

City of Palo Alto



Comprehensive Annual Financial Report



Fiscal Year Ended
June 30, 2002



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Transmittal Letter

December, 2002

THE HONORABLE CITY COUNCIL
Palo Alto, California

Attention: Finance Committee

COMPREHENSIVE ANNUAL FINANCIAL REPORT
YEAR ENDED JUNE 30, 2002

Members of the Council and Citizens of Palo Alto:

Transmittal: The Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2002 is submitted for Council review in accordance with Article IV, Section 13 of the City of Palo Alto Charter and published as a matter of public record for interested citizens. This transmittal letter provides information regarding the economy and the governing structure in Palo Alto. An overview of the City's financial activities for the fiscal year is discussed in detail in the Management's Discussion and Analysis section of the CAFR. While the independent auditor has expressed an opinion on the financial statements contained in this report, management takes sole responsibility for the contents of the CAFR. To the best of its knowledge, staff believes the CAFR information is accurate in all material respects.

THE PALO ALTO ECONOMY

Local Trends: The City of Palo Alto, population 60,500, is a largely built-out community in the heart of the Silicon Valley and Greater San Francisco economies. The adjacent Stanford University, one of the most prestigious institutions of higher education in the nation, has produced much of the talent that founded many successful high-tech companies in Palo Alto and the entire Silicon Valley. With significant employment in several industries and a diverse revenue base, Palo Alto has enjoyed an economic stability lacking in other cities. However, like many cities, several of Palo Alto's major revenue sources have been affected by the dramatic change in the local and national economy. Rising unemployment, declining consumer confidence and the erosion in corporate profitability continues to impact local revenues. The City has taken a number of steps to prepare for the fiscal challenges that it faces. Palo Alto recently completed an update of its long-range financial plan. In addition, the City Manager engaged staff in a citywide retooling of the 2001-02 budget called "Strengthening the Bottom Line". During this process, the City conducted an across-the-board review of program and project budgets resulting in expenditure reductions to offset declining revenues.

Employment Trends: Palo Alto is home to a diverse base of many large, medium and small firms. The number of jobs in Palo Alto total more than 100,000. With a local workforce just over 38,000, commuters hold almost two-thirds of Palo Alto jobs. Palo Alto employment opportunities are sought after and include education and research at Stanford University, high technology at the Stanford Research Park, and health care with two medical facilities of national stature, the Palo Alto Medical Foundation and the Stanford Medical Center. Stanford University (education), Space Systems Loral (research and development), Palo Alto Medical Foundation (health care), Foothill College (education), Veterans' Affairs Palo Alto Health Care (health care), Roche Pharmaceuticals (pharmaceutical



manufacturing), Hewlett-Packard/Compaq (electronics), and Agilent Technologies (Electronics), all exceed 1,000 employees. Both the City of Palo Alto and the Palo Alto School District (PAUSD) are also major employers.

Evidence of the shrinking economy is abundant. The Bay Area’s unemployment rate was a historical low of 1.7 percent in December of 2000 and has risen steadily since then, rising more quickly than the national rate. The Employment Development Department (EDD) confirmed that the Santa Clara County unemployment rate ratcheted up to 7.5 in 2001-02. Palo Alto’s unemployment rate increased from a low of 1.5 percent in 1999-00 to 3.7 percent in 2001-02. This was driven by dot.com closures and technology job cuts in mid-2001 and more recently in 2002. Job reductions have occurred at firms having a local presence such as Intel, Sun Microsystems, Siebel, Oracle, and Hewlett Packard/Compaq.

Real Estate Market: Assessed property valuation, which increased 9 percent in 1990-00 and 10 percent in 2000-01, jumped almost 13 percent in the past year to \$13.1 billion. The Bay Area housing market has remained the bright spot in this otherwise difficult economy. Although home sales have slowed recently, the demand for housing in Palo Alto and low interest rates are expected to sustain residential property values. However, with retail and office vacancy rates rising, the City anticipates reductions in assessed property values in the commercial and the high-end housing market. Despite this adjustment, the City expects property tax revenues to continue to rise.

THE PALO ALTO GOVERNMENT

As a charter city delivering a full range of municipal services and public utilities under the council-manager form of government, Palo Alto offers an outstanding quality of life for its residents. The independent PAUSD has achieved state and national recognition for the excellence of its programs. The City has dedicated 4,000 acres of open space to parks and wildlife preserves. Public facilities include six libraries, four community centers, a cultural arts center, adult and children’s theaters, a junior museum and a golf course. The City provides a diversity of human services for seniors and youths, an extensive continuing education program, concerts, exhibits, team sports and special events.

City Council: The Council consists of nine members elected at-large for four-year, staggered terms. At the first meeting of each calendar year, the Council elects a Mayor and Vice-Mayor from its membership, with the Mayor having the duty of presiding over Council meetings. The Council is the appointing authority for the City Manager and three other officials, the City Attorney, City Clerk, and City Auditor, who all report directly to it.

Finance Committee: While retaining the authority to approve all actions, the City Council has established a subcommittee to review financial matters. Staff provides the CAFR, the results of external and internal audits and periodic budget-versus-actual, investment and performance measure reports to the Finance Committee and Council to assist in their evaluation of the City’s financial performance.

City Manager: The City Manager directs administrative services, human resources, public works, planning and community environment, public safety, and community services departments and also the municipal electric, water, gas, wastewater collection, wastewater treatment, storm drainage, and refuse utilities (the utilities represent almost two-thirds of the City’s revenues).

SUMMARY

Awards: During the past year, the City received two awards for the prior fiscal year CAFR, one from the Government Finance Officers Association (GFOA) for “excellence in financial reporting” and one from the California Society of Municipal Finance Officers (CSMFO) for “outstanding financial reporting”. This is the eighth consecutive year the City has received both of these awards and the current certificates appear immediately after the end of this transmittal letter. The 2001-02 CAFR has



also been submitted to the GFOA and CSMFO award programs and management believes that, once again, it will meet the criteria for these distinguished financial reporting awards. Last year, the City prepared its second “popular” report, designed to provide a synopsis of the City’s financial activities. The City received its second GFOA’s Popular Annual Financial Reporting award for this report.

Acknowledgment: This CAFR reflects the hard work, talent and commitment of the staff members of the Administrative Services Department. This document could not have been accomplished without their efforts and each contributor deserves sincere appreciation. Management wishes to acknowledge the support of Trudy Eikenberry, Accounting Manager, and the Senior Accountants, Staff Accountants, and Accounting Specialists for the high level of professionalism and dedication they bring to the City of Palo Alto. Management would also like to express its appreciation to Maze & Associates, the City’s independent auditors, who assisted and contributed to the preparation of this Comprehensive Annual Financial Report.

Special acknowledgment also should be given to the City Council Finance Committee for its support and interest in directing the financial affairs of the City in a responsible, professional and progressive manner.

Respectfully submitted,

CARL YEATS,
Administrative Services Director

FRANK BENEST,
City Manager



City of Palo Alto City Officials

City Council

Victor Ojakian, *Mayor*

Dena Mossar, *Vice-Mayor*

Bern Beecham	Jim Burch
Hillary Freeman	Judy Kleinberg
Yoriko Kishimoto	Nancy Lytle

Finance Committee

Jim Burch, *Chair*
 Yoriko Kishimoto
 Nancy Lytle
 Jack Morton

Policy and Services Committee

Judy Kleinberg, *Chair*
 Bern Beecham
 Hillary Freeman
 Dena Mossar

Council-Appointed Officers

City Manager

Frank Benest

City Attorney

Ariel-Pierre Calonne

City Clerk

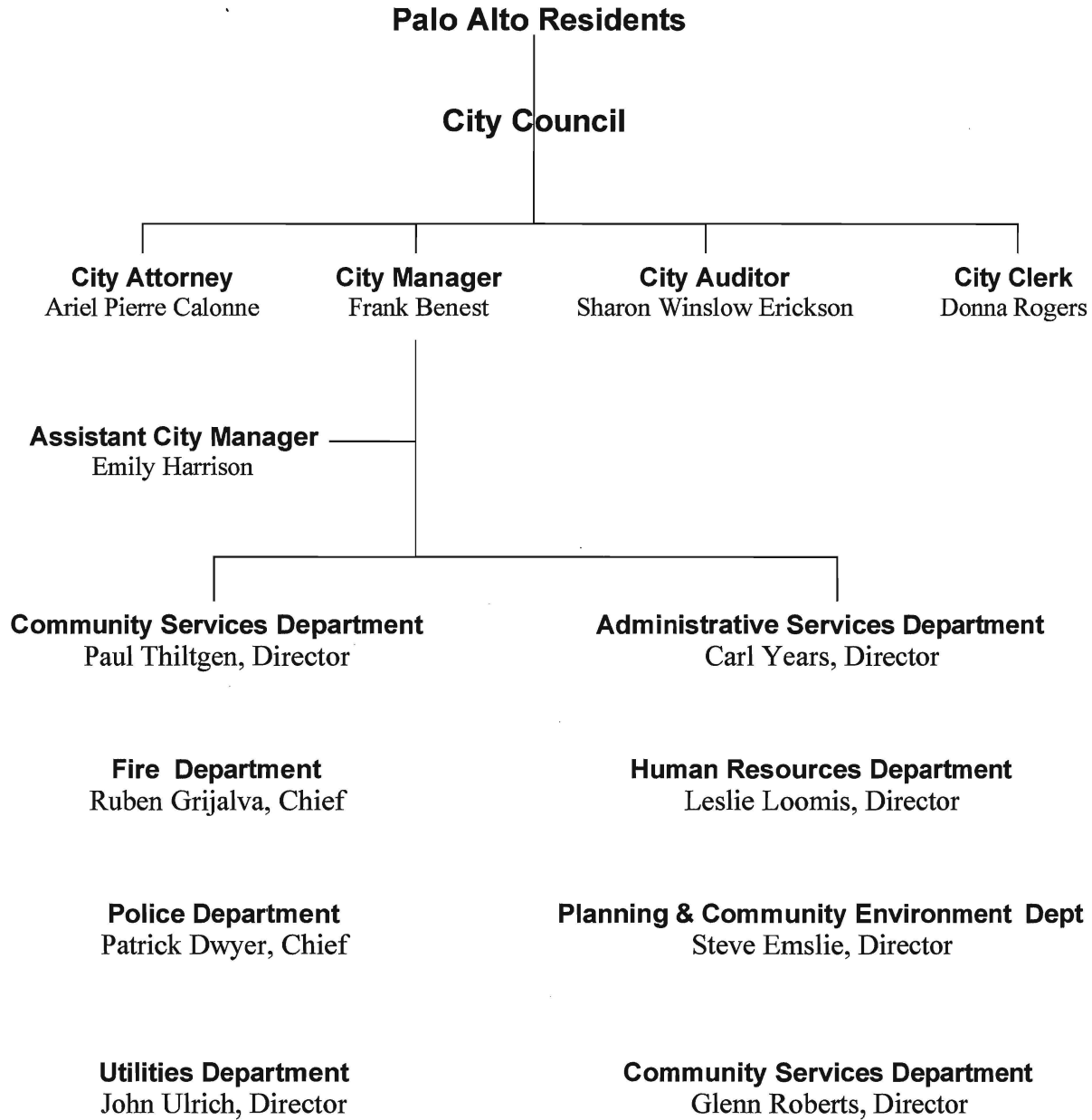
Donna Rogers

City Auditor

Sharon Winslow Erickson



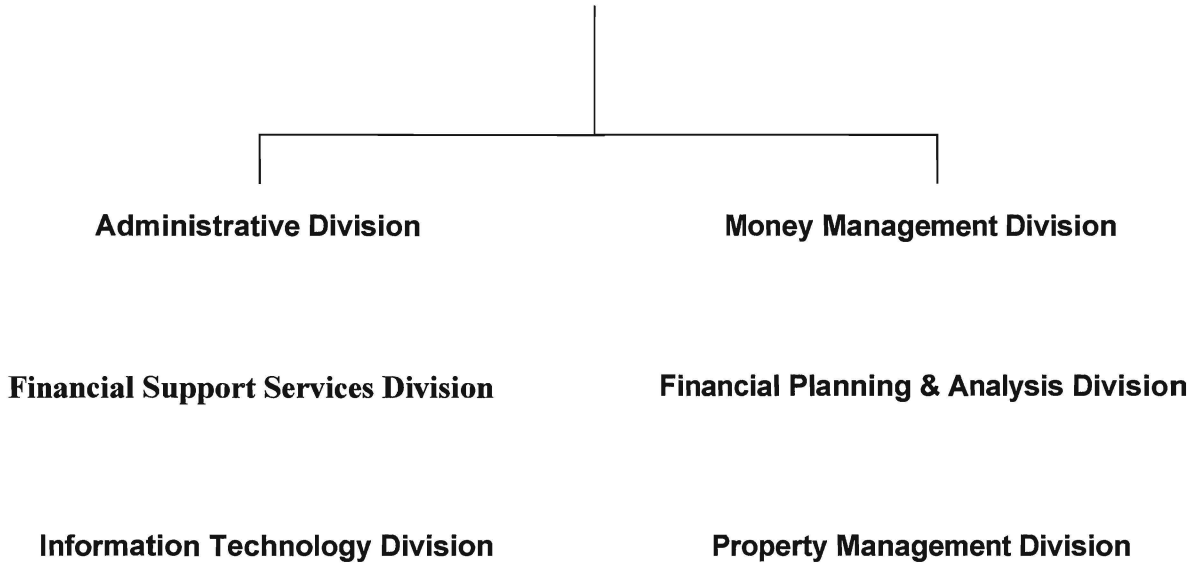
City of Palo Alto Organization





Administrative Services Organization

Administrative Services Department



Mission Statement

To provide proactive administrative and technical support to City departments and decision makers, and to safeguard and facilitate the optimal use of City resources.

Government Finance Officers Association of the United States and Canada - Award

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Palo Alto,
California

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2001

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Imelda Aruwa
President

Jeffrey L. Esser
Executive Director



California Society of Municipal Finance Officers – Award

California Society of Municipal Finance Officers

Certificate of Award

Outstanding Financial Reporting 2000-2001

Presented to the

City of Palo Alto



This certificate is issued in recognition of meeting professional standards and criteria in reporting which reflect a high level of quality in the annual financial statements and in the underlying accounting system from which the reports were prepared.

February 20, 2002

Annie Roberts
Chair, Professional & Technical Standards Committee

Dedicated to Excellence in Municipal Financial Management

**INDEPENDENT AUDITOR'S REPORT
ON BASIC FINANCIAL STATEMENTS**

ACCOUNTANCY CORPORATION
1931 San Miguel Drive - Suite 100
Walnut Creek, California 94596
(925) 930-0902 • FAX (925) 930-0135
E-Mail: maze@mazeassociates.com
Website: www.mazeassociates.com

Honorable Mayor and City Council
City of Palo Alto, California

We have audited the basic financial statements of the City of Palo Alto as of and for the year ended June 30, 2002, as listed in the Table of Contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America and the standards for financial audits contained in *Government Auditing Standard*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining on a test basis evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the basic financial statements referred to above present fairly in all material respects the financial position of the City of Palo Alto at June 30, 2002 and the results of its operations and the cash flows of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles in the United States of America.

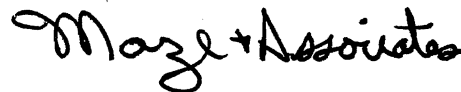
The basic financial statements referred to above follow the requirements of Government Accounting Standards Board Statements No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, No. 36, *Recipient Reporting for Certain Non-exchange Revenues, an Amendment of GASB Statement No. 33*, No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments; Omnibus*, and No. 38, *Certain Financial Statement Note Disclosures*, as discussed in Note 1 to the Basic Financial Statements.

Management's Discussion and Analysis is supplementary information required by the Government Accounting Standards Board, but is not part of the basic financial statements. We have applied certain limited procedures to this information, principally inquiries of management regarding the methods of measurement and presentation of this information, but we did not audit this information and we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued reports dated October 31, 2002 on our consideration of the City of Palo Alto's internal control structure and on its compliance with laws and regulations.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental information listed in the Table of Contents is presented for purposes of additional analysis and is not a required part of the basic statements. Such information has been subjected to the auditing procedures applied in our audit of the City-Wide and fund financial statements, and in our opinion is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The statistical section listed in the Table of Contents was not audited by us, and we do not express an opinion on this information.



October 31, 2002

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Management's Discussion and Analysis.....

This year the City implemented the provisions of Government Accounting Standards Board Statement 34, "Basic Financial Statements—and Management's Discussion & Analysis—for State and Local Governments", known as GASB 34. GASB 34 represents a profound and far-reaching change in accounting and reporting for municipalities. It represents an effort to make governmental reporting clearer and more understandable to readers.

GASB 34 requires the City to make substantial changes to its financial statement format. In addition, the City must provide this discussion and analysis of its financial activities for the fiscal year. Other changes will be described in the financial statements themselves. Please read this document in conjunction with the accompanying Transmittal Letter and Basic Financial Statements. Where possible, fiscal year 2000-01 amounts have been restated in the GASB 34 format for comparison purposes.

OVERVIEW OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORT

The Comprehensive Annual Financial Report (CAFR) is presented in six sections:

- Introductory section, which includes the Transmittal Letter and general information;
- Management's Discussion and Analysis (this section);
- The Basic Financial Statements, which include the Citywide and the Fund financial statements, along with the Notes to these financial statements;
- Required Supplemental Information;
- Combining statements for Non-major Governmental Funds and Fiduciary Funds; and
- Statistical information.

Basic Financial Statements

The Basic Financial Statements contain the Citywide Financial Statements and the Fund Financial Statements. These sets of financial statements provide two different views of the City's financial activities and financial position, long and short-term views.

The Citywide Financial Statements are new statements required by GASB 34 and provide a longer-term view of the City's activities as a whole, and include the Statement of Net Assets and the Statement of Activities. The Statement of Net Assets provides information about the financial position of the City as a whole, including all its capital assets and long-term liabilities on a full accrual basis of accounting, similar to that used by private-sector companies. The Statement of Activities provides information about all the City's revenues and expenses, also on a full accrual basis, with an emphasis on measuring net revenues or expenses of each of the City's programs. The Statement of Activities explains in detail the change in net assets for the year. The amounts in the Statement of Net Assets and the Statement of Activities are separated into Governmental and Business-type Activities in order to provide a summary of these activities for the City as a whole.

The Fund Financial Statements report the City's operations in more detail than the Citywide statements and focus primarily on the short-term activities of the City's General Fund and any other Major Funds, which include the Capital Projects Fund, the Water Services Fund, the Electric Services Fund, the Gas Services Fund, the Wastewater Collection Fund, the Wastewater Treatment Fund, the Refuse Services Fund, the Storm Drainage Services Fund and the External Services Fund. The Fund Financial Statements measure only current revenues and expenditures, current assets, liabilities and fund balances, excluding capital assets, long-term debt and other long-term amounts.

The City acts solely as a depository agent for Special Assessment Districts and certain other entities. The fiduciary statements provide information about the cash balances and activities of these Special Assessment Districts and other entities. These statements are separate from, and their balances are excluded from, the City's financial statements.



Management Discussion and Analysis

Together, all these statements are now called the Basic Financial Statements; formerly they were called the General Purpose Financial Statements.

Citywide Financial Statements

Governmental Activities - All of the City's basic services are considered to be governmental functions, including City Council, City Manager, City Attorney, City Clerk, City Auditor, Administrative Services, Human Resources, Public Works, Planning and Community Development, Police, Fire, Community Services, and non-departmental services. These services are supported by general City revenues such as taxes, and by specific program revenues such as fees.

The City's Governmental Activities include the activities of the Palo Alto Public Improvement Corporation, a separate legal entity financially accountable to the City.

Business-type Activities - All of the City's enterprise activities are reported here, including Water Services, Electric Services, Gas Services, Wastewater Collection Services, Wastewater Treatment Services, Refuse Services, Storm Drainage Services and External Services. Unlike governmental services, these services are supported by charges paid by users based on the amount of service they use.

Citywide Financial Statements are prepared on the accrual basis of accounting, which means they measure the flow of all economic resources of the City as a whole.

Fund Financial Statements

The Fund Financial Statements provide detailed information about each of the City's most significant funds, called Major Funds. The concept of Major Funds, and the determination of which are Major Funds, was established by GASB 34 and replaces the concept of combining like funds and presenting them in total. Instead, each Major Fund is presented individually, with all Non-major Funds combined in a single column on each fund statement. Subordinate schedules present the detail of these Non-major Funds. Major Funds present the major activities of the City for the year. The General Fund is always a Major Fund, but other funds may change from year to year as a result of changes in the pattern of City activities.

Fund Financial Statements include Governmental, Enterprise and Internal Service Funds.

Governmental Fund financial statements are prepared on the modified accrual basis of accounting, which means they measure only current financial resources and uses. Capital assets and other long-lived assets, along with long-term liabilities, are presented only in the Citywide Financial Statements. In 2001-02, the City has two Major Governmental Funds, the General Fund and the Capital Projects Fund.

Enterprise and Internal Service Fund financial statements are prepared on the full accrual basis of accounting, as in the past, and include all their assets and liabilities, current and long-term.

Since the City's Internal Service Funds provide goods and services only to the City's Governmental and Business-type Activities, their activities are reported only in total at the Fund level. Internal Service Funds may not be Major Funds because their revenues are derived from other City funds. These revenues are eliminated in the Citywide Financial Statements and any related profits or losses are returned to the activities that created them, along with any residual net assets of the Internal Service Funds.

Comparisons of Budget and Actual financial information are presented only for the General Fund and any Major Special Revenue Funds.

Fiduciary Statements

The City is the agent for certain assessment districts, holding amounts collected from property owners which await transfer to these Districts' bond trustees. The City's fiduciary activities are reported in the separate Statements of Fiduciary Net Assets and the Agency Funds Statement of Changes in Assets and Liabilities. These activities are excluded from the City's other financial statements because the City cannot use these assets to finance its own operations.

FINANCIAL HIGHLIGHTS

The City's growth continued in fiscal year 2001-02, but slowed from the pace of the past few years. The City was adversely affected by the national economic recession, which started in March 2001 and ended nine years of economic expansion in the Santa Clara Valley, popularly known as Silicon Valley. The high tech sector was particularly hard hit by this recession, which caused a significant reduction in City revenues. Silicon Valley lost about 25,000 jobs or about 1.8 percent of net employment, which contrasts with average growth rates of around 3.9 percent in net employment for the prior eight years. The September 2001 terrorist attacks served to further weaken the already vulnerable economy, especially travel related industries.

Sales levels of Silicon Valley employers slipped significantly, and vacancy rates for office, manufacturing and research and development space rose rapidly as companies cut back or closed their doors. These declines translated primarily into lower receipts of sales taxes, hotel taxes, and lower utility income.

Fiscal year 2001-02 financial highlights include the following:

Citywide

- The City's total net assets increased \$64.7 million in 2001-02. At June 30, 2002, net assets totaled \$909.4 million.
- Citywide revenues include program revenues of \$261.4 million and general revenues of \$97.4 million, totaling \$358.8 million.
- Total Citywide expenses were \$294.1 million.

Fund Level – Governmental Funds

- Governmental Fund balances increased to \$139.4 million.
- Governmental Fund revenues decreased to \$107.5 million in 2001-02, down \$3.9 million from the prior year amount of \$111.4 million.
- Governmental Fund expenditures increased to \$116.8 million in 2001-02, up \$0.9 million from 2000-01 levels of \$115.9 million.
- General Fund revenues of \$98.2 million represented a decrease of \$4.4 million over 2000-01 revenues of \$102.6 million.
- General Fund fund balance of \$63.4 million at June 30, 2002 compared favorably with 2000-01 fund balance of \$61.0 million.

Fund Level – Enterprise Funds

- Enterprise Fund net assets increased to \$482.2 million, a \$12.5 million increase in 2001-02.
- Enterprise Fund revenues totaled \$199.1 million in 2001-02, down \$20.1 million from the prior year revenues of \$219.2 million.
- Enterprise Fund expenses increased to \$182.6 million in 2001-02, up \$19.1 million from prior year levels of \$163.5 million.

FINANCIAL PERFORMANCE

Citywide Financial Statements – Governmental Activities

The following analysis focuses on the net assets and changes in net assets of the City's Governmental Activities, presented in the Citywide Statement of Net Assets and Statement of Activities.

Governmental Activities			
<i>Net Assets at June 30, 2002</i>			
(in Millions)			
	2002	2001	Increase/ (Decrease) from
Cash and investments	\$181.4	\$138.5	\$42.9
Other assets	22.0	19.2	2.8
Capital assets	266.9	257.7	9.2
Total Assets	470.3	415.4	54.9
Long-term debt outstanding	14.4	11.5	2.9
Other liabilities	29.8	28.9	0.9
Total Liabilities	44.2	40.4	3.8
Net assets:			
Invested in capital assets, net of debt	252.2	246.2	6.0
Restricted	56.8	22.3	34.5
Unrestricted	117.1	106.5	10.6
Total Net Assets	\$ 426.1	\$375.0	\$51.1

The City's governmental net assets increased \$51.1 million to \$426.1 million in 2001-02 from \$375 million in 2000-01. This increase is the change in net assets and is explained below:

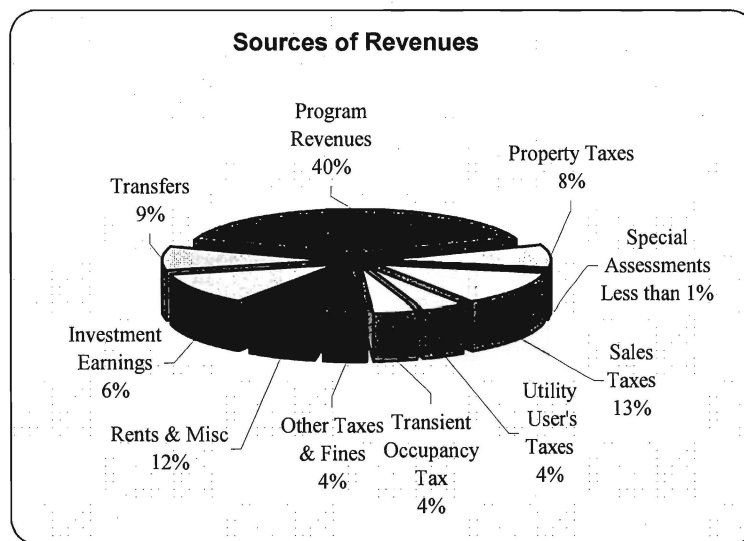
- Cash and investments increased \$42.9 million, principally as a result of a contribution from the University Parking Assessment District of \$31.8 million and \$3.5 million from the issuance of the 2002B Downtown Parking Improvement Project Certificates of Participation.
- Other assets increased \$2.8 million mainly due to fire and communication service charges and reimbursements from Stanford University in the amount of \$1.0 million.
- Repayments reduced long-term debt by \$4.2 million, and new debt in the amount of \$7.1 million was issued in 2001-02.
- Net assets invested in capital assets, net of related debt, increased \$6.0 million due to the addition of infrastructure and other assets, as discussed in the Capital Assets section of the Management's Discussion and Analysis and due to debt issued as discussed in the Long-term Debt section.
- Restricted net assets increased \$34.5 million largely as a result of the contribution from the University Parking Assessment District, which is restricted under the assessment bond indenture to project improvements.
- Unrestricted net assets of \$ 117.1 million represent current net assets available to finance subsequent year operations and other expenditures approved by City Council.

Governmental Activities – Revenues

REVENUES <i>Governmental Activities</i>		
Revenues by Source (\$000)	2002	%
Program revenues:		
Charges for services	24.1	15.3%
Operating contributions & grants	5.6	3.6%
Capital contributions & grants	32.4	20.6%
Total program revenues	\$ 62.1	39.5%
General revenues:		
Property Taxes	13.3	8.5%
Special Assessments	0.1	0.1%
Sales Taxes	20.1	12.8%
Utility User's Taxes	6.5	4.1%
Transient Occupancy Tax	6.6	4.2%
Other Taxes and Fines	6.2	3.9%
Investment Earnings	10.6	6.7%
Rents and Miscellaneous	18.5	11.8%
Transfers	13.3	8.5%
Total General Revenues	95.2	60.5%
Total Revenues	\$ 157.3	100.0%

The table above shows that Governmental Activity revenues totaled \$157.3 million in 2001-02.

Program revenues include charges for service, operating grants and contributions, and capital grants and contributions generated from or restricted to each activity. Program revenues include the \$31.8 million contribution from the University Avenue Off-Street Parking Assessment District. A comparative analysis of revenues has not been performed, as prior year data on the full accrual basis is not available.



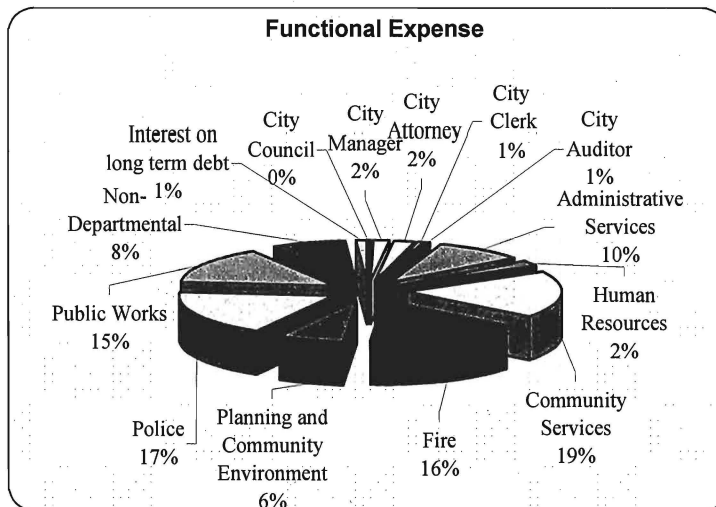
General revenues are composed of taxes and other revenues not specifically generated by or restricted to individual activities. All tax revenues, investment earnings, and rents for governmental facilities are included in general revenues.

Governmental Activities - Expenses

The table below presents the expenses and net revenue/(expense) for each of the City's Governmental Activities and interest on long-term debt. Net cost is defined as total program cost less the revenues generated by those specific activities. Public Works shows revenue in excess of expenses at \$19.9 million due to the receipt of the \$31.8 million contribution from the University Avenue Off-Street Parking Assessment District. These revenues are capital contributions that are to be spent on capital assets. As of June 30, 2002, the City held \$28.1 million of this contribution. A comparative analysis of expenses has not been performed, as prior year data on the full accrual basis is not available.

EXPENSES & NET CHANGE		
<i>Governmental Activities</i>		
(in Millions)		
<u>Functions (\$000)</u>	<u>Expenses</u>	<u>Revenue (Expenses)</u>
City Council	(\$0.2)	(\$0.2)
City Manager	(1.8)	(1.8)
City Attorney	(2.4)	(2.4)
City Clerk	(0.6)	(0.6)
City Auditor	(0.6)	(0.6)
Administrative Services	(10.1)	(10.0)
Human Resources	(2.2)	(2.2)
Public Works	(15.7)	19.9
Planning and Community	(7.3)	(1.3)
Police	(19.0)	(14.6)
Fire	(16.9)	(8.9)
Community Services	(19.9)	(11.9)
Non-Departmental	(8.4)	(8.4)
Interest on long-term debt	(1.1)	(1.1)
Total	\$ (106.2)	\$ (44.1)

Total Governmental Activity expenses totaled \$106.2 million in 2001-02. The Functional Expenses Chart below includes only current year expenses. It does not include capital outlays, which are now added to the City's capital assets. In 2001-02, the City added \$9.2 million in capital assets. The composition of 2001-02 additions is shown in detail in the Capital Asset section of the Management's Discussion and Analysis.



Citywide Financial Statements – Business-type Activities

The following analysis focuses on the net assets and changes in net assets of the City’s Business-type Activities, presented in the Citywide Statement of Net Assets and Statement of Activities.

