

City of Palo Alto, CA
**Comprehensive
 Annual Financial
 Report**
Fiscal Year Ended June 30, 2003





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City of Palo Alto
Office of the City Manager

Transmittal Letter

December 16, 2003

THE HONORABLE CITY COUNCIL
Palo Alto, California

Attention: Finance Committee

COMPREHENSIVE ANNUAL FINANCIAL REPORT
YEAR ENDED JUNE 30, 2003

Members of the Council and Citizens of Palo Alto:

Transmittal: The Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2003 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 60,465, is a largely built-out community in the heart of the Silicon Valley and Greater San Francisco areas. 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 Silicon Valley. With varied, stable employers such as Stanford University, the Palo Alto Medical Foundation, Roche Pharmaceuticals, and three hospitals, Palo Alto customarily has enjoyed an economic stability and diverse revenue base lacking in other cities. Since January 2001, however, the combination of a steep decline in the local technology industry, persistent weakness in the national economy, and instability in international affairs has impacted Palo Alto's economy. These events have caused high local unemployment rates and low consumer confidence undermining key revenue sources such as sales and transient occupancy taxes. Economic trends emerging in 2001-02 have continued unabated in 2002-03, causing further erosion in important City revenues.

The City has been proactive in dealing with its fiscal challenges. Based on projections in its annual long-range financial plan and vigilant monitoring of resources and expenses, the City has closed expected shortfalls in 2001-02, 2002-03, and in its 2003-04 budget. The City Manager has repeatedly engaged staff in a "Strengthening the Bottom Line" process whereby the City conducted across-the-board reviews of program and project budgets resulting in expenditure reductions and revenue enhancements 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 around 100,000. With a local workforce somewhat over 35,000, 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), 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 a weak local 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 nearly 9.0 percent in 2002-03. Palo Alto's unemployment rate increased from a low of 1.5 percent in 1999-00 to 4.4 percent in 2002-03. Job losses were driven primarily by dot.com closures and declining sales in the maturing technology sector. Reductions in force have repeatedly occurred from 2001-02 through 2002-03 at firms having a local and area presence. These include: Hewlett Packard/Compaq, Sun Microsystems, Siebel, Oracle, and Apple. A recent trend toward outsourcing high paying computer programming and other technical jobs to India and China also has contributed to the economic malaise.

Real Estate Market: Assessed property valuation has experienced solid growth since the early 1990s. In 2002-03 assessed valuation jumped almost 13 percent over the prior year to \$13.1 billion. While the Bay Area housing market has been a bright spot in the past several years, growth in valuation appears to be slowing. Santa Clara County forecasts relatively anemic growth of 3 percent in 2003-04. Commercial and high-end residential property values have declined given high vacancy rates and low demand, respectively. Changes in property tax receipts tend to lag economically sensitive sources such as sales taxes. Although Palo Alto's property values tend to remain relatively steady because of its school system and public amenities, rising mortgage rates and the weak job market will continue to exert pressure on valuation.

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 Palo Alto Unified School District (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 five libraries, four community centers, a cultural arts center, adult and children's theaters, a junior museum and zoo, 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 ninth consecutive year the City has received both of these awards and the current certificates appear immediately after the end of this transmittal letter. The 2002-03 CAFR also has 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.

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 must 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

Dena Mossar, *Mayor*

Bern Beecham, *Vice-Mayor*

Victor Ojakian

Jim Burch

Hillary Freeman

Judy Kleinberg

Yoriko Kishimoto

Nancy Lytle

Jack Morton

Finance Committee

Jack Morton, *Chair*

Bern Beecham

Hillary Freeman

Yoriko Kishimoto

Policy and Services Committee

Jim Burch, *Chair*

Judy Kleinburg

Nancy Lytle

Vic Ojakian

Council-Appointed Officers

City Manager

Frank Benest

City Attorney

Ariel-Pierre Calonne

City Clerk

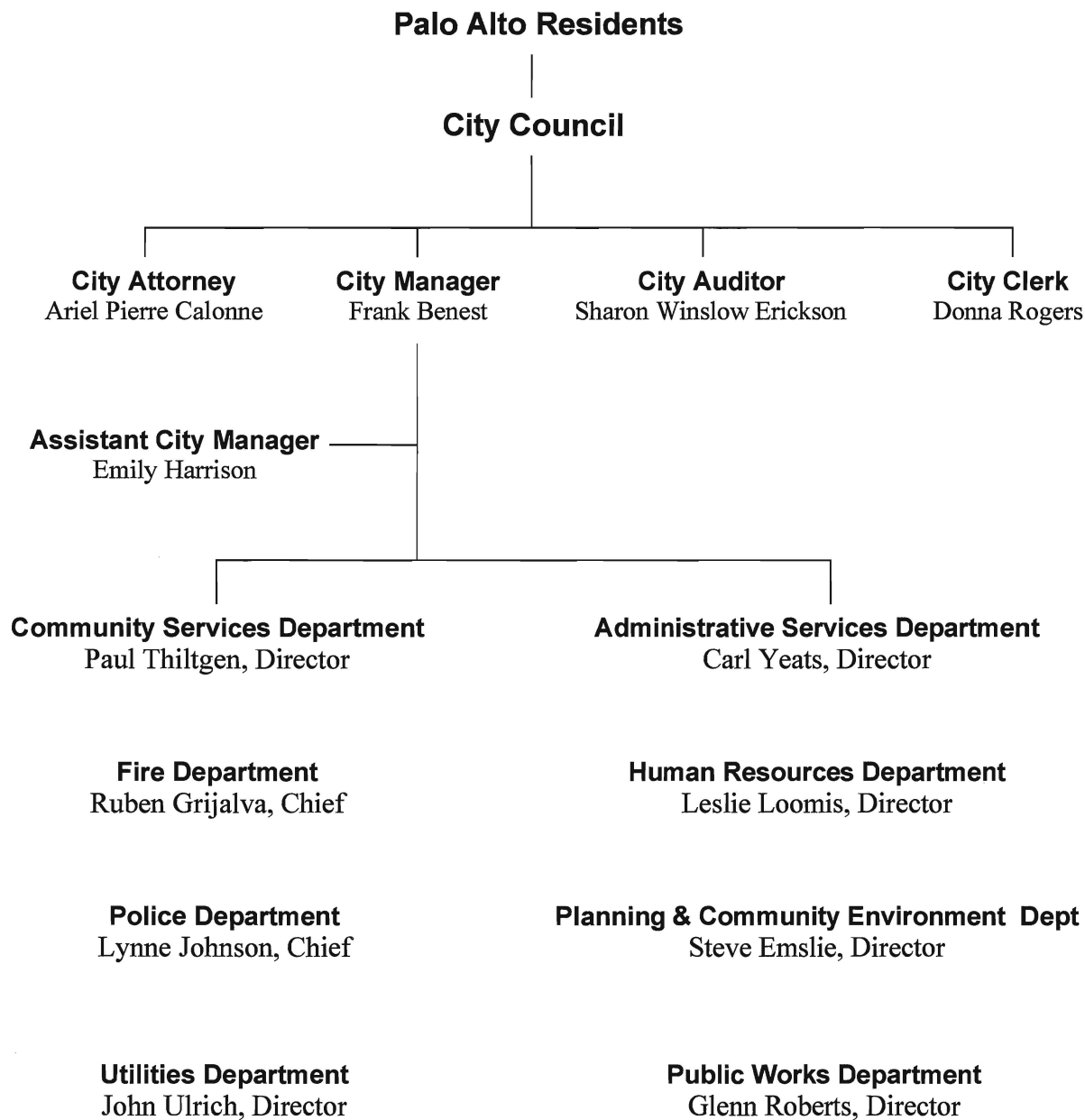
Donna Rogers

City Auditor

Sharon Winslow Erickson



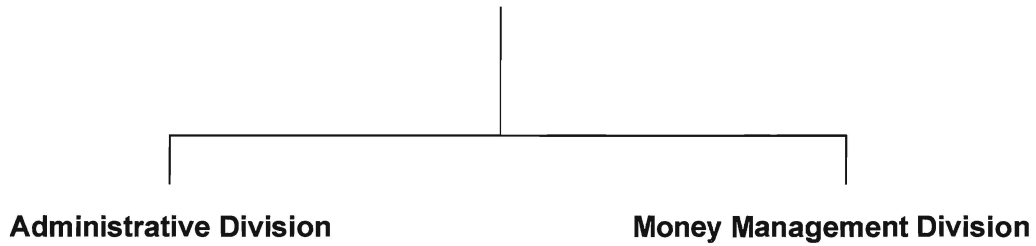
City of Palo Alto Organization





Administrative Services Organization

Administrative Services Department



Financial Support Services Division

Financial Planning & Analysis Division

Information Technology Division

Property Management Division

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, 2002

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.



President

Executive Director



California Society of Municipal Finance Officers - Award


**California Society of
Municipal Finance Officers**

Certificate of Award

Outstanding Financial Reporting 2001-2002

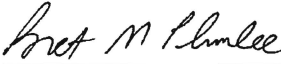
Presented to the

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 24, 2003



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 governmental activities, business-type activities, each major fund and the aggregate remaining fund information of the City of Palo Alto, California as of and for the year ended June 30, 2003, which collectively comprise the City's basic financial statements 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 financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Palo Alto, California as of June 30, 2003 and the respective changes in the financial position and cash flows, where applicable thereof and the respective budgetary comparisons listed as part of the basic financial statements for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued reports dated October 24, 2003 on our consideration of the City of Palo Alto's internal control structure and on its compliance with laws and regulations.

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

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The supplemental section listed in the Table of Contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information 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.

The Introductory and Statistical Sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly we express no opinion on them.

Maze & Associates

October 24, 2003

A Professional Corporation



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Management's Discussion and Analysis

With the 2002-03 Comprehensive Annual Financial Report (CAFR), the City will have implemented the provisions of Government Accounting Standards Board Statement 34 (GASB 34), "Basic Financial Statements – and Management's Discussion & Analysis – for State and Local Governments" for two consecutive years. GASB 34 required municipalities to make fundamental changes in accounting and reporting in an effort to make government financial performance clearer and more understandable to readers. GASB 34 has required the City to make substantial changes to its financial statement format. Moreover, the City must provide more detailed discussion and analysis of its financial activities, particularly in comparing results to the prior fiscal year and to the 2002-03 fiscal year budget. Other required changes will be described in the financial statements below. To obtain a complete picture of the City's financial condition, this document should be read in conjunction with the accompanying Transmittal Letter and Basic Financial Statements.

OVERVIEW OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORT

The CAFR is presented in six sections:

- An introductory section which includes the Transmittal Letter and general information;
- Management's Discussion and Analysis;
- The Basic Financial Statements which include the Citywide and Fund Financial Statements, along with the Notes to these statements;
- Supplemental Information;
- Statistical information; and
- Single Audit

Basic Financial Statements

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

The Citywide Financial Statements provide a longer-term view of the City's activities as a whole. They include the Statement of Net Assets and the Statement of Activities. The Statement of Net Assets includes the City's 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 the City's revenues and expenses on a full accrual basis, with an emphasis on measuring net revenues or expenses for 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.

The Fund Financial Statements display the City's operations in more detail than the Citywide statements. They focus primarily on the short-term activities of the City's General Fund and other major funds such as the Capital Projects Fund, Water Services Fund, Electric Services Fund, Gas Services Fund, Wastewater Collection Fund, Wastewater Treatment Fund, Refuse Services Fund, Storm Drainage Services Fund and External Services.

For certain entities and funds, the City acts solely as a depository agent. For example, the City has several Assessment Districts for which it provides fiduciary statements showing the cash balances and activities of these districts. These statements are separate from, and their balances are excluded from, the City's financial statements. Together, all these statements are called Basic Financial Statements.

Citywide Financial Statements

Governmental Activities - All of the City's basic services are considered to be governmental activities. These include the 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, and Redevelopment Agency separate legal entities financially accountable to the City.

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

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 2002-03, 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, such as Printing and Mailing services, may not be considered 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

Economic Background

The weak local and State economy experienced in 2001-02 persisted into 2002-03. Whereas the City and Santa Clara Valley, popularly known as Silicon Valley, experienced nine years of economic expansion prior to March 2001, they have undergone a significant downturn since that time. The technology sector was particularly hard hit by this slump causing a considerable reduction in economically sensitive City revenues such as sales and transient occupancy taxes. Silicon Valley lost 180,000 jobs or about 13.0 percent of net employment, which contrasts with average growth rates of around 3.9 percent in net employment from 1993-94 through 2000-01. Various factors contributing to the weak economy and loss of jobs include: the "dot-com" bubble, excessive telecommunications and high tech inventories, the September 2001 terrorist attacks, weak corporate profits, and the war in Iraq.

With unemployment rates in the County and State hovering around 8.5 and 6.7 percent, respectively, in 2002-03, there have been negative impacts on office, manufacturing and R & D vacancy rates; hotel occupancy rates; business to business and retail sales; and in commercial building activity. This has translated into lower receipts of sales taxes, planning, building and inspection fees, and lower utility income. The depth of the local downturn has prompted the City to implement cost containment measures for the 2003-04 fiscal year.

The comparisons in the discussion and analysis below are between 2002-03 and 2001-02. All increases and decreases are expressed relative to 2001-02 results. Fiscal year 2002-03 financial highlights include the following:

Citywide

- The City's total net assets increased to \$956.8 million, a \$47.4 million increase.
- The City's total capital assets, net of related debt, increased to \$559.2 million, a \$36.4 million increase.
- The City's total restricted net assets decreased to \$38.8 million, a \$19.7 million drop.
- The City's total unrestricted net assets increased to \$358.8 million, a \$30.7 million increase.
- Citywide revenues totaled \$309.0 million, a decrease of \$49.8 from the prior year. This total consists of \$218.2 million in program revenues and \$90.8 million in general revenues. Program revenues decreased by \$43.2 million while general revenues decreased by \$6.6 million.
- Total Citywide expenses were \$261.6 million, a \$32.6 million decrease.
- Citywide total assets increased to \$1,060.1 million, a \$32.2 million increase.
- Citywide capital assets, net of depreciation, increased by \$40.1 million to \$608.2 million.
- Citywide other assets decreased \$7.9 million to \$451.9 million.
- Citywide total liabilities were \$103.3 million, a decrease of \$15.2 million.
- Citywide long-term debt decreased \$2.1 million to \$59.5 million.
- Citywide other liabilities were \$43.8 million, a decrease of \$13.1 million.

Fund Level - Governmental Funds

- Governmental Fund balances decreased to \$125.6, a \$13.8 million change.
- Governmental Fund revenues decreased to \$103.9 million, a \$3.6 million drop.
- Governmental Fund expenditures were \$132.9, a \$16.1 million increase.
- General Fund revenues came in at \$96.3 million, a drop of \$1.9 million over prior year levels.
- General Fund expenditures are \$98.9 million, a drop of \$0.2 million.
- The General Fund balance of \$66.3 million at June 30, 2003 was an increase of \$2.9 million from the prior year.

Fund Level - Enterprise Funds

- Enterprise Fund net assets increased to \$510.1 million, a \$27.9 million increase.
- Enterprise Fund revenues decreased to \$187.7 million, down \$11.4 million from prior year revenues.
- Enterprise Fund expenses fell to \$151.5 million, a \$31.1 million decrease.

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</i>			
(in Millions)			
	2003	2002	Increase/ (Decrease) from 2002
Cash and investments	\$173.7	\$181.4	(\$7.7)
Other assets	23.5	22.0	1.5
Capital assets	293.0	266.9	26.1
Total Assets	490.2	470.3	19.9
Long-term debt outstanding	13.4	14.4	(1.0)
Other liabilities	29.9	29.8	0.1
Total Liabilities	43.3	44.2	(0.9)
Net assets:			
Invested in capital assets, net of debt	279.3	252.2	27.1
Restricted	37.2	56.8	(19.6)
Unrestricted	130.4	117.1	13.3
Total Net Assets	\$446.9	\$426.1	\$20.8

The City's governmental net assets increased \$20.8 million to \$446.9 million in 2002-03. This change results from the following:

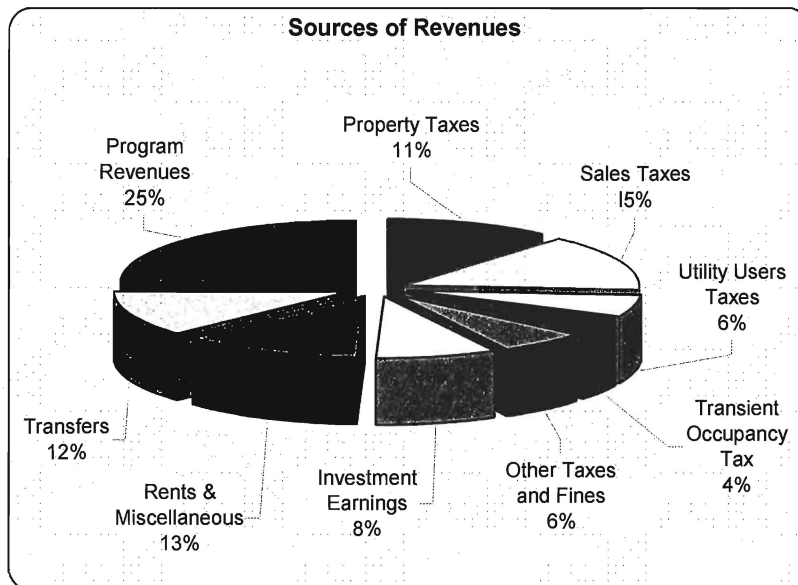
- Cash and investments decreased by \$7.7 million, this consists of cash outlays from fiscal agent cash of \$17.4 million to construct two new parking garages and an increase of \$8.0 million in Internal Service Funds cash balance.
- Capital assets increased \$26.1 million net of depreciation. \$23.6 million is a result of garage construction in the University Avenue Parking Assessment District.
- Net assets invested in capital assets net of related debt increased \$27.1 million as the City added two new parking garages and other General Fund infrastructure assets as discussed under the Capital Assets sections below.
- Restricted net assets decreased \$19.6 million. This decrease results from the prior year contribution from the University Avenue Parking Assessment District whose bond indenture restricted the use of bond proceeds.
- Unrestricted net assets of \$ 130.4 million, an increase of \$13.3 million, represent current net assets available to finance subsequent year operations and other expenditures approved by City Council.

GOVERNMENTAL ACTIVITIES
Revenues for the Year ended June 30
 (in Millions)

Revenues by Source	2003	2002	Increase/ (Decrease) from 2002
Program revenues:			
Charges for services	\$25.4	\$24.2	\$1.2
Operating contributions & grants	4.5	5.6	(1.1)
Capital contributions & grants	0.6	32.4	(31.8)
Total program revenues	<u>30.5</u>	<u>62.2</u>	<u>(31.7)</u>
General revenues:			
Property Taxes	13.9	13.3	0.6
Sales Taxes	18.0	20.1	(2.1)
Utility User's Taxes	7.1	6.5	0.6
Transient Occupancy Tax	5.3	6.6	(1.3)
Other Taxes and Fines	7.3	6.2	1.1
Investment Earnings	10.2	10.6	(0.4)
Rents and Miscellaneous	15.3	18.5	(3.2)
Transfers	14.7	13.3	1.4
Total General Revenues	<u>91.8</u>	<u>95.1</u>	<u>(3.3)</u>
Total Revenues	<u>\$122.3</u>	<u>\$157.3</u>	<u>(\$35.0)</u>

Governmental Activities – Revenues

The table above shows that governmental revenues totaled \$122.3 million in 2002-03, a decrease of \$35.0 million compared to prior year revenues of \$157.3 million. The change primarily results from a \$31.8 million decrease in capital contributions and grants. Again, this is a reflection of bond proceeds received in 2001-02 for the new downtown parking garages. The remainder of the change, \$3.2 million, results from lower general revenues such as sales and transient occupancy taxes and rents.



Program revenues such as charges for services; operating grants and contributions; and capital grants and contributions are generated from or restricted to each activity. Program revenues include contributions from the University Avenue Off-Street Parking Assessment District as well as recurring resources.

