Washington State Auditor's Office

Independence • Respect • Integrity

Financial Statements Audit Report

City of Mukilteo

Snohomish County

For the period January 1, 2013 through December 31, 2013

Published August 17, 2015

Report No. 1014844

Washington State Auditor's Office

August 17, 2015

Mayor and City Council
City of Mukilteo
Mukilteo, Washington

Report on Financial Statements

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

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

Sincerely,

JAN M. JUTTE, CPA, CGFM

ACTING STATE AUDITOR

OLYMPIA, WA

TABLE OF CONTENTS

City of Mukilteo
Snohomish County
January 1, 2013 through December 31, 2013

2013-001 The City's internal controls over accounting and financial reporting continue to be inadequate to ensure financial statements are accurate and complete.

Background

It is the responsibility of City management to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting. In the prior audit we identified and communicated deficiencies in controls that adversely affect the City's ability to produce reliable financial statements. Our current audit found that internal control weaknesses continue to affect the City's ability to produce financial statements that are free from error.

The City spent 2013 recovering from a computer server crash that affected multiple financial systems at the City. The preparation and audit of the 2012 financial statements was delayed as the City worked for months to recover its financial data. Further, as the City was starting to prepare its 2013 financial statements, the City experienced turnover in its key accounting positions beginning with the finance director leaving in March 2014, followed by the retirement of the accounting manager in January 2015, the staff accountant in February 2015 and the replacement finance director in June 2015.

The computer server crash and subsequent turnover in personnel delayed the preparation of the 2013 financial statements. The City submitted the 2013 financial statements on November 20, 2014 – 174 days after the deadline as prescribed by State Law (RCW 43.09.230). These issues also caused delays in the audit process as employees responsible for preparing and maintaining key information were not available.

Description of Condition

We identified the following deficiencies in internal controls over accounting and financial reporting that represent a material weakness:

- Although the City has procedures to perform a review of the prepared financial statements, the review was not adequate to detect and correct errors prior to audit.

- City employees responsible for financial statement preparation did not research and consider the accounting and financial reporting of applicable Government Accounting Standards to ensure the City's financial reporting is accurate and complete under Generally Accepted Accounting Principles (GAAP).

We further identified that internal controls over accounting and reporting of capital assets were not adequate to ensure accurate classification of capitalized expenditures. This deficiency in internal controls represents a significant deficiency.

Cause of Condition

The City did not dedicate the necessary time and resources to accurately present financial statements in accordance with the Government Accounting Standards Board (GASB) requirements. Further, the City did not make it a priority to provide training to the accounting staff who prepares financial statements.

Additionally, we found that communication between accounting staff and the Public Works Department was not adequate to ensure accurate classification of capital assets.

Effect of Condition

Inaccurate financial reports limit access to financial information used by City officials, the public, state and federal agencies, and other interested parties. It also hinders the audit process and increases audit costs.

We identified the following material errors during our audit:

- The City did not review the balance "Net Investment in Capital Assets" after a software performed the calculation for the balance.

    - Governmental Activities Net Investment in Capital Assets was overstated by $3,022,200 on the Government wide Statement of Net Position.

    - Internal Service Fund Net Investment in Capital Assets was overstated by $1,982,444 on the Proprietary Fund Statement of Net Position.

- City staff did not research and consider the accounting and financial reporting of applicable accounting standards, such as GASB Statement No. 54, related to fund balance classifications. The City is responsible for supporting how it classified its fund balances into the new categories. The City relied on a spreadsheet provided by the prior year auditors to state its fund balances without gaining an understanding of why balances are classified as restricted, committed, assigned, or unassigned.
    - The City classified $2,461,946 of assigned and committed fund balance as restricted.

The City corrected the material errors listed above on the final financial statements.

Additionally, we identified the following significant error that was not detected by the City but was identified during our audit:

- Expenditures capitalized as construction in progress were not reclassified timely as projects became substantially complete.
    - 12 of 27 Governmental activities projects totaling $4,726,839 and 6 of 9 Business type activities totaling $593,247 should have either been reclassified as a depreciable capital asset or expensed if the project was cancelled.

The City chose not to correct the significant errors on the financial statements.

We identified additional, less significant errors in the financial statements and notes to the financial statements. Despite these internal control issues and noted errors, the City ultimately provided financial statements upon which we are issuing an unmodified opinion.

Recommendation

We continue to recommend the City:

- Provide staff with the necessary resources, training, and oversight to prepare accurate and complete financial statements.
- Ensure a person knowledgeable of GAAP reporting requirements performs a detailed, technical review of the financial statements.
- Create and retain documentation to support fund balance classifications.
- Comply with state law requiring filing their financial reports with the State Auditor's Office within 150 days after its fiscal year end.

City's Response

The City of Mukilteo appreciates the opportunity to respond to the observations and conclusions drawn by the staff of the Washington State Auditor's Office. As was discussed in the 2012 audit report, the City experienced a major computer systems failure in 2012 that resulted in the loss of critical financial data. As the City recovered from the computer systems failure during the first two quarters of 2013, it also experienced changes in the senior finance department staff.

The City has hired technically skilled senior staff that has incorporated State Auditor recommended best business practices that include internal accounting and financial reporting controls, and reconciliation techniques. Standardized accounting standard operating procedures are in development to ensure proper oversight of all finance department functions. The City will be sending key staff to identified relevant workshops and training seminars in the coming months to ensure future accounting and financial reporting is in accordance with Governmental Accounting Standards and applicable Generally Accepted Accounting Principles.

Auditor's Remarks

We thank the City for its response and action plan to address the issues identified in this finding. We will follow up on these matters in our next audit.

Applicable Laws and Regulations

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

> The American Institute of Certified Public Accountants, Statement on Auditing Standards No. 115 defines significant deficiencies and material weaknesses as follows:
>
> > a. Significant deficiency: A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
> >
> > b. Material weakness: A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Budgeting, Accounting and Reporting System (BARS) Manual, Accounting, Accounting Principles and General Procedures, Internal Control, states:

> Internal control is a management process for keeping an entity on course in achieving its business objectives, as adopted by the governing body. This management control system should ensure that resources are guarded against waste, loss and misuse; that reliable data is obtained, maintained, and fairly disclosed in financial statement and other reports; and resource use is consistent with laws, regulations and policies.
>
> Each entity is responsible for establishing and maintaining an effective system of internal control throughout their government.

RCW 43.09.200 – Local Government Accounting – Uniform System of Accounting, states:

> The state auditor shall formulate, prescribe, and install a system of accounting and reporting for all local governments, which shall be uniform for every public institution, and every public office, and every public account of the same class.
>
> The system shall exhibit true accounts and detailed statements of funds collected, received, and expended for account of the public for any purpose whatever, and by all public officers, employees, or other persons.
>
> The accounts shall show the receipt, use, and disposition of all public property, and the income, if any, derived therefrom; all sources of public income, and the amounts due and received from each source; all receipts, vouchers, and other documents kept, or required to be kept, necessary to isolate and prove the validity of every transaction; all statements and reports made or required to be made, for the internal administration of the office to which they pertain; and all reports published or required to be published, for the information of the people regarding any and all details of the financial administration of public affairs.

RCW 43.09.230 – Local Government Accounting – Accounting Reports – Comparative Statistics, states:

> The state auditor shall require from every local government financial reports covering the full period of each fiscal year, in

accordance with the forms and methods prescribed by the state auditor, which shall be uniform for all accounts of the same class.

Such reports shall be prepared, certified, and filed with the state auditor within one hundred fifty days after the close of each fiscal year.

STATUS OF PRIOR AUDIT FINDINGS

City of Mukilteo
Snohomish County
January 1, 2013 through December 31, 2013

This schedule presents the status of findings reported in prior audit periods. The status listed below is the representation of the City of Mukilteo. The State Auditor's Office has reviewed the status as presented by the City.

<table>
<tr><td>Audit Period:
January 1, 2012 through December 31, 2012</td><td>Report Ref. No.:
1011496</td><td>Finding Ref. No.:
1</td></tr>
<tr><td colspan="3">Finding Caption
The City's internal controls over accounting and financial reporting are not adequate to ensure the financial statements are accurate and complete.</td></tr>
<tr><td colspan="3">Background:
We identified the following deficiencies in internal controls over accounting and financial reporting that represent material weaknesses:
The City's financial statements are complex and require employees to have a high level of understanding of the accounting principles required and the relationship the statements have to one another. The City experienced employee turnover in the position primarily responsible for the creation of the financial statements. City management did not provide adequate training to ensure new staff understood and were aware of proper accounting procedures. The original financial statements and subsequent revisions we received for audit contained misstatements.
City employees responsible for financial statement preparation did not research and consider the accounting and financial reporting of applicable Government Accounting Standards to ensure the City's financial reporting is accurate and complete under Generally Accepted Accounting Principles (GAAP).
Although the City has procedures to perform a final review of the prepared financial statements, due to turnover in key accounting staff, an independent review was not performed of the statements prior to our audit.</td></tr>
<tr><td colspan="3">Status of Corrective Action: (check one)
☐ Fully Corrected   ☒ Partially Corrected   ☐ No Corrective Action Taken   ☐ Finding is considered no longer valid</td></tr>
<tr><td colspan="3">Corrective Action Taken:
The Finance Director conducted a review of the City's financial statements prior to the State's audit. The City has taken steps to ensure technically qualified staff are in the positions responsible for general ledger management and preparation of all required financial statements.</td></tr>
</table>

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

City of Mukilteo
Snohomish County
January 1, 2013 through December 31, 2013

Mayor and City Council
City of Mukilteo
Mukilteo, Washington

We have audited, 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, the financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Mukilteo, Snohomish County, Washington, as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated August 5, 2015. Although our opinion on the basic financial statements is not affected, management has not presented all of the required asset condition assessments or annual maintenance and preservation estimates in the infrastructure modified approach information, which is a material departure from the prescribed guidelines. As discussed in Note 1 to the financial statements, during the year ended December 31, 2013, the City implemented Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Audit Findings and Responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Audit Findings and Responses as Finding 2013-001 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Audit Findings and Responses as Finding 2013-001 to be significant deficiencies.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the City’s financial statements are free from 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*.

CITY’S REPONSE TO FINDINGS

The City’s response to the findings identified in our audit is described in the accompanying Schedule of Audit Findings and Responses. The City’s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. 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.

JAN M. JUTTE, CPA, CGFM

ACTING STATE AUDITOR

OLYMPIA, WA

August 5, 2015

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

City of Mukilteo
Snohomish County
January 1, 2013 through December 31, 2013

Mayor and City Council
City of Mukilteo
Mukilteo, Washington

REPORT ON THE FINANCIAL STATEMENTS

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 Mukilteo, Snohomish County, Washington, as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed on page 17.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express 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 from material misstatement.

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

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

Opinion

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 Mukilteo, as of December 31, 2013, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Matters of Emphasis

As discussed in Note 1 to the financial statements, in 2013, the City adopted new accounting guidance, Governmental Accounting Standards Board *Statement No. 65, Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 18 through 30, budgetary comparison information on pages 80 through 82, infrastructure condition and maintenance data on pages 78 through 79, and information on postemployment benefits other than pensions on page 83 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 our audit of the basic financial statements. Although our opinion on the basic financial statements is not affected, management has not presented all of the required asset condition assessments or annual maintenance and preservation estimates in the infrastructure modified approach information, which is a material departure from the prescribed guidelines. 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.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated August 5, 2015 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over financial reporting and compliance.

JAN M. JUTTE, CPA, CGFM

ACTING STATE AUDITOR

OLYMPIA, WA

August 5, 2015

FINANCIAL SECTION

City of Mukilteo
Snohomish County
January 1, 2013 through December 31, 2013

REQUIRED SUPPLEMENTARY INFORMATION

BASIC FINANCIAL STATEMENTS

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis

The City of Mukilteo presents the Management Discussion and Analysis of its financial activities for the year ended December 31, 2013. This information is designed to assist the reader in focusing on significant issues facing the City while providing an overview of the City's financial activity. The City encourages readers to consider this information in conjunction with additional information provided in the financial statements and related notes that follow.

Financial Highlights

- The assets of the City of Mukilteo exceeded liabilities as of December 31, 2013 by $189,126,387. Of this amount, $8,918,199 represents unrestricted net position which may be used to meet the government's ongoing obligations to citizens and creditors.

- The City's financial activities consist of primarily governmental activities; business-type activities incorporate the Surface Water Management Fund.

- The City's assets totaled $202,458,728 of which the investment in capital assets net of related debt totaled $174,751,845; short-term ($2,687,866) and long-term liabilities ($10,644,478) totaled $13,332,344, and net position $189,126,387 as noted above.

- The City's overall financial position decreased $250,061 during 2013. This decrease is attributable to decreases related to governmental activities of $88,046 and to business-type activities of $162,015. However, because of the restatement to beginning net position, overall net position as of December 31, 2014 rose to $189,126,387.

  It is important to note that the decrease in financial position is entirely due to depreciation expense applied to the City's capital assets of governmental and business-type activities. Pursuant to generally accepted accounting principles, depreciation is a legitimate expense applicable to the City's capital assets. However, it does not impair the City's ability to operate since it has no effect on the City's cash and other current assets used to finance operations.

  Ending fund balance in the City's governmental funds, which do not recognize depreciation expense, increased $40,306 from 2012 to $11,317,880. Ending net position in the City's Surface Water Management Fund (the City's one business-type activity) decreased $162,015 during 2013. However, if depreciation expense of $333,145 is excluded, net position increased $171,130.

- At the end of the current fiscal year, the City of Mukilteo's governmental funds reported combined ending fund balances of $11,317,880. Approximately $2.1 million of this amount is available for spending at the City's discretion in the General Fund (*unassigned fund balance).*

- Reflected in the General Fund operating statements, revenues totaling $13,062,836 - primarily from taxes and licenses & permits - were used to support expenditures in the following major activities totaling $12,081,096:
  - $2,610,306 was applied to General Government purposes – City Council, Legal, Administration, and Finance;
  - $7,154,811 for Public Safety – Police, Fire, and Protective Inspection;
  - $297,841 for Physical Environment – Air Pollution and Environment;
  - $1,008,427 for Economic Environment;
  - $694,439 for Culture and Recreation
  - $77,626 for Transportation
  - $237,646 for Capital Outlay.

OVERVIEW OF THE FINANCIAL STATEMENTS

The City's basic financial statements consist of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. The report also contains other supplementary information. This section will introduce and explain the basic financial statements.

