



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

February 9, 2015

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

Finance Committee Recommendation to Accept Macias Gini & O'Connell's Audit of the City of Palo Alto's Financial Statements as of June 30, 2014 and Management Letter

The Office of the City Auditor recommends acceptance of Macias Gini & O'Connell's Audit of the City of Palo Alto's Financial Statements as of June 30, 2014 and Management Letter. At its meeting on December 2, 2014, the Finance Committee approved and unanimously recommended the City Council accept this report. The Finance Committee minutes are included in this packet.

Respectfully submitted,

Harriet Richardson
City Auditor

ATTACHMENTS:

- Attachment A: Macias Gini & O'Connell's Audit of the City of Palo Alto's Financial Statements as of June 30, 2014 and Management Letter (PDF)
- Attachment B: Finance Committee Meeting Minutes Excerpt (December 2, 2014) (PDF)

Department Head: Harriet Richardson, City Auditor



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

December 2, 2014

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, 2014 and Management Letter

RECOMMENDATION

We recommend the Finance Committee review and forward to the City Council for approval the City of Palo Alto's audited financial statements for the fiscal year ended June 30, 2014, and the accompanying reports provided by Macias Gini & O'Connell LLP.

DISCUSSION

The City Charter requires that the City Council, through the City Auditor, to engage an independent certified public accounting firm to conduct the annual financial audit. The selected firm reports the results of the audit, in writing, to the City Council. Macias Gini & O'Connell LLP, a certified public accounting firm based in Sacramento, California, conducted the audits of the City's financial statements for the fiscal year ended June 30, 2014.

The Administrative Services Department provides the Comprehensive Annual Financial Report (CAFR) and Single Audit Report, including the following Independent Auditor's Reports, to the Finance Committee:

- Independent Auditor's Reports on the Financial Statements (CAFR)
- 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 (Single Audit Report)
- Independent Auditor's Report on Compliance for Each Major Program and on Internal Control over Compliance Required by OMB Circular A-133 (Single Audit Report)

We are providing copies of the following financial statements and reports, as prepared by MGO:

- Report to the City Council (the "Management Letter") – Attachment A
- Independent Accountant's Report on Applying Agreed-Upon Procedures Related to the Article XIII-B Appropriations Limit for the year ended June 30, 2014 – Attachment B
- Pedestrian/Bicycle Facilities Grants, Metropolitan Transportation Commission, Transportation Development Act Funds, Article III, Independent Auditor's Reports, Financial Statements and Supplementary Information for the year ended June 30, 2014 – Attachment C

- 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, 2014 – Attachment D
- Palo Alto Public Improvement Corporation (a Component Unit of the City of Palo Alto), Annual Financial Report for the year ended June 30, 2014 – Attachment E
- Regional Water Quality Control Plant, Independent Auditor's Report and Financial Statements for the year ended June 30, 2014 – Attachment F
- Cable TV Franchise – Independent Auditor's Report and Statements of Franchise Revenues and Expenditures for the years ended December 31, 2013 and 2012 – Attachment G

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,



Harriet Richardson
City Auditor

ATTACHMENTS:

- Attachment A: Report to the City Council FY2014 (PDF)
- Attachment B: GANN Report FY2014 (PDF)
- Attachment C: TDA Report FY2014 (PDF)
- Attachment D: GO Bonds Report FY2014 (PDF)
- Attachment E: Public Improvement Corp FY2014 (PDF)
- Attachment F: RWQCP FY2014 (PDF)
- Attachment G: Cable TV Franchise Report FY2014 (PDF)

Department Head: Harriet Richardson, City Auditor

CITY OF PALO ALTO

Report to the City Council

For the Year Ended June 30, 2014

**CITY OF PALO ALTO
Report to the City Council
For the Year Ended June 30, 2014**

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Oakland

LA/Century City

Newport Beach

San Diego

Seattle

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

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Palo Alto, California (City), as of and for the year ended June 30, 2014, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of 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 entity'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 material weaknesses. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Following this letter, we have included a report on required communications to those charged with governance, 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 Finance Committee, management and others within the City, and is not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 17, 2014

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CITY OF PALO ALTO
Report to the City Council
For the Year Ended June 30, 2014

REQUIRED COMMUNICATIONS

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Palo Alto (City) as of and for the year ended June 30, 2014. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated July 30, 2014. Professional standards also require that we communicate to you the following information related to our audit.

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. The City implemented three new Governmental Accounting Standards Board (GASB) pronouncements, consisting of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB 65); GASB Statement No. 66, *Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62*; and GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*.

As of July 1, 2013, the City implemented GASB 65 and restated beginning net position by \$1.1 million and \$0.7 million to write off unamortized bond issuance costs that were previously reported as assets in governmental activities and business-type activities, respectively. Further, the unamortized loss on refunding of debt of \$0.4 million was reclassified from contra liabilities to deferred outflows of resources in three major enterprise funds – Water, Gas and Storm Drainage.

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.

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.

CITY OF PALO ALTO
Report to the City Council
For the Year Ended June 30, 2014

REQUIRED COMMUNICATIONS (Continued)

- *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 reported 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.

Certain financial statements disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were the disclosure of the City's Pension Plans in Note 11, the Retiree Health Benefits in Note 12 and the Commitments and Contingencies in Note 16.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no 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. Below is a table that summarizes the uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to each opinion unit's 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
Report to the City Council
For the Year Ended June 30, 2014

REQUIRED COMMUNICATIONS (Continued)

Summary of Uncorrected Financial Statement Misstatements:

Index	Fund	Description	Debit	Credit
<i>For Fund Financial Statements</i>				
PJE 2014.1	Capital	Accounts Receivable	\$ 657,749	
PJE 2014.1	Projects	Deferred Inflows of Resources (unavailable revenue)		\$ 657,749
	Fund	(To accrue intergovernmental revenue earned by the City as of June 30, 2014 and to defer recognition, as the receipt of the reimbursement was not collected within the City's availability period of 90 days for governmental funds.)		
<i>For Government-Wide Financial Statements</i>				
PJE 2014.1	Governmental	Accounts Receivable	\$ 657,749	
PJE 2014.1	Activities	Revenue - Capital Grant Revenue for Public Works		\$ 657,749
		(To accrue intergovernmental revenue earned by the City as of June 30, 2014.)		

Disagreements with Management

For purposes of this letter, a disagreement with management is 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 November 17, 2014.

