



## **CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR**

**February 21, 2012**

**The Honorable City Council  
Palo Alto, California**

### **Finance Committee Recommendation to Accept MGO's Financial Statements and Letter**

The City Auditor's Office recommends acceptance of Macias Gini & OConnell's (MGO) Audit of the City of Palo Alto's Financial Statements as of June 30, 2011 and Management Letter. At its meeting on December 14, 2011, the Finance Committee approved and unanimously recommended the City Council accept this report. The Finance Committee action minutes are included in this packet.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "JPelletier", is written over a horizontal line.

**Jim Pelletier  
City Auditor**

#### **ATTACHMENTS:**

- Attachment A: MGO's Financial Statements and Letter (PDF)
- Attachment B: Finance Committee Meeting Action Minutes Excerpt (December 14, 2011)(PDF)

Department Head: Jim Pelletier, City Auditor





# CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

December 14, 2011

The Honorable City Council  
 Attention: Finance Committee  
 Palo Alto, California

## Macias Gini & O'Connell's Audit of the City of Palo Alto's Financial Statements as of June 30, 2011 and Management Letter

### RECOMMENDATION

We recommend the Finance Committee review and recommend to the City Council acceptance of the external audited financial statements and management letter.

### DISCUSSION

The City Charter requires the City Council (through the City Auditor) to engage an independent certified public accounting firm to conduct the annual external audit and report the results of that audit in writing to the City Council. Macias Gini & O'Connell LLP (MGO), an accountancy corporation based in Sacramento, California, conducted the audit of the City's financial statements as of June 30, 2011. The Independent Auditor's Report (the "opinion letter") and Single Audit Report (the audit of federal funds received by the City which includes the report on internal control over financial reporting and the Office of Management and Budget (OMB) Circular A-133 compliance requirements supplement) are included in the Comprehensive Annual Financial Report for the fiscal year ended June 30, 2011.

Macias Gini & O'Connell also completed the following reports for the City of Palo Alto, as attached:

- Memorandum on Internal Control and Required Communications for the year ended June 30, 2011 (the "management letter") - Attachment A
- Independent Auditor's Report on Compliance with the Proposition 111 2010-2011 Appropriation Limit Increment (the "Gann limit letter") - Attachment B
- Public Improvement Corporation Basic Component Unit Financial Statements for the year ended June 30, 2011 - Attachment C
- Regional Water Quality Control Plant Financial Statements for the year ended June 30, 2011 - Attachment D
- Cable TV Franchise Statements of Revenues and Expenditures for the years ended December 31, 2010 and 2009 - Attachment E
- Redevelopment Agency of the City of Palo Alto Basic Component Unit Financial

Statements for the year ended June 30, 2011 - Attachment F

- General Obligation Bonds Capital Projects Fund for year ended June 30, 2011 - Attachment G

David Bullock from Macias Gini & O'Connell will be available at the December 14th Finance Committee meeting to answer questions. I would like to express appreciation to Macias Gini & O'Connell, and Laura Kuryk and her staff in the Administrative Services Department for their hard work and cooperation during the audit.

Respectfully submitted,



Ian Hagerman  
Senior Performance Auditor

**ATTACHMENTS:**

- Attachment A: Memorandum on Internal Control and Required Communications (PDF)
- Attachment B: Independent Auditor's Report on Compliance with the Proposition 111 2010-2011 Appropriation Limit Increment (PDF)
- Attachment C: Public Improvement Corporation Basic Component Unit Financial Statements (PDF)
- Attachment D: Regional Water Quality Control Plant Financial Statements (PDF)
- Attachment E: Cable TV Franchise Statements of Revenues and Expenditures (PDF)
- Attachment F: Redevelopment Agency of the City of Palo Alto Basic Component Unit Financial Statements (PDF)
- Attachment G: General Obligation Bonds Capital Projects Fund (PDF)

Department Head: Ian Hagerman, Sr. Performance Auditor



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



**Certified Public Accountants.**

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

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Honorable Mayor and City Council  
City of Palo Alto, California

In planning and performing our audit of the financial statements of the City of Palo Alto, California (City) as of and for the year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal controls over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing our opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

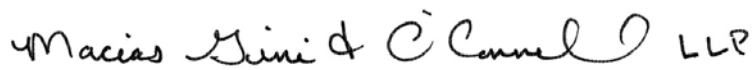
A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination 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 was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

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. We consider the deficiencies in City's internal control identified in the accompanying summary of current year recommendations under items 2011-01 through 2011-08 to be significant deficiencies.

Following this letter, we have included a report on communications with the Finance Committee (Committee) as required by auditing standards generally accepted in the United States of America.

This communication is intended solely for the information and use of the Mayor and City Council, the Committee, management and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

  
Walnut Creek, California  
December 1, 2011



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

**REQUIRED COMMUNICATIONS**

We have audited the financial statements of the City of Palo Alto as of and for the year ended June 30, 2011 and have issued our report thereon dated December 1, 2011. Professional auditing standards require that we communicate to you the following information related to our audit.

**I. The Auditor's Responsibility Under U.S. Generally Accepted Auditing Standards and OMB Circular A-133**

As stated in our engagement letter dated May 10, 2011, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal controls over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions is not an objective of our audit. Also in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the City's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* applicable to each of its major programs for the purpose of expressing an opinion on the City's compliance with those requirements. While our audit will provide a reasonable basis for our opinion, it will not provide a legal determination on the City's compliance with those requirements.

As part of our audit, we considered the City's internal control. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

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

**REQUIRED COMMUNICATIONS (Continued)**

**II. Other Information in Documents Containing Audited Financial Statements**

Our responsibility for other information in documents containing the City's financial statements and our report thereon does not extend beyond financial information identified in our report, and we have no obligation to perform any procedures to corroborate other information contained in these documents. We, however, read the other information included in the City's comprehensive annual financial report to determine whether any matters came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or its manner of presentation, appearing in the basic financial statements. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or its manner of presentation, appearing in the basic financial statements.

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

**III. Planned Scope and Timing of the Audit**

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter dated May 10, 2011.

**IV. Significant Audit Findings**

***Qualitative Aspects of Accounting Practices***

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the City's basic financial statements. With the exception of the item described below, no significant changes were made to the basic financial statements during the year as a result of new accounting pronouncements.

As described in Note 1(k) to the City's basic financial statements, the City adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

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

**REQUIRED COMMUNICATIONS (Continued)**

The most sensitive estimates affecting the financial statements were:

- *Fair value of investments.* The City's investments are generally carried at fair value, which is defined as the amount that the City could reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller and is generally measured by quoted market prices.
- *Estimated allowance for losses on notes and loans receivable.* The allowance for losses on notes and loans receivable was based on management's estimate regarding the likelihood of collectability.
- *Useful life estimates for capital assets.* The estimated useful lives of capital assets were based on management's estimate of the economic life of its capital assets.
- *Accrued landfill closure/post-closure costs.* The City has estimated, based on a study conducted by consultants, the closure/post-closure costs of the Palo Alto Landfill based on what it would cost to perform all currently mandated closure and post-closure care. Actual closure and post-closure care costs may be higher due to inflation variances, changes in technology, or changes in State or federal regulations.
- *Valuation of the net other postemployment benefits (OPEB) asset.* The net OPEB asset is the amount of cumulative City contributions that exceeded the actuarially determined annual required contributions, which is based upon certain approved actuarial assumptions.
- *Annual required contributions to pension and other postemployment benefit plans.* The City is required to contribute to its pension and OPEB plans at an actuarially determined rate and to measure these benefit costs based upon certain approved actuarial assumptions.
- *Claims loss reserve.* The City is exposed to a variety of risks of loss due to general liability, workers' compensation and other claims and records an estimate of these losses based on actuarial studies performed by third party actuaries. These studies are prepared based on the City's prior claims history, which is used as a basis for extrapolating losses for known and incurred but not report claims. Actual loss experience may vary from these estimates.

We evaluated the key factors and assumptions used to develop the accounting estimates described above in determining that they are reasonable in relation to the City's basic financial statements taken as a whole.

***Difficulties Encountered in Performing the Audit***

We encountered no significant difficulties in dealing with management in performing and completing our audit.

***Corrected and Uncorrected Misstatements***

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

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

**REQUIRED COMMUNICATIONS (Continued)**

***Disagreements with Management***

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

***Management Representations***

We have requested certain representations from management that are included in the management representation letter dated December 1, 2011.

***Management Consultations with Other Independent Accountants***

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

***Other Audit Findings or Issues***

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

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

**2011-01 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's 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's 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.

**2011-02 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. 2011-01.

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

**2011-03 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's 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's 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. 2011-01.

**2011-04 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's 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's network and financial data at increased risk of unauthorized access.

We recommend the City's 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.

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

***Management's Response:***

Same response as provided under finding no. 2011-01.

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

**2011-05 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. 2011-01.

**2011-06 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. 2011-01.

**2011-07 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**  
**Current Year Recommendations**  
**For the Year Ended June 30, 2011**

**2011-07 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.

**2011-08 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**  
**Status of Prior Year Comment**  
**For the Year Ended June 30, 2011**

**2010-01 Gas Services Charges to Electric Fund**  
***(Significant Deficiency)***

During the course of the audit, it was noted that the utility billing for the Gas Fund was not setup in the accounting software (BANNER) to record expenditures to the Electric Fund and revenues to the Gas Fund.

COBUG, a 5-Megawatt backup generator powered by natural gas for power outage emergencies was purchased by the City a few years ago. The generator was owned by the Electric Fund but fueled by the Gas Fund. In November 2007, City intended to add the COBUG meter to a reading route of the Gas Fund and bill the Electric Fund using BANNER. However the set up process was not completed and the Electric Fund was not being billed by the Gas Fund for utility service for the last three fiscal years. The total unbilled amounts approximated \$500,000.

