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*January 20, 2004*

Honorable Mayor, Councilmembers and Citizens of Manhattan Beach  
Manhattan Beach City Hall  
Manhattan Beach, California 90266

The Comprehensive Annual Financial Report (CAFR) of the City of Manhattan Beach for the Fiscal Year Ended **June 30, 2003 (FY2003)** is hereby submitted. This report has been prepared in accordance with generally accepted accounting principles as set forth in the pronouncements of the Governmental Accounting Standards Board (GASB). This report is also in compliance with the relevant requirements of Governmental Accounting, Auditing and Financial Reporting published by the Government Finance Officers Association of the United States and Canada. Responsibility for the accuracy, completeness and fairness of the data presented, including all disclosures, rests with management. We believe the information presented is accurate in all material aspects, and that it is reported in a manner designed to fairly present the financial position and results of operations of the various funds, account groups, and component unit of the City of Manhattan Beach. All disclosures necessary to enable the reader to gain an understanding of the City's financial activities have been included.

***In terms of presentation and method, the 2003 report marks a year of great change.*** This year's report has been completely reformatted to comply with the new reporting model developed by the GASB statement 34. City staff is thankful for City Council's full support in providing the resources and guidance needed to ensure financial reporting compliance. This project is completed after well over a year in planning and implementation and involved several major steps including: completion of a citywide identification and assessment of Infrastructure valuations; completion of a utility cost allocation study; development of new accounting models to facilitate the new reporting; a shift in audit planning; redesign of the published CAFR; introduction of newly developed asset valuation & depreciation policies; and identification of new computerized fixed asset management tools.

GASB statement 34 is intended to improve financial reporting by adding significant information not previously provided in local government financial statements. Some of the most significant changes in reporting as required by this new standard are as follows:

- A major addition is the inclusion of the government wide financial statements which were designed to show the reader the net assets and equity of the City as a whole and report on the total cost of providing city services. To do so this new accounting model introduces a Statement of Net Assets and a Statement of Activities which are newly presented in the forefront of the CAFR document.

- These particular statements are prepared using the accrual basis of accounting versus the modified accrual method applied in the traditional fund financial statements. In the past the full accrual method of accounting, which is typical of private sector reporting, was only utilized for the City's enterprise funds or business activity operations. This accrual basis of accounting recognized revenue as earned as opposed to actual receipt, and expenses are recorded when the transaction occurs rather than when payment is made. In so far as the accrual method is applied to the government wide statements only, a reconciliation between city wide and fund statements is provided as a key to understanding the differences in reporting methods and results.
- The new model includes an emphasis on the City's major funds as shown in the Government Fund Statements. These new statements along with the citywide statements are further analyzed in a new required narrative called the Management Discussion and Analysis (MDA). This MDA provides financial highlights and interprets the financial reports by analyzing changes with an emphasis on the change in net assets and results of operations. The MDA is also intended to disclose any significant economic or legislative events or decisions that affect the financial condition of the City.

In accordance with the above-mentioned guidelines, the accompanying report consists of three sections. The ***Introductory Section*** contains this transmittal letter, a list of the City's principal elected and appointed officials, and an organizational chart. The ***Financial Section*** consists of the Independent Auditors' Report, the Management Discussion and Analysis, the Government Wide Financial Statements, notes to the financial statements, and combining financial statements and schedules. The ***Statistical Section***, which is not audited, contains selected financial and demographic information, generally presented on a multi-year basis.

## **DESCRIPTION OF REPORTING ENTITY**

The City of Manhattan Beach was incorporated December 12, 1912, as a general law city in the State of California. The City operates under a Council-Manager form of government and provides the following services: police, fire, highway and streets, cultural and recreation, planning and zoning, utilities, and general administrative services.

