

FINANCIAL SECTION

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Honorable Mayor and City Council
City of Redlands
Redlands, California

INDEPENDENT AUDITORS' REPORT

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

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

The information identified in the accompanying table of contents as *management's discussion and analysis* and *required supplementary information* is not a required part of the basic financial statements but is supplementary information required by accounting standards generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the City of Redlands' basic financial statements. The introductory section, combining and individual nonmajor fund financial statements, schedules and statistical tables are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements and schedules

Honorable Mayor and City Council
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have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section and statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2007 on our consideration of the City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financing reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Mayer Hoffman McCann P.C.

Irvine, California
December 21, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the financial performance of the City of Redlands provides an overview of the City's financial activities for the fiscal year ended June 30, 2007. Please read it in conjunction with the transmittal letter and financial statements identified in the accompanying table of contents.

Using the Accompanying Financial Statements

This annual CAFR consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities provide information about the activities of the City as a whole and present a longer-term view of the City's finances. Also included in the accompanying report are fund financial statements. For governmental activities, the fund financial statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements also report the City's operations in more detail than the government-wide statements by providing information about the City's most significant funds. The remaining statements provide financial information about activities for which the City acts solely as a trustee or agent for the benefit of those outside of the government.

OVERVIEW OF THE FINANCIAL STATEMENTS

The annual report consists of four parts – *management's discussion and analysis* (this section), the *basic financial statements*, *required supplementary information*, and an optional section that presents *combining statements* for non-major governmental funds and internal service funds. The basic financial statements include two kinds of statements that present different views of the City:

- The first two statements are *government-wide financial statements* that provide both *long-term* and *short-term* information about the City's overall financial status.
- The remaining statements are *fund financial statements* that focus on *individual parts* of the City government, reporting the City's operations in *more detail* than the government-wide statements.
 - The *governmental funds* statements tell how *general government* services like public safety were financed in the *short term* as well as what remains for future spending.
 - *Proprietary fund* statements offer *short- and long-term* financial information about the activities the government operates like businesses, such as the sewer system.
 - *Fiduciary fund* statements provide information about fiduciary relationships – like the agency funds of the City – in which the City acts solely as *agent* or *trustee* for the benefit of others, to whom the resources in question belong.

The financial statements also include *notes* that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of *required supplementary information* that provides additional financial and budgetary information.

Figure A-1 summarizes the major features of the City's financial statements, including the portion of the City government they cover and the types of information they contain. The remainder of this overview section of management's discussion and analysis explains the structure and contents of each of the statements.

Figure A-1

Major Features of the City's Government-wide and Fund Financial Statements

	Government-wide Statements	Fund Statements		
		<u>Governmental Funds</u>	<u>Proprietary Funds</u>	<u>Fiduciary Funds</u>
Scope	Entire City government (except fiduciary funds) and the City's component units	The activities of the City that are not proprietary or fiduciary	Activities the City operates similar to private businesses	Instances in which the City is the trustee or agent for someone else's resources
Required financial statements	<ul style="list-style-type: none"> • Statement of net assets • Statement of activities 	<ul style="list-style-type: none"> • Balance sheet • Statement of revenues, expenditures and changes in fund balances 	<ul style="list-style-type: none"> • Statement of net assets • Statement of revenues, expenses and changes in net assets • Statement of cash flows 	<ul style="list-style-type: none"> • Statement of fiduciary net assets • Statement of changes in fiduciary net assets
Accounting basis and measurement focus	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
Type of asset/liability information	All assets and liabilities, both financial and capital, and short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets or long-term debt included	All assets and liabilities, both financial and capital, and short-term and long-term	All assets and liabilities, both short-term and long-term; the City's fiduciary funds do not currently contain capital assets, although they can
Type of inflow/outflow information	All revenues and expenses during the year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year; expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during the year, regardless of when cash is received or paid	All revenues and expenses during the year, regardless of when cash is received or paid

Reporting the City as a Whole

The accompanying **government-wide financial statements** include two statements that present financial data for the City as a whole. One of the most important questions asked about the City's finances is, "Is the City, as a whole, better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about the City as a whole and about its activities in a way that helps answer this question. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the City's net assets and changes in them. You can think of the City's net assets – the difference between assets and liabilities – as one way to measure the City's financial health, or *financial position*. Over time, *increases and decreases* in the City's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the City's property tax base and the condition of the City's roads, to assess the *overall health* of the City.

In the Statement of Net Assets and the Statement of Activities, we divide the City services into two kinds of activities:

- Governmental activities – Most of the City's basic services are reported here. Sales taxes, property taxes, state subventions, and other revenues finance most of these activities.
- Business-type activities – The City charges a fee to customers to help it cover all or most of the cost of the services accounted for in these funds.

