

CITY OF PALO ALTO, CALIFORNIA



2010-2011 Comprehensive Annual Financial Report

Fiscal Year Ended June 30, 2011



*City of Palo Alto
California*

**Comprehensive
Annual Financial
Report**

**For the fiscal year ended
June 30, 2011**



Prepared by: Administrative Services Department

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CITY OF PALO ALTO
For the Year Ended June 30, 2011

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City of Palo Alto
Office of the City Manager

Transmittal Letter.....

December 6, 2011

THE HONORABLE CITY COUNCIL

Palo Alto, California

Attention: Finance Committee

COMPREHENSIVE ANNUAL FINANCIAL REPORT

YEAR ENDED JUNE 30, 2011

Members of the Council and Citizens of Palo Alto:

Transmittal: The Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2011, is submitted for Council review in accordance with Article III, Section 16 and Article IV, Section 13 of the City of Palo Alto Charter and is 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 opinions on the basic 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 Macias Gini & O’Connell LLP, 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. Macias Gini & O’Connell LLP concluded, based on the audit, that there was a reasonable basis for rendering an unqualified opinion for the fiscal year ended June 30, 2011, 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, Macias Gini & O’Connell LLP 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 64,417, 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, the Stanford Shopping Center and businesses such as Hewlett-Packard Company, VMware, Facebook, and Space Systems Loral, Palo Alto has enjoyed diverse employment and revenue bases.

Like jurisdictions throughout the country, the City was impacted by the “Great Recession,” and is now showing signs of slow recovery. At the end of Fiscal Year (FY) 2011, the City’s unemployment rate had dropped to 5.5 percent from 6.1 percent the prior year, as compared to Santa Clara County’s unemployment rate of 10.3 percent, and the state’s rate of 12.4 percent.

Property taxes in FY 2011 were marginally lower than in FY 2010. This was a consequence of commercial property valuation appeals many of which have not been processed and will impact FY 2012 revenue levels. In addition, the City has seen a falloff in its telephone utility user tax. Changes in provider billing practices are believed to cause this revenue source decline.

The City believes it will take multiple years for revenue sources to fully recover from the effects of the “Great Recession.” This perspective is reinforced by recent volatility in the stock market and challenges to the developed and developing economies.

The City also faces rising benefit costs and a significant backlog in infrastructure investment. As with past economic downturns, the City is proactively taking steps to align expenses and revenues through service and program cuts, revenue enhancements, and employee compensation savings. The City Council adopted a General Fund budget for FY 2012 that eliminated a projected deficit of \$3.1 million, after implementing a total of \$14.3 million in structural changes during the prior two fiscal years. The City’s non-safety employees have accepted a number of cost-sharing concessions, along with a reduced retirement benefit for new employees. The City is in continued negotiations with public safety employees to seek comparable concessions.

Employment Trends: Palo Alto is home to a strong mix of small, medium, and large firms. Employment opportunities within the City 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 Alto Health Care facility, the Palo Alto Medical Foundation, Hewlett Packard, the Palo Alto Unified School District, and the City of Palo Alto.

Real Estate Market: In its most recent annual report, the Santa Clara County Assessor’s Office noted that Santa Clara County’s 2011/2012 assessment roll increased by just under 1%, from \$296 billion to \$299 billion, and that “compared to the last three years, this very small increase in property assessments provides encouraging news, and hopefully signifies the beginning of a positive trend out of the depths of the Great Recession.” There are, however, significant geographic differences within the County. For example, Los Altos Hills and Los Altos had increases of 3.81 and 3.59 percent, respectively; Palo Alto’s roll increased by 2.39 percent; but Milpitas experienced a 3.48 percent decline.

With its highly regarded school district, well-educated and high-income population, cultural amenities, and the presence of Stanford University, the City's real estate values are typically shielded from major price swings. However, Palo Alto experienced just 0.36 percent growth in 2011 after 3.8 percent growth in 2010, which in turn was down from its 11.43 percent growth in FY 2009.

Long Range Financial Forecast: The City of Palo Alto produces a 10 year Long Range Financial Forecast (LRFF) annually. This comprehensive report analyzes, for example, local, state, and federal economic conditions; short and long-term revenue and expense trends; expense challenges such as funding retiree medical benefits; revenue opportunities such as instituting an occupancy tax increase; and infrastructure needs. The forecast is designed to highlight finance issues which the City can address proactively. Moreover, it is a tool that allows policymakers an opportunity to prioritize funding needs over time.

Delivered to Council in December or January, this forecast sets the tone and themes for the annual budget process that begins in January. The forecast is one of the many tools and reports the City uses for financial planning. These include, for example: quarterly revenue and expense analysis, midyear budget adjustments, a five-year capital improvement plan, quarterly sales tax reports, and actuarial reports to ascertain long-term retiree liabilities. The City is conscientious and pro-active in financial planning.

It is worthwhile to note that during the last two economic downturns, the City has balanced its annual budget via expenditure reductions or revenue enhancements and has not drawn down reserves.

Cash and Investments: The City of Palo Alto invests its excess cash prudently and has adopted an investment policy as prescribed by State law. The policy states that investments are to be made in the following priority order: safety, liquidity, and yield. As of June 30, 2011, the City had \$373 million (par value) in its portfolio. Its principal investments were in agency securities, treasuries, and a State of California investment pool. The City's investment practice is to buy securities and hold them to maturity to avoid principal loss. Staff provides a quarterly report of investments for Council review. During FY 2011, staff complied with all requirements of the City's 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 the positions of City Manager, City Attorney, City Clerk, and City Auditor, and those positions report directly to the City Council.

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.



Introduction

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, fiber optics, 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 an award for the prior fiscal year CAFR from the Government Finance Officers Association (GFOA) for "excellence in financial reporting." The 2011 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 Laura Kuryk, 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 Macias Gini & O'Connell LLP, the City's independent external 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,

LALO PEREZ,
Administrative Services Director

JAMES KEENE,
City Manager



City of Palo Alto City Officials

City Council

Sid Espinosa, *Mayor*

Yiaway Yeh, *Vice-Mayor*

Pat Burt

Gail A. Price

Karen Holman

Greg Scharff

Larry Klein

Greg Schmid

Nancy Shepherd

Finance Committee

Greg Scharff, *Chair*

Greg Schmid

Nancy Shepherd

Yiaway Yeh

Policy and Services Committee

Gail A. Price, *Chair*

Pat Burt

Karen Holman

Larry Klein

Council-Appointed Officers

City Manager

James Keene

City Attorney

Molly Stump

City Clerk

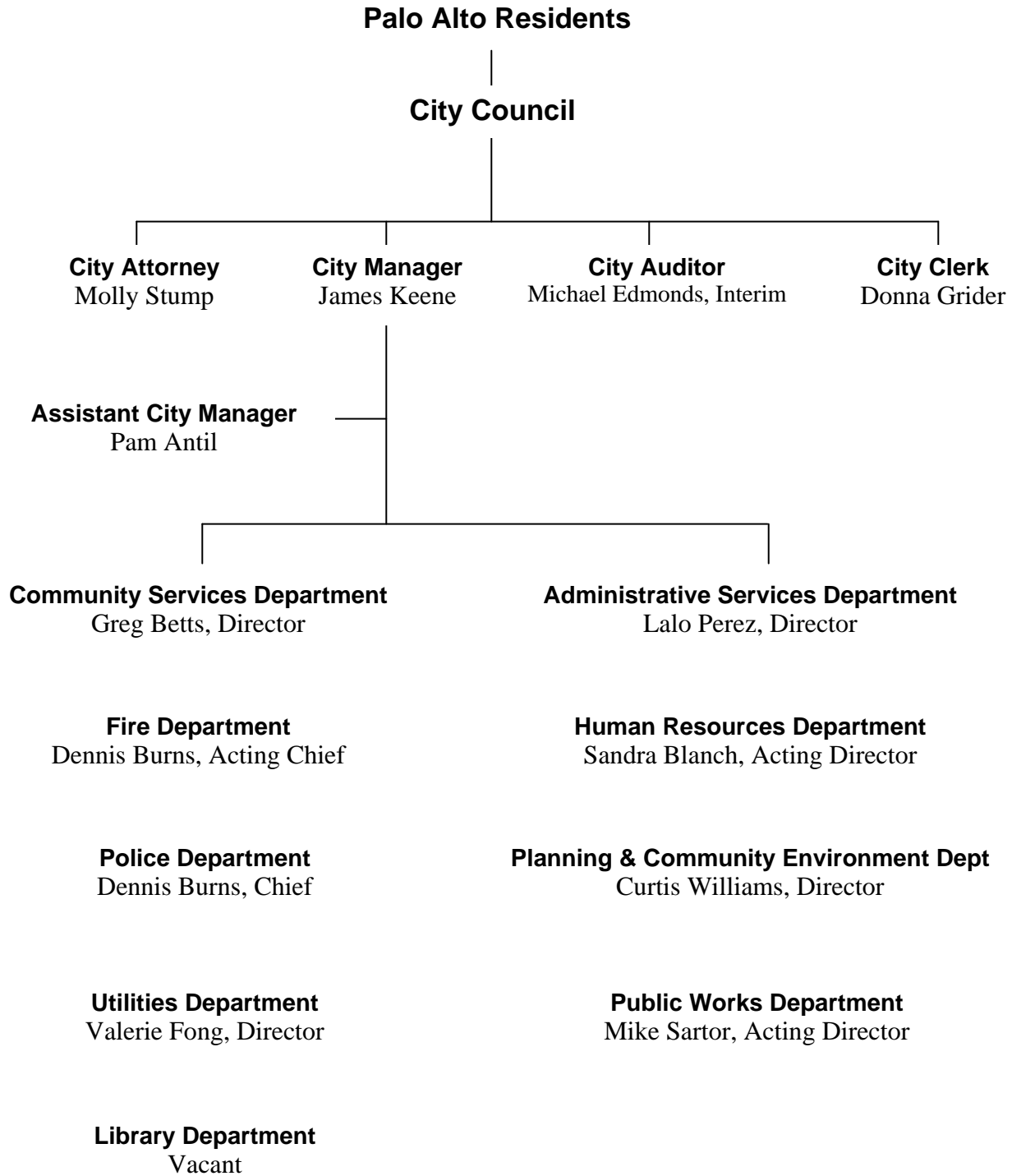
Donna Grider

City Auditor

Michael Edmonds, Interim

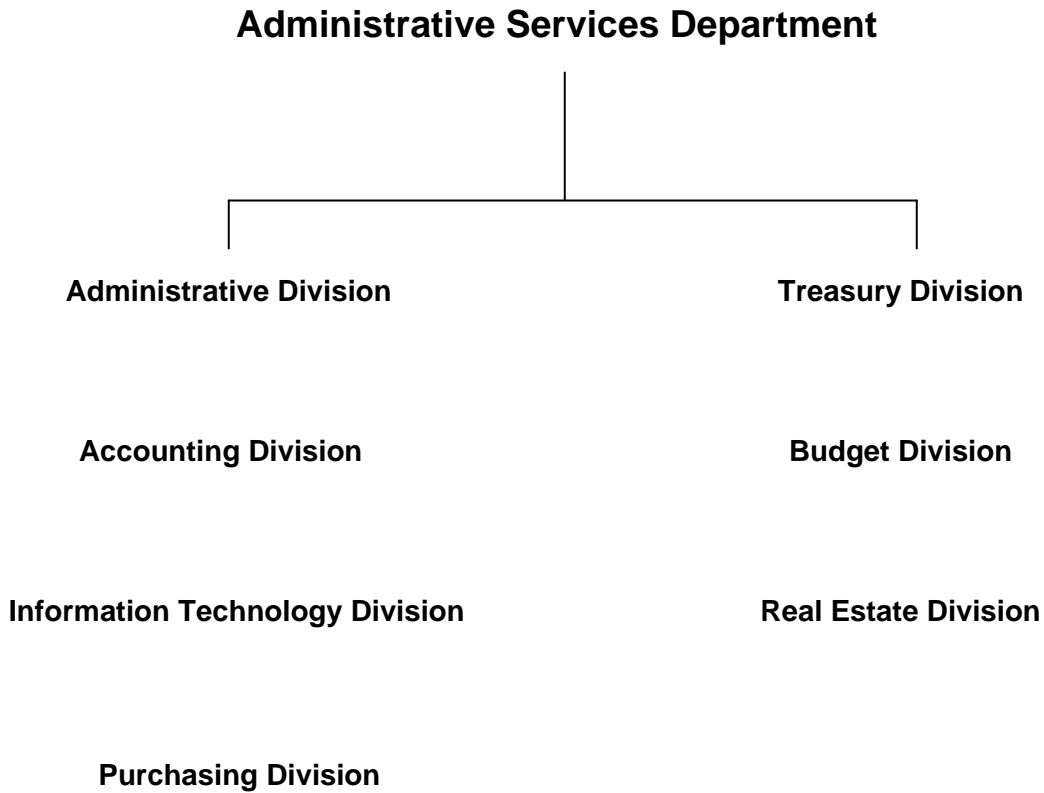


City of Palo Alto Organization





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, 2010

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.



Linda C. Janson

President

Jeffrey R. Emer

Executive Director

INDEPENDENT AUDITOR'S REPORT

Honorable Mayor and City Council
City of Palo Alto, California

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Palo Alto, California (City), as of and for the year ended June 30, 2011, 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 opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of June 30, 2011, and the respective changes in financial position and, where applicable, cash flows thereof and the respective budgetary comparison for the General Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1(k) to the basic financial statements, effective July 1, 2010, the City adopted the provisions of Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 1, 2011 on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's financial statements as a whole. The introductory section, combining and individual nonmajor fund financial statements and schedules, statistical section, and schedule of expenditures of federal awards (SEFA) are presented for purposes of additional analysis and as required by OMB Circular A-133 for the schedule of expenditures of federal awards and are not a required part of the financial statements. The combining and individual nonmajor fund financial statements and schedules and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied by us in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements 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 do not express an opinion or provide any assurance on them.

Macias Gini & Cunnell LLP
Walnut Creek, California
December 1, 2011



Management's Discussion and Analysis

Management's Discussion and Analysis (MD&A) provides an overview of the City of Palo Alto's financial performance for the fiscal year ended June 30, 2011. 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 that includes the Transmittal Letter and general information
- Management's Discussion and Analysis
- The Basic Financial Statements that include the Government-wide and Fund Financial Statements, along with the Notes to these statements
- Supplemental Information
- Statistical Information
- Single Audit

Basic Financial Statements

The Basic Financial Statements contain the Government-wide 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 Government-wide Financial Statements provide a longer-term view of the City's activities as a whole. They include the Statement of Net Assets and the Statement of Activities. The Statement of Net Assets includes the City's capital assets and long-term liabilities on a full accrual basis of accounting similar to that used by private sector companies. The Statement of Activities provides information about the City's revenues and expenses on a full accrual basis, with an emphasis on measuring net revenues or expenses for each of the City's programs. The Statement of Activities explains in detail the change in net assets for the year. The amounts in the Statement of Net Assets and the Statement of Activities are separated into Governmental and Business-type Activities in order to provide a summary of these activities for the City.

The Fund Financial Statements display the City's operations in more detail than the Government-wide financial 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, Fiber Optics Fund, Gas Services Fund, Wastewater Collection Services Fund, Wastewater Treatment Services Fund, Refuse Services Fund, Storm Drainage Services Fund and Airport 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



Management's Discussion and Analysis

these districts. These entities are independent, and their balances are excluded from the City's financial statements.

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

Government-wide 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 Environment, Police, Fire, Community Services, and Library. These services are supported by general City revenues such as taxes, and by specific program revenues such as fees and grants.

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. The Redevelopment Agency was dissolved on September 6, 2011, as discussed in Note 17.

Business-type Activities - All of the City's enterprise activities are reported as Business-type Activities, including Water, Electric, Fiber Optics, Gas, Wastewater Collection, Wastewater Treatment, Refuse, Storm Drainage and Airport. Unlike governmental services, these services are supported by charges paid by customers based on services used, except for Airport which is currently supported by a long-term advance from the General Fund, as discussed in Note 4.

Government-wide 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 Governmental Accounting Standards Board (GASB) Statement No. 34 and replaced 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 Government-wide Financial Statements. In Fiscal Year (FY) 2011, 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 Technology and General Benefits, cannot be considered Major Funds because their revenues are derived from other City Funds. Revenues between Funds are eliminated in the Government-wide 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 and actual financial comparison information is presented only for the General Fund and all Major Special Revenue Funds.

Fiduciary Statements

The City is the fiduciary agent for certain assessment districts such as the University Avenue Area Parking Assessment District, and holds amounts collected from property owners that await transfer to the districts' bond trustees. The City's fiduciary activities are reported in the separate Statement of Fiduciary Assets and Liabilities and the supplemental 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

Like jurisdictions throughout the country, the City was impacted by the "Great Recession," and is now showing signs of slow recovery. At the end of FY 2011, the City's unemployment rate had dropped to 5.5 percent from 6.1 percent the prior year, as compared to Santa Clara County's unemployment rate of 10.3 percent.

More recently, the recovery in Silicon Valley has outpaced that of the state. The state's economic recovery seems to have stalled, according to the California Department of Finance. While about 25,000 jobs were gained each month between January and April, about 900 jobs were lost in each month from May to August. The state unemployment rate rose from 12.0 to 12.1 percent from July to August, before falling to 11.9 percent in September, leaving California with the second highest unemployment rate, behind Nevada.

In contrast, the unemployment rate in Santa Clara County fell in September from 9.9 percent to 9.6 percent, according to the state's Employment Development Department. While most of this decrease came from added jobs in the technology sector, 1,000 construction jobs were also added in the South Bay that month.

The City believes it will take multiple years to fully recover from the effects of the "Great Recession." While revenue sources seem to be recovering in the short-term, the City's long-term structural expenses continue to rise. The CalPERS system, for example, charges rates dependent on its investment returns, which are tied to the stock market returns and the nation's economic progress. The City's healthcare expenses for employees and retirees are tied to continually rising healthcare costs – again, independent of other economic upward trends.

The City continues to take steps to align expenses and revenues through service and program cuts, revenue enhancements, and employee compensation savings. The City Council adopted a General Fund budget for FY 2012 that eliminated a projected deficit of \$3.1 million, after implementing a total of \$14.3 million in structural changes during the prior two fiscal years. The City's non-safety employees, along with one of its public safety units, have accepted a number of cost-sharing concessions, along with a reduced retirement benefit for new employees. The City is in continued negotiations with the remaining public safety employees to seek comparable concessions.



Management's Discussion and Analysis

Through its 10 year Long Range Financial Forecast, the City closely monitors available resources versus current and long-term expenses. This tool has enabled the City to be forewarned and forearmed as it confronts the numerous uncertainties and challenges that jurisdictions across the nation are facing.

Government-wide

- The City's total net assets increased to \$1,186 million, a \$44.1 million increase. Governmental activities had an increase of \$9.9 million and are discussed on page 8. Business-type activities had an increase of \$34.2 million and are discussed on page 13.
- The City's total invested in capital assets, net of related debt, increased to \$781.2 million, a \$12.4 million increase. Governmental activities had a net decrease of \$4.7 million. Business-type activities had an increase of \$17.1 million primarily in the Water Fund and the Electric Fund.
- The City's total restricted net assets decreased to \$16.4 million, a \$22.2 million decrease. This reflects a \$14.9 million decrease for governmental special revenue programs, a decrease of \$3.7 million for governmental capital projects and a decrease of \$3.6 million for the City's debt service.
- The City's total unrestricted net assets increased to \$388.5 million, a \$53.9 million increase. Governmental activities had an increase of \$32.5 million and Business-type activities had an increase of \$21.4 million.
- Government-wide revenues totaled \$409 million, an increase of \$13.5 million from the prior year. This total consists of \$310.4 million in program revenues and \$98.6 million in general revenues. Program revenues increased by \$11.2 million, and general revenues increased by \$2.3 million.
- Total Government-wide expenses were \$364.9 million, a \$6 million increase.
- Government-wide total assets increased to \$1,412 million, a \$44.5 million increase.
- Government-wide capital assets increased by \$32.8 million to \$859.1 million.
- Government-wide cash and other assets increased \$11.7 million to \$552.9 million.
- Government-wide total liabilities were \$225.9 million, an increase of \$.4 million.
- Government-wide long-term debt decreased \$.1 million to \$151.9 million.
- Government-wide other liabilities were \$74 million, an increase of \$.5 million.

Fund Level – Governmental Funds

- Governmental Fund balances decreased to \$141.1 million, a \$12.6 million decrease.
- Governmental Fund revenues increased to \$132.4 million, a \$12.4 million increase.
- Governmental Fund expenditures were \$160.9 million, a \$17.5 million increase.
- General Fund revenues came in at \$117.3 million, an increase of \$7.4 million over the prior year.
- General Fund expenditures were \$121.5 million, an increase of \$2.6 million.
- The General Fund balance of \$44.2 million at June 30, 2011, was an increase of \$2.7 million from the prior year (refer to Performance of Governmental Funds – General Fund, page 16).



Fund Level – Enterprise Funds

- Enterprise Fund net assets increased to \$668.1 million, a \$33 million increase.
- Enterprise Fund operating revenues increased to \$265.8 million, a \$3.8 million increase from prior year revenues.
- Enterprise Fund operating expenses decreased to \$214 million, a \$4.5 million decrease.

FINANCIAL PERFORMANCE

Government-wide 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 Government-wide Statement of Net Assets and Statement of Activities.

GOVERNMENTAL ACTIVITIES			
<i>Net Assets at June 30</i>			
(in Millions)			
	<u>2011</u>	<u>2010</u>	<u>Increase/ (Decrease)</u>
Cash and investments	\$ 190.6	\$ 192.5	\$ (1.9)
Other assets	47.5	47.1	0.4
Capital assets	393.4	376.0	17.4
Total Assets	<u>631.5</u>	<u>615.6</u>	<u>15.9</u>
Long-term debt outstanding	64.8	65.9	(1.1)
Other liabilities	50.8	43.7	7.1
Total Liabilities	<u>115.6</u>	<u>109.6</u>	<u>6.0</u>
Net Assets:			
Invested in capital assets, net of debt	364.8	369.5	(4.7)
Restricted	16.4	34.3	(17.9)
Unrestricted	134.7	102.2	32.5
Total Net Assets	<u>\$ 515.9</u>	<u>\$ 506.0</u>	<u>\$ 9.9</u>

The City's Governmental activities total net assets increased \$9.9 million to \$515.9 million in FY 2011. This change results from the following:

- Capital assets increased \$17.4 million due to additions to the City's roadway network and sidewalks, Parks and Open Space facilities' improvements, the College Terrace Library seismic upgrade, and City-purchased easements.
- Other liabilities increased \$7.1 million, primarily due to costs for the Mitchell Park Library and Community Center project.
- Net assets invested in capital assets, net of related debt, decreased \$4.7 million to \$364.8 million.
- Restricted net assets decreased \$17.9 million to \$16.4 million. Unrestricted net assets increased \$32.5 million to \$134.7 million. Unrestricted net assets represent current net assets available to finance subsequent year operations and other expenditures approved by City Council.

Governmental Activities – Revenues

GOVERNMENTAL ACTIVITIES			
<i>Revenues for the Year ended June 30</i>			
(in Millions)			
Revenues by Source	2011	2010	Increase/ (Decrease)
Program Revenues:			
Charges for services	\$ 36.0	\$ 30.4	\$ 5.6
Operating grants and contributions	2.9	4.8	(1.9)
Capital grants and contributions	1.9	1.3	0.6
Total Program Revenues	40.8	36.5	4.3
General Revenues:			
Property taxes	29.2	26.0	3.2
Sales taxes	20.7	18.0	2.7
Utility user tax	10.8	11.3	(0.5)
Transient occupancy tax	8.1	6.9	1.2
Other taxes	8.2	4.1	4.1
Investment earnings	3.5	6.5	(3.0)
Rents and miscellaneous	12.4	12.7	(0.3)
Total General Revenues	92.9	85.5	7.4
Total Revenues	\$ 133.7	\$ 122.0	\$ 11.7

The table above shows that Governmental activities revenues totaled \$133.7 million in FY 2011, an increase of \$11.7 million over prior year revenues of \$122 million.

Charges for services increased by \$5.6 million from prior year for an ending balance of \$36 million. The increase includes the following:

- \$2.5 million increase in permit and plan checking fees due to increased building activity;
- \$1.0 million increase in in-lieu housing fees due to completion of major developments, and
- \$.9 million increase in charges to Stanford for police, communication and fire services.

Operating contributions and grants decreased by \$1.9 million from the prior year primarily due to the following:

- \$.4 million less for HUD Children's Library improvements;
- \$.5 million less in Proposition 42 traffic congestion relief;
- \$.4 million less in CDBG funding, and
- \$.3 million less in reimbursement of state mandated costs.



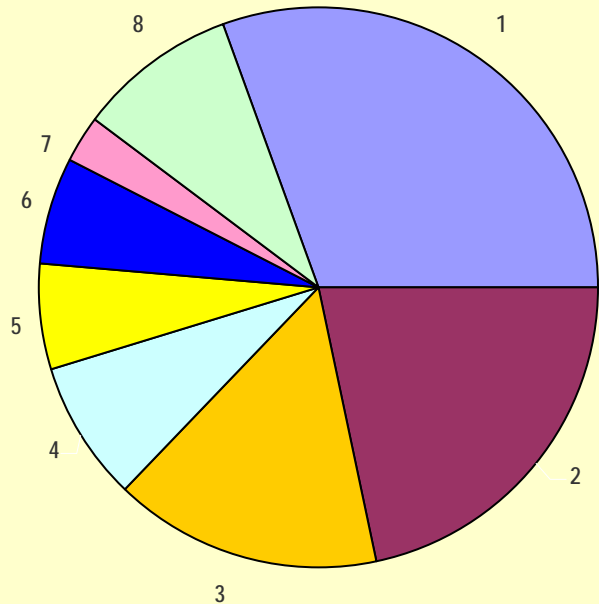
Management's Discussion and Analysis

Property taxes had an increase of \$3.2 million, sales taxes increased by \$2.7 million, the utility user tax decreased by \$0.5 million, and transient occupancy taxes increased by \$1.2 million. The property tax increase is a result of first year tax receipts from the assessment for the general obligation library bond debt. The sales tax increase is due to an uptick in sales activity, primarily in department store, miscellaneous retail and electronic equipment. Transient occupancy taxes increased as a result of higher levels of business activity which improved occupancy and room rates. Other taxes increased from \$4.1 million to \$8.2 million primarily due to a \$1.5 million increase in documentary transfer tax and new gas tax revenues of \$.6 million. Investment earnings decreased by \$3 million. This is a result of decreased investment earnings of \$.7 million, and a negative \$2.3 million for the year-end adjustment to fair value required by 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.

Sources of Revenues

- 1- Program Revenues - 31%
- 2- Property Taxes - 22%
- 3- Sales Taxes - 15%
- 4- Utility User Tax - 8%
- 5- Transient Occupancy Tax - 6%
- 6- Other Taxes - 6%
- 7- Investment Earnings - 3%
- 8- Rents and Miscellaneous - 9%



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

Governmental Activities – Expenses

The table below presents a comparison of FY 2011 and FY 2010 expenses (does not include encumbrances and reappropriations) by Governmental Activities and interest on long-term debt. Total Governmental Activities functional expense was \$140.9 million in FY 2011, a decrease of \$.4 million.

GOVERNMENTAL ACTIVITIES			
<i>Expenses and Change in Net Assets for the Year ended June 30</i>			
(in Millions)			
Activities	2011	2010	Increase/ (Decrease)
City Council	\$ 0.1	\$ 0.5	\$ (0.4)
City Manager	1.8	2.4	(0.6)
City Attorney	1.0	2.6	(1.6)
City Clerk	0.8	1.4	(0.6)
City Auditor	0.1	2.6	(2.5)
Administrative Services	9.9	17.9	(8.0)
Human Resources	1.3	3.7	(2.4)
Public Works	19.4	18.7	0.7
Planning and Community Environment	15.0	12.1	2.9
Police	30.5	29.3	1.2
Fire	28.5	26.4	2.1
Community Services	22.9	17.2	5.7
Library	6.9	6.1	0.8
Interest on long-term debt	2.7	0.4	2.3
Total Functional Expense	140.9	141.3	(0.4)
Increase/(Decrease) in Net Assets before Transfers	(7.2)	(19.4)	12.2
Transfers in	17.1	14.0	3.1
Change in Net Assets	9.9	(5.4)	15.3
Net Assets, Beginning	506.0	511.4	(5.4)
Net Assets, Ending	<u>\$ 515.9</u>	<u>\$ 506.0</u>	<u>\$ 9.9</u>

Administrative Services expense decreased by \$8 million due to the following:

- Expense classifications were changed in FY 2011 to effect a more informative presentation. In the prior year, the net of interdepartmental revenues and expenses was included with miscellaneous revenue. Effective for FY 2011, interdepartmental revenues and expenses are spread back to individual departments, reducing Administrative Services expense by \$3 million.

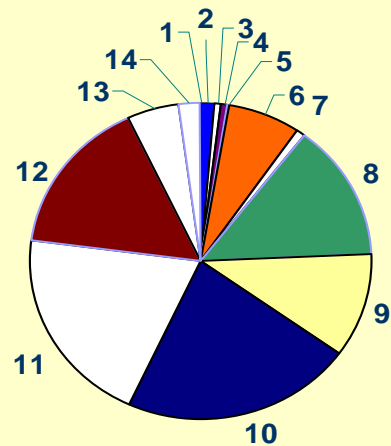
Management's Discussion and Analysis

- In the prior year, stores inventory cost of sales of \$2.2 million was included in Administrative Services expense. Effective for FY 2011, the cost of sales was netted with stores revenue and the net was reported as miscellaneous general revenue.
- In FY 2011, \$.9 million was received from Refuse Services Fund for interest on unpaid landfill rent.
- In FY 2010, \$1.9 million was expended for additional retiree medical, compared to \$1.0 million in FY 2011 for additional benefits allocation.

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 FY 2011, the City added \$17.4 million in net capital assets. The composition of FY 2011 additions is shown in detail in the Capital Asset section of Management's Discussion and Analysis.

Functional Expense

- 1- City Council - less than 1%
- 2.- City Manager 1%
- 3- City Attorney - less than 1%
- 4- City Clerk - less than 1%
- 5- City Auditor - less than 1%
- 6- Administrative Services 7%
- 7- Human Resources 1%
- 8- Public Works 14%
- 9- Planning & Community Environment 11%
- 10-Police 22%
- 11-Fire 21%
- 12-Community Services 16%
- 13-Library 5%
- 14-Interest on long-term debt 2%



Government-wide 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 Government-wide Statement of Net Assets and Statement of Activities.

BUSINESS-TYPE ACTIVITIES			
<i>Net Assets at June 30</i>			
(in Millions)			
	2011	2010	Increase/ (Decrease)
Cash and investments	\$ 274.0	\$ 262.6	\$ 11.4
Other assets	40.8	39.0	1.8
Capital assets	465.7	450.3	15.4
Total Assets	780.5	751.9	28.6
Long-term debt outstanding	87.1	86.1	1.0
Other liabilities	23.2	29.8	(6.6)
Total Liabilities	110.3	115.9	(5.6)
Net Assets:			
Invested in capital assets, net of debt	416.4	399.3	17.1
Restricted	0.0	4.3	(4.3)
Unrestricted	253.8	232.4	21.4
Total Net Assets	\$ 670.2	\$ 636.0	\$ 34.2

The City's Business-type activities total net assets increased \$34.2 million to \$670.2 million in FY 2011.

- Cash and investments increased \$11.4 million primarily due to the decrease in the retail purchase of utilities for Electric.
- Capital assets increased \$15.4 million to \$465.7 million in FY 2011 as a result of Water and Electric infrastructure improvements.
- Other liabilities decreased \$6.6 million primarily as a result of \$2.3 million less accrued for utility construction costs, \$1.8 million less accrued for hydro power, and \$1.9 million less accrued for partner's year-end true-up for Wastewater Treatment.
- Net assets invested in capital assets, net of related debt, increased \$17.1 million to \$416.4 million. The increase was mostly due to \$8 million of capital improvements in Water and \$7.5 million of capital improvements in Electric.
- The amount shown as restricted net assets for debt service in FY 2010 is now correctly reduced by the amount of debt outstanding that was deposited to debt service reserve accounts when the debt was issued, thereby reducing the balance to zero at year-end. Unrestricted net assets of

Management's Discussion and Analysis

\$253.8 million, an increase of \$21.4 million from 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 \$108.7 million, the Calaveras reserve for stranded costs of \$55.6 million, and the emergency plant replacement reserve of \$6.7 million.

BUSINESS-TYPE ACTIVITIES Revenues for the Year ended June 30 (in Millions)

Revenues by Source	2011	2010	Increase/ (Decrease)
Program Revenues:			
Water	\$ 28.1	\$ 27.0	\$ 1.1
Electric	122.1	121.9	0.2
Fiber Optics	3.3	3.1	0.2
Gas	43.6	44.5	(0.9)
Wastewater Collection	15.6	15.1	0.5
Wastewater Treatment	20.5	16.9	3.6
Refuse	30.6	28.6	2.0
Storm Drainage	5.8	5.6	0.2
Total Program Revenues	269.6	262.7	6.9
General Revenues:			
Investment earnings	5.7	10.8	(5.1)
Total General Revenues	5.7	10.8	(5.1)
Total Revenues	\$ 275.3	\$ 273.5	\$ 1.8

The table above presents the revenues for each of the City's Business-type Activities or Enterprise Funds. The City operates the Water, Electric, Fiber Optics, Gas, Wastewater Collection, Wastewater Treatment, Refuse, Storm Drainage and Airport Funds, which are Major Funds and are presented in the Basic Financial Statements.

Business-type Activities revenues totaled \$275.3 million, an increase of \$1.8 million from the prior year. Revenues were significantly affected by the following events:

- Program Revenues for Wastewater Treatment increased \$3.6 million from prior year as a result of \$1.6 million in grant revenue for the reclaimed water project and \$1.9 million for increased billings to the partners and to Wastewater Collection.
- Investment earnings decreased \$5.1 million due to a decrease in interest earnings on investments. Electric decreased \$2.5 million, Water decreased \$1.2 million and Gas decreased \$0.5 million from prior year.

BUSINESS-TYPE ACTIVITIES
Expenses and Change in Net Assets for the Year ended June 30
 (in Millions)

Activities	2011	2010	Increase/ (Decrease)
Water	\$ 24.3	\$ 21.0	\$ 3.3
Electric	100.1	107.9	(7.8)
Fiber optics	1.6	1.4	0.2
Gas	32.0	32.5	(0.5)
Wastewater collection	12.3	10.7	1.6
Wastewater treatment	19.7	13.5	6.2
Refuse	30.7	28.1	2.6
Storm drainage	3.2	2.5	0.7
Airport	0.1	0.0	0.1
Total Functional Expense	224.0	217.6	6.4
Increase in Net Assets before Transfers	51.3	55.9	(4.6)
Transfers out	17.1	14.0	3.1
Total Transfers	17.1	14.0	3.1
Change in Net Assets	34.2	41.9	(7.7)
Net Assets, Beginning	636.0	594.1	41.9
Net Assets, Ending	\$ 670.2	\$ 636.0	\$ 34.2

The table above presents a comparison of the FY 2011 and FY 2010 expenses for the City's Business-type Activities. Encumbrances and reappropriations are not included.

Business-type Activities expenses and transfers increased \$9.5 million for a total of \$241.1 million. Changes to expenses were significantly affected by the following events:

- Functional Expense for the Water Fund increased \$3.3 million from prior year due to a \$1.6 million increase in retail purchase of utilities and a \$.9 million increase in operating and administrative expenses.
- Functional Expense for the Electric Fund decreased \$7.8 million primarily due to a decrease in the retail purchase of utilities. Further detail may be found in Note 16 to the financial statements.
- Functional Expense for the Wastewater Treatment Fund increased by \$6.2 million due to allocation of the prior year operating transfers.



FUND FINANCIAL STATEMENTS

Performance of Governmental Funds

As of June 30, 2011, the City's Governmental Funds reported combined fund balances of \$141.1 million, a decrease of \$12.6 million or 8.2 percent compared with the prior year. The decrease is primarily due to the expenditure of Library bond proceeds in the current year.

As discussed more fully in Note 1, the City implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, for the year ended June 30, 2011. Fund balances are classified on the face of the financial statement as nonspendable, restricted, committed, assigned and unassigned.

Governmental Fund revenues and other financing sources decreased \$51.1 million from prior year to \$162.7 million. Revenues and other financing sources in the General Fund increased \$3.4 million; Capital Projects Fund decreased \$58.6 million, due primarily to the receipt of library bond proceeds from the General Obligation Bond in the prior year; Non-major Fund revenues and other financing sources increased by \$4 million.

Governmental Fund expenditures and other uses were \$175.4 million, an increase of \$10.6 million from the prior year. General Fund expenditures and other uses decreased \$1.1 million, Capital Projects Fund expenditures increased by \$10.4 million, and Non-major Fund expenditures and other uses increased by \$1.3 million.

General Fund

Governmental Funds – General Fund – Balance Sheet

As of June 30, 2011, the General Fund Balance totaled \$44.2 million, compared to \$41.5 million in the prior year. This represents 36.4 percent of direct General Fund expenditures, providing a buffer against unexpected financial events. The Fund Balance has been classified as \$6.1 million nonspendable, \$6.2 million assigned, and \$31.9 million unassigned. Of the unassigned amount, \$31.4 million is designated by the Council for budget stabilization.

General Fund

Governmental Funds – General Fund – Statement of Revenues, Expenditures and Changes in Fund Balance

The General Fund ended the year with a \$2.7 million increase in fund balance, for a total of \$44.2 million, compared to a \$1.8 million decrease in the prior year.

The City of Palo Alto's General Fund revenues totaled \$117.3 million in FY 2011. This represents an increase of \$7.4 million, or 6.8 percent, compared to the prior year.

General Fund expenditures and other uses totaled \$132.5 million, a decrease of \$1.1 million from the prior year. Transfers out decreased \$3.6 million as a result of the prior year Equity Transfer Stabilization Reserve that was returned to the Gas and Electric Funds.

General Fund - Statement of Revenues, Expenditures and Changes in Fund Balance Budget and Actual

Sales taxes increased by \$2.8 million or 15.3 percent over FY 2010 levels for a total of \$20.7 million, which is \$2.5 million more than the adopted budget and \$1.2 million greater than the adjusted budget. The City has seen an uptick in department store, miscellaneous retail, and electronic equipment sales activity. New auto



sales, however, continue to slump. Overall, sales tax receipts have been trending upward, although stock market volatility, the broader economy, and consumer sentiment can change this pattern quickly.

