# MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of King County's (the County) Comprehensive Annual Financial Report (CAFR) presents a narrative overview and analysis of the financial activities of the County for the year ended December 31, 2003. We encourage readers to consider this information in conjunction with the additional information that is furnished in the letter of transmittal, which can be found preceding this narrative, and with the County's financial statements and notes to the financial statements, which follow.

The County is in its second year of implementing new reporting standards with significant changes in content and structure from years prior to fiscal year ended December 31, 2002.

## FINANCIAL HIGHLIGHTS – PRIMARY GOVERNMENT

- As of December 31, 2003, the assets of the County exceeded its liabilities by $2,904.4 million (net assets). Because all of the County's net assets are either invested in capital assets or restricted as to use, the combined unrestricted net assets showed a $252.1 million deficit at the end of the year.

- In 2003, the County's total net assets increased by 7.3 percent or $197.1 million. The governmental net assets increased by 17.4 percent or $181.0 million, and the business-type net assets increased by 1.0 percent or $16.1 million.

- As of December 31, 2003, the County's governmental funds reported combined ending fund balances of $332.4 million. Approximately 60.8 percent or $202.3 million is unreserved fund balance available for spending at the government's discretion within the purposes specified for the County's funds.

- At the end of 2003, the unreserved, undesignated fund balance for the general fund was $67.9 million amounting to 14.6 percent of total general fund expenditures for 2003. Total fund balance for the general fund increased 5.6 percent or $5.1 million for the year.

- The County's total bonded debt decreased by $69.5 million or 2.8 percent in 2003 due primarily to the $94.4 million of debt service payments made during the year.

## OVERVIEW OF THE FINANCIAL STATEMENTS

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

### Government-wide Financial Statements

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

most businesses, taking into account all revenues and expenses connected with the fiscal year, even if cash involved has not been received or paid. The government-wide financial statements include two statements:

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

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

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

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

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

**Discretely presented component units.** The government-wide financial statements include not only King County itself as the *primary government*, but also three legally separate entities for which the County is financially accountable: the Harborview Medical Center (HMC), the Washington State Major League Baseball Stadium Public Facilities District (PFD), and the Cultural Development Authority (CDA) of King County. Financial information for these component units is reported separately from the financial information presented for the primary government itself in a single, aggregated presentation in the government-wide financial statements. Individual financial statements for each component unit can be found immediately following the fiduciary funds financial statements in the Basic Statements section of this report.

**Fund Financial Statements**

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

**Governmental funds.** Most of the basic services provided by the County are financed through governmental funds. Governmental funds are used to account for essentially the same functions that are reported as governmental activities in the government-wide financial statements. Unlike the government-wide financial statements, however, the governmental funds financial statements focus on: (1) how cash and other financial assets can readily be converted to available resources; and (2) the balances left at year-end that are available for spending. Such information may be useful in determining whether there will be adequate financial resources available to meet the current needs of the County.

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

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

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

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

**Proprietary funds.** Proprietary funds are generally used to account for services for which the County charges customers a fee. Proprietary funds provide the same type of information as shown in the government-wide financial statements, only in more detail. Like the government-wide financial statements, proprietary funds financial statements use the accrual basis of accounting. There is no reconciliation needed between the government-wide financial statements for business-type activities and the proprietary funds financial statements. The basic proprietary funds financial statements can be found immediately following the governmental funds financial statements.

The County maintains the following two types of proprietary funds:

> ***Enterprise funds*** are used to report the same functions presented as business-type activities in the government-wide financial statements. The proprietary funds financial statements provide separate information for the Water Quality Enterprise and the Public Transportation Enterprise, both considered to be major funds of the County for financial reporting

purposes. All other enterprise funds are aggregated into a single presentation within the proprietary funds financial statements.

***Internal service funds*** are used to report activities that provide services to the County's other programs and activities on a cost reimbursement basis. The County uses internal service funds to account for its motor pool, information and telecommunications services, facilities management, risk management, employee benefits and retirement, and financial and various other administrative services. These services predominantly benefit governmental rather than business-type functions and have been included within governmental activities in the government-wide financial statements. One internal service fund that provides equipment and fleet maintenance and procurement for the Water Quality Enterprise is included within the business-type activities in the government-wide financial statements but is combined with all other internal service funds into a single aggregated presentation in the proprietary funds financial statements.

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

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

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

**Notes to the financial statements**

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

**Other information**

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

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

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

### Analysis of Net Assets

Net assets may serve over time as a useful indicator of a government's financial position. As indicated in the condensed financial information on the following page, which was derived from the government-wide Statement of Net Assets, the County's combined net assets (governmental and business-type activities) were $2,904.4 million at the end of 2003. This is an increase of 7.3 percent or $197.1 million over the net assets of the previous year, as restated.

**Governmental activities.** Although net assets of the County's governmental activities increased 17.4 percent to $1,220.7 million, all of the net assets are either subject to external restrictions as to how they may be used, or are invested in capital assets (e.g., land, buildings, infrastructure, right-of-way, equipment, and work in progress) less any related outstanding debt used to acquire those assets. Consequently, *unrestricted net assets* for governmental activities showed a $354.6 million deficit at the end of 2003. This is a 13.4 percent or $54.9 million decrease in the deficit in unrestricted net assets as of fiscal year-end 2002.

