

*City of Palo Alto, California*

**2005-2006**

**Comprehensive**

**Annual Financial Report**

*Fiscal Year Ended June 30, 2005*







*City of Palo Alto  
California*

**Comprehensive  
Annual Financial  
Report**

**For the fiscal year ended  
June 30, 2006**



Prepared by: Administrative Services Department

This page is intentionally left blank.



# Table of Contents.....

## INTRODUCTION

Letter of Transmittal .....	v
City Officials .....	ix
Organizational Structure .....	x
Administrative Services Department Organization .....	xi
GFOA Certificate of Achievement for Excellence in Financial Reporting .....	xii
CSMFO Certificate of Award for Outstanding Financial Reporting.....	xiii

## FINANCIAL SECTION

Independent Auditor’s Report on Basic Financial Statement.....	xv
----------------------------------------------------------------	----

## M D & A

Management’s Discussion and Analysis.....	1
-------------------------------------------	---

## BASIC FINANCIAL STATEMENTS

### Citywide Financial Statements

Statement of Net Assets .....	25
Statement of Activities .....	26

### Fund Financial Statements

#### Major Governmental Funds:

Balance Sheet.....	29
Reconciliation of Fund Balances to Governmental Activities Net Assets.....	30
Statement of Revenues, Expenditures, and Changes in Fund Balance .....	31
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities.....	32
Statement of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual .....	33

## **BASIC FINANCIAL STATEMENTS (Continued)**

### **Major Proprietary Funds:**

Statement of Net Assets .....	36
Statements of Revenues, Expenses and Changes in Net Assets .....	38
Statement of Cash Flows.....	40

### **Fiduciary Funds:**

Statement of Fiduciary Net Assets .....	45
-----------------------------------------	----

### **Notes to Financial Statements**

Index to the Notes to the Basic Financial Statements .....	47
Notes to Basic Financial Statements .....	49

## **SUPPLEMENTAL INFORMATION**

### **Non-major Governmental Funds**

Combining Balance Sheets .....	102
Combining Statements of Revenues, Expenditures and Changes in Fund Balances.....	106
Combining Schedule of Revenues, Expenditures and Changes in Fund Balance—Budget and Actual.....	110

### **Internal Service Funds**

Combining Statements of Net Assets .....	119
Combining Statements of Revenues, Expenses and Changes in Net Assets.....	120
Combining Statements of Cash Flows.....	121

### **Fiduciary Funds**

Statement of Changes in Assets and Liabilities - All Agency Funds.....	124
------------------------------------------------------------------------	-----



**STATISTICAL SECTION**

**Financial Trends**

Net Assets by Component ..... 127

Changes in Net Assets ..... 128

Fund Balances of Governmental Funds ..... 130

Changes in Fund Balance of Governmental Funds ..... 132

**Revenue Capacity**

Assessed Value of Taxable Property..... 134

Property Tax Rates, All Overlapping Governments ..... 135

Property Tax Levies and Collections ..... 136

Principal Property Taxpayers ..... 137

**Debt Capacity**

Ratio of Outstanding Debt by Type..... 138

Computation of Direct and Overlapping Debt..... 139

Computation of Legal Bonded Debt Margin ..... 140

Revenue Bond Coverage..... 141

**Demographic and Economic Information**

Taxable Transactions by Type of Business..... 142

Demographic and Economic Statistics ..... 143

Principal Employers ..... 144

**Operating Information**

Full-Time Equivalent City Government Employees by Function ..... 145

Operating Indicators by Function/Program..... 146

Capital Asset Statistics by Function/Program ..... 148

Insurance Coverage..... 150



**SINGLE AUDIT SECTION**

Schedule of Current Year Findings and Questioned Costs ..... 155

Section I - Summary of Auditor’s Results..... 155

Section II – Financial Statement Findings ..... 157

Section III – Federal Award Findings and Questioned Costs..... 157

Section IV - Status of Prior Year Findings  
and Questioned Costs ..... 157

Schedule of Expenditures of Federal Awards..... 159

Notes to the Schedule of Expenditures of Federal Awards..... 161

Report on Internal Control over Financial Reporting and On Compliance  
And Other Matters Based on an Audit of Financial Statements  
Performed In Accordance with Government Auditing Standards ..... 163

Report on Compliance with Requirements Applicable To  
Each Major Program and on Internal Control Over Compliance  
in Accordance with OMB Circular A-133..... 165



**City of Palo Alto**  
*Office of the City Manager*

## **Transmittal Letter**.....

December 12, 2006

**THE HONORABLE CITY COUNCIL**  
**Palo Alto, California**

*Attention:* Finance Committee

**COMPREHENSIVE ANNUAL FINANCIAL REPORT**  
**YEAR ENDED JUNE 30, 2006**

**Members of the Council and Citizens of Palo Alto:**

**Transmittal:** The Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2006, 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 completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control that it has established for this purpose. The objective of internal controls is to provide reasonable, rather than absolute, assurance that the CAFR information is accurate in all material respects.

***INDEPENDENT AUDIT***

The City of Palo Alto's financial statements have been audited by Maze and Associates, a firm of licensed certified public accountants. The goal of the audit is to obtain reasonable assurance that the financial statements are free of material misstatement. Maze and Associates concluded, based on the audit, that there was a reasonable basis for rendering an unqualified opinion for the fiscal year ended June 30, 2006, and that the financial statements are fairly presented in conformity with generally accepted accounting principles (GAAP). The independent auditor's report is presented as the first component of the financial section of this report.

In addition, Maze and Associates also conducts the federally mandated "Single Audit" designed to meet the special needs of federal grantor agencies. The standards governing the Single Audit require the independent auditor to report on the fair presentation of the financial statements, government's internal controls and compliance with legal requirements. These reports are available in the Single Audit section of the CAFR.



## THE PALO ALTO ECONOMY

**Local Trends:** The City of Palo Alto, population 62,148, is a largely “built-out” community in the heart of Silicon Valley and the greater San Francisco and San Jose areas. The adjacent Stanford University, one of the premier 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 and relatively stable employers such as Stanford University, the Stanford Medical Center, the Palo Alto Medical Foundation, the Palo Alto Unified School District, and businesses such as the Stanford Shopping Center, Hewlett-Packard/Compaq, and Roche Pharmaceuticals, Palo Alto has enjoyed a diverse employment and revenue base. The City, however, was not immune from the pervasive economic downturn that began in January 2001.

This downturn, manifested by layoffs in the technology sector, lack of capital investment, curtailed venture capital activity, and weaker consumer spending persisted into 2003-04, with signs of recovery emerging through 2004-05. The economy has continued to recover steadily, if slowly, through 2005-06. Venture Capital investment has continued to rise in Silicon Valley – showing a 27 percent jump from first quarter 2005 to first quarter 2006. Economically sensitive revenue sources such as sales and transient occupancy tax revenues have continued to rebound slowly after years of declines.

Since January 2001, the City has engaged in a series of revenue enhancement and expense reduction programs. Therefore it did not need to draw down reserves to solve the numerous financial tests it faced. While the economy now seems on a fairly stable footing, growth is quite slow and may slow further. The housing market, for example, has softened given rising interest rates and high home prices. This could result in weaker consumer spending and low to no growth in property tax revenue.

The City faces a number of potential expense and revenue challenges in the future. These include: funding rising employee benefit costs and existing and new infrastructure needs; warding off strong competition from neighboring city retail outlets for sales tax dollars; changing technology which threaten our future UUT revenues; and preventing the potential exodus of automobile dealerships generating high sales tax receipts. Furthermore, new GASB rules require the City to recognize expenditures to cover future retiree medical premiums and to establish a funding plan. To counter these challenges, the City has initiated changes in health benefit plans, launched new efforts to maintain and attract businesses and to explore new revenue sources, and explored options for setting aside retiree medical funds and for investing more heavily in the City’s infrastructure. Based on its efforts to date, the City is well positioned to meet future economic challenges.

**Employment Trends:** Palo Alto is home to a strong mix of large, medium and small firms. Palo Alto employment opportunities are much sought after and include: education at Stanford University, high technology at the Stanford Research Park, and health care at two medical facilities of national stature. Numerous institutions that have more than 1,000 employees include: the University, the Veterans Affairs Palo Health Care facility, the Medical Foundation, Hewlett Packard/Compaq, the Palo Alto Unified School District, and the City of Palo Alto.

However, over the last few years, a number of local and regional technology companies have implemented layoffs, including Agilent, Apple, Sun Microsystems, Oracle, Hewlett Packard/Compaq, Intel, and others. Consequently, Palo Alto’s unemployment rate rose to a high of 4.4 percent in July 2003. During the same period, the Santa Clara County unemployment rate rose to 8.4 percent. As the economy has slowly rebounded since 2003, unemployment rates have declined. Over the last year, unemployment rates declined from 2.7 percent to 2.3 percent in Palo Alto and from 5.8 percent to 5.0 percent in Santa Clara County. The number of jobs in the County grew 3 percent from August 2005 to August 2006. That growth is predicted to continue in the near future.



**Real Estate Market:** Assessed value of property in Santa Clara County increased by \$21.77 billion, or 9.07 percent from the previous year. The year's growth was strong relative to the past ten years: the growth rate has exceeded 9.07 percent only three times since 1997; last year's growth rate was 7.99 percent. The healthy increase is attributed principally to improving commercial and industrial property values, after four years of declining and then stagnant growth.

According to the Santa Clara County Assessor, "Silicon Valley continues to experience realignment from technology manufacturing to an internet-based economy. Companies like E-Bay, Google, Yahoo and Apple are expanding while other companies like Sun and HP are consolidating their facilities...In contrast, the 'hot' residential market is beginning to cool as the number of deeds recorded declined 4 percent over the prior year. In addition, the number of residential properties, in which market value declined below the purchase price, doubled during the past year."

In Palo Alto assessed valuation increased by 8.31 percent, compared to an 8.7 percent increase from 2003-04 to 2004-05. Palo Alto has experienced similar trends to those of the County, with a slowing residential market and a growing commercial market. It is expected, should a sustained housing downturn emerge, that Palo Alto residential values will remain relatively stable compared to other Peninsula cities. This phenomenon occurred during the housing downturn of the early 1990's and resulted from the strong demand to be located in the Palo Alto Unified School District.

Palo Alto secured property (property subject to a lien) values were 8.9 percent higher in 2005-06 than in 2004-05, but unsecured property values rose by only 2.1 percent.

**Cash and Investments:** The City of Palo Alto invests funds prudently and has adopted an investment policy as prescribed by State law that restricts the City to investments emphasizing, in the following priority order, safety, liquidity and yield. Staff provides a quarterly report of investments for Council and Finance Committee review. The City's investment practice is to buy securities and hold them to maturity to avoid potential losses from a sale. During 2005-06, staff complied with all aspects of the investment policy.

## **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, an adult and children's theater, 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 which the City Manager and three other officials, the City Attorney, City Clerk, and City Auditor, report directly to.

**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, periodic budget-versus-actual, and 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, libraries, public works, planning and community environment, public safety, 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 twelfth consecutive year the City has received both of these awards and the current certificates appear immediately after the end of this transmittal letter. As of 2005-06 the filing requirements for CSMFO have changed. If an agency applies for the GFOA award the agency is not eligible to also apply for the CSMFO award. The 2005-06 CAFR has been submitted to the GFOA award program and management believes that, once again, it will meet the criteria for this distinguished financial reporting award.

**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, Payroll Analysts 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

Judy Kleinberg, *Mayor*

Yoriko Kishimoto, *Vice-Mayor*

John Barton

Bern Beecham

LaDoris Cordell

Peter Drekmeier

Larry Klein

Jack Morton

Dena Mossar

### Finance Committee

Yoriko Kishimoto, *Chair*

Bern Beecham

Larry Klein

Dena Mossar

### Policy and Services Committee

LaDoris Cordell, *Chair*

John Barton

Peter Drekmeier

Jack Morton

## Council-Appointed Officers

### City Manager

Frank Benest

### City Attorney

Gary Baum

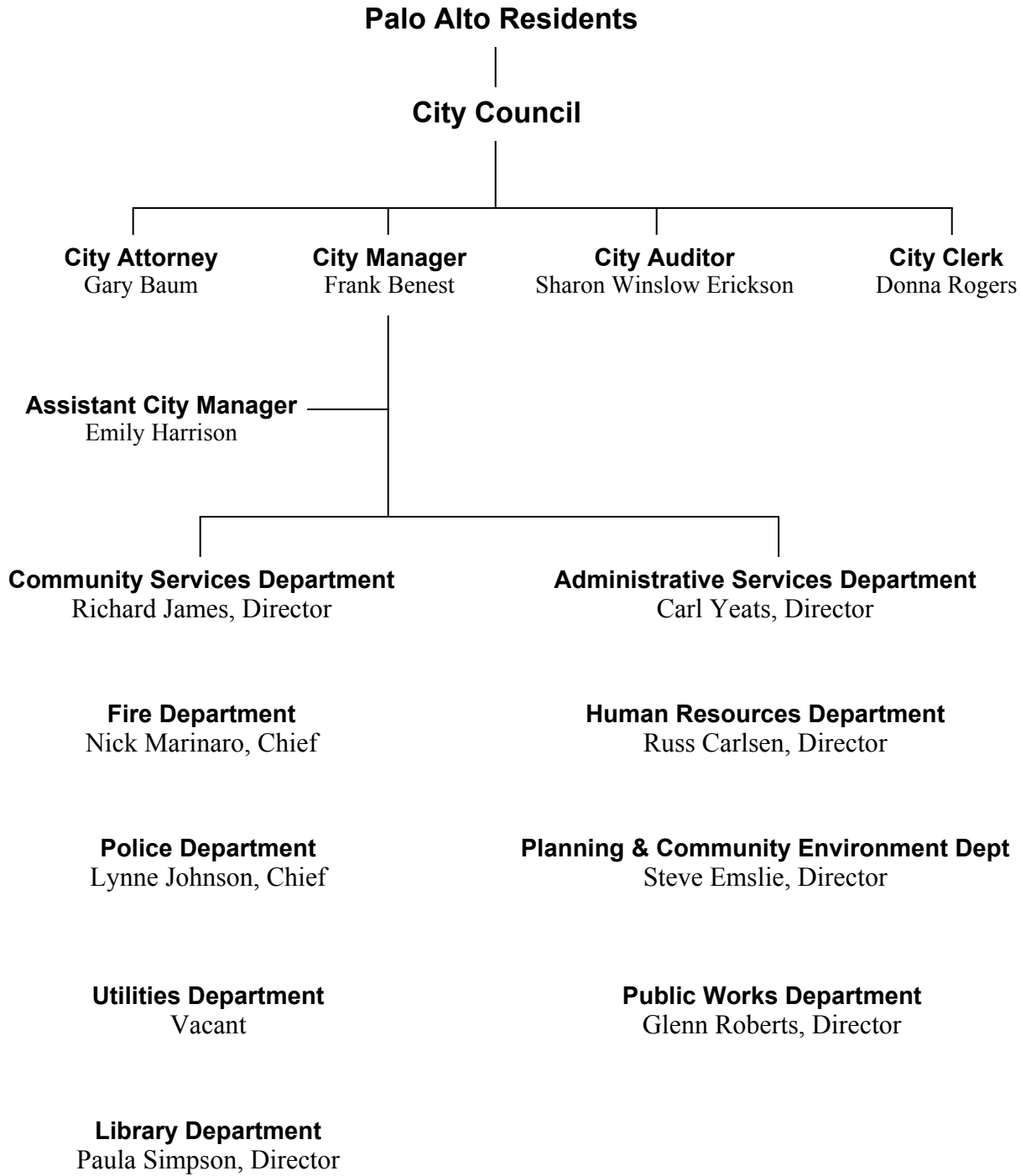
### City Clerk

Donna Rogers

### City Auditor

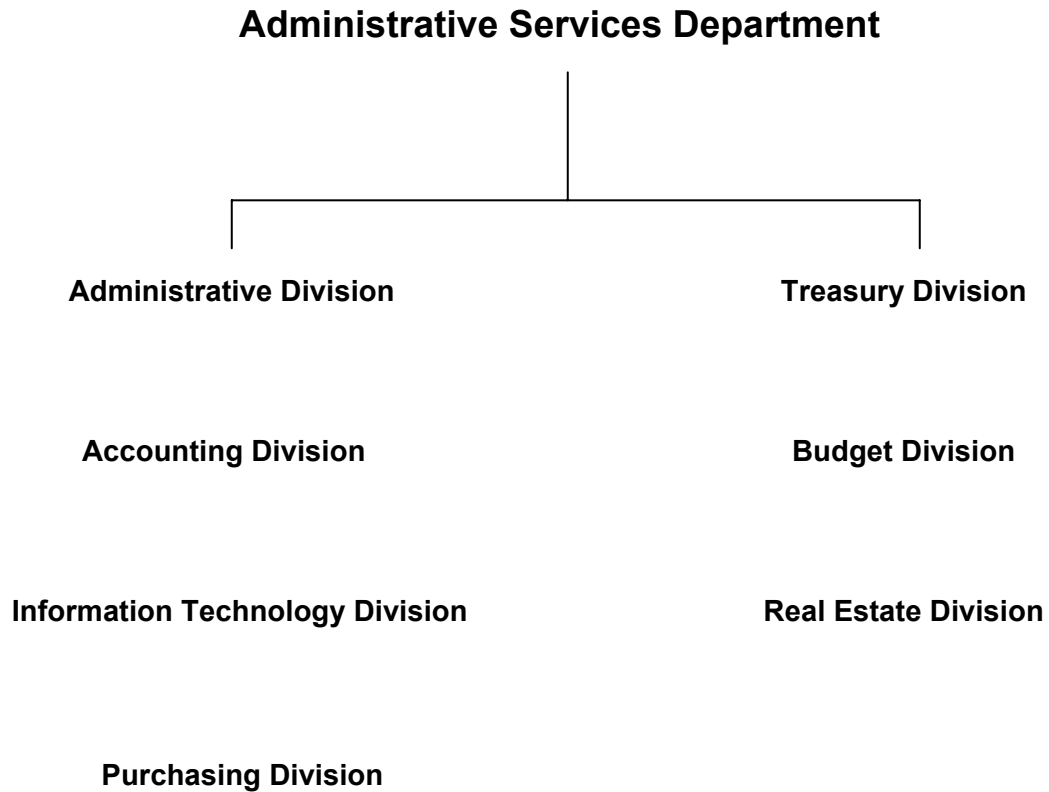
Sharon Winslow Erickson

# City of Palo Alto Organization .....





# Administrative Services Organization .....



## 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, 2005

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.



*Carla E. Perry*

President

*Jeffrey R. Emer*

Executive Director



# California Society of Municipal Finance Officers – Award .....

## California Society of Municipal Finance Officers

Certificate of Award

**Outstanding Financial Reporting 2004-05**

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, 2006**

Bill Thomas, Chair  
Professional & Technical Standards Committee

***Dedicated to Excellence in Municipal Financial Management***



This page is intentionally left blank.

# MAZE & ASSOCIATES

## INDEPENDENT AUDITOR'S REPORT ON BASIC FINANCIAL STATEMENTS

Honorable Mayor and City Council  
City of Palo Alto, California

**ACCOUNTANCY CORPORATION**  
3478 Buskirk Ave. - Suite 215  
Pleasant Hill, California 94523  
(925) 930-0902 • FAX (925) 930-0135  
maze@mazeassociates.com  
www.mazeassociates.com

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, 2006, 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, 2006 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 13, 2006 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 13, 2006

A Professional Corporation



This page is intentionally left blank.

# Management's Discussion and Analysis

With the 2005-06 Comprehensive Annual Financial Report (CAFR), the City will have complied with 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 five consecutive years. The implementation 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. The requirements of GASB 34 are such that the City needed to make substantial changes to its financial statement format. Moreover, the City is required to provide more detailed discussion and analysis of its financial activities, particularly in comparing 2005-06 results to the prior fiscal year activity and to the 2005-06 fiscal year budget. Other required changes are described in the subsequent financial statements below. To obtain a complete understanding 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





## **Management Discussion and Analysis**

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. Their focus is 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 Fund.

For certain entities and funds, the City acts solely as a depository agent. For example, the City has several Assessment Districts for which it produces fiduciary statements detailing the cash balances and activities of these districts. These statements are independent, and their balances are excluded from the City's financial statements.

Together, all these statements are called the Basic Financial Statements.

### **Citywide Financial Statements**

**Governmental Activities** - All of the City's basic services are considered to be governmental activities. Included in basic services are 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, Library 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 also include the activities of the Palo Alto Public Improvement Corporation and the Redevelopment Agency which are separate legal entities financially accountable to the City.

**Business-Type Activities** - All of the City's enterprise activities are reported as business-type activities, 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 customers 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 for 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. Therefore, each Major Fund is presented individually, with all Non-major Funds combined in a single column on each fund statement. Subordinate schedules display these



Non-major Funds in more detail. Major Funds present the major activities of the City for the year. The General Fund is always considered 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 2005-06, the City had 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, similar to that used by private-sector companies. These statements, as in the past include all their assets and liabilities, current and long-term.

Since the City's Internal Service Funds provide goods and services exclusively to the City's Governmental and Business-type activities, their activities are only reported in total at the Fund level. Internal Service Funds, such as Printing and Mailing services, can not be considered Major Funds because their revenues are derived from other City Funds. Revenues between Funds are eliminated in the Citywide Financial Statements and any related profits or losses in Internal Service Funds are returned to the activities in which they were created, along with any residual net assets of the Internal Service Funds.

Budget vs. Actual financial comparisons information are presented only for the General Fund and all Major Special Revenue Funds.

### ***Fiduciary Statements***

The City is the fiduciary 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 utilize these assets to finance its own operations.

## ***FINANCIAL HIGHLIGHTS***

### **Economic Background**

The economic recovery that began in 2004-05 continued steadily, if slowly, through 2005-06. Unemployment rates over the last year declined from 2.7 percent to 2.3 percent in Palo Alto and from 5.8 percent to 5.0 percent in Santa Clara County. Statistics on job growth in the County indicate a 3.0 percent growth from August 2005 to August 2006. Venture Capital investment has continued to rise in Silicon Valley – showing a 27.0 percent jump from first quarter 2005 to first quarter 2006. Economically sensitive revenue sources such as sales and transient occupancy tax revenues have continued to rebound after years of declines.

Since January 2001, the City has engaged in a series of expense reduction programs, so it did not need to draw down reserves to solve the numerous financial tests it faced. While the economy now seems on a fairly stable footing, growth is quite slow and may slow further. The housing market has cooled rapidly, portending potential reductions in property tax revenues and weaker consumer spending.

The City faces a number of potential expense and revenue challenges in the future. These include: funding rising employee benefit costs and existing and new infrastructure needs; warding off strong competition from neighboring city retail outlets for sales tax dollars; legal developments which threaten our future UUT revenues; and preventing the potential exodus of automobile dealerships generating high sales tax receipts. Furthermore, new GASB rules require the City to recognize expenditures to cover future retiree medical premiums and to establish a funding plan. To counter these challenges, the City has initiated changes in health benefit plans; launched new efforts to maintain and attract businesses and to explore new revenue sources; and explored options for setting aside retiree medical funds and for investing more heavily in the City's infrastructure. Based on its efforts to date, the City is proactively positioning itself to meet future economic challenges.

The comparisons in the discussion and analysis below are between 2005-06 and 2004-05. All increases and decreases are expressed relative to 2004-05 results. Fiscal year 2005-06 financial highlights include the following:

#### **Citywide**

- The City's total net assets increased to \$1,013.5 million, a \$43.3 million increase.
- The City's total capital assets, net of related debt, increased to \$630.1 million, a \$21.4 million increase.
- The City's total restricted net assets increased to \$31.6 million, a \$2.6 million increase.
- The City's total unrestricted net assets increased to \$351.9 million, a \$19.5 million increase.
- Citywide revenues totaled \$357.1 million, an increase of \$72.6 million from the prior year. This total consists of \$279.2 million in program revenues and \$77.9 million in general revenues. Program revenues and general revenues increased by \$53.8 million and \$18.8 million respectively.
- Total Citywide expenses were \$313.7 million, a \$25.8 million increase.
- Citywide total assets increased to \$1,118.9 million, a \$38.6 million increase.
- Citywide capital assets, increased by \$20.3 million to \$685.7 million.
- Citywide other assets increased \$18.3 million to \$433.2 million.
- Citywide total liabilities were \$105.4 million, a decrease of \$4.8 million.
- Citywide long-term debt decreased \$2.1 million to \$52.4 million.
- Citywide other liabilities were \$53.0 million, a decrease of \$2.7 million.





**Fund Level – Governmental Funds**

- Governmental Fund balances increased to \$101.2 million, a \$3.0 million increase.
- Governmental Fund revenues increased to \$111.6 million, an \$11.3 million increase.
- Governmental Fund expenditures were \$122.9 million, a \$1.9 million decrease.
- General Fund revenues came in at \$102.1 million, an increase of \$9.2 million over the prior year.
- General Fund expenditures are \$107.1 million, an increase of \$6.4 million.
- The General Fund balance of \$34.2 million at June 30, 2006 was an increase of \$2.4 million from the prior year (refer to Performance of Governmental Funds – General Fund, Page #14).

**Fund Level – Enterprise Funds**

- Enterprise Fund net assets increased to \$549.7 million, a \$27.9 million increase.
- Enterprise Fund operating revenues increased to \$240.6 million, a \$45.0 million increase over prior year revenues.
- Enterprise Fund operating expenses increased to \$183.7 million, a \$21.2 million increase.

## 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.

<b>GOVERNMENTAL ACTIVITIES</b>			
<i>Net Assets at June 30</i>			
(in Millions)			
	<u>2006</u>	<u>2005</u>	<u>Increase/ (Decrease) from 2005</u>
Cash and investments	\$160.2	\$149.8	\$10.4
Other assets	29.9	27.6	2.3
Capital assets	324.8	318.5	6.3
<b>Total Assets</b>	<u><b>514.9</b></u>	<u><b>495.9</b></u>	<u><b>19.0</b></u>
Long-term debt outstanding	10.2	11.0	(0.8)
Other liabilities	39.7	35.1	4.6
<b>Total Liabilities</b>	<u><b>49.9</b></u>	<u><b>46.1</b></u>	<u><b>3.8</b></u>
<b>Net Assets:</b>			
Invested in capital assets, net of debt	311.3	305.2	6.1
Restricted	29.9	27.3	2.6
Unrestricted	123.8	117.3	6.5
<b>Total Net Assets</b>	<u><b>\$465.0</b></u>	<u><b>\$449.8</b></u>	<u><b>\$15.2</b></u>

The City’s governmental net assets increased \$15.2 million to \$465.0 million in 2005-06. This change results from the following:

- Cash and investments increased by \$10.4 million primarily from an increase in the Internal Service Funds cash balance.
- Capital assets increased \$6.3 million net of depreciation; \$4.9 million is a result of roadway network and \$1.1 million of internal service fund capital improvement projects.
- Other liabilities increased by \$4.6 million, primarily from a \$3.7 million increase in claims payable.