The City responded that the COBUG gas meter has been added to the meter reading route. The Gas Fund billed and received \$453,266 from the Electric Fund for three prior years of service. All financial transactions are recorded and are current as of FY 2010 financial statements.

**Current Year Status:** Corrected.

**CITY OF PALO ALTO**  
**List of Uncorrected Adjustments**  
**For the Year Ended June 30, 2011**

<u>#</u>	<u>Fund</u>	<u>Financial Statements Line item/Description</u>	<u>Debit</u>	<u>Credit</u>
1	Capital Projects Fund Capital Projects Fund	Gain/Loss on Sale Construction in Progress  (To record the loss on capital asset due to termination of construction project for Public Safety Building)	\$ 183,343	\$ 183,343
2	Capital Projects Fund Capital Projects Fund	Capital Outlay Accounts Payable (To record the retainage payable for capital outlay incurred in FY2011)	306,519	306,519
3	Various Funds Various Funds	Expenditures Accounts Payable (To accrue expenses, that are individually below City's established threshold for accrual, incurred in FY2011 but paid after year-end through CalCard.)	692,774	692,774

**CITY OF PALO ALTO**

Agreed-Upon Procedures Report for  
Appropriations Limit Calculation

For the Year Ended June 30, 2011



**Certified Public Accountants.**



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

**Independent Accountant's Report  
on Applying Agreed-Upon Procedures**

We have performed the procedures enumerated below to the accompanying Appropriations Limit Worksheet of the City of Palo Alto, California (City), for the year ended June 30, 2011. These procedures, which were agreed to by the City and the League of California Cities (as presented in the publication entitled *Article XIII B California Constitution Appropriations Limit Procedures Guidelines for California Counties*), were performed solely to assist the City in meeting the requirements of Section 1.5 of Article XIII B of the California Constitution. The City's management is responsible for the Appropriations Limit Worksheet. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures performed and our findings were as follows:

1. We obtained the completed worksheets setting forth the calculations necessary to establish the City's appropriations limit and compared the limit and annual adjustment factors included in those worksheets to the limit and annual adjustment factors that were adopted by resolution of the City Council. We also compared the population and inflation options included in the aforementioned worksheets to those that were selected by a recorded vote of the City Council.

Finding: No exceptions were noted as a result of our procedures.

2. For the accompanying Appropriations Limit Worksheet, we added last year's limit to total adjustments, and compared the resulting amount to this year's limit.

Finding: No exceptions were noted as a result of our procedures.

3. We compared the current year information presented in the accompanying Appropriations Limit Worksheet to the worksheets described in No. 1 above.

Finding: No exceptions were noted as a result of our procedures.

4. We compared the prior year appropriations limit presented in the accompanying Appropriations Limit Worksheet to the prior year appropriations limit adopted by the City Council.

Finding: No exceptions were noted as a result of our procedures.

We were not engaged to, and did not conduct an examination, the objective of which would be the expression of an opinion on the Appropriations Limit Worksheet. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. No procedures have been performed with respect to the determination of the appropriations limit for the base year, as defined by Article XIII B of the California Constitution.

This report is intended solely for the information and use of the City Council and City management 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, CALIFORNIA**  
**Appropriations Limit Worksheet**  
**For the Year Ended June 30, 2011**

Appropriations limit, fiscal year 2009-2010 \$ 116,380,638

Adjustment factors:

Population growth	1.44+100	
	100	1.0144

Inflation	-2.54+100	
	100	0.9746

Appropriations limit, fiscal year 2010-2011	\$ 115,057,884
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**CITY OF PALO ALTO  
PUBLIC IMPROVEMENT CORPORATION**  
(A Component Unit of the City of Palo Alto)

Annual Financial Report  
For the Year Ended June 30, 2011



**Certified Public Accountants.**





**CITY OF PALO ALTO**  
**PUBLIC IMPROVEMENT CORPORATION**  
(A Component Unit of the City of Palo Alto)

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

### **Independent Auditor's Report**

We have audited the accompanying basic financial statements of the governmental activities and the major fund of the Palo Alto Public Improvement Corporation (Corporation), a component unit of the City of Palo Alto, as of and for the year ended June 30, 2011, 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 the auditing standards generally accepted in the United States of America. 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 Corporation'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 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 financial position of the governmental activities and the major fund of the Palo Alto Public Improvement Corporation as of June 30, 2011, and the results of its operations for the year then ended, in conformity with generally accepted accounting principles in the United States of America.

As discussed in Note 2(e) to the basic financial statements, effective July 1, 2010, the Corporation adopted the provisions of Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

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.

Walnut Creek, California  
December 1, 2011

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**CITY OF PALO ALTO**  
**PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
Management's Discussion & Analysis (Unaudited)

The Palo Alto Public Improvement Corporation (Corporation), a component unit of the City of Palo Alto (City), follows the provisions of Government Accounting Standards Board (GASB) Statement No. 34 (GASB 34), *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*.

The Corporation is controlled by the City of Palo Alto and was organized to assist the City in financing public improvements. The Corporation issues debt and turns the proceeds of the debt over to the City under lease agreements that provide a revenue source for the repayment of this debt. The Corporation has three debt issues and has turned the proceeds of these issues over to the City, which pledged certain lease payments as collateral for this debt as discussed in Note 4 to the financial statements.

**FISCAL 2011 FINANCIAL HIGHLIGHTS**

GASB 34 requires the issuance of government-wide financial statements as well as fund financial statements. The government-wide financial statements report the balance of the Corporation's long-term debt issues while the individual fund statements do not.

In fiscal year 2002, the Corporation issued its 2002A Civic Center Refinancing Certificates of Participation (COPs) in the amount of \$3.5 million to refund its 1992 Civic Center Project COPs, reducing debt service requirements by \$372 thousand and producing an accounting gain of \$137 thousand. The Corporation also issued its 2002B Downtown Parking Improvements COPs in the amount of \$3.6 million. In fiscal year 2005, a partial redemption was completed by placing excess construction and debt service reserve funds into an escrow account to defease \$900 thousand of the 2002B Downtown Parking Improvements COPs. These issues, including the 1998 Golf Course Capital Improvements COPs, comprise the Corporation's outstanding debt.

Interest expense and other fiscal agent charges on these COP issues was \$332 thousand for fiscal year 2011, a decrease of \$37 thousand over the prior year. The interest for leases on the assets securing these COP issues was \$297 thousand, a decrease of \$78 thousand from the prior year. Program expenses exceeded lease revenues by \$36 thousand, thereby resulting in a decrease in net assets of \$19 thousand over the prior year.

The Corporation ended fiscal year 2011 with total assets of \$6.1 million, a decrease of \$0.9 million from the prior year. Total assets consist of \$1.2 million in cash and \$4.9 million of leases receivable (recorded at net present value) from the City of Palo Alto. Total liabilities were \$6.0 million, a decrease of \$0.9 million from the prior year, and included \$1.0 million of current liabilities as well as \$5.0 million of long-term debt.

At the fund level, the Corporation's expenditures exceed its revenues by \$18 thousand.

As of June 30, 2011, the Corporation had one fund, the Debt Service Fund, which reported a \$1.3 million fund balance, reflecting an \$18 thousand decrease over the prior year.

**CITY OF PALO ALTO**  
**PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
 Management's Discussion & Analysis (Unaudited)

## **OVERVIEW OF THE CORPORATION'S BASIC FINANCIAL STATEMENTS**

The Basic Financial Statements are in two parts:

- 1) Management's discussion and analysis (this part),
- 2) The basic financial statements, which include the government-wide and the fund financial statements, along with the notes to these financial statements.

The basic financial statements comprise the government-wide financial statements and the fund financial statements. These two sets of financial statements provide two different views of the Corporation's financial activities and financial positions, both short-term and long-term.

The government-wide financial statements provide a long-term view of the Corporation's activities as a whole, and comprise the statement of net assets and the statement of activities. The statement of net assets provides information about the financial position of the Corporation as a whole, including all its long-term liabilities on the full accrual basis, similar to that used by corporations. The statement of activities provides information about all the Corporation's revenues and expenses on the full-accrual basis, with the emphasis on measuring net revenues or expenses of the Corporation's program. The statement of activities explains in detail the change in net assets for the year.

The fund financial statements report the Corporation's operations in more detail than the corporate-wide statements and focus primarily on the short-term activities of the debt service fund. Fund financial statements measure only current revenues and expenditures; current assets, liabilities and fund balances; and they exclude capital assets and long-term debt.

Together, these statements are called the basic financial statements.

## **DEBT ADMINISTRATION**

The Corporation issues debt in the form of Certificates of Participation (COPs) for future lease receipts from the City of Palo Alto. Legally, these COPs issues are the Corporation's debt only; the City is liable only for the payment of the amounts set forth in the lease securing each COPs issue.

The Corporation issued two COPs for the fiscal year ending June 30, 2002, one of which was refunded by an earlier issue.

## **ECONOMIC OUTLOOK AND MAJOR INITIATIVES**

The economy of the City of Palo Alto and its major initiatives for the coming year are discussed in detail in the City's Comprehensive Annual Financial Report.

