

**COMPREHENSIVE
ANNUAL FINANCIAL REPORT
OF THE
KENAI PENINSULA BOROUGH
ALASKA**

**FOR THE FISCAL YEAR ENDED
JUNE 30, 2005**

**DALE BAGLEY
BOROUGH MAYOR**

PREPARED BY
DEPARTMENT OF FINANCE

SCOTT G. HOLT
DIRECTOR OF FINANCE

CRAIG C. CHAPMAN
CONTROLLER

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**KENAI PENINSULA BOROUGH, ALASKA
COMPREHENSIVE ANNUAL FINANCIAL REPORT
YEAR ENDED JUNE 30, 2005**

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KENAI PENINSULA BOROUGH

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DALE BAGLEY
MAYOR

October 28, 2005

Honorable Members of the Assembly
Citizens of the Kenai Peninsula Borough

In accordance with Section 29.35.120 of Alaska Statutes, we are pleased to submit the Comprehensive Annual Financial Report for the year ended June 30, 2005. The financial statements were prepared in conformance with generally accepted accounting principles (GAAP) and audited in accordance with generally accepted auditing standards by a firm of licensed certified public accountants.

This report consists of management's representations concerning the finances of the Kenai Peninsula Borough ("Borough"). Consequently, management assumes full responsibility for the completeness and reliability of the information presented in this report. To provide a reasonable basis for making these representations, management of the Borough has established a comprehensive internal control framework that is designed both to protect the government's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the Borough's financial statements in conformity with GAAP. Because the cost of internal controls should not outweigh their benefits, the Borough's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatements. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

The Borough's financial statements have been audited by Mikunda, Cottrell & Company, a firm of independent certified public accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of the Borough for the fiscal year ended June 30, 2005, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the Borough's financial statements for the fiscal year ended June 30, 2005, are fairly presented in conformity with GAAP. The independent auditor's report is presented as the first component of the financial section of this report.

The independent audit of the financial statements of the Borough was part of a broader, federally mandated "Single Audit" designed to meet the special needs of federal and State of Alaska grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the

audited government's internal controls and compliance with certain legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal and state awards. These reports are available in the Borough's separately issued Single Audit Report.

GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The Borough's MD&A can be found immediately following the report of the independent auditors.

Profile of the Kenai Peninsula Borough

The Borough was incorporated in 1964 as a second-class borough. It occupies a geographic area of approximately 25,600 miles. The Borough is located in the south central part of the state of Alaska. The Borough is empowered to levy a property tax on both real and personal properties located within its boundaries. State of Alaska law mandates that second-class boroughs provide certain services on an areawide basis to all taxpayers. All other services must be approved by a majority of voters who are to receive the services. This gives taxpayers control over the type and level of services they receive and pay for. Currently, the Borough provides the following areawide services: assessment and collection of property taxes and sales tax collection for the Borough and cities within the Borough, planning, solid waste disposal, education, senior citizen funding, post secondary education, 911 emergency communications, emergency management and general administrative services. Non-areawide services provided by the Borough include fire protection, hospital services, emergency medical and ambulance services, recreation, senior citizen funding, road maintenance, economic development, tourism promotion, and special assessment authority for utility line extensions and road improvement districts. The Borough also has non-areawide port and harbor powers that are not currently exercised. Funding for the Borough, by order of financial significances, is provided from property tax, sales tax, state revenue, interest earnings, federal revenue, and other sources.

The Borough operates under a assembly-mayor form of government. Policy-making and legislative authority are vested in a governing assembly consisting of nine members. The assembly is responsible, among other things, for passing ordinances, adopting the budget, and appointing committees. The mayor is the Borough's executive officer and is responsible for carrying out the policies and ordinances of the Borough, for overseeing the day-to-day operations of the government, and for appointing the heads of the various departments. The assembly and mayor are elected on a non-partisan basis. Assembly members serve three-year staggered terms, with 3 members elected each year and are elected by district. The mayor is elected at large and serves a three-year term.

The Borough is financially accountable for a legally separate school district, which is reported separately within the Borough's financial statements.

Budgetary Control

The annual budget serves as the foundation for the Borough's financial planning and control. All departments, and service areas submit budgets to the mayor on or about February 20th. The

mayor uses these requests for developing a proposed budget. The mayor submits his proposed budget to the assembly at the first regular assembly meeting in May. The assembly is required to hold public hearings on the proposed budget. The assembly is required by state statute to set the annual mill rate prior to June 15th. The budget is appropriated by fund, department, and object. The mayor is authorized to make transfers within departments and objects. Assembly action is required to transfer between funds and departments or other major budget classifications. Budget-to-actual comparisons are provided in this report for each individual governmental fund for which an annual budget has been appropriated. For the general fund, this comparison is presented on pages 37-38 as part of the basic financial statements for the governmental funds. For governmental funds, other than the General Fund, these comparisons start on page 89.

