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April 23, 2010

Mr. Mark Brinkman, President
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Re: Financial Analysis of the City of Lynnwood

Dear Mark:

Pursuant to your request, we have analyzed the Comprehensive Annual Financial Reports (CAFR) of the City of Lynnwood (City) for the years ended December 31, 2004 through December 31, 2008 and the unaudited financial statements that we obtained from William Burton for the City's General Fund, Special Revenue Funds, Capital Project Funds, Debt Service Funds, Enterprise Funds and Internal Service Funds for the year ended December 31, 2009. For the purposes of this report, we will concentrate on the General Fund.

Our overall conclusion from analyzing the above financial information is that the financial position of the City of Lynnwood is extremely weak, with the General Fund technically insolvent at December 31, 2009. We have prepared Exhibit I through Exhibit V to highlight our findings.

EXHIBIT I

Exhibit I-A analyzes the City's **General Fund's liquidity**. The cash and investments demonstrate the ability to "write the check", and fund balances available demonstrates the availability of funds (unreserved-undesignated), as well as those designated only for administrative priorities. **The cash and investments balance and the fund balances must be compared to each other with the lesser amount of the two being the portion truly available at December 31st of each year.** We have also summarized the General Fund's other assets and liabilities to aid in our analysis.

Assets and Liabilities

The cash and investment balance is affected by other factors besides actual surpluses and deficits. The increase in receivables and other current assets, and the decline in liabilities cause cash and investments to decline, which can offset an actual surplus or increase the effects of a deficit. The opposite is true for decreasing receivables and other current assets, and the growth of liabilities which increase cash and investment balances.

- The General Fund's cash and investments were relatively strong between 2004 and 2008, ranging from a low of \$3.2 million to a high of \$4.2 million.



- During the year ended December 31, 2009, cash and investments fell from \$3.8 million at December 31, 2008 to \$71,371 at year end.
 - The liquidation of the General Fund's cash and investments in 2009 was primarily due to the \$5.3 million operating deficit.
 - If not for a short term loan of \$3 million from the utility funds, the General Fund's cash and investment balance would have been negative.
- The General Fund's other assets, primarily receivables, ranged from a low of \$3.3 million in 2006 to a high of \$3.8 million in 2008.
- The increases in the General Fund's liabilities from 2005 through 2009 had a positive effect on the cash balance.
 - The majority of the General Fund's liabilities are either accounts payable or deferred revenue.
 - Deferred revenue represents receivables that have been recorded, but are not available under the modified accrual method of accounting.
 - Deferred revenues ranged between \$374,101 in 2008 and \$455,044 in 2009.
 - Most of the increase in liabilities from 2005 through 2008 occurred in accounts payable.
 - Delaying the payment of accounts payable and letting the liabilities increase allowed the City to accumulate additional cash and investments at year end.
 - In 2009, accounts payable declined from \$1.1 million to \$519,247.
 - The decline in accounts payable was offset by an increase in due to other funds from zero in 2008 to \$3 million in 2009.
 - As we noted above, without this loan, the General Fund would have been overdrawn, and unable to pay its bills.

Asset to Liability Ratio

As a rule, financial health would dictate that both total assets and this ratio increase or maintain over time. If the ratio is already healthy, it should remain relatively constant. Though this ratio can vary widely due to the timing of tax, grant collections or the payment of bills, any large drop should be explained. A ratio barely over 1 leaves very little fund balances, and a ratio below 1 is a serious problem.

- The City of Lynnwood's General Fund's Asset to Liability ratio was strong from December 31, 2004 to December 31, 2008, ranging from a low of 4.98 in 2008 to a high of 7.77 in 2005.
 - The decline in this ratio from its high in 2005 to 2008 is due to liabilities growing faster than assets.
- At December 31, 2009, the asset to liability also fell below 1 to 0.97, meaning that for every \$1 of liabilities, the General Fund had \$0.97 of assets.
 - This is a very serious problem as the General Fund is technically insolvent as it cannot pay all of its liabilities from current resources.



Fund Balance

While the rise and decline of cash and investments are affected by several factors, as we will show in Exhibit III, the change in the total fund balance is primarily due to the fund's actual surpluses or deficits. Other important highlights:

- In 2006, the total fund balance as reported of \$6,196,669 in the Balance Sheet did not match the total fund balance reported in the Statement of Revenues, Expenditures and changes in Fund Balance of \$6,286,433.
- Between 2004 and 2008, the fund balance exceeded \$5.3 million, all of it unreserved.
- The General Fund's unreserved fund balance can be used for any purpose and is not restricted by outside sources.
 - In essence, the unreserved portion of the General Fund is the City's reserves.
- In 2009, per the unaudited December 31, 2009 balance sheet, the General Fund's fund balance became a negative \$115,733.
 - This is a serious problem as the City had used all of its reserves during the 2009 fiscal year.
 - The only resources available to the General Fund are loans from other funds.
 - These are one-time resources and cannot be used as an ongoing funding source.
 - We were informed that the \$3 million due to other funds is a loan from the Water Fund.
 - Under Washington law,
 - The Council must approve of the transfer/loan,
 - There must be a plan to repay the loan with interest, and
 - It must be paid back within 4 years.
- The City does not have the resources for further operating deficits and to finance ongoing operations.

Exhibit I-B is a graphic representation of the General Fund's cash and investments and fund balances.

Findings:

- The City's once healthy General Fund's cash and investment balance declined precipitously from \$3.8 million at December 31, 2007 to \$71,371 per the unaudited December 31, 2009 balance sheet.
- The General Fund's total fund balance is a negative \$115,733, the amount liabilities exceed assets,
 - As such, the General Fund is technically insolvent at December 31, 2009.
- The General Fund has no reserves available to finance ongoing operating deficits.
- Borrowing from other funds is a short-term solution, not a permanent solution.

**EXHIBIT I-A
CITY OF LYNNWOOD
GENERAL FUND**

For the Years Ended December 31,

| | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009 Unaudited</u> |
|---|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|---------------------------|
| Assets | | | | | | |
| Cash and investments | 3,186,994 | 4,207,702 | 4,180,761 | 3,770,091 | 3,826,675 | 71,371 |
| Other assets | 3,416,863 | 3,362,982 | 3,275,461 | 3,702,745 | 3,811,299 | 3,790,875 |
| Total Assets | <u><u>6,603,857</u></u> | <u><u>7,570,684</u></u> | <u><u>7,456,222</u></u> | <u><u>7,472,836</u></u> | <u><u>7,637,974</u></u> | <u><u>3,862,246</u></u> |
| Liabilities | | | | | | |
| Accounts payable | 746,694 | 497,902 | 748,551 | 605,448 | 1,067,030 | 456,288 |
| Due to other Funds | 0 | 0 | 0 | 0 | 0 | 3,000,000 |
| Deferred revenue | 429,208 | 390,489 | 386,024 | 433,644 | 374,101 | 455,044 |
| Unearned revenue | 0 | 0 | 1,865 | 4,578 | 5,185 | 3,688 |
| Liabilities paid from restricted assets | 96,697 | 86,443 | 123,113 | 232,196 | 85,979 | 62,959 |
| Total Liabilities | <u><u>1,272,599</u></u> | <u><u>974,834</u></u> | <u><u>1,259,553</u></u> | <u><u>1,275,866</u></u> | <u><u>1,532,295</u></u> | <u><u>3,977,979</u></u> |
| Asset to liability ratio | <u><u>5.19</u></u> | <u><u>7.77</u></u> | <u><u>5.92</u></u> | <u><u>5.86</u></u> | <u><u>4.98</u></u> | <u><u>0.97</u></u> |
| Fund Balance | | | | | | |
| Unreserved | 5,331,258 | 6,595,850 | 6,196,669 | 6,196,970 | 6,105,679 | (115,733) |
| Unreserved - Undesignated | | | | | | |
| Total unreserved balance | <u><u>5,331,258</u></u> | <u><u>6,595,850</u></u> | <u><u>6,196,669</u></u> | <u><u>6,196,970</u></u> | <u><u>6,105,679</u></u> | <u><u>(115,733)</u></u> |
| Total Fund Balance | <u><u>5,331,258</u></u> | <u><u>6,595,850</u></u> | <u><u>6,196,669</u></u> | <u><u>6,196,970</u></u> | <u><u>6,105,679</u></u> | <u><u>(115,733)</u></u> |
| Total Liabilities and Fund Balance | <u><u>6,603,857</u></u> | <u><u>7,570,684</u></u> | <u><u>7,456,222</u></u> | <u><u>7,472,836</u></u> | <u><u>7,637,974</u></u> | <u><u>3,862,246</u></u> |

