

FINANCE DEPARTMENT

23 Russell Boulevard – Davis, California 95616
Accounts Payable & Payroll – 530/757-5615 – FAX: 530/758-0204
Utilities, Business Licenses & Citations: 530/757-5651 – TDD 530/757-5666



November 10, 2006

Honorable Mayor and City Council
City of Davis
Davis, California

I hereby submit the Comprehensive Annual Financial Report (CAFR) of the City of Davis for the Fiscal Year ended June 30, 2006. This report was prepared by the Finance Department and responsibility for both the accuracy of the presented data and the completeness and fairness of its presentation, including all disclosures, rests with the city. We believe the data, as presented, is accurate in all material aspects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of the City as measured by the financial activity of its various funds; and that all disclosures necessary to enable the reader to gain the maximum understanding of the city's financial affairs have been included.

This CAFR is organized in three sections: introductory, financial, and statistical. The Introductory section includes this transmittal letter, a list of the principal officials of the City of Davis, an organization chart of the city government and a community profile designed to acquaint the reader with the city. The Financial section includes management discussion and analysis, the city's basic financial statements, required supplemental information and the combining financial statements for non-major funds, as well as the independent auditor's report on these financial statements. The Statistical section includes selected financial information on the city government and economic and demographic information on the community, generally presented in a multi-year comparative format. The section is intended to give the reader a broader perspective on the city's financial affairs than is provided in the other sections of the report.

The City is required to undergo an annual Single Audit in conformity with the provisions of the Single Audit Act Amendments of 1996 and the U. S. Office of Management and Budget Circular A-133, *Audits of State and Local Governments and Non-Profit Organizations*. The City's Single Audit for Fiscal Year 2005-2006 will be completed shortly and a separate Single Audit Report will be prepared. As soon as it is completed, a copy of that Report may be obtained by contacting the city Finance Department.

This report includes all funds of the City of Davis. The City provides services to its citizens in the areas of public safety; community planning and development; water, waste water and sanitation utilities; transportation, recreation, cultural and social assistance. In addition, the City Council of the City of Davis has financial responsibility and accountability for the following legally separate entities: Redevelopment Agency of the City of Davis, City of Davis Public

Facilities Financing Authority and Community Facilities District 1991-2 (Mace Ranch). Financial information on these entities has, therefore, been included in this report.

Included as a part of this letter are several attachments which provide important information regarding the operations, economic environment and financial position of the City. The attachments are:

Attachment A	Governmental Structure, Local Economic Condition and Outlook
Attachment B	Highlights and Accomplishments
Attachment C	Financial Information
Attachment D	Other Information

The preparation of the Comprehensive Annual Financial Report was made possible by the dedicated service of the entire Finance Department staff. Each member of the Department has our appreciation for the contributions made in the preparation of this report.

Respectfully submitted,

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

Paul Navazio
Finance Director

ATTACHMENT A

GOVERNMENTAL STRUCTURE, LOCAL ECONOMIC CONDITION AND OUTLOOK

The City of Davis is a general law city and employs the Council Manager form of government. The City Council is comprised of five council members. One of these serves as the Mayor and another as the Mayor Pro Tem. Council members are elected for an overlapping four-year term on a citywide basis (called "at large"). The member elected with the greatest number of votes serves as Mayor Pro Tem for the first two years of the term and Mayor for the last two years of the term. The City Council acts as the legislative and policy-making body. Council appoints the City Manager and awards the contract for City Attorney services. The City Manager is the chief administrator and is responsible for hiring department directors and oversees the work of City staff in implementing the policies and priorities of the City Council.

The City of Davis is a university and residential community internationally known for its commitment to implementing progressive and innovative programs. Located just 13 miles west of the State Capital in Sacramento, the center of State government operations, and home to the University of California, Davis, the City has an economy that has traditionally mirrored employment trends in these two institutions.