Factors Affecting Financial Condition

Economy

The Borough's economy has experienced consistent, gradual growth since the late 1980's. Local indicators point to continued growth and stability. Borough wide, the general government tax rate has decreased from 8.59 mills in FY1996 to 6.5 mills in FY2003 and has remained constant at this rate through FY2005. This reduction in the mill rate was made possible by the use of fund balance, which was deemed to be in excess of required amount and taxable property values increasing at a rate faster than expenditures. Sales tax continues to generate a larger portion of the borough's revenue; in FY1998, sales tax revenue represented 21% of total general fund revenues; in FY2004 sales tax revenue represents almost 28%. Oil and gas continues to provide stable employment in the Borough, with gas on the increase and oil on a slow decline. New exploration for natural gas resulted in the construction of a gas line from Ninilchik to Kenai, while two oil production platforms were shut in and taken offline due to poor production levels. Overall oil production decreased to 8,220,000 barrels annually. In future years, an increase in the mill rate or other revenues sources will be necessary to support the current level expenditures.

Long term financial planning

The South Peninsula Hospital and Central Peninsula General Hospital are both in the process of constructing additions to their facilities. The South Peninsula Hospital Service Area issued 20-year Service Area General Obligation bonds through the Alaska Municipal Bond Bank, in the amount of \$10,290,000 on September 30, 2003, annual debt payments are approximately \$800,000. On December 18, 2003, Central Peninsula General Hospital Service Area issued 20-year Service Area General Obligation bonds in the amount of \$47,985,000 for the purpose of expanding their facility, annual debt payments are approximately \$3,750,000. Additionally, the Borough issued 20 year bonds through the Alaska Municipal Bond Bank in the amount of \$14,700,000 for the construction of a new middle school located in Seward, Alaska. Annual debt payments are approximately \$1,100,000 and are eligible for 70% reimbursement from the State of Alaska.

Cash management policies and practices

The Borough utilizes a central treasury to aggregate cash from all funds and the School District for cash management and investment purposes. Interest income on investments is allocated monthly to participating funds based on its average equity balance. Some funds, in particular the Enterprise Funds and the Special Revenue Central Emergency Service Area Fund and the School District, have operating and activity cash that is not aggregated in the central treasury.

The Borough Code of Ordinances authorizes investment in obligations of the U. S. Treasury, its agencies and instrumentalities, bankers' acceptances of the fifty largest banks, investment grade corporate bonds, high rated commercial paper, repurchase agreements, fully collateralized certificates of deposit, money market mutual funds, high rated bonds and notes issued by a state or political subdivision thereof, and the Alaska Municipal League Investment Pool, Inc. The Borough Code of Ordinances also places limitations on maturity of investments. In addition, investment guidelines are contained in an Investment Policy established by the Finance Director and approved by the mayor.

Risk Management

The Borough has a limited self-insurance program, which is administered by a risk management committee. As part of this program, resources are accumulated in an internal service fund to meet potential losses. The Borough has third party coverage's subject to self-insured retentions, which are more fully described in the notes.

Pension and Other Postemployment Benefits

The Borough provides pensions benefits for all eligible employees through the State of Alaska Public Employees Retirement System (PERS). The Borough has no obligations in connection with employee benefits offered through this plan beyond its annual required payment to the pension plan. Employer rates for FY05 was 12.81%, rates are scheduled to be 12.81% for FY06, and increase to 22.81 % in FY07, and to 25.34% in FY08. The increase in rates is necessary to cover the unfunded liability of the plan.

The Kenai Peninsula Borough School District provides pensions benefits for all eligible employees through PERS and Teachers Retirement System (TRS). The school district has no obligations in connection with employee benefits offered through this plan beyond its annual required payments to the pension plans. The school district will also be looking at increases to their PERS and TRS rates

The South Peninsula Hospital (hospital) employees participate in a defined benefit single employer plan. The plan was established and is administered by the hospital's private non-profit operator. Each year, an independent actuary calculates the amount of the annual contribution the non-profit hospital operator must make to the pension plan. As of last valuation date, the non-profit pension plan was funded at 114% of the present value of the projected benefits earned by employees.

The Central Peninsula General Hospital employees participate in a defined contribution pension plan established by the hospital's non-profit operator under Internal Revenue Code 403 (b). Under the plan, the non-profit operator matches employee contributions up to 4% of gross pay.

Additional information on pension arrangements and postemployment benefits can be found starting on page 62 in the notes to the financial statements.

Awards and Acknowledgments

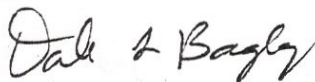
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Kenai Peninsula Borough for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2004. This was the twenty-fourth consecutive year that the Borough has received this prestigious award. In order to be awarded a Certificate of Achievement, the Borough published an easily readable and efficiently organized CAFR, whose contents conformed to program standards. This report satisfied both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the certificate of Achievement Program's requirements and are submitting it to the GFOA to determine its eligibility for another certificate.

In addition, the Borough also received the GFOA's Distinguished Budget Presentation Award for its FY2005 annual budget document. In order to qualify for the Distinguished Budget Presentation Award, the Borough's budget document was judged to be proficient in several categories, including as a policy document, a financial plan, an operations guide, and a communications device.

The preparation of this report was made possible by the dedicated service of the entire staff of the Finance Department. We wish to express our appreciation to all members of the Finance Department who assisted and contributed to the preparation of this report, with a special thanks to Catherine Wallace and Troy Tankersley, Division Managers; Terry Eubank, Auditor/Accountant; Brandi Harbaugh, Treasury Accountant; and Laurie Wood, Administrative Assistant. We also want to thank the finance department staff at the Kenai Peninsula Borough School District, the South Peninsula Hospital, and Central Peninsula General Hospital for their assistance. We also want to thank the members of the Borough Assembly for your interest and support in planning and conducting the financial operations of the Borough in a responsible and progressive manner.

