



June 25, 2015

Honorable Mayor, Members of the City Council, and the Citizens
of the City of Ketchikan, Alaska

We are pleased to present the Comprehensive Annual Financial Report (CAFR) of the City of Ketchikan, Alaska for the year ended December 31, 2014. Section 5.2 of the City Charter requires an independent audit of the City's financial records and transactions by a certified public accountant within four months after the end of the City's fiscal year. The City Council was notified on May 7, 2015 that the audit would be delayed due to the implementation of the City's new utility billing system.

The CAFR was prepared by the City of Ketchikan Finance Department. The accuracy of the data in this financial report, and the completeness and the fairness of the presentation, including all disclosures is the responsibility of management. To provide a reasonable basis for making these representations, a comprehensive internal control framework has been established that is designed to protect the City's assets from loss, theft, or misuse and to maintain sufficient reliable information for the preparation of the City's financial statements in conformity with generally accepted accounting principles. Because the cost of internal controls should not outweigh the benefits, the framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement. As management, we attest that to the best of our knowledge and belief that this financial report is complete and reliable in all material aspects.

The City's financial statements were audited by Mecham, Richardson and Company. The goal of the independent audit was to provide reasonable assurance that the financial statements of the City for the year ended December 31, 2014, are free of material misstatement. The independent audit involved examining on a test basis, evidence supporting the amounts and significant estimates made by management; and evaluating the overall financial statement presentation. Based upon the audit, the independent auditor concluded that there was a reasonable basis for rendering an unmodified opinion that the City's financial statements for the year ended December 31, 2014 are fairly presented in conformity with generally accepted accounting principles. The independent auditor's report is presented as the first component of the financial section of this report.

As a recipient of federal and state financial assistance, the City is required as part of its annual audit to undergo a federal single audit and a state single audit. The federal single audit was performed in accordance with the provisions of the Single Audit Act Amendments of 1996, and the US Office of Management and Budget's Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The state single audit was performed in accordance with the State of Alaska Single Audit Regulation 2 AAC 45.010 and *Audit Guide and Compliance Supplement for State Single Audits*. These audits were designed to meet the special needs of federal and state grantor agencies. The standards governing single audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the City's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal and state awards. Information related to these single audits, including the Schedules of Expenditures of Federal Awards and State Financial Assistance, the auditor's reports on the internal control and compliance with applicable laws and regulations, and the schedules of findings and questioned costs are included in separately issued reports.

Generally accepted accounting principles require 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's MD&A can be found immediately following the independent auditor's report.

Profile of the Government

The City of Ketchikan, incorporated in 1900, is a community of 8,314 and is the fifth largest city in Alaska. Located on Revillagigedo Island in southern Southeast Alaska, and within the boundaries of the Tongass National Forest, Ketchikan is 680 miles north of Seattle, Washington, and 230 miles south of Alaska's capital, Juneau. Ketchikan is the largest city located within the Ketchikan Gateway Borough and occupies five square miles.

The City is a home rule municipality operating under the Council-Manager form of government. The Mayor and the seven-member City Council are elected for staggered three-year terms by the community at large. Local elections are held annually in October. The governing board is responsible for enacting ordinances, adopting the annual budget, establishing policy, and appointing a City Manager/Utility General Manager, a City Clerk and a City Attorney.

The City Manager/Utility General Manager serves at the pleasure of the City Council and is responsible for implementing the ordinances and policies of the governing board; and overseeing the daily operations of general government and the City's public utilities, including Ketchikan Public Utilities (KPU), the municipally owned electric, telecommunications and water utility.

The City provides a full range of general government services, including police and fire protection; emergency medical services; cemetery; library; museum; harbors; parking; street maintenance and improvements; and solid waste collection and disposal. The City also operates three enterprise funds that provide port, wastewater, and electric, telephone and water utility services.

The annual budget serves as the foundation for the City's financial planning and control. In the fall of each year, departments of the City are required to submit requests for appropriations and capital projects to the City Manager/KPU General Manager. The City Manager/KPU General Manager uses these requests as the basis for developing a proposed annual budget and five-year capital improvement plan and presents both spending plans to the City Council for review in November. The City Council is required to hold a public hearing on the proposed budget and to adopt a final budget no later than three days before the start of the City's fiscal year, which begins on January 1. The appropriated budget is prepared by fund, function and department. Department heads may make certain transfers of appropriations within a department. Transfers of appropriations between departments and reserves require approval of the City Council. Budget-to-actual comparisons are provided in this report for each individual governmental fund for which an appropriated annual budget has been adopted. For the general fund and all major special revenue governmental funds of the City, this comparison is presented as required supplementary information. For nonmajor government funds with appropriated budgets, this comparison is presented in the governmental funds subsection of this report.

Local Economy

The information presented in the City's annual financial report is perhaps best understood when it is considered in the context of the local economy in which the City is a participant. From the moment of the City's founding in 1900, the local economy has been based on natural resources. During the early 1900's mining and fishing were important area industries. At one point in its history, Ketchikan was known as the "Salmon Capital of the World". By the 1950's, mining's role in the local economy had diminished and fishing was in the process of being replaced by timber as the major industry that would drive the local economy for nearly fifty years. This transition occurred because two 50-year timber contracts to cut timber in the Tongass National Forest were awarded by the US Forest Service. The contracts resulted in the construction of two major pulp mill facilities, one of which was located in Ketchikan, and the development of several saw mills in and near Ketchikan.

For most of the second half of the 20th Century, the fishing and timber industries co-existed and the community enjoyed the benefits of a stable economy that grew at a slow, but consistent pace. By the time the 1990's arrived, both industries were under duress. The fishing industry was suffering from high operating costs, excessive inventories, low market prices and competition from farmed fish. The timber industry was faced with addressing environmental issues; changing government regulations that affected the supply of timber from the Tongass National Forest and impacted the cost of doing business; and the premature cancellation of the 50-year timber contracts. Overcoming these issues was difficult at best and eventually resulted in the closure of

the Ketchikan pulp mill facility in 1997 and the subsequent closure of a several local saw mills and other regional timber operations in Southeast Alaska.