Business-type Activities			
<i>Net Assets at June 30, 2002</i>			
(in Millions)			
	<u>2002</u>	<u>2001</u>	<u>Increase/ (Decrease) from 2001</u>
Cash and investments	\$231.8	\$198.7	\$33.1
Other assets	24.6	37.7	(13.1)
Capital assets	301.2	281.3	19.9
Total Assets	<u>557.6</u>	<u>517.7</u>	<u>39.9</u>
Long-term debt outstanding	47.2	23.5	23.7
Other liabilities	27.0	24.5	2.5
Total Liabilities	<u>74.2</u>	<u>48.0</u>	<u>26.2</u>
Net assets:			
Invested in capital assets, net of debt	270.6	257.8	12.8
Restricted	1.7	1.0	0.7
Unrestricted	211.1	210.9	0.2
Total Net Assets	<u>\$483.4</u>	<u>\$469.7</u>	<u>\$13.7</u>

The City’s Business-type net assets increased \$13.7 million to \$483.4 million in 2001-02, from \$469.7 million in 2000-01.

- Cash and investments increased \$33.1 million, principally as a result of the issuance of 2002 Utility Revenue Bonds of \$26.1 million.
- Other assets declined \$13.1 million due to the Electric Fund accounts receivable related to excess capacity revenue, which decreased \$13.0 million from the prior year.
- Repayments reduced long-term debt by \$1.9 million, and new debt in the amount of \$25.6 million was issued in 2001-02.
- Net assets invested in capital assets, net of related debt, decreased \$12.8 million due to the addition of infrastructure and other assets, mainly in the Electric Services Enterprise Fund which increased \$10.6 million.
- Unrestricted net assets of \$211.1 million represent liquid assets available to finance day-to-day operations and other expenditures approved by City Council, and increased \$0.2 million in 2001-02. This amount includes reserves set aside by Council for rate stabilization in the amount of \$101.0 million, Calaveras in the amount of \$65.5 million, and emergency plant replacement in the amount of \$6.2 million.

Business-type Activities			
(in Millions)			
Net (Expense) Revenue From Services			
	2002	2001	Increase/ (Decrease) from 2001
Water	\$3.3	\$4.1	(\$0.8)
Electric	(4.7)	40.1	(44.8)
Gas	12.9	(3.0)	15.9
Wastewater Collection	1.0	1.9	(0.9)
Wastewater Treatment	0.7	1.2	(0.5)
Refuse	(2.0)	1.2	(3.2)
Storm Drainage	0	(0.2)	(0.2)
External Services	0	0	0
Totals	\$11.2	\$45.3	(\$34.1)

The table above presents the net cost of each of the City’s Business-type Activities or Enterprise Funds. During the year, net cost is defined as total program cost less the revenues generated by those specific activities. Business-type Activities were significantly affected by the following events:

- Fall off of Electric Services excess capacity sales and costs of sales from the prior year due to stabilization of the electric market in 2001-02.
- Gas rates increased in early 2001-02.

Details are presented below for each Major Enterprise Fund.

FUND FINANCIAL STATEMENTS

Performance of Governmental Funds

At June 30, 2002, the City’s Governmental Funds reported combined fund balances of \$139.4 million, an increase of \$38.7 million or 38.5 percent compared with last year. Part of this increase occurred in the General Fund, which accounted for \$2.4 million. The Capital Projects Fund, which includes a transfer from the University Avenue Assessment District Agency Fund for construction of two new parking structures in the downtown area, accounted for another \$32.2 million. The remaining portion of the increase was attributable to non-major funds.

Governmental Fund revenues and other financing sources increased \$32.2 million this year to a new total of \$173.8 million. This is primarily attributed to the significant contribution from the University Avenue Assessment District. Revenues and other financing sources in the Capital Project Fund increased \$33.3 million, with Non-major Fund revenues and other financing sources increasing by \$2.9 million. These increases were offset by a decline of \$4.0 million in General Fund revenues and other financing sources.

Governmental Fund expenditures and other uses increased \$4.0 million this year to \$135.1 million. Capital Projects Fund expenditures and other uses drove this increase growing by \$9.1 million, with General Fund expenditures and other uses declining \$1.8 million and Non-major Fund expenditures and other uses dropping \$3.3 million.

General Fund – The General Fund ended the year with a \$2.4 million addition to fund balance, compared to \$4.7 million in the prior year. Although Palo Alto’s financial performance remained solid in 2001-02, the weak economy undermined key revenue sources. The City experienced dramatic declines in sales tax, transient occupancy tax, and documentary transfer tax revenues this fiscal year. These revenue declines were partially offset by growth in property tax revenues, rental income, and program revenues.

During this time of economic instability, Palo Alto continues to rely upon the diversity and strength of its revenue base. In spite of key revenue declines, Palo Alto’s General Fund revenues and other financing sources reached \$112.8 million in 2001-02, a modest decline of \$4.0 million or 3.6 percent from the prior year. Revenues and other financing sources ended the year within 1 percent of the adjusted budget. With the current state of the economy, the City closely monitored revenue receipts, making budget adjustments totaling \$4.6 million to recognize declining revenues.

Sales tax, the City’s largest revenue source, dropped by \$5.7 million or 22.1 percent, compared to the prior year. Rising unemployment, declining consumer confidence, and the waning financial condition of businesses caused a drop in spending and sales tax. No economic segment escaped unscathed. Declines in sales tax from the prior year ranged from 13 percent or \$5.0 million in department stores to 40 percent or \$1.2 million in miscellaneous retail sales. Other drops include business services (39 percent or \$3.0 million), electronic equipment (32 percent or \$0.4 million), automobiles (26 percent or \$1.0 million), apparel stores (22 percent or \$0.4 million), and restaurants (17 percent or \$0.5 million).

Transient occupancy tax also experienced a steep decline from the prior year, falling by \$2.8 million or 29.8 percent from 2000-01. This drop results from declining occupancy and daily hotel rates. Occupancy rates tumbled from an average of 73 percent in 2000-01 to 58 percent in 2001-02. Average daily hotel charges dropped from \$154 in 2000-01 to \$136 in 2001-02.

Documentary transfer tax fell by \$0.9 million or 24.5 percent from 2000-01 levels. The soft local economy, high industrial and office space vacancies and the drop in commercial property sales impacted this revenue source.

In contrast to these sharp declines, several revenue sources performed well in 2001-02. Property tax revenues exceeded the prior year by \$1.2 million or 9.9 percent. Property tax receipts in 2001-02 reflect the hot housing and commercial market of the last several years. Recent data suggests that housing prices are holding firm in the Bay Area because demand has remained high and interest rates low. Rental income increased by \$2.2 million, driven by increases in landfill rent from the Refuse Fund and inflation adjustments.

General Fund revenue declines prompted an across-the-board review of General Fund program and project budgets in 2001-02. At midyear the City made several critical budget reductions totaling \$5.5 million to offset projected revenue shortfalls. Among other things the City implemented a hiring freeze resulting in a \$1.5 million reduction, reduced contract services by \$0.3 million, reduced general expenses, supplies and materials by \$0.3 million, reduced transfers to the capital projects fund by \$0.7 million, and implemented a freeze in the replacement schedule of the citywide fleet saving \$0.8 million. As a result of these reductions, General Fund expenditures and other uses ended the year at \$110.4 million, representing a decrease of \$2.0 million or 1.8 percent from prior year levels.

At June 30, 2002, the General Fund fund balance totaled \$63.4 million. This represents 64.3 percent of direct General Fund expenditures, providing a generous buffer against unexpected financial events. Of this \$7.8 million is reserved and \$55.6 is unreserved. A substantial portion of the unreserved amount is designated by the Council for budget stabilization, \$22.7 million at year end, and infrastructure improvements, \$30.2 million at year end. In addition, a new equity transfer stabilization designation was established in 2001-02 in the amount of \$.8 million. This designation would be used in the event that the Electric or Gas Fund was unable to make its required equity transfer to the General Fund.

Capital Projects Fund – Capital Projects Fund expenditures and other uses were \$16.7 million in 2001-02, which is \$9.1 million more than the prior year. The increases resulted from the downtown parking structure project, library master planning efforts, the Homer Avenue under crossing project, and augmented expenditures related to the rehabilitation and maintenance of the City's General Fund infrastructure.

Non-major Fund – These funds are not presented separately in the Basic Financial Statements, but are individually presented as Supplemental Information.

PERFORMANCE OF ENTERPRISE FUNDS

At June 30, 2002, the City's Enterprise Funds reported combined net assets of \$482.2 million, which is an increase of \$12.5 million or 2.7 percent compared with last year. Despite the turmoil in the energy industry, the City's Electric Fund remains strong. The Electric Fund alone contributed retained earnings of \$262.1 million, accounting for 54.4 percent of total Enterprise Fund retained earnings this fiscal year. In 2001-02, electric and gas energy prices have reduced substantially since the energy crisis of the prior year. This market stabilization can be attributed to lower loads due to lower economic activity and close regulatory scrutiny.

In 2001-02, staff established a new Enterprise Fund, the External Services Fund, to capture services provided to surrounding communities that may require assistance in areas not typically staffed in their organizations. The primary areas of focus will be technology and training.

Water Fund – Revenue remained stable in 2001-02. The Water Fund ended the year with net income of \$2.1 million, compared to \$2.9 million in the prior year. Operating expense increases drove the year-to-year change, resulting from increased staff costs. In order to accelerate the completion of water system capital projects, the City issued debt in February 2002 to support capital work in the Water and Gas funds.

Electric Fund – Revenues declined by \$37.8 million from 2000-01. Although retail revenues increased by \$15.7 million as a result of a 43 percent rate increase, sales of surplus electricity declined by \$52.4 million. Last year, the City sold its surplus electricity at significantly higher than anticipated prices as a result of the energy crisis. Operating expenses rose by \$11.4 million primarily as a result of a \$6.9 million NCPA pool settlement related to 2000-01 activity, as well as increases in staff costs, rent and electric line clearing costs partially offset by a reduction in the costs associated with the purchase of surplus electricity in 2000-01. The Electric Fund ended the year with a net loss of \$2.5 million, compared to net income of \$42.7 million in 2000-01.

Gas Fund – The June 1, 2001 rate increase of 67 percent drove up revenues by \$18.0 million from the prior year. The rate increase was necessary to cover increased commodity costs and to replenish reserves that were depleted as a result of significant increase in gas supply costs. Operating expenses rose by \$2.2 million due to increased gas commodity and staff costs. As a result of the substantial rate increase, year end results went from a net loss of \$4.5 million in 2000-01 to net income of \$10.8 million in 2001-02.

Wastewater Collection Fund – In 2001-02, revenues declined by \$0.5 million due to a drop in consumption by commercial customers. Operating expenses increased by \$0.3 million. Operating costs have increased as a result of escalating employee benefits costs mainly due to healthcare cost increases, higher energy costs, and increased overhead and administrative costs at the Wastewater Treatment plant.

Wastewater Treatment Fund – Revenues remained stable in 2001-02. Operating expenses increased by \$1.1 million from the prior year primarily due to increases in electric and gas charges and staff costs. The Fund ended the year with net income of \$0.7 million, compared to \$1.8 million in the prior year.

Refuse Fund - Revenues decreased by \$0.4 million from 2000-01 resulting from declines in drop box and bin rental revenues due to the economic downturn. Operating expenses increased by \$3.0 million primarily resulting from an additional one-time payment on accumulated landfill rent to the General Fund, contributions to the landfill closure liability, and an increase in technology application and infrastructure replacement charges. The Fund ended the year with a net loss of \$1.1 million, compared to a \$2.7 million gain in the prior year.

Storm Drainage Fund - The Storm Drainage Fund continues to experience a net loss before transfers due to insufficient revenue from existing utility rates. Supplemental funding from the General Fund is required in order to maintain the current level of service. In 2001-02, revenues and expenditures remained stable, with the Fund receiving \$0.9 million from the General Fund to continue basic storm drain maintenance and water quality protection programs.

External Services Fund - Created in 2001-02, this Fund provides information technology and training services to neighboring municipalities and other community organizations. The Fund generated revenue of \$0.4 million in 2001-02, breaking even in its first year of operation.

CAPITAL ASSETS

GASB 34 requires the City to record all its capital assets including infrastructure, which was not recorded in prior years. Infrastructure includes roads, bridges, signals and similar assets used by the entire population. GASB 34 also allows the City four years to record all its infrastructure assets in its financial statements, however as of June 30, 2002, all of the City's infrastructure assets have been included in the financial statements.

Capital Assets at June 30, 2002		
(in Millions)		
	<u>2002</u>	<u>2001</u>
Governmental Activities		
<i>Capital Assets</i>		
Land and improvements	\$67.8	\$57.2
Street trees	16.0	16.2
Construction in progress	6.2	
Buildings and improvements	53.8	63.3
Equipment	7.2	6.9
Roadway network	210.9	203.9
Recreation & open space network	6.6	6.0
Less accumulated depreciation	(114.1)	(107.4)
<i>Internal Service Fund Assets</i>		
Construction in progress	0.8	1.0
Equipment	26.6	24.5
Less accumulated depreciation	(15.0)	(13.9)
Total Governmental	\$266.8	\$257.7
Business-type Activities		
Land	\$1.5	\$1.5
Construction in progress	64.9	47.4
Buildings and improvements	10.7	11.3
Equipment	384.6	372.1
Less accumulated depreciation	(160.5)	(151.0)
Total Business-type	\$301.2	\$281.3

In 2001-02, the City recorded the cost of infrastructure assets totaling \$233.7 million, and computed the amount of accumulated depreciation for these assets. At the end of 2001-02, the cost of infrastructure and other capital assets recorded on the City's financial statements is shown in the table above.

The principal additions in 2001-02 were in Governmental Activity construction in progress which increased \$6.2 million mainly due to the downtown parking structure project costs of \$4.0 million and the roadway network increased due to street improvements of \$3.9 million. Business-type Activity increases in the Electric Enterprise Fund amounted to \$10.6 million consisting of Electric Custom Design and Connection Project costs of \$2.1 million, System Reconstruction and Improvement Project costs of \$2.7 million and Stanford Park Underground Cable Rebuild Project costs of \$1.1 million. Gas Fund capital asset additions increased \$5.0 million due to gas main replacements.

During 2001-02, Governmental Activity capital improvement projects focused on the rehabilitation and replacement of the City's General Fund infrastructure. Several years ago the City inventoried, assessed and prioritized work on its buildings, facilities, streets, sidewalks, medians, bikeways, parks and open space. This effort resulted in a long-term plan to rehabilitate Palo Alto's General Fund infrastructure.

In total the City faces an infrastructure bill of \$100.0 million over the next ten years. The infrastructure budget in 2001-02 totaled \$9.6 million. Some of the key infrastructure projects underway this fiscal year include park, athletic field, and trail improvements, facility lighting enhancements, traffic island and median improvements, implementation of the Mitchell Park improvement plan, resurfacing of the parking lots and entrance ways at the Baylands Nature Preserve, and acceleration of sidewalk and street repairs to eliminate backlogs.

The City depreciates all its capital assets over their estimated useful lives, as required by GASB 34. The purpose of depreciation is to spread the cost of a capital asset over the years of its useful life so that an allocable portion of the cost of the asset is borne by all users. Additional information on capital assets and depreciable lives may be found in Note 6.

DEBT ADMINISTRATION

Each of the City's debt issues is discussed in detail in Notes 7 and 8 to the financial statements. At June 30, 2002, the City's debt comprised:

Long-term Debt at June 30, 2002		
(in Millions)		
	2002	2001
Governmental Activity Debt		
<i>General Long-term Obligations:</i>		
1992 Civic Center Certificates of Participation		\$3.7
1998 Golf Course Certificates of Participation	\$6.6	7.0
2002A Civic Center Refinancing Certificates of Participation	3.5	
2002B Downtown Parking Improvements Certificates of Participation	3.6	
<i>Special Assessment Debt with City Commitment</i>		
1987 California Avenue Parking Bonds	0.6	0.7
	<u>14.3</u>	<u>11.4</u>
<i>Internal Service Long-term Obligations:</i>		
Information Systems Capital Lease Obligations	0.1	0.1
Total Governmental Activity Debt	<u>\$14.4</u>	<u>\$11.5</u>
Business-type Activity Debt		
<i>Enterprise Long-term Obligations:</i>		
Utility Revenue Bonds		
1995 Series A	\$7.3	\$7.5
1999 Refunding	16.7	17.1
2002 Series A	24.7	
Less: unamortized discount/issuance cost	(1.5)	(1.1)
Total Business-type Activity	<u>\$47.2</u>	<u>\$23.5</u>

The following new debt was issued in 2001-02:

- Certificates of Participation (COPs) for Civic Center Refinancing (Series 2002A - Tax Exempt) in the amount of \$3.5 million and Downtown Parking Improvements Project (Series 2002B - Taxable) in the amount of \$3.6 million. The series 2002A proceeds were used for refinancing the City's 1992 COPs based on lower, current interest rates and significant net present value savings. The 1992 COPs were used to seismically retrofit the Civic Center and for other capital improvements. The series 2002B proceeds will be used to construct a non-parking area adjacent to one of the new parking structures in the University Avenue Assessment District.



Management Discussion and Analysis

This area will be built using taxable COPs and is targeted for office and retail space. The City will use rental revenues to pay debt service and to provide funding for teen programs throughout the City.

- Utility Revenue Bonds in the amount of \$24.7 million were issued in order to accelerate funding of much needed capital projects. The proceeds will be used for water and gas system capital improvements such as replacement of mains, rehabilitation of wells, and the building of an underground reservoir.

In 2001-02, Standard & Poors (S&P) reaffirmed the City's overall AAA rating (a rating based on issuing General Obligation bond debt), the highest general city credit rating possible. The City also received an AA+ rating from S&P Investor Services for the 2002 COPs. The AA+ rating, one notch below the highest possible AAA rating is considered "high-quality grade" and works to lower interest rate and other debt issuance costs. Finally, S&P and Moody's have given an AA- and Aa3 rating, respectively, to the City's 2002 Utility Revenue bonds. While at the lower end of the "high-quality grade" rating, the rating received is excellent given the volatile utility markets. The rating agencies are recognizing the City's strong reserves, solid revenues, and sound management in the light of significant upheaval in the commodity markets.

SPECIAL ASSESSMENT DISTRICT DEBT

Special assessment districts in different parts of the City have also issued debt to finance infrastructure and facilities construction entirely in those districts. At June 30, 2002, a total of \$0.6 million in special assessment district debt was outstanding, issued by the California Avenue Parking Special Assessment District. The City is contingently obligated for this debt and it has been included in the City's governmental long-term debt.

During 2001-02, the second series of University Avenue Off-Street Parking Assessment District Improvement Bonds in the amount of \$35.5 were issued. The proceeds will be used to construct two new parking garages. This issue along with the outstanding balance of two prior issues total \$37.2 million. This debt is secured only by special assessments on the real property in the district issuing the debt, and is not the City's responsibility, although the City does act as these Districts' agent in the collection and remittance of assessments.

ECONOMIC OUTLOOK

The economy of the City is discussed in the accompanying Transmittal Letter.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

The CAFR is intended to provide citizens, taxpayers, investors, and creditors with a general overview of the City's finances. Questions about this report should be directed to the Administrative Services Department, at 250 Hamilton Avenue, Palo Alto, California. The report can be viewed on the City of Palo website at: www.city.palo-alto.ca.us



Citywide Statement of Net Assets and Statement of Activities.....

The Citywide Statement of Net Assets and the Statement of Activities are entirely new statements required by Government Accounting Standards Board (GASB) Statement 34. Their purpose is to summarize the entire City’s financial activities and financial position. They are prepared on the same basis as is used by most businesses, which means they include all the City’s assets and all its liabilities, as well as all its revenues and expenses. This is known as the full accrual basis—the effect of all the City’s transactions is taken into account, regardless of whether or when cash changes hands. All material internal transactions between City funds have been eliminated.

The Statement of Net Assets reports the difference between the City’s total assets and the City’s total liabilities, including all the City’s capital assets and all its long-term debt. The Statement of Net Assets presents similar information to the old balance sheet format, but presents it in a way that focuses the reader on the composition of the City’s net assets, by subtracting total liabilities from total assets.

The Statement of Net Assets summarizes the financial position of all the City’s Governmental Activities in a single column, and the financial position of all the City’s Business-type Activities in a single column; these columns are followed by a Total column that presents the financial position of the entire City.

The City’s Governmental and Business-type Activities include the activities of its General Fund, along with all its Special Revenue, Capital Projects, Debt Service Funds, and Enterprise Funds. Since the City’s Internal Service Funds service these Funds, their activities are consolidated with Governmental and Business-type Activities, after eliminating inter-fund transactions and balances.

The Statement of Activities reports increases and decreases in the City’s net assets. It is also prepared on the full accrual basis, which means it includes all the City’s revenues and all its expenses, regardless of when cash changes hands. This differs from the “modified accrual” basis used in the Fund financial statements, which reflect only current assets, current liabilities, available revenues and measurable expenditures.

The format of the Statement of Activities differs considerably from those used in the past. It presents the City’s expenses first, listed by program, and follows these with the expenses of its Business-type Activities. Program revenues—that is, revenues which are generated directly by these programs—are then deducted from program expenses to arrive at the net expense of each governmental and Business-type program. The City’s general revenues are then listed in the Governmental Activities or Business-type Activities column, as appropriate, and the Change in Net Assets is computed and reconciled with the Statement of Net Assets.

Both these Statements include the financial activities of the City and the Public Improvement Corporation, which is a legally separate component unit of the City because it is controlled by the City, which is financially accountable for its activities.

These new financial statements along with the fund financial statements and footnotes are called *Basic Financial Statements*; the term General Purpose Financial Statements is no longer used.



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City of Palo Alto - Statement of Net Assets

June 30, 2002

(In thousands of dollars)

	Governmental Activities	Business-type Activities	Totals
ASSETS			
Cash and investments (Note 3)	\$144,965	\$213,445	\$358,410
Cash and investments with fiscal agents (Note 3)	36,475	18,394	54,869
Receivables:			
Accounts and intergovernmental	7,508	21,786	29,294
Interest receivable	2,025	2,897	4,922
Loans receivable (Note 5)	9,968		9,968
Internal balances (Note 4)	100	(100)	
Inventory of materials and supplies	2,350		2,350
Capital assets, net of depreciation (Note 6)	266,887	301,166	568,053
	<u>470,278</u>	<u>557,588</u>	<u>1,027,866</u>
LIABILITIES			
Accounts payable and accrued liabilities	6,313	19,726	26,039
Accrued salaries and benefits	3,944	936	4,880
Accrued compensated absences (Note 1)	11,541		11,541
Claims payable (Note 14)	8,025		8,025
Accrued landfill closure liability (Note 9)		6,376	6,376
Long-term debt (Notes 7 and 8)			
Due in one year	910	1,256	2,166
Due in more than one year	13,464	45,954	59,418
	<u>44,197</u>	<u>74,248</u>	<u>118,445</u>
NET ASSETS (Note 10)			
Invested in capital assets, net of related debt	252,183	270,622	522,805
Restricted for:			
Special revenue programs	21,118		21,118
Capital projects:			
Downtown parking structure	30,079		30,079
Other capital projects	3,450		3,450
Debt service	2,138	1,728	3,866
	<u>56,785</u>	<u>1,728</u>	<u>58,513</u>
Unrestricted net assets	<u>117,113</u>	<u>210,990</u>	<u>328,103</u>
Total net assets	<u>\$426,081</u>	<u>\$483,340</u>	<u>\$909,421</u>

See accompanying notes to financial statements

City of Palo Alto - Statement of Activities

For the Year Ended June 30, 2002

(In thousands of dollars)

Functions/Programs	Program Revenues				Net (Expense) Revenue and Change in Net Assets		Total
	Total Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	
Governmental Activities:							
City Council	\$238				(\$238)		(\$238)
City Manager	1,765				(1,765)		(1,765)
City Attorney	2,410				(2,410)		(2,410)
City Clerk	633	\$1			(632)		(632)
City Auditor	583				(583)		(583)
Administrative Services	10,138	12	\$84	\$29	(10,013)		(10,013)
Human Resources	2,166				(2,166)		(2,166)
Public Works	15,656	320	2,993	32,258	19,915		19,915
Planning and Community Environmen	7,311	4,062	1,959		(1,290)		(1,290)
Police	19,049	3,966	485		(14,598)		(14,598)
Fire	16,870	7,976			(8,894)		(8,894)
Community Services	19,850	7,793	47	93	(11,917)		(11,917)
Non-Departmental	8,412				(8,412)		(8,412)
Interest on long-term debt	1,094				(1,094)		(1,094)
Total Governmental Activities	106,175	24,130	5,568	32,380	(44,097)		(44,097)
Business-type Activities:							
Water	12,722	16,034		36		\$3,348	3,348
Electric	98,405	93,755				(4,650)	(4,650)
Gas	28,778	41,658				12,880	12,880
Wastewater Collection	8,489	9,292		149		952	952
Wastewater Treatment	13,287	13,987				700	700
Refuse	23,750	21,777				(1,973)	(1,973)
Storm Drainage	2,188	2,221				33	33
External Services	349	380				31	31
Total Business-type Activities	187,968	199,104		185		11,321	11,321
Total	\$294,143	\$223,234	\$5,568	\$32,565	(44,097)	11,321	(32,776)
General revenues:							
Taxes:							
Property taxes					13,270		13,270
Special assessments					57		57
Sales taxes					20,085		20,085
Utility user's taxes					6,457		6,457
Transient occupancy tax					6,615		6,615
Other taxes and fines					6,227		6,227
Investment earnings					10,589	15,620	26,209
Rents and Miscellaneous					18,524		18,524
Transfers					13,334	(13,334)	
Total general revenues and transfers					95,158	2,286	97,444
Change in Net Assets					51,061	13,607	64,668
Net Assets-Beginning					375,020	469,733	844,753
Net Assets-Ending					\$426,081	\$483,340	\$909,421

See accompanying notes to financial statements



Fund Financial Statements.....

Introduction

GASB 34 revises the format of the Fund Financial Statements so that only individual major funds are presented, while non-major funds are combined in a single column. Major funds are defined generally as having significant activities or balances in the current year. The practice of combining like funds and presenting their totals in separate columns (Combined Financial Statements) has been discontinued, along with the use of the General Fixed Assets and General Long-term Debt Groups of Accounts.

Major Governmental Funds

The funds described below were determined to be Major Funds by the City in fiscal year 2001-02. Individual non-major funds may be found in the Supplemental section.

General Fund

The General Fund is used for all the general revenues of the City not specifically levied or collected for other City funds, and related expenditures.

Capital Projects Fund

The Capital Projects Fund is utilized to account for resources used for the acquisition and construction of capital facilities by the City, with the exception of those assets financed by proprietary funds.



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City of Palo Alto - Governmental Funds

Balance Sheet - June 30, 2002

(In thousands of dollars)

	General	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
ASSETS				
Cash and investments (Note 3):				
Available for operations	\$57,841	\$20,518	\$12,718	\$91,077
Cash and investments with fiscal agent		35,040	1,435	36,475
Receivables				
Accounts and intergovernmental	6,541	109	68	6,718
Special Assessment			595	595
Interest receivable	1,101	21	179	1,301
Notes receivable (Note 5)	1,293		8,675	9,968
Interfund receivables (Note 4)	155			155
Inventory of materials and supplies	1,985			1,985
	<u>\$68,916</u>	<u>\$55,688</u>	<u>\$23,670</u>	<u>\$148,274</u>
LIABILITIES				
Accounts payable and accrued liabilities	\$3,041	\$2,387	\$262	\$5,690
Accrued salaries and benefits	2,212			2,212
Deferred revenue	75		595	670
Interfund payable and advances (Note 4)	155		155	310
	<u>5,483</u>	<u>2,387</u>	<u>1,012</u>	<u>8,882</u>
FUND BALANCES				
Reserved for: (Note 10):				
Encumbrances	4,502	3,450	2,852	10,804
Downtown parking structure		27,277		27,277
Notes	1,293			1,293
Inventory of materials and supplies	1,985			1,985
Debt service			1,543	1,543
Debt proceeds		2,802		2,802
Unreserved, designated for:				
Unrealized gain on investments	1,520		230	1,750
Special revenue projects			11,919	11,919
Equity transfer stabilization	756			756
Reappropriations	514	19,772	2,939	23,225
Budget stabilization	22,674			22,674
Infrastructure	30,189			30,189
Unreserved undesignated			3,175	3,175
	<u>63,433</u>	<u>53,301</u>	<u>22,658</u>	<u>139,392</u>
Total Liabilities and Fund Balances	<u>\$68,916</u>	<u>\$55,688</u>	<u>\$23,670</u>	<u>\$148,274</u>

See accompanying notes to financial statements



City of Palo Alto - Governmental Funds
Reconciliation of Fund Balances to Governmental Activities Net Assets
June 30, 2002

(In thousands of dollars)

Governmental fund fund balances from prior page \$139,392

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds (Note 6) 266,887

Internal service funds are used by management to charge the costs of certain activities, such as insurance and central services and maintenance, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets. 33,668

Accrual adjustment to remove deferred revenue from the balance sheet 670

Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds (Note7) (14,536)

Net assets of governmental activities \$426,081

See accompanying notes to financial statements

City of Palo Alto - Governmental Funds

Statement of Revenues, Expenditures and

Changes in Fund Balance - For the Year Ended June 30, 2002

(In thousands of dollars)

	General	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
REVENUES				
Property taxes	\$13,231			\$13,231
Special assessments			\$132	132
Sales taxes	20,085			20,085
Utility users' tax	6,457			6,457
Transient occupancy tax	6,615			6,615
Other taxes and fines	8,407		1,055	9,462
Charges for services	16,667			16,667
From other agencies	857	\$829	2,174	3,860
Permits and licenses	2,901			2,901
Investment earnings	5,923	247	861	7,031
Rental income	12,516			12,516
Other revenue	4,576	1,017	2,987	8,580
Total Revenues	<u>98,235</u>	<u>2,093</u>	<u>7,209</u>	<u>107,537</u>
EXPENDITURES				
Current operations:				
City Council	234			234
City Manager	1,763			1,763
City Attorney	2,300			2,300
City Clerk	663			663
City Auditor	600			600
Administrative Services	10,393			10,393
Human Resources	2,282			2,282
Public Works	9,549			9,549
Planning and Community Environment	7,378			7,378
Police	19,047		28	19,075
Fire	16,722			16,722
Community Services	19,499			19,499
Non-Departmental	8,259			8,259
Capital outlay		16,308	624	16,932
Debt service:				
Principal payments			465	465
Interest and fiscal fees			686	686
Total Expenditures	<u>98,689</u>	<u>16,308</u>	<u>1,803</u>	<u>116,800</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(454)</u>	<u>(14,215)</u>	<u>5,406</u>	<u>(9,263)</u>
OTHER FINANCING SOURCES (USES)				
Proceeds from long term debt (Note 7)		3,101	3,954	7,055
Payment to refunded bond escrow agent (Note 7)			(3,820)	(3,820)
Contribution from Assessment District (Note 8)		31,823		31,823
Transfers in (Note 4)	14,531	11,852	1,006	27,389
Transfers (out) (Note 4)	(11,683)	(345)	(2,416)	(14,444)
Total Other Financing Sources (Uses)	<u>2,848</u>	<u>46,431</u>	<u>(1,276)</u>	<u>48,003</u>
Net change in fund balances	2,394	32,216	4,130	38,740
Fund balances at beginning of year	<u>61,039</u>	<u>21,085</u>	<u>18,528</u>	<u>100,652</u>
Fund balances at end of year	<u>\$63,433</u>	<u>\$53,301</u>	<u>\$22,658</u>	<u>\$139,392</u>

See accompanying notes to financial statements



**City of Palo Alto - Reconciliation of the
Statement of Revenues, Expenditures and
Changes in Fund Balances of
Governmental Funds to the Statement of Activities**
For the Year Ended June 30, 2002
(In thousands of dollars)

Net change in fund balances-total governmental funds	\$38,740
Amounts reported for Governmental Activities in the Statement of Activities are different because:	
Governmental Funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. The capital outlay expenditures are therefore	
	15,236
The capital outlay retirements are therefore deducted from fund balance	
	(213)
Depreciation expense is deducted from fund balance (Depreciation expense is net of Internal Service Fund depreciation \$2,683 which has already been allocated to serviced funds.)	
	(6,676)
Bond proceeds provide current financial resources to Governmental Funds, but issuing debt increases long-term liabilities in the Statement of Net Assets. Repayment of bond principal is an expenditure in the Governmental Funds, but in the Statement of Net	
Proceeds from long-term debt are deducted from fund balance	
	(7,055)
Payment to bond escrow agent is added back to fund balance	
	3,670
Fund balance is increased by the amount of debt repayment	
	465
Some amounts reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in Governmental Funds.	
	(246)
Internal Service Funds are used by management to charge the costs of certain activities, such as equipment acquisition, maintenance, and insurance to individual funds. The net revenue (expense) of all Internal Service Funds is reported with Governmental Activities.	
	<u>7,140</u>
Change in net assets of Governmental Activities	<u><u>\$51,061</u></u>

See accompanying notes to financial statements

City of Palo Alto - General Fund
Statement of Revenues, Expenditures and Changes in Fund Balance
Budget and Actual - For the Year Ended June 30, 2002

(In thousands of dollars)

	Budgeted Amount		Actual Amount Budgetary Basis	Variance from Final Budget
	Adopted	Adjusted		Positive (Negative)
REVENUES				
Property taxes	\$12,236	\$12,836	\$13,231	\$395
Sales taxes	25,602	21,046	20,084	(962)
Utility users' tax	7,024	6,278	6,457	179
Transient occupancy tax	10,300	7,056	6,615	(441)
Other taxes, fines & penalties	9,320	7,777	8,407	630
Charges for services	15,769	16,401	16,670	269
Permits and licenses	2,912	3,033	2,901	(132)
Charges to other funds	10,946	10,794	9,584	(1,210)
Rental income	10,531	12,011	12,516	505
Other revenues	8,943	10,240	11,355	1,115
Transfers in	13,414	14,941	14,531	(410)
Prior year encumbrance and reappropriations		5,381	5,381	
Total Revenues	126,997	127,794	127,732	(62)
EXPENDITURES				
Current operations:				
Administrative Departments	19,011	21,278	20,466	812
Community Services	23,191	24,518	22,942	1,576
Fire	17,031	18,012	17,871	141
Planning and Community Environment	7,848	9,594	8,952	642
Police	20,277	21,105	20,595	510
Public Works	13,403	14,032	12,959	1,073
Non-Departmental	12,184	5,914	8,375	(2,461)
Transfers out	12,821	11,502	11,683	181
Total Use of Funds	125,766	125,955	123,843	2,474
EXCESS OF REVENUES - BUDGETARY BASIS	\$1,231	\$1,839	3,889	\$2,050
Adjustments to Budgetary Basis:				
Current year encumbrance/reappropriations			3,851	
Prior year encumbrance/reappropriations			(5,381)	
Stores adjustment, net			36	
EXCESS OF REVENUES - GAAP BASIS			2,395	
Fund balances at beginning of year			61,038	
Fund balances at end of year, GAAP basis			\$63,433	

See accompanying notes to financial statements



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Proprietary Funds.....

