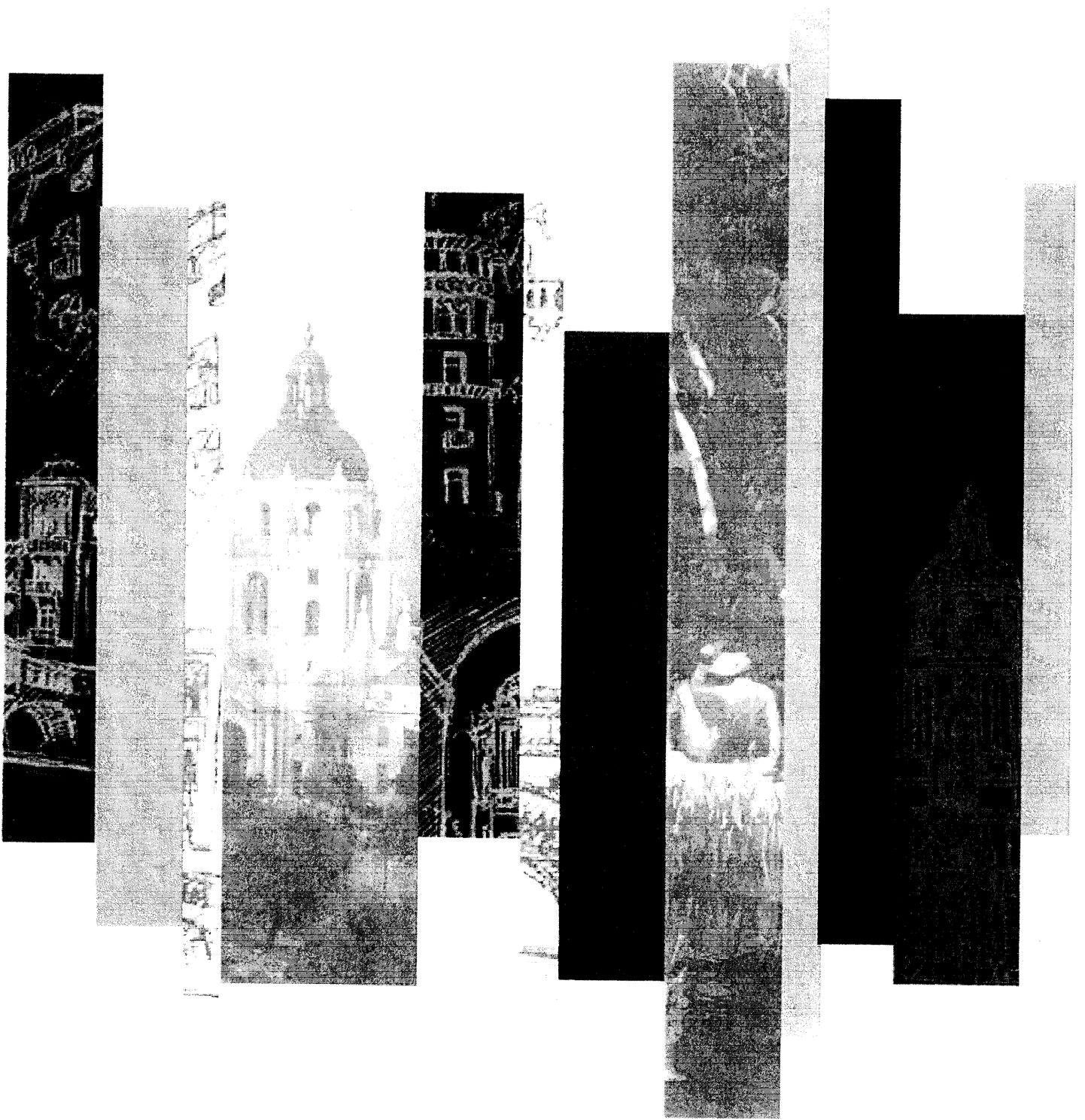
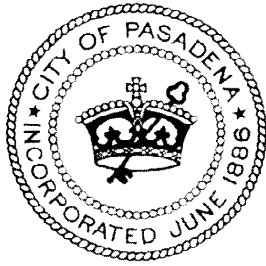


