



January 30, 2004

The Honorable Mayor Gavin Newsom
The Honorable Members of the Board of Supervisors
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, 2003, with the Independent Auditors' Report, submitted in compliance with City Charter Sections 2.115 and 3.105 and California Government Code Sections 25250 and 25253. The CAFR has been prepared by the Controller's Office in conformance with the principles and standards for financial reporting set forth by the Governmental Accounting Standards Board (GASB). Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the City. I believe that the data, as presented, is accurate in all material respects; that its presentation fairly shows the financial position and the results of the City's operations as measured by the financial activity of its various funds; and that the included disclosures will provide the reader with an understanding of the City's financial affairs.

This is the third year the City prepares the CAFR using the new financial reporting requirements as prescribed by the GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* (GASB 34). This GASB Statement requires that management provide a narrative introduction, overview, and analysis to accompany the Basic Financial Statements in the form of a Management's Discussion & Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The MD&A can be found immediately following the report of the independent auditors.

Our CAFR is divided into the following 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 is prepared in accordance with the GASB 34 requirements by including the MD&A, the Basic Financial Statements including notes and the Required Supplementary Information. The Basic Financial Statements include the government-wide financial statements that present an overview of the City's entire financial operations and the fund financial statements that present the financial information of each of the City's major funds, as well as non-major governmental, fiduciary and other funds. Also included in this section is the Independent Auditors' Report on the basic financial statements.

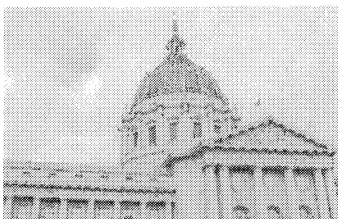
The Statistical Section includes tables containing historical financial data, debt statistics, and miscellaneous social and economic data of the City that are of interest to potential investors in our bonds and to other readers. The data includes ten-year revenue and expenditure information on an inflation-adjusted basis.

THE REPORTING ENTITY AND ITS SERVICES

The City and County of San Francisco (City), established by Charter in 1850, is a legal subdivision of the State of California with the governmental powers of both a city and a county under California law. The City's powers are exercised through a Board of Supervisors serving as the legislative authority, and a Mayor and other independent elected officials serving as the executive authority. The services provided by the City include public protection, public transportation, construction and maintenance of all public facilities, water, parks, public health systems, social services, planning, tax collection, and many others.

This CAFR includes the financial activities of the primary government, which encompasses several enterprise activities, as well as all of its component units. Component units include legally separate entities for which the primary government is financially accountable and that have substantially the same board as the City or provide services entirely to the City. For reporting purposes the operations of the San Francisco County Transportation Authority, the San Francisco Parking Authority, and the San Francisco Finance Corporation are blended with the City. In addition, there are two component units, the San Francisco Redevelopment Agency and the Treasure Island Development Authority, which are legally separate entities but which have some financial interdependency with the City. For reporting purposes these entities are shown as discretely presented component units.

SAN FRANCISCO'S GOVERNMENT, ECONOMY AND OUTLOOK



San Francisco is the economic and cultural hub of the Bay Area. The county is geographically the smallest in California, occupying just forty-seven square miles of land, but is the most densely populated in the state. The population has grown by approximately six percent over the past ten years, to 791,600.ⁱ San Francisco is racially and ethnically diverse, with minority groups combining to represent just over 56 percent of the population and no single group forming a majority.ⁱⁱ

San Francisco is a charter city, exercising the powers and duties of both a city and county. The elected Mayor of San Francisco serves as the executive, and appoints the heads of most city departments. Many departments are also advised by commissions or boards whose members are appointed either by the Mayor, or, in some cases, by a combination of the Mayor, the Board of Supervisors, and other elected officials. Elected officials include the Assessor-Recorder, City Attorney, District Attorney, Public Defender, Treasurer, and Sheriff. In November 2000, the eleven members of the Board of Supervisors were elected by district for the first time since the 1970s. In order to provide for staggered terms of office, a lottery was held which determined that members elected to seats in the City's even-numbered supervisorial districts would serve a two-year initial term, with elections for these seats conducted again in the fall of 2002. All Board of Supervisors seats are now on the cycle of full four-year terms, with elections in even-numbered years.