**EXHIBIT I-B
CITY OF LYNNWOOD
ANALYSIS OF THE GENERAL FUND'S FUND BALANCE**

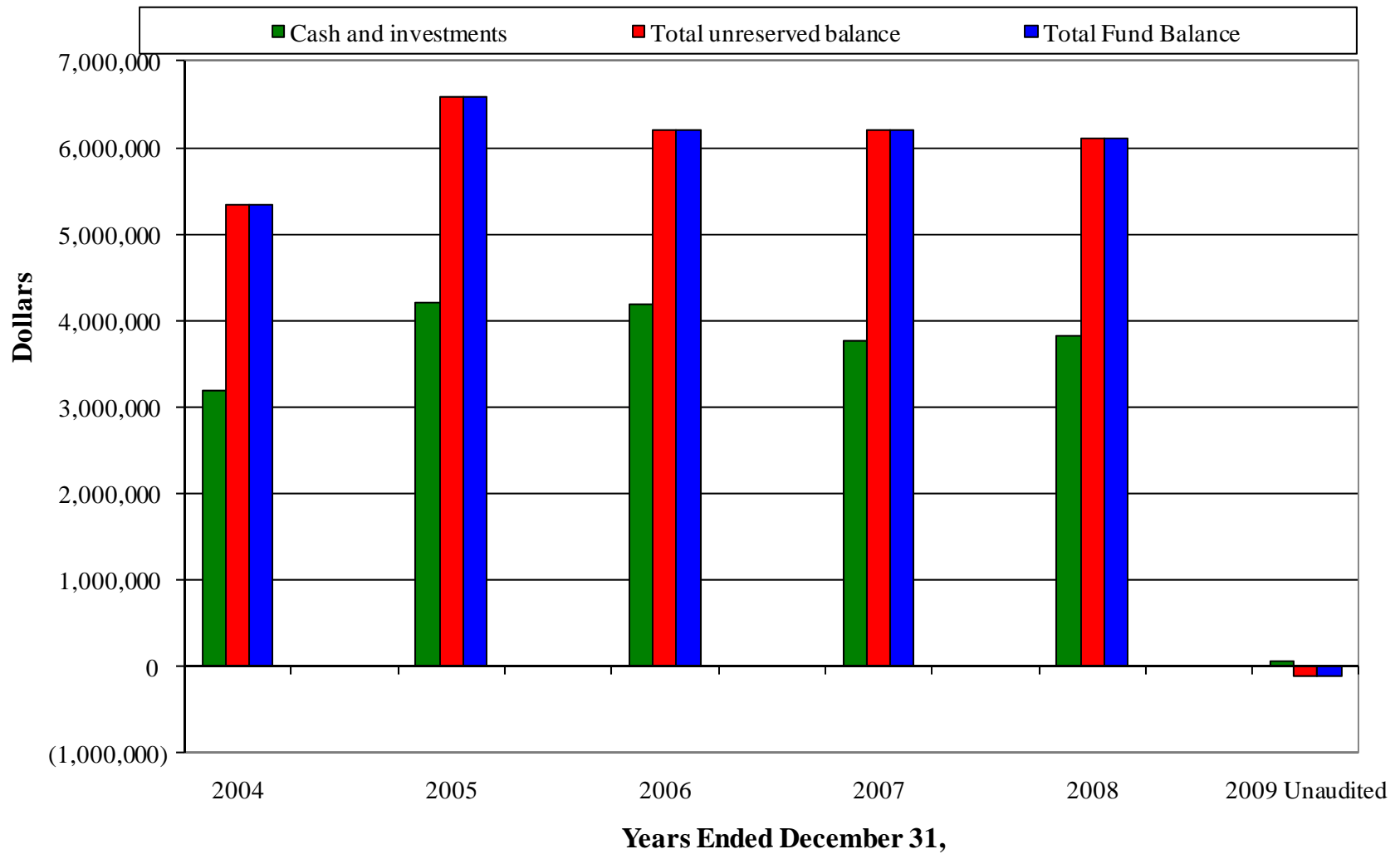




EXHIBIT II

Exhibit II calculates two ratios, the General Fund’s unreserved fund balance to its annual revenues and General Fund’s unreserved fund balance to its annual expenditures, and compares them to historical benchmarks. The ratios calculated in this exhibit are intended to serve as a measure of resources available so they can be compared to a benchmark or standard in determining the financial health of the General Fund. Historically, a 5% ratio of the unreserved fund balance to either its annual revenues or expenditures has been considered the minimum ratio in determining a healthy fund balance.

- Standard & Poors (S&P) considers 5% to 15% of operating revenues to be “adequate” when benchmarking the General Fund’s total ending fund balance, and 2% to 8% of operating revenues to be “adequate” for benchmarking the unreserved fund balance.
- Moody’s Investor Services (Moody’s) believe a minimum level of between 5% and 10% of unreserved fund balance to expenses should be targeted.
- Fitch IBCA (Fitch) considers an unreserved fund balance equal to 5% of expenditures and transfers or revenues and transfers a sound level.
- The Government Financial Officers Association (GFOA) recommends for those governments that compare the unreserved fund balance to revenues, the minimum unreserved fund balance be no less than 5% to 15% of general fund revenues and 8% to 17% for expenditures.
- Furthermore, a small government should have a larger unreserved fund balance, as a larger government usually has more revenue sources.

Transfers to or from the General Fund should be analyzed to determine if they are regular, continuing, and whether they are a funding responsibility of the General Fund. Transfers to the General Fund that meet these criteria should be included in revenues and transfers from the General Fund should be included in expenditures. For the City of Lynnwood, we determined that all the transfers to the General Fund should be included in revenues and all transfers from the General Fund should be included in expenditures.

The following table shows our calculation of adjusted total revenues.

Computation of Adjusted Revenues

| Fiscal Year | | | |
|-------------|------------|--------------|------------|
| Ended | Revenues | Transfers to | Adjusted |
| June 30, | | General Fund | Revenues |
| 2004 | 30,872,932 | 2,428,112 | 33,301,044 |
| 2005 | 33,284,471 | 2,421,968 | 35,706,439 |
| 2006 | 34,964,159 | 1,624,558 | 36,588,717 |
| 2007 | 39,224,443 | 3,115,653 | 42,340,096 |
| 2008 | 40,269,274 | 5,255,326 | 45,524,600 |
| 2009 | | | |
| (Unaudited) | 37,203,490 | 5,535,285 | 42,738,775 |



The following table shows our calculation of the adjusted expenditures.

Computation of Adjusted Expenditures

| Fiscal Year | | | |
|-------------|--------------|----------------|--------------|
| Ended | | Transfers from | Adjusted |
| June 30, | Expenditures | General Fund | Expenditures |
| 2004 | 33,788,300 | 1,038,628 | 34,826,928 |
| 2005 | 33,694,423 | 848,429 | 34,542,852 |
| 2006 | 36,022,190 | 3,341,033 | 39,363,223 |
| 2007 | 40,139,180 | 2,290,379 | 42,429,559 |
| 2008 | 42,982,027 | 2,438,291 | 45,420,318 |
| 2009 | | | |
| (Unaudited) | 46,780,195 | 1,302,782 | 48,082,977 |

Exhibit II-A computes the ratio of the unreserved fund balance to the adjusted revenue and the unreserved fund balance to the adjusted expenditures ratio and compares them to the 5% benchmark for both revenues and expenditures for each year presented in our report.

- After increasing in the December 31, 2005 fiscal year to its high of 18.47%, the revenue ratio declined slowly each year to 13.41% in 2008.
 - In 2009, the revenue ratio collapsed to a negative 0.27%, far below the 5% benchmark.
- The expenditure ratio mirrored the collapse of the revenue benchmark.
 - It too experienced a slow decline from its high of 19.09% in 2005 to 13.44% in 2008, then collapsed to a negative 0.24% at December 31, 2009.

Exhibit II-B and **Exhibit II-C** are graphic representations of Exhibit II-A data.

Findings:

- Both ratios are at crisis levels.

**EXHIBIT II-A
CITY OF LYNNWOOD
% OF UNRESERVED FUND BALANCE TO GAAP REVENUES AND EXPENDITURES
GENERAL FUND**

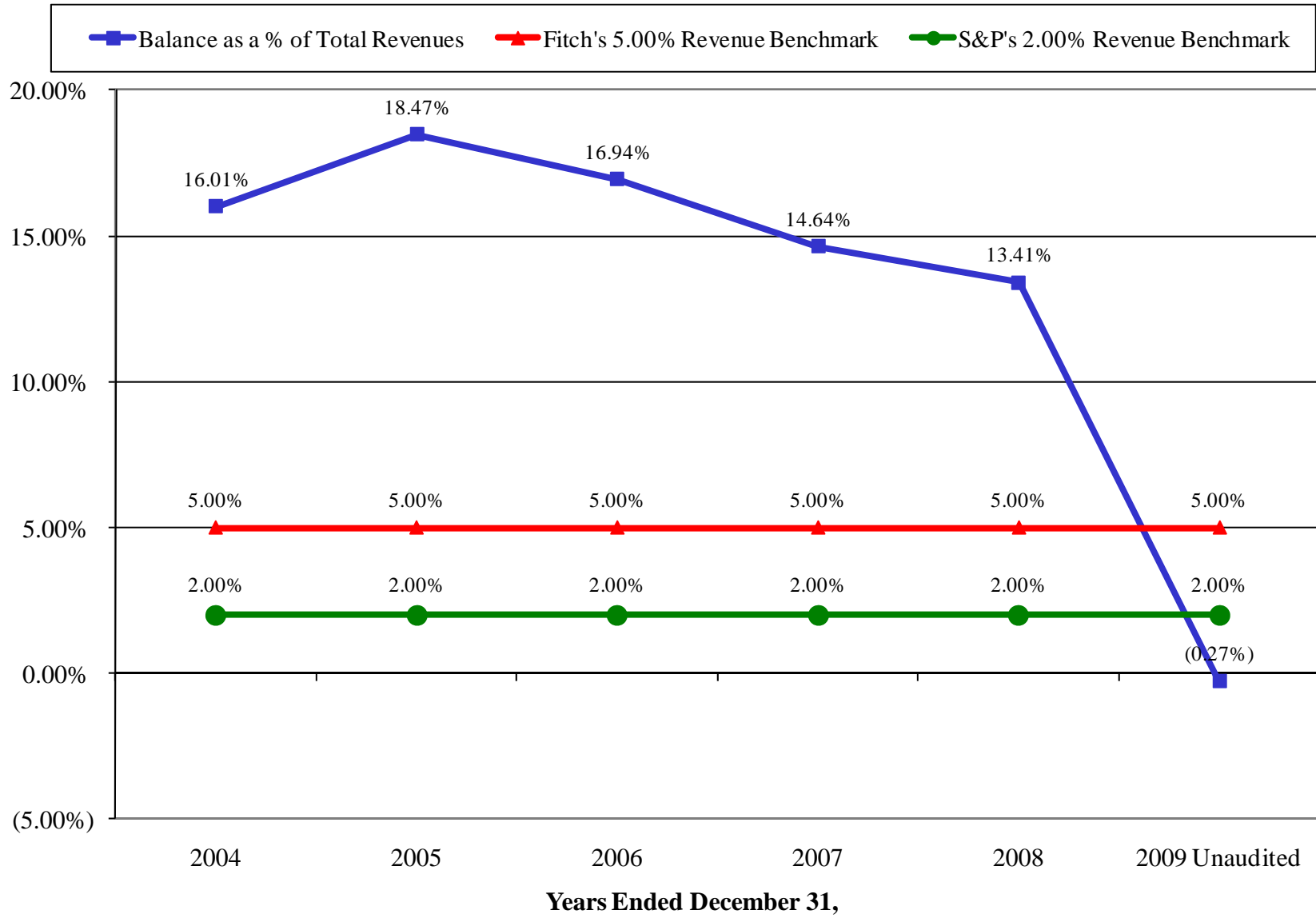
Unreserved Fund Balance to GAAP Revenues

| <i>Year Ended June 30,</i> | <i>Unreserved Fund Balance</i> | <i>Adjusted GAAP Revenues</i> | <i>Balance as a % of Total Revenues</i> | <i>5% of Adjusted Revenues</i> | <i>Unreserved Fund Balance in Excess of 5% of Revenues</i> |
|--------------------------------|------------------------------------|-----------------------------------|---|--|--|
| 2004 | 5,331,258 | 33,301,044 | 16.01% | 1,665,052 | 3,666,206 |
| 2005 | 6,595,850 | 35,706,439 | 18.47% | 1,785,322 | 4,810,528 |
| 2006 | 6,196,669 | 36,588,717 | 16.94% | 1,829,436 | 4,367,233 |
| 2007 | 6,196,970 | 42,340,096 | 14.64% | 2,117,005 | 4,079,965 |
| 2008 | 6,105,679 | 45,524,600 | 13.41% | 2,276,230 | 3,829,449 |
| 2009 Unaudited | (115,733) | 42,738,775 | (0.27%) | 2,136,939 | (2,252,672) |