**Net Assets as of December 31, 2003**
**(In millions)**

| | Governmental Activities | | Business-type Activities | | Total | |
|---|---|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| **Assets:** | | | | | | |
| Current and other assets | $ 725.4 | $ 753.0 | $ 743.8 | $ 879.1 | $ 1,469.2 | $ 1,632.1 |
| Capital assets | 1,857.0 | 1,647.7 | 2,967.9 | 2,760.6 | 4,824.9 | 4,408.3 |
| Total assets | 2,582.4 | 2,400.7 | 3,711.7 | 3,639.7 | 6,294.1 | 6,040.4 |
| **Liabilities:** | | | | | | |
| Long-term liabilities | 1,113.6 | 1,119.2 | 1,776.4 | 1,614.6 | 2,890.0 | 2,733.8 |
| Other liabilities | 248.1 | 247.6 | 251.6 | 357.4 | 499.7 | 605.0 |
| Total liabilities | 1,361.7 | 1,366.8 | 2,028.0 | 1,972.0 | 3,389.7 | 3,338.8 |
| **Net Assets:** | | | | | | |
| Invested in capital assets, net of related debt | 1,316.2 | 1,148.0 | 1,220.5 | 1,124.5 | 2,536.7 | 2,272.5 |
| Restricted | 259.1 | 295.4 | 360.7 | 407.7 | 619.8 | 703.1 |
| Unrestricted | (354.6) | (409.5) | 102.5 | 135.5 | (252.1) | (274.0) |
| Total net assets | $ 1,220.7 | $ 1,033.9 | $ 1,683.7 | $ 1,667.7 | $ 2,904.4 | $ 2,701.6 |

This deficit does not mean that the County's governmental activities do not have resources available to pay their obligations in the coming year. The increase in net assets for governmental activities in 2003 reflects the County's ability, on an annual basis, to meet its current obligations in those activities including the related debt service requirements. The deficit in the unrestricted net assets is the result of the governmental activities having long-term commitments that are greater than currently available resources. Specifically, the County's governmental activities include general obligation debt of $478.9 million, $32.2 million less than at the end of 2002, for which no corresponding assets are recorded, but for which future revenues are obligated.

Of the amount of debt with no corresponding assets, 68.7 percent or $329.1 million is related to assets that are recorded on the books of the County's three discretely presented component

units: the Washington State Major League Baseball Stadium PFD ($250.0 million), the Harborview Medical Center ($73.7 million) and the Cultural Development Authority ($5.4 million). As discretely presented component units, these entities are not part of the primary government or incorporated into this analysis. The remainder of the debt, for which there are no corresponding assets, consists of $116.0 million associated with the Kingdome facility, which was demolished to make room for the Seahawks (Qwest) Football Stadium, and $33.8 million used to finance assets that have been contributed by the County to other programs and services that benefit the citizens of the County.

**Business-type activities.** There was a slight increase in net assets of the business-type activities of 1.0 percent to $1,683.7 million. Of the total net assets for business-type activities, 72.5 percent or $1,220.5 million is invested in capital assets (e.g., land, buildings, vehicles, plant assets, equipment, and work in progress), net of related debt. This is an increase of $96.0 million over 2002 due primarily to the ongoing significant capital asset acquisition plans of the Water Quality and Public Transportation Enterprise operations. The business-type activities use these capital assets to provide services to their customers; consequently, these assets are not available for future spending. The resources needed to repay the debt incurred to acquire these assets must be provided from other sources since the capital assets themselves cannot be liquidated for these liabilities. Another 21.4 percent of the total net assets for the business-type activities is restricted as to use for capital construction ($256.8 million), debt service ($98.8 million), and litigation settlements ($5.1 million). The remaining 6.1 percent or $102.5 million is unrestricted net assets that may be used to finance the continuing operations of the County's business-type activities. Any balance in the unrestricted net assets for business-type activities cannot be used to reduce the unrestricted net asset deficit in governmental activities.

The combination of the $354.6 million deficit in the governmental activities unrestricted net assets and the $102.5 million positive balance in the business-type activities unrestricted net assets resulted in the deficit of $252.1 million in total unrestricted net assets for the County as a whole.

**Analysis of Changes in Net Assets**

The increase in 2003 in the County's total net assets resulted from revenues exceeding related expenses and reflects the County's ability to meet its ongoing obligations including its debt service requirements. Approximately 40.8 percent of the County's total revenues came from taxes, primarily property tax and the retail sales and use tax. Charges for various goods and services provided 40.0 percent of the total revenues, while 17.8 percent was derived from operating and capital grants and contributions (including state and federal assistance). The County's expenses cover a range of services, the largest of which were for law, safety and justice; public transportation; mental and physical health; and water quality.

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

**Governmental activities.** Governmental activities accounted for 91.9 percent of the total growth in net assets of the County, resulting in an increase in the County's net assets of $181.0 million. Program revenues for governmental activities total $735.2 million and include the amount paid by those who directly benefited from the programs ($432.9 million), and by other governments and organizations that subsidized certain programs with operating grants and contributions ($198.6 million), and capital grants and contributions ($103.7 million). In 2003 the cost of all governmental activities was $1,151.3 million. The County paid for the $416.1 million remaining "public benefit" portion of governmental activities with $394.9 million in property

taxes, $121.2 million in retail sales and use taxes, and $71.6 million in other revenues including other taxes and interest earnings offset by the loss on the sale of capital assets. As discussed earlier, all of the increase in governmental activities net assets was either restricted as to use or used to acquire capital assets to provide services to the County's citizens.

