Washington State Auditor
Brian Sonntag

INDEPENDENT AUDITOR'S REPORT

June 30, 2006

The Honorable Ron Sims, County Executive
King County
Seattle, Washington

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of King County, Washington, as of and for the year ended December 31, 2005, as listed in the table of contents. These financial statements are the responsibility of the County's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Public Transportation Fund and the Water Quality Fund, which are both major funds and represent 92 percent, 89 percent and 87 percent, respectively, of the assets, net assets, and revenues of the County's business-type activities. We also did not audit the financial statements of the Harborview Medical Center, which statements reflect 57 percent, 57 percent, and 98 percent, respectively, of the assets, net assets and revenues of the aggregate discretely presented component unit information. These financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the Public Transportation Fund, the Water Quality Fund, and Harborview Medical Center, is based solely on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the King County, Washington, as of December 31, 2005, and the respective changes in financial position and cash flows, where applicable, thereof, and the respective budgetary comparison for the General Fund and Public Health Fund funds, for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1, during the year ended December 31, 2005, the County has implemented the Governmental Accounting Standards Board's Statement 40, Deposit and Investment Risk Disclosures.

The management's discussion and analysis on pages 3 through 20 and infrastructure modified approach information on pages 115 through 117 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. 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 performed for the purpose of forming opinions on the financial statements that collectively comprise the County's basic financial statements. The accompanying information listed as combining financial statements and supplemental information on pages 119 through 226 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The information identified in the table of contents as the introductory and Statistical Sections is presented for purposes of additional analysis and is not a required part of the basic financial statements of the County. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of King County's (the County) Comprehensive Annual Financial Report (CAFR) presents a narrative overview and analysis of the financial activities of the County for the year ended December 31, 2005. We encourage readers to consider this information in conjunction with the additional information that is furnished in the letter of transmittal, which can be found preceding this narrative, and with the County's financial statements and notes to the financial statements, which follow.

FINANCIAL HIGHLIGHTS – PRIMARY GOVERNMENT

- As of December 31, 2005, the assets of the County exceeded its liabilities by $3,262.5 million (net assets). Because all of the County's net assets are either invested in capital assets or restricted as to use, the combined unrestricted net assets showed a $314.6 million deficit at the end of the year.
- In 2005 the County's total net assets increased by 9.6 percent or $285.3 million. The governmental net assets increased by 20.8 percent or $258.6 million, and the business-type net assets increased by 1.5 percent or $26.7 million.
- As of December 31, 2005, the County's governmental funds reported combined ending fund balances of $417.0 million. Approximately 71 percent or $294.8 million is unreserved fund balance available for spending at the government's discretion within the purposes specified for the County's funds.
- At the end of 2005 the unreserved, undesignated fund balance for the General Fund was $96.6 million, amounting to 19.9 percent of total General Fund expenditures for 2005. Total fund balance for the General Fund increased 18.1 percent or $22.0 million for the year.
- The County's total bonded debt increased by 2.7 percent or $80.5 million in 2005 due primarily to issuance of $200 million of general obligation bonds payable from sewer revenue offset by $116.5 million of debt service principal payments made during the year.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the County's basic financial statements which include three components: (1) government-wide financial statements; (2) fund financial statements; and (3) notes to the financial statements. This report also contains required supplementary information and other supplementary information in addition to the basic financial statements.

Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the County's finances in a manner similar to a private sector business. The statements provide short-term and long-term information about the County's financial position, which assists in assessing the County's financial condition at the end of the fiscal year. These statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This means they follow methods that are similar to those used by most businesses, taking into account all revenues and expenses connected with the fiscal year,

even if cash involved has not been received or paid. The government-wide financial statements include two statements:

The **statement of net assets** presents all of the County's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in the County's net assets may serve as a useful indicator of whether the financial position of the County is improving or deteriorating.

The **statement of activities** presents information showing how the County's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. As a result, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods, such as revenues pertaining to uncollected taxes and expenses pertaining to earned but unused vacation and sick leave.

Both of the government-wide financial statements have separate sections for three different types of County programs or activities:

Governmental activities. The activities in this section are principally supported by taxes and intergovernmental revenues. Most of the County's basic services fall into this category, including general government; law, safety and justice; physical environment; transportation; economic environment; mental and physical health; culture and recreation; and debt service. Also included within the governmental activities are the operations of the County's four flood control zone districts, of which only one is currently active. Although legally separate from the County, these component units are blended with the primary government (King County) because of their governance relationship with the County.

Business-type activities. These functions are intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services. These business-type activities include the operation of the County's public transportation system, wastewater treatment facilities, solid waste disposal facilities, airport, and other services.

Discretely presented component units. The government-wide financial statements include not only King County itself as the primary government, but also four legally separate entities for which the County is financially accountable: the Harborview Medical Center (HMC), the Washington State Major League Baseball Stadium Public Facilities District (PFD), the Cultural Development Authority (CDA) of King County, doing business as 4Culture, and Flood Control Zone Districts. Financial information for the first three of these component units is reported separately from the financial information presented for the primary government itself in a single, aggregated presentation in the government-wide financial statements. Individual financial statements for each component unit can be found immediately following the fiduciary funds financial statements in the Basic Statements section of this report. Financial data for the fourth entity, Flood Control Zone Districts, are presented as part of the primary government on a blended basis and are classified as Special Revenue funds.

Fund Financial Statements

The fund financial statements are designed to report information about groupings of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the County can be divided into three categories: **governmental** funds, **proprietary** funds, and **fiduciary** funds.

Governmental funds. Most of the basic services provided by the County are financed through governmental funds. Governmental funds are used to account for essentially the same functions that are reported as governmental activities in the government-wide financial statements. Unlike the government-wide financial statements, however, the governmental funds financial statements focus on how cash and other financial assets can readily be converted to available resources, and the balances left at year-end that are available for future spending. Such information may be useful in determining whether there will be adequate financial resources available to meet the current needs of the County.