UC Davis represents, by far, the largest employer in the Davis area with 29,000 academic, staff and student employees on the campus. The university has approximately 30,000 students enrolled; however, University officials expect an increase in student demand in the next several years and preliminary projections foresee 31,000 students enrolled by the year 2010. A number of building and infrastructure projects are being undertaken on the campus to prepare for this growth. Joint efforts between university and city officials in land use and infrastructure planning have received greater emphasis to ensure that the campus and the community can accommodate the expanding student population.

UC Davis has been estimated to contribute \$2.7 billion, annually, to the regional economy. Besides its impact as an academic institution, the university is an acknowledged international leader in agricultural, biological, biotechnological and environmental science and has increased its efforts at strengthening ties with private industry. Mutually beneficial university-private relationships are encouraged and UC Davis is becoming an increasingly valuable "drawing card" for economic development efforts in the community and the region.

The entire Sacramento region enjoyed the economic boom of the late 1990s. (Despite the slowing national, state, and regional economies over the past few years) the Sacramento region is expected to remain one of the fastest growing areas in California. Sacramento has seen higher percentage gains in population, employment, income, and retail sales than any other region in the State over the last several years. The region has emerged as a center for high-tech manufacturing and research & development firms. Back-office operations for large San Francisco Bay Area firms have also begun moving into the Sacramento region with its lower cost

land and relative earthquake safety as advantages. While the duration and depth of the current economic slowdown is unknown, the Sacramento region will likely fare better than other major metropolitan areas of the State.

Over the past two years, cities have successfully worked to greatly insulate their General Fund revenues from adverse impacts from State budget problems. After several years of annual property tax shifts and loss of vehicle license fee revenues, cities worked with the State to secure passage of Proposition 1A (November 2004) which now protects cities share of property and sales tax revenues. In addition, vehicle license fee revenues have been largely replaced by in-lieu property tax payments, which in turn, now fall under the constitutional protection of Proposition 1A.

More recently, this past election, (November 2006) saw the passage of another Proposition 1A, which provides cities with additional protection against loss of Prop 42 Transportation funding (from state sales tax on gasoline). While these recent statewide initiatives significantly protect local revenues from actions by the State, there remain a few areas where local revenues are still vulnerable to State actions. These include reimbursement for State Mandated Costs and booking fees. Another area that remains of concern to the City is the potential for State actions related to local tax-increment revenues generated by local redevelopment agencies.

Although overall development activity in the City began to decline in 2001-2002, the City issued permits for about 155,312 square feet of new commercial and industrial construction during 2005-2006, up 67,732 square feet from the prior year. Highlights of this development activity include new office and industrial buildings in Mace Ranch and South Davis. These developments will contribute incremental property tax, sales tax, and business license tax revenues to the City's General Fund in the coming years.

Residential development continues to lag recent historical trends. While 400 new single family units were built in each of the three years ending in fiscal year 1999-2000, that figure has dropped off steadily over the past five years: 2000-2001 – 264 units; 2001-02 – 119 units; 2002-03 – 66 units; 2003-04 – 72 units; 2004-05 – 59 units; and 2005-06 – 42units, not from lack of demand, but rather supply constraints. As of November 2006, approximately 97 single-family lots remain in currently approved subdivisions. The City's recently amended General Plan decreased the amount of single family residential development from the prior plan. Development capacity for limited additional multi-family development remains within the plan, while the University has developed a project to help accommodate projected growth in student population on campus (outside the City boundary).

ATTACHMENT B

HIGHLIGHTS AND ACCOMPLISHMENTS

Davis Municipal Golf Course Renovation

The snack bar, pro shop and restrooms were remodeled to update the buildings and comply with ADA requirements. A creative combination of funding sources enabled the project to be completed without the use of General Fund or Park impact fees and without raising green fees, keeping the course affordable to users.

Mace Ranch Community Park

The 23 acre park was opened in September 2005 and encompasses approximately 23 acres of land, with 5 acres reserved for habitat. The park accommodates both the need for recreation facilities and the desire to preserve wildlife and habitat and received the California Park & Recreation Society's Award of Excellence in Park Planning and Design.

