MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the City of Eureka, we offer readers of the City of Eureka's financial statements this narrative overview and analysis of the financial activities of the City of Eureka for the fiscal year ended June 30, 2005. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal found in the introductory section of this annual report.

Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to the City of Eureka's basic financial statements. The City of Eureka's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide financial statements. The government-wide financial statements are designed to provide readers with a broad overview of the City of Eureka's finances, in a manner similar to private-sector business.

The statement of net assets presents information on all of the City of Eureka's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City of Eureka is improving or deteriorating.

The statement of activities presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City of Eureka that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City of Eureka include general government, public safety, community development, community services, culture-recreation, highways and street, public works, and interest on long-term debt. The business-type activities of the City of Eureka include water, wastewater, transit, harbor, building, and golf operations.

The government-wide financial statements include not only the City of Eureka itself (known as the primary government), but also a legally separate redevelopment agency for which the City of Eureka is financially accountable. The redevelopment agency, although legally separate, functions for all practical purposes as a department of the City of Eureka, and therefore has been included as an integral part of the primary government.

The government-wide financial statements can be found on page 13-15 of this report.

Fund financial statements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Eureka, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City of Eureka can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on short-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's short-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's short-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City of Eureka maintains fourteen individual governmental funds. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances for the general fund and the redevelopment funds, which are considered to be major funds. Data from the other nine governmental funds are combined into a single, aggregated presentation. Individual fund data for these nonmajor governmental funds is provided in the form of combining statements found in the supplemental statements and schedules section of this report.

The City of Eureka adopts an annual appropriated budget for its general fund. A budgetary comparison schedule has been provided for the general fund to demonstrate compliance with this budget and is found on page 77 in the basic financial statements section of this report. The basic governmental fund financial statements can be found on pages 16-23 of this report.

Proprietary funds. The City of Eureka maintains two different types of proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City of Eureka uses enterprise funds to account for its water, wastewater, transit, harbor, building, and golf operations. Internal service funds are an accounting device used to accumulate and allocate costs internally among the City of Eureka's various functions. The City of Eureka uses internal service funds to account for its equipment operation, risk management, information technology, and redevelopment administration. Because these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary funds financial statements provide separate information for the water, wastewater, transit, harbor, building, and golf operations, all of which are considered to be major funds of the City of Eureka. Conversely, all internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of combining statements found in the supplemental statements and schedules section of this report.

The basic proprietary fund financial statements can be found on pages 24-33 of this report.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City of Eureka's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

The basic fiduciary fund financial statements can be found on pages 34-35 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 36-76 of this report.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City of Eureka's progress in funding its obligation to provide pension benefits to its employees. Required supplementary information can be found on pages 80-82 of this report.

The combining statements and schedules referred to earlier in connection with nonmajor governmental funds and internal service funds are presented immediately following the required supplementary information. Combining and individual fund statements and schedules can be found on pages 88-105 of this report.

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City of Eureka, assets exceeded liabilities by $145,721,782 at the close of the most recent fiscal year.

A large portion of the City of Eureka's net assets (80 percent) reflects its investment in capital assets (e.g., land, easements, buildings, machinery, and infrastructure); less any related debt used to acquire those assets that is still outstanding. The City of Eureka uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City of Eureka's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

City of Eureka's Net Assets
Year Ending June 30, 2005

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
Current and other assets	$ 25,219,249	$ 25,953,063	$ 18,675,993	$ 19,903,721	$ 43,895,242	$ 45,856,784
Capital assets	73,130,650	52,117,887	70,515,774	69,579,478	143,646,424	121,697,365
Total assets	98,349,899	78,070,950	89,191,767	89,483,199	187,541,666	167,554,149
Long-term liabilities outstanding	17,735,028	18,036,010	17,736,175	19,500,284	35,471,203	37,536,294
Other liabilities	4,232,268	4,366,221	2,116,413	1,617,769	6,348,681	5,983,990
Total liabilities	21,967,296	22,402,231	19,852,588	21,118,053	41,819,884	43,520,284
Net assets:						
Invested in capital assets, net of related debt	60,192,828	36,214,745	56,367,517	51,425,885	116,560,345	87,640,630
Restricted	14,440,769	1,968,932	4,714,780	7,244,903	19,155,549	9,213,835
Unrestricted	1,749,006	17,485,042	8,256,882	9,694,358	10,005,888	27,179,400
Total Net Assets	$ 76,382,603	$ 55,668,719	$ 69,339,179	$ 68,365,146	$ 145,721,782	$ 124,033,865

An additional portion of the City of Eureka's net assets (13 percent) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets ($10,005,888) may be used to meet the government's ongoing obligations to citizens and creditors.