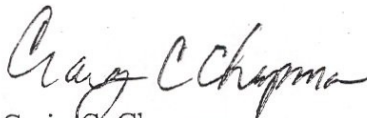
Respectfully submitted,



Dale L. Bagley
Mayor



Scott G. Holt
Director of Finance



Craig C. Chapman
Controller

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Kenai Peninsula Borough,
Alaska

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2004

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



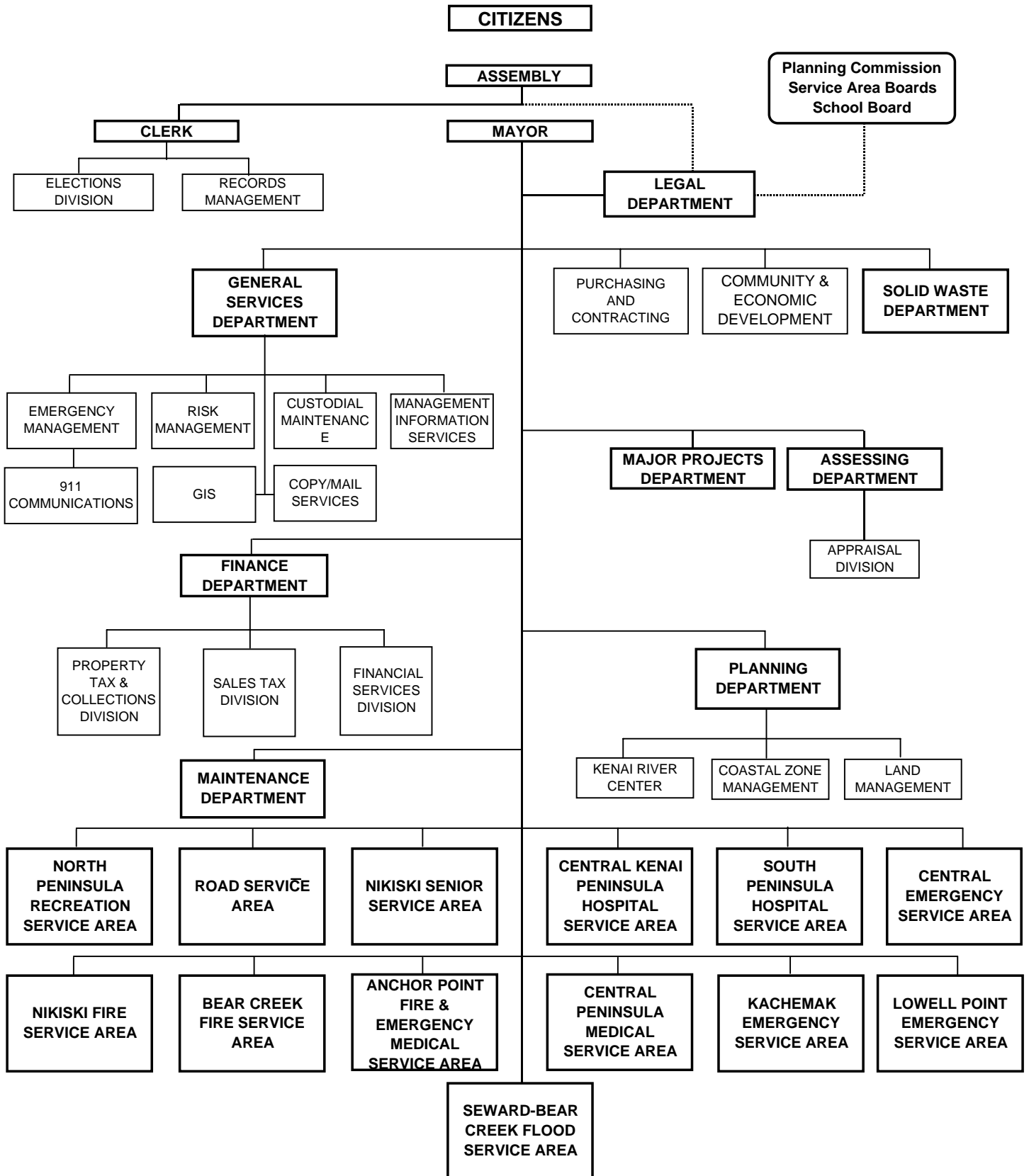
Nancy L. Zielle

President

Jeffrey R. Emmer

Executive Director

KENAI PENINSULA BOROUGH ORGANIZATIONAL CHART



KENAI PENINSULA BOROUGH

List of Principal Officials

Assembly Members

Gary Superman	President
Chris Moss	Vice President
Dan Chay	
Paul Fischer	
Betty Glick	
Ron Long	
Milli Martin	
Grace Merkes	
Pete Sprague	

The legislative power of the Kenai Peninsula Borough is vested in an assembly of nine members. This assembly meets in regular session every first and third Tuesday of the month in the Assembly Chambers located in the Borough Administration Building at 144 North Binkley Street, Soldotna, Alaska.

