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1. Summary of Significant Accounting Policies

The City of Annapolis (the City) is an incorporated municipality governed by a mayor and eight aldermen who together constitute the City Council. The City government provides most basic local governmental services except education, which is provided through the Anne Arundel County Board of Education.

For financial reporting purposes, the basic financial statements include the various departments governed directly by the City Council. The City does not have any component units as defined by generally accepted accounting principles in the United States of America (GAAP). A component unit is defined as a separate legal entity that a primary government must include as part of its financial reporting entity for fair presentation in conformity with GAAP. The Mayor is responsible for appointing the commissioners of the Annapolis Public Housing Authority, but the City's accountability for this organization does not extend beyond making the appointment.

The accounting policies of the City conform to GAAP as applicable to governmental units. The following is a summary of the more significant policies:

(A) Basis of Presentation - Fund Accounting

The accounting system is organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations.

The City's funds are grouped into two broad fund categories and five generic fund types for financial statement presentation purposes. Governmental funds include the general, special revenue and capital projects funds. Proprietary funds include enterprise funds and an internal service fund. The City has one fiduciary fund which is comprised of a pension trust fund.

The basic financial statements include certain prior-year summarized (as restated) comparative information in total but not at the level of detail required for a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the government's financial statements as of and for the year ended June 30, 2010 (as restated), from which the summarized information was derived.

(B) Basis of Accounting

**GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The government-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all non-fiduciary activities of the primary government. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which primarily rely on fees and charges for support. Internal service fund activity is eliminated to avoid "doubling up" revenues and expenses. Fiduciary funds are excluded from the government-wide financial statements.

The government-wide statements are prepared using the economic resources measurement focus and the accrual basis of accounting. This is the same approach used in the preparation of the proprietary fund financial statements but differs from the manner in which governmental fund financial statements are prepared. Therefore, governmental fund financial statements include reconciliations with brief explanations to better identify the relationship between the government-

1. Summary of Significant Accounting Policies, Continued

wide statements and the statements for governmental funds. The primary effect of internal activity has been eliminated from the government-wide financial statements. Exceptions to this rule is when the amounts are reasonably equivalent in value to the interfund services provided and other charges between various functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

The government-wide Statement of Activities presents a comparison between expenses, both direct and indirect, and program revenues for each segment of the business-type activities of the City and for each governmental program. Direct expenses are those that are specifically associated with a service, program or department and are therefore clearly identifiable to a particular function. Indirect expenses for centralized services and administrative overhead are allocated among the programs, functions and segments using a full cost allocation approach and are presented separately to enhance comparability of direct expenses between governments that allocate direct expenses and those that do not. Program revenues include charges paid by the recipients of the goods or services offered by the programs and grants and contributions that are restricted to meet the operational or capital requirements of a particular program. Revenues not classified as program revenues are presented as general revenue. The comparison of program revenues and expenses identifies the extent to which each program or business segment is self-financing or draws from the revenues of the City.

Net assets should be reported as restricted when constraints placed on net asset use are either externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or imposed by laws through constitutional provisions or enabling legislation. The net assets restricted for other purposes result from special revenue funds and the restrictions on their net asset use.

Separate 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.

**FUND FINANCIAL STATEMENTS**

Fund financial statements report detailed information about the City. The focus of governmental and enterprise fund financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Non-major funds are aggregated and presented in a single column except for the special revenue fund which is presented in a separate column. The internal service fund is presented in a single column on the face of the proprietary fund statements.

**GOVERNMENTAL FUNDS**

All governmental funds are accounted for using the modified accrual basis of accounting and the current financial resources measurement focus. Under this basis, revenues are recognized in the accounting period in which they become measurable and available. The City considers revenues to be available if they are collected within sixty days of the end of the current year. Expenditures are recognized in the accounting period in which the fund liability is incurred, if measurable.

The major governmental funds are:

General Fund - This is the City's primary operating fund. It is used to account for all financial resources except those required to be accounted for in another fund.

1. Summary of Significant Accounting Policies, Continued

Capital Projects Fund - The Capital Projects Fund is used to account for financial resources and expenditures applied to the construction of capital facilities and major purchased items for all governmental fund types.

The Non Major Governmental Fund is:

Special Revenue Fund - The Special Revenue Fund is used to account for Community Development Block Grants received from the Federal government.

(C) Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e. revenues and other financing sources) and decreases (i.e. expenditures and other financing uses) in net current assets. The unreserved fund balance is a measure of available spendable resources.

The modified accrual basis of accounting is followed by the governmental funds. Under this basis, revenues are recorded when susceptible to accrual, i.e., both measurable and available. Available means collectible within the current period or soon enough thereafter, within sixty days of the end of the current year, to be used to pay liabilities of the current period. Expenditures are recorded for decreases in net financial resources when a fund liability is incurred, if measurable, except for debt service, which is recognized when due.

Property taxes levied during the current year are recorded as receivables and deferred revenue, net of estimated uncollectible amounts. The net receivables collected during the current year and within sixty days after year end are recognized as revenues in the current year.

Income taxes, highway user fees, hotel / motel taxes, admission taxes and rent payments are all major revenue sources susceptible to accrual and so have been recognized as revenues in the current year.

Licenses and permits, charges for non-enterprise services, fines and forfeitures and miscellaneous revenues (except investment earnings) are recorded as revenues when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned since they are measurable and available.

In applying the susceptible to accrual concept to intergovernmental revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. There are, however, essentially two types of these revenues. In one, monies must be expended on the specific purpose or project before any amounts will be paid to the City; therefore, revenues are recognized based upon the expenditures recorded. In the other, monies are virtually unrestricted as to purpose of expenditure and are usually revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenues at the time of receipt or earlier if the susceptible to accrual criteria are met.

1. Summary of Significant Accounting Policies, Continued

**PROPRIETARY FUNDS**

All proprietary funds are accounted for using the accrual basis of accounting. The accrual basis of accounting recognizes revenues when they are earned and expenses when liabilities are incurred. These funds account for operations that are primarily financed by user charges. All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the balance sheet. Net assets (i.e., net total assets) are segregated into invested in capital assets, net of related debt, restricted and unrestricted. Proprietary funds operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net assets. In accordance with GASB Statement No. 20, *"Accounting and Financial Reporting for Proprietary Funds and other Governmental Entities that use Proprietary Fund Accounting*," the City has elected not to follow any pronouncements issued by the Financial Accounting Standards Board after November 30, 1989.

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

The major proprietary funds are:

Water Fund - To account for all financial activity associated with the operation of the City's water plant and water distribution system. The water plant is responsible for the production, treatment, testing, storage and initial distribution of all potable water for the customers of the City. The water distribution division is responsible for meter reading, and operating, maintaining and repairing the distribution system.