Ketchikan's economy is still dependent on natural resources but it has transitioned from one that is based on the extraction and development of natural resources to one that is more focused on the preservation of natural resources so they can be shared with future generations from around the world. The fishing and timber industries continue to play an important role in the local economy, but Ketchikan's popularity as a major port of call for large cruise ships and their passengers continues to grow. As a result, tourism has surpassed fishing and timber as the most vibrant segment of the local economy. The number of visitors arriving by large cruise ship has increased from 236,000 in 1990 to a record 938,000 in 2013. The latest forecast for 2015 is projecting that 29 large cruise ships will make 462 stops and bring approximately 944,000 passengers to the community. The growth in tourism has led local government and private businesses to make significant investments in the land-based facilities and port infrastructure necessary to accommodate the needs of the industry. The City invested over \$40 million dollars in 2006 to expand and improve its port berthing facilities. Private companies have invested millions of dollars to develop a retail complex at the former Spruce Mill property and Berth IV and its adjacent ground transportation area. The City recently completed phase three of a \$26 million four-phase project to replace Berths I and II. Phase four will be completed in 2016. Upon completion of phase four, the City will have completely replaced its port infrastructure with four modern cruise ship berths capable of serving approximately 1.8 million passengers annually.

The City is a major contributor to the community's economy and has played an important role in planning and supporting economic development. The City is the community's sole provider of electric utility services; the largest provider of port and harbor services; a major provider of telecommunication services; the owner of the Ketchikan Medical Center, a major regional health care facility; and the lead local governmental agency responsible for constructing and maintaining a significant portion of the community's transportation infrastructure, all of which affect the overall direction and health of the local economy. The City is one of the community's top five employers with an annual payroll of \$20.4 million.

The City is located within the boundaries of the Ketchikan Gateway Borough, which had a population of 13,825 in 2014. Approximately 60 percent of the community's population, or 8,314 residents, make their home within the city limits. The City's population peaked in 1997 at 8,552, the last year of operations for the Ketchikan Pulp Company. School enrollment also peaked in 1997 at 2,782 pupils and has since followed a similar downward trend, until bottoming out at 2,110 students in 2009. In 2014, the Ketchikan Gateway Borough School District reported an enrollment of 2,360 pupils.

The shift in the local economy from timber to tourism has resulted in a labor force that has become more seasonal. In 2014, the monthly employment varied between 5,839 and 7,566. The average employed labor force in 2014 was 6,539 with employment peaking at 7,566 in July. The unemployment rate for 2014 was 7.6 percent, a slight increase from the 7.5 percent that was reported for 2013. Per capita income for 2011, 2012 and 2013 was \$54,824, \$56,045 and \$56,591, respectively. No figures were available for 2014.

In 2014, assessed values increased by 1.4% to \$869.8 million. The projected change in assessed values for 2015 is less than 1%. Assessed values appear to be entering another period of little or no appreciation in property values. Gross retail sales decreased from \$570.4 million in 2013 to \$558.7 million in 2014, or 2.1 percent and taxable retail sales declined by 3.4%. The City collected 10.8 million in sales tax revenues in 2014, or 5.7 percent more than 2013 but the increase was due to the City's decision to raise its sales tax rate from 3.5% to 4, effective April 1, 2014.

Long-Term Financial Planning and Relevant Financial Policies

The mission of the City is to provide cost effective programs and services consistent with the goals of preserving and enhancing the current quality of life enjoyed by the citizens of Ketchikan. The long-term financial planning efforts of the City are directed towards identifying events and situations that may hinder the City's ability to achieve these goals, taking proactive or preemptive roles in developing strategic solutions to address the challenges that have been presented, and developing reasonable and prudent plans for ensuring that the City has the financial resources available to carry out its strategic solutions. In this context, the governing board and management of the City strive to promote policies and adopt plans that:

- Minimize the local tax burden and support reasonable and equitable fees for local government services.

- Encourage the development of reliable utility services that are adequate to meet the demands of the community at affordable rates that encourage private investment in the community.
- Actively address state mandates or regulatory issues that threaten to increase the cost of local government.
- Support full funding for the development and maintenance of infrastructure necessary to encourage economic development in the community and maintain Ketchikan's position as the major economic hub of Southern Southeast Alaska.

Harbors Development – The community's five harbors serve the boating public, commercial fishermen and other commercial marine enterprises. These harbors used to be owned and maintained by the State of Alaska until they were transferred to the City over the course of several years, with the first transfer taking place in 2001. Under State ownership, the harbors were not well maintained and many of the transferred harbors had fallen into disrepair. Included in the City's 2015-2019 Capital Improvement Program for the Harbor Department is \$6.6 million to correct the remaining deficiencies caused by deferring maintenance and to restore the harbor facilities so they can be operated safely. To finance these projects, the City plans to issue up to \$5 million in general obligation bonds and has already dedicated its share of the state raw fish tax for harbor improvements. In order to provide for the debt service on the general obligation bonds, the City Council has adopted a plan to increase harbor rates as the bonds are issued. In 2013, a 7% rate increase was approved and a second 7% rate increase for 2014 was recently approved. As of December 31, 2014 the City had issued \$2.72 million in general obligation bonds for improvements that are currently under construction. The City plans to issue up to \$2 million in general obligation bonds for additional improvements planned for 2015.

Ketchikan Medical Center – In 2009, the City Council approved a master plan for the Ketchikan Medical Center, which is owned by the City and operated by PeaceHealth of Bellingham, WA under a long-term lease agreement with the City. The master plan concluded that the current facility is outdated and recommended improvements totaling \$75 million. The plan recommended a new wing consisting of a surgical suite and clinical space; the relocation of the main and emergency room entrances; and renovations to the existing structure. In 2014, the City issued a \$41.3 million general obligation bond and secured a \$15 million state grant and began construction of the new wing. This phase is expected to cost approximately \$50 million. Debt service for the bond will be provided from the City's current 1% Hospital Sales Tax. The City has about \$8 million available for the remaining improvements recommended by the master plan and will need to seek \$12 million in additional funding before it can begin work on these improvements. The wing is expected to be completed in June 2016.