It is important to note that the General Fund's financial statements incorporate the financial activities of the City Reserve Fund, Paine Field Emergency Reserve Fund, LEOFF Reserve Fund, Health Insurance Administration Reserve Fund, Unemployment Compensation Reserve Fund, and the Technology Replacement Fund.

Government-Wide Financial Statements

Government-wide financial statements are designed to provide readers a picture of the financial condition and activities of the City of Mukilteo, as a whole, with a broad overview and in a manner similar to private-sector businesses. One of the most important questions asked about the City's finances is, "Is the City as a whole better or worse off as a result of this year's activities?" The Statement of Net Position and the Statement of Activities report information about the City as a whole and about its activities using the accrual basis of accounting that helps answer this question.

The government-wide financial statements have separate columns for governmental activities and business-type activities. The City's governmental activities include general government (legislative, executive, finance, and personnel), public safety (police and fire), physical environment, economic environment, culture/recreation, and transportation.

The City's business-type activity consists of the surface water utility. Governmental activities are primarily supported by taxes, charges for services, and grants, while business-type activities are self-supporting through user fees and charges.

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 is similar to the balance sheet of a private sector business. Over time, increases or decreases in net position serve as a useful indicator of improvement or deterioration in the City's overall financial health.

The **Statement of Activities** presents information designed to show how the City's net position changed during the year. This statement distinguishes revenue generated by specific functions (program revenue) from revenue provided by taxes and other sources not related to a specific function (general revenues). Program revenue (charges for services, grants, and contributions) is compared to expenses for those functions in order to show how much each function either supports itself or relies on taxes and other general funding sources for support. All activity on this statement is 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 are included in the statement of activities as revenues and expenses even though no cash has changed hands.

The government-wide financial statements can be found immediately following the Management Discussion & Analysis.

Fund Financial Statements
The fund financial statements will look familiar to the traditional users of governmental financial statements. However, the focus is now on major funds rather than fund types.

A fund is a group of related accounts used to maintain control over resources that are segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. There are three categories of City funds: governmental funds, proprietary funds, and fiduciary funds.

Governmental Funds account for essentially the same functions reported as governmental activities in the government-wide financial statements. Most of the City's basic services are reported in the governmental funds. These statements, however, focus on cash and other assets that can readily be converted to available resources, as well as any balances remaining at year-end. Such information is useful in determining what financial resources are available in the near future to finance the City's programs.

Readers may better understand the long-term impact of the government's near-term financing decisions by comparing the information presented for the governmental funds with similar information presented for governmental activities in the government-wide financial statements. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate the comparison.

Information for the four major governmental funds is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances; information for the non-major funds is presented in the aggregate.

Proprietary Funds account for services for which the City charges outside customers or internal City departments. Proprietary funds provide the same information as shown in the government-wide financial statements, only in more detail, since both use the accrual basis of accounting.

Proprietary funds report the same functions presented as business-type activities in the government-wide financial statements.

The City has two types of proprietary funds: enterprise funds and internal service funds. Enterprise funds are used to account for goods and services provided to external users such as citizens and businesses. Internal service funds are used to account for goods and services provided internally to various City departments and funds.

The enterprise fund statements provide information for the City's surface water utility. The City uses internal service funds to account for 1) its fleet of vehicles, and 2) facilities maintenance. Because these services largely benefit governmental rather than business-type functions, they have been included within the governmental activities in the government-wide financial statements.

Fiduciary Funds account for assets held by the City in a trustee capacity. Fiduciary funds are not included in the government-wide financial statements because their assets are held in a trustee or agency capacity for others and cannot be used to support City programs. The City has one fiduciary fund that is classified as an agency fund with assets and liabilities equal to each other.

Notes to the Financial Statements

The notes to the financial statements are an integral part of the financial statements. They provide additional disclosures essential to a full understanding of the information provided in the government-wide and fund financial statements. The notes to the financial statements immediately follow the basic financial statements in this report.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Position

The Statement of Net Position can serve as a useful indicator of the City's financial position. The City's net position on December 31, 2013 and 2012 totals $189,126,387 and $189,052,008, respectively. Following is a condensed version of the government-wide statement of net position for 2013 compared with 2012.

Figure 1: Condensed Statement of Net Position

	Governmental Activities		Business-type Activities		Total	
	2013	2012	2013	2012	2013	2012
Current and other assets	$ 14,813,194	$ 15,734,166	$ 1,504,300	$ 1,459,321	$ 16,317,494	$ 17,193,487
Noncurrent assets	181,677,746	180,687,849	4,463,489	4,678,229	186,141,235	185,366,078
Total assets	196,490,941	196,422,015	5,967,789	6,137,550	202,458,729	202,559,565
Current and other liabilities	2,592,075	1,095,843	95,791	100,915	2,687,866	1,196,758
Long-term liabilities	10,644,478	12,308,176	-	2,623	10,644,478	12,310,799
Total liabilities	13,236,553	13,404,019	95,791	103,538	13,332,344	13,507,557
NET POSITION						
Net investment in capital assets	170,288,356	169,325,548	4,463,489	4,678,229	174,751,845	174,003,777
Restricted	5,456,344	5,123,700	-	-	5,456,344	5,123,700
Unrestricted	7,509,690	8,568,748	1,408,509	1,355,783	8,918,199	9,924,531
Total net position	$ 183,254,389	$ 183,017,995	$ 5,871,997	$ 6,034,012	$ 189,126,387	$ 189,052,008

The largest portion of the City's net position reflects investment of approximately $174.8 million in capital assets such as land, buildings, and equipment. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending.

The restricted portion of net position of approximately $5.5 million primarily consists of approximately $4.8 million for capital improvements, $130,150 for emergency medical services, $185,820 for tourism, and $215,602 for transportation. Additional information on the City's restricted portion of net position can be found in Note 12. The unrestricted portion of net position of approximately $8.9 million may be used to meet ongoing obligations to citizens and creditors.

Note 1 of the Notes to the Financial Statements provides information regarding fund balance classifications for the major and non-major governmental funds. General Fund amounts identified as nonspendable and restricted fund balance constitute a minor component of overall fund balance that does not affect its ability to finance future operations.

The fund balance of the two remaining major governmental funds is restricted to use for the purposes for which the funds were created and, therefore, does not affect their ability to finance future operations. The same is true for the non-major governmental funds as well.

Change in Net Position

The change in net position table illustrates the increases and decreases in net position of the City resulting from its operating activities. The City's net position decreased $250,061 during 2013 - $88,046 due to governmental activities and $162,015 due to business-type activities. However, because of the restatement to beginning net position, overall net position as of December 31, 2013 increased to $189,126,387.

The following is a condensed version of the City's changes in net position taken from the Statement of Activities. The table below shows revenues, expenses, and related changes in net position in tabular form for governmental activities apart from business-type activities for 2013 and 2012.

Figure 2: Changes in Net Position Resulting from Revenues and Expenses

	Governmental Activities		Business-type Activities		Total	
	2013	2012	2013	2012	2013	2012
REVENUES						
Program revenues:						
Charges for services	$ 3,782,427	$ 3,327,437	$ 1,293,185	$ 1,280,618	$ 5,075,612	$ 4,608,055
Operating grants and contributions	26,269	83,884	266,583	842,342	292,852	926,227
Capital grants and contributions	826,348	262,466	-	-	826,348	262,466
General revenues:				-	-	-
Property Taxes	6,577,046	6,183,673	-	-	6,577,046	6,183,673
Sales Taxes	2,681,225	2,345,106	-	-	2,681,225	2,345,106
Other Taxes	5,116,837	4,458,126	-	-	5,116,837	4,458,126
Interest and Investment Earnings	22,446	32,860	1,709	3,088	24,155	35,948
Other	59,038	699,760	-	-	59,038	699,760
Total revenues	19,091,636	17,393,313	1,561,477	2,126,048	20,653,113	19,519,362
EXPENSES						
Governmental activities:						
General Government	3,437,323	3,559,645	-	-	3,437,323	3,559,645
Public Safety	9,736,294	9,014,962	-	-	9,736,294	9,014,962
Physical Environment	297,841	285,518	-	-	297,841	285,518
Economic Environment	1,154,831	1,044,990	-	-	1,154,831	1,044,990
Culture and Recreation	2,613,481	2,276,222	-	-	2,613,481	2,276,222
Transportation	1,546,508	1,621,469	-	-	1,546,508	1,621,469
Interest on Debt	393,405	431,983	-	-	393,405	431,983
Business-Type activities:						
Surface Water Management	-	-	1,723,492	1,628,344	1,723,492	1,628,344
Total expenses	19,179,683	18,234,790	1,723,492	1,628,344	20,903,175	19,863,133
Change in net position before special items and transfers	(88,046)	(841,477)	(162,015)	497,704	(250,062)	(343,772)
Transfers	-	-	-	-	-	-
Change in net position	(88,046)	(841,477)	(162,015)	497,704	(250,062)	(343,772)
Net position - beginning (as restated)	183,342,434	183,859,473	6,034,012	5,536,308	189,376,446	189,395,781
Net position - ending	$ 183,254,389	$ 183,017,996	$ 5,871,997	$ 6,034,012	$ 189,126,387	$ 189,052,009

Governmental Activities Analysis

At the end of 2013, Net Position totaled $183,254,389. Key elements of 2013 revenues and expenditures are as follows:

- Cost of all governmental activities in 2013 was approximately $19.2 million. Of this amount, approximately $4.7 million was paid for by those who directly benefited from the programs or by other governments and organizations that subsidized certain programs with grants and contributions. The net expense (total expenses less program revenues) or approximately $14.5 million was the cost of governmental services paid primarily by the City's taxpayers.
- Property, Sales, and Utility taxes are the primary sources of tax revenue available to fund general city operations.

- Charges for Services, including business license & development fees, permits, inspections, plan review services, and community center user fees totaled approximately $3.8 million in 2013.

Business-Type Activities Analysis

The City's Surface Water Management Fund's financial position decreased in 2013 by $162,015. Although 2013 charges for service revenue totaled $1,293,185, total expenses including deprecation and other operating expenses such as personnel services, supplies, and professional services exceeded total revenues including interest revenue by $162,015. Excluding non-cash depreciation expense of $333,145, revenues exceeded operating expenses by $169,420.

At the end of the current fiscal year, the City's Surface Water Management Fund reported a net position of approximately $5.9 million. Of this amount, approximately $4.5 million is invested in capital assets, and approximately $1.4 million constitutes unrestricted net position, which is available for discretionary spending.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

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

Governmental Funds

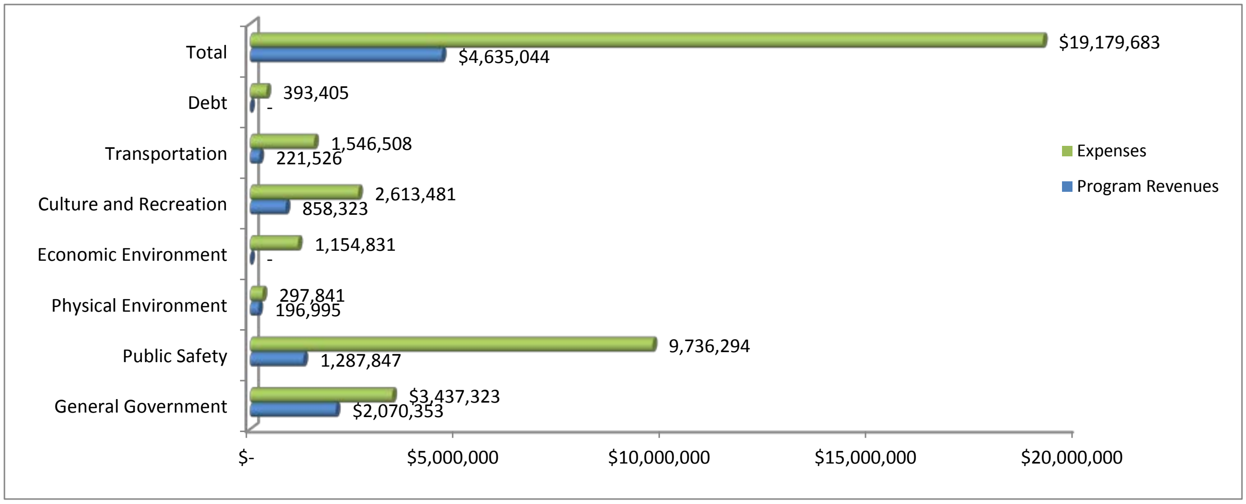
The focus of the City's governmental funds analysis is to provide information on near-term revenues/financial resources and expenditures. This information helps determine the City's financing requirements in the near future. In particular, fund balance measures the City's net resources available for spending at the end of the fiscal year.

At the end of the current fiscal year the City's governmental funds reported ending fund balances of approximately $11.3 million. Approximately $2.1 million of that amount constitutes unassigned fund balance in the General Fund which is available for discretionary spending. The remainder of the fund balance is non-spendable, restricted, assigned, or committed for various purposes and is not available for new spending. Excluding transfers between Funds and minor revenue from capital asset sales, revenues for the governmental funds in 2013 totaled approximately $18 million; expenditures totaled approximately $17.5 million.

Figure 3: Governmental Activities

For the Year Ended December 31, 2013

Functions/Programs	Program Revenues	% of Total	Expenses	% of Total	Net (Expense) Revenue
General Government	$ 2,070,353	44.67%	$ 3,437,323	17.92%	$ (1,366,970)
Public Safety	1,287,847	27.79%	9,736,294	50.76%	(8,448,447)
Physical Environment	196,995	4.25%	297,841	1.55%	(100,846)
Economic Environment	-	0.00%	1,154,831	6.02%	(1,154,831)
Culture and Recreation	858,323	18.52%	2,613,481	13.63%	(1,755,158)
Transportation	221,526	4.78%	1,546,508	8.06%	(1,324,982)
Debt	-	0.00%	393,405	2.05%	(393,405)
Total	$ 4,635,044	100.00%	$ 19,179,683	100.00%	$ (14,544,639)



The General Fund is the main operating fund of the City in which all revenues and expenditures for ordinary City operations are recorded, unless legally required to be accounted for in another Fund. Taxes are the major revenue source. At the end of 2013, the fund balance of the General Fund was $5,477,577. As a measure of the Fund's liquidity, the ending fund balance is 45% of the Fund's 2013 expenditures. As of December 31, 2013, total assets were $6,257,271; total liabilities were $779,694.

