



Agenda Item #: _____

Staff Report

City of Manhattan Beach

TO: Honorable Mayor Tell and Members of the City Council

THROUGH: Geoff Dolan, City Manager

FROM: Bruce Moe, Finance Director
Russell J. Morreale, Assistant Finance Director
Henry Mitzner, Controller

DATE: December 19, 2006

SUBJECT: **Presentation of the Comprehensive Annual Financial Report (CAFR) for June 30, 2006**

RECOMMENDATION:

The Finance Subcommittee and staff recommend that the City Council receive and file the Comprehensive Annual Financial Report (CAFR) for Fiscal Year 2005-2006.

FISCAL IMPLICATION:

This action tonight provides the City's annual audited financial statements for the 2006 fiscal year with no resulting financial or budgetary requests. Although some financial challenges do exist, the City had a good year as evidenced by a General Fund surplus of \$4.15 million which has come in above original 2006 budget projections.

BACKGROUND:

Attached is the City's Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2006 (Attachment "B"). This independent audit report is prepared by our auditors, Lance, Soll and Lunghard, the certified public accountancy firm selected in FY 2003-2004. We would like to take this opportunity to acknowledge the professionalism and diligence displayed by our auditors in the planning, execution and completion of the FY 2005-2006 audit. Their hard work was completed with the utmost professionalism and teamwork, while maintaining their objectivity. It is also the fourth year of compliance with Governmental Accounting Standards Board (GASB) pronouncement No. 34 (GASB34), discussed in more detail below. *Additionally, this year's CAFR has been modified to comply with yet another new GASB requirement, GASB 44, resulting in a completely re-designed and quite informative Statistical section.* The report was discussed with the City's auditors at the December 5th meeting of the Finance Subcommittee.

DISCUSSION:

Overall Summary of Results:

Finance is pleased to report that the City has again attained an *unqualified audit opinion* validating the fair and accurate presentation of our financial status as of June 30, 2006. As the CAFR

indicates, 2006 ended with the City in good fiscal health. The City again experienced a strong General Fund operating surplus (\$4.15 million); governmental revenues came in strong, with growth coming mainly from property tax; sales tax, hotel tax, and service revenues. We are pleased to report that we met budget projections in all areas, validating the financial budget and planning process. Governmental fund balances have been maintained in line with financial policies, adopted reserve designations have been preserved, and adopted budgetary and investment guidelines have been met as a result of prudent fiscal management and controls citywide. This year's report again validates the City's financial accounting systems, procedures and management controls.

As reported last year, this CAFR again reflects rising operational costs in the areas of salaries, benefits, and insurance which remain as challenge areas to be addressed in prospective budget years. In fact, a review of the City's Insurance Fund reveals a negative equity balance when both short and long term liabilities are considered. Although insurance costs always remain a challenge, the fund's fiscal condition was addressed in the FY 2006-2007 budget.

As we look forward, it appears that last year's State budget crisis is beyond us although the current year audit reflects the final ERAF shift of \$650,000. Additionally, cash flow is impacted by the dollar for dollar swap of sales tax for property tax, due to the variations in timing of receipt of those payments (twice annually versus monthly). On the other hand, we are pleased to report that the State made an early re-payment to the City of the 2003 VLF GAP loan..

Organization of the Document:

The organization of the document is as follows:

The ***Introductory Section*** includes the City's transmittal letter providing an executive summary of the financial and economic events characterizing the 2005-2006 fiscal year. A review of the transmittal letter will help the reader understand the City's organizational structure and provides performance highlights of the City's most significant funds and operations.

The ***Financial Section*** presents the independent auditors' report. The auditors' report contains two main sections: the Audit Opinion and the Management Discussion & Analysis (MDA). ***The Audit Opinion***, worded in an industry standard format, provides a statement by the auditors attesting to the fair presentation of financial data in conformity with generally accepted accounting principles and government accounting standards. The Management Discussion & Analysis (MDA), which was a new requirement under GASB 34, is a key report for our readers. The MDA is intended to serve as an introduction to the City's basic financial statements, which comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements, which is an overview and analysis of the financial activities of the City of Manhattan Beach for the fiscal year ended June 30, 2006.

The ***Government-wide financial statements*** are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business. This section is very different from the traditional budgetary fund presentation made in the past because these statements utilize full accrual accounting requiring the capitalization of assets and fund consolidations, much like is done in private industry. The statements included in this section are the ***statement of net assets*** and the ***statement of activities***. Both government-wide statements are designed to show the annual increase or decrease in ***net assets*** and, in doing so, distinguish

functions of the City 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 include general government, public safety, public works, planning, building and safety, and recreation. The City's business-type activities include water, waste water, storm water and parking.

The ***Fund Financial Statements*** is the section that reports on the City's operations on a traditional modified accrual and budgetary basis. A key document to view in this section can be found on pages 30 and 31 which present, at a glance, the City's actual performance for the year for all governmental funds. Changes of note in the section include: (1) the inclusion of reconciliations between the government wide and fund statements necessary because of the difference in accounting methods and presentation between the two, (2) the grouping of Special Revenue Funds as "non-major" governmental funds given their relative materiality, and (3) the more detailed presentation of the City's business-like enterprise funds. A final major difference deals with the change in how fund balance reserves and restrictions are presented. GASB 34 limits the presentation of fund restrictions to very specific items resulting in much larger unreserved balances as compared to what is presented in the budget and pre-GASB 34 CAFR's. This being the case, the reader is well served to view note #7 to get a sense of fund balances before and after restrictions and major City Council designations. Once these designations are considered, the unreserved balances clearly line up on an historical and budgetary basis in conformance with the City's fiscal and capital plan.

