CityofRedmond
WASHINGTON

June 20, 2006

To the Honorable Mayor, the Redmond City Council, and Citizens of Redmond, Washington:

The Comprehensive Annual Financial Report of the City of Redmond for the fiscal year ended December 31, 2005, is submitted herewith. This report is published to comply with State law (RCW 43.09.230) requiring annual reports for Washington municipal governments to be certified and filed with the State Auditor's Office within 150 days after the close of each fiscal year.

Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures, rests with city management. The city operates under a system of accounting internal controls that are concerned with the safeguarding of assets and the reliability of financial records. The definition of accounting control assumes reasonable, but not absolute, assurance that the objectives expressed in it will be accomplished by the system. The concept of reasonable assurance recognizes that the cost of internal control should not exceed the benefits expected to be derived.

Cities and counties of the State of Washington must comply with the Budgeting, Accounting and Reporting System (BARS) prescribed by the Office of the State Auditor. State law also provides for an annual independent audit by the Office of the State Auditor.

As a recipient of federal, state, and county financial assistance the City is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act Amendments of 1996 and Budget Circular A-133, *Audits of State and Local Governments*. This audit is conducted by the State Auditor's Office in conjunction with the City's annual independent audit. The results of the City's single annual audit for the fiscal year ended December 31, 2005 provided no instances of material weaknesses in the internal control structure or significant violations of applicable laws and regulations.

GAAP requires that management provide a narrative introduction, overview and analysis to accompany the basic financial statements in the form of *Management's Discussion and Analysis (MD&A)*. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The City of Redmond's MD&A can be found immediately following the independent auditor's report.

Profile of the Government

Incorporated in 1912, Redmond is the sixteenth largest city in the state of Washington encompassing an area of 16.85 square miles east of downtown Seattle on the east side of Lake Washington. Redmond has grown from a population of 1,453 in 1960 to a 2005 population of 47,600.

Redmond is a non-charter code city, operating under Section 35A of the Revised Code of Washington. It has a Mayor/Council form of government. The Mayor and the seven member City Council are elected for staggered four-year terms and are elected at-large, rather than by district. Members of the City Council are responsible for establishing the general direction and policies for the City and for providing the resources necessary to carry out those policies. As the City's chief administrator, the Mayor is responsible for carrying out the policy and direction set by the City Council. This includes the enforcement of laws and ordinances, the execution of contracts and agreements, and maintenance of peace and order in the city.

The City of Redmond provides a full range of municipal services, including police and fire, emergency medical services, planning and zoning, street maintenance and construction, parks and recreation, and general administrative services. The City operates enterprise funds for water and wastewater services and stormwater management.

This report includes all funds, account groups, agencies, and boards and commissions that are controlled by, or dependent on, the city's executive and legislative departments. Included as part of the reporting entity are the Redmond Public Corporation and Redmond Community Properties. Additional information on these entities can be found in the Notes to the Financial Statements.

The City prepares budgets on the modified accrual basis in accordance with the Revised Code of Washington (RCW) 35A.33. Biennial budgets must be adopted by the City Council prior to the first of each odd numbered calendar year. Reviews are conducted at mid-biennium and any changes for the second half of the biennium are adopted by the City Council.

The biennial budget serves as the foundation for the City of Redmond's financial planning and control. The budget is prepared by fund and department. A budget increase or decrease to a fund must be authorized by the City Council, while appropriation changes within a fund may be authorized by the Mayor. All budgets are controlled on a fund basis.

Local Economy

Redmond has evolved from a small town with logging and farming as its chief industries into a city of high tech and light manufacturing, business parks, and a large outdoor mall adjacent to the downtown retail core. The largest employer in Redmond is Microsoft with United Parcel Service, the Lake Washington School District, and Genie Industries also having a significant presence in the city.

Although the economy shows signs of improving, Redmond continues to be impacted by the economic recession that began in 2001 with annual sales tax revenue remaining below the peak year of 2000. Development activity declined 56% from the boom years of the late 1990's, hitting its low point in the 2003/2004 biennium. Activity began to pick up in 2005 and continues to look promising for 2006 and beyond. Impact fees and real estate excise taxes, two indicators of development activity, increased in 2005. Microsoft expansion in the next three years is projected to be over $1 billion as 14 new buildings and 3.1 million square feet of office space are added to their Redmond campus. Microsoft has pledged $35 million to support city infrastructure such as streets and utility lines.

