



November 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, 2004, with the Independent Auditor's 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 fourth 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 Auditor's 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 been stable over the last year, growing by less than one percent, to approximately 792,700.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, Sheriff and Treasurer. Beginning in November 2000, the Board of Supervisors was elected by district for the first time since the 1970s. There are eleven districts, with staggered elections for five and six seats at a time held in even numbered years. Board members serve four-year terms and any vacancies are filled by Mayoral appointment.

In 2001 the United States economy entered a multi-year downturn, with significant losses in the stock market, rising unemployment, and decreasing consumer confidence. With its high concentration of technology and internet companies, the Bay Area was hit hard by the economic slowdown. San Francisco lost approximately 65,000 to 75,000 jobs in the period from 2001 to 2003, nearly twice as many as were lost in the last significant recession of 1991 to 1993.ⁱⁱⁱ These job losses pushed the unemployment rate to a peak of 7.9 percent in July 2002, however gradual improvement in the City's job picture has occurred in each of the last two fiscal years. By June of 2004, San Francisco's unemployment rate had decreased to 5.9 percent and, for the first time in two years, was slightly better than that of California as a whole at 6.4 percent.^{iv} While the softening of the technology sector has significantly stalled the overall local economy, some professional services categories that are also critical to San Francisco's economy have displayed stability or growth during the period. Legal services, publishing, insurance, and securities, after experiencing some job losses, have improved to the point where these industries together now employ several thousand more people than during the economic peak of 2000.

San Francisco's downtown office real estate market was extremely competitive through the 1990s and vacancy rates dropped below one percent at some points. Matching the overall economic situation, this trend reversed in fiscal years 2000-2001 and 2001-2002, with vacancy rates rising into the 20 percent range. However by 2002-2003 the market had begun to stabilize and at the close of this fiscal year the overall vacancy rate was down from 17.1 percent in June 2003 to 15.4 percent in June 2004, including both direct and sublet space. Asking prices for office space rents as of June 2004^v stood at an average of approximately \$22 per square foot, down from the July 2000 high point of \$80 per square foot. These 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.

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

^v Source: Newmark, Office Market Report, Second Quarter, 2004

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

Despite weaknesses in areas of the economy, property values in San Francisco remain among the highest in the nation. Over the most recent ten year period, 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 1,726 new units of housing permitted during fiscal year 2004, a housing shortage persists. The gap between demand and supply has contributed to a worsening affordability gap in the City, with home ownership remaining out of reach for most residents and workers. As of June 2004, the median price for an average single family home in San Francisco had increased 15.4 percent from the prior year and stood at \$665,000.^{vii} As of July 2004, the average assessed valuation in the City stood at \$313,000 for single family homes and \$475,000 for condominiums. Average assessed valuations tend to be lower than market norms would indicate because the limits on property tax increases under California's Proposition 13 have generally motivated 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. Since passage of the bond measure, bond proceeds have funded downpayment assistance loans to 261 first time homebuyers and financed the development of 2,176 affordable rental units and beds. However, the voters have twice rejected proposed new affordable housing bond authorizations in the elections of 2002 and 2004 and housing continues to be one of the City's significant challenges to development.



The City's property tax revenue, the single largest source of tax revenue for the City's general fund, grew in some cases by as much as 12 percent annually over the last five years, reflecting the steady rise in property values and prices during the time period. In fiscal year 2003-2004, this trend continued, with property tax revenues rising by approximately 5.4 percent. 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. Hotel room tax revenues exhibited among the most severe downturn, dropping from a \$188 million high in fiscal year 2000-2001 to \$129 million in fiscal year 2002-2003. Hotel tax revenue in fiscal year 2003-2004 recovered to the level of \$148 million and budgeted growth of approximately six percent is forecast during fiscal year 2004-2005, which would mean revenues commensurate with the late 1990s levels. While recovery in this sector seems to be underway, the hotel tax trend of recent years nonetheless represents a significant loss of funding for local cultural institutions and general City services which the government has had to absorb since 2001.