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
Report to the City Council
For the Year Ended June 30, 2014

REQUIRED COMMUNICATIONS (Continued)

Other Matters

We applied certain limited procedures to Management's Discussion and Analysis, which is required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding 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 did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the combining and individual nonmajor fund financial statements and schedules and the schedule of expenditures of federal awards, as required by the Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, which accompany the financial statements but are not RSI. With respect to this supplementary information, 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.

We were not engaged to report on the introductory and statistical sections, which accompany the financial statements but are not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

CITY OF PALO ALTO
Report to the City Council
For the Year Ended June 30, 2014

CURRENT YEAR RECOMMENDATIONS

Item # 2014-001 – Informational Comment New Pension Accounting Standards

In June 2012, the Governmental Accounting Standards Board (GASB) approved Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*. This statement primarily relates to reporting by governments that provide pensions to their employees and is effective for fiscal years beginning after June 15, 2014. Key changes include the following:

- Separating how the accounting and financial reporting is determined from how pensions are funded.
- Employers with defined benefit pension plans will recognize a net pension liability and pension expense, as defined by the standard, in their government-wide, proprietary and fiduciary fund financial statements, as applicable.
- Incorporating ad hoc cost-of-living adjustments and other ad hoc postemployment benefit changes into projections of benefit payments, if an employer's past practice and future expectations of granting them indicate they are essentially automatic.
- Using a discount rate that blends (a) the expected long-term rate of return on pension plan investments to projected benefit payments for which plan assets are expected to be available to make projected benefit payments, and, if applicable, (b) the interest rate on a tax-exempt 20-year AA/Aa-or higher rated municipal bond index to projected benefit payments for which plan assets are not expected to be available for long-term investment in a qualified trust.
- Adopting a single actuarial cost allocation method – entry age normal – rather than the current choice among six actuarial cost methods.
- Requiring more extensive note disclosures and required supplementary information.

The City will be subject to the provisions of this statement beginning with the fiscal year ending June 30, 2015. GASB Statement No. 68 replaces the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and GASB Statement No. 50, *Pension Disclosures*, as they relate to pensions that are administered through trusts or similar arrangements meeting certain criteria. GASB Statement No. 68 changes the existing framework for accounting and financial reporting of pension costs and obligations of defined benefit pension plans and enhances note disclosures and required supplementary information for both defined benefit and defined contribution pension plans.

Recommendation

It is likely that these new pension standards will dramatically change the City's financial statements and disclosures related to its pension plans, and may result in the recognition of a significant net pension liability. We recommend the City start planning and coordinating for the impact of these new pension standards by working closely with CalPERS, the auditors and the actuaries (plan actuaries and, if necessary, a separate consulting actuary) and by developing methodologies for recording the pension information when it becomes available.

Management's Response

We are aware that GASB No. 68 will dramatically change the financial statements and disclosures related to the City's pension plans, and will result in the recognition of a significant net pension liability. In order to prepare, City staff has been reading published materials, attending seminars and webinars, and communicating with CalPERS and our auditors on the timing and nature of information that will be required.

CITY OF PALO ALTO
Report to the City Council
For the Year Ended June 30, 2014

CURRENT YEAR RECOMMENDATIONS (Continued)

Item 2014-002 – Informational Comment
Uniform Guidance for Federal Awards

The Office of Management and Budget (OMB) published new guidance for federal award programs, *OMB Uniform Guidance: Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, commonly referred to as the “Uniform Guidance”, on December 26, 2013. The new guidance is a key component of a larger federal effort to more effectively focus federal grant resources on improving performance and outcomes while ensuring the financial integrity of taxpayer dollars. By streamlining eight federal regulations into a single, comprehensive policy guide, the government can better administer grants and other types of financial assistance by decreasing the administrative burden for recipients and reducing the risk of waste, fraud and abuse.

The new requirements will become effective a year after its issuance, December 26, 2014, and the City’s annual single audit for fiscal year ending June 30, 2016 will be subject to the provisions of the Uniform Guidance. Federal agencies must implement policies and procedures by promulgating regulations to be effective December 26, 2014. The City must apply the requirements of the Uniform Guidance to any new federal awards made after December 26, 2014 and to additional funding to existing awards made after that date. Of particular importance are the provisions for procurement, time and effort reporting, and subrecipient monitoring.

We recommend that the City analyze the Uniform Guidance and work closely with its grantor agencies to determine what system changes are needed to comply with the new grant management requirements beginning on December 26, 2014. The Council on Financial Assistance Reform (COFAR) and OMB have conducted webcasts about the Uniform Guidance, which are now archived at www.cfo.gov/COFAR. COFAR has also published *Frequently Asked Questions for New Uniform Guidance at 2 CFR 200*, which may provide additional guidance to the City.

Management’s Response

We are aware that OMB has published new guidance for federal award programs which will affect the City’s annual single audit for the fiscal year ending June 30, 2016. City staff is preparing by reading published materials and attending seminars and webinars. City staff will be working closely with grantors to ensure compliance with new requirements.

CITY OF PALO ALTO
Report to the City Council
For the Year Ended June 30, 2014

STATUS OF PRIOR YEAR RECOMMEDATIONS

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. 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 Chief Information Officer (CIO), 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.

Current Year Status:

In Progress. The CIO budgeted for the development of a disaster recovery plan in FY13. The project was initiated in March 2013. In January 2014, the City engaged Moss Adams LLP to conduct a Disaster Relief – Business Continuity Planning analysis for critical IT services, such as SAP, GIS, Internet services, e-mail services, and network services. As a result, the City has issued an RFP to hire qualified vendors to implement the recommendations. This is expected to be completed by June 2015.

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.

**CITY OF PALO ALTO
Report to the City Council
For the Year Ended June 30, 2014**

STATUS OF PRIOR YEAR RECOMMENDATIONS (CONTINUED)

2011-03 - A Comprehensive IT Risk Assessment Has Not Been Performed (continued)
(Significant Deficiency)

Current Year Status:

In Progress. The City's ISM has conducted a preliminary security assessment to identify areas of improvement. As of April 2014, the ISM has initiated an Information Security Risk Assessment project with Information Security Risk Assessment (ISRA) project plan. Expected completion of ISRA is June 2015.

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 Accela, 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.