The Recreation & Cultural Services Fund is a special revenue fund which receives recreation and cultural service activity fees and rental revenues, and finances the expenditures for the operation and maintenance of the Rosehill Community Center's building and programs. At the end of 2013, the fund balance was $0 as a result of the annual operating transfer from the General Fund of $225,502. As of December 31, 2013, total assets and liabilities were $307,660.

Emergency Medical Services Fund is a special revenue fund which receives the bulk of its revenues from a voter- approved tax levy to finance advanced life support services. At the end of 2013, the fund balance was $130,150. As a measure of the Fund's liquidity, the ending fund balance is 6.7% of the Fund's 2013 expenditures. As of December 31, 2013, total assets were $266,671 and total liabilities were $136,521.

The Real Estate Excise Tax I Fund is a capital projects fund which receives real estate excise tax (REET) proceeds from one half of the .50% tax that is locally imposed on all sales of real property. The second half is recorded in the REET II fund. At the end of 2013, the fund balance was $4,267,855. As a measure of the Fund's liquidity, the ending fund balance is 23 times the Fund's 2013 expenditures. As of December 31, 2013, total assets were $4,269,769 and total liabilities were $1,914.

Other Governmental Funds: the City has nine other governmental funds, which includes four special revenue funds, four capital projects funds and one debt service fund. These funds reported total assets of $1,597,861, total liabilities of $155,563 and fund balances totaling $1,442,298.

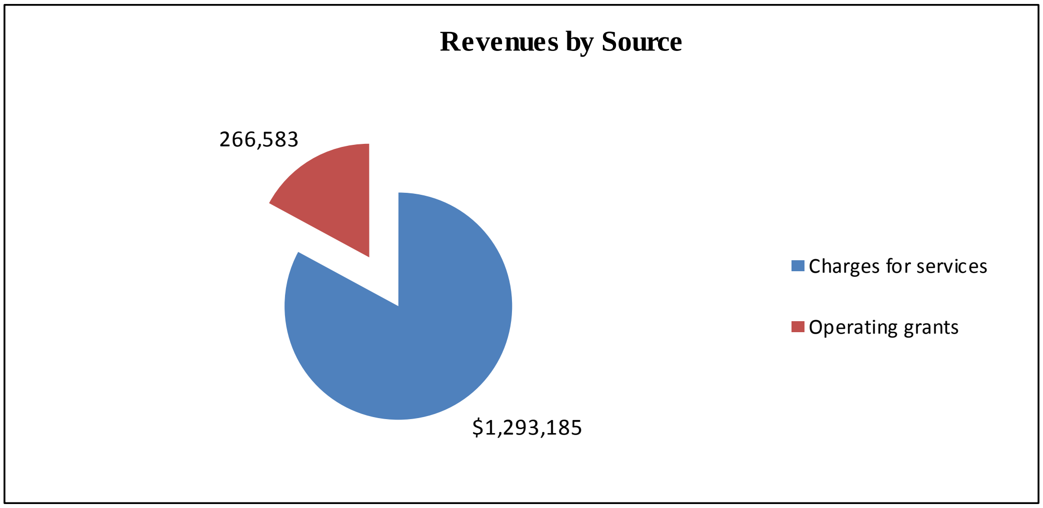
Business-type Activities
The City's proprietary fund statements provide the same type of information found in the government-wide financial statements, but in more detail.

The **Surface Water Management Fund**, an enterprise fund, generates its operating revenues primarily from user fees. Net position of the Fund at the end of the year totaled approximately $5.9 million. The largest portion of proprietary net position, approximately $4.5 million, reflects investment in capital assets. The remaining $1.4 million represents unrestricted net position.

Figure 4: Proprietary or "Business-Type" Activities

For the Year Ended December 31, 2013

Revenue Sources		Revenue	% of Total
Charges for services	$	1,293,185	82.9%
Operating grants		266,583	17.1%
Total	$	1,559,768	100.0%



GENERAL FUND BUDGETARY HIGHLIGHTS

During the year there was an overall increase of $551,831 in budgeted expenditures and transfers to other funds between the original and final amended budget.

A comparison of the actual performance of the General Fund to the final budget indicates that total revenues and transfers in exceeded budgeted amounts by approximately $380,000. Total tax revenues exceeded budgeted tax revenues by approximately $219,000. Business license and permit revenues exceeded budget by approximately $102,000. And charges for services exceeded budget by approximately $121,000.

Expenditures and transfers out were also approximately $380,000 below budget. This consisted primarily of approximately $148,000 savings for general government services, $120,000 savings in public safety, $76,000 savings for physical environment, $40,000 savings for economic environment, $129,000 savings for capital expenditures, and culture & recreation savings of $12,000. Transportation expenditures were $58,000 over budget. Transfers out were $87,400 in excess of budget to eliminate a negative fund balance in the Recreation & Cultural Services Fund.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The City's investment in capital assets for its governmental and business-type activities as of December 31, 2013 totals approximately $185.4 million (net of accumulated depreciation). The City's investment in joint venture is excluded from this amount.

Figure 5: Capital Assets at Year End, Net of Depreciation

	Governmental Activities		Business-type Activities		Total	
	2013	2012	2013	2012	2013	2012
Land	26,226,985	24,354,240	150,000	150,000	26,376,985	24,504,240
Right of Way Easements	10,580,181	10,580,181	-	-	10,580,181	10,580,181
Art Collections	192,689	183,890	-	-	192,689	183,890
Capital Assets	311,258,971	310,410,247	6,490,146	6,471,076	317,749,117	316,881,323
Construction In Progress	4,962,519	5,190,661	839,443	740,108	5,801,962	5,930,769
	353,221,345	350,719,219	7,479,589	7,361,184	360,700,934	358,080,403
Less: accumulated depreciation	(172,247,989)	(170,031,371)	(3,016,100)	(2,682,956)	(175,264,089)	(172,714,327)
Capital assets, net	$ 180,973,357	$180,687,846	$ 4,463,489	$ 4,678,229	$185,436,846	$185,366,076

Additional information on the City's capital assets can be found in Note 5 to the financial statements.

The Statement of Net Position reflects investment in capital assets for governmental activities, net of related debt, of $170,288,356. This was calculated by subtracting outstanding bond debt of $10,685,000 from capital assets of $180,973,356 (excluding the City's investment in three joint ventures discussed in Note 15).

As discussed in greater detail in Note 5 and the Required Supplementary Information Section, in 2012 the City adopted the Modified Accounting Approach for the calculation of depreciation of the City's streets pursuant to Governmental Accounting Standards Board Statement No. 34. The City completed a pavement condition assessment in 2007 and in 2014. Thus, the City has not complied with the requirement to perform an assessment at least every three years. Additional disclosures are required as well. The City intends to comply as part of the Annual Financial Statements for the year ending December 31, 2014.

Long-Term Debt
During 2009 Standard & Poor's assigned its highest municipal bond rating of AAA for the City's issuance of $12,585,000 in limited tax general obligation bonds for the construction of a new community center. This is the only outstanding bond issue that the City has and no further bond issuances are anticipated. The 2009 bond debt is backed by the full faith and credit of the City Principal payments began in 2010. The AAA rating was reaffirmed by Standard & Poor's in 2014. Additional information on long-term debt can be found in Note 8 to the financial statements. The 2013 principal payment of $495,000 reduced the outstanding bond debt to $10,685,000 as of the end of 2013. Annual principal and interest payments are made from funding provided by the City's Real Estate Excise Tax I and II Funds.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS

The City's 2014 budget is a continuation of our plan to keep the City on solid ground for providing services to our citizens during 2014 and for years to come. The plan for the City recognizes the financially unsettling times we have experienced as a community, but also recognizes the fact that we cannot control the economy as a whole. With this being said, the 2014 Budget lays out the City's vision for achieving our immediate priorities and implementing our long-term goals beyond 2014.

The budget emphasizes working with the resources that we have. As it stands now, Mukilteo is in good economic shape. Bank-owned homes represent a small fraction of the houses on the market, and area employers, including Boeing, are hiring again. The City continues to spend to keep its infrastructure in good shape.

Standard & Poor's spent many hours in understanding the City's finances and financial polices while developing their credit rating for the Community Center bond issue. Standard & Poor's research was concluded by recognizing our City's unique financial position and renewing their highest rating (AAA) in August 2014. This rating stated more about what kind of City Mukilteo has become and where we are headed than simply telling investors we are a safe haven to invest in.

To quote Standard & Poor's bond rating rationale, they state the basis for our credit strengths include:

- Very strong wealth and income levels;
- Maintenance of very strong unrestricted fund balances
- Good financial policies and practices; and
- Low to moderate debt burden with low carrying charges.

Much time will be spent in 2014 working on setting priorities, understanding details, enhancing our long-range financial plan, and updating the Comprehensive and Capital Facilities Plans, all while looking to the long term health, public safety, and viability of our City.

Keeping our City on solid ground has been and will continue to be a subject of discussion by Council, staff, and citizens. This discussion centers on five areas: the City's Comprehensive Plan, maintaining our infrastructure, keeping our community safe, development of the City's Long-range Financial Plan, and protecting Paine Field for airplane and related manufacturing.

The City's **main priority** for the past seven years: **Keeping Our Community Safe**. During the past seven years we strategically staffed our Police and Fire departments with the goal to fully provide efficient, fast, and reliable emergency medical, fire response, and law enforcement. The 2014 budget provides funding to maintain this goal.

Under Mayor Gregerson's leadership, the City's broad goal is **A Sustainable, Well-Run City with Safe, and Strong Neighborhoods** with the following components:

- **Budget efficiently and effectively** to align with our priorities
- Support **diversity in our community**
- **Plan well** and **look forward to the future** in decision making
- Ensure residents are **safe** in our homes and neighborhoods
- **Empower** city employees to collaborate, support and serve
- Provide high quality two-way **communications** with residents and encourage full **participation** in City government
- Manage **appropriate growth** that minimizes environmental impact and uses land efficiently
- Improve **accessibility and mobility** to destinations throughout our community
- Ensure **access to quality recreation & cultural** facilities and services for residents of all ages
- Support local businesses to ensure a **healthy economy**

The City's financial health and stability is intricately linked to these top priorities. In 2010, we officially launched the City's **Long-range Financial Planning Team**. During 2013, this team reviewed and recommended updates to the City's financial policies and financial plan. Once complete, the Long-range Financial Plan will serve as the basis for the development of future budgets.

The 2014 budget plan recognizes that 2013 provided a reason for the City to continue its optimism for the recovery of the economy. The magnitude of the recent economic downturn resulted in a budget balancing strategy that included the use of carefully managed expenditures, anticipated revenue increases, and the prudent use of fund reserves.

2014 Budget Overview

Budgeted revenues and transfers in for all funds total $28.9 million. Total budgeted expenditures and transfers out total $33.4 million.

In keeping with the City's fiscally conservative approach, the budget includes an estimated ending General Fund, fund balance of $3,413,223, which equals 25% of 2014 General Fund expenditures and transfers out.

Requests for Information

The City's financial statements are designed to provide users with a general overview of the City's finances as well as demonstrate the City's accountability to its citizens, investors, creditors, and other customers. If you have a question about this report, please contact the Finance Director: City of Mukilteo, 11930 Cyrus Way, Mukilteo WA 98275, 425-263-8030.

Statement of Net Position

December 31, 2013

	Primary Government		
	Governmental Activities	Business-type Activities	Total
ASSETS			
Current assets:			
Cash and Cash Equivalents	$ 13,203,971	$ 1,235,319	$ 14,439,290
Accounts Receivable (Net of allowance for uncollectibles)	448,972	126,953	575,925
Taxes Receivable	1,157,363	142,028	1,299,391
Prepaids	2,888	-	2,888
Total current assets	14,813,194	1,504,300	16,317,494
Noncurrent assets:			
Investment in Joint Venture	704,389	-	704,389
Land	26,226,985	150,000	26,376,985
Right of Way Easements	10,580,181	-	10,580,181
Art Collection	192,689	-	192,689
Capital Assets (Net of accumulated depreciation)	139,010,982	3,474,046	142,485,028
Construction In Progress	4,962,519	839,443	5,801,962
Total noncurrent assets	181,677,746	4,463,489	186,141,235
Total assets	196,490,941	5,967,789	202,458,728
LIABILITIES			
Wages Payable	561,623	79,963	641,586
Accounts Payable	478,747	15,828	494,575
Deposits Payable	200,777	-	200,777
Compensated Absences	617,725	-	617,725
Unearned Revenue	205,580		205,580
Other Accrued Liabilities	214	-	214
Long-Term Liabilities			
Due Within One Year	527,408	-	527,408
Due In More Than One Year	10,644,478	-	10,644,478
Total liabilities	13,236,553	95,791	13,332,344
NET POSITION			
Investment in capital assets, net of related debt	170,288,356	4,463,489	174,751,845
Restricted for:			
Capital Improvements	4,820,499	-	4,820,499
Emergency Medical Services	130,151	-	130,151
Nonspendable	2,888	-	2,888
Public Safety	27,858		27,858
Hotel/Motel Lodging Tax	185,820	-	185,820
Debt Service	7,228	-	7,228
Other Purposes	66,296	-	66,296
Transportation	215,602	-	215,602
Unrestricted	7,509,690	1,408,509	8,918,199
Total net position	$ 183,254,389	$ 5,871,998	$ 189,126,387

The notes to financial statements are an integral part of this statement.

CITY OF MUKILTEO

Statement of Activities

For the Year Ended December 31, 2013

		Program Revenues			Net (Expense) Revenue and Changes in Net Position — Primary Government		
Functions/Programs	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	Total
Governmental activities:							
General Government	$ 3,437,323	$ 2,025,724	$ 5,046	$ 39,583	$ (1,366,969)	$ -	$ (1,366,969)
Public Safety	9,736,294	815,143	19,176	453,528	(8,448,447)	-	(8,448,447)
Physical Environment	297,841	196,248	747	-	(100,846)	-	(100,846)
Economic Environment	1,154,831	-	-	-	(1,154,831)	-	(1,154,831)
Culture and Recreation	2,613,481	614,936	1,300	242,087	(1,755,158)	-	(1,755,158)
Transportation	1,546,508	130,376	-	91,150	(1,324,982)	-	(1,324,982)
Interest and Fiscal Changes	393,405	-	-	-	(393,405)	-	(393,405)
Total governmental activities	19,179,683	3,782,427	26,269	826,348	(14,544,639)	-	(14,544,639)
Business-type activities:							
Surface Water Management	1,723,492	1,293,185	266,583	-	-	(163,724)	(163,724)
Total business-type activities	1,723,492	1,293,185	266,583	-	-	(163,724)	(163,724)
Total primary government	$ 20,903,175	$ 5,075,612	$ 292,852	$ 826,348	(14,544,639)	(163,724)	(14,708,363)
General revenues:							
Property Taxes					6,577,046	-	6,577,046
Sales Taxes					2,681,225	-	2,681,225
Utility Taxes					2,734,782	-	2,734,782
Fuel Taxes					455,749	-	455,749
Excise Taxes					1,697,537	-	1,697,537
Hotel-Motel Taxes					228,769	-	228,769
Interest					22,446	1,709	24,155
Miscellaneous					59,038	-	59,038
Total general revenues					14,456,592	1,709	14,458,301
Change in net position					(88,046)	(162,015)	(250,061)
Net position - beginning (as restated; see Notes 17 & 18)					183,342,434	6,034,012	189,376,446
Net position - ending					$ 183,254,389	$ 5,871,997	$ 189,126,387

The notes to financial statements are an integral part of this statement.