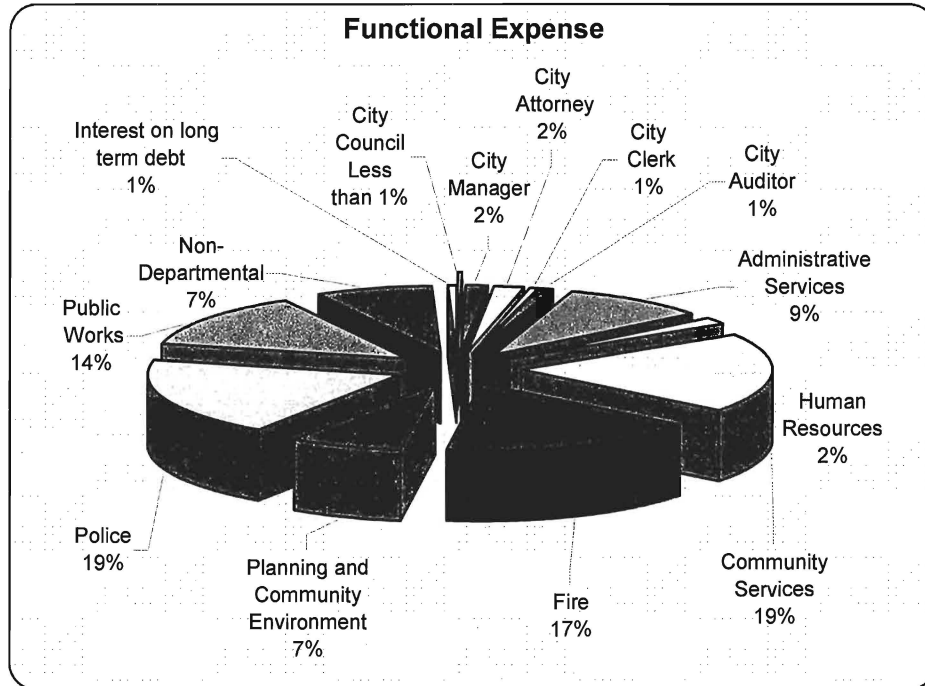
General revenues are composed of taxes and other revenues not specifically generated by or restricted to individual activities. All tax revenues, investment earnings, rents for governmental facilities, and fees for services are included in general revenues.

Governmental Activities - Expenses

The table below presents a comparison of 2002-03 and 2001-02 expenses (does not include encumbrances and reappropriations) by Governmental Activities and interest on long-term debt. Total Governmental Activities expense was \$101.6 million in 2002-03, a decline of \$4.6 million.

GOVERNMENTAL ACTIVITIES			
<i>Expenses for the year ended June 30</i>			
(in Millions)			
	<u>2003</u>	<u>2002</u>	<u>Increase/ (Decrease) from 2002</u>
City Council	\$0.2	\$0.2	
City Manager	1.5	1.8	(\$0.3)
City Attorney	2.0	2.4	(0.4)
City Clerk	0.6	0.6	
City Auditor	0.6	0.6	
Administrative Services	9.7	10.1	(0.4)
Human Resources	1.7	2.2	(0.5)
Public Works	13.7	15.7	(2.0)
Planning and Community Environment	7.5	7.3	0.2
Police	19.3	19.0	0.3
Fire	16.9	16.9	
Community Services	19.7	19.9	(0.2)
Non-Departmental	7.5	8.4	(0.9)
Interest on long-term debt	0.7	1.1	(0.4)
Totals	<u>\$101.6</u>	<u>\$106.2</u>	<u>(\$4.6)</u>

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 2002-03, the City added \$26.1 million in capital assets. The composition of 2002-03 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</i>			
(in Millions)			
	<u>2003</u>	<u>2002</u>	<u>Increase/ (Decrease) from 2002</u>
Cash and investments	\$233.5	\$231.8	\$1.7
Other assets	21.2	24.6	(3.4)
Capital assets	315.2	301.2	14.0
Total Assets	<u>569.9</u>	<u>557.6</u>	<u>12.3</u>
Long-term debt outstanding	46.1	47.2	(1.1)
Other liabilities	13.9	27.0	(13.1)
Total Liabilities	<u>60.0</u>	<u>74.2</u>	<u>(14.2)</u>
Net assets:			
Invested in capital assets, net of debt	279.9	270.6	9.3
Restricted	1.7	1.7	
Unrestricted	228.3	211.1	17.2
Total Net Assets	<u>\$509.9</u>	<u>\$483.4</u>	<u>\$26.5</u>

The City's Business-type net assets increased \$26.5 million to \$509.9 million in 2002-03.

- Cash and investments increased \$1.7 million as a result of operations.
- Other assets decreased \$3.4 million to \$21.2 million as a result of Electric Fund and Gas Fund accounts receivable decreases of \$2.4 million.
- Capital assets increased \$14.0 million to \$315.2 million in 2002-03. This increase is primarily a result of electric and gas infrastructure improvements totaling \$9.0 million.
- Repayments reduced long-term debt \$1.1 million to \$46.1 million. No debt was issued in 2002-03.
- Net assets invested in capital assets net of related debt increased \$9.3 million to \$279.9 million. This rise in assets was caused by \$4.3 million of improvements in the Electric Fund and \$4.7 million in Gas Fund improvements.
- Unrestricted net assets of \$228.3 million, an increase of \$17.2 million over the prior year, represent liquid assets available to finance day-to-day operations and other expenditures approved by the City Council. This amount includes such Council designated reserves as rate stabilization reserves of \$113.7 million, the Calaveras reserve for stranded costs of \$68.0 million and the emergency plant replacement reserve of \$6.5 million.

BUSINESS-TYPE ACTIVITIES			
(in Millions)			
Net (Expense) Revenue			
From Services			
	2003	2002	Increase/ (Decrease) from 2002
Water	\$4.4	\$3.3	\$1.1
Electric	17.9	(4.7)	22.6
Gas	7.4	12.9	(5.5)
Wastewater Collection	2.0	1.0	1.0
Wastewater Treatment	(0.8)	0.7	(1.5)
Refuse	(2.9)	(2.0)	(0.9)
Storm Drainage	(0.3)	0	(0.3)
External Services	0	0	0
Totals	\$27.7	\$11.2	\$16.5

The table above presents the net cost of each of the City's Business-type Activities or Enterprise Funds. The City operates the Water, Electric, Gas, Wastewater Collection, Wastewater Treatment, Refuse, Storm Drainage and External Services Enterprise Funds, which are major funds and are presented in the Basic Financial Statements. Net cost is defined as total program cost less the revenues generated by those specific activities.

Business-type Activities showing a total increase of \$16.5 million over 2001-02 were significantly affected by the following events:

- Net revenues in the Electric activity increased by \$22.6 million. This resulted from a series of settlements, pooling agreements and refunds from such entities as the City of Roseville, the Northern California Power Agency, and the Western Area Power Agency as well as from lower market prices for electricity.
- Net revenues in the Gas activity decreased by \$5.5 million in 2002-03 primarily due to a 26.7 percent rate decrease beginning July 1, 2002.

FUND FINANCIAL STATEMENTS

Performance of Governmental Funds

At June 30, 2003, the City's Governmental Funds reported combined fund balances of \$124.4 million, a decrease of \$15.0 million or 10.8 percent compared with the prior year. The decrease reflects the inclusion in 2001-02 of a significant contribution from the University Avenue Assessment District Agency Fund to the Capital Projects Fund. The year-to-year decrease was somewhat offset by a \$2.9 million increase in the General Fund balance.

Governmental Fund revenues and other financing sources decreased \$38.1 million for a total of \$135.7 million. Revenues and other financing sources in the Capital Project Fund decreased \$32.9 million as a result of the receipt of the Assessment District's bond proceeds in 2001-02. Non-major Fund revenues and other financing sources decreased by \$4.9 million, \$3.9 million is due to refinancing of long-term debt with proceeds received in 2001-02.

Governmental Fund expenditures and other uses increased \$15.6 million this year to \$150.7 million. Capital Projects Fund expenditures and other uses drove this increase growing by \$16.6 million with General Fund expenditures and other uses declining \$0.9 million and non-major fund expenditures and other uses dropping \$0.1 million. Once again, the increase in Capital Projects Fund expenditures is a result of parking garage construction.

General Fund – The General Fund ended the year with a \$2.9 million addition to fund balance, compared to \$2.4 million in the prior year. The \$2.9 million excess of revenues over expense consists of \$1.5 million in an unrealized gain on City investments; \$0.8 million resulting from a Utilities payment to an Equity Transfer Stabilization Reserve; and \$0.7 million from the City's ongoing "Strengthening the Bottom Line" (SBL) effort that began in 2001-02. The purpose of the SBL initiative was to close an estimated \$11.5 million budget gap by reducing operating expenses and enhancing revenues. The principal sources for the gap were significant declines in sales and transient occupancy tax revenues and rising salary and benefit costs. Although the City was successful in closing the gap in 2002-03, it continues to monitor its economically sensitive revenue sources and expenditures carefully.

In spite of key revenue declines, Palo Alto's General Fund revenues and other financing sources reached \$112.4 million in 2002-03, a modest decline of \$0.4 million. Revenues and other financing sources ended the year within 2.7 percent of the adjusted budget.

Sales tax, the City's largest revenue source, underwent a second year of decline in 2002-03, falling by \$2.1 million or 10.2 percent compared to the prior year. This high rate of decline caused the City to adjust its adopted budget for sales taxes at midyear downward from \$21.0 million to \$19.5 million. Because of rising unemployment, persistent and weak consumer confidence, ongoing weakness in the corporate sector, and a one-time prior year adjustment (\$0.5 million), sales tax at year-end came in \$1.5 million or 7.7 percent under the adjusted budget. The drop in sales tax receipts was spread among all economic segments and across all geographic areas within the City. Notable declines came in auto and department store sales and in the Stanford Shopping mall and the downtown business district.

Transient occupancy tax also fell for a second year declining by \$1.3 million or 19.4 percent compared to 2001-02. Once again, the City was forced at midyear to adjust the adopted budget of \$7.0 million downward by \$0.4 million. With occupancy and daily rates continuing to deteriorate for the remainder of the fiscal year, revenues totaled a weak \$5.3 million at year-end, \$1.3 million or 19.2 percent below the adjusted budget. Average vacancy rates dropped from 58.0 percent in 2001-02 to 54.0 percent in 2002-03. More significantly, average daily rates fell from \$136 to \$122 during the same period.

Two other revenue sources showed weakness in 2002-03: other revenues and charges for services. Other revenues were \$1.0 million or 10.8 percent below the adjusted budget and \$2.9 million or 25.9 percent below the prior year. The variance from budget was primarily due to lower interest income from sharply declining interest rates. The variance from 2001-02 results was due to a fall in interest income and the reflection of a one-time FEMA payment for a prior year claim in 2001-02 revenues.

Charges for services fell \$0.9 million below the adopted and adjusted budget levels for 2002-03 and were \$0.1 million above the prior year. Nearly half of the budget variance is a consequence of a delay in implementing a new component of the City's paramedic program, Basic Life Support (BLS) which is scheduled for implementation in 2003-04. The remaining difference is a consequence of lower than anticipated golf, zone plan checking, architectural review board and other fees that were negatively affected by the economy.

Somewhat offsetting the revenue declines were increases in other taxes and fines. These revenues came in \$1.5 million or 18.9 percent above the adopted budget and \$1.0 million or 11.4 percent above the adjusted budget. The primary reason for the variances was documentary transfer taxes that were \$0.6 million or 22.2 percent higher than the prior year. Several large and unexpected commercial transactions contributed to the positive results. The remainder of the variance was the result of motor vehicle license fee revenues exceeding budget and the prior year due to the timing of accruals.

With the second consecutive year of revenue declines, the City engaged in another across-the-board review of program and project budgets in 2002-03 to close an identified \$11.5 million gap. Building upon \$5.5 million in budget reductions made in the prior year, the City entered a second round of budget reduction and revenue enhancement efforts to offset continuing General Fund revenue declines. These included, for example, a voluntary furlough, a hiring freeze whereby more than 30 positions were held vacant, and a curtailment of contract services and material and supply expenditures. At year-end, salary and benefit savings were realized in nearly all City departments with major savings in Community Services (\$2.0 million), Administrative Departments (\$1.4 million), Police (\$1.0 million), Public Works (\$1.1) and Fire (\$0.9 million). Additional savings of \$1.6 million were found in contract services.

At June 30, 2003, the General Fund Balance totaled \$66.3 million. This represents 67.1 percent of direct General Fund expenditures, providing a buffer against unexpected financial events. Of this, \$8.2 million is reserved and \$58.1 is unreserved. A substantial portion of the unreserved amount is designated by the Council for budget stabilization, \$21.4 million at year-end; and infrastructure improvements, \$33.4 million at year-end. The equity transfer stabilization designation, established in 2001-02, totaled \$1.5 million at year-end. This reserve would be used in the event that the Electric or Gas Fund was unable to make its required equity transfer to the General Fund.

Based on its Long Range Financial Plan and consistent monitoring of revenues, the City has been proactive in aligning General Fund resources and expenditures. Due to restructuring efforts and increased reliance on technology, the City has reduced expenditures without, at this time, significantly impacting services to the public. Public safety, public works, planning, and cultural and community services have been maintained at solid levels despite the need to reduce costs. Maintenance of these service levels will depend heavily on State budget actions. Additional takeaways of sales tax, property tax, or vehicle fees will jeopardize service levels. In terms of liquidity or cash flow, the City is in a strong position at this time. As a full service City providing all utilities to the community, there is a steady cash flow to cover expenditures.

Capital Projects Fund – Capital Projects Fund expenditures and other uses were \$33.2 million in 2002-03, which is an increase of \$16.6 million from the prior year. This level of expenditure is consistent with the City's effort to rehabilitate and maintain its existing infrastructure and to construct two new downtown parking structures. Capital expenditures include \$18.4 million on the garages, \$5.4 million on streets and sidewalks, \$3.9 million on information technology needs. Other important expenditures include, for example, emergency generator replacements, park and facility improvements, library master planning efforts, traffic calming and bike lane improvements, and the Homer Avenue under crossing project.

Non-major Funds -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, 2003, the City's Enterprise Funds reported total net assets of \$510.1 million, an increase of \$27.9 million or 5.8 percent compared with last year. The Electric and Gas Funds contributed net assets of \$280.5 million and \$62.2, respectively, to total net assets. These assets constitute 67.1 percent of the Enterprise Funds' total net assets. Unrestricted net assets for these two funds total \$174.1 million, an \$18.2 million or 11.7 percent increase over 2001-02.

Water Fund – Revenue increased by \$1.7 million in 2002-03. The Water Fund ended the year with net income of \$3.0 million, compared to \$2.1 million in the prior year, a \$.9 million or 42.9 percent increase. The rise in net income is primarily due to a 20 percent rate increase effective July 1, 2002. There will be a series of rate increases to consumers in coming years as commodity costs rise to pay for major capital improvements related to the Hetch-Hetchy distribution system. Toward this end, the Water Fund's unrestricted net assets increased from \$15.9 million to \$18.4 million in 2002-03. Increases in this Fund's Rate Stabilization Reserve are designed to mitigate sharp price and rate changes.

Electric Fund – Operating revenues declined to \$91.6 million, a \$2.2 million drop from 2001-02. This decrease results from \$6.1 million in lower excess capacity (surplus energy) sales that, in turn, was offset by higher wholesale and other operating revenues. Lower excess capacity (surplus energy) sales resulted from less energy available for sale within the Northern California Power Agency (NCPA) pool and lower market prices. Wholesale revenues increased due to a one-time settlement payment related to Calaveras debt while other operating revenues increased due to Central Valley Project loan repayments and a prior year legal settlement.

Operating expenses declined from \$92.8 million in 2001-02 to \$67.1 in 2002-03, a significant drop of \$25.7 million. Approximately \$9 million of the decrease resulted from lower availability of surplus energy for sale within the NCPA pool, as previously explained. The remaining decline of \$16 million was a consequence of a pooling settlement agreement in a prior year and reliability charge refunds from the Western Area Power Administration (WAPA). Due to lower legal expenses in 2002-03, resource management expenses declined by \$2.2 million.

The Electric Fund ended the year with a net gain of \$18.4 million compared to a net loss of \$2.5 million in 2001-02.

Gas Fund – A 26.7 percent rate decrease for 2002-03 caused revenues to decrease by \$11.9 million compared to the prior year. In June 2001, Gas Fund rates increased 67 percent to cover dramatically increased commodity prices; hence the rate adjustment in 2002-03 as commodity prices fell. As gas prices and usage fell in 2002-03, commodity expenditure decreased by \$6.8 million. Year-end results show net income of \$5.4 million in 2002-03 compared to net income of \$10.8 million in 2001-02.

Wastewater Collection Fund - In 2002-03 collection rates increased by 25 percent. Compared to the prior year, revenues rose by \$1.4 million or 15.1 percent. Although operating costs rose by a slight \$0.1 million due to salary and benefit increases, commercial flows dropped as a consequence of the weak economy. Utility costs in this Fund declined by \$.3 million or 5.8 percent. Net income increased to \$2.5 million, a rise of \$0.8 million over 2001-02.

Wastewater Treatment Fund – Revenues decreased by \$0.4 million in 2002-03, while operating expenses increased by \$0.3 million. This increase was due to higher salary and benefit increases. The Fund ended the year with net loss of \$0.2 million, compared to a net gain of \$0.7 million in the prior year. Total net assets at year-end totaled a solid \$33.6 million.

Refuse Fund – Refuse operating revenues moved down a slight \$0.1 million in 2002-03. Lower commercial and building activity caused this decline. Operating and maintenance expenses rose by \$0.6 million due to higher salary and benefit costs. Rent decreased by \$0.5 million because of a one-time payment for deferred rent made in the prior year. The fund ended the year with a net loss of \$1.9 million, compared to a \$1.1 million loss in the prior year. Total net assets at year-end totaled \$16.7 million.

Storm Drainage Fund - The Storm Drainage Fund continues to experience a net loss before transfers due to insufficient revenue from existing fees. Supplemental funding from the General Fund is required in order to maintain the current level of service. In 2002-03, operating revenues remained stable at \$2.2 million. The Fund required a transfer of \$0.9 million from the General Fund to continue basic services and maintain water quality standards.

External Services Fund - Created in 2001-02, this Fund provides information technology and training services to neighboring municipalities and other community organizations. As part of the City's effort to enhance revenues, the Fund added three outside contracts in 2002-03. The Fund generated revenue and operating expenses of \$0.6 million in 2002-03 as it positions itself to expand services.

CAPITAL ASSETS

GASB 34 requires the City to record all its capital assets including infrastructure. Infrastructure includes roads, bridges, signals and similar assets used by the entire population. Although GASB 34 allowed the City four years to record all its infrastructure assets in its financial statements, as of June 30, 2002 all assets were included in the financial statements. The table below shows capital assets and the amount of accumulated depreciation for these assets for Governmental and Business-type Activities (further detail may be found in Note 6 to the financial statements).

CAPITAL ASSETS AT JUNE 30			
(in Millions)			
	<u>2003</u>	<u>2002</u>	<u>Increase/ (Decrease) from 2002</u>
Governmental Activities			
<i>Capital Assets</i>			
Land and improvements	\$67.8	\$67.8	
Street trees	15.8	16.0	(\$0.2)
Construction in progress	33.2	6.2	\$27.0
Buildings and improvements	54.0	53.8	\$0.2
Equipment	7.9	7.2	\$0.7
Roadway network	216.9	210.9	\$6.0
Recreation & open space network	7.8	6.6	\$1.2
Less accumulated depreciation	(120.8)	(114.1)	(\$6.7)
<i>Internal Service Fund Assets</i>			
Construction in progress	0.7	0.8	(\$0.1)
Equipment	26.0	26.6	(\$0.6)
Less accumulated depreciation	(16.3)	(14.9)	(\$1.4)
Total Governmental	<u>\$293.0</u>	<u>\$266.9</u>	<u>\$26.1</u>
Business-type Activities			
Land	\$1.5	\$1.5	
Construction in progress	57.9	64.9	(\$7.0)
Buildings and improvements	16.6	10.7	\$5.9
Transmission, Distribution & Treatment Systems	406.1	384.6	\$21.5
Less accumulated depreciation	(166.9)	(160.5)	(\$6.4)
Total Business-type	<u>\$315.2</u>	<u>\$301.2</u>	<u>\$14.0</u>

Governmental Activities capital assets net of depreciation, increased by \$26.1 million compared to 2001-02. Significant increases occurred in construction in progress (\$27.0 million) and in the roadway network (\$6.0 million). Construction activity is due to the building of two new downtown parking structures and roadway improvements rose as a consequence of the City's enhanced infrastructure efforts and additional State funding. Total Business-type activities capital assets net of depreciation, increased by \$14.0 million. Areas of increase included buildings and improvements and equipment. The increase in buildings and improvements consisted of \$5.9 million in the Storm Drainage Enterprise Fund. The change in transmission, distribution and treatment systems of \$21.5 million comprised mostly of \$16.0 million in the Electric Enterprise Fund and \$3.0 million in the Wastewater Treatment Enterprise Fund. These increases were somewhat offset by a \$7.0 million decrease in construction in progress. This decrease can be attributed to an increase in assets capitalized.