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

Current Year Status:

In progress. ISM will meet with the owners of following application and request them to comply with the newly developed password policy v2.5:

- Class – Parks & Recs
- Chameleon – Animal Services
- Horizon – Library
- Accela – Plan

Expected completion date is December 31, 2014.

CITY OF PALO ALTO, CALIFORNIA

Independent Accountant's Report on Applying
Agreed-Upon Procedures Related to
the Article XIII-B Appropriations Limit

For the Year Ended June 30, 2014

**Independent Accountant's Report
on Applying Agreed-Upon Procedures Related to
the Article XIII-B Appropriations Limit**

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

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, 2014. These procedures, which were agreed to by the City and the League of California Cities (as presented in the publication entitled *Agreed-Upon Procedures Applied to the Appropriations Limitation Prescribed by Article XIII B of California Constitution*), 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 audit, 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. However, this report is a matter of public record and its distribution is not limited.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 17, 2014

CITY OF PALO ALTO, CALIFORNIA

Pedestrian/Bicycle Facilities Grants
Metropolitan Transportation Commission
Transportation Development Act Funds, Article III

Independent Auditor's Reports,
Financial Statements and
Supplementary Information

For the Year Ended June 30, 2014

CITY OF PALO ALTO, CALIFORNIA
 Pedestrian/Bicycle Facilities Grants
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Sacramento

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Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Pedestrian/Bicycle Facilities Grants (Grants) made to the City of Palo Alto, California (City), by the Metropolitan Transportation Commission, Transportation Development Act Funds, Article III, as of and for the year ended June 30, 2014, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Grants as of June 30, 2014, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 1 to the financial statements, the financial statements of the Grants are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and the major governmental fund of the City that is attributable to the activities of the Grants. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2014, and changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters***Other Information***

Our audit was conducted for the purpose of forming an opinion on the financial statements. The accompanying schedule of construction projects with capital outlay expenditures (Schedule) is presented for purposes of additional analysis and is not a required part of the financial statements. The Schedule is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards* and the Transportation Development Act, we have also issued our report dated November 17, 2014 on our consideration of the City's internal control over the Grants' 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 the Transportation Development Act in considering the City's internal control over the Grants' financial reporting and compliance.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 17, 2014

CITY OF PALO ALTO, CALIFORNIA
 Pedestrian/Bicycle Facilities Grants
 Metropolitan Transportation Commission
 Transportation Development Act Funds, Article III
 Balance Sheet
 June 30, 2014

Assets	
Due from the Metropolitan Transportation Commission	\$ 15,000
	<u>15,000</u>
Liabilities	
Due to the City of Palo Alto	\$ 15,000
Deferred inflows of resources	
Unavailable Revenue	15,000
Fund balance (deficit)	
Unassigned	<u>(15,000)</u>
Total liabilities, deferred inflows of resources and fund balance (deficit)	<u>\$ 15,000</u>

See accompanying notes to the financial statements.

CITY OF PALO ALTO, CALIFORNIA
 Pedestrian/Bicycle Facilities Grants
 Metropolitan Transportation Commission
 Transportation Development Act Funds, Article III
 Statement of Revenues, Expenditures, and Changes in Fund Balance (Deficit)
 For the Year Ended June 30, 2014

Revenues	
Grant	\$ 55,597
Expenditures	
Capital outlay	<u>55,597</u>
Change in fund balance (deficit)	-
Fund Balance (Deficit) - beginning of year	<u>(15,000)</u>
Fund Balance (Deficit) - end of year	<u><u>\$ (15,000)</u></u>

See accompanying notes to the financial statements.

CITY OF PALO ALTO, CALIFORNIA
Pedestrian/Bicycle Facilities Grants
Metropolitan Transportation Commission
Transportation Development Act Funds, Article III
Notes to the Financial Statements
For the Year Ended June 30, 2014

NOTE 1 – DESCRIPTION OF REPORTING ENTITY

The accompanying financial statements are prepared from the accounts and financial transactions of the City of Palo Alto, California (City) for the projects funded under the Transportation Development Act of 1971 (TDA) Article III of the State of California, which include the construction of pedestrian and bicycle paths. The financial statements do not purport to present the financial position or changes in financial position of the City. The projects represent a portion of the accounts of the City and, as such, are included in the City's basic financial statements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) *Basis of Presentation*

The Pedestrian/Bicycle Facilities Grants (Grants) have been accounted for in the capital project fund, which is a major governmental fund type and is included in the City's basic financial statements. The capital project fund accounts for resources used for acquisition and construction of capital facilities by the City, with the exception of those assets financed by proprietary funds.

(b) *Basis of Accounting*

The accompanying financial statements have been prepared on the modified accrual basis of accounting. Under the modified accrual basis of accounting, expenditures are recorded when the related governmental fund liabilities are incurred. Grant revenues, which are received as reimbursement for specific purposes or projects, are recognized when they become measurable and available (received within 60 days after year-end).

(c) *Fund Balance (Deficit)*

The City reports fund balance for governmental funds in specific classifications (nonspendable, restricted, committed, assigned and unassigned) based on the extent to which the City is bound to the constraints on the specific purposes for which funds can be spent. At June 30, 2014, the Grants reported a fund balance deficit of \$15,000. The fund balance deficit will be cured once the grant reimbursement becomes available to repay the funds advanced from the City.

(d) *Due to the City of Palo Alto*

Cash has been advanced to the Grants' projects for expenditures paid by the City's major capital projects fund for the benefit of the TDA Article III projects. The projects are obligated to immediately repay these advances upon receipt of reimbursement from the Metropolitan Transportation Commission.

CITY OF PALO ALTO, CALIFORNIA
Pedestrian/Bicycle Facilities Grants
Metropolitan Transportation Commission
Transportation Development Act Funds, Article III
Notes to the Financial Statements
For the Year Ended June 30, 2014

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Deferred inflows of resources

A deferred inflow of resources is defined as an acquisition of net position or fund balances applicable to a future reporting period and will not be recognized as an inflow of resources (revenue) until that time. The reimbursement from the Metropolitan Transportation Commission that are not yet available are recorded as deferred inflows of resources since the balances are not current financial resources.

NOTE 3 – COMPLIANCE REQUIREMENTS

The TDA is defined at Chapter 4 of the California Public Utilities Code commencing with Section 99200. Funds received pursuant to Section 99235 of the TDA (Article 3) may only be used for facilities provided for exclusive use by the project.