Administration

Dale Bagley	Borough Mayor
Scott Holt	Finance Director
Colette Thompson	Borough Attorney
Richard Campbell	General Services Director
Sherry Biggs	Borough Clerk
Shane Horan	Assessing Director
Max Best	Planning Director
Walter Robson	Major Projects Director
Dave Tressler	Maintenance Director
Catherine Mayer	Solid Waste Director
Mark Fowler	Purchasing & Contracting Officer

KENAI PENINSULA BOROUGH

Finance Department

Finance Director

Scott Holt

Division Managers

Craig Chapman
Cathey Wallace
Troy Tankersley
Rhonda Krohn

Controller
Budget
Sales Tax
Property Tax

Accounting Staff

Jerri Braun
Tracy Davis
Terry Eubank
Amy Falk
Brandi Harbaugh
Rene Schaffner
Charlene Hibpshman
Robin Horne
DeRay Jones

Becky Karsten
Lauri Lingafelt
Erin Lockwood
Nancy Myers
Marie Payfer
Misty Merriman
Joanne Rodgers
Cathy Wagner
Laurie Wood

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AUDITOR REPORT

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MIKUNDA, COTTRELL & Co.

A Professional Corporation

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

215 Fidalgo, Suite 206 • Kenai, Alaska 99611

(907) 283-3484, Fax (907) 283-5842

Independent Auditor's Report

Members of the Assembly
Kenai Peninsula Borough
Soldotna, Alaska

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the Kenai Peninsula Borough, Alaska, as of and for the year ended June 30, 2005, which collectively comprise the Borough's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Kenai Peninsula Borough's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the Kenai Peninsula Borough, Alaska, as of June 30, 2005, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the General Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 27, 2005 on our consideration of the Borough's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Members of the Assembly
Kenai Peninsula Borough

The management's discussion and analysis, as identified in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Kenai Peninsula Borough's basic financial statements. The introductory section, combining and individual nonmajor fund statements, combining internal service funds statements, capital asset schedules, statistical section and single audit schedules, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund statements, combining internal service fund statements, capital asset schedules, the schedule of expenditures of federal awards and the schedule of state financial assistance are presented for purposes of additional analysis and have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section and the statistical section, as identified in the table of contents, have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Mihumda, Cottrell & Co.

September 27, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

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Management's Discussion and Analysis

As management of the Kenai Peninsula Borough (Borough), we offer the readers of the Borough's financial statements this overview and analysis of the Borough's financial activities for the fiscal year ended June 30, 2005. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal, which can be found on pages 1-5 of this report.

Financial Highlights

- The assets of the Kenai Peninsula Borough exceeded its liabilities at the close of the most recent year by \$348.7 million. Of this amount, \$92.0 million (unrestricted net assets) is legally unreserved and may therefore be used to meet the Borough's ongoing obligations to citizens and creditors. Much of this amount has been previously designated by the Borough assembly for specific purposes and is discussed in more detail on page 23 and page 51.
- At the end of the current fiscal year, unreserved fund balance for the General Fund was \$17.1 million, a decrease of \$2.9 million. Of this amount \$11.8 million was unreserved, undesignated and available for spending. The unreserved, undesignated fund balance for the General Fund represented 20.6% of total General Fund expenditures and transfers. This compares to 26.2% as of June 30, 2004.
- The Borough's total net assets increased \$3.3 million.
- As of the close of the current fiscal year, the Borough's governmental funds reported combined ending fund balances of \$60.5 million, a decrease of \$13.3 million in comparison to the prior year.
- The Borough's total outstanding debt decreased \$3.9 million to a year-end balance of \$88.8 million.

Overview of the Financial Statements

The management discussion and analysis serves as an introduction to the Borough's basic financial statements, which are the government-wide financial statements, fund financial statements, and notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements.

Government-wide financial statements.

The government-wide financial statements report information about the overall finances of the Borough similar to a business enterprise. These statements combine and consolidate short-term, spendable resources with capital assets and long-term obligations.

The statement of net assets presents information on all of the Borough's assets less liabilities, which results in net assets. The statement is designed to display the financial position of the Borough. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Borough is improving or deteriorating.

The statement of activities provides information which shows how the Borough's net assets changed as a result of the year's activities. The statement uses the accrual basis of accounting, which is similar to the accounting used by private-sector business. All of the revenues and expenses are reported regardless of the timing of when cash is received or paid.

The Statement of Net Assets and the Statement of Activities distinguish functions of the Borough that are financed primarily by taxes, intergovernmental revenues, and charges for services (governmental activities) from functions where user fees and charges to customers help to cover all or most of the cost of services (business-type activities). The Borough's governmental activities include general government, solid waste, public safety, recreation, education, and road and trail maintenance. The business-type activities of the Borough are for the operations of two hospitals.

The government-wide financial statements present not only the Borough itself, which is the primary government, but also its component unit, the Kenai Peninsula Borough School District for which the Borough is financially accountable. Financial information for the School District is reported separately from the financial information presented for the primary government itself. The government-wide financial statements can be found on pages 31-32 of this report.

Fund financial statements.

