CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: PUBLIC SAFETY, FINANCE AND STRATEGIC SUPPORT COMMITTEE

FROM: Scott P. Johnson

SUBJECT: SEE BELOW

DATE: December 20, 2007

Approved Kay Winer

Date 12/12/07

SUBJECT: EXTERNAL AUDITOR'S REPORTS: SINGLE AUDIT REPORTS FOR THE YEAR ENDED JUNE 30, 2007 AND REPORTS TO THE PUBLIC SAFETY, FINANCE, AND STRATEGIC SUPPORT COMMITTEE, FISCAL YEAR ENDED JUNE 30, 2007

RECOMMENDATION

Accept the Single Audit Report and Reports to the Public Safety, Finance and Strategic Support Committee for the fiscal year ended June 30, 2007 as issued by Macias Gini & O'Connell LLP, the City's external auditor.

BACKGROUND

Attached for the Public Safety, Finance and Strategic Support Committee's (Committee) review are the Single Audit report for the year ended June 30, 2007 and Reports to the Committee for the City, the Retirement Plans, Hayes Mansion and Team San Jose. Each report is discussed briefly as follows:

Single Audit Reports

The Single Audit Act of 1984 was enacted to simplify the process of auditing federal grants administered by state, local governments and non-profit organizations by combining all federal grants under one audit instead of each Federal Agency performing separate audits.

As part of the annual audit process, the independent auditing firm audits the City's federal grant programs to ensure compliance with federal requirements as specified in the Single Audit Act of 1984 as amended. Based on the audit, the independent auditor issues a Single Audit Report to the City Council. The attached Single Audit Report contains the auditor's findings, recommendations and the City's response and corrective action plans as appropriate.

Report to the Committee

The independent auditing firm conducts an audit for the purpose of expressing an opinion on the City's general purpose financial statements. Accordingly, the auditor's work includes an examination of the internal controls of the City. During the audit, the auditor also looks at the financial and management organization and other operational matters to determine if they can make recommendations for improvements or other operating efficiencies.

Based on this work, the auditor issues A Report to the Public Safety, Finance and Strategic Support Committee. The attached Report contains the external auditor's recommendations as well as the appropriate departmental responses noting action to be taken, where necessary.

ANALYSIS

Single Audit Reports

Macias, Gini & O'Connell, LLP audited the City's federal grant program, including the Airport's Passenger Facility Charges, for the fiscal year ended June 30, 2007. The audit was conducted in accordance with Generally Accepted Auditing Standards and Government Auditing Standards. The auditor reviewed the City's internal controls in light of compliance requirements applicable to each of its major federal programs and to the passenger facilities charges program. No material weaknesses were identified.

The Single Audit Act requires any audit finding and/or questioned cost be incorporated into the Single Audit Report along with a corrective action plan. This year's report lists three findings of lesser magnitude than material weaknesses for which the auditor recommends corrective action. City management has established a corrective action plan for each finding and its responses to the findings are included in the report. The Single Audit Act also requires a status report on any prior year findings, which is also included in the current year's Single Audit.

Report to the Committee

Macias, Gini & O'Connell, LLP audited the City's general purpose financial statements for the fiscal year ended June 30, 2007 in accordance with generally accepted auditing standards and issued their opinion that the financial statements were presented fairly in conformity with generally accepted accounting principles. The financial statements and the Auditor's Report on the financial statements were presented to the Committee at its November 15, 2007 meeting and subsequently accepted by the City Council on December 4, 2007.

During the course of the audit, the auditor conducted a limited examination of the City's internal controls and management practices. The auditor looked for material weakness or reportable conditions that would require immediate disclosure to the Council in accordance with generally accepted auditing standards. The auditor's Report to the Committee for fiscal year ended June 30, 2007 contains both findings for the 2006-07 year and also notes upcoming financial reporting pronouncements which will impact the City's financial statements in subsequent years.

Staff's response to the auditor's findings and other communications is included in the attached report. Finally, the auditors report also contains a status report of prior year findings for the Committee's consideration.

PUBLIC OUTREACH

Not Applicable.

COORDINATION

The departments of Housing, Retirement, Transportation, Office of Emergency Services, and the City Auditor's Office and Hayes Mansion and Team San Jose have reviewed and commented on these reports and the auditor's findings.

SCOTT P. JOHNSON
Director, Finance Department

Attachment

SAN JOSE CONVENTION AND CULTURAL FACILITIES
(An Activity of the City of San José)

Public Safety, Finance &
Strategic Support Committee

Fiscal Year Ended
June 30, 2007

SAN JOSE CONVENTION AND CULTURAL FACILITIES

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

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MGO
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Members of the Public Safety, Finance &
Strategic Support Committee and
San José City Council
San José, California

In planning and performing our audit of the financial statements of the San José Convention and Cultural Facilities (the Center), an activity of the City of San José (the City), as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the Center's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the governmental unit's internal control. Accordingly, we do not express an opinion on the effectiveness of the governmental unit's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies as listed as items 2007-A, 2007-B, and 2007-C to be significant deficiencies in the Center's internal control. In addition, we noted other matters involving the internal control and its operation that we have reported to management as listed in the table of contents.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the deficiencies listed as items 2007-A and 2007-B constitute material weaknesses.

The Center's written response to the findings identified in our audit is described in the Schedule of Comments and Responses. We did not audit the Center's responses and, accordingly, we express no opinion on it. In addition, we have already discussed our comments and recommendations with various Center personnel, and we would be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing these recommendations.

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

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

Very truly yours,

MACIAS GINI & O'CONNELL LLP

Macias Gini & O'Connell LLP

Certified Public Accountants
Walnut Creek, California

October 30, 2007

SAN JOSE CONVENTION AND CULTURAL FACILITIES

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

REQUIRED COMMUNICATIONS

We have audited the financial statements of the San José Convention and Cultural Facilities (the Center), an activity of the City of San José (the City) as of and for the year ended June 30, 2007. Professional standards require that we provide you with the following information related to our audit.

I. The Auditor's Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our Engagement Communications section of our General Audit Plan dated June 29, 2007, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free from material misstatements and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

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

II. Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our contract with the City, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Center are described in Note 2 to the Center's financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2007. We noted no transactions entered into by the Center during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

III. Accounting Estimates

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:

- Estimated allowance for losses on accounts receivable
- Depreciation estimates for capital assets, including depreciation methods and useful lives assigned to depreciable property

Management's judgments and estimates were based on the following:

- Estimated allowances for losses on accounts receivable were based on the direct write-of method.
- Useful lives for depreciable property were determined by management based on the nature of the capital asset.

REQUIRED COMMUNICATIONS

III. Accounting Estimates (Continued)

We evaluated the key factors and assumptions used to develop these accounting estimates in determining that they are reasonable in relation to the financial reporting units that collectively comprise the Center's financial statements.

IV. Audit Adjustments

For the purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Center's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Center, either individually or in the aggregate, indicate matters that could have a significant effect on the Center's financial reporting process except as discussed as items 2007-A and 2007-B. In addition, the attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the individual financial reporting units that collectively comprise the Center's financial statements.

V. Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter 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.

VI. 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 Center'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.

VII. Issues Discussed with Management Prior to Our Retention

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 Center's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

VIII. Difficulties in Performing the Audit

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

SCHEDULE OF COMMENTS AND RESPONSES

INTRODUCTION

In May 2006, the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) issued Statement on Auditing Standards No. 112, *Communicating Internal Control Related Matters Identified in an Audit* (SAS112). SAS112 was designed to make the standards consistent with those already in place for publicly-traded companies by establishing a standard for determining seriousness of a control issue and classifying it into one of three categories:

- Control deficiency
- Significant deficiency (replaces old term "reportable condition")
- Material weakness.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

A *significant deficiency* is a control deficiency or a combination of control deficiencies such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.

A *material weakness* is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

These definitions redefined and/or replaced the old definitions – management letter comment; reportable condition and material weakness as follows.

Old Definitions	New Definitions
Material weakness	**Material weakness**
Reportable condition	**Significant deficiency**
Management letter comment (under Yellow Book only)	**Other matters related to internal control**

This new pronouncement significantly increases the likelihood that an auditor may be required to report either a "significant deficiency" or a "material weakness" in conjunction with the financial statement audit.

SCHEDULE OF COMMENTS AND RESPONSES

Item #2007 A - Material Weakness #1
Reconciliation of the City Subsidy

The City provides an operating subsidy to the San Jose Convention and Cultural Facilities (Center) to subsidize the operating losses generated from the Center's activities. The City subsidy is funded from a portion of the City's Transient Occupancy Tax and revenues from City parking garages located at the Center. The Center records the City's subsidy as a direct contribution to its equity accounts thereby understating its annual financial activity. Generally accepted accounting principles require that these subsidies be recorded as part of the Center's financial activity as an addition to net assets. In addition, we noted that the Center's trial balance did not capture fire insurance expenses paid directly by the City as part of the Center's annual subsidy from the City.

We recommend the Center modify the chart of accounts to add operating accounts that record and track the different types of subsidies and withdrawals. In addition, we recommend that the Convention Center perform monthly reconciliations of the City subsidy and expenses paid directly by the City to verify that the amounts recorded in the general ledger agrees to the amounts reported by the City.

Management Response:

It has been the Center's practice to record the City's subsidy at the balance sheet level via equity accounts. In order for subsidy transactions to flow through to the operating statement, the Center will add operating accounts to its chart of accounts.

The City does communicate to the Center when funds are transferred from the cash receipts bank account ("Receipts Account") to reimburse the City for costs, primarily City payroll, incurred by the City on the Center's behalf. The City subsidizes the portion of the transfer only to the extent that funds are insufficient in the Receipts Account to transfer to the City. In addition, the City and Team San Jose (TSJ) each perform bank reconciliations on the Receipts Account, and during this process, the City and the Center communicate to each other on transfers in and out of the Receipts Account.

The City will reconcile all expenses paid directly by the City on behalf of the Center, including expenses that will not be reimbursed by the Center (those considered a subsidy or contribution from the City), to assure the transactions are included on the Center's records.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

Item #2007 B - Material Weakness #2
Reconciliation of Detailed Schedules to the General Ledger

As part of the Center's year end closing procedures, the Center prepares detailed schedules to support its reported financial statement balances. During our audit, we noted that the Center's detailed schedules did not agree to the reported financial statement amounts. For example, the Center's manual capital asset schedules did not agree to the depreciation expense nor to the capital asset classifications (depreciable and nondepreciable capital assets) reported. In addition, the Center does not record recurring financial transactions consistently making it difficult for reviewers to identify the transactions' purpose, prepare financial analysis, and correct unusual items.

We recommend the Center ensure that all detailed schedules are prepared and reconciled to the financial statement balances prior to the audit. In addition, the Center should designate an individual in the organization who is responsible to review these schedules during its monthly and year-end closing process.

Management Response:

Management believes the issue is that adjustments to the detailed schedules resulting in the financial statement balances were not clearly documented or readily identifiable on the schedules. The Center will reconcile the detailed schedules to the financial statements in a clear and concise manner, and the reconciliations will be reviewed by the Center's Chief Financial Officer ("CFO") prior to the audit.

Item #2007 C - Significant Deficiency #1
Calculation of Allowance for Doubtful Accounts

The Center uses a direct write-off method for identifying bad debts. Under this method, the actual amount of uncollectible accounts receivable is deducted from the sales revenue in the accounting period in which the Convention Center determines to be uncollectible, instead of creating a provision for them in the period in which those sales occurred. Although this method is based on facts instead of estimates, it goes contrary to the matching concept of accounting and is generally not acceptable for financial reporting purposes.

We recommend that management create a provision for its doubtful accounts during the period in which the sales occur. This provision is normally estimated based on a percentage of sales or percentage of outstanding receivables. As the Center develops a longer collection history, the calculation of the allowance can be modified to reflect its collection trends.

Management Response:

Management would like to respond that the direct write-off method is simple to use and in management's opinion does not misstate the value of accounts receivable at year end. However, as the auditors point out this method does not match revenues and expenses properly and is not acceptable for financial reporting purposes. Consequently, based on the auditors observation and recommendation, management will implement an "allowance for doubtful accounts" policy for recognizing bad debt expense and valuing accounts receivable beginning with fiscal year 2007-08.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

SAN JOSE CONVENTION CENTER (Continued)

Item #2007 D - Other Internal Control Matter #1
Journal Entry Process

The Center's journal entries for recurring items such as insurance do not regularly have supporting documentation to validate the entry. All journal entries should be required to have supporting documentation prior to posting. In addition, journal entries are to be reviewed and approved by the CFO prior to posting. During our testing, we found 1 transaction out of a sample of 25 transactions (or an exception rate of 4%) that did not indicate the CFO's approval.

We recommend that the Center require employees to follow the procedures implemented for the journal entry process. Failure to follow these procedures raises the risk of misstatements.

Management Response:

Concerning recurring journal entries, supporting documentation that supports the entry will be present in a file and available for review. Staff believes that this approach is efficient, practical and provides the necessary level of internal control. With respect to Chief Financial Officer (CFO) journal entry approval staff would note that the CFO approves all journal entries prior to posting to the general ledger. Staff is of the opinion that current procedures are adequate, and that the one exception noted by the auditors was an oversight and not a systemic failure to follow procedures.

Item #2007 E - Other Internal Control Matter #2
Application of Discounts

The Center provides discounts to customers who purchase a sufficient amount of other services such as food and beverage, and internet services. The discounts are recorded to other income rather than building revenues, leading to an overstatement of building revenues and an understatement of other income.

Given that the discounts apply to building revenues, we recommend that the Center record these discounts in building revenues rather than other income. This will prevent the misstatement of other revenue line items.

Management Response:

Staff agrees with the auditors finding and recommendation and effective July 1, 2007, the Center started recording discounts provided to customers (clients who purchase a sufficient amount of other services) against building revenues rather than other income.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

Item #2007 F - Other Comment #1
Developing a Disaster Recovery Plan

The Center's management does not have a well-defined, written disaster recovery plan. While the Center's new management started in July 2004, the time to make contingency plans is before disaster strikes, such as a fire, earthquake or terrorist act. It is important that all personnel be aware of their responsibilities in the event of an emergency to minimize the negative affect on operations.

We recommend that the City require management to develop a disaster recovery plan to better plan for future emergencies.

Management Response:

The Center agrees that having a well defined, written disaster recovery plan is important. In addition, the Center agrees that having this plan properly communicated to all personnel is key to a smooth operation during an emergency. The Center will work with the City to develop a well-defined, written disaster recovery plan.

SAN JOSE CONVENTION AND CULTURAL FACILITIES

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS

PJE #	Account Name	Account Number	Debit	Credit
1	Contributions from the City of San Jose	999-00-00	175,561.00	
	Other expenses	612-51-10		175,561.00
	To reconcile the City contributions recorded in the Center's general ledger to the detailed schedule provided by the City.			

HAYES MANSION
CONFERENCE CENTER

Public Safety, Finance &
Strategic Support Committee

Fiscal Year Ended
June 30, 2007

HAYES MANSION CONFERENCE CENTER

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

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Members of the Public Safety, Finance &
Strategic Support Committee and
San José City Council
San José, California

In planning and performing our audit of the financial statements of the Hayes Mansion Conference Center (the Center) as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the Center's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the governmental unit's internal control. Accordingly, we do not express an opinion on the effectiveness of the governmental unit's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Center's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. However, we identified the deficiencies listed as items 2007-A, 2007-B, and 2007-C to be significant deficiencies in the Center's internal control. In addition, we noted other matters involving the internal control and its operation that we have reported to management as listed in the table of contents.

The Center's written response to the findings identified in our audit is described in the Schedule of Comments and Responses. We did not audit the Center's responses and, accordingly, we express no opinion on it. In addition, we have already discussed our comments and recommendations with various Center personnel, and we would be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing these recommendations.

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

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

Very truly yours,

MACIAS GINI & O'CONNELL LLP

Macias Gini & O'Connell LLP

Certified Public Accountants
Walnut Creek, California

September 24, 2007

HAYES MANSION CONFERENCE CENTER

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

REQUIRED COMMUNICATIONS

We have audited the financial statements of the Hayes Mansion Conference Center (Center) as of and for the year ended June 30, 2007. Professional standards require that we provide you with the following information related to our audit.

I. The Auditor's Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our Engagement Communications section of our General Audit Plan dated June 29, 2007, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free from material misstatements and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

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

II. Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our contract with the City, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Center are described in Note 2 to the Center's financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2007. We noted no transactions entered into by the Center during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

III. Accounting Estimates

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:

- Estimated allowance for losses on accounts receivable
- Depreciation estimates for capital assets, including depreciation methods and useful lives assigned to depreciable property

Management's judgments and estimates were based on the following:

- Estimated allowances for losses on accounts receivable were based on historical experience.
- Useful lives for depreciable property were determined by management based on the nature of the capital asset.

REQUIRED COMMUNICATIONS

III. Accounting Estimates (Continued)

We evaluated the key factors and assumptions used to develop these accounting estimates in determining that they are reasonable in relation to the financial reporting units that collectively comprise the Center's financial statements.

IV. Audit Adjustments

For the purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Center's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Center, either individually or in the aggregate, indicate matters that could have a significant effect on the Center's financial reporting process. In addition, the attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the individual financial reporting units that collectively comprise the Center's financial statements.

V. Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter 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.

VI. 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 Center'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.

VII. Issues Discussed with Management Prior to Our Retention

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 Center's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

VIII. Difficulties in Performing the Audit

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

HAYES MANSION CONFERENCE CENTER

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

SCHEDULE OF COMMENTS AND RESPONSES

INTRODUCTION

In May 2006, the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) issued Statement on Auditing Standards No. 112, *Communicating Internal Control Related Matters Identified in an Audit* (SAS112). SAS112 was designed to make the standards consistent with those already in place for publicly-traded companies by establishing a standard for determining seriousness of a control issue and classifying it into one of three categories:

- Control deficiency
- Significant deficiency (replaces old term "reportable condition")
- Material weakness.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

A *significant deficiency* is a control deficiency or a combination of control deficiencies such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.

A *material weakness* is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

These definitions redefined and/or replaced the old definitions – management letter comment; reportable condition and material weakness as follows.

Old Definitions	New Definitions
Material weakness	**Material weakness**
Reportable condition	**Significant deficiency**
Management letter comment (under Yellow Book only)	**Other matters related to internal control**

This new pronouncement significantly increases the likelihood that an auditor may be required to report either a "significant deficiency" or a "material weakness" in conjunction with the financial statement audit.

SCHEDULE OF COMMENTS AND RESPONSES

Item #2007 A - Significant Deficiency #1
Communication of Pay Rate Changes

During our test of controls over payroll, we selected a transaction where the employee received an overpayment of a salary increase. A lack of coordination between the Human Resources Department and the Payroll Department resulted in two payments for the retroactive period of the pay-rate increase.

We recommend that the Center implement procedures that require pay-rate increases be documented and communicated by Human Resources Department to Payroll Department. Payroll can then communicate pay rate changes to ADP. A lack of controls over the communication of changes in pay rates could result in future errors.

Management Response:

Procedures have been put into place requiring the Human Resources Department to notify the Payroll Department in writing of all pay rate changes and/or status changes. In addition, any related communications with ADP will be initiated by the Payroll Department. Staff believes that these additional procedures will address the issues of overpayment and lack of coordination noted by the auditors.

Item #2007 B - Significant Deficiency #2
Reconciliation of Debt Service Expenses

During our testing of debt service reimbursements, we noted that the Center records its debt service reimbursements based on the City's annual budgeted amounts. Included in the budget are interest payments on the Center's variable rate debt. The Center's does not adjust the estimated debt service reimbursement payments to the actual debt service payments made.

We recommend that management reconciles the actual amount of interest paid on the bonds during the fiscal year with the budgeted amount of interest recorded and records an adjustment for the difference.

Management Response:

Management will reconcile actual debt service payments versus budgeted debt service reimbursements during each fiscal year and make any necessary adjustments to reflect accurate debt service repayments on the Center's financial statements.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

Item #2007 C - Significant Deficiency #3
Journal Entry Process – Approval Process

Journal entries are generally initiated, prepared and posted by the Assistant Controller and reviewed and approved by the Controller. This does not provide sufficient segregation of duties as a possibility exists for journal entries to be posted without the Controller's approval and go undetected. This possibility exists because the Assistant Controller has the ability to prepare and post the journal entries without seeking approval from the Controller.

We recommend that the Center require the posting of journal entries to be made by a person that is neither the Controller nor Assistant Controller. If limiting the Assistant Controller's function is not possible with the current finance system, then a procedure should be instituted that requires the Controller to sign-off a log of all entries posted each month to ensure that each one was approved.

Management Response:

A listing of journal entries processed without the Controller's approval will be submitted to the Controller for review each month. The Controller will document such review. In addition, staff would note that financial statements have been and are scrutinized on a monthly basis by the Dolce Strategic Team, City staff and the City's consultant; thereby providing an alternative internal control procedure.

Item #2007 D - Other Internal Control Matter #1
Journal Entry Process – Record Keeping

During our internal controls testing of a sample of twenty-five journal entries, we noted the following three transactions that did not have adequate supporting documentation:

- Two reclassifications entries and
- One entry to record the Winchester Mystery House ticket sales.

Supporting documentation is necessary to ensure accuracy and completeness of the journal entries.

We recommend the Center's Accounting Department implement formal procedures that require supporting documentation to be attached to each journal entry. This procedure should be applied to all non-recurring and reclassifying journal entries.

Management Response:

The procedure for providing supporting documentation for all journal entries, as noted by the auditors, has been reviewed with the accounting staff and will be followed for all journal entries on a go-forward basis.

Item #2007 E - Other Internal Control Matter #2
Capitalization Policy

During our capital assets testing, we noted that the Center classified transactions related to a mutli-year project that are not placed in operations in the current year as a depreciable asset subject to deprecation computations. Items that are not ready to be placed in operation should be classified as nondepreciable capital assets .

We recommend the Center analyze its capital asset activity each year to properly classify its capital asset additions. Individual purchases not identified as part of a project should be capitalized if it meets the Center's capitalization policy. Individual purchases identified as part of a project should be added to a nondepreciable category, such as construction in progress, until the project is complete and placed into service.

Management Response:

Effective fiscal year 2007-08, the Center will accumulate project related costs in a construction in progress account until the project is complete and the asset is placed in service, at which time the accumulated project cost will be transferred to the appropriate depreciable capital asset account.

HAYES MANSION CONFERENCE CENTER

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS

PJE #	Account Name	Account Number	Debit	Credit
1	Bad debt	81120.85-85	350.24	
	Provision for doubtful accounts	12290		350.24
	To write off the discounted portion of a receivable balance in order to resolve a disputed invoice.			
2	Guest ledger	12100	31,313.09	
	Advance deposits - hotel	22000		31,313.09
	To reclass the credit balances in the Guest Ledger to deferred revenues			
3	Incentives	25020	2,069.76	
	Accrued - incentive pay	69950.10-10		2,069.76
	To increase accrued incentive pay and related incentive expense to agree to the total amount on the schedule recalculated subsequent to June 30, 2007.			
4	Benefits	71000.85-85	3,010.97	
	Accrued 401(k) savings plan	25060		3,010.97
	To accrue 401(k) expenses from June 24, 2007 through June 30, 2007 that were included as part of the pay period ending July 7, 2007.			
5	Audit/accounting/consulting	81060.85-85	1,750.00	
	Accrued expense - other	25290		1,750.00
	To accrue the Hutchinson consulting fees for the month of June 2007.			
6	Electricity	86100.87-87	15,501.37	
	Gas	86200.87-87	2,952.64	
	Accrued expense - other	25290		18,454.01
	To accrue the PG&E utilities used from June 21 through June 30, 2007 that were included in the invoice covering the service period from June 21 through July 21, 2007.			
7	Construction in progress		28,705.48	
	Accumulated depreciation - FF&E	17020	2,598.00	
	Furniture and equipment	16020		28,705.48
	Depreciation/amortization	88700.89-89		2,598.00
	To reclass the open project costs for the soft goods and signage upgrade from the Furniture and Equipment account to the Construction in Progress account.			
8	Accumulated depreciation - FF&E	17020	584.00	
	Equipment repair	82020.10-10	2,765.41	
	Furniture and equipment	16020		2,765.41
	Depreciation/amortization	88700.89-89		584.00
	To expense the additions in capital assets that fell below the $5,000 minimum threshold for capitalization.			
9	Miscellaneous receivables	12230	2,076.92	
	Spa standard monthly rent	46860.60-68		2,076.92
	To record deferred revenue for the spa operating lease.			
10	Suspense account	12203	29,926.69	
	Accrued expense - other	25290		29,926.69
	To reverse the amounts recorded to suspense that should have been recorded to revenues. The amount is reclassed to accrued expense because a second adjustment was posted by the client to record the revenue earned.			
11	Hayes debt and bond service	88500	149,631.75	
	City of SJ subsidy	88750		149,631.75
	To adjust the debt service payments made by Hayes Mansion to the City of San Jose to agree to the actual amounts calculated in the debt service schedules at June 30, 2007.			

CITY OF SAN JOSE, CALIFORNIA

Single Audit Reports

Basic Financial Statements with
Federal Compliance Section

For the Year Ended June 30, 2007

CITY OF SAN JOSE, CALIFORNIA

For the Year Ended June 30, 2007

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CITY OF SAN JOSE, CALIFORNIA

For the Year Ended June 30, 2007

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City Council
City of San José, California

Independent Auditor's Report

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California (the City), as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of San José, California, as of June 30, 2007, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note I.E. to the financial statements, the City adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 26, 2007, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis, the budgetary comparison information and the schedules of funding progress listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and do not express an opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards and schedule of revenues and expenditures of passenger facility charges are presented for purposes of additional analysis as required by OMB Circular A-133 and the *Passenger Facility Charges Audit Guide for Public Agencies,* respectively, and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Macias Gini & O'Connell LLP
Certified Public Accountants

Walnut Creek, California
October 26, 2007

Management's Discussion and Analysis

Management's Discussion and Analysis (MD&A) provides an overview of the City of San José's activities and financial performance for the fiscal year ended June 30, 2007. We encourage readers to read the MD&A in conjunction with the basic financial statements that immediately follow it, with the transmittal letter at the beginning of the Introductory Section, and with other portions of this Comprehensive Annual Financial Report. All amounts have been rounded to the nearest one hundred thousand dollars and one tenth of a percent.

FINANCIAL HIGHLIGHTS

- Total assets exceed total liabilities at June 30, 2007 by $7.023 billion (net assets). Of this amount, unrestricted net assets of $330.0 million may be used to meet the City's ongoing obligations to citizens and creditors. In addition, restricted net assets of $749.4 million are dedicated to specific purposes and $5.944 billion is invested in capital assets, net of related debt.
- Total net assets decreased by $233.5 million or 3.2 percent during 2006-07 from $7.257 billion to $7.023 billion. Depreciation expense of $381.0 million accounts for this decrease. Excluding depreciation, net assets increased by $147.5 million.
- Governmental funds reported combined ending fund balances of $1.382 billion at June 30, 2007, which are $24.7 million or 1.8 percent more than the June 30, 2006 balances. Increases in fund balances for the General Fund ($43.6 million), and other nonmajor funds ($59.2 million) were partially offset by the fund balance decreases of the Redevelopment Agency ($5.7 million), Housing Activities ($42.2 million), San José Financing Authority Debt Service ($16.4 million) and Special Assessment Districts ($13.8 million). Unreserved fund balance comprises $806.6 million or 58.4 percent of combined governmental fund balances at June 30, 2007 and is available to meet the City's current and future spending needs at its discretion.
- Unreserved fund balance for the General Fund is $244.9 million at June 30, 2007 and represents 38.7 percent of total General Fund expenditures during 2006-07.
- Total long-term obligations increased by $68.3 million during 2006-07 to $4.319 billion at June 30, 2007, an increase of 1.6 percent over the amount at June 30, 2006. Primary factors leading to this increase during the year include the issuance of general obligation bonds and the issuance of Redevelopment Agency tax allocation bonds used primarily to advance refund a portion of other tax allocation bonds.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis provides an introduction to the City of San José's basic financial statements which are comprised of four components:

- Government-wide Financial Statements
- Fund Financial Statements
- Notes to the Basic Financial Statements
- Required Supplementary Information.

In addition, this report also contains other supplementary information.

Government-wide Financial Statements

Government-wide Financial Statements provide readers with a broad overview of the City of San José's finances in a manner similar to that of a private-sector business.

The ***statement of net assets*** presents information on all assets and liabilities and reports the difference between the two as *net assets.* Over time, increases or decreases in net assets may serve as a useful indicator of whether the City's financial position is improving or deteriorating.

The ***statement of activities*** presents information showing how the net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods. Examples include revenues pertaining to uncollected taxes and expenses pertaining to earned but unused vacation and sick leave.

Both of these government-wide financial statements address functions that principally are supported by taxes and intergovernmental revenues (*governmental activities)* and other functions that intend to recover all or in part a portion of their costs through user fees and charges (*business-type activities).* The governmental activities of the City of San José include general government, public safety, capital maintenance, community services, and sanitation. Its business-type activities include airport, wastewater treatment, water supply, and various parking management operations.

The government-wide financial statements include not only the primary government of the City of San José, but also a legally separate redevelopment agency and three legally separate financing authorities for which the City is financially accountable.

Fund Financial Statements

Fund Financial Statements report information about groupings of related accounts used to maintain control over resources segregated for specific activities or objectives. As do other state and local governments, the City of San José uses fund accounting to ensure and demonstrate finance-related legal compliance. Each City fund falls into one of three categories: *governmental funds, proprietary funds,* or *fiduciary funds*.

Governmental funds account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows* and *outflows of spendable resources,* as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating the City of San José's capacity to finance its programs in the near future.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate comparison between *governmental funds* and *governmental activities.*

The governmental funds balance sheet and the governmental funds statement of revenues, expenditures and changes in fund balances present information separately for the General Fund, Redevelopment Agency, Housing Activities, Special Assessment Districts, and the San José Financing Authority Debt Service, which are all classified as major funds. These statements also report several individual governmental funds classified as nonmajor funds such as special revenue, debt service, and capital projects funds which are combined into a single, aggregated presentation. Individual fund data for each of the nonmajor governmental funds is provided in the form of *combining statements* elsewhere in this report.

The City of San José adopts an annual appropriated budget for its General Fund and Housing Activities. This report includes budgetary comparison statements to demonstrate compliance with these budgets.

Proprietary funds generally account for services charged to external or internal customers through fees. Proprietary funds provide the same type of information as shown in the government-wide financial statements for *business-type activities*, only in more detail. The City of San José accounts for its airport, wastewater treatment, water supply, and parking management operations in proprietary funds.

Fiduciary funds account for resources held for the benefit of City of San José employees and outside parties in a similar manner as that for proprietary funds. Pension plan trust funds, private purpose trust funds, and agency funds are reported as fiduciary funds. The government-wide financial statements do not include fiduciary funds as their resources are not available to support City of San José programs.

Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Required Supplementary Information includes the budgetary schedules for General Fund and Housing Activities. In addition, pension schedules present the City of San José's progress towards funding its obligation to provide future pension benefits for its active and retired employees.

Combining and individual fund statements and schedules referred to earlier provide information for nonmajor governmental funds and fiduciary funds and are presented immediately following the required supplementary information.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Analysis of net assets: As noted earlier, net assets may serve as a useful indicator of a government's financial position. For the City of San José, assets exceeded liabilities by $7.023 billion at the June 30, 2007 close of the current fiscal year.

The following table is a condensed summary of the City's net assets for governmental and business-type activities:

Statement of Net Assets
June 30, 2007 and 2006
(in thousands)

	Governmental Activities		Business-type Activities		Totals	
	FY 2007	FY 2006	FY 2007	FY 2006	FY 2007	FY 2006
Assets:						
Current and other assets…….. $	1,839,606	1,754,132	597,993	679,995	2,437,599	2,434,127
Capital assets………………….	7,952,920	8,163,242	1,374,028	1,230,239	9,326,948	9,393,481
Total assets…………….	9,792,526	9,917,374	1,972,021	1,910,234	11,764,547	11,827,608
Liabilities:						
Current and other liabilities…..	321,904	283,173	100,591	37,235	422,495	320,408
Long-term liabilities……………	3,696,129	3,603,842	622,542	646,505	4,318,671	4,250,347
Total liabilities…………	4,018,033	3,887,015	723,133	683,740	4,741,166	4,570,755
Net assets:						
Invested in capital assets, net of related debt…………	5,193,578	5,402,375	750,334	689,045	5,943,912	6,091,420
Restricted net assets…………	501,391	735,931	248,039	279,505	749,430	1,015,436
Unrestricted net assets……….	79,524	(107,947)	250,515	257,944	330,039	149,997
Total net assets……….. $	5,774,493	6,030,359	1,248,888	1,226,494	7,023,381	7,256,853

At June 30, 2007, the City of San José reported positive balances in all three categories of net assets, both for the City as a whole, as well as for its separate governmental and business-type activities.

At $5.944 billion, investment in capital assets (infrastructure, land, buildings, other improvements, vehicles, and equipment, less outstanding debt used to acquire them) comprise 84.6 percent of the City of San José's total net assets. Since these assets are not liquid and they provide services to citizens, they are not available for future spending.

Of the total net assets, $330.0 million or 4.7 percent represents unrestricted net assets available for meeting the City's ongoing obligations to citizens and creditors. Governmental activities show a positive balance of $79.5 million in unrestricted net assets and business-type activities show a positive balance of $250.5 million. An additional portion of the City's net assets representing $749.4 million or 10.7 percent of the total are subject to legal restrictions on their use.

During 2006-07, the City of San José's net assets decreased by $233.5 million or 3.2 percent. Nonetheless, revenues increased at a faster rate than expenses during the year which narrowed the revenue shortfall for 2006-07. This is an improvement over 2005-06 when expenses outpaced revenues by $247.1 million.

Notable changes in the statement of net assets between June 30, 2007 and June 30, 2006 include:

- Capital assets decreased by $66.5 million or less than 1.0 percent compared to the prior fiscal year. Governmental capital assets decreased by $210.3 million, but were partially offset by an increase in business-type capital assets of $143.8 million. The decrease in governmental capital assets resulted from asset additions of $154.4 million less $339.9 million in depreciation expense for major infrastructure and other assets and asset deletions of $24.8 million. The majority of the increase in business-type capital assets was due to continued airport expansion construction projects in the amount of $126.3 million and a sewer improvement project of $36.0 million.

- Current and other assets increased by $3.5 million or less than 1.0 percent due to an $85.5 million increase for governmental activities offset by an $82.0 million decrease for business-type activities. The increase for governmental activities primarily resulted from unspent general obligation bond proceeds for capital projects. Conversely, bond proceeds expended on airport capital projects caused the decrease for business-type activities.

- Long-term liabilities increased by a net amount of $68.3 million or 1.6 percent principally due to the issuance of general obligation bonds for $90.0 million.

- Current and other liabilities for the City increased by $102.1 million or 31.9 percent. Increases of $39.9 million in accounts payable due to timing, $33.3 million in short term notes payable due to the Airport commercial paper program, and $15.2 million in short term notes payable due to the issuance of City of San José Financing Authority lease revenue commercial notes account for the majority of this change. The proceeds of the lease revenue commercial paper notes are funding the new City Hall offsite parking garage; technology, furniture and relocation services for the new City Hall; municipal facility improvements; the consolidated utility billing system; and the Central Service Yard Phase II project.

- Net assets invested in capital assets, net of related debt decreased $147.5 million or 2.4 percent. While the business-type activities increased by $61.3 million, general government activities accounted for the overall result with a decrease of $208.8 million.

Analysis of activities: The following table indicates the changes in net assets for governmental and business-type activities:

Statement of Activities
For the Year Ended June 30, 2007 and 2006
(in thousands)

	Governmental Activities		Business-type Activities		Totals	
	FY 2007	FY 2006	FY 2007	FY 2006	FY 2007	FY 2006
Revenues:						
Program revenues:						
Fees, fines, and charges for services.......... $	273,679	264,517	264,926	257,610	538,605	522,127
Operating grants and contributions..............	93,090	76,004	8,284	8,398	101,374	84,402
Capital grants and contributions..................	68,835	60,337	17,927	32,956	86,762	93,293
General revenues:						
Property taxes..	467,917	430,426	-	-	467,917	430,426
Utility taxes..	79,129	75,489	-	-	79,129	75,489
Franchise taxes......................................	40,415	36,760	-	-	40,415	36,760
Transient and occupancy taxes..................	21,400	19,214	-	-	21,400	19,214
Sales taxes shared revenue.......................	145,340	136,031	-	-	145,340	136,031
State of California in-lieu............................	5,911	5,817	-	-	5,911	5,817
Business license tax.................................	39,502	37,236	-	-	39,502	37,236
Unrestricted interest and investment earnings.	39,359	23,682	21,138	13,079	60,497	36,761
Other revenue..	35,875	42,076	-	-	35,875	42,076
Total revenues.....................................	1,310,452	1,207,589	312,275	312,043	1,622,727	1,519,632
Expenses:						
General government................................	120,362	180,633	-	-	120,362	180,633
Public safety..	393,449	351,331	-	-	393,449	351,331
Capital maintenance................................	528,727	514,025	-	-	528,727	514,025
Community services................................	276,343	220,719	-	-	276,343	220,719
Sanitation..	99,720	91,353	-	-	99,720	91,353
Interest and fiscal charges........................	154,135	144,444	-	-	154,135	144,444
Norman Y. Mineta San José International Airport..	-	-	139,623	125,770	139,623	125,770
Wastewater Treatment System...................	-	-	111,435	108,510	111,435	108,510
Municipal Water System............................	-	-	22,618	19,896	22,618	19,896
Parking System......................................	-	-	9,787	10,058	9,787	10,058
Total expenses....................................	1,572,736	1,502,505	283,463	264,234	1,856,199	1,766,739
Excess (deficiency) before transfers	(262,284)	(294,916)	28,812	47,809	(233,472)	(247,107)
Transfers..	6,418	7,772	(6,418)	(7,772)	-	-
Change in net assets.............................	(255,866)	(287,144)	22,394	40,037	(233,472)	(247,107)
Net assets at beginning of year	6,030,359	6,317,503	1,226,494	1,186,457	7,256,853	7,503,960
Net assets at end of year.......................... $	5,774,493	6,030,359	1,248,888	1,226,494	7,023,381	7,256,853

Governmental activities: Net assets for governmental activities decreased by $255.9 million or 4.2 percent during 2006-07 from $6.030 billion to $5.774 billion. On a favorable note, total revenues increased at a rate of 8.5% compared to expenses increasing at a rate of 4.7%. During 2005-06, revenues and expenses increased at rates of 7.9% and 9.4 percent, respectively.

Significant elements of the decrease in net assets for governmental activities from June 30, 2006 to June 30, 2007 are as follows:

- General government expenses decreased by $60.3 million or 33.4 percent between years primarily due to the prior year accrual for a settlement agreement with the County of Santa Clara and a decrease in general liability claims classified as probable.

- Public safety increased by $42.1 million or 12.0 percent between years primarily due to higher wage, pension, healthcare and benefit costs, including the retroactive Fire arbitration settlement. Playing a role in the City's decade of investment, capital maintenance increased by $14.7 million or 2.9 percent due to the City's growing basic infrastructure maintenance requirements and community services increased by $55.6 million or 25.2 percent due to the opening of two new branch libraries and an increase in the City's valuation allowance on its housing loan receivable balance.

