



AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Financial Statements

September 30, 2007 and 2006

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

For the fiscal year ended September 30, 2007

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Independent Auditors' Report

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 governmental activities and major fund of the Air Quality Improvement Fund (the Fund), a component financial reporting unit of the City of Long Beach, California, as of and for the year ended September 30, 2007, which collectively comprise the Fund's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express opinions on these financial statements based on our audit. The accompanying financial statements of the Fund as of and for the year ended September 30, 2006 were audited by other auditors whose report thereon dated April 2, 2007 expressed unqualified opinions on those statements.

We conducted our audit 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 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 audit provides reasonable basis for our opinions.

As discussed more fully in note 1 to the financial statements, the accompanying financial statements of the Fund are intended to present the financial position and the changes in the financial position attributable to the 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, 2007 and 2006, and the changes in its financial position for the years then ended, in conformity with U.S. generally accepted accounting principles.

In our opinion, the 2007 financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities and major fund of the Air Quality Improvement Fund as of September 30, 2007, and the changes in its financial position and the budgetary comparison for the Fund's governmental fund for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 18, 2008 on our consideration of the 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 and 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 audit.

The management of the Air Quality Improvement 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

July 18, 2008

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Statements of Net Assets

September 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Assets:		
Current assets		
Pooled cash and cash equivalents (note 2)	\$ 936,179	784,527
Due from other governments – motor vehicle fees	150,000	149,928
Total current assets	<u>1,086,179</u>	<u>934,455</u>
Noncurrent assets:		
Capital assets, net of accumulated depreciation	73,948	—
Total assets	<u>1,160,127</u>	<u>934,455</u>
Liabilities:		
Current liabilities:		
Accounts payable	406,484	16,000
Net assets:		
Invested in capital assets	73,948	—
Restricted for future capital projects – transportation	679,695	918,455
Total net assets	<u>\$ 753,643</u>	<u>918,455</u>

See accompanying notes to financial statements.

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Statements of Activities

For the fiscal year ended September 30, 2007

Functions/programs	Program revenues		Net (expense) revenue and changes in net assets
	Expenses	Operating grants and contributions	September 30, 2007
Air quality mitigation	\$ 433,211	590,848	157,637
General revenues:			
Unrestricted investment earnings			37,820
Capital asset transfers			(360,269)
Total general revenues and transfers			<u>(322,449)</u>
Change in net assets			(164,812)
Net assets – October 1			<u>918,455</u>
Net assets – September 30			\$ <u><u>753,643</u></u>

Functions/programs	Program revenues		Net (expense) revenue and changes in net assets
	Expenses	Operating grants and contributions	September 30, 2006
Air quality mitigation	\$ 846,193	587,623	(258,570)
General revenues:			
Unrestricted investment earnings			36,314
Capital asset transfers			—
Total general revenues and transfers			<u>36,314</u>
Change in net assets			(222,256)
Net assets – October 1			<u>1,140,711</u>
Net assets – September 30			\$ <u><u>918,455</u></u>

See accompanying notes to financial statements.

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Balance Sheets and Reconciliation of Fund Balance to
Net Assets in the Statement of Net Assets

For the fiscal year ended September 30, 2007

Assets	2007	2006
Current assets:		
Pooled cash and cash equivalents (note 2)	\$ 936,179	784,527
Due from other governments – motor vehicle fees	150,000	149,928
Total current assets	<u>\$ 1,086,179</u>	<u>934,455</u>
Liabilities		
Current liabilities:		
Accounts payable	\$ 406,484	16,000
Fund Balance		
Reserved for:		
Encumbrances	32,339	—
Future capital projects – transportation	647,356	918,455
Total fund balance	<u>679,695</u>	<u>918,455</u>
Total liabilities and fund balance	<u>\$ 1,086,179</u>	<u>934,455</u>
Reconciliation of fund balance to net assets in the statement of net assets:		
Fund balance	\$ 679,695	918,455
Capital assets used in governmental activities are not current financial resources and, therefore, are not reported in the governmental funds balance sheet.	73,948	—
Net assets of governmental activities	<u>\$ 753,643</u>	<u>918,455</u>

See accompanying notes to financial statements.

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Statements of Revenues, Expenditures, and Changes in Fund Balance and Reconciliation of Statements of Revenues, Expenditures, and Changes in Fund Balance to the Statement of Activities

Years ended September 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Revenues:		
From other agencies	\$ 590,848	587,623
Interest earnings	37,820	36,314
Total revenues	<u>628,668</u>	<u>623,937</u>
Expenditures:		
Air quality mitigation measures	749,626	360,741
Liquefied natural gas fueling stations	116,302	483,698
Administration	1,500	1,754
Total expenditures	<u>867,428</u>	<u>846,193</u>
Change in fund net assets	(238,760)	(222,256)
Fund balance – October 1	<u>918,455</u>	<u>1,140,711</u>
Fund balance – September 30	<u>\$ 679,695</u>	<u>918,455</u>
Reconciliation of statements of revenues, expenditures, and changes in fund balance to the statement of activities:		
Net change in fund balance	\$ (238,760)	(222,256)
Governmental funds report capital outlay as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful life and reported as depreciation expense. This is the amount by which capital outlay exceeds depreciation and capital asset transfers in the current period.	<u>73,948</u>	<u>—</u>
Change in net assets of governmental activities	<u>\$ (164,812)</u>	<u>(222,256)</u>

See accompanying notes to financial statements.