A fund is a grouping of related accounts that is used to maintain control over resources that have segregated for specific activities or objectives. The Borough, like other state and local governments, uses fund accounting to ensure and demonstrate fiscal accountability. All of the funds of the Borough can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental funds financial statements focus on the short-term view of the Borough's operations. Because the focus of government funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for the governmental funds with similar information presented for governmental activities in the government-wide financial statements. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities. The Borough maintains 39 individual governmental funds. Information is presented separately in the Governmental Fund Balance Sheet and Governmental Statement of Revenues, Expenditures, and Changes in Fund Balances for the General Fund and Bond Funded Capital Project Fund. The other 37 governmental funds are combined and shown as Other Governmental Funds on the Governmental Fund Balance Sheet and Governmental Statement of Revenues, Expenditures, and Changes in Fund Balances. Individual fund information for the nonmajor funds is presented in the Combining Balance Sheet Nonmajor Governmental Funds and Combining Statement of Revenues, Expenditures, and Changes in Fund Balances Nonmajor Funds.

The basic governmental fund financial statements can be found on pages 33-38 of this report. Budgetary comparison statements for 15 special revenue funds and 3 debt service funds with annual budgets are provided on pages 84-99 and 112-113 respectively to demonstrate compliance with these budgets.

Proprietary funds.

The Borough maintains two different types of proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The Borough uses enterprise funds to account for its hospitals. Internal service funds are an accounting device used to accumulate and allocate costs internally among the Borough's various functions. The Borough uses internal service funds to account for its risk management and equipment replacement programs. Because these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements. Both internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of combining statements elsewhere in this report.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. Proprietary fund financial statements provide separate information for the Central Peninsula General Hospital and South Peninsula Hospital, both of which are considered to be major funds of the Borough. The basic proprietary fund financial statements can be found on pages 39-43 of this report.

Fiduciary funds.

Fiduciary funds are used to account for assets held by the Borough in a trustee capacity or as an agent for others. Activities from fiduciary funds are not included in the government-wide financial statements because the Borough cannot use these assets for its operations. The accounting for fiduciary funds is much like that used in proprietary funds. The basic fiduciary aggregated fund financial statements can be found on page 44 of this report.

Notes to the financial statements.

The notes provide additional information that is essential to a full understating of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 47-68 of this report.

Other information.

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information. The combining statements referred to earlier in connection with nonmajor governmental funds can be found on pages 71-113 and internal service funds can be found on pages 117-119 of this report.

Government-wide Financial Analysis**Net Assets**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the Borough, assets exceeded liabilities by \$348.7 million, at June 30, 2005 compared to \$345.4 million at June 30, 2004. By far the largest portion of the Borough's net assets (70%) reflects its investment in capital assets (e.g. land, buildings, machinery, etc.) less any related debt used to acquire those assets that are still outstanding. The Borough uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the Borough's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since capital assets themselves cannot be used to liquidate these liabilities. During FY2005, governmental activities capital assets, net of

accumulated depreciation of the Borough increased \$8.8million. Current and other assets include \$75.0 million and \$89.3 million of cash and investments held for government activities at June 30, 2005 and 2004. Governmental activities long-term debt decreased by \$2.0 million or approximately 5.9%. Restricted net assets of \$13.3 and \$23.3 in 2005 and 2004 respectively, result from restrictions imposed legally or externally by creditors, debt covenants, or grantors.

For business-type activities, \$45.1 million (56%) and \$41.1 million (55%) of net assets is unrestricted and may be used to meet the ongoing need of these organizations at June 30, 2005 and 2004. This represents an increase of \$3.9 million or approximately 9.6%. Current and other assets include assets whose use is limited of \$65.7 million and \$70.5 million resulting from restrictions imposed externally by debt covenants and internally by directors.

Net Assets
June 30, 2005
(in millions)

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
Current and other assets	\$ 84.6	\$ 98.8	\$ 104.4	\$ 106.3	\$ 189.0	\$ 205.1
Capital assets	230.6	221.8	44.5	37.2	275.1	259.0
Total assets	<u>315.2</u>	<u>320.6</u>	<u>148.9</u>	<u>143.5</u>	<u>464.1</u>	<u>464.1</u>
Long-term debt outstanding	31.9	33.9	58.9	60.9	90.8	94.8
Other liabilities	15.4	16.5	9.2	7.5	24.6	24.0
Total liabilities	<u>47.3</u>	<u>50.4</u>	<u>68.1</u>	<u>68.4</u>	<u>115.4</u>	<u>118.8</u>
Net assets						
Invested in capital assets, net of related debt	207.8	206.0	35.7	34.0	243.5	240.0
Restricted	13.2	23.3	0.0	0.0	13.2	23.3
Unrestricted	<u>46.9</u>	<u>40.9</u>	<u>45.1</u>	<u>41.1</u>	<u>92.0</u>	<u>82.0</u>
Total net assets	<u>\$ 267.9</u>	<u>\$270.2</u>	<u>\$ 80.8</u>	<u>\$ 75.1</u>	<u>\$ 348.7</u>	<u>\$ 345.3</u>

Governmental activities.

Governmental activities decreased the Borough's net assets by \$2.3 million. This compares to a decrease of \$5.3 million for the year ended June 30, 2004. Key elements of this is as follows:

- Construction of a new Middle School in Seward with capitalized cost incurred during FY05 of \$6.5 million and a new landfill with capitalized cost incurred of \$4.2 million.
- Continued spending of the General Fund, fund balance to offset increases in expenditures.
- Investment earnings increased \$2.3 million when compared to FY04. In FY04, unrealized losses of \$2.8 million were recognized versus \$.9 million in FY05.
- Total funding for education increased \$2.1 million.