In 2001 the United States economy contracted for the first time in ten years, with significant losses in the stock market, rising unemployment, and decreasing consumer confidence. With a high concentration of technology and internet companies, the Bay Area has been hit hard by the economic slowdown. San Francisco lost approximately 65,000 to 75,000 jobs in the current downturn, nearly twice as many as were lost in the last significant recession of 1991-1993.ⁱⁱⁱ Job losses pushed the unemployment rate to a peak of 7.9 percent in July 2002. By the close of the City's fiscal year in June of 2003, San Francisco's unemployment rate had improved slightly and stood at 7.4 percent, but was still slightly worse than that of California as a whole at 6.8 percent.^{iv} While the softening of the technology sector has stalled the local economy, some professional services categories that have long been critical to San Francisco's economy have displayed stability or growth over the last three years. Legal services, publishing, insurance, and securities, after experiencing some job losses, have recovered and improved to the point where these industries together now employ several thousand more people than during the economic peak in 2000.



Downtown office vacancy rates, which decreased steadily for over eight years in the 1990s, dropping below one percent at certain points, have reversed and increased in each of the last two fiscal years. However by the middle of fiscal year 2002-2003 that trend had begun to stabilize and occupancy stood at levels comparable to the mid 1990s, before the run-up associated with the technology boom. At the close of the fiscal year the overall vacancy rate was 17.1 percent, including both direct and sublet space. Asking prices for office space rents have similarly declined from the high point by as much as 73 percent, from an

ⁱ Source: California Department of Finance

ⁱⁱ Source: United States Census

ⁱⁱⁱ Source: San Francisco Quarterly Economic Briefing, April 2003

^{iv} Source: Employment Development Department

average of \$80 per square foot in July of 2000, to around \$22 per square foot by June 2003.^v San Francisco's downtown business district is now affordable for companies previously priced out of the local market, particularly small businesses, with approximately 45 percent of the vacant space in the range from one to 5,000 square feet.^{vi} Substantially lower office rental rates have made it more economic to locate in San Francisco and have contributed to the recovery in professional service jobs in the City.

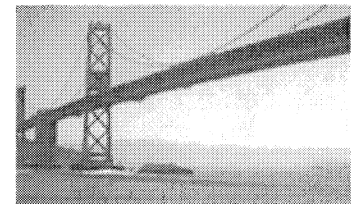


Despite weaknesses in areas of the economy, property values in San Francisco remain among the highest in the nation. Since 1993, San Francisco's median home price has increased by nearly 96 percent and the Bay Area's ongoing housing need keeps upward pressure on the City's residential real estate market. Despite steady construction, including 1,279 new units of housing permitted during fiscal year 2003, a housing shortage persists. The gap between demand and supply has

contributed to a steadily worsening affordability gap in the City, with homeownership remaining out of reach for most residents and workers. As of June 2003, the median price for an average single family home in San Francisco had increased slightly from the prior year and stood at \$543,000, a level that was affordable by less than 25 percent of the population.^{vii} As of November 2003, the average assessed valuation in the City stood at \$265,000 for single family homes and \$366,000 for a condominium—both averages tend to be lower because the limits on property tax increases under California's Proposition 13 provide incentives for owners to buy and hold property. Partly due to these affordability hurdles and market conditions, 65 percent of the City's residents rent their homes, and only 35 percent own,^{viii} substantially below the national average where 68 percent own their homes.^{ix} Affordable housing continues to be built and developed in the City, funded in part by a \$100 million general obligation bond issue approved by the voters in 1996. During the November 2002 election, however, voters rejected an additional \$250 million bond authorization, and the City is therefore exploring other options for housing construction and purchase programs.

