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***December 19, 2006***

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, 2006 (FY2006)*** 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). ***The FY2006 complies with GASB statement 34 (GASB 34) and, this report also marks the first year of implementation of GASB statement 44 (GASB 44) in presenting an updated Statistical Section to complement the GASB 34 format.*** Transitioning to these new standards 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; Re-formatting the Statistical section; and introduction of newly developed asset valuation and depreciation policies. In FY2006, these practices were continued in compiling this year-end report.

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.

## **SERVICE EFFORTS AND MAJOR INITIATIVES**

### **Service Efforts**

In FY 2006, the City of Manhattan Beach continued to provide a high level of service to its residents and citizens. The City adhered to its financial policies and adopted financial plan as evidenced by the budget-to-actual reporting presented within this document. \$62.7 million was originally budgeted to support the City's many services and programs. Additionally, \$11.14 million in capital projects was budgeted for the year. Budgetary limits were adhered to 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 and reserves have been maintained.

Fire Department Temporary Facility Address: 1599 Valley Drive, Manhattan Beach, CA 90266 FAX (310) 802-5201  
Police Department Temporary Facility Address: 1501 N. Peck Ave., Manhattan Beach, CA 90266 FAX (310) 802-5101  
Public Works Department Address: 3621 Bell Avenue, Manhattan Beach, CA 90266 FAX (310) 802-5301  
Visit the City of Manhattan Beach Web Site at [www.citymb.info](http://www.citymb.info)

Some of the key capital improvements expenditures in 2006 include the following:

- \$12.8 million of additional work in progress costs towards the construction of a new Police and Fire facility. Construction commenced in February 2004 and was substantially completed within the current year.
- \$2.1 million towards the completion of the Strand Improvements.
- \$1.8 million towards the completion of the Metlox Public Plaza which was opened for business in the current year.
- \$1.6 of vehicle purchases, including \$850,481 of capital leases for a new Fire and Sewer Vacuum truck.
- \$1.2 in Water, Storm and Wastewater system improvements mainly related the line replacements and valve and control upgrades.
- \$1.1 million of citywide street improvement projects the bulk of which related to Police-fire Streetscape, Valley-Morningside resurfacing, 15<sup>th</sup> and Ardmore intersection, and annual slurry seal re-conditioning.
- \$1 Million in Furniture and Fixture additions related to the new Police-Fire Facility
- \$892,242 for improvements to the El Porto parking lot.

## Major Initiatives

In FY 2006, 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 current year the City substantially completed the construction of the new Police/Fire facility and civic center plaza. The grand opening ceremony was held in July 2006 for full operations. The project budget is valued at \$41 million. The City designated specific reserves of \$28 million in the Capital Projects Fund for this project. In December 2004, the City issued \$12.9 million in fixed rate Certificates of Participation to fully fund the construction of the new Police and Fire facility. ***As of the date of this report, the City finalized the project with the contractor and reported a budget savings of over \$1 million on the entire project.*** The resulting debt service is financed through dedicated revenues earmarked within the Capital Improvement Fund.

***Metlox Improvements and Development:*** The City held a grand opening for the Metlox parking structure in January 2004 followed by a grand opening for the public plaza and retail phases in November 2005. The Metlox parking structure provides 460 spaces, serving the new development as well as the entire downtown. It was completed at a cost of \$14.6 million. The private retail development includes a hotel, retail, restaurant and office space elements. This multi-million dollar development is having a positive economic impact, adding to the City's ground lease, property, hotel, and retail tax revenue base. In concert with this private phase, the City began the construction of a 40,000 square foot town square and retains ownership of the underlying land, parking facilities

and public open space. ***In the current year an additional \$1.8 million in project improvement costs were expended in completing the town square. As of the date of this report, the entire public improvement project has been completed within budget.*** This public improvement was financed through the issuance of \$13.35 million in Certificates of Participation, issued in January 2003, and the resulting debt service will be paid through dedicated Parking Fund revenues. All debt and capital transactions have been recorded in the parking enterprise fund and are backed by the strength of the City's overall credit.

***Strand Improvement Project:*** In FY 2005-2006 the City budget appropriated an additional \$1.5 million which sets aside all reserves necessary to fund this \$4.5 million project. This capital project has been cash funded in entirety. This project involved years of planning, community discussion and outreach before construction commenced in FY 2005. The project involves the replacement of the cement walkways, upgrades of all lighting and electrical elements, the renovation of drainage systems, the introduction of viewing alcoves, updates to trash receptacles, and replacement of exiting benches. In the current year construction costs of approximately \$2.1 million were incurred on this exciting improvement which spans the entire length of the Strand. The project will be completed in FY2006-2007 and is on pace to fall within budget.