- Net assets invested in capital assets net of related debt increased \$6.1 million as the City added General Fund infrastructure assets as discussed in the Capital Assets section.
- Unrestricted net assets increased \$6.5 million for a total of \$123.8 million; this represents 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)

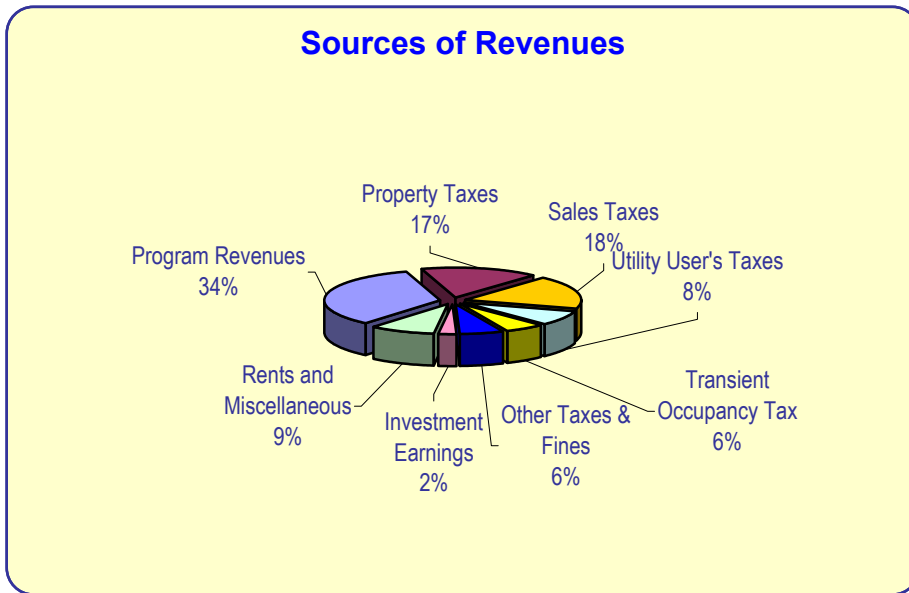
<b>Revenues by Source</b>	<b>2006</b>	<b>2005</b>	<b>Increase/ (Decrease) from 2005</b>
<b>Program Revenues:</b>			
Charges for services	\$31.1	\$25.2	\$5.9
Operating contributions & grants	4.0	3.7	0.3
Capital contributions & grants	3.2	0.8	2.4
<b>Total Program Revenues</b>	<b>38.3</b>	<b>29.7</b>	<b>8.6</b>
<b>General Revenues:</b>			
Property Taxes	18.7	16.7	2.0
Sales Taxes	20.3	19.3	1.0
Utility User's Taxes	8.8	7.3	1.5
Transient Occupancy Tax	6.4	5.7	0.7
Other Taxes and Fines	7.0	5.6	1.4
Investment Earnings	2.6	5.0	(2.4)
Rents and Miscellaneous	10.4	13.0	(2.6)
<b>Total General Revenues</b>	<b>74.2</b>	<b>72.6</b>	<b>1.6</b>
<b>Total Revenues</b>	<b>\$112.5</b>	<b>\$102.3</b>	<b>\$10.2</b>

**Governmental Activities – Revenues**

The table above shows that governmental revenues totaled \$112.5 million in 2005-06, an increase of \$10.2 million compared to prior year revenues of \$102.3 million.

Property taxes had an increase of \$2.0 million, utility user’s taxes increased by \$1.5 million and other taxes and fines increased by \$1.4 million. Investment earnings decreased by \$2.4 million. The decrease is a result of the year-end adjustment to carrying value for investments and reflects the year to year change in carrying value. This mark to market is a requirement of GASB 31.

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 other 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.

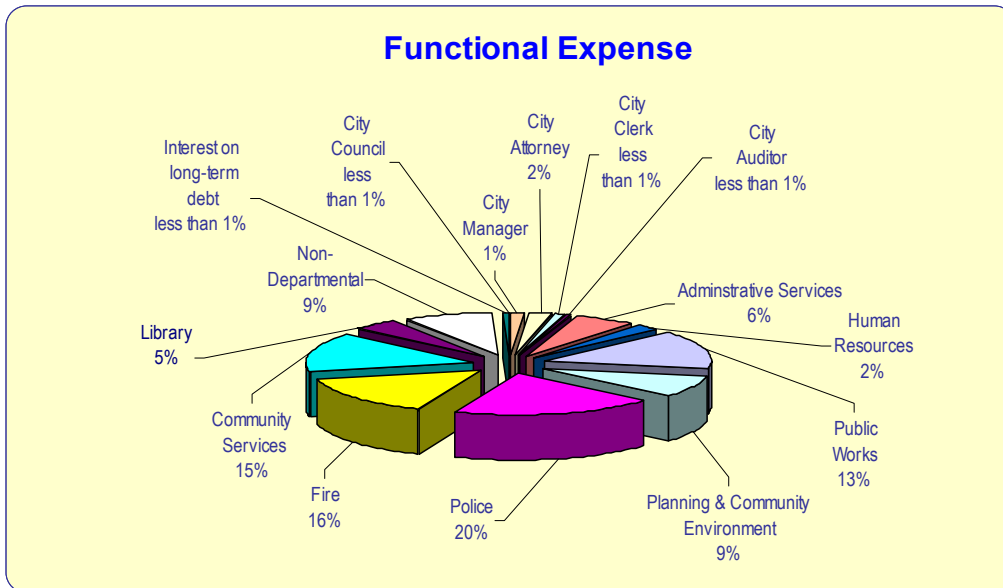
## Governmental Activities – Expenses

The table below presents a comparison of 2005-06 and 2004-05 expenses (does not include encumbrances and reappropriations) by Governmental Activities and interest on long-term debt. Total Governmental Activities functional expense was \$118.8 million in 2005-06, an increase of \$1.0 million.

<b>GOVERNMENTAL ACTIVITIES</b>			
<i>Expenses for the Year ended June 30</i>			
(in Millions)			
<b>Activities</b>	<b>2006</b>	<b>2005</b>	<b>Increase/ (Decrease) from 2005</b>
City Council	\$0.1	\$0.1	\$0.0
City Manager	1.6	1.7	(0.1)
City Attorney	2.6	2.7	(0.1)
City Clerk	0.9	0.8	0.1
City Auditor	0.8	0.8	0.0
Administrative Services	7.0	7.0	0.0
Human Resources	2.6	2.4	0.2
Public Works	17.6	16.4	1.2
Planning and Community Environment	9.9	10.2	(0.3)
Police	23.4	22.4	1.0
Fire	18.8	18.1	0.7
Community Services	17.3	17.2	0.1
Library	5.3	4.8	0.5
Non-Departmental	10.4	12.5	(2.1)
Interest on long-term debt	0.5	0.7	(0.2)
<b>Total Functional Expense</b>	<b>\$118.8</b>	<b>\$117.8</b>	<b>\$1.0</b>
Increase/(Decrease) in Net Assets before Transfers	(6.3)	(15.6)	9.3
Transfers in	\$21.5	\$14.1	\$7.4
Change in Net Assets	\$15.2	(\$1.5)	\$16.7
Net Assets-Beginning	449.8	451.3	(1.5)
Net Assets-Ending	<u>\$465.0</u>	<u>\$449.8</u>	<u>\$15.2</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 2005-06, the City added \$6.3 million in capital assets. The composition of 2005-06 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.

<b>BUSINESS-TYPE ACTIVITIES</b>			
<i>Net Assets at June 30</i>			
(in Millions)			
	<u>2006</u>	<u>2005</u>	<u>Increase/ (Decrease) from 2005</u>
Cash and investments	\$209.0	\$209.7	(\$0.7)
Other assets	34.1	27.8	6.3
Capital assets	360.9	346.9	14.0
<b>Total Assets</b>	<b>604.0</b>	<b>584.4</b>	<b>19.6</b>
Long-term debt outstanding	42.3	43.6	(1.3)
Other liabilities	13.2	20.4	(7.2)
<b>Total Liabilities</b>	<b>55.5</b>	<b>64.0</b>	<b>(8.5)</b>
Net assets:			
Invested in capital assets, net of debt	318.8	303.5	15.3
Restricted	1.7	1.8	(0.1)
Unrestricted	228.0	215.1	12.9
<b>Total Net Assets</b>	<b>\$548.5</b>	<b>\$520.4</b>	<b>\$28.1</b>

The City’s Business-type net assets increased \$28.1 million to \$548.5 million in 2005-06.

- Cash and investments decreased \$0.7 million as a result of operations. Other assets increased \$6.3 million to \$34.1 million primarily as the result of an increase of \$6.0 million in Accounts Receivable.
- Capital assets increased \$14.0 million to \$360.9 million in 2005-06. This increase is primarily a result of water, electric and gas infrastructure improvements totaling \$12.2 million.
- Repayments reduced long-term debt \$1.3 million to \$42.3 million. No new debt was issued in 2005-06.
- Net assets invested in capital assets net of related debt increased \$15.3 million to \$318.8 million. The increase was mostly due to \$4.3 million of improvements in the Water

## Management Discussion and Analysis

Fund, \$5.0 million in Electric Fund improvements, \$3.0 million in Gas Fund improvements and \$1.7 million in Wastewater Collection Fund improvements.

- Unrestricted net assets of \$228.0 million, an increase of \$12.9 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 Council designated reserves such as the rate stabilization reserves of \$91.2 million, the Calaveras reserve for stranded costs of \$73.2 million and the emergency plant replacement reserve of \$7.6 million.

### BUSINESS-TYPE ACTIVITIES

Revenues for the Year ended June 30  
(in Millions)

Revenues by Source	2006	2005	Increase/ (Decrease) from 2005
<b>Program Revenues:</b>			
Water	\$21.1	\$21.0	\$0.1
Electric	119.4	88.7	30.7
Gas	37.0	31.2	5.8
Wastewater Collection	13.8	12.0	1.8
Wastewater Treatment	18.8	16.0	2.8
Refuse	24.8	23.4	1.4
Storm Drainage	5.2	2.5	2.7
External Services	0.8	0.8	0.0
<b>Total Program Revenues</b>	<b>240.9</b>	<b>195.6</b>	<b>45.3</b>
<b>General Revenues:</b>			
Investment Earnings	3.6	8.1	(4.5)
<b>Total General Revenues</b>	<b>3.6</b>	<b>8.1</b>	<b>(4.5)</b>
<b>Total Revenues</b>	<b>\$244.5</b>	<b>\$203.7</b>	<b>\$40.8</b>

The table above presents the revenues for 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.

Business-type Activity revenues totaled \$244.5 million, an increase of \$40.8 million from prior year. Revenues were significantly affected by the following events:

- Program Revenues for the Electric fund increased \$30.7 million primarily due to a 19.5 percent rate increase effective July 1, 2005 and an increase in Surplus Energy Revenue.



- Program Revenues for the Gas fund increased \$5.8 million primarily due to a 15 percent rate increase effective July 1, 2005.
- Investment earnings decreased \$4.5 million due to the year-end adjustment to the carrying value for investments.

**BUSINESS-TYPE ACTIVITIES**

*Expenses for the Year ended June 30*

(in Millions)

Activities	2006	2005	Increase/ (Decrease) from 2005
Water	\$15.9	\$15.0	\$0.9
Electric	91.6	73.1	18.5
Gas	29.1	26.7	2.4
Wastewater Collection	11.0	8.9	2.1
Wastewater Treatment	16.7	17.5	(0.8)
Refuse	27.0	25.0	2.0
Storm Drainage	2.7	3.3	(0.6)
External Services	0.8	0.8	0.0
<b>Total Functional Expense</b>	<b>\$194.8</b>	<b>\$170.3</b>	<b>\$24.5</b>
Increase in Net Assets before Transfers/Special Items	49.6	33.7	15.9
Transfers/Special Items			
Special Item	0.0	21.5	(21.5)
Transfers out	21.5	14.1	7.4
Total Transfers/Special Items	\$21.5	\$35.6	(\$14.1)
Change in Net Assets	\$28.1	(\$1.9)	\$30.0
Net Assets-Beginning	520.4	522.3	(1.9)
Net Assets-Ending	\$548.5	\$520.4	\$28.1

The table above presents a comparison of the 2005-06 and 2004-05 expenses for the City's Business-type Activities. Encumbrances and reappropriations are not included.

Business-type Activity expenses, transfers and special items increased \$10.4 million for a total of \$216.3 million. Changes to expenses were significantly affected by the following events:

- Surplus Energy costs increased \$10.3 million in the Electric Fund. These costs are associated with the increase in Surplus Energy Revenue due to favorable weather conditions. (Further detail may be found in Note 16 to the financial statements).



## Management Discussion and Analysis

- In the Gas Fund, commodity costs increased \$2.6 million.
- Administration and General expense for the Wastewater Collection Fund increased \$1.4 million.
- Refuse Fund Operation and Maintenance expense increased \$1.8 million.
- Special Items expense decreased \$21.5 million. The prior year expense included a \$21.5 million legal settlement with Enron Corporation.

## FUND FINANCIAL STATEMENTS

### Performance of Governmental Funds

At June 30, 2006, the City's Governmental Funds reported combined fund balances of \$101.2 million, an increase of \$3.0 million or 3.1 percent compared with the prior year

Governmental Fund revenues and other financing sources decreased \$22.5 million for a total of \$138.3 million. Revenues and other financing sources in the General Fund increased \$9.2 million; Capital Project Fund decreased \$31.3 (prior year included the operating transfer to move the infrastructure reserve from General Fund to Capital Project Fund). Non-major Fund revenues and other financing sources decreased by \$0.3 million.

Governmental Fund expenditures and other uses decreased \$37.2 million this year to \$135.3 million. General Fund expenditures decreased \$28.2 million, Capital Projects Fund expenditures decreased by \$8.7 million; and non-major fund expenditures and other uses decreased by \$0.3 million.

**General Fund** – The General Fund ended the year with a \$2.4 million increase for a total of \$34.2 million fund balance, compared to \$35.0 million decrease in the prior year. Prior year included \$35.9 million operating transfer to move the infrastructure reserve to the Capital Projects Fund.

Palo Alto's General Fund revenues totaled \$102.1 million in 2005-06. This represents an increase of \$9.2 million or 10.0 percent compared to the prior year. Economically sensitive revenues such as sales and transient occupancy taxes (TOT) have rebounded after the steep declines experienced after the "dot-com" bust in 2001. There are headwinds that could potentially derail revenue growth. These include a potential housing bubble; the modest and vulnerable job growth rate on the Peninsula; strong competition for tax dollars from malls, discount chains, and hotels in surrounding communities; and the possible exodus of automobile dealerships. As indicated in the Economics Background section, the City is positioning itself to deal with many of these challenges.

Sales tax, the City's largest revenue source, realized a second year of growth reaching \$20.3 million in 2005-06. Revenue grew \$1.0 million or 5.2 percent compared to the prior year. Economic segments contributing to the positive results included: office and electronic equipment, miscellaneous retail, drug stores, and auto sales. Segments that turned in weak performances included: department and furniture/appliance stores, recreations products and business services.

Transient occupancy tax (TOT) revenue has registered a second year of improvement. Receipts rose to \$6.4 million in 2005-06, a \$0.7 million or 12.4 percent increase over the prior year. Average occupancy rates increased from 61.0 percent in 2004-05 to 70.5 percent in 2005-06. In addition,



average daily room rates rose from \$119.22 in the previous year to \$130.72 in 2005-06, a gain of 9.6 percent.

As in 2004-05, documentary transfer tax revenue (reported as part of Other Taxes and Fines) performed well in 2005-06. The City realized \$5.7 million from this source, an increase of \$2.1 million or 11.3 percent compared to the previous year. This revenue source has risen primarily as a consequence of major commercial transactions and secondarily by the healthy appreciation in residential housing values over the past few years. As the housing market slows, however, it is anticipated that this revenue source will return to historical levels.

Property tax revenue turned in solid results as a consequence of the locally active residential and the healthier commercial markets. Compared to the prior year, property taxes increased by \$2.1 million or 12.5 percent. Finally, General Fund revenues also were boosted by the State’s early, one-time payback of \$1.0 million in motor vehicle license fee revenues.

Planning and Building fees were above expectations by \$0.8 million due to increased construction permits for large complex projects necessitating more staff time and higher fees. Administrative citations were below forecast by \$0.2 million, mainly from the cancellation of invoices relating to the Bradshaw settlement. Paramedic revenues were below forecast by \$0.1 million due to lower than anticipated inter-facility transports. Green fees also were \$0.3 million below expectations due to a long rainy season. Finally, street cut fees were \$0.1 million below forecast due to lower than anticipated street cut activities.

At June 30, 2006, the General Fund Balance totaled \$34.2 million. This represents 31.1 percent of direct General Fund expenditures, providing a buffer against unexpected financial events. Of this, \$8.0 million is reserved and \$26.2 million is unreserved. Included in the reserved amount is \$0.3 million for the prepayment of Storm Drain rate increases over a three year period. A substantial portion of the unreserved balance amount is designated by the Council for budget stabilization, \$22.7 million at year-end. The designation for equity transfer stabilization designation, established in 2001-02, amounted to \$3.4 million at year-end. This reserve would be utilized in the event that the Electric or Gas Fund were not in a position to make their required equity transfer to the General Fund.

General Fund expenditures and other uses totaled \$115.1 million, a decrease of \$28.2 million from prior year. This decrease was due to a \$34.9 million decrease in the operating transfer for infrastructure reserve to the Capital Projects Fund. This was partially offset by the \$3.6 million purchase of the Bressler property from the Peninsula Open Space Trust and salary expenditure increase in Police (\$1.5 million), Fire (\$0.4 million), and Library (\$0.4 million).

**Capital Projects Fund** – Capital Projects Fund expenditures and other uses were \$13.8 million in 2005-06, which is a decrease of \$8.7 million from the prior year. This decrease is mainly the result of reduced expenditures of capital projects of \$4.5 million and a decrease of \$3.8 million in other financing uses. This level of expenditure is consistent with the City’s effort to rehabilitate and maintain its existing infrastructure.

**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, 2006, the City's Enterprise Funds reported total net assets of \$549.7 million, an increase of \$27.9 million or 5.3 percent compared with last year. The Electric and Gas Funds contributed net assets of \$304.1 million and \$62.9 million, respectively, to total net assets. These assets constitute 66.7 percent of the Enterprise Funds' total net assets. Unrestricted net assets for these two funds total \$161.3 million, and \$12.6 million a 8.5 percent increase over 2004-05.

**Water Fund** – Revenues decreased by \$0.2 million in 2005-06. In 2005-06 rates did not increase and consumption decreased 0.1 million CCF. The Water Fund ended the year with net income of \$1.7 million, compared to \$3.7 million in the prior year, a \$2.0 million or 54.0 percent decrease. The drop in net income is primarily due to an increase in interest expense and transfers out.

**Electric Fund** – Operating revenues increased to \$119.4 million, a \$30.7 million increase from 2004-05. This increase is primarily due to a 19.5 percent rate increase effective July 1, 2005 and an increase of \$17.6 million in Surplus Energy Revenue. Operating expenses increased from \$68.0 million in 2004-05 to \$83.1 million in 2005-06, an increase of \$15.1 million. The Electric Fund ended the year with a net income of \$18.2 million compared to a net loss of \$5.6 million in 2004-05. The increase in net income was mainly the result of the Special Item expense of \$19.0 million that only occurred in 2004-05.

**Gas Fund** – A 15 percent rate increase effective July 1, 2005 increased revenue \$5.7 million over 2004-05. Operating expenses increased to \$28.3 million in 2005-06 as compared to \$26.7 million in 2004-05. An increase of \$1.6 million or 6.0 percent increase. The Gas Fund ended the year with a net income of \$3.8 million, compared to a \$1.7 million net loss in 2004-05. The increase in net income was mainly the result of the Special Item expense of \$3.4 million that only occurred in 2004-05.

**Wastewater Collection Fund** – Operating revenues increased to \$13.8 million, a \$1.8 million increase from 2004-05. A 12 percent rate increase effective July 1, 2005 contributed to the revenue increase. Operating expenses increased to \$10.8 million, a \$1.9 million increase from 2004-05. The Wastewater Collection Fund ended the year with a net income of \$2.6 million, a decrease of \$0.8 million from 2004-05.

**Wastewater Treatment Fund** – Revenues increased in 2005-06 by \$2.8 million, while operating expenses increased by \$0.8 million. Additional partner billings for the Water Reclamation and Flow Meter projects increased revenue. The Wastewater Treatment Fund ended the year with a net income of \$1.3 million, compared to a net income of \$0.7 million in 2004-05.

**Refuse Fund** – Refuse Fund revenues increased to \$24.8 million in 2005-06, an increase of \$1.4 million or 6.0 percent from 2004-05. Operating expenses increased \$1.9 million to \$26.4 million in 2005-06. The Refuse Fund ended the year with a net loss of \$2.6 million, compared to a \$1.2 million net loss in 2004-05. The increase in net loss is primarily due to additional expense of \$1.8 million for new recycling, yard trimming and garbage carts purchased in 2005-06.



**Storm Drainage Fund** – The voter approved ballot measure effective June 1, 2005 affected operating revenues as they increased \$2.7 million in 2005-06. Operating expenses decreased \$0.4 million and the supplemental funding from the General Fund was eliminated. The General Fund has agreed to prepay twelve years of rate increases over a three year period. This prepayment will give the Storm Drain Fund working capital for CIP projects. The prepayment amount for 2005-06 was \$0.5 million. The Storm Drainage Fund ended the year with a net income of \$2.9 million, as compared to a net loss of \$0.2 million in 2004-05.

**External Services Fund** - Created in 2001-02, this Fund provides information technology and training services to neighboring municipalities and other community organizations. Revenues increased to \$0.9 million in 2005-06 from \$0.8 million in 2004-05. This increase is primarily due to contract fee increases for existing contracts. The External Services Fund ended the year with a net loss of \$12.0 thousand as compared to a net income of \$27.0 thousand in 2004-05.

## 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)

	2006	2005	Increase/ (Decrease) from 2005
<b>Governmental Activities</b>			
<i>Capital Assets</i>			
Land and improvements	\$71.4	\$67.8	\$3.6
Street trees	15.3	15.4	(0.1)
Construction in progress	24.4	55.5	(31.1)
Buildings and improvements	91.2	54.6	36.6
Equipment	8.6	8.2	0.4
Roadway network	230.0	225.1	4.9
Recreation & open space network	12.1	11.2	0.9
Less accumulated depreciation	(142.2)	(133.8)	(8.4)
<i>Internal Service Fund Assets</i>			
Construction in progress	3.2	2.1	1.1
Equipment	32.0	31.8	0.2
Less accumulated depreciation	(21.2)	(19.4)	(1.8)
<b>Total Governmental</b>	<b>\$324.8</b>	<b>\$318.5</b>	<b>\$6.3</b>
<b>Business-type Activities</b>			
Land	\$1.9	\$2.0	(\$0.1)
Construction in progress	63.1	91.4	(28.3)
Buildings and improvements	18.1	16.9	1.2
Transmission, Distribution & Treatment Systems	471.5	425.4	46.1
Less accumulated depreciation	(193.8)	(188.7)	(5.1)
<b>Total Business-type</b>	<b>\$360.8</b>	<b>\$346.9</b>	<b>\$13.9</b>



Governmental Activities capital assets net of depreciation, increased by \$6.3 million compared to 2004-05. This increase was primarily due to a \$4.9 million increase for the roadway network and \$3.6 million for the purchase of the Bressler property. This year also included a prior year reclassification of \$32.7 million from construction in progress to buildings to reflect the capitalization of the parking garages, which are Lot R and Lot S/L.

Work on the City's infrastructure is a continuation of a ten-year plan, totaling \$100 million, developed to address the needs of the City's aging infrastructure. The ten-year plan included an assessment and prioritization of work needed on buildings, facilities, streets, sidewalks, medians, bikeways, parks and open space. Current key infrastructure projects include improvements to streets and sidewalks, refurbishing of park playgrounds and irrigation systems, upgrading athletic fields, open space and trail improvements, and facility renovations.

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, 2006, the City's debt was comprised of the following:

<b>LONG-TERM DEBT AT JUNE 30</b>			
(in Millions)			
	<b>2006</b>	<b>2005</b>	<b>Increase/ (Decrease) from 2005</b>
<b>Governmental Activity Debt:</b>			
<b>General Long Term Obligations:</b>			
1998 Golf Course Certificates of Participation	\$5.4	\$5.7	(\$0.3)
2002A Civic Center Refinancing Certificates of Participation	2.2	2.6	(0.4)
2002B Downtown Parking Improvements Certificates of Participation	2.3	2.4	(0.1)
<b>Special Assessment Debt with City Commitment</b>			
1987 California Avenue Parking Bonds	0.2	0.3	(0.1)
<b>Total Governmental Activity Debt</b>	<b>\$10.1</b>	<b>\$11.0</b>	<b>(\$0.9)</b>
<b>Business-Type Activity Debt:</b>			
<b>Enterprise Long Term Obligations:</b>			
Utility Revenue Bonds			
1995 Series A	\$6.3	\$6.5	(\$0.2)
1999 Refunding	15.1	15.5	(0.4)
2002 Series A	21.9	22.7	(0.8)
Less: unamortized discount/issuance cost	(1.0)	(1.1)	0.1
<b>Total Business-type Activity</b>	<b>\$42.3</b>	<b>\$43.6</b>	<b>(\$1.3)</b>

The City did not issue any new debt in 2005-06. 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.





## ***SPECIAL ASSESSMENT DISTRICT DEBT***

Special assessment districts throughout different parts of the City have also issued debt to finance infrastructure and facilities construction exclusively in their districts. At June 30, 2006, a total of \$0.2 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, therefore it has been included as part of the City's governmental long-term debt.

## ***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, 4<sup>th</sup> Floor, Palo Alto, California. This report and other financial reports can be viewed on the City of Palo website at: [www.cityofpaloalto.org](http://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).



This page is intentionally left blank.



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

The Citywide Statement of Net Assets and the Statement of Activities summarize all of the 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 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 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.

These Statements include the financial activities of the City Public Improvement Corporation and Redevelopment Agency, which are legally separate component units of the City because they are controlled by the City, which is financially accountable for its activities.

These financial statements along with the fund financial statements and footnotes are called *Basic Financial Statements*.

This page is intentionally left blank.

## City of Palo Alto - Statement of Net Assets .....

June 30, 2006

(In thousands of dollars)

	Governmental Activities	Business-type Activities	Totals
<b>ASSETS</b>			
Cash and investments (Note 3):			
Available for operations	\$157,456	\$207,095	\$364,551
Cash and investments with fiscal agent	2,696	1,881	4,577
Receivables:			
Accounts and intergovernmental	7,862	32,988	40,850
Interest receivable	2,070	2,618	4,688
Notes and loans receivable (Note 5)	15,234		15,234
Internal balances (Note 4)	1,450	(1,450)	
Prepaid items	305		305
Inventory of materials and supplies (Note 1)	3,015		3,015
Capital assets (Note 6):			
Nondepreciable	114,358	65,029	179,387
Depreciable, net of depreciation	210,469	295,848	506,317
Total assets	<u>514,915</u>	<u>604,009</u>	<u>1,118,924</u>
<b>LIABILITIES</b>			
Accounts payable and accrued liabilities	6,340	5,839	12,179
Accrued salaries and benefits	1,424	500	1,924
Unearned revenue	89		89
Accrued compensated absences (Note 1)			
Due within one year	8,847		8,847
Due in more than one year	3,487		3,487
Claims payable (Note 14)			
Due within one year	6,033		6,033
Due in more than one year	13,512		13,512
Accrued landfill closure liability (Note 9)			
Due in more than one year		6,880	6,880
Long-term debt (Notes 7 and 8)			
Due within one year	850	1,466	2,316
Due in more than one year	9,290	40,822	50,112
Total liabilities	<u>49,872</u>	<u>55,507</u>	<u>105,379</u>
<b>NET ASSETS (Note 10)</b>			
Invested in capital assets, net of related debt	<u>311,335</u>	<u>318,738</u>	<u>630,073</u>
Restricted for:			
Special revenue programs	21,001		21,001
Capital projects			
Downtown parking structure	488		488
Other capital projects	6,664		6,664
Debt service	1,732	1,732	3,464
Total Restricted	<u>29,885</u>	<u>1,732</u>	<u>31,617</u>
Unrestricted net assets	<u>123,823</u>	<u>228,032</u>	<u>351,855</u>
Total net assets	<u>\$465,043</u>	<u>\$548,502</u>	<u>\$1,013,545</u>

See accompanying notes to financial statements

City of Palo Alto - Statement of Activities .....

For the Year Ended June 30, 2006

(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	Capital Grants and Contributions	Governmental Activities	
<b>Governmental Activities:</b>						
City Council	\$141				(\$141)	(\$141)
City Manager	1,563				(1,563)	(1,563)
City Attorney	2,598	\$22			(2,576)	(2,576)
City Clerk	945	2			(943)	(943)
City Auditor	843				(843)	(843)
Administrative Services	6,972	627			(6,345)	(6,345)
Human Resources	2,546				(2,546)	(2,546)
Public Works	17,596	805	\$1,865	\$3,150	(11,776)	(11,776)
Planning and Community Environment	9,931	5,509	1,530	6	(2,886)	(2,886)
Police	23,411	4,178	322		(18,911)	(18,911)
Fire	18,747	9,078	1		(9,668)	(9,668)
Community Services	17,296	10,803	200		(6,293)	(6,293)
Library	5,323	129	58		(5,136)	(5,136)
Non-Departmental	10,400				(10,400)	(10,400)
Interest on long-term debt	512				(512)	(512)
<b>Total Governmental Activities</b>	<b>118,824</b>	<b>31,153</b>	<b>3,976</b>	<b>3,156</b>	<b>(80,539)</b>	<b>(80,539)</b>
<b>Business-type Activities:</b>						
Water	15,881	21,108			\$5,227	5,227
Electric	91,570	119,418			27,848	27,848
Gas	29,107	36,977			7,870	7,870
Wastewater Collection	11,005	13,801			2,796	2,796
Wastewater Treatment	16,747	18,778			2,031	2,031
Refuse	26,989	24,795			(2,194)	(2,194)
Storm Drainage	2,673	5,174			2,501	2,501
External Services	868	854			(14)	(14)
Total Business-type Activities	194,840	240,905			46,065	46,065
<b>Total</b>	<b>\$313,664</b>	<b>\$272,058</b>	<b>\$3,976</b>	<b>\$3,156</b>	<b>(80,539)</b>	<b>(34,474)</b>
<b>General revenues:</b>						
Taxes:						
Property taxes					18,731	18,731
Sales taxes					20,315	20,315
Utility user's taxes					8,759	8,759
Transient occupancy tax					6,393	6,393
Other taxes					7,033	7,033
Investment earnings					2,567	3,631
Miscellaneous					10,440	10,440
Transfers					21,545	(21,545)
Total general revenues and transfers					95,783	(17,914)
Change in Net Assets					15,244	28,151
Net Assets-Beginning					449,799	520,351
Net Assets-Ending					\$465,043	\$548,502
						\$1,013,545

See accompanying notes to financial statements



# Fund Financial Statements.....

## Introduction

The Fund Financial Statements are presented by individual major funds, 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.

