



City Hall 1400 Highland Avenue Manhattan Beach, CA 90266-4795
Telephone (310) 802-5000 FAX (310) 802-5001 TDD (310) 546-3501

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

We are pleased to present the Comprehensive Annual Financial Report (CAFR) of the City of Manhattan Beach for the Fiscal Year ended June 30, 2007. This report has been prepared in accordance with generally accepted accounting principles (GAAP) as set forth in the pronouncements of the Governmental Accounting Standards Board (GASB).

The City's financial policies require an independent audit be performed annually, and that the auditor's opinions be included in the Comprehensive Annual Financial Report. Further, it states that the results be reviewed with the Finance Subcommittee, and presented to the City Council no later than February 1st of the following year. The Finance Subcommittee met with the auditors and discussed the results in December 2007.

Responsibility for the accuracy of the data and the fairness of presentation, including all footnotes and disclosures, rests with the City. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds of the City. All material, statements and disclosures necessary for the reader to obtain a thorough understanding of the City's financial activities have been included.

The City's financial statements have been audited by Lance, Soll & Lunghard, CPAs, an accounting firm selected by the City Council, based on a recommendation from the Finance Subcommittee. The goal of the independent audit was to provide reasonable assurance that the financial statements of the City are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the City of Manhattan Beach's financial statements for the fiscal year ended June 30, 2007, are fairly presented in conformity with GAAP.

The independent auditors' report is presented as the first component of the financial section of this 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.

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

Profile of the Government

The City of Manhattan Beach was incorporated in 1912 under the general laws of the State of California. The city operates under the Council-Manager form of government. The City Council is comprised of five members elected at-large for overlapping four-year terms. Each member serves as Mayor for a nine month period once during his or her four year term in office. The City Treasurer is also elected to a four year term, and serves as the chairperson for the Finance Subcommittee. Elected officials are limited to two terms.

The City Council is responsible for, among other things, passing ordinances, adopting the budget, appointing committees, and appointing the City Manager and City Attorney. The City Council members also serve as the governing body of the Manhattan Beach Capital Improvements Corporation (please see Note 1 in the CAFR for more information).

In addition, the City Council appoints the members of the following advisory Boards and Commissions:

Planning Commission	Parking and Public Improvements Commission
Parks & Recreation Commission	Cultural Arts Commission
Library Commission	Board of Building Appeals

Service Efforts

The city provides a variety of services to the community, including:

- Police
- Fire and paramedic services
- Parks and recreation
- Building and safety
- Solid waste and recycling
- Water and waste water utilities
- Storm water management
- Parking facilities
- Street and landscape maintenance
- General government

In FY 2007, the City of Manhattan Beach continued to provide a high level of service to the community. In fact, our biennial resident satisfaction survey conducted in November 2006 indicated continued, very high levels of satisfaction with City services.

The City adhered to its financial policies and adopted financial plan. \$75.6 million was originally budgeted to support the City's many services and programs. Additionally, \$5.4 million in capital projects was budgeted for the year. Budgetary limits were adhered to on a citywide basis. All funds performed as expected in line with the City's financial policy guidelines and reserves have been maintained.

Some of the key capital improvement and equipment expenditures in 2007 include the following:

- \$2.05 million in costs to complete the construction of a new Police and Fire facility.
- \$1.26 million towards the completion of the Strand Improvements.
- \$601,852 for City Hall upgrades.
- \$338,312 towards the artificial turf project at the Manhattan Village soccer field.
- \$1.49 million in vehicle and machinery purchases.
- \$1.93 million in Water, Storm and Wastewater system improvements mainly related the line replacements and valve and control upgrades.
- \$382,900 for the Facilities Strategic Plan
- \$556,314 in Furniture and Fixture additions related to the new Police & Fire Facility

Major Initiatives

In FY 2007, 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: The City completed the construction of the new Police/Fire facility and civic center plaza. The City cash-funded \$28 million of the \$41 million project. In December 2004, the City issued \$12.9 million in fixed rate Certificates of Participation to fund the balance. At completion, we realized budget savings of over \$1 million on the entire project. The remaining funds have been transferred to the Capital Improvements Fund for use on other projects. The debt service is financed through dedicated revenues earmarked within the Capital Improvement Fund. While the project took over ten years from initial discussions to final completion, we can be proud that our safety services have a state-of-the-art facility from which to provide outstanding services for decades to come.