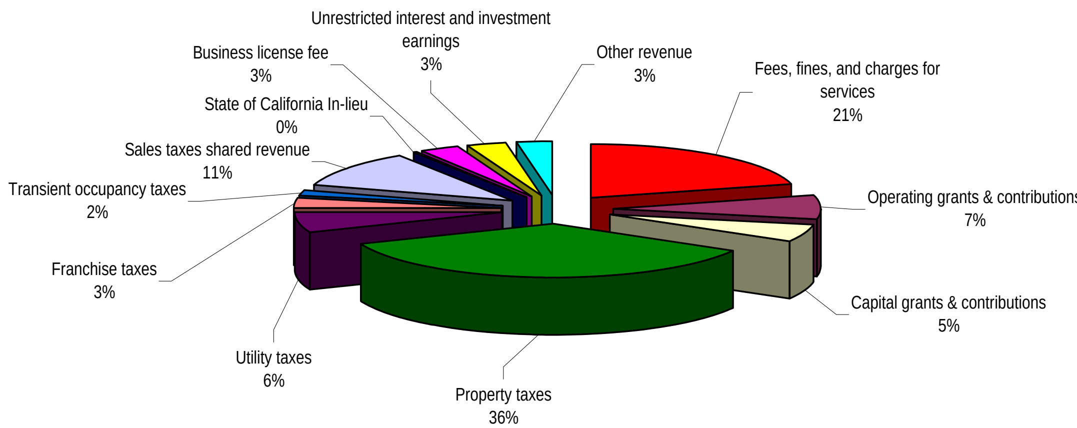
- Depreciation expense for infrastructure and other capital assets was $339.9 million, an increase of 1.5 percent.

- Helping to offset the increase in expenses, property tax revenue increased by $37.5 million or 8.7 percent primarily due to the State not withholding $11.1 million in revenue as part of its budget balancing strategy as the State did in 2005-06 and modest growth in secured property tax revenue related to both the residential and commercial sectors, and sales tax revenue increased by $9.3 million or 6.8 percent primarily due to "triple flip" revenues received from the State.

- In addition, fees, fines and charges for services, operating grants and contributions, capital grants and contributions, utility taxes, franchise taxes, transient occupancy taxes, State of California in-lieu revenue, business license tax and unrestricted interest and investment earnings increased by $62.3 million or 10.4 percent. Some factors contributing to the overall increase include net increases in average hotel room rates and occupancy rates, additional revenue collections resulting from more successful enforcement of the City's business tax ordinance and the Business Tax Amnesty program, and a larger investment pool and greater return on investments resulting from increases in earned interest yields during the year.

- Annualized investment interest yield increased from 3.9 percent as of June 30, 2006 to 4.7 percent as of June 30, 2007. The earned interest yield reflects the continued overall increase in market rates.

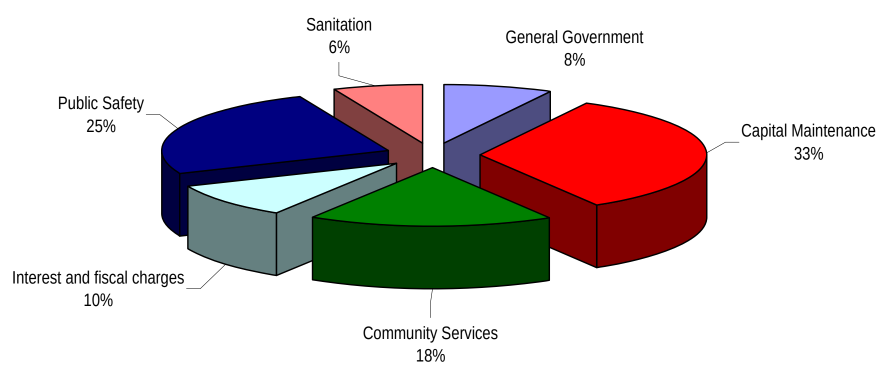
Revenue 2007



The chart above shows the principal components of 2006-07 revenue sources for governmental activities. Of the $1.310 billion in total revenues generated by governmental activities, 68.0 percent is attributable to property taxes (36.0 percent), fees, fines, and charges for services (21.0 percent), and sales taxes (11.0 percent). The percentage distribution of revenues to these categories is consistent with 2005-06.

The chart below shows the principal categories of 2006-07 expenses for governmental activities. Of the $1.573 billion in total expenses generated by governmental activities, 76.0 percent is attributable to capital maintenance (33.0 percent), public safety (25.0 percent), and community services (18.0 percent). The percentage distribution of expenses to these categories is consistent with 2005-06.

Expenses 2007



Business-type activities: Business-type activities net assets increased by $22.4 million or 1.8 percent to $1.249 billion during 2006-07.

The notable components of the increase in net assets for business-type activities during 2006-07 are:

- The Norman Y. Mineta San José International Airport (Airport) net assets increased by $7.7 million or 1.9 percent. The Airport incurred an operating loss of $32.4 million in 2006-07, an unfavorable increase of $5.1 million or 18.7 percent compared to the 2005-06 loss of $27.3 million. Operating revenues decreased by $0.07 million or less than 1.0 percent reflecting lower rental and concessions revenue. Operating expenses of $127.6 million in 2006-07 were 4.1% higher compared to 2005-06 primarily due to increases in general and administrative costs. Nonoperating revenues exceeded nonoperating expenses in 2006-07 by $29.0 million, a decrease of $4.3 million or 12.9 percent from the 2005-06. An increase in interest expense of $8.8 million was partially offset by an increase in investment income of $3.6 million. In addition, the Airport received $9.7 million in capital contributions primarily from Airport Improvement Program grants.

- Wastewater Treatment System net assets increased by $12.4 million or 1.9 percent from $646.2 million to $658.6 million. Operating revenues increased $4.2 million or 3.8 percent from $109.5 million in 2005-06 to $113.7 million in 2006-07 primarily due to a sewer service rate increase of 4.5 percent. Total operating expenses increased by $3.2 million or 3.0 percent primarily due to higher general and administrative costs to cover additional regulatory requirements. Nonoperating revenues increased by $4.4 million attributable primarily to an increase in investment income of $4.1 million. Capital contributions of $4.3 million in 2006-07 consisting primarily of donated assets from developers represent a decrease of $11.5 million compared to 2005-06.

- Municipal Water System net assets increased by $2.5 million or 3.1 percent from $82.1 million to $84.7 million. Operating revenues of $22.4 million increased $2.1 million or 10.4 percent from $20.3 million due in part to monthly rate increases and a slight increase in the number of gallons delivered to customers. Offsetting this gain, operating expenses of $22.4 million increased $2.7 million or 13.8 percent from $19.7 million primarily due to higher operations and maintenance costs for upgrades to facilities to meet customer needs and comply with regulatory requirements. Capital contributions of $3.9 million decreased $2.7 million or 40.6 percent from $6.6 million; however, capital contributions, consisting of donated assets from developers, continued to be the major factor leading to the increase in net assets.

- Parking System net assets decreased by $0.2 million or less than 1.0 percent from $91.3 million to $91.1 million. Operating revenues increased $0.03 million or less than 1.0 percent showing relatively flat earnings. Operating expenses decreased by $0.3 million or 2.7 percent primarily due to lower operations and maintenance costs.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

As noted earlier, the City uses ***fund accounting*** to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds

The City of San José's governmental funds provide information about near-term inflows, outflows, and resources balances available for spending. Such information is useful in assessing the City's financial requirements for its programs and activities. In particular, unreserved fund balance at the fiscal year end may serve as a useful measure of a government's capacity for spending in future years. Governmental funds reported by the City of San José include the General Fund, Special Revenue Funds, Debt Service Funds, and Capital Project Funds.

As of June 30, 2007, the City's governmental funds reported combined fund balances of $1.382 billion, an increase of $24.7 million or 1.8 percent compared to the balance at June 30, 2006. *Unreserved fund balance* at $806.6 million constitutes 58.4 percent of the combined balances and is available for spending at the City's discretion. The $575.5 million remainder of the governmental fund balances is *reserved* to indicate that it is *not* available for new spending because the following portions have been committed to particular purposes:

- $233.7 million for advances, loans, and other assets that are long-term in nature and thus do not represent currently available resources;
- $198.2 million for contractual commitments of 2006-07 carried into fiscal year of 2007-08;
- $143.6 million for debt service payable in new fiscal year of 2007-08.

Revenues and other financing sources for governmental functions totaled approximately $2.555 billion in 2006-07, an increase of $569.4 million or 28.7 percent over 2005-06 primarily due to redevelopment agency refunding bonds issued of $701.2 million.

General Fund: The General Fund is the chief operating fund of the City of San José. At June 30, 2007, its unreserved fund balance is $244.9 million or 87.3 percent of the $280.6 million total General Fund balance. Comparing both unreserved fund balance and total fund balance to total fund expenditures may be useful as a measure of the General Fund's capacity to liquidate future obligations. At June 30, 2007, unreserved fund balance represents 38.7 percent of total General Fund expenditures of $633.0 million, while total fund balance represents 44.3 percent. This measure of financial health has improved significantly over the prior fiscal year. At June 30, 2006, the same measures were 33.3 percent and 38.8 percent respectively of $611.0 million in 2005-06 expenditures.

Significant growth in key revenue sources in 2006-07 was sufficient to meet all expenditure obligations for the first time since 2000-01. In addition, net transfers in to the General Fund further contributed to a net increase in fund balance. Actual performance surpassed the City of San José General Fund budget balancing strategies, which included a combination of ongoing cost reductions, prudent fee increases and the strategic use of reserves and one-time revenues, by achieving a $43.6 million or 18.4 percent addition to the General Fund balance during 2006-07.

In 2006-07, General Fund revenues of $674.3 million were $71.8 million or 11.9 percent higher than 2005-06 revenues of $602.5 million. An upturn in the local economy accounts for this positive result with property tax revenue the primary factor increasing by $23.3 million for the year. Other revenue sources showing significant increases between fiscal years were sales tax ($9.6 million) primarily due to "triple flip" revenues received from the State and interest and other revenues ($22.2 million) primarily due to a larger investment pool and increases in earned interest yields during the year.

General Fund expenditures of $633.0 million in 2006-07 were $22.0 million or 3.6 percent higher than 2005-2006 expenditures of $611.0 million. Increases in general government of $7.5 million and public safety of $27.0 million were due to higher wage, pension, healthcare and benefit costs, especially those relating to the Police Officer's Association agreement. These increases were partially offset by a decrease in capital outlay of $23.4 million attributable primarily to the FMC land purchase which occurred in the prior year.

Redevelopment funds: The Redevelopment Agency (Agency) fund accounts for the activities of the Redevelopment Agency of the City of San José that redevelops and upgrades blighted areas. Balances for the Agency's governmental funds decreased $5.7 million or 4.4 percent to $122.0 million at June 30, 2007. A deficit of revenues over expenditures of $90.0 million was mostly offset by other financing sources of $84.3 million.

The following are some of the highlights for the Agency:

- Revenues increased by 12.7 million or 7.7 percent to $176.2 million from $163.5 million in the prior fiscal year. This increase is primarily due to a $12.0 million increase in tax increment revenue, attributable mainly to the improving commercial and industrial property values.

- Expenditures decreased $6.6 million, or 2.4 percent from the prior fiscal year. An increase of $19.8 million in bond issuance and advance refunding escrow costs related to the issuance of taxable tax allocation bonds and tax allocation refunding bonds was offset by a decrease of $20.7 million in capital maintenance which was attributable primarily to the prior year transfer to the City from the proceeds from the 2005 Housing set-aside tax allocation bonds.

- Other financing sources increased $76.6 million over other financing sources of $7.7 million in 2005-06. The primary source of this increase was the issuance of Tax Allocation Taxable Bonds Series 2006A-T for $14.3 million and Tax Exempt Series B for $67.0 million.

Additional information about the Agency's finances appears in their separately issued financial statements.

Housing funds: The Housing Activities fund accounts for the City of San José's commitment to providing low and moderate income residents with a diverse range of safe, decent, and affordable housing opportunities. Objectives include preserving the existing affordable housing stock, increasing the supply of affordable housing, and providing services to homeless and at-risk populations. Redevelopment Agency tax allocation bonds and 20 percent of the gross property tax increment provide the fund's primary resources. As required by California State law, the tax increment revenue is used solely for affordable housing. The fund's loans receivable balance (net) which represents loans to developers of various affordable housing projects decreased during the current year by $38.8 million or 16.0 percent to $204.4 million at June 30, 2007. This decrease is primarily due to the City's review of the valuation account(s) and determining that the allowance should be increased in the Housing Activities Fund. As a result, the City recorded an expense of $54.5 million to increase the valuation allowance for those loan portfolios that met the City's valuation allowance policy criteria.

Total expenditures increased by $47.2 million or 156.9% to $77.3 million from $30.1 million in the prior fiscal year, which is primarily due to an increase in allowance for doubtful accounts for receivables from developers of various housing projects.

Special assessment funds: The Special Assessment Districts fund accounts for debt issuance and capital improvements related to the specific purposes of eight special assessment and community facilities districts located in different parts of the City of San José. A total of $71.6 million in special assessment debt outstanding at June 30, 2007 is secured by special assessments or taxes charged to the owners real property in the district issuing the debt. The City of San José is not obligated to cure any deficiency or redeem any debt of special assessment districts. However, the City may voluntarily choose to cure a deficiency at its sole discretion. There was no new special assessment debt issued during 2006-07.

Total expenditures increased by $10.6 million or 78.7% to $24.1 million from $13.5 million in the prior fiscal year. This increase is primarily due to an $11.1 million reimbursement of development costs to the developers of the Evergreen Specific Plan Property Ownership Partnership.

Financing authority funds: The San José Financing Authority Debt Service fund accounts for the issuance of commercial paper notes secured by lease revenues as a mechanism for financing City of San

José public improvements such as the offsite parking garage for City Hall, Phase II improvements of the City's Central Service Yard, non-construction costs for technology, furniture, equipment and relocation services at City Hall, and procuring the consolidated utility billing system. The amount of commercial paper notes outstanding increased from $65.1 million on June 30, 2006 to $80.3 million on June 30, 2007, a net increase of $15.2 million or 23.3 percent.

Total other financing sources increased by $58.3 million or 202.0% to $29.4 million. This increase is primarily due to increases in transfers in of $20.5 million for debt service payments and a decrease of $34.3 million in commercial paper proceeds transfers out for capital projects and operations.

Proprietary funds

The City's proprietary funds provide the same type of information found in the government-wide financial statements for business-type activities, but in more detail. At June 30, 2007, the unrestricted net assets were $61.2 million for the Norman Y. Mineta San José International Airport, $161.4 million for the Wastewater Treatment System, $8.7 million for the Municipal Water System and $19.1 million for the Parking System. Net assets for proprietary funds grew from $1.226 billion at June 30, 2006 to $1.249 billion at June 30, 2007, an increase of $22.4 million or 1.8 percent. Other aspects of proprietary fund activities are discussed in the business-type activities section above.

GENERAL FUND BUDGETARY HIGHLIGHTS

The City of San José charter requires staff to submit operating and capital budgets to the City Council prior to the beginning of a new fiscal year that begins each July 1 and ends on the following June 30. Council approved the 2007-08 budgets in June 2007. The City is now in the second half of its *Decade of Investment*, which is transforming much of the City's infrastructure. Major improvements continue in the City's parks, community centers, libraries and public safety facilities and as a result, the City is continuing to dedicate significant resources towards addressing critical service and infrastructure needs in the 2007-08 budgets.

During the fiscal year ended June 30, 2007, there was a $40.7 million increase in budgeted revenues between the original and final amended operating budget for the General Fund. The majority of the increase was due to increases in interest earnings, reimbursement for SB90 claims, proceeds from the new Comcast franchise agreement and litigation settlement, and rebudget of the Coyote Valley Specific Plan.

In addition, there was a $37.7 million increase in appropriations between the original and final amended operating budget for the General Fund. Following are the main components of the increase:

- A supplemental appropriation of $14.6 million to General Government that included increases related to a special election held in City Council Districts 4 and 6, information technology upgrades, funding the implementation of certain hiring process improvements and establishing an arts stabilization fund to finance lines of credit to various arts organizations in financial crises.
- A supplemental appropriation of $11.9 million to Public Safety that included increases related to the 2005 Urban Areas Security Initiative (UASI), certain reallocations from the 2004 and 2005 UASI budgets to support operational costs related to Orange Alerts (terrorists threat level) at the Norman Y. Mineta San José International Airport and revised 2005 training plans. These costs were reimbursed to the General Fund by a transfer from the Airport. Additional police personal costs and other re-budget increases related to phase III of an automated fingerprint identification system.
- A supplemental appropriation of $7.3 million for Community Services that included increases related to enhanced park maintenance, funding for San José after school programs, improved operations associated with animal care and animal services programs, neighborhood revitalization strategies and expanded strong neighborhood initiatives.

Actual budgetary basis expenditures of $663.4 million were $87.1 million less than the amended budget and $49.3 million less than the original budget. Savings were experienced over all expenditure categories.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The City of San José's investment in capital assets, net of accumulated depreciation, for its governmental and business-type activities together amounted to $9.327 billion at June 30, 2007. This investment includes land, infrastructure, structures and improvements, vehicles, equipment, intangible assets, and construction-in-progress. The City of San José's decision to depreciate infrastructure capital assets results in recording a large non-cash depreciation expense each year that offsets additions to capital assets. The result of the new additions less depreciation expense during 2006-07 yielded a decrease of $66.5 million or less than 1.0 percent in net capital asset balance between June 30, 2006 and June 30, 2007.

Total construction-in-progress increased $170.3 million or 32.4 percent from $524.9 million at June 30, 2006 to $695.2 million at June 30, 2007. The governmental activities' portion of construction-in-progress increased $40.8 million. Business-type activities contributed a net increase of $129.5 million to construction-in–progress including the on-going Airport expansion ($91.2 million) and Wastewater Systems ($38.7 million) projects. Outstanding commitments related to construction-in-progress at June 30, 2007 totaled $55.8 million and $188.5 million for governmental and business-type activities, respectively.

The City of San José records infrastructure assets at historical cost in the government-wide financial statements and depreciates assets from acquisition date to the end of the current fiscal year as required by GASB Statement No. 34. For governmental fund financial statements recording purposes, capital asset purchases are recorded as expenditures, rather than capitalizing and recording related depreciation. Capital assets, net of depreciation, for governmental and business-type activities are presented below to illustrate changes between June 30, 2006 and June 30, 2007 (in thousands):

		Governmental activities		Business-type activities		Total		Increase/ (Decrease)
		2007	2006	2007	2006	2007	2006	Percent of Change
Land	$	550,416	558,079	134,926	134,926	685,342	693,005	-1.1%
Construction in progress		296,914	256,123	398,252	268,766	695,166	524,889	32.4%
Buildings		822,140	813,819	281,334	295,680	1,103,474	1,109,499	-0.5%
Improvements, other than buildings		33,557	28,269	506,219	476,109	539,776	504,378	7.0%
Infrastructure		6,211,589	6,469,997	-	-	6,211,589	6,469,997	-4.0%
Furniture, fixtures, vehicles and equipment		36,813	35,206	41,657	42,341	78,470	77,547	1.2%
Intangible assets		-	-	7,932	8,256	7,932	8,256	-3.9%
Property under capital leases		1,491	1,749	3,708	4,161	5,199	5,910	-12.0%
Total capital assets	$	7,952,920	8,163,242	1,374,028	1,230,239	9,326,948	9,393,481	-0.7%

Additional information about the City's capital assets can be found in Note III.D to the financial statements.

General Fund Bonded Debt Limit

The City of San José Charter limits bonded indebtedness for General Obligation bonds to 15 percent of the total assessed valuation of all real and personal property within the City. The total assessed value on the City's 2006-07 tax roll was $112.923 billion, which results in a net total debt capacity of $16.428 billion. As of June 30, 2007, the City had $510.7 million of General Obligation bonds outstanding.

General Obligation Bond Rating

During May 2007, the City received confirmation of its general obligation bond ratings from the three major rating agencies: Aa1 from Moody's; AA+ from Standard & Poor's; and AA+ from Fitch. These ratings place San Jose in the second highest rating category (only one "notch" below Aaa/AAA/AAA), ranking it higher than the State of California and all other California large cities.

Outstanding Debt

The City's debt service obligations include general obligation bonds, revenue bonds, lease revenue bonds, special assessment bonds, and Redevelopment Agency tax allocation bonds.

At June 30, 2007, the City had $3.433 billion of gross outstanding long-term debt related to governmental activities and $608.3 million related to business-type activities, for a total of $4.041 billion. These amounts for the fiscal year ended June 30, 2006 were $3.323 billion for governmental activities and $625.2 million for business-type activities, for a total of $3.949 billion.

The table below identifies the net changes in each category (in thousands):

		As of June 30 2007	As of June 30 2006	Net Change
Governmental Activities				
General obligation bonds	$	510,710	432,445	78,265
HUD Section 108 loan		25,436	25,436	-
Lease, reassessment and revenue bonds		641,551	646,070	(4,519)
Special assessments		71,580	75,007	(3,427)
Redevelopment Agency		2,183,295	2,144,495	38,800
Sub-total		3,432,572	3,323,453	109,119
Business-Type Activities				
Revenue bonds		562,730	576,060	(13,330)
State of CA-Revolving Fund Loan		45,585	49,153	(3,568)
Sub-total		608,315	625,213	(16,898)
Total:	$	4,040,887	3,948,666	92,221

Additional information about the City's long-term obligations appears in Note III.F. of the notes to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

- The City of San José continues to confront the need for significant budget reductions. Even though revenues continue to rise, the challenge is to keep expenditures within available resources. In general, the economy for San José is projected to grow in 2007-08 but at a slower rate than that experienced in 2006-07. The primary reason for the slowdown is the cooling of the housing market, where economically sensitive revenue sources, such as Sales Tax, Construction and Conveyance Taxes and Property Taxes may be impacted by the housing market slowdown.

- The 2007-08 budget focuses on City Council priorities, directing resources toward essential services, basic infrastructure requirements, economic development opportunities, and maintaining the City's strong commitment to neighborhoods. To meet these community needs, the City Council approved a balanced General Fund budget for 2007-08. Two significant strategies employed by the City Council to balance the budget were: 1) to focus reduction efforts on the elimination of vacant positions; and, 2) to employ the use of one-time funding to address significant infrastructure maintenance needs. Consequently, the final budget includes a combination of ongoing cost reductions, the strategic use of reserves and necessary fee increases.

- Effective for fiscal years beginning after December 15, 2006, the Governmental Accounting Standards Board (GASB) Statement No. 45 requires governments to report the amount of unfunded liabilities for post-retirement benefits other than pensions, such as for medical benefits. GASB 45 also encourages governments to fund these liabilities over the long-term. As an initial investment towards funding these liabilities, pending the development of a longer term strategy, a total of $2.0 million is included in the 2007-08 budget.

- The 2007-08 budget will implement rate increases of 9.0 percent for the Storm Sewer and Sewer Service and Use Charge, 28.0 percent for Recycle Plus, and 7.0 percent for the Municipal Water System in order to maintain a reliable utility infrastructure.

- On September 18, 2007, the City Council adopted a resolution to implement the terms of the award resulting from the interest arbitration between the City and the International Association of Firefighters, Local 230. The retroactive portion of the award totaling approximately $11.1 million through June 30, 2007 has been fully reserved in the general fund balance. The impact to the 2007-08 budget is approximately $6.6 million.

- For the 2006 calendar year, the average local unemployment rate was 5.0 percent, which was slightly above the California State average unemployment rate of 4.9 percent. These rates reflect significant improvement as the local and California State average unemployment rates have decreased by 1.0 percent and 0.5 percent, respectively, compared to calendar year 2005.

All of these factors were considered in preparing the City's budget for 2007-08.

REQUEST FOR INFORMATION

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the City's finances. Questions concerning any of the information provided in his report or requests for additional financial information should be addressed to the Director of Finance, 200 E. Santa Clara Street, San José, CA 95113.

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Basic
Financial Statements

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Basic Financial Statements

City of San José
Statement of Net Assets
June 30, 2007
($000's)

		Governmental Activities	Business-Type Activities	Total
ASSETS				
Equity in pooled cash and investments	$	714,730	294,148	1,008,878
Other cash and investments		6	-	6
Receivables (net of allowances for uncollectibles)		170,952	12,030	182,982
Due from outside agencies		2,162	662	2,824
Internal balances		(9,700)	9,700	-
Inventories		2,553	1,282	3,835
Loans receivable (net)		252,007	250	252,257
Advances and deposits		671	6,020	6,691
Other assets		18,466	5,233	23,699
Restricted assets:				
Equity in pooled cash and investments		91,831	147,848	239,679
Other cash and investments		542,993	100,269	643,262
Receivables (net of allowances for uncollectibles)		-	11,476	11,476
Deferred bond issuance costs (net of accumulated amortization)		52,935	9,075	62,010
Capital assets (net of accumulated depreciation):				
Nondepreciable		847,330	533,178	1,380,508
Depreciable		7,105,590	840,850	7,946,440
Total assets		9,792,526	1,972,021	11,764,547
LIABILITIES				
Accounts payable		75,486	45,158	120,644
Accrued liabilities		36,433	1,924	38,357
Interest payable		49,049	6,538	55,587
Due to outside agencies		15,574	-	15,574
Short term notes payable		80,279	41,424	121,703
Unearned revenue		19,840	1,150	20,990
Advances, deposits, and reimbursable credits		29,512	4,067	33,579
Other liabilities		15,731	330	16,061
Noncurrent obligations:				
Due within one year		118,857	27,155	146,012
Due in more than one year		3,577,272	595,387	4,172,659
Total liabilities		4,018,033	723,133	4,741,166
NET ASSETS				
Invested in capital assets, net of related debt		5,193,578	750,334	5,943,912
Restricted for:				
Debt service		53,475	37,366	90,841
Capital projects		244,876	121,626	366,502
Community services		199,983	-	199,983
Public safety		3,057	-	3,057
City of Santa Clara equity in Wastewater Treatment System		-	89,047	89,047
Unrestricted		79,524	250,515	330,039
Total net assets	$	5,774,493	1,248,888	7,023,381

The notes to the financial statements are an integral part of this statement.

City of San José
Statement of Activities
For the Year Ended June 30, 2007
($000's)

Functions/Programs	Expenses	Program Revenues: Fees, Fines, and Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets: Governmental Activities	Net (Expense) Revenue and Changes in Net Assets: Business -Type Activities	Net (Expense) Revenue and Changes in Net Assets: Total
Governmental activities:							
General government	$ 120,362	56,125	118	2,991	(61,128)	-	(61,128)
Public safety	393,449	21,776	21,686	-	(349,987)	-	(349,987)
Capital maintenance	528,727	26,559	19,886	65,844	(416,438)	-	(416,438)
Community services	276,343	73,671	50,930	-	(151,742)	-	(151,742)
Sanitation	99,720	95,548	470	-	(3,702)	-	(3,702)
Unallocated interest and fiscal charges	154,135	-	-	-	(154,135)	-	(154,135)
Total governmental activities	**1,572,736**	**273,679**	**93,090**	**68,835**	**(1,137,132)**	**-**	**(1,137,132)**
Business -Type activities:							
Norman Y. Mineta San José International Airport	139,623	118,978	8,284	9,694	-	(2,667)	(2,667)
Wastewater Treatment System	111,435	113,772	-	4,326	-	6,663	6,663
Municipal Water System	22,618	22,399	-	3,907	-	3,688	3,688
Parking System	9,787	9,777	-	-	-	(10)	(10)
Total business-type activities	**283,463**	**264,926**	**8,284**	**17,927**	**-**	**7,674**	**7,674**
Total	**$ 1,856,199**	**538,605**	**101,374**	**86,762**	**(1,137,132)**	**7,674**	**(1,129,458)**

	Governmental Activities	Business -Type Activities	Total
General revenues:			
Taxes:			
Property and other taxes	467,917	-	467,917
Utility	79,129	-	79,129
Franchise	40,415	-	40,415
Transient and occupancy	21,400	-	21,400
Sales taxes shared revenue (unrestricted)	145,340	-	145,340
State of California in-lieu (unrestricted)	5,911	-	5,911
Business license tax	39,502	-	39,502
Unrestricted interest and investment earnings	39,359	21,138	60,497
Other revenue	35,875	-	35,875
Transfers	6,418	(6,418)	-
Total general revenues and transfers	**881,266**	**14,720**	**895,986**
Change in net assets	**(255,866)**	**22,394**	**(233,472)**
Net assets - beginning	**6,030,359**	**1,226,494**	**7,256,853**
Net assets - ending	**$ 5,774,493**	**1,248,888**	**7,023,381**

The notes to the financial statements are an integral part of this statement.

City of San José
Balance Sheet
Governmental Funds
June 30, 2007
($000's)

		General Fund	Redevelopment Agency	Housing Activities
ASSETS				
Equity in pooled cash and investments held in City Treasury	$	226,713	76,832	53,285
Other cash and investments		-	-	-
Receivables (net of allowance for uncollectibles)		59,356	1,348	3,033
Due from outside agencies		1,896	-	51
Due from other funds		34,745	246	59
Inventories		-	-	-
Loans receivable (net)		2,391	38,247	204,370
Advances and deposits		13	260	-
Restricted assets:				
Equity in pooled cash and investments held in City Treasury		933	-	967
Other cash and investments		86	95,251	-
Advances to other funds		3,607	830	-
Other assets		-	-	18,007
Total assets	$	329,740	213,014	279,772
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	$	10,133	10,271	686
Accrued salaries, wages, and payroll taxes		20,930	333	268
Due to other funds		131	1,143	-
Due to other agencies		302	22,772	-
Short term notes payable		-	-	-
Deferred revenue		6,946	38,808	24,753
Advances, deposits, and reimbursable credits		7	2,765	-
Advances from other funds		250	14,912	580
Other liabilities		10,444	-	-
Total liabilities		49,143	91,004	26,287
Fund balances:				
Reserved for:				
Encumbrances		28,678	29,044	39,284
Noncurrent advances, loans and other assets		7,030	5,127	203,522
Debt service		-	89,615	-
Restricted cash commitments		-	-	3
Unreserved reported in:				
General fund		244,889	-	-
Special revenue funds		-	-	10,676
Debt service funds		-	-	-
Capital projects funds		-	(1,776)	-
Total fund balances		280,597	122,010	253,485
Total liabilities and fund balances	$	329,740	213,014	279,772

The notes to the financial statements are an integral part of this statement.

Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
-	-	354,759	711,589
-	-	6	6
71,935	2	35,278	170,952
15	-	200	2,162
-	-	38,413	73,463
-	-	2,553	2,553
-	-	6,999	252,007
330	-	68	671
39,823	153	49,955	91,831
10,747	52,359	384,550	542,993
-	-	8,112	12,549
-	-	459	18,466
122,850	52,514	881,352	1,879,242
11,728	27	42,570	75,415
17	-	3,471	25,019
-	-	72,885	74,159
-	-	-	23,074
-	80,279	-	80,279
71,906	-	9,977	152,390
4,009	-	22,731	29,512
-	3,607	2,204	21,553
-	-	5,287	15,731
87,660	83,913	159,125	497,132
671	94	100,419	198,190
5	-	17,971	233,655
21,257	-	32,744	143,616
-	-	5	8
-	-	-	244,889
-	-	274,856	285,532
-	(31,493)	-	(31,493)
13,257	-	296,232	307,713
35,190	(31,399)	722,227	1,382,110
122,850	52,514	881,352	1,879,242

City of San José
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets
June 30, 2007
($000's)

Total fund balances-governmental funds (Page 22)		$ 1,382,110
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consist of:		
Land	550,416	
Infrastructure assets	11,237,282	
Other capital assets	1,539,837	
Accumulated depreciation	(5,374,615)	
Total capital assets		7,952,920
Interest payable on long-term debt does not require the use of current financial resources and, therefore, interest payable is generally not accrued as a liability in the balance sheet of governmental funds.		(49,049)
Bond issuance costs are expended in governmental funds when paid, however, are capitalized and amortized over the life of the corresponding bonds for purposes of the statement of net assets. Deferred charges, net of amortization		52,935
Special Assessments are reported as revenue when levied in government-wide financial statements. In governmental funds, these assessments are reported as deferred revenue (a liability) since they are not available.		71,580
Long-term receivables are not available to pay for current period expenditures and, therefore, are deferred on the modified accrual basis.		60,970
The Public Works Program Support Internal Service fund is used by management to charge its costs to individual funds. The assets and liabilities of the internal service fund is included in governmental activities in the Statement of Net Assets.		2,775
Other accrued liabilities do not require the use of current financial resources and, therefore are not accrued as a liability in the balance sheet of governmental funds.		(11,119)
Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:		
Bonds and notes payable	$ (3,438,353)	
Accreted interest on capital appreciation bonds	(2,323)	
Compensated absences	(89,991)	
Claims and judgments	(143,157)	
Other	(14,805)	
Total long-term liabilities		(3,688,629)
Net assets of governmental activities (Page 20)		$ 5,774,493

The notes to the financial statements are an integral part of this statement.

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City of San José
Statement of Revenues, Expenditures
and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2007
($000's)

		General Fund	Redevelopment Agency	Housing Activities
REVENUES				
Taxes and special assessments	$	475,843	161,818	-
Licenses, permits, and fines		88,611	-	-
Intergovernmental		20,488	-	8,407
Charges for current services		29,624	-	-
Rent		-	1,022	-
Interest and other revenues		59,719	13,322	14,148
Total revenues		674,285	176,162	22,555
EXPENDITURES				
Current:				
General government		86,048	15,765	-
Public safety		368,840	-	-
Capital maintenance		43,303	73,557	-
Community services		129,064	-	77,240
Sanitation		1,833	-	-
Capital outlay		3,922	12,370	-
Debt service:				
Principal		-	42,435	-
Interest and fiscal charges		-	89,771	-
Bond issuance costs		-	19,286	-
Advance refunding escrow		-	13,014	-
Total expenditures		633,010	266,198	77,240
Excess (deficiency) of revenues over (under) expenditures		41,275	(90,036)	(54,685)
OTHER FINANCING SOURCES (USES)				
Bonds issued		-	81,300	-
Refunding bonds issued		-	701,185	-
Premiums on bonds		-	29,158	-
Payment to refunded bond escrow agent		-	(712,615)	-
Proceeds from sale of capital assets		-	8,491	-
Transfers in		38,073	22,159	32,364
Transfers out		(35,721)	(45,310)	(19,940)
Total other financing sources (uses)		2,352	84,368	12,424
Net change in fund balances		43,627	(5,668)	(42,261)
Fund balances - beginning		236,970	127,678	295,746
Fund balances - ending	$	280,597	122,010	253,485

The notes to the financial statements are an integral part of this statement.

Special Assessment Districts	San José Financing Authority Debt Service	Nonmajor Governmental Funds	Total Governmental Funds
7,251	-	143,778	788,690
-	-	-	88,611
-	-	63,156	92,051
-	-	235,757	265,381
-	-	9,304	10,326
3,020	2,991	47,431	140,631
10,271	2,991	499,426	1,385,690
-	-	125,442	227,255
-	-	1,735	370,575
16,453	-	100,597	233,910
-	-	48,221	254,525
-	-	97,913	99,746
142	-	114,235	130,669
3,427	9,390	12,235	67,487
4,068	36,536	20,225	150,600
-	914	464	20,664
-	1,960	-	14,974
24,090	48,800	521,067	1,570,405
(13,819)	(45,809)	(21,641)	(184,715)
-	-	90,000	171,300
-	36,555	-	737,740
-	1	965	30,124
-	(32,522)	-	(745,137)
-	-	-	8,491
-	48,393	80,682	221,671
-	(23,003)	(90,784)	(214,758)
-	29,424	80,863	209,431
(13,819)	(16,385)	59,222	24,716
49,009	(15,014)	663,005	1,357,394
35,190	(31,399)	722,227	1,382,110

City of San José
Reconciliation of the Changes in Fund Balances of Governmental Funds
to the Statement of Activities
For the Year Ended June 30, 2007
($000's)

Net change in fund balances--total governmental funds (Page 26)		$ 24,716
Amounts reported for governmental activities in the statement of activities are different because:		
Capital outlays are reported as expenditures in governmental funds. However, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these amounts are:		
Capital outlay	130,669	
Depreciation expense	(339,890)	
Excess of depreciation expense over capital outlay		(209,221)
The net effect of various miscellaneous transactions involving capital assets (i.e. sales, retirements, trade-ins, donations)		
Donated assets	23,738	
Disposal of assets	(24,839)	
		(1,101)
Bond issuance costs are expended in governmental funds when paid, however, are capitalized and amortized over the life of the corresponding bonds for the purposes of the statement of activities.		
Bond issuance costs	20,664	
Amortization of bond issuance costs	(8,185)	
Total bond issuance costs, net of amortization		12,479
Repayment of long-term obligation principal is reported as an expenditure in governmental funds and, thus, has the effect of reducing fund balance because current financial resources have been used. For the government-wide statements, however, the principal payments reduce the liabilities in the statement of net assets and do not result in an expense in the statement of activities. The City's long-term obligations were reduced because principal payments were made to bond holders and HUD.		800,671
Accrued interest expense on long-term debt is reported in the government-wide statement of activities, but does not require the use of current financial resources. Amortization of bond premiums, discounts and deferred amounts on refunding should be expensed as a component of interest expense on the statement of activities. This amount represents the net accrued interest expense and the amortization of bond premiums, discounts and deferred amounts on refunding not reported in governmental funds.		
Accrued interest on capital appreciation bonds	(250)	
Discount/(premium) on bonds issued	(30,124)	
Increase in accrued interest expense	(1,400)	
Amortization of deferred amounts, premiums and discounts	1,398	
Deferred amounts on bonds issued	29,676	
Total net interest expense and amortization of discount/premium		(700)
Bond and loan proceeds provide current financial resources to governmental funds, however, issuing debt increases long-term liabilities in the statement of net assets.		(909,040)
Because some revenues will not be collected for several months after the City's fiscal year ends, they are not considered "available" revenue and are deferred in the governmental funds. Deferred revenues increased by this amount this year.		12,150
Some items reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of:		
Net decrease in accrued landfill postclosure costs	465	
Net increase in net pension obligation	(6)	
Net increase in vacation, sick leave, and compensatory time	(6,185)	
Net decrease in estimated liability for self-insurance	30,398	
Net increase in other accrued liabilities	(11,119)	
Net increase in arbitrage liability	(1,790)	
Total additional expenditures		11,763
The net revenues of the Public Works Program Support Internal Service fund is reported with the governmental activities		2,417
Change in net assets of governmental activities (Page 21)		$ (255,866)

The notes to the financial statements are an integral part of this statement.

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City of San José
Statement of Fund Net Assets
Proprietary Funds
June 30, 2007
($000's)

	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Totals	Public Works Program Support Internal Service Fund
ASSETS						
Current assets:						
Equity in pooled cash and investments held in City Treasury	$ 54,369	214,448	13,511	11,820	294,148	3,141
Receivables (net of allowance for uncollectibles)	3,779	4,101	2,866	1,284	12,030	-
Due from outside agencies	-	662	-	-	662	-
Due from other funds	188	1,208	-	-	1,396	-
Inventories	-	1,282	-	-	1,282	-
Total unrestricted current assets	58,336	221,701	16,377	13,104	309,518	3,141
Restricted assets:						
Equity in pooled cash and investments held in City Treasury	129,524	16,801	-	1,523	147,848	-
Other cash and investments	100,035	234	-	-	100,269	-
Receivables (net of allowances for uncollectibles)	11,476	-	-	-	11,476	-
Prepaid expenses, advances and deposits	5,233	-	-	-	5,233	-
Total restricted current assets	246,268	17,035	-	1,523	264,826	-
Total current assets	304,604	238,736	16,377	14,627	574,344	3,141
Noncurrent assets:						
Deferred bond issuance costs (net of accumulated amortization)	8,246	829	-	-	9,075	-
Loan receivable	250	-	-	-	250	-
Advances and deposits	6,020	-	-	-	6,020	-
Advances to other funds	-	5,732	-	6,800	12,532	-
Capital assets (net of accumulated depreciation):						
Nondepreciable	311,958	200,214	2,186	18,820	533,178	-
Depreciable	361,274	354,139	73,738	51,699	840,850	-
Total noncurrent assets	687,748	560,914	75,924	77,319	1,401,905	-
Total assets	992,352	799,650	92,301	91,946	1,976,249	3,141

The notes to the financial statements are an integral part of this statement.