The City's property tax revenue, the single largest source of tax revenue for the City's general fund, has grown in some cases by as much as 12 percent annually over the last five years, reflecting the steady growth in property values and prices during the time period. In fiscal year 2002-2003, this trend softened, with property tax revenues relatively flat overall, partly as a result of an increasing number and value of assessment appeals. Trends in other sources of local tax revenue have been more typical of the downturn in the business cycle, with hotel room, sales, parking, and other local taxes decreasing as much as 30 percent in the period of steepest decline from the fiscal year 2000-2001 peak to fiscal year 2001-2002. Over these last two fiscal years, hotel room tax revenues have exhibited among the most severe downturn, dropping from \$188 million in fiscal year 2000-2001 to \$132 million in fiscal year 2001-2002 and \$127 million in fiscal year 2002-2003. Budgeted growth of five percent is forecast during fiscal year 2003-2004, which would mean revenues commensurate with the level of fiscal year 1996-1997. This trend represents a significant loss of funding for local cultural institutions and general City services which the government has had to absorb since 2001.

At San Francisco International Airport (SFO) passenger traffic continued to decline due to a number of factors including the sluggish economy, the war in Iraq and the outbreak of SARS in the Far East. Compared to the previous year, passengers using the airport in fiscal year 2002-2003 decreased by 5.8 percent from 31.6 million to 29.8 million. The Convention and Visitors Bureau estimates that 14 million people visited San Francisco in calendar year 2002, a 12.5 percent decrease from the year before. Visitor spending in the City totalled approximately \$5.9 billion for the calendar year, down by 9.2 percent from the 2001 level of \$6.5 billion.^x In the two years prior to the travel downturn associated with both September 11 and with the contraction in the business cycle, hotel occupancy rates in the City averaged around 80 percent. During fiscal year 2002-2003 this figure



^v Source: Newmark, Office Market Report, Second Quarter, 2003

^{vi} Source: San Francisco Quarterly Economic Briefing, April 2003

^{vii} Source: California Association of Realtors

^{viii} Source: San Francisco Quarterly Economic Briefing, April 2003

^{ix} Source: U.S. Census Bureau Housing Vacancy Survey Third Quarter 2003

^x Source: San Francisco Convention and Visitor's Bureau

averaged 66 percent, a slight increase from the 63 percent rate in fiscal year 2001-2002. Occupancy rates for fiscal year 2003-2004 are projected to improve, as convention business is slated to be stronger.^{xi}

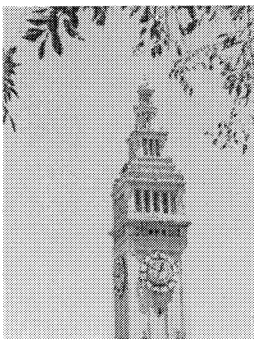
While the economic contraction in the nation and the Bay Area have affected the City's economy, San Francisco overall retains a solid foundation of business and industry diversification. The City's economic base includes national and global companies and locally owned small businesses. San Francisco has large employers ranging from Provident Financial to The Gap, yet the small business sector is also strong, with 96 percent of businesses employing fewer than fifty people.^{xii} San Francisco is a financial and banking center of the West, with the Pacific Stock Exchange, Wells Fargo Bank and Charles Schwab among others headquartered here; in banking activity, San Francisco ranks second only to New York City. The City also functions as a center of world and Pacific Rim trade, with foreign consulates, trade offices, and significant activity in import/export and foreign investment.

MAJOR INITIATIVES AND ACHIEVEMENTS

A number of significant initiatives, outlined below, are underway in San Francisco that will have a positive effect on the City's economic health and its ability to provide services to residents and businesses.

Economic Development

San Francisco's new Moscone West Convention Center officially opened in June 2003. The 300,000 square foot addition to the City's convention facilities is located at Fourth and Howard Streets half a block west of the existing Convention Center and next to Yerba Buena Center—a center of downtown activity with theaters, retail, restaurants, and open space. The new building offers glass-walled, light-filled lobbies on three levels, movable walls on the second and third floors which can be configured into highly flexible meeting, exhibit, tradeshow and classroom space designs, and a theatre-style area on the third floor which can accommodate up to 7,000 people. Moscone West makes it possible for San Francisco to attract convention business that would have otherwise been turned away due to lack of sufficient space or available dates. Confirmed events booked through 2013 at the new facility are estimated to be worth over \$950 million in direct expenditures in the City.