During 2002-03, Palo Alto's capital improvement projects focused on the rehabilitation and replacement of the City 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. At that time, a ten-year plan costing \$100 million was developed to deal with the backlogged and highest priority infrastructure projects. Since the beginning of the General Fund Infrastructure Program, the City has spent or encumbered \$16.4 million on infrastructure projects. Some of the key infrastructure projects include: streets and sidewalk improvements, a complete renovation at the Mitchell Community Park, refurbishing of park playground and irrigation systems, upgrading athletic fields, open space and trail improvements, facility lighting enhancements, traffic islands and medians, and facility improvements. A major study has been conducted to enhance City library facilities and considerable building system work is budgeted for the City's Civic Center.

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, 2003, the City's debt comprised:

LONG-TERM DEBT AT JUNE 30			
(in Millions)			
	2003	2002	Increase/ (Decrease) from 2002
Governmental Activity Debt:			
<i>General Long Term Obligations:</i>			
1998 Golf Course Certificates of Participation	\$6.2	\$6.6	(\$0.4)
2002A Civic Center Refinancing Certificates of Participation	3.2	3.5	(0.3)
2002B Downtown Parking Improvements Certificates of Participation	3.4	3.6	(0.2)
<i>Special Assessment Debt with City Commitment</i>			
1987 California Avenue Parking Bonds	0.5	0.6	(0.1)
	<u>13.3</u>	<u>14.3</u>	<u>(1.0)</u>
<i>Internal Service Long-Term Obligations:</i>			
Information Systems Capital Lease Obligations	0.1	0.1	
Total Governmental Activity Debt	<u>\$13.4</u>	<u>\$14.4</u>	<u>(\$1.0)</u>
Business-type Activity Debt:			
<i>Enterprise Long Term Obligations:</i>			
Utility Revenue Bonds			
1995 Series A	\$7.1	\$7.3	(\$0.2)
1999 Refunding	16.3	16.7	(0.4)
2002 Series A	24.0	24.7	(0.7)
Less: unamortized discount/issuance cost	(1.3)	(1.5)	0.2
Total Business-type Activity	<u>\$46.1</u>	<u>\$47.2</u>	<u>(\$1.1)</u>

The City did not issue new debt in 2002-03. Although there are discussions about long-term projects that may require debt financing, there are no immediate plans or needs to issue debt. As stated in the Statistical Section of the CAFR, the combined direct debt ratio to assessed valuation for the General Fund is a low 0.1 percent compared to the allowable, legal debt margin of 15 percent.

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 its 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.

Although the past two years have brought significant revenue challenges to the City's General Fund, it has made the necessary alignments in its cost structures to maintain solid reserves and sound financial management of its resources.

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, 2003, a total of \$0.5 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.

Throughout this analysis, references have been made to two new parking garages funded by University Avenue Off-Street Parking Assessment District Improvement Bonds. These bonds were issued in 2000-01 and in 2001-02 and the resulting debt is secured only by special assessments on the real property in the district issuing the debt. The debt is not the City's responsibility, although the City does act as these Districts' agent in the collection and remittance of assessments and has acted in the capacity of managing the construction project.

ECONOMIC OUTLOOK

The economy of the City is discussed in the accompanying Transmittal Letter and in this Discussion and Analysis.

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. This report and other financial reports can be viewed on the City of Palo website at: www.cityofpaloalto.org. On the home page, under "Browse by Topic" select City Departments, select Administrative Services. Within Administrative Services there are reports under "Finance" and there are links to reports by division (such as Purchasing or Budget).



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Citywide Statement of Net Assets and Statement of Activities

The Citywide Statement of Net Assets and the Statement of Activities are 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, 2003

(In thousands of dollars)

	Governmental Activities	Business-type Activities	Totals
ASSETS			
Cash and investments (Note 3)	\$154,611	\$221,030	\$375,641
Cash and investments with fiscal agents (Note 3)	19,111	12,495	31,606
Receivables:			
Accounts and intergovernmental	7,822	18,351	26,173
Interest receivable	2,012	2,917	4,929
Loans receivable (Note 5)	11,126		11,126
Internal balances (Note 4)	115	(115)	
Inventory of materials and supplies	2,391		2,391
Capital assets, net of depreciation (Note 6)	293,051	315,187	608,238
Total assets	490,239	569,865	1,060,104
LIABILITIES			
Accounts payable and accrued liabilities	5,582	7,429	13,011
Accrued salaries and benefits	3,188		3,188
Accrued compensated absences	11,863		11,863
Claims payable (Note 14)	9,253		9,253
Accrued landfill closure liability (Note 9)		6,446	6,446
Long-term debt (Notes 7 and 8)			
Due in one year	827	1,310	2,137
Due in more than one year	12,645	44,759	57,404
Total liabilities	43,358	59,944	103,302
NET ASSETS (Note 10)			
Invested in capital assets, net of related debt	279,306	279,885	559,191
Restricted for:			
Special revenue programs	21,478		21,478
Capital projects:			
Downtown parking structure	9,824		9,824
Other capital projects	3,550		3,550
Debt service	2,260	1,728	3,988
Restricted	37,112	1,728	38,840
Unrestricted net assets	130,463	228,308	358,771
Total net assets	\$446,881	\$509,921	\$956,802

See accompanying notes to financial statements

City of Palo Alto - Statement of Activities

For the Year Ended June 30, 2003

(In thousands of dollars)

Functions/Programs	Total Expenses	Program Revenues		Net (Expense) Revenue and Change in Net Assets		Total	
		Charges for Services	Grants and Contributions	Operating Grants and Contributions	Capital Grants and Contributions		Governmental Activities
Governmental Activities:							
City Council	\$234					(\$234)	(\$234)
City Manager	1,565					(1,565)	(1,565)
City Attorney	2,028	\$92				(1,936)	(1,936)
City Clerk	598	1				(597)	(597)
City Auditor	646	1				(645)	(645)
Administrative Services	9,723	406	\$3	\$14		(9,300)	(9,300)
Human Resources	1,728					(1,728)	(1,728)
Public Works	13,702	1,058	1,666	621		(10,357)	(10,357)
Planning and Community Environment	7,485	5,119	2,285			(81)	(81)
Police	19,273	3,396	413			(15,464)	(15,464)
Fire	16,859	7,811	9			(9,039)	(9,039)
Community Services	19,633	7,537	91			(12,005)	(12,005)
Non-Departmental	7,449		1			(7,448)	(7,448)
Interest on long-term debt	675					(675)	(675)
Total Governmental Activities	101,598	25,421	4,468	635	(71,074)		(71,074)
Business-type Activities:							
Water	13,237	17,654				\$4,417	4,417
Electric	73,744	91,622				17,878	17,878
Gas	22,270	29,714				7,444	7,444
Wastewater Collection	8,712	10,676				1,964	1,964
Wastewater Treatment	14,312	13,556				(756)	(756)
Refuse	24,635	21,691				(2,944)	(2,944)
Storm Drainage	2,489	2,192				(297)	(297)
External Services	583	605				22	22
Total Business-type Activities	159,982	187,710				27,728	27,728
Total	\$261,580	\$213,131	\$4,468	\$635	(71,074)	27,728	(43,346)
General revenues:							
Taxes:							
Property taxes					13,882		13,882
Sales taxes					18,041		18,041
Utility user's taxes					7,067		7,067
Transient occupancy tax					5,333		5,333
Other taxes and fines					7,275		7,275
Investment earnings					10,213	13,583	23,796
Rents and miscellaneous					15,333		15,333
Transfers					14,730	(14,730)	
Total general revenues and transfers					91,874	(1,147)	90,727
Change in Net Assets					20,800	26,581	47,381
Net Assets-Beginning					426,081	483,340	909,421
Net Assets-Ending					\$446,881	\$509,921	\$956,802

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 2002-03. 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, 2003

(In thousands of dollars)

	General	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
ASSETS				
Cash and investments (Note 3):				
Available for operations	\$58,764	\$21,021	\$11,770	\$91,555
Cash and investments with fiscal agent		17,475	1,636	19,111
Receivables				
Accounts and intergovernmental	6,307	384	615	7,306
Special Assessment			510	510
Interest receivable	1,101	4	161	1,266
Notes receivable (Note 5)	1,276		9,850	11,126
Interfund receivables and advances (Note 4)	553			553
Inventory of materials and supplies	2,027			2,027
	<u>\$70,028</u>	<u>\$38,884</u>	<u>\$24,542</u>	<u>\$133,454</u>
Total Assets				
LIABILITIES				
Accounts payable and accrued liabilities	\$1,178	\$2,805	\$266	\$4,249
Accrued salaries and benefits	2,313			2,313
Deferred revenue	75		510	585
Interfund payable and advances (Note 4)	155		538	693
	<u>3,721</u>	<u>2,805</u>	<u>1,314</u>	<u>7,840</u>
Total Liabilities				
FUND BALANCES				
Reserved for: (Note 10):				
Encumbrances	4,853	3,550	4,200	12,603
Downtown parking structure		9,614		9,614
Notes	1,276		9,850	11,126
Inventory of materials and supplies	2,027			2,027
Debt service			1,750	1,750
Debt proceeds		210		210
Unreserved, designated for:				
Unrealized gain on investments	1,533		207	1,740
Special revenue projects			7,393	7,393
Equity transfer stabilization	1,535			1,535
Reappropriations	312	22,705	94	23,111
Budget stabilization	21,395			21,395
Infrastructure	33,376			33,376
Undesignated, reported in Special Revenue Funds			(266)	(266)
	<u>66,307</u>	<u>36,079</u>	<u>23,228</u>	<u>125,614</u>
Total Fund Balances				
Total Liabilities and Fund Balances	<u>\$70,028</u>	<u>\$38,884</u>	<u>\$24,542</u>	<u>\$133,454</u>

See accompanying notes to financial statements



City of Palo Alto - Governmental Funds
Reconciliation of Fund Balances to Governmental Activities Net Assets
June 30, 2003

(In thousands of dollars)

Governmental fund fund balances from prior page \$125,614

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) 293,051

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. (Excludes capital assets reported above and debt reported below) 41,262

Accrual adjustment to remove deferred revenue from the balance sheet 585

Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds (Notes 7 & 8) (13,631)

Net assets of governmental activities \$446,881

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, 2003

(In thousands of dollars)

	General	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
REVENUES				
Property taxes	\$13,821			\$13,821
Special assessments			\$130	130
Sales taxes	18,041			18,041
Utility users' tax	7,067			7,067
Transient occupancy tax	5,333			5,333
Other taxes and fines	9,398		1,266	10,664
Charges for services	16,798			16,798
From other agencies	533	\$1,452	1,791	3,776
Permits and licenses	3,161			3,161
Investment earnings	5,490	406	856	6,752
Rental income	13,229			13,229
Other revenue	3,424	103	1,568	5,095
Total Revenues	96,295	1,961	5,611	103,867
EXPENDITURES				
Current operations:				
City Council	234			234
City Manager	1,630			1,630
City Attorney	2,113			2,113
City Clerk	655			655
City Auditor	660			660
Administrative Services	10,251			10,251
Human Resources	1,978			1,978
Public Works	9,858			9,858
Planning and Community Environment	7,721			7,721
Police	19,703		16	19,719
Fire	16,841			16,841
Community Services	19,793			19,793
Non-Departmental	7,442			7,442
Capital outlay		31,807	596	32,403
Debt service:				
Principal payments			875	875
Interest and fiscal fees			696	696
Total Expenditures	98,879	31,807	2,183	132,869
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(2,584)	(29,846)	3,428	(29,002)
OTHER FINANCING SOURCES (USES)				
Contribution from Assessment District (Note 8)		425		425
Transfers in (Note 4)	16,092	13,609	1,701	31,402
Transfers (out) (Note 4)	(10,634)	(1,410)	(4,559)	(16,603)
Total Other Financing Sources (Uses)	5,458	12,624	(2,858)	15,224
Net change in fund balances	2,874	(17,222)	570	(13,778)
Fund balances at beginning of year	63,433	53,301	22,658	139,392
Fund balances at end of year	<u>\$66,307</u>	<u>\$36,079</u>	<u>\$23,228</u>	<u>\$125,614</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, 2003 (In thousands of dollars)

Net change in fund balances-total governmental funds (\$13,778)

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 added back to fund balance

The capital outlay, net of retirements, are therefore deducted from fund balance 34,901

Depreciation expense is deducted from fund balance (Depreciation expense is net of Internal Service Fund depreciation of \$2,651 which has already been allocated to serviced funds.) (6,706)

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 Assets the repayment reduces long-term liabilities.

Fund balance is increased by the amount of debt repayment 875

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.

Other accruals 30

Deferred revenue (85)

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. 5,563

Change in net assets of Governmental Activities \$20,800

City of Palo Alto - General Fund

Statement of Revenues, Expenditures and Changes in Fund Balance
Budget and Actual - For the Year Ended June 30, 2003

(In thousands of dollars)

	Budgeted Amount		Actual Amount Budgetary Basis	Variance from Final Budget
	Adopted	Adjusted		Positive (Negative)
REVENUES				
Property taxes	\$13,536	\$13,644	\$13,821	\$177
Sales taxes	21,035	19,542	18,041	(1,501)
Utility users' tax	7,370	7,370	7,067	(303)
Transient occupancy tax	7,000	6,600	5,333	(1,267)
Other taxes, fines & penalties	7,903	8,440	9,398	958
Charges for services	17,730	17,750	16,801	(949)
Permits and licenses	3,319	3,319	3,162	(157)
Charges to other funds	11,827	11,913	11,521	(392)
Rental income	13,008	13,008	13,224	216
Other revenues	9,106	9,426	8,411	(1,015)
Transfers in	14,335	15,381	16,092	711
Prior year encumbrance and reappropriations		3,851	3,851	
Total Revenues	126,169	130,244	126,722	(3,522)
EXPENDITURES				
Current operations:				
Administrative Departments	19,300	21,311	19,885	1,426
Community Services	24,530	25,388	23,363	2,025
Fire	19,055	19,289	18,364	925
Planning and Community Environment	8,359	9,756	9,422	334
Police	21,888	22,442	21,430	1,012
Public Works	14,327	14,672	13,529	1,143
Non-Departmental	6,870	6,117	7,442	(1,325)
Transfers out	11,579	11,158	10,634	524
Total Use of Funds	125,908	130,133	124,069	6,064
EXCESS OF REVENUES - BUDGETARY BASIS	\$261	\$111	2,653	\$2,542
Adjustments to Budgetary Basis:				
Current year encumbrance/reappropriations			4,279	
Prior year encumbrance/reappropriations			(3,851)	
Stores adjustment, net			(207)	
EXCESS OF REVENUES - GAAP BASIS			2,874	
Fund balances at beginning of year			63,433	
Fund balances at end of year, GAAP basis			\$66,307	

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 2002-03.

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.

City of Palo Alto - Proprietary Funds

Statement of Net Assets - June 30, 2003

(In thousands of dollars)

	Business-type Activities			
	Water	Electric	Gas	Wastewater Collection
ASSETS				
Current Assets:				
Cash and investments (Note 3):				
Available for operations	\$16,782	\$145,791	\$19,973	\$11,395
Cash and investments with fiscal agent	6,068		6,177	
Accounts receivable, net	2,579	9,018	2,656	1,375
Interest receivable	221	1,925	265	139
Inventory of materials and supplies				
Total Current Assets	25,650	156,734	29,071	12,909
Noncurrent Assets:				
Interfund receivable (Note 4)				
Capital assets (Note 6)	40,448	127,918	47,489	45,424
Total Noncurrent Assets	40,448	127,918	47,489	45,424
Total Assets	66,098	284,652	76,560	58,333
LIABILITIES				
Current Liabilities:				
Accounts payable and accrued liabilities	1,201	4,135	1,367	374
Accrued salaries and benefits				
Interfund payable (Note 4)				
Current portion of revenue bonds (Note 7)	304		371	47
Current portion of capital lease (Note 7)				
Accrued claims payable - current (Note 14)				
Total Current Liabilities	1,505	4,135	1,738	421
Noncurrent liabilities:				
Accrued compensated absences - noncurrent (Note 1)				
Accrued claims payable - noncurrent (Note 14)				
Landfill closure and postclosure care (Note 9)				
Capital lease obligations (Note 7)				
Utility revenue bonds, net of unamortized issuance costs and discounts (Note 7)	10,339		12,613	1,511
Total Noncurrent Liabilities	10,339		12,613	1,511
Total Liabilities	11,844	4,135	14,351	1,932
NET ASSETS				
Invested in capital assets, net of related debt	35,095	127,918	39,732	43,866
Restricted for debt service (Note 10)	778		950	
Unrestricted (Note 10)	18,381	152,599	21,527	12,535
Total Net Assets	\$54,254	\$280,517	\$62,209	\$56,401

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 Assets of 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	
\$10,892	\$15,412	\$997		\$221,242	\$62,844
250				12,495	
	2,276	301	\$146	18,351	6
153	201	13		2,917	746
					364
<u>11,295</u>	<u>17,889</u>	<u>1,311</u>	<u>146</u>	<u>255,005</u>	<u>63,960</u>
					255
32,436	5,386	16,086		315,187	10,387
<u>32,436</u>	<u>5,386</u>	<u>16,086</u>		<u>315,187</u>	<u>10,642</u>
<u>43,731</u>	<u>23,275</u>	<u>17,397</u>	<u>146</u>	<u>570,192</u>	<u>74,602</u>
159	116	77		7,429	1,117
					875
			115	115	
298		290		1,310	
					47
					3,149
<u>457</u>	<u>116</u>	<u>367</u>	<u>115</u>	<u>8,854</u>	<u>5,188</u>
					11,863
					6,104
	6,446			6,446	10
<u>9,685</u>		<u>10,611</u>		<u>44,759</u>	
<u>9,685</u>	<u>6,446</u>	<u>10,611</u>		<u>51,205</u>	<u>17,977</u>
<u>10,142</u>	<u>6,562</u>	<u>10,978</u>	<u>115</u>	<u>60,059</u>	<u>23,165</u>
22,703	5,386	5,185		279,885	10,330
				1,728	
<u>10,886</u>	<u>11,327</u>	<u>1,234</u>	<u>31</u>	<u>228,520</u>	<u>41,107</u>
<u>\$33,589</u>	<u>\$16,713</u>	<u>\$6,419</u>	<u>\$31</u>	<u>510,133</u>	<u>\$51,437</u>
				(212)	
				<u>\$509,921</u>	

City of Palo Alto - Proprietary Funds
Statements of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2003
(In thousands of dollars)

	Business-type Activities			
	Water	Electric	Gas	Wastewater Collection
OPERATING REVENUES				
Sales of utilities:				
Customers	\$16,471	\$66,723	\$28,511	\$9,949
City departments	829	2,004	768	202
Wholesale		4,233		
Excess capacity		9,061		
Wastewater treatment				
Service connection charges and miscellaneous	174	362	339	41
Charges for services				
Other operating revenues	180	9,239	96	484
Total Operating Revenues	17,654	91,622	29,714	10,676
OPERATING EXPENSES				
Purchase of utilities				
Retail	5,743	30,058	15,315	4,917
Excess Capacity		7,404		
Administration and general	2,078	5,214	2,160	549
Engineering (operating)	160	970	197	99
Resource management and energy efficiency programs	294	7,142	700	
Operations and maintenance	2,534	8,142	2,334	1,704
Rent	1,402	3,405	276	183
Depreciation and amortization	915	4,775	1,116	1,083
Claims payments and changes in estimated self-insurance liability				
Compensated absences and other benefits				
Total Operating Expenses	13,126	67,110	22,098	8,535
Operating Income	4,528	24,512	7,616	2,141
NONOPERATING REVENUES (EXPENSES)				
Return on investment	1,103	8,875	1,248	671
Interest (expense)	(2)		(2)	(83)
Joint venture debt service (Note 15)		(5,762)		
Gain (loss) on disposal of fixed assets	(8)	(432)	(8)	(4)
Other				
Net Nonoperating Revenues (Expenses)	1,093	2,681	1,238	584
Income (Loss) Before Contributions and Transfers	5,621	27,193	8,854	2,725
Transfers in (Note 4)	61	523	14	1
Transfers (out) (Note 4)	(2,674)	(9,291)	(3,468)	(209)
Change in Net Assets	3,008	18,425	5,400	2,517
Total net assets at beginning of year	51,246	262,092	56,809	53,884
Total net assets at end of year	\$54,254	\$280,517	\$62,209	\$56,401