To ensure the city keeps abreast of and incorporates economic conditions into its financial plans, revenues are projected for the next six years and the forecast is updated annually. Operating expenses are supported by ongoing revenues per city policy. During the lean economic years of 2001 to 2005 significant cost cutting measures were implemented to keep city expenses in line with actual revenues. The City Council continued to develop a long-term financial strategy to best position the city in future years. This work was completed in early 2006.

Long-term Financial Planning and Relevant Financial Policies

In early 2006 the Redmond City Council adopted a 6-year financial plan to address existing service deficiencies. In line with the city's financial policy to maintain a diversified and stable revenue system, the financial strategy calls for increases in four revenue sources for 2006. In May voters will be asked to increase the property tax levy above the 1% maximum increase allowed by law without a vote. The utility tax rate and the business license fee will increase to ensure residents do not shoulder the entire burden of increased revenues. Developer fees will be increased to establish user fees at a level related to the cost of providing the service consistent with existing fiscal policies.

As part of the fiscal strategy, the Council also reviewed the city's general operating reserve policy. The reserve will be maintained at 8.5%, a level that was supported on an interim basis until a complete review could be done. The prior reserve requirement was determined to be higher than necessary based on the city's prior use and a survey of surrounding entities' reserve levels, all of which were lower than Redmond's.

City financial policies restrict the use of borrowed funds for capital improvements that can't be financed from current revenues. Debt is not used for current operations.

Redmond is in a continuous process of both short-term and long-term financial planning. Short-term financial planning is inherent in the development of the city's biennial budget. Concurrent with the biennial budget, the city's long-term capital needs and potential funding sources are assessed. During each biennial budget planning process, initiatives for the next two years are identified. The budget is developed with the goal of attaining these initiatives.

Major Initiatives

Redmond completed its City Campus Project in 2005 when over 300 city employees moved from six owned or leased buildings at various locations around the city into a new city hall building. In keeping with two of the city's identified strategic directions, community oriented government and optimal service delivery, citizens and employees alike now enjoy more centralized and efficiently delivered services. The new city hall, designed to be a water efficient, environmentally advanced building, was completed on time and within budget.

A second major initiative completed in 2005 was the last stage of the conversion from an outdated finance/payroll/human resources computer system to a new enterprise wide system.

A major ten year review of the city's Comprehensive Plan was completed allowing the city to continue to move forward with development in an organized fashion. The Plan includes development design standards, building heights, and permitted uses among its many guiding regulations. Also completed in 2005 was a Transportation Master Plan. This plan addresses public health and safety, adequate maintenance, and provision of needed transportation facilities to serve growth including ideas for alternatives to driving.

The Quadrant Corporation completed construction of a new fire station at its Urban Planned Development (UPD) east of the city limits and donated the land and building to the city. The UPD is in Fire District 34 which is served by the City of Redmond. Plans to staff and open the station will be completed in early 2006.

The city has embarked on a multi-year project to update all of its wells. Well number 4 has been rehabilitated and well number 5 is due for a rehabilitation beginning in 2006 that will modernize the purification of the water and significantly reduce the use of chemicals.

Awards and Acknowledgments

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Redmond for its Comprehensive Annual Financial Report for the fiscal year ended December 31, 2004. This was the twentieth consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The GFOA has also awarded the Distinguised Budget Presentation Award to the City of Redmond for its 2005-2006 biennial budget document. This is the first year in many years the city has submitted its budget to GFOA due to staff limitations in the city's Financial Planning Division. The GFOA gives this award to governments whose budget document meets the GFOA's criteria as an effective policy document, operations guide, financial plan, and communication device.

The preparation of the Comprehensive Annual Financial Report on a timely basis could not have been accomplished without the efforts and dedication of the staff of the Finance Department. I would like to express my appreciation to my staff and other personnel from various departments and agencies who assisted in its preparation. Also, I would like to thank the Mayor and the City Council for their continued interest and support in planning and conducting the financial operations of the City in a dedicated and responsible manner.

Respectfully submitted,

Lenda Crawford
Finance Director

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