City of San José
Statement of Fund Net Assets
Proprietary Funds
June 30, 2007
($000's)

		Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Totals	Public Works Program Support Internal Service Fund
LIABILITIES							
Current liabilities:							
Accounts payable	$	4,097	6,030	1,912	586	12,625	71
Accrued liabilities		83	1,669	115	57	1,924	295
Interest payable		-	468	-	-	468	-
Due to other funds		-	-	700	-	700	-
Accrued vacation, sick leave and compensatory time		257	4,540	48	155	5,000	-
Estimated liability for self-insurance		-	1,209	151	7	1,367	-
Loans payable		-	3,633	-	-	3,633	-
Total current liabilities unrestricted		4,437	17,549	2,926	805	25,717	366
Current liabilities payable from restricted assets:							
Accounts payable and accrued liabilities		32,533	-	-	-	32,533	-
Interest payable		5,769	301	-	-	6,070	-
Accrued vacation, sick leave and compensatory time		3,187	-	-	-	3,187	-
Estimated liability for self-insurance		560	-	-	-	560	-
Advances and deposits payable		781	-	-	-	781	-
Deferred revenue		1,150	-	-	-	1,150	-
Short term notes payable		41,424	-	-	-	41,424	-
Current portion of bonds payable		9,257	4,151	-	-	13,408	-
Total current liabilities payable from restricted assets		94,661	4,452	-	-	99,113	-
Total current liabilities		99,098	22,001	2,926	805	124,830	366
Noncurrent liabilities:							
Estimated liability for self-insurance		3,310	3,375	-	-	6,685	-
Advances from other funds		-	-	3,528	-	3,528	-
Advance contributions from participating agencies		-	2,100	-	-	2,100	-
Advances, deposits and reimbursable credits		-	-	1,186	-	1,186	-
Loans payable		-	41,952	-	-	41,952	-
Bonds payable (net of discount and deferred loss on premium/refunding)		475,090	71,660	-	-	546,750	-
Other liabilities		330	-	-	-	330	-
Total noncurrent liabilities		478,730	119,087	4,714	-	602,531	-
Total liabilities		577,828	141,088	7,640	805	727,361	366
NET ASSETS							
Invested in capital assets, net of related debt		234,957	368,934	75,924	70,519	750,334	-
Restricted for debt service		35,843	-	-	1,523	37,366	-
Restricted for capital projects		82,491	39,135	-	-	121,626	-
City of Santa Clara equity in Wastewater Treatment System		-	89,047	-	-	89,047	-
Unrestricted		61,233	161,446	8,737	19,099	250,515	2,775
Total net assets	$	414,524	658,562	84,661	91,141	1,248,888	2,775

City of San José
Statement of Revenues, Expenses, and Changes in Fund Net Assets
Proprietary Funds
For the Year Ended June 30, 2007
($000's)

	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Totals	Public Works Program Support Internal Service Fund
OPERATING REVENUES						
Charges for services	$ 50,746	92,755	22,369	9,777	175,647	15,229
Rentals and concessions	39,890	1,731	-	-	41,621	-
Customer transportation fees	4,451	-	-	-	4,451	-
Service connection, engineering and inspection	-	4,901	-	-	4,901	-
Contributions	-	10,638	-	-	10,638	-
Other	108	3,704	-	-	3,812	-
Total operating revenues	95,195	113,729	22,369	9,777	241,070	15,229
OPERATING EXPENSES						
Operations and maintenance	79,198	63,605	19,092	2,483	164,378	12,317
General and administrative	28,786	25,428	794	5,302	60,310	-
Depreciation and amortization	19,645	17,892	2,533	1,845	41,915	-
Materials and supplies	-	280	-	156	436	-
Total operating expenses	127,629	107,205	22,419	9,786	267,039	12,317
Operating income (loss)	(32,434)	6,524	(50)	(9)	(25,969)	2,912
NONOPERATING REVENUES (EXPENSES)						
Passenger facility charges	22,169	-	-	-	22,169	-
Operating grants	8,284	-	-	-	8,284	-
Investment income	8,935	10,982	616	605	21,138	-
Land and building rental	-	43	-	-	43	-
Interest expense	(11,994)	(3,969)	(199)	-	(16,162)	-
Contributions refunded to participating agencies	-	(260)	-	-	(260)	-
Loss on disposal of capital assets	-	(1)	-	-	(1)	-
Other revenues (expenses)	1,614	-	30	(1)	1,643	-
Net nonoperating revenues (expenses)	29,008	6,795	447	604	36,854	-
Income (loss) before capital contributions and transfers	(3,426)	13,319	397	595	10,885	2,912
Capital contributions	9,694	4,326	3,907	-	17,927	-
Transfers in	1,419	-	193	75	1,687	-
Transfers out	-	(5,275)	(1,960)	(870)	(8,105)	(495)
Changes in net assets	7,687	12,370	2,537	(200)	22,394	2,417
Net assets - beginning	406,837	646,192	82,124	91,341	1,226,494	358
Net assets - ending	$ 414,524	658,562	84,661	91,141	1,248,888	2,775

The notes to the financial statements are an integral part of this statement.

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City of San José
Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2007
($000's)

		Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Totals	Public Works Program Support Internal Service Fund
CASH FLOWS FROM OPERATING ACTIVITIES							
Receipts from customers and users	$	94,151	104,477	21,639	9,426	229,693	15,229
Payments to suppliers		(77,077)	(41,412)	(15,978)	(6,334)	(140,801)	-
Payments to employees		(34,938)	(47,924)	(3,567)	(1,697)	(88,126)	(12,322)
Other receipts (payments)		1,166	10,638	-	-	11,804	-
Net cash provided by (used in) operating activities		(16,698)	25,779	2,094	1,395	12,570	2,907
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES							
Transfer from other funds		1,419	-	193	75	1,687	-
Transfer to other funds		-	(5,275)	(1,960)	(870)	(8,105)	(495)
Advances (to) from other funds		-	461	(700)	(274)	(513)	-
Subsidies from operating grants		8,270	-	-	-	8,270	-
Advances, deposits and credits		9	-	(58)	-	(49)	-
Net cash provided by (used in) by noncapital and related financing activities		9,698	(4,814)	(2,525)	(1,069)	1,290	(495)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES							
Passenger facility charges received		21,930	-	-	-	21,930	-
Proceeds from commercial paper		33,335	-	-	-	33,335	-
Subsidies from capital grants		10,039	880	-	-	10,919	-
Acquisition and construction of capital assets		(97,471)	(47,869)	(1,134)	(1,933)	(148,407)	-
Principal paid on debt		(9,365)	(7,533)	-	-	(16,898)	-
Interest paid on debt		(23,486)	(3,786)	-	-	(27,272)	-
Advances, deposits and credits paid		(2,039)	-	-	-	(2,039)	-
Net cash used in capital and related financing activities		(67,057)	(58,308)	(1,134)	(1,933)	(128,432)	-
CASH FLOWS FROM INVESTING ACTIVITIES							
Proceeds from sales and maturities of investments		172,973	216	-	-	173,189	-
Purchase of investments		(52,781)	-	-	-	(52,781)	-
Interest and dividends received		11,953	10,563	584	846	23,946	-
Land and building rentals		-	42	-	-	42	-
Net cash provided by investing activities		132,145	10,821	584	846	144,396	-
Net change in cash and cash equivalents		58,088	(26,522)	(981)	(761)	29,824	2,412
Cash and cash equivalents - beginning		186,657	258,005	14,492	14,104	473,258	729
Cash and cash equivalents - ending	$	244,745	231,483	13,511	13,343	503,082	3,141

(Continued)

The notes to the financial statements are an integral part of this statement.

City of San José
Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2007
($000's)

		Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Totals	Public Works Program Support Internal Service Fund
Reconciliation of operating income (loss) to net cash provided (used in) by operating activities:							
Operating income (loss)	**$**	(32,434)	6,524	(50)	(9)	(25,969)	2,912
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:							
Depreciation and amortization		19,645	17,892	2,533	1,845	41,915	-
Other nonoperating revenues(expenses)		1,614	-	30	(1)	1,643	-
Decrease (increase) in:							
Accounts receivable		(745)	1,531	(760)	(349)	(323)	-
Due from outside agencies		-	(144)	-	-	(144)	-
Due from other funds		(22)	-	-	-	(22)	-
Inventories		-	(42)	-	-	(42)	-
Prepaid expenses		(5,076)	-	-	-	(5,076)	-
Increase (decrease) in:							
Accounts payable and accrued liabilities		250	113	284	(105)	542	(5)
Accrued vacation, sick leave and compensatory time		302	427	4	13	746	-
Estimated liability for self-insurance		(22)	(522)	53	1	(490)	-
Deferred revenues		(291)	-	-	-	(291)	-
Advances and deposits payable		81	-	-	-	81	-
Total adjustments		15,736	19,255	2,144	1,404	38,539	(5)
Net cash provided by (used in) operating activities	$	(16,698)	25,779	2,094	1,395	12,570	2,907
Reconciliation of cash and cash equivalents to the statement of net assets:							
Equity in pooled cash and investments held in City Treasury							
Unrestricted	$	54,369	214,448	13,511	11,820	294,148	3,141
Restricted		129,524	16,801	-	1,523	147,848	-
Other investments		100,035	234	-	-	100,269	-
Less investments not meeting the definition of cash equivalents		(39,183)	-	-	-	(39,183)	-
	$	244,745	231,483	13,511	13,343	503,082	3,141
Noncash noncapital, capital and related financing activities:							
Loss on disposal of capital assets	$	-	1	-	-	1	-
Acquisition of capital assets on accounts payable and accrued liabilities		29,923	-	-	-	29,923	-
Bond discount/(premium)		769	-	-	-	769	-
Capitalized interest		7,680	-	-	-	7,680	-
Contributions from developers and other funds		-	3,370	3,907	-	7,277	-

The notes to the financial statements are an integral part of this statement.

City of San José
Statement of Fiduciary Net Assets
Fiduciary Funds
June 30, 2007
($000's)

		Pension Trust Funds	James Lick Private Purpose Trust Fund	Agency Funds
ASSETS				
Equity in pooled cash and investments held				
in City Treasury	$	-	33	1,672
Investments of retirement plans:				
Investments, excluding securities lending collateral:				
Domestic fixed maturities		1,359,720	-	-
International fixed maturities		145,407	-	-
Domestic equities		1,825,025	-	-
International equities		1,143,233	-	-
Private equities		64,671	-	-
Derivatives		43	-	-
Real estate		276,605	-	-
Cash equivalents and short term investments		(74)	-	-
Securities lending cash collateral investment pool		701,023	-	-
Total investments		5,515,653	-	-
Other cash and investments		-	32	-
Receivables (net of allowances				
for uncollectibles):				
Accrued investment income		14,698	-	16
Employee contributions		1,941	-	-
Employer contributions		4,920	-	-
Other		135,193	-	-
Total assets		5,672,405	65	1,688
LIABILITIES				
Due to brokers		364,902	-	-
Securities lending collateral, due to borrowers		701,023	-	-
Accrued salaries, wages and payroll taxes		-	-	7
Other liabilities		7,830	-	1,681
Total liabilities		1,073,755	-	1,688
NET ASSETS				
Held in trust for:				
Employees' pension benefits		4,451,184	-	-
Employees' postemployment healthcare benefits		147,466	-	-
Other purpose		-	65	-
	$	4,598,650	65	-

The notes to the financial statements are an integral part of this statement.

City of San José
Statement of Changes in Fiduciary Net Assets
Fiduciary Funds
For the Year Ended June 30, 2007
($000's)

	Pension Trust Funds	James Lick Private Purpose Trust Fund
ADDITIONS		
Investment income:		
Interest	$ 66,305	14
Dividends	35,814	-
Net rental income	10,646	-
Net change in fair value of plan investments	610,411	-
Investment expenses	(18,145)	-
Total investment income	705,031	14
Securities lending activities:		
Securities lending income	34,026	-
Securities lending expenses	(32,387)	-
Total securities lending activities	1,639	-
Contributions:		
Employer	117,439	-
Employees	46,021	-
Total contributions	163,460	
Total additions	870,130	14
DEDUCTIONS		
General and administrative	4,200	-
Health insurance	33,058	-
Refunds to terminated employees	1,217	-
Retirement and other benefits paid:		
Death benefits paid	10,908	-
Retirement benefits paid	157,088	-
Total deductions	206,471	-
Change in net assets	663,659	14
Net assets - beginning	3,934,991	51
Net assets - ending	$ 4,598,650	65

The notes to the financial statements are an integral part of this statement.

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INDEX TO THE NOTES

I. Summary of Significant Accounting Policies

A. Reporting Entity

The City of San José, California (the "City"), was chartered on March 25, 1850, and has operated under a Council–Manager form of government since 1916. The City has defined its reporting entity in accordance with generally accepted accounting principles ("GAAP") in the United States of America, which provide guidance for determining which governmental activities, organizations, and functions should be included in the reporting entity. In evaluating how to define the City for financial reporting purposes, management has considered all potential component units. The primary criterion for including a potential component unit within the reporting entity is the governing body's financial accountability. A primary government is financially accountable if it appoints a voting majority of a component unit's governing body and it is able to impose its will on the component unit, or if there is a potential for the component unit to provide specific financial benefits to, or impose specific financial burdens on, the primary government. A primary government may also be financially accountable if a component unit is fiscally dependent on the primary government regardless of whether the component unit has a separately elected governing board, a governing board appointed by a higher level of government, or a jointly appointed board. Based upon the application of these criteria, the following is a brief description of each component unit included within the City's reporting entity. All such component units have been "blended" as though they are part of the primary government because the component unit's governing body is substantively the same as the City's primary government, and/or the component units provide services entirely, or almost entirely, to the City or otherwise exclusively, or almost exclusively, benefits the City, even though it does not provide services directly to it.

- **Redevelopment Agency of the City of San José** – The Redevelopment Agency of the City of San José (the "Redevelopment Agency") was created by the City Council with the authority and responsibility for redeveloping and upgrading blighted areas of the City. The members of the City Council are also members of the Redevelopment Agency's Board of Directors and, as such, are authorized to transact business and exercise their power to plan, engineer, and carry out projects of the Redevelopment Agency.

- **Parking Authority of the City of San José** – The Parking Authority of the City of San José (the "Parking Authority") was created by the City Council to provide funding through debt issuance for parking facilities constructed on City-owned land. Such parking facilities are leased to the City. Members of the City Council are also members of the Parking Authority's Board of Directors.

- **San José – Santa Clara Clean Water Financing Authority** – The San José **–** Santa Clara Clean Water Financing Authority (the "Clean Water Financing Authority") was created pursuant to a Joint Exercise of Powers Agreement between the City of San José and the City of Santa Clara. The purpose was to finance the acquisition of, and additions and improvements to the existing San José – Santa Clara Water Pollution Control Plant (the Plant). The Clean Water Financing Authority is governed by a five-member Board of Directors, three are members of the City Council of the City of San José and two are members of the City Council of the City of Santa Clara. The Clean Water Financing Authority and the cities of San José and Santa Clara subsequently entered into an Improvement Agreement, which requires each city to make base payments that are at least equal to each city's allocable share of debt service requirements of the Clean Water Financing Authority's outstanding revenue bonds.

(Continued)

- **City of San José Financing Authority** – The City of San José Financing Authority (the "Authority") was created by a Joint Exercise of Powers Agreement between the City and the Redevelopment Agency. The Authority was created for the purpose of facilitating the financing of public improvements and facilities within the City and is authorized to issue bonds for this purpose. The Authority is governed by an 11 member Governing Board, which consists of the members of the City Council.

Separate financial reports for the fiscal year ended June 30, 2007, containing additional information and more detailed information regarding financial condition and change in financial position, are available from the City's Director of Finance, 200 East Santa Clara Street; 13th Floor, San José, CA 95113-1905, for the following:

- Federated City Employees' Retirement System (the "System")
- Police and Fire Department Retirement Plan (the "Plan")
- Redevelopment Agency of the City of San José
- Norman Y. Mineta San José International Airport
- San José – Santa Clara Clean Water Financing Authority

B. Financial Statement Presentation

***Government-wide Financial Statements*.** The government-wide financial statements (i.e. the statement of net assets and the statement of activities) display information about the primary government (the "City") and its component units. These statements include the financial activities of the overall government, except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. For example, the direct expenses charges based on actual use are not eliminated, whereas indirect expense allocations made in the funds are eliminated. These statements distinguish between the *governmental* and *business-type* activities of the City. Governmental activities, which normally are supported by taxes, intergovernmental revenues and other non-exchange transactions, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties.

The statement of activities, which is included in the government-wide financial statements, presents a comparison between direct expenses and program revenues for each business-type activity of the City and each function of the City's governmental activities. Direct expenses are those that are specifically associated with a business-type activity or governmental function and; therefore, are clearly identifiable to a particular activity or function. Program revenues include 1) fees, fines and charges paid by the recipients of goods or services offered by the programs, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are instead presented as general revenues.

***Fund Financial Statements*.** The fund financial statements provide information about the City's funds, including its fiduciary funds. Separate statements for each fund category, such as governmental, proprietary and fiduciary, are presented. The emphasis of fund financial statements are on the major governmental and enterprise funds of the City and are reported separately in the accompanying financial statements. All remaining governmental funds are aggregated and reported as non-major funds in the accompanying financial statements.

(Continued)

Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

The City reports the following major governmental funds:

The ***General Fund*** is the City's primary operating fund. It accounts for all revenues and expenditures necessary to carry out basic governmental activities of the City that are not accounted for through other funds.

The ***Redevelopment Agency Fund*** is a capital projects fund that accounts for administrative, operating, low-to-moderate income housing program, debt and construction activities necessary to carry out responsibilities for redeveloping and upgrading blighted areas in the City.

The ***Housing Activities Fund*** is a special revenue fund that accounts for the City's affordable housing activities.

The ***Special Assessment Districts Fund*** is a capital projects fund that accounts for the capital project and debt activities related to debt issued to finance public improvements benefiting properties against which special assessments or special taxes are levied.

The **City of San José Financing Authority** is a debt service fund that accounts for the debt activities related to capital projects funded with Authority debt.

The City reports the following major enterprise funds:

The ***Norman Y. Mineta San José International Airport Fund*** accounts for the activities of the City owned commercial service and general aviation airport.

The ***Wastewater Treatment System Fund*** accounts for the financing, construction, and operations of the City's sewer system, the Water Pollution Control Plant (the Plant), and the regional water reclamation program.

The ***Municipal Water System Fund*** accounts for the operations of the five water system operating districts: North San José, Evergreen, Coyote, Edenvale and Alviso.

The ***Parking System Fund*** accounts for the operations of the parking garage facilities, parking lots and parking meters located within the City.

The City reports the following fiduciary fund types:

The ***Pension Trust Funds*** account for the accumulated resources to be used for retirement annuity and postemployment healthcare payments to members of the Federated City Employees' Retirement System (the "System") and the Police and Fire Department Retirement Plan (the "Plan" and collectively, the "Retirement System").

The ***James Lick Private Purpose Trust Fund*** is used to account for resources legally held in trust for use towards the support of the Eastfield Home of Benevolence (orphanage). All resources of the fund, including any earnings on invested resources, are used to support the organization's activities.

The ***Agency Funds*** account for assets held by the City in a custodial capacity on behalf of the San José Arena and the Health Care Financing Administration.

(Continued)

The City reports the following internal service fund:

The ***Public Works Program Support Fund*** is used to account for Public Works Department administrative services provided to citywide capital programs and certain other Public Works operating divisions on a cost reimbursement basis.

C. Measurement Focus and Basis of Accounting

The basis of accounting determines when transactions are reported on the financial statements. The government-wide, proprietary and fiduciary funds (excluding agency funds) financial statements are reported using the economic resources measurement focus. The government-wide, proprietary fund and trust funds financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non-exchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property and sales taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenues from sales and use, transient occupancy and utility user tax are recognized when the underlying transactions take place. Revenues from grants, entitlements and donations are recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental funds are reported using the current financial resources measurement focus. This focus is on the determination of, and changes in financial resources, and generally only current assets and current liabilities are included in the balance sheet. These funds use the modified accrual basis of accounting, whereby revenues are recognized in the accounting period in which they become both measurable and available to finance expenditures of the fiscal period. For this purpose, the City considers revenues as available if they are collected within sixty days of the end of the current fiscal period. Expenditures are generally recorded when a liability is incurred. However, principal and interest on long-term debt and certain estimated liabilities, such as compensated absences and self-insurance claims, are recorded only when payment is due.

In governmental funds, revenues from taxes, licenses, franchise taxes, interest, certain state and federal grants and charges for services associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues in the current period. All other revenue items are considered measurable and available only when cash is received by the City.

Proprietary funds distinguish between operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund’s principal ongoing operations. The principal operating revenues of the City’s enterprise funds are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Under the terms of grant agreements, the City funds certain programs by a combination of specific cost-reimbursement grants, categorical block grants and general revenues. Thus, when program expenses are incurred, there are both restricted and unrestricted net assets available to finance the program. It is the City’s policy to first apply restricted cost-reimbursement grant resources to such programs, followed by restricted categorical block grants, and then by unrestricted general revenues.

All business-type activities and enterprise funds of the City follow FASB Statements and Interpretations issued on or before November 30, 1989, Accounting Principles Board Opinions or any Accounting Research Bulletins unless those pronouncements conflict with or contradict GASB pronouncements.

D. Use of Estimates

A number of estimates and assumptions relating to the reporting of revenues, expenditures/expenses, assets and liabilities, and the disclosure of contingent liabilities were used to prepare these financial statements in conformity with accounting principals generally accepted in the United States of America. Actual results could differ from those estimates.

E. New Pronouncements

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Post-employment Benefit Plans Other Than Pension Plans*. This statement establishes uniform financial reporting standards for other post-employment benefits (OPEB) plans. This statement was developed to address the growing concern about the magnitude of state and local governments' obligation to provide OPEB for their employees and the lack of information about those obligations in general purpose external financial reports. The approach followed in this statement generally is consistent with the approach adopted for defined benefit pension plans with modifications to reflect differences between pension plans and OPEB plans. The statement applies for OPEB trust funds included in the financial reports of plan sponsors or employers, as well as for the stand-alone financial reports of OPEB plans or the public employee retirement systems, or other third parties, that administer them. Application of this statement is effective for the City's fiscal year ended June 30, 2007. The additional disclosures concerning the implementation of GASB 43 is available in note IV.

The City is currently analyzing its accounting practices to determine the potential impact on the financial statements for the following Governmental Accounting Standards Board (GASB) Statements:

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions*, which addresses how state and local governments should account for and report their costs and obligations related to post-employment healthcare and other non-pension benefits. Collectively, these benefits are commonly referred to as other post-employment benefits, or OPEB. The statement generally requires that employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. This statement's provisions may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. This statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. Application of this statement is effective for the City's fiscal year ending June 30, 2008.

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, which establishes criteria that governments will use to ascertain whether the proceeds received, should be reported as revenue or as a liability. The criteria should be used to determine the extent to which a transferor government either retains or relinquishes control over the receivables or future revenues through its continuing involvement with those receivables or future revenues. This Statement also provides additional guidance for sales of receivables and future revenues within the same financial reporting entity.

Application of this statement is effective for the City's fiscal year ending June 30, 2008.

In November 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations,* which addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the statement excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning. Application of this statement is effective for the City's fiscal year ending June 30, 2009

In May 2007, GASB issued Statement No. 50, *Pension Disclosures*, which more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits (OPEB) and, in doing so, enhances information disclosed in notes to financial statements or presented as required supplementary information (RSI) by pension plans and by employers that provide pension benefits. The reporting changes required by this Statement amend applicable note disclosure and RSI requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,* and No. 27, *Accounting for Pensions by State and Local Governmental Employers,* to conform with requirements of Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* and No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.* Application of this statement is effective for the City's fiscal year ending June 30, 2008.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets.* This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. Application of this statement is effective for the City's fiscal year ending June 30, 2010.

F. Assets, Liabilities, and Net Assets or Equity

1. Cash and Cash Equivalents

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

2. Equity in Pooled Cash and Investments Held in City Treasury

Most cash balances of the City's funds and some of its component units are pooled and invested by the City Treasurer unless otherwise dictated by legal or contractual requirements. Income and losses arising from the investment activity of pooled cash are allocated to the participating funds and component units on a monthly basis, based on their proportionate shares of the average weekly cash balance.

3. Deposits and Investments

Investments are accounted for in accordance with the provisions of GASB Statement No. 31; *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.* This Statement requires governmental entities to report investments at fair value in the statement of net assets or balance sheet and to recognize the corresponding change in fair value of investments in the year in which the change occurred.

Pooled Cash and Investments held in City Treasury. The City reports its investments held in City Treasury at fair value. The fair value is based on quoted market information obtained from fiscal agents or other sources. Income from some investments is allocated directly to the General Fund rather than the fund that holds the investment on which the income was earned. The assignment of the income from these investments is supported by legal or contractual provisions approved by the City Council. For the fiscal year ended June 30, 2007, the total investment income from these funds allocated to the General Fund was approximately $4,693,000.

Retirement Systems. Investments of the Retirement Systems are reported at their fair value and include securities lending transactions. Securities traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. Investments that do not have an established market are reported at estimated fair value. The fair value of the private equities are based on the net asset value of those funds as ascertained from the most recently available investor reports or financial statements issued by the manager of those funds. The fair value of real estate investments is based on independent appraisals. The Retirement Systems investments in pooled holdings have the accompanying securities held by the fund manager in accordance with the above standards. At June 30, 2007, the Retirement Systems had the following pooled holdings: $24,295,000 in fixed income, $404,547,000 in international equities, $412,623,000 in domestic equities, $58,323,000 in real estate, and $64,671,000 in private equities. Purchases and sales of securities are reflected on the date of trade. Investment income is recognized as earned. Rental income from real estate activity is recognized as earned, net of expenses.

Other Investments. Non-pooled investments are generally carried at fair value. However, investments in guaranteed investment contracts are carried at cost and special assessments bonds at amortized cost. Income from non-pooled investments is recorded based on the specific investments held by the fund. The interest income is recorded in the fund that earned the interest.

4. Inventory

Inventory of the proprietary funds is valued at the lower of cost (first-in/first-out) or market. In the governmental funds, inventory items are valued at average cost. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased.

5. Special Assessment Districts

Special assessments are recorded as receivables when they become a lien on property. Special assessments not considered available are recorded as receivables and offset by deferred revenues in the governmental fund financial statements. The special assessment bonds are fully secured by liens against the privately owned properties benefited by the improvements for which the bonds were issued. There is no reserve for delinquent receivables since priority liens exist against the related properties and hence the City's management believes value will ultimately be received by the City. Surplus funds remaining at the completion of a special assessment district project are disposed of in accordance with the City Council's resolutions and with the applicable assessment bond laws of the State of California. A liability is recorded for the balance remaining until a final legal determination has been made.

(Continued)

6. Advances and Deposits

Amounts deposited in connection with eminent domain proceedings and special assessment surpluses are reported as advances and deposits. In the governmental fund statements, non-current portions of these are offset equally by either a deferred credit or a fund-balance reserve account that indicates they do not constitute expendable financial resources available for appropriation.

7. Other Assets

Other assets primarily consist of real properties acquired outright and/or through foreclosure in connection with the housing rehabilitation program. These assets are recorded at the lower of cost or estimated net realizable value.

8. Bond Issuance Costs; Original Issue Discounts and Premiums and Deferred Amounts on Refundings

In the government-wide financial statements and the proprietary fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are deferred and are amortized over the term of the related debt. Gains or losses occurring from advance refundings, completed subsequent to June 30, 1993, are deferred and amortized into expense for both business-type activities and proprietary funds. For governmental activities, they are deferred and amortized into expense if they occurred subsequent to June 30, 2001.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

9. Restricted Assets

Assets that are restricted for specific uses by bonded debt requirements, grant provisions or other requirements are classified as restricted because they are maintained in separate bank accounts or by fiscal agents, and their use is limited by applicable bond covenants or agreements.

10. Capital Assets

Capital assets include land, buildings, improvements, vehicles and equipment, infrastructure and all other tangible and intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Capital assets are reported in the applicable governmental or business-type activity columns in the government-wide financial statements and the proprietary funds’ statement of net assets. Capital assets are defined as assets with an initial individual cost of more than $5,000 for general capital assets and $100,000 for major infrastructure assets, and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the time received. Capital outlay is recorded as expenditures of the governmental funds and as assets in the government-wide financial statements to the extent the City’s capitalization threshold is met. Interest incurred during the construction phase of capital assets of business-type activities is reflected in the capitalized value of the asset constructed, net of interest earned on the invested proceeds over the same period. Amortization of assets acquired under capital leases is based on the shorter of the lease term or the estimated useful life of the asset and is included in depreciation and amortization.

(Continued)

Buildings and improvements, infrastructure, and vehicles and equipment are depreciated using the straight-line method over the following estimated useful lives:

Buildings	5 – 40 years
Improvements, other than buildings	10 - 50 years
Infrastructure	25 - 50 years
Vehicles and equipment	2 - 40 years
Furniture and fixtures	10 years
Intangible assets	40 years

Capital assets, which are used for general governmental purposes and are not available for expenditure, are accounted for and reported in the government-wide financial statements. Capital assets that meet the definition of the major infrastructure networks or extend the life of existing infrastructure networks are capitalized as infrastructure. Infrastructure networks include road, bridges, drainage systems, and lighting systems.

11. Compensated Absences – Accrued Vacation, Sick Leave, and Compensatory Time

Vested vacation, sick leave, compensatory time, and related benefits are accrued as appropriate. For governmental funds, compensated absence obligations are recorded in the appropriate governmental funds when due. The portion not currently due is recorded in the government-wide financial statements. For enterprise funds, compensated absences are expensed when earned by employees. At year-end, the accrued but unpaid compensated absence obligations are recorded as current and non-current liabilities in the appropriate enterprise funds.

Vacation pay may be accumulated up to a maximum of 400 hours or two times of annual accrual rate and carried forward for more than one year in most circumstances. Sick pay vests when a full-time employee reaches 15 years of service (20 years for police officers and firefighters) based on the following percentages, up to a maximum of 1,200 accumulated hours:

Hours Accumulated	Amount Vested
1 to 399	50%
400 to 799	60%
800 to 1,200	75%

The amount vested for police officers and firefighters who have accumulated over 1,200 and 1,680 hours of sick leave, respectively, is 100%, provided that, the employee is a non-disabled, service retiree whom has not lost their life while on active service.

Management employees who have 15 years of service become vested for 75% of an additional 192 hours of sick leave above the 1,200 hour maximum, provided these hours were earned in the last 2 years of service.

Payments for vacation and compensatory time to regularly scheduled part-time employees who retire after 15 years of service are based on actual earned hours.

12. Inter-fund Transactions

Inter-fund transactions are reflected as loans, services provided, reimbursements and/or transfers. Loans and balances related to unsettled service transactions are reported as receivables and payables as appropriate, are subject to elimination upon consolidation of similar fund types, and are referred to as either "due to/from other funds" (i.e., the current portion of inter-fund loans and unsettled service transactions) or “advances to/from other funds” (i.e., the non-current portion of inter-fund loans). Any residual balances outstanding between the governmental activities and the business-type activities are reported in the government-wide financial statements as “internal balances”. Advances to other funds, as reported in the fund financial statements, are offset by a fund-balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not available financial resources.

Services provided are deemed to be at market or near market rates and are treated as revenues and expenditures/expenses. Reimbursements are defined as when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other inter-fund transactions are treated as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide presentation.

13. Self-Insurance

The City is self-insured for workers’ compensation, general liability, auto liability, and certain other risks. The City’s workers’ compensation activities are funded and accounted for separately in the fund financial statements based upon the activities of each fund. The current portion of claims liability are accounted for in the General Fund and the enterprise funds on the basis of settlements reached or judgments entered within the current fiscal year. In the government-wide financial statements and the enterprise fund financial statements, the estimated liability for all self-insurance liability claims is recorded as a liability.

14. Net Assets/Fund Equity

The government-wide and proprietary fund financial statements utilize a net assets presentation. Net assets are categorized as invested in capital assets (net of related debt), restricted, and unrestricted.

- *Invested In Capital Assets, Net of Related Debt* - This category groups all capital assets, including infrastructure, into one component of net assets. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction, or improvement of these assets reduce the balance in this category.

- *Restricted Net Assets* – This category represents net assets that have 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. At June 30, 2007, the government-wide statement of net assets reported restricted assets of $506.0 million in governmental activities and $248.0 in business type activities. Of these amounts $360.0 million and $108.4 million, respectively, are restricted by enabling legislation.

- *Unrestricted Net Assets* – This category represents net assets of the City, not restricted for any project or other purpose.

In the governmental fund financial statements, reserves and designations segregate portions of fund balance that are either not available or have been earmarked for specific purposes. The various reserves and designations are established by actions of the City Council and management and can be increased, reduced or eliminated by similar actions.

(Continued)

Reservations of fund balance are described as follows:

- *Encumbrances* - to reflect the outstanding contractual obligations for which, goods and services have not been received.
- *Non-current advances, loans, other assets, and cash commitments* - to reflect the portion of assets that are not currently available as a spendable resource.
- *Debt service* - to reflect the funds held by trustees or other fiscal agents for future payment of principal and interest related to bond issue. These funds are not available for general operations.

Portions of unreserved fund balance may be designated to indicate tentative plans for financial resource utilization in a future period. Such plans or intent are subject to change and have not been legally authorized or may not result in expenditures. Fund balance designations include:

- *Contingencies* - to reflect management's intent to expend certain funds for future unanticipated needs.
- *Future projects and redevelopment activities* - to reflect management's intent to expend certain funds approved for capital projects in prior year's but not yet completed.

The unreserved governmental fund balance designations at June 30, 2007 are composed of the following (dollars in thousands):

	General Fund	Redevelopment Agency	Housing Activities	Special Assessment Districts	San Jose Financing Authority	Nonmajor Funds	Total
Unreserved, designated for:							
Future projects	$ 91,850	-	-	13,257	-	571,088	$ 676,195
Contingencies	67,176	-	-	-	-	-	67,176
Undesignated	85,863	(1,776)	10,676	-	(31,493)	-	63,270
Total unreserved fund balances	$ 244,889	(1,776)	10,676	13,257	(31,493)	571,088	$ 806,641

15. Property Taxes

Property taxes are collected on behalf of and remitted to the City by Santa Clara County (the County). The amount of property tax levies is restricted by Article 13A of the California State Constitution (commonly referred to as Proposition 13).

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

	Secured	Unsecured
Valuation/lien dates	January 1	January 1
Levy dates	October 1	July 1
Due dates (delinquent after)	50% on November 1 (December 10)	July 1 (August 31)
	50% on February 1 (April 10)	

The City has elected to participate in the "Teeter Plan" offered by the County whereby cities receive 100% of secured property and supplemental property taxes levied in exchange for foregoing any interest and penalties collected on the related delinquent taxes. Accordingly, property taxes levied for the fiscal year are recorded as revenue when received from the County.

General property taxes are based either on a flat 1% rate applied to the fiscal 1976 full value of the property or on 1% of the sales price of the property on sales transactions and construction that occur after the fiscal 1976 valuation. Assessed values on properties (exclusive of increases related to sales and construction) can rise at a maximum of 2% per year depending on increases in the consumer price index.

The City's net assessed valuation for the fiscal year ended June 30, 2007, was approximately $109.7 billion, an increase of approximately 9% over the previous year. The tax rate was approximately $0.189 per $100 of assessed valuation, which included the 1% basic levy and additional levies for general obligation bonds Measures “O” and “P” (2000) and Measure “O” (2002).

16. Wastewater Treatment System

The Wastewater Treatment System is an enterprise of the City and is comprised of the Water Pollution Control Plant (the Plant), including South Bay Water Recycling and the San José Sewage Collection System.

The Plant provides wastewater treatment services to the City of San José and to seven other sewage collection agencies. The Clean Water Financing Authority was established to provide financing for the capital programs of the Plant including the regional water reclamation program. The City's sewer service rates pay for the City's share of the Plant operations, maintenance, and administration and capital costs.

In 1959, the City and the City of Santa Clara entered into an agreement to jointly own and operate the Plant. Under the agreement, the City of San José serves as the administering agency and is responsible for operating and maintaining the Plant. The cities own an undivided interest in the Plant and share in the capital and operating costs on a pro rata basis, determined by the ratio of each city's assessed valuation to the sum of both cities' assessed valuations. Annually, these percentages are determined and applied to the capital and operating costs, on an accrual basis.

For the fiscal year ended June 30, 2007, the City's portion of the capital and operating costs was approximately 80% and, based on operations through the fiscal year ended June 30, 2007, the City's interest in the net assets of the Plant was approximately 80%.

II. Stewardship, Compliance, and Accountability

A. Deficit Fund Balances

Deficit fund balances of $2,234,000, $424,000 and $31,399,000 were reported in non-major capital projects Fiber Optics Development Fund, the Civic Center Improvement Fund and the City of San José Financing Authority major debt service fund, respectively. The deficit fund balance for the Fiber Optics Development Fund will be eliminated with future transfers from the General Fund. The Civic Center Improvement Fund deficit will be eliminated with transfers made from future commercial paper proceeds. The San José Financing Authority deficit fund balance will be eliminated with future debt service transfers from other governmental funds.

(Continued)

III. Detailed Notes on All Funds

A. Cash, Deposits and Investments

Total City cash, deposits and investments, at fair value, are as follows (dollars in thousands):

	Governmental Activities	Business-type Activities	Fiduciary Funds: Pension Trust	Fiduciary Funds: Private-Purpose Trust	Fiduciary Funds: Agency	Carrying Value
Equity in pooled cash and investments	$ 714,730	294,148	-	33	1,672	$ 1,010,583
Other cash and investments	6	-	-	-	-	6
Restricted investments:						
Equity in pooled cash and investments	91,831	147,848	-	-	-	239,679
Other cash and investments	542,993	100,269	-	-	-	643,262
Investments of retirement plans	-	-	5,515,653	-	-	5,515,653
Total deposits and investments	$ 1,349,560	542,265	5,515,653	33	1,672	7,409,183
Deposits						(11,835)
Investments						7,421,018
Total deposits and investments						$ 7,409,183

Pooled Cash and Investments Held in City Treasury. The City maintains a cash and investment pool that is available for use by all funds and certain component units. Each fund's portion of this pool is displayed on the accompanying governmental fund balance sheets and proprietary fund statement of net assets as "Equity in pooled cash and investments held in City Treasury."

Other Cash and Investments. The City has other investments outside the City Treasury that are invested pursuant to various governing bond covenants, San José Municipal Code or California Government Code provisions.

Other investments consist primarily of deposits and investments with trustees related to the issuance of bonds and to certain loan programs operated by the City. These investments are made either in accordance with bond covenants, and are pledged for payment of principal, interest, and specified capital improvements or in accordance with trust and grant agreements.

Investments in Retirement Plans. The Retirement Systems' funds are invested pursuant to policy guidelines established by the Retirement Systems' Boards. The objective of the investment policy is to maximize the expected return of the funds at an agreed upon level of risk. The Retirement Boards have established percentage guidelines for types of investments to ensure the portfolio is diversified.

Investments in forward currency contracts of the Pension Trust Funds are recorded commitments to purchase or sell stated amounts of international currency. The Retirement Systems' net position in these contracts is recorded at fair value as short-term international currency investments. The fair value of forward currency contracts is determined by quoted currency prices from national exchanges.

Investment Risk. The investments are subject to certain types of risk, including interest rate risk, credit quality risk, concentration of credit risk, custodial credit risk and foreign currency risk. These risks are addressed separately for the investments related to governmental and business-type activities and those related the Retirement Systems, as follows:

1. **Governmental and Business-Type Activities**

Interest Rate Risk. Interest rate risk is the risk that changes in market rates will adversely affect the fair market value of an investment. Generally, the longer the time of maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. Additionally, the fair values of the investments may be highly sensitive to interest rate fluctuations. One of the ways that the City manages its exposure to interest rate risk is by purchasing a combination of shorter-term and longer-term investments and by timing the cash flows from the maturities so that a portion is maturing or coming close to maturing evenly over time, as necessary to provide the cash flow and liquidity needs for operations. As of June 30, 2007, there were no investments, with fair values, that were highly sensitive to interest rate fluctuation.

