



# CITY OF LONG BEACH

**C-7**

DEPARTMENT OF FINANCIAL MANAGEMENT

333 West Ocean Boulevard 6<sup>th</sup> Floor • Long Beach, CA 90802 • (562) 570-6845 • Fax (562) 570-5836

August 18, 2009

HONORABLE MAYOR AND CITY COUNCIL  
City of Long Beach  
California

## RECOMMENDATION:

Refer the Comprehensive Annual Financial Report (CAFR), Separately Issued Financial Statements and the Federal Single Audit for the Fiscal Year Ended September 30, 2008 to the Budget Oversight Committee. (Citywide)

## DISCUSSION

### **Comprehensive Annual Financial Report**

The Comprehensive Annual Financial Report (CAFR), prepared by the Financial Management Department, contains audited financial information on all City funds for the fiscal year ended September 30, 2008 (FY 08) in accordance with generally accepted accounting principles. In accordance with Section 302(e) of the City Charter, the CAFR is submitted annually to the City Council. It is important to note that the CAFR is designed to report historical financial information only and is not designed to report financial projections or budgetary priorities.

We are pleased to report that the Independent Auditor's Report, found on page 1, concluded that the City's financial statements present fairly, in all material respects, the financial position of the City, and its related cash flow and budgetary information. The audit was conducted by KPMG LLP, a certified public accounting firm, under contract with the City Auditor.

The CAFR provides Basic Financial Statements that combine all of the City's assets and liabilities in one consolidated statement. Total City net assets, on an all funds basis, as shown on page 27, were \$3.9 billion as of September 30, 2008, which included \$3.2 billion for enterprise operations such as the Harbor Fund, Water Fund and Tidelands Fund. Net assets increased by \$200.8 million from FY 07 and are in the form of buildings, real property, bond proceeds, funds reserved for capital projects, debt service and grants-funded programs. Most of these funds are restricted by federal or state law and are not available for discretionary use.

As of September 30, 2008, the unreserved fund balance for the General Fund reflects the Emergency Reserve of \$40.1 million, comprised of \$37.6 million designated by the City Council, plus \$2.5 million required by the City Charter, which reflects 10 percent of total General Fund expenditures, consistent with the City Council's financial policy.

A separately issued Management Letter accompanying the CAFR provides certain recommendations from KPMG LLP on how the City can improve its financial reporting and internal controls. City management has reviewed KPMG's recommendations and has responded to each issue in the attached letter (Attachment A).

### **GASB 45**

For the fiscal year ended September 30, 2008, the City was required to implement GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions (OPEB)*. This new accounting pronouncement requires government entities to report the unfunded liability associated with retiree healthcare benefits (e.g. medical, vision, and dental). As such, the City has reported within the CAFR an unfunded liability of \$86.9 million. This amount represents the subsidized value of earned healthcare benefits for existing employees and retirees. For the fiscal year ended September 30, 2008, the Annual Required Contribution (ARC) to prefund earned OPEB benefits was \$8.1 million, actual contributions were \$2.9 million reflecting the City's pay-as-you-go policy, which leaves a net OPEB obligation of \$5.2 million.

### **Separately Issued Financial Reports and Statements**

In addition to the CAFR, certain City funds, joint powers authorities, and other subsidiary entities are also required to submit audited annual financial statements under separate cover, including the Harbor Department, Water Department, Redevelopment Agency, Long Beach Housing Development Company, Aquarium of the Pacific and the Gas Enterprise Fund. These separate reports are enclosed and are issued annually to meet distinct legal and financial requirements. The financial statement for Long Beach Transit, a discretely presented component unit of the City, for which the City is the sole shareholder, is also included.

A separately issued Management Letter accompanying the Gas financial statements provides a recommendation from KPMG LLP on how Long Beach Gas and Oil (LBGO) can improve its financial reporting and internal controls. LBGO management has reviewed KPMG's recommendation and has responded to the issue in the attached letter (Attachment B).

**Federal Single Audit**

Lastly, the Federal Single Audit required by the Federal Office of Management and Budget for municipalities receiving over \$500,000 annually in federal funds is also enclosed.

TIMING CONSIDERATIONS

Action on this item is not time critical.

FISCAL IMPACT

There is no fiscal impact associated with this action.

SUGGESTED ACTION:

Approve recommendation.