## Major Governmental Funds

The funds described below were determined to be Major Funds by the City in fiscal year 2005-06. 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.

This page is intentionally left blank.



## City of Palo Alto - Governmental Funds .....

### Balance Sheet - June 30, 2006

(In thousands of dollars)

	General	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
<b>ASSETS</b>				
Cash and investments (Note 3):				
Available for operations	\$25,251	\$44,664	\$7,093	\$77,008
Cash and investments with fiscal agent		1,329	1,367	2,696
Receivables:				
Accounts and intergovernmental	7,010	110	443	7,563
Special assessment			225	225
Interest receivable	1,179	4	111	1,294
Notes and loans receivable (Note 5)	1,208		14,026	15,234
Interfund receivables and advances (Note 4)	211		250	461
Prepaid items	305			305
Inventory of materials and supplies	2,539			2,539
	<u>\$37,703</u>	<u>\$46,107</u>	<u>\$23,515</u>	<u>\$107,325</u>
<b>LIABILITIES</b>				
Accounts payable and accrued liabilities	\$2,407	\$1,606	\$381	\$4,394
Accrued salaries and benefits	990	34		1,024
Deferred revenue	89		376	465
Interfund payable and advances (Note 4)			250	250
	<u>3,486</u>	<u>1,640</u>	<u>1,007</u>	<u>6,133</u>
<b>FUND BALANCES</b>				
Reserved for (Note 10):				
Encumbrances	3,914	6,664	236	10,814
Downtown parking structure		488		488
Notes and loans	1,208		13,875	15,083
Inventory of materials and supplies	2,539			2,539
Prepaid items	305			305
Debt service			1,334	1,334
Unreserved, designated for:				
Special revenue projects			5,183	5,183
Equity transfer stabilization	3,405			3,405
Reappropriations	115	16,628	2,508	19,251
Budget stabilization	22,731			22,731
Infrastructure		20,687		20,687
Undesignated, reported in				
Special Revenue Funds			(628)	(628)
	<u>34,217</u>	<u>44,467</u>	<u>22,508</u>	<u>101,192</u>
	<u>\$37,703</u>	<u>\$46,107</u>	<u>\$23,515</u>	<u>\$107,325</u>

See accompanying notes to financial statements

**City of Palo Alto - Governmental Funds .....**  
**Reconciliation of Fund Balances to Governmental Activities Net Assets**  
**June 30, 2006**

*(In thousands of dollars)*

Governmental Fund fund balances from prior page \$101,192

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) 324,827

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. 48,954  
(Excludes capital assets reported above and debt reported below)

Accrual adjustment to remove deferred revenue from the balance sheet 376

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) (10,306)

Net assets of governmental activities \$465,043

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, 2006**

*(In thousands of dollars)*

	General	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>				
Property taxes	\$18,731			\$18,731
Special assessments			\$268	268
Sales taxes	20,315			20,315
Utility users' tax	8,759			8,759
Transient occupancy tax	6,393			6,393
Other taxes and fines	9,288		1,132	10,420
Charges for services	18,672			18,672
From other agencies	982	\$3,430	1,519	5,931
Permits and licenses	4,238		67	4,305
Investment earnings	255	1,045	272	1,572
Rental income	12,198		6	12,204
Other revenue	2,247	26	1,785	4,058
Total Revenues	<u>102,078</u>	<u>4,501</u>	<u>5,049</u>	<u>111,628</u>
<b>EXPENDITURES</b>				
Current operations:				
City Council	141			141
City Manager	1,499			1,499
City Attorney	2,497			2,497
City Clerk	886			886
City Auditor	841			841
Administrative Services	6,106			6,106
Human Resources	2,329			2,329
Public Works	9,036			9,036
Planning and Community Environment	8,412		880	9,292
Police	22,249		30	22,279
Fire	18,114			18,114
Community Services	19,740			19,740
Library	5,170			5,170
Non-Departmental	10,077		312	10,389
Capital outlay		13,243		13,243
Debt service:				
Principal payments			810	810
Interest and fiscal fees			523	523
Total Expenditures	<u>107,097</u>	<u>13,243</u>	<u>2,555</u>	<u>122,895</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(5,019)</u>	<u>(8,742)</u>	<u>2,494</u>	<u>(11,267)</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in (Note 4)	15,384	9,713	1,543	26,640
Transfers (out) (Note 4)	(7,978)	(600)	(3,812)	(12,390)
Total Other Financing Sources (Uses)	<u>7,406</u>	<u>9,113</u>	<u>(2,269)</u>	<u>14,250</u>
Net change in fund balances	2,387	371	225	2,983
Fund balances at beginning of year	31,830	44,096	22,283	98,209
Fund balances at end of year	<u>\$34,217</u>	<u>\$44,467</u>	<u>\$22,508</u>	<u>\$101,192</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, 2006**  
*(In thousands of dollars)*

Net change in fund balances-total governmental funds \$2,983

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. 16,041

Depreciation expense is deducted from fund balance  
(Depreciation expense is net of Internal Service Fund depreciation  
\$3.070 million which has already been allocated to serviced  
funds.) (9,246)

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. 810

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.

Interest payable 11  
Deferred revenue 51

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. 4,594

Change in net assets of Governmental Activities. \$15,244

See accompanying notes to financial statements

**City of Palo Alto - General Fund** .....

**Statement of Revenues, Expenditures and Changes in Fund Balance**  
**Budget and Actual - For the Year Ended June 30, 2006**

(In thousands of dollars)

	Budgeted Amount		Actual Amount Budgetary Basis	Variance from Final Budget Positive (Negative)
	Adopted	Adjusted		
<b>REVENUES</b>				
Property taxes	\$16,986	\$18,242	\$18,754	\$512
Sales taxes	19,036	20,020	20,316	296
Utility users' tax	8,341	8,522	8,759	237
Transient occupancy tax	6,173	6,173	6,393	220
Other taxes, fines & penalties	6,845	7,830	9,265	1,435
Charges for services	18,760	18,836	18,670	(166)
Permits and licenses	4,084	3,505	4,236	731
Charges to other funds	8,924	9,453	9,703	250
Rental income	12,332	12,261	12,276	15
Other revenues	4,140	7,125	5,560	(1,565)
Transfers in	15,108	15,158	15,384	226
Prior year encumbrance and reappropriations		3,569	3,569	
<b>Total Revenues</b>	<b>120,729</b>	<b>130,694</b>	<b>132,885</b>	<b>2,191</b>
<b>EXPENDITURES</b>				
Current operations:				
Administrative Departments	15,119	17,151	16,549	602
Community Services	19,635	24,277	23,829	448
Fire	20,160	20,552	20,517	35
Library	5,633	5,919	5,892	27
Planning and Community Environment	8,766	9,848	9,649	199
Police	24,314	24,784	24,655	129
Public Works	11,451	11,955	11,829	126
Non-Departmental	9,043	7,258	10,091	(2,833)
Transfers out	6,572	6,852	7,978	(1,126)
<b>Total Use of Funds</b>	<b>120,693</b>	<b>128,596</b>	<b>130,989</b>	<b>(2,393)</b>
<b>EXCESS OF REVENUES OR EXPENDITURES BUDGETARY BASIS</b>	<b>\$36</b>	<b>\$2,098</b>	<b>1,896</b>	<b>(\$202)</b>
Adjustments to Budgetary Basis:				
Current year encumbrance/reappropriations			4,026	
Prior year encumbrance/reappropriations			(3,569)	
Current year stores adjustment, net			(14)	
Prior year stores adjustment			48	
<b>EXCESS OF REVENUES OVER EXPENDITURES - GAAP BASIS</b>			<b>2,387</b>	
Fund balances at beginning of year			<b>31,830</b>	
Fund balances at end of year, GAAP basis			<b>\$34,217</b>	

See accompanying notes to financial statements

This page is intentionally left blank.



# 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 City has elected to treat all of its Enterprise Funds as Major Funds in fiscal year 2005-06.

Proprietary Funds do not provide for the disclosure of budget versus actual comparisons.

### 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, 2006**  
*(In thousands of dollars)*

	Business-type Activities-Enterprise Funds			
	Water	Electric	Gas	Wastewater Collection
<b>ASSETS</b>				
Current Assets:				
Cash and investments (Note 3):				
Available for operations	\$17,283	\$140,579	\$11,264	\$12,833
Cash and investments with fiscal agent	809		987	
Accounts receivable, net	3,191	20,758	2,438	1,808
Interest receivable	220	1,747	153	160
Interfund receivables				
Inventory of materials and supplies				
<b>Total Current Assets</b>	<b>21,503</b>	<b>163,084</b>	<b>14,842</b>	<b>14,801</b>
Noncurrent Assets:				
Interfund receivable (Note 4)				
Capital assets, nondepreciable (Note 6)	10,412	23,491	11,436	13,986
Capital assets, depreciable (Note 6)	42,548	119,294	49,755	38,662
<b>Total Noncurrent Assets</b>	<b>52,960</b>	<b>142,785</b>	<b>61,191</b>	<b>52,648</b>
<b>Current Total Assets</b>	<b>74,463</b>	<b>305,869</b>	<b>76,033</b>	<b>67,449</b>
<b>LIABILITIES</b>				
Current Liabilities:				
Accounts payable and accrued liabilities	1,871	1,636	1,158	203
Accrued salaries and benefits	58	180	68	35
Accrued compensated absences (Note 1)				
Interfund payable (Note 4)				
Current portion of revenue bonds (Note 7)	329		402	54
Accrued claims payable - current (Note 14)				
<b>Total Current Liabilities</b>	<b>2,258</b>	<b>1,816</b>	<b>1,628</b>	<b>292</b>
Noncurrent liabilities:				
Accrued compensated absences - noncurrent (Note 1)				
Interfund payable (Note 4)				
Accrued claims payable - noncurrent (Note 14)				
Landfill closure and postclosure care (Note 9)				
Utility revenue bonds, net of unamortized issuance costs and discounts (Note 7)	9,401		11,471	1,397
<b>Total Noncurrent Liabilities</b>	<b>9,401</b>		<b>11,471</b>	<b>1,397</b>
<b>Total Liabilities</b>	<b>11,659</b>	<b>1,816</b>	<b>13,099</b>	<b>1,689</b>
<b>NET ASSETS</b>				
Invested in capital assets, net of related debt	43,259	142,785	49,353	51,197
Restricted for debt service	780		952	
Unrestricted	18,765	161,268	12,629	14,563
<b>Total Net Assets</b>	<b>\$62,804</b>	<b>\$304,053</b>	<b>\$62,934</b>	<b>\$65,760</b>

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

Net Business-type Activities

See accompanying notes to financial statements





Business-type Activities-Enterprise funds					Governmental
Wastewater	Refuse	Storm	External	TOTALS	Activities -
Treatment		Drainage	Service		Internal Service
					Funds
\$12,728	\$9,189	\$3,219		\$207,095	\$80,448
85				1,881	
1,291	2,631	585	\$286	32,988	74
175	122	41		2,618	776
					25
					476
<u>14,279</u>	<u>11,942</u>	<u>3,845</u>	<u>286</u>	<u>244,582</u>	<u>81,799</u>
					25
3,324	1,953	427		65,029	3,186
27,612	3,179	14,798		295,848	10,846
<u>30,936</u>	<u>5,132</u>	<u>15,225</u>		<u>360,877</u>	<u>14,057</u>
<u>45,215</u>	<u>17,074</u>	<u>19,070</u>	<u>286</u>	<u>605,459</u>	<u>95,856</u>
249	329	393		5,839	1,780
95	45	12	7	500	400
					8,847
			236	236	
341		340		1,466	
					6,033
<u>685</u>	<u>374</u>	<u>745</u>	<u>243</u>	<u>8,041</u>	<u>17,060</u>
			25	25	3,487
	6,880			6,880	13,512
<u>8,817</u>		<u>9,736</u>		<u>40,822</u>	
<u>8,817</u>	<u>6,880</u>	<u>9,736</u>	<u>25</u>	<u>47,727</u>	<u>16,999</u>
<u>9,502</u>	<u>7,254</u>	<u>10,481</u>	<u>268</u>	<u>55,768</u>	<u>34,059</u>
21,863	5,132	5,149		318,738	14,032
				1,732	
13,850	4,688	3,440	18	229,221	47,765
<u>\$35,713</u>	<u>\$9,820</u>	<u>\$8,589</u>	<u>\$18</u>	<u>549,691</u>	<u>\$61,797</u>
				<u>(1,189)</u>	
				<u>\$548,502</u>	

**City of Palo Alto - Proprietary Funds**  
**Statements of Revenues, Expenses and Changes in Net Assets**  
**For the Year Ended June 30, 2006**  
*(In thousands of dollars)*

	Business-type Activities - Enterprise Funds			
	Water	Electric	Gas	Wastewater Collection
<b>OPERATING REVENUES</b>				
Sales of utilities:				
Customers	\$19,506	\$82,886	\$35,392	\$12,949
City departments	924	2,614	1,040	249
Wholesale				
Surplus energy		22,573		
Wastewater treatment				
Service connection charges and miscellaneous	228	753	427	210
Charges for services				
Other operating revenues	179	10,592	118	350
<b>Total Operating Revenues</b>	<b>20,837</b>	<b>119,418</b>	<b>36,977</b>	<b>13,758</b>
<b>OPERATING EXPENSES</b>				
Purchase of utilities				
Retail	6,472	40,917	21,375	6,364
Surplus energy		14,725		
Administration and general	2,776	6,585	2,121	1,716
Engineering (operating)	195	964	237	174
Resource management and energy efficiency programs	464	3,496	807	
Operations and maintenance	2,875	7,820	2,340	1,337
Rent	1,506	3,114	143	75
Depreciation and amortization	995	5,511	1,249	1,114
Claims payments and changes in estimated self-insurance liability				
Compensated absences and other benefits				
<b>Total Operating Expenses</b>	<b>15,283</b>	<b>83,132</b>	<b>28,272</b>	<b>10,780</b>
<b>Operating Income</b>	<b>5,554</b>	<b>36,286</b>	<b>8,705</b>	<b>2,978</b>
<b>NONOPERATING REVENUES (EXPENSES)</b>				
Return on investment	437	2,359	187	271
Interest (expense)	(457)		(558)	(77)
Joint venture debt service (Note 15)		(8,400)		
Gain (loss) on disposal of fixed assets	(148)	(60)	(278)	(131)
Capacity fees	271			43
Other				
<b>Net Nonoperating Revenues (Expenses)</b>	<b>103</b>	<b>(6,101)</b>	<b>(649)</b>	<b>106</b>
<b>Income (Loss) Before Transfers and Special Item</b>	<b>5,657</b>	<b>30,185</b>	<b>8,056</b>	<b>3,084</b>
Transfers in (Note 4)	20	612		36
Transfers (out) (Note 4)	(3,987)	(12,581)	(4,294)	(502)
<b>Change in Net Assets</b>	<b>1,690</b>	<b>18,216</b>	<b>3,762</b>	<b>2,618</b>
<b>Total net assets at beginning of year</b>	<b>61,114</b>	<b>285,837</b>	<b>59,172</b>	<b>63,142</b>
<b>Total net assets at end of year</b>	<b>\$62,804</b>	<b>\$304,053</b>	<b>\$62,934</b>	<b>\$65,760</b>

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 - Enterprise Funds					Governmental Activities - Internal Service Funds
Wastewater Treatment	Refuse	Storm Drainage	External Service	TOTALS	
	\$20,094	\$4,827		\$175,654	
\$6,417	954	283		12,481	
				22,573	
11,034				11,034	
				1,618	
					\$57,130
1,327	3,747	64	\$854	17,231	
18,778	24,795	5,174	854	240,591	57,130
	7,887			83,015	
				14,725	
2,256	1,600	376	30	17,460	11,482
797	364	340		3,071	
		164		4,931	
11,253	12,050	676	830	39,181	3,512
	4,289			9,127	
2,568	243	534		12,214	3,070
					9,957
					32,566
16,874	26,433	2,090	860	183,724	60,587
1,904	(1,638)	3,084	(6)	56,867	(3,457)
188	161	34	(6)	3,631	995
(179)	(497)	(623)		(2,391)	
		(13)		(8,400)	
				(630)	(166)
				314	
					232
9	(336)	(602)	(6)	(7,476)	1,061
1,913	(1,974)	2,482	(12)	49,391	(2,396)
500	204	534		1,906	8,360
(1,072)	(899)	(116)		(23,451)	(1,065)
1,341	(2,669)	2,900	(12)	27,846	4,899
34,372	12,489	5,689	30		56,898
\$35,713	\$9,820	\$8,589	\$18		\$61,797
				305	
				\$28,151	

**City of Palo Alto - Proprietary Funds**

**Statement of Cash Flows -**

**For the Year Ended June 30, 2006**

*(In thousands of dollars)*

	Business-type Activities - Enterprise Funds			
	Water	Electric	Gas	Wastewater Collection
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>				
Receipts from customers	\$19,655	\$112,403	\$35,565	\$12,855
Payments to suppliers	(11,181)	(76,391)	(26,497)	(7,858)
Payments to employees	(2,925)	(7,001)	(2,295)	(1,793)
Internal activity - receipts from other funds	924	2,614	1,040	249
Claims paid				
Other receipts	179		118	350
Net Cash From Operating Activities	<u>6,652</u>	<u>31,625</u>	<u>7,931</u>	<u>3,803</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>				
Interfund receipts				
Transfers in	20	612		36
Transfers (out)	(3,987)	(12,581)	(4,294)	(502)
Net Cash From Noncapital Financing Activities	<u>(3,967)</u>	<u>(11,969)</u>	<u>(4,294)</u>	<u>(466)</u>
<b>CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:</b>				
Acquisition and construction of fixed assets	(5,418)	(10,525)	(4,566)	(2,935)
Proceeds from sale of capital assets				
Capacity fees	271			43
Principal paid on long-term debt	(313)		(379)	(38)
Interest paid on long-term debt	(457)	(8,400)	(558)	(77)
Cash Flows From Capital Financing Activities	<u>(5,917)</u>	<u>(18,925)</u>	<u>(5,503)</u>	<u>(3,007)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>				
Interest on investments	456	2,235	186	254
Net Cash Flows	(2,776)	2,966	(1,680)	584
Cash and cash equivalents at beginning of year	20,868	137,613	13,931	12,249
Cash and cash equivalents at end of year	<u>\$18,092</u>	<u>\$140,579</u>	<u>\$12,251</u>	<u>\$12,833</u>
<b>FINANCIAL STATEMENT PRESENTATION:</b>				
Cash and investments available for operations	\$17,283	\$140,579	\$11,264	\$12,833
Cash and investments with fiscal agent	809		987	
Cash and cash equivalents at end of year	<u>\$18,092</u>	<u>\$140,579</u>	<u>\$12,251</u>	<u>\$12,833</u>
<b>Reconciliation of operating income (loss) to Cash Flows from</b>				
Operating income (loss)	\$5,554	\$36,286	\$8,705	\$2,978
Adjustments to reconcile operating income (loss) to cash				
Depreciation and amortization	995	5,511	1,249	1,114
Other				
Changes in assets and liabilities:				
Accounts receivable	(79)	(4,401)	(254)	(304)
Prepaid items		203		
Inventory of materials and supplies				
Accounts and other payables	182	(5,974)	(1,769)	15
Accrued claims payable and other liabilities				
Net Cash From Operating Activities	<u>\$6,652</u>	<u>\$31,625</u>	<u>\$7,931</u>	<u>\$3,803</u>

See accompanying notes to financial statements

Business-type Activities - Enterprise Funds					Governmental Activities - Internal Service Funds
Wastewater Treatment	Refuse	Storm Drainage	External Service	TOTALS	
\$9,940	\$19,976	\$4,917		\$215,311	\$57,137
(11,961)	(24,455)	(928)		(159,271)	(3,728)
(2,471)	(1,702)	(409)	(\$886)	(19,482)	(43,912)
6,417	954	283		12,481	
					(4,295)
1,327	3,935	64	1,001	6,974	66
3,252	(1,292)	3,927	115	56,013	5,268
			(109)	(109)	25
500	204	534		1,906	8,360
(1,072)	(899)	(116)		(23,451)	(1,065)
(572)	(695)	418	(109)	(21,654)	7,320
(2,623)	(112)	(611)		(26,790)	(2,593)
				314	
(287)		(293)		(1,310)	
(179)	(497)	(623)		(10,791)	
(3,089)	(609)	(1,527)		(38,577)	(2,593)
166	176	(7)	(6)	3,460	989
(243)	(2,420)	2,811		(758)	10,984
13,056	11,609	408		209,734	69,464
\$12,813	\$9,189	\$3,219		\$208,976	\$80,448
\$12,728	\$9,189	\$3,219		\$207,095	\$80,448
85				1,881	
\$12,813	\$9,189	\$3,219		\$208,976	\$80,448
\$1,904	(\$1,638)	\$3,084	(\$6)	\$56,867	(\$3,457)
2,568	243	534		12,214	3,070
					66
(1,094)	(118)	90	147	(6,013)	7
				203	
					(242)
(126)	33	219	(26)	(7,446)	162
	188			188	5,662
\$3,252	(\$1,292)	\$3,927	\$115	\$56,013	\$5,268

This page is intentionally left blank.



# *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.

This page is intentionally left blank.



**City of Palo Alto - Fiduciary Funds .....****Statement of Fiduciary Net Assets - June 30, 2006***(In thousands of dollars)*

	<u>Agency Funds</u>
ASSETS	
Cash and investments available for operations (Note 3)	\$1,015
Cash and investments with fiscal agents (Note 3)	6,046
Interest receivable	<u>72</u>
Total Assets	<u><u>\$7,133</u></u>
LIABILITIES	
Due to bondholders	\$6,389
Due to other governments	<u>744</u>
Total Liabilities	<u><u>\$7,133</u></u>

See accompanying notes to financial statements

This page is intentionally left blank.



# Index.....

	<b>Page</b>
1. Summary of Significant Accounting Policies	49
2. Budgets and Budgetary Accounting	54
3. Cash and Investments	55
4. Interfund Transactions	60
5. Notes and Loans Receivable	63
6. Capital Assets	68
7. General Long-Term Obligations	74
8. Special Assessment Debt	78
9. Landfill Closure and Post-closure Care	80
10. Net Assets and Fund Balances	81
11. Pension Plans	84
12. Retiree Health Benefits	86
13. Deferred Compensation Plan	87
14. Risk Management	87
15. Joint Ventures	89
16. Commitments and Contingencies	92

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.



This page is intentionally left blank.

## 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, 4<sup>th</sup> Floor, 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.

These Standards 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.

Operating expenses for enterprise funds and internal service funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All expenses not meeting this definition are reported as nonoperating expenses.

## Major Funds

The City's Major Governmental and Business-type Funds need to 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 10 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 Service 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 to retirees.

**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 three 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, claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as *expenditures* in Governmental Funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as *other financing sources*.

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

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

Certain indirect costs are included in program expenses reported for individual functions and activities. Transactions representing the exchange of interfund goods and services have also been included.

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. Amounts expected to be "permanently liquidated", such as what is due to be paid because of a realized employment action, are recorded as fund liabilities 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 \$8.166 million and \$8.559 million as of June 30, 2005 and 2006, respectively. As of June 30, 2005 and 2006, the City has vested accumulated sick pay of \$3.618 million and \$3.775 million, respectively. At June 30, 2006 \$8.847 million of accumulated vacation and overtime compensation and vested accumulated sick pay balances are due within one year.

During fiscal 2005-06, the City paid \$4.351 million against these liabilities and recorded additional accruals of \$4.901 million.

### 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 within 60 days after year end.

### 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.

### Closed Fund

The Downtown Planned Community Special Revenue Fund was closed as of June 30, 2006.

## 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 results of unanticipated expenses. Sufficient resources were available within each fund to finance these excesses.

The General Fund's actual expenditures and operating transfers out (includes \$1.0 million to Infrastructure Reserve) exceeded budget in the amounts of \$2,393 thousand in fiscal year 2005-06. This was offset by revenues exceeding budget by \$2,191 thousand for a net of \$202 thousand.



## 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.

#### Policies

The City invests in individual investments and in investment pools. Individual investments are evidenced by specific identifiable *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 increase security, the City employs the Trust Department of a bank as the custodian of certain City managed investments, regardless of their form.

The City's investments are carried at fair value, as required by generally accepted accounting principles. 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.

#### 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	\$364,551
Cash and investments with fiscal agents	<u>4,577</u>
City cash and investments	369,128
Cash and investments available for operations in	
Fiduciary Funds (separate Statement)	1,015
Cash and investments with fiscal agents	
Fiduciary Funds (separate Statement)	<u>6,046</u>
Total cash and investments	<u><u>\$376,189</u></u>

### Investments Authorized by the City’s Investment Policy & Debt Agreements

The table below identifies the investment types that are authorized by the City’s Investment Policy. The table also identifies certain provisions of the City’s Investment Policy that address interest rate risk, credit risk and concentration of credit risk. The table addresses investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the City, rather than the general provisions of the City’s investment policy.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Minimum Credit Quality</u>	<u>Maximum Percentage of Portfolio</u>	<u>Maximum Investment In One Issuer</u>
U.S. Government Securities	10 years	N/A	No Limit	No Limit
U.S. Government Agency Securities	10 years	N/A	No Limit (A)	No Limit
Certificates of Deposit	10 years	N/A	20%	10% of the par value of portfolio
Bankers Acceptances	180 days (D)	N/A (D)	30%	\$5 million
Commercial Paper	270 days	AAA	15%	\$3 million (B)
Local Agency Investment Fund	N/A	N/A	No Limit	\$40 million per account
Short-Term Repurchase Agreements	1 year	N/A	No Limit	No Limit
City of Palo Alto Bonds	N/A	N/A	No Limit	No Limit
Money Market Deposit Accounts	N/A	N/A (E)	No Limit	10%
Mutual Funds (F)	N/A	N/A	20%	10%
Negotiable Certificates of Deposit	10 years	N/A	10%	\$5 million
Medium Term Corporate Notes	5 years	AA	10%	\$5 million
Obligations of States (C)	N/A	A2/A	No Limit	No Limit

(A) Callable and multi-step securities are limited to no more than twenty percent of the par value of the portfolio, provided that:  
 1) the potential call dates are known at the time of purchase.  
 2) the interest rates at which they "step-up" are known at the time of purchase.  
 3) the entire face value of the security is redeemed at the call date.

(B) The lesser of \$3 million or 10% of outstanding commercial paper of any one institution.

(C) Utility Revenue Bonds 2002 Series A and 1999 Series A allow General Obligations of states with a Minimum Credit Quantity Rating of A-2/A by Moody’s and S&P.

(D) Utility Revenue Bonds 2002 Series A and 1999 Series A require a Minimum Credit Quality Rating of A-1/P-1 by Moody’s and S&P and maturing no more than 360 days.  
 Utility Revenue Bonds 1995 limit the maximum maturity to 365 days.

(E) Utility Revenue Bonds 2002 Series A and 1999 Series A require a Minimum Credit Quality Rating of AAAM or AAAM-G by S&P.

(F) Utility Revenue Bonds 2002 Series A , Golf PIC COP 1998, University Avenue Parking Bond 2001 and University Avenue Parking Bond 2002 are allowed to invest in the California Asset Management Program.

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.



## Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Normally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

Information about the sensitivity of the fair values of the City's investments (including investments held by bond trustees) to market interest rate fluctuations is provided by the following table that shows the distribution to the City's investments by maturity or earliest call date (in thousands):

Type of Investments	Less Than One Year	One to Three Years	Three to Five Years	Over Five Years	Total
U.S. Treasury Notes	\$8,436	\$8,246			\$16,682
U.S. Federal Agency Securities	87,379	132,549	\$114,280	\$4,603	338,811
U.S. Federal Agency Mortgage Backed Securities		4			4
Money Market Mutual Funds (government securities)	12,471				12,471
Certificates of Deposit	4,998				4,998
California Asset Management Program	1,431				1,431
Local Agency Investment Fund	842				842
<b>Total Investments</b>	<b>\$115,557</b>	<b>\$140,799</b>	<b>\$114,280</b>	<b>\$4,603</b>	<b>375,239</b>
<i>Cash in banks and on hand</i>					950
<b>Total Cash and Investments</b>					<b>\$376,189</b>

## Local Agency Investment Fund

The City is a 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 on demand, and 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. At June 30, 2006, these investments matured in an average of 152 days.

Mutual funds are available for withdrawal on demand and at June 30, 2006 matured in an average of 11 days.

### Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The City’s investments (including investments held by bond trustees) include the following investments that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above):

#### Highly Sensitive Investments

#### Fair Value at Year End (in thousands)

US Federal Agency Mortgage Backed Securities. These securities are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows affects the fair value of these securities and makes the values of these securities highly sensitive to changes in interest rates.

\$4

US Federal Agency Callable Securities. These securities are subject to early redemption in a period of declining interest rates. The resultant reduction in expected total cash flows affects the fair value of these securities and makes the values of these securities highly sensitive to changes in interest rates.

70,189

#### Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the actual rating as provided by Standard & Poor’s investment rating system as of June 30, 2006 for each investment type (in thousands):

<u>Investment Type</u>	<u>AAA</u>	<u>A-1+</u>	<u>Total</u>
U.S. Federal Agency Securities	\$335,769	\$3,042	\$338,811
U.S. Federal Agency Mortgage Backed Securities	4		4
Money Market Mutual Funds (government securities)	12,471		12,471
<b>Total</b>	<b>\$348,244</b>	<b>\$3,042</b>	<b>351,286</b>

#### Not Rated:

Certificates of Deposit	4,998
California Asset Management Program	1,431
Local Agency Investment Fund	842

#### Exempt from Credit Rating Disclosure:

U.S. Treasury Notes	16,682
---------------------	--------

Cash in banks and on hand	950
<b>Total Cash and Investments</b>	<b>\$376,189</b>



### Concentration of Credit Risk

Investments in any one issuer, other than U.S. Treasury securities, mutual funds, and external investment pools, that represent 5 percent or more of total City portfolio Entity-wide investments, are as follows at June 30, 2006 (in thousands):

<u>Investments</u>	<u>Reporting Type</u>	<u>Investment Amount</u>
Federal Farm Credit Bank	U.S. Federal Agency Securities	\$29,707
Federal Home Loan Mortgage Corp	U.S. Federal Agency Securities	61,397
Federal National Mortgage Association	U.S. Federal Agency Securities	66,897
Federal Home Loan Bank	U.S. Federal Agency Securities	155,214
Federal Agriculture Mortgage Corp	U.S. Federal Agency Securities	21,281

### Custodial Risk

California Law requires banks and savings and loan institutions to pledge government securities with a market value of 110 percent of the City's cash on deposit or first trust deed mortgage notes with a value of 150 percent 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.

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, the City will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The City's Investment Policy limits its exposure to custodial credit risk by requiring that all security transactions entered into by the City, be conducted on a delivery-versus-payment basis. Securities are to be held by a third party custodian.



# 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 subsidize a fund. Less often, a transfer may be made to open or close a fund.

Transfers between City funds during fiscal year 2005-06 were as follows (in thousands):

Fund Receiving Transfer	Fund Making Transfer	Amount Transferred	
<b>General Fund</b>	Street Improvement Special Revenue Fund	\$292	
	Special Districts Special Revenue Fund	785	
	Redevelopment Agency Special Revenue Fund	9	
	Capital Projects Fund	50	
	Water Enterprise Fund	2,445	A
	Electric Enterprise Fund	8,694	A
	Gas Enterprise Fund	2,939	A
	Wastewater Collection Enterprise Fund	4	A
	Refuse Enterprise Fund	166	A
<b>Special Revenue Funds:</b>			
Federal Revenue	General Fund	98	
Federal Revenue	Housing In-Lieu Special Revenue Fund	250	
Redevelopment Agency	General Fund	9	
Downtown Planned Community	General Fund	4	
<b>Debt Service Funds:</b>			
Golf Course Improvements	General Fund	529	
Civic Center Financing	General Fund	340	
	Special Districts Special Revenue Fund	80	
Downtown Parking Improvement	General Fund	233	
<b>Capital Projects Fund</b>	General Fund	6,212	B
	Street Improvement Special Revenue Fund	641	C
	Special Districts Special Revenue Fund	400	
	Transportation Mitigation Special Revenue Fund	690	
	Developer's Impact Fee Special Revenue Fund	467	
	Electric Enterprise Fund	1,303	B





<u>Fund Receiving Transfer</u>	<u>Fund Making Transfer</u>	<u>Amount Transferred</u>	
<b>Enterprise Funds:</b>			
Water Fund	Gas Enterprise Fund	\$10	
	Wastewater Collection Enterprise Fund	10	
Electric	Capital Projects Fund	107	
	Water Enterprise Fund	340	
	Gas Enterprise Fund	156	
	Wastewater Collection Enterprise Fund	3	
	Refuse Enterprise Fund	5	
Wastewater Collection	Storm Drainage Enterprise Fund	1	
	Capital Projects Fund	36	
	Water Enterprise Fund	500	
Wastewater Treatment	General Fund	6	
Refuse	Special Districts Special Revenue Fund	198	
Storm Drainage	General Fund	534	
<b>Internal Service Funds:</b>			
Vehicle Replacement and Maintenance	General Fund	13	
	Capital Projects Fund	5	
Technology	Water Enterprise Fund	47	
	Electric Enterprise Fund	128	
	Gas Enterprise Fund	73	
	Wastewater Collection Enterprise Fund	37	
	Wastewater Treatment Enterprise Fund	23	
	Refuse Enterprise Fund	43	
	Storm Drainage Enterprise Fund	4	
	Retiree Health Benefits	Capital Projects Fund	402 D
		Water Enterprise Fund	655 D
		Electric Enterprise Fund	2,456 D
		Gas Enterprise Fund	1,116 D
		Wastewater Collection Enterprise Fund	448 D
		Wastewater Treatment Enterprise Fund	1,049 D
Refuse Enterprise Fund		685 D	
Storm Drainage Enterprise Fund		111 D	
Technology Internal Service Fund		642 D	
Vehicle Replacement and Maintenance Internal Service Fund		347 D	
Printing and Mailing Services Internal Service Fund	76 D		
		\$36,906	

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) Allocation of funds to construct capital assets.
- (C) Transfer to return unspent construction funds.
- (D) Transfer to fund the retiree medical benefits.



**Current Interfund Balance**

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, 2006, the Federal Revenue Special Revenue Fund owed the Housing In-Lieu Special Revenue Fund \$250 thousand. The External Service Business-type Fund owed \$211 thousand and \$25 thousand to the General Fund and the Technology Internal Service Fund, respectively.

**Long-Term Interfund Advances**

The City also had a long-term interfund advance which the External Service Enterprise Fund owed the Technology Internal Service Fund \$25 thousand at June 30, 2006. The amount is expected to be repaid over four fiscal years commencing in 2004-05 from External Service Enterprise 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 \$356 thousand as of June 30, 2006.

**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, 2006, the City's notes and loans receivable totaled (in thousands):

Palo Alto Housing Corporation:	
Oak Manor Townhouse	\$1,355
Emerson Street Project	375
Alma Single Room Occupancy Development	2,222
Barker Hotel	1,441
Sheridan Apartments	2,248
Oak Court Apartments, L.P.	1,960
Mid-Peninsula Housing Coalition:	
Palo Alto Gardens Apartments	1,000
Community Working Group, Inc	1,280
Opportunity Center Associates, L.P.	750
Home Rehabilitation Loans	123
Executive Relocation Assistance Loans	1,208
Below Market Rate Assessment Loans	53
Stevenson Housing - Hot Water	81
Adolescent Counseling	57
Palo Alto Senior Housing Project	28
Clara-Mateo Alliance	11
Lytton Gardens Assisted Living	101
Emergency Housing Consortium	41
Alma Gardens Apartment	900
<b>Total</b>	<b><u>\$15,234</u></b>

### Housing Loans

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

### Oak Manor Townhouse

On January 7, 1991, the City loaned \$2.1 million to assist in the acquisition of an apartment complex to be used to provide rental housing for low and very low income households. This loan bears interest at three percent, is due in annual installments until 2011 and is collateralized by a subordinated deed of trust. Under the terms of the loan agreement, loan payments are forgiven if the Corporation meets the objective of this project. During the year ended June 30, 2006 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.

In July 2004, the City agreed to loan up to \$41 thousand to Palo Alto Housing Corporation to rehabilitate the interior of the Barker Hotel. The loan is funded entirely by Community Development Block Grant funds and is collateralized by a deed of trust on the property. Annual loan payments are deferred until certain criteria defined in the loan agreement are reached. The loan shall be forgiven if the borrower satisfactorily complies with all the terms and conditions of the loan agreement.

### **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.



### **Oak Court Apartments**

On August 18, 2003, in connection with the loan to Oak Court Apartments L.P. discussed below, the City loaned \$5.874 million to the Palo Alto Housing Corporation for the purchase of land on which Oak Court Apartments, L.P. constructed a 53-unit rental apartment complex for low and very low-income households with children. The note bears interest of five percent and is secured by a deed of trust. Annually accrued interest is added to the principal balance and note payments are due annually after 55 years, or beginning in 2058, unless the Corporation elects to extend the note until 2102, as define in the regulatory agreement. The City does not expect to collect the loan balance and has therefore recorded an allowance for doubtful accounts amounting to \$5.874 million.

### **Oak Court Apartments, L.P.**

On August 18, 2003, the City loaned \$1.960 million to Oak Court Apartments, L.P. for the construction of a 53-unit rental apartment complex for low and very low-income households with children which was completed in April 2005. The note bears no interest until certain criteria defined in the note are satisfied, at which time the note will bear an interest rate not to exceed three percent. The note is secured by a subordinate deed of trust. The principal balance is due in 2058.

### **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 loaned \$1.280 million to 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 is funded by \$1.280 million dollars of Community Development Block Grant funds. The note bears no interest and is secured by a first deed of trust. No repayment of the \$1.280 million will be required, provided that compliance with the City's agreement is maintained. After 89 years of compliance with the regulatory agreement, the City's loan would convert to a grant and its deed of trust would be reconveyed.

### **Opportunity Center Associates L.P.**

On July 19, 2004, the City loaned \$750 thousand to the Opportunity Center Associates L.P. for construction of 89 units of rental housing for extremely low-income and very low-income households. The loan is funded by \$750 thousand of Residential Housing Funds. The note bears three percent interest and is secured by a deed of trust. The principal balance is due September 1, 2007 but can be extended an additional 55 years if certain conditions in the loan agreement are met.

### **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 one 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, 2006, 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 \$53 thousand to Below Market Rate home owners with low incomes and /or very limited assets for capital repairs and improvements of their property. The loan bears interest at three percent and is secured by a deed of trust on the property. Loan payments are deferred until 2032. In 2006, the City did not accrue interest.

### **Stevenson Housing Hot Water Loans**

In July 2004, the City agreed to loan up \$38 thousand to Palo Alto Senior Housing Project, Inc to refurbish the hot water piping system at the Stevenson House Senior Housing facility. In April 2005, the City agreed to increase the loan by \$45 thousand, bringing the total loan to \$83 thousand. The loan is funded entirely by Community Development Block Grant funds, and bears simple interest of six percent. Principal and interest payments are deferred until July 1, 2010, as long as the borrower continues to comply with all terms and conditions of the agreement.

### **Adolescent Counseling Services Loans**

In October 2003, the City agreed to loan up to \$111 thousand to Adolescent Counseling Services for rehabilitation expenses in connection with a rental housing facility for teenage girls. The loan is funded entirely by Community Development Block Grant funds, bears interest at three percent and is secured by a deed of trust on the property.

### **Palo Alto Senior Housing Project Loans**

In July 2003, the City agreed to loan up to \$45.2 thousand to Palo Alto Senior Housing Project for home improvements in the independent living facility for low-income seniors. The loan is funded entirely by Community Development Block Grant funds, bears interest at six percent and is secured by a deed of trust on the property. Principal and interest payments are deferred until 2009. Principal and interest on the loan shall be forgiven if the borrower satisfactorily complies with all the terms set forth in the July 2003 agreement.

### **Clara-Mateo Alliance Loans**

In July 2003, the City agreed to loan up to \$200 thousand to Clara-Mateo Alliance for rehabilitation of the kitchen at the Elsa Segovia Center to provide services for the homeless. The loan is funded entirely by Community Development Block Grant funds, bears interest at six percent and is secured by a deed of trust on the property. Principal and interest payments are deferred until 2009. Principal and interest on the loan shall be forgiven if the borrower satisfactorily complies with all the terms and conditions set forth in the July 2003 agreement.

### **Lytton Gardens Assisted Living**

In June 2005, the City agreed to loan up \$109 thousand to Community Housing Inc. to upgrade and modernize the existing kitchens at the senior residential facility known as Lytton Gardens Assisted Living. The loan is funded entirely by Community Development Block Grant funds, and bears simple interest of three percent. Principal and interest payments are deferred until July 1, 2035, as long as the borrower continues to comply with all terms and conditions of the agreement.



### **Emergency Housing Consortium**

In November 2005, the City agreed to loan up \$75 thousand to Emergency Housing Consortium, to cover architectural expenses that will be incurred in rehabilitating and expanding the property. The loan is funded entirely by Community Development Block Grant funds, and bears simple interest of three percent. Principal and interest payments are deferred until July 1, 2035, as long as the borrower continues to comply with all terms and conditions of the agreement.

### **Alma Gardens Apartment**

In March 2006, the City agreed to loan up \$1.15 million to Community Working Group, Inc. to acquire a ten-unit multi-family housing complex known as Alma Garden Apartment. The loan is funded entirely by Community Development Block Grant funds. Principal and interest payments will be made as provided in the note until July 1, 2061, as long as the borrower continues to comply with all terms and conditions of the agreement.



## 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.

The City has recorded all its public domain (infrastructure) capital assets, which consists of Roadway, Recreation and Open Space, in its 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. Capital assets with limited useful lives may/can 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.





<b>GOVERNMENTAL ACTIVITIES</b>	<b>Years</b>
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
<b>BUSINESS-TYPE ACTIVITIES</b>	
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, 2006 were (in thousands):

	Balance June 30, 2005	Additions	Retirements	Transfers	Balance June 30, 2006
<i>Governmental activities</i>					
Capital assets not being depreciated					
Land and improvements	\$67,847	\$3,560			\$71,407
Street trees	15,432		(\$124)		15,308
Construction in progress					
Governmental funds	55,459	12,568		(\$43,570)	24,457
Internal service funds	2,157	1,564		(535)	3,186
<b>Total capital assets not being depreciated</b>	<b>140,895</b>	<b>17,692</b>	<b>(124)</b>	<b>(44,105)</b>	<b>114,358</b>
Capital assets being depreciated					
Buildings and improvements	54,570	54	(142)	36,704	91,186
Equipment					
Governmental funds	8,140	38	(704)	1,185	8,659
Internal service funds	31,766	1,333	(1,620)	535	32,014
Roadway network	225,082			4,835	229,917
Recreation & open space network	11,240			846	12,086
<b>Total capital assets being depreciated</b>	<b>330,798</b>	<b>1,425</b>	<b>(2,466)</b>	<b>44,105</b>	<b>373,862</b>
Less accumulated depreciation					
Buildings and improvements	(50,614)	(3,106)	142		(53,578)
Equipment					
Governmental funds	(6,798)	(267)	671		(6,394)
Internal service funds	(19,393)	(3,070)	1,294		(21,169)
Roadway network	(72,211)	(5,594)			(77,805)
Recreation & open space network	(4,168)	(279)			(4,447)
<b>Net capital assets being depreciated</b>	<b>(153,184)</b>	<b>(12,316)</b>	<b>2,107</b>		<b>(163,393)</b>
<b>Total depreciable assets</b>	<b>177,614</b>	<b>(10,891)</b>	<b>(359)</b>	<b>44,105</b>	<b>210,469</b>
<b>Governmental activity capital assets, net</b>	<b>\$318,509</b>	<b>\$6,801</b>	<b>(\$483)</b>		<b>\$324,827</b>

## Business-type Capital Assets

Changes in the City's Enterprise Fund capital assets during the year ended June 30, 2006 were (in thousands):

	Balance June 30, 2005	Additions	Retirements	Transfers	Balance June 30, 2006
<i>Business-type activities</i>					
Capital assets not being depreciated					
Land and improvements	\$1,953				\$1,953
Construction in progress	91,376	\$25,537		(\$53,837)	63,076
<b>Total capital assets not being depreciated</b>	<b>93,329</b>	<b>25,537</b>		<b>(53,837)</b>	<b>65,029</b>
Capital assets being depreciated					
Buildings and structures	16,918		(\$35)	1,228	18,111
Transmission, distribution, and treatment systems	425,386	871	(7,341)	52,609	471,525
<b>Total capital assets being depreciated</b>	<b>442,304</b>	<b>871</b>	<b>(7,376)</b>	<b>53,837</b>	<b>489,636</b>
Less accumulated depreciation					
Buildings and structures	(4,885)	(330)	22		(5,193)
Transmission, distribution, and treatment systems	(183,817)	(11,503)	6,725		(188,595)
<b>Net capital assets being depreciated</b>	<b>(188,702)</b>	<b>(11,833)</b>	<b>6,747</b>		<b>(193,788)</b>
<b>Total depreciable assets</b>	<b>253,602</b>	<b>(10,962)</b>	<b>(629)</b>	<b>53,837</b>	<b>295,848</b>
<b>Business-type activity capital assets, net</b>	<b>\$346,931</b>	<b>\$14,575</b>	<b>(\$629)</b>		<b>\$360,877</b>

## 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	\$925
Administrative Services	4	Electric	5,511
Community Services	466	Gas	1,165
Fire	81	Wastewater Collection	1,104
Police	34	Wastewater Treatment	2,536
Public Works	8,585	Refuse	243
Planning	10	Storm Drainage	349
Non departmental (Common Use Assets)	11		<b>\$11,833</b>
Library Dept	44		
Internal Service Funds	3,070		
	<b>\$12,316</b>		

**Construction in Progress and Completed Projects**

Construction in progress in fiscal year 2005-06 comprise (in thousands):

Expended to  
June 30, 2006

**Governmental Activities:**

Open Space Trails & Amenities	\$770
Open Space Parking Improvement	539
Park Facilities Improvement	1,518
Park Backflow Replacement & Irrigation	519
Civic Center Infrastructure Improvements	1,455
Lucie Stern Community Center Improvements	109
Community Services Lighting Enhancements	138
Homer Avenue Undercrossing	5,541
Library Master Plan Project	974
Children's Theater System Upgrade	202
Roth Building Wings Demo	1,348
Fire Communication Computer System	224
Police Building Project	838
San Mateo Drive Bridges	110
Library Automation Service	204
Public Safety Mobile Data	164
Fire Portable Radio Replacement	131
Sand Hill Road Bridge	173
Children's Library Improvement	1,142
Cambridge Parking Structure	125
Mitchell Park Library & Community Center	207
Fire Stations 3 & 4 Feasibility Study	188
Animal Shelter Expansion & Renovation	577
Arastradero Preserve Gateway	709
Street Maintenance	150
Roofing Replacement	100
Building Systems Improvements	120
American w/ Disabilities Act Compliance	552
School Site Irrigation	212
Mitchell Park Facilities Improvements	1,127
San Antonio/101 Signal	234
Sidewalk Repairs	883
Interior Finishes Construction	212
Safe Routes to School	196
Security Systems Improvement	196
Photovoltaic Design & Installations	411
Charleston/Arastradero Plan	219
Street Lights Improvement	106
El Camino Median Landscaping	293
Main Library Configuration	140
Vehicle Replacement Fund	1,213
Technology Fund	1,973
Other construction in progress	1,401

**Total governmental construction in progress**

**\$27,643**



**Enterprise Funds:**

Storm drainage structural and water quality improvements	\$403
Gas system extension replacements and improvements	1,277
Water system extension replacements and improvements	1,237
Electric distribution system improvements	3,745
Other electrical improvement projects	12,592
Water quality control plant equipment replacement and lab facilities	1,963
Sewer system rehabilitation and extensions	9,550
Other construction in progress	<u>32,309</u>
<b>Total enterprise construction in progress</b>	<b><u><u>\$63,076</u></u></b>

Allocations of Enterprise Fund administration and general expenses of \$4.74 million have been capitalized and included in amounts expended to June 30, 2006.

## Note 7.....

### GENERAL LONG-TERM OBLIGATIONS

#### The City’s Long -Term Obligations

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

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

	Original Issue Amount	Balance June 30, 2005	Retirements	Balance June 30, 2006	Current Portion
<b>Governmental Activity Debt:</b>					
<i>General Long Term Obligations:</i>					
<b>1998 Golf Course Certificates of Participation,</b> 4.00-5.00%, due 09/01/2018	\$7,750	\$5,680	\$295	\$5,385	\$310
<b>2002A Civic Center Refinancing Certificates of Participation,</b> 2.00-4.00%, due 03/01/2012	3,500	2,560	330	2,230	340
<b>2002B Downtown Parking Improvements Certificates of Participation</b> 4.55-6.00%, due 03/01/2022	3,555	2,385	85	2,300	90
<b>Total Governmental Activity Debt</b>	<u>\$14,805</u>	<u>\$10,625</u>	<u>\$710</u>	<u>\$9,915</u>	<u>\$740</u>
<b>Business-type Activity Debt:</b>					
<i>Enterprise Long Term Obligations:</i>					
<b>Utility Revenue Bonds,</b>					
1995 Series A, 5.0-6.25%, due 6/01/2020	\$8,640	\$6,540	\$280	\$6,260	\$296
1999 Refunding, 3.25-5.25%, due 06/01/2024	17,735	15,530	420	15,110	440
2002 Series A, 3.00-5.00%, due /01/2026	26,055	22,665	710	21,955	730
Less: unamortized discount/ issuance cost		(1,137)	(100)	(1,037)	
	<u>\$52,430</u>	<u>\$43,598</u>	<u>\$1,310</u>	<u>\$42,288</u>	<u>\$1,466</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 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 percent - 6.50 percent, and are payable from lease revenues received by the Palo Alto Public Improvement Corporation from the City from available funds.

On January 25, 2005 the City defeased \$900 thousand of the 2002B Downtown Parking Improvements Certificates of Participation. Surplus cash from the Civic Center Refinancing and Downtown Parking Improvement Project Construction account were placed in an irrevocable trust to provide for future debt payments. Accordingly, the trust account assets and the liability for the defeased Bonds are not included on the financial statements. The outstanding amount of the defeased debt at June 30, 2006 is \$840 thousand. The defeasance resulted in an overall debt service savings of \$1,511 thousand and an economic gain of \$462 thousand.

**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 and External Services 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 percent 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 percent), Wastewater Treatment (64.6 percent) and Storm Drain (25.2 percent). 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 percent term bond, and a \$5.12 million 5.25 percent 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 percent to 5 percent. 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 Ended June 30	<u>Governmental Activities</u>		<u>Business-Type Activities</u>	
	Principal	Interest	Principal	Interest
2007	\$740	\$475	\$1,466	\$2,147
2008	770	446	1,525	2,088
2009	800	415	1,590	2,025
2010	840	381	1,655	1,955
2011	870	345	1,730	1,880
2012-2016	3,200	1,183	9,995	8,072
2017-2021	2,475	377	12,785	5,267
2022-2026	220	14	12,579	1,703
<b>Total</b>	<u><u>\$9,915</u></u>	<u><u>\$3,636</u></u>	<u><u>43,325</u></u>	<u><u>\$25,137</u></u>

**Reconciliation of long-term debt**

Less unamortized discount/issuance cost	<u>(1,037)</u>
<b>Net long-term debt</b>	<u><u>\$42,288</u></u>





**Debt Call Provisions**

Long-term debt as of June 30, 2006 is callable on the following terms and conditions:

	<u>Initial Call Date</u>	
<b><i>Governmental Activities Long Term Debt</i></b>		
<b>1998 Certificates of Participation</b>	09/01/2008	(3)
<b>2002B Certificates of Participation</b>	03/01/2011	(2)
<b><i>Business-Type Activities Long Term Debt</i></b>		
<b>Utility Revenue Bonds -</b>		
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 percent 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 percent 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 percent 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, 2006 the amount of Bonds outstanding was \$9.360 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, 2006 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 Issue Amount	Balance June 30, 2005	Retirements	Balance June 30, 2006	Current Portion
<b>Governmental Activity Debt</b>					
<b>1987 California Avenue</b>					
<b>Parking,</b>					
6.70-9.25%, due 09/02/2007	\$1,325	\$325	\$100	\$225	\$110

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

For the Year Ending June 30	<b>Governmental Activities</b>	
	Principal	Interest
2007	\$110	\$13
2008	115	5
Total	\$225	\$18



### **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, 2006, the District's outstanding debt amounted to \$1.290 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, 2006, the District's outstanding debt amounted to \$8.750 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. As of June 30, 2006, \$0.605 million of the bonds were called and the remaining outstanding debt amounted to \$30.450 million.



## 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 (\$188 thousand in fiscal 2005-06) as mandated by the State of California. Landfill closure and post-closure liability for fiscal years 2006 and 2005 were \$6.880 million and \$6.692, respectively. Currently, 94.5 percent of the landfill capacity has been used to date. Based on this percentage, \$6.502 million is expected to be recorded as future landfill closure and post-closure liability.

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 2011. 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, 2006 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 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, 2006, Governmental Funds reservations and designations included (in thousands):

	Major Funds		
	General Fund	Capital Projects Fund	Non- Major Funds
Reserved for:			
Encumbrances	\$3,914	\$6,664	\$236
Downtown parking structure		488	
Notes and loans	1,208		13,875
Inventory of materials and supplies	2,539		
Prepaid Items	305		
Debt service			1,334
<b>Total Reserved Fund Balance</b>	<b>\$7,966</b>	<b>\$7,152</b>	<b>\$15,445</b>
Unreserved, designated for:			
Special revenue projects			\$5,183
Equity transfer stabilization	\$3,405		
Reappropriations	115	\$16,628	2,508
Budget stabilization	22,731		
Infrastructure		20,687	
<b>Total Unreserved/Designated Fund Balances</b>	<b>\$26,251</b>	<b>\$37,315</b>	<b>\$7,691</b>



**Notes to Basic Financial Statements – Note 10**

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. The project was funded with debt proceeds.

Reserves for **notes, loans, inventory of materials and supplies, and prepaid items** 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.

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, 2006, internal service fund net assets reservations and designations included (in thousands):

Reserved net assets-	
Commitments and reappropriations	\$3,935
Unreserved:	
Designated for:	
Future catastrophic losses	3,744
Retiree health care	26,505
Interfund advances/payables	50
Undesignated	<u>13,531</u>
 Net assets unrestricted	 <u><u>\$47,765</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.

Designated for **interfund advances/payables** represents the portion of net assets set aside to indicate these items do not represent available, spendable resources even though they are a component of assets.

**Enterprise Funds**

At June 30, 2006, Enterprise Fund net assets reservations included (in thousands):

	Water	Electric	Gas	Wastewater Collection	Wastewater Treatment	Refuse	Storm Drainage	External Services	Total
Rate stabilization									
Supply		\$64,542	\$2,801						\$67,343
Distribution	\$4,143	12,281	3,868						20,292
Operations				\$4,293	(\$4,597)	\$3,099	\$720		3,515
	<u>4,143</u>	<u>76,823</u>	<u>6,669</u>	<u>4,293</u>	<u>(4,597)</u>	<u>3,099</u>	<u>720</u>		<u>91,150</u>
Emergency plant replacement	1,279	2,567	972	629	2,195				7,642
Calaveras		73,163							73,163
Reappropriations	10,463	5,687	3,928	2,518	13,378	150	1,772		37,896
Commitments	2,581	3,641	692	7,069	2,598	848	608		18,037
Restricted bond proceeds					21				21
Underground loan		693							693
Refuse Water									
Resources Board						590			590
Public benefit program		1,384							1,384
Central Valley Project		(2,692)							(2,692)
Debt Service	780		952						1,732
External Service -									
InformationTechnology								\$18	18
<b>Total</b>	<b>\$19,246</b>	<b>\$161,266</b>	<b>\$13,213</b>	<b>\$14,509</b>	<b>\$13,595</b>	<b>\$4,687</b>	<b>\$3,100</b>	<b>\$18</b>	<b>\$229,634</b>

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 for multiple employer defined benefit pension plans 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 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 years of full time employment. Funding contributions for both Plans are determined annually on an actuarial basis as of June 30 by CALPERS.