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

The County maintains a general fund and several other individual governmental funds organized according to their type (special revenue, debt service, and capital projects). Two governmental funds, the General Fund and the Public Health Fund, are considered to be major funds for financial reporting purposes. Each of the major funds is presented in a separate column in the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances. Data from the other governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor funds is provided in the form of combining and subcombining statements in the Governmental Funds section of this report, following the Basic Statements section.

The County adopts an annual budget appropriated at the department/division level for the General Fund and at the fund level for the Public Health Fund. A budgetary comparison statement has been provided for each of the two major governmental funds.

The basic governmental funds financial statements can be found immediately following the government-wide statements.

Proprietary funds. Proprietary funds are generally used to account for services for which the County charges customers a fee. Proprietary funds provide the same type of information as shown in the government-wide financial statements, only in more detail. Like the government-wide financial statements, proprietary funds financial statements use the accrual basis of accounting. The basic proprietary funds financial statements can be found immediately following the governmental funds financial statements.

The County maintains the following two 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 proprietary funds financial statements provide separate information for the Water Quality Enterprise and the Public Transportation Enterprise, both considered to be major funds of the County for financial reporting purposes. All other enterprise funds are aggregated into a single presentation within the proprietary funds financial statements.

Internal service funds are used to report activities that provide services to the County's other programs and activities on a cost reimbursement basis. The County uses internal service funds to account for its motor pool, information and telecommunications services,

facilities management, risk management, employee benefits, and financial and various other administrative services. These services predominantly benefit governmental rather than business-type functions and have been included within governmental activities in the government-wide financial statements. One internal service fund that provides equipment and fleet maintenance and procurement for the Water Quality Enterprise is included within the business-type activities in the government-wide financial statements but is combined with all other internal service funds into a single aggregated presentation in the proprietary funds financial statements.

Individual fund data for each of the nonmajor proprietary funds is provided in the form of combining statements found in the Proprietary Funds section of this report.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds include the investment trust funds, used to report investment activity conducted by the County on behalf of legally separate entities, such as special districts and public authorities that are not part of the County's reporting entity, and the agency funds. Since the resources of these funds are not available to support the County's own programs, they are not reflected in the government-wide financial statements. The accounting used for fiduciary funds is much like that used for proprietary funds. The basic fiduciary funds financial statements can be found immediately following the proprietary funds financial statements.

Individual fund data for each of the fiduciary funds is provided in the form of combining statements that can be found in the Fiduciary Funds section of this report.

Notes to the financial statements

The notes provide additional information essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found immediately following the individual component unit financial statements in the Basic Statements section of this report.

Other information

Required supplementary information. In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information on infrastructure assets reported using the modified approach. The required supplementary information immediately follows the notes to the financial statements in the Basic Statements section of this report.

Combining Statements. The combining and subcombining statements, referred to earlier, are presented in separate sections immediately following the required supplementary information.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Analysis of Net Assets

Net assets may serve over time as a useful indicator of a government's financial position. As indicated in the condensed financial information on the following page, which was derived from the government-wide Statement of Net Assets, the County's combined net assets (governmental and business-type activities) were $3,262.5 million at the end of 2005. This is an increase of 9.6 percent or $285.3 million over the net assets of the previous year, as restated.

Governmental activities. Although net assets of the County's governmental activities increased 20.8 percent to $1,503.7 million, all of the net assets are either subject to external restrictions as

to how they may be used, or are invested in capital assets (e.g., land, buildings, infrastructure, right-of-way, equipment, and work in progress) less any related outstanding debt used to acquire those assets. Consequently, unrestricted net assets for governmental activities showed a $408.4 million deficit at the end of 2005. This is a 12.2 percent or $56.7 million decrease in the deficit in unrestricted net assets from that of fiscal year-end 2004.

Net Assets as of December 31, 2005
(in thousands)

	Governmental Activities		Business-type Activities		Total	
	2005	2004 [a]	2005	2004 [a]	2005	2004 [a]
Assets						
Current and other assets	$ 886,496	$ 784,720	$ 825,120	$ 676,414	$ 1,711,616	$ 1,461,134
Capital assets	2,208,545	2,054,196	3,398,347	3,255,960	5,606,892	5,310,156
Total Assets	3,095,041	2,838,916	4,223,467	3,932,374	7,318,508	6,771,290
Liabilities						
Long-term liabilities	1,310,429	1,399,620	2,144,772	1,955,781	3,455,201	3,355,401
Other liabilities	280,961	194,261	319,834	244,427	600,795	438,688
Total Liabilities	1,591,390	1,593,881	2,464,606	2,200,208	4,055,996	3,794,089
Net Assets						
Invested in capital assets, net of related debt	1,622,170	1,448,891	1,353,356	1,362,113	2,975,526	2,811,004
Restricted	289,894	261,227	311,665	283,105	601,559	544,332
Unrestricted	(408,413)	(465,083)	93,840	86,948	(314,573)	(378,135)
Total net assets	$ 1,503,651	$ 1,245,035	$ 1,758,861	$ 1,732,166	$ 3,262,512	$ 2,977,201

(a) Current and other assets, Other liabilities, and Unrestricted net assets have been restated, see Note 15, "Restrictions, Reserves, Designations, and Changes in Equity" – Restatements of Beginning Balances.

This deficit does not mean that the County's governmental activities do not have resources available to pay their obligations in the coming year. The increase in net assets for governmental activities in 2005 reflects the County's ability, on an annual basis, to meet its current obligations in those activities including the related debt service requirements. The deficit in the unrestricted net assets is the result of the governmental activities having long-term commitments that are greater than currently available resources. Specifically, the County's governmental activities include general obligation debt of $565.4 million, $39.3 million less than at the end of 2004, for which no corresponding assets are recorded but for which future revenues are obligated.

Of the amount of debt with no corresponding assets, 75.7 percent or $427.8 million is related to assets that are recorded on the books of two of the County's three discretely presented component units: the Washington State Major League Baseball Stadium PFD ($207.4 million), and the Harborview Medical Center ($220.4 million). As discretely presented component units, these entities are not part of the primary government or incorporated into this analysis. The remainder of the debt, for which there are no corresponding assets, consists of $109.9 million associated with the Kingdome facility, which was demolished to make room for the Seahawks (Qwest) Football Stadium, and $27.6 million used to finance assets that have been contributed by the County to other programs and services that benefit the citizens of the County.