Travel and tourism are among the main drivers of San Francisco's economy. The travel decline precipitated by the sluggish national economy was further exacerbated in the Bay Area by the war in Iraq and outbreaks of Sudden Acute Respiratory Syndrome in Asian nations directly linked to San Francisco by air and trade routes. However, there are now signs of a gradual recovery in San Francisco's tourism sector. At San Francisco International Airport (SFO) passenger traffic increased 6.4% from the previous fiscal year, with an increase of 5.7% in domestic volume and an increase of 8.9% in international volume. Passenger traffic has increased by 17% in total from the 2001 low point. The Convention and Visitors Bureau estimates that 14.29 million people visited San Francisco in calendar year 2003, a 4.1 percent increase from the year before. Visitor spending in the City totalled approximately \$6.03 billion for the calendar year, up 1.9 percent from the 2002 level of \$5.9 billion.^x In the two years prior to the travel downturn, hotel occupancy rates in the City averaged around 80 percent. During calendar year 2003 this figure averaged 67.9 percent, a slight increase from the 64.6 percent rate in 2002. Occupancy rates for fiscal year 2004-2005 are forecast to improve somewhat with stronger scheduled convention business during the year.^{xi}

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

xi Source: PKF Consulting

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.

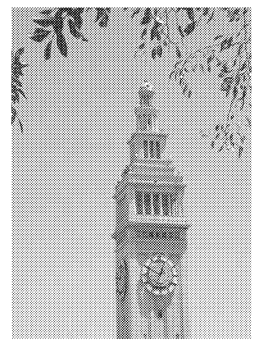
Economic Development

By a number of indicators, the San Francisco economy is slowly recovering from the losses of recent years, and changes over the most recent fiscal year include some new construction and business location developments. In November 2003, the \$410 million Bloomingdale's project broke ground in downtown San Francisco, beginning construction of a 1.5 million square foot complex that will contain shops, restaurants, a market hall, and offices on the Market Street site of the former Emporium Building. The development is expected to create approximately 700 construction jobs and generate 1,900 new retail jobs when it opens in 2006. The Gymboree Corporation signed a long-term lease in March 2004 to relocate its corporate headquarters from Burlingame, California to San Francisco, which will bring approximately 350 employees to the City by the end of the calendar year. In September 2004, Gladstone Institutes, a biomedical research center specializing in Alzheimer's, HIV/AIDS and cardiovascular disease, moved into a new \$72 million building in the Mission Bay area, becoming the first major non-University of California San Francisco enterprise in this developing region, with approximately 300 researchers and support staff now, and more than 500 staff planned for when growth is complete.

Preceding Gladstone, the largest of the planned medical research buildings in Mission Bay, the UCSF Genentech Hall, was opened in January 2004 and a second facility, the Genetics Development and Behavioral Sciences Building, was opened in March 2004. Overall housing and infrastructure development continue in Mission Bay—located south and east of downtown in an area of industrial buildings and former rail yards. Over the 20 to 30 year construction and development period of the Mission Bay neighborhood over 31,000 new permanent jobs are forecast. Mission Bay will eventually provide approximately 1,700 affordable housing units, over 50 acres of open space, a new public school, public library and new Fire and Police stations. To date, construction has been completed on 1,080 residential units, 55,000 square feet of neighborhood-serving retail, 510,000 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 and related facilities.

The City reached a final agreement with the U.S. Navy in March 2004 to govern the transfer of the first 78 acres of the 500-acre Hunters Point Naval Shipyard to the City. Although the former naval facility was closed in 1974, transfer of the site to the City has been delayed as environmental cleanup and other hazard concerns were addressed. The first phase of the planned redevelopment will include 1,600 units of housing, with 32 percent set aside as affordable. In addition, 300,000 square feet of retail and commercial development are planned, along with a five-acre multi-purpose community campus and 34 acres of parks, recreation areas and open space. Approximately 250 construction jobs are forecast during the first phase of development with an additional 1,000 full-time jobs expected after the completion of Phase I in approximately five years.