Reporting the City's Most Significant Funds

The **fund financial statements** provide detailed information about the City's most significant funds – not the City as a whole. Some funds are required to be established by State law or by bond covenants. However, City Council establishes many other funds to help it control and manage money for particular purposes or to show that it is meeting administrative responsibilities for using certain taxes, grants, or other money. The City's two kinds of funds – *governmental* and *proprietary* – use different accounting approaches.

- *Governmental funds* – Most of the City's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other *current financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the City's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. We describe the relationship or differences between *governmental activities* (reported in the Statement of Net Assets and the Statement of Activities) and *governmental funds* in a reconciliation on the page following the fund financial statements.
- *Proprietary funds* – When the City charges customers for the services it provides – whether to outside customers or to other units of the City – these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. In fact, the City's enterprise funds (a component of proprietary funds) are the same as the business-type activities we report in the government-wide statements but provide more detail and additional information, such as cash flows, for proprietary funds. We use internal service funds (the

other component of proprietary funds) to report activities that provide supplies and services for the City's other programs and activities.

Reporting the City's Fiduciary Responsibilities

The City is an agent for certain assets held for, and under the control of, other organizations and individuals. All of the City's fiduciary activities are reported in a separate Statement of Fiduciary Assets. We exclude these activities from the City's other financial statements because the City cannot use these assets to finance its operations. The City is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

A summary of the government-wide *statement of net assets* follows:

CITY OF REDLANDS Statement of Net Assets June 30, 2007

Table 1

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006	2007	2006	2007	2006
Current and other Assets	68,245,276	62,835,891	55,635,021	48,138,038	123,880,297	110,973,929
Capital Assets	435,214,607	394,673,614	139,946,478	137,392,890	575,161,085	532,066,504
Total Assets	503,459,883	457,509,505	195,581,499	185,530,928	699,041,382	643,040,433
Long-term Debt Outstanding	72,321,273	73,285,839	44,840,273	48,040,697	117,161,546	121,326,536
Other Liabilities	5,737,239	5,210,272	3,971,262	3,645,332	9,708,501	8,855,604
Total Liabilities	78,058,512	78,496,111	48,811,535	51,686,029	126,870,047	130,182,140
Net Assets:	425,401,371	379,013,394	146,769,964	133,844,899	572,171,335	512,858,293
Invested in Capital Assets,						
Net of Debt	376,161,773	338,283,471	118,629,704	101,228,505	494,791,477	439,511,976
Restricted	19,431,228	19,302,690	-	-	19,431,228	19,302,690
Unrestricted	29,808,370	21,427,233	28,140,260	32,616,394	57,948,630	54,043,627
Total Net Assets	425,401,371	379,013,394	146,769,964	133,844,899	572,171,335	512,858,293

The increase in net assets can provide an indication that the overall financial position of the City improved during the year, by a total of \$59,313,042 as indicated in the Changes in Net Assets Table 2 below. Table 1 shows that net assets of the government-wide activities increased by 11.6% from \$512,858,293 in 2006 to \$572,171,335 in 2007. Governmental Activities net assets increased by 12.2% from \$379,013,394 at June 2006 to \$425,401,371 at June 30, 2007. The City's net assets of business-type activities increased by 9.7% from \$133,844,899 in 2006 to \$146,769,964 in 2007.

The increase in the net assets of the Governmental Activities during 2007 was primarily the result of increases in capital assets, including \$31,822,967 for 805,406 square feet of added right-of-way surrounding various residential tracts, Redlands Early Education Center and Judson Elementary School; completion of over \$12 million of Construction in Progress that was added to infrastructure during the year; a land acquisition of \$1,010,200 by the Redevelopment Agency of a property on Third Street known as the Packing House; and increases in Equipment and Vehicles of approximately \$1.1 million in mobile computers and surveillance equipment for the Police department and \$1.2 million in lease-purchased vehicles, including police vehicles and two Seagrave pumpers for the Fire department at \$485,000 each. The increase in net assets of the Business Activities resulted, in part, due to an increase of \$2.6 million in Capital Assets.