The City has the ability and generally has the intention to hold all investments until their respective maturity dates. The average maturity of the City's pooled cash and investments as of June 30, 2007, was approximately 569 days or 19 months. The Investment Policy does not prohibit the sale of securities prior to maturity. However any portfolio restructuring requires prior conceptual approval in writing from the City Manager and the Director of Finance. Section 14.2 of the Investment Policy further defines the parameters with respect to restructuring the portfolio.

Credit Quality Risk. Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This risk is measured by the assignment of a rating by a nationally recognized statistical rating organization.

Investment in Local Agency Investment Fund. The City is a voluntary participant in the California Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Local Investment Advisory Board (Board). The Board consists of five members as designated by state statute. The fair value of the City's investment in the LAIF pool is reported in the accompanying financial statements at amounts based upon the City's pro-rate share of the fair value provided by the LAIF, for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by the LAIF, which are recorded on an amortized cost basis, which is different from the fair value of the City's position in the LAIF pool.

As of June 30, 2007, the City's investment in LAIF is approximately $137,705,000. The total amount recorded by all public agencies in LAIF at that date is approximately $19,736,253,000,000. Of that amount, 97% is invested in non-derivative financial products and 3% in structured notes and asset backed securities.

Concentration of Credit Risk. The City Council adopted an investment policy (the "Policy") on April 2, 1985, as amended on June 5, 2007, related to the City's cash and investment pool, which is subject to annual review. The Policy prohibits investment in securities purchased with the intent to trade for a profit. Per the Policy the investments conform to Sections 53600 et seq. of the California Government Code and the applicable limitations contained within the Policy.

(Continued)

The following table identifies the investment types that are authorized for the City by the California Government Code and Policy, where more restrictive:

Authorized Investment Type	Maximum Maturity	Maximum Percentage or Dollar of Portfolio	Maximum Investment in One Issuer
U.S. Treasury Obligations	5 Years	None	None
U.S. Government Agency Issues	5 Years	None	None
Bankers' Acceptances	180 Days	25%	5%
Insured Time Deposits	3 Years	$10 Million	5%
Uninsured Time Deposits	18 Months	$10 Million	5%
Commercial Paper	270 Days	20%	5%
Negotiable Certificates of Deposit	180 Days	25%	5%
Repurchase Agreements	10 Days	None	None
Reverse Repurchase Agreements	30 Days	$25 Million or 20%	Only one instrument permitted at a time
Corporate Notes	3 Years	15%	5%
Local Agency California Investment Fund	None	None	None
Money Market Mutual Funds	None	15%	5%
California Municipal Bonds – Category 1	5 Years	15%	5%
California Municipal Bonds – Category 2	5 Years	5%	5%
California Municipal Bonds – Category 3	5 Years	10 %	5%
Investment Agreements	None	None	None

Other restrictions on investments are summarized as follows:

- Purchases of United States government agency securities are limited to issues of Federal Farm Credit Banks (FFCBs), the Federal Home Loan Banks (FHLBs), Federal Home Loan Mortgage Corporation (FHLMC), the Federal National Mortgage Association (FNMA), and Student Loan Marketing Association (SLMA).
- The purchase of Banker Acceptances (BAs) are limited to issues by domestic U.S. or foreign banks and which must be rated by Fitch as follows: an issuer of "B" or better for domestic U.S., "C" or better for California banks or "A/B"" or better for foreign banks. Additionally, foreign BAs must be in U.S. dollar denominations.
- Insured and uninsured time deposits are limited to issuances from banks and savings and loans with offices located in the San Jose area and deposits shall not exceed the net worth of that depository. Additionally, concerning uninsured time deposits, depositories must have an issuer rating of "B" or better by Fitch Ratings and be collateralized in a manner prescribed by state law for depositories.
- Investments in commercial paper are limited to investments in domestic corporations with the highest ranking or with the highest letter and number rating as provided for by the three nationally recognized rating services. Issuing corporations must be organized and operating within the U.S. and have total assets in excess of $500,000,000.
- Negotiable certificates of deposit are limited to banks and savings and loans with an issuer rating of "A/B" or better by Fitch Ratings and may not exceed the net worth of issuing institution.

- Repurchase agreements are to be executed only with primary dealers of the Federal Reserve Bank of New York and financial institutions, which have entered into the City's Master Repurchase Agreement and any subsequent amendments to the Master Repurchase Agreement. Securities accepted as collateral for the repurchase agreement are limited to U.S. Treasury or U.S. Federal Government Agencies permitted under the Policy. The market value of the securities that have been accepted as collateral shall, at the time of transfer, equal at least 102 percent face value of the repurchase agreement. For other than overnight investments, the securities transferred shall be marked to market on a daily basis and maintained at a market value to at least 102 percent of purchase agreement's face value.

- Corporate notes eligible for investment must be rated "A" or better by two of the three nationally recognized rating services.

- Funds invested in Local Agency Investment Fund, a State of California managed investment pool, may be made up to the maximum dollar amount per separate legal entity in conformity with account balance limits authorized by the California State Treasurer.

- Investments in money market mutual funds are limited to those funds registered with the Securities and Exchange Commission and for which either one of the credit criteria are met: (1) obtained the highest ranking or highest letter and numerical rating provided by no less than two nationally recognized rating services or (2) retained an investment advisor registered with the SEC. Investments by the funds are restricted to U.S. Treasury and U.S. Government Agency backed securities permitted under the Policy and be maintained at no less than $1.00 per share.

- Reverse repurchase agreements under the Policy are limited to the lesser of $25,000,000 or 20% of the portfolio value and to those occasions where unanticipated short-term cash requirements can be met more advantageously by initiating a reverse repurchase agreement than by selling a security into the secondary market prior to maturity.

- Investment agreements may be used for the investment of bond proceeds in accordance with the permitted investment provisions of the specific bond indentures and in accordance with other safeguards outlined in the Policy to reduce the risk associated with a Provider's inability to meet its contractual obligations.

- California municipal bonds under the Policy are limited to a total of no more than 20% of the portfolio value. The Policy establishes three California municipal bond categories (1 through 3): bonds issued by the City or its agencies (as defined in the Policy), by the State of California, and by other California local agencies, respectively. Eligible securities must be rated AA or better by two nationally recognized rating services. For category 3, a rating of AAA through credit enhancements is also permitted.

The Policy permits the Director of Finance to authorize investments that depart from the Policy's numerical limits if such an action is in the best interest of the City and is otherwise consistent with the Policy and applicable City, State and federal laws. Whenever a deviation from the Policy is made, it must be reported to the City Manager and the City Council within one business day. During fiscal year ended June 30, 2007, there were no deviations from or violations against the Policy.

(Continued)

The Policy stipulates that no more than 5% of the total portfolio can be invested in investments of a single institution other than securities issued by the U.S. Treasury, U.S. Government Agencies (as defined in the policy) and LAIF.

The following schedule indicates the interest rate risk, credit quality risk and concentration credit risk of the City's investments, as of June 30, 2007. The credit ratings listed are for Moody's Investors Services and Standard and Poor's, respectively. Certain investments, such as obligations, which are backed by the full faith and credit of the United States Government, are exempt from credit rating disclosures (dollars in thousands):

Type of Investment	Credit Rating	Maturity: Under 30 Days	Maturity: 31 - 180 Days	Maturity: 181 - 365 Days	Maturity: 1 - 5 Years	Maturity: Over 5 Years	Carrying Value
Pooled investments in the City Treasury:							
U.S. Treasury notes and bonds	Exempt	$ -	10,020	-	-	-	$ 10,020
Federal Farm Credit Banks *	Aaa / AAA	-	20,107	-	138,347	-	158,454
Federal Farm Credit Banks - Callable	Aaa / AAA	-	-	2,956	2,098	-	5,054
Federal Home Loan Banks *	Aaa / AAA	-	90,017	61,678	304,415	-	456,109
Federal Home Loan Banks - Callable*	Aaa / AAA	-	9,895	9,925	83,787	-	103,608
Federal Home Loan Banks - Discount*	P-1 / A-1+	41,933	-	-	-	-	41,933
Federal Home Loan Mortgage Corporation *	Aaa / AAA	-	39,169	8,326	119,275	-	166,770
Federal Home Loan Mortgage Corporation - Callable*	Aaa / AAA	-	-	4,883	74,486	-	79,369
Federal Home Loan Mortgage Corporation - Discount*	P-1 / A-1+	53,117	1,368	-	-	-	54,485
Federal National Mortgage Association	Aaa / AAA	-	4,981	29,916	19,531	-	54,429
Federal National Mortgage Association - Callable	Aaa / AAA	-	-	-	4,722	-	4,722
Commercial paper	P-1 / A-1+	59,071	-	-	-	-	59,071
Money market mutual funds	AAAm	1,047	-	-	-	-	1,047
Local agency investment fund	Not Rated	-	74,616	-	-	-	74,616
Total pooled investments in the City Treasury		155,168	250,173	117,684	746,660	-	1,269,685
Other funds:							
U.S. Treasury bills	Exempt	39	-	-	-	-	39
U.S. Treasury notes and bonds	Exempt	-	-	404	-	-	404
Federal Home Loan Banks - Discount **	P-1 / A-1+	123,192	1,900	-	-	-	125,092
Federal Home Loan Mortgage Corporation - Discount **	P-1 / A-1+	126,225	62,179	1,083	-	-	189,488
Federal National Mortgage Association - Discount**	P-1 / A-1+	43,725	-	-	-	-	43,725
Investment agreements***	Not Rated	-	2,490	-	-	34,171	36,661
Commercial paper	P-1 / A-1+	8,863	-	-	-	-	8,863
Money market mutual funds	AAAm	168,319	-	-	-	-	168,319
Local agency investment fund	Not Rated	-	63,089	-	-	-	63,089
Total other funds		470,364	129,658	1,487	-	34,171	635,680
Total citywide investments (excluding Retirement Systems)		$ 625,531	379,831	119,171	746,660	34,171	1,905,365
Retirement Systems:							
Total investments in Retirement Systems (See page 60 and 61)							5,515,653
Total investments							$ 7,421,018

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* Investments with these issuers represent more than 5% of the City's pooled investments held in the City's Treasury.

** Investments with these issuers represent more than 5% of the investments held outside of the City's Treasury.

*** The City invested $34,171 in MBIA investment agreements which are more than 5% of the investments held outside the City's Treasury.

Custodial Credit Risk. Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the City will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker - dealer) to a transaction, the City will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code requires that a financial institution secure its deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by the depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged governmental securities and/or first trust deed mortgage notes held in the collateral pool must be at least 110% and 150% of the

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City's deposits, respectively. The collateral is held by the pledging financial institution's trust department and is considered held in the City's name.

As of June 30, 2007, the carrying amount of the City's deposits with financial institutions was in an overdraft position amount of $11,835,000 and the bank balance was $13,916,000. The difference between the carrying amount and bank balance relates to outstanding checks and wire transfers issued against the general operating account. Of the bank balance, $500,000 was covered by Federal depository insurance and $13,416,000 was collateralized.

Foreign Currency Risk. The risk that changes in exchange rates will adversely affect the fair value of an investment. As of June 30, 2007, the investments in the City's investment pool were not subject to foreign currency risk.

2. Retirement Systems

Interest Rate Risk. The fair value of fixed-maturity investments fluctuate in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value of those instruments. The fair value of interest sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, and other general market conditions. Certain fixed maturity investments have call provisions that could result in shorter maturity periods. The Retirement Systems do not have policies for managing interest rate risk, although the Retirement Systems do hold certain investments that could be affected by changes in interest rates. The Retirement Systems have investments in U.S. Government National Mortgage Association (GNMA's) in the amount of $14,736,000 and U.S. government agency securities in the amount of $481,248,000 backed by mortgage pass-throughs which are sensitive to interest rate changes. Therefore, if interest rates decline, the mortgages are subject to prepayments by borrowers. In addition, $9,527,000 of the asset backed securities, $10,110,000 of the collateralized mortgage obligations, and $4,696,000 of the corporate securities are floating rate securities tied to 1–3 month LIBOR. The Retirement Systems also had $2,298,000 of the collateralized mortgage obligations invested in floating rate securities tied to 1–12 month LIBOR plus 32-45 bps and $1,495,000 of floating rate FHMC's securities tied to the one-year CMT plus 212.9 bps. In addition, the Retirement Systems have investments in international government variable rate bond in the amount of $533,000 which are linked to the URINUSCA Index that is reset semi-annually and investments in international corporate bonds of which $2,715,000 is principal only and $703,000 which is a floater linked to the KRN 3 month CD that is reset quarterly.

Custodial Credit Risk. For an investment, custodial credit risk is the risk that an entity will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party if the counterparty fails. The Retirement System's custodians hold all investments of the Retirement Systems in the Retirement Systems' name except for the assets held "not-in-bank" pooled funds that are held under custody of the investment managers' custodian bank.

Credit Quality Risk. Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This risk is measured by nationally recognized statistical rating organizations that provide rating of debt securities quality, based on a variety of factors, such as the financial conditions of the issuers, which provide investors with some idea of the issuer's ability to meet its obligations.

The System's assets shall generally be invested in investment grade, marketable, fixed-income securities. Domestic fixed maturity investment grade shall be defined as being rated Baa/BBB or better by two of the following three rating service: Moody's Investors Service, Standard & Poor's or Fitch Ratings. If the ratings are provided by only two agencies and the third is non-rated, the most conservative (lowest) rating will be assigned. If only one agency assigns a rating, that rating will be

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used. Up to 15% investment in BB or B securities will be permitted with written authorization of the System's Board. The investment managers employed to manage domestic fixed-income securities will have discretion in the day-to-day management of the funds under their control. International fixed maturity must be at least Aa3/AA-. If the corresponding ratings assigned by S&P and Moody's are not equivalent the higher rating will be used for purposes of measuring portfolio and security quality. If a security is not rated by S&P or Moody's, the equivalent rating determined by the investment manager's research department will be used. If bonds are downgraded below the minimum credit quality allowable in the guidelines at the time of purchase, the Investment Manager is permitted to hold up to 2% of the System's portfolio managed by the individual manager, using the lower of S&P, Moody's, and Fitch's rating in the event of a split-rated security.

All domestic and international bonds and notes in which the Plan's assets are invested, and which mature one year or more from the date of original issues, are required to carry a rating of "BBB" or better by two of the following three services: Standard & Poor's, Moody's Investors Service, or Fitch Ratings. In the event that ratings are provided by only two agencies and the third is non-rated, the most conservative (lowest) rating will be assigned. If only one agency assigns a rating, that rating will be used; or, if unrated, shall be of equivalent quality in the judgment of the investment manager to a similar domestic issue. Investment managers may, with prior written authorization, invest a maximum of 20% of their fixed income portfolio in bonds or notes that are rated B or BB. If bonds are downgraded below the minimum credit quality allowable in the guidelines at the time of purchase, the Investment Manager is permitted to hold up to 2% of the System's portfolio managed by the individual manager, using the lower of S&P, Moody's, and Fitch's rating in the event of a split-rated security.

The Retirement Systems may hedge against the possible adverse effects of currency fluctuations on the Retirement Systems' portfolio of international fixed income obligations when it is considered appropriate. Short-term investments may consist of commercial paper rated at least A1 or P1, repurchase agreements, short-term U.S. securities, and other money market investments.

The credit ratings listed below are for Moody's Investors Services and/or Standard and Poor's. Certain investments, such as obligations backed by the full faith and credit of the United States Government, are exempt from credit rating disclosure.

The following schedule indicates the credit quality rate risk of the Retirement System's investments, by category, as of June 30, 2007. (dollars in thousands):

Ratings		Total	Percentage
AAA	$	386,194	25.66%
AA		58,463	3.88%
A		70,749	4.70%
BBB		91,314	6.07%
BB		35,179	2.34%
B		23,928	1.59%
CCC & below		1,113	0.07%
Not rated*		838,230	55.69%
	$	1,505,170	100.00%

* Includes Government and Collective Short-term Investment Funds, the pooled domestic and international bonds, GNMA, FNMA and FHMLC TBA's (underlying securities to be announced)

(Continued)

Concentration of Credit Risk. The Retirement Systems' investment policies limit the aggregate amount that can be invested in each class of investments. The policy limits are as follows:

	Type of Investment	Policy Limits and Descriptions
The Plan	Domestic Equity	Minimum of 29% and maximum of 39% of the market value of the aggregate portfolio.
	International Equity	Minimum of 10% and maximum of 25% of the market value of the aggregate portfolio.
	Emerging Market Equity	Limited to 8% of the market value of the aggregate portfolio.
	Domestic Fixed Income	Minimum of 15% and maximum of 25% of the market value of the aggregate portfolio.
	Long Duration Fixed Income	Limited to 7% of the market value of the aggregate portfolio.
	Private Market Equity	Limited to 8% of the market value of the aggregate portfolio.
	Real Estate	Limited to 17% of the market value of the aggregate portfolio. Real estate investments include: - Apartment complexes located in Houston, TX and Colorado Springs, CO. - Office buildings located in Denver, CO; San Jose, CA; Anchorage, AK and near Chicago, IL. - Warehouse located near Minneapolis, MN.
The System	Domestic Equity	Minimum of 38% and maximum of 48% of the market value of the aggregate portfolio.
	International Equity	Minimum of 10% and maximum of 20% of the market value of the aggregate portfolio.
	Domestic Bonds	Minimum of 24% and maximum of 34% of the market value of the aggregate portfolio.
	Global Bonds	Minimum of 4% and maximum of 10% of the market value of the aggregate portfolio.
	Private Market Equity	Limited to 6% of the market value of the aggregate portfolio.
	Real Estate	Minimum of 3% and maximum 9% of the market value of the aggregate portfolio. Real estate investments include: - Warehouse located in Northern California. - Interest in six separate real estate funds managed by third parties.

As of June 30, 2007, the System held $186,353,000 of the investment issued by the Federal National Mortgage Association (including non-USD) which represents 10.0% of its plan net assets.

The collective short-term investment fund is used for overnight investment of all excess cash in the Retirement Systems' funds. It is invested by the Retirement Systems' custodians, and held in the Retirement Systems' custodians' names. This fund consists of:

- Short-term fixed obligations of the U.S. government or any federal agency, or of other issuers that are fully guaranteed by the U.S. government or a federal agency as to repayment of principal and the payment of interest;
- Repurchase agreements with major banks and U.S. government securities dealers that are collateralized by obligations of the U.S. government or a federal agency, or obligations fully guaranteed by the U.S. government or a federal agency; and
- Fully insured bank deposits.
- The System also has commercial paper, certificates of deposits and short term corporate obligations.

Foreign Currency Risk. The risk that changes in foreign exchange rates will adversely affect the fair value of an investment. As of June 30, 2007, the Retirement Systems were subject to foreign currency risk. To mitigate this risk, individual investment managers are permitted to defensively hedge currency to mitigate the impact on currency fluctuation on the underlying asset value.

Forward International Currency Contracts. The Retirement Systems made investments in forward currency contracts, which are commitments to purchase or sell stated amounts of international currency. The Retirement Systems utilize these contracts to control exposure and facilitate the settlement of international security purchase and sale transactions. At June 30, 2007, the Retirement Systems' net position in these contracts is recorded at fair value as short-term international currency investments. The fair values of forward currency contracts are determined by quoted currency prices from national exchanges. The Retirement Systems' investments in forward

(Continued)

currency contracts bear credit risk in that parties to the contracts may fail to perform according to the terms of the contract. As of June 30, 2007, total commitments in forward currency contracts to purchase and sell foreign currencies for the System were $10,008,000 and $10,008,000, respectively, with market values of $10,003,000 and $10,044,000 respectively. As of June 30, 2007, total commitments in forward currency contracts to purchase and sell foreign currencies for the Plan were $4,974,000 and $4,974,000 respectively, with fair values of $4,948,000 and $4,981,000, respectively. The Retirement Systems' commitments relating to forward currency contracts are settled on a net basis. The following tables provide information related to the various investment risks that may affect the investments of the Retirement System (dollars in thousands):

	Maturity						
Type of Investment	**3 Months or Less**	**3 - 6 Months**	**6 Months - 1 Year**	**1 - 5 Years**	**6 - 10 Years**	**More Than 10 Years**	**Total Fair Value**
Fixed Maturity:							
Domestic:							
U.S. Treasury Securities	-	10,923	8,888	81,794	31,489	59,544	192,638
U.S. Treasury Strips	-	-	-	-	-	112	112
GNMA	-	-	-	-	-	14,736	14,736
FHLB	-	936	219	2,748	1,095	-	4,998
FHLMC	8,677	-	-	2,180	5,343	76,615	92,815
FNMA	17,012	-	371	4,667	14,825	346,560	383,435
Other U.S. Gov't Agency Securities	-	-	-	430	955	9,811	11,196
Asset Backed Securities	-	-	-	25,502	8,857	22,752	57,111
Collateralized Mortgage Obligations	-	-	-	2,883	-	125,966	128,849
Corporate Bonds	2,894	2,255	2,915	58,269	63,775	108,870	238,978
State and Local Obligations	-	-	-	-	-	2,999	2,999
Collective Short Term Investments	223,346	-	-	-	-	-	223,346
Pooled Domestic Bonds	-	-	-	-	8,507	-	8,507
Total domestic maturities	251,929	14,114	12,393	178,473	134,846	767,965	1,359,720
International:							
Government bonds:							
British Pound	-	-	-	1,374	404	1,966	3,744
Canadian Dollar	-	-	-	154	1,251	-	1,405
Colombian Peso	-	-	-	152	514	95	761
Euro Currency	-	-	-	7,747	6,182	9,049	22,978
Japanese Yen	8,354	-	3,142	5,031	4,248	2,826	23,601
Mexican Peso	-	-	-	-	-	416	416
New Zealand Dollar	-	-	-	-	644	-	644
Norwegian Krone	-	-	-	1,008	1,264	-	2,272
Polish Zloty	-	-	-	-	1,119	-	1,119
Singapore Dollar	-	-	-	3,476	-	-	3,476
South African Rand	-	-	-	918	-	-	918
Swedish Krona	-	-	-	2,257	-	-	2,257
USD Denominated	-	-	-	-	1,600	3,457	5,057
Total international government bonds	8,354	-	3,142	22,117	17,226	17,809	68,648
Corporate Bonds:							
British Pound	-	-	-	1,990	2,079	423	4,492
Canadian Dollar	-	-	-	-	719	47	766
Euro Currency	-	-	-	3,144	3,145	245	6,534
Iceland Krona	-	-	1,121	-	-	-	1,121
Indonesian Rupiah	-	-	-	422	-	-	422
Japanese Yen	-	-	-	5,558	2,829	1,559	9,946
Malaysian Ringgit	-	-	-	2,213	-	-	2,213
Mexican Peso	-	-	-	-	302	942	1,244
South Korean Won	-	-	-	1,504	-	-	1,504
Swiss Franc	-	-	-	1,132	-	-	1,132
USD Denominated	549	-	-	8,108	10,082	12,858	31,597
Total international corporate bonds	549	-	1,121	24,071	19,156	16,074	60,971
Pool International Fixed Maturity	-	-	-	-	2,716	13,072	15,788
Total international fixed maturities	8,903	-	4,263	46,188	39,098	46,955	145,407
Derivatives	162	(106)	(13)	-	-	-	43
Total fixed maturity	260,994	14,008	16,643	224,661	173,944	814,920	1,505,170

(Continued)

	Maturity						
Type of Investment	3 Months or Less	3 - 6 Months	6 Months - 1 Year	1 - 5 Years	6 - 10 Years	More Than 10 Years	Total Fair Value
Equities:							
Domestic							1,412,402
Pooled domestic equity							412,623
Total domestic equities							1,825,025
International:							
International currency:							
Australian Dollar							21,776
Brazilian Real							13,345
British Pound							113,284
Canadian Dollar							20,143
Danish Krone							1,263
Egyptian Pound							1,863
Euro Currency							222,310
Hong Kong Dollar							15,897
Indian Rupee							6,047
Indonesian Rupiah							2,239
Japanese Yen							120,187
Malaysian Ringgit							2,531
Mexican Peso							7,152
New Zealand Dollar							1,968
Norwegian Krone							8,874
Polish Zloty							1,213
Singapore Dollar							10,114
South African Rand							4,846
South Korean Won							19,290
Swedish Krona							9,817
Swiss Franc							34,785
Taiwan Dollar							8,450
United Arab Emirates Dirham							1,001
USD Denominated							90,291
Total international currency							738,686
Pooled International Equities							404,547
Total international equities							1,143,233
Total equities							2,968,258
Private equity							64,671
Real Estate							276,605
Forward international currency contracts							(74)
Securities Lending Collateral							701,023
Total investments of retirement plans							$ 5,515,653

(Continued)

Securities Lending. The municipal code and the investment policies, adopted by the Retirement Systems, permit the use of a securities lending program with its principal custodian banks (Custodians). The Retirement Systems do not have a threshold for securities lending. The investment policy of the System requires that loan maturities cannot stretch beyond one year, and no more than 15% of the portfolio can be lent longer than six months. The custodial agreements with the Retirement Systems' custodians authorize such custodian to loan securities in the Retirement Systems' investment portfolio under such terms and conditions, as the custodians deem advisable and to permit the loaned securities to be transferred into the name of the borrowers. The Retirement Systems receive a fee from the borrower for the use of the loaned securities. If the loaned securities are not returned by the borrower, the custodians are responsible for replacement of the loaned securities with other securities of the same issuer, class and denomination, or if such securities are not available on the open market, the custodians are required to credit the Retirement Systems' account with the market value of such unreturned loaned securities. All securities loan agreements can be terminated on demand within a period specified in each agreement by either the Retirement Systems or borrowers.

Securities lending collateral represents investments in an investment pool purchased with cash collateral, as well as securities collateral that may be pledged or sold without a default by the borrower. Securities lending transactions collateralized with securities that cannot be pledged or sold without borrower default are not reported as assets and liabilities in the fiduciary statement of net assets. The Retirement Systems do not match the maturities of investments made with cash collateral with the securities on loan.

The loaned securities as of June 30, 2007 consisted of U.S. Treasury securities, U.S. government agency securities, domestic corporate bonds, international corporate bonds, international government bonds, domestic equity securities, and international equity securities. In return, the Retirement Systems receive collateral in the form of cash or securities equal to at least 102% for domestic and 105% for international of the transferred securities plus accrued interest for reinvestment.

As of June 30, 2007, the underlying securities loaned by the Retirement Systems as a whole amounted to approximately $700,968,000. The cash collateral and the non-cash collateral totaled $701,023,000 and $20,438,000, respectively. The Retirement Systems had no exposure to credit risk related to the securities lending transactions as of June 30, 2007.

(Continued)

The following table provides information concerning securities lent and collateral received as of June 30, 2007 (dollars in thousands):

	The Plan	The System	Total Fair Value
Type of Investment Lent			
For Cash Collateral:			
U.S. treasury securities	$ 113,503	39,919	153,422
U.S. government agency securities	6,767	130	6,897
Domestic corporate bonds	16,893	20,921	37,814
International corporate bonds	-	337	337
International government bonds	-	3,239	3,239
Domestic equity securities	270,006	103,041	373,047
International equity securities	84,551	21,600	106,151
Total lent for cash collateral	491,720	189,187	680,907
For Non-Cash Collateral:			
U.S. treasury securities	9,266	835	10,101
Domestic corporate bonds	-	2,196	2,196
Domestic equity securities	4,998	1,648	6,646
International equity securities	-	1,118	1,118
Total lent for non-cash collateral	14,264	5,797	20,061
Total securities lent	$ 505,984	194,984	700,968
Type of Collateral Received			
Cash collateral	$ 507,105	193,918	701,023
Non-cash collateral:			
For lent U.S. treasury securities	9,382	853	10,235
For lent domestic corporate bonds	-	2,181	2,181
For lent domestic equity securities	5,152	1,694	6,846
For lent international equity securities	-	1,176	1,176
Total non-cash collateral	14,534	5,904	20,438
Total collateral received	$ 521,639	199,822	721,461

(Continued)

B. Receivables, Net of Allowances

Receivables at year-end of the City's major individual funds and non-major funds taken in aggregate, including the applicable allowances for uncollectible accounts are as follows (dollars in thousands):

Receivables – Governmental Activities:	General Fund	Redevelopment Agency	Housing Activities	Special Assessment Districts	San Jose Financing Authority	Total Nonmajor Funds	Governmental Activities
Taxes	$ 32,079	297	-	-	-	6,691	$ 39,067
Accrued interest	4,860	235	1,710	354	2	3,925	11,086
Grants	6,600	-	1,273	-	-	8,602	16,475
Special assessments	-		-	71,583	-	-	71,583
Other	27,983	850	50	-	-	17,256	46,139
Less: allowance for uncollectibles	(12,166)	(34)	-	(2)	-	(1,196)	(13,398)
Total receivables, net	$ 59,356	1,348	3,033	71,935	2	35,278	$ 170,952

Business-Type Activities:	Norman Y. Mineta San José International Airport	Wastewater Treatment System	Municipal Water System	Parking System	Total Business-Type Activities
Accounts	$ 10,058	2,064	2,747	1,166	$ 16,035
Accrued interest	2,369	1,866	129	124	4,488
Grants	3,277	484	-	-	3,761
Less: allowance for uncollectibles	(449)	(313)	(10)	(6)	(778)
Total receivables, net	$ 15,255	4,101	2,866	1,284	$ 23,506

Special assessment receivables in the amount of $71,580,000 are not expected to be collected within the subsequent year.

C. Loans Receivable

The composition of the City's loans receivable as of June 30, 2007 is as follows (dollars in thousands:

Type of Loan	General Fund	Redevelopment Agency	Housing Activities	Nonmajor Funds	Total Governmental Activities
20% Housing Program Developer, rehabilitation, second mortgage and relocation loans	$ -	-	456,805	-	$ 456,805
Loans funded by federal grants	-	-	60,926	7,721	68,647
Economic development, real estate developer and other loans	2,391	45,902	-	1,659	49,952
Less: allowance	-	(7,655)	(313,361)	(2,381)	(323,397)
Total loans, net	$ 2,391	38,247	204,370	6,999	$ 252,007

California Community Redevelopment Law requires that at least 20% of the incremental tax revenues generated from redevelopment project areas be used to increase, improve, and preserve the affordable housing stock for families and individuals with very low, low, and moderate incomes. In response to this requirement, the City established its 20% Housing Program to offer financial assistance to qualified developers, families, and individuals by providing loans at "below market" rates.

Typical loans and related terms are summarized as follows:

Loan Type	Interest Rate	Due
New construction	0 - 4%	up to 55 years
Multi-unit rental rehabilitation	3%	5 or more years
Take-out (first time homeowners)	4%	7 to 40 years
Home improvement	3 - 6%	1 to 30 years

(Continued)

Loans are secured by first, second, or third deeds of trust except for take-out loans, which are all secured by second deeds of trust. Interest and principal are typically due in installments, except for take-out loans, which do not require payments until their due date.

The City has also invested in multi-family rental housing projects serving low to moderate income individuals through subordinate loans with terms of up to 40 years. Generally, these loans are to be repaid through fixed payments or net cash flow from project operations, and the term and potential risk of each loan is different. Because of the net cash flow feature of these second mortgages, earnings and repayments are not as definite as with other loans receivable. There is greater risk of variability in the timing of payments and, potentially, a lower probability of eventual repayment on these second mortgage loans than on other loans.

The City maintains a valuation allowance against loans receivable comprised of an allowance for risk and an allowance for present value discount. The allowance for risk is maintained to provide for losses that can be reasonably anticipated. The allowance is based upon continuing consideration of changes in the character of the portfolio, evaluation of current economic conditions, and such other factors that, in the City's judgment, deserve recognition in estimating potential loan losses. The allowance for risk takes into consideration maturity dates, interest rates, and other relevant factors.

In accordance with City policy, loans are funded at below market rates of interest with amortizing and deferred repayment terms. This policy exists to enhance the well-being of the recipients or beneficiaries of the financial assistance, who, as described above, are very low, low, or moderate-income individuals or families, or developers of housing for such individuals or families.

Accordingly, for financial statement purposes, the City has established an allowance account against the loans receivable balance containing a present value discount. The present value discount gives recognition to the economic cost of providing loans at interest rates below market, and represents an estimate of the present value of projected net cash flows to the City from the loan portfolio. The present value discount attributable to the loans will be recognized as interest income only as such loans are repaid in full because of the deferred nature of the loan portfolio and the high level of uncertainty relating to the likelihood that cash flows will occur as projected. The difference between the individual outstanding loan balances and the calculated net present value of the loans results in the allowance for present value discount. Losses are recognized through charges to the allowance and any subsequent recoveries are added to the allowance.

For the fiscal year ended June 30, 2007, the City reviewed the valuation allowance by taking into account the risk factors noted above and assessing the valuation account(s) in general. Based on this review, the City determined that the allowance should be increased in the Housing Activities Fund. As a result, the City recorded an expense of $54.5 million to increase the valuation allowance for those loan portfolios that met the City's valuation allowance policy criteria.

The City's management believes the combined amount of the aforementioned risk and present value discount allowances is adequate to reflect the net realizable value of the Community Development Block Grant ("CDBG") loans, Home Investment Partnership Program ("HOME") loans, and 20% Housing Program loans receivable as of June 30, 2007.

In the normal course of operations for housing programs, the City has outstanding commitments to extend credit, which have been encumbered as of June 30, 2007. These commitments involve elements of credit and interest rate risk similar to those described above for outstanding loans receivable. As of June 30, 2007, amounts committed to extend credit under normal lending agreements totaled approximately $36,701,000.

(Continued)

D. Capital Assets

1. Summary Schedule

The following is a summary of capital assets activity for the fiscal year ended June 30, 2007 (dollars in thousands):

		Balance June 30, 2006	Additions	Deletions	Transfers	Balance June 30, 2007
Governmental activities:						
Capital assets, not being depreciated:						
Land	$	558,079	14,203	24,352	2,486	550,416
Construction in progress		256,123	89,648	487	(48,370)	296,914
Total capital assets, not being depreciated		814,202	103,851	24,839	(45,884)	847,330
Capital assets, being depreciated:						
Buildings		1,020,010	3,234	-	32,770	1,056,014
Improvements, other than buildings		39,514	-	-	7,274	46,788
Infrastructure		11,193,115	38,452	-	5,715	11,237,282
Vehicles and equipment*		91,918	8,870	553	125	100,360
Furniture & fixtures*		26,382	-	-	-	26,382
Property under capital leases		13,379	-	-	-	13,379
Total capital assets, being depreciated		12,384,318	50,556	553	45,884	12,480,205
Less accumulated depreciation for:						
Buildings		206,191	27,683	-	-	233,874
Improvements, other than buildings		11,245	1,986	-	-	13,231
Infrastructure		4,723,118	302,575	-	-	5,025,693
Vehicles and equipment*		80,456	4,750	553	-	84,653
Furniture & fixtures*		2,638	2,638	-	-	5,276
Property under capital leases		11,630	258	-	-	11,888
Total accumulated depreciation		5,035,278	339,890	553	-	5,374,615
Total capital assets, being depreciated, net		7,349,040	(289,334)	-	45,884	7,105,590
Governmental activities capital assets, net	$	8,163,242	(185,483)	24,839	-	7,952,920
Business-type Activities:						
Capital assets, not being depreciated:						
Land	$	134,926	-	-	-	134,926
Construction in progress		268,770	169,526	-	(40,044)	398,252
Total capital assets, not being depreciated		403,696	169,526	-	(40,044)	533,178
Capital assets, being depreciated:						
Buildings		503,937	282	-	(20)	504,199
Improvements, other than buildings		795,662	14,034	-	37,354	847,050
Vehicles and equipment		142,128	1,093	15	2,710	145,916
Intangible assets		15,188	-	-	-	15,188
Property under capital leases		13,406	-	-	-	13,406
Total capital assets, being depreciated		1,470,321	15,409	15	40,044	1,525,759
Less accumulated depreciation for:						
Buildings		208,258	14,607	-	-	222,865
Improvements, other than buildings		319,557	21,274	-	-	340,831
Vehicles and equipment		99,786	4,488	15	-	104,259
Intangible assets		6,932	324	-	-	7,256
Property under capital leases		9,245	453	-	-	9,698
Total accumulated depreciation		643,778	41,146	15	-	684,909
Total capital assets, being depreciated, net		826,543	(25,737)	-	40,044	840,850
Business-type activities capital assets, net	$	1,230,239	143,789	-	-	1,374,028

* Furniture & fixtures associated with the new City Hall Project were reclassified from vehicles and equipment.

(Continued)

2. Depreciation

Depreciation expense charged to various governmental and business type activities of the City for the fiscal year ended June 30, 2007 is as follows (dollars in thousands):

Governmental activities:		
General government	$	11,275
Public safety		3,534
Capital maintenance		303,187
Community services		21,892
Sanitation		2
Total depreciation expense governmental activities	$	339,890
Business-type activities:		
Norman Y. Mineta San José International Airport	$	18,876
Wastewater Treatment System		17,892
Municipal Water System		2,533
Parking System		1,845
Total depreciation expense business-type activities	$	41,146

3. Intangible Assets

Intangible assets consist primarily of the Airport's acquisition of certain habitational rights and navigation/relocation easements made in accordance with its land acquisition program under the California Noise Reduction Act. All costs associated with such acquisitions have been capitalized as intangible assets. Amortization of such intangible assets is calculated using the straight-line method over a 40 year estimated useful life. Amortization expense that was reported for the year ended June 30, 2007 related to these acquisitions was approximately $320,000.

4. Capitalized Interest

Interest costs that related to the acquisition of buildings and improvements and equipment acquired with tax-exempt and taxable debt are capitalized for business-type activities. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project, with interest earned on invested debt proceeds over the same period. Capitalized interest cost is prorated to completed projects based on the completion date of each project. For the year ended June 30, 2007, the total amount of interest capitalized in the Airport Enterprise Fund, net of allowable interest earned of temporary investment proceeds, was approximately $7,680,000.

5. Construction Commitments

Commitments outstanding as of June 30, 2007, related to governmental and business-type activities construction in progress totaled approximately $55,807,000 and $188,540,000 respectively.

(Continued)

E. Leases

The City has commitments under various operating lease agreements requiring annual rental payments, which are described as follows:

Governmental Activities

The City has ongoing commitments under operating lease agreements for business equipment, office facilities and land necessary for City operations, which expire at various dates through 2022. Each governmental fund includes the expenditures related to such lease agreements. There are both cancelable and non-cancelable lease agreements. Rental expenditures reported by the General Fund, Nonmajor Governmental Funds and the Redevelopment Agency Fund under these capital lease agreements for the fiscal year ended June 30, 2007 amounted to approximately $1,443,000, $678,000 and $3,235,000, respectively. The future minimum lease payments anticipated under the existing lease commitments, as of June 30, 2007, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	General Fund	Nonmajor Governmental Funds	Redevelopment Agency	Total Govermental Activities
2008	$ 1,605	$ 728	$ 7,719	$ 10,052
2009	1,591	768	5,651	8,010
2010	917	807	5,083	6,807
2011	706	848	4,593	6,147
2012	1,127	887	4,601	6,615
2013-2017	-	688	2,958	3,646
2018-2022	-	-	2,098	2,098
Totals	$ 5,946	$ 4,726	$ 32,703	$ 43,375

Business-Type Activities

The Airport leases its office space under two separate operating lease agreements. The lease agreements, as amended, expire in January 2009 and December 2009, respectively. Rental expense for the Airport's office space for the year ended June 30, 2007 was approximately $3,079,000. In June 2001, the Airport entered into an operating lease and maintenance agreement of 20 compressed natural gas powered buses. The term of the agreement is from March 1, 2003 to February 28, 2010. Rental expenses for the Airport buses for the year ended June 30, 2007 was approximately $2,029,000.