- Public safety cost decreased \$1.1 million. The largest fact of this decrease was a reduction in spending on the Spruce Bark Beetle program of \$.7 million.

Business-type activities.

Business type activities increased the Borough’s net assets by \$5.6 million. This compares to an increase of \$2.8 million for the year ended June 30, 2004. Key elements of this is as follows:

- Decrease in loss from operations at South Peninsula Hospital from \$1.5 million in the year ended June 30, 2004 to \$.3 million in the year ended June 30, 2005.
- Net patient service revenue at Central Peninsula Hospital increased 8% as a result of strong outpatient volume and price increases.
- Patient revenue at South Peninsula Hospital increased 13% mainly as a result of increased surgical coverage.
- Both hospitals have embarked on expansion projects. Central Kenai Peninsula General Hospital has started a \$49.9 million remodel and expansion to their current facility. Ground breaking was held in June 2004, completion is expected in 2006. Bonds in the amount of \$47.3 million were sold in December 2003 to finance the expansion. South Peninsula General Hospital has started a \$17.0 million remodel and expansion to their current facility. Ground breaking is scheduled for 2006, completion is expected to be in 2008. Bonds in the amount of \$10.3 million were sold September 2003, the balance of the project is being financed with internal sources.

The net assets for the Borough’s business-type activities are \$80.8 million. As with the governmental activities, a substantial portion (56%) of the net assets is invested in capital assets. The Borough uses these assets to provide services to the citizens. The unrestricted net assets of the business-type activities are \$45.1 million as of June 30, 2005 compared to \$41.1 million at June 30, 2004.

Changes in net assets.

The Borough’s total revenues and expenses for governmental and business-type activities are reflected in the following chart:

	Governmental Activities		Business-type Activities		Total	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Revenues:						
Program revenues:						
Charges for services	\$ 1.7	\$ 1.5	\$ 74.5	\$ 67.2	\$ 76.2	\$ 68.7
Operating grants and contributions	3.3	2.2	-	-	3.3	2.2
Capital grants and contributions	1.7	2.2	-	-	1.7	2.2

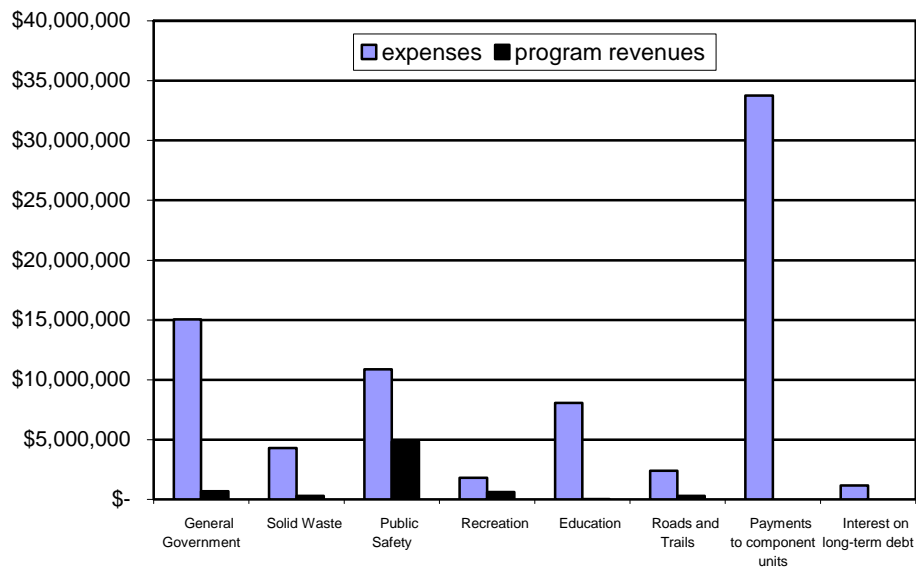
General revenues:						
Property taxes	42.1	42.7	4.6	3.0	46.7	45.7
Sales taxes	15.7	14.9	-	-	15.7	14.9
Other	10.6	8.9	.6	.1	11.2	9.0
Total revenues	<u>75.1</u>	<u>72.4</u>	<u>79.7</u>	<u>70.3</u>	<u>154.8</u>	<u>142.7</u>

Expenses:						
General government	15.0	13.8	-	-	15.0	13.8
Solid waste	4.3	4.5	-	-	4.3	4.5
Public safety	10.9	11.6	-	-	10.9	11.6
Recreation	1.8	1.4	-	-	1.8	1.4
Education	8.1	9.1	-	-	8.1	9.1
Road and trails	2.4	4.4	-	-	2.4	4.4
Payments to component unit- Kenai Peninsula Borough						
School District	33.7	31.6	-	-	33.7	31.6
Interest on long-term debt	1.2	1.3	-	-	1.2	1.3
Hospitals	-	-	74.0	67.5	74.0	67.5
Total expenses	<u>77.4</u>	<u>77.7</u>	<u>74.0</u>	<u>67.5</u>	<u>151.4</u>	<u>145.2</u>

Increase (decrease) in net assets	(2.3)	(5.3)	5.7	2.8	3.4	(2.5)
Net assets, beginning of year	<u>270.2</u>	<u>275.5</u>	<u>75.1</u>	<u>72.3</u>	<u>345.3</u>	<u>347.8</u>
Net assets, end of year	<u>\$267.9</u>	<u>\$270.2</u>	<u>\$80.8</u>	<u>\$75.1</u>	<u>\$348.7</u>	<u>\$345.3</u>

