



**Office of the Washington State Auditor**  
**Pat McCarthy**

# **Financial Statements Audit Report**

## **City of Mercer Island**

**For the period January 1, 2017 through December 31, 2017**

**Published February 25, 2019**

**Report No. 1023295**





## Office of the Washington State Auditor

**Pat McCarthy**

February 25, 2019

Council  
City of Mercer Island  
Mercer Island, Washington

### **Report on Financial Statements**

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

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

Sincerely,

A handwritten signature in cursive script that reads "Pat McCarthy".

Pat McCarthy  
State Auditor  
Olympia, WA

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**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 Mercer Island  
January 1, 2017 through December 31, 2017**

Council  
City of Mercer Island  
Mercer Island, 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 Mercer Island, as of and for the year ended December 31, 2017, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated February 12, 2019.

**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.

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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## 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*.

## 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.



Pat McCarthy

State Auditor

Olympia, WA

February 12, 2019

# INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

## City of Mercer Island January 1, 2017 through December 31, 2017

Council  
City of Mercer Island  
Mercer Island, 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 Mercer Island, as of and for the year ended December 31, 2017, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed on page 9.

### 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 Mercer Island, as of December 31, 2017, 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.

## **Other Matters**

### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and required supplementary information listed on page 9 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. 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 February 12, 2019 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.

A handwritten signature in black ink that reads "Pat McCarthy". The signature is written in a cursive, flowing style.

Pat McCarthy  
State Auditor  
Olympia, WA

February 12, 2019



## **FINANCIAL SECTION**

### **City of Mercer Island January 1, 2017 through December 31, 2017**

#### **REQUIRED SUPPLEMENTARY INFORMATION**

Management's Discussion and Analysis – 2017

#### **BASIC FINANCIAL STATEMENTS**

Statement of Net Position – 2017

Statement of Activities – 2017

Balance Sheet – Governmental Funds – 2017

Statement of Revenues, Expenditures and Changes in Fund Balance – Governmental  
Funds – 2017

Statement of Net Position – Proprietary Funds – 2017

Statement of Revenues, Expenses and Changes in Net Position – Proprietary Funds –  
2017

Statement of Cash Flows – Proprietary Funds – 2017

Statement of Net Position – Fiduciary Funds – 2017

Statement of Changes in Fiduciary Net Position – Fiduciary Funds – 2017

Notes to the Financial Statements – 2017

#### **REQUIRED SUPPLEMENTARY INFORMATION**

Schedule of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual  
– General Fund – 2017

Schedule of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual  
– Street Fund – 2017

Schedule of Proportionate Share of the Net Pension Liability – PERS 1, PERS 2/3,  
PSERS, LEOFF, LEOFF 2 – 2017

Schedule of Employer Contributions – PERS 1, PERS 2/3, PSERS, LEOFF, LEOFF 2 –  
2017

Schedule of Changes in Net Pension Liability and Related Ratios – Firefighters Pension  
Fund – 2017

Money-Weighted Rate of Return – Firefighters Pension Fund – 2017

GASB 67 Schedule of Employer Contributions – Firefighters Pension Fund – 2017  
Schedule of Funding Progress – OPEB – 2017  
Schedule of Employer Contributions – OPEB – 2017  
Notes to Required Supplementary Information – 2017

**City of Mercer Island  
Management's Discussion and Analysis  
For the Year Ended December 31, 2017**

The discussion and analysis of the City of Mercer Island's financial performance provides an overall review of the City's financial activities for the year ended December 31, 2017. The intent of this discussion and analysis is to look at the City's financial performance as a whole. We encourage readers to consider the information presented here in conjunction with the basic financial statements to enhance their understanding of the City's financial performance. For comparison purposes, the 2016 fiscal year data is also included in the discussion.

**FINANCIAL HIGHLIGHTS**

Key financial highlights for 2017 are as follows:

- The assets and deferred outflow of resources of the City of Mercer Island exceeded its liabilities and deferred inflows of resources at the close of the 2017 fiscal year by \$227,591,885 (*net position*). Of this amount, \$25,361,105 represents unrestricted net position, which may be used to meet the City's business type and governmental activities ongoing obligations.
- The City of Mercer Island's total net position increased \$9,747,929 in 2017 compared to the prior fiscal year. The overall increase in net position is a result of operations and changes to the City's proportionate share of pension accruals under GASB Statement 68.
- At the close of 2017, the City's governmental funds reported combined fund balances of \$22,122,410, an increase of \$2,086,087 relative to 2016. Approximately 25% of this amount (\$5,565,472) is available for spending at the City's discretion (*unassigned fund balance*). All of the unassigned fund balance is reported in the General Fund, and \$3,439,884 of this amount has been designated by the City Council as a contingency reserve.
- At the end of 2017, unrestricted fund balance (the total of *committed*, *assigned*, and *unassigned* components of *fund balance*) for the General Fund was \$8,641,278, or approximately 30% of total General Fund expenditures.
- The City of Mercer Island's total outstanding long-term debt at the end of 2017 was \$15,724,681, which represents a decrease of \$1,698,027 from the end of 2016. During 2017, the City redeemed \$1,076,460 in general obligation bonds, \$218,810 in capital lease obligations, and \$402,757 in loans.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

The discussion and analysis provided here are intended to serve as an introduction to the City of Mercer Island's basic 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. This report also includes supplementary information intended to furnish additional detail to support the basic financial statements.

**Government-wide Financial Statements.** The *government-wide financial statements* are designed to provide readers with a broad overview of the City of Mercer Island's finances in a manner similar to a private-sector business.

The *statement of net position* presents financial information on all of the City's assets, liabilities, and deferred inflows/outflows of resources, with the difference reported as net position. Over time,

increases or decreases in net position may serve as a useful indicator of whether the financial position of the City of Mercer Island is improving or deteriorating.

The *statement of activities* presents information showing how the City of Mercer Island's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported for some items that will only result in cash flows in future fiscal periods.

Both of these government-wide financial statements distinguish between functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, streets and trails, youth and family services, development services, and culture and recreation. The business-type activities of the City include a water utility, a sewer utility, and a storm water utility.

The government-wide financial statements can be found in the basic financial statements section of this report.

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

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

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

The City of Mercer Island currently maintains twelve individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, the Street Fund and the Capital Improvement Fund, which are considered to be major funds. Data from the other governmental funds are combined into a single aggregated presentation.

The basic governmental fund financial statements can be found in the basic financial statement section of this report.

**Proprietary Funds.** The City of Mercer Island maintains two different types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses enterprise funds to account for its water utility, sewer utility, and storm water utility. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for the maintenance and replacement of fleet vehicles and the maintenance and replacement of technology assets. Because both of these services predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for all three utilities, which are considered to be major funds of the City. Both internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements.

The basic proprietary fund financial statements can be found in the basic financial statement section of this report.

**Fiduciary Funds.** Fiduciary funds are used to account for resources held for the benefit of parties outside of the government. Fiduciary funds are *not* reported in the government-wide financial statements, because the resources of those funds are not available to support the City of Mercer Island's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

Mercer Island maintains two different types of fiduciary funds. The *Pension Trust Fund* is used to report resources held in trust for retirees covered by the pre-LEOFF 1 Firemen's Pension Fund. The *Agency Fund* reports resources held by the City in a custodial capacity for individuals.

The fiduciary fund financial statements can be found in the basic financial statement section of this report.

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

**Other Information.** In addition to the basic financial statements and accompanying notes, this report presents *required supplementary information* concerning the City of Mercer Island's progress in funding its obligation to provide pension and OPEB benefits to its employees.

## GOVERNMENT-WIDE OVERALL FINANCIAL ANALYSIS

The net position of the City as of December 31, 2017 and December 31, 2016 is summarized and analyzed below. As noted earlier, net position over time may serve as a useful indicator of a government's financial position.

### City of Mercer Island's Net Position

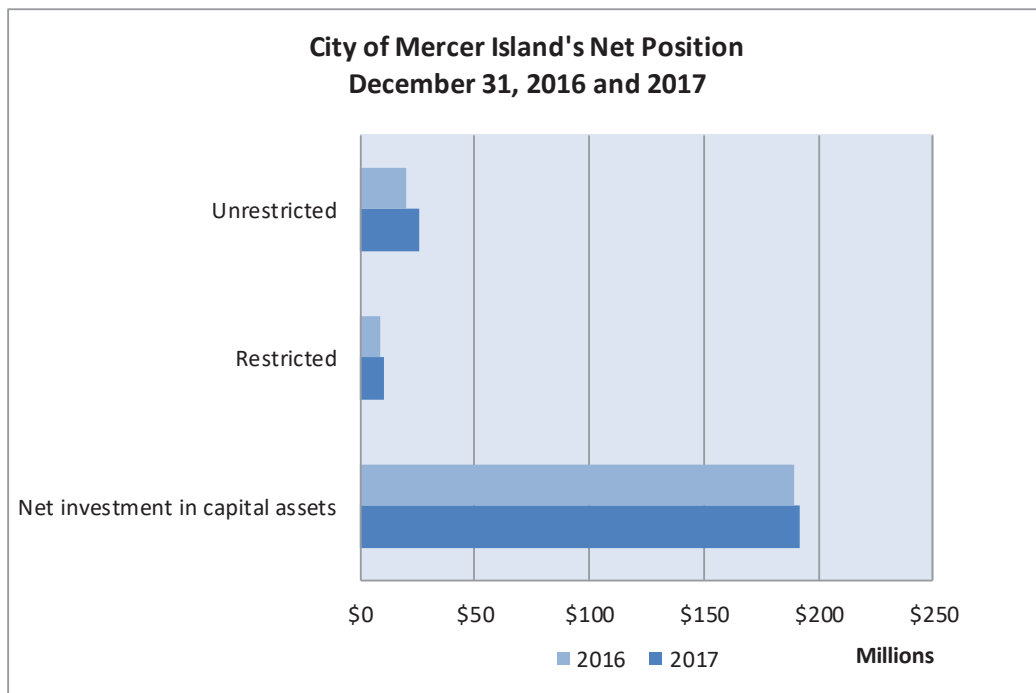
	Governmental Activities		Business Type Activities		Total	
	2017	2016	2017	2016	2017	2016
<b>Assets</b>						
Current and other assets	\$ 28,749,399	\$ 26,345,504	\$ 20,351,503	\$ 17,266,194	\$ 49,100,902	\$ 43,611,698
Net Pension Asset	4,483,369	2,094,526	-	-	4,483,369	2,094,526
Land	106,789,823	106,829,660	203,992	203,992	106,993,815	107,033,652
Capital assets net of accumulated depreciation	48,832,702	49,882,746	49,342,526	49,454,101	98,175,228	99,336,847
Construction in progress	2,257,397	226,515	87,988	180,032	2,345,385	406,547
Total assets	\$ 191,112,690	\$ 185,378,951	\$ 69,986,009	\$ 67,104,319	\$ 261,098,699	\$ 252,483,270
<b>Deferred Outflow of Resources</b>						
Deferred amount on refunding	\$ 48,549	36,085	336,777	-	\$ 385,326	\$ 36,085
Pensions	1,915,062	2,964,231	321,358	406,392	2,236,420	3,370,623
Total deferred outflow of resources	\$ 1,963,611	\$ 3,000,316	\$ 658,135	\$ 406,392	\$ 2,621,746	\$ 3,406,708
<b>Liabilities</b>						
Current Liabilities	\$ 3,239,056	\$ 3,452,635	\$ 1,651,370	\$ 2,113,664	\$ 4,890,426	\$ 5,566,299
Non-Current Liabilities	15,901,802	18,436,644	12,331,551	13,207,406	28,233,353	31,644,050
Total liabilities	\$ 19,140,859	\$ 21,889,279	\$ 13,982,921	\$ 15,321,071	\$ 33,123,780	\$ 37,210,350
<b>Deferred Inflow of Resources</b>						
Unavailable revenue	\$ 209,637	235,546	-	-	\$ 209,637	\$ 235,546
Pensions	2,478,400	502,532	316,744	97,593	2,795,144	600,125
Total deferred inflow of resources	\$ 2,688,037	\$ 738,078	\$ 316,744	\$ 97,593	\$ 3,004,781	\$ 835,671
<b>Net Position</b>						
Net investment in capital assets	\$ 153,626,635	\$ 151,519,722	\$ 38,211,661	\$ 37,870,701	\$ 191,838,296	\$ 189,390,423
Restricted	10,392,484	8,685,492	-	-	10,392,484	8,685,492
Unrestricted	7,228,287	5,546,696	18,132,818	14,221,345	25,361,105	19,768,041
Total net position	\$ 171,247,406	\$ 165,751,910	\$ 56,344,479	\$ 52,092,046	\$ 227,591,885	\$ 217,843,956

For the City of Mercer Island, assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by \$227,591,885 at the close of 2017. The largest component of the City's total net position at \$191,838,296, or 84.3%, is net investment in capital assets (e.g. land, buildings, machinery, equipment, vehicles, and infrastructure), which subtracts out any related outstanding debt that was used to acquire those assets. The City uses these capital assets to provide a variety of services to its citizens. Accordingly, these assets are not available for future spending. Although the City's investment in capital assets is reported net of related debt, it should be noted that the resources used to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to pay these liabilities.

Approximately 4.6%, or \$10,392,484, of the City's total net position represents resources that are subject to external restrictions on how they may be used. The increase in restricted net position in 2017, as compared to 2016, is primarily the result of an increase in real estate excise tax revenues,

which are restricted for capital projects related to streets, pedestrian/bicycle facilities, parks, and public buildings. The remaining 11.1%, or \$25,361,105, of the City's total net position is unrestricted and may be used to meet the government's ongoing obligations. Though it should be noted that \$18,132,818, or 71.5% of unrestricted net position is in the business type activities and can only be used to meet the ongoing obligations of the City's water, sewer and storm-water utilities.

At the end of the 2017 fiscal year, the City of Mercer Island had positive balances in all reported categories of net position, both for the government as a whole, as well as for its separate governmental and business-type activities. The same situation was true for the prior fiscal year.



A more detailed look at the revenues and expenses underlying the changes in the City's net position is presented on the following page. Compared to the prior year, the City's total net position increased \$9.7 million in 2017. The reasons for this overall increase are discussed in the following sections for governmental activities and business-type activities.

**Change in Accounting Principle.** As required, the City implemented GASB Statement 68, *Accounting and Financial Reporting for Pensions*, for the year ending December 31, 2015. GASB 68 requires a liability for pension obligations, known as the Net Pension Liability (NPL), be recognized on the balance sheets of participating employers. Changes in the NPL are recognized as pension expense on the income statement or reported as deferred inflow/outflow of resources depending on the nature of the change.

**Governmental Activities.** At the end of 2017, the City's total net position for governmental activities was \$171,247,406. Governmental activities increased \$5,495,495 in 2017 primarily due to better than expected real estate excise tax and development fee revenues and continued diligence by operating departments to keep expenditures low.

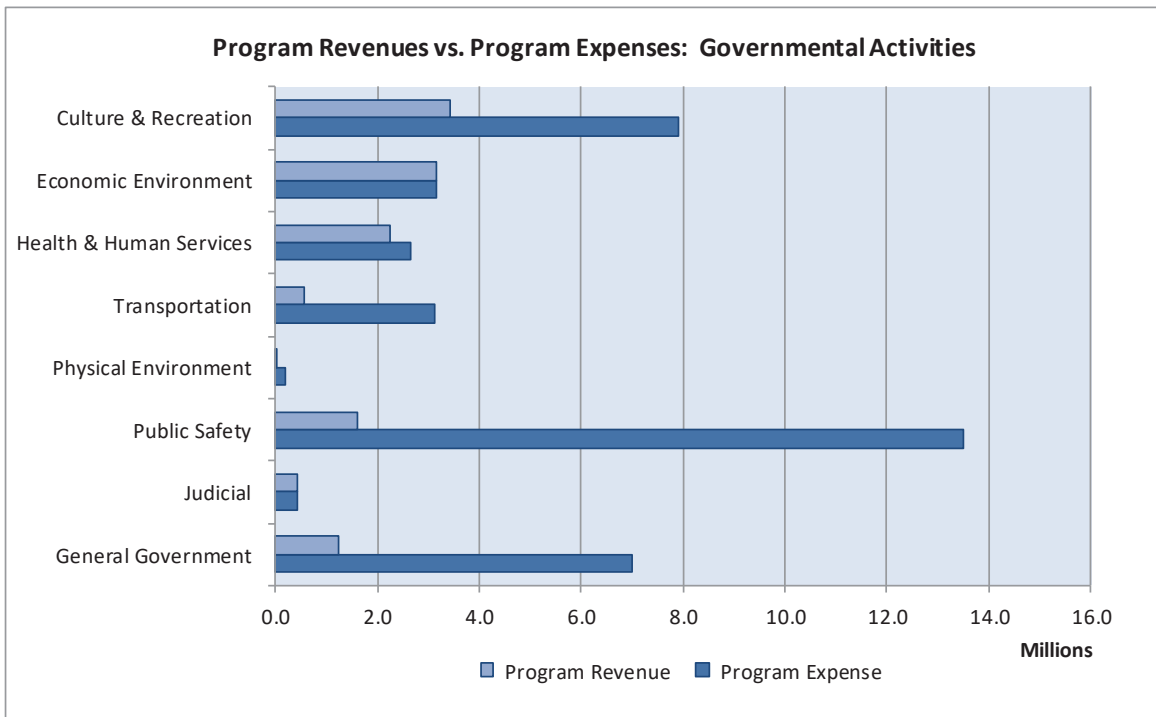
Comparing 2017 to 2016, total revenues increased \$4.3 million, or 11%, with the largest dollar increases coming from real estate excise tax (\$1,989,935), charges for services (\$796,971), and capital grants and contributions (\$796,007). The overall increase in charges for services of 8.1% can be primarily attributed to license, permit and zoning fees. This revenue category consists of development fees, a cable franchise fee, and business license fees. The 53.8% increase in real estate excise tax is mainly due to the sale three large commercial properties generating \$1.7 million in REET revenues.

Total expenditures in 2017 increased \$2.9 million, or 8.3%, over 2016. Of particular note, general government increased \$1.7 million, or 32.4%, and transportation increased \$322,311, or 11.6%. The increase in general government expenditures was wholly driven by I-90 loss of mobility negotiations. A total of \$1.7 million was spent to reach a mitigation agreement with Sound Transit. Noteworthy increases in transportation costs include a contract with King County to provide Mercer Island specific transit services, and an increase in street-related capital projects in 2017 versus 2016.



## City of Mercer Island's Changes in Net Position

	Governmental Activities		Business type Activities		Total	
	2017	2016	2017	2016	2017	2016
<b>Revenues:</b>						
Charges for services	\$ 10,677,181	\$ 9,880,210	\$ 19,691,139	\$ 18,378,688	\$ 30,368,320	\$ 28,258,898
Operating grants and contributions	1,005,143	679,511	306,044	-	1,311,187	679,511
Capital grants and contributions	1,019,045	223,038	477,259	-	1,496,304	223,038
Property tax	13,028,884	12,627,702			13,028,884	12,627,702
Sales tax	4,806,169	5,395,863			4,806,169	5,395,863
B&O tax	5,259,430	4,790,624			5,259,430	4,790,624
Real estate excise tax	5,690,681	3,700,746			5,690,681	3,700,746
Other taxes	1,338,980	1,327,784			1,338,980	1,327,784
Investment earnings	215,555	128,369	160,239	84,008	375,794	212,377
<b>Total revenues</b>	<b>\$ 43,041,068</b>	<b>\$ 38,753,847</b>	<b>\$ 20,634,681</b>	<b>\$ 18,462,696</b>	<b>\$ 63,675,749</b>	<b>\$ 57,216,543</b>
<b>Expenses:</b>						
General government	\$ 7,005,901	\$ 5,289,508			\$ 7,005,901	\$ 5,289,508
Judicial	426,271	391,524			426,271	391,524
Public safety	13,505,679	13,314,031			13,505,679	13,314,031
Physical environment	174,297	150,351			174,297	150,351
Transportation	3,105,474	2,783,163			3,105,474	2,783,163
Health & human services	2,652,954	2,508,247			2,652,954	2,508,247
Economic environment	3,157,151	2,939,500			3,157,151	2,939,500
Culture and recreation	7,890,885	7,595,480			7,890,885	7,595,480
Interest on long term debt	79,143	107,098	202,584	278,646	281,727	385,744
Water			5,624,272	5,534,203	5,624,272	5,534,203
Sewer			8,322,875	7,306,009	8,322,875	7,306,009
Stormwater			2,010,126	1,541,114	2,010,126	1,541,114
<b>Total expenses</b>	<b>\$ 37,997,755</b>	<b>\$ 35,078,902</b>	<b>\$ 16,159,857</b>	<b>\$ 14,659,972</b>	<b>\$ 54,157,612</b>	<b>\$ 49,738,874</b>
<b>Increase (decrease) in net position before transfers, special and extraordinary items</b>	<b>\$ 5,043,313</b>	<b>\$ 3,674,945</b>	<b>\$ 4,474,824</b>	<b>\$ 3,802,724</b>	<b>\$ 9,518,137</b>	<b>\$ 7,477,669</b>
Disposition of capital assets	380,353	25,391	-	-	380,353	25,391
Transfers	222,392	(42,269)	(222,392)	42,269	-	-
Increase (decrease) in net position	5,646,058	3,658,067	4,252,432	3,844,993	9,898,490	7,503,060
Net position beginning of year	165,751,910	162,093,844	52,092,046	48,247,053	217,843,956	210,340,897
Prior period adjustment	(150,563)	-	-	-	(150,563)	-
<b>Net position, end of year</b>	<b>\$ 171,247,406</b>	<b>\$ 165,751,910</b>	<b>\$ 56,344,479</b>	<b>\$ 52,092,046</b>	<b>\$ 227,591,883</b>	<b>\$ 217,843,956</b>



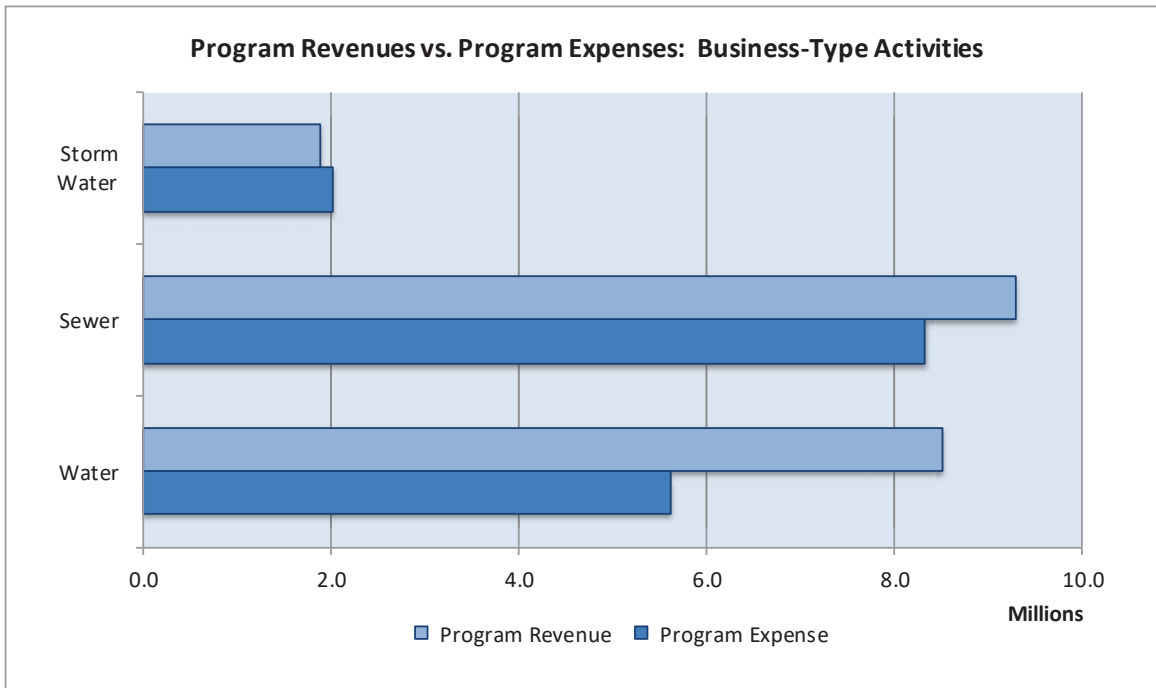
**Business-type Activities.** At the end of 2017, the City's total net position for business-type activities, encompassing the water, sewer, and storm water utilities, was \$56,344,479. The total net position for business-type activities increased \$4,252,432 in 2017 primarily due to increased rate revenues and lower than expected capital reinvestment expenditures.

Comparing 2017 to 2016, total operating revenues, which excludes investment earnings, increased \$1.6 million, or 7.8%, which is primarily attributable to charges for services. Total expenditures in 2017 increased \$1.5 million compared to 2016.

