

File No. 100457

Committee Item No. 1

Board Item No. \_\_\_\_\_

## COMMITTEE/BOARD OF SUPERVISORS

### AGENDA PACKET CONTENTS LIST

Committee: Government Audit and Oversight Date April 22, 2010

Board of Supervisors Meeting Date \_\_\_\_\_

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| * <input checked="" type="checkbox"/> | <input type="checkbox"/> | <u>Comprehensive Annual Financial Report (Cover &amp; Controller's letter only)</u> |
| * <input checked="" type="checkbox"/> | <input type="checkbox"/> | <u>Report to Government Audit and Oversight Committee</u>                           |
| * <input checked="" type="checkbox"/> | <input type="checkbox"/> | <u>Report on Internal Control over Financial Reporting and on Compliance</u>        |
| * <input checked="" type="checkbox"/> | <input type="checkbox"/> | <u>Independent Auditor's Report (Management's Discussion and Analysis only)</u>     |
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Completed by: Alisa Somera Date April 16, 2010

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The complete document can be found in the file.



**CITY AND COUNTY OF  
SAN FRANCISCO, CALIFORNIA**

**Comprehensive Annual Financial Report  
Year ended June 30, 2009**



**Prepared by:  
Office of the Controller**

A handwritten signature in black ink, appearing to read "Ben Rosenfield".

**Ben Rosenfield  
Controller**

December 23, 2009

The Honorable Mayor Gavin Newsom  
The Honorable Members of the Board of Supervisors  
Citizens of the City and County of San Francisco  
San Francisco, California

Ladies and Gentlemen:

I am pleased to present the Comprehensive Annual Financial Report (CAFR) of the City and County of San Francisco, California (the City) for the fiscal year ended June 30, 2009 (FY 2008-2009), with the independent auditor's report. The report is submitted in compliance with City Charter sections 2.115 and 3.105, and California Government Code Sections 25250 and 25253. The Office of the Controller prepared the CAFR in conformance with the principles and standards for financial reporting set forth by the Governmental Accounting Standards Board (GASB).

The City is responsible for the accuracy of the data and for the completeness and fairness of its presentation. The existing comprehensive structure of internal accounting controls in the City provides reasonable assurance that the financial statements are free of any material misstatements. Since the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements. I believe that the reported data is accurate in all material respects and that its presentation fairly depicts the City's financial position and changes in its financial position as measured by the financial activity of its various funds. I am confident that the included disclosures provide the reader with an understanding of the City's financial affairs.

The City's Charter requires an annual audit of the Controller's records. The records have been audited by Macias Gini & O'Connell LLP and are presented in this CAFR. The CAFR also incorporates financial statements for San Francisco International Airport, the San Francisco Water Enterprise, Hetch Hetchy Water and Power, the Municipal Transportation Agency, the San Francisco Wastewater Enterprise, the Port of San Francisco, the City of San Francisco Market Corporation, the City and County of San Francisco Finance Corporation, the San Francisco County Transportation Authority, the City and County of San Francisco Health Service System, the San Francisco City and County Employees' Retirement System, and the San Francisco Redevelopment Agency.

This letter of transmittal is designed to complement the Management's Discussion and Analysis (MD&A) section of the CAFR. The MD&A provides a narrative overview and analysis of the Basic Financial Statements and is presented after the independent auditor's report.

**KEY FINANCIAL REPORT SECTIONS:**

The **Introductory Section** includes information about the organizational structure of the City, the City's economy, major initiatives, status of City services, and cash management.

The **Financial Section** includes the MD&A, Basic Financial Statements, notes to the Basic Financial Statements, and required supplementary information. The Basic Financial Statements include the government-wide financial statements that report on all City financial operations, and also include fund financial statements that present information for all City funds. The independent auditor's report on the Basic Financial Statements is also included.

The financial statements of several enterprise activities and of all component units of government are included in this CAFR. Some component units' financials are blended with the City's, such as: the San Francisco County Transportation Authority, the San Francisco Finance Corporation, and the San Francisco Parking Authority. The reason for this is that these component units have the same governing body as the primary government or provides services exclusively to the City. In other instances, namely, for the San Francisco Redevelopment Agency and the Treasure Island Development Authority, financial reporting is shown separately. Supplemental combining statements and schedules for non-major governmental funds, internal service funds and fiduciary funds are also presented in the financial section.

The **Statistical Section** includes up to ten years of historical financial data and miscellaneous social and economic information that conforms to GASB standards for reporting—Statement No. 44. This section may be of special interest to prospective investors in our bonds.

### **SAN FRANCISCO'S ECONOMY:**

#### **Overview of Recent Trends**

The national recession which started in December 2007 finally began to affect the San Francisco economy in October 2008, in the wake of the financial crisis following the collapse of Lehman Brothers. The depth of the local recession can most clearly be seen in the number of unemployed, which has nearly doubled from June 2008 to June 2009. The City's unemployment rate rose to an average rate of 7.4% during FY 2008-2009, the highest annual rate in over 10 years. In addition to higher unemployment, the recession of FY 2008-2009 has led to lower retail sales, declining consumer prices, housing and commercial real estate price drops, and higher vacancies and lower rates in hotels and commercial real estate.

Nonetheless, San Francisco's economy has continued to outperform most other jurisdictions in California, and the State itself, during the recession. To place San Francisco's economic performance in context, the State of California's economy has continued to worsen since 2006. The clearest indication of this distress is the state's employment situation. During FY 2008-2009, California's unemployment rate increased by over 50%, to a rate of 11.6% in June 2009.

San Francisco did not feel the national recession until well into FY 2008-2009. The recession initially formed in areas of the State that suffered severe housing price declines and construction industry contractions. These declines occurred with the collapse of a housing bubble built on speculative overbuilding and an excessive spread of high-risk mortgages. The housing bubble in California was significant, but for the most part did not spread to coastal counties such as San Francisco, where rates of housing construction have remained low by State standards.

The housing market downturn broadened into an economy-wide credit and financial crisis in the fall of 2008. San Francisco businesses were not immune, and immediately curtailed investment and shed jobs. Almost every sector of the City's economy lost jobs during FY 2008-2009. Job losses were led, in percentage terms, by the construction, retail trade, and financial service sectors. Only health care and educational services have maintained employment during the recession.

Nevertheless, San Francisco's long-term economic fundamentals – the quality of its workforce, environment, technological base, and cultural amenities – remain among the strongest of any city in the United States. These competitive advantages are likely to secure the City's continued prosperity after the current recession ends.

#### **Significant Economic Outcomes**

Several aspects of San Francisco's recent economic performance over the past several years are discussed in more detail in the following section.

***Population: Rising through 2008***

Since 2000, the California Department of Finance and the U.S. Census Bureau have released significantly different estimates of San Francisco's population. For both calendar years 2007 and 2008, both sources indicated a rise in San Francisco's population over the prior years' levels. According to the Census Bureau, San Francisco had 808,976 residents as of July 1, 2008, a 1.2% increase over July 1, 2007. The Department of Finance reported San Francisco's population as 835,364 as of January 1, 2008, a 0.7% increase over the same date in 2007. In addition, the Department of Finance has estimated San Francisco's population to be 845,559 as of January 1, 2009, a 1.2% increase over the same date in 2008.

***Employment Base: Severe Job Losses, But Outperforming the State***

The wage and salaried employment base of San Francisco fell by 17,000 jobs between March 2008 and March 2009, based on the latest preliminary data available from the Bureau of Labor Statistics. This 3.0% drop is the largest annual change since 2003, and partially reverses a 4.0% increase in employment during the prior year. To put the recent job loss into context, San Francisco lost 94,000 jobs between 2000 and 2004, or 16% of its total wage and salary employment base, according to the Employment Development Department. Although that represents four consecutive years of job losses, each of the first three years of the 2000-2004 recession featured annual job losses that were greater than what San Francisco experienced between March 2008 and March 2009.

San Francisco's average monthly unemployment rate for FY 2008-2009 rose to 7.4%, an increase of nearly two-thirds over the average annual figure for the prior fiscal year. Despite the significant increase in local joblessness, San Francisco had a lower unemployment rate than most California counties, as of the end of June 2009. The State's unemployment rate rose from 7.6% to 11.6% during this same fiscal year.

***Taxable Sales: Significant Declines Late in the Fiscal Year***

Unlike most of the State of California, San Francisco's taxable sales base grew through most of 2008, even as the national economy entered a severe recession. However, as of the second quarter of FY 2008-2009, the City saw annual declines in taxable sales and its associated sales tax revenue. Actual taxable sales declined by 11.2% in the second quarter of FY 2008-2009, 17.6% in the third quarter, and 20.5% in the fourth quarter, all versus the same quarter in the prior fiscal year. Overall, taxable sales declined by 11.3% in FY 2008-2009, versus the prior year.

**San Francisco's Major Industries**

San Francisco's economy is dependent on the global competitiveness of two primary sets of industry clusters: knowledge-based businesses centered around professional, financial, and information services, and experience-based businesses centered on tourism. San Francisco's continued economic growth has been, and will in the future be, due to the competitiveness of these key elements of its economy. In addition, a new set of emerging technology-based industries has helped diversify San Francisco's economy in recent years. Nevertheless, almost all major segments of the local economy have suffered employment declines during FY 2008-2009.

***Financial, Professional, and Business Services***

The core of San Francisco's knowledge-based economy is its large downtown concentration of corporate headquarters, banks and financial services companies, and professional services such as law firms and consultants. The competitiveness of these industry clusters is important to San Francisco's long-term economic outlook.

In March 2008, San Francisco held over 173,000 private sector jobs in financial activities and business and professional services, according to the Bureau of Labor Statistics. As a group, employment in these

industries declined by 11,000 jobs between March 2008 and March 2009, a 6.1% overall reduction. In California, employment in these sectors declined by 7.1% during the same period, while nationally they declined by 5.7%.

The commercial real estate market in downtown San Francisco provides another indicator of the challenges facing the City's knowledge-based industries during the current recession. In the April to June 2009 period, the City's commercial vacancy rate increased by approximately 30%. Average commercial lease rates experienced a corresponding decline of 30.6% during the same period, with an average annual asking lease rate of \$32.67 per square foot.

### ***Tourism and Hospitality***

The other major segment of San Francisco's economic base is the tourism and hospitality industry. Like the downtown office sector, tourism experienced a strong recovery after the recession of the early 2000s, but experienced declines during FY 2008-2009.

There were approximately 73,000 people working in arts, recreation, cultural services, accommodation, and food services in San Francisco in March 2009, according to the latest preliminary data from the Bureau of Labor Statistics. This represents a loss of over 3,400 jobs, or a 4.7% decrease, versus the prior year. After several years of growth that exceeded State and national levels, San Francisco's loss in FY 2008-2009 exceeded the State's decline of 4.2% and the national decline of 3.1%.

Like most of the rest of the local economy, San Francisco's hotel sector entered FY 2008-2009 with strength, only to see rapid declines in the second quarter which continued until the end of the fiscal year. Both occupancy rates and average daily rates declined, resulting in a combined reduction in revenue per available room-night of 11.5% during the fiscal year.

### ***Emerging Industries: Biotechnology and Clean Technology***

Recombinant genetic engineering, the central innovation that created the biotechnology industry, was co-invented by a researcher at the University of California, San Francisco (UCSF) in the 1970s. Between UCSF, Stanford University, the University of California at Berkeley, and other local research institutions, the Bay Area is the leading biomedical research region in the world.

Until recently, however, few biotechnology companies were located in San Francisco itself. This has begun to change with the growth of the Mission Bay redevelopment area. Mission Bay now houses a new UCSF campus, and growing amounts of lab and incubator space for researchers and start-up companies. Today, San Francisco is home to 52 life sciences companies and has 6% of the Bay Area's occupied space for biotechnology, up from just 1% in 2003. As Mission Bay continues to develop, it is expected that San Francisco's biotechnology industry will continue to grow.

San Francisco also has a growing clean technology industry, with over 200 firms located within the City, including Suntech America, the world's largest solar manufacturer, that has located their North American headquarters in San Francisco.

## **SAN FRANCISCO GOVERNMENT:**

### **Profile of San Francisco Government**

The City and County of San Francisco was established by Charter in 1850, and is the only legal subdivision of the State of California with the governmental powers of both a city and a county. The City's legislative power is exercised through a Board of Supervisors, while its executive power is vested upon a Mayor and other appointed and elected officials. Key public services provided by the City include public

safety and protection, public transportation, water and sewer, parks and recreation, public health, social services and land-use and planning regulation. The heads of most of these departments are appointed by the Mayor and advised by commissions and boards appointed by City elected officials.

Elected officials include the Mayor, Members of the Board of Supervisors, Assessor-Recorder, City Attorney, District Attorney, Public Defender, Sheriff, Superior Court Judges, and Treasurer. Since November 2000, the eleven-member Board of Supervisors has been elected through district elections. The eleven district elections are staggered for five and six seats at a time, and held in even-numbered years. Board members serve four-year terms and vacancies are filled by Mayoral appointment.

### **San Francisco's Budgetary Process**

The City adopts annual budgets for all governmental funds and typically adopts project-length budgets for capital projects and certain debt service funds. The budget is adopted at the character level of expenditure within each department, and the department level and fund is the legal level of budgetary control. Note 2(c) to the Basic Financial Statements summarizes the budgetary roles of City officials and the timetable for their various budgetary actions according to the City Charter.

In November 2009, City voters approved a change to the City's Charter which requires the City to adopt a host of financial planning tools, including a two-year budget, a five-year financial plan, and a series of financial policies. The Charter amendment phases these changes in over a four year period, beginning in FY 2010-2011.

### **Key Government Initiatives**

San Francisco's industry competitiveness and overall prosperity are underpinned by a number of local economic foundations that benefit City residents, visitors, and businesses. Improvement affecting core City infrastructure, to proceeding with key redevelopment and land-use projects, to initiatives aimed at improving the quality of life for those that live, work, and visit the City. The City government is taking steps to strengthen these advantages, and thereby helping to secure the City's continued prosperity. Some important initiatives are described below.

### **Key Initiatives: Housing and Commercial Development**

San Francisco's recovery and future economic growth depends on developing new residential and commercial areas. Despite the recession, the City continued to make significant progress on these objectives in FY 2008-2009.

#### ***Treasure Island Redevelopment Project***

The City has proceeded during the past year with planning for the redevelopment of Treasure Island, a former military base in the San Francisco Bay. By leveraging private capital and the City's entitlement power, the City plans to develop the closed base into a green, sustainable community. The Treasure Island Plan will add 6,000 new residential units, including 1,800 at below-market rate. The planned project also includes 250,000 square feet of retail and commercial space, 450 hotel rooms, entertainment venues and cultural exhibitions, and a 300-acre park.

#### ***Bayview and Hunters Point Redevelopment Projects***

A similar development opportunity exists along San Francisco's southern waterfront, at Candlestick Point and the Hunters Point Shipyard. Current plans include up to 10,000 housing units, over two million square feet of research and development space, and over 350 acres of open space and waterfront park land. A new 49ers stadium could be an element of that revitalization effort; plans are proceeding with, and without, a stadium alternative. Revitalizing these waterfront sites will create badly-needed jobs, affordable housing and parks and open space for the Hunters Point community, and the broader region.



In June 2008, City voters approved Proposition G, supporting the combined Hunters Point Shipyard Candlestick Point redevelopment project. This measure affirmed the actions of both the Redevelopment Agency Commission and the Board of Supervisors, who in 2007 endorsed the conceptual framework to plan for an integrated, mixed-use project in the southeast corner of the City. In addition, the Navy's cleanup and transfer of the Shipyard parcels to the City are accelerating, including an \$82 million federal appropriation for the Navy's clean-up of the site during FY 2008-2009, a significant increase over appropriations in prior years.

### **Key Initiatives: Transportation Infrastructure**

San Francisco's economic recovery and future development will raise demand for transportation and create a need for increased infrastructure investment. The City is planning for this growth across all modes, including bus, rail, and air.

#### ***The Transbay Transit Center***

Rising freeway congestion in the Bay Area make it critical for the region to have the ability to rapidly bring large numbers of workers into a transit-accessible employment center. Downtown San Francisco can serve this function better than any other area in the region, and the Transbay Center will significantly strengthen this capacity. Plans for a multi-modal hub located in the City's core – the Transbay Transit Center – are targeted to meet this need.

In 2006, the Transbay Transit Center project obtained Federal and State environmental approvals. The Center will initially feature an expanded terminal for buses to and from surrounding counties, and is planned to include a terminal for commuter rail from San Mateo County, high speed rail from Southern California, and pedestrian connections to both Bay Area Rapid Transit (BART) and City Municipal Transportation Agency (MTA) subways. Plans for the Transbay Center include a mixed use transit tower, where development will fund much of the transit infrastructure.