Effective July 1, 2004, the separate Police and Fire Plans were combined into one Safety Plan. Prior actuarial valuation information for Safety is not available, since the plans were combined.

The Plans’ provisions and benefits in effect at June 30, 2006, are summarized as follows:

	<u>Safety</u>	<u>Miscellaneous</u>
Benefit vesting schedule	5 years service	5 years service
Benefit payments	monthly for life	monthly for life
Retirement age	50	50
Monthly benefits, as a % of annual salary	3%	1.426-2.418%
Required employee contribution rates	9%	7%
Required employer contribution rates	27.778%	12.410%

The City’s current 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 7.75 percent is assumed, including inflation at 3 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 tracked and amortized over 30 years.

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, 2004 (in thousands):

*Safety 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
2003	\$193,154	\$170,471	\$22,683	88.3%	\$18,855	120.3%
2004	201,972	177,827	24,145	88.0%	17,458	138.3%

*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
2002	\$235,232	\$258,317	(\$23,085)	109.8%	\$57,445	(40.2%)
2003	272,422	257,123	15,299	94.4%	60,498	25.3%
2004	290,552	267,794	22,758	92.2%	60,316	37.7%

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

Actuarially required contributions for all plans for fiscal years 2006, 2005, and 2004 were \$19.167, \$15.840, and \$7.887, 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 2005-06, expenditures for retiree health care for approximately 612 eligible retired employees totaled \$3.599 million, including administrative fees. The premium is based upon an average annual cost of coverage per retiree of \$6 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.

During the current fiscal year, Milliman, Inc. performed an actuarial valuation to determine the City’s retiree medical liability. The unfunded liability ranges from \$83 million to \$149 million depending on the discount rate assumption used which ranges from 4 percent to 7.75 percent. The lower range of the discount rate is based on the rate of return of the City’s current investment portfolio and assumes staff managing the funds internally. The higher range is based on staff being able to use a trust or deposit funds with CALPERS, which has an expected rate of return of 7.75 percent on its pension fund investments. As of June 30, 2006 the City has saved \$26.5 million towards the liability. This is an increase from prior year of \$8.0 million in transfers from Enterprise and Internal Service funds, a partial payment toward their unfunded liability.

Staff is evaluating various options for both reducing the liability and saving the required funds to meet recommended annual contribution levels. It is anticipated that funding and investment recommendations will be presented to Council for approval in the winter of 2006.

The Retiree Fund’s net assets consist of the following for the fiscal years ended June 30 (in thousands):

<b>Retiree Health Benefits</b>	<b>2006</b>	<b>2005</b>
Net assets, beginning of year	\$18,265	\$18,178
Interest earnings	729	703
Unrealized gain (loss) on investments	(476)	(118)
Interdepartmental charges	3,599	2,701
Compensated benefits	(3,599)	(3,199)
Transfers in	7,987	
	<b>\$26,505</b>	<b>\$18,265</b>



## 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 \$750 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 \$34 million per occurrence. The City retains the risk for the first \$1 million 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.



**Notes to Basic Financial Statements – Note 14**

During the fiscal year ended June 30, 2006 the City contributed \$546 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 (in thousands):

	Year Ended June 30	
	2006	2005
Beginning Balance	\$13,883	\$10,548
Liability for current and prior fiscal year claims and claims incurred but not reported (IBNR)	9,981	7,508
Claims paid	(4,319)	(4,173)
Ending Balance	<u>\$19,545</u>	<u>\$13,883</u>
Current Portion	<u>\$6,033</u>	<u>\$4,084</u>



## Note 15.....

### JOINT VENTURES

#### General

The City participates in joint ventures through Joint Powers Authorities (JPA) 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, 2006, the City was billed for a total of \$32.379 million by NCPA. The bills were for direct NCPA related debt and service costs, along with payments related to the City's Western contract, payments to the City's electric suppliers and other commitments the City made, for which NCPA acts as the City's billing and settlement agent.

The City's interest in NCPA projects and reserves, as computed by NCPA, was \$8.256 million at June 30, 2006. 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 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 \$1.5 million 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 percent and 6.158 percent, 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, 2006 is \$161.811 million. The City's participation in this project was 6.158 percent, or \$9.964 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 percent of this Project's debt service and operating costs. At June 30, 2006, the book value of this Project's plant, equipment and other assets was \$511.981 million, while its long-term debt totaled \$503.981 million and other liabilities totaled \$2.703 million. The City's share of the Project's long term-debt amounted to \$116.132 million at that date.



### **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 percent share of this Project and the City has an 11.0736 percent 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 million 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 percent 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, 2006, the book value of this Project's plant, equipment and other assets was \$4.107 million, while its long term debt totaled \$3.297 million. The City's share of the Project's long-term debt amounted to \$365 thousand at that date.

### **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 percent 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 \$420.225 million as of June 30, 2006. The City's share of this debt is \$16.809 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 million of Commercial Paper debt backed by a Letter of Credit. The City's share of the Commercial Paper was \$1.384 million at June 30, 2006, 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 a portion of 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 expired in December 2004, with an option for an additional ten-year term. The City renewed the lease for 10 years in 2005. 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 a 90 day 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, 2006 amounted to \$6.042 million.

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

<u>Year ended June 30:</u>	<u>Payments</u>
2007	\$6,253
2008	6,440
2009	6,633
2010	6,832
2011	7,035
2012-2015	<u>30,312</u>
	<u>\$63,505</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 2005-06 this resulted in payments to PASCO of \$ 7.887 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, 2006. 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, 2006 is \$3.697 million. During the year ended June 30, 2006, the City paid \$ 414 thousand as its portion of current debt service.

## **UTILITIES ENERGY RESOURCE MANAGEMENT**

### **Energy Markets in the United States and California**

U.S. and California electric and gas prices have been volatile in the past year. The City purchased electricity in fiscal year 2005-06 under a diversified electric supply portfolio plan as per the portfolio planning guidelines established in 2001 and 2002 by City Council under the Long-term Electric Acquisition Plan (LEAP). Due to the City’s commodity purchase strategy, whereby purchases are made on a 3-year forward basis in a laddered fashion, most of the supplies for fiscal year 2005-06 were purchased at lower cost ahead of time. This 3-year laddered purchase program resulted in the City’s electric and gas utility customers enjoying lower retail rates in fiscal year 2005-06 compared to what they would have paid if exposed to volatile market prices during the year. The retail load for electricity and natural gas during the year were 966 million kWh and 3.1 million MMBtu respectively. The City’s retail rates continue to be lower than neighboring utilities.

The City’s average wholesale electric commodity purchase cost during the year was approximately 5.3 ¢/kWh while the average spot market prices were close to 6.5 ¢/kWh; the corresponding average gas commodity costs for the gas pool customers were \$5.77/MMBtu compared to a spot market price of \$8.22/MMBtu. The supply cost advantage is expected to continue in fiscal year 2006-07, but will be at a lower level for natural gas as the City purchases additional supplies on a forward basis at higher market prices.

Due to extremely wet weather conditions in Northern California during the Winter and Spring months, approximately 84 percent of City’s electric supply was from hydro resources, well above the 50 percent level expected under average precipitation conditions. Wind and landfill gas based electric supply accounted for 7 percent of the resources, with the balance purchased from the wholesale electric market.

Market based energy supplies purchased by the City at the beginning of the year was sold in the market as abundant electricity supplies from the hydro resources were made available to meet City’s electric loads. The surplus energy from the City’s electric portfolio was sold in the market, generating surplus energy sales revenues of \$22.6 million (the imputed expense associated with the surplus energy sold from the overall electric supply portfolio was calculated at \$14.7 million during the year, and is shown separately in the Statement of Revenues, Expenses, and Changes in Net Assets).

The table below outlines the forward electric and natural gas commodity supply commitments made by the City with each supplier as of June 30, 2006. Monthly payments are made to suppliers upon delivery of supplies for the month.

Forward Natural Gas Commodity Supply Commitments as of June 30, 2006

Supplier	FY06/07	FY07/08	FY08/09	Total
BP	\$ 3,947,647			\$ 3,947,647
Coral Energy	\$ 5,243,927	\$ 7,486,521	\$ 5,949,745	\$ 18,680,193
Sempra	\$ 5,001,369	\$ 4,181,175	\$ 1,602,400	\$ 10,784,944
	\$ 14,192,943	\$ 11,667,696	\$ 7,552,145	\$ 33,412,784
Average Cost (\$/MMBtu)	\$6.31	\$7.23	\$8.44	\$7.02

Forward Electricity Commodity Supply Commitments as of June 30, 2006

Supplier	FY06/07	FY07/08	FY08/09	FY09/10	Total
BP	\$ 2,671,200		-	-	\$ 2,671,200
Coral Power	5,830,135	4,019,595	4,505,235	2,021,235	\$ 16,376,200
Sempra	9,323,023	2,496,785		-	\$ 11,819,808
	\$ 17,824,358	\$ 6,516,380	\$ 4,505,235	\$ 2,021,235	\$ 30,867,208
Average Cost (cents/kWh)	5.36 ¢	4.31 ¢	3.87 ¢	3.66 ¢	4.71 ¢

The City’s natural gas transportation contract entered into in 2005 with Pacific Gas and Electric Company (PG&E) was in effect during the year, and will be in place until the end of 2007. This contract, commonly known as Gas Accord III between PG&E and its transportation customers, provides City’s retail customers stable transportation costs.

Significant energy bills signed into California law during the 2005-06 Legislative Session are listed below.

AB 380 (Chapters 9/29/2005) requires that every local publicly owned electric utility serving end-use customers, at a minimum, meet the most recent minimum planning reserve and reliability criteria approved by the Board of Trustees of the Western Systems Coordinating Council until minimum planning reserve and reliability criteria are adopted by the Western Electricity Coordinating Council. The City Council approved the Electric Resource Adequacy Plan for the City in May 2006.

AB 1037 (Chapters 9/29/2005) requires investor owned utilities (IOUs), municipal utilities and the CPUC to make energy-efficiency programs a priority before acquiring other sources of electricity or building new transmission lines. AB 1037 merely codifies the Energy Action Plan’s loading order for IOUs, but also extends the loading order to apply to municipal utilities. The City’s long-term electric resource plan addresses the loading order prescribed in the law.



In addition to the State initiatives, the Federal Energy Policy Act of 2005 passed with a number of sections that impact public power. The Federal Energy Regulatory Commission (FERC) authority has been increased over transmission grid reliability, which opens the door for FERC to claim “limited” jurisdiction over municipal owned transmission and some retail programs such as demand response. There are also requirements for municipal utilities to consider adoption of net metering and smart metering programs.

## Future Outlook

### *Electric*

The Council-approved Long-term Electric Acquisition Plan (LEAP) set a 10 percent new renewable supply target by 2008, rising to 20 percent by 2015. In fiscal year 2005-06, 7 percent of City’s energy needs were met with new renewable supply and is expected to reach 16 percent by end of 2007. The City anticipates reaching a 30 percent new renewable standard by the end of the decade. The wind and landfill gas resources are competitive with conventional resources, allowing the City to accelerate its renewable energy goals and meet Council’s target ahead of schedule. Palo Alto Green, the City’s voluntary green power program, achieved the highest participation rate in the country in fiscal year 2005-06, and currently accounts for an additional 3 percent of the City’s energy needs from renewable resources.

In conformance with LEAP Guidelines, the City conducted a feasibility study investigating the potential for meeting a portion of its electric supply needs with local generation within City limits. The study found that large-scale gas-fired power generation within Palo Alto would not be technically and economically feasible. Based on this finding, the Council redirected the local generation efforts to focus on clean small-scale distributed generation and cogeneration within Palo Alto, and possible power generation opportunities that may arise outside of Palo Alto, but within or near the Greater Bay Area. A cogeneration implementation plan is being developed.

The City’s electric retail rates were held steady during the year. Natural gas retail rates were increased during the year to recover higher purchase cost. Utilities purchase cost of \$21.4 for natural gas during the year was above the \$18.8 million cost incurred during fiscal year 2004-05. The cost is projected to increase further in 2006-07.

The Utilities Department energy procurement efforts conform to the Council-approved Energy Risk Management Policies. These include a formal oversight role (Middle Office) within the Administrative Services Department. A quarterly energy risk management report is provided to the Council as part of this oversight role. As of August 2006, all except one of the risk management program recommendations made by the City Auditor in her July 2002 audit report have been implemented. Further segregation of back-office settlement duties from the front and middle office commodity procurement and management duties has been implemented. We expect the auditor to approve the final change.

The CAISO is in the process of implementing a number of initiatives with the stated goals of reliable and efficient operation of the transmission grid. Implementation of these initiatives, or the Market Redesign and Technology Update (MRTU), is anticipated to occur in November 2007. An underlying component of MRTU is the use of location specific prices for the scheduling of energy transactions, which could lead to significant cost increases for transmission services for the City in the form of increased congestion and loss exposure for delivery of power to NP15 from the City’s resources.



Another component of MRTU is the resource adequacy requirements, whereby load-serving entities must show that they have sufficient generation capacity to meet their peak load, including requirements for local area transmission reliability. To date, the resource adequacy proceedings have resided primarily with the CPUC. However, it is possible that the CAISO will enforce CPUC-type requirements on all load serving entities, including municipal utilities, which could lead to significant cost increases for load serving entities in transmission-congested areas. The Council-approved Electric Resource Adequacy Program, requires the City to maintain a 15 percent reserve margin to cover monthly peak loads, however this program does not yet address the requirement to show (by ownership or contracts) capacity from generation resources located within the Greater Bay Area. The City is actively participating in efforts to ensure fair market design and fair treatment of costs allocated to Bay Area municipal loads by the CAISO and other regulatory agencies. The City is also working with the cities of Santa Clara and Alameda to advocate for higher electric transmission reliability standards and the building of additional transmission infrastructure into the Greater Bay Area.

The following energy bills are pending in the State legislature and will have a direct or indirect impact on utilities operations.

AB 2021(Levine): Existing law requires publicly owned utilities to invest in all cost effective, reliable and feasible energy efficiency. AB 2021 restates that requirement and adds additional reporting requirements for publicly owned utilities. It requires municipal utilities to prepare 10-year energy efficiency plans every 3 years. It requires annual performance reporting to customers and the California Energy Commission. Implementing such programs are expected to lower overall costs, but may increase retail rates.

SB 1368(Perata): This bill prohibits all utilities from investing in power plant projects or contracts that are not at least as clean as a combined cycle gas turbine project. It would require all electricity contracts of five years or longer to be reviewed by the CEC for compliance. The bill is now on the Governor's desk.

AB 32(Nunez): AB 32 is this year's major mandatory climate change bill which will apply to publicly owned utilities. It requires the Air Resources Board to first determine the 1990 level of greenhouse emissions statewide and then to adopt any and all regulations it deems necessary to meet that level by 2020. The bill also includes a provision for greenhouse gas emission fees with no apparent limit on the amount of fees that can be charged to a utility. The bill is now on the Governor's desk.

SB 1 (Chaptered 8/21/2006) that adds requirements to the CPUC's California Solar Initiative Program and extends a similar program requirement to local publicly owned electric utilities. This bill requires that every local publicly owned electric utility serving end-use customers, on or before January 1, 2008, adopt, implement, and finance a solar initiative program for the purpose of investing in, and encouraging the increased installation of, residential and commercial solar energy systems. The bill requires a local publicly owned electric utility to make certain program information available to its customers, to the Legislature, and to the Energy Commission on an annual basis beginning June 1, 2008. The City will implement all the requirements of the legislation as soon as practical.

### **Natural Gas**

Declining production in the U.S. and Canada, strong U.S. and international demand, and uncertainty in the middle-east is expected to keep natural gas prices high for at least another year. Projected increase in liquefied natural gas (LNG) imports is expected to make up the declining production in the U.S and Canada in the long term, and is expected to lower prices by 2009. Market price volatility has increased and is expected to remain high in the short term.

The City expects to continue implementing its 3-year laddering strategy. The City will also examine additional strategies to control commodity cost.



## Water

The City's water use during fiscal year 2005-06 declined slightly over the prior year. Usage has remained essentially flat for the past 5-10 years and is only two-thirds of what it was in 1976. Water supply costs for fiscal year 2005-06 fell about 9 percent from fiscal year 2004-05 as the City's water supplier, the San Francisco Public Utilities Commission (SFPUC), lowered rates to draw down a reserve its suburban customers built up as a result of a settlement of various accounting and cost classification issues.

The outlook for water supply costs indicates an upward trend as the SFPUC embarks on a much delayed, but essential, upgrade to the regional water system facilities. In the November 2002 elections, the San Francisco electorate approved a bond measure to pay for San Francisco's one-third share of the cost of the Water System Improvement Program (WSIP) that was estimated to be about \$3 billion at the time. Costs for the WSIP are now expected to be about \$4.3 billion. When other planned projects are factored in, the total cost to upgrade and improve the regional water system is about \$4.9 billion. The Bay Area Water Supply and Conservation Agency (BAWSCA) and the San Francisco Bay Area Regional Financing Authority were created in 2003 to provide funding for the two-thirds share of the WSIP costs allocated to the agencies that purchase water from the SFPUC, including Palo Alto. Estimates for these increased costs have been factored into City's long-term water rate projections. However, the wholesale agencies (including the City) may be asked to make an up-front capital commitment, rather than pay for their share of the improvements over time through increased SFPUC wholesale water rates.

During fiscal year 2005-06, the City completed a re-assessment of the potential market for recycled water within Palo Alto. The 2006 Recycled Water Market Survey was conducted to update the estimates of cost and potential for expanding the recycled water distribution system that were last examined in 1992. The market survey found that the cost of recycled water is still more costly than the current estimate of future water cost from the SFPUC. However, outside funding, from the state and federal governments, or other regional partners, may make the project cost-effective for Palo Alto. In fiscal year 2006-07, staff plans to recommend that a facility plan, pre-design, and preparation of environmental documents be started. This step is necessary to compete for any available grant funding opportunities.

## Contingent Liabilities

Much of the uncertainties faced by the Utilities Department as an aftermath of the 2000-01 energy crisis were resolved over the last couple of years. However, a number of uncertainties remain. Following a Fall 2005 Ninth Circuit Court determination that FERC lacked authority under the Federal Power Act to grant refund relief against governmental agencies, the California Attorney General has filed a complaint for refunds against NCPA and other governmental agencies for electricity sold during the California Energy Crisis in 2000-01, but has not served the complaint on NCPA. As a result, there is no immediate deadline by which to respond to the complaint. Another dispute between Western Area Power Administration (Western) and PG&E regarding PG&E's claim to recover certain ISO related costs has also not been resolved. The potential exposure to liability under the Attorney General lawsuit or the Pacific Gas and Electric Company's CAISO-related claim is not likely to have a material adverse effect on the City's financial condition.

**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, claims or assessments that are likely to have a material adverse effect on the City's financial condition.



**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 taxes in error and that the City was obligated to refund these taxes from future sales tax revenues. The City is in process of challenging the Board’s findings. However, as of June 30, 2006, the issue had not been settled and the refund had not been returned.

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



# Non-major Governmental Funds.....

## **STREET IMPROVEMENT**

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

## **FEDERAL REVENUE**

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

## **HOUSING IN-LIEU**

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

## **SPECIAL DISTRICTS**

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

## **TRANSPORTATION MITIGATION**

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

## **LOCAL LAW ENFORCEMENT**

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

## **DOWNTOWN PLANNED COMMUNITY**

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

## **ASSETS SEIZURE**

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

## **DEVELOPER'S IMPACT FEE**

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

## **REDEVELOPMENT AGENCY ADMINISTRATION**

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

## **DOWNTOWN BUSINESS IMPROVEMENT DISTRICT**

The Downtown Business Improvement District Fund was established to account for the activities of the Palo Alto Downtown Business Improvement District, which was established to enhance the viability of the downtown business district.





## ***Non-major Governmental Funds***

### **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 accumulates 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.





This page is intentionally left blank.



**City of Palo Alto - Non-Major Governmental Funds** .....  
**Combining Balance Sheets- June 30, 2006**  
*(In thousands of dollars)*

	<u>SPECIAL REVENUE FUNDS</u>					
	<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	\$206	\$221	\$2,630	\$882	\$1,454	\$207
Cash and investments with fiscal agent						
Receivables:						
Accounts	107	253	41			
Special assessments						
Interest	10		31	11	16	2
Notes		5,813	8,213			
Interfund receivables and advances			250			
<b>Total Assets</b>	<b><u>\$323</u></b>	<b><u>\$6,287</u></b>	<b><u>\$11,165</u></b>	<b><u>\$893</u></b>	<b><u>\$1,470</u></b>	<b><u>\$209</u></b>
LIABILITIES						
Accounts payable		\$200	\$165			
Deferred revenue			151			
Interfund payable and advances		250				
<b>Total Liabilities</b>		<b><u>450</u></b>	<b><u>316</u></b>			
FUND EQUITY						
Reserved for:						
Encumbrances	\$17	39	122			\$54
Notes receivable		5,813	8,062			
Debt service						
Unreserved, designated for:						
Special Revenue Funds						
Special revenue projects			2,665	\$893	\$1,470	155
Reappropriations	1,750	758				
Unreserved, undesignated						
Special Revenue Funds	<u>(1,444)</u>	<u>(773)</u>				
	<u>323</u>	<u>5,837</u>	<u>10,849</u>	<u>893</u>	<u>1,470</u>	<u>209</u>
	<b><u>\$323</u></b>	<b><u>\$6,287</u></b>	<b><u>\$11,165</u></b>	<b><u>\$893</u></b>	<b><u>\$1,470</u></b>	<b><u>\$209</u></b>



.....

SPECIAL REVENUE FUNDS				DEBT SERVICE FUNDS		
<u>Downtown Planned Community</u>	<u>Assets Seizure</u>	<u>Developer's Impact Fee</u>	<u>Redevelopment Agency</u>	<u>Downtown Business Improvement District</u>	<u>Golf Course</u>	<u>Civic Center Refinancing</u>
	\$18	\$1,315		\$44	\$759	\$363
				42		
		16		1	24	
	<u>\$18</u>	<u>\$1,331</u>		<u>\$87</u>	<u>\$783</u>	<u>\$363</u>
				\$16		
				16		
				4	\$783	\$352
	<u>\$18</u>	<u>\$1,331</u>		<u>67</u>		<u>11</u>
	<u>18</u>	<u>1,331</u>		<u>71</u>	<u>783</u>	<u>363</u>
	<u>\$18</u>	<u>\$1,331</u>		<u>\$87</u>	<u>\$783</u>	<u>\$363</u>

(Continued)

.....



City of Palo Alto - Non-Major Governmental Funds .....

Combining Balance Sheets- June 30, 2006

(In thousands of dollars)

	<u>DEBT SERVICE FUNDS</u>		Total Non-major Governmental Funds
	<u>Downtown Parking Improvement</u>	<u>Special Assessment Debt</u>	
<b>ASSETS</b>			
Cash and investments			
Available for operations		\$116	\$7,093
Cash and investments with fiscal agent	\$245		1,367
Receivables:			
Accounts			443
Special assessments		225	225
Interest			111
Notes			14,026
Interfund receivables and advances			250
	<u>\$245</u>	<u>\$341</u>	<u>\$23,515</u>
<b>LIABILITIES</b>			
Accounts payable			\$381
Deferred revenue		\$225	376
Interfund payable and advances			250
	<u></u>	<u>225</u>	<u>1,007</u>
<b>FUND EQUITY</b>			
Reserved for:			
Encumbrances			236
Notes receivable			13,875
Debt service	\$159	40	1,334
Unreserved, designated for:			
Special Revenue Funds			
Special revenue projects			5,183
Reappropriations			2,508
Unreserved, undesignated			
Special Revenue Funds	86	76	(628)
	<u>245</u>	<u>116</u>	<u>22,508</u>
	<u>\$245</u>	<u>\$341</u>	<u>\$23,515</u>



This page is intentionally left blank.



**City of Palo Alto - Non-Major Governmental Funds** .....  
**Combining Statements of Revenues, Expenditures and**  
**Changes in Fund Balances -**  
**For the Year Ended June 30, 2006**  
*(In thousands of dollars)*

	SPECIAL REVENUE FUNDS					
	Street Improvement	Federal Revenue	Housing In-Lieu	Special Districts	Transportation Mitigation	Local Law Enforcement
REVENUES						
Special assessments						
Other taxes and fines	\$1,132					
From other agencies:						
Community Development Block Grant State of California		\$1,405				\$100
Other revenue from other agencies		7				7
Permit and licenses				\$67		
Return on investment	8	61	\$62	18	\$36	4
Rental income			6			
Other:						
Housing In-Lieu - residential			10			
Housing In-Lieu - commercial			102			
University Avenue Parking				732	28	
California Avenue Parking				125		
Other fees			160			
Total Revenues	<u>1,140</u>	<u>1,473</u>	<u>340</u>	<u>942</u>	<u>64</u>	<u>111</u>
EXPENDITURES						
Current:						
Planning and Community Environment		620	260			
Public Safety - Police						30
Non Departmental			136			
Debt service:						
Principal retirement						
Interest and fiscal charges						
Total Expenditures		<u>620</u>	<u>396</u>			<u>30</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>1,140</u>	<u>853</u>	<u>(56)</u>	<u>942</u>	<u>64</u>	<u>81</u>
OTHER FINANCING SOURCES (USES)						
Transfers in		348				
Transfers (out)	(933)		(250)	(1,463)	(690)	
Total Other Financing Sources (Uses)	<u>(933)</u>	<u>348</u>	<u>(250)</u>	<u>(1,463)</u>	<u>(690)</u>	
Net Change in Fund Balance	207	1,201	(306)	(521)	(626)	81
Fund balances at the beginning of year	116	4,636	11,155	1,414	2,096	128
Fund balances at end of year	<u>\$323</u>	<u>\$5,837</u>	<u>\$10,849</u>	<u>\$893</u>	<u>\$1,470</u>	<u>\$209</u>



SPECIAL REVENUE FUNDS				DEBT SERVICE FUNDS		
Downtown Planned Community	Assets Seizure	Developer's Impact Fee	Redevelopment Agency	Downtown Business Improvement District	Golf Course	Civic Center Refinancing
				\$137		
	\$1	\$13		3	\$48	\$13
		628				
	1	641		140	48	13
				176		
					295	330
					261	92
				176	556	422
	1	641		(36)	(508)	(409)
\$4		(467)	\$9 (9)		529	420
4		(467)			529	420
4	1	174		(36)	21	11
(4)	17	1,157		107	762	352
	\$18	\$1,331		\$71	\$783	\$363

(Continued)



**City of Palo Alto - Non-Major Governmental Funds .....**  
**Combining Statements of Revenues, Expenditures and**  
**Changes in Fund Balances -**  
**For the Year Ended June 30, 2006**  
*(In thousands of dollars)*

	DEBT SERVICE FUNDS		Total Non-major Governmental Funds
	Downtown Parking Improvement	Special Assessment District	
REVENUES			
Special assessments		\$131	\$268
Other taxes and fines			1,132
From other agencies:			
Community Development Block Grant			1,405
State of California			100
Other revenue from other agencies			14
Permit and licenses			67
Return on investment	\$5		272
Rental income			6
Other:			
Housing In-Lieu - residential			10
Housing In-Lieu - commercial			102
University Avenue Parking			760
California Avenue Parking			125
Other fees			788
Total Revenues	5	131	5,049
EXPENDITURES			
Current:			
Planning and Community Environment			880
Public Safety - Police			30
Non Departmental			312
Debt service:			
Principal retirement	85	100	810
Interest and fiscal charges	149	21	523
Total Expenditures	234	121	2,555
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(229)	10	2,494
OTHER FINANCING SOURCES (USES)			
Transfers in	233		1,543
Transfers (out)			(3,812)
Total Other Financing Sources (Uses)	233		(2,269)
Net Change in Fund Balance	4	10	225
Fund balances at the beginning of year	241	106	22,283
Fund balances at end of year	\$245	\$116	\$22,508





This page is intentionally left blank.