Additional information about each City utility is provided below:

- **Water Utility** revenue is derived from three sources: 1) bi-monthly service charges, 2) system connection fees, and 3) miscellaneous work orders. The majority of the revenue comes from bi-monthly service charges. The City uses consumption based rates for water. Ratepayers pay a base fee plus a consumption charge according to the number of cubic feet of water used. A ramped rate for usage was built into the rate structure to encourage conservation.
- **Sewer Utility** revenue is derived from two sources: 1) bi-monthly service charges, and 2) system connection fees. The majority of the revenue comes from bi-monthly service charges. Residential sewer rates are charged on a water consumption basis. The utility uses the four most recent winter months to determine the average water consumption for each residence. Commercial accounts are charged based on the actual consumption of water. The bi-monthly service charges have two components: 1) a City charge for sewer maintenance and operations, including transmission of the sewage to the treatment plant; and 2) a King County "pass through" charge for treatment costs. The City collects the latter charge from all sewer customers, remitting the full amount to King County, which provides sewer treatment services to the City.

- **Storm Water Utility** revenue is derived from bi-monthly service charges, which are based on the amount of impervious surface on the customer's property. A sample of residences was taken when the utility was formed, and the average impervious surface for a residence was determined to be 3,419 sq ft. That is considered one (1) equivalent residential unit (ERU). All residences are charged one ERU on a bi-monthly basis. All other properties are charged based on the actual impervious surface.



## FINANCIAL ANALYSIS OF GOVERNMENTAL & PROPRIETARY FUNDS

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

**Governmental Funds.** The focus of the City's *governmental funds* is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for discretionary use, because it represents that portion of fund balance that is not restricted, committed, or assigned for a specific purpose by an external party, the City itself, or a group or individual that has been delegated authority to assign resources to be used for particular purposes by the Mercer Island City Council.

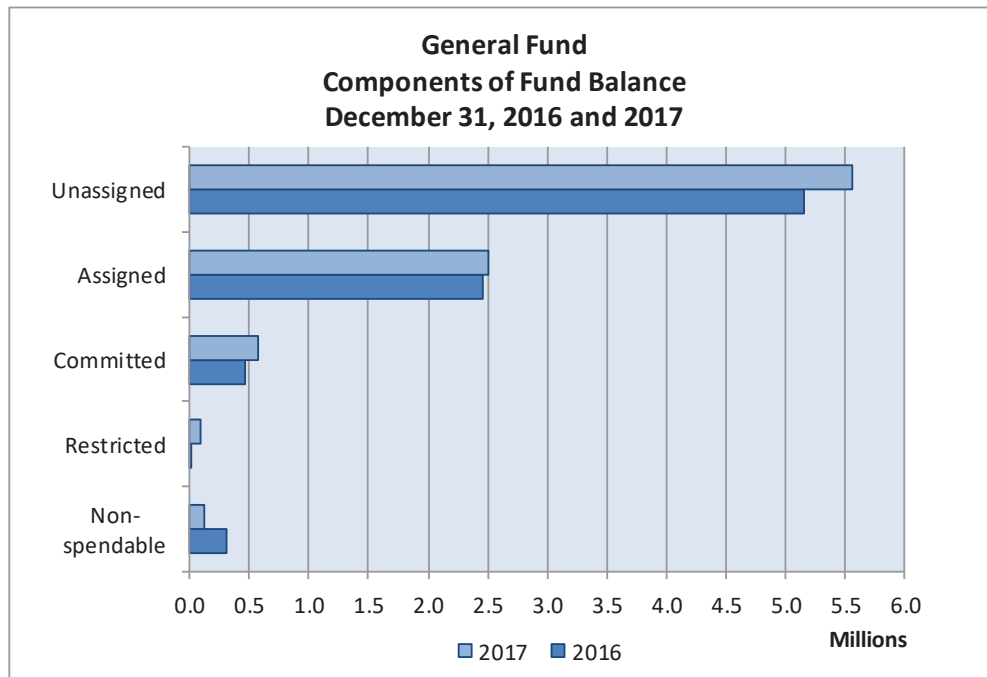
The following analysis is based on the Balance Sheet for Governmental Funds and the Statement of Revenues, Expenditures, and Changes in Fund Balance for Governmental Funds.

At the end of 2017 the City's combined ending fund balances for governmental funds amounted to \$22,122,410 which represents an increase of \$2,086,086 from the prior year. Of this combined total, \$5,565,472, or 25%, constitutes *unassigned fund balance*, which is available for spending at the City's discretion. The remainder of the combined ending fund balances consists of the following: 1) \$406,713 that is *non-spendable* (i.e. not in a spendable form); 2) 9,731,448 that is *restricted* for particular purposes; 3) \$2,314,196 that is *committed* for particular purposes; and 4) \$4,104,582 that is *assigned* for particular purposes.

Drilling down further, a brief analysis of each of the City's major governmental funds follows for the General Fund and Capital Improvement Fund.

The **General Fund** is the largest operating fund of the City. It accounts for all financial resources and transactions of the City except those required to be accounted for in another fund. Taxes are the primary revenue source for the General Fund. The 2016 ending fund balance was \$8,848,635, which represents an increase of \$442,118 after the effects of prior period adjustments, or 5.3%, relative to 2016. Comparing 2017 to 2016, total revenues increased \$1,109,377, or 3.9%, and total expenditures, excluding transfers out, increased \$3,081,425, or 11.8%.

As a measure of the General Fund's liquidity, unassigned fund balance equals 19.0% of total General Fund expenditures, and total fund balance equals 30.3% of total General Fund expenditures.



The **Street Fund** is a special revenue fund that accounts for the financial resources dedicated to street maintenance and construction. The fund balance at the end of 2017 was \$5,285,108, a 36% increase from the prior year. The primary driver of the increase in fund balance was higher than expected REET revenue in 2017.

The **Capital Improvement Fund** is a capital projects fund that accounts for those financial resources that are used for the acquisition, construction, and preservation of the City's "general government" (i.e. not utility) capital assets and facilities, which include parks, open space, and public buildings. The 2017 ending fund balance was \$5,216,040, which represents an increase of \$1,058,356, or 25%, relative to 2016. This increase in fund balance is mainly due to higher than expected REET revenues in 2017. Interfund transfers out of the Capital Improvement Fund relate to paying the debt service on non-voted bonds for the Mercer Island Community & Event Center (MICEC). The original bonds that financed the construction of the MICEC were advance refunded in 2013. As a result, the Capital Improvement Fund will continue to realize debt service cost savings.

**Other Governmental Funds  
Components of Fund Balance  
December 31, 2016 and 2017**

Fund Balance Component	Street Fund			Capital Improvement Fund			Other Governmental Funds		
	2016	2017	% Change	2016	2017	% Change	2016	2017	% Change
Non-spendable	-	-	N/A	-	-	N/A	285,856	285,856	0.0%
Restricted	3,573,880	5,029,445	40.7%	3,413,632	4,242,956	24.3%	1,376,053	372,547	-72.9%
Committed	50,466	155,979	N/A	32,864	95,537	N/A	1,199,958	1,487,250	23.9%
Assigned	249,684	99,684	-60.1%	696,546	877,546	26.0%	750,870	626,975	-16.5%
Unassigned	-	-	N/A	-	-	N/A	-	-	N/A
<b>Total fund balance</b>	<b>3,874,030</b>	<b>5,285,108</b>	<b>36.4%</b>	<b>4,143,042</b>	<b>5,216,040</b>	<b>25.9%</b>	<b>3,612,737</b>	<b>2,772,629</b>	<b>-23.3%</b>

**Proprietary Funds.** The City's *proprietary funds* provide the same type of information found in the government-wide financial statements, but in more detail. The total net position of the City's proprietary funds, as well as the change in total net position over the prior year, was addressed above under Business-Type Activities in the Government-Wide Overall Financial Analysis section.

Drilling down further, a brief analysis of each of the City's major proprietary funds follows for the Water Fund, Sewer Fund, and Storm Water Fund. The analysis is based on the Statement of Net Position for Proprietary Funds and the Statement of Revenues, Expenses, and Changes in Net Position for Proprietary Funds.

The **Water Fund** is an enterprise fund that accounts for all operating, maintenance, and capital activities associated with the City's water utility. The 2017 ending net position was \$23,877,026, which represents an increase of \$3,033,304, or 14.6%, relative to 2016. Operating income was \$2,907,600 in 2017, representing an accumulation of funding for capital projects in coming years.

The **Sewer Fund** is an enterprise fund that accounts for all operating, maintenance, and capital activities associated with the City's sewer utility. The 2017 ending net position was \$20,664,465, which represents an increase of \$671,262, or 3.4%, relative to 2016. Operating income was \$988,065 in 2017, representing an accumulation of funding for capital projects in coming years.

The **Storm Water Fund** is an enterprise fund that accounts for all operating, maintenance, and capital activities associated with the City's storm water utility. The 2017 ending net position was \$11,833,739, which represents an increase of \$585,650, or 5.2%, relative to 2016. The stormwater utility had an operating loss of \$124,014 in 2017.

**Proprietary Funds  
Components of Net Position  
December 31, 2016 and 2017**

Net Position Component	Water Fund			Sewer Fund			Storm Water Fund		
	2016	2017	% Change	2016	2017	% Change	2016	2017	% Change
Net investment in capital assets	13,899,550	14,170,867	2.0%	16,277,798	16,144,477	-0.8%	7,693,354	7,896,317	2.6%
Unrestricted	6,944,173	9,706,159	39.8%	3,715,405	4,519,988	21.7%	3,554,734	3,937,422	10.8%
<b>Total net position</b>	<b>20,843,723</b>	<b>23,877,026</b>	<b>0</b>	<b>19,993,203</b>	<b>20,664,465</b>	<b>3.4%</b>	<b>11,248,088</b>	<b>11,833,739</b>	<b>5.2%</b>

**GENERAL FUND BUDGETARY HIGHLIGHTS**

**Original budget compared to final budget.** The City of Mercer Island budgets on a biennial basis with each biennial budget beginning in an odd numbered year by state law. Comparing the final amended 2017-2018 General Fund budget to the originally adopted budget, total budgeted expenditures and other financing uses were increased \$5,145,734. Following are the *major* budgetary changes to the originally adopted 2017-2018 **General Fund** budget:

- \$1,300,000 for I-90 loss of mobility negotiations;
- \$1,035,704 transfer of 2016 surplus to contingency reserve;
- \$343,886 in additional support for the Youth and Family Services Fund;
- \$124,000 to fund additional code compliance resources;

**CAPITAL ASSETS & DEBT ADMINISTRATION**

**Capital assets.** The City of Mercer Island's investment in capital assets for its governmental and business-type activities as of December 31, 2017 amounts to \$207,514,427 (net of accumulated depreciation). It includes land, buildings, improvements, machinery and equipment, infrastructure, construction in progress, and intangibles.

**City of Mercer Island's Capital Assets (net of depreciation)**

Capital Asset	Governmental Activities		Business-Type Activities		Total	
	2017	2016	2017	2016	2017	2016
Land	\$106,789,823	\$106,829,660	\$203,992	\$203,992	\$106,993,815	\$107,033,652
Buildings	20,329,675	21,041,754	430,048	430,048	20,759,723	21,471,802
Improvements	7,083,962	7,654,342	86,701,901	85,033,666	93,785,863	92,688,008
Machinery & equipment	4,691,241	4,840,297	1,582,705	1,539,948	6,273,946	6,380,245
Infrastructure	15,715,079	15,253,437		-	15,715,079	15,253,437
Construction in progress	2,257,397	226,515	87,988	180,032	2,345,385	406,547
Intangibles	1,012,744	1,092,917	18,129	18,129	1,030,873	1,111,046
Accumulated depreciation			(39,390,257)	(37,567,689)	(39,390,257)	(37,567,689)
	<u>\$157,879,921</u>	<u>\$156,938,922</u>	<u>\$49,634,506</u>	<u>\$49,838,126</u>	<u>\$207,514,427</u>	<u>\$206,777,048</u>

Major capital asset events during the 2017-2018 biennium include the following:

- Multiple projects to improve parks and playfields, including Island Crest Park sports field improvements;
- An investment of \$1.7 million in street infrastructure that included neighborhood street overlays and roadside shoulders on East Mercer Way;
- The purchase and implementation of CityWorks enterprise asset management software;
- Replacement purchases for 7 fleet vehicles and equipment including a new Aid Car for the Fire Department and a Boom Truck for Public Works; and
- Continued investment in Utility infrastructure that included mains, hydrants and watercourse improvements.

Those capital assets that are subject to depreciation are depreciated over their useful lives based on the straight-line method.

Additional information on the City of Mercer Island's capital assets can be found in Note 11 (Capital Assets) in the notes to the financial statements.

**Long-term debt.** At the end of 2017, the City of Mercer Island had total debt outstanding of \$15,724,681. Of this amount, \$11,499,696 is debt backed by the full faith and credit of the government. The remainder of the City's long term obligations comprises capital leases and Public Works Trust Fund loans. The City of Mercer Island maintains bond ratings with Moody's Investors Service. Moody's upgraded the City's non-voted (i.e. limited tax) general obligation (LTGO) bond rating in February 2017 from Aa1 to Aaa. The City does not have any voted (i.e. unlimited tax) general obligation (UTGO) debt.

**City of Mercer Island's Outstanding Long-term Debt**

Type of Debt	Governmental		Business-Type		Total	
	2017	2016	2017	2016	2017	2016
General obligation bonds	\$ 3,701,668	\$ 4,636,305	\$ 7,798,028	\$ 7,939,851	\$ 11,499,696	\$ 12,576,156
Capital leases	600,169	818,979	-	-	600,169	818,979
Public works loans	-	-	3,624,816	4,027,573	3,624,816	4,027,573
TOTAL	\$ 4,301,837	\$ 5,455,284	\$ 11,422,844	\$ 11,967,424	\$ 15,724,681	\$ 17,422,708

The City has one Public Works Trust Fund loan from the State of Washington. This loan was for sewer capital improvements to the Sewer Lake Line. Debt service on the loan is paid for by sewer utility rates. The City currently has no revenue bonds.

Washington State law limits the amount of general obligation debt a governmental entity may issue to 7.5% of its total assessed valuation, subject to a 60% majority vote of qualified electors. Of the 7.5% limit, 2.5% is for general purposes, 2.5% is for open space/park facilities, and 2.5% is for utilities. Non-voted (i.e. limited tax) general obligation indebtedness is limited to 1.5% of assessed valuation. The combination of all debt cannot exceed 7.5% of assessed valuation. The City of Mercer Island's debt obligations are substantially below the statutory limits for debt capacity.

Additional information on the City's long term debt can be found in Note 8 (Long-term Debt), Note 9 (Leases), and Note 10 (Changes in Long-term Liabilities) in the notes to the financial statements.

**NEXT YEAR'S BUDGET, RATES AND ECONOMIC FACTORS**

Mercer Island is an affluent, single family residential community that is essentially built out. Its real property assessed valuation per square mile is the highest of any city in King County. Also, the per capita income level is more than two times the state average. Six major revenues account for 93.5% of the General Fund's 2017-2018 budgeted revenues: 1) property tax (41.5%), 2) sales tax (15.7%), 3) utility taxes (14.5%), 4) license & permit fees (11.6%), 5) recreation program & rental fees (5.7%); and 6) EMS revenues (4.5%). Collectively, these six revenues are projected to decline 0.5% in 2017 and to grow 0.9% in 2018. By comparison, total budgeted expenditures are increasing 1.5% in 2017 and 1.6% in 2018.

For 2017-2018 and beyond, the General Fund's annual revenue growth is projected to lag annual expenditure growth. At the root of the revenue growth problem is property tax, which makes up 41.5% of the General Fund's total revenues in 2017-2018 and is limited by state law to 1% growth per year plus an allowance for "new construction" (which generates an additional 1% per year on average). Taken together, the effective cap on property tax growth is 2% per year, which puts an unrealistic burden for



growth on the City's other major revenues. In addition, after experiencing a high level of development activity in 2014-2016, with construction-related sales tax and development fees hitting all-time highs in 2016, significant reductions in these revenue sources are projected in 2017-2018 as development activity slows down. Accordingly, to balance the 2017-2018 General Fund Budget, the City had to use: 1) \$910,448 of the 2016 projected General Fund surplus; and 2) \$505,195 in other one-time resources made available by combining the Criminal Justice Fund with the General Fund in 2017.

To maintain current service levels after 2018, a new, ongoing funding source is needed beginning in 2019. A public engagement process was conducted in the first quarter 2018, utilizing a diverse community stakeholder group of 26 residents, appointed by the City Manager and tasked with the following:

- Reviewing the City's operating and capital funding challenges and their primary drivers;
- Exploring the various operating and capital funding options; and
- Making a recommendation to the City Manager and the City Council regarding an operating levy lid lift and a capital levy lid lift.

Given that the City is leanly staffed relative to other full service cities in King County, in terms of the number of employees per 1,000 population, and that past biennial citizen surveys have consistently found that a majority of citizens want to maintain current service levels, it is expected that an operating levy lid lift November 2018 general election ballot. The ballot measure would be subject to a simple majority approval.

The City of Mercer Island has a history of excellent financial management practices and prudent fiscal policies that have served the City well over the years. For example, the City has various operating and capital reserves, which have been established to address unanticipated, significant revenue shortfalls or to provide funding for unplanned, significant expenditures. In addition, the City has very little debt, relying on a "pay as you go" approach for most of its capital projects. Continued adherence to these practices and policies has helped the City secure an Aaa bond rating (the highest possible rating) from Moody's for its LTGO bonds.

#### **REQUEST FOR FINANCIAL INFORMATION**

This financial report is designed to provide our citizens, taxpayers, creditors and investors with a general overview of the City's finances and to show the City's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Director, City of Mercer Island, Washington, 9611 SE 36th Street, Mercer Island, Washington 98040.

**City of Mercer Island  
Statement of Net Position  
December 31, 2017**

	<b>Governmental Activities</b>	<b>Business-type Activities</b>	<b>Total</b>
<b>ASSETS</b>			
<i>Current assets:</i>			
Cash & cash equivalents	\$ 25,588,949	\$ 18,854,214	\$ 44,443,163
Receivables (net)	3,008,842	1,377,054	4,385,896
Internal balances	30,751	(30,751)	-
Inventories	120,857	150,986	271,843
<i>Noncurrent Assets:</i>			
Net pension asset	4,483,369	-	4,483,369
Capital assets not being depreciated:			
Land	106,789,823	203,992	106,993,815
Construction in progress	2,257,397	87,988	2,345,385
Capital assets net of depreciation:			
Buildings, improvements, machinery and equipment.	33,117,623	49,342,526	82,460,149
Infrastructure	15,715,079	-	15,715,079
Total assets	<u>\$ 191,112,690</u>	<u>\$ 69,986,009</u>	<u>\$ 261,098,700</u>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>			
Deferred amount on refunding	\$ 48,549	\$ 336,777	\$ 385,326
Pensions	1,915,062	321,358	2,236,420
Total deferred outflows of resources	<u>\$ 1,963,611</u>	<u>\$ 658,135</u>	<u>\$ 2,621,746</u>
<b>LIABILITIES</b>			
<i>Current liabilities:</i>			
Accounts payable and accrued exp.	\$ 1,555,454	\$ 683,712	\$ 2,239,166
Accrued interest payable	15,233	30,808	46,041
Bonds, notes, loans payable	868,518	907,757	1,776,276
Other current liabilities	41,131	29,093	70,224
Unearned revenue - other	758,720	-	758,720
<i>Noncurrent liabilities:</i>			
Net pension liability	8,007,978	1,662,049	9,670,027
Due in more than one year	7,893,824	10,669,502	18,563,327
Total liabilities	<u>\$ 19,140,859</u>	<u>\$ 13,982,921</u>	<u>\$ 33,123,780</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>			
Unavailable revenue - property taxes	\$ 209,637	\$ -	\$ 209,637
Pensions	2,478,400	316,744	2,795,144
Total deferred inflows of resources	<u>\$ 2,688,037</u>	<u>\$ 316,744</u>	<u>\$ 3,004,781</u>
<b>NET POSITION</b>			
Net investment in capital assets	\$ 153,626,635	\$ 38,211,661	\$ 191,838,296
Restricted for:			
Debt service	23,981	-	23,981
Investment in parks, open space and buildings	4,438,493	-	4,438,493
Streets, paths and trails	5,342,475	-	5,342,475
Criminal Justice	97,514	-	97,514
Court trust and jails	86,499	-	86,499
Emergency Assistance	90,462	-	90,462
Expendable permanent fund	27,204	-	27,204
Non expendable permanent fund	285,856	-	285,856
Unrestricted	7,228,287	18,132,818	25,361,105
Total net position	<u>\$ 171,247,406</u>	<u>\$ 56,344,479</u>	<u>\$ 227,591,885</u>

The Notes to the Financial Statements are an integral part of this Statement.

**City of Mercer Island**  
**Statement of Activities**  
**For the Year Ending December 31, 2017**

	Expenses	Program Revenues		Net (Expense) Revenue & Changes in Net Position		
		Charges for	Operating	Capital	Governmental	Business-type
		Services	Grants & Contributions	Grants & Contributions	Activities	Activities
						Total
<b>FUNCTIONS/PROGRAMS</b>						
<b>Primary Government</b>						
Governmental activities:						
Judicial	\$ 426,271	\$ 411,111	\$ -	\$ -	\$ (15,160)	\$ (15,160)
General government	7,005,901	1,202,457	35,944	-	(5,767,500)	(5,767,500)
Public safety	13,505,678	935,604	300,022	366,918	(11,903,134)	(11,903,134)
Physical environment	174,297	-	31,251	-	(143,046)	(143,046)
Transportation	3,105,474	482,140	92,312	-	(2,531,022)	(2,531,022)
Human services	2,652,954	1,804,165	451,647	-	(397,142)	(397,142)
Economic environment	3,157,151	3,131,815	23,480	-	(1,856)	(1,856)
Culture & recreation	7,890,885	2,709,890	70,485	652,128	(4,458,383)	(4,458,383)
Interest on long-term debt	79,143	-	-	-	(79,143)	(281,727)
Total governmental activities	\$ 37,997,754	\$ 10,677,181	\$ 1,005,143	\$ 1,019,045	\$ (25,296,385)	\$ (25,498,969)
Business-type Activities:						
Water	\$ 5,624,272	\$ 8,513,464	\$ 27,320	\$ -	\$ 2,916,512	\$ 2,916,512
Sewer	8,322,875	9,300,557	-	-	977,682	977,682
Other utilities	2,010,126	1,877,118	278,725	477,259	622,975	622,975
Total business type activities	15,957,274	19,691,139	306,044	477,259	4,517,168	4,517,168
Total primary government	\$ 53,955,027	\$ 30,368,320	\$ 1,311,187	\$ 1,496,304	\$ (25,296,385)	\$ (20,981,800)
<b>GENERAL REVENUES:</b>						
Property taxes					\$ 13,028,884	\$ 13,028,884
Sales taxes					4,806,169	4,806,169
B&O taxes					5,259,430	5,259,430
Real estate excise taxes					5,690,681	5,690,681
Other taxes					1,338,980	1,338,980
Investment earnings					215,555	160,239
Gain (loss) on disposal of capital assets					380,353	380,353
<b>TRANSFERS</b>					222,392	(222,392)
Total general revenues & transfers					\$ 30,942,444	\$ (62,153)
Change in net position					\$ 5,646,060	\$ 4,252,431
Net position - beginning					165,751,910	52,092,046
Prior period adjustments					(150,563)	-
Net position - ending					\$ 171,247,406	\$ 56,344,479

**City of Mercer Island  
Balance Sheet  
Governmental Funds  
December 31, 2017**

	General Fund	Street	Capital Improve	Other Governmental Funds	Total Governmental Funds
<b>ASSETS</b>					
Cash & cash equivalents	\$ 8,988,403	\$ 5,217,817	\$ 5,089,586	\$ 2,343,861	\$ 21,639,668
Receivables (net)	1,554,327	296,698	243,056	627,936	2,722,018
Inventories	120,857			681	121,538
Total assets	10,663,588	5,514,515	5,332,643	2,972,478	24,483,223
<b>LIABILITIES</b>					
<i>Current Liabilities:</i>					
Accounts payable and accrued exp.	808,494	229,407	116,603	196,820	1,351,324
Unearned revenue-other	755,691			3,029	758,720
Deposits payable	41,131			-	41,131
Total liabilities	1,605,316	229,407	116,603	199,849	2,151,176
<b>DEFERRED INFLOWS OF RESOURCES</b>					
Unavailable revenue-property taxes	209,637			-	209,637
Total deferred inflows of resources	209,637	-	-	-	209,637
<b>FUND BALANCE</b>					
Non-Spendable	120,857	-		285,856	406,713
Restricted	86,499	5,029,445	4,242,956	372,547	9,731,448
Committed	575,430	155,979	95,537	1,487,250	2,314,196
Assigned	2,500,377	99,684	877,546	626,975	4,104,582
Unassigned	5,565,472	-		-	5,565,472
Total fund balance	8,848,635	5,285,108	5,216,040	2,772,629	22,122,410
<b>Total liabilities, deferred inflows of resources, and fund balances</b>	<b>\$ 10,663,588</b>	<b>\$ 5,514,515</b>	<b>\$ 5,332,643</b>	<b>\$ 2,972,478</b>	<b>\$ 24,483,223</b>

Total Fund Balance for Governmental Funds \$ 22,122,410

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

Capital assets used in governmental activities are not financial resources and are not reported in the funds	153,643,084
Other long-term assets are not available to pay for current period expenditures are deferred in the funds	6,667,452
Long-term liabilities are not due and payable in the current period and are not reported in the funds	(18,209,164)

Internal service funds are used by management to charge the costs of certain activities to individual funds.