The financial statements present the financial activity of the City of Manhattan Beach (the primary government) and its component unit. The component unit discussed below is included in the City's reporting entity because of the significance of its operational or financial relationships with the City, although it is a legally separate organization. However, the City of Manhattan Beach elected officials have continuing full or partial accountability for fiscal matters of this entity. The financial reporting entity consists of: (1) the City, (2) organizations for which the City is financially accountable, and (3) organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the City's financial statements to be misleading or incomplete.

An organization is fiscally dependent on the primary government if it is unable to adopt its own budget, levy taxes or set rates or charges, or issue bonded debt without approval by the primary government. In a blended presentation, a component unit's balances and transactions are reported in a manner similar to the balances and transactions of the City. Component units are presented on a blended basis when the component unit's governing body is substantially the same as the City's or the component unit provides services almost entirely to the City.

**Blended Component Units:** The financial statements of the City of Manhattan Beach include the financial activities of the Manhattan Beach Capital Improvements Corporation. The Capital Improvements Corporation was formed on August 6, 1996 and first used to issue debt to finance capital improvements to the City's water and wastewater systems. In FY2002 this corporation issued \$9,535,000 in debt to refinance existing ground lease commitments for the newly opened Marine Avenue Sports Fields resulting in long term savings of both interest and principal. Most recently, in January 2003, this entity issued \$13.35 million in fixed rate Certificates of Participation for the construction of a new two level downtown subterranean parking structure and outdoor plaza discussed in more detail below.

## **SERVICE EFFORTS & MAJOR INITIATIVES**

### **Service Efforts**

In FY2003, the City of Manhattan Beach maintained a high level of service to its residents and citizens. The City adhered once again to its financial policies and adopted financial plan as evidenced by the budget-to-actual reporting presented within this document. \$48.62 million was originally budgeted to support the City's many services and programs. \$21.5 million in capital projects was budgeted for the year. The City adhered to all budgetary limits on a citywide basis with the General Fund reporting a healthy surplus once again. All funds performed as expected in line with the City's financial policy guidelines.

Some of the key capital improvements completed and/or initiated in 2003 include the following:

- \$5.8 million for the first several months of construction costs of a two level subterranean public parking structure at Metlox.
- \$1.5 million of pre-construction costs for the new police/fire facility. These 2003 costs involved final design and engineering of the facility.
- \$1.1 million for significant improvements to Polliwog Park. This expenditure marks the completion of the second phase of this exciting park improvement.
- \$1.0 million in maintaining the City's citywide annual street resurfacing program.
- \$1.4 million for a variety of Water, Sewer & Storm water utility facility & line improvements.
- \$450,000 for the Roundhouse rehabilitation with an additional \$40,000 for pier utility upgrades.
- \$200,000 in neighborhood parkette improvements
- \$700,000 in a variety of street projects.

## **Major Initiatives**

In FY2003, the City of Manhattan Beach made significant progress on many of the key work plan items identified in the operating budget. A recap of these accomplishments follows:

***Public Safety Facility Project:*** In the previous year the City outlined a specific financing plan for the future construction of a new public safety facility to replace existing Police and Fire buildings that are outdated and limited in space. In the current year great headway was made in the furtherance of this project culminating in the award of a contract in calendar 2003. Project design and valuation has been completed and is estimated to cost \$39 million including costs incurred to date. In the November 2001 election, the City sought voter approval of a \$15 million General Obligation Bond to facilitate the financing of this facility. The required two-thirds approval was not attained and the City proceeded to develop an internal financing plan. Alternative financing options in procuring the remaining balance of required funds were presented to City Council in FY2002. The City designated specific reserves of \$20 million in the Capital Projects Fund for this improvement in line with FY2003 projections. This reserve level will be increased to \$25 million in 2003-2004 right on schedule with financial plans developed in prior years. The remaining amount will be financed with a combination of debt and the use of reserves.