Unreserved Fund Balance to GAAP Expenditures

| <i>Year Ended June 30,</i> | <i>Unreserved Fund Balance</i> | <i>Adjusted GAAP Expenditures</i> | <i>Balance as a % of Total Expenditures</i> | <i>5% of Adjusted Expenditures</i> | <i>Unreserved Fund Balance in Excess of 5% of Expenditures</i> |
|--------------------------------|------------------------------------|---------------------------------------|---|--|--|
| 2004 | 5,331,258 | 34,826,928 | 15.31% | 1,741,346 | 3,589,912 |
| 2005 | 6,595,850 | 34,542,852 | 19.09% | 1,727,143 | 4,868,707 |
| 2006 | 6,196,669 | 39,363,223 | 15.74% | 1,968,161 | 4,228,508 |
| 2007 | 6,196,970 | 42,429,559 | 14.61% | 2,121,478 | 4,075,492 |
| 2008 | 6,105,679 | 45,420,318 | 13.44% | 2,271,016 | 3,834,663 |
| 2009 Unaudited | (115,733) | 48,082,977 | (0.24%) | 2,404,149 | (2,519,882) |

**EXHIBIT II-B
CITY OF LYNNWOOD
UNRESERVED FUND BALANCE AS A % OF TOTAL REVENUES**



**EXHIBIT II-C
CITY OF LYNNWOOD
UNRESERVED FUND BALANCE AS A % of TOTAL EXPENDITURES**

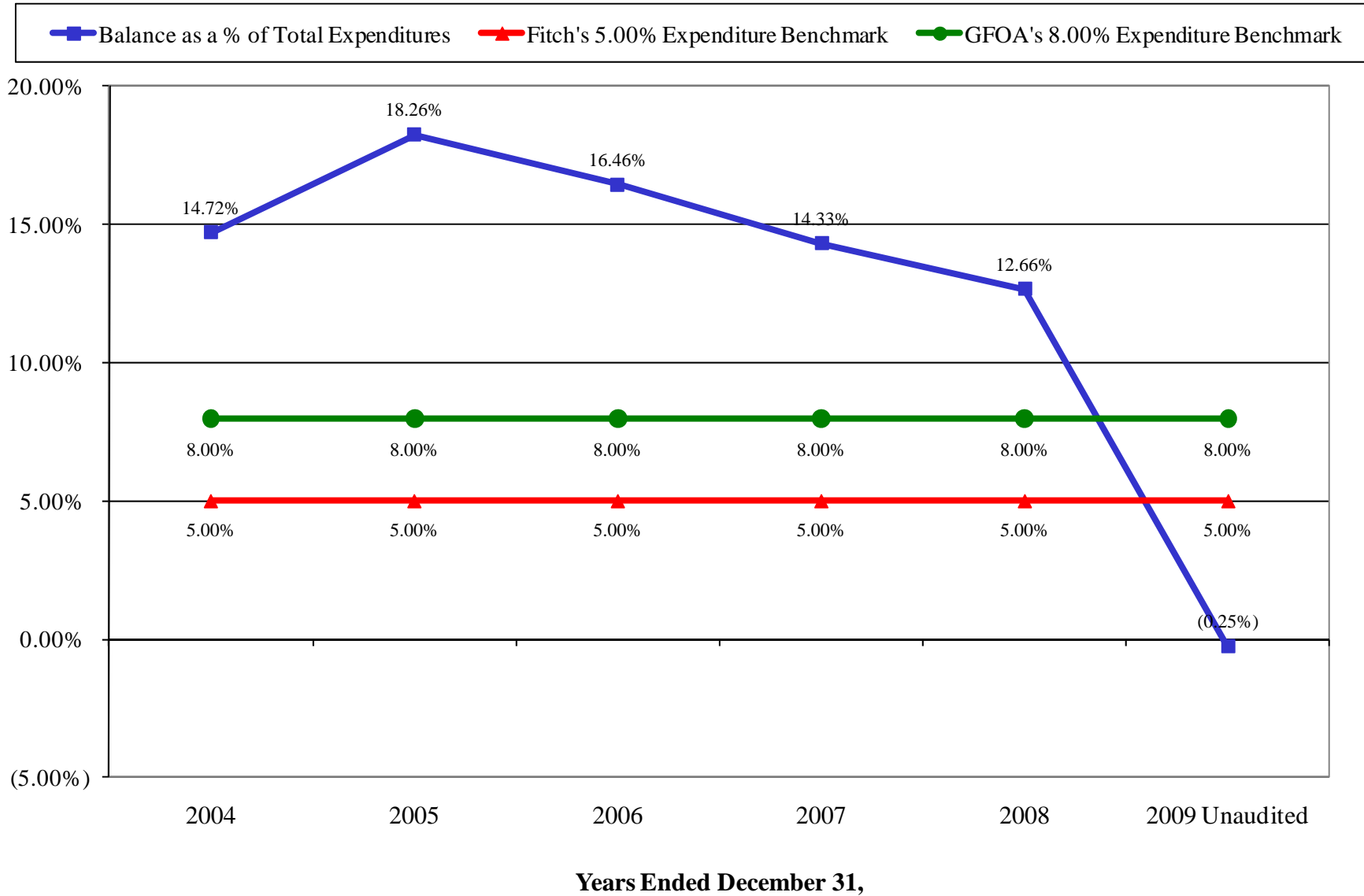




EXHIBIT III

The **budget** is an economic and political document that prioritizes a government's spending. As the year progresses, budgets are amended due to changing economic conditions, new information or shifting priorities. Amendments can occur up to the date the financial statements are issued. **Exhibit III** demonstrates the transitory and conservative manner in which budgets are made and amended versus what actually happens. A variance is the difference between the budget amounts and the actual amounts. A "favorable" revenue variance occurs when actual revenues exceed budgeted revenues and a "favorable" expenditure variance occurs when budgeted expenditures exceed actual expenditures. "Unfavorable" variances are the opposite of favorable variances. The City of Lynnwood issues biennial budgets in the odd numbered years.

Generally Accepted Accounting Principles (GAAP) requires a budgetary comparison of the adopted annual budget, final budget and actual budget basis revenues, expenditures and changes in fund balances for the purpose of evaluating the City's budgetary controls and planning process. For those governments on a biennial budget, the comparison is normally still presented on an annual basis. In its CAFR, it appears the City does not separate the first year of its biennial budget from the second year, but presents both years as one amount in the budget to actual comparison. As such, in the odd years when the City releases its biennial budget, the budget to actual comparison compares two years of budgeted revenues, expenditures and other financing sources (uses) to one year of actual revenues, expenditures and other financing sources (uses). This makes the evaluation and analysis of the City budget control more difficult. However, by comparing half of the budgeted revenues and expenditures in the odd years to actual revenues, we can more properly evaluate the City's budget process.

Revenues

- Due to the City's practice of comparing two years of budgeted revenues to one year of actual revenues in the odd years, the General Fund experienced large unfavorable adopted budget revenue variances in 2005, 2007 and 2009.
 - However, if we compare the actual revenues in the odd years to 50% of the budgeted revenues, the General Fund had favorable variances in 2005 and 2007.
 - Even comparing only 50% of the 2009 adopted budget to actual 2009 revenues, the General Fund had a large unfavorable variance of \$5 million.
 - In the even years, the adopted budget experienced a small unfavorable variance in 2004 and favorable variances in 2006 and 2008.
- The City amended its revenues in five of the six years presented,
 - The amendments decreased the General Fund's budgeted **revenues** slightly in 2004 and 2005 by less than 0.35%.
 - In 2009, the City decreased the budgeted revenues by \$4.9 million, almost 6%.
 - Amendments increased revenues in 2007 and 2008.
- The General Fund's final budgeted revenues experienced the same pattern of variances as the adopted budget.
 - Large unfavorable variances in the odd years when comparing the one year actual revenues to two years of budgeted revenues.
 - Favorable variances when comparing 50% of the final budgeted revenues to actual revenues in 2005 and 2007.



- An unfavorable final budget variance of \$2.6 million in 2009.
- In the even years, the final budget experienced a small unfavorable variance in 2004 and favorable variances in 2006 and 2008.

Expenditures

- Again, due to the City's apparent practice of comparing two years of budgeted expenditures to one year of actual expenditures, the General Fund's adopted budgeted expenditures experienced large unfavorable variances in the odd years covered by our report.
 - Using the same procedure of comparing only 50% of the adopted budget to actual, the General Fund had a favorable variance of \$2.2 million in 2005 and unfavorable variances of approximately \$793,000 and \$3 million in 2007 and 2009 respectively.
 - Adopted budgeted expenditures exceeded actual expenditures in each even year presented.
- The City's amendments increased budgeted expenditures in four of the six years presented.
 - Amendments decreased budgeted expenditures in 2005 and 2009.
- The final expenditure budget experienced larger favorable variances in the even years due to the amendments increasing budgeted expenditures.
 - In the odd years, when comparing 50% of the final budget to actual expenditures, the final budget experienced a larger favorable variance in 2005 and a smaller unfavorable variance in 2009 due to the decreases in budgeted expenditures.
 - The 2009 unfavorable variance totaled \$3.5 million.
 - In 2007, when comparing 50% of the final budgeted expenditures to actual expenditures, the General Fund experienced a favorable variance of \$1.7 million as opposed to an unfavorable variance.
- Over the period covered by our report, revenues never exceeded expenditures before other financing sources (uses).

