

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

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KPMG LLP
Suite 2000
355 South Grand Avenue
Los Angeles, CA 90071-1568

Independent Auditors' Report

The Honorable Mayor and City Council
The Citizens of the City of Long Beach, California:

We have audited the accompanying financial statements of the Gas Enterprise Fund of the City of Long Beach, California (Gas Enterprise Fund), an enterprise fund of the City of Long Beach, California (the City), as of and for the years ended September 30, 2008 and 2007, as listed in the table of contents. These financial statements are the responsibility of the City. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Gas Enterprise Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed more fully in note 1, the accompanying financial statements of the Gas Enterprise Fund are intended to present the financial position and the changes in financial position and cash flows attributable to the Gas Enterprise Fund. They do not purport to, and do not, present fairly the financial position of the City of Long Beach, California, as of September 30, 2008 and 2007, and the changes in its financial position and, where applicable, its cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Gas Enterprise Fund of the City of Long Beach, California, as of September 30, 2008 and 2007, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in notes 1 and 6 to the financial statements, effective October 1, 2007, the Gas Enterprise Fund adopted Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, in accounting for its postretirement healthcare costs.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 30, 2009 on our consideration of the Gas Enterprise Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial

reporting or on compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management of the Gas Enterprise Fund of the City of Long Beach has not presented management's discussion and analysis that U.S. generally accepted accounting principles require to supplement, although not to be part of, the basic financial statements.

KPMG LLP

June 23, 2009

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Statements of Net Assets
September 30, 2008 and 2007
(In thousands)

Assets	2008	2007
Current assets:		
Pooled cash and cash equivalents (note 2)	\$ 280	6,029
Nonperforming investments (note 2)	104	—
Accounts receivable, net of allowance for doubtful accounts of \$667 and \$490 at September 30, 2008 and 2007, respectively	5,436	2,822
Due from the City of Long Beach	768	733
Due from Long Beach Bond Finance Authority	807	—
Inventory	1,535	1,128
Prepaid expenses	46	—
Total current assets	8,976	10,712
Noncurrent assets:		
Restricted assets:		
Pooled cash and cash equivalents (note 2)	2,541	4,632
Nonpooled investments (note 2)	650	650
Advance to Tidelands Enterprise Fund (note 3)	3,445	4,213
Capital assets (note 4):		
Nondepreciable	9,309	6,399
Depreciable, net	72,728	66,890
Total capital assets, net	82,037	73,289
Total noncurrent assets	88,673	82,784
Total assets	97,649	93,496
Liabilities		
Current liabilities:		
Accounts payable	5,303	5,241
Accrued wages payable	513	408
Due to the City of Long Beach	237	201
Deferred revenues	400	540
Amounts payable from restricted assets:		
Accrued interest payable	22	25
Current portion of long-term debt (note 5)	940	925
Customer deposits	2,144	1,852
Total current liabilities	9,559	9,192
Long-term debt, net of current portion (note 5)	20,989	19,925
Less unamortized discount/deferred cost	(76)	(91)
Net long-term debt	20,913	19,834
Total liabilities	30,472	29,026
Net Assets		
Invested in capital assets, net of related debt	60,184	53,649
Restricted for capital projects	243	1,468
Restricted for debt service	782	819
Unrestricted	5,968	8,534
Total net assets	\$ 67,177	64,470

See accompanying notes to financial statements.

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Statements of Revenues, Expenses, and Changes in Fund Net Assets

Years ended September 30, 2008 and 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Sale of gas (note 8)	\$ 101,003	92,316
Remarketed gas	13,951	7,863
Other service charges	8,131	7,332
Total operating revenues	<u>123,085</u>	<u>107,511</u>
Operating expenses:		
Purchase of gas (note 8)	81,219	69,136
Personal services	13,817	12,895
Customer service and general	10,616	10,575
Provision for doubtful accounts	503	409
Amortization	11	11
Depreciation expense (note 4)	3,297	3,098
Total operating expenses	<u>109,463</u>	<u>96,124</u>
Operating income	<u>13,622</u>	<u>11,387</u>
Nonoperating income (expense):		
Interest income	147	1,057
Interest expense	(523)	(615)
Loss on disposition of property	(136)	(441)
Other income, net	1,308	774
Total nonoperating income, net	<u>796</u>	<u>775</u>
Net income before transfers	14,418	12,162
Transfers to other City departments (note 7)	<u>(11,711)</u>	<u>(11,402)</u>
Change in net assets	2,707	760
Total net assets, beginning of year	<u>64,470</u>	<u>63,710</u>
Total net assets, end of year	<u>\$ 67,177</u>	<u>64,470</u>

See accompanying notes to financial statements.