CITY OF MUKILTEO

Balance Sheet - Governmental Funds

December 31, 2013

	General	Recreation & Cultural Services	Emergency Medical Services	Real Estate Excise Tax I	Total Nonmajor Funds	Total Governmental Funds
ASSETS						
Cash and Cash Equivalents	$ 4,992,544	$ 307,590	$ 140,349	$ 4,213,635	$ 1,405,541	$ 11,059,659
Accounts Receivable	246,188	70	111,536	-	57,803	415,597
Due from Other Funds	30,350	-	-	-	-	30,350
Intergovernmental Revenue	-	-	-	33,374	-	33,374
Taxes Receivable	985,301	-	14,786	22,760	134,517	1,157,364
Prepayments	2,888	-	-	-	-	2,888
Total assets	$ 6,257,271	$ 307,660	$ 266,671	$ 4,269,769	$ 1,597,861	$ 12,699,232
LIABILITIES						
Wages Payable	$ 434,513	$ 36,594	$ 73,362	$ -	$ 8,210	$ 552,679
Accounts Payable	165,826	13,500	63,159	1,914	74,784	319,183
Due to Other Funds	30,350	-	-	-	72,569	102,919
Unearned Revenue	11,060	194,520	-	-	-	205,580
Deposits Payable	137,731	63,046	-	-	-	200,777
Other Accrued Liabilities	214	-	-	-	-	214
Total liabilities	779,694	307,660	136,521	1,914	155,563	1,381,352
FUND BALANCES (DEFICITS)						
Nonspendable	2,888	-	-	-	-	$ 2,888
Restricted	66,296	-	130,150	4,267,855	1,223,264	5,687,565
Committed	1,043,654	-	-	-	-	1,043,654
Assigned	2,288,672	-	-	-	219,034	2,507,706
Unassigned	2,076,068	-	-	-	-	2,076,068
Total fund balances	5,477,577	-	130,150	4,267,855	1,442,298	11,317,880
Total liabilities and fund balances	$ 6,257,271	$ 307,660	$ 266,671	$ 4,269,769	$ 1,597,861	$ 12,699,232

The notes to financial statements are an integral part of this statement.

Reconciliation - Balance Sheet of Governmental Funds to the Statement of Net Position

December 31, 2013

Fund balances of governmental funds		$11,317,880
Capital assets used in governmental activities are not current period financial resources, and therefore are not reported in the funds.		
Land	24,385,935	
Right of Way easements	10,580,181	
Art Collection	183,890	
Construction in Progress	5,235,794	
Buildings	27,934,915	
Improvements other than Buildings	9,585,393	
Machinery and Equipment	4,972,663	
Infrastructure	264,661,136	
Accumulated Depreciation	(169,632,909)	
		177,906,998
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the funds. The assets and liabilities of the internal service fund are included in governmental activities in the statement of net position.		
Bonds Payable (Net): Includes Deferred Bond Premium	(10,957,725)	
Other Post-Employment Benefits	(139,710)	
Compensated Absences	(692,176)	
		(11,789,611)
Investment in Joint Venture		
Investment in Joint Venture - SERS	249,652	
Investment in Joint Venture - AHA	1,209	
Investment in Joint Venture - SNOCOM	453,528	
		704,389
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the costs of those assets are depreciated over their estimated useful lives.		
Donation of Capital Assets	432,000	
Disposal of Fixed Assets	(17,813)	
		414,187
Assets and liabilities of internal service funds are included in governmental activities in the statement of net position.		4,700,547
Net position of governmental activities		$183,254,389

The notes to financial statements are an integral part of this statement.

CITY OF MUKILTEO

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

For the Year Ended December 31, 2013

	General	Recreation & Cultural Services	Emergency Medical Services	Real Estate Excise Tax I	Total Nonmajor Funds	Total Governmental Funds
REVENUES						
Charges for Services	$ 613,791	$ 473,818	$ 161,430	$ -	$ 215,706	$ 1,464,745
Miscellaneous	220,766	1,362	564	3,374	13,904	239,969
Investment Income	9,882	324	218	5,726	2,695	18,845
Taxes	10,345,228	-	1,632,320	668,685	957,585	13,603,818
Licenses and Permits	1,362,846	800	-	-	35,000	1,398,646
Intergovernmental Revenue	363,378	-	-	91,150	687,836	1,142,364
Fines and Forfeitures	146,945	-	-	-	-	146,945
Total revenues	13,062,836	476,304	1,794,532	768,935	1,912,726	18,015,332
EXPENDITURES						
Current:						
General Government	2,610,306	-	-	-	-	$ 2,610,306
Public Safety	7,154,811	-	1,952,816	-	-	9,107,627
Physical Environment	297,841	-	-	-	-	297,841
Economic Environment	1,008,427	-	-	-	137,463	1,145,890
Culture and Recreation	694,439	722,198	-	-	2,973	1,419,610
Transportation	77,626	-	-	-	800,202	877,828
Debt service:						
Administrative charges	-	-	-	-	299	299
Interest	-	-	-	-	410,813	410,813
Principal retirement	-	-	-	-	495,000	495,000
Capital outlay:						
Capital Outlay	237,646	-	-	183,223	739,043	1,159,912
Total expenditures	12,081,096	722,198	1,952,816	183,223	2,585,793	17,525,126
Excess (deficiency) of revenues over expenditures	981,740	(245,894)	(158,284)	585,712	(673,067)	490,206
OTHER FINANCING SOURCES (USES)						
Transfer In	-	225,502	-	250,000	945,130	1,420,632
Transfers Out	(1,106,302)	-	-	(444,530)	(319,800)	(1,870,632)
Sale of Capital Assets	100	-	-	-	-	100
Total other financing source (uses)	(1,106,202)	225,502	-	(194,530)	625,330	(449,900)
Net change in fund balances	(124,462)	(20,393)	(158,284)	391,182	(47,737)	40,306
Fund balances - beginning	5,602,037	20,393	288,436	3,876,673	1,490,034	11,277,573
Fund balances - ending	$ 5,477,577	$ 0	$ 130,150	$ 4,267,855	$ 1,442,298	$ 11,317,880

The notes to financial statements are an integral part of this statement.

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

For the Year Ended December 31, 2013

Net change in fund balances - total governmental funds		$33,836
Amounts reported for governmental activities in the statement of Net Position are different because:		
Capital assets used in governmental activities are not current period financial resources, and therefore are not reported in the funds.		
Joint Venture - AHA	1,209	
Joint Venture - SNOCOM	453,528	
		454,737
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 the governmental funds.		
Change in Other Post Employment Benefits Payable	14,195	
Change in Compensated Absences Payable	(20,352)	
Depreciation of Investment in Joint Venture - SERS	(18,107)	
		(24,264)
Repayment of bond principal is an expenditure in governmental funds, but the repayment reduces long-term liabilities in the statement Net Position.		
Principal Payments	495,299	
		495,299
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.		
Amortization of Bond Premium	17,408	
		17,408
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the costs of those assets are allocated over their estimated useful lives.		
Capital Outlays	1,179,463	
		1,179,463
Depreciation Expense		
Depreciation Expense - Improvements	(642,632)	
Depreciation Expense - M&E	(644,691)	
Depreciation Expense - Infrastructure	(476,374)	
Depreciation Expense - Buildings	(792,417)	
		(2,556,114)
Net revenue (loss) of internal service funds		311,586
Change in Net Position of governmental activities		($88,046)

The notes to financial statements are an integral part of this statement.

Statement of Net Position - Proprietary Funds

December 31, 2013

	Business-type Activities	Governmental Activities
	Surface Water Management	Internal Service Funds
ASSETS		
Current assets:		
Cash and Cash Equivalents	$ 1,235,319	$ 2,144,313
Accounts Receivable	126,953	-
Interfund Loans Receivable	-	72,569
Taxes	142,028	-
Total current assets	1,504,300	2,216,882
Noncurrent assets:		
Land	150,000	-
Construction in Progress	839,443	1,161,318
Capital Assets (Net)	3,474,046	1,482,056
Art Collections	-	8,799
Total noncurrent assets	4,463,489	2,652,173
Total assets	5,967,789	4,869,055
LIABILITIES		
Current liabilities:		
Wages Payable	79,963	8,944
Accounts Payable	15,828	159,564
Total current liabilities	95,791	168,508
Noncurrent liabilities:		
Total noncurrent liabilities	-	-
Total liabilities	95,791	168,508
NET POSITION		
Net investment in capital assets	4,463,489	2,652,173
Unrestricted	1,408,509	2,048,374
Total net position	$ 5,871,998	$ 4,700,547

The notes to financial statements are an integral part of this statement.

Statement of Revenues, Expenses and Changes in Net Position – Proprietary Funds

For the Year Ended December 31, 2013

	Business-type Activities	Governmental Activities
	Surface Water Management	Internal Service Funds
OPERATING REVENUES		
Operating Grants	$ 266,583	$ -
Charges for Services	1,293,185	617,867
Total operating revenues	1,559,768	617,867
OPERATING EXPENSES		
Personnel Services	636,879	135,327
Supplies	45,218	31,376
Other Services and Charges	420,584	316,538
Intergovernmental Services	287,667	-
Depreciation	333,145	257,089
Total Operating Expenses	1,723,493	740,330
Operating Income (Loss)	(163,725)	(122,463)
NONOPERATING REVENUES (EXPENSES)		
Investment Income	1,709	3,600
Total Nonoperating Revenues (Expenses)	1,709	3,600
Income (Loss) Before Transfers In	(162,016)	(118,863)
Transfer In	-	450,000
Change in Net Position	(162,016)	331,137
Total Net Position - January 1	6,034,012	4,388,961
Prior Period Adjustments	-	(19,552)
Total Net Position - December 31	$ 5,871,996	$ 4,700,546

The notes to financial statements are an integral part of this statement.

Statement of Cash Flows
Proprietary Funds

For the Year Ended December 31, 2013

	Activities - Enterprise Funds		Governmental Activities	
	Surface Water Management		Internal Service Funds	
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash Receipts from Customers	$	1,157,075	$	617,867
Payments to Employees		(628,198)	$	(135,327)
Payments to Suppliers		(769,897)	$	(347,835)
Net Cash Provided (Used) by Operating Activities		(241,020)		134,705
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Acquisition and Construction of Capital Assets	$	(118,404)	$	(1,412,586)
Total Non-Cash Investing, Capital and Financing Activities	$	(118,404)	$	(1,412,586)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES				
Loan Repayment		-		70,000
Transfers (to)/from Other Funds		-		450,000
Operating Grants		266,583		-
Net Cash Provided (Used) by Non-Capital Financing Activities		266,583		520,000
CASH FLOWS FROM INVESTING ACTIVITIES				
Investment Income		1,709		3,600
Net Cash Provided (Used) by Investing Activities		1,709		3,600
Net Increase (Decrease) in Cash and Cash Equivalents		(91,132)		(754,281)
Cash and Cash Equivalents, January 1		1,326,451		2,898,594
Cash and Cash Equivalents, December 31	$	1,235,319	$	2,144,313
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:				
Operating Loss	$	(163,724)	$	(122,463)
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:				
Depreciation		333,145		257,089
(Increase)Decrease in Receivables		(402,694)		-
Increase (Decrease) in Wages Payable		8,681		8,594
Increase (Decrease) in Accounts Payable		(16,428)		(8,515)
Net Cash Provided (Used) by Operating Activities	$	(241,020)	$	134,705

The notes to financial statements are an integral part of this statement.

CITY OF MUKILTEO

Fiduciary Funds
Statement of Net Position

December 31, 2013

	Agency Funds
ASSETS	
Cash and Cash Equivalents	$ 33,235
Total assets	33,235
LIABILITIES	
Accounts Payable	334
Due to State - Building Code Fees	2,736
Leasehold Excise Tax Payable	7,630
Due to State - Forfeitures & Seizures	(75)
Sales and Use Tax Payable	(542)
Deposits	23,153
Total liabilities	33,235
NET POSITION	-

The notes to financial statements are an integral part of this statement.

Note 1 – Summary of Significant Accounting Policies

The financial statements of the City of Mukilteo 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 significant accounting policies are described below.

A. Reporting Entity

The City of Mukilteo was incorporated on May 12, 1947 and operates as a non-charter code city with a Mayor-Council form of government under the provisions of Revised Code of Washington (RCW) 35A, et al. This form is commonly referred to as an “optional code city” that essentially enjoys all the rights and privileges granted to larger cities or charter cities. Legislative authority is vested in a seven-member City Council. Council members are elected by position number to four-year overlapping terms. Three to four council members are up for election every two years. The Council is composed of a president and vice-president who are elected by the Council for a one year term each. The Mayor serves as the Chief Executive Officer and is elected to a four-year term by general election. The Mayor appoints the City Administrator, with confirmation by the Council. The City Administrator oversees all City operations and implements policy direction.

The City’s major operations include police protection, fire control/prevention and emergency medical response, parks and recreation, planning and zoning, street improvement, and general administrative services. In addition, the City owns and operates a surface water management system.

As required by GAAP, the City’s financial statements present the City of Mukilteo, the primary government. There are no component units included in these statements.

B. Government-Wide and Fund Financial Statements

The basic financial statements include both government-wide (based on the City as a whole) and fund financial statements.

The **government-wide financial statements** (i.e., the statement of net position and the statement of activities) report information on all of the nonfiduciary activities of the primary government. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for services.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segments are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Interest on general long-term debt is not allocated to the various functions. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods and services provided by a given function or segment of the City, 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.