Other Financing Sources (Uses)

- For the City, actual other financing sources (uses) are mostly transfers in and out of the General Fund, but they also include the proceeds from the sale of assets and loan proceeds.
- In 2004, 2006, and 2008, the final years of the biennial budgets, the amendments to the General Fund reduced net other financing sources (uses) all three years.
 - In 2004 and 2006, the primary reason for the decline of budgeted net other financing sources (uses) were increases to budgeted transfers to other funds.
 - In 2008, a combination of decreased budgeted transfers from other funds and increased transfers to other funds decreased the final net budgeted other financing sources (uses).
 - The adopted budget in 2004, 2006, and 2008 experienced two unfavorable variances and one favorable.
 - In 2004 and 2008, actual transfers to the General Fund exceeded the adopted budget by \$132,500 and \$242,000 respectively.



- In 2006, actual proceeds from the sale of fixed assets exceeded budgeted proceeds by \$2.6 million, offsetting the increase in actual transfers out.
- In 2008, budgeted transfers from the General Fund exceeded actual transfers from the General Fund by \$375,000 and \$576,000 for the adopted budget and final budget respectively.
- The budgeted other financing sources (uses) in 2005, 2007, and 2009 include two years of transfers to and from the General Fund.
 - In 2005, the adopted and final budgeted transfers for two years to the General Fund were \$3.9 million and \$4 million respectively, as opposed to the actual one year transfers of \$2.4 million.
 - Again, comparing the actual one year transfers to 50% of the budgeted two year transfers shows a possible favorable variance of \$500,000 and \$400,000 for the adopted and final budget respectively.
 - Actual transfers from the General Fund were approximately 50% of both the 2005 adopted and final budgets transfers.
 - In 2007, the adopted and final budgeted transfers for two years to the General Fund were \$6.2 million and \$8.1 million respectively, as opposed to actual one year transfers of \$3.1 million.
 - When comparing the actual one year transfers to the General Fund to 50% of the budgeted two year transfers, the adopted budget had a negligible unfavorable adopted budget variance and a possible unfavorable final budget variance of \$947,000.
 - The City increased the two year budgeted transfers from the General Fund to other funds from \$4.9 million in the adopted budget to \$5.1 million in the final budget.
 - Comparing the actual annual 2007 transfers of \$2.3 million to 50% of the two year budgeted transfers equates to approximate favorable variances of \$173,000 for the adopted budget and \$262,000 for the final budget.
 - In 2009, the two year adopted and final budgeted transfers to the General Fund were \$6.5 million and \$7.1 million respectively.
 - 50% of the two year budgets for transfers to the General Fund equate to \$3.2 million for the adopted budget and \$3.5 million for the final budget.
 - When comparing the actual one year transfers to the General Fund of \$5.5 million to 50% of the budgeted two year transfers, the results are a \$2.3 million favorable adopted budget variance and a \$3 million favorable final budget variance.
 - In 2009, the City's amendments decreased the two year budgeted transfers from the General Fund to other funds from \$4.2 million to \$3.2 million.
 - Half of the budgeted two years of transfers from the General Fund are \$2.1 million and \$1.6 million.
 - When compared to actual 2009 transfers to other funds of \$1.3 million, transfers out had a possible favorable adopted budget variance of \$800,000 and a \$300,000 final budget favorable variance.



- In 2009, actual net other financing sources for one year exceeded the budgeted net other financing sources for both the adopted budget and the final budget.
- In 2007, 2008 and 2009, the City increased the amount of transfers to the General Fund and decreased the transfers from the General Fund.

General Fund Surplus (Deficit)

The City's General Fund experienced one actual surplus and five actual deficits.

- In the three years for which we have one year budgets, 2004, 2006, and 2008, the City budgeted large deficits for both the adopted and final budgets ranging from \$1.8 million to \$5.8 million.
 - In each of these three years, the General Fund experienced large favorable variances ranging from \$1.7 million to \$5.4 million.
 - Instead of the large budgeted deficits, the General Fund had much smaller deficits.
- In 2009, the General Fund had a \$5.3 million operating deficit.

The City of Lynnwood prepares its budget on a basis other than GAAP. The third page of **Exhibit III-A** is a reconciliation of the actual budget basis accounting surplus (deficit) to the GAAP accounting basis surplus (deficit) from 2004 through 2008. When we requested the unaudited financial statements for 2009, William Burton told us the budget to actual is the same as the GAAP statement at this point in time. The finance department prepares the GAAP statement first then goes back and makes adjustments to bring it into a budget based schedule. As such, we do not have 2009 budget to GAAP reconciliation information.

- As shown in this exhibit, the General Fund performed better under the GAAP basis of accounting than the budget basis of accounting in three of the five years from 2004 to 2008.

Page 3 also includes a reconciliation of the beginning General Fund's fund balance to the ending General Fund's fund balance. Besides the actual annual operating surpluses and deficits, another factor affecting the fund balance is **prior period adjustments**. These are corrections of a prior year or years' errors, or changes in accounting principle. Prior period adjustments are shown as a change to the beginning equity balance on the balance sheet.

- During the period covered by our report, the total fund balance decreased from \$6.4 million at January 1, 2004 to a negative \$115,733 at December 31, 2009.
- As shown in this exhibit, changes to the General Fund's fund balance were primarily due to the annual surpluses or deficits.
 - During the period covered the cumulative deficit was \$5.4 million, of which \$5.3 million occurred in 2009.
- Cumulative prior period adjustments in 2004, 2008, and 2009 totaling \$1.1 million further reduced the fund balance to its negative position at December 31, 2009.
 - Most of the prior period adjustments occurred in 2008 and 2009.
 - The 2008 prior period adjustment corrected an overstatement of 2007 revenues.
 - We do not have an explanation of the 2009 prior period adjustment.

Exhibit III-B and Exhibit III-C are graphic representations of the total variances in Exhibit III-A.



Findings:

- The City's budget process from 2004 through 2008 was very conservative as the City has consistently budgeted large deficits in its adopted budget.
- Except for 2009, it appears the General Fund's actual results were better than those budgeted by the City.
- The General Fund's revenues never exceeded expenditures before other financing sources (uses).
- In 2009, the City budget process became overly optimistic in its budget process. Instead of large favorable variances, the General Fund had large unfavorable variances.
- The General Fund's operating deficit in 2009 was almost nine times greater than the two year adopted budgeted 2009-2010 deficit of \$677,000 and \$2.2 million larger than the final budget.

EXHIBIT III-A
CITY OF LYNNWOOD
TRANSITORY AND CONSERVATIVE NATURE OF THE BUDGET
GENERAL FUND

For the Years Ended December 31,

| | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> <i>(Unaudited)</i> |
|--|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------------------|
| Revenue | | | | | | |
| <i>Adopted Budget</i> | 30,956,545 | 67,225,006 | 33,781,461 | 75,260,225 | 39,481,361 | 84,467,848 |
| Total Amendments | (105,823) | (153,570) | 0 | 3,171,029 | 500,000 | (4,911,692) |
| <i>Final Budget</i> | <u>30,850,722</u> | <u>67,071,436</u> | <u>33,781,461</u> | <u>78,431,254</u> | <u>39,981,361</u> | <u>79,556,156</u> |
| % Change from <i>Adopted Budget</i> | <u>(0.34%)</u> | <u>(0.23%)</u> | <u>0.00%</u> | <u>4.21%</u> | <u>1.27%</u> | <u>(5.81%)</u> |
| <i>Actual - Budgetary Basis</i> | <u>30,746,721</u> | <u>33,418,655</u> | <u>34,871,403</u> | <u>39,232,555</u> | <u>40,059,421</u> | <u>37,203,490</u> |
| <i>Adopted Revenue Variance</i> | <u>(209,824)</u> | <u>(33,806,351)</u> | <u>1,089,942</u> | <u>(36,027,670)</u> | <u>578,060</u> | <u>(47,264,358)</u> |
| Variance as a % of <i>Adopted Budget</i> | <u>(0.68%)</u> | <u>(50.29%)</u> | <u>3.23%</u> | <u>(47.87%)</u> | <u>1.46%</u> | <u>(55.96%)</u> |
| <i>Final Revenue Variance</i> | <u>(104,001)</u> | <u>(33,652,781)</u> | <u>1,089,942</u> | <u>(39,198,699)</u> | <u>78,060</u> | <u>(42,352,666)</u> |
| Variance as a % of <i>Final Budget</i> | <u>(0.34%)</u> | <u>(50.17%)</u> | <u>3.23%</u> | <u>(49.98%)</u> | <u>0.20%</u> | <u>(53.24%)</u> |
| Expenditures | | | | | | |
| <i>Adopted Budget</i> | 36,069,882 | 71,715,928 | 37,486,967 | 78,692,839 | 43,502,567 | 87,499,546 |
| Total Amendments | 188,339 | (548,509) | 494,600 | 4,948,910 | 120,616 | (843,371) |
| <i>Final Budget</i> | <u>36,258,221</u> | <u>71,167,419</u> | <u>37,981,567</u> | <u>83,641,749</u> | <u>43,623,183</u> | <u>86,656,175</u> |
| % Change from <i>Adopted Budget</i> | <u>0.52%</u> | <u>(0.76%)</u> | <u>1.32%</u> | <u>6.29%</u> | <u>0.28%</u> | <u>(0.96%)</u> |
| <i>Actual - Budgetary Basis</i> | <u>33,793,504</u> | <u>33,694,423</u> | <u>36,022,190</u> | <u>40,139,180</u> | <u>42,982,027</u> | <u>46,780,195</u> |
| <i>Adopted Expenditure Variance</i> | <u>2,276,378</u> | <u>38,021,505</u> | <u>1,464,777</u> | <u>38,553,659</u> | <u>520,540</u> | <u>40,719,351</u> |
| Variance as a % of <i>Adopted Budget</i> | <u>6.31%</u> | <u>53.02%</u> | <u>3.91%</u> | <u>48.99%</u> | <u>1.20%</u> | <u>46.54%</u> |
| <i>Final Expenditure Variance</i> | <u>2,464,717</u> | <u>37,472,996</u> | <u>1,959,377</u> | <u>43,502,569</u> | <u>641,156</u> | <u>39,875,980</u> |
| Variance as a % of <i>Final Budget</i> | <u>6.80%</u> | <u>52.65%</u> | <u>5.16%</u> | <u>52.01%</u> | <u>1.47%</u> | <u>46.02%</u> |