## **CONTACTING THE AGENCY'S FINANCIAL MANAGEMENT**

These Basic Financial Statements are intended to provide citizens, taxpayers, investors, and creditors with a general overview of the Agency's finances. Questions about these Statements should be directed to the Finance Department of the City of Palo Alto, 250 Hamilton Avenue, CA 94301.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
Statement of Net Assets  
June 30, 2011

**Assets:**

Cash and investments held by trustee	\$ 1,267,828
Investment in leases to City of Palo Alto	<u>4,866,132</u>
Total assets	<u>6,133,960</u>

**Liabilities:**

Interest payable	104,805
Long-term debt:	
Due in one year	905,000
Due in more than one year	<u>4,990,000</u>
Total liabilities	<u>5,999,805</u>

**Net Assets:**

Restricted for debt service	<u><u>\$ 134,155</u></u>
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See accompanying notes to financial statements.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
Statement of Activities  
For the Year Ended June 30, 2011

**Expenses:**

Interest and fiscal agent charges	\$ 332,375
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**Program revenues:**

Interest on leases from City of Palo Alto	296,670
Net program expenses	(35,705)

**General Revenues:**

Investment income	3,062
Miscellaneous revenue	14,086
Change in net assets	(18,557)
Net assets, beginning of the year	152,712
Net assets, end of the year	\$ 134,155

See accompanying notes to financial statements.



**PALO ALTO PUBLIC IMPROVEMENT CORPORATION****(A Component Unit of the City of Palo Alto)**

Balance Sheet

Debt Service Fund

June 30, 2011

**Assets:**

Cash and investments held by trustee	\$ 1,267,828
Investment in leases to City of Palo Alto	<u>4,866,132</u>
Total assets	<u><u>\$ 6,133,960</u></u>

**Liabilities and Fund Balance:**

## Liabilities:

Deferred revenue	<u>4,866,132</u>
Total liabilities	4,866,132
Fund balance restricted for debt service	<u>1,267,828</u>
Total liabilities and fund balance	<u><u>\$ 6,133,960</u></u>

**Reconciliation of fund balance to net assets:**

Fund balance restricted for debt service	\$ 1,267,828
Accrual adjustment to remove deferred revenue from the balance sheet	4,866,132

Some liabilities, including bonds payable, are not due and payable in the the current period and therefore are not reported in the funds:

Interest payable	(104,805)
Long-term debt due within one year	(905,000)
Long-term debt in more than one year	<u>(4,990,000)</u>
Net assets of governmental activities	<u><u>\$ 134,155</u></u>

See accompanying notes to financial statements.

**PALO ALTO PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
Statement of Revenues, Expenditures and Changes in Fund Balance  
Debt Service Fund  
For the Year Ended June 30, 2011

**Revenues:**

Lease receipts from City of Palo Alto:

Principal	\$ 882,426
Interest	296,670
Investment income from cash and investments	3,062
Miscellaneous revenue	<u>14,086</u>
Total revenues	<u>1,196,244</u>

**Expenditures:**

Debt service:

Principal repayment	870,000
Interest and fiscal agent charges	<u>344,570</u>
Total expenditures	<u>1,214,570</u>
Net change in fund balance	(18,326)
Fund balance, beginning of the year	<u>1,286,154</u>
Fund balance, end of the year	<u><u>\$ 1,267,828</u></u>

**Reconciliation of net change in fund balance to net change in net assets:**

Net change in fund balances-total governmental funds \$ (18,326)

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

Repayment of bond principal is an expenditure in the governmental funds,  
but in the statement of net assets the repayment reduces long-term liabilities. 870,000

Some amounts reported in the statement of revenues, expenditures and changes  
in fund balances reflect the collection of an asset which are not includable as  
as revenues on the statement of activities.

Change in deferred revenue	(882,426)
Change in interest payable	<u>12,195</u>
Change in net assets of governmental activities	<u><u>\$ (18,557)</u></u>

See accompanying notes to financial statements.

**CITY OF PALO ALTO**  
**PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
 Notes to Basic Financial Statements  
 For the Year Ended June 30, 2011

**NOTE 1 – DESCRIPTION OF REPORTING ENTITY**

The Palo Alto Public Improvement Corporation (the Corporation) was incorporated in September 1983 under the General Nonprofit Corporation Law of the State of California to acquire, construct and lease capital improvement projects. The Corporation is exempt from federal income taxes under Section 501(c)(4) of the Internal Revenue Code. The Corporation provides financing of public capital improvements for the City through the issuance of Certificates of Participation (COPs), a form of debt which allows investors to participate in a stream of future lease payments. Proceeds from the COPs are used to construct projects which are leased to the City for lease payments which are sufficient in timing and amount to meet the debt service requirements of the COPs.

The Corporation is an integral part of the City of Palo Alto. It primarily services the City and its governing body is composed of the City Council. Therefore, the financial data of the Corporation has also been included as a blended component unit within the City's comprehensive annual financial report for the year ended June 30, 2011.

**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES**

**(a) Basis of Presentation**

**Government-wide Statements:** The statement of net assets and the statement of activities include the financial activities of the Corporation. Eliminations have been made to minimize the double counting of internal activities.

The statement of activities presents a comparison between direct expenses and program revenues for each function of the Corporation's activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs, and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. 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 Corporation's funds. Separate statements for each governmental fund are presented. The emphasis of fund financial statements is on major individual funds, each of which is displayed in a separate column.

**(b) Major Funds**

Major funds are defined as funds that have either assets, liabilities, revenues or expenditures equal to ten percent of their fund-type total and five percent of the grand total. The Corporation has one fund which is reported as a major governmental fund in the accompanying financial statements:

**Debt Service Fund** – This fund accounts for debt service payments on the Corporation's long-term debt issues.

**CITY OF PALO ALTO**  
**PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
Notes to Basic Financial Statements  
For the Year Ended June 30, 2011

**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(c) Investment in Leases**

Improvements financed by the Corporation are leased to the City for their entire estimated useful life and will become the City property at the conclusion of the lease. The Corporation therefore records the present value of the lease and considers the leased improvement to have been sold for this amount when leased.

**(d) Net Assets**

The government-wide financial statements utilize a net assets presentation. Net assets are categorized as restricted and unrestricted.

*Restricted Net Assets* – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

**(e) Fund Balances**

During the year ended June 30, 2011, the Corporation implemented GASB 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.

At June 30, 2011, the Corporation's governmental funds' fund balances include the following classifications:

*Restricted Fund Balance* – includes 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.

**(f) Estimates**

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**CITY OF PALO ALTO**  
**PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
Notes to Basic Financial Statements  
For the Year Ended June 30, 2011

**NOTE 3 – CASH AND INVESTMENTS HELD BY TRUSTEE**

Under the provisions of the Corporation's COP issues, a Trustee holds and invests the Corporation's cash.

**(a) Interest Rate Risk**

Interest rate risk is the risk that a change in market interest rates will adversely affect the fair value of an investment. Normally, the longer it takes an investment to reach maturity, the greater will be that investment's sensitivity to changes in market rates. Information about the sensitivity of the fair values of the Corporation's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the Corporation's investments by maturity:

<u>Investment Type</u>	<u>Amount</u>	<u>Maturity Date</u>
California Asset Management Program	\$ 624,261	57 Days *
U.S. Agency obligations:		
Federal National Mortgage Association	586,653	10/30/2012
Money Market Mutual Funds	13,914	28 Days *
Total Investments held by Trustee	<u>\$ 1,224,828</u>	

\* Maturity dates listed in number of days represents the weighted average maturity of the investment.

*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. CAMP'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, fair value approximated cost. At June 30, 2011, these investments have an average maturity of 57 days.

Money Market Mutual Funds are available for withdrawal on demand at June 30, 2011, and have an average maturity of 28 days.

**(b) Credit Risk**

Generally, 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. The actual ratings as of June 30, 2011, for all U.S. Agency Obligations and Money Market Mutual Funds are Aaa as provided by Moody's Investment Rating system. As an external investment pool, the California Asset Management Program was rated Aaam as of June 30, 2011.

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**  
**PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
Notes to Basic Financial Statements  
For the Year Ended June 30, 2011

**NOTE 3 – CASH AND INVESTMENTS HELD BY TRUSTEE (continued)**

**(c) Investment Policy**

The Corporation 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 Corporation fails to meet its obligation under these debt issues. The California Government Code requires these funds to be invested in accordance with bond indentures or State statute. All these funds have been invested as permitted under the Code. The Investment Policy is described in detail in the City of Palo Alto Comprehensive Annual Financial Report.

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

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 Agencies	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	N/A	30%	\$5 million
Commercial Paper	270 days	AAA	15%	\$3 million (B)
Local Agency Investment Fund	N/A	N/A	No Limit	\$50 million per account
Short-Term Repurchase Agreements	1 year	N/A	No Limit	No Limit
City of Palo Alto Bonds	N/A	N/A	No Limit	No Limit
Money Market Deposit Accounts	N/A	N/A	No Limit	10%
Mutual Funds (C)	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

(A) Callable and multi-step securities are limited to no more than twenty percent of the par value of the portfolio, provided that:

- 1) the potential call dates are known at the time of purchase.
- 2) the interest rates at which they "step-up" are known at the time of purchase.
- 3) the entire face value of the security is redeemed at the call date

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

**Debt Agreements:**

(C) 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.

**CITY OF PALO ALTO**  
**PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
Notes to Basic Financial Statements  
For the Year Ended June 30, 2011

**NOTE 4 – CERTIFICATES OF PARTICIPATION**

The Corporation's changes in long-term debt are presented below:

	Balance June 30, 2010	Retirements	Balance June 30, 2011	Current Portion
<b>Governmental Activity Debt:</b>				
<b>Certificates of Participation</b>				
<b>1998 Golf Course</b>				
4.00 - 5.00%, due 09/01/2018	\$ 4,060,000	\$ 370,000	\$ 3,690,000	\$ 385,000
<b>2002A Civic Center Refinancing</b>				
2.00 - 4.00%, due 03/01/2012	795,000	390,000	405,000	405,000
<b>2002B Downtown Parking</b>				
<b>Improvements</b>				
4.55 - 6.50%, due 03/01/2022	1,910,000	110,000	1,800,000	115,000
	<u>\$ 6,765,000</u>	<u>\$ 870,000</u>	<u>\$ 5,895,000</u>	<u>\$ 905,000</u>

In August 1998, the Corporation issued the **Golf Course Capital Improvements and Refinancing Project Certificates of Participation, Series 1998**, in the amount of \$7.8 million to refund and subsequently retire the 1978 Golf Course Lease Revenue Bonds issued by the City through the Palo Alto Golf Course Corporation 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 drains facilities, replacing the existing irrigation system, upgrading the driving range, and installing new cart paths. Under the terms of the 1998 COPs, the Corporation transferred \$473 thousand to an agent for the Golf Course Corporation which used the funds to retire the 1978 Bonds.