Introduction

Proprietary Funds account for City operations financed and operated in a manner similar to a private business enterprise. The intent of the City is that the cost of providing goods and services be financed primarily through user charges.

The concept of Major Funds established by GASB Statement 34 extends to Enterprise Funds. The City has elected to treat all of its Enterprise Funds as Major Funds in fiscal year 2001-02.

GASB 34 does not provide for the disclosure of budget versus actual comparisons for the Proprietary Funds.

Water Services Fund

This fund accounts for all financial transactions relating to the City's Water service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Electric Services Fund

This fund accounts for all financial transactions relating to the City's Electric service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Gas Services Fund

This fund accounts for all financial transactions relating to the City's Gas service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Wastewater Collection Fund

This fund accounts for all financial transactions relating to the City's Wastewater Collection service. Collections are on a user charge basis to residents and business owners located in Palo Alto.

Wastewater Treatment Fund

This fund accounts for all financial transactions relating to the City's Wastewater Treatment. Services are on a user charge basis to residents and business owners located in Palo Alto.

Refuse Services Fund

This fund accounts for all financial transactions relating to the City's Refuse service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Storm Drainage Services Fund

This fund accounts for all financial transactions relating to the City's Storm Drain service. Services are on a user charge basis to residents and business owners located in Palo Alto.

External Service Fund

This fund accounts for all financial transactions relating to the City's External Services provided to surrounding communities. Service charges are established on a case-by-case basis.



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City of Palo Alto - Proprietary Funds

Statement of Net Assets - June 30, 2002

(In thousands of dollars)

	Business-type Activities			
	Water	Electric	Gas	Wastewater Collection
ASSETS				
Current Assets:				
Cash and investments (Note 3):				
Available for operations	\$13,687	\$142,417	\$15,412	\$11,181
Cash and investments with fiscal agent	7,760		9,892	
Accounts receivable, net	2,755	10,444	3,606	1,382
Interest receivable	184	1,950	213	146
Interfund receivable (Note 4)				
Inventory of materials and supplies				
Total Current Assets	<u>24,386</u>	<u>154,811</u>	<u>29,123</u>	<u>12,709</u>
Noncurrent Assets:				
Property, plant and equipment, net	38,529	123,616	42,813	42,935
Total Noncurrent Assets	<u>38,529</u>	<u>123,616</u>	<u>42,813</u>	<u>42,935</u>
Total Assets	<u>62,915</u>	<u>278,427</u>	<u>71,936</u>	<u>55,644</u>
LIABILITIES				
Current Liabilities:				
Accounts payable and accrued liabilities	649	15,978	1,661	110
Accrued salaries and benefits	97	357	141	61
Interfund payable (Note 4)				
Current portion of revenue bonds (Note 7)	293		358	46
Current portion of capital lease (Note 7)				
Accrued compensated absences - current (Note 1)				
Accrued claims payable - current (Note 14)				
Landfill closure and postclosure care (Note 9)				
Total Current Liabilities	<u>1,039</u>	<u>16,335</u>	<u>2,160</u>	<u>217</u>
Noncurrent liabilities:				
Accrued compensated absences - noncurrent (Note 1)				
Accrued claims payable - noncurrent (Note 14)				
Capital lease obligations				
Utility revenue bonds, net of unamortized issuance costs and discounts	10,630		12,967	1,543
Total Noncurrent Liabilities	<u>10,630</u>	<u></u>	<u>12,967</u>	<u>1,543</u>
Total Liabilities	<u>11,669</u>	<u>16,335</u>	<u>15,127</u>	<u>1,760</u>
NET ASSETS				
Invested in capital assets, net of related debt	34,588	123,616	38,430	41,346
Restricted for debt service (Note 10)	778		950	
Unrestricted (Note 10)	15,880	138,476	17,429	12,538
Total Net Assets	<u>\$51,246</u>	<u>\$262,092</u>	<u>\$56,809</u>	<u>\$53,884</u>

Some amounts reported for *Business-type Activities* in the Statement of Net Assets are different because certain Internal Service Fund assets and liabilities are included with Business-type Activities

Net Business-type Activities

See accompanying notes to financial statements

Business-type Activities					Governmental Activities - Internal Service Funds
Wastewater Treatment	Refuse	Storm Drainage	External Service	TOTALS	
\$11,320	\$17,417	\$810	\$48	\$212,292	\$55,041
298		444		18,394	
456	2,764	274	105	21,786	195
156	236	11	1	2,897	724
					255
					365
<u>12,230</u>	<u>20,417</u>	<u>1,539</u>	<u>154</u>	<u>255,369</u>	<u>56,580</u>
<u>32,233</u>	<u>5,507</u>	<u>15,533</u>		<u>301,166</u>	<u>12,418</u>
<u>32,233</u>	<u>5,507</u>	<u>15,533</u>		<u>301,166</u>	<u>12,418</u>
<u>44,463</u>	<u>25,924</u>	<u>17,072</u>	<u>154</u>	<u>556,535</u>	<u>68,998</u>
288	862	175	3	19,726	377
171	72	22	15	936	1,732
			100	100	
284		275		1,256	
					35
					8,672
					2,822
	6,376			6,376	
<u>743</u>	<u>7,310</u>	<u>472</u>	<u>118</u>	<u>28,394</u>	<u>13,638</u>
					2,869
					5,203
					49
<u>9,944</u>		<u>10,870</u>		<u>45,954</u>	
<u>9,944</u>		<u>10,870</u>		<u>45,954</u>	<u>8,121</u>
<u>10,687</u>	<u>7,310</u>	<u>11,342</u>	<u>118</u>	<u>74,348</u>	<u>21,759</u>
22,303	5,507	4,832		270,622	12,334
				1,728	
<u>11,473</u>	<u>13,107</u>	<u>898</u>	<u>36</u>	<u>209,837</u>	<u>34,905</u>
<u>\$33,776</u>	<u>\$18,614</u>	<u>\$5,730</u>	<u>\$36</u>	<u>482,187</u>	<u>\$47,239</u>
				<u>1,153</u>	
				<u>\$483,340</u>	

City of Palo Alto - Proprietary Funds
Statements of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2002
(In thousands of dollars)

	Business-type Activities			
	Water	Electric	Gas	Wastewater Collection
OPERATING REVENUES				
Sales of utilities:				
Customers	\$14,834	\$67,187	\$39,932	\$8,405
City departments	699	1,927	1,141	149
Wholesale		1,886		
Excess capacity		15,139		
Wastewater treatment				
Service connection charges and miscellaneous	294	737	516	
Charges for services			69	122
Other operating revenues	207	6,879		616
Total Operating Revenues	<u>16,034</u>	<u>93,755</u>	<u>41,658</u>	<u>9,292</u>
OPERATING EXPENSES				
Purchase of utilities				
Retail	5,871	45,786	22,142	5,212
Excess Capacity		16,045		
Administration and general	2,042	4,875	2,360	540
Engineering (operating)	158	801	252	94
Resource management and energy efficiency program	302	10,297	672	
Operations and maintenance	2,466	8,130	2,157	1,380
Rent	986	2,589	183	100
Depreciation and amortization	909	4,306	1,116	1,083
Claims payments and changes in estimated self-insurance liability				
Compensated absences and other benefits				
Total Operating Expenses	<u>12,734</u>	<u>92,829</u>	<u>28,882</u>	<u>8,409</u>
Operating Income	<u>3,300</u>	<u>926</u>	<u>12,776</u>	<u>883</u>
NONOPERATING REVENUES (EXPENSES)				
Return on investment	984	10,845	700	925
Interest (expense)				(85)
Joint venture debt service		(5,703)		
Gain (loss) on disposal of fixed assets		(47)	97	
Other				
Net Nonoperating Revenues (Expenses)	<u>984</u>	<u>5,095</u>	<u>797</u>	<u>840</u>
Income (Loss) Before Contributions and Transfers	<u>4,284</u>	<u>6,021</u>	<u>13,573</u>	<u>1,723</u>
Contributions	36			149
Transfers in (Note 4)	124	195	208	12
Transfers (out) (Note 4)	(2,366)	(8,693)	(3,012)	(214)
Change in Net Assets	<u>2,078</u>	<u>(2,477)</u>	<u>10,769</u>	<u>1,670</u>
Total net assets at beginning of year	49,168	264,569	46,040	52,214
Total net assets at end of year	<u>\$51,246</u>	<u>\$262,092</u>	<u>\$56,809</u>	<u>\$53,884</u>

Some amounts reported for *Business-type Activities* in the Statement of Net Assets are different because certain Internal Service Fund assets and liabilities are included with Business-type Activities

Net Business-type Activities

Business-type Activities					Governmental
Wastewater	Refuse	Storm	External	TOTALS	Activities -
Treatment		Drainage	Service		Internal Service
					Funds
	\$18,534	\$2,091		\$150,983	
\$5,317	657	120		10,010	
				1,886	
				15,139	
8,554				8,554	
				1,547	
				191	\$43,860
116	2,586	10	\$380	10,794	
<u>13,987</u>	<u>21,777</u>	<u>2,221</u>	<u>380</u>	<u>199,104</u>	<u>43,860</u>
	7,774			86,785	
				16,045	
1,432	1,511	602		13,362	3,999
1,037	407	481		3,230	
				11,271	
8,813	7,858	540	349	31,693	2,198
	5,789			9,647	
2,443	242	425		10,524	2,683
					3,481
					30,064
<u>13,725</u>	<u>23,581</u>	<u>2,048</u>	<u>349</u>	<u>182,557</u>	<u>42,425</u>
<u>262</u>	<u>(1,804)</u>	<u>173</u>	<u>31</u>	<u>16,547</u>	<u>1,435</u>
	1,376	48	5	15,620	3,667
737	(396)	(228)		(911)	(12)
				(5,703)	
				50	
					109
					715
<u>535</u>	<u>980</u>	<u>(180)</u>	<u>5</u>	<u>9,056</u>	<u>4,479</u>
<u>797</u>	<u>(824)</u>	<u>(7)</u>	<u>36</u>	<u>25,603</u>	<u>5,914</u>
				185	984
3	79	911		1,532	389
(105)	(377)	(99)		(14,866)	
<u>695</u>	<u>(1,122)</u>	<u>805</u>	<u>36</u>	<u>12,454</u>	<u>7,287</u>
<u>33,081</u>	<u>19,736</u>	<u>4,925</u>		<u>469,733</u>	<u>39,952</u>
<u>\$33,776</u>	<u>\$18,614</u>	<u>\$5,730</u>	<u>\$36</u>	<u>482,187</u>	<u>\$47,239</u>
				<u>1,153</u>	
				<u>\$483,340</u>	

City of Palo Alto - Proprietary Funds
Statement of Cash Flows -
For the Year Ended June 30, 2002
(In thousands of dollars)

	Business-type Activities			
	Water	Electric	Gas	Wastewater Collection
CASH FLOWS FROM OPERATING ACTIVITIES:				
Receipts from customers	\$14,632	\$105,423	\$40,205	\$8,647
Payments to suppliers	(10,774)	(79,569)	(25,748)	(7,144)
Payments to employees	(2,068)	(4,881)	(2,304)	(545)
Internal activity - Receipts from other funds	699	1,927	1,141	149
Claims paid				
Other receipts (payments)	207			616
Net Cash From Operating Activities	<u>2,696</u>	<u>22,900</u>	<u>13,294</u>	<u>1,723</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:				
Interfund receipts (payments)				
Transfers in	124	195	208	12
Transfers (out)	(2,366)	(8,693)	(3,012)	(214)
Net Cash From Noncapital Financing Activities	<u>(2,242)</u>	<u>(8,498)</u>	<u>(2,804)</u>	<u>(202)</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:				
Acquisition and construction of fixed assets	(2,926)	(14,918)	(5,249)	(5,116)
Proceeds from sale of capital assets			529	
Proceeds from bond issuance	11,730		14,325	
Bond issuance costs paid	(190)		(256)	
Principal paid on long-term debt	(617)		(744)	(31)
Interest paid on long-term debt		(5,703)		(85)
Cash Flows From Capital Financing Activities	<u>7,997</u>	<u>(20,621)</u>	<u>8,605</u>	<u>(5,232)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:				
Interest on investments	970	10,855	564	975
Net Cash Flows	<u>9,421</u>	<u>4,636</u>	<u>19,659</u>	<u>(2,736)</u>
Cash and cash equivalents at beginning of year	12,026	137,781	5,645	13,917
Cash and cash equivalents at end of year	<u>\$21,447</u>	<u>\$142,417</u>	<u>\$25,304</u>	<u>\$11,181</u>
FINANCIAL STATEMENT PRESENTATION:				
Cash and investments available for operations	\$13,687	\$142,417	\$15,412	\$11,181
Cash and investments with fiscal agent	7,760		9,892	
Cash and cash equivalents at end of year	<u>\$21,447</u>	<u>\$142,417</u>	<u>\$25,304</u>	<u>\$11,181</u>
NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES:				
Increase in contributed fixed assets	<u>\$36</u>			<u>\$149</u>
Reconciliation of operating income (loss) to Cash Flows from Operating Activities				
Operating income (loss)	\$3,300	\$926	\$12,776	\$883
Adjustments to reconcile operating income (loss) to cash				
flows from operating activities:				
Depreciation and amortization	909	4,306	1,116	1,083
Other				
Changes in assets and liabilities:				
Accounts receivable	(496)	13,595	(312)	120
Prepays and inventory of materials and supplies		443		
Accounts and other payables	(1,017)	3,630	(286)	(363)
Accrued claims payable and other liabilities				
Net Cash From Operating Activities	<u>\$2,696</u>	<u>\$22,900</u>	<u>\$13,294</u>	<u>\$1,723</u>

See accompanying notes to financial statements

Business-type Activities					Governmental Activities - Internal Service Funds
Wastewater Treatment	Refuse	Storm Drainage	External Service	TOTALS	
\$9,191	\$17,860	\$2,024	(\$105)	\$197,877	\$43,669
(10,194)	(21,177)	(926)	(346)	(155,878)	(2,429)
(1,426)	(1,511)	(596)	15	(13,316)	(33,841)
5,317	657	120		10,010	
					(4,569)
116	2,724	10	380	4,053	715
3,004	(1,447)	632	(56)	42,746	3,545
			100	100	(100)
3	79	911		1,532	389
(105)	(377)	(99)		(14,866)	
(102)	(298)	812	100	(13,234)	289
(1,516)	(26)	(918)		(30,669)	(2,556)
				529	132
				26,055	
				(446)	
(237)		(235)		(1,864)	(29)
(202)	(396)	(228)		(6,614)	(12)
(1,955)	(422)	(1,381)		(13,009)	(2,465)
731	1,398	40	4	15,537	3,581
1,678	(769)	103	48	32,040	4,950
9,940	18,186	1,151		198,646	50,091
\$11,618	\$17,417	\$1,254	\$48	\$230,686	\$55,041
\$11,320	\$17,417	\$810	\$48	\$212,292	\$55,041
298		444		18,394	
\$11,618	\$17,417	\$1,254	\$48	\$230,686	\$55,041
				\$185	\$984
\$262	(\$1,804)	\$173	\$31	\$16,547	\$1,435
2,443	242	425		10,524	2,683
					715
637	(674)	(67)	(105)	12,698	(191)
				443	(104)
(338)	651	101	18	2,396	95
	138			138	(1,088)
\$3,004	(\$1,447)	\$632	(\$56)	\$42,746	\$3,545



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Fiduciary Funds

Introduction

These funds account for assets held by the City in trust or as an agent for various assessment and community facilities districts. The financial activities of these funds are excluded from the Citywide financial statements, but are presented in separate Fiduciary Fund financial statements.



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City of Palo Alto - Fiduciary Funds

Statement of Fiduciary Net Assets - June 30, 2002

(In thousands of dollars)

	<u>Agency Funds</u>
ASSETS	
Cash and investments available for operations	\$1,043
Cash and investments with fiscal agents	5,485
Interest receivable	48
Other receivable	<u>22</u>
Total Assets	<u><u>\$6,598</u></u>
LIABILITIES	
Accounts payable and accrued liabilities	\$8
Due to bondholders	5,884
Due to other governments	<u>706</u>
Total Liabilities	<u><u>\$6,598</u></u>



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Notes are essential to present fairly the information contained in the overview level of basic financial statements. Narrative explanations are intended to communicate information that is not readily apparent or cannot be included in the statements and schedules themselves, and to provide additional disclosures as required by the Governmental Accounting Standards Board.



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Note 1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Palo Alto was incorporated in 1894 and operates as a charter city, having had its first charter granted by the State of California in 1909. The City operates under the Council-Manager form of government and provides the following services: public safety (police and fire), public works, electric, water, gas, wastewater, storm drain, refuse, golf course, planning and zoning, general administration services, library, open space and science, recreational and human services.

Reporting Entity

The City is governed by a nine member council elected by City residents. The City is legally separate and fiscally independent which means it can issue debt, set and modify budgets and fees and sue or be sued. The accompanying Basic Financial Statements present the financial activity of the City, which is the primary government presented, along with the financial activities of its component units, which are entities for which the City is financially accountable. Although they are separate legal entities, *blended* component units are in substance part of the City’s operations and are reported as an integral part of the City’s financial statements. This City’s component units, which are described below are blended.

The Palo Alto Public Improvement Corporation provides financing of public capital improvements for the City through the issuance of Certificates of Participation (COPs), a form of debt, which allows investors to participate in a stream of future lease payments. Proceeds from the COPs are used to construct projects which are leased to the City. The lease payments are sufficient in timing and amount to meet the debt service requirements of the COPs. The Corporation is controlled by the City, which performs all accounting and administrative functions for the Corporation. The financial activities of the Corporation are included in the Golf Course and Civic Center Debt Service Funds and the Capital Projects Fund.

The Palo Alto Redevelopment Agency is a separate government entity whose purpose is to prepare and implement plans for improvement, rehabilitation, and development of certain areas within the City. The City Council and the Redevelopment Agency Board are composed of the same individuals. Certain administrative and accounting functions are performed by City staff. The financial activities of the Agency have been included in these financial statements in the Redevelopment Agency Special Revenue Fund.

Financial statements for the Palo Alto Public Improvement Corporation may be obtained from the City of Palo Alto, Administrative Services Department, 250 Hamilton Avenue, Palo Alto, CA 94301. Separate financial statements are not issued for the Palo Alto Redevelopment Agency.

Basis of Presentation

The City’s Basic Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America. The Government Accounting Standards Board is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the United States.

The accompanying financial statements are presented on the basis set forth in GASB Statements No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, No. 36, *Recipient Reporting for Certain Non-exchange Revenues, an Amendment of GASB Statement No. 33*, No. 37, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*; *Omnibus*, and No. 38, *Certain Financial Statement Note Disclosures*.



These Statements require that the financial statements described below be presented.

Citywide Statements: The Statement of Net Assets and the Statement of Activities display information about the primary government (the City) and its component units. These statements include the financial activities of the overall City government, except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. These statements distinguish between the governmental and Business-type activities of the City. Governmental Activities generally are financed through taxes, intergovernmental revenues, and other non-exchange transactions. Business-type Activities are financed in whole or in part by fees charged to external parties.

The Statement of Activities presents a comparison between direct expenses and program revenues for each segment of the Business-type Activities of the City and for each function of the City’s Governmental Activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs, (b) grants and contributions that are restricted to meeting the operational needs of a particular program and (c) fees, grants and contributions that are restricted to financing the acquisition or construction of capital assets. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements: The Fund financial statements provide information about the City’s funds, including fiduciary funds and blended component units. Separate statements for each fund category—governmental, proprietary, and fiduciary—are presented. The emphasis of Fund financial statements is on major individual governmental and enterprise funds, each of which is displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as non-major funds.

Proprietary Fund *operating* revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Non-operating* revenues, such as subsidies and investment earnings, result from non-exchange transactions or ancillary activities.

Major Funds

GASB Statement 34 defines Major Funds and requires that the City’s Major Governmental and Business-type Funds be identified and presented separately in the Fund financial statements. All other funds, called Non-major Funds, are combined and reported in a single column, regardless of their fund-type.

Major Funds are defined as funds that have either assets, liabilities, revenues or expenditures/expenses equal to ten percent of their fund-type total and five percent of the grand total. The General Fund is always a Major Fund. The City may also select other funds it believes should be presented as Major Funds.

The City reported the following Major Governmental Funds in the accompanying financial statements:

General Fund - This is the City’s primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

Capital Projects Fund - This fund accounts for resources used for the acquisition and construction of capital facilities by the City, with the exception of those assets financed by Proprietary Funds.

The City reported all its Enterprise Funds as Major Funds in the accompanying financial statements:

Water Services Fund - This fund accounts for all financial transactions relating to the City’s Water service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Electric Services Fund- This fund accounts for all financial transactions relating to the City’s Electric service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Gas Services Fund- This fund accounts for all financial transactions relating to the City’s Gas service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Wastewater Collection Services Fund- This fund accounts for all financial transactions relating to the City’s Wastewater Collection. Collections are on a user charge basis to residents and business owners located in Palo Alto.

Wastewater Treatment Services Fund- This fund accounts for all financial transactions relating to the City’s Wastewater Treatment. Services are on a user charge basis to residents and business owners located in Palo Alto.

Refuse Services Fund- This fund accounts for all financial transactions relating to the City’s Refuse service. Services are on a user charge basis to residents and business owners located in Palo Alto.

Storm Drainage Services Fund- This fund accounts for all financial transactions relating to the City’s Storm Drain service. Services are on a user charge basis to residents and business owners located in Palo Alto.

External Services Fund- This fund accounts for all financial transactions relating to the City’s External services provided to surrounding communities.

The City also reports the following fund types:

Internal Service Funds - These funds account for fleet replacement and maintenance, technology, central duplicating, printing and mailing services, administration of compensated absences and health benefits, and the City’s self-insured workers’ compensation and general liability programs, all of which are provided to other departments on a cost-reimbursement basis. Also included is the Retiree Health Benefits Internal Service Fund which accounts for benefits when the amount of actual benefits exceed one and one-half percent of the City’s gross payroll cost in any fiscal period.

Fiduciary Funds- These funds account for assets held by the City in trust or as an agent for various assessment and community facilities districts. The financial activities of these funds are excluded from the Citywide financial statements, but are presented in separate Fiduciary Fund financial statements.

Agency Funds- These funds are custodial in nature and do not involve measurement of results of operations. The City maintains four agency funds.

Basis of Accounting

The Citywide, Proprietary, and Fiduciary fund financial statements are reported using the *economic resources measurement focus* and the full *accrual basis* of accounting. Revenues are recorded when *earned* and expenses are recorded at the time liabilities are *incurred*, regardless of when the related cash flows take place.

Governmental Funds are reported using the *current financial resources* measurement focus and the *modified accrual* basis of accounting. Under this method, revenues are recognized when *measurable and available*. The City considers all revenues reported in the Governmental Funds to be available if the revenues are collected within sixty days after year-end. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured. General

capital asset acquisitions are reported as *expenditures* in Governmental Funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as *other financing sources*.

Those revenues susceptible to accrual include taxes, intergovernmental revenues, interest and charges for services.

Grant revenues are recognized in the fiscal year in which all eligibility requirements are met. Under the terms of grant agreements, the City may fund certain programs with a combination of cost-reimbursement grants, categorical block grants, and general revenues. Thus, both restricted and unrestricted net assets may be available to finance program expenditures. The City's policy is to first apply restricted grant resources to such programs, followed by general revenues if necessary.

Certain indirect costs are included in program expenses reported for individual functions and activities.

The City follows those Financial Accounting Standard Board Statements issued before November 30, 1989, which do not conflict with Governmental Accounting Standards Board Statements.

Inventory of Materials and Supplies

Materials and supplies are held for consumption and are valued at average cost. The consumption method is used to account for inventories. Under the consumption method, inventories are recorded as an expenditure at the time inventory items are used, rather than purchased.

Compensated Absences

The liability for compensated absences includes the vested portions of vacation, sick leave, and overtime compensation pay. The City's liability for accrued compensated absences is recorded in the General Benefits and Insurance Internal Service Fund. The Fund is reimbursed through payroll charges to all other funds. Earned but unpaid vacation and overtime compensation pay is recognized as an expense or expenditure in the Proprietary and Governmental Fund types when earned because the City has provided financial resources for the full amount through its budgetary process. Vested accumulated sick pay is paid in the event of termination due to disability and under certain conditions specified in employment agreements primarily restricted to individuals with fifteen or more years of continuous service. The City had accumulated vacation and overtime compensation pay of \$7.571 million, and vested accumulated sick pay of \$3.97 million as of June 30, 2002.

Property Tax

Santa Clara County assesses properties and bills, collects, and distributes property taxes to the City. The County remits the entire amount levied and handles all delinquencies, retaining interest and penalties. Secured and unsecured property taxes are levied on January 1 of the preceding fiscal year.

Secured property tax is due in two installments, on November 1 and February 1, and becomes a lien on those dates. It becomes delinquent on December 10 and April 10, respectively. Unsecured property tax is due on July 1, and becomes delinquent on August 31. Collection of delinquent accounts is the responsibility of the County, which retains all penalties.

The term "unsecured" refers to taxes on personal property other than real estate, land and buildings. These taxes are secured by liens on the property being taxed. Property tax revenues are recognized by the City in the fiscal year they are assessed, provided they become available as defined above.



Classification Changes

As of July 1, 2001, the City reports the Community Projects Donation Agency Fund, Human Services Projects Agency Fund and the Developers Deposit Agency Fund in the General Fund.

As of July 1, 2001, the City closed the Assets Seizure Agency Fund to the Assets Seizure Special Revenue Fund.

As of July 1, 2001, the City closed the Retiree Health Benefit Agency Fund to the Retiree Health Benefit Internal Service Fund.

New Funds

The Developers Impact Fee Special Revenue Fund was established to account for fees imposed on new developments for parks, community centers and libraries.

Civic Center Refinancing 2002A Certificates of Participation Debt Service Fund was established to account for revenues received from the General Fund to provide payment of principal and interest associated with the 2002A Civic Center Refinancing Certificate of Participation as they become due.

Downtown Parking Improvement 2002B Certificates of Participation Debt Service Fund was established to account for revenues received from the General Fund to provide payment of principal and interest associated with the 2002B Downtown Parking Improvement Certificate of Participation as they become due.

External Service Enterprise Fund was established to account for all financial transactions relating to the City’s external services in providing surrounding communities services not typically staffed by their organizations.

Redevelopment Agency Administration Special Revenue Fund was established to account for the activities of administrating the Redevelopment Agency.

Rounding

All amounts included on the basic financial statements, combining statements, fiduciary statements, footnotes and schedules are presented to the nearest thousands in accordance with the City’s policy.



Note 2.....

BUDGETS AND BUDGETARY ACCOUNTING

1. The City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures and the means of financing them.
2. Public hearings are conducted to obtain public comments.
3. The Adopted budget is legally enacted through passage of a budget ordinance for all funds except for Agency Funds.
4. The City Manager is authorized to reallocate funds from a contingent account maintained in the General Fund in conformance with the adopted policies set by the City Council. Additional appropriations to departments in the General Fund, or to total appropriations for all other budgeted funds, or transfers of appropriations between funds, require approval by the City Council. These amendments are added to the Adopted budget and the resulting totals are reflected as Adjusted budget amounts.
5. Expenditures may not legally exceed budgeted appropriations at the department level for the General Fund, and at the fund level for Special Revenue and Debt Service Funds.
6. Formal budgetary integration is employed as a management control device during the year in all funds except Agency Funds and Downtown Planned Community and Developer Impact Fee Special Revenue Funds and the Civic Center Refinancing and Downtown Parking Improvement Debt Service Funds.
7. Budgets for governmental funds are adopted on a basis consistent with generally accepted accounting principles (GAAP) for all funds, except that General Fund encumbrances are treated as budgetary expenditures when incurred and stores (materials, parts and supplies) transactions included in the General Fund are not budgeted.
8. Expenditures for the Capital Projects Fund are budgeted and managed on a project length basis and budget to actual comparisons for these expenditures have been excluded from the accompanying financial statements.

Excess of Expenditures over Appropriations

The funds below incurred expenditures and operating transfers in excess of their budgets in the amounts indicated as the result of unanticipated expenses. Sufficient resources were available within each fund to finance these excesses.

The Terman Lease Debt Service Fund, Special District and Asset Seizure Special Revenue Funds actual expenditures and operating transfers out exceeded budget in the amounts of \$96, \$31, and \$17 thousand respectively.



Note 3

CASH AND INVESTMENTS

The City pools cash from all sources and all funds except Restricted Cash and Investments with Fiscal Agents so that it can be invested at the maximum yield, consistent with safety and liquidity, while individual funds can make expenditures at any time.

Investment income is allocated among funds on the basis of average month-end cash and investment balances in these funds.