San Francisco's Embarcadero and waterfront were connected to the City in a new way in March 2003 with the reopening of the Ferry Building, complete now after a three-year, \$90 million preservation effort by the Port of San Francisco. The building has been restored with glass fronts on the eastern side of the building facing the Bay, brick and marble surfaces throughout, and the re-creation of the central hall, over 650 feet long and illuminated with vaulted skylights. The first floor tenants, some operational and others still under construction, are primarily producers and vendors of local and gourmet food and wine, plus a number of new bars and restaurants. Prime office space makes up the second floor. The Ferry Plaza Farmer's Market moved back to its traditional location in the summer of 2003, taking over the public spaces in front and back of the building on Saturdays and Thursdays. Travelers going to and from the

Marin, Oakland/Alameda and North Bay ferries are able to take advantage of the restored Ferry Building's public restrooms, new plazas, refurbished walkways, lighting and landscaping.

Housing and infrastructure development continues in the City's newest neighborhood in Mission Bay, south and east of downtown. Over the 20 to 30 year development period of Mission Bay, the area is projected to create over 31,000 new permanent jobs, and hundreds of ongoing jobs in construction. The Third Street Light Rail being built by the Municipal Railway (MUNI) will serve as the primary transit conduit for the area, which will also include approximately 1,700 affordable housing units, over 50 acres of open space, a new public school, and new Fire and Police station. Construction has been completed on 384 residential units, 27,500 square feet of neighborhood-serving retail, 285,000 square feet of commercial office space, and 555,000 square feet of life science research space and other facilities for the University of California San Francisco medical complex. The largest of the planned medical research buildings, UCSF Genentech Hall,

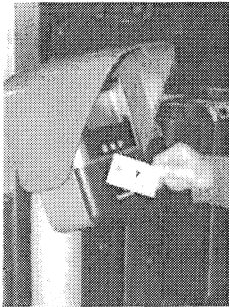
^{xi} Source: PKF Consulting

^{xii} Source: San Francisco Chamber of Commerce

was completed in October 2002 and opened in 2003, and a second facility, the Genetics Development and Behavioral Sciences Building, was completed in August 2003.

San Francisco's water system, including the Hetch Hetchy reservoir, other reservoirs in the Bay Area and the Sierra and network of pipelines, tunnels and other facilities, deliver water to approximately 2.4 million people in the City and surrounding communities. The City's sewer system provides services to residents and businesses within San Francisco. In November of 2002, San Francisco voters approved two ballot measures that position the City's Public Utilities Commission (PUC) to build needed repairs and improvements throughout the system. A \$1.6 billion bond measure, financed by the rates charged to retail water users, together with \$2 billion in additional financing to be provided by the system's wholesale customers, will allow for seismic strengthening, upgrades in water storage systems, and improvements to distribution facilities. The second measure gives the PUC an increased ability to issue revenue bonds for water and sewer facilities, effectively repeals a sewer rate freeze which had been imposed in 1998, and gives the PUC more control over its contracting, employment, and financial management practices. Taken together, these changes give the PUC a significantly improved operating environment and will allow the agency to more effectively meet customer demands for reliable and quality utility services in the years to come.

Transportation



The City and the Bay Area's economic health and quality of life are recognized as being linked to its capacity to move people and goods efficiently throughout the nine-county area. In December of 2002, the City joined the other members of the regional Metropolitan Transportation Commission (MTC) in launching a new 511 information system providing real-time information via phone and web access on road and traffic conditions, transit information, and other services such as vanpool matching throughout the Bay Area. MUNI is a critical link in this and other regional efforts including a pilot program now underway with five other local transportation systems to implement TransLink, a smart-card system that will eventually be usable on all 21 transportation systems in the greater Bay Area.

BART opened four new stations in the summer of 2003 on the San Mateo peninsula south of the City including the station at SFO. The new BART connection provides direct rail service from downtown San Francisco and the Bay Area to the Airport for the first time. A trip from downtown to the SFO station takes approximately 30 minutes at a cost of \$4.95. The BART station is connected to all terminals through the AirTrain, SFO's new automated people mover. The \$430 million electronic system runs 24 hours a day on rubber wheels atop a concrete guideway. Opened in February 2003, AirTrain takes travelers to the passenger terminals and also to Airport parking and rental car lots on its five-mile circuit.

