

**NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2004****NOTE 3 – STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY****Bases of Budgeting**

With the exception of the reconciling items described in the Reconciliation of Budgetary Basis and Generally Accepted Accounting Principles (GAAP) Basis Statements and Schedules section of this note, King County uses the modified accrual basis of budgeting for the General Fund and most Debt Service and Special Revenue Funds. Revenues are estimated on the basis of when they become susceptible to accrual, for example, intergovernmental revenues, where revenue estimates are matched with appropriations. Budgeted appropriations include both Expenditures and Other financing uses; they are budgeted based on liabilities expected to be incurred in the acquisition of goods and services. These are annual budgets applicable to the current fiscal year.

Twenty-five Special Revenue Funds have annual budgets with budgeting concepts identical to the General Fund. Twenty-four of these funds are presented in the budget and actual schedules of this report. One of these funds, the Arts and Cultural Education Fund, was inactive in 2004.

Two Special Revenue Funds (the Community Development Block Grant Fund and the Miscellaneous Grants Fund) do not have an annual basis of budgeting. Budgets within these funds are on a multi-year basis with the budget for a particular program covering one or more fiscal years. Total revenues and expenditures for the program are budgeted at its inception and any unexpended balance at the end of the fiscal year is reappropriated to the next fiscal year.

The Flood Control Zone Districts Funds are not budgeted. These funds account for four flood control zone districts' activities in accordance with chapter 86.15 RCW.

The Road Improvement Districts Maintenance Fund is not budgeted. This fund reports the road district maintenance assessment activity in accordance with chapter 36.88 RCW.

The Treasurer's Operations and Maintenance Fund, pursuant to RCW 84.56.020, is not budgeted.

Three Debt Service Funds have an annual budget with budgeting concepts identical to the General Fund. These funds are presented in the budget and actual statements of this report. In the Limited Obligation Bond Redemption Fund, revenues and expenditures related to proprietary type debt service payments are budgeted.

Two Debt Service Funds, the Road Improvement Districts Special Assessment Debt Redemption Fund and Road Improvement Guaranty Fund, are not budgeted. These funds report road improvement districts' special assessments revenues and debt service expenditures in accordance with chapter 36.88 RCW.

All funds in the Capital Projects Fund type, except the Road Improvement Districts Construction Fund and the Harborview Medical Center Bond Administration Fund, are controlled by multi-year budgets. However, capital budget appropriations are canceled at the end of the year unless the County Executive submits to the County Council the report of the final year-end reconciliation of expenditures for all capital projects on or before March 1 of the year following

**NOTES TO FINANCIAL STATEMENTS
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the year of the appropriation and each year thereafter in which the appropriation remains open.

The Road Improvement Districts Construction Fund is not budgeted. This fund reports capital improvement assessments construction activity in accordance with chapter 36.88 RCW.

The Harborview Medical Center Bond Administration Fund, opened and closed in 2004, was not budgeted. The fund was created administratively to record, in compliance with generally accepted accounting principles, a 2004 receipt of bond proceeds in the Primary Government and the recognition of an expenditure to show an effective capital contribution to Harborview Medical Center.

The Enterprise and Internal Service Funds (with the exception of the Insurance Fund) are budgeted on the modified accrual basis rather than the accrual basis (the GAAP basis for proprietary funds). Appropriations are based on an estimate of expenditures expected to be incurred in the acquisition of goods and services during the fiscal year. Estimated revenues are based on the amount estimated to be earned and available during the fiscal year.

The Insurance Fund is budgeted on the modified accrual basis with one exception. Consistent with the intent of the County ordinance that delegates full claims settlement authority to the County Executive, the recognition of the portion of judgment and claim settlements that occurs and remains unpaid at the end of a fiscal year, and exceeds current year expenditure appropriations, is deferred to the following year when the claim is paid. In 2004 no judgment and claim settlement recognition was deferred to a future period on the budgetary basis schedules due to insufficient appropriations in the current year.

The Trust and Agency Funds are not budgeted.

Encumbrances

Encumbrances outstanding as of December 31, 2004, are shown in the following schedule by fund type:

Year-end Encumbrances Outstanding as of December 31, 2004

General Fund	\$ 5,100,011
Public Health Fund	1,278,450
Special Revenue Funds	22,271,088
Capital Projects Funds	61,479,139
Enterprise Funds	4,258,340
Internal Service Funds	<u>5,415,003</u>
Total All Funds	<u>\$ 99,802,031</u>

**NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2004****NOTE 3 – CONTINUED****Reconciliation of Budgetary Basis and GAAP Basis Statements and Schedules for Governmental Funds**

In the General and budgeted Special Revenue and Debt Service Funds, the legally prescribed budgetary basis differs from the GAAP basis in 2004. For those statements and schedules in which budget comparisons are presented, the legally adopted budget is compared with actual data on the budgetary basis rather than the GAAP basis. Budget to actual statements and schedules of the governmental funds include an explanation of the differences between the two bases. All statements that do not have budget comparisons are prepared on the GAAP basis.

