

November 22, 2006

Honorable Mayor and Members of
the Hermosa Beach City Council

City Council Meeting of
December 12, 2006

**2005-06 COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)
(Including Report from Independent Auditor)**

RECOMMENDATION

It is recommended that the City Council:

Receive and file the 2005-06 Comprehensive Annual Financial Report (CAFR), which includes the report from Caporicci and Larson, our independent auditors.

BACKGROUND

Annually the City has a financial audit performed by an independent, certified public accounting firm. The auditor's report is located behind the second divider that is labeled "Financial Section".

When the City Council extended the audit agreement in January 2005, we indicated that our goal was to complete the audit and produce the CAFR earlier than we had in the past. Last year we completed the audit and produced the CAFR by the first meeting in January, which was one meeting earlier. **This year we succeeded in producing the CAFR in time for the December meeting, which is a whole month earlier than two years ago and is probably as early as is possible. The earlier time frame requires a tremendous effort from both staff and the auditors and we are very pleased we were able to meet it.**

GASB, or the Governmental Accounting Standards Board, is the standard-setting body for state and local government financial reporting. GASB 34 is the statement that established new financial reporting standards, which, for our City, were implemented for the 2002-03 fiscal year reporting. Implementation of the new standards involved a complete overhaul of report formatting and development of conversion entries for the required reports. Even though the new reporting format was implemented four years ago, staff still struggles with the requirements and conversions necessary to comply since we only deal with it once a year.

This year, we are also complying with a new reporting requirement, GASB Statement 44, Economics Condition Reporting: The Statistical Section. As such, the statistical section in the back of the CAFR has been completely revamped to comply.

For 2005-06, the City again received an unqualified opinion, which indicates that the auditor believes the financial statements present a fair picture of the financial position of the City, as opposed to a qualified opinion, in which the auditor "qualifies" or limits his opinion for specific reasons, such as lack of capital asset accounting, significant internal control deficiencies or non-compliance with other GASB requirements such as GASB 34.

The report will again be submitted to the Government Finance Officers Association (GFOA) to qualify for the Certificate of Achievement for Excellence in Financial Reporting for the sixteenth time. The award program requires a high level of compliance with governmental standards, inclusion of information well beyond the general-purpose financial statements and an unqualified audit opinion.

ANALYSIS

As a reminder, the new reporting model:

- presents financial information in new formats, namely, the Government Wide Financial Statements, beginning on page 17. These are designed to show net assets and equity of the City as a whole, provide information on the cost of services and show how programs are financed.
- requires a new section, Management's Discussion and Analysis (MD &A) to present financial highlights and assess performance for the year.
- requires reporting on "major" funds rather than aggregate fund types.
- requires accrual accounting for all governmental funds, meaning that long term assets and liabilities (such as capital assets, including infrastructure) are included in addition to short term assets and liabilities. All revenues and all costs of providing services are also reported, not just those received or paid in or soon after year-end.

Additional information and analysis can be found in the Transmittal Letter starting on page v and in the Management Discussion and Analysis (MD & A) starting on page 3. General Fund information is found on page 11. **Some of the comments are repeated herein for the purpose of having this staff report stand alone. Since comparative information for the General Fund for 2004-05 and 2005-06 is not included in the CAFR, it is presented below. Amounts for 2004-05 have been adjusted to include the Parking Fund for comparative purposes since the Parking Fund was combined with the General Fund in 2005-06.**