Sewer Fund - To account for all financial activity associated with the operation of the City's sewage collection and treatment program. The sewer fund consists of two divisions: sewer plant and sewer collection. The sewer collection division is responsible for operating, maintaining and repairing the sewage conveyance system. Sewage treatment is performed at a single, jointly-owned plant site controlled and operated by Anne Arundel County. The City has a fifty percent ownership of the property, plant and equipment, but does not have joint control of the financial or operating policies, thus the arrangement is not considered a joint venture. The current agreement calls for the City to share in actual costs for fifty percent of capital improvements and a flow-based percentage of operational costs.

Off Street Parking Fund - To account for all financial activity associated with the operation of the City's municipal off street parking facilities. The parking facilities include three parking garages and two parking lots.

Transportation Fund - To account for all financial activity associated with the operation and maintenance of the City's public transportation system. The transportation fund consists of three divisions: Administration, Transit Operations and Maintenance.

1. Summary of Significant Accounting Policies, Continued

The non-major proprietary funds shown aggregated are:

Dock Fund - To account for all financial activity associated with the management and control of the City's waterways, including slips and mooring buoys, showers and restrooms for boaters, sewage pump-out facilities for boaters, and maintenance of the City Dock area.

Market Fund - To account for all financial activity associated with the operation of the City's Market House, an enclosed pavilion housing vendors who sell a variety of affordable carry-out foods and beverages.

Stormwater Management Fund - To account for all financial activity associated with the maintenance of public storm drainage systems, which include pipes, inlets, manholes, drainage ways and stormwater management facilities.

Refuse Fund - To account for all financial activity associated with the operation of the City's residential refuse, yard waste, recycling and bulk disposal systems. The refuse fund consists of three divisions: Residential Refuse, Yard Waste Recycling and Curbside Recycling.

The City's only Internal Service Fund is used to account for the activities of a self-insurance program for general and automotive liability claims. The liability for unpaid claims, which is included in other liabilities, is based upon individual case estimates reported as of June 30, 2011 and management's estimate of claims incurred, but not reported to that date.

When both restricted and unrestricted resources are available for use, it is the government's policy to use restricted resources first, and then unrestricted resources as they are needed.

**FIDUCIARY FUND - PENSION TRUST FUND**

The City currently has one fiduciary fund, Pension Trust Fund, which is used to account for pension assets held by the City in a trustee capacity. This fund is accounted for and reported in a manner similar to proprietary funds since capital maintenance is critical.

(D) Budgetary Process

The City follows these procedures in establishing its budgetary data for the General Fund, Capital Projects Fund, and Enterprise Funds.

(1) By the second Monday in March, the Mayor submits to the City Council a proposed budget for the General Fund and each of the enterprise funds for the fiscal year commencing the following July 1.

(2) The budget is referred to the Finance Committee, which makes recommendations on the budget to the full City Council by the second Monday in May.

(3) The City Council holds public hearings to obtain taxpayer comments.

(4) No later than June 30, the budget is legally enacted through passage of a budget ordinance which establishes spending authority by fund for the operations of the City.

1. Summary of Significant Accounting Policies, Continued

(5) Supplemental appropriations and transfers between funds must be approved by the City Council. The allocation of funds from the surplus of the budget requires a two-thirds vote by the City Council.

(6) All budgets are on an annual basis except the Capital Projects Fund budget, which is on a project basis. Budgets are adopted using the same basis of accounting as used for reporting purposes. Unencumbered appropriations lapse at June 30 for all funds, except the Capital Projects Fund.

Budgetary Control

Annually budgets are adopted on a departmental level. Any budget changes subsequent to the adoption by the City Council, including any transfers between expenditure classifications, between departments or between funds, must be approved by the Financial Committee and full City Counsel.

The following are departments which incurred overages in their budget:

| | Budget | Actual | Variance | Note |
|---|---|---|---|---|
| Mayor and Alderman | $ 2,352,353 | $ 2,437,774 | $ (85,421) | 1 |
| Finance | $ 2,988,670 | $ 3,048,604 | $ (59,934) | 2 |

Note 1). Mayor and Alderman finished the year over budget due to staff positions being filled that were not previously budgeted.
Note 2). The Finance department finished the year over budget due to additional audit expenses that were unexpected and unbudgeted.

(E) Investments

Short-term investments of the City are recorded at fair value. Investments in the Pension Trust Fund represent the pension plan's ownership interests in the net assets of various investment funds. The investments in these funds are recorded at fair value.

(F) Inventories and Prepaid Items

Inventories consist of supplies and materials valued at cost using the first-in/first-out method and prepaid items consist of insurance premiums, collection services and bulk permit for postage valued at cost using the consumption method. They are recorded as expenditures/expenses as the items are used.

(G) Capital Assets and Depreciation

The accounting and reporting treatment applied to the capital assets associated with a fund are determined by its measurement focus. General capital assets are long-lived assets of the City as a whole. When purchased, such assets are recorded as expenditures in the governmental funds and capitalized in government wide activities. The valuation bases for general capital assets are historical cost, or where historical cost is not available, estimated historical cost based on replacement cost. The minimum capitalization threshold is any individual item with a total cost greater than $5,000 and a useful life of more than one year.

1. Summary of Significant Accounting Policies, Continued

Capital assets in the proprietary funds are capitalized in the fund in which they are utilized. The valuation bases for proprietary fund capital assets are the same as those used for the general capital assets. Donated capital assets are capitalized at estimated fair market value on the date donated.

Depreciation of capital assets is computed and recorded using the straight-line method. Estimated useful lives of the various classes of depreciable capital assets are as follows: building, 20 to 50 years; improvement/infrastructure, 5 to 50 years; and equipment, 2 to 15 years.

(H) Vacation and Sick Leave

Vacation benefits are earned by employees of the City based on time in service, and the rights to such benefits are vested after 6 months of service. Sick leave is also accumulated by employees based on time in service. Accumulated sick leave benefits do not vest and are not paid unless sickness causes employees to be absent; however, accumulated sick time not used is credited to months of service in the calculation of employees' retirement benefits.

The City records vested vacation benefits as earned. All vacation benefits are accrued when incurred in the government-wide and proprietary fund financial statements. The amount earned and unused is recorded as a liability in the respective funds of the City when notification of termination is received prior to year end. In accordance with GASB Statement Number 16,"*Accounting for Compensated Absences*," the City also recorded the related social security and Medicare taxes as a liability as of June 30, 2011.

(I) Cash and Cash Equivalents

For purposes of the statement of cash flows, money market and highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

(J) Fund Balance Reporting

The Board has adopted the requirements of GASB Statement No. 54, “Fund Balance Reporting and Governmental Fund Type Definitions.” This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. Additionally, this statement clarifies the definitions of the general fund, capital projects, and special revenue fund, as applicable to the City. This statement changes the fund balance classifications reported on the Governmental Fund Balance Sheet and requires expanded disclosure of the Council’s policies and procedures as it relates to authority levels, spending policy, and reporting of encumbrances. Fund balance reclassifications made to conform to the provisions of this Statement have been applied retroactively by restating fund balance for all prior periods presented.