(Continued)

The future minimum payments anticipated under these commitments, as of June 30, 2007, are as follows (dollars in thousands):

Fiscal Year Ending June 30,	Operating Leases	
2008	$	5,021
2009		4,632
2010		2,620
Total	$	12,273

The City also leases building space, facilities, and/or the privilege of operating a concession to tenants and concessionaries resulting in receipt of annual rents, which are described as follows:

Governmental Activities

In October 1991, the City entered into a 15-year agreement with the San José Arena Management Corporation (the Manager), an unrelated entity, regarding the management, operations, and maintenance of the San José Arena, and use of the San José Arena by the San José Sharks, a franchise of the National Hockey League. The Manager is required to pay the City an annual payment of $500,000 in each of the first 6 years of the agreement. The annual payment increases by $100,000 each year in years 7 through 10 and totals $1,000,000 annually in years 11 through 15. Additionally, the City received a portion of the luxury-box suite revenue beginning in year 4 and may receive a portion of hockey-ticket sales revenues in years 11 through 15. The fiscal year ended June 30, 2007 was year 14 of the lease for which the City received approximately $2,119,000. As of June 30, 2007, leased assets had total historic cost of approximately $109,865,000 and accumulated depreciation of approximately $35,892,000.

Business-Type Activities

The Airport is served by 16 major commercial airlines under terms and conditions that provide the airlines with the right to use the Airport's facilities, equipment, improvements and services, and to occupy certain premises and facilities. Of these airlines, 3 operate under long-term lease agreements, while the 13 remaining airlines operate on a month-to-month basis. Such long-term lease agreements incorporate a "residual cost methodology," as called for under the Master Lease Agreements, whereby landing fees and terminal rents are set such that, over time, the Airport's total revenues equal total expenses, including debt service requirements and certain budgeted capital items, as well as estimated maintenance and operation expenses, but excluding depreciation.

As provided in the Master Lease Agreements, actual year-end surplus, as defined, can be used to lower or stabilize airline rates in future fiscal years. For the fiscal year ended June 30, 2007, the Airport's actual revenues exceeded its expenses and reserve requirements by approximately $21,954,000. The surplus received during the fiscal year ended June 30, 2007 will be credited to the airlines as a reduction of future rates and charges.

The Airport also enters into leases with concessionaires, airline carriers, and other business entities for building space and/or the privilege of operating a concession at the Airport. The terms of these operating leases range from 1 month to 34 years. The leases with concessionaires are generally based on the greater of a percentage of their sales or a minimum annual guaranteed amount.

The future minimum rentals to be received from the aforementioned operating leases, as of June 30, 2007, are as follows (dollars in thousands):

Fiscal Year Ending June 30,		
2008	$	38,944
2009		36,303
2010		41,798
2011		28,454
2012		28,361
2013-2017		20,410
2018-2022		11,242
2023-2027		11,242
2028-2032		8,464
2033-2037		6,966
2038-2042		1,637
Total	$	233,821

These future minimum rentals are based upon annual rates and charges agreed to by the airlines and other tenants. In addition to the future minimum rentals disclosed above, the Airport expects to receive approximately $885,000 from month-to-month rentals in fiscal year ending June 30, 2008. As of June 30, 2007, leased assets had historic costs of approximately $94,273,000 and accumulated depreciation of approximately $39,814,000.

F. Long-Term Debt and Other Obligations

1. Summary Schedule of Long-Term Debt

The following is a summary of long-term debt of the City as of June 30, 2007 (dollars in thousands):

	Purpose	Issue Amount	Issue Date	Final Maturity	Range of Interest Rates	Principal Payments (millions)	Balance, June 30, 2007
Governmental Activities:							
City of San Jose:							
General Obligation Bonds:							
Series 2001 (Libraries and Parks)	Community Facilities	$ 71,000	06/06/2001	09/01/2031	4.25-5.125%	2.37	$ 59,150
Series 2002 (Libraries, Parks, Public Safety)	Community Facilities	116,090	07/18/2002	09/01/2032	4.00-5.00%	3.87	100,610
Series 2004 (Libraries, Parks, Public Safety)	Community Facilities	118,700	07/14/2004	09/01/2034	4.00-5.00%	3.96	110,790
Series 2005 (Libraries and Public Safety)	Community Facilities	46,300	06/23/2005	09/01/2035	3.00-7.50%	1.54-1.55	44,760
Series 2006 (Libraries and Parks)	Community Facilities	105,400	06/29/2006	09/01/2036	4.00-5.00%	3.51-3.52	105,400
Series 2007 (Parks and Public Safety)	Community Facilities	90,000	06/20/2007	09/01/2037	4.00-8.00%	0.00-3.00	90,000
							510,710
HUD Section 108 Note	Economic Development	25,436	02/10/2005	08/01/2024	Variable	0.93-2.08	25,436
City of San Jose Financing Authority:							
Lease Revenue Bonds:							
Series 1993B (Community Facilities)	Community Facilities	18,045	04/13/1993	11/15/2012	5.80-6.00%	0.25-0.35	4,126
Series 1997B (Fire, Childcare, Library Land)	Community Facilities	9,805	07/29/1997	08/01/2012	4.60-4.875%	0.36-0.41	2,290
Series 2000C (Taxable) (Ice Centre)	Refunding	22,200	12/13/2000	12/01/2021	Variable	0.90-2.05	19,800
Series 2001B (Taxable) (Hayes Mansion)	Conference Center	24,000	02/14/2001	07/01/2024	Variable	0.10-2.20	24,000
Series 2001C (Taxable) (Hayes Mansion)	Conference Center	18,500	02/14/2001	07/01/2024	Variable	0.10-1.70	18,500
Series 2001D (Hayes Mansion)	Conference Center	10,800	02/14/2001	07/01/2026	Variable	0.00-4.60	10,800
Series 2001E (Communication Center)	Refunding	18,610	03/29/2001	05/01/2010	4.00-5.00%	2.01-4.04	8,145
Series 2002B (Civic Center Project)	Civic Center	292,425	11/14/2002	06/01/2037	3.25-5.25%	0.14-33.45	292,285
Series 2002C (Civic Center Project)	Civic Center	60,000	11/14/2002	06/01/2039	Variable	0.00-21.79	60,000
Series 2003A (Central Service Yard)	Refunding	22,625	09/18/2003	10/15/2023	3.00-4.70%	0.88-1.61	20,190
Series 2004A (Taxable) (Ice Centre)	Ice Centre	9,225	06/03/2004	12/01/2024	Variable	0.00-2.55	9,225
Series 2005A (Taxable) (Land Acquisition)	Economic Development	54,480	02/17/2005	03/01/2029	Variable	1.40-3.88	52,650
Series 2005B (AMT) (Land Acquisition)	Economic Development	25,545	02/17/2005	03/01/2034	Variable	0.00-4.97	25,545
Series 2006A (Civic Center Project)	Refunding	57,440	06/01/2006	06/01/2039	4.00-5.00%	0.00-17.44	57,440
Series 2007A (Recreational Facilities)	Refunding	36,555	06/28/2007	08/15/2030	4.125-4.75%	0.86-2.22	36,555
							641,551
Special Assessment Bonds with Limited Governmental Commitment:							
Special Assessment Bonds:							
Series 24K (Seismic Retrofit)	Seismic Retrofit	823	06/29/1993	09/02/2013	8.50%	0.03-0.06	310
Series 24Q (Hellyer-Piercy)	Public Infrastructure	27,595	06/26/2001	09/02/2023	4.80-5.875%	0.89-2.05	23,345
Series 24R (2002 Consolidated Refunding)	Consolidated Refunding	13,940	07/03/2002	09/02/2015	2.90-4.375%	1.01-1.22	9,840
Special Tax Bonds:							
CFD No. 1 (Capitol Expressway Auto Mall)	Public Infrastructure	4,100	11/18/1997	11/01/2022	5.10-5.70%	0.14-0.30	3,240
CFD No. 6 (Great Oaks-Route 85)	Public Infrastructure	12,200	12/18/2001	09/01/2023	4.50-6.00%	0.43-0.97	11,030
CFD No. 9 (Bailey/Highway 101)	Public Infrastructure	13,560	02/13/2003	09/01/2032	4.10-6.65%	0.23-0.95	12,565
CFD No. 10 (Hassler-Silver Creek)	Public Infrastructure	12,500	07/23/2003	09/01/2023	3.40-5.25%	0.47-0.94	11,250
							71,580

(Continued)

	Purpose	Issue Amount	Issue Date	Final Maturity	Range of Interest Rates	Principal Payments (millions)	Balance, June 30, 2007
Governmental Activities (continued):							
Redevelopment Agency:							
Tax Allocation Bonds:							
Series 1993 (Merged Area Refunding)	Advance Refundings	$ 692,075	12/15/1993	08/01/2015	6.00%	0.00-18.20	$ 83,565
Series 1997 (Merged Area)	Redevelopment Projects	106,000	03/27/1997	08/01/2028	5.375-5.625%	0.01-0.72	7,190
Series 1998 (Merged Area)	Redevelopment Projects	175,000	03/19/1998	08/01/2009	5.00%	0.00-1.51	2,050
Series 1999 (Merged Area)	Redevelopment Projects	240,000	01/06/1999	08/01/2019	4.75%	0.00-7.17	12,920
Series 2002 (Merged Area)	Redevelopment Projects	350,000	01/24/2002	08/01/2015	4.00-4.50%	0.00-11.29	22,565
Series 2003 (Merged Area)	Redevelopment Projects	135,000	12/22/2003	08/01/2033	4.00-5.00%	0.00-34.10	127,545
Series 2004A (Merged Area)	Refunding	281,985	05/27/2004	08/01/2019	4.229-5.25%	8.78-31.90	268,550
Series 2005A (Merged Area)	Refunding	152,950	07/25/2005	08/01/2028	3.25-5.00%	0.11-26.21	152,950
Series 2005B (Merged Area)	Refunding	67,130	07/25/2005	08/01/2015	4.917-5.00%	4.23-21.56	67,130
Series 2006A (Merged Area)	Redevelopment Projects	14,300	11/14/2006	08/01/2022	5.35-5.65%	1.00-6.00	14,300
Series 2006B (Merged Area)	Redevelopment Projects	67,000	11/14/2006	08/01/2035	4.50-5.00%	1.00-21.00	67,000
Series 2006C (Merged Area)	Refunding	423,430	12/15/2006	08/01/2032	3.75-5.00%	12.00-74.28	423,430
Series 2006D (Merged Area)	Refunding	277,755	12/15/2006	08/01/2023	4.00-5.00%	0.45-67.33	277,755
							1,526,950
Revenue Bonds (Subordinate):							
Series 1996A (Merged Area)	Redevelopment Projects	29,500	06/27/1996	07/01/2026	Variable	0.80-2.00	27,400
Series 1996B (Merged Area)	Redevelopment Projects	29,500	06/27/1996	07/01/2026	Variable	0.80-2.00	27,400
Series 2003A (Taxable) (Merged Area)	Redevelopment Projects	45,000	08/27/2003	08/01/2028	Variable	1.10-3.10	43,900
Series 2003B (Merged Area)	Redevelopment Projects	15,000	08/27/2003	08/01/2032	Variable	0.00-3.90	15,000
							113,700
City of San Jose Financing Authority Revenue Bonds (Subordinate):							
Series 2001A (4th & San Fernando)	Parking Facility	48,675	04/10/2001	09/01/2026	3.80-5.25%	1.38-3.21	42,545
Series 2001F (Convention Center)	Refunding	186,150	07/26/2001	09/01/2022	4.00-5.00%	6.15-14.73	166,215
							208,760
HUD Section 108 Note (Masson/Dr. Eu/Security)	Redevelopment Projects	5,200	02/11/1997	08/01/2016	Variable	0.25-0.47	3,470
HUD Section 108 Note (CIM Block 3/Central Plac	Redevelopment Projects	13,000	02/08/2006	08/01/2025	Variable	0.00-1.14	13,000
HUD Section 108 Note (Story/King Retail)	Redevelopment Projects	18,000	06/30/2006	08/01/2025	Variable	0.00-1.57	18,000
							34,470
CSCDA - 2005 ERAF Loan	Redevelopment Projects	19,085	04/27/2005	08/01/2015	4.34-5.01%	1.71-2.36	16,085
CSCDA - 2006 ERAF Loan	Redevelopment Projects	14,920	05/03/2006	08/01/2016	5.34-5.67%	1.24-1.91	13,935
							30,020
Housing Set-Aside Tax Allocation Bonds:							
Series 1997E (AMT) (Merged Area)	Affordable Housing	17,045	06/23/1997	08/01/2027	5.75-5.85%	0.34-3.67	17,045
Series 2003J (Taxable) (Merged Area)	Afford. Housing/Refunding	55,265	07/10/2003	08/01/2024	2.60-5.25%	2.02-3.51	48,120
Series 2003K (Merged Area)	Afford. Housing/Refunding	13,735	07/10/2003	08/01/2029	2.50-4.40%	0.23-1.07	10,970
Series 2005A (Merged Area)	Refunding	10,445	06/30/2005	08/01/2024	3.75-5.00%	0.97-2.27	10,445
Series 2005B (Taxable) (Merged Area)	Refunding	119,275	06/30/2005	08/01/2035	4.07-5.46%	0.70-8.30	118,325
Series 2005C (AMT) (Merged Area)	Afford. Housing/Refunding	33,075	06/30/2005	08/01/2035	Variable	0.10-1.57	32,245
Series 2005D (AMT) (Merged Area)	Afford. Housing/Refunding	33,075	06/30/2005	08/01/2035	Variable	0.10-1.57	32,245
							269,395
Total Governmental Activities - Bonds, Certificates of Participation and Notes Payable							$ 3,432,572
Business-type Activities:							
Norman Y. Mineta San Jose International Airport:							
Revenue Bonds:							
Series 1998A (AMT)	Refunding	14,015	01/27/1998	03/01/2018	4.30-4.75%	0.66-1.09	9,350
Series 2001A	Runway Construction	158,455	08/14/2001	03/01/2031	3.65-5.25%	3.42-10.06	145,810
Series 2002A	Refunding	53,600	01/09/2003	03/01/2018	4.00-5.375%	0.00-9.29	53,600
Series 2002B (AMT)	Refunding	37,945	01/09/2003	03/01/2012	4.00-5.00%	2.38-6.55	26,785
Series 2004A (AMT)	Airport Facilities	70,000	06/24/2004	06/01/2034	Variable	0.00-16.05	70,000
Series 2004B (AMT)	Airport Facilities	70,000	06/24/2004	06/01/2034	Variable	0.00-16.05	70,000
Series 2004C (AMT)	Airport Facilities	75,730	06/24/2004	03/01/2026	4.625-5.25%	0.00-10.59	75,730
Series 2004D	Airport Facilities	34,270	06/24/2004	03/01/2028	5.00%	0.00-12.56	34,270
							485,545
Clean Water Financing Authority:							
Revenue Bonds:							
Series 2005A	Refunding	54,020	10/05/2005	11/15/2016	3.25-5.00%	4.31-5.80	50,055
Series 2005B	Refunding	27,130	10/05/2005	11/15/2020	Variable	0.00-6.88	27,130
							77,185
State of California - Revolving Fund Loan	Wastewater Facilities	73,566	Various	05/01/2019	Various	1.77-4.35	45,586
Total Business-type Activities - Bonds and Loan Payable							$ 608,316
Grand Total							$ 4,040,888

2. Debt Compliance

There are a number of limitations and restrictions contained in the various bond indentures. The City believes it is in compliance with all significant limitations and restrictions.

3. Legal Debt Limit and Margin

The City's legal debt limit and debt margin (as defined by Section 1216 of the City Charter) as of June 30, 2007, are approximately $16,938,385,000 and $16,427,675,000, respectively. In accordance with the California Community Redevelopment Law, the Redevelopment Agency establishes its own legal debt limit, based primarily on the aggregate of all future projected tax increment revenues from existing redevelopment areas.

4. Arbitrage

The Tax Reform Act of 1986 instituted certain arbitrage restrictions with respect to the issuance of tax-exempt bonds after August 31, 1986. Arbitrage regulations deal with the investment of all tax-exempt bond proceeds at an interest yield greater than the interest yield paid to bondholders. Generally, all interest paid to bondholders can be retroactively rendered taxable if applicable rebate liabilities are not reported and paid to the Internal Revenue Service (IRS) at least every five years. During the current year, the City performed calculations to determine the rebate liabilities for the tax-exempt bond issues listed above. However, as no bond issue with a positive rebate liability was due for a fifth-year payment, the amount calculated has been recorded as a liability to the IRS. The rebate liability amount is recorded as a liability in the Governmental Activities column of the government-wide statements in the amount of $1,801,000.

5. Special Assessment Bonds with Limited City Commitment

All obligations of the City under the Special Assessment Bonds are not considered general obligations of the City, but are considered limited obligations, payable solely from the assessments and special taxes, and from the funds pledged therefore under the Paying Agent Agreement or Fiscal Agent Agreement. Neither the faith and credit nor the taxing power of the City, or any political subdivision thereof, is pledged to the payment of the bonds. Notwithstanding any other provision of the Paying Agent Agreements for these bonds, the City is not obligated to advance available surplus funds from the City Treasury to cure any deficiency in the various redemption funds established for repayment of these bonds; provided, however, the City is not prevented, in its sole discretion, from so advancing funds. As of June 30, 2007, the City has recorded approximately $71,581,000 of deferred revenue and related special assessments and special taxes receivables in the Special Assessment Districts Fund. These balances consist primarily of property tax assessments and special taxes to be collected in the future by the County for the City for debt service.

As of June 30, 2007, there are assessment surpluses of approximately $2,521,000 that have been declared by the City Council. These are included in advances and deposits liabilities on the accompanying statement of net assets and governmental funds balance sheet. Such surpluses will either be used to correct construction deficiencies or will be returned to the assessment-district property owners.

6. Conduit Debt

The City has issued multifamily housing revenue bonds to provide funds for secured loans to builders of multifamily housing projects. The purpose of the program is to provide needed rental housing for very low to moderate-income households. To comply with Internal Revenue Service requirements in order to meet the tax-exempt status, the owner is required to set aside 20% of all units built for very low income households. The bonds are payable solely from payments made on the related secured loans. These tax-exempt housing bonds have maturity dates that are due at various dates through February 1, 2047. As of June 30, 2007, the outstanding bond issues aggregated to approximately $527,899,000.

In August 1997, the Agency served as the conduit issuer of $10,595,000 in Multifamily Housing Revenue Bonds in order to provide funds for a mortgage loan to finance a multifamily rental housing project in the Japantown Redevelopment Project Area. The Agency has no obligation for these bonds as they are secured primarily by fully modified pass-through mortgage-backed securities guaranteed as to timely payment of principal and interest by the Government National Mortgage Association. The purpose of the bonds issue was for expanding the community's supply of low to moderate-income housing and constructing a community center and retail space. The loan is secured on a non-recourse basis, and is insured by the Federal Housing Authority pursuant to and in accordance with the provisions of Section 221(d)(4) of the National Housing Act and applicable regulations thereunder. At June 30, 2007, the outstanding balance was approximately $9,856,000.

In April 1998, the Agency served as the conduit issuer of $38,000,000 in Multifamily Housing Revenue Bonds in order to provide funds for a mortgage loan to finance the acquisition and construction of a multifamily residential project in the Century Center Redevelopment Project Area. The Agency has no obligation for these bonds, as they will be payable solely from, secured, to the extent, and as provided in the indenture, by a pledge of certain revenues and other amounts to be received by the Agency under the Loan Agreement. The borrower, a developer, has arranged for an initial irrevocable direct pay letter of credit to be issued in favor of the trustee. As of June 30, 2007, there has been no principal retirement.

In the opinion of the City's officials, these bonds are not payable from any revenues or assets of the City. Neither the faith and credit nor the taxing power of the City, the state, or any political subdivision thereof are pledged for the payment of the principal or interest on the bonds.

(Continued)

7. Summary of Changes in Long-term Obligations

The changes in long-term obligations for the year ended June 30, 2007, are as follows (dollars in thousands):

	June 30, 2006	Additional Obligations, Interest Accretion and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2007	Amounts Due Within One Year
Governmental Activities:					
Long-term debt payable:					
General Obligation bonds	$ 432,445	90,000	(11,735)	510,710	$ 15,245
HUD Section 108 loan	25,436	-	-	25,436	934
San Jose Financing Authority					
Lease revenue bonds	643,565	36,555	(40,892)	639,228	7,586
Accreted interest on capital appreciation bonds	2,505	250	(432)	2,323	458
Special Assessment bonds with limited governmental commitment	75,007	-	(3,427)	71,580	3,181
Redevelopment Agency					
Revenue bonds	331,870	-	(9,410)	322,460	6,720
HUD Section 108 notes payable	34,705	-	(235)	34,470	250
Tax allocation bonds	1,745,275	782,485	(731,415)	1,796,345	33,840
California Statewide Communities Development Authority - ERAF loan	32,645	-	(2,625)	30,020	2,950
Total long-term debt payable	3,323,453	909,290	(800,171)	3,432,572	71,164
Less deferred amounts:					
For refunding	(34,482)	(29,676)	3,495	(60,663)	(3,400)
For issuance premiums	45,527	30,124	(4,961)	70,690	4,900
For issuance discounts	(3,399)	-	68	(3,331)	(70)
Total deferred amounts	7,646	448	(1,398)	6,696	1,430
Total long-term debt payable and deferred amounts	3,331,099	909,738	(801,569)	3,439,268	72,594
Other Long-term obligations:					
Loan to City (Hayes Mansion)	1,908	-	(500)	1,408	298
Arbitrage liability	11	1,790	-	1,801	-
Accrued vacation, sick leave and compensatory time	83,806	42,405	(36,220)	89,991	36,000
Accrued landfill postclosure costs	10,230	-	(465)	9,765	465
Estimated liability for self-insurance	173,555	24,565	(47,463)	150,657	9,500
Net pension obligation	3,233	258	(252)	3,239	-
Total other long-tern obligations	272,743	69,018	(84,900)	256,861	46,263
Governmental activities long-term obligations	$ 3,603,842	978,756	(886,469)	3,696,129	$ 118,857

(Continued)

	June 30, 2006	Additional Obligations and Net Increases	Current Maturities, Retirements, and Net Decreases	June 30, 2007	Amounts Due Within One Year
Business-Type Activities:					
Norman Y. Mineta San Jose International Airport:					
Revenue bonds	$ 494,910	-	(9,365)	485,545	$ 9,745
Deferred amounts:					
For refunding	(4,775)	-	777	(3,998)	(726)
For issuance premiums	5,676	-	(204)	5,472	272
For issuance discounts	(2,711)	-	39	(2,672)	(34)
Clean Water Financing Authority:					
Revenue bonds	81,150	-	(3,965)	77,185	4,310
Deferred amounts:					
For refunding	(2,688)	-	270	(2,418)	(270)
For issuance premiums	1,156	-	(112)	1,044	111
State of California - Revolving Fund Loan	49,153	-	(3,568)	45,585	3,633
Accrued vacation, sick leave and compensatory time	7,442	4,577	(3,832)	8,187	8,187
Estimated liability for self-insurance	9,103	1,335	(1,826)	8,612	1,927
Business-type long-term obligations	$ 638,416	5,912	(21,786)	622,542	$ 27,155

Sources of funds to meet debt service requirements are revenues derived from user fees and charges for services recorded in their respective enterprise funds.

Debt service payments are made from various sources. General Obligation bonds debt service payments are made from property taxes recorded in the Non-major Governmental Funds. Lease Revenue Bonds debt service payments are made from lease rental revenue from "lessee" departments in the General Fund and Non-major Funds. Assessment and Reassessment Bonds debt service payments are made from property tax assessments and reassessments recorded in the Special Assessment Districts Fund. Tax Allocation Bonds and Redevelopment Agency Revenue Bonds debt service payments are made from tax increment revenue recorded in the Redevelopment Agency Fund. Other Long-Term Obligations payments are primarily made from general revenue recorded in the General Fund.

8. Annual Requirements to Maturity

The annual requirements to amortize all bonds and notes outstanding as of June 30, 2007, are as follows (dollars in thousands):

	Governmental Activities				
	General Obligation Bonds and HUD Section 108 Loan		Lease Revenue and Reassessment Bonds [1,2,3]		
Fiscal Year Ending June 30,	Principal	Interest	Principal	Accreted Interest	Interest
2008	$ 16,179	23,956	7,586	458	29,843
2009	19,198	24,390	7,870	480	30,072
2010	19,253	23,395	10,329	501	29,724
2011	19,283	22,471	6,899	521	29,213
2012	19,319	21,639	8,210	540	28,885
2013-2017	97,461	94,976	57,484	556	137,185
2018-2022	99,566	72,140	87,845	-	119,481
2023-2027	97,157	48,023	114,745	-	94,105
2028-2032	91,245	25,243	113,895	-	67,926
2033-2037	54,485	6,233	160,515		36,457
2038-2042	3,000	71	63,850	-	3,792
Total	$ 536,146	362,537	639,228	3,056	606,683

	Governmental Activities			
	Special Assessment Bonds With Limited Government Commitment		Redevelopment Agency [1,3]	
Fiscal Year Ending June 30,	Principal	Interest	Principal	Interest
2008	$ 3,181	3,705	43,760	103,822
2009	3,290	3,575	50,720	101,540
2010	3,429	3,433	62,990	98,782
2011	3,558	3,280	67,205	95,626
2012	3,718	3,113	70,765	92,355
2013-2017	19,454	12,714	402,555	405,031
2018-2022	19,270	7,707	488,395	297,476
2023-2027	10,825	2,560	496,795	171,830
2028-2032	3,910	997	354,710	71,509
2033-2037	945	31	145,400	10,355
	$ 71,580	41,115	2,183,295	1,448,326

(Continued)

	Business-Type Activities					
	Airport (1)		Wastewater Treatment System (1)			
	Revenue Bonds		Revenue Bonds		Loans Payable	
Fiscal Year Ending June 30,	Principal	Interest	Principal	Interest	Principal	Interest
2008	$ 9,745	22,802	4,310	2,793	3,633	831
2009	11,180	22,351	4,480	2,636	3,699	765
2010	11,645	21,839	4,640	2,484	3,767	697
2011	12,120	21,317	4,790	2,331	3,835	628
2012	12,620	20,776	4,945	2,155	3,905	559
2013-2017	72,420	93,767	27,790	7,636	20,621	1,698
2018-2022	74,435	74,348	26,230	1,876	6,125	143
2023-2027	91,385	54,131	-	-	-	-
2028-2032	127,395	29,108	-	-	-	-
2033-2037	62,600	3,706	-	-	-	-
Total	$ 485,545	364,145	77,185	21,911	45,585	5,321

[1] Projected interest payments for the variable rate series of bonds are based on the following rates in effect on June 30, 2007. Lease Revenue Bonds: Series 2000C (5.30%), Series 2001B (5.35%), Series 2001C (5.32%), Series 2001D (3.67%), Series 2002C (3.65%), Series 2004A (5.22%), Series 2005A (5.35%), Series 2005B (3.82%). Redevelopment Agency Revenue Bonds: Series 1996A (3.65%), Series 1996B (3.55%), Series 2003A (5.38%), Series 2003B (3.65%). Redevelopment Agency Housing Set-Aside Tax Allocation Bonds: Series 2005C (3.76%), Series 2005D (3.73%). Airport Revenue Bonds: Series 2004A (3.85%), Series 2004B (3.87%). Clean Water Financing Authority Revenue Bonds: Series 2005B (3.65%). HUD Section 108 Notes: City of San Jose and Redevelopment Agency Loans (5.56%). Each series may be set at different interest rate calculation modes, including daily, weekly, monthly, and long rates.

[2] Amount shown is accreted value payable in each period. As of June 30, 2007, $2,323,000 of value had accreted on the outstanding capital appreciation bonds, which combined with the $639,228,000 of outstanding current interest bonds totals $641,551,000 of outstanding lease revenue debt.

[3] Projected debt service payments for the City of San Jose Financing Authority Series 2001A Parking Revenue Bonds and Series 2001F Lease Revenue Bonds is included in the Redevelopment Agency Redevelopment Project category, reflecting that the Redevelopment Agency is the primary source of payment for those bonds.

For governmental and business-type activities, the specific year for payment of estimated liabilities for accrued vacation, sick leave and compensatory time, accrued landfill post-closure cost, estimated liability for self-insurance and for the net pension obligation is not practicable to determine.

9. New Debt Issuances and Unused Authorizations

Governmental Activities

Redevelopment Agency of the City of San José Merged Area Redevelopment Project Taxable Tax Allocation Bonds, Series 2006A-T and Tax Allocation Bonds, Series 2006B. On November 14, 2006, the Redevelopment Agency issued $14,300,000 of Series 2006A-T (taxable) and $67,000,000 of Series 2006B tax allocation bonds (together, the "Series 2006AB Bonds"). The proceeds of the Series 2006AB bonds were used to finance multiple redevelopment projects within the Agency's Merged Area Redevelopment Project. The 2006 Tax Allocation Bonds are issued in parity with other outstanding Tax Allocation Bonds issued by the Agency. Debt service is payable from the Agency's tax increment revenues.

The Series 2006A-T bonds, which are insured by Radian Asset Assurance Inc., bear interest at fixed rates ranging from 5.35% to 5.65%, and have a final maturity date of August 1, 2022. The Series 2006B bonds, which are also insured by Radian Asset Assurance Inc., bear interest at fixed rates ranging from 4.50% to 5.00%, and have a final maturity date of August 1, 2035.

Redevelopment Agency of the City of San José Merged Area Redevelopment Project Tax Allocation Refunding Bonds, Series 2006C and Series 2006D. On December 15, 2006, the Redevelopment Agency issued $423,430,000 of Series 2006C and $277,755,000 of Series 2006D tax allocation bonds. The proceeds of the Series 2006C bonds were used to current refund a portion of the Agency's Series 1993 tax allocation bonds and advance refund portions of the Agency's Series 1993, Series 1997, Series 1998 and Series 2002 tax allocation bonds. The proceeds of the Series 2006D bonds were used to advance refund portions of the Agency's Series 1998 and Series 1999 tax allocation bonds. Debt service is payable from the Agency's tax increment revenues.

This refunding generated approximately $22,604,000 of aggregate debt service savings (net of available funds) and $21,656,000 of net economic gain, representing 3.1% of the refunded debt. The Series 2006C bonds, which are insured by MBIA Insurance Corporation, bear interest at fixed rates ranging from 3.75% to 5.00%, and have a final maturity date of August 1, 2032. The Series 2006D bonds, which are insured by Ambac Assurance Corporation, bear interest at fixed rates ranging from 4.00% to 5.00%, and have a final maturity date of August 1, 2023.

City of San José General Obligation Bonds, Series 2007 (Parks and Public Safety Projects). On June 20, 2007, the City issued $90,000,000 of Series 2007 general obligation bonds. The proceeds will be used to fund $22,100,000 of parks projects and $67,900,000 of public safety projects. Debt service on the Series 2007 bonds is payable from ad valorem taxes levied upon all property subject to taxation by the City. The Series 2007 bonds bear interest at fixed rates ranging from 4.00% to 8.00%, and have a final maturity date of September 1, 2037.

At June 30, 2007, the City has issued $547,490,000 in general obligation bonds to provide funds for the acquisition and construction of major capital facilities and parks. Of this amount, as of June 30, 2007, $510,710,000 is outstanding. Of the total amount authorized to be issued of $598,820,000, there remains an unused balance of $51,330,000.

City of San José Financing Authority Lease Revenue Refunding Bonds, Series 2007A (Recreational Facilities Refunding). On June 28, 2007, the Authority issued $36,555,000 of Series 2007A lease revenue refunding bonds. The proceeds of the Series 2007A bonds were used to current refund a portion of the Authority's Series 1993B lease revenue bonds, current refund all of the Authority's Series 1997A lease revenue bonds, and advance refund all of the Authority's Series 2000B lease revenue bonds. Debt service will be paid from several City Council District Construction and Conveyance Tax Funds, the Municipal Golf Course Fund, and the Community Facilities Revenue Fund.

Series 2007A bonds net proceeds and cash remaining in the debt service and debt service reserve funds of the refunded bonds were used to establish refunding escrows for each series of refunded bonds on the date of issuance of the Series 2007A bonds. The refunding escrows provided for the principal, call premium and accrued interest through the date of redemption for each series of refunded bonds. The Series 1997A bonds in the amount of $5,965,000 were redeemed on August 15, 2007, and the Series 1993B bonds in the amount of $5,795,000 were redeemed on September 24, 2007. The Series 2000B bonds in the amount of $21,500,000 are considered defeased and will be redeemed on August 15, 2008. The refunded bonds have been removed from the City's basic financial statements.

This refunding generated approximately $3,600,000 of aggregate debt service savings (net of available funds) and $1,300,000 of net economic gain, representing 3.9% of the refunded debt. The Series 2007A bonds, which are insured by Ambac Assurance Corporation, bear interest at fixed rates ranging from 4.125% to 4.75%, and have a final maturity date of August 15, 2030.

City of San José Financing Authority Lease Revenue Commercial Paper Notes Payable. On January 13, 2004, the City Council and the City of San José Financing Authority each adopted a resolution authorizing the issuance of City of San José Financing Authority tax-exempt lease revenue commercial paper notes in an amount not to exceed $98,000,000. This commercial paper program was established as a mechanism for financing public improvements of the City including the offsite parking garage for the new Civic Center and non-construction costs for technology, furniture, equipment and relocation services for the new Civic Center. On November 9, 2005, the City Council and the Authority authorized use of the commercial paper program to finance procurement costs of the City's consolidated utility billing system.

Subsequently, on June 21, 2005, the City Council and the City of San José Financing Authority each adopted a resolution authorizing the issuance of taxable lease revenue commercial paper notes, under the same $98,000,000 not to exceed limitation as the tax-exempt notes. This subsequent authorization permits the Authority to issue taxable commercial paper notes to pay for expenses otherwise authorized under the commercial paper program, but ineligible to be paid from tax-exempt commercial paper proceeds.

On November 15, 2005, the City Council and the City of San José Financing Authority each adopted a resolution expanding the capacity of the lease revenue commercial paper program from $98,000,000 to $116,000,000 and authorizing the issuance of commercial paper notes to pay a portion of the costs of the Phase II improvements at the City's Central Service Yard and a portion of the demolition and clean-up costs at the City's Main Service Yard.

On May 22, 2007, the City Council and the City of San José Financing Authority each adopted a resolution authorizing the issuance of lease revenue commercial paper notes to pay for capital improvements at the City's HP Pavilion.

Under this program, the Authority is able to issue commercial paper notes at prevailing interest rates for periods of maturity not to exceed 270 days. The commercial paper notes are secured by a pledge of lease revenues from various City assets and are additionally secured by a letter of credit issue on a several basis by State Street Bank and Trust Company and the California State Teachers' Retirement System (CalSTRS).

During fiscal year 2006-07, the Authority issued $2,161,000 of commercial paper notes for the New City Hall and offsite parking garage, $1,546,000 for technology, furniture and relocation services for the New City Hall, $19,000 for municipal facility improvements, $5,090,000 for the consolidated utility billing system, $16,052,000 for the Central Service Yard Phase II project, and $186,000 for other adjustments.

Also during fiscal year 2006-07, the Authority redeemed $590,000 of commercial paper notes for the new City Hall offsite parking garage, $7,517,000 for technology, furniture and relocation services for the new City Hall, $370,000 for municipal facility improvements, and $1,402,000 for the consolidated utility billing system.

On June 30, 2007, $80,279,000 of Authority tax-exempt commercial paper notes were outstanding at interest rates ranging from 3.70% to 3.75%. On June 30, 2007, no Authority taxable commercial paper notes were outstanding.

The change in commercial paper payables are as follows (dollars in thousands):

June 30, 2006	Additions & other adjustments	Deletions	June 30, 2007
$ 65,104	25,054	(9,879)	$ 80,279

Business-Type Activities

Airport Commercial Paper Notes Payable. On November 2, 1999, the City Council adopted a resolution authorizing the issuance of City of San José, San José International Airport subordinated commercial paper notes in three series (Series A -- Tax-Exempt, Series B -- Subject to the AMT, Series C -- Taxable) in an amount not to exceed $100,000,000. The commercial paper program was established to provide an interim source of financing for the initial capital projects in the Airport Master Plan until a permanent financing plan was finalized and implemented.

Subsequently, on April 1, 2003, the City Council authorized use of the commercial paper program to fund costs associated with implementation of the requirements under the federal Aviation and Transportation Security Act (ATSA).

On June 20, 2006, the City Council approved an expansion of the Airport commercial paper program from $100,000,000 to $200,000,000 to ensure that funding would be available for the award of the design and construction contracts related to the rephased Airport Master Plan projects. On January 9, 2007, the City Council approved an additional expansion of the Airport commercial paper program from $200,000,000 to $450,000,000 to ensure that funding would be available for the award of the design and construction contracts related to the rephased Airport Master Plan projects. Various Airport Master Plan projects over the next several years are focused on completion of the North Concourse Projects as well as the implementation of a Terminal Area Improvement Program (the "TAIP"). Additionally, the Airport commercial paper program may be used to pay costs related to the Airport's lease of the former FMC property and to pay debt service costs related to the City of San José Airport Revenue Bonds, Series 2004.

Under this program, the City is able to issue commercial paper notes at prevailing interest rates for periods of maturity not to exceed 270 days. The commercial paper is secured by a subordinate pledge of the Airport's revenues and additionally secured by a letter of credit issued on a several basis by JPMorgan Chase Bank, Bank of America, Citibank and Dexia Credit Local.

During fiscal year 2006-07, no Series A commercial paper notes were issued or outstanding. During fiscal year 2006-07, the City issued $22,048,000 of Series B commercial paper notes and $11,287,000 of Series C commercial paper notes.

On June 30, 2007, $41,424,000 of Airport commercial paper notes were outstanding at interest rates ranging from 3.74% to 5.35%.

The change in commercial paper payables are as follows (dollars in thousands):

June 30, 2006	Additions	Deletions	June 30, 2007
$8,089	33,335	-	$41,424

10. Landfill Post-closure Costs

The City has five closed landfills for which post-closure and monitoring services may be required for approximately a 30 year period which began in fiscal year 1996, coinciding with the closure of the last landfill. An estimated liability of $9,765,000 related to the closed landfills is recorded in the government-wide financial statements as of June 30, 2007. The City's Environmental Compliance Officer performs an annual evaluation of the aforementioned liability. Actual costs may be higher due to inflation, changes in technology, or changes in regulations. The City does not own or operate any open landfills at this time.

(Continued)

11. Estimated Liability for Self-Insurance

The City is exposed to various risks of losses related to torts, errors and omissions, general liability, injuries to employees, unemployment claims, and employee health and dental insurance. The City maintains an all-risk property policy where the maximum total liability in a single occurrence for all coverage combined will not exceed $1,000,000,000, with a single occurrence deductible of $100,000 for property damage and time element combined. This policy also provides coverage for loss due to flood in the amount for Zone A and V of $10,000,000 (reduced from $15,000,000), Zone B $15,000,000 (reduced from $25,000,000) and $50,000,000 in all other flood zones with flood deductibles ranging from $100,000 to $1,000,000 per occurrence depending on the flood zone. The City reduced its coverage for Zone A and V and Zone B during the fiscal year in response to the current insurance market. The City has an airport liability policy covering the Airport, which provides a limit of $200,000,000 combined single limit for bodily injury and property damage with a $25 million each occurrence limit for personal injury subject to a per occurrence deductible of $100,000. During the past three years, there have been no instances of the amount of claim settlements exceeding insurance coverage.

Claims liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. The result of the process to estimate the claims liability is not an exact amount as it depends on many complex factors, such as inflation, changes in legal doctrines, new discovered information and damage awards. Accordingly, claims are reevaluated periodically to consider the effects of inflation, recent claims settlement trends (including frequency and amount of pay-outs), economic and social factors, newly discovered information and changes in the law. The estimate of the claims liability also includes increases or decreases to previously reported unsettled claims.