Separate **fund financial statements** are provided for governmental funds, proprietary funds, and fiduciary funds, 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.

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 statements. The fiduciary fund financial statements have no measurement focus since they primarily represent assets held by the City in a custodial capacity. 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 earned by December 31 (all eligibility requirements have been met) and the revenue is expected to be collected within 60 days after year-end. Expenditures are recorded when the related debt is incurred, except for un-matured interest on general long-term debt, which is recognized when the obligations are expected to be liquidated with expendable available financial resources.

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

As a general rule, the effect of the interfund activity has been eliminated for the government-wide financial statements.

Amounts reported as program revenues include 1) charges to customers, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally restricted resources are reported as general revenues rather than program revenues. General revenues include all taxes.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as needed. The order of use of unrestricted resources (committed, assigned, or unassigned) is subject to determination based on the nature and circumstances of the specific needs at the time and the funds involved.

The City uses an agency fund to account for assets held for the benefit of others. Agency funds have no measurement focus.

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 General Fund includes administration, finance, police, fire, planning and community development, parks maintenance, and public works and engineering management.

Financial statements for the General Fund include the City Reserve Fund, Paine Field Emergency Reserve Fund, LEOFF Reserve Fund, Health Insurance Administration Reserve Fund, Unemployment Compensation Reserve Fund, and the Technology Replacement Fund.

The **Recreation and Cultural Services Center Fund** receives a transfer from the General Fund as well as Community Center activity fees and rental revenues, and finances for the operations and maintenance of the Community Center's building and programs.

The **Emergency Medical Services Fund** receives tax revenues from a voter-approved tax levy to finance advanced life support (ALS) services.

The **Real Estate Excise Tax I Fund** receives 50% of the revenues the City receives from taxes levied on the sale of real estate. By law, these revenues must be used solely for capital projects.

The City reports the following enterprise fund:

The **Surface Water Management Fund** accounts for the revenues and expenses to operate and maintain the surface water management system. The principal operating revenues of the fund are charges to customers for services. Operating expenses include the cost of services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Additionally, the City reports the following non-major funds:

Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes:

The **Drug Enforcement Fund** was created in 2011 and is regulated by the Revised Code of Washington Chapter 69.50 which prescribes procedures relating to the seizure and forfeiture of proceeds from the sale of illegal drugs. This fund may be used for drug enforcement equipment, investigations, education, or similar purposes as defined by state law. A portion of monies forfeited must be remitted to the state or federal government as applicable.

The **Hotel/Motel Lodging Tax Fund** receives the 2% hotel/motel tax assessed on hotels/motels within the City. These funds are mandated to be used only for tourism promotion and operations and maintenance of tourism facilities in the City.

The **Street Fund** receives a transfer from the General Fund, in addition to 68.14% of the Motor Vehicle Fuel Excise Tax (gas tax) received. These revenues are used for street maintenance.

The **Arterial Street Fund** receives 31.86% of the Motor Vehicle Fuel Excise Tax (gas tax), and may be used for the construction, improvement, chip sealing, seal-coating, and repair of arterial highways and city streets.

Debt Service Funds are used to account for the accumulation of funds for the periodic payment of principal and interest on general long-term debt:

The **Limited Tax General Obligation Bond Fund** receives transfers from the Real Estate Excise Tax I and II Funds, and is used to pay principal and interest on the $12,585,000 in bonds issued in 2009.

Capital Projects Funds are used to account for financial resources used for the acquisition or construction of major capital facilities (other than those financed by business-type/proprietary funds):

The **Parks Acquisition and Development Fund** receives revenue from park mitigation fees and grants, and is used to finance expenditures for park development.

The **Transportation Impact Fee Fund** receives revenues from fees which are authorized under the State Environmental Policy Act (SEPA) and the Growth Management Act (GMA) to help offset the cost of transportation capital facilities needed to accommodate new growth and development. Impact fee revenues collected are used to design, engineer, and construct transportation facilities that are consistent with the capital facilities and transportation elements of the Mukilteo comprehensive plan.

The **Real Estate Excise Tax II Fund** receives the remaining 50% of the revenues the City receives from taxes levied on the sale of real estate. Revenues must be used for capital projects.

The **Municipal Facilities Fund** receives transfers from the General Fund which are used to construct City facilities.

Internal Service Funds are used to provide goods and services to other departments and funds on a cost reimbursement basis:

The **Equipment Replacement Fund** finances the replacement, pursuant to a detailed equipment replacement schedule, of all capital equipment owned by the City. Departments are charged an annual fee set aside to replace capital equipment in the future.

The **Facilities Maintenance Fund** receives transfers from the General Fund, which are used to finance expenditures related to the maintenance of City facilities.

Fiduciary Funds are used to account for assets held by a governmental unit in a trustee capacity or as an agent for individuals, private organizations, other governmental units, and/or other funds. These include (a) private-purpose trust funds, (b) pension (and other employee benefit) trust funds, (c) investment trust funds, and (d) agency funds. The City reports one fiduciary/agency fund:

The **Treasurer's Suspense Fund** is used to report assets which are held in a custodial capacity for others. Fund assets do not belong to the City.

D. Budgetary Information

1. Scope of Budget
   Annual appropriated budgets are adopted at the fund level for general, special revenue, debt service and capital project funds, on the modified accrual basis of accounting. Budgets for capital project funds are adopted at the level of the individual project and are shown in the financial statements on an annual basis. The financial statements contain 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.

   Appropriations lapse at year-end. If unused appropriations are needed in the following year, they must be re-appropriated in the next year's operating budget. The City does not use encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation for subsequent expenditure.

2. Amending the Budget
The Mayor and City Administrator are authorized to transfer budgeted amounts within any fund. However, any revisions that alter the total appropriations of a fund, or that affect the number of authorized employee positions, salary ranges, hours, or other conditions of employment must be approved by the City Council. When the City Council determines that it is in the best interest of the City to increase or decrease the appropriations for a particular fund, it may do so by ordinance approved by one more than a simple majority after holding public hearings.

3. Excess of Expenditures over Appropriations
There have been no material violations of finance related legal or contractual provisions in any major or non-major City fund.

E. Assets, Liabilities, Fund Balance, Net Position or Equities

1. Cash and Cash Equivalents
It is the City's policy to invest all temporary cash surpluses. Of the $14,439,290 of cash and cash equivalents at December 31, 2013, the City had $11,654,186 in the Washington State Local Government Investment Pool. This investment is considered to be a cash equivalent as it is available on demand and can be liquidated to meet daily cash flow needs. The interest on this investment is prorated to the various funds.

The City considers short-term investments (including restricted assets) in the State Treasurer's Investment Pool and any other investment with a maturity of three months or less at acquisition date to be cash equivalents. For additional information see Note No. 3, *Deposits and Investments*.

2. Investments - See *Deposits and Investments* Note No 3.

3. Receivables
Taxes receivable consist of property taxes and related interest and penalties. (See Note 4 *Property Taxes*) 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 by private individuals or organizations for goods and services including amounts earned for which billings have not been prepared.

4. Amounts Due To and From Other Funds and Governments, Interfund Loans and Advances Receivable
Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are reported as interfund loans receivable and payable. (See Note 13 *Interfund Balances and Transfers*).

5. Inventories and prepaid items
   Inventories in governmental funds consist of expendable supplies held for consumption. The cost is recorded as expenditure at the time individual inventory items are purchased.

   Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

6. Restricted Assets and Liabilities
   Certain assets and related liabilities may be subject to externally imposed restrictions and would accordingly be reported as restricted. There were no restricted assets or liabilities for the current reporting year.

7. Capital Assets - See Capital Assets Note No. 5.
   Capital Assets are defined as land of any value; artwork and historic collections of any value; improvements and infrastructure; buildings, their furnishings, fixtures, and furniture; equipment, machinery, vehicles, and tools, with a value of $5,000 or more for non-infrastructure or $10,000 or more per item for infrastructure, and having a useful life exceeding one year from the date of acquisition. All non-infrastructure assets with a cost of *$5,000* or more, and infrastructure additions where individual items cost $10,000 or more, will be capitalized. Although *Small and Attractive Assets* (assets costing less than *$5,000*) do not meet the city's capitalization threshold, due to ease of conversion to private use, they are considered assets for purposes of marking and identification, records keeping, and tracking.

   Costs for additions or improvements to capital assets are capitalized when they increase the effectiveness or efficiency of the asset. The City has adopted the Modified Approach for streets and, as a result, infrastructure is treated as an inexhaustible capital asset, thereby eliminating the need for depreciation accounting. The costs for normal maintenance and repairs are not capitalized. Major outlays for capital assets are capitalized as the projects are constructed. Interest incurred during the construction phase of projects is reflected in the capitalized value of the asset constructed.

   Property, plant, and equipment of the City, are depreciated using the straight-line method over the following estimated useful lives:

Assets	Useful Life (Years)
Buildings and Improvements	5 – 100
Storm Drainage Systems	6 – 75
Street Systems	15 – 51
Park Facilities and Streetscape	30
Streetlights and Traffic Control Devices	40
Equipment	3 – 20
Furniture and Fixtures	3 – 20
Vehicles	3 – 30
Computers / Software	3

8. Compensated Absences
Compensated absences are absences for which employees will be paid, such as vacation and sick leave. All vacation is accrued when incurred in the government-wide and proprietary fund financial statements. Non-represented full-time employees may not carry over more than two years' worth of accrued vacation to the next calendar year. Any vacation earned that exceeds the maximum accumulation allowable will be forfeited by the employee. Employees who work under the terms of a collective bargaining agreement should refer to their contract for information regarding earned vacation.

Non-represented employees who separate honorably from the City (e.g., voluntary resignation or disability or service retirement) may receive payment for unused accumulated sick leave in accordance with the following schedule:

Years of Service	% Paid
Less Than 5 Years	33.33%
Between 5 and 10 Years	66.67%
More Than 10 Years	100.00%

Employees who work under the terms of a collective bargaining agreement should refer to their contract for information regarding sick leave.

9. Other Accrued Liabilities
These accounts consist of accrued wages and accrued employee benefits.

10. Long-Term Debt
See Long-Term Debt Note No. 8.

11. Unearned Revenues
    Includes amounts received but not yet earned. Unearned Revenues are recorded in the Governmental Funds Balance Sheet.

12. Governmental Fund Balance Classifications
    The City follows the provisions of GASB Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions*. This Statement requires governmental fund balances to be reported in five classifications – nonspendable, restricted, committed, assigned, or unassigned. Nonspendable fund balances are those not in a spendable form (such as inventories or long-term receivables) or subject to legal/contractual requirements to be maintained intact. Restricted fund balances are subject to limitations imposed by external sources such as creditors, grantors, laws or regulations. Committed fund balances are designated for specific purposes through formal action of the government's highest level of decision making authority (City Council). Assigned fund balances reflect the government's intent to be used for specific purposes, but are neither restricted nor committed. Unassigned fund balance is not restricted, committed, or assigned to a specific purpose within the General Fund.

    The details of fund balance classifications for the General Fund as reported on the Balance Sheet – Governmental Funds are as follows:

Nonspendable:		
* Prepaid postage		2,888
Restricted:		
* Health Self-Insured Administration Reserves, as required by Washington State Administrative Code		66,296
Committed:		
* Set aside for the payment of LEOFF Plan 1 insurance premiums and medical expenses	117,207	
* Unemployment Compensation Reserve	40,488	
* Technology Replacement Reserve	132,786	
* General Fund Contingency Reserve	753,173	1,043,654
Assigned:		
* General Fund Operating Reserve		2,288,672
Unassigned		2,076,068
Total General Fund Fund Balance		**$ 5,477,577**

The details of fund balance classifications for the Major Special Revenue Funds as reported on the Balance Sheet – Governmental Funds are as follows:

	Restricted
Emergency Medical Services Fund	
Voter-approved tax levy revenues restricted for emergency medical services	130,150
Real Estate Excise Tax I	
Real estate excise taxes restricted by law for capital projects	4,267,855
	$ 4,398,005

The details of fund balance classifications for the other non-major governmental funds as reported on the Balance Sheet – Governmental Funds are as follows:

	Restricted	Assigned
Seizure and forfeiture of proceeds from the sale of illegal drugs: use is restricted by state law	27,858	
Hotel/Motel Lodging Tax Fund For use in the promotion of tourism	185,820	
Motor vehicle fuel excise tax revenues restricted for construction, improvement or repair of streets	115,660	
Restricted bond proceeds	7,228	
Park mitigation fees restricted for park development	118,453	
Transportation impact fees restricted for transportation facilities	92,084	
Real Estate Excise taxes restricted by law for capital projects	552,643	
Maintenance of streets	123,518	
Assigned for construction of City Facilities		219,034
	$ 1,223,264	**$ 219,034**

Fund balances classified as committed can only be used for specific purposes as prescribed by the City Council via a resolution. Modifications to committed funds must also be made by resolution. Assigned fund balances are also designated by action of the City Council.

When both restricted resources and other resources (i.e., committed, assigned, and unassigned) can be used for the same purposes, it is the City's practice to use restricted resources first. Furthermore, when committed, assigned, and unassigned resources can be used for the same purpose, it is the City's practice to use committed resources first, assigned second, and unassigned last.

F. Other

1. Use of Estimates
   The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the statement of net position/balance sheet and the reported amounts of revenues and expenses/expenditures during the reporting period. Actual results can differ from those estimates.

2. Adoption of new Accounting Pronouncements
   The City implemented the following Governmental Accounting Standards Board pronouncement for the fiscal year ended December 31, 2013:

   - **GASB Statement No. 65 –** In March 2012, GASB issued Statement 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify certain items that were previously reported as assets and liabilities. The requirements of this Statement are effective for years beginning, after December 15, 2012 and were implemented during 2013. Refer to Note 18 for additional information.

Note 2 – Stewardship, Compliance and Accountability

The City maintains the following reserves and minimum fund balance policies:

Contingency Fund Reserve: $1,000,000 to provide a financial cushion to cover revenue shortfalls resulting from unexpected economic changes or recessionary periods or to provide resources in the event of major unplanned expenditures the City could face as a result of natural disaster, for example. At December 31, 2013, the fund balance of this Fund, which is combined with the General Fund for financial reporting purposes, is $753,173 due to City Council approval of expenditures during 2013 for emergency repairs totaling $246,827. Management intends to increase this to the full $1,000,000 at its earliest opportunity.