1. Nonspendable – amounts that cannot be spent because they are either not in spendable form or they are legally required to be maintained intact such as inventory, prepaid expenses, or other assets.
2. Restricted – amounts that can be spent only for specific purposes because of constitutional provisions or enabling legislation or because of constraints that are externally imposed by creditors, grantors, contributors, or the laws or regulations of other governments.

1. Summary of Significant Accounting Policies, Continued

3. Committed – amounts that can only be used for specific purposes determined by a formal action of the Council, the highest level of decision-making authority for the City. Commitments may be established, modified, or rescinded only through ordinances or resolutions approved by the Council.
4. Assigned – amounts that do not meet the criteria to be classified as restricted or committed but that are intended to be used for specific purposes determined by a formal action of the Council such as adopting the annual budget.
5. Unassigned – all other spendable amounts.

(K) Negative Fund Balance

The City plans to eliminate the Stormwater Management Fund, Dock Fund and Transportation Fund deficit through a combination of cost reductions and contributions from the General Fund.

(L) Allowance for Uncollectible Receivables

The City calculates its allowances for uncollectible receivables using historical collection data and, in certain cases, specific account analysis. The total allowance amounts are summarized below.

| | |
|---|---|
| Primary Government | |
| General Fund | $207,015 |
| Business-type | |
| Dock Fund | 5,000 |
| Total | 213,015 |

2. Reconciliation of Government-wide and Fund Financial Statements

(A) Explanation of certain differences between the governmental fund balance sheet and the government-wide statement of net assets

The governmental fund balance sheet includes reconciliation between fund balance - total governmental funds, net assets and governmental activities as reported in the governmental-wide statement of net assets. The details of long term liabilities, including bonds payable, long term compensated absences and self insurance, are not due and payable in the current period and therefore are not reported in the funds are as follows:

| | |
|---|---|
| Long term debt | $ 57,445,057 |
| Compensated absences | 2,719,904 |
| Accrued debt interest | 707,135 |
| Net Pension Obligation | 7,823,232 |
| Self insurance costs | 3,536,307 |
| Net adjustment to reduce fund balance - total governmental funds to arrive at net assets - governmental activities | $ 72,231,635 |

2. Reconciliation of Government-wide and Fund Financial Statements, Continued

(B) Explanation of certain 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 a reconciliation between net changes in fund balances - total governmental funds and changes in net assets of governmental activities as reported in the governmental-wide statement of activities. The details of Governmental funds report capital outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period. The details are as follows:

| | | |
|---|---|---|
| Capital outlay | $ | 2,214,653 |
| Gain / (Loss) on disposal | | (141,941) |
| Depreciation expense | | (2,961,458) |
| Net adjustment to increase net changes in fund balances - total governmental funds to arrive at changes in net assets of governmental activities | $ | (888,746) |

| | |
|---|---|
| Compensated Abscences | (275,134) |
| Self Insurance | 1,402,816 |
| Pension Obligation | (6,128,420) |
| Accrued Interest | (8,263) |
| Other | (1,287,684) |
| Total expenses reported in statement of activities that do not require the use of current financial resources. | (6,296,685) |

3. Property Tax

The City's real property tax is levied each July 1 on the assessed values certified as of that date for all taxable real property located in the City. At that time, a lien is placed against the property. Assessed values are established by the Maryland State Department of Assessments and Taxation at predetermined percentages of estimated market value. A revaluation of all property is required to be completed every three years. Payments are due by September 30. Beginning October 1, interest is charged each month or fraction thereof until such taxes are paid. Delinquent taxes are collected, after the ninth month of delinquency, by tax sales conducted by Anne Arundel County. The assessed market value of taxable real property and personal property as of July 1, 2010, was approximately $6,786,499,757 and $164,187,500 respectively.

4. Deposits and Investments

The City maintains an investment pool that is available to all funds except the Pension Trust Fund, which holds investments separate from other City funds and controls its own cash transactions. All other City cash receipt and disbursement transactions are initiated in the General Fund and amounts applicable to other funds are transferred through the respective interfund receivable and payable accounts. The cash balance of the Internal Service Fund is maintained in a separate account at the Maryland Local Government Investment Pool.

(A) City's Cash and Investments

Custodial Credit Risk - Deposits: In the case of deposits, this is the risk that in the event of a bank failure, the government's deposits may not be returned. The City's investment policy requires at least 102% collateralization of deposits. The carrying amount of total deposits, for the City was $7,039,266 and the bank balance was $7,346,912. as of June 30, 2011. The bank balance was covered by federal depository insurance or by collateral held by the City's agent in the City's name.

Money Markets: The City invests in money market funds which are not subject to custodial credit risk.

Investments: The City is authorized to invest in obligations of the U. S. Treasury, agencies and instrumentalities, bankers' acceptances, repurchase agreements, certificates of deposit, and the state's local government investment pool.

4. Deposits and Investments, Continued

Interest Rate Risk: The City plans its investments to match cash flow requirements. In accordance with its investment policy, the City does not directly invest in securities maturing more than one year from the date of purchase. The Maryland Local Government Investment Pool (MLGIP) used by the City is operated in accordance with Rule2a7 of the Investment Company Act of 1940. The City's investments in the pool are not included in the computation of weighted average maturity. The City's investment in MLGIP was $1,700,598. as of June 30,2011.

Credit Risk: State law and the City's investment policy limits investments in bankers' acceptances and commercial paper to the highest letter and numerical rating by at least one nationally recognized statistical rating organization. The Maryland Local Government Investment Pool is rated "AAA" by Standard & Poor's.

Concentration of Credit Risk: The City's investment policy, with the exception of U.S. Treasury securities and authorized pools, states no more than one-third of the City's total investment portfolio will be invested with a single financial institution.

(B) Pension Trust Fund Cash and Investments

The City's Pension Trust fund, the Police & Fire Retirement Plan (the Plan) has an investment policy that is designed to provide benefits as anticipated through a carefully planned and executed investment program that achieves a reasonable long term total return consistent with the level of risk assumed. To help achieve this return, professional investment managers are employed by the Plan to manage the Plan's assets. The Plan employs State Street Bank as trustee for the assets.

Cash: As of June 30, 2011, the Plan had no cash with the Plan's trustee.

Investments: Contractually, the City's investment managers are restricted to investments in common stock, public bonds, real estate and alternative investment funds. The Plan's investment policy includes an asset allocation plan for investments. The target allocation is 49% equities, 34% fixed income, 6% real estate, and 11% alternatives. The minimum and maximum percentages for equities are 34% and 64%, respectively, and for fixed income are 24% and 44%, respectively.