**Changes in Net Assets**
**For the Year Ended December 31, 2003**
**(In millions)**

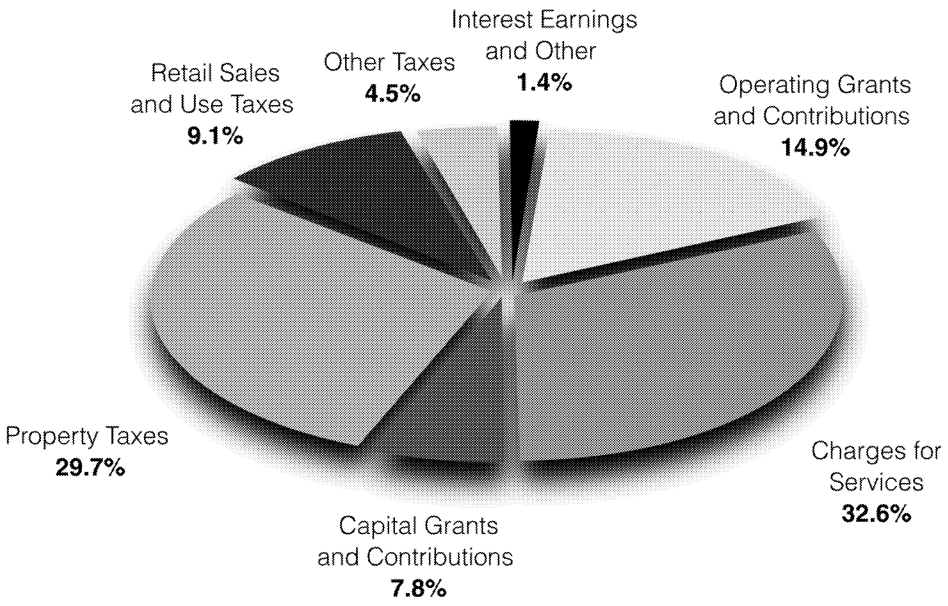
| | Governmental Activities | | Business-type Activities | | Total | |
|---|---|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| **Revenues** | | | | | | |
| Program revenues: | | | | | | |
| Charges for services | $ 432.9 | $ 430.3 [a] | $ 422.5 | $ 420.5 | $ 855.4 | $ 850.8 |
| Operating grants and contributions | 198.6 | 187.8 [a] | 24.3 | 31.3 | 222.9 | 219.1 |
| Capital grants and contributions | 103.7 | 83.1 | 53.8 | 52.1 | 157.5 | 135.2 |
| General revenues: | | | | | | |
| Property taxes | 394.9 | 390.7 | - | - | 394.9 | 390.7 |
| Retail sales and use taxes | 121.2 | 120.9 | 296.7 | 297.3 | 417.9 | 418.2 |
| Other taxes | 59.6 | 49.8 | - | - | 59.6 | 49.8 |
| Unrestricted interest earnings | 20.2 | 30.1 | 10.9 | 26.3 | 31.1 | 56.4 |
| Gain (loss) on sale of capital assets | (1.3) | (12.5) | 0.4 | (4.1) | (0.9) | (16.6) |
| Total revenues | 1,329.8 | 1,280.2 | 808.6 | 823.4 | 2,138.4 | 2,103.6 |
| **Expenses[b]** | | | | | | |
| General government | 52.4 | 43.3 | - | - | 52.4 | 43.3 |
| Law, safety and justice | 491.8 | 462.8 | - | - | 491.8 | 462.8 |
| Physical environment | 52.4 | 51.6 | - | - | 52.4 | 51.6 |
| Transportation | 64.7 | 63.4 | - | - | 64.7 | 63.4 |
| Economic environment | 80.4 | 73.3 | - | - | 80.4 | 73.3 |
| Mental and physical health | 327.2 | 316.6 | - | - | 327.2 | 316.6 |
| Culture and recreation | 36.4 | 33.7 | - | - | 36.4 | 33.7 |
| Interest and other debt service costs | 46.0 | 53.1 | - | - | 46.0 | 53.1 |
| Airport | - | - | 11.5 | 11.8 | 11.5 | 11.8 |
| Public transportation | - | - | 464.5 | 446.2 | 464.5 | 446.2 |
| Solid waste | - | - | 78.5 | 79.3 | 78.5 | 79.3 |
| Water quality | - | - | 229.3 | 236.5 | 229.3 | 236.5 |
| Other enterprises activity | - | - | 6.2 | 5.4 | 6.2 | 5.4 |
| Total expenses | 1,151.3 | 1,097.8 | 790.0 | 779.2 | 1,941.3 | 1,877.0 |
| Increase in net assets before transfers | 178.5 | 182.4 | 18.6 | 44.2 | 197.1 | 226.6 |
| Transfers | 2.5 | (0.9) | (2.5) | 0.9 | - | - |
| Increase in net assets | 181.0 | 181.5 | 16.1 | 45.1 | 197.1 | 226.6 |
| Net assets, beginning of year (Restated) | 1,039.6 | 852.4 | 1,667.7 | 1,622.6 | 2,707.3 | 2,475.0 |
| Net assets, end of year | $ 1,220.6 | $ 1,033.9 | $ 1,683.8 | $ 1,667.7 | $ 2,904.4 | $ 2,701.6 |

[a] 2002 revenues have been restated for comparison purposes only. $200.0 million recorded as operating grant revenues in 2002 should have been classified as fees for services.

