

Washington State Auditor's Office
Financial Statements Audit Report

City of Port Orchard
Kitsap County

Audit Period
January 1, 2006 through December 31, 2006

Report No. 73802

Issue Date
January 7, 2008



WASHINGTON
BRIAN SONNTAG
STATE AUDITOR



**Washington State Auditor
Brian Sonntag**

January 7, 2008

Mayor and City Council
City of Port Orchard
Port Orchard, Washington

Report on Financial Statements

Please find attached our report on the City of Port Orchard's financial statements.

We are issuing this report in order to provide information on the City's financial condition.

In addition to this work, we look at other areas of our audit client's operations for compliance with state laws and regulations. The results of that audit will be included in a separately issued accountability report.

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR

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Kitsap County
January 1, 2006 through December 31, 2006**

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters in Accordance with *Government Auditing Standards*

**City of Port Orchard
Kitsap County
January 1, 2006 through December 31, 2006**

Mayor and City Council
City of Port Orchard
Port Orchard, Washington

We have audited the financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Port Orchard, Kitsap County, Washington, as of and for the year ended December 31, 2006, which collectively comprise the City's basic financial statements, and have issued our report thereon dated November 7, 2007.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of the City's compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended for the information and use of management and the Mayor and City Council. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

A handwritten signature in black ink, appearing to read "Brian Sonntag". The signature is fluid and cursive, with the first name "Brian" and last name "Sonntag" clearly distinguishable.

BRIAN SONNTAG, CGFM
STATE AUDITOR

November 7, 2007

Independent Auditor's Report on Financial Statements

City of Port Orchard Kitsap County January 1, 2006 through December 31, 2006

Mayor and City Council
City of Port Orchard
Port Orchard, Washington

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Port Orchard, Kitsap County, Washington, as of and for the year ended December 31, 2006, which collectively comprise the City's basic financial statements as listed on page 5. These financial statements are the responsibility of the City'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 opinions.

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, each major fund and the aggregate remaining fund information of the City of Port Orchard, as of December 31, 2006, and the respective changes in financial position and, where applicable, cash flows thereof, and the respective budgetary comparison for the General and Street funds, 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 on our consideration of the City's internal control over financial reporting and on 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.

The management's discussion and analysis on pages 6 through 11 is not a required part of the basic financial statements but is 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.

A handwritten signature in black ink, appearing to read "Brian Sonntag". The signature is fluid and cursive, with the first name "Brian" and last name "Sonntag" clearly distinguishable.

BRIAN SONNTAG, CGFM
STATE AUDITOR

November 7, 2007

Financial Section

**City of Port Orchard
Kitsap County
January 1, 2006 through December 31, 2006**

REQUIRED SUPPLEMENTAL INFORMATION

Management's Discussion and Analysis – 2006

BASIC FINANCIAL STATEMENTS

Statement of Net Assets – 2006

Statement of Activities – 2006

Balance Sheet – Governmental Funds – 2006

Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds – 2006

Reconciliation of Statement of Revenues, Expenditures and Changes in Fund Balance of Governmental Funds to the Statement of Activities – 2006

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Statement of Cash Flows – Proprietary Funds – 2006

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Notes to Financial Statements – 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

The City of Port Orchard's discussion and analysis is a narrative overview of the City's financial activities for the fiscal year ended December 31, 2006. The information presented here should be read in conjunction with the financial statements and notes to the financial statements that follow.

FINANCIAL HIGHLIGHTS

- City of Port Orchard assets exceeded its liabilities at December 31, 2006 by \$47.5 million.
- Capital assets (net of depreciation and related debt) account for about 74 percent of this amount, with a value of \$35.1 million.
- Of the remaining net assets, \$12.3 million may be used to meet the government's ongoing obligations to citizens and creditors, without legal restriction.
- The government's total net assets show an increase of \$1,601,218. This change was in contributed capital and the acquisition of assets.
- As of December 31, 2006, City of Port Orchard's governmental funds reported combined ending fund balances of \$million. Over 21% of this total amount, \$697,978 is available for spending at the government's discretion. Unreserved fund balance for the general fund was \$427,375 at December 31, 2006.
- City of Port Orchard's total bonded debt decreased by \$152,146 during the fiscal year. At December 31, 2006 the total outstanding bonded debt was \$2,386,945.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis provides an introduction and overview to the City of Port Orchard's basic financial statements. This information will assist users in interpreting the basic statements. We will also provide other supplementary information in addition to the basic financial statements. This financial discussion and analysis should assist the reader in understanding the City's financial condition.

Basic Financial Statements

The basic financial statements are comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and, 3) notes to the financial statements. The financial section of this report also contains required supplementary information, in addition to the basic financial statements.

Government-wide Financial Statements

Government-wide financial statements provide readers with a broad overview of the City of Port Orchard's finances in a manner similar to a private-sector business, distinguishing functions of the City of Port Orchard that are principally supported by taxes and intergovernmental revenues (referred to as "governmental activities") from functions that are intended to recover all or a significant portion of their costs through user fees and charges (referred to as "business-type activities"). The governmental activities of the City of Port Orchard include a full range of local government services provided to the public, such as law enforcement and public safety; road construction and maintenance; community planning and development; parks and recreation facilities; and other community services. In addition, other general government services are provided, such as, tax collection, and the issuance of permits and licenses. The business-type activities of the City of Port Orchard include water and sewer utility management and operation.

The Statement of Net Assets presents information on all of the City of Port Orchard's assets and liabilities, with the difference between the two reported as net assets. This statement serves a purpose similar to that of the balance sheet of a private-sector business. Over time, increases or decreases in net assets may serve as one indicator of whether the financial position of the City is improving or deteriorating. Other indicators include the condition of the City's infrastructure systems (roads, drainage systems, bridges, etc.), changes in property tax base, and general economic conditions within the City.

The Statement of Activities presents information showing how the government's net assets changed during 2006. This statement separates program revenue (revenue generated by specific programs through charges for services, grants, and contributions) from general revenue (revenue provided by taxes and other sources not tied to a particular program). This shows the extent each program relies on taxes for funding. All changes in net assets are reported using the accrual basis of accounting, which requires that revenues be reported when they are earned and expenses are reported when the goods and services are received. Items such as uncollected taxes, unpaid vendor invoices for items received in 2006, and earned but unused vacation leave will be included in the statement of activities as revenue and expense, even though the cash associated with these items was not received or distributed in 2006.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Port Orchard, like other state and local governments, uses fund accounting for compliance with finance-related legal requirements. All of the funds of the City fall into three categories: governmental funds, proprietary funds, and fiduciary funds. Governmental funds account for most, if not all, of a government's tax-supported activities. Proprietary funds account for a government's business type activities, where all or part of the costs of activities are supported by fees and charges that are paid directly by those who benefit from the activities. Fiduciary funds account for resources that are held by the government as an agent for parties outside of the government. The resources of fiduciary funds cannot be used to support the government's own programs.

Governmental Funds

The Governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances present separate columns of financial data for the general fund and the City street fund. These are considered major funds. Data from the remaining governmental funds are combined into a single, aggregated presentation.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. Governmental funds financial statements focus on near-term inflows and outflows of spendable resources and on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating a government's near-term financing requirements in comparison to near-term resources available.

Because the focus of governmental funds financial statements is narrower than that of government-wide financial statements accrual basis focus, it is useful to compare information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. This gives readers a better understanding of 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 reconciliation to the governmental activities column in the government-wide statements, facilitating this comparison.

The City maintains budgetary controls over its operating funds. Budgetary controls ensure compliance with legal provisions embodied in the annual appropriated budget. Governmental funds budgets are established in accordance with state law, and are adopted on a fund level. Personnel services are budgeted by position and by prorating the costs based on time allocation to the various funds. Budgetary variances are discussed later in this section.

Proprietary Funds

Currently, the City has one type of proprietary fund. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses one enterprise fund to account for its water and sewer utilities operation.

Proprietary fund statements provide the same type of information as the government-wide financial statements, only in more detail, since both apply the accrual basis of accounting. In comparing the proprietary fund statement of net assets to the business-type column on the government-wide statement of net assets, the total net assets agree, and therefore need no reconciliation. In comparing the total

assets and total liabilities between the same two statements, you will notice slightly different amounts. This is because the "internal balances" line on the government-wide statement combines the "due from other funds" (asset) and the "due to other funds" (liabilities) from the proprietary fund statement in a single line in the asset section of the government-wide statement.

Fiduciary Funds

Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statement because the resources of those funds are not available to support the City of Port Orchard's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided, and are an integral part of the government-wide and fund financial statements.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Assets

As noted earlier, changes in net assets may serve as a useful indicator of a government's financial position. The City of Port Orchard's net assets total \$47,537,338 at December 31, 2006. The following is a condensed version of the government-wide statement of net assets.

City of Port Orchard's Net Assets

	Governmental Activities 2006	Governmental Activities 2005	Business-Type Activities 2006	Business-Type Activities 2005	Total Activities 2006	Total Activities 2005
Current and other assets	\$ 4,655,851	\$ 4,274,792	\$ 8,397,143	\$ 8,616,375	\$ 13,052,994	\$ 12,891,167
Capital assets	14,382,186	14,314,458	23,466,262	22,155,170	37,848,448	36,469,628
Total assets	19,038,037	18,589,250	31,863,405	30,771,545	50,901,442	49,360,795
Long-Term liabilities	1,945,651	2,059,057	954,528	1,020,962	2,900,179	3,080,019
Other liabilities	308,397	204,290	155,528	140,366	463,925	344,656
Total liabilities	2,254,048	2,263,347	1,110,056	1,161,328	3,364,104	3,424,675
Net Assets						
Invested in capital assets, net of related debt	12,636,923	12,457,907	22,548,529	21,182,614	35,185,452	33,640,521
Unrestricted	4,147,066	3,867,996	8,204,820	8,427,603	12,351,886	12,295,599
Total net assets	\$ 16,783,989	\$ 16,325,903	\$ 30,753,349	\$ 29,610,217	\$ 47,537,338	\$ 45,936,120

The largest portion of the City's net assets (74 percent) reflects its investment in capital, less any related debt used to acquire those assets that is still outstanding. The City's capital assets are used to provide services to citizens. Consequently, the value of these assets of \$35,185,452, are not available for future spending. The remaining balance of \$12,351,886 (unrestricted net assets) represents the amount that may be used to meet the City's ongoing obligations.