These assets and liabilities are included in governmental activities in the statement of net position.

7,023,623

**Net position of governmental activities**

\$ 171,247,406

See also **NOTE 2** for detailed reconciliation.

**City of Mercer Island**  
**Statement of Revenues, Expenditures, and Change in Fund Balance**  
**Governmental Funds**  
**For the Year Ended December 31, 2017**

Page 1 of 2

	General	Street	Capital Imp	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>					
Taxes:					
Property	\$ 11,850,029		\$ 352,658	\$ 618,100	12,820,787
Sales	4,806,169			-	4,806,169
B&O	4,641,451			617,979	5,259,430
REET	-	2,845,340	2,845,340	-	5,690,681
Licenses & permits	3,410,802			6,650	3,417,452
Intergovernmental	610,396	578,258	500,570	678,540	2,367,764
Charges for services	2,659,256	304,690	243,673	2,247,731	5,455,349
Fines & forfeitures	405,781			-	405,781
Investment earnings	211,031			2,861	213,891
Other revenues	1,030,708		149,057	600,741	1,780,507
Total revenues	29,625,624	3,728,288	4,091,299	4,772,602	42,217,813
<b>EXPENDITURES</b>					
Current:					
Judicial	444,740			-	444,740
General government	6,162,652		208,072	116,258	6,486,983
Public safety	13,603,874		25,045	114,460	13,743,379
Physical environment	66,721			72,954	139,675
Transportation	855,468	1,043,007		121,714	2,020,189
Health & human services	13,808		19,566	2,631,873	2,665,247
Economic environment	3,192,733			487	3,193,220
Culture & recreation	4,861,411		1,274,907	841,364	6,977,682
Debt service:					
Principal	-			920,000	920,000
Interest	-			93,782	93,782
Capital outlay:					
General government	-			15,400	15,400
Public safety	18,995			-	18,995
Physical environment	-			260,424	260,424
Transportation	-	1,667,213		-	1,667,213
Economic environment	-			42,626	42,626
Culture & recreation	-		1,708,364	91,962	1,800,325
Total expenditures	29,220,403	2,710,220	3,235,953	5,323,303	40,489,880
Excess (deficiency) of revenues over (under) expenditures	405,222	1,018,067	855,346	(550,701)	1,727,934
<b>OTHER FINANCING SOURCES (USES)</b>					
Transfers in	1,321,678	467,881	169,119	1,446,837	3,405,515
Transfers out	(1,122,461)	(74,870)	(296,000)	(1,736,244)	(3,229,574)
Refunding debt proceeds	367,891			-	367,891
Sale of capital assets	-		329,891	-	329,891
Debt defeasance-payment to escrow agent	(365,006)			-	(365,006)
Total other financing sources (uses)	202,102	393,011	203,010	(289,407)	508,716
Net change in fund balances	607,323	1,411,078	1,058,356	(840,108)	2,236,650
Fund balances - Beginning	8,406,516	3,874,030	4,143,042	3,612,737	20,036,324
Prior Period Adjustment	(165,205)		14,641	-	(150,563)
Fund balances - Ending	\$ 8,848,634	\$ 5,285,108	\$ 5,216,040	\$ 2,772,629	22,122,410

The Notes to the Financial Statements are an integral part of this statement.

**City of Mercer Island**  
**Statement of Revenues, Expenditures, and Change in Fund Balance**  
**Governmental Funds**  
**For the Year Ended December 31, 2017**

Page 2 of 2

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

Net changes in fund balances for governmental funds	2,236,650
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds	254,663
Governmental funds report capital outlays as expenditures. In the statement of activities, the cost of those assets is depreciated over their estimated useful lives.	
Current year depreciation is:	
Capital Outlays	3,804,983
Depreciation Expense	(2,768,151)
Disposal of Infrastructure Asset	(39,837)
	<u>996,994</u>
	996,994
The issuance of long term debt is a resource and the repayment of bond principal is an expenditure in governmental funds. These transactions effect liabilities in the Statement of net position.	
Debt Principal repayments and related costs.	951,491
Expenses in the statement of activities do not require the use of current financial resources and are not reported as expenditure in governmental funds. Total:	753,719
Internal service funds are used by management to charge the costs of certain activities to individual funds. The net income/(loss) of most of these activities is reported with governmental activities.	452,543
Change in net position of governmental activities	<u>\$ 5,646,060</u>
See also <b>NOTE 3</b> for detailed reconciliation.	

The Notes to the Financial Statements are an integral part of this statement.

**City of Mercer Island  
Statement of Net Position  
Proprietary Funds  
December 31, 2017**

	Business-type Activities--Enterprise Funds				Governmental
	Water Fund	Sewer Fund	Storm Drain Fund	Total Enterprise Funds	Activities-Internal Service Funds
ASSETS					
Current assets:					
Cash & cash equivalents	\$ 10,409,061	\$ 4,490,951	\$ 3,954,202	\$ 18,854,214	\$ 3,949,281
Receivables (net)	292,956	511,082	573,016	1,377,054	396
Inventories	140,062	10,924	-	150,986	-
Noncurrent assets:					
Capital assets:					
Land	106,125	97,866	-	203,992	-
Construction in progress	-	87,988	-	87,988	-
Depreciable assets (net of accumulated depreciation)	15,173,269	26,272,941	7,896,317	49,342,526	4,236,839
Total assets	26,121,473	31,471,752	12,423,535	70,016,760	8,186,516
DEFERRED OUTFLOW of RESOURCES					
Deferred amount on refunding	\$ -	336,777	-	336,777	-
Pensions	140,594	102,098	78,666	321,358	65,276
Total Deferred Outflow of Resources	140,594	438,875	78,666	658,135	65,276
LIABILITIES					
Current liabilities:					
Accounts payable and accrued exp.	\$ 313,167	\$ 239,839	\$ 130,706	\$ 683,712	\$ 204,130
Accrued interest payable	3,460	27,347	-	30,808	8,730
Bonds, notes, loans payable	70,000	837,757	-	907,757	98,518
Deposits payable	17,400	-	11,693	29,093	-
Noncurrent liabilities:					
Compensated absences	76,764	35,978	41,672	154,415	43,948
Bonds, notes, loans payable	1,038,527	9,476,560	-	10,515,087	501,651
Net pension liability	727,146	528,047	406,856	1,662,049	337,604
Total liabilities	2,246,465	11,145,529	590,927	13,982,921	1,194,581
DEFERRED INFLOW of RESOURCES					
Pensions	\$ 138,576	100,632	77,536	316,744	64,339
Total Deferred Inflow of Resources	138,576	100,632	77,536	316,744	64,339
NET POSITION					
Net investment in capital assets	\$ 14,170,867	\$ 16,144,477	\$ 7,896,317	\$ 38,211,661	\$ 3,636,670
Unrestricted	9,706,159	4,519,988	3,937,422	18,163,569	3,356,203
Total net position	\$ 23,877,026	\$ 20,664,465	\$ 11,833,738	\$ 56,375,230	\$ 6,992,873
Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds:				(30,751)	
Net position of business-type activities				\$ 56,344,479	

The Notes to the Financial Statements are an integral part of this statement

**City of Mercer Island**  
**Statement of Revenues, Expenses, and Changes in Net Position**  
**Proprietary Funds**  
**For the year ended December 31, 2017**

	<b>Water Fund</b>	<b>Sewer Fund</b>	<b>Storm Drain Fund</b>	<b>Total Enterprise Funds</b>	<b>Governmental Activities-Internal Service Funds</b>
<b>OPERATING REVENUES</b>					
Charges for Services:					
Charge for services	\$ 8,520,498	\$ 9,300,557	\$ 1,877,118	\$ 19,698,173	\$ 1,997,633
Total operating revenues	<u>8,520,498</u>	<u>9,300,557</u>	<u>1,877,118</u>	<u>19,698,173</u>	<u>1,997,633</u>
<b>OPERATING EXPENSES</b>					
Maintenance & operations	2,171,820	2,083,766	1,743,018	5,998,604	1,359,584
Water purchased for resale	1,998,695	-	-	1,998,695	-
Metro sewer charges	-	4,713,277	-	4,713,277	-
Administrative and general	253,823	280,245	-	534,069	-
Insurance	121,390	58,710	17,856	197,956	31,580
State utility taxes	436,355	194,971	30,029	661,355	-
Depreciation	630,815	981,523	210,229	1,822,568	754,609
Total operating expenses	<u>5,612,898</u>	<u>8,312,492</u>	<u>2,001,133</u>	<u>15,926,523</u>	<u>2,145,773</u>
Operating income (loss)	<u>2,907,600</u>	<u>988,065</u>	<u>(124,014)</u>	<u>3,771,650</u>	<u>(148,140)</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>					
Investment earnings	82,006	40,466	37,767	160,239	1,664
Interest expense	-	(202,584)	-	(202,584)	(16,853)
Other non-operating revenue	27,320	-	755,984	783,303	441,337
Gain (loss) on disposition of assets	-	-	-	-	90,299
Total non-operating income (expense)	<u>109,326</u>	<u>(162,119)</u>	<u>793,751</u>	<u>740,958</u>	<u>516,447</u>
Income before contributions & transfers	<u>3,016,925</u>	<u>825,946</u>	<u>669,737</u>	<u>4,512,608</u>	<u>368,307</u>
Transfers in	134,182	-	-	134,182	46,451
(Transfers out)	(117,803)	(154,684)	(84,087)	(356,574)	-
Change in net position	<u>3,033,304</u>	<u>671,262</u>	<u>585,650</u>	<u>4,290,216</u>	<u>414,758</u>
Net position--beginning	<u>20,843,721</u>	<u>19,993,204</u>	<u>11,248,088</u>	<u>52,085,012</u>	<u>6,578,115</u>
Net position --ending	<u>\$ 23,877,026</u>	<u>\$ 20,664,465</u>	<u>\$ 11,833,738</u>	<u>\$ 56,375,230</u>	<u>\$ 6,992,873</u>
Adjustment for the net effect of the current year activity between the internal service funds and the enterprise funds.				(37,785)	
Change in net position of business-type activities				<u>\$ 4,252,431</u>	



**City of Mercer Island**  
**Statement of Cash Flows**  
**Proprietary Funds**  
**For the Year Ended December 31, 2017**

	Water	Sewer	Storm Drain	Totals	Total Internal Service Funds
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Receipts from customers and users	\$ 8,475,496	\$ 9,236,470	\$ 1,861,650	\$ 19,573,616	\$ 1,997,633
Payments to employees	(1,409,218)	(1,126,539)	(782,978)	(3,318,736)	(686,625)
Payments to suppliers	(1,352,326)	(1,370,778)	(1,147,821)	(3,870,925)	(617,587)
Payments to other governments	(2,435,050)	(4,908,248)	(30,029)	(7,373,326)	0
NET CASH PROVIDED BY OPERATING ACTIVITIES	3,278,902	1,830,905	(99,178)	5,010,629	693,421
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>					
Other non-operating revenues	27,320	0	0	27,320	233,240
Interfund transfers received/(paid)	134,182	0	0	134,182	22,890
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	161,502	0	0	161,502	256,130
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>					
Cash contributions in aid of capital purchases	(117,803)	(154,684)	219,638	(52,849)	208,097
Interfund transfers received in aid of construction	0	0	0	0	23,561
Purchase of capital assets	(802,076)	(370,650)	(413,192)	(1,585,918)	(699,447)
Deferred charges paid on capital debt issuance	0	115,541	0	115,541	0
Principal paid on capital debt	(65,000)	(932,757)	0	(997,757)	(218,810)
Interest paid on capital debt	(43,475)	(215,660)	0	(259,135)	(22,697)
Proceeds from sales of capital assets	0	0	0	0	91,129
NET CASH PROVIDED BY CAPITAL FINANCING ACTIVITIES	(1,028,354)	(1,558,211)	(193,554)	(2,780,119)	(618,166)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Interest received on Investments	71,283	35,615	33,826	140,724	1,303
NET CASH PROVIDED BY INVESTING ACTIVITIES	71,283	35,615	33,826	140,724	1,303
Net increase(decrease)in cash	2,483,333	308,309	(258,906)	2,532,735	332,687
Cash January 1, 2017	7,925,728	4,182,642	4,213,109	16,321,478	3,616,594
Cash December 31, 2017	10,409,061	4,490,951	3,954,202	18,854,214	3,949,281
Cash at the end of the year consists of:					
Operating fund cash	10,409,061	4,490,951	3,954,202	18,854,214	3,949,281
Total cash at the end of the year	10,409,061	4,490,951	3,954,202	18,854,214	3,949,281
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>					
Operating income (loss)	\$ 2,907,600	\$ 988,065	\$ (124,014)	\$ 3,771,650	\$ (148,140)
Adjustments to reconcile operating income to net cash provided by operating activities					
Depreciation	630,815	981,523	210,229	1,822,568	754,609
(Increase)decrease in accounts receivable	(45,002)	(64,087)	(15,468)	(124,557)	0
Increase(decrease) in accounts payable	(103,046)	(148,130)	(200,764)	(451,941)	91,508
Increase (decrease) in salary and benefit payable	(111,464)	73,534	30,839	(7,091)	(4,556)
Total adjustments	371,302	842,840	24,836	1,238,979	841,561
Net cash provided by operating activities	\$ 3,278,902	\$ 1,830,905	\$ (99,178)	\$ 5,010,629	\$ 693,421

The Notes to the Financial Statements are an integral part of this statement.

**City of Mercer Island**  
**Statement of Net Position**  
**Fiduciary Funds**  
**December 31, 2017**

	<b>Firemens Pension Trust Fund</b>	<b>Agency Funds</b>
<b>ASSETS</b>		
Cash & cash equivalents	\$ 887,710	\$ 59,234
Receivables	1,948	-
Total assets	<u>889,658</u>	<u>59,234</u>
<b>LIABILITIES</b>		
Benefits payable	\$ 4,262	\$ 57,234
Deposits	-	2,000
Total liabilities	<u>\$ 4,262</u>	<u>59,234</u>
<b>NET POSITION</b>		
Held in trust for pension and other benefits	<u>885,396</u>	<u>-</u>
Total net position restricted for pensions	<u><u>\$ 885,396</u></u>	<u><u>-</u></u>

The Notes to the Financial Statements are an integral part of this statement,

**City of Mercer Island**  
**Statement of Changes in Net Position**  
**Fiduciary Funds**  
**For the year ended December 31, 2017**

	<b>Firemens Pension Trust Fund</b>
<b>ADDITIONS:</b>	
Contributions:	
Taxes	\$ 58,682
Other	-
Total other contributions	<u>58,682</u>
Investment earnings:	
Interest & dividends	<u>8,183</u>
Total net investment income (loss)	<u>8,183</u>
Total additions	<u>66,866</u>
<b>DEDUCTIONS:</b>	
Benefit payments	<u>83,187</u>
Total deductions	<u>83,187</u>
Change in net position	(16,321)
<b>Net position - Beginning</b>	<u>901,717</u>
<b>Net position - Ending</b>	<u><u>\$ 885,396</u></u>

The Notes to the Financial Statements are an integral part of this statement.

## **NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The financial statements of the City of Mercer Island 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 City's significant accounting policies are described below.

### **Organization**

The City of Mercer Island was incorporated on July 18, 1960. It remained separate from the Town of Mercer Island (which occupied the area now in the central business district) until July of 1970. The City has a council-manager form of government and operates under Title 35A of the Revised Code of Washington (RCW). The City Council is composed of seven non-partisan members elected at large for 4 year terms. From among the council members a mayor is elected for a term of two years. Day-to-day City operations are under the direction of a city manager, who is appointed by the council. The City provides general government services including police, fire service, streets and trails, parks and recreation, planning and zoning, permits and inspection, general administrative and water, sewer, and storm water services.

### **Reporting Entity**

The City of Mercer Island operates under the laws of the State of Washington applicable to the council-manager form of government. As required by generally accepted accounting principles the financial statements present the City of Mercer Island as the primary government.

Blended Component Unit – The Mercer Island Transportation Benefit District was formed by the City Council on October 20, 2014. The purpose of the District is to fund the maintenance, improvement and preservation of existing transportation facilities. The City of Mercer Island Council appointed itself to act as the seven-member governance board of the District. At its December 7, 2015 meeting, the City Council adopted ordinance 15C-24 authorizing the City to assume the rights, powers, functions, immunities and obligations of the Mercer Island Transportation Benefit District. The Mercer Island Transportation Benefit District is reported as a part of the primary government as a Special revenue Fund because of its governance structure and because its sole purpose is to finance and construct Mercer Island streets. The District is funded by a \$20 excise tax on all vehicles registered within the City of Mercer Island. Under contract with the Washington State Department of Licensing, the vehicle excise taxes began collection in May 2015.

### **Government-Wide and Fund Financial Statements**

The city's basic financial statements consist of government-wide statements, including a statement of net position and a statement of activities, and fund financial statements which provide a more detailed level of financial information

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

The statement of activities demonstrates the degree to which the direct expenses of a given function are paid for by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and 2) grants and contributions that are restricted to

meeting the operational or capital requirements of a particular function. Taxes and other items not properly included as 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.

#### **Measurement Focus and Basis of Accounting**

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

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 45 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, sales tax, State shared revenues, utility taxes, franchise fees, grants, and reimbursements under inter-local agreements 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 interfund activity has been eliminated for the government-wide financial statements. Exceptions to this general rule are charges between the government's utility functions and various other functions of the government.

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

The proprietary fund statements distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and delivering goods in connection with the funds principal ongoing operations. The principal operating revenues of the City's utility funds and internal service funds are charges to customers for sales and services, vehicle replacement, and computer replacements. Operating expenses for enterprise funds and internal service funds include the cost of sales and services, administrative expenses, and depreciation of capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

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 they are needed.

### Financial Statement Presentation

The City of Mercer Island reports the following major governmental funds:

The **General Fund** is the general operating fund of the City. It accounts for all financial resources and transactions of the City except those required to be accounted for in another fund.

The **Street Fund** is a special revenue fund that accounts for revenues and expenditures for street maintenance, preservation and construction.

The **Capital Improvement Fund** accounts for financial resources to be used for the acquisition, construction and preservation of the City's general government capital assets and facilities.

The City reports the following major Proprietary Funds:

The **Water Fund** accounts for all activities necessary for the operation, maintenance, and capital reinvestment required to provide water services to Mercer Island residents.

The **Sewer Fund** accounts for all activities necessary for the operation, maintenance, and capital reinvestment required to provide waste water services to Mercer Island residents.

The **Storm and Surface Water Fund** accounts for all activities necessary for the operation, maintenance, and capital reinvestment required to provide storm water services to Mercer Island residents.

Additionally the City reports the following fund types:

**Permanent Funds** account for principle restricted donation earnings. The City has one permanent fund, the Youth Service Endowment, which was created as long term funding mechanism to support ongoing YFS programs.

**Special Revenue Funds** account for revenues derived from restricted or committed taxes, grants, contributions, and other resources for specific purposes. The City has four non-major special revenue funds: Transportation Benefit District, Criminal Justice, Beautification, and the Youth and Family Services fund.

**Capital Funds** account for the financial resources to be used for the acquisition or construction of capital facilities other than those financed by enterprise or internal service funds. The City has three non-major capital funds: Technology and Equipment Fund, Station 92 Construction, and the Capital Reserve fund.

**Internal service funds** account for fleet maintenance and information technology services provided to other departments of the city.

**Agency funds** account for assets held by the city as an agent for private individuals or other governments. Agency funds are custodial in nature (assets equal liabilities) and do not involve the measurement of the results of operations.

The **Pension Trust Fund** accounts for the activities of the Firemen's Pension Fund, which accumulates resources for excess pension benefit payments to qualified firefighters.

### **Budget Policy**

The City of Mercer Island budgets its funds in accordance with the Revised Code of Washington (RCW) Chapter 35A.34. The City of Mercer Island biennial budget is adopted by appropriation ordinance of the Mercer Island City Council and may be amended by subsequent ordinances. Budgets are legally adopted for all general and special revenue fund types on the modified accrual basis, in accordance with GAAP (Generally Accepted Accounting Principles). The City also establishes budgets for the following other fund types: debt service, capital projects, internal service, proprietary, and fiduciary funds. Biennial budgets for debt service and capital project funds are determined by debt issue ordinances and capital spending plans, respectively, therefore, budgetary comparisons, are not reported in the basic financial statements. Nor are budgetary comparisons presented for proprietary fund types, as they are "management budgets", determined on the working capital basis. Washington State law requires that a mid-biennial review and modification be conducted between September 1st and December 31st of the first year of the biennium.

The budget, as adopted, constitutes the legal authority for expenditures. The City's budget is adopted at the fund level, so that expenditures may not legally exceed appropriations at that level of detail. Transfers or revisions within funds are allowed, however, any revisions that alter the total expenditures must be approved by the City Council. When the City Council determines that it is in the best interest of the City to amend the budget appropriations it may do so by ordinance approved by one more than the majority after holding a public meeting. To date the City's 2017-2018 biennial budget has been amended three (3) times during the 2017-2018 biennium. The financial statements present the original and final budgetary information as approved. The original budget is the first complete adopted budget. The final budget is the original budget adjusted by all revisions, transfers and supplemental appropriations legally authorized. All appropriations, except for budgeted capital projects and appropriations for federal and state grant projects, lapse at the end of the biennium. Unexpended resources must be re-appropriated in the subsequent biennial period. The City does not use encumbrances.

The steps taken in the budget process are as follows: City departments begin budget preparation in late spring, incorporating policies, goals, and priorities set by City Council in their Management and Budget Policies, during their annual retreat, and during regular Council meetings throughout the year. By November 1st of even years, in compliance with the law, the City Manager submits a balanced proposed budget to the City Council for the two fiscal years commencing the following January 1. The operating budget includes proposed expenditures and the means of financing them. Public budget hearings are conducted by the City Council in November and December, in accordance with State Law, to obtain taxpayer comments. Should the Council decide to make changes in the preliminary budget; the changes are made after the public hearings and before the adoption of the budget ordinance in December. Washington State law requires that the City Council adopt a balanced budget, which is legally enacted through passage of an ordinance, on or before December 31st.

### **Cash and Investments**

It is the City's policy to invest all temporary (residual) cash surpluses. These investments are reported on the Statement of Net Position as cash and cash equivalents. Included in cash and cash equivalents are currency on hand, investments with the State Investment Pool and other investments. Residual cash from all funds is pooled and the interest earned on the investments is allocated back to various funds on a pro-rata basis. See Note 5.

The City, by State law, is authorized to purchase Certificates of Deposit issued by Washington State depositories that participate in a State Insurance Pool, U.S. Treasury and Agency Securities and banker's acceptances. All security transactions, entered into by the City of Mercer Island, are conducted on a delivery versus payment (DVP) basis. Securities are held by a third party custodian designated by the Finance Director. Investments are reported at Fair market value in accordance with GASB Statement 31.

### Receivables

The City of Mercer Island recognizes receivables in its financial statements based on the accounting requirements for each statement. Receivables are as follows:

**Taxes:** The City's property tax collection records show that approximately 98% of the property taxes due are collected in the year of the levy and delinquent taxes are collected in the next few years. Historically, all taxes have been collected; therefore no allowance for uncollectible taxes is recorded.

**Sales Tax:** Sales Tax collected and remitted by the State within 45 days of the fiscal year end is reported as receivables at year end.

**Other Taxes:** Utility taxes and franchise fees remitted within 45 days of the fiscal year end are reported as receivables at year end.

**Interest:** Interest receivable consists of interest earned on investments, notes or contracts at the end of the year.

**Accounts Receivable:** Customer accounts receivable consists of amounts owed by private individuals or organizations for City goods and services provided. Uncollectible amounts are considered immaterial and the direct write-off method is used when necessary.

### Inter-fund Transactions

During the course of normal operations, the City has numerous transactions between City funds. Quasi-external transactions such as buying goods and services are recorded as revenues and expenses. Reimbursements to a fund for expenditures previously paid that are more properly applicable to another fund are recorded as expenditures in the reimbursing fund and a reduction of expenditure in the fund receiving reimbursement.

All other inter-fund transactions are reported as transfers. As a general rule the effect of inter-fund activity has been eliminated from the government-wide financial statements. Direct expenses of the functional categories are included in the government-wide statement of activities while indirect expense allocations are eliminated. Indirect expenses are primarily charged to the various functions through the use of internal service funds for fleet maintenance and information technology. Elimination of payments to internal service funds are treated as expense reductions. No other indirect expenses are allocated to the various governmental functions. Exceptions to this general rule are charges between the government's utility functions and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as *interfund loans receivable/payable*. All other outstanding balances between funds are reported as *due to/from other funds*. Any residual balances outstanding between the governmental activities and business-type activities are reported in the government wide financial statements as *internal balances*.

