

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY
BOND PROJECTS FUND
(A Fund of the City of San José)

Independent Auditor's Reports,
Financial Statements,
Other Supplementary Information and
Independent Accountant's Report

For the Period from July 18, 2002
Through June 30, 2009

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND
(A Fund of the City of San José)
For the Period from July 18, 2002 through June 30, 2009

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City Council
Members of the Citizen's Oversight Committee
City of San José, California

Independent Auditor's Report

We have audited the accompanying financial statements of the Neighborhood Security Bond Projects Fund, a fund of the City of San José (City), as of June 30, 2009 and for the period from July 18, 2002 through June 30, 2009, as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting as it pertains to the Neighborhood Security Bond Projects Fund activities. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the financial statements of the Neighborhood Security Bond Projects Fund are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and nonmajor fund of the City that is attributable to the transactions of the Neighborhood Security Bond Projects Fund. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2009 and the changes in its financial position for the period from July 18, 2002 through June 30, 2009 in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Neighborhood Security Bond Projects Fund as of June 30, 2009 and the changes in financial position for the period from July 18, 2002 through June 30, 2009 in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 1, 2011 on our consideration of City's internal control over financial reporting as it pertains to the Neighborhood Security Bond Projects Fund activities and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Neighborhood Security Bond Projects Fund has not presented the management's discussion and analysis that accounting principles generally accepted in the United States has determined is necessary to supplement, although not required to be part of, the financial statements.

The accompanying other supplementary information are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the City Council, the Citizen's Oversight Committee, the City Auditor and the City's management and is not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & Connell LLP

Certified Public Accountants
Walnut Creek, California

March 1, 2011

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Balance Sheet

June 30, 2009

Assets

Advance and deposits	\$ 3,470
Restricted assets:	
Equity in pooled cash and investments held in City Treasury	6
Investments held with fiscal agents	60,444,415
Total assets	<u>\$ 60,447,891</u>

Liabilities and Fund Balances

Liabilities:	
Accounts payable	\$ 1,941,177
Accrued salaries, wages and payroll taxes	101,216
Due to the City	12,949,366
Total liabilities	<u>14,991,759</u>
Fund balances:	
Reserved for encumbrances	19,895,786
Reserved for noncurrent advances and deposits	3,470
Unreserved, undesignated	25,556,876
Total fund balances	<u>45,456,132</u>
Total liabilities and fund balances	<u>\$ 60,447,891</u>

See accompanying notes to the financial statements.

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Statement of Revenues, Expenditures and Changes in Fund Balance

For the Period from July 18, 2002 through June 30, 2009

Revenues:

Investment income	\$ 14,324,310
Intergovernmental	96,123
Other	7,442
	14,427,875
Total revenues	14,427,875

Expenditures:

Capital outlay:	
West Community Policing Center	2,035,704
South San Jose Police Substation	63,603,512
Fire Station 12 - Relocation	4,488,819
Fire Station 34	6,768,148
Fire Station 35	6,586,899
Fire Station Upgrades	8,458,305
Fire Training Center	1,929,222
Land Acquisition - Fire Stations	6,280,081
Central Community Police Station Exterior Improvement	323,382
Fire Station 25 - Relocation	5,599,924
Fire Station 17 - Relocation	4,684,721
Fire Station 23 - Relocation	90,717
Driver Safety Training Center	681,415
Fire Station 36	1,352,800
Fire Station 2 - Rebuild	2,752,878
Fire Station 21 - Relocation	229,871
Fire Station 19 - Relocation	3,193,937
Fire Station 37	121,438
Emergency Communication and Dispatch Center	1,439,124
East Community Policing Center	50,257
Program-Wide Administration	3,721,589

Debt service:

Arbitrage rebate payment	254,000
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Total expenditures	124,646,743
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Deficiency of revenues under expenditures	(110,218,868)
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Other Financing Sources:

Bond proceeds	155,675,000
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Change in fund balance	45,456,132
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Fund balance, beginning of period	-
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Fund balance, end of period	\$ 45,456,132
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See accompanying notes to the financial statements.