Sale of the Telecommunications Utility – On April 6, 2010, the qualified voters of the City passed a ballot proposition authorizing a sale of the City owned telecommunication utility by a vote of 388 to 375. This proposition was driven by growing concerns about KPU Telecommunications' long-term ability to participate financially in a very competitive industry that requires continuing investments in technology and infrastructure necessary to meet consumer demand for new and innovated telecommunication products and services. Since 2010, the City has been working with a broker specializing in purchasing and selling telecommunication properties. Discussions have been held with potential buyers but none of discussions resulted in an offer that could be presented to the City Council for consideration. The City's broker has recently identified several parties that have expressed an interest in acquiring the City's telecommunications utility. It is premature to say that an offer will be forthcoming but if a sale does occur, the City will face several fiscal challenges operating its electric and water utilities without the subsidies that have been provided by the telecommunications utilities.

State Fiscal Crisis – The State of Alaska is an oil producing state that relies heavily on taxes assessed against oil companies operating the oil fields located in the state to fund its operating and capital budgets. The recent decline in oil prices has had a dramatic impact on the State's revenue forecast for its upcoming fiscal year, which begins on July 1, 2015. Absent any significant reductions in spending, the State is facing a \$3 billion budgetary shortfall in Fiscal Year 2016. The fiscal health of the State is important to the City and other local governments around the State. The City relies on the State to provide revenue sharing of approximately \$500,000 annually to fund its General Fund and millions of dollars in grants to help pay for the cost of transportation and utility infrastructure improvements. In addition to the direct financial assistance the State provides to the City, it also provides employment opportunities for approximately 9% of the local labor force. The loss of employment opportunities with the State could have an adverse impact on the local economy.

Depending on the duration of the depressed oil prices, the City may have to adjust its long-term planning to account for the loss of revenues and employment opportunities from the State.

Property Tax and Debt Policies – The City currently subscribes to a policy of maintaining a stable property tax levy in order to promote Ketchikan as an attractive place to live and encourage economic development. Changes in the property tax levy are made in the context of a long-term perspective. As a result, increases or decreases in the property tax levy are made only if the long-term financial needs of the City warrant such changes. Short-term financial needs are addressed by making adjustments to the reserves of the City's general fund. The policy has been successful for the 25 years. Since 1990, the City has lowered its mill rate six times and raised it twice.

The City Charter requires that the voters authorize all general obligation and revenue bonds issued by the City at either a special or regular municipal election. The City currently limits the issuance of revenue bonds to finance improvements for its electric, telecommunications, water and wastewater utilities and its port operations. In addition, revenue bonds can only be issued provided that the net revenue available from the pledged activities is equal to or greater than 1.25 times annual debt service after the issuance of the revenue bonds.

Major Initiatives

The City is a part of a progressive community that seeks to improve the quality of life for its citizens. During 2014, a number of initiatives were undertaken by the City to improve the utility infrastructure, encourage economic development, enhance public safety and public health, promote the education and cultural experience of its citizens, and improve administrative efficiencies of city government. Some of the major initiatives are as follows:

- Issued a \$41.32 million general obligation bond to finance a new surgical suite and clinical offices for the Ketchikan Medical Center. This project is the cornerstone of the community's strategic plan for improving the delivery of health care in Ketchikan and southern Southeast Alaska.
- Issued a \$2.72 million general obligation bond to finance harbor improvements planned for Bar Harbor. This project will replace two major floats that are in dire need of replacement.
- Implemented a community wide all hazards warning system.
- Completed the long overdue renovation of City Hall. The project included a new roof, new siding and completely revamped offices for the finance department and a customer service area on the first floor.
- Implemented a new utility billing system for utility and miscellaneous billing. This system is part of the City's multi-year ERP project
- Placed the \$31 million Whitman Lake hydroelectric project in service. This project will reduce the community's reliance on diesel generation and eventually result in lower rates for energy.
- Completed the \$5.8 million Bar Harbor drive down float facility. This new facility will allow vehicular access to marine vessels for the purpose of loading and unloading supplies and materials. The drive down float will be used by the general public and the commercial fishing fleet.
- Completed and placed in service a multi-million dollar 4G/LTE wireless telecommunication network.
- Completed and placed in service the third phase of the four phase Berths I and II Replacement Project. This \$8.8 million phase replaced the Front Street extension adjacent to the Port of Ketchikan and the ground transportation area for Berth II.
- Completed and placed in service the Jackson/Monroe sewer and water main replacement project. This \$8.1 million project will improve sewer and water services to a major residential area of Ketchikan.
- Hired a new Fire Chief and manager for the Ted Ferry Civic Center.

Awards and Acknowledgements

The Government Finance Officers Association of the United States and Canada (the "GFOA") awarded a Certificate of Achievement for Excellence in Financial Reporting to the City for its comprehensive annual financial report for the fiscal year ended December 31, 2013. This was the thirty-fifth year that the City has received this prestigious award.

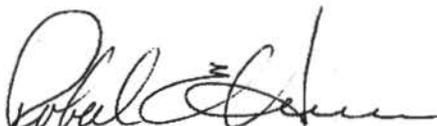
In order to be awarded a Certificate of Achievement, the City published an easily readable and efficiently organized comprehensive annual financial report. This report satisfied both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The preparation of the comprehensive annual financial report was a team effort on the part of the professional staff of the Finance Department. Without their efforts, it would not have been possible to produce this report. Each member worked many extra hours and exhibited an extraordinary effort to ensure the accuracy and timeliness of this report. We appreciate their dedication and the contributions they made to this effort. These individuals are:

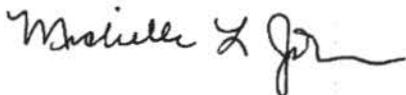
Stan Aegerter	Joe Graham
Anita Beaudoin	Patty Keeley
Gretchen Blanchard	Camille Nelson
Vickie Boyd	Korry Olsen
Angie Delaney	Tracey Sader
Cristina Doyle	Terry Sivertsen

We would also like to express our appreciation to City Manager Karl Amylon and personnel from other City departments who assisted us in the preparation of this financial report. Finally, we would like to thank the Mayor and members of the City Council for their continued interest and support in planning and conducting the financial affairs of the City in a dedicated and responsible manner.