CITY OF PASADENA



COMPREHENSIVE ANNUAL FINANCIAL REPORT
YEAR ENDED JUNE 30, 2006

City of Pasadena, California



COMPREHENSIVE ANNUAL FINANCIAL REPORT

Year Ended June 30, 2006



Bill Bogaard
Mayor



Steve Madison
Vice Mayor
District 6



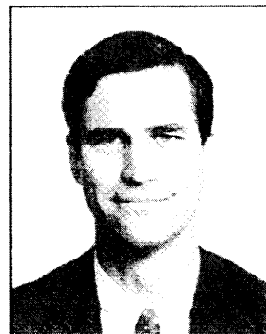
Joyce Sreator
Council Member
District 1



Paul Little
Council Member
District 2



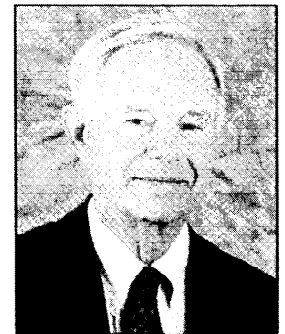
Chris Holden
Council Member
District 3



Steve Haderlein
Council Member
District 4



Victor Gordo
Council Member
District 5



Sidney E. Tyler, Jr.
Council Member
District 7

CYNTHIA J. KURIZ, CITY MANAGER
JAY M. GOLDSTONE, DIRECTOR OF FINANCE
PREPARED BY THE CITY OF PASADENA DEPARTMENT OF FINANCE

CITY OF PASADENA
Comprehensive Annual Financial Report
Year Ended June 30, 2006

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Introductory
Section



DEPARTMENT OF FINANCE

September 28, 2006

To the Honorable Mayor, Members of the City Council
and the Citizens of the City of Pasadena, California

In accordance with Section 907.5 of the City Charter, the Department of Finance hereby submits the Comprehensive Annual Financial Report (CAFR) of the City of Pasadena, California (City) for the fiscal year ended June 30, 2006. This report has been prepared in accordance with Generally Accepted Accounting Principles (GAAP) as set forth in the pronouncements of the Governmental Accounting Standards Board (GASB). GASB has the primary responsibility for determining accounting and financial reporting standards for state and local government entities.

Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the management of the City. It is believed that the data, as presented, is accurate in all material respects, and is presented in a manner designed to fairly set forth the financial position and results of operations of the City and component units as measured by the financial activity of the various funds and account groups, and that it contains all disclosures necessary to enable the reader to gain the maximum understanding of the City's financial affairs and evaluate its financial condition.

The City Charter requires an independent audit of the financial statements of all accounts of the City by an independent certified public accountant. Accordingly, this year's audit was undertaken by Mayer Hoffman McCann PC, a firm of licensed certified public accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of the City of Pasadena for the fiscal year ended June 30, 2006, are free of material misstatement. The independent audit involved 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; and evaluating the overall financial statement presentation. The independent auditor

Honorable Mayor, Members of the City Council
and the Citizens of the City of Pasadena, California
September 28, 2006

concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the City of Pasadena's financial statements for the fiscal year ended June 30, 2006, are fairly presented in conformity with GAAP. The independent auditor's report is presented as the first component of the financial section of this report.

In addition to meeting the requirements set forth in the City Charter, the independent audit was also part of the broader, federally mandated Single Audit Act of 1984, as amended in 1996, and the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* to meet the needs of federal grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the City's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. These reports are available in the City of Pasadena's separately issued Single Audit Report.

GAAP require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of a Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The City of Pasadena's MD&A can be found immediately following the report of the independent auditor.

GOVERNMENTAL STRUCTURE

The City was incorporated in 1886 and became a charter City in 1901. The City operates under the powers granted by a City Charter which dictates the responsibilities of the City Council and City Manager. There are seven City Council members who are nominated and elected by district for overlapping four-year terms. In addition, there is a citywide elected Mayor who also serves for four years.

The City Council is responsible, among other things, for setting policies, passing ordinances, adopting the budget, appointing committees and hiring the City's manager, attorney, clerk and prosecutor. The City Manager is responsible for carrying out policies and ordinances of the City Council, appointing the heads of the City's departments and overseeing the day-to-day operations of the City.

The City covers an area of 23 square miles in the northwestern portion of the San Gabriel Valley and has a population of 144,000, according to the State Department of Finance. The City is bounded on the west by the cities of Los Angeles, Glendale and La Canada,

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on the south by South Pasadena and San Marino, on the east by Arcadia and Sierra Madre, and on the north by the unincorporated community of Altadena.

REPORTING ENTITY AND ITS SERVICES

This report includes all funds of the City, as well as all of its component units. Component units are legally separate entities for which the City is financially accountable.