With respect to the general liability accrual, the City has numerous unsettled lawsuits filed or claims asserted against it as of June 30, 2007. The City Attorney and, with respect to workers' compensation claims, the City's Risk Manager have reviewed these claims and lawsuits in order to evaluate the likelihood of an unfavorable outcome to the City and to arrive at an estimate of the amount or range of potential loss to the City. The City has included a provision for losses in its claims liability for loss contingencies that are both probable and can be reasonably estimated.

Changes in the reported liability during the past two years are as follows (dollars in thousands):

Liability as of July 1, 2005	$	140,910
Claims and changes in estimates during 2006		64,598
Claims payments		(22,850)
Liability as of June 30, 2006		182,658
Claims and changes in estimates during 2007		(6,379)
Claims payments		(17,010)
Liability as of June 30, 2007	$	159,269

(a) *Owner Controlled Insurance Programs*

On March 31, 2004, the City acquired certain liability insurance coverage (see chart below) for major components of the "2004 Security Projects" (currently referred to as the North Concourse Project) at the Norman Y. Mineta San José International Airport (the "Airport") through an Owner

Controlled Insurance Program ("OCIP"). An OCIP is a single insurance program that provides commercial general liability, excess liability and workers' compensation insurance coverage for construction jobsite risks of the project owner, general contractors and all subcontractors associated with construction at the designated project site.

	2004 Security Projects	
Coverages	**Limits**	**Deductible Per Occurrence**
General Liability	$2 million per occurrence/ $4 million aggregate	$250,000
Workers' Compensation	Statutory	$250,000
Employers' Liability	$2 million per accident	$250,000
Excess Liability	$150,000,000	None

The 2004 Security Projects OCIP Project terms include a 36-month construction period with ten years completed operations for general liability. The City extended the term to 53 months to correspond to the new estimated completion date.

On March 15, 2007, the City bound additional liability insurance through another OCIP for major components of the Airport's Terminal Area Improvement Program ("TAIP OCIP"). The term and construction period for this program is 57 months. The coverages for this program are as follows:

	Terminal Area Improvement Projects	
Coverages	**Limits**	**Deductible Per Occurrence**
General Liability	$2 million per occurrence/ $4 million aggregate	$250,000
Workers' Compensation	Statutory	$250,000
Employers' Liability	$1 million per accident	$250,000
Excess Liability	$200,000,000	None

12. Net Pension Obligation

The City determined the net pension obligation at transition (July 1, 1997) amounted to $2,300,000 for the Federated Employees' Retirement System (the System) in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. The methods and assumptions that apply for the calculation of the net pension obligation are those that are used for amortizing actuarial experience gains and losses in determining the City's contribution rates. The System's amortization factors incorporate the use of an investment return rate of 8.25% and an inflation rate of 4.50%, with an amortization period of 21 years as a level percentage of projected payroll on an open basis, resulting in an amortization factor of 12.83 for fiscal 2007.

(Continued)

G. Interfund Transactions

The composition of interfund balances as of June 30, 2007, with explanations of significant transactions, is as follows (dollars in thousands):

1. Due from/Due to other funds

Due From/Due to other funds

Receivable Fund	Payable Fund	Amount	
General Fund	Redevelopment Agency	$ 1,084	(1)
	Nonmajor governmental funds	33,661	(2)
Housing Activities	Redevelopment Agency	59	(3)
Nonmajor governmental funds	Nonmajor governmental funds	38,413	(4)
Redevelopment Agency	General Fund	131	(5)
	Nonmajor governmental funds	115	(6)
Wastewater Treatment System	Nonmajor governmental funds	508	(7)
	Municipal Water System	700	(8)
Norman Y. Mineta San Jose International Airport	Nonmajor governmental funds	188	(9)
		$ 74,859	

(1) $451 represents interest receivable accrual from pooled investment and $633 staff support labor charges and other various accruals.
(2) $31,939 is working capital short term borrowing; $1,336 represents accrual of gas tax transfer, and $386 represents accrual of Construction & Conveyance tax transfer.
(3) Represent year-end tax increment accrual.
(4) Short-term borrowing for working capital.
(5) Represent accrual of interest receivable of pooled cash funds.
(6) $65 represents accrual 4th Street communication conduit cost and $50 represents accrual for WRT Solomon Agreement.
(7) $50 represents short term portion of loan for Fiber Optics Conduit and $458 represents short term portion loan for sewer extension program.
(8) Represents short term portion of loan for North Coyote Valley Water Project.
(9) Represents reimbursable expenses related to the FMC project.

(Continued)

2. Advances to/Advances from other funds

Receivable Fund	Payable Fund	Amount	
General Fund	San Jose Financing Authority	$ 3,607	(1)
Redevelopment Agency	Housing Activities	580	(2)
	General Fund	250	(3)
Nonmajor governmental funds	Redevelopment Agency	8,112	(4)
Parking System	Redevelopment Agency	6,800	(5)
Wastewater Treatment System	Nonmajor governmental funds	2,204	(6)
	Municipal Water System	3,528	(7)
		$ 25,081	

(1) $310 represents loan to fund Seismic District bond issuance costs and $3,297 represents loan to support City-owned golf course.
(2) $580 represents loan to the YMCA Villa Nueva housing project.
(3) Represents executive director home loan.
(4) Represents parkland vouchers fees for low income housing projects and is expected to be repaid in 2010.
(5) Redevelopment Agency loan from the Parking Reserve Fund and is expected to be repaid in 2009.
(6) Represents long-term loans for the Fiber Optic conduit project is scheduled to be paid within 15 years from 1996.
(7) Represents loans for the North Coyote Valley Water Project and is scheduled to be paid including the interest earned at the City pooled investments interest rate.

3. Transfers in/Transfers out

Transfers are indicative of funding for capital projects, lease payments or debt service and subsidies of various City operations. The following schedules summarize the City's transfer activity with explanations of significant transactions (dollars in thousands):

Between Governmental and Business-type Activities:

Transfers from	Transfers to	Amount	
General Fund	Municipal Water System	$ 193	(1)
Nonmajor governmental funds	Norman Y. Mineta San Jose International Airport	1,419	(2)
San Jose Financing Authority	Parking System	75	(3)
Parking System	Redevelopment Agency	90	(4)
	Nonmajor governmental funds	780	(5)
Municipal Water System	General Fund	1,735	(6)
	Nonmajor governmental funds	61	(7)
	San Jose Financing Authority	164	(8)
Wastewater Treatment System	General Fund	3,648	(9)
	Nonmajor governmental funds	1,279	(10)
	San Jose Financing Authority	348	(11)
Public Works Program Support	Nonmajor governmental funds	495	(12)
		$ 10,287	

(1) Refund of over-paid rate of return and In-Lieu fees.
(2) Reimburse expenses for FMC project.
(3) Transfer Interest earned from debt service for the joint parking project.
(4) Transfer surplus revenue and interest earned to Redevelopment Agency per partnership agreement.
(5) Transfer of convention center parking receipts and debt service payment.
(6) Municipal Water System payments for in-lieu taxes and rate of return on assets.
(7) Transfer for debt service payment and commercial paper redemption.
(8) Transfer for commercial paper redemption expense.
(9) Wastewater Treatment System payments for in-lieu taxes.
(10) City Hall debt service payments.
(11) Commercial paper redemption.
(12) Debt service payments for City Hall project.

(Continued)

Between Funds within the Governmental Activities:

Transfers from	Transfers to	Amount	
General Fund	Redevelopment Agency	$ 50	(1)
	San Jose Financing Authority	6,185	(2)
	Nonmajor governmental funds	29,293	(3)
Redevelopment Agency	General Fund	335	(4)
	Housing Activities	32,364	(5)
	San Jose Financing Authority	3,363	(6)
	Nonmajor governmental funds	9,248	(7)
Housing Activities	Redevelopment Agency	18,583	(8)
	General Fund	120	(9)
	Nonmajor governmental funds	1,237	(10)
Nonmajor governmental funds	Redevelopment Agency	3,436	(11)
	General Fund	32,235	(12)
	Nonmajor governmental funds	15,361	(13)
	San Jose Financing Authority	38,333	(14)
San Jose Financing Authority	Nonmajor governmental funds	22,928	(15)
		$ 213,071	

(1) Reimburse RDA for share of Mariachi Festival expenses.
(2) Various debt service payments and commercial paper redemption.
(3) Various debt service payments, loan repayment and operating transfers.
(4) San Jose arena pass through payment.
(5) 20% tax increment tax transfers.
(6) Debt service payment for 4th & San Fernando parking garage.
(7) Transfers for various capital project.
(8) Debt service payment.
(9) Transfer to General Fund for acquisition of City-owned properties.
(10) Debt service payments.
(11) $962 represents transfers for various capital projects and $2,474 represents a loan repayment.
(12) Various transfers for operations and capital projects.
(13) Various transfers for debt service, operations and capital projects.
(14) Various transfers for debt service payments.
(15) Transfer commercial paper proceeds for capital projects and operations.

IV. Other Information

A. Employee Defined Benefit Retirement Systems

1. Systems Description

The City sponsors and administers two single employer defined benefit retirement systems, the Police and Fire Department Retirement Plan (the “Plan”) and the Federated City Employees’ Retirement System (the “System” and collectively, “the Retirement Systems”), which together cover all full-time and certain part-time employees of the City. Each of them provides postemployment health subsidy benefits in addition to regular retirement benefits. The Retirement Systems are accounted for as separate Pension Trust Funds. The estimated payrolls for employees covered under the Plan and the System for the fiscal year ended June 30, 2007, were approximately $209,025,000 and $280,575,000, respectively. The City’s total payroll for the fiscal year ended June 30, 2007, was approximately $566,133,000.

The separately issued annual reports of the Retirement Systems and the City's municipal code provide more detailed information about the Retirement Systems. Those reports may be obtained by writing to the City of San José Department of Retirement Services, 1737 North First Street, Suite 580, San José, California 95112.

The Retirement Systems provide general retirement benefits under single employer Defined Benefit Pension Plans, including pension, death, disability, as well as postemployment medical and dental benefits under the Postemployment Healthcare Plans. Benefits are based on average final compensation, years of service, and limited required cost-of-living increases. The Retirement Systems are administered by the Director of Retirement, an employee of the City, under the direction of the Retirement Systems' Boards of Administration. The contribution and benefit provisions and all other requirements are established by City ordinances.

The current membership in the Retirement Systems as of June 30, 2007, is as follows:

	The Plan	The System
Defined Benefit Pension Plans:		
Retirees and beneficiaries currently receiving benefits	1,536	2,749
Terminated vested members not yet receiving benefits	71	530
Active members	2,145	4,143
Total	3,752	7,422
Postemployment Healthcare Plans:		
Retirees and beneficiaries currently receiving benefits	1,375	2,053
Terminated vested members not yet receiving benefits	13	77
Active members	2,145	4,143
Total	3,533	6,273

The Retirement Systems are not subject to the provisions of the Employee Retirement Income Security Act of 1974. It is the City's policy to obtain actuarial valuations for the Retirement Systems every two years.

2. Funding Policy

Contributions to the Defined Benefit Pension Plan for each Retirement System for both the City and the participating employees are based upon an actuarially determined percentage of each employee's base salary sufficient to provide adequate assets to pay benefits when due. The significant assumptions used to compute the Retirement Systems' (excluding Postemployment Health Care Plans) actuarially determined contribution requirements are the same as those used to compute the actuarial accrued liability shown in the Schedule of Funding Progress for the Defined Benefit Pension Plan.

Contribution rates for the City and the participating employees for fiscal year ended June 30, 2007 were established in accordance with actuarially determined requirements computed through actuarial valuations dated June 30, 2005. The contribution rates and the amounts contributed to the Plan and the System for the fiscal year ended June 30, 2007, are as follows:

	The Plan			The System		
	City	Participants	Total	City	Participants	Total
Actuarial Rate:						
Defined Benefit Plan:						
7/01/05 - 7/01/06	21.77%	8.27%		14.96%	4.26%	
7/02/06 - 6/30/07	21.03%	7.48%		18.16%	4.26%	
12/17/06 - 6/30/07*	24.32%	7.89%		N/A	N/A	
Postemployment Healthcare Plan:						
7/01/05 -7/01/06	3.27%	2.89%		2.16%	1.80%	
7/02/06 - 6/30/07	4.19%	3.78%		3.82%	3.32%	
Annual Pension Contribution (in thousands):						
Defined Benefit Plan	$ 46,625	$ 16,051	$ 62,676	$ 51,004	$ 12,370	$ 63,374
Postemployment Healthcare Plan	9,082	7,989	17,071	10,728	9,611	20,339
	$ 55,707	$ 24,040	$ 79,747	$ 61,732	$ 21,981	$ 83,713

* This rate is for Police members only.

The Retirement Systems completed new actuarial valuations dated June 30, 2005 and the rates were effective July 2, 2006. The new rates increased the Plan's contribution from the City from 25.04% to 25.22% and for the employees the rate increased from 11.16% to 11.26%. Funding status of the Plan was reduced from 100.2% to 97.8%. The new rates also increased the System's contributions from the City from 17.12% to 21.98% and for the employees the rate increased from 6.06% to 7.58%. Funding status of the System was reduced from 97.6% to 80.9%. On December 17, 2006, the City's actuarial rate for Police increased by 3.29% due to scheduled retirement benefit increases required pursuant the Police Officers Association's memorandum of agreement effective July 1, 2006.

3. Annual Pension Cost and Net Pension Obligation

The City's annual pension cost and net pension obligation to the Plan and the System (excluding the Postemployement Healthcare Plans) as of and for the fiscal year ended June 30, 2007, were as follows (dollar in thousands):

	The Plan	The System
Annual required contribution	$ 46,625	$ 51,004
Interest on net pension obligation	-	258
Adjustment to annual required contribution	-	(252)
Annual pension cost	46,625	51,010
Contributions made	(46,625)	(51,004)
Increase in net pension obligation	-	6
Net pension obligation – beginning of year	-	3,233
Net pension obligation – end of year	$ -	$ 3,239

The following is three-year trend information for the City's single-employer pension plans (dollars in thousands):

	Fiscal year ended	Annual Pension Cost (APC)	Percent APC Contributed	Net Pension Obligation
The Plan	6/30/05	$ 41,835	100%	$ -
	6/30/06	43,473	100%	-
	6/30/07	46,625	100%	-
The System	6/30/05	$ 41,552	100%	$ 3,220
	6/30/06	41,267	100%	3,233
	6/30/07	51,004	100%	3,239

(Continued)

4. Actuarial Assumptions and Methods

The more significant actuarial assumptions and methods used in the calculations of employee and employer contributions to the Retirement Systems (excluding Postemployment Healthcare Plans) for the fiscal year ended June 30, 2007 are as follows:

Method/Assumption	The Plan	The System
Valuation date	June 30, 2005	June 30, 2005
Actuarial cost method	Entry age normal cost method	Entry age normal cost method
Amortization method for actuarial accrued liabilities	Level percentage of payroll	Level percentage of payroll
Remaining amortization period	12 years, closed for unfunded pension liabilities; 16 years, closed for gains and losses between valuations	30 years, open
Actuarial asset valuation method	5 year smoothed market	5 year smoothed market
Investment rate of return	8.00% per annum	8.25% per annum
Postretirement mortality	The 1994 Male Group Annuity Mortality Table, with a four-year set back, is used for male members. The 1994 Female Group Annuity Mortality Table, with a one year set forward, is used for female members.	The 1994 Group Annuity Mortality Table used for healthy retirees and beneficiaries. The disabled mortality table used was the 1981 Disability Mortality Table.
Active service, withdrawal, death, disability service retirement	Based upon the June 30, 2005 experience analysis	Tables based on current experience
Salary increases	10.00% for employees for the first five years of service; 7% for 6 or 7 years of service and 4.75% in excess of 7 years of service. Of the total salary increases of 4.00%, 3.00% is for inflation and 1.00% is real across-the-board salary increase.	The rate of annual salary increase for all members with at least 5 years of service is equal to 4.25% plus an added merit component for those with 0-4 years of service.
Cost-of-living adjustments	3.00% a year	3.00% a year

(Continued)

5. *Implementation of GASB 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*

As noted earlier in the Notes to the Financial Statements, the City implemented GASB 43 in fiscal year 2006-07. GASB 43 applies to the City's Postemployment Healthcare Plans and requires additional disclosure with respect to the healthcare plans. This information is noted below:

Plan Description. The City administers Postemployment Healthcare Plans for employees retiring under the City's Retirement Systems. The two health care plans are single-employer defined benefit plans. The City issues publicly available financial reports that include financial statements and required supplementary information for the Postemployment Healthcare Plans. The financial reports may be obtained by writing to the City of San Jose, Office of Retirement Services, 1737 North First Street, Suite 580 San Jose, California 95112.

Basis of Accounting. The financial statements for the Postemployment Healthcare Plans are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to each plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

Method Used to Value Investments. The valuation method is discussed more fully, for the Retirement Systems, in the Summary of Significant Accounting Policies, Note I. F.3., entitled "Deposits and Investments—Retirement Systems".

Actuarial information. Certain actuarial information with respect to the Postemployment Healthcare Plans is disclosed in the Required Supplementary Information section of the financial statements, in accordance with the provisions of GASB 43.

B. Defined Contribution Retirement Plan

In January 1995, the Agency Board adopted a single employer defined contribution retirement plan, the Redevelopment Agency of the City of San José Retirement Plan (the Retirement Plan), which provides pension benefits for its non-civil service employees. For eligible employees who contribute 3.5% of their annual base salary, the Agency contributes approximately 9.0%. The Agency's contributions are based on a formula taking into account employee annual base salary and length of service. The Agency's contributions for each employee (and interest allocated to the employee's account) are fully vested after three years of continuous service from the original date of employment. The Agency's contributions and interest forfeited by employees who leave employment before vesting occurs may be used to reduce the Agency's contribution requirement or to offset plan-operating expenses. The Agency contracts with an advisor to manage the pension plan with all assets of the plan being held in trust by a third party custodian in the name of each of the Plan's participants. Each of the Plan's participants directs the investments of his/her separate account. The Agency's Board of Directors may authorize changes to the Plan.

The Agency's total payroll in fiscal year ended June 30, 2007 for all non-civil service employees was approximately $8,406,000. Contributions to the plan during the year ended June 30, 2007, made by both the Agency and the participating employees, amounted to approximately $739,000 and $280,000, respectively.

(Continued)

C. Commitments and Contingencies

1. Norman Y. Mineta San José International Airport

Purchase Commitments. As of June 30, 2007, the Airport was obligated for purchase commitments of approximately $190,201,000, primarily for the noise attenuation, design and construction of the North Concourse building and Taxiway Y reconstruction. Additionally, the Airport has projected that it will expend or encumber approximately $967,000,000 on proposed capital projects during the next five fiscal years. It is anticipated that funding for such capital projects will be provided primarily by proceeds from passenger facility charges (PFC), federal grant monies, bond proceeds and other Airport revenues.

Fuel Storage Facility. In 1985, a fuel leak was discovered in the Airport's fuel storage facility. The Airport and a fuel supplier with a fuel storage facility adjacent to the City owned facility agreed to share the costs of a study to develop an acceptable cleanup program for the contaminated site. The cleanup program submitted to the Santa Clara Valley Water District, the responsible regulatory authority, was approved and the cleanup program commenced during the fiscal year ended June 30, 1991. The agreement between the Airport and the fuel supplier required the Airport to pay 60% of the costs and the fuel supplier to pay the balance of 40% of the costs. The fuel supplier also receives a 10% management fee for overseeing the cleanup operation. As of June 30, 2007, the Airport has accrued approximately $330,000 to reflect its share of the remaining estimated costs of the initial phase of the cleanup program. On December 22, 1998, due to minimal fuel activities, the Airport temporarily closed its facility and ceased operation at that time. It has been mandated by the regulatory agencies that the final closure of the facility must occur by May 2008. The timing of the complete closure of the facility, which is dependent upon the construction of the new fueling facility at the Airport, and an estimate of the full costs of the existing tank removal and final site remediation have not yet been determined. As of June 30, 2007 and based on presently available information, the Airport's management does not anticipate that the full costs of remediation of the fuel storage facility will have a significant impact on the Airport's financial position or results of operations.

Acoustical Treatment Program. The Airport has an Acoustical Treatment Program (ACT) to comply with the requirements of Title 21 of the California Noise Standard. The program provides acoustical treatment to residences in the noise impact areas surrounding the Airport, at no cost to the property owners. The program is primarily funded by grants from the Federal Aviation Administration (FAA) and by PFC revenues. The Airport expended approximately $9,335,000 on noise attenuation projects during the fiscal year ended June 30, 2007 and expects to spend approximately $25,372,000 during fiscal year ending June 30, 2008.

Master Plan. The Airport Master Plan consists of a program of facility improvements designed to fully accommodate commercial aviation demand (passengers and cargo) projected for the year 2017, with development phased as demand warrants and is determined to be financially feasible. The Master Plan was originally adopted by the City of San Jose in June 1997 and approved by the Federal Aviation Administration (FAA) in December 1999. Subsequent to its 1997 approval, the Airport Master Plan has been revised through a series of City-approved amendments. The Master Plan development program currently includes approximately 70 improvement projects, of which about half have been completed or are underway.

The Airport development program incorporates environmental mitigation measures and other requirements set forth in the City's Airport Master Plan Environmental Impact Report (EIR) and Implementation Ordinance, and the California Air Resources Board's air quality certification for runway improvements. These associated requirements have also been updated subsequent to their original issuance.

2. Redevelopment Agency

Tax Sharing Agreement with the County of Santa Clara. On May 22, 2001, the County of Santa Clara, City of San José and the Agency amended and restated the 1993 Tax Revenue Sharing Agreement (the new agreement). The new agreement requires the Agency to provide the County a portion of the Agency's bond proceeds in addition to the 1993 revenue sharing amounts. The money will be used by the County to undertake redevelopment projects in or of benefit to the merged area, and requires the Agency to transfer funds to the County to pay for such projects. Such payments are considered Delegated Payments. Until June 30, 2004, the Delegated Payment was equal to the County's pass-through payment. However, after January 1, 2004, the Delegated Payment was re-defined as 20% of the proceeds of any debt secured by the Agency's non-housing tax increment revenues (excluding refunding bonds). For the fiscal year ended June 30, 2007, the pass-through payment totaled approximately $14,695,000 and Delegated Payments totaled in the amount of $15,383,000.

In August 2004, the City and the Agency filed a lawsuit seeking a judicial determination as to whether the County had breeched an agreement entered into among the parties in May 2001 (the 2001 Agreement). The 2001 Agreement included provisions regarding redevelopment tax increment allocation and the application of land use procedures in County territory within the San Jose urban service area. The City and the Agency contend that under the 2001 Agreement, the County was required to abide by City land use procedures before it entered into agreements with private entities for the development of a theater on the County fairgrounds.

In April 2005, the County filed a cross compliant against the City and the Agency alleging, among other things, breach of the 2001 Agreement, breach of the 2001 Agreement's implied covenant of good faith and fair dealing, and intentional interference with prospective economic relations. The County's cross compliant alleges no specific amount of damages and seeks damages and restitution according to proof. In addition a second lawsuit was filed by the County challenging the Council's approval of the North San Jose Development Policies Update. These lawsuits resulted in a settlement in November 2006.

The settlement among the City, Agency and County is that each agreed to dismiss their respective lawsuits and the Agency and/or City would pay the County a sum of $22.5 million, to be used by County on specified facilities that benefit the citizens of the City of San José. The Agency and/or City will pay the $22.5 million in three installments of $7.5 million over a three-year period, commencing on July 1, 2007. At June 30, 2007, the related liabilities are recorded as part of non-current obligations in the government wide financial statements. In addition, as part of the agreement, the City is required to fund up to $11 million toward certain improvements on Montague Expressway no later than June 30, 2010.

3. San José - Santa Clara Water Pollution Control Plant

The City's 2007-2011 Five-Year Capital Improvement Program includes the South Bay Water Recycling (SBWR) project, a regional water reclamation program to recycle highly treated wastewater for irrigation and industrial uses in the cities of San José, Santa Clara, and Milpitas, California. This program is part of an action plan, developed by the City and other agencies tributary to the Plant and adopted by the Regional Water Quality Control Board (RWQCB), to control the amount of effluent discharged by the Plant into San Francisco Bay.

(Continued)

The SBWR distribution system includes approximately 60 miles of pipe, a four million-gallon reservoir, a transmission pump station, and two booster pump stations. These facilities were constructed between 1996 and 1998 at a capital cost of approximately $140,000,000 funded by the tributary agencies, grants, and bond proceeds.

Proceeds from the 1995 Series A and B San Jose-Santa Clara Clean Water Financing Authority Sewer Revenue Bonds, which were refunded during the Fiscal Year 2005-06, (2005 Series A and B Sewer Revenue Bonds) and other funds were used to pay for the City's share of Phase I costs. The City of Santa Clara's share of Phase I costs was approximately $20,067,000. Sources of funding included credit for the City of Santa Clara's existing non-potable water reclamation distribution system, in-kind services, additional construction, and City of Santa Clara sewer utility cash reserves. Other sources of funding for Phase I included U.S. Bureau of Reclamation grants, $6,449,000 transferred in fiscal year 1995 from the Authority to the City's Wastewater Treatment Plant Capital Fund, and cash contributions from the other participating agencies.

In June 1997, the RWQCB and the City approved the Proposed Revision to the South Bay Action Plan, which described the projects necessary to reduce average dry weather effluent flow from the Plant to below 120 million gallons per day (mgd) and protect salt marsh habitat for endangered species in the South Bay as required by RWQCB Order 94-117. These projects include expanding the Phase I non-potable reuse system by extending additional piping, placing greater emphasis on water conservation programs, reducing infiltration inflow, augmenting stream flow, and creating wetlands. The estimated cost for implementing these projects was $127,500,000, of which $98,130,000 has been expended or encumbered. These estimated costs are to be funded by the City and other tributary agencies through a combination of State Revolving Fund Loans, Sewage Treatment Plant Connection Fees, federal grants, and cash contributions.

4. Federal Financial Assistance Programs

The City participates in a number of federally assisted grant programs, primarily with the Department of Housing and Urban Development, the Department of Transportation, the Department of Interior, the Department of Labor, and the Department of Justice. These programs are subject to program compliance audits by the grantors or their representatives.

Although the City’s grant programs have been audited in accordance with the provisions of the Single Audit Act Amendments of 1996 for the fiscal year ended June 30, 2007, these programs are still subject to financial and compliance audits by federal auditors, and to resolution of identified findings and questioned costs. At this time, the amount of expenditures, if any, which may be disallowed by the granting agencies cannot be determined.

(Continued)

D. Subsequent Events

1. Debt Issues

City of San José Airport Revenue Bonds, Series 2007A (AMT) and Series 2007B. On September 13, 2007, the City issued $545,755,000 of Series 2007A and $179,260,000 of Series 2007B airport revenue bonds (together, the “2007 Bonds”). The proceeds of the 2007 Bonds will be used to pay (and to redeem commercial paper notes issued to pay) a portion of the costs of Phase I of the Airport Development Program at the Norman Y. Mineta San José International Airport. Debt service on the 2007 Bonds will be paid from General Airport Revenues and certain other funds. The 2007 Bonds are insured by Ambac Assurance Corporation.

The Series 2007A bonds are subject to the Alternative Minimum Tax (AMT), bear interest at fixed rates ranging from 5.00% to 6.00%, and have a final maturity date of March 1, 2047. The Series 2007B bonds bear interest at fixed rates ranging from 4.25% to 5.00% and have a final maturity date of March 1, 2037.

A note repayment fund for the Series B commercial paper notes, in the amount of $32,446,000, was funded from a combination of Series 2007A and Series 2007B bonds proceeds and will be used to redeem a portion of the outstanding Series B commercial paper notes when those notes mature on December 6, 2007.

Redevelopment Agency of the City of San José Merged Area Redevelopment Project Taxable Tax Allocation Bonds, Series 2007A-T and Tax Allocation Bonds, Series 2007B. On October 24, 2007, the Redevelopment Agency sold $21,330,000 of Series 2007A-T (taxable) and $191,600,000 of Series 2007B tax allocation bonds (together, the “Series 2007AB Bonds”). The Series 2007AB Bonds transaction is scheduled to close on November 7, 2007. The proceeds of the Series 2007AB bonds will be used to finance multiple redevelopment projects within the Agency’s Merged Area Redevelopment Project. Debt service is payable from the Agency’s tax increment revenues.

The Series 2007A-T bonds, which are insured by XL Capital Assurance Inc., bear interest at a fixed rate of 5.10%, and have a maturity date of August 1, 2017. The Series 2007B bonds, which are also insured by XL Capital Assurance Inc., bear interest at fixed rates ranging from 4.25% to 5.00%, and have a final maturity date of August 1, 2036.

2. Liability Issues

Labor Contract Settlement of Firefighters Association Local 230. On September 18, 2007, the City Council adopted a resolution to implement the terms of the interest arbitration between the City and the International Association of Firefighters, Local 230. The term of the agreement is from fiscal year 2004-05 through 2008-09. The annual direct cost of the interest arbitration award is zero in 2004-05, approximately $1.5 million in 2005-06 and approximately $9.6 million in 2006-07. At June 30, 2007, these retroactive portion of the settlement have been designated in the General Fund and are recorded as other accrued liabilities in the government wide financial statements. Other issues decided by the arbitration award, such as changes to retirement benefits, will impact future periods.

3. Operations Issues

New Airline Lease Agreement. Three of the passenger airlines (Alaska Airlines, Delta Airlines, and US Airways) and one cargo airline (United Parcel Service) providing service at the Airport have signed the new airline lease agreement, which is scheduled to become effective December 1, 2007. The new airline lease agreement is scheduled to expire on June 30, 2012, may be extended for one additional five-year term by mutual consent of the City and the Signatory Airlines (as defined below). The key provisions in the new agreement include compensatory rate making for the terminal cost center and residual rate making for the airfield cost center.

The new airline lease agreement provides that any passenger airline that (a) signs an agreement substantially similar to the new airline lease agreement, (b) provides passenger service at the Airport, (c) leases from the City an amount of exclusive use premises (not including gates) in the terminal deemed sufficient by the Director of Aviation to support the airline's operation and (d) at the time the airline executes its agreement with the City, operates at least one scheduled flight, scheduled year-round, at least three days per week shall be a Signatory Airline. The new airline lease agreement also provides that any air cargo carrier will also be a Signatory Airline if the air cargo carrier (a) signs an agreement with the City substantially similar to the new airline lease agreement (other than in connection with terminal facilities), (b) leases from the City cargo support space at the Airport for a term at least equal to the term of the new airline lease agreement, (c) guarantees a minimum of 142,000 pounds of maximum gross certificated landed weight per scheduled flight and (d) at the time it executes its agreement with the City, operates at least five scheduled flights per week.

(Continued)

Required Supplementary Information

City of San José
General Fund
Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
For the Year Ended June 30, 2007
($000's)

		Budgeted Amounts Original	Budgeted Amounts Final	Actual Amounts Budgetary Basis Variance with Final Budget Over (Under)	Actual Amounts Budgetary Basis	Budgetary to GAAP Differences	Actual Amounts GAAP Basis	
REVENUES								
Taxes:								
Property	$	184,914	189,314	2,512	191,826	-	191,826	
Sales		144,008	149,074	888	149,962	-	149,962	
Utility		76,098	77,748	1,381	79,129	-	79,129	
State of California in-lieu		5,212	6,212	(301)	5,911	-	5,911	
Franchise		36,904	38,862	1,553	40,415	-	40,415	
Other		7,600	7,600	1,000	8,600	-	8,600	
Licenses, permits and fines		87,197	89,597	(986)	88,611	-	88,611	
Intergovernmental		22,020	26,048	(5,560)	20,488	-	20,488	
Charges for current services		29,157	29,448	176	29,624	-	29,624	
Interest and other revenues		39,692	59,642	(1,359)	58,283	1,436	59,719	(1)
Total revenues		632,802	673,545	(696)	672,849	1,436	674,285	
EXPENDITURES								
Current:								
General government		115,233	129,785	(34,765)	95,020	(8,972)	86,048	(2), (3)
Public safety		373,079	384,997	(11,573)	373,424	(4,584)	368,840	(2)
Capital maintenance		68,602	71,077	(20,274)	50,803	(7,500)	43,303	(2)
Community services		149,509	156,816	(19,442)	137,374	(8,310)	129,064	(2)
Sanitation		2,581	2,785	(279)	2,506	(673)	1,833	(2)
Capital outlay		3,664	4,943	(720)	4,223	(301)	3,922	(2), (3)
Total expenditures		712,668	750,403	(87,053)	663,350	(30,340)	633,010	
Excess (deficiency) of revenues over expenditures		(79,866)	(76,858)	86,357	9,499	31,776	41,275	
OTHER FINANCING SOURCES (USES)								
Transfers in		36,330	36,843	1,230	38,073	-	38,073	
Transfers out		(35,238)	(35,801)	80	(35,721)	-	(35,721)	
Total other financing sources (uses)		1,092	1,042	1,310	2,352	-	2,352	
Net change in fund balances		(78,774)	(75,816)	87,667	11,851	31,776	43,627	
Fund balances - beginning		209,418	209,418	-	209,418	27,552	236,970	
Beginning encumbrance		-	-	-	26,362	-	-	
Fund balances - ending	$	130,644	133,602	87,667	247,631	59,328	280,597	

Explanation of differences:
(1) Gain or loss in fair value of investments are not formally budgeted transactions.
(2) Encumbrances of funds for which formal budget are prepared.
(3) Expenditures and repayments that increase and decrease certain loan receivables for which formal budgets are prepared.

See accompanying notes to the required supplementary information.

City of San José
Housing Activities
Schedule of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual
For the Year Ended June 30, 2007
($000's)

	Budgeted Amounts Original	Budgeted Amounts Final	Actual Amounts Budgetary Basis Variance with Final Budget Over (Under)	Actual Amounts Budgetary Basis	Budgetary to GAAP Differences	Actual Amounts GAAP Basis	
REVENUES							
Intergovernmental	$ 21,287	21,474	(12,743)	8,731	(324)	8,407	(1), (3)
Interest and other revenues	26,177	26,177	(6,520)	19,657	(5,509)	14,148	(1), (3)
Total revenues	47,464	47,651	(19,263)	28,388	(5,833)	22,555	
EXPENDITURES							
Current:							
Capital maintenance	-	130	(130)	-	-	-	
Community services	111,858	113,723	(34,312)	79,411	(2,171)	77,240	(2), (3)
Total expenditures	111,858	113,853	(34,442)	79,411	(2,171)	77,240	
Excess (deficiency) of revenues over expenditures	(64,394)	(66,202)	15,179	(51,023)	(3,662)	(54,685)	
OTHER FINANCING SOURCES (USES)							
Capital lease financing proceeds							
Transfers in	45,707	46,224	(13,860)	32,364	-	32,364	
Transfers out	(19,940)	(19,940)	-	(19,940)	-	(19,940)	
Total other financing sources (uses)	25,767	26,284	(13,860)	12,424		12,424	
Net change in fund balances	(38,627)	(39,918)	1,319	(38,599)	(3,662)	(42,261)	
Fund balance - beginning	23,047	23,047	-	23,047	272,699	295,746	
Add beginning encumbrance balance	-	-	-	26,572	-	-	
Fund balances - ending	$ 23,008	(16,871)	1,319	11,020	269,037	253,485	

Explanation of differences:
(1) Gain or loss in fair value of investments are not formally budgeted transactions.
(2) Encumbrances of funds for which formal budget are prepared.
(3) Expenditures and repayments that increase and decrease certain loan receivables for which formal budgets are prepared.

See accompanying notes to the required supplementary information.

Required Supplementary Information
Schedules of Funding Progress (Dollars in Thousands)
(Unaudited-See accompanying independent auditor's report)

Police and Fire Department Retirement Plan - Defined Benefit Plan

Actuarial Valuation Date	Actuarial Value of Assets (1)	Entry Age Actuarial Accrued Liability (AAL) (2)	Unfunded (Overfunded) AAL	Funded Ratio	Annual Covered Payroll (3)	(Overfunded) Unfunded AAL as a Percentage of Covered Payroll
6/30/01 (4)	$ 1,713,812	1,492,732	(221,080)	115%	171,779	(129)%
6/30/03	1,826,287	1,823,200	(3,087)	100%	202,222	(2%)
6/30/05	1,983,090	2,027,432	44,342	98%	210,018	21%

Federated City Employees' Retirement System - Defined Benefit Plan

Actuarial Valuation Date	Actuarial Value of Assets (1)	Entry Age Actuarial Accrued Liability (AAL) (2)	Unfunded AAL	Funded Ratio	Annual Covered Payroll (3)	Unfunded AAL as a Percentage of Covered Payroll
6/30/01	$ 1,060,144	1,072,333	12,189	99%	252,696	5%
6/30/03	1,280,719	1,311,691	30,972	98%	292,961	11%
6/30/05	1,384,454	1,711,370	326,716	81%	286,446	114%

(1) Excludes accounts payable and postemployment healthcare plan assets.
(2) Excludes postemployment healthcare liability.
(3) Annual covered payroll represents the actuarial estimate of annual covered payroll for the subsequent year.
(4) After adoption of the Supplemental Retiree Benefit Reserve (SRBR) program.

Implementation of GASB 43
Financial Reporting for Postemployment Benefit Plans Other than Pension Plans

In fiscal year 2006-07, the City implemented the reporting requirements of GASB 43. The following schedules of funding progress are presented for the Plan's and the System's Postemployment Healthcare Benefit Plans based on the most recent actuarial valuation report.

Police and Fire Department Retirement Plan - Postemployment Healthcare Benefit Plan

Actuarial Valuation Date	Actuarial Value of Assets	Entry Age Actuarial Accrued Liability (AAL)	Unfunded AAL	Funded Ratio	Annual Covered Payroll (3)	Unfunded AAL as a Percentage of Covered Payroll
6/30/06	$ 38,381	851,217	812,836	5%	218,521	372%

Federated City Employees' Retirement System - Postemployment Healthcare Benefit Plan

Actuarial Valuation Date	Actuarial Value of Assets	Entry Age Actuarial Accrued Liability (AAL)	Unfunded AAL	Funded Ratio	Annual Covered Payroll	Unfunded AAL as a Percentage of Covered Payroll
6/30/06	$ 81,288	702,939	621,651	12%	275,559	226%

(Continued)

I. Budgetary Information

The adopted budget represents the financial and organizational plan by which the policies and programs approved by the City Council will be implemented. It includes: (1) the programs, projects, services and activities to be provided during the fiscal year; (2) estimated revenues available to finance the operating plan; and (3) the estimated spending requirements of the operating plan. The City Charter requires that the City establish a budgetary system for general operations and prohibits expending funds for which there is no legal appropriation.

Annual budgets are prepared for the General Fund and all special revenue funds except for the following:

- Developer Fees
- William F. Prusch, Jr.
- Emergency Reserve
- Special Assessment Special Services

The annual appropriation ordinance adopts the budget at the appropriation level by expenditure category (personal services, nonpersonal) within departments. Accordingly, the lowest level of budgetary control exercised by the City Council is the appropriation level within a department. The City's legal level of budgetary control is so detailed that it is not practical to demonstrate compliance within the CAFR itself. As a result, the City prepares a separate report to demonstrate compliance with its legal level of budgetary control.

Capital project budgets are based on a project time frame rather than a fiscal year time frame and therefore are not included. Debt Service Funds appropriations were implicitly adopted by the Council when the formal bond resolutions were approved.

II. Budgetary Results Reconciled to GAAP

The budgetary process is based upon accounting for certain transactions on a basis other than the accounting principles generally accepted in the United States (GAAP) basis. The results of operations are presented in the accompanying budget and actual comparison schedules in accordance with the budgetary process (budgetary basis) to provide a meaningful comparison with the budget.

The major differences between the budgetary basis actual and GAAP basis are as follows:

- Year-end encumbrances are recognized as the equivalent of expenditures in the budgetary basis financial statements, while encumbered amounts are not recognized as expenditures on the GAAP basis until the equipment, supplies, or services are received.