In August 2003, the Port of San Francisco began a two-year, \$44 million rehabilitation and development project for three of its historic piers, Piers 1½, 3, and 5. The project will include restaurants, office space, public access to the Bay, boat docks, and a water taxi landing. In March 2004, the Port began construction on the first phase of the International Cruise and Bryant Street Pier Project, a \$400 million mixed-use project that will feature a 100,000 square foot state-of-the-art international cruise terminal, offices, retail space, 136 condominiums, and a new waterfront park. The new cruise terminal will be able to handle two large cruise ships simultaneously with thousands of passengers. Completion of the entire project is anticipated in 2008. The Port has seen a dramatic increase in passenger cruise activity and is projecting 2004 to be its busiest cruise season in history with 90 port calls and over 200,000 passengers expected.



A former bus layover yard is now being developed as the Mission & Stuart Hotel Project, a boutique 200-room hotel with restaurant and retail space on the ground floor. The hotel will be operated and maintained privately and is expected to provide the Municipal Transportation Agency an average of \$4.79 million a year over the term of the 65-year lease, for a total of more than \$300 million. Located near the foot of Market Street and across The Embarcadero from the recently reopened historic Ferry Building, the site will also include a rent-free location for a combination transit museum and retail shop to be operated by the Market Street Railway, a non-profit group that is dedicated to the acquisition, restoration, and operation of historic transit vehicles in San Francisco. The Project will integrate stops and passenger shelters for MUNI's F Market & Wharves historic streetcar line and various incentives to use transit will be provided to staff and guests at the hotel.

Transportation and Infrastructure

San Francisco International Airport (SFO) continues to improve its economic position and to ramp up passenger services, working towards recovery from the 2001 downturn in air travel. Three new low-fare, coast-to-coast travel operations started service at the Airport during the last fiscal year. In November of 2003, AirTran Airways began daily nonstop service between Atlanta and SFO. In January 2004, ATA became the only carrier in the nation to offer direct nonstop service from SFO to New York's LaGuardia Airport. America West Airlines began the first low-fare nonstop service between SFO and New York's Kennedy Airport in December 2003 and began SFO to Boston Logan service in March 2004. International travel options also expanded as SFO became Air New Zealand's newest American gateway on June 30, 2004. Nonstop service between SFO and Auckland International Airport will operate three days a week in both directions. SFO is Air New Zealand's first new international gateway since 1995 and is the 21st destination on its international network. In June of 2004, Virgin Airlines announced its selection of San Francisco as the operational headquarters of Virgin USA, a domestic low-cost carrier. Virgin USA will hire more than 1,500 employees in its first two years of operations. It will be the only airline with its principal operations based in California.



Bay Area Rapid Transit (BART), the Bay Area's major regional rail service provider, opened four new stations in the summer of 2003 on the San Mateo peninsula south of the City including the long-planned station at SFO. The new BART connection provides direct rail service from downtown San Francisco and the Bay Area to the Airport, with the BART station connected to all terminals through the AirTrain. AirTrain is an automated people mover that takes travelers to the passenger terminals and also to Airport parking and rental car lots on a five-mile circuit. Airport ridership contributed to an increase in BART's total annual passengers for the first time in three years, to over 91 million in fiscal year 2004.

San Francisco's light rail system, the MUNI Metro, serves the downtown underground along the business, civic, shopping and financial centers of the Market Street corridor, and provides above ground service in the neighborhoods west and south of the center. The City is at the mid-point of building a major service expansion, the Third Street Light Rail, to connect the South of Market, Mission Bay, and the southeast sectors of San Francisco to the rest of the Metro system. The project is proceeding on schedule, with the major construction phase slated for completion in summer 2005. Lighting and landscaping have recently been installed along the entire corridor. Following a completion and testing period, passenger service is expected to begin in April or May of 2006, providing new fast, clean, efficient service for areas of the City that are currently underserved by transit.

