

COMPREHENSIVE
ANNUAL FINANCIAL REPORT
OF THE
KENAI PENINSULA BOROUGH
ALASKA

FOR THE FISCAL YEAR ENDED
JUNE 30, 2005

DALE BAGLEY
BOROUGH MAYOR

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

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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

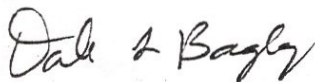
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Kenai Peninsula Borough for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2004. This was the twenty-fourth 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.

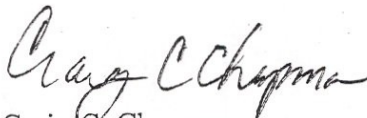
Respectfully submitted,



Dale L. Bagley
Mayor



Scott G. Holt
Director of Finance



Craig C. Chapman
Controller

AUDITOR REPORT

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INTERNAL SERVICE FUNDS

CAPTIAL ASSETS

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