**EXHIBIT III-A
CITY OF LYNNWOOD
TRANSITORY AND CONSERVATIVE NATURE OF THE BUDGET
GENERAL FUND**

For the Years Ended December 31,

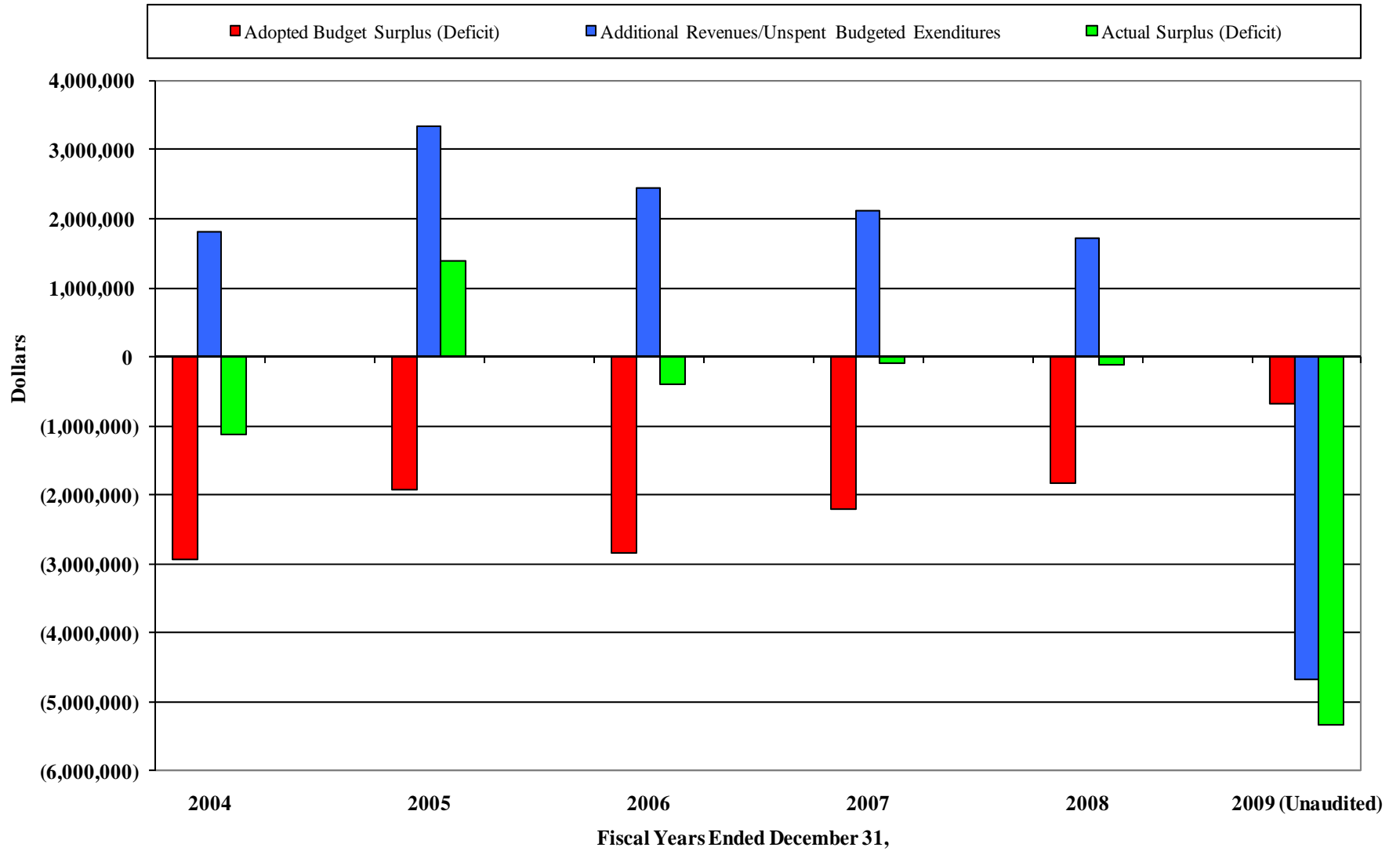
| | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009 (Unaudited)</u> |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|-----------------------------|
| Other financing sources (uses) | | | | | | |
| <i>Adopted</i> Budget | 2,181,384 | 2,557,150 | 858,346 | 1,227,407 | 2,200,904 | 2,354,593 |
| Total Amendments | (372,073) | (24,265) | (2,465,088) | 1,795,471 | (379,683) | 1,616,637 |
| <i>Final</i> Budget | <u>1,809,311</u> | <u>2,532,885</u> | <u>(1,606,742)</u> | <u>3,022,878</u> | <u>1,821,221</u> | <u>3,971,230</u> |
| % Change from <i>Adopted</i> Budget | <u>(17.06%)</u> | <u>(0.95%)</u> | <u>(287.19%)</u> | <u>146.28%</u> | <u>(17.25%)</u> | <u>68.66%</u> |
| <i>Actual</i> - Budgetary Basis | <u>1,927,378</u> | <u>1,674,540</u> | <u>748,614</u> | <u>825,274</u> | <u>2,817,035</u> | <u>4,236,903</u> |
| <i>Adopted</i> Other Financing Sources (Uses) | | | | | | |
| Variance | <u>(254,006)</u> | <u>(882,610)</u> | <u>(109,732)</u> | <u>(402,133)</u> | <u>616,131</u> | <u>1,882,310</u> |
| Variance as a % of <i>Adopted</i> Budget | <u>(11.64%)</u> | <u>(34.52%)</u> | <u>(12.78%)</u> | <u>(32.76%)</u> | <u>27.99%</u> | <u>79.94%</u> |
| <i>Final</i> Other Financing Sources (Uses) Variance | <u>118,067</u> | <u>(858,345)</u> | <u>2,355,356</u> | <u>(2,197,604)</u> | <u>995,814</u> | <u>265,673</u> |
| Variance as a % of <i>Final</i> Budget | <u>6.53%</u> | <u>(33.89%)</u> | <u>(146.59%)</u> | <u>(72.70%)</u> | <u>54.68%</u> | <u>6.69%</u> |
| Total Variance Adopted Budget | | | | | | |
| Favorable (Unfavorable) | <u>1,812,548</u> | <u>3,332,544</u> | <u>2,444,987</u> | <u>2,123,856</u> | <u>1,714,731</u> | <u>(4,662,697)</u> |
| Variance as a % of Budgeted Expenditures | <u>5.03%</u> | <u>4.65%</u> | <u>6.52%</u> | <u>2.70%</u> | <u>3.94%</u> | <u>(5.33%)</u> |
| Total Variance Final Budget | | | | | | |
| Favorable (Unfavorable) | <u>2,478,783</u> | <u>2,961,870</u> | <u>5,404,675</u> | <u>2,106,266</u> | <u>1,715,030</u> | <u>(2,211,013)</u> |
| Variance as a % of Budgeted Expenditures | <u>6.84%</u> | <u>4.16%</u> | <u>14.23%</u> | <u>2.52%</u> | <u>3.93%</u> | <u>(2.55%)</u> |
| Excess (Deficiency) of Adopted Budget Revenues Over Adopted Budget Expenditures Including Other Financial Sources (Uses) | <u>(2,931,953)</u> | <u>(1,933,772)</u> | <u>(2,847,160)</u> | <u>(2,205,207)</u> | <u>(1,820,302)</u> | <u>(677,105)</u> |
| Excess (Deficiency) of Final Budget Revenues Over Final Budget Expenditures Including Other Financial Sources (Uses) | <u>(3,598,188)</u> | <u>(1,563,098)</u> | <u>(5,806,848)</u> | <u>(2,187,617)</u> | <u>(1,820,601)</u> | <u>(3,128,789)</u> |
| Excess (Deficiency) of Actual Revenues Over Final Actual Expenditures Including Other Financial Sources (Uses) | <u>(1,119,405)</u> | <u>1,398,772</u> | <u>(402,173)</u> | <u>(81,351)</u> | <u>(105,571)</u> | <u>(5,339,802)</u> |

EXHIBIT III-A
CITY OF LYNNWOOD
RECONCILIATION OF BUDGET BASIS ACCOUNTING TO GAAP BASIS ACCOUNTING
GENERAL FUND

For the Years Ended December 31,

| | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> <i>(Unaudited)</i> |
|--|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-----------------------------------|
| Excess (Deficiency) of Actual Revenues Over Final Actual Expenditures Including Other Financial Sources (Uses) - Budget Basis | (1,119,405) | 1,398,772 | (402,173) | (81,351) | (105,571) | (5,339,802) |
| Reconciliation of Budget to GAAP Accounting | | | | | | |
| GAPP Revenue difference | 0 | 0 | 89,764 | 0 | 0 | N/A |
| Accounts receivable outstanding- prior year | (43,662) | (142,822) | (32,519) | (10,317) | (4,718) | N/A |
| Accounts receivable outstanding-current year | 142,822 | 32,519 | 10,317 | 4,718 | 246,230 | N/A |
| Interest accrual prior year | (304,222) | (331,273) | (307,392) | (332,586) | (330,073) | N/A |
| Interest accrual current year | 331,273 | 307,392 | 332,586 | 330,073 | 298,414 | N/A |
| Other accruals current year | 5,204 | 0 | 0 | 0 | 0 | N/A |
| Total difference between Budget and GAAP basis of Accounting | <u>131,415</u> | <u>(134,184)</u> | <u>92,756</u> | <u>(8,112)</u> | <u>209,853</u> | <u>0</u> |
| Excess (Deficiency) of Actual Revenues Over Final Actual Expenditures Including Other Financial Sources (Uses) - GAAP Basis | (987,990) | 1,264,588 | (309,417) | (89,463) | 104,282 | (5,339,802) |
| Beginning Fund Balance | 6,394,926 | 5,331,258 | 6,595,850 | 6,286,433 | 6,196,970 | 6,105,679 |
| Prior period adjustment | (75,678) | 4 | 0 | 0 | (195,573) | (881,610) |
| Ending Fund Balance | <u><u>5,331,258</u></u> | <u><u>6,595,850</u></u> | <u><u>6,286,433</u></u> | <u><u>6,196,970</u></u> | <u><u>6,105,679</u></u> | <u><u>(115,733)</u></u> |