Blended component units, although legally separate entities, are, in substance, part of the City's operations and are included in this CAFR as part of the City. Accordingly, the Pasadena Public Financing Authority, Pasadena Parking Authority, the Pasadena Civic Improvement Corporation (PCIC), the Pasadena Fire and Police Retirement System (FPRS), the Pasadena Housing Authority and the Pasadena Community Development Commission (PCDC) are reported as part of the City. Discretely presented component units are reported in a separate column in the combined financial statements to emphasize that they are legally separate from the City and to differentiate their financial position, results of operations and cash flows from those of the City. The Rose Bowl Operating Company (RBOC) and the Pasadena Center Operating Company (PCOC) are the discretely presented component units.

The City provides a full range of municipal services including: public safety (police and fire), street construction and maintenance, refuse collection, water and power utilities, sewer utilities, library, culture and recreation, public improvements, planning and zoning, health services, housing and community development, and general administrative and support services.

Budgetary Controls

The City adopts a comprehensive budget detailed by department and fund prior to the beginning of each fiscal year, July 1. From the effective date of the budget, funds become appropriated to the departments for the objects and purposes identified. At any public meeting after the adoption of the budget, the City Council may amend or supplement the budget by a motion adopted by the affirmative vote of at least five members of the City Council. The accounts of the City are maintained by line item detail or object of expenditure. The legal level of budgetary control (the level at which management may not reassign resources or over spend appropriations) is at the departmental level within each fund. Revenues are estimated annually and monitored on an ongoing basis to ensure there are adequate resources to cover expenditures.

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MAJOR GOALS AND ACCOMPLISHMENTS

The City Council has outlined the following goals:

- Assure a Safe and Secure Community
- Foster Economic Prosperity
- Protect and Enhance Neighborhood Vitality and Livability
- Focus on Planning, Programming and Reinvesting in Pasadena's Parks and Open Space
- Maintain and Reinvest in the City's Physical Assets to Assure Their Availability for Future Generations
- Operate an Effective and Cost Efficient Government
- Protect and Enhance Pasadena's Economic, Ethnic and Cultural Diversity

In recognition of these goals, the City continues to promote strong public safety, cohesive neighborhoods, aggressive economic development and effective government. Major and noteworthy accomplishments during fiscal year 2006 are as follows:

- The City is the first public health department in the state to successfully implement a digital field inspection program for retail food establishments.
- The City is the first in Southern California to adopt a ten year strategy to adopt a ten year strategy to end homelessness. Pasadena's strategic plan includes enhanced coordinated efforts in preventing people from losing their homes, increased overnight and transitional housing, and more staff and volunteers to manage the cases of individuals who may need services in addition to shelter.
- The City received \$250,000 Exterior Accessibility Grants for Renters Program (EAGR), funded by the California Department of Housing and Community Development for improvements to properties with disabled tenants. Rental property owners with low-income, disabled tenants may be eligible for grants to fund modifications including ramps, curb cuts, railings, grab bars, mechanical lifts, Braille signage and other improvements to make properties more accessible from the exterior, interior or common areas such as laundry facilities.
- Approved by Pasadena City Council on July 25, Cultural Nexus is a product of the community, the result of 18 months of dialogue among more than 500 participants. The intent of the 10-year plan is to provide a policy framework to ensure better support and access to art and culture. Four policies, nine

Honorable Mayor, Members of the City Council
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principles and approximately 30 tasks will guide its implementation. Cultural Nexus calls for a wider participation in art education programs, a public art collection that reflects Pasadena's unique and international character, and a brand that identifies Pasadena as an intersection of art, culture, design and science.

- A \$979,947 federal grant has been awarded to the Pasadena Public Health Department on behalf of the Pasadena Healthcare Consortium to establish new approaches to better coordinated health care services and referrals for uninsured people in the greater Pasadena area. The service area for the project, called Pasadena Healthcare Link, includes Pasadena, Sierra Madre and Altadena. Other core members of the consortium include Community Health Alliance of Pasadena (CHAP), Young & Healthy Pasadena and Huntington Hospital.
- The City is one of five winners of the 2005 National Award for Smart Growth Achievement, recognized for innovative approaches to development that strengthens community identity and protects the environment. The City was commended for its Central District Specific Plan. The City was given the award for Policies and Regulations, a category that recognizes regulatory and policy initiatives that advance smart growth and actions that remove barriers to or provide incentives for smart growth.
- Pasadena Water and Power (PWP), which celebrates its 100th anniversary, continues to move closer to meeting its Renewable Portfolio Standard of 10 percent renewable energy resources with its first delivery of energy from the Ormat Geothermal Project. PWP received 1 megawatt (MW) of the clean, "green" energy from Ormat on Jan. 26, 2006. The Ormat project is located near the Salton Sea and consists of two separate power generation plants: the Heber Geothermal Facilities and the Ormesa Geothermal Facilities. The Heber facility is completed and once it begins running at full capacity it will provide PWP with 1.5 MW of energy. The Ormesa facility is due to be completed in late 2006 and will supply PWP with another 1.5 MW.
- In April 2006, Pasadena's newest park, Vina Vieja opened. This 7.5 acre park contains not only traditional green space and play equipment amenities, but also a two-acre fenced section for dogs to roam off-leash.