NOTE 4 – SECTION 99301 – INTEREST EARNED ON ALLOCATED FUNDS

The City incurred and paid expenditures prior to the receipt of the Grant reimbursements; as a result, no interest was earned on Grant funds.

CITY OF PALO ALTO, CALIFORNIA
 Pedestrian/Bicycle Facilities Grants
 Metropolitan Transportation Commission
 Transportation Development Act Funds, Article III

Schedule of Construction Projects with Capital Outlay Expenditures
 For the Year Ended June 30, 2014

The following schedule identifies the projects with capital outlay expenditures during fiscal year 2014:

Title of Project	Project Number	Awards Carried Over from Prior Year	Current Year Allocation/ (Recission)	Total Awards	Cumulative Capital Outlay Expenditures as of June 30, 2013	Current Year Capital Outlay Expenditures	Cumulative Capital Outlay Expenditures as of June 30, 2014	Status of Project
TDA 11-12 Bicycle Detection at Traffic Signals	12001042	\$ 55,597	\$ -	\$ 55,597	\$ -	\$ 55,597	\$ 55,597	Completed
TDA 12-13 Fabian Way Enhanced Bike Lane Improvements	13001027	43,359	-	43,359	15,000	-	15,000	On-going
TDA 13-14 Charleston "Connection Corridor" Pathway Improvement Project	14001039	-	82,712	82,712	-	-	-	On-going
		\$ 98,956	\$ 82,712	\$ 181,668	\$ 15,000	\$ 55,597	\$ 70,597	

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Sacramento

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

**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 *Governmental Auditing Standards* and
the Transportation Development Act**

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

We have audited, in accordance with the 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, the accompanying financial statements of the Pedestrian/Bicycle Facilities Grants (Grants) made to the City of Palo Alto, California (City), by the Metropolitan Transportation Commission, Transportation Development Act Funds, Article III, as of and for the year ended June 30, 2014, and the related notes to the financial statements, and have issued our report thereon dated November 17, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over the Grants' financial reporting (internal control) to determine the auditing procedures that are appropriate in the circumstances 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. 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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Grants' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, including the applicable statutes, rules and regulations of the Transportation Development Act, including Section 6666 of Title 21, of the California Code of Regulations, and the allocation instructions and resolutions of the Metropolitan Transportation Commission, 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* or the Transportation Development Act.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control over compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 17, 2014

**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, 2014

CITY OF PALO ALTO
GENERAL OBLIGATION BONDS CAPITAL PROJECTS FUND
(A Fund of the City of Palo Alto)
For the Year Ended June 30, 2014

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Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Palo Alto General Obligation Bonds Capital Projects Fund (Fund), a fund of the City of Palo Alto, California (City), as of and for the year ended June 30, 2014, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2014, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

As discussed in Note 2(a) to the financial statements, the financial statements present only the Fund and do not purport to, and do not, present fairly the financial position of the City as of June 30, 2014, and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 17, 2014 on our consideration of the City's internal control over the 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 internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over the Fund's financial reporting and compliance.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 17, 2014

CITY OF PALO ALTO
GENERAL OBLIGATION BONDS CAPITAL PROJECTS FUND
(A Fund of the City of Palo Alto)
Balance Sheet
June 30, 2014

Assets	
Restricted cash and investments (Note 3)	<u>\$ 19,368,023</u>
Liabilities and Fund Balance	
Liabilities:	
Accounts payable and accrued liabilities	\$ 5,180,282
Fund Balance:	
Restricted for capital projects	<u>14,187,741</u>
Total liabilities and fund balance	<u>\$ 19,368,023</u>

See accompanying notes to financial statements.

CITY OF PALO ALTO
GENERAL OBLIGATION BONDS CAPITAL PROJECTS FUND
(A Fund of the City of Palo Alto)
Statement of Revenues, Expenditures and
Changes in Fund Balance
For the Year Ended June 30, 2014

Revenues	
Investment income	\$ 47,579
Expenditures	
Capital outlay:	
Downtown Library	580
Mitchell Park Library and Community Center	2,864,959
Main Library new construction and improvements	15,180,921
Temporary Facility	284,262
Total capital outlay	18,330,722
Debt service - interest and fiscal charges	82,370
Total expenditures	18,413,092
Net change in fund balance	(18,365,513)
Fund balance, beginning of the year	32,553,254
Fund balance, end of year	\$ 14,187,741

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 Year Ended June 30, 2014

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 2010 (2010 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 (Project). Proceeds from the 2010 Library Bonds included par of \$55,305,000 and a premium on issue of \$3,766,208 for a total of \$59,071,208. During the fiscal year ended June 30, 2013, the City issued General Obligation Bonds, Election of 2008, Series 2013A (2013A Library Bonds) for the remaining authorized amount of \$20,695,000. The premium on issue was \$1,011,615 for the total proceeds of \$21,706,615.

Specific projects approved by the City Council to be funded by the 2010 and 2013A Library Bonds proceeds are as follows:

Project	Amended Budget	Expenditures Not Charged to Bond Proceeds	As of June 30, 2014		
			Cumulative Bond Eligible Expenditures	Encumbrances Outstanding	Project Balance Remaining
Downtown Library Improvements	\$ 4,208,225	\$ 356,987	\$ 4,163,174	\$ 45,051	\$ -
Mitchell Park Library and Community Center	48,300,843	1,864,673	39,619,458	5,642,996	3,038,389
Temporary Facility	639,858	155,529	504,597	23,861	111,400
Temporary Main Library	622,863	42,355	513,693	4,888	104,282
Main Library New Construction and Improvements	24,453,096	841,665	17,473,271	6,826,158	153,667
Total	<u>\$ 78,224,885</u>	<u>\$ 3,261,209</u>	<u>\$ 62,274,193</u>	<u>\$ 12,542,954</u>	<u>\$ 3,407,738</u>

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES**(a) Reporting Entity**

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, 2014, and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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 Year Ended June 30, 2014

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Basis of Presentation

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.

(c) 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. The City considers revenues susceptible to accrual to be available if the revenues are collected within ninety days after year-end, except for property taxes, which are available if collected within sixty days after year-end.

(d) Fund Balance

Fund balance is reported in specific classifications (nonspendable, restricted, committed, assigned and unassigned), which create a hierarchy primarily based on the extent to which the Fund 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, 2014.

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.