Business-type activities. There was an increase of 1.5 percent to $1,758.9 million in net assets of the business-type activities. Of the total net assets for business-type activities, 77.0 percent or $1,353.4 million is invested in capital assets (e.g., land, buildings, vehicles, plant assets, equipment, and work in progress), net of related debt. The business-type activities use these capital assets to provide services to their customers; consequently, these assets are not available for future spending. The resources needed to repay the debt incurred to acquire these assets must be provided from other sources since the capital assets themselves cannot be liquidated for these liabilities. Another 17.7 percent of the total net assets for the business-type activities is restricted as to use for capital construction ($201.9 million), debt service ($106.4 million), and other purposes ($3.4 million). The remaining 5.3 percent or $93.8 million is unrestricted net assets that may be used to finance the continuing operations of the County's business-type activities. Any balance in the unrestricted net assets for business-type activities cannot be used to reduce the unrestricted net asset deficit in governmental activities.

The combination of the $408.4 million deficit in the governmental activities unrestricted net assets and the $93.8 million positive balance in the business-type activities unrestricted net assets resulted in the deficit of $314.6 million in total unrestricted net assets for the County as a whole.

Analysis of Changes in Net Assets

The increase in 2005 in the County's total net assets resulted from revenues exceeding related expenses and reflects the County's ability to meet its ongoing obligations including its debt service requirements. Approximately 41.3 percent of the County's total revenues came from taxes, primarily Property taxes and the Retail sales and use taxes. Charges for various goods and services provided 38.2 percent of the total revenues, while 18.6 percent was derived from operating and capital grants and contributions (including state and federal assistance). The County's expenses cover a range of services, the largest of which were for law, safety and justice; mental and physical health; public transportation; and water quality.

The condensed financial information on the following page is derived from the government-wide Statement of Activities and reflects how the County's net assets changed during the 2005 fiscal year.

Governmental activities. Governmental activities accounted for 90.6 percent of the total growth in net assets of the County, resulting in an increase in the County's governmental activities net assets of $258.6 million. Program revenues for governmental activities total $805.7 million and include the amount paid by those who directly benefited from the programs ($455.8 million), and by other governments and organizations that subsidized certain programs with operating grants and contributions ($193.3 million), and capital grants and contributions ($156.6 million). In 2005 the cost of all governmental activities was $1,229.6 million. The County paid for the $424.0 million remaining "public benefit" portion of governmental activities with $447.0 million in property taxes, $138.6 million in retail sales and use taxes, and $96.0 million in other revenues, including other taxes and interest earnings. As discussed earlier, all of the increase in governmental activities net assets was either restricted as to use or used to acquire capital assets to provide services to the County's citizens.

Changes in Net Assets
For the Year Ended December 31, 2005
(In thousands)

	Governmental Activities		Business-type Activities		Total	
	2005	2004 [a]	2005	2004 [a]	2005	2004 [a]
Revenues						
Program revenues						
Charges for services	$ 455,768	$ 447,303	$ 464,344	$ 442,448	$ 920,112	$ 889,751
Operating grants and contributions	193,299	182,333	14,141	35,715	207,440	218,048
Capital grants and contributions	156,613	97,108	83,987	91,381	240,600	188,489
General revenues						
Property taxes	447,041	433,593	-	-	447,041	433,593
Retail sales and use taxes	138,572	128,610	341,149	314,192	479,721	442,802
Other taxes	67,617	66,956	-	-	67,617	66,956
Unrestricted interest earnings	28,352	18,395	16,397	9,737	44,749	28,132
Total revenues	1,487,262	1,374,298	920,018	893,473	2,407,280	2,267,771
Expenses[b]						
General government [c]	85,544	79,613	-	-	85,544	79,613
Law, safety and justice	476,530	475,074	-	-	476,530	475,074
Physical environment	51,828	58,024	-	-	51,828	58,024
Transportation	90,091	70,786	-	-	90,091	70,786
Economic environment	87,438	76,331	-	-	87,438	76,331
Mental and physical health [d]	346,681	504,261	-	-	346,681	504,261
Culture and recreation	36,988	38,973	-	-	36,988	38,973
Interest and other debt service costs	54,538	49,383	-	-	54,538	49,383
Airport	-	-	15,537	12,344	15,537	12,344
Public transportation	-	-	529,679	508,290	529,679	508,290
Solid waste	-	-	95,457	78,003	95,457	78,003
Water quality	-	-	245,870	239,670	245,870	239,670
Other enterprises activity	-	-	5,788	6,155	5,788	6,155
Total expenses	1,229,638	1,352,445	892,331	844,462	2,121,969	2,196,907
Increase in net assets before transfers	257,624	21,853	27,687	49,011	285,311	70,864
Transfers	992	486	(992)	(486)	-	-
Increase in net assets	258,616	22,339	26,695	48,525	285,311	70,864
Net assets, beginning of year (Restated)	1,245,035	1,222,696	1,732,166	1,683,641	2,977,201	2,906,337
Net assets, end of year	$ 1,503,651	$ 1,245,035	$ 1,758,861	$ 1,732,166	$ 3,262,512	$ 2,977,201

(a) Net assets, beginning of year has been restated, see Note 15, "Restrictions, Reserves, Designations, and Changes in Equity" – Restatements of Beginning Balances.