Additions to Construction in Progress of \$6,432,569 included approximately \$4.2 million attributable to the Water Fund, for the CIP Pipe Line Replacement Phase II, the CIP Master Plan, the Mill Creek Reservoirs and the HTWTP/California Connection projects; approximately \$2.2 million was attributable to the Sewer Fund for the CIP Replacement Mains, the Mentone Boulevard Sewer, and the WWTP Annual Replacement Program projects. Construction in Progress was reduced by \$3,084,937 for completed sewer (\$1,795,748) and water pipelines (\$1,289,189) and transferred to Infrastructure assets. These changes were offset by a net accumulated depreciation of \$4.1 million for all capital assets of the business-type activities. Current and other assets of the Business Activities increased by \$7.5 million. Cash increased by \$3 million in the Water Fund, primarily as a result of increased charges to customers resulting from a 7% rate increase in January of 2006 and again in 2007, as well as land sale proceeds of \$584,767 from San Bernardino Valley Municipal Water District for an easement. Cash in the Sewer Fund increased by over \$1 million due to increased revenue in charges for services and impact fees of approximately \$730,000, increased investment income of approximately \$200,000 and \$423,074 from the County as reimbursement for its share of the Mentone Boulevard Sewer Project. Cash in the Disposal Fund increased by \$3.2 million over the prior year primarily due to a \$3.4 million adjustment related to the landfill closure that resulted in a one-time, nonrecurring reduction of cash in the prior year.

A summary of the government-wide statement of activities follows:

Change in Net Assets – Year Ended June 30, 2007
Table 2

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006	2007	2006	2007	2006
Program Revenues:						
Charges for Services	9,487,041	9,306,510	34,805,661	31,569,061	44,292,702	40,875,571
Operating Grants & Contributions	18,206,757	18,542,273	617,206	423,720	18,823,963	18,965,993
Capital Grants & Contributions	36,180,849	3,715,690	7,512,629	7,891,272	43,693,478	11,606,962
General Revenues:						
Property Taxes	27,036,122	23,914,760	52,655	-	27,088,777	23,914,760
Sales Taxes	14,762,456	15,267,688	-	-	14,762,456	15,267,688
Franchises	3,659,356	1,097,157	-	-	3,659,356	1,097,157
Other Taxes	1,543,302	1,230,525	-	-	1,543,302	1,230,525
Investment Income	2,421,829	2,180,119	2,714,291	1,442,393	5,136,120	3,622,512
Intergovernmental	654,950	1,225,814	-	-	654,950	1,225,814
Total Revenues	113,952,662	76,480,536	45,702,442	41,326,446	159,655,104	117,806,982
Program Expenses:						
General Government	13,987,953	11,868,103	-	-	13,987,953	11,868,103
Public Safety	36,805,550	36,994,587	-	-	36,805,550	36,994,587
Highways and Streets	8,492,440	8,325,785	-	-	8,492,440	8,325,785
Culture and Recreation	3,668,992	3,692,986	-	-	3,668,992	3,692,986
Library	1,845,482	1,871,418	-	-	1,845,482	1,871,418
Interest and Fiscal Charges	2,883,874	3,713,659	-	-	2,883,874	3,713,659
Water	-	-	14,926,296	14,882,261	14,926,296	14,882,261
Disposal	-	-	8,753,717	8,799,485	8,753,717	8,799,485
Sewer	-	-	7,458,724	6,922,541	7,458,724	6,922,541
Aviation	-	-	268,309	218,316	268,309	218,316
Cemetery	-	-	541,946	591,363	541,946	591,363
Groves	-	-	708,779	749,143	708,779	749,143
Total Expenses	67,684,291	66,466,538	32,657,771	32,163,109	100,342,062	98,629,647
Increase in Net Assets before Transfers	46,268,371	10,013,998	13,044,671	9,163,337	59,313,042	19,177,335
Transfers	119,606	-	(119,606)	-	-	-
Increase (decrease) Net Assets	46,387,977	10,013,998	12,925,065	9,163,337	59,313,042	19,177,335
Beginning Net Assets	379,013,394	368,999,396	133,844,899	124,681,562	512,858,293	493,680,958
Ending Net Assets	425,401,371	379,013,394	146,769,964	133,844,899	572,171,335	512,858,293

Governmental Activities

Revenues for the City's governmental activities increased 49.2% from \$76,480,536 in 2006 to \$113,952,662 in 2007. Total governmental activity expenses increased by 1.8% from \$66,466,538 in 2006 to \$67,684,291 in 2007. The cost of all *government-wide* activities increased by 1.7% from \$98,629,647 in 2006 to \$100,342,062 in 2007. As shown in the Statement of Activities pages 17 and 18 of the CAFR, the amount that taxpayers ultimately financed for these activities through City taxes was \$3,809,644, while other costs were paid by those who directly benefited from the programs (\$9,487,041), by other governments and organizations that subsidized certain programs with operating grants and contributions (\$18,206,757), or capital grants and contributions (\$36,180,849). Overall, the City's governmental program revenues were \$63,874,647 including intergovernmental aid, fees for services, and contributions from developers.

The reasons for significant changes in the revenues and expenses of the City's governmental activities presented above are as follows:

Charges for services increased by \$180,531, or 1.9% in 2007 with notable increases in mutual aid in the General Fund and Cost Recovery in the Local Transportation Fund.