Investments of the Plan as of June 30, 2011:

| Investments | | Fair Value |
|---|---|---|
| Common stocks | $ | 81,808,739 |
| Money market funds | | 4,606,392 |
| Fixed income | | 38,781,427 |
| Commodities | | 14,658,791 |
| Real estate investment trust | | 5,698,419 |
| Total | $ | 145,553,768 |

Interest rate risk: The Plan's investment policy does not place any limits on the investment managers with respect to the duration of their investments. The following list shows the Plan's investments and their related weighted-average maturities:

4. Deposits and Investments, Continued

| Investment Type | Fair Value | Weighted Average Maturity (in years) |
|---|---|---|
| Corporate bonds | $ 33,466,879 | 10.3 |
| U.S. Agency securities | 5,314,548 | 3.7 |
| Total | $ 38,781,427 | |
| Portfolio weighted average maturity | | 5.9 |

Credit Risk: Bonds must have a rating of “Baa/BBB” or equivalent by two of the three primary rating agencies.

Custodial Credit Risk: State Street invests in a money market fund on behalf of the Plan. As of June 30, 2011, the amount in the money market fund was $4,606,392. This fund is uninsured and uncollateralized. All other investments of the fund are held by State Street Bank as trustee in the Plan’s name.

5. Liability for Unpaid Claims

The liability for the City's Self Insurance is $3,536,307. which represents primarily long term unpaid claims. See note 14 for additional information.

6. Capital Assets and Depreciation

Capital asset activity for the year ended June 30, 2011 was as follows:

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|
| Governmental activities: | | | | |
| Not being depreciated: | | | | |
| Land | $ 4,260,493 | $ - | $ - | $ 4,260,493 |
| Construction in process | 1,414,328 | 1,812,456 | (100,000) | 3,126,784 |
| Subtotal | 5,674,821 | 1,812,456 | (100,000) | 7,387,277 |
| Other capital assets: | | | | |
| Buildings | 48,748,192 | - | - | 48,748,192 |
| Improvements/infrastructure | 63,728,394 | - | - | 63,728,394 |
| Equipment | 14,436,126 | 402,197 | (309,211) | 14,529,112 |
| Subtotal | 126,912,712 | 402,197 | (309,211) | 127,005,698 |
| Accumulated depreciation: | | | | |
| Buildings | (11,015,087) | (859,568) | - | (11,874,655) |
| Improvements/infrastructure | (31,821,056) | (744,398) | - | (32,565,454) |
| Equipment | (9,009,417) | (1,357,492) | 267,270 | (10,099,639) |
| Subtotal | (51,845,560) | (2,961,458) | 267,270 | (54,539,748) |
| Net capital assets | $ 80,741,973 | $ (746,805) | $ (141,941) | $ 79,853,227 |

6. Capital Assets and Depreciation, Continued

Depreciation was charged to functions as follows:

| | |
|---|---|
| Governmental activities: | |
| General government | $ 224,714 |
| Public safety | 1,400,403 |
| Community services | 554,405 |
| Public works | 781,936 |
| Total governmental activities depreciation expense | $ 2,961,458 |

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|
| Business-type activities: | | | | |
| Not being depreciated: | | | | |
| Land | $ 3,243,441 | $ - | $ - | $ 3,243,441 |
| Construction in process | 4,646,278 | 587,677 | (1,265,706) | 3,968,249 |
| Subtotal | 7,889,719 | 587,677 | (1,265,706) | 7,211,690 |
| Other capital assets: | | | | |
| Buildings | 44,252,492 | - | - | 44,252,492 |
| Improvements/infrastructure | 41,874,131 | 236,368 | - | 42,110,499 |
| Equipment | 9,873,191 | 996,590 | (1,665,737) | 9,204,044 |
| Subtotal | 95,999,814 | 1,232,958 | (1,665,737) | 95,567,035 |
| Accumulated depreciation: | | | | |
| Buildings | (19,190,417) | (1,117,270) | - | (20,307,687) |
| Improvements/infrastructure | (13,815,631) | (707,271) | 70,339 | (14,452,563) |
| Equipment | (8,099,651) | (628,356) | 1,488,655 | (7,239,352) |
| Subtotal | (41,105,699) | (2,452,897) | 1,558,994 | (41,999,602) |
| Net capital assets | $ 62,783,834 | $ (632,262) | $ (1,372,449) | $ 60,779,123 |

Depreciation was charged to functions as follows:

| | |
|---|---|
| Business-type activities: | |
| Water | $ 596,051 |
| Sewer | 632,921 |
| Off street parking | 415,440 |
| Transportation | 489,114 |
| Non Major Funds | 319,371 |
| Total business-type activities depreciation expense | $ 2,452,897 |

7. Debt

The City issues general obligation bonds to provide funds for the acquisition and construction of major capital facilities. General obligation bonds have been issued for both governmental and business-type activities. These bonds therefore are reported in the proprietary funds if they are expected to be repaid from proprietary fund revenues. In addition, general obligation bonds have been issued to refund general obligation bonds. General obligation bonds are direct obligations and pledge the full faith and credit of the City. All debt service payments are made from the General fund and expenses are then allocated to the appropriate proprietary fund. The City also participates in the Maryland Local Government Insurance Trust (LGIT), a public entity risk pool, which provides insurance for claims in excess of coverage provided by the City's self-insurance fund. In 1990, Certificates of Participation were issued by LGIT with the City's share being approximately 2% of the total. All claims payments are made from the Trust's fund balance and are due annually through 2011.

Under provisions of Article 41, Section 14-101 through 14-109 of the Annotated Code of Maryland, the City has participated in Economic Development Revenue Bonds for various projects within the City. Neither the bonds, nor the interest thereon, constitute an indebtedness or contingent liability of the City and, accordingly, they are not included in the basic financial statements. During fiscal year 2007, the City issued $13,445,000 of these bonds on behalf of St. John's College, a Maryland not-for-profit educational corporation. The aggregate amount of conduit debt outstanding as of June 30, 2010 was $13,055,000. which is the most recent information available.