Property taxes decreased by \$.3 million or 1.1 percent from FY 2010 to FY 2011 for a total of \$25.7 million. This is \$.2 million less than the adopted budget and \$.4 million greater than the adjusted budget. Amidst the significant downturn in the housing market, the City has had relatively stable housing valuations and tax revenues. A significant number of assessment appeals by commercial property owners, however, caused the City to adjust its budget projections for FY 2011.

Transient occupancy tax (TOT) revenues were \$8.1 million in FY 2011, a \$1.2 million or 17.8 percent increase over FY 2010. The \$8.1 million is \$1.1 million greater than the adopted budget and \$.7 million greater than the adjusted budget. This revenue source has shown considerable improvement in FY 2011, likely due to heightened and healthy business activity on the Peninsula. Both occupancy and room rates have been marching upward, and this trend appears to be continuing into FY 2012.

Documentary transfer tax came in at \$5.2 million, an increase of \$1.5 million or 40.5 percent from the prior year. Actual revenue results were \$1.2 million above the FY 2011 adjusted budget. As a consequence of multiple large commercial transactions, this tax source turned in a robust performance in FY 2011. Since it is dependent on the volume and size of transactions, transfer tax receipts can vary considerably from year to year. For FY 2011, seventeen transactions, or 1.9 percent of the volume, accounted for \$.9 million, or 64 percent, of the increase. After the "Great Recession", this tax fell to \$3 million from a high in previous years of \$5 million. While receipts have risen again to over \$5 million, there is uncertainty at this time as to whether this mark will be achieved in FY 2012.

Charges for services were \$22.4 million in FY 2011, an increase of \$2.7 million from the prior year, an increase of \$2.4 million from the adopted budget and an increase of \$1.5 million from the adjusted budget.

Return on investment totaled \$.6 million, a decrease of \$2.1 million from the prior year, and a decrease of \$1.1 million and \$.8 million from the adopted and adjusted budgets, respectively. The budget does not include the year-end adjustment to the carrying value of investments.

Charges to other funds totaled \$11.2 million, a \$.2 million increase from prior year. Charges to other funds were \$.6 million greater than the adopted budget and \$.5 million greater than adjusted budget.

Non-Departmental expenditures and encumbrances totaled \$8 million, a decrease of \$.8 million from the prior year, and \$1.1 million more than the adjusted budget due to a \$1 million allocation to increase the General Benefits Internal Services Fund

Capital Projects Fund – Capital Projects Fund expenditures and other uses were \$36.3 million in FY 2011, which is an increase of \$10.3 million from the prior year. 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, 2011, the City's Enterprise Funds reported total net assets of \$668.1 million, an increase of \$33 million or 5.2 percent compared with the prior year. The increase was primarily from the Water, Electric and Gas Funds for \$3.5 million, \$13.1 million and \$6.2 million, respectively. These net assets constitute 75.2 percent of the Enterprise Funds' total net assets. Unrestricted net assets for these three funds totaled \$202.5 million, a 5.7 percent increase from FY 2010.



Management's Discussion and Analysis

Water Services Fund – Water ended the year with change in net assets of \$3.5 million, compared to \$7 million in the prior year, a \$3.5 million decrease. The decrease in change in net assets is primarily due to a \$1.6 million increase in retail purchase of utilities and a \$1.2 million decline in return on investments. The ending Rate Stabilization Reserve (RSR) balance is \$10.6 million.

Electric Services Fund – Electric ended the year with a change in net assets of \$13.1 million compared to \$9.4 million in the prior year. The increase in change in net assets is due to a \$7.5 million decrease in the purchase of utilities expense, offset by a \$2.5 million decline in return on investments and a \$2.5 million decrease in transfers in. The ending balance for the RSR is \$66.3 million, an increase of \$12 million.

Fiber Optics Fund – Fiber Optics ended the year with a change in net assets of \$2.1 million, the same as the prior year. The ending RSR is \$10.1 million.

Gas Services Fund – Gas ended the year with a change in net assets of \$6.2 million, compared to \$7.9 million in the prior year, a decrease of \$1.7 million. The decrease is due to a \$.5 million decline in return on investments and a \$.9 million reduction in transfers in. The RSR has an ending balance of \$16.2 million, a decrease of \$2.3 million.

Wastewater Collection Services Fund - Wastewater Collection ended the year with a change in net assets of \$3.4 million compared to \$4.7 million in the prior year. The decrease in change in net assets is primarily due to a \$.9 million increase in purchase of utilities expense and a \$.5 million reduction in capital grants and contributions. The RSR had an ending balance of \$5.9 million.

Wastewater Treatment Services Fund – Wastewater Treatment ended the year with a change in net assets of \$1.4 million compared to a negative change in net assets of \$1.2 million in FY 2010. The improvement in change in net assets is due to increased revenue resulting from \$1.6 million for the reclaimed water project and \$1.9 million in increased billings to the partners and to Wastewater Collection. The ending RSR balance is \$3 million compared to a negative \$12.4 million in the prior year. The improvement is due to a \$10 million reduction in the appropriation for the Disinfection Facility Improvement Program in December 2010 as a result of savings realized from lower bids.

Refuse Services Fund – Refuse ended the year with a change in net assets of \$.3 million, compared to a \$2.7 million negative change in net assets in FY 2010. The increased change in net assets is due to increased revenue of \$1.9 million, which resulted primarily from increased disposal fees due to the reinstatement of commercial drop-offs, and \$.8 million in increased transfers in. The ending RSR balance is negative \$5 million, compared to a negative \$4.9 million the prior year. Compliance requirements for the landfill closure and post-closure maintenance plan are discussed in detail in Note 9.

Storm Drainage Services Fund – Storm Drainage ended the year with a change in net assets of \$3 million compared to a change in net assets of \$2.5 million in the prior year, an increase of \$.5 million. The RSR had an ending balance of \$1.6 million compared to \$.3 million in the prior year.

Airport Fund – Airport was created in the current fiscal year. The initial funding was \$.3 million and primarily all of that remains in the cash account at the end of the year. The ending RSR balance is negative \$.1 million.

CAPITAL ASSETS

GASB 34 requires the City to record all its capital assets, including infrastructure and intangible assets. Infrastructure includes roads, bridges, signals and similar assets used by the entire population. The table below shows capital assets and the amount of accumulated depreciation for these assets for Governmental and Business-type Activities. Further detail may be found in Note 6 to the financial statements.

CAPITAL ASSETS AT JUNE 30 (in Millions)

	<u>2011</u>	<u>2010</u>	<u>Increase/ (Decrease)</u>
Governmental Activities			
<i>Capital Assets</i>			
Land and improvements	\$ 78.6	\$ 78.5	\$ 0.1
Street trees	15.4	15.1	0.3
Intangible assets	3.8	0.0	3.8
Construction in progress	36.2	32.3	3.9
Buildings and improvements	124.0	114.6	9.4
Equipment	9.7	8.2	1.5
Roadway network	267.5	260.5	7.0
Recreation and open space network	21.8	18.5	3.3
Less accumulated depreciation	(183.7)	(174.0)	(9.7)
<i>Internal Service Fund Assets</i>			
Construction in progress	0.2	0.6	(0.4)
Equipment	51.7	51.3	0.4
Less accumulated depreciation	(31.8)	(29.6)	(2.2)
Total Governmental	\$ 393.4	\$ 376.0	\$ 17.4
Business-type Activities			
Land	\$ 5.0	\$ 5.0	\$ -
Construction in progress	132.4	111.8	20.6
Buildings and improvements	31.9	30.9	1.0
Transmission, distribution and treatment systems	545.6	536.6	9.0
Less accumulated depreciation	(249.2)	(234.0)	(15.2)
Total Business-type	\$ 465.7	\$ 450.3	\$ 15.4

Governmental Activities' capital assets net of depreciation increased by \$17.4 million over FY 2010. This increase was primarily due to capitalizations for improvements to the City's roadway network and sidewalks, Parks and Open Space facility improvements, the College Terrace Library seismic upgrade, and City-purchased easements.



Management's Discussion and Analysis

Business-type Activities' capital assets net of depreciation increased by \$15.4 million over FY 2010. The increased amounts are primarily driven by construction in progress of \$8 million in Water, \$7.5 million in Electric, and \$3.6 million in Wastewater Treatment.

In early 2010, the Palo Alto City Council established an Infrastructure Blue Ribbon Commission (IBRC) to review the City's General Fund infrastructure needs and to recommend resources to fill any funding gaps identified. Their work builds upon two prior consultant studies that have helped the City address backlogged and other necessary work. The Commission's findings and recommendations will be delivered to the City Council in December 2011.

Major capital projects that are currently in progress, and the remaining capital commitment of each, are as follows:

- Mitchell Park Library and Community Center - \$35.6 million
- Main Library - \$17.3 million
- Art Center electrical and mechanical upgrades - \$7.2 million
- Civic Center infrastructure improvements - \$2.6 million

The City depreciates 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 Note 7 to the financial statements. Effective for FY 2011, bond issuance costs have been reclassified to noncurrent assets, rather than netted with long-term debt. FY 2010 has also been reclassified in the following table. At June 30, 2011, the City's debt was comprised of the following:

LONG-TERM DEBT AT JUNE 30 (in Millions)

	<u>2011</u>	<u>2010</u>	<u>Increase/ (Decrease)</u>
Governmental Activities Debt:			
General Long-Term Obligations:			
1998 Golf Course Certificates of Participation	\$ 3.7	\$ 4.1	\$ (0.4)
2002A Civic Center Refinancing Certificates of Participation	0.4	0.8	(0.4)
2002B Downtown Parking Improvements Certificates of Participation	1.8	1.9	(0.1)
General Obligation Bonds			
2010 Series A	55.3	55.3	0.0
Add: unamortized premium	3.6	3.8	(0.2)
Total Governmental Activities Debt	\$ 64.8	\$ 65.9	\$ (1.1)
Business-type Activities Debt:			
Enterprise Long-Term Obligations:			
Utility Revenue Bonds			
1995 Series A	\$ 4.6	\$ 5.0	\$ (0.4)
1999 Refunding	12.7	13.2	(0.5)
2002 Series A	18.1	18.9	(0.8)
2009 Series A	34.2	35.0	(0.8)
Less: unamortized premium (discount)	(0.2)	(0.2)	0.0
Energy Tax Credit Bonds			
2007 Series A	1.1	1.2	(0.1)
State Water Resources Loan			
2007	8.1	8.6	(0.5)
2009	8.6	4.5	4.1
Less: unamortized premium (discount)	(0.1)	(0.1)	0.0
Total Business-type Activities Debt	\$ 87.1	\$ 86.1	\$ 1.0



Management's Discussion and Analysis

On June 30, 2010, the City issued \$55.3 million in General Obligation Bonds to finance costs for construction of the new Mitchell Park Library and Community Center and to make substantial capital improvements to the Main and Downtown Libraries. The pledge of future net revenues ends upon repayment of the remaining debt service on the bonds and is scheduled to occur in 2040.

As stated in the Statistical Section of the CAFR, the combined direct debt ratio to assessed valuation for the General Fund is a low 0.28 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. As of June 30, 2011, the City had no special assessment district debt with City commitment outstanding.

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, 4th Floor, Palo Alto, California. This report and other financial reports can be viewed on the City of Palo Alto website at: www.cityofpaloalto.org. On the home page, select City Departments, select Administrative Services, and select Financial Reporting. Within Financial Reporting, there are links to reports by title and reporting date or use the following link: www.cityofpaloalto.org/depts/asd/financial_reporting/asp

GOVERNMENT-WIDE 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*.

CITY OF PALO ALTO

Statement of Net Assets

June 30, 2011

(Amounts in Thousands)

	Governmental Activities	Business-Type Activities	Total
Assets:			
Cash and investments available for operations (Note 3)	\$ 148,452	\$ 237,409	\$ 385,861
Receivables, net:			
Accounts and intergovernmental	8,234	30,332	38,566
Interest receivable	1,188	1,863	3,051
Notes and loans receivable (Note 5)	10,809	-	10,809
Internal balances (Note 4)	(1,727)	1,727	-
Net OPEB asset (Note 12)	23,006	-	23,006
Due from other government agencies	-	4,500	4,500
Inventory of materials and supplies and prepaids	5,413	9	5,422
Deferred charges	552	2,342	2,894
Restricted cash and investments with fiscal agents (Note 3)	42,187	30,970	73,157
Restricted cash for post-closure landfill (Note 3)	-	5,599	5,599
Capital assets (Note 6):			
Nondepreciable	134,183	137,408	271,591
Depreciable, net of accumulated depreciation	259,221	328,316	587,537
Total assets	<u>631,518</u>	<u>780,475</u>	<u>1,411,993</u>
Liabilities:			
Accounts payable and accrued liabilities	14,678	10,089	24,767
Accrued salaries and benefits	2,436	1,126	3,562
Unearned revenue	369	1,213	1,582
Accrued compensated absences (Note 1):			
Due in one year	3,100	-	3,100
Due in more than one year	6,286	-	6,286
Claims payable (Note 14):			
Due in one year	5,873	-	5,873
Due in more than one year	18,030	-	18,030
Accrued landfill closure liability and post-closure care (Note 9):			
Due in more than one year	-	10,771	10,771
Long-term debt (Note 7):			
Due in one year	1,796	3,548	5,344
Due in more than one year	63,044	83,570	146,614
Total liabilities	<u>115,612</u>	<u>110,317</u>	<u>225,929</u>
Net Assets (Note 10):			
Invested in capital assets, net of related debt	364,747	416,418	781,165
Restricted for:			
Special revenue programs	10,825	-	10,825
Capital projects	2,150	-	2,150
Debt service	2,040	-	2,040
Eyerly Family	1,422	-	1,422
Total restricted net assets	<u>16,437</u>	<u>-</u>	<u>16,437</u>
Unrestricted	<u>134,722</u>	<u>253,740</u>	<u>388,462</u>
Total net assets	<u>\$ 515,906</u>	<u>\$ 670,158</u>	<u>\$ 1,186,064</u>

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Statement of Activities
For the Year Ended June 30, 2011
(Amounts in Thousands)

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		Total
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-Type Activities	
Governmental Activities:							
City Council	\$ 15	\$ -	\$ -	\$ -	\$ (15)	\$ -	\$ (15)
City Manager	1,842	-	-	-	(1,842)	-	(1,842)
City Attorney	953	-	-	-	(953)	-	(953)
City Clerk	803	-	-	-	(803)	-	(803)
City Auditor	138	-	-	-	(138)	-	(138)
Administrative Services	9,888	2,889	32	619	(6,348)	-	(6,348)
Human Resources	1,346	-	-	-	(1,346)	-	(1,346)
Public Works	19,357	2,419	774	1,277	(14,887)	-	(14,887)
Planning and Community Environment	15,031	7,237	1,907	7	(5,880)	-	(5,880)
Police	30,465	3,237	100	-	(27,128)	-	(27,128)
Fire	28,531	12,037	-	-	(16,494)	-	(16,494)
Community Services	22,845	7,724	11	-	(15,110)	-	(15,110)
Library	6,920	480	60	-	(6,380)	-	(6,380)
Interest on long-term debt	2,742	-	-	-	(2,742)	-	(2,742)
Total Governmental Activities	140,876	36,023	2,884	1,903	(100,066)	-	(100,066)
Business-Type Activities:							
Water	24,268	26,624	610	864	-	3,830	3,830
Electric	100,130	122,109	-	-	-	21,979	21,979
Fiber Optics	1,561	3,322	-	-	-	1,761	1,761
Gas	32,051	43,584	-	-	-	11,533	11,533
Wastewater Collection	12,275	15,094	-	507	-	3,326	3,326
Wastewater Treatment	19,731	18,830	-	1,633	-	732	732
Refuse	30,684	30,469	-	-	-	(215)	(215)
Storm Drainage	3,229	5,796	-	-	-	2,567	2,567
Airport	31	-	-	-	-	(31)	(31)
Total Business-Type Activities	223,960	265,828	610	3,004	-	45,482	45,482
Total	\$ 364,836	\$ 301,851	\$ 3,494	\$ 4,907	(100,066)	45,482	(54,584)
General revenues:							
Taxes:							
Property taxes					29,156	-	29,156
Sales taxes					20,746	-	20,746
Utility user tax					10,851	-	10,851
Transient occupancy tax					8,082	-	8,082
Transfer and other taxes					8,156	-	8,156
Investment earnings					3,500	5,722	9,222
Miscellaneous					12,377	-	12,377
Transfers (Note 4)					17,083	(17,083)	-
Total general revenues and transfers					109,951	(11,361)	98,590
Change in net assets					9,885	34,121	44,006
Net assets, beginning of year					506,021	636,037	1,142,058
Net assets, end of year					\$ 515,906	\$ 670,158	\$1,186,064

See accompanying notes to basic financial statements.

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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 2011. 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.

CITY OF PALO ALTO
Governmental Funds
Balance Sheet
June 30, 2011
(Amounts in Thousands)

	General Fund	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
Assets:				
Cash and investments available for operations (Note 3)	\$ 37,150	\$ 27,382	\$ 23,182	\$ 87,714
Receivables, net:				
Accounts and intergovernmental	7,682	272	220	8,174
Interest receivable	546	138	143	827
Notes and loans receivable (Note 5)	985	-	9,824	10,809
Prepaid items	1,213	-	-	1,213
Advance to other fund (Note 4)	300	-	-	300
Inventory of materials and supplies	3,587	-	-	3,587
Restricted cash and investments with fiscal agents (Note 3)	-	40,962	1,225	42,187
Total assets	\$ 51,463	\$ 68,754	\$ 34,594	\$ 154,811
Liabilities and Fund Balances:				
Liabilities:				
Accounts payable and accrued liabilities	\$ 4,693	\$ 6,013	\$ 298	\$ 11,004
Accrued salaries and benefits	2,222	76	4	2,302
Deferred revenue	369	-	-	369
Total liabilities	7,284	6,089	302	13,675
Fund balances (Note 10):				
Nonspendable:				
Notes and loans receivable	985	-	-	985
Prepaid items	1,213	-	-	1,213
Inventories	3,587	-	-	3,587
Advance to other fund	300	-	-	300
Eyerly family	-	-	1,422	1,422
Restricted for:				
Transportation mitigation	-	-	4,344	4,344
Federal revenue	-	-	4,619	4,619
Street improvement	-	-	1,598	1,598
Local law enforcement	-	-	264	264
Library bond project	-	35,961	-	35,961
Improvement to parking garage	-	595	-	595
Debt service	-	-	3,265	3,265
Committed to:				
Capital projects	-	6,693	-	6,693
Developer's impact fees	-	-	5,287	5,287
Housing in-lieu	-	-	11,662	11,662
Special districts	-	-	1,075	1,075
Downtown business	-	-	58	58
Assigned to:				
Unrealized gains on investments	2,830	-	696	3,526
Infrastructure	-	3,199	-	3,199
Capital projects	-	16,217	-	16,217
Other general government purposes	3,405	-	2	3,407
Unassigned to:				
Budget Stabilization	31,376	-	-	31,376
Reappropriations	483	-	-	483
Total fund balances	44,179	62,665	34,292	141,136
Total liabilities and fund balances	\$ 51,463	\$ 68,754	\$ 34,594	\$ 154,811

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
 Reconciliation of the Balance Sheet of Governmental Funds to
 the Statement of Net Assets - Governmental Activities
 June 30, 2011
 (Amounts in Thousands)

Total fund balances reported on the governmental funds balance sheet	\$ 141,136
<p>Amounts reported for governmental activities in the statement of net assets are different from those reported in the governmental funds above because of the following:</p>	
Costs of issuance related to the bonds are capitalized and amortized over the life of the bonds in the government-wide financial statements	552
Capital assets used in governmental activities are not current assets or financial resources and therefore are not reported in the governmental funds (Note 6)	393,404
Internal service funds are used by management to charge the costs of activities such as insurance, equipment acquisition and maintenance, and certain employees' benefits to individual funds. The assets and liabilities of the internal service funds are therefore included in governmental activities in the statement of net assets (excludes capital assets reported above)	46,805
Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the governmental funds:	
Interest payable	(1,151)
Long-term debt (Note 7)	<u>(64,840)</u>
Net assets of governmental activities	<u><u>\$ 515,906</u></u>

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Governmental Funds
Statement of Revenues, Expenditures and Changes in Fund Balances
For the Year Ended June 30, 2011
(Amounts in Thousands)

	General Fund	Capital Projects Fund	Other Governmental Funds	Total
Revenues:				
Property taxes	\$ 25,688	\$ -	\$ 3,468	\$ 29,156
Special assessments	-	-	92	92
Sales taxes	20,746	-	-	20,746
Utility users tax	10,851	-	-	10,851
Transient occupancy tax	8,082	-	-	8,082
Other taxes and fines	7,296	-	1,661	8,957
Charges for services	22,311	-	-	22,311
From other agencies	397	778	439	1,614
Permits and licenses	5,074	-	359	5,433
Investment earnings	565	1,184	521	2,270
Rental income	14,264	-	19	14,283
Other revenue	2,020	1,986	4,618	8,624
Total revenues	117,294	3,948	11,177	132,419
Expenditures:				
Current:				
City Council	18	-	-	18
City Manager	1,867	-	-	1,867
City Attorney	934	-	-	934
City Clerk	796	-	-	796
City Auditor	131	-	-	131
Administrative Services	3,285	-	-	3,285
Human Resources	1,320	-	-	1,320
Public Works	11,317	-	-	11,317
Planning and Community Environment	9,368	-	941	10,309
Police	30,497	-	22	30,519
Fire	28,355	-	-	28,355
Community Services	20,029	-	-	20,029
Library	6,509	-	-	6,509
Non-Departmental	7,078	-	274	7,352
Capital outlay	-	35,486	-	35,486
Debt service:				
Principal	-	-	870	870
Interest and fiscal charges	-	-	1,815	1,815
Total expenditures	121,504	35,486	3,922	160,912
Excess (deficiency) of revenues over (under) expenditures	(4,210)	(31,538)	7,255	(28,493)
Other financing sources (uses):				
Other	-	(101)	-	(101)
Transfers in (Note 4)	17,932	11,202	1,189	30,323
Transfers out (Note 4)	(11,000)	(747)	(2,605)	(14,352)
Total other financing sources (uses)	6,932	10,354	(1,416)	15,870
Change in fund balances	2,722	(21,184)	5,839	(12,623)
Fund balances, beginning of year	41,457	83,849	28,453	153,759
Fund balances, end of year	\$ 44,179	\$ 62,665	\$ 34,292	\$ 141,136

See accompanying notes to basic 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 - Governmental Activities
For the Year Ended June 30, 2011
(Amounts in Thousands)

Net change in fund balances - total governmental funds \$ (12,623)

Amounts reported for governmental activities in the statement of activities are different from those reported in the governmental funds above because of the following:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the costs of these assets are capitalized and allocated over their estimated useful lives and reported as depreciation expense. Therefore, the activities associated with capital assets are as follows:

Capital outlay added back to fund balance for current year additions	36,564
Depreciation expense is deducted from fund balance (depreciation expense is net of internal service fund depreciation of \$4,695 (Note 6), which has already been allocated through the internal service fund activities below	(9,708)
Disposal and impairment of capital assets	(7,232)

Principal payments on long-term liabilities are reported as expenditures in governmental funds when paid. The governmental activities, however, report principal payments as a reduction of long-term debt on the statement of net assets. Interest accrued on long-term debt and amortization of bond issuance costs and premiums do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. Therefore, the activities associated with long-term debt are as follows:

Principal paid during the year	870
Change in interest payable	(1,034)
Amortization of deferred costs of issuance	(19)
Amortization of bond premium	126

Internal service funds are used by management to charge the costs of activities, such as insurance, equipment acquisition and maintenance, and employees' benefits to individual funds. The portion of the net revenue (expense) of these internal service funds arising out of their transactions with governmental funds is reported with governmental activities.

	<u>2,941</u>
Change in net assets of governmental activities	<u>\$ 9,885</u>

CITY OF PALO ALTO
General Fund
Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
For the Year Ended June 30, 2011
(Amounts in Thousands)

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
Sales taxes	\$ 18,218	\$ 19,507	\$ 20,746	\$ 1,239
Property taxes	25,907	25,323	25,688	365
Transient occupancy tax	7,021	7,400	8,082	682
Utility users tax	11,429	10,824	10,851	27
Other taxes, fines and penalties	5,943	6,139	7,296	1,157
Charges for services	20,008	20,924	22,390	1,466
Permits and licenses	4,593	5,102	5,058	(44)
Return on investments	1,646	1,337	565	(772)
Rental income	13,716	13,776	14,264	488
From other agencies	155	221	295	74
Charges to other funds	10,622	10,681	11,211	530
Other revenues	1,490	1,584	2,117	533
Prior year encumbrances and reappropriations	-	3,963	3,963	-
Total revenues	120,748	126,781	132,526	5,745
Charges for appropriations (outflows):				
Current:				
City Attorney	2,369	2,812	2,808	4
City Auditor	982	1,081	1,081	-
City Clerk	1,093	1,270	1,257	13
City Council	142	193	192	1
City Manager	2,178	2,455	2,456	(1)
Administrative Services	6,293	6,456	6,446	10
Community Services	20,032	20,530	20,518	12
Fire	27,007	29,014	29,012	2
Human Resources	2,817	2,677	2,666	11
Library	6,609	6,733	6,722	11
Planning and Community Environment	9,320	10,427	10,416	11
Police	30,579	31,288	31,286	2
Public Works	13,084	13,846	13,842	4
Non-Departmental	5,970	6,899	7,958	(1,059)
Total expenditures	128,475	135,681	136,660	(979)
(Deficiency) of revenues over (under) expenditures	(7,727)	(8,900)	(4,134)	4,766
Other financing sources (uses):				
Transfers in	18,684	18,677	17,932	(745)
Transfers out	(10,924)	(11,224)	(11,000)	224
Total other financing sources (uses)	7,760	7,453	6,932	(521)
Excess (deficiency) of revenues over (under) expenditures, budgetary basis	\$ 33	\$ (1,447)	2,798	\$ 4,245
Adjustment to Budgetary Basis:				
Current year encumbrances/reappropriations			3,887	
Prior year encumbrances/reappropriations			(3,963)	
Excess of revenues over expenditures, GAAP basis			2,722	
Fund balance at beginning of year, GAAP basis			41,457	
Fund balance at ending of year, GAAP basis			\$ 44,179	

See accompanying notes to basic financial statements.

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 2011.

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.

Fiber Optics Fund

This fund accounts for all financial transactions relating to the City's Fiber Optics service. Services are on a user charge basis to licensees 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.

Airport Fund

This fund was established to account for financial transactions relating to the Palo Alto Airport. The City will be taking over operation of the airport from Santa Clara County no later than 2017.

CITY OF PALO ALTO
Proprietary Funds
Statement of Fund Net Assets
June 30, 2011
(Amounts in Thousands)

	Business-Type Activities-Enterprise Funds			
	Water	Electric	Fiber Optics	Gas
Assets:				
Current assets:				
Cash and investments available for operations (Note 3)	\$ 24,365	\$ 129,137	\$ 11,392	\$ 32,544
Accounts receivable, net	3,507	15,572	534	2,997
Interest receivable	296	941	78	224
Due from other government agencies	-	-	-	-
Inventory of materials and supplies	-	-	-	-
Net OPEB asset (Note 12)	-	-	-	-
Restricted cash and investments with fiscal agents (Note 3)	29,991	-	-	978
Restricted cash for landfill closure (Note 3)	-	-	-	-
Total current assets	<u>58,159</u>	<u>145,650</u>	<u>12,004</u>	<u>36,743</u>
Noncurrent assets:				
Due from other government agencies	-	-	-	-
Deferred bond issuance costs	612	53	-	167
Deposit	-	9	-	-
Capital assets (Note 6):				
Nondepreciable	27,663	39,498	1,049	22,937
Depreciable, net	<u>51,616</u>	<u>123,189</u>	<u>5,891</u>	<u>57,351</u>
Total noncurrent assets	<u>79,891</u>	<u>162,749</u>	<u>6,940</u>	<u>80,455</u>
Total assets	<u>138,050</u>	<u>308,399</u>	<u>18,944</u>	<u>117,198</u>
Liabilities:				
Current liabilities:				
Accounts payable and accrued liabilities	2,504	2,659	40	1,235
Accrued salaries and benefits	151	347	25	168
Unearned revenue	-	-	-	-
Accrued compensated absences (Note 1)	-	-	-	-
Current portion of revenue bonds (Note 7)	1,277	100	-	479
Accrued claims payable (Note 14)	-	-	-	-
Total current liabilities	<u>3,932</u>	<u>3,106</u>	<u>65</u>	<u>1,882</u>
Noncurrent liabilities:				
Accrued compensated absences (Note 1)	-	-	-	-
Accrued claims payable (Note 14)	-	-	-	-
Advance from other fund (Note 4)	-	-	-	-
Landfill closure and post-closure care (Note 9)	-	-	-	-
Utility revenue bonds, net of unamortized discounts/premiums (Note 7)	<u>41,895</u>	<u>941</u>	<u>-</u>	<u>9,464</u>
Total noncurrent liabilities	<u>41,895</u>	<u>941</u>	<u>-</u>	<u>9,464</u>
Total liabilities	<u>45,827</u>	<u>4,047</u>	<u>65</u>	<u>11,346</u>
Net assets:				
Invested in capital assets, net of related debt	66,710	161,699	6,940	71,490
Unrestricted (deficit)	<u>25,513</u>	<u>142,653</u>	<u>11,939</u>	<u>34,362</u>
Total net assets	<u>\$ 92,223</u>	<u>\$ 304,352</u>	<u>\$ 18,879</u>	<u>\$ 105,852</u>

Some amounts reported for Business-Type Activities in the statement of net assets are different because certain Internal Service Fund assets and liabilities are included with Business-Type Activities

Net assets reported in Business-Type Activities

See accompanying notes to basic financial statements.

Business-Type Activities-Enterprise Funds						Governmental Activities - Internal Service Funds
Wastewater Collection	Wastewater Treatment	Refuse	Storm Drainage	Airport	Totals	
\$ 15,774	\$ 14,974	\$ 3,009	\$ 5,936	\$ 278	\$ 237,409	\$ 60,738
1,683	2,244	3,209	586	-	30,332	60
113	106	64	40	1	1,863	361
-	250	-	-	-	250	-
-	-	-	-	-	-	613
-	-	-	-	-	-	23,006
-	-	-	1	-	30,970	-
-	-	5,599	-	-	5,599	-
<u>17,570</u>	<u>17,574</u>	<u>11,881</u>	<u>6,563</u>	<u>279</u>	<u>306,423</u>	<u>84,778</u>
-	4,250	-	-	-	4,250	-
22	1,340	-	148	-	2,342	-
-	-	-	-	-	9	-
22,840	18,229	2,734	2,458	-	137,408	151
<u>44,779</u>	<u>21,372</u>	<u>416</u>	<u>23,702</u>	<u>-</u>	<u>328,316</u>	<u>19,935</u>
<u>67,641</u>	<u>45,191</u>	<u>3,150</u>	<u>26,308</u>	<u>-</u>	<u>472,325</u>	<u>20,086</u>
<u>85,211</u>	<u>62,765</u>	<u>15,031</u>	<u>32,871</u>	<u>279</u>	<u>778,748</u>	<u>104,864</u>
331	1,289	1,736	290	5	10,089	2,523
92	207	103	32	1	1,126	134
-	-	-	1,213	-	1,213	-
-	-	-	-	-	-	3,100
68	1,169	-	455	-	3,548	-
-	-	-	-	-	-	5,873
<u>491</u>	<u>2,665</u>	<u>1,839</u>	<u>1,990</u>	<u>6</u>	<u>15,976</u>	<u>11,630</u>
-	-	-	-	-	-	6,286
-	-	-	-	-	-	18,030
-	-	-	-	300	300	-
-	-	10,771	-	-	10,771	-
<u>1,122</u>	<u>22,143</u>	<u>-</u>	<u>8,005</u>	<u>-</u>	<u>83,570</u>	<u>-</u>
<u>1,122</u>	<u>22,143</u>	<u>10,771</u>	<u>8,005</u>	<u>300</u>	<u>94,641</u>	<u>24,316</u>
<u>1,613</u>	<u>24,808</u>	<u>12,610</u>	<u>9,995</u>	<u>306</u>	<u>110,617</u>	<u>35,946</u>
66,451	22,129	3,150	17,849	-	416,418	20,086
<u>17,147</u>	<u>15,828</u>	<u>(729)</u>	<u>5,027</u>	<u>(27)</u>	<u>251,713</u>	<u>48,832</u>
<u>\$ 83,598</u>	<u>\$ 37,957</u>	<u>\$ 2,421</u>	<u>\$ 22,876</u>	<u>\$ (27)</u>	<u>668,131</u>	<u>\$ 68,918</u>
					<u>2,027</u>	
					<u>\$ 670,158</u>	

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Proprietary Funds
Statement of Revenues, Expenses and Changes in Fund Net Assets
For the Year Ended June 30, 2011
(Amounts in Thousands)

	<u>Business-Type Activities-Enterprise Funds</u>			
	<u>Water</u>	<u>Electric</u>	<u>Fiber Optics</u>	<u>Gas</u>
Operating revenues:				
Sales of utilities:				
Customers	\$ 24,719	\$ 107,892	\$ -	\$ 41,724
City departments	1,313	3,253	733	1,135
Surplus energy	-	3,680	-	-
Service connection charges and miscellaneous	282	1,329	-	516
Charges for services	-	-	-	-
Other	310	5,955	2,589	209
Total operating revenues	<u>26,624</u>	<u>122,109</u>	<u>3,322</u>	<u>43,584</u>
Operating expenses:				
Purchase of utilities:				
Retail	10,678	56,368	-	21,464
Surplus energy	-	4,879	-	-
Administrative and general	3,268	4,673	516	3,039
Engineering (operating)	247	1,200	-	280
Resource management and energy efficiency	576	5,868	-	1,602
Operations and maintenance	4,885	9,340	770	3,297
Rent	2,122	3,588	14	230
Depreciation and amortization	1,422	7,341	267	1,848
Claims payments and changes in estimated self-insurance liability	-	-	-	-
Refund of charges for services	-	-	-	-
Compensated absences and other benefits	-	-	-	-
Total operating expenses	<u>23,198</u>	<u>93,257</u>	<u>1,567</u>	<u>31,760</u>
Operating income (loss)	3,426	28,852	1,755	11,824
Nonoperating revenues (expenses):				
Return on investments	181	3,205	323	821
Interest expense	(1,011)	(7,247)	-	(488)
Gain (loss) on disposal of capital assets	(248)	(49)	-	(46)
Other nonoperating revenues	610	-	-	-
Total nonoperating revenues (expenses)	<u>(468)</u>	<u>(4,091)</u>	<u>323</u>	<u>287</u>
Income (loss) before transfers and capital contributions	2,958	24,761	2,078	12,111
Capital contributions	864	-	-	-
Transfers in	123	550	-	35
Transfers out	(449)	(12,206)	(9)	(5,925)
Change in net assets	3,496	13,105	2,069	6,221
Net assets, beginning of year	<u>88,727</u>	<u>291,247</u>	<u>16,810</u>	<u>99,631</u>
Net assets, end of year	<u>\$ 92,223</u>	<u>\$ 304,352</u>	<u>\$ 18,879</u>	<u>\$ 105,852</u>

Some amounts reported for Business-Type Activities in the statement of activities are different because certain Internal Service Fund activities are included with Business-Type Activities

Change in net assets reported in Business-Type Activities

See accompanying notes to basic financial statements.

Business-Type Activities-Enterprise Funds						Governmental Activities- Internal Service Funds
Wastewater Collection	Wastewater Treatment	Refuse	Storm Drainage	Airport	Totals	
\$ 14,159	\$ 11,104	\$ 25,137	\$ 5,383	\$ -	230,118	\$ -
128	7,468	1,232	357	-	15,619	-
-	-	-	-	-	3,680	-
575	-	-	-	-	2,702	-
-	-	-	-	-	-	72,001
232	258	4,100	56	-	13,709	-
<u>15,094</u>	<u>18,830</u>	<u>30,469</u>	<u>5,796</u>	<u>-</u>	<u>265,828</u>	<u>72,001</u>
7,414	-	12,529	-	-	108,453	-
-	-	-	-	-	4,879	-
943	-	1,622	348	31	14,440	8,174
195	2,167	413	345	-	4,847	-
-	-	-	231	-	8,277	-
2,227	14,515	10,824	885	-	46,743	8,299
115	-	4,289	-	-	10,358	-
1,457	2,195	657	857	-	16,044	4,695
-	-	-	-	-	-	6,772
-	-	-	-	-	-	114
-	-	-	-	-	-	42,387
<u>12,351</u>	<u>18,877</u>	<u>30,334</u>	<u>2,666</u>	<u>31</u>	<u>214,041</u>	<u>70,441</u>
2,743	(47)	135	3,130	(31)	51,787	1,560
454	471	99	164	4	5,722	1,200
(90)	(632)	(606)	(542)	-	(10,616)	-
-	-	-	(35)	-	(378)	85
-	-	-	-	-	610	59
<u>364</u>	<u>(161)</u>	<u>(507)</u>	<u>(413)</u>	<u>4</u>	<u>(4,662)</u>	<u>1,344</u>
3,107	(208)	(372)	2,717	(27)	47,125	2,904
507	1,633	-	-	-	3,004	-
75	-	1,036	325	-	2,144	1,703
(271)	(9)	(326)	(32)	-	(19,227)	(591)
<u>3,418</u>	<u>1,416</u>	<u>338</u>	<u>3,010</u>	<u>(27)</u>	<u>33,046</u>	<u>4,016</u>
<u>80,180</u>	<u>36,541</u>	<u>2,083</u>	<u>19,866</u>	<u>-</u>		<u>64,902</u>
<u>\$ 83,598</u>	<u>\$ 37,957</u>	<u>\$ 2,421</u>	<u>\$ 22,876</u>	<u>\$ (27)</u>		<u>\$ 68,918</u>
					<u>1,075</u>	
					<u>\$ 34,121</u>	

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Proprietary Funds
Statement of Cash Flows
For the Year Ended June 30, 2011
(Amounts in Thousands)

	<u>Business-Type Activities-Enterprise Funds</u>			
	<u>Water</u>	<u>Electric</u>	<u>Fiber Optics</u>	<u>Gas</u>
Cash flows from operating activities:				
Cash received from customers	\$ 25,104	\$ 112,652	\$ (21)	\$ 42,302
Cash refunds to customers	-	-	-	-
Cash payments to suppliers for goods and services	(19,230)	(84,649)	(762)	(27,212)
Cash payments to employees	(3,237)	(4,618)	(510)	(2,993)
Internal activity- receipts (payment) from (to) other funds	1,313	3,253	733	1,135
Other receipts	310	5,955	2,589	209
Net cash provided by (used in) operating activities	<u>4,260</u>	<u>32,593</u>	<u>2,029</u>	<u>13,441</u>
Cash flows from noncapital financing activities:				
Receipt (disbursement) of loans from (to) other funds	-	-	-	-
Transfers in	123	550	-	35
Transfers out	(449)	(12,206)	(9)	(5,925)
Cash flows used in noncapital financing activities	<u>(326)</u>	<u>(11,656)</u>	<u>(9)</u>	<u>(5,890)</u>
Cash flows from capital and related financing activities:				
Acquisition and construction of capital assets	(8,328)	(11,137)	(587)	(2,936)
Capital grants and contributions	864	-	-	-
Interest subsidy received from Build America Bond	610	-	-	-
Proceeds from debt issuance	-	-	-	-
Principal paid on long-term debt	(1,200)	(100)	-	(459)
Interest paid on long-term debt	(1,029)	(7,236)	-	(478)
Cash flows used in capital and related financing activities	<u>(9,083)</u>	<u>(18,473)</u>	<u>(587)</u>	<u>(3,873)</u>
Cash flows from investing activities:				
Interest received	274	3,327	323	839
Net change in cash and cash equivalents	<u>(4,875)</u>	<u>5,791</u>	<u>1,756</u>	<u>4,517</u>
Cash and cash equivalents, beginning of year	<u>59,231</u>	<u>123,346</u>	<u>9,636</u>	<u>29,005</u>
Cash and cash equivalents, end of year	<u>\$ 54,356</u>	<u>\$ 129,137</u>	<u>\$ 11,392</u>	<u>\$ 33,522</u>
Financial statement presentation:				
Cash and investments from operations	\$ 24,365	\$ 129,137	\$ 11,392	\$ 32,544
Cash and investments with fiscal agent	29,991	-	-	978
Cash and cash equivalents, end of year	<u>\$ 54,356</u>	<u>\$ 129,137</u>	<u>\$ 11,392</u>	<u>\$ 33,522</u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:				
Operating income (loss)	\$ 3,426	\$ 28,852	\$ 1,755	\$ 11,824
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:				
Depreciation and amortization	1,422	7,341	267	1,848
Other	-	-	-	-
Change in assets and liabilities:				
Accounts receivable	103	(249)	(21)	62
Inventory of materials and supplies	-	-	-	-
Deposits	-	(9)	-	-
Net OPEB asset	-	-	-	-
Accounts payable and accrued liabilities	(722)	(3,397)	22	(339)
Accrued salaries and benefits	31	55	6	46
Accrued compensated absences	-	-	-	-
Unearned revenue	-	-	-	-
Landfill closure and post-closure care	-	-	-	-
Accrued claims payable and other liabilities	-	-	-	-
Net cash provided by (used in) operating activities	<u>\$ 4,260</u>	<u>\$ 32,593</u>	<u>\$ 2,029</u>	<u>\$ 13,441</u>

See accompanying notes to basic financial statements.