Honorable Mayor, Members of the City Council
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FACTORS AFFECTING FINANCIAL CONDITION

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the City of Pasadena operates.

Local Economy

Pasadena's economic base is very diversified. Some of the leading industries include health care, telephone utilities, engineering and construction, financial services, higher education, cosmetics and general retail merchandise. Thirty-five major companies provide over 37,500 jobs in the City. Pasadena has withstood many of the economic challenges faced by most cities throughout California and has experienced stable revenues and strong economic activities, especially in the area of housing construction. The growth the City has seen has come from a combination of economic recovery and business expansion through a resurgence of commercial, retail and residential development.

Long-term Financial Planning

The financial picture of the City is consistently being monitored. The local economy is expected to remain strong and closely monitors federal and state legislation that may affect local revenues. Increasing labor costs, including benefits and workers' compensation payments, will present the biggest challenges in the coming fiscal year. The General Fund five-year forecast reveals a stable economic outlook, but suggests the growth in expenses will exceed growth in revenues. The City will continue to identify new revenue sources, restructure its debt, look for ways through legislation and/or lobbying efforts to establish guaranteed funding sources, revenue opportunities and streamline operations and/or determine which programs and services the City can no longer afford to provide.

Cash Management Policies and Practices

In order to maximize interest earnings, the City employs a pooled cash system managed by the City Treasurer. Pooled cash is maintained in an invested position providing for reasonable liquidity to meet maturing obligations. Interest revenue derived from pooled cash is allocated to participating funds on a monthly basis, based on the average monthly cash balance of each fund, except for investment earnings associated with funds not legally required to receive pooled investment income, and that has been assigned to and

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recorded as revenue of the general fund, as provided by California Government code Section §53647.

Both realized and unrealized changes in fair value that occur during a fiscal year are recognized and recorded as net changes in fair value of investments. Investment earnings include interest earnings and all other investment income.

Note 2 (Cash and Investments) of the basic financial statements lists the types of City investments and their credit risk categories.

Risk Management

The City funds self-insurance with self-administered claim programs to provide for workers' compensation and liability risks. These activities are accounted for in Internal Services funds, which are a proprietary fund type. The fund revenues are primarily premium charges to other funds. The City purchased limits of \$20,000,000 in excess of its \$5,000,000 self-insurance program for liability claims through Great Lakes Insurance Company and Evanston Insurance Company in FY 2004. The City purchased \$25 million limits in excess of its \$7.5 million self-insurance limits for workers' compensation claims through Employer's Reinsurance Corporation (ERC), which was a change from the prior year when the City purchased Statutory Limits in excess of a \$500,000 self-insured retention. No self-insurance claim settlement exceeded the self-insurance retention in the past three years.

The Workers' Compensation Supervisor and staff administer the claims process, coordinate benefit delivery to injured workers, and ensure employees receive all benefits to which they are entitled, in the most expeditious, cost efficient manner possible within the context of the laws of the State of California. The Safety Officer and staff coordinate employee safety training and monitoring Citywide.

The Liability Claims Coordinator and staff administer the pre-litigation liability claims process, purchase property insurance or other insurance to protect City's assets, and manage risks of accidental loss to City resources other than workers compensation claims. The program includes the identification and measurement of risks of accidental loss, application of appropriate risk management techniques for minimizing or avoiding retained risk, the transfer of risk to others by the purchase of policies of insurance for specific, separately funded enterprise liabilities, and coordinating risk management and/or insurance requirements for persons dealing with the City, such as vendors, permittees, licensees, and contractors.

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ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Locally, Pasadena's economy remains strong. The City's unemployment rate is consistently below county and state averages. The local real estate market is competitive, with home values typically above the median for California and office space vacancy rates half of the county average. Existing local companies are expanding and other important companies are relocating to Pasadena. In fact, a key challenge for the City is to assist in identifying sufficient office space for those firms wishing to locate in Pasadena as well as those existing businesses in need of additional space. The City's economic base continues to become evermore diverse further strengthening Pasadena's position as a center for technology and financial services as well as higher education.