Design work continues for a planned Central Subway that will extend MUNI Metro service from Mission Bay and the Market Street corridor north into Chinatown and North Beach. Community meeting processes are currently underway to help determine the optimal alignment of the subway. During the fiscal year, the Municipal Transportation Agency also completed station enhancements to accommodate future F-line (historic streetcar) service to the ballpark, and new track and refurbished platforms along the Ocean Avenue corridor. Along the California Street cable car line and the Geary Street corridor better signalization was installed which will improve traffic management, transit passenger loading and pedestrian safety for these high-use areas.

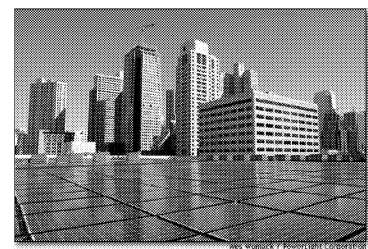


The MTA has now completed installation of the NextBus passenger service information system on all rail lines, and the agency is proceeding with installation on all trolley lines. NextBus provides expected bus arrival and wait time information for passengers at street stops and on the internet. Implementation also proceeded during the year for the Translink regional fare system, tying together 21 transit systems in six Bay Area counties with a single smart card for all buses, trains, light rail and ferries. Full, integrated use of Translink is slated for fiscal year 2006. Finally, during fiscal year 2004, the MTA successfully passed a new Transit Impact Development Fee, whereby most non-residential development in San Francisco will pay a per-square foot fee to compensate for additional demand for transit services created by the new construction. The fee will help MUNI maintain service levels in the face of increasing demand.

Construction of the City's newest boulevard, planned to provide service from the Bay Bridge and 101 corridors and the north Mission area across Market Street, proceeded during fiscal year 2004. Demolition of elevated freeway structures damaged in the 1989 Loma Prieta earthquake was completed, and grading and site preparation for what will become the Octavia Boulevard got underway. For this project, 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. An important link in the City's network of bicycle routes was achieved with the completion of a bridge pathway for bike travel westbound on Cesar Chavez Street. Finally, as an additional aid to traffic management in the City, the regional 511 information system, which provides real-time information via phone and web access on road and traffic conditions, was expanded in 2004 to include coverage of the U.S. 101 freeway corridor in San Francisco.

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 which effectively repealed a rate freeze, authorized a \$1.6 billion bond issue to be financed through retail rate charges and restructured the agency to give the PUC more control over contracting, employment, and financial management practices. With these improvements, the PUC is moving forward on planning, design and construction for 77 critical projects to improve the water enterprise system both locally and regionally. By the end of fiscal year 2004, construction was underway for four and planning or design processes were in progress for another 42 projects.

Reacting to rolling blackouts and soaring energy prices that have affected California energy markets, San Francisco voters in November 2001 overwhelmingly approved a \$100 million revenue bond initiative to fund solar generation, energy efficiency measures and other renewable power sources for public buildings. In October 2003, the Moscone Center Energy Project, at San Francisco's premier conference facility, became the first solar installation to be completed since the solar bond was approved. The \$7.5 million project was funded by \$5.2 million in local funding and \$2.3 million in State funding through Public Utilities Commission and Energy Commission incentives. A 675 kilowatt solar electric system now generates 825,000 kilowatt hours of electricity output each year and, when combined with energy efficiency upgrades, will achieve an annual net reduction of 4.9 million kilowatt hours in electricity demand and \$614,643 in annual utility bill savings for the convention facility.



In September of 2003, the City launched Generation Solar, a residential and commercial solar program that will provide at least 100 participants in its first phase with installation and financing for photovoltaic systems and accompanying energy-conservation measures. The program seeks to reduce the cost of solar power through bulk purchasing, low-cost financing, and maximum utilization of state and federal subsidies. The effort also combines solar generation with energy-efficiency, reduced permitting costs, and a City marketing program.