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Statements of Cash Flows

Years ended September 30, 2008 and 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Cash received from customers	\$ 107,381	99,656
Cash received from remarketed gas	12,741	7,863
Cash paid to employees	(13,475)	(12,650)
Cash paid to suppliers	(92,429)	(84,665)
Other income	501	774
Net cash provided by operating activities	<u>14,719</u>	<u>10,978</u>
Cash flows used in noncapital financing activities:		
Transfer to other City departments	<u>(11,711)</u>	<u>(11,402)</u>
Net cash used in noncapital financing activities	<u>(11,711)</u>	<u>(11,402)</u>
Cash flows from capital and related financing activities:		
Proceeds from other funds under due from City of Long Beach	733	698
Payments for capital acquisitions	(12,181)	(11,555)
Principal repayments of long-term debt	(925)	(905)
Interest paid	(522)	(615)
Proceeds from issuance of long-term obligation	2,004	7,500
Net cash used in capital and related financing activities	<u>(10,891)</u>	<u>(4,877)</u>
Cash flows from investing activities:		
Interest income	43	1,057
Net cash provided by investing activities	<u>43</u>	<u>1,057</u>
Net decrease in cash and cash equivalents	<u>(7,840)</u>	<u>(4,244)</u>
Cash and cash equivalents, beginning of year	<u>10,661</u>	<u>14,905</u>
Cash and cash equivalents, end of year	\$ <u>2,821</u>	\$ <u>10,661</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 13,622	11,387
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	3,308	3,109
Other income	1,308	774
Decrease (increase) in accounts receivable, net	(2,614)	414
Increase in due from Long Beach Bond Finance Authority	(807)	
Increase in inventory	(407)	(104)
Increase in other assets	(46)	—
(Decrease) increase in accounts payable	62	(4,670)
Increase in accrued wages payable	105	43
Increase in due to City of Long Beach	36	21
Decrease in deferred revenues	(140)	(26)
Increase in customer deposits	292	30
Total adjustments	<u>1,097</u>	<u>(409)</u>
Net cash provided by operating activities	\$ <u>14,719</u>	\$ <u>10,978</u>

See accompanying notes to financial statements.

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

(1) Description of Gas Utility Operation and Summary of Significant Accounting Policies

The following is a summary of the significant accounting policies of the Gas Enterprise Fund of the City of Long Beach (Gas Enterprise Fund).

(a) General

The Long Beach Gas Department (the Department) was established in 1924 under a provision of the City Charter of the City of Long Beach, California (City). The Department's purpose is to regulate and control the use, sale, and distribution of natural gas by the City. These activities are accounted for in the City's Gas Enterprise Fund. To accomplish its stated purpose, the Gas Enterprise Fund purchases natural gas on the open market and then distributes it to more than 145,000 commercial and residential customers. Natural gas rates are established by the Long Beach City Council and are based on prevailing natural gas rates. As a regulated enterprise, SFAS No. 71 Accounting for the Effects of Certain Types of Regulations (SFAS No. 71), which requires that the effects of the rate-making process be recorded in financial statements, is applicable. Such effects primarily concern the time at which various items enter into the determination of changes in fund net assets. However, as the Department's rates are based on weighted average current costs of gas, management believes these effects to be minimal and accordingly do not apply the provisions of SFAS No. 71. Management will continue to evaluate its applicability based on changes in the regulatory and competitive environment.

Natural gas is purchased by the City under long-term natural gas contracts from both local and out-of-state sources and is transported through Southern California Gas Company's pipelines on behalf of the City. Natural gas is then delivered to customers' homes and businesses via the City's 1,800 miles of gas pipeline infrastructure.

In October 1998, the Long Beach City Council approved the direct pass-through of natural gas commodity costs to customers allowing the City to fully recover this actual cost. The methodology is used by other gas utilities in California.

Effective October 1, 2005, the Department, the Southeast Resource Recovery Facility (SERRF), and the Long Beach Department of Oil Properties consolidated as one city department and became collectively known as Long Beach Gas and Oil (LBGO).

(b) Reporting Entity

The Gas Enterprise Fund is part of the overall financial reporting entity of the City. As a proprietary fund of the City, the Gas Enterprise Fund's financial operations are included in the City's Comprehensive Annual Financial Report (CAFR). The City's CAFR may be obtained by contacting the City's Department of Financial Management at 333 W. Ocean Blvd., Long Beach, California 90802.

The Gas Enterprise Fund's revenues are collected through the City's customer billing system and its expenditures are paid through the City's disbursement system and are, therefore, subject to the City's internal control procedures.

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Notes to Financial Statements

September 30, 2008 and 2007

(c) *Implementation of New Accounting Pronouncements*

The following summarizes implemented Government Accounting Standards Board (GASB) pronouncements and their impact, if any, on the financial statements:

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The statement addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. The statement generally requires that employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB costs for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. This statement's provisions may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. This statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. Application of this statement is effective for the fiscal year ended September 30, 2008 and the additional disclosure required by GASB 45 can be found in note 6.

In September 2007, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. The statement establishes criteria that governments will use to determine whether certain transactions should be regarded as a sale and reported as revenue or regarded as collateralized borrowing and recorded as a liability. Examples of such transactions include the sale of delinquent taxes, certain mortgages, student loans, or future revenue such as those from tobacco settlement agreements. The statement also includes provisions that stipulate that governments should not revalue assets that are transferred between financial reporting entity components. The requirements of this statement are effective for the financial statements for periods beginning after December 15, 2006. Application of this statement is effective for the City's fiscal year ended September 30, 2008. For the fiscal year ended September 30, 2008, the provisions of GASB 48 have been determined to be nonapplicable to the Gas Enterprise Fund.

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Notes to Financial Statements

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In May 2007, GASB issued Statement No. 50, *Pension Disclosures – an amendment of GASB Statements No. 25 and No. 27*. The statement more closely aligns the financial reporting requirements for pensions with those for OPEB and, in doing so, enhances information disclosed in notes to financial statements or presented as required supplementary information (RSI) by pension plans and by employers that provide pension benefits. The reporting changes required by this statement amend applicable note disclosure and RSI requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, to conform to requirements of Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Application of this statement is effective for the City's fiscal year ended September 30, 2008. No additional disclosure for GASB 50 was required for the Gas Enterprise Fund.

The City is currently analyzing its accounting practices to determine the potential impact on the financial statements for the following GASB statements:

In November 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. The statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations. The statement focuses on the current or potential detrimental effects of existing pollution through participation in pollution remediation activities such as site assessments and clean-ups. The scope of the statement excludes pollution prevention or control obligations with respect to current operations and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning. The requirements of this statement are effective for financial statements periods beginning after December 15, 2007, and include measurement of pollution remedial liabilities at the beginning of the fiscal period as to restate beginning net assets. Governments with sufficient objective verifiable information to apply expected cash flow techniques to determine prior period liabilities are required to do for all periods presented. Application of this statement is effective for the City's fiscal year ending September 30, 2009.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. The statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. Application of this statement is effective for the City's fiscal year ending September 30, 2010.