City revenues remain stable with moderate growth. Nevertheless, the City still faces fiscal challenges as the cost of providing services to the public continues to rise. In recent years these costs have grown at a rate greater than the growth in revenues. A main contributor to this was the dramatic increase in employee pension costs brought on by changes in benefit levels, coupled with market losses for the Public Employee Retirement System (PERS). This situation has stabilized as a result of several factors. PERS introduced a new formula for calculating pension contributions that will reduce volatility, and most importantly the system's investment performance has improved considerably in recent years. Most recently a three year agreement was reached with the City's non-safety bargaining units that will improve pension benefits, while maintaining the City's overall pension contribution costs through the introduction of an employee contribution. This agreement will have to be ratified through an election involving all affected employees.

The General Fund five-year financial plan continues to be the mechanism by which the long-term financial health of the City is monitored. By tracking and trending current and anticipated revenues and expenses, the plan provides a tool for the City's policymakers. The current five-year projection indicates that revenues will not fully match expenses in fiscal year 2007. Although a cause for some concern, these projections tend to be conservative and there is every reason to believe that by continuing to monitor revenues and expenses closely, reducing costs through efficiencies, pursuing new revenues, and if necessary, making reasonable and balanced cost reductions, the overall financial health of the City will stay strong and City services will be maintained. The Adopted Operating Budget for fiscal year 2007 includes both modest reductions aimed at maintaining the City's fiscal discipline, and enhancements intended to further the goals of the City as discussed in greater detail below.

Honorable Mayor, Members of the City Council
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September 28, 2006

Additionally, as mentioned above, the Adopted Operating Budget includes funding towards the restoration of the eight percent General Fund Reserve. City policy calls for a reserve in the General Fund equal to eight percent of the current year's appropriations. In fiscal year 2004, as part of the response to a significant loss of revenues to the state, the City capped the reserve at its then current level of \$13.25 million, which represented 7.17 percent of then current appropriations. The fiscal year 2006 Budget included funding sufficient to bring the reserve to a level of 7.5 percent of appropriations. The Adopted Operating Budget for fiscal year 2007 includes an additional \$448,633, thus bringing the reserve to 7.55 percent. It is expected that the reserve will be fully funded at eight percent by fiscal year 2012.

City revenues remain stable; however, threats to some important General Fund revenues have recently emerged. Advances in technology have brought about dramatic changes in the telecommunications industry and vastly increased customer choice. Today the lines between telephone companies and cable companies and the services they provide have blurred. Many cities such as Pasadena rely on revenue from Utility Users Taxes (UUT) applied to telecommunications (i.e., cable television, telephone, long distance, and mobile/cellular) water, electricity and natural gas, as well as franchise fees assessed on cable providers to fund critical services.

Changes in state and federal law as well as a number of legal challenges to the manner in which Utility Users Taxes are applied may reduce or eliminate local governments' ability to raise revenue through the UUT and franchise fees. Pasadena currently receives \$2.2 million in UUT and franchise fee revenue related to cable television and \$10.7 million related to other telephone, long distance and mobile/cellular services. Combined these revenues account for 7.7 percent of total General Fund revenues.

Previously the City had established a \$3 million reserve within the General Fund for the purpose of making any necessary supplemental contributions to the Fire and Police retirement system. Based on current projections, supplemental contributions to that system will be required in fiscal year 2007 and into the future, however, it is anticipated that funding for such will be available from tax increment from the City's downtown redevelopment project area. Accordingly, the \$3 million reserve is recommended to be re-designated for use in the event of a loss of UUT and/or franchise fee revenues.

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AWARDS AND ACKNOWLEDGEMENTS

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Pasadena for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2005. The Certificate of Achievement is the highest form of recognition in governmental accounting and financial reporting, and its attainment represents a significant accomplishment by a government and its management.

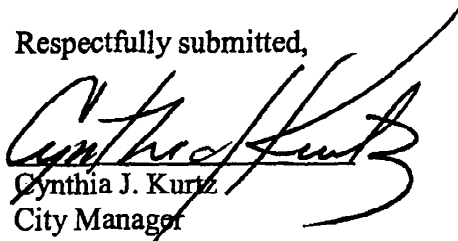
In addition, the City has been awarded the Certificate of Award for Outstanding Financial Reporting from the California Society of Municipal Finance Officers (CSMFO) association for the fiscal year ended June 30, 2005.


Both certificates are valid for a period of one year only. Staff believes this current report continues to conform to the program requirements and will submit it to the CSMFO and GFOA award programs for consideration.

The preparation of this report on a timely basis could not have been accomplished without the efficient and dedicated services of the entire Department of Finance staff.

The Mayor and City Council should also be acknowledged for their leadership, support and continuing efforts to maintain the City's strong fiscal health.

Respectfully submitted,


Cynthia J. Kurtz
City Manager


Stephen Stark
Director of Finance