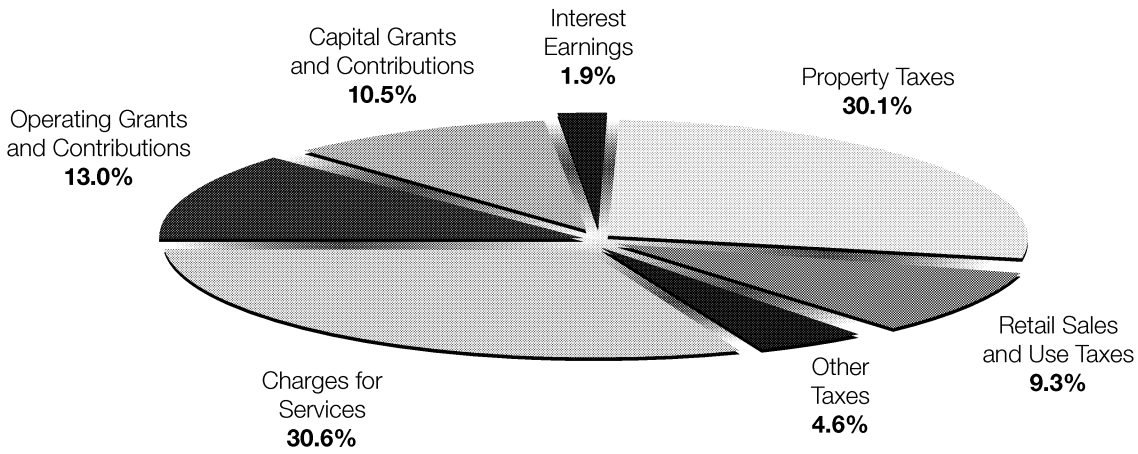
(b) Expenses for all functions include the allocation of indirect expenses from the general government function. The amount of indirect general government expenses allocated to each function is shown in a separate column on the County's government-wide Statement of Activities alongside the column that reflects the direct operating expenses incurred by each function. As a result of this allocation, the $85.5 million in General government expense above consists of $119.9 million in direct program expenses and loss on disposal (transfer) of capital assets of $26.9 million reduced by a net allocation of $61.3 million to other County functions.

(c) General government expenses includes loss on sale/disposal of capital assets of $26.9 million and $38.0 million in 2005 and 2004, respectively. The 2005 loss of on sale/disposal of capital assets includes the write-off of $15.2 million of costs from the Financial System Replacement Project.

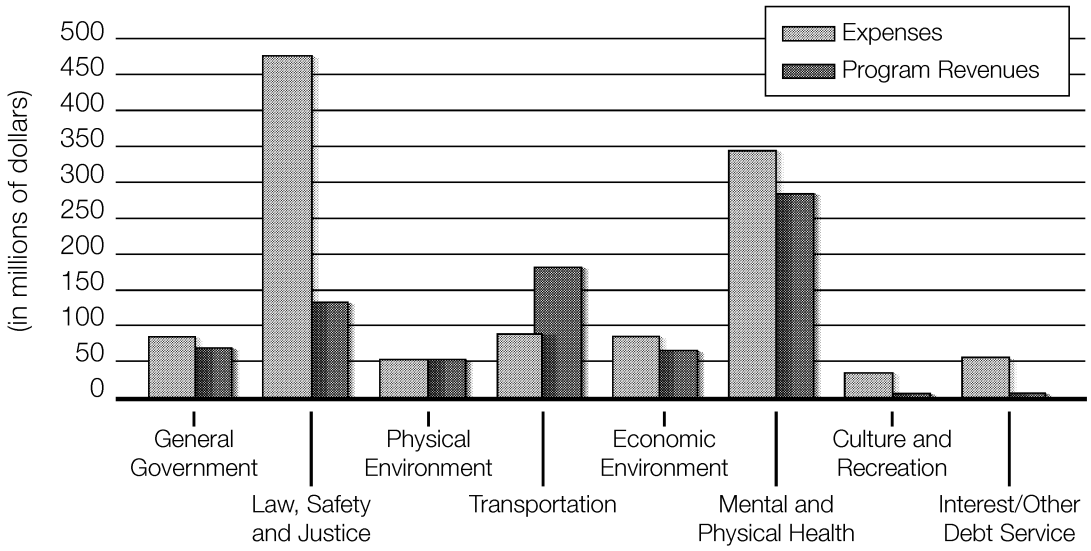
(d) 2004 Mental and physical health expenses includes $165.3 million of expenses related to the issuance of unlimited tax general obligation bonds for the component unit Harborview Medical Center (HMC). While King County retains the liability for the bonds, the bond proceeds were transferred to HMC.

The charts below illustrate the County's revenues by source and its expenses and program revenues by function for its governmental activities:

Revenue by Source – Governmental Activites
2005



Expenses and Program Revenues – Governmental Activites
2005



Charges for services provided 30.6 percent, and property taxes 30.1 percent, of total revenues for governmental activities. One of the most significant expense amounts is for Law, safety and justice, a function that requires the greatest usage of general government revenues. The primary revenue sources for Mental and physical health are charges for services and operating grants and contributions, which paid for 82.6 percent of the activities for that function. In 2005 Transportation received $128 million in infrastructure and right-of-way capital assets from developers, which enabled program revenues to exceed expenses. These capital contributions accounted for nearly half of the 2005 increase in governmental activities net assets.

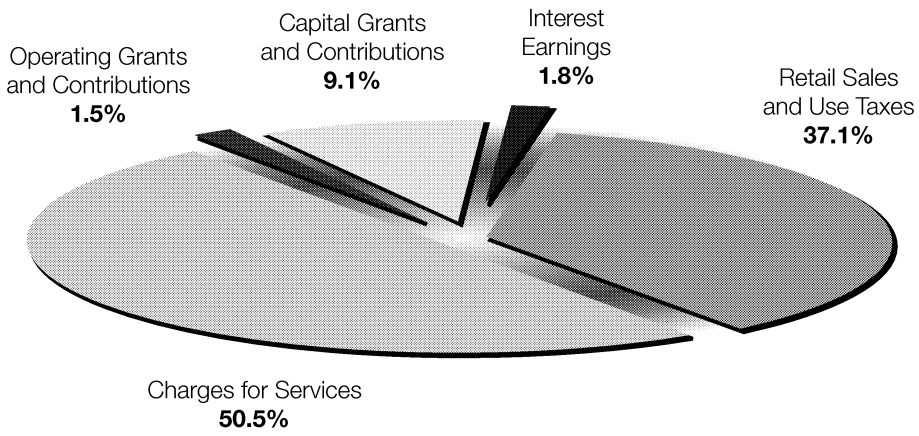
A comparison of the cost of services by function for the County's governmental activities is shown below, along with the revenues used to cover the net expenses of the governmental activities (in thousands):