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In November of 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. The statement establishes consistent standards for the reporting of land and other real estate held as investments by essentially similar entities. It requires endowments to report their land and other real estate investments at fair value. Governments also are required to report the changes in fair value as investment income and to disclose the methods and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported at fair value. This statement more appropriately reports the resources available in endowments and more closely aligns financial reporting with the objectives of endowments. It results in property held for similar purposes by comparable entities being reported in the same manner. Reporting land and other real estate held as investments at fair value enhances users' ability to meaningfully evaluate an entity's investment decisions and performance. Application of this statement is effective for the City's fiscal year ending September 30, 2009.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. The statement specifically requires governments to measure and report most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The requirement of reporting the derivative instruments at fair value on the face of financial statements gives the users of financial statements a clearer look into the risks their governments are sometimes exposed to when they enter into these transactions and how those risks are managed. The statement also addresses hedge accounting requirements and improves disclosures, providing a summary of the government's derivative instrument activity, its objectives for entering into derivative instruments, and their significant terms and risks. Application of this statement is effective for the City's fiscal year ending September 30, 2010.

(d) *Measurement Focus and Basis of Accounting*

The accompanying financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The Gas Enterprise Fund generally follows private sector standards of accounting and financial reporting issued on or before November 30, 1989 to the extent that such standards do not conflict with or contradict guidance of the GASB. The City and, by consequence, the Gas Enterprise Fund also have the option of following subsequent private sector guidance for their business-type activities and enterprise funds, subject to the same limitation. The City and the Gas Enterprise Fund have elected not to follow subsequent private sector guidance.

Operating revenues consist of charges to customers for services provided; the costs of providing such services are considered to be operating expenses and all other revenues and expenses are considered to be nonoperating in nature. In keeping with City policy, unbilled service receivables are not recognized, as their effect on a year-to-year basis is not material. Revenues collected in advance such as customer deposits are recorded as deferred revenue, a liability account, for financial statement purposes. Revenue is recognized in the fiscal year in which the earnings process is complete.

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Notes to Financial Statements

September 30, 2008 and 2007

(e) Pooled Cash, Cash Equivalents, and Other Investments

In order to maximize investment return, the Gas Enterprise Fund pools its available general cash with that of the City. The City's cash management pool is used essentially as a demand deposit account by the participating units; therefore, the Gas Enterprise Fund has defined cash and cash equivalents as pooled cash and investments, including restricted pooled cash and investments. Investment decisions are made by the City Treasurer and approved by a general investment committee whose membership includes a member of the management group of the Gas Enterprise Fund.

Interest income and realized gains and losses arising from such pooled cash and investments are apportioned to each participating unit based on the relationship of an individual unit's respective daily cash balances to aggregated pooled cash and investments. The Gas Enterprise Fund's share of pooled cash and investments, as of September 30, 2008 and 2007, is stated at fair value. The value of each investment is based on independent third-party pricing provided to the City (note 2).

The Gas Enterprise Fund's nonpooled investments consist of guaranteed investment contracts held by the bond trustee and amounted to \$650,000 at September 30, 2008, and 2007. These guaranteed investment contracts do not have stated maturity dates.

(f) Inventories

Inventories of supplies are stated at the lower of average cost or market determined on a first-in, first-out basis.

(g) Restricted Assets

Amounts designated for bond indenture requirements and refunding customer deposits are recorded as restricted assets. Related liabilities of the Gas Enterprise Fund are identified as amounts payable from restricted assets when such obligations are incurred. Proceeds from commercial paper issuance and gas prepay cost discount, which are reserved for capital projects, are likewise recorded as restricted assets.

(h) Capital Assets

The Gas Enterprise Fund defines capital assets as those with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. The cost of additions to property, plant, and equipment and replacement of retired property is capitalized. The cost of constructed assets includes labor, materials, interest, and allocated indirect expenses such as engineering, supervision, and construction and transportation equipment. The cost of minor replacements is regarded as a period cost and is expensed as incurred. Upon retirement or sale, the costs of the affected plant assets as well as the related accumulated depreciation are removed from the Gas Enterprise Fund's accounting records. Resulting gains or losses are recognized as a component of the change in net assets in the year of removal (note 4).

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Notes to Financial Statements

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Depreciation of capital assets is provided using the straight-line method over the estimated service lives of the assets, as follows:

Building, structures, and improvements	10 to 50 years
Transmission and distribution equipment	35 to 50 years
Other machinery and equipment	5 to 30 years

Contributed assets are recorded at fair market value when received.

(i) *Compensated Absences*

Vacation and sick leave benefits are paid through a citywide Employee Benefits Internal Service Fund administered by the City. The cost of these benefits is recognized by the Gas Enterprise Fund through regular payroll burden charges from the Employee Benefits Internal Service Fund based on estimates of benefits earned for vacation pay and sick leave.

(j) *Pension Plan and Postretirement Benefits*

All full time Gas Enterprise Fund employees are members of the State of California Public Employees' Retirement System (CalPERS), a statewide plan available to most municipalities in the state. CalPERS acts as a common investment and administrative agent for cities in California. The Gas Enterprise Fund is billed by the City for its share of pension costs based upon rates established by CalPERS for the City's general employees. No separate pension benefit obligation is calculated for the Gas Enterprise Fund; accordingly, no obligation is presented herein. The Gas Enterprise Fund also participates in the City's Retired Employee Health Insurance Program. This program is a single employer defined benefit healthcare plan.