On January 16, 2002, the Corporation issued the **2002A Civic Center Refinancing Certificates of Participation** in the amount of \$3.5 million to refund the City's 1992 Civic Center Project Certificates of Participation. 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 from the City from available funds. During the year ended June 30, 2002, the 1992 Civic Center COPs were retired.

On January 16, 2002, the Corporation issued the **2002B Downtown Parking Improvements Certificates of Participation** in the amount of \$3.6 million 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 from the City from available funds.

On January 25, 2005, the City defeased \$900 thousand of the 2002B Downtown Parking Improvements Certificates of Participation. The City placed \$1.0 million in surplus cash from the Civic Center Refinancing and Downtown Parking Improvement Project Construction account in an irrevocable trust to provide for future debt payments. Accordingly, the trust account assets and the liability for the defeased Bonds are not included on the financial statements. The total defeased amount was paid off on March 1, 2011.

**CITY OF PALO ALTO**  
**PUBLIC IMPROVEMENT CORPORATION**  
**(A Component Unit of the City of Palo Alto)**  
 Notes to Basic Financial Statements  
 For the Year Ended June 30, 2011

**NOTE 4 – CERTIFICATES OF PARTICIPATION (continued)**

The COPs are payable and secured by lease revenues received by the Public Improvement Corporation from any City General Fund revenue source. Principal and interest are payable semi-annually on March 1 and September 1.

Future annual debt service on the COPs is expected to be provided by the lease receipts discussed above, and is shown below:

For the Year Ending June 30	Principal	Interest	Total
2012	\$ 905,000	\$ 305,559	\$ 1,210,559
2013	530,000	263,511	793,511
2014	555,000	235,509	790,509
2015	590,000	205,575	795,575
2016	620,000	173,275	793,275
2017-2021	2,475,000	376,900	2,851,900
2022	220,000	14,300	234,300
Total	<u>\$ 5,895,000</u>	<u>\$ 1,574,629</u>	<u>\$ 7,469,629</u>

**NOTE 5 – SUBSEQUENT EVENT**

**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%. Semi-annual payments will be made through September 1, 2018. The City used its Fire Department rolling stock as the collateral in this Agreement.



**CITY OF PALO ALTO  
REGIONAL WATER QUALITY  
CONTROL PLANT**

Independent Auditor's Report

For the Year Ended  
June 30, 2011



**Certified Public Accountants.**



**CITY OF PALO ALTO  
REGIONAL WATER QUALITY CONTROL PLANT**

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

### **Independent Auditor's Report**

We have audited the accompanying Statements of Net Expenditures and Net Changes in Commitments and Quarterly Billings (financial statements) of the City of Palo Alto Regional Water Quality Control Plant (Plant), a component unit of City of Palo Alto (City), for the year ended June 30, 2011. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 the Plant's 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 2, the financial statements referred to above were prepared for the purpose of complying with the provisions of the Basic Agreement between the City of Palo Alto, the City of Mountain View, and the City of Los Altos for the Acquisition, Construction and Maintenance of a Joint Sewer System dated October 10, 1968, and subsequent letters of agreement dated December 5, 1977, January 14, 1980, April 9, 1985, July 3, 1990, July 31, 1992, and March 16, 1998, and is not intended to be a presentation in accordance with generally accepted accounting principles in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net expenditures and net changes in commitments of the Regional Water Quality Control Plant, and its quarterly billings to the Cities of Mountain View and Los Altos for the year ended June 30, 2011, on the basis of accounting described in Note 2.

This report is intended solely for the information and use of the Mayor, Members of the City Council, management, and others within the City of Palo Alto, and the Cities of Mountain View and Los Altos 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

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**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**  
Statement of Net Expenditures and Net Changes in Commitments  
For the Year Ended June 30, 2011

	Total	City of Mountain View	City of Los Altos	City of Palo Alto
Direct Expenditures:				
Source control program	\$ 1,243,460	\$ 444,040	\$ 128,699	\$ 670,721
Public outreach	121,526	43,397	12,578	65,551
Permitting and enforcement	1,037,386	284,782	16,927	735,677
Operations and maintenance	11,024,911	3,936,996	1,141,077	5,946,838
System improvement CIP (Note 3)	658,704	235,223	68,176	355,305
Total Direct Expenditures	14,085,987	4,944,438	1,367,457	7,774,092
Indirect Administrative Expenditures:				
Source control program	923,869	329,914	95,620	498,335
Public outreach	1,963	701	203	1,059
Permitting and enforcement	415,222	262,876	15,624	136,722
Operations and maintenance	1,899,041	678,147	196,550	1,024,344
Total Indirect Expenditures	3,240,095	1,271,638	307,998	1,660,460
Debt Service Expenditures:				
Refunding 1990 Series A Bonds	284,790	145,243	22,214	117,333
1999 Wastewater Treatment New Project	538,144	203,903	50,962	283,279
Total Debt Service Expenditures	822,934	349,146	73,176	400,612
Total Expenditures	18,149,017	6,565,221	1,748,631	9,835,165
Deduct Joint Systems Revenues (Note 5)	(317,933)	(113,534)	(32,906)	(171,493)
Net Expenditures	17,831,084	6,451,687	1,715,725	9,663,672
Add Net Changes in Commitments (Note 1)	686,769	245,245	71,081	370,443
Net Expenditures and Net Changes in Commitments Due from Members	<u>\$ 18,517,853</u>	<u>\$ 6,696,932</u>	<u>\$ 1,786,806</u>	<u>\$ 10,034,115</u>

See accompanying notes to the financial statements.

**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**  
Statement of Quarterly Billings  
For the Year Ended June 30, 2011

	<u>City of Mountain View</u>	<u>City of Los Altos</u>
Billings by Quarter, Beginning:		
July 1, 2010	\$ 1,774,241	\$ 532,046
October 1, 2010	1,880,637	556,442
January 1, 2011	1,148,729	356,114
April 1, 2011	<u>2,036,406</u>	<u>586,936</u>
Total quarterly billings	6,840,013	2,031,538
Net expenditures and net changes in commitments	<u>6,696,932</u>	<u>1,786,806</u>
Excess of total billings over		
net expenditures and net changes in commitments	<u>\$ 143,081</u>	<u>\$ 244,732</u>

See accompanying notes to the financial statements.



**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**

Notes to the Financial Statements  
For the Year Ended June 30, 2011

**NOTE 1 – THE REPORTING ENTITY**

The Cities of Palo Alto, Mountain View and Los Altos (the Members) participate jointly in the cost of maintaining and operating the Regional Water Quality Control Plant and related system (the Plant). The Members shared the original costs of acquisition and construction of the Plant in the same proportions as the allocation of capacity rights to them. The City of Palo Alto (the City) is the owner and administrator of the Plant. The Cities of Mountain View and Los Altos are entitled to use a portion of the capacity of the Plant for a period of 50 years as set forth in the Basic Agreement between the City of Palo Alto, the City of Mountain View and the City of Los Altos for Acquisition, Construction and Maintenance of a Joint Sewer System dated October 10, 1968 and subsequent letters of agreement dated December 5, 1977, January 14, 1980, April 9, 1985, July 3, 1990, July 31, 1992 and March 16, 1998. The original agreement, as amended, may terminate any time after 50 years provided that written notice of withdrawal is tendered ten years preceding the date of withdrawal.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Plant is an enterprise that is operated by the City and its operations are accounted for as an enterprise fund in the City's basic financial statements. The accompanying financial statements are intended to present the Plant's net expenditures and net changes in commitments and quarterly billings by the Plant to the Cities of Mountain View and Los Altos pursuant to the agreement of the Members as described above and are not intended to be a complete presentation of the Plant's financial position or results of operations. Additionally, the capital cost and the outstanding debt of the Plant are not presented in these statements but are presented in the basic financial statements of the City.

Plant expenditures, commitments and joint system revenues, debt service and industrial waste compliance expenditures are shared by the Members based on agreed upon allocation percentages. The expenditures and commitments, including indirect administrative expenditures (see Note 3), are allocated to each of the Members based primarily on their respective percentages of the annual sewage flow and treatment needed for suspended solids, chemical oxygen demand and ammonia. Commitments represent operating encumbrances with suppliers for long-term projects, which have not yet been completed. Net changes in commitments represent commitments of \$1,966,496 at June 30, 2011, less commitments of \$1,279,727 at June 30, 2010. Revenues from services, fines and penalties are allocated to each of the Members in the same proportions as those of expenditures and commitments. Debt service payments are allocated based on percentages established at the time of bond issuance. Industrial waste compliance (Public Outreach and permitting and enforcement) charges are allocated to Members primarily based on upon the number of industries and efforts required to maintain compliance with sewage use ordinances and other EPA regulations.