(Expenses) Net of Program Revenues	
General government	$ (16,329)
Law, safety and justice	(341,580)
Physical environment	(195)
Transportation	92,476
Economic environment	(23,485)
Mental and physical health	(60,182)
Culture and recreation	(28,581)
Interest and other debt service costs	(46,082)
Total expenses	(423,958)
General revenues	
Property taxes	447,041
Retail sales and use taxes	138,572
Other taxes	67,617
Unrestricted interest earnings	28,352
Other	992
Increase in net assets	$ 258,616

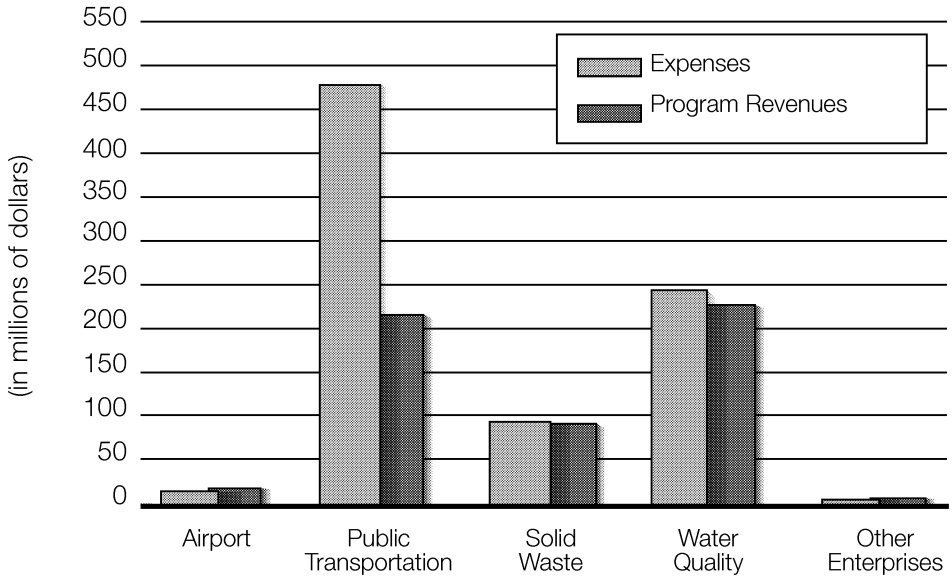
Business-type activities. Business-type activities increased the County's net assets by $26.7 million in 2005, accounting for 9.4 percent of the total growth in net assets of the County. Total revenues for business-type activities were $920.0 million. The cost of all business-type activities for 2005 was $892.3 million. Of that amount, 63.0 percent or $562.5 million was funded from program revenues, including $464.4 million in charges for services, $14.1 million from other governments and organizations that subsidized certain programs with operating grants, and $84.0 million in capital grants and contributions. The Public Transportation program operations are subsidized with retail sales and use tax revenues, which amounted to $341.1 million in 2005. In addition, the business-type activities received $16.4 million in unrestricted interest earnings and other rental income.

The charts on the following page illustrate the County's business-type revenues by source and business-type expenses and program revenues by function:

Revenue by Source – Business-type Activites
2005



Expenses and Program Revenues – Business-type Activites
2005



FINANCIAL ANALYSIS OF THE COUNTY'S FUNDS

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

Governmental Funds

The focus of the County's governmental funds is to provide information on near-term inflows, outflows, and balances of resources that are available for spending. Such information is useful in assessing the County's financing requirements. In particular, unreserved fund balances may serve as a useful measure of a government's net financial resources available for spending at the end of the fiscal year.

At December 31, 2005, the County's governmental funds reported combined ending fund balances of $417.0 million, an increase of $10.5 million in comparison with the prior year after restating beginning fund balances. Approximately 71 percent ($294.8 million) constitutes unreserved fund balance which is available for spending in the coming year at the County's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed to the liquidation of outstanding contracts and purchase orders of the prior fiscal year ($77.1 million), to pay debt service ($23.8 million), for prepayments ($4.3 million), and for a variety of other restricted purposes ($17 million).

Overall governmental fund revenues totaled approximately $1,392.6 million for 2005, which represents an increase of 2.6 percent or $35.8 million over the fiscal year ended December 31, 2004. The increase was primarily due to strong growth in Property taxes (up $12.1 million), Retail sales and use taxes (up $10.0 million), and Interest earnings (up $8.4 million). In 2005 expenditures for governmental funds totaled $1,390.6 million, a decrease of 13.8 percent or $222.8 million from the previous fiscal year. This large decrease was caused by one-time 2004 expenditures of $165.3 million related to the transfer to HMC of the proceeds of two 2004 Unlimited Tax General Obligation Bond Issues used to finance seismic upgrades and public health and safety improvements for Harborview Medical Center (HMC) and the King County Medical Examiner's Office, and $62.5 million related to the acquisition of an office building via capital lease in 2004. Excluding these one-time expenditures, expenditures were up 0.4 percent or $5.1 million from the previous fiscal year, an increase of $57.3 million (5.1 percent) in Current expenditures, $2.7 million (2 percent) in Debt Service expenditures, and a decrease of $54.9 million (39.6 percent) in Capital Outlay expenditures due to decreased capital outlay expenditures of $20.2 million in the Building Repair and Replacement Fund, $26.3 million in the County Road Fund and $15 million in the Open Space Projects Acquisition and Improvement Fund. Total revenues for governmental funds exceeded expenditures by $2.0 million in 2005 compared to expenditures exceeding revenues by $256.6 million for the 2004 fiscal year (including the one-time expenditures listed above).