(k) *Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities as of the date of the financial statements. Actual results could differ from those estimates.

(l) *Net Assets*

The Gas Enterprise Fund has adopted a policy of generally utilizing restricted funds, prior to unrestricted funds, when an expense is incurred for purposes for which both are available.

The Gas Enterprise Fund's net assets are classified into the following net asset categories:

Invested in Capital Assets, Net of Related Debt – Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

Restricted – Amounts designated for bond indenture requirements and refunding customer deposits. Related liabilities of the Gas Enterprise Fund are identified as amounts payable from restricted assets

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when such obligations are incurred. Proceeds from commercial paper issuance and gas prepay cost discount, which are reserved for capital projects, are likewise recorded as restricted assets.

Unrestricted – All other categories of net assets.

(m) Reclassifications

Certain amounts reported in fiscal year 2007 have been reclassified to conform to the fiscal year 2008 presentation. Such reclassifications had no effect on the previously reported change in net assets.

(2) Pooled Cash and Cash Equivalents

As of September 30, 2008 and 2007, the Gas Enterprise Fund's pooled cash and cash equivalents amounted to \$2,821,000 and \$10,661,000, respectively, which represented 0.166% and 0.632%, respectively, of the City's cash management pool of \$1,703,568,000 and \$1,686,441,000, respectively. Cash and investments as of September 30, 2008 are classified in the accompanying statements of net assets as follows (in thousands):

	<u>2008</u>	<u>2007</u>
Pooled cash and cash equivalents	\$ 2,821	10,661
Nonpooled cash and investments	650	650
Nonperforming investment	104	—
Total cash and investments	<u>\$ 3,575</u>	<u>11,311</u>

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

(a) Investments Authorized by the California Government Code and the City's Investment Policy

The table below identifies the investment types that are authorized for the City by the City's investment policy. The table also identifies certain provisions of the City's investment policy that address interest rate risk, credit risk, and concentration of credit risk. This table does not address debt proceeds held by bond trustee, which are governed by the provisions of debt agreements of the City, rather than the general provision of the California Government Code or the City's investment policy.

Authorized investment type	Maximum maturity	Maximum percentage of portfolio	Maximum investment in one issuer
Bonds issued by the City	5 years *	30%	None
U.S. Treasury notes, bonds, or bills	5 years *	None	None
Registered state warrants or treasury notes or bonds of the State of California	5 years *	30%	None
Local agency bonds	5 years *	30	None
Federal agency securities	5 years *	40	None
Banker's acceptances	180 days	40	30%
Commercial paper	270 days	25	10
Negotiable certificates of deposit	5 years *	30	10
Time certificates of deposit	5 years *	100	10
Repurchase agreements	90 days	100	None
Reverse repurchase agreements	92 days	20	None
Securities lending program	92 days	20	None
Medium-term notes	5 years *	30	10%
Money market funds	N/A	20	10
Local agency investment fund (LAIF)	N/A	None	\$40 million per account
Asset-backed securities	5 years	20%	None
Mortgage-backed securities	5 years	20	None

* Maximum maturity of five years unless a longer maturity is approved by the City Council, either specifically or as part of an investment program, at least three months prior to purchase.

(b) Investments Authorized by Debt Agreements

Investment of debt proceeds held by bond trustee is governed by provisions of the debt agreements.

(c) Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments, and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming closer to

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maturing evenly over time as necessary to provide cash flow and liquidity need for operations. The following schedule indicates the interest rate risk of the City's investments, which includes the amount the Gas Enterprise Fund has invested with the City as of September 30 (in thousands):

<u>Investment type</u>	<u>2008</u>		<u>2007</u>	
		Weighted average maturity (in years)		Weighted average maturity (in years)
Interdepartment loan (Health Savrs)	\$ 2,892	10.60	\$ 3,098	11.60
U.S. Treasury notes	55,817	0.41	145,149	0.90
Federal agency securities	1,289,370	1.96	1,190,784	2.28
Medium-term notes	84,148	0.99	49,881	1.83
Short-term commercial paper	—	—	135,874	0.02
Local Agency Investment Fund (LAIF)	160,849	0.09	139,156	0.01
Government-managed rate account	69,931	—	—	—
Subtotal city pool	<u>1,663,007</u>		<u>1,663,942</u>	
Cash and deposits	60,313	—	32,878	—
Outstanding checks	<u>(19,752)</u>	—	<u>(10,379)</u>	—
Total city pool	<u>\$ 1,703,568</u>		<u>\$ 1,686,441</u>	
Nonperforming short-term investment	\$ 3,963	—	\$ —	—

(d) Investments with Fair Values Highly Sensitive to Investment Risk

The City had no investments with values that were highly sensitive to investment risk as of September 30, 2008 and 2007. Highly sensitive investments are investments whose sensitivity to market interest rate fluctuations are not fully addressed by use of one of the five methods for reporting interest rate risk.

(e) Risks and Uncertainties

The City may invest in various types of investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investments securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statements of financial position.

The City invests in securities with contractual cash flows, such as asset-backed securities and mortgage-backed securities. The value, liquidity, and related income of these securities are sensitive to change in economic conditions, including real estate value, and delinquencies or defaults, or both,

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and may be adversely affected by shifts in the market's perception of the issuers and changes in interest rates.