At the end of the current fiscal year, the City of Eureka is able to report positive balances in all three categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities. The same situation held true for the prior fiscal year. Overall, total net assets increased by $21,687,917 the majority of which is a result of prior year retroactive infrastructure adjustments.

There was an increase of $12,471,837 in restricted net assets reported in connection with the City of Eureka's governmental activities. This increase resulted from housing related activities. During the same time period, unrestricted net assets in the City's governmental activities decreased by $15,736,036 as a result of restricting housing related net assets.

Changes in net assets. The statement of net assets provides a snapshot at a given point in time of the assets and liabilities of the City. The other government-wide statement provided is the Statement of Activities. This statement provides the reader with information regarding the revenues, expenses, and changes in net assets over the fiscal year. Generally, all changes to the City's net assets from one fiscal year to the next flows through the statement of activities.

The City of Eureka's net assets increased by $21,687,917, (which includes a prior period adjustment in the amount of $14,261,937 which represents the City's retroactive reporting of Infrastructure under GASB Statement No. 34 and a restatement of land held for resale). Changes in net assets resulting from governmental activities increased by $20,713,884 while changes in net assets resulting from business-type activities increased by $974,033.

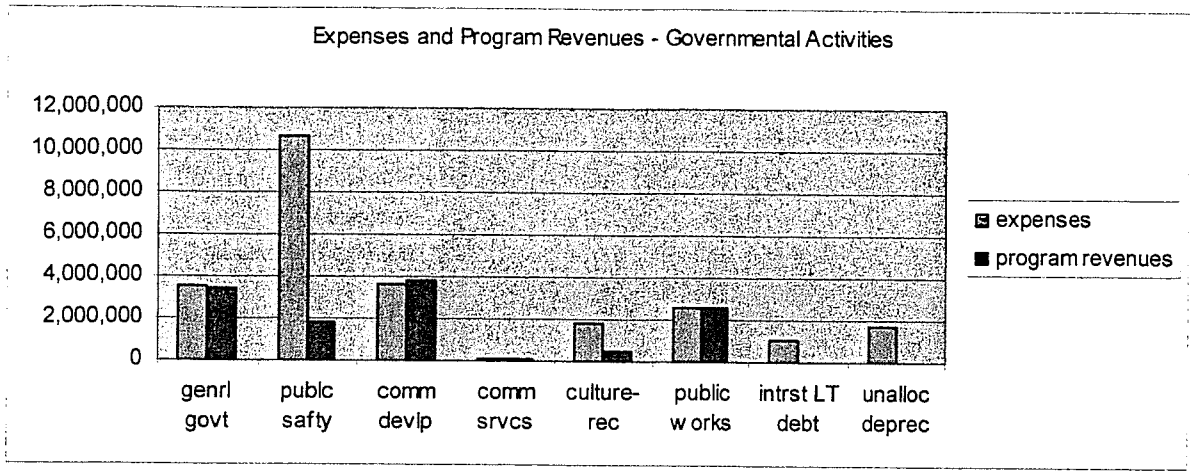
Details of the City's changes in net assets are as follows:

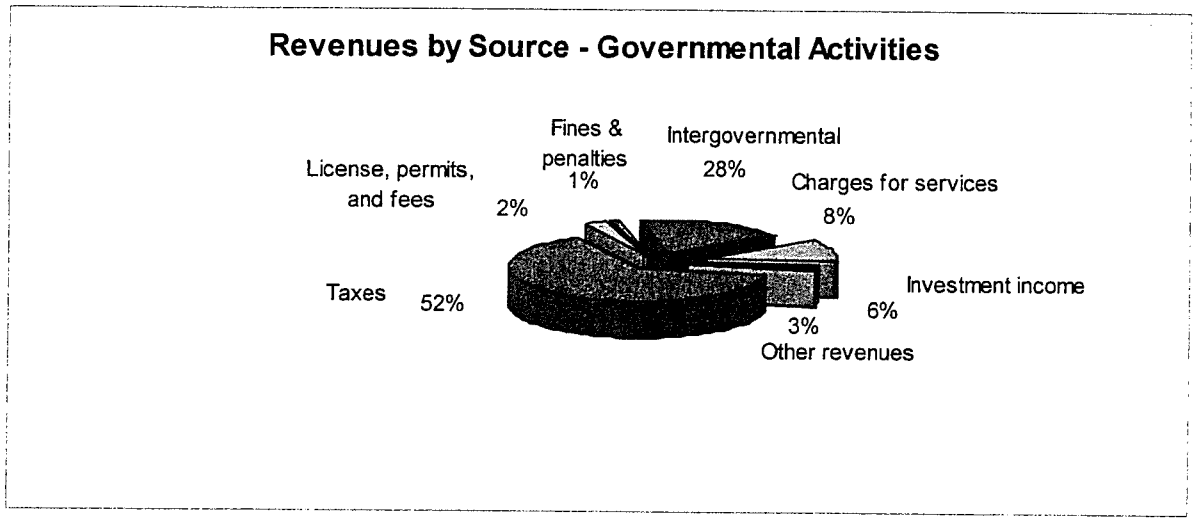
City of Eureka's Changes in Net Assets
Year Ending June 30, 2005