**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**

Notes to the Financial Statements (continued)  
For the Fiscal Year Ended June 30, 2011

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The percentages used for the year ended June 30, 2011, to allocate expenditures, commitments and revenues were:

	<u>City of Mountain View</u>	<u>City of Los Altos</u>	<u>City of Palo Alto</u>
Public outreach, source control program, operation and maintenance, system improvement CIP, commitments and joint system revenues	35.71%	10.35%	53.94%
Debt Services Expenditures:			
Refunding 1990 Series A Bonds	51.00%	7.80%	41.20%
1999 Wastewater Treatment New Project	37.89%	9.47%	52.64%
Permitting and enforcement	37.70%	2.24%	60.06%

The City is allocated 53.94% of total usage of the treatment plant. The City does not fully utilize its percentage allocation, therefore, the City has entered into separate contracts to allocate portions its excess to other entities. Fiscal year 2011 allocations are as follows:

East Palo Alto Sanitary District	6.80%
Stanford University	6.80%
Town of Los Altos Hills	1.14%
Remaining City Percentages	<u>39.20%</u>
Total	<u><u>53.94%</u></u>

The agreement the City has with the above entities has no effect on the partnership agreement between the Members.

Billings are made in advance and are based on the adopted budget for the plant and estimated sewage flow. Excess billings (over) under net expenditures and net changes in commitments are offset against the subsequent year payments during the second quarter of the subsequent fiscal year.

**NOTE 3 – SYSTEM IMPROVEMENT CIP (MINOR CAPITAL)**

The basic agreement between the Members, dated October 10, 1968, provides that the administrator of the Plant is responsible for capital additions. These capital additions should be for the replacement of obsolete or worn-out units, or minor capital additions to improve the efficiency of the Plant's operations. Per an addendum to the agreement dated March 16, 1998, the Members agreed that capital additions should not exceed \$1.9 million in 1998-99 (base year). For futures years, the base year amount will be adjusted annually based on increases to the Consumer Price Index-Urban Wage Earners and Clerical Workers for the San Francisco-Oakland-San Jose area. Actual System Improvement CIP expenditures amounted to \$658,704 for fiscal year 2011.

**CITY OF PALO ALTO**  
**REGIONAL WATER QUALITY CONTROL PLANT**

Notes to the Financial Statements (continued)  
For the Fiscal Year Ended June 30, 2011

**NOTE 4 – INDIRECT ADMINISTRATION EXPENDITURES**

Indirect expenditures include those costs allocated from the City's General Fund administrative services, which supports all operating departments of the City. Other indirect expenses are administrative charges from the City's Internal Services Funds. These allocations are applied on a uniform basis throughout the City. The allocations are in accordance with the subsequent letter of agreement dated April 9, 1985.

**NOTE 5 – DEBT SERVICE EXPENDITURES**

Debt service expenditures include principal repayments, interest expenses and amortization of bond discount reduced by any interest income earned from cash with fiscal agent, related to the 1999 Series A Bonds.

In prior years, the City, City of Mountain View, City of Los Altos, Town of Los Altos Hills, East Palo Alto Sanitary District and Stanford University agreed to issue new bonds (1999 Series A Bonds) to finance the rehabilitation of the Wastewater Treatment System's two sludge incinerators and to refund the existing 1990 Series A Bonds.

	1999 Wastewater Treatment New Project	Refunding of 1990 Series A Bonds	Total
City of Palo Alto	\$ 1,887,012	\$ 649,132	\$ 2,536,144
City of Mountain View	1,873,660	1,324,228	3,197,888
City of Los Altos	468,292	202,529	670,821
East Palo Alto Sanitary District	377,798	308,987	686,785
Stanford University	260,107	106,457	366,564
Town of Los Altos Hills	78,131	5,193	83,324
Total	<u>\$ 4,945,000</u>	<u>\$ 2,596,526</u>	<u>\$ 7,541,526</u>

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.

**CITY OF PALO ALTO  
REGIONAL WATER QUALITY CONTROL PLANT**

Notes to the Financial Statements (continued)  
For the Fiscal Year Ended June 30, 2011

**NOTE 5 – DEBT SERVICE EXPENDITURES (Continued)**

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.

**NOTE 6 – JOINT SYSTEM REVENUES**

The Plant's joint system revenues for the year ended June 30, 2011 total \$317,933. This consisted of \$7,500 for salt water marsh services, \$47,149 from the City's Water Fund for lab services, \$201,539 for septic tank hauling services and \$61,745 in other revenues.

**NOTE 7 – RELATED PARTY TRANSACTIONS**

During fiscal year 2011, the Plant paid the City \$2,217,514 for utility costs. Such costs are included in the Statement of Net Expenditures and Net Changes in Commitments as source control program, permitting and enforcement, and operations and maintenance expenditures.

Vehicle replacement charges of \$26,066 were paid to the City's Equipment Replacement Fund, which is included in the Statement of Net Expenditures and Net Changes in Commitments as operations and maintenance expenditures.

**CABLE TV FRANCHISE**  
Statements of Franchise  
Revenues and Expenditures

For the Years Ended  
December 31, 2010 and 2009



**Certified Public Accountants.**

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The Members of the  
Cable TV Franchise

### **Independent Auditor's Report**

We have audited the accompanying Statements of Franchise Revenues and Expenditures of the Cable TV Franchise (Franchise) for the year ended December 31, 2010, as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements as of December 31, 2009, were audited by other auditors whose opinion dated October 22, 2010 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 of designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Franchise's internal control over the 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, the statements referred to above were prepared for the purpose of complying with the provisions of the Amended and Restated Joint Exercise of Powers Agreement signed on June 9, 2009, between the City of Palo Alto, the City of East Palo Alto, the City of Menlo Park, the County of San Mateo, the County of Santa Clara and the Town of Atherton, for the provision of cable television and video services, and are not intended to be a presentation in accordance with generally accepted accounting principles in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the revenues and expenditures of the Franchise for the year ended December 31, 2010, on the basis of accounting described in Note 1.

This report is intended for the information of the members, management, and others within the City of Palo Alto, the City of East Palo Alto, the City of Menlo Park, the County of San Mateo, the County of Santa Clara and the Town of Atherton. However, this report is a matter of public record and its distribution is not limited.

*Macias Gini & Connell LLP*

Walnut Creek, California  
December 1, 2011

**CABLE TV FRANCHISE**  
**Statements of Franchise Revenues and Expenditures**  
**For the Years Ended December 31, 2010 and 2009**

	<u>2010</u>	<u>2009</u>
<b>Revenues:</b>		
Franchise fees	<u>\$ 1,551,464</u>	<u>\$ 1,451,778</u>
<b>Expenditures:</b>		
Franchise administration	61,418	46,955
Consulting fees	<u>14,384</u>	<u>7,953</u>
Total expenditures	<u>75,802</u>	<u>54,908</u>
<b>Net receipts</b>	<u><u>\$ 1,475,662</u></u>	<u><u>\$ 1,396,870</u></u>

	<u>2010</u>		<u>2009</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
<b>Allocation of Net Receipts:</b>				
City of Palo Alto	\$ 730,938	49.5%	\$ 688,238	49.3%
City of Menlo Park	390,098	26.4%	364,636	26.1%
City of East Palo Alto	141,683	9.6%	136,881	9.8%
Town of Atherton	104,044	7.1%	100,961	7.2%
County of Santa Clara	78,097	5.3%	76,287	5.5%
County of San Mateo	<u>30,802</u>	<u>2.1%</u>	<u>29,867</u>	<u>2.1%</u>
Total	<u><u>\$ 1,475,662</u></u>	<u><u>100.0%</u></u>	<u><u>\$ 1,396,870</u></u>	<u><u>100.0%</u></u>

See accompanying notes to the financial statements.



**CABLE TV FRANCHISE**  
Notes to Financial Statements  
For the Years Ended December 31, 2010 and 2009

**NOTE 1 – JOINT OPERATING AGREEMENT AND BASIS OF ACCOUNTING**

In July 1983, a Joint Exercise of Powers Agreement was entered into by and between the Cities of Palo Alto, Menlo Park, East Palo Alto, the Counties of San Mateo and Santa Clara and the Town of Atherton (the “Members”) for the purpose of obtaining a state-of-the-art cable service for residents, businesses, and institutions, within each of their jurisdictions in the most efficient and economical manner possible.

On August 9, 2000, the City of Palo Alto (the “City”), acting on behalf of the Members, signed a Franchise Agreement with TCI Cablevision of California, Inc., a wholly owned subsidiary of AT&T Broadband, third party contractor, which was granted a non-exclusive franchise to construct, operate, maintain and repair a cable television system within the Members jurisdictions. In 2002, the franchise agreement was transferred from AT&T Broadband to Comcast Corporation.

TCI Cablevision of California, Inc. also signed an asset purchase agreement with Cable Communications Cooperative of Palo Alto, Inc. (CCCOPA), the former cable television system operator/owner, and acquired the system.

In October 1988, a Joint Operating Agreement was formed by the Members in which the City was granted the power and the authority to administer and coordinate the activities of the Franchise and exercise the rights and responsibilities of the City pursuant to the Franchise. The activities are administered by the City and are accounted for as part of the Administrative Services Department within the General Fund of the City’s basic financial statements. The program is accounted for using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recorded when susceptible to accrual (both measurable and available) and expenditures are recognized when the liability is incurred.

On January 1, 2007, the Digital Infrastructure and Video Competition Act (DIVCA) went into effect. Under DIVCA, cable and video service franchises are now granted exclusively by the California Public Utilities Commission (Commission) rather than by local franchising entities. On March 30, 2007, the Commission granted AT&T a statewide franchise. Comcast was allowed to seek a state franchise after January 1, 2008, when another state franchise holder (in this case AT&T) entered the local market. On January 2, 2008, the Commission granted Comcast a state franchise.

On June 9, 2009, the Members approved an amended and restated Joint Exercise of Powers Agreement, in substitution of the existing Joint Exercise of Powers Agreement and the Joint Operating Agreement, to reflect changes in the law due to DIVCA and to continue to allow the City to administer the cable and video franchise enforcement and monitoring process for state franchise holders.