Housing, Health and Safety



In its efforts to combat chronic homelessness, during fiscal year 2003-004 the City began implementation of a voter initiative known as “Care Not Cash,” using local dollars allocated for homeless individuals eligible for county General Assistance programs to provide housing instead of cash grants. The centerpiece of this effort is increased development of supportive housing units in single room occupancy hotels and other underutilized buildings mostly located in the City center. These units offer residents greater stability than a shelter or temporary housing setting, and

on-site services will include case workers and employment programs. Starting in May 2004, the City was able to open 624 housing units in nine rehabilitated buildings and offer housing to 716 homeless participants. Also during the fiscal year, the City worked on development of a 10-year plan to end chronic homelessness in San Francisco entitled “Changing Direction.” The plan’s central strategy is a “housing first” model emphasizing immediate placement in permanent housing where residents have access to on-site services necessary to stabilize the individuals and keep them housed. The plan calls for the creation of 3,000 units of new permanent supportive housing and for the phase out of ineffective shelter-based programs.

The City’s Affordable Housing and Homeownership Program (a \$100 million bond approved in 1996) combined with federal, state and local funds to produce 1,037 units of affordable housing for the cities’ homeless, seniors and low and moderate-income families over the last year. The majority of people assisted by the City’s affordable housing programs are homeless individuals and families, low-income families with children, seniors and low and moderate-income homeowners. Three rental developments at the Ambassador Hotel, 315 Turk Street and the McAllister Street Co-ops were completed in 2004 for a total of 157 units providing supportive services to tenants. An additional 395 rental units were created for seniors and low-income individuals in five developments: the Kokoro Assisted Living Facility, Padre Apartments, Herald Hotel Apartments, Bayanihan House and Dudley Apartments. The City was also able to leverage its funds to preserve 458 affordable rental units at Golden Gate Apartments, Namiki Apartments, Marlton Manor, Maria Manor and Clayton Hotel. Finally, the City assisted low and-moderate income families by providing ten affordable ownership units and 17 rehabilitation loans to low-and moderate income homeowners.

In July of 2003, the Department of Public Health implemented the McMillan Stabilization Pilot Project, a medically supervised sobering facility providing medical screening, case management services, and linkages to a comprehensive continuum of care to homeless alcohol-dependent persons. The goals of the program are to provide better care for homeless alcohol-dependent persons and improve their health outcomes while decreasing the number of inappropriate ambulance trips and emergency room visits. During the first half of the fiscal year, the Project treated approximately 1,200 individuals and referred 300 individuals for case management. Approximately 43% of McMillan Center clients stay overnight at the facility.

In February 2004, San Francisco announced the creation of a Working Families Tax Credit for low-income San Franciscans. The \$6 million pilot program, modeled after the federal Earned Income Tax Credit, will be funded in part with private philanthropic dollars. The first payments will be issued in the summer and fall of 2005. Like the federal program, the Working Families Tax credit is designed to support and encourage work by supplementing the income of low-wage workers, and to stimulate the economy through job incentives.

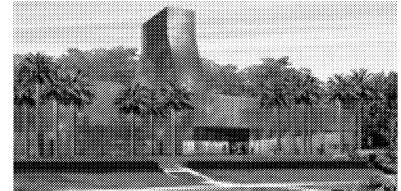
Cultural and Recreational Facilities

Public arts, educational and recreational institutions in San Francisco have been the recipients in the 1990s and 2000s of both significant voter-approved bond funding and private and community financial support for capital campaigns. As a result, the City has seen several milestones and completions recently, including the opening in the refurbished Civic Center of the new Asian Art Museum in March 2003 and of the restored Conservatory of Flowers in September 2003. Work continues on two bond programs that are benefiting residents and neighborhoods across San Francisco—one for branch libraries and another for

local parks. Finally, construction work is now underway on new buildings for two important institutions both located in Golden Gate Park—the de Young Museum and the Academy of Sciences.

During fiscal year 2003-2004, construction began at two branch library sites—the Excelsior and Mission Bay branch libraries. The ground-breaking in December 2003 for the new Mission Bay Branch Library marks a unique development in this new area of the City that will build both a state of the art library facility and senior housing on the same site. Planning and design was in progress during the year for an additional fourteen branch library renovations and new construction projects. Overall, the City's Branch Library Improvement Program is using funds approved by the voters in a \$105.9 million local bond, plus State grants and private funding to renovate, expand and/or acquire 24 neighborhood libraries by 2010.