**EXHIBIT III-B
CITY OF LYNNWOOD
ADOPTED BUDGET VARIANCE ANALYSIS**



**EXHIBIT III-C
CITY OF LYNNWOOD
FINAL BUDGET VARIANCE ANALYSIS**

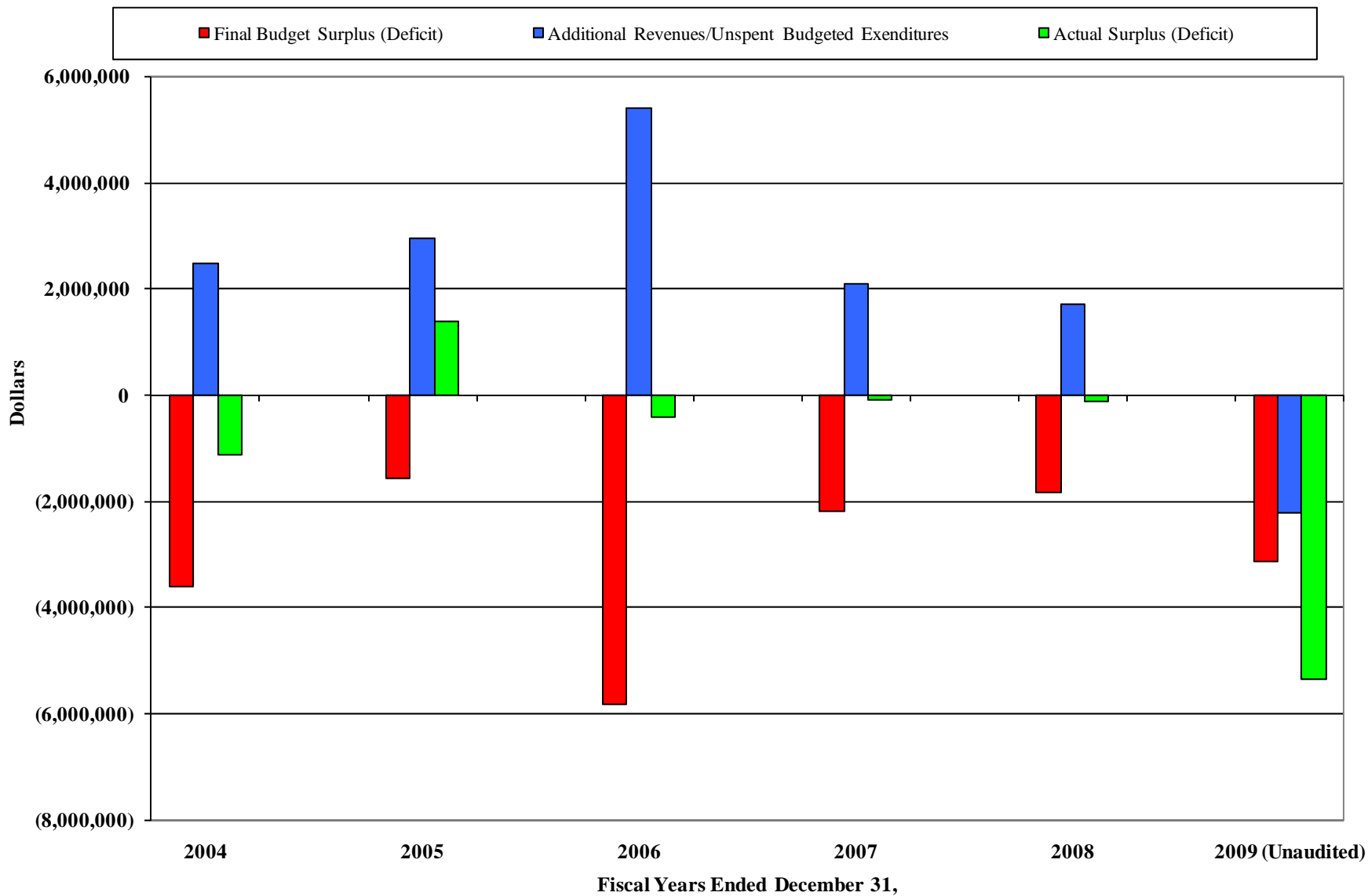




EXHIBIT IV

Exhibit IV is an analysis of the General Fund’s revenues by source and the expenditures by function. We have also reviewed other financial information on assessed property values and have analyzed the City’s Fund Revenue Analysis showing revenue collections through February 2010.

Revenues

Total revenues increased from \$35 million in 2006 to \$40.3 million in 2008 before declining to \$37.2 million in 2009. Total revenues grew at an annual rate of 12.18% in 2007, 2.66% in 2008, and declined 7.61% in 2009. As of February 2010, though revenues are above the 2010 budget, they are below 2009 revenue collections.

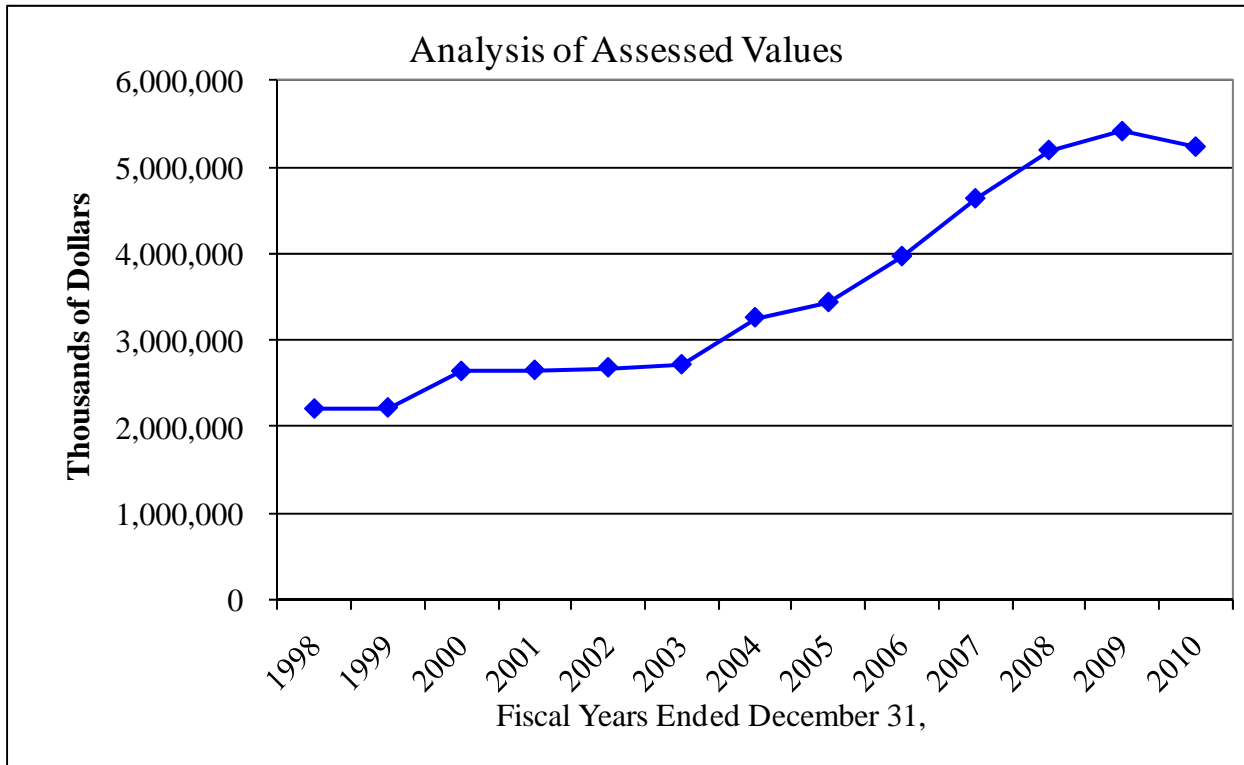
- Property taxes increased from \$6.6 million in 2006 to \$7.1 million in 2008 but only grew \$94,000 to \$7.2 million in 2009. The county treasurer acts as an agent for property taxes levied in the county for all taxing authorities. Taxes are levied annually on January 1 on property value listed as of the prior May 31. These taxes become an enforceable lien against properties as of January 1. Assessed values are established by the county assessor at 100% of fair market value.
 - The growth in property tax revenues reflects the increase in the City’s assessed property values as shown in the following tables.

Analysis of Assessed Values

| Fiscal Year Ended December 31, | Net Assessed Value | % Change From Prior Year |
|--------------------------------|--------------------|--------------------------|
| 1998 | 2,199,789,878 | N/A |
| 1999 | 2,212,368,299 | 0.57% |
| 2000 | 2,635,336,634 | 19.12% |
| 2001 | 2,647,682,807 | 0.47% |
| 2002 | 2,677,290,610 | 1.12% |
| 2003 | 2,713,237,600 | 1.34% |
| 2004 | 3,258,200,242 | 20.09% |
| 2005 | 3,434,830,302 | 5.42% |
| 2006 | 3,967,684,480 | 15.51% |
| 2007 | 4,639,280,269 | 16.93% |
| 2008 | 5,198,902,581 | 12.06% |
| 2009 | 5,417,861,993 | 4.21% |
| 2010 | 5,237,466,464 | (3.33%) |
| IRR since 1998 | | 7.50% |
| IRR since 2004 | | 8.23% |



- The assessed values for the years ended 1998 through 2008 were obtained from the City's CAFRs. The assessed values for 2009 and 2010 were obtained from the Snohomish County assessor's office.
- The City's assessed values increased dramatically since 2003, with double digit growth in four of the seven years presented.
- Since 2007, the growth rate declined in each of the last three years and became negative in 2010 with assessed values declining 3.33%.
- The decline in assessed property values in 2010, along with the flat growth in 2009, portends a decline in property tax revenues in 2010.
- As of February 28, 2010, the City has not received any 2010 tax revenues.