***Utility Under-grounding:*** As of the date of this report the City successfully facilitated the creation of two additional utility under-grounding districts valued at approximately \$13 million. Assessment District bonds were issued in August 2006 culminating several years of coordination by our City's Public Works department. Debt service for these bonds will be paid entirely through participating homeowner property tax assessments. The resulting bond proceeds reimbursed the City for originating costs incurred in the project lifecycle. All project dollars have been deposited with assigned trustee depositories and construction will begin in FY 2007. As we look into future years, several other such under-grounding districts are anticipated to be formed.

***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 the new Police & Fire facility. The City received the highest possible rating, "AAA," from both S&P and Fitch. With this good news, the City proceeded to issue bonds for both facilities starting with Metlox Certificates of Participation in January 2003 at a size of \$13.35 million (including all issuance costs, reserve and capitalized interest requirements). The bond issuance for Police/Fire, took place in November 2004 at a value of \$12.98 million. The City realized a healthy General Fund surplus these past years and used these resources to increase cash funding and reduce the final debt sizing. FY 2004 surplus reserves were also used to increase the Police/Fire project budget contingency levels. The City's credit rating was updated with this latest bond issuance and again received a rating of "AAA" from S&P and Fitch. Furthermore, we are very pleased that a similar rating was received from Moody's as part of this bond sale.

## **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:*** City management 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 strong 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, 2005, 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 State's Government Code and a formal investment policy which is adopted annually by the City Council. The policy 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 \$500,000 per occurrence for Liability and \$750,000 for Worker's Compensation. Under ICRMA, Worker's Compensation and liability insurance coverage in excess of the self-insured amount is provided up to a limit of \$150,000,000 and \$20,000, 000 respectively. 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 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 the 2006 year reflects very strong financial results. The fund again outpaced expectations coming in with an operating surplus of \$4.15 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 equaled \$21.6 million after \$182,000 of net transfers out primarily to the Capital Improvement and Police/Fire Construction Funds. Under the GASB 34 model this fund reports an unreserved fund balance of \$20.52 million before policy and City Council designations. On a governmental basis, including financial policy, liability and uncertainty reserve limits, an unreserved and undesignated fund balance of \$4.8 million remains available for use at City Council's discretion as of year end.

During the current fiscal year, General Fund revenues exceeded expenses by approximately \$4.15 million. After transfer activity, the fund balance increased by \$3.9 million. The transfer activity included:

- \$230,000 to the Capital Improvement Fund to complete funding of the citywide the Facilities Strategic Plan project budget.
- \$48,000 of excess reserves from the County Lot Fund was transferred into the General Fund in line with contractual terms and budget projections.

The City's General Fund revenue base continues to do well. This can be noted by the following trends:

Revenue	2005 Actual	2006 Actual	Increase
Property Tax	\$13.60	\$15.50	\$1.90
Sales Tax	7.30	8.20	0.90
Hotel Tax	2.10	2.70	0.60
Business License Tax	2.30	2.50	0.20
Other taxes	1.90	2.20	0.30
License and Permits	1.50	1.70	0.20
Fines	1.80	1.80	0.00
Interest and Rent	2.40	2.60	0.20
Other Agencies	0.80	1.30	0.50
Services	7.30	7.30	0.00
<b>Total</b>	<b>\$41.00</b>	<b>\$45.80</b>	<b>\$4.80</b>

On an overall basis, General Fund revenues increased by 12%, and came in at 111% of our annual budget estimates with property tax being the clear front runner. Sales tax performed well with a 13% increase over last year while Hotel Tax showed another tremendous gain of 30% compared to 2005. This year we received a one time early State re-payment of the VLF Gap loan in the amount of \$615,000 making up most of the increase in revenues from other agencies. Interest income has made a recovery from the prior years' rate slump with interest and rents coming in at an 11% increase. Revenue clearly performed strongly being the largest component of the \$4.15 million dollar surplus realized.

General Fund expenditures came in 2% below budget resulting in the surplus noted above. On the other hand, compared to last year, expenses have risen by 10%, or \$3.8 million, mostly driven by salary, pension, and insurance costs. Clearly, rising costs are a significant challenge that reinforces the need to maintain prudent, proactive and conservative planning while maintaining tight budgetary controls. Maintaining such controls is critical to assure healthy surplus margins in future years. Although the current year performance is strong, the rate of expense increase outweighs the rate of revenue growth which is a trend worthy of our attention.