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND
(A Fund of the City of San José)
Notes to the Financial Statements
For the Period from July 18, 2002 through June 30, 2009

NOTE 1 – BACKGROUND

In March 2002, registered voters of the City of San José (City) approved Measure O (2002), San José 911, Fire, Police, Paramedic and Neighborhood Security Act, authorizing the issuance and sale of not to exceed \$159,000,000 in general obligation bonds (Neighborhood Security Bonds) to be used to fund the construction of fire and police stations, training facilities and 911 communications facilities and the cost of land acquisition for the improvements to neighborhood security facilities throughout the City.

The table below sets forth the amount of Neighborhood Security general obligation bonds authorized and issued pursuant to Measure O (2002):

	<u>Amount</u>	<u>Date</u>
Voter authorization	\$ 159,000,000	March 5, 2002
Bonds issued:		
Series 2002 Bonds	39,375,000	July 18, 2002
Series 2004 Bonds	14,400,000	July 14, 2004
Series 2005 Bonds	25,000,000	June 23, 2005
Series 2007 Bonds	67,900,000	June 20, 2007
Series 2009 Bonds	9,000,000	June 25, 2009
Total bonds issued	<u>155,675,000</u>	
Authorized but unissued	<u><u>\$ 3,325,000</u></u>	

As of June 30, 2009, significant projects approved by the City Council to be funded by the bond proceeds which remain to be completed are as follows:

<u>Projects</u>
<i>Fire</i>
Fire Station 2 - Rebuild
Fire Station 19 - Relocation
Fire Station 21 - Relocation
Fire Station 36
Fire Station 37
Fire Training Center
<i>Police</i>
South San Jose Police Substation

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Notes to the Financial Statements (Continued)

For the Period from July 18, 2002 through June 30, 2009

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements present only the financial position and the changes in financial position of the Neighborhood Security Bond Projects Fund (Fund) and do not purport to, and do not, present fairly the City's financial position as of June 30, 2009 and the changes in its financial position for the period from July 18, 2002 through June 30, 2009 in conformity with accounting principles generally accepted in the United States of America.

A capital projects fund (governmental fund) is used to account for the City's Neighborhood Security Bond Projects activities. Capital projects funds are used to account for financial resources (bond proceeds and investment income) to be used for the acquisition of land or acquisition and construction of major governmental facilities.

Basis of Accounting

The Fund's activity is reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. The City considers investment income to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures are generally recorded when a liability is incurred, as under accrual accounting.

Restricted Cash and Investments

Cash and investments that are restricted for specified uses by bond covenants or other requirements are classified as restricted. The Fund's restricted cash and investments are held with fiscal agent accounts to be spent only on authorized capital projects. The Fund's restricted cash and investments are subject to the requirements of the City's adopted investment policy and the bond indenture.

Due to the City

The Fund's cash and investments balances are pooled and invested by the City and the Fund's overdraft position of the City's pooled investments is displayed on the balance sheet as "Due to the City." It is the City's policy not to charge interest to those funds that have a negative average monthly cash balances. Income earned or losses arising from positive pooled investments are allocated on a monthly basis by the City Treasury to the Fund based on the average weekly cash balances.

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Notes to the Financial Statements (Continued)

For the Period from July 18, 2002 through June 30, 2009

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fund Balances

In the governmental fund financial statements, reserves and designations segregate portions of fund balance that are either not available or have been earmarked for specific purposes. The various reserves and designations are established by actions of the City Council and management and can be increased, reduced or eliminated by similar actions.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make certain estimates and assumptions that affect the reported amounts and disclosures. Accordingly, actual results may differ from those estimates.