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

Change in Net Assets of Business-type Activities

See accompanying notes to financial statements

Business-type Activities					Governmental
Wastewater	Refuse	Storm	External	TOTALS	Activities -
Treatment		Drainage	Service		Internal Service
					Funds
	\$18,401	\$2,037		\$142,092	
\$4,963	654	125		9,545	
				4,233	
				9,061	
8,398				8,398	
				916	
					\$47,234
195	2,636	30	\$605	13,465	
13,556	21,691	2,192	605	187,710	47,234
	7,965			63,998	
				7,404	
1,427	1,438	579		13,445	5,010
1,061	470	549		3,506	
				8,136	
9,052	8,436	620	600	33,422	2,390
	5,289			10,555	
2,514	236	407		11,046	2,651
					5,372
					30,561
14,054	23,834	2,155	600	151,512	45,984
(498)	(2,143)	37	5	36,198	1,250
671	948	72	(5)	13,583	3,461
(202)	(306)	(227)		(822)	(9)
		(69)		(5,762)	
				(521)	(864)
					429
469	642	(224)	(5)	6,478	3,017
(29)	(1,501)	(187)		42,676	4,267
	86	918		1,603	431
(158)	(486)	(42)	(5)	(16,333)	(500)
(187)	(1,901)	689	(5)	27,946	4,198
33,776	18,614	5,730	36		47,239
\$33,589	\$16,713	\$6,419	\$31		\$51,437

(1,365)

\$26,581

City of Palo Alto - Proprietary Funds
Statement of Cash Flows -
For the Year Ended June 30, 2003
(In thousands of dollars)

	Business-type Activities			
	Water	Electric	Gas	Wastewater Collection
CASH FLOWS FROM OPERATING ACTIVITIES:				
Receipts from customers	\$16,821	\$91,044	\$29,800	\$9,997
Payments to suppliers	(9,581)	(68,964)	(19,116)	(6,639)
Payments to employees	(2,175)	(5,571)	(2,301)	(610)
Internal activity - Receipts from other funds	829	2,004	768	202
Claims paid				
Other receipts (payments)	180		96	484
Net Cash From Operating Activities	6,074	18,513	9,247	3,434
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:				
Interfund receipts (payments)				
Transfers in	61	523	14	1
Transfers (out)	(2,674)	(9,291)	(3,468)	(209)
Net Cash From Noncapital Financing Activities	(2,613)	(8,768)	(3,454)	(208)
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:				
Acquisition and construction of capital assets	(2,842)	(9,509)	(5,800)	(3,576)
Proceeds from sale of capital assets				
Principal paid on long-term debt	(280)		(341)	(31)
Interest paid on long-term debt & joint venture debt service	(2)	(5,762)	(2)	(83)
Cash Flows From Capital Financing Activities	(3,124)	(15,271)	(6,143)	(3,690)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Interest on investments	1,066	8,900	1,196	678
Net Cash Flows	1,403	3,374	846	214
Cash and cash equivalents at beginning of year	21,447	142,417	25,304	11,181
Cash and cash equivalents at end of year	<u>\$22,850</u>	<u>\$145,791</u>	<u>\$26,150</u>	<u>\$11,395</u>
FINANCIAL STATEMENT PRESENTATION:				
Cash and investments available for operations	\$16,782	\$145,791	\$19,973	\$11,395
Cash and investments with fiscal agent	6,068		6,177	
Cash and cash equivalents at end of year	<u>\$22,850</u>	<u>\$145,791</u>	<u>\$26,150</u>	<u>\$11,395</u>
Reconciliation of operating income (loss)				
to Cash Flows from Operating Activities				
Operating income (loss)	\$4,528	\$24,512	\$7,616	\$2,141
Adjustments to reconcile operating income (loss) to cash flows from operating activities:				
Depreciation and amortization	915	4,775	1,116	1,083
Other				
Changes in assets and liabilities:				
Accounts receivable	176	1,426	950	7
Prepays and Inventory of materials and supplies				
Accounts and other payables	455	(12,200)	(435)	203
Accrued claims payable and other liabilities				
Net Cash From Operating Activities	<u>\$6,074</u>	<u>\$18,513</u>	<u>\$9,247</u>	<u>\$3,434</u>

Business-type Activities					Governmental
Wastewater	Refuse	Storm	External	TOTALS	Activities -
Treatment		Drainage	Service		Internal Service
					Funds
\$8,854	\$18,889	\$2,010	(\$41)	\$177,374	\$47,423
(10,242)	(22,906)	(1,267)	(603)	(139,318)	(2,576)
(1,598)	(1,510)	(601)	(15)	(14,381)	(35,179)
4,963	654	125		9,545	
					(4,144)
195	2,706	30	605	4,296	429
2,172	(2,167)	297	(54)	37,516	5,953
			15	15	
	86	918		1,603	431
(158)	(486)	(42)	(5)	(16,333)	(500)
(158)	(400)	876	10	(14,715)	(69)
(2,717)	(115)	(1,029)		(25,588)	(1,616)
					132
(245)		(358)		(1,255)	(27)
(202)	(306)	(113)		(6,470)	(9)
(3,164)	(421)	(1,500)		(33,313)	(1,520)
674	983	70	(4)	13,563	3,439
(476)	(2,005)	(257)	(48)	3,051	7,803
11,618	17,417	1,254	48	230,686	55,041
\$11,142	\$15,412	\$997		\$233,737	\$62,844
\$10,892	\$15,412	\$997		\$221,242	\$62,844
250				12,495	
\$11,142	\$15,412	\$997		\$233,737	\$62,844
(\$498)	(\$2,143)	\$37	\$5	\$36,198	\$1,250
2,514	236	407		11,046	2,651
					429
456	488	(27)	(41)	3,435	189
					1
(300)	(818)	(120)	(18)	(13,233)	205
	70			70	1,228
\$2,172	(\$2,167)	\$297	(\$54)	\$37,516	\$5,953



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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, 2003***(In thousands of dollars)*

	<u>Agency Funds</u>
ASSETS	
Cash and investments available for operations (Note 3)	\$1,065
Cash and investments with fiscal agents (Note 3)	5,299
Interest receivable	<u>62</u>
Total Assets	<u><u>\$6,426</u></u>
LIABILITIES	
Due to bondholders	\$5,674
Due to other governments	<u>752</u>
Total Liabilities	<u><u>\$6,426</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 and Redevelopment Agency may be obtained from the City of Palo Alto, Administrative Services Department, 250 Hamilton Avenue, Palo Alto, CA 94301.

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 and Proprietary 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 ninety days after year-end. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, 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 \$8.037 million, and vested accumulated sick pay of \$3.826 million as of June 30, 2003.



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.

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.



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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 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 Street Improvement Special Revenue Fund actual expenditures and operating transfers out exceeded budget in the amount of \$1,054.



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.

Investments are carried at fair value, which is the same as fair market value and are categorized as follows at June 30, 2003 (in thousands):

	Cash and Investments		Total
	Available for Operations	With Fiscal Agents	
Category 1 Investments:			
U.S. Agency Obligations	\$363,766	\$10,516	\$374,282
Pooled Investments (non Categorized):			
Local Agency Investment Fund	12,283	61	12,344
California Asset Management Program		23,045	23,045
Mutual funds (government securities)	766	3,283	4,049
Total Investments	376,815	36,905	413,720
Cash in banks (overdraft) and on hand	(109)		(109)
Total Cash and Investments	<u>\$376,706</u>	<u>\$36,905</u>	<u>\$413,611</u>

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	\$375,641
Cash and investments with fiscal agents	<u>31,606</u>
City cash and investments	407,247
Cash and investments available for operations in	
Fiduciary Funds (separate Statement)	1,065
Cash and investments with fiscal agents	
Fiduciary Funds (separate Statement)	<u>5,299</u>
Total cash and investments	<u>\$413,611</u>

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 \$2.008 million, of which \$100 thousand was insured (Category 1) and \$1.908 million was collateralized as discussed above (Category 2) at June 30, 2003.

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, 2003 (in thousands):

Type of Investment	Fair Value
Local Agency Investment Fund	\$12,283
Mutual funds (government securities)	766
U.S. Agency Obligations:	
Maturities of less than 1 year	67,898
Maturities of 1 to 3 years	147,208
Maturities of 3 to 5 years	90,248
Maturities of 5 to 10 years	58,289
Mortgage Backed Securities, Maturing in 15 Years	<u>123</u>
Total Investments Available for Operations	<u><u>\$376,815</u></u>

Authorized City Investments

Investment instruments authorized for purchase include:

- 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. LAIF management calculates the fair value and cost of the entire LAIF pool. The City adjusts its cost basis invested in LAIF to fair value based on this ratio. 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.

Return on Investments

The City earned \$17.4 million in interest income for a yield of 5.03 percent in its portfolio for the year. At year-end, the City adjusted its portfolio for an “unrealized” \$6.0 million gain due to the accounting requirement to markup the portfolio to fair value. The current fair value of the portfolio is 105.1 percent of the book value. However, because the City’s practice is to hold securities until they mature, changes in market price do no affect the City’s investment principal.

The composition of the return on investments for all the City’s funds was \$17.4 million in interest income plus \$6.0 million representing the net gains recognized as a result of fair value changes. These amounts total to \$23.4 million, representing the total return on investments

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 2002-03 were as follows (in thousands):

Fund Receiving Transfer	Fund Making Transfer	Amount Transferred
General Fund	Street Improvement Special Revenue Fund	\$646
	Federal Revenue Special Revenue Fund	136
	Housing In-Lieu Special Revenue Fund	20
	Special Districts Special Revenue Fund	371
	Local Law Enforcement Special Revenue Fund	192
	Redevelopment Agency Special Revenue Fund	101
	Capital Projects Fund	1,008 A,B
	Water Enterprise Fund	2,239 A
	Electric Enterprise Fund	8,377 A
	Gas Enterprise Fund	2,832 A
	Wastewater Collection Enterprise Fund	4 A
	Refuse Enterprise Fund	166 A
Local Law Enforcement Special Revenue Fund	General Fund	5
Redevelopment Agency Special Revenue Fund	General Fund	104
Debt Service Funds:		
Golf Course	General Fund	556
Golf Course	Capital Projects Fund	337
Civic Center	General Fund	319
Civic Center	Special Districts Special Revenue Fund	80
Civic Center Refinancing	General Fund	300
Capital Project Fund	General Fund	8,166 C
	Street Improvement Special Revenue Fund	2,651
	Local Law Enforcement Special Revenue Fund	276
	Water Enterprise Fund	305
	Electric Enterprise Fund	841
	Gas Enterprise Fund	406
	Wastewater Collection Enterprise Fund	87
	Wastewater Treatment Enterprise Fund	145
	Refuse Enterprise Fund	203
	Storm Drainage Enterprise Fund	29
	Technology Internal Service Fund	500

Notes to Basic Financial Statements - Note 4

Enterprise Funds:

Water	Capital Projects Fund	9 C
Water	Gas Enterprise Fund	26
Water	Wastewater Collection Enterprise Fund	26
Electric	Capital Projects Fund	41 C
Electric	Water Enterprise Fund	117
Electric	Gas Enterprise Fund	169
Electric	Wastewater Collection Enterprise Fund	84
Electric	Refuse Enterprise Fund	99
Electric	Storm Drainage Enterprise Fund	13
Gas	Capital Projects Fund	14 C
Wastewater Collection	Capital Projects Fund	1 C
Refuse	Special Districts Special Revenue Fund	86
Storm Drainage	General Fund	918

Internal Service Funds:

Vehicle Replacement and Maintenance	General Fund	176
Technology Fund	General Fund	90
Technology Fund	Water Enterprise Fund	12
Technology Fund	Electric Enterprise Fund	72
Technology Fund	Gas Enterprise Fund	35
Technology Fund	Wastewater Collection Enterprise Fund	8
Technology Fund	Wastewater Treatment Enterprise Fund	13
Technology Fund	Refuse Enterprise Fund	17
Technology Fund	Storm Drainage Enterprise Fund	3
Technology Fund	External Services Enterprise Fund	5
		\$33,436

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 return unspent construction funds.
- (C) Allocation of funds to construct capital assets.

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, 2003, the Federal Revenue Special Revenue Fund and External Services Enterprise Fund owed the General Fund \$538 thousand and \$15 thousand, respectively.



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 2003-04 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. Advances without specified repayment terms total \$359 thousand as of June 30, 2003.

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, 2003, 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	2,248
Mid-Peninsula Housing Coalition:	
Palo Alto Gardens Apartments	1,000
Community Working Group, Inc	1,181
Home Rehabilitation Loans	167
Executive Relocation Assistance Loans	1,275
Below Market Rate Assessment Loans	<u>54</u>
Total	<u><u>\$11,126</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, the annual loan payment is forgiven if the Corporation meets the objective of this project. During the year ended June 30, 2003 the objective 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.

Community Working Group, Inc

On May 13, 2002 the City signed a loan agreement with the Community Working Group, Inc for the predevelopment, relocation and acquisition of a 95-unit complex for the continuation of very low-income households. The loan was funded in fiscal 2002-2003 in the amount of \$1.181 million using Community Development Block Grant funds. The note bears no interest and is secured by a first deed of trust. The principal balance is due and payable on December 31, 2003.

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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, 2003, the City had two outstanding employee home loans due in 2030 and 2031 respectively.

Below Market Rate Assessment Loans

In December 2002 the City loaned \$54 thousand to Below Market Rate home owners with low incomes and /or very limited assets for capital repairs and improvements of their property. The loans bear three percent and are secured by deeds of trust on the properties. Loan payments are deferred until 2032.



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 last year, the City 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, 2003 were (in thousands):

	Balance				Balance
	June 30, 2002	Additions	Retirements	Transfers	June 30, 2003
<i>Governmental activities</i>					
Capital assets not being depreciated:					
Land and improvements	\$67,847				\$67,847
Street trees	15,990		(\$144)		15,846
Construction in progress	6,980	\$35,791		(\$8,821)	33,950
	<u>90,817</u>	<u>35,791</u>	<u>(144)</u>	<u>(8,821)</u>	<u>117,643</u>
Total capital assets not being depreciated					
Capital assets being depreciated					
Buildings and improvements	53,823			193	54,016
Equipment	33,886	1,159	(2,591)	1,411	33,865
Roadway network	210,872			6,027	216,899
Recreation & open space network	6,603			1,190	7,793
	<u>305,184</u>	<u>1,159</u>	<u>(2,591)</u>	<u>8,821</u>	<u>312,573</u>
Total capital assets being depreciated					
Less accumulated depreciation					
Buildings and improvements	(49,701)	(315)			(50,016)
Equipment	(20,784)	(3,090)	1,306		(22,568)
Roadway network	(55,089)	(5,800)			(60,889)
Recreation & open space network	(3,540)	(152)			(3,692)
	<u>(129,114)</u>	<u>(9,357)</u>	<u>1,306</u>		<u>(137,165)</u>
Net capital assets being depreciated					
Total depreciable assets	<u>176,070</u>	<u>(8,198)</u>	<u>(1,285)</u>	<u>8,821</u>	<u>175,408</u>
<i>Governmental activity capital assets, net</i>					
	<u>\$266,887</u>	<u>\$27,593</u>	<u>(\$1,429)</u>		<u>\$293,051</u>

Business-type Capital Assets

Changes in the City's Enterprise Fund capital assets during the year ended June 30, 2003 were (in thousands):

	Balance June 30, 2002	Additions	Retirements	Transfers	Balance June 30, 2003
<i>Business-type activities</i>					
Capital assets not being depreciated:					
Land and improvements	\$1,541				\$1,541
Construction in progress	64,909	\$24,164		(\$31,147)	57,926
Total capital assets not being depreciated	66,450	24,164		(31,147)	59,467
Capital assets being depreciated:					
Buildings and structures	10,654			5,971	16,625
Transmission, distribution, and treatment systems	384,568	1,424	(\$5,138)	25,176	406,030
Total capital assets being depreciated	395,222	1,424	(5,138)	31,147	422,655
Less accumulated depreciation					
Buildings and structures	(3,488)	(695)			(4,183)
Transmission, distribution, and treatment systems	(157,018)	(10,351)	4,617		(162,752)
Net capital assets being depreciated	(160,506)	(11,046)	4,617		(166,935)
Total depreciable assets	234,716	(9,622)	(521)	31,147	255,720
<i>Business-type activity capital assets, net</i>	<u>\$301,166</u>	<u>\$14,542</u>	<u>(\$521)</u>		<u>\$315,187</u>

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	\$915
Administrative Services	111	Electric	4,775
Community Services	408	Gas	1,116
Fire	89	Wastewater Collection	1,083
Police	139	Wastewater Treatment	2,514
Public Works	5,934	Refuse	236
Planning	3	Storm Drainage	407
Non-departmental (Common Use Assets)	11		<u>\$11,046</u>
Internal Service Funds	<u>2,651</u>		
	<u>\$9,357</u>		

Construction in Progress and Completed Projects

Construction in progress in fiscal year 2002-03 comprise (in thousands):

	Expended to June 30, 2003
Governmental Funds:	
Park trails	\$453
Baylands parking improvement	117
Park facilities improvement	1,266
Park backflow replacement and irrigation	259
Civic Center infrastructure	239
Homer Avenue undercrossing	710
Library master plan project	974
Citywide GIS data	361
Enterprise resource planning	2,905
Roth Building wings	234
Embarcadero pedestrian/Bike bridge	382
Fire computer system	146
Park backflow replacement and irrigation	259
Permit information tracking system	185
Downtown parking structure	23,672
Public Safety building	596
Vehicle Replacement Fund	778
Other construction in progress	<u>414</u>
Total governmental construction in progress	<u><u>\$33,950</u></u>
Enterprise Funds:	
Storm drainage structural and water quality improvements	\$140
Gas system extension replacements and improvements	1,062
Water system extension replacements and improvements	1,288
Electric distribution system improvements	458
Other electrical improvement projects	9,606
Water quality control plant equipment replacement and lab facilities	
Sewer system rehabilitation and extensions	8,522
Other construction in progress	<u>36,850</u>
Total enterprise construction in progress	<u><u>\$57,926</u></u>

Allocations of Enterprise Fund administration and general expenses of \$4.14 million have been capitalized and included in amounts expended to June 30, 2003.

Note 7

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, 2002	Retirements	Balance June 30, 2003	Current Portion
Governmental Activity Debt:					
<i>General Long Term Obligations:</i>					
1998 Golf Course Certificates of Participation, 4.00-5.00%, due 09/01/2018	\$7,750	\$6,640	\$405	\$6,235	\$270
2002A Civic Center Refinancing Certificates of Participation, 2.00-4.00%, due 03/01/2012	3,500	3,500	300	3,200	315
2002B Downtown Parking Improvements Certificates of Participation 4.55-6.00%, due 03/01/2022	3,555	3,555	85	3,470	105
	<u>14,805</u>	<u>13,695</u>	<u>790</u>	<u>12,905</u>	<u>690</u>
<i>Internal Service Long Term Obligations:</i>					
Information Systems Capital Lease Obligations, 10.46%, due 8/2/2004	128	84	27	57	47
	<u>128</u>	<u>84</u>	<u>27</u>	<u>57</u>	<u>47</u>
Total Governmental Activity Debt	<u>\$14,933</u>	<u>\$13,779</u>	<u>\$817</u>	<u>\$12,962</u>	<u>\$737</u>
Business-type Activity Debt:					
<i>Enterprise Long Term Obligations:</i>					
Utility Revenue Bonds,					
1995 Series A, 5.0-6.25%, due 06/01/2020	\$8,640	\$7,290	\$235	\$7,055	\$250
1999 Refunding, 3.25-5.25%, due 06/01/24	17,735	16,690	370	16,320	385
2002 Series A, 3.00-5.00%, due 06/01/23	26,055	24,685	650	24,035	675
Less: unamortized discount/ issuance cost		(1,455)	(114)	(1,341)	
	<u>\$52,430</u>	<u>\$47,210</u>	<u>\$1,141</u>	<u>\$46,069</u>	<u>\$1,310</u>

Description of the City's Long-Term Debt Issues

1998 Golf Course COPS - In August 1998, the City's Public Improvement Corporation issued Golf Course Improvement Certificates of Participation (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 which were subsequently retired. 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. A \$2.86 million 6.25% term bond is due June 1, 2020. In lieu of a reserve fund, the Bonds are secured by a Surety Bond issued by AMBAC Indemnity Corporation.