At December 31, 2006, the City of Port Orchard reports positive balances in two categories of net assets, for the government as a whole, as well as for separate governmental and business-type activities.

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Statement of Activities

In 2006 the City's total net assets increased by \$1,601,217. The governmental net assets increased \$458,085 and business-type activities increased \$1,143,132.

The following is a condensed version of the statement of changes in net assets for the City. The full statement is a tabular depiction of the relationship of revenues and expenses for the City's governmental activities and proprietary funds. In the full statement, several of these categories vary from 2005, due to changing the application of the program revenue, charges for services, to the expenditure functions as reported in prior years.

City of Port Orchard's Statement of Activities						
	Governmental Activities		Business-type Activities		Total Primary Government	
	2006	2005	2006	2005	2006	2005
Revenues:						
Program revenues:						
Charges for services	\$ 1,092,252	\$ 912,259	\$ 2,990,607	\$ 2,630,139	\$ 4,082,859	\$ 3,542,398
Operating grants & contributions	413,267	393,681	0	0	413,267	393,681
Capital grants and contributions	411,058	657,831	1,348,717	515,527	1,759,775	1,173,358
General revenues:						
Property taxes	1,244,095	966,135	0	0	1,244,095	966,135
Sales taxes	2,813,018	2,700,435	0	0	2,813,018	2,700,435
Other taxes	1,639,531	1,600,141	0	0	1,639,531	1,600,141
Interest income	178,875	101,092	108,356	136,719	287,231	237,811
Other revenues	11,090	5,615	0	0	11,090	5,615
Total Revenues	7,803,186	7,337,189	4,447,680	3,282,385	12,250,866	10,619,574
Expenses:						
General government	1,342,594	1,252,083	0	0	1,342,594	1,252,083
Judicial	430,908	404,922	0	0	430,908	404,922
Public safety	2,703,055	2,497,021	0	0	2,703,055	2,497,021
Physical environment	124,791	110,043	0	0	124,791	110,043
Transportation	1,208,975	932,567	0	0	1,208,975	932,567
Health and human services	14,027	15,608	0	0	14,027	15,608
Economic environment	374,047	298,674	0	0	374,047	298,674
Culture and recreation	564,234	541,421	0	0	564,234	541,421
Water - Sewer	0	0	3,304,548	4,701,370	3,304,548	4,701,370
Interest on long-term debt	58,470	61,124	0	0	58,470	61,124
Total Expense	6,821,101	6,113,463	3,304,548	4,701,370	10,125,649	10,814,833
Change in net assets	982,085	1,223,726	1,143,132	(1,418,985)	2,125,217	(195,259)
Net Assets 1/1/06	16,325,907	15,102,181	29,610,217	32,789,814	45,936,124	47,891,995
Prior Period Adjustment	(524,000)	0	0	(1,760,612)	(524,000)	(1,760,612)
Net Assets 12/31/06	\$ 16,783,992	\$ 16,325,907	\$ 30,753,349	\$ 29,610,217	\$ 47,537,341	\$ 45,936,124

Governmental Activity Analysis

The City's tax revenues have increased by \$429,933 in 2006. The main source of revenue came from retail sales and use tax, which increased from the prior year by \$112,583 (42%). Property tax revenues have risen by \$277,960. Total expenses in governmental activities increased by 12%. The City incurred an increase in general government of \$90,511, judicial of \$25,986, public safety of \$206,034, physical environment of \$14,748, transportation of \$276,408, economic environment of \$75,373, culture and recreation of \$22,813 and a decrease in health & human services of (\$1,581). The net assets associated with governmental activities increased by \$982,805.

Business-Type Activities Analysis

This year, the water-sewer fund had increases in operating revenues of 13.5%, and 5.6% increase in operating expenses, with an overall increase in net assets of 3.9%.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

Governmental Funds Analysis

The City uses fund accounting to ensure compliance with legal requirements and to assist in the budgeting and operations of the different activities of the City. Of the 9 funds the City has, the governmental funds are categorized into four fund types. Each type has its unique purpose. Two funds are classified as major funds for the purposes of this report, based on criteria set forth by the GASB. Those funds are the general fund and the street fund.

The general fund's fund balance by (\$226,426), which is 30%, as a result of 2006 operations. The largest source of revenue is sales and use tax representing 52%. The largest expenditure category is security of persons and property, representing 50% of the general fund's activity. The accounts receivable balance is related to court revenues and miscellaneous receivables, which represent 58% of total assets. The City had budgeted to use part of fund balance and it did.

The street fund had a 45% in fund balance (\$229,382). This decrease is due to 2006 paving projects including 2005 projects carried over and completed in this year.

The change in total governmental funds' fund balance was an overall increase of \$186,533. A large increase is from accumulating reserves in the non-major governmental funds for future capital projects. All other governmental funds had a combined decrease in their fund balances of (\$409,775). None of the fund balance is restricted, committed or limited on use, but either state law or council action limits some fund balance; the fund resources are not restricted for future use.

Business-Type Fund Analysis

Proprietary funds are those funds that account for government operations where the intent is for the costs to be primarily paid for by user charges. Enterprise funds are those funds that provide services primarily to external users, and internal service funds provide their services primarily within the City, or to other governmental units.

The water-sewer fund is the only business-type fund in the City. This fund had total net assets at year-end of \$30.7 million. This fund had operating losses of \$96,802. The water-sewer Fund had an increase in total net assets of 3.9%, \$1,143,132. The increasing numbers of users are having the dual effect of increasing revenues-and increasing demands on the systems.

GENERAL FUND BUDGETARY HIGHLIGHTS

The City appropriates funds through an annual budget process. An additional \$100,000 was added to the original budget and some line items were amended. State law allows funds to be expended if authorized by an ordinance amending the original budget. Revenues ended the year ahead of the amended budget by 6%. Expenditures were only 95% of the budget. This reflects the emphasis that the City has put on reducing expenditures while still providing efficient service.

The final budget showed increases (decreases) in: general government of \$18,000, judicial of (\$18,010, security of persons and property of \$44,680, physical environment of \$18,830, economic development of (\$3,435), culture and recreation of \$22,585 and capital expenditures of \$17,350. The City had planned and budgeted to use a portion of the general fund balance in 2006, but because of increased revenues and conservative expenditures, the fund balance did not decrease as significantly as expected.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The City of Port Orchard’s investment in capital assets, including construction in progress, for its governmental and business type activities as of December 31, 2006, amounts to \$37,848,448 (net of accumulated depreciation). This investment in capital assets includes land, buildings, system improvements, machinery and equipment, park facilities, and construction in progress on buildings and systems.

	Governmental Activities		Business Activities		Government Wide	
	1/1/2006	12/31/2006	1/1/2006	12/31/2006	1/1/2006	12/31/2006
Land	\$ 1,255,796	\$ 1,255,796	\$ 726,103	\$ 726,103	\$ 1,981,899	\$ 1,981,899
Construction in Progress	167,258	401,509	135,405	780,339	302,663	1,181,848
Buildings	5,428,453	5,296,021	2,371,285	2,333,516	7,799,738	7,629,537
Equipment	573,903	554,183	1,235,216	1,149,052	1,809,119	1,703,235
Infrastructure	6,365,048	6,874,677	17,687,161	18,477,252	24,052,209	25,351,929
	<u>\$ 13,790,458</u>	<u>\$ 14,382,186</u>	<u>\$ 22,155,170</u>	<u>\$ 23,466,262</u>	<u>\$ 35,945,628</u>	<u>\$ 37,848,448</u>

In the governmental activities, other improvements beginning balance of \$524,000 was eliminated, as it was not a capital lease and should not have been added to the City’s capital assets.

The governmental activities increase in construction in progress was due to Tremont Street Widening, the Cedar Heights Sidewalk Project and the Bay Street Pedestrian Path, buildings and equipment decrease was annual depreciation. Infrastructure increased due to paving at Bay Street, Mitchell Avenue, Sidney Avenue, Sedgwick Road and storm water.

Business activities increase in construction in progress included the Gorst Sewer Study, Water Rights, Canyon Court Lift Station, Annapolis Intertie/Building, and Well #10. Buildings and equipment decrease was annual depreciation. The increase in infrastructure was donated assets.

Additional information on the City of Port Orchard’s capital assets can be found in Note 6 (capital assets) of this report.

Long-Term Debt

At December 31, 2006, the City of Port Orchard had total long-term debt outstanding of \$2,900,178. Of this amount, \$2,386,945 is general obligation bonds, \$276,050 in a long-term loan made with a private party. \$237,183 is long-term compensated absences.

During 2006, the City of Port Orchard’s net total debt decreased by \$179,840. The decrease included annual payments on the outstanding debt and changes in compensated absences. The City’s remaining capacity for non-voted debt is approximately \$8.5 million. The legal debt limitation, including voter-approved debt, is approximately \$18.1 million.

Additional information on the City’s long-term debt can be found in Note 9 (long-term debt) of the notes to the financial statement in this report.

Requests for Information

This financial report is designed to provide a general overview of the City of Port Orchard’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 Finance Department, City of Port Orchard, 216 Prospect Street, Port Orchard, WA, 98366.