NOTE 3 – RESTRICTED CASH AND INVESTMENTS

A summary of the Fund’s restricted cash and investments at June 30, 2009 are as follows:

<u>Type of Cash and Investment</u>	<u>Fair Value</u>	<u>Standard and Poor's Credit Risk Rating</u>	<u>Weighted Average Maturity</u>
City of San Jose Cash and Investment Pool	\$ 6	Unrated	259 days
State of California Local Agency Investment Fund	39,645,080	Unrated	235 days
Wells Fargo Treasury Money Market Mutual Fund	20,799,335	AAAm	55 days
Total restricted cash and investments	<u>\$ 60,444,421</u>		

The Fund has investments subject to provisions of the bond indentures of its various bond issues. According to the bond indentures, the City is permitted to invest in the City’s cash and investment pool, the State of California Local Agency Investment Fund (LAIF), obligations of the U.S. Treasury or U.S. Government agencies, time deposits, money market mutual funds invested in U.S. Government securities, along with various other investments.

Government Code Section 16429.1 authorizes each local government agency to invest funds in the LAIF administered by the California State Treasurer. The total amount recorded by all public agencies in LAIF at June 30, 2009 was approximately \$25.2 billion. Of that amount, 85.29% was invested in non-derivative financial products and 14.71% in structured notes and asset backed securities. The Local Investment Advisory Board (Board) has oversight responsibility for LAIF. The Board consists of five members as designated by State Statute. The value of the pool shares in LAIF, which may be withdrawn, is determined on an amortized cost basis, which is different than the fair value of the Fund’s position in the pool.

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Notes to the Financial Statements (Continued)

For the Period from July 18, 2002 through June 30, 2009

NOTE 3 – RESTRICTED CASH AND INVESTMENTS (Continued)

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This risk is measured by the assignment of a rating by nationally recognized statistical rating organizations. The City has mitigated credit risk by limiting investments to the safest types of securities, by prequalifying financial institutions, by diversifying the portfolio and by establishing monitoring procedures.

Concentration Credit Risk

Concentration of credit risk is the risk that the failure of any one issuer would place an undue financial burden on the Fund. Investments issued by or explicitly guaranteed by the U.S. government and investments in mutual funds and other pooled investments are exempt from this requirements, as they are normally diversified themselves.

Interest Rate Risk

Interest rate risk is the risk that changes in market rates will adversely affect the fair market value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market rates. The City has mitigated interest rate risk by establishing policies over liquidity, including maturity limits by investment classification. These limits, for investments other than external investment pools and money market mutual funds, are as few as 10 days and as long as 5 years.

NOTE 4 – BOND PROCEEDS

As of June 30, 2009, the Fund has received proceeds from bond issues as follows:

	<u>Total Bonds Issued</u>			<u>Allocation of Bond Proceeds</u>			
	<u>Par Amount</u>	<u>Bond Premium</u>	<u>Total Proceeds</u>	<u>Neighborhood Security Bond Projects Funds</u>	<u>Branch Library Bond Projects Fund</u>	<u>Parks and Recreation Bond Projects Fund</u>	<u>Debt Services Funds</u>
Series 2001 Bonds	\$ 71,000,000	\$ 702,671	\$ 71,702,671	\$ -	\$ 31,000,000	\$ 40,000,000	\$ 702,671
Series 2002 Bonds	116,090,000	1,701,525	117,791,525	39,375,000	30,000,000	46,715,000	1,701,525
Series 2004 Bonds	118,700,000	1,928,232	120,628,232	14,400,000	58,300,000	46,000,000	1,928,232
Series 2005 Bonds	46,300,000	803,299	47,103,299	25,000,000	21,300,000	-	803,299
Series 2006 Bonds	105,400,000	2,436,112	107,836,112	-	60,000,000	45,400,000	2,436,112
Series 2007 Bonds	90,000,000	965,400	90,965,400	67,900,000	-	22,100,000	965,400
Series 2008 Bonds	33,100,000	516,037	33,616,037	-	5,285,000	27,815,000	516,037
Series 2009 Bonds	9,000,000	276,396	9,276,396	9,000,000	-	-	276,396
Total	<u>\$ 589,590,000</u>	<u>\$ 9,329,672</u>	<u>\$ 598,919,672</u>	<u>\$ 155,675,000</u>	<u>\$ 205,885,000</u>	<u>\$ 228,030,000</u>	<u>\$ 9,329,672</u>