The following is a summary of changes in long-term liabilities by type of the City for the year ended June 30, 2011:

| | Beginning Balance | Additions and Adjustments | Reductions | Ending Balance | Amount due within one year |
|---|---|---|---|---|---|
| Governmental activities: | | | | | |
| General obligation bonds | $ 55,026,790 | $ 22,538,856 | $ (20,831,795) | $ 56,733,851 | $ 1,525,353 |
| Unamortized premium | - | 1,792,759 | (9,960) | 1,782,799 | 59,759 |
| Unamortized issuance cost | - | (306,760) | 1,704 | (305,056) | (10,225) |
| Unamortized loss on refunding | - | (1,373,606) | 37,124 | (1,336,482) | (222,747) |
| Other debt | 931,215 | - | (361,270) | 569,945 | 376,123 |
| Total Long term debt | 55,958,005 | 22,651,249 | (21,164,197) | 57,445,057 | 1,728,263 |
| OPEB | 7,493,326 | 4,784,951 | - | 12,278,277 | - |
| Compensated absences | 2,704,351 | 31,321 | - | 2,735,672 | 15,768 |
| Total long-term liabilities | $ 66,155,682 | 27,467,521 | (21,164,197) | 72,459,006 | $ 1,744,031 |
| Business-type activities: | | | | | |
| General obligation bonds | $ 28,590,338 | $ 13,281,144 | $ (13,245,332) | $ 28,626,150 | $ 769,647 |
| Unamortized premium | - | 911,371 | (5,063) | 906,308 | 30,379 |
| Unamortized issuance cost | - | (187,462) | 1,041 | (186,421) | (6,249) |
| Unamortized loss on refunding | 58,019 | (814,212) | 73,084 | (683,109) | (125,669) |
| Other debt | 625,178 | - | (142,634) | 482,544 | 147,693 |
| Total Long term debt | 29,273,535 | 13,190,841 | (13,318,904) | 29,145,472 | 815,801 |
| OPEB | 1,081,573 | - | (161,151) | 920,422 | - |
| Compensated absences | 388,215 | 39,885 | - | 428,100 | - |
| Total long-term liabilities | $ 30,743,323 | $ 13,230,726 | $ (13,480,055) | $ 30,493,994 | $ 815,801 |

The City Charter limits the aggregate amount of bonds and other indebtedness to 10% of the assessable base of the City, which includes real and personal property. The limitation amount does not include Water fund and Sewer fund indebtedness because that debt is paid solely by user fees from the respective fund. As of June 30, 2011, the debt margin of the City was as follows:

7. Debt, Continued

| | | |
|---|---|---|
| Assessable basis upon which tax levy for year beginning July 1, 2010 was calculated | $ | 6,437,267,368 |
| Debt limit; 10% of assessable basis | $ | 643,726,737 |
| Debt subject to limitation | | 86,590,528 |
| Debt margin | $ | 557,136,209 |

Long-term debt amounts are comprised of the following as of June 30, 2011:

| | | |
|---|---|---|
| Governmental activities: | | |
| General obligation bonds: | | |
| Refunding Bonds of 2003: $3,571,236; interest 2.65%; due serially to 2015 | $ | 1,479,114 |
| Public Improvement Bonds of 2005: $12,042,500; interest 3.5%; due serially to 2025 | | 7,624,936 |
| Public Improvement Bonds of 2007: $21,391,600; interest 4.25%; due serially to 2022 | | 8,792,102 |
| Public Improvement Bonds of 2009: $23,121,380; interest 2.0%; due serially to 2029 | | 16,098,843 |
| Public Improvements and Refunding Bonds of 2011: $22,738,856; interest 2.0% to 5.0%; due serially to 2040 | | 22,738,856 |
| | | 56,733,851 |
| Other debt: | | |
| Capital Lease: $1,770,036; interest 4.07%; vehicle financing Maturing August 2012 | | 569,945 |
| Total governmental activities long-term debt | $ | 57,303,796 |

7. Debt, Continued

Short term debt consisted of the following at; June 30, 2011

| Description | Interest Rate | Amount Outstanding |
|---|---|---|
| $5,000,000 Bank line of Credit dated February 21, 2011; maturing on February 11,2012 | One month Libor +. 70%; which was .89% at June 30, 2011 | $5,000,000 |
| $5,000,000 Bank line of Credit dated April 15,2011; maturing on November 30,2011 | One month Libor +. 70%; which was .89% at June 30, 2011 | 3,000,000 |
| $10,000,000 Tax Anticipation Note with a dated June 30, 2011, due June 30, 2012 | 1.66% | 10,000,000 |
| Total | | $18,000,000 |

7. Debt, Continued

Long-term debt amounts are comprised of the following as of June 30, 2011:

| | |
|---|---|
| Business-type activities: | |
| General obligation bonds: | |
| Refunding Bonds of 2003: $4,118,764; interest 2.65%; due serially to 2015 | $ 1,705,886 |
| Public Improvement Bonds of 2005: $2,957,500; interest 3.5%; due serially to 2025 | 2,225,064 |
| Public Improvement Bonds of 2007: $7,508,400; interest 4.25%; due serially to 2022 | 5,277,898 |
| Public Improvement Bonds of 2009: $3,848,620; interest 2.0%; due serially to 2029 | 6,336,158 |
| Public Improvements and Refunding Bonds of 2011: $13,081,144; interest 2.0% to 5.0%; due serially to 2040 | 13,081,144 |
| | 28,626,150 |
| Other debt: | |
| State of Maryland Water Quality loan: $1,570,795; interest 3.25%; payable from net cash provided by operations of sewer as generated Maturity Date 02-01-2015 | 404,824 |
| Capital Lease: $244,964; interest 4.07%; vehicle financing Maturity Date 08-28-2012 | 77,720 |
| | 482,544 |
| Total business-type activities debt | $ 29,108,694 |

Interest costs incurred on general obligation bonds allocated to the business-type activities were $1,144,601 for the year ended June 30, 2011.

Long-term debt maturities excluding the unamortized loss on refunding of $199,853 in business-type activities are scheduled as follows:

| | General obligation bonds | | Other debt | | |
|---|---|---|---|---|---|
| | Principal | Interest | Principal | Interest | Total |
| Governmental activities: | | | | | |
| 2012 | $ 1,525,353 | $ 2,250,780 | $ 376,123 | $ 19,408 | $ 4,171,665 |
| 2013 | 1,169,770 | 2,377,973 | 193,822 | 3,944 | 3,745,509 |
| 2014 | 2,512,347 | 2,330,104 | - | - | 4,842,451 |
| 2015 | 2,622,013 | 2,238,974 | - | - | 4,860,987 |
| 2016 | 2,774,880 | 2,133,717 | - | - | 4,908,597 |
| 2017 - 2021 | 15,562,592 | 8,837,176 | - | - | 24,399,768 |
| 2022 - 2026 | 17,340,510 | 5,195,644 | - | - | 22,536,153 |
| 2027 - 2031 | 10,524,606 | 1,702,372 | - | - | 12,226,979 |
| 2032 - 2036 | 1,880,937 | 368,378 | - | - | |
| 2037 - 2041 | 820,843 | 91,970 | - | - | 912,813 |
| Total | $ 56,733,851 | $ 27,527,088 | $ 569,945 | $ 23,352 | $ 82,604,921 |