The **General Fund** is the chief operating fund for the County. At the end of the fiscal year, total fund balance for the General Fund equaled $144.0 million. Unreserved fund balance, the amount considered available to spend, totaled $125.3 million. Of that amount, $28.7 million has been designated for working capital purposes and contingencies and is not considered available to spend. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 25.9 percent of total General Fund expenditures, a slight increase from the 24.6 percent of a year ago. Total fund balance represents 29.7 percent of total General Fund expenditures, an increase from the 27.2 percent of a year ago.

The fund balance of the County's General Fund increased by $22.0 million during the current fiscal year. Key factors in this growth are as follows:

- Effective January 1, 2005, the revenues and expenditures formerly accounted for in the Criminal Justice Fund (a special revenue fund) are included in the General Fund. This change resulted in an increase of General Fund revenues and expenditures of $17.9 million (3.4 percent) and $16.2 million (3.6 percent), respectively. The criminal justice revenues includes $12.1 million of local retail sales and use taxes that can be used exclusively for criminal justice purposes.

- Excluding the criminal justice revenues, other revenues grew by $18.1 million (3.4 percent) due to an increase of $6.5 million in taxes (which was primarily due to an increase of $5.4 million in non-criminal justice Retail sales and use taxes), a $6.7 million increase in Charges for services, and a $5.2 million increase in interest earnings.

- Excluding the criminal justice expenditures, other expenditures increased $19.7 million (4.4 percent). Over 55 percent of the $19.7 million increase was in Law, safety and justice and over 26 percent of the $19.7 million increase was in General government services.

- The $79.3 million in excess revenues over expenditures was reduced by $57.3 million in other financing uses, which were up $4.7 million from 2004 due to increased support of other funds by the General Fund.

The **Public Health Fund**, a special revenue fund, is used to finance health service centers located throughout the County and other public health programs to promote health and prevent disease to King County residents. At the end of 2005 it had a total fund balance of $9.7 million, of which $7.2 million was unreserved and available for spending. Revenues declined $5.6 million from the 2004 level due to a $2.9 million decline in Licenses and permit revenues and a $4.4 million decline in Intergovernmental revenues. During the same period, expenditures declined only $1.3 million.

Proprietary Funds

The County's proprietary funds provide the same type of information found in the government-wide financial statements for business-type activities. This information is presented on the same basis of accounting, but provides more detail.

As discussed in the business-type activities previously, the County's net assets increased by $26.7 million as a result of operations in the proprietary funds adjusted to reflect the consolidation of internal service fund activities related to the enterprise funds. Of the two major proprietary funds, the Public Transportation Enterprise provided $36.9 million of this increase while the net assets of the Water Quality Enterprise declined by $12.2 million.

The **Public Transportation Enterprise** accounts for the operations, maintenance, capital improvements, and expansion of public transportation and related facilities in the County. At the end of 2005 the Public Transportation Enterprise had total net assets of $1,240.7 million of which 80.3 percent or $995.9 million was invested in capital assets, net of related debt; 15.9 percent or $197.1 million was restricted as to use for capital purposes and bond reserves; and 3.8 percent or $47.7 million was unrestricted and available for spending. Net assets increased by $36.9 million in 2005, down from the 2004 change in net assets of $53.6 million. In 2005 operating revenues increased by $17.7 million (15.6 percent) and operating expenses increased by $44.5 million (9.3 percent). These charges were influenced by a number of factors, including: operating expenses other than depreciation increased by $27.6 million, of the increase 59 percent were employment-related expenses and 27.5 percent were increases in fuel expenses; operating revenues in 2005 included funds received in the construction fund of $7.0 million for work performed for others; and Federal and other operating subsidies decreased by $21.6 million in 2005 due to available federal grant funds being directly associated with fleet purchases rather than assigned as a federal maintenance grant.

The **Water Quality Enterprise** accounts for the operation, maintenance, capital improvements, and expansion of the County's water pollution control facilities. Total net assets in the enterprise fund were $327.7 million at the end of 2005 of which 61.3 percent or $200.9 million was invested in capital assets, net of related debt; 30.2 percent or $98.9 million was restricted as to use for construction projects and debt service; and the remaining 8.5 percent or $27.9 million was unrestricted and available for spending. In 2005 Water Quality created a rate stabilization reserve of $14.5 million from current year operating revenues. The rate stabilization reserve is used to maintain a level sewer rate across current and future years. The monthly sewer rate increased form $23.40 in 2004 to $25.60 in 2005 and the associated Residential Customer Equivalents (RCE) customer base grew from 687,909 to 689,817. Total sewer rate revenues increased by $3.8 million reflecting an overall 0.3 percent increase attributable to increases in both the rate and the RCE. Capacity charges for new sewer connections increased from $18.00 per residential equivalent per month to $34.05 per month for 15 years. Capacity charge revenues increased $4.0 million reflecting the higher rate and the addition of 9,628 new sewer connections. Water Quality remained focused on controlling operating costs during 2005 with operating expenses net of depreciation increasing $0.9 million between 2004 and 2005.

General Fund Budgetary Highlights

The County's final General Fund budget differs from the original budget in that it reflects an anticipated increase in appropriations of $40.4 million. However, actual budgetary basis expenditures were only $8.4 million more than the original budget resulting in an underutilization of the total final appropriation authority by $32.0 million, including $5.0 million underexpenditures in General governmental services; $10.9 million in Law, safety and justice; and $15.1 million in Transfers out. During the year total revenues exceeded budgetary estimates by $31.2 million and total expenditures were less than budgetary estimates by $32.0 million, eliminating the need to draw upon the existing fund balance.

CAPITAL ASSETS, INFRASTRUCTURE, AND DEBT ADMINISTRATION

Capital assets

The King County primary government's investment in capital assets for its governmental and business-type activities as of December 31, 2005, amounts to $5.6 billion (net of accumulated depreciation). Capital assets include land, right-of-way, conservation easements and development rights, buildings, improvements other than buildings, roads and bridges infrastructure, vehicles, furniture, machinery and equipment, and construction work-in-progress. The total increase in the investment in capital assets over the previous year was 5.6 percent (7.5 percent increase for governmental activities and 4.4 percent increase for business-type activities).