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Notes to the Financial Statements (Continued)

For the Period from July 18, 2002 through June 30, 2009

NOTE 5 – COMMITMENTS

At June 30, 2009, the Fund has related outstanding project construction and other commitments as follows:

<u>Project</u>	<u>Amount</u>
Driver Safety Training Center	\$ 552
Emergency Communication and Dispatch Center	7,744
Fire Station 2 - Rebuild	1,197,423
Fire Station 12 - Relocation	16,900
Fire Station 17 - Relocation	13,215
Fire Station 19 - Relocation	2,028,717
Fire Station 21 - Relocation	2,552
Fire Station 25 - Relocation	18,840
Fire Station 35	500
Fire Station 36	199,842
Fire Station 37	3,101
Fire Station Upgrades	5,212
Fire Training Center	131,004
South San Jose Police Substation	16,133,743
Program-Wide Administration	136,441
Total reserved for encumbrances	\$ 19,895,786

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Combining Balance Sheets

June 30, 2003 through 2009

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Assets				
Accrued interest receivable	\$ 292,338	\$ 64,027	\$ -	\$ 89,482
Advance and deposits	-	-	-	-
Restricted assets:				
Equity in pooled cash and investments held in City Treasury	40,965,640	13,271,296	13,386,854	14,245,581
Investments held with fiscal agents	16,046	25,334,865	63,581,280	45,888,096
Total assets	<u>\$ 41,274,024</u>	<u>\$ 38,670,188</u>	<u>\$ 76,968,134</u>	<u>\$ 60,223,159</u>
Liabilities and Fund Balances				
Liabilities:				
Accounts payable	\$ 55,748	\$ 413,338	\$ 169,368	\$ 379,228
Accrued salaries, wages and payroll taxes	41,073	68,250	53,416	50,550
Due to the City	2,093,483	8,077,174	10,783,084	7,206,713
Total liabilities	<u>2,190,304</u>	<u>8,558,762</u>	<u>11,005,868</u>	<u>7,636,491</u>
Fund balances:				
Reserved for encumbrances	484,033	1,924,847	2,194,665	18,861,714
Reserved for noncurrent advances and deposits	-	-	-	-
Unreserved, undesignated	38,599,687	28,186,579	63,767,601	33,724,954
Total fund balances	<u>39,083,720</u>	<u>30,111,426</u>	<u>65,962,266</u>	<u>52,586,668</u>
Total liabilities and fund balances	<u>\$ 41,274,024</u>	<u>\$ 38,670,188</u>	<u>\$ 76,968,134</u>	<u>\$ 60,223,159</u>

2007	2008	2009
\$ 113,283	\$ 20	\$ -
-	3,470	3,470
12,129,005	2,656	6
<u>114,526,202</u>	<u>94,114,308</u>	<u>60,444,415</u>
<u>\$ 126,768,490</u>	<u>\$ 94,120,454</u>	<u>\$ 60,447,891</u>
\$ 3,278,174	\$ 4,413,617	\$ 1,941,177
56,738	77,013	101,216
<u>22,275,007</u>	<u>10,325,749</u>	<u>12,949,366</u>
<u>25,609,919</u>	<u>14,816,379</u>	<u>14,991,759</u>
10,572,369	48,140,211	19,895,786
-	3,470	3,470
<u>90,586,202</u>	<u>31,160,394</u>	<u>25,556,876</u>
<u>101,158,571</u>	<u>79,304,075</u>	<u>45,456,132</u>
<u>\$ 126,768,490</u>	<u>\$ 94,120,454</u>	<u>\$ 60,447,891</u>