The project is scheduled for completion in 2014, followed by completion of an extension of the Caltrain rail line to the site in 2018. Once completed, the Center is expected to serve more than 100,000 people per day through nine different transportation systems.

#### ***Expanded Capacity at San Francisco International Airport***

The San Francisco International Airport (SFO) is nearing completion of a \$383 million renovation of Terminal 2 from a 10-gate international terminal to a 14-gate domestic terminal. As a result of the international economic slowdown, U.S. airports have experienced an average decline of 7.7% in air traffic. In contrast, air traffic at SFO has decreased by only 0.8% as a result of additional flights being offered by low-cost carriers. Virgin America and American Airlines are the anticipated tenants of the new Terminal 2, which is scheduled to open in early 2011.

#### ***Improved Municipal Transit Planning***

The City has recently completed a comprehensive review of current and projected transit travel patterns and produced a series of recommended changes to the City's mass transit system designed to improve reliability and reduce travel times. The analytical and planning phase of this project concluded during FY 2008-2009.

The City is currently developing a five-year implementation plan for these recommendations. The plan will include goals and target outcomes, a phasing plan for route updates and service changes, a detailed list of required capital projects and funding strategies, and a master schedule with critical path steps to deliver the five-year program. Concurrently, the City will commence required environmental assessment processes during spring 2010.

***Subway System Expansion***

In 2007 the City completed an extension of its light-rail system from the edge of the City's financial district to the City's southeast sector through completion of the Third Street Light Rail Project. The next phase of this project, titled the Central Subway Project, will extend this light rail line underneath the City's financial district to Chinatown. The City is now completing preliminary engineering work and anticipates receiving federal approval to enter into the final design of the project late in FY 2009-2010.

**Key Initiatives: Health and Human Services**

Public health and human services are important to the long-run productivity of the workforce. The City offers a host of health and safety net services, including operation of two public hospitals, the administration of federal, state, and local entitlement programs, and a vast array of community-based health and human services.

***Access to Healthcare***

The City launched the Healthy San Francisco program in 2007 with the goal of increasing access to healthcare for San Francisco residents. The program creates a mandate for many businesses in San Francisco to either provide employer-paid health insurance for their employees or to pay into an expansion of the City's public health network. The program is funded with a mix of grants, employer-paid fees, and through a redirection of local funds allocated for public health services.

During this past fiscal year, the City's Department of Public Health has focused on expanding enrollment and broadening the medical provider network participating in the program. The provider network now includes a number of private and nonprofit community health care associations and hospitals. By the end of FY 2008-2009, over 43,000 uninsured adult residents had enrolled in the program, or approximately 72% of the City's estimated uninsured population.

***Rebuilding the City's Public Hospitals***

The City is in the process of replacing and modernizing both of its public hospitals, Laguna Honda Rehabilitation Center and San Francisco General Hospital.

The replacement of Laguna Honda is scheduled for completion during the coming fiscal year. The \$585 million project has been funded with a mix of General Obligation bonds, tobacco settlement revenues, and certificates of participation. Three new seismically-safe buildings, which will be home to 780 residents, will open in April 2010.

The voters approved a General Obligation bond measure to fund the replacement of San Francisco General Hospital in November 2008. This \$887 million project is required given changes to state law governing seismic requirements for hospitals. It will replace the existing facility with a new nine-story building on the existing hospital campus. The hospital is the only trauma center in San Francisco, and also acts as the safety net hospital for our residents. Preliminary excavation and utility work on the site has already commenced, with completion expected in 2015.

**Key Initiatives: Quality of Life**

In recent years the City has completed renovation and expansion of a number of recreational and cultural facilities that serve those that live, work, and visit the City. The experience generated by these institutions is one of the keys to the maintaining the high quality of life that, in turn, serves to attract and retain the City's many visitors and residents.

***New Museums***

Several museums have recently opened, broadening the base of available cultural amenities. During the past three years, the California Academy of Sciences and de Young Museum have reopened in new and expanded facilities. The Contemporary Jewish Museum, Museum of the African Diaspora, and Walt Disney Family Museum and Library have all opened during this same period. And work is underway to relocate the Exploratorium Museum to a larger, more central waterfront location.

***Parks and Libraries***

San Francisco voters have approved a number of bond measures to fund capital improvements to the City's parks and libraries during the past decade, most recently with the approval of a \$185 million General Obligation bond for improvements to neighborhood parks in February 2008. This most-recent parks improvement measure includes funds for seismic improvement, disability access, and facility renovation at key facilities and parks throughout the City, and is scheduled for completion by FY 2013-2014.

A comprehensive capital improvement program intended to renovate the City's branch library system is proceeding, with planned improvements at over half of the City's branches now complete. The \$187 million program, funded with a mix of General Obligation and lease-revenue bonds, focuses on seismic safety, accessibility, and modernization of facilities for current uses. The program is scheduled for completion in FY 2010-2011.

**SUMMARY:****Short Term Weakness, Long Term Strength**

The economic recession that had begun earlier elsewhere in the State had significant impacts on San Francisco's economy in FY 2008-2009. Unemployment rates increased, consumer prices declined, retail sales weakened, housing and commercial real estate price declined, and vacancy rates in commercial real estate and hotels increased.

Corresponding tax revenue declines forced reductions in general government services and resulted in the need for mid-year budget corrections to maintain a Charter-required balanced budget. These pressures on the City's General Fund budget are expected to continue into FY 2009-2010 and FY 2010-2011.

As discussed above, however, San Francisco is positioned to maintain its historic strength after the current recession ends. Significant investments in key infrastructure and land-use projects will provide needed jobs and economic stimulus in the short-term, with long-term benefits resulting to the City and region's economic competitiveness. These investments are complemented by a number of key initiatives aimed at improving the quality of life of those who live in and visit the City. In the longer term, the City and region's longstanding advantages in workforce educational attainment, research and development, entrepreneurial talent, venture capital financing, and quality of life are likely to ensure it remains among the most competitive regional economies in the world.

**Certificate of Achievement Award**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2008. This was the 27<sup>th</sup> consecutive year (fiscal years ended June 30, 1982 – 2008) that the City has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR. The CAFR must satisfy both Generally Accepted Accounting Principles (GAAP) and applicable legal requirements.

Acknowledgements

I would like to express my appreciation to the entire staff of the Controller's Office whose professionalism, dedication, and efficiency are responsible for the preparation of this report. I would also like to thank Macias Gini & O'Connell LLP for their invaluable professional support in the preparation of the CAFR. Finally, I want to thank the Mayor and the Board of Supervisors for their interest and support in planning and conducting the City's financial operations.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'B. Rosenfield', with a long horizontal flourish extending to the right.

Ben Rosenfield  
Controller

**CITY AND COUNTY OF SAN FRANCISCO**

Report to Government Audit and Oversight Committee  
For the Year Ended June 30, 2009

**CITY AND COUNTY OF SAN FRANCISCO**  
Report to Government Audit and Oversight Committee  
For the Year Ended June 30, 2009

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**MACIAS GINI & O'CONNELL LLP**  
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SACRAMENTO

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LOS ANGELES

NEWPORT BEACH

SAN DIEGO

Government Audit and Oversight Committee  
Mr. Ben Rosenfield, Controller  
City and County of San Francisco  
San Francisco, California

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City and County of San Francisco, California (City), as of and for the year ended June 30, 2009, 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. Our opinions on the financial statements, insofar as they relate to the San Francisco International Airport, San Francisco Water Enterprise, Hetch Hetchy Water and Power, San Francisco Municipal Transportation Agency, San Francisco Wastewater Enterprise, San Francisco Market Corporation, City and County of San Francisco Finance Corporation, and the Health Service System, are based solely on the reports of other auditors. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are separately reported by those auditors. Professional auditing standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards*, and U.S. Office of Management and Budget (OMB) Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our General Audit Plan to you dated July 20, 2009. Professional standards also require that we communicate to you other information related to our audit as discussed in the Required Communications section.

In planning and performing our audit of the City's basic financial statements, 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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

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

of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies presented in the Current Year Recommendations as findings 2009-01 and 2009-04 through 2009-06 to be significant deficiencies. In addition, we noted other matters involving the internal control and its operation that we have reported to management as described in the Current Year Recommendations section.

The City's written responses to the findings identified in our audit are described in the Current Year Recommendations section. We did not audit the City's responses and, accordingly, we express no opinion on them. In addition, we would be pleased to discuss the recommendations in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing these recommendations.

We have included in this letter a summary of communications with the Board of Supervisors' Government Audit and Oversight Committee as required by professional auditing standards. We have also provided a status of prior year recommendations made by us and other auditors as they relate to the General City, the San Francisco Redevelopment Agency, San Francisco City and County Employees' Retirement System, and the Port of San Francisco. We would like to thank City management and staff for the courtesy and cooperation extended to us during the course of our engagement.

The accompanying communications and recommendations are intended solely for the information and use of the Government Audit and Oversight Committee, Board of Supervisors, City management and others within the organization and are not intended to be or should be used by anyone other than these specified parties.



Certified Public Accountants

Walnut Creek, California  
December 23, 2009



**CITY AND COUNTY OF SAN FRANCISCO**  
Report to Government Audit and Oversight Committee  
For the Year Ended June 30, 2009

**REQUIRED COMMUNICATIONS**

**I. Qualitative Aspects of Accounting Practice**

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 2 to the financial statements. As described in Note 2(r) to the basic financial statements, the City adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* in the year ended June 30, 2009. GASB Statement No. 49 requires the City to estimate its expected pollution remediation outlays and disclose information about their pollution obligations associated with clean up efforts, which are described in Note 11 to the financial statements. The implementation of this Statement resulted in an obligation of \$1.8 million in the City's governmental activities and an obligation of \$31.7 million in its business-type activities.

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred except for the Port of San Francisco's restatements of net assets described in Note 2(t) to implement GASB Statement No. 49 in the amount of \$27.5 million and to correct land improvement balances in the amount of \$15.5 million.

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:

- a) Fair value of investments in the pension trust fund
- b) Accrual and disclosure of claims liabilities
- c) Estimated contractual adjustments and bad debt allowances for patient accounts receivable
- d) Cost report settlement receivables and payable
- e) Estimated bad debt allowance for accounts and loans receivable
- f) Accrual of compensated absences
- g) Depreciation estimates for capital assets, including depreciation methods and useful lives assigned to depreciable properties
- h) Accrual and disclosure of pension and other postemployment benefits
- i) Estimated pollution remediation costs

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

- a) Management's estimate of the fair value of investments in the pension trust fund is discussed in Note 2(d) to the financial statements. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair value derived from third party pricing services. The fair values of real estate and alternative investments are based on net asset values provided by the investment managers and general partners, respectively.
- b) Reserves for workers' compensation and general liability claims were based on actuarially evaluations using historical loss and other data. Reserves for other claims liabilities were determined by attorney judgment about the ultimate outcome of the claim.
- c) Estimated bad debt allowances for patient accounts receivable were based on historical experience.

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**REQUIRED COMMUNICATIONS (Continued)**

**I. Qualitative Aspects of Accounting Practice (Continued)**

- d) Estimated contractual adjustments and cost report balances were based on prior cost report adjustments, previous regulatory settlements, and potential future retrospective adjustments.
- e) Estimated bad debt allowance for accounts receivable was based on historical experience and loans receivable was based on the type of loan (e.g., forgivable, deferred, grant or amortizing) and management's estimate regarding the likelihood of collectibility based on loan provisions and collateral.
- f) Accrual of compensated absences is based on unused employee sick leave and vacation and the employees' pay rates at year-end.
- g) Useful lives for depreciable property were determined by management based on the nature of the capital asset.
- h) Accruals and disclosures of pension and other postemployment benefits are based on actuarial studies performed by the City's independent actuaries.
- i) Estimated pollution remediation costs are based on reports from independent consultants.

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

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were the disclosures related to pension benefits and other postemployment benefits. The disclosures about pension benefits and other postemployment benefits are described in Note 9 to the financial statements and are based on actuarial valuations.

**II. Difficulties Encountered in Performing the Audit**

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

**III. Corrected and Uncorrected Misstatements**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected certain misstatements, which consist primarily of a \$126.6 million reclassification of unrestricted net assets to net assets invested in capital assets, net of related debt. The attached schedule on page 21 summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

**IV. Disagreements with Management**

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

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**REQUIRED COMMUNICATIONS – SIGNIFICANT AUDIT FINDINGS (Continued)**

**V. Management Representations**

We have requested certain representations from management that are included in the management representation letter dated December 23, 2009.

**VI. Management Consultations with Other Independent Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the governmental unit’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. Other Audit Findings or Issues**

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit’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. Other Information in Documents Containing Audited Financial Statements**

During the year, the City included its audited basic financial statements for the year ended June 30, 2008, 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.

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

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**CURRENT YEAR RECOMMENDATIONS**

**San Francisco Redevelopment Agency (Agency)**

**2009-01 Inadequate Segregation of Duties Over Accounting Journal Entries**

*Significant Deficiency*

During our audit of the Agency, we noted a lack of segregation of duties over the recording of financial journal entries. The Agency does not have a process in place to review the journal entries prepared by the Agency's accounting supervisor. A lack of segregation of duties in this area increases the risk that improper recording of accounting transactions and financial activity can be disguised in accounting entries in the Agency's financial system. We recommend that the Agency segregate the duties of preparing journal entries from recording within the financial reporting process to minimize the risk of improper or erroneous accounting transactions.

*Management Response*

In the past, the Agency had insufficient staffing in the Accounting Division and continues to address challenges due to turnover of employees who have been with the Agency for over 10-20 years. The Agency has added additional staff in the past year and will implement the necessary changes to ensure proper internal controls. The Agency will train the recently added Accountant III staff to prepare and reconcile the journal entries and the Accounting Supervisor will review and approve thereafter.

**San Francisco City and County Employees' Retirement System (Retirement System)**

**2009-02 Preparation of Investment Disclosures**

*Other Matter*

The accounting division utilizes investment data provided by the custodian bank and investment managers to prepare the financial statement disclosures required by Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*. Whereas custodian statements are usually provided to the accounting division one month after the fiscal year-end, individual investment managers often provide updated investment information two to three months later. The accounting division must adjust the Retirement System's accounting records, financial statements, and related disclosures to reflect data reported by investment managers subsequent to the receipt of the custodian statements.

Based on our observation and discussion with accounting staff, we noted that the process to update investment data is very time-consuming as data provided by the investment managers are predominantly in non-editable formats (e.g. Adobe Acrobat files) and must be manually compared to existing records and adjusted. Although revised data may relate to numerous individual securities, the accounting division, for efficiency purposes, generally adjusts differences between the custodian statements and the investment manager statements in lump sum amounts. Our audit procedures revealed that these lump sum adjustments were not consistently incorporated into the investment disclosures, which were subsequently corrected.

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**CURRENT YEAR RECOMMENDATIONS (Continued)**

**2009-02 Preparation of Investment Disclosures (Continued)**

We recommend that the accounting and investment divisions work with the custodian bank and the investment managers to better coordinate the format and timing of investment data. The accounting division should request that data be provided in editable electronic formats (e.g. Excel spreadsheets) to allow staff to efficiently adjust the accounting records, financial statements and related disclosures. The accounting division should continue to perform procedures ensuring the conformity of the related disclosures with generally accepted accounting principles. Deadlines should be clearly established with the custodian and the investment managers to allow sufficient time for internal review and external audit procedures.

*Management Response*

San Francisco Employees' Retirement System (SFERS) management has reviewed recommendations made by the external auditors (MGO) with custody bank representatives of the Northern Trust Bank (TNT).

GASB Statement No. 40 requires the reporting of investment disclosure related to investment risks: credit risk (including custodial credit risk and concentration of credit risk), interest rate risk, and foreign currency risk. SFERS accounting will meet with management from MGO to review existing accounting procedures to ensure they conform to GASB Statement No. 40 disclosure requirements and generally accepted accounting principles.

It was agreed that on July 1 following the end of each fiscal year, SFERS Managing Director of Public Markets would send notification to all investment managers to provide TNT with investment data necessary for timely financial reporting and credit ratings on or before August 1. The request will clarify that data be provided in editable electronic formats (e.g. Excel spreadsheets) as recommended. This notification should have an immediate effect on reducing differences between the managers' and TNT's statements at June 30 minimizing year-end adjustments. This early notification will include clearly established due dates and allow time for analysis by SFERS accounting and investment staff and the external auditors.