Business-Type Activities-Enterprise Funds						Governmental Activities- Internal Service Funds
Wastewater Collection	Wastewater Treatment	Refuse	Storm Drainage	Airport	Totals	
\$ 14,810	\$ 10,080	\$ 25,170	\$ 5,128	\$ -	\$ 235,225	\$ 71,979
-	-	-	-	-	-	(114)
(9,782)	(18,522)	(27,893)	(1,672)	5	(189,717)	(8,523)
(925)	30	(1,606)	(344)	(30)	(14,233)	(51,688)
128	7,468	1,232	357	-	15,619	(4,347)
232	258	3,748	56	-	13,357	59
<u>4,463</u>	<u>(686)</u>	<u>651</u>	<u>3,525</u>	<u>(25)</u>	<u>60,251</u>	<u>7,366</u>
-	-	-	(550)	300	(250)	-
75	-	1,036	325	-	2,144	1,703
(271)	(9)	(326)	(32)	-	(19,227)	(591)
<u>(196)</u>	<u>(9)</u>	<u>710</u>	<u>(257)</u>	<u>300</u>	<u>(17,333)</u>	<u>1,112</u>
(4,226)	(3,220)	(284)	(1,170)	-	(31,888)	(2,351)
507	1,906	-	-	-	3,277	-
-	-	-	-	-	610	-
-	3,970	-	-	-	3,970	-
(64)	(850)	-	(430)	-	(3,103)	-
(89)	(405)	(606)	(511)	-	(10,354)	-
<u>(3,872)</u>	<u>1,401</u>	<u>(890)</u>	<u>(2,111)</u>	<u>-</u>	<u>(37,488)</u>	<u>(2,351)</u>
459	475	113	163	3	5,976	1,241
854	1,181	584	1,320	278	11,406	7,368
14,920	13,793	8,024	4,617	-	262,572	53,370
<u>\$ 15,774</u>	<u>\$ 14,974</u>	<u>\$ 8,608</u>	<u>\$ 5,937</u>	<u>\$ 278</u>	<u>\$ 273,978</u>	<u>\$ 60,738</u>
\$ 15,774	\$ 14,974	\$ 3,009	\$ 5,936	\$ 278	\$ 237,409	\$ 60,738
-	-	5,599	1	-	36,569	-
<u>\$ 15,774</u>	<u>\$ 14,974</u>	<u>\$ 8,608</u>	<u>\$ 5,937</u>	<u>\$ 278</u>	<u>\$ 273,978</u>	<u>\$ 60,738</u>
\$ 2,743	\$ (47)	\$ 135	\$ 3,130	\$ (31)	\$ 51,787	\$ 1,560
1,457	2,195	657	857	-	16,044	4,695
-	-	-	-	-	-	59
76	(1,024)	33	22	-	(998)	(22)
-	-	-	-	-	-	(156)
-	-	-	-	-	(9)	-
-	-	-	-	-	-	236
169	(1,840)	162	(211)	5	(6,151)	17
18	30	16	4	1	207	(415)
-	-	-	-	-	-	(1,033)
-	-	-	(277)	-	(277)	-
-	-	(352)	-	-	(352)	-
-	-	-	-	-	-	2,425
<u>\$ 4,463</u>	<u>\$ (686)</u>	<u>\$ 651</u>	<u>\$ 3,525</u>	<u>\$ (25)</u>	<u>\$ 60,251</u>	<u>\$ 7,366</u>

See accompanying notes to basic financial statements.

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FIDUCIARY FUNDS

Introduction

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

CITY OF PALO ALTO
Statement of Fiduciary Net Assets
June 30, 2011
(Amounts in Thousands)

	Agency Funds
Assets:	
Cash and investments available for operations (Note 3)	\$ 3,118
Restricted cash and investments with fiscal agents (Note 3)	3,906
Interest receivable	32
Total assets	\$ 7,056
 Liabilities:	
Due to bondholders	\$ 6,145
Due to other governments	911
Total liabilities	\$ 7,056

See accompanying notes to basic financial statements.

CITY OF PALO ALTO
Index to the Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

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

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CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Palo Alto (the City) 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, fiber optics, water, gas, wastewater, storm drain, refuse, golf course, planning and zoning, general administration services, library, open space and science, recreational and human services.

(a) 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 activities 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 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 (the Corporation) provides financing of public capital improvements for the City through the issuance of Certificates of Participation (COPs), a form of debt that allows investors to participate in a stream of future lease payments. Proceeds from the COPs are used to construct projects that are leased to the City. The lease payments are sufficient in timing and amount to meet the debt service requirements of the COPs. The Board of Directors of the Corporation is composed of the same members as the City Council. 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 (the 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. As of June 29, 2011, changes to the California Redevelopment Law have terminated the authority of redevelopment agencies to undertake new obligations to redevelop property. On September 12, 2011, the City filed Ordinance No. 5126 dissolving the operations of the Agency, as discussed in Note 17.

Financial statements for the Corporation and the Agency may be obtained from the City of Palo Alto, Administrative Services Department, 4th Floor, 250 Hamilton Avenue, Palo Alto, CA 94301.

(b) 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 Governmental Accounting Standards Board (GASB) is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the United States.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

These standards require that the financial statements described below be presented:

Government-Wide Statements: The statement of net assets and the statement of activities display information about the primary government 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. However, interfund goods and services transactions have not been eliminated in the consolidation process. 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 for goods and 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, enterprise and internal service 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 non-operating expenses.

(c) Major Funds

The City's major governmental and enterprise 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 5 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 on a qualitative basis.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 of 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 the City.

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 the City.

Fiber Optics Fund – This fund accounts for all financial transactions relating to the City’s fiber optics service. Services are on a user-charge basis to licensees located in the City.

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 in the City.

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

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 the City.

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 the City.

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 the City.

Airport Fund – This fund was established to account for financial transactions relating to the Palo Alto Airport. The City will be taking over operation of the airport from Santa Clara County no later than 2017.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The City also reports the following funds:

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.

Vehicle Replacement and Maintenance – This fund accounts for the maintenance and replacement of vehicles and equipment used by all City departments. The source of revenues is on reimbursement of fleet replacement and maintenance costs allocated to each department by usage of vehicle..

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 on reimbursement of costs for support provided to other departments.

Printing and Mailing Services – This fund accounts for central duplicating, printing and mailing services provided to all City departments. The source of revenue for this fund is from reimbursement of costs for services and supplies purchased by other departments.

General Benefits – This fund accounts for the administration of compensated absences and health benefits.

Workers’ Compensation Insurance Program – This fund accounts for the administration of the City’s self-insured workers’ compensation program.

General Liability Insurance Program – This fund accounts for the administration of the City’s self-insured general liability program.

Retiree Health Benefit – This fund accounts for the retiree health benefits.

Fiduciary Funds – These funds account for assets held by the City, an agent for assessment districts and members of the Cable Joint Powers Authority. These funds are custodial in nature and do not involve measurement of results of operations. The City maintains three agency funds. The financial activities of these funds are excluded from the government-wide financial statements, but are presented in separate fiduciary fund financial statements. Agency funds apply the accrual basis of accounting but do not have a measurement focus.

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

Cable Joint Powers Authority – This fund accounts for the activities of the cable television system on behalf of the members.

University Avenue Area Parking Assessment District – This 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
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) *Basis of Accounting*

The government-wide 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 revenues susceptible to accrual reported in the governmental funds to be available if the revenues are collected within ninety days after year-end, except for property taxes, which are collected within sixty days after year-end.

Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as *other financing sources*.

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 Standards Board (FASB) Statements and predecessor pronouncements issued before November 30, 1989, which do not conflict with GASB Statements, in both the government-wide financial statements for the governmental and business-type activities and the proprietary fund financial statements. The City has elected not to apply FASB pronouncements issued after November 30, 1989 to business-type activities and enterprise funds.

(e) *Cash and Cash Equivalents*

Restricted and unrestricted pooled cash and investments held in the City Treasury, and other unrestricted investments invested by the City Treasurer, are considered cash equivalents for purposes of the statement of cash flows because the City's cash management pool and funds invested by the City Treasurer possess the characteristics of demand deposit accounts. Other restricted and unrestricted investments with maturities of less than three months at the time of purchase are considered cash equivalents for purposes of the statement of cash flows.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Deposits and Investments

The City’s investments are carried at fair value, as required by GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. 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.

(g) 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 expenditures at the time inventory items are used, rather than purchased.

(h) Compensated Absences

The liability for compensated absences includes the vested portion of vacation, sick leave, and overtime compensation pay. The City’s liability for accrued compensated absences is recorded in the General Benefits 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 Fund. The fund is reimbursed through payroll charges to all other funds. Earned but unpaid vacation and overtime compensation pay are 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.

During the fiscal year ended June 30, 2011, changes to the compensated absences were as follows (in thousands):

Beginning balance	\$ 10,419
Additions	5,770
Payments	<u>(6,803)</u>
Ending balance	<u>\$ 9,386</u>
Current portion	<u>\$ 3,100</u>

(i) Property Tax

Santa Clara County (the 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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Property Tax (Continued)

The County assesses property values, levies bills and collects taxes as follows:

	<u>Secured</u>	<u>Unsecured</u>
Lien Dates	January 01	January 01
Levy Dates	October 01	July 01
Due Dates	50% on November 01 50% on February 01	Upon receipt of billing
Delinquent after	December 10 (for November) April 10 (for February)	August 31

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.

(j) Rounding

All amounts included in the basic financial statements and footnotes are presented to the nearest thousand in accordance with the City’s policy.

(k) Effects of New Pronouncements

During the year ended June 30, 2011, the City implemented the following GASB Statement:

In February 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The initial distinction in reporting fund balance information is identifying amounts that are considered *nonspendable*, such as fund balance associated with prepaid items. This Statement provides for additional classification as restricted, committed, assigned and unassigned based on the relative strength of the constraints that control how specific amounts can be spent. The details for the governmental fund balance classifications prescribed under this Statement are separately discussed in Note 10.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. This statement clarifies that when actuarially determined OPEB measures are reported by an agent multiple-employer OPEB plan and its participating employers, those measures should be determined as of a common date and at a minimum frequency to satisfy the agent multiple-employer OPEB plan’s financial reporting requirements. The City participates in the California Employers’ Retirees Benefit Trust (CERBT), an agent multiple-employer OPEB plan, which requires all participating employers to have the same actuarial valuation date. As a result, the City conducted its biennial valuation on June 30, rather than January 1, effective for 2011.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Effects of New Pronouncements (Continued)

The City is currently analyzing its accounting practices to determine the potential impact on the financial statements for the following GASB Statements:

In November 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. This Statement addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. Common examples of SCAs include long-term arrangements between a transferor (a government) and an operator (governmental or nongovernmental entity) in which the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public Asset in exchange for significant consideration, and the operator collects and is compensated by fees from third parties. Application of this Statement is effective for the City's fiscal year ending June 30, 2013.

In November 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*. GASB Statement No. 61 is designed to improve financial reporting for governmental entities by amending the requirements of GASB Statement No. 14, *The Financial Reporting Entity*, and GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet the needs of users and address reporting entity issues that have come to light since these statements were issued in 1991 and 1999, respectively. GASB Statement No. 61 improves the information presented about the financial reporting entity, which is comprised of a primary government and related entities (component units) and amends the criteria for blending – that is, reporting component units as if they were part of the primary government – in certain circumstances. Application of this Statement is effective for the City's fiscal year ending June 30, 2013.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the FASB and AICPA pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The requirements of this Statement are effective for the City's fiscal year ending June 30, 2013.

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. This Statement also amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The requirements of this Statement are effective for the City's fiscal year ending June 30, 2013.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Effects of New Pronouncements (Continued)

In June 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*. This Statement sets forth criteria to establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The requirements of this Statement enhance comparability and improve financial reporting by clarifying the circumstances in which hedge accounting should continue when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The requirements of this Statement are effective for the City's fiscal year ending June 30, 2012.

(l) Use of Estimates

The accompanying basic financial statements have been prepared on the modified accrual and accrual basis of accounting in accordance with generally accepted accounting principles. This requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

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 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 Adopted Budget amounts.
5. As defined in the municipal code, expenditures may not 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.
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.
8. Expenditures for the Capital Projects Fund are budgeted and maintained on a project length basis. Budget to actual comparisons for these expenditures have been excluded from the accompanying financial statements.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 3 – CASH AND INVESTMENTS

The City pools cash from all sources and all funds, except restricted bond proceeds with fiscal agents, and invests its pooled idle cash according to State of California law and the City’s Investment Policy. The basic principles underlying the City’s investment philosophy are to ensure the safety of public funds, ensure that sufficient funds are available to meet current expenditures, and achieve a reasonable rate of return on investments.

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.

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):

	Governmental Activities	Business-Type Activities	Fiduciary Funds	Total
Cash and investments:				
Available for operations	\$ 148,452	\$ 237,409	\$ 3,118	\$ 388,979
Held with fiscal agents	42,187	30,970	3,906	77,063
Held for landfill closure costs	-	5,599	-	5,599
Total cash and investments	<u>\$ 190,639</u>	<u>\$ 273,978</u>	<u>\$ 7,024</u>	<u>\$ 471,641</u>

Investments Authorized by the City’s Investment Policy and 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 trustees that are governed by the provisions of debt agreements of the City, rather than the general provisions of the City’s Investment Policy.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 3 – CASH AND INVESTMENTS (Continued)

Authorized Investment Type	Maximum Maturity	Minimum Credit Quality	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
U.S. Government Securities	10 years	N/A	No Limit	No Limit
U.S. Government Agency Securities (C)	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) \$50 million per account
Local Agency Investment Fund	N/A	N/A	No Limit	No Limit
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	No Limit
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
Bonds of State of California Municipal Agencies	10 years	AA/AA2	10%	No Limit

(A) Callable and multi-step securities are limited to no more than 25% 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.

Debt Agreements:

(C) Utility Revenue Bonds 2002 Series A and 1999 Series A allow general obligations of states with a minimum credit quality rating of A2/A by Moody's and Standard & Poor's.

(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 Standard & Poor's and maturing after no more than 360 days. Utility Revenue Bonds 1995 limit the maximum maturity to 365 days.

(E) Water Revenue Bonds 2009 Series A, Utility Revenue Bonds 2002 Series A and 1999 Series A require a minimum credit quality rating of AAAM or AAAM-G by Standard & Poor's.

(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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 3 – CASH AND INVESTMENTS (Continued)

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates may 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 rate fluctuations is provided by the following table that shows the distribution of 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. Federal Agency Securities	\$ 42,379	\$ 107,942	\$ 113,381	\$ 96,853	\$ 360,555
U.S. Treasury Notes	6,027	4,129	-	-	10,156
Money Market Mutual Funds	21,326	-	-	-	21,326
California Asset Management Program	47,221	-	-	-	47,221
Local Agency Investment Fund	30,333	-	-	-	30,333
Total Investments	<u>\$ 147,286</u>	<u>\$ 112,071</u>	<u>\$ 113,381</u>	<u>\$ 96,853</u>	469,591
Certificates of Deposit					167
Cash in bank and on hand					<u>1,883</u>
Total Cash and Investments					<u>\$ 471,641</u>

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 is based on accounting records maintained by LAIF, which are recorded on an amortized cost basis. 5.01% of LAIF’s investment portfolio are collateralized mortgage obligations, 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, 2011, these investments matured in an average of 237 days.

California Asset Management Program

The City is a voluntary participant in the California Asset Management Program (CAMP). CAMP is an investment pool offered by the California Asset Management Trust (the Trust). The Trust is a joint powers authority and public agency created by the Declaration of Trust and established under the provisions of the California Joint Exercise of Powers Act (California Government Code Sections 6500 et seq., or the “Act”) for the purpose of exercising the common power of its participants to invest certain proceeds of debt issues and surplus funds. The Pool’s investments are limited to investments permitted by subdivisions (a) to (n), inclusive, of Section 53601 of the California Government Code. The City reports its investments in CAMP at the fair value amounts provided by CAMP, which is the same as the value of the pool share. At June 30, 2011, the fair value approximated the City’s cost. At June 30, 2011, these investments have an average maturity of 57 days.

Money market mutual funds are available for withdrawal on demand and at June 30, 2011, matured in an average of 28 days.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 3 – CASH AND INVESTMENTS (Continued)

Investment with Fair Values Highly Sensitive to Interest Rate Fluctuations

At June 30, 2011, the City’s investments (including investments held by bond trustees) include U.S. Federal Agency Callable Securities in the amount of \$67.9 million that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above). 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.

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, 2011, for each investment type (in thousands):

<u>Investment Type</u>	<u>AAA/AAAm</u>	<u>Total</u>
U.S. Federal Agency Securities	\$ 360,555	\$ 360,555
U.S. Treasury Notes	10,156	10,156
Money Market Mutual Funds	21,326	21,326
California Asset Management Program	47,221	47,221
Total	<u>\$ 439,258</u>	<u>439,258</u>
Not Rated:		
Certificates of Deposit		167
Local Agency Investment Fund		30,333
Cash In Bank and On Hand		<u>1,883</u>
Total Cash and Investments		<u>\$ 471,641</u>

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 investments are as follows at June 30, 2011 (in thousands):

<u>Investments</u>	<u>Reporting Type</u>	<u>Fair Value at Year-End (in thousands)</u>
Federal Home Loan Bank	U.S. Federal Agency Securities	\$ 130,100
Federal Farm Credit Bank	U.S. Federal Agency Securities	110,623
Federal National Mortgage Assoc.	U.S. Federal Agency Securities	32,785
Federal Home Loan Mortgage Corp.	U.S. Federal Agency Securities	28,581

On August 5, 2011, Standard & Poor's lowered its long-term credit rating on debt of the U.S. government from “AAA” to “AA+.” This action affected Standard & Poor's view of U.S. public finance debt instruments that are directly or indirectly backed by the U.S. As a result, on August 8, 2011, Standard & Poor's lowered its long-term credit ratings of U.S. government-sponsored enterprises and public debt issues that have credit enhancement guaranteed by those government-sponsored enterprises to “AA+.” The credit downgrades relate to the credit risk associated with the City’s investments in U.S. Treasuries and U.S. Agency Securities

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 3 – CASH AND INVESTMENTS (Continued)

Custodial Credit 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 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 FY 2011 were as follows (in thousands):

Fund Receiving Transfer	Fund Making Transfer	Amount Transferred
General Fund	Nonmajor Governmental Funds	\$ 1,212 A
	Water Services Fund	7 A
	Electric Services Fund	11,231 A
	Fiber Optics Fund	1 A
	Gas Services Fund	5,311 A
	Wastewater Collection Fund	4 A
	Refuse Services Fund	166 A
Capital Projects Fund	General Fund	9,858 B
	Nonmajor Governmental Funds	1,081 B
	Water Services Fund	8 B
	Electric Services Fund	225 B
	Fiber Optics Fund	7 B
	Gas Services Fund	15 B
	Wastewater Collection Fund	8 B
Nonmajor Governmental Funds	General Fund	1,109 A
	Nonmajor Governmental Funds	80 A
	Subtotal	\$ 30,323

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 4 – INTERFUND TRANSACTIONS (Continued)

(Continued)

Fund Receiving Transfer	Fund Making Transfer	Amount Transferred
Water Services Fund	Capital Projects Fund	\$ 57 C
	Gas Services Fund	33 B
	Wastewater Collection Fund	33 B
Electric Services Fund	General Fund	33 E
	Capital Projects Fund	117 C
	Water Services Fund	200 B
	Gas Services Fund	200 B
Gas Services Fund	Capital Projects Fund	35 C
Refuse Services Fund	Capital Projects Fund	138 C
	Nonmajor Governmental Funds	232 E
	Wastewater Collection Fund	75 B
	Internal Service Funds	591 D
Wastewater Collection Fund	Capital Projects Fund	75 B
Storm Drainage Services Fund	Capital Projects Fund	325 B
Internal Service Funds	Water Services Fund	234 C
	Electric Services Fund	750 C
	Gas Services Fund	366 C
	Wastewater Collection Fund	151 C
	Wastewater Treatment Fund	9 C
	Refuse Services Fund	160 C
	Storm Drainage Services Fund	32 C
	Fiber Optics Fund	1 C
	Subtotal	3,847
	Total	\$ 34,170

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 refund replacement charges.
- (E) Transfer to reimburse the Utility Funds for costs incurred for the benefit of funds making the transfer.

Interfund Commitment

During FY 2002, the City established the Palo Alto Redevelopment Agency (the 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 principles require that such amounts be treated as transfers in the year made. Advances without specified repayment terms total approximately \$389,000 as of June 30, 2011. On September 6, 2011, the City filed Ordinance No. 5126 dissolving the operations of the Agency and, accordingly, this advance will not be repaid to the City.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 4 – INTERFUND TRANSACTIONS (Continued)

Long-Term Interfund Advance

On December 6, 2010, the City Council accepted an Airport Business Plan of the Palo Alto Airport (PAO) and approved creation of a new Airport Enterprise Fund to facilitate the transition of PAO control from the Santa Clara County to the City. The Council approved the General Fund to fund the new Airport Enterprise Fund in the amount of \$300,000 for environmental analysis, legal and personnel costs for the transition. According to the agreement, the Airport Fund will repay the \$300,000 with interest equal to the average return yield on the City's investment portfolio in 6 years to the General Fund. As of June 30, 2011, the outstanding amount is \$300,000.

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, 2011, the City's notes and loans receivable totaled (in thousands):

Palo Alto Housing Corporation:	
Oak Manor Townhouse	\$ 705
Tree House Apartments	5,150
Emerson Street Project	375
Alma Single Room Occupancy Development	2,222
Barker Hotel	2,111
Sheridan Apartments	2,248
Oak Court Apartments, L.P.	7,835
Mid-Peninsula Housing Coalition:	
Palo Alto Gardens Apartments	195
Community Working Group, Inc.	1,280
Opportunity Center Associates, L.P.	750
Home Rehabilitation Loans	76
Executive Relocation Assistance Loans	985
Below Market Rate Assessment Loans	74
Stevenson Housing:	
Hot Water	81
Fire Alarm	48
Oak Manor Townhouse Water System	114
Palo Alto Senior Housing Project	28
Clara-Mateo Alliance	11
Lytton Gardens Assisted Living	101
Emergency Housing Consortium	75
Alma Gardens Apartments	1,150
Total Notes and Loans	25,614
Less: Valuation Allowance	(14,805)
Total Notes and Loans, Net	<u>\$ 10,809</u>

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 5 – NOTES AND LOANS RECEIVABLE (Continued)

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 nonspendable, restricted or committed fund balances, as they are not expected to be repaid immediately.

Some of these loans contain forgiveness clauses that provide for the amount loaned to be forgiven if the third party maintains compliance with the terms of the loan and associated regulatory agreements. Since some of these loans are secured by trust deeds, that are subordinated to other debt on the associated projects or are only repayable from residual cash receipts on the projects, collectability of some of the outstanding balances may not be realized. As a result of the forgiveness clauses and nature of these housing projects and associated cash flows, a portion of the outstanding balances of the loans has been offset by a valuation allowance.

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 3 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, 2011, the objective was met. The annual loan payment was forgiven for the calendar year ended December 31, 2010.

Tree House Apartments

In March 2009, the City agreed to loan \$2.8 million to the Tree House Apartments, L.P. for the purchase of the real property located at 488 West Charlton Road. On March 23, 2010, the City wired the full loan amount to an escrow account. The loan consisted of \$1.8 million funded by Community Development Block Grant funds; the remaining \$1 million was funded by residential funds. An additional development loan in the amount of \$2.5 million was approved by the City on October 18, 2010. As of June 30, 2011, the outstanding balance for the Tree Housing Apartment in aggregate is \$5.2 million. Principal and interest payments will be deferred for 55 years. However, if the borrower has earned extra income, and if acceptable to the other entities providing final permanent sources of funds, payment of interest and principal based on the City's proportionate share of the project's residual receipts from net operating income shall be made by the borrower. In no event shall full payment be made by the borrower later than concurrently with the expiration or earlier termination of the loan agreement, which is March 23, 2064.

Emerson Street Project

On November 8, 1994, the City loaned \$375,000 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 2010 after which the loan bears interest at 3 percent per year. The principal balance is due in 2034.

Alma Single Room Occupancy Development

On December 13, 1996, the City authorized \$2.7 million to the Alma Place Associates, L.P. for the development of a 107-unit single room occupancy development. This loan bears interest at 3 percent and is collateralized by a subordinated deed of trust. Loan payments are deferred until 2014. The principal balance is due in 2041.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 5 – NOTES AND LOANS RECEIVABLE (Continued)

Barker Hotel

On April 12, 1994, the City loaned a total of \$2.1 million for the preservation, rehabilitation and expansion of a low-income, single occupancy hotel. This loan was funded by three sources: \$400,000 from the Housing In-Lieu Fund, \$1 million from HOME Investment Partnership Program Funds, and \$670,000 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.

In July 2004, the City agreed to loan up to \$41,000 to the 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 \$2.5 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 \$1.6 million in Community Development Block Grant funds, and \$825,000 in Housing In-Lieu funds. The note bears interest at 9 percent when available surplus cash from the project equals or exceeds 25 percent of interest calculated using 9 percent. When available surplus cash falls below this level, the note bears interest at 3 percent. The note is collateralized by a second deed of trust and an affordability reserve account held by the Palo Alto Housing Corporation. Annual loan payments were deferred until the Palo Alto Housing Corporation accumulated \$1 million in an affordability reserve account. Two principal payments totaling \$202,438 have been made, and interest has also been paid. The remaining 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 \$5.9 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 5 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 Palo Alto Housing Corporation elects to extend the note until 2102, as defined in the regulatory agreement.

Oak Court Apartments, L.P.

On August 18, 2003, the City loaned \$1.9 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 3 percent. The note is secured by a subordinate deed of trust. The principal balance is due in 2060.

Palo Alto Gardens Apartments

On April 22, 1999, the City loaned \$1 million to the Mid-Peninsula Housing Coalition (the Coalition) for the purchase and rehabilitation of a 155-unit complex for the continuation of low-income housing. This loan is funded by \$659,000 in Community Development Block Grant funds and \$341,000 in Housing In-Lieu funds. The two notes bear interest at 3 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. Principal and interest payments began in FY 2008. The principal balance is due in 2039.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 5 – NOTES AND LOANS RECEIVABLE (Continued)

Community Working Group, Inc.

On May 13, 2002, the City loaned \$1.3 million to the Community Working Group, Inc. for predevelopment, relocation and acquisition of land for development of an 89-unit complex and homeless service center for very low income households. The loan is funded by \$1.3 million of Community Development Block Grant funds. The note bears no interest and is secured by a first deed of trust. No repayment of the \$1.3 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 re-conveyed.

Opportunity Center Associates, L.P.

On July 19, 2004, the City loaned \$750,000 for a 55-year term 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 \$750,000 of residential housing funds. The note bears 3 percent interest and is secured by a deed of trust. The loan remains outstanding and becomes due at the end of the 55-year term.

Home Rehabilitation Loans

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 trust, 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 ended June 30 plus one-quarter of 1 percent. Principal and interest payments are due bi-weekly. Employees must pay off any outstanding balance of their loans within a certain period after ending employment with the City. As of June 30, 2011, the City had two outstanding home loans, one from the previous City Manager and one from the current City Manager.

The original purchase cost for the previous City Manager's home was \$1.4 million and the City holds a 60 percent equity share. The loan balance owed as of June 30, 2011 was approximately \$401,000. The previous City Manager can remain in the home until December 2017, or until his children have left Palo Alto public schools, whichever occurs first.

The original purchase cost for the current City Manager's home was \$1.9 million and the City holds a 75 percent equity share. The loan balance owed as of June 30, 2011 is approximately \$459,000. During FY 2011, the Council authorized a capital improvement loan of \$125,000. Loans for capital improvements are made on a dollar for dollar matching basis, with an equal equity contribution made by the City Manager. The loan balance owed as of June 30, 2011 was approximately \$125,000.

Below Market Rate Assessment Loans

In December 2002, the City loaned \$74,000 to below market rate homeowners with low incomes and/or very limited assets for capital repairs, special assessments and improvements of their properties. The loans bear interest at 3 percent and are secured by a deed of trust on each property. Loan payments are deferred until 2032. In 2011, the City did not receive interest payments.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 5 – NOTES AND LOANS RECEIVABLE (Continued)

Stevenson Housing Hot Water

In July 2004, the City agreed to loan up to \$38,000 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 \$45,000, bringing the total loan to \$83,000. The loan is funded entirely by Community Development Block Grant funds and bears simple interest of 6 percent. Principal and interest payments were deferred until July 1, 2010. Since the borrower has complied with all terms and conditions of the agreement, the loan will be written off.

Stevenson Housing Fire Alarm

In December 2006, the City agreed to loan up to \$48,000 to the Palo Alto Senior Housing Project, Inc. to repair and upgrade the existing fire alarm system at the Stevenson House Senior Housing facility. The loan is funded entirely by Community Development Block Grant funds and bears simple interest of 6 percent. Principal and interest payments are deferred until July 1, 2012, as long as the borrower continues to comply with all terms and conditions of the agreement.

Oak Manor Townhouse Water System

On May 12, 2003, the City Council approved to allocate \$113,672 to Palo Alto Housing Corporation Housing Apartments, Inc (PAHCA, Inc) to replace the water pipes with an intention to provide a permanent solution to Oak Manor's plumbing needs. Repayment of the loan will not be required unless the property is sold, the program is terminated or purpose of the program is changed without City's approval prior to July 1, 2033. The loan for this project is a subordinated to the existing City loan with PAHCA, Inc of January 7, 1991 for the acquisition of the project site, which is discussed in this section earlier.

Palo Alto Senior Housing Project

In July 2003, the City agreed to loan up to \$45,000 to the 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 6 percent and is secured by a deed of trust on the property. 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. In April 2008, the City provided \$47,600 for the purpose of repairing and upgrading the fire alarm system at the Senior Housing facility. As of June 30, 2011, the outstanding balance was \$28,000.

Clara-Mateo Alliance

In July 2003, the City agreed to loan up to \$200,000 to Clara-Mateo Alliance for rehabilitation of the kitchen and the Elsa Segovia Center to provide services for the homeless. The loan is funded entirely by Community Development Block Grant funds, bears interest at 6 percent and is secured by a deed of trust on the property. Repayment of the loan will not be required unless the property is sold or the program terminated. 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 to \$109,000 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 3 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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 5 – NOTES AND LOANS RECEIVABLE (Continued)

Emergency Housing Consortium

In November 2005, the City agreed to loan up to \$75,000 to the 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 3 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 Garden Apartments

In March 2006, the City agreed to loan up to \$1.2 million to Community Working Group, Inc. to acquire a 10-unit multi-family housing complex known as the Alma Garden Apartments. The loan is funded entirely by Community Development Block Grant funds. Principal and interest payments are deferred 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 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 one year. 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 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 capital assets, consisting of roadway and recreation and open space, in its government-wide financial statements. GASB Statement No. 34 requires that all capital assets with limited useful lives be depreciated over their estimated useful lives. Alternatively, the "modified approach" may be used for certain capital assets. Depreciation is not provided under this approach, but all expenditures on these assets are expensed unless they are additions or improvements. The City has elected to use the depreciation method for its capital assets. The purpose of depreciation is to spread the cost of capital assets equitably among all users over the life of those 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 statement of net assets as a reduction in the book value of capital assets.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 6 – CAPITAL ASSETS (Continued)

Depreciation is calculated 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.

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

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 6 – CAPITAL ASSETS (Continued)

General Capital Assets

Changes in the City's general capital assets during the year ended June 30, 2011 were (in thousands):

	Balance July 1, 2010	Additions	Retirements	Transfers	Balance June 30, 2011
<i>Governmental activities</i>					
Nondepreciable capital assets:					
Land and improvements	\$ 78,480	\$ -	\$ -	\$ 81	\$ 78,561
Street trees	15,052	84	(252)	490	15,374
Intangible assets	-	3,617	-	183	3,800
Construction in progress	32,334	32,736	(6,980)	(21,793)	36,297
Total nondepreciable capital assets	<u>125,866</u>	<u>36,437</u>	<u>(7,232)</u>	<u>(21,039)</u>	<u>134,032</u>
Depreciable capital assets:					
Buildings and structures	114,605	36	-	9,275	123,916
Equipment	8,200	91	(13)	1,432	9,710
Roadway network	260,489	-	-	7,086	267,575
Recreation and open space network	18,552	-	(10)	3,246	21,788
Total depreciable capital assets	<u>401,846</u>	<u>127</u>	<u>(23)</u>	<u>21,039</u>	<u>422,989</u>
Less accumulated depreciation:					
Buildings and structures	(60,754)	(2,482)	-	-	(63,236)
Equipment	(6,089)	(359)	13	-	(6,435)
Roadway network	(101,197)	(6,256)	-	-	(107,453)
Recreation and open space network	(5,978)	(611)	10	-	(6,579)
Total accumulated depreciation	<u>(174,018)</u>	<u>(9,708)</u>	<u>23</u>	<u>-</u>	<u>(183,703)</u>
Depreciable capital assets, net	<u>227,828</u>	<u>(9,581)</u>	<u>-</u>	<u>21,039</u>	<u>239,286</u>
Internal service fund capital assets					
Construction in progress	637	2,521	-	(3,007)	151
Equipment	51,311	58	(2,661)	3,007	51,715
Less accumulated depreciation	(29,603)	(4,695)	2,518	-	(31,780)
Net internal service fund capital assets	<u>22,345</u>	<u>(2,116)</u>	<u>(143)</u>	<u>-</u>	<u>20,086</u>
Governmental activities capital assets, net	<u>\$ 376,039</u>	<u>\$ 24,740</u>	<u>\$ (7,375)</u>	<u>\$ -</u>	<u>\$ 393,404</u>

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 6 – CAPITAL ASSETS (Continued)

Business-Type Capital Assets

Changes in the City's enterprise fund capital assets during the year ended June 30, 2011 were (in thousands):

	July 1, 2010	Additions	Retirements	Transfers	June 30, 2011
<i>Business-type activities</i>					
Nondepreciable capital assets:					
Land and improvements	\$ 4,971	\$ -	\$ -	\$ -	\$ 4,971
Construction in progress	111,778	31,554	-	(10,895)	132,437
Total nondepreciable capital assets	116,749	31,554	-	(10,895)	137,408
Depreciable capital assets:					
Buildings and structures	30,900	-	(54)	1,014	31,860
Transmission, distribution and treatment systems	536,593	892	(1,728)	9,791	545,548
Total depreciable capital assets	567,493	892	(1,782)	10,805	577,408
Less accumulated depreciation:					
Buildings and structures	(7,281)	(710)	18	-	(7,973)
Transmission, distribution and treatment systems	(226,703)	(15,216)	800	-	(241,119)
Total accumulated depreciation	(233,984)	(15,926)	818	-	(249,092)
Depreciable capital assets, net	333,509	(15,034)	(964)	10,805	328,316
Business-type activities capital assets, net	\$ 450,258	\$ 16,520	\$ (964)	\$ (90)	\$ 465,724

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 are as follows (in thousands):

<i>Governmental Activities</i>		<i>Business-Type Activities</i>	
City Manager	\$ 28	Water	\$ 1,388
Community Services	973	Electric	7,331
Fire	126	Fiber Optics	267
Police	77	Gas	1,837
Public Works	8,240	Wastewater Collection	1,455
Planning	53	Wastewater Treatment	2,165
Non-departmental	10	Refuse	657
Library	201	Storm Drainage	826
Internal Service Funds	4,695		\$ 15,926
	<u>\$ 14,403</u>		

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 6 – CAPITAL ASSETS (Continued)

Construction In Progress and Completed Projects

Construction in progress during FY 2011 is comprised of the following (in thousands):

<u>Governmental Activities</u>	Expended to June 30, 2011
ADA Compliance Cubberley Wing I Elevator	\$ 257
Americans With Disabilities	1,066
Art Center Electrical & Mech Upgrades	963
Art Center Kiln Hood	85
Art In Public Places	65
Bicycle Boulevards Implementation Project	169
Building Systems Improvements	341
Charleston/Arastradero Corridor Plan	974
Children's Theatre Fire/Life Safety Upgrade	47
Civic Center Chiller Drive Replacement	72
Civic Center Infrastructure Improvements	3,804
College Terrace Library Improvements	33
College Terrace Traffic Calming	143
Comprehensive Parking	43
Crime Scene Evidence Collection Vehicle	174
Cubberley Mechanical & Electrical Upgrade	181
Downtown Library Improvements	3,774
Downtown Tree Grates	38
ECR/Stanford Intersection	254
El Camino/Ventura Traffic Signal	110
Fire Station Improvements	1,071
Foothills Park Interpretive Center Improvements	55
Golf Maintenance Yard	36
Greer Park Phase IV	1,610
Highway 101 Pedestrian/Bicycle Overpass	230
Interior Finishes Construction	370
Library & Comm Center Temp Facilities	658
Lot J Cowper/Webster Structural Repairs	39
Main Library Construction & Improvements	793
Mitchell Park Library & Community Center	1,230
Mitchell Park Library & Community Center	14,169
Municipal Service Center Improvements	192
Park Maintenance Shop Remodel	58
Park Restroom Installation	378
Public Safety Building Project	183
Rinconada Pool Plaster Construction	118
Roth Building Maintenance	165
Safe Routes To School (10026)	357
San Antonio Road Median Improvements	1,465

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 6 – CAPITAL ASSETS (Continued)

	Expended to June 30, 2011
Governmental Activities (Continued)	
School Site Irrigation	\$ 436
Security System Improvements	215
Stern Community Center/Theater Ext. Paint	95
Ticket Machines	36
Traffic Signal Central System	36
Traffic Signal Upgrades	651
Other Construction in Progress	245
Vehicle Replacement Fund	151
	<u>37,636</u>
Total Governmental Activities Construction In Progress	<u>\$ 37,636</u>
 Business-Type Activities	
Storm drainage structural and water quality improvements	\$ 1,794
Gas system extension replacements and improvements	17,333
Water system extension replacements and improvements	16,941
Electric distribution system improvements	13,840
Other electrical improvements projects	787
Water quality control plant equipment replacement and lab facilities	6,992
Sewer system rehabilitation and extensions	4,332
Other construction in progress	70,418
	<u>132,437</u>
Total Business-Type Activities Construction In Progress	<u>\$ 132,437</u>

Allocations of business-type activity administration and general expenses of \$10.6 million have been capitalized and included in amounts expended through June 30, 2011.