- **Exhibit IV-B** is an analysis of Zillow.Com's median housing value for Lynnwood, Washington we obtained from Zillow's website on April 21, 2010.
 - I have reviewed collaborating evidence from DQ News, a real estate database that shows similar declines.
 - Since May 2009, the valuation date for assessed property tax values, the City's median market value has continued to decline.
 - This portends continuing declines in the City's assessed values in 2010.
- The City's most important tax revenue is sales tax revenues.
 - Since its high of \$18.8 million in 2007, sales tax revenues declined to \$14.4 million in 2009, with \$3 million of that decline in 2009.
 - As of February 2010, sales tax revenues, though apparently on budget, are below February 2009's two month sales tax receipts.
- Other revenues that declined from 2007 to 2008 include:



- Licenses and permits declined approximately \$360,000 in each of the last two years. For the first two months of 2010, due to a spike in February, it is above last year and above budget.
- Fines and forfeitures declined \$319,000 in 2009 and for the first two months of 2010 are below 2009 revenues.
- Charges for services declined slightly in 2009 and are above 2009 revenues in 2010.
- Miscellaneous revenues, which include interest income, rents and other revenues declined in each of the years since 2006. These revenues the first two months of 2010, though higher than budgeted revenue, are still below 2009 at February 2010.
- The City's two major tax revenues declined or began to soften in 2008.

Expenditures

Expenditures grew each year from \$36 million in 2006 to \$46.8 million in 2009. The annual growth rate was 11.43% in 2007, 7.08% in 2008, and 8.84% in 2009. All expenditure functions experienced strong growth, exceeding 4.15% in 2009.

- General government expenditures grew from \$7 million in 2006 to \$9.6 million in 2009, an increase of \$2.6 million. The annual growth rates were 11.9%, 11.06% and 9.67% in 2007, 2008, and 2009 respectively.
- Public safety expenditures experienced strong growth since 2006, but not as strong as general government, growing from \$19.8 million in 2006 to \$25.9 million in 2009. The annual growth rates were 9.98%, 9.35% and 8.7% in 2007, 2008, and 2009 respectively.
- The next two largest expenditure functions, physical environment and culture and recreation, grew.
 - Though physical environment increased only 4.15% in 2009, it increased over 31% since 2006.
 - Culture and recreation increased 6.19% in 2009.
- In 2007, expenditures exceeded revenues before other financing sources (uses) by \$915,000. In 2009, expenditures exceeded revenues before other financing sources (uses) by \$9.6 million, an increase of over 1,000%.

Findings:

- The City's revenues declined \$3.1 million in 2009, but its most important revenue source, sales tax revenues, and its residential property values, the base for its second largest tax revenue, began their decline in 2007.
 - The decline in property values slowed the growth of property tax revenues in 2009 and will probably result in a decline in property tax revenues in 2010.
- While revenues declined in 2009, expenditures increased \$3.8 million, growing the operating deficit before other financing sources (uses) from \$2.7 million to \$9.6 million.

**EXHIBIT IV-A
CITY OF LYNNWOOD
ANALYSIS OF GOVERNMENTAL FUNDS' STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES**

| | <u>2006</u> | <u>2007</u> | Change From 2006 to 2007 | | <u>2008</u> | Change From 2007 to 2008 | | <u>2009</u> <i>(Unaudited)</i> | Change From 2007 to 2008 | |
|----------------------|-------------------|-------------------|--------------------------|-----------------|-------------------|--------------------------|-----------------|-----------------------------------|--------------------------|-----------------|
| | | | <u>\$ Change</u> | <u>% Change</u> | | <u>\$ Change</u> | <u>% Change</u> | | <u>\$ Change</u> | <u>% Change</u> |
| Revenues | | | | | | | | | | |
| Taxes | | | | | | | | | | |
| Property | 6,644,021 | 6,806,172 | 162,151 | 2.44% | 7,113,197 | 307,025 | 4.51% | 7,207,325 | 94,128 | 1.32% |
| Sales | 17,872,542 | 18,787,221 | 914,679 | 5.12% | 17,421,035 | (1,366,186) | (7.27%) | 14,393,803 | (3,027,232) | (17.38%) |
| B&O | 1,742,864 | 1,801,127 | 58,263 | 3.34% | 1,834,633 | 33,506 | 1.86% | 2,533,476 | 698,843 | 38.09% |
| Other | 238,736 | 204,624 | (34,112) | (14.29%) | 160,219 | (44,405) | (21.70%) | 164,291 | 4,072 | 2.54% |
| Licenses and Permits | 1,732,805 | 2,520,777 | 787,972 | 45.47% | 2,162,513 | (358,264) | (14.21%) | 1,802,636 | (359,877) | (16.64%) |
| Intergovernmental | | | | | | | | | | |
| Revenues | 1,134,533 | 1,296,691 | 162,158 | 14.29% | 1,504,564 | 207,873 | 16.03% | 1,850,490 | 345,926 | 22.99% |
| Charges for Services | 2,549,387 | 3,072,915 | 523,528 | 20.54% | 3,897,157 | 824,242 | 26.82% | 3,850,209 | (46,948) | (1.20%) |
| Fines and Forfeits | 1,853,132 | 3,596,296 | 1,743,164 | 94.07% | 5,053,279 | 1,456,983 | 40.51% | 4,733,938 | (319,341) | (6.32%) |
| Miscellaneous | | | | | | | | | | |
| Interest | 722,937 | 747,197 | 24,260 | 3.36% | 649,615 | (97,582) | (13.06%) | 232,381 | (417,234) | (64.23%) |
| Rent | 434,348 | 362,849 | (71,499) | (16.46%) | 386,100 | 23,251 | 6.41% | 386,956 | 856 | 0.22% |
| Other | 38,854 | 28,574 | (10,280) | (26.46%) | 86,962 | 58,388 | 204.34% | 47,985 | (38,977) | (44.82%) |
| Total Revenue | <u>34,964,159</u> | <u>39,224,443</u> | <u>4,260,284</u> | <u>12.18%</u> | <u>40,269,274</u> | <u>1,044,831</u> | <u>2.66%</u> | <u>37,203,490</u> | <u>(3,065,784)</u> | <u>(7.61%)</u> |

EXHIBIT IV-A
CITY OF LYNNWOOD
ANALYSIS OF GOVERNMENTAL FUNDS' STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES

| | Change From 2006 to 2007 | | | | Change From 2007 to 2008 | | | Change From 2007 to 2008 | | |
|---|--------------------------|-------------------|------------------|-----------------|--------------------------|--------------------|-----------------|-----------------------------------|--------------------|-----------------|
| | <u>2006</u> | <u>2007</u> | <u>\$ Change</u> | <u>% Change</u> | <u>2008</u> | <u>\$ Change</u> | <u>% Change</u> | <u>2009</u> <u>(Unaudited)</u> | <u>\$ Change</u> | <u>% Change</u> |
| Expenditures | | | | | | | | | | |
| Current | | | | | | | | | | |
| General Government | 7,009,842 | 7,843,888 | 834,046 | 11.90% | 8,711,556 | 867,668 | 11.06% | 9,553,712 | 842,156 | 9.67% |
| Public Safety | 19,834,591 | 21,814,765 | 1,980,174 | 9.98% | 23,854,968 | 2,040,203 | 9.35% | 25,931,390 | 2,076,422 | 8.70% |
| Physical Environment | 3,649,195 | 4,066,135 | 416,940 | 11.43% | 4,605,184 | 539,049 | 13.26% | 4,796,290 | 191,106 | 4.15% |
| Human Services | 458,112 | 498,266 | 40,154 | 8.77% | 616,405 | 118,139 | 23.71% | 718,148 | 101,743 | 16.51% |
| Culture and Recreation | 5,007,087 | 5,546,827 | 539,740 | 10.78% | 4,949,042 | (597,785) | (10.78%) | 5,255,492 | 306,450 | 6.19% |
| Capital Outlay | 59,937 | 367,534 | 307,597 | 513.20% | 244,265 | (123,269) | (33.54%) | 524,341 | 280,076 | 114.66% |
| Debt Service | | | | | | | | | | |
| Principal | 0 | 0 | 0 | 0.00% | 0 | 0 | 0.00% | 0 | 0 | 0.00% |
| Interest | 3,426 | 1,765 | (1,661) | (48.48%) | 607 | (1,158) | (65.61%) | 822 | 215 | 35.42% |
| Total Expenditures | <u>36,022,190</u> | <u>40,139,180</u> | <u>4,116,990</u> | <u>11.43%</u> | <u>42,982,027</u> | <u>2,842,847</u> | <u>7.08%</u> | <u>46,780,195</u> | <u>3,798,168</u> | <u>8.84%</u> |
| Excess (Deficiency) of Revenues Over Expenditures | <u>(1,058,031)</u> | <u>(914,737)</u> | <u>143,294</u> | <u>(13.54%)</u> | <u>(2,712,753)</u> | <u>(1,798,016)</u> | <u>196.56%</u> | <u>(9,576,705)</u> | <u>(6,863,952)</u> | <u>253.03%</u> |