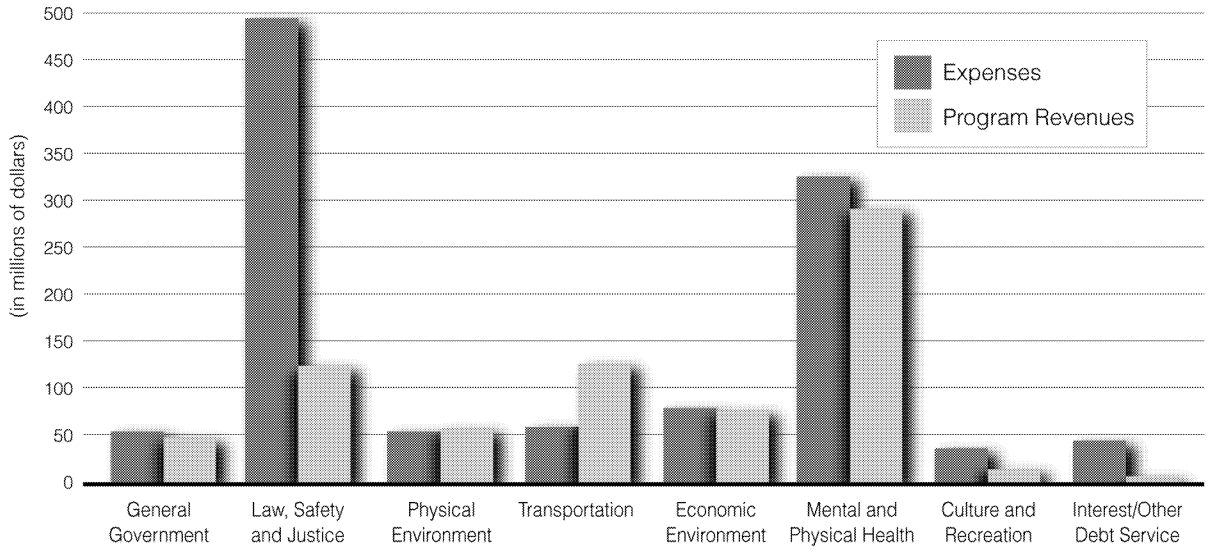
[b] Expenses for all functions include the allocation of indirect expenses from the general government function. The amount of indirect general government expenses allocated to each function is shown in a separate column on the County's government-wide Statement of Activities alongside the column that reflects the direct operating expenses incurred by each function. As a result of this allocation, the $52.4 million in General government expense above consists of $111.2 million in direct program expenses reduced by a net allocation of $58.8 million to other County functions.

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

**Revenues by Source - Governmental Activities**




**Expenses and Program Revenues - Governmental Activities**



Charges for services provided 32.6 percent, and property taxes 29.7 percent, of total revenues for governmental activities. The most significant expense amount is for Law, safety and justice, a function that requires the greatest usage of general government revenues. The primary revenue sources for Mental and physical health are charges for services and operating grants and contributions, which pay for 87.5 percent of the activities for that function. In 2003 Transportation received $52.0 million in infrastructure capital assets (roads) and $23.0 million in right-of-way (land) from other local governments, capital contributions that enabled program revenues to exceed expenses.

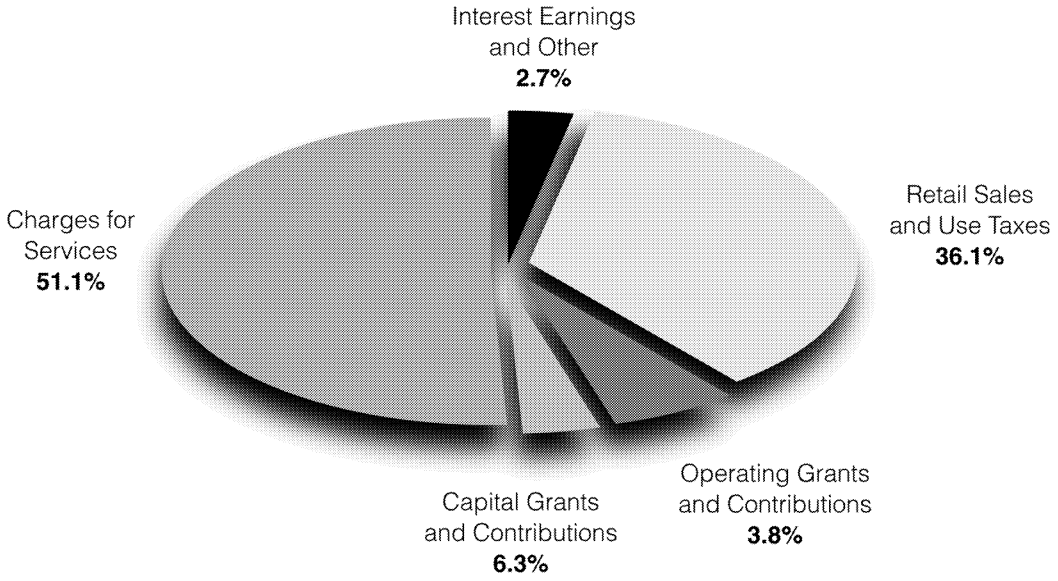
A comparison of the cost of services by function for the County's governmental activities is shown below, along with the revenues used to cover the net expenses of the governmental activities (expressed in millions):

| | |
|---|---|
| **Earnings Net of Program Revenues:** | |
| General government | $ (4.2) |
| Law, safety and justice | (370.5) |
| Physical environment | 5.1 |
| Transportation | 63.6 |
| Economic environment | (10.1) |
| Mental and physical environment | (37.2) |
| Culture and recreation | (24.3) |
| Interest and other debt service costs | (38.5) |
| Total expenses | (416.1) |
| **General revenues:** | |
| Property taxes | 394.9 |
| Retail sales and use taxes | 121.2 |
| Other taxes | 59.6 |
| Unrestricted interest earnings | 20.2 |
| Other | 1.2 |
| Increase in net assets | $ 181.0 |