### Inventories

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



Inventories in proprietary funds are valued by the first in, first out (FIFO) valuation method which approximates market. A periodic inventory is maintained for operating consumables, where the cost is capitalized when the inventory is purchased and expensed when the item is consumed.

### **Long Term Obligations**

In the government-wide financial statements and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net position. Bond premiums and discounts are deferred and amortized over the life of the bonds using the straight line method. Bonds payable are reported net of the applicable bond premium or discount.

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

### **Capital Assets**

Capital assets, which include property, plant, equipment, improvements, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type columns in the government-wide financial statements. Capital assets are defined by the City as assets with an initial, individual cost of more than \$10,000 and an estimated useful life in excess of two years. All vehicles, computers, production printers and projection equipment are capitalized regardless of the initial cost. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are valued at acquisition price. See also Note 11.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business type activities is included as part of the capitalized value of the assets constructed. The total interest expense incurred by the City as a whole during the fiscal year is \$333,172. Of this amount, \$51,444 was included as part of the cost of capital assets under construction in connection with water system improvements and several sewer system improvements.

Land, construction in progress, intangible assets with indefinite useful lives, and works of art are not depreciated. Infrastructure acquired subsequent to fiscal years ended after June 30, 1980 is reported. Property, plant, infrastructure, and equipment of the city are depreciated using the straight line method over the following estimated useful lives:

ASSET	YEARS
Buildings\Bldg Improvements	30-50
Infrastructure	10-50
Other Improvements	10-50
Equipment	5-10
Intangibles - Software	4-10

### **Deferred Outflows/Inflows of Resources**

In addition to assets, the statement of net position may report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expenditure) until then. The City reports deferred outflow of resources related to pensions and for the difference between the reacquisition price and the net carrying amount of debt that resulted from the advance refunding of general obligation debt.

In addition to liabilities, the statement of financial position may report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The City reports deferred inflow of resources related to pensions and for property taxes levied for the current or prior years that are unavailable at year end.

### **Pensions**

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of all state sponsored pension plans and additions to/deductions from those plans' fiduciary net position have been determined on the same basis as they are reported by the Washington State Department of Retirement Systems. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

### **Compensated Absences - Vacation and Sick Leave**

The City records a liability for accumulated unused vacation leave and salary related payments associated with the payment of vacation leave. All vacation leave is accrued when incurred in the government-wide, proprietary, and fiduciary fund financial statements.

Vacation leave for permanent full-time employees accumulates monthly at annual rates ranging from 12 to 21 days unless otherwise provided for in a collective bargaining agreement. Permanent part-time employees who work at least 8 hours per week earn vacation leave on a pro-rata basis. Employees with at least 5 years and 10 years of service may convert respectively 3 and 5 days of accrued vacation leave to cash, paid through the regular payroll. At termination of employment, employees with the required length of service may receive cash payment for accumulated vacation leave up to a maximum of 30 days. The payment is based on current wages at termination. In accordance with GASB Statement 16, the City accrues a liability for vacation pay.

Sick leave for permanent full-time employees accumulates monthly at the rate of one day for each full month of service unless otherwise provided in a collective bargaining agreement. Permanent part-time employees who work at least 8 hours per week earn sick leave on a pro-rata basis. Sick leave can be accrued to a maximum of 90 days; however, no compensation for accrued sick leave is paid on termination. Accordingly, no liability is recorded for accrued sick leave.

### **Unearned Revenue**

Unearned revenues are those which are measurable but not yet available under the modified accrual basis of accounting. Accordingly, they are not recorded as revenue in the fund financial statements. The City has recognized two unearned revenue items in 2017:

- Rental charges for future scheduled use of City Community Center and Park facilities.
- Unearned permit and development fee revenues.

### **Net Position**

The difference between fund assets and deferred outflows of resources and liabilities and deferred inflows of resources is “net position” on the government-wide, proprietary, and fiduciary fund statements, and is “fund balance” on the governmental statements.

### **Fund Balance Components**

In accordance with GASB Statement 54 the fund balance amounts for governmental funds have been classified as either non-spendable, restricted, committed, assigned, or unassigned.

- **Non-spendable** fund balance includes items that cannot be spent. This includes activity that is not in a spendable form (inventories, prepaid amounts, long term portion of loans/notes receivable, or property held for resale unless the proceeds are restricted, committed or assigned) and activity that is legally or contractually required to remain intact, such as the principal balance in a permanent fund.
- **Restricted** fund balance represents fund balance which has constraints placed on the use of the funds by creditors, grantors, contributors, or laws and regulations of outside governments, or through constitutional provisions or enabling legislation.
- **Committed** fund balance can be used only for specific purposes pursuant to constraints imposed by a formal action of the Mercer Island City Council, the City’s highest level of decision making authority. This formal action is the adoption of an ordinance.
- **Assigned** fund balance includes amounts that are constrained by the City’s intent to be used for a specific purpose, but are neither restricted nor committed. Assignments of fund balance result from resolution, policy, and budget appropriation and are directed by the City Council, the City Manager, and the Finance Director. For governmental funds, other than the General Fund, this is the residual amount within the fund that is not restricted or committed.
- **Unassigned** fund balance is the residual amount of the General Fund not included in the four categories described above. Also, any deficit fund balances within the other governmental fund types are reported as unassigned.

As allowed by the Revised Code of Washington (RCW 35.34.250) the City of Mercer Island maintains a contingency reserve. According to Washington State law, the balance of the Contingency reserve is limited to 37.5 cents per \$1,000 of assessed valuation. The funding goal is to maintain a target balance of ten percent (10%) of budgeted expenditures in the General Fund. The Contingency reserve is intended to address significant revenue shortfalls, and unanticipated, non-recurring, or emergency expenditures. These funds may not be used to establish or support costs that are recurring in nature. Any usage of Contingency Fund reserves must be appropriated by ordinance by the City Council. In the event the Contingency Fund reserves are used, the city shall strive to restore the fund to the ten percent (10%) level within three years. Replenishment of the reserve will be a high priority of the City Council. The balance of the contingency reserve at December 31, 2017 is \$3,439,884 and is included in the un-assigned fund balance of the General Fund.

**NOTE 2 – RECONCILIATION OF GOVERNMENT WIDE AND FUND FINANCIAL STATEMENTS**

**Explanation of aggregated differences between the governmental fund balance sheet and the government-wide statement of net position.**

The governmental fund balance sheet includes reconciliation between total fund balance and total net position as reported in the government-wide statement of net position. The details of the aggregated differences are presented below:

Other long term assets, and deferred outflows of resources, are not available to pay for current period expenditures and therefore are not reported in the funds:

Net Pension Asset (NPA)	\$ 4,483,369
Deferred Outflow of Resources - pensions	1,849,786
Municipal Court receivable	285,747
Deferred Outflow of Resources -refunding	19,971
Deferred Outflow of Resources -refunding	28,578
Net adjustment	<u>\$ 6,667,452</u>

Capital Assets are not financial resources in governmental funds, but are reported in the Statement of Net Assets at their net depreciable value:

Capital assets not subject to depreciation	
Land	\$ 90,407,073
Land infrastructure ROW	16,382,750
Construction in progress	2,257,397
Depreciable infrastructure (net)	15,715,079
Other depreciable assets (net)	28,880,785
Net adjustment	<u>\$ 153,643,084</u>

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

Net Pension Liability (NPL)	\$ (7,670,374)
G.O. bonds payable	(3,530,000)
Net OPEB obligation	(3,074,688)
Deferred Inflow of Resources - Pension	(2,414,061)
Compensated absences	(1,341,870)
Un-amortized premium/discount (net)	(171,668)
Interest payable on long term debt	(6,503)
Net adjustment	<u>\$ (18,209,164)</u>

**Explanation of aggregated differences between the governmental fund statement of revenues, expenditures, and changes in fund balances and the government-wide statement of activities**

The governmental fund statement of revenues, expenditures, and changes in fund balances includes reconciliation between net changes in fund balances for total governmental funds and changes in net position of governmental activities as reported in the government wide statement of activities. The details of the aggregated differences are presented below:

Governmental funds report capital outlays as expenditures. The Statement of Activities allocates the cost of capital outlay over the asset useful life as depreciation.

Capital outlays	\$ 3,804,983
Depreciation Expense	(2,768,151)
Vacate infrastructure asset	<u>(39,837)</u>
Net adjustment	<u>\$ 996,994</u>

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds:

Municipal Court receivable	\$ 5,330
Special Funding for LEOFF	252,218
Net effect of other financing sources and uses	<u>(2,885)</u>
Net adjustment	<u>\$ 254,663</u>

The proceeds from the issuance of long-term debt provide current financial resources to governmental funds and are reported as revenues. Repayments of long-term debt use current financial resources and are reported as expenditures in governmental funds. Neither the receipt of debt proceeds nor the payment of debt principal affect the Statement of Activities, but are reported as increases and decreases in non-current liabilities in the Statement of Net Position:

Principal payment G.O. bonds	\$ 920,000
Net change in interest payable on long term debt	1,505
Amortization of premium/discounts (net)	37,493
Amortization of deferred inflow of resources (net)	<u>(7,506)</u>
Net adjustment	<u>\$ 951,491</u>

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:

Net OPEB obligation	\$ (327,991)
Change in compensated absence payable	(47,391)
Adjustment to Pension Expense	<u>1,129,101</u>
Net adjustment	<u>\$ 753,719</u>

**NOTE 3 – BUDGETARY INFORMATION****Final Budget**

The City Council biennially adopts a budget by ordinance establishing appropriations for City funds and may during the year authorize supplemental appropriations. Amounts shown in the accompanying financial statements represent the original budgeted amounts plus all supplemental appropriations. Revisions made to the original budget are shown below:

<b>Fund</b>	<b>Original Biennial Budget</b>	<b>Biennium Adjustments</b>	<b>Final Biennial Budget</b>
<b>General Government</b>			
General	\$ 58,869,162	\$ 5,145,734	\$ 64,014,896
Contingency	-	700,000	700,000
1% Arts Fund	30,000	24,914	54,914
YFS Endowment	1,000	-	1,000
Total General Government	<u>\$ 58,900,162</u>	<u>\$ 5,870,648</u>	<u>\$ 64,770,810</u>
<b>Special Revenue Funds</b>			
Street	\$ 6,184,205	\$ 1,412,442	\$ 7,596,647
TBD	700,000	-	700,000
Criminal Justice	1,222,163	(121,549)	1,100,614
Beautification	1,906,729	229,930	2,136,659
YFS Fund	5,192,969	416,766	5,609,735
Total Special Revenue	<u>\$ 15,206,066</u>	<u>\$ 1,937,589</u>	<u>\$ 17,143,655</u>
Total General & Special Revenue	<u><u>\$ 74,106,228</u></u>	<u><u>\$ 7,808,237</u></u>	<u><u>\$ 81,914,465</u></u>

**NOTE 4 – GOVERNMENTAL FUND BALANCES**

**Composition of Fund Balance**

It is the policy of the City that expenditures for which more than one category of fund balance could be used, that the order of use is: Restricted Fund Balance, Committed Fund Balance, Assigned Fund Balance, and Unassigned Fund Balance.

The following shows the composition of the fund balance of the governmental funds, by major fund, for the fiscal year ended December 31, 2017:

	General	Street	Capital Improvement	Other Governmental Funds	Total Governmental Funds
<b>Nonspendable</b>					
ARCH long term receivable	\$ -	\$ -	\$ -	\$ -	\$ -
Permanent fund principle				285,856	285,856
Supplies inventory	120,857			-	120,857
Total Nonspendable	120,857	-	-	285,856	406,713
<b>Restricted</b>					
Capital investment in parks, buildings and open space			4,222,170	100,000	4,322,170
Criminal justice				56,169	56,169
Drug enforcement & education				41,345	41,345
Human services				117,666	117,666
Jails	79,437				79,437
Municipal Court Trust	7,062				7,062
KC parks expansion levy funds			20,786		20,786
Streets, paths and trails		5,029,445		57,367	5,086,812
Total Restricted	86,499	5,029,445	4,242,956	372,547	9,731,448
<b>Committed</b>					
Art in public places	207,200				207,200
Parks, streets, paths and trails		155,979	95,537		251,516
Human services				146,552	146,552
LEOFF 1 long term care	328,230				328,230
Self insurance	40,000				40,000
Town center beautification				1,340,698	1,340,698
Total Committed	575,430	155,979	95,537	1,487,250	2,314,196
<b>Assigned</b>					
Appropriated fund balance					-
Athletic turf field replacement			877,546		877,546
Capital improvements				69,999	69,999
Compensated absence	1,252,228				1,252,228
Debt service				23,982	23,982
LEOFF 1 long term care	1,077,966				1,077,966
Petty cash	2,950				2,950
Self insurance	69,750				69,750
Streets, paths and trails		99,684			99,684
Technology and equipment	97,483			532,995	630,478
Total Assigned	2,500,377	99,684	877,546	626,976	4,104,582
<b>Unassigned</b>					
	5,565,472	-	-	-	5,565,472
<b>Total Fund Balance</b>	<b>\$ 8,848,635</b>	<b>\$ 5,285,108</b>	<b>\$ 5,216,040</b>	<b>\$ 2,772,629</b>	<b>\$ 22,122,410</b>

## NOTE 5 - DEPOSITS AND INVESTMENTS

### Deposits

The City of Mercer Island's bank deposits are covered by the Federal Deposit Insurance Corporation (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC). All deposits not covered by the FDIC are covered by the PDPC.

<u>Cash and Deposits</u>	
Cash on hand	2,950
FDIC or PDPC Insured Bank Deposits	\$ 899,840
<b>Total</b>	<b>\$ 902,790</b>

### Investments

All surplus cash is invested in accordance with an investment policy approved by the Mercer Island City Council (January 2012). State law defines eligible investments to only those securities and deposits authorized by statute (RCW 39.58, 39.59, 43.250, and 43.84.080). Eligible investments which the City held at year end include Government Sponsored Enterprises, Washington State Local Government Investment Pool, obligations of state and local government agencies, and FDIC and PDPC Insured Bank Deposits. Investments are carried at fair market value in accordance with GASB 31.

### Investments Measured at Amortized Cost

Cash held in the Washington State Local Government Investment Pool (LGIP) is managed and operated by the Office of the State Treasurer (OST). This pool represents an interest in a group of securities and has no specific security subject to custodial risk. The State Finance Committee is the administrator of the statute that created the pool and adopts appropriate rules. The State Treasurer is responsible for establishing the investment policy for the pool and reviews it annually. Any proposed changes are reviewed by the LGIP Advisory Committee. The terms of the policy are designed to ensure the safety and liquidity of the funds deposited in the LGIP. The LGIP is invested in a manner that meets the maturity, quality, diversification and liquidity requirements set forth by GASB for external investment pools that elect to measure, for financial reporting purposes, investments at amortized cost. The LGIP has no limitations or restrictions on withdrawals.

<u>Investments Measured at Amortized Cost</u>	
Washington State Local Government Investment Pool	\$24,513,049
<b>Total</b>	<b>\$24,513,049</b>

### Custodial Credit Risk

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

### Credit Risk

Credit risk is the chance that an issuer will fail to pay principal or interest in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause the price of the investment to decline. The City's investment policy applies the prudent person standard; investments will be made with judgment and care, under circumstances then prevailing, which a person of prudence, discretion and intelligence would use in the



management of their own affairs, not for speculation, but for investment purposes. The Washington State Local Government Investment Pool is a 2a7-like pool and is unrated. The credit ratings on securities held by the City of Mercer Island on December 31, 2017, are listed below:

Investment Type	Ratings		Fair Value
	Moody's	S&P	
Government Sponsored Enterprises			
Federal Farm Credit Bank	AAA	AA+	\$ 4,950,916
Federal Home Loan Bank	AAA	AA+	4,948,808
Federal Home Mortgage Association	AAA	AA+	3,932,260
Federal Hme LN MTG Corp	AAA	AA+	4,975,168
Municipal Security			
Port of Seattle	A1	A+	1,041,050
Total			\$ 19,848,202

### Concentration of Credit Risk

Concentration of credit risk is the risk associated with a lack of diversification or having too much invested in a few individual issues. It is the City's policy to diversify its investments by security type and institution. The City's policy is to assure that no single institution or security is invested to such an extent that a delay of liquidation at maturity is likely to cause a current cash flow emergency. With the exception of U.S. Treasury securities and authorized pools, no more than 30% of the entity's total investment portfolio will be invested in a single security type, issuer or financial institution, and no more than 5% invested with State or political subdivision securities. Detail information on concentration risk is covered in the City of Mercer Island's Investment Policy.

Investment Type	Fair Value	Cost Based Measure	Percent of Total
<b>Government Sponsored Enterprises</b>			
Federal Farm Credit Bank	\$ 4,950,916		10.9%
Federal Home Loan Bank	\$ 4,948,808		10.9%
Federal Home Mortgage Association	\$ 3,932,260		8.7%
Federal Hme LN MTG Corp	\$ 4,975,168		11.0%
<b>Municipal Security</b>			
Port of Seattle	1,041,050		2.3%
Cash on hand		2,950	0.0%
FDIC or PDPC Insured Bank Deposits		1,025,906	2.3%
Washington State LGIP		\$ 24,513,049	54.0%
<b>Total</b>	<b>\$ 19,848,202</b>	<b>\$ 25,541,905</b>	
Total Cash, Deposits and Investments		<b>\$ 45,390,107</b>	

\* Of the total, \$946,944 is cash and investments of Fiduciary Funds.

### Interest Rate Risk

Interest Rate Risk is the risk that changes in interest rates will adversely affect the fair value of an investment. As a means of limiting its exposure to fair value losses arising from rising interest rates, the City's policy limits investments in securities to those maturing no more than five years from the date of purchase.

The Washington State Local Government Investment Pool is an unrated 2a-7 like pool as defined by GASB 31, accordingly participants balances are not subject to interest rate risk as the weighted average maturity of the portfolio will not exceed 90 days. The Average Days to Maturity on December 31, 2017, was 37 days.

The following schedule presents the investments and related maturities as of December 31, 2017.

Investment Type	Fair Value	Maturity (in Years)	
		Less Than 1	1-5
Government Sponsored Enterprises	\$18,807,152	\$ 3,990,168	\$ 14,816,984
Municipal Security	1,041,050		1,041,050
<b>Total</b>	<b>\$19,848,202</b>	<b>\$ 3,990,168</b>	<b>\$ 15,858,034</b>

### Fair Value Hierarchy

Securities classified as Level 1 in the fair value hierarchy are valued using prices quoted in active markets for identical securities, Level 2 securities are valued using observable, and Level 3 securities are valued using unobservable inputs. U.S. Government Sponsored Enterprise securities classified in Level 2 are valued using quoted prices for similar securities and interest rates. The level of fair value measurement is based on the lowest level of significant input for the security type in its entirety. There are no Level 1 or Level 3 security classifications to report. Cash on hand, bank deposits, cash held by other entities and the Local Government Investment Pool (LGIP) are valued using a cost based measure. The following schedule presents the investments and method of fair value measurement as of December 31, 2017:

Investment Type	Total	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Government Sponsored Enterprises	\$18,807,152		\$ 18,807,152	
Municipal Security	1,041,050		1,041,050	
<b>Total</b>	<b>\$19,848,202</b>	<b>\$ -</b>	<b>\$ 19,848,202</b>	<b>\$ -</b>

#### NOTE 6 – PROPERTY TAXES

The King County Treasurer acts as an agent to collect property taxes levied in the County for all taxing authorities. Taxes are levied annually on January 1 on property value listed as of the prior May 31. Assessed values are established by the County Assessor at 100 percent of fair market value. A reevaluation of all property is required every two years. Taxes are due in two equal installments on April 30 and October 31. Collections are distributed on a daily basis. The amount of taxes receivable at year end are recorded as receivables and offset by deferred revenue. No allowance for uncollectable taxes is established because delinquent taxes are considered fully collectable.

The City is permitted by law to levy up to \$3.10000 per \$1,000 of assessed valuation for general governmental services. This amount may be reduced for any of the following three reasons:

1. The Washington State Constitution limits the total regular property taxes to 1 percent of assessed valuation or \$10 per \$1,000 of value. If the taxes of all districts (except for ports and utility districts) exceed this amount, each is proportionately reduced until the total is at or below the 1 percent limit.
2. Washington State law in RCW 84.55.010 limits the growth of regular property taxes to the lesser of inflation (as measured by the Implicit Price Deflator) or 101%, after adjustments. Inflation can be expected to exceed one percent; consequently, the levy lid will normally be 101%.
3. The City is allowed by law in RCW 84.55.050 to ask the voters to approve increases in excess of the 101% limit. A simple majority of voters can approve a “levy lid lift” that would increase the base for the following year. That base can be increased either forever, for a limited period of time, or for a particular purpose

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

For 2017 the City's tax levy was \$1.07739 per \$1,000 on a total assessed valuation of \$12,083,477,559 for a total levy of \$13,018,650. The total property tax levy includes the regular statutory levy and special levies as detailed below:

**General Levy**

Regular Statutory Levy	\$ 11,413,770
------------------------	---------------

**LID Lifts**

Lid Lift - 2008	936,260
Lid Lift - 2012	668,620

<b>Total Property Tax Levy 2015</b>	<b><u>\$ 13,018,650</u></b>
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**NOTE 7 - INTERFUND TRANSFERS****Transfers In and Transfers Out**

During the course of normal operations, the City has numerous transactions between City funds. Reimbursements to a fund for expenditures previously paid that are more properly applicable to another fund are recorded as expenditures in the reimbursing fund and a reduction of expenditure in the fund receiving reimbursement. As a general rule the effect of inter-fund activity has been eliminated from the government-wide financial statements.

<b>Fund</b>	<b>Transfer In</b>	<b>Transfer Out</b>
Major Governmental Funds		
General Fund	\$ 1,321,678	\$ 1,122,461
Street Fund	467,881	74,870
Capital Improvement Fund	169,119	296,000
Non-Major Governmental Funds		
Transportation Benefit District		350,000
Criminal Justice Fund		1,024,572
Beautification Fund		45,000
Youth & Family Services Fund	459,121	19,566
Non-Voted Bond Fund	395,682	
Technology and Equipment Fund	592,034	
Station 92 Construction Fund		297,106
Internal Service Fund		
Equipment Rental (Fleet) Fund	22,890	
Computer Replacement Fund	23,561	
Proprietary Funds		
Water Fund	134,182	117,803
Sewer Fund		154,684
Stormwater Fund		84,087
<b>Total Transfers In/Out</b>	<b>\$ 3,586,148</b>	<b>\$ 3,586,148</b>

Transfers out of the General fund include the ongoing support of Youth and Family Services programs at \$409,121 and funding for future technology and equipment purchases of \$250,000. Transfers out of the business type funds were to cover the utility portion of capital reinvestment costs.

The Criminal Justice Fund was closed in 2017 and the remaining cash balance transferred out to the General Fund in support of Police and criminal justice expenditures. The Station 92 construction project was final in 2017, the capital fund closed and the remaining cash balance transferred to the General fund.

**NOTE 8 - LONG-TERM DEBT**

The City of Mercer Island issues general obligation bonds (G.O.) to finance large capital improvement projects. General obligation bonds are a direct obligation of the City, which pledges its full faith and credit for repayment. General obligation bonds have been issued for both general government and business-type activities and are being repaid from the applicable resources. There are two kinds of G.O. bonds: (1) non-voted or councilmanic, which the City can issue up to a specified limit without a vote of the people; and (2) voter-approved bonds, which require a vote of the people because a special (excess) property tax levy is needed for bond repayment.