General Fund Operating Reserves: An amount equal to two months of General Fund budgeted operating expenditures, to provide for adequate cash flow, budget contingencies, and insurance reserves. This reserve is part of the General Fund and is not a separate Fund combined with the General Fund for financial reporting purposes. At December 31, 2013 the balance of this reserve is $2,288,672.

Hotel/Motel Lodging Tax Reserves: The City maintains a Hotel/Motel Lodging Tax Reserve Fund in an amount equal to one prior complete year's revenues in ending fund balance. This Fund is combined with the General Fund for financial reporting purposes. The fund balance of the Hotel/Motel Lodging Tax Fund is reported as restricted - allowable expenditures are prescribed by state law. At December 31, 2013, the balance of this reserve fund is $185,820. Staff and the Lodging Tax Advisory Committee monitor the ending balance in this Reserve.

Technology Replacement Reserves: For the replacement of entity-wide computer hardware, software, or telephone equipment identified in the City's Technology Replacement listing. The required level of reserve is equivalent to each year's scheduled replacement costs. This Fund is combined with the General Fund for financial reporting purposes. At December 31, 2013, the balance of this reserve is $132,786. Staff monitors the ending balance in this Reserve.

Health Self-Insured Administration Reserves: To provide Washington State mandated reserves for the City's self-insured dental and vision benefits for City employees; equivalent to 16 weeks of budgeted expenditures. This Fund is combined with the General Fund for financial reporting purposes. At December 31, 2013, the balance of this reserve is $66,296. Staff monitors the ending balance in this Reserve.

Equipment and Vehicle Replacement Reserves: To provide for the replacement of vehicles and equipment identified in the City's equipment replacement listing. The required level of reserve in this internal service fund equals each year's scheduled replacement costs. Contributions are made through assessments to the using Funds calculated on a per asset basis. At December 31, 2013, ending net position in the Equipment Replacement Fund totaled $4,634,617. Staff monitors the ending balance in this Reserve.

Surface Water Management Fund Reserves: The City maintains an operating reserve within the Surface Water Management Fund, an enterprise fund, in an amount equal to no less than 20% of budgeted operating revenues. At December 31, 2013, ending net position in this fund totaled $5,871,996.

Note 3 – Deposits and Investments

Deposits

The City's deposits and certificates of deposit are entirely covered by federal depository insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC).

Investments

As of December 31, 2013, the City had the following investments:

Investment Type	Fair Value	Weighted Average Maturity (Years)
12-Month Certificate of Deposit (CD)	$1,006,320	1.0
Local Government Investment Pool	11,654,186	0.0
Total Fair Value	**$12,660,506**	

The Local Government Investment Pool (LGIP) is operated by the Washington State Treasurer and is comparable to a Rule 2a-7 money market fund recognized by the Securities and Exchange Commission. Rule 2a-7 funds are limited to high quality obligations with limited maximum and average maturities, the effect of which is to minimize both market and credit risk. The pool is subject to oversight by the Washington State Auditor's Office and also subject to a financial audit by an independent auditor.

All investments in the LGIP are recorded at cost which is equivalent to fair value. The fair value of the City's position in the pool is the same as the value of the pool shares.

Interest Rate Risk

The City manages its exposure to declines in fair values by limiting the weighted average maturity of its investments portfolio to three years or less. Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than five years from the date of purchase. Reserve funds may be invested in securities maturing in more than five years if the maturity of such investment is made to coincide as nearly as practicable with the expected use of funds.

Credit Risk

As required by state law, all City investments are obligations of the U.S. Government, U.S. agency issues, obligations of the State of Washington, repurchase agreements, banker's acceptances, the Washington State Local Government Investment Pool, County Investment Pool, and time certificates of deposit with authorized Washington State banks.

The Washington State Local Government Investment Pool is operated in a manner consistent with the SEC's Rule 2a-7 of the Investment Act of 1940, and is unrated.

Custodial Credit Risk – Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the City's deposits may not be returned to it. All City deposits are insured by the Federal Depository Insurance (FDIC) up to $250,000. All deposits not covered by FDIC insurance are covered by the Public Deposit Protection Commission (PDPC) of the State of Washington for amounts over $250,000.

The PDPC is a statutory authority established under Washington State Law Revised Code of Washington (RCW) chapter 39.58. It consists of multiple financial institution collateral arrangement that provides for additional assessments against members of the pool on a pro rata basis up to a maximum of 10 percent of each institution's public deposits. Provisions of RCW 39.85 section 60 authorize the PDPC to make pro-rata assessments in proportion to the maximum liability of each such depository as it existed on the date of loss.

Custodial Credit Risk – Investments

For investments, this is the risk that in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. For all of 2013, the City invested only in the Washington State Local Government Investment Pool.

Concentration of Credit Risk

Concentration risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The City limits its exposure to concentration risk by investing in U.S. government obligations or U.S. government agency securities.

The maximum to be invested in any one issuer is as follows:

Security Type	Portfolio Max.
Certificate of Deposit (CD)*	90%
U.S. Treasuries	90%
U.S. Agencies	90%
State of WA Bonds	20%
Local Gov't Bonds	10%
State Pool (LGIP)	100%

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

Financial Statements	Governmental Activities	Business-Type Activities	Total Primary Govt.	Fiduciary Funds	Total
Cash and Cash Equivalents	$13,203,971	$1,235,319	$14,439,290	$33,235	$14,472,525
	$13,203,971	$1,235,319	$14,439,290	$33,235	$14,472,525

Note 4 – Property Taxes

As prescribed by GASB Statement No. 34, property taxes are recognized as revenue in the government-wide financial statements when an enforceable legal claim has arisen. Therefore, the City recognizes revenue and a receivable for the entire tax levy in the year it was levied. No allowance for uncollectible accounts is established because delinquent taxes are considered fully collectible. For governmental fund financial statements, the property tax revenues not collected within 60 days of the year end are recorded as unearned revenue.

The county treasurer acts as an agent to collect property tax 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 installments payments is 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 tax is recorded as a receivable and revenue when levied. Property tax collected in advance of the fiscal year to which it applies is recorded as deferred inflow and recognized as revenue of the period to which it applies. No allowance for uncollectible tax is established because delinquent taxes are considered fully collectible. Prior year tax levies were recorded using the same principle, and delinquent taxes are evaluated annually.

The City may levy up to $3.375 per $1,000 of assessed valuation for general governmental services, subject to two limitations:

Washington State law (RCW 84.55.010) limits the growth of regular property taxes to 6 percent (6%) per year, after adjustments for new construction. If the assessed valuation increases by more than 6 percent (6%) due to revaluation, the levy rate will be decreased.

The Washington State Constitution limits the total regular property taxes to 1 percent (1%) of assessed valuation or $10 per $1,000 of value. If the taxes of all districts exceed that amount, each is proportionally reduced until the total is at or below the 1 percent (1%) limit.

Special levies approved by the voters are not subject to the limitations listed above.

Note 5 – Capital Assets

Capital asset activity for the year ended December 31, 2013 is as follows:

Governmental Activities	**2013 Beginning Balance**	**Increases**	**Decreases**	**2013 Ending Balance**
Capital assets, not being depreciated:				
Land	24,354,240	1,872,745	0	26,226,985
Right of way	10,580,181	0	0	10,580,181
Art Collection	183,890	8,799	0	192,689
Construction in Progress	5,190,661	0	(228,142)	4,962,519
Total capital assets, not being depreciated:	40,308,972	1,881,544	(228,142)	41,962,374
Capital assets, being depreciated:				
Buildings	27,946,242	5,777	0	27,952,020
Other Improvements	8,728,260	935,429	(17,813)	9,645,876
Machinery and Equipment	9,074,609	543,830	(618,500)	8,999,939
Infrastructure	264,661,136	0	0	264,661,136
Total capital assets being depreciated:	310,410,247	1,485,037	(636,313)	311,258,971
Less accumulated depreciation for:				
Buildings	(4,743,997)	(793,415)	0	(5,537,413)
Other Improvements	(2,405,487)	(649,469)	6,145	(3,048,811)
Machinery and Equipment	(4,640,891)	(893,943)	590,438	(4,944,396)
Infrastructure	(158,240,995)	(476,374)	0	(158,717,368)
Total accumulated depreciation:	(170,031,370)	(2,813,202)	596,583	(172,247,989)
Total capital assets, being depreciated, net:	140,378,877	(1,328,165)	(39,730)	139,010,982
Governmental activities capital assets, net:	180,687,848	553,379	(267,872)	180,973,356

Capital assets of the internal service funds are included in the Governmental Activities table above. Detailed activity information for these assets is as follows:

Internal Service Funds Capital Assets	2013 Beginning Balance	Increases	Decreases	2013 Ending Balance
Capital assets, not being depreciated:				
Construction in Progress	25,542	1,135,776	0	1,161,318
Capital assets, being depreciated:				
Buildings	14,234	2,870	0	17,105
Other Improvements	8,040	44,715	0	52,755
Art Collections	0	8,799	0	8,799
Machinery & Equipment	4,260,462	385,314	(618,500)	4,027,275
Total capital assets being depreciated	4,282,736	441,698	(618,500)	4,105,934
Less accumulated depreciation for:				
Machinery & Equipment	(2,904,478)	(267,829)	590,438	(2,581,869)
Buildings	0	(2,400)	0	(2,400)
Other Improvements	0	(30,810)	0	(30,810)
Total accumulated depreciation:	(2,904,478)	(301,040)	590,438	(2,615,079)
Total capital assets, being depreciated, net:	1,378,258	140,659	(28,062)	1,490,855
Internal Service Funds Assets, Net:	1,403,800	1,276,434	(28,062)	2,652,173

Business-type Activities	2013 Beginning Balance	Increases	Decreases	2013 Ending Balance
Capital assets, not being depreciated:				
Land	150,000	0	0	150,000
Construction in Progress	740,108	99,334	0	839,443
Total capital assets, not being depreciated:	890,108	99,334	0	989,443
Capital assets, being depreciated:				
Other Improvements	3,445,943	19,070	0	3,465,013
Other Improvements - Contractor Contributions	2,805,470	0	0	2,805,470
Machinery and Equipment	219,664	0	0	219,664
Total capital assets being depreciated:	6,471,076	19,070	0	6,490,146
Less accumulated depreciation for:				
Other Improvements	(1,984,483)	(280,273)	0	(2,264,755)
Other Improvements Contractor Contributions	(612,722)	(37,687)	0	(650,409)
Machinery and Equipment	(85,752)	(15,185)	0	(100,936)
Total accumulated depreciation:	(2,682,956)	(333,145)	0	(3,016,100)
Total capital assets, being depreciated, net:	3,788,121	(314,075)	0	3,474,046
Business activities capital assets, net:	4,678,229	(214,740)	0	4,463,489

As of January 1, 2012, the City changed from the Depreciation approach to the Modified approach in calculating depreciation of streets. GASB No. 37 permits this change in accounting estimate to be applied prospectively. Therefore, streets will continue to be reported at cost less accumulated depreciation at the time the Modified approach was adopted.

Depreciation expense was charged to functions of the primary government as follows in the government-wide financial statements:

Governmental Actvities	
General Government	476,198
Public Safety	499,255
Economic Environment	8,941
Culture and Recreation	1,160,127
Transportation	668,680
Total Depreciation Expense - Governmental Activities	$ 2,813,202
Business-Type Activities	
Surface Water	333,145
Total Depreciation Expense - Business-Type Activities	$333,145

<u>Construction Commitments</u>

The City has active construction projects as of December 31, 2013. At year end, the City's commitments under construction contracts are as follows:

	Spent to Date	Remaining Commitment
Governmental		
61st Place Retaining Wall Failure	158,625	947,500
School Zone Flasher	36,345	31,000
SR 526 Bike-Ped Path to Boeing	74,805	215,820
Business Type		
2nd Street Storm System Realignment	16,619	130,000
61st Place Retaining Wall Failure	-	125,000
Decant Station Roof/Vault	21,334	100,000
Smuggler's Gulch Stormwater Project	189,183	1,143,817
	$ 496,911	2,693,137

Note 6 – Retirement and Pension Plans

Substantially all City of Mukilteo full-time and qualifying part-time employees participate in one of three 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; employees of legislative committees; employees of district and municipal courts, 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.

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 the age of 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) was 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 was 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 Early Retirement Reduction Factor (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 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 1,176 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2012:

Retirees and Beneficiaries Receiving Benefits	82,242
Terminated Plan Members, Vested	30,515
Active Plan Members, Vested and Nonvested	150,590
Total	**263,347**

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 at 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. As a result of the implementation of the Judicial Benefit Multiplier Program in January 2007, a second tier of employer and employee rates was developed to fund, along with investment earnings, the increased retirement benefits of those justices and judges that participate in the program.

The methods used to determine the contribution requirements are established under state statute in accordance with 33 Chapters 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2013, are as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer	9.21 %**	9.21%**	9.21%***
Employee	6.00 %****	4.92%****	*****

* The employer rates include the employer administrative expense fee currently set at 0.18%.
** The employer rate for state elected officials is 13.73% for Plan 1 and 9.21% for Plan 2 and Plan 3.
*** Plan 3 defined benefit portion only.
**** The employee rate for state elected officials is 7.50% for Plan 1 and 4.92% for Plan 2.
***** Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

Both the City of Mukilteo and its employees made the required contributions. The City's required contributions for the years ended December 31 were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
2013	$12,832	$223,056	$37,339
2012	$8,998	$181,517	$45,257
2011	$6,418	$157,861	$44,076

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

<u>Plan Description</u>
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 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	2.0%
10 but less than 20 years	1.5%
5 but less than 10 years	1.0%

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.

GASB Statement 27 does not require the number of participating employers and members to be presented in the notes to the financial statements. The information has been provided here so it can be included in the notes if desired.

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, 2012:

Retirees and Beneficiaries Receiving Benefits	10,189
Terminated Plan Members, Vested	689
Active Plan Members, Vested and Nonvested	16,906
Total	**27,784**

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 could be changed by statute.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2012, are as follows:

	LEOFF Plan 1	LEOFF Plan 2
Employer*	0.18%	5.23%
Employee	0.00%	8.41%
State	N/A	3.36%

* The employer rates include the employer administrative fee of 0.18%

Both the City of Mukilteo and the employees made the required contributions. The City's required contributions for the years ended December 2013 were as follows:

	LEOFF Plan 1	LEOFF Plan 2
2013	$0	$263,090
2012	$0	$260,068
2011	$0	$250,820

Note 7 – Risk Management

The City of Mukilteo 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 162 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 in the 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 is 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 $750,000 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.