Major capital projects that are currently in progress, and the remaining capital commitment of each, are as follows:

- Mitchell Park Library and Community Center - \$35.6 million
- Main Library - \$17.3 million
- Art Center electrical and mechanical upgrades - \$7.2 million
- Civic Center infrastructure improvements - \$2.6 million.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS

The City’s Long-Term Obligations

Bond premiums and discounts 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. Effective for FY 2011, bond issuance costs have been reclassified to noncurrent assets, rather than netted with long-term debt.

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 July 1, 2010	Additions	Retirements	Balance June 30, 2011	Current Portion
Governmental Activities Debt:						
<i>General Long-Term Obligations:</i>						
1998 Golf Course	\$ 7,750	\$ 4,060	\$ -	\$ 370	\$ 3,690	\$ 385
Certificates of Participation, 4.00-5.00%, due 09/01/2018						
2002A Civic Center Refinancing Certificates of Participation, 2.00-4.00%, due 03/01/2012	3,500	795	-	390	405	405
2002B Downtown Parking Improvements Certificates of Participation, 2.00-4.00%, due 03/01/2022	3,555	1,910	-	110	1,800	115
General Obligation Bonds 2010 Series A, 2.00-5.00%, due 08/01/2040	55,305	55,305	-	-	55,305	765
Add: unamortized premium	-	3,766	-	126	3,640	126
Total Governmental Activities Debt	\$ 70,110	\$ 65,836	\$ -	\$ 996	\$ 64,840	\$ 1,796

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

	Original Issue Amount	Balance July 1, 2010	Additions	Retirements	Balance June 30, 2011	Current Portion
Business-Type Activities Debt:						
<i>Enterprise Long-Term Obligations:</i>						
Utility Revenue Bonds						
1995 Series A, 5.00-6.25%, due 06/01/2020	\$ 8,640	\$ 4,969	\$ -	\$ 375	\$ 4,594	\$ 395
1999 Refunding, 3.25-5.25%, due 06/01/2024	17,735	13,235	-	520	12,715	550
2002 Series A, 3.00-5.00%, due 06/01/2026	26,055	18,885	-	833	18,052	872
2009 Series A, 1.80-5.95%, due 06/01/2035	35,015	35,015	-	825	34,190	835
Less: unamortized Premium/(Discount)		(186)	-	(16)	(170)	-
Energy Tax Credit Bonds						
2007 Series A, 0%, Due 12/15/2021	1,500	1,200	-	100	1,100	100
Less: unamortized Premium/(Discount)		(65)	-	(6)	(59)	-
State Water Resources Loans						
2007, 0%, due 06/30/2029	9,000	8,550	-	450	8,100	450
2009, 2.6%, due 11/30/2030	8,500	4,530	4,066	-	8,596	346
Total Business-Type Activities Debt	<u>\$ 106,445</u>	<u>\$ 86,133</u>	<u>\$ 4,066</u>	<u>\$ 3,081</u>	<u>\$ 87,118</u>	<u>\$ 3,548</u>

Description of the City's Long-Term Debt Issues

1998 Golf Course Certificates of Participation (COPs) – In August 1998, the City's Public Improvement Corporation issued Golf Course Improvement COPs, Series 1998, in the amount of \$7.8 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 Corporation from the City's available funds.

2002B Downtown Parking Improvement Project COPs – On January 16, 2002, the City issued \$3.6 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, and are payable from lease revenues received by the Corporation from the City's available funds.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

On January 25, 2005, the City defeased \$.9 million of the 2002B Downtown Parking Improvements COPs. 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. The defeasance resulted in an overall debt service savings of \$1.5 million and an economic gain of \$.5 million. Accordingly, the trust account assets and the liability for the defeased bonds are not included on the financial statements. The total defeased amount was completely paid off on March 1, 2011.

2010 General Obligation Bonds (GO) – On June 30, 2010, the City issued \$55.3 million of GO bonds to finance costs for constructing a new Mitchell Park Library and Community Center, as well as substantial improvements to the Main Library and the Downtown Library. Principal payments are due annually on August 1 and interest payments semi-annually on February 1 and August 1 from 2 percent to 5 percent, and are payable from property tax revenues.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$55.3 million principal and \$48.0 million interest as the remaining debt service on the bonds, which is scheduled to occur in FY 2041. In FY 2011 there were no principal payments due.

1995 Utility Revenue Bonds, Series A – The City issued \$8.6 million of 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 Services Fund and Fiber Optics Fund. Principal payments are payable annually on June 1 and interest payments semi-annually on June 1 and December 1. A \$2.9 million 6.3 percent term bond is due June 1, 2020.

As required by the Indenture, the City established a debt service reserve fund for the Bonds (the “Reserve Account”), with a minimum funding level requirement in the Reserve Account (the “Reserve Requirement”). At the time it issued the Bonds, the City satisfied the Reserve Requirement with a deposit into the Reserve Account of a surety bond (the “Surety Bond”) in the amount of \$685,340 issued by Ambac Indemnity Corporation (renamed to Ambac Assurance Corporation in 1997).

On November 9, 2010, Ambac Financial Group Inc. (Ambac Financial) filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. Ambac Financial is a holding company whose affiliates provide financial guarantees and financial services to its customers. Ambac Indemnity Corporation, now known as Ambac Assurance Corporation, is a subsidiary of Ambac Financial. Ambac has issued a reserve fund surety bond of \$685,340 that expires on June 1, 2020 and is on deposit in the Reserve Fund account securing the Bonds. According to the Trust Agreement for these bonds, in the event that such surety bond for any reason terminates or expires, and the remaining amount on deposit in the Reserve Fund account is less than the required reserve, the City is to address such shortfall by delivering to the trustee a surety bond or a letter of credit meeting the criteria of a Qualified Reserve Facility under the Trust Agreement, or depositing cash to the General Account in up to twelve equal monthly installments. Information about Ambac Financial is available on Form 10-K and Form 10-Q filed by Ambac Financial; the City refers to this information for reference only, and does not intend to incorporate any such information herein. The City is not certain about the effect of the bankruptcy proceedings, if any, on the Surety Bond.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

The pledge of future Net Revenues for the above funds ends upon repayment of the \$4.6 million principal and \$1.6 million interest as the remaining debt service on the bonds, which is scheduled to occur in 2020. For FY 2011, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$237.3 million; operating costs, including operating expenses but not interest, depreciation or amortization, amounted to \$167.0 million. Net Revenues available for debt service amounted to \$70.3 million, which represented coverage of 103.1 times over the \$0.7 million in debt service.

1999 Utility Revenue and Refunding Bonds, Series A – The City issued \$17.7 million of 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 two Wastewater Treatment 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 Drainage (25.2 percent). Principal payments are payable annually on June 1 and interest payments semi-annually on June 1 and December 1. A \$3.1 million 5.3 percent term bond, and a \$5.1 million 5.3 percent term bond are due June 1, 2021 and 2024, respectively.

As required by the Indenture, the City established a debt service reserve fund for the Bonds (the “Reserve Account”), with a minimum funding level requirement in the Reserve Account (the “Reserve Requirement”). At the time it issued the Bonds, the City satisfied the Reserve Requirement with a deposit into the Reserve Account of a surety bond (the “Surety Bond”) in the amount of \$1,647,300 issued by Ambac Indemnity Corporation (renamed to Ambac Assurance Corporation in 1997).

On November 9, 2010, Ambac Financial Group Inc. (Ambac Financial) filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. Ambac Financial is a holding company whose affiliates provide financial guarantees and financial services to its customers. Ambac Indemnity Corporation, now known as Ambac Assurance Corporation, is a subsidiary of Ambac Financial. Ambac has issued a reserve fund surety bond of \$1,647,300 that expires on June 1, 2024 and is on deposit in the Reserve Fund account securing the Bonds. According to the Trust Agreement for these bonds, in the event that such surety bond for any reason terminates or expires, and the remaining amount on deposit in the Reserve Fund account is less than the required reserve, the City is to address such shortfall by delivering to the trustee a surety bond or a letter of credit meeting the criteria of a Qualified Reserve Facility under the Trust Agreement, or depositing cash to the General Account in up to twelve equal monthly installments. Information about Ambac Financial is available on Form 10-K and Form 10-Q filed by Ambac Financial; the City refers to this information for reference only, and does not intend to incorporate any such information herein. The City is not certain about the effect of the bankruptcy proceedings, if any, on the Surety Bond.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$12.7 million principal and \$5.8 million interest as the remaining debt service on the bonds, which is scheduled to occur in 2024. For FY 2011, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$40.8 million; operating costs, including operating expenses but not interest, depreciation or amortization, amounted to \$29.4 million. Net Revenues available for debt service amounted to \$11.4 million, which represents coverage of 9.45 times over the \$1.2 million in debt service.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

2002 Utility Revenue Bonds, Series A – On January 24, 2002, the City issued \$26.1 million of 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.

The pledge of future Net Revenues for the above funds ends upon repayment of the \$18.1 million principal and \$7.8 million interest as the remaining debt service on the bonds, which is scheduled to occur in 2026. For FY 2011, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$71.2 million; operating costs, including operating expenses but not interest, depreciation or amortization, amounted to \$51.7 million. Net Revenues available for debt service amounted to \$19.5 million, which represented coverage of 11.3 times over the \$1.7 million in debt service.

2007 Electric System Clean Renewable Energy Tax Credit Bonds, Series A – In October 2007, the City issued \$1.5 million of Electric Utility Clean Renewable Energy Tax Credit Bonds (CREBs), 2007 Series A, to finance the City’s photovoltaic solar panel project. The Bonds do not bear interest. In lieu of receiving periodic interest payments, bondholders are allowed annual federal income tax credits in an amount equal to a credit rate for such CREBs multiplied by the outstanding principal amount of the CREBs owned by the bondholders. The Bonds are payable solely from and secured solely by a pledge of the Net Revenues of the Electric system and the other funds pledged under the Indenture.

The pledge of future Electric Fund Net Revenues ends upon repayment of the \$1.1 million remaining debt service on the bonds, which is scheduled to occur in 2021. For FY 2011, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$125.3 million; operating costs, including operating expenses but not interest, depreciation or amortization, amounted to \$85.9 million. Net Revenues available for debt service amounted to \$39.4 million, which represented coverage of 394 times over the \$0.1 million in debt service.

2009 Water Revenue Bonds, Series A – On October 6, 2009, the City issued \$35.0 million of Water Revenue Bonds to finance certain improvements to the City’s water utility system. Principal payments are due annually on June 1, and interest payments are due semi-annually on June 1 and December 1 from 1.80 percent to 5.95 percent. The 2009 Revenue Bonds are secured by net revenues generated by the Water Services Fund. The 2009 Bonds were issued as bonds designated as “Direct Payment Build America Bonds” under the provisions of the American Recovery and Reinvestment Act of 2009 (“Build America Bonds”). The City expects to receive a cash subsidy payment from the United States Treasury equal to 35 percent of the interest payable on the 2009 Bonds. The lien of the 1995 Bonds on the Net Revenues is senior to the lien on Net Revenues securing the 2009 Bonds and the 2002 Bonds. The City received subsidy payments amounting to \$609,798, which represents 35 percent of the two interest payments due on December 1, 2010 and June 1, 2011.

The pledge of future Net Revenues for the above funds ends upon repayment of the the \$34.2 million principal and \$27.4 million interest as the remaining debt service on the bonds, which is scheduled to occur in 2035. For FY 2011, Net Revenues, including operating revenues and non-operating interest earnings, amounted to \$26.8 million; operating costs, including operating expenses but not interest, depreciation or amortization, amounted to \$21.8 million. Net Revenues available for debt service amounted to \$5.0 million, which represented coverage of 1.96times over the \$2.6 million in debt service.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

2007 State Water Resources Loan – In October 2007, the City approved the \$9 million loan agreement with State Water Resources Control Board (SWRCB) to finance the City’s Mountain View/Moffett Area reclaimed water pipeline project. Under the terms of the contract, the City has agreed to repay \$9 million to the State in exchange for receiving \$7.5 million in proceeds to be used to fund the Project. The difference between the repayment obligation and proceeds amounts to \$1.5 million and represents interest on the outstanding balance. Loan proceeds are drawn down as the project progresses, and debt service payments commenced on June 30, 2010. Concurrently with the loan, the City entered into various other agreements including a cost sharing arrangement with the City of Mountain View. Pursuant to that agreement, City of Mountain View agreed to finance a portion of the project with a \$5 million loan repayable to the City. This loan has been recorded as “Due from other government agencies” in the accompanying financial statements.

2009 State Water Resources Loan – In October 2009, the City approved an \$8.5 million loan agreement with State Water Resources Control Board (SWRCB) to finance the City’s Ultraviolet Disinfection project. As of June 30, 2011, the full loan in the amount of \$8.5 million was drawn down and became outstanding. Interest in the amount of \$96,000 was accrued and added to the outstanding loan balance.

Debt Service Requirements (in thousands):

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

For the Year Ending June 30	Governmental Activities			Business-Type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2012	\$ 1,670	\$ 2,808	\$ 4,478	\$ 3,548	\$ 3,736	\$ 7,284
2013	1,530	2,750	4,280	3,651	3,635	7,286
2014	1,575	2,694	4,269	3,775	3,505	7,280
2015	1,640	2,640	4,280	3,914	3,366	7,280
2016	1,690	2,575	4,265	4,069	3,216	7,285
2017-2021	8,600	11,576	20,176	22,942	13,465	36,407
2022-2026	7,820	9,705	17,525	23,984	8,247	32,231
2027-2031	9,570	7,667	17,237	12,569	4,382	16,951
2032-2036	11,985	5,209	17,194	8,895	1,361	10,256
2037-2041	15,120	1,964	17,084	-	-	-
Total	<u>\$ 61,200</u>	<u>\$ 49,588</u>	<u>\$ 110,788</u>	<u>\$ 87,347</u>	<u>\$ 44,913</u>	<u>\$ 132,260</u>

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

Debt Call Provisions

Long-term debt as of June 30, 2011 is callable on the following terms and conditions:

	<u>Initial Call Date</u>	
<i>Governmental Activities Long-Term Debt</i>		
1998 Certificates of Participation	09/01/08	(3)
2002B Certificates of Participation	03/01/11	(2)
2010A General Obligation Bonds		
\$6.595 million due 08/01/2032	08/01/31	(4)
\$4.890 million due 08/01/2034	08/01/33	(4)
\$17.725 million due 08/01/2040	08/01/35	(4)
<i>Business-Type Activities Long-Term Debt</i>		
Utility Revenue Bonds		
1999 Refunding	06/01/09	(1)
2002 Series A	06/01/12	(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.
- (4) Callable in any order specified by the City at par value plus any accrued interest beginning on the initial call date.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 7 – GENERAL LONG-TERM OBLIGATIONS (Continued)

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 in that 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, 2011, the amount of bonds outstanding was \$5.1 million.

Long-term Debt without City Commitment

On July 23, 2007, the City approved the issuance of two variable rate demand Tax-Exempt Revenue Bonds by the Association of Bay Area Governments (ABAG) Finance Authority in the amounts of \$160 million and \$180 million for the construction of the Albert L. Schultz Jewish Community Center and a new continuing care retirement community, respectively. The debt is payable by the borrowers, Albert L. Schultz Jewish Community Center and 899 Charleston, LLC. The City has no legal or moral liability with respect to the payment of these debts.

NOTE 8 – SPECIAL ASSESSMENT DEBT

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, 2011, the District's outstanding debt amounted to \$750 thousand.

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 this District. Therefore, this debt is not included in Governmental Activities long-term debt of the City. At June 30, 2011, the District's outstanding debt amounted to \$7.69 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 this District. Therefore, this debt is not included in Governmental Activities long-term debt of the City. In June 2004, \$3.75 million of the bonds were called. As of June 30, 2011, the remaining outstanding debt amounted to \$27.0 million.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 9 – LANDFILL CLOSURE AND POST-CLOSURE CARE

State and Federal laws and regulations require the City to properly close the Palo Alto Refuse Disposal Site (Palo Alto Landfill) after it stops accepting waste by constructing a final cover on top of the approximately 126 acre landfill to cap the wastes, and by performing certain maintenance and monitoring activities at the site for a minimum of thirty years after closure. The first section of the landfill closed in 1991 was a 29-acre section designated “Phase I” costing \$1.6 million. Phase I was subsequently converted to a pastoral park (Byxbee Park) and opened to the public. The remaining sections of the landfill are designated as Phase IIA (22.5 acres closed in 1992 at a cost of \$.9 million), Phase IIB (23.2 acres closed in 2000 at a cost of \$1.2 million) and Phase IIC, a 51.2 acre active area currently being filled. Phase IIC is currently expected to be filled by 2011 and is projected for closure in 2012. The 30 years of post-closure maintenance costs will be paid after the State certifies the Phase IIC closure (expected in early 2013).

In accordance with State regulations, a final closure and post-closure maintenance plan was produced by a consultant and submitted to State and local regulatory agencies in 2009. As part of this plan, the City’s consultant updated cost forecasts for both the remaining Phase IIC closure and for the 30 year post-closure maintenance activities.

Landfill closure and post-closure liabilities for FY 2011 were \$10.8 million. Currently 99.9% percent of the landfill capacity has been used to date. Based on estimated costs to be incurred in FY 2011, \$10.8 million is expected to be recorded as future landfill closure and post-closure liability.

The City is required by State and Federal laws and regulations to make annual funding contributions to finance closure and post-closure care. In FY 2011, for the \$5.2 million post-closure maintenance, the City changed its financial assurance mechanism from an enterprise fund mechanism to a pledge of revenue agreement with the California Integrated Waste Management Board. The \$5.6 million closure liability remains under the enterprise fund mechanism. The City is in compliance with these requirements for the year ended June 30, 2011.

The landfill closure balance as of June 30, 2011 comprised the following (in thousands):

		<u>Funding Mechanism</u>
Closure	\$ 5,599	Cash on hand
Post-closure care	<u>5,172</u>	Future revenues
Balance	<u><u>\$ 10,771</u></u>	

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

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

As prescribed by GASB Statement No. 54, governmental funds report fund balances in classifications based primarily on the extent to which the City is bound to honor constraints on the specific purposes for which amounts in the funds can be spent. Fund balances for governmental funds are made up of the following:

Nonspendable Fund Balance – comprised of amounts that are: (a) not in spendable form, or (b) legally or contractually required to be maintained intact. The "not in spendable form" criterion includes items that are not expected to be converted to cash, for example: prepaid items, land held for redevelopment and long-term notes receivable. The corpus of the permanent fund is contractually required to be maintained intact.

Restricted Fund Balance – comprised of amounts that can be spent only for the specific purposes stipulated by external resource providers, constitutionally or through enabling legislation. Restrictions may effectively be changed or lifted only with the consent of resource providers.

Committed Fund Balance – comprised of amounts that can only be used for the specific purposes determined by a formal action of the City's highest level of decision-making authority, the City Council. Commitments may be changed or lifted only by the City taking the same formal action that imposed the constraint originally (for example: resolution and ordinance).

Assigned Fund Balance – comprised of amounts intended to be used by the City for specific purposes that are neither restricted nor committed. Intent is expressed by the City Council or official to which the City Council has delegated the authority to assign amounts to be used for specific purposes.

Unassigned Fund Balance – is the residual classification for the General Fund and includes all amounts not contained in the other classifications. Unassigned amounts are technically available for any purpose. Other governmental funds may only report negative unassigned fund balance, which occurs when a fund has a residual deficit after allocation of fund balance to the nonspendable, restricted or committed categories.

The City implemented GASB 54 in FY2011 as discussed in Note 1. The fund balances of all governmental funds are presented by the above mentioned categories on the face of the financial statements. In circumstances when an expenditure is made for a purpose for which amounts are available in multiple fund balance categories, fund balance is depleted in the order of restricted, committed, assigned, and unassigned.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 10 – NET ASSETS AND FUND BALANCES (Continued)

The General Fund Budget Stabilization Reserve (BSR) is established by authority of the General Fund Reserve Policy, which is approved by the City Council and included in the City's annual adopted budget. The BSR is maintained in the range of 15 to 20 percent of General Fund operating expenditures, with a target of 18.5 percent. Any reserve level below 15 percent requires City Council approval. At the discretion of the City Manager, a reserve balance above 18.5 percent may be transferred to the Infrastructure Reserve within the Capital Projects Fund. The purpose of the General Fund BSR is to fund unbudgeted, unanticipated one-time costs. The BSR is not meant to fund ongoing, recurring General Fund operating expenditures.

As of June 30, 2011 total outstanding encumbrances related to governmental activities were \$3.4 million for the General Fund, \$25.9 million for the Capital Projects Fund, and \$0.7 million for the Special Revenue Funds.

Enterprise Funds

At June 30, 2011, Enterprise Fund net assets (in thousands):

	Water	Electric	Fiber Optics	Gas	Wastewater Collection	Wastewater Treatment	Refuse	Storm Drainage	Airport	Total
Unrestricted										
Rate stabilization										
Supply	\$ -	\$ 57,091	\$ -	\$ 8,789	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 65,880
Distribution	-	9,240	-	7,399	-	-	-	-	-	16,639
Operations	<u>10,639</u>	<u>-</u>	<u>10,130</u>	<u>-</u>	<u>5,896</u>	<u>3,020</u>	<u>(5,049)</u>	<u>1,640</u>	<u>(118)</u>	<u>26,158</u>
	10,639	66,331	10,130	16,188	5,896	3,020	(5,049)	1,640	(118)	108,677
Emergency plant replacement	1,000	1,000	1,000	1,000	1,000	1,747	-	-	-	6,747
Calaveras	-	55,558	-	-	-	-	-	-	-	55,558
Reappropriations	12,458	13,254	723	10,440	9,275	7,822	2,122	1,838	-	57,932
Commitments	1,416	2,330	86	6,734	976	2,679	1,533	1,549	91	17,394
Underground loan	-	736	-	-	-	-	-	-	-	736
Notes & Loans	-	-	-	-	-	560	-	-	-	560
Landfill corrective action	-	-	-	-	-	-	665	-	-	665
Public benefit program	-	3,139	-	-	-	-	-	-	-	3,139
Central Valley Project	-	305	-	-	-	-	-	-	-	305
Total	<u>\$ 25,513</u>	<u>\$ 142,653</u>	<u>\$ 11,939</u>	<u>\$ 34,362</u>	<u>\$ 17,147</u>	<u>\$ 15,828</u>	<u>\$ (729)</u>	<u>\$ 5,027</u>	<u>\$ (27)</u>	<u>\$ 251,713</u>

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

Internal Service Funds

At June 30, 2011, Internal Service Funds unrestricted net assets (in thousands):

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits	Workers' Compensation Insurance Program	General Liabilities Insurance Program	Retiree Health Benefits	Total
Unrestricted net assets:								
Commitments	\$ 1,684	\$ 1,330	\$ 59	\$ 339	\$ 14	\$ 18	\$ -	\$ 3,444
Future catastrophic losses	-	-	-	-	86	82	-	168
Retiree health care	-	-	-	-	-	-	26,285	26,285
Capital Projects	951	10,212	28	-	-	-	-	11,191
Available	<u>5,175</u>	<u>2,082</u>	<u>(139)</u>	<u>626</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,744</u>
Total	<u>\$ 7,810</u>	<u>\$ 13,624</u>	<u>\$ (52)</u>	<u>\$ 965</u>	<u>\$ 100</u>	<u>\$ 100</u>	<u>\$ 26,285</u>	<u>\$ 48,832</u>

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 10 – NET ASSETS AND FUND BALANCES (Continued)

Commitments represents the portion of net assets set aside for open purchase orders.

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

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

Capital projects represents the portion of net assets set aside for adopted capital projects.

NOTE 11 – PENSION PLANS

CalPERS Safety and Miscellaneous Employees’ Plans

Substantially all permanent City employees are eligible to participate in pension plans offered by the 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 one year of full-time employment. Funding contributions for both Plans are determined annually on an actuarial basis as of June 30 by CalPERS.

The Plans’ provisions and benefits in effect at June 30, 2011, 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%	1.092 - 3%
Required employee contribution rates	9%	7.999%
Required employer contribution rates	24.695%	17.555%

Effective July 17, 2010, the City implemented a 2 percent at 60 retirement plan for Miscellaneous employees.

The City’s current labor contracts with Safety Police and Safety Management employees require it to pay employee contributions as well as its own. Starting January 2, 2010, Safety Fire employees paid the entire employee contribution of 9 percent and the City paid the employer contributions. Within the Miscellaneous group, Service Employees International Union (SEIU) employees contribute 5.75 percent of the employee contributions with the City paying the balance. Within the Miscellaneous group, the management employees contribute 2 percent of the employee contributions with the City paying the balance. Contributions are collected through payroll deductions and the City remits those contributions to CalPERS.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 11 – PENSION PLANS (Continued)

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.

Actuarially determined employer and employee contributions for all plans for fiscal years 2011, 2010 and 2009 were \$24 million in each of those years. 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.

The City uses the actuarially determined percentages of payroll to calculate and pay contributions to CalPERS. This results in no net pension obligations or unpaid contributions. Annual Pension Costs representing the payment of annual required contributions determined by CalPERS for the last three fiscal years were as follows (in thousands):

Fiscal Year Ended	Annual Pension Cost (APC)	Percent of APC Contributed	Net Pension Obligation
<i>Safety Plan</i>			
June 30, 2009	\$ 5,437	100%	\$ -
June 30, 2010	5,441	100%	-
June 30, 2011	6,029	100%	-
<i>Miscellaneous Plan</i>			
June 30, 2009	10,963	100%	-
June 30, 2010	10,891	100%	-
June 30, 2011	12,354	100%	-

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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 11 – PENSION PLANS (Continued)

The Schedule of Funding Progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. 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 (in thousands):

Safety Plan:

Valuation Date	Actuarial				Funded Ratio	Annual Covered Payroll	Unfunded Liability as a % of Payroll
	Entry Age	Value of Assets	Unfunded	Funded			
	Accrued Liability		Liability	Ratio			
2008	\$ 258,964	\$ 228,883	\$ 30,081	88.4%	\$ 22,181	135.6%	
2009	280,293	236,274	44,019	84.3%	22,087	199.3%	
2010	293,895	244,413	49,482	83.2%	23,030	214.9%	

Miscellaneous Plan:

Valuation Date	Actuarial				Funded Ratio	Annual Covered Payroll	Unfunded Liability as a % of Payroll
	Entry Age	Value of Assets	Unfunded	Funded			
	Accrued Liability		Liability	Ratio			
2008	\$ 443,337	\$ 379,837	\$ 63,500	85.7%	\$ 63,934	99.3%	
2009	499,200	398,765	100,435	79.9%	65,602	153.1%	
2010	521,269	416,810	104,459	80.0%	62,496	167.1%	

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 11 – PENSION PLANS (Continued)

The significant actuarial assumptions adopted by CalPERS' Board of Administration that were used to prepare the City's actuarial valuations for both the Safety and Miscellaneous Plans are as follows:

Safety Plan

Valuation Date	6/30/2010*	6/30/2008**
Actuarial Cost Method	Entry Age Normal Cost Method	Entry Age Normal Cost Method
Amortization Method	Level percent of payroll	Level percent of payroll
Average Remaining Period	29 Years as of the Valuation Date	32 Years as of the Valuation Date
Asset Valuation Method	15 Year Smoothed Market	15 Year Smoothed Market
Actuarial Assumptions:		
Investment Rate of Return	7.75% (net of administrative expenses)	7.75% (net of administrative expenses)
Projected Salary Increases	3.55% to 13.15% depending on age, service, and type of employment	3.25% to 13.15% depending on age, service, and type of employment
Inflation	3.00%	3.00%
Payroll Growth	3.25%	3.25%
Individual Salary Growth	A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%.	A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%.

Miscellaneous Plan

Valuation Date	6/30/2010*	6/30/2008**
Actuarial Cost Method	Entry Age Normal Cost Method	Entry Age Normal Cost Method
Amortization Method	Level percent of payroll	Level percent of payroll
Average Remaining Period	20 Years as of the Valuation Date	19 Years as of the Valuation Date
Asset Valuation Method	15 Year Smoothed Market	15 Year Smoothed Market
Actuarial Assumptions:		
Investment Rate of Return	7.75% (net of administrative expenses)	7.75% (net of administrative expenses)
Projected Salary Increases	3.55% to 14.45% depending on age, service, and type of employment	3.25% to 14.45% depending on age, service, and type of employment
Inflation	3.00%	3.00%
Payroll Growth	3.25%	3.25%
Individual Salary Growth	A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%.	A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%.

* The June 30, 2010 valuations, which are the most recent valuations, were used to disclose the funded status.

** The June 30, 2008 valuations were used to determine the contribution requirements for FY 2010/11

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

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

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. Employees who retire directly from the City are eligible for retiree health benefits if they retire on or after age 50 with 5 years of service and are receiving a monthly pension from CalPERS.

For all employees hired before January 1, 2004, the City pays for 100 percent of the cost of retiree health benefits for retirees for their lifetimes. The City also pays a portion of health benefits for dependents of retirees equal to 90 percent of the premiums for 2011 and increasing 5 percent per year until the City's share reaches 100 percent of dependent premiums for 2013 and beyond.

For management employees, fire fighter and fire chief association members hired on or after January 1, 2004, and SEIU employees hired on or after January 1, 2005, the City pays for 50 percent of the above described benefits after 10 years of service, and the City's portion increases by 5 percent for each additional year of service up to 20 years. For management, fire fighter and fire chief association members who retire on or after January 1, 2006, and for SEIU employees who retire on or after January 1, 2007, the maximum premium amount the City will pay toward health insurance will be equal to the second highest CalPERS Bay Area Basic plan premium (currently the Blue Shield HMO premium).

During FY 2008, the City implemented the provisions of Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes uniform financial reporting standards for employers providing other postemployment benefits (OPEB). As part of the implementation, the City elected to participate in an irrevocable trust to provide a funding mechanism for the OPEB and to apply the provisions of the statement on a prospective basis. The Trust, California Employers' Retirees Benefit Trust (CERBT), is administrated by CalPERS and managed by a separately appointed board, which is not under control of the City Council. This Trust is not considered a component unit of the City.

Funding Policy and Actuarial Assumptions

The City's policy is to prefund these benefits by accumulating assets in the Trust Fund discussed above pursuant to City Council Resolution. The annual required contribution (ARC) was determined as part of a January 1, 2009, actuarial valuation using the entry age normal actuarial cost method. This is a projected benefit cost method, which takes into account those benefits that are expected to be earned in the future as well as those already accrued. The actuarial assumptions include: (a) 7.75 percent investment rate of return, (b) 3.25 percent projected annual salary increase, and (c) 5 percent health inflation increase. The actuarial methods and assumptions used include techniques that smooth the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Actuarial calculations reflect a long-term perspective and actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. The calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing costs between the City and plan members to that point. Actuarially determined amounts are subject to revision at least biannually as results are compared to past expectations and new estimates are made about the future. The City's OPEB unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll using a 30 year open amortization period.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 12 – RETIREE HEALTH BENEFITS (Continued)

Generally accepted accounting principles permit assets to be treated as OPEB assets and deducted from the Actuarial Accrued Liability when such assets are placed in an irrevocable trust or equivalent arrangement. During the year ended June 30, 2011, the City made contributions and amortized the Net OPEB asset to fund the current year ARC. As a result, the City has calculated and recorded the Net OPEB Asset, representing the difference between the ARC, amortization and contributions, as presented below (in thousands):

Annual required contribution	\$ 9,786
Amortization on the Net OPEB Asset	2,280
Interest on the Net OPEB Asset	<u>(1,801)</u>
Annual OPEB Cost	<u>10,265</u>
Contributions made:	
Contributions to OPEB Trust	1,832
Contributions to Retirees	1,981
City portion of current year premiums paid*	<u>6,216</u>
Total contributions made	<u>10,029</u>
Change in Net OPEB Asset	(236)
Net OPEB Asset, beginning of year	<u>23,242</u>
Net OPEB Asset, end of year	<u><u>\$ 23,006</u></u>

* FY 2011 premiums for 860 retirees.

Shortly after year-end, the City contributed an additional \$2.4 million to the Trust.

The Plan's annual required contributions and actual contributions for the past three years ended June 30 are set forth below (in thousands):

Fiscal Year	Annual OPEB Cost	Actual Contribution	Percentage of OPEB Cost	Net OPEB Obligation (Asset)
June 30, 2009	\$ 8,729	\$ 5,904	68%	\$ (26,352)
June 30, 2010	10,329	7,219	70%	(23,242)
June 30, 2011	10,265	10,029	98%	(23,006)

The Schedule of Funding Progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. Trend data from the actuarial studies is presented below (in thousands):

Valuation Date	Entry Age Accrued Liability	Value of Assets	Unfunded Liability	Funded Ratio	Annual Covered Payroll	Unfunded Liability as a % of Payroll
January 1, 2007	\$ 102,237	\$ -	\$ 102,237	0.0%	\$ 97,600	104.8%
January 1, 2009	129,661	24,616	105,045	19.0%	98,940	106.2%
January 1, 2011	169,979	35,294	134,685	20.8%	80,664	167.0%
June 30, 2011 *	179,923	40,222	139,701	22.4%	83,285	167.7%

* In accordance with GASB Statement No. 57, the CERBT required all trust participants to use a common valuation date. Therefore, the City is required to conduct its biennial valuation on June 30, rather than January 1, effective for 2011.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 12 – RETIREE HEALTH BENEFITS (Continued)

The retiree activities in the City’s Retiree Health Benefit Internal Service Fund consist of the following for the year ended June 30 (in thousands):

Retiree Health Benefits	2011	2010
Net assets, beginning of year	\$ 25,504	\$ 26,362
Interest earnings	60	73
Unrealized gain (loss) on investments	35	49
Interdepartmental charges	10,980	9,698
Compensated benefits	(10,294)	(10,614)
Transfers in (out)	-	(64)
Net assets, end of year	<u>\$ 26,285</u>	<u>\$ 25,504</u>

NOTE 13 – DEFERRED COMPENSATION PLAN

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

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

NOTE 14 – RISK MANAGEMENT

Coverage

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

The City has a workers’ compensation insurance policy with coverage up to the statutory limit set by the State of California. The City retains the risk for the first \$500,000 in losses for each accident and employee under this policy.

The City also has public employee dishonesty insurance with a \$5,000 deductible and coverage up to \$1 million per loss.

The City’s property and machinery insurance policy has various deductibles and various coverage based on the type 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 \$74 million per occurrence. The City retains the risk for the first \$1 million in losses for each occurrence under this policy.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 14 – RISK MANAGEMENT (Continued)

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

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

During the year ended June 30, 2011, the City contributed \$0.9 million to ACCEL for current year coverage.

Audited financial statements are available from ACCEL at 160 Spear Street, San Francisco, California 94105-2709.

Claims Liability

The City provides for the uninsured portion of claims and judgments in the General Benefits and Insurance Internal Service Funds. Claims and judgments, including a provision for claims incurred but not reported, and claim adjustment expenses 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 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. Dental liability is based on a percentage of current year actual expense. General and workers’ compensation liabilities are based on the results of actuarial studies, and include amounts for claims incurred but not reported as follows as of June 30 (in thousands):

	Year Ended June 30	
	2011	2010
Beginning balance	\$ 21,478	\$ 21,438
Liability for current and prior fiscal years claims and claims incurred but not reported (IBNR)	6,665	4,385
Claims paid	(4,240)	(4,345)
Ending balance	\$ 23,903	\$ 21,478
Current portion	\$ 5,873	\$ 6,532

The City has not incurred a claim that has exceeded its insurance coverage limits in any of the last three years, nor have there been any significant reductions in insurance coverage.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 15 – JOINT VENTURES

General

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

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

Northern California Power Agency

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

During the year ended June 30, 2011, the City incurred expenses totaling \$56.4 million for purchased power and assessments earned by NCPA.

The City's interest in NCPA projects and reserves, as computed by NCPA, was \$7.2 million at June 30, 2011. This amount represents the City's portion of funds, which resulted from the settlement with third parties of issues with financial consequences and reconciliations of several prior years' budgets for programs. It is recognized that all the funds credited to the City are linked to the collection of revenue from the City's ratepayers, or to the settlement of disputes relating to electric power supply and that the money was collected from the City's ratepayers to pay power bills. Additionally, the NCPA Commission identified and approved the funding of specific reserves for working capital, accumulated employees' post-retirement medical benefits, and billed property taxes for the geothermal project. The Commission also identified a number of contingent liabilities that may or may not be realized, the cost of which in most cases is difficult to estimate at this time. One such contingent liability is the steam field depletion, which will require funding to cover debt service and operational costs in excess of the expected value of the electric power. The General Operating Reserve is intended to minimize the number and amount of individual reserves needed for each project, protect NCPA's financial condition and maintain its credit worthiness. These funds are available on demand, but the City has left them with NCPA as a reserve against these contingencies identified by NCPA.