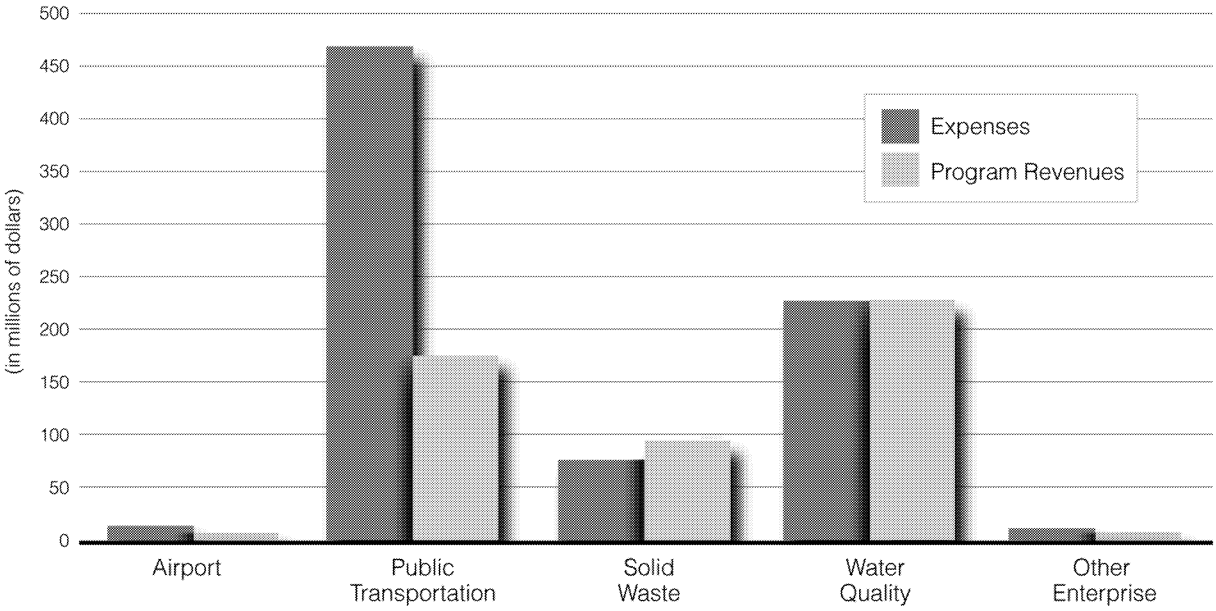
**Business-type activities.** Business-type activities increased the County's net assets by $16.0 million in 2003, accounting for 8.1 percent of the total growth in net assets of the County. Total revenues for business-type activities were $808.6 million. The cost of all business-type activities for 2003 was $790.1 million. Of that amount, 63.4 percent or $500.6 million was funded from program revenues, including $422.5 million in charges for services, $24.3 million from other governments and organizations that subsidized certain programs with operating grants, and $53.8 million in capital grants and contributions. The Public Transportation program operations are subsidized with retail sales and use tax revenues, which amounted to $296.7 million in 2003. In addition, the business-type activities received $11.3 million in unrestricted interest earnings and other general revenue.

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

**Revenues by Source - Business-type Activities**




**Expenses and Program Revenues - Business-type Activities**



## FINANCIAL ANALYSIS OF THE COUNTY'S FUNDS

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

**Governmental Funds**

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

At December 31, 2003, the County's governmental funds reported combined ending fund balances of $332.4 million, a decrease of $24.6 million in comparison with the prior year after restating beginning fund balance. Approximately 60.9 percent ($202.3 million) constitutes ***unreserved fund balance***, which is available for spending in the coming year at the County's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed to liquidate existing contracts and purchase orders of the prior fiscal year ($99.3 million), to pay debt service ($19.9 million), for asset prepayments ($4.1million), and for a variety of other restricted purposes ($6.9 million).

Overall governmental fund revenues totaled approximately $1,298.9 million for 2003, which represents an increase of 3.2 percent or $40.2 million over the fiscal year ended December 31, 2002. In 2003 expenditures for governmental funds totaled $1,370.9 million, an increase of 7.3 percent or $93.7 million from the previous fiscal year. Expenses for governmental funds exceeded revenues by $72.0 million in 2003 compared to a deficiency of $18.5 million at the end of the 2002 fiscal year. This increase in expenditures over revenues is due primarily to a one-time increase of $24.9 million for litigations costs and a $40.0 million increase in capital outlay as a result of the County's capital program.

The **General Fund** is the chief operating fund for the County. At the end of the fiscal year, total fund balance for the General Fund equaled $96.2 million. Unreserved fund balance, the amount considered available to spend, totaled $87.7 million. Of that amount, $19.8 million has been designated for working capital purposes and contingencies and is not considered available to spend. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 18.8 percent of total general fund expenditures, a slight increase from the 18.1 percent of a year ago. Total fund balance represents 20.7 percent of total general fund expenditures, a slight increase from the 20.2 percent of a year ago.

The fund balance of the County's General Fund increased by $5.1 million during the current fiscal year. Key factors in this growth are as follows:

- Revenues remained fairly stable at $503.2 million increasing a total of $9.9 primarily due to a $6.1 million increase in property tax revenues along with a $1.9 million increase in penalties and interest on delinquent property taxes largely as a result of higher tax collection rates, fueled in large measure by low interest rates during the year;

- Significant planned reductions in 2003 operating expenditures in parks, criminal justice, and human services enabled operating expenditures to decrease to $445.5 million leaving an excess of revenues over expenses of $57.7 million to provide for one-time accrued litigation expenses of $20.3 million.

- The $37.4 million in excess revenues over expenditures was reduced by $32.3 million in other financing uses which had decreased by $1.5 million from the previous year due primarily to a one-time transfer of $1.1 million excess fund balance from certain internal service funds and a $0.6 million increase in gain on the sale of capital assets.

The **Public Health Fund**, a special revenue fund, is used to finance health service centers located throughout the County and other public health programs. At the end of 2003 it had a total fund balance of $8.9 million, of which $5.0 million was unreserved and available for spending. Total revenues increased $3.3 million, offset by an increase in expenditures of $8.4 million. The decrease in fund balance of $1.3 million is due to an equal increase in environmental health license and permit fee revenues that are deferred due to fee increases that are to cover future years.