San Francisco continues to invest in its light rail system, the MUNI Metro, which serves the downtown underground along the Market Street corridor, fans out into above ground service in the neighborhoods west and south, and includes the historic F-line streetcar service from Castro Street down Market Street and along the Embarcadero bayfront to Fisherman's Wharf. The major expansion project now underway, the Third Street light rail, will link communities in the City's southeast neighborhoods to South of Market, Mission Bay, downtown, and the rest of the Metro system. Construction of Phase 1, which links the 4th and King Street area to the Bayshore Caltrain station, proceeded in fiscal year 2002-2003 with underground electrical work in the Mission and Islais Creek areas completed, and a contract for construction of the new \$100 million Metro East LRV facility awarded. Design has begun for Phase 2, which will eventually build a new subway from 4th and King Streets north into Chinatown/North Beach. During the year, MUNI also completed track and system upgrades on both the L and K light rail lines, improving service to San Francisco City College, the Parkside neighborhood and the San Francisco Zoo among other areas. MUNI delivered a third year of special expanded hours service to the new downtown baseball stadium, PacBell Park, with ridership increasing to approximately 8,000 people on average for home Giants games. A series of information technology improvements at MUNI got underway in fiscal year 2002-2003 including a new maintenance and inventory system, new scheduling and dispatch, and expansion of the *NextBus* information system—providing expected bus arrival and wait time information for passengers at street stops.

The challenge of financing local public transit improvements and operations has been met creatively by both government and citizens over the last two fiscal years. New funding has come from two series of tax-

advantaged public-private leases of MUNI's Breda light rail cars, a fare increase in September 2003 on MUNI for the first time in more than ten years, and increases to parking meter and garage rates that support the transit system. Unlike many large urban transportation systems, MUNI has been able to balance its budget and avoid service reductions during the current economic downturn. San Francisco voters also approved, in November 2003, a more than twenty-year extension of a one-half cent sales tax which funds transit, congestion management, road repair and other transportation improvements.

The 1989 Loma Prieta earthquake resulted in damage to and the eventual demolition of a number of elevated freeways in San Francisco including those along the Embarcadero and in the Hayes Valley area crossing over Market Street. The last of these demolitions was completed in the spring of 2003, with the ramps to Fell Street and the north Mission area being razed in preparation for construction of the new Octavia Boulevard. Octavia Street will be widened to a four lane two-way roadway separated by a central median, and flanked on either side by a one-way street with on-street parallel parking. Work along the medians, roadway, and sidewalks will include installation of new traffic signals, light fixtures, tree plantings, and benches. The intent of the new boulevard, which will begin construction in 2004, is to provide a smooth transition of vehicle travel from local streets to arterials, and from those arterials to the remaining portion of the elevated new Central Freeway. Also among the street improvements in the City during the year was completion of a project to underground utilities, build streetscape improvements, and resurface the road along the major commercial and residential corridor on Ocean Ave.

Housing, Health and Safety

San Francisco's \$100 million Affordable Housing and Home Ownership Bond Program, approved by the voters in 1996, combined with federal, state and other funding that the City has been able to leverage, successfully developed approximately 2,200 units of housing and beds in group housing, and assisted approximately 250 low and moderate-income households to become first-time homebuyers. Significant affordable housing projects completing construction during the year include Rich Sorro Commons (100 units of family rental housing), SOMA Studios (162 units of family rental housing), and Bayview Commons (30 units of family rental housing). An additional 71 units or beds were rehabilitated in four developments for special needs housing, including households that were formerly homeless and/or living with HIV/AIDS. The Treasure Island Homeless Development Initiative continued to develop housing on the former military base in San Francisco Bay, with renovation of 84 units of housing for homeless families getting underway in April 2002.

The majority of the individuals assisted by the City's affordable housing programs are considered at higher risk for homelessness and eviction—households headed by women, families with children, and seniors, with few other opportunities to become homeowners in San Francisco. As noted above, however, voters rejected a proposal for a second, \$250 million affordable housing bond in November 2002, and the City is currently exploring other ways to fund affordable housing efforts.