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. The 1990 Utility Revenue Refunding Bonds, Series A and the 1992 Utility Revenue Bonds, Series A, were subsequently retired.

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. 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. In lieu of a reserve fund, the Bonds are secured by a Surety Bond issued by AMBAC Indemnity Corporation.

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
2004	\$737	\$607	\$1,310	\$2,306
2005	727	580	1,365	2,256
2006	740	555	1,410	2,203
2007	770	528	1,465	2,147
2008	805	497	1,525	2,088
2009-2013	4,150	1,934	8,695	9,373
2014-2018	3,390	1,009	11,005	7,052
2019-2023	1,643	198	14,150	3,906
2024-2026			6,485	571
Total	\$12,962	\$5,908	47,410	\$31,902

Reconciliation of long-term debt

Less unamortized original issue discount	(1,341)
Net long-term debt	\$46,069

Debt Call Provisions

Long-term debt as of June 30, 2003 is callable on the following terms and conditions:

	<u>Initial Call Date</u>	
<i>Governmental Activities Long Term Debt</i>		
1998 Certificates of Participation	09/01/2008	(3)
2002B Certificates of Participation	03/01/2011	(2)
<i>Business-Type Activities Long Term Debt</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, 2003 the amount of Bonds outstanding was \$10.950 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, 2003 the district was in compliance with the repayment and other requirements of its respective debt issue. The City accounts for resources available to pay special assessment debt in a Debt Service Fund. 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		Retirements	Balance 6-30-03	Current Portion
	Issue Amount	Balance 6-30-02			
Governmental Activity Debt					
1987 California Avenue Parking,					
6.70-9.25%, due 09/02/2007	\$1,325	\$595	\$85	\$510	\$90
	<u>\$1,325</u>	<u>\$595</u>	<u>\$85</u>	<u>\$510</u>	<u>\$90</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
2004	\$90	\$35
2005	95	28
2006	100	21
2007	110	13
2008	115	5
Total	<u>\$510</u>	<u>\$102</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.

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, 2003, the District's outstanding debt amounted to \$1.545 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, 2003, the District's outstanding debt amounted to \$9.120 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.

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, 2003, the District's outstanding debt amounted to \$35.460 million.

During fiscal year 2002-03, the District contributed \$425 thousand 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 2003 amount is \$6.446 million. Currently, 89.7 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, 2003 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, 2003, Governmental Funds reservations and designations included (in thousands)

	Major Funds		
	General Fund	Capital Projects Fund	Non-Major Funds
Reserved for:			
Encumbrances	\$4,853	\$3,550	\$4,200
Downtown parking structure		9,614	
Notes	1,276		9,850
Inventory of materials and supplies	2,027		
Debt service			1,750
Debt proceeds		210	
Total Reserved Fund Balance	<u>\$8,156</u>	<u>\$13,374</u>	<u>\$15,800</u>
Unreserved; designated for:			
Unrealized gain on investment	\$1,533		\$207
Special revenue projects			7,393
Equity transfer stablization	1,535		
Reappropriations	312	22,705	94
Budget stabilization	21,395		
Infrastructure	33,376		
Total Unreserved/Designated Fund Balances	<u>\$58,151</u>	<u>\$22,705</u>	<u>\$7,694</u>

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 **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, 2003, internal service fund net assets reservations and designations included (in thousands):

Reserved net assets-

Commitments and reappropriations	\$3,134
Unreserved:	
Designated for:	
Future catastrophic losses	6,839
Retiree health care	18,111
Interfund advances/payables	255
Undesignated	<u>12,768</u>

Net assets unrestricted	<u><u>\$41,107</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, 2003, Enterprise Fund net assets reservations included (in thousands):

	Water	Electric	Gas	Wastewater Collection	Wastewater Treatment	Refuse	Storm Drainage	External Services	Total
Reserved net assets:									
Rate stabilization									
Supply		\$53,420	\$11,443						\$64,863
Distribution		12,038	7,304						19,342
Operations	\$10,449			\$4,019	\$6,090	\$8,209	\$743		29,510
	10,449	65,458	18,747	4,019	6,090	\$8,209	743		113,715
Emergency plant									
replacement	1,054	2,393	858	521	1,631				6,457
Calaveras		67,965							67,965
Reappropriations	7,075	10,950	1,433	6,868	1,031	1,496	118		28,971
Commitments	4,788	4,978	3,343	1,080	2,025	1,032	84	23	17,353
Restricted bond									
proceeds			1,967		61				2,028
Conservation loan			34						34
Underground loan		648							648
Refuse Water									
Resources Board						590			590
Shasta rewind loan		64							64
Public benefit									
program		14							14
Central Valley									
Project		129							129
Debt Service	778		950						1,728
External Service -									
Information									
Technology								8	8
Total	\$24,144	\$152,599	\$27,332	\$12,488	\$10,838	\$11,327	\$945	\$31	\$239,704

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, 2003, 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	20.104%	0%	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.

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, 2001 (in thousands):

Safety Police Plan:

Actuarial						
Valuation Date	Entry Age Accrued Liability	Value of Assets	Unfunded (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	Unfunded (Overfunded) Liability as a % of Payroll
1999	\$58,868	\$63,555	(\$4,687)	108.0%	\$6,311	(74.3%)
2000	70,289	69,998	291	99.6%	6,858	4.2%
2001	74,102	72,195	1,907	97.4%	7,007	27.2%

Safety Fire Plan:

Actuarial						
Valuation Date	Entry Age Accrued Liability	Value of Assets	Unfunded (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	Unfunded (Overfunded) Liability as a % of Payroll
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%)
2001	95,116	106,757	(11,641)	112.2%	10,426	(111.7%)

Miscellaneous Plan:

Actuarial						
Valuation Date	Entry Age Accrued Liability	Value of Assets	Unfunded (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	Unfunded (Overfunded) Liability as a % of Payroll
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%)
2001	211,510	272,025	(60,515)	128.6%	51,933	(116.5%)

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

Notes to Basic Financial Statements - Note 11

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, 2001 (in thousands):

	<u>Safety</u>		<u>Miscellaneous</u>
	<u>Police</u>	<u>Fire</u>	
Actuarial Value of Assets 6/30/00	\$69,998	\$104,220	\$262,285
Contributions received	1,388	970	3,675
Benefits and Refunds Paid	(3,009)	(4,064)	(8,371)
Transfers & Miscellaneous Adjustments	(6)	(9)	(13)
Expected Investment Earnings Credited	<u>5,709</u>	<u>8,473</u>	<u>21,448</u>
Expected Actuarial Value of Assets 6/30/01	<u>\$74,080</u>	<u>\$109,590</u>	<u>\$279,024</u>
Market Value of Assets 6/30/01	<u>\$68,424</u>	<u>\$101,094</u>	<u>\$258,025</u>
Actuarial Value of Assets 6/30/01	<u>\$72,195</u>	<u>\$106,757</u>	<u>\$272,025</u>

Additional disclosures will be included when made available by PERS.

Actuarially required contributions for all plans for fiscal years 2003, 2002, and 2001 were, \$3.587, \$5.313, and \$5.826 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 2002-03, expenditures for retiree health care for approximately 535 eligible retired employees totaled \$2.396 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 \$600 thousand surplus was generated for fiscal year 2002-03. In addition, the interest earnings for the year totaled \$1,063 million, bringing the balance to \$18,111 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, 2003 (in thousands):

<u>Retiree Health Benefits</u>	<u>2003</u>	<u>2002</u>
Net assets, beginning of year	\$16,448	\$14,199
Interest earnings	807	802
Unrealized gain on investments	256	347
Interdepartmental charges	<u>600</u>	<u>1,100</u>
Net assets, end of year	<u>\$18,111</u>	<u>\$16,448</u>

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 \$19.5 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, 2003 the City contributed \$521 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, 2003 (in thousands):

	<u>Year Ended June 30</u>	
	<u>2003</u>	<u>2002</u>
Beginning Balance	\$8,025	\$9,113
Liability for current and prior fiscal year claims and claims incurred but not reported (IBNR)	4,727	2,844
Claims paid	<u>(3,499)</u>	<u>(3,932)</u>
Ending Balance	<u>\$9,253</u>	<u>\$8,025</u>



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, 2003, the City incurred expenses totaling \$6.549 million for purchased power and assessments earned by NCPA.

The City's interest in NCPA projects and reserves, as computed by NCPA, was \$3.574 million at June 30, 2003. 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, 2003 is \$304.616 million. The City's participation in this project was 6.158%, or \$18.758 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, 2003, the book value of this Project's plant, equipment and other assets was \$525.547 million, while its long-term debt totaled \$520.183 million and other liabilities totaled \$915.645 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 11.0736% 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 11.0736% 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, 2003, the book value of this Project's plant, equipment and other assets was \$6.203 million, while its long term debt totaled \$5.449 million. The City's share of the Project's long-term debt amounted to \$686.874 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, 2003 the book value of this Project's plant, equipment and other assets was \$7.722 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 \$448.027 million as of June 30, 2003. The City's share of this debt is \$17.921 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 \$1.295 million at June 30, 2003, 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, 2003 amounted to \$5.3 million.

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

<u>Year ending June 30:</u>	<u>Payments</u>
2004	\$5,851
2005	5,966
2006	6,116
2007	6,299
2008	6,488
2009-2015	<u>51,178</u>
	<u><u>\$81,898</u></u>

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 2002-03 this resulted in payments to PASCO of \$7.965 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, 2003. 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. During the fiscal year ending June 30, 2003 the 1992 bonds were refunded by issuing the 2003 Solid Waste Revenue Bonds in the amount of \$20.575 million. 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, 2003 is \$4.376 million. During the year ended June 30, 2003, the City paid \$306 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 stabilized since the energy crisis during 2000-01. The more stable market prices for electricity at present is attributed to the lower loads due to lower economic activity and continuing conservation efforts, and the close scrutiny conducted by Federal and State regulators of energy traders. The lower prices, regulatory uncertainties, financially weakened utilities and power plant developers have resulted in a halt in construction of large power plants in California and around the country. If this inaction continues to exist, it could lead to electricity shortages once again if the economy recovers and electricity demand rises in the near future. The California Independent System Operator and Silicon Valley Manufacturers Group have also alerted their stakeholders to the possibility of an energy shortage as early as summer of 2005.

Gas prices have also stabilized since the energy crisis; however, natural gas market prices continue to be quite high compared to levels seen in late the 1990's. Increased demand and reduced yield on new natural gas wells have been attributed to these higher prices. The renewed interest in increasing import capability of liquid natural gas into the U.S is expected to result in reduced likelihood of a sustained natural gas price spike in the future.

The investigations by various Federal and State agencies in connection with energy trades executed during the 2000/2001 energy crisis continues, though a number of settlements were reached between the state and electricity and natural gas suppliers in the past year. Most of the utility companies are still in financial disarray. The liquidity in the market for energy products has reduced substantially due to the exit of a number of energy trading companies from the wholesale energy trading market.

The awareness of the benefits of the municipal utility ownership model appears to have increased as a result of the energy crisis. 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 stronger since the crisis. Municipal utilities continue to remain financially strong and appear to be the only parties at present with plans to build new generation assets.

Future Outlook

Electric

The City is in the process of securing new long-term electricity supply commitments in anticipation of reduced energy availability starting in 2005 from the City's energy contract with the Western Area Power Administration (Western). The Palo Alto City Council approved the Long-Term Electric Acquisition Plan ("LEAP") in October 2002 and the LEAP Implementation Plan in August 2003. LEAP is designed to meet the City's objectives of continuing to provide low and stable electric rates to retail customers. As part of LEAP, the City will negotiate a number of energy contracts in the coming year and will also investigate participation in a power plant investment. The City expects to invest in new renewable electricity generation resources to meet 10 percent of its energy needs by 2008 and 20 percent of its energy needs by 2015.

The expiration of the present Western contract in December 2004 will result in higher energy cost. These higher costs have been incorporated into the City's long-term electric rate projections. Electric rates are projected to increase starting in 2005. However, the City's electric rates are projected to continue to be substantially lower than PG&E rates.

The Council also approved the Energy Risk Management Policies in October 2002, including the institution of a formal oversight role (middle office) within the Administrative Services Department. This has resulted in a greater degree of oversight and control over Utilities Department operations. This oversight role was recommended by external consultants, the City Auditor, and also conforms to best industry practices. Most of the risk management program recommendations made by the City Auditor in her July 2002 audit report have been implemented or are in process.

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 efficiently operate the transmission grid and to spur transmission grid investments. 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. There exist fundamental problems with MD02 and the City is actively participating in rectifying these problems. The City is also actively participating in efforts to ensure fair treatment of costs allocated to Bay Area municipal loads by the CAISO and regulatory agencies. The CAISO initiatives appear to continue to follow the principle professed by FERC's Standard Market Design (SMD) proposal and the related white paper on the topic. The City is also working with the cities of Santa Clara and Alameda to advocate for higher electric transmission reliability standards and building additional transmission into the Bay Area.



Natural Gas

The outlook for the California gas supply market remains uncertain. It appears the relatively high natural gas prices at \$4-\$5/MMBtu will remain for the foreseeable future. The renewed interest in increasing import capability of liquid natural gas into the U.S, with active support from the Chairman of the Federal Reserve, is expected to result in a reduced likelihood of a sustained natural gas prices spike like the ones seen during the 2000-01 energy crisis.

Staff is undertaking a Gas Utility Long-Term Plan (GULP) evaluation. In August 2003 the Council approved a formal set of planning objectives and guidelines for the gas utility. The GULP evaluation is expected to analyze the merits of acquiring natural gas reserves, storage capability, and other related assets to ensure low and stable rates for the City's retail natural gas customers. Also included in the GULP analysis will be a reevaluation of the City's three-year gas purchase laddering strategy.

Water

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 pay for San Francisco's one-third share of the approximately \$3 billion cost of a capital improvement program. A new state water agency, the Bay Area Water Supply and Conservation Agency (BAWSCA), and a Regional Financing Authority were created in 2003 to provide the funding for the two-thirds share of the CIP costs allocated to the agencies that purchase water from the SFPUC. These increased costs have been factored into Palo Alto's long-term rate projections. However, the wholesale agencies (including Palo Alto) may be asked to make a capital commitment, rather than pay for their share of the improvements through increased SFPUC wholesale water rates.

Contingent Liability

There are a number of large uncertainties related to utility operations. These uncertainties are periodically evaluated by staff and have been considered in developing the Reserve Guidelines approved by Council in October 2003. Major uncertainties facing the Utilities Department are discussed below.

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 revenues from the surplus sales generated by the Northern California Power Agency (NCPA), the City's resource scheduler and operator. These surplus sales were recognized and the contingencies were noted in the City's 2000-01 and 2001-2002 financial statements. The outcome of the inquiry and the amounts at issue continue to be uncertain at this time.

The long standing dispute between PG&E and NCPA regarding PG&E's rights to pass-through CAISO charges, related to Scheduling Coordinator Services (SCS), under the PG&E-NCPA Transmission Interconnection Agreement has not been settled. PG&E claims that it incurred, approximately \$24 million SCS Tariff charges on behalf of NCPA pool loads between April 1998 and August 2002. Of this amount, approximately \$7.8 million is estimated by NCPA to be Palo Alto's share. This amount and PG&E's contractual rights to pass various SCS Tariff charges are being disputed by NCPA along with other entities that had similar interconnection agreements with PG&E. Proceedings are now underway before the FERC to resolve the dispute. An initial finding as to whether PG&E has the rights to pass through SCS charges is expected by April 2004, with final resolution expected later in the year. Due to high a degree of uncertainty surrounding the dispute, the final outcome is hard to quantify. City believes that PG&E has no legal or factual basis for its proposed tariff and will continue to vigorously contest the charges through joint NCPA action.

Western and PG&E have a dispute regarding PG&E's ability to pass through higher transmission costs to Western customers such as Palo Alto. This dispute has festered since 2001, but FERC has consistently ruled in favor of Western. However, a recent Court ruling, in response to PG&E's appeal, has asked FERC to reconsider its past decision. There is some risk that if PG&E prevails, transmission rates to deliver Western energy to Palo Alto may increase by approximately \$2.5 million/year sooner than January 2005, the present rate increase date projections. There is also a risk that PG&E may be permitted to charge for past periods.

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.

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, 2003, 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.



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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.

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.