7. Debt, Continued

| | General obligation bonds | | Other debt | | |
|---|---|---|---|---|---|
| | Principal | Interest | Principal | Interest | Total |
| Business-type activities: | | | | | |
| 2012 | $ 769,647 | $ 1,135,675 | $ 147,693 | 12,945 | $ 2,065,959 |
| 2013 | 590,230 | 1,199,853 | 125,967 | 8,384 | 1,924,434 |
| 2014 | 1,267,653 | 1,175,699 | 102,772 | 5,314 | 2,551,438 |
| 2015 | 1,322,987 | 1,129,718 | 106,112 | 2,699 | 2,561,516 |
| 2016 | 1,400,120 | 1,076,608 | - | - | 2,476,728 |
| 2017 - 2021 | 7,852,408 | 4,458,968 | - | - | 12,311,376 |
| 2022 - 2026 | 8,749,490 | 2,621,563 | - | - | 11,371,053 |
| 2027 - 2031 | 5,310,394 | 858,965 | - | - | 6,169,359 |
| 2032 - 2036 | 949,063 | 185,872 | | | 1,134,935 |
| 2037 - 2041 | 414,158 | 46,405 | | | 460,563 |
| Total | $ 28,626,150 | $ 13,889,326 | $ 482,544 | $ 29,342 | $ 43,027,361 |

Included in other debt for both the governmental-wide and business-type activities is a capital lease with a principal balance due of $569,945 and $77,720, respectively, and a total imputed interest of $23,352 and $3,184 respectively. The City acquired vehicles at a cost of $2,015,000.

8. Pension Plans

Generally, all regular City employees, except policemen and firemen, participate in the Employees Retirement and Pension Systems (Systems), a cost sharing multiple-employer defined benefit plan sponsored and administered by the State Retirement and Pension System of Maryland. Police and fire personnel participate in a single employer defined benefit pension and disability plan, which is administered by the City's personnel director. In addition, the City established an eight-member police and fire retirement plan commission to review funding and actuarial reports and to make investing decisions. The City Council has the authority to establish and amend benefit and contribution provisions. The Systems were created by the Maryland General Assembly and the Police and Fire System was established by City legislation.

Plan Description and Contribution Information

(A) Cost Sharing Multiple-Employer Plan

The Systems provide retirement, disability, and death benefits to participants and their beneficiaries. The State Retirement and Pension System of Maryland issues a publicly available financial report that includes financial statements and required supplementary information. The financial report may be obtained by writing to State Retirement Agency of Maryland, 120 East Baltimore Street, Baltimore, Maryland 21202.

Members of the Retirement System are required to contribute 5% and the City is required to contribute the remaining amount. For the participants in the Pension System, the City contributes 100%. City contributions to the Systems, which were equal to 100% of the required contributions which for the years ended June 30 2011, 2010, 2009, and 2008, were $1,795,694, $1,296,073, $1,157,512, and $1,277,876, respectively.

8. Pension Plans, Continued

(B) Single Employer Plan

The Police and Fire System is a single-employer defined benefit plan that covers the police and fire personnel of the City. The plan provides retirement, disability, and death benefits to its members and beneficiaries. Participants with twenty years of service and hired before August 1, 1972, or those hired between August 1, 1972, and August 1, 1979, and age 55 are eligible for benefits equal to 2% of average earnings times years of service to a maximum of thirty years but no benefits are provided for early retirement. Participants in the revised version of the plan with twenty-five years of service are eligible for benefits equal to 2% of average earnings times years of service to a maximum of thirty-seven and one-half years. Reduced benefits are available under this plan at age 50 with twenty years of service.

Participants in the original plan are required to contribute 3% of their annual salary and the revised plan participants are required to contribute 5% of their annual salary. The City is required to fund the remaining cost of the plan. As the City has historically fully funded the annual required contribution, the annual pension cost is equal to the annual required contribution. The contribution rate applied to actual payroll is actuarially determined and consists of a normal cost component and an unfunded actuarial liability component. For the year ended June 30, 2011 the City had an annual required contribution of $6,128,420.The City did not make its required contribution, thus, the City has a net pension obligation of $7,823,232 as of June 30, 2011. Administrative costs of the plan are financed through investment earnings. The Plan is considered part of the City's reporting entity and is included in the City's financial statements as Pension Trust funds. There is no separately issued financial report for this plan.

The financial statements of the plan are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. The City's contributions are recognized when due and a formal commitment to provide the contributions has been made. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. All plan investments are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price on the City's balance sheet date. Securities without an established market are reported at estimated fair value.

The number of employees covered and current membership classification as of July 1, 2010, are as follows:

| | |
|---|---|
| Non-Active Members: | |
| Retirees and beneficiaries receiving benefits | 163 |
| Terminated employees not yet receiving benefits | 30 |
| | 193 |
| Active Employees: | |
| Fully vested | 5 |
| Non-vested | 223 |
| | 228 |
| Total | 421 |

8. Pension Plans, Continued

Additional information as of the latest actuarial valuation follows:

| | |
|---|---|
| Actuarial valuation date | 7/1/10 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level dollar |
| Remaining amortization period | 10 years - open |
| Asset valuation method | Asset smoothing |
| Actuarial assumptions: | |
| Investment rate of return | 7.5% compounded annually |
| Projected salary increases | 6.0% compounded annually |
| Cost of living adjustments | 2.5% compounded annually |
| Inflation rate | 5.0% |
| Contribution rates: | |
| Members | 3 - 5% |

Funding status and historical trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due and is presented as required supplementary information in the section which follows the "Notes to Financial Statements" section.

Three-Year Trend Information

| Fiscal Year Ended | Annual Pension Cost (APC) | Percentage Contributed | Net Pension Obligation (NPO) |
|---|---|---|---|
| 2009 | $ 852,556 | 27% | 622,683 |
| 2010 | 4,644,603 | 0% | 4,644,603 |
| 2011 | 6,128,420 | 0% | 6,128,420 |

| Fiscal Year Ended | Total Annual Pension cost | Employer Contribution | Increase in Net Pension Obligation | Net Pension Obligation (Asset), beginning of year | Net Pension obligation ( Asset), end of year | Percent of annual Pension cost contributed |
|---|---|---|---|---|---|---|
| 7/1/2008 | 852,556 | 229,873 | 622,683 | (3,572,473) | (2,949,790) | 27% |
| 7/1/2009 | 4,644,603 | - | 4,644,603 | (2,949,790) | 1,694,813 | 0% |
| 7/1/2010 | 6,128,420 | - | 6,128,420 | 1,694,812 | 7,823,232 | 0% |

Three year funded status for plan is as follows:

| Actuarial Valuation Date | Actuarial Value of Assets ( a ) | Actuarial Accrued Liability (AAL) - Entry Age ( b ) | Unfunded AAL ( b - a ) | Funded Ratio ( a/b ) | Covered Payroll ( c ) | Unfunded AAL as a Percentage of Covered Payroll ( (b-a)/c ) |
|---|---|---|---|---|---|---|
| 7/1/2008 | $ 164,784,504 | $ 144,581,879 | $ (20,202,625) | 114% | $ 14,950,161 | -135% |
| 7/1/2009 | 153,849,420 | 158,457,044 | 4,607,624 | 97% | 16,586,365 | 28% |
| 7/1/2010 | 148,766,081 | 167,926,510 | 19,160,429 | 89% | 14,826,326 | 129% |