***Metlox Improvements & Development:*** The City held a grand opening for the Metlox parking structure in January 2004. This structure holds 460 spaces which is a welcome addition to the City's downtown district. The public parking portion of the project was completed within budget and on schedule at a cost of \$14.6 million. Since the purchase of the Metlox site in 1997/1998 the City engaged a financial advisor, selected a development partner, completed conceptual design with community input, finalized an environmental impact report, and began construction in the current year. The private retail portion of this development will include a mix of hotel, retail, restaurant and office space elements, and the developer has entered into a long term ground lease with the City. This multi-million dollar project is projected to be a positive economic benefit adding to the City's ground lease, property, hotel, and retail tax revenue base. In concert with this private phase, the City will construct a 40,000 square foot town square which, along with the retail improvements, is scheduled for completion in 2005. The City retains ownership of the underlying land, parking facilities and public open space. In May 2002 financing options were presented to City Council for the public parking and space component of this development. This resulted in a decision to debt finance \$11.6 million of the public project cost and increase dedicated parking meter revenues to assist funding the resulting future debt service. This plan was adopted and resulting certificates of participation were issued in January 2003. All debt financing, and capital transactions have been recorded in the parking enterprise fund and are backed by the strength of the City's overall credit.

**Financial Credit Rating:** The City obtained a financial credit rating in anticipation of issuing bonds for the construction of public improvements at the Metlox site as well as a new Police/Fire facility. The results of the credit rating have come in and the City has attained the highest possible rating, “AAA,” from both S&P and Fitch. With this good news, the City proceeded with its plans to issue bonds for both facilities starting with Metlox Certificates of Participation which were sold in January 2003 at a size of \$13.3 million (including all issuance costs, reserve and capitalized interest requirements). The bond issuance for Police/Fire, to take place in calendar 2004, is estimated at \$11 million although this amount is yet to be determined. Because the City realized a healthy General Fund surplus in 2003, over \$4 million, the possibility of further cash funding the project is being analyzed at this time.

**General Plan Update:** The 2002-2003 Council work plan included a goal to complete an update of the City’s General Plan. This process was completed in fiscal year 2004 and involved a number of community meetings, public discussions, completion of an environmental impact report, and final adoption of the plan. This significant event sets the direction for planning and building development as we move into the future and sets the tone for maintaining the superior quality of life that this City is known for.

**Completed Labor Negotiations:** Within the last eighteen months the city successfully negotiated and ratified several multi-year employee group contracts. These included Fire, Police and Miscellaneous employee groups.

**Ongoing Water/Wastewater System Upgrade:** In September 1996, the City issued \$4,615,000 in Certificates of Participation through the Manhattan Beach Capital Improvements Corporation to finance the upgrade of the City’s water and wastewater systems. Through this aggressive five-year capital project, important Water and Sewer infrastructure improvements have been made throughout the City. Net revenues of the Water and Wastewater Funds secure the 30-year issue. As of June 30, 2002 all construction fund balances for Water and Wastewater have been expended. The related remaining debt service is recorded in each respective enterprise fund for a total outstanding principal amount of \$4,345,000.

**GASB 34:** One of the key work plan items put forth for FY 2003 was to effect full compliance with the accounting requirements of GASB 34. All City departments are happy to deliver the first issuance of this GASB 34 compliant report as of June 30, 2003 in evidence of completing this goal. Many staff members were involved in this project, but special recognition is due to both the Finance and Public Works Engineering for their outstanding efforts in bringing this project home. As we look forward to future years staff will redirect their efforts towards updating systems and procedures in support of this new reporting model. That being said we have successfully completed this first major milestone.

## **FINANCIAL CONTROLS AND PROCEDURES**

***Financial Policies:*** Throughout the years, the City of Manhattan Beach has followed a fiscally conservative philosophy of building and maintaining healthy financial reserves. This practice has allowed the City to continue providing quality services to its residents in a time when many local agencies were being forced to cut back due to fiscal constraints. In 1997-1998, the City Council approved the City's first set of financial policies, designed to promote sound financial management and ensure that the City's fiscal integrity remains intact as staff and Councilmembers change. This Comprehensive Annual Financial Report reflects the implementation of these financial guidelines and presents all fund reserves and designations in an effort to define fund balance commitments and obligations as of the financial report date.