- Certain loan transactions are recognized as expenditures for the budgetary basis but not for the GAAP basis. When these loans are made, they are recorded as receivables for the GAAP basis and as expenditures for the budgetary basis. When loan repayments are received, they are recorded as reductions to receivables for the GAAP basis, but are recognized as revenues for the budgetary basis.

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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*

City Council
City of San José, California

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 San José, California (the City) as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements, and have issued our report thereon dated October 26, 2007. As discussed in Note I.E. to the financial statements, the City adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 43*, Financial Reporting for Postemployment Benefits Plans Other Than Pension Plans.* We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and wound not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 2007-A, 2007-B and 2007-C to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies hat are also considered to be material weaknesses. However, we consider the significant deficiency described as item 2007-A to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the City in a separate letter dated October 26, 2007.

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

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

Macias Gini & O'Connell LLP

Certified Public Accountants

Walnut Creek, California
October 26, 2007

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Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Program and the Passenger Facility Charges Program and on Internal Control over Compliance in Accordance with OMB Circular A-133

City Council
City of San José, California

Compliance

We have audited the compliance of the City of San José, California (the City) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* and the *Passenger Facility Charge Audit Guide for Public Agencies* issued by the Federal Aviation Administration *(PFC Guide)* that are applicable to each of its major federal programs and to the passenger facility charges program, respectively, for the year ended June 30, 2007. The City's major federal programs are identified in the summary of auditor's results section of the accompanying federal awards schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs and the passenger facility charges program is the responsibility of the City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

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

In our opinion, the City complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs and to the passenger facility charges program for the year ended June 30, 2007. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying federal awards schedule of findings and questioned costs as items 2007-1, 2007-2 and 2007-3.

Internal Control Over Compliance

The management of the City is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs and the passenger facility charges program. In planning and performing our audit, we considered the City's internal control over compliance with the requirements that could have a direct and material effect on a major federal program and the passenger facility charges program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying federal awards schedule of findings and questioned costs as items 2007-1, 2007-2, and 2007-3 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program or the passenger facility charges program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not consider any of the deficiencies described in the accompanying federal awards schedule of findings and questioned costs to be material weaknesses.

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

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

Macias Gini & O'Connell LLP
Certified Public Accountants
Walnut Creek, California

November 27, 2007

CITY OF SAN JOSE, CALIFORNIA
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2007

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures Federal Grant	Expenditures Other
U.S. Department of Commerce					
Economic Adjustment Assistance	11.307	07-39-02866	$ 345,000	$ 54,148	
Economic Adjustment Assistance	11.307	07-79-05812	200,000	149,465	$ -
Total U.S. Department of Commerce			545,000	203,613	-
U.S. Department of Housing and Urban Development					
Community Development Block Grants/ Entitlement Grants	14.218	B04-05-06 MC-06-0021	33,936,188	11,870,568	-
Community Development Block Grants/ Entitlement Grants	14.218	Prior Year Ending Loan Balance	-	6,875,308	-
Subtotal Community Development Block Grants/Entitlement Grants			33,936,188	18,745,876	-
Emergency Shelter Grants Program	14.231	S05-MC-060021	444,240	79,150	-
Emergency Shelter Grants Program	14.231	S06-MC-060021	441,400	419,848	-
Subtotal Emergency Shelter Grants Program			885,640	498,998	-
Home Investment Partnerships Program	14.239	M01-02 MC06215	8,637,000	3,217,778	-
Home Investment Partnerships Program	14.239	M03-04 MC06215	10,136,633	65,607	-
Home Investment Partnerships Program	14.239	M05-06 MC06215	9,185,083	849,379	-
Home Investment Partnerships Program	14.239	Prior Year Ending Loan Balance	-	34,091,166	-
Subtotal Home Investment Partnerships Program			27,958,716	38,223,930	-
Housing Opportunities for Persons with AIDS	14.241	CA-39-H04-F069	792,000	18,531	-
Housing Opportunities for Persons with AIDS	14.241	CA-39-H05-F069	736,000	306,593	-
Housing Opportunities for Persons with AIDS	14.241	CA-39-H06-F069	738,000	480,973	-
Housing Opportunities for Persons with AIDS	14.241	CA-39-H103-0001	1,323,800	503,422	-
Subtotal Housing Opportunities for Persons with AIDS			3,589,800	1,309,519	-
Community Development Block Grants/ Brownfields Economic Development Initiative	14.246	B-04-BD-06-0024	2,000,000	1,374,776	-
Community Development Block Grants/ Brownfields Economic Development Initiative	14.246	B-95-ED-06-0074	475,000	200,000	-
Subtotal Brownfields Economic Development Initiative			2,475,000	1,574,776	
Community Development Block Grants_Section 108 Loan Guarantees	14.248	B-95-MC-06-0021	5,200,000	1,350,000	-
Community Development Block Grants_Section 108 Loan Guarantees	14.248	B-01-MC-06-0021	13,000,000	4,378,527	-
Subtotal Section 108 Loan Guarantees			18,200,000	5,728,527	-
Total U.S. Department of Housing and Urban Development			87,045,344	66,081,626	-

See accompanying notes to the Schedule of Expenditures of Federal Awards and
Schedule of Revenues and Expenditures of Passenger Facility Charges

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures Federal Grant	Expenditures Other
U.S. Department of Interior					
Outdoor Recreation Acquisition, Development and Planning	15.916	06-01458	153,780	153,780	-
Total U.S. Department of Interior			153,780	153,780	-
U.S. Department of Justice					
Part D - Research, Evaluation, Technical Assistance and Training	16.542	2003-MC-CX-K001	1,099,491	178,597	-
Title V_Delinquency Prevention Program	16.548	2005JLFX0158	246,661	899	-
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	2005-VT-BX-1155	225,000	52,439	48,451
Community Capacity Development Office	16.595	2005-WS-Q5-0110	175,000	59,625	-
Community Capacity Development Office	16.595	2006-WS-Q6-0046	225,000	42,784	-
Subtotal Community Capacity Development Office			400,000	102,409	-
Public Safety Partnership and Community Policing Grants	16.710	2003INWX1	4,922,884	59,560	19,853
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2005-DJ-BX-1720	381,780	165,613	-
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2006-DJ-BX-0883	259,780	6,753	-
Subtotal Edward Byrne Memorial Justice Assistance Grant Program			641,560	172,366	-
Total U.S. Department of Justice			7,535,596	566,270	68,304
U.S. Department of Labor					
Pass-through State of California, Employment Development Department:					
WIA Cluster:					
WIA Adult Program	17.258	R692502	3,604,321	2,804,910	-
WIA Youth Activities	17.259	R692502	3,684,062	1,955,216	-
WIA Dislocated Workers	17.260	R692502	4,941,422	3,793,958	-
WIA Adult Program	17.258	R760350	3,919,296	2,677,229	-
WIA Youth Activities	17.259	R760350	3,737,133	2,078,549	-
WIA Dislocated Workers	17.260	R760350	3,880,639	2,063,389	-
Subtotal WIA Adult/Youth/Dislocated Workers Programs			23,766,873	15,373,251	-
Total U.S. Department of Labor			23,766,873	15,373,251	-

See accompanying notes to the Schedule of Expenditures of Federal Awards and
Schedule of Revenues and Expenditures of Passenger Facility Charges

CITY OF SAN JOSE, CALIFORNIA
Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2007

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures Federal Grant	Expenditures Other
U.S. Department of Transportation					
Federal Aviation Administration:					
Airport Improvement Program	20.106	3-06-0226-51	7,000,000	1,569,172	328,217
Airport Improvement Program	20.106	3-06-0226-52	8,000,000	243,667	32,380
Airport Improvement Program	20.106	3-06-0226-53	6,000,000	50,125	56,391
Airport Improvement Program	20.106	3-06-0226-57	4,000,000	3,212,912	790,427
Airport Improvement Program	20.106	3-06-0226-61	3,400,000	1,870,869	428,663
Airport Improvement Program	20.106	3-06-0226-62	14,659,598	5,219,074	1,297,934
Airport Improvement Program	20.106	3-06-0226-63	6,000,000	962,341	231,780
Airport Improvement Program	20.106	3-06-0226-65	2,520,191	2,520,191	606,985
Airport Improvement Program	20.106	3-06-0226-67	6,000,000	713,941	171,952
Subtotal Airport Improvement Program			57,579,789	16,362,292	3,944,729
Highway Planning and Construction					
Pass-through California Department of Transportation:					
Federal-Aid Highway Program					
SVSC ITS Enhancement	20.205	ITS99-5005(058)	1,187,204	28,833	-
SVSC West Corridor - Stevens Creek - CMAQ	20.205	CML-5005(064)	3,961,604	316,473	-
SVSC West Corridor - Stevens Creek - STIP	20.205	CML-5005(064)	125,000	41,002	-
TEA-21-ITS: New CC TMC (Web II)	20.205	ITS03-5005(073)	579,123	28,150	-
Federal Street Maintenanc	20.205	SCL 050028	16,300,666	3,791,446	-
HBRR Seismic Bridge Retrofit - Julian Street	20.205	BRLZ 5005(080)	327,000	61,186	7,927
HBRR Seismic Bridge Retrofit - Southwest Expressway	20.205	BRLZ 5005(079)	256,000	67,422	8,735
HBRR Seismic Bridge Retrofit - William Street	20.205	BRLZ 5005(081)	263,000	63,494	8,226
Subtotal pass-through California Department of Transportation			22,999,597	4,398,006	24,888
Pass-through the Metropolitan Transportation Commission					
HBRR - Willow Glen Way Bridge	20.205	BRLZ 5005(038)	3,428,354	2,646,861	15,620
Subtotal Highway Planning and Construction			26,427,951	7,044,867	40,508
Total U.S. Department of Transportation			84,007,740	23,407,159	3,985,237

See accompanying notes to the Schedule of Expenditures of Federal Awards and
Schedule of Revenues and Expenditures of Passenger Facility Charges

Federal Grantor/Pass-Through Grantor/Program	Federal Catalog Number	Grant Identifying Number	Grant Amount	Expenditures Federal Grant	Expenditures Other
National Endowment for the Humanities					
Pass-through the California State Library					
State Library Program:					
Staff Education Grant	45.310	40-6503	10,009	3,531	-
Cultural Crossroads	45.310	40-6703	24,998	22,498	-
Subtotal State Library Program			35,007	26,029	-
Total National Endowment for the Humanities			35,007	26,029	-
U.S. Department of Education					
Fund for the Improvement of Education	84.215	U215K040089	397,640	10,878	-
Total U.S. Department of Education			397,640	10,878	-
Corporation for National and Community Services					
Retired and Senior Volunteer Program	94.002	06SRPCA017	186,322	82,562	188,096
Senior Companion Program	94.016	03SCPCA017	384,921	22,710	445
Senior Companion Program	94.016	06SRPCA007	130,309	130,309	143,034
Subtotal Retired and Senior Volunteer Program			515,230	153,019	143,479
Total Corporation for National and Community Services			701,552	235,581	331,575
U.S. Department of Homeland Security					
Disaster Grants - Public Assistance					
(Presidentially Declared Disasters)	97.036	3248 EM	-	438,322	-
National Explosives Detection Canine Team Program	97.072	DTSA20-03-H-01015	919,186	197,186	251,325
Pass-through the California Office of Emergency Services					
FY 04 Urban Areas Security Initiative	97.008	2004-0014 #085-68000	9,923,545	6,853,445	-
FY 05 Urban Areas Security Initiative	97.008	2005-0015 #085-68000	6,019,311	5,094,366	-
Subtotal Urban Areas Security Initiative			15,942,856	11,947,811	-
Emergency Management Performance Grants	97.042	2005-15 #085-00000	117,949	117,949	-
Metropolitan Medical Response System	97.071	2006-0071	232,330	13,297	-
Subtotal California Office of Emergency Services			16,293,135	12,079,057	-
Total U.S. Department of Homeland Security			17,212,321	12,714,565	251,325
Total Federal Awards			$ 221,400,853	$ 118,772,752	$ 4,636,441

See accompanying notes to the Schedule of Expenditures of Federal Awards and Schedule of Revenues and Expenditures of Passenger Facility Charges

CITY OF SAN JOSE, CALIFORNIA

Schedule of Revenues and Expenditures of Passenger Facility Charges

Year Ended June 30, 2007

Passenger Facility Charges Project Number/Description		Identifying Number	Passenger Facility Charges Project Amount	Expenditures	Revenue Recognized
Total Passenger Facility Charges Collection Revenues					
Passenger Facility Charges Collections			$ -	$ -	$ 22,169,383
Interest Earned on PFC Program			-	-	3,195,013
Passenger Facility Charges Projects					
#1	Communication Center Upgrade	92-01-C-00-SJC	500,000	-	-
#2	Fire Truck Replacement	92-01-C-00-SJC	599,826	-	-
#3	Handlift Replacement	92-01-C-00-SJC	103,000	-	-
#4	Noise Attenuation	92-01-C-06-SJC	47,171,000	8,529	-
#5	Noise Monitoring System Upgrade	92-01-C-00-SJC	184,000	-	-
#6	Noise Remedy/Land Acquisition	92-01-C-00-SJC	5,133,000	-	-
#7	Security Access Control System	92-01-C-07-SJC	1,032,000	-	-
#40a	Runway 30L Reconstruction	98-06-I-00-SJC	72,022,700	-	-
#40b	Runway 30L Extension	98-06-I-00-SJC	38,671,724	-	-
#41	Aircraft Noise & Operation Management System	99-07-C-00-SJC	100,000	-	-
#42	Emergency Command Post Relocation & Equipment	99-07-C-00-SJC	150,000	-	-
#43	Interim Federal Inspection Service (FIS) Facility	99-08-C-02-SJC	36,879,750	(118,623)	-
#44	Airfield Lighting Control System	99-07-C-00-SJC	200,000	-	-
#46	Ewert Road Improvements	99-07-C-00-SJC	408,000	-	-
#47	Skyport Access to Airport Boulevard	99-07-C-00-SJC	1,083,000	-	-
#48	Taxiway Y Pavement Reconstruction	99-07-C-01-SJC	2,100,000	-	-
#49	Transportation Access Plan, Terminal Area Concept	99-07-C-01-SJC	1,050,000	-	-
#50	Terminal C Ramp Lighting Improvement	99-07-C-00-SJC	37,000	-	-
#51	Acoustical Treatment of Four Eligible Schools	99-07-C-01-SJC	7,500,000	-	-
#52	Taxiway Z - Apron Reconstruction (Phase II)	00-11-C-00-SJC	825,000	-	-
#53	Terminal C Fire Protection	00-11-C-00-SJC	580,000	-	-
#54	Fiber Optic Cable to ARC & Fire Station 29	00-11-C-00-SJC	85,000	-	-
#55	Green Island Bridge	00-11-C-00-SJC	825,000	-	-
#56	Replacement of AACS and CCTV	00-11-C-00-SJC	4,075,000	22,493	-
#57	Skyport Grade Separation	00-11-C-00-SJC	18,218,000	-	-
#58	Terminal Drive Improvements	00-11-C-00-SJC	1,146,000	-	-
#59	Replacement of PASSUR	00-11-C-00-SJC	221,000	-	-
#60	Terminal C Restroom	00-11-C-00-SJC	2,485,000	-	-
#61	Interim Air Cargo Ramp Extension	00-11-C-01-SJC	1,100,000	-	-
#62	Runway 30R/12L Reconstruction	00-11-C-00-SJC	84,105,103	-	-
#63	Noise Attenuation Category II & III	00-11-C-00-SJC	4,500,000	1,544	-
#64	Taxiway Y Extension	00-11-C-00-SJC	12,890,000	-	-
#65	Extended Noise Attenuation	02-13-C-00-SJC	61,589,000	2,211,078	-
#66	Taxiway Y Reconstruction	04-14-C-00-SJC	39,131,000	12,812,525	-
#67	Terminal B - North Concourse	06-15-C-00-SJC	495,095,000	-	-
	Total Passenger Facility Charge Projects		$ 941,795,103	$ 14,937,546	$ 25,364,396

See accompanying notes to the Schedule of Expenditures of Federal Awards and Schedule of Revenues and Expenditures of Passenger Facility Charges

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CITY OF SAN JOSE, CALIFORNIA

Notes to the Schedule of Expenditures of Federal Awards and
Schedule of Revenues and Expenditures of Passenger Facility Charges

Year Ended June 30, 2007

(1) GENERAL

The accompanying schedule of expenditures of federal awards (SEFA) presents the activity of the federal award programs of the City of San José, California (the City). The City's reporting entity is defined in Note I to its basic financial statements. The SEFA includes all federal awards received directly from federal agencies and federal awards passed-through other governmental agencies. In addition, the SEFA includes local, state and other expenditures matched along with the federal award expenditures.

The schedule of revenues and expenditures of passenger facility charges (PFCs) presents only the activity of the passenger facility charges program of the Norman Y. Mineta San José International Airport (Airport), an enterprise fund of the City. PFCs are fees imposed on enplaned passengers by the Airport for the purpose of generating revenue for Airport projects that increase capacity, increase safety, mitigate noise impact and enhance competition between and among air carriers in accordance with Federal Aviation Administration approvals.

(2) BASIS OF PRESENTATION

The accompanying schedules are presented using the modified accrual basis of accounting for program expenditures accounted for in the governmental funds and the accrual basis of accounting for program expenditures accounted for in the proprietary funds as described in Note I to the City's basic financial statements, with the exception of the City's loan programs (see Note 6).

(3) RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS

Expenditures of federal awards and PFCs are reported in the City's basic financial statements as expenditures in the general, special revenue and capital projects funds and as expenses for non-capital expenditures and as additions to capital assets for capital related expenditures in the enterprise funds. Federal award expenditures agree or can be reconciled with the amounts reported in the City's basic financial statements.

(4) RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Amounts reported in the SEFA and Schedule of Revenues and Expenditures of Passenger Facility Charges agree to or can be reconciled with the amounts reported in the related federal financial reports.

(5) AMOUNTS PROVIDED TO SUBRECIPIENTS

Included in the total expenditures of federal awards are the following amounts passed through to subrecipients:

Program Title	Federal Catalog Number	Amount Provided to Subrecipients
Community Development Block Grants – Entitlement Grants	14.218	$ 3,076,719
Emergency Shelter Grants Program	14.231	445,429
Housing Opportunities for Persons with AIDS	14.241	1,287,170
Workforce Investment Act (WIA) Adult Program	17.258	1,665,087
Workforce Investment Act (WIA) Youth Activities	17.259	1,865,344
Workforce Investment Act (WIA) Dislocated Workers	17.260	1,850,556
Highway Planning and Construction	20.205	2,534,969
Urban Areas Security Initiative	97.008	5,596,571

(6) LOANS OUTSTANDING

The City participates in certain federal award programs that sponsor revolving loan programs, which are administered by the City. These programs maintain servicing and trust arrangements with the City to collect loan repayments. The funds are returned to the programs upon repayment of the principal and interest. The federal government has imposed certain continuing compliance requirements with respect to the loans under the Community Development Block Grants/Entitlement Grants (CDBG) and the HOME Investment Partnership Program (HOME). In accordance with Subpart B, Section 205 of the Office of Management and Budget Circular A-133, the City has reported the outstanding balance of loans from previous years that have continuing compliance requirements as of June 30, 2007 along with the value of total outstanding and new loans made during the current year in the schedule. The following is a summary of the loan programs maintained by the City and their balances at June 30, 2007:

Program Title	CFDA Number	Amount Outstanding	Prior year loans with continuing compliance requirements	New Loans
Community Development Block Grants/Entitlement Grants	14.218	$ 7,721,408	$ 6,875,308	$ 846,100
HOME Investment Partnerships Program	14.239	36,352,787	34,091,166	2,261,621
		$44,074,195	$ 40,966,474	$ 3,107,721

(7) AIRPORT EXPENDITURES

The Federal Aviation Administration reimburses the Airport for approximately 80% of allowable Airport Improvement Program (AIP) grant expenditures. The remaining unreimbursed portion of grant expenditures, if eligible, are reimbursed from PFC revenue. Total allowable AIP expenditures are presented in the accompanying SEFA.

The accompanying schedule of revenues and expenditures of passenger facility charges includes approximately 20% of expenditures reimbursed by PFC revenue for AIP approved projects and 100% for non-AIP approved projects.

(8) SAN JOSE AREA WATER RECLAMATION & REUSE PROGRAM

The San José Area Water Reclamation & Reuse Program assists the City and tributary agencies of the San José-Santa Clara Water Pollution Control Plant in protecting endangered species habitats, achieving federally mandated water quality standards and reducing reliance on area surface, ground water, and imported water supplies. The U.S. Department of Interior – Bureau of Reclamation awarded the City $32.5 million in federal fiscal year 1995 and approved an increase of $2.5 million in federal fiscal year 2000. Funding for subsequent years, up to $35 million, is contingent upon subsequent Congressional appropriations acts. As a result of the timing of the subsequent funding approvals, the City requests reimbursements for costs incurred in prior fiscal years.

As of September 30, 2007, Congress appropriated $27,100,299 and the City has claimed cumulative reimbursements of $26,616,047 of which $407,390 was claimed in fiscal year 2007 for expenditures incurred prior to fiscal year ended June 30, 2007. At June 30, 2007, the City has recorded a reimbursement request receivable in the amount of $484,252 that is awaiting final approval from the State Water Resources Control Board (SWRCB), the administering agent for the U.S. Department of the Interior.

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CITY OF SAN JOSE, CALIFORNIA

Federal Awards Schedule of Findings and Questioned Costs

Year Ended June 30, 2007

Section I Summary of Auditor's Results

Financial Statements

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

Federal Awards

Internal control over major programs:	
♦ Material weakness(es) identified?	No
♦ Significant deficiencies identified that are not considered to be material weaknesses?	Yes
Type of auditor's report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?	Yes

Identification of major programs:

Federal Catalog Number	Name of Federal Program or Cluster
14.239	Home Investment Partnerships Program
14.248	Community Development Block Grants_Section 108 Loan Guarantees
17.258, 17.259, 17.260	Workforce Investment Act Cluster
20.106	Airport Improvement Program
20.205	Highway Planning and Construction
97.008	Urban Areas Security Initiative

Dollar threshold used to distinguish between type A and type B programs:	$2,334,188
Auditee qualified as a low-risk auditee?	Yes

Section II Financial Statement Findings

Item #2007 A - Housing Loan Reserves Calculations

The City's Housing Department conducts an analysis of its loan portfolio as part of the City's year-end closing process. The Housing Department uses complex spreadsheet formulas to estimate the value of the City's housing loan reserves. From the analysis, the Housing Department prepares a year-end adjustment to record the estimated value of the City's loan loss reserves for financial statement purposes. During our audit, we noted that the Housing Department's loan portfolio analysis included a computation error resulting in a potential understatement of the loan loss reserves of $34.2 million. The City subsequently recorded these adjustments to correct the understatements in the June 30, 2007 financial statements.

We recommend that the Housing Department implement controls to review these analyses in order to insure that accurate financial information is available.

Management Response:
The Housing Department (Department) is aware that the existing system used to track and report outstanding loans needs improvement. In recognition of this need, the Department is moving forward with plans to purchase a database system that will address many of the risks associated with using spreadsheets for financial tracking and reporting.

Additionally, to improve the checks and balances within the Department's processes, the Department has requested and was granted a new Housing Policy and Planning Administrator position to oversee all Department loan collections and compliance functions. To further improve controls, a team of staff members from various parts of the Department are meeting on a monthly basis to address processes and procedural problems, including the simplification and documentation of the Department's financial reports. Staff is confident that these steps will improve the Department's system of internal controls and address the issues raised by the auditors.

Section II Financial Statement Findings (Continued)

Item #2007 B - Internal Controls Over Financial Reporting

The core of the City's financial statement financial reporting process is internally developed Excel spreadsheets. These spreadsheets are complicated files — not only because they contain a multitude of formulas and data, but because all the formulas are intricately linked to data distributed in various parts of the worksheet prepared by different preparers. As a result, even one small error—a transposed digit or an incorrect formula—can lead to miscalculations throughout the entire spreadsheet. During our audit we noted that the City's combining debt service fund balance sheets included incorrect mathematical formulas and the City's combining fund financial statements did not correlate to the basic financial statements.

We recommend the City's Finance Department draft financial reporting disciplines, re-engineer its financial worksheets to include cross checks and error checks and incorporate verification and testing of business-critical spreadsheets.

Management Response:
The use of spreadsheets is pervasive in financial applications in general and certainly for the City. Unfortunately, while spreadsheets are a great tool they are notoriously difficult to validate. All spreadsheet applications offer limited internal checks for the logic of an operation. However, if the user incorrectly defines a column of numbers to be totaled, the application will not catch such a mistake.

There are many ways to validate spread sheet applications ranging from the use of "add on" audit applications written specifically for spreadsheets to manual checking. Currently, the City validates spreadsheets during the design phase of the spreadsheet and then primarily through manual checks once a spreadsheet has been put into use.

Staff believes the auditors have raised a good point and are in agreement that additional testing, validation and verifications needs to be done to ensure the accuracy of the City's financial spreadsheet applications. Staff will research various audit packages that can be purchased and also explore developing other spreadsheet review procedures. Based on this work staff will develop a program of validation for critical financial spread sheet applications and implement the program beginning with fiscal year 2007-08.

While staff is confident that these steps will address the auditor's concerns, staff believes that a still larger issue needs to be considered. More specifically, the City's Financial Management System, (FMS) is almost 20 years old. Over the years there have been upgrades, however, the basic system remains the same. The key concern is that FMS has not kept up with ever increasing demands for financial and management data. Given these shortfalls, among others, staff will be reviewing the feasibility of bringing forward a recommendation to Council to consider a new enterprise based accounting/financial management system.

Section II Financial Statement Findings (Continued)

Item #2007 C - Workers' Compensation Claims Control

The City administers a self-insured workers' compensation program and is responsible for paying all of the workers' compensation claims its employees file and the related administrative expenses. Once an employee files a workers' compensation claim, the City estimates the total amount the City will have to pay over the life of the claim and records this amount in its workers' compensation database system. The City rely on their workers' compensation claims database reports to estimate its liabilities and as such it is imperative that it maintains current and accurate documentation supporting the information included in its database.

The Human Resources Department (HRD) is assigned as the unit responsible for administering the workers' compensation program. In FY2006-07, the HRD had 9 claims adjusters and 2 supervising claim adjusters responsible for approximately 1,600 cases or 178 cases per adjustor. This is above the industry norm of 150 cases per adjustor and is a contributing factor in the following exceptions noted in our test of 40 active case files out of population of 923 active case files:

- Internal Control Exceptions:
  - 7 claim files had claim reserve amounts over the individual claim adjuster's authorized threshold
  - 2 claim files had reserve amounts added to the worker's compensation system without supporting documentation
  - 2 claim files had reserve amounts modified in the worker's compensation system without updating the supporting documentation

- Compliance with State Laws and/or Regulations Exceptions:
  - 1 claim file did not include the Doctor's First Response Reports (Form 5021) on file
  - 2 claim files included notification letters sent to the injured employee after the 14 days due date

The City should evaluate its control processes to ensure that it has the appropriate level of resources to ensure that the database system claims information are appropriately supported and reviewed to meet financial reporting and State compliance requirements.

Management Response:
The State of California Self Insurance Plans (agency that monitors California employers that are self insured and self administered) recommends that an adjuster should handle no more than about 150 claims. The City's adjusters have an average caseload of 351 claims, more than twice the amount the State recommends.

In the FY 07-2008 budget, the Human Resources Department has been authorized 5 additional adjusters that will be added to the existing staff. These additional 5 adjusters will lower the average caseload to approximately 260 to 280 files per adjuster. This will be a more reasonable level allowing improved management of the claims in such areas as the process for reserve changes and timely notification letters to injured employees.

In addition, the Department is eliminating the direct caseload work of the Senior Workers' Compensation Adjusters in the reorganization of caseloads. This will allow these two positions to focus on reviewing, monitoring, and assisting the claims staff in all aspects of the claim process.

Given the budget constraints that the City must work with, staff is satisfied that the five additional adjuster positions and the ability to reorganize case work loads will significantly improve the work load issues in this area.

Section III Federal Award Findings and Questioned Costs

Finding No. 2007-1 **U.S. Department of Housing and Urban Development**
HOME Investment Partnerships Program, CFDA #14.239

U.S. Department of Transportation
Highway Planning and Construction, CFDA #20.205

U.S. Department of Homeland Security
Urban Areas Security Initiative (UASI), CFDA #97.008

Schedule of Expenditures of Federal Awards

Criteria:
The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profits Organizations* (OMB Circular A-133), requires that the City prepare a schedule showing total expenditures for the year for each federal program. Further, OMB Circular A-133 requires that the auditor identify and audit all high-risk type A federal programs. The City's Type A programs are those with current year expenditures exceeding $2,342,452.

Condition:
During our audit, we noted that the City included the following misstatements in its final draft schedule of expenditures of federal awards (SEFA):

- CFDA #14.239 HOME Investment Partnerships Program reported a loan disbursement in the amount of $15,000 twice.
- CFDA #20.205 Highway Planning and Construction reported encumbrances related to the Willow Glen project in the amount of $343,600. Encumbrances are not expenditures but represent the estimated amount of expenditures ultimately to result if unperformed contracts in progress are completed.
- CFDA #20.205 Highway Planning and Construction overstated/(understated) expenditures in the some of the federally assisted projects, summarized as follows:
    - SVSC ITS Enhancement project by $(171);
    - SVSC West Corridor – Stevens Creek CMAQ by $(29,283);
    - TEA-21-ITS: New CC TMC (Web II) by $402;
    - HBRR Seismic Bridge Retrofit – Southwest Expressway by $(48,302);
    - HBRR Seismic Bridge Retrofit – William Street by $(48,119);
    - HBRR – Willow Glen Way Bridge by $(24,882)
- CFDA #97.008 Urban Areas Securities Initiatives also reported encumbrances in the amount of $500,585, thereby overstating the SEFA.

The City subsequently corrected the expenditure amounts reported in its final SEFA.

Effect:
The City's SEFA serves as the basis in determining the number of major programs required to be audited in a fiscal year. Inaccuracy in its SEFA reporting may result in high-risk Type A programs not captured for testing and Type B programs not subject to the required audit risk assessment.

Questioned Costs:
N/A

Section III Federal Award Findings and Questioned Costs (Continued)

Finding No. 2007-1 (Continued)

Recommendation:
We recommend the City at least annually communicate federal grant reporting requirements to all City departments. The communication should include guidance and updates on identification of funding source (federal, state and other) and on when to record revenues and expenditures in the general ledger. Furthermore, an annual reconciliation comparing amounts claimed as reimbursements from the grantor, amounts reported in the City's general ledger and the amounts reported on the SEFA should be prepared by the grantee departments and reviewed by the Finance Department.

Management Response and Corrective Action Plan:
The City agrees with the auditor's recommendation for additional communication with City departments concerning grant administration and reporting. The City is also in agreement with the recommendation to prepare a grant reconciliation. Currently, Finance Department staff requests City departments to provide federal grant expenditures information three times each fiscal year. In addition, Finance staff provides each department with a list of instructions on how to report the grant expenditures accurately which includes instructions to exclude encumbrances. Effective in fiscal year 2007-08, Finance staff will require City departments to provide a reconciliation of reimbursable grant expenditures reported on the SEFA schedule to expenditures recorded in the City's accounting system at the end of every fiscal year.

Section III Federal Award Findings and Questioned Costs (Continued)

Finding No. 2007-2 **U.S. Department of Transportation**
Highway Planning and Construction, CFDA #20.205

U.S. Department of Homeland Security
Urban Areas Security Initiative (UASI), CFDA #97.008
Subrecipient Monitoring

Criteria:
Under the requirements of the Single Audit Act and OMB Circular A-133, subrecipients of federal awards must be monitored by the primary recipient to determine whether the subrecipient has expended the awards in accordance with applicable laws and regulations. Furthermore, OMB Circular A-133 provides that, in such instances, the primary recipient should, among other things:

1. Determine whether the subrecipient has met the audit requirements of OMB Circular A-133, if applicable;
2. Determine whether the subrecipient spent federal awards provided in accordance with applicable laws and regulations; and
3. Consider various risk factors in developing subrecipient monitoring procedures such as:
   a. relative size and complexity of the federal awards administered by the subrecipient,
   b. prior experience with each subrecipient, and
   c. cost-effectiveness of various monitoring procedures.

The primary recipient's responsibilities may be discharged for subrecipients receiving federal awards of $500,000 or more by relying upon independent audits of the subrecipients, performed in accordance with OMB Circular A-133. For those subrecipients that are required to obtain single audit reports in accordance with OMB Circular A-133, the City, as the primary recipient, is also required to ensure that the audits are performed, and must follow-up on the resolution of all reported findings and questioned costs.

The primary recipient's responsibilities may be discharged for subrecipients receiving federal awards less than $500,000 by performing a combination of the following procedures:

1. Relying on appropriate procedures performed by the primary recipient's internal audit department or program management personnel through on-site visits;
2. Reviewing documentation in support of amounts claimed for reimbursement; and
3. Applying certain agreed-upon procedures.

Condition:
During fiscal year 2006-2007, the City's Department of Transportation did not perform monitoring procedures over its subrecipient, the Santa Clara Valley Water District (SCVWD), as required by Federal grant requirements. In addition. the City's Office of Emergency Services Department did not monitor the City's four Urban Area Securities Initiate (UASI) grant recipients we selected for subrecipient testing. During the year, the City provided $2,534,969 and $5,596,571 to its subrecipients related to the Highway Planning & Construction and the UASI grants, respectively.

Section III Federal Award Findings and Questioned Costs (Continued)

Finding No. 2007-2 (Continued)

Effect:
Without reviewing the City's subrecipient single audit reports for findings and questioned costs, the City did not issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and did not ensure that the subrecipient takes appropriate and timely corrective action and consider whether subrecipient audits necessitate adjustment of the City's own records as required under OMB Circular A-133 § Subpart D.400. If questioned costs at the subrecipient level are found to be unallowable by the City, the City may require the pass-through entity to adjust its financial records and its federal expenditure reports.

Questioned Costs:
N/A

Recommendation:
We recommend that the City's Department of Transportation and the Office of Emergency Services develop and implement policies requiring the review and resolution of subrecipient findings and questioned costs. The City should obtain and review the subrecipient A-133 audit reports and ensure that the subrecipients have taken the appropriate and timely corrective action on any findings. As part of the City's finding-resolution process, the City should estimate the total unallowable costs that are associated with each subrecipient finding and consider the need to adjust financial records and federal expenditure reports.

Management Response and Corrective Action Plan:
Office of Emergency Services: The Office of Emergency Services (OES) has established corrective action plans, in accordance with OMB Circular A-133 and the Single Audit Act, for: (a) conducting monitoring visits of Urban Area Security Initiative (UASI) grant subrecipients and (b) reviewing the subrecipient's most recent A-133 audit reports. Actions on each of these plans were in progress while the auditors conducted their field work.

OES has conducted all but 6 of the equipment monitoring visits; the remaining 6 visits are scheduled for completion no later than December 7, 2007. OES has requested the most recent A-133 audit reports from all of its subrecipients. The audit reports received by OES to date have been reviewed for any findings and the subrecipients haves taken appropriate actions where necessary. OES plans to complete the audit report review for all of its subrecipients by end of first calendar quarter of 2008.

Department of Transportation: The Department of Transportation (DOT) will amend its grant guidelines to include provisions requiring staff to monitor and determine whether the subrecipient of federal awards has expended the awards in accordance with applicable laws and regulations under the requirements of the Single Audit Act and OMB Circular A-133, and to review and resolve any findings and questioned costs.

The DOT staff has obtained and reviewed the Santa Clara Valley Water District's Single Audit Report for the year ended June 30, 2006, and the report did not disclose any findings or questioned costs.

Section III Federal Award Findings and Questioned Costs (Continued)

Finding No. 2007-3 **U.S. Department of Transportation**
Highway Planning and Construction, CFDA #20.205

Procurement and Suspension and Debarment

Criteria
Under the compliance requirements of OMB grants management common rule (21 CFR 1403.42) and OMG Circular A-133, all financial and programmatic records and supporting documents must be retained for three years. In addition, non-federal entities are prohibited from contracting with or making sub-awards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred. In accordance with the Code of Federal Regulations, Title 21 Chapter III *Office of National Drug Control Policy*, part 1404 *Government-wide Debarment and Suspension (Non-procurement)*, and Title 44 Chapter I *Federal Emergency Management Agency, Department of Homeland Security*, part 117 *Government-wide Debarment and Suspension (Nonprocurement) and Government-wide Requirements for Drug-Free Workplace (Grants)*, a covered transaction includes all nonprocurement transactions (e.g. grants, cooperative agreements, and subawards to subrecipients) unless specifically excluded by these codes, and any procurement contracts for goods and services if any of the following applies:

- The contract is expected to equal or exceed the federal procurement small purchase threshold of $25,000;
- The contract requires the consent of the federal grantor agency;
- The contract, regardless of amount, will provide the contractor with critical influence on or substantive control over that covered transaction. Such persons include principal investigators and providers of federally required audit services.

The covered transaction may be at (a) the primary tier, between a Federal agency and a unit of government; or (b) a lower tier, between a participant in a covered transaction and another individual, corporation, partnership, association, unit of government, or legal entity, however organized. Accordingly, when the City, as the primary recipient, enters into a covered transaction with an entity at a lower tier, the City must verify that the entity is not suspended or debarred or otherwise excluded.

Condition:
During our tests of controls and compliance over procurement contract, we noted that the City did not verify whether the potential contractor is listed in the Excluded Parties List System (EPLS) maintained by the General Services Administration (GSA) to ensure that the contractors were not suspended or debarred or otherwise excluded when a procurement contract was made.

Effect:
While the results of our testing did not indicate that the contractors were suspended, debarred or excluded from participation in federally funded contracts during the current fiscal year, we cannot verify whether the County performed such verifications before the contracts were awarded

Questioned Costs:
N/A

Section III Federal Award Findings and Questioned Costs (Continued)

Finding No. 2007-3 (Continued)

Recommendation:
We recommend that the City Department receiving Federal assistance and the Contract Compliance Division formalize and document procurement policies and procedures for federally funded contracts that are subject to suspension and debarment verification and retain documentation to indicate the City has performed such procedures before awarding the contract.

Management Response and Corrective Action Plan:
"Debarment and Suspension Certification" was included in the project specification; however, it was not implemented in the bidding procedures. Also, the following clause was included but was not emphasized during the bid process: "Signing this Proposal on the signature portion thereof shall also constitute signature of this Certification."

Public Works staff will include "Debarment and Suspension Certification" as part of the bid proposal for projects funded by Federal grants. In addition, the City plans to include a signature block in the certification to emphasize our commitment for implementing this requirement. Inclusion of this document in the bid proposal will satisfy this Federal requirement.

CITY OF SAN JOSE, CALIFORNIA

Passenger Facility Charges Schedule of Findings and Questioned Costs

Year Ended June 30, 2007

Section I Summary of Auditor's Results

Financial Statements

Type of auditor's report issued on the basic financial statements of the City:	Unqualified
Internal control over financial reporting:	
♦ Material weakness(es) identified?	No
♦ Significant deficiencies identified that are not considered to be material weaknesses?	None reported
Noncompliance material to the financial statements noted?	No

Passenger Facility Charges

Internal control over Passenger Facility Charges:	
♦ Material weakness(es) identified?	No
♦ Significant deficiencies identified that are not considered to be material weaknesses?	None reported
Type of auditor's report issued on compliance for the Passenger Facility Charges program:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133 in relation to the Passenger Facility Charge program?	No

Section II Financial Statement Findings

None reported.

Section III Passenger Facility Charges Findings and Questioned Costs

None reported.