Golden Gate Park is the site of both the de Young Museum and the Academy of Sciences. With the move of the Asian Art Museum to downtown and the demolition of the older buildings that had housed both it and the de Young, the new de Young will include a 293,000 square foot main building, a sculpture garden, and a copper-clad tower designed by the architects Herzog & de Meuron. The new facility will more than double the gallery space for exhibition of the de Young's collections of American art from the 17th to 20th centuries and art of the native Americas, Africa and the Pacific. Construction of the de Young got underway in fiscal year 2003-2004, with a scheduled opening for the Museum in October 2005. Across the concourse, the City's Academy of Sciences closed in December 2003 and relocated its 18 million-specimen collection to a temporary exhibit and research facility at 10th and Howard Streets downtown. The new Academy, supported by a local bond issue, State funding, and private gifts, will cost approximately \$370 million, with a 2008 opening planned. The Academy's aquarium, planetarium and natural history collection will be housed in a new building that incorporates green design principals including a "living roof" of landscaped areas, glass facings and a piazza blending it with the park surroundings.



Status of City Services

In the spring of 2004, the Controller's Office conducted its ninth annual Citizen Survey, measuring, for calendar year 2003, residents' satisfaction with local government and their opinions on the quality of public services over time. The survey results show that:

- A consistent proportion of residents—almost half of survey respondents, choose "fair" in assessing how well local government provides services overall.
- Public safety ratings changed little from the previous year, however San Franciscans reporting feeling safer walking alone in their neighborhoods in 2003 than they did in any year from 1997-2002.
- In most categories, MUNI's ratings are the best of any year since the survey has been conducted. However, the public's ratings of MUNI fares were the lowest since 1997, following on a September 2003 fare increase—the system's first since 1992. Citizen ratings of MUNI's timeliness and reliability have improved slightly, with 42% positive ratings, up from only 15% in 1999.
- San Franciscans are visiting parks and participating in recreational programs at almost the same level as last year. Over half (59%) of respondents report going to a City park at least once a month in the past year.
- Library visits have declined slightly with 26% of respondents visiting a branch library at least once a month in the past year and 15% visiting the main library at least once a month. Seventy-one percent of respondents rate collections favorably and 81% describe the quality of assistance provided by library staff as good or very good.

- About half (52%) of residents rate the pavement condition of the streets in their neighborhood as “good” or “very good,” an increase from 45% last year, whereas only 27% feel favorably about the pavement condition of City streets overall, a slight decrease from the previous year. Both neighborhood and citywide ratings of street quality are better than they were in 2002.
- As in previous years, 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.

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, 2003, estimate the plan is 109% 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 2003-2004 was 1.86%. 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, presented in the Comprehensive Annual Financial Report (CAFR), have been audited by a consortium led by Macias, Gini & Company LLP, and includes Louie and Wong LLP, Haile Girma Company, and the QBIS Group, Inc. The CAFR also incorporates the separately audited financial statements of the City's selected individual funds, enterprise funds and component units. These components were audited as follows: KPMG LLP audited the Airport, Hetch Hetchy, Water Department, Clean Water Program, Municipal Railway, Health Service System and the City's Finance Corporation; Williams, Adley & Company, LLP audited the Employees' Retirement System and the Redevelopment Agency; and Hood & Strong, LLP audited the San Francisco Port.

Macias, Gini & Company LLP Independent Auditor's Report on our current financial statements is presented in the Financial Section of the CAFR. It makes reference to the independent audit reports issued by the auditors noted above.

CERTIFICATE OF ACHIEVEMENT

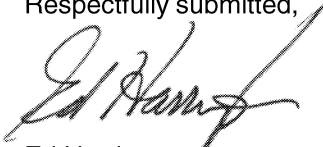
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2003. This was the twenty-second consecutive year (fiscal years ended June 30, 1982 – 2003) 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 Macias, Gini & Company 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,



Ed Harrington
Controller