Respectfully submitted,



Robert E. Newell, Jr., CPA
Finance Director



Michelle L. Johansen
Accounting Manager



Government Finance Officers Association

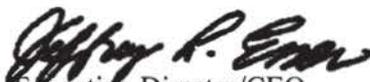
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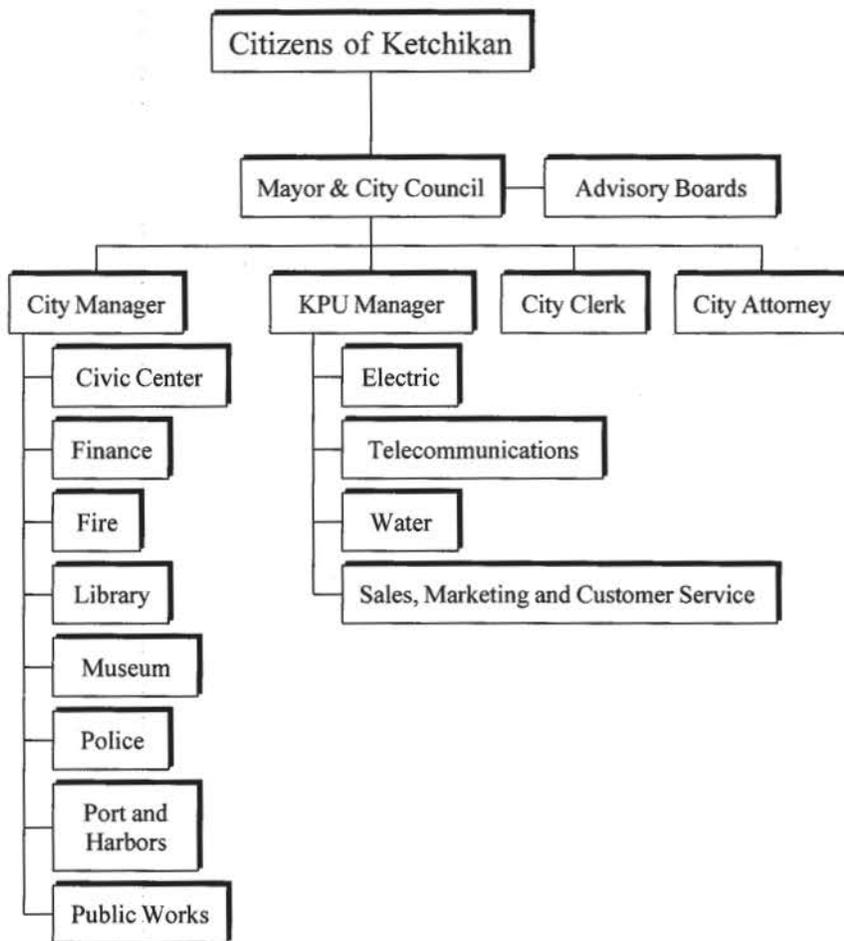
**City of Ketchikan
Alaska**

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended

December 31, 2013


Executive Director/CEO

CITY OF KETCHIKAN, ALASKA
ORGANIZATIONAL CHART
DECEMBER 31, 2014



CITY OF KETCHIKAN, ALASKA

PRINCIPAL CITY OFFICIALS

December 31, 2014

MAYOR AND CITY COUNCIL

<i>City Mayor</i>	<i>Lew Williams III</i>
<i>City Councilmember</i>	<i>KJ Harris</i>
<i>City Councilmember</i>	<i>DeAnn Karlson</i>
<i>City Councilmember</i>	<i>Matt Olsen</i>
<i>City Councilmember</i>	<i>Robert Sivertsen</i>
<i>City Councilmember</i>	<i>David Kiffer</i>
<i>City Councilmember</i>	<i>Judy Zenge</i>
<i>City Councilmember</i>	<i>Richard Coose</i>

CITY STAFF

<i>City Manager/KPU General Manager</i>	<i>Karl R. Amylon</i>
<i>City Clerk</i>	<i>Katherine M. Suiter</i>
<i>City Attorney</i>	<i>Mitchell A. Seaver</i>
<i>Finance Director</i>	<i>Robert E. Newell, Jr.</i>
<i>Police Chief</i>	<i>Alan W. Bengaard</i>
<i>Fire Chief</i>	<i>Abner L. Hoage</i>
<i>Acting Public Works Director/Engineering Mgr.</i>	<i>Steven R. Corporon</i>
<i>Library Director</i>	<i>Linda S. Lyshol</i>
<i>Museum Director</i>	<i>Lacey G. Simpson</i>
<i>Civic Center Manager</i>	<i>Alice M. Nelson</i>
<i>Port and Harbors Director</i>	<i>Steven R. Corporon</i>
<i>Telecommunications Utility Manager</i>	<i>Edward L. Cushing</i>
<i>Water Utility Manager</i>	<i>John C. Kleinegger</i>
<i>Electric Utility Manager</i>	<i>Andrew R. Donato</i>
<i>Sales, Marketing & Customer Service Manager</i>	<i>Kim N. Simpson</i>



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INDEPENDENT AUDITOR'S REPORT



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**MECHAM, RICHARDSON AND COMPANY
CERTIFIED PUBLIC ACCOUNTANTS**

Member of the AICPA Private Companies Practice Section

1734 TONGASS AVENUE
KETCHIKAN, ALASKA 99901
(907) 225-9688
FAX (907) 225-9687

Partners
Edward B. Mecham, CPA
S. Dirk Richardson, CPA

INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and
Members of the City Council
City of Ketchikan
Ketchikan, Alaska

Report on the Financial Statements

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 Ketchikan, Alaska as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Managements Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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 Ketchikan, Alaska, as of December 31, 2014, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, and budgetary comparison information on pages 19 through 33 and 77 through 80, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquires, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Ketchikan, Alaska's basic financial statements. The combining and individual major and nonmajor fund financial statements, and schedules, as listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining and individual major and nonmajor fund financial statements, and schedules, as listed in the table of contents are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining and individual major and nonmajor fund financial statements,

**MECHAM, RICHARDSON AND COMPANY
CERTIFIED PUBLIC ACCOUNTANTS**

To the Honorable Mayor and
Members of the City Council
City of Ketchikan, Alaska

and schedules, as listed in the table of contents are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The introductory section and statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 25, 2015 on our consideration of the City of Ketchikan'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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City of Ketchikan's internal control over financial reporting and compliance.