Operating Grants and Contributions decreased by \$335,516, or 1.8% from prior year. General Government had a net increase of approximately \$514,000, with approximately \$1 million from the County of San Bernardino Housing Authority for a senior housing project known as Vista Del Sol. Reductions of approximately \$569,000 in Public Safety and \$2.9 million in Highways and Streets resulted from adjustments for decreases in deferred revenue. Culture and Recreation increased by approximately 2.6 million primarily as a result of state grants in the amount of \$2.2 million for the Sports Park and \$550,000 grant from the County for the Boys & Girls Club. A decrease for the Library was a result of a state grant reduction of \$62,000 from prior year.

Capital Grants and Contributions increased by approximately \$32.5 million. This is primarily the result of right-of-way contributions in Highways and Streets valued at \$31,822,967.

Property Taxes increased by \$3.1 million or 13.1%, over prior year due to growth in the assessed value of residential and commercial properties. Growth in assessed value was 17.4%, compared to a countywide growth of 17.9%. The largest value increase in the City was attributed to a local utility which had its value increase from \$300.4 million to \$549.8 million.

Sales Tax decreased by \$505,232 or 3.3%, due to an adjustment in the amount received from the State Compensation fund for the triple flip and as a result of a decrease in automobile sales.

Franchise Fees increased by \$2.6 million or 233.5%, as a result of a major increase in gas usage by a local utility, resulting in a \$2.2 million increase in franchise fees from the Gas Company.

Other taxes increased by \$312,777 or 25.4%, primarily as a result of an increase in Transient Occupancy Tax received from two new hotels in the City.

Intergovernmental revenues decreased by \$570,864 or 46.6%, with reductions of approximately \$150,000 in motor vehicle license fees and \$215,000 in Public Safety donations, as well as reductions in State-mandated cost reimbursements and other reimbursements.

Investment income increased by \$241,710 or 11.1%, due to increased rates of return.

General Government expenses increased by \$2.1 million or 17.9%, primarily as a result of a \$1.8 million increase in special program expenditures in the Low & Moderate Income Housing Fund. Approximately \$1 million of this amount was spent to reimburse the Housing Authority of the County of San Bernardino for costs they incurred pursuant to an agreement with the City to develop an affordable senior housing complex known as Vista Del Sol. The remaining expenses were for other housing programs, including First Time Homebuyers, Home Painting, and Great Neighborhoods.

Public Safety expenses decreased by \$189,037 or 0.5%. While overall Public Safety operating expenditures increased by \$657,761 due to an increase in Emergency Services of \$666,767, the decrease on the Statement of Activities is primarily the result of GASB 34 adjustments. In the prior year, \$434,000 was charged to Public Safety expenses as a result of a GASB 34 Internal Service Fund consolidation entry. In the current year, only \$262,000 was charged to Public Safety as a result of the GASB 34 Internal Service Fund consolidation.

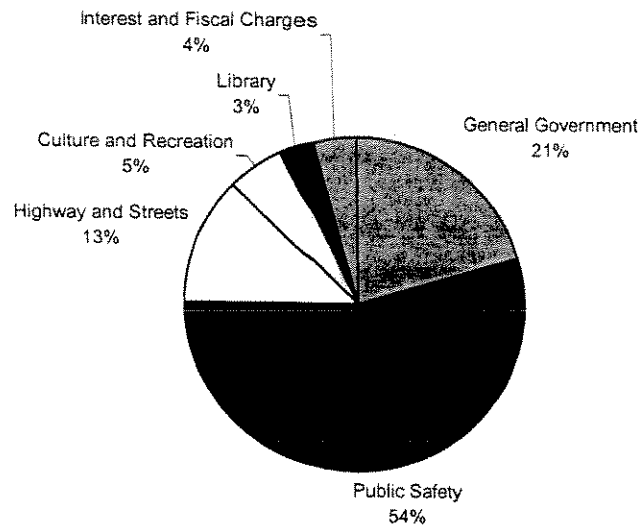
Highways and Streets increased by \$166,655 or 2.0%, due to increases in special contractual and professional services for engineering consulting and inspection services.

Culture and Recreation expenses decreased by \$23,994 or 0.6%. Although Culture and Recreation operating expenses decreased by \$249,000 due to savings in contractual services in Recreation and savings in water expenses in Parks, the smaller decrease shown in the Statement of Activities is primarily due to a GASB 34 adjustment relating to depreciation.

Library expenses decreased by \$25,936 or 1.4% primarily as a result of GASB 34 adjustments of \$39,294 due to the net change in compensated absences and \$12,688 for internal service fund charges.

Interest and fiscal charges decreased by \$829,785 or 22.3% primarily due to the Redevelopment Agency paying off its advance from the General Fund.