**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, 2006**  
*(In thousands of dollars)*

	SPECIAL REVENUE FUNDS					
	Street Improvement			Federal Revenue		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
REVENUES						
Special assessments						
Other taxes and fines	\$1,126	\$1,132	\$6			
From other agencies:						
Community Development Block Grant State of California				\$779	\$1,405	\$626
Other revenue from other agencies				10	7	(3)
Permit and licenses						
Return on investment	1	8	7		61	61
Rental income						
Other:						
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees				7		(7)
Total Revenues	<u>1,127</u>	<u>1,140</u>	<u>13</u>	<u>796</u>	<u>1,473</u>	<u>677</u>
EXPENDITURES						
Current operations:						
Planning and Community Environment				1,275	620	655
Public Safety - Police						
Community Services						
Non Departmental						
Debt service:						
Principal retirement						
Interest and fiscal charges						
Total Expenditures				<u>1,275</u>	<u>620</u>	<u>655</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>1,127</u>	<u>1,140</u>	<u>13</u>	<u>(479)</u>	<u>853</u>	<u>1,332</u>
OTHER FINANCING SOURCES (USES)						
Transfers in				285	348	63
Transfers (out)	(1,462)	(933)	529	(35)		35
Total Other Financing Sources (Uses)	<u>(1,462)</u>	<u>(933)</u>	<u>529</u>	<u>250</u>	<u>348</u>	<u>98</u>
Net Change in Fund Balance	<u>(\$335)</u>	<u>207</u>	<u>\$542</u>	<u>(\$229)</u>	<u>1,201</u>	<u>\$1,430</u>
Fund balances at the beginning of year		<u>116</u>			<u>4,636</u>	
Fund balances at end of year		<u>\$323</u>			<u>\$5,837</u>	



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)
\$148	\$62	(\$86)	\$61	\$67	\$67	\$102	\$36	(\$66)
9	6	(3)		18	(43)			
200	10	(190)						
200	102	(98)	894	732	(162)	480	28	(452)
			116	125	9			
380	160	(220)						
937	340	(597)	1,071	942	(129)	582	64	(518)
363	260	103						
569	136	433						
932	396	536						
5	(56)	(61)	1,071	942	(129)	582	64	(518)
(250)	(250)		(1,402)	(1,463)	(61)	(690)	(690)	
(250)	(250)		(1,402)	(1,463)	(61)	(690)	(690)	
(\$245)	(306)	(\$61)	(\$331)	(521)	(\$190)	(\$108)	(626)	(\$518)
	11,155			1,414			2,096	
	\$10,849			\$893			\$1,470	

(Continued)



**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, 2006**  
*(In thousands of dollars)*

	SPECIAL REVENUE FUNDS				
	Local Law Enforcement			Downtown Planned Community	
	Budget	Actual	Variance	Budget	Variance
			Positive		Positive
		(Negative)		(Negative)	
<b>REVENUES</b>					
Special assessments					
Other taxes and fines					
From other agencies:					
Community Development Block Grant					
State of California	\$100	\$100			
Other revenue from other agencies	7	7			
Permit and licenses					
Return on investment	4	4			
Rental income					
Other:					
Housing In-Lieu - residential					
Housing In-Lieu - commercial					
University Avenue Parking					
California Avenue Parking					
Other fees					
<b>Total Revenues</b>	<b>111</b>	<b>111</b>			
<b>EXPENDITURES</b>					
Current operations:					
Planning and Community Environment					
Public Safety - Police	111	30	\$81		
Community Services					
Non Departmental					
Debt service:					
Principal retirement					
Interest and fiscal charges					
<b>Total Expenditures</b>	<b>111</b>	<b>30</b>	<b>81</b>		
<b>EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES</b>		<b>81</b>	<b>81</b>		
<b>OTHER FINANCING SOURCES (USES)</b>					
Transfers in				\$4	\$4
Transfers (out)					
<b>Total Other Financing Sources (Uses)</b>				<b>4</b>	<b>4</b>
<b>Net Change in Fund Balance</b>		<b>81</b>	<b>\$81</b>	<b>4</b>	<b>\$4</b>
Fund balances at the beginning of year		128		(4)	
Fund balances at end of year		<u>\$209</u>			



SPECIAL REVENUE FUNDS											
Asset Seizure			Developer's Impact Fee			Redevelopment Agency			Downtown Business Improvement District		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
									\$154	\$137	(\$17)
\$1	\$1		\$32	\$13	(\$19)				4	3	(1)
			553	628	75						
1	1		585	641	56				158	140	(18)
			118		118				183	176	7
1		\$1									
			118		118				183	176	7
	1	1	467	641	174				(25)	(36)	(11)
			(467)	(467)		9	\$9	(9)			
			(467)	(467)							
	1	\$1		174	\$174				(\$25)	(36)	(\$11)
	17			1,157						107	
	\$18			\$1,331						\$71	

(Continued)



**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, 2006**  
*(In thousands of dollars)*

	DEBT SERVICE FUNDS					
	Golf Course			Civic Center Refinance		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
REVENUES						
Special assessments						
Other taxes and fines						
From other agencies:						
Community Development Block Grant						
State of California						
Other revenue from other agencies						
Permit and licenses						
Return on investment	\$40	\$48	\$8	\$2	\$13	\$11
Rental income						
Other:						
Housing In-Lieu - residential						
Housing In-Lieu - commercial						
University Avenue Parking						
California Avenue Parking						
Other fees						
Total Revenues	<u>40</u>	<u>48</u>	<u>8</u>	<u>2</u>	<u>13</u>	<u>11</u>
EXPENDITURES						
Current operations:						
Planning and Community Environment						
Public Safety - Police						
Community Services						
Non Departmental						
Debt service:						
Principal retirement	295	295		330	330	
Interest and fiscal charges	261	261		92	92	
Total Expenditures	<u>556</u>	<u>556</u>		<u>422</u>	<u>422</u>	
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(516)</u>	<u>(508)</u>	<u>8</u>	<u>(420)</u>	<u>(409)</u>	<u>11</u>
OTHER FINANCING SOURCES (USES)						
Transfers in	516	529	13	420	420	
Transfers (out)						
Total Other Financing Sources (Uses)	<u>516</u>	<u>529</u>	<u>13</u>	<u>420</u>	<u>420</u>	
Net Change in Fund Balance	<u>21</u>	<u>\$21</u>		<u>11</u>	<u>\$11</u>	
Fund balances at the beginning of year		<u>762</u>			<u>352</u>	
Fund balances at end of year		<u>\$783</u>			<u>\$363</u>	



DEBT SERVICE FUNDS						TOTAL		
Downtown Parking Improvement			Special Assessment District			Non-major Governmental Funds		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
			\$121	\$131	\$10	\$275	\$268	(\$7)
						1,126	1,132	6
						779	1,405	626
						100	100	
						17	14	(3)
							67	67
\$2	\$5	\$3				397	272	(125)
						9	6	(3)
						200	10	(190)
						200	102	(98)
						1,374	760	(614)
						116	125	9
						940	788	(152)
<u>2</u>	<u>5</u>	<u>3</u>	<u>121</u>	<u>131</u>	<u>10</u>	<u>5,533</u>	<u>5,049</u>	<u>(484)</u>
						1,638	880	758
						111	30	81
						118		118
						753	312	441
85	85		100	100		810	810	
149	149		21	21		523	523	
<u>234</u>	<u>234</u>		<u>121</u>	<u>121</u>		<u>3,953</u>	<u>2,555</u>	<u>1,398</u>
<u>(232)</u>	<u>(229)</u>	<u>3</u>		<u>10</u>	<u>10</u>	<u>1,580</u>	<u>2,494</u>	<u>914</u>
232	233	1				1,462	1,543	81
						(4,315)	(3,812)	503
<u>232</u>	<u>233</u>	<u>1</u>				<u>(2,853)</u>	<u>(2,269)</u>	<u>584</u>
	4	\$4		10	\$10	(\$1,273)	225	\$1,498
	<u>241</u>			<u>106</u>			<u>22,283</u>	
	<u>\$245</u>			<u>\$116</u>			<u>\$22,508</u>	



*Non-major Governmental Funds*

*This page is intentionally left blank.*





# 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.

### 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 BENEFIT

This fund accounts for the retiree health benefits.



This page is intentionally left blank.



**City of Palo Alto - Internal Service Funds** .....

**Combining Statements of Net Assets - June 30, 2006**

*(In thousands of dollars)*

	<u>Vehicle Replacement and Maintenance</u>	<u>Technology</u>	<u>Printing and Mailing Services</u>	<u>General Benefits and Insurance</u>	<u>Retiree Health Benefit</u>	<u>Total</u>
<b>ASSETS</b>						
<b>Current Assets</b>						
Cash and investments available for operations	\$4,647	\$11,949	\$462	\$37,108	\$26,282	\$80,448
Accounts receivable, net	9			65		74
Interest receivable	62	155	7	329	223	776
Interfund receivables		25				25
Inventory of materials and supplies	476					476
<b>Total Current Assets</b>	<b>5,194</b>	<b>12,129</b>	<b>469</b>	<b>37,502</b>	<b>26,505</b>	<b>81,799</b>
<b>Noncurrent Assets:</b>						
Interfund receivables		25				25
Capital assets, nondepreciable	1,213	1,973				3,186
Capital assets, net of depreciation	8,591	2,228	27			10,846
<b>Total Noncurrent Assets</b>	<b>9,804</b>	<b>4,226</b>	<b>27</b>			<b>14,057</b>
<b>Total Assets</b>	<b>14,998</b>	<b>16,355</b>	<b>496</b>	<b>37,502</b>	<b>26,505</b>	<b>95,856</b>
<b>LIABILITIES</b>						
<b>Current Liabilities</b>						
Accounts payable and accrued liabilities	48	172		1,560		1,780
Accrued salaries and benefits	20	56	5	319		400
Accrued compensated absences				8,847		8,847
Accrued claims payable - current				6,033		6,033
<b>Total Current Liabilities</b>	<b>68</b>	<b>228</b>	<b>5</b>	<b>16,759</b>		<b>17,060</b>
<b>Long-term Liabilities</b>						
Accrued compensated absences				3,487		3,487
Accrued claims payable				13,512		13,512
<b>Total Long-term Liabilities</b>				<b>16,999</b>		<b>16,999</b>
<b>Total Liabilities</b>	<b>68</b>	<b>228</b>	<b>5</b>	<b>33,758</b>		<b>34,059</b>
<b>NET ASSETS</b>						
Investment in capital assets	9,804	4,201	27			14,032
Unrestricted	5,126	11,926	464	3,744	26,505	47,765
<b>Total Net Assets</b>	<b>\$14,930</b>	<b>\$16,127</b>	<b>\$491</b>	<b>\$3,744</b>	<b>\$26,505</b>	<b>\$61,797</b>



**City of Palo Alto - Internal Service Funds** .....  
**Combining Statements of Revenues, Expenses and**  
**Changes in Net Assets - For the Year Ended June 30, 2006**  
*(In thousands of dollars)*

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits and Insurance	Retiree Health Benefit	Total
<b>OPERATING REVENUES</b>						
Charges for services	<u>\$5,587</u>	<u>\$6,875</u>	<u>\$1,155</u>	<u>\$39,914</u>	<u>\$3,599</u>	<u>\$57,130</u>
<b>OPERATING EXPENSES</b>						
Administration and general	354	8,380	1,320	1,416	12	11,482
Operations and maintenance	3,512					3,512
Depreciation and amortization	1,955	1,112	3			3,070
Claim payments and change in estimated self-insured liability				9,957		9,957
Compensated absences and other benefits	<u>50</u>			<u>28,929</u>	<u>3,587</u>	<u>32,566</u>
Total Operating Expenses	<u>5,871</u>	<u>9,492</u>	<u>1,323</u>	<u>40,302</u>	<u>3,599</u>	<u>60,587</u>
Total Operating Income (Loss)	<u>(284)</u>	<u>(2,617)</u>	<u>(168)</u>	<u>(388)</u>		<u>(3,457)</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>						
Return on investment	105	218	24	395	253	995
Gain (loss) on disposal of fixed assets	(166)					(166)
Other nonoperating revenues	<u>229</u>		<u>3</u>			<u>232</u>
Total Nonoperating Revenues	<u>168</u>	<u>218</u>	<u>27</u>	<u>395</u>	<u>253</u>	<u>1,061</u>
Income (Loss) Before Transfers	(116)	(2,399)	(141)	7	253	(2,396)
Transfers in	13	360			7,987	8,360
Transfers (out)	<u>(347)</u>	<u>(642)</u>	<u>(76)</u>			<u>(1,065)</u>
Change in Net Assets	(450)	(2,681)	(217)	7	8,240	4,899
Net assets at beginning of year	<u>15,380</u>	<u>18,808</u>	<u>708</u>	<u>3,737</u>	<u>18,265</u>	<u>56,898</u>
Net assets at end of year	<u>\$14,930</u>	<u>\$16,127</u>	<u>\$491</u>	<u>\$3,744</u>	<u>\$26,505</u>	<u>\$61,797</u>



**City of Palo Alto - Internal Service Funds** .....

**Combining Statements of Cash Flows - For the Fiscal Year Ended June 30, 2006**

*(In thousands of dollars)*

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits and Insurance	Retiree Health Benefit	Total
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>						
Receipts from customers	\$5,649	\$6,875	\$1,155	\$39,858	\$3,600	\$57,137
Payments to suppliers	(3,726)				(2)	(3,728)
Payments to employees	(444)	(9,015)	(1,335)	(29,520)	(3,598)	(43,912)
Claims paid				(4,295)		(4,295)
Other receipts	63		3			66
Net cash provided by operating activities	1,542	(2,140)	(177)	6,043		5,268
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>						
Interfund payments		25				25
Transfers in	13	360			7,987	8,360
Transfers (out)	(347)	(642)	(76)			(1,065)
Cash flows from noncapital financing activities	(334)	(257)	(76)		7,987	7,320
<b>CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES</b>						
Acquisition and construction of fixed assets	(2,121)	(472)				(2,593)
Cash flows from capital financing activities	(2,121)	(472)				(2,593)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>						
Interest and dividends on pooled investments	107	235	25	377	\$245	989
Net Cash Flows	(806)	(2,634)	(228)	6,420	8,232	10,984
Cash and investments at beginning of year	5,453	14,583	690	30,688	18,050	69,464
Cash and investments at end of year	\$4,647	\$11,949	\$462	\$37,108	\$26,282	\$80,448
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>						
Operating income (loss)	(\$284)	(\$2,617)	(\$168)	(\$388)		(\$3,457)
Adjustments to reconcile operating income (loss) to cash flows from operating activities:						
Depreciation and amortization	1,955	1,112	3			3,070
Other	63		3			66
Changes in assets and liabilities:						
Accounts receivable	62			(56)	\$1	7
Inventory of materials and supplies	(242)					(242)
Accounts and other payables	(12)	(635)	(15)	825	(1)	162
Accrued claims payable				5,662		5,662
Net cash provided by operating activities	\$1,542	(\$2,140)	(\$177)	\$6,043		\$5,268



This page is intentionally left blank.



# *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.

Fiduciary Funds are 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 three 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.

### **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, 2006**  
*(In thousands of dollars)*

	Balance <u>June 30, 2005</u>	Additions	Reductions	Balance <u>June 30, 2006</u>
<u>California Avenue Parking Assessment District</u>				
ASSETS				
Cash and investments available for operations	\$293	\$148	\$161	\$280
LIABILITIES				
Due to bondholders	\$293	\$148	\$161	\$280
<u>Cable Joint Powers Authority</u>				
ASSETS				
Cash and investments available for operations	\$1,268	\$183	\$716	\$735
Interest receivable	15	9	15	9
Total assets	<u>\$1,283</u>	<u>\$192</u>	<u>\$731</u>	<u>\$744</u>
LIABILITIES				
Due to other governments	<u>\$1,283</u>	<u>\$192</u>	<u>\$731</u>	<u>\$744</u>
<u>University Avenue Area Parking Assessment District</u>				
ASSETS				
Cash and investments with fiscal agents	\$6,213	\$2,855	\$3,022	\$6,046
Interest receivable	64	63	64	63
Total assets	<u>\$6,277</u>	<u>\$2,918</u>	<u>\$3,086</u>	<u>\$6,109</u>
LIABILITIES				
Due to bondholders	<u>\$6,277</u>	<u>\$2,918</u>	<u>\$3,086</u>	<u>\$6,109</u>
<u>Total Agency Funds</u>				
ASSETS				
Cash and investments available for operations	\$1,561	\$331	\$877	\$1,015
Cash and investments with fiscal agents	6,213	2,855	3,022	6,046
Interest receivable	79	72	79	72
Total assets	<u>\$7,853</u>	<u>\$3,258</u>	<u>\$3,978</u>	<u>\$7,133</u>
LIABILITIES				
Due to bondholders	\$6,570	\$3,066	\$3,247	\$6,389
Due to other governments	1,283	192	731	744
Total liabilities	<u>\$7,853</u>	<u>\$3,258</u>	<u>\$3,978</u>	<u>\$7,133</u>





## 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.

### ***Financial Trends***

These schedules contain trend information to help the reader understand how the City's financial performance and well being have changed over time:

1. Net Assets by Component
2. Changes in Net Assets
3. Fund Balances of Governmental Funds
4. Changes in Fund Balance of Governmental Funds

### ***Revenue Capacity***

These schedules contain information to help the reader assess the City's most significant local revenue source, the property tax:

1. Assessed Value of Taxable Property
2. Property Tax Rates, All Overlapping Governments
3. Property Tax Levies and Collections
4. Principal Property Taxpayers

### ***Debt Capacity***

These schedules present information to help the reader assess the affordability of the City's current levels of outstanding debt and the City's ability to issue additional debt in the future:

1. Ratio of Outstanding Debt by Type
2. Computation of Direct and Overlapping Debt
3. Computation of Legal Bonded Debt Margin
4. Revenue Bond Coverage



***Demographic and Economic Information***

These schedules offer demographic and economic indicators to help the reader understand the environment within which the City's financial activities take place:

1. Taxable Transactions by Type of Business
2. Demographic and Economic Statistics
3. Principal Employers

***Operating Information***

These schedules contain service and infrastructure data to help the reader understand how the information in the City's financial report relates to the services the City provides and the activities it performs:

1. Full-Time Equivalent City Government Employees by Function
2. Operating Indicators by Function/Program
3. Capital Asset Statistics by Function/Program
4. Insurance Coverage

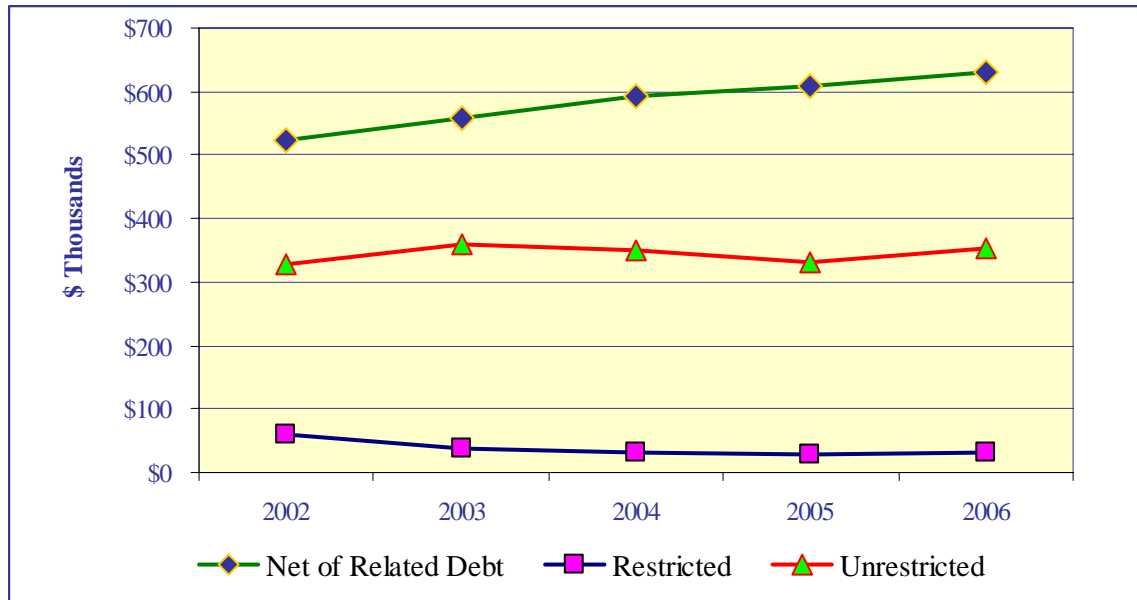
***Sources***

Unless otherwise noted, the information in these schedules is derived from the Comprehensive Annual Financial Reports for the relevant year. The City implemented GASB Statement 34 in 2002; schedules presenting government-wide information include information beginning in that year.



### City of Palo Alto - Net Assets by Component

Last Five Fiscal Years (\$000)  
(Accrual Basis of Accounting)



#### Fiscal Year Ended June 30,

	2002	2003	2004	2005	2006
<b>Governmental activities</b>					
Invested in capital assets, net of related debt	\$252,183	\$279,306	\$297,125	\$305,225	\$311,335
Restricted	56,785	37,112	30,417	27,273	29,885
Unrestricted	117,113	130,463	123,762	117,301	123,823
<b>Total governmental activities net assets</b>	<b>\$426,081</b>	<b>\$446,881</b>	<b>\$451,304</b>	<b>\$449,799</b>	<b>\$465,043</b>
<b>Business-type activities</b>					
Invested in capital assets, net of related debt	\$270,622	\$279,885	\$294,197	\$303,473	\$318,738
Restricted	1,728	1,728	1,798	1,750	1,732
Unrestricted	210,990	228,308	226,278	215,128	228,032
<b>Total business-type activities net assets</b>	<b>\$483,340</b>	<b>\$509,921</b>	<b>\$522,273</b>	<b>\$520,351</b>	<b>\$548,502</b>
<b>Primary government</b>					
Invested in capital assets, net of related debt	\$522,805	\$559,191	\$591,322	\$608,698	\$630,073
Restricted	58,513	38,840	32,215	29,023	31,617
Unrestricted	328,103	358,771	350,040	332,429	351,855
<b>Total primary government net assets</b>	<b>\$909,421</b>	<b>\$956,802</b>	<b>\$973,577</b>	<b>\$970,150</b>	<b>\$1,013,545</b>

Source: Annual Financial Statements

## City of Palo Alto - Changes in Net Assets

**Last Five Fiscal Years (\$000)**  
**(Accrual Basis of Accounting)**

	<b>Fiscal Year Ended June 30,</b>				
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b><u>Expenses</u></b>					
<b>Governmental Activities:</b>					
City Council	\$238	\$234	\$269	\$130	\$141
City Manager	1,765	1,565	1,663	1,725	1,563
City Attorney	2,410	2,028	2,300	2,653	2,598
City Clerk	633	598	808	770	945
City Auditor	583	646	668	764	843
Administrative Services	10,138	9,723	6,271	6,982	6,972
Human Resources	2,166	1,728	2,078	2,410	2,546
Public Works	15,656	13,702	14,460	16,400	17,596
Planning and Community Environment	7,311	7,485	8,898	10,162	9,931
Police	19,049	19,273	20,414	22,416	23,411
Fire	16,870	16,859	17,308	18,127	18,747
Community Services	19,850	19,633	20,864	17,240	17,296
Library				4,835	5,323
Non-Departmental	8,412	7,449	7,618	12,474	10,400
Interest on Long Term Debt	1,094	675	635	693	512
<b>Total Governmental Activities Expenses</b>	<b><u>\$106,175</u></b>	<b><u>\$101,598</u></b>	<b><u>\$104,254</u></b>	<b><u>\$117,781</u></b>	<b><u>\$118,824</u></b>
<b>Business-Type Activities:</b>					
Water	\$12,722	\$13,237	\$16,047	\$14,969	\$15,881
Electric	98,405	73,744	73,545	73,051	91,570
Gas	28,778	22,270	22,994	26,656	29,107
Wastewater Collection	8,489	8,712	9,203	8,907	11,005
Wastewater Treatment	13,287	14,312	14,868	17,457	16,747
Refuse	23,750	24,635	24,282	24,959	26,989
Storm Drainage	2,188	2,489	2,975	3,336	2,673
External Services	349	583	688	760	868
<b>Total Business-Type Activities Expenses</b>	<b><u>187,968</u></b>	<b><u>159,982</u></b>	<b><u>164,602</u></b>	<b><u>170,095</u></b>	<b><u>194,840</u></b>
<b>Total Primary Government Expenses</b>	<b><u>\$294,143</u></b>	<b><u>\$261,580</u></b>	<b><u>\$268,856</u></b>	<b><u>\$287,876</u></b>	<b><u>\$313,664</u></b>

### **Program Revenues**

#### **Governmental Activities**

##### **Charges for Services:**

City Council					
City Manager					
City Attorney		\$92	\$64	\$22	\$22
City Clerk	\$1	1	1		2
City Auditor		1			
Administrative Services	12	406	815	480	627
Human Resources					
Public Works	320	1,058	260	573	805
Planning and Community Environment	4,062	5,119	3,074	4,090	5,509
Police	3,966	3,396	4,415	3,801	4,178
Fire	7,976	7,811	7,565	8,555	9,078
Community Services	7,793	7,537	7,846	7,592	10,803
Library				133	129
Operating Grants and Contributions	5,568	4,468	4,213	3,677	3,976



## City of Palo Alto - Changes in Net Assets

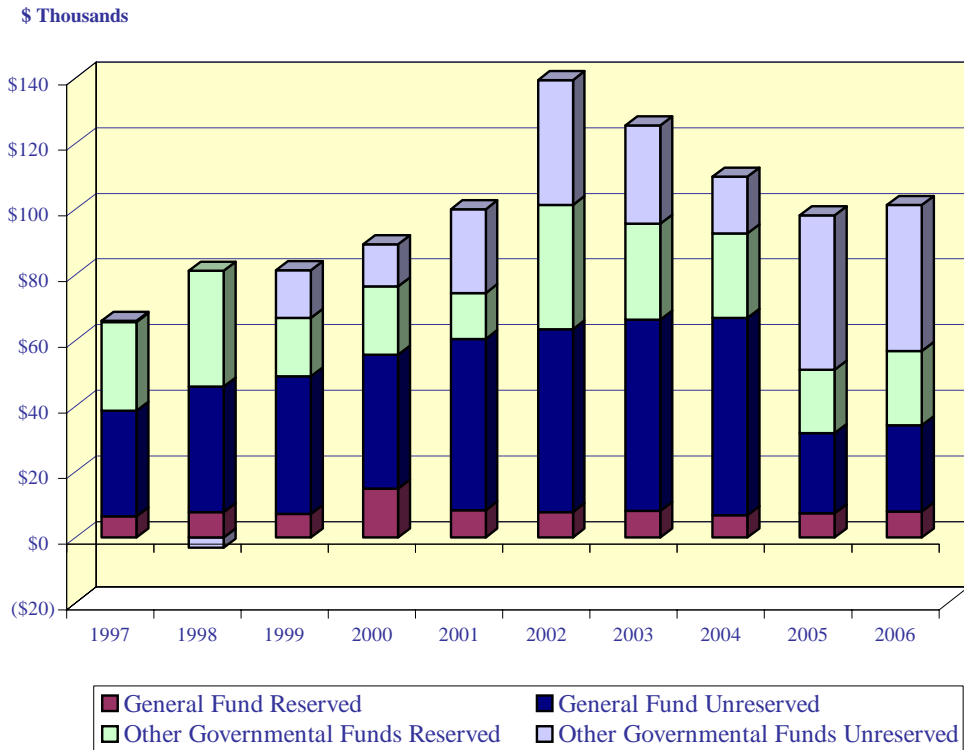
Last Five Fiscal Years (\$000)

(Accrual Basis of Accounting)

	Fiscal Year Ended June 30,				
	2002	2003	2004	2005	2006
Capital Grants and Contributions	32,380	635	1,990	804	3,156
Total Government Activities Program Revenues	<u>62,078</u>	<u>30,524</u>	<u>30,243</u>	<u>29,727</u>	<u>38,285</u>
<b>Business-Type Activities:</b>					
Charges for Services:					
Water	16,034	17,654	21,993	21,041	21,108
Electric	93,755	91,622	92,617	88,737	119,418
Gas	41,658	29,714	24,839	31,206	36,977
Wastewater Collection	9,292	10,676	12,647	12,041	13,801
Wastewater Treatment	13,987	13,556	14,744	15,982	18,778
Refuse	21,777	21,691	21,923	23,387	24,795
Storm Drainage	2,221	2,192	2,170	2,484	5,174
External Services	380	605	585	766	854
Operating Grants and Contributions					
Capital Grants and Contributions	185				
Total Business-Type Activities Program Revenue	<u>199,289</u>	<u>187,710</u>	<u>191,518</u>	<u>195,644</u>	<u>240,905</u>
<b>Total Primary Government Program Revenues</b>	<u><u>\$261,367</u></u>	<u><u>\$218,234</u></u>	<u><u>\$221,761</u></u>	<u><u>\$225,371</u></u>	<u><u>\$279,190</u></u>
<b>Net (Expense)/Revenue</b>					
Governmental Activities	(\$44,097)	(\$71,074)	(\$74,011)	(\$88,054)	(\$80,539)
Business-Type Activities	11,321	27,728	26,916	25,549	46,065
<b>Total Primary Government Net Expense</b>	<u><u>(\$32,776)</u></u>	<u><u>(\$43,346)</u></u>	<u><u>(\$47,095)</u></u>	<u><u>(\$62,505)</u></u>	<u><u>(\$34,474)</u></u>
<b>General Revenues and Other Changes in Net Assets</b>					
Governmental Activities:					
Taxes:					
Property Taxes	\$13,270	\$13,882	\$13,707	\$16,657	\$18,731
Sales Taxes	20,085	18,041	18,151	19,308	20,315
Utilities Users Taxes	6,457	7,067	7,152	7,269	8,759
Transient Occupancy Tax	6,615	5,333	5,489	5,686	6,393
Other taxes	6,284	7,275	8,493	5,580	7,033
Investment Earnings	10,589	10,213	326	4,988	2,567
Rents and Miscellaneous	18,524	15,333	10,165	12,997	10,440
Transfers	13,334	14,730	14,951	14,064	21,545
Total Government Activities	<u>95,158</u>	<u>91,874</u>	<u>78,434</u>	<u>86,549</u>	<u>95,783</u>
Business-Type Activities:					
Investment Earnings	15,620	13,583	387	8,093	3,631
Special Item				(21,500)	
Transfers	(13,334)	(14,730)	(14,951)	(14,064)	(21,545)
Total Business-Type Activities	<u>2,286</u>	<u>(1,147)</u>	<u>(14,564)</u>	<u>(27,471)</u>	<u>(17,914)</u>
<b>Total Primary Government</b>	<u><u>\$97,444</u></u>	<u><u>\$90,727</u></u>	<u><u>\$63,870</u></u>	<u><u>\$59,078</u></u>	<u><u>\$77,869</u></u>
<b>Change in Net Assets</b>					
Governmental Activities	\$51,061	\$20,800	\$4,423	(\$1,505)	\$15,244
Business-Type Activities	13,607	26,581	12,352	(1,922)	28,151
<b>Total Primary Government</b>	<u><u>\$64,668</u></u>	<u><u>\$47,381</u></u>	<u><u>\$16,775</u></u>	<u><u>(\$3,427)</u></u>	<u><u>\$43,395</u></u>

Source: Annual Financial Statements

**City of Palo Alto - Fund Balances of Governmental Funds**  
*Last Ten Fiscal Years (\$000)*  
**(Modified Accrual Basis of Accounting)**



	<b>Fiscal Year Ended June 30,</b>									
	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>General Fund</b>										
Reserved	\$6,495	\$7,678	\$7,237	\$14,838	\$8,282	\$7,780	\$8,156	\$6,735	\$7,332	\$7,966
Unreserved	32,080	38,226	41,900	40,927	52,114	55,653	58,151	60,087	24,498	26,251
<b>Total General Fund</b>	<b>\$38,575</b>	<b>\$45,904</b>	<b>\$49,137</b>	<b>\$55,765</b>	<b>\$60,396</b>	<b>\$63,433</b>	<b>\$66,307</b>	<b>\$66,822</b>	<b>\$31,830</b>	<b>\$34,217</b>
<b>All Other Governmental Funds</b>										
Reserved	\$26,973	\$35,241	\$17,796	\$20,717	\$14,086	\$37,924	\$29,174	\$25,790	\$19,305	\$22,597
Unreserved, reported in:										
Special revenue funds	1,241	2,933	5,273	4,908	7,466	18,263	7,428	6,875	7,643	7,063
Capital project funds	(746)	(5,991)	9,195	7,987	18,005	19,772	22,705	10,419	39,431	37,315
<b>Total all other governmental funds</b>	<b>\$27,468</b>	<b>\$32,183</b>	<b>\$32,264</b>	<b>\$33,612</b>	<b>\$39,557</b>	<b>\$75,959</b>	<b>\$59,307</b>	<b>\$43,084</b>	<b>\$66,379</b>	<b>\$66,975</b>

(a) The change in total fund balance for the General Fund and other governmental funds is explained in Management's Discussion and Analysis.