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, 2003
(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	\$1,661		\$5,482	\$1,444	\$2,676	\$191
Cash and investments with fiscal agent						
Receivables:						
Accounts	117	\$498				
Special assessments						
Interest	21		72	19	32	2
Notes		4,498	5,352			
Total Assets	<u>\$1,799</u>	<u>\$4,996</u>	<u>\$10,906</u>	<u>\$1,463</u>	<u>\$2,708</u>	<u>\$193</u>
LIABILITIES						
Accounts payable		\$43	\$155	\$68		
Deferred revenue						
Interfund payable and advances		538				
Total Liabilities		<u>581</u>	<u>155</u>	<u>68</u>		
FUND EQUITY						
Reserved for:						
Encumbrances	\$1,671	373	2,001			\$155
Notes receivable		4,498	5,352			
Debt service						
Unreserved, designated for:						
Unrealized gain on investments	34		110	23	\$33	1
Special revenue projects			3,288	1,372	2,675	37
Reappropriations	94					
Unreserved, undesignated		(456)				
	<u>1,799</u>	<u>4,415</u>	<u>10,751</u>	<u>1,395</u>	<u>2,708</u>	<u>193</u>
	<u>\$1,799</u>	<u>\$4,996</u>	<u>\$10,906</u>	<u>\$1,463</u>	<u>\$2,708</u>	<u>\$193</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</u>	<u>Golf Course</u>	<u>Civic Center Refinancing</u>
\$22	\$17	\$176		\$962	\$351
		2		12	
<u>\$22</u>	<u>\$17</u>	<u>\$178</u>		<u>\$974</u>	<u>\$351</u>
				\$974	\$351
\$1 21	\$1	\$4			
	16	174			
22	17	178		974	351
<u>\$22</u>	<u>\$17</u>	<u>\$178</u>		<u>\$974</u>	<u>\$351</u>

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City of Palo Alto - Non-Major Governmental Funds

Combining Balance Sheets- June 30, 2003

(In thousands of dollars)

	<u>DEBT SERVICE FUNDS</u>		Total Non-major Governmental Funds
	<u>Downtown Parking Improvement</u>	<u>Special Assessment Debt</u>	
ASSETS			
Cash and investments			
Available for operations		\$101	\$11,770
Cash and investments with fiscal agent	\$323		1,636
Receivables:			
Accounts			615
Special assessments		510	510
Interest	1		161
Notes			9,850
	<u>324</u>	<u>611</u>	<u>24,542</u>
Total Assets			
LIABILITIES			
Accounts payable			\$266
Deferred revenue		\$510	510
Interfund payable and advances			538
		<u>510</u>	<u>1,314</u>
FUND EQUITY			
Reserved for:			
Encumbrances			4,200
Notes receivable			9,850
Debt service	\$324	101	1,750
Unreserved, designated for:			
Unrealized gain on investments			207
Special revenue projects			7,393
Reappropriations			94
Unreserved, undesignated			(266)
	<u>324</u>	<u>101</u>	<u>23,228</u>
	<u>\$324</u>	<u>\$611</u>	<u>\$24,542</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, 2003
(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>
REVENUES					
Special assessments					
Other taxes and fines	\$1,266				
From other agencies:					
Community Development Block Grant		\$1,647			
Local Law Enforcement Block Grant					
State of California			\$1		
Other revenue from other agencies		9			
Return on investment	168	22	348	\$81	\$145
Other:					
Housing In-Lieu - residential			294		
Housing In-Lieu - commercial			342		
University Avenue Parking				570	
California Avenue Parking				98	
Other fees			108		
Total Revenues	<u>1,434</u>	<u>1,678</u>	<u>1,093</u>	<u>749</u>	<u>145</u>
EXPENDITURES					
Current:					
Public Safety - Police					
Capital outlay		417	174		
Debt service:					
Principal retirement					
Interest and fiscal charges					
Total Expenditures		<u>417</u>	<u>174</u>		
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>1,434</u>	<u>1,261</u>	<u>919</u>	<u>749</u>	<u>145</u>
OTHER FINANCING SOURCES (USES)					
Transfers in					
Transfers (out)	(3,297)	(136)	(20)	(537)	
Total Other Financing Sources (Uses)	<u>(3,297)</u>	<u>(136)</u>	<u>(20)</u>	<u>(537)</u>	
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER USES	<u>(1,863)</u>	<u>1,125</u>	<u>899</u>	<u>212</u>	<u>145</u>
Fund balances at the beginning of year	<u>3,662</u>	<u>3,290</u>	<u>9,852</u>	<u>1,183</u>	<u>2,563</u>
Fund balances at end of year	<u>\$1,799</u>	<u>\$4,415</u>	<u>\$10,751</u>	<u>\$1,395</u>	<u>\$2,708</u>



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SPECIAL REVENUE FUNDS				DEBT SERVICE FUNDS		
Local Law Enforcement	Downtown Planned Community	Assets Seizure	Developer's Impact Fee	Redevelopment Agency	Golf Course	Civic Center Refinancing
\$18						
116						
23	\$2	\$2	\$9		\$49	\$3
4			152			
161	2	2	161		49	3
		16				
5					405	300
					297	122
5		16			702	422
156	2	(14)	161		(653)	(419)
5				\$104	893	399
(468)				(101)		
(463)				3	893	399
(307)	2	(14)	161	3	240	(20)
500	20	31	17	(3)	734	371
\$193	\$22	\$17	\$178		\$974	\$351

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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, 2003
(In thousands of dollars)

	<u>DEBT SERVICE FUNDS</u>		Total Non-major Governmental Funds
	<u>Downtown Parking Improvement</u>	<u>Special Assessment District</u>	
REVENUES			
Special assessments		\$130	\$130
Other taxes and fines			1,266
From other agencies:			
Community Development Block Grant			1,647
Local Law Enforcement Block Grant			18
State of California			117
Other revenue from other agencies			9
Return on investment	\$4		856
Other:			
Housing In-Lieu - residential			294
Housing In-Lieu - commercial			342
University Avenue Parking			570
California Avenue Parking			98
Other fees			264
Total Revenues	<u>4</u>	<u>130</u>	<u>5,611</u>
EXPENDITURES			
Current:			
Public Safety - Police			16
Capital outlay			596
Debt service:			
Principal retirement	85	85	875
Interest and fiscal charges	236	41	696
Total Expenditures	<u>321</u>	<u>126</u>	<u>2,183</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(317)</u>	<u>4</u>	<u>3,428</u>
OTHER FINANCING SOURCES (USES)			
Transfers in	300		1,701
Transfers (out)			(4,559)
Total Other Financing Sources (Uses)	<u>300</u>		<u>(2,858)</u>
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER USES	<u>(17)</u>	<u>4</u>	<u>570</u>
Fund balances at the beginning of year	<u>341</u>	<u>97</u>	<u>22,658</u>
Fund balances at end of year	<u><u>\$324</u></u>	<u><u>\$101</u></u>	<u><u>\$23,228</u></u>



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City of Palo Alto - Non-major Governmental Funds
Combining Schedule of Revenues, Expenditures and
Changes in Fund Balances -Budget and Actual
For the Year Ended June 30, 2003
(In thousands of dollars)

	SPECIAL REVENUE FUNDS					
	Street Improvement			Federal Revenue		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
REVENUES						
Property taxes						
Special assessments						
Other taxes and fines	\$1,126	\$1,266	\$140			
From other agencies:						
Community Development Block Grant				\$1,058	\$1,647	\$589
County Measure A/B	491		(491)			
Local Law Enforcement Block Grant						
State of California						
Other revenue from other agencies				15	9	(6)
Return on investment	85	168	83	20	22	2
Other:						
Great Western Bank - loan payoff				10		(10)
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees						
Total Revenues	<u>1,702</u>	<u>1,434</u>	<u>(268)</u>	<u>1,103</u>	<u>1,678</u>	<u>575</u>
EXPENDITURES						
Current:						
Public Safety - Police						
Capital outlay				1,719	417	1,302
Debt service:						
Principal retirement						
Interest and fiscal charges						
Total Expenditures				<u>1,719</u>	<u>417</u>	<u>1,302</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>1,702</u>	<u>1,434</u>	<u>(268)</u>	<u>(616)</u>	<u>1,261</u>	<u>1,877</u>
OTHER FINANCING SOURCES (USES)						
Transfers in						
Transfers (out)	<u>(2,243)</u>	<u>(3,297)</u>	<u>(1,054)</u>	<u>(140)</u>	<u>(136)</u>	<u>4</u>
Total Other Financing Sources (Uses)	<u>(2,243)</u>	<u>(3,297)</u>	<u>(1,054)</u>	<u>(140)</u>	<u>(136)</u>	<u>4</u>
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER USES	<u>(\$541)</u>	<u>(1,863)</u>	<u>(\$1,322)</u>	<u>(\$756)</u>	<u>1,125</u>	<u>\$1,881</u>
Fund balances at the beginning of year		<u>3,662</u>			<u>3,290</u>	
Fund balances at end of year		<u>\$1,799</u>			<u>\$4,415</u>	



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SPECIAL REVENUE FUNDS

Housing In-Lieu			Special Districts			Transportation Mitigation		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
	\$1	\$1						
\$218	348	130	\$61	\$81	\$20	\$138	\$145	\$7
400	294	(106)						
475	342	(133)						
			579	570	(9)	480		(480)
			90	98	8			
50	108	58						
1,143	1,093	(50)	730	749	19	618	145	(473)
458	174	284						
458	174	284						
685	919	234	730	749	19	618	145	(473)
(20)	(20)		(586)	(537)	49			
(20)	(20)		(586)	(537)	49			
<u>\$665</u>	899	<u>\$234</u>	<u>\$144</u>	212	<u>\$68</u>	<u>\$618</u>	145	<u>(\$473)</u>
	<u>9,852</u>			<u>1,183</u>			<u>2,563</u>	
	<u>\$10,751</u>			<u>\$1,395</u>			<u>\$2,708</u>	

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City of Palo Alto - Non-major Governmental Funds
Combining Schedule of Revenues, Expenditures and
Changes in Fund Balances -Budget and Actual
For the Year Ended June 30, 2003
(In thousands of dollars)

	SPECIAL REVENUE FUNDS					
	Local Law Enforcement			Downtown Planned Community		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
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		\$18	\$18			
State of California	\$120	116	(4)			
Other revenue from other agencies						
Return on investment	14	23	\$9	\$1	\$2	\$1
Other:						
Great Western Bank - loan payoff						
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees		4	4			
Total Revenues	<u>134</u>	<u>161</u>	<u>27</u>	<u>1</u>	<u>2</u>	<u>1</u>
EXPENDITURES						
Current:						
Public Safety - Police						
Capital outlay	72	5	67			
Debt service:						
Principal retirement						
Interest and fiscal charges						
Total Expenditures	<u>72</u>	<u>5</u>	<u>67</u>			
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>62</u>	<u>156</u>	<u>94</u>	<u>1</u>	<u>2</u>	<u>1</u>
OTHER FINANCING SOURCES (USES)						
Transfers in	5	5				
Transfers (out)	(465)	(468)	(3)			
Total Other Financing Sources (Uses)	<u>(460)</u>	<u>(463)</u>	<u>(3)</u>			
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER USES	<u>(\$398)</u>	<u>(307)</u>	<u>\$91</u>	<u>\$1</u>	<u>2</u>	<u>\$1</u>
Fund balances at the beginning of year		<u>500</u>			<u>20</u>	
Fund balances at end of year		<u>\$193</u>			<u>\$22</u>	



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SPECIAL REVENUE FUNDS

Assets Seizure			Developer's Impact Fee			Redevelopment Agency		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
	\$2	\$2		\$9	\$9	\$9		(\$9)
			\$553	152	(401)			
	2	2	553	161	(392)	9		(9)
\$26	16	10				84		84
26	16	10				84		84
(26)	(14)	12	553	161	(392)	(75)		75
						176 (101)	\$104 (101)	(72)
						75	3	(72)
<u>(\$26)</u>	<u>(14)</u>	<u>\$12</u>	<u>\$553</u>	<u>161</u>	<u>(\$392)</u>	<u> </u>	<u>3</u>	<u>\$3</u>
	<u>31</u>			<u>17</u>			<u>(3)</u>	
	<u>\$17</u>			<u>\$178</u>				

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City of Palo Alto - Non-major Governmental Funds
Combining Schedule of Revenues, Expenditures and
Changes in Fund Balances -Budget and Actual
For the Year Ended June 30, 2003
(In thousands of dollars)

	DEBT SERVICE FUNDS					
	Golf Course			Special Assessment District		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
REVENUES						
Property taxes						
Special assessments				\$126	\$130	\$4
Other taxes and fines						
From other agencies:						
Community Development Block Grant						
County Measure A/B						
Local Law Enforcement Block Grant						
State of California						
Other revenue from other agencies						
Return on investment	\$38	\$49	\$11			
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>38</u>	<u>49</u>	<u>11</u>	<u>126</u>	<u>130</u>	<u>4</u>
EXPENDITURES						
Current:						
Public Safety - Police						
Capital outlay						
Debt service:						
Principal retirement	405	405		85	85	
Interest and fiscal charges	297	297		41	41	
Total Expenditures	<u>702</u>	<u>702</u>		<u>126</u>	<u>126</u>	
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(664)</u>	<u>(653)</u>	<u>11</u>		<u>4</u>	<u>4</u>
OTHER FINANCING SOURCES (USES)						
Transfers in	520	893	373			
Transfers (out)						
Total Other Financing Sources (Uses)	<u>520</u>	<u>893</u>	<u>373</u>			
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER USES	<u>(\$144)</u>	<u>240</u>	<u>\$384</u>		<u>4</u>	<u>\$4</u>
Fund balances at the beginning of year		<u>734</u>			<u>97</u>	
Fund balances at end of year		<u>\$974</u>			<u>\$101</u>	



.....

TOTAL		
Non-major Governmental Funds		
Budget	Actual	Variance Positive (Negative)
\$126	\$130	\$4
1,126	1,266	140
1,058	1,647	589
491		(491)
	18	18
120	117	(3)
15	9	(6)
584	849	265
10		(10)
400	294	(106)
475	342	(133)
1,059	570	(489)
90	98	8
603	264	(339)
<u>6,157</u>	<u>5,604</u>	<u>(553)</u>
26	16	10
2,333	596	1,737
490	490	
338	338	
<u>3,187</u>	<u>1,440</u>	<u>1,747</u>
<u>2,970</u>	<u>4,164</u>	<u>1,194</u>
701	1,002	301
(3,555)	(4,559)	(1,004)
<u>(2,854)</u>	<u>(3,557)</u>	<u>(703)</u>
<u>\$116</u>	607	<u>\$491</u>
	<u>21,946</u>	
	<u>\$22,553</u>	

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Non-major Governmental Funds

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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.

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City of Palo Alto - Internal Service Funds
Combining Statements of Net Assets - June 30, 2003
(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	\$3,703	\$11,080	\$638	\$29,539	\$17,884	\$62,844
Accounts receivable, net	1			5		6
Interest receivable	49	147	8	315	227	746
Inventory of materials and supplies	364					364
Total Current Assets	4,117	11,227	646	29,859	18,111	63,960
Noncurrent Assets:						
Interfund receivables	155	100				255
Capital assets, net of depreciation	10,201	186				10,387
Total Noncurrent Assets	10,356	286				10,642
Total Assets	14,473	11,513	646	29,859	18,111	74,602
LIABILITIES						
Current Liabilities						
Accounts payable and accrued liabilities	11	77		1,029		1,117
Accrued salaries and benefits				875		875
Accrued claims payable - current				3,149		3,149
Capital lease obligation - current		47				47
Total Current Liabilities	11	124		5,053		5,188
Long-term Liabilities						
Accrued compensated absences				11,863		11,863
Accrued claims payable				6,104		6,104
Capital lease obligation		10				10
Total Long-term Liabilities		10		17,967		17,977
Total Liabilities	11	134		23,020		23,165
NET ASSETS						
Investment in capital assets, net of related debt	10,201	129				10,330
Unrestricted	4,261	11,250	646	6,839	18,111	41,107
Total Net Assets	\$14,462	\$11,379	\$646	\$6,839	\$18,111	\$51,437

City of Palo Alto - Internal Service Funds

Combining Statements of Revenues, Expenses and

Changes in Net Assets - For the Year Ended June 30, 2003

(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	\$4,754	\$5,326	\$978	\$35,576	\$600	\$47,234
OPERATING EXPENSES						
Administration and general	524	2,422	907	1,157		5,010
Operations and maintenance	2,390					2,390
Depreciation and amortization	2,531	114	6			2,651
Claim payments and change in estimated self-insured liability				5,372		5,372
Compensated absences and other benefits				30,561		30,561
Total Operating Expenses	5,445	2,536	913	37,090		45,984
Total Operating Income (Loss)	(691)	2,790	65	(1,514)	600	1,250
NONOPERATING REVENUES (EXPENSES)						
Return on investment	233	699	41	1,425	1,063	3,461
Interest (expense)		(9)				(9)
Loss on disposal of fixed assets	(864)					(864)
Other nonoperating revenues	6		1	422		429
Total Nonoperating Revenues	(625)	690	42	1,847	1,063	3,017
Income (Loss) Before Contributions and Transfers	(1,316)	3,480	107	333	1,663	4,267
Transfers in	176	255				431
Transfers (out)		(500)				(500)
Change in Net Assets	(1,140)	3,235	107	333	1,663	4,198
Net assets at beginning of year	15,602	8,144	539	6,506	16,448	47,239
Net assets at end of year	\$14,462	\$11,379	\$646	\$6,839	\$18,111	\$51,437

City of Palo Alto - Internal Service Funds
Combining Statements of Cash Flows - For the Fiscal Year Ended June 30, 2003
(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	\$4,754	\$5,326	\$978	\$35,765	\$600	\$47,423
Payments to suppliers	(2,639)	63				(2,576)
Payments to employees	(555)	(2,422)	(925)	(31,277)		(35,179)
Claims paid				(4,144)		(4,144)
Other receipts	6		1	422		429
Net cash provided by operating activities	<u>1,566</u>	<u>2,967</u>	<u>54</u>	<u>766</u>	<u>600</u>	<u>5,953</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Interfund payments						
Transfers in	176	255				431
Transfers (out)		(500)				(500)
Cash flows from noncapital financing activities	<u>176</u>	<u>(245)</u>				<u>(69)</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES						
Acquisition and construction of fixed assets	(1,521)	(95)				(1,616)
Proceeds from sale of capital assets	132					132
Principal paid on long term obligation		(27)				(27)
Interest paid on long term obligation		(9)				(9)
Cash flows from capital financing activities	<u>(1,389)</u>	<u>(131)</u>				<u>(1,520)</u>
CASH FLOWS FROM INVESTING ACTIVITIES						
Interest and dividends on pooled investments	227	660	41	1,433	1,078	3,439
Net Cash Flows	580	3,251	95	2,199	1,678	7,803
Cash and investments at beginning of year	3,123	7,829	543	27,340	16,206	55,041
Cash and investments at end of year	<u>\$3,703</u>	<u>\$11,080</u>	<u>\$638</u>	<u>\$29,539</u>	<u>\$17,884</u>	<u>\$62,844</u>
CASH FLOWS FROM OPERATING ACTIVITIES						
Operating income (loss)	(\$691)	\$2,790	\$65	(\$1,514)	\$600	\$1,250
Adjustments to reconcile operating income (loss) to cash flows from operating activities:						
Depreciation and amortization	2,531	114	6			2,651
Other	6		1	422		429
Changes in assets and liabilities:						
Accounts receivable				189		189
Inventory of materials and supplies	1					1
Accounts and other payables	(281)	63	(18)	441		205
Accrued claims payable				1,228		1,228
Net cash provided by operating activities	<u>\$1,566</u>	<u>\$2,967</u>	<u>\$54</u>	<u>\$766</u>	<u>\$600</u>	<u>\$5,953</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, 2003
(In thousands of dollars)

	<u>Balance</u>			<u>Balance</u>
	<u>June 30, 2002</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2003</u>
<u>California Avenue Parking Assessment District</u>				
ASSETS				
Cash and investments available for operations	<u>\$339</u>	<u>\$145</u>	<u>\$161</u>	<u>\$323</u>
LIABILITIES				
Due to bondholders	<u>\$339</u>	<u>\$145</u>	<u>\$161</u>	<u>\$323</u>
<u>San Francisquito Creek Joint Powers Authority</u>				
ASSETS				
Cash and investments available for operations	<u>\$8</u>		<u>\$8</u>	
Total assets	<u>\$8</u>		<u>\$8</u>	
LIABILITIES				
Accounts payable	<u>\$8</u>		<u>\$8</u>	
Total liabilities	<u>\$8</u>		<u>\$8</u>	
<u>Cable Joint Powers Authority</u>				
ASSETS				
Cash and investments available for operations	<u>\$696</u>	<u>\$71</u>	<u>\$25</u>	<u>\$742</u>
Interest receivable	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>
Total assets	<u>\$706</u>	<u>\$81</u>	<u>\$35</u>	<u>\$752</u>
LIABILITIES				
Due to other governments	<u>\$706</u>	<u>\$81</u>	<u>\$35</u>	<u>\$752</u>



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	<u>Balance</u> <u>June 30, 2002</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2003</u>
<u>University Avenue Area Parking Assessment District</u>				
ASSETS				
Cash and investments with fiscal agents	\$5,485	\$2,450	\$2,636	\$5,299
Interest receivable	38	52	38	52
Other receivable	22		22	
Total assets	<u>\$5,545</u>	<u>\$2,502</u>	<u>\$2,696</u>	<u>\$5,351</u>
LIABILITIES				
Due to bondholders	<u>\$5,545</u>	<u>\$2,502</u>	<u>\$2,696</u>	<u>\$5,351</u>

Total Agency Funds

ASSETS				
Cash and investments available for operations	\$1,043	\$216	\$194	\$1,065
Cash and investments with fiscal agents	5,485	2,450	2,636	5,299
Interest receivable	48	62	48	62
Other receivable	22		22	
Total assets	<u>\$6,598</u>	<u>\$2,728</u>	<u>\$2,900</u>	<u>\$6,426</u>
LIABILITIES				
Accounts payable	\$8		\$8	
Due to bondholders	5,884	\$2,647	2,857	\$5,674
Due to other governments	706	81	35	752
Total liabilities	<u>\$6,598</u>	<u>\$2,728</u>	<u>\$2,900</u>	<u>\$6,426</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.