Expenses by Functions Governmental Activity



Business-Type Activities

Revenues of the City's Business-Type Activities (See Table 2) increased by 10.6% from \$41,326,446 in 2006 to \$45,702,442 in 2007 and expenses increased by 1.5% from \$32,163,109 in 2006 to \$32,657,771 in 2007.

Charges for Services in the Water Fund increased by \$2.2 million or 15%, primarily as a result of a rate increases of 7% in January, 2006 and again in 2007, increased demand for water due to a year that was one of the driest on record and a 1% growth in the customer base

Charges for Services in the Sewer Fund increased by \$947,528 or 15.5%, primarily due to a rate increase of 4% in 2007 and because the increased demand on water has a corresponding impact on sewer usage. In addition, this category included the reimbursement from the County for its share of the Mentone Boulevard Sewer Project.

Charges for Services in the Aviation Fund increased by \$55,527 or 35.8 per cent as a result of an increase in tie-down rental income.

No notable changes in charges for services occurred in the Cemetery or Groves funds.

Operating Grants and Contributions increased by approximately \$193,500 or 45.7% primarily due to the net between \$365,000 in federal aviation grant monies received in the prior year and current year land sale proceeds of \$584,767 for Texas Reservoir property from San Bernardino Valley Municipal Water District.

Capital Grants and Contributions decreased by approximately \$379,000 or 4.8%. A decrease of \$853,146 in the Water Fund resulted from a decrease in impact fees, primarily for resident capital improvement charges; an increase of \$261,994 in the Disposal Fund resulted from an increase in impact fees, primarily for nonresident capital improvement charges; and an increase of \$212,509 in the Sewer Fund resulted from an overall increase in impact fees, with approximately \$770,000 in increases for nonresident capital improvement charges and approximately \$557,000 in decreases for resident capital improvement charges.

Investment income increased by \$1,271,898 as a result of increased cash and higher rates of return.

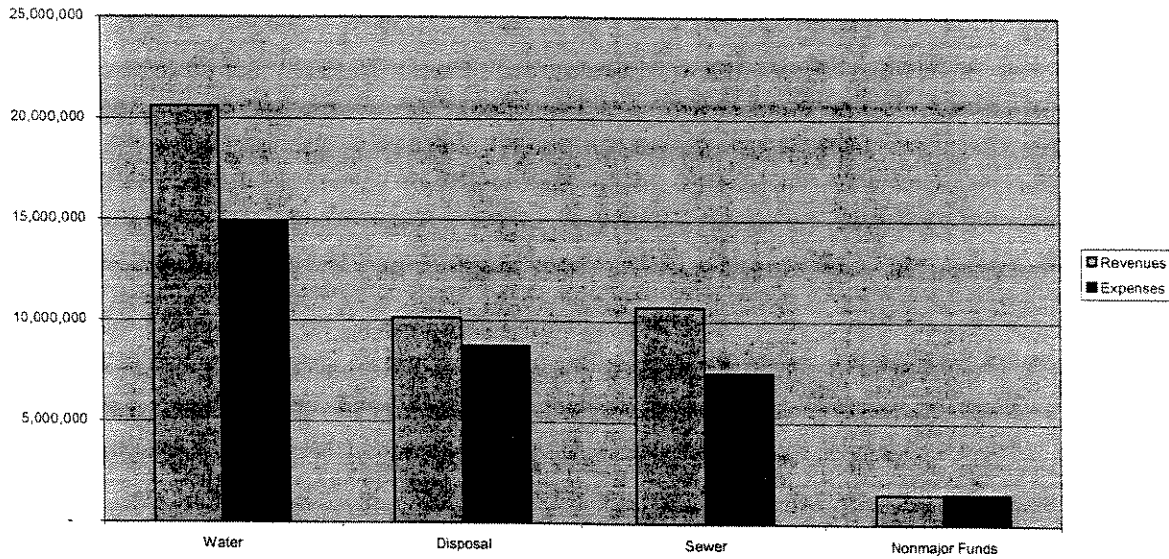
Operating expenses of the City's Business Activities for the three Utilities remained fairly constant with no significant changes except in the Sewer Fund where operating expenses increased by \$536,183 or 7.7% over prior year. Almost \$350,000 of the increase came as a result of salary and benefit increases, including increases in worker's compensation, compensated absences, and approximately \$200,000 in increases for chemical, lab and other materials and maintenance supplies for the sewer system.

In the Aviation Fund, operating expenses increased by \$49,993 or 22.9% due to an increase of approximately \$65,000 in interest expense on the Aviation's outstanding loan which is based on the average annual Local Agency Investment Fund (LAIF) rate. The LAIF rate increased by almost two points over prior year. In addition, salaries and benefits increased by approximately \$9,000, offset by a decrease of nearly \$25,000 in architectural and engineering services.