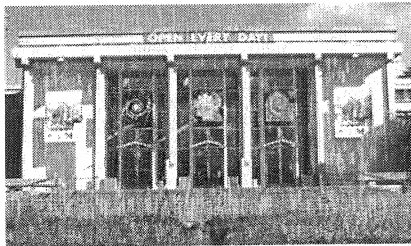
Groundbreaking was formally held in November 2003 for the new Laguna Honda complex, the City's project to rebuild existing hospital facilities, build supportive care housing and provide a complete continuum of long-term healthcare services. Financed by general obligation bonds, tobacco settlement funds and supplemental Medicaid payments, the new Laguna Honda will be built to modern design, environmental, seismic, and technological standards. The project's Environmental Impact Reports and community consultation processes were substantially completed in 2002, however community outreach and update efforts continue throughout construction of the project. Trenching and utility installation is currently underway, and construction activities will ramp up in early 2004.

With improvements made to San Francisco's 911 and wireless phone carrier systems, cell phone users gained faster access to emergency services as of July 2002. The City's 911 Center can now receive emergency calls directly from the user instead of having them routed through the California Highway Patrol, becoming the first city and county in the State to achieve this milestone. A second stage of this effort will implement changes giving the City better location information from cell phones, allowing tracking of calls where the user cannot or does not give an accurate location for emergency response.

Cultural and Recreational Facilities

The revitalization of the City's Civic Center achieved another significant milestone in March 2003 with the completion and grand opening of the City's Asian Art Museum—Chong Moon Lee Center for Asian Art and Culture. The opening completes an eight-year effort, financed with \$51 million in voter-approved bonds and over \$100 million in private gifts, to create a new home for the Museum's world-renowned collection of nearly 15,000 pieces representing cultures throughout Asia. The City's former Main Library, a 1917 Beaux Arts building, has been transformed into 40,000 square feet of galleries, educational and conservation space, while preserving historically significant architecture and features of the original building. The new facility more than doubles the number of objects from the collection that can be displayed, and includes a café, museum store, and terrace overlooking a refurbished public promenade on Fulton Street facing the new Main Library.

Construction at the Conservatory of Flowers was nearing completion at the end of fiscal year 2003. A gala re-opening was held in September 2003 for the unique 1878 Victorian building (see cover photo). The building is the oldest glass and wood conservatory in the United States, housing a collection of 1500 specimens of rare and endangered species, including carnivorous plants and a world-famous orchid collection. The Conservatory has been closed since 1995 when winter storms and 100 mph winds shattered over 40 percent of the glass panes and destroyed thousands of plants. The meticulous restoration of the Conservatory required specialized expertise to re-use the original redwood and glass building materials. The total project cost was over \$25 million, including \$15 million in private donations raised by the Friends of Recreation and Parks, a non-profit partner to the City's Recreation and Park Department. An ongoing collaboration between the two organizations will continue to raise funds and operate the Conservatory.



Golden Gate Park's other public and arts institutions also saw significant events during the year. Demolition of the old DeYoung Museum structures and site preparation for the new building was completed, and construction is underway for a scheduled opening in 2005. Across the concourse, the City's Academy of Sciences closed at the end of 2003 in preparation for relocation to a downtown site. The temporary location will house and display the fish and other natural history collections while the new Academy, supported by a bond issue, is built on the Golden Gate Park site for a 2008 opening.

A two-year, \$16 million renovation of the City's 27-hole municipal golf complex at Harding Park was completed in July 2003, with the course re-opened to the public in August. The project was funded with California Resource Bonds, and an innovative fee structure will keep play affordable for local residents. The renovation respects the 1925 design of the original course, while adding bunkers and re-contoured surfaces. Added yardage on the course enhances Harding's ability to host professional golf events. The Professional Golf Association (PGA) is a partner in the project, and the first PGA event will take place at the refurbished courses in October 2005. Other improvements include a new driving range and maintenance facility. The Harding Park Golf Courses will also serve as a home base for the San Francisco First Tee Program, a youth golf and life skills teaching project.