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**CURRENT YEAR RECOMMENDATIONS (Continued)**

**2009-03 Management's Discussion and Analysis**

*Other Matter*

As part of the Retirement System's financial reporting process, the Retirement System's accounting division prepares the management's discussion and analysis (MD&A) to discuss reasons for changes in financial position and results of operations in the current fiscal year when compared to the prior fiscal year. The MD&A meets the minimum standards required by generally accepted accounting principles; however, we believe incorporating the unique perspectives of the managers responsible for key activities would enhance the usefulness of the financial statements and improve the readers' understanding of the Retirement System. Appropriate personnel in the investment and benefit services divisions, at a minimum, should be involved in the preparation of the MD&A to explain significant changes for the current fiscal year and to address any known facts, conditions, or decisions that are expected to have a significant impact on the Retirement System's financial position or results of operations.

We recommend that management responsible for significant activities collaborate to provide more detailed narrative explanations of the significant changes in financial position and results of operations. The accounting division should coordinate the analysis to ensure compliance with the financial reporting standards and to avoid redundancy in the MD&A.

*Management Response*

SFERS concurs with this observation for improved MD&A reporting.

Investment Management Directors for Public and Private Markets will review with SFERS Deputy Director for Investments to provide appropriate comments for the MD&A. External auditors are invited to address inquiries to our Investment Management Directors regarding both methods of measurement and presentation within the MD&A and Notes to Financial Statements.

SFERS Administrator of Operations regularly meets with SFERS Deputy Director for Operations and Accounting to review all plan changes that occur during the fiscal year. This information is highlighted in the MD&A under "Currently Known Facts and Events" and Notes to Financial Statements. SFERS Management will ensure that comments from senior staff are incorporated into the MD&A.

SFERS Accounting Division does coordinate analysis to ensure compliance with financial reporting standards, providing staff with continuing education on governmental accounting and financial reporting standards and industry related pension roundtable seminars for Defined Benefit (DB) government pension plans. SFERS Finance Manager will coordinate with our external auditors on recommendations to avoid redundancy, improvement in the content information within MD&A and where applicable, incorporate best practices for effective communication to our readers.

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**CURRENT YEAR RECOMMENDATIONS (Continued)**

**Port of San Francisco (Port)**

**2009-04 Disaster Recovery Plan – Information Systems and Business Continuity**  
*Significant Deficiency*

Controls over information systems are necessary due to reliance on these systems to process financial transactions. Among other things, general controls over data center operations include backup and recovery procedures and disaster recovery planning. A control deficiency exists when a necessary control objective is missing. A significant deficiency exists if it is important enough to merit attention by those charged with governance.

The Port does not have well defined, written disaster recovery procedures. Personnel should be aware of their responsibilities in the event of an emergency situation that precludes the use of the existing facilities at Pier 1. In addition, critical documents and agreements should be inventoried and digitized to ensure these agreements can be accessed in the event of physical destruction of the original agreements and Port records at Pier 1.

We suggest that management develop a disaster recovery plan that includes, but is not limited to, the following matters:

- Responsibilities of various personnel in an emergency.
- Identification of a physical location with similar or compatible equipment to allow management to re-establish administration and management.
- Location of, and access to, off-site storage of electronic data.
- A listing of all data files that would have to be obtained from the off-site storage location.
- Priority of critical applications and reporting requirements during the emergency period.

We understand that the Port's Information Systems Department is currently pursuing possible funding sources to provide the necessary resources to properly design and document a disaster recovery plan. We recommend that preliminary documentation and plan development occur presently.

*Management Response*

We agree. While Port staff has devoted substantial time on emergency operations planning and disaster recovery from an asset management perspective, we do not have a comprehensive recovery plan covering our information systems and other elements that provide for continuity of key internal business processes. The Port's Director of Homeland Security is leading an effort to develop a Continuity of Operations Plan ("COOP Plan"). The COOP plan will identify major items (e.g. communications, computers and records) that different Port divisions will require to set up operations at an alternate location.

The Port applied for funding in the 2008 round of the federal Port Security Grant Program to complete an information technology security and disaster recovery plan. The application has been approved at the local level and forwarded to the Federal Emergency Management Agency for final consideration. The scope of work for the proposed project will include a vulnerability assessment, business continuity plan and recovery plan. The disaster recovery plan will provide for resumption or continuity of Port business which depends upon software applications, data, hardware, communications (such as networking) and other technology infrastructure. The plan will provide a recovery point objective and a recovery time objective, identifying how much data loss could be tolerated, and how long the Port could sustain an outage. An infrastructure hot site strategy will also be key deliverable.

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**CURRENT YEAR RECOMMENDATIONS (Continued)**

**2009-05 Physical Inventory of Capital Assets and Maintenance of Capital Assets Records**  
*Significant Deficiency*

Controls over information and the procedures surrounding capital asset transactions and historical records are essential to the ability to accurately process financial activity and maintain capital asset records. The severity of a deficiency is dependent on the magnitude of the potential or actual misstatement and the possibility that the entity's controls will fail to prevent, or detect and correct a misstatement of an account balance or disclosure.

Our review of the Port's capital asset records revealed that there may be assets that have not been correctly recorded in the Port's records and/or there may be assets recorded on the Port's records that are no longer in use. In addition, a prior period restatement in the amount of \$12.3 million was required to properly state accumulated depreciation on land improvements that were not previously depreciated in accordance with generally accepted accounting principles and the capital asset policies of the City. A restatement of \$3.2 million was required to write off assets no longer in service. We also noted that the information captured in the capital asset records was in some cases not sufficient to determine the exact nature of the asset.

We believe that these conditions indicate the need for the Port to perform a complete physical inventory of its capital assets to properly identify items included in its capital asset records. This process will allow the Port to develop procedures whereby the asset listing provides sufficient detail so that the assets can be identified based on the records. This will ensure an accurate accounting for assets.

The listing should include the following data:

- Description of the asset
- Cost, vendor name
- Date placed in service, physical location of the asset
- Estimated useful life

Complete capital asset information such as the above would provide an effective control for the safeguarding of these assets and the means to properly identify and dispose of property and equipment no longer in use.

*Management Response*

We agree in concept but do not have the resources to perform a single, comprehensive physical inventory count and reconciliation of all capital assets, given the considerable long history and nature of these assets. As an alternative, we propose a phased approach to verifying and improving the capital asset records. After we update the Port's capital asset accounting policy and procedures to be consistent with the City's, we will give first priority to evaluating the land and land improvement accounts which have not been subjected to much review until the current restatement adjustment, which largely centered around street and other land improvements that were historically recorded as permanent assets and not depreciated.

While we believe that the restatement adjustment recorded in 2009 substantially corrects the situation at the financial statement level, additional work is required to improve the more detailed asset listings and the documented data for each asset. Equipment assets are already subject to regular evaluation and periodic physical count observation. Building and improvement assets were the subject of a scheduled five-year property observation project completed in 2004.



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**CURRENT YEAR RECOMMENDATIONS (Continued)**

**General City**

**2009-06 Capital Asset Database**

*Significant Deficiency*

The City's *Fixed Assets Definitions and Guidelines* ("Guidelines") establish policies and guidelines for the accounting and tracking of the City's capital assets. These Guidelines require all City departments to use the standard capitalization thresholds for capitalizing each major class of assets. The capitalization thresholds are \$100,000 for infrastructure, \$100,000 for buildings and improvements, and \$5,000 for equipment. Justification for any deviation from these thresholds must be documented on the fixed asset change form to be maintained on file by the departmental property managers. Furthermore, all assets that are retired or disposed of in any way should be updated in the City's capital asset system (FAACS) on a regular basis to reflect all assets disposals that occurred.

As a result of our audit procedures over capital assets, we noted the following as of June 30, 2009:

- Capital assets totaling \$4.9 million (net of \$11.8 million in accumulated depreciation) in FAACS have original costs below the City's specified capitalization thresholds.
- Three demolished capital assets totaling \$0.25 million (net of \$1.8 million in accumulated depreciation) were not removed from FAACS.

Certain departments use FAACS to track grant-funded assets. Because FAACS is used as the basis for the capital asset balances in the City's financial statements, assets that are below the capitalization thresholds are also reported. Furthermore, a complete physical inventory of the City's capital assets has not been performed since fiscal year 2001.

We recommend the City establish procedures to exclude assets below the capitalization thresholds for financial reporting purposes. Furthermore, management should emphasize the timely removal of demolished or disposed assets from the capital asset listing. The City should also periodically conduct a complete physical inventory of its capital assets.

*Management Response*

The Controller's Office will continue to provide guidance to departments regarding the City's capitalization thresholds and the process for retiring assets upon disposal or demolition. We will also work with departments to determine alternate means of tracking grant-funded capital assets that are less than the City's capitalization thresholds. Also, the Controller's Office will work with City departments to determine an approach for performing a physical inventory of fixed assets given our limited resources.

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**CURRENT YEAR RECOMMENDATIONS (Continued)**

**2009-07 Net Assets Calculation**

*Control Deficiency*

The Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, classifies net assets in three components: invested in capital assets, net of related debt; restricted; and unrestricted.

The results of our audit procedures identified the following misclassifications of net assets:

- \$126.6 million of net assets invested in capital assets, net of related debt was incorrectly classified as unrestricted net assets, due to a spreadsheet error that was subsequently corrected by the City.
- \$17.2 million of unamortized debt issuance costs were erroneously included in the calculation of net assets invested in capital assets, net of related debt. The GASB’s implementation guidance related to the accounting treatment of issuance costs was updated in 2008 to specify such costs should be included as part of unrestricted net assets.

In addition, the City issues debt that may be intended for capital and non-capital purposes (e.g. affordable housing), and allocates the related proceeds to the appropriate net assets component based on their specific uses. While specific allocation is permitted, the City may for efficiency purposes consider the entire amount of the bond proceeds capital-related unless a significant portion of the proceeds is spent for noncapitalizable purposes.

Many of the governmental accounting issues have become increasingly complex and require extensive expertise and knowledge of the accounting system to ensure that the accounting and reporting are accurate and in accordance with applicable standards. Recent and continuing retirements and staff cuts limit the Controller’s Office’s capacity to plan for and implement new GASB requirements. Those requirements are intended to reduce the risk of financial error and improve accounting and financial reporting efficiency. Further, the added workload on the remaining Controller’s Office staff increases the potential risk of financial accounting and reporting errors. It also could result in losses in productivity and effectiveness in the event that these employees become incapacitated or leave City employment. Finally, if the accounting and reporting units in other City departments are experiencing similar reductions, the risks of financial accounting and reporting errors to the City will be more acute.

We recommend the Controller’s Office continue its cross-training program efforts and implement succession plans to broaden staff’s skill sets and reduce the risks of interruptions during normal business operations. This will also strengthen internal controls by establishing an additional level of review. We also recommend that City staff stay abreast of changes in accounting pronouncements and guidance.

*Management Response*

The Controller’s Officer agrees in concept with the recommendation, however due to projected budget deficits, we are unable to replace all staff who have retired, including one who was responsible for training. The Controller’s Office has the latest GASB annual subscription service and continues to review it as time permits with the staff time available. In addition, the spreadsheet error that was identified would have been found in our normal review process. However, due to timing constraints, we provided the audit staff the spreadsheet before we finished our review. We noted the error and made the correction to the draft statements. Going forward we will implement a process whereby we identify the higher risk areas and implement an appropriate level of review to ensure that material adjustments are identified and corrected in a timely manner.

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**CURRENT YEAR RECOMMENDATIONS (Continued)**

**2009-08 Internal Control over Inter-Department Billings**  
*Control Deficiency*

Throughout the year, City departments often use the services of other City departments. The departments enter into an inter-departmental agreement to specify the terms of services to be provided, which also prompts the Controller's Office to set up the budgeted costs in a work order in the City's general ledger system FAMIS. Throughout the year, the provider department bills the user department for services provided and applies payments to the work order.

As part of the year-end closing process, the Controller's Office reviews the fiscal year's billings against the work order budgets to check whether all services provided have been billed in the correct fiscal year. However, there are instances where departments provide services to user departments prior to signing an inter-department agreement or setting up a work order. Once the agreement is signed and a work order is established, then the provider department will bill and recover the costs from the user department.

During our audit, we noted the following:

- Two inter-departmental transactions totaling \$814,421 in the Department of Public Health (DPH) were incurred in the fiscal year ended June 30, 2008 but recorded in the fiscal year ended June 30, 2009. These transactions represent charges for one month of health services provided by the City's clinics.
- The Children and Families Commission did not record a receivable due from the City's Department of Children, Youth and their Families (DCYF) in the amount of \$234,742 for program expenditure recoveries in the prior year. It also did not record a liability (payable) due to the DCYF in the amount of \$410,777 for services rendered during the current fiscal year related to the Bachelors of Arts Bonus program.

As part of the year-end closing process, management should ensure that all billings from other City departments are reconciled with the inter-department agreements and that variances are appropriately reviewed. In addition, management should make estimated accrual of billings for those departments where experience has indicated a lag in the billings from the provider department. This will help ensure all inter-department transactions for services rendered or received are captured in the proper reporting period.

*Management Response*

The Department of Public Health concurs with the recommendation. To ensure all inter-governmental transactions for services rendered or received are captured in the proper reporting period, DPH plans to review all inter-departmental agreements and billings at year-end and make the appropriate accruals based on sound estimates.

For fiscal year 2009-2010, the Children and Families Commission staff will improve the year-end process for reviewing all payments for inter-departmental work orders. We will model this procedure after the one currently in place for reviewing year-end grant payments. Each work order will be reviewed individually to ensure that all payments from July 2009 to June 2010 have either been processed or accounted for with a year-end journal entry.

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**CURRENT YEAR RECOMMENDATIONS (Continued)**

**2009-09 Reporting of Investment Transactions**

*Other Matter*

When investments are purchased, there are two key dates involved in the transactions: trade date and settlement date. Trade date is the date that the order is executed in the market. Settlement date is when the transfer of shares is made between the two parties. The amount of time between the trade date and the settlement date differs from one security to another. The GASB Comprehensive Implementation Guide states that investment transactions should be accounted for based on the trade date. The trade date is the date on which the transaction occurred and is the date the government is exposed to (or released from) the rights and obligations of the ownership of the instrument.

The Office of the Treasurer records its investment transactions using the settlement date because it manages investment activities based on when funds are settled in the City's account. Due to the timing difference between the trade and settlement dates, investment transactions may not be recorded in the appropriate accounting period.

For year-end financial reporting purposes, the Treasurer's Office should track and reconcile investment trades that are executed before but settled after year-end to ensure transactions are reported in accordance with accounting principles generally accepted in the United States of America.

*Management Response*

The Office of the Treasurer concurs with the recommendation and will implement the new process for the fiscal year 2010 audit.

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**CURRENT YEAR RECOMMENDATIONS (Continued)**

**Single Audit**

**2009-10 Subrecipient Monitoring**

Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program (CFDA No. 16.580)

HIV Emergency Relief Project Grants (CFDA No. 93.914)

HIV Prevention Activities – Health Department Based (CFDA No. 93.940)

*Control Deficiency*

Under the requirements of the Single Audit Act Amendments of 1996 and OMB Circular A-133, the primary recipient of federal awards must monitor its subrecipients to determine whether the subrecipients have expended the awards in accordance with applicable laws and regulations. Furthermore, OMB Circular A-133 provides that the primary recipient should, among other things, determine whether the subrecipients have met the audit requirements of OMB Circular A-133, if applicable.

Subrecipients who expend federal awards of \$500,000 or more in a fiscal year are required to have single audits in accordance with OMB Circular A-133. The City, as the primary recipient, is required to ensure that such audits are performed, and must issue a management decision on audit findings within six months after receipt of the subrecipients' audit reports and ensure that the subrecipients take appropriate and timely corrective action.

The Department of Public Health (DPH) follows the Citywide Fiscal and Compliance Nonprofit Monitoring Guidelines and engages the City Services Auditor (CSA) to assist in subrecipient monitoring by compiling findings of selected subrecipients. DPH program managers collect single audit reports from subrecipients throughout the year and upload the reports to a centralized database. The CSA reviews the uploaded reports and compiles the subrecipient report findings into one document on an annual basis. The DPH will then follow up with the respective subrecipients on corrective actions taken. The timing of this process does not allow the DPH to issue management decisions on subrecipient audit findings within the required timeframe (six months after the receipt of the reports).

During our testing of the City's compliance with subrecipient monitoring requirements, we noted that for 2 out of 38 subrecipients tested from a total population of 104 subrecipients for the 3 programs cited above, the DPH did not issue management decisions of audit findings noted in the subrecipients' single audit reports within the required timeframe.

We recommend the City increase the frequency of its reviews of the subrecipients' single audit reports and issue a decision on audit findings monthly to ensure compliance with OMB's subrecipient monitoring requirements.