***Internal Control Structure:*** Management of the City is responsible for establishing and maintaining fiscal internal controls designed to safeguard the assets of the government from loss, theft or misuse, and to ensure that accounting data is accurately compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of controls should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits require estimates and judgments by management.

***Budgetary Controls and Changes:*** The City of Manhattan Beach maintains budget controls. The objective of these controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the City Council. Budget control is primarily maintained at the fund level in the governmental fund types. The City maintains a centralized purchasing function as one method of accomplishing budgetary controls. All purchase orders are reviewed by Purchasing and Finance management to assure adequate budget funding before binding commitments are finalized. Additionally, all machinery and equipment purchases are processed through centralized warehouse receiving to further strengthen internal controls. The City's financial software includes a full encumbrance purchasing accounting system with real time approval and budget checking capabilities. Full encumbrance accounting allows for the speedy identification of fund obligations at the time of requisition, providing tremendous budgetary control. The Comprehensive Annual Financial Report isolates all encumbrance obligations existing at June 30, 2003, related to governmental funds, and presents them as fund balance reserves on the respective balance sheets.

***Cash Management:*** It is the City's policy to invest all temporarily idle short-term funds and longer-term reserves in a manner that will maximize return without sacrificing security and jeopardizing liquidity requirements. Idle funds are invested in accordance with the Government Code and a formal investment policy approved by the City Council. The policy, which is reviewed and updated annually, allows investments in a variety of specific instruments such as Certificates of Deposit, Bankers Acceptances, U.S. Government and Agency securities, Repurchase Agreements, Commercial Paper, and the State's Local Agency Investment Fund.

**Risk Management.** The City is a member of the Independent Cities Risk Management Authority (ICRMA), a joint powers authority consisting of twenty-eight medium-sized California municipalities, for the purpose of pooling the City of Manhattan Beach's risk for general liability losses with those of other member cities. The City's self-insured retention is \$250,000 per occurrence for Liability and Worker's Compensation. Under the ICRMA, insurance coverage in excess of the self-insured amount is provided up to a limit of \$20,000,000. Premiums for excess insurance coverage are set annually based upon actual claims experience as well as other factors.

## **EXECUTIVE FINANCIAL OVERVIEW**

This top level overview is presented as a supplement to the more detailed and comprehensive analysis presented in the following Management Discussion and Analysis (MDA). As such it serves to highlight key financial performance indicators for our major funds. We encourage all readers to review the MDA for a further analysis of the City's financial condition.

### **General Fund**

The General fund is the primary operating fund of the City of Manhattan Beach and it suffices to say that the 2003 year reflects very good financial results. In fact, this fund outpaced expectations coming in with an operating surplus of \$4.7 million. We attribute this performance to our continued adherence to prudent financial planning and policy setting, conservative budgeting, and faithful monitoring and stewardship by all city staff. At the end of the current fiscal year the total General Fund balance reached \$20.8 million. Under the GASB 34 model this fund reports an unreserved fund balance of \$17.1 million before policy and City Council designations. With financial policy, liability and uncertainty reserve limits considered, this fund reports an unreserved and undesignated fund balance of \$4.8 million which remains available for use at City Council's discretion.

During the current fiscal year, General Fund revenues exceeded expenses by approximately \$4.65 million. Transfer activity within the fund resulted in an increase in fund balance of \$2.2 million. The transfer activity included:

- \$3.8 million into the Capital Improvement Fund to further build reserves for the construction of the new public safety facility, which begins in FY 2003-2004;
- \$234,500 to the Capital Improvement Fund for future Strand Walkway improvements;
- \$426,436 to the Insurance Reserve Fund to maintain risk management policy reserves;
- \$2.1 million from certain business type activity funds into the General Fund as a result of the cost allocation plan study.