CITY OF PORT ORCHARD
 Statement of Net Assets
 December 31, 2006

Assets	Governmental Activities	Business-type Activities	Total Primary Government
Cash and Cash Equivalents	\$ 3,154,579	\$ 2,196,233	\$ 5,350,812
Receivables (Net of Allowance for Uncollectible)			
Taxes Receivable	68,634	0	68,634
Accounts Receivable	1,033,096	486,856	1,519,952
Intergovernmental Receivable	325,810	0	325,810
Due from Other Governmental Units	45,437	0	45,437
Deferred Charges	28,295	10,403	38,698
Restricted Assets			
Cash	0	0	0
Investment in Joint Venture	0	5,703,651	5,703,651
Capital Assets (Net of Accumulated Depreciation)			
Land	1,255,796	726,103	1,981,899
Buildings	5,296,021	2,333,516	7,629,537
Machinery and Equipment	554,183	1,149,052	1,703,235
Infrastructure	6,874,677	18,477,252	25,351,929
Construction Work in Progress	401,509	780,339	1,181,848
Total Assets	<u>\$ 19,038,037</u>	<u>\$ 31,863,405</u>	<u>\$ 50,901,442</u>
Liabilities and Net Assets			
Current Liabilities:			
Accounts Payable and Other Current Liabilities	\$ 252,776	\$ 84,895	\$ 337,671
Accrued Interest Payable	4,580	1,694	6,274
Unearned Revenue	51,041	0	51,041
Deferred Credits	0	68,939	68,939
Noncurrent Liabilities:			
Due within One Year	114,938	42,208	157,146
Due in More than One Year	1,830,713	912,320	2,743,033
Total Liabilities	<u>2,254,048</u>	<u>1,110,056</u>	<u>3,364,104</u>
Net Assets:			
Invested in Capital Assets, Net of Related Debt	12,636,923	22,548,529	35,185,452
Restricted for:			
Capital	0	0	0
Unrestricted	4,147,066	8,204,820	12,351,886
Total Net Assets	<u>16,783,989</u>	<u>30,753,349</u>	<u>47,537,338</u>
Total Liabilities and Net Assets	<u>\$ 19,038,037</u>	<u>\$ 31,863,405</u>	<u>\$ 50,901,442</u>

The notes to the financial statements are an integral part of this statement

CITY OF PORT ORCHARD
Statement of Activities
December 31, 2006

Functions/Programs	Net (Expense) Revenue and Changes in Net Assets					
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Business - type Activities	Total
PRIMARY GOVERNMENT						
Governmental Activities:						
General Government	\$ 1,342,594	\$ 186,744	\$ 310,269	\$ 0	\$ (845,581)	\$ (845,581)
Judicial	430,908	340,104	0	0	(90,804)	(90,804)
Public Safety	2,703,055	218,876	35,716	0	(2,448,463)	(2,448,463)
Physical Environment	124,791	614	57,282	62,675	(4,220)	(4,220)
Transportation	1,208,975	79,002	0	348,383	(781,590)	(781,590)
Health and Human Services	14,027	0	0	0	(14,027)	(14,027)
Economic Environment	374,047	259,108	0	0	(114,939)	(114,939)
Culture and Recreation	564,234	7,804	10,000	0	(546,430)	(546,430)
Interest on Long-Term Debt	58,470	0	0	0	(58,470)	(58,470)
TOTAL GOVERNMENTAL ACTIVITIES	6,821,101	1,092,252	413,267	411,058	(4,904,524)	(4,904,524)
Business-Type Activities:						
Water - Sewer	3,304,547	2,990,608	0	1,348,717	1,034,778	1,034,778
TOTAL BUSINESS-TYPE ACTIVITIES	3,304,547	2,990,608	0	1,348,717	1,034,778	1,034,778
Total Primary Government	\$ 10,125,648	\$ 4,082,860	\$ 413,267	\$ 1,759,775	\$ (4,904,524)	\$ (3,869,746)
General Revenues:						
Taxes:						
Property Taxes Levied for General Purposes					1,244,095	0
Sales and Use Taxes					2,813,018	0
Business and Occupation Taxes					1,639,531	0
Unrestricted Investment Earnings					178,875	108,356
Gain on Sale of Capital Assets					11,090	11,090
Total General Revenues, Extraordinary, Special Items, and Transfers					5,886,609	108,356
Change in Net Assets					982,085	1,143,134
Net Assets - Beginning					16,325,907	29,610,217
Prior Period Adjustment					(524,000)	(524,000)
Net Assets - Ending					16,783,992	30,753,351
					\$	\$

The notes to the financial statements are an integral part of this statement

CITY OF PORT ORCHARD
 Governmental Funds
 Balance Sheet
 December 31, 2006

	General Fund	Street Fund	Other Governmental Funds	Total Governmental Funds
Assets:				
Cash and Cash Equivalents	\$ 639,272	\$ 361,554	\$ 2,153,754	\$ 3,154,580
Property Taxes Receivables (net)	25,827	42,807	0	68,634
Accounts Receivable	966,995	12,956	53,145	1,033,096
Intergovernmental Receivable	0	0	325,810	325,810
Due from Other Governmental Units	26,274	7,322	11,841	45,437
Total Assets	<u>1,658,368</u>	<u>424,639</u>	<u>2,544,550</u>	<u>4,627,557</u>
Liabilities and Fund Balances:				
Liabilities:				
Accounts Payable	\$ 109,033	\$ 103,729	\$ 40,014	\$ 252,776
Unearned Revenue	625	0	0	625
Deferred Revenues	1,025,832	42,807	53,144	1,121,783
Total Liabilities	<u>1,135,490</u>	<u>146,536</u>	<u>93,158</u>	<u>1,375,184</u>
Fund Balances:				
Reserved for				
Advance Travel/Petty Cash	1,500	0	0	1,500
Unreserved	427,375	270,603	0	697,978
Designated	94,002	7,500	0	101,502
Unreserved, Reported in Nonmajor:				
Special Revenue Funds	0	0	390,648	390,648
Capital Project Funds	0	0	2,060,744	2,060,744
Total Fund Balances	<u>522,877</u>	<u>278,103</u>	<u>2,451,392</u>	<u>3,252,373</u>
Total Liabilities and Fund Balances	<u>\$ 1,658,367</u>	<u>\$ 424,639</u>	<u>\$ 2,544,550</u>	

Amounts reported for governmental activities in the statement of net assets are different because (See Note 2 also):

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds 14,382,186

Other long-term assets are not available to pay for current-period expenditures and, therefore are deferred in the funds 1,071,368

Long-term liabilities that are not due and payable in the current period and are not reported in the funds (1,921,935)

Net assets of governmental activities \$ 16,783,992
 The notes to the financial statements are an integral part of this statement

CITY OF PORT ORCHARD

Governmental Funds

Statement of Revenues, Expenditures and Changes in Fund Balances
For the year ended December 31, 2006

	General Fund	Street Fund	Other Governmental Funds	Total Governmental Funds
Revenues:				
Property Taxes	\$ 234,744	\$ 1,012,131	\$ 0	\$ 1,246,875
Retail Sales and Use Taxes	2,712,428	0	100,590	2,813,018
Other Taxes	1,119,778	0	519,753	1,639,531
License and Permits	226,573	2,395	0	228,968
Intergovernmental	214,198	136,675	285,647	636,520
Charges for Services	320,273	13,360	0	333,633
Fines and Forfeits	232,911	34	4,307	237,252
Interest Earnings	53,745	29,546	95,062	178,353
Rents and Royalties	84,576	4,785	0	89,361
Contributions/Donations	7,569	0	550	8,119
Miscellaneous	27,328	64,829	7,527	99,684
Total Revenues	5,234,123	1,263,755	1,013,436	7,511,314
Expenditures:				
Current				
General Government	1,214,412	0	0	1,214,412
Judicial	430,908	0	0	430,908
Security/Persons and Property	2,607,642	0	5,470	2,613,112
Physical Environment	119,477	0	0	119,477
Transportation	0	874,262	0	874,262
Economic Environment	374,047	0	0	374,047
Mental and Physical Health	14,027	0	0	14,027
Culture and Recreation	443,629	0	92,494	536,123
Capitalized Expenditures	63,140	603,875	325,288	992,304
Debt Service				
Principal Retirement	0	0	109,500	109,500
Interest/Fiscal Charges	0	0	57,701	57,701
Total Expenditures	5,267,282	1,478,137	590,453	7,335,873
Excess (Deficiency) of Revenues Over (Under) Expenditures	(33,159)	(214,382)	422,983	175,442
Other Financing Sources (Uses)				
Long-term Debt Proceeds - Refunding Bonds	0	0	0	0
Sale of Fixed Assets	1,090	10,000	0	11,090
Payment to Refunded Bond Escrow Agent	0	0	0	0
Transfers In	10,712	0	294,202	304,914
Transfers Out	(205,069)	(25,000)	(74,845)	(304,914)
Total Other Financing Sources and Uses	(193,267)	(15,000)	219,357	11,090
Net Change in Fund Balances	(226,426)	(229,382)	642,340	186,532
Fund Balance at Beginning of Year	749,305	507,485	1,809,054	3,065,844
Fund Balance at End of Year	\$ <u>522,879</u>	\$ <u>278,103</u>	\$ <u>2,451,394</u>	\$ <u>3,252,376</u>

The notes to the financial statements are an integral part of this statement

CITY OF PORT ORCHARD

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balance
of Governmental Funds to the Statement of Activities
Year Ended December 31, 2006

Amounts reported for governmental activities in the statement of activities are different because:

Net changes in fund balances - total governmental funds:	\$	186,532
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expenses. This is the amount by which capital outlays exceeded depreciation in the current period.		403,923
The net effect of various miscellaneous transactions involving capital assets (i.e., sales, trade-ins, and donations) to increase net assets.		187,805
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.		92,455
The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance costs, premiums, discounts and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items.		109,500
Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.		1,870
Changes in Net Assets (governmental activities)	\$	<u>982,085</u>