Source: Annual Financial Statements

This page is intentionally left blank.

## City of Palo Alto - Changes in Fund Balance of Governmental Funds Last Ten Fiscal Years (\$000)

(Modified Accrual Basis of Accounting)

	<b>Fiscal Year Ended June 30,</b>				
	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>
<b>Revenues</b>					
Sales tax	\$18,277	\$20,011	\$20,225	\$22,867	\$20,085
Property tax	7,735	8,903	9,521	10,770	13,231
Other taxes	16,654	19,150	20,393	23,582	20,485
Permits and licenses	9,087	8,984	8,810	12,408	2,901
Fines, forfeits and penalties	1,219	1,161	1,475	1,703	2,181
Interest and rentals	12,966	14,525	13,992	13,874	19,547
From other agencies	2,239	1,732	3,374	3,282	3,860
Charges for services	4,193	4,507	4,751	5,053	16,667
Other	4,380	6,354	4,376	6,213	8,580
<b>Total Revenues</b>	<b>76,750</b>	<b>85,327</b>	<b>86,917</b>	<b>99,752</b>	<b>107,537</b>
<b>Expenditures</b>					
Administration (1)	11,689	12,987	15,066	15,772	18,557
Public works	7,339	8,172	9,202	8,827	9,522
Planning and community environment	4,320	4,832	5,674	6,639	6,652
Police	14,804	16,093	16,705	17,666	18,306
Fire	12,292	13,100	13,949	14,512	15,973
Community services	13,972	15,050	16,820	17,858	18,469
Library (2)					
Non-departmental	6,086	6,298	6,520	6,927	14,487
Special revenue and capital projects	7,581	6,749	16,605	13,151	11,089
Debt service	2,319	2,293	2,509	2,801	2,817
<b>Total Expenditures</b>	<b>80,402</b>	<b>85,574</b>	<b>103,050</b>	<b>104,153</b>	<b>115,872</b>
Excess (deficiency) of revenues over (under) expenditures	(3,652)	(247)	(16,133)	(4,401)	(8,335)
<b>Other Financing Sources (Uses)</b>					
Transfers in	21,636	23,825	24,715	27,795	26,150
Transfers (out)	(9,205)	(11,097)	(649)	(15,418)	(14,487)
Contribution from assessment district					4,112
Proceeds from long term debt					
Bond proceeds			7,750		
Payments to refunded bond escrow			(649)		(705)
<b>Total other financing sources (uses)</b>	<b>12,431</b>	<b>12,728</b>	<b>31,167</b>	<b>12,377</b>	<b>15,070</b>
<b>Net Change in fund balances</b>	<b>\$8,779</b>	<b>\$12,481</b>	<b>\$15,034</b>	<b>\$7,976</b>	<b>\$6,735</b>
Debt service as a percentage of noncapital expenditures	(a)	(a)	(a)	(a)	(a)

**Source:** Annual Financial Statements

**Note:**

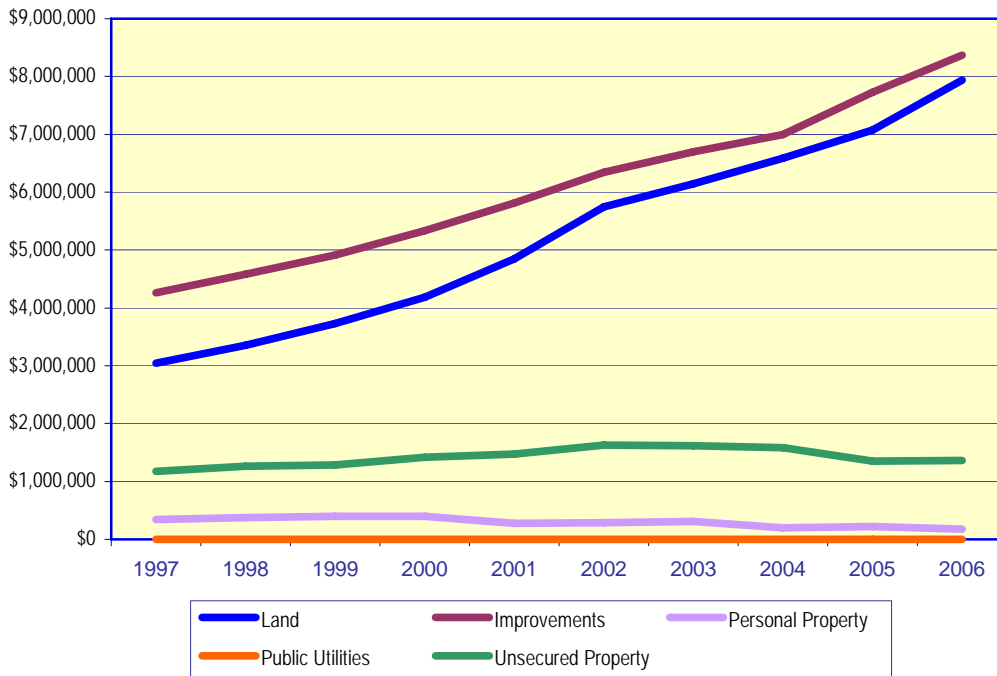
- (a) The City implemented GASB Statement 34 in fiscal year 2002. Therefore this calculation is included only for fiscal years subsequent to that date.
- (1) Comprised of the following departments: City Council, City Manager, City Attorney, City Clerk, City Auditor, Administrative Services and Human Resources.
- (2) Prior to 2005, Library was included in Community Services.





<b>Fiscal Year Ended June 30,</b>				
<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
\$20,085	\$18,041	\$18,151	\$19,308	\$20,315
13,231	13,821	13,707	16,657	\$18,731
20,485	21,070	22,427	19,941	\$23,712
2,901	3,161	2,563	3,183	4,305
2,181	2,124	2,884	2,096	2,128
19,547	19,981	11,480	14,968	13,776
3,860	3,776	4,661	2,757	5,931
16,667	16,798	16,018	17,159	18,672
8,580	5,095	1,681	4,269	4,058
<u>107,537</u>	<u>103,867</u>	<u>93,572</u>	<u>100,338</u>	<u>111,628</u>
18,235	17,521	13,862	14,509	14,299
9,549	9,858	8,031	9,060	9,036
7,378	7,721	8,793	9,692	9,292
19,047	19,719	19,962	21,117	22,279
16,722	16,841	16,891	17,615	18,114
19,499	19,793	19,934	16,298	19,740
			4,800	5,170
8,259	7,442	7,598	9,028	10,389
16,960	33,584	22,289	21,317	13,243
1,151	1,571	1,419	1,368	1,333
<u>116,800</u>	<u>134,050</u>	<u>118,779</u>	<u>124,804</u>	<u>122,895</u>
<u>(9,263)</u>	<u>(30,183)</u>	<u>(25,207)</u>	<u>(24,466)</u>	<u>(11,267)</u>
27,389	31,402	28,632	60,429	26,640
(14,444)	(16,603)	(19,133)	(46,622)	(12,390)
31,823	425			
7,055				
<u>(3,820)</u>			<u>(1,038)</u>	
<u>48,003</u>	<u>15,224</u>	<u>9,499</u>	<u>12,769</u>	<u>14,250</u>
<u>\$38,740</u>	<u>(\$14,959)</u>	<u>(\$15,708)</u>	<u>(\$11,697)</u>	<u>\$2,983</u>
1.1%	1.6%	1.5%	1.3%	1.2%

**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	Total Direct Tax Rate
	Land	Improvements	Personal Property	Net Local Secured Roll	Public Utilities	Unsecured Property	Exemptions Net of State Aid			
1997	\$3,045,477	\$4,259,209	\$340,073	\$7,644,759	\$2,410	\$1,173,563	\$614,200	\$8,206,532	1%	
1998	\$3,353,027	\$4,585,725	\$381,091	\$8,319,843	\$2,652	\$1,265,100	\$701,972	\$8,885,623	1%	
1999	\$3,729,475	\$4,920,111	\$394,610	\$9,044,196	\$2,842	\$1,279,315	\$702,485	\$9,623,868	1%	
2000	\$4,187,357	\$5,335,026	\$394,198	\$9,916,581	\$3,362	\$1,415,999	\$802,164	\$10,533,778	1%	
2001	\$4,849,233	\$5,816,633	\$280,958	\$10,946,824	\$3,309	\$1,473,678	\$813,896	\$11,609,915	1%	
2002	\$5,744,675	\$6,347,719	\$292,812	\$12,385,206	\$3,371	\$1,627,594	\$913,475	\$13,102,696	1%	
2003	\$6,140,438	\$6,692,162	\$309,386	\$13,141,986	\$3,859	\$1,612,179	\$951,807	\$13,806,217	1%	
2004	\$6,588,474	\$6,996,106	\$195,859	\$13,780,439	\$3,956	\$1,582,368	\$1,196,546	\$14,170,217	1%	
2005	\$7,075,300	\$7,722,660	\$220,585	\$15,018,545	\$4,150	\$1,354,310	\$1,402,039	\$14,974,966	1%	
2006	\$7,941,482	\$8,364,668	\$174,666	\$16,480,815	\$4,084	\$1,361,117	\$1,595,871	\$16,250,145	1%	

Source: County of Santa Clara Assessor's Office

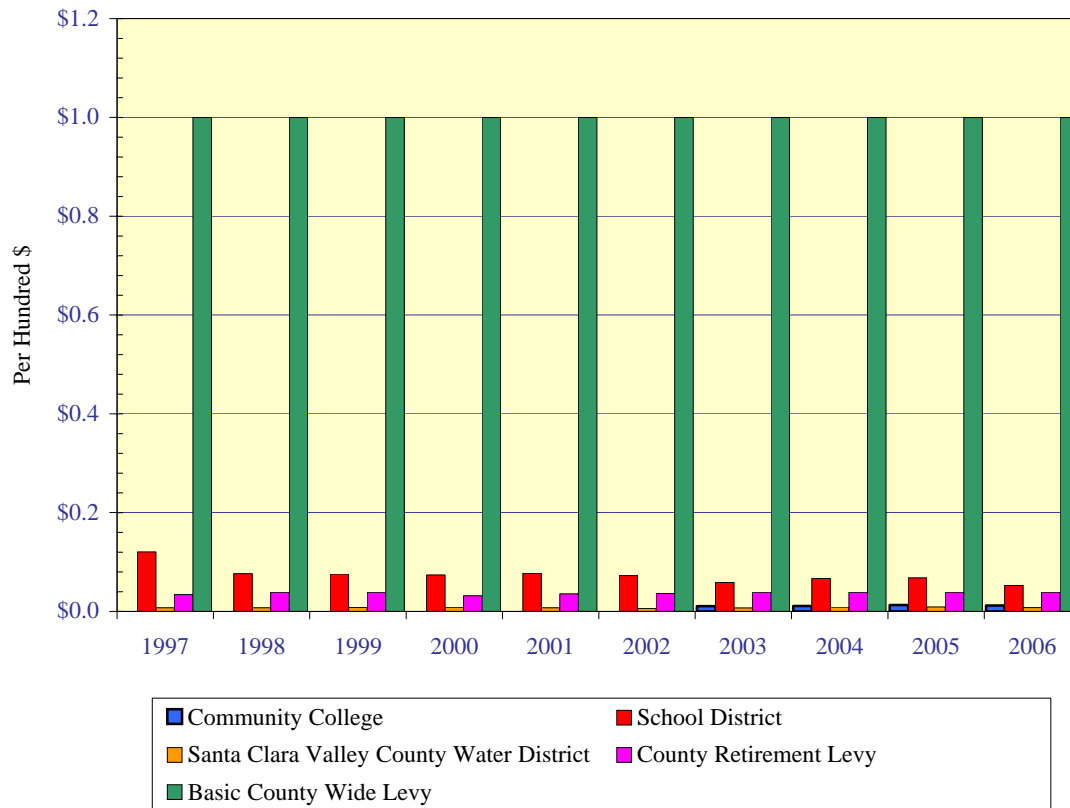
Note: Beginning in fiscal year 1988-89, Chapter 921 of the Statutes of 1987 requires the establishment of a single county-wide tax rate area for the assignment of the assessed value of certain types of state-assessed utility property and sets forth formulas for the determination of county-wide tax rates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

Fiscal years 2003-05 have been revised by the County of Santa Clara Assessor's Office.



**City of Palo Alto - Property Tax Rates**  
**All Overlapping Governments**  
*Last Ten Fiscal Years*



<b>Fiscal Year</b>	<b>Basic County Wide Levy</b>	<b>County Retirement Levy</b>	<b>Santa Clara Valley Water District</b>	<b>School District</b>	<b>Community College</b>	<b>Total</b>
1997	\$1.0000	\$0.0340	\$0.0076	\$0.1205	\$0.0000	\$1.1621
1998	1.0000	0.0388	0.0076	0.0764	0.0000	1.1228
1999	1.0000	0.0388	0.0082	0.0757	0.0000	1.1227
2000	1.0000	0.0319	0.0085	0.0740	0.0000	1.1144
2001	1.0000	0.0356	0.0075	0.0771	0.0000	1.1202
2002	1.0000	0.0364	0.0062	0.0727	0.0000	1.1153
2003	1.0000	0.0388	0.0072	0.0586	0.0108	1.1154
2004	1.0000	0.0388	0.0087	0.0666	0.0110	1.1251
2005	1.0000	0.0388	0.0092	0.0680	0.0129	1.1289
2006	1.0000	0.0388	0.0078	0.0526	0.0119	1.1111

Source: County of Santa Clara, Tax Rates and Information

## City of Palo Alto - Property Tax Levies and Collections

### Last Ten Fiscal Years (\$000)

<u>Fiscal Year</u>	<u>Total Tax Levy (a)</u>	<u>Current Tax Collections</u>	<u>Percent of Levy Collected</u>	<u>Delinquent Tax Collections (b)</u>	<u>Total Tax Collections</u>	<u>Percent of Total Tax Collections to Tax Levy</u>
1997	\$7,735	\$7,735	100%		\$7,735	100%
1998	7,660	7,660	100%		7,660	100%
1999	9,521	9,521	100%		9,521	100%
2000	10,770	10,770	100%		10,770	100%
2001	12,110	12,110	100%		12,110	100%
2002	13,231	13,231	100%		13,231	100%
2003	13,821	13,821	100%		13,821	100%
2004	13,707	13,707	100%		13,707	100%
2005	16,657	16,657	100%		16,657	100%
2006	18,731	18,731	100%		18,731	100%

**Source:** County of Santa Clara Assessor's Office

**Note:** Current tax collections beginning in 1993 have been reduced by a mandatory tax reallocation imposed by the State of California.

- (a) During fiscal year 1995, the County began providing the City 100% of its tax levy under an agreement which allows the County to keep all interest and delinquency charges collected.
- (b) 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 that fiscal year.



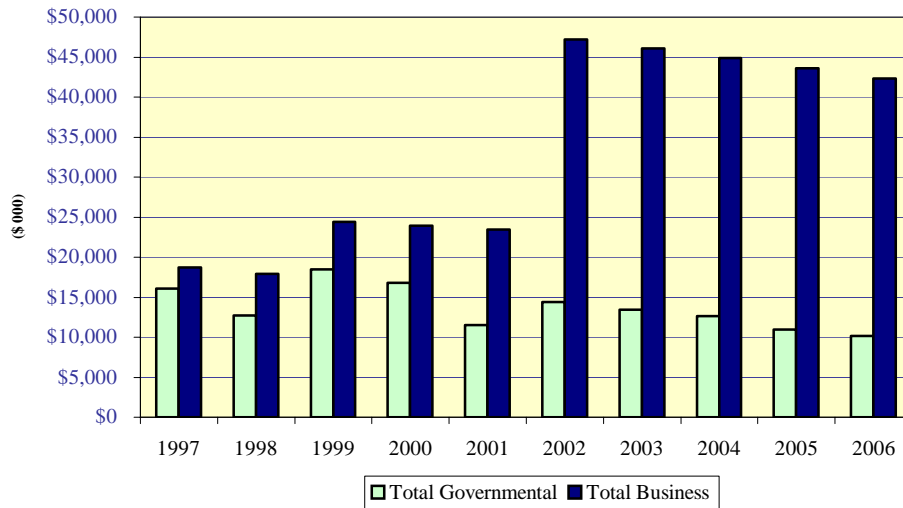
**City of Palo Alto - Principal Property Tax Payers**  
**Current Year and Nine Years Ago (\$000)**

<b>Taxpayer</b>	<b>2005-06</b>			<b>1996-97</b>		
	<b>Taxable Assessed Value</b>	<b>Rank</b>	<b>Percentage of Total City Taxable Assessed Value</b>	<b>Taxable Assessed Value</b>	<b>Rank</b>	<b>Percentage of Total City Taxable Assessed Value</b>
Leland Stanford Jr University	\$2,518,267	1	15.5%	\$1,338,432	1	16.3%
Space System /Loral Inc.	179,249	2	1.1%	157,790	2	1.9%
Sun Microsystems Inc.			0.0%	48,685	3	0.6%
Harbor Investments Partners	47,150	5	0.3%	39,433	4	0.5%
S I Palo Alto Inc.			0.0%	35,970	5	0.4%
Cowper-Hamilton Associates			0.0%	35,083	6	0.4%
University Partners and Associates			0.0%	25,511	7	0.3%
Stanford Square Limited Partners			0.0%	21,338	8	0.3%
Maytai Investments, Inc.			0.0%	15,499	9	0.2%
Digital Equipment Corporation			0.0%	14,674	10	0.2%
Agilent Technologies Inc.	72,852	3	0.4%			0.0%
CEP Town & Country Investors, LLC	49,858	4	0.3%			0.0%
Hamilton Associates	38,082	6	0.2%			0.0%
505 Hamilton Avenue Partners	37,085	7	0.2%			0.0%
California Pacific Comm. Corp.	34,232	8	0.2%			0.0%
EOP-Embarcadero Place, LLC	30,500	9	0.2%			0.0%
Thoits Bros Inc.	29,168	10	0.2%			0.0%
<b>Subtotal</b>	<b>\$3,036,443</b>		<b>18.7%</b>	<b>\$1,732,415</b>		<b>21.1%</b>
<b>Total Net Assessed Valuation:</b>						
Fiscal Year 2005-2006	\$16,259,145					
Fiscal Year 1996-1997	\$8,206,532					

**Source:** County of Santa Clara compiled by Hunt Consulting, LLC



**City of Palo Alto - Ratio of Outstanding Debt by Type**  
**Last Ten Fiscal Years (\$000)**



**Governmental Activities**

Fiscal Year	General Revenue Bonds	Certificates of Participation	Special Assessment Debt	Capital Lease Obligations	Total
1997	\$725	\$5,675	\$8,080	\$1,581	\$16,061
1998	625	5,215	5,685	1,186	12,711
1999		12,480	5,195	791	18,466
2000		11,625	4,670	537	16,832
2001		10,700	670	113	11,483
2002		13,695	595	84	14,374
2003		12,905	510	57	13,472
2004		12,215	420	25	12,660
2005		10,625	325		10,950
2006		9,915	225		10,140

**Business-Type Activities**

Fiscal Year	Utility Revenue Bonds	Total	Total Primary Government	Percentage of Assessed Value (a)	Per Capita (b)
1997	\$18,724	\$18,724	\$34,785	0.42%	\$0.58
1998	17,915	17,915	30,626	0.34%	0.51
1999	24,368	24,368	42,834	0.45%	0.70
2000	23,935	23,935	40,767	0.39%	0.66
2001	23,465	23,465	34,948	0.30%	0.57
2002	47,210	47,210	61,584	0.47%	1.02
2003	46,069	46,069	59,541	0.43%	0.98
2004	44,862	44,862	57,522	0.38%	0.95
2005	43,598	43,598	54,548	0.34%	0.88
2006	42,288	42,288	52,428	0.32%	0.84

**Sources:** City of Palo Alto  
 (a) County of Santa Clara (assessed value)  
 (b) State of California, Department of Finance (population)

**Note:** Debt amounts exclude any premiums, discounts, or other amortization amounts.  
 Details regarding the City's outstanding debt can be found in the notes to the financial statements.



## City of Palo Alto - Computation of Direct and Overlapping Debt

June 30, 2006

<b>2005-06 Assessed Valuation</b>	<u><u>\$16,250,145,000</u></u>		
	Total	Percentage	Amount
	Debt	Applicable	Applicable
		To City of	To City of
	<u>Outstanding</u>	<u>Palo Alto (1)</u>	<u>Palo Alto</u>
<b><u>OVERLAPPING TAX AND ASSESSMENT DEBT:</u></b>			
Foothill-DeAnza Community College District	\$240,259,999	22.975%	\$55,199,735
Palo Alto Unified School District	110,605,000	88.965%	98,399,738
Fremont Union High School District	138,590,000	0.006%	8,315
Mountain View-Los Altos Union High School District	43,665,171	1.039%	453,681
Cupertino Union School District	124,045,023	0.002%	2,481
Los Altos School District	102,721,243	0.952%	977,906
Whisman School District	25,166,689	4.010%	1,009,184
City of Palo Alto Special Assessment Bonds	40,705,000	100.000%	40,705,000
Santa Clara Valley Water District Benefit Assessment District	<u>183,850,000</u>	<u>7.515%</u>	<u>13,816,328</u>
<b>TOTAL OVERLAPPING TAX AND ASSESSMENT DEBT</b>	<u><u>\$1,009,608,125</u></u>		<u><u>\$210,572,368</u></u>
<b><u>DIRECT AND OVERLAPPING GENERAL FUND DEBT:</u></b>			
Santa Clara County General Fund Obligations	\$920,595,000	7.515%	\$69,182,714
Santa Clara County Board of Education Certificates of Participation	17,170,000	7.515%	1,290,326
Foothill-DeAnza Community College District Certificates of Participation	20,440,000	22.975%	4,696,090
Mountain View-Los Altos Union High School District Certificates of Participation	7,945,000	1.039%	82,549
Cupertino Union School District Certificates of Participation	4,520,000	0.002%	90
City of Palo Alto General Fund Obligations	9,915,000	100.000%	9,915,000
Midpeninsula Regional Open Space Park District General Fund Obligations	<u>111,690,193</u>	<u>13.184%</u>	<u>14,725,235</u>
<b>TOTAL DIRECT AND OVERLAPPING GENERAL FUND DEBT</b>	<u><u>\$1,092,275,193</u></u>		<u><u>\$99,892,004</u></u>
<b>COMBINED TOTAL DEBT</b>	<u><u>\$2,101,883,318</u></u>		<u><u>\$310,464,372</u></u> (2)

(1) Percentage of overlapping agency's assessed valuation located within boundaries of the city.

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

Ratios to Assessed Valuation

Combined Direct Debt (\$9,915,000)	0.06%
Total Overlapping Tax and Assessment Debt	1.30%
Combined Total Debt	1.91%

STATE SCHOOL BUILDING AID REPAYABLE AS OF 06/30/06: \$0

Source: California Municipal Statistics, Inc.

## City of Palo Alto - Computation of Legal Bonded Debt Margin

**June 30, 2006**

(in thousands of dollars)

**Assessed Valuation:**

Secured property assessed value, net of exempt real property	<u>\$16,250,066</u>	
<b>Bonded debt limit 3.75% of assessed value (a)</b>		<u>\$609,377</u>

**Amount of debt subject to limit:**

Certificates of participation	9,915	
Special assessment debt with government commitment	<u>225</u>	
Total Debt	10,140	
Less amount of debt not subject to limit	<u>10,140</u>	
Amount of debt subject to limit		<u>0</u>

**Legal bonded debt margin** \$609,377

Fiscal Year	Debt Limit	Total Net Debt Applicable to Limit	Legal Debt Margin	Total net debt applicable to the limit as a percentage of debt limit
1997	\$307,745	\$0	\$307,745	0.00%
1998	333,211	0	333,211	0.00%
1999	360,895	0	360,895	0.00%
2000	395,017	0	395,017	0.00%
2001	435,372	0	435,372	0.00%
2002	491,351	0	491,351	0.00%
2003	516,615	0	516,615	0.00%
2004	561,561	0	561,561	0.00%
2005	609,378	0	609,378	0.00%
2006	609,377	0	609,377	0.00%

**Source:** Annual Financial Statements

**Note:** (a) California Government Code, Section 43605 sets the debt limit at 15%. The Code section was enacted prior to the change in basing assessed value to full market value when it was previously 25% of market value. Thus, the limit shown as 3.75% is one-fourth the limit to account for the adjustment of showing assessed valuation at full cash value. Prior year limits have been adjusted to conform to the current year methodology.

