The NOO of \$483,747 is included as a noncurrent liability on the Statement of Net Position.

Fiscal Year Ending 12/31/2011	
Determination of annual required contribution	
Normal costs at year end	\$20,336
Amortization of unfunded actuarial accrued liabilities (UAAL)	152,512
Annual required contribution (ARC)	\$172,848
Determination of net OPEB obligation (NOO)	
Annual required contribution	\$172,848
Interest on NOO	16,471
Adjustments to ARC	(34,081)
Annual OPEB cost	155,238
Contribution	(37,510)
Increase (decrease) in NOO	117,728
NOO - beginning	366,019
NOO - ending	\$483,747

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
12/31/2011	155,238	24.16%	\$483,747
12/31/2010	140,342	20.66%	366,019
12/31/2009	159,184	17.46%	254,672

As of January 1, 2011, 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
12/31/2011	\$ -	\$1,637,907	\$1,637,907	0.00%	\$189,156	865.90%
12/31/2010	-	1,441,638	1,441,638	0.00%	189,156	762.14%
12/31/2009	-	1,551,851	1,551,851	0.00%	185,436	836.87%

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

The City used the 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, 2009 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 2011. 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..

Note 18 – Closure and Post Closure Care Costs

The City owns a municipal landfill site which ceased receiving solid waste materials 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 previously prepared a landfill closure plan, conducted Phase I during 1993, with completion of successive Phases implemented through 2003. In compliance with GASB Statement 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, the City of Oak Harbor has determined that there is no remaining landfill closure liability as of December 31, 2011.

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. 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.

The City has above-ground fuel tanks at both the Public Works facility and at the city marina. Both fuel tank systems utilizes the VeederRoot monitoring system which performs a series of daily tests on the fuel tanks and reports, among other things, any unusual fuel level variances or leakage occurrences in the tanks. The systems have not indicated any leaks or contamination in 2011.

There have been no obligating events or issues of pollution remediation during 2011.

Note 20 – Other Disclosures

Accounting and Reporting Changes

Governmental Fund Balance Reporting

As required by GASB #54, titled Fund Balance Reporting and Governmental Fund Type Definitions, the City has prepared its 2011 financial statements using the provisions of the standard that require the classification of governmental fund type fund balances into various categories based primarily on the constraints governing the use of the resources within such funds. Implementation of this standard has no impact on the beginning of year net assets or fund balances of the City's governmental fund types.

Subsequent Events

In February, Scimitar Construction was awarded a contract in the amount of \$335,000 for the Safe Routes to School Projects. This project will improve eight street crossing on arterial routes. The improvements will include pedestrian activated, solar powered in-roadway-warning lights and warning signs at the intersections. Improvements to sidewalks and curb ramps are also included in the project.

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. Additional remains were unknowingly transported to an offsite location. This discovery has resulted in the need for significant archeological analysis.

The City entered into a contract with Equinox Research and Consulting International (ERCI) in March to complete, submit, and finalize a permit application to Washington State Department of Archaeology and Historic Preservation (DAHP) which would define the methodological protocols for the recovery effort (Phase 1). This agreement was set not to exceed \$30,000. This contract was amended in April once the specifics of the permit were known (Phase 2). The amount was increased to \$318,758.25 to encompass the first eight weeks of field work. Phase 2 includes (1) planning, administration, documentation and reporting; (2) archaeological analysis; (3) field equipment; (4) field labor; and (5) housing and travel. It is expected that a third amendment will be required (Phase 3) bringing the final total to an estimated \$1.02 to \$1.93 million.

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. In March, this agreement was modified retroactively to January 2011 through December 2012 to reduce the rate charged to the Navy for waste water treatment from \$3.04 per thousand gallons to \$1.69. This modification resulted in a refund to the Navy of \$149,842.10. Negotiations to the agreement will continue in the fall.

The City is currently entering initial negotiations for the establishment of two new bargaining units representing certain Public Works and Marina employees. The City anticipates that the negotiations and the related drafting of the new agreements will take considerable time and effort. Due to the complexity and time constraints of these types of negotiations, the City entered into a contract with Braun Consulting Group in the amount of \$55,650 for assistance in completing this effort.

On April 30, 2012, the Department of Archeological and Historical Preservation (DAHP) issued a permit to the City to perform recovery work for Pit Road and four other sites. In May, the City entered into an agreement with the Swinomish Indian Tribal Community to fulfill the monitoring requirements of the permit. The agreement will also cover indirect costs, mileage, and archival and funerary boxes. The contract is set not to exceed \$600,000.

The Gun Club Road Water Main project involves the installation of new water mains to service the future North Reservoir. The contract was awarded to C. Johnson Construction, Inc. in the amount of \$1,143,575.63. A second contract for \$115,000 was awarded to KBA Construction Management, Inc. for the management of the project.

In May, the City revised 2011 Marina Rate Schedule to include contract pricing for moorage and a new fuel pricing methodology. All of the rates will remain unchanged; the contract pricing is an addition to the current rate schedule. Contract pricing offers a reduced price incentive for those customers executing a lease agreement of greater than one year. It is expected that this will attract new customers and increase occupancy. The fuel pricing changes include a more steady price and discounts for over-night guests.



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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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