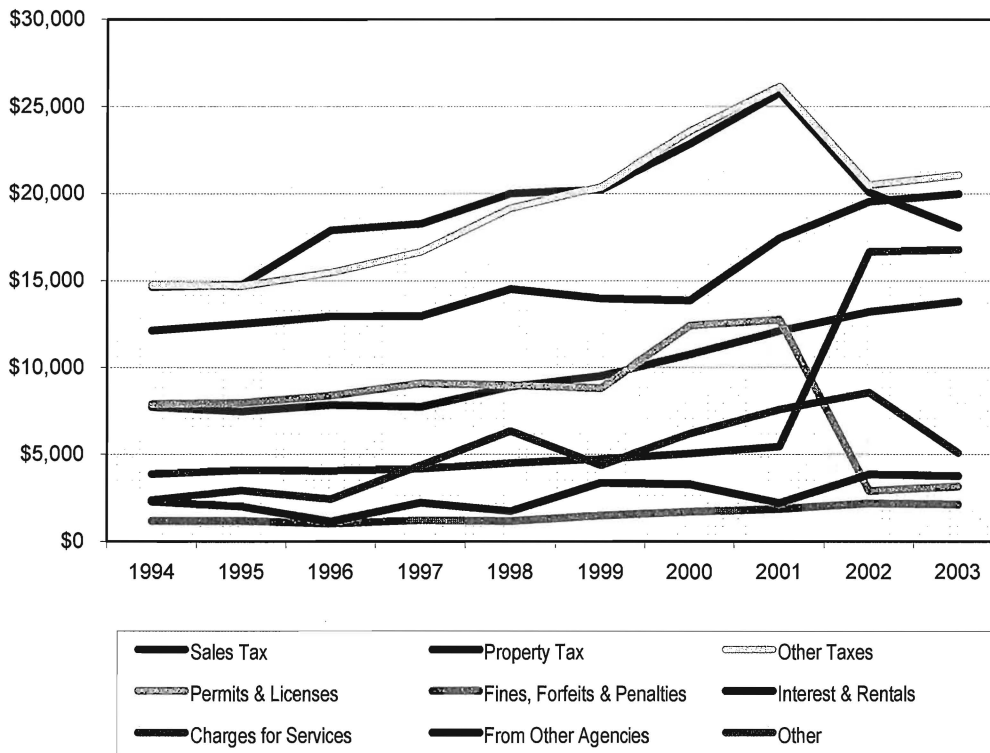


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City of Palo Alto - General Governmental Revenues by Source

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
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
2003	18,041	13,821	21,070	3,161	2,124	19,981	16,798	3,776	5,095	103,867

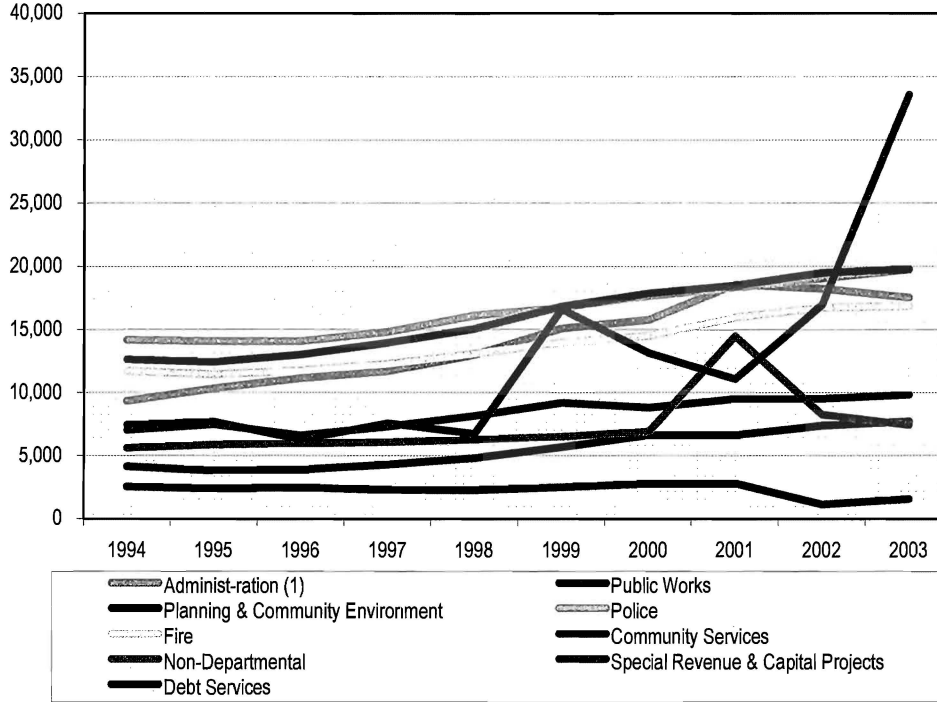
** Revenue categories were changed to align with budget classifications in 2002

Source: Annual Financial Statements

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

All Governmental Fund Types

Last Ten Fiscal Years (\$000s)



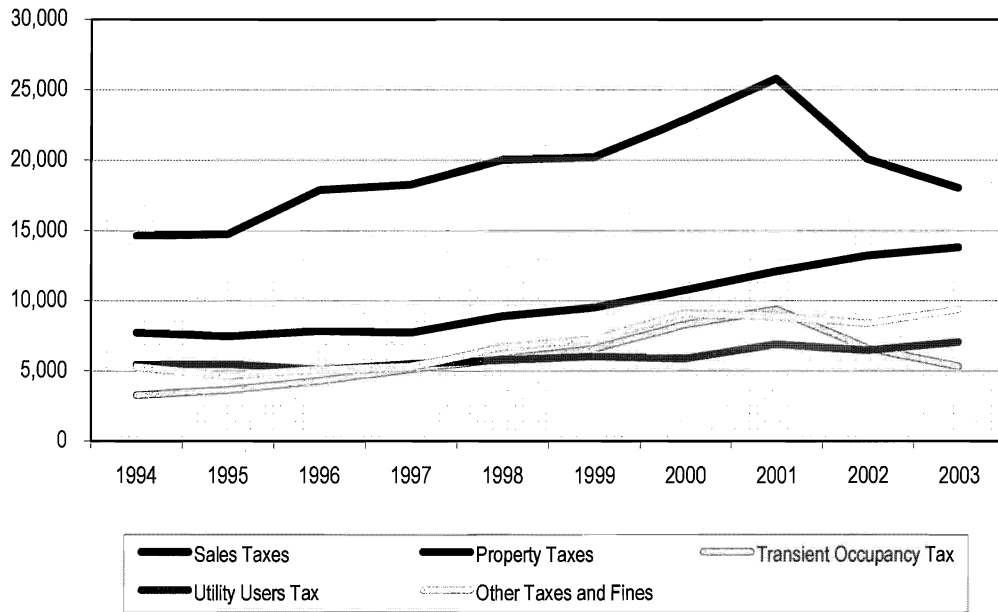
Fiscal Year	Administ-ration (1)	Public Works	Planning & Community Environment	Police	Fire	Community Services	Non-Departmental	Special Revenue & Capital Projects	Debt Services	Total
(2) 1994	\$9,343	\$7,058	\$4,160	\$14,150	\$11,718	\$12,651	\$5,645	\$7,450	\$2,569	\$74,744
1995	10,340	7,517	3,842	14,058	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
2003	17,521	9,858	7,721	19,719	16,841	19,793	7,442	33,584	1,571	134,050

Source: Annual Financial Statements

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

(2) During fiscal year 1993-94 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.

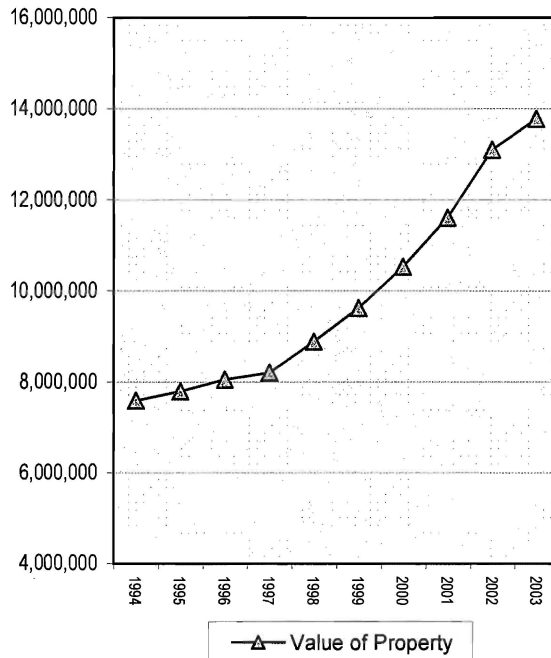
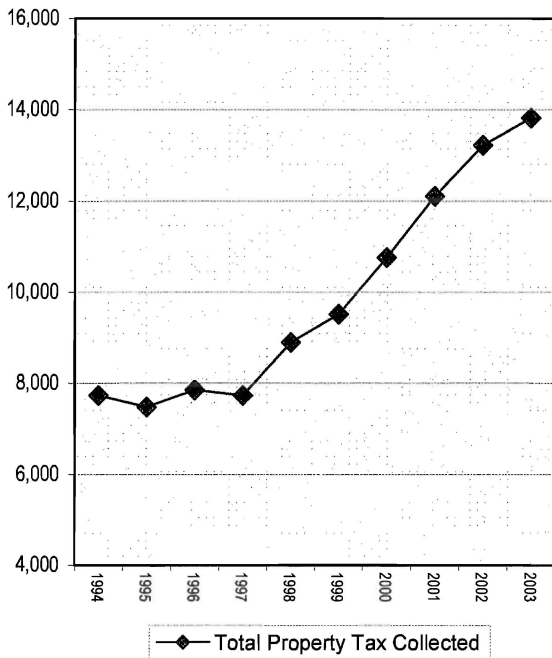
City of Palo Alto - General Fund Tax Revenues by Source.....
Last Ten Fiscal Years (\$000)



Fiscal Year	Sales Taxes	Property Taxes	Transient Occupancy Tax	Utility Users Tax	Other Taxes and Fines	Total
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
2003	18,041	13,821	5,333	7,067	9,398	53,660

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 (\$ Billions)

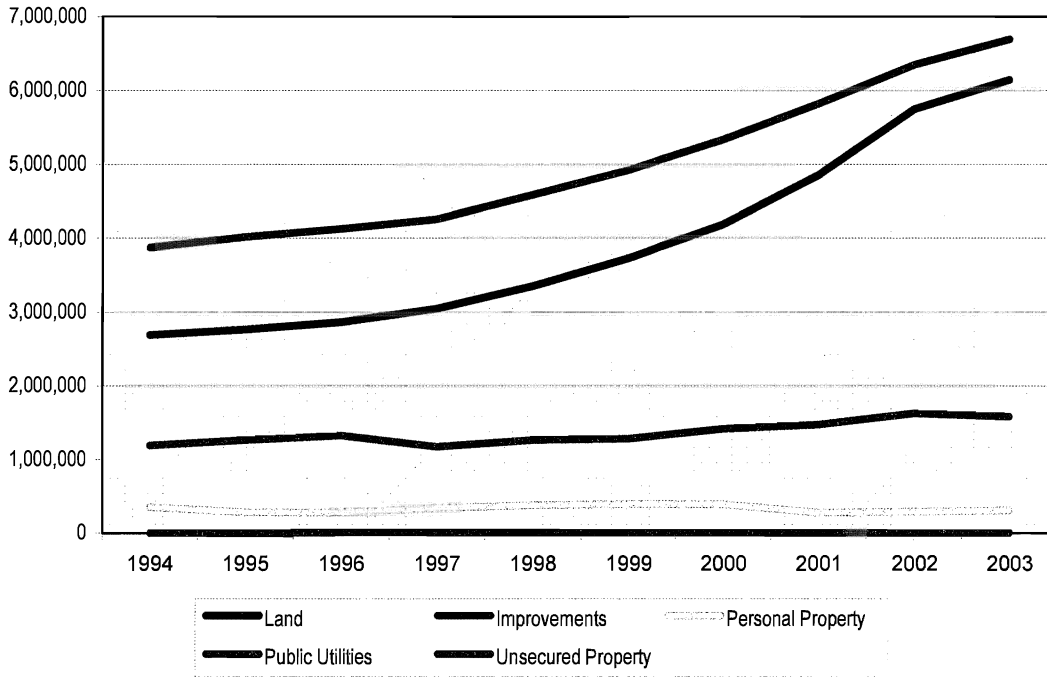


Fiscal Year	Total Tax Levy	Current Tax Collections	Delinquent Tax Collections	Total Property Tax Collected	Value of Property Subject to Basic County Wide Tax Rate (\$000s)
1994	\$7,310	\$7,310	\$219	\$7,737	\$7,592,131
1995	7,485	7,485	427	7,485	7,795,396
1996	7,854	7,854	A	7,854	8,058,927
1997	7,735	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
2003	13,821	13,821	A	13,821	13,776,406

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			Subtotal	Less			Total Assessed Value
	Land	Improvements	Personal Property	Net Local Secured Roll	Public Utilities	Unsecured Property	Exemptions Net of State Aid	
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
2003	6,140,438	6,692,162	309,386	13,141,986	3,859	1,582,368	951,807	13,776,406

SOURCE: County of Santa Clara Assessor's Office

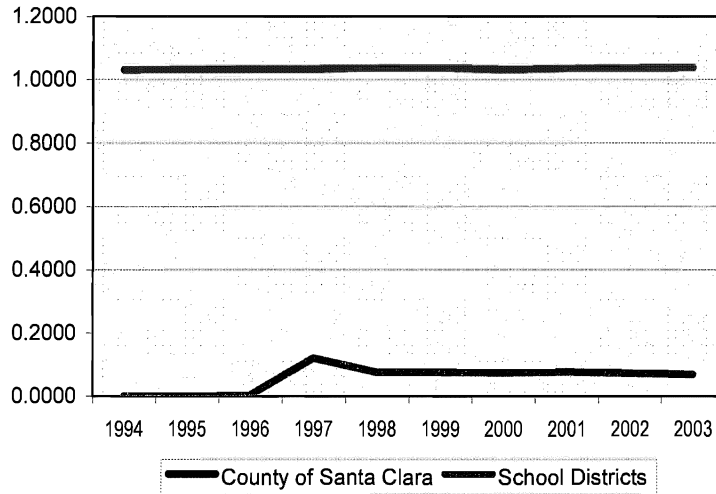
NOTE: Beginning in fiscal year 1988-89, Chapter 921 of the Statutes of 1987 requires the establishment of a single county-wide tax rate area for the assignment of the assessed value of certain types of state-assessed utility property and sets forth formulas for the determination of county-wide tax rates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

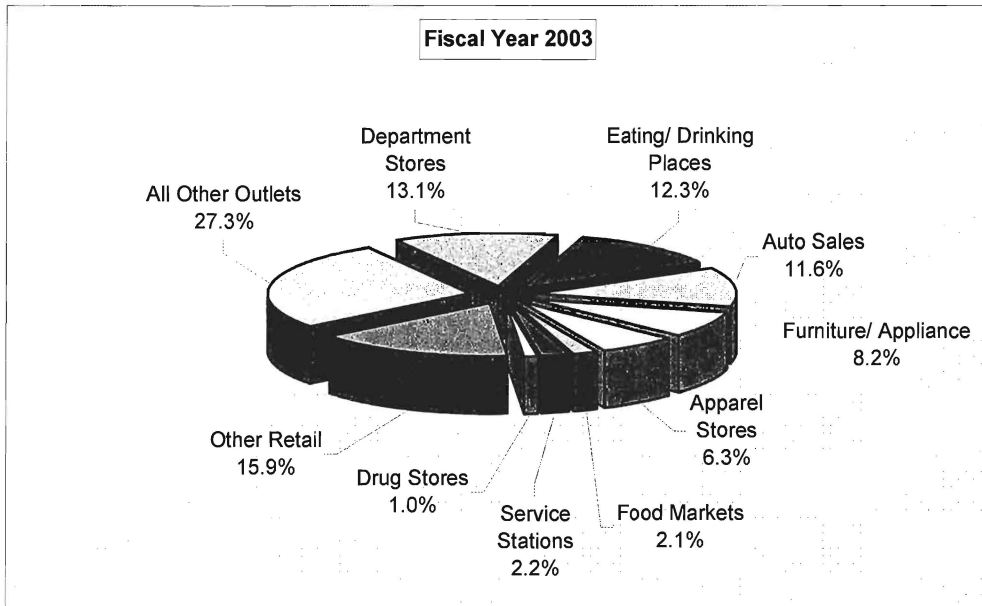
Per \$100 of Assessed Value - Last Ten Years



Fiscal Year	County of Santa Clara	School Districts	Total
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
2003	1.0388	0.0694	1.1082

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 Ten Fiscal Years (\$millions)



RETAIL STORES

Fiscal Year	Department Stores	Eating/ Drinking Places	Auto Sales	Furniture/ Appliance	Apparel Stores	Food Markets	Service Stations	Drug Stores	Other Retail	Retail Total	All Other Outlets	Total
1994	\$2,082	\$1,475	\$775	\$850	\$929	\$275	\$278	\$119	\$3,646	\$10,429	3,735	\$14,164
1995	2,090	1,532	1,024	975	1,019	266	281	113	3,678	\$10,978	3,967	\$14,945
1996	2,436	1,727	1,374	1,145	921	285	292	108	3,155	\$11,443	4,711	\$16,154
1997	2,656	1,839	1,595	1,238	1,031	297	327	119	3,740	\$12,842	4,518	\$17,360
1998	2,925	2,032	2,112	1,388	1,033	325	318	131	4,177	\$14,441	5,026	\$19,467
1999	2,740	2,077	2,265	1,485	1,116	344	269	143	4,079	\$14,518	5,128	\$19,646
2000	3,011	2,379	2,724	1,845	1,226	347	323	173	4,169	\$16,197	6,386	\$22,583
2001	3,112	2,551	3,118	1,824	1,343	351	417	186	4,706	\$17,608	7,270	\$24,878
2002	2,646	2,321	2,533	1,593	1,171	371	379	180	3,674	\$14,868	5,009	\$19,877
2003	2,316	2,172	2,094	1,455	1,114	375	388	171	2,811	\$12,896	4,834	\$17,730

Source: California State Board of Equalization compiled by The HDL Companies

NOTE: All amounts have been restated in Fiscal Year totals. Prior CAFR amounts were reported as Calendar Year totals.