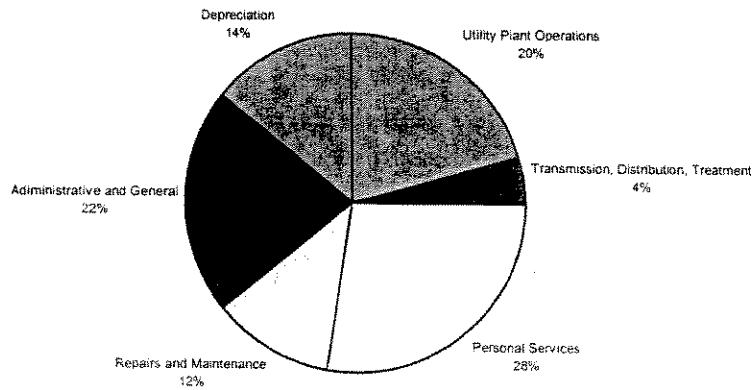
Cemetery operating expenses decreased by \$49,917 or 8.4% as a result of a decrease in excess of \$17,000 in resale materials, over \$27,000 in decreased general government service charges and a decrease of more than \$5,000 in water/sewer disposal costs.

Operating expenses of the Groves Fund decreased by \$40,364 or 5.4% due to a decrease of approximately \$69,000 in special contractual services, offset by an increase in salaries and benefits of almost \$22,000, net decreases in other services and supplies of nearly \$7,000.

Expenses and Program Revenues - Business-type Activities



Operating Expenses - Business-type Activities



MAJOR FUNDS

As noted earlier, the City uses fund accounting to provide proper financial management of the City's resources and to demonstrate compliance with finance-related legal requirements.

Major Governmental Funds. The **General Fund** is the chief operating fund of the City. At the end of June 2007, total fund balance of the general fund was \$13,247,724, an increase of

\$1,438,764 or 12.2% from the prior year fund balance of \$11,808,960. As a measure of the general fund's liquidity, it can be useful to compare the total fund balance to total fund expenditures, which show that fund balance is 25.3% of general fund expenditures, however only \$4.35 million of the \$13.2 million fund balance is unreserved. The unreserved fund balance of \$4.35 million, together with the \$4.15 million fund balance reserved for contingency and capital, the only portion of the reserved fund balance readily available for spending, represents 16.3% of general fund expenditures. Total general fund expenditures this year were \$612,015 more than prior year and total general fund revenue this year was \$5,700,461 more than prior year.

Significant changes in the revenues of the City's General Fund from the prior year are as follows:

- Sales Tax decreased \$505,232 from prior year due to a State adjustment in the compensation amount;
- Property Tax increased by \$3,182,374 (includes amount previously shown in Motor Vehicle In-Lieu Revenue) largely due to additional valuation from the power plant completion;
- Franchise Fees increased \$2,562,199 with the start-up of gas powered electrical generators;
- "Other" Taxes increased \$241,429, mainly due to additional TOT taxes;
- Licenses & Permits increased \$28,911;
- Intergovernmental decreased \$239,021 (included Motor Vehicle In-Lieu Revenue in prior years) due to variations in VLF and State grants;
- Charges for services increased \$412,883, mainly due to an increase in Mutual Aid Reimbursement;
- Charges for Services to other City funds decreased by \$96,794 as a result of an updated cost allocation review;
- Investment Income decreased \$131,902;
- "Other" Revenue increased by \$245,614.

The **Public Facilities Development** fund accounts for the collection and related expenditure of development impact fees designated for constructing new and upgrading existing public facilities. This fund holds an Advance Payable to the General Fund in the amount of \$3,751,378. This is a decrease from last year of \$233,058 due to a payment on the advance. The increase in fund balance/net assets is primarily due to a repayment on the advance in 2006 of \$1.1 million versus the repayment in the current year.

The **General Capital Improvement** fund accounts for the collection and related expenditure of grant revenues received by the City for general construction projects. This fund currently reflects the multi-million dollar construction activity of the City's long awaited Sports Park.

Major Enterprise Funds. The **Water Fund** has total net assets of \$76,794,382 at the end of the fiscal year; \$5,221,178 is unrestricted. The **Disposal Fund** has total net assets of \$17,148,184 at the end of the fiscal year; \$1,953,904 are unrestricted. The **Sewer Fund** has total net assets of \$36,344,741 at the end of the fiscal year; \$1,161,734 are unrestricted. These funds account for the respective utility services provided by the City. Other factors concerning the finances of these funds have already been addressed in the discussion of the City's business-type activities.