The City’s Policy Reserves and designations discussed above and presented in the General Fund at year end include the following:

- \$6.7 million in an ongoing operational financial policy reserve designed to cover 20% of budgetary funding requirements.
- \$2 million in economic uncertainty reserves to protect against sudden changes in the economic or legislative climate.
- \$2 million in pension stabilization reserves which was established in the current year given the known high dollar increases in employee retirement costs on the near horizon.
- \$1.6 million in reserves to cover vested employee leave benefits.

Although the rate growth has slowed from 2001 levels, the City’s General Fund revenue base continues to do well. This can be noted by the following trends:

<b>REVENUE</b>	<b>2002 ACTUAL</b>	<b>2003 ACTUAL</b>	<b>VARIANCE</b>
Property Tax	9.1 M	10.0 M	.9 M
Sales Tax	6.9 M	6.9 M	-
Hotel Tax	1.7 M	1.7 M	-
Business License Tax	1.8 M	2.0 M	.2 M
License & Permits	1.3 M	1.5 M	.2 M
Fines	1.8 M	1.9 M	.1 M
Interest & Rent	3.5 M	2.9 M	(.4 M)
Vehicle In Lieu	1.9 M	2.1 M	.2 M
Services	4.6 M	5.6 M	1 M

On an overall basis, General Fund revenues increased by a respectable margin and came in at 105% of our annual budget estimates with property tax being the clear front runner. Charges for services were bolstered by the completion of a new utility cost allocation study which resulted in an increased level of cost recovery for the General Fund. On the other side of the equation, Sales Tax & Hotel Tax continue to remain flat as projected. In the end result, these results are quite reassuring considering the fact that the economy is in state of recovery from 2001/2002 recessionary pressures.

## **Other Funds**

### **Capital Improvement Fund**

The Capital Improvement Fund was established to drive capital planning for general government operations. In FY 2003 this fund performed as expected and is well positioned to fund our most important capital infrastructure projects. Dedicated revenues in this fund amounted to \$1.2 million and capital expenditures equaled \$2.5 million including initial costs for the Police/Fire facility, mostly relocation and demolition, of \$1.6 million.



At the end of the current fiscal year the total fund balance reached **\$24.9 million**. Of this balance, **\$20.7 million** has been specifically earmarked for planned infrastructure projects leaving an unreserved and undesignated balance of \$4.2 million. Key designations at year end include:

- **\$18.4 million** for the construction of a new Police/ Fire facility
- **\$1.10 million** for improvements to the Strand walkway
- **\$1.00 million** for improvements to Artesia Boulevard

The 2003-2004 budget projects an increase to the Police/Fire reserve of \$25 million including project expenditures made to date. The formal award for construction of the new facility was awarded in fiscal 2003-2004 with construction to begin in February 2004. The total cost of this project approximates \$39 million and will be funded through a combination of cash reserves and debt issuance.

### **Special Revenue & Enterprise Funds**

All other Governmental and Business Type funds performed within budget and have met financial projections and expectations. The City continues to see significant cost increases in insurance claims and premiums and has again found the need to supplement the Insurance fund balance with a General Fund transfer of approximately \$420,000. Our city, along with the State, has identified rising insurance costs as one of the financial challenges to be reckoned with in future years. Ultimately the solution to this issue can only come through legislative change at both the State and/or Federal level.

### **Trust and Agency Funds**

In several cases, the City acts as a custodian of funds held for the benefit of others which mostly relates to the administration of employee pension and 401(a) compensation plan. It is significant to note that this financial report does not include the value of trust holdings in the employees' 457 deferred compensation plan valued at \$9,666,745 at June 30, 2003. This recognizes enacted legislation establishing the City as a plan trustee and protecting these employee-owned assets from external creditors.