At the close of 2017 the City has seven Councilmanic bond issues outstanding. The City periodically reviews existing debt outstanding to determine if more favorable long term financing terms exist that would indicate savings to be gained by refunding. In August 2017 the City issued \$6,205,000.00 in Limited Tax General Obligation Refunding bonds. The bond proceeds will be used to refund a portion of the City's outstanding limited tax general obligation bonds for debt service savings

**General Obligation Bonds, Issuances, Redemptions, and Balances Outstanding**

	Date of Issue	Date of Final Maturity	Interest Rates	Amount Originally Issued	Beginning Unmatured Debt 1/1/17	Amount Issued	Current Period Reductions	Ending Unmatured Debt 12/31/17
2009 LTGO	8/17/09	12/1/22	2.0/3.75	1,000,000	505,000		425,000	80,000
2009 LTGO	8/17/09	12/1/29	2.0/4.25	9,405,000	6,790,000		6,355,000	435,000
2011 LTGO	3/23/11	12/1/30	2.5/4.25	1,500,000	1,160,000		65,000	1,095,000
2013 LTGO	2/6/13	12/1/21	1.0/2.0%	4,940,000	2,905,000		560,000	2,345,000
2013 LTGO	2/6/13	12/1/23	1.0/2.0%	1,140,000	895,000		120,000	775,000
2013 LTGO	2/6/13	12/1/17	1.0/2.0%	630,000	155,000		155,000	-
2017 LTGO	8/17/17	12/1/22	2.0 / 4.0%	335,000	-	335,000	5,000	330,000
2017 LTGO	8/17/17	12/1/29	1.95 / 4.0%	5,870,000	-	5,870,000	45,000	5,825,000
<b>Total GO Bonds</b>				<b>\$ 24,820,000</b>	<b>\$ 12,410,000</b>	<b>\$ 6,205,000</b>	<b>\$ 7,730,000</b>	<b>\$ 10,885,000</b>

\*Councilmanic Bonds

The 2009 LTGO Bond issued for funding capital improvements at the South Mercer playfields were partially defeased using the proceeds of the 2017 LTGO Advance Refunding bonds issued in August 2017. The liability for the defeased bonds has been removed from the statement of Net Position. The remaining portion of the 2009 issuance is presented in the Statement of Net Position net of the related premium. The total bonds payable plus premiums net of amortization are as follows:

Bonds outstanding	\$ 80,000
Plus un-amortized bond premium	9
Bonds outstanding net	<u>\$ 80,009</u>

The 2013 LTGO Bond issuance for financing the constructing and equipping of Fire Station 92 and additional Fire apparatus is presented in the Statement of Net Position net of the related premium. The total bonds payable plus premiums net of amortization are as follows:

Bonds outstanding	\$ 2,345,000
Plus un-amortized bond premium	<u>108,293</u>
Bonds outstanding net	<u><u>\$ 2,453,293</u></u>

Proceeds from the 2013 LTGO Refunding Bonds were used to advance refund the 2004 CCMV construction bonds. The Refunding bonds are presented in the Statement of Net Position net of the related premium. The total bonds payable plus premiums net of amortization are as follows:

Bonds outstanding	\$ 775,000
Plus un-amortized bond premium	<u>30,476</u>
Bonds outstanding net	<u><u>\$ 805,476</u></u>

The 2009 LTGO bonds issued for capital improvements to the Sewer lake line were partially defeased using the proceeds of the 2017 LTGO Advance Refunding bonds issued in August 2017. The liability for the defeased bonds has been removed from the statement of Net Position. The remaining portion of the 2009 issuance is presented in the business type Statement of Net Position net of the related discount. The total bonds payable minus unamortized discount is as follows:

Bonds outstanding	\$ 435,000
Less un-amortized bond discount	<u>(1,901)</u>
Bonds outstanding net	<u><u>\$ 433,099</u></u>

The 2011 LTGO bond issuance for capital improvements to the First Hill neighborhood water system is presented in the business type Statement of Net Position net of the related premium. The total bonds payable plus the unamortized bond premium is as follows:

Bonds outstanding	\$ 1,095,000
Plus un-amortized bond premium	<u>13,527</u>
Bonds outstanding net	<u><u>\$ 1,108,527</u></u>

Proceeds from the 2017 LTGO Refunding Bonds were used to advance refund a portion of the 2013 South Mercer Playfields bonds. The refunding bonds are presented in the Statement of Net Position net of the related premium. The total bonds payable plus premiums net of amortization are as follows:

Bonds outstanding	\$ 330,000
Plus un-amortized bond premium	<u>32,891</u>
Bonds outstanding net	<u><u>\$ 362,891</u></u>

Proceeds from the 2017 LTGO Refunding Bonds were used to advance refund a portion of the 2013 Sewer Lake Line bonds. The refunding bonds are presented in the business type Statement of Net Position net of the related premium. The total bonds payable plus premiums net of amortization are as:

Bonds outstanding	\$ 5,825,000
Plus un-amortized bond premium	<u>431,402</u>
Bonds outstanding net	<u><u>\$ 6,256,402</u></u>

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

Year	Governmental Activities		Business Type Activities	
	Principal	Interest	Principal	Interest
2018	770,000	78,040	505,000	242,823
2019	780,000	61,800	510,000	227,455
2020	795,000	44,700	525,000	207,580
2021	820,000	27,200	555,000	187,105
2022	225,000	9,100	565,000	165,280
2023-2027	140,000	2,800	3,185,000	483,150
2028-2030	-	-	1,510,000	66,275
<b>TOTAL</b>	<b>\$ 3,530,000</b>	<b>\$ 223,640</b>	<b>\$ 7,355,000</b>	<b>\$ 1,579,668</b>

#### Advance Refunding

In 2013 the City advance refunded a portion (\$640 thousand) of the 2003 LTGO Bonds to reduce its total combined debt service payments over the next four years by \$35,336 and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$37,609. The advance refunding also resulted in a difference between the net reacquisition price (funds deposited in escrow to refund old bonds) and the net carrying amount of the old debt of \$7,163. This amount, reported in the statement of net position as a deferred outflow of resources, will be charged to operations through the year 2017 using the effective interest method.

In 2013 the City advance refunded a portion (\$1.135 million) of the 2004 LTGO Bonds to reduce its total combined debt service payments over the next ten years by \$180 thousand and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$170.3 thousand. The advance refunding also resulted in a difference between the net reacquisition price (funds deposited in escrow to refund old bonds) and the net carrying amount of the old debt of \$51,441. This amount, reported in the statement of net position as a deferred outflow of resources, will be charged to operations through the year 2023 using the effective interest method.

In 2017 the City advance refunded a portion (\$6.28 million) of the 2009 LTGO Bonds to reduce its total combined debt service payments over the next twelve years by \$659.4 thousand and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$585.5 thousand. The advance refunding also resulted in a difference between the net reacquisition price (funds deposited in escrow to refund old bonds) and the net carrying amount of the old debt of \$356,748. This amount, reported in the statement of net position as a deferred outflow of resources, will be charged to operations through the year 2029 using the effective interest method.

**Public Works Trust Fund Debt, Issuances, Redemptions and Balances Outstanding**

	Date of Issue	Date of Final Maturity	Interest Rate	Amount Originally Issued	Beginning Unmatured Debt 1/1/2017	Amount Issued	Current Period Reductions	Ending Unmatured 12/31/2017
Sewer Lake Line	1/31/05	7/1/26	1.5%	7,000,000	4,027,572		402,757	3,624,816
<b>Total PWTF Debt</b>				<b>\$ 7,000,000</b>	<b>\$ 4,027,572</b>	<b>\$ -</b>	<b>\$ 402,757</b>	<b>\$ 3,624,816</b>

The annual debt service requirements to maturity for public works trust fund loans are as follows:

<b>PWTF - Business Type Activities</b>			
<b>Year</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2018	402,757	18,124	420,881
2019	402,757	16,110	418,868
2020	402,757	14,097	416,854
2021	402,757	12,083	414,840
2022	402,757	10,069	412,826
2023-2026	1,611,029	20,138	1,631,167
<b>Total</b>	<b>\$ 3,624,816</b>	<b>\$ 90,620</b>	<b>\$ 3,715,437</b>

There are a number of other limitations and restrictions contained in the various bond indentures. The City is in compliance with all significant limitations and restrictions.



## NOTE 9 - LEASES

### Capital Leases

In 2007 the Mercer Island City Council authorized a contract with Pierce Manufacturing to purchase one Midi Pumper Fire Truck and two Velocity Pumper Trucks through Lease Purchase financing agreements with Municipal Asset Management Inc. in the amounts of \$251,982 and \$1,035,026 respectively. These lease agreements qualify as capital leases for accounting purposes.

In 2012 the Mercer Island City Council authorized another contract with Pierce Manufacturing to purchase one Velocity Pumper Truck through a Lease Purchase financing agreement with Municipal Asset Management Inc. in the amount of \$619,546.50. The lease agreement qualifies as capital lease for accounting purposes.

In 2015 the Mercer Island City Council authorized another contract with Pierce Manufacturing to purchase one Midi Pumper Truck through a Lease Purchase financing agreement with Municipal Asset Management Inc. in the amount of \$341,295. The lease agreement qualifies as capital lease for accounting purposes.

The assets acquired through capital leases are as follows:

Asset	Governmental Activities
Pierce Velocity Fire Pumper	\$ 517,513
Pierce Velocity Fire Pumper	517,513
Pierce Midi Fire Pumper	251,982
Pierce Velocity Fire Pumper	619,547
Pierce Midi Fire Pumper	333,286
Less Accumulated Depreciation	(820,471)
<b>Total</b>	<b>\$ 1,419,369</b>

The future minimum lease obligation payments as of December 31, 2017 are as follows:

Year	Principal	Interest	Total
2018	98,518	14,966	113,484
2019	100,972	12,512	113,484
2020	103,487	9,996	113,483
2021	106,065	7,419	113,484
2022	108,707	4,777	113,484
2023-2024	82,420	3,116	85,536
<b>Total</b>	<b>\$ 600,169</b>	<b>\$ 52,786</b>	<b>\$ 652,955</b>

**NOTE 10 - CHANGES IN LONG TERM LIABILITIES**

Long term liability activity for the year ended December 31, 2017 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<b>Governmental Activities</b>					
Bonds payable:					
General obligation bonds	\$ 4,460,000	\$ 335,000	\$ (1,265,000)	\$ 3,530,000	\$ 770,000
Capital lease	818,979	-	(218,810)	600,169	98,518
Deferred amounts:					
Issuance discounts	-	-	-	-	
For issuance premiums	176,305	32,891	(37,528)	171,668	
Total Bonds Payable	5,455,284	367,891	(1,521,338)	4,301,837	868,518
Net Pension Liability	10,043,722		(2,035,744)	8,007,978	
OPEB payable (net)	2,746,697	327,991	-	3,074,688	
Compensated absences	1,324,751	61,066	-	1,385,817	
Total governmental activity					
long term liabilities	<u>\$ 19,570,454</u>	<u>\$ 756,948</u>	<u>\$ (3,557,082)</u>	<u>\$ 16,770,319</u>	<u>\$ 868,518</u>
<b>Business Type Activities</b>					
Bonds payable	\$ 7,950,000	\$ 5,870,000	\$ (6,465,000)	\$ 7,355,000	\$ 505,000
Issuance discounts	(24,719)	-	22,816	(1,903)	
For issuance premiums	14,570	431,402	(1,041)	444,931	
PWTF Loans	4,027,573	-	(402,757)	3,624,816	402,757
Net Pension Liability	1,988,895	-	(326,846)	1,662,049	
Compensated absences	138,845	15,570	-	154,415	
Total business type activity					
long term liabilities	<u>\$ 14,095,162</u>	<u>\$ 6,316,972</u>	<u>\$ (7,172,828)</u>	<u>\$ 13,239,306</u>	<u>\$ 907,757</u>

Internal service funds predominantly serve the governmental funds. Accordingly, long-term liabilities for them are included as part of the above totals for governmental activities. At year end \$43,948 of internal service funds compensated absences Liability are included in the above amounts. Compensated absences for governmental activities are liquidated in the governmental fund from which the employee's salary is paid.

**NOTE 11 – CAPITAL ASSETS**

**Changes in Capital Assets – Governmental Activities**

Asset Class	Balance 12/31/2016	Reclass	Additions	Deletions	Balance 12/31/2017
Capital assets not being depreciated					
Land	\$ 90,407,073				\$ 90,407,073
Land infrastructure	16,422,587			(39,837)	16,382,750
Construction in progress	51,911		1,957,028	(29,112)	1,979,828
Construction in progress - infrastructure	174,604		233,156	(130,191)	277,569
Total capital assets not being depreciated	\$ 107,056,175	\$ -	2,190,185	(199,140)	\$ 109,047,220
Capital assets being depreciated					
Buildings	\$ 29,874,438		\$ 72,502		\$ 29,946,940
Infrastructure	33,489,516		1,564,248		35,053,764
Improvements	13,983,201		36,465	(123,906)	13,895,760
Machinery & Equipment	2,590,375		84,464	(84,235)	2,590,604
Machinery & Equipment - IS	10,022,182		699,447	(666,074)	10,055,555
Intangibles	2,592,199		16,422		2,608,621
Total capital assets being depreciated	\$ 92,551,911	\$ -	2,473,548	(874,215)	\$ 94,151,244
Less accum depreciation For:					
Buildings	\$ (8,832,685)		\$ (784,580)		\$ (9,617,265)
Infrastructure	(18,236,079)		(1,102,606)		(19,338,685)
Improvements	(6,328,859)		(606,845)	123,906	(6,811,798)
Machinery & Equipment	(2,042,909)		(177,526)	84,235	(2,136,201)
Machinery & Equipment - IS	(5,729,351)		(754,609)	665,243	(5,818,717)
Intangibles	(1,499,282)		(96,594)		(1,595,877)
Total accum depreciation	\$ (42,669,166)	\$ -	\$ (3,522,761)	\$ 873,384	\$ (45,318,542)
Total net depreciable capital assets	\$ 49,882,746	\$ -	\$ (1,049,213)	\$ (830)	\$ 48,832,702
<b>Total governmental capital assets (net)</b>	<b>\$ 156,938,921</b>	<b>\$ -</b>	<b>\$ 1,140,972</b>	<b>\$ (199,970)</b>	<b>\$ 157,879,922</b>

**Asset Useful Lives**

	Estimated Service Life
Buildings	30-50 years
Infrastructure	10-50 years
Improvements Other Than Buildings	10-50 years
Equipment	5-10 years

**Changes in Capital Assets - Business Type Activities**

Asset Class	Balance 12/31/2016	Additions	Reductions	Balance 12/31/2017
Capital asset not being depreciated				
Land	\$ 203,992	\$ -	\$ -	\$ 203,992
Construction in progress	180,033	-	(92,045)	87,988
Total capital asset not being depreciated	384,024	-	(92,045)	291,979
Capital assets being depreciated				
Intangibles	\$ 18,129	\$ -	\$ -	\$ 18,129
Buildings	430,048	-	-	430,048
Improvements (other than buildings)	85,033,666	1,668,236	-	86,701,901
Machinery & Equipment	1,539,948	42,757	-	1,582,705
Accumulated depreciation	(37,567,689)	(1,822,568)	-	(39,390,257)
Total net depreciable capital assets	\$ 49,454,101	\$ (111,575)	\$ -	49,342,526
<b>Total business type capital assets - net</b>	<b>\$ 49,838,125</b>	<b>\$ (111,575)</b>	<b>\$ (92,045)</b>	<b>\$ 49,634,506</b>

**Depreciation Expense**

Depreciation was charged to functions/programs of the primary government as follows:

**Governmental Activities**

General government	\$ 221,700
Public safety	369,335
Physical environment	31,565
Transportation	1,102,606
Economic environment	19,390
Mental health	30,967
Culture and recreation	992,589
Capital assets held by internal service funds are charged to the various functions based on their usage of the assets	754,609
Total depreciation expense - governmental activities	<u>\$ 3,522,761</u>

**Business Type Activities**

Water	\$ 630,815
Sewer	981,523
Stormwater	210,229
Total depreciation expense - business type activities	<u>\$ 1,822,568</u>

**Construction Obligations**

The City has active capital improvement projects as of December 31, 2017. There are no material commitments associated with these projects.

**Interest Capitalization**

In proprietary funds, interest incurred during the construction phase of the capital assets is included as part of the capitalized value of the asset constructed. The total interest expense for the City as a whole during the fiscal year was \$333,172. Of this amount, \$51,444 was included as part of the cost of capital assets under construction in connection with water system improvements and various sewer system improvements.

## **NOTE 12 - RISK MANAGEMENT**

The city of Mercer Island 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 161 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, errors or omissions, stop gap, employment practices and employee benefits liability. Limits are \$4 million per occurrence in the self-insured layer, and \$21 million in limits above the self-insured layer is provided by reinsurance. Total limits are \$25 million per occurrence subject to aggregates and sublimits. The Board of Directors determines the limits and terms of coverage annually.

Insurance for property, automobile physical damage, fidelity, inland marine, and boiler and machinery coverage are purchased on a group basis. Various deductibles apply by type of coverage. Property coverage is self-funded from the members' deductible to \$750,000, for all perils other than flood and earthquake, and insured above that to \$300 million per occurrence subject to aggregates and sublimits. Automobile physical damage coverage is self-funded from the members' deductible to \$250,000 and insured above that to \$100 million per occurrence subject to aggregates and sublimits.

In-house services include risk management consultation, loss control field services, and claims and litigation administration. WCIA contracts for certain claims investigations, consultants for personnel and land use issues, insurance brokerage, actuarial, 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, reinsurance and other 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.

#### NOTE 13 - PENSION PLANS

The following table represents the aggregate pension amounts for all plans which are subject to the requirements of the GASB Statement 68, *Accounting and Financial Reporting for Pensions* for the year 2017:

Aggregate Pension Amounts – All Plans	
Pension liabilities	\$9,670,027
Pension assets	4,483,369
Deferred outflows of resources	2,236,419
Deferred inflows of resources	2,795,144
Pension expense/expenditures	552,047

#### State Sponsored Pension Plans

Substantially all of the City of Mercer Island's full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing, multiple-employer public employee defined benefit and defined contribution retirement plans. The state Legislature establishes, and amends, laws pertaining to the creation and administration of all public retirement systems.

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 98540-8380

Or the DRS CAFR may be downloaded from the DRS website at [www.drs.wa.gov](http://www.drs.wa.gov).

#### Public Employees' Retirement System (PERS)

PERS members include elected officials; state employees; employees of the Supreme, Appeals and Superior Courts; employees of the legislature; employees of district and municipal courts; employees of local governments; and higher education employees not participating in higher education retirement programs. PERS is comprised of three separate pension plans for membership purposes. PERS plans 1 and 2 are defined benefit plans, and PERS plan 3 is a defined benefit plan with a defined contribution component.

**PERS Plan 1** provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the member's average final compensation (AFC) times the member's years of service. The AFC is the average of the member's 24 highest consecutive service months. Members are eligible for retirement from active status at any age with at least 30 years of service, at age 55 with at least 25 years of service, or at age 60 with at least five years of service. Members retiring from active status prior to the age of 65 may receive actuarially reduced benefits. Retirement benefits are actuarially reduced to reflect the choice of a survivor benefit. Other benefits include duty and non-duty disability payments, an optional cost-of-living adjustment (COLA), and a one-time duty-related death benefit, if found eligible by the Department of Labor and Industries. PERS 1 members were vested after the completion of five years of eligible service. The plan was closed to new entrants on September 30, 1977.

### **Contributions**

The **PERS Plan 1** member contribution rate is established by State statute at 6 percent. The employer contribution rate is developed by the Office of the State Actuary and includes an administrative expense component that is currently set at 0.18 percent. Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates. The PERS Plan 1 required contribution rates (expressed as a percentage of covered payroll) for 2017 were as follows:

<b>PERS Plan 1</b>		
<b>Actual Contribution Rates:</b>	<b>Employer</b>	<b>Employee*</b>
January – June 2017:		
PERS Plan 1	6.23%	6.00%
PERS Plan 1 UAAL	4.77%	6.00%
Administrative Fee	0.18%	
<b>Total</b>	<b>11.18%</b>	<b>6.00%</b>
July – December 2017:		
PERS Plan 1	7.49%	6.00%
PERS Plan 1 UAAL	5.03%	
Administrative Fee	0.18%	
<b>Total</b>	<b>12.70%</b>	<b>6.0%</b>

\* For employees participating in JBM, the contribution rate was 12.26%

**PERS Plan 2/3** provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the member's average final compensation (AFC) times the member's years of service for Plan 2 and 1 percent of AFC for Plan 3. The AFC is the average of the member's 60 highest-paid consecutive service months. There is no cap on years of service credit. Members are eligible for retirement with a full benefit at 65 with at least five years of service credit. Retirement before age 65 is considered an early retirement. PERS Plan 2/3 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 benefit that is reduced by a factor that varies according to age for each year before age 65. PERS Plan 2/3 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 three percent for each year before age 65; or
- With a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules.

PERS Plan 2/3 members hired on or after May 1, 2013 have the option to retire early by accepting a reduction of five percent for each year of retirement before age 65. This option is available only to those who are age 55 or older and have at least 30 years of service credit. PERS Plan 2/3 retirement benefits are also actuarially reduced to reflect the choice of a survivor benefit. Other PERS Plan 2/3 benefits include duty and non-duty disability payments, a cost-of-living allowance (based on the CPI), capped at three percent annually and a one-time duty related death benefit, if found eligible by the Department of Labor and Industries. PERS 2 members are vested after completing five years of eligible service. 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 12 months of that service are earned after age 44.

**PERS Plan 3** defined contribution benefits are totally dependent on employee contributions and investment earnings on those contributions. PERS Plan 3 members choose their contribution rate upon joining membership and have a chance to change rates upon changing employers. As established by statute, Plan 3 required defined contribution rates are set at a minimum of 5 percent and escalate to 15 percent with a choice of six options.



Employers do not contribute to the defined contribution benefits. PERS Plan 3 members are immediately vested in the defined contribution portion of their plan.

### **Contributions**

The **PERS Plan 2/3** employer and employee contribution rates are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. The Plan 2/3 employer rates include a component to address the PERS Plan 1 UAAL and an administrative expense that is currently set at 0.18 percent. Each biennium, the state Pension Funding Council adopts Plan 2 employer and employee contribution rates and Plan 3 contribution rates. The PERS Plan 2/3 required contribution rates (expressed as a percentage of covered payroll) for 2017 were as follows:

<b>PERS Plan 2/3</b>		
<b>Actual Contribution Rates:</b>	<b>Employer 2/3</b>	<b>Employee 2*</b>
January – June 2017:		
PERS Plan 2/3	6.23%	6.12%
PERS Plan 1 UAAL	4.77%	
Administrative Fee	0.18%	
Employee PERS Plan 3		Variable
<b>Total</b>	<b>11.18%</b>	<b>6.12%</b>
July – December 2017:		
PERS Plan 2/3	7.49%	7.38%
PERS Plan 1 UAAL	5.03%	
Administrative Fee	0.18%	
Employee PERS Plan 3		Variable
<b>Total</b>	<b>12.70%</b>	<b>7.38%</b>

\* For employees participating in JBM, the contribution rate was 15.30% for January – June 2017 and 18.45% for July – December 2017.

The City of Mercer Islands' actual contributions to the plan were \$1,475,731 for the year ended December 31, 2017.

### **Public Safety Employees' Retirement System (PSERS)**

PSERS Plan 2 was created by the 2004 Legislature and became effective July 1, 2006. To be eligible for membership, an employee must work on a full time basis and:

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

PSERS membership includes:

- PERS 2 or 3 employees hired by a covered employer before July 1, 2006, who met at least one of the PSERS eligibility criteria and elected membership during the period of July 1, 2006 to September 30 2006; and

- Employees hired on or after July 1, 2006 by a covered employer, that meet at least one of the PSERS eligibility criteria.

PSERS covered employers include:

- Certain State of Washington agencies (Department of Corrections, Department of Natural Resources, Gambling commission, Liquor Control Board, Parks and Recreation Commission, and Washington State Patrol),
- Washington State Counties,
- Washington State Cities (except for Seattle, Spokane, and Tacoma),
- Correctional entities formed by PSERS employers under the Interlocal Cooperation Act.

PSERS Plan 2 provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the average final compensation (AFC) for each year of service. The AFC is based on the member's 60 consecutive highest creditable months of service. Benefits are actuarially reduced for each year that the member's age is less than 60 (with ten or more service credit years in PSERS), or less than 65 (with fewer than ten service credit years). There is no cap on years of service credit. Members are eligible for retirement at the age of 65 with five years of service; or at the age of 60 with at least ten years of PSERS service credit; or at age 53 with 20 years of service. Retirement before age 60 is considered an early retirement. PSERS members who retire prior to the age of 60 receive reduced benefits. If retirement is at age 53 or older with at least 20 years of service, a three percent per year reduction for each year between the age at retirement and age 60 applies. PSERS Plan 2 retirement benefits are actuarially reduced to reflect the choice of a survivor benefit. Other benefits include duty and non-duty disability payments, an optional cost-of living adjustment (COLA), and a one-time duty-related death benefit, if found eligible by the Department of Labor and Industries. PSERS Plan 2 members are vested after completing five years of eligible service.

### **Contributions**

The **PSERS Plan 2** employer and employee contribution rates are developed by the Office of the State Actuary to fully fund Plan 2. The Plan 2 employer rates include components to address the PERS Plan 1 unfunded actuarial accrued liability and administrative expense currently set at 0.18 percent. Each biennium, the state Pension Funding Council adopts Plan 2 employer and employee contribution rates.

The PSERS Plan 2 required contribution rates (expressed as a percentage of current-year covered payroll) for 2017 were as follows:

PSERS Plan 2		
Actual Contribution Rates:	Employer	Employee
January – June 2017:		
PSERS Plan 2	6.59%	6.59%
PERS Plan 1 UAAL	4.77%	
Administrative Fee	0.18%	
<b>Total</b>	<b>11.54%</b>	<b>6.59%</b>
July – August 2017:		
PSERS Plan 2	6.73%	6.73%
PERS Plan 1 UAAL	5.03%	
Administrative Fee	0.18%	
<b>Total</b>	<b>11.94%</b>	<b>6.73%</b>
September - December 2017:		
PSERS Plan 2	6.74%	6.74%
PERS Plan 1 UAAL	5.03%	
Administrative Fee	0.18%	
<b>Total</b>	<b>11.95%</b>	<b>6.74%</b>

The City of Mercer Islands' actual contributions to the plan were \$8,521 for the year ended December 31, 2017.

#### **Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF)**

LEOFF membership includes all full-time, fully compensated, local law enforcement commissioned officers, firefighters, and as of July 24, 2005, emergency medical technicians. LEOFF is comprised of two separate defined benefit plans.