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

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 15 – JOINT VENTURES (Continued)

Geothermal Projects

A purchased power agreement with NCPA obligated the City for 6.2 percent and 6.2 percent, respectively, of the operating costs and debt service of the two NCPA 110-megawatt geothermal steampowered 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, 2011 is \$79.4 million. The City's participation in this project was 6.2 percent, or \$4.9 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 22.9 percent of this Project's debt service and operating costs. At June 30, 2011, the book value of this Project's plant, equipment and other assets was \$417.5 million, while its long-term debt totaled \$367.3 million and other liabilities totaled \$50.2 million. The City's share of the Project's long-term debt amounted to \$84.2 million at that date.

Geothermal Public Power Line

In 1983, NCPA, the 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 11.1 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.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 15 – JOINT VENTURES (Continued)

However, because the project financing provided funding for an ownership interest in a Pacific Gas & Electric (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 11.1 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, 2011, the book value of this Project's plant, equipment and other assets was zero, and its long-term debt totaled zero.

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 was obligated to pay 4 percent of TANC's debt-service and operating costs. However, a Resolution was approved authorizing the execution of a Long-Term Layoff Agreement (LTLA) between the Cities of Palo Alto and Roseville. These two agencies desired to "layoff" their entitlement rights to the California-Oregon Transmission Project (COTP) (and Roseville's South of Tesla entitlement rights) for a period of 15 years to those acquiring Members (Sacramento Municipal Utility District, Turlock Irrigation District, and Modesto Irrigation District). The effective date of this Agreement was February 1, 2009. As a result, the City is obligated to pay zero percent of TANC's debt-service and operating costs starting February 1, 2009, for a period of fifteen years.

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 \$421.4 million as of June 30, 2010. The City's share of this debt is zero due to the LTLA mentioned above.

Construction of the COTP was complete as of June 30, 1993. The transmission line was energized March 24, 1993. Because funding of certain participants' shares in the project was needed pending approval of their applications for participation, TANC issued \$93.8 million of Commercial Paper debt backed by a Letter of Credit. The City's share of the Commercial Paper was zero at June 30, 2011, due to the LTLA mentioned above.

TANC Financial Information

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

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

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 on December 31, 2004, upon which the City exercised its first option to extend for 10 years, for a new expiration date of 12/31/2014. The lease provides for two more five-year options to extend, 1/1/2015 to 12/31/2019, and 1/1/2020 to 12/31/2024. The City’s rent for the facilities is \$7.1 million per year plus insurance, repairs and maintenance. Should any new law or regulation require the expenditure of work in excess of \$250,000, per the terms of the lease, the City and PAUSD may renegotiate the lease. This lease is cancelable upon 90 days’ written notice in the event funds are not appropriated by the City. In addition, the lease is contingent upon authorization by the Palo Alto electorate if it exceeds the City’s Proposition 4 (Gann) appropriations limitation in any fiscal year. Lease expenditures for the year ended June 30, 2011, amounted to \$7.1 million.

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

<u>Year ending June 30</u>	<u>Payments</u>
2012	\$ 7,061
2013	7,273
2014	7,491
2015	7,716
2016	7,945
2017-2020	<u>34,184</u>
	<u>\$ 71,670</u>

GreenWaste of Palo Alto – As of July 1, 2009, GreenWaste of Palo Alto is the new contractor for waste collection, transportation, and processing services. The new agreement has a term of eight years, until June 30, 2017, with the potential to extend the contract to 2021. Base compensation for GreenWaste is a set amount for the first two years of the contract, and is adjusted annually thereafter based on CPI indicators stipulated in their contract. In FY 2011 this resulted in payments to GreenWaste of \$10.5 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, 2011. If the City initiates the termination of the contracts, it is required to pay the other partners their unamortized contribution towards the capital assets.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 16 – COMMITMENTS AND CONTINGENCIES (Continued)

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 a capacity share of 21.3 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 ended June 30, 2003, the 1992 bonds were refunded by issuing the 2003 Solid Waste Revenue Bonds in the amount of \$20.6 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 21.3 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, 2011, is \$2.4 million. During the year ended June 30, 2011, the City paid \$0.4 million as its portion of current debt service.

In FY 2008, the members agreed to finance an Equipment Replacement Project from existing reserves and proceeds from the Solid Waste Revenue Bond, Series 2007. The City has committed to repay 27.8 percent of the remaining debt service on the Bonds. The City's portion of the Bonds amounts to \$1.9 million as of June 30, 2011. During the year ended June 30, 2011, the City paid \$0.1 million 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 continued to be volatile during the year. The City purchased electricity in FY 2011 in conformance with the Council-approved Long-term Electric Acquisition Plan (LEAP) established in 2001 and last modified in March 2011. Due to the City's commodity purchase strategy, whereby purchases are made on a 3-year forward basis in a ladder fashion, the City's gas utility has a higher average cost of gas for its pool customers in FY 2011 compared to the average market price during the year. The City's average natural gas commodity cost for the gas pool customers was \$6.84/MMBtu compared to a spot market price of \$4.30/MMBtu. The primary reason the City's natural gas costs were higher than market was due to a dramatic drop in spot market prices in FY 2009 after gas had been purchased and costs were locked in. The City's average wholesale electric commodity purchase cost during the fiscal year was approximately 5.4¢/kWh while the average spot market prices were approximately 3.5¢/kWh.

Hydroelectric supplies were at high levels in FY 2011, which resulted in less energy purchased from the market. Hydroelectric production accounted for 58 percent of the City's electric supply in FY 2011 instead of 50 percent in a normal hydrologic year. These hydroelectric supplies derive from two sources – from contract with the Western Area Power Administration and from the City's partial ownership of the Calaveras Hydroelectric Project. Wind and landfill gas resources accounted for 19 percent of the electric supply in FY 2011, with the balance purchased from the wholesale electric market. The City transacts with qualified suppliers for the market purchases, and the Northern California Power Agency (NCPA), which provides scheduling services for the City, buys and sells electricity within the month as needed to meet the City's demands.

Incidental sales of surplus energy resulted in revenues of \$3.7 million during the year. (The expense associated with the surplus energy sold from the overall electric supply portfolio was calculated at \$4.9 million for the year, and is shown separately on the Statement of Revenues, Expenses and Changes in Net Assets.)

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 16 – COMMITMENTS AND CONTINGENCIES (Continued)

During FY 2009, the City executed a 15-year assignment of its full share of ownership and obligations in the California Oregon Transmission Project (COTP). The assignment resulted in lower cost to serve the City’s electric rate payers in FY 2011 and is projected to continue saving the City throughout the term of the assignment.

The City has executed Electric and Gas Master Agreements with suppliers to procure electricity and natural gas supplies. The table below outlines the electric and natural gas commodity supply commitments made by the City with these suppliers as of June 30, 2011. Monthly payments are made to suppliers upon delivery of supplies for the month. The City’s procurement plans 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.

Forward Electricity Commodity Supply Commitments as of June 30, 2011

Supplier	FY 2012	FY 2013	Total
BP	\$ 2,331,326	\$ 2,120,640	\$ 4,451,966
Powerex	6,691,783	1,613,675	8,305,458
SENA	2,635,200	-	2,635,200
	11,658,309	3,734,315	15,392,624
Average Cost (\$/MWh)	52.50	48.30	51.42

Forward Natural Gas Commodity Supply Commitments as of June 30, 2011

Supplier	FY 2012	FY 2013	FY 2014	Total
BP	\$ 2,868,864	\$ -	\$ -	\$ 2,868,864
JP Morgan	1,205,420	967,910	-	2,173,330
Powerex	574,540	1,227,170	611,310	2,413,020
SENA	4,536,733	1,597,500	-	6,134,233
	9,185,557	3,792,580	611,310	13,589,447
Average Cost (\$/MMBtu)	6.52	5.94	4.97	6.26

The City’s natural gas transportation contract with the Pacific Gas and Electric Company (PG&E) went into effect starting January 1, 2011, and will be in place until the end of 2014. This contract, commonly known as Gas Accord V, between PG&E and its transportation customers provides the City’s retail customers stable transportation costs. Palo Alto retains access to transmission capacity on par with PG&E’s core customers although rates increased for all shippers. Palo Alto’s backbone transmission rate increased by approximately 40 percent or \$150,000 per year. This is due to a shifting of costs from the pipeline in the south to the northern pipeline. Despite this projected cost increase, the City will continue to benefit from its transportation contract with PG&E.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 16 – COMMITMENTS AND CONTINGENCIES (continued)

Future Outlook

Electric

The market price for fossil fuel based electricity is projected to be relatively low for the next 12 months – at 3 to 4¢/kWh – but in the longer term it is expected to return to a higher level of 6 to 8¢/kWh. The price premium commanded by renewable energy projects remains significantly higher than “brown” market power. Costs for renewable energy are expected to remain high in the foreseeable future. The higher prices will result in higher costs to meet the City’s renewable energy supply targets.

The Council-approved Renewable Portfolio Standard (RPS), last updated in March 2011, is to meet 33 percent of the Citywide load with renewable resource supplies by 2015. On April 12, 2011 California adopted legislation (SB X12) requiring an RPS for all load serving entities including public owned utilities. The law requires utilities to procure renewable energy supplies to meet 20 percent of their retail sales by December 31, 2013, 25 percent of their retail sales by December 31, 2016 and 33 percent of their retail sales by December 31, 2020. For calendar year 2010, renewable supplies accounted for approximately 20.6 percent of retail sales. Going forward, the City continues to be on track to meet the City’s RPS as well as the state mandated RPS. Based on existing and committed renewable supplies – which are detailed in the table below – the City expects to have a renewable energy supply level as a percentage of retail sales of 28.6 percent in calendar year 2013, 30.7 percent in calendar year 2016, and 30.4 percent in calendar year 2020. In FY 2011, the Council re-approved the Western GeoPower renewable energy contract; this project is expected to begin operation in late 2013. In order to procure the remaining renewable energy to achieve RPS level of 33 percent of retail sales, the City is currently developing a feed-in-tariff program to buy energy from projects developed in Palo Alto. The City is also in the process of issuing a solicitation for additional long-term renewable energy purchase contracts from projects located throughout the western United States.

Project Name	Technology	Nameplate Capacity (MW)	Nominal Generation (MWh/yr)	Currently Online	Actual or Expected Contract Start Date	Location (state)	Contracting Date	Contract Term (years)
Shiloh	Wind	25	74,400	Yes	2006	California	2005	15
High Winds	Wind	20	51,800	Yes	2004	California	2004	23.5
Santa Cruz Landfill	LFG	1.6	11,200	Yes	2006	California	2004	20
Ox Mountain Landfill	LFG	5.7	40,800	Yes	2009	California	2005	20
Keller Canyon Landfill	LFG	2	11,800	Yes	2009	California	2005	20
Johnson Canyon Landfill	LFG	1.4	11,200	No	2011	California	2009	20
San Joaquin Landfill	LFG	4.3	32,000	No	2012	California	2010	20
Crazy Horse Canyon Landfill	LFG	2.9	21,600	No	2012	California	2010	20
Western GeoPower	Geothermal	3.9	33,100	No	2013	California	2011	25

Energy efficiency is the most cost-effective electric resource available to the City. It is considered a primary resource for the electric utility. Reducing the need for energy and renewable energy supplies are two of the main methods the City plans to employ to achieve the greenhouse gas reduction targets established in the City’s Climate Protection Plan. The City’s first 10-year Electric Energy Efficiency Plan, adopted by the Council in 2007, had a goal of reducing the City’s electric needs by 3.5 percent by 2016 by employing energy efficiency measures. For the first three years of the 2007 Plan’s implementation, actual energy savings exceeded the annual goals set in the plan. In May 2010, Council adopted the updated 2010

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 16 – COMMITMENTS AND CONTINGENCIES (continued)

10-year Electric Energy Efficiency Plan, which more than doubled the energy efficiency goals of the 2007 Plan. The goal for the 2010 Plan is to reduce the City's electric needs by 7.2 percent by 2020 by employing energy efficiency measures.

PaloAltoGreen, the City's volunteer green power program, currently accounts for an additional 6 percent of the City's energy needs from renewable resources. The City also has a program to encourage small-scale ultra-clean distributed generation and co-generation applications within the City, but there have been no applicants for this program. The City is planning to re-evaluate this program to make sure that it provides the proper incentive for customers to build such clean and efficient units at their premises.

The CAISO implemented its Market Redesign and Technology Update (MRTU) in April 2009. An underlying component of MRTU is the use of location-specific prices for the scheduling of energy transactions. These locational prices are determined hourly and reflect the marginal costs of meeting demand and resolving congestion on the transmission grid, which adds more uncertainty and volatility to the cost of transmission services for the City.

The City continues to follow the development of laws and associated regulations related to implementation of AB 32 (California Global Warming Solutions Act of 2006, Chaptered 9/27/2006). In December 2008, the California Air Resources Board (CARB) approved the Scoping Plan, which is the primary guidance document for shaping how California will reduce its greenhouse gas (GHG) emissions to 1990 levels by 2020 as called for by AB 32. The scoping plan has a range of GHG reduction actions, which include direct regulations, alternative compliance mechanisms, monetary and non-monetary incentives, voluntary actions, market-based mechanisms such as a cap-and-trade system, and an AB 32 cost of implementation fee regulation to fund the program. CARB is tasked with completing the majority of the work in designing the implementation details by October 28, 2011, with most regulations and other initiatives adopted by the start of 2012. In FY 2011, CARB delayed the start of the compliance obligations for electricity providers under the cap-and-trade system by one year, from January 1, 2012 to January 1, 2013. At this time it is anticipated that the cap-and-trade system will go into full effect in 2013, but it is still unclear what the financial impact will be to the City.

Natural Gas

Long-term market prices for natural gas have remained depressed since the market price decline in 2008/2009. Increasing U.S. and international demand resulting from economic recovery and potential clean energy legislation may put pressure on gas prices in the long term, however low to moderate gas prices are forecasted for the next year or two. The gas laddering strategy used to hedge gas portfolio costs is currently under review. The City also employs asset management strategies to lower overall commodity costs.

In March 2011, the Council approved a plan to implement a voluntary customer program similar to PaloAltoGreen for non-fossil fuel gas supplies. The City continues to search for potential supplies that are priced in a reasonable range for program marketability.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 16 – COMMITMENTS AND CONTINGENCIES (continued)

Water

The City's water use during FY 2011 increased about 2 percent from the prior year. Usage is highly dependent on weather conditions, but has remained essentially flat for the past 10 years. Current water usage is only 64 percent of what it was in 1975. The small increase in usage in FY 2011 may be attributed to some level of economic recovery and increased rainfall. Water supply costs for FY 2011 increased by 17.9 percent from FY 2010, primarily due to a 15 percent increase in the San Francisco Public Utilities Commission (SFPUC) wholesale water rate in FY 2011. The increase was related in part to extensive capital improvements on the Hetch Hetchy Water System and in part decreased consumption in San Francisco and other Bay Area Water Supply & Conservation Agency (BAWSA) agencies, which required a higher per unit wholesale rate in order to recover fixed costs.

Water supply costs are expected to continue to trend upward as the SFPUC implements its upgrade to the regional water system facilities, the Water System Improvement Program (WSIP). Costs for the WSIP are expected to be about \$4.6 billion. Estimates for these increased costs have been factored into the City's long-term water supply cost projections.

Palo Alto is a member of the Bay Area Water Supply and Conservation Agency (BAWSCA), which represents all the agencies that buy water on a wholesale basis from the City and County of San Francisco (San Francisco.) The relationship between each of the BAWSCA agencies and San Francisco is specified in a 25-year water service contract, which expired on June 30, 2009. Each agency, including Palo Alto, has approved a new 25-year Water Supply Agreement with San Francisco effective on July 1, 2009. The new contract contains the same mechanism for cost allocation as in the old contract and the contract has other improvements regarding water quality and fair treatment in water supply emergencies. However, a new supply limitation will require that the BAWSCA agencies work together to reduce long-term demand so that additional diversions from the Tuolumne River are minimized or eliminated.

During FY 2009, the City completed a Recycled Water Facility Plan, which provides more detailed design information on the project to expand the recycled water distribution. After circulating a Draft Mitigated Negative Declaration document for comments, it was determined that additional study would be required to address the water quality of the recycled water, particularly the salinity levels, which would negatively impact plant materials. The City embarked on a single-issue Environmental Impact Report in FY 2010 to address this issue. The environmental documents, which are necessary to compete for grant funding opportunities, are expected to be completed in FY 2012.

Contingent Liabilities

Many of the uncertainties faced by the Utilities Department as an aftermath of the 2000-01 energy crisis have been resolved. The Ninth Circuit Court determined that the Federal Energy Regulatory Commission (FERC) lacked authority under the Federal Power Act to grant refund relief against governmental agencies, and the United States Supreme Court declined to review that decision. Nonetheless a number of entities ("the California Parties") filed suit against the NCPA and other municipal utilities seeking refunds for sales made to the CAISO and Power Exchange during the energy crisis. The suit was filed in the Superior Court in Los Angeles in April 2007. In March 2010, the issue was resolved in a settlement agreement and the City made a payment to the California Parties and no further claims are expected. On April 29, 2010, the FERC issued an order approving the settlement between NCPA and the California Parties. Another dispute between the Western Area Power Administration and PG&E regarding PG&E's claim to recover certain CAISO related costs has not been resolved.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 16 – COMMITMENTS AND CONTINGENCIES (continued)

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 materially 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 \$.6 million sales 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, 2011, 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 costs were questioned 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.

NOTE 17 – SUBSEQUENT EVENTS

Approval of the Expansion of Stanford Medical Center

On June 6, 2011, the City Council approved a Development Agreement between the City and Stanford Hospital and Clinics, Lucile Salter Packard Children’s Hospital at Stanford, and the Board of Trustees of the Leland Stanford Junior University (collectively, the “SUMC Parties”), whereby the SUMC Parties will enhance and expand their facilities and the City will grant the SUMC Parties the right to develop the facilities in accordance with Project Approvals described in the Agreement.

Under the terms of the Agreement, the City received \$20.8 million in August, 2011 to be used for various community and mitigation measures as specified in the Agreement. The City will receive a further \$23.4 million over the course of the project.

Refinancing of the 2002A Golf Course Certificate of Participation

On August 2, 2011, the City entered into a master lease-purchase agreement (the Agreement) with JPMorgan Chase Bank N.A., whereby the proceeds together with the bond reserve fund were used to refund the Certificates of Participation, Series 1998 (Golf Course Improvements and Refinancing Project). The principal amount financed by the Agreement was \$3.2 million and will be repaid at an interest rate of 2.49 percent. Semi-annual payments will be made through September 1, 2018. The City used its Fire Department rolling stock as the collateral in this Agreement.

Dissolution of the Redevelopment Agency

On September 6, 2011, the City adopted Ordinance No. 5126 to dissolve the Palo Alto Redevelopment Agency (Agency) pursuant to Health & Safety Code Section 33140, effective October 7, 2011. The Agency was formed in October 2001, pursuant to Section 33101 of the Community Redevelopment Law, and was reported as one of the City’s special revenue funds. In response to the 2011-12 State budget bill, the City has evaluated that the Agency has not identified a qualifying redevelopment area and has not conducted any redevelopment activities, including redeveloping or acquiring land, entering into contract, issuing bonds or incurring housing obligations, since its formation. Hence, the City Council approved its dissolution.

CITY OF PALO ALTO
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011

NOTE 17 – SUBSEQUENT EVENTS (Continued)

Dissolution of the Redevelopment Agency (Continued)

The League of California Cities and the California Redevelopment Association (CRA) filed a lawsuit on July 18, 2011 on behalf of cities, counties and redevelopment agencies petitioning the California Supreme Court to overturn Assembly Bills X1 26 and 27 on the grounds that these bills violate the California Constitution. On August 11, 2011, the California Supreme Court issued a stay of all of Assembly Bill X1 27 and most of Assembly Bill X1 26. However, the Agency decided to move forward with the dissolution regardless of the outcome of the California Supreme Court.

Issuance of 2011 Series A, Utility Revenue Refunding Bonds

On September 8, 2011, the City issued \$17.2 million in Lease Revenue Bonds (2011 Bonds) with an average interest rate of 3.33 percent and an original bond premium of \$1.3 million. On the date of issuance, the proceeds of the 2011 Bonds together with existing bond reserves of \$20.3 million were used to refund on a current basis the Utility Revenue Bonds, 2002 Series A (2002 Bonds). The 2002 Bonds were issued to finance improvements to the City's municipal water utility system and the natural gas utility system. The remaining proceeds were used to pay for the costs of issuance of the 2011 Bonds and other costs relating to the refunding.

CITY OF PALO ALTO
 Non-major Governmental Funds
 Combining Balance Sheet
 June 30, 2011
 (Amounts in Thousands)

	Special Revenue Funds	Debt Service Funds	Permanent Fund	Total
Assets:				
Cash and investments:				
Available for operations	\$ 19,720	\$ 2,040	\$ 1,422	\$ 23,182
Cash and investments with fiscal agents	-	1,225	-	1,225
Receivables, net:				
Accounts	220	-	-	220
Interest	133	-	10	143
Notes	9,824	-	-	9,824
Total assets	<u>\$ 29,897</u>	<u>\$ 3,265</u>	<u>\$ 1,432</u>	<u>\$ 34,594</u>
Liabilities and fund balances:				
Liabilities:				
Accounts payable and accruals	\$ 288	\$ -	\$ 10	\$ 298
Accrued salaries and benefits	4	-	-	4
Total liabilities	<u>292</u>	<u>-</u>	<u>10</u>	<u>302</u>
Fund balances:				
Nonspendable				
Eyerly family	-	-	1,422	1,422
Restricted				
Transportation mitigation	4,344	-	-	4,344
Federal revenue	4,619	-	-	4,619
Street improvement	1,598	-	-	1,598
Local law enforcement	264	-	-	264
Debt Service	-	3,265	-	3,265
Committed				
Developer's impact fee	5,287	-	-	5,287
Housing In-Lieu	11,662	-	-	11,662
Special Districts	1,075	-	-	1,075
Downtown Business	58	-	-	58
Assigned				
Unrealized gain on investment	696	-	-	696
Other general government	2	-	-	2
Total fund balances	<u>29,605</u>	<u>3,265</u>	<u>1,422</u>	<u>34,292</u>
Total liabilities and fund balances	<u>\$ 29,897</u>	<u>\$ 3,265</u>	<u>\$ 1,432</u>	<u>\$ 34,594</u>

CITY OF PALO ALTO
 Non-major Governmental Funds
 Combining Statement of Revenues, Expenditures and Changes in Fund Balances
 For the Year Ended June 30, 2011
 (Amounts in Thousands)

	Special Revenue Funds	Debt Service Funds	Permanent Fund	Total
Revenues:				
Property taxes	\$ -	\$ 3,468	\$ -	\$ 3,468
Special assessments	92	-	-	92
Other taxes and fines	1,661	-	-	1,661
From other agencies:				
Community Development Block Grants	338	-	-	338
State of California	101	-	-	101
Permits and licenses	359	-	-	359
Return on investments	484	3	34	521
Rental income	19	-	-	19
Other:				
Housing In-Lieu - residential	2,574	-	-	2,574
University Avenue Parking	963	-	-	963
California Avenue Parking	102	-	-	102
Other fees	964	11	4	979
Total revenues	<u>7,657</u>	<u>3,482</u>	<u>38</u>	<u>11,177</u>
Expenditures:				
Current:				
Planning and Community Environment	941	-	-	941
Public safety - Police	22	-	-	22
Non-Departmental	256	-	18	274
Debt service:				
Principal retirement	-	870	-	870
Interest and fiscal charges	-	1,815	-	1,815
Total expenditures	<u>1,219</u>	<u>2,685</u>	<u>18</u>	<u>3,922</u>
Excess of revenues over expenditures	<u>6,438</u>	<u>797</u>	<u>20</u>	<u>7,255</u>
Other financing sources (uses):				
Transfers in	10	1,179	-	1,189
Transfers out	<u>(2,605)</u>	<u>-</u>	<u>-</u>	<u>(2,605)</u>
Total other financing sources (uses)	<u>(2,595)</u>	<u>1,179</u>	<u>-</u>	<u>(1,416)</u>
Change in fund balances	3,843	1,976	20	5,839
Fund balances, beginning of year	<u>25,762</u>	<u>1,289</u>	<u>1,402</u>	<u>28,453</u>
Fund balances, end of year	<u>\$ 29,605</u>	<u>\$ 3,265</u>	<u>\$ 1,422</u>	<u>\$ 34,292</u>

NON-MAJOR GOVERNMENTAL FUNDS

Special Revenue 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.

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

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

DOWNTOWN BUSINESS DEVELOPMENT DISTRICT

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

CITY OF PALO ALTO
Non-major Special Revenue Funds
Combining Balance Sheet
June 30, 2011
(Amounts in Thousands)

	<u>Street Improvement</u>	<u>Federal Revenue</u>	<u>Housing In-Lieu</u>	<u>Special Districts</u>
Assets:				
Cash and investments:				
Available for operations	\$ 1,440	\$ 374	\$ 6,533	\$ 1,116
Receivables:				
Accounts	195	-	-	-
Interest	9	-	45	7
Notes	-	4,266	5,558	-
Total assets	<u>\$ 1,644</u>	<u>\$ 4,640</u>	<u>\$ 12,136</u>	<u>\$ 1,123</u>
Liabilities and fund balances:				
Liabilities:				
Accounts payable and accruals	\$ -	\$ 21	\$ 234	\$ 6
Accrued salaries and benefits	-	-	-	4
Total liabilities	<u>-</u>	<u>21</u>	<u>234</u>	<u>10</u>
Fund balances:				
Restricted				
Transportation mitigation	-	-	-	-
Federal revenue	-	4,619	-	-
Street improvement	1,598	-	-	-
Local law enforcement	-	-	-	-
Committed				
Developer's impact fee	-	-	-	-
Housing In-Lieu	-	-	11,662	-
Special Districts	-	-	-	1,075
Downtown Business	-	-	-	-
Assigned				
Unrealized gain on investment	46	-	240	38
Other general government	-	-	-	-
Total fund balances	<u>1,644</u>	<u>4,619</u>	<u>11,902</u>	<u>1,113</u>
Total liabilities and fund balances	<u>\$ 1,644</u>	<u>\$ 4,640</u>	<u>\$ 12,136</u>	<u>\$ 1,123</u>

<u>Transportation Mitigation</u>	<u>Local Law Enforcement</u>	<u>Assets Seizure</u>	<u>Developer's Impact Fee</u>	<u>Redevelopment Agency</u>	<u>Downtown Business Development District</u>	<u>Total</u>
\$ 4,475	\$ 250	\$ 2	\$ 5,450	\$ -	\$ 80	\$ 19,720
-	25	-	-	-	-	220
31	2	-	39	-	-	133
-	-	-	-	-	-	9,824
<u>\$ 4,506</u>	<u>\$ 277</u>	<u>\$ 2</u>	<u>\$ 5,489</u>	<u>\$ -</u>	<u>\$ 80</u>	<u>\$ 29,897</u>
\$ -	\$ 6	\$ -	\$ -	\$ -	\$ 21	\$ 288
-	-	-	-	-	-	4
-	6	-	-	-	21	292
4,344	-	-	-	-	-	4,344
-	-	-	-	-	-	4,619
-	-	-	-	-	-	1,598
-	264	-	-	-	-	264
-	-	-	5,287	-	-	5,287
-	-	-	-	-	-	11,662
-	-	-	-	-	-	1,075
-	-	-	-	-	58	58
162	7	-	202	-	1	696
-	-	2	-	-	-	2
<u>4,506</u>	<u>271</u>	<u>2</u>	<u>5,489</u>	<u>-</u>	<u>59</u>	<u>29,605</u>
<u>\$ 4,506</u>	<u>\$ 277</u>	<u>\$ 2</u>	<u>\$ 5,489</u>	<u>\$ -</u>	<u>\$ 80</u>	<u>\$ 29,897</u>

CITY OF PALO ALTO
Non-major Special Revenue Funds
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
For the Year Ended June 30, 2011
(Amounts in Thousands)

	Street Improvement	Federal Revenue	Housing In-Lieu	Special Districts	Transportation Mitigation
Revenues:					
Special assessments	\$ -	\$ -	\$ -	\$ -	\$ -
Other taxes and fines	1,631	-	-	30	-
From other agencies:					
Community Development Block Grants	-	338	-	-	-
State of California	-	-	1	-	-
Permits and licenses	-	-	-	359	-
Return on investments	(3)	(22)	224	26	100
Rental income	-	-	19	-	-
Other					
Housing In-Lieu - residential	-	-	2,574	-	-
University Avenue Parking	-	-	-	963	-
California Avenue Parking	-	-	-	102	-
Other fees	-	145	321	-	50
Total revenues	<u>1,628</u>	<u>461</u>	<u>3,139</u>	<u>1,480</u>	<u>150</u>
Expenditures:					
Current:					
Planning and Community Environment	-	505	368	68	-
Public safety - Police	-	-	-	-	-
Non-Departmental	-	40	29	119	-
Total expenditures	<u>-</u>	<u>545</u>	<u>397</u>	<u>187</u>	<u>-</u>
Excess (deficiency) of revenues over (under) expenditures	<u>1,628</u>	<u>(84)</u>	<u>2,742</u>	<u>1,293</u>	<u>150</u>
Other financing sources (uses):					
Transfers in	-	-	-	-	-
Transfers out	(1,042)	-	-	(1,221)	(82)
Total other financing sources (uses)	<u>(1,042)</u>	<u>-</u>	<u>-</u>	<u>(1,221)</u>	<u>(82)</u>
Change in fund balances	586	(84)	2,742	72	68
Fund balances, beginning of year	<u>1,058</u>	<u>4,703</u>	<u>9,160</u>	<u>1,041</u>	<u>4,438</u>
Fund balances, end of year	<u>\$ 1,644</u>	<u>\$ 4,619</u>	<u>\$ 11,902</u>	<u>\$ 1,113</u>	<u>\$ 4,506</u>

Local Law Enforcement	Assets Seizure	Developer's Impact Fee	Redevelopment Agency	Downtown Business Development District	Total
\$ -	\$ -	\$ -	\$ -	\$ 92	\$ 92
-	-	-	-	-	1,661
-	-	-	-	-	338
100	-	-	-	-	101
-	-	-	-	-	359
6	-	150	-	3	484
-	-	-	-	-	19
-	-	-	-	-	2,574
-	-	-	-	-	963
-	-	-	-	-	102
-	2	446	-	-	964
<u>106</u>	<u>2</u>	<u>596</u>	<u>-</u>	<u>95</u>	<u>7,657</u>
-	-	-	-	-	941
22	-	-	-	-	22
-	-	-	-	68	256
<u>22</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>68</u>	<u>1,219</u>
<u>84</u>	<u>2</u>	<u>596</u>	<u>-</u>	<u>27</u>	<u>6,438</u>
-	-	-	10	-	10
<u>(30)</u>	<u>-</u>	<u>(220)</u>	<u>(10)</u>	<u>-</u>	<u>(2,605)</u>
<u>(30)</u>	<u>-</u>	<u>(220)</u>	<u>-</u>	<u>-</u>	<u>(2,595)</u>
54	2	376	-	27	3,843
<u>217</u>	<u>-</u>	<u>5,113</u>	<u>-</u>	<u>32</u>	<u>25,762</u>
<u>\$ 271</u>	<u>\$ 2</u>	<u>\$ 5,489</u>	<u>\$ -</u>	<u>\$ 59</u>	<u>\$ 29,605</u>

CITY OF PALO ALTO
 Non-major Special Revenue Funds
 Combining Schedule of Revenues, Expenditures and Changes in Fund Balances -
 Budget and Actual
 For the Year Ended June 30, 2011
 (Amounts in Thousands)

	Street Improvement			Federal Revenue		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
Revenues:						
Special assessments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other taxes and fines	1,127	1,631	504	-	-	-
From other agencies:						
Community Development Block Grants	-	-	-	663	338	(325)
State of California	-	-	-	-	-	-
Other revenue from other agencies	-	-	-	276	-	(276)
Permits and licenses	-	-	-	-	-	-
Return on investments	31	(3)	(34)	-	(22)	(22)
Rental income	-	-	-	-	-	-
Other:						
Housing In-Lieu - residential	-	-	-	-	-	-
University Avenue Parking	-	-	-	-	-	-
California Avenue Parking	-	-	-	-	-	-
Other fees	-	-	-	7	145	138
Total revenues	<u>1,158</u>	<u>1,628</u>	<u>470</u>	<u>946</u>	<u>461</u>	<u>(485)</u>
Expenditures:						
Current:						
Planning and Community Environment	-	-	-	1,336	505	831
Public safety - Police	-	-	-	-	-	-
Non-Departmental	-	-	-	-	40	(40)
Total expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,336</u>	<u>545</u>	<u>791</u>
Excess (deficiency) of revenues over (under) expenditures	<u>1,158</u>	<u>1,628</u>	<u>470</u>	<u>(390)</u>	<u>(84)</u>	<u>306</u>
Other financing sources (uses):						
Transfers in	-	-	-	5	-	(5)
Transfers out	(1,042)	(1,042)	-	(5)	-	5
Total other financing sources (uses)	<u>(1,042)</u>	<u>(1,042)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Change in fund balances	<u>\$ 116</u>	<u>586</u>	<u>\$ 470</u>	<u>\$ (390)</u>	<u>(84)</u>	<u>\$ 306</u>
Fund balances, beginning of year		<u>1,058</u>			<u>4,703</u>	
Fund balances, end of year		<u>\$ 1,644</u>			<u>\$ 4,619</u>	

Housing In-Lieu			Special Districts			Transportation Mitigation		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
-	-	-	30	30	-	-	-	-
-	1	1	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	306	359	53	-	-	-
153	224	71	29	26	(3)	145	100	(45)
9	19	10	-	-	-	-	-	-
3,500	2,574	(926)	-	-	-	-	-	-
-	-	-	963	963	-	-	-	-
-	-	-	94	102	8	-	-	-
222	321	99	-	-	-	562	50	(512)
3,884	3,139	(745)	1,422	1,480	58	707	150	(557)
4,850	368	4,482	148	68	80	-	-	-
-	-	-	-	-	-	-	-	-
1,603	29	1,574	128	119	9	-	-	-
6,453	397	6,056	276	187	89	-	-	-
(2,569)	2,742	5,311	1,146	1,293	147	707	150	(557)
-	-	-	-	-	-	-	-	-
-	-	-	(1,349)	(1,221)	128	(82)	(82)	-
-	-	-	(1,349)	(1,221)	128	(82)	(82)	-
\$ (2,569)	2,742	\$ 5,311	\$ (203)	72	\$ 275	\$ 625	68	\$ (557)
	9,160			1,041			4,438	
	\$ 11,902			\$ 1,113			\$ 4,506	

(Continued)

CITY OF PALO ALTO
 Non-major Special Revenue Funds
 Combining Schedule of Revenues, Expenditures and Changes in Fund Balances -
 Budget and Actual
 For the Year Ended June 30, 2011
 (Amounts in Thousands)

	Local Law Enforcement			Asset Seizure			Developer's Impact Fee		
	Budget	Actual	Variance Positive (Negative)	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	125	100	(25)	-	-	-	-	-	-
Other revenue from other agencies	-	-	-	-	-	-	-	-	-
Permits and licenses	-	-	-	-	-	-	-	-	-
Return on investments	5	6	1	-	-	-	152	150	(2)
Rental income	-	-	-	-	-	-	-	-	-
Other:									
Housing In-Lieu - residential	-	-	-	-	-	-	-	-	-
University Avenue Parking	-	-	-	-	-	-	-	-	-
California Avenue Parking	-	-	-	-	-	-	-	-	-
Other fees	-	-	-	-	2	2	553	446	(107)
Total revenues	<u>130</u>	<u>106</u>	<u>(24)</u>	<u>-</u>	<u>2</u>	<u>2</u>	<u>705</u>	<u>596</u>	<u>(109)</u>
Expenditures:									
Current:									
Planning and Community Environment	-	-	-	-	-	-	-	-	-
Public safety - Police	153	22	131	-	-	-	-	-	-
Non-Departmental	-	-	-	-	-	-	-	-	-
Total expenditures	<u>153</u>	<u>22</u>	<u>131</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(23)</u>	<u>84</u>	<u>107</u>	<u>-</u>	<u>2</u>	<u>2</u>	<u>705</u>	<u>596</u>	<u>(109)</u>
Other financing sources (uses):									
Transfers in	-	-	-	-	-	-	-	-	-
Transfers out	(30)	(30)	-	-	-	-	(220)	(220)	-
Total other financing sources (uses)	<u>(30)</u>	<u>(30)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(220)</u>	<u>(220)</u>	<u>-</u>
Change in fund balances	<u>\$ (53)</u>	<u>54</u>	<u>\$ 107</u>	<u>\$ -</u>	<u>2</u>	<u>\$ 2</u>	<u>\$ 485</u>	<u>376</u>	<u>\$ (109)</u>
Fund balances, beginning of year		<u>217</u>			<u>-</u>			<u>5,113</u>	
Fund balances, end of year		<u>\$ 271</u>			<u>\$ 2</u>			<u>\$ 5,489</u>	

Redevelopment Agency			Downtown Business Improvement District			Total Non-major Special Revenue Funds		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
\$ -	\$ -	\$ -	\$ 160	\$ 92	\$ (68)	\$ 160	\$ 92	\$ (68)
-	-	-	-	-	-	1,157	1,661	504
-	-	-	-	-	-	663	338	(325)
-	-	-	-	-	-	125	101	(24)
-	-	-	-	-	-	276	-	(276)
-	-	-	-	-	-	306	359	53
-	-	-	2	3	1	517	484	(33)
-	-	-	-	-	-	9	19	10
-	-	-	-	-	-	3,500	2,574	(926)
-	-	-	-	-	-	963	963	-
-	-	-	-	-	-	94	102	8
-	-	-	-	-	-	1,344	964	(380)
-	-	-	162	95	(67)	9,114	7,657	(1,457)
-	-	-	-	-	-	6,334	941	5,393
-	-	-	-	-	-	153	22	131
9	-	9	170	68	102	1,910	256	1,654
9	-	9	170	68	102	8,397	1,219	7,178
(9)	-	9	(8)	27	35	717	6,438	5,721
9	10	1	-	-	-	14	10	(4)
-	(10)	(10)	-	-	-	(2,728)	(2,605)	123
9	-	(9)	-	-	-	(2,714)	(2,595)	119
<u>\$ -</u>	<u>-</u>	<u>\$ -</u>	<u>\$ (8)</u>	<u>27</u>	<u>\$ 35</u>	<u>\$ (1,997)</u>	<u>3,843</u>	<u>\$ 5,840</u>
				<u>32</u>			<u>25,762</u>	
	<u>\$ -</u>			<u>\$ 59</u>			<u>\$ 29,605</u>	

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NON-MAJOR GOVERNMENTAL FUNDS

Debt Service Funds

GOLF COURSE

This fund accounts for revenues received from the General Fund to provide payment of principal and interest associated with Certificates of Participation 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.