Major capital asset events during 2005 included the following:

- Capital assets of the Water Quality enterprise increased by 8.3 percent over the previous year. The change is a result of replacement and additions to the interceptor and siphon systems, purchases of land, additional storage capacity, extensions of sewer trunk lines and continued efforts to control odor and improve sewage-handling technology. Two combined sewer outflow projects were completed for $218.0 million and significant acquisitions of real property and conveyances were made for the Brightwater treatment plant project. These activities are in line with the Enterprise's Regional Wastewater Services Plan.

- Infrastructure activity resulted in an increase of 10.0 percent in capitalized roads and bridges over the previous year. A significant portion of this comes from donated construction of $93.8 million from private residential and commercial developments. Other road projects consisted of new road construction; work on existing roads, including lane widening and resurfacing; and installing safety and traffic equipment. The Road Services Division completed two road widening projects for $43.0 million.

- The Public Transportation Enterprise buildings and improvements increased by 5.0 percent over the previous year. The Enterprise's capital program is focused on continued systemwide improvement and expansion, base expansions and modifications, and acquisition and development of passenger facilities such as park-and-ride facilities. The $17.8 million Redondo Heights Park-and-Ride featuring 700 parking stalls was recently completed.

- Governmental capital land increased by 7.9 percent over the previous year. A notable increase is the $45.5 million in right-of-way donated by private residential and commercial developments. Acquisition of land and land rights for the purpose of preserving open space and farms, and conserving forests, also contributed to the land increase.

- Upgrades and improvements to the King County Courthouse, the King County Correctional Facility, and other outlying office buildings highlighted governmental building activity in 2005 but generally there was a slowdown following the large scale Courthouse seismic project during the previous two years.

- Overall, equipment decreased by 7.5 percent generally due to more retirements than additions, particularly in the Public Transportation Enterprise. Spending in technology, however, continued across the board with about $10.1 million incurred for computer hardware and software purchases.

More detailed information on the County's capital assets can be found in Note 6 – Capital Assets.

King County's Capital Assets
(in millions)

	Governmental activities		Business-type activities		Total	
	2005	2004	2005	2004	2005	2004
Land	$ 686.2	$ 635.8	$ 282.8	$ 243.1	$ 969.0	$ 878.9
Buildings*	461.8	467.7	582.5	495.3	1,044.3	963.0
Improvements other than buildings*	24.9	26.6	1,083.8	911.6	1,108.7	938.2
Infrastructure	910.5	800.8	-	-	910.5	800.8
Equipment*	73.0	71.9	753.7	820.9	826.7	892.8
Construction in progress	52.1	51.4	695.5	785.1	747.6	836.5
Total	$ 2,208.5	$ 2,054.2	$ 3,398.3	$ 3,256.0	$ 5,606.8	$ 5,310.2

*net of depreciation

Infrastructure

The County has elected to use the modified approach in reporting roads and bridges. Under the modified approach, asset condition is reported rather than recording depreciation. The rating scales for pavements (roads) and bridges are further explained in the required supplementary information, which follows the notes to the basic financial statements.

The County performs condition assessments on its network of roads through the King County Pavement Management System, which generates a Pavement Condition Index (PCI) for each segment of arterial and local access road in the network. The PCI is a numerical index on a 100-point scale that represents the pavement's functional condition based on the quantity, severity, and type of visual distress. Condition assessments are undertaken every three years.

It is the policy of the King County Roads Division to maintain at least 80 percent of the road system at a PCI of 40 or better. In the most recent condition assessments, 87.8 percent of the arterial roads in the County and 88.5 percent of the local access roads in the County had a PCI rating at 40 and above. The majority of roads that fall below the established rating are local access roads that are situated in rural areas. The amount budgeted in 2005 for road maintenance was $24.4 million. The amount actually expended was $15.8 million. Underspending of the budgeted amount is a result of the removal of roads from the project list because of conflicts with anticipated utility work, cost efficiencies related to a relatively few roads to be resurfaced in remote locations, and weather-related work reductions or stoppages.

The County currently maintains 181 bridges. Physical inspections to uncover deficiencies are carried out at least every two years and documented. There is also an annual evaluation to determine which bridges are candidates for replacement or rehabilitation using a 10-point priority scale based on various factors of bridge condition. A key element in the priority scale is the sufficiency rating, which is a numerical rating (on a 100-point scale) of a bridge based on its structural adequacy and safety, essentiality for public use, and its serviceability and functional obsolescence. The policy of the King County Roads Division is to maintain bridges in such a manner that no more than 12 (6.6 percent) will have a sufficiency rating of 20 or less. The most current complete assessment showed 9 bridges at or below this threshold. The amount budgeted in 2005 to maintain and preserve bridges was $20.0 million. Actual amounts expended were $12.9 million. Underspending of the budgeted amount is due to the construction schedule of certain projects extending beyond the budget year.

Debt Administration

At the end of 2005, King County primary government has total bonded debt outstanding of $3,037.0 million for its governmental activities and business-type activities. Of this amount, $1,847.2 million is comprised of debt backed by the full faith and credit of the County. The $1,189.8 million remainder of the County's bonded debt represents bonds secured solely by specified revenue sources (i.e., revenue bonds).

King County's Outstanding Debt
General Obligation and Revenue Bonds
(in millions)

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
General obligation bonds	$ 966.3	$ 1,043.3	$ 741.1	$ 560.9	$ 1,707.4	$ 1,604.2
General Obligation lease revenue bonds	139.8	142.0 [a]	-	-	139.8	142.0
Revenue bonds	-	-	1,189.8	1,210.3	1,189.8	1,210.3
Total	$ 1,106.1	$ 1,185.3	$ 1,930.9	$ 1,771.2	$ 3,037.0	$ 2,956.5

(a) In prior years, the general obligation lease revenue bonds were not included on this schedule. See Note 13, "Debt " – Schedule of Long-term Debt.