(e) 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 Year Ended June 30, 2014

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 Fund Investment Policy

Pursuant to terms of the 2010 and 2013A Library Bonds 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 are limited to investments permitted by subdivisions (a) to (n), inclusive, of Section 53601 of the California Government Code, which includes U.S. federal securities and the California Asset Management Program (CAMP) Pool. CAMP Pool is an investment pool offered by the California Asset Management Trust (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 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 investment in Federal Home Loan Bank at the fair value. The Fund reports its investments in CAMP Pool at the fair value amounts provided by CAMP, which is the same as the value of the pool share.

(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:

Investment Type	Amount	Maturities	Credit Rating
California Asset Management Program Pool	\$ 11,356,920	37 Days	Not rated
Federal Home Loan Bank	8,000,320	25 Days	AA+
Cash held with U.S. Bank	10,783	Not Applicable	Not Applicable

(c) 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.

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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*

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

We have audited, in accordance with the 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, the financial statements of the City of Palo Alto General Obligation Bonds Capital Projects Fund (Fund), a fund of the City of Palo Alto, California (City), as of and for the year ended June 30, 2014, and the related notes to the financial statements, and have issued our report thereon dated November 17, 2014.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City’s internal control over the Fund’s financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. 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 entity’s financial statements will not be prevented, or detected and corrected on a timely basis. *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.

Our consideration of internal control 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 material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Handwritten signature in black ink that reads "Macias Gini & O'Connell LLP". The signature is written in a cursive, flowing style.

Walnut Creek, California
November 17, 2014

Independent Accountant’s Report on Compliance with Measure N

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

We have examined the City of Palo Alto’s (City) compliance with certain provisions of Measure N for the year ended June 30, 2014 as follows:

- a) Proceeds from the sale of general obligation bonds (Bonds) were used only for the purposes specified in Measure N;
- b) Proceeds from 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, 2014, 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, 2014.

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 & O’Connell LLP
Walnut Creek, California
November 17, 2014

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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, 2014

Current Year Findings:

No matters were noted.

Status of Prior Year Findings:

No matters were noted.

**PALO ALTO PUBLIC IMPROVEMENT
CORPORATION**

(A Component Unit of the City of Palo Alto)

Annual Financial Report
For the Year Ended June 30, 2014

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
For the Year Ended June 30, 2014

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Independent Auditor's Report

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

We have audited the accompanying financial statements of the governmental activities and the major fund of Palo Alto Public Improvement Corporation (Corporation), a component unit of the City of Palo Alto, California (City), as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Corporation's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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 the major fund of the Corporation as of June 30, 2014, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 4 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.

Handwritten signature in black ink that reads "Macias Gini & O'Connell LLP". The signature is written in a cursive, flowing style.

Walnut Creek, California
November 17, 2014

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Management's Discussion & Analysis (Unaudited)
For the Year Ended June 30, 2014

The Palo Alto Public Improvement Corporation (Corporation), a component unit of the City of Palo Alto (City), follows the provisions of Governmental 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 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 one debt issue outstanding and has turned the proceeds over to the City, which pledged certain lease payments as collateral for this debt as discussed in Note 4 to the financial statements.

FISCAL YEAR 2014 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 while the individual fund statements do not.

In fiscal year 2002, the Corporation issued its 2002B Downtown Parking Improvements Certificates of Participation (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.

As of June 30, 2014, the 2002B Downtown Parking Improvements COPs comprise the Corporation's outstanding debt.

At the government-wide level, interest and fiscal agent charges were \$99 thousand for fiscal year 2014, a decrease of \$8 thousand from the prior year. The interest for leases on the assets securing this COP issue was \$101 thousand, a decrease of \$8 thousand from the prior year. The interest on leases from the City exceeded interest expense by \$3 thousand, thereby resulting in an increase in net position of \$3 thousand over the prior year.

The Corporation ended fiscal year 2014 with total assets of \$1.7 million, a decrease of \$0.1 million from the prior year. Total assets consist of \$251 thousand in cash and investments and \$1.4 million of leases receivable from the City of Palo Alto. Total liabilities were \$1.5 million, a decrease of \$0.1 million from the prior year, and included \$176 thousand of current liabilities as well as \$1.3 million of long-term debt due in more than one year.

At the fund level, the Corporation's revenues nearly equaled the expenditures. As of June 30, 2014, the Corporation had one fund, the Debt Service Fund, which reported a \$251 thousand restricted fund balance.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Management's Discussion & Analysis (Unaudited)
For the Year Ended June 30, 2014

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 position and the statement of activities. The statement of net position 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 position 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 along with the notes to the financial statements are called the basic financial statements.

DEBT ADMINISTRATION

The Corporation issues debt in the form of COPs for future lease receipts from the City of Palo Alto. Legally, these COP 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 COP issue.

As of June 30, 2014, the Corporation has one outstanding debt related to the 2002B Downtown Parking Improvement projects with an outstanding balance of \$1.4 million.

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 CORPORATION'S FINANCIAL MANAGEMENT

These Basic Financial Statements are intended to provide citizens, taxpayers, investors, and creditors with a general overview of the Corporation's finances. Questions about these financial 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 Position
June 30, 2014

Assets

Cash and investments held for operations	\$ 12,845
Cash and investments held by trustee	237,955
Investment in leases to the City of Palo Alto	<u>1,430,000</u>
Total assets	<u>1,680,800</u>

Liabilities

Interest payable	30,983
Long-term debt:	
Due in one year	145,000
Due in more than one year	<u>1,285,000</u>
Total liabilities	<u>1,460,983</u>

Net Position

Restricted for debt service	<u><u>\$ 219,817</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, 2014

Expenses

Interest and fiscal agent charges	\$ 98,583
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Program revenues

Interest on leases from the City of Palo Alto	101,400
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Net program revenues	<u>2,817</u>
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General Revenues

Investment earnings	<u>21</u>
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Change in net position	2,838
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Net position, beginning of the year	<u>216,979</u>
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Net position, end of the year	<u><u>\$ 219,817</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)
 Balance Sheet
 Debt Service Fund
 June 30, 2014

Assets

Cash and investments held for operations	\$ 12,845
Cash and investments held by trustee	237,955
Investment in leases to City of Palo Alto	1,430,000
Total assets	<u>\$ 1,680,800</u>

Deferred Inflows of Resources

Unavailable lease receipt from the City of Palo Alto	\$ 1,430,000
--	--------------