Budgeted Level of Expenditures

Appropriations are authorized by ordinance, generally at the fund level, with the exceptions of the General Fund and five Special Revenue Funds (the Community Development Block Grant, County Road, Criminal Justice, Developmental Disabilities, and Miscellaneous Grants Funds), which are appropriated at the department/division level, and Capital Projects Funds, which are appropriated at the project level.

These are the legal levels of budgetary control. Unless otherwise provided by the appropriation ordinances, all unexpended and unencumbered annual appropriations lapse at the end of the year. The budgetary comparison schedules (budgetary basis) include variances at the function of expenditure level. These variances are presented for informational purposes only and, if negative, do not constitute a legal violation. Administrative control is guided by the establishment of more detailed line item budgets.

Expenditures including Other Financing Uses, in Excess of Amounts Legally Authorized**Funds with Multi-year Budgets**

Thirty-two capital projects in ten Capital Projects and Enterprise Funds with multi-year budgets have a combined total of \$5.0 million of expenditures in excess of budget. These deficits are expected to be corrected by additional appropriations in 2005.

Funds with Annual Budgets

All funds and departments/divisions with annual budgets completed the year within their legally authorized expenditures, including other financing uses except for one Debt Service Fund. Payments made in 2004 to the escrow agent from Debt Service Funds were authorized by Washington state law (RCW 82.14.360) and/or County ordinances nos. 12686 and 13953. Although the payments were authorized by law or ordinance and the revenue to cover the payments was available, \$8,103,230 was not appropriated as required. As a result, expenditures exceeded appropriations in the Limited General Obligation Bond Redemption Fund by \$3,635,567.

Fund Balance and Net Asset Deficits

Construction and Facilities Management Fund – The deficit of \$1,311,085 is the result of a net loss in 2003. The loss was primarily due to 2003 budget actions intended to reduce the fund's

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working capital. During 2004 the deficit was reduced by \$273,046 from \$1,584,131. It is anticipated that the fund will increase its working capital in 2005, further reducing the deficit. In conjunction with the 2006 budget, a multi-year plan is being developed to eliminate the deficit over a period of time.

County Road Fund – The deficit of \$2,432,096 is the result of a negative \$1,486,483 Prior Period Adjustment to revenue for a 1990 Federal Emergency Management Agency (FEMA) Grant and a \$945,613 shortfall in programmed revenue due to a delay in the sale of assets. It is anticipated that asset sales and an increase in property tax revenue in 2005 will eliminate the deficit.

Open Space Projects Acquisition and Improvement – The deficit of \$21,417,237 is the result of temporary short-term financing of critical capital acquisitions through the issuance of bond anticipation notes which will eventually be retired with general obligation bonds. When the long-term bonds are issued, the fund balance deficit will be eliminated.

Printing/Graphic Arts Services Fund – The deficit of \$382,086 is the result of a decline in printing and graphics internal revenue. Sales volume is expected to increase in 2005 due to an emerging business opportunity with City of Seattle government agencies, the acquisition of additional equipment and printing capabilities, and marketing activities directed at King County agencies. Combined with modest rate increases, these initiatives are expected to generate sufficient revenue to eliminate the deficit by late 2005.

Safety and Workers' Compensation Fund – The deficit of \$43,352,484 is the result of losses in several years in the last ten years and the change of the method in 2004 for estimating workers' compensation claim liabilities from using primarily the case reserves to an actuarially developed liabilities estimate. The change resulted in a large increase in the reported liabilities and related expenses in 2004. A funding plan is being developed to build the assets to equal the liabilities over a number of years.

Transfer of Development Credit Program Fund – The deficit of \$1,235,736 is the result of spending financed by short-term borrowing which will eventually be reimbursed by contributions from the Conservation Futures Levy Fund.

Water Quality Enterprise Bond Covenants

With respect to the year ended December 31, 2004, the Water Quality Enterprise complied with all covenants stipulated by its bond resolutions, except for providing audited financial statements and a consulting engineer's report within 120 days of year-end and having a minor (\$87,277) shortfall in bond reserves. The Water Quality Enterprise has six months beyond the 120 days to comply with the reporting covenants. It is management's intention to remedy noncompliance within the applicable six-month period. The minor shortfall in the bond reserves was corrected in February 2005.