9. Other Post-Employment Benefits

Plan Description

The City provides a post-employment health insurance program through the General Fund in addition to the pension benefits. These post-employment benefits are subject to change at any time. All employees who retire from the City may participate in the program. In order to be eligible, the retiree must have met normal service retirement criteria, and immediately preceding retirement been enrolled in a medical, vision or prescription drug insurance plan offered to active employees of the City. The City will pay 80% of the retiree's health insurance premium based upon these criteria. Other retirees who do not meet the eligibility criteria are permitted to participate in the health insurance program by paying the full premium at the group rate. Actuarial valuations for post-employment plans involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as results are compared to past expectations and new estimates are made about the future. The City does not provide a separate, audited GAAP-basis post-employment benefit plan report.

Funding Policy

The City has not yet established a formal policy nor has it restricted any funds for the plan. The City is currently paying the retirees' healthcare costs on a "pay-as-you-go" basis.

Actuarial Methods and Assumptions

The actuarial valuations of the individual plans involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, such as future employment, mortality, and healthcare costs. The actuarially determined amounts regarding the funded status of the plans and the annual required contributions (ARC) of the City and other participating agencies are subject to continual revision, as actual results are compared to past expectations and new estimates are made about the future.

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

Actuarial Assumptions
Additional information as of the latest actuarial valuation follows:

| | |
|---|---|
| Actuarial valuation date | 7/01/10 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level percent open |
| Remaining amortization period | 30 years |
| Asset valuation method | Market Value |
| Actuarial assumptions: | |
| Investment rate of return | 4.5% |
| Projected salary increases | 3.5% (plus merit scale) |
| Rate of medical inflation | 11.4% for FY2010, 9.5% for FY2011 grading to 4.5% over 15 years |
| Rate of prescription inflation | 0.0% for FY2010, 9.5% for FY2011 grading to 4.5% over 15 years |
| Rate of dental and vision inflation | 0.0% for FY2010, 4.5% for all future years |

9. Other Post-employment Benefits, Continued

Annual Costs and Net Obligation

In accordance with the requirements of GASB Statement No. 45, the portion of the unfunded Annual Required Contribution, as determined by actuaries, has been recognized as an expense, and the net OPEB obligation has been recognized as a liability on the City's government-wide financial statements.

Three-Year Trend Information

| Fiscal Year Ended | Annual OPEB Cost | Percentage of Annual OPEB Cost Contributed | Annual Net OPEB Obligation |
|---|---|---|---|
| 2009 | $ 5,103,367 | 19.4% | 4,113,367 |
| 2010 | 5,817,532 | 23.3% | $ 4,461,532 |
| 2011 | 6,244,503 | 26.0% | 4,623,803 |

| Fiscal Year Ended | Total Annual OPEB cost | Employer Contribution | Increase in Net OPEB Obligation | Net OPEB Obligation, beginning of year | Net OPEB obligation, end of year | Percent of annual OPEB cost contributed |
|---|---|---|---|---|---|---|
| 2009 | $ 5,103,367 | 990,000 | 4,113,367 | - | 4,113,367 | 19.4% |
| 2010 | 5,817,532 | 1,356,000 | 4,461,532 | 4,113,367 | 8,574,899 | 23.3% |
| 2011 | 6,244,503 | 1,620,700 | 4,623,803 | 8,574,899 | 13,198,702 | 26.0% |

Three year funded status of the plan as of July 1, 2010, was as follows:

| Actuarial Valuation Dates | Actuarial Value of Assets ( a ) | Actuarial Accrued Liability (AAL) - Entry Age ( b ) | Unfunded AAL ( b - a ) | Funded Ratio ( a/b ) | Covered Payroll ( c ) | Unfunded AAL as a Percentage of Covered Payroll ( (b-a)/c ) |
|---|---|---|---|---|---|---|
| 6/30/2009 | - | $ 43,567,000 | $ 43,567,000 | 0% | $ 29,208,000 | 149% |
| 6/30/2010 | - | 48,371,000 | 48,371,000 | 0% | 30,230,000 | 160% |
| 6/30/2011 | - | 46,146,000 | 46,146,000 | 0% | 31,350,000 | 147% |

10. Interfund Receivables, Payables and Transfers

Interfund receivables and payables, which are for temporary balances between other funds and the general fund where cash is pooled, consist of the following at June 30, 2011:

| Receivable Fund | Payable Fund | Amount |
|---|---|---|
| General Fund | Water Fund | $ 1,631,513 |
| | Off Street Parking Fund | 9,015,073 |
| | Dock Fund | 7,640,229 |
| | Transportation Fund | 4,273,077 |
| | Stormwater Management Fund | 339,951 |
| Special Revenue Fund | General Fund | 260,602 |
| Capital Projects Fund | General Fund | 4,402,822 |
| Sewer Fund | General Fund | 633,166 |
| Market Fund | General Fund | 95,849 |
| Refuse Collection Fund | General Fund | 792,831 |
| Internal Service Fund | General Fund | 75,242 |
| Total | | $ 29,160,355 |

The City allocates interest between the general and enterprise funds based upon month-end interfund balances at the average monthly interest rate of the state's local government investment pool. Such allocation for the year ended June 30, 2011 is reported as an interfund credit in the general fund and as a portion of the administrative charge from general fund in the enterprise funds.

Transfers between other funds and the general fund consist of the following as of June 30, 2011:

| Transfers In | Transfers Out | Amount |
|---|---|---|
| General Fund | Stormwater Management Fund | $ 213,020 |
| | Refuse Fund | 451,230 |
| | Capital Projects Fund | 379,140 |
| | Special Revenue Fund | 30,000 |
| Capital Projects Fund | General Fund | 425,000 |
| Water Fund | Sewer Fund | 634,660 |
| Transportation Fund | Off Street Parking Fund | 500,000 |
| Total | | $ 2,633,050 |

Transfers are used to move unrestricted revenues to fund various programs, provide subsidies, and support “pay-as-you-go” funding. The City transferred $425,000 from the General Fund to the Capital Projects Fund to support “pay-as-you-go” funding for various capital projects.

11. Contingencies

The City, in the normal course of activities, is a defendant in several lawsuits. Losses, if any, are estimated to be less than the City's insurance coverage. Potential liabilities are covered by the City's self-insurance fund and the City's participation in the Maryland Local Government Insurance Trust, a public entity risk pool.