Categorization of Credit Risk of Securities Instruments

The City invests in individual investments and in investment pools. Individual investments are evidenced by specific identifiable pieces of paper called securities instruments, or by an electronic entry registering the owner in the records of the institution issuing the security, called the book entry system. In order to maximize security, the City employs the Trust Department of a bank as the custodian of all its investments, regardless of their form.

The City categorizes its individual securities instruments in ascending order to reflect the relative risk of loss of these instruments. This risk is called Credit Risk, the lower the number, the lower the risk.

The three levels of risk prescribed by generally accepted accounting principles are described below:

Category 1 - The City is the registered owner of securities held in book entry form by the bank’s Trust Department. Securities instruments in this category are in the City’s name and are in the possession of the Trust Department of the bank employed by the City solely for this purpose.

Category 2 - Securities instruments and book entry form securities in this category are in the bank’s name but are held by the Bank’s Trust Department in a separate account in the City’s name.

Category 3 - None of the City’s investments are in this category, which would include only City-owned securities instruments or book entry form securities, which were not in the City’s name and not held by the bank’s Trust Department.

Pooled Investments - Pooled investments are not categorized because of their pooled, rather than individual nature.

Notes to Basic Financial Statements - Note 3

Investments are carried at fair value, which is the same as fair market value and are categorized as follows at June 30, 2002 (in thousands):

	Cash and Investments		Total
	Available for Operations	With Fiscal Agents	
Category 1 Investments:			
U.S. Agency Obligations	\$331,856	\$30,614	\$362,470
Pooled Investments (non Categorized):			
Local Agency Investment Fund	9,851		9,851
California Asset Management Program		24,803	24,803
Mutual funds (government securities)	13,266	4,937	18,203
Total Investments	354,973	60,354	415,327
Cash in banks (overdraft) and on hand	4,480		4,480
Total Cash and Investments	\$359,453	\$60,354	\$419,807

The City must maintain required amounts of cash and investments with trustees under the terms of certain debt issues. These funds are unexpended bond proceeds or are pledged as reserves to be used if the City fails to meet its obligations under these debt issues. The California Government Code requires these funds to be invested in accordance with City ordinance, bond indentures or State statute. All these funds have been invested as permitted under the Code.

Cash and investments maturing in three months or less at the time of purchase are considered to be liquid assets for purposes of measuring cash flows.

Classification

Cash and investments are classified in the financial statements as shown below, based on whether or not their use is restricted under the terms of City debt instruments or Agency agreements (in thousands):

Cash and investments available for operations	\$358,410
Cash and investments with fiscal agents	54,869
City cash and investments	413,279
Cash and investments in Fiduciary Funds (separate Statement)	6,528
Total cash and investments	\$419,807

Cash Deposits

California Law requires banks and savings and loan institutions to pledge government securities with a market value of 110% of the City's cash on deposit or first trust deed mortgage notes with a value of 150% of the deposit as collateral for these deposits. Under California Law this collateral is held in the City's name and places the City ahead of general creditors of the institution. The City has waived collateral requirements for the portion of deposits covered by federal deposit insurance.

Cash in banks is entirely insured (Category 1) or collateralized by the institution holding the deposit (Category 2), as discussed above.

Bank balances before reconciling items were \$4.810 million, of which \$100 thousand was insured (Category 1) and \$4.710 million was collateralized as discussed above (Category 2) at June 30, 2002.

Market Risk and Investment Maturities

Market risk is the risk that investments will decline in market value. The City limits market risk by limiting the types and maturities of its investments and by not borrowing against its investments. Investment yield is ranked after safety and liquidity in making investment decisions. All investments are held to maturity and maturities are matched to the City’s projected cash flow needs. Investments managed by the City mature as follows at June 30, 2002 (in thousands):

Type of Investment	Fair Value
Local Agency Investment Fund	\$9,851
Mutual funds (government securities)	13,266
U.S. Agency Obligations:	
Maturities of less than 1 year	67,043
Maturities of 1 to 3 years	140,591
Maturities of 3 to 5 years	116,617
Maturities of more than 5 years	7,476
Mortgage Backed Securities, Maturing in 15 Years	<u>129</u>
 Total Cash and Investments Available for Operations	 <u><u>\$354,973</u></u>

Authorized City Investments

Investment instruments authorized for purchase include:

1. Securities of the U.S. Government or its agencies. The maximum stated final maturity of individual securities in the portfolio shall not exceed ten years. No limit on purchase of these securities, except for Callable and Multi-step-up agency securities, limited to no more than twenty percent of the City’s portfolio, provided that:
 - the potential call dates are known at the time of purchase;
 - the interest rates at which they “step-up” are known at the time of purchase; and
 - the entire face value of the security is redeemed at the call date.
2. Certificates of Deposit (or Time Deposits) with federally insured institutions. No more than twenty percent of the City’s portfolio may be invested in CD’s. Rollovers are not permitted without specific instruction from authorized City staff.
3. Bankers Acceptance Notes. Purchases from any one bank may not exceed \$5 million, and total bankers acceptance notes may not exceed thirty percent of the City’s investment portfolio.
4. Short-term Commercial Paper. Purchases of commercial paper may not exceed 180 days maturity or more than fifteen percent of the City’s investment portfolio, and purchases from any one institution may not exceed \$3 million.
5. State of California Local Agency Investment Fund.
6. Short-term Repurchase Agreements (REPO). Agreement shall not exceed one year and market value of securities that underlay a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities.

7. City of Palo Alto Bonds.
8. California Asset Management Program.
9. Money Market Deposit Accounts.
10. Mutual Funds which are limited essentially to the above investments, registered with the Federal Securities and Exchange Commission (SEC), and which are rated in the highest rating category by a nationally recognized rating service. No more than twenty percent of the City's portfolio may be invested in mutual funds, and no more than ten percent of the portfolio may be in any one Mutual Fund.
11. Medium-Term Corporate Notes. No more than ten percent of the City's investment portfolio may be invested in Medium-Term Corporate Notes, and purchases may not exceed \$5 million invested in any single issuer, other than the U.S. Government, its agencies and instrumentality.

The City is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. The City reports its investment in LAIF at the fair value amount provided by LAIF. The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis. Included in LAIF's investment portfolio are collateralized mortgage obligation, mortgage-backed securities, other asset-backed securities, loans to certain state funds, and floating rate securities issued by Federal agencies, government-sponsored enterprises, and corporations.

Investments Carrying Value

The City adjusts the carrying value of its investments to reflect their fair value at each fiscal year end, and it includes the effects of these adjustments in income for that fiscal year.

Note 4

INTERFUND TRANSACTIONS

Transfers Between Funds

With Council approval, resources may be transferred from one City fund to another. The purpose of the majority of transfers is to reimburse a fund, which has made an expenditure on behalf of another fund. Less often, a transfer may be made to open or close a fund. Transfers between City funds during fiscal year 2001-02 were as follows (in thousands):

Fund Receiving Transfer	Fund Making Transfer	Amount Transferred
General Fund	Street Improvement Special Revenue Fund	\$235
	Federal Revenue Special Revenue Fund	116
	Special Districts Special Revenue Fund	459
	Transportation Mitigation Special Revenue Fund	50
	Local Law Enforcement Special Revenue Fund	84 A
	Terman Lease Debt Service Fund	96 B
	Capital Projects Fund	289
	Water Enterprise Fund	2,171
	Electric Enterprise Fund	8,126
	Gas Enterprise Fund	2,746
	Wastewater Collection Enterprise Fund	2 A
	Refuse Enterprise Fund	157
	General Fund	225 D
Redevelopment Agency Special Revenue Fund		
Debt Service Funds:		
Golf Course	General Fund	677
Civic Center	Special Districts Special Revenue Fund	80
Civic Center Refinancing 2002A COPs	General Fund	24
Capital Project Fund		
	General Fund	9,606
	Street Improvement Special Revenue Fund	937
	Special Districts Special Revenue Fund	55
	Transportation Mitigation Special Revenue Fund	226 C
	Water Enterprise Fund	87
	Electric Enterprise Fund	471
	Gas Enterprise Fund	139
	Wastewater Collection Enterprise Fund	70
	Wastewater Treatment Enterprise Fund	87
	Refuse Enterprise Fund	157
	Storm Drainage Enterprise Fund	17

Notes to Basic Financial Statements – Note 4

Enterprise Funds:

Water	Capital Projects Fund	5	C
Water	Gas Enterprise Fund	56	
Water	Wastewater Collection Enterprise Fund	55	
Water	Storm Drainage Enterprise Fund	8	
Electric	Capital Projects Fund	12	C
Electric	Water Enterprise Fund	43	
Electric	Gas Enterprise Fund	50	
Electric	Wastewater Collection Enterprise Fund	29	
Electric	Refuse Enterprise Fund	54	
Electric	Storm Drainage Enterprise Fund	7	
Gas	Capital Projects Fund	8	C
Gas	Water Enterprise Fund	48	
Gas	Electric Enterprise Fund	48	
Gas	Wastewater Collection Enterprise Fund	48	
Gas	Storm Drainage Enterprise Fund	56	
Wastewater Collection	Capital Projects Fund	4	C
Wastewater Collection	Storm Drainage Enterprise Fund	8	
Wastewater Treatment	Capital Projects Fund	3	C
Refuse	Special Districts Special Revenue Fund	78	
Refuse	Capital Projects Fund	1	C
Storm Drainage	General Fund	911	

Internal Service Funds:

Vehicle Replacement and Maintenance	Capital Projects Fund	23	
Technology Fund	General Fund	240	
Technology Fund	Water Enterprise Fund	17	
Technology Fund	Electric Enterprise Fund	48	
Technology Fund	Gas Enterprise Fund	21	
Technology Fund	Wastewater Collection Enterprise Fund	10	
Technology Fund	Wastewater Treatment Enterprise Fund	18	
Technology Fund	Refuse Enterprise Fund	9	
Technology Fund	Storm Drainage Enterprise Fund	3	
		<u>\$29,310</u>	

The reasons for these transfers are set forth below:

- (A) Transfer to reimburse the General Fund for costs incurred for the benefit of funds making the transfer.
- (B) Transfer to close Terman Lease Debt Service Fund.
- (C) Allocation of funds to construct capital assets.
- (D) Transfer of funds used to set up Redevelopment Agency Special Revenue Fund

Current Interfund Balances

Current interfund balances arise in the normal course of business and are expected to be repaid shortly after the end of the fiscal year. At June 30, 2002, the Federal Revenue Special Revenue Fund owed the General Fund \$155 thousand.

Long-Term Interfund Advances

The City has a long-term interfund advance which the General Fund owes the Vehicle Replacement and Maintenance Internal Service Fund \$155 thousand. The amount is expected to be repaid over three fiscal years commencing with 2003-2004 from General Fund Community Services Department resources.

The City also has a long-term interfund advance which the External Services Enterprise Fund owes the Technology Internal Service Fund \$100 thousand. The amount is expected to be repaid over five fiscal years commencing in 2002-03 from External Service Fund resources.



Interfund Commitment

During fiscal year 2001-02, the City established the Palo Alto Redevelopment Agency. The Agency and the City have an agreement whereby the City will advance funds to the Agency in support of start up and formation costs. However, the interfund advances have no specific repayment date. Generally accepted accounting principals require that such amounts be treated as transfers in the year made. As of June 30, 2002, the Agency owed the City \$225 thousand in advances without specified repayment terms.

Internal Balances

Internal balances represent the net interfund receivables and payables remaining after the elimination of all such balances within Governmental and Business-type Activities.

Note 5

Notes and Loans Receivable

At June 30, 2002, the City's notes and loans receivable totaled (in thousands):

Palo Alto Housing Corporation:	
Oak Manor Townhouse	\$1,204
Emerson Street Project	375
Alma Single Room Occupancy Development	2,222
Barker Hotel	1,400
Sheridan Apartments	2,247
Mid-Peninsula Housing Coalition:	
Palo Alto Gardens Apartments	1,000
Home Rehabilitation Loans	227
Executive Relocation Assistance Loans	1,293
	<u>1,293</u>
Total	<u><u>\$9,968</u></u>

Housing Loans

The City engages in programs designed to encourage construction or improvement in low-to-moderate income housing or other projects. Under these programs, grants or loans are provided under favorable terms to homeowners or developers who agree to spend these funds in accordance with the City's terms. These loans have been offset by reserved fund balances, as they are not expected to be repaid immediately.

Oak Manor Townhouse

On January 7, 1991, the City loaned \$2.1 million to assist in the acquisition of an apartment complex to be used to provide rental housing for low and very low income households. This loan bears interest at three percent, is due in annual installments until 2011 and is collateralized by a subordinated deed of trust. Under the terms of the loan agreement, loan payments are forgiven if the Corporation meets the objective of this project. During the year ended June 30, 2002 the obligation was not met. The annual loan payment was not forgiven.

Emerson Street Project

On November 8, 1994 the City loaned \$375 thousand for expenses necessary to acquire an apartment complex for the preservation of rental housing for low and very low-income households in the City. This loan is collateralized by a second deed of trust. The loan bears no interest until 2009 after which the loan bears interest at three percent per year. The principal balance is due in 2034.

Alma Single Room Occupancy Development

On December 13, 1996 the City loaned \$2.695 million to the Alma Place Association for the development of a 107 unit single room occupancy development. This loan bears interest at three percent and is collateralized by a subordinated deed of trust. Loan payments are deferred until 2014. The principal balance is due in 2041.

Barker Hotel

On April 12, 1994 the City loaned a total of \$2.07 million for the preservation, rehabilitation and expansion of a low income, single room occupancy hotel. This loan was funded by three sources: \$400 thousand from the Housing In-Lieu Special Revenue Fund, \$1 million from HOME Investment



Partnership Program Funds, and \$670 thousand from Community Development Block Grant Funds. All three notes bear no interest and are collateralized by a deed of trust, which is subordinated to private financing. Loan repayments are deferred until 2035. The City does not expect to collect the entire loan balance and has therefore recorded an allowance for doubtful accounts amounting to \$670 thousand to reduce the carrying value of the loans to \$1.4 million.

Sheridan Apartments

On December 8, 1998 the City loaned \$2.45 million to the Palo Alto Housing Corporation for the purchase and rehabilitation of a 57 unit apartment complex to be used for senior and low income housing. The loan is funded by \$1.625 million in Community Development Block Grant Funds, and \$825 thousand in Housing In-Lieu funds. The note bears interest at nine percent when available surplus cash from the project equals or exceeds twenty-five percent of interest calculated using nine percent. When available surplus cash falls below this level the note bears interest at three percent. The note is collateralized by a second deed of trust and an Affordability Reserve Account held by the Corporation. Annual loan payments are deferred until the Corporation accumulates \$1 million in an Affordability Reserve Account. The principal balance is due in 2033.

Palo Alto Gardens Apartments

On April 22, 1999 the City loaned \$1 million to the Mid-Peninsula Housing Coalition for the purchase and rehabilitation of a 155 unit complex for the continuation of low income housing. This loan is funded by \$659 thousand in Community Development Block Grant funds and \$341 thousand in Housing In-Lieu funds. There are two notes that bear interest at three percent and are secured by second deeds of trust and a City Affordability Reserve Account held by the Coalition. Annual loan payments are deferred until certain criteria defined in the notes are reached. The principal balance is due in 2039.

Home Rehabilitation

The City administers a closed housing rehabilitation loan program initially funded with Community Development Block Grant funds. Under this program, individuals with incomes below a certain level are eligible to receive low interest loans, for rehabilitation work on their homes. These loans are secured by deeds of trusts, which may be subordinated to subsequent encumbrances upon said real property with the prior written consent of the City. The loan repayments may be amortized over the life of the loans, deferred or a combination of both.

Executive Relocation Assistance Loans

The City Council may authorize a mortgage loan as part of a relocation assistance package to executive staff. The loans are secured by first deeds of trust and interest is adjusted annually based on the rate of return of the invested funds of the City for the year ending June 30 plus one quarter of 1 percent. Principal and interest payments are due bi-weekly. Employees must pay off any outstanding balance of their loans within a certain period after ending employment with the City. As of June 30, 2002, the City had two outstanding employee home loans due in 2030 and 2031 respectively.



Note 6.....

CAPITAL ASSETS

Valuation

All capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Contributed capital assets are valued at their estimated fair market value on the date contributed. The City’s policy is to capitalize all assets when costs are equal to/or exceed \$5,000 and the useful life exceeds three years. Infrastructure assets are capitalized when costs are equal to/or exceed \$100,000.

Proprietary Fund capital assets are recorded at cost including significant interest costs incurred under restricted tax-exempt borrowings, which finance the construction of capital assets. These interest costs, net of interest earned on investment of the proceeds of such borrowings are capitalized and added to the cost of capital assets during the construction period. Maintenance and repairs are expensed as incurred.

GASB 34 Changes

With the implementation of GASB Statement 34, the City has recorded all its public domain (infrastructure) capital assets, which consists of the following networks: Roadway, Recreation and Open Space in its Citywide financial statements. Capital assets formerly reported in the General Fixed Assets Account Group are now reported in the Citywide financial statements.

GASB Statement 34 requires that all capital assets with limited useful lives be depreciated over their estimated useful lives. Alternatively, the “modified approach” may be used for certain capital assets. Depreciation is not provided under this approach, but all expenditures on these assets are expensed, unless they are additions or improvements. The City has elected to use the depreciation method for its capital assets.

The purpose of depreciation is to spread the cost of capital assets equitably among all users over the life of these assets. The amount charged to depreciation expense each year represents that year’s pro rata share of the cost of capital assets.

Depreciation has been provided on capital assets. Depreciation of all capital assets is charged as an expense against operations each year and the total amount of depreciation taken over the years, called accumulated depreciation, is reported on the balance sheet as a reduction in the book value of capital assets.

Depreciation is provided using the straight line method which means the cost of the asset is divided by its expected useful life in years and the result is charged to expense each year until the asset is fully depreciated. The City has assigned the useful lives listed below to capital assets.

GOVERNMENTAL ACTIVITIES	Years
Buildings & structures	10-30
Equipment:	
Computer equipment	4
Office machinery & equipment	5
Machinery & equipment	10
Roadway network includes pavement, striping & legends, curbs, gutters & sidewalks, parking lots, traffic signage and bridges	5-40
Recreation and open space network includes major park facilities, park trails, bike paths and median	25-40
 BUSINESS-TYPE ACTIVITIES	
Buildings and structures	25-60
Vehicles and heavy equipment	3-10
Machinery and equipment	10-50
Transmission and distribution systems	10-100

General Capital Assets

Changes in the City's general capital assets during the year ended June 30, 2002 were (in thousands):

	Balance				Balance
	June 30, 2001	Additions	Retirements	Transfers	June 30, 2002
<i>Governmental Activities</i>					
Capital assets not being					
Land and improvements	\$57,198	\$596		\$10,053	\$67,847
Street trees	16,203		(\$213)		15,990
Construction in progress	972	6,980		(972)	6,980
Total capital assets not being depreciated	<u>74,373</u>	<u>7,576</u>	<u>(213)</u>	<u>9,081</u>	<u>90,817</u>
 Capital assets being depreciated:					
Buildings and improvements	63,300	567		(10,044)	53,823
Accumulated depreciation	(49,389)	(312)			(49,701)
Equipment	31,452	3,068	(1,597)	963	33,886
Accumulated depreciation	(19,195)	(3,163)	1,574		(20,784)
Roadway network	203,948	6,924			210,872
Accumulated depreciation	(49,334)	(5,755)			(55,089)
Recreation & open space network	5,962	641			6,603
Accumulated depreciation	(3,411)	(129)			(3,540)
Net capital assets being depreciated	<u>183,333</u>	<u>1,841</u>	<u>(23)</u>	<u>(9,081)</u>	<u>176,070</u>
<i>Governmental Activity capital assets, net</i>	<u>\$257,706</u>	<u>\$9,417</u>	<u>(\$236)</u>		<u>\$266,887</u>

Business-type Capital Assets

Changes in the City's Enterprise Fund capital assets during the year ended June 30, 2002 were (in thousands):

	Balance June 30, 2001	Additions	Retirements	Transfers	Balance June 30, 2002
Business-type Activities					
Capital assets not being depreciated:					
Land and improvements	\$1,541				\$1,541
Construction in progress	47,382	\$29,518		(\$11,991)	64,909
Total capital assets not being depreciated	48,923	29,518		(11,991)	66,450
Capital assets being depreciated:					
Buildings and structures	11,287		(\$633)		10,654
Accumulated depreciation	(3,489)	(247)	248		(3,488)
Transmission, distribution, and treatment systems	372,091	1,254	(768)	11,991	384,568
Accumulated depreciation	(147,497)	(10,194)	673		(157,018)
Net capital assets being depreciated	232,392	(9,187)	(480)	11,991	234,716
Business-type Activity capital assets, net	\$281,315	\$20,331	(\$480)		\$301,166

Capital Asset Contributions

Some capital assets may be acquired using Federal and State grant funds, or they may be contributed by developers or other governments. Generally accepted accounting principles require that these contributions be accounted for as revenues at the time the capital assets are contributed

Depreciation Allocation

Depreciation expense was charged to functions and programs based on their usage of the related assets. The amounts allocated to each function or program were as follows (in thousands):

<i>Governmental Activities</i>		<i>Business-type Activities</i>	
City Manager	\$11	Water	\$906
Administrative Services	135	Electric	4,308
Community Services	389	Gas	1,111
Fire	86	Wastewater Collection	1,072
Police	179	Wastewater Treatment	2,409
Public Works	5,865	Refuse	242
Non-departmental (Common Use Assets)	11	Storm Drainage	394
	\$6,676		\$10,442



Construction in Progress and Completed Projects

Construction in progress in fiscal year 2001-02 comprise (in thousands):

	Expended to June 30, 2002
Enterprise Funds:	
Storm drainage structural and water quality improvements	\$238
Gas system extension replacements and improvements	2,567
Water system extension replacements and improvements	1,093
Electric distribution system improvements	10,225
Other electrical improvement projects	12,043
Water Quality Control Plant equipment replacement and lab facilities	787
Sewer system rehabilitation and extensions	8,250
Other construction in progress	29,706
	<u>\$64,909</u>

Allocations of Enterprise Fund administration and general expenses of \$4.47 million have been capitalized and included in amounts expended to June 30, 2002.

Note 7

GENERAL LONG-TERM OBLIGATIONS

The City's Long -Term Obligations

Bond discounts and issuance costs of long-term debt issues are amortized over the life of the related debt. Gains or losses between the net book value of debt and funds placed in escrow to defease that debt are amortized over the remaining life of either the refunded debt or the refunding debt, whichever is shorter.

The City's long-term debt issues and transactions, other than Special Assessment debt discussed in Note 8, were as follows (in thousands):

	Original Issue Amount	Balance June 30, 2001	Additions	Retirements	Balance June 30, 2002	Current Portion
Governmental Activity Debt:						
<i>General Long-Term Obligations:</i>						
1992 Civic Center Certificates of Participation, 3.60-6.70%, due 03/01/2012	\$7,670	\$3,670		\$3,670		
1998 Golf Course Certificates of Participation, 4.00-5.00%, due 09/01/2018	7,750	7,030		390	\$6,640	\$405
2002A Civic Center Refinancing Certificates of Participation, 2.00-4.00%, due 03/01/2012	3,500		\$3,500		3,500	300
2002B Downtown Parking Improvements Certificates of Participation, 4.55-6.00%, due 03/01/2022	3,555		3,555		3,555	85
	<u>22,475</u>	<u>10,700</u>	<u>7,055</u>	<u>4,060</u>	<u>13,695</u>	<u>790</u>
<i>Internal Service Long-Term Obligations:</i>						
Information System Capital Lease Obligations, 10.46%, due 08/02/2004	128	113		29	84	35
Total Governmental Activity Debt	<u>\$22,603</u>	<u>\$10,813</u>	<u>\$7,055</u>	<u>\$4,089</u>	<u>\$13,779</u>	<u>\$825</u>
Business-type Activity Debt						
<i>Enterprise Long-Term Obligations:</i>						
Utility Revenue Bonds,						
1995 Series A, 5.00-6.25%, due 06/01/2020	\$8,640	\$7,515		\$225	\$7,290	\$236
1999 Refunding, 3.25-5.25%, due 06/01/2024	17,735	17,050		360	16,690	370
2002 Series A, 3.00-5.00%, due 06/01/2023	26,055		\$26,055	1,370	24,685	650
Less: unamortized discount/issuance cost		(1,100)	(446)	(91)	(1,455)	
	<u>\$52,430</u>	<u>\$23,465</u>	<u>\$25,609</u>	<u>\$1,864</u>	<u>\$47,210</u>	<u>\$1,256</u>

Description of the City's Long-Term Debt Issues

1992 Civic Center COPS – The City issued Certificates of Participation (COPS) on March 1, 1992 to refinance its 1983 COPS and finance certain improvements of its Civic Center.

On January 16, 2002 the City defeased the 1992 COPS by placing the proceeds of the 2002A Civic Center Refinancing COPS in the amount of \$3.5 million, as well as \$320 thousand in cash on hand, in an irrevocable trust to provide for future debt payments. Accordingly, the trust account assets and the liability for the defeased Bonds are not included on the financial statements. The outstanding amount of the 1992 COPS was retired on March 1, 2002.

1998 Golf Course COPS – In August 1998, the City's Public Improvement Corporation issued Golf Course Improvement COPS, Series 1998 in the amount of \$7.75 million to retire the 1978 Golf Course Lease Revenue Bonds, and to finance various improvements at the Palo Alto Public Golf Course, including upgrading five fairways and various traps, trees and greens, constructing new storm drain facilities, replacing the existing irrigation system, upgrading the driving range, and installing new cart paths. The 1998 COPS are secured by lease revenues received by the Public Improvement Corporation from golf course revenues or other unrestricted revenues of the City. Principal and interest are payable semi-annually each March 1 and September 1.

2002A Civic Center Refinancing COPS – On January 16, 2002 the City issued \$3.5 million of COPS to refund the City's 1992 COPS. The refunding resulted in an overall debt service savings of \$372 thousand and an economic gain of \$191 thousand. Principal payments for the 2002A COPS are due annually on March 1 and interest payments semi-annually on March 1 and September 1 and are payable from lease revenues received by the Palo Alto Public Improvement Corporation from the City from available funds.

2002B Downtown Parking Improvement Project COPS – On January 16, 2002 the City issued \$3.555 million of COPS to finance the construction of certain improvements to the non-parking area contained in the City's Bryant /Florence Garage complex. Principal payments are due annually on March 1 and interest payments semi-annually on March 1 and September 1 from 4.55% - 6.5%, and are payable from lease revenues received by the Palo Alto Public Improvement Corporation from the City from available funds.

Information Systems Capital Lease – In fiscal year 2000-01, the City signed a lease to finance the acquisitions of certain information systems hardware and software. Debt service is repayable from the Technology Internal Service Fund revenues.

1995 Utility Revenue Bonds, Series A – The City issued Utility Revenue Bonds on February 1, 1995 to finance certain extensions and improvements to the City's Storm Drainage and Surface Water System. The Bonds are special obligations of the City payable solely from and secured by a pledge of and lien upon the revenues derived by the City from the funds, services and facilities of all Enterprise Funds except the Refuse Fund. Principal payments are payable annually on June 1 and interest payments semi-annually on June 1 and December 1. In lieu of a reserve fund, the Bonds are secured by a Surety Bond issued by AMBAC Indemnity Corporation. A \$2.86 million 6.25% term bond is due June 1, 2020.

1999 Utility Revenue and Refunding Bonds, Series A – The City issued Utility Revenue Bonds on June 1, 1999 to refund the 1990 Utility Revenue Refunding Bonds, Series A and the 1992 Utility Revenue Bonds, Series A, and to finance rehabilitation of the Wastewater Treatment System's two sludge incinerators. A portion of the proceeds from the 1999 Bonds amounting to \$9.929 million was used to purchase US Government Securities. These securities were placed in irrevocable trusts with a Trustee to provide for the remaining debt service requirements on the 1990 and 1992 Bonds. Accordingly, the 1990 and 1992 Bonds are considered to be defeased and have been removed, along with the trusts, from

the accompanying financial statements. During the year ended June 30, 2001 the 1992 Utility Revenue Bonds, Series A were retired.

In accordance with City policy, the difference between the amount deposited in escrow of \$9.929 million and the carrying value of the refunded bonds of \$9.403 million has been capitalized and included in unamortized discounts/issuance costs and amortized over the remaining life of the refunded debt.

The 1999 Bonds are special obligations of the City payable solely from and secured by a pledge of and lien upon certain net revenues derived by the City’s Sewer System and its storm and surface water system (the “Storm Drain System”). As of June 30, 2001, the 1999 Bonds had been allocated to and were repayable from net revenues of the following enterprise funds: Wastewater Collection (10.2%), Wastewater Treatment (64.6%) and Storm Drain (25.2%). Principal payments are payable annually on June 1 and interest payments semi-annually on June 1 and December 1. In lieu of a reserve fund, the Bonds are secured by a Surety Bond issued by AMBAC Indemnity Corporation. A \$3.125 million 5.25% term bond, and a \$5.12 million 5.25% term bond are due June 1, 2021 and 2024, respectively.

2002 Utility Revenue Bonds, Series A – On January 24, 2002 the City issued Utility Revenue Bonds to finance certain improvements to the City’s water utility system, and the City’s natural gas utility system. Principal payments are due annually on June 1 and interest payments are due semi-annually on June 1 and December 1 from 3% to 5%. The 2002 Revenue Bonds are secured by net revenues generated by the Water Services and Gas Services Funds.

Debt Service Requirements (in thousands):

Debt service and capitalized lease requirements are shown below for all long-term debt.

For the Year Ending June 30	Governmental Activities		Business-Type Activities	
	Principal	Interest	Principal	Interest
2003	\$825	\$662	\$1,256	\$2,354
2004	732	607	1,309	2,306
2005	727	580	1,365	2,256
2006	740	555	1,410	2,203
2007	770	528	1,465	2,147
2008-2012	4,380	2,127	8,315	9,748
2013-2017	3,210	1,186	10,485	7,577
2018-2022	2,395	325	13,450	4,604
2023-2026			9,610	1,061
Total	\$13,779	\$6,570	\$48,665	\$34,256

Debt Call Provisions

Long-term debt as of June 30, 2002 is callable on the following terms and conditions:

	<u>Initial Call Date</u>
<i>Governmental Activities Long-Term</i>	
1998 Certificates of Participation	09/01/2008 ⁽³⁾
2002B Certificates of Participation	03/01/2011 ⁽²⁾
<i>Business-Type Activities Long-Term</i>	
Utility Revenue Bonds -	
1995 Series A	06/01/2004 ⁽¹⁾
1999 Refunding	06/01/2009 ⁽¹⁾
2002 Series A	06/01/2012 ⁽¹⁾

- (1) Callable in inverse numerical order of maturity at par plus a premium of 2% beginning on the initial call date. The call price declines subsequent to the initial date.
- (2) Callable in any order specified by the City at par plus a premium of 1% beginning on the initial call date. The call price declines subsequent to the initial date.
- (3) Callable in any order specified by the Trustee at par plus a premium of 1% beginning on the initial call date. The call price declines subsequent to the initial date.

Leasing Arrangements

COPS and Capital Leases are issued for the purpose of financing the construction or acquisition of projects defined in each leasing arrangement. Projects are leased to the City for lease payments which, together with unspent proceeds of the leasing arrangement, will be sufficient to meet the debt service obligations of the leasing arrangement. At the termination of the leasing arrangement title to the project will pass to the City.

Leasing arrangements are similar to debt; they allow investors to participate in a share of guaranteed payments which are made by the City. Because they are similar to debt, the present value of the total of the payments to be made by the City is recorded as long-term debt. The City's leasing arrangements are included in long-term obligations discussed above.

Conduit Financing

On December 15, 1996, the City acted as a financial intermediary in order to assist Lytton Gardens Health Care Center in issuing Insured Revenue Refunding Bonds. The Bonds are payable solely from revenues collected by Lytton Gardens Health Care Center. The City has not included these Bonds in its basic financial statements since it is not legally or morally obligated for the repayment of the Bonds. At June 30, 2002 the amount of Bonds outstanding was \$11.415 million.