The above does not include debt recorded in the Enterprise Funds because such debt is not subject to legal debt margin.

Special assessment debt excludes debt where there is no government commitment.

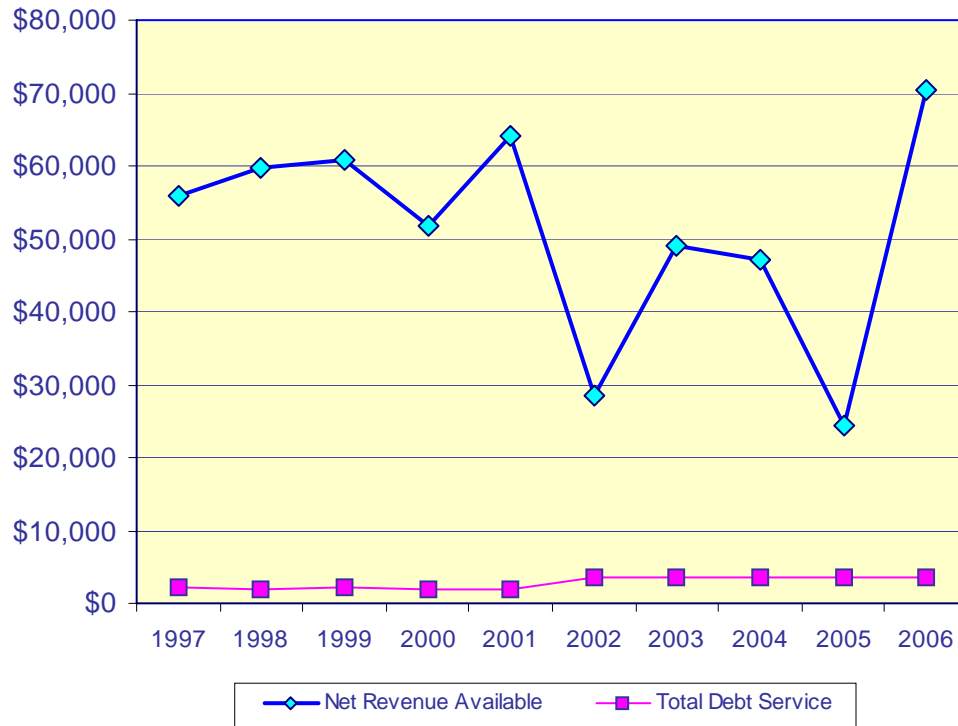




## City of Palo Alto - Revenue Bond Coverage.....

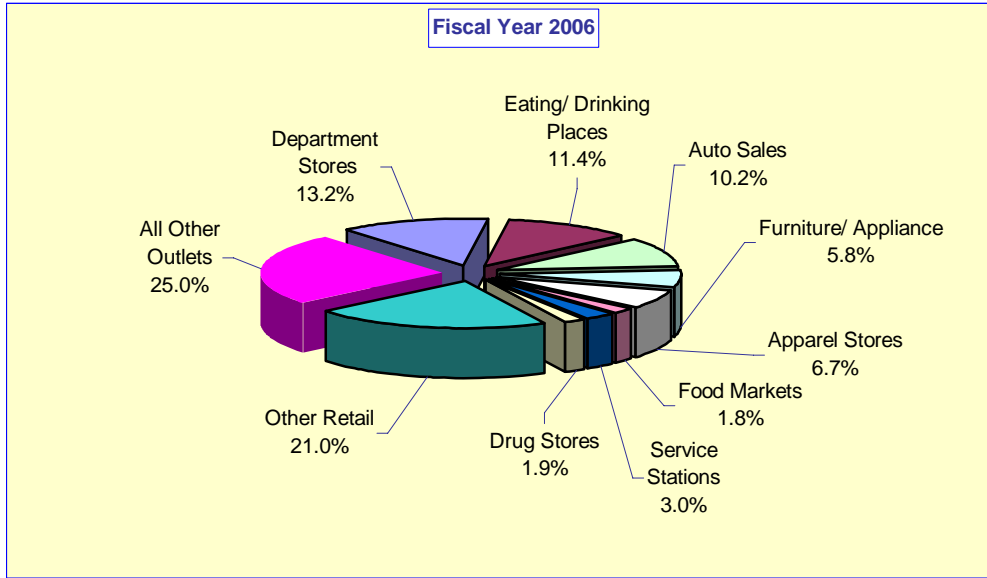
Water, Electric, Gas, Wastewater Collection,  
Wastewater Treatment and Storm Drainage Funds

Last Ten Fiscal Years (\$000)



Fiscal Year	Gross Revenue	Direct Operating Expenditures	Net Revenue Available for Debt Services (1)	Debt Service			Coverage
				Principal	Interest	Total	
1997	\$133,081	\$77,104	\$55,977	\$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	896	1,163	2,059	29.60
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	176,947	148,345	28,602	1,955	1,660	3,615	7.91
2003	165,414	116,268	49,146	1,255	2,354	3,609	13.62
2004	169,047	121,988	47,059	1,310	2,307	3,617	13.01
2005	171,493	147,123	24,370	1,365	2,257	3,622	6.73
2006	214,944	144,465	70,479	1,410	2,203	3,613	19.51

**City of Palo Alto- Taxable Transactions by Type of Business.....  
Last Ten Fiscal Years (\$000)**



**RETAIL STORES**

Fiscal Year	Department Stores	Eating/ Drinking Places	Auto Sales	Furniture/ Appliance	Apparel Stores	Food Markets	Service Stations	Drug Stores	Other Retail	Retail Stores Total	All Other Outlets	Total
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
2004	2,425	2,168	1,958	1,479	1,186	351	437	168	3,698	13,870	3,997	17,867
2005	2,621	2,206	1,966	1,176	1,310	356	533	317	3,590	14,075	5,139	19,214
2006	2,664	2,306	2,062	1,168	1,346	370	595	392	4,244	15,147	5,042	20,189

**Source:** California State Board of Equalization, compiled by MBIA Muniservices Company

**Note:** Fiscal Year 2005 is restated to include State and County Pools in the All Other Outlets category.

**SALES TAX RATES FOR THE  
FISCAL YEAR ENDED JUNE 30, 2006**

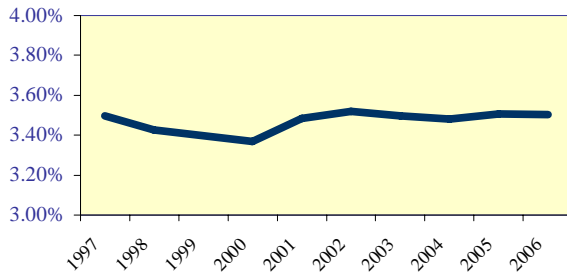
State Funds	6.00%
County Transportation Fund (Transportation Development)	0.25%
County Transportation Fund	1.00%
City	1.00%
<b>Total</b>	<b>8.25%</b>

**Source:** California State Board of Equalization

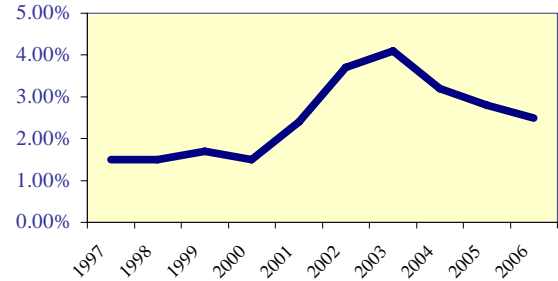


## City of Palo Alto - Demographic and Economic Statistics

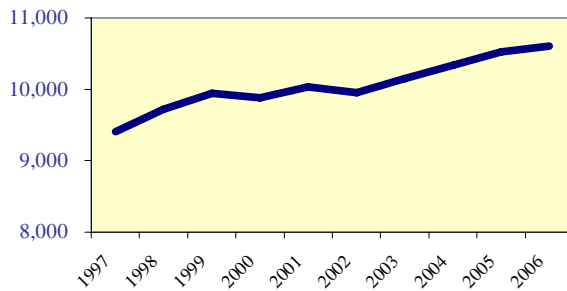
### Last Ten Fiscal Years



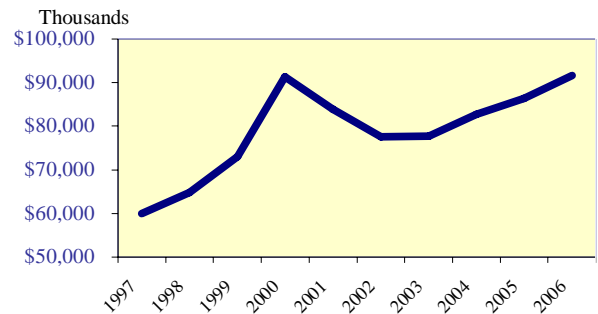
City Population as a % of County Population



City Unemployment Rate



City School Population



Total County Personal Income

Fiscal Year	City of Palo Alto Population	City of Palo Alto Unemployment Rate (%)	City of Palo Alto School Population	Santa Clara County Population	City Population % of County	Santa Clara Total County Personal Income (\$000)
1997	57,800	1.5%	9,407	1,653,100	3.50%	\$60,003,613
1998	57,900	1.5%	9,719	1,689,900	3.43%	64,850,110
1999	58,300	1.7%	9,946	1,715,400	3.40%	73,045,821
2000	58,500	1.5%	9,881	1,736,700	3.37%	91,386,821
2001	60,200	2.4%	10,031	1,728,680	3.48%	83,838,707
2002	60,500	3.7%	9,952	1,719,565	3.52%	77,548,912
2003	60,465	4.1%	10,151	1,729,917	3.50%	77,680,349
2004	60,246	3.2%	10,341	1,731,422	3.48%	82,638,917
2005	61,674	2.8%	10,527	1,759,585	3.51%	86,400,000 *
2006	62,148	2.5%	10,607	1,773,258	3.50%	91,600,000 *

Source: California State Department of Finance  
 State Employment Development Office  
 Palo Alto Unified School District

\* California State Department of Transportation Forecasts



### City of Palo Alto - Principal Employers

Current Year

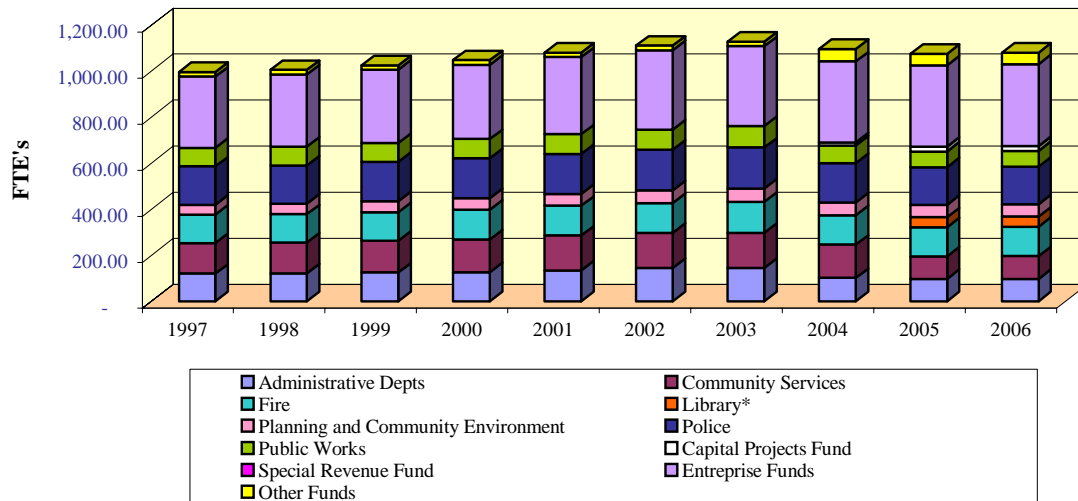
	<b>2005-06</b>
<b>Employer</b>	<b>Number of Employees (1)</b>
Stanford Hospital & Clinics	5000-9999
Agilent Technologies	1000-4999
Hewlett Packard	1000-4999
Palo Alto Medical Foundation	1000-4999
Roche Bioscience	1000-4999
Space Systems Loral	1000-4999
VA Palo Alto Health Care System	1000-4999
Wilson Sonsini Goodrich & Rosati	1000-4999
Lucille Packard Children's Hospital	1000-4999
TIBCO Software	1000-4999
City of Palo Alto	1000-4999
Varian	1000-4999
Lockheed Martin Advanced	500-999
Cooley Godward	500-999
Alza Corporation	500-999
CPI International	500-999
EPRI	500-999
Macy's	500-999
<b>Total City Day Population</b>	<b>62,148</b>

**Source:** Reference USA & Palo Alto Chamber of Commerce

**Note:** (1) 2005-06 number of employees as of year 2002.



### City of Palo Alto - Full-Time Equivalent City Government Employees by Function Last Ten Fiscal Years



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
<b>Governmental Funds</b>										
<b>General Fund</b>										
Administrative Depts	119.35	120.76	124.35	126.35	133.35	143.60	145.10	101.10	96.24	96.65
Community Services	134.00	134.00	139.25	142.25	152.00	153.00	153.00	144.75	98.25	99.25
Fire	122.00	123.00	124.00	128.00	129.00	129.00	132.50	128.50	126.00	127.00
Library*									44.00	44.25
Planning and Community Environment	43.00	45.00	46.00	51.00	52.00	56.50	59.00	54.80	53.30	53.30
Police	167.50	167.50	171.00	173.00	173.00	176.50	177.50	171.00	164.50	164.00
Public Works	79.53	80.53	82.42	83.42	85.98	87.05	93.05	76.20	67.90	67.90
<b>Capital Projects Fund</b>								12.70	20.20	20.20
<b>Special Revenue Fund</b>								1.20	1.20	1.20
<b>Enterprise Funds</b>										
<b>Public Works Department</b> (Refuse, Storm Drain, Wastewater Treatment)	103.47	105.47	106.58	107.58	109.52	110.45	110.45	111.35	112.65	112.65
<b>Utilities Department</b>  (Administrative, Electric, Gas, Wastewater Collection, Water )	206.50	208.50	211.50	215.50	224.50	230.50	229.50	233.75	233.90	235.90
<b>CPA External Services</b>						4.00	7.00	5.70	6.00	6.00
<b>Other Funds</b>										
Printing and Mailing	5.15	5.15	5.15	5.15	5.15	4.15	4.15	4.15	4.70	4.60
Technology								33.15	29.56	29.60
Equipment Management	14.00	14.00	14.00	14.00	14.00	15.00	15.00	16.00	16.00	16.00
<b>Total</b>	<b>994.50</b>	<b>1,003.91</b>	<b>1,024.25</b>	<b>1,046.25</b>	<b>1,078.50</b>	<b>1,109.75</b>	<b>1,126.25</b>	<b>1,094.35</b>	<b>1,074.40</b>	<b>1,078.50</b>

\* Library became its own entity effective 2005, originally part of Community Services.

Source: City of Palo Alto - Adopted Operating Budget

**City of Palo Alto - Operating Indicators by Function/Program**  
*Last Ten Fiscal Years*

<b>Function / Program</b>	<b>Fiscal Year</b>			
	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
<b>Public Safety:</b>				
Fire:				
Number of Fire Hydrants	1,500	1,500	1,699	1,708
<b>Planning &amp; Community Environment</b>				
Number of Housing Units	25,625	25,701	25,708	25,732
Commercial & Industrial Space - Million Sq Ft	27.1	27.1	27.1	27.3
<b>Electric Utility</b>				
Number of Customer Accounts	27,540	27,641	27,674	27,533
Million of KWH Sold	1,078	1,121	1,124	1,134
<b>Water Utility</b>				
Number of Customer Accounts	19,249	19,298	19,322	18,921
Million CCF Sold	6.4	5.8	6.1	6.6
<b>Gas Utility</b>				
Number of Customer Accounts	23,311	23,327	23,322	23,154
Million Therms Sold	35.0	37.0	41.0	37.0
<b>Waste Water</b>				
Number of Customer Accounts	21,929	25,951	21,975	21,973
Millions of Gallons Processed	10,169	10,339	9,426	9,834

**Source:** City of Palo Alto  
 State of California, Dept of Finance (housing units)



Fiscal Year					
2001	2002	2003	2004	2005	2006
1,729	1,741	1,746	2,653	2,653	2,699
26,048	26,841	26,934	27,019	27,522	27,767
27.3	27.3	27.3	27.3	27.3	27.3
28,097	28,348	28,408	28,482	28,539	28,653
1,057	997	957	958	959	966
19,335	19,437	19,487	19,557	19,605	19,645
5.9	5.9	5.6	6.0	5.3	5.2
23,101	23,116	23,169	23,216	23,300	23,353
36.7	33.7	31.8	31.5	32.0	31.5
21,752	21,772	21,819	21,830	21,825	21,784
9,243	8,699	8,704	8,238	8,395	8,972

## City of Palo Alto - Capital Asset Statistics by Function/Program

### Last Ten Fiscal Years

Function/Program	Fiscal Year			
	1997	1998	1999	2000
<b>Public Safety:</b>				
Fire:				
Fire Stations	7	8	8	8
Fire Apparatus	24	24	24	23
Police:				
Police Stations	1	1	1	1
Police Patrol Vehicles	30	26	27	29
<b>Community Services</b>				
Acres - Downtown Parks	142	142	142	170
Acres - Open Space	3,997	3,997	3,997	3,731
Parks	36	36	36	35
Golf Course	1	1	1	1
Tennis Courts	47	51	51	52
Athletic Center	1	1	1	1
Community Centers	4	4	4	4
Theatres	3	3	3	3
Cultural Center	1	1	1	1
Junior Museum and Zoo	1	1	1	1
Swimming Pools	3	3	3	1
Nature Center	2	2	2	2
Libraries	6	6	6	6
<b>Public Works</b>				
Number of Trees Maintained	38,600	39,200	39,832	39,923
<b>Electric Utility</b>				
Overhead Pole Miles	192	185	183	228
Underground Trench Miles	251	200	202	209
<b>Water Utility</b>				
Miles of Water Mains	216	215	220	221
<b>Gas Utility</b>				
Miles of Gas Mains	171	170	169	170
<b>Waste Water</b>				
Miles of Sanitary Sewer Lines	219	219	219	219

Source: City of Palo Alto





Fiscal Year					
2001	2002	2003	2004	2005	2006
8	8	8	8	8	8
24	25	22	23	25	25
1	1	1	1	1	1
33	33	33	30	30	30
170	170	170	170	170	170
3,731	3,731	3,731	3,731	3,731	3,731
33	34	34	34	35	35
1	1	1	1	1	1
52	52	52	52	52	52
1	1	1	1	1	1
4	4	4	4	4	4
3	3	3	3	3	3
1	1	1	1	1	1
1	1	1	1	1	1
1	1	1	1	1	1
2	2	2	2	2	2
6	6	6	5	5	5
38,094	37,941	34,939	35,440	35,096	34,841
227	227	227	227	225	217
220	186	186	186	188	210
222	226	226	226	226	217
201	207	207	207	207	207
218	202	202	202	202	202

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

June 30, 2006

TYPE	COVERAGE (Deductible)	LIMITS	COMPANY	EXPIRATION DATE
<b>PROPERTY LOSS</b>				
Blanket	All real & personal property (\$25,000 deductible), Fine Arts (\$2,500 deductible)	\$314,730,659	CA Public Entity Property Program	07/01/07
Boiler & Machinery	All real & personal property (\$50,000 deductible)	\$1,000,000 maximum all risk per occurrence limit  \$1,000,000 minimum contingent business interruption	CA Public Entity Property Program	07/01/07
Flood Insurance	All real property 1305 Middlefield Road (\$1,000 deductible)	\$500,000	Hartford Fire Insurance Company	04/07/07
<b>FINANCIAL LOSS</b>				
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.	03/22/09
<b>UMBRELLA EXCESS LIABILITY</b>				
	City is a member of an insurance pool participating with a number of other California cities (\$1,000,000 self-insured retention)	\$44,000,000 annual aggregate	Insurance Company of Pennsylvania	07/01/07
Trustees Errors and Omissions	Bodily injury and property damage liability  Errors and omissions liability			
<b>SPECIAL LIABILITY</b>				
Volunteers Accident	Medical - Each person / (\$100 deductible)	\$20,000	Life Insurance Co. of North America	02/03/07
Special Events	Bodily injury	\$1,000,000 per occurrence	Axis Surplus Insurance Company	01/01/07
<b>AUTOMOBILE LIABILITY</b>				
City Manager Vehicle Only	Physical Damage (\$1,000 deductible comp. collision)	\$1,000,000	Progressive Com.  Auto Insurance	04/11/07
<b>EMPLOYEE BENEFIT</b>				
Travel Accident	Indemnity, based on salary	\$1,500,000 per accident	Life Insurance Co. of North America	06/01/07
<b>EMPLOYEE HEALTH PLAN</b>				
	The City participates in the California Public Employees' Medical and Health Care Act (PEMHCA) program to provide medical benefits to employees and retirees			
<b>WORKERS' COMPENSATION</b>				
	City is self-insured for first \$500,000 liability	\$500,000 per occurrence		07/01/07
<b>EXCESS WORKERS' COMPENSATION</b>				
	Pooled Retention	\$5,000,000 limit per occurrence - Workers Comp and Employers Liability	CA. Public Entity Insurance Authority	07/01/07
	Reinsured Layer	\$150,000,000 workers comp per occurrence, excess of pooled retention limit, includes \$5,000,000 employers liability excess of \$5,000,000 pooled retention	National Union Fire Insurance Co.	07/01/07

SOURCE: Human Resources Dept, City of Palo Alto



# Single Audit Index.....

Schedule of Current Year Findings and Questioned Costs .....	155
Section I - Summary of Auditor’s Results .....	155
Section II – Financial Statement Findings.....	157
Section III – Federal Award Findings and Questioned Costs .....	157
Section IV - Status of Prior Year Findings and Questioned Costs.....	157
Schedule of Expenditures of Federal Awards .....	159
Notes to Schedule of Expenditures of Federal Awards.....	161
Report On Internal Control over Financial Reporting and On Compliance And Other Matters Based on an Audit of Financial Statements Performed In Accordance With Government Auditing Standards.....	163
Report On Compliance with Requirements Applicable To Each Major Program and On Internal Control Over Compliance In Accordance With OMB Circular A-133 .....	165



This page is intentionally left blank.



## *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.



This page is intentionally left blank.



# Schedule of Findings.....

## SCHEDULE OF FINDINGS AND QUESTIONED COSTS

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

We are required by the Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-profit Organizations*, to present an overview of the Single Audit which is presented below.

We have audited the basic financial statements of the City of Palo Alto, California, for the year ended June 30, 2006 and have issued our unqualified report thereon dated October 13, 2006. 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 as amended in 1996 and OMB A-133.

### Section I—Summary of Auditor’s Results

#### Financial Statements

	Unqualified		
Type of auditor’s report issued:	_____		
Internal control over financial reporting:			
• Material weakness(es) identified?	_____	X	No
• Reportable conditions(s) identified that are not considered to be material weaknesses?	_____	X	None reported
Noncompliance material to financial statements noted?	_____	X	No



**Schedule of Findings**

Federal Awards

Type of auditor’s report issued on compliance for major programs:

Unqualified

\_\_\_\_\_

Internal control over major programs:

- Material weakness(es) identified?

\_\_\_\_\_  X  No

- Reportable condition(s) identified that are not considered to be material weaknesses

\_\_\_\_\_  X  none reported

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?

\_\_\_\_\_  X  no

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
14.218	Department of Housing and Urban Development: Community Development Block Grant.
20.205	Department of Transportation: Highway planning and construction grant

Dollar threshold used to distinguish between Type A and type B programs:

\$300,000

Auditee qualified as low-risk auditee?

X  yes \_\_\_\_\_





**Section II – Financial Statement Findings**

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 other matters to City Council in our separate Memorandum on Internal Controls dated October 13, 2006.

**Section III – Federal Award Findings and Questioned Costs**

**Current Year Findings and Questioned Costs**

Our audit did not disclose any findings or questioned costs required to be reported in accordance with OMB Circular A-133.

**Section IV - Status of Prior Year Findings and Questioned Costs**

**Prepared by Management**

There were no unresolved prior year findings



This page is intentionally left blank.



**CITY OF PALO ALTO**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
 FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Program Name	Grantor/ Pass-Through Entity Grant Number	Catalog of Federal Domestic Assistance Number	Program Expenditures
<b>Department of Housing and Urban Development</b>			
Community Development Block Grant Program Program Expenditures	B-05-MC-06-0020	14.218	\$138,056
<b>Subgrants:</b>			
Emergency Housing Consortium			8,000
Catholic Charities Ombudsman Program			6,000
Clara Mateo Alliance Shelter			21,000
New Housing Development			12,100
Clara Mateo Alliance Family Shelter			21,392
InnVision			24,000
Shelter Network Haven Housing			19,000
Economic and Social Opportunities, Inc.			60,000
Project Sentinel - Fair Housing			26,800
Mid-Peninsula Alano Group			5,000
Palo Alto Housing Corporation:			
Barker Counseling			23,000
Oak Manor Townhouse			6,714
Current year loans			1,111,059
		<b>14.218</b>	<b>1,482,121</b>
U.S. Department of Transportation,			
Highway Planning and Construction Grant (Passed through California Department of Transportation)		20.205	
Traffic Signal System Upgrade	CML-5100(006)		103,656
Pedestrian and Bike Path	STPLER-5100(005)		392,252
			495,908
Governor's Office of Emergency Services (Passed through California Department of Transportation)	FEMA-3033110-DR-CA, OES ID #085-55282	20.703	97,503
Department of Energy	DE-FG36-03GO13066	81.122	89,847
<b>TOTAL FEDERAL FINANCIAL AWARDS</b>			<b>\$2,165,379</b>

See Notes to Schedule of Expenditures of Federal Awards



This page is intentionally left blank.



## NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

### Note 1.....

#### Reporting Entity

The Schedule of Expenditure of Federal Awards (the Schedule) includes expenditures of federal awards for the City and its component units as disclosed in the notes to the Basic Financial Statements.

### 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. All proprietary funds are accounted for using the accrual basis of accounting. Expenditures of Federal Awards reported on the Schedule are recognized when incurred.

OMB Circular A-133 requires that certain adjustments be made to expenditures recognized when incurred. The adjustments applicable to the City are summarized below:

Loan Program with continuing Compliance Requirements - The City operates a loan program under which it must insure participants maintain compliance with program requirements on an on-going basis. OMB Circular A-133 section .205(b) requires that expenditures for the above program include the balance of loans outstanding at the beginning of the year plus cash received from the program.

### Note 3.....

#### Direct and Pass-Through Federal Awards

Federal awards may be granted directly to the City by a 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 when they occur.



This page is intentionally left blank.



**ACCOUNTANCY CORPORATION**  
3478 Buskirk Ave. - Suite 215  
Pleasant Hill, California 94523  
(925) 930-0902 • FAX (925) 930-0135  
maze@mazeassociates.com  
www.mazeassociates.com

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE  
AND OTHER MATTERS 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 the City of Palo Alto as of and for the year ended June 30, 2006, and have issued our report thereon dated October 13, 2006. 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.

***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 an opinion 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 reportable 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 caused by error or fraud 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 13, 2006.

***Compliance and Other Matters***

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 grant agreements, 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*.

*A Professional Corporation*

This report is intended solely for the information and use of the City Council, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Mage + Associates*

October 13, 2006





**ACCOUNTANCY CORPORATION**  
3478 Buskirk Ave. - Suite 215  
Pleasant Hill, California 94523  
(925) 930-0902 • FAX (925) 930-0135  
maze@mazeassociates.com  
www.mazeassociates.com

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO  
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN  
ACCORDANCE WITH OMB CIRCULAR A-133**

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 U.S. Office of Management and Budget (*OMB Circular A-133 Compliance Supplement*) that are applicable to each of its major federal programs for the year ended June 30, 2006. The City's major federal programs are identified in Section I - Summary of Auditor's Results included on 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 auditing standards generally accepted 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 of Palo Alto'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 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, 2006

*A Professional Corporation*

### *Internal Control over Compliance*

The management of the City is responsible for establishing and maintaining effective internal control over compliance with the 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 the 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 reportable 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 caused by error or fraud 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.

### Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the business type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended June 30, 2006, and have issued our report thereon dated October 13, 2006. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for the purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such 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.

*Maze + Associates*

October 13, 2006

---

*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.*

---

**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:***

ADA Coordinator  
250 Hamilton Avenue  
(650) 329-2550  
[ada@cityofpaloalto.org](mailto:ada@cityofpaloalto.org)

This page is intentionally left blank.