General Fund Revenue

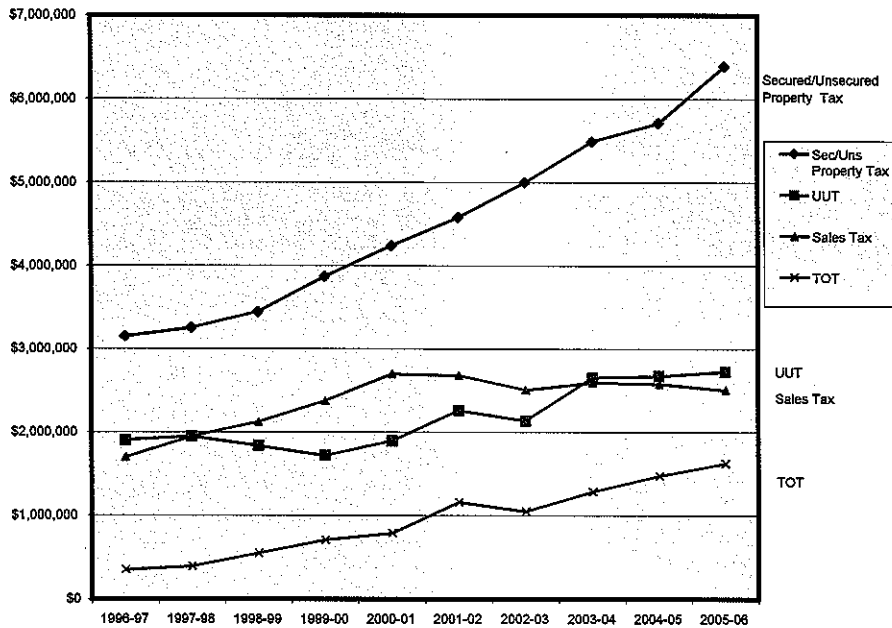
General Fund revenue increased 9% over 2004-05 and was 6% over budget estimates.

REVENUE SOURCE	Revenue FY 05-06 Amount	Increase (Decrease) Over FY 04-05	% Of Increase (Decrease)	% Of Total
Property Taxes	\$8,361,888	\$2,140,352	34.40	34.35
Sales Tax	2,511,004	(73,010)	(2.83)	10.31
Utility User Tax	2,726,085	50,889	1.90	11.20
Transient Occupancy Tax	1,628,394	150,782	10.20	6.69
Other Taxes	1,832,162	133,751	7.88	7.53
Licenses & Permits	868,085	166,617	23.75	3.57
Fines & Forfeitures	1,588,815	(277,223)	(62.53)	6.53
Use of Money and Property	312,248	(34,534)	(9.96)	1.28
Intergovernmental Revenue	559,933	(699,534)	(55.54)	2.30
Charges for Services	3,765,895	229,132	13.38	15.47
Miscellaneous	71,318	(151,944)	(67.77)	0.29
Interest	117,730	24,800	29.60	0.48
Total	<u>\$24,343,557</u>	<u>\$1,660,078</u>	<u>8.54%</u>	<u>100.00%</u>

Taxes

Revenue from taxes generates 70% of General Fund revenue. The graph below tracks the four largest revenue sources over the past ten years.

General Fund – Largest Revenue Sources



Total property tax revenue increased 34% due to inclusion of property tax received in lieu of vehicle license fees, which are now distributed with and are to be considered property tax. The graph above shows secured and unsecured tax only, which increased 13% and 3%, respectively.

Sales Tax revenue is 3% down from 2004-05. Fortunately, BMW stayed longer than they originally planned or the decrease would be greater. There has been interest from a number of parties in the remainder of that site; hopefully a sales tax-generating business will eventually reside there again.

Sales Tax By Class*

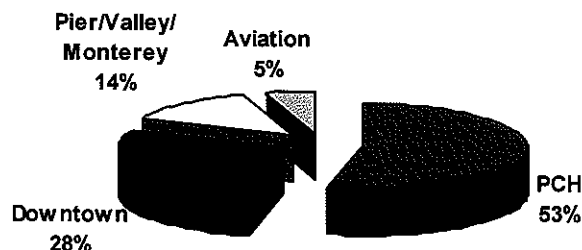
Top Ten Categories

RANK/BUSINESS CLASS	Sales Tax 2005-06	Increase/ (Decrease)	% of Change Prev. Yr.	% of Total
1. Eating/Drinking Places	\$699,265	\$39,369	5.97	32.86
2. Auto Dealers and Supplies	340,825	(283,597)	(45.42)	16.01
3. Other Retail	281,023	22,619	8.75	13.20
4. Building Materials	212,980	24,887	13.23	10.01
5. Food Stores	205,322	11,466	5.91	9.65
6. Service Stations	125,833	23,934	23.49	5.91
7. Business, Service & Repair	114,831	3,300	2.96	5.40
8. Furniture/Appliance	60,261	2,732	4.75	2.83
9. Drug Stores	#	#	9.37	#
10. Apparel Stores	35,570	5,598	18.68	1.67

