

KITSAP COUNTY CONSOLIDATED HOUSING AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 1998

NOTE 9 - RISK MANAGEMENT

The Kitsap County Consolidated Housing Authority is a member of the Housing Authority Risk Retention Pool (HARRP). Chapter 48.62 RCW authorizes the governing body of any one or more governmental entities to form together into or join a pool or organization for the joint purchasing of insurance, and/or joint self-insuring, and/or joint hiring or contracting for risk management services to the same extent that they may individually purchase insurance, self-insure, or hire or contract for risk management services. An agreement to form a pooling arrangement was made pursuant to the provisions of Chapter 39.34 RCW, the Interlocal Cooperation Act. The pool was formed on March 1, 1987 when housing authorities in the State of Washington joined together by signing an Interlocal Governmental Agreement to pool their self-insured losses and jointly purchase insurance and administrative services. Thirty-two Washington PHA's have joined the pool, along with twenty PHA's in Oregon, twenty-eight in California and one in Nevada.

The pool allows members to establish a plan of self insurance, jointly purchase insurance coverage and to provide such related services as risk management and loss control. Coverage for Errors and Omissions liability is on a "claims made basis." All other coverage is on an "occurrence" basis. The pool provides the following forms coverage for its members: General Liability, Property, Errors & Omissions, Fidelity and Automobile Liability. The Pool self-insures the first \$250,000 per occurrence of their General Liability, Errors & Omissions and Property exposures and purchases \$1,750,000 in reinsurance. The Auto Liability program self insures up to \$2,000,000 per claim.

Members make an annual contribution based upon an actuarial study to fund the pool. Members have no individual deductible in the General Liability and Auto Liability programs. In regards to the Errors & Omissions coverage, members carry a deductible of 1/10th of each loss subject to a minimum of \$2,500 and a maximum of \$25,000 for each claim. They may choose a \$1,000, \$5,000 or \$25,000 per occurrence deductible in the Property program. Since the pool is a cooperative effort, any claims falling within HARRP's self-insured retention will be paid from the pooled funds contributed by all the members.

Each new member pays the pool a non-refundable membership fee. This amount covers the member's share of organizational expenses and the cost of analyzing their loss data and risk profile. Members contract to remain in the pool for a minimum of three years, and must give notice 30 days before terminating participation. The Interlocal Governmental Agreement is renewed automatically each year after the initial three year period. The annual premium is calculated to cover all anticipated expenses. Any shortfall will be covered by the pool surplus and reserves, there is no additional assessment feature in the Agreement.

The pool is fully funded by its member participants. Claims are filed by members with HARRP. HARRP maintains a full time staff including an Executive Director, a Risk Manager and employees providing appropriate support.

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NOTE 9 - RISK MANAGEMENT(Continued)

HARRP is governed by a Board of Directors consisting of representatives from nine member PHA's. Three Directors are elected from among the PHA members of the Association of Washington Housing Authorities; three from PHA members of the Association of Oregon Housing Authorities; and three from PHA members of the Northern California/Nevada Executive Directors Association. The Board meets at least once each quarter to conduct the business affairs of HARRP. The Board also has established an Executive Committee, a Claims/Loss Management Committee, an Insurance/Underwriting Committee and an Audit Committee which are standing committees.

The portion of the member housing authority balances of the Pool not attributable to unassigned retained earnings has been funded by capital contributions of the participants. Until October 1, 1991, participating authorities were required to provide a capital contribution equal to 25% of the 1986 Insurance Service Organization (ISO) rates for property damage and general liability insurance applicable to the member. At December 31, 1994 these capital contributions totals \$1,004,239. These capital contributions vest over an eight-year period as follows:

- Less than four years, 0%
- Four Years, 20%
- Five Years, 40%
- Six Years, 60%
- Seven Years, 80%
- Eight Years, 100%

A member who terminates its membership with the Pool is entitled to receive the vested portion of its capital contribution as outlined above. Total member capital contributions of \$1,004,239 was vested as of December 31, 1994. Due to its positive financial conditions HARRP has fully refunded to the member authorities the capital contributions of \$1,004,239 as of December 31, 1994. The refund of vested capital contributions upon the termination of membership is subject to additional conditions and limitations as set forth in the pool's amended and restated Intergovernmental Cooperation Agreement. Effective during 1992, the pool amended and restated the Intergovernmental Cooperating Agreement. Under the amended and restated Intergovernmental Cooperation Agreement, members accepted on or after October 1, 1992 have not been required to make a capital contribution to the pool. Members who were credited with a reduction of property insurance premiums aggregating \$81,949 during 1991 and \$121,606 during 1992 are deemed under the amended and restated Intergovernmental Cooperation Agreement to have received a return of a portion of their capital contributions in the amount credited to them. The amended and restated Intergovernmental Cooperation Agreement sets forth the manner in which the Pool may return the capital contributions to the members. An additional credit against premiums, in the amount of \$393,444 for 1993 and \$407,240 for 1994. These, too, were deemed a return of capital contributions and constituted a return of all such capital contributions to the member authorities.