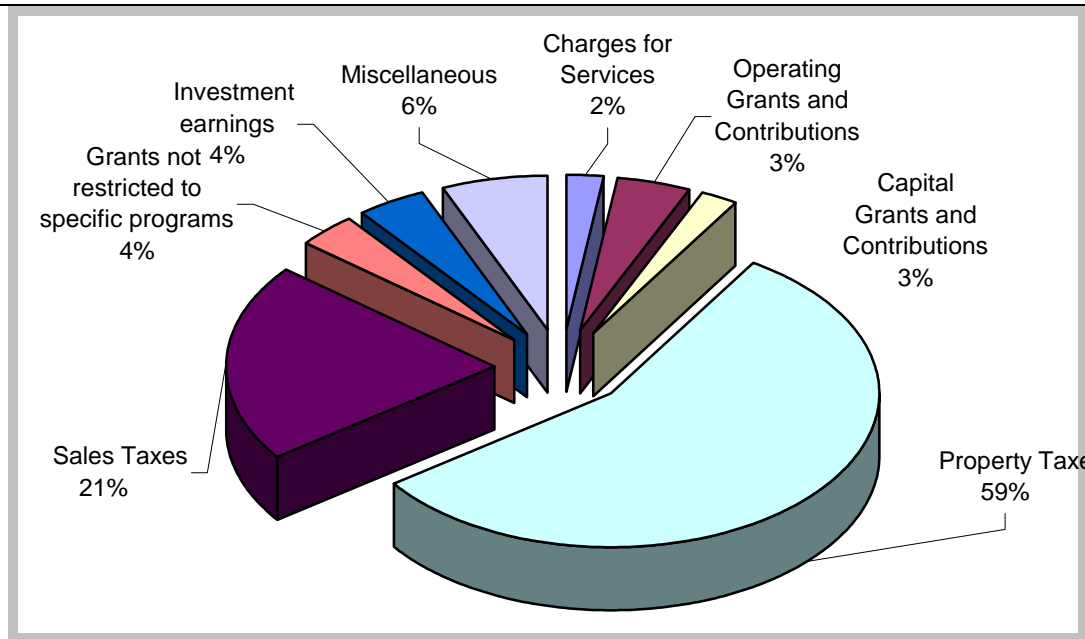
Expenses and Program Revenues – Governmental Activities

The graph shown below compares program expenses with associated revenues. It should be noted that revenue generated through sales and property tax are considered general revenues and are therefore not included on this graph.



Revenues by Source – Governmental Activities

The graph shown below depicts all sources of revenues, both program and general.



Financial Analysis of the Government's Funds

As noted earlier, the Borough uses fund accounting to ensure and demonstrate compliance with finance related legal requirements.

Governmental funds.

The focus of the Borough's governmental funds is to provide information on near-term inflow, outflows, and balances of spendable resources. Such information is useful in assessing the Borough's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Did the Borough generate enough revenue to pay for current obligations? What is available for spending at the end of the year?

At the end of the current fiscal year, the Borough's governmental funds reported combined ending fund balances of \$60.5 million, a decrease of \$13.3 million in comparison with the prior year. A portion of this amount is reserved to indicate it is not available to new spending because it has already been committed: 1) to liquidate contracts and purchase orders of the prior period 2) to liquidate prepaid expenses, 3) or for other restricted purposes. The remainder of fund balance is unreserved (\$54.3); and is available for spending at the government's discretion.

The General Fund is the chief operating fund of the Borough. At the end of the current fiscal year, total fund balance was \$17.2 million, unreserved fund balance was \$17.1 million, and unreserved undesignated fund balance was \$11.8 million. Total fund balance decreased \$3.1 million from the prior year. Key factors include:

- Continued use of fund balance to support expenditures. The Borough developed a fund balance policy in 1999 that determined fund balance was in excess of needed amounts and reduced the mill rate. By reducing the mill rate, the Borough authorized the use of fund balance to support expenditures. The Borough is currently within the fund balance range .
- An increase in funding to the Kenai Peninsula Borough School District in the amount of \$2.1 million.

Proprietary funds.

The Borough's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. Unrestricted net assets of the hospitals at the end of the year were \$45.1 million. Other factors concerning the finances of the proprietary funds have already been addressed in the discussion of the of the Borough's business-type activities.

General Fund Budgetary Highlights

During the year there were increase of \$872,886 in appropriations between the original budget and the final amended budget. They were relatively minor, were financed by an appropriation of fund balance and can be briefly summarized as follows:

- Mayor
 - \$13,100 to cover health insurance cost in excess of budgeted amounts.
 - \$ 2,000 transferred to Kenai River Center for Watershed Forum sponsorship.
- Legal Department
 - \$30,000 to cover cost associated with Board of Equalization hearings.
- Finance
 - \$48,400 to cover health insurance cost in excess of budgeted amounts.
- Assessing
 - \$35,000 to cover cost associated with Board of Equalization hearings.
 - \$51,500 to cover health insurance cost in excess of budgeted amounts.
 - \$80,000 to cover cost associated with Oil and Gas Company audit.
- Planning
 - \$10,000 to cover health insurance cost in excess of budgeted amounts.
- Public Safety
 - \$16,500 to cover cost associated with a new 911 dispatcher.
- Transfers
 - \$322,551 additional funding for the Kenai Peninsula Borough School District.
 - \$37,500 to supplement the Solid Waste capital improvements at the Tyonek Landfill.
 - \$239,835 transferred to capital projects for the Emergency Response Center.
 - \$3,000 match from Planning (\$1,000) and Mayors (\$2,000) departments for sponsorship of a floodplain management workshop.