*Management Response*

DPH concurs. DPH will review its procedures to increase the frequency of reviews of subrecipient single audit reports and decisions on audit findings to ensure compliance with OMB's subrecipient monitoring requirements.

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**CURRENT YEAR RECOMMENDATIONS (Continued)**

**Other Observations and Informational Items**

**2009-11 Economic Factors Affecting Financial Reporting**  
*Informational*

The City continues to face a myriad of challenges stemming from the current downturn in the economy. To make matters worse, as the City learns to work with current resource limitations, it is facing increasing demands due to increased regulatory and operational requirements. Examples of recent changes on the regulatory front include Governmental Accounting Standards Board (GASB) No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*; additional reporting requirements under section 1512 of the American Recovery and Reinvestment Act of 2009 (Recovery Act); new IRS regulation on required withholding on payments greater than \$10,000; and Federal Trade Commission (FTC) "Red Flags" rules on developing, implementing, and administering identity theft prevention programs. Furthermore, the City is facing unprecedented fiscal operating challenges related to tightening credit markets, altering employees' roles and responsibilities in response to recent layoffs and staff reductions; and addressing funding challenges with its pension and other postemployment benefit obligations. As the City considers service and administrative reductions in the current environment, such actions should be balanced with the City's need for ongoing monitoring and assessment of risks facing the City.

In light of the many regulatory and operational changes affecting the City, we recommend the City perform a comprehensive, coordinated City-wide risk assessment of key business processes and evaluate related controls over financial reporting. Risk assessment is a fundamental part of a good internal control system and will help identify areas where the City has significant exposure. The information gained from the risk assessment process will prove vital to executive management and the Board of Supervisors in making decisions and determining how best to direct the City's limited resources. The effort should be led by the Controller's Office and supported by leadership from the various City departments.

*Management Response*

The Controller's Office will perform a City-wide risk assessment of key business processes and is currently evaluating the internal controls of City departments.

**2009-12 American Recovery and Reinvestment Act**  
*Informational*

The American Recovery and Reinvestment Act of 2009 (Recovery Act) provides approximately \$300 billion dollars in additional federal funds which will be passed down from federal agencies to state and local governments and institutions of higher education. These federal funds are intended to either supplement existing federal programs, create new programs, or to provide more broad fiscal relief.

The Recovery Act mandates that there be an unprecedented amount of oversight and transparency over the spending of all funds associated with it. The Office of Management and Budget (OMB) set up a web site to be the central point for the transparency part of the mandate. Also, the OMB issued guidance to the federal agencies regarding how they should carry out programs and activities relating to the Recovery Act that promotes timeliness and accountability.

**CITY AND COUNTY OF SAN FRANCISCO**  
Report to Government Audit and Oversight Committee  
For the Year Ended June 30, 2009

**CURRENT YEAR RECOMMENDATIONS (Continued)**

**2009-12 American Recovery and Reinvestment Act (Continued)**

The OMB guidance addresses many issues and responsibilities including the following:

- Recipients are required to clearly distinguish Recovery Act funds from non-Recovery Act funds.
- New programs or existing programs that have significant changes in compliance requirements will be identified with a new Catalog of Federal Domestic Assistance (CFDA) number.
- Federal agencies designated Recovery Act programs as high-risk for single audit purposes.
- Extensive quarterly reporting to federal agencies may be required from recipients of Recovery Act funding, which will be due within 10 days of each calendar quarter-end.
- Federal agencies are required to initiate additional oversight to address the unique implementation risks of the Recovery Act. The expectation in this area is that federal agencies will establish defined strategies to prevent or timely detect waste, fraud, or abuse.
- Federal agencies will also use the single audit process as a means of promoting accountability for Recovery Act funds.
- The Federal Audit Clearinghouse (FAC) is required to make publicly available on the internet all single audit reports filed with the FAC for fiscal years ended September 30, 2009, and later.

Based on the information above, it is clear Recovery Act funds will have a significant impact on your single audit. While the Recovery Act may not have an immediate impact on the City's single audit for the year ended June 30, 2009, it is likely that it will have a significant impact over the following two fiscal years. Therefore, the City should be in the process of planning and assessing risks associated with the receipt, spending and reporting of Recovery Act funds. Specifically, you should consider the following:

- Whether control procedures in place over federal expenditures are appropriate, operating effectively, designed to detect and prevent unallowable expenditures, and to detect or prevent fraud and abuse.
- Whether the existing staffing resources are adequate to address the increased reporting and monitoring requirements as a result of the Recovery Act. The City should also identify individual(s) who will monitor requirements and provide consistent guidance to the organization.
- Whether additional controls and system requirements will be needed to ensure that Recovery Act funds can be separately identified and tracked.
- Whether new controls will need to be established to meet the stringent reporting requirements to federal agencies.
- If Recovery Act funds will be passed down to subrecipients, whether controls are in place to ensure appropriate subrecipient monitoring and also whether any new controls will need to be established related to new subrecipient reporting responsibilities.

*Management Response*

The City did receive Recovery Act funding for the fiscal year ended June 30, 2009, and began quarterly reporting for the quarter ended September 30, 2009 for all federal direct grants. For other Recovery Act grants, federal and activity reports are submitted instead to prime recipients, primarily the State of California, that have awarded funds to the City as a subrecipient. These reports are submitted to prime recipients in the manner outlined in the terms and conditions of each grant for which the City is a subrecipient. The Controller's Office is monitoring the federal requirements and providing support and guidance to departments that receive the Recovery Act funds, and will continue to assess risks associated with the receipt, spending and reporting of those funds and all other federal funds received by the City.

**CITY AND COUNTY OF SAN FRANCISCO**  
Report to Government Audit and Oversight Committee  
For the Year Ended June 30, 2009

**STATUS OF PRIOR YEAR RECOMMENDATIONS**

<b>Reference Number: 2008-01 Risk Assessment and Monitoring over Financial Reporting</b>	
Recommendation	The City has a fiduciary responsibility as a steward of public funds. We recommend the City perform a comprehensive risk assessment analysis and document its internal control policies and procedures that address the identified risks.
Status of Corrective Action:	See current year comment 2009-12.
<b>Reference Number: 2008-02 Information Technology Governance</b>	
Finding/Comment:	<p>The City operates under a decentralized structure wherein departments independently establish information technology policies and procedures according to their operations. As a result, variations exist in IT policies and procedures among City departments.</p> <p>We recommend that the Committee on Information Technology (COIT) prioritize the drafting and release of formal information technology policies and procedures to be used as a guideline by all City departments to establish basic level IT controls citywide.</p>
Status of Corrective Action:	The City agrees and this recommendation has been implemented. The COIT Architecture subcommittee has developed a workplan that prioritizes the drafting and release of formal information technology policies and procedures to be used by all City departments to establish basic IT controls.
<b>Reference Number: 2008-03 Monitoring of Network Activities</b>	
Finding/Comment:	During fiscal year 2008, the Department of Technology (DT) was temporarily locked out of a portion of the City's wide-area network (WAN) and could not make changes to network configurations during the lock-out period. We recommend that DT evaluate the circumstances causing the lock-out and design procedures to mitigate the risk of similar events occurring in the future.
Status of Corrective Action:	The City agrees and this recommendation has been implemented by taking action to remediate the situation and mitigate the risk of similar events in the future.
<b>Reference Number: 2008-04 Maintenance of Subsidiary Records</b>	
Finding/Comment:	The San Francisco General Hospital (SFGH) has agreements with Medicare and Medi-Cal that provide reimbursement to SFGH based on established rates. Our audit noted that the spreadsheet prepared by staff to estimate related liabilities did not support the nature and reasons for the deferred credit liability recorded in the City's financial statements. We recommend that management review the spreadsheet for accuracy.
Status of Corrective Action:	Implemented.



**CITY AND COUNTY OF SAN FRANCISCO**  
Report to Government Audit and Oversight Committee  
For the Year Ended June 30, 2009

**STATUS OF PRIOR YEAR RECOMMENDATIONS (Continued)**

<b>Reference Number:</b>	<b>2008-05 Summer Food Service Program for Children (CFDA no. 10.559) Procurement Requirement</b>
Finding/Comment:	During our single audit, we noted the Department of Children, Youth, and their Families (DCYF) incorrectly categorized a service provider as a subrecipient instead of a vendor. DCYF should follow the guidance in Circular A-133 in determining whether service providers should be treated as subrecipients or vendors. Management may also consult the federal granting agency for assistance in making such determination.
Status of Corrective Action:	Implemented.
<b>Reference Number:</b>	<b>2008-06 New Government Accounting Standard – GASB No. 53 <i>Accounting and Financial Reporting for Derivative Instruments</i></b>
Finding/Comment:	GASB Statement No. 53 specifically requires most derivative instruments to be measured at fair value, which may significantly change the City's accounting treatment of its derivative instruments. We recommend that the City begin its evaluation of the reporting requirements of this new standard.
Status of Corrective Action:	In progress. The Controller's Office and affected departments continue to evaluate the impacts of this Statement.
<b>Reference Number:</b>	<b>2008-07 New Government Accounting Standard – GASB No. 54 <i>Fund Balance Reporting and Governmental Fund Type Definitions</i></b>
Finding/Comment:	This Statement significantly changes the accounting and financial reporting for the City's fund balance classifications and categorization of individual funds. The Controller's Office should begin working with departments to evaluate the purpose of established governmental funds and related restrictions on revenues sources.
Status of Corrective Action:	In progress. The Controller's Office is evaluating the impacts of this Statement.
<b>Reference Number:</b>	<b>2007-02 Improvements in Financial Reporting</b>
Finding/Comment:	The City's reporting process is highly complex. We noted several areas where financial reporting could be improved.
Status of Corrective Action:	Implemented. The City has evaluated and implemented recommendations based on a cost-benefit analysis.

CITY AND COUNTY OF SAN FRANCISCO  
Report to Government Audit and Oversight Committee  
For the Year Ended June 30, 2009

**STATUS OF PRIOR YEAR RECOMMENDATIONS (Continued)**

<b>Reference Number:</b>	<b>2007-03 Monitoring of Decentralized Cash Collection Points</b>
Finding/Comment:	Due to the decentralized organizational structure of the City, each City department is responsible for monitoring its cash collection locations to ensure adequate internal controls are in place to prevent embezzlement. We recommend that the management develop a comprehensive list of cash collection points and develop procedures to ensure that offsite locations have appropriate controls in place.
Status of Corrective Action:	In process. During the past year, the Treasurer and Tax Collector's Office has compiled a comprehensive list of bank depository information and the City has been working on identifying all decentralized cash collection points. The Controller's Office is also in process of developing a monitoring plan.
<b>Reference Number:</b>	<b>2006: Pollution Remediation Obligations</b>
Finding/Comment:	GASB issued Statement No. 49, <i>Accounting and Financial Reporting for Pollution Remediation Obligations</i> which addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations. This Statement is effective for the fiscal year ending June 30, 2009.
Status of Corrective Action:	Implemented. The City adopted the provisions of GASB Statement No. 49 for the fiscal year ended June 30, 2009.
<b>Reference Number:</b>	<b>Port 2008-01 Controls over Materials and Supplies</b>
Finding/Comment:	Certain findings involving internal controls over materials and supplies inventories were identified as a result of the audit.
Status of Corrective Action:	In Progress. The City Services Auditor completed a detailed review of the Port Maintenance Division's inventory controls in March 2008. Port management has been working to implement audit recommendations.

**CITY AND COUNTY OF SAN FRANCISCO**  
 Report to Government Audit and Oversight Committee  
 For the Year Ended June 30, 2009

**UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS**

Index	Fund Type	Description	BALANCE SHEET / STATEMENT OF NET ASSETS				INCOME STATEMENT					
			Assets		Liabilities		Net Assets		Revenue		Expenses	
			DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)
GF 1	General Fund General Fund	General City Responsibility Expense Accounts Payable <i>To accrue unemployment insurance reimbursement charge for the 4th quarter</i>	\$ -	\$ -	\$ -	(2,121,817)	\$ -	\$ -	\$ -	\$ -	\$ -	2,121,817
		<b>TOTAL GENERAL FUND</b>	\$ -	\$ (2,121,817)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	2,121,817
NM 1	Special Revenue Fund Special Revenue Fund Special Revenue Fund Special Revenue Fund	Advance to Component Unit Due from Component Unit Fund balance reserved for assets not available for appropriation Unreserved fund balance <i>To adjust loan to TIDA as long term</i>	\$ 2,271,000 (2,271,000)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
		<b>TOTAL NONMAJOR GOVERNMENTAL FUNDS</b>	\$ 2,271,000	\$ (2,271,000)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
GH 1	San Francisco General Hospital San Francisco General Hospital	Other operating revenues Contractual services <i>To eliminate the gross up of revenue and expenses related to DPH - AIDS Office use of UCSF.</i>	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,799,613	\$ -	\$ -	(2,799,613)
GH 2	San Francisco General Hospital San Francisco General Hospital	Inventories Materials & Supplies Cost <i>To adjust year end inventory to pharmacy in-patient count</i>	585,396	-	-	-	-	-	-	-	-	(585,396)
GH 3	San Francisco General Hospital San Francisco General Hospital	Net Assets Rents and Concessions Revenue <i>To recognize Gladstone settlement in period incurred</i>	-	-	-	(639,000)	-	-	639,000	-	-	-
GH 4	San Francisco General Hospital San Francisco General Hospital San Francisco General Hospital	Charges for services receivable, net Net patient service revenue Deferred credits (third party liabilities) <i>To adjust net patient service revenues and related accounts based on audit analysis of A/R and Third Party liabilities.</i>	3,500,000 400,000	-	-	-	-	-	-	(3,900,000)	-	-
		<b>TOTAL SAN FRANCISCO GENERAL HOSPITAL</b>	\$ 4,485,396	\$ -	\$ -	\$ (639,000)	\$ -	\$ (639,000)	\$ (461,387)	\$ -	\$ -	(3,385,009)

**CITY AND COUNTY OF SAN FRANCISCO**  
 Report to Government Audit and Oversight Committee  
 For the Year Ended June 30, 2009

**UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS (Continued)**

Index	Fund Type	Description	BALANCE SHEET / STATEMENT OF NET ASSETS		INCOME STATEMENT					
			Assets DR (CR)	Liabilities DR (CR)	Net Assets DR (CR)	Revenue DR (CR)	Expenses DR (CR)			
GF 1	General Fund General Fund	General City Responsibility Expense Accounts Payable <i>To accrue unemployment insurance reimbursement charge for the 4th quarter</i>	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
GA 1	Governmental Activities Governmental Activities	General Liability Legal Expense <i>To correct over accrual for large cases excluded from actuary report</i>	-	(6,921,000)	-	-	-	-	-	6,921,000
GA 2	Governmental Activities Governmental Activities Governmental Activities Governmental Activities Governmental Activities Governmental Activities Governmental Activities	Accumulated Depreciation - Building Accumulated Depreciation - Equipment Accumulated Depreciation - Infrastructure Beginning Net Assets Building Equipment Infrastructure Depreciation Expense <i>To remove capital assets below City threshold</i>	3,863,539 7,524,783 410,228 (6,173,789) (7,342,799) (2,991,281)	-	5,147,654	-	-	-	-	(238,335)
<b>TOTAL GOVERNMENTAL ACTIVITIES</b>			<b>\$ (4,909,319)</b>	<b>\$ (9,042,817)</b>	<b>\$ 5,147,654</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 8,804,482</b>	
<b>TOTAL BUSINESS-TYPE ACTIVITIES</b>			<b>\$ 4,485,396</b>	<b>\$ -</b>	<b>\$ (639,000)</b>	<b>\$ (461,387)</b>	<b>\$ (461,387)</b>	<b>\$ (3,385,009)</b>	<b>\$ (3,385,009)</b>	



KPMG LLP  
55 Second Street  
San Francisco, CA 94105

**Report on Internal Control over Financial Reporting and on Compliance and Other  
Matters Based on an Audit of Financial Statements Performed in Accordance with  
*Government Auditing Standards***

The Honorable Mayor, Board of Supervisor,  
and San Francisco Municipal Transportation Agency Board of Directors  
City and County of San Francisco, California:

We have audited the financial statements of the San Francisco Municipal Transportation Agency (SFMTA) of the City and County of San Francisco, California (the City) as of and for the year ended June 30, 2009, and have issued our report thereon dated November 24, 2009. 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 SFMTA's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SFMTA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of SFMTA's internal control over financial reporting.

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

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

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether SFMTA'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*.

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

This report is intended solely for the information and use of the Mayor, Board of Supervisors, San Francisco Municipal Transportation Agency Board of Directors, and management, and is not intended to be and should not be used by anyone other than these specified parties.