Mecham, Richardson and Company

Ketchikan, Alaska
June 25, 2015



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MANAGEMENT'S DISCUSSION AND ANALYSIS

The management of the City of Ketchikan is pleased to provide the users of the City's financial statements this narrative overview and analysis of the financial activities of the City for the year ended December 31, 2014. We encourage users to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal and the information included in the notes to the financial statements.

Financial Highlights

- The City's assets exceeded its liabilities by \$336.6 million (net position) for the calendar year reported.
- Total net position is comprised of the following:
 - 1) Net investment in capital assets of \$268.4 million, include property and equipment, net of accumulated depreciation, and reduced for outstanding debt related to the purchase or construction of capital assets.
 - 2) Resources of \$20.4 million are restricted by constraints imposed from outside the City such as debt covenants, granting agencies, laws, or regulations.
 - 3) Unrestricted resources of \$47.8 million are available to maintain the City's continuing obligations to its citizens and creditors.
- The City's governmental funds reported total ending fund balance of \$71.5 million this year. This compares to the prior year ending fund balance of \$26.9 million showing an increase of \$44.7 million during the current year.
- At the end of the current calendar year, unassigned fund balance for the General Fund was \$3.7 million, or 15 percent of total General Fund expenditures. This was an increase of \$372,906 from the prior year. The General Fund also reported an operating deficit of \$252,265.
- The City's proprietary funds reported total ending net position of \$164.5 million this year. This compares to the prior year ending net position of \$158.7 million, an increase of \$5.8 million.
- The City's mill rate remained at 6.7. The City has only increased its mill rate twice in past 24 years.

The above financial highlights are explained in more detail in the "financial analysis" section of this document.

Overview of the Financial Statements

This discussion and analysis introduces the City's basic financial statements. The basic financial statements include: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements. The City also includes in this report additional information to supplement the basic financial statements. Comparative data is presented when available.

Government-wide Financial Statements

The City's annual report includes two government-wide financial statements. These statements provide both long-term and short-term information about the City's overall financial status. Financial reporting at this level uses a perspective similar to that found in the private sector with its basis in accrual accounting and elimination or reclassification of activities between funds.

The first of these government-wide statements is the *Statement of Net Position*. This is the government-wide statement of position presenting information that includes all of the City's assets and liabilities, with the difference reported as *net position*. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the City as a whole is improving or deteriorating. Evaluation of the overall health of the City would extend to other

nonfinancial factors such as the diversification of the taxpayer base or the condition of City infrastructure, in addition to the financial information provided in this report.

The second government-wide statement is the *Statement of Activities*, which reports how the City's net position changed during the current calendar year. All current year revenues and expenses are included regardless of when cash is received or paid. An important purpose of the design of the statement of activities is to show the financial reliance of the City's distinct activities or functions on revenues provided by the City's taxpayers.

Both of the government-wide financial statements distinguish governmental activities of the City that are principally supported by taxes and intergovernmental revenues from business-type activities that are intended to recover all or a significant portion of their costs through user fees and charges. Governmental activities include general government, public safety, public works, culture, harbors, and health and welfare. Business-type activities include Ketchikan Public Utilities (KPU), the Port of Ketchikan and wastewater utility services.

Fund Financial Statements

A fund is an accountability unit used to maintain control over resources segregated for specific activities or objectives. The City uses funds to ensure and demonstrate compliance with finance-related laws and regulations. Within the basic financial statements, fund financial statements focus on the City's most significant funds rather than the City as a whole. Major funds are separately reported while all others are combined into a single, aggregated presentation. Individual fund information for nonmajor funds is provided in the form of combining statements in a later section of this report.

The City has two kinds of funds:

Governmental funds are reported in the fund financial statements and encompass the same functions reported as governmental activities in the government-wide financial statements. However, the focus is very different with fund statements providing a distinctive view of the City's governmental funds. These statements report short-term calendar accountability focusing on the use of spendable resources and balances of spendable resources available at the end of the year. They are useful in evaluating annual financing requirements of governmental programs and the commitment of spendable resources for the near term.

Since the government-wide focus includes the long-term view, comparisons between these two perspectives may provide insight into the long-term impact of short-term financing decisions. Both the governmental fund balance sheet and the governmental fund operating statement provide a reconciliation to assist in understanding the differences between these two perspectives.

Proprietary funds are reported in the fund financial statements and generally report services for which the City charges customers a fee. The City has five proprietary funds; three are classified as enterprise funds and two are internal service funds. The enterprise funds essentially encompass the same functions reported as business-type activities in the government-wide statements. Services are provided to customers external to the City organization for electric, water, telecommunications and wastewater utilities and port facilities.

Internal service funds are an accounting mechanism used to accumulate and allocate costs internally among the City's various functions. The City uses internal funds to account for its risk management and insurance programs and compensated absences. Internal service fund assets and liabilities are predominantly governmental and have been included in the governmental activities of the government-wide statements of net position.

Notes to the Basic Financial Statements

The accompanying notes to the financial statements provide information essential to a full understanding of the government-wide and fund financial statements.

Required Supplementary Information

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City's budget presentations. A budgetary comparison schedule is included as "required supplementary information" for the general fund. The schedule demonstrates compliance with the City's adopted and final revised budget.

Supplementary Information

As discussed, the City reports major funds in the basic financial statements. Combining and individual statements and schedules for nonmajor funds are presented as supplementary information in this report.