Strand Improvement Project: Substantial progress was made in FY 2006-2007 on this \$4.5 million project. 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 existing benches. In the current year construction costs of approximately \$1.26 million were incurred. The project will be completed in FY2007-2008 on-budget.

Utility Under-grounding: In FY 2006-2007, the City completed financing of two new underground assessment districts with the issuance of bonds for \$9.2 million. Construction Fund proceeds together with homeowner prepayments totaled \$11.2 million, and was paid to the utilities involved in the project (Edison, Verizon and Time Warner). These utilities are responsible for the improvement projects. Property owners who chose not to prepay their prorata share of the project will be assessed for their share of the district debt issued to complete the project.

Community Facility Strategic Plan

During FY 2006-2007, we commenced our Community Facility Strategic Plan. This effort, which has involved many community meetings and discussion, as well as surveys of our residents, is designed to identify our needs for new and replacement facilities to serve our residents well into the future. Prospective projects include a new library, community center and aquatics facilities. While the final scope and associated costs has yet to be determined, additional resources, as well as a community vote, will be necessary in order to construct and operate the new facilities.

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 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 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 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 rapid 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, 2007, 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 City 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 million and \$20 million 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 (MD&A). As such, it serves to highlight key financial performance indicators for our major funds. We encourage readers to review the MD&A 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 2007 year reflects strong financial results. Fund balance increased by \$2.91 million before transfers. 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 \$20.98 million after \$3.9 million of net transfers out, primarily to the Capital Improvement and Insurance Reserve Funds. Under the GASB 34 model this fund reports an unreserved fund balance of \$19.7 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 \$4.3 million remains available for use at City Council's discretion as of year end.

General Fund expenditures exceeded revenues by \$3.89 million. The cause of the imbalance was fully expected, and is the result of a cost saving measure from the sale of pension obligation bonds (POB's). In March, 2007, the City sold \$6.8 million in POB's to liquidate unfunded liabilities for police and fire retirement plans. The issue resulted in present value savings of \$430,000 by, in essence, refinancing this liability at a lower interest rate. The proper accounting for this transaction states the payment of the bond proceeds to satisfy the liability with the pension plan (CalPERS) as an expenditure. However, the bond proceeds are not treated as offsetting revenue, rather they are considered "other financing sources," which appear after General Fund year-end revenues and expenditures are netted. When considering this transaction, the year-end results in the General Fund increased fund balance by \$2.91 million before transfers.

General Fund transfers included:

- \$2.46 million to the Capital Improvement Fund for future projects.
- \$1.34 million was transferred from the General Fund to the Insurance Reserve Fund to off-set increasing expenses and maintain policy levels.
- \$76,000 of excess reserves from the County Lot Fund was transferred into the General Fund in line with contractual terms and budget projections.
- \$50,000 was transferred from the General Fund to the Parking Fund to maintain working capital levels.
- \$69,270 was transferred to the Street Lighting Fund to relieve an operational deficit.

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

Revenue Category	2006 Actual	2007 Actual	Increase (Decrease)	%
Property Tax	\$ 15,523,154	\$ 17,116,975	\$ 1,593,821	10.3%
Other Taxes (Sales, Hotel, Business License)	15,559,661	15,993,673	434,012	2.8%
Licenses and Permits (Building Permits, Construction Permits, Film Permits)	1,694,393	1,639,680	(54,713)	-3.2%
Fines (Parking Citations, Vehicle Code Fines)	1,787,514	2,025,694	238,179	13.3%
Interest and Rents (Interest Earnings, Ground Leases)	2,623,594	3,655,099	1,031,505	39.3%
Received from Other Agencies (Vehicle License Fees, Grants)	1,347,606	775,941	(571,666)	-42.4%
Service Charges (Plan Check Fees, P&R Classes, Ambulance Fees, etc.)	4,291,221	4,542,896	251,675	5.9%
Interfund Charges (Administrative Service Charges)	2,544,353	2,706,096	161,743	6.4%
Miscellaneous	489,353	384,166	(105,187)	-21.5%
Totals	<u>\$ 45,860,850</u>	<u>\$ 48,840,221</u>	<u>\$ 2,979,371</u>	<u>6.5%</u>