**KPMG LLP**

November 24, 2009

**2009-01 Lack of Controls over Inventory Count Process**

***Criteria***

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.

***Condition***

In performing an inventory count at the Green Warehouse on May 16, 2009, the count of stock code 024-10-0622 (Motor) was erroneously recorded by the warehouse personnel to be 32 items on hand, when the warehouse in fact had 6 items at the point of count.

Additionally, it was noted that approximately half of the counters of the Green Warehouse were also employed at the Green Warehouse, and for two of the five days, the count was supervised by two Green Warehouse supervisors.

***Cause***

Adequate controls over the inventory count process were not in place at the Green warehouse which could cause an error in the inventory count process.

***Recommendation***

In performing the inventory count in warehouses, the warehouse management should implement general controls to prevent errors in recording the count.

***Management Response***

This observation reflects a problem where the counter did not observe the process established in the Inventory Instructions, to only count what is actually observed. In this instance, the maintenance Rebuild shop rebuilds a motor unit and does a "turn in" to the parts counter so it can be entered into the inventory system. Due to the part size and a lack of space in the Green Storeroom, many of the rebuilt items are located in the shop. When the maintenance department is in need of a rebuilt item stored in the shop, the item is taken and the storeroom is informed of a work order number for the item to be issued. The counter observed 6 of the (024-10-0622) Rebuilt PCC Motors in the Maintenance department. He had prior knowledge of more than six and wrote the number he recalled instead of what he actually observed.

It has been the practice to utilize Muni storekeepers to conduct inventories, a process that enhances accuracy as the staff is familiar with the various parts. If the counter is familiar with the storeroom inventory, identification of an incorrectly placed part is facilitated. As a control measure, the staff conducting the actual count is not responsible for entering any of the data in the system.

With the goal of stricter controls, all counting staff will be trained in advance to comply with all Inventory Count Instructions, including counting only what is observed. Training sessions will include classroom instruction and practice counts to assure understanding and compliance with written instructions.

**2009-2. Lack of Control over the Review of Financial Statements**

***Criteria***

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.

***Condition***

The process of preparing the yearend financial statements includes performing a number of nonroutine steps, as well performing reviews of the resulting financial statements. During the current year we noted the following errors in the draft financial statements;

- A self-insurance adjustment was noted late in the process. Management should identify items earlier in the closing process and assign an accounting staff to ensure that the self-insurance related entries are properly recorded in the financial statements.
- As this was the first year complete MTA financial statements were compiled to be audited, several policy decisions had to be researched and made. However, \$114 million of cash received from fines, forfeitures, penalties and other was misclassified as non-capital financing activities in the statement of cash flows. Although such amounts were correctly presented on the statement of revenues, expenditures, and changes in net assets, different definitions are used for the statement of cash flows.

***Cause***

Nonroutine transactions and disclosures were not appropriately reviewed during the preparation of the yearend financial statements.

***Recommendation***

When preparing financial statements, management should perform a thorough review of the information to ensure the amounts are properly captured and classified in the financial statements.

***Management Response***

- SFMTA management has historically performed review and evaluation of the agency's workers compensation data to ensure that the information is complete and accurately reflected in the agency's financial statements. This quality control review procedure would have also normally been performed at FY2009 fiscal year end had it not been for the retirement of the manager in the unit. Going forward, SFMTA management will ensure that the quality control review procedure is performed and properly documented regardless of staff changes. In addition, SFMTA will continue to work with the Controller's Office to ensure the reconciliation process is completed.



## Appendix A

- Given that FY2009 is the first year that SFMTA is issuing a consolidated financial report that includes the operations of MUNI, Parking and Traffic, and the Parking Garages, SFMTA management is very pleased that only two findings related to the financial statement presentation were identified. SFMTA correctly recorded the fines, forfeitures, penalties and others in the statement of revenues, expenditures and net assets while inadvertently misclassifying the cash from the same source as non-capital financing activities in the statement of cash flows. This is an oversight and SFMTA will ensure that proper review will be performed to avoid this from recurring in the future.





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SACRAMENTO

OAKLAND

LOS ANGELES

NEWPORT BEACH

SAN DIEGO

The Honorable Mayor Gavin Newsom  
 The Honorable Members of the Board of Supervisors  
 City and County of San Francisco

**Independent Auditor's Report**

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City and County of San Francisco, California (City), as of and for the year ended June 30, 2009, 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 did not audit the financial statements of the San Francisco International Airport, San Francisco Water Enterprise, Hetch Hetchy Water and Power, San Francisco Municipal Transportation Agency, San Francisco Wastewater Enterprise, San Francisco Market Corporation, City and County of San Francisco Finance Corporation, and the Health Service System, which collectively represent the following percentages of assets, net assets/fund balances and revenues/additions as of and for the year ended June 30, 2009.

Opinion Unit	Assets	Net Assets/ Fund Balances	Revenues/ Additions
Governmental activities	2%	15%	0%
Business-type activities	91%	85%	71%
Aggregate remaining fund information	3%	0%	8%

Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based solely on the reports of the other auditors. The prior year partial and summarized comparative information has been derived from the City's 2008 basic financial statements and, in our report dated January 30, 2009, we expressed unqualified opinions, based on our audit and the reports of other auditors, on the respective financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information.

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

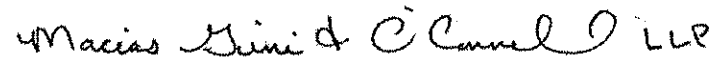
In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City as of June 30, 2009, and the respective changes in financial position and, where applicable, cash flows thereof, and the respective budgetary comparison for the General Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2(r) to the basic financial statements, effective July 1, 2008, the City adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*.

The financial statements include partial or summarized prior year comparative information. Such prior year information does not include all of the information required to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the City's basic financial statements for the year ended June 30, 2008, from which such partial or summarized information was derived.

The management's discussion and analysis and schedules of funding progress listed in the accompanying 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 and the other auditors 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 and the other auditors did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The introductory section, combining fund financial statements and schedules and the statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining fund financial statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied by us in the audit of the basic financial statements and, accordingly, we express no opinion on them.

  
Certified Public Accountants

Walnut Creek, California  
December 23, 2009

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the City and County of San Francisco's (the City) Comprehensive Annual Financial Report (CAFR) presents a narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2009. We encourage readers to consider the information presented here in conjunction with additional information in our transmittal letter. Certain amounts presented as 2007-2008 summarized comparative financial information in the basic financial statements have been reclassified to conform to the presentation in the 2008-2009 basic financial statements.

### FINANCIAL HIGHLIGHTS

The assets of the City exceeded its liabilities at the end of the fiscal year by approximately \$6.07 billion (net assets). Of this amount, the City's unrestricted net assets, decreased from \$229.5 million to a deficit of \$165.2 million.

The government's total net assets decreased by \$368.1 million or 5.7 percent over the previous fiscal year. Within the \$368.1 million, the government's total capital assets net of related debt and restricted assets increased by \$71.6 million, which includes a \$15.5 million decrease related to an adjustment to beginning net assets of the business-type activities, and were offset by a \$394.7 million decrease in unrestricted net assets. A significant portion of the decrease in unrestricted net assets is due to recognition of \$301.3 million other postemployment benefit expense and \$33.5 million pollution remediation liabilities in the current fiscal year, of which \$27.5 million was reported as an adjustment to beginning net assets as a result of the implementation of the new pollution remediation accounting standard.

The City's governmental funds reported total revenues of \$3.68 billion; an \$8.2 million or 0.2 percent slight increase over the prior year. The growth in property tax revenues of \$92.7 million and the growth in federal and state grant revenues of approximately \$49.2 million were largely offset by declines in other local taxes and other revenues. Governmental funds expenditures totaled \$3.65 billion for this period, a \$109.4 million or 3.1 percent increase, reflecting increases in cost of living and growth in demand for government services.

At the end of the fiscal year, the City's General Fund had an unreserved fund balance of \$28.2 million, representing 1.2 percent of total General Fund expenditures of \$2.41 billion. The General Fund's unreserved fund balance decreased by 63.4 percent from the prior year amount of \$77.1 million. Factors contributing to this decline include a moderate decrease in total revenue, increase in demand for services and the City's related use of fund balances.

The City's total long-term debt, including all bonds, loans, commercial paper and capital leases increased by \$454.9 million during this fiscal year. The City issued a total of \$963.9 million in debt. Of this amount, \$175.5 million was for general obligation bonds for improvement works for the San Francisco General Hospital, clean and safe neighborhood parks as well as Seismic Safety Loan Program. A total of \$163.3 million in certificates of participation for the Laguna Honda Hospital were issued for the construction and improvement of the Laguna Honda Hospital. The City also issued a total of \$118.1 million General Obligation Bonds to refund the variable rate General Obligation Bonds (Laguna Honda Hospital) and a total of \$145.3 million in Lease Revenue Refunding bonds to refund the variable rates Lease Revenue Bonds (Moscone Center Expansion Project). In addition, the San Francisco International Airport issued a total of \$314.9 million Revenue Refunding Notes to refund various variable rate demand bonds.

## OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components: (1) **Government-wide** financial statements, (2) **Fund** financial statements, and (3) **Notes** to the financial statements. This report also contains other **supplementary information** in addition to the basic financial statements themselves. These various elements of the Comprehensive Annual Financial Report are related as shown in the graphic below.

### Organization of City and County of San Francisco Comprehensive Annual Financial Report

<b>CAFR</b>	Introductory Section	<b>INTRODUCTORY SECTION</b>			
	+				
	Financial Section	<b>Management's Discussion and Analysis</b>			
		<b>Government-wide Financial Statements</b>	<b>Fund Financial Statements</b>		
		Statement of net assets	<b>Governmental Funds</b>	<b>Proprietary Funds</b>	<b>Fiduciary Funds</b>
			Balance Sheet	Statement of net assets	Statement of fiduciary net assets
		Statement of activities	Statement of revenues, expenditures, and changes in fund balances	Statement of revenues, expenses, and changes in fund net assets	Statement of changes in fiduciary net assets
			Budgetary comparison statement	Statement of cash flows	
		Notes to the Financial Statements			
		<b>Required Supplementary Information Other Than MD&amp;A</b>			
Information on individual non-major funds and other supplementary information that is not required					
+					
Statistical Section	<b>STATISTICAL SECTION</b>				

The following figure summarizes the major features of the financial statements. The overview section below also describes the structure and contents of each of the statements in more detail.

	Government-wide Statements	Fund Financial Statements		
		Governmental	Proprietary	Fiduciary
<b>Scope</b>	Entire entity (except fiduciary funds)	The day-to-day operating activities of the City for basic governmental services	The day-to-day operating activities of the City for business-type enterprises	Instances in which the City administers resources on behalf of others, such as employee benefits
<b>Accounting basis and measurement focus</b>	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus	Accrual accounting and economic resources focus; except agency funds do not have measurement focus
<b>Type of asset and liability information</b>	All assets and liabilities, both financial and capital, short-term and long-term	Current assets and liabilities that come due during the year or soon thereafter	All assets and liabilities, both financial and capital, short-term and long-term	All assets held in a trustee or agency capacity for others
<b>Type of inflow and outflow information</b>	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during the year or soon thereafter; expenditures when goods or services have been received and the related liability is due and payable	All revenues and expenses during year, regardless of when cash is received or paid	All additions and deductions during the year, regardless of when cash is received or paid

#### Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The **statement of net assets** presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether or not the financial position of the City is improving or deteriorating.

The **statement of activities** presents information showing how the City's 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 only result in cash flows in future fiscal periods, such as revenues pertaining to uncollected taxes and expenses pertaining to earned but unused vacation and sick leave.

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include public protection, public works, transportation and commerce, human welfare and neighborhood development, community health, culture and recreation, general administration and finance, and general City responsibilities. The business-type activities of the City include an airport, port, public transportation systems (including parking), water and power operations, an acute care hospital, a long-term care hospital, sewer operations, and a produce market.

The government-wide financial statements include not only the City itself (known as the primary government), but also a legally separate redevelopment agency, the San Francisco Redevelopment Agency, and a legally separate development authority, the Treasure Island Development Authority (TIDA), for which the City is financially accountable. Financial information for these component units is reported separately from the financial information presented for the primary government. Included within the governmental activities of the government-wide financial statements are the San Francisco County Transportation Authority and San Francisco Finance Corporation. Included within the business-type activities of the government-wide financial statements is the operation of the San Francisco Parking Authority. Although legally separate from the City, these component units are blended with the primary government because of their governance or financial relationships to the City.

#### Fund Financial Statements

The fund financial statements are designed to report information about groupings of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into the following three categories: **governmental funds**, **proprietary funds**, and **fiduciary funds**.

**Governmental funds.** Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements - i.e. most of the City's basic services are reported in governmental funds. These statements, however, focus on (1) how cash and other financial assets can readily be converted to available resources and (2) the balances left at year-end that are available for spending. Such information may be useful in determining what financial resources are available in the near future to finance the City's programs.

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 this comparison between governmental funds and governmental activities.

The City maintains several individual governmental funds organized according to their type (special revenue, debt service, capital projects and permanent funds). Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances for the General Fund, which is considered to be a major fund. Data from the remaining governmental funds are combined into a single, aggregated presentation. Individual fund data for each of the non-major governmental funds is provided in the form of combining statements elsewhere in this report.



The City adopts an annually appropriated budget for its General Fund. A budgetary comparison statement has been provided for the General Fund to demonstrate compliance with this budget.

**Proprietary funds.** Proprietary funds are generally used to account for services for which the City charges customers - either outside customers, or internal units or departments of the City. Proprietary funds provide the same type of information as shown in the government-wide financial statements, only in more detail. The City maintains the following two types of proprietary funds:

- **Enterprise funds** are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for the operations of the San Francisco International Airport (SFO or Airport), Port of San Francisco (Port), San Francisco Water Enterprise (Water), Hetch Hetchy Water and Power (Hetch Hetchy), Municipal Transportation Agency (MTA), Laguna Honda Hospital, San Francisco General Hospital Medical Center, and the San Francisco Wastewater Enterprise (Wastewater), all of which are considered to be major funds of the City.
- **Internal Service funds** are used to report activities that provide supplies and services for certain City programs and activities. The City uses internal service funds to account for its fleet of vehicles, management information services, printing and mail services, and for lease-purchases of equipment by the San Francisco Finance Corporation. Because these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements. The internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of combining statements elsewhere in this report.

**Fiduciary funds.** Fiduciary funds are used to account for resources held for the benefit of parties outside the City. The City employees' pension and health plans, the external portion of the Treasurer's Office investment pool, and the agency funds are reported under the fiduciary funds. Since the resources of these funds are not available to support the City's own programs, they are not reflected in the government-wide financial statements. The accounting used for fiduciary funds is much like that used for proprietary funds.

#### **Notes to the Basic Financial Statements**

The 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**

In addition to the basic financial statements and accompanying notes, this report presents certain required supplementary information concerning the City's progress in funding its obligation to provide pension and other postemployment benefits to its employees.

#### **Combining Statements and Schedules**

The combining statements and schedules referred to earlier in connection with non-major governmental funds, internal service funds, and fiduciary funds are presented immediately following the required supplementary information on pensions and other postemployment benefits.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

### Net Assets June 30, 2009 (In thousands)

	Governmental activities		Business-type activities		Total	
	2009	2008	2009	2008 *	2009	2008 *
<b>Assets:</b>						
Current and other assets.....	\$ 1,982,121	\$ 1,905,426	\$ 2,106,943	\$ 2,109,649	\$ 4,089,064	\$ 4,015,075
Capital assets.....	3,028,915	2,931,077	9,460,894	9,148,394	12,489,809	12,079,471
Total assets.....	<u>5,011,036</u>	<u>4,836,503</u>	<u>11,567,837</u>	<u>11,258,043</u>	<u>16,578,873</u>	<u>16,094,546</u>
<b>Liabilities:</b>						
Noncurrent liabilities outstanding...	2,750,324	2,324,641	5,558,722	5,558,339	8,309,046	7,882,980
Other liabilities.....	955,509	926,806	1,248,969	851,355	2,204,478	1,778,161
Total liabilities.....	<u>3,705,833</u>	<u>3,251,447</u>	<u>6,807,691</u>	<u>6,409,694</u>	<u>10,513,524</u>	<u>9,661,141</u>
<b>Net assets:</b>						
Invested in capital assets, net of related debt **.....	1,725,203	1,436,842	4,017,577	3,935,008	5,443,483	5,371,850
Restricted.....	371,831	410,111	415,237	421,904	787,068	32,015
Unrestricted (deficit) **.....	<u>(791,831)</u>	<u>(261,897)</u>	<u>327,332</u>	<u>491,437</u>	<u>(165,202)</u>	<u>229,540</u>
Total net assets.....	<u>\$ 1,305,203</u>	<u>\$ 1,585,056</u>	<u>\$ 4,760,146</u>	<u>\$ 4,848,349</u>	<u>\$ 6,065,349</u>	<u>\$ 6,433,405</u>

\* The 2008 ending balances in the table above have not been restated as discussed in Note 2(f) to the basic financial statements.