The ***Notes to the Financial Statements*** section follows, which provides financial disclosures about the City's financial statements. With the introduction of GASB 34 in recent years, we urge readers to closely review these notes which have been modified for this new accounting standard. Those familiar with our pre-GASB 34 statements will note that the presentation of long term liabilities and fund balances has been modified to take on a more citywide flavor. The notes now reflect the GASB 34 required citywide capital asset valuation which is presented in the highlight of changes portion of this section. Note #5 now presents the value of all owned assets citywide and the impact of the GASB 34 valuations required as part of this implementation.

This section is followed by the ***Combining Financial Statements & Schedules*** and the ***Statistical Section***. The combining statements are presented in the traditional fund manner and report on the detail of all non-major funds which appear on a combined basis in the front of the document. ***This year the Statistical section has been completely re-designed in conformity with GASB 44.*** Staff is happy to report that we have met the requirements of GASB 44 within the established deadline, June 30, 2006. This is a welcome change as this revised section now presents very useful long-term trends which assist the reader in evaluating the City's financial condition over time. Most of the new schedules present a ten (10) year trend of operations. As this is the first year of implementation, we will continue to expand and build on this new development for the CAFR. The Statistical Section is not subject to audit investigation although staff has spent many hours assuring the historical accuracy of the numbers presented.

Management Letter Findings:

The independent auditors' report typically includes a formal Management Letter indicating internal

control areas which are in need of improvement. In the current year, no management letter points were found as a result of the internal control reviews indicative of the City's strong internal controls.

CONCLUSION:

The Finance Subcommittee and staff recommend that the City Council receive and file the 2005-2006 CAFR.

Attachments: A: Audit Statement of Responsibilities
B. CAFR at a Glance
C. June 30, 2006 Comprehensive Annual Financial Report



Certified Public Accountants

Brandon W. Burrows
Donald L. Parker
Michael K. Chu
David E. Hale
A Professional Corporation
Donald G. Slater
Richard K. Kikuchi

Retired

Robert C. Lance
1914-1994
Richard C. Soll
Fred J. Lunghard, Jr.
1928-1999

October 19, 2006

Finance Subcommittee
City of Manhattan Beach
Manhattan Beach, CA 90265

We have audited the financial statements of the City of Manhattan Beach for the year ended June 30, 2006, and have issued our report thereon dated October 19, 2006. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Accounting Standards Generally Accepted in the United States of America and Government Auditing Standards

Our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the City of Manhattan Beach. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the City of Manhattan Beach's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City of Manhattan Beach are described in the notes to the financial statements. We noted no transactions entered into by the City of Manhattan Beach during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you of, or transactions for which there is a lack of authoritative guidance or consensus.



Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. Where applicable, the City utilized accounting estimates for depreciation on City assets and for reporting incurred but not reported amounts relating to the liability for claims and judgments. The methodology used during this audit is consistent with that of prior years. We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded, either individually or in the aggregate, indicate matters that could have a significant effect on the financial reporting process.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.



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Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

Other Communications

When applicable, the City of Manhattan Beach implemented the following two new Governmental Accounting Standards Board (GASB) pronouncements, which were effective for fiscal year 2005-2006, audits:

GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section*
GASB Statement No. 47, *Accounting For Termination Benefits*

This information is intended solely for the use of the Finance Subcommittee and management of the City of Manhattan Beach and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

Lance, Soll & Lunghard, LLP

B. CAFR at a Glance

2006 CAFR at a Glance

- **Introduction & Compliance**
 - Auditors – Lance Soll & Lughard
 - Draft presented to the Finance Sub-committee December 5th
 - Unqualified "Clean" Opinion – No internal control findings
 - GASB 34 Compliant - 4th Year of Implementation – **GASB 44 Compliant FY2006**
- **Financial**
 - **General Fund**
 - \$4.15 Million General Fund Surplus [Mid Year Projection - \$3.5 mil]
 - GF Total Fund Balance \$21.5 Mil
 - Financial & Investment Policies Maintained
 - Revenues exceed budget 109% - 12% actual increase
 - Expenses within budget 98% - 10% actual increase
 - \$4.8 million available in the Gen Fund [07 Budget trsfr \$2.5 mil from Gen to CIP Fund]
 - **Other Funds & Performance Indicators**
 - \$1.8 million available in the CIP Fund [07 Budget trsfr \$2.5 mil from Gen to CIP Fund]
 - Strand – Police/Fire-Metlox Paid In Full
 - Policy reserves maintained
 - Govt. Funds - healthy unreserved balances
 - Utility Funds – healthy reserves & positive operations
 - Fiduciary obligations met
 - Major capital assets added – Police Fire \$12.8 mil – Strand \$2.1 mil- \$1.8 Metlox - \$1.8 Streets - \$1 mil El Porto Lot
 - No New bond debt issued – Fire & Sewer Truck Lease \$720K
- **Challenge Indicators**
 - Insurance Fund In Policy – negative balance considering long term reserves [07 Budget trsfr \$1.3 mil from Gen Fund]
 - Storm Water Fund Quickly Depleting Reserves [Prop 218 Vote Required]
 - Rate Studies may be required for Utility & Parking Funds
 - Rising Operational Costs – Salary & Benefits-PERS-Insurance
 - Future Infrastructure Funding
 - State Budget – Always a Concern