***Deferred Compensation Plan for Full-Time Employees:*** Management employees receive a City-paid contribution ranging from 2.5 to 4.5 percent of their salary into a 401(a) plan. The liability balances for these deferred compensation plans are recorded in the Special Deposits Fund along with restricted deposits held for safety operations and our Employee Section 125 Flexible Spending Plan.

***City Pension Plans:*** This fund is used to account for the supplemental retirement and single highest year programs, dormant plans which were previously offered by the City. The Pension Trust Fund is used to account for the distribution of these plans for former employees still receiving benefits.

## **THIRD PARTY ADMINISTERED PENSION PLANS**

***Defined Benefit Pension Plan:*** The City contracts with the California Public Employees Retirement System (CalPERS) for certain retirement, disability, death and survivor benefits for full-time employees. The annual actuarial valuation by CalPERS changes from year to year, and the City's contribution rates are modified accordingly.

***Retirement Plan for Part-Time Employees:*** From 1990 to 1997, the City of Manhattan Beach provided its own retirement plan for Part-time, Seasonal and Temporary employees not eligible for participation in the California Public Employees Retirement System. This plan was eliminated in June 1997, as the City opted to provide the Public Agency Retirement System (PARS) program instead.

## **Significance of GASB 34 on Capital Asset Presentation**

Although many impacts of GASB 34 on these financial statements were discussed above, one would be remiss not to point out the tremendous reporting impact that this pronouncement has on the City's valuation and treatment of Capital Assets. In this regard we encourage the reader to review the notes and the Management Discussion and Analysis for this important information.

GASB 34 now requires that local governments quantitatively value and capitalize all owned asset including capital infrastructure. This infrastructure includes such highly visible and material items as streets, walkways, lights, signs, buildings, etc. Consequently this pronouncement requires that these assets be depreciated in full compliance with accrual accounting methodology. This presentation of capital assets was always required of our enterprise funds in the past and now it is required when reporting the government wide financial statements for all such funds.

In the end result a valuation of all City Infrastructure was completed and these results have been included in the financial statements. At the end of the day government wide capital assets have been valued on a gross basis at \$134 million and \$96.4 million on a net basis after depreciation. These values are presented at original estimated cost and, as such, their replacement cost would be considerably higher. The increase to last year's cost valuations as a result of the valuation study exceeds \$35 million before depreciation. Most of was increased cost results from the quantification of the original cost of the City's roadways.

## **OTHER INFORMATION**

***Independent Audit:*** The accounting firm of Vavrinek, Trine, Day and Co., LLP, was selected by the City to perform the annual audit. The auditors' report on the general purpose financial statements and combining and individual fund statements and schedules is included in the financial section of the City's Comprehensive Annual Financial Report. The City was not required to conduct a single-audit, an audit of Federal Grant Funding, and, as such, no separate single audit opinion and report is included.

***Acknowledgments:*** Preparation of this report could not have been accomplished without the efficient and dedicated services of the Finance Department staff. We would like to express our appreciation to all members of the department, particularly Russell Morreale, Henry Mitzner, Luisa Camba, Sande Johnson and Eugene Wee who assisted and contributed to its preparation. A special thanks is extended to Vavrinek, Trine, Day and Co., LLP, our independent auditors, for their professionalism and diligence in preparing this year end financial report. Another special thanks is due to Bonnie Shrewsbury and Dana Greenwood of Public Works for their tremendous assistance to Finance in the GASB 34 asset valuation project and again to Russell Morreale & Henry Mitzner for coordinating this GASB 34 effort over the course of this past year. We would also like to thank the Mayor, members of the City Council, and the City Treasurer for their leadership and support, without which the preparation of this report would not have been possible.

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Geoff Dolan, City Manager

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Bruce Moe, Finance Director

# Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Manhattan Beach,  
California

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2002

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



*Edward Harrington*

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which reflect a high level of quality in the annual financial statements  
and in the underlying accounting system from which the reports were prepared.*

*February 24, 2003*

*Bret M. Plimlee*  
Chair, Professional & Technical Standards Committee

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