In February 2003, the City opened Rincon Park, a new two-acre park and public open space along the San Francisco waterfront. Stretching 1,000 feet from the foot of Folsom Street, the park has new lawns, landscaping, seating along architectural walls, a waterfront promenade and a sculpture, Cupid's Span, by artists Claes Oldenburg and Coosje van Bruggen, framing views of San Francisco Bay, Treasure Island, and beyond. The park joins another significant completion in the Rincon Point-South Beach Redevelopment Area, of China Basin Park, located along McCovey Cove south of Pacific Bell Park. China Basin Park is a collaborative project of the Port, Redevelopment Agency, other local agencies and private funders, and the Giants, who constructed facilities including landscaping, historical markers and picnic areas. The Giants will maintain the area until 2010, when it will be turned back over to the Port of San Francisco for maintenance.

A June 1997 bond issue of \$48 million, added to more than \$25 million in private donations, funded extensive infrastructure improvements to sections of the San Francisco Zoo which opened in the summer of 2003. The construction moves the main entrance of the Zoo to its westernmost end, with entrances from Sloat Boulevard and the Great Highway, with a new visitor center, café, secured parking lot, new central walkway, Lemur Forest exhibit, and art installations throughout the Zoo through a program sponsored by the San Francisco Arts Commission. Further Zoo exhibit and infrastructure improvements are planned and scheduled for opening in 2003 and 2004.

Neighborhood parks, playgrounds, and other facilities are being built and renovated with a general obligation bond and the extension of the City's Open Space Fund, approved by voters in 2000. Play areas, gardens, clubhouses, tennis courts, benches and ballfields were built or upgraded in fiscal year 2002-2003 at sites all across the City including at the South Sunset Playground, Koshland Park, Excelsior Playground, and Parque Ninos Unidos. An agricultural area was built which will become the Visitation Valley Greenway including fruit trees, vegetable plots and pathways, and serving as an outdoor classroom for schoolchildren and visitors.

A \$105.9 million bond program approved by the voters in November 2000 to improve San Francisco's branch libraries continued its work in 2003 with the acquisition of sites for the Glen Park, Ingleside, Visitation Valley and Portola Branch Libraries and planning and design work for renovation of an additional thirteen branch libraries. Plans are in place and ground will be broken shortly for construction of the new Mission Bay Branch Library which will be part of a multi-use building including senior housing through an innovative project coordinated with the Redevelopment Agency. The Library successfully launched a new Integrated Library System that includes the on-line catalogue, community information and referrals, and many other electronic tools, culminating a three-year process to replace and upgrade this vital public service. Improvements that had been recommended in a Post-Occupancy Evaluation of the new Main Library were completed and the Library is developing plans for additional improvements including a redesign of the first floor service areas and opening up for public use of nearly 18,000 square feet of floor space currently housing back-office functions. A newly purchased building in the South of Market area will serve as the Library's Support Services Center.

Status of City Services

In the spring of 2003, the City, through the Controller's Office, conducted its eighth annual Citizen Survey. A total of 1,519 San Franciscans were surveyed, providing their opinions of recreation programs and parks, libraries, public transportation (MUNI), streets, public safety, general City performance and budget priorities.

The 2003 survey results show that:

- MUNI's ratings are the best of any year since the survey has been conducted. Citizen ratings of the system's timeliness and reliability have improved the most, with 41% positive ratings in 2003, up from only 15% in 1999.
- Public safety ratings improved, with San Franciscans reporting feeling safer walking alone in their neighborhoods in 2002 and 2003 than they did in any year from 1997-2001.
- Survey respondents report visiting the City's libraries and parks, and participating in recreation programs, more frequently than in the previous year.
- 45 percent of respondents rate the pavement condition of the streets in their neighborhood as "good" or "very good," whereas only 29 percent feel favorably about the pavement condition of City streets overall. Both neighborhood and citywide ratings of street quality are better than they were two years ago.