\*\* In accordance with GASB implementation guidance, the City reclassified \$299.3 million of total net assets from invested in capital assets, net of related debt to unrestricted to reflect the primary government as a whole perspective.

### Analysis of Net Assets

Net assets may serve as a useful indicator of the government's financial position. At the end of fiscal year 2008-2009, the City's total net assets exceeded liabilities by \$6.07 billion.

The largest portion of the net assets reflects the City's \$5.4 billion investment in capital assets (e.g. land, buildings, and equipment) less any outstanding debt related to the acquisition of these assets. This is 89.8 percent of the City's total net assets, a 1.3 percent increase over the prior year, and is largely due to growth in net capital assets with the governmental activities as well as at the Laguna Honda Hospital, Hetch Hetchy, and Water, which are business-type activities of the City. Since the government uses capital assets to provide services, these assets are not available for future spending. Further, the resources required to pay the debt related to these assets must come from other sources since the capital assets themselves cannot be liquidated to pay that liability.

Another portion of the City's net assets, \$787.1 million (13.0 percent) represents restricted resources that are subject to external limitations regarding their use. The governmental activities have a \$791.8 million deficit in the unrestricted net asset component, due to an overall increase in expenses over revenues as well as the continual recognition of other postemployment benefit expense, in conformance and compliance with GASB Statement No. 45 requirements. Also contributing to the governmental activities deficit unrestricted net assets is \$299.3 million of long-term bonds used for the purpose of rebuilding and improving Laguna Honda Hospital (see Note 2 (k)). The business-type activities reported positive balances in all categories of net assets at the end of this fiscal year.

**Changes in Net Assets**  
**Year Ended June 30, 2009**  
(In thousands)

	Governmental activities		Business-type activities		Total	
	2009	2008	2009	2008	2009	2008
<b>Revenues</b>						
Program revenues:						
Charges for services.....	\$ 392,411	\$ 461,625	\$ 2,034,298	\$ 1,973,961	\$ 2,426,709	\$ 2,435,586
Operating grants and contributions.....	909,695	926,089	186,776	181,725	1,096,471	1,107,814
Capital grants and contributions.....	44,048	36,079	87,253	152,511	131,301	188,590
General revenues:						
Property taxes.....	1,302,071	1,189,511	-	-	1,302,071	1,189,511
Business taxes.....	388,653	396,025	-	-	388,653	396,025
Sales and use tax.....	172,794	190,967	-	-	172,794	190,967
Hotel room tax.....	214,460	219,089	-	-	214,460	219,089
Utility users tax.....	89,801	86,964	-	-	89,801	86,964
Other local taxes.....	126,017	155,951	-	-	126,017	155,951
Interest and investment income.....	35,434	57,929	49,691	67,217	85,125	125,146
Other.....	44,086	25,939	201,624	233,244	245,710	259,183
Total revenues.....	<u>3,719,470</u>	<u>3,746,168</u>	<u>2,559,642</u>	<u>2,608,658</u>	<u>6,279,112</u>	<u>6,354,826</u>
<b>Expenses</b>						
Public protection.....	1,109,311	1,020,457	-	-	1,109,311	1,020,457
Public works, transportation and commerce.....	254,955	342,411	-	-	254,955	342,411
Human welfare and neighborhood development.....	908,449	848,195	-	-	908,449	848,195
Community health.....	608,733	567,410	-	-	608,733	567,410
Culture and recreation.....	319,994	347,433	-	-	319,994	347,433
General administration and finance.....	238,601	250,295	-	-	238,601	250,295
General City responsibilities.....	72,634	80,887	-	-	72,634	80,887
Unallocated interest on long-term debt.....	93,387	97,694	-	-	93,387	97,694
Airport.....	-	-	683,335	651,581	683,335	651,581
Transportation.....	-	-	863,218	830,411	863,218	830,411
Port.....	-	-	71,778	67,495	71,778	67,495
Water.....	-	-	277,162	252,802	277,162	252,802
Power.....	-	-	96,228	109,436	96,228	109,436
Hospitals.....	-	-	820,236	812,399	820,236	812,399
Sewer.....	-	-	184,977	182,712	184,977	182,712
Market.....	-	-	1,144	1,052	1,144	1,052
Total expenses.....	<u>3,606,084</u>	<u>3,554,782</u>	<u>2,998,078</u>	<u>2,907,888</u>	<u>6,604,142</u>	<u>6,462,670</u>
Increase/(decrease) in net assets before special items and transfers....	113,406	191,386	(438,436)	(299,230)	(325,030)	(107,844)
Special items.....	-	-	-	(41,026)	-	(41,026)
Transfers.....	(393,259)	(477,341)	393,259	477,341	-	-
Change in net assets.....	(279,853)	(285,955)	(45,177)	137,085	(325,030)	(148,870)
Net assets at beginning of year, as restated..	<u>1,585,056</u>	<u>1,871,011</u>	<u>4,805,323</u>	<u>4,711,264</u>	<u>6,390,379</u>	<u>6,582,275</u>
Net assets at end of year.....	<u>\$ 1,305,203</u>	<u>\$ 1,585,056</u>	<u>\$ 4,760,146</u>	<u>\$ 4,848,349</u>	<u>\$ 6,065,349</u>	<u>\$ 6,433,405</u>

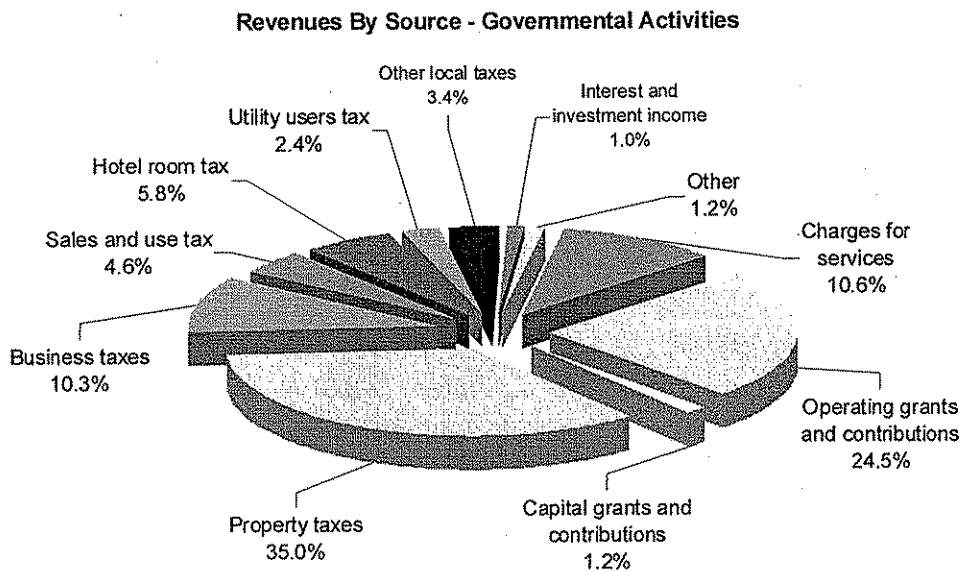
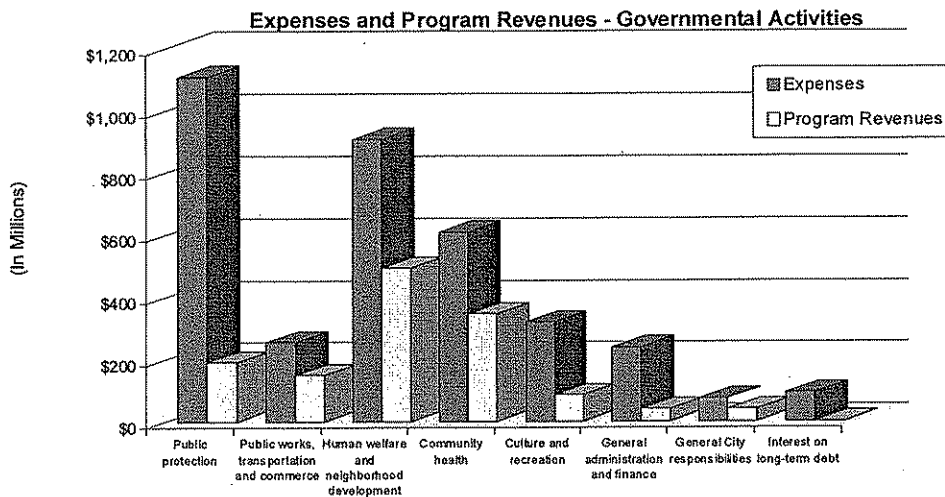
\* The 2008 ending balances in the table above have not been restated as discussed in Note 2 to the basic financial statements.

**Analysis of Changes in Net Assets**

The City's total net assets decreased by \$325.0 million during fiscal year 2008-2009. Both the governmental and business-type activities realized net asset decreases of \$279.9 million and \$45.2 million, respectively. Within the business-type activities, Laguna Honda reported a major growth in net assets of \$77.0 million mainly due to the capital asset transfers funded with governmental resources.

In addition, Water, Wastewater, Hetch Hetchy and Market Corporation also reported a combined growth of \$51.4 million increase in net assets due to these funds managing their decreasing revenues against their expenses. These increases are offset by the combined decrease of net assets of \$173.5 million from the remaining enterprises, including MTA, Airport, Port and General Hospital.

The City's governmental-type activities experienced a \$26.7 million or 0.7 percent decline in total revenues. Despite the \$112.6 million growth in property tax and \$8.0 million in capital grants and contributions and a combined growth of \$21.0 million in utility user taxes and other revenues, there was a general decline in remaining revenue sources that range from \$7.4 million in business taxes to \$69.2 million in charges for services. The City's governmental activities expenses also increased moderately by \$51.3 million or 1.4 percent this fiscal year, which contributed to the gap between public expenses and revenues. A discussion of these and other changes is presented in the governmental activities and business-type activities sections that follow.



**Governmental activities.** Governmental activities decreased the City's total net assets by approximately \$279.9 million. Key factors contributing to this year's change are discussed below.

Overall, total revenues from governmental activities were \$3.72 billion, a \$26.7 million or 0.7 percent decrease over the prior year. For the same period, expenses totaled \$3.61 billion before transfers of \$393.3 million, resulting in a total net asset decrease of \$279.9 million by June 30, 2009.

Property tax revenue grew significantly by \$112.6 million or 9.5 percent primarily due to a growth in assessed valuation in the current fiscal year over prior fiscal year. Business taxes decreased by \$7.4 million or 1.9 percent. Revenues from hotel, sales, utility users and other local taxes totaled approximately \$603.1 million, a \$49.9 million decrease over the prior year. Of this, property transfer tax (part of other local taxes) decreased by \$37.3 million or 43.2% that reflected the depressed number and value of transactions for the City for the fiscal year. Sales and use tax decreased by \$18.2 million or 9.5%, hotel room tax by \$4.6 million or 2.1% and parking tax (part of other local taxes) by \$2.7 million or 4.1%. The Access Line Tax of \$10 million approved by voters in November 2008 that replaced the Emergency Response Fee helped to improve the revenue shortfall in the other local taxes. In general, the decreases in other local taxes correlated with declined business and tourist activities as well as the increased unemployment rate caused by the global credit crunch and weak economy.

Total charges for services revenues dropped this year by \$69.2 million, or 15.0 percent. Of this amount, \$50.1 million was the decline of development impact fees due to a downturn in the economy that negatively affected development and construction activities and sale of housing units. The remaining decreases reflected a general decline in governmental fee-based services including building safety charges, building permits, ambulance billings and others.

Interest and investment income revenue was down by \$22.5 million, 38.8 percent, due to declining interest rates on the City's pooled investments from the gross annual 4.3 percent to 2.6 percent and lower daily cash balances caused by delays in state grant and subvention payments during the fiscal year. In general, these returns reflect the City's concentration of investments in Treasury Bills and Notes and other government agencies short-term investments. As interest rates fell and stayed low for short term investments, the Portfolio included investments with longer maturities that had higher interest yields. As of June 30, 2009, 45.7% of the pooled investment will mature within 1 year compared to the 71.1% last fiscal year. Also, the portfolio now holds Temporary Liquidity Guarantee Program bonds, which are corporate bonds backed by the Federal Deposit Insurance Corporation and the U.S. government. At the end of the fiscal year, deposits and investments for governmental activities with the City Treasury were \$984.3 million, a 15.3 percent decrease over the prior year.

Revenues from capital grants and contributions totaled \$44.0 million this year compared to \$36.1 million last year. This \$7.9 million, or 22.1 percent increase was mainly for streets, roads and library improvement projects.

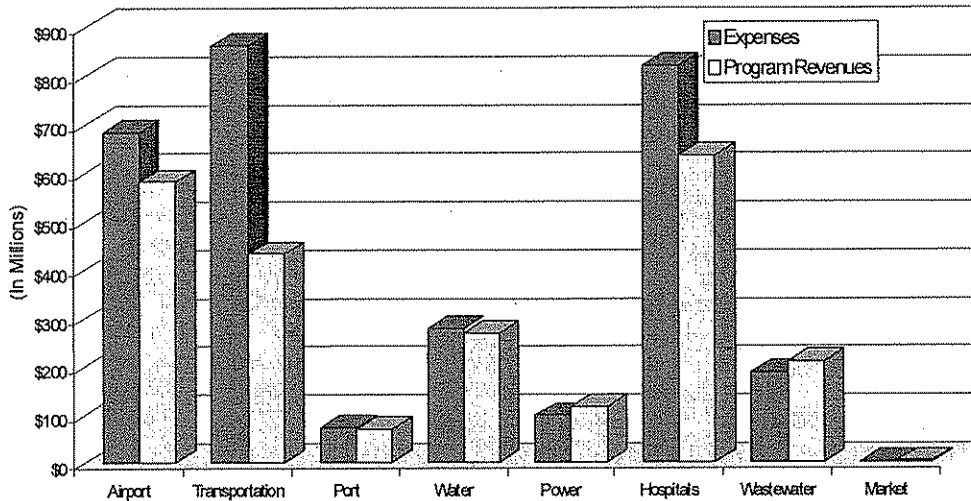
Net transfers to business-type activities were \$393.3 million, a 17.6 percent or \$84.1 million decrease over the prior fiscal year. The total General Fund transfers to MTA, General Hospital and Laguna Honda remains at about the same level of \$402 million this fiscal year. Yet, both General Hospital and Laguna Honda reimbursed the General Fund for a total of approximately \$50.9 million of capital expenditures related to the hospital rebuild projects paid in prior years. In addition, the transfers from the San Francisco County Transportation Authority to MTA were reduced by \$24.8 million and the City Facilities Improvement Funds to Laguna Honda for the hospital rebuild were reduced by approximately \$8.7 million.

The increase in total governmental expenses of \$51.3 million or 1.4% was primarily due to increases in demand for the government's services, salaries related expenses, including other postemployment benefits, and claims against the City. Major components of the increase include approximately \$60.3 million increases in the human welfare and neighborhood services functions due to growth in increased aid programs, social services contracts and various community based organization services. Community health expenses also grew by \$41.3 million due to higher levels of health services that were provided. The majority of the growth in public protection services is offset by a similar amount in the

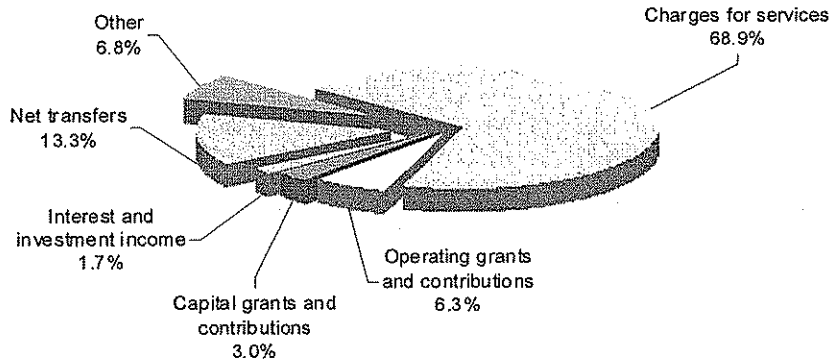
decline in public works, transportation and commerce since the Emergency Communications Department has been reclassified to the public protection function from the public works, transportation and commerce function in the last fiscal year. This reclassification is to better reflect the nature of services provided by the department. These overall increases in expenses are partially offset by decreases of \$27.4 million, \$11.7 million, and \$8.3 million in the functions of culture and recreation, general administration and general city responsibilities expenses, respectively, due to a combination of decreases in administrative costs and decreased elections and related expenses as compared to last year.