Note 8.....

SPECIAL ASSESSMENT DEBT

Special Assessment Debt with City Commitment

Special assessment districts exist in the City to provide improvements to properties located in those districts. Properties are assessed for the cost of improvements; these assessments are payable over the term of the debt issued to finance the improvements. The total amount of the assessment is recorded as a receivable and deferred revenue at the time the related debt is issued, and reduced as assessments are collected. The City is obligated to be the purchaser of last resort or to advance available City funds to repay this debt in the event of default by any of these districts. At June 30, 2002 all these districts were in compliance with the repayment and other requirements of their respective debt issues. The City accounts for resources available to pay special assessment debt in its Debt Service Funds. The special assessment debt is included in the City's Governmental Activities long-term debt.

Special assessment debt with City commitment comprises the following issues (in thousands):

	Original Issue Amount	Balance June 30,2001	Retirements	Balance June 30,2002	Current Portion
Governmental Activity Debt					
1987 California Avenue Parking, 6.70-9.25%, due 09/02/2007	\$1,325	\$670	\$75	\$595	\$85
	<u>\$1,325</u>	<u>\$670</u>	<u>\$75</u>	<u>\$595</u>	<u>\$85</u>

Special assessment debt service requirements, including principal and interest, are as follows (in thousands):

For the Year Ending June 30	Governmental Activities	
	Principal	Interest
2003	\$85	\$41
2004	90	35
2005	95	28
2006	100	21
2007	110	13
2008-2012	115	5
Total	<u>\$595</u>	<u>\$143</u>

Description of Special Assessment Debt with City's Commitment

1987 California Avenue Parking Assessment District Assessment Bonds - The City issued Special Assessment Bonds on April 13, 1987 to finance the acquisition of land and related improvements for the purpose of providing public parking in the City. Principal payments are payable annually on September 2 and interest payments semi-annually on March 2 and September 2.

1989 University Avenue Area Off-street Parking Assessment District Refunding and Improvement Bonds - The City issued Special Assessment Bonds on December 18, 1989 to advance refund all of the outstanding University Avenue Lot J Parking Garage Assessment District Bonds of 1984 and to provide funds for the acquisition of one floor of public parking in a parking structure. Principal payments are payable annually on September 1 and interest payments semi-annually on March 1 and September 1. During fiscal year, 2001-02 proceeds from the University Avenue Area Off-Street Parking Assessment District Bonds, Series 2001-A, were used to defease the 1989 Bonds by placing the proceeds in an irrevocable trust to provide for all future debt service payments. Accordingly, the trust account assets and the liability for the defeased Bonds are not included in the financial statements. At June 30, 2002, 1989 University Avenue Area Off-street Parking Assessment District Bonds were outstanding in the amount of \$2.84 million.

Special Assessment Debt with no City Commitment

The California Avenue Parking Assessment District No. 92-13 issued Assessment Bonds of 1993, but the City has no legal or moral liability with respect to the payment of this debt, which is secured only by assessments on the properties in this District. Therefore, this debt is not included in Governmental Activities long-term debt of the City. At June 30, 2002, the District's outstanding debt amounted to \$1.62 million.

The University Avenue Area Off-Street Parking Assessment District issued Assessment Bonds of Series 2001-A, but the City has no legal or moral liability with respect to the payment of this debt, which is secured only by assessments on the properties in the District. Therefore, this debt is not included in Governmental Activities long-term debt of the City. At June 30, 2002, the District's outstanding debt amounted to \$9.135 million. A portion of the proceeds from the 2001 Bonds amounting to \$3.2 million was used to defease the 1977 University Avenue Area Off-Street Parking Assessment District Bonds and the 1989 University Avenue Area Off-street Parking Assessment District Refunding and Improvement Bonds. At June 30, 2002, 1977 University Avenue Area Off-street Parking Assessment District Bonds were outstanding in the amount of \$70 thousand.

The University Avenue Area Off-Street Parking Assessment District issued Assessment Bonds of Series 2002-A, but the City has no legal or moral liability with respect to the payment of this debt, which is secured only by assessments on the properties in the District. Therefore, this debt is not included in Governmental Activities long-term debt of the City. At June 30, 2002, the District's outstanding debt amounted to \$35.460 million.

During fiscal year 2001-02, the District contributed \$31.823 million representing project funds to the City. The City has agreed to hire consultants and contractors and oversee the construction of the project. These funds have been accounted for as a Contribution from Assessment District in the Basic Financial Statements.



Note 9.....

LANDFILL CLOSURE AND POST-CLOSURE CARE

State and Federal laws and regulations require the City to place a final cover on the remaining open areas of the Palo Alto Refuse Disposal Site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for thirty years after closure. Closure costs of \$1.561 million were reported in fiscal 1991-92, when a section of the refuse area was capped with a final cover and Byxbee Park was constructed on top of that section. A second section of the refuse area was capped with a final cover during fiscal year 1992-93, with closure costs of \$904 thousand. The remaining closure and post-closure care costs are expected to be paid only near and after the date that the refuse site stops accepting waste.

An updated cost estimate for the landfill closure and post-closure, based on landfill capacity, was performed during 2001. The estimates of these costs were based upon 2001 cost and are adjusted annually for inflation as mandated by the State of California. The 2002 amount is \$6.376 million. Currently, 89.2 percent of the landfill capacity has been used to date.

Total cost estimates are based on what it would cost to perform all currently mandated closure and post-closure care in 2001. The City expects to close the refuse area in the year 2013. Actual closure and post-closure care costs may be higher due to inflation variances, changes in technology, or changes in State or Federal regulations.

The City is required by State and federal laws and regulations to make annual funding contributions to finance closure and post-closure care. The City is in compliance with these requirements for the year ended June 30, 2002 with the establishment of the fully-funded liability for this purpose.



Note 10

NET ASSETS AND FUND BALANCES

Net Assets

Net assets are the excess of all the City’s assets over all its liabilities, regardless of fund. Net assets are divided into three categories under GASB Statement 34. These categories apply only to net assets, and are described below:

Invested in Capital Assets, net of related debt describes the portion of net assets which is represented by the current net book value of the City’s capital assets, less the outstanding balance of any debt issued to finance these assets.

Restricted describes the portion of net assets which is restricted as to use by the terms and conditions of agreements with outside parties, governmental regulations, laws, or other restrictions which the City cannot unilaterally alter. These principally include bond proceeds received for use on capital projects, debt service requirements, and special revenue programs subject to limitations defined regulations and laws underlying such programs.

Unrestricted describes the portion of net assets which is not restricted as to use.

Fund Balances, Reserves and Designations

In the Fund financial statements, fund balances represent the net current assets of each fund. Net current assets generally represent a fund’s cash and receivables, less its liabilities. Portions of a fund’s balance may be reserved or designated for future expenditure.

At June 30, 2002, Governmental Funds reservations and designations included (in thousands):

	Major Funds		Non-major Funds
	General Fund	Project Fund	
Reserved for:			
Encumbrances	\$ 4,502	\$ 3,450	\$ 2,852
Downtown parking structure		27,277	
Notes	1,293		
Inventory of materials and supplies	1,985		
Debt service			1,543
Debt proceeds		2,802	
Total Reserved Fund Balance	\$ 7,780	\$ 33,529	\$ 4,395
Unreserved; designated for:			
Unrealized gain on investment	\$ 1,520		\$ 230
Capital and special revenue projects			11,919
Equity transfer stabilization	756		
Reappropriations	514	\$ 19,772	2,939
Budget stabilization	22,674		
Infrastructure	30,189		
Total Unreserved/Designated Fund Balances	\$ 55,653	\$ 19,772	\$ 15,088

Reserve for **encumbrances** represents the portion of fund balance set aside for open purchase orders.

Reserve for **downtown parking structure** represents a portion of fund balance for the Downtown Parking Improvement Project.

Reserves for **notes and inventory** are the portions of fund balance set aside to indicate these items do not represent available, spendable resources even though they are a component of assets.

Reserve for **debt service** is the portion of fund balance legally restricted for the payment of principal and interest on long-term liabilities.

Reserve for **debt proceeds** is the portion of fund balance legally restricted for the expenditure of bond proceeds on authorized project costs.

Designated for **unrealized gain on investments** is the portion of fund balance used to accumulate gains on the market values of investments.

Designated for **capital and special revenue projects** is the portion of fund balance for use on capital outlay projects.

Designated for **equity transfer stabilization** is the portion of fund balance to replace required equity transfer by Gas, or Electric Enterprise Funds in the event the fund was unable to make its required equity transfer.



Designated for **reappropriations** is the portion of fund balance set aside for subsequent years' appropriations.

Designated for **budget stabilization** is the portion of fund balance to be used to supplement the regular budget when unexpected events such as state government action, a downturn in the economy or a natural disaster reduces revenue or creates obligations that significantly impact the current year budget.

Designated for **infrastructure** is the portion of fund balance to be used for financing future capital improvements.

Internal Service Funds

At June 30, 2002, internal service fund net assets reservations and designations included (in thousands):

Reserved net assets	
Commitments and reappropriations	\$3,085
Unreserved:	
Designated for:	
Future catastrophic losses	6,506
Retiree health care	16,448
Interfund advances/payables	255
Undesignated	<u>8,611</u>
Net assets unrestricted	<u><u>\$34,905</u></u>

Reserve for **commitments and reappropriations** represents the portion of net assets set aside for open purchase orders.

Designated for **future catastrophic losses** is the portion of net assets to be used for unforeseen future losses.

Designated for **retiree health care** represents the portion of net assets set aside to defer future costs of retiree health care coverage.

Enterprise Funds

At June 30, 2002, Enterprise Fund net assets reservations included (in thousands):

	Water	Electric	Gas	Waste- water Collection	Waste- water Treatment	Refuse	Storm Drainage	External Service	Total
Rate stabilization									
Supply		\$47,911	\$7,922						\$55,833
Distribution		7,907	6,664						14,571
Operations	\$9,190			\$5,135	\$5,929	\$9,967	\$404	\$1	30,626
	<u>9,190</u>	<u>55,818</u>	<u>14,586</u>	<u>5,135</u>	<u>5,929</u>	<u>9,967</u>	<u>404</u>	<u>1</u>	<u>101,030</u>
Emergency plant replacement	979	2,335	820	484	1,543				6,161
Calaveras		65,466							65,466
Reappropriations	5,753	9,866	1,456	5,224	633	1,496	486		24,914
Commitments	3,434	4,030	2,517	1,652	3,221	1,054	95	3	16,006
Restricted bond proceeds	3,213		6,600		162		80		10,055
Underground loan		635							635
Conservation loan			34						34
Refuse Water- Resources Board						590			590
Shasta rewind loan		64							64
Central Valley Project		118							118
Public benefit program		144							144
Debt Service	778		950						1,728
External Service - Information Technology								14	14
External Service - Human Resources								18	18
Total	<u>\$23,347</u>	<u>\$138,476</u>	<u>\$26,963</u>	<u>\$12,495</u>	<u>\$11,488</u>	<u>\$13,107</u>	<u>\$1,065</u>	<u>\$36</u>	<u>\$226,977</u>

The City Council has committed unreserved net assets for general contingencies, future capital and debt service expenditures including operating and capital contingencies for unusual or emergency expenditures.



Note 11

PENSION PLANS

CALPERS Safety and Miscellaneous Employees Plans

Substantially all permanent City employees are eligible to participate in pension plans offered by California Public Employees Retirement System (CALPERS) an agent multiple employer defined benefit pension plan which acts as a common investment and administrative agent for its participating member employers. CALPERS provides retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. The City's employees participate in the separate Safety (police and fire) and Miscellaneous (all other) Employee Plans. Benefit provisions under both Plans are established by State statute and City resolution. Benefits are based on years of credited service, equal to one year of full time employment. Funding contributions for both Plans are determined annually on an actuarial basis as of June 30 by CALPERS. The City contributes these amounts and has no pension benefit obligation.

The Plans' provisions and benefits in effect at June 30, 2002, are summarized as follows:

	Safety		Miscellaneous
	Police	Fire	
Benefit vesting schedule	5 years service	5 years service	5 years service
Benefit payments	monthly for life	monthly for life	monthly for life
Retirement age	50	50	50
Monthly benefits, as a % of annual salary	3%	3%	1.426%-2.418%
Required employee contribution rates	9%	9%	7%
Required employer contribution rates	21.322%	11.814%	0%

The City's labor contracts require it to pay employee contributions as well as its own.

CALPERS determines contribution requirements using a modification of the Entry Age Normal Method. Under this method, the City's total normal benefit cost for each employee from date of hire to date of retirement is expressed as a level percentage of the related total payroll cost. Normal benefit cost under this Method is the level amount the employer must pay annually to fund an employee's projected retirement benefit. This level percentage of payroll method is used to amortize any unfunded actuarial liabilities. The actuarial assumptions used to compute contribution requirements are also used to compute the actuarial accrued liability. The City does not have a net pension obligation since it pays these actuarially required contributions monthly.

CALPERS uses the market related value method of valuing the Plan's assets. An investment rate of return of 8.25 percent is assumed, including inflation at 3.5 percent. Annual salary increases are assumed to vary by duration of service. Changes in liability due to plan amendments, changes in actuarial assumptions, or changes in actuarial methods are amortized as a level percentage of payroll on a closed basis over twenty years. Investment gains and losses are accumulated as they are realized and ten percent of the net balance is amortized annually.

Notes to Basic Financial Statements – Note 11

The Plans' actuarial value (which differs from market value) and funding progress over the most recently available three years is set forth below at their actuarial valuation date of June 30, 2000 (in thousands):

Safety Police Plan:

Valuation Date	Actuarial			Funded Ratio	Annual Covered Payroll	Unfunded (Overfunded) Liability as a % of Payroll
	Entry Age Accrued Liability	Value of Assets	(Unfunded) Overfunded Liability			
1998	\$55,471	\$56,762	\$1,291	102.3%	\$5,836	(22.1%)
1999	58,868	63,555	4,686	108.0%	6,311	(74.3%)
2000	70,289	69,998	(291)	99.6%	6,858	4.2%

Safety Fire Plan:

Valuation Date	Actuarial			Funded Ratio	Annual Covered Payroll	Unfunded (Overfunded) Liability as a % of Payroll
	Entry Age Accrued Liability	Value of Assets	(Unfunded) Overfunded Liability			
1998	\$70,445	\$84,651	\$14,206	120.2%	\$8,073	(176.0%)
1999	75,323	94,899	19,576	126.0%	8,853	(221.1%)
2000	87,651	104,220	16,569	118.9%	8,805	(188.2%)

Miscellaneous Plan:

Valuation Date	Actuarial			Funded Ratio	Annual Covered Payroll	Unfunded (Overfunded) Liability as a % of Payroll
	Entry Age Accrued Liability	Value of Assets	(Unfunded) Overfunded Liability			
1998	\$163,374	\$207,573	\$44,199	127.1%	\$40,146	(110.1%)
1999	175,293	236,517	61,224	134.9%	43,710	(140.1%)
2000	194,552	262,285	67,733	134.8%	47,866	(141.5%)

Audited annual financial statements and ten-year trend information are available from CALPERS at P.O. Box 942709, Sacramento, CA 94229-2709.

PERS has reported that the value of the net assets in the Plans held for Pension Benefits changed as follows during the year ended June 30, 2000 (in thousands):

	Safety		
	Police	Fire	Miscellaneous
Actuarial Value of Assets 6/30/99	\$63,555	\$94,899	\$236,517
Contributions received	1,551	1,449	4,247
Benefits and Refunds Paid	(2,984)	(3,861)	(7,737)
Transfers & Miscellaneous Adjustments	2	9	(94)
Expected Investment Earnings Credited	5,185	7,732	19,368
Expected Actuarial Value of Assets 6/30/00	<u>\$67,309</u>	<u>\$100,228</u>	<u>\$252,301</u>
Market Value of Assets 6/30/00	<u>\$75,377</u>	<u>\$112,204</u>	<u>\$282,255</u>
Actuarial Value of Assets 6/30/00	<u>\$69,998</u>	<u>\$104,220</u>	<u>\$262,285</u>

Additional disclosures will be included when made available by PERS.

Actuarially required contributions for all plans for fiscal years 2002, 2001, and 2000 were, \$5.313, \$5.826, and \$7.122 million, respectively. The City made these contributions as required, together with certain immaterial amounts required as the result of the payment of overtime and other additional employee compensation.

Note 12

RETIREE HEALTH BENEFITS

In addition to providing pension benefits, the City participates in the California Public Employees Medical and Health Care Act program to provide certain health care benefits for retired employees. Substantially all of the City's employees may become eligible for those benefits if they reach normal retirement age while working for the City. The costs of retiree health care are recognized as expenditures when premiums are paid. For fiscal year 2001-02, expenditures for retiree health care for approximately 514 eligible retired employees totaled \$1.901 million, including administrative fees. The premium is based upon an average annual cost of coverage per retiree of \$4 thousand.

In the fiscal year ended June 30, 1993, the City received a \$6.1 million refund from the California Public Retirement System ("CALPERS") through the passage of Assembly Bill (AB) 702. This amount was placed in a separate fund to defer future costs of retiree health care coverage. During the fiscal year ended June 30, 1995, the City established and transferred the amount to a separate fund which is now accounted for as an Internal Service Fund.

The City pays annual retiree medical premiums out of its operating budget. In 2001, Aon Consulting performed a valuation on the retiree medical benefit and determined an actuarial liability of \$93.5 million. Since the City has saved \$14.0 million towards that liability, the unfunded portion is \$79.5 million. However, Aon did not incorporate the value of the City's continued savings toward that liability, which has ranged in the \$1.1 to \$2.0 million per year range. Assuming this rate of savings continues, the unfunded liability would be reduced to the \$60 million range. Staff is evaluating various options for both reducing the liability and saving the required funds to address it. Because of the magnitude of the liability, staff budgets retiree medical expenses through its benefit allocations. As a result, a \$1.1 million surplus was generated for fiscal year 2001-02. In addition, the interest earnings for the year totaled \$1.3 million, bringing the balance to \$16.4 million. This interest earnings is recorded in the Retiree Health Benefit Internal Service Fund.

The Retiree Fund's net assets consist of the following for the fiscal year ended June 30, 2002 (in thousands):

Retiree Health Benefits	2002	2001
Net assets, beginning of year	\$14,199	\$10,944
Interest earnings	802	706
Unrealized gain on investments	347	334
Interdepartmental charges	1,100	2,215
Net assets, end of year	\$16,448	\$14,199



Note 13.....

DEFERRED COMPENSATION PLAN

City employees may defer a portion of their compensation under City sponsored Deferred Compensation Plans created in accordance with Internal Revenue Code Section 457. Under these Plans, participants are not taxed on the deferred portion of their compensation until distributed to them; distributions may be made only at termination, retirement, death or in an emergency as defined by the Plans.

The laws governing deferred compensation plan assets now require plan assets to be held by a Trust for the exclusive benefit of plan participants and their beneficiaries. Since the assets held under these plans are not the City's property and are not subject to City control, they have been excluded from these financial statements.

Note 14.....

RISK MANAGEMENT

Coverage

The City provides dental coverage to employees through programs which are administered by a service agent. The City is self-insured for the dental coverage.

The City has a workers' compensation insurance policy with coverage up to the statutory limit set by the State of California. The City retains the risk for the first \$500 thousand in losses for each accident and employee under this policy.

The City also has public employee dishonesty insurance with a \$5 thousand deductible and coverage up to \$1 million per loss. The City's property and machinery insurance policy has various deductibles and various coverages based on the kind of machinery.

The City is a member of the Authority for California Cities Excess Liability (ACCEL) which provides general liability, including auto liability, insurance coverage up to \$10 million per occurrence. The City retains the risk for the first \$500 thousand in losses for each occurrence under this policy.

ACCEL was established for the purpose of creating a risk management pool for central California municipalities. ACCEL is governed by a Board of Directors consisting of representatives of its member cities. The board controls the operations of ACCEL, including selection of management and approval of the annual budget.

The City's deposits with ACCEL equal the ratio of the City's payroll to the total payrolls of all entities. Actual surpluses or losses are shared according to a formula developed from overall loss costs and spread to member entities on a percentage basis after a retrospective rating.

During the fiscal year ended June 30, 2002 the City contributed \$437 thousand to ACCEL for current year coverage.

Audited financial statements are available from ACCEL at 160 Spear Street, San Francisco, California 94105.

Claims Liability

The City provides for the uninsured portion of claims and judgments in the General Benefits and Insurance Internal Service Fund. Claims and judgments, including a provision for claims incurred but not reported, are recorded when a loss is deemed probable of assertion and the amount of the loss is reasonably determinable. As discussed, above, the City has a coverage for such claims, but it has retained the risk for the deductible, or uninsured portion of these claims.

The City's liability for uninsured claims is limited to dental, general liability, and workers' compensation claims, as discussed above, and was estimated by management based on prior years claims experience as follows as of June 30, 2002 (in thousands):

	Year Ended June 30	
	2002	2001
Beginning Balance	\$9,113	\$8,243
Liability for current and prior fiscal year claims and claims incurred but not reported (IBNRS)	2,844	4,420
Claims paid	-3,932	-3,350
Ending Balance	\$8,025	\$9,313



Note 15

JOINT VENTURES

General

The City participates in joint ventures through Joint Powers Authorities (JPAs) established under the Joint Exercise of Powers Act of the State of California. As separate legal entities, these JPAs exercise full powers and authorities within the scope of the related Joint Powers Agreement, including the preparation of annual budgets, accountability for all funds, the power to make and execute contracts and the right to sue and be sued. Obligations and liabilities of the JPAs are not those of the City.

Each JPA is governed by a board consisting of representatives from each member agency. Each board controls the operations of its respective JPA, including selection of management and approval of operating budgets, independent of any influence by member agencies beyond their representation on the Board.

Northern California Power Agency

The City is a member of Northern California Power Agency (NCPA), a joint powers agency which operates under a joint powers agreement among fifteen public agencies. The purpose of NCPA is to use the combined strength of its members to purchase, generate, sell and interchange electric energy and capacity through the acquisition and use of electrical generation and transmission facilities. Each agency member has agreed to fund a pro rata share of certain assessments by NCPA and enter into take-or-pay power supply contracts with NCPA. While NCPA is governed by its members, none of its obligations are those of its members unless expressly assumed by them.

During the year ended June 30, 2002, the City incurred expenses totaling \$4.996 million for purchased power and assessments earned by NCPA.

The City's interest in NCPA projects and reserves, as computed by NCPA, was \$3.552 million at June 30, 2002. This amount represents the City's portion of funds which resulted from the settlement with third parties of issues with financial consequences and reconciliations of several prior years' budgets for programs. It is recognized that all the funds credited to the City are linked to the collection of revenue from the City's ratepayers, or to the settlement of disputes relating to electric power supply and that the money was collected from the City's ratepayers to pay power bills. Additionally, the NCPA Commission identified and approved the funding of specific reserves for working capital, accumulated employees post-retirement medical benefits, and billed property taxes for the geothermal project. The Commission also identified a number of contingent liabilities that may or may not be realized, the cost of which in most cases is difficult to estimate at this time. One such contingent liability is the steam field depletion which will require funding to cover debt service and operational costs in excess of the expected value of the electric power. The General Operating Reserve is intended to minimize the number and amount of individual reserves needed for each project, protect NCPA's financial condition and maintain its credit worthiness. These funds are available on demand, but the City has left them with NCPA as a reserve against these contingencies identified by NCPA.

Members of NCPA may participate in an individual project of NCPA without obligation for any other project. Member assessments collected for one project may not be used to finance other projects of NCPA without the member's permission.

Geothermal Projects

A purchased power agreement with NCPA obligated the City for 6.158% and 6.158%, respectively, of the operating costs and debt service of the two NCPA 110-megawatt geothermal steam powered generating plants, Project Number 2 and Project Number 3.

The City's participation in the Geothermal Project was sold to Turlock Irrigation District in October 1984. Accordingly, the City is liable for payment of outstanding geothermal related debt only in the event that Turlock fails to make specified payments. Total outstanding debt of the NCPA Geothermal Project at June 30, 2002 is \$346.494 million. The City's participation in this project was 6.158%, or \$21.337 million.

NCPA's Geothermal Project has experienced a greater than originally anticipated decline in steam production from geothermal wells on its leasehold property. Results of the continuing well analysis program indicate that the potential productive capacity of the geothermal steam reservoir is less than originally estimated. Therefore, NCPA has modified the operations of the Geothermal Project to reduce the average annual output from past levels. As a result, the per unit cost of energy generated by the projects will be higher than anticipated.

NCPA will continue to monitor the wells while pursuing alternatives for improving and extending reservoir performance, including supplemental water re-injection, plant equipment modifications, and changes in operating methodology. NCPA, along with other steam field operators, has observed a substantial increase in steam production in the vicinity of re-injection wells and is attempting to increase water re-injection at strategic locations. NCPA, other steam developers, and the Lake County Sanitation District are constructing a wastewater pipeline project that will greatly increase the amount of water available for re-injection.

Calaveras Hydroelectric Project

In July 1981, NCPA agreed with Calaveras County Water District to purchase the output of the North Fork Stanislaus River Hydroelectric Development Project and to finance its construction. Debt service payments to NCPA began in February 1990 when the project was declared substantially complete and power was delivered to the participants. Under its power purchase agreement with NCPA, the City is obligated to pay 22.92% of this Project's debt service and operating costs. At June 30, 2002, the book value of this Project's plant, equipment and other assets was \$525 million, while its long-term debt totaled \$517.883 million and other liabilities totaled \$983 thousand. The City's share of the Project's long term-debt amounted to \$118.699 million at that date.

In April 1991, the City signed an agreement with the City of Roseville to sell a 6.52% portion of its capacity share of NCPA's Calaveras hydroelectric plant for a period of 14 years. Under the terms of the sale agreement, Roseville pays all the operation and maintenance costs associated with 6.52% of the plant. In addition, Roseville will also pay the City a portion of the net debt service obligations of the current long-term debt associated with the Hydroelectric Project No. 1. However, if Roseville defaults, the City is secondarily liable for the outstanding debt service obligations.



Geothermal Public Power Line

In 1983, NCPA, Sacramento Municipal Utility District, the City of Santa Clara and the Modesto Irrigation District (joint owners) initiated studies for a Geothermal Public Power Line (GPPL) which would carry power generated at several existing and planned geothermal plants in the Geysers area to a location where the joint owners could receive it for transmission to their load centers. NCPA has an 18.5% share of this Project and the City has an 11.074% participation in NCPA’s share. In 1989, the development of the proposed Geothermal Public Power Line was discontinued because NCPA was able to contract for sufficient transmission capacity to meet its needs in the Geysers. However, because the project financing provided funding for an ownership interest in a PG&E transmission line, a central dispatch facility and a performance bond pursuant to the Interconnection Agreement with PG&E, as well as an ownership interest in the proposed GPPL, NCPA issued \$16,000,000 in long-term, fixed-rate revenue bonds in November 1989 to defease the remaining variable rate refunding bonds used to refinance this project. The City is obligated to pay its 11.074% share of the related debt service, but debt service costs are covered through NCPA billing mechanisms that allocate the costs to members based on use of the facilities and services.

At June 30, 2002, the book value of this Project’s plant, equipment and other assets was \$6.854 million, while its long term debt totaled \$6.114 million. The City’s share of the Project’s long-term debt amounted to \$759 thousand at that date.

Northwest Power Purchase Contract

The City’s participation with other NCPA members in a long-term contract for purchase of power from the Washington Water Power Company was approved in 1993. At that date the City did not have a share of the Project’s long-term debt. On February 1, 1997, the NCPA issued \$18,310,000 in Northwest Resource Revenue Bonds. The proceeds were used to finance a portion of a payment made under the Northwest Power Purchase Contract and costs of issuance of the debt. Under the NCPA Agreement for Financing Electric Capacity, the City was obligated to pay 13.61% of this debt service. At June 30, 2002 the book value of this Project’s plant, equipment and other assets was \$7.779 million, while its long-term debt was retired.

NCPA Financial Information

NCPA’s financial statements can be obtained from NCPA, 180 Cirby Way, Roseville, CA 95678.

Transmission Agency of Northern California (TANC)

The City is a member of a joint powers agreement with 14 other entities in the Transmission Agency of Northern California (TANC). TANC’s purpose is to provide electrical transmission or other facilities for the use of its members. While governed by its members, none of TANC’s obligations are those of its members unless expressly assumed by them. The City is obligated to pay 4% of TANC’s debt-service and operating costs.

According to the 1985 Project Agreement with TANC for the development of the California-Oregon Transmission Project (COTP) and subsequent related project agreements, the City is obligated to pay its share of the project’s costs, including debt service and is entitled to the use of a percentage of the project’s transmission or transfer capacity. TANC has issued four series of Revenue Bonds and Commercial Paper Notes totaling \$435.476 million as of June 30, 2002. The City’s share of this debt is \$17.419 million.

Construction of the COTP was complete as of June 30, 1993. The transmission line was energized March 24, 1993. Because funding of certain project participants’ shares in the project was needed

pending approval of their applications for participation, TANC issued \$93,781,238 of Commercial Paper debt backed by a Letter of Credit. The City's share of the Commercial Paper was \$2.795 million at June 30, 2002, which is included in the share of debt discussed above. Shares and obligations of the existing participants could increase pending final project subscription.

TANC Financial Information

TANC's financial statements can be obtained from TANC, P.O. Box 15129, Sacramento, CA 95851.

Note 16

COMMITMENTS AND CONTINGENCIES

Palo Alto Unified School District – The City leases the former Cubberley School site and eleven extended day care sites from the Palo Alto Unified School District (PAUSD). The lease is part of a larger agreement which includes a covenant not to develop certain properties owned by the PAUSD. The lease term expires in December 2004 with an option for an additional ten year term. The City’s rent for the facilities is \$4.963 million per year plus insurance, repairs and maintenance work to be completed, which are not to exceed \$250 thousand per year. This lease is cancelable upon 90 days’ written notice in the event funds are not appropriated by the City. In addition, the lease is contingent upon authorization by the Palo Alto electorate if it exceeds the City’s Proposition 4 (Gann) appropriations limitation in any fiscal year. Lease expenditures for the year ended June 30, 2002 amounted to \$6.4 million.

Future minimum annual lease and covenant payments are as follows (in thousands):

Year ending June 30:	Payments
2003	\$5,356
2004	6,006
2005	6,210
2006	6,421
2007	6,640
2008-2012	46,940
	\$77,573

Palo Alto Sanitation Company – In 1999 the City, under the provisions of a new agreement, contracted with the Palo Alto Sanitation Company (PASCO) for services related to residential and commercial refuse collection, curbside recycling, and other operation special programs. The new agreement has a term of seven years and ten months from the effective date of September 1, 1999. The new contract revised the method by which compensation is paid to PASCO to be more in-line with the industry standard. The method establishes compensation based on the relationship between costs and profits and includes periodic performance reviews. In 2001-02 this resulted in a payment to PASCO of \$7.774 million.

City of Palo Alto Regional Water Quality Control Plant – The cities of Palo Alto, Mountain View and Los Altos (the Partners) participate jointly in the cost of maintaining and operating the City of Palo Alto Regional Water Quality Control Plant and related system (the Plant). The City is the owner and administrator of the Plant which provides the transmission, treatment and disposal of sewage for the Partners. The cities of Mountain View and Los Altos are entitled to use a portion of the capacity of the Plant for a specified period of time. Each partner has the right to rent unused capacity from/to the other partners. The expenses of operations and maintenance are paid quarterly by each partner based on its pro rata share of treatment costs. Additionally, joint system revenues are shared by the partners in the same ratio as expenses are paid. The amended agreement has a term of fifty years beginning from the original signing in October 1968, but may be terminated by any partner upon ten years’ notice to the other partners. All sewage treatment property, plant and equipment are included in the Wastewater Treatment Enterprise Fund’s capital assets balance at June 30, 2002. If the City initiates the termination of the contracts, it is required to pay the other partners their unamortized contribution towards the capital assets.