**LEOFF Plan 1** provides retirement, disability and death benefits. Retirement benefits are determined per year of service calculated as a percent of final average salary (FAS) as follows:

- 20+ years of service – 2.0% of FAS
- 10-19 years of service – 1.5% of FAS
- 5-9 years of service – 1% of FAS

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 ten years of service. Members are eligible for retirement with five years of service at the age of 50. Other benefits include duty and non-duty disability payments, a cost-of living adjustment (COLA), and a one-time duty-related death benefit, if found eligible by the Department of Labor and Industries. LEOFF 1 members were vested after the completion of five years of eligible service. The plan was closed to new entrants on September 30, 1977.

#### **Contributions**

Starting on July 1, 2000, **LEOFF Plan 1** employers and employees contribute zero percent, as long as the plan remains fully funded. The LEOFF Plan I had no required employer or employee contributions for fiscal year 2015. Employers paid only the administrative expense of 0.18 percent of covered payroll.

**LEOFF Plan 2** provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the final average salary (FAS) per year of service (the FAS is based on the highest consecutive 60 months). Members are eligible for retirement with a full benefit at 53 with at least five years of service credit. Members who retire prior to the age of 53 receive reduced benefits. 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. Otherwise, the benefits are actuarially reduced for each year prior to age 53. LEOFF 2 retirement benefits are also actuarially reduced to reflect the choice of a survivor benefit. Other benefits include duty and non-duty disability payments, a cost-of-living allowance (based on the CPI), capped at three percent annually and a one-time duty-related death benefit, if found eligible by the Department of Labor and Industries. LEOFF 2 members are vested after the completion of five years of eligible service.

### **Contributions**

The **LEOFF Plan 2** employer and employee contribution rates are developed by the Office of the State Actuary to fully fund Plan 2. The employer rate included an administrative expense component set at 0.18 percent. Plan 2 employers and employees are required to pay at the level adopted by the LEOFF Plan 2 Retirement Board. The LEOFF Plan 2 required contribution rates (expressed as a percentage of covered payroll) for 2017 were as follows:

<b>LEOFF Plan 2</b>		
<b>Actual Contribution Rates:</b>	<b>Employer</b>	<b>Employee</b>
January – June 2017:		
State and local governments	5.05%	8.41%
Administrative Fee	0.18%	
<b>Total</b>	<b>5.23%</b>	<b>8.41%</b>
July – December 2017:		
State and local governments	5.25%	8.75%
Administrative Fee	0.18%	
<b>Total</b>	<b>5.43%</b>	<b>8.75%</b>

The City of Mercer Islands' actual contributions to the plan were \$419,206 for the year ended December 31, 2017.

The Legislature, by means of a special funding arrangement, appropriates money from the state General Fund to supplement the current service liability and fund the prior service costs of Plan 2 in accordance with the recommendations of the Pension Funding Council and the LEOFF Plan 2 Retirement Board. This special funding situation is not mandated by the state constitution and could be changed by statute. For the state fiscal year ending June 30, 2016, the state contributed \$62,155,262 to LEOFF Plan 2. The amount recognized by the City of Mercer Island as its proportionate share of this amount is \$252,218.

### **Actuarial Assumptions**

The total pension liability (TPL) for each of the DRS plans was determined using the most recent actuarial valuation completed in 2017 with a valuation date of June 30, 2016. The actuarial assumptions used in the valuation were based on the results of the Office of the State Actuary's (OSA) *2007-2012 Experience Study* and the *2015 Economic Experience Study*.

Additional assumptions for subsequent events and law changes are current as of the 2016 actuarial valuation report. The TPL was calculated as of the valuation date and rolled forward to the measurement date of June 30, 2017. Plan liabilities were rolled forward from June 30, 2016, to June 30, 2017, reflecting each plan's normal cost (using the entry-age cost method), assumed interest and actual benefit payments.

- **Inflation:** 3.0% total economic inflation; 3.75% salary inflation

- **Salary increases:** In addition to the base 3.75% salary inflation assumption, salaries are also expected to grow by promotions and longevity.
- **Investment rate of return:** 7.5%

Mortality rates were based on the RP-2000 report's Combined Healthy Table and Combined Disabled Table, published by the Society of Actuaries. The OSA applied offsets to the base table and recognized future improvements in mortality by projecting the mortality rates using 100 percent Scale BB. Mortality rates are applied on a generational basis; meaning, each member is assumed to receive additional mortality improvements in each future year throughout his or her lifetime.

There were minor changes in methods and assumptions since the last valuation.

- For all plans except LEOFF Plan 1, how terminated and vested member benefits are valued was corrected.
- How the basic minimum COLA in PERS Plan 1 is valued for legal order payees was improved.
- For all plans, the average expected remaining service lives calculation was revised.

#### **Discount Rate**

The discount rate used to measure the total pension liability for all DRS plans was 7.5 percent.

To determine that rate, an asset sufficiency test included an assumed 7.7 percent long-term discount rate to determine funding liabilities for calculating future contribution rate requirements. (All plans use 7.7 percent except LEOFF 2, which has assumed 7.5 percent). Consistent with the long-term expected rate of return, a 7.5 percent future investment rate of return on invested assets was assumed for the test. Contributions from plan members and employers are assumed to continue being made at contractually required rates (including PERS 2/3, PSERS 2, SERS 2/3, and TRS 2/3 employers, whose rates include a component for the PERS 1, and TRS 1 plan liabilities). Based on these assumptions, the pension plans' fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return of 7.5 percent was used to determine the total liability.

#### **Long-Term Expected Rate of Return**

The long-term expected rate of return on the DRS pension plan investments of 7.5 percent was determined using a building-block-method. In selecting this assumption, the Office of the State Actuary (OSA) reviewed the historical experience data, considered the historical conditions that produced past annual investment returns, and considered capital market assumptions and simulated expected investment returns provided by the Washington State Investment Board (WSIB). The WSIB uses the capital market assumptions and their target asset allocation to simulate future investment returns over various time.

**Estimated Rates of Return by Asset Class**

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2017, are summarized in the table below. The inflation component used to create the table is 2.2 percent and represents the WSIB's most recent long-term estimate of broad economic inflation.

Asset Class	Target Allocation	% Long-Term Expected Real Rate of Return Arithmetic
Fixed Income	20%	1.70%
Tangible Assets	5%	4.90%
Real Estate	15%	5.80%
Global Equity	37%	6.30%
Private Equity	23%	9.30%
	<b>100%</b>	

**Sensitivity of NPL**

The table below presents the City of Mercer Island's proportionate share of the net pension liability calculated using the discount rate of 7.5 percent, as well as what the City of Mercer Island's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.5 percent) or 1-percentage point higher (8.5 percent) than the current rate.

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
PERS 1	\$5,453,125	\$4,476,412	\$3,630,369
PERS 2/3	11,261,609	4,180,093	(1,622,158)
PSERS 2	25,536	3,803	(13,237)
LEOFF 1	(792,139)	(1,067,910)	(1,304,735)
LEOFF 2	739,100	(3,415,459)	(6,800,421)

**Pension Plan Fiduciary Net Position**

Detailed information about the State's pension plans' fiduciary net position is available in the separately issued DRS financial report.

**Pension Liabilities (Assets), Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions**

At June 30, 2017, the City of Mercer Island reported a total pension liability of \$8,660,308 and a total pension asset of \$4,483,369 for its proportionate share of the net pension asset and liabilities as follows:

	Liability (or Asset)
PERS 1	\$ 4,476,412
PERS 2/3	4,180,093
PSERS 2	3,803
LEOFF 1	(1,067,910)
LEOFF 2	(3,415,459)

The amount of the liability/ (asset) reported above for LEOFF Plans 1 and 2 reflects a reduction for State pension support provided to the City of Mercer Island. The amount recognized by the City as its proportionate share of the net pension liability/(asset), the related State support, and the total portion of the net pension liability/(asset) that was associated with the City were as follows:

	LEOFF 1 Asset	LEOFF 2 Asset
Employer's proportionate share	(1,067,910)	(3,415,459)
State's proportionate share of the net pension (asset) associated with the employer	(7,223,320)	(2,215,545)
TOTAL	(8,291,230)	(5,631,004)

At June 30, the City's proportionate share of the collective net pension liabilities was as follows:

	Proportionate Share 6/30/2016	Proportionate Share 6/30/2017	Change in Proportion
PERS 1	0.001729%	0.002610%	0.000881%
PERS 1 UAAL	0.090373%	0.094077%	0.003704%
PERS 2/3	0.115169%	0.120307%	0.005138%
PSERS 2	0.019563%	0.019410%	-0.000153%
LEOFF 1	0.070876%	0.070386%	-0.000490%
LEOFF 2	0.234565%	0.246128%	0.011563%

Employer contribution transmittals received and processed by the DRS for the fiscal year ended June 30 are used as the basis for determining each employer's proportionate share of the collective pension amounts reported by the DRS in the *Schedules of Employer and Nonemployer Allocations* for all plans except LEOFF 1.

LEOFF Plan 1 allocation percentages are based on the total historical employer contributions to LEOFF 1 from 1971 through 2000 and the retirement benefit payments in fiscal year 2017. Historical data was obtained from a 2011 study by the Office of the State Actuary (OSA). In fiscal year 2017, the state of Washington contributed 87.12 percent of LEOFF 1 employer contributions and all other employers contributed the remaining 12.88 percent of employer contributions. LEOFF 1 is fully funded and no further employer contributions have been required since June 2000. If the plan becomes underfunded, funding of the remaining liability will require new legislation. The allocation method the plan chose reflects the projected long-term contribution effort based on historical data.

In fiscal year 2017, the state of Washington contributed 39.35 percent of LEOFF 2 employer contributions pursuant to [RCW 41.26.725](#) and all other employers contributed the remaining 60.65 percent of employer contributions.

The collective net pension liability (asset) was measured as of June 30, 2017, and the actuarial valuation date on which the total pension liability (asset) is based was as of June 30, 2016, with update procedures used to roll forward the total pension liability to the measurement date.

#### Pension Expense

For the year ended December 31, 2017, the City of Mercer Island recognized pension expense as follows:

	Pension Expense
PERS 1	\$390,718
PERS 2/3	467,348
PSERS 2	4,660
LEOFF 1	(164,225)
LEOFF 2	108,782
Firefighter Pension Fund	(255,236)
TOTAL	\$552,047

# Deferred Outflows of Resources and Deferred Inflows of Resources

At December 31, 2017, the City reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

PERS1	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience		
Net difference between projected and actual investment earnings on pension plan investments		\$167,047
Changes of assumptions		
Changes in proportion and differences between contributions and proportionate share of contributions		
Contributions subsequent to the measurement date		
TOTAL		\$167,047

PERS 2/3	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$423,542	\$137,476
Net difference between projected and actual investment earnings on pension plan investments		1,114,312
Changes of assumptions	44,401	
Changes in proportion and differences between contributions and proportionate share of contributions	371,817	230,875
Contributions subsequent to the measurement date	833,979	
TOTAL	\$1,673,738	\$1,482,663

PSERS	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$2,249	\$270
Net difference between projected and actual investment earnings on pension plan investments		2,667
Changes of assumptions	32	
Changes in proportion and differences between contributions and proportionate share of contributions	54	265
Contributions subsequent to the measurement date	4,602	
TOTAL	\$6,937	\$3,202

LEOFF 1	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience		
Net difference between projected and actual investment earnings on pension plan investments		\$99,234
Changes of assumptions		
Changes in proportion and differences between contributions and proportionate share of contributions		
Contributions subsequent to the measurement date		
TOTAL		\$99,234



LEOFF 2	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$150,116	\$129,520
Net difference between projected and actual investment earnings on pension plan investments		766,795
Changes of assumptions	4,113	
Changes in proportion and differences between contributions and proportionate share of contributions	146,446	146,683
Contributions subsequent to the measurement date	224,065	
TOTAL	\$524,740	\$1,042,998

State Sponsored Plans & Firefighters Pension	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$575,907	\$267,266
Net difference between projected and actual investment earnings on pension plan investments	31,004	2,150,055
Changes of assumptions	48,546	
Changes in proportion and differences between contributions and proportionate share of contributions	518,317	377,822
Contributions subsequent to the measurement date	1,062,646	
TOTAL	\$2,236,420	\$2,795,143

Deferred outflows of resources related to pensions resulting from the City's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2017. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

For the year ended December 31, 2017

Changes in proportion and difference between contributions and proportionate share of contributions								
	PERS 1	PERS 2/3		PSERS 2		LEOFF 1	LEOFF 2	
Recognition Period (Years)	N/A	Inflows	Outflows	Inflows	Outflows	N/A	Inflows	Outflows
Year								
2018	-	(104,943)	160,522	(52)	13	-	(26,803)	36,612
2019	-	(104,943)	82,220	(52)	13	-	(26,803)	36,612
2020	-	(20,989)	30,018	(52)	13	-	(26,803)	36,612
2021	-	-	30,018	(52)	13	-	(12,975)	36,612
2022	-	-	30,018	(42)	-	-	(9,518)	-
Thereafter	-	-	39,023	(15)	-	-	(43,782)	-
Total Deferred (Inflows)/Outflows	\$ -	\$ (230,875)	\$ 371,817	\$ (265)	\$ 54	\$ -	\$ (146,683)	\$ 146,446

The recognition period for each plan is equal to the average of the expected remaining service lives of all employees provided with pensions through the pension plan, which was determined at the beginning of the measurement period.

For the fiscal year ended June 30, 2017

Differences between expected and actual experience								
	PERS 1	PERS 2/3		PSERS 2		LEOFF 1	LEOFF 2	
Recognition Period (Years)		Inflows	Outflows	Inflows	Outflows		Inflows	Outflows
Year								
2018	\$ -	\$ (62,490)	\$ 171,759	\$ (23)	\$ 561	\$ -	\$ (13,490)	\$ 46,048
2019	-	(62,489)	91,121	(23)	561	-	(13,490)	46,048
2020	-	(12,497)	37,363	(23)	561	-	(13,490)	46,048
2021	-	-	37,364	(23)	561	-	(13,490)	11,972
2022	-	-	37,364	(23)	6	-	(13,493)	-
Thereafter	-	-	48,573	(153)	-	-	(62,066)	-
Total Deferred (Inflows)/Outflows	\$ -	\$ (137,476)	\$ 423,542	\$ (270)	\$ 2,249	\$ -	\$ (129,520)	\$ 150,116

The recognition period for each plan is equal to the average of the expected remaining service lives of all employees provided with pensions through the pension plan, which was determined at the beginning of the measurement period.

For the fiscal year ended June 30, 2017

Net differences between projected and actual earnings on plan investments					
	PERS 1	PERS 2/3	PSERS	LEOFF 1	LEOFF 2
Year					
2018	(112,913)	(573,636)	(1,107)	(62,278)	(388,198)
2019	35,648	70,805	(59)	16,796	43,845
2020	(8,277)	(125,643)	(406)	(6,707)	(88,562)
2021	(81,505)	(485,839)	(1,095)	(47,045)	(333,880)
2022	-	-	-	-	-
2023	-	-	-	-	-
Total Deferred (Inflows)/Outflows	\$ (167,047)	\$ (1,114,312)	\$ (2,667)	\$ (99,234)	\$ (766,795)

The recognition period is a closed, five-year period for all plans.

For the fiscal year ended June 30, 2017

Changes in assumptions								
	PERS 1	PERS 2/3		PSERS 2		LEOFF 1	LEOFF 2	
Recognition Period (Years)		Inflows	Outflows	Inflows	Outflows		Inflows	Outflows
Year								
2018	-	-	20,372	-	7	-	-	1,285
2019	-	-	19,149	-	7	-	-	1,285
2020	-	-	3,903	-	7	-	-	1,285
2021	-	-	296	-	7	-	-	258
2022	-	-	296	-	3	-	-	-
Thereafter	-	-	385	-	3	-	-	-
Total Deferred (Inflows)/Outflows	\$ -	\$ -	\$ 44,401	\$ -	\$ 32	\$ -	\$ -	\$ 4,113

The recognition period for each plan is equal to the average of the expected remaining service lives of all employees provided with pensions through the pension plan, which was determined at the beginning of the measurement period.

## Local Government Pension Trust Funds - Firefighters Pension Fund

### Plan Description

In addition to the two statewide retirement systems, the City is the administrator of a Firemen's Pension Plan, which is shown as a pension trust fund in the financial reports of the City. The Firemen's Pension Plan (FPP) is a

closed, single-employer defined benefit pension plan established in conformance with Revised Code of Washington (RCW) 41.18. The Plan provided retirement and disability benefits, annual cost of living adjustments, and death benefits to Plan members and beneficiaries. Retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

Membership is limited to firefighters employed prior to March 1, 1970 when the LEOFF retirement system was established. The City's obligation under the Plan consists of paying the difference between pension and medical benefits provided by LEOFF1 and those provided by the FPP for covered firefighters who retire after March 1, 1970. At December 31, 2017, there were a total of six individuals covered by this system, six of whom are retired and all of whom qualified to receive benefits during 2017.

Under State law, the FPP is provided an allocation of 25% of all moneys received by the State from taxes on fire insurance premiums. Other funding sources include interest earnings, member contributions made prior to the inception of LEOFF, property taxes committed by action of the City Council, and City contributions required to meet projected future pensions obligations.

#### **Actuarial Assumptions**

The total pension liability (TPL) for the plan was determined using the most recent actuarial valuation completed in 2018 with a valuation date of January 1, 2018.

- **Inflation:** 2.25% total economic inflation; 3.25% salary inflation
- **Investment rate of return (Discount Rate):** 3.50%

Mortality assumptions are based on the 2007-2012 Experience Study for the LEOFF Retirement System prepared by the Office of the State Actuary. Mortality rates are expected to continue to decrease in the future, and the resulting longevity should be anticipated in a valuation.

There were minor changes in methods and assumptions since the last valuation.

- Demographic experience decreased since the last valuation.
- Excess benefits increased less than anticipated over the past two years.

#### **Plan Investments**

All surplus cash is invested in accordance with an investment policy approved by the Mercer Island City Council (January 2012). State law defines eligible investments as only those securities and deposits authorized by statute (RCW 39.58, 39.59, 43.250, and 43.84.080). Eligible investments which the City held at year end include Government owned and Government-sponsored agencies, Washington State Local Government Investment Pool, and FDIC and PDPC Insured Bank Deposits. Investments are carried at fair market value in accordance with GASB 31.

Investment in the Washington State Local Government Investment Pool is not evidenced by securities that exist in physical or book entry form in the name of the City. Therefore, this investment is treated as a type of investment with a market value equal to net realizable value of the City's share of the pool based on the pool's valuation method. Year-end investments in the pool are included in Cash and Investments on the Statement of Net Position and the Statement of Fiduciary Net Position.

The money weighted rate of return considers the changing amounts actually invested during a period and weights the amount of pension plan investments by the proportion of time they are available to earn a return during that period. External cash flows are determined on a monthly basis and are assumed to occur at the

beginning of each month. External cash inflows are netted with external cash outflows, resulting in a net external cash flow in each month. The money-weighted rate of return is calculated net of investment expenses.<sup>1</sup>

### Discount Rate Sensitivity Analysis

The following table presents the net pension liability calculated using the discount rate of 3.5%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (2.5%) or 1 percentage point higher (4.5%) than the current rate

	1% Decrease 2.5%	Current Discount Rate 3.5%	1% Increase 4.5%
Total pension liability	\$ 2,124,286	\$ 1,895,115	\$ 1,701,274
Fiduciary net position	885,396	885,396	885,396
Net Pension Liability	<u>\$ 1,238,890</u>	<u>\$ 1,009,719</u>	<u>\$ 815,878</u>

### Calculation of Money-Weighted Rate of Return

Firefighters' Pension Fund	Net External Cash Flows	Periods Invested	Period Weight	Net External Cash Flows with Interest
Beginning Value - January 1, 2017	\$ 901,717	12.00	1.00	\$ 910,006
Monthly net external cash flows:				
January	(8,392)	12.00	1.00	(76.98)
February	(7,497)	11.00	0.92	(63.04)
March	(7,497)	10.00	0.83	(57.31)
April	5,708	9.00	0.75	39.27
May	27,079	8.00	0.67	165.60
June	(6,730)	7.00	0.58	(36.01)
July	(6,730)	6.00	0.50	(30.87)
August	(6,730)	5.00	0.42	(25.72)
September	(6,730)	4.00	0.33	(20.58)
October	6,475	3.00	0.25	14.85
November	(6,730)	2.00	0.17	(10.29)
December	(6,730)	1.00	0.08	(5.14)
Ending Value - December 31, 2017				\$ 885,396
<b>Money Weighted Rate of Return</b>	<b>0.92%</b>			

### Net Pension Liability

The Net Pension Liability (NPL) is defined by the Total Pension Liability minus the plans' Fiduciary Net Position. Where the total pension liability is the portion of actuarial present value of projected benefit payments that is attributable to past periods of member services using the Entry Age Normal cost method based on the requirements of GASB 67.

<sup>1</sup> Milliman Financial Reporting Valuation

The total pension liability was determined by using the most recent actuarial valuation completed in 2018 with a valuation date of January 1, 2018. Total pension liability was calculated as of the measurement date of December 31, 2017. The reporting date is December 31, 2017 which is the same as the Plans fiscal year ending date.

The City believes an assumed discount rate of 3.5% is an appropriate long-term rate of return on investments for its Firefighters' pension fund. The Bond Buyer General Obligation 20-bond municipal bond index for bonds that mature in 20 years is 3.44% as of December 31, 2017. Rounding this rate to the nearest quarter percent gives a discount rate of 3.5%. Using 3.5% for both the long term expected rate of return and the bond index means that 3.5% can be used as the single discount rate.

#### Net Pension Liability Schedule

	December 31, 2016	December 31, 2017
Total pension liability	\$ 2,181,042	\$ 1,895,115
Fiduciary net position	901,717	885,396
Net pension liability	<u>\$ 1,279,325</u>	<u>\$ 1,009,719</u>
Plan Fiduciary net position as a % of total pension liability	41.34%	46.72%
Covered Payroll	0	0
Net pension liability as a % of covered payroll	N/A	N/A

#### Key Actuarial Assumptions

	December 31, 2016	December 31, 2017
Discount Rate	3.50%	3.50%
Long-term rate of return, net	3.50%	3.50%
Municipal bond rate	3.50%	3.50%
Valuation Date	January 1, 2016	January 1, 2018
Measurement Date	December 31, 2016	December 31, 2017
Inflation	2.25%	2.25%
Salary increases-including inflation	3.25%	3.25%
Actuarial cost method	Entry Age Normal	Entry Age Normal
Mortality	RP-2000 Mortality Table (combined healthy) with generational projection using 100% of Projection Scale BB, with ages set back one year for males and forward one year for females (set forward two years for disabled members)	RP-2000 Mortality Table (combined healthy) with generational projection using 100% of Projection Scale BB, with ages set back one year for males and forward one year for females (set forward two years for disabled members)

Changes in Net Pension Liability			
	Total Pension Liability (a)	Increase (Decrease) Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)
Balances as of December 31, 2016	\$ 2,181,042	\$ 901,717	\$ 1,279,325
Changes for the Year:			
Service Cost	-	-	-
Interest on total pension liability	74,893	-	74,893
Effect of plan changes	-	-	-
Effect of economic/demographic gains or losses	(277,633)	-	(277,633)
Effect of assumptions changes or inputs	-	-	-
Benefit payments	(83,187)	(83,187)	-
Medical payments from fund	-	-	-
Employer contributions	-	26,410	(26,410)
Contributions from state fire insurance premium tax	-	32,272	(32,272)
Net investment income	-	8,184	(8,184)
Administrative expenses	-	-	-
Balances as of December 31, 2017	\$ 1,895,115	\$ 885,396	\$ 1,009,719

Investment gains/losses are recognized in pension expense over a period of five years. Economic and demographic gains/losses, assumption changes or inputs are recognized over the average remaining service life for all active and inactive members. For the firefighters pension fund immediate recognition is used as the average remaining services life is less than one.

#### Deferred Outflows of Resources and Deferred Inflows of Resources

At December 31, 2017, the City reported deferred outflows of resources and deferred inflows of resources related to the Firefighter pension fund from the following sources:

Firefighter Pension Fund	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience		
Net difference between projected and actual investment earnings on pension plan investments	\$31,004	
Changes of assumptions		
Changes in proportion and differences between contributions and proportionate share of contributions		
Contributions subsequent to the measurement date		
TOTAL	\$31,004	\$0

Amounts currently reported as deferred outflows of resources and deferred inflows of resources related to the pension fund will be recognized in pension expense as follows:

Year ended December 31:	Amount
2018	\$10,911
2019	10,912
2020	4,590
2021	4,591
Thereafter	

Schedules of required supplementary information that include a 10 year schedule of changes in the net pension liability and related ratios and a 10 year schedule of the money-weighted rate of return, immediately following the Notes, are provided to present multi-year trend information.

The information presented in the preceding required schedules was determined as part of the actuarial valuations at the dates indicated.