(f) Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by the California Government Code, the City's investment policy, and the actual rating as of year-end for each investment type (in thousands):

City's pooled investments – investment type	Minimum legal rating	Rating as of year-end 2008					
		Not required to be rated	A-1+	A-1	AAA	AA-	Unrated
Cash and investments in city pool:							
Interdepartment loan							
(Health Savrs)	N/A	\$ 2,892	2,892	—	—	—	—
U.S. Treasury notes	N/A	55,817	55,817	—	—	—	—
Federal agency securities	N/A	1,289,370	—	—	—	1,289,370	—
Medium-term notes	A	84,148	—	—	—	84,148	—
Short-term commercial paper	N/A	—	—	—	—	—	—
LAIF	N/A	160,849	160,849	—	—	—	—
Government managed rate account	N/A	69,931	69,931	—	—	—	—
Subtotal city pool		1,663,007	289,489	—	—	1,373,518	—
Cash and deposits		60,313	—	—	—	—	60,313
Outstanding checks		(19,752)	—	—	—	—	(19,752)
Total city pool		\$ 1,703,568	289,489	—	—	1,373,518	40,561
Nonperforming short-term investment	N/A	\$ 3,963	—	—	—	—	3,963
Rating as of year-end 2007							
City's pooled investments – investment type	Minimum legal rating	Not required to be rated	A-1+	A-1	AAA	AA-	Unrated
Interdepartment loan							
(Health Savrs)	N/A	\$ 3,098	3,098	—	—	—	—
U.S. Treasury notes	N/A	145,149	145,149	—	—	—	—
Federal agency securities	N/A	1,190,784	—	—	—	1,190,784	—
Medium-term notes	A	49,881	—	—	—	44,861	5,020
Short-term commercial paper	N/A	135,874	—	54,350	81,524	—	—
LAIF	N/A	139,156	139,156	—	—	—	—
Subtotal city pool		1,663,942	287,403	54,350	81,524	1,235,645	5,020
Cash and deposits		32,878	—	—	—	—	32,878
Outstanding checks		(10,379)	—	—	—	—	(10,379)
Total city pool		\$ 1,686,441	287,403	54,350	81,524	1,235,645	22,499

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

(g) Concentration of Credit Risk

The investment policy of the City contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Investments in any one issuer that represents 5% or more of the City's total pooled investments are as follows (in thousands):

Issuer	Investment type	Reported amount	
		2008	2007
Federal Farm Credit Bank	Federal agency securities	\$ 93,000	89,334
Federal Home Loan Bank	Federal agency securities	477,696	354,763
Federal Home Loan Mortgage Association	Federal agency securities	359,571	307,865
Federal National Mortgage Association	Federal agency securities	359,103	438,822
U.S. Treasury	U.S. Treasury notes and bonds	55,817	145,149
Commercial Paper	Unsecured corporate debt		135,874
Corporate Debt Securities	Unsecured corporate debt	84,148	
LAIF	State pool investment	160,849	139,156

(h) Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker/dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits. The California Government Code requires that a financial institution secure deposits made by state or local government units by pledging securities in an undivided collateral pool held by a depository regulated under the state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure the City's deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

All securities owned by the City are deposited in trust for safekeeping with a custodial bank different from the City's primary bank except for one City-issued bond and investment in the State's LAIF.

As of September 30, 2008, the City reported deposits of \$60,313,000 less \$19,752,000 for checks outstanding. As of September 30, 2007, the City's deposits were \$32,878,000 less \$10,379,000 for checks outstanding.

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

(i) *Investment in State Investment Pool*

The City is a voluntary participant in the LAIF that is regulated by California Government Code Section 16429 under the oversight of the treasurer of the State of California. The fair value of the City's investment in this pool is reported in the City's financial statements at amounts based upon the City's pro rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis. Included in LAIF's investment portfolio are mortgage-backed securities, loans to certain state funds, securities with interest rates that vary according to changes in rates greater than a one-for-one basis, and structured basis.

(j) *Reverse Repurchase Agreements*

There were no transactions involving reverse repurchase agreements during the fiscal years ended September 30, 2008 and 2007.

(k) *GASB Statement No. 31*

GASB Statement No. 31, *Certain Investments and External Investment – Pools*, requires that certain investments and external investment pools be reported at fair value. At September 30, 2008 and 2007, the effect of valuing the City's investments at fair value did not have a material impact on either the City's or Gas Enterprise Fund's financial position.

(l) *Securities Lending*

The City did not engage in any securities lending programs for the fiscal years ended September 30, 2008 and 2007. In accordance with GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, no assets or liabilities have been recorded in the accompanying financial statements. However, from time to time, the City engages in limited securities lending activities. These activities are governed by formal agreement with the City's contract bank. This agreement limits the nature and amount of the transactions and provides for full collateralization of each transaction.

(3) *Advances to Other General City Funds*

The Gas Enterprise Fund has a long-term receivable from the City's Tideland Enterprise Fund. Under the terms of the agreement, the Gas Enterprise Fund is to receive annual payments in an amount necessary to cover the actual debt service requirements of the Gas Utility Revenue Bonds (note 5).

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

(4) Capital Assets

Activities in capital assets for the years ended September 30, 2008 and 2007 are as follows (in thousands):

	2008				Balance, September 30, 2008
	Balance, October 1, 2007	Additions	Retirements	Transfers	
Capital assets, not being depreciated:					
Land	\$ 203	—	—	—	203
Construction in progress	6,196	12,029	—	(9,119)	9,106
Total capital assets not being depreciated	6,399	12,029	—	(9,119)	9,309
Capital assets being depreciated:					
Buildings and improvements	5,642	—	—	—	5,642
Distribution systems	128,652	—	(710)	9,119	137,061
Storage structures	318	—	—	—	318
Machinery and equipment	1,783	152	(134)	—	1,801
Total capital assets being depreciated	136,395	152	(844)	9,119	144,822
Less accumulated depreciation:					
Buildings and improvements	(3,456)	(124)	—	—	(3,580)
Distribution systems	(64,243)	(3,094)	574	—	(66,763)
Storage structures	(236)	(6)	—	—	(242)
Machinery and equipment	(1,570)	(73)	134	—	(1,509)
Total accumulated depreciation	(69,505)	(3,297)	708	—	(72,094)
Total capital assets being depreciated, net	66,890	(3,145)	(136)	9,119	72,728
Total	\$ 73,289	8,884	(136)	—	82,037