Government-wide Financial Analysis

Statement of Net Position

The City's net position at December 31, 2014 and 2013 totaled \$336.6 million and \$310.6 million, respectively. The net position for the City as a whole increased by \$26 million. The following table summarizes the net position of the City's governmental and business-type activities:

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City of Ketchikan's Net Position

	Governmental Activities		Business-type Activities		Total	
	2014	2013	2014	2013	2014	2013
Current and other assets	\$ 83,084,963	\$ 35,712,438	\$ 45,129,957	\$ 47,595,777	\$ 128,214,920	\$ 83,308,215
Capital assets	157,351,713	136,879,120	188,432,159	185,691,495	345,783,872	322,570,615
Deferred outflows of resources	60,887	81,183	61,284	129,454	122,171	210,637
Total assets & def. outflows	240,497,563	172,672,741	233,623,400	233,416,726	474,120,963	406,089,467
Current and other liabilities	8,231,283	5,362,395	\$ 7,466,238	\$ 10,175,550	15,697,521	15,537,945
Long-term liabilities	60,188,680	15,427,703	61,630,581	64,528,523	121,819,261	79,956,226
Total liabilities	68,419,963	20,790,098	69,096,819	74,704,073	137,516,782	95,494,171
Net position:						
Net investment in capital assets	143,909,094	123,952,440	124,479,056	118,874,119	268,388,150	242,826,559
Restricted	8,922,032	8,148,212	11,494,674	9,098,473	20,416,706	17,246,685
Unrestricted	19,246,474	19,781,991	28,552,851	30,740,061	47,799,325	50,522,052
Total net position	\$ 172,077,600	\$ 151,882,643	\$ 164,526,581	\$ 158,712,653	\$ 336,604,181	\$ 310,595,296

The largest component of the City's net position is its net investment in capital assets. The City's net investment in capital assets accounts for 79.7 percent of its net position. These capital assets include land, buildings, equipment, vehicles, and infrastructure used to provide services to the citizens of the City. These assets are not available for future spending. For the City as a whole, its net investment in capital assets increased by \$25.6 million. The net investment in capital assets for the City's governmental activities increased by \$20 million and the net investment in capital assets for business-type activities increased by \$5.6 million.

Approximately 6.1 percent of the City's net position is restricted because of limitations placed on how these resources may be used. Included are resources restricted for debt service, bond proceeds for capital improvements, state grants for harbor improvements, Commercial Passenger Vessel Excise Tax funds for services provided to passengers and program specific resources accounted for in special revenue funds. The resources restricted for harbor improvements were awarded to the City at the time it assumed ownership of previously owned state harbor facilities. Programs provided by the City include solid waste collection and disposal, harbors, and cemetery services.

A portion of the City's net position is unrestricted and may be available to meet the City's ongoing financial obligations. This portion represents resources not restricted by external requirements nor invested in capital assets. The unrestricted portion of net position amounted to \$48.0 million, or 14.2 percent of total net position. This is a decrease of \$2.7 million from 2013. Unrestricted net position reported for the City's governmental activities decreased by \$536,000 and the unrestricted net position of the City's business-type activities decreased by \$2.2 million.

Net position may serve over time as a useful indicator of a government's financial position. Since the City began reporting its net position in 2003, it has increased from \$207.2 million to \$336.6 million. Over the past 11 years, the City's financial position has improved by \$129.4 million, or 62 percent.

Changes in Net Position

The City's net position increased \$26 million in 2014. The net position for governmental and business-type activities increased \$20.2 and \$5.8 million, respectively. The following table provides a summary of the changes in the City's net position:

City of Ketchikan's Changes in Net Position

	Governmental Activities		Business-type Activities		Total	
	2014	2013	2014	2013	2014	2013
Revenues:						
Program:						
Charges for services	\$ 6,640,071	\$ 6,428,833	\$ 46,723,153	\$ 48,761,367	\$ 53,363,224	\$ 55,190,200
Operating grants and contributions	2,444,297	1,562,913	2,973,832	2,280,470	5,418,129	3,843,383
Capital grants and contributions	18,050,935	2,736,373	12,261,064	20,670,211	30,311,999	23,406,584
General:						
Taxes	16,897,495	16,099,913	-	-	16,897,495	16,099,913
Other	850,706	739,077	456,031	494,470	1,306,737	1,233,547
Total revenues	44,883,504	27,567,109	62,414,080	72,206,518	107,297,584	99,773,627
Expenses:						
General government	2,683,962	2,472,898	-	-	2,683,962	2,472,898
Public safety	9,723,428	8,807,683	-	-	9,723,428	8,807,683
Culture	3,300,295	3,445,959	-	-	3,300,295	3,445,959
Health and welfare	1,099,588	747,893	-	-	1,099,588	747,893
Public works	10,373,365	10,840,175	-	-	10,373,365	10,840,175
Harbor	2,192,468	1,851,082	-	-	2,192,468	1,851,082
Interest	1,519,245	655,947	-	-	1,519,245	655,947
KPU	-	-	36,906,790	38,140,800	36,906,790	38,140,800
Port	-	-	11,012,311	9,133,140	11,012,311	9,133,140
Wastewater	-	-	2,477,247	2,642,018	2,477,247	2,642,018
Total expenses	30,892,351	28,821,637	50,396,348	49,915,958	81,288,699	78,737,595
Increase in net position before transfers	13,991,153	(1,254,528)	12,017,732	22,290,560	26,008,885	21,036,032
Transfers	6,203,804	1,265,199	(6,203,804)	(1,265,199)	-	-
Increase in net position	20,194,957	10,671	5,813,928	21,025,361	26,008,885	21,036,032
Net position - January 1	151,882,643	151,871,972	158,712,653	137,687,292	310,595,296	289,559,264
Net position - December 31	\$ 172,077,600	\$ 151,882,643	\$ 164,526,581	\$ 158,712,653	\$ 336,604,181	\$ 310,595,296

Governmental Activities. The City's net position from governmental activities increased \$20.2 million. This increase is \$20,184,286 more than the increase that occurred in 2013. The key elements in the change in net position from the prior year are as follows:

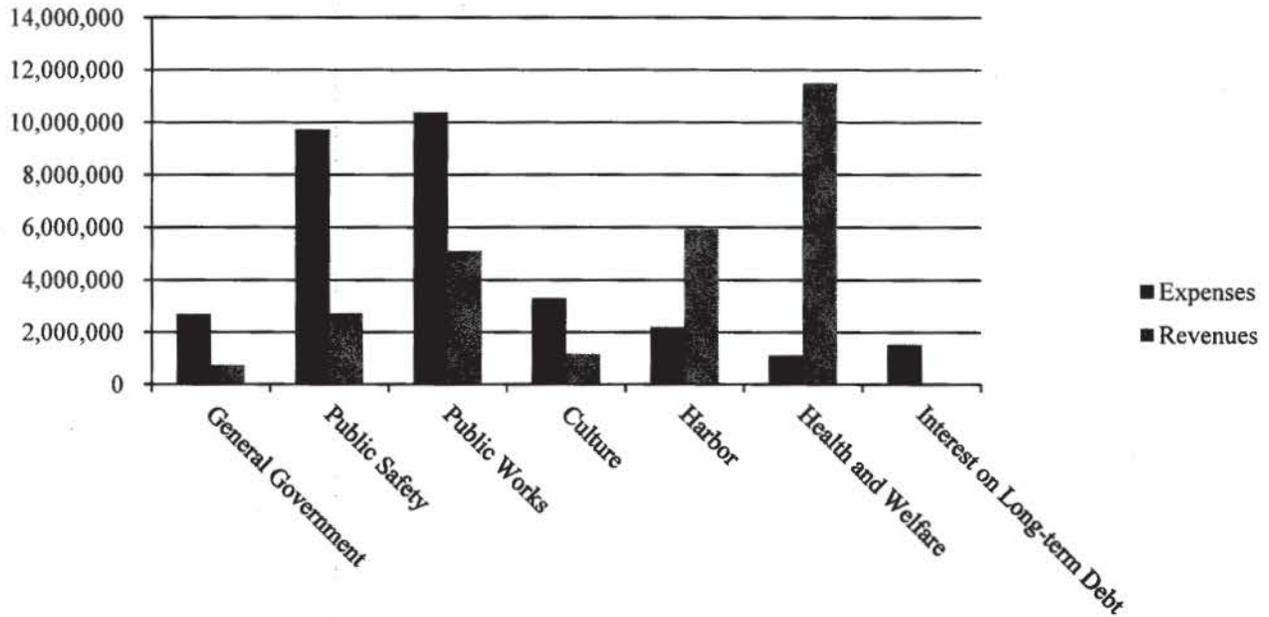
- Capital grants and contributions increased by \$15.3 million. Nearly \$9 million of the increase is attributable to a grant from the State of Alaska to fund the new addition for the Ketchikan Medical Center. The remaining balance of the increase came from a grant to fund harbor improvements at Bar Harbor and a grant for the construction of promenade located in downtown Ketchikan adjacent to Stedman Street.

- Operating grants and contributions increased by \$881 thousand. The decision by the State of Alaska to increase its on-behalf retirement contributions to the Alaska Public Employees Retirement System (PERS) resulted in the City receiving \$1.3 million more than 2013. The on-behalf payments were allocated between governmental and business-type activities.
- Tax revenues increased by \$798 thousand. The increase occurred because the City raised its consumer sales tax rate from 3.5% to 4%, effective April 1, 2014.
- Public safety expenses increased by \$916 thousand. Approximately 62% of the increase was attributable to the increase in the on-behalf retirement contributions made by the State of Alaska to the PERS.
- Health and welfare expenses increased \$352 thousand. Approximately 44% of the increase was for bond issuance costs associated with the issuance of a \$43.2 million general obligation bond to finance improvements for the Ketchikan Medical Center. The remaining balance was for increased maintenance costs associated with an aging facility.
- Public works expenses decreased \$467 thousand. The decrease was driven primarily by vacancies and decreases in maintenance costs and costs associated with the abatement of abandoned buildings.
- Interest expenses increased by \$863 thousand because the City issued \$44 million dollars of general obligation bonds to finance improvements for its healthcare and harbor facilities. The bonds were issued in June 2014.
- Transfers increased by \$4.94 million due to transfers from the Port Enterprise Fund into the Major Capital Improvements Fund to fund the cost of the replacement of the Front Street Extension and the design for the reconstruction of the Thomas Basin Seawall.

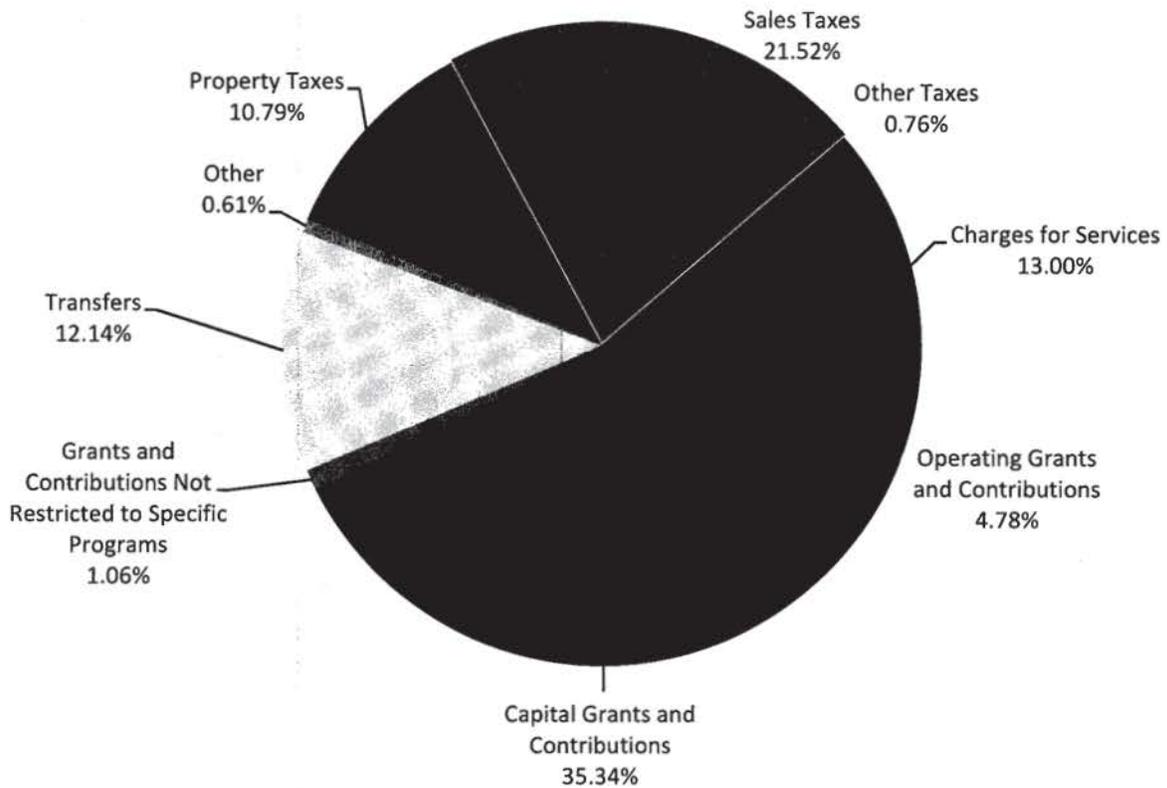
The following graphs compare program revenues with expenses and illustrate the revenues by source for governmental activities.