The accompanying financial statements are intended to present the Franchise’s revenues and expenditures pursuant to the Joint Exercise of Powers Agreement and are not intended to be a complete presentation of the Franchise’s financial position or results of operations.

As compensation for services under the state franchise agreements, AT&T and Comcast pay annual franchise fees in an amount equal to 5% of annual gross revenues, taking into account a reasonable adjustment for bad debts. From these fees the City of Palo Alto is first reimbursed for out-of-pocket franchise administration costs. The remaining fees are distributed to each Member according to the percentage of revenues derived from the residents and businesses in each of the entities compared to revenues in total.

**CABLE TV FRANCHISE**  
Notes to Financial Statements  
For the Years Ended December 31, 2010 and 2009

**NOTE 2 – PRIOR FRANCHISE SETTLEMENTS**

A prior Franchise Agreement with CCCOPA was set to expire on March 24, 2001. On June 21, 1999, the City of Palo Alto hired a cable communications consultant and retained the services of a law firm to assist in the franchise renewal process. On July 31, 2000, CCCOPA reimbursed the City \$185,000 toward the actual costs incurred as part of the franchise renewal efforts.

On July 24, 2000, the City reached a settlement with CCCOPA in the amount of \$220,000 to resolve outstanding claims resulting from CCCOPA's alleged failure to fully perform under the prior Franchise Agreement.

On November 22, 2004, the City reached a settlement agreement with Comcast regarding cable plant construction claims in the amount of \$175,000. This money was to be used towards the institutional network connection costs.

In 2006, the City conducted a franchise compliance audit performed by the City Auditor's Office. A settlement was reached in the amount of \$155,391.

In addition, CCCOPA paid the City a \$250,000 grant to use to acquire, install, and/or maintain equipment to be used in connection with an institutional network defined in the Franchise Agreement.

These amounts have been deposited and are being held by the City and are earning interest. The City has since spend part of the settlements amount on various projects including installing and maintaining the institutional network equipment. As of December 31, 2010, remaining total amount on deposit, including \$7,877 in interest receivable, was \$906,514.

**REDEVELOPMENT AGENCY OF  
THE CITY OF PALO ALTO**

Independent Auditor's Reports,  
Management's Discussion and Analysis, and  
Basic Financial Statements

For The Year Ended June 30, 2011



**Certified Public Accountants.**



**REDEVELOPMENT AGENCY OF THE  
CITY OF PALO ALTO**

For the Year Ended June 30, 2011

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Board of Directors of the  
Redevelopment Agency of the City of Palo Alto  
Palo Alto, California

### **Independent Auditor's Report**

We have audited the accompanying financial statements of the governmental activities and major fund of the Redevelopment Agency of the City of Palo Alto (Agency), a component unit of the City of Palo Alto (City), as of and for the year ended June 30, 2011, which collectively comprise the Agency's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion 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 the Agency's 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 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 and major fund of the Agency for the year ended June 30, 2011, and the respective changes in financial position thereof, and the respective budgetary comparison for the year then ended, in conformity with generally accepted accounting principles in the United States of America.

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

As discussed in Note 3 to the basic financial statements, the City Council of the City of Palo Alto passed Ordinance No. 5126 on September 6, 2011 dissolving the Agency effective October 7, 2011.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 1, 2011, on our consideration of the internal control over the Agency's 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 the 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 GASB, 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.

*Macias Gini & Connell LLP*

Walnut Creek, California  
December 1, 2011



## **REDEVELOPMENT AGENCY OF THE CITY OF PALO ALTO**

Management's Discussion and Analysis (Unaudited)

For the Year Ended June 30, 2011

The Redevelopment Agency of the City of Palo Alto (Agency), a component unit of the City of Palo Alto (City) was formed on July 9, 2001. As discussed in Note 3 to the basic financial statements, the City Council passed Ordinance No. 5126 on September 6, 2011, dissolving the Agency effective October 7, 2011.

### **FISCAL 2011 FINANCIAL HIGHLIGHTS-AGENCY-WIDE BASIS AND FUND BASIS**

During fiscal year 2011, the Agency incurred costs in the amount of \$10 thousand. The Agency received a transfer from the City in the amount of \$10 thousand to fund these costs. As of June 30, 2011, the Agency had not yet adopted a project area nor received any tax increment revenues.

### **OVERVIEW OF THE AGENCY'S BASIC FINANCIAL STATEMENTS**

The Basic Financial statements are in two parts:

- 1) Management's discussion and analysis (this part),
- 2) The basic financial statements, which include the government-wide and the fund financial statements, along with the notes to these financial statements.

#### **The Basic Financial Statements**

The basic financial statements comprise the government-wide financial statements and the fund financial activities and financial position-long-term and short-term.

The government-wide financial statements provide a longer-term view of the Agency's activities as a whole, and comprise the statement of net assets and the statement of activities. The statement of net assets provides information about the financial position of the Agency as a whole, including all its long-term liabilities on the full accrual basis, similar to that used by corporations. The statement of activities provides information about all the Agency's revenues and all its expenses, also on the full accrual basis, with the emphasis on measuring net revenues or expenses of the Agency's program. The statement of activities explains in detail the change in net assets for the year.

The fund financial statements report the Agency's operations in more detail than the Agency-wide statements and focus primarily on the short-term activities. The fund financial statements measure only current assets, liabilities and fund balances.

Together, all these statements are now called the basic financial statements.

### **CONTACTING THE AGENCY'S FINANCIAL MANAGEMENT**

These Basic Financial Statements are intended to provide citizens, taxpayers, investors, and creditors with a general overview of the Agency's finances. Questions about these Statements should be directed to the Finance Department of the City of Palo Alto, 250 Hamilton Avenue, CA 94301.

**REDEVELOPMENT AGENCY OF THE CITY OF PALO ALTO**

Statement of Net Assets and  
 Governmental Fund Balance Sheet  
 June 30, 2011

	Redevelopment General Fund	Adjustments	Governmental Activities - Statement of Net Assets
Assets:			
Cash and investments	\$ -	\$ -	\$ -
Liabilities:			
Accounts payable	\$ -	-	-
Fund balances/net assets:			
Fund balances:			
Unassigned	-	-	-
Total liabilities and fund balances	\$ -		
Net assets:			
Unrestricted		-	-
Total net assets		\$ -	\$ -

See accompanying notes to the financial statements.

**REDEVELOPMENT AGENCY OF THE CITY OF PALO ALTO**  
Statement of Activities and  
Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances  
For the Year Ended June 30, 2011

	Redevelopment General Fund	Adjustments	Statement of Activities
	<u>          </u>	<u>          </u>	<u>          </u>
Expenditures/expenses:			
Community development:			
Planning and community reimbursements to the City of Palo Alto	\$       9,978	\$           -	\$       9,978
General revenues:			
Intergovernmental revenues from the City of Palo Alto	<u>          9,978</u>	<u>          -</u>	<u>          9,978</u>
Change in fund balances/net assets	-	-	-
Fund balances/net assets,			
Beginning of year	<u>          -</u>	<u>          -</u>	<u>          -</u>
End of year	<u><u>      \$    -</u></u>	<u><u>      \$    -</u></u>	<u><u>      \$    -</u></u>

See accompanying notes to the financial statements.

**REDEVELOPMENT AGENCY OF THE CITY OF PALO ALTO**

## Redevelopment General Fund

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

For the Year Ended June 30, 2011

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
Intergovernmental revenues from the City of Palo Alto	\$ 8,500	\$ 8,500	\$ 9,978	\$ 1,478
Expenditures:				
Community development:				
Planning and community reimbursements to the City of Palo Alto	8,500	8,500	9,978	(1,478)
Net change in fund balances	<u>\$ -</u>	<u>\$ -</u>	-	<u>\$ -</u>
Fund balance, beginning of year			-	
Fund balance, end of year			<u>\$ -</u>	

See accompanying notes to the financial statements.

**REDEVELOPMENT AGENCY OF THE CITY OF PALO ALTO**

Notes to Basic Financial Statements

For the Year Ended June 30, 2011

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****(a) Organization and Purpose**

The Redevelopment Agency (Agency) of the City of Palo Alto was created on July 9, 2001, under the provisions of the Redevelopment Law (California Health and Safety Code). The City Council of the City of Palo Alto (City) serves as the governing body of the Agency and the City Manager serves as the Executive Director.

On September 19, 2001, the Edgewood Redevelopment Project Area (Edgewood Plaza) was designated as a survey area and the process for the adoption of the redevelopment plan was initiated. The redevelopment plan for Edgewood Plaza was not ultimately adopted by the City Council. The City has not designated any other redevelopment project areas for revitalization.

The Agency is an integral part of the City and, accordingly, the accompanying financial statements are included as a blended component unit of the basic financial statements prepared by the City. A component unit is a separate governmental unit, agency or nonprofit corporation which, when combined with all other component units, constitutes the reporting entity as defined in the City's basic financial statements.

On September 6, 2011, pursuant to Health & Safety Code Section 33140 the City Council of the City of Palo Alto passed Ordinance No. 5126 dissolving the Agency, effective October 7, 2011 (see Note 3).

**(b) Financial Statement Presentation**

The Agency'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 of America.

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

**Government-wide Statements:** The statement of net assets and the statement of activities include the financial activities of the overall Agency government. Eliminations have been made to minimize the double counting of internal activities.

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

**Fund Financial Statements:** The fund financial statements provide information about the Agency. The Agency considers the Redevelopment Agency General Fund to be a major fund.