On an overall basis, General Fund revenues increased by 6.5% over 2006 results, and came in 7.2% over our budget estimates. Property tax continued to perform well as real estate demand remained strong during FY 2006-2007. Sales tax was flat from the prior year's actual receipts, but came in ahead of budgetary estimates by 3%. Hotel Tax showed another tremendous gain of 16% compared to 2006, and outpaced our budget projections by 14%. Interest income and unrealized gains on investments increased by \$926,000 as well.

Despite the increase in fund balance before transfers of \$2.91 million, and revenue growth of 6.5%, the fund balance increase is \$1.24 million lower than last year (FY 2005-2006 had a \$4.15 increase in fund balance). This decline is due to increases in expenditures as follows:

- Salaries and wages increased by \$1.87 million, or 9%
- Group medical insurance rose by \$234,102, up 12%
- Workers compensation costs escalated by \$111,300, an increase of 7%
- Pension costs went up by \$315,053, or 7%
- Materials and services went up by \$1.38 million (11%)

Overall, expenditures came in 1.1% below budget projections, but increased over the prior year by 10.1% (exclusive of the pension obligation bond expenditure). Fewer staff vacancies this past year is a major reason for the year-over-year increase. Clearly, rising costs is an area of concern that needs to be addressed.

Other Funds

Capital Improvement Funds

The Capital Improvement Funds are comprised of three distinct and separate funds: the Capital Improvement Projects Fund (CIP), which is designed to manage general governmental capital projects; the Underground Assessment Fund (UAD), utilized for the construction of resident-driven utility undergrounding; and the Safety and Civic Center Construction Fund, used to manage the funds for our new Police & Fire facility.

In FY 2007, the CIP Fund performed as expected. Revenues in this fund amounted to \$1.6 million, and capital expenditures equaled \$3.7 million. Transfers-in of \$3.9 million were made for future projects, including \$1.44 from the liquidation of the remaining Civic Center Construction Fund at project completion. At June 30, 2007 the total balance in the CIP Fund was \$7.6 million. Of this balance, \$5.6 million has been specifically earmarked for planned infrastructure projects and restricted bond cash, leaving an unreserved and undesignated balance of \$2 million. Designations at year end include:

- \$1.07 million for Playground equipment
- \$753,690 for the Manhattan Village soccer field artificial turf project
- \$443,790 to complete the Strand improvement project
- \$280,000 for Live Oak and Manhattan Heights fencing projects
- \$100,000 for Downtown Streetscape improvements
- \$100,000 for improvements to Artesia Boulevard

The Underground Assessment Fund (UAD) had \$8.7 million in revenues and \$11.1 million in expenditures. The revenues reflect the bond proceeds and contributions from property owners of \$8.5 million for two new assessment districts, while the expenditures include funds expended towards UAD projects. This fund exists mainly as a pass-through between the utility companies and residents, since the City acts as a conduit for project funding and construction. At the end of the current fiscal year the total balance in the UAD Fund was \$657,891, mainly from construction funds for districts 04-1, 04-3 and 04-5. 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.

The Safety and Civic Center Construction Fund received \$92,000 in interest income while expending \$2.3 million to complete the project. With the completion of the project, the remaining funds (\$1.44 million) were transferred to the Capital Improvement Fund for future projects.

Special Revenue, Internal, and Enterprise Funds

All other Governmental and Business Type funds performed within budget. However, several under-performing funds deserve our attention.