Assets

Accrued interest receivables
Advance and deposits
Restricted assets:
Equity in pooled cash and investments held in City Treasury
Investments held with fiscal agents
Total assets

Liabilities and Fund Balances

Liabilities:
Accounts payable
Accrued salaries, wages and payroll taxes
Due to the City
Total liabilities

Fund balances:
Reserved for encumbrances
Reserved for noncurrent advances and deposits
Unreserved, undesignated
Total fund balances
Total liabilities and fund balances

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND

(A Fund of the City of San José)

Combining Schedules of Revenues, Expenditures and Changes in Fund Balances by Fiscal Year
For the Period from July 18, 2002 through June 30, 2009

	2003	2004	2005	2006
Revenues:				
Investment income	\$ 1,883,039	\$ (19,507)	\$ 975,304	\$ 2,457,695
Intergovernmental	15,985	-	3,516	23,277
Other	-	-	-	-
Total revenues	1,899,024	(19,507)	978,820	2,480,972
Expenditures:				
Capital outlay:				
West Community Policing Center	70,470	883,494	122,776	957,277
South San Jose Police Substation	179,540	377,820	348,739	9,735,667
Fire Station 12 - Relocation	29,754	26,897	92,201	440,270
Fire Station 34	103,094	42,250	186,697	479,074
Fire Station 35	54,999	30,810	178,582	542,443
Fire Station Upgrades	841,968	3,778,809	1,513,869	1,296,646
Fire Training Center	514,334	471,868	31,600	19,581
Land Acquisition - Fire Stations	12,319	1,807,683	837,322	71,578
Central Community Police Station Exterior Improvement	46,224	277,158	-	-
Fire Station 25 - Relocation	-	123,604	174,437	790,976
Fire Station 17 - Relocation	-	141,647	122,727	393,669
Fire Station 23 - Relocation	-	79,182	12,420	(885)
Driver Safety Training Center	-	277,353	784	60,652
Fire Station 36	-	34,524	32,919	101,540
Fire Station 2 - Rebuild	-	-	45,527	161,100
Fire Station 21 - Relocation	-	-	28,367	23,206
Fire Station 19 - Relocation	-	-	-	76,699
Fire Station 37	-	-	-	-
Emergency Communication and Dispatch Center	-	-	33,132	204,710
East Community Policing Center	-	-	-	10,662
Program-Wide Administration	337,602	599,688	765,881	491,705
Debt service:				
Arbitrage rebate payment	-	-	-	-
Total expenditures	2,190,304	8,952,787	4,527,980	15,856,570
Deficiency of revenues under expenditures	(291,280)	(8,972,294)	(3,549,160)	(13,375,598)
Other Financing Sources:				
Bond proceeds	39,375,000	-	39,400,000	-
Change in fund balances	39,083,720	(8,972,294)	35,850,840	(13,375,598)
Fund balances, beginning of period	-	39,083,720	30,111,426	65,962,266
Fund balances, end of period	\$ 39,083,720	\$ 30,111,426	\$ 65,962,266	\$ 52,586,668