- A consistent proportion of residents—almost half of survey respondents, choose "fair" in assessing how well local government provides services overall.
- Residents of the southeastern part of San Francisco feel the least safe in their neighborhoods, and experience more crime than residents of other areas of the City. They are also less satisfied with the City's parks, MUNI, street conditions, and overall local government performance.
- Choosing among key services on a question related to the City budget, survey respondents are most willing to protect funding for fire/emergency medical services and health services. They are most willing to cut funds for street cleaning and parks and recreation. Those with household incomes of less than \$50,000 per year express more support for funding health and human services than higher-income residents.

OTHER FINANCIAL INFORMATION

Internal Controls

In developing and evaluating the City's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding: (1) the safeguarding of assets against loss from unauthorized use or disposition; and (2) the reliability of financial records for preparing financial statements and maintaining accountability for assets. 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 evaluation of costs and benefits requires estimates and judgments by management. All internal control evaluations occur within the above framework. We believe that the City's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

Budgetary Process

The City's budget is a detailed operating plan, which identifies estimated costs and results in relation to estimated revenues. The budget includes: (1) the programs, projects, services, and activities to be carried on during the fiscal year; (2) the estimated revenue available to finance the operating plan; and (3) the estimated spending requirements of the operating plan. The budget represents a process where policy decisions by the Mayor and Board of Supervisors are made, implemented, and controlled. Note 2(c) to the basic financial statements summarizes the budgetary roles of various City officials and the timetable for their various budgetary actions according to the City Charter.

Pension Trust Fund Operations

The City has a defined benefit retirement plan (Employees' Retirement System) in which a substantial majority of full-time employees participate. The plan's most recent actuarial calculations, as of July 1, 2002, estimate the plan is 118% funded.

Cash Management

The City's pooled deposits and investments are invested pursuant to policy established by the Treasurer working with the City's Treasury Oversight Committee. The City's investment policy seeks the preservation of capital, liquidity and yield, in that order of priority. The policy addresses soundness of financial institutions holding our assets and the types of investments permitted by the California Government Code. The earned yield for the fiscal year 2002-2003 was 2.77%. The Employees' Retirement System and the Redevelopment Agency deposits and investments are maintained outside the City Treasury and follow policies established by their respective governing boards.

Risk Management

With certain exceptions, it is the policy of the City not to purchase commercial insurance against property or liability risks. Instead, the City believes it is more economical to manage its risks internally and set aside funds as needed for estimated current claim settlements and unfavorable judgments through annual appropriations and supplemental appropriations. The City maintains limited coverage for certain facilities, primarily property of the San Francisco International Airport, Port of San Francisco, Municipal Railway, Hetch Hetchy, Water Department, Moscone Convention Center and art at City-owned museums. Additionally, various types of liability insurance coverage are maintained by the City for the Port and the Airport. The City is self-insured for workers' compensation claims. Claims payment history (experience) and payroll costs (exposure) are considered when calculating the claims liabilities and workers' compensation outstanding liabilities for each department. The City's insurance/self-insurance program is reviewed annually in the budget process. The claims liabilities and workers' compensation liabilities reported on the statement of net assets have been actuarially determined and include an estimate of incurred but not reported losses.

INDEPENDENT AUDIT

The City's Charter requires an annual audit of the Controller's records. These records, represented in the Comprehensive Annual Financial Report, have been audited by a consortium headed by the nationally recognized certified public accounting firm, KPMG LLP. The consortium also includes Calvin Louie CPA (representing a separate consortium known as Associated Asian CPA Firms), Lamorena and Chang CPAs, Yano and Associates, and Rodriguez, Perez, Delgado & Co. CPAs. The various enterprise funds, the Health Service System, the Employees' Retirement System, the San Francisco County Transportation Authority and the Redevelopment Agency have been separately audited. The Independent Auditors' Report on our current financial statements is presented in the Financial Section.

CERTIFICATE OF ACHIEVEMENT

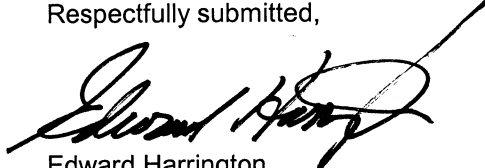
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2002. This was the twenty-first consecutive year (fiscal years ended June 30, 1982 – 2002) 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.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGMENTS

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 KPMG 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,



Edward Harrington
Controller