Variations between the final budget and actual revenues and expenditures include the following:

- Interest earnings came in approximately \$1,000,000 more than budgeted due to reduction in unrealized losses from prior year and increase in rates during the year.
- Sales tax came in \$700,000 more than budgeted, mainly due to a strong fishing season in the summer of 2004.
- Personnel cost were \$400,000 less than budgeted due to positions not being filled.
- Contract services were \$185,000 less than budgeted as projects previously authorized were delayed or canceled.

Capital Assets and Debt Administration

Capital assets.

The Borough's investment in capital assets for its governmental and business-type activities as of June 30, 2005 amounts to \$275.1 million (net of accumulated depreciation), an increase of \$16.1 million from the prior year. This investment in capital assets includes land, buildings, machinery and equipment, roads, and infrastructure.

Major additions to capital assets during the current fiscal year included the following:

Various major repairs and additions to school facilities	\$8.4 million
Capital improvements/equipment at the Borough's Two hospitals	\$9.5 million
Various major repairs and additions to Borough landfills	\$4.6 million
A variety of major repairs for existing roads and bridges	\$1.5 million
Various major repairs and additions to public safety facilities	\$2.3 million

Kenai Peninsula Borough Capital Assets (in millions, net of depreciation)

	Governmental activities		Business-type activities		Total	
	2005	2004	2005	2004	2005	2004
Land & Improvements	\$ 62.8	\$ 63.2	\$ 1.0	\$ 1.0	\$ 63.8	\$ 64.2
Buildings	126.0	129.6	20.0	21.3	146.0	150.9
Improvements other than buildings	12.4	13.8	.1	-	12.5	13.8
Machinery and equipment	7.1	6.4	11.2	11.5	18.3	17.9
Infrastructure	3.9	2.3	-	-	3.9	2.3
Construction in progress	18.4	6.5	12.2	3.4	30.6	9.9
Total governmental funds capital assets	<u>\$230.6</u>	<u>\$221.8</u>	<u>\$ 44.5</u>	<u>\$ 37.2</u>	<u>\$ 275.1</u>	<u>\$ 259.0</u>

Additional information on the Borough's capital assets can be found in Note E on pages 58-59 of this report.

Long-term debt.

At the end of the current fiscal year, the Borough had total debt outstanding of \$88.8 million, (not including bond premium) a decrease of \$3.9 million from June 30, 2004. Of this amount, \$81.6 million was bonded and backed by the full faith and credit of the Borough or Service Areas of the Borough. The remaining debt consists of debt secured by equipment, for pension obligation, and landfill closure cost.

Kenai Peninsula Borough Outstanding Debt
(in millions)

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
General Obligation bonds	\$ 25.5	\$ 28.7	\$ 56.6	\$ 58.3	\$ 82.1	\$ 87.0
Other debt	6.4	5.2	.3	.5	6.7	5.7
Total outstanding debt	<u>\$ 31.9</u>	<u>\$ 33.9</u>	<u>\$ 56.9</u>	<u>\$ 58.8</u>	<u>\$ 88.8</u>	<u>\$ 92.7</u>

Additional information on the Borough's long-term debt can be found in note H on pages 61-63 of this report.

The Borough's general obligation bonds that were sold in December 2003, received a rating of Aaa from Moody's Investors Services.

Economic Factors and the Next Year's Budget and Rates

Unemployment stood at 9.6%, which is above the national average of 6%. In 2001, the Borough established a fund balance policy. The results of this policy indicated that the General Fund, fund balance was in excess of both the minimum amount and the maximum amount. With fund balance in excess of allowable amounts, the Borough was able to reduce the mill rate from 8.0 mills in FY2000 to 7.5 in FY2001, to 7.0 mills in FY2002 and to 6.5 mills in FY2003. The mill rate stayed at 6.5 mills for FY2004 and FY2005.

At the end of FY2006, the Borough's fund balance will be at the minimum amount allowed by Borough ordinance. In order to maintain compliance with this policy, additional revenues, a reduction in expenditures, or a combination will be needed in an amount equal to 1.7 mills.

In setting the budgets for FY2006, the Borough considered a number of issues with Borough wide impact, among them:

- A sufficient level of funding necessary to meet the needs of Borough residents, visitors and communities.
- A reduction in State of Alaska funding for Revenue Sharing and Safe Communities. These programs had provided annual funding to the Borough of approximately \$1.5 million.
- A continued reduction in the historical variance between budget and actual revenues and expenditures.

- Maintenance of the borough's financial condition including compliance with the borough's fund balance policy.
- The highest level of local educational funding that borough residents can reasonably afford and sustain.
- A high quality capital and operational maintenance program that ensures the continued use and economic value of borough assets.

All of these factors were considered in preparing the Borough's budget for FY2006.

Request for Information

This financial report is designed to provide a general overview of the Borough's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Director of Finance, Kenai Peninsula Borough, 144 N. Binkley, Soldotna, Alaska, 99669.

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