Actuarial cost method:	Entry Age Normal Cost Method
Amortization Period:	UAAL Amortized over a closed 30 year period
Asset Valuation Method:	Market Value

Actuarial economic assumptions:	
Investment Rate of Return	3.50%
Projected salary increases	3.25%

**NOTE 14- OTHER POST EMPLOYMENT BENEFITS**

The City of Mercer Island provides post-retirement health care benefits to LEOFF 1 retirees in accordance with State statutes. Membership is limited to public safety personnel hired prior to March 1, 1970. Currently, 36 retirees meet the eligibility requirements. The City provides medical insurance and reimburses for all validated claims for medical, dental, nursing care, and hospitalization costs incurred by these retirees.

For the year ending December 31, 2017 the City's cost for providing these benefits were as follows:

<b>Medical Costs</b>	
Insurance premiums	\$ 191,764
Direct medical costs	78,059
Total cost	<u>\$ 269,823</u>

Funding for LEOFF retiree healthcare costs is provided entirely by the City on a pay-as-you-go basis.

**Annual OPEB Cost and Net OPEB Obligation**

The City's annual Other Post Employment Benefit (OPEB) cost is calculated based upon the annual required contribution (ARC), an amount actuarially determined in accordance with 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 thirty years beginning January 1, 2008. The following table shows the City's annual OPEB cost for 2018, the most current actuarial valuation date for the City's obligations.

<b>OPEB - Schedule of Funding Progress</b>			
<b>(in thousands)</b>			
<b>Valuation Date</b>	<b>January 1, 2011</b>	<b>January 1, 2014</b>	<b>January 1, 2018</b>
Actuarial Value of Assets	\$ -	\$ -	\$ -
Actuarial Accrued Liabilities	14,285	10,626	10,658
Unfunded Actuarial Accrued Liabilities (UAAL)	14,285	10,626	10,658
Funded Ratio	0%	0%	0%
Covered Payroll	NA	NA	NA
UAAL as a Percentage of Covered Payroll	NA	NA	NA

As of January 1, 2018 the plan was 0% funded. The actuarial accrued liability for benefits was \$10,658,000 and the actuarial value of plan assets was \$0.00 resulting in a UAAL of \$10,658,000.

The City pays medical costs associated with other post-employment benefits on a pay as you go basis. The City has funded \$1,406,196 of the liability in an assignment of fund balance and continues to set aside funding as the opportunity arises. This assigned amount is not reflected in the actuarial valuation because the funds are not accounted for in a separate trust fund as required by GASB Statement Nos. 43 and 45.



**Annual OPEB Cost and Net OPEB Obligation**

	<b>12/31/2015</b>	<b>12/31/2016</b>	<b>12/31/2017</b>
Annual Required Contribution (ARC)			
1 Annual Normal Cost - Begin of Year	-	-	-
Amortization of Unfunded Actuarial			
2 Liability (UAAL) - Begin of Year	654,653	654,653	654,653
3 Interest to End of Year $[(1+2) \times (i)]^*$	24,549	24,549	24,549
4 ARC at End of Year	679,202	679,202	679,202
5 Interest on Net OPEB Obligation	83,229	91,952	103,001
6 Adjustment to ARC	136,737	151,068	184,389
7 Annual OPEB Cost ( 4+5-6)	625,694	620,086	597,814
8 Employer Contributions	393,085	325,451	269,823
9 Change in Net OPEB Obligations (7-8)	232,609	294,636	327,991
10 Net OPEB Obligation at Begin of Year	2,219,453	2,452,062	2,746,697
11 Net OPEB Obligation at End of Year	2,452,062	2,746,697	3,074,688

\* 'i' is the assumed interest rate that year; 3.75% in 2015, 2016 and 2017.

**Schedule of Employer Contributions**

Fiscal Year Ending 12/31	<b>2015</b>	<b>2016</b>	<b>2017</b>
Total Employer Contributions	393,085	325,451	269,823
Annual Required Contribution (ARC)	679,202	679,202	679,202
Percentage of ARC Contributed	58%	48%	40%

**Annual OPEB Cost and Net OPEB Obligation**

Fiscal Year Ending	<b>2015</b>	<b>2016</b>	<b>2016</b>
Annual OPEB Cost	625,694	620,086	597,814
Contribution as a Percentage of Annual OPEB Cost	63%	52%	45%
Net OPEB Obligation	\$ 2,452,062	\$ 2,746,697	\$ 3,074,688

The net OPEB obligation of \$3,074,688 is included as a noncurrent liability on the Statement of Net Position.

**Actuarial Assumptions**

The actuarial assumptions are intended to estimate the future experience of members. Valuation assumptions include:

Actuarial Cost Method: The liabilities are calculated according to Entry Age Normal funding method.

Replacement of Terminated Members: The City's Firemen's Pension Fund and LEOFF 1 are closed groups. No new members are permitted.

Valuation of Assets: As of the valuation date, there are no assets set aside to pay for these benefits.

Amortization Period: 30-year, closed as of January 1, 2008.

Economic Assumptions: Discount Rate 3.50%

Medical Inflation 3.4% for pre-65 and 0.9% for post-65 in 2018

LTC inflation Rate 4.50%

A required Schedule of Funding Progress, immediately following the Notes, is provided to present multi-year trend information regarding the decrease in plan assets relative to the actuarial accrued liability for benefits.

**NOTE 15 – FUND EQUITIES**

**Governmental Fund Types**

The City recognizes that some of the assets occasionally carried in governmental funds are not available resources and thus are not legally available for appropriation. Accordingly, the City has reclassified ending fund balance amounts in accordance with GASB Statement No. 54. Amounts previously reported as reserved and unreserved are now reported as non-spendable, restricted, committed, assigned, or unassigned.

**Proprietary Fund Type**

Contributed capital in proprietary funds (Water Revenue, Sewer Revenue, Storm Water Management, Computer Replacement and Equipment Rental) represents contributed capital assets, or contributions for capital asset acquisition, from other funds, governments, customers and developers. Operating reserves are maintained in each of the utility funds in accordance with the City's Management and Budget Policies

**NOTE 16 – BUDGET TO GAAP RECONCILIATION**

The City budgets separate managerial funds to account for the resources and expenditures related to 1% for Art in Public Places programming and the contingency reserve. In implementing the new requirements of GASB Statement No. 54 the 1% Arts Fund and the Contingency fund no longer qualify as special revenue funds. The funds have been combined with the General Fund for financial reporting purposes resulting in a perspective difference. The following schedule reconciles revenues and expenditures on the budgetary basis to revenues and expenditures as reported on the Statement of Revenues, Expenditures and Changes in Fund Balances.

	General Fund	Biennium
Revenues on the budgetary basis	\$ 29,115,438	\$ 29,115,438
Increase (decrease) due to perspective difference	510,186	510,186
Revenues on the GAAP basis	29,625,624	29,625,624
Expenditure on the budgetary basis	29,213,240	29,213,240
Increase (decrease) due to perspective difference	7,162	7,162
Expenditure on the GAAP basis	29,220,402	29,220,402
Other financing sources (uses) on the budgetary basis	(133,602)	(133,602)
Increase (decrease) due to perspective difference	335,704	335,704
Other financing sources (uses) on the GAAP basis	202,102	202,102
Fund Balance beginning of year on the budgetary basis	5,432,955	5,432,955
Increase (decrease) due to perspective difference	2,808,356	2,808,356
Fund Balance beginning of year on the GAAP basis	8,241,311	8,241,311
Fund Balance end of year on the budgetary basis	5,201,551	5,201,551
Increase (decrease) due to perspective difference	3,647,084	3,647,084
Fund Balance end of year on the GAAP basis	\$ 8,848,635	\$ 8,848,635

## **NOTE 17 – ACCOUNTING AND REPORTING CHANGES**

### **Tax Abatement**

In August 2015, GASB issued Statement No. 77, “Tax Abatement Disclosures,” effective for entities with fiscal years beginning after December 15, 2015. Statement No. 77 requires disclosure of tax abatement information about (1) a reporting government’s own tax abatement agreements and (2) those that are entered into by other governments and reduce the reporting government’s tax revenues. The city assessed the effects of tax abatements on its financial position and determined the impact to be immaterial; therefore, financial statement disclosure is not required.

### **Changes to Non-Major Funds**

The City closed two non-major reporting funds in 2017:

1. The *Criminal Justice Special Revenue Fund* was closed in the first quarter of 2017. The portion of restricted fund balance associated with federal, state and local narcotics investigations and seizures (\$76,042) was transferred to the Technology and Equipment fund. The portion of restricted fund balance specific to spending on jails (\$79,437) was transferred to the general fund and remains restricted at year end. The portion of restricted fund balance accumulated from the 0.10% criminal justice (\$945,135) sales tax was transferred to the General Fund and spent in the current year for criminal justice purposes.
2. The *Station 92 Construction Fund* was closed in 2017. Final closeout of the Fire Station 92 construction project occurred in 2017. Accordingly, the capital fund was closed and the remaining fund balance (\$297,105.5) transferred to the General Fund.

### **Prior Period Adjustment - ARCH Receivable**

A receivable from Saint Andrews Housing group has been carried in the City’s General fund since its inception in October, 1999. The last payment against this receivable was collected in 2009. Given the number of years the receivable has been outstanding and because no active efforts at collection are anticipated, the City has elected to write-off this receivable balance. Prior period adjustment of \$165,204.75 to write of the receivable as uncollectable.

### **Prior Period Adjustment - Retainage Payable**

A retainage account associated with improvements to the Mercerdale Hillside park has been held in-house by the City since at least 2005. Contractor associated with the project deemed ineligible to receive remaining balance of retainage due. Prior period adjustment of \$14,641.40 posted to the Capital Improvement Projects Fund to write off the balance due.

**NOTE 18 - CONTINGENT LIABILITIES AND LITIGATION**

There are various contingent liabilities and pending legal actions which City officials consider routine and part of the ordinary course of business. In the opinion of City officials, adequate provision has been made for any losses which may reasonably be foreseen. In the opinion of the City's legal advisor, there are no claims or actions pending against the City whose adverse outcome would pose a threat to continued City operations, or materially alter the financial condition of the City.

## NOTE 19 - JOINT VENTURES

### Eastside Public Safety Communications Agency

The Eastside Public Safety Communications Agency (EPSCA), an emergency regional radio access service, was established on May 26, 1992, by an Interlocal Agreement (Agreement 1), pursuant to the Interlocal Cooperation Act, Chapter 39.34 RCW, among the Cities of Bellevue, Redmond, Kirkland and Mercer Island (Principals), municipal corporations organized under the laws of the State of Washington. Agreement 1 was amended June 10, 1993, to include the City of Issaquah as an additional principal in EPSCA's governance. The duration of this agreement was for ten years, and under the terms set forth in Resolution R-18 as approved by majority vote of the Executive Board in regular open meeting on April 11, 2002 it was extended for a subsequent five year period until May 18, 2007. EPSCA began principal operations in December 1995.

EPSCA is governed by an Executive Board (Board), which is composed of the Chief Executive officers of the Principals. The Executive Board is responsible for review and approval of all budgetary, financial and contractual matters.

An Operations Committee (Committee) composed of the Chief of Police and Fire Chief of each principal, reports to the board and oversees budget preparation, rates, revenues, expenditures, policies and other operational issues. The Committee also includes representation from non-principal EPSCA user agencies.

EPSCA has developed an Eastside radio communications system which is integrated with a regional radio communications network. Its capital funding derives from a September 15, 1992, voter-approved King County excess property tax levy of \$57,016,764. EPSCA's portion of the levy was \$10,004,469.

Operating revenues derive from fees charged to the Principals for communications services and from subscriber fees for communications services.

Agreement 1 provides for a weighted vote according to the proportion of each Principal's system radios in relation to the total number of system radios used by all Principals. As of December 31, 2016, the weighted vote was as follows:

Bellevue	46.340 %
Kirkland	18.399 %
Redmond	23.807 %
Mercer Island	6.098 %
Issaquah	5.356 %
	100.000 %

These percentages are reviewed and adjusted annually at January 1 based on the number of radios on the system in use by current principals as of December 31 of the preceding year.

Upon dissolution, Agreement 1 provides for distribution of retained earnings among the Principals based on the weighted voting percentages in force at the time of dissolution. Any property contributed without charge would revert to the contributing Principal.

In August of 1993, EPSCA entered into an Interlocal Cooperation Agreement (Agreement 2), pursuant to Chapter 39.34 RCW, with King County, Seattle, and Valley Communications (Sub regions), municipal corporations organized under the laws of the State of Washington. Agreement 2 governs the development, acquisition and installation of the emergency radio communication system (System).

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Agreement 2 provides that upon voluntarily termination of any Sub region's participation in the System, it surrenders its radio frequencies, relinquishes its equipment and transfers any unexpended levy proceeds and equipment replacement reserves to another Sub region or a consortium of Sub regions.

Thus, in accordance with Agreement 2, the Principals of EPSCA have no equity interest in EPSCA's contributed capital (\$10,502,938 from King County levy proceeds) as of December 31, 2004. Capital contributed to Mercer Island as of December 31, 2004 amounted to \$344,692.

The City of Mercer Island's share of retained earnings and capital is deemed immaterial and thus is not reflected in the financial statements. Compiled financial statements for EPSCA can be obtained from EPSCA c/o Jessie Morgan, 16100 N.E. 8th Street, Bellevue, Washington 98004.

### **ARCH – Housing Coalition**

In November 1992, the cities of Bellevue, Kirkland, Redmond, and King County joined to establish A Regional Coalition for Housing (ARCH). The agreement was amended in January 1993 to add clarifying language regarding responsibility and disillusionment. Subsequently, the cities of Bothell, Issaquah, and Woodinville joined ARCH. Mercer Island joined ARCH in March, 1994.

The purpose of ARCH is to cooperatively formulate affordable housing goals and policies and to foster efforts to provide affordable housing by combining public funding with private-sector resources. Operating funding is provided by the member cities. ARCH identifies and prioritizes projects which the member cities fund directly through their own grants, Community Development Block Grants, and HUD grants.

ARCH is governed by an Executive Board composed of the chief executive officer from each member agency. The Executive Board is responsible for review and approval of all budgetary, financial, policy, and contractual matters. The Board is assisted by an administrative staff and a Citizen Advisory Board.

Each member city is responsible for contributing operating revenues as determined from the ARCH annual budget. Contributions from the member cities are based on each member's population.

Members withdrawing from the agreement relinquish all rights to any reserve funds, equipment, or material purchased. Upon dissolution, the agreement, as amended, provides for distribution of net position among the members based on the percentage of the total annual contributions during the period of the Agreement paid by each member. The City's share of net position is deemed immaterial and thus is not reflected in the financial statement.

Budget monitoring information can be obtained from ARCH, c/o Art Sullivan, 16625 NE 87<sup>th</sup> Street, Redmond, WA 98052.

### **Eastside Narcotics Task Force**

The Eastside Narcotics Task Force (ENTF) was formed by the cities of Mercer Island, Bellevue, Kirkland, Redmond and Issaquah for the purpose of mutual support in the fight against drug crimes. In 1990, ENTF engaged the support services of the King County Prosecutors Office. The King County Sheriff's Office joined ENTF in 2002. In May of 2010 the ENTF again amended the Interlocal agreement to include the Washington State Patrol. In October of 2009, the City of Issaquah permanently withdrew its' ENTF membership.

The task force is governed by an Executive Board consisting of the Police Chiefs and Directors of Public Safety. The Executive Board is responsible for formulating policy, establishing annual budgets, and acquiring, holding,



and disposing of real and personal property. The Task Force is managed by a Commander who is responsible for the operation of the task force and the accomplishment of the goals and objectives of the task force.

Member agencies share in the costs and proceeds of the operation of the Task Force. All revenues are disbursed to the participating Agencies based on current participation.

In late 2015 the Executive Board determined it was in the best interest of member Cities to dissolve the ENTF. The ENTF ILA states that upon dissolution, each agency's share of Task Force forfeiture assets is calculated based on current participation. Mercer Islands estimated share is approximately 12.3% as of December 31, 2015. No funds will be distributed to member Cities until all remaining obligations of the ENTF have been paid. The City's share of assets is \$36,917.60, which was distributed in March of 2017. The Cities share of the ENTF forfeiture assets is deemed immaterial and thus is not reflected in the financial statements.

Budget monitoring information can be obtained from Eastside Narcotics Task Force, c/o Carl Krikorian, Police Finance Manager, Bellevue Police Department, 450 110<sup>TH</sup> Ave NE, Bellevue, WA 98009.

#### **E-Gov Alliance**

In March 2002 the City of Mercer Island joined the Cities of Bellevue, Bothell, Burien, Issaquah, Kenmore, Kirkland, Sammamish and Woodinville in forming the E-Gov Alliance. The Alliance establishes on-line services through a jointly operated internet portal. Additionally, the Alliance has established a partnership with Microsoft to help define the E-Gov architecture, provide consulting services, offer training, and donated software.

The inter-local agreement may be terminated if Principals holding at least sixty percent (60%) of the weighted vote of all of the Principals are in concurrence. Upon termination, all property acquired shall be disposed of as follows: (1) property contributed without charge by any member shall revert to the contributor, (2) all property purchased after the effective date of the inter-local agreement shall be distributed to the Principals based upon each Principals proportional ownership interest at the time of the sale of the property. The City's share of the net position is deemed immaterial and thus is not reflected in the financial statements.

Budget monitoring information may be obtained from City of Bellevue, Information Technology Department, PO Box 90012, Bellevue, WA 98009.

#### **NORCOM**

In November of 2007, the City of Kirkland, with the cities of Bellevue, Bothell, Clyde Hill, Medina, Mercer Island, and Snoqualmie, along with Eastside Fire and Rescue, King County Fire Protection Districts 27 and 45, King and Kittitas County Fire Protection District 51, Northshore Fire Department, Shoreline Fire Department, and Woodinville Fire and Life Safety District entered into an interlocal agreement to establish and maintain a consolidated emergency service communications center. In 2008, the City of Redmond joined as a subscriber. Prior to the interlocal agreement, the formation efforts were carried out under a Joint Powers Agreement originally approved in 2005 and amended in 2006 and 2007. On July 1, 2009, the separate dispatch operations of the cities of Bellevue and Kirkland were combined and began operating as the North East King County Regional Public Safety Communications Agency (or NORCOM). NORCOM includes 911 telephone answering, computer aided dispatch of fire, police and EMS resources, public safety field technology and a records management system.

Operating revenues are provided by user fees charged to each member based on average call volume. For 2016 the City of Mercer Island's share of these fees was \$780,711.

Additional financial information can be obtained from NORCOM, c/o Finance Manager, P.O. Box 50911, Bellevue, WA 98015.

#### **NOTE 20 – POLLUTION REMEDIATION OBLIGATIONS**

In 1991 the City's Maintenance Shop found a problem when it tested the "tightness" of its three underground storage tanks for unleaded gasoline and diesel fuel. A subsequent site investigation found minor problems but no failure of the three tanks or connecting piping. Soil samples, test pits and monitoring wells indicated that contamination was not widespread. A consultant's report concluded that "the quantity of the petroleum released was probably quite small and poses little impact to the surrounding environment."

The state Department of Ecology (DOE) recommended quarterly monitoring of three on-site monitoring wells. It is unclear from DOE and City records whether the City followed this recommendation. In June of 1993, the three tanks were removed along with an estimated 100 cubic yards of contaminated soils. Sampling of the excavation site found the soils removal was successful, but groundwater contamination was still present. The City installed an "air sparing/vapor extraction system" to remove groundwater contamination. Use of the system required a permit from the Puget Sound Air Pollution Control Agency. For reasons that are not known, the permit was never granted and the system was not activated.

In early July of 2004, the soils and groundwater of the site occupied by Honeywell International to the west and north of Maintenance Shop were tested as part of due diligence for a prospective sale of the property. The property is jointly owned by the Archdiocese of Seattle and two other out-of-state religious organizations. The consultants performing this testing found evidence of petroleum hydrocarbons and associated contaminants in soil and groundwater samples that exceeded state cleanup standards as defined by the Model Toxics Control Act. When notified of these results, the City hired Golder Associates to investigate. Golder conducted the original site investigation in 1991.

In two phases of work, Golder installed new monitoring wells, did soils borings, and tested the existing monitoring wells. Golder confirmed that the Maintenance Shop tanks were the only possible source of the petroleum contamination on the Honeywell site. Golder found that the contamination extended in groundwater beneath the Honeywell office building. Golder believes that petroleum contamination from the Maintenance Shop tanks may have migrated in groundwater to the Honeywell site along the original path of the stream that now flows generally east to west at the south end of the property. The course of the stream likely was altered to its present south to north flow prior to construction of the building occupied by Honeywell. The old stream channel is believed to be contained in a sandy layer between two impervious layers of clay and hard silt.

On Feb. 22, 2005, the City authorized Golder to begin a third phase of work that will define the precise extent of the petroleum contamination at the Honeywell site, test the indoor air in the Honeywell building to determine whether the contamination beneath the building is affecting air quality, begin removing petroleum contamination in groundwater, and recommend a plan for the final cleanup and monitoring of the Site.

The 2004-2005 remedial investigation found a gasoline groundwater plume extending north from the former underground tank site, under the former Honeywell building, and turning to the northeast toward City Hall.

Cleanup of the affected groundwater is required under the State Model Toxics Control Act (MTCA). Golder was asked to develop a conceptual remedial approach for cleanup of the groundwater plume. After the conceptual approach was presented to John Bails of the Washington State Department of Ecology (DOE) and verbally approved, work began on a detailed plan for remediation. Following DOE acceptance, the remedial action plan as formalized and engineering design and compliance monitoring plans were completed in the summer of 2006.

The remedial action consisted of four components:

- Highly impacted groundwater was removed from the area north of the stream separating the Maintenance and Honeywell properties via excavation and the installation of an 80-foot-long by 10-foot-deep interceptor trench. The trench extracts impacted groundwater and pumps it to an activated carbon-based treatment system on the Maintenance property. After treatment, the water discharges to a King County/METRO sanitary sewer under discharge authorization number 4125-01.
- Approximately 260 cubic yards of highly contaminated soil were excavated from the south side of the Honeywell building.
- Biodegradation of the volatile organic compounds (VOCs) associated with the groundwater contamination plume has been enhanced by the introduction of ambient air via four buried airlines that intersect the gasoline plume and the application of oxidative chemicals.
- An existing network of monitoring wells to track the progress of the remediation was expanded. Short-term and long-term groundwater, surface water, and indoor air monitoring activities have been instituted.

In general, concentrations of gasoline and its VOC constituents remain above MTCA cleanup levels but appear to be decreasing with time. The property data for both sites showed progress in reducing the size of the plume, although test wells below the original fuel site still exceeded MTCA requirements. At the recommendation of Golder Associates, a pilot in-situ chemical oxidation test was implemented to accelerate the biodegradation of the contaminated groundwater.

In 2014, the City consulted with Farallon Consulting to complete a technical review of the remediation response, including the evaluation of the proposed pilot in-situ chemical oxidation test. Farallon recommended revamping the monitoring reports, including further descriptions of existing site conditions, cleanup activities, the evaluation of data, and moving from quarterly monitoring intervals to annual reports. Due to concerns over the effectiveness of the costly “in-situ” oxidation treatment, the City transitioned away from in-situ chemical applications in 2015 and 2016.

In compliance with the MTCA, the City continues to monitor and report on the remediation efforts annually. Remedial actions including the introduction of air into the subsurface to improve biological degradation continue. However, no chemical oxidation (Persulfate injections) are currently scoped. Golder also continues to maintain the remediation system and provide administrative support to complete the King County Metro discharge authorization permit and the DOE monitoring reports.

At significant points during this process, the City has consulted with the State Department of Ecology (DOE) and confirmed that the work being undertaken is appropriate and meets regulatory requirements. DOE has informed the City that the cleanup and monitoring process likely won't be completed for three to five years. DOE's Voluntary Compliance Program for underground storage tanks will allow the City to recover 50% of its costs, up to \$200,000, for the contamination investigation, clean-up and monitoring, following the issuance of a “No Further Action” letter at the completion of monitoring of the site.