Solid Waste Materials Recovery and Transfer Station (SMaRT Station) - On June 9, 1992, the City, along with the City of Mountain View, signed a Memorandum of Understanding (MOU) with the City of Sunnyvale (Sunnyvale) to participate in the construction and operation of the SMaRT station which recovers recyclable materials from the municipal solid waste delivered from participating cities. Per the MOU, the City has capacity share of 21.27 percent of this facility and reimburses its proportionate capacity share of design, construction, and operation costs to Sunnyvale.

On December 1, 1992, the Sunnyvale Financing Authority issued \$24.6 million in revenue bonds to finance the design and construction costs of the SMaRT Station. Even though these bonds are payable from and secured by the net revenues of Sunnyvale's Utilities Enterprise, the City is obligated to reimburse Sunnyvale 21.27 percent of total debt service payments related to these bonds. The City's portion of remaining principal balance for SMaRT revenue bonds as of June 30, 2002 is \$4.035 million. During the year ended June 30, 2002, the City paid \$396 thousand as its portion of current debt service.

UTILITIES ENERGY RESOURCE MANAGEMENT

The Energy Markets in the U.S. and California

Electric and gas energy prices have decreased substantially since the energy crisis during 2000-01 and have stabilized over the past six- to twelve- months. Low and stable market prices in recent months can be attributed to the current lower loads due to lower economic activity and the close scrutiny of energy traders conducted by Federal and State regulators. It is believed that the lower prices, regulatory uncertainties, and resulting investment uncertainties have precipitated delays in the construction of large power plants in California and possibly around the country. If this inaction continues to exist, there is concern that this could lead to energy shortages once again if the economy recovers and electricity demand rises in the near future.

A number of energy marketing and trading organizations that were created in the late-1990s to provide services for a deregulated electric market are being investigated by various Federal and State agencies in connection with energy trades executed during the energy crisis. Some of these organizations are now experiencing financial difficulty and are downsizing their businesses or withdrawing from the energy marketing and trading business. Pacific Gas and Electric Company ("PG&E") is still embroiled in Chapter 11 bankruptcy proceedings, and significant disagreements between the California Public Utilities Commission ("CPUC") and PG&E related to supply procurement activities remain. Overall liquidity in the market has decreased and the number of creditworthy suppliers that can provide energy supply services to the City has been reduced.

Municipal utilities to some extent have not yet been significantly impacted by the turmoil in the energy industry. With the increased awareness of the benefits of local ownership, such as congruence of shareholder-ratepayer interests, local accountability, and public input in the decision making process, municipal utilities seem to have emerged as stronger and more dynamic institutions in response to the turmoil. However, significant uncertainties continue to exist and these will have to be actively monitored by the City.

Future Outlook

The City is in the process of securing new long-term electricity supply commitments in anticipation of the energy shortfall expected to arise in 2005 on account of the expiry of a contract with the Federal government. The Palo Alto City Council approved the Long-Term Electric Acquisition Plan ("LEAP") in October 2002, and LEAP is designed to improve the City's chances of continuing to provide low and stable electric rates to retail customers. The City may participate in a number of power plant investments

and negotiate a number of energy contracts in the coming years. The City expects to invest in new renewable electricity generation resources to meet up to 20 percent of its energy needs by 2015. The LEAP recommendations, if implemented, will result in higher supply costs. These costs have been incorporated into the City's long-term energy rate projections.

The Council also approved the Energy Risk Management Policies in October 2002. Implementation of various risk management recommendations made by the City Auditor in her July 2002 audit report continues.

The Standard Market Design (SMD) proposal of the Federal Energy Regulatory Commission ("FERC") to streamline nationwide transmission grid operations and management has engendered considerable uncertainty for the City. California's grid operator (CAISO) is in the process of implementing a number of initiatives to comply with the FERC's recent SMD order. The initiative, commonly known as Market Design 2002 (MD02), could lead to significant cost increases for transmission services for entities located in relatively transmission-congested areas such as the Bay Area. The City is actively participating in the efforts to direct the discussion in a manner, which would ensure fair treatment of market participants by the regulatory agencies.

The City continues to actively participate in the Pacific Gas & Electric Company (PG&E) bankruptcy proceedings to protect the interests of unsecured creditors, including the interests of the City.

The outlook for the California gas supply market remains uncertain. PG&E's restructuring plan could cause its intrastate pipelines to be regulated by the FERC, resulting in costs to the City. Gas supply costs are market-driven and by implication are potentially volatile. The City follows a "three-year laddering" strategy to purchase gas, and the objective of this strategy is to secure stable and low rates.

The outlook for water supply costs indicates an upward trend as the San Francisco Public Utilities Commission (SFPUC) embarks on a much delayed, but essential, upgrade to its wholesale facilities. In the November 2002 elections, the San Francisco electorate voted in favor of a bond measure to defray the costs of a capital improvement program. These increased costs have been factored into long-term rate projections.

Contingent Liability

The FERC's inquiry into the events and actions that may have caused or contributed to high market prices during the 2000-01 energy crisis has yet to be completed. It is possible that Palo Alto may have to refund some of the excess capacity sales generated by the Northern California Power Agency (NCPA), the City's resource scheduler and operator. These excess capacity sales were recognized and the contingencies were noted in the City's 2000-01 financial statements. The outcome of the inquiry and the amounts at issue continue to be uncertain at this time.

During 2001, Enron North America ("ENA") supplied natural gas and provided gas acquisition and transportation services to the City pursuant to three contracts, and Enron Power Marketing, Inc. ("EPMI") provided power to the City pursuant to one contract (the "Power Agreement"). The purchase represented approximately 20 percent of the City's projected need for power during the specified contract period.

In inducing the City to enter into the several agreements, Enron Corporation and its affiliates, ENA and EPMI, each made representations about their net worth, financial strength and other material matters and in audited financial statements. Enron Corporation has publicly admitted and acknowledged a number of financial irregularities and conflicts of interest, and has made representations which are apparently false and misleading. The Enron entities have also failed to disclose information concerning certain off-balance sheet limited partnerships.

At the end of November 2001, the City gave notice of defaults to EPMI and ENA in connection with the electric and gas contracts with the City. In early December 2001, Enron Corporation, ENA, and EPMI filed for protection under Chapter 11 of the United States Bankruptcy Code. Those cases, and the bankruptcy cases of other Enron affiliates, are pending in the United States Bankruptcy Court for the Southern District of New York.

Contemporaneously with the receipt of notices of default and filing their Chapter 11 petitions, the Enron affiliates ceased to perform their obligations under the agreements. The City has arranged for alternative sources of supply. Service disruptions to the City's utility customers have not occurred and are not expected. The agreements for the supply of gas and power provide for early termination payments under certain circumstances. The amounts of such payments would be based on the present value of the difference between the contract price and market prices. The Enron affiliates could contend that the City is obligated to pay early termination payments under the terms of the agreements upon termination. The City denies any and all liability to the Enron affiliates under the agreements, including any liability for early termination payments. The City asserts that those agreements are void, unenforceable and subject to rescission, and any obligations that it may have had have been excused. In the event of litigation, which is unfavorable to the City, a resolution of the termination of the agreements is not expected to have a material adverse impact on the City's electric or gas retail rates and charges or electric utility or gas utility operations.

The contingency related to NCPA pool settlement, related to 2000-01 activity, did materialize during the year and has been treated as an expense in the financial statements for 2001-02.

Litigation - The City is subject to litigation arising in the normal course of business. In the opinion of the City Attorney there is no pending litigation which is likely to have a material adverse effect on the financial position of the City.

Sales Tax Adjustment - On April 14, 1999 the State Board of Equalization informed the City that it had been allocated and paid \$594 thousand in sales and use taxes in error and that the City was obligated to refund these taxes from future sales tax revenues. The City is in the process of challenging the Board's finding. However, as of June 30, 2002, the issue had not been settled and the refund had not been returned.

Grant Programs - The City participates in Federal and State grant programs. These programs have been audited by the City's independent accountants in accordance with the provisions of the Federal Single Audit Act amendments of 1996 and applicable State requirements. No cost disallowances were proposed as a result of these audits; however, these programs are still subject to further examination by the grantors and the amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time. The City expects such amounts, if any, to be immaterial.



Non-major Governmental Funds.....

STREET IMPROVEMENT

This fund accounts for revenues received from state gas tax, allocations must be spent on the construction and maintenance of the road network system of the City.

FEDERAL REVENUE

This fund accounts for grant funds received under the Community Development Act of 1974 and HOME Investment Grant Programs, for activities approved and subject to federal regulations.

HOUSING IN-LIEU

This fund accounts for revenues from commercial and residential developers to provide housing under the City's Below Market Rate program.

SPECIAL DISTRICTS

This fund accounts for revenues from parking permits and for maintenance of various parking lots within the City's parking districts.

TRANSPORTATION MITIGATION

This fund accounts for revenues from fees or contributions required for transportation mitigation issues encountered as a result of City development.

LOCAL LAW ENFORCEMENT

This fund accounts for revenues received in support of City's law enforcement program.

DOWNTOWN PLANNED COMMUNITY

This fund accounts for revenues received from contributions and fees that will be used to implement downtown improvements.

ASSETS SEIZURE

This fund accounts for seized property and funds associated with drug trafficking. Under California Assembly Bill No. 4162, the monies are released to the City for specific expenditures related to law enforcement activities.

DEVELOPER'S IMPACT FEE

This fund accounts for fees imposed on new developments for parks, community centers and libraries.

REDEVELOPMENT AGENCY ADMINISTRATION

This fund accounts for the activities of administrating the Redevelopment Agency.

TERMAN LEASE

This fund accounts for revenues received to provide payment of principal and interest on the long-term lease of the former Terman School with the Palo Alto Unified School District.

GOLF COURSE

This fund accounts for revenues received from the General Fund to provide payment of principal and interest associated with general obligation debt issued for the City's golf course.



Non-major Governmental Funds

CIVIC CENTER

This fund accounts for revenues received from the General Fund to provide payment of the Civic Center Certificate of Participation as they become due.

CIVIC CENTER REFINANCING

This fund accounts for revenues received from the General Fund to provide payment of principal and interest associated with the 2002A Civic Center Refinancing Certificates of Participation as they become due.

DOWNTOWN PARKING IMPROVEMENT

This fund accounts for revenues received from the General Fund to provide payment of principal and interest associated with the 2002B Downtown Parking Improvement Certificate of Participation as they become due.

SPECIAL ASSESSMENT DEBT

This fund accumulate monies for payments of special assessment improvement bonds which are financed by assessments placed on property owners within the University Avenue and California Avenue Parking district.



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City of Palo Alto - Non-Major Governmental Funds
Combining Balance Sheets- June 30, 2002
(In thousands of dollars)

SPECIAL REVENUE FUNDS

	<u>Street Improvement</u>	<u>Federal Revenue</u>	<u>Housing In-Lieu</u>	<u>Special Districts</u>	<u>Transportation Mitigation</u>	<u>Local Law Enforcement</u>
ASSETS						
Cash and investments						
Available for operations	\$3,612	\$25	\$4,657	\$1,233	\$2,533	\$493
Cash and investments with fiscal agent						
Receivables:						
Accounts		68				
Special assessments						
Interest	50		64	17	30	7
Notes		3,376	5,299			
Total Assets	<u>\$3,662</u>	<u>\$3,469</u>	<u>\$10,020</u>	<u>\$1,250</u>	<u>\$2,563</u>	<u>\$500</u>
LIABILITIES						
Accounts payable		\$24	\$168	\$67		
Deferred revenue						
Interfund payable and advances		155				
Total Liabilities		<u>179</u>	<u>168</u>	<u>67</u>		
FUND EQUITY						
Reserved for:						
Encumbrances	\$667	152	1,960			\$73
Debt service						
Unreserved, designated for:						
Unrealized gain on investments	56		85	26	\$46	9
Special revenue projects			7,807	1,157	2,517	418
Reappropriations	2,939					
Unreserved, undesignated		3,138				
	<u>3,662</u>	<u>3,290</u>	<u>9,852</u>	<u>1,183</u>	<u>2,563</u>	<u>500</u>
	<u>\$3,662</u>	<u>\$3,469</u>	<u>\$10,020</u>	<u>\$1,250</u>	<u>\$2,563</u>	<u>\$500</u>



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<u>SPECIAL REVENUE FUNDS</u>				<u>DEBT SERVICE FUNDS</u>	
<u>Downtown Planned Community</u>	<u>Assets Seizure</u>	<u>Developer's Impact Fee</u>	<u>Redevelopment Agency Administration</u>	<u>Terman Lease</u>	<u>Golf Course</u>
\$20	\$31	\$17			\$723
					11
<u>\$20</u>	<u>\$31</u>	<u>\$17</u>			<u>\$734</u>
			\$3		
			3		
					\$734
\$20	\$8				
	23	\$17	(3)		
20	31	17	(3)		734
<u>\$20</u>	<u>\$31</u>	<u>\$17</u>			<u>\$734</u>

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City of Palo Alto - Non-major Governmental Funds

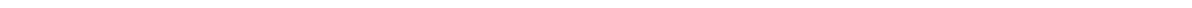
Combining Balance Sheets- June 30, 2002

(In thousands of dollars)

	<u>DEBT SERVICE FUNDS</u>				Total Non-major Governmental Funds
	<u>Civic Center Refinancing</u>	<u>Civic Center Improvement</u>	<u>Downtown Parking Improvement</u>	<u>Special Assessment Debt</u>	
ASSETS					
Cash and investments					
Available for operations				\$97	\$12,718
Cash and investments with fiscal agent	\$371		\$341		1,435
Receivables:					
Accounts					68
Special assessments				595	595
Interest					179
Notes					8,675
	<u>371</u>		<u>341</u>		<u>8,675</u>
Total Assets	<u><u>\$371</u></u>		<u><u>\$341</u></u>	<u><u>\$692</u></u>	<u><u>\$23,670</u></u>
LIABILITIES					
Accounts payable					\$262
Deferred revenue				\$595	595
Interfund payable and advances					155
					<u>155</u>
Total Liabilities				<u>595</u>	<u>1,012</u>
FUND EQUITY					
Reserved for:					
Encumbrances					2,852
Debt service	\$371		\$341	97	1,543
Unreserved, designated for:					
Unrealized gain on investments					230
Special revenue projects					11,919
Reappropriations					2,939
Unreserved, undesignated					3,175
	<u>371</u>		<u>341</u>	<u>97</u>	<u>22,658</u>
	<u><u>\$371</u></u>		<u><u>\$341</u></u>	<u><u>\$692</u></u>	<u><u>\$23,670</u></u>



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City of Palo Alto - Non-Major Governmental Funds
Combining Statements of Revenues, Expenditures and
Changes in Fund Balances -
For the Year Ended June 30, 2002
(In thousands of dollars)

	<u>SPECIAL REVENUE FUNDS</u>				
	<u>Street</u>	<u>Federal</u>	<u>Housing</u>	<u>Special</u>	<u>Transportation</u>
	<u>Improvement</u>	<u>Revenue</u>	<u>In-Lieu</u>	<u>Districts</u>	<u>Mitigation</u>
REVENUES					
Property taxes					
Special assessments					
Other taxes and fines	\$1,055				
From other agencies:					
Palo Alto Unified					
San Francisco Airport					
Stanford University					
Community Development Block Grant		\$178			
County Measure A/B	1,800				
Local Law Enforcement Block Grant					
State of California					
TDA grant					
Other revenue from other agencies		51			
Return on investment	202	11	\$305	\$84	\$168
Other:					
Great Western Bank - loan payoff		2			
Housing In-Lieu - residential			226		
Housing In-Lieu - commercial			1,543		
University Avenue Parking				560	428
California Avenue Parking				118	
Other fees			91		
Total Revenues	<u>3,057</u>	<u>242</u>	<u>2,165</u>	<u>762</u>	<u>596</u>
EXPENDITURES					
Current:					
Public Safety - Police					
Capital outlay		153	211		
Debt service:					
Principal retirement					
Interest and fiscal charges					
Total Expenditures		<u>153</u>	<u>211</u>		
EXCESS (DEFICIENCY) OF REVENUES					
OVER EXPENDITURES	<u>3,057</u>	<u>89</u>	<u>1,954</u>	<u>762</u>	<u>596</u>
OTHER FINANCING SOURCES (USES)					
Proceeds from bonds					
Payment to bond escrow agent					
Transfers in					
Transfers (out)	(1,172)	(116)		(672)	(276)
Total Other Financing Sources (Uses)	<u>(1,172)</u>	<u>(116)</u>		<u>(672)</u>	<u>(276)</u>
EXCESS (DEFICIENCY) OF REVENUES AND					
OTHER FINANCING SOURCES OVER					
EXPENDITURES AND OTHER USES	1,885	(27)	1,954	90	320
Fund balances at the beginning of year	1,777	3,317	7,898	1,093	2,243
Fund balances (deficit) at end of year	<u>\$3,662</u>	<u>\$3,290</u>	<u>\$9,852</u>	<u>\$1,183</u>	<u>\$2,563</u>



SPECIAL REVENUE FUNDS					DEBT SERVICE FUNDS			
Local Law Enforcement	Downtown Planned Community	Assets Seizure	Developer's Impact Fee	Redevelopment Agency	Terman Lease	Golf Course	Civic Center	Civic Center Refinancing
\$23								
122								
35	\$1	\$3				\$34	\$14	\$2
		2	\$17					
180	1	5	17			34	14	2
		28		\$228				
32						390		
						313	118	91
32		28		228		703	118	91
148	1	(23)	17	(228)		(669)	(104)	(89)
							3,038	460
							(3,796)	(24)
(84)					225	677	80	24
(84)					(96)			
					225	(96)	(678)	460
64	1	(23)	17	(3)	(96)	8	(782)	371
436	19	54			96	726	782	
\$500	\$20	\$31	\$17	(\$3)		\$734		\$371

(Continued)

City of Palo Alto - Non-major Governmental Funds
Combining Statements of Revenues, Expenditures and
Changes in Fund Balances -
For the Year Ended June 30, 2002
(In thousands of dollars)

	DEBT SERVICE FUNDS		Total Non-major Governmental Funds
	Downtown Parking Improvement	Special Assessment District	
REVENUES			
Property taxes			
Special assessments		\$132	\$132
Other taxes and fines			1,055
From other agencies:			
Palo Alto Unified			
San Francisco Airport			
Stanford University			
Community Development Block Grant			178
County Measure A/B			1,800
Local Law Enforcement Block Grant			23
State of California			122
TDA grant			
Other revenue from other agencies			51
Return on investment	\$2		861
Other:			
Great Western Bank - loan payoff			2
Housing In-Lieu - residential			226
Housing In-Lieu - commercial			1,543
University Avenue Parking			988
California Avenue Parking			118
Other fees			110
Total Revenues	2	132	7,209
EXPENDITURES			
Current:			
Public Safety - Police			28
Capital outlay			624
Debt service:			
Principal retirement		75	465
Interest and fiscal charges	117	47	686
Total Expenditures	117	122	1,803
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(115)	10	5,406
OTHER FINANCING SOURCES (USES)			
Proceeds from bonds	456		3,954
Payment to bond escrow agent			(3,820)
Transfers in			1,006
Transfers (out)			(2,416)
Total Other Financing Sources (Uses)	456		(1,276)
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER USES	341	10	4,130
Fund balances at the beginning of year		87	18,528
Fund balances (deficit) at end of year	\$341	\$97	\$22,658



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City of Palo Alto - Non-major Governmental Funds
Combining Statements of Revenues, Expenditures and
Changes in Fund Balances -Budget and Actual
For the Year Ended June 30, 2002
(In thousands of dollars)

	SPECIAL REVENUE FUNDS					
	Street Improvement			Federal Revenue		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
REVENUES						
Property taxes						
Special assessments						
Other taxes and fines	\$1,126	\$1,055	(\$71)			
From other agencies:						
Community Development Block Grant				\$771	\$178	(\$593)
County Measure A/B	491	1,800	1,309			
Local Law Enforcement Block Grant						
State of California						
TDA grant						
Other revenue from other agencies				20	51	31
Return on investment	150	202	52	25	11	(14)
Other:						
Great Western Bank - loan payoff				10	2	(8)
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees						
Total Revenues	<u>1,767</u>	<u>3,057</u>	<u>1,290</u>	<u>826</u>	<u>242</u>	<u>(584)</u>
EXPENDITURES						
Current:						
Public Safety - Police						
Capital outlay				1,030	153	877
Debt service:						
Principal retirement						
Interest and fiscal charges						
Total Expenditures				<u>1,030</u>	<u>153</u>	<u>877</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>1,767</u>	<u>3,057</u>	<u>1,290</u>	<u>(204)</u>	<u>89</u>	<u>293</u>
OTHER FINANCING SOURCES (USES)						
Proceeds from bonds						
Payment to bond escrow agent						
Transfers in						
Transfers (out)	(2,042)	(1,172)	870	(130)	(116)	14
Total Other Financing Sources (Uses)	<u>(2,042)</u>	<u>(1,172)</u>	<u>870</u>	<u>(130)</u>	<u>(116)</u>	<u>14</u>
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER USES	<u>(\$275)</u>	<u>1,885</u>	<u>\$2,160</u>	<u>(\$334)</u>	<u>(27)</u>	<u>\$307</u>
Fund balances at the beginning of year		<u>1,777</u>			<u>3,317</u>	
Fund balances (deficit) at end of year		<u>\$3,662</u>			<u>\$3,290</u>	



SPECIAL REVENUE FUNDS

Housing In-Lieu			Special Districts			Transportation Mitigation		
Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
\$221	\$305	\$84	\$37	\$84	\$47	\$138	\$168	\$30
400	226	(174)						
950	1,543	593	490	560	70	480	428	(52)
	91	91	90	118	28			
<u>1,571</u>	<u>2,165</u>	<u>594</u>	<u>617</u>	<u>762</u>	<u>145</u>	<u>618</u>	<u>596</u>	<u>(22)</u>
282	211	71						
<u>282</u>	<u>211</u>	<u>71</u>						
<u>1,289</u>	<u>1,954</u>	<u>665</u>	<u>617</u>	<u>762</u>	<u>145</u>	<u>618</u>	<u>596</u>	<u>(22)</u>
			(641)	(672)	(31)	(276)	(276)	
			(641)	(672)	(31)	(276)	(276)	
<u>\$1,289</u>	<u>1,954</u>	<u>\$665</u>	<u>(\$24)</u>	<u>90</u>	<u>\$114</u>	<u>\$342</u>	<u>320</u>	<u>(\$22)</u>
	<u>7,898</u>			<u>1,093</u>			<u>2,243</u>	
	<u>\$9,852</u>			<u>\$1,183</u>			<u>\$2,563</u>	

(Continued)

City of Palo Alto - Non-major Governmental Funds
Combining Statements of Revenues, Expenditures and
Changes in Fund Balances

Budget and Actual - For the Year Ended June 30, 2002

(In thousands of dollars)

	SPECIAL REVENUE FUNDS					
	Local Law Enforcement			Assets Seizure		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
REVENUES						
Property taxes						
Special assessments						
Other taxes and fines						
From other agencies:						
Community Development Block Grant						
County Measure A/B						
Local Law Enforcement Block Grant	\$23	\$23				
State of California	122	122				
TDA grant						
Other revenue from other agencies						
Return on investment		35	\$35		\$3	\$3
Other:						
Great Western Bank - loan payoff						
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees					2	2
Total Revenues	<u>145</u>	<u>180</u>	<u>35</u>	<u>11</u>	<u>5</u>	<u>5</u>
EXPENDITURES						
Current:						
Public Safety - Police				\$11	28	(17)
Capital outlay	412	32	380			
Debt service						
Principal retirement						
Interest and fiscal charges						
Total Expenditures	<u>412</u>	<u>32</u>	<u>380</u>	<u>11</u>	<u>28</u>	<u>(17)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(267)</u>	<u>148</u>	<u>415</u>	<u>(11)</u>	<u>(23)</u>	<u>(12)</u>
OTHER FINANCING SOURCES (USES)						
Proceeds from bonds						
Payment to bond escrow agent						
Transfers in	3		(3)			
Transfers (out)	(168)	(84)	84			
Total Other Financing Sources (Uses)	<u>(165)</u>	<u>(84)</u>	<u>81</u>			
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER USES	<u>(\$432)</u>	<u>64</u>	<u>\$496</u>	<u>(\$11)</u>	<u>(23)</u>	<u>(\$12)</u>
Fund balances at the beginning of period		<u>436</u>			<u>54</u>	
Fund balances (deficit) at end of year		<u>\$500</u>			<u>\$31</u>	

Non-major Governmental Funds

SPECIAL REVENUE FUNDS			DEBT SERVICE FUNDS					
Redevelopment Agency			Terman Lease			Golf Course		
Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
\$14		(\$14)	\$277 10		(\$277) (10)	\$45	\$34	(\$11)
<u>14</u>		<u>(14)</u>	<u>287</u>		<u>(287)</u>	<u>45</u>	<u>34</u>	<u>(11)</u>
299	\$228	71				390 313	390 313	
<u>299</u>	<u>228</u>	<u>71</u>				<u>703</u>	<u>703</u>	
<u>(285)</u>	<u>(228)</u>	<u>57</u>	<u>287</u>		<u>(287)</u>	<u>(658)</u>	<u>(669)</u>	<u>(11)</u>
	225	225		(96)	(96)	628	677	49
	<u>225</u>	<u>225</u>		<u>(96)</u>	<u>(96)</u>	<u>628</u>	<u>677</u>	<u>49</u>
<u>(285)</u>	(3)	<u>\$282</u>	<u>\$287</u>	(96)	<u>(\$383)</u>	<u>(\$30)</u>	8	<u>\$38</u>
			<u>96</u>				<u>726</u>	
	<u>(\$3)</u>						<u>\$734</u>	

(Continued)

City of Palo Alto - Non-major Governmental Funds
Combining Statements of Revenues, Expenditures and
Changes in Fund Balances
Budget and Actual - For the Year Ended June 30, 2002
(In thousands of dollars)

	DEBT SERVICE FUNDS					
	Civic Center			Special Assessment District		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
REVENUES						
Property taxes						
Special assessments				\$852	\$132	(\$720)
Other taxes and fines						
From other agencies:						
Community Development Block Grant						
County Measure A/B						
Local Law Enforcement Block Grant						
State of California						
TDA grant						
Other revenue from other agencies						
Return on investment	\$39	\$14	(\$25)			
Other:						
Great Western Bank - loan payoff						
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees						
Total Revenues	<u>39</u>	<u>14</u>	<u>(25)</u>	<u>852</u>	<u>132</u>	<u>(720)</u>
EXPENDITURES						
Current:						
Public Safety - Police						
Capital outlay						
Debt service						
Principal retirement				590	75	515
Interest and fiscal charges	119	118	1	262	47	215
Total Expenditures	<u>119</u>	<u>118</u>	<u>1</u>	<u>852</u>	<u>122</u>	<u>730</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(80)</u>	<u>(104)</u>	<u>(24)</u>		<u>10</u>	<u>10</u>
OTHER FINANCING SOURCES (USES)						
Proceeds from bonds		3,038	3,038			
Payment to bond escrow agent		(3,796)	(3,796)			
Transfers in	80	80				
Transfers (out)						
Total Other Financing Sources (Uses)	<u>80</u>	<u>(678)</u>	<u>(758)</u>			
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER USES		<u>(782)</u>	<u>(\$782)</u>		<u>10</u>	<u>\$10</u>
Fund balances at the beginning of period		<u>782</u>			<u>87</u>	
Fund balances (deficit) at end of year					<u>\$97</u>	



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TOTAL		
Non-major Governmental Funds		
Budget	Actual	Variance Favorable (Unfavorable)
\$852	\$132	(\$720)
1,126	1,055	(71)
771	178	(593)
491	1,800	1,309
23	23	
122	122	
297	51	(246)
679	856	177
10	2	(8)
400	226	(174)
950	1,543	593
970	988	18
90	118	28
<u> </u>	<u>93</u>	<u>93</u>
<u>6,781</u>	<u>7,187</u>	<u>406</u>
11	28	(17)
2,023	624	1,399
980	465	515
<u>694</u>	<u>478</u>	<u>216</u>
<u>3,708</u>	<u>1,595</u>	<u>2,113</u>
<u>3,073</u>	<u>5,592</u>	<u>2,519</u>
	3,038	3,038
	(3,796)	(3,796)
711	982	271
<u>(3,257)</u>	<u>(2,416)</u>	<u>841</u>
<u>(2,546)</u>	<u>(2,192)</u>	<u>354</u>
<u>\$527</u>	3,400	<u>\$2,873</u>
	<u>18,509</u>	
	<u>\$21,909</u>	



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Internal Service Funds.....

Introduction

Internal Service Funds are used to finance and account for special activities and services performed by a designated department for other departments in the City on a cost reimbursement basis.

The concept of Major Funds introduced by GASB Statement 34 does not extend to Internal Service Funds because they do not do business with outside parties. GASB Statement 34 requires that for the Statement of Activities, the net revenues or expenses of each Internal Service Fund be eliminated by netting them against the operations of the other City departments which generated them. The remaining balance sheet items are consolidated with these same funds in the Statement of Net Assets.

However, Internal Service Funds are still presented separately in the Fund financial statements, including the funds below.

VEHICLE REPLACEMENT AND MAINTENANCE

This fund accounts for the maintenance and replacement of vehicles and equipment used by all City departments. The source of revenue is an accumulation of resources.

TECHNOLOGY

This fund accounts for replacement and upgrade of technology, and covers four primary areas used by all City departments: desktop, infrastructure, applications, and technology research and development. The source of revenue is an accumulation of resources.

PRINTING AND MAILING SERVICES

This fund accounts for central duplicating, printing and mailing services provided to all City departments. Source of revenue for this fund is on reimbursement of costs for services and supplies purchased by other departments.

GENERAL BENEFITS AND INSURANCE

This fund accounts for the administration of compensated absences and health benefits, and the City's self-insured workers' compensation and general liability programs.

RETIREE HEALTH BENEFITS

This fund accounts for the retiree health benefits when the amount of actual benefits exceed one and one-half percent of the City's gross payroll costs in any fiscal period.

.....