Respectfully Submitted,

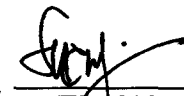


STEPHEN W. HANNAH  
CITY CONTROLLER



LORI ANN FARRELL  
DIRECTOR OF FINANCIAL MANAGEMENT/CFO

APPROVED:



PATRICK H. WEST  
CITY MANAGER

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ATTACHMENTS:

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) MANAGEMENT LETTER (ATTACHMENT A)  
GAS ENTERPRISE FUND MANAGEMENT LETTER (ATTACHMENT B)  
COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) FOR THE CITY OF LONG BEACH, CALIFORNIA  
FEDERAL SINGLE AUDIT REPORT  
THE HARBOR DEPARTMENT COMPREHENSIVE FINANCIAL REPORT  
COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE LONG BEACH WATER DEPARTMENT  
REDEVELOPMENT AGENCY OF THE CITY OF LONG BEACH ANNUAL FINANCIAL REPORT  
THE LONG BEACH HOUSING DEVELOPMENT COMPANY ANNUAL FINANCIAL REPORT  
AQUARIUM OF THE PACIFIC FINANCIAL STATEMENTS  
AQUARIUM OF THE PACIFIC CONSOLIDATING FINANCIAL STATEMENTS  
CITY OF LONG BEACH GAS ENTERPRISE FUND ANNUAL FINANCIAL REPORT  
LONG BEACH TRANSIT COMPREHENSIVE ANNUAL FINANCIAL REPORT



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

June 30, 2009

The City Council  
 City of Long Beach  
 333 West Ocean Blvd.  
 Long Beach, CA 90081

Ladies and Gentlemen:

We have audited the financial statements of the City of Long Beach, California (the City), for the year ended September 30, 2008, and have issued our report thereon dated June 30, 2009. In planning and performing our audit of the financial statements of the City in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

During our audit, we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized below.

In addition, we identified certain deficiencies in internal control that we consider to be significant deficiencies and communicated them in writing to management and those charged with governance on June 30, 2009.

\* \* \* \* \*

### **Allowance for Uncollectible Accounts**

#### ***Observation***

Based on the results of our test work, we noted that management does not currently utilize a systematic method for the review of accounts receivable to determine the adequacy of the related allowance for doubtful accounts. The accounts receivable system is configured to automatically reserve receivables aged over a specific amount and time period. However, in our test work we identified instances where items were significantly aged beyond the allotted time period but were not properly reserved. Periodic review of the allowance for doubtful accounts would help management avoid sudden increases in bad debt expense.

#### ***Recommendation***

Standard procedures for the periodic review of accounts receivable should be established and documented. The procedures should include consideration of the aging of the balance, payment history, and extent of



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insurance coverage for each account. Guidelines for reserve percentages should be established to facilitate the review.

***Management's Response***

The City conditionally accepts KPMG's recommendation. The Department of Financial Management will either create new or update existing procedures for the annual review of accounts receivable including the aging of the balance, payment history, and extent of insurance coverage for each account. Guidelines for reserve percentages will also be established to facilitate the review. However, due to staffing and time constraints, these new procedures may not be fully implemented in time for the close of the 2009 fiscal year and its ensuing annual audit.

**Net Assets**

***Observation***

During our audit, we noted that there are no written policies or procedures in place related to the annual review of the classification of net assets as part of the City's comprehensive annual financial reporting process.

***Recommendation***

We recommend that the City formalize its policies or procedures for the documentation and support for the classification of net assets to ensure that the basis of the restriction is external and not an internal designation by the City.

***Management's Response***

The City conditionally accepts KPMG's recommendation. The City will endeavor to formalize policies and procedures for the annual review, classification, and documentation of net assets to ensure the basis for the restriction is external and not an internal designation by the City. These new policies and procedures will be developed concurrently with the City's analysis of new fund balance reporting revisions required by the Government Accounting Standards Board. It is important to note that while formal written policies and procedures are not currently in place, there is an extensive annual review of net assets that is performed during the development of the comprehensive annual financial report.

**Account Analysis**

***Observation***

During our audit, we noted several accounts which have been stale for several years. Upon review, it was determined that these items were not recorded in the proper financial statement category. As a result of these errors, adjustments related to the land held for resale in the Community Development fund as well as recognition of collections held in trust revenue for the Aggregate Remaining funds information were identified.

***Recommendation***

We recommend that management review all accounts to ensure that the information presented is accurate. Management's review should include a review for clerical errors as well an analysis to ensure that the information presented is reasonable given the circumstances. The analyses should be retained and reviewed



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by a responsible official as part of the monthly closing cycle. This procedure will provide improved assurance that accounting errors will be detected and corrected in a timely manner.

#### ***Management's Response***

The City conditionally accepts KPMG's recommendation. The Department of Financial Management currently has a process to review various accounts during the year-end process. In addition, each year it is communicated to departments to review various accounts within their responsibility. Unfortunately, due to staffing and time constraints, not all accounts are reviewed to the level of detail that KPMG has recommended. The Department of Financial Management is in the process of improving the communication with departments regarding year-end procedures to ensure all significant accounts are reconciled with the goal of detecting and correcting accounting errors in a more timely manner. However, due to existing staffing and time constraints, these new procedures may not be fully implemented in time for the close of the 2009 fiscal year and its ensuing annual audit.