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NOTE 9 - RISK MANAGEMENT(Continued)

HARRP's Amended & Restated Intergovernmental Cooperation Agreement permits the HARRP Board to declare a dividend to be paid to HARRP's members with respect to any calendar year. The HARRP Board declared such a dividend payable in 1995 for calendar years 1987 & 1988. The combined dividend for 1987 & 1988 was \$990,043. In 1996 the Board declared a dividend for calendar year 1989 totaling \$595,024. Starting January 1997, the Board has declared a dividend for 1990 totally \$967,208.

In determining the "share" of any declared dividend available to HARRP's Member Authorities, a calculation is made to determine each Member's "Net Financial Contribution" for the year in question. The "Net Financial Contribution" is defined as the Member's written premium for the year, reduced by the Member's paid claims for the year. The "Net Financial Contribution" of each Member having a positive balance is divided by the total of all the Member's "Net Financial Contributions" to determine what percent of the available funds will be returned to each such Member.

A record date of January 31, 1997 was established for payment of this dividend. In order to qualify for the payment, membership in HARRP must have continued through that date. Qualified members were given the option of receiving a check from HARRP equal to their dividend(s) or having that amount applied to their renewal premium. The Housing Authority received no dividends as of the record date of January 31, 1997.

NOTE 10 – PAYMENT IN LIEU OF TAXES

Payment in Lieu of Taxes (PILOT) are cash payments made by the all funds (except the Component Units) to other governments in lieu of payment real estate taxes and cash payments made by all funds to the local fire district in lieu of real estate taxes. Total PILOT reported on the financial statements was \$76,166.

NOTE 11 – CONTINGENCIES

Claims and Judgments The Housing Authority participates in a number of federal, state, and county programs that are fully or partially funded by grants received from other governmental units. Expenditures financed by grants are subject to audit by the appropriate grantor government. If expenditures are disallowed due to noncompliance with grant program regulations, the Housing Authority may be required to reimburse the grantor government. As of June 30, 1998, significant amounts of grant expenditures have not been audited, but the Housing Authority believes that disallowed expenditures discovered in subsequent audits, if any, will not have a material effect on any of the individual funds or the overall financial position of the Housing Authority.

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NOTE 11 – CONTINGENCIES (Continued)

Year 2000 Compliance The year 2000 issue results from computer programs being written using two digits rather than four to define the applicable year. Computer programs, at the Housing Authority and elsewhere, with time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculation causing disruptions of operations, including, among other things, a temporary inability to produce and distribute products, process transactions or engage in similar normal business activities. To address the Year 2000 issue and its risks, the Housing Authority has involved senior management in the evaluation of risks associated with Year 2000 and has hired an experienced Information Systems Manager to implement appropriate remediation and contingency plans.

The Company's preparations for the Year 2000 cover all information systems supported activities and other systems and issues. All of the information systems used at the Housing Authority have been identified and evaluated and the organization is in the process of implementing remediation plans for bringing non-compliant applications into compliance. The majority of computer and telephony applications are relatively recent purchases that are not expected to be affected by the Year 2000 problem. The Authority expects to have completed its remediation efforts and contingency planning for information systems by mid-1999. To address issues arising from non-information supported systems or embedded chips and to evaluate the Authority's exposure to third parties' failures to remediate their Year 2000 problems, the Authority is in the process of identifying the critical product and service suppliers for each of its programs. The organization has solicited information from these critical suppliers about their remediation and contingency plans and their ability to meet the Housing Authority's needs in the Year 2000. There can be no guarantee that the other companies on which the Housing Authority relies will be prepared for the Year 2000 and that their Year 2000 problems will not have an adverse effect on the Authority.

The Housing Authority has spent approximately \$ 149,000 in direct costs for the Year 2000 compliance project through fiscal year 1998 and expects to spend an additional \$150,000 to complete its remediation efforts. These costs and the date on which the Authority plans to complete the Year 2000 modification and testing processes are management's best estimates, which are based on numerous assumptions about future events, including the continued availability of certain resources, third party modification plans and other factors. There can be no guarantee that these estimates will prove true and actual results could differ significantly from those projected.

Disallowed Expenditures Amounts received or receivable under federal grants-in-aid programs are subject to audit and adjustment by the granting agency. Any disallowed claims, including amounts already received, may constitute a liability of the Housing Authority. The amount, if any, of expenditures which may be disallowed cannot be determined at this time although the Housing Authority expects such amounts, if any, to be immaterial.

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NOTE 12 - SUBSEQUENT EVENTS

On August 13, 1998 the Housing Authority, in its capacity as General Partner in the Dye's Inlet Limited Partnership, entered into a contract in the amount of \$1,333,777 with Synergy Construction Inc. for construction of an 18 unit low income senior independent living apartment project. On September 1, 1998 the Housing Authority entered into a contract in the amount of \$924,000 with Synergy Construction Inc. for construction of a three story office building.