City of Palo Alto - Internal Service Funds
Combining Statements of Net Assets - June 30, 2002
(In thousands of dollars)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits and Insurance	Retiree Health Benefit	Total
ASSETS						
Current Assets						
Cash and investments available for operation	\$3,123	\$7,829	\$543	\$27,340	\$16,206	\$55,041
Accounts receivable, net	1			194		195
Interest receivable	43	108	8	323	242	724
Interfund receivables	155	100				255
Inventory of materials and supplies	365					365
Total Current Assets	3,687	8,037	551	27,857	16,448	56,580
Capital assets, net of depreciation	12,207	205	6			12,418
Total Assets	15,894	8,242	557	27,857	16,448	68,998
LIABILITIES						
Current Liabilities						
Accounts payable and accrued liabilities	261	14	11	91		377
Accrued salaries and benefits	31		7	1,694		1,732
Accrued compensated absences - current				8,672		8,672
Accrued claims payable - current				2,822		2,822
Capital lease obligation - current		35				35
Total Current Liabilities	292	49	18	13,279		13,638
Long-term Liabilities						
Accrued compensated absences				2,869		2,869
Accrued claims payable				5,203		5,203
Capital lease obligation		49				49
Total Long-term Liabilities		49		8,072		8,121
Total Liabilities	292	98	18	21,351		21,759
NET ASSETS						
Investment in capital assets, net of related debt	12,207	121	6			12,334
Unrestricted	3,395	8,023	533	6,506	16,448	34,905
Total Net Assets	\$15,602	\$8,144	\$539	\$6,506	\$16,448	\$47,239

City of Palo Alto - Internal Service Funds

Combining Statements of Revenues, Expenses and

Changes in Net Assets - For the Year Ended June 30, 2002

(In thousands of dollars)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits and Insurance	Retiree Health Benefit	Total
OPERATING REVENUES						
Charges for services	\$4,348	\$4,355	\$1,043	\$33,014	\$1,100	\$43,860
OPERATING EXPENSES						
Administration and general	543	1,565	886	1,005		3,999
Operations and maintenance	2,198					2,198
Depreciation and amortization	2,572	104	7			2,683
Claim payments and change in estimated self-insured liability				3,481		3,481
Compensated absences and other benefits				30,064		30,064
Total Operating Expenses	5,313	1,669	893	34,550		42,425
Total Operating Income (Loss)	(965)	2,686	150	(1,536)	1,100	1,435
NONOPERATING REVENUES (EXPENSES)						
Return on investment	246	451	25	1,796	1,149	3,667
Interest (expense)		(12)				(12)
Gain on disposal of fixed assets	109					109
Other nonoperating revenues	480		9	226		715
Total Nonoperating Revenues	835	439	34	2,022	1,149	4,479
Income (Loss) Before Contributions and Transfers	(130)	3,125	184	486	2,249	5,914
Contributions	984					984
Transfers in	23	366				389
Change in Net Assets	877	3,491	184	486	2,249	7,287
Net assets at beginning of year	14,725	4,653	355	6,020	14,199	39,952
Net assets at end of year	\$15,602	\$8,144	\$539	\$6,506	\$16,448	\$47,239

City of Palo Alto - Internal Service Funds
Combining Statements of Cash Flows - For the Fiscal Year Ended June 30
(In thousands of dollars)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits and Insurance	Retiree Health Benefit	Total
CASH FLOW FROM OPERATING ACTIVITIES						
Receipts from customers	\$4,348	\$4,355	\$1,043	\$32,823	\$1,100	\$43,669
Payments to suppliers	(2,301)	(128)				(2,429)
Payments to employees	(550)	(1,565)	(879)	(30,847)		(33,841)
Claims paid				(4,569)		(4,569)
Other receipts	480		9	226		715
Net cash provided by operating activities	<u>1,977</u>	<u>2,662</u>	<u>173</u>	<u>(2,367)</u>	<u>1,100</u>	<u>3,545</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Interfund payments		(100)				(100)
Transfer in	23	366				389
Cash flows from noncapital financing activities	<u>23</u>	<u>266</u>				<u>289</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES						
Acquisition and construction of fixed assets	(2,556)					(2,556)
Proceeds from sale of capital assets	132					132
Principal paid on long term obligation		(29)				(29)
Interest paid on long term obligation		(12)				(12)
Cash flows from capital financing activities	<u>(2,424)</u>	<u>(41)</u>				<u>(2,465)</u>
CASH FLOWS FROM INVESTING ACTIVITIES						
Interest and dividends on pooled investments	250	408	22	1,795	1,106	3,581
Net Cash Flows	(174)	3,295	195	(572)	2,206	4,950
Cash and investments at beginning of year	3,297	4,534	348	27,912	14,000	50,091
Cash and investments at end of year	<u>\$3,123</u>	<u>\$7,829</u>	<u>\$543</u>	<u>\$27,340</u>	<u>\$16,206</u>	<u>\$55,041</u>
NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES:						
Increase in contributed fixed assets	<u>\$984</u>					<u>\$984</u>
CASH FLOWS FROM OPERATING ACTIVITIES						
Operating income (loss)	(\$965)	\$2,686	\$150	(\$1,536)	\$1,100	\$1,435
Adjustments to reconcile operating income (loss) to cash flows from operating activities:						
Depreciation and amortization	2,572	104	7			2,683
Other	480		9	226		715
Changes in assets and liabilities:						
Accounts receivable				(191)		(191)
Inventory of materials and supplies	(104)					(104)
Accounts and other payables	(6)	(128)	7	222		95
Accrued claims payable				(1,088)		(1,088)
Net cash provided by operating activities	<u>\$1,977</u>	<u>\$2,662</u>	<u>\$173</u>	<u>(\$2,367)</u>	<u>\$1,100</u>	<u>\$3,545</u>



Fiduciary Funds.....

Introduction

Fiduciary Funds are used to account for assets held by the City acting in a fiduciary capacity for other entities and individuals. The funds are operated to carry out the specific actions required by the trust agreements, ordinances and other governing regulations.

GASB Statement 34 requires that the Fiduciary Funds the City has, be presented separately from the Citywide and Fund financial statements.

Agency Funds are custodial in nature and do not involve measurement of results of operations. The City maintains four agency funds, as follows:

CALIFORNIA AVENUE PARKING ASSESSMENT DISTRICT

This fund accounts for receipts and disbursements associated with the 1993 Parking District No. 92-13 Assessment Bonds.

SAN FRANCISQUITO CREEK JOINT POWERS AUTHORITY

The fund accounts for the activities for maintenance, flood control measures, and environmental preservation of the creek.

CABLE JOINT POWERS AUTHORITY

The fund was established to account for the activities of the cable television system on behalf of the members.

UNIVERSITY AVENUE AREA PARKING ASSESSMENT DISTRICT

The fund accounts for the receipts and disbursements associated with the Series 2001-A University Avenue Area Off-Street Parking Assessments Bonds.



City of Palo Alto - Agency Funds
Statement of Changes in Assets and Liabilities -
For the Fiscal Year Ended June 30, 2002
(In thousands of dollars)

	<u>Balance</u> <u>June 30, 2001</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2002</u>
<u>California Avenue Parking Assessment District</u>				
ASSETS				
Cash and investments available for operations	\$355	\$143	\$159	\$339
LIABILITIES				
Due to bondholders	\$355	\$143	\$159	\$339
<u>San Francisquito Creek Joint Powers Authority</u>				
ASSETS				
Cash and investments available for operations	\$125	\$15	\$132	\$8
Interest receivable	2		2	
Total assets	<u>\$127</u>	<u>\$15</u>	<u>\$134</u>	<u>\$8</u>
LIABILITIES				
Accounts payable	\$44	\$8	\$44	\$8
Due to developers	83	7	90	
Total liabilities	<u>\$127</u>	<u>\$15</u>	<u>\$134</u>	<u>\$8</u>
<u>Cable Joint Powers Authority</u>				
ASSETS				
Cash and investments available for operations	\$695	\$61	\$60	\$696
Interest receivable	10	10	10	10
Total assets	<u>\$705</u>	<u>\$71</u>	<u>\$70</u>	<u>\$706</u>
LIABILITIES				
Due to other governments	<u>\$705</u>	<u>\$71</u>	<u>\$70</u>	<u>\$706</u>



University Avenue Area Parking Assessment District

ASSETS				
Cash and investments with fiscal agents	\$1,802	\$36,665	\$32,982	\$5,485
Interest receivable		38		38
Other receivable		22		22
	<u>\$1,802</u>	<u>\$36,725</u>	<u>\$32,982</u>	<u>\$5,545</u>
LIABILITIES				
Due to other governments	<u>\$1,802</u>	<u>\$36,725</u>	<u>\$32,982</u>	<u>\$5,545</u>

Total Agency Funds

ASSETS				
Cash and investments available for operations	\$1,175	\$219	\$351	\$1,043
Cash and investments with fiscal agents	1,802	36,665	32,982	5,485
Interest receivable	12	48	12	48
Other receivable		22		22
	<u>\$2,989</u>	<u>\$36,954</u>	<u>\$33,345</u>	<u>\$6,598</u>
LIABILITIES				
Accounts payable	\$44	\$8	\$44	\$8
Due to bondholders	2,157	36,868	33,141	5,884
Due to other governments	<u>788</u>	<u>78</u>	<u>160</u>	<u>706</u>
	<u>\$2,989</u>	<u>\$36,954</u>	<u>\$33,345</u>	<u>\$6,598</u>



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Statistical Section.....

The statistical section contains comprehensive statistical data which relates to physical, economic, social and political characteristics of the City. It is intended to provide users with a broader and more complete understanding of the City and its financial affairs than is possible from the financial statements and supporting schedules included in the financial section.

In this section, readers will find comparative information related to the City's revenue sources, expenditures, property tax valuations, levies and collections, general obligation bonded debt, utility revenue debt service, demographics and pension plan funding. Where available, the comparative information is presented for the last ten fiscal years.

In addition, this section presents information related to the City's legal debt margin computation, principal taxpayers, notary and security bond coverages, and other miscellaneous statistics pertaining to services provided by the City.

In contrast to the financial section, the statistical section information is not usually subject to independent audit.

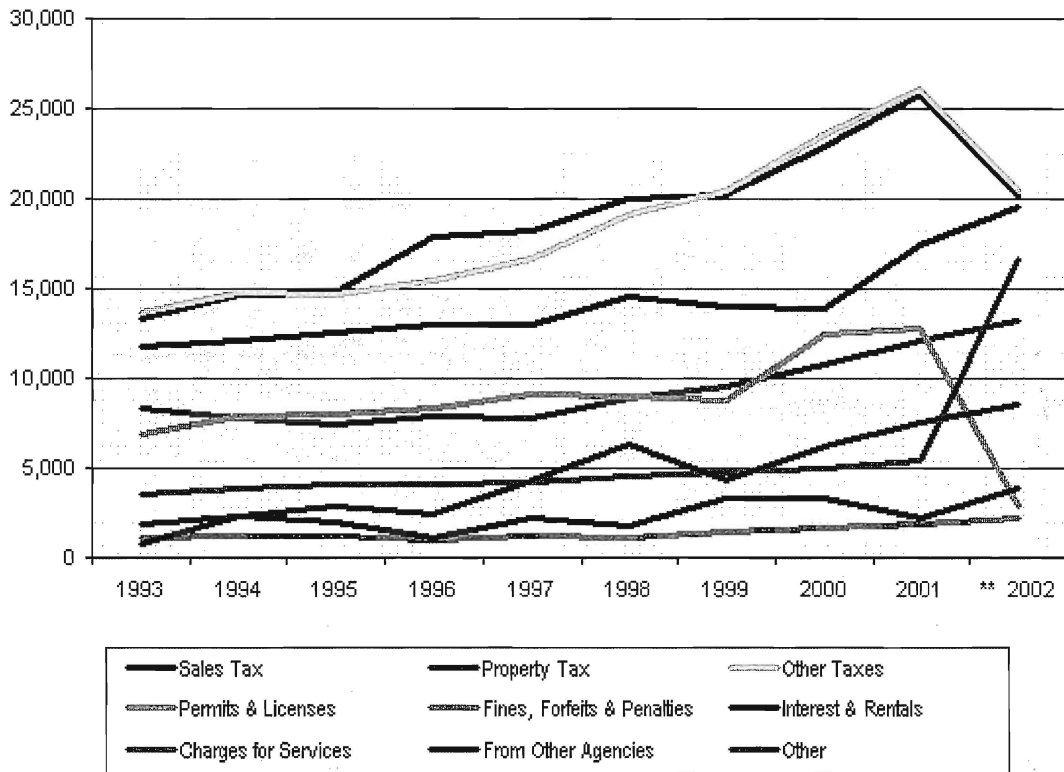


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City of Palo Alto - General Governmental Revenues by Source

All Governmental Fund Types

Last Ten Fiscal Years (\$000s)



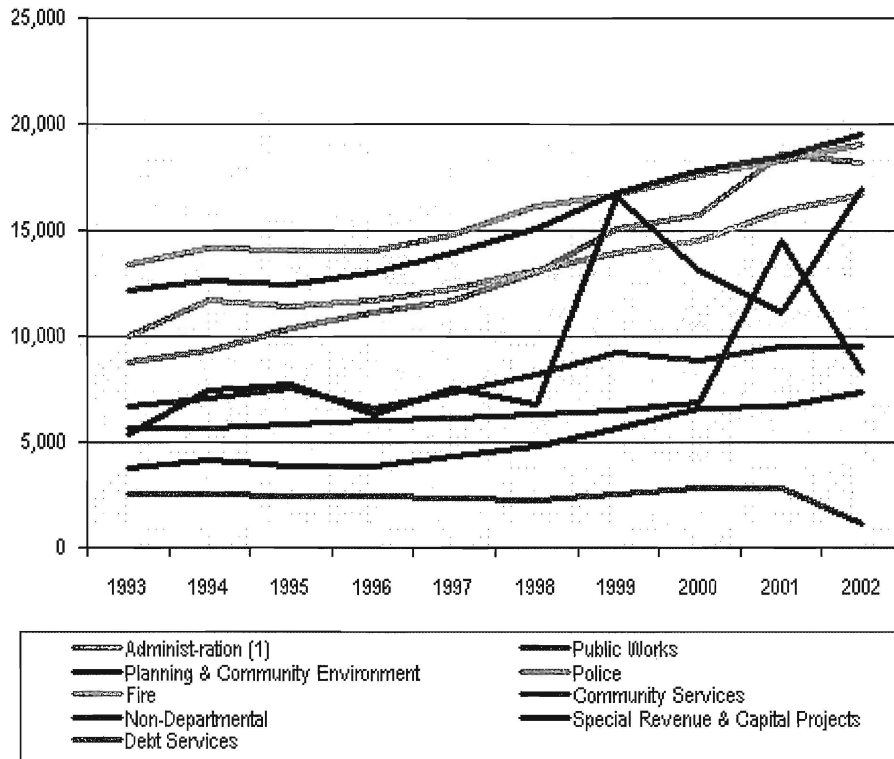
Fiscal Year	Sales Tax	Property Tax	Other Taxes	Permits & Licenses	Fines, Forfeits & Penalties	Interest & Rentals	Charges for Services	From Other Agencies	Other	Total
1993	13,322	8,367	13,663	6,923	1,068	11,725	3,565	1,910	750	61,293
1994	14,635	7,737	14,763	7,915	1,180	12,132	3,884	2,295	2,381	66,922
1995	14,765	7,485	14,682	7,955	1,179	12,528	4,097	2,007	2,938	67,636
1996	17,895	7,854	15,469	8,380	1,032	12,953	4,073	1,144	2,445	71,245
1997	18,277	7,735	16,654	9,087	1,219	12,966	4,193	2,239	4,380	76,750
1998	20,011	8,903	19,150	8,984	1,161	14,525	4,507	1,732	6,354	85,327
1999	20,225	9,521	20,393	8,810	1,475	13,992	4,751	3,374	4,376	86,917
2000	22,867	10,770	23,582	12,408	1,703	13,874	5,053	3,282	6,213	99,752
2001	25,786	12,110	26,160	12,743	1,873	17,432	5,466	2,208	7,590	111,368
** 2002	20,085	13,231	20,485	2,901	2,181	19,547	16,667	3,860	8,580	107,537

** Revenue categories were changed to align with budget classifications in 2002

City of Palo Alto - General Governmental Expenditures by Function.....

All Governmental Fund Types

Last Ten Fiscal Years (\$000s)

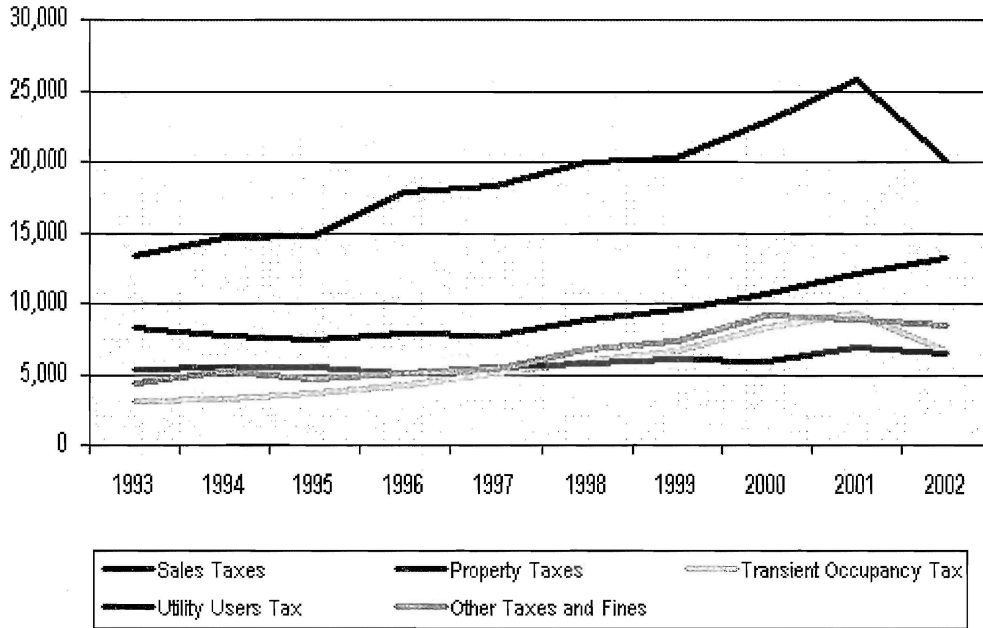


Fiscal Year	Administ-ration (1)	Public Works	Planning & Community Environment	Police	Fire	Community Services	Non-Departmental	Special Revenue & Capital Projects	Debt Services	Total
1993	8,809	6,673	3,757	13,380	10,040	12,183	5,632	5,342	2,541	68,357
1994	9,343	7,058	4,160	14,150	11,718	12,651	5,645	7,450	2,569	74,744
1995	10,340	7,517	3,842	14,058	11,437	12,435	5,884	7,722	2,415	75,650
1996	11,133	6,614	3,901	14,066	11,739	13,019	5,992	6,296	2,490	75,250
1997	11,689	7,339	4,320	14,804	12,292	13,972	6,086	7,581	2,319	80,402
1998	12,987	8,172	4,832	16,093	13,100	15,050	6,298	6,749	2,293	85,574
1999	15,066	9,202	5,674	16,705	13,949	16,820	6,520	16,605	2,509	103,050
2000	15,772	8,827	6,639	17,666	14,512	17,858	6,927	13,151	2,801	104,153
2001	18,557	9,522	6,652	18,306	15,973	18,469	14,487	11,089	2,817	115,872
2002	18,235	9,549	7,378	19,047	16,722	19,499	8,259	16,960	1,151	116,800

NOTES: (1) Comprised of the following departments: City Council, City Manager, City Attorney, City Clerk, City Auditor, Administrative Services and Human Services

(2) During fiscal year 1994-94 the City implemented GASB Statement No.14. The Reporting Entity, and as a result, the Palo Alto Centennial 1994, Inc., was included in the beginning of this year. Data prior to 1993-94 has not been restated.

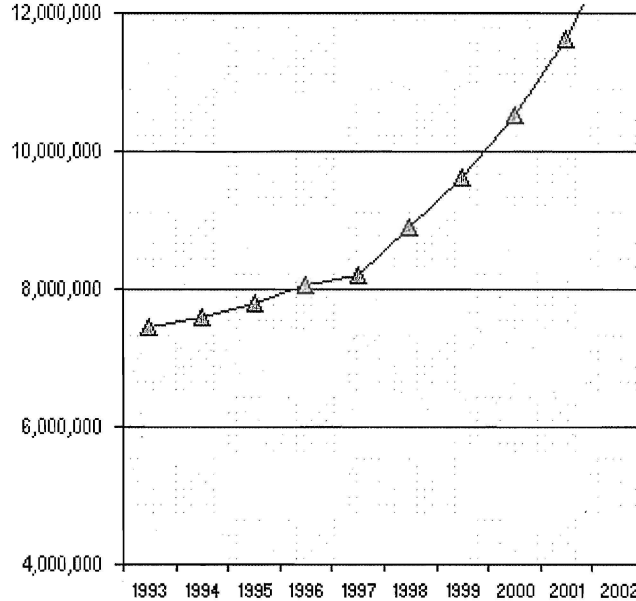
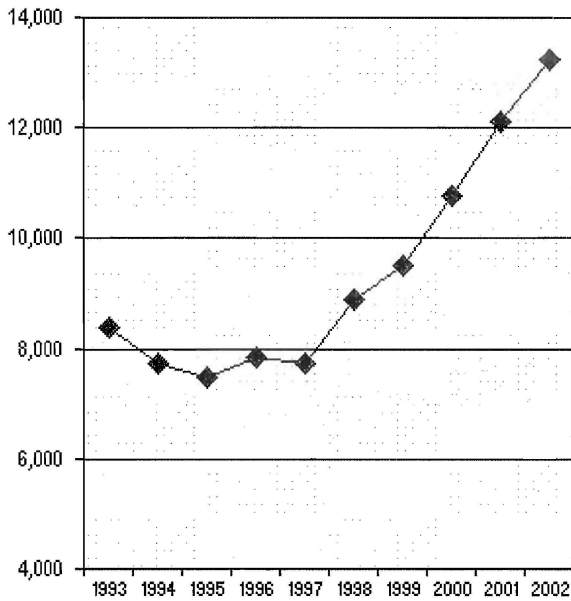
City of Palo Alto - General Fund Tax Revenues by Source.....
Last Ten Fiscal Years (\$000)



Fiscal Year	Sales Taxes	Property Taxes	Transient Occupancy Tax	Utility Users Tax	Other Taxes and Fines	Total
1993	13,322	8,367	3,109	5,362	4,333	34,493
1994	14,635	7,737	3,301	5,455	5,277	36,405
1995	14,765	7,485	3,643	5,482	4,633	36,008
1996	17,895	7,854	4,279	5,098	5,092	40,218
1997	18,277	7,735	5,107	5,509	5,299	41,927
1998	20,011	8,903	5,846	5,780	6,694	47,234
1999	20,225	9,521	6,551	6,039	7,255	49,591
2000	22,867	10,770	8,293	5,861	9,096	56,887
2001	25,786	12,110	9,359	6,895	8,887	63,037
2002	20,085	13,231	6,615	6,457	8,407	54,795

SOURCE: City of Palo Alto: Administrative Services Department, Comprehensive Annual Financial Reports

City of Palo Alto - Property Tax Levies and Collections.....
Last Ten Fiscal Years (\$000s)



◆ Total Property Tax Collected

▲ Value of Property

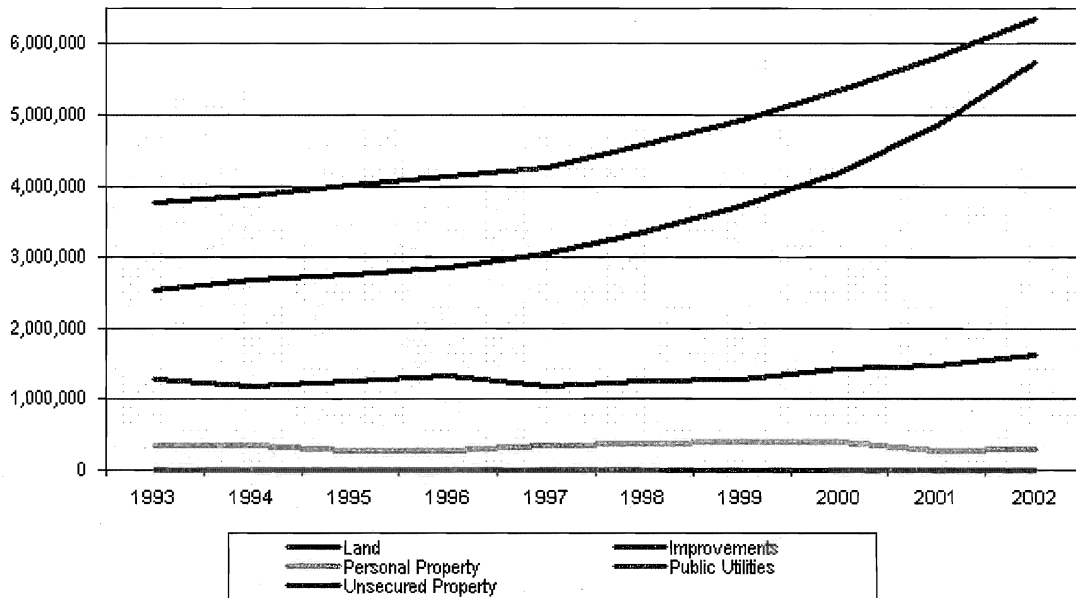
Fiscal Year	Total Tax Levy	Current Tax Collections	Delinquent Tax Collections	Total Property Tax Collected	Value of Property Subject to Basic County Wide Tax Rate
1993	\$8,373	\$8,148	\$183	\$8,367	\$7,443,688
1994	7,310	7,310	219	7,737	7,592,131
1995	7,485	7,485	427	7,485	7,795,396
1996	7,854	7,854	A	7,854	8,058,927
1997	7,735	7,735	A	7,735	8,206,532
1998	7,660	8,903	A	8,903	8,885,623
1999	9,521	9,521	A	9,521	9,623,868
2000	10,770	10,770	A	10,770	10,533,778
2001	12,110	12,110	A	12,110	11,609,915
2002	13,231	13,231	A	13,231	13,102,696

Source: County of Santa Clara Assessor's Office

Note:

Effective with the fiscal year 1993-94, the City is on the Teeter Plan, under which the County of Santa Clara Pays the full tax levy due. All prior delinquent taxes were also received in this fiscal year. Assessed value of property is considered to be an estimate of full market value.

City of Palo Alto - Assessed Value of Taxable Property.....
Last Ten Fiscal Years (\$000)



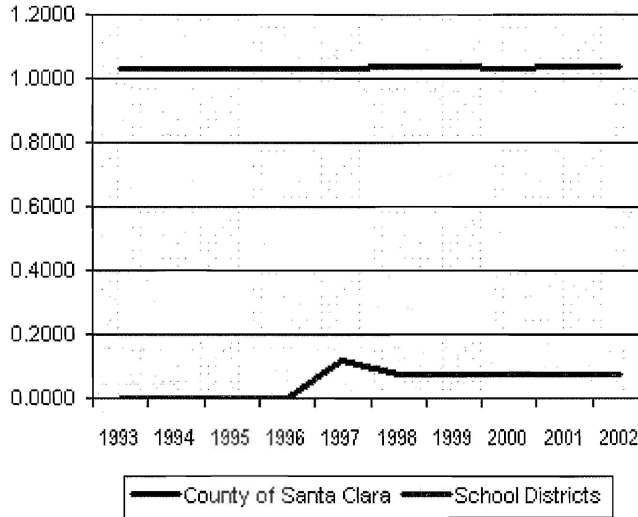
Fiscal Year	Net Local Secured Roll		Personal Property	Subtotal Net Local Secured Roll	Public Utilities	Unsecured Property	Less Exemptions Net of State Aid	Total Assessed Value
	Land	Improvements						
1993	2,533,275	3,758,000	356,415	6,647,690	3,200	1,290,140	497,342	7,443,688
1994	2,687,134	3,876,127	353,803	6,917,064	1,425	1,188,354	514,712	7,592,131
1995	2,764,558	4,018,251	281,479	7,064,288	1,508	1,262,254	532,654	7,795,396
1996	2,865,710	4,129,805	277,037	7,272,552	2,508	1,325,835	541,968	8,058,927
1997	3,045,477	4,259,209	340,073	7,644,759	2,410	1,173,563	614,200	8,206,532
1998	3,353,027	4,585,725	381,091	8,319,843	2,652	1,265,100	701,972	8,885,623
1999	3,729,475	4,920,111	394,610	9,044,196	2,842	1,279,315	702,485	9,623,868
2000	4,187,357	5,335,026	394,198	9,916,581	3,362	1,415,999	802,164	10,533,778
2001	4,849,233	5,816,633	280,958	10,946,824	3,309	1,473,678	813,896	11,609,915
2002	5,744,675	6,347,719	292,812	12,385,206	3,371	1,627,594	913,475	13,102,696

SOURCE: County of Santa Clara Assessor's Office

NOTE: Beginning in fiscal year 1988-89, Chapter 921 of the Statutes of 1987 requires the establishment of a single county-wide tax rate area for the assignment of the assessed value of certain types of state-assessed utility property and sets forth formulas for the determination of county-wide tax rates for this particular type of property.

The State Constitution requires property to be assessed at one hundred percent of the most recent purchase price, plus an increment of no more than two percent annually, plus any local over-rides. These values are considered to be full market values.

City of Palo Alto - Property Tax Rates.....
All Overlapping Governments
Per \$100 of Assessed Value - Last Ten Years

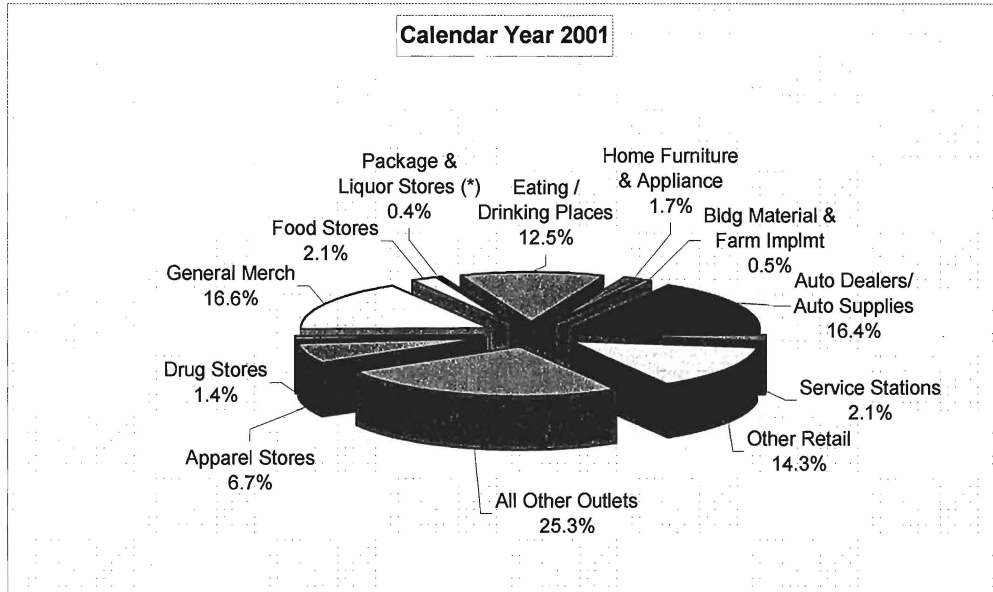


Fiscal Year	County of Santa Clara	School Districts	Total
1993	1.0290	0.0030	1.0320
1994	1.0310	0.0000	1.0310
1995	1.0330	0.0000	1.0330
1996	1.0340	0.0030	1.0370
1997	1.0340	0.1210	1.1550
1998	1.0388	0.0764	1.1152
1999	1.0388	0.0757	1.1145
2000	1.0319	0.0740	1.1059
2001	1.0356	0.0771	1.1127
2002	1.0364	0.0727	1.1091

Source: County of Santa Clara, Tax Rates and Information

City of Palo Alto- Taxable Transactions by Type of Business.....