An investment committee, using investment brokers, produces additional revenue by investment of WCIA's assets in financial instruments which comply with all State guidelines.

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.

Regarding workers' compensation, RCW Title 51 requires the City to ensure payment of benefits to employees for job-related injuries and diseases. The City participates in the State of Washington Workers' Compensation program. Premiums are based on individual employer's reported payroll hours and insurance rates based on each employer's risk classification and past experience.

The City is self-insured for dental and vision benefits for City staff. Per State of Washington Office of Financial Management guidelines, the City is required to maintain a reserve balance in an amount not less than eight weeks of program expenses. An additional contingency reserve established by the City Council is recommended but not required. The City currently sets aside eight weeks plus a contingency of eight additional weeks for a total of sixteen. At December 31, 2013, a total of $66,296 is set aside for the self-insured reserves as presented in Note 12.

Note 8 – Long-Term Debt

The City may issue two types of general obligation bonds, Limited Tax General Obligation bonds (LTGO) and Unlimited Tax General Obligation bonds (UTGO) to provide funding for the acquisition and construction of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the City. During 2009 the City authorized the issuance of a Limited Tax General Obligation (LTGO) bond in the amount of $12,585,000 for construction of a new community center. This debt was issued with a premium of $348,159 and issuance costs of $129,398 (issuance costs include underwriter's discount, bond counsel fees, rating agency fees, registration costs, printing expenses, and any miscellaneous costs deemed necessary). As discussed further in Note 19, the balance of deferred bond issuance costs of $107,832 as of December 31, 2012 have been written off pursuant to GASB Statement No. 65. This debt has been issued for the general government and will be repaid with Real Estate Excise Taxes (REET) revenues.

At December 31, 2013, the City had the following general obligation bonds outstanding:

Purpose	Original Amount Issued	Date of Original Issue	Date of Final Maturity	Interest Rates	Amount of Installments	Balance 12/31/13
General Government						
2009 LTGO Bonds - Community Center	$ 12,585,000	09/10/09	12/01/29	3.54%	$84,301 - $909,313	$ 10,685,000

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

	Governmental Activities		
Year Ending December 31	Principal	Interest	Total Requirements
2014	510,000	395,962	905,962
2015	525,000	382,613	907,613
2016	545,000	363,962	908,962
2017	560,000	347,613	907,613
2018	580,000	328,963	908,963
2019-2023	3,215,000	1,322,000	4,537,000
2024-2028	3,880,000	652,000	4,532,000
2029	870,000	34,800	904,800
Total	$ 10,685,000	$ 3,827,913	$ 14,512,913

Rebatable Arbitrage

Arbitrage occurs when the City invests funds borrowed at tax-exempt rates of interest in higher yielding taxable securities. These interest earnings in excess of interest expense must be remitted to the federal government. At the fund level, the City recognizes this liability only when it is due and payable. The City had no arbitrage excess earnings liability in 2013.

Note 9 – Leases

Operating Leases

During 2011 the City entered into a non-cancelable operating lease for a police department vehicle. The lease payments totaled $5,455 for this year. The final lease payment will be made in 2015. The future minimum lease payments are as follows:

Year Ending December 31	Amount
2014	$ 5,455
2015	5,455
Total	$ 10,910

Note 10 – Changes in Long-Term Liabilities

For the year ended December 31, 2013, changes in long-term liabilities are as follows:

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year	Due Beyond One Year
Governmental Activities						
Bonds Payable:						
Series 2009 Bonds, $12,585,000 Issued	$11,180,000	$0	($495,000)	$10,685,000	510,000	$10,175,000
Unamortized Bond Premium	290,133	0	(17,408)	272,725	17,408	$255,317
Total Bonds Payable:	11,470,133	0	(512,408)	10,957,725	527,408	10,430,317
OPEB Payable	125,515	14,195	0	139,710	0	$139,710
Compensated Absences	712,528	0	(20,352)	692,176	617,725	$74,451
Governmental Activity Long-Term Liabilities:	$12,308,176	$14,195	($532,760)	$11,789,611	$1,145,133	$10,644,478

The costs of other post-employment benefits are charged to the General Fund. The costs of compensated absences for governmental activities are charged in the same manner as employee salaries, and are expenditures of the General, Street, Recreation and Cultural Services Center, and Emergency Medical Services funds.

Note 11 – Contingencies and Litigation

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

The City participates in a number of federal 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. City management believes that such disallowances, if any, will be immaterial.

Note 12 – Restricted Net Position

Restrictions on net position are imposed in three ways: (1) by external sources, (2) by law via the constitution, and, (3) by law through enabling legislation. Enabling legislation allows the City to assess, levy or otherwise mandate payment of resources from external providers and includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. The government-wide statement of net position reports total restricted net position of $5,456,340. Details regarding the nature of restricted net position are as follows:

Nonspendable Prepaid Postage	2,888
Real Estate Excise Tax 1, restricted for capital improvements	4,267,855
Emergency medical services tax levy funds, to provide advanced life support services	130,150
Health self-insured administration reserves, as required by Washington State Administrative Code	66,296
Motor vehicle fuel tax funds, restricted for maintenance and construction of streets	123,518
Transportation impact fees restricted for transportation capital improvements	92,084
Real Estate Excise Tax 2, restricted for capital improvements	552,643
LTGO Bond Fund	7,228
Seized and forfeited proceeds of illegal drug sales, expenditures and disbursements are prescribed by state law	27,858
Hotel/Motel lodging tax funds, restricted for the promotion of tourism	185,820
Total Restricted Net Position	**$ 5,456,340**

Note 13 – Interfund Balances and Transfers

Transactions that would be treated as revenues or expenditures if they involved organizations external to the governmental unit are accounted for as revenues or expenditures in the funds involved. Transactions which constitute reimbursements of a fund for expenditures initially made from that fund, which are properly applicable to another fund, are recorded as expenditures in the reimbursing fund and as reductions of the expenditure in the fund that is reimbursed. Transfers between funds are included in the results of both governmental and proprietary funds (as other sources/uses in governmental funds and as non-operating revenues/expenses in proprietary funds).

Direct overhead costs charged by the General Fund to the Surface Water Management Fund are not eliminated from the Statement of Activities.

Transfers to support the operations of other funds are recorded as **Transfers In** or **Transfers Out** from the appropriate funds and are classified as **Other Financing Sources or Uses**.

Loans between funds are classified as **Due from Other Funds** and **Due to Other Funds** on the governmental funds balance sheet. As of December 31, 2013, there was an interfund loan from the Equipment Replacement Fund to the Hotel/Motel Lodging Tax Fund for the purchase of a visitor's center building. Details of interfund loan activity are presented in the table below.

Interfund transfers are the flow of assets without a reciprocal return of assets, goods or services in return. The City uses transfers to:

- Move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them.

- Move receipts restricted to debt service from the funds collecting the receipts to the debt service fund as debt service payments become due.

- Use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

Transfers and Interfund loan activity together with loan balances as of December 31, 2013 are as follows:

Transfers In		Transfers Out	
LEOFF I Reserve	25,000	General Fund	25,000
Street Fund	430,800	General Fund	170,000
Recreation & Cultural Services Fund	225,502	General Fund	430,800
Technology Replacement Fund	170,000	General Fund	225,502
LTGO Bond Fund	444,530	General Fund	450,000
LTGO Bond Fund	69,800	Transportation Impact Fee Fund	250,000
REET I Fund	250,000	REET I Fund	444,530
Facilities Maintenance Fund	450,000	REET II Fund	69,800
Total Transfers In	**2,065,632**	**Total Transfers Out**	**2,065,632**

Due From Other Funds		Due to Other Funds	
General Fund		**Paine Field Emergency Reserve Fund**	
Loan Receivable - Beginning Balance	0	Loan Payable - Beginning Balance	0
2013 Loan Made	30,350	2013 Loan Received	30,350
Ending Balance	30,350	Ending Balance	30,350
Equipment Replacement Reserve Fund		**Hotel/Motel Lodging Tax Fund**	
Loan Receivable - Beginning Balance	142,569	Loan Payable - Beginning Balance	142,569
Principal Repayment Received	(70,000)	Principal Repayment Disbursed	(70,000)
Ending Balance	72,569	Ending Balance	72,569
Total Due from Other Funds	**102,919**	**Total Due to Other Funds**	**102,919**

~Note that the Paine Field Emergency Reserve Fund is combined with the General Fund for financial statement presentation purposes.

CITY OF MUKILTEO

Note 14 – Receivable and Payable Balances

Receivables at December 31, 2013, are as follows:

Activities	Accounts Receivable	Taxes Receivable	Total
Governmental Activities			
General Fund	$246,188	985,301	1,231,489
Recreation & Cultural Services	70	0	70
Emergency Medical Services	111,536	14,786	126,322
Real Estate Excise Tax I Fund	33,374	22,760	56,134
Other Governmental Funds	57,803	134,517	192,320
Total Governmental Activities	$448,971	1,157,364	1,606,335
Business-Type Activities			
Surface Water Fund	126,953	142,028	268,981
Total Business-Type Activities	$126,953	142,028	268,981

Payables at December 31, 2013, are as follows:

Activities	Accounts Payable	Wages Payable	Total
Governmental			
General Fund	$165,826	434,513	600,339
Recreation & Cultural Services	13,500	36,594	50,094
Emergency Medical Services	63,159	73,362	136,521
Real Estate Excise Tax I Fund	1,914	0	1,914
Other Governmental Funds	74,784	8,210	82,994
Total Governmental	$319,183	552,679	871,862
Business-Type Activities			
Surface Water Fund	15,828	79,963	$95,791
Internal Service Funds	159,564	8,944	168,508
Total Business-Type	$175,392	88,907	264,299

Note 15 – Joint Ventures

Snohomish County Emergency Radio System [SERS]

The City entered into a single joint venture with Snohomish County and other local governments in the establishment and operations of the Snohomish County Emergency Radio System (SERS). The purpose of the venture is to equip and operate a radio system primarily for the use of public safety agencies. Control of this joint venture is shared equitably by the controlling organizations. This entity is reported as a governmental joint venture. The City of Mukilteo's share of the assets and equity as of December 31, 2013 is $249,652.

The Snohomish County Emergency Radio System is considered a separate reporting entity. Each participant's share of authority is defined by the terms of the enabling charter. Oversight is provided by the City Council and Board of County Commissioners and is divided between the County and the participating cities. Separate financial statements can be obtained from Snohomish County Emergency Radio System, 1121 SE Everett Mall Way, Suite 210, Everett, WA 98208.

Southwest Snohomish County Public Safety Communications Agency [SNOCOM]

The City participates in a single joint venture with other local governments in the "*Southwest Snohomish County Public Safety Communications Agency,*" (SNOCOM) a public non-profit corporation formed in 1971 and incorporated in 2014. The purpose of SNOCOM is to provide public safety communications, records retention, and other board approved functions.

SNOCOM was established via an interlocal agreement between the City of Mukilteo, six other cities and Snohomish County Fire District 1 all located within the county. Each member city and the Fire District provides voting members to the SNOCOM board of directors. The purpose of SNOCOM is to provide communications and dispatching for public health and safety services in Southwest Snohomish County.

The Cities of Brier, Edmonds, Lynnwood, Mill Creek, Mountlake Terrace, Mukilteo, Woodway, and Fire District 1 are jointly responsible for the financing of SNOCOM. The interlocal agreement details clearly an allocation formula that determines each member's share in the joint venture and its reported equity interest in their respective financial statements. It incorporates each agency's population, assessed value and usage of 911 calls for service. Each member provides a voting representative to SNOCOM's governing board of directors. The SNOCOM board has the authority to approve project expenditures and adopt SNOCOM budget.

At December 31, 2013, the City owned an equity interest in the SNOCOM joint venture of $453,528. This value has been recorded in the government wide statements as an asset for the year ended December 31, 2013. The equity interest is adjusted to the extent of revenue and expenditure transactions occurring between the City of Mountlake Terrace and SNOCOM as recorded in the City of Mountlake Terrace's financial records. The City of Mountlake Terrace, which acts as the entity's fiscal agent under the Interlocal Agreement for Financial Services signed on November 25, 2009, prepares the unaudited financial information. Separate financial statements for the Snohomish County Public Safety Communication Agency can be obtained from the City of Mountlake Terrace, Finance Department, and 6100 219th St SW, Suite 200, Mountlake Terrace, WA 98043.

AHA – Alliance for Housing Affordability

In September 2013, the City of Mukilteo joined the cities of Edmonds, Everett, Granite Falls, Lake Stevens, Lynnwood, Marysville, Mill Creek, Mountlake Terrace, and Snohomish, the Town of Woodway, and Snohomish County to establish the Alliance for Housing Affordability (AHA). The agreement was amended in May 2014 to add the City of Arlington and in June 2014 to add the City of Stanwood.

The purpose of AHA is to cooperatively formulate affordable housing goals and policies and to foster efforts to provide affordable housing by providing expertise and information to member jurisdictions. Operating funding is provided by the member cities.

AHA is governed by a Joint Board composed of an elected official from each member. The Joint Board is responsible for review and approval of all budgetary, financial, policy, and contractual matters. The Board is assisted by an administrative staff housed at the Housing Authority for Snohomish County. Fiscal agent duties are performed by the City of Mountlake Terrace.

Each member city is responsible for contributing operating revenues as determined from the AHA annual budget. Contributions from the member cities are based on each member's population. A grant from the Gates Foundation provided $50,000 to assist with the first two years of organizational start-up. The City of Mukilteo’s equity share to date is:

Year	AHA Budget	Mukilteo’s Share	Mukilteo’s Share as % of AHA Budget
2013	$89,850	$1,209	1.34%

Members withdrawing from the agreement relinquish all rights to any reserve funds, equipment, or material purchased. Upon dissolution, the agreement provides for distribution of net assets among the members based on the percentage of the total annual contributions during the period of the Agreement paid by each member.

Budget monitoring information, as well as financial statements, can be obtained from Finance Director, City of Mountlake Terrace; 6100 219th Street SW, Mountlake Terrace WA 98043 or from the Alliance for Housing Affordability, 12625 4th Ave W, Suite 200, Everett, WA 98204.

Note 16 – Other Postemployment Benefit (OPEB) Plans

Plan Description

In addition to pension benefits per state law, the City provides defined benefit, post-retirement health care benefits to LEOFF I employees who are 50 years of age with twenty years of service or on disability leave. This system is a closed, single-employer, defined benefit pension system. Only two former retired public safety employees are eligible for this benefit. The City pays 100% of the cost of medical insurance. Premera Blue Cross is the underwriter. After age 65, benefits are coordinated with Medicare. Any amount not paid by the underwriter is reimbursed by the City.