LIBRARY PROJECT

This fund accounts for revenues received from property taxes to provide payment of principal and interest associated with the 2010 General Obligation Bonds as they become due

CITY OF PALO ALTO
 Non-major Debt Service Funds
 Combining Balance Sheet
 June 30, 2011
 (Amounts in Thousands)

	Golf Course	Civic Center Refinancing	Downtown Parking Improvement	Library Projects	Total
Assets:					
Cash and investments :					
Available for operations	\$ 43	\$ -	\$ -	\$ 1,997	\$ 2,040
Cash and investments with fiscal agents	624	351	250	-	1,225
Total Assets	<u>\$ 667</u>	<u>\$ 351</u>	<u>\$ 250</u>	<u>\$ 1,997</u>	<u>\$ 3,265</u>
Fund balances:					
Restricted:					
Debt Service	667	351	250	1,997	3,265
Total fund balances	<u>667</u>	<u>351</u>	<u>250</u>	<u>1,997</u>	<u>3,265</u>
Total liabilities and fund balances	<u>\$ 667</u>	<u>\$ 351</u>	<u>\$ 250</u>	<u>\$ 1,997</u>	<u>\$ 3,265</u>

CITY OF PALO ALTO
 Non-major Debt Service Funds
 Combining Statement of Revenues, Expenditures and Changes in Fund Balances
 For the Year Ended June 30, 2011
 (Amounts in Thousands)

	Golf Course	Civic Center Refinancing	Downtown Parking Improvement	Library Project	Total
Revenues:					
Property taxes	\$ -	\$ -	\$ -	\$ 3,468	\$ 3,468
Return on investments	1	1	1	-	3
Other					
Other fees	-	-	11	-	11
Total revenues	1	1	12	3,468	3,482
Expenditures:					
Debt service:					
Principal retirement	370	390	110	-	870
Interest and fiscal charges	190	31	123	1,471	1,815
Total expenditures	560	421	233	1,471	2,685
Excess (deficiency) of revenues over (under) expenditures	(559)	(420)	(221)	1,997	797
Other financing sources:					
Transfers in	528	418	233	-	1,179
Total other financing sources	528	418	233	-	1,179
Change in fund balances	(31)	(2)	12	1,997	1,976
Fund balances, beginning of year	698	353	238	-	1,289
Fund balances, end of year	\$ 667	\$ 351	\$ 250	\$ 1,997	\$ 3,265

CITY OF PALO ALTO
 Non-major Debt Service Funds
 Combining Schedule of Revenues, Expenditures and Changes in Fund Balances -
 Budget and Actual
 For the Year Ended June 30, 2011
 (Amounts in Thousands)

	Golf Course			Civic Center Refinance		
	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
Revenues:						
Special assessments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Return on investments	32	1	(31)	13	1	(12)
Other fees	-	-	-	-	-	-
Total revenues	<u>32</u>	<u>1</u>	<u>(31)</u>	<u>13</u>	<u>1</u>	<u>(12)</u>
Expenditures:						
Debt service:						
Principal retirement	370	370	-	390	390	-
Interest and fiscal charges	190	190	-	31	31	-
Total expenditures	<u>560</u>	<u>560</u>	<u>-</u>	<u>421</u>	<u>421</u>	<u>-</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(528)</u>	<u>(559)</u>	<u>(31)</u>	<u>(408)</u>	<u>(420)</u>	<u>(12)</u>
Other financing sources (uses):						
Other	-	-	-	-	-	-
Transfers in	528	528	-	408	418	10
Total other financing sources (uses)	<u>528</u>	<u>528</u>	<u>-</u>	<u>408</u>	<u>418</u>	<u>10</u>
Change in fund balances	<u>\$ -</u>	<u>(31)</u>	<u>\$ (31)</u>	<u>\$ -</u>	<u>(2)</u>	<u>\$ (2)</u>
Fund balances, beginning of year		<u>698</u>			<u>353</u>	
Fund balances, end of year		<u>\$ 667</u>			<u>\$ 351</u>	

Downtown Parking Improvement			Library Project			Total Non-major Debt Service Funds		
Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)	Budget	Actual	Variance Positive (Negative)
\$ -	\$ -	\$ -	\$ 3,491	\$ 3,468	\$ (23)	\$ 3,491	\$ 3,468	\$ (23)
9	1	(8)	9	-	(9)	63	3	(60)
-	11	11	-	-	-	-	11	11
9	12	3	3,500	3,468	(32)	3,554	3,482	(72)
110	110	-	-	-	-	870	870	-
123	123	-	1,472	1,471	(1)	1,816	1,815	(1)
233	233	-	1,472	1,471	(1)	2,686	2,685	(1)
(224)	(221)	3	2,028	1,997	(31)	868	797	(71)
-	-	-	-	-	-	-	-	-
224	233	9	-	-	-	1,160	1,179	19
224	233	9	-	-	-	1,160	1,179	19
\$ -	12	\$ 12	\$ 2,028	1,997	\$ (31)	\$ 2,028	1,976	\$ (52)
	238			-			1,289	
	\$ 250			\$ 1,997			\$ 3,265	

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NON-MAJOR GOVERNMENTAL FUNDS

Permanent Fund

EYERLY FAMILY

This fund accounts for the revenues received from assets donated by Mr. and Mrs. Fred Eyerly for the City and or its citizenry.

CITY OF PALO ALTO
 Non-major Permanent Fund
 Schedule of Revenues, Expenditures and Changes in Fund Balances -
 Budget and Actual
 For the Year Ended June 30, 2011
 (Amounts in Thousands)

	Eyerly Permanent Fund		
	Budget	Actual	Variance Positive (Negative)
Revenues:			
Return on investments	\$ 49	\$ 34	\$ (15)
Other fees	-	4	4
Total revenues	49	38	(11)
Expenditures:			
Current:			
Non-Departmental	-	18	(18)
Total expenditures	-	18	(18)
Excess (deficiency) of revenues over (under) expenditures	49	20	(29)
Change in fund balances	\$ 49	20	\$ (29)
Fund balances, beginning of year		1,402	
Fund balances, end of year		\$ 1,422	

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 on reimbursement of fleet replacement and maintenance costs allocated to each department by usage of vehicle.

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 on reimbursement of costs for support provided to other departments.

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

This fund accounts for the administration of compensated absences and health benefits.

WORKERS' COMPENSATION INSURANCE PROGRAM

This fund accounts for the administration of the City's self-insured workers' compensation programs.

GENERAL LIABILITIES INSURANCE PROGRAM

This fund accounts for the administration of the City's self-insured general liability programs.

RETIREE HEALTH BENEFIT

This fund accounts for the retiree health benefits.

CITY OF PALO ALTO
Internal Service Funds
Combining Statement of Fund Net Assets
June 30, 2011
(Amounts in Thousands)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits	Workers' Compensation Insurance Program	General Liabilities Insurance Program	Retiree Health Benefit	Total
Assets:								
Current Assets:								
Cash and investments:								
Available for operations	\$ 7,241	\$ 13,990	\$ -	\$ 12,570	\$ 17,961	\$ 5,714	\$ 3,262	\$ 60,738
Accounts receivable, net	60	-	-	-	-	-	-	60
Interest receivable	50	92	-	69	102	31	17	361
Inventory of materials and supplies	613	-	-	-	-	-	-	613
Net OPEB assets	-	-	-	-	-	-	23,006	23,006
Total Current Assets	7,964	14,082	-	12,639	18,063	5,745	26,285	84,778
Noncurrent Assets:								
Capital assets:								
Non-Depreciable	151	-	-	-	-	-	-	151
Depreciable, net	13,910	6,013	12	-	-	-	-	19,935
Total Noncurrent Assets	14,061	6,013	12	-	-	-	-	20,086
Total Assets	22,025	20,095	12	12,639	18,063	5,745	26,285	104,864
Liabilities:								
Current Liabilities:								
Accounts payable and accrued liabilities	121	346	49	1,974	33	-	-	2,523
Accrued salaries and benefits	29	102	3	-	-	-	-	134
Accrued compensated absences	4	10	-	3,086	-	-	-	3,100
Accrued claims payable - current	-	-	-	328	3,978	1,567	-	5,873
Total Current Liabilities	154	458	52	5,388	4,011	1,567	-	11,630
Noncurrent liabilities:								
Accrued compensated absences	-	-	-	6,286	-	-	-	6,286
Accrued claims payable	-	-	-	-	13,952	4,078	-	18,030
Total Liabilities	154	458	52	11,674	17,963	5,645	-	35,946
Net assets:								
Invested in capital assets	14,061	6,013	12	-	-	-	-	20,086
Unrestricted (deficit)	7,810	13,624	(52)	965	100	100	26,285	48,832
Total Net Assets (deficit)	\$ 21,871	\$ 19,637	\$ (40)	\$ 965	\$ 100	\$ 100	\$ 26,285	\$ 68,918

CITY OF PALO ALTO
Internal Service Funds
Combining Statement of Revenues, Expenses and Changes in Fund Net Assets
For the Year Ended June 30, 2011
(Amounts in Thousands)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits	Workers' Compensation Insurance Program	General Liabilities Insurance Program	Retiree Health Benefit	Total
Operating revenues:								
Charges for services	\$ 7,605	\$ 10,399	\$ 1,100	\$ 35,358	\$ 5,080	\$ 1,479	\$ 10,980	\$ 72,001
Total operating revenues	7,605	10,399	1,100	35,358	5,080	1,479	10,980	72,001
Operating expenses:								
Administrative and general	788	3,546	1,167	338	574	1,254	507	8,174
Operations and maintenance	2,537	5,646	-	115	-	1	-	8,299
Depreciation and amortization	1,609	3,083	3	-	-	-	-	4,695
Claim payments and change in estimated self-insured liability	-	-	-	1,703	4,796	273	-	6,772
Refund of charges for services	113	1	-	-	-	-	-	114
Compensated absences and other benefits	-	-	-	32,600	-	-	9,787	42,387
Total operating expenses	5,047	12,276	1,170	34,756	5,370	1,528	10,294	70,441
Operating income (loss)	2,558	(1,877)	(70)	602	(290)	(49)	686	1,560
Nonoperating revenues (expenses):								
Return on investments	221	383	(1)	163	290	49	95	1,200
Gain on disposal of capital assets	85	-	-	-	-	-	-	85
Other nonoperating revenues	59	-	-	-	-	-	-	59
Total nonoperating revenues (expenses)	365	383	(1)	163	290	49	95	1,344
Income (loss) before transfers	2,923	(1,494)	(71)	765	-	-	781	2,904
Transfers in	-	1,703	-	-	-	-	-	1,703
Transfers out	(591)	-	-	-	-	-	-	(591)
Change in net assets	2,332	209	(71)	765	-	-	781	4,016
Net assets, beginning of year	19,539	19,428	31	200	100	100	25,504	64,902
Net assets (deficit), end of year	\$ 21,871	\$ 19,637	\$ (40)	\$ 965	\$ 100	\$ 100	\$ 26,285	\$ 68,918

CITY OF PALO ALTO
Internal Service Funds
Combining Statement of Cash Flows
For the Year Ended June 30, 2011
(Amounts in Thousands)

	Vehicle Replacement and Maintenance	Technology	Printing and Mailing Services	General Benefits	Workers' Compensation Insurance Program	General Liabilities Insurance Program	Retiree Health Benefit	Total
Cash flows from operating activities:								
Cash received from customers	\$ 7,583	\$ 10,399	\$ 1,100	\$ 35,358	\$ 5,080	\$ 1,479	\$ 10,980	\$ 71,979
Cash refunds to customers	(113)	(1)	-	-	-	-	-	(114)
Cash payments to suppliers for goods and services	(2,607)	(5,864)	49	(101)	-	-	-	(8,523)
Cash payments to employees	(788)	(3,540)	(1,169)	(34,271)	(600)	(1,262)	(10,058)	(51,688)
Cash payments for judgments and claims	-	-	-	(1,707)	(2,213)	(427)	-	(4,347)
Other cash receipts	59	-	-	-	-	-	-	59
Cash flows provided by (used in) operating activities	4,134	994	(20)	(721)	2,267	(210)	922	7,366
Cash flows from noncapital financing activities:								
Transfers in	-	1,703	-	-	-	-	-	1,703
Transfers out	(591)	-	-	-	-	-	-	(591)
Cash flows provided by (used in) noncapital financing activities	(591)	1,703	-	-	-	-	-	1,112
Cash flows from capital and related financing activities:								
Acquisition of capital assets	(2,294)	(57)	-	-	-	-	-	(2,351)
Cash flows from investing activities:								
Interest received/(paid)	217	381	(1)	350	188	18	88	1,241
Net change in cash and cash equivalents	1,466	3,021	(21)	(371)	2,455	(192)	1,010	7,368
Cash and cash equivalents, beginning of year	5,775	10,969	21	12,941	15,506	5,906	2,252	53,370
Cash and cash equivalents, end of year	\$ 7,241	\$ 13,990	\$ -	\$ 12,570	\$ 17,961	\$ 5,714	\$ 3,262	\$ 60,738
Reconciliation of operating income (loss) to net cash flows provided by (used in) operating activities:								
Operating income (loss)	\$ 2,558	\$ (1,877)	\$ (70)	\$ 602	\$ (290)	\$ (49)	\$ 686	\$ 1,560
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:								
Depreciation	1,609	3,083	3	-	-	-	-	4,695
Other	59	-	-	-	-	-	-	59
Change in assets and liabilities:								
Accounts receivable	(22)	-	-	-	-	-	-	(22)
Inventory of materials and supplies	(156)	-	-	-	-	-	-	(156)
Net OPEB asset	-	-	-	-	-	-	236	236
Accounts and other payables	86	(218)	49	133	(26)	(7)	-	17
Accrued salaries and benefits	(4)	(4)	(2)	(405)	-	-	-	(415)
Accrued compensated absences	4	10	-	(1,047)	-	-	-	(1,033)
Accrued claims payable	-	-	-	(4)	2,583	(154)	-	2,425
Cash flows provided by (used in) operating activities	\$ 4,134	\$ 994	\$ (20)	\$ (721)	\$ 2,267	\$ (210)	\$ 922	\$ 7,366

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
All Agency Funds
Statement of Changes in Assets and Liabilities
For the Year Ended June 30, 2011
(Amounts in Thousands)

<u>California Avenue Parking Assessment District</u>	Balance July 1, 2010	Additions	Deletions	Balance June 30, 2011
Assets:				
Cash and investments available for operations	\$ 220	\$ -	\$ 12	\$ 208
Liabilities:				
Due to bondholders	\$ 220	\$ -	\$ 12	\$ 208
<u>Cable Joint Powers Authority</u>				
Assets:				
Cash and investments available for operations	\$ 885	\$ 19	\$ -	\$ 904
Interest receivable	8	-	1	7
Total assets	\$ 893	\$ 19	\$ 1	\$ 911
Liabilities:				
Due to other governments	\$ 893	\$ 19	\$ 1	\$ 911
<u>University Avenue Area Parking Assessment District</u>				
Assets:				
Cash and investments available for operations	\$ 2,330	\$ -	\$ 324	\$ 2,006
Cash and investments with fiscal agents	3,902	4	-	3,906
Interest receivable	29	-	4	25
Total assets	\$ 6,261	\$ 4	\$ 328	\$ 5,937
Liabilities:				
Due to bondholders	\$ 6,261	\$ 4	\$ 328	\$ 5,937
<u>Total Agency Funds</u>				
Assets:				
Cash and investments available for operations	\$ 3,435	\$ 19	\$ 336	\$ 3,118
Cash and investments with fiscal agents	3,902	4	-	3,906
Interest receivable	37	-	5	32
Total assets	\$ 7,374	\$ 23	\$ 341	\$ 7,056
Liabilities:				
Due to bondholders	\$ 6,481	\$ 4	\$ 340	\$ 6,145
Due to other governments	893	19	1	911
Total liabilities	\$ 7,374	\$ 23	\$ 341	\$ 7,056

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 sources, property tax and electric charges:

1. Electric Daily Loads and Top Customers by Usage
2. Electric Operating Revenue by Source
3. Assessed Value of Taxable Property
4. Property Tax Rates, All Overlapping Governments
5. Property Tax Levies and Collections
6. Principal Property Taxpayers
7. Assessed Valuation and Parcels by Land Use
8. Per Parcel Assessed Valuation of Single Family Homes

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

STATISTICAL SECTION

Operating Information

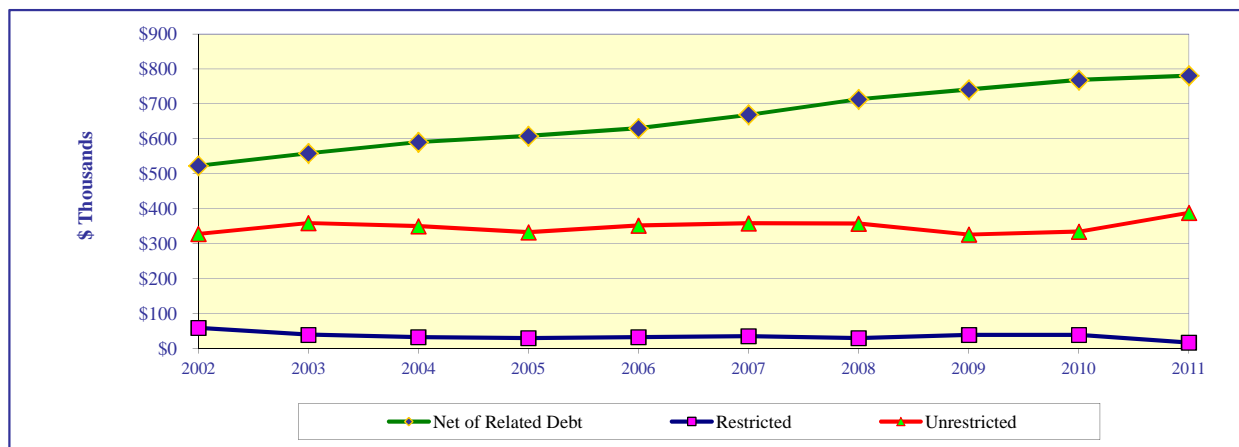
These schedules contain service and infrastructure data to help the reader understand how the information in the City's financial report relates to the services the City provides and the activities it performs:

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 Ten Fiscal Years (\$000)
(Accrual Basis of Accounting)



Fiscal Year Ended June 30,

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Governmental activities										
Invested in capital assets, net of related debt	\$252,183	\$279,306	\$297,125	\$305,225	\$311,335	\$326,411	\$343,537	\$356,657	\$369,499	\$364,747
Restricted	56,785	37,112	30,417	27,273	29,885	32,576	27,428	36,632	34,323	16,437
Unrestricted	117,113	130,463	123,762	117,301	123,823	127,190	130,460	118,133	102,199	134,722
Total governmental activities net assets	\$426,081	\$446,881	\$451,304	\$449,799	\$465,043	\$486,177	\$501,425	\$511,422	\$506,021	\$515,906
Business-type activities										
Invested in capital assets, net of related debt	\$270,622	\$279,885	\$294,197	\$303,473	\$318,738	\$342,922	\$370,303	\$384,313	\$399,317	\$416,418
Restricted	1,728	1,728	1,798	1,750	1,732	1,732	1,732	1,732	4,300	0
Unrestricted	210,990	228,308	226,278	215,128	228,032	230,912	226,539	208,025	232,420	253,740
Total business-type activities net assets	\$483,340	\$509,921	\$522,273	\$520,351	\$548,502	\$575,566	\$598,574	\$594,070	\$636,037	\$670,158
Primary government										
Invested in capital assets, net of related debt	\$522,805	\$559,191	\$591,322	\$608,698	\$630,073	\$669,333	\$713,840	\$740,970	\$768,816	\$781,165
Restricted	58,513	38,840	32,215	29,023	31,617	34,308	29,160	38,364	38,623	16,437
Unrestricted	328,103	358,771	350,040	332,429	351,855	358,102	356,999	326,158	334,619	388,462
Total primary government net assets	\$909,421	\$956,802	\$973,577	\$970,150	\$1,013,545	\$1,061,743	\$1,099,999	\$1,105,492	\$1,142,058	\$1,186,064

Source: Annual Financial Statements

City of Palo Alto - Changes in Net Assets

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

	Fiscal Year Ended June 30,									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Expenses										
Governmental Activities:										
City Council	\$238	\$234	\$269	\$130	\$141	\$180	\$323	\$394	\$455	\$15
City Manager	1,765	1,565	1,663	1,725	1,563	1,760	2,273	2,085	2,399	1,842
City Attorney	2,410	2,028	2,300	2,653	2,598	2,390	2,653	2,575	2,621	953
City Clerk	633	598	808	770	945	900	1,241	1,098	1,369	803
City Auditor	583	646	668	764	843	838	1,379	2,053	2,601	138
Administrative Services **	10,138	9,723	6,271	6,982	6,972	6,419	15,477	17,784	17,893	9,888
Human Resources	2,166	1,728	2,078	2,410	2,546	2,472	2,806	3,448	3,707	1,346
Public Works	15,656	13,702	14,460	16,400	17,596	16,645	18,565	21,270	18,658	19,357
Planning and Community Environment	7,311	7,485	8,898	10,162	9,931	12,929	16,388	12,940	12,114	15,031
Police	19,049	19,273	20,414	22,416	23,411	23,861	27,740	29,288	29,351	30,465
Fire	16,870	16,859	17,308	18,127	18,747	19,530	22,386	23,199	26,448	28,531
Community Services	19,850	19,633	20,864	17,240	17,296	15,729	17,736	19,862	17,171	22,845
Library		0	0	4,835	5,323	5,347	6,321	6,244	6,143	6,920
Non-Departmental **	8,412	7,449	7,618	12,474	10,400	12,133	0	0	0	0
Interest on Long Term Debt	1,094	675	635	693	512	477	438	404	370	2,742
Total Governmental Activities Expenses	\$106,175	\$101,598	\$104,254	\$117,781	\$118,824	\$121,610	\$135,726	\$142,644	\$141,300	\$140,876
Business-Type Activities:										
Water	\$12,722	\$13,237	\$16,047	\$14,969	\$15,881	\$16,794	\$18,842	\$20,271	\$21,037	\$24,268
Electric	98,405	73,744	73,545	73,051	91,570	99,294	108,032	122,268	107,910	100,130
Fiber Optics *	0	0	0	0	0	0	0	1,284	1,407	1,561
Gas	28,778	22,270	22,994	26,656	29,107	30,690	37,211	34,603	32,498	32,051
Wastewater Collection	8,489	8,712	9,203	8,907	11,005	10,085	12,023	14,875	10,696	12,275
Wastewater Treatment	13,287	14,312	14,868	17,457	16,747	15,901	18,902	36,896	13,466	19,731
Refuse	23,750	24,635	24,282	24,959	26,989	25,372	28,827	37,217	28,119	30,684
Storm Drainage	2,188	2,489	2,975	3,336	2,673	2,517	3,202	2,943	2,491	3,229
Airport	-	-	-	-	-	-	-	-	-	31
External Services	349	583	688	760	868	767	984	0	0	0
Total Business-Type Activities Expenses	187,968	159,982	164,602	170,095	194,840	201,420	228,023	270,357	217,624	223,960
Total Primary Government Expenses	\$294,143	\$261,580	\$268,856	\$287,876	\$313,664	\$323,030	\$363,749	\$413,001	\$358,924	\$364,836
Program Revenues										
Governmental Activities:										
Charges for Services:										
City Council										
City Manager										
City Attorney			\$64	\$22	\$22	\$13	\$16	\$12	\$53	
City Clerk	\$1	1	1		2					
City Auditor		1								
Administrative Services	12	406	815	480	627	835	870	726	984	\$2,889
Human Resources						11				
Public Works	320	1,058	260	573	805	968	1,310	1,169	1,258	2,419
Planning and Community Environment	4,062	5,119	3,074	4,090	5,509	6,267	5,498	4,704	4,813	7,237
Police	3,966	3,396	4,415	3,801	4,178	4,179	4,274	3,947	4,093	3,237
Fire	7,976	7,811	7,565	8,555	9,078	9,610	9,418	10,723	10,244	12,037
Community Services	7,793	7,537	7,846	7,592	10,803	9,128	10,314	8,522	8,729	7,724
Library				133	129	146	176	177	199	480
Operating Grants and Contributions	5,568	4,468	4,213	3,677	3,976	5,642	4,029	3,599	4,829	2,884

* Prior to 2009, Fiber Optics was included in Electric

** Beginning in 2008, includes expenditures classified as Non-departmental in prior years (GFOA recommendation)

City of Palo Alto - Changes in Net Assets

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

	Fiscal Year Ended June 30,									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Capital Grants and Contributions	32,380	635	1,990	804	3,156	1,756	1,930	3,810	1,280	1,903
Total Government Activities Program Revenues	62,078	30,524	30,243	29,727	38,285	38,555	37,835	37,389	36,482	40,810
Business-Type Activities:										
Charges for Services:										
Water	16,034	17,654	21,993	21,041	21,108	23,495	26,510	27,120	26,259	26,624
Electric	93,755	91,622	92,617	88,737	119,418	102,549	103,833	119,320	121,900	122,109
Fiber Optics *	0	0	0	0	0	0	0	3,336	3,105	3,322
Gas	41,658	29,714	24,839	31,206	36,977	42,221	49,021	47,838	44,450	43,584
Wastewater Collection	9,292	10,676	12,647	12,041	13,801	14,848	15,102	14,486	15,136	15,094
Wastewater Treatment	13,987	13,556	14,744	15,982	18,778	16,957	22,889	28,425	16,915	18,830
Refuse	21,777	21,691	21,923	23,387	24,795	25,532	28,805	29,101	28,568	30,469
Storm Drainage	2,221	2,192	2,170	2,484	5,174	5,181	5,450	5,505	5,647	5,796
External Services	380	605	585	766	854	789	112	0	0	0
Operating Grants and Contributions									361	610
Capital Grants and Contributions	185					756	1,594	639	475	3,004
Total Business-Type Activities Program Revenue	199,289	187,710	191,518	195,644	240,905	232,328	253,316	275,770	262,816	269,442
Total Primary Government Program Revenues	\$261,367	\$218,234	\$221,761	\$225,371	\$279,190	\$270,883	\$291,151	\$313,159	\$299,298	\$310,252
Net (Expense)/Revenue										
Governmental Activities	(\$44,097)	(\$71,074)	(\$74,011)	(\$88,054)	(\$80,539)	(\$83,055)	(\$97,891)	(\$105,255)	(\$104,819)	(\$100,066)
Business-Type Activities	11,321	27,728	26,916	25,549	46,065	30,908	25,293	5,413	45,189	45,482
Total Primary Government Net Expense	(\$32,776)	(\$43,346)	(\$47,095)	(\$62,505)	(\$34,474)	(\$52,147)	(\$72,598)	(\$99,842)	(\$59,630)	(\$54,584)
General Revenues and Other Changes in Net Assets										
Governmental Activities:										
Taxes:										
Property Taxes	\$13,270	\$13,882	\$13,707	\$16,657	\$18,731	\$21,466	\$23,084	\$25,432	\$25,981	\$29,156
Sales Taxes	20,085	18,041	18,151	19,308	20,315	22,194	22,623	20,089	17,991	20,746
Utilities Users Taxes	6,457	7,067	7,152	7,269	8,759	9,356	10,285	11,030	11,295	10,851
Transient Occupancy Tax	6,615	5,333	5,489	5,686	6,393	6,709	7,976	7,111	6,858	8,082
Other taxes	6,284	7,275	8,493	5,580	7,033	6,293	6,261	3,364	4,055	8,156
Investment Earnings	10,589	10,213	326	4,988	2,567	8,747	12,313	8,525	6,514	3,500
Rents and Miscellaneous	18,524	15,333	10,165	12,997	10,440	13,670	11,896	15,682	12,729	12,377
Transfers	13,334	14,730	14,951	14,064	21,545	15,754	18,701	24,020	13,994	17,083
Total Government Activities	95,158	91,874	78,434	86,549	95,783	104,189	113,139	115,253	99,417	109,951
Business-Type Activities:										
Investment Earnings	15,620	13,583	387	8,093	3,631	11,910	16,416	14,103	10,769	5,722
Special Item				(21,500)						
Transfers	(13,334)	(14,730)	(14,951)	(14,064)	(21,545)	(15,754)	(18,701)	(24,020)	(13,994)	(17,083)
Total Business-Type Activities	2,286	(1,147)	(14,564)	(27,471)	(17,914)	(3,844)	(2,285)	(9,917)	(3,225)	(11,361)
Total Primary Government	\$97,444	\$90,727	\$63,870	\$59,078	\$77,869	\$100,345	\$110,854	\$105,336	\$96,192	\$98,590
Change in Net Assets										
Governmental Activities	\$51,061	\$20,800	\$4,423	(\$1,505)	\$15,244	\$21,134	\$15,248	\$9,998	(\$5,402)	\$9,885
Business-Type Activities	13,607	26,581	12,352	(1,922)	28,151	27,064	23,008	(4,504)	41,964	34,121
Total Primary Government	\$64,668	\$47,381	\$16,775	(\$3,427)	\$43,395	\$48,198	\$38,256	\$5,494	\$36,562	\$44,006

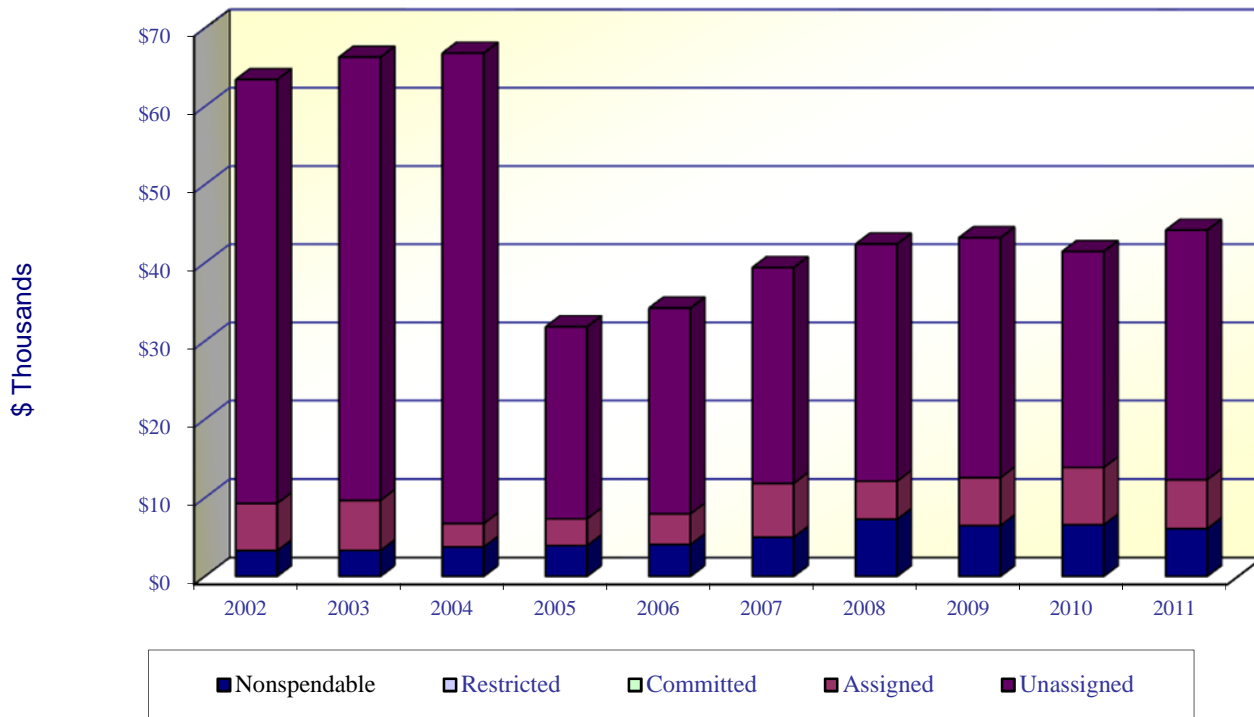
Source: Annual Financial Statements

* Prior to 2009, Fiber Optics was included in Electric

City of Palo Alto - Fund Balances of Governmental Funds (General Fund)

Last Ten Fiscal Years (\$000)

(Modified Accrual Basis of Accounting)



Fiscal Year Ended June 30,

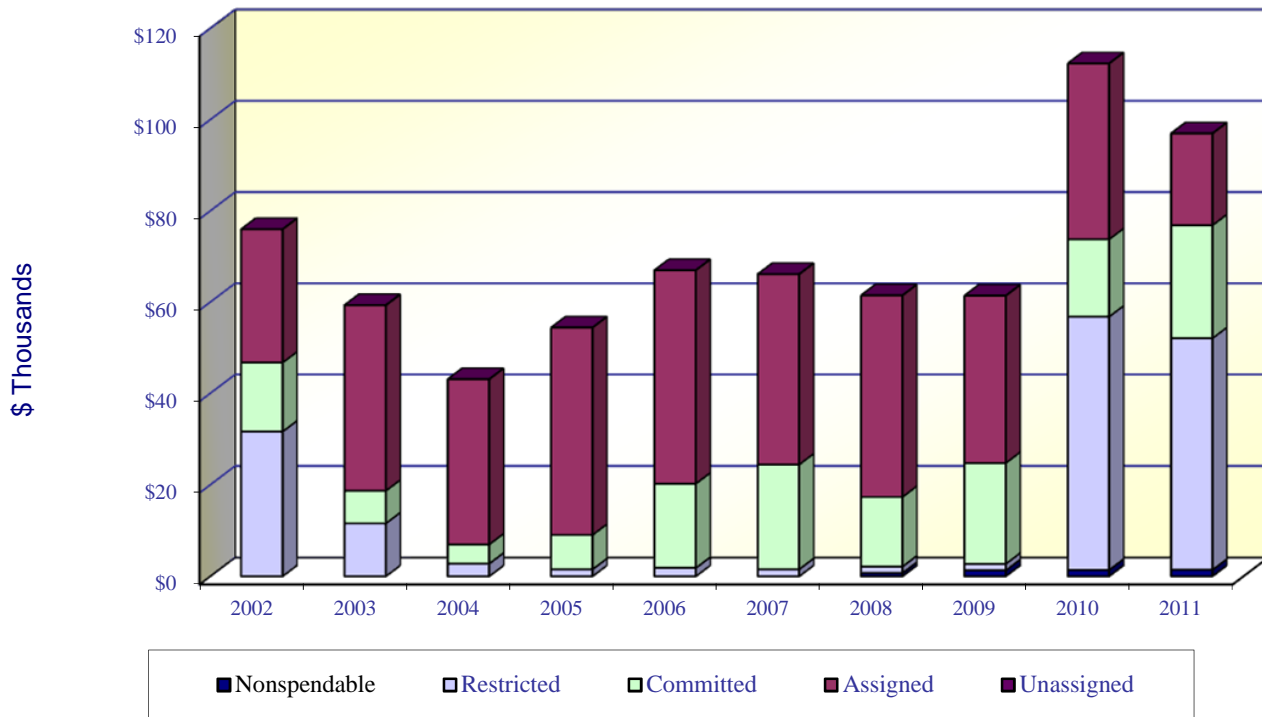
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
General Fund										
Nonspendable	\$3,278	\$3,303	\$3,762	\$3,931	\$4,052	\$5,002	\$7,286	\$6,476	\$6,581	\$6,085
Restricted	0	0	0	0	0	0	0	0	0	0
Committed	0	0	0	0	0	0	0	0	0	0
Assigned	6,022	6,386	2,973	3,401	3,914	6,855	4,851	6,100	7,295	6,235
Unassigned	54,133	56,618	60,087	24,498	26,251	27,551	30,278	30,648	27,581	31,859
Total General Fund	\$63,433	\$66,307	\$66,822	\$31,830	\$34,217	\$39,408	\$42,415	\$43,224	\$41,457	\$44,179

Source: Annual Financial Statements

City of Palo Alto - Fund Balances of Governmental Funds (All Other Governmental Funds)

Last Ten Fiscal Years (\$000)

(Modified Accrual Basis of Accounting)



Fiscal Year Ended June 30,

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
All Other Governmental Funds										
Nonspendable	\$0	\$0	\$0	\$0	\$0	\$0	\$731	\$1,308	\$1,402	\$1,422
Restricted	31,622	11,574	2,761	1,522	1,822	1,540	1,406	1,412	55,400	50,644
Committed	15,094	7,127	4,206	7,521	18,430	22,883	15,207	22,043	16,962	24,776
Assigned	29,243	40,606	36,117	45,358	46,723	41,684	44,116	36,629	38,538	20,114
Unassigned	0	0	0	0	0	0	0	0	0	1
Total all other governmental funds	\$75,959	\$59,307	\$43,084	\$54,401	\$66,975	\$66,107	\$61,460	\$61,392	\$112,302	\$96,957

Source: Annual Financial Statements

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

(Modified Accrual Basis of Accounting)

	Fiscal Year Ended June 30,			
	2002	2003	2004	2005
Revenues				
Sales tax	\$20,085	\$18,041	\$18,151	\$19,308
Property tax	13,231	13,821	13,707	16,657
Other taxes	20,485	21,070	22,427	19,941
Permits and licenses	2,901	3,161	2,563	3,183
Fines, forfeits and penalties	2,181	2,124	2,884	2,096
Interest and rentals	19,547	19,981	11,480	14,968
From other agencies	3,860	3,776	4,661	2,757
Charges for services	16,667	16,798	16,018	17,159
Other	8,580	5,095	1,681	4,269
Total Revenues	107,537	103,867	93,572	100,338
Expenditures				
Administration (1)	18,235	17,521	13,862	14,509
Public works	9,549	9,858	8,031	9,060
Planning and community environment	7,378	7,721	8,793	9,692
Police	19,047	19,719	19,962	21,117
Fire	16,722	16,841	16,891	17,615
Community services	19,499	19,793	19,934	16,298
Library (2)				4,800
Non-departmental	8,259	7,442	7,598	9,028
Special revenue and capital projects	16,960	33,584	22,289	21,317
Debt service - Principal payments	465	875	780	785
Debt Service - Interest and fiscal fees	686	696	639	583
Total Expenditures	116,800	134,050	118,779	124,804
Excess (deficiency) of revenues over (under) expenditures	(9,263)	(30,183)	(25,207)	(24,466)
Other Financing Sources (Uses)				
Transfers in	27,389	31,402	28,632	60,429
Transfers (out)	(14,444)	(16,603)	(19,133)	(46,622)
Other				
Contribution from assessment district	31,823	425		
Proceeds from long term debt	7,055			
Payments to refunded bond escrow	(3,820)			(1,038)
Total other financing sources (uses)	48,003	15,224	9,499	12,769
Net Change in fund balances	\$38,740	(\$14,959)	(\$15,708)	(\$11,697)
Debt service as a percentage of noncapital expenditures	1.1%	1.6%	1.5%	1.3%

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.