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
Revenues:						
Program Revenues:						
Charges for services	$ 2,565,212	$ 2,772,294	$ 10,733,264	$ 8,729,462	$ 13,298,476	$ 11,501,756
Operating grants and contributions	5,519,557	1,775,335	-	1,109,640	5,519,557	2,884,975
Capital grants and contributions	4,171,641	3,350,372	729,167		4,900,808	3,350,372
General Revenues:					-	-
Taxes:					-	-
Property taxes	4,551,056	4,543,445			4,551,056	4,543,445
Sales taxes	9,612,899	8,398,120			9,612,899	8,398,120
Other taxes	2,658,362	2,882,261			2,658,362	2,882,261
Investment income	1,582,007	234,169	696,148	368,894	2,278,155	603,063
Other	1,239,211	855,772		457,676	1,239,211	1,313,448
Total revenues	31,899,945	24,811,768	12,158,579	10,665,672	44,058,524	35,477,440
Expenses:						
General government	3,509,992	3,692,654			3,509,992	3,692,654
Public safety	10,688,693	10,331,006			10,688,693	10,331,006
Community development	3,614,988	2,517,447			3,614,988	2,517,447
Community services	67,087	132,253			67,087	132,253
Culture - recreation	1,852,558	1,262,761			1,852,558	1,262,761
Public works	2,580,587	2,684,340			2,580,587	2,684,340
Interest on long-term debt	1,088,993	1,811,098			1,088,993	1,811,098
Unallocated depreciation	1,728,090	-			1,728,090	-
Water			3,562,419	3,936,017	3,562,419	3,936,017
Wastewater			4,847,871	5,187,671	4,847,871	5,187,671
Transit			1,433,596	1,687,429	1,433,596	1,687,429
Harbor			1,157,822	1,219,715	1,157,822	1,219,715
Building			461,251	410,449	461,251	410,449
Golf			38,597	49,254	38,597	49,254
Total expenses	25,130,988	22,431,559	11,501,556	12,490,535	36,632,544	34,922,094
Increase in net assets before transfers	6,768,957	2,380,209	657,023	(1,824,863)	7,425,980	555,346
Transfers	(317,010)	(155,596)	317,010	155,596	-	-
Increase in net assets	6,451,947	2,224,613	974,033	(1,669,267)	7,425,980	555,346
Net assets - 7/1/04	55,668,719	53,444,106	68,365,146	70,034,413	124,033,865	123,478,519
Prior Period adjustments	14,261,937	-		-	14,261,937	-
Net assets - 7/1/04 - Restated	69,930,656	53,444,106	68,365,146	70,034,413	138,295,802	123,478,519
Net assets - 6/30/05	$ 76,382,603	$ 55,668,719	$ 69,339,179	$ 68,365,146	$ 145,721,782	$ 124,033,865

The City's largest governmental revenue source, sales tax, accounts for 30% of total revenues. During the current fiscal year, sales tax increased by $1,214,779 (14 percent). Most of this increase is the product of increased consumer spending both by locals and visitors in Humboldt County. Property tax is the next largest governmental revenue source and they account for 14% of total revenues.

Operating grants for governmental activities furnished resources to support five of the City of Eureka's functions: general government, public safety, redevelopment, community development, and community services.



