



CITY OF PORTLAND

OFFICE OF MANAGEMENT AND FINANCE

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December 2, 2005

Mayor Tom Potter, City Commissioners,
City Auditor, and Citizens of the
City of Portland, Oregon

The Bureau of Financial Services is pleased to submit the Comprehensive Annual Financial Report (CAFR) of the City of Portland, Oregon (the City) for the fiscal year ended June 30, 2005.

This report is published to provide the City Council, City staff, our citizens, and other readers with detailed information concerning the financial position and activities of the City. City management is responsible for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures.

To the best of our knowledge and belief, the enclosed report is accurate in all material respects and is organized in a manner designed to fairly present the financial position and results of operations of the City as measured by the financial activity of its various funds. The accompanying disclosures are necessary to enable the reader to gain the maximum understanding of the City's financial affairs.

THE REPORT

The CAFR is presented in three sections: introductory, financial, and statistical. The introductory section includes this transmittal letter, a list of principal officials, organizational charts, and the Government Finance Officers Association of the United States and Canada's (GFOA) Certificate of Achievement for Excellence in Financial Reporting.

The financial section is prepared in accordance with accounting principles generally accepted in the United States of America. This section of the CAFR includes the Management's Discussion and Analysis (MD&A), which can be found immediately following the report of the independent auditors, the basic financial statements and combining and individual fund statements and schedules, as well as the independent auditor's report and required supplementary information.

The MD&A is a narrative introduction, overview, and analysis to accompany the basic financial statements and should be read in conjunction with the transmittal letter. The basic financial statements include the government-wide financial statements that present an overview of the City's entire operations, while the fund level statements present the financial information of each of the City's major funds, as well as nonmajor funds.

Lastly, the statistical section includes selected financial and demographic information, generally presented on a multi-year basis.

CITY PROFILE

The City, with a population in excess of 550,000, comprises an area of approximately 145 square miles in northwestern Oregon. Located astride the Willamette River at its confluence with the Columbia River, the City is the center of commerce, industry, transportation, finance, and services for a metropolitan area of almost 2 million people. The City is also the largest city in Oregon, the seat of Multnomah County, and the second largest city in the Pacific Northwest.

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Letter of Transmittal, Continued:

The City, incorporated in 1851, is a home rule charter city. The City Charter is the basic law under which the City operates and can be amended only by a vote of the people. In 1913 a modified commission was created, which is rare in cities as large as Portland.

The Charter provides for five non-partisan Council members, called Commissioners, including the Mayor. They are elected at-large to four-year terms. The Mayor and Commissioners act as legislators and administrators, with the Commissioners responsible for enacting City laws, enforcing City laws, and administering bureaus under the respective Commissioner's supervision. The Mayor assigns the bureaus to each Commissioner.

The City Auditor is also elected and required by Charter to be a Certified Public Accountant, Certified Internal Auditor, or Certified Management Accountant. The Auditor is not part of the Council and has no formal voting authority.

The City operates under the provisions of the City Charter and City Code, which are consistent with the Oregon Constitution and State law (the Oregon Revised Statutes). Ordinances are passed by a simple majority vote of three of the five Council members.

The City provides the following services as authorized in its Charter:

- Planning and community development: buildings review, housing services, employment and economic development
- Citizen and community services: neighborhood improvements, housing development, and shelter programs
- Public safety: police, fire, and rescue, emergency communications and emergency management
- Transportation and parking: street maintenance, neighborhood traffic studies, and street improvements
- Support services/legislative/administrative: communications, facilities, financial, fleet, human resources, information, printing, and risk management
- Parks, recreational and cultural services
- Utilities: water and sewer
- Other operations: refuse disposal and environmental remediation

REPORTING ENTITY

This report includes all funds of the City including those organizations required to be included because the City is financially accountable for them. Under the City Charter, the Fire and Police Disability and Retirement Fund and the Portland Development Commission (PDC) are required to have separate financial audits conducted by external certified public accountants. The various funds of these organizations are also included in this report, and the information presented has been condensed from the separately commissioned audit reports to conform to City reporting formats.