The notes to the financial statements are an integral part of this statement

CITY OF PORT ORCHARD

General Fund

Statement of Revenues, Expenditures and Changes in Fund Balances

Budget (GAAP Basis) and Actual

For the Fiscal Year Ended December 31, 2006

	Budgeted Amounts		Actual Amount	Variance with Final Budget
	Original	Final		
Revenues:				
Property Taxes	\$ 197,315	197,315	\$ 234,744	\$ 37,429
Sales and Use Taxes	2,500,000	2,545,000	2,712,428	167,428
Other Taxes	1,118,550	1,118,550	1,119,778	1,228
License and Permits	216,770	216,770	226,573	9,803
Intergovernmental	129,110	179,110	214,198	35,088
Charges for Services	291,700	291,700	320,273	28,573
Fines and Forfeits	242,500	242,500	232,911	(9,589)
Interest Earnings	32,585	32,585	53,745	21,160
Rents and Royalties	95,900	95,900	84,576	(11,324)
Contributions/Donations	0	0	7,569	7,569
Miscellaneous	1,500	6,500	27,328	20,828
Total Revenues	4,825,930	4,925,930	5,234,123	308,193
Expenditures:				
Current				
General Government	1,209,701	1,227,701	1,214,412	13,289
Judicial	449,199	431,189	430,908	281
Security/Persons and Property	2,738,675	2,783,355	2,607,642	175,713
Physical Environment	100,802	119,632	119,477	155
Economic Environment	459,639	456,204	374,047	82,157
Mental and Physical Health	14,123	14,123	14,027	96
Culture and Recreation	426,219	448,804	443,629	5,175
Capitalized Expenditures	49,500	66,850	63,140	3,710
Total Expenditures	5,447,858	5,547,858	5,267,282	280,576
Excess (Deficiency) of Revenues Over (Under) Expenditures	(621,928)	(621,928)	(33,159)	588,769
Other Financing Sources (Uses):				
Sale of Fixed Assets	0	0	1,090	1,090
Transfers In	150,000	150,000	10,712	(139,288)
Transfers Out	(205,069)	(205,069)	(205,069)	0
Total Other Financing Sources and Uses	(55,069)	(55,069)	(193,267)	(138,198)
Net Change in Fund Balance	(676,997)	(676,997)	(226,426)	450,571
Fund Balances at Beginning of Year	765,000	765,000	749,305	(15,695)
Fund Balances at End of Year	\$ 88,003	\$ 88,003	\$ 522,879	\$ 434,876

The notes to the financial statements are an integral part of this statement

CITY OF PORT ORCHARD

Street Fund

Statement of Revenues, Expenditures and Changes in Fund Balances
Budget (GAAP Basis) and Actual

For the Fiscal Year Ended December 31, 2006

	Budgeted Amounts		Actual Amount	Variance with Final Budget
	Original	Final		
Revenues:				
Property Taxes	\$ 1,052,685	\$ 1,052,685	\$ 1,012,131	\$ (40,554)
License and Permits	2,100	2,100	2,395	295
Intergovernmental	207,900	207,900	136,675	(71,225)
Charges for Services	16,300	16,300	13,360	(2,940)
Fines and Forfeits	0	0	34	34
Interest Earnings	10,000	10,000	29,546	19,546
Rents and Royalties	4,700	4,700	4,785	85
Contributions/Donations	0	0	0	0
Miscellaneous	62,970	62,970	64,829	1,859
Total Revenues	1,356,655	1,356,655	1,263,755	(92,900)
Expenditures:				
Current:				
Security/Persons and Property	0	0	0	0
Transportation	795,975	989,215	874,262	114,953
Capitalized Expenditures	700,600	684,940	603,875	81,065
Total Expenditures	1,496,575	1,674,155	1,478,137	196,018
Excess (Deficiency) of Revenues Over (Under) Expenditures	(139,920)	(317,500)	(214,382)	103,118
Other Financing Sources (Uses):				
Sale of Fixed Assets	0	0	10,000	10,000
Transfers In	0	0	0	0
Transfers Out	(25,000)	(25,000)	(25,000)	0
Total Other Financing Sources and Uses	(25,000)	(25,000)	(15,000)	10,000
Net Change in Fund Balance	(164,920)	(342,500)	(229,382)	113,118
Fund Balances at Beginning of Year	350,000	350,000	507,485	157,485
Fund Balances at End of Year	\$ 185,080	\$ 7,500	\$ 278,103	\$ 270,603

The notes to the financial statements are an integral part of this statement

CITY OF PORT ORCHARD

Proprietary Funds
 Statement of Net Assets
 December 31, 2006

	Major Enterprise Fund Water-Sewer
Assets:	
<i>Current Assets:</i>	
Cash and Cash Equivalents	\$ 2,196,233
Receivables (net)	
Accounts	486,856
Restricted Assets	
Cash and Cash Equivalents	0
Total Current Assets	<u>2,683,089</u>
<i>Long-term Assets:</i>	
Deferred Charges	10,403
Investment in Joint Venture	5,703,651
Property, Plant and Equipment (Net)	<u>23,466,262</u>
Total Long-term Assets	<u>29,180,316</u>
Total Assets	<u><u>31,863,405</u></u>
Liabilities and Net Assets	
<i>Current Liabilities:</i>	
Accounts Payable	84,895
Accrued Interest Payable	1,694
Bonds, Notes, Loans Payable	<u>42,208</u>
Total Current Liabilities	<u>128,797</u>
<i>Long-term Liabilities:</i>	
Bonds, Notes and Loan Payable (Net)	875,525
Deferred Credits	68,939
Accrued Employee Benefits	<u>36,795</u>
Total Long-term Liabilities	<u>981,259</u>
Total Liabilities	<u>1,110,056</u>
<i>Net Assets:</i>	
Invested in Capital Assets, Net of Related Debt	22,548,529
Restricted for Capital Purposes	0
Unrestricted	<u>8,204,820</u>
Total Net Assets	<u>30,753,349</u>
Total Liabilities and Net Assets	<u>\$ <u>31,863,405</u></u>

The notes to the financial statements are an integral part of this statement

CITY OF PORT ORCHARD

Proprietary Funds

Statement of Revenues, Expenses and Changes in Fund Net Assets

For the Fiscal Year Ended December 31, 2006

	Major Enterprise Fund Water-Sewer
Operating Revenues	
Charge for Services	\$ 2,945,279
Miscellaneous	40,418
Total Operating Revenues	<u>2,985,697</u>
Operating Expenses	
Operations	
General Operations	1,972,285
Power, Water, Gas Purchased for Resale	159
Customer Service and Marketing	176,599
General Administration	261,250
Taxes	213,933
Depreciation, Amortization, Depletion	458,273
Total Operating Expenses	<u>3,082,499</u>
Operating Income (loss)	(96,802)
Nonoperating Revenues (Expenses)	
Interest Earnings	108,356
Interest and Fiscal Charges	(21,731)
Concurrency Fees	4,910
Net Income (Loss) of Joint Ventures	(200,318)
Total Nonoperating Revenues (Expenses)	<u>(108,783)</u>
Income (Loss) before Contributions and Transfers	(205,585)
Capital Contributions	<u>1,348,717</u>
Increase (Decrease) in Net Assets	1,143,132
Total Net Assets at Beginning of Year	29,610,217
Prior Period Adjustment	0
Total Net Assets at End of Year	<u>\$ 30,753,349</u>

The notes to the financial statements are an integral part of this statement

CITY OF PORT ORCHARD
 Proprietary Funds
 Statement of Cash Flows
 For the Fiscal Year Ended December 31, 2006

		Major Enterprise Fund Water-Sewer
Cash Flows from Operating Activities:		
Cash Received from Customers	\$	2,951,946
Cash Payments to Suppliers		(1,608,304)
Cash Payments to Employees		(786,360)
Cash Payments to other Governments (Taxes)		(213,933)
Net Cash Provided by Operating Activities		343,349
Cash Flows from Noncapital Financing Activities:		
Contribution to Joint Venture		(507,251)
Net Cash Provided (Used) by Noncapital Financing Activities		(507,251)
Cash Flows from Capital and Related Financing Activities:		
Acquisition and Construction of Capital Assets		(620,169)
Principal Paid on GO Bond Issuance		(40,500)
Principal Paid on Other Long-Term Obligations		(25,200)
Interest Paid on Revenue Bonds and Other Long-Term Debt		(21,341)
Receipt of Capital Contributions		199,520
Net Cash Provided for Capital and Related Financing Activities		(507,690)
Cash Flows from Investing Activities:		
Interest on Investments		108,356
Net Cash Used by Investing Activities		108,356
Net Increase (Decrease) in Cash and Cash Equivalents		(563,236)
Cash and Cash Equivalents at 2005 End of Year		2,759,469
Cash and Cash Equivalents at End of Year	\$	2,196,233
Cash and Cash Equivalents		2,196,233
Restricted Cash and Cash Equivalents		0
Total Cash and Cash Equivalents	\$	2,196,233

The notes to the financial statements are an integral part of this statement

CITY OF PORT ORCHARD

Proprietary Funds

Statement of Cash Flows

For the Fiscal Year Ended December 31, 2006

	Major Enterprise Fund Water-Sewer
Reconciliation of Operating Income (Loss) to Net	
Cash Used by Operating Activities:	
Net Operating Income (Loss)	\$ (96,802)
Adjustments to Reconcile Net	
Operating Income (Loss) to Net	
Cash Provided by Operations:	
Depreciation Expense	458,273
(Increase) Decrease in Receivables	(37,902)
Increase (Decrease) in Current Payables	16,004
Increase (Decrease) in Accrued Employee Benefits	(376)
Increase (Decrease) in Deferred Lease	(758)
Receipt of Non-Operating Revenues	4,910
Total Adjustments	<u>440,151</u>
Net Cash Provided by Operating Activities	<u>\$ 343,349</u>
Noncash Investing, Financing and Capital Activities	
Capital Assets Donated	\$ 819,765

The notes to the financial statements are an integral part of this statement.

CITY OF PORT ORCHARD

Fiduciary Funds
 Statement of Net Assets
 December 31, 2006

	Wastewater Treatment Facilities Agency Fund	Trust & Agency Fund	Total Fiduciary Funds
Assets:			
<i>Current Assets:</i>			
Cash and Cash Equivalents	\$ 29,348	168	29,516
Accounts Receivable	3,500	0	3,500
Total Current Assets	32,848	168	33,016
<i>Long-term Assets:</i>			
Property, Plant and Equipment (Net)	19,122,016	0	19,122,016
Total Long-term Assets	19,122,016	0	19,122,016
Total Assets	19,154,864	168	19,155,032
Liabilities and Net Assets			
<i>Current Liabilities:</i>			
Accounts Payable	32,598	0	32,598
Intergovernmental Payable	325,810	0	325,810
Custodial Accounts		168	168
Total Current Liabilities	358,408	168	358,576
<i>Long-term Liabilities:</i>			
Bonds, Notes and Loan Payable (Net)	14,461,521	0	14,461,521
Total Long-term Liabilities	14,461,521	0	14,461,521
Total Liabilities	14,819,929	168	14,820,097
<i>Due to Other Governments</i>			
Due to Other Governments	4,334,935	0	4,334,935
Total Liabilities & Due to Other Governments	\$ 19,154,864	168	19,155,032

The notes to the financial statements are an integral part of this statement

CITY OF PORT ORCHARD
Notes To Financial Statements
December 31, 2006

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the City have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting and Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The significant accounting policies are described below.