CITY OF SAN JOSE, CALIFORNIA

Summary Schedule of Prior Audit Findings

Year Ended June 30, 2007

Reference Number:	**2006-A – Financial Reporting**
Audit Finding:	The current lack of resources, particularly those devoted to financial reporting, has resulted in financial statement drafts containing numerous errors and requiring more review time by the external auditors.
Status of Corrective Action:	Partially corrected. See current year finding 2007-B.
Reference Number:	**2006-B – General Liability Claims**
Audit Finding:	During our review of the City's estimation process for general claims liabilities, we noted certain claims defined as "reasonably possible" were incorrectly included in the liability estimate. During our testing we also noted three other areas that warrant additional attention, as follows: (1) certain claims closed during the year were not removed from the listing used to develop year end liability estimates, (2) the amount reserved for two of the twenty claims tested was understated, and (3) estimated losses are not being properly allocated to the City's major enterprise funds.
Status of Corrective Action:	Corrected.
Reference Number:	**2006-1**
Federal Catalog Number/ Program Name:	14.248 / Community Development Block Grants_Section 108 Loan Guarantees 14.246 / Community Development Block Grants/Brownfields Economic Development Initiative 20.205 / Highway Planning Construction
Audit Finding:	During our audit we noted that the City did not capture $52 million in federal expenditures under the Community Development Block Grants_Section 108 Loan Guarantees Program (CFDA #14.248) and on the draft schedule of expenditures of federal awards (SEFA). In addition, we noted that the City identified two other grants awarded to the Redevelopment Agency that had expenditures for the current year and prior years that were not captured in the City's draft SEFA.
Status of Corrective Action:	Corrected.
Reference Number:	**2006-2**
Federal Catalog Number/ Program Name:	97.008 / Urban Areas Security Initiative (UASI)
Audit Finding:	The City did not monitor all five of the grant recipients selected for subrecipient testing to ensure that the subrecipeints did not have findings nor questioned costs related to the UASI program requiring the City's resolution.
Status of Corrective Action:	Not corrected. See finding 2007-2.

CITY OF SAN JOSE

Public Safety, Finance &
Strategic Support Committee

Fiscal Year Ended
June 30, 2007

CITY OF SAN JOSE

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

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Members of the Public Safety, Finance &
Strategic Support Committee and
San José City Council
San José, 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 San José as of and for the year ended June 30, 2007, 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 our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the governmental unit's internal control. Accordingly, we do not express an opinion on the effectiveness of the governmental unit's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies as listed as items 2007-A, 2007-B, and 2007-C to be significant deficiencies in internal control; item 2007-I to be a significant deficiency in the Federated City Employees Retirement System's and the Police and Fire Departments Retirement Plan's (collectively, Retirement Systems') internal control. In addition, we noted other matters involving the internal control and its operation that we have reported to management as listed in the table of contents.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the deficiency listed as item 2007-A constitutes a material weakness.

The City's written response to the findings identified in our audit is described in the Schedule of Comments and Responses. We did not audit the City's responses and, accordingly, we express no opinion on it. In addition, we have already discussed our comments and recommendations with various City personnel, and we would be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing these recommendations.

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

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

Very truly yours,

MACIAS GINI & O'CONNELL LLP

Macias Gini & O'Connell LLP

Certified Public Accountants
Walnut Creek, California

October 26, 2007

CITY OF SAN JOSE

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

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 City of San José (City), which collectively comprise the City's basic financial statements (BFS) for the year ended June 30, 2007, and have issued our report thereon dated October 26, 2007. In addition to the City's BFS, we audited the financial statements of the governmental activities and each major fund of the Redevelopment Agency of the City of José; the financial statements of the Norman Y. Mineta San José International Airport, Federated City Employees' Retirement System, Police and Fire Department Retirement Plans, San José-Santa Clara Clean Water Financing Authority, and City of San José Deferred Compensation Plan as of and for the year ended June 30, 2007. Professional standards require that we provide you with the following information related to our audit.

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

As stated in our Engagement Communications section of our General Audit Plan dated June 29, 2007, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free from material misstatements and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

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

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

II. Other Information in Documents Containing Audited Financial Statements

During the year, the City included audited financial statements in various debt offering documents (e.g., Official Statements.) We do not have an obligation to perform any procedures to corroborate other information contained in such debt offering documents. We were not associated with and did not have any involvement with such documents. Accordingly, we did not perform any procedures on these documents and provide no assurance as to the other information contained in the debt offering documents.

REQUIRED COMMUNICATIONS (Continued)

III. Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our contract with the City, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City are described in Note 1 to the City's basic financial statements. With the exception of the item described below, no new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2007.

Postemployment Benefit Plans Reporting - As described in Note 1 to the City's basic financial statements, the City implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. This Statement establishes uniform financial reporting standards for other postemployment benefits (OPEB) as part of the total compensation offered to attract and retain the services of qualified employees.

We noted no transactions entered into by the City during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

IV. Accounting Estimates

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
- Estimated allowance for losses on accounts receivable
- Estimated valuation allowance for loans receivable
- Accrual and disclosure of self-insurance claims liabilities
- Depreciation estimates for capital assets, including depreciation methods and useful lives assigned to depreciable property
- Accrual and disclosure of compensated absences
- Pension plans' employer and employee contribution requirements

Management's judgments and estimates were based on the following:

- Fair values of investments were based on quoted market prices, except for real estate, which is based on independent appraisals and for private equities which are based on actual cash flows to/from the Retirement Systems and the transactions and unrealized gain/loss as ascertained from the most recently available investor reports or financial statements issued by the manager of those funds.
- Estimated allowances for losses on accounts receivable were based on historical experience.

REQUIRED COMMUNICATIONS (Continued)

IV. Accounting Estimates (Continued)

- Estimated valuation allowance for loans receivable comprised of an allowance for risk and an allowance for present value discount. The allowance for risk was based on the consideration of the changes in the portfolio character, evaluation of current economic conditions and management's estimate regarding the likelihood of collectibility based on loan provisions and collateral. The allowance for present value discount was based on management's estimate of the present value of projected net cash flows to the City from the loan portfolio.
- Reserves for workers' compensation was based on management's estimate obtained from information derived from the City's claims database system adjusted for a projection of unreported claims and discounted.
- Reserves for general liability and other claims liabilities were determined by attorney judgment about the ultimate outcome of the claim.
- Accrual and disclosures of compensated absences were based on accrued eligible hours of vacation and sick leave at current pay rates for eligible employees.
- Useful lives for depreciable property were determined by management based on the nature of the capital asset.
- Pension Plans' employer and employee contributions requirements were based on actuarially determined contribution rates.

We evaluated the key factors and assumptions used to develop these accounting estimates in determining that they are reasonable in relation to the financial reporting units that collectively comprise the City's basic financial statements.

V. Audit Adjustments

For the purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the City's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the City, either individually or in the aggregate, indicate matters that could have a significant effect on the City's financial reporting process. In addition, the attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the individual financial reporting units that collectively comprise the City's basic financial statements.

VI. Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter 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.

REQUIRED COMMUNICATIONS (Continued)

VII. 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.

VIII. Issues Discussed with Management Prior to Our Retention

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.

IX. Difficulties in Performing the Audit

The completion of our audit was extended because of additional work related to the City's implementation of GASB Statement No. 43 in the areas of obtaining documentation of the basis of the City's actuarial assumptions and reconciliations of the actual employee census data used in computing the unfunded actuarial accrued liabilities.

SCHEDULE OF COMMENTS AND RESPONSES

INTRODUCTION

In May 2006, the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) issued Statement on Auditing Standards No. 112, *Communicating Internal Control Related Matters Identified in an Audit* (SAS112). SAS112 was designed to make the standards consistent with those already in place for publicly-traded companies by establishing a standard for determining seriousness of a control issue and classifying it into one of three categories:

- Control deficiency
- Significant deficiency (replaces old term “reportable condition”)
- Material weakness.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

A *significant deficiency* is a control deficiency or a combination of control deficiencies such that there is more than a remote likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected.

A *material weakness* is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

These definitions redefined and/or replaced the old definitions – management letter comment; reportable condition and material weakness as follows.

Old Definitions	New Definitions
Material weakness	**Material weakness**
Reportable condition	**Significant deficiency**
Management letter comment (under Yellow Book only)	**Other matters related to internal control**

This new pronouncement significantly increases the likelihood that an auditor may be required to report either a “significant deficiency” or a “material weakness” in conjunction with the financial statement audit.

SCHEDULE OF COMMENTS AND RESPONSES

CITY'S COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)
Item #2007 A - Material Weakness #1
Housing Loan Reserves Calculations

The City's Housing Department conducts an analysis of its loan portfolio as part of the City's year-end closing process. The Housing Department uses complex spreadsheet formulas to estimate the value of the City's housing loan reserves. From the analysis, the Housing Department prepares a year-end adjustment to record the estimated value of the City's loan loss reserves for financial statement purposes. During our audit, we noted that the Housing Department's loan portfolio analysis included a computation error resulting in a potential understatement of the loan loss reserves of $34.2 million. The City subsequently recorded these adjustments to correct the understatements in the June 30, 2007 financial statements.

We recommend that the Housing Department implement controls to review these analyses in order to insure that accurate financial information is available.

Management Response:

The Housing Department (Department) is aware that the existing system used to track and report outstanding loans needs improvement. In recognition of this need, the Department is moving forward with plans to purchase a database system that will address many of the risks associated with using spreadsheets for financial tracking and reporting.

Additionally, to improve the checks and balances within the Department's processes, the Department has requested and was granted a new Housing Policy and Planning Administrator position to oversee all Department loan collections and compliance functions. To further improve controls, a team of staff members from various parts of the Department are meeting on a monthly basis to address processes and procedural problems, including the simplification and documentation of the Department's financial reports. Staff is confident that these steps will improve the Department's system of internal controls and address the issues raised by the auditors.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

CITY'S COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)
Item #2007 B – Significant Deficiency #1
Internal Controls Over Financial Reporting

The core of the City's financial statement financial reporting process is internally developed Excel spreadsheets. These spreadsheets are complicated files — not only because they contain a multitude of formulas and data, but because all the formulas are intricately linked to data distributed in various parts of the worksheet prepared by different preparers. As a result, even one small error—a transposed digit or an incorrect formula—can lead to miscalculations throughout the entire spreadsheet. During our audit we noted that the City's combining debt service fund balance sheets included incorrect mathematical formulas and the City's combining fund financial statements did not correlate to the basic financial statements.

We recommend the City's Finance Department draft financial reporting disciplines, re-engineer its financial worksheets to include cross checks and error checks and incorporate verification and testing of business-critical spreadsheets.

Management Response:

The use of spreadsheets is pervasive in financial applications in general and certainly for the City. Unfortunately, while spreadsheets are a great tool they are notoriously difficult to validate. All spreadsheet applications offer limited internal checks for the logic of an operation. However, if the user incorrectly defines a column of numbers to be totaled, the application will not catch such a mistake.

There are many ways to validate spread sheet applications ranging from the use of "add on" audit applications written specifically for spreadsheets to manual checking. Currently, the City validates spreadsheets during the design phase of the spreadsheet and then primarily through manual checks once a spreadsheet has been put into use.

Staff believes the auditors have raised a good point and are in agreement that additional testing, validation and verifications needs to be done to ensure the accuracy of the City's financial spreadsheet applications. Staff will research various audit packages that can be purchased and also explore developing other spreadsheet review procedures. Based on this work staff will develop a program of validation for critical financial spread sheet applications and implement the program beginning with fiscal year 2007-08.

While staff is confident that these steps will address the auditor's concerns, staff believes that a still larger issue needs to be considered. More specifically, the City's Financial Management System, (FMS) is almost 20 years old. Over the years there have been upgrades, however, the basic system remains the same. The key concern is that FMS has not kept up with ever increasing demands for financial and management data. Given these shortfalls, among others, staff will be reviewing the feasibility of bringing forward a recommendation to Council to consider a new enterprise based accounting/financial management system.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

CITY'S COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) (Continued)
Item #2007 C - Significant Deficiency #2
Workers' Compensation Claims Control

The City administers a self-insured workers' compensation program and is responsible for paying all of the workers' compensation claims its employees file and the related administrative expenses. Once an employee files a workers' compensation claim, the City estimates the total amount the City will have to pay over the life of the claim and records this amount in its workers' compensation database system. The City relies on their workers' compensation claims database reports to estimate its liabilities and as such it is imperative that it maintains current and accurate documentation supporting the information included in its database.

The Human Resources Department (HRD) is assigned as the unit responsible for administering the workers' compensation program. In FY2006-07, the HRD had 9 claims adjusters and 2 supervising claim adjusters responsible for more cases than the industry norm. This is a contributing factor in the following exceptions noted in our test of 40 active case files out of population of 923 active case files:

- *Internal Control Exceptions:*
  - 7 claim files had claim reserve amounts over the individual claim adjuster's authorized threshold
  - 2 claim files had reserve amounts added to the worker's compensation system without supporting documentation
  - 2 claim files had reserve amounts modified in the worker's compensation system without updating the supporting documentation

- *Compliance with State Laws and/or Regulations Exceptions:*
  - 1 claim file did not include the Doctor's First Response Reports (Form 5021) on file
  - 2 claim files included notification letters sent to the injured employee after the 14 days due date

The City should evaluate its control processes to ensure that it has the appropriate level of resources to ensure that the database system claims information are appropriately supported and reviewed to meet financial reporting and State compliance requirements.

Management Response:

The State of California Self Insurance Plans (agency that monitors California employers that are self insured and self administered) recommends that an adjuster should handle no more than about 150 claims. The City's adjusters have an average caseload of 351 claims, more than twice the amount the State recommends.

In the FY 2007-08 budget, the Human Resources Department has been authorized 5 additional adjusters that will be added to the existing staff. These additional 5 adjusters will lower the average caseload to approximately 260 to 280 files per adjuster. This will be a more reasonable level allowing improved management of the claims in such areas as the process for reserve changes and timely notification letters to injured employees.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

CITY'S COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) (Continued)

In addition, the Department is eliminating the direct caseload work of the Senior Workers' Compensation Adjusters in the reorganization of caseloads. This will allow these two positions to focus on reviewing, monitoring, and assisting the claims staff in all aspects of the claim process.

Given the budget constraints that the City must work with, staff is satisfied that the five additional adjuster positions and the ability to reorganize case work loads will significantly improve the work load issues in this area.

Item #2007 D - Other Internal Control Matters #1
Application of the Availability Criterion for Revenue Recognition

The City considers Governmental Fund revenues to be available if they are collected within 60 days after year-end. The availability criterion principle requires that revenues be recognized when they are collectible within the current period or soon enough thereafter to be used to pay liabilities in the current period. During our audit, we noted that the City did not consistently apply the availability criterion in its governmental fund financial statements.

We recommend that the Finance Department continue training financial statement preparers on the application of the availability criterion. In addition, the Finance Department should establish a review process at the end of the 60-day period to compare governmental departments' significant revenue year-end accruals with remittances received. Departments that show significant variances in collections of receivables should provide documentation supporting the validity and propriety of the revenue recorded.

Management Response:

As noted by the auditors, the City does apply the "60 day" criteria to revenue recognition for governmental funds. In addition, the City believes that it applies the "60 day" rule on a consistent basis. However, as a practical matter, smaller amounts that are not material to the City's financial statements may be recognized on a cash basis. That is, these amounts will be recognized as revenue in the year in which they are received, even though they meet the "60 day" rule for accrual.

The City does agree, however, that review of year end cut-off criteria is important and this topic will continue to be an important part of the City's year end preparation and training program. In addition, staff will prepare an analysis of significant collection variances as part of the year end closing process.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

CITY'S COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) (Continued)
Item #2007 E - Other Internal Control Matters #2
Interest Income Allocation and Recording

During FY2006-07, we noted that the City started allocating interest income from the Underground Utility Special Revenue Fund directly to the General Fund. GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* states the following:

> *…income from investments associated with one fund is assigned to another fund because of legal or contractual provisions. In that situation, the accounting treatment should be based on the specific language of the legal or contractual provisions. If, however, the investment income is assigned to another fund for other than legal or contractual reasons -- for example, management decision -- the income should be recognized in the fund that reports the investments. The transfer of that income to the recipient fund should be reported as an operating transfer.*

The City's Municipal Code Section 4.80.1970 states that the City Council may transfer earned interest on moneys deposited into said fund to any other fund for any other purpose subject to any contractual or other legal limitations. The City should review its recording and allocation of its pooled investment income.

Management Response:

As noted by the auditors, the City does allocate interest earning from certain funds directly to the General Fund. In some cases the allocation is based on legal or contractual reasons, in others the allocation is made due to City Council direction. The auditors have noted that in those cases where the assignment is not due to legal or contractual reasons then the reporting of interest earnings is treated differently. In such cases, interest income is recognized in the fund that reports the investments (originating fund) and the transfer of funds to the receipt fund is recognized as an operating transfer.

Staff is in agreement and will review all funds that are required to assign interest earnings to the General Fund. Then, depending on the reason for the allocation, interest earnings will either be accounted for directly in the General Fund, or in the originating fund with the proceeds transferred to the General Fund, shown as an operating transfer.

Item #2007 F - Other Internal Control Matters #3
Accounting for Intra-Entity Sale of Assets

During the year, the City recorded a property transfer from the General Fund to the Housing Activities Fund at fair market value. In essence the City as a whole recognized a gain when it transfers one property from one fund to another. Generally accepted accounting principles (GAAP) state that when accounting for the transfer of capital and financial assets within the same financial reporting entity, the transferee should recognize the assets received at the ***carrying value*** of the transferor.

We recommend that the City provide additional training to its fund accountants to better evaluate transactions that were approved on a budgetary basis to what should be reported on a GAAP basis.

Management Response:

The auditors have made a good observation with respect to intra city transactions that are characterized as "sales' of property between City funds. In preparing for the upcoming (2007-08) year end close and CAFR, staff will provide additional training in this area and will record any such transactions on a GAAP basis.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

CITY'S COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) (Continued)
Item #2007 G - Other Comment #1
Risk Assessment Over Financial Reporting

The City of San Jose has a fiduciary responsibility as a steward of public funds. In order to fulfill this responsibility, the City has implemented internal controls that serve as the first line of defense in safeguarding assets. Additionally, these controls are designed to ensure: (1) effective and efficient operations, (2) reliable financial reporting and (3) compliance with applicable laws and regulations. The Committee on Sponsoring Organizations of the Treadway Commission (COSO) has established a nationally recognized framework for internal control in its *Internal Control – Integrated Framework* and its related *Guidance for Smaller Public Companies: Reporting on Internal Controls over Financial Reporting*. The COSO framework establishes five elements of internal control: (1) Control Environment; (2) Risk Assessment; (3) Control Activities; (4) Information and Communication; and (5) Monitoring. Risk Assessment and Monitoring are integral parts of internal control and management should periodically evaluate the risks and monitor the changes facing the City. This process involves evaluating both previously identified risks and potential new risks and providing assurance that (1) controls are designed properly to address significant risks and (2) controls are operating effectively.

The Auditing Standards Board (ASB) of the American Institute of Certified Public Accountant's (AICPA) recently adopted a set of eight Statements of Auditing Standards (SAS No. 104 through 111), which, among other things, require auditors to assess an organization's design of controls and determine whether the controls have been placed in operation for all elements of internal control over financial reporting. If controls do not exist, are poorly designed or not operating effectively, the auditor must evaluate the control deficiency and report the deficiency to management, including whether the control deficiency is a significant deficiency or material weaknesses. These standards are also incorporated in *Government Auditing Standards* (July 2007 Revision) issued by the Comptroller General of the United States. The City should perform a comprehensive risk assessment analysis and document its risk assessment policies and procedures for each fiscal year beginning July 1, 2007. We recommend the City review the COSO *Internal Control – Integrated Framework and its related Guidance for Smaller Public Companies: Reporting on Internal Controls over Financial Reporting* and adopt the best practices outlined therein.

Management Response:

In December of 2005, the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) issued Statement on Auditing Standards No. 103, *Audit Documentation*. In early 2006, the ASB released a set of eight pronouncements (SAS Nos. 104-111) dealing with various aspects of assessment of risk in a financial statement audit. These statements are commonly referred to as the "risk-assessment suite." Then, in May of 2006, the ASB released SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit*. Normally, the issuance of such standards would be of primary interest to audit professionals. However, because of the potential impact to those being audited, the auditor has brought this issue to the attention of the City. Further, the auditors are recommending that the City take certain steps to recognize and prepare for an evolving audit environment.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

CITY'S COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) (Continued)

Management agrees, in general, that the new auditing standards, (effective FY 2007-08), present a changing landscape with respect to the City's system of financial internal controls. The literature, however, does not proscribe or dictate a particular system of internal control. Rather, the auditors will be looking for the presence of certain elements or procedures. For example, the auditors will look at various financial reporting risks, i.e. a material misstatement; controls designed to mitigate those risks and monitoring procedures to assure compliance. Consequently, it is up to the entity to design a system that best meets its business needs with these concepts in mind.

In the long run, staff agrees that it is in the best interest of the City to bring its system of internal controls into alignment with the new standards. However, this will not be an insignificant task. The review of existing City operations, analysis and design of new controls and monitoring procedures will take substantial resources for a major city such as San Jose. There is much in the literature, however, that can be of assistance.

Since the passage of the Sarbanes-Oxley Act in 2002, many public companies have relied on the 1992 *COSO Internal Control – Integrated Framework* publication to assist them in meeting requirement under the Act. In addition, the audit standards noted above, as well as the *Government Auditing Standards* (July 2007 Revision) reference the COSO publication and the internal control framework which it sets out. Consequently, management agrees with the auditors recommendation that the City should perform a review of internal controls, using the *COSO Internal Control – Integrated Framework and its related Guidance for Smaller Public Companies: Reporting on Internal Controls over Financial Reporting* as a guide.

As noted above, performing such a review will require a significant allocation of City resources. Accordingly, management will take forward a project, in the operating budget, for the upcoming fiscal year. At that time Council will have an opportunity to review the project in the context of the budget process. If the project is approved, or to the extent approved, management will be able to move forward with the review in fiscal year 2008-09.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

CITY'S COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) (Continued)
Item #2007 H - Other Comment #2
Pollution Remediation Obligations

In November 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations. These obligations represent the current or potential detrimental effects of existing pollution and the necessary pollution remediation activities such as site assessments and cleanups. This statement identifies five specific obligating events after which a government is required to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as a liability or, if appropriate, capitalized when goods and services are acquired. Obligating events include the following:

- The government is compelled to take pollution remediation action because of an imminent endangerment.
- The government violates a pollution prevention–related permit or license.
- The government is named, or evidence indicates that it will be named, by a regulator as a responsible party or potentially responsible party (PRP) for remediation, or as a government responsible for sharing costs.
- The government is named, or evidence indicates that it will be named, in a lawsuit to compel participation in pollution remediation.
- The government commences or legally obligates itself to commence pollution remediation.

We encourage the City take the following steps prior to the effective date of these new rules:

- Determine the nature and source of the City's potential environmental obligations;
- Evaluate and estimate the potential obligation; and
- Determine the existence of any recoveries.

The City will be required to implement GASB No. 49 for the fiscal year ending June 30, 2009.

Management Response:

Staff appreciates the auditors bringing GASB No. 49 to the attention of the City. Depending on the facts, GASB No. 49 has the potential to have a significant impact on the City's financial statements. Staff anticipates bringing forward a proposal during the upcoming annual budget process to begin preparing for the implementation of this GASB in 2008-09.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM'S (SYSTEM) AND THE POLICE AND FIRE DEPARTMENTS RETIREMENT PLAN'S (PLAN) CAFRs
Item #2007 I - Significant Deficiency #1
Review of Investment Schedules

Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*, requires state and local governments disclose in the financial statements common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. The System's and Plan's financial reporting process for its investment disclosures is dependent on internally developed Excel spreadsheets. The Department of Retirement Services (DRS) Investment Manager is responsible for compiling information downloaded from the investment custodian's website into this spreadsheet. The Investment Manager then sorts and subtotals the downloaded information to categorize and create investment schedules relating to the investments risks required by GASB Statement No. 40.

Although the investments are reconciled in total to the custodian statement, the classifications of investments in the final schedules are not subject to a secondary level of review. As a result, the System and Plan are subject to the risk that classification errors could occur and not be detected, in addition to creating delays in the financial reporting process. During our audit, we noted the Plan's investment credit quality schedule did not agree to the custodian statement due to sorting errors in the Excel spreadsheets used to summarize the data to support required disclosures. Although, we did not note these types of errors during our review of the System's disclosures, we believe that there is a risk for these errors to also occur in the System's financial statements disclosures.

We recommend Department of Retirement Services (DRS) management designate a qualified individual to perform a secondary review of the investment schedules before they are used to prepare the financial statements disclosures submitted for audit. A typical review should include: checking for spreadsheet formula errors, ensuring proper classification of investment categories, and reconciling total investments to amounts reported in the general ledger.

Management's Response

Staff would like to note that there are several levels of review already in place for a majority of the investment-related information contained in the System's and Plan's year end financial statements. Even with these reviews in place, however, it is possible for errors to occur, particularly as to how a specific investment is classified. For example, a bond with a maturity that should fall in the "6 to 10 Years" category could be put into the "More than 10 Years" category or a sorting error could put a bond in the wrong rating category.

With respect to spreadsheet formula errors, staff recognizes that validation and verification of spreadsheets is a critical control function. During the upcoming year staff will implement a program of spreadsheet review and validation. In addition, staff will explore a procedure to provide for a secondary review of investment schedules before they submitted for the auditors review.

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM'S (SYSTEM) AND THE POLICE AND FIRE DEPARTMENTS RETIREMENT PLAN'S (PLAN) CAFRs
Item #2007 J - Other Internal Control Matters #1
Census Data Integrity

Contributions to the Defined Postemployment Healthcare Plan are made by both the City and the participating employees using actuarially determined percentages of each employee's base salary. Actuarial valuations of an ongoing plan involve estimates of uncertain future events. The Board's actuary develops and recommends for adoption a set of economic and demographic actuarial assumptions to anticipate future plan experience. While the actuary reviews the financial information and census data furnished by System management for reasonableness, it relies on management to provide accurate and complete data for use in the actuarial valuation. Inaccurate or incomplete financial and census data could have a material impact on actuarial results.

As part of our audit process, we confirmed selected census data with the System's actuary. For 1 out of 25 retirees selected for confirmation out of a total population of 2,220 retirees, the actuary indicated it has no dental record for the selected individual. However, the detailed information supported the fact that this selected individual had dental benefits. Upon further investigation, the Department of Retirement Services determined 32 out of 1,500 people had dental coverage but were excluded from the data provided to the actuary. The projected error from incomplete data provided to the actuary approximately increases the unfunded actuarial liability by $621,651 and the annual required contribution by $38,526 as of the actuarial date of June 30, 2006.

We recognize the System's current efforts to remedy the condition. We recommend that System management take extra precaution in reviewing and reconciling census data provided to the actuary for future valuations to ensure the information is complete and accurate.

Management's Response

Data for the 2006 Health Study, which was submitted to the System's actuary was obtained through a special report created by the System's software consultant. On a go forward basis, staff will work with its software consultant to develop a Healthcare Data Extract file similar to the one prepared for pension plan valuations. Staff believes that this new report will address any errors or shortfalls noted in the report submitted for the 2006-07 fiscal year.

STATUS OF PRIOR YEARS COMMMENTS

2006 Comment:	***Financial Reporting***
Condition/Effect/ Recommendation:	We recommend the City's Finance Director or a qualified designee play a more active role in monitoring and reviewing the financial reporting process. This monitoring and review process should include verifying that all significant accounts and non-routine transactions are properly supported; ensuring proper consolidation, transfer, mapping and roll-up of account balances; reconciling related party transactions (e.g., with the Redevelopment Agency) and reviewing "top level" adjustments. Additionally, the City should re-evaluate the adequacy of the current resource level in the Finance Department, simplify the existing financial reporting spreadsheets and offer additional financial reporting training to enhance the professional development of its staff.
Status:	In process. See Item 2007-B.
2006 Comment:	***General Claims Liabilities***
Condition/Effect/ Recommendation:	We recommend the City's Finance Department take the lead in coordinating efforts with the City Attorney's Office (CAO) and developing the GAAP basis legal accruals. In preparation for the annual audit, City Finance staff should meet with the CAO staff to ensure both departments have a clear understanding of the GAAP reporting requirements. Additionally, CAO staff should make process improvements to ensure loss runs are being timely updated, reserves are fairly stated and losses are properly allocated to the appropriate funds.
Status:	Implemented.
2005 Comment:	***The Cascade Effect of Sarbanes-Oxley***
Condition/Effect/ Recommendation:	We recommend the City's Finance Department, in coordination with the City Auditor, begin developing an internal controls management program similar to the type contemplated by SOX and OMB Circular A-123. The objectives of the program should include: adoption of a control framework, documentation and testing of key process controls, with a focus on fraud prevention and improved financial reporting. Annually, City management should report on this program to the Making Government Work Better Committee and provide an assertion on the status of the City's internal controls.
Status:	See comment 2007-G.

STATUS OF PRIOR YEARS COMMMENTS (Continued)

2004 Comment:	***Post-retirement Health Care Benefits***
Condition/Effect:	In February 2003, the Governmental Accounting Standards Board (GASB) issued proposed rules on accounting and financial reporting by employers for post-retirement health care benefits other than pensions. These new rules will require the actuaries of the Federated City Employees' Retirement System (System) and the San Jose Police and Fire Department Retirement Plan (Plan) to project the total cost of these health benefits when developing the annual required contribution (ARC) and this amount will need to be reported and disclosed in the financial statements. This is a significant change from the System and the Plan's past practice of using 15-year and 10-year funding horizons, respectively, for purposes of the ARC.
Recommendation:	We recommend consulting with the System and the Plan's actuaries to develop a better understanding and to quantify the impact of these proposed rules, and to monitor the development of these accounting pronouncements.
Status:	The City implemented GASB Statement No. 43 in the current fiscal year and is in the process of implementing GASB Statement No. 45 in fiscal year 2007-2008.
2004 Comment:	***Unresolved Bank Reconciliation Activity***
Condition:	While testing the City's bank reconciliation process, we noted the bank reconciliation completed as of June 30, 2004 included a number of aged reconciling items. While the dollar amount of these items is not material, they should be investigated and resolved. The majority of items are identified on the bank reconciliation as differences between payroll disbursement interfaces and cash disbursements.
Recommendation:	We recommend the City investigate and resolve these aged reconciling items. Failure to resolve identified differences in a timely manner could make them increasingly difficult to trace and may result in potential errors or intentional misstatements going undetected.
Status:	Implemented.
2004 Comment:	***Repayment of Net Pension Obligation***
Condition:	During fiscal year 1997/1998, the City implemented GASB Statement No. 27, Accounting for Pensions by State and Local Governmental Employers. As of July 1, 1997, the City recorded a net pension obligation in the amount of $2.3 million for the Federated Employees' Retirement System (System). Since recording this obligation, it has grown from $2.3 million to $3.2 million at June 30, 2004.
Recommendation:	We recommend City staff work with the Federated Pension Board to develop a funding plan. Developing a funding plan will demonstrate the City's commitment to funding this obligation and establish a timeline to accomplish this goal.
Status:	In progress. The City's Finance Department is working with the Department of Retirement Services to determine the proper amount to be included in its funding plan.

CITY OF SAN JOSE

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS

Governmental Funds

Impact of Adjustments on Fund Financial Statement Captions ($000) - Increase (Decrease)

Description (Nature)	Statement of Net Assets			Changes of Net Assets		
of Audit Difference	**Assets**	**Liabilities**	**Net Assets**	**Current Year**	**Prior Year**	**Total**
GENERAL FUND						
Adjustment to revenue accrual (additional)	$ 1,375	$ -	$ 1,375	$ 1,375	$ (1,351)	$ 24
Adjustment to revenue accrual (unavailable)	-	1,949	(1,949)	(1,949)	109	(1,840)
Accrual of unrecorded expenditures and accounts payable	-	580	(580)	(580)	-	(580)
To record cash reconciling items between Treasury and FMS	2,138	-	2,138	2,138	-	2,138
Adjust investment to fair value	(34)	-	(34)	(34)	-	(34)
	-	-	-	-	-	-
Total	$ 3,479	$ 2,529	$ 950	$ 950	$ (1,242)	$ (292)
Financial statement amounts	$ 329,740	$ 49,143	$ 280,597			$ 43,627
Impact as a percentage of f/s amounts	1.06%	5.15%	0.34%			-0.67%
REDEVELOPMENT AGENCY						
	$ -	$ -	-	$ -	$ -	$ -
Total	$ -	$ -	$ -	$ -	$ -	$ -
Financial statement amounts	$ 213,014	$ 91,004	$ 122,010			$ (5,668)
Impact as a percentage of f/s amounts	0.00%	0.00%	0.00%			0.00%
HOUSING ACTIVITIES						
To adjust the valuation of other assets	$ (147)	$ -	$ (147)	$ (120)	$ 27	$ (93)
To adjust the loan receivable balance	124	(947)	$ 1,071	1,071	-	$ 1,071
Total	$ (23)	$ (947)	$ 924	$ 951	$ 27	$ 978
Financial statement amounts	$ 279,772	$ 26,287	$ 253,485			$ (42,261)
Impact as a percentage of f/s amounts	-0.01%	-3.60%	0.36%			-2.31%
SPECIAL ASSESSMENT DISTRICT						
	$ -	$ -	$ -	$ -	$ -	$ -
Total	$ -	$ -	$ -	$ -	$ -	$ -
Financial statement amounts	$ 122,850	$ 87,660	$ 35,190			$ (13,819)
Impact as a percentage of f/s amounts	0.00%	0.00%	0.00%			0.00%
SAN JOSE FINANCING AUTHORITY						
To adjust the beginning balance of commercial paper	$ -	$ -	$ -	$ (185)	$ 185	$ -
Total	$ -	$ -	$ -	$ (185)	$ 185	$ -
Financial statement amounts	$ 52,514	$ 83,913	$ (31,399)			$ (16,385)
Impact as a percentage of f/s amounts	0.00%	0.00%	0.00%			0.00%
ALL OTHER FUNDS (NONMAJOR GOVERNMENTAL; INTERNAL SERVICE; AND FIDUCIARY FUNDS)						
Adjustment to revenue accrual (unavailable)	$ -	$ 1,595	$ (1,595)	$ (1,595)	$ 2,540	$ 945
Accrual of unrecorded expenditures and accounts payable	-	1,671	(1,671)	(1,671)	-	(1,671)
Total other funds	$ -	$ 3,266	$ (3,266)	$ (3,266)	$ 2,540	$ (726)
Financial statement amounts						
Nonmajor governmental funds	$ 881,352	$ 159,125	$ 722,227			$ 59,222
Internal service fund	3,141	366	2,775			2,417
Agency funds	1,688	1,688	-			-
Private purpose trust	65	-	65			14
Pension trust funds	5,672,405	1,073,755	4,598,650			663,659
Total financial statement amounts	$ 6,558,651	$ 1,234,934	$ 5,323,717			$ 725,312
Impact as a percentage of f/s amounts	0.00%	0.26%	-0.06%			-0.10%

CITY OF SAN JOSE

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS (Continued)

Enterprise Funds

Impact of Adjustments on Fund Financial Statement Captions ($000) - Increase (Decrease)

Description (Nature) of Audit Difference	Statement of Net Assets: Assets	Statement of Net Assets: Liabilities	Statement of Net Assets: Net Assets	Changes of Net Assets: Current Year	Changes of Net Assets: Prior Year	Changes of Net Assets: Total
Norman Y. Mineta San Jose International Airport						
To record workers compensation claims development expense	$ -	$ 829	$ (829)	$ (829)	$ 1,416	$ 587
Total	$ -	$ 829	$ (829)	$ (829)	$ 1,416	$ 587
Financial statement amounts	$ 992,352	$ 577,828	$ 414,524			$ 7,687
Impact as a percentage of f/s amounts	0.00%	0.14%	-0.20%			7.64%
Wastewater Treatment System						
To record workers compensation claims development expense	$ -	$ 978	$ (978)	$ (978)	$ 1,803	$ 825
Total	$ -	$ 978	$ (978)	$ (978)	$ 1,803	$ 825
Financial statement amounts	$ 799,650	$ 141,088	$ 658,562			$ 12,370
Impact as a percentage of f/s amounts	0.00%	0.69%	-0.15%			6.67%
Municipal Water System						
To record workers compensation claims development expense	$ -	$ 33	$ (33)	$ (33)	$ 29	$ (4)
Record unbilled revenue and reverse prior year accrual	1,170	-	1,170	1,170	(996)	174
Total	$ 1,170	$ 33	$ 1,137	$ 1,137	$ (967)	$ 170
Financial statement amounts	$ 92,301	$ 7,640	$ 84,661			$ 2,537
Impact as a percentage of f/s amounts	1.27%	0.43%	1.34%			6.70%
Parking System						
To record workers compensation claims development expense	$ -	$ 2	$ (2)	$ (2)	$ 2	$ -
Total	$ -	$ 2	$ (2)	$ (2)	$ 2	$ -
Financial statement amounts	$ 91,946	$ 805	$ 91,141			$ (200)
Impact as a percentage of f/s amounts	0.00%	0.25%	0.00%			0.00%

In addition, the effects of the uncorrected adjustments on the Government-Wide Statements resulted in a net increase of $1,582,000 in the changes in net assets to the Business-type Activities.

CITY OF SAN JOSE

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2007

UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS (Continued)

Government Wide Statements - Governmental Activities

Impact of Adjustments on Government-Wide Statement Financial Statement Captions ($000) - Increase (Decrease)

Description (Nature)	Statement of Net Assets			Changes of Net Assets		
of Audit Difference	**Assets**	**Liabilities**	**Net Assets**	**Current Year**	**Prior Year**	**Total**
GENERAL FUND						
Adjustment to revenue accrual (additional)	$ 1,375	$ -	$ 1,375	$ 1,375	$ (1,351)	$ 24
Accrual of unrecorded expenditures and accounts payable	580	580	-	-	-	-
To record cash reconciling items between Treasury and FMS	2,138	-	2,138	2,138	-	2,138
Adjust investment to fair value	(34)	-	(34)	(34)	-	(34)
Subtotal general fund	$ 4,059	$ 580	$ 3,479	$ 3,479	$ (1,351)	$ 2,128
REDEVELOPMENT AGENCY FUND						
	$ -	$ -	$ -	$ -	$ -	$ -
Subtotal redevelopment agency fund	$ -	$ -	$ -	$ -	$ -	$ -
HOUSING ACTIVITIES FUND						
To adjust the valuation of other assets	$ (147)	$ -	$ (147)	$ (147)	$ 27	$ (120)
To adjust the loan receivable balance	124	(947)	$ 1,071	1,071	-	$ 1,071
Subtotal housing activities fund	$ (23)	$ (947)	$ 924	$ 924	$ 27	$ 951
SPECIAL ASSESSMENT DISTRICT FUND						
	$ -	$ -	$ -	$ -	$ -	$ -
Subtotal special assessment district fund	$ -	$ -	$ -	$ -	$ -	$ -
SAN JOSE FINANCING AUTHORITY						
To adjust the beginning balance of commercial paper	$ -	$ -	$ -	$ (185)	$ 185	$ -
Subtotal San Jose Financing Authority	$ -	$ -	$ -	$ (185)	$ 185	$ -
OTHER NONMAJOR GOVERNMENTAL FUNDS						
Accrual of unrecorded expenditures and accounts payable	$ 1,671	$ 1,671	$ -	$ -	$ -	$ -
Subtotal nonmajor governmental funds	$ 1,671	$ 1,671	$ -	$ -	$ -	$ -
OTHER GOVERNMENT -WIDE ADJUSTMENTS						
To record workers compensation claims development expense	$ -	$ 21,158	$ (21,158)	$ (21,158)	$ 37,229	$ 16,071
Total government-wide - Governmental Activities adjustments	$ 5,707	$ 22,462	$ (16,755)			$ 19,150
Financial statement amounts	$ 9,792,526	$ 4,018,033	$ 5,774,493			$ (255,866)
Impact as a percentage of f/s amounts	0.06%	0.56%	-0.29%			-7.48%