**City of Mercer Island**  
**General Fund**  
**Schedule of Revenues, Expenditures, and Changes in Fund Balances - Budget and Actual**  
**For the Year Ended December 31, 2017**

	<b>Budgeted Amounts</b>			
	<b>Original Budget 2017- 2018</b>	<b>Final Budget 2017-2018</b>	<b>Actual for Biennium 2017</b>	<b>Variance From Final Budget 2017- 2018</b>
<b>REVENUES</b>				
Taxes:				
Property	\$ 24,033,663	\$ 24,033,663	\$ 11,850,029	\$ (12,183,634)
Sales	9,101,000	10,458,000	4,806,169	(5,651,831)
B&O	8,380,900	8,380,900	4,361,512	(4,019,388)
Licenses & Permits	6,749,000	6,904,000	3,410,802	(3,493,198)
Intergovernmental	1,063,462	1,286,452	610,396	(676,056)
Charges for Services	6,354,480	6,354,480	2,623,821	(3,730,659)
Fines & Forfeitures	830,000	830,000	405,781	(424,219)
Investment Earnings	12,000	12,000	16,219	4,219
Other Revenues	1,463,378	1,463,378	1,030,708	(432,670)
Total revenues	<u>57,987,883</u>	<u>59,722,873</u>	<u>29,115,438</u>	<u>(30,607,435)</u>
<b>EXPENDITURES</b>				
Current:				
Judicial	974,197	974,197	444,740	(529,457)
General Government	10,057,715	11,912,152	6,162,652	(5,749,500)
Public Safety	25,296,738	26,595,530	13,622,869	(12,972,661)
Physical Environ		-	66,721	66,721
Transportation	3,372,166	3,410,777	855,468	(2,555,309)
Health & Human Services		-	13,808	13,808
Economic Environment	6,623,904	6,830,317	3,192,733	(3,637,584)
Culture & Recreation	10,195,328	10,195,328	4,854,249	(5,341,079)
Total expenditures	<u>56,520,048</u>	<u>59,918,301</u>	<u>29,213,240</u>	<u>(30,705,061)</u>
Excess (deficiency) of revenues over (under) expenditures	<u>1,467,835</u>	<u>(195,428)</u>	<u>(97,802)</u>	<u>97,626</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in	-	2,021,677	2,021,677	0
Transfers out	(2,349,115)	(3,728,705)	(2,158,165)	1,570,540
Debt proceeds & capital leases		-	-	-
Refunding debt proceeds		367,891	367,891	-
Debt defeasance - payment to escrow		(367,891)	(365,006)	2,885
Misc Other Financing Sources		-	-	-
Total other financing sources (uses)	<u>(2,349,115)</u>	<u>(1,707,028)</u>	<u>(133,603)</u>	<u>1,573,425</u>
Net change in fund balances	(881,280)	(1,902,456)	(231,405)	1,671,051
Fund balances - Beginning	1,103,279	1,103,279	5,598,160	4,494,881
Prior Period Adjustments			(165,205)	(165,205)
Fund balances - Ending	<u>\$ 221,999</u>	<u>\$ (799,177)</u>	<u>\$ 5,201,550</u>	<u>\$ 6,000,727</u>

The notes to the Financial Statements are an integral part of this schedule.

**City of Mercer Island**  
**Street Fund**  
**Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual**  
**For the Year Ended December 31, 2017**

	Budgeted Amounts			Variance From
	Original Budget 2017-2018	Final Budget 2017-2018	Actual for Biennium 2017	Final Budget 2017- 2018
REVENUES				
Taxes:				
Other	\$ 3,224,500	\$ 3,224,500	\$ 2,845,340	(379,160)
Intergovernmental	1,097,000	1,397,000	578,258	(818,742)
Charges for Services		22,473	304,690	282,217
Total revenues	4,321,500	4,643,973	3,728,288	(915,685)
EXPENDITURES				
Current:				
Transportation	6,184,205	7,521,777	2,710,220	(4,811,557)
Total expenditures	6,184,205	7,521,777	2,710,220	(4,811,557)
Excess (deficiency) of revenues over (under) expenditures	(1,862,705)	(2,877,804)	1,018,067	3,895,871
OTHER FINANCING SOURCES (USES)				
Transfers in	750,000	892,753	467,881	(424,872)
Transfers out		(74,870)	(74,870)	-
Total other financing sources (uses)	750,000	817,883	393,011	(424,872)
Net change in fund balances	(1,112,705)	(2,059,921)	1,411,078	3,470,999
Fund balances - Beginning	2,179,388	2,179,388	3,874,030	1,694,642
Fund balances - Ending	\$ 1,066,683	\$ 119,467	\$ 5,285,108	\$ 5,165,641

The notes to the financial statement are an integral part of this schedule

**City of Mercer Island**  
**Schedule of Proportionate Share of the Net Pension Liability**  
**PERS1**  
**As of June 30, 2017**  
**Last 10 Fiscal Years**

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Employer's proportion of the net pension liability (asset)	0.0943380%	0.0921020%	0.1014210%	0.090700%	N/A	N/A	N/A	N/A	N/A	N/A
Employer's proportionate share of the net pension liability/ (asset)	\$ 4,476,412	\$ 4,946,311	\$ 5,305,261	4,569,055	N/A	N/A	N/A	N/A	N/A	N/A
<b>TOTAL</b>	<b>\$ 4,476,412</b>	<b>\$ 4,946,311</b>	<b>\$ 5,305,261</b>	<b>4,569,055</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>
Employer's covered employee payroll	11,809,152	10,729,144	11,164,401	9,553,259	N/A	N/A	N/A	N/A	N/A	N/A
Employer's proportionate share of the net pension liability as a percentage of covered employee payroll	263.8%	216.9%	210.4%	209.1%	N/A	N/A	N/A	N/A	N/A	N/A
Plan fiduciary net position as a percentage of the total pension liability	61.24%	57.03%	59.10%	61.19%	N/A	N/A	N/A	N/A	N/A	N/A

<b>Key Actuarial Assumptions</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Discount Rate	7.50%	7.50%	7.50%	7.50%
Long-term rate of return, net	7.50%	7.50%	7.50%	7.50%
Valuation Date	June 30,2016	June 30,2015	June 30,2014	June 30,2013
Measurement Date	June 30,2017	June 30,2016	June 30,2015	June 30,2014
Inflation	3.00%	3.00%	3.00%	3.00%
Salary increases-including inflation	3.75%	3.75%	3.75%	3.75%
Actuarial cost method	Entry Age Cost	Entry Age Normal	Entry Age Normal	Entry Age Normal
Mortality	RP-2000 Mortality Table (combined healthy) using 100% of Projection Scale BB			

**City of Mercer Island**  
**Schedule of Proportionate Share of the Net Pension Liability**  
**PERS 2/3**  
**As of June 30, 2017**  
**Last 10 Fiscal Years**

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Employer's proportion of the net pension liability	0.120307%	0.115169%	0.125812%	0.112022%	N/A	N/A	N/A	N/A	N/A	N/A
Employer's proportionate share of the net pension liability	\$ 4,180,093	\$ 5,798,668	\$ 4,495,334	2,264,369	N/A	N/A	N/A	N/A	N/A	N/A
<b>TOTAL</b>	<b>\$ 4,180,093</b>	<b>\$ 5,798,668</b>	<b>\$ 4,495,334</b>	<b>2,264,369</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>
Employer's covered employee payroll	\$ 11,809,152	\$ 10,729,144	\$ 11,164,401	9,553,259	N/A	N/A	N/A	N/A	N/A	N/A
Employer's proportionate share of the net pension liability as a percentage of covered employee payroll	35.40%	54.05%	40.26%	23.70%	N/A	N/A	N/A	N/A	N/A	N/A
Plan fiduciary net position as a percentage of the total pension liability	90.97%	85.82%	89.20%	93.29%	N/A	N/A	N/A	N/A	N/A	N/A

<b>Key Actuarial Assumptions</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Discount Rate	7.50%	7.50%	7.50%	7.50%
Long-term rate of return, net	7.50%	7.50%	7.50%	7.50%
Valuation Date	June 30, 2016	June 30, 2015	June 30, 2014	June 30, 2013
Measurement Date	June 30, 2017	June 30, 2016	June 30, 2015	June 30, 2014
Inflation	3.00%	3.00%	3.00%	3.00%
Salary increases-including inflation	3.75%	3.75%	3.75%	3.75%
Actuarial cost method	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal
Mortality	RP-2000 Mortality Table (combined healthy) using 100% of Projection Scale BB			

**City of Mercer Island**  
**Schedule of Proportionate Share of the Net Pension Liability**  
**PSERS**  
**As of June 30, 2017**  
**Last 10 Fiscal Years**

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Employer's proportion of the net pension liability (asset)	0.019410%	0.019563%	0.022901%	0.021583%	N/A	N/A	N/A	N/A	N/A	N/A
Employer's proportionate share of the net pension liability/ (asset)	\$ 3,803	\$ 8,314	\$ 4,180	(3,125)	N/A	N/A	N/A	N/A	N/A	N/A
<b>TOTAL</b>	<b>\$ 3,803</b>	<b>\$ 8,314</b>	<b>\$ 4,180</b>	<b>(3,125)</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>
Employer's covered employee payroll	\$ 68,723	\$ 63,388	\$ 67,051	57,659	N/A	N/A	N/A	N/A	N/A	N/A
Employer's proportionate share of the net pension liability as a percentage of covered employee payroll	5.53%	13.12%	6.23%	5.42%	N/A	N/A	N/A	N/A	N/A	N/A
Plan fiduciary net position as a percentage of the total pension liability	96.26%	90.41%	95.08%	105.01%	N/A	N/A	N/A	N/A	N/A	N/A

<b>Key Actuarial Assumptions</b>	2017	2016	2015	2014
Discount Rate	7.50%	7.50%	7.50%	7.50%
Long-term rate of return, net	7.50%	7.50%	7.50%	7.50%
Valuation Date	June 30,2016	June 30,2015	June 30,2014	June 30,2013
Measurement Date	June 30,2017	June 30,2016	June 30,2015	June 30,2014
Inflation	3.00%	3.00%	3.00%	3.00%
Salary increases-including inflation	3.75%	3.75%	3.75%	3.75%
Actuarial cost method	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal
Mortality	RP-2000 Mortality Table (combined healthy) using 100% of Projection Scale BB			



**City of Mercer Island**  
**Schedule of Proportionate Share of the Net Pension Liability**  
**LEOFF 1**  
**As of June 30, 2017**  
**Last 10 Fiscal Years**

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Employer's proportion of the net pension liability (asset)	0.070386%	0.070876%	0.071143%	0.071676%	N/A	N/A	N/A	N/A	N/A	N/A
Employer's proportionate share of the net pension liability/ (asset)	\$ (1,067,910)	\$ (730,226)	\$ (857,430)	(869,280)	N/A	N/A	N/A	N/A	N/A	N/A
<b>TOTAL</b>	<b>\$ (1,067,910)</b>	<b>\$ (730,226)</b>	<b>\$ (857,430)</b>	<b>(869,280)</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>
Employer's covered employee payroll	\$ -	\$ -	\$ -	\$ -	N/A	N/A	N/A	N/A	N/A	N/A
Employer's proportionate share of the net pension liability as a percentage of covered employee payroll	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Plan fiduciary net position as a percentage of the total pension liability	135.96%	123.74%	127.36%	126.91%	N/A	N/A	N/A	N/A	N/A	N/A

<b>Key Actuarial Assumptions</b>	2017	2016	2015	2014
Discount Rate	7.50%	7.50%	7.50%	7.50%
Long-term rate of return, net	7.50%	7.50%	7.50%	7.50%
Valuation Date	June 30,2016	June 30,2015	June 30,2014	June 30,2013
Measurement Date	June 30,2017	June 30,2016	June 30,2015	June 30,2014
Inflation	3.00%	3.00%	3.00%	3.00%
Salary increases-including inflation	3.75%	3.75%	3.75%	3.75%
Actuarial cost method	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal
Mortality	RP-2000 Mortality Table (combined healthy) using 100% of Projection Scale BB			

**City of Mercer Island**  
**Schedule of Proportionate Share of the Net Pension Liability**  
**LEOFF 2**  
**As of June 30, 2017**  
**Last 10 Fiscal Years**

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Employer's proportion of the net pension liability (asset)	0.246128%	0.234565%	0.261715%	0.244566%	N/A	N/A	N/A	N/A	N/A	N/A
Employer's proportionate share of the net pension liability/ (asset)	\$ (3,415,459)	\$ (1,364,300)	\$ (2,689,907)	(3,245,496)	N/A	N/A	N/A	N/A	N/A	N/A
State's proportionate share of the net pension liability (asset) associated with the employer	\$ (252,218)	\$ (233,944)	\$ (253,636)	(227,796)	N/A	N/A	N/A	N/A	N/A	N/A
<b>TOTAL</b>	<b>\$ (3,667,677)</b>	<b>\$ (1,598,244)</b>	<b>\$ (2,943,542)</b>	<b>(3,473,292)</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>
Employer's covered employee payroll	\$ 7,699,330	\$ 7,105,964	\$ 7,596,018	6,806,464	N/A	N/A	N/A	N/A	N/A	N/A
Employer's proportionate share of the net pension liability as a percentage of covered employee payroll	44.36%	19.20%	35.41%	47.68%	N/A	N/A	N/A	N/A	N/A	N/A
Plan fiduciary net position as a percentage of the total pension liability	113.36%	106.04%	111.67%	116.75%	N/A	N/A	N/A	N/A	N/A	N/A

<b>Key Actuarial Assumptions</b>	2017	2016	2015	2014
Discount Rate	7.50%	7.50%	7.50%	7.50%
Long-term rate of return, net	7.50%	7.50%	7.50%	7.50%
Valuation Date	June 30,2016	June 30,2015	June 30,2014	June 30,2013
Measurement Date	June 30,2017	June 30,2016	June 30,2015	June 30,2014
Inflation	3.00%	3.00%	3.00%	3.00%
Salary increases-including inflation	3.75%	3.75%	3.75%	3.75%
Actuarial cost method	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal
Mortality	RP-2000 Mortality Table (combined healthy) using 100% of Projection Scale BB			

**City of Mercer Island**  
**Schedule of Employer Contributions**  
**PERS Plan 1**  
**As of December 31, 2017**  
**Last 10 Fiscal Years**

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Statutorily or contractually required contributions	\$ -	\$ 5,050	\$ 19,181	\$ 15,336	N/A	N/A	N/A	N/A	N/A	N/A
Contributions in relation to the statutorily or contractually required contributions	\$ -	\$ (5,050)	\$ (19,181)	\$ (15,336)	N/A	N/A	N/A	N/A	N/A	N/A
Contribution deficiency (excess)	\$ -	\$ -	\$ -	\$ -	N/A	N/A	N/A	N/A	N/A	N/A
Covered employer payroll	\$ 12,413,233	\$ 11,266,419	\$ 11,048,090	\$ 10,261,952	N/A	N/A	N/A	N/A	N/A	N/A
Contributions as a percentage of covered employee payroll	0.0%	0.0%	0.2%	0.1%	N/A	N/A	N/A	N/A	N/A	N/A

City of Mercer Island  
Schedule of Employer Contributions  
PERS Plan 2 / 3  
As of December 31, 2017  
Last 10 Fiscal Years

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Statutorily or contractually required contributions	\$ 1,475,731	\$ 1,259,585	\$ 1,123,738	\$ 941,919	N/A	N/A	N/A	N/A	N/A	N/A
Contributions in relation to the statutorily or contractually required contributions	\$ (1,475,731)	\$ (1,259,585)	\$ (1,123,738)	\$ (941,919)	N/A	N/A	N/A	N/A	N/A	N/A
Contribution deficiency (excess)	\$ -	\$ -	\$ -	\$ -	N/A	N/A	N/A	N/A	N/A	N/A
Covered employer payroll	\$ 12,413,233	\$ 11,266,419	\$ 11,048,090	\$ 10,261,952	N/A	N/A	N/A	N/A	N/A	N/A
Contributions as a percentage of covered employee payroll	11.9%	11.2%	10.2%	9.2%	N/A	N/A	N/A	N/A	N/A	N/A

**City of Mercer Island**  
**Schedule of Employer Contributions**  
**PSERS**  
**As of December 31, 2017**  
**Last 10 Fiscal Years**

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Statutorily or contractually required contributions	\$ 8,521	\$ 7,725	\$ 7,147	\$ 6,649	N/A	N/A	N/A	N/A	N/A	N/A
Contributions in relation to the statutorily or contractually required contributions	\$ (8,521)	\$ (7,725)	\$ (7,147)	\$ (6,649)	N/A	N/A	N/A	N/A	N/A	N/A
Contribution deficiency (excess)	\$ -	\$ -	\$ -	\$ -	N/A	N/A	N/A	N/A	N/A	N/A
Covered employer payroll	\$ 72,649	\$ 66,943	\$ 64,792	\$ 63,085	N/A	N/A	N/A	N/A	N/A	N/A
Contributions as a percentage of covered employee payroll	11.7%	11.5%	11.0%	10.5%	N/A	N/A	N/A	N/A	N/A	N/A

**City of Mercer Island**  
**Schedule of Employer Contributions**  
**LEOFF 1**  
**As of December 31, 2017**  
**Last 10 Fiscal Years**

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Statutorily or contractually required contributions	\$ -	\$ -	\$ -	\$ -	N/A	N/A	N/A	N/A	N/A	N/A
Contributions in relation to the statutorily or contractually required contributions	\$ -	\$ -	\$ -	\$ -	N/A	N/A	N/A	N/A	N/A	N/A
Contribution deficiency (excess)	\$ -	\$ -	\$ -	\$ -	N/A	N/A	N/A	N/A	N/A	N/A
Covered employer payroll	\$ -	\$ -	\$ -	\$ -	N/A	N/A	N/A	N/A	N/A	N/A
Contributions as a percentage of covered employee payroll	0.0%	0.0%	0.0%	0.0%	N/A	N/A	N/A	N/A	N/A	N/A

**City of Mercer Island**  
**Schedule of Employer Contributions**  
**LEOFF 2**  
**As of December 31, 2017**  
**Last 10 Fiscal Years**

	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
Statutorily or contractually required contributions	\$ 419,206	\$ 390,720	\$ 393,006	\$ 375,430	N/A	N/A	N/A	N/A	N/A	N/A
Contributions in relation to the statutorily or contractually required contributions	\$ (419,206)	\$ (390,720)	\$ (393,006)	\$ (375,430)	N/A	N/A	N/A	N/A	N/A	N/A
Contribution deficiency (excess)	\$ -	\$ -	\$ -	\$ -	N/A	N/A	N/A	N/A	N/A	N/A
Covered employer payroll	\$ 7,874,867	\$ 7,470,757	\$ 7,481,851	\$ 7,178,393	N/A	N/A	N/A	N/A	N/A	N/A
Contributions as a percentage of covered employee payroll	5.3%	5.2%	5.3%	5.2%	N/A	N/A	N/A	N/A	N/A	N/A

**Firefighters Pension Fund**  
**GASB 67 Schedule of Changes in Net Pension Liability and Related Ratios**

\$ Thousands	Fiscal Year Ending December 31:										
	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
<b>Total Pension Liability</b>											
Service Cost	\$0	\$0	\$0	\$0	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Interest on total pension liability	75	67	67	68	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Effect of plan changes	0	0	0	0	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Effect of economic/demographic gains or losses	-278	17	17	0	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Effect of assumptions changes or inputs	0	217	217	52	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Benefit payments	-83	-91	-91	-77	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net change in total pension liability	-\$286	\$210	\$210	\$43	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total pension liability, beginning	2181	1971	1971	1927	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total pension liability, ending (a)	\$1,895	\$2,181	2181	1970	N/A	N/A	N/A	N/A	N/A	N/A	N/A
<b>Fiduciary Net Position</b>					N/A	N/A	N/A	N/A	N/A	N/A	N/A
Employer contributions	\$26	\$26	\$26	\$26	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Contributions from state fire insurance premium tax	32	30	31	31	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Investment income net of investment expenses	8	5	1	3	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Benefit payments	-83	-83	-91	-77	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Medical payments from fund	0	0	0	0	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Administrative expenses	0	0	0	0	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net change in plan fiduciary net position	-16	-22	-32	-16	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Fiduciary net position, beginning	901	923	955	971	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Fiduciary net position, ending (b)	885	901	923	955	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net pension liability, ending = (a)-(b)	\$1,010	\$1,279	\$1,258	\$1,015	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Fiduciary net position as a % of total pension liability	46.7%	41.3%	42.3%	48.5%	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Covered Payroll	\$0	\$0	\$0	\$0	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net pension liability as a % of covered payroll	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

**Firefighters Pension Fund**  
**GASB 67 Money-Weighted Rate of Return**

Fiscal Year Ending December 31	Net Money-Weighted Rate of Return
2008	N/A
2009	N/A
2010	N/A
2011	N/A
2012	N/A
2013	N/A
2014	0.35%
2015	0.13%
2016	0.55%
2017	0.92%



**Firefighters Pension Fund  
GASB 67 Schedule of Employer Contributions**

<b>Fiscal Year Ending December 31</b>	<b>Actuarially Determined Contribution</b>	<b>Actual Employer Contribution*</b>	<b>Contribution Deficiency (Excess)</b>	<b>Covered Payroll</b>	<b>Contribution as a % of Covered Payroll</b>
2008	69,613	24,199	45,414	0	N/A
2009	69,613	23,871	45,742	0	N/A
2010	69,613	25,418	44,195	0	N/A
2011	67,183	25,666	41,517	0	N/A
2012	67,183	51,702	15,481	0	N/A
2013	67,183	54,424	12,759	0	N/A
2014	68,856	57,433	11,423	0	N/A
2015	68,856	57,700	11,156	0	N/A
2016	68,856	56,017	12,839	0	N/A
2017	68,856	58,682	10,174	0	N/A

**City of Mercer Island  
OPEB - Schedule of Funding Progress  
(in thousands)**

<b>Valuation Date</b>	<b>January 1, 2011</b>	<b>January 1, 2014</b>	<b>January 1, 2018</b>
Actuarial Value of Assets	\$ -	\$ -	\$ -
Actuarial Accrued Liabilities	14,285	10,626	10,658
Unfunded Actuarial Accrued Liabilities (UAAL)	14,285	10,626	10,658
Funded Ratio	0%	0%	0%
Covered Payroll	NA	NA	NA
UAAL as a Percentage of Covered Payroll	NA	NA	NA

**City of Mercer Island  
Schedule of Employer Contributions  
OPEB**

<b>Fiscal Year Ending 12/31</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Actual Employer Contributions	429,188	458,745	468,551	482,074	476,465	476,465	385,205	393,085	325,451	269,823
Disbursements										
Total Employer Contributions	429,188	458,745	468,551	482,074	476,465	427,209	385,205	393,085	325,451	269,823
Annual Required Contribution (ARC)	699,446	699,446	699,446	899,071	899,071	899,071	679,202	679,202	679,202	679,202
Percentage of ARC Contributed	61%	66%	67%	54%	53%	48%	57%	58%	48%	40%

**NOTES TO RSI****Local Government Pension Trust Fund - Firefighters Pension Fund**

In addition to the two statewide retirement systems, the City is itself the administrator of a Firemen's Pension System, which is shown as a pension trust fund in the financial reports of the City.

Schedules of required supplementary information including a 10 year schedule of changes in the net pension liability and related ratios, a 10 year schedule of employer contributions, and a 10 year schedule of the money-weighted rate of return are provided to present multi-year trend information.

Employer contributions for pensions are total contributions to the fund net of disbursements from the fund for medical expenses under RCW 41.26.150. It includes revenues from fire insurance premium taxes. Prior to 2014, administrative expenses were also subtracted from employer contributions.

GASB Statement 67 has separated funding from financial reporting. Paragraph 32c of GASB 67 provides guidance for a schedule of an actuarially determined contribution, if such contribution is calculated. For the above schedule, titled *GASB 67 Schedule of Employer Contributions*, the actuarially determined contribution shown is equal to the Annual Required Contribution previously reported under GASB 25.

The total pension liability was determined by an actuarial valuation as of the valuation date, calculated based on the discount rate and key actuarial assumptions detailed below, and projected forward to the measurement date.

<i>Key Actuarial Assumptions</i>	<b>December 31, 2016</b>	<b>December 31, 2017</b>
Discount Rate	3.50%	3.50%
Long-term rate of return, net	3.50%	3.50%
Municipal bond rate	3.50%	3.50%
Valuation Date	January 1, 2016	January 1, 2018
Measurement Date	December 31, 2016	December 31, 2017
Inflation	2.25%	2.25%
Salary increases-including inflation	3.25%	3.25%
Actuarial cost method	Entry Age Normal	Entry Age Normal
Mortality	RP-2000 Mortality Table (combined healthy) with generational projection using 100% of Projection Scale BB, with ages set back one year for males and forward one year for females (set forward two years for disabled members)	RP-2000 Mortality Table (combined healthy) with generational projection using 100% of Projection Scale BB, with ages set back one year for males and forward one year for females (set forward two years for disabled members)

**OPEB Cost and Net OPEB Obligation**

The City's annual Other Post Employment Benefit (OPEB) cost is calculated upon the annual required contribution (ARC), an amount actuarially determined in accordance with 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 thirty years beginning January 1, 2008.

The actuarial assumptions are intended to estimate the future experience of members. Valuation assumptions include:

<b>Key Actuarial Assumptions</b>		<b>December 31, 2017</b>	
Discount Rate		3.50%	
Medical Trend:			
	<b>Year</b>	<b>Pre-65</b>	<b>Post-65</b>
	2018-2019	3.4%	0.9%
	2019-2020	8.0%	7.2%
	2020-2022	4.9%	4.9%
	2022-2025		4.8%
	2025-2032		4.7%
	2032-2040		4.8%
Valuation Date		January 1, 2018	
Measurement Date		December 31, 2017	
Long term care inflation rate		4.50%	
Actuarial cost method		Entry Age Normal	
Mortality - Service retired members		RP-2000 Mortality Table (combined healthy) with generational projection using 100% of Projection Scale BB, with ages set back one year for males and forward one year for females (set forward two years for disabled members)	
Mortality - Disabled members		RP-2000 Mortality Table (combined healthy) with generational projection using 100% of Projection Scale BB, with ages set forward two years	

## 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.

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