Fiscal Year Ended June 30,

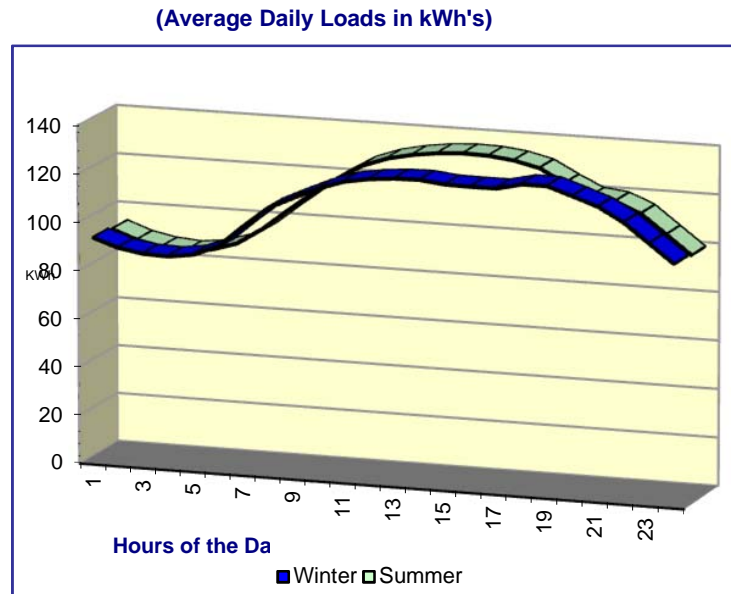
2006	2007	2008	2009	2010	2011
\$20,315	\$22,194	\$22,623	\$20,089	\$17,991	\$20,746
18,731	21,466	23,084	25,432	25,981	29,156
23,712	23,698	25,202	22,712	23,206	26,149
4,305	4,711	4,761	4,033	4,408	5,433
2,128	2,517	2,183	2,131	1,857	1,833
13,776	17,750	20,507	19,183	19,045	16,553
5,931	3,448	4,300	5,984	3,035	1,614
18,672	19,929	19,610	19,837	19,775	22,311
4,058	7,503	4,713	6,223	4,724	8,613
111,628	123,216	126,983	125,624	120,022	132,408
14,299	14,399	16,250	16,002	17,353	8,351
9,036	9,256	10,072	10,064	9,787	11,317
9,292	11,874	9,861	10,462	9,480	10,309
22,279	23,305	27,006	27,053	26,728	30,519
18,114	19,146	21,644	21,904	24,294	28,355
19,740	16,533	17,138	17,451	16,451	20,029
5,170	5,260	6,219	5,985	5,900	6,509
10,389	12,122	14,089	10,765	10,149	7,352
13,243	17,478	21,626	21,485	22,006	35,486
810	850	885	800	840	870
523	489	451	416	382	1,815
122,895	130,712	145,241	142,387	143,370	160,912
(11,267)	(7,496)	(18,258)	(16,763)	(23,348)	(28,504)
26,640	27,701	33,437	39,903	34,835	30,323
(12,390)	(15,882)	(16,819)	(22,399)	(21,415)	(14,352)
				59,071	(90)
14,250	11,819	16,618	17,504	72,491	15,881
\$2,983	\$4,323	(\$1,640)	\$741	\$49,143	(\$12,623)
1.2%	1.2%	1.1%	1.0%	1.0%	2.1%

City of Palo Alto - Electric Daily Loads and Top Customers by Usage

June 30, 2011

(in thousands of kWh)

Daily Hours	# Kilowatt Hours	
	(Oct-Mar) Winter	(Apr-Sep) Summer
0	93,533	92,647
1	90,081	88,935
2	88,307	86,821
3	87,933	85,983
4	89,385	87,089
5	93,615	90,323
6	102,552	96,901
7	110,866	105,185
8	115,737	113,038
9	120,311	119,961
10	123,822	125,999
11	125,539	129,720
12	126,447	131,914
13	126,613	133,301
14	125,445	133,904
15	125,276	133,609
16	125,259	132,405
17	127,671	129,973
18	127,644	124,528
19	124,246	119,626
20	120,690	118,503
21	115,015	114,209
22	107,167	106,419
23	99,405	98,557



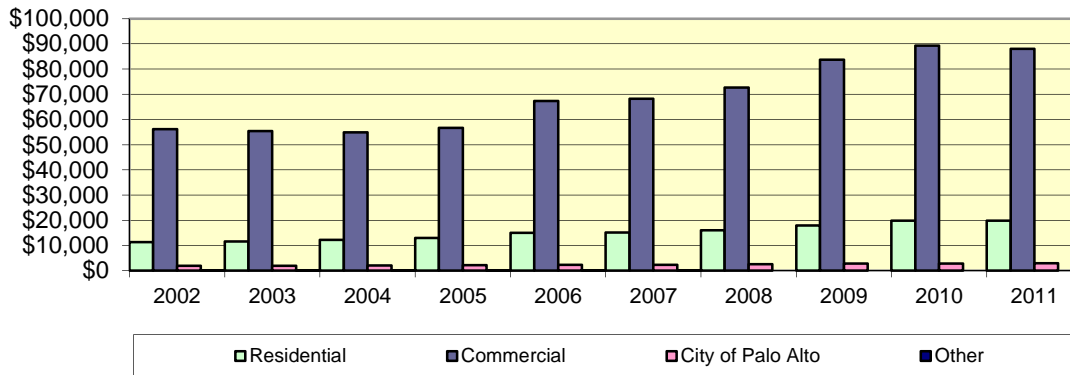
Source: City of Palo Alto, Utilities Resource Management

Top Ten Electric Customers by Usage

Customer (alphabetical order)	Type of Business	kWh's	% of System Total
529 Bryant St LLC	Technology		
City of Palo Alto	Municipal		
CPI-David Morman	Research		
Hewlett Packard	Computer		
Space System Loral	Satellite & Satellite Systems		
Stanford Hines Interests	Property Management		
Stanford Hospital	Hospital		
Varian Medical Systems	Manufacturing of Medical Equipment		
Veterans Admin Hospital	Hospital		
VMWare Inc.	Computer		
Total		340,236,175	35.95 %

Source: City of Palo Alto, Utilities Department

City of Palo Alto - Electric Operating Revenue by Source
Last Ten Fiscal Years (\$000)



Fiscal Year	Residential	Commercial	City of Palo Alto	Other	Total
2002	11,377	56,214	1,925	6	69,521
2003	11,657	55,353	2,004	24	69,039
2004	12,245	54,881	2,047	66	69,240
2005	13,009	56,683	2,222	67	71,981
2006	14,973	67,389	2,395	97	84,854
2007	15,150	68,214	2,397	69	85,829
2008	16,109	72,632	2,571	0	91,312
2009	17,939	83,710	2,823	0	104,472
2010	19,898	89,315	2,890	0	112,103
2011	19,848	88,076	2,991	0	110,915

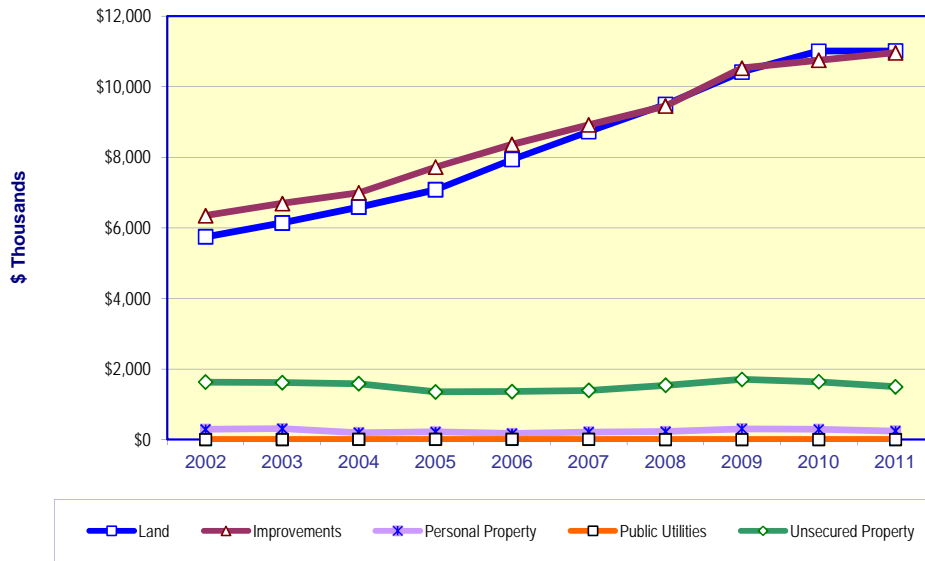
Top Ten Electric Revenue

Customer (alphabetical order)	Type of Business	Net Charges	% of System Total
529 Bryant St LLC	Technology		
City of Palo Alto	Municipal		
CPI-David Morman	Research		
Hewlett Packard	Computer		
Space System Loral	Satellite System		
Stanford Hines Interests	Property Mgmt		
Stanford Hospital	Hospital		
Varian Medical Systems	Manufacturing		
Veterans Admin Hospital	Hospital		
VMWare Inc.	Computer		
Total		\$ 38,007,506	35.36%

Source: City of Palo Alto, Utilities Department

Notes: Revenue includes all utilities (metered and non-metered), revenue adjustments, and Primary Voltage discount. Does not include CEC surcharge, UUT, Solar and Rap discounts, and deposits.

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



Fiscal Year	Net Local Secured Roll			Subtotal			Less			Total Direct Tax Rate
	Land	Improvements	Personal Property	Net Local Secured Roll	Public Utilities	Unsecured Property	Exemptions Net of State Aid	Total Assessed Value		
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	16,480,816	4,084	1,361,117	1,595,871	16,250,146	1%	
2007	8,725,485	8,915,623	213,154	17,854,262	3,923	1,391,284	1,639,856	17,609,613	1%	
2008	9,497,746	9,453,436	228,875	19,180,057	3,174	1,536,584	1,797,327	18,922,488	1%	
2009	10,420,139	10,527,617	303,688	21,251,444	2,573	1,702,884	1,871,292	21,085,609	1%	
2010	11,007,650	10,752,671	288,148	22,048,469	2,573	1,638,436	1,809,119	21,880,359	1%	
2011	11,011,160	10,962,928	241,280	22,215,368	2,573	1,495,574	1,757,241	21,956,274	1%	

Source: County of Santa Clara Assessor's Office

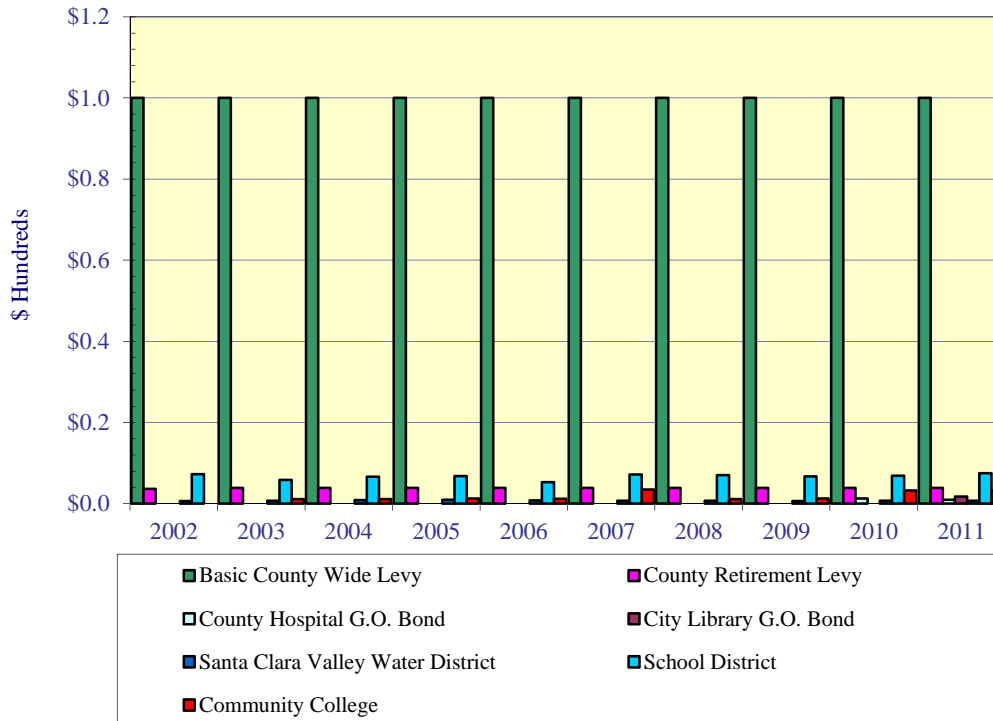
Note: Beginning in fiscal year 1988-89, Chapter 921 of the Statutes of 1987 requires the establishment of a single county-wide tax rate area for the assignment of the assessed value of certain types of state-assessed utility property and sets forth formulas for the determination of county-wide tax rates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

City of Palo Alto - Property Tax Rates

All Overlapping Governments

Last Ten Fiscal Years



Fiscal Year	Basic County Wide Levy	County Retirement Levy	County* Hospital G. O. Bond (Measure A)	City** Library G. O. Bond (Measure N)	Santa Clara Valley Water District	School District	Community College	Total
2002	1.0000	0.0364	0.0000	0.0000	0.0062	0.0727	0.0000	1.1153
2003	1.0000	0.0388	0.0000	0.0000	0.0072	0.0586	0.0108	1.1154
2004	1.0000	0.0388	0.0000	0.0000	0.0087	0.0666	0.0110	1.1251
2005	1.0000	0.0388	0.0000	0.0000	0.0092	0.0680	0.0129	1.1289
2006	1.0000	0.0388	0.0000	0.0000	0.0078	0.0526	0.0119	1.1111
2007	1.0000	0.0388	0.0000	0.0000	0.0072	0.0720	0.0346	1.1526
2008	1.0000	0.0388	0.0000	0.0000	0.0071	0.0702	0.0113	1.1274
2009	1.0000	0.0388	0.0000	0.0000	0.0061	0.0674	0.0123	1.1246
2010	1.0000	0.0388	0.0122	0.0000	0.0074	0.0686	0.0322	1.1592
2011	1.0000	0.0388	0.0095	0.0171	0.0072	0.0751	0.0326	1.1803

*The County General Obligation Bond (Measure A) was passed in 2008 to fund the seismic upgrade of the Santa Clara Valley Medical Center. Rates were first levied for the 2009-10 fiscal year.

**The City of Palo Alto General Obligation Bond (Measure N) was passed in 2008 to fund the construction and renovation of three of the City's libraries. Rates were first levied for the 2010-11 fiscal year.

Source: County of Santa Clara, Tax Rates and Information

City of Palo Alto - Property Tax Levies and Collections

Last Ten Fiscal Years (\$000)

Fiscal Year	Total Tax Levy (a)	Current Tax Collections	Percent of Levy Collected	Delinquent Tax Collections (b)	Total Tax Collections	Percent of Total Tax Collections to Tax Levy
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%
2007	21,466	21,466	100%	-	21,466	100%
2008	23,084	23,084	100%	-	23,084	100%
2009	25,432	25,432	100%	-	25,432	100%
2010	25,981	25,981	100%	-	25,981	100%
2011	25,688	25,688	100%	-	25,688	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 Taxpayers

Current Year and Nine Years Ago (\$000)

Taxpayer	FY 2011			FY 2002		
	Taxable Assessed Value	Rank	Percentage of Total City Taxable Assessed Value	Taxable Assessed Value	Rank	Percentage of Total City Taxable Assessed Value
Leland Stanford Jr University	\$3,328,472	1	15.2%	\$1,955,683	1	17.2%
Space System /Loral, Inc.	208,784	2	1.0%	187,824	2	1.7%
899 Charleston	157,700	3	0.7%			0.0%
Albert L Schultz Jewish Community Center	123,255	4	0.6%			0.0%
Arden Realty Limited Partnership	111,632	5	0.5%			0.0%
Whisman Ventures, LLC	104,281	6	0.5%			0.0%
ECI 2 Bayshore LLC / ECI Hamilton LLC	73,349	7	0.3%			0.0%
Blackhawk Parent LLC	49,821	8	0.2%			0.0%
Ronald & Ann Williams Charitable Foundation	42,951	9	0.2%			0.0%
300 / 400 Hamilton Associates	41,123	10	0.2%			0.0%
Agilent Technologies			0.0%	81,317	3	0.7%
Embarcadero Place Associates			0.0%	76,500	4	0.7%
Sun Microsystems, Inc.			0.0%	73,970	5	0.7%
Harbor Investment Partners			0.0%	58,026	6	0.5%
California Pacific Commercial Corp.			0.0%	50,657	7	0.4%
Cowper-Hamilton Associates			0.0%	40,361	8	0.4%
529 Bryant Street			0.0%	36,250	9	0.3%
Pacific Hotel Dev Venture LP			0.0%	35,067	10	0.3%
Subtotal	\$4,241,368		19.3%	\$2,595,655		22.8%
Total City Taxable Assessed Value						
FY 2011	\$21,956,274					
FY 2002	\$11,379,838					

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

City of Palo Alto - Assessed Valuation and Parcels By Land Use

As Of June 30, 2011

	2010-11 Assessed Valuation (a)	% of Total	No. of Parcels	% of Total	No. of Taxable Parcels	% of Total
Non-Residential:						
Agricultural/Forest	\$ 25,742,741	0.13	50	0.25	34	0.17
Commercial	1,486,858,269	7.27	470	2.31	464	2.31
Professional/Office	2,385,942,691	11.66	484	2.38	465	2.31
Industrial/Research & Development	1,975,226,900	9.65	189	0.93	184	0.91
Recreational	20,804,566	0.10	14	0.07	11	0.05
Government/Social/Institutional	351,145,899	1.72	104	0.51	40	0.20
Miscellaneous	6,313,752	0.03	16	0.08	15	0.07
Subtotal Non-Residential	<u>\$ 6,252,034,818</u>	<u>30.56</u>	<u>1,327</u>	<u>6.53</u>	<u>1,213</u>	<u>6.02</u>
Residential:						
Single Family Residence	\$ 11,506,870,425	56.25	14,912	73.42	14,885	74.00
Condominium/Townhouse	1,435,220,989	7.02	2,743	13.50	2,739	13.62
2-4 Residential Units	340,294,612	1.66	526	2.59	526	2.61
5+ Residential Units/Apartments	694,174,103	3.39	331	1.63	306	1.52
Mobile Home	71,042	0.00	7	0.03	7	0.03
Subtotal Residential	<u>\$ 13,976,631,171</u>	<u>68.32</u>	<u>18,519</u>	<u>91.17</u>	<u>18,463</u>	<u>91.78</u>
Vacant Parcels	<u>\$ 229,460,815</u>	<u>1.12</u>	<u>465</u>	<u>2.30</u>	<u>440</u>	<u>2.20</u>
Total	<u><u>\$ 20,458,126,804</u></u>	<u><u>100.00</u></u>	<u><u>20,311</u></u>	<u><u>100.00</u></u>	<u><u>20,116</u></u>	<u><u>100.00</u></u>

Source: California Municipal Statistics, Inc.

Note:

This schedule is provided as required by the Continuing Disclosure Agreement for the City's Series 2010A General Obligation Bond and is not required by Government Accounting Standards Board (GASB). Therefore, ten years of comparison data is not presented.

(a) Local Secured Assessed Valuation, Excluding Tax-Exempt Property

City of Palo Alto - Per Parcel Assessed Valuation of Single Family Homes

June 30, 2011

	No. of Parcels	2010-11 Assessed Valuation	Average Assessed Valuation	Median Assessed Valuation
Single Family Residential	14,885	\$11,506,870,425	\$773,051	\$567,149

2010-11 Assessed Valuation	No. of Parcels (a)	% of Total	Cumulative % of Total	Total Valuation	No. of % of Total	Cumulative % of Total
\$0 - \$99,999	2,085	14.007	14.007	\$ 155,194,242	1.349	1.349
\$100,000 - \$199,999	2,017	13.551	27.558	277,894,745	2.415	3.764
\$200,000 - \$299,999	1,015	6.819	34.377	253,767,993	2.205	5.969
\$300,000 - \$399,999	855	5.744	40.121	299,307,295	2.601	8.570
\$400,000 - \$499,999	870	5.845	45.966	392,818,001	3.414	11.984
\$500,000 - \$599,999	878	5.899	51.864	483,210,968	4.199	16.183
\$600,000 - \$699,999	749	5.032	56.896	488,078,563	4.242	20.425
\$700,000 - \$799,999	686	4.609	61.505	515,766,103	4.482	24.907
\$800,000 - \$899,999	781	5.247	66.752	664,641,232	5.776	30.683
\$900,000 - \$999,999	741	4.978	71.730	704,718,248	6.124	36.808
\$1,000,000 - \$1,099,999	706	4.743	76.473	738,400,223	6.417	43.225
\$1,100,000 - \$1,199,999	554	3.722	80.195	638,039,562	5.545	48.769
\$1,200,000 - \$1,299,999	424	2.849	83.043	529,245,429	4.599	53.369
\$1,300,000 - \$1,399,999	362	2.432	85.475	488,049,730	4.241	57.610
\$1,400,000 - \$1,499,999	323	2.170	87.645	467,586,288	4.064	61.674
\$1,500,000 - \$1,599,999	313	2.103	89.748	484,896,920	4.214	65.888
\$1,600,000 - \$1,699,999	205	1.377	91.125	337,668,636	2.934	68.822
\$1,700,000 - \$1,799,999	163	1.095	92.220	284,459,104	2.472	71.294
\$1,800,000 - \$1,899,999	132	0.887	93.107	244,458,723	2.124	73.419
\$1,900,000 - \$1,999,999	105	0.705	93.813	204,125,993	1.774	75.193
\$2,000,000 and Greater	921	6.187	100.000	2,854,542,427	24.807	100.000
Total	14,885	100.000		\$ 11,506,870,425	100.000	

Source: California Municipal Statistics, Inc.

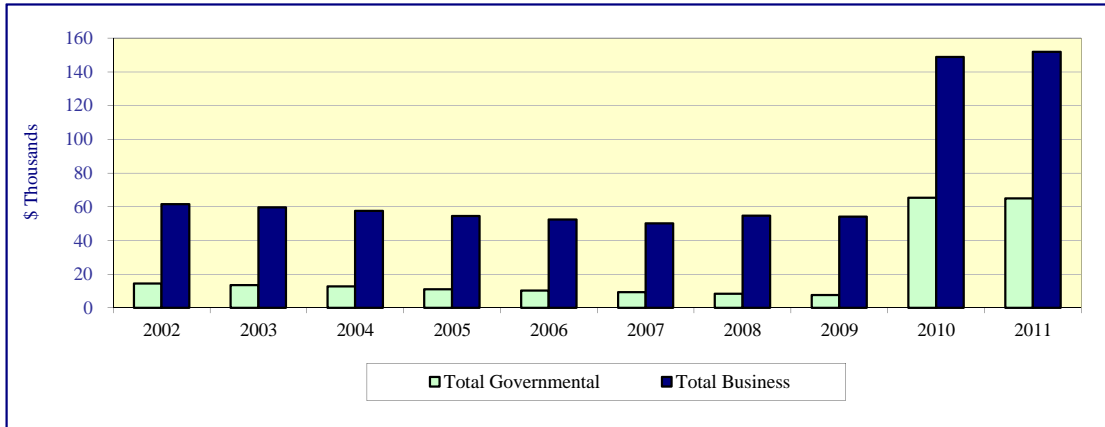
Note:

This schedule is provided as required by the Continuing Disclosure Agreement for the City's Series 2010A General Obligation Bond and is not required by Government Accounting Standards Board (GASB). Therefore, ten years of comparison data is not presented.

(a) Improved single family residential parcels. Excludes condominiums and parcels with multiple family units.

City of Palo Alto - Ratio of Outstanding Debt by Type

Last Ten Fiscal Years (\$000)



Governmental Activities

Fiscal Year	Certificates of Participation	General Obligation Bonds	Special Assessment Debt	Capital Lease Obligations	Total
2002	13,695	0	595	84	14,374
2003	12,905	0	510	57	13,472
2004	12,215	0	420	25	12,660
2005	10,625	0	325	0	10,950
2006	9,915	0	225	0	10,140
2007	9,175	0	115	0	9,290
2008	8,405	0	0	0	8,405
2009	7,605	0	0	0	7,605
2010	6,765	58,500	0	0	65,265
2011	5,895	58,945	0	0	64,840

Business-Type Activities

Fiscal Year	Utility Revenue Bonds	Total	Total Primary Government	Percentage of Assessed Value (a)	Percentage of Personal Income (b)	Per Capita (c)
2002	47,210	47,210	61,584	0.47 %	2.04%	\$1.02
2003	46,069	46,069	59,541	0.43 %	1.97%	\$0.98
2004	44,862	44,862	57,522	0.38 %	1.87%	\$0.95
2005	43,598	43,598	54,548	0.34 %	1.67%	\$0.88
2006	42,288	42,288	52,428	0.32 %	1.53%	\$0.84
2007	40,887	40,887	50,177	0.28 %	1.46%	\$0.80
2008	46,310	46,310	54,715	0.29 %	1.54%	\$0.86
2009	46,565	46,565	54,170	0.26 %	1.47%	\$0.84
2010	83,647	83,647	148,912	0.68 %	4.46%	\$2.28
2011	87,117	87,117	151,957	0.69 %	4.45%	\$2.36

Sources: City of Palo Alto

(a) County of Santa Clara (assessed value)

(b) Per capita personal income are only available for Santa Clara County.

Personal income is the product of the countywide per capita amount and the City's population.

(c) State of California, Department of Finance (population)

California State Department of Transportation Forecasts

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, 2011

FY 2011 Assessed Valuation

\$21,956,274,024

	Total Debt Outstanding	Percentage Applicable To City of Palo Alto (a)	Amount Applicable To City of Palo Alto
<u>OVERLAPPING TAX AND ASSESSMENT DEBT:</u>			
Santa Clara County	\$334,900,000	8.276%	\$27,716,324
Santa Clara Valley Water District, Zone W-1	405,000	0.473%	1,916
Foothill-DeAnza Community College District	650,224,288	23.470%	152,607,640
Palo Alto Unified School District	229,109,249	88.460%	202,670,042
Fremont Union High School District	265,975,108	0.002%	5,320
Los Gatos Joint Union High School District	55,215,000	0.011%	6,074
Mountain View-Los Altos Union High School District	50,486,384	1.030%	520,010
Cupertino Union School District	122,899,991	0.004%	4,916
Los Altos School District	86,664,000	1.042%	903,039
Mountain View-Whisman School District	2,645,000	1.014%	26,820
Saratoga Union School District	47,550,032	0.023%	10,937
Whisman School District	19,129,761	3.630%	694,410
City of Palo Alto	55,305,000	100.000%	55,305,000
El Camino Hospital District	143,805,000	0.093%	133,739
City of Palo Alto Special Assessment Bonds	35,480,000	100.000%	35,480,000
Santa Clara Valley Water District Benefit Assessment District	143,160,000	8.276%	11,847,922
TOTAL OVERLAPPING TAX AND ASSESSMENT DEBT	<u>\$2,242,953,813</u>		<u>\$487,934,109</u>
<u>DIRECT AND OVERLAPPING GENERAL FUND DEBT:</u>			
Santa Clara County General Fund Obligations	\$786,980,000	8.276%	\$65,130,465
Santa Clara County Pension Obligations	386,024,822	8.276%	31,947,414
Santa Clara County Board of Education Certificates of Participation	12,580,000	8.276%	1,041,121
Foothill-DeAnza Community College District Certificates of Participation	21,215,000	23.470%	4,979,161
Los Gatos-Saratoga Joint Union High School District Certificates of Participation	9,650,000	0.011%	1,062
Mountain View-Los Altos Union High School District Certificates of Participation	6,115,000	1.030%	62,985
Saratoga Union High School District Certificates of Participation	6,110,000	0.023%	1,405
City of Palo Alto General Fund Obligations	5,895,000	100.000%	5,895,000
Santa Clara County Vector Control District Certificates of Participation	3,800,000	8.276%	314,488
Midpeninsula Regional Open Space Park District General Fund Obligations	131,003,031	13.742%	18,002,437
TOTAL DIRECT AND OVERLAPPING GENERAL FUND DEBT	<u>\$1,369,372,853</u>		<u>\$127,375,538</u>
TOTAL DIRECT DEBT			\$61,200,000
TOTAL OVERLAPPING DEBT			\$554,109,647
COMBINED TOTAL DEBT	<u><u>\$3,612,326,666</u></u>		<u><u>\$615,309,647</u></u> (b)

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

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

Ratios to Assessed Valuation

Direct Debt (\$55,305,000)	0.25%
Combined Direct Debt (\$61,200,000)	0.28%
Total Overlapping Tax and Assessment Debt	2.22%
Combined Total Debt	2.80%

STATE SCHOOL BUILDING AID REPAYABLE AS OF 06/30/11: \$0

Source: California Municipal Statistics, Inc.

City of Palo Alto - Computation of Legal Bonded Debt Margin

June 30, 2011

(in thousands of dollars)

Assessed Valuation:

Secured property assessed value, net of exempt real property	<u><u>\$21,956,274</u></u>
--	----------------------------

Bonded debt limit 3.75% of assessed value (a)	<u>\$823,360</u>
--	------------------

Amount of debt subject to limit: (b)

Certificates of participation	5,895
General Obligation Bonds	55,305
Special assessment debt with government commitment	<u>0</u>
Total Debt	<u>61,200</u>

Less amount of debt not subject to limit	<u>5,895</u>
--	--------------

Amount of debt subject to limit	<u><u>55,305</u></u>
---------------------------------	----------------------

Legal bonded debt margin	<u><u>\$768,055</u></u>
---------------------------------	-------------------------

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
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%
2007	660,360	0	660,360	0.00%
2008	709,593	0	709,593	0.00%
2009	790,710	0	790,710	0.00%
2010	820,513	55,305	765,208	7.23%
2011	823,360	55,305	768,055	7.20%

Source: Annual Financial Statements

Notes:

(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.

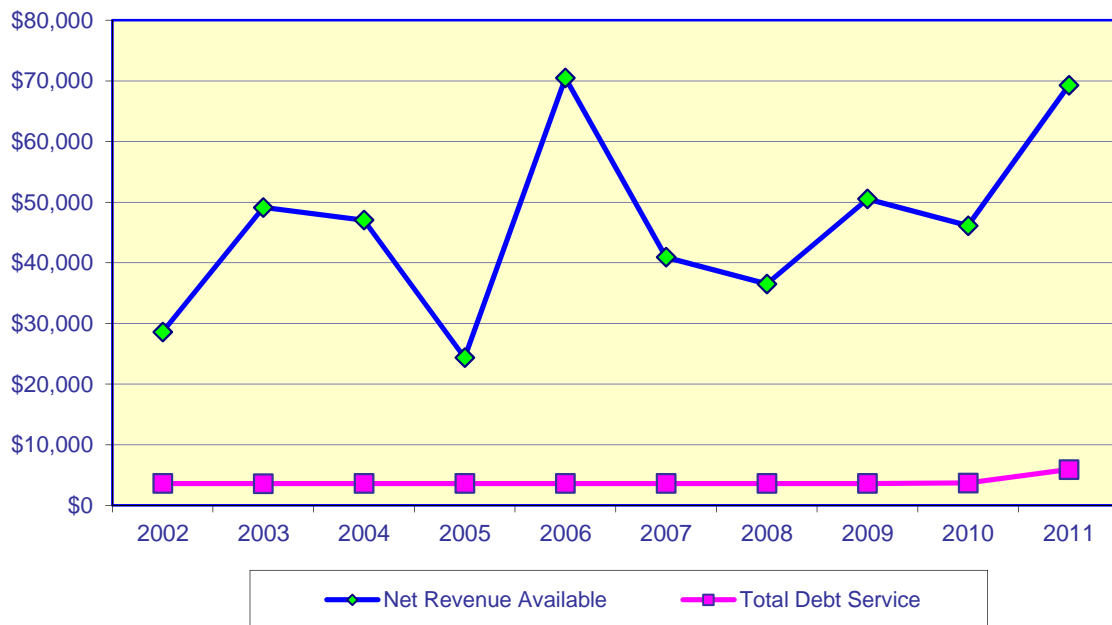
(b) In accordance with California Government Code Section 43605, only the City's general obligation bonds are subject to the legal debt limit of 15%. The above does not include debt recorded in the Enterprise Funds because such debt is not subject to legal debt margin.

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 (a)	Debt Service			Coverage
				Principal	Interest	Total	
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
2007	205,258	164,340	40,918	1,465	2,147	3,612	11.33
2008	222,799	186,285	36,514	1,525	2,088	3,613	10.11
2009	246,028	195,489	50,539	1,590	2,024	3,614	13.98
2010	233,774	187,658	46,116	1,755	1,954	3,709	12.43
2011	237,600	168,328	69,272	2,655	3,261	5,916	11.71

Source: Annual Financial Statements

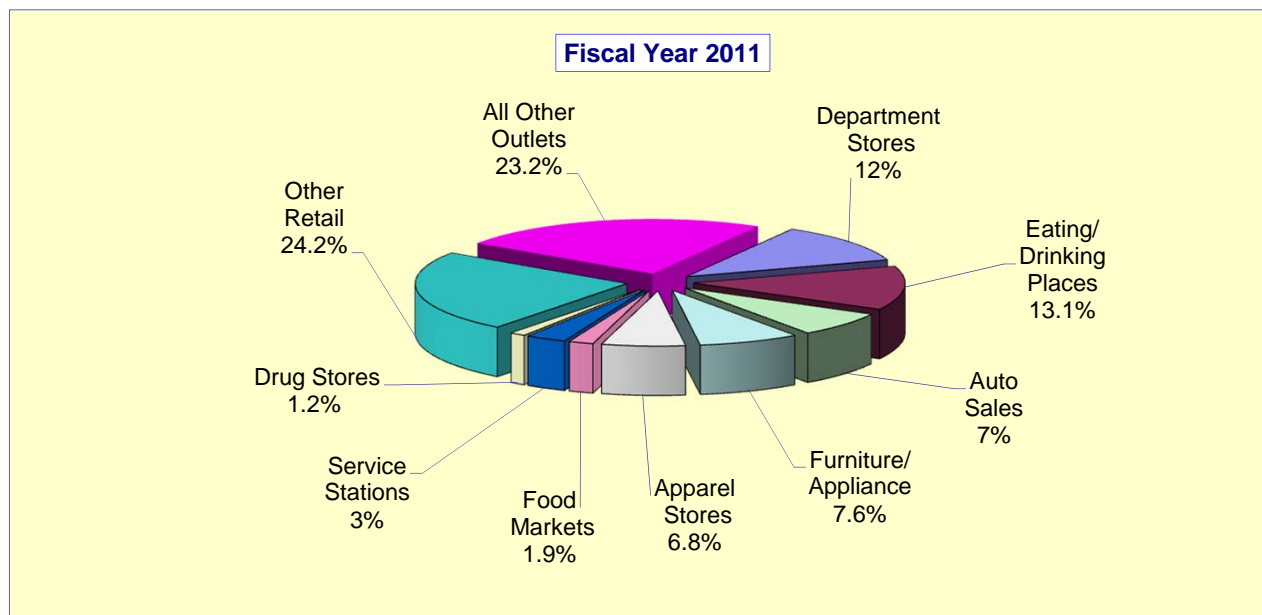
Note: (a) Excludes depreciation and amortization expense.

Details regarding the City's outstanding debt can be found in the notes to the financial statements.

FY 2008 Principal for Debt Service was restated due to correction of data.

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
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
2007	2,751	2,486	1,954	1,109	1,485	374	602	203	5,075	16,039	5,185	21,224
2008	2,685	2,566	1,731	1,685	1,497	349	622	405	4,682	16,222	5,066	21,288
2009	2,251	2,443	1,358	1,431	1,258	315	493	214	4,284	14,047	5,277	19,324
2010	2,215	2,418	1,288	1,402	1,254	343	549	219	4,458	14,146	4,268	18,414
2011	2,374	2,621	1,474	1,564	1,292	381	630	242	4,873	15,451	4,848	20,299

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

SALES TAX RATES FOR THE FISCAL YEAR ENDED JUNE 30, 2011

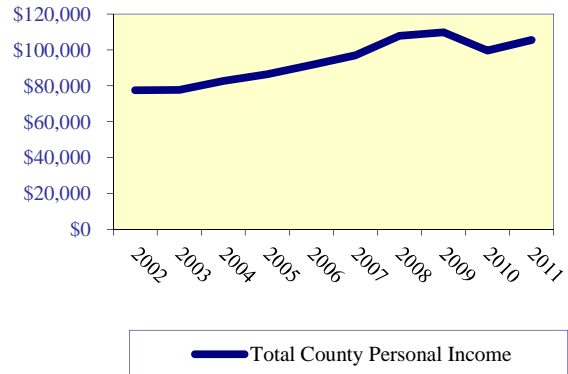
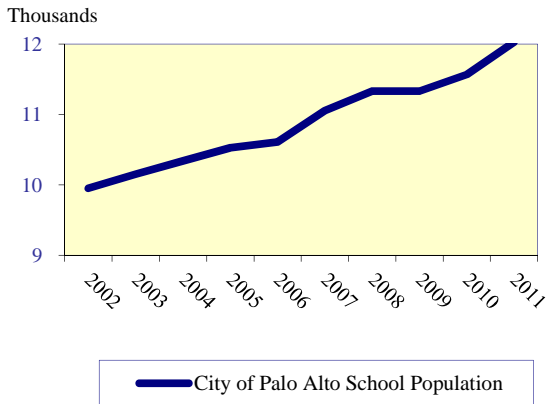
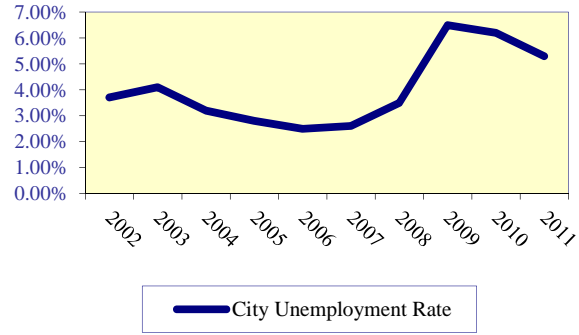
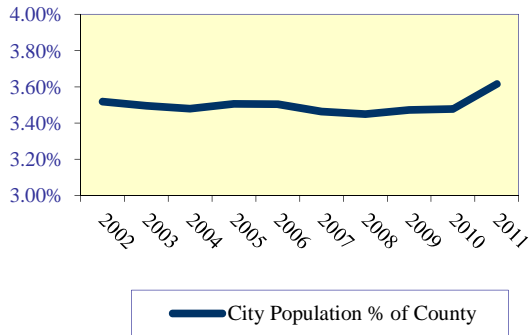
State Funds	7.00%
County Transportation Fund (Transportation Development Act)	0.25%
County Transportation Fund	1.00%
City	1.00%
	9.25%

Source: California State Board of Equalization

Note: Effective July 1, 2011 the sales tax rate decreased to 8.25%.