#### **Non-GAAP Policies**

##### ***Observation***

During our audit, we reviewed the City's internal control process in place to identify new non-GAAP policies and quantify the impact of new and existing non-GAAP policies to the financial statements. We noted that the City does not have a formal process in place to identify new non-GAAP policies. Furthermore, the City does not perform an analysis during the year to quantify the impact of the new and existing non-GAAP policies to the year-end financial statements. As a result of the procedures performed, we noted the City did not quantify the impact of the following non-GAAP policies:

- Use of the straight line method for amortizing the discount/premium and bond issuance costs, rather than the effective interest rate method as required by Accounting Principles Board Opinion (APB) 21 Paragraph 15.
- Lack of accrual of expenses under \$10,000.
- Computation of not capitalizing interest in accordance with Financial Accounting Standards Board (FASB) Statement No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants* an amendment of FASB Statement No. 34.

##### ***Recommendation***

We recommend that the City enhance its internal controls related to the documentation and calculation of the impact of non-GAAP policies to ensure that adopted policies do not result in a material misstatement of the financial statements.



***Management's Response***

With the help of KPMG, the City has identified existing non-GAAP policies. The City will not implement any new policies that are not in compliance with GAAP unless an effectiveness analysis is performed and the impact on the financial statements is determined to be immaterial. During the fiscal year just ended, the City eliminated a number of non-GAAP policies, such as the recording of pooled cash at book value instead of market value, and will continue to eliminate additional noncompliant policies if cost effective. The following are specific responses to the three non-GAAP policies addressed by KPMG:

- Use of the straight-line method for amortizing the discount/premium and bond issuance costs – All of the City's long-term debt schedules now include summary comparisons of the straight-line method and the effective-interest-rate method on bond discounts, premiums, and bond issuance costs for all bonds and certificates of participation. The City will record all debt from fiscal year 2008 forward using the effective-interest-rate method.
- Lack of accrual of expenses under \$10,000 – The City believes that the accrual of invoices less than \$10,000 is neither cost effective nor material to the City's financial statements. During the search for unrecorded liabilities, the City reviews the financial impact of not accruing these invoices. In addition, at the request of KPMG, the City provides a list of invoices that have not been accrued allowing KPMG to quantify this non-GAAP policy.
- Computation of capitalizing interest – The City will begin to capitalize interest during the current or subsequent fiscal years.

**IT General Controls – Logical Access**

***Observation***

Based on our online observation of the Windows Network Environment, we noted that the logon attempt value is currently configured to 20 attempts.

***Recommendation***

Windows logical access controls should be established and commensurate with the following best practice related to logon attempts:

- User accounts should be locked after three failed attempts. Locked user accounts should be manually reactivated by the system administrator after investigation.

***Management's Response***

Logon attempts have been changed to a maximum of five, effective September 14, 2008.

**IT General Controls – User Administration**

***Observation***

Based on our online observation of the mainframe system and the network, we noted that 24 out of 40 employees' access were not disabled in a timely manner upon termination. Moreover, of the 24 employees, 2 employees' access to FAMIS application has not been revoked. Per discussion with management, it was noted that employee's access to the network and FAMIS application should be



disabled within three business days upon termination. Additionally, we noted one 'Request for Service' for access to FAMIS and ADPICS that was not properly approved.

***Recommendation***

User account administration procedures (including user access additions, modifications, and deletions) should be communicated, enforced, and followed by the user community at all times.

***Management's Response***

Research and analysis was completed on the list of 40 employees and it was determined that all 40 do not have access to any of the CLB systems or Network. This access was taken away after Tech Services was notified of their separation from the City.

To ensure that strict guidelines are followed, Tech Services management has established an SOP (Standard Operating Procedure) that documents the proper process to be followed by Tech Services Staff when an employee is separated from the City. Tech Services Management has reviewed this SOP with all involved employees to ensure the SOP will be followed.

With relation to the 'Request for Service' which was not properly approved, it was determined that the access was appropriate. However, the person who authorized that access did not have authorization authority at the time. It was granted subsequently.

**IT General Controls – Documentation of Change Management**

***Observation***

Prior to August 1, 2008, we noted that although there is a formal change management process, the evidence and documentation was not maintained in a consistent manner. As such, we could not perform audit procedures over the change management process, prior to August 1, 2008.

***Recommendation***

Adequate change management procedures should be designed and implemented to ensure that changes to the system are made in a controlled manner. We recommend the following:

- All change requests should be authorized by management;
- Appropriate change management software should be utilized to support the migration of program changes to the production environment;
- User acceptance sign-off should be obtained before changes are migrated to the production environment; and
- Test criteria should be documented and applied for all testing.