Varsity Theatre

The City of Davis acquired the Varsity building, which the City had previously been renting. The facility is leased to local entrepreneurs, netting a cash flow increase and preserving the historical flavor to the downtown.

Brady Family Aquatics Building

The City of Davis partnered with the Davis Aqua Masters and the Davis Aquadarts to build a 1300 square foot building at Civic Center pool to provide office and storage for the swim groups in addition to a public meeting room.

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ATTACHMENT C

FINANCIAL INFORMATION

The City's accounting records are organized and operated on the basis of funds. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts and fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

City management staff is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles and facilitates internal management reporting. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

In addition, the City maintains budgetary controls. The objective of these controls is to ensure compliance with legal provisions embodied in the annual budget approved by the City Council via the annual appropriation ordinance. All operating, special revenue, debt service and capital improvement activities of the City are included in the annual appropriated budget. The legal level of budgetary control (that is, the level at which actual expenditures may not legally exceed the appropriated amount) is at the fund level. The City also maintains an encumbrance accounting system as one technique in accomplishing budgetary control. Open encumbrances at June 30, 2006 are reported as reservations of fund balance in the City's governmental funds. Management considers such encumbrances as a use of budgetary authority and they are reflected as equivalent to an expenditure in the accompanying budget and actual schedules. In conformance with generally accepted accounting principles, encumbrances are otherwise not included in the accompanying operating statements.

We believe that the statements and schedules included in the Financial Section of this report demonstrate that the City is meeting its responsibility for sound financial management.

For a more comprehensive analysis of the City's financial information, please refer to Management's Discussion and Analysis contained in the Financial Section.

CASH MANAGEMENT

The City pools all cash funds not held by fiscal agents in order to maximize investment opportunities and increase flexibility. Investment earnings are credited back to all funds contributing to the pool, based on the fund's cash balance as a percentage of the pool. Investment responsibility is located organizationally within the Finance Department, but internal control is rigorously maintained to provide accountability and to protect the City's cash assets.

Investments are conservatively managed with the three primary objectives of (1) safety of principal, (2) liquidity to meet disbursement requirements, and (3) investment yield pursued in that order.

During the 2005-06 Fiscal Year, a portion of the City's pooled cash was invested in the Local Agency Investment Fund, an investment pool for local agencies operated by the State of California Treasurer's Office. Investments were also placed in federally sponsored agency notes where opportunities presented themselves to enhance investment yield while maintaining safety and liquidity. Total investment earnings for all funds held in the city treasury totaled \$2,214,889, a return of 3.253%. Our return is slightly lower than the average effective yield of the Local Agency Investment Fund of 3.859%

At the June 30, 2006 close of the City's fiscal year, \$88,446,363 was held in the City's treasury with investments valued based on fair value (rather than the actual amount invested). During Fiscal Year 1997-98, the City adopted the requirements of Governmental Accounting Standards Board Statement 31, which calls for the recognition in the City's accounts of the unrealized net market value gain or loss on investments held by the City and its fiscal agents.

RISK MANAGEMENT

The Yolo County Public Agency Risk Management Insurance Authority (YCPARMIA) JPA handles the City's risk management. The deductible for liability is \$5,000 and for workers comp is \$1,000. This limits the City's risk to an insignificant amount.

ATTACHMENT D

OTHER INFORMATION

INDEPENDENT AUDIT

The City's financial statements were audited by the independent accounting firm of Maze & Associates Accountancy Corporation. Their unqualified opinion is presented at the front of the financial section. We wish to express our appreciation to the staff of Maze & Associates for their assistance during the audit process.

AWARDS

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 of Davis for its comprehensive annual financial report for the fiscal year ended June 30, 2005. This was the eighth consecutive year 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 comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report, which implements GASB Statement 34, continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA and CSMFO to determine its eligibility for another certificate.