EXHIBIT IV-A
CITY OF LYNNWOOD
ANALYSIS OF GOVERNMENTAL FUNDS' STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES

| | <u>2006</u> | <u>2007</u> | Change From 2006 to 2007 | | <u>2008</u> | Change From 2007 to 2008 | | <u>2009</u> <i>(Unaudited)</i> | Change From 2007 to 2008 | |
|---------------------------------------|-------------------------|-------------------------|--------------------------|------------------|-------------------------|--------------------------|------------------|-----------------------------------|---------------------------|-------------------|
| | | | <u>\$ Change</u> | <u>% Change</u> | | <u>\$ Change</u> | <u>% Change</u> | | <u>\$ Change</u> | <u>% Change</u> |
| Other Financing Sources (Uses) | | | | | | | | | | |
| Transfers In | 1,624,558 | 3,115,653 | 1,491,095 | 91.78% | 5,255,326 | 2,139,673 | 68.67% | 5,535,285 | 279,959 | 5.33% |
| Transfers (Out) | (3,341,032) | (2,290,379) | 1,050,653 | (31.45%) | (2,438,291) | (147,912) | 6.46% | (1,302,782) | 1,135,509 | (46.57%) |
| Sale of Capital Assets | <u>2,465,088</u> | <u>0</u> | <u>(2,465,088)</u> | <u>(100.00%)</u> | <u>0</u> | <u>0</u> | <u>0.00%</u> | <u>4,400</u> | <u>4,400</u> | <u>0.00%</u> |
| Total Other Financing Sources (Uses) | <u>748,614</u> | <u>825,274</u> | <u>76,660</u> | <u>10.24%</u> | <u>2,817,035</u> | <u>1,991,761</u> | <u>241.35%</u> | <u>4,236,903</u> | <u>1,419,868</u> | <u>50.40%</u> |
| Net Changes in Fund Balances | (309,417) | (89,463) | 219,954 | <u>(71.09%)</u> | 104,282 | 193,745 | <u>(216.56%)</u> | (5,339,802) | (5,444,084) | <u>(5220.54%)</u> |
| Fund Balances, January 1 | <u>6,595,850</u> | <u>6,286,433</u> | <u>(309,417)</u> | | <u>6,196,970</u> | <u>(89,463)</u> | | <u>6,105,679</u> | <u>(91,291)</u> | |
| Prior Period Adjustment | <u>0</u> | <u>0</u> | <u>0</u> | | <u>(195,573)</u> | <u>(195,573)</u> | | <u>(881,610)</u> | <u>(686,037)</u> | |
| Fund Balances, December 31 | <u><u>6,286,433</u></u> | <u><u>6,196,970</u></u> | <u><u>(89,463)</u></u> | | <u><u>6,105,679</u></u> | <u><u>(91,291)</u></u> | | <u><u>(115,733)</u></u> | <u><u>(6,221,412)</u></u> | |

**EXHIBIT IV-B
CITY OF LYNNWOOD
ZILLOW.COM MEDIAN RESIDENTIAL MARKET VALUE**

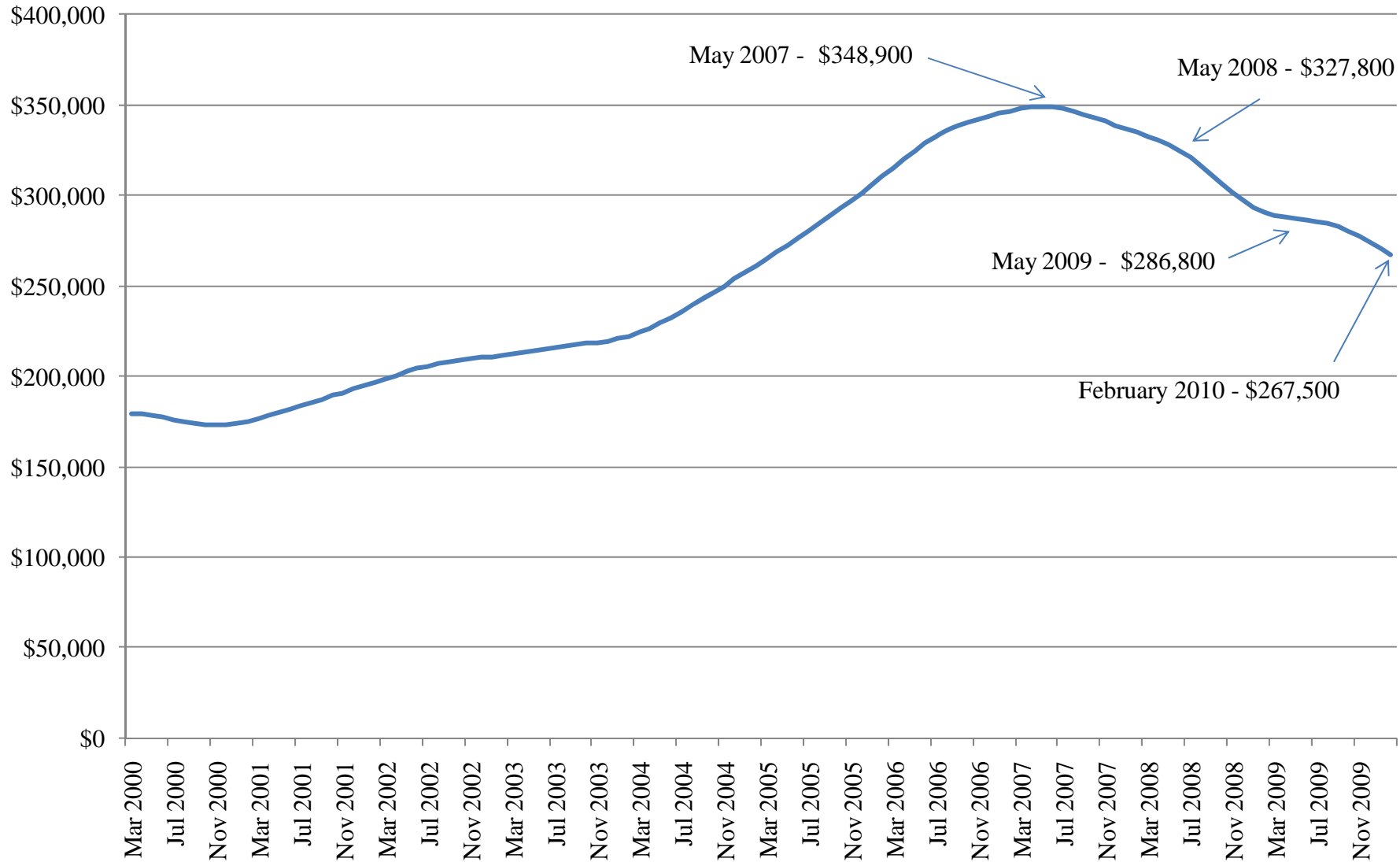




Exhibit V

Exhibit V is an analysis of **transfers to and from the General Fund**.

Other funds transferred moneys to the General fund over the period covered by our report. We included transfers from other funds as General Fund revenues.

- Most of the moneys transferred to the General Fund came from the Special Revenue Fund Group. We reviewed the Special Revenue fund and determined the following.
- EMS Property Tax Fund receives the Emergency Medical Services Levy and distributes it to the General Fund as transfers. This fund has transferred significant moneys that grew each year from \$1.4 million in 2004 to \$2.4 million in 2009.
- Two funds that have transferred large moneys to other funds all years covered by our report are the Arterial Street Fund and the Criminal Justice Fund.
 - Other funds have also transferred small amounts of money to other fund.
- In 2009, the City transferred all moneys in the Revenue Stabilization Fund to other the General Fund.
 - This fund was established to accumulate money to cover periods of revenue shortages in the General Fund, and for expenditures deemed necessary by the City Council.
- Since December 31, 2006, cash and investment in the nonmajor Special Revenue Fund Group declined from \$8.2 million to \$5.5 million.

The General Fund transferred moneys to other funds over the period covered by our report. We included transfers to other funds as General Fund expenditures.

Findings:

- The transfers to the General Fund from the EMS Property Tax Fund, Arterial Street Fund and the Criminal Justice Fund are ongoing and appear to fund specific expenditures in the General Fund.
- The \$2 million transfer from the Revenue Stabilization Fund was a one-time revenue source, as it depleted the fund.
 - This fund held \$2 million from 2004 through 2008.
- Cash and investments held by the nonmajor Special Revenue Funds declined \$2.7 million.
- Resources in the nonmajor Special Revenue Funds have been depleted.

EXHIBIT V
CITY OF LYNNWOOD
ANALYSIS OF GENERAL FUND TRANSFERS

For the Years Ended December 31,

| | <i>2004</i> | <i>2005</i> | <i>2006</i> | <i>2007</i> | <i>2008</i> | <i>2009</i> <i>Unaudited</i> |
|--|------------------|------------------|--------------------|------------------|------------------|---------------------------------|
| Funds Making Transfers To the General Fund | | | | | | |
| Special Revenue | 2,082,411 | 1,780,820 | 1,624,558 | 2,797,653 | 4,715,765 | N/A |
| Debt Service | 345,701 | 624,958 | 0 | 220,000 | 177,266 | N/A |
| Capital Projects | | 16,190 | 0 | 98,000 | 362,295 | N/A |
| | <u>2,428,112</u> | <u>2,421,968</u> | <u>1,624,558</u> | <u>3,115,653</u> | <u>5,255,326</u> | <u>5,535,285</u> |
| Funds Receiving Transfers From the General Fund | | | | | | |
| Special Revenue | 37,470 | 15,075 | 255,212 | 201,514 | 342,563 | N/A |
| Debt Service | 610,480 | 627,074 | 581,824 | 663,980 | 620,691 | N/A |
| Capital Projects | 270,000 | 62,600 | 2,362,600 | 0 | 1,148,000 | N/A |
| Enterprise | 41,643 | 39,172 | 36,890 | 0 | 0 | N/A |
| Internal Service | 79,035 | 104,508 | 104,507 | 1,424,885 | 327,037 | N/A |
| | <u>1,038,628</u> | <u>848,429</u> | <u>3,341,033</u> | <u>2,290,379</u> | <u>2,438,291</u> | <u>1,302,782</u> |
| Net Transfer in (out) | <u>1,389,484</u> | <u>1,573,539</u> | <u>(1,716,475)</u> | <u>825,274</u> | <u>2,817,035</u> | <u>4,232,503</u> |



CONCLUSION

Our findings include the following:

- The General Fund is technically insolvent at December 31, 2009.
- The General Fund has maintained strong cash and investments and total fund balance throughout the period covered by our report. Most of the fund balance is unreserved.
- The City's conservative budget process became overly optimistic in 2009.
 - The City's most important tax revenue source, sales taxes, started its decline in 2008.
 - The City's assessed property base, though it grew, was under assault due to declining housing values that started in May 2007.
 - The economic meltdown and financial crisis occurred during the 2009 budget process.
 - In our opinion, a projected \$9.2 million increase in biennial revenues was overly optimistic.
- Current year revenues are below 2009 revenues for the comparable period.
- The City has depleted its Revenue Stabilization Fund.

In our opinion, the City of Lynnwood's financial position is extremely weak. As of December 31, 2009, its General fund is technically insolvent and it has little or no reserves and declining revenues.

Sincerely,

Bacchecki, Crom & Co., LLP

BACHECKI, CROM & CO., LLP