City of Palo Alto - Demographic and Economic Statistics

Last Ten Fiscal Years



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)
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 *
2007	62,615	2.6%	11,056	1,808,056	3.46%	96,900,000 *
2008	63,367	3.5%	11,329	1,837,075	3.45%	107,900,000 *
2009	64,484	6.5%	11,329	1,857,621	3.47%	109,700,000 *
2010	65,408	6.2%	11,565	1,880,876	3.48%	99,600,000 *
2011	64,417	5.3%	12,024	1,781,427	3.62%	105,500,000 *

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 and Three Years Ago

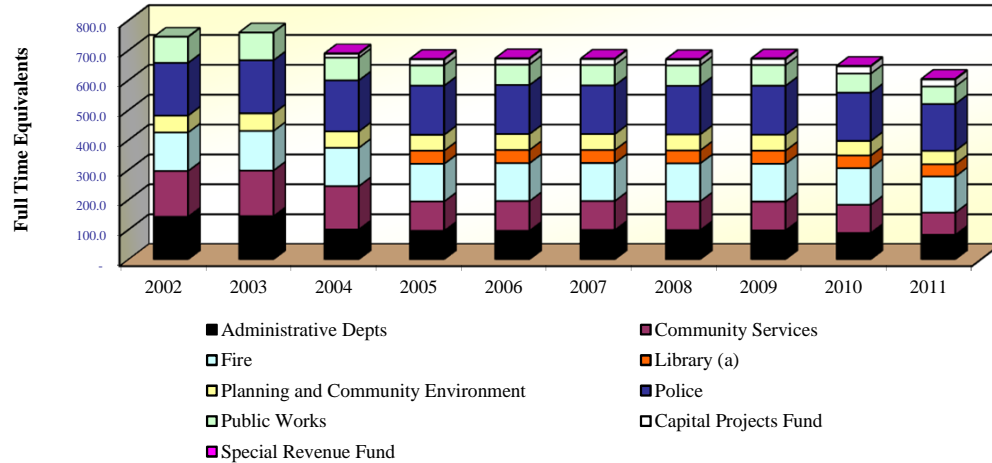
Employer	FY 2011			FY 2008	
	Number of Employees	Rank	Percentage of Total City Employment	Number of Employees	Rank
Stanford University	10,223	1	9.3%	9,821	1
Stanford University Medical Center/Hospital	5,813	2	5.3%	5,025	2
Lucile Packard Children's Hospital	3,549	3	3.2%	3,326	4
Veteran's Affairs Palo Alto Health Care System	3,500	4	3.2%	3,500	3
Hewlett-Packard Company	2,001	5	1.8%	2,001	5
Palo Alto Medical Foundation	2,000	6	1.8%	2,000	6
Space Systems Loral	1,700	7	1.5%	1,700	7
Wilson Sonsini Goodrich Rosati	1,500	8	1.4%	1,500	8
Palo Alto Unified School District	1,318	9	1.2%	1,304	9
City of Palo Alto	1,019	10	0.9%	1,100	10
Subtotal	<u>32,623</u>		<u>29.7%</u>		
Total City Day Population	<u>110,000</u>				

Source: www.ReferenceUSA.com, www.stanfordhospital.org, www.lpch.org, www.pausd.org, www.stanford.edu, www.cityofpaloalto.org

Note: Reporting as a statistical started in FY 2006. Comparable data was not available until FY 2008.

City of Palo Alto - Full-Time Equivalent City Government Employees by Function

Last Ten Fiscal Years



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Governmental Funds										
General Fund										
Administrative Depts	143.60	145.10	101.10	96.24	96.65	99.05	98.65	97.80	89.30	82.84
Community Services	153.00	153.00	144.75	98.25	99.25	97.25	96.25	96.50	94.25	74.50
Fire	129.00	132.50	128.50	126.00	127.00	127.00	127.00	126.69	122.69	120.74
Library (a)				44.00	44.25	43.75	43.75	43.75	42.25	41.25
Planning and Community Environment	56.50	59.00	54.80	53.30	53.30	53.30	53.30	53.30	48.85	44.60
Police	176.50	177.50	171.00	164.50	164.00	163.00	163.00	164.00	161.50	157.00
Public Works	87.05	93.05	76.20	67.90	67.90	67.90	67.90	69.23	63.67	58.57
Capital Projects Fund			12.70	20.20	20.20	20.00	20.00	20.67	24.67	23.67
Special Revenue Fund			1.20	1.20	1.20	1.20	1.20	1.20	1.15	1.65
Enterprise Funds										
Public Works Department (Refuse, Storm Drain, Wastewater Treatment)	110.45	110.45	111.35	112.65	112.65	112.65	112.65	113.55	114.63	115.01
Utilities Department (Administrative, Electric, Gas, Wastewater Collection, Water)	230.50	229.50	233.75	233.90	235.90	234.90	234.90	238.01	241.61	250.71
CPA External Services (b)	4.00	7.00	5.70	6.00	6.00	5.80	5.80	-	-	-
Other Funds										
Printing and Mailing	4.15	4.15	4.15	4.70	4.60	4.65	4.05	4.05	4.05	1.57
Technology			33.15	29.56	29.60	29.80	29.80	30.65	30.65	30.41
Equipment Management	15.00	15.00	16.00	16.00	16.00	16.20	16.20	16.20	16.08	16.08
Total	1,109.75	1,126.25	1,094.35	1,074.40	1,078.50	1,076.45	1,074.45	1,075.60	1,055.35	1,018.60

Source: City of Palo Alto - Adopted Operating Budget

Notes: (a) Library became its own entity effective 2005, originally part of Community Services.

(b) CPA External Services of the original 5.80 FTE, .80 FTE was transferred to the Technology Fund and 5.00 FTE was eliminated.

City of Palo Alto - Operating Indicators by Function/Program

Last Ten Fiscal Years

<u>Function / Program</u>	<u>Fiscal Year</u>		
	<u>2002</u>	<u>2003</u>	<u>2004</u>
Public Safety:			
Fire:			
Number of Fire Hydrants	1,741	1,746	1,874
Planning & Community Environment:			
Number of Housing Units	26,841	26,934	27,019
Commercial & Industrial Space - Million Sq Ft	27.3	27.3	27.3
Electric Utility:			
Number of Customer Accounts	28,348	28,408	28,482
Million of KWH Sold	997	957	958
Fiber Optics Utility:			
Number of Fiber Optic Connections	30	23	18
Water Utility:			
Number of Customer Accounts	19,437	19,487	19,557
Million CCF Sold	5.9	5.6	6.0
Gas Utility:			
Number of Customer Accounts	23,116	23,169	23,216
Million Therms Sold	33.7	31.8	31.5
Waste Water:			
Number of Customer Accounts	21,772	21,819	21,830
Millions of Gallons Processed	8,699	8,704	8,238

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

Note: Fiscal Years 2004-2006, number of fire hydrants are restated due to change in source of data.
Fiscal Years 2007 and 2008, for Water Utility - Million CCF Sold, are restated due to correction of measuring units.

Fiscal Year

2005	2006	2007	2008	2009	2010	2011
1,873	1,919	1,944	1,948	1,949	1,954	1,852
27,522	27,767	27,763	27,938	28,291	28,445	28,216
27.3	27.3	27.3	27.3	27.3	27.3	27.3
28,539	28,653	28,684	29,024	28,527	28,527	29,708
959	966	978	977	996	965	946
39	22	23	27	26	24	24
19,605	19,645	19,726	19,942	19,442	19,916	20,248
5.3	5.2	5.4	5.5	5.7	5.0	5.0
23,300	23,353	23,357	23,502	23,090	23,322	23,816
32.0	31.5	31.3	32.2	30.6	30.7	30.9
21,825	21,784	21,835	21,990	22,210	22,193	22,320
8,395	8,972	9,220	8,510	7,958	8,184	8,652

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

Last Ten Fiscal Years

Function/Program	Fiscal Year			
	2002	2003	2004	2005
Public Safety:				
Fire:				
Fire Stations	8	8	8	8
Fire Apparatus	25	22	23	25
Police:				
Police Stations	1	1	1	1
Police Patrol Vehicles	33	33	30	30
Community Services:				
Acres - Downtown/Urban Parks	170	170	170	170
Acres - Open Space	3,731	3,731	3,731	3,731
Parks and Preserves	34	34	34	35
Golf Course	1	1	1	1
Tennis Courts	52	52	52	52
Athletic Center	1	1	1	1
Community Centers	4	4	4	4
Theatres	3	3	3	3
Cultural Center/Art Center	1	1	1	1
Junior Museum and Zoo	1	1	1	1
Swimming Pools	1	1	1	1
Nature Center	2	2	2	2
Libraries:				
Libraries	6	6	5	5
Public Works:				
Number of Trees Maintained	37,941	34,939	35,440	35,096
Electric Utility:				
Overhead Pole Miles	227	227	227	225
Underground Trench Miles	186	186	186	188
Water Utility:				
Miles of Water Mains	226	226	226	226
Gas Utility:				
Miles of Gas Mains	207	207	207	207
Waste Water:				
Miles of Sanitary Sewer Lines	202	202	202	202

Source: City of Palo Alto

Fiscal Year

2006	2007	2008	2009	2010	2011
8	8	8	8	8	8
25	25	23	28	28	27
1	1	1	1	1	1
30	30	30	30	30	30
170	157	157	157	157	157
3,731	3,744	3,744	3,744	3,744	3,744
35	36	36	36	36	36
1	1	1	1	1	1
52	51	51	51	51	51
1	4	4	4	4	4
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	3	3	3	3	3
5	5	5	5	5	5
34,841	34,556	35,322	35,255	35,255	35,207
217	194	193	193	193	193
210	252	253	253	253	253
217	217	217	214	214	214
207	207	207	207	205	205
202	202	202	207	207	207

City of Palo Alto - Insurance Coverage
June 30, 2011

TYPE	COVERAGE (Deductible)	LIMITS	COMPANY	EXPIRATION DATE
PROPERTY LOSS				
Blanket	All real & personal property (\$10,000 deductible), Fine Arts (\$2,500 deductible)	\$380,029,130	CA Public Entity Property Program	07/02/16
Boiler & Machinery	All real & personal property (\$25,000 deductible)	\$100,000,000 maximum all risk per occurrence limit \$1,000,000 minimum contingent business interruption	CA Public Entity Property Program	07/02/16
Flood Insurance	All real property 1305 Middlefield Road (\$1,000 deductible)	\$500,000	Hartford Fire Insurance Co.	04/08/16
FINANCIAL LOSS				
Employee Dishonesty	Position bond-faithful performance per loss (\$5,000 deductible)	\$1,000,000 / \$4,000,000 x \$1,000,000 per occurrence for City Mgr. & Director of ASD	Fidelity & Deposit Co.	03/23/16
UMBRELLA EXCESS LIABILITY	City is a member of an insurance pool participating with a number of other California cities (\$1,000,000 self-insured retention)	\$100,000,000 annual aggregate	Everest Ins. Co. Lexington Ins Co. Axis & Arch	07/02/16
Trustees Errors and Omissions	Bodily injury and property damage liability Errors and omissions liability			
SPECIAL LIABILITY				
	Each occurrence			
Volunteers Accident	Medical - Each person / (\$100 deductible)	\$20,000	QBE Insurance Co.	02/04/16
Special Events	Bodily injury	\$1,000,000 per occurrence	Colony Insurance Company	01/02/16
EMPLOYEE BENEFIT				
Travel Accident	Indemnity, based on salary	\$1,500,000 per accident	Life Insurance Co. of North America	06/02/16
EMPLOYEE HEALTH PLAN	The City participates in the California Public Employees' Medical and Health Care Act (PEMHCA) program to provide medical benefits to employees and retirees			
WORKERS' COMPENSATION				
	City is self-insured for first \$750,000 liability	\$750,000 per occurrence		07/02/16
EXCESS WORKERS' COMPENSATION	Pooled Retention	\$4,000,000 limit per occurrence - Workers Comp and Employers Liability	CSAC Excess Insurance Authority	07/02/16
	Reinsured Layer	\$45,000,000 workers comp per occurrence, excess of pooled retention limit, includes \$5,000,000 employers liability	ACE American Insurance Co.	07/02/16

Source: Human Resources Dept, City of Palo Alto

CITY OF PALO ALTO
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For the Year Ended June 30, 2011

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

INDEPENDENT AUDITOR’S 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

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 of Palo Alto, California, (City), as of and for the year ended June 30, 2011, and have issued our report thereon dated December 1, 2011. Our report includes an explanatory paragraph indicating that the City adopted the provisions of Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the City is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the City’s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City’s internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City’s financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weakness. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described as items 2011-A through 2011-H in Section II of the accompanying schedule of findings and questioned costs over financial statements that we consider to be significant deficiencies in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 or other matters that are required to be reported under *Government Auditing Standards*.

The City's responses to the findings identified in our audit are described in Section II of the accompanying schedule of findings and questioned costs. We did not audit the City's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Mayor and City Council, management, 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.

Macias Gini & Connell LLP

Walnut Creek, California

December 1, 2011

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

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS
THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

Compliance

We have audited City of Palo Alto's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the City's major federal programs for the year ended June 30, 2011. The City's major federal programs are identified in the summary of the auditor's result section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

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

In our opinion, the City complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2011-1, 2011-4 and 2011-6.

Internal Control Over Compliance

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 the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected or corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2011-1, 2011-3, and 2011-5 to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2011-2 and 2011-4 to be significant deficiencies.

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the Mayor and City Council, management, 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.

Macias Gini & Connell LLP
Walnut Creek, California
December 1, 2011

CITY OF PALO ALTO
Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2011

Grantor/Pass-Through Grantor/Program Title	Grantor Identifying Number	Federal CFDA Number	Expenditures	Subrecipients Expenditures
U.S. Department of Housing and Urban Development				
<i>Direct</i>				
CDBG - Entitlement Grants Cluster				
Community Development Block Grants/Entitlement Grants	B-10-MC-06-0020	14.218	\$ 487,032	\$ 358,946
ARRA - Community Development Block Grant Entitlement Grants (CDBG-R)	B-09-MY-06-0020	14.253	52,426	47,049
Subtotal - CDBG - Entitlement Grants Cluster			<u>539,458</u>	<u>405,995</u>
U.S. Department of Interior				
<i>Direct</i>				
ARRA - Water Reclamation and Refuse Program	R10AP20003	15.504	4,939,600	-
U.S. Department of Justice				
<i>Direct</i>				
Equitable Sharing Program	CA0431200	16.CA0431200	1,222	-
U.S. Department of Transportation				
<i>Pass-through State of California Department of Transportation</i>				
ARRA - Surface Transportation Discretionary Grants for Capital Investments				
ARRA - Alma Road Rehabilitation	ESPL-5100(013)	20.932	322,545	-
Environmental Protection Agency				
<i>Pass-through California State Water Resources Control Board</i>				
ARRA - Capitalization Grants for Clean Water State Revolving Funds	09-814-550	66.458	2,166,607	-
U.S. Department of Energy				
<i>Direct</i>				
ARRA - Energy Efficiency and Conservation Block Grant	DE-SC0002146	81.128	527,152	-
U.S. Department of Homeland Security				
<i>Direct</i>				
Assistance to Firefighter Grant	EMW-2008-FO-12589	97.044	136,430	-
<i>Pass-through from County of Santa Clara</i>				
State Homeland Security Grant	2008-0006	97.073	6,088	-
Total U.S. Department of Homeland Security			<u>142,518</u>	<u>-</u>
TOTAL FEDERAL FINANCIAL AWARDS			<u>\$ 8,639,102</u>	<u>\$ 405,995</u>

CITY OF PALO ALTO
Notes to the Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2011

NOTE 1 – REPORTING ENTITY

The Schedule of Expenditures of Federal Awards (the Schedule) includes expenditures of federal awards for the City of Palo Alto, California, 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 measurement focus applied. All governmental funds are accounted for using the modified accrual basis of accounting. All proprietary funds are accounted for using the 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:

Expenditure of Long-Term Debt Proceeds – In this fiscal year, the City received proceeds from long-term debt funded by the federal government, passed through the California State Water Resources Control Board under CFDA number 66.458. In accordance with the OMB Circular A-133, section .205(d), the City included current year expenditures of such proceeds on the Schedule.

NOTE 3 – DIRECT AND INDIRECT (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 of federal award programs when they occur.

NOTE 4 – RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Amounts reported in the Schedule agree to or can be reconciled with the amounts reported in the related federal financial reports.

NOTE 5 – RELATIONSHIP TO BASIC FINANCIAL STATEMENTS

Federal awards and expenditures agree to or can be reconciled with the amounts reported in the City's basic financial statements.

CITY OF PALO ALTO
 Schedule of Findings and Questioned Costs
 For the Year Ended June 30, 2011

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued on the basic financial statements of the City:	Unqualified
Internal control over financial reporting:	
◆ Material weakness(es) identified?	No
◆ Significant deficiency(ies) identified that are not considered to be material weaknesses?	Yes
Noncompliance material to the financial statements noted?	No

Federal Awards

Internal control over major programs:	
◆ Material weakness(es) identified?	Yes
◆ Significant deficiency(ies) identified that are not considered to be material weaknesses?	Yes
Type of auditor's report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?	Yes
Identification of major programs:	

<u>Program Title</u>	<u>CFDA Number</u>
CDBG – Entitlement Grants Cluster	14.218 & 14.253
ARRA – Water Reclamation and Refuse Program	15.504
ARRA – Surface Transportation Discretionary Grants for Capital Investment	20.932
ARRA –Capitalization Grants for Clean Water State Revolving Funds	66.458
ARRA – Energy Efficiency and Conservation Block Grant Program	81.128

Dollar threshold used to distinguish between type A and type B programs:	\$300,000
Auditee qualified as a low-risk auditee?	No

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2011

Section II – Financial Statement Findings

2011-A A Comprehensive Disaster Recovery Plan Has Not Been Fully Developed and Tested
(Significant Deficiency)

General computer controls should ensure that plans have been developed and documented to provide contingency for unforeseeable events, including the recovery of operational and financial data in the event of a disaster. The City, however, has not completed the development of a comprehensive disaster recovery plan. The current draft plan started development in 2008 and has yet to be completed. City IT management stated the prolonged plan development process was due to a lack of sufficient resources. The lack of a comprehensive plan that has been fully tested places the City at an increased risk of loss of financial data in the event of a disaster that affects the City's server room.

We recommend the City CIO (acting), working with the City Manager, should plan to budget for the resources necessary to complete the development of a comprehensive disaster recovery plan. Once the plan is completed, it should be fully tested to ensure the City's financial data can be restored in a reasonable amount of time.

Management's Response:

The City's management agrees with this finding, which is consistent with other reports on the SAP/IT system. The IT Department was created by the City Manager as a stand alone department in the FY2012 budget. The Department was created, in part, to provide greater focus on IT priorities, such as security, among others. The IT Department will be lead by a new Chief Information Officer. The finding will be evaluated by the new IT Department as part of building a work plan for the future.

2011-B The City's IT Assets Are Exposed to an Active Water-Based Fire Suppression System
(Significant Deficiency)

General computer controls should ensure that IT assets are adequately protected from physical and environmental hazards. The City's server room, however, still has an active water-based fire suppression system. This places the City's IT assets at increased risk of damage should the system be activated or should a pipe rupture.

We recommend the City CIO (acting), working with the City Manager, should research the feasibility of implementing a dry fire suppression system in the City's server room. Alternately, the active water-based system could be replaced by a dry-pipe system. If it is determined that the systems could be implemented, the City should budget for the replacement of the water-based system. Should the system replacement be deemed infeasible, alternative mitigating controls should be implemented, such as the installation of high temperature sprinkler heads and the development of a comprehensive disaster recovery plan.

Management's Response:

Same response as provided under finding no. 2011-A.

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2011

Section II – Financial Statement Findings (Continued)

2011-C A Comprehensive IT Risk Assessment Has Not Been Performed
(Significant Deficiency)

General computer controls over the access to programs and data should require that a mechanism or procedures be in place to identify and react to risks arising from internal and external sources. A comprehensive means to identify IT risks is through the periodic performance of IT risk assessments. The City, however, has not performed a formal comprehensive and independent IT risk assessment to help identify the risks to the delivery of IT services and the accuracy and integrity of the City’s financial and personnel data.

We recommend the City CIO (acting) should plan and budget for an independent IT risk assessment to be performed on the department’s functions. The risk assessment should focus on identifying all of the possible risks to the City IT department, the delivery of IT services and the accuracy and integrity of the City’s financial and personnel data. The risk assessment should quantify the likelihood of an event, the impact of the event and the mitigating controls that would address the possible risk. The risk assessment should also include network penetration testing to ascertain the vulnerabilities of the City’s computer network from hacking attempts.

Management’s Response:

Same response as provided under finding no. 2011-A.

2011-D City IT Department Does Not Have Oversight Over Non-Core Financial Applications
(Significant Deficiency)

The City has several applications that are used by the various departments. These include; Class, used by Parks and Recreation; Chameleon, used by Animal Services; Horizon, used by the Libraries; and Acella, used for Permitting. These applications are owned by the individual departments and not controlled nor managed by the City IT Department. Since management of the applications is decentralized, the individual applications may not adhere to best practices for application access (password configuration) or management of authorization profiles. This places the City network and financial data at increased risk of unauthorized access.

We recommend the City Internal Auditor, working with the CIO (acting), should review the password configuration requirements being used in the City’s non-core financial applications. If it is found that the password requirements do not meet industry best practices shown in the table below, the password configuration settings within the applications should be updated, if possible.

Account Setting	Best Practices
Password Length (Min.)	7-9 characters
Expiration Period	30-60 days
Account Lockout Threshold	3-5 invalid logon attempts will lock the account.
Strong Passwords Required	Yes

Management’s Response:

Same response as provided under finding no. 2011-A.

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2011

Section II – Financial Statement Findings (Continued)

2011-E City Firewalls Are Managed by a Single Person
(Significant Deficiency)

General computer controls require that logical security management be properly administered. The City's firewalls, however, are accessible and configurable by mainly only one person within the IT Department. Although the City has additional staff that can assist with firewall activities, it does not have a single staff person that is a dedicated back up. This places the City's network, application and data at increased risk should this person be unavailable for an extended period, or if the one person decided to lock all others out of the network.

We recommend the CIO (acting) should either have at least one other IT staff or manager trained in the management of firewalls or have an outside consultant retained for these services. An additional secured account should also be created for firewall administration that could be used in the event the primary firewall administrator is unavailable for an extended period of time.

Management's Response:

Same response as provided under finding no. 2011-A.

2011-F City Has Not Performed PCI Data Security Standards Compliance Assessment
(Significant Deficiency)

The Payment Card Industry Data Security Standard (PCI DSS) is a set of requirements designed to ensure that all entities that process, store or transmit credit card information maintain a secure environment. Entities that do not comply with PCI DSS may be subject to fines, card replacement costs, forensic audits, brand damage, etc., by the major credit card brands should a breach event occur. The City, however, has not performed a compliance assessment for PCI DSS.

We recommend the City Manager, working with the CIO (acting) should have a PCI compliance audit conducted over the City's payment card practices and security measures.

Management's Response:

Same response as provided under finding no. 2011-A.

2011-G City-wide Capital Asset Policies are Outdated
(Significant Deficiency)

During the current year, the City purchased software in the amount of \$232,696 and capitalized it as a nondepreciable asset under governmental-type activities. Given the constant evolution of technology, software typically has a useful life ranging from 5 to 20 years based on the expected duration and complexities of the system, rather than treating it as indefinite. Capitalizing software as nondepreciable seems to overstate the value of these intangible assets over time and would necessitate a large write-off when service utility is diminished or when it becomes obsolete.

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2011

Section II – Financial Statement Findings (Continued)

2011-G City-wide Capital Asset Policies are Outdated (Continued)
(Significant Deficiency)

Furthermore, upon our review of capital assets, we observed that the City-wide capital asset policies currently in place have not been updated since 1996 for governmental funds and 2005 for enterprise funds. These policies should be updated to address current practices and the provisions of subsequently issued Governmental Accounting Standards Board (GASB) guidance that may not be properly reflected in these dated policies. For instance, GASB issued Statement No. 34 in December 1999 that made revolutionary changes over the accounting and reporting of capital assets, including new provisions for infrastructure, and issued Statement No. 51 in June 2007 that provided accounting and financial reporting guidance for intangible assets, including internally generated computer software.

We recommend that the City review and update the current capital asset policies for both governmental and enterprise funds to ensure the City is properly accounting and reporting for its capital assets under U.S. generally accepted accounting principles. Once the updated policies are in place, we also recommend the City conduct a review of its existing capital assets to ensure compliance with these policies.

Management's Response:

The City's management agrees with this finding and will be undertaking a comprehensive review of their existing capital asset policy. Once any necessary revisions are updated and approved, we will evaluate any impact on the capital asset balances.

2011-H Accounting for Retention Payable
(Significant Deficiency)

During our search for unrecorded liabilities, which included an examination of disbursements issued subsequent to year-end, we observed that the City does not accrue a liability for retention amounts withheld from its payments to vendors. In total, we identified 7 payments within our sample of disbursements that contained retention amounts withheld totaling \$322,871, which were not accrued as fund liabilities. While retention amounts may not be due and payable until some future date when project milestones are met to the City's satisfaction, they are customarily recognized as a liability since the goods and/or services have been received.

We recommend that the City review its current practices over accounting for retention payable to determine whether or not its liabilities are understated for amounts owed to vendors. At a minimum, the City should accumulate a total of retention amounts withheld to determine the significance of these amounts by opinion unit and, for governmental funds, whether or not the timing of payments would necessitate the recording of a fund liability in the current period.

Management's Response:

The City's management agrees with this finding and will be evaluating the options available in our existing system to record these liabilities. The results of the evaluation will determine how we can best implement this change from a practical perspective.

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2011

Section III - Federal Award Findings and Questioned Costs

Reference Number: 2011-1
Federal Program Title(s): ARRA - Energy Efficiency and Conservation Block Grant Program
Federal Catalog Number(s): 81.128
Federal Agency: Department of Energy
Pass-Through Entity: N/A – Direct Federal Fund
Federal Award Number and Year: DE-SC0002146 and 2010-11
Category of Finding: Reporting

Criteria:

As a recipient of federal awards, the City is required to comply with the reporting requirements under the grant agreement. Appendix 6 of the grant agreement states, “You are required to submit an itemized cost report, by project activity, with submittal of the SF-425, Federal Financial Report. The itemized cost report must address each item of the Budget Category of the SF-424A.”

Condition:

Under Appendix 6 of the grant agreement and per discussion with the Contract Specialist from the Department of Energy, the Itemized Cost Report is due quarterly along with the SF-425 Reports. The City did not submit the required itemized costs reports on a quarterly basis during the fiscal year.

Cause:

The Resource Planner, who is responsible for administering this program, was not aware of these reporting requirements due to oversight.

Effect:

The City did not comply with the reporting requirement listed in the grant agreement.

Questioned Costs:

There are no questioned costs.

Recommendation:

We recommend that responsible personnel for administering the program review the reporting requirements outlined in the grant terms and conditions to ensure compliance with reporting requirements.

Management’s Response and Corrective Action Plan:

Unlike the other EECBG reports, the itemized cost report was not required of all EECBG recipients and was not mentioned in webinars and email communication explaining the EECBG reporting requirements. The DOE made a monitoring visit on September 19, 2011 to review a 35 point questionnaire and address any reporting or programmatic issues. No reporting or programmatic issues were brought to staff’s attention during the visit.

As corrective action, City Staff has already emailed the quarterly itemized cost reports dating back to Q1, 2010 to the EECBG Contract Specialist at the DOE on November 17, 2011. In the future, when staff submits the quarterly ARRA reports, staff will continue to email the itemized cost reports to the EECBG Contract Specialist.

Responsible Staff: Christine Tam, Resource Planner

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2011

Section III – Federal Award Findings and Questioned Costs (continued)

Reference Number: 2011-2
Federal Program Title(s): ARRA - Energy Efficiency and Conservation Block Grant Program
Federal Catalog Number(s): 81.128
Federal Agency: Department of Energy
Pass-Through Entity: N/A – Direct Federal Fund
Federal Award Number and Year: DE-SC0002146 and 2010-11
Category of Finding: Reporting

Criteria:

As a direct recipient of federal funding, the City is required to submit various reports as required by Part 4 of the *OMB A-133 Compliance Supplement* and grant agreement. The required reports include *SF-425 Report*, *DOE Quarterly Performance Reports*, *ARRA Section 1512 Reports*, and *Itemized Cost Reports*. These reports must be mathematically accurate, must agree to the underlying data and must be summarized in accordance with the required or stated criteria and methodology. In order to mitigate risk of non-compliance, each report should be reviewed prior to submission. As required by OMB Circular A-133, Subpart C – Auditees, Section .300(b) – Auditee Responsibilities, the City, as the grant recipient, should maintain internal control over Federal programs that provides reasonable assurance that the City is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

Condition:

Each of the required reports was prepared by the Resource Planner based on information summarized by responsible personnel (Engineering, Utilities, and Accounting). The reports cover the two projects funded by the EECBG grants – LED Street Light and the Home Energy Program. The reports are then reviewed by the Utility Marketing Services Manager, and approved verbally most of the time. Hence, there is no evidence that shows the Utility Marketing Services Manager is performing this review. The lack of documentation prevents management from demonstrating that the internal control is operating as designed to ensure the reports were prepared accurately in accordance to the program requirements. In addition, while the Utility Marketing Service Manager is familiar with the Home Energy Program only, the information related to LED Street Light program were not adequately reviewed.

We noted no discrepancies between the reports and its supporting documents from the samples selected for testing.

Cause:

Since the draft reports were available electronically, the City believes that a verbal communication on the review is adequate.

Effect:

Although we noted no exceptions during our testing, we are unable to conclude that the required reports had been properly reviewed and authorized due to lack of documentation over the reporting process.

Questioned Costs:

There are no questioned costs.

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2011

Section III – Federal Award Findings and Questioned Costs (continued)

Recommendation:

We recommend that the City assign the review process to personnel that are familiar and knowledgeable with the projects to ensure an appropriate level of review is performed. We also recommend that the City maintain documentation of approval for all reports to demonstrate that the review process is performed in a timely manner. Documentation such as an email approval, signatures on the draft reports or something similar would be acceptable to document the personnel who reviewed the report for compliance with grant requirements.

Management's Response and Corrective Action Plan:

Prior to submitting the reports electronically, City staff will print out a copy of the draft reports for approval by the Utility Marketing Services Manager who oversees the Home Energy Report program and Senior Management Analyst who verifies the expenditures in the financial system. The draft report will also be emailed to the Supervising Electric Engineer who oversees the LED Streetlight project for approval; the email correspondence with the Supervising Electric Engineer will be printed and filed with the paper approval as back-up documentation of management review.

Responsible Staff: Christine Tam, Resource Planner

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2011

Section III – Federal Award Findings and Questioned Costs (continued)

Reference Number: 2011-3
Federal Program Title(s): ARRA - Energy Efficiency and Conservation Block Grant Program
Federal Catalog Number(s): 81.128
Federal Agency: Department of Energy
Pass-Through Entity: N/A – Direct Federal Fund
Federal Award Number and Year: DE-SC0002146 and 2010-2011
Category of Finding: SEFA Reporting

Criteria:

The City is required to, according to Section .300 of OMB Circular A-133, identify in its accounts, all Federal awards received and expended and the Federal programs under which they were received as well as prepare appropriate financial statements, including the schedule of expenditures of Federal awards (SEFA) in accordance with Section .310. Accordingly, the SEFA shall provide total Federal awards expended for each individual Federal program.

Condition:

During the review of the reporting for this program, 2 invoices in the total amount of \$50,000 were included in the reimbursement claims, and thus were reimbursed with federal awards. However, these 2 invoices were coded as City expenditures in the City's general ledger system by mistake, and thus were not included in the preliminary SEFA provided by the Administrative Services Department of the City. Per review of the expenditure details, the related expenditures were for allowable costs under the program guidelines incurred in the current fiscal year. Therefore, the expenditures should be reported as part of the program expenditures on the SEFA for the current fiscal year.

Cause:

This occurred due to the City's oversight when reviewing the financial reports submitted to the Department of Energy and the review of the coding of the expenditures in general ledger system.

Effect:

The total program expenditure on the SEFA was materially understated by \$50,000 or 9%.

Questioned Costs:

None

Recommendation:

We recommend that the City perform a review of the financial reports submitted to federal agencies and reconcile these amounts with the general ledger to ensure that federal expenditures are accurately reflected on the SEFA. In addition, the City should retain records that show that a secondary review on the financial report preparation was performed.

Management Response and Corrective Action:

City staff received approval from the DOE to reallocate \$50,000 of the federal award from the LED streetlight project to the home energy report. There was an oversight to update the purchase order for the home energy report to reflect the \$50,000 change. The purchase order has been updated accordingly with the correct account assignments to differentiate between federal and city funds. In the future, staff will keep a hard copy of the financial reports reflecting both federal and city expenditures.

Responsible Staff: Christine Tam, Resource Planner

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2011

Section III – Federal Award Findings and Questioned Costs (continued)

Reference Number: 2011-4
Federal Program Title: CDBG – Entitlement Grants Cluster
Federal Catalog Numbers: 14.218 and 14.253 (ARRA)
Federal Agency: Department of Housing and Urban Development
Pass-Through Entity: N/A
Federal Award Numbers and Year: B-10-MC-06-0020, B-09-MY-06-0020, 2010-2011
Category of Finding: Subrecipient Monitoring

Criteria:

Section 400(d)(1) of OMB Circular A-133 requires a pass-through entity to, at the time of the subawards, identify federal awards made by informing each subrecipient of the CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of the information is not available, the pass-through entity shall provide the best information available to describe the Federal awards.

For ARRA subawards, the pass-through entity should, at the time of the subawards, identify the amount of ARRA funds provided by the subaward and advise the subrecipient of the requirement to identify ARRA funds in the Schedule of Expenditures of Federal Awards (SEFA) and the data collection form (SF-SAC).

For FY2011, subrecipients expenditures were \$358,946 for CFDA 14.218 and \$47,049 for CFDA 14.253 (ARRA.)

Condition:

The City did not communicate the CFDA and Federal Award numbers to the subrecipients at the time of the subawards.

Cause:

The lack of communication for the CFDA number was a finding in the FY 2010 single audit. However the subgrants for FY 2011 had already been awarded prior to the finding. The City was not aware that they were required to notify the subgrantees of the Federal Award number.

Effect:

The City is not in compliance with the requirements of OMB Circular A-133 section 400(d)(1).

Questioned Costs:

There are no questioned costs.

Recommendation:

We recommend that the City immediately inform the existing subrecipients about this information and include all applicable information about the Federal funding source and document the communication at the time of the subaward.

Management Response and Corrective Action:

The finding in the FY 2010 single audit occurred after the FY 2011 subrecipient awards and subsequent contracts had been issued. As such, the information was not communicated to the subrecipients nor was it included on the CDBG subrecipient contracts. For FY 2012, the CFDA title and number has been provided on all CDBG subrecipients contracts.

Responsible Staff: Consuelo Hernandez, CDBG Coordinator

CITY OF PALO ALTO
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2011

Section III – Federal Award Findings and Questioned Costs (continued)

Reference Number: 2011-5
Federal Program Title: CDBG – Entitlement Grants Cluster
Federal Catalog Numbers: 14.218 and 14.253 (ARRA)
Federal Agency: Department of Housing and Urban Development
Pass-Through Entity: N/A
Federal Award Numbers and Years: B-10-MC-06-0020, B-09-MY-06-0020, 2010-2011
Category of Finding: Suspension and Debarment

Criteria:

According to 24 CFR 84.35, grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party that is debarred or suspended or is otherwise excluded from or ineligible for participation in federal assistance programs. The City, as the grantee of the federal awards, is required to perform any of the following to comply with this requirement: (1) checking the Excluded Parties List System (EPLS), (2) collecting certification from subgrantees if allowed by this rule or (3) adding a clause or condition to the covered transaction with the subgrantees.

Condition:

The City did not perform a debarment and suspension check on the subgrantees when awarding subgrants in FY 2011. Six subgrantees were selected for testing, and all of them did not have documentation that their status was verified in EPLS, although based on our testing, none of them were noted as debarred or suspended in the EPLS.

For FY2011, subrecipients expenditures were \$358,946 for CFDA 14.218 and \$47,049 for CFDA 14.253 (ARRA.)

Cause:

The City was not aware that this was required for subrecipients. Thus, the City did not perform the verification at the time of subawards.

Effect:

Without verification prior to the subawards, the City runs a risk of passing through federal grants to an entity that was suspended or debarred. Hence, the City would not be in compliance with this requirement.

Questioned Costs:

There are no questioned costs.

Recommendation:

We recommend that the City check the Excluded Parties List System at EPLS.gov or include a clause in the contract prior to awarding subgrants to ensure that the subgrantee is eligible for Federal Funds.

Management Response and Corrective Action:

The City was not aware that a debarment and suspension check was required for its public service subrecipients. Historically, this has only been applied to construction activities and a debarment and suspension check is performed for the contractor and all subcontractors prior to awarding a construction contract.

Prior to awarding a CDBG Allocation, the City will perform a debarment and suspension check for all subrecipients.

Responsible Staff: Consuelo Hernandez, CDBG Coordinator

CITY OF PALO ALTO
Summary Schedule of Prior Audit Findings
For the Year Ended June 30, 2011

Section IV – Status of Prior Year Findings and Questioned Costs

Finding #SA 2010-01

Grant Agreement Retention

Federal Program Title: ARRA – Energy Efficiency and Conservation Block Grant Program
Federal Catalog Number: 81.128
Condition: The City staff did not have a complete copy of the grant agreement on file. Until asked about the agreement, staff had not recalled that a copy of the agreement had been posted on the website.
Status of Corrective Action Plan: Corrected.

Finding #SA 2010-02

Communicating the CFDA Number to Subrecipients

Federal Program Title: CDBG – Entitlement Grants Cluster
Federal Catalog Number: 14.218 & 14.253
Condition: CFDA number was not included in the subrecipient agreements as required by OMB Circular A-133.
Status of Corrective Action Plan: See current year finding #2011-4.

Finding #SA 2010-03

Signed Grant Agreement Retention

Federal Program Title: Economic Development Initiative, Special Project, Neighborhood Initiative and Miscellaneous Grants
Federal Catalog Number: 14.251
Condition: The City staff did not have a signed copy of grant agreement #B-05-SP-CA-0721 on file.
Status of Corrective Action Plan: Not applicable as the City did not have any expenditures incurred in current year under this program.

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

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