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

	2007				Balance, September 30, 2007
	Balance, October 1, 2006	Additions	Retirements	Transfers	
Capital assets, not being depreciated:					
Land	\$ 203	—	—	—	203
Construction in progress	5,196	11,554	—	(10,554)	6,196
Total capital assets not being depreciated	<u>5,399</u>	<u>11,554</u>	<u>—</u>	<u>(10,554)</u>	<u>6,399</u>
Capital assets being depreciated:					
Buildings and improvements	5,642	—	—	—	5,642
Distribution systems	119,971	—	(1,873)	10,554	128,652
Storage structures	318	—	—	—	318
Machinery and equipment	1,940	—	(157)	—	1,783
Total capital assets being depreciated	<u>127,871</u>	<u>—</u>	<u>(2,030)</u>	<u>10,554</u>	<u>136,395</u>
Less accumulated depreciation:					
Buildings and improvements	(3,328)	(128)	—	—	(3,456)
Distribution systems	(62,978)	(2,761)	1,496	—	(64,243)
Storage structures	(230)	(6)	—	—	(236)
Machinery and equipment	(1,460)	(203)	93	—	(1,570)
Total accumulated depreciation	<u>(67,996)</u>	<u>(3,098)</u>	<u>1,589</u>	<u>—</u>	<u>(69,505)</u>
Total capital assets being depreciated, net	<u>59,875</u>	<u>(3,098)</u>	<u>(441)</u>	<u>10,554</u>	<u>66,890</u>
Total	\$ <u>65,274</u>	<u>8,456</u>	<u>(441)</u>	<u>—</u>	<u>73,289</u>

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

(5) Long-Term Debt

Long-term debt activities for the 2008 and 2007 fiscal years are as follows (in thousands):

	2008			Balance, September 30, 2008
	Balance, October 1, 2007	Increase	Decrease	
Long-term debt:				
2005 Commercial paper	\$ 15,255	2,004	—	17,259
2005 Gas Utility Revenue Bonds	5,595	—	(925)	4,670
Current portion of long-term debt, due within one year	(925)	(940)	925	(940)
Unamortized discount	(26)	—	4	(22)
Unamortized issuance cost	(65)	—	11	(54)
Net long-term debt	<u>\$ 19,834</u>	<u>1,064</u>	<u>15</u>	<u>20,913</u>
	2007			Balance, September 30, 2007
	Balance, October 1, 2006	Increase	Decrease	
Long-term debt:				
2005 Commercial paper	\$ 7,755	7,500	—	15,255
2005 Gas Utility Revenue Bonds	6,500	—	(905)	5,595
Current portion of long-term debt, due within one year	(905)	(925)	905	(925)
Unamortized discount	(31)	—	5	(26)
Unamortized issuance cost	(76)	—	11	(65)
Net long-term debt	<u>\$ 13,243</u>	<u>6,575</u>	<u>16</u>	<u>19,834</u>

As of September 30, 2008 and 2007, \$17,259,000 and \$15,255,000, respectively, in commercial paper notes have been issued and have had interest rates ranging from 1.3% to 3.6% since their issuance. The commercial paper notes, Series A and B (taxable) were authorized in an aggregate principal amount not to exceed \$35,000,000. The program termination date is July 1, 2020 unless terminated earlier or extended in accordance with program terms. The commercial paper notes shall not have maturities exceeding 270 days and shall not bear interest rate in excess of the lesser of (a) 12% per annum and (b) the maximum rate of interest permitted by law. The Gas Enterprise Fund intends to continue to refinance the commercial paper notes to periods greater than a year; accordingly, the outstanding amounts have been classified as a long-term obligation.

The 2005 Gas Utility Revenue Bonds, (2005 Bonds), are payable through August 1, 2013 with a total debt service in the amount of \$5,069,400 as of September 30, 2008. The 2005 Bonds have interest rates ranging from 2.000% to 3.125%.

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

Annual debt service requirements to maturity for these bonds are as follows:

	Annual debt service requirements		
	Principal	Interest	Total
Fiscal year ending September 30:			
2009	\$ 940,000	131,462	1,071,462
2010	970,000	107,963	1,077,963
2011	990,000	82,500	1,072,500
2012	1,020,000	54,037	1,074,037
2013	750,000	23,438	773,438
Total	\$ 4,670,000	399,400	5,069,400

The bond agreement contains certain restrictive covenants. The Gas Enterprise Fund's management believes that the Gas Enterprise Fund has complied with these covenants during the fiscal years ended September 30, 2008 and 2007.

(6) Retirement Programs

(a) Pension Plan

The Department participates on a cost-sharing basis with the City in the California Public Employees' Retirement System (CalPERS), a defined benefit, agent multiple-employer pension system that acts as a common investment and administrative agent for entities in California. The system also provides death and disability benefits.

The Department is billed by the City for its share of pension costs based upon rates established by CalPERS for the City's general employees. CalPERS does not calculate a separate pension obligation for the Department; accordingly, no separate obligation is presented herein. The Department's contributions to CalPERS were \$1,862,869, \$1,696,131, and \$1,477,458, for fiscal years 2008, 2007 and 2006, respectively, which was equal to its annual required contribution.

Contribution requirements of plan members and the City are established and may be amended by CalPERS. Effective October 1, 2007, the City contribution payments to CalPERS' Miscellaneous Plan is 11.866% plus the employee rate of 8.0%. Effective in fiscal year 2007, all miscellaneous employees pay 2.0% of the 8.0% employee rate.