The charts on the previous page illustrate expenses and program revenues by functional area, and all revenues by source. As shown, public protection is the largest function (30.8 percent), followed by human welfare and neighborhood development (25.2 percent) and community health (16.9 percent). General revenues are not shown by program or function because they are used to support activities citywide. The distribution of these revenues shows property tax (35.0 percent) as the single largest funding source, followed by operating grants and contributions (24.5 percent), charges for services (10.6 percent), and business taxes (10.4 percent). This relative ranking is equivalent to the prior fiscal year and the actual percentage distributions showed only small differences.

**Expenses and Program Revenues - Business-type Activities**



**Revenues By Source and Net Transfers - Business-type Activities**



**Business-type activities.** Business-type activities decreased the City's net assets by \$45.2 million. Key factors contributing to this decline are:

- The Municipal Transportation Agency (MTA) had net assets of \$1.83 billion at the end of this fiscal year, a \$73.7 million decrease for the period. The City's municipal railway, MUNI, accounts for 97.6 percent or \$1.79 billion of these net assets. The remainder represents the combined net assets of the Department of Parking and Traffic and the Parking Authority. MUNI's net assets decreased by \$70.9 million this fiscal year compared to an increase of \$14.3 million the prior fiscal year. This year's change was based on \$668.0 million in total revenues and net transfers versus \$738.7 million in total expenses. Net transfers increased by \$23.2 million and operating and non-operating revenues grew by about \$1.7 million. The latter reflects modest increases in passenger fare, advertising rental and other revenues. At the same time, the railway saw a \$74.8 million decrease in federal and state capital contributions and a \$35.2 million increase in total expenses. Within this, salary and fringe benefit expense, including the cost of other post-employment benefits, increased by \$21.3 million and the cost of service from other City departments rose by \$13.6 million. The remaining expense increase is due to a small net increase in depreciation, contractual services, and administrative expenses. This year, the City's General Fund total subsidy to MTA was \$229.7 million. Of this, \$180.8 million went to MUNI and \$48.9 million went to the Department of Parking and Traffic. This was a \$26.2 million increase and a \$0.7 million decrease, respectively, for each entity over the prior year.
- Laguna Honda Hospital, the City's skilled nursing care hospital, increased net assets by \$77.0 million or 20.1 percent this year, reflecting continued progress on construction of the new hospital complex. This increase is primarily related to \$97.6 million of transfers from the non-major governmental funds for the hospital's capital activities, which are supported by general obligation bonds and certificates of participation. The increase is partially offset by a transfer of \$25.9 from Laguna Honda Hospital to the General Fund to reimburse the General Fund for certain hospital capital asset expenditures. Laguna Honda Hospital also received a \$55.5 million subsidy from the General Fund offset by \$47.9 million in losses this year as compared to a \$49.8 million in losses in the prior year.
- General Hospital, the City's acute care hospital had a decrease in net assets of \$58.0 million, which resulted in a net deficit of \$16.1 million at June 30, 2009. The decrease was partially the result of a smaller operating subsidy from the General Fund that was \$19.1 million less than the prior year. General Hospital also transferred \$25.0 million to the General Fund to reimburse capital activities related to the General Hospital rebuild project that were previously paid by the General Fund.
- Hetch Hetchy operates San Francisco's water storage and power generating facilities in the Sierra Nevada Mountains. Its total net assets were \$444.4 million at the end of fiscal year 2009, a \$23.2 million increase over the prior year when a \$14.7 million decrease was reported. That decrease consisted of a \$26.5 increase in net assets from operating and non-operating revenue and expenses offset by a \$41.2 million one-time write-off of a turbine project. This year, Hetch Hetchy's operating expenses fell by \$13.2 million due to a \$10.1 million decrease in the cost of purchased power from the Western System Power Pool and a \$13.7 million decrease in claims liability expenses. These were offset by increases of \$4.3 million in personnel costs, \$4.1 million in contractual service costs, \$2.2 million for San Francisco's new Go-Solar incentive program as well as increases in depreciation and other expenses equaling about \$2.1 million. Total revenues for this year were \$122.1 million, a decrease of \$14.4 million since last year. This includes a \$6.6 million decrease in revenues from electricity sales to Modesto and Turlock Irrigation Districts and other municipalities; a \$2.6 million decrease in revenue from TIDA, a \$2.6 million increase in sales to City departments, and a \$2.1 million increase in water assessment fees to the San Francisco Water Enterprise and others. This year's total revenue decrease also included an approximately \$12.1 million decline in non-operating revenue primarily due to \$7.6 million one-time refunds and reimbursements in the prior year, and about a \$2.3 million fall in investment and interest income in fiscal year 2009 due to lower interest rates.

- The City's Water Enterprise reported net assets of \$462.3 million, a \$1.0 million or 0.2 percent increase over the prior year. The enterprise is engaged in a massive, multi-billion dollar, ten-year project to rebuild the City's water system know as the Water System Improvement Program (WSIP). Directly related to this effort, the enterprise's total assets and total liabilities increased by \$243.8 million and \$242.8 million, respectively. Within this, net capital assets rose by \$233.3 million and current assets increased by \$11.1 million, including a \$13.7 million total increase in receivables from suburban customers and approximately \$4.7 million increase in receivables from mainly other City retail ratepayers, offset by a \$7.8 million decrease in cash balances due to a decline in interest earnings and increases in operating expenses. Liabilities show an increase of \$229.6 million in commercial paper associated with WSIP, a reduction of \$25.3 million in bond principal repayment, approximately \$20.0 million increase in accounts payable for capital projects, and the WSIP program; \$15.9 increase in the liability for other postemployment benefit expenses, and \$4.3 million in arbitrage payable expense, and a net reduction of about \$1.3 million in claims and other current liabilities.
- The City's Wastewater Enterprise had net assets of \$1.01 billion at the end of this fiscal year, a \$26.7 million or 2.7 percent increase for the fiscal year. The enterprise reported total revenues of \$211.7 million, a \$4.2 million increase over the prior year. This included an \$11.5 million increase in charges for service due to a 9.0% rate increase on July 1, 2008. That was partially offset by a decline of \$5.4 million in capacity fee revenues related to a drop in building permits, and a decrease of \$1.9 million in interest and other income, reflecting the drop in interest rates during the period. Total expenses were about \$185.0 million, a \$2.3 million increase over the prior year. This included an increase of \$5.6 million for services of other departments, particularly the City's Department of Public Works for sewer repair, street cleaning and engineering work. Concurrently, contractual service expense increased \$1.9 million, material and supplies declined by \$3.8 million, interest and other expenses fell by a net of \$1.7 million.
- The Port had an increase in net assets of \$2.5 million from its current year activities, however the ending net assets decreased by a total of \$40.6 million due to prior year restatements, which resulted from a prior year adjustment for fixed assets of \$15.5 million and a restatement due to recognizing a pollution remediation cost of \$27.5 million in accordance with GASB Statement No. 49.
- The Airport's net assets decreased by \$44.0 million or 14.0 percent from the prior year. The decrease is primarily the result of increased operating expenses over last year of \$27.3 million and a decrease in nonoperating revenues of \$12.2 million and an increase in nonoperating expenses of \$4.4 million and a decreased federal capital contribution of \$11.3 million. The main reasons for the increase in operating expenses was higher personnel costs of \$14.3 million due to base wage increases and other postemployment benefits, and increased depreciation expense of \$7.1 million due to additional capital assets placed in service and additional contractual services of \$3.3 million for marketing and other services. In addition, repairs and maintenance increased by \$1.7 million. Although operating revenues grew by \$15.5 million or 2.9% driven largely by increased aviation revenues, concession and parking and transportation revenue, it was not enough to offset the combined effect of the aforementioned increases in operating expenses and the decreases in nonoperating revenues mostly due to lower interest and other earnings, and the increase in interest expense. Finally, the transfer from the Airport to the City's General Fund was \$26.8 million this year, a 3.5 percent growth over fiscal year 2007-2008.



## 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 focus of the City's governmental funds statements is to provide information on near-term inflows, outflows, and balances of resources available for future spending. Such information is useful in assessing the City's financing requirements. The unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Types of governmental funds reported by the City include the General Fund, Special Revenue Funds, Debt Service Funds, Capital Project Funds, and the Permanent Fund.

At the end of the current fiscal year, the City reported combined ending governmental fund balances of \$985.0 million, an increase of \$13.3 million over the prior year. The City realized growth in total governmental funds revenues, including growth in property tax revenues, federal and state revenues for a total of \$141.9 million. These increases were offset by a decline in the rest of other taxes, such as business, hotel room tax, other local taxes, as well as interest and investment income as discussed earlier, leaving a net increase of \$8.2 million in revenues for the fiscal year.

The governmental funds have a combined deficit of \$63.5 million in the unrestricted fund balance component. Of the \$63.5 million deficit, \$95.6 million was from Special Revenue and Capital Projects funds. The remainder of the fund balances in governmental funds is reserved, a measure of the fund resources already committed and not available for new spending. These commitments include support for (1) a General Fund "rainy day" reserve (\$98.3 million), (2) encumbrances for existing contracts and purchase orders (\$233.1 million), (3) funds continued for programs or projects in future fiscal years (\$610.2 million), (4) funds reserved for future debt service payments (\$75.9 million), and (5) assets not available for appropriation (\$31.1 million).

The General Fund is the chief operating fund of the City and had an unreserved fund balance of \$28.2 million and a total fund balance of \$301.7 million at the end of the fiscal year. For the year, the General Fund's total revenues exceeded expenditures by \$306.6 million, before transfers and other items of \$410.6 million. In the aggregate, the resulting total fund balance decreased by \$104.0 million for the fiscal year ended June 30, 2009. Overall, this was due to smaller than expected increase in revenues, particularly in real estate property transfer tax, grants and subventions, and an increased rate of expenditure growth due to growth in demand for services and personnel costs across City functions. These factors were partly offset by management controls on the General Fund expenditures put in place during the middle of this fiscal year.

As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. For this fiscal year, the unreserved fund balance of \$28.2 million represents 1.17 percent of total General Fund expenditures of \$2.4 billion, and the total fund balance of \$301.7 million represents essentially 12.5 percent of that amount. At the end of the prior fiscal year, the General Fund's unreserved fund balance of \$77.1 million was 3.2 percent of total expenditures of \$2.39 billion, and the total fund balance represented approximately 17.0 percent of expenditure. This change also reflects the City's relatively higher use of budgetary use of balances and reserves in fiscal 2008-2009 due to the weak economy of the City.

**Proprietary Funds**

The City's proprietary fund statements provide the same type of information found in the business-activities section of the government-wide financial statements, but in more details.

At the end of the current fiscal year, the unrestricted net assets for the Airport were \$226.3 million, the Water Enterprise \$83.9 million, the Hetch Hetchy Water and Power were \$170.7 million, the Wastewater Enterprise Program were \$26.3 million, and the Port were \$31.7 million. In addition, the MTA, the San Francisco General Hospital and Laguna Honda Hospital had deficits in unrestricted net assets of \$106.5 million, \$67.5 million and \$42.2 million, respectively.

The following table shows actual revenues, expenses and results of operations for the current fiscal year in the City's proprietary funds (in thousands). As seen here, the total net assets for these funds decreased by approximately \$45.2 million due to current year operations. Reasons for this change are discussed in the previous section on the City's business-type activities.

	Operating Revenues	Operating Expenses	Operating Income (Loss)	Non-Operating Revenues (Expense)	Capital Contributions and Others	Interfund Transfers	Change In Net Assets
Airport.....	\$ 551,283	\$ 478,589	\$ 72,694	\$ (119,634)	\$ 29,780	\$ (26,849)	\$ (44,009)
Water.....	265,781	248,315	17,466	(15,356)	-	(1,143)	967
Hetch Hetchy.....	115,274	96,228	19,046	4,477	-	(302)	23,221
Municipal Transportation Agency.....	257,083	860,471	(603,388)	235,572	55,915	237,882	(74,019)
General Hospital.....	448,881	628,387	(179,506)	66,365	-	55,155	(57,986)
Wastewater Enterprise.....	208,654	169,300	39,354	(12,663)	-	-	26,691
Port.....	66,467	71,234	(4,767)	2,037	1,558	3,644	2,472
Laguna Honda Hospital.....	119,329	191,266	(71,937)	24,034	-	124,872	76,969
Market Corporation.....	1,546	1,144	402	115	-	-	517
Total.....	<u>\$ 2,034,298</u>	<u>\$ 2,744,934</u>	<u>\$ (710,636)</u>	<u>\$ 184,947</u>	<u>\$ 87,253</u>	<u>\$ 393,259</u>	<u>\$ (45,177)</u>

**Fiduciary Funds**

The City maintains fiduciary funds for the assets of the San Francisco Employee's Retirement System and Health Service System, and manages the investment of monies held in trust to benefit public service employees. At the end of the current fiscal year, the net assets of the Retirement System and Health Services System combined totaled \$11.9 billion, representing a \$3.96 billion decrease over the prior year, a 24.9 percent change. This decrease is essentially due to a decrease in the fair value of the Retirement System's investments resulting from a decline in financial and real estate market conditions. The Investment Trust Fund's net assets were \$565.4 million at year's end, compared to \$538.4 million at the end of the previous fiscal year. This 5.0 percent increase represents the increase in additions over withdrawals or distributions to external participants in the current year.

**General Fund Budgetary Highlights**

The City's final budget differs from the original budget in that it contains carry-forward appropriations for various programs and projects, and supplemental appropriations approved during the fiscal year. In fiscal year 2008-2009, the City approved approximately \$3.3 million in General Fund supplemental appropriations with additional state revenues associated with the November 2008 and May 2009 elections.

During the year, actual revenues and other resources were \$162.2 million less than budgeted. The City realized \$9.5 million more revenue than budgeted in property taxes and utility users taxes. There was a total of \$171.7 million shortfall of actual revenue compared to budgeted revenue in other categories, namely, business taxes, other local taxes, licenses permits and franchises, fines forfeitures and penalties, rents and concessions, federal, state and other grants and subventions, charges for services, and other resources.

Differences between the final budget and the actual (budgetary basis) expenditures resulted in \$128.9 million in expenditure savings. Major factors include:

- \$31.4 million savings in the Human Services Agency, due largely to lower than budgeted client assistance and aid as well as other operating costs. These savings are partially offset by reductions in Human Service federal and state subvention revenues.
- \$22.2 million savings in Fire, Police, Juvenile Probation and Sheriff departments achieved through delayed or freezing certain civilian and uniform positions.
- \$28.0 million in savings due to close-out of unspent General Reserve not used for supplemental appropriation or other contingencies during fiscal year 2008-2009.
- \$20.3 million in savings on general administration and finance and other general city responsibilities.
- \$14.1 million in savings in salary and fringe benefit costs in the Department of Public Health. In addition, the General Services Agency – Department of Public Works and Business and Economic Development had a combined savings of \$7.5 million primarily from capital projects and some City grant programs.

The net effect of revenue shortfall, savings in expenditures and reduction in appropriations and reserve balances was a positive unreserved budgetary fund balance available for subsequent year appropriation of \$95.4 million at the end of fiscal year 2008-2009. The City's fiscal year 2009-2010 Adopted Original Budget assumed an available balance of \$94.5 million, so an additional \$0.9 million remains available. (See also Note 4 to the Basic Financial Statements for additional fund balance details.)

### Capital Assets and Debt Administration

#### Capital Assets

The City's capital assets for its governmental and business-type activities as of June 30, 2009, increased by \$410.3 million, 3.4 percent, to \$12.49 billion (net of accumulated depreciation). Capital assets include land, buildings and improvements, machinery and equipment, park facilities, roads, streets, and bridges. Governmental activities contributed \$97.8 million or 0.8 percent to this total while \$312.5 million or 2.5 percent was from business-type activities. Details are shown in the table below.

**Capital Assets, Net of Accumulated Depreciation  
(in thousands)**

	Governmental Activities		Business-type Activities		Total	
	2009	2008	2009	2008 *	2009	2008 *
Land.....	\$ 155,512	\$ 151,917	\$ 180,919	\$ 196,264	\$ 336,431	\$ 348,181
Facilities and Improvement..	2,337,478	2,188,543	6,306,617	6,114,993	8,644,095	8,303,536
Machinery and equipment....	58,648	60,701	785,888	780,793	844,536	841,494
Infrastructure.....	290,144	281,329	793,866	794,180	1,084,010	1,075,509
Property held under lease....	-	-	2,218	2,464	2,218	2,464
Easements.....	-	-	62,694	65,448	62,694	65,448
Construction in progress.....	187,133	248,587	1,328,692	1,194,252	1,515,825	1,442,839
Total.....	<u>\$ 3,028,915</u>	<u>\$ 2,931,077</u>	<u>\$ 9,460,894</u>	<u>\$ 9,148,394</u>	<u>\$ 12,489,809</u>	<u>\$ 12,079,471</u>

\* The 2008 ending balances in the table above have not been restated as discussed in Note 2 to the basic financial statements.