A. REPORTING ENTITY

The City of Port Orchard, Washington was incorporated on September 1, 1890 and operates under the laws of the State of Washington applicable to non-charter code cities (second-class city) with a Mayor/Council form of government. As required by the generally accepted accounting principles the financial statements represent the City of Port Orchard. The City has no components units.

B. GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

Government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the primary government. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segments are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. In the full statement, several of the categories vary from 2005, due to changing the application of the program revenue and charges for services to the expenditure function as reported in prior years. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Fund financial statements are separate financial statements provided for governmental funds, proprietary funds and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

C. MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION

Basis of accounting refers to the point at which revenues and expenditures/expenses are recognized in the accounts and reported in the financial statements. Basis relates to the timing of the measurements made, regardless of the measurement focus applied.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are

CITY OF PORT ORCHARD
Notes To Financial Statements
December 31, 2006

recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements report the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 30 days of the end of the current fiscal period. Property tax is considered to be available if it is collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgements, are recorded only when payment is due.

Property taxes, franchise taxes, licenses and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the City.

The City reports the following major governmental funds:

The general fund is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The street fund accounts for revenue from State motor vehicle fuel taxes and expenditures for street construction, maintenance and repair. This fund accounts for transportation activities that the city council wants to review separately from other activities.

The government reports the following major proprietary funds:

The water-sewer fund accounts for the activity of the City's utility. Its revenues are received from the sales of water and sewer services. Expenses are for the maintenance and extensions of drainage, water and sewer service facilities, operating a water supply system, maintaining sewer treatment plants and operating a water drainage system.

Additionally, the government reports the following fund types:

Debt service funds account for the accumulation of resources for the payment of general long-term debt principal and interest.

Special revenue funds account for revenues from specific taxes, grants, or other sources, which are designated to finance particular activities of the City.

Capital project funds account for the acquisition or construction of general government capital improvements.

Agency funds represent assets held in a trustee or agency capacity for others and do not report results of operation. The City as Treasurer of the construction project of the Joint Wastewater Treatment Facility, holds the resources for the expansion in an agency fund.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same

CITY OF PORT ORCHARD
Notes To Financial Statements
December 31, 2006

limitation. The government has elected not to follow subsequent private-sector guidance. As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes and other charges between the government's water and sewer function and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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

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

D. BUDGETARY INFORMATION

1. Scope of budget

Annual appropriated budgets are adopted for the general fund, special revenue funds, debt service funds not related to special assessments and capital project funds, on the modified accrual basis of accounting. Budgets for debt service and capital project funds are adopted at the level of the individual debt issue or project and for fiscal periods that correspond to the lives of debt issues or projects. There is no difference between the budgetary basis and generally accepted accounting principles.

Proprietary funds are budgeted on the full accrual basis for management control purposes only.

Appropriations for general and special revenue funds lapse at year-end.

2. Adopting the budget

The City's budget procedures are mandated by RCW 35.33. The steps in the budget process are as follows:

1. Prior to November 1, the Mayor submits to the City Council. This budget is based on priorities established by the Council and estimates provided by City Departments during the preceding months, and balanced with revenue estimates made by the City Treasurer.
2. The Council conducts public hearings on the proposed budget in October and December.
3. The Council makes its adjustments to the proposed budget and adopts by ordinance a final balanced budget no later than December 31.
4. Within 30 days of adoption, the budget is available to the public.

CITY OF PORT ORCHARD
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3. Amending the budget

The City Treasurer is authorized to transfer budgeted amounts between departments within any fund; however any revisions that alter the total expenditures of a fund or that affect the number of authorized employee positions, salary ranges or other conditions of employment must be approved by the City Council.

When the Council determines that it is in the best interest of the City to increase or decrease the appropriations for a particular fund, it may do so by ordinance approved by one more than the majority after two readings.

Budget amounts shown in the basic financial statements are the final authorized amounts as revised during the year.

The financial statements contain the original and final budget information. The original budget is the first complete appropriated budget. The final budget is the original budget adjusted by all reserves, transfers, allocations, supplemental appropriations, and other legally authorized changes applicable for the fiscal year.

E. ASSETS, LIABILITIES AND NET ASSETS OR EQUITIES

1. Cash & Cash Equivalents

The City's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition. Cash resources of individual funds are invested into government investment pools with interest directly accruing for the benefit of the investing funds. This policy covers all funds operated by the City. Cash resources required for immediate reasons (within the next month) are invested to the extent possible in short-term investments with interest accruing to the benefit of each individual fund based on the monthly average cash balance of each fund.

Statutes authorize the City to invest in obligations of the U.S. Treasury, U.S. Agencies and instrumentalities, banker's acceptances, repurchase agreements, and the state treasurer's and county's investment pool. The City is also authorized to enter into reverse repurchase agreements, but did not participate in these investments during 2006.

Investments for the City are reported at fair value. The State Treasurer's Investment Pool and Kitsap County Investment Pool operate in accordance with appropriate state laws and regulations. The reported values of the pools are the same as the fair value of the pool shares.

For purposes of the statement of cash flows, the City considers the State and County government investment pools and all highly liquid investments with maturity of three months or less to be cash equivalents.

2. Receivables

Property tax receivables are shown net of an allowance for uncollectibles.

The Kitsap County Treasurer acts as an agent to collect property taxes levied in the County for all taxing authorities. Taxes are levied annually before December 15, and become a lien as of January 1, on property value listed as of the prior May 31. Assessed values are established by the County assessor at 100 percent of fair market value. A revaluation of all property is required every four years.

CITY OF PORT ORCHARD
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Taxes are due in two equal installments on April 30 and October 31. The County treasurer remits collections monthly to the appropriate district. Taxes receivable consists of property taxes and related interest and penalties. (See Note 5) Accrued interest receivable consists of amounts earned on investments, notes and contracts at the end of the year.

Special assessments are recorded when levied. Special assessments receivable consists of current and delinquent assessments and related interest and penalties. There were no outstanding special assessments receivable at December 31, 2006. Deferred assessments consist of unbilled special assessments that are liens against the property benefited.

Customer accounts receivable consists of amounts owed from private individuals or organizations for goods and services including amounts owed for which billings have not been prepared. Notes and contracts receivable consists of amounts owed on open accounts from private individuals or organizations for goods and services rendered.

3. Amounts due to and from other funds and governments, interfund loans and advances receivable

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

Advances between funds, as reported in the fund financial statements, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

4. Inventories

Inventories in governmental funds consist of expendable supplies held for consumption. The cost is recorded as an expenditure at the time individual items are purchased. Inventories in the proprietary funds are not significant and not recorded.

5. Capital assets

Capital assets, which include property, plant, equipment and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the City as assets with an initial, individual cost of more than \$4,000 (amount not rounded) and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

CITY OF PORT ORCHARD
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Property, plant and equipment are depreciated using the straight line method over the following estimated useful lives:

<u>Asset Category</u>	<u>Useful Life</u>
Buildings	50
Infrastructure	10-40
Utility Improvements	10-100
Mowers/Public Work Equipment	6-12
Vehicles	5
Office & Computer Equipment	4

The City has acquired certain assets with funding provided by federal financial assistance programs. Depending on the terms of the agreements involved, the federal government could retain an equity interest in these assets. However, the City has sufficient legal interest to accomplish the purposes for which the assets were acquired, and has included such assets within the applicable column in the statement of net assets.

6. Compensated absences

Compensated absences are absences for which employees will be paid, such as vacation and comp-time. In governmental funds, compensated absences that are expected to be liquidated with expendable available financial resources are reported as an expenditure and fund liability in the fund that will pay for them. In proprietary (and similar trust) funds, compensated absences are recorded as an expense and liability of the fund that will pay for them.

Vacation pay, which may be accumulated up to 30 days at December 31, is payable upon resignation, retirement or death (upon termination, pay is limited to 240 hours). Law enforcement employees (excluding management) earn 120 hours holiday leave annually and may carry over 96 hours at December 31st. This is payable upon resignation, retirement or death. Sick leave may be accumulated up to 960 hours and is not payable upon resignation, retirement or death.

7. Other accrued liabilities

This account consists of accrued wages and accrued employee benefits.

8. Deferred revenues

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but have not yet been earned.

	<u>Unavailable</u>	<u>Unearned</u>
Delinquent property taxes receivable (general fund)	25,827	0
Delinquent property taxes receivable (street fund)	42,807	0
Court receivables - not yet collected (general fund)	949,590	0
Court receivables - not yet collected (nonmajor governmental funds)	53,144	0
Kitsap Transit Prepaid Lease - not yet earned	0	50,416
Total deferred/unearned revenue for governmental funds	<u>1,071,368</u>	<u>50,416</u>

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9. Long-term obligations

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premium and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

10. Fund reserves and designations

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance are as follows:

GENERAL FUND	
Park Acquisition	50,387
Presentation System	6,500
City Hall Repairs	37,115
	94,002
STREET FUND	
Street Vacation Abutting Water (RCW 35.79.035)	7,500
	101,502

NOTE 2. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

A. EXPLANATION OF CERTAIN DIFFERENCES BETWEEN THE GOVERNMENTAL FUNDS BALANCE SHEET AND THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS

The governmental funds balance sheet includes a reconciliation between fund balance—total governmental funds and net assets—governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that “long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds.”