2007	2008	2009	Total	
\$ 2,971,704	\$ 4,480,517	\$ 1,575,558	\$ 14,324,310	Revenues:
-	53,345	-	96,123	Investment income
5,804	1,638	-	7,442	Intergovernmental
				Other
<u>2,977,508</u>	<u>4,535,500</u>	<u>1,575,558</u>	<u>14,427,875</u>	Total revenues
				Expenditures:
				Capital outlay:
1,687	-	-	2,035,704	West Community Policing Center
2,574,867	14,304,632	36,082,247	63,603,512	South San Jose Police Substation
1,169,548	2,062,278	667,871	4,488,819	Fire Station 12 - Relocation
5,519,245	429,302	8,486	6,768,148	Fire Station 34
4,034,453	1,744,558	1,054	6,586,899	Fire Station 35
634,971	370,999	21,043	8,458,305	Fire Station Upgrades
424,012	365,954	101,873	1,929,222	Fire Training Center
1,628,273	1,244,849	678,057	6,280,081	Land Acquisition - Fire Stations
-	-	-	323,382	Central Community Police Station Exterior Improvement
4,015,770	503,414	(8,277)	5,599,924	Fire Station 25 - Relocation
866,247	2,475,700	684,731	4,684,721	Fire Station 17 - Relocation
-	-	-	90,717	Fire Station 23 - Relocation
106,955	234,180	1,491	681,415	Driver Safety Training Center
170,186	525,454	488,177	1,352,800	Fire Station 36
192,336	365,212	1,988,703	2,752,878	Fire Station 2 - Rebuild
14,570	17,461	146,267	229,871	Fire Station 21 - Relocation
181,362	741,318	2,194,558	3,193,937	Fire Station 19 - Relocation
-	76,089	45,349	121,438	Fire Station 37
231,834	89,442	880,006	1,439,124	Emergency Communication and Dispatch Center
34,189	5,406	-	50,257	East Community Policing Center
505,100	579,748	441,865	3,721,589	Program-Wide Administration
-	254,000	-	254,000	Debt service:
				Arbitrage rebate payment
<u>22,305,605</u>	<u>26,389,996</u>	<u>44,423,501</u>	<u>124,646,743</u>	Total expenditures
(19,328,097)	(21,854,496)	(42,847,943)	(110,218,868)	Deficiency of revenues under expenditures
<u>67,900,000</u>	<u>-</u>	<u>9,000,000</u>	<u>155,675,000</u>	Other Financing Sources:
				Bond proceeds
48,571,903	(21,854,496)	(33,847,943)	45,456,132	Change in fund balances
52,586,668	101,158,571	79,304,075	-	Fund balances, beginning of period
<u>\$ 101,158,571</u>	<u>\$ 79,304,075</u>	<u>\$ 45,456,132</u>	<u>\$ 45,456,132</u>	Fund balances, end of period

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City Council
Members of the Citizen's Oversight Committee
City of San José, California

**Independent Auditor's Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

We have audited the accompanying financial statements of the Neighborhood Security Bond Projects Fund (Fund), a fund of the City of San José (City), as of June 30, 2009 and for the period from July 18, 2002 through June 30, 2009, and have issued our report thereon dated March 1, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as it pertains to the Fund's activities, as a basis for designing our auditing procedures for the purpose of expressing our opinion on the Fund's financial statements but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraphs and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we considered to be material weaknesses, as defined above. However, we identified a deficiency in internal control over financial reporting, described in the Schedule of Comment and Response as item 2009-A that we consider to be a significant deficiency in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The City's response to the finding identified in our audit is described in the accompanying schedule of comment and response. We did not audit the City's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the City Council, the Citizen's Oversight Committee, the City Auditor and the City's management and is not intended to be and should not be used by anyone other than these specified parties.

 Macias Gini & Connell LLP

Certified Public Accountants
Walnut Creek, California

March 1, 2011

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND
(A Fund of the City of San José)
Schedule of Comment and Response
For the Period from July 18, 2002 through June 30, 2009

Item #2009-A – Significant Deficiency

Timely Analysis of Expenditures and Reimbursements of Funds Paid Using the City’s Cash Pool

When the City incurs expenditures for bond-related projects, the City records the transactions in the Neighborhood Security Bond Projects Fund (Fund) and pays these expenditures with cash held in the City’s Cash Pool, rather than using bond proceeds held with trustees. As bond projects incur expenditures, project managers within City departments track project expenditures and submit these expenditures in batches along with a memorandum to the Finance Department’s Debt Management Group (Finance Department) for approval. The Finance Department then performs a detailed analysis of the expenditures before submission of the request to the trustee for reimbursement from bond proceeds.