The Parking Fund had income, before transfers, of \$121,664. This year's operation included Metlox bond interest expense of \$598,559 which is supported by the Fund's revenue stream. It is important to note that while the fund had positive net income, the overall cash flow generated from parking operations is insufficient to meet payment of bond principal and provide for future capital improvements. For FY 2006-2007, the fund experienced negative cash flow of \$292,422. A transfer from the General Fund for \$50,000 maintained policy reserve levels within the fund. Future transfers will be required to sustain the fund, unless near-term action is taken to raise revenues.

Water Fund net income from operations fell from \$598,000 in FY 2006 to \$80,000 in 2007 – the result of operating expenses (labor, materials, services, etc.) rising by 12.7%, while revenues only rose at a rate of 4%. Similarly, Waste Water Fund net operating income decreased by 42%, from \$244,530 in FY 06 to \$141,940 for FY 07. Operating expenses increased by 12%, or \$125,608. Both funds' performance indicates that future rate increases are necessary to sustain operations, and provide for maintenance and future capital improvements.

Storm Water Fund net operating income dropped from the prior year by \$42,600 (58%) due to operating expenses increasing by 51,201 (19%). Storm Water operations are increasingly impacted by new regulations and mandates, resulting in increased expenditures. Given that the revenues in this fund are virtually fixed, and cannot be changed without a Proposition 218 vote, General Fund subsidies may be required in the future to support operations.

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 in the Insurance Reserve Fund to match these claims. Due to the increasing trend of both Workers Compensation and Liability costs, charge outs have not kept pace. In order to relieve the total net asset deficit position of the fund, there was a General Fund transfer of \$1.3 million. The increasing trend of paid claims continues to be an area of concern for us.

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 totaling \$15.9 million at June 30, 2007. 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 debt service funds held in trust on behalf of the under-grounding assessment districts. This fund accounts for assessment collections and the related debt service payments. The cash held as of June 30, 2007, will be used to pay bondholders in FY 2007-2008.

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. In FY 2007, the City issued pension obligation bonds (POB's) in the amount of \$6.8 million to liquidate the City's unfunded liabilities within these plans. The savings are derived from issuing bonds at a lower interest rate than applied by CalPERS. The present value savings realized from this sale was approximately \$430,000. The accounting for these bonds was discussed previously in the General Fund section of this letter.

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

GASB 34 requires state and local governments to report financial information in two distinct presentations:

Government wide statements - These are consolidated financial statements for Citywide operations based on full accrual accounting. They are not presented on a fund basis, but on a fiscal operations basis. There are two major categories – governmental and business type. The focus is on the flow of economic resources versus flow of funds (working capital). Business type activities include the Enterprise Funds which have always been reported on a full accrual flow of economic resources basis. The governmental activities include General Fund, Capital Improvement Funds, Special

Revenue Funds, Internal Service Funds and all current and non current assets and liabilities associated with these funds. Governmental activities account for all capital assets such as land, buildings, facilities, infrastructure (roads, sidewalks), vehicles, machinery, and equipment. Capital assets of governmental activities are expensed via depreciation. Capital expenditures and payment on debt service principal are excluded since those transactions involve flow of funds and not economic resources.

Fund statements – This section includes information on the City’s major governmental and enterprise funds. Governmental funds (General, Capital Improvement, and Special Revenue Funds) are prepared using the flow of funds measurement focus. Balance sheets for the governmental funds include only current assets and current liabilities; therefore the fund balance is the working capital. There is a budget-to-actual comparison for the General Fund (original, final budget, actual amounts and variance). Budgetary comparisons for other governmental funds are shown in the Combining Financial Statements & Schedules which follows the footnotes. Proprietary fund statements are presented using full accrual accounting and the focus is flow of economic resources.

Please refer to Management Discussion and Analysis (MD&A) in the Financial Section that follows.

OTHER INFORMATION

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 Henry Mitzner, Sande Johnson, Eugene Wee, Luisa Camba, and Helga Foushanes who assisted and contributed to its preparation. A special thanks to Lance, Soll & Lunghard, LLP our independent auditors, for their professionalism and diligence in preparing this year end financial report. 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.



Geoff Dolan, City Manager

Bruce Moe, Finance Director