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The details of this difference are as follows:

Bonds payable	1,722,800
Plus: Deferred charge on refunding (to be amortized as interest expense)	15,934
Less: Deferred charge for issuance costs (to be amortized over life of debt)	(28,295)
Plus: Issuance premium (to be amortized as interest expense)	6,528
Accrued interest payable	4,580
Compensated absences	<u>200,388</u>
Net adjustment to reduce fund balance - total governmental funds to arrive at net assets - governmental activities	<u><u>1,921,935</u></u>

B. EXPLANATION OF CERTAIN DIFFERENCES BETWEEN THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES AND THE GOVERNMENT-WIDE STATEMENT OF ACTIVITIES

The governmental funds statement of revenues, expenditures and changes in fund balances includes a reconciliation between net changes in fund balances—total governmental funds and changes in net assets of governmental activities as reported in the government-wide statement of activities. One element of that reconciliation explains, “governmental funds report capital outlays as expenditures.” However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.”

The details of this difference are as follows:

Capital outlay	992,304
Depreciation expense	<u>(588,381)</u>
Net adjustment to decrease net changes in fund balances—total governmental funds to arrive at changes in net assets of governmental activities	<u><u>403,923</u></u>

Another element of that reconciliation states that “revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.”

The details of this \$92,455 difference are as follows:

Municipal Court revenue	95,235
Tax revenues - unavailable	<u>(2,780)</u>
Net adjustment to increase net changes in fund balances—total governmental funds to arrive at changes in net assets of governmental activities	<u><u>92,455</u></u>

Another element of that reconciliation states “Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.”

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The details of this \$1,870 difference are as follows:

Accrued interest	229
Employee benefits accrual	2,118
Amortization of issuance costs	(2,265)
Amortization of deferred amount on refunding	1,266
Amortization of bond premiums	<u>522</u>
Net adjustment to decrease net changes in fund balances—total governmental funds to arrive at changes in net assets of governmental activities	<u><u>1,870</u></u>

NOTE 3. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

There have been no material violations of finance-related legal or contractual provisions.

NOTE 4. DEPOSITS AND INVESTMENTS

DEPOSITS

The City has no policy related to custodial credit risk; however, all deposits are insured or collateralized with securities held by the entity or by the agent in the City's name.

The Washington State Treasurer's Office Local Government Investment Pool and the Kitsap County Investment Pool are classified as a 2(a) 7 investment pools, and therefore the City states the fair value of its investment in the pools based upon the share price of the pools. The City considers the amount invested in the government investment pools to be liquid investments, and as such cash equivalents.

The book value of deposits does not materially differ from the bank balance of deposits. As of December 31, 2006, the carrying amount of City cash and cash equivalents represents category one as follows:

	<u>12/31/2006</u>
Cash on hand	\$ 2,800
Cash deposits in bank accounts	12,180
Washington State Local Government Investment Pool	4,195,112
Kitsap County Investment Pool	<u>1,140,722</u>
Total cash and cash equivalents	<u>\$ 5,350,814</u>

The City's deposits and certificates of deposit are entirely covered by federal depository insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC).

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INVESTMENTS

As required by state law, all investments of the City's funds are obligations of the U.S. Government, U.S. agency issues, obligations of the State of Washington, general obligations of Washington State municipalities, or certificates of deposit with Washington State banks and savings and loan institutions. All temporary investments are stated at fair value. The only investments made by the City are with the Washington State Treasurer's Office Local Government Investment Pool (LGIP), and the Kitsap County Investment Pool, which are classified as cash equivalents. These are unrated external investment pools.

Further, the City is not subject to foreign currency risk or interest rate risk.

NOTE 5. PROPERTY TAXES

The Kitsap County Treasurer acts as an agent to collect property taxes levied in the County for all taxing authorities. Collections are distributed after the end of each month.

Property Tax Calendar

January 1	Taxes are levied and become an enforceable lien against properties.
February 14	Tax bills are mailed.
April 30	First of two equal installment payments is due.
May 31	Assessed value of property established for next year's levy at 100 percent of market value.
October 31	Second installment is due.

A City is permitted by law to levy up to \$3.60 per \$1,000 of assessed valuation for general governmental services. The City is annexed to South Kitsap Fire and Rescue. South Kitsap Fire may levy up to \$1.50 and the difference of South Kitsap Fire's levy and \$3.60 is the City's capacity. Washington State Constitution and Washington State Law, RCW 84.55.010 limit the rate.

The City's regular levy for 2006 was \$2.1274 per \$1,000 on an assessed valuation of \$590,880,351 for a total regular levy of \$1,257,022.

Special levies approved by the voters are not subject to the limitations listed above. In 2006, there was no outstanding voter approved bonds, therefore there was no additional levy.

CITY OF PORT ORCHARD
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NOTE 6. CAPITAL ASSETS

A. CAPITAL ASSETS

A summary of capital asset activity for the year ended December 31, 2006 was as follows:

	Restated Beginning Bal. 01/01/06	Increases	Decreases	Ending Balance
Governmental activities:				
Capital assets, not being depreciated				
Land and other improvements*	\$ 1,255,796	\$ 0	\$ 0	\$ 1,255,796
Construction in progress	167,258	252,155	17,904	401,509
Total capital assets, not being depreciated	1,423,054	252,155	17,904	1,657,305
Capital assets, being depreciated/depleted:				
Buildings	6,384,825	0	0	6,384,825
Equipment	1,703,659	144,928	18,916	1,829,671
Infrastructure	18,490,995	800,930	10,000	19,281,925
Total capital assets being depreciated	26,579,479	945,858	28,916	27,496,421
Less accumulated depreciation for:				
Buildings	956,372	132,432	0	1,088,804
Equipment	1,129,756	164,648	18,916	1,275,488
Infrastructure	12,125,947	291,301	10,000	12,407,248
Improvements other than buildings	0	0	0	0
Total accumulated depreciation	14,212,075	588,381	28,916	14,771,540
Total capital assets, being depreciated, net	12,367,404	357,477	0	12,724,881
Governmental activities capital assets, net	\$ 13,790,458	\$ 609,632	\$ 17,904	\$ 14,382,186

*Note The beginning balance of Land and Other Improvements is restated to reflect the correct beginning balance. \$524,000 has been deducted to remove property which does not belong to the City.

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental activities:	
General government	130,300
Security of persons and property	89,943
Transportation	334,713
Physical environment	5,314
Culture and recreation	28,111
Total depreciation expense—governmental activities	\$588,381

CITY OF PORT ORCHARD
Notes To Financial Statements
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	Balance 01/01/06	Increases	Decreases	Ending Balance
Business-type activities:				
Capital assets, not being depreciated:				
Land	\$ 726,103	\$ 0	\$ 0	726,103
Construction in progress	135,405	665,569	20,635	780,339
Total capital assets, not being depreciated	861,508	665,569	20,635	1,506,442
Capital assets, being depreciated:				
Buildings and system	2,815,418	16,515	0	2,831,933
Improvements other than buildings	21,140,565	1,070,445	0	22,211,010
Machinery and equipment	2,921,579	41,670	4,199	2,959,050
Total capital assets, being depreciated	26,877,562	1,128,630	4,199	28,001,993
Less accumulated depreciation for:				
Buildings and system	444,133	54,284	0	498,417
Improvements other than buildings	3,453,404	280,354	0	3,733,758
Machinery and equipment	1,686,363	123,635	0	1,809,998
Total accumulated depreciation	5,583,900	458,273	0	6,042,173
Total capital assets, being depreciated, net	21,293,662	670,357	4,199	21,959,820
Business-type activities capital assets, net	\$ 22,155,170	\$ 1,335,926	\$ 24,834	\$ 23,466,262

Depreciation expense was charged to functions/programs of the primary government as follows:

Business-type activities:	
Water-Sewer	458,273
Total depreciation expense—business-type activities	\$458,273

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Notes To Financial Statements
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B. CONSTRUCTION COMMITMENTS

At year-end the government's commitments with contractors are shown below.

2006 Governmental Construction In Progress Activity:

Project	Spent to Date	Remaining Commitment
Bay Street Pedestrian Path	\$110,091	\$ 1,164
Bay Street Enhancement	50	-0-
Tremont Street Widening	252,463	444,515
Cedar Heights Sidewalk	38,905	10,207
Total	\$401,509	\$455,886

2006 Business-type Construction In Progress Activity:

Project	Spent to Date	Remaining Commitment
Gorst Sewer Study	\$ 20,379	\$ -0-
Water Rights	71,095	19,883
Canyon Court Lift Station	31,515	44,907
Annapolis Intertie Building	55,455	22,494
Annapolis Intertie	75,580	24,093
Well #10	526,315	-0-
Total	\$780,339	\$111,377

NOTE 7. PENSION PLANS

Substantially all City of Port Orchard full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380. The following disclosures are made pursuant to GASB Statement 27, *Accounting for Pensions by State and Local Government Employers*.

PUBLIC EMPLOYEES' RETIREMENT SYSTEM (PERS) PLANS 1, 2 AND 3

Plan Description:

PERS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a combination defined benefit/defined contribution plan. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals and Superior courts (other than judges in a judicial retirement system); employees of legislative committees; community and technical colleges, college and university employees (not in national higher education retirement programs); judges of district and municipal courts; and employees of local governments. PERS participants who joined the system by September 30, 1977

CITY OF PORT ORCHARD
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are Plan 1 members. Those who joined on or after October 1, 1977 and by either February 28, 2002 for state and higher education employees, or August 31, 2002 for local government employees, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS participants joining the system on or after March 1, 2002 for state and higher education employees, or September 1, 2002 for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. PERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PERS retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

Plan 1 retirement benefits are vested after an employee completes five years of eligible service. Plan 1 members are eligible for retirement at any age after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The annual pension is 2 percent of the average final compensation per year of service, capped at 60 percent. The average final compensation is based on the greatest compensation during any 24 eligible consecutive compensation months. If qualified, after reaching the age of 66 a cost-of-living allowance is granted based on years of service credit and is capped at 3 percent annually.

Plan 2 retirement benefits are vested after an employee completes five years of eligible service. Plan 2 members may retire at the age of 65 with five years of service, or at the age of 55 with 20 years of service, with an allowance of 2 percent of the average final compensation per year of service. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period. Plan 2 retirements prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a 3 percent per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit; and a cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index), and capped at 3 percent annually.

Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. The defined benefit portion provides a benefit calculated at 1 percent of the average final compensation per year of service. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period. Effective June 7, 2006 Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years if twelve months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan. Vested Plan 3 members are eligible to retire with full benefits at age 65 or at age 55 with 10 years of service. Retirement prior to the age of 64 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a 3 percent per year reduction applies; otherwise an actuarial reduction will apply. The benefit is also actuarially reduced to reflect the choice of a survivor option. There is no cap on years of service credit; and Plan 3 provides the same cost-of-living allowance as Plan 2. The defined contribution portion can be distributed in accordance with an option selected by the member; either as a lump sum or pursuant to other options authorized the Employee Retirement Benefits Board.

There are 1,181 participating employers in PERS. Membership in PERS consisted of the following at September 30, 2005:

Retirees and Beneficiaries Receiving Benefits	68,609
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	22,567
Active Plan Members Vested	104,574
Active Plan Members Nonvested	<u>51,004</u>
Total	<u>246,754</u>

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Funding Policy:

Each biennium the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6 percent for local government unit employees. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan, and member contributions finance the defined contribution portion. The Employee Retirement Benefits Board sets Plan 3 employee contribution rates. Six rate options are available ranging from 5 to 15 percent; two of the options are graduated rates dependent on the employee's age. The methods used to determine the contribution requirements are established under state statute in accordance with Chapters 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2006, were as follows:

	<u>PERS Plan 1</u>	<u>PERS Plan 2</u>	<u>PERS Plan 3</u>
Employer*	3.69%	3.69%	3.69%
Employee	6.00%	3.50%	***

*The employer rates include the employer administrative expense fee currently set at .18%.

**Plan 3 defined benefit portion only.

***Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 members.

The City and the employees made the required contributions. The City's required contributions for the years ending December 31 were as follows:

	<u>PERS Plan 1</u>	<u>PERS Plan 2</u>	<u>PERS Plan 3</u>
2006	\$29,531	\$94,905	8,449
2005	25,916	55,938	4,374
2004	20,732	41,617	0

LAW ENFORCEMENT OFFICERS' AND FIREFIGHTERS' (LEOFF) PLANS 1 AND 2

Plan Description:

LEOFF is a cost-sharing multiple-employer retirement system comprised of two separate defined benefit plans. LEOFF participants who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977 are Plan 2 members. Membership in the system includes all full-time, fully compensated, local law enforcement officers and firefighters. LEOFF membership is comprised primarily of non-state employees. Effective July 1, 2003, the LEOFF Plan 2 Retirement Board was established to provide governance of LEOFF Plan 2. The Board's duties include adopting contribution rates and recommending policy changes to the Legislature for the LEOFF Plan 2 retirement plan. LEOFF defined benefits are financed from a combination of investment earnings, employer and employee contributions, and a special funding situation in which the state pays the remainder through state legislative appropriations. LEOFF retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

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Plan 1 retirement benefits are vested after an employee completes five years of eligible service. Plan 1 members are eligible for retirement with five years of service at the age of 50. The benefit per year of service is calculated as a percent of final average salary is as follows:

<u>Term of Service</u>	<u>Percent of Final Average</u>
20 or more years	2.0%
10 but less than 20 years	1.5%
5 but less than 10 years	1.0%

The final average salary is the basic monthly salary received at the time of retirement, provided a member has held the same position or rank for 12 months preceding the date of retirement. Otherwise, it is the average of the highest consecutive 24 months' salary within the last 10 years of service. If membership was established in LEOFF after February 18, 1974, the service retirement benefit is capped at 60 percent of final average salary. A cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index).

Plan 2 retirement benefits are vested after an employee completed five years of eligible service. Plan 2 members may retire at the age of 50 with 20 years of service, or at 53 with five years of service, with an allowance of 2 percent of the final average salary per year of service. The final average salary is based on the highest consecutive 60 months. Plan 2 retirements prior to the age of 53 are reduced 3 percent for each year that the benefit commences prior to the age of 53 and to reflect the choice of a survivor option. There is no cap on years of service credit; and a cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index), capped at 3 percent annually.

There are 376 participating employers in LEOFF.	
Membership in LEOFF consisted of the following as	
of the latest actuarial valuation date for the plans of	
September 30, 2005:Retirees and Beneficiaries	
Receiving Benefits	8,723
Terminated Plan Members Entitled to But Not Yet	
Receiving Benefits	577
Active Plan Members Vested	12,348
Active Plan Members Nonvested	3,543
Total	<u>25,191</u>

Funding Policy:

Starting on July 1, 2000, Plan 1 employers and employees will contribute zero percent as long as the plan remains fully funded. Employer and employee contribution rates are developed by the Office of the State Actuary to fully fund the plan. Plan 2 employers and employees are required to pay at the level adopted by the Department of Retirement Systems in accordance with 41.45 RCW. All employers are required to contribute at the level required by state law. The Legislature, by means of a special funding arrangement, to appropriate money from the state General Fund to supplement the current service liability and fund the prior service costs of Plan 1 and Plan 2 in accordance with the requirements of the Pension Funding Council. However, this special funding situation is not mandated by the state constitution and this funding requirement could be returned to the employers by a change of statute. The methods used to determine the contribution rates are established under state statute in accordance with Chapters 41.26 and 41.45 RCW.

CITY OF PORT ORCHARD
Notes To Financial Statements
December 31, 2006

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2006, were as follows:

	<u>LEOFF Plan 1</u>	<u>LEOFF Plan 2</u>
Employer*	.18%	4.90%**
Employee	0.00%	7.85%
State	0.00%	3.13%

*The employer rates include the employer administrative expense fee currently set at 0.18%.

The City and the employees made the required contributions. The City's required contributions for the years ending December 31 were as follows:

	<u>LEOFF Plan 1</u>	<u>LEOFF Plan 2</u>
2006	\$ 0	\$142,766
2005	0	115,818
2004	0	95,994

OTHER RETIREMENT SYSTEMS – VOLUNTEER FIRE FIGHTERS’ RELIEF AND PENSION FUND

The Volunteer Fire Fighters’ Relief and Pension Fund System is a cost-sharing multiple-employer retirement system, which was created by the Legislature in 1945 under Chapter 41.24 RCW. It provides pension, disability and survivor benefits. Membership in the system requires service with a fire department of an electing municipality of Washington State except those covered by LEOFF. The system is funded through member contributions of \$30 per year; employer contributions of \$30 per year; 40 percent of the Fire Insurance Premium Tax; and earnings from the investment of moneys by the Washington State Investment Board. However, members may elect to withdraw their contributions upon termination.

As of January 1, 2002, the City annexed to South Kitsap Fire and Rescue. South Kitsap Fire now reports former City of Port Orchard volunteers. The City does have police reserve officers covered under this system.

NOTE 8. RISK MANAGEMENT

The City of Port Orchard is a member of the Association of Washington Cities Risk Management Service Agency (AWC RMSA). Chapter 48.62 RCW authorizes the governing body of any one or more governmental entities to form together into or join a pool or organization for the joint purchasing of insurance, and/or joint self-insuring, and/or joint hiring or contracting for risk management services to the same extent that they may individually purchase insurance, self-insure, or hire or contract for risk management services. An agreement to form a pooling arrangement was made pursuant to the provisions of Chapter 39.34 RCW, the Interlocal Cooperation Act. The AWC RMSA was formed on January 1, 1989 when 32 municipalities in the State of Washington joined together by signing an Interlocal Governmental Agreement to pool their self-insured losses and jointly purchase insurance and administrative services. Currently, 82 municipalities participate in the pool (as of 12/31/06).

The AWC RMSA allows members to establish a program of joint insurance and provides risk management services to all members. All coverages are on an occurrence basis. The AWC RMSA provides all risk property, comprehensive crime, general liability, automobile liability, police liability, public officials liability, employee fidelity and faithful performance, and boiler and machinery insurance coverage.

CITY OF PORT ORCHARD
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December 31, 2006

Boiler and machinery is included with the property insurance carrier, as of June 1, 2005, and employee fidelity coverage is a stand-alone policy that the AWC RMSA arranges for its members. The AWC RMSA also allows members to group purchase airport liability coverages.

Members pay an annual assessment to the AWC RMSA. The AWC RMSA is responsible for payment of all covered causes of loss against the jurisdiction above the stated retention. AWC RMSA, itself, pays out of its own funds all claims up to \$300,000 for liability and \$25,000 for property and thereafter purchases excess liability insurance through NLC Mutual Insurance Company, up to \$1 million, and CV Starr, from \$1 million to \$5 million. The excess property coverage is purchased through Affiliated FM, using the Pool's broker, Willis of Seattle, Inc. Since the AWC RMSA is a cooperative program, the members of the AWC RMSA are jointly liable.

Members contract to remain in the pool a minimum of one year and must give one-year notice before terminating participation. The Interlocal Governmental Agreement is renewed automatically each year. Even after termination, a member is still responsible for contributions to the Pool for any unresolved, unreported and in-process claims for the period they were a signatory to the Interlocal Governmental Agreement. The Pool is governed by a board of directors serving ex-officio as the AWC Board of Directors.

As discussed above, the AWC RMSA establishes a loss fund for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses.

The specific financials of the AWC RMSA can be seen in the Annual Report on file with the City of Port Orchard.

NOTE 9. LONG-TERM DEBT

A. LONG-TERM DEBT

The City issues general obligation bonds to provide funds for the acquisition and construction of major capital facilities. The City has \$2,360,000 in general obligation bonds outstanding on December 31, 2006. The original amount was \$3,000,000.00.