The total bonded debt was increased over 2004 by 2.7 percent or $80.5 million (6.7 percent or $79.2 million decrease for governmental activities and 9.0 percent or $159.7 million increase for business-type activities). The decrease of bonded debt outstanding in the governmental activities was primarily due to the $77.1 million of debt service payments in 2005. The business-type activities' bonded debt was increased due to the issuance of $200.0 million of general obligation bonds payable from sewer revenues to finance the Wastewater Treatment Division's capital needs.

During 2005 the County refinanced $24.4 million of general obligation bonds to take advantage of lower interest rates through advance refunding. The refinancing is expected to decrease future aggregate debt service payments by $1.8 million over the life of the bonds.

The County maintains a rating of "Aa1" from Moody's, a rating of "AAA" from Standard & Poor's, and a rating of "AA+" from Fitch for its limited tax general obligation debt. For its unlimited tax general obligation debt, the County has a rating of "Aaa" from Moody's, a rating of "AAA" from Standard & Poor's, and a rating of "AAA" from Fitch. The ratings for its Wastewater Treatment Division's revenue debt are "A1" from Moody's and "AA" from Standard & Poor's.

State statutes limit the amount of general obligation debt that the County may issue to 2 ½ percent of its total assessed valuation for both general county purposes and metropolitan functions. The current debt limitation of total general obligations is $6,764.3 million for both general county purposes and metropolitan functions, which is significantly higher than the County's outstanding general obligation debt of $1,196.8 million for general county purposes and $771.9 million for metropolitan functions.

Additional information on King County's long-term debt can be found in Note 13 – Debt.

ECONOMIC FACTORS, INITIATIVES, AND NEXT YEAR'S BUDGETS AND RATES

- Economic conditions have a direct impact on the County's revenues and the demand for County services. The County's revenue sources include taxes, charges for services, and intergovernmental revenues. The largest single source is taxes, which comprise approximately one-third of total revenue and consist primarily of taxes on real property. Property taxes tend to be stable since levy rates are calculated months in advance and King

County establishes assessed value from the preceding four years of real estate sales. Other tax sources, such as the retail sales tax, are more volatile and directly influenced by economic conditions in the region.

Property assessment growth in King County for 2005 was 8.5 percent, compared with 5.6 percent growth in 2004, 4.8 percent growth in 2003, and 6.7 percent growth in 2002.

The total dollar amount of regular property taxes that may be levied annually by the County without a vote of its electors is limited to 101 percent of the highest levy in the three previous years, excluding new construction, improvements, and state-assessed property.

- County general fund property tax collections increased by 0.8 percent in 2005, compared with 3.6 percent growth in 2004, and 2.8 percent growth in 2003. All three years are below the 4.5 percent growth in 2002, 4.6 percent growth in 2001, and 6.6 percent growth in 2000.

  General Fund sales tax receipts grew by 7.45 and 6.19 percent in 2005 and 2004, respectively, compared with a 0.72 percent decline in 2003, and a cumulative 7.17 percent decline between 2000 and 2003.

- Personal income in the County grew by an average annual increase of 5.2 percent between 2003 and 2005, compared with average growth of 2.0 percent between 2001 and 2003.

  Unemployment in King County decreased from 2004 to 2005. The annual unemployment rates were 4.8 percent and 5.2 percent for 2005 and 2004, respectively. Both years are an improvement over 6.2 percent in 2003.

  Total regional employment growth exceeded population growth in 2005 by 2.7 percent to 0.9 percent, and in 2004 by 1.4 percent to 0.5 percent, respectively.

- King County will continue to face numerous challenges, including volatile energy prices, rising employee and programmatic healthcare costs, retirement plan contribution rate increases, and the need to raise sufficient revenues to support utility, transit system, and general government operations.

  King County still faces substantial difficulties in balancing revenues with the demand for services. Property tax growth remains capped at approximately 3 percent annually over the coming years (1 percent plus the value of new construction). While costs since 2003 have been held well under historic growth rates of 5 to 6 percent, the County faces a challenge to continue to limit growth in expenditures with labor cost drivers and service utilization levels.

- By law, the County is required to adopt a balanced budget. The entire 2006 budget for the County, adopted by the County Council in November 2005, was $3,487.4 million. Of this amount, $604.8 million is appropriated for the General Fund; $816.8 million for enterprise funds (including public transportation, solid waste and wastewater treatment); and $705.0 million for special revenue funds (including public health, emergency medical services, human services, and road funds). The budget also includes $796 million committed to capital improvements for wastewater treatment, transit, roads, parks and other major public facilities.

- In 2005 there were no large annexations or incorporations. Census data in 2000 confirmed continued decline in the County's unincorporated area population while overall County population grew. Between 1990 and 2000, the County's population grew from 1.5 million to 1.7 million. In 1990 more than 500,000 people lived in unincorporated King County; by 2000,

this had declined to 350,000. The fiscal impacts of annexation depend upon the revenue-generating capacity of an area compared with its service demands.

The County annexation initiative, started in 2004, identified ten urban unincorporated areas that by County Planning Policies should be incorporated or annexed into cities by 2012. Annexation or incorporation of urban unincorporated areas is also encouraged by the Washington State Growth Management Act. In early 2006 the Washington State Legislature enacted a credit against the state sales tax for cities that annex areas with over ten thousand residents. The annexing city is eligible for the credit, which is effectively a sales tax rate of 0.1 percent, applied in both the newly annexed area and within the prior city boundaries. If the annexed area population exceeds twenty thousand, the applicable credit rate is 0.2 percent. The first of ten major potential annexation areas, Klahanie, approved annexation in November 2005. This annexation is on hold, however, pending resolution of the city of Issaquah's insistence that area residents assume a portion of the city's debt — this measure was narrowly rejected on the same ballot.

REQUESTS FOR INFORMATION

This financial report is designed to provide an overview of the County's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the Chief Accountant/Manager, Financial Management Section, Room 653, Administration Building, 500 Fourth Ave., Seattle, WA 98104.