Major capital asset events during the current fiscal year included the following:

- Under governmental activities, net capital assets increased by \$97.8 million mainly due to the increase in construction in progress and completed assets at various park and recreational sites, branch libraries, various street improvement and traffic signal upgrades. About \$226.0 million worth of construction-in-progress work was substantially completed and capitalized as facilities and improvement and infrastructure. Of the completed projects, \$119.9 million is for the California Academy of Science and approximately \$56.8 million for various Recreation Centers such as Duboce Park, Larsen Sava Pool and J.P. Murphy Clubhouse and \$46.6 million in various street and public work projects. Apart from the increase in various city-wide parks, libraries, public works and traffic signal projects, the City also funded the General Hospital Rebuild Project with general obligation bonds proceeds issued in the fiscal year. The rebuild project for the fiscal year totaled \$39.6 million and was recorded under the governmental activities.
- The Water Enterprise's net capital assets increased by \$233.3 million or 18.4 percent. Close to 53.3 percent, or \$124.2 million, of the change reflects the net increase in construction-in-progress on the enterprise's ten-year capital plan, including the Water System Improvement Program. This change includes a \$282.7 million increase in construction projects offset by \$138.8 million in transfers to facilities and improvements, \$14.5 million transfers to equipment, and \$5.2 million expensed for projects not continued. Major additions to construction work included Tesla Treatment Facility, McLaren Park Pump Station Upgrade, New Crystal Springs Bypass Tunnel, Local Water Main Replacement Program and other Water System Improvement Program. The remaining net increase of \$48.8 million reflects the increase to facilities, improvements and equipment less increase to depreciation. The Water Enterprise had \$12.7 million in development costs and \$9.9 million in site acquisition as of June 30, 2009 for an office building located at 525 Golden Gate Avenue. Demolition of existing site was completed in June 2009. Construction is expected to start in January 2010 with an expected completion date of February 2012, with an expected occupancy date of April 2012.
- MTA's net capital assets decreased by \$36.3 million or 1.8 percent, compared to the previous year, which was attributed to a decline in construction work for new and existing projects and more depreciation expense for existing assets. Construction completion of the Muni Metro East Maintenance Facility occurred in the summer of 2008. The facility is a new, state-of-the-art storage yard, maintenance shop and operations/dispatch facility for a fleet of 80 light rail vehicles. The advanced preliminary engineering for Phase II of the Third Street Light Rail Project is near completion and is pending approval to enter into final design in fiscal year 2010.
- Laguna Honda Hospital's net capital assets increased by \$112.8 million or 35.4 percent due almost entirely to construction-in-progress on the capital project to rebuild the hospital. This work is principally funded by the Laguna Honda General Obligation Bonds and the Certificates of Participation issued by the City.
- General Hospital's net capital assets decreased by \$13.5 million or 20.0 percent, primarily due to handing over the hospital rebuild project to the governmental activities for managing and financing with the first series of \$131.7 million general obligation bonds issued in the current fiscal year. The total amount approved by the voters for the rebuild project is \$887.4 million.
- The Wastewater Enterprise reported a net increase of \$34.1 million or 2.5 percent due to completion of the Southeast Water Pollution Control Program Digester Cover and Mixing Improvements, Oceanside Heating, Ventilation, Air conditioning assessment, North Point Facilities Wet Weather Improvements-Pumps, and other capital projects throughout the system.
- Hetch Hetchy net capital assets increased by \$14.3 million or 5.5 percent during the year. Contributing to this net increase was the addition in construction work in progress and in land and rights-of-way over depreciation and deletion of assets.

- The Airport's net capital assets decreased \$16.2 million or 0.5 percent largely due to depreciation and deletions of certain capital projects. Major capital additions this fiscal year included Terminal 2 Renovation, Secure Connector Terminal 3 to Boarding Area G, and Runway 28R-10L Overlay and Reconstruction.
- The Port's net capital assets decreased by \$16.3 million or 5.9 percent from its previously reported capital asset balance of \$275.1 million primarily due to a restatement of \$15.5 million on certain land improvements that had not been depreciated but determined to be exhaustible assets and should have been depreciated in prior periods and \$2.5 million of reclassification of other assets to capital assets.

At the end of the year, the City's business-type activities had approximately \$520.0 million in commitments for various capital projects. Of this, Water Enterprise had an estimated \$303.4 million, MTA had \$68.4 million, Wastewater had \$23.8 million, Airport had \$39.0 million, Hetch Hetchy had \$22.3 million, Port had \$7.2 million, Laguna Honda had \$53.7 million and the General Hospital had \$2.2 million. In addition, there was approximately \$58.2 million reserved for encumbrances in capital project funds for the general government.

For government-wide financial statement presentation, all depreciable capital assets were depreciated from acquisition date to the end of the current fiscal year. Fund financial statements record capital asset purchases as expenditures.

For governmental activities, no net infrastructure assets were recorded in fiscal year 2000-2001 (the first year of presentation in the GASB 34 format), because the historical costs did not meet the threshold established by GASB. Beginning in fiscal year 2001-2002, newly completed projects are capitalized and ongoing infrastructure projects are accounted for in construction in progress.

Additional information about the City's capital assets can be found in Note 7 to the Basic Financial Statements.

### **Debt Administration**

At the end of the current fiscal year, the City had total long-term and commercial paper debt outstanding of \$8.04 billion. Of this amount, \$1.17 billion is general obligation bonds backed by the full faith and credit of the City and \$6.87 billion is revenue bonds, loans, certificates of participation, capital leases, and other debt of the City secured solely by specified revenue sources.

As noted previously, the City's total long-term debt including all bonds, loans, commercial paper and capital leases increased by \$454.9 million during fiscal year 2008-2009, due to the issuance of new debt in the governmental and business-type activities. The net increase in obligations was \$221.6 million in governmental activities and was primarily due to issuance of new debt. For the business-type activities, the net increase in obligations was \$233.3 million primarily due to the issuance of commercial paper by the Airport, San Francisco Water Enterprise and San Francisco Wastewater Enterprise.

The City issued \$578.4 million in refunding bonds, with \$118.1 million in general obligation refunding bonds to take advantage of lower interest rates to reduce debt payments; \$145.3 million in lease revenue refunding bonds and \$314.9 million by the Airport in revenue refunding notes to stabilize variable interest expense set to reset to higher rates due to the downgrade of the bonds insurers caused by the turmoil in the financial markets. The Airport likewise converted the tax status of \$266.7 million of variable rate refunding bonds, from Alternative Minimum Tax (AMT) to Non-AMT to lower interest payments. In addition, the City issued \$131.7 million in general obligation bonds to finance the rebuilding and improve the earthquake safety of the San Francisco General Hospital and \$42.5 million to finance the construction and improvement of parks and recreational facilities in the City and made the fourth borrowing in the amount of \$1.3 million on the Seismic Safety Loan Program general obligation bonds under the Board of Supervisors Resolution No. 65-07 for loans to finance the seismic retrofitting of masonry buildings within the City. Lease revenue bonds for \$34.3 million were issued, through the San Francisco Finance

Corporation to finance the construction and renovation of public libraries and certificates of participation were issued for \$163.3 million for the construction and equipping of Laguna Honda Hospital. The San Francisco International Airport, San Francisco Water Enterprise and San Francisco Wastewater Enterprise issued commercial paper in the total amount of \$1.2 billion of which \$845.3 million was repaid. The Hetch Hetchy Water and Power Enterprise issued \$6.3 million in clean renewable energy bonds to finance the installation of solar energy equipment on selected City-owned facilities.

The City's Charter imposes a limit on the amount of general obligation bonds the City can have outstanding at any given time. That limit is three percent of the taxable assessed value of property in the City - approximately \$150 billion in value as of the close of the fiscal year. As of June 30, 2009, the City had \$1.17 billion in authorized, outstanding property tax-supported general obligation bonds, which is equal to approximately 0.75 percent of gross (0.78 percent of net) taxable assessed value of property. As of June 30, 2009, there were an additional \$1.2 billion in bonds that were authorized but unissued. If all of these general obligation bonds were issued and outstanding in full, the total debt burden would be approximately 1.52 percent of gross (1.58 percent of net) taxable assessed value of property.

The City's underlying ratings on general obligation bonds as of June 30, 2009 were:

Moody's Investors Service, Inc.	Aa2
Standard and Poor's	AA
Fitch Ratings	AA-

During the fiscal year, Moody's Investors Service upgraded the City's rating to Aa2 from Aa3 and revised the City's rating outlook from positive to stable, and Standard and Poor's affirmed rating with a stable outlook. Fitch Ratings affirmed ratings with their stable rating outlook on all the City's outstanding bonds.

The City's enterprise activities maintained their underlying debt ratings this fiscal year. The Airport's underlying bond ratings were affirmed by all rating agencies in conjunction with the issuance of their revenue refunding notes and the conversion of their variable rate refunding bonds to non-AMT. Moody's Investors Services, Standard & Poor's, and Fitch Ratings maintained their long-term rating of "A1", "A", and "A", respectively. The San Francisco Water Enterprise carried underlying ratings of "A1" and "AA-" from Moody's and Standard and Poor's, respectively. The San Francisco Waste Water Enterprise carried underlying ratings of "A2" and "A+" from Moody's and Standard & Poor's respectively.

Additional information in the City's long-term debt can be found in Note 8 to the Basic Financial Statements.

### **Economic factors and next year's budget and rates**

The City, like the State, is faced with a set of financial challenges over the next few years. The following economic factors were considered in the City's fiscal year 2009-2010 budget.

- By the end of fiscal year 2008-2009, San Francisco's economy was weathering the State's recession relatively well compared to other Bay Area cities and regions throughout the State. The fundamental cause of the recession in California, as well as several other states in the United States, has been the downturn in the housing market. Housing prices across California have rapidly declined after more than a decade of double-digit annual appreciation.
- San Francisco's housing prices have fallen, although the rate of decline has been much lower than the state average. Between the second quarter of 2008 and the second quarter of 2009, housing prices in California have fallen by an average of 15.5 percent, whereas in the San Francisco metropolitan division they only fell by 8.1 percent during the same period<sup>1</sup>.

<sup>1</sup> Source: Office of Federal Housing Enterprise Oversight Housing Price Index. The San Francisco Metropolitan Division includes San Francisco, San Mateo and Marin Counties.

- There is a fundamental difference in the City's housing market and those in the fast-growing suburban areas of the state. Consequently, San Francisco's economy has proven far more resilient than other parts of the state. While low mortgage rates certainly contributed to rising housing prices in San Francisco during the early years of the decade, the City has relatively few sub-prime mortgages, and its default rate on those mortgages has been far below the state average. During fiscal year 2008-2009, San Francisco recorded 1,424 Notices of Default, which was only 0.4 percent of the state total of 389,138<sup>2</sup>. By contrast, San Francisco has approximately 2.2 percent of the state's population, suggesting a per capita default rate that was only one-sixth of the state average.
- The wage and salary employment base of San Francisco lost 16,999 jobs between March 2008 and March 2009, the latest data available<sup>3</sup>.
- Unemployment in San Francisco rose during fiscal year 2008-2009 to an annual average of 7.4 percent, up from 4.6 percent in 2007-2008. Nevertheless, this rate is significantly below the state average of 9.6 percent and further confirms the essential strength of the City's economy in the face of the state and national recession. San Francisco's June 2009 unemployment rate of 9.9 percent was the 8<sup>th</sup> lowest among California's 58 counties<sup>4</sup>.
- The office market struggled in fiscal year 2008-2009, with the vacancy rate climbing from 10.5 percent in the third quarter of 2008 to 15.2 percent in the second quarter of 2009. During the same period, office rental rates fell 30.4 percent to \$32.67 per square foot as of the second quarter of 2009<sup>5</sup>. In addition, the market experienced almost 1,325,000 square feet of negative net absorption during this time period. Despite falling commercial space under construction, fiscal year 2008-2009 saw the completion of a 33-story office tower at 555 Mission Street, the first high-rise office completed in San Francisco in five years.
- San Francisco's long-term economic fundamentals – the quality of its workforce, environment, technological base, and cultural amenities – are among the strongest of any city in the United States. These competitive advantages are likely to secure the City's continued prosperity during and after the economic recovery.

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<sup>2</sup> Source: DataQuick.

<sup>3</sup> Source: U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

<sup>4</sup> Source: State of California Employment Development Department (EDD).

<sup>5</sup> Source: Grubb & Ellis.

## REQUESTS FOR INFORMATION

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. Below are the contacts for questions about this report or requests for additional financial information.

### ***City and County of San Francisco***

Office of the Controller  
1 Dr. Carlton B. Goodlett Place, Room 316  
San Francisco, CA 94102-4694

### **Individual Department Financial Statements**

#### ***San Francisco International Airport***

Office of the Airport Deputy Director  
Business and Finance Division  
PO Box 8097  
San Francisco, CA 94128

#### ***Port of San Francisco***

Fiscal Officer  
Pier 1, The Embarcadero  
San Francisco, CA 94111

#### ***San Francisco Water Enterprise***

Hetch Hetchy Water and Power  
San Francisco Wastewater Enterprise  
Director of Accounting Financial Services  
1155 Market Street, 4th Floor  
San Francisco, CA 94103

#### ***Laguna Honda Hospital***

Chief Financial Officer  
375 Laguna Honda Blvd.  
San Francisco, CA 94116

#### ***Municipal Transportation Agency***

MTA Finance and Administration  
1 South Van Ness Avenue, 8<sup>th</sup> Floor  
San Francisco, CA 94103

#### ***Health Service System***

1145 Market Street, Suite 200  
San Francisco, CA 94103

#### ***San Francisco General Hospital Medical Center***

Chief Financial Officer  
1001 Potrero Avenue, Suite 2A7  
San Francisco, CA 94110

#### ***San Francisco Employees' Retirement System***

Executive Director  
30 Van Ness Avenue, Suite 3000  
San Francisco, CA 94102

### **Component Unit Financial Statement**

#### ***San Francisco Redevelopment Agency***

One South Van Ness Avenue, 5<sup>th</sup> Floor  
San Francisco, CA 94103

### **Blended Component Units Financial Statements**

#### ***San Francisco County Transportation Authority***

Deputy Director for Administration and Finance  
100 Van Ness Avenue, 26<sup>th</sup> Floor  
San Francisco, CA 94102

#### ***San Francisco Finance Corporation***

Mayor's Office of Public Finance  
City Hall, Room 336  
1 Dr. Carlton B. Goodlett Place  
San Francisco, CA 94102

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SAN FRANCISCO

**INTRODUCTION FORM**

By a member of the Board of Supervisors or the Mayor

2010 APR -6 PM 1:55

BY \_\_\_\_\_

Time Stamp or  
Meeting Date \_\_\_\_\_

I hereby submit the following item for introduction:

- \_\_\_\_\_ 1. For reference to Committee:  
An ordinance, resolution, motion, or charter amendment.
- \_\_\_\_\_ 2. Request for next printed agenda without reference to Committee
- X  3. Request for Committee hearing on a subject matter.
- \_\_\_\_\_ 4. Request for letter beginning "Supervisor \_\_\_\_\_ inquires...".
- \_\_\_\_\_ 5. City Attorney request.
- \_\_\_\_\_ 6. Call file from Committee.
- \_\_\_\_\_ 7. Budget Analyst request (attach written motion).

[Note: For the Imperative Agenda (a resolution not on the printed agenda), use a different form.]

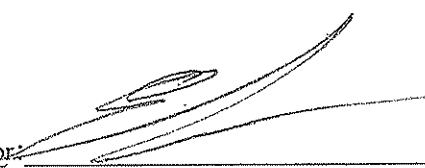
**Sponsor(s): Supervisor Mar**

**SUBJECT:**

Hearing for the City's external auditors (Macias Gini & O'Connell and KPMG) to present the Comprehensive Annual Financial Report (CAFR), Single Audit, and their Management Letters related to the City audit for Fiscal Year 2008-09. This hearing is required under charter Section 9.117.

This item should be scheduled for the Government Audits & Oversight Committee.

Signature of Sponsoring Supervisor: \_\_\_\_\_



**For Clerk's Use Only:**