GENERAL FUND BUDGET

Differences between the original 2006-2007 budget and the final amended 2006-2007 budget of the General Fund can be briefly summarized as follows:

- Total Revenues - \$2,224,068 increase in the budget.
- General Government - \$99,456 increase in the budget
- Public Safety - \$1,142,535 increase in the budget.
- Highways and Streets - \$47,312 increase in the budget.
- Culture and Recreation - \$43,213 increase in the budget.
- Library – \$50,001 decrease in the budget.
- Capital Outlay - \$2,043,364 increase in the budget.
- Debt Service –\$215,608 decrease in budget.

Major deviations between the final budget of the General Fund and its actual operating results were as follows:

	Final Budget	Actual Amounts	Favorable (Unfavorable) Variance
Total Revenues	\$ 53,126,403	\$ 53,842,997	\$ 716,594
General Government	8,432,563	8,410,768	21,795
Public Safety	31,687,016	31,431,608	255,408
Highways and Streets	4,169,812	4,047,053	122,759
Culture and Recreation	3,174,962	3,096,177	78,785
Library	1,876,432	1,851,926	24,506
Capital Outlay	2,540,686	2,967,666	(426,980)
Debt Service	706,257	525,713	180,544
Total Expenditures	\$ 52,587,728	\$ 52,330,911	\$ 256,817

Revenues were over budget estimates due to higher than expected receipts in all categories offsetting a decrease in taxes and intergovernmental revenues. The two major increases were for Pre-annexation Agreements, \$605,902, and Investment Income, \$466,759.

General Government Expenditures were generally maintained in all categories and departments. This, along with the deferral of expenditures into the next fiscal year through encumbrances and carryovers, primarily of contractual services, was enough to cover the slight overages in retiree health insurance, garage charges and electricity. Together these net to a 0.45% difference.

Public Safety expenditures were also under budget due to savings in salaries and benefits, services and supplies. These combined with the deferral of expenditures into the next fiscal year through encumbrances and carryovers, primarily of contractual services, have allowed a 0.8% difference in this function.

Highways and Streets were under budget primarily for the same reasons. Expenditures were maintained in all categories and with encumbrances and carryovers deferring contractual and other professional services, this led to a 2.9% decrease.

Culture and Recreation was under budget primarily as a result of savings in the Recreation division for contractual services and supplies and in the Parks division for water. Together these offset increases in garage charges and building supplies to end the year with a 2.5% decrease.

Library expenditures were under budget due to savings in part-time salaries and various benefits. There were also some savings in the books and audio-visual materials categories resulting in a 1.3% difference.

Capital expenditures ended the year over budget by 16.8%. This is largely due to the lease value of safety vehicles and equipment in the amount of \$1,269,165. This amount, however, was offset by the San Timoteo Canyon Road paving project coming in under budget by \$381,481.

Debt Service expenditures were under budget by 25.5%. This was largely due to the structuring of lease payments for fire vehicles in arrears which defers these expenditures into the next fiscal year along with an encumbrance for lease payments on Motorola police radios.

The favorable variance of \$256,817 of expenditures under budget was the result of careful review of vacant positions and a concerted effort by management and staff to maintain expenditure levels to preserve the unreserved fund balance in the last months of the fiscal year.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital assets

The City's equity investment in capital assets for its governmental and business-type activities as of June 30, 2007, amounted to \$575,161,085 (net of accumulated depreciation). This investment in capital assets includes land, buildings and improvements, machinery and equipment, vehicles, infrastructure, water stock, rights of way and construction in progress.

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

The City completed work on the Alabama Street Bridge and continued work on the Orange Street Bridge, both destroyed by storms in the early 1990s. The city spent \$3,207,512 this fiscal year on these bridges. Total costs for these bridges is approaching \$9.8 million to date and will cost over \$10 million at completion. The City spent \$2,971,625 on development of the Sports Park project bringing total costs for that project to almost \$8.7 million. Significant street projects by Public Works included \$1,183,019 for San Timoteo Canyon Road, \$314,865 for New York Street traffic signals, and \$289,783 toward a major project at the intersection of Colton Avenue, Alabama and Redlands Boulevard. Another major project this year has been the construction of the Boys and Girls club building. Expenditures this year total \$2,246,309 and costs will be approximately \$4.5 million upon completion. Other expenditures included vehicle and equipment replacement purchases totaling \$1,652,384, \$1,010,200 for acquisition of downtown property, \$433,668 for roofing and building projects, and \$787,151 for Police department computer and equipment improvements.

The Water Utility continued infrastructure improvements to the Mill Creek Reservoir, \$463,102, Hinckley treatment plant, \$223,095, and the North Orange well project in the amount of \$333,982. The Utility also continued construction of improvements through the State Water Connection Project totaling \$363,511 to meet enhanced treatment requirements. The focus, however, was on the Capital Improvement Program where expenditures totaled \$2,898,714.

The Wastewater (Sewer) Utility incurred \$1,465,789 in expenditures for its Capital Improvement Program of lines and mains. During this period the Utility also spent \$707,858 for the Mentone Boulevard line.