**Proprietary Funds**

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

As discussed in the business-type activities above, the County's net assets increased by $16.1 million as a result of operations in the proprietary funds adjusted to reflect the consolidation of internal service fund activities related to the enterprise funds. Of the two major proprietary funds, the Public Transportation Enterprise provided $9.5 million of this increase while the net assets of the Water Quality Enterprise increased by $0.4 million.

The **Public Transportation Enterprise** accounts for the operations, maintenance, capital improvements, and expansion of public transportation and related facilities in the County under the King County Transit Division. At the end of 2003 the Public Transportation Enterprise had total net assets of $1,150.1 million of which 74.8 percent or $860.3 million was invested in capital assets, net of related debt; 22.9 percent or $263.6 million was restricted as to use for capital purposes and bond reserves; and 2.3 percent or $26.2 million was unrestricted and available for spending. Net assets increased by $9.5 million in 2003, a significant reduction from the $41.3 million increase recorded in 2002. The 2003 increase was principally attributable to a $4.7 million net gain on the sale of fixed assets and a $4.5 million increase in capital grant revenues received from federal and state agencies for bus replacement and upgrades to transit facilities.

The **Water Quality Enterprise** accounts for the operation, maintenance, capital improvements, and expansion of the County's water pollution control facilities under the King County Wastewater Treatment Division. Total net assets in the enterprise fund were $337.7 million at the end of 2003 of which 67.7 percent or $228.5 million was invested in capital assets, net of related debt; 23.2 percent or $78.4 was restricted as to use for construction projects and debt service; and the remaining 9.1 percent or $30.8 million was unrestricted and available for spending. Revenues and expenditures remained relatively unchanged from 2002 resulting in only a $0.4 million increase in net assets in 2003.

**General Fund Budgetary Highlights**

The County's final general fund budget differs from the original budget in that it reflects an anticipated increase in appropriations of $35.7 million. However, actual expenditures incurred were only $9.4 million more than the original budget resulting in an underutilization of the supplemental authority by $26.3 million. Law, safety and justice utilized $11.1 million of its $18.7 million supplemental request for expenses related to the investigation and prosecution of significant legal cases. The supplemental appropriations were funded from available fund

balance. During the year total revenues exceeded budgetary estimates by $18.3 million and total expenditures were less than budgetary estimates by $26.3 million eliminating the need to draw upon the existing fund balance.

The County's fiscal policies provide that the ending undesignated budgetary fund balance for the general fund should be planned at between six and eight percent of estimated annual revenues. The ending undesignated fund balance on a budgetary basis for 2003 was $26.1 million after planned reserves and designations of budgetary fund balance of approximately $52.2 million.

## CAPITAL ASSETS, INFRASTRUCTURE, AND DEBT ADMINISTRATION

### Capital Assets

The King County primary government's investment in capital assets for its governmental and business-type activities as of December 31, 2003, amounts to $4,825.0 million (net of accumulated depreciation). Capital assets include land, right-of-way, farmland development rights, buildings, improvements other than buildings, roads and bridges infrastructure, vehicles, machinery and equipment, furniture, and construction in progress. The total increase in the investment in capital assets from 2002 to 2003 was 9.2 percent or $407.5 million. Investment in capital assets increased in governmental activities by 12.1 percent or $200.5 million and in business-type activities by 7.5 percent or $207.0 million.

Major capital asset events during 2003 included the following:

- Governmental activities land increased by 14.3 percent or $74.0 million. In addition to regular County acquisitions, this increase includes acquisitions of infrastructure-related right-of-way that are reported under land ($23 million in contributions from private developers and special districts, and $14.2 million transferred from Work in Progress related to the Sammamish Plateau Access Road (SPAR) project).

- The SPAR – North Link project was opened to traffic in 2003. The new highway network, which links the Sammamish Plateau to Interstate 90, was a collaborative effort between the County, Sound Transit, and Washington State. The County spent about $33.0 million (life-to-date) in construction and acquisition of right-of-way for a major section of the new highway.

- The ongoing project to retrofit the King County Courthouse Facility for a seismic and code-required life and safety system added $36.0 million to general capital construction in progress costs. The project is expected to be completed in August 2004.

- King County collaborated with various land conservation organizations to acquire (in fee simple or via conservation easements) critical open space areas as part of the program to preserve open space and contain urban sprawl. Notable among the acquisitions are 36 acres of the Juanita Woodlands ($7.0 million) in north King County and the 260 acres of the Treemont property ($8.8 million) in east King County.

- Technology spending also picked up during the year. $10.0 million worth of PC and network-related equipment was purchased by County agencies in line with departmental initiatives to improve current systems and a central PC replacement program. The Radio Communications enterprise added $6.9 million of radio equipment to interface to the 800-

megahertz trunked radio backbone, and the Emergency Management Division acquired $3.2 million of new telephone equipment for the E-911 system.

- Solid Waste capital asset construction activity included preparation of the next refuse areas in the Cedar Hills regional landfill, and facility upgrades and improvements to the transfer stations. The acquisition of the property on Harbor Island, the selected site for the future inter-modal facility for waste export, was also completed at a cost of $8.5 million.

- Capital assets of the Water Quality Enterprise increased by $150.9 million (net of accumulated depreciation) or 9.2 percent over 2002. The change is a result of replacement and additions to the interceptor and siphon systems, purchases of land, additional storage capacity, extensions of sewer trunk lines, and continued efforts to control odor and improve sewage-handling technology. Construction in progress increased by 48.7 percent or $148.8 million from the continued implementation of the Enterprise's Regional Wastewater Services Plan.