Fund balance

Restricted for debt service	<u>250,800</u>
Total liabilities and fund balance	<u>\$ 1,680,800</u>

Reconciliation of fund balance to net position

Fund balance restricted for debt service	\$ 250,800
Accrual adjustment to remove deferred inflows of resources from the balance sheet	1,430,000
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	(30,983)
Long-term debt due within one year	(145,000)
Long-term debt due in more than one year	<u>(1,285,000)</u>
Net position of governmental activities	<u>\$ 219,817</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, 2014

Revenues:

Lease receipts from the City of Palo Alto:

Principal	\$ 130,000
Interest	101,400
Investment earnings	21
Total revenues	231,421

Expenditures:

Debt service:

Principal repayment	130,000
Interest and fiscal agent charges	101,400
Total expenditures	231,400
Net change in fund balance	21
Fund balance, beginning of the year	250,779
Fund balance, end of the year	\$ 250,800

Reconciliation of net change in fund balance to change in net position

Net change in fund balance - debt service fund	\$ 21
--	-------

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 position the repayment reduces long-term liabilities.	130,000
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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 revenues on the statement of activities.

Change in deferred inflows of resources	(130,000)
Change in interest payable	2,817
Change in net position of governmental activities	\$ 2,838

See accompanying notes to financial statements.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Notes to the Basic Financial Statements
For the Year Ended June 30, 2014

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 (City). 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, 2014.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

Government-wide Statements: The statement of net position 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 interest earnings, are presented as general revenues.

Fund Financial Statements: The fund financial statements provide information about the Corporation's funds. The emphasis of fund financial statements is on major individual funds, of which the Corporation only reports one debt service fund.

(b) Major Fund

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.

(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 during the year ended June 30, 2022. The Corporation therefore records the present value of the lease and considers the leased improvement to have been sold for this amount when leased.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Notes to the Basic Financial Statements
For the Year Ended June 30, 2014

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Net Position

The government-wide financial statements utilize a net position presentation. Net position is further categorized as net investment in capital assets, restricted and/or unrestricted. As of June 30, 2014, the entire net position was considered restricted.

Restricted Net Position – 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) Deferred Inflows of Resources

A deferred inflow of resources is defined as an acquisition of net position or fund balances applicable to a future reporting period and will not be recognized as an inflow of resources (revenue) until that time. On the governmental fund balance sheet, the lease receipts from the City corresponding to the debt are recorded as deferred inflows of resources since the balances are not current financial resources. The City considers revenues susceptible to accrual to be available if the revenues are collected within ninety days after year-end, except for property taxes, which are available if collected within sixty days after year-end.

(f) Fund Balances

At June 30, 2014, the Corporation's governmental funds' fund balances include the following classification:

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.

(g) 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.

(h) New Accounting Standards Implemented

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. As of July 1, 2013, the Corporation adopted this GASB statement and reclassified the revenues that were not collected within the availability period from liability to deferred inflows of resources in the government fund financial statements.

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

Notes to the Basic Financial Statements

For the Year Ended June 30, 2014

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 held for purposes of bond reserves.

(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>	<u>Credit Rating</u>
Money Market Mutual Fund	\$ 237,955	38 days	AAAm

(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, 2014 for the Money Market Mutual Funds is AAAM, as provided by Moody's Investors Services.

(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 statutes. 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.

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

Notes to the Basic Financial Statements

For the Year Ended June 30, 2014

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

Authorized Investment Type	Maximum Maturity	Minimum Credit Quality	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
U.S. Government Securities	10 years (*)	N/A	No Limit	No Limit
U.S. Government Agency Securities	10 years (*)	N/A	No Limit (A)	No Limit
				10% of the par value of
Certificates of Deposit	10 years (*)	N/A	20%	portfolio
Bankers Acceptances	180 days	N/A	30%	\$5 million
Commercial Paper	270 days	A-1	15%	\$3 million (B)
				\$50 million per
Local Agency Investment Fund	N/A	N/A	No Limit	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	No Limit
Mutual Funds	N/A	N/A	20%	10%
Negotiable Certificates of Deposit	10 years (*)	N/A	10%	\$5 million
Medium-Term Corporate Notes	5 years	AA	10%	\$5 million
Bonds of State of California Municipal Agencies	10 years (*)	AA/AA2	10%	No Limit

(A) Callable and multi-step securities are limited to no more than 25% of the par value of the portfolio, provided that: 1) the potential call dates are known at the time of purchase, 2) the interest rates at which they "step-up" are known at the time of purchase, 3) the entire face value of the security is redeemed at the call date.

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

(*) The maximum maturity is based on the Investment Policy that is approved by the City Council and is less restrictive than the California Governmental Code.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Notes to the Basic Financial Statements
For the Year Ended June 30, 2014

NOTE 4 – CERTIFICATES OF PARTICIPATION

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

	Balance June 30, 2013	Retirements	Balance June 30, 2014	Amount due in one year
Governmental Activity Debt:				
Certificates of Participation				
2002B Downtown Parking				
2-4%; due 03/01/2022	\$ 1,560,000	\$ 130,000	\$ 1,430,000	\$ 145,000

On January 16, 2002, the Corporation issued the 2002B Downtown Parking Improvements Certificates of Participation (2002B COPs) 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.

The 2002B COPs are payable and secured by lease revenues received by the Corporation from any City of Palo Alto General Fund revenue source.

Future annual debt service on the 2002B COPs is expected to be provided by the lease receipts discussed above, and is shown below:

For the Year Ending June 30,	Principal	Interest Payment	Total Payment
2015	\$ 145,000	\$ 92,950	\$ 237,950
2016	150,000	83,526	233,526
2017	160,000	73,776	233,776
2018	170,000	63,376	233,376
2019	185,000	52,326	237,326
2020 - 2022	620,000	82,226	702,226
	<u>\$ 1,430,000</u>	<u>\$ 448,180</u>	<u>\$ 1,878,180</u>

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

Independent Auditor's Report
and Financial Statements

For the Year Ended
June 30, 2014

**CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT
For the Year Ended June 30, 2014**

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Independent Auditor's Report

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

We have audited the accompanying financial statements of the City of Palo Alto Regional Water Quality Control Plant (Plant), an enterprise operation of the City of Palo Alto, California (City), for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Plant's financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of the Basic Agreement between the City, 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, as described in Note 2 to the financial statements. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the revenues, expenditures and quarterly billings of the Plant for the year ended June 30, 2014, in accordance with the financial reporting provisions of the Basic Agreement between the City, 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, described in Note 2 to the financial statements.