The City's Disposal Utility was relatively conservative this year with equipment purchases in the amount of \$237,580. There are many emission standards that will have an impact on vehicle costs in the future and the division was focusing on preparing for implementation of these regulations.

Overall, the City's net capital assets increased by \$43,094,581 for the fiscal year ended June 30, 2007, or 8.1% over prior year. The Infrastructure, Rights of Way and Construction in Progress categories increased by a net of \$42,503,845, representing 98.6% of the increase. This is due largely to the completion of development projects throughout the city and the recognition of these assets by the City.

Capital assets for the governmental and business-type activities are presented below to illustrate changes from the prior year:

	Governmental Activities		Business-type Activities		Total		Increase/ (Decrease) Percent of Change
	2007	2006	2007	2006	2007	2006	
Land	\$ 27,550,936	\$ 26,540,739	\$ 27,840,335	\$ 27,840,335	\$ 55,391,274	\$ 54,381,074	1.68%
Buildings & Improvements	15,632,582	15,257,009	77,000,030	76,970,231	92,632,612	92,227,240	0.44%
Machinery/Equip./Vehicles	17,321,363	15,177,465	11,570,873	11,441,073	28,892,236	26,616,538	8.54%
Infrastructure	410,809,113	398,928,393	115,338,069	112,253,153	526,147,202	511,181,546	2.93%
Water Stock	-	-	9,264,712	9,179,433	9,264,712	9,179,433	0.93%
Rights of Way	31,822,967	-	-	-	31,822,967	-	-
Construction in Progress	8,571,341	10,958,346	10,013,101	6,665,470	18,584,442	17,623,816	5.45%
Accum. Depreciation	(76,493,698)	(72,186,338)	(111,080,662)	(106,956,805)	(187,574,360)	(179,145,143)	4.71%
Total	\$ 435,214,607	\$ 394,673,614	\$ 139,946,478	\$ 137,392,890	\$ 575,161,085	\$ 532,066,504	8.10%

Internal Service Fund capital assets, in the net amount of \$126,159, are included in Governmental Activities.

The City's infrastructure assets are recorded at historical cost in the government-wide financial statements as required by GASB No. 34.

Additional information on the City's Capital Assets can be found in Note 4 of the Notes to the Basic Financial Statements.

LONG-TERM DEBT

Major Long-Term debt events during the current fiscal year include the following:

- Leased five Police vehicles valued at \$135,165.
- Leased a light rescue unit and equipment for the Fire department valued at \$125,000.
- Leased two Seagrave Fire pumpers and equipment valued at \$970,000.

- Entered a lease for \$39,000 to complete an upgrade to computer and video equipment for the community access channel run by City staff.
- Issued \$1,985,000 in notes payable related to the completion of the City's Sport Park development project.
- Amortized bond issue costs totaling \$53,338.
- Paid \$7,060,887 scheduled principal and \$4,317,057 interest on existing debt. This included the final payment on the Solid Waste COPs.

Long-Term debts for governmental and business-type activities are presented below to illustrate changes from the prior year:

	Governmental Activities		Business-type Activities		Total		Increase/ (Decrease) Percent of Change
	2007	2006	2007	2006	2007	2006	
Capital Lease Obligations	\$ 2,283,200	\$ 1,407,827	\$ -	\$ -	\$ 2,283,200	\$ 1,407,827	62.18%
General Obligation Bonds	3,625,000	4,075,000	-	-	3,625,000	4,075,000	-11.04%
Tax Allocation Bonds	39,375,000	41,105,000	-	-	39,375,000	41,105,000	-4.21%
Certificates of Participation	15,310,000	16,620,000	-	880,000	15,310,000	17,500,000	-12.51%
Add: Issuance Premium	533,380	586,718	-	-	533,380	586,718	-9.09%
Revenue Bonds	-	-	27,550,000	29,730,000	27,550,000	29,730,000	-7.33%
Notes Payable	2,048,891	135,645	12,069,804	12,508,936	14,118,695	12,644,581	11.66%
Claims Payable	2,321,085	2,321,085	-	-	2,321,085	2,321,085	0.00%
Compensated Absences	6,824,717	7,034,564	734,205	804,744	7,558,922	7,839,308	-3.58%
Landfill Closure Liability	-	-	4,486,264	4,117,017	4,486,264	4,117,017	8.97%
Total	<u>\$ 72,321,273</u>	<u>\$ 73,285,839</u>	<u>\$ 44,840,273</u>	<u>\$ 48,040,697</u>	<u>\$ 117,161,546</u>	<u>\$ 121,326,536</u>	<u>-3.43%</u>

Additional information on the City's Long-Term Debt can be found in Note 5 and 6 of the Notes to the Basic Financial Statements.

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