Further information regarding the City's participation in CalPERS may be found in the City's Comprehensive Annual Financial Report for the year ended September 30, 2008.

(b) Postretirement Health Care Benefits

Plan Description

The Department participates in the City's Retired Employees Health Insurance Program. This program is a single-employer defined benefit healthcare plan.

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

Under the provisions of the City's Personnel Ordinance, upon retirement, the City allows retirees, their spouses, and eligible dependents to use the cash value at retirement of the retiring employee's accumulated unused sick leave to pay for health, dental, and long-term care insurance premiums. Full-time City employees are entitled to receive up to 96 hours of sick leave per year. Unused sick leave may be accumulated until termination or retirement. No sick leave benefits are vested. The City has provided two one-time early retirement incentive programs. The first had a maximum value of \$25,000 for employees, based on age, who retired during calendar year 1996 and the second incentive offered a 16 hour increase in sick leave per year of service to management employees who retired by June 30, 2004. In all cases, once the cash value of the retired employee's unused sick leave is exhausted, the retiree can terminate coverage or elect to continue paying the premiums at the retiree's expense.

At September 30, 2008, there were 635 participants in the City's Retired Employees Health Insurance Program, and the noninterest-bearing cash value equivalent of the remaining unused sick leave for the current retirees totaled \$16,369,000. Total premiums and actual claims paid by the City under the Retired Employees Health Insurance Program for the fiscal year ended September 30, 2008 were \$6,212,000, and are included in the expenses of the Employee Benefits Internal Service Fund.

Termination Benefits

As of September 30, 2008, the City has recorded a liability in the Employee Benefits Internal Service Fund of \$72,751,000 based on an actuarial study of current and future retiree accumulated sick leave in accordance with Governmental Accounting Standards Board (GASB) Statement No. 16, *Accounting for Compensated Absences* (GASB 16). The liability takes into account an estimate of future usage, additional leave accumulation and wage increases for both current retirees and active employees, and an additional amount relating to the sick leave incentive for employees who retired during calendar year 1996. The actuarial study assumes an investment return of 5.0 percent; wage increases of 3.5 percent per year for miscellaneous and 4.5 percent per year for safety employees, and insurance premium increases of 4.5 percent. The estimated current portion of such obligation of \$5,850,000 has been fully funded and the long-term portion of the liability of \$66,901,000 is being funded, over time, through burden rates charged to the various City funds, applied as a percent of current productive salaries.

Other Postemployment Benefits

As of September 30, 2008, the City has also recorded a liability in the Employee Benefits Internal Service Fund of \$5,249,000 based on an actuarial study of the "implicit subsidy" as defined by GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB 45). While the City does not directly contribute any funding towards the cost of premiums for retirees, the ability to obtain coverage at any active employees rate constitutes an economic benefit to the retirees. The inclusion of the retirees in the City's health care benefit plans increases the overall health plan rates. The economic benefit is defined as an "implicit subsidy" under GASB 45.

The ability to participate in the City's plan by self-paying the premiums extends for the lifetime of the retiree. However, upon attaining the age of Medicare eligibility, the retiree may enter a plan coordinated by Medicare. Standard actuarial practice assumes that Medicare supplemental plans do

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

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not generally give rise to an implicit subsidy, and while we have included Medicare eligible retirees in this valuation, their liability under GASB 45 and their implicit subsidy are both zero.

This plan does not issue a separate financial report.

Funding Policy

The contribution requirement of plan members and the City are established and may be amended by the City. The required contribution is based on projected pay-as-you-go financing requirements, with an additional amount to prefund benefits as determined annually by the City Council. As of September 30, 2008, the City has not prefunded the plan.

Annual OPEB Cost and Net OPEB Obligation

The City's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount that is actuarially determined in accordance with the requirements of GASB 45. The ARC represents the level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The following table shows the components of the City's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the City's net OPEB obligation (in thousands):

Annual required contribution	\$	8,102
Interest on net OPEB obligation		—
Adjustment to annual required contribution		—
		<hr/>
Annual OPEB cost (expense)		8,102
Contribution made		<hr/> (2,853)
Increase in net OPEB obligation		5,249
Net OPEB obligation – beginning of year		—
		<hr/>
Net OPEB obligation – end of year	\$	<hr/> <u>5,249</u>

The ARC was determined as part of the January 2006 actuarial valuation. For the year ended September 30, 2008, the City's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation were as follows (in thousands):

	<u>Annual OPEB cost</u>	<u>Percentage of annual OPEB cost contributed</u>	<u>Net OPEB obligation</u>
Fiscal year ended:			
September 30, 2008	\$ 8,102	35	5,219

The OPEB liability is not recorded in the Department's financial statement.

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

Funded Status and Funding Progress

The funded status of the plan as of September 30, 2008 was as follows (in thousands):

Actuarial accrued liability (AAL)	\$	86,868
Actuarial value of plan assets		<u>—</u>
Unfunded actuarial accrued liability (UAAL)	\$	<u><u>86,868</u></u>
Funded ratio (actuarial value of plan assets/AAL)		—%
Covered payroll	\$	284,484
UAAL as a percentage of covered payroll		30.5%
ARC as a percentage of covered payroll		2.8

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Actuarial Methods and Assumption

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the January 1, 2006, actuarial valuation the entry age normal cost method was used. The actuarial assumptions included a five percent investment rate of return (net of administrative expenses), an annual healthcare trend rate that begins at 12% for HMO plans and nine percent for PPO plans that grades down to four and one half percent for all plans by September 30, 2017, and an inflation assumption of three percent. The Entry Age Normal (EAN) cost method spreads plan costs for each participant from entry date to the expected retirement date. Under the EAN cost method, the plan's normal cost is developed as a level amount over the participants' working lifetime. The actuarial value of plan assets was zero. The plan's unfunded actuarial accrued liability is being amortized using the level percentage of payroll method on an open basis over 30 years.