Basis of Accounting

As discussed in Note 2 to the financial statements, the financial statements are prepared in accordance with the financial reporting provisions of the Basic Agreements between the City, City of Mountain View and the City of Los Altos, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Restriction on Use

This report is intended solely for the information and use of the City Council and management of the Cities of Palo Alto, Mountain View and Los Altos, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Macias Gini & O'Connell LLP". The signature is written in a cursive, slightly slanted style.

Walnut Creek, California
November 17, 2014

CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT
Statement of Net Expenditures
For the Year Ended June 30, 2014

	Total	City of Mountain View	City of Los Altos	City of Palo Alto
Direct Expenditures:				
Source control program	\$ 1,075,218	\$ 416,647	\$ 111,608	\$ 546,963
Public outreach	77,138	29,891	8,007	39,240
Permitting and enforcement	1,064,727	290,230	17,172	757,325
Operations and maintenance	11,709,460	4,537,416	1,215,442	5,956,602
System improvement CIP (Note 3)	3,252,622	1,260,391	337,622	1,654,609
Total Direct Expenditures	<u>17,179,165</u>	<u>6,534,575</u>	<u>1,689,851</u>	<u>8,954,739</u>
Indirect Administrative Expenditures (Note 4):				
Source control program	725,716	281,215	75,329	369,172
Public outreach	1,089	422	113	554
Permitting and enforcement	411,477	267,904	15,852	127,721
Operations and maintenance	2,314,768	896,973	240,273	1,177,522
Total Indirect Administrative Expenditures	<u>3,453,050</u>	<u>1,446,514</u>	<u>331,567</u>	<u>1,674,969</u>
Debt Service Expenditures (Note 5):				
Refunding 1990 Series A Bonds	283,420	144,544	22,107	116,769
1999 Wastewater Treatment New Project	541,932	205,338	51,321	285,273
2009 State Water Resource Loan	555,726	210,565	52,627	292,534
Total Debt Service Expenditures	<u>1,381,078</u>	<u>560,447</u>	<u>126,055</u>	<u>694,576</u>
Total Expenditures	22,013,293	8,541,536	2,147,473	11,324,284
Deduct Joint Systems Revenues (Note 6)	<u>(365,520)</u>	<u>(141,639)</u>	<u>(37,941)</u>	<u>(185,940)</u>
Net Expenditures	<u>\$ 21,647,773</u>	<u>\$ 8,399,897</u>	<u>\$ 2,109,532</u>	<u>\$ 11,138,344</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, 2014

	<u>City of Mountain View</u>	<u>City of Los Altos</u>
Billings by Quarter, Beginning:	-	
July 1, 2013	\$ 1,895,430	\$ 476,765
October 1, 2013	2,179,296	544,771
January 1, 2014	1,895,430	476,765
April 1, 2014	<u>2,171,800</u>	<u>534,730</u>
Total quarterly billings	8,141,956	2,033,031
Net expenditures	<u>8,399,897</u>	<u>2,109,532</u>
Excess of total billings over net expenditures	<u>\$ (257,941)</u>	<u>\$ (76,501)</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, 2014

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 share 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, 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 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.

In prior years, commitments representing operating encumbrances with suppliers were included as part of the billing to the Plant's partners. Starting in fiscal year 2014, the Plant did not include commitments in their billing to partners. As a result, the expenditures in the statement of net expenditures represent actual costs incurred and the statement no longer includes a provision for the change in commitments.

Plant expenditures, 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, including indirect administrative expenditures (see Note 4), 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. Revenues from services, fines and penalties are allocated to each of the Members in the same proportions as those of expenditures. 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 regulations from Environmental Protection Agency.

CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT

Notes to the Financial Statements (continued)
For the Year Ended June 30, 2014

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The percentages used for the year ended June 30, 2014, to allocate expenditures 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, operations and maintenance, system improvement CIP and joint system revenues	38.75%	10.38%	50.87%
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%
2009 State Water Resources Loan	37.89%	9.47%	52.64%
Permitting and enforcement	37.81%	2.24%	59.95%

The City is allocated 50.87% 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 of its excess to other entities. Fiscal year 2014 allocations are as follows:

East Palo Alto Sanitary District	6.24%
Stanford University	6.31%
Town of Los Altos Hills	1.41%
Remaining City percentages	<u>36.91%</u>
Total	<u>50.87%</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 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 future 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. For fiscal year 2013-14, the adjusted capital additions limit is \$2,800,893. Actual System Improvement CIP expenditures amounted to \$3,252,622 for fiscal year 2014.

CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT

Notes to the Financial Statements (continued)
For the Year Ended June 30, 2014

NOTE 4 – INDIRECT ADMINISTRATIVE 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 expense and amortization of bond discount reduced by any interest income earned from investments with the fiscal agent, related to the 1999 Series A Bonds (split for the portions used for the “New Project” and refunding of the 1990 Series A Bonds) and the 2009 State Water Resources loan.

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 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. In October 2009, the City approved the 2009 State Water Resources Loan to finance the Ultraviolet Disinfection Project. The outstanding principal amount of debts as of June 30, 2014 are allocated as follows:

	1999 Wastewater Treatment New Project	Refunding of 1990 Series A Bonds	2009 State Water Resources Loan	Total
City of Palo Alto	\$ 1,553,111	\$ 533,521	\$ 2,884,164	\$ 4,970,796
City of Mountain View	1,542,124	1,088,384	2,863,758	5,494,266
City of Los Altos	385,429	166,459	715,750	1,267,638
East Palo Alto Sanitary District	310,948	253,956	577,437	1,142,341
Stanford University	214,082	87,498	397,556	699,136
Town of Los Altos Hills	64,306	4,268	119,418	187,992
Total	<u>\$ 4,070,000</u>	<u>\$ 2,134,086</u>	<u>\$ 7,558,083</u>	<u>\$ 13,762,169</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 May 1, 2013, Ambac Financial emerged from bankruptcy protection which had been filed under Chapter 11 of the Bankruptcy Code in November 2010. Ambac Assurance remains subject to rehabilitation proceedings undertaken by the Wisconsin Office of the Commissioner of Insurance. The City is not certain about the effect of the proceedings, if any, on the Surety Bond.