- Capital assets of the Transportation Enterprise increased by $45.7 million. The Enterprise acquired 100 new standard 40-foot low-floor buses, 14 trolleys, 38 ACCESS vans, and 208 passenger vans. Significant expenditures were also noted for park and ride expansion at Eastgate and Redondo Heights, and upgrades to operating facilities at the East and South bases. Federal grants funded $40.9 million of 2003 capital improvements. In updating its fleet, Transit retired 185 old buses and numerous vans and small buses.

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

**King County's Capital Assets**
**(net of depreciation)**
**(in millions)**

| | Governmental activities | | Business-type activities | | Total | |
|---|---|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| Land | $ 590.7 | $ 516.7 [a] | $ 225.5 | $ 205.0 | $ 816.2 | $ 721.7 |
| Buildings and improvements | 344.6 | 349.3 | 1,382.1 | 1,327.4 | 1,726.7 | 1,676.7 |
| Infrastructure | 714.0 | 603.0 | - | - | 714.0 | 603.0 |
| Equipment | 89.9 | 76.4 | 731.1 | 765.5 | 821.0 | 841.9 |
| Construction in progress | 117.8 | 111.1 | 629.3 | 463.1 | 747.1 | 574.2 |
| Total | $ 1,857.0 | $ 1,656.5 | $ 2,968.0 | $ 2,761.0 | $ 4,825.0 | $ 4,417.5 |

[a] 2002 cost of land for governmental activities was restated by $8.8 million for prior year acquisitions that were not previously reported.

**Infrastructure**

The County has elected to use the modified approach as defined in GASB Statement No. 34 for infrastructure reporting for its roads and bridges. Under the modified approach, asset condition is reported rather than recording depreciation. The rating scales for pavements (roads) and bridges are further explained in the required supplementary information, which follows the notes to the basic financial statements.

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

It is the policy of the King County Roads Division to maintain at least 80 percent of the road system at a PCI of 40 or better. In the most recent condition assessments, 87.9 percent of the arterial roads in the County and 86.0 percent of the local access roads in the County had a PCI rating at 40 and above. The majority of roads that fall below the established rating are local access roads that are situated in rural areas. The amount budgeted in 2003 for road maintenance was $38.8 million. The amount actually expended was $34.6 million. Underspending of the budgeted amount is a result of the removal of roads from the project list because of conflicts with anticipated utility work, cost efficiencies related to a relatively few roads to be resurfaced in remote locations, and weather-related work reductions or stoppages.

The County currently maintains 181 bridges. Physical inspections to uncover deficiencies are carried out at least every two years and documented in an inspections report. There is also an annual evaluation to determine which bridges are candidates for replacement or rehabilitation using a 10-point priority scale based on various factors of bridge condition. A key element in the priority scale is the sufficiency rating, which is a numerical rating (on a 100-point scale) of a bridge based on its structural adequacy and safety, essentiality for public use, and its serviceability and functional obsolescence. The policy of the King County Roads Division is to maintain bridges in such a manner that no more than 12 (6.6 percent) will have a sufficiency rating of 20 or less. As of December 31, 2003, there were 10 bridges in this category. The amount budgeted in 2003 to maintain and preserve bridges was $3.8 million. Actual amounts expended were $3.4 million.

**Debt Administration**

At December 31, 2003, King County had total bonded debt outstanding of $2,501.4 million in its governmental activities and business-type activities. Of this amount, $1,463.2 million is comprised of debt backed by the full faith and credit of the County and $0.1 million is special assessment debt for which the government is liable in the event of default by the property owners subject to the assessment. The remainder of the County's bonded debt of $1,038.1 million represents bonds secured solely by specified revenue sources (i.e., revenue bonds).

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

| | Governmental Activities | | Business-type Activities | | Total | |
|---|---|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| General obligation bonds | $ 854.4 | $ 900.1 | $ 528.8 | $ 633.3 | $ 1,383.2 | $ 1,533.4 |
| General obligation bond anticipation notes | 80.0 | 85.0 | - | - | 80.0 | 85.0 |
| Special assessment debt with governmental commitment | 0.1 | 0.1 | - | - | 0.1 | 0.1 |
| Revenue bonds | - | - | 1,038.1 | 952.4 | 1,038.1 | 952.4 |
| Total | $ 934.5 | $ 985.2 | $ 1,566.9 | $ 1,585.7 | $ 2,501.4 | $ 2,570.9 |

During the 2003 fiscal year the County's total bonded debt decreased by 2.8 percent or $69.5 million. The bonded debt decreased in the governmental activities by 5.1 percent or $50.7 million and in the business-type activities by 1.2 percent or $18.8 million. The key factor for the decrease was $94.4 million of debt service payments made during the year.

Also during 2003 the County refinanced some of its existing debt to take advantage of favorable interest rates:

- The County entered into two general obligation bond refinancings that are expected to decrease future aggregate debt service payments by $12.4 million.

- Using excess proceeds from special taxes and revenues, the County completed a partial defeasance of general obligation (baseball stadium) bonds that is expected to decrease debt service payments by $7.1 million.

- The County issued sewer revenue bonds to refinance previously outstanding general obligation bonds payable from sewer revenues. The result is expected to decrease future aggregate debt service payments by $10.2 million.

At December 31, 2003, the County had short-term general obligation bond anticipation notes of $80.0 million outstanding that mature on October 1, 2004. The notes were issued to finance the County Courthouse and other building construction and improvement projects. A portion of the note proceeds were used to pay and retire 2002 notes that matured on October 1, 2003.

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

State statutes limit the amount of general obligation debt a governmental entity may issue to 2 ½ percent of its total assessed valuation. The current debt limitation for the County's general county purposes is $5,895.9 million, which is significantly in excess of the County's outstanding general obligation debt.