General obligation bonds are direct obligations and pledge the full faith and credit of the government. These bonds generally are issued as 20-year serial bonds with equal amounts of principal maturing each year. General obligation bonds are either created by 3/5 majority vote of the people and, therefore, financed by a special tax levy; or created by ordinance, adopted by the City Council, and normally financed from general revenues (councilmanic bonds). General obligation bonds currently outstanding are as follows:

<u>Name of Issuance</u>	<u>Purpose</u>	<u>Issuance Date</u>	<u>Maturity Date</u>	<u>Interest Rate</u>	<u>Debt Outstanding</u>
	Business Type & Governmental				
2003 LTGO Bond	Activities	6/1/2003	12/1/2019	2%-3.8%	\$ <u>2,360,000</u>
Total General Obligation Bonds					\$ <u><u>2,360,000</u></u>

CITY OF PORT ORCHARD
Notes To Financial Statements
December 31, 2006

The City provides for cash to fund current debt service requirements as a part of the budgeting process. Annual debt service requirements to maturity for general obligation bonds are as follows:

	Governmental Activities			Business-Type Activities		
	Principal	Interest	Total Requirements	Principal	Interest	Total Requirements
2007	113,150	54,964	168,114	41,850	20,329	62,179
2008	113,150	52,136	165,286	41,850	19,282	61,132
2009	116,800	49,306	166,106	43,200	18,236	61,436
2010	120,450	46,386	166,836	44,550	17,156	61,706
2011	124,100	42,772	166,872	45,900	15,820	61,720
2012-2016	675,250	154,105	829,355	249,750	56,997	306,747
2017-2019	459,900	34,625	494,525	170,100	12,806	182,906
	<u>\$ 1,722,800</u>	<u>\$ 434,294</u>	<u>\$ 2,157,094</u>	<u>\$ 637,200</u>	<u>\$ 160,626</u>	<u>\$ 797,826</u>

B. GOVERNMENTAL NOTE

Government note in business activity outstanding at year-end is as follows:

Name & Amount of Issuance	Purpose	Issuance Date	Maturity Date	Interest Rate	Debt Outstanding
<u>Business-type Activities</u>					
McCormick Note	Capital	11/23/1998	N/A	0.00%	276,050
Business-type Total					<u>276,050</u>
<i>Total Note</i>					<u>\$ 276,050</u>

The promissory note that was entered into for the purchase of the McCormick Water Company is being repaid with new McCormick water connection fees as the revenue source. There is \$700 paid on each of the first 550 connections and \$225 paid on the 551st connection through the 800th connection. Payments are made no less frequent than quarterly. This type of note does not have a repayment schedule.

C. REFUNDED DEBT

In prior years, the City has defeased various bond issues by creating separate irrevocable trust funds. New debt has been issued and the proceeds have been used to purchase US Government securities that were placed in the trust funds. The investments and fixed earnings from the investments are sufficient to fully service the defeased debt until the debt is called or matures. For financial reporting purposes, the debt has been removed as a liability from the governmental activities column of the statement of net assets. At December 31, 2006, \$75,000 of bonds outstanding are considered defeased.

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NOTE 10. CHANGES IN LONG-TERM LIABILITIES

The following is a summary of long-term debt changes of the City for the year ended December 31, 2006:

	Beginning			Ending	Due Within
	<u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u>	<u>One Year</u>
Governmental activities					
Bonds payable:					
General obligation bonds	\$ 1,832,300	\$ 0	\$ 109,500	\$ 1,722,800	\$ 113,150
Less deferred amounts					
For issuance premiums (discounts)	7,051	0	522	6,529	522
On refunding	17,200	0	1,266	15,934	1,266
Total bonds payable	<u>1,856,551</u>	<u>0</u>	<u>111,288</u>	<u>1,745,263</u>	<u>114,938</u>
Compensated absences	<u>202,506</u>	<u>0</u>	<u>2,118</u>	<u>200,388</u>	<u>0</u>
Governmental activity long-term liabilities	<u>\$ 2,059,057</u>	<u>\$ 0</u>	<u>\$ 113,406</u>	<u>\$ 1,945,651</u>	<u>\$ 114,938</u>
Business-type activities					
Bonds payable					
General obligation bonds	\$ 677,700	\$ 0	40,500	\$ 637,200	\$ 41,850
Less deferred amounts					
For issuance premiums (discounts)	2,592	0	192	2,400	192
On refunding	2,248	0	166	2,082	166
Total bonds payable	<u>682,540</u>	<u>0</u>	<u>40,858</u>	<u>641,682</u>	<u>42,208</u>
Private note	301,250	0	25,200	276,050	0
Compensated absences	<u>37,171</u>	<u>0</u>	<u>376</u>	<u>36,795</u>	<u>0</u>
Business-type activity long-term liabilities	<u>\$ 1,020,961</u>	<u>\$ 0</u>	<u>\$ 66,434</u>	<u>\$ 954,527</u>	<u>\$ 42,208</u>

NOTE 11. CONTINGENCIES AND LITIGATION

The City of Port Orchard has situations which are not yet resolved, but based on available information, in the opinion of management, the City of Port Orchard's insurance policies/and or reserves are adequate to pay all known or pending claims.

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Notes To Financial Statements
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NOTE 12. INTERFUND TRANSFERS

Interfund transfers are the flow of assets without a reciprocal return of assets, goods or services. These are transfers to support other funds without a requirement for repayment. The interfund transfer activity for the year is as follows:

	General Fund	City Street	Nonmajor Gov't Funds	Total
Transfer In:				
General Fund	\$ 0	\$ 0	\$ 10,712	\$ 10,712
Street Fund	\$ 0	\$ 0	\$ 0	\$ 0
Nonmajor Governmental Funds	\$ 0	\$ 0	\$ 294,202	\$ 294,202
Total	\$ 0	\$ 0	\$ 304,914	\$ 304,914
	General Fund	City Street	Nonmajor Gov't Funds	Total
Transfer Out:				
General Fund	\$ 0	\$ 0	\$ 205,069	\$ 205,069
Street Fund	\$ 0	\$ 0	\$ 25,000	\$ 25,000
Nonmajor Governmental Funds	\$ 3,752	\$ 0	\$ 71,093	\$ 74,845
Total	\$ 3,752	\$ 0	\$ 301,162	\$ 304,914

NOTE 13. INTERGOVERNMENTAL RECEIVABLES AND PAYABLE BALANCES

	Account	Balance 12/31/06
A. Receivables		
Governmental Activities	302 0.132.00.00	\$325,810
B. Payables		
Agency Fund	404 0.227.00.00	\$325,810

The purpose was a short-term interfund loan from a reserve fund to the Joint Wastewater Treatment Facility Expansion.

NOTE 14. JOINT VENTURES

In 1983, the City of Port Orchard and Karcher Creek Sewer District amended an intergovernmental agreement relating to the construction and management of the secondary wastewater treatment facility. This joint venture establishes the Sewer Advisory Committee consisting of three representatives from each entity who prepare and monitor the facilities budget, after it is adopted by the City and District.

The Sewer District is responsible for the daily operation of the facility. The participants pay their share of the O & M expenses based on their portion of flow into the facility. The current cost sharing is 47% City and 53% District.

CITY OF PORT ORCHARD
Notes To Financial Statements
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The District & the City share 50/50% ownership in the facility's total assets. In 2006, the City's portion of the facilities decrease in assets is \$200,318, which was due primarily to depreciation expense. The City of Port Orchard's equity interest in the secondary wastewater treatment facility assets was \$3,310,565 on December 31, 2006. The City's equity interest in the expansion at the end of 2006 was \$2,393,086 for a total of \$5,703,651.

In 2002, the Wastewater Treatment Facility began expansion plans. The cost of this expansion is now approximately \$21.52 million with completion anticipated in 2007. The project was approved for a \$10 million Public Works Trust Fund Loan in 2002 and another 6.8 million in 2003. Both loans are issued on behalf of the Joint Venture in the City of Port Orchard's name. Payment on debt is made by the Joint Venture; therefore the loan is not disclosed as a liability of the City. The draw down on the loans began in 2004 and as of December 31, 2006, the City has drawn \$15,960,000.00. At the end of 2006, \$21,374,858 had been spent on the project, and the total project was approximately 95% physically complete. The construction contract was complete. The City and Karcher Creek Sewer District will share in the excess expenditures.

The City of Port Orchard is the lead agent in the construction project. The City, as Treasurer of the project, holds the resources for the expansion in an agency fund. At the completion, the agency fund will be closed to the Joint Venture.

The treatment facility is utilizing a new Zenon membrane technology that provides an advanced level of wastewater treatment that is very effective in particulate and pathogen removal. It is also instrumental in eliminating color, Total Organic Carbon (TOC) and Dissolved Organic Carbon (DOC) when combined with coagulant addition. In short, the Zenon membrane will yield a highly treated water effluent as a product of this process.

The expansion of the Wastewater Treatment Facility will increase the capacity from 2.8 million gallons per day to 4.5 million gallons per day, with the possibility of future expansion.

Complete financial statements for the treatment facility can be obtained from Karcher Creek Sewer District at P O Box 1309, Port Orchard, WA 98366.

NOTE 15. POST RETIREMENT BENEFITS OTHER THAN PENSION BENEFIT

In addition to the pension benefits described in Note 7 the City of Port Orchard provides post retirement health care benefits to LEOFF 1 employees in accordance with RCW 41.26.150. Currently, LEOFF 1 retirees meet those eligibility requirements.

The City of Port Orchard reimburses 100 percent of the amount of validated claims for medical, prescription, and hospitalization costs incurred by LEOFF 1 retirees. The City also reimbursed \$88.50 per month, for a Medicare supplement for one retiree eligible for Medicare.

Employer contributions are financed on pay-as-you-go basis. Expenditures for post retirement health care benefits are recognized as retirees report claims.

During the year, expenditures of \$58,590 were recognized for post retirement health care.

NOTE 16. OTHER DISCLOSURES

PRIOR PERIOD ADJUSTMENTS

A prior period adjustment in the amount of \$524,000 is reflected in the Governmental Activities Capital Assets to correct the inclusion of an asset, which did not belong to the City. That amount should not have been included in capital assets in prior years.



ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

Our mission is to work in cooperation with our audit clients and citizens as an advocate for government accountability. As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

The State Auditor's Office has 300 employees who are located around the state to deliver our services effectively and efficiently. Approximately 65 percent of our staff are certified public accountants or hold other certifications and advanced degrees.

Our regular audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. We also perform fraud and whistleblower investigations. In addition, we have the authority to conduct performance audits of state agencies and local governments.

The results of our audits are widely distributed through a variety of reports, which are available on our Web site. We continue to refine our reporting efforts to ensure the results of our audits are useful and understandable.

We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive program to coordinate audit efficiency and to ensure high-quality audits.

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Chief Policy Advisor
Director of Administration
Director of Audit
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Director of Special Investigations
Director for Legal Affairs
Local Government Liaison
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