12. Capital Facilities and Connection Charges

In the enterprise funds, capital facility charges are assessed to property owners over a period of thirty years from the date related properties physically connect to the City's water and/or sanitary sewage collection and treatment systems. Such charges are legally restricted to pay for capital construction within the systems or to pay for debt service on debt issued to finance such construction. As such construction is typically financed with debt, the City recognizes the annual charges earned as an addition to contributed capital. Charges levied and receivable in future years are reported as a receivable and deferred revenue.

A connection charge not exceeding the cost of connecting to the systems is assessed and collected prior to connection. Such revenue is recognized as operating income and recorded as charges for services.

13. Grants

The City receives grants from time-to-time. Expenditures from certain grants are subject to audit by the grantor, and the City is contingently liable to refund amounts received in excess of allowable expenditures. In the opinion of the City's management, no material refunds will be required as a result of disallowed expenditures.

14. Risk Management

The City is exposed to various risks of loss related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to workers; and natural disasters. The City maintains a self-insurance fund which includes coverage for general liability, workers compensation, and the administration of the health insurance plan. The City also participates in the Maryland Local Government Insurance Trust, a public entity risk pool, which provides insurance for claims in excess of coverage provided by the City's self-insurance fund.

This is a total risk and cost sharing pool for all participants. In the event that the Trust's General Fund falls into a deficit that cannot be satisfied by transfers from the Trust's capital and surplus accounts, the Trustees shall determine a method to fund the deficit. The Trust agreement empowers the Trustees to assess an additional premium to each deficit-year participant. Debt issues could also be used to fund a deficit.

Premiums are charged to the City's General Fund, with no provision made for claim liability in addition to premiums, unless an assessment is made by the Trust. There have been no assessments during the year ended June 30, 2011.

Risk Management, Continued

The City accounts for the financial operations of the self-insurance fund in the Internal Service Fund. The City maintains excess coverage to reduce the exposure from catastrophic claims. A third party insurance administrator is employed to estimate funding requirements and liabilities of the self-insurance fund. The funding for each year represents the present value of the amount needed to pay the expected final settlement values for all claims which occur in that year regardless of the date reported. Claims "incurred but not reported" are accounted for as self insurance costs on the government-wide statement of net assets. The carrying amount of liabilities for unpaid claims is presented at present value using a discount rate of 4% to recognize the time value of money. The changes in accrued payables and other liabilities during fiscal years 2011 and 2010 were as follows:

| | FY 2011 | FY 2010 |
|---|---|---|
| Beginning accrued payables and other liabilities | $ 4,939,123 | $ 4,591,535 |
| Incurred claims and changes in estimates | (256,309) | 1,193,235 |
| Claim payments | (1,146,507) | (845,647) |
| Ending accrued payables and other liabilities | $ 3,536,307 | $ 4,939,123 |

There have been no reductions in insurance coverage from the prior year and during the last five years the total amount of settlements has not exceeded insurance coverage.

15. Landfill Closure

In accordance with the Maryland Department of the Environment regulations, as of June 30, 1993, the City's landfill operations were terminated. As of March 31, 1998, the landfill is closed with closure and post closure costs recorded under current Federal and State regulations. The City will continue the monitoring process per the regulations and currently plans to maintain the site as open space. Actual costs may be higher due to inflation, changes in technology, or changes in regulations. An annual appropriation is established for the monitoring costs and any post closure care requirements exceeding the original estimates will be covered by future tax revenues.

16. Prior Period Adjustment

The net assets of the governmental activities were restated to correct an error in accounting for the net pension asset that existed at June 30, 2009. The restatement resulted in an increase of $2,949,791 to net pension assets at June 30, 2009.

Additionally, the June 30, 2010 statements of Net Assets and Activities were restated to record the pension expense and related net pension obligation for the Retirement Plan for members of the Police and Fire Departments of the City of Annapolis. The effect of this adjustment was to decrease the net pension asset, the net changes in assets and net assets at June 30, 2010 as follows:

16. Prior Period Adjustment Continued

| | Net Pension Asset (Obligation) | 2010 Changes in Net Assets | Net Assets |
|---|---|---|---|
| As originally stated | $ - | | $ 49,474,228 |
| Effect of 2009 Adjustment | 2,949,791 | | 2,949,791 |
| June 30, 2009, as Restated | 2,949,791 | | 52,424,019 |
| Change in net assets- 2010 as originally stated | | $ (14,400,976) | (14,400,976) |
| Effect of 2010 Adjustment | (4,644,603) | (4,644,603) | (4,644,603) |
| June 30, 2010, as Restated | $ (1,694,812) | $ (19,045,579) | $ 33,378,440 |

**CITY OF ANNAPOLIS, MARYLAND**
**Required Supplementary Information**
(Unaudited)

**Police and Fire Retirement Plan**
**Schedules of Funding Progress**

| Actuarial Valuation Date | Actuarial Value of Assets ( a ) | Actuarial Accrued Liability (AAL) - Entry Age ( b ) | (Over funded) Unfunded AAL ( b - a ) | Funded Ratio ( a/b ) | Covered Payroll ( c ) | Unfunded AAL as a Percentage of Covered Payroll ( (b-a)/c ) |
|---|---|---|---|---|---|---|
| 7/1/2005 | $ 142,494,713 | $ 118,559,059 | $ (23,935,654) | 120% | $ 13,079,646 | -183% |
| 7/1/2006 | 150,042,660 | 129,054,424 | (20,988,236) | 116% | 13,316,802 | -158% |
| 7/1/2007 | 160,959,883 | 136,422,216 | (24,537,667) | 118% | 13,991,065 | -175% |
| 7/1/2008 | 164,784,504 | 144,581,879 | (20,202,625) | 114% | 14,950,161 | -135% |
| 7/1/2009 | 153,849,420 | 158,457,044 | 4,607,624 | 97% | 16,586,365 | 28% |
| 7/1/2010 | 148,766,081 | 167,926,510 | 19,160,429 | 89% | 14,826,326 | 129% |

A negative Unfunded Actuarial Accrued Liability represents a funding excess.

**Other Post-employment Benefits Plan**
**Schedules of Funding Progress**

| Actuarial Valuation Date | Actuarial Value of Assets ( a ) | Actuarial Accrued Liability (AAL) - Entry Age ( b ) | Unfunded AAL ( b - a ) | Funded Ratio ( a/b ) | Covered Payroll ( c ) | Unfunded AAL as a Percentage of Covered Payroll ( (b-a)/c ) |
|---|---|---|---|---|---|---|
| 6/30/2009 | - | $ 43,567,000 | $ 43,567,000 | 0% | $ 29,208,000 | 149% |
| 6/30/2010 | - | 48,371,000 | 48,371,000 | 0% | 30,230,000 | 160% |
| 6/30/2011 | - | 46,146,000 | 46,146,000 | 0% | 31,350,000 | 147% |