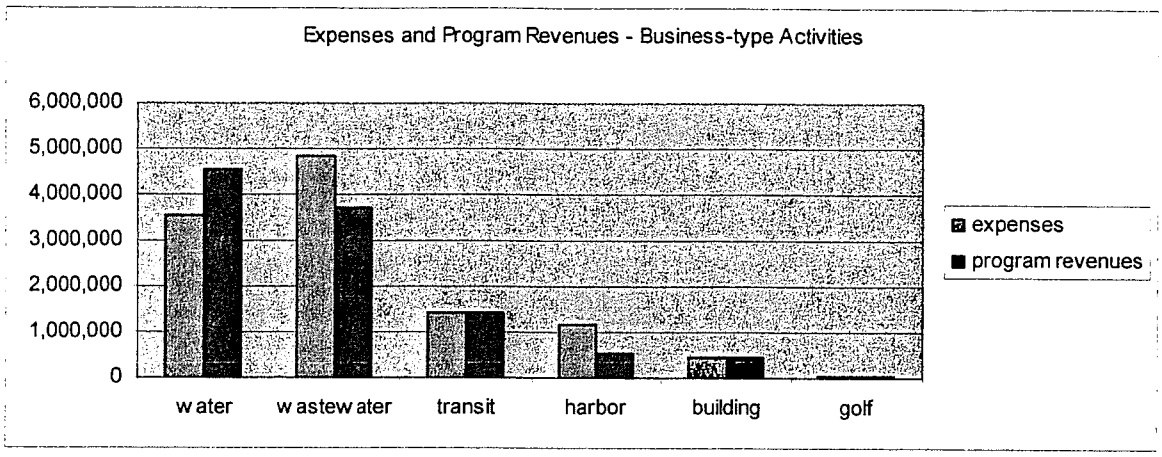


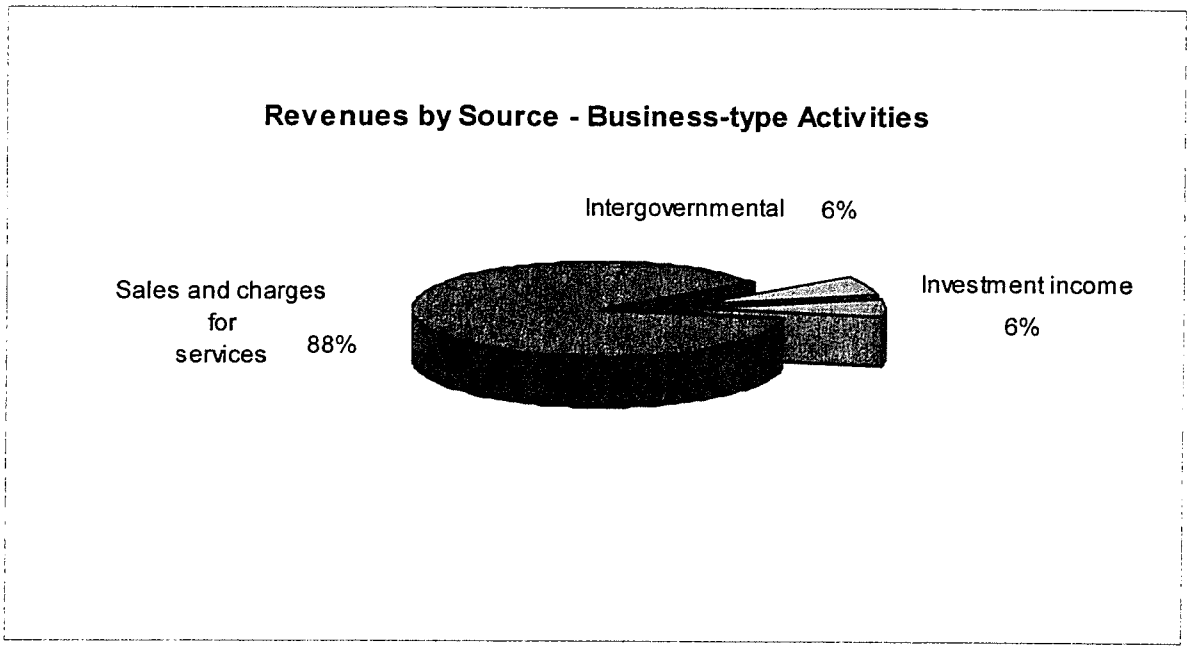
Public safety expenses account for 43% of total governmental activity expenses, an increase of 3% over the prior fiscal year. Of this increase, 65% can be attributed to employee costs.

Business-type activities. Business-type activities increased the City of Eureka's net assets by $974,003 (1% of total net assets). Increased water and wastewater rates along with decreases in employee costs account for this increase.