* Threshold for inclusion, \$300 per quarter
 # Information omitted if fewer than four businesses in the category

Sales Tax by Geographic Area

LOCATION	Revenue 2004-05	% of Total	% Chg	Revenue 2005-06	% of Total
PCH	1,258,106	60%	(19)%	1,021,198	53%
Downtown	516,405	24%	6%	546,762	28%
Pier/Valley/Monterey	246,698	12%	5%	259,820	14%
Aviation	88,448	4%	2%	90,096	5%



Utility user tax revenue grew by 2%. It is likely the City will have to consider amending the utility tax ordinance, and perhaps even placing the issue on the ballot, to maintain the existing tax revenue. Staff will keep the City Council apprised as legal issues develop.

Transient occupancy tax increased 10% with overall hotel occupancy at 79%.

The License and Permit and Charges for Services categories reflect increased fees implemented with the updated user fee study.

Fines and forfeitures decreased because fewer parking citations were issued due to staffing shortages and municipal court fines declined due to a change in release policy regarding public intoxication, which resulted in fewer arrests. There was also one-time revenue from prosecution of a fraudulent fire extinguisher case in the prior year.

General Fund Expenditures

General Fund expenditures increased 13% from 2004-05 and were 5% under budget.

GENERAL FUND	Expenditures FY 05-06 Amount	Increase (Decrease) Over FY 04-05	% Of Increase (Decrease)	% Of Total
Legislative & Legal	\$963,031	\$236,005	24.51	4.31
General Government	2,116,181	450,495	21.29	9.48
Public Safety	14,186,925	1,486,308	10.48	63.57
Community Development	1,327,389	275,698	20.77	5.95
Culture & Recreation	1,105,544	165,386	14.96	4.95
Public Works	2,540,396	414,832	16.33	11.38
Capital Outlay	79,598	(162,034)	(203.57)	0.36
Total	\$22,319,064	\$2,866,690	12.84%	100.00%

Salary and benefit increases for changes to employee bargaining units affect all categories. The City is also making the annual required contribution for all employee groups for post employment health benefits, as we do for retirement benefits, which affects all categories.

The Legislative/Legal and General Government both increased due to higher overall litigation costs and litigation related to personnel matters. There was also election expense for the special election held.

Community Development costs increase with the fluctuation of plan check costs and additional costs to cover vacancies.

General Fund Unspent Funds

The policy of transferring unspent funds in the General Fund to the Insurance Fund, Equipment Replacement Fund (ERF) and Compensated Absences Fund was implemented in 1995-96 to build equity and provide funds for amounts owed to employees for accumulated leave. The policy was changed in 1998-99 to discontinue allocating funds to the Compensated Absences Fund (since the target amount was reached) and create a Capital Improvement Fund for street improvements, etc.

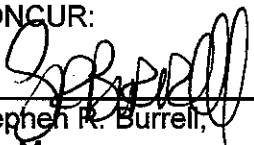
The City Council amends the policy, as necessary, when goals or targets are met. For 2005-06, \$2,561,270 was transferred to the Contingency Fund, Insurance Fund, Equipment Replacement Fund and Capital Improvement Fund (\$640,318 each fund).

The next opportunity to review our financial picture will be Midyear Budget Review on February 13, 2007, at which time we will review progress on the financial goals and make any adjustments or transfers, as necessary.

Gary Caporicci, the partner in charge of our audit, is on vacation; however Eileen Lin, the manager of our audit, will be available at the meeting for comments or questions.

If you have particular questions about details in the reports, we would appreciate knowing them in advance so we can give you a complete answer.

CONCUR:



Stephen R. Burrell,
City Manager



Viki Copeland,
Finance Director

The reports are available for review in the library and the Finance Department.