**REDEVELOPMENT AGENCY OF THE CITY OF PALO ALTO**

Notes to Basic Financial Statements

For the Year Ended June 30, 2011

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****(c) Major Funds**

Major funds are defined as funds that have either assets, liabilities, revenues or expenditures/expenses equal to ten percent of their fund-type total and five percent of the grand total. Major funds are identified and presented separately in the fund financial statements.

The Agency reported the following major governmental fund in the accompanying financial statements:

*Redevelopment General Fund* - This fund accounts for the activities of establishing and administering the Redevelopment Agency.

**(d) Basis of Accounting**

The Agency-wide 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 flow takes 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 Agency considers all revenues reported in the governmental funds to be available if the revenues are collected within sixty days after year-end. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as *expenditures* in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as *other financing sources*.

Non-exchange transactions, in which the Agency gives or receives value without directly receiving or giving equal value in exchange, include property taxes, grants, entitlements, and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

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

**(e) Budgets and Budgetary Accounting**

Budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP).

Budget amounts in the financial statements are as originally adopted, or as amended by the Board.

Formal budgetary integration is employed as a management control device. Encumbrance accounting is employed as an extension of formal budgetary integration in all funds. Under encumbrance accounting, purchase orders, contracts and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation. Encumbrances outstanding at year end are reported as reservations of fund balances since they do not constitute expenditures or liabilities and are reappropriated in the following year.

**REDEVELOPMENT AGENCY OF THE CITY OF PALO ALTO**

Notes to Basic Financial Statements

For the Year Ended June 30, 2011

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****(f) Net Assets**

Net assets are the excess of all the Agency's assets over all its liabilities. Net assets, which are determined only at the Agency-wide level, were zero at June 30, 2011.

**(g) Fund Balances**

During the year ended June 30, 2011, the Agency implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The objective to 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. There was no fund balance at June 30, 2011.

**NOTE 2 – TRANSACTIONS WITH THE CITY**

During fiscal year 2001-02, the City established the Redevelopment Agency. The Agency and the City have an agreement whereby the City will advance funds to the Agency in support of startup and formation costs. However, the interfund advances have no specific repayment date. Generally accepted accounting principles require that such amounts as well as the repayments be treated as transfers in the year made.

**NOTE 3 – DISSOLUTION OF THE REDEVELOPMENT AGENCY**

In June 2011, the California legislature adopted Assembly Bill 1x 26 ("AB1x 26" or the "Dissolution Bill") and Assembly Bill 1x 27 ("AB1x 27" or the "Continuation Bill"). The Dissolution Bill immediately suspends all new redevelopment activities and incurrence of indebtedness, and dissolves redevelopment agencies effective October 1, 2011 that do not otherwise "opt-in" under the Continuation Bill. In response to the newly enacted legislation, the City concluded that the Agency has not identified a qualifying redevelopment project area and has not conducted any redevelopment activities, including redeveloping or acquiring land, entering into contracts, issuing bonds or incurring housing obligations, since its formation. As a result, pursuant to Health & Safety Code Section 33140 the City Council of the City of Palo Alto adopted Ordinance No. 5126 on September 6, 2011 to dissolve the Agency effective October 7, 2011.

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 continue with the dissolution regardless of the outcome of the California Supreme Court decision.

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Board of Directors of the  
Redevelopment Agency of the City of Palo Alto  
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 and major fund of the Redevelopment Agency of the City of Palo Alto (Agency), a component unit of the City of Palo Alto (City), California, as of and for the year ended June 30, 2011, which collectively comprise the Agency's basic financial statements, and have issued our report thereon dated December 1, 2011. Our report includes explanatory paragraphs indicating that the Agency adopted the provisions of Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* and indicating that the Agency dissolved, effective October 7, 2011. 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 Agency 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 related to the Agency 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 related to the Agency. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting related to the Agency.

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 misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Agency'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 would not necessarily identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the Agency'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*.

This report is intended solely for the information and use of the Governing Board of the Agency, management, pass-through entities, and the State Controller's Office 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



Board of Directors of the  
Redevelopment Agency of the City of Palo Alto  
Palo Alto, California

**Independent Auditor's Report on Compliance of  
California Redevelopment Agencies and on  
Internal Control over Compliance**

***Compliance***

We have audited the Redevelopment Agency of the City of Palo Alto's (Agency) compliance with the requirements specified in the State of California's *Guidelines for Compliance Audits of California Redevelopment Agencies* issued by the State Controller's Office, applicable to the Agency's statutory requirements identified below for the year ended June 30, 2011. Compliance with the requirements referred to above is the responsibility of the Agency's management. Our responsibility is to express an opinion on the Agency's compliance based on our audit.

We conducted our compliance audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the State of California's *Guidelines for Compliance Audits of California Redevelopment Agencies (Guidelines)*, issued by the State Controller's Office, as interpreted in the *Auditing Procedures for Accomplishing Compliance Audits of California Redevelopment Agencies, August 2011*, issued by the Governmental Accounting and Auditing Committee of the California Society of Certified Public Accountants. Those standards and the Guidelines require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the compliance requirements referred to above that could have a material effect on the statutory requirements listed below occurred. An audit includes examining on a test basis, evidence about the Agency'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 Agency's compliance with those requirements.

In our opinion, the Agency complied, in all material respects, with the compliance requirements referred to above that are applicable to the statutory requirements of the Agency for the year ended June 30, 2011.

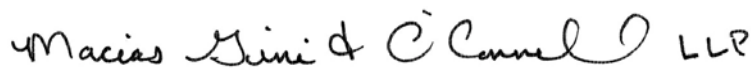
***Internal Control over Compliance***

Management of the Agency is responsible for establishing and maintaining effective internal control over compliance and with the compliance requirements referred to above. In planning and performing our audit, we considered the Agency's internal control over compliance to determine the auditing procedures for the purpose of expressing our opinion on compliance, 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 Agency's internal control over compliance.

*A deficiency in internal control over compliance* 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, noncompliance 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 a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses in internal control over compliance. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the Governing Board of the Agency, management, and the State Controller's Office and is not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & C Counsel LLP

Walnut Creek, California  
December 1, 2011

**CITY OF PALO ALTO  
GENERAL OBLIGATION BONDS  
CAPITAL PROJECTS FUND  
(A Fund of the City of Palo Alto)**

Independent Auditor's Reports,  
Financial Statements, and  
Independent Accountant's Report

For the Year Ended June 30, 2011



**Certified Public Accountants.**



**CITY OF PALO ALTO**  
**GENERAL OBLIGATION BONDS CAPITAL PROJECTS FUND**  
(A Fund of the City of Palo Alto)

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

### **Independent Auditor's Report**

We have audited the accompanying financial statements of the City of Palo Alto General Obligation Bonds Capital Projects Fund, a fund of the City of Palo Alto (City), as of and for the year ended June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with 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 of 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 the Fund's 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2(a) to the financial statements, the financial statements of the City of Palo Alto General Obligation Bonds Capital Projects Fund are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and the nonmajor governmental funds of the City that is attributable to the activities of the City of Palo Alto General Obligation Bonds Capital Projects Fund. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2011 and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Palo Alto General Obligation Bonds Capital Projects Fund as of June 30, 2011, and the changes in financial position thereof for the year then ended, in conformity with generally accepted accounting principles in the United States of America.

As discussed in Note 2(c) to the financial statements, as of June 30, 2011, the City adopted the provisions of Governmental Accounting Standards Board (GASB) 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 the City of Palo Alto General Obligation Bonds Capital Projects Fund's 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 the City's internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the 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.

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the GASB 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. Our opinion on the basic financial statements is not affected by this missing information.

*Macias Gini & Connell LLP*

Walnut Creek, California  
December 1, 2011

**CITY OF PALO ALTO**  
**GENERAL OBLIGATION BONDS CAPITAL PROJECTS FUND**

Balance Sheet  
June 30, 2011

**Assets:**

Restricted cash and investments (Note 3) with	
City Treasury - CAMP	\$ 40,329,115
Trustee	37,877
Interest receivable	<u>137,623</u>
Total assets	<u><u>\$ 40,504,615</u></u>

**Liabilities and fund balances:**

## Liabilities:

Accounts payable and accrued liabilities	\$ 4,542,456
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## Fund balances:

Restricted for Capital Projects	<u>35,962,159</u>
Total liabilities and fund balances	<u><u>\$ 40,504,615</u></u>

See accompanying notes to financial statements.

**CITY OF PALO ALTO**  
**GENERAL OBLIGATION BONDS CAPITAL PROJECTS FUND**  
Statement of Revenues, Expenditures and  
Changes in Fund Balance  
For the Year Ended June 30, 2011

**Revenues:**

Interest on cash and investments	\$ 144,377
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**Expenditures:**

## Capital outlay:

Downtown Library	3,097,417
Mitchell Park Library and Community Center	14,231,580
Main Library New Construction and Improvements	690,965
Temporary Facility	141,677
Total capital outlay	18,161,639

## Debt service:

Costs of issuance, discounts and fees	101,350
Other Fees	26,023
Total expenditures	18,289,012

Net change in fund balance	(18,144,635)
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Fund balance, beginning of the year	54,106,794
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Fund balance, end of year	\$ 35,962,159
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See accompanying notes to financial statements.

**CITY OF PALO ALTO**  
**GENERAL OBLIGATION BONDS CAPITAL PROJECTS FUND**  
**(A Fund of the City of Palo Alto)**

Notes to the Financial Statements  
For the Fiscal Year Ended June 30, 2011

**NOTE 1 – BACKGROUND**

On November 4, 2008, more than two thirds of registered voters of the City of Palo Alto (City) approved Measure N and authorized the issuance and sale of general obligation bonds not to exceed \$76,000,000 to be used to construct a new energy-efficient Mitchell Park Library and Community Center, expand and renovate the Main Library, and renovate the Downtown Library. Funds will also be used to provide additional space to expand library collections, add new children's and group program areas, replace outdated lighting, provide modern ventilation and air conditioning systems and ensure seismic safety and enhance disabled access.