***Management's Response***

The documented Change Management Process was developed in August 2008; hence, the City had only two months, through September 30, 2008, to demonstrate that the Process was being followed.





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The Change Management Process is being followed and each Supervisor is maintaining the documentation. The documentation is related to a Remedy Change Request Ticket. Fiscal year 2009 will provide a full year of data that demonstrates compliance with this recommendation.

#### **IT General Controls –Change Management**

##### ***Observation***

Of the 99 users with access to migrate changes to the production environment via the PROD.JCL screen, 4 users did not have appropriate access to the screen, 4 test accounts were in the production environment, 8 user accounts were duplicate and were used to unlock primary accounts (since failure logins or user inactivity can cause accounts to be locked out) and 11 Generic IDs were present within the user access listing.

Of the 79 users with access to migrate changes to production environment via the PROD.PGMLIB screen, 4 test accounts were in the production environment, 10 user accounts were duplicate and were used to unlock primary accounts (since failure logins or user inactivity can cause accounts to be locked out), and 13 Generic IDs were present within the user access listing.

We noted that access to production environment as excessive.

##### ***Recommendation***

We recommend that access to production programs and data is restricted and limited to personnel independent of the development function and that programs are implemented into the live production environment only upon receipt of appropriate authorization. Authorization for changes should only be granted subject to evidence of adequate documentation and testing of changes to systems.

##### ***Management's Response***

Of the 99 users with access to migrate changes to the production environment via PROD.JCL screen, 95-user id's reflected appropriate access. Of the 99 user accounts, only 4 users did not have appropriate access to the screen. In addition, please note that 4 test accounts were in the production environment, 8 user accounts were duplicate and were used to unlock primary accounts (since failure logins or user activity can cause accounts to be locked out), and 11 Generic Ids were present within the user access listing, all necessary and appropriate functions of the Technology Services Department.

Of the 79 users with access to migrate changes to the production environment via the PROD.PGMLIB screen, 4 test accounts were in the production environment, 10 user accounts were duplicate and were used to unlock primary accounts (since failure logins or user inactivity can cause accounts to be locked out), and 13 generic IDs were present within the user access listing

Six accounts are being deleted that had access to PROD.JCL because they were obsolete. These accounts are:

KOALEMA  
RGS  
JALAMON  
TIRICKS



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KSL  
KWLIM

On a single mainframe server, you can run multiple test and production systems like IMS, CICS, and DB2. Unlike a Windows server system, you can intermingle test and production environments on the same mainframe server. These accounts are not always users, but also represent task names that run under the mainframe system.

\* \* \* \* \*

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the City's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

The City's written response to our comments and recommendations has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

This communication is intended solely for the information and use of management, the City Council, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

**KPMG LLP**



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

June 23, 2009

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

We have audited the financial statements of the Gas Enterprise Fund of the City of Long Beach, California (the Gas Enterprise Fund), an enterprise fund of the City of Long Beach, California (the City), as of and for the year ended September 30, 2008, and have issued our report thereon dated June 23, 2009. In planning and performing our audit of the financial statements of the Gas Enterprise Fund, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the Gas Enterprise Fund's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the Gas Enterprise Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Gas Enterprise Fund's internal control.

During our audit, we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

\* \* \* \* \*

**Non-GAAP Policies**

*Observation*

The Gas Enterprise Fund has adopted a number of non-GAAP policies to sustain the operational efficiency of the entity. Management presumes that the quantitative and qualitative impact of all adopted non-GAAP policies is immaterial to the year-end financial statements.

During our audit, we reviewed the Gas Enterprise Fund's internal control process in place to identify new non-GAAP policies and quantify the impact of new and existing non-GAAP policies to the financial statements. We noted that management does not have a formal process in place to identify new non-GAAP policies. Furthermore, an analysis is not performed during the year to quantify the impact of the new and existing non-GAAP policies to the year-end financial statements.

*Recommendation*

We recommend that the Gas Enterprise Fund enhance its internal controls related to the documentation and calculation of the impact of non-GAAP policies to ensure that adopted policies do not result in a material misstatement of the financial statements.



The Honorable Mayor and City Council  
of the City of Long Beach, California  
The Citizens of the City of Long Beach, California  
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*Management's Response*

Long Beach Gas and Oil (LBGO) department management understands its responsibility of enforcing internal controls to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with GAAP.

LBGO will take the steps needed to further enhance its internal controls related to the documentation and calculation of the impact of non-GAAP policies with the goal of ensuring that those policies do not result in a material misstatement within the financial statements.

LBGO will continue to enhance its internal controls as recommended by KPMG to ensure effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations.

\* \* \* \* \*

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the Gas Enterprise Fund's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This communication is intended solely for the information and use of the Mayor of the City, and the City's management, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

**KPMG LLP**