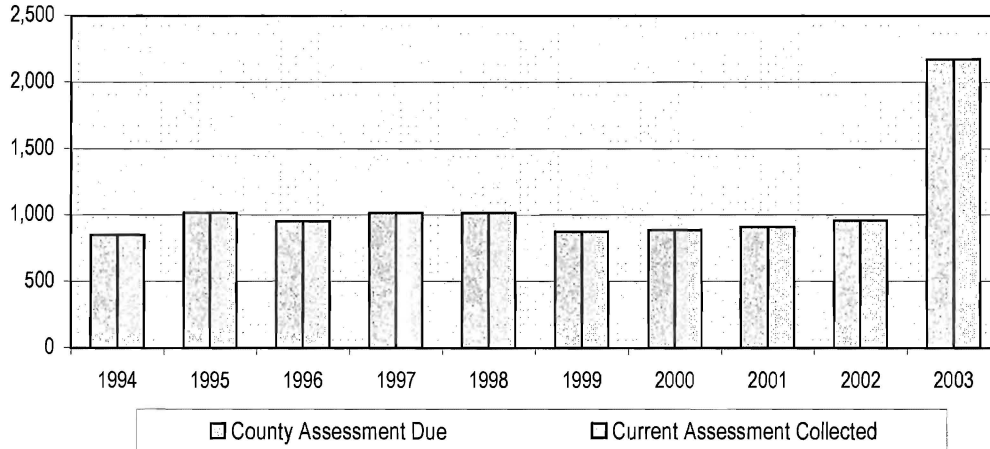
**SALES TAX RATES FOR THE
 FISCAL YEAR ENDED JUNE 30, 2003**

State Funds	6.00%
County Transportation Fund (Transportation Development Act)	0.25%
County Transportation Fund	1.00%
City	1.00%
	8.25%

Source: California State Board of Equalization

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
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
2003	2,169	2,169	(A)	2,169

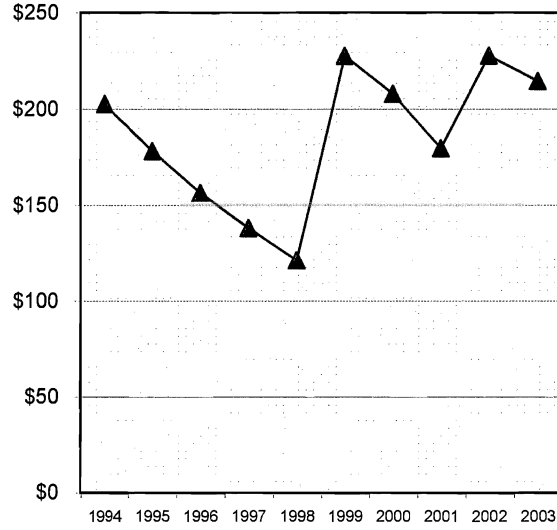
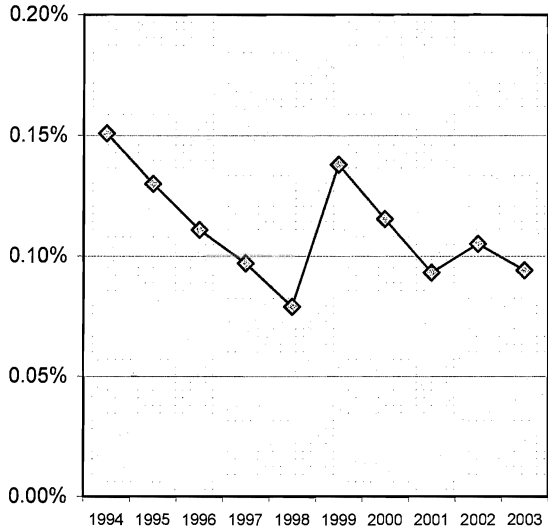
Source: County of Santa Clara Assessor's Office

Notes: (A) 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 Certificates of Participation Bonded Debt to Assessed Value and Net Certificates of Participation

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
1994	56,700	\$7,592,131	\$11,498	0.151%	202.79
1995	56,700	7,795,396	10,103	0.130%	178.18
1996	57,000	8,058,927	8,916	0.111%	156.42
1997	57,800	8,206,532	7,981	0.097%	138.08
1998	57,900	8,885,623	7,026	0.079%	121.35
1999	58,300	9,623,868	13,271	0.138%	227.63
2000	58,500	10,533,778	12,162	0.115%	207.90
2001	60,200	11,609,915	10,813	0.093%	179.62
2002	60,500	13,102,696	13,778	0.105%	227.74
2003	60,465	13,776,406	12,962	0.094%	214.37

Source: Annual Financial Statements

City of Palo Alto - Computation of Legal Debt Margin
June 30, 2003
(in thousands of dollars)

<hr/>	
2002-2003 Assessed Valuation	<u>13,776,406</u>
Debt limit - 15% of assessed value	2,066,461
Amount of debt applicable to debt limit:	
Certificates of participation	12,905
Capital lease obligations	57
Special assessment debt with governmental commitment	<u>510</u>
Total	13,472
Less amount of debt not applicable to debt limit	<u>0</u>
Total amount of debt applicable to debt limit	<u>13,472</u>
Legal debt margin	<u><u>2,052,989</u></u>
<hr/>	

Source: Annual Financial Statements

- 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 (aka: 1993 California Avenue Parking) debt because there is no government commitment (\$1,545)

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

June 30, 2003 (\$000)

2002-2003 Assessed Valuation \$13,776,406

	Percentage Applicable To City of Palo Alto	June 30, 2003 Bonded Debt
Direct and Overlapping Bonded Debt		
OVERLAPPING TAX AND ASSESSMENT DEBT:		
Santa Clara Valley Water District, Zone W-1	0.573	\$40,339
Foothill-De Anza Community College District	22.461	23,345,971
Palo Alto Unified School District	89.171	111,102,607
Fremont Union High School District	0.008	10,786
Mountain View-Los Altos Union High School District	1.090	517,286
Cupertino Union School District	0.006	7,493
Los Altos School District	0.983	831,461
Whisman School District	4.255	1,207,288
City of Palo Alto Special Assessment Bonds	100.000	46,650,000
Santa Clara Valley Water District Benefit Assessment District	7.580	15,438,186
Total Overlapping tax and assessment debt		199,151,417
DIRECT AND OVERLAPPING GENERAL FUND OBLIGATION DEBT:		
Santa Clara County General Fund Obligations	7.580	45,972,700
Santa Clara County Board of Education Certificates of Participation	7.580	1,441,716
Foothill-DeAnza Community College District Certificates of Participation	22.461	5,934,196
Mountain View-Los Altos Union High School District Certificates of Participation	1.090	50,685
Cupertino Union School District Certificates of Participation	0.006	442
City of Palo Alto General Fund Obligations	100.000	12,905,000
Midpeninsula Regional Open Space Park District General Fund Obligations	13.300	14,379,319
Santa Clara Valley Water District Certificates of Participation		
El Camino Hospital District Authority	0.108	1,318
Total gross direct and overlapping General Fund obligation debt		80,685,376
Less: El Camino Hospital Authority (100% self-supporting)		1,318
Total net direct and overlapping General Fund obligation debt		80,684,058
GROSS COMBINED TOTAL DEBT		279,836,793 ⁽¹⁾
NET COMBINED TOTAL DEBT		\$279,835,475

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

Ratios to Assessed Valuation:

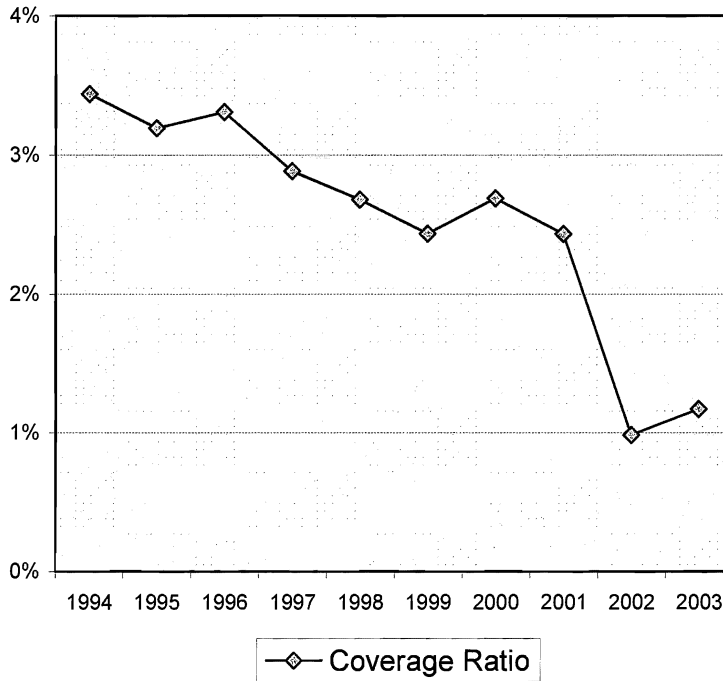
Combined Direct Debt (\$12,905,000)	0.09%
Total Overlapping Tax and Assessment Debt	1.44%
Gross Combined Total Debt	2.03%
Net Combined Total Debt	2.03%

STATE SCHOOL BUILDING AID REPAYABLE AS OF 6/30/03:

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 General Expenditures (1)	Debt Service			Coverage Ratio
		Principal	Interest	Total	
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%
2003	134,050	875	696	1,571	1.17%

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

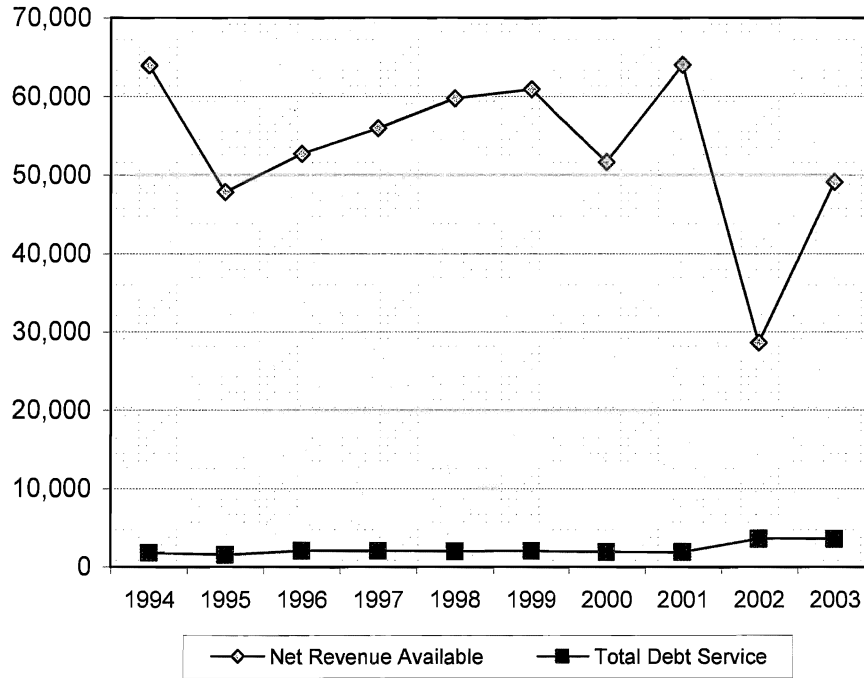
Source: Governmental Funds:
Statement of Revenues, Expenditures, and Changes in Fund Balance



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

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

Last Ten Fiscal Years (\$000)



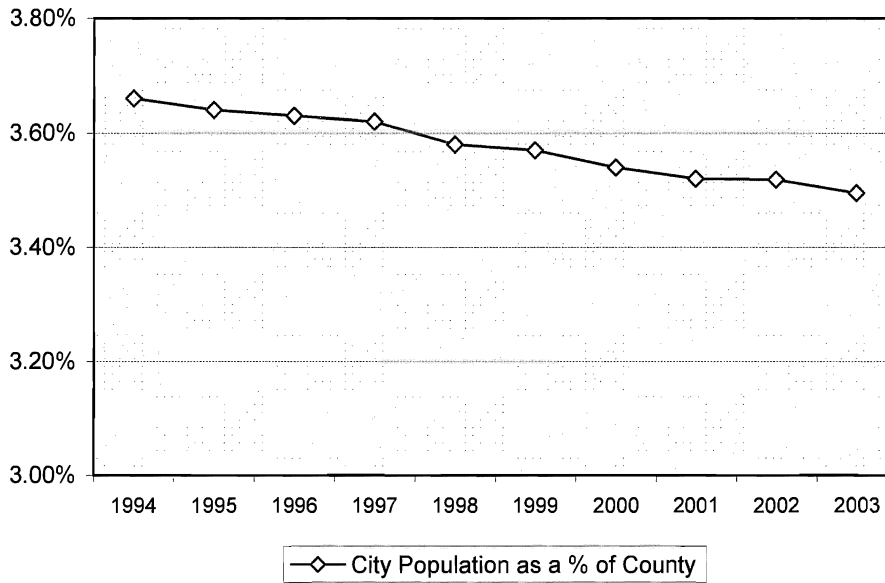
Fiscal Year	Gross Revenue	Direct Operating Expenditures (1)	Net Revenue Available for Debt Services (2)	Debt Service			Coverage
				Principal	Interest	Total	
1994	132,317	68,371	63,946	875	945	1,820	35.14
1995	124,537	76,693	47,844	555	997	1,552	30.83
1996	120,828	68,096	52,732	755	1,308	2,063	25.56
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	177,327	148,694	28,633	1,955	1,660	3,615	7.92
2003	166,019	116,869	49,150	1,255	2,354	3,609	13.62

Source: Annual Financial Statements

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

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

Last Ten Fiscal Years (\$000)



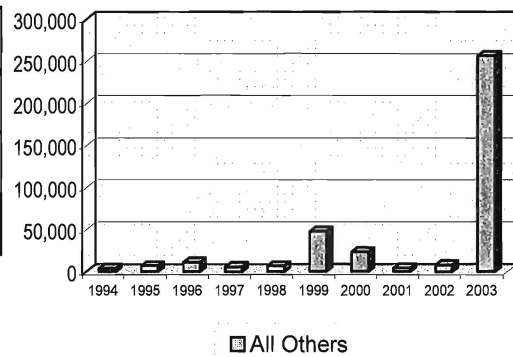
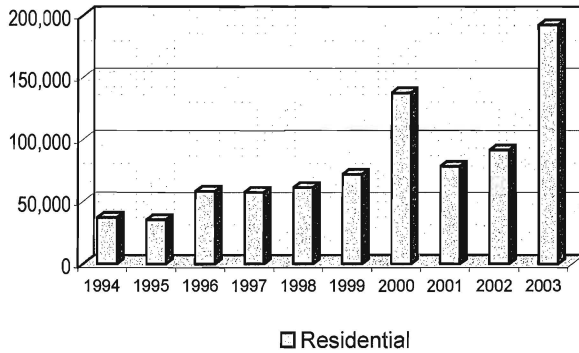
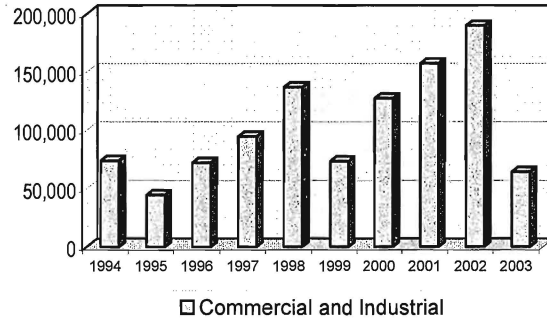
Fiscal Year	City Size Square Miles	Street Miles	City Population	(1) County Population	City Population % of County	(2) School Population	(3) Unemployment Rate
1994	25.98	193.12	56,700	1,587,800	3.66%	8,334	3.30%
1995	25.98	193.12	56,700	1,607,700	3.64%	8,419	2.80%
1996	25.98	193.12	57,000	1,612,300	3.63%	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%
2003	25.98	193.12	60,465	1,729,917	3.50%	10,151	4.10%

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
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
2003	13,776,406	725	64,219	2,275	192,359	3,000	256,578

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

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

June 30, 2003 (\$000)

TYPE	COVERAGE (Deductible)	LIMITS	COMPANY	EXPIRATION DATE
PROPERTY LOSS				
Blanket	All real & personal property (\$25,000 deductible), Fine Arts (\$2,500 deductible)	\$248,536,204	CA Public Entity Property Program	07/01/04
Boiler & Machinery	All real & personal property (\$50,000 deductible)	\$500,000 combined limit excluding power generation facilities	CA Public Entity Property Program	07/01/04
		\$100,000 combined business interruption		
Flood Insurance	All real property 1305 Middlefield Road (\$1000 deductible)	\$500,000	Hartford Fire Insurance Company	04/05/04
FINANCIAL LOSS				
Employee Dishonesty	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	07/01/04
UMBRELLA EXCESS	City is a member of an insurance pool participating with a number of other California cities (\$1,000,000 self-insured retention)	\$19,500,000 annual aggregate	Insurance Company of Pennsylvania	07/01/04
SPECIAL LIABILITY				
Volunteers Accident	Each occurrence Medical - Each person / (\$25 deductible)	\$20,000	American National Insurance Company	01/01/04
Special Events	Bodily injury	\$1,000,000 per occurrence	General Star Indemnity Company	01/01/04
AUTOMOBILE LIABILITY				
City Manager Vehicle Only	Physical Damage (\$1,000 deductible comp. collision)	\$1,000,000	Progressive Com. Vehicle Insurance	04/11/04
Utility Director Vehicle	Physical Damage (\$1,000 deductible comp. Collision)	\$1,000,000	Progressive Com. Vehicle Insurance	04/11/04
EMPLOYEE BENEFIT				
Travel Accident	Indemnity, based on salary	\$1,500,000 per accident	Life Insurance Co. of North America	06/01/06
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 \$750,000 liability	\$750,000 per occurrence		07/01/04
EXCESS WORKERS' COMPENSATION				
	Pooled Retention	\$50,000,000 limit per occurrence - Workers Comp and Employers Liability	CA. Public Entity Ins Authority	07/01/04
	Reinsured Layer	\$45,000,000 workers comp per occurrence, excess of pooled retention limit, includes \$5,000,000 employers liability excess of \$5,000,000 pooled retention, \$10,000,000 sublimit for terrorism	CA. Public Entity Ins Authority	07/01/04

SOURCE: Sandra Blanch, Human Resources Dept, City of Palo Alto

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

June 30, 2003 (\$000)

Taxpayer	Type of Business	Assessed Valuation	Percent of Total Assessed Valuation
Leland Stanford Jr. University	University and Ancillary	\$2,034,196	15.48%
Space Systems/Loral, Inc.	Research and Development	255,731	1.95%
Agilent Technologies	Communications and Life Science	82,038	0.62%
Sun Microsystems, Inc,	Computers and Electronics	78,072	0.59%
Harbor Investment Partners	Offices, Banks and Clinics	59,186	0.45%
Embaracadero Place Associates	Offices, Banks and Clinics	49,250	0.37%
Cowper-Hamilton Associates	Offices, Banks and Clinics	41,168	0.31%
California Pacific Commercial Corp.	Offices, Banks and Clinics	34,226	0.26%
Pacific Hotel Development Venture	Offices, Banks and Clinics	31,131	0.24%
Embarcadero Bayshore Investors	Offices, Banks and Clinics	31,093	0.24%
Totals		\$2,696,091	20.52%
2002/2003 Local Secured Assessed Valuation:		\$13,141,986	

SOURCE: County of Santa Clara compiled by Hunt Consulting, LLC

City of Palo Alto - Miscellaneous Statistics

June 30, 2003

YEAR CITY DISCOVERED	1769	NUMBER OF HOUSING UNITS	26,934
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	34,939
POPULATION	60,465		

POLICE PROTECTION

Number of Stations	1
Number of Full-time Positions	178
Number of Police Patrol Vehicles	33

FIRE PROTECTION

Number of Stations	8
Number of Full-time Positions	130
Number of Fire Apparatus	22
Number of Fire Hydrants	1,746

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

MUNICIPAL UTILITY PLANTS:

WATER

Millions of CCF Sold	5.6
Accounts	19,487
Miles of Water Mains	226

WASTEWATER

Millions of Gallons Processed	8,704
Accounts	21,819
Miles of Sanitary Sewer Lines	202

ELECTRIC

Millions of kWh Sold	957
Accounts	28,408
Pole Miles of Overhead Lines	227
Trench Miles of Underground Lines	186

GAS

Millions of Therms Sold	31.8
Accounts	23,169
Miles of Gas Mains	207



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Financial Statements Performed in Accordance
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Report on Compliance and Internal Control
Over Compliance Applicable to Each Major
Federal Award Program..... 156



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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.



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Website: www.mazeassociates.com

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, 2003 and have issued our unqualified report thereon dated October 24, 2003. 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 24, 2003.

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) and Department of Transportation Highway Planning and Construction Grant (CFDA #20.205) were major programs.

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.

Maze + Associates

October 24, 2003

CITY OF PALO ALTO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

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	\$140,661
Subgrants:			
Mid Peninsula Citizens for Fair Housing			25,800
Emergency Housing Consortium			8,490
Saint Vincent dePaul			10,000
New Housing Development			20,288
Stevenson Hs Emergency Cal			47,321
Clara Mateo Alliance Shelter			22,000
Clara Mateo Alliance Family Shelter			28,750
Emerson St PAHC			67,583
Elsa Segovia Rehab			54,160
Lytton Elevator			65,000
InnVision			20,715
Shelter Network Haven Housing			20,000
Palo Alto Housing Corporation:			
Barker Counseling			24,745
Loans Receivable			<u>4,000,378</u>
Total CDBG Expenditures		14.218	<u>4,555,891</u>
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	128,876
	6-MTCPA01	20.205	<u>192,000</u>
Total Department of Transportation Expenditures			<u>320,876</u>
U.S. Department of Justice			
Local Law Enforcement Block Grant		16.592	<u>50,421</u>
National Parks Service	H8350010002	15.916	<u>22,000</u>
TOTAL FEDERAL FINANCIAL AWARDS			<u><u>\$5,949,188</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, 2003, and have issued our report thereon dated October 24, 2003. 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.

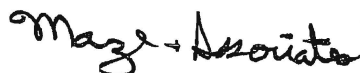
Compliance

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 24, 2003.

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.



October 24, 2003

A Professional Corporation

**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, 2003. 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, 2003.

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, 2003, 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.

Maze + Associates

October 24, 2003



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The City of Palo Alto is located in northern Santa Clara County, approximately 35 miles south of the City of San Francisco and 12 miles north of the City of San Jose. Spanish explorers named the area for the tall, twin-trunked redwood tree they camped beneath in 1769. Palo Alto incorporated in 1894 and the State of California granted its first charter in 1909.

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Americans With Disabilities Act Statement

In compliance with Americans with Disabilities Act (ADA) of 1990, this document may be provided in other accessible formats.

For information contact:

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