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EXPENSES AND PROGRAM REVENUES –GOVERNMENTAL ACTIVITIES



REVENUE BY SOURCE – GOVERNMENTAL ACTIVITIES



Business-type Activities. The City's net position from business-type activities increased \$5.8 million. This increase is \$15.2 million less than the increase that occurred in 2013. The City's business-type activities include electric, telecommunications, water and wastewater utilities; and port operations. The key elements in the change in net position from the prior year are as follows:

Charges for services decreased \$2 million. The table below summarizes charges of services by business-type activity.

	2014	2013
Electric	\$ 16,300,445	\$ 18,839,766
Telecommunications	16,097,808	15,241,977
Water	3,171,300	3,081,904
Port	8,578,059	9,145,920
Wastewater	2,575,541	2,451,800
	<u>\$ 46,723,153</u>	<u>\$ 48,761,367</u>

Electric utility revenues decreased \$2.5 million. This decrease was the result of suspending the surcharge implemented in 2013 to recover from the ratepayers the incremental costs of diesel generation and less demand for energy due to an unusually warm winter. Telecommunication utility revenues increased \$919,000 due to customer demand for non-regulated services such as internet and television, and special access revenues. In July 2014, the National Exchange Carriers Association, a not-for-profit association created to administer fees that long distance companies pay to access local telephone networks, increased special access tariff significantly. Water and wastewater revenues increased due to rate increases of 8% and 4%, respectively. Port revenues decreased \$568,000 primarily because of a decrease in the number of passengers arriving by cruise ship. The number of passengers decreased from 938,000 in 2013 to 878,000 in 2014, largely due the cancellation of sailings by a major cruise ship due to mechanical issues.

Capital grants and contributions decreased \$8.4 million due to the winding down of a number of multi-year utility and port capital improvements projects. In 2014, the City completed the Whitman Lake hydroelectric project, the third phase of the Berth I and II replacement project, and the Jackson and Monroe Streets sewer and water main replacement project.

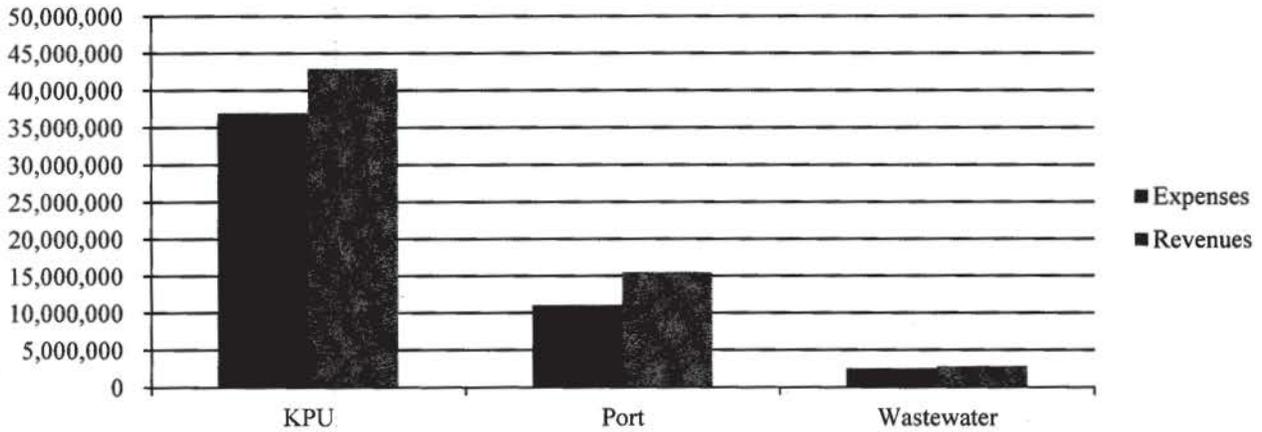
The overall expenses of the City's business-type activities for 2014 increased from \$49.9 million to \$50.4 million, or \$481 thousand. The table summarizes expenses by business-type activity

	2014	2013
Electric	\$17,352,078	\$19,685,532
Telecommunications	15,649,634	14,429,057
Water	3,905,078	4,026,211
Port	11,012,311	9,133,140
Wastewater	2,477,247	2,642,018
	<u>\$50,396,348</u>	<u>\$49,915,958</u>

The expenses of the electric utility decreased in 2014 by \$2.3 million. Nearly 80% of the decrease was due to not needing to operate the diesel generators to meet consumer demand for electric energy in 2014. The expenses of the telecommunications utility increased \$1.3 million because of the growth of its non-regulated internet, IPTV and wireless operations. This growth has increased the cost of operations by \$680,000 and depreciation by \$344,000. The expenses of the port increased \$1.9 million due to the write-off of port assets that were replaced as part of the Berths I and II Replacement Project. In 2014, the City completed Phase III.

The following graphs compare program revenues with program expenses and illustrate the revenues by source for business-type activities.

EXPENSES AND PROGRAM REVENUES –BUSINESS-TYPE ACTIVITIES



REVENUE BY SOURCE –BUSINESS-TYPE ACTIVITIES