Taxable Transactions by Type of Business
Last Nine Fiscal Years (\$millions)



RETAIL STORES

Calendar Year	Apparel Stores	Drug Stores	General Merch	Food Stores	Package & Liquor Stores (*)	Eating / Drinking Places	Home Furniture & Appliance	Bldg Mtrl & Farm Implmt	Auto Dirs., Auto Supplies	Service Stations	Other Retail	Retail Stores Total (*)	All Other Outlets	Total All Outlets
1992	\$790	\$120	\$2,010	\$340	\$30	\$1,250	\$340	\$80	\$790	\$270	\$1,470	\$7,490	\$5,030	\$12,520
1993	900	110	2,030	280	30	1,310	360	70	790	280	1,570	7,730	4,860	12,590
1994	980	110	2,110	270	30	1,340	360	80	940	270	1,630	8,120	4,820	12,940
1995	890	110	2,290	270	40	1,510	400	120	1,290	280	1,780	8,980	5,570	14,550
1996	970	110	2,450	290	40	1,650	430	160	1,570	320	1,860	9,850	5,420	15,270
1997	990	210	2,820	340	40	1,960	330	80	1,930	280	1,690	10,670	5,880	16,550
1998	1,010	140	2,760	350	50	2,060	320	60	2,260	240	1,870	11,120	5,540	16,660
1999	1,150	170	2,870	350	60	2,280	360	60	2,610	300	2,080	12,290	6,450	18,740
2000	1,300	230	3,110	370	60	2,500	370	60	3,330	330	2,560	14,220	7,130	21,350
2001	1,111	232	2,745	349	63	2,057	278	89	2,705	350	2,356	12,335	4,184	16,519

* Amounts represent totals or categories less than one tenth of one percent and are not displayed in the charts above

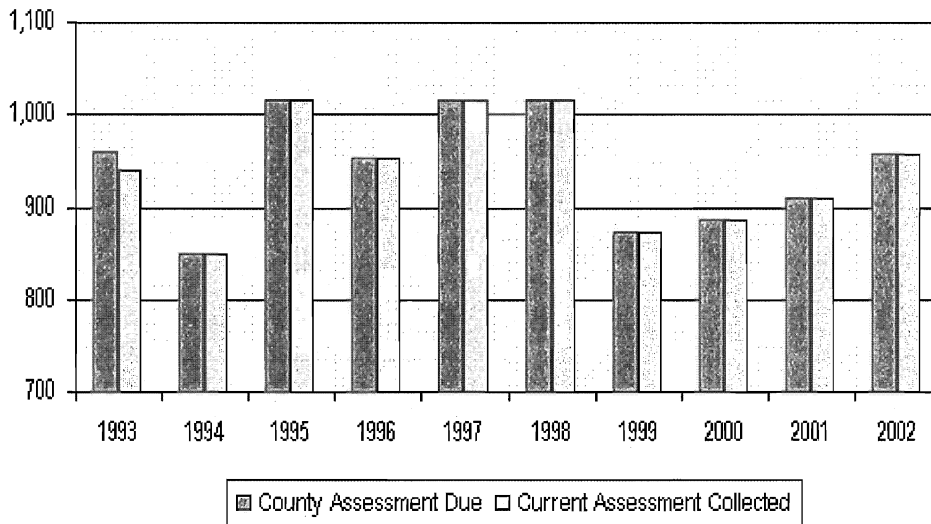
**SALES TAX RATES FOR THE
 CALENDAR YEAR ENDED DECEMBER 31, 2001**

State General Fund	5.75%
County Transportation Fund (Transportation Development Act)	0.25%
County Transportation Fund	1.00%
City	1.00%

Source: California State Board of Equalization 8.00%

City of Palo Alto - Special Assessment Billings and Collections.....

Last Ten Fiscal Years (\$000)



Fiscal Year	County Assessment Due	Current Assessment Collected	Delinquent & Penalties Collected	Special Assessment Billings and Collections
1993	959	939	11	950
1994	850	850	14	864
1995	1,016	1,016	(A)	1,016
1996	952	952	(A)	952
1997	1,016	1,016	(A)	1,016
1998	1,015	1,015	(A)	1,015
1999	874	874	(A)	874
2000	887	887	(A)	887
2001	910	910	(A)	910
2002	958	958	(A)	958

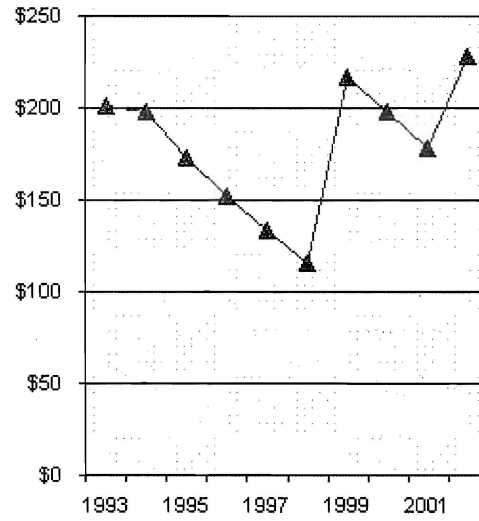
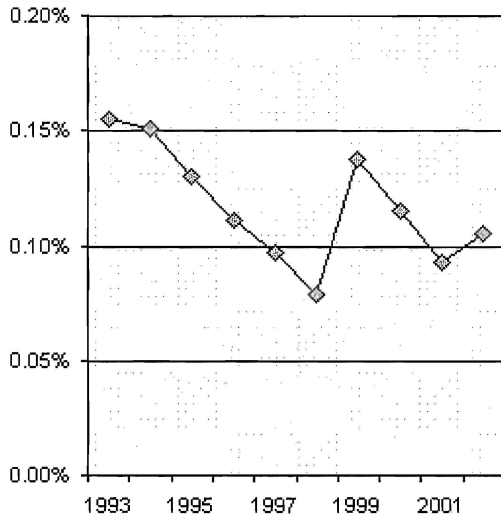
Source: County of Santa Clara Assessor's Office

Notes: Effective with the fiscal year 1993-94, the City is on the Teeter Plan, under which the County of Santa Clara pays the full tax levy due. Payment for all prior delinquencies was also received in this fiscal year.

**City of Palo Alto - Ratio of Net General Obligation
Bonded Debt to Assessed Value and Net General Obligation**

Bonded Debt per Capita

Last Ten Fiscal Years



—◇— Net Bonded Debt to Assessed Valuations

—▲— Net Bonded Debt Per Capita

Fiscal Year	Population	Assessed Value (in Thousands)	Bonded Debt (in Thousands)	Net Bonded Debt to Assessed Valuations	Net Bonded Debt Per Capita
1993	57,300	7,443,688	11,541	0.155%	201.41
1994	58,100	7,592,131	11,498	0.151%	197.90
1995	58,580	7,795,396	10,103	0.130%	172.47
1996	58,500	8,058,927	8,916	0.111%	152.41
1997	59,900	8,206,532	7,981	0.097%	133.24
1998	60,500	8,885,623	7,026	0.079%	116.13
1999	61,200	9,623,868	13,271	0.138%	216.85
2000	61,500	10,533,778	12,162	0.115%	197.76
2001	60,835	11,609,915	10,813	0.093%	177.74
2002	60,487	13,102,696	13,779	0.105%	227.80

City of Palo Alto - Computation of Legal Debt Margin.....
June 30, 2002
(in thousands of dollars)

2001-2002 Assessed Valuation	<u><u>13,102,696</u></u>
Debt limit - 15% of assessed value	1,965,404
Amount of debt applicable to debt limit:	
Certificates of participation	13,695
Capital lease obligations	84
Special assessment debt with governmental commitment	<u>595</u>
Total	14,374
 Less amount of debt not applicable to debt limit	 <u>0</u>
 Total amount of debt applicable to debt limit	 <u>14,374</u>
 Legal debt margin	 <u><u>1,951,030</u></u>

- Note** (1) The above does not include debt recorded in the Enterprise Funds because such debt is not subject to legal debt margin
- (2) Special assessments debt excludes Cambridge Ave. parking debt because there is no government commitment (\$1,620)

City of Palo Alto - Computation of Direct and Overlapping Bonded Debt.....

June 30, 2002 (\$000)

2001-2002 Assessed Valuation	\$13,102,696	
		June 30, 2002 Bonded Debt
	Percentage Applicable To City of Palo Alto	
Direct and Overlapping Bonded Debt		
OVERLAPPING TAX AND ASSESSMENT DEBT:		
Santa Clara County Flood Control and Water Conservation District, Zone W-1	0.554	\$45
Foothill-De Anza Community College District	22.415	22,069
Palo Alto Unified School District	89.058	114,248
Fremont Union High School District	0.009	8
Mountain View-Los Altos Union High School District	1.193	585
Cupertino Union School District	0.007	7
Los Altos School District	0.978	831
Whisman School District	4.861	1,455
City of Palo Alto Special Assessment Bonds	100.000	46,810
Midpeninsula Regional Open Space Park District	-	0
Total Overlapping tax and assessment debt		186,058
DIRECT AND OVERLAPPING GENERAL FUND OBLIGATION DEBT:		
Santa Clara County General Fund Obligations	7.616	36,421
Santa Clara County Board of Education Certificates of Participation	7.616	1,409
Foothill-DeAnza Community College District Certificates of Participation	22.415	6,058
Mountain View-Los Altos Union High School District Certificates of Participation	1.193	58
Cupertino Union School District Certificates of Participation	0.007	1
City of Palo Alto General Fund Obligations	100.000	13,695
Midpeninsula Regional Open Space Park District Certificates of Participation	13.223	14,626
Santa Clara Valley Water District Certificates of Participation	7.616	15,201
El Camino Hospital District Authority	0.146	2
Total gross direct and overlapping General Fund obligation debt		87,471
Less: El Camino Hospital Authority (100% self-supporting)		2
Total net direct and overlapping General Fund obligation debt		87,469
GROSS COMBINED TOTAL DEBT		273,529⁽¹⁾
NET COMBINED TOTAL DEBT		\$273,527

(1) Excludes tax and revenue anticipation notes, revenue, mortgage revenue and tax allocation bonds and non-bonded capital lease obligations.

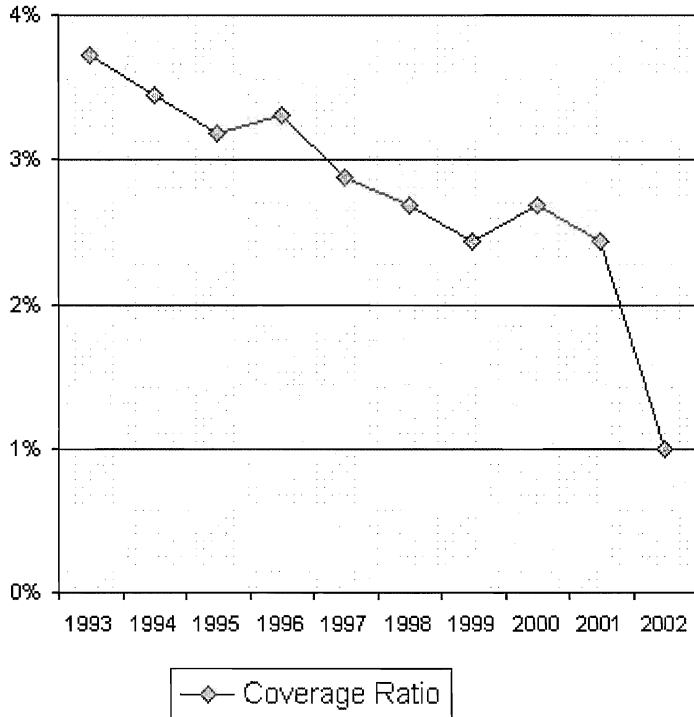
Ratios to Assessed Valuation:

Combined Direct Debt (\$13,695)	0.10%
Total Overlapping Tax and Assessment Debt	1.42%
Gross Combined Total Debt	2.09%
Net Combined Total Debt	2.09%
STATE SCHOOL BUILDING AID REPAYABLE AS OF 6/30/02:	\$0

SOURCE: California Municipal Statistics, Inc.

City of Palo Alto - Ratio of Annual Debt Service Expenditures for General Bonded Debt to Total General Expenditures.....

Last Ten Fiscal Years (\$000)



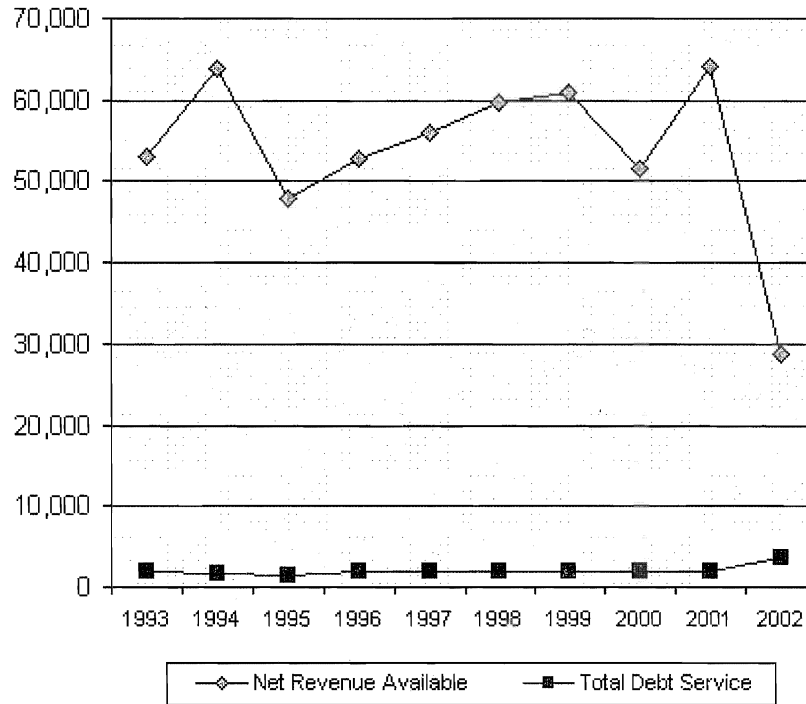
Fiscal Year	Total		Debt Service		Coverage Ratio
	General Expenditures (1)	Principal	Interest	Total	
1993	\$68,357	\$1,274	\$1,267	\$2,541	3.72%
1994	74,744	1,305	1,264	2,569	3.44%
1995	75,650	1,245	1,170	2,415	3.19%
1996	75,250	1,365	1,125	2,490	3.31%
1997	80,402	1,355	964	2,319	2.88%
1998	85,574	1,405	888	2,293	2.68%
1999	103,050	1,553	956	2,509	2.43%
2000	104,153	1,775	1,026	2,801	2.69%
2001	115,872	1,895	922	2,817	2.43%
2002	116,800	465	686	1,151	0.99%

Note: (1) Includes general, special revenue, debt services and capital project funds

City of Palo Alto -Revenue Bond Coverage.....

**Water, Electric, Gas, Wastewater Collection
Wastewater Treatment, and Storm Drainage Funds**

Last Ten Fiscal Years (\$000)

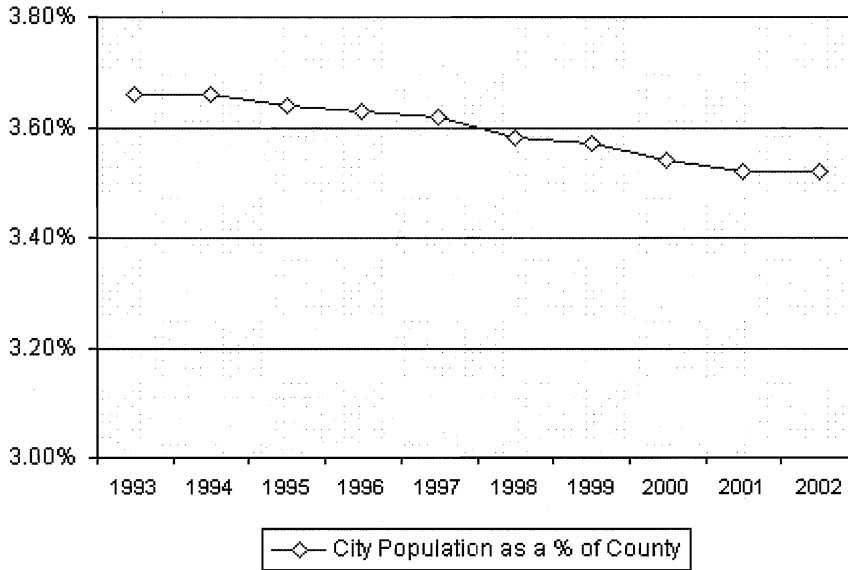


Fiscal Year	Gross Revenue	Direct Operating Expenditures (1)	Net Revenue Available for Debt Services (2)	Debt Service			Coverage
				Principal	Interest	Total	
1993	119,274	66,212	53,062	735	1,159	1,894	28.02
1994	132,317	68,371	63,946	875	945	1,820	35.14
1995	124,537	76,693	47,844	555	997	1,552	30.83
1996	120,828	68,096	52,732	755	1,308	2,063	25.56
1997	133,081	77,107	55,974	801	1,263	2,064	27.12
1998	144,195	84,415	59,780	840	1,214	2,054	29.10
1999	141,696	80,748	60,948	895	1,163	2,058	29.62
2000	130,550	78,880	51,670	545	1,363	1,908	27.08
2001	197,022	133,012	64,010	555	1,342	1,897	33.74
2002	177,334	148,697	28,637	1,955	1,660	3,615	7.92

Notes: (1) 1993-94 excludes electric rebate.
(2) Excludes depreciation and amortization expense.

City of Palo Alto - Demographic Statistics.....

Last Ten Fiscal Years (\$000)

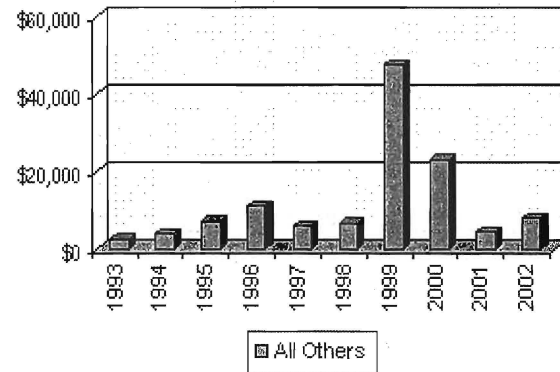
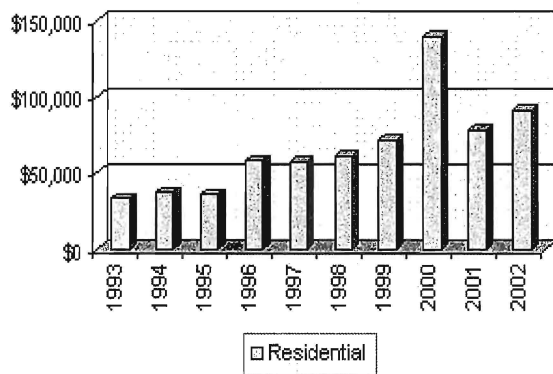
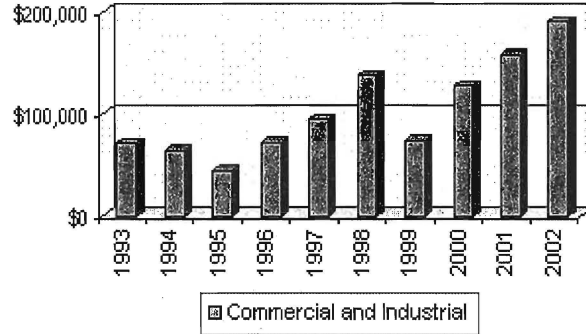


Fiscal Year	City Size Square Miles	Street Miles	City Population	(1) County Population	City Population % of County	(2) School Population	(3) Unemployment Rate
1993	25.98	193.12	56,300	1,563,800	3.66%	7,970	3.04%
1994	25.98	193.12	56,700	1,587,800	3.66%	8,334	3.30%
1995	25.98	193.12	56,700	1,607,700	3.64%	8,419	2.80%
1996	25.98	193.12	57,000	1,612,300	3.63%	9,122	1.90%
1997	25.98	193.12	57,800	1,653,100	3.62%	9,407	1.50%
1998	25.98	193.12	57,900	1,689,900	3.58%	9,719	1.50%
1999	25.98	193.12	58,300	1,715,400	3.57%	9,946	1.70%
2000	25.98	193.12	58,500	1,736,700	3.54%	9,881	1.50%
2001	25.98	193.12	60,200	1,728,680	3.52%	10,031	2.40%
2002	25.98	193.12	60,500	1,719,565	3.52%	9,952	3.70%

Sources: (1) State Department of Finance
 (2) Palo Alto Unified School District.
 (3) State Employment Development Office

City of Palo Alto - Construction Activity

Last Ten Fiscal Years (\$000)



Fiscal Year	Commercial & Industrial		Residential		All Other		
	Property Values	Number of Permits	Valuation	Number of Permits	Valuation	Number of Permits	Valuation
1993	\$7,443,688	395	\$71,167	1,079	\$33,065	65	\$2,506
1994	7,592,131	400	74,001	1,081	37,284	96	3,823
1995	7,795,396	384	44,471	1,032	35,563	72	7,055
1996	8,058,927	410	72,271	1,194	58,262	89	11,052
1997	8,206,532	377	94,485	1,095	57,617	106	5,874
1998	8,885,623	374	136,761	1,154	61,316	80	6,704
1999	9,623,898	330	73,462	1,167	71,989	106	47,325
2000	10,533,778	428	127,107	1,113	137,674	371	23,113
2001	11,609,915	820	157,088	2,599	78,345	25	4,200
2002	13,102,696	690	189,698	2,498	91,416	1	8,000

Sources: City of Palo Alto: Planning and Community Environment Department

City of Palo Alto - Insurance Coverage.....

June 30, 2002 (\$000)

TYPE	COVERAGE (Deductible)	LIMITS	COMPANY	DATE
PROPERTY LOSS				
Blanket	All real & personal property (\$25,000 deductible)	\$187,665,012	CA Public Entity Property Program	07/01/02
Boiler & Machinery	All real & personal property (\$50,000 deductible)	\$100,000 combined limit excluding power generation facilities \$50,000,000 business interruption	CA Public Entity Property Program	07/01/02
Flood Insurance	All real property 1305 Middlefield Road (\$1000 deductible)	\$500,000	South Carolina Insurance Company	04/07/03
FINANCIAL LOSS				
Employee Blanket	Position bond-faithful performance per loss (\$5,000 deductible)	\$1,000,000 / \$4,000,000 x \$1,000,000 per occurrence for City Mgr. & Director of ASD	Fidelity & Deposit Co.	03/22/04
Trustees Errors and Omissions	Trustees errors and omissions	\$19,500,000	Insurance Company of Pennsylvania	07/01/03
UMBRELLA EXCESS	City is a member of an insurance pool participating with a number of other California cities (\$50,000 self-insured retention)	\$19,500,000 / \$10,000,000 per occurrence	Insurance Company of Pennsylvania	07/01/03
SPECIAL LIABILITY				
Volunteers Accident	Each occurrence Medical - Each person / (\$25 deductible)	\$20,000	American National Insurance Company	01/01/03
Special Events	Bodily injury	\$1,000,000 per occurrence	General Star Indemnity Company	01/01/03
AUTOMOBILE LIABILITY				
City Manager Vehicle Only	Physical Damage (\$1,000 deductible comp. collision)	\$1,000,000	Progressive Com. Vehicle Insurance	04/11/03
Utility Director Vehicle	Physical Damage (\$1,000 deductible comp. Collision)	\$1,000,000	Progressive Com. Vehicle Insurance	04/11/03
EMPLOYEE BENEFIT				
Travel Accident	Indemnity, based on salary	\$1,500,000 per accident	Life Insurance Co. of North America	06/01/03
EMPLOYEE HEALTH PLAN				
	The City participates in the California Public Employees' Medical and Health Care Act (PEMHCA) program to provide medical benefits to employees and retirees			
WORKERS' COMPENSATION				
	City is self-insured for first \$500,000 of liability	\$500,000 per occurrence		07/01/03
EXCESS WORKERS' COMPENSATION				
	Excess Workers' Compensation	\$25,000,000 limit per accident	Employers' Reinsurance Corporation	07/01/03
	Employers Liability	\$2,000,000 employers' liability		

SOURCE: Joe Schreckenghaust, Human Resources Dept, City of Palo Alto

City of Palo Alto - Top Ten Property Taxpayers.....

June 30, 2002 (\$000)

Taxpayer	Type of Business	Assessed Valuation	Percent of Total Assessed Valuation
Leland Stanford Jr. University	University and Ancillary	\$1,955,683	17.19%
Space Systems/Loral, Inc.	Research and Development	187,824	1.65%
Agilent Technologies	Communications and Life Science	81,317	0.71%
Embaracadero Place Associates	Offices, Banks and Clinics	76,500	0.67%
Sun Microsystems, Inc,	Computers and Electronics	73,970	0.65%
Harbor Investment Partners	Offices, Banks and Clinics	58,026	0.51%
California Pacific Commercial Corp.	Offices, Banks and Clinics	50,657	0.45%
Cowper-Hamilton Associates	Offices, Banks and Clinics	40,361	0.35%
529 Bryant Street	Offices, Banks and Clinics	36,250	0.32%
Pacific Hotel Development Venture	Offices, Banks and Clinics	35,067	0.31%
Totals		\$2,595,655	22.81%

2001/2002 Local Secured Assessed Valuation:

\$11,379,838

SOURCE: County of Santa Clara, Center for Urban Analysis

City of Palo Alto - Miscellaneous Statistics.....

June 30, 2002

YEAR CITY DISCOVERED	1769	NUMBER OF HOUSING UNITS	26,841
DATE OF INCORPORATION	April 16, 1894	COMMERCIAL AND INDUSTRIAL SPACE	27.3 Million Square Feet
INCORPORATED AS CHARTER CITY	July 1, 1909	LAND AREA	25.98 Square Miles
FORM OF GOVERNMENT	Council-Manager	CITY MAINTAINED TREES	37,941
POPULATION	60,500		

POLICE PROTECTION

Number of Stations	1
Number of Full-time Positions	176
Number of Police Patrol Vehicles	33

MUNICIPAL UTILITY PLANTS:

FIRE PROTECTION

Number of Stations	8
Number of Full-time Positions	129
Number of Fire Apparatus	25
Number of Fire Hydrants	1,741

WATER

Millions of CCF Sold	5.9
Accounts	19,437
Miles of Water Mains	226

WASTEWATER

Millions of Gallons Processed	8,699
Accounts	21,772
Miles of Sanitary Sewer Lines	202

COMMUNITY SERVICES

Acres - Downtown Parks	170
Acres - Open Space	3,731
Parks	34
Golf Course	1
Tennis Courts	52
Athletic Center	1
Community Centers	4
Theatres	3
Cultural Centre	1
Junior Museum - Zoo	1
Swimming Pools	1
Nature Centers	2
Libraries	6

ELECTRIC

Millions of kWh Sold	997
Accounts	28,348
Pole Miles of Overhead Lines	227
Trench Miles of Underground Lines	186

GAS

Millions of Therms Sold	33.7
Accounts	23,116
Miles of Gas Mains	207



Single Audit Index

Summary of Findings and Questioned Costs CPA Letter

Schedule of Expenditures of Federal Awards 137

Notes to Schedule of Expenditures of Federal Awards..... 139

Report on Compliance and on Internal Control
Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance
With Government Auditing Standards CPA Letter

Report on Compliance and Internal Control
Over Compliance Applicable to Each Major
Federal Award Program..... CPA Letter



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Single Audit Section

This section provides an overview of grant awards received from the Federal government. The Single Audit Act Amendments of 1996 require local governments to report and audit Federal funds separately from their Basic Financial Statements.

SUMMARY OF FINDINGS AND QUESTIONED COSTS

Honorable Mayor and Members of the
City Council of the City of Palo Alto, California

We have audited the basic financial statements of the City of Palo Alto, California, for the year ended June 30, 2002 and have issued our unqualified report thereon dated October 31, 2002. These basic financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America; *Government Auditing Standards*, issued by the Comptroller General of the United States and the Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non profit Organizations*. We performed a Single Audit as requested by the City to comply with the provisions of the Single Audit Act Amendments of 1996 and OMB A-133 and are required to present the following summary:

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Audit of Basic Financial Statements

Our audit did not disclose any reportable conditions, or material weaknesses or instances of noncompliance material to the basic financial statements. However we did communicate matters to the City Council in our separate Memorandum on Internal Controls dated October 31, 2002.

Audit of Major Programs

Our audit did not disclose any reportable conditions or material weaknesses in internal controls over major programs. We have issued an unqualified opinion on compliance with the requirements applicable to major programs.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)

Identification of Major Programs

The Department of Housing and Urban Development Community Development Block Grant (CFDA #14.218) was a major program.

Dollar Threshold Used to Distinguish Between Type A and Type B Programs

The threshold for Type A programs was \$300,000.

Organizational Risk Evaluation

The City was assessed as a low risk auditee based on prior years reporting results, our overall knowledge of the City and other criteria specified by the Office of Management and Budget.

FINDINGS RELATED TO FINANCIAL STATEMENTS

There were no findings required to be reported under Generally Accepted Government Auditing Standards.

FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARDS

There were no findings or questioned costs required to be reportable under OMB Circular A-133 section .510(a)

SUMMARY OF PRIOR YEAR FINDINGS

There were no findings in the prior year.

Mage + Associates

October 31, 2002



CITY OF PALO ALTO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2002

Program Name	Grantor/ Pass-Through Entity Grant Number	Catalog of Federal Domestic Assistance Number	Program Expenditures
Department of Housing and Urban Development			
Community Development Block Grant Program			
Program Expenditures	B-00-MC-06-0020	14.218	\$120,331
Subgrants:			
Mid Peninsula Citizens for Fair Housing			24,800
Emergency Housing Consortium			8,490
Catholic Charities- OMBUDSMAN			8,490
New Housing Development			18,739
Clara Mateo Alliance Shelter			28,750
Clara Mateo Alliance Family Shelter			12,000
Shelter Network Haven Housing			18,000
Palo Alto Housing Corporation:			
Information & Referral			21,707
Barker Counseling			22,745
Loans Receivable			<u>2,819,293</u>
Total CDBG Expenditures		14.218	3,103,345
HOME Investment Partnership Program Grant			
Loan Receivable		14.239	<u>1,000,000</u>
U.S. Department of Transportation, Highway Planning and Construction Grant (Passed through California Department of Transportation)	CML-5100	20.205	<u>32,671</u>
U.S. Department of Justice Local Law Enforcement Block Grant		16.592	<u>24,752</u>
TOTAL FEDERAL FINANCIAL AWARDS			<u><u>\$4,160,768</u></u>

See Notes to Schedule of Expenditures of Federal Awards



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NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Note 1

Reporting Entity

The financial statements of the City of Palo Alto and the Schedule of Expenditure of Federal Awards include the financial activities of the City as well the separate legal entities described below, since they are governed by the City Council sitting in a separate capacity or they provide services exclusively to the City.

The City's Basic Financial Statements include the financial activities of the City, the Palo Alto Regional Quality Control Plant, the Palo Alto Golf Course Corporation, and the Palo Alto Public Improvement Corporation, all of which are controlled by and dependent on the City. While these are separate legal entities, City Council serves in separate session as their governing body and their financial activities are integral to those of the City. Their financial activities have been aggregated and merged (termed "blended") with those of the City in the accompanying financial statements.

Financial statements for the above component units can be obtained from the City of Palo Alto, 250 Hamilton Avenue, Palo Alto, CA 94301.

The financial statements exclude the Palo Alto Cable Cooperative Franchise, as it is administered by a board separate from and independent of the City.

Note 2

Basis of Accounting

Basis of accounting refers to *when* revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus applied. All governmental funds and agency funds are accounted for using the modified accrual basis of accounting.

Expenditures of Federal Awards reported on the Schedule are recognized when incurred. An exception to this rule is expenditures of federal awards for loan programs. The City operates the Community Development Block Grant and HOME Investment Partnership loan programs under which it must insure participants maintain compliance with program requirements on an ongoing basis. OMB Circular A-133 section .205(b) requires that expenditures for the above programs include the balance of loans outstanding plus cash received from the program.

Note 3

Direct and Pass-Through Federal Awards

Federal awards may be granted directly to the City by the Federal granting agency or may be granted to other government agencies which pass-through federal awards to the City. The Schedule includes both of these types Federal award programs.

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**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Honorable Mayor and City Council
City of Palo Alto, California

We have audited the basic financial statements of City of Palo Alto as of and for the year ended June 30, 2002, and have issued our report thereon dated October 31, 2002. We conducted our audit in accordance with generally accepted auditing standards 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.

Compliance

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However we did communicate other matters to City Council in our separate Memorandum on Internal Controls dated October 31, 2002.

This report is intended for the information of the City Council, management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

Maze Associates

October 31, 2002

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REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM

Honorable Mayor and City Council
City of Palo Alto, California

Compliance

We have audited the compliance of the City of Palo Alto with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2002. The City's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the City's compliance with those requirements.

In our opinion, the City of Palo Alto complied in all material respects with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2002.

Internal Control Over Compliance

City management is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Report on Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of City of Palo Alto as of and for the year ended June 30, 2002, and have issued our report thereon dated October 30, 2002. Our audit was made for the purpose of forming an opinion on the basic financial statements of the City of Palo Alto taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. The information in that schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and in our opinion is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

This report is intended for the information of the City Council, management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

Mage + Associates

October 31, 2002