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

(7) Transfers to Other City Departments

Transfers consist of the following as of September 30, 2008 and 2007 (in thousands):

	<u>2008</u>	<u>2007</u>
Transfers to:		
General Fund	\$ 11,711	11,402
Total transfers	\$ <u>11,711</u>	<u>11,402</u>

(8) Gas Rates

The City of Long Beach Gas Enterprise Fund passes along the actual cost of natural gas it provides to its customers.

Effective October 1, 2007, LBGO renegotiated terms with local gas suppliers which includes a purchase price equal to LBGO's lowest cost of gas purchased during the month of delivery and the understanding that their volumes will be supplemental to the prepay volumes purchased.

Effective November 1, 2007, LBGO entered into a long-term prepay contract with Merrill Lynch Commodities Inc. (MLCI). Under this new contract, MLCI became the primary provider of natural gas for LBGO. The contract price is equal to the applicable market index price for the month in which the gas delivery occurs, less \$0.83 per one million British thermal units (MMBtus) of gas delivered. LBGO reserves the gas prepay costs savings to facilitate funding of its gas utility's long-term infrastructure requirements.

Effective November 1, 2007, the City's contract with Coral Energy was renegotiated and will expire on March 31, 2009. Under the new contract, Coral Energy continues to provide storage, scheduling, forecasting, and balancing services to the City of Long Beach. Additional agreements with Coral Energy allow for the purchase of additional natural gas supply, if needed, and also provide fixed price gas, ceilings, and floor caps to protect LBGO customers from large fluctuations in the natural gas market.

(9) Commitments and Contingencies

The Gas Enterprise Fund is subject to claims and lawsuits arising from the normal course of business. Representatives of the City Attorney's Office routinely evaluate such claims. The management of the Gas Enterprise Fund may make provision for probable losses if deemed appropriate or upon advice of legal counsel. To the extent that such provision for damages is considered necessary, appropriate amounts are reflected in the accompanying financial statements. Based upon information obtained from the City Attorney with respect to the remaining cases, it is the opinion of management that any liability for unreserved claims and suits will not have a material impact on the financial statements of the Gas Enterprise Fund.

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

(10) Subsequent Event

(a) *Utility Billing System*

The City Council approved the replacement of the City's current Utility Billing (UB) system due to the operational needs of the Water, Public Works, and LBGO Departments. The existing UB system is a 27-year old, staff-developed system and is costly to integrate with other systems built with newer technology to meet the City's business needs. Technology Services Department is in the initial phase of the Customer Information (UB) System Selection Project to select a new utility billing system for the City. The estimated software, hardware, and implementation service costs, internal costs, and additional maintenance costs are estimated to range from \$12 million to \$15 million. The Water, Public Works, and LBGO Departments agreed to contribute to the recovery of these costs.

The City has contracted for the past 19 years with Southern California Edison (SCE) for the provision of manual gas and water meter reading services. This contract will expire in March 2010 with no option to renew, as SCE will no longer be in the meter reading business. The City Council approved the request to execute an agreement with Langham Consulting Services, Inc. to conduct a nationwide search and selection process for a Meter Reading Service Vendor and provide project management services for the full implementation of the meter reading service transition. The Financial Management Department is leading the project and the projected costs, not to exceed \$360,400, are to be shared by the Water and Gas Enterprise Funds.

(b) *Supply Management Services*

The contract for supply management services with Coral Energy will terminate March 31, 2009. LBGO is soliciting proposals for a natural gas management service provider as well as a commodity hedging agreement to manage LBGO's gas supply and its daily delivery into the utility's distribution system for all its customers and to provide financial transaction options to protect the City's customers from large price fluctuations in the natural market. The new contract will take effect April 1, 2009.

(c) *Relocation of Gas Pipeline*

The City of Long Beach owns a natural gas pipeline that goes from the east side of the City through Orange County to the power plant at Huntington Beach. The City has owned this pipeline since the early 1950s. This line is being leased to Southern California Gas Company (SoCalGas), who operates and maintains this pipeline but is not responsible for capital expenses.

Orange County Transit Authority (OCTA) acting as the agent for CalTrans is requiring the City to relocate a segment of this pipeline in the area of the Bolsa Chica Blvd Bridge and Seal Beach Blvd Bridge. This requirement is associated with the widening of the 405/22 Freeway. The cost for this relocation is currently estimated at around \$5 million. However, if CalTrans is not successful with negotiation with Seal Beach Naval Station for access rights on the south side of the freeway, LBGO will be required to relocate pipeline on surface streets, which will cost approximately \$13 million. LBGO is working with OCTA to determine the schedule and the actual scope of work. It is expected that LBGO relocation project will commence later in FY 2009 and will continue over the next four to five years.

GAS ENTERPRISE FUND OF THE CITY OF LONG BEACH

Notes to Financial Statements

September 30, 2008 and 2007

The pipeline also runs through a section known as the Bolsa Chica Wetlands. Recent housing developments have created an access issue where SoCalGas can no longer maintain “vital” valves. LBGO is working with SoCalGas’ environmental engineering consultants and other agencies including the California Coastal Commission to determine a new location for this valve and the removal of the old valve station. The expected cost for this work is approximately \$0.5 million. This work is currently under development and schedule is unknown at this point.

**CITY OF LONG BEACH
GAS ENTERPRISE FUND**

Financial Statements

September 30, 2008 and 2007

(With Independent Auditors' Report Thereon)



CITY OF LONG BEACH, CALIFORNIA