On June 9, 2010, the City issued General Obligation Bonds, Election of 2008, Series 2010A (Library Bonds) to finance the costs of constructing a new energy efficient, environmentally friendly Mitchell Park Library and Community Center, renovating and expanding Main Library, and renovating the Downtown Library, including enhancements at all three facilities for seismic safety and disabled access, expanded space for library collections, meeting and study areas, and new air conditioning, ventilation and lighting systems (the "Project"). Proceeds from the Library Bonds included par of \$55,305,000 and a premium on issue of \$3,766,208 for a total of \$59,071,208. The Bonds are the first of two series of bonds to be sold and issued under the Authorization to finance a portion of the Project. As of June 30, 2011, \$20,695,000, of the Authorization remains unissued.

Specific projects approved by Council to be funded by the Library Bonds are as follows:

Project	Amended Budget	Expenditures Not Charged to Bond Proceeds	As of June 30, 2011		
			Cumulative Bond Eligible Expenditures	Encumbrances Outstanding	Project Balance Remaining
Downtown Library	\$ 5,212,000	\$ 318,307	\$ 3,678,350	\$ 725,048	\$ 808,602
Mitchell Park Library and Community Center	49,152,752	619,165	17,822,048	21,891,802	9,438,902
Main Library New Construction and Improvements	1,850,000	78,252	690,965	1,102,693	56,342
Temporary Facility	645,000	148,061	504,728	23,862	116,410
Total	<u>\$ 56,859,752</u>	<u>\$ 1,163,785</u>	<u>\$ 22,696,091</u>	<u>\$ 23,743,405</u>	<u>\$ 10,420,256</u>

**CITY OF PALO ALTO**  
**GENERAL OBLIGATION BONDS CAPITAL PROJECTS FUND**  
**(A Fund of the City of Palo Alto)**

Notes to the Financial Statements  
For the Fiscal Year Ended June 30, 2011

**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES**

**(a) Basis of Presentation**

The accompanying financial statements present only the financial position and the changes in financial position of the General Obligation Bonds Capital Projects Fund (Fund) and do not purport to, and do not, present fairly the City's financial position as of June 30, 2011, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

A capital projects fund (governmental fund) is used to account for the City's General Obligation Bond Projects activities. Capital projects funds are used to account for financial resources (e.g., bond proceeds and investment income) that are restricted, committed, or assigned to expenditures for capital outlays, including the acquisition of land or acquisition and construction of major governmental facilities. This fund is a set of self-balancing accounts which comprise its assets, liabilities, fund balance, revenues and expenditures.

**(b) Basis of Accounting**

Basis of accounting refers to when revenues and expenditures are recognized. The projects are accounted for in a governmental fund type, and the modified accrual basis of accounting is used. Under the modified accrual basis, revenues are recognized when they become measurable and available as net current assets. Expenditures are recognized when they are incurred.

**(c) Fund Balance**

In June 2011, the City adopted the provisions of Government Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. GASB Statement No. 54 outlines the requirement to report the fund balance for governmental funds in specific classifications (nonspendable, restricted, committed, assigned and unassigned), which create a hierarchy primarily based on the extent to which the City is bound to the constraints of the specific purposes for which funds can be spent. The Fund only has restricted fund balance at June 30, 2011.

Restricted fund balance includes amounts when constraints placed on use of resources are either: (1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or (2) imposed by law through constitutional provisions or enabling legislation. The City will spend the most restricted dollars in accordance with restrictions imposed before less restricted resources in the following order: (a) committed; (b) assigned and (c) unassigned.

**(d) Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make certain estimates and assumptions that affect the reported amounts and disclosures. Accordingly, actual results may differ from those estimates.

**CITY OF PALO ALTO**  
**GENERAL OBLIGATION BONDS CAPITAL PROJECTS FUND**  
**(A Fund of the City of Palo Alto)**

Notes to the Financial Statements  
For the Fiscal Year Ended June 30, 2011

**NOTE 3 – RESTRICTED CASH AND INVESTMENTS**

The Fund's investments are carried at fair value, as required by generally accepted accounting principles. The Fund 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 revenues for that fiscal year.

**(a) Project Funds Investment Policy**

Pursuant to terms of the Trust Agreement, bond proceeds to be used for project costs were remitted to and are maintained by the City as agent for the Bondholders. The City's Investment Policy allows it to invest in a variety of types of investments subject to maturity maximums, concentration limitations, and minimum credit quality requirements. Allowed investment types include U.S. government securities, U.S., government agency securities, certificates of deposit, money market mutual funds, banker's acceptances, commercial paper, the Local Agency Investment Fund, medium term corporate notes, state of California municipal agencies and city bonds.

**(b) Interest Rate Risk**

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Normally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. Information about the sensitivity of the fair values of the Fund's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the Fund's investments by maturity:

<u>Investment Type</u>	<u>Amount</u>	<u>Maturity Date</u>
California Asset Management Program	\$ 17,648,792	57 Days *
U.S. Agency obligations:		
Federal Home Loan Bond Global Bonds	17,669,433	7/27/2011
Federal Home Loan Bond Notes	5,010,890	1/9/2012
Cash held with U.S. Bank	37,877	N/A
Total Cash and Investments held by Trustee	<u>\$ 40,366,992</u>	

\* 57 days represents weighted average maturity of investment pool.

**(c) California Asset Management Program**

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 Fund 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, these investments had an average maturity of 57 days, were rated AAA and amounted to \$17.6 million.

**CITY OF PALO ALTO**  
**GENERAL OBLIGATION BONDS CAPITAL PROJECTS FUND**  
**(A Fund of the City of Palo Alto)**

Notes to the Financial Statements  
For the Fiscal Year Ended June 30, 2011

**NOTE 3 – RESTRICTED CASH AND INVESTMENTS (Continued)**

**(d) Credit Risk**

Generally, 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. The actual ratings as of June 30, 2011, for all U.S. Agency Obligations and Money Market Mutual Funds are Aaa as provided by Moody's Investors Services. As an external investment pool, the California Asset Management Program was rated Aaam as of June 30, 2011.

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.

**(e) Permitted Investments with Trustee**

The Fund must maintain funds to be used for costs of issuance on the Bonds with a Trustee under the terms of the Bond Trust agreement. These funds are normally held in cash or invested in money market funds, which are a permitted investment under the Trust agreement, and amounted to \$38 thousand as of June 30, 2011.



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

**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 City of Palo Alto General Obligation Bonds Capital Projects Fund, a fund of the City of Palo Alto, 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* and an explanatory paragraph describing management's omission of the management's discussion and analysis required by accounting principles generally accepted in the United States of America. We conducted our audit in accordance with generally accepted auditing standards in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

***Internal Control over Financial Reporting***

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 opinion 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.

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 combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the entity'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 would not necessarily identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the City of Palo Alto General Obligation Bonds Capital Projects Fund'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 and other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the City Council, the Oversight Committee, the City Auditor and the City's management 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



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

**Independent Accountant's Report on Compliance with Measure N**

We have examined the City of Palo Alto's (City) compliance with certain provisions of Measure N for the year ended June 30, 2011, as follows:

- a) Proceeds from the sale of the Bonds were used only for the purposes specified in Measure N.
- b) Proceeds for the Bonds were deposited into a Library/Community Center Project Construction Fund held by the City; and
- c) The Administrative Services Director of the City filed an annual report with the City Council commencing not later than November 1, 2010, containing pertinent information regarding the amount of funds collected and expended, as well as the status of the Library/Community Center project listed in the Measure.

Management is responsible for the City's compliance with those requirements. Our responsibility is to express an opinion on the City's compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and accordingly, included 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 examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on the City's compliance with specified requirements.

In our opinion, the City complied, in all material respects, with the aforementioned requirements for the year ended June 30, 2011.

This report is intended solely for the information and use of the City Council, the Oversight Committee, the City Auditor and the City's management 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

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**CITY OF PALO ALTO  
GENERAL OBLIGATION BONDS CAPITAL PROJECTS FUND  
(A Fund to the City of Palo Alto)**

Status of Current Year and Prior Year Findings  
For the Year Ended June 30, 2011

***Current Year Findings:***

No matters were noted.

***Status of Prior Year Findings:***

**FY2010 Comment**

**10-01 Annual Reporting**

**Condition**

The City did not submit an annual report, which is required to contain pertinent information regarding the amount of funds collected and expended as well as the status of the Library Projects approved in Measure N.

**Recommendation**

Administrative Services Director should prepare and file the report annually with Council.

**Status**

Corrected. The City submitted a separate report on November 16, 2010 for the prior year report and submitted its FY2010-11 annual report to the City Council on November 1, 2011.



## FINANCE COMMITTEE

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### ACTION MINUTES EXCERPT

Special Meeting  
December 14, 2011

#### Roll Call

Chairperson Scharff called the meeting to order at 6:06 p.m. in the Council Conference Room, 250 Hamilton Avenue, Palo Alto, California.

Present: Scharff (Chair), Schmid, Shepherd, Yeh (arrived at 7:41)

Absent:

#### Oral Communications

None

#### Agenda Items

1. Macias Gini & O'Connell's Audit of the City of Palo Alto's Financial Statements as of June 30, 2011 and Management Letter.

**MOTION:** Council Member Shepherd moved, seconded by Council Member Schmid, that the Finance Committee recommend to the City Council acceptance of the External Audited Financial Statements and Management Letter.

**MOTION PASSED:** 3-0, Yeh Absent

ADJOURNMENT: Meeting adjourned at 8:55 pm.