During the first half of 2004 the County completed the sale of $110.0 million of voter-approved general obligation bonds to provide funding for seismic improvements to the Harborview Medical Center and $49.7 million of limited tax general obligation bonds to finance Transit Division's capital improvement program. Also, it sold $185.0 million of sewer revenue bonds to provide funding for its Wastewater Treatment Division's capital improvement program and $61.8 million of sewer revenue refunding bonds to refund the series 1999-2 bond issues.

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

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

- Property value growth has slowed significantly, with assessed valuation up just 4.8 percent in 2003 compared with a 6.6 percent growth in 2002, a 12 percent growth in 2001, and a 13.3 percent growth in 2000. The decline is attributable to the ailing commercial market.

- Sales tax receipts in the County (excluding those collected for public transportation) remained relatively stable in 2003 with a 0.7 percent decline, compared to a decline of 3.1 percent in 2002 and 3.3 percent in 2001, the first decline since implementation of the local option sales tax in 1971.

- Unemployment remained relatively high at roughly 68,800 workers or 6.8 percent over the course of 2003. The tight labor market for skilled technical workers of the late 1990s is now characterized by a surplus, with a growing list of defunct internet-related firms.

- In 2003 there were no large annexations or incorporations and none are anticipated in the near future. Census data in 2000 confirmed the continued decline in the County's unincorporated area population while overall County population grew. Between 1990 and 2000, the county's population grew from 1.5 million to 1.7 million. In 1990, more than 500,000 people lived in unincorporated King County; by 2000, this had declined to 350,000. The fiscal impacts of annexation and incorporation on the County depend on the revenue-generating capacity of an area compared with its service demands. Many of the remaining unincorporated urban areas of the County do not generate significant commercial activity and sales tax revenues, although these areas have relatively high service demands. The taxpayers of the region subsidize services provided to these urban unincorporated areas. The general fund subsidy for urban unincorporated King County is estimated at more than $37 million for 2004.

- Washington State Initiative Measure No. 747 (I-747) was approved by the State's voters in November 2001. I-747 reduced the limit on the total dollar amount of regular property taxes that may be levied annually by a taxing district (including the County) without a vote of its electors from 106 percent to 101 percent of the highest levy in the three previous years excluding new construction, improvements, and state-assessed property. Because I-747's limitation applies to the dollar amount levied rather than to levy rates, increases in the value of existing property exceeding one percent per year will result in decreasing tax levy rates.

- Washington State Initiative Measure No. 776 (I-776), approved by voters in November 2002, limits motor vehicle license fees to $30 per year and repeals certain laws allowing governments to impose taxes or fees on motor vehicles for transportation purposes including annual local option vehicle license fees. King County imposed an annual local option vehicle license fee in the maximum authorized amount of $15, generating approximately $5 million in annual revenues for the County's roads program. Although I-776 was ruled unconstitutional in April 2003 in King County Superior Court, the ruling was overturned by the Washington State Supreme Court.

- Over the past year, the County has reached tentative settlements of three class action lawsuits. Two of the three lawsuits involve how the County pays its employees. The *Dupuis, Covey,* and *Roberts/Duncan* settlements have received approval from both the King County Council and the King County Superior Court, and are currently in the claim disbursement process. The cash costs of these settlements are being paid for by both available moneys within existing appropriation levels and reserves in various County funds.

By law, the County is required to adopt a balanced budget. The entire 2004 budget for the County, adopted by the County Council in November 2003, totals $2,913.1 million. Of this amount, $528.8 million is appropriated for the Current Expense Fund (General Fund); $551.2 million for public transportation, solid waste and wastewater treatment (enterprise funds); and $624.6 million for public health, emergency medical services, human services, and roads (special revenue funds). The budget also includes $579.1 million committed to capital improvements for roads, parks and other major public facilities.

The structural deficit in the Current Expense fund budget continues to persist due primarily to the constraints on property tax growth as a result of passage of I-747 and growing demands on the criminal justice system. The County responded to a $24 million structural deficit by reducing spending and securing new revenues in 2004. Expenditure cuts totaling $8 million were enacted in the 2004 Current Expense fund budget with major cuts to the courts and jail systems. Seven million dollars in new revenue was realized from the Parks Levy, approved by voters in May 2003. Combined with efforts by the Parks Division to generate revenue through parking fees, concerts and other efforts, further cuts to parks in 2004 were avoided and some funding reductions from 2002-2003 have been restored. Another $7 million was sought from the solid waste utility by charging rent on the Cedar Hills landfill, but this measure is currently the subject of a legal challenge and collection of rent cannot be guaranteed. Finally, $2 million in Unincorporated Area Levy funds was redirected from the Roads Division to the Sheriff's Office to offset traffic enforcement costs in unincorporated King County.

The 2004 budget was driven in large measure by recommendations of the Budget Advisory Task Force, which was convened by the County Executive over the preceding year. The task force included two former state governors, judges, business leaders, and other prominent citizens to consider strategies to provide for the County's long-term fiscal health. The task force recommended a variety of solutions to the structural deficit ranging from service prioritization, technological efficiencies and an improved alignment between service delivery and revenues.

Two program initiatives have been launched to reduce the County's ongoing structural deficit:

- Established a $10 million Transition Fund for the purpose of supporting critical investments in technology; key investments include electronic medical and court records, enhanced security, and streamlined payroll processing;

- Included a $10 million Annexation Incentive Reserve in the 2004 Current Expense fund budget and earmarked other monies from the Road Levy and Real Estate Excise Tax revenues to encourage cities to annex major potential areas designated for annexation under the Growth Management Act and provide both cities and residents in the County's urban unincorporated areas the means to at least partially finance the transition to city rule; the estimated 2004 Current Expense fund subsidy for urban unincorporated King county is more than $37 million.

## REQUESTS FOR INFORMATION

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