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. As noted in the Required Supplementary Information (RSI), the annual covered payroll is $0 since no current employees or retirees are eligible for the benefit other than the two retirees noted above. The Unfunded Actuarial Accrued Liability as a percentage of covered payroll is 0%.

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 twenty years as of June 30, 2009. The following table shows the components of the City's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the City's net OPEB. For 2013, the City has fully funded the OPEB obligation.

	2013
Annual required contribution	$54,503
Interest on net OPEB obligation	5,648
Adjustment to annual required contribution	(11,687)
Annual OPEB cost (expense)	48,464
Contributions made	(34,269)
Change in NPO	14,195
Net OPEB Obligation - Beginning of Year	125,515
Net OPEB Obligation - End of Year	$139,710

The City's OPEB costs, the percentage of OPEB cost contributed to the plan, and the net OPEB obligation for 2013 and the two preceding years are as follows:

Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
12/31/2011	$56,302	58.2%	$32,770
12/31/2012	$51,514	68.5%	$35,284
12/31/2013	$48,464	70.7%	$34,269

Funded Status and Funding Progress

As of June 30, 2009, the most recent actuarial valuation date, the plan was 0% funded. The accrued liability for the 2013 benefits was $585,340 and the actuarial value of the assets was $0 resulting in an UAAL of $585,340. 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.

<u>Actuarial Methods and Assumptions</u>
We used the alternative measurement method permitted under GASB Statement No. 45. A single retirement age of 56.24 was assumed for all active members for the purpose of determining the AAL and normal cost. Retirement, disability, 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 (OSA). Healthcare costs and trends were determined by Milliman and used by OSA in the state-wide LEOFF 1 medical study performed in 2011. The results were based on grouped data with 4 active groupings and 4 inactive groupings. The actuarial cost method used to determine the AAL was Projected Unit Credit. The AAL and 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.

Significant actuarial assumptions used in the valuation include:

- 5.0 percent investment return, compounded annually
- The medical inflation trend starts at 9.0% in 2007 and decreases to 5.0% in 2015. It remains at 5.0% after 2015
- The expected long-term care inflation trend is 4.5% for all years.

Note 17 – Prior Period Adjustments

In 2013, two errors were discovered and corrected that affected the beginning equity of Internal Service Funds. First, fixed assets, net of depreciation, purchased in prior years by the ISF but recorded as general fixed assets are now properly recorded as assets of the ISF. Second, ISF depreciation expense for the years 2008-2012 was not recorded. Correction of these two errors resulted in a net reduction to beginning equity of $19,552.

Note 18 – Change in Accounting Principle

Pursuant to GASB 65 which is effective for years beginning after December 15, 2012, debt issuance costs, except for any portion related to prepaid insurance costs, are to be recognized as an expense in the period incurred. Prepaid insurance costs are to be reported as an asset and amortized to expense over the duration of the related debt.

In 2009, the City issued Limited Tax General Obligation General Obligation bonds in the amount of $12,585,000 for construction of a new community center. Bond issuance costs of $123,398 were capitalized as an asset – deferred bond issuance costs – to be amortized during the duration of the debt ending in 2029. None of the issuance costs pertained to prepaid insurance.

As of December 31, 2012, deferred bond issuance costs yet to be amortized totaled $114,302. Accordingly, beginning net position on the Statement of Activities has been reduced to reflect the write-off of the remaining asset balance.

Note 19 – Deferred Compensation

The City provides to all full-time employees a deferred compensation plan under *Section 457of the Internal Revenue Code.* Under this program, employees may voluntarily elect to defer a portion of their salary to future years to a maximum of $17,500 per year; with no required contributions from the City. The City does not exercise any control or fiduciary responsibility over the plan's assets. Therefore, the assets, liabilities and transactions are not included in the City's financial statements

Condition Assessment and Preservation of Infrastructure Eligible for Modified Accounting Approach

Streets:

The City of Mukilteo has taken a pragmatic approach with pavement management practices associated with public streets. The City performed a city wide pavement condition assessment in 2007 and updated the Pavement Management Program (PMP). The Pavement Management Program provides a management tool to inventory street pavement, assess pavement condition, record historical surface improvements, forecast street budget requirements, and view impacts of funding on City-wide pavement condition over time. The Pavement Management Program will be updated in 2015 to include a menu of techniques and updated funding plan.

The PMP is also a tool for analyzing pavement conditions and recommending rehabilitation strategies based in funding levels. A major component of the PMP is the Pavement Condition Index (PCI). The City's surface rehabilitation strategy is based on PCI scores and the corresponding condition category. Streets with PCI scores over 90 are considered to be "excellent" condition and would require no resurfacing treatment. Streets with PCI scores from 70 to 89 are considered "very good", however, may require cracks to be sealed and a single chip seal surface treatment. Streets with scores from 50 to 69 are considered "good" and may require patching, crack sealing, single chip seal or double chip seal surface treatment. Streets with PCI scores between 25 and 49 are considered "poor" and generally require a thick asphalt overlay. Street with scores below 25 are "very poor" and are in need of surface reconstruction.

The City completed a pavement condition assessment in 2007 and again in 2014. The City recognizes that to be eligible for the modified approach for reporting infrastructure and related depreciation, it is required to comply with the reporting requirements of Governmental Accounting Standards Board Statement No. 34. The City recognizes that for 2013 it has not complied with the requirement to present, as part of the RSI, infrastructure condition performed at least every three years and the estimated annual amount to maintain and preserve the infrastructure. Additional disclosures are required as well.

A summary of the assessment completed in 2007 is shown in the table below:

Table 1

Overall Pavement Condition Assessment 2007		
Condition Rating	**Miles**	**Percentage**
Excellent	23.6	38.20%
Very Good	20.4	33.00%
Good	13.1	21.20%
Poor	4.8	7.60%
Very Poor	0	0.00%
Total	**61.9**	**100.00%**

The City street system is broken down into four functional classifications: Arterial, Urban Minor Arterial, Collector, and Residential. There is a State highway (SR 525) which is considered an arterial street that bisects the City: this surface is maintained by WSDOT. The entire pavement system within the City of Mukilteo is composed of approximately 61.9 miles of paved surface and is divided into 405 pavement management segments. To assist in planning the surfacing needs, the City streets were grouped by functional class (Arterial, Urban Minor Arterial, Collector, and Residential). The table below shows the City's pavement mileage by functional classification:

Table 2

Pavement Mileage by Functional Class	
Functional Classification	**Centerline Miles**
Arterial (excluding SR 525 and SR 526)	1.3
Urban Minor Arterial	6.7
Collector	48.9
Residential	5.0
Total	**61.9**

As a general rule, from 2007-2013 the City would perform rehabilitative surface treatments on streets rated down to a PCI of about 60 using chip seals. However, below that score asphalt replacement will generally be needed. Streets in the 60-80 range may have some cracks but generally, more than anything else, will be suffering from oxidation of the top surface. This leads to hairline crack formation which allows the entrance of water into and below the pavement, leading to a shortened pavement life. Chip sealing restores the oxidized surface and seals the pavement to prevent water entrance.

By chip sealing, the expensive street resurfacing cycle is broken where pavement is allowed to degrade to the point that it must be ground off and replaced with new asphalt. Based on the 2007 Pavement Management Program, the common scenario is that a newly paved street, after 7-10 years, will start developing cracks and be crack sealed. Then over the next 7-9 years it would further deteriorate and finally have to be replaced. Chip sealing replaces this cycle with pavement refreshment about 7-10 years into the life, a second chip seal around 14-16 years and a third one around 24-25 years. Sometime after 30 years the pavement can be ground and, possibly, the chip sealing process started over again.

Below is information on actual expenditures incurred in resurfacing and preserving the street system at or above the minimum acceptable condition level from 2009 to 2013.

Table 3

Street Preservation Expenditure History					
Year	**2013**	**2012**	**2011**	**2010**	**2009**
Expended	$360,420	333,419	354,860	295,946	321,618

Schedule of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual

General Fund

For the Year Ended December 31, 2013

	Budgeted Amounts Original	Budgeted Amounts Final	Actual	Variance with Final Budget
REVENUES				
Charges for Services	$ 492,900	$ 492,900	$ 613,791	$ 120,891
Miscellaneous	179,750	181,796	220,866	39,070
Investment Income	12,000	12,000	9,882	(2,118)
Taxes	10,026,300	10,126,300	10,345,228	218,928
Licenses and Permits	1,260,800	1,260,800	1,362,846	102,046
Intergovernmental Revenue	370,660	409,726	363,378	(46,348)
Fines and Forfeitures	189,100	189,100	146,945	(42,155)
Total revenues	12,531,510	12,672,622	13,062,936	390,314
EXPENDITURES				
Current:				
General Government	2,731,950	2,758,031	2,610,306	(147,725)
Public Safety	7,207,025	7,274,518	7,154,811	(119,707)
Physical Environment	222,600	374,100	297,841	(76,259)
Economic Environment	1,036,650	1,048,650	1,008,427	(40,223)
Culture and Recreation	669,610	706,166	694,439	(11,727)
Transportation	-	20,000	77,626	57,626
Capital Outlay	166,550	366,660	237,646	(129,014)
Total expenditures	12,034,385	12,548,125	12,081,096	(467,029)
Excess (deficiency) of revenues over expenditures	497,125	124,497	981,840	857,343
OTHER FINANCING SOURCES (USES)				
Transfer In	205,000	205,000	195,000	(10,000)
Transfers Out	(1,175,800)	(1,213,891)	(1,301,302)	(87,411)
Total other financing source (uses)	(970,800)	(1,008,891)	(1,106,302)	(97,411)
Net change in fund balances	(473,675)	(884,394)	(124,462)	759,932
Fund balances - beginning	5,602,037	5,602,037	5,602,037	-
Fund balances - ending	$ 5,128,362	$ 4,717,643	$ 5,477,575	$ 759,932

The Budget is prepared in accordance with generally accepted accounting principles (GAAP).

Schedule of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual

Recreation & Cultural Services Fund

For the Year Ended December 31, 2013

	Budgeted Amounts			Variance with
	Original	Final	Actual	Final Budget
REVENUES				
Charges for Services	$ 477,710	$ 496,710	$ 473,818	$ (22,892)
Miscellaneous	-	-	1,362	1,362
Investment Income	200	200	324	124
Licenses and Permits	500	500	800	300
Total revenues	478,410	497,410	476,304	(21,106)
EXPENDITURES				
Current:				
Culture and Recreation	684,200	741,291	722,198	(19,093)
Total expenditures	684,200	741,291	722,198	(19,093)
Excess (deficiency) of revenues over expenditures	(205,790)	(243,881)	(245,894)	(2,013)
OTHER FINANCING SOURCES (USES)				
Transfer In	100,000	138,091	225,502	87,411
Total other financing source (uses)	100,000	138,091	225,502	87,411
Net change in fund balances	(105,790)	(105,790)	(20,393)	85,398
Fund balances - beginning	20,393	20,393	20,393	-
Fund balances - ending	$ (85,397)	$ (85,397)	$ (0)	$ 85,398

The Budget is prepared in accordance with generally accepted accounting principles (GAAP).

CITY OF MUKILTEO

Schedule of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual
Emergency Medical Services Fund
For the Year Ended December 31, 2013

	Budgeted Amounts			Variance with
	Original	Final	Actual	Final Budget
REVENUES				
Charges for Services	$ 234,800	$ 234,800	$ 161,430	$ (73,370)
Miscellaneous	2,200	2,200	564	(1,636)
Investment Income	200	200	218	18
Taxes	1,579,220	1,579,220	1,632,320	53,100
Total revenues	1,816,420	1,816,420	1,794,532	(21,888)
EXPENDITURES				
Current:				
Public Safety	1,896,858	1,944,758	1,952,816	8,058
Total expenditures	1,896,858	1,944,758	1,952,816	8,058
Excess (deficiency) of revenues over expenditures	(80,438)	(128,338)	(158,284)	(29,946)
Net change in fund balances	(80,438)	(128,338)	(158,284)	(29,946)
Fund balances - beginning	288,436	288,436	288,436	-
Fund balances - ending	$ 207,998	$ 160,098	$ 130,152	$ (29,946)

Schedule of Employer Contributions without Advanced Funding

FY Ended Dec. 31		Annual OPEB Cost		Annual Contribution	Percent Contributed		Current Year OPEB Obligation		Cumulative OPEB Obligation
2008	$	59,568	$	26,136	43.9%	$	33,432	$	33,432
2009	$	54,688	$	26,192	47.9%	$	28,496	$	61,928
2010	$	52,002	$	28,177	54.2%	$	23,825	$	85,753
2011	$	56,302	$	32,770	58.2%	$	23,532	$	109,285
2012	$	51,514	$	35,284	68.5%	$	16,230	$	125,515
2013	$	48,464	$	34,269	70.7%	$	14,195	$	139,710

Schedule of Funding Progress of Other Post-Employment Benefits

FY Ended Dec. 31	Actuarial Valuation Date		Actuarial Value of Assets		Actuarial Accrued Liability		Unfunded Actuarial Accrued Liability [UAAL]	Funded Ratio		Covered Payroll	UAAL as Percent of Covered Payroll
2008	1/1/2008	$	-	$	639,736	$	639,736	0%	$	-	0%
2009	6/30/2009	$	-	$	604,602	$	604,602	0%	$	-	0%
2010	1/1/2010	$	-	$	590,466	$	590,466	0%	$	-	0%
2011	1/1/2011	$	-	$	648,973	$	648,973	0%	$	-	0%
2012	1/1/2012	$	-	$	609,708	$	609,708	0%	$	-	0%
2013	1/1/2013	$	-	$	585,340	$	585,340	0%	$	-	0%

ABOUT THE STATE AUDITOR'S OFFICE

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

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

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.

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 as well as fraud, state whistleblower and citizen hotline investigations.

The results of our work are widely distributed through a variety of reports, which are available on our website and through our free, electronic subscription service.

We take our role as partners in accountability seriously, and provide training and technical assistance to governments, and have an extensive quality assurance program.

Contact information for the State Auditor's Office	
Deputy Director for Communications	Thomas Shapley Thomas.Shapley@sao.wa.gov (360) 902-0367
Public Records requests	(360) 725-5617
Main telephone	(360) 902-0370
Toll-free Citizen Hotline	(866) 902-3900
Website	www.sao.wa.gov