## **Other Funds**

### **Capital Improvement Funds**

The City recently introduced two new funds to this category. In FY 2004 the Police and Fire Construction Fund (PFC) was added as well as the Utility Under-Grounding Fund (UAD). These funds were added to manage the construction of the two related major capital projects. The previously established Capital Improvement Fund (CIP) was originally created to drive capital planning for general government operations and continues in this same capacity.

In FY 2006, the CIP Fund performed as expected and is well positioned to fund our most important capital infrastructure projects. Dedicated revenues in this fund amounted to \$1.1 million, grants another \$252,000, and capital expenditures equaled \$3.8 million. This fund accepted transfers in of \$705,000, \$475,000 of excess reserve dollars from the Police Fire to fund City Hall remodel costs, and \$230,000 from the General Fund to augment the Citywide Facilities Strategic plan study.

At June 30, 2006 the total balance in the CIP Fund was \$5.8 million. Of this balance, \$3.8 million has been specifically earmarked for planned infrastructure projects and restricted bond cash leaving an unreserved and undesignated balance of \$2 million. Key designations at year end include:

- \$1.7 million for improvements to the Strand walkway
- \$835,695 Restricted Police/Fire Bond Reserves
- \$631,708 to complete the City Hall Remodel
- \$240,000 to complete the Council Chamber Remodel
- \$230,000 for the facilities strategic plan
- \$100,000 for improvements to Artesia Boulevard
- \$100,000 for the Live Oak Park Baseball Field Refurbishment

At the end of the current fiscal year the total fund balance in the PFC Fund was \$3.6 million which is completely dedicated for the construction of the new facility.

At the end of the current fiscal year the total fund balance in the UAD Fund was \$3.2 million made up primarily of homeowner assessment pre-payments on districts 05-2 and 05-6. Bonds were issued in August 2006 for these districts in funding improvements valued over \$12 million. These bonds are not obligations of the City as there are supported, in entirety, by assessed homeowners and paid through a special assessment property tax.

### **Special Revenue, Internal, and Enterprise Funds**

All other Governmental and Business Type funds performed within budget and have met financial projections and expectations. As has been the trend in recent years, Workers Compensation claims and reserves continue to remain at high levels and have resulted in increased departmental charge outs to augment fund balances. Although this fund's balance remains within fiscal policy levels, long term liabilities cause a deficit in the total fund balance. The FY 2006-2007 budget responded to this need by transferring \$1.3 million into the Insurance Fund from excess General Fund reserves. Our City, along with the State, has identified rising insurance costs as one of the financial challenges in future years. Ultimately the solution to this issue can only come through legislative change at 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) deferred compensation plans. All such plans funding requirements have been maintained. City Plans include the supplemental retirement and single highest year programs - dormant plans which were previously offered by the City. 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 \$13.9 million at June 30, 2006. This recognizes enacted legislation establishing the City as a plan trustee and protecting these employee-owned assets from external creditors.

The trust and agency fund group also includes funds held in trust on behalf of the under-grounding assessment districts. This fund accounts for assessment collections and the related debt service payments.

### **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 qualified employees. The annual actuarial valuation by CalPERS changes from year to year, and the City's contribution rates are modified accordingly. In FY 2005-2006, the City's Police and Fire plans were moved into the CalPERS pools, a mandatory change for cities of our size. The Financial notes reflect the impact of this change which is intended to smooth rates for all member cities over time.

***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.

Government wide capital assets have been valued on a gross basis at \$192 million and at \$170 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. Increases over last year approximate \$22 million after depreciation most of which results from the \$12.8 million capitalization of Police and Fire facility building, another \$1 million for related furniture & fixtures, and \$2.1 million for Strand Improvements improvements. The remaining asset increase resulted from improvements to city roadways, parks, utilities, general equipment, and vehicles.

## **OTHER INFORMATION**

***Independent Audit:*** The accounting firm of Lance, Soll & Lunghard, 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, Sherry Morelan, Luisa Camba, Sande Johnson, Eugene Wee, Helga Foushanes, and Steve Charelian who assisted and contributed to its preparation. A special thanks is extended to Lance, Soll & Lunghard, LLP our independent auditors, for their professionalism and diligence in preparing this year end financial report and again to Russell Morreale and Henry Mitzner for coordinating this audit transition in this fourth year of GASB 34 implementation. 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