ECONOMIC CONDITIONS AND OUTLOOK

A. Recent economic performance

The Portland metropolitan area's economy continued to rebound from recession during FY2004-05. Published Bureau of Labor Statistics data for both the State and regional economies clearly show the return of more normal economic growth patterns. Regional employment measured by place of work has grown for the past six quarters beginning during the last quarter of FY2003-04. As of the first quarter of FY2005-06 employment by place of work was 1.2 percent ahead of first quarter FY2004-05. The local area's unemployment rate has similarly improved. For all of FY2003-04 the Portland area's unemployment rate averaged 7.9 percent and was among one of the highest nationally. By the first quarter of FY2005-06 the unemployment rate registered 5.9 percent, with the preliminary September 2005 unemployment rate at just 5.4 percent. Oregon's economy, taken as a whole, also did well during FY2004-5. Oregon's economy registered consistent employment gains throughout FY2004-5 and, as of

Letter of Transmittal, Continued:

the first quarter of FY2005-06, employment by place of work was 3.1 percent ahead of year-ago. Both Oregon and the local area economy continued, throughout the course of FY2004-05, to register declining unemployment rates and solid job growth.

Local area inflation shows signs of stirring, mirroring national trends. For the 12 months ended July 2005 inflation was up about 2.4% year-over-year with price escalation annualizing at about 2.6 percent for the first six months of calendar 2005. Energy costs continue to be a problem area, both nationally and locally, where a large natural gas rate increase took place October 1. Healthcare cost increases as measured by the local area consumer price index for medical care services also accelerated during the first half of calendar 2005 with this index increasing about 5 percentage points higher than a year-ago. The improved economic environment during FY2004-05 translated directly into revenue growth in the General Fund.

B. Outlook

The economic outlook for FY2005-06 as well as the FY2006-07 budget cycle continues to be guarded. Though the General Fund's revenue outlook is improved, cost pressures, particularly in the healthcare area, continue to challenge City and General Fund finances. The national economy continues to show good growth despite the two devastating gulf coast hurricanes and increased energy related inflation. Most observers believe that national economic growth will slow during the fourth quarter of calendar 2005 without stalling out into recession. The local economy appears set to continue expanding for the remainder of FY2005-06 and on through FY2006-07. The City's current economic and revenue forecast is based on this economic framework, and recent employment data continue to support this viewpoint.

C. Long-term financial planning

The City maintains a five-year financial planning horizon. The City reduced General Fund current service levels in the FY2005-06 budget, beginning an iterative strategy of bringing budgets into line with expected large increases in healthcare funding requirements forecast to occur beginning with the FY2006-07 budget year. Better revenue growth will help blunt but cannot offset increased healthcare funding requirements. The most recent five-year financial forecast continues to point to the need for further service level reductions over the next two budget cycles in order to bring costs into line with projected five-year financial plan resource estimates.

The Council is utilizing a three-year strategy to bring General Fund requirements in line with resources, beginning with the FY2005-06 budget. In addition to \$5.7 million in ongoing cuts incorporated in the Adopted Budget, the Council plans to cut spending by about \$4.9 million annually in FY2006-07 and in FY2007-08. This strategy will help avoid unnecessary reductions as the economy improves and resources increase. It also will better link funding decisions to the City's five-year strategic plan that will be developed over the next two years.

Non-General Fund bureaus face resource challenges necessary to fund major capital project and maintenance requirements. The Bureau of Environmental Services anticipates a 5.9% annual increase in the average family sewer/stormwater bill for each of the next five years to fund the massive combined sewer overflow project. This project responds to a state mandate to separate sewer discharges and stormwater run-off. The Water Bureau has imposed an average retail rate increase of 0.6% for FY2005-06. Capital projects are planned for infrastructure maintenance and replacement, to respond to new development in the City and to monitor water quality. Transportation faces a funding gap and growing maintenance backlog. Discretionary funds were reallocated in FY2005-06 to add \$1.2 million to enhance street maintenance efforts.