CITY OF PALO ALTO
REGIONAL WATER QUALITY CONTROL PLANT

Notes to the Financial Statements (continued)
For the Year Ended June 30, 2014

NOTE 6 – JOINT SYSTEM REVENUES

The Plant's joint system revenues for the year ended June 30, 2014 total \$365,520, which consisted of the following:

Salt water marsh services	\$	7,500
Laboratory services from the City's Water Fund		58,660
Septic hauling services		240,731
Other revenues		58,629
		\$ 365,520
		\$ 365,520

NOTE 7 – RELATED PARTY TRANSACTIONS

During fiscal year 2014, the Plant paid the City \$2,218,178 for utility costs. Such costs are included in the Statement of Net Expenditures as source control program, permitting and enforcement, and operations and maintenance expenditures.

Vehicle replacement charges of \$51,957 were paid to the City's Equipment Replacement Fund, which is included in the Statement of Net Expenditures as operations and maintenance expenditures.

CABLE TV FRANCHISE
Independent Auditor's Report
and Statements of Franchise
Revenues and Expenditures

For the Years Ended
December 31, 2013 and 2012

CABLE TV FRANCHISE
For the Years Ended December 31, 2013 and 2012

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Sacramento

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

Independent Auditor's Report

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

We have audited the accompanying Statements of Franchise Revenues and Expenditures of the Cable TV Franchise (Franchise) for the years ended December 31, 2013 and 2012, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting 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 as described in Note 1 of the financial statements. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the revenues and expenditures of the Franchise for the years ended December 31, 2013 and 2012, in accordance with the financial reporting 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, described in Note 1 to the financial statements.

Basis of Accounting

As discussed in Note 1 to the financial statements, the financial statements are prepared in accordance with the financial reporting 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, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to that matter.

Restriction on Use

This report is intended solely for the information and use of the governing bodies and management of 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, and is not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 17, 2014

CABLE TV FRANCHISE
Statements of Franchise Revenues and Expenditures
For the Years Ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Revenues:		
Franchise fees	<u>\$ 1,738,703</u>	<u>\$ 1,691,763</u>
Expenditures:		
Franchise administration	37,672	56,250
Consulting fees	<u>4,335</u>	<u>3,600</u>
Total expenditures	<u>42,007</u>	<u>59,850</u>
Net receipts	<u><u>\$ 1,696,696</u></u>	<u><u>\$ 1,631,913</u></u>

	<u>2013</u>		<u>2012</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
Allocation of Net Receipts:				
City of Palo Alto	\$ 832,656	49.1%	\$ 810,493	49.7%
City of Menlo Park	450,460	26.5%	429,336	26.3%
City of East Palo Alto	165,557	9.8%	160,212	9.8%
Town of Atherton	120,600	7.1%	114,205	7.0%
County of Santa Clara	94,067	5.5%	85,227	5.2%
County of San Mateo	<u>33,356</u>	<u>2.0%</u>	<u>32,440</u>	<u>2.0%</u>
Total	<u><u>\$ 1,696,696</u></u>	<u><u>100.0%</u></u>	<u><u>\$ 1,631,913</u></u>	<u><u>100.0%</u></u>

See accompanying notes to the financial statements.

CABLE TV FRANCHISE
Notes to the Financial Statements
For the Years Ended December 31, 2013 and 2012

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 (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 (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 (AT&T), 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 to Comcast Corporation (Comcast).

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, the Members entered into a Joint Operating Agreement 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 Agreement. The activities are administered by the City and are accounted for within the General Fund and the Technology 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 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 the Financial Statements
For the Years Ended December 31, 2013 and 2012

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 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 acquire, install, and/or maintain equipment to be used in connection with an institutional network defined in the Franchise Agreement.

The settlements and grant have been deposited and are being held by the City and earning interest. The City has since spent a part of the balance on various projects including installing and maintaining the institutional network equipment. As of December 31, 2013, the remaining balance on deposit with the City, including \$5,186 in interest receivable, was \$791,240.



FINANCE COMMITTEE MINUTES

Special Meeting
Tuesday, December 2, 2014

Chairperson Berman called the meeting to order at 6:08 P.M. in the Council Chambers, 250 Hamilton Avenue, Palo Alto, California.

Present: Berman (Chair), Burt, Holman, Kniss

Absent:

Oral Communications

None.

Agenda Items

2. Macias Gini & O'Connell's Audit of the City of Palo Alto's Financial Statements as of June 30, 2014 and Management Letter.

Harriet Richardson, City Auditor, reported the Office of the City Auditor coordinated the annual financial audit as required by the City Charter and the Municipal Code. Macias, Gini & O'Connell (MGO) issued an unmodified opinion for all of the City's basic financial statements. That meant the financial statements were presented fairly in all material respects. MGO made two recommendations for the current year, both pertained to determining actions the City needed to take to comply with new statements issued by the Governmental Accounting Standards Board (GASB). MGO also reported on the status of four prior-year recommendations which pertained to the City's Information Technology (IT) Department.

David Bullock, Macias Gini & O'Connell's (MGO), explained that an unmodified opinion was the highest level of assurance that could be provided by auditors. Restatements resulted from implementing new GASB standards. All estimates were listed in the financial statements. MGO's testing did not disclose material misstatements. MGO passed on one misstatement as they did not believe it was material to the financial statements. Nothing negative occurred during the year. The two current recommendations were not deficiencies but informational. GASB 68, new reporting standards for pensions, would significantly change the reporting of

MINUTES

pensions in financial statements. With respect to the prior year recommendations, the City had been strategically addressing them as a whole. Three remaining items were noted as in progress; although, there was some question whether the Disaster Recovery Plan was in progress or complete.

MOTION: Vice Mayor Kniss moved, seconded by Chair Berman to approve the report on the financial statements as of June 30, 2014.

Council Member Burt was unsure whether the Motion contained the correct action.

Council Member Berman advised that the Finance Committee should forward the financial statements to the Council rather than approve them.

MOTION WITHDRAWN BY THE MAKER AND SECONDER

MOTION: Council Member Kniss moved, seconded by Chair Berman to recommend to the City Council approval of the City of Palo Alto's audited financial statements for the Fiscal Year ending June 30, 2014, and the accompanying reports provided by Macias Gini & O'Connell LLP.

MOTION PASSED: 4-0