Key elements of this increase are as follows.

- Charges for services for business-type activities account for 88% of total revenues. The water and wastewater funds account for a significant portion of this total, which resulted from the approval of a 13% water rate increase and a 22% wastewater rate increase designed primarily to provide additional resources to meet debt service requirements. Revenues also increased as a result of a modest increase in demand. The remainder of total revenues is attributable to modest growth in harbor, transit, and building fund operations, which resulted from a combination of additional new customers, increased usage on the part of several current customers, and community economic development.
- Charges for services cover 93% of business type activity expenses. The remaining 7% is funded by grants, contributions, and use of unreserved fund balance.
- Investment earnings totaled $696,148 for business-type activities because of investments within the portfolio which had an average yield of 4.47% at June 30, 2005 and an average maturity of 1.82 years.





Financial Analysis of the Government's Funds

As noted earlier, the City of Eureka uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the City of Eureka's governmental funds is to provide information on short-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City of Eureka's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the City of Eureka's governmental funds reported combined ending fund balances of $16,479,387, a decrease of $2,754,025 in comparison with the prior year. The majority of this fund balance is reserved to indicate that it is not available for new spending because it has already been committed for the following purposes: 1) to account for payments due on notes receivable ($6,177,479); 2) for advances to other funds ($6,256,807); and 3) for land held for resale ($4,788,745).

The general fund is the chief operating fund of the City of Eureka. At the end of the current fiscal year, unreserved fund balance of the general fund was $2,365,536 an increase of $544,070 in comparison with the prior year. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance at the end of the fiscal year represented 13% of total general fund expenditures, an increase of 3% over the prior year, while total fund balance represents 48% of the same amount.

The fund balance of the City of Eureka's general fund increased by $1,114,498 during the current fiscal year. Key factors in this increase are as follows:

- $923,831 additional revenues through taxes such as sales tax and property tax than budgeted
- $160,785 in additional investment income based on higher tax revenue receipts.
- $29,882 more revenues in the areas of franchise fees, fines and forfeits than anticipated.

The redevelopment and housing funds have a total fund balance of $6,275,015, all of which will be used for specific redevelopment and housing activities.

Proprietary funds. The City of Eureka's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net assets of the water and wastewater funds at the end of the year amounted to $8,485,328 and those for other proprietary funds total $(228,446). This negative net assets is a result of the activities within the City's harbor fund.

General Fund Budgetary Highlights

Differences between the original budget and the final amended budget (including transfers out) were seven percent higher ($1,234,079 added to $18,043,763 in original appropriations) and can be briefly summarized as follows:

- $42,000 court case settlement fees
- $183,200 additional professional fees within public safety appropriations
- $60,000 additional due to new zoo facility brought on line during the year
- $237,800 interest repayment for TRANS debt not originally budgeted
- $711,000 in various increases in general government, public safety and public works as a result of salary agreements with employee groups

Of this increase, $1,819,438 was budgeted from available fund balance. During the year, however, actual expenditures were less than budgetary estimates, thus drawing only $1,448,446 from existing fund balance.

Differences between the final budget and actual budgetary expenditures were two percent less than appropriated ($370,992 less than $19,277,842) and can be briefly summarized as follows:

- $296,060 in reductions in general government activities mainly the result of deferral of capital outlay expenditures
- $74,932 in changes to allocations for capital outlay (mainly the result of budgeted capital outlay expenditures which were moved into materials and services as they did not meet the City's capitalization threshold for capital outlay items)

Capital Asset and Debt Administration

Capital assets. The capital assets of the City are those assets that are used in the performance of the City's functions, including infrastructure. At June 30, 2005, the City of Eureka's net capital assets for its governmental and business-type activities amounts to $143,587,820 (net of accumulated depreciation). The investment in capital assets includes land, easements, buildings, improvements other than buildings, machinery and equipment, infrastructure, and construction in progress. Net additions to capital assets of the City over the prior year totaled $21,890,455.

Major capital asset events during the current fiscal year included the following:

- The majority of the change in capital assets was through the recording of prior year retroactive infrastructure adjustments totaling $15,518,900.
- Construction in progress such as the High Tank Water Project and Water Transmission Line Replacement accounting for an increase of $1,793,892 as of the close of the fiscal year.
- A variety of street construction projects added $501,623 to total construction in progress at the close of the fiscal year (mainly the Fairway Drive improvements).
- Construction in progress for the City's Fishermen's Terminal Project added $2,779,195 during this fiscal year for this building project.
- The V Street Congestion Relief project accounted for $855,362 in construction in progress.
- Construction in progress for the City's Multiple Assistance Center added $441,483 during this fiscal year for this building project.