During our audit, we noted that the City did not request reimbursements from bond proceeds for several expenditures recorded in the Fund. Subsequent to our inquiry, the City performed an analysis of all unreimbursed expenditures and determined that these unreimbursed expenditures are comprised of eligible costs of \$203,018 and ineligible costs of \$235,497. Below is the City’s detail of the unreimbursed cost by fiscal year:

Fiscal Year Ended	Total Unreimbursed Cost	Deemed Eligible	Deemed Ineligible
June 30, 2003	\$ 71,980	\$ 65,097	\$ 6,883
June 30, 2004	54,380	14,393	39,987
June 30, 2005	57,328	29,581	27,747
June 30, 2006	142,354	43,426	98,928
June 30, 2007	93,965	46,181	47,784
June 30, 2008	18,508	4,340	14,168
Total	\$ 438,515	\$ 203,018	\$ 235,497

For the costs deemed eligible, the City properly recorded the expenditures in the Fund and paid the vendors using cash held in the City’s Cash Pool. However, reimbursements of the City’s cash were not submitted to the Trustee as of June 30, 2009. As such, the Fund has had a liability with the City in excess of one year that is reimbursable with bond proceeds. The City subsequently submitted the request to the Trustee during the year ended June 30, 2010 to obtain cash reimbursements for these eligible costs.

For the costs deemed ineligible, the City recorded the expenditures not considered reimbursable by Measure O (2002) in the Fund. During the year ended June 30, 2010, the City transferred \$190,646 from the City’s General Fund and Construction and Conveyance Tax Fund to partially reimburse the Fund for these ineligible costs. The City is planning to transfer the remaining \$44,851 from other City funds to reimburse the balance during fiscal year ending June 30, 2011.

CITY OF SAN JOSE
NEIGHBORHOOD SECURITY BOND PROJECTS FUND
(A Fund of the City of San José)
Schedule of Comment and Response
For the Period from July 18, 2002 through June 30, 2009

Item #2009-A – Significant Deficiency

**Timely Analysis of Expenditures and Reimbursement of Funds Paid Using the City’s Cash Pool
(Continued)**

The City should periodically analyze and review expenditures that have not been reimbursed for more than 6 months to ensure that only eligible expenditures are recorded in the Fund and expenditures paid using the City’s Cash Pool are reimbursed from the bond funds held with the trustees on a timely basis.

Management Response

Finance Department’s current practice is to confirm that all expenditures recorded in the bond funds are reimbursed in each accounting period. Finance Department will advise the project departments to transfer out any expenditures charged to the bond funds but are deemed ineligible as part of the disbursement review process. As part of ongoing administration of the disbursement process, Finance Department will periodically follow up with the project departments to verify the transfers of ineligible expenditures.

City Council
Members of the Citizen's Oversight Committee
City of San José, California

Independent Accountant's Report

We have examined the City of San José's (City) compliance with certain provisions of Measure O (2002) for the period from July 18, 2002 through June 30, 2009 as follows:

- Bond proceeds were used for the construction of fire and police stations, training facilities and 911 communications facilities and the cost of land acquisition for these improvements.
- Bond proceeds will be deposited in a special account.
- A citizen's oversight committee was established and review annual reports of the expenditures of the bond proceeds.

Management is responsible for the City's compliance with those requirements. Our responsibility is to express an opinion on the City's compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on the City's compliance with specified requirements.

In our opinion, the City complied, in all material respects, with the aforementioned requirements for the period from July 18, 2002 through June 30, 2009.

This report is intended solely for the information and use of the City Council, the Citizen's Oversight Committee, the City Auditor and the City's management and is not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & Counsel LLP

Certified Public Accountants
Walnut Creek, California

March 1, 2011

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