D. Major initiatives

Highlights of specific decisions and initiatives in the FY2005-06 Budget are as follows:

- A fire station scheduled to open in FY2006-07 is deferred indefinitely and the Fire Bureau will conduct a service delivery system study.

Letter of Transmittal, Continued:

- \$1 million is budgeted for strategic policing initiatives.
- FY2005-06 is the last year of a three year Business License Surcharge that has raised \$6 million annually for Portland schools. Council also granted \$600,000 for various initiatives to improve the efficiency of school services.
- \$1.2 million was budgeted for an effort to acquire Portland General Electric. That initiative was unsuccessful and some budgeted funds remain.
- A community visioning and strategic planning program was initiated. This work will continue for about two years and will give guidance to the City's budgeting and future resource allocation decisions.
- One time funds totaling \$478,000 were provided for developing two parks along with \$835,000 for addressing much needed parks maintenance.
- \$1.2 million was redirected to increase street preservation work.
- Work will continue on the Combined Sewer Overflow (CSO) project with \$92.7 million budgeted for related projects in FY2005-06.
- A review of the City's charter was funded that will include an evaluation of the City's governing structure and several service delivery issues.
- A review of the City's Fire Police Disability & Retirement system was funded.
- Publicly financed campaigns for candidates running for City elected offices were funded.
- Acquisition of a new management information system was approved, the cost of which will be spread over an eight year period.

OTHER FINANCIAL INFORMATION

A. Financial policies

To help ensure its continued ability to meet immediate and long-term service objectives the City has adopted and adheres to a set of Comprehensive Financial Management Policies. These policies govern the allocation and management of resources including use of one time only funds.

B. Accounting system and budgetary control

The City's accounting system supports an adequate internal control structure. This structure helps to safeguard the City's assets against loss, theft, or misuse. The accounting system provides reliable financial records for preparing financial statements in conformity with generally accepted accounting principles. The internal control structure provides reasonable, but not absolute, assurance that the City's assets are safeguarded. The concept of reasonable assurance first recognizes that the cost of a control should not exceed the benefits likely to be derived. Secondly, the evaluation of costs and benefits require estimates and judgments by management.

The preparation of the City's budget is governed by Oregon Budget Law, ORS 294.305 to 294.565. The Mayor proposes a budget and the City Council serves as the Budget Committee in approving and adopting the budget. Public notice is given for all Budget Committee meetings. Citizens are involved in the budget process through surveys, forums and public hearings.

The City Council is required to adopt a budget no later than June 30, the close of the fiscal year. This annual budget serves as the foundation for the City's financial planning and control. The budget is prepared and presented by bureau and fund.

Council has set the level of appropriations under Oregon Budget Law at the organizational unit level, generally by bureau. Additionally transfers between major object categories are allowed with approval of the Commissioner-in-Charge. The Council conducts three major budget monitoring and amendment actions during the fiscal year to address changing financial needs and conditions.

OTHER INFORMATION

A. Independent audit

The City's Charter requires an annual audit of the City's financial records. These records, represented in the CAFR, have been audited by the City's independent Certified Public Accountants, Moss Adams LLP. This audit included the City's Single Audit for FY2004-05 pursuant to OMB Circular A-133.

B. Certificate of Achievement

The GFOA has awarded a Certificate of Achievement for Excellence in Financial Reporting to the City for its CAFR for the last twenty-three consecutive fiscal years.

In order to be awarded a Certificate of Achievement, the City must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such reports 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 report continues to conform to Certificate of Achievement Program requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

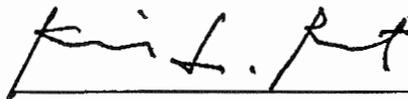
C. Acknowledgments

We would like to express our sincere gratitude to the City personnel who contributed to this report, especially personnel in the Accounting Division. Appreciation is also extended to the major bureaus, City Council, City Auditor, and the many City managers whose leadership and commitment are vital to the health and vitality of Portland.

Respectfully submitted,



Timothy Grewe
Chief Administrative Officer
Office of Management & Finance



Kenneth L. Rust
Chief Financial Officer
Bureau of Financial Services