City of Eureka Capital Assets
(net of depreciation)
Year Ending June 30, 2005

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
Land	$ 4,042,899	$ 3,646,899	$ 8,835,741	$ 8,835,741	$ 12,878,640	$ 12,482,640
Easements	23,922,864	23,922,864			23,922,864	23,922,864
Buildings	4,858,184	5,008,500	6,146,853	5,756,988	11,005,037	10,765,488
Improvements other than buildings	8,585,326	11,022,152	19,726,396	20,705,934	28,311,722	31,728,086
Machinery and equipment	4,623,214	3,677,226	19,226,209	20,361,134	23,849,423	24,038,360
Infrastructure	16,029,251	658,358	4,851,524	4,703,530	20,880,775	5,361,888
Construction in progress	11,068,912	4,181,888	11,670,447	9,216,151	22,739,359	13,398,039
Total Capital Assets	$ 73,130,650	$ 52,117,887	$ 70,457,170	$ 69,579,478	$ 143,587,820	$ 121,697,365

Additional information on the City of Eureka's capital assets can be found in note 7 on pages 58-59 of this report.

Long-term debt. At the end of the current fiscal year, the City of Eureka had total bonded debt outstanding of $31,379,754. Of this amount, $11,060,000 comprises debt backed by revenues within the water fund, another $4,244,754 comprises debt backed by revenues within the wastewater fund, $825,000 comprises debt backed by revenues within the harbor fund and $15,250,000 in tax allocation bonds backed by incremental tax revenues from the redevelopment project areas.

City of Eureka Outstanding Debt
Year Ending June 30, 2005

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
Revenue bonds payable, net	$ 15,250,000	$ 15,250,000	$ 16,129,754	$ 16,915,991	$ 31,379,754	$ 32,165,991
Capital leases	493,652	653,142			493,652	653,142
Loans payable			2,526,304	2,584,293	2,526,304	2,584,293
Net pension obligation	1,810,012	2,132,868			1,810,012	2,132,868
Compensated absences	824,000	889,146	103,118	128,569	927,118	1,017,715
Total	$ 18,377,664	$ 18,925,156	$ 18,759,176	$ 19,628,853	$ 37,136,840	$ 38,554,009

The City of Eureka Redevelopment Agency and its water and wastewater funds all maintain a "AAA" rating from Standard & Poor's.

Changes to the City's long-term debt included net decreases to compensated absences of $90,597 and reductions through debt service and loan payments of $1,326,572

State statutes limit the amount of general obligation debt a governmental entity may issue to 3.75 percent of its total assessed valuation. The current debt limitation for the City of Eureka is $65,128,081 which is significantly in excess of the City of Eureka's outstanding general obligation debt.

Additional information on the City of Eureka's long-term debt can be found in note 9 on pages 61-68 of this report.

Economic Factors and Next Year's Budgets and Rates

- The unemployment rate for the City of Eureka is currently 6.75 percent, which is an increase from a rate of 4.9 percent a year ago. This does not compare favorably to the state's average unemployment rate of 5.1 percent and the national average rate of 5.0 percent.
- The occupancy rate of the City's main street area has improved to 98 percent over the last ten years.

- Inflationary trends in the region compare favorably to national indices.

All of these factors were considered in preparing the City of Eureka's budget for the 2005-06 fiscal year.

During the current fiscal year, the unreserved fund balance in the general fund increased to $2,365,536 which is available in the 2005-06 fiscal year for appropriation. Of this amount the City of Eureka has appropriated $1,100,128 for spending in the 2005-06 fiscal year budget. It is intended that this use of available fund balance will avoid the need to raise taxes or charges significantly during the 2005-06 fiscal year.

Water fund rates were increased for the 2005-06 budget year. The water rates were increased by an average of 13% for all customers. These rate increases were necessary to finance debt service on the new debt issued during the 2002-03 fiscal year within the water fund. Rate increases for the wastewater fund were increased by 22% mid-way into the 2005-06 budget year for all customers with the exception of the senior citizen rate to finance debt issued during the 2002-03 fiscal year within the wastewater fund.

Requests for Information

This financial report is designed to provide a general overview of the City of Eureka's finances for all those with an interest in the government's finances, and to demonstrate the City's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Finance Director, City of Eureka, 531 K Street, Eureka, California, 95501.