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Statements of Revenues, Expenditures, and
Changes in Fund Balance – Budget and Actual

Years ended September 30, 2007 and 2006

2007				
	Budgeted amounts		Actual	Variance with final budget - favorable (unfavorable)
	Original	Final		
Revenues:				
From other agencies	\$ 530,000	530,000	590,848	60,848
Use of money and property	18,500	18,500	37,820	19,320
Total revenues	548,500	548,500	628,668	80,168
Expenditures:				
Air quality mitigation measures	765,000	765,000	749,626	15,374
Liquified natural gas fueling stations	116,302	116,302	116,302	—
Administration	—	—	1,500	(1,500)
Total expenditures	881,302	881,302	867,428	13,874
Excess of expenditures over revenues	(332,802)	(332,802)	(238,760)	94,042
Fund balance – October 1, budgetary basis	918,455	918,455	918,455	—
Fund balance – September 30, budgetary basis	\$ <u>585,653</u>	<u>585,653</u>	<u>679,695</u>	<u>94,042</u>
2006				
	Budgeted amounts		Actual	Variance with final budget - favorable (unfavorable)
	Original	Final		
Revenues:				
From other agencies	\$ 530,000	530,000	587,623	57,623
Use of money and property	18,500	18,500	36,314	17,814
Total revenues	548,500	548,500	623,937	75,437
Expenditures:				
Air quality mitigation measures	490,000	490,000	360,741	129,259
Liquified natural gas fueling stations	600,000	600,000	483,698	116,302
Administration	—	—	1,754	(1,754)
Total expenditures	1,090,000	1,090,000	846,193	243,807
Excess of expenditures over revenues	(541,500)	(541,500)	(222,256)	319,244
Fund balance – October 1, budgetary basis	1,140,711	1,140,711	1,140,711	—
Fund balance – September 30, budgetary basis	\$ <u>599,211</u>	<u>599,211</u>	<u>918,455</u>	<u>319,244</u>

See accompanying notes to financial statements.

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Notes to Financial Statements

September 30, 2007 and 2006

(1) Reporting Entity and Summary of Significant Accounting Policies

(a) *Air Quality Improvement Fund*

California Assembly Bill 2766 authorizes the State of California's (the State's) various regional air pollution control districts to levy fees on motor vehicles. These fees are to be used to reduce air pollution. Under this program, the State Department of Motor Vehicles collects the fees and allocates amounts collected among the local regional air quality pollution control districts for vehicles registered with the respective district's jurisdiction. Locally, the South Coast Air Quality Management District (SCAQMD) is responsible for administering funds allocated by the State. Forty cents of every dollar is proportionately allocated among the cities and counties with the SCAQMD's jurisdiction based upon population. Amounts attributable to the City of Long Beach, California (the City), are maintained in the Air Quality Improvement Fund (the Fund) of the City of Long Beach, California (the City), a separate fund administered by the City.

(b) *Reporting Entity*

As noted above, the Fund is included as a fund of the City's Comprehensive Annual Financial Report (CAFR). It is combined with other funds restricted for transportation projects and reported as the Transportation Fund. The City's CAFR may be obtained by contacting the City's Department of Financial Management at 333 W. Ocean Blvd., Long Beach, CA 90802.

(c) *Basis of Accounting and Measurement Focus and Financial Statement Presentation*

The entitywide financial statements are presented on economic resources measurement focus and accrual basis of accounting. Accordingly, all of the Fund's assets and liabilities including capital assets are included in the accompanying statements of net assets. Revenues are recorded when earned and expenses are recorded when a liability is incurred regardless of the timing of the related cash flows.

The fund financial statements are accounted for as a special revenue fund and reported on a current financial resources measurement focus and the modified accrual basis of accounting. Accordingly, only current assets and liabilities are included in the balance sheets. Revenues are recorded in the period in which they become measurable and available. Revenues are considered available if collectible within 60 days of the end of the fiscal period. Expenditures are recorded at the time liabilities are incurred, if measurable.

Taxpayer-assessed tax revenues (e.g. motor vehicle fees), net of estimated refunds and uncollectible amounts, and interest associated with the current fiscal period are all considered susceptible to accrual and have been recognized as revenues of the current fiscal period. All other revenue items are considered measurable and available only when cash is received.

AIR QUALITY IMPROVEMENT FUND

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Notes to Financial Statements

September 30, 2007 and 2006

(d) *Implementation of New Accounting Pronouncements*

In June 2004, Governmental Accounting Standards Board (GASB) issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. The City will implement this statement for the fiscal year ended September 30, 2008. This statement is not expected to have a significant impact on the presentation of the fund's financial statements.

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*. This 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. The City plans on implementing GASB Statement No. 48 for the fiscal year ended September 30, 2008. This statement is not expected to have a significant impact on the presentation of the fund's financial statements.

In November 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This statement provides guidance on how to calculate and report the costs and obligations associated with pollution cleanup efforts. This statement is not effective for the fund until the fiscal year ended September 30, 2009. This statement is not expected to have a significant impact on the presentation of the fund's financial statements.

(e) *Budgetary Principles*

The Air Quality Improvement Fund is required to adopt an annual budget on or before September 30 for the ensuing fiscal year. From the effective date of the budget, the amounts stated therein as proposed expenditures become appropriations to the fund. All appropriations lapse at the end of the fiscal year to the extent that they have not been expended or encumbered.

(f) *Encumbrances*

Encumbrances outstanding at year-end are not reported as expenditures, but are reported as a reservation of fund balance available for subsequent year expenditures based on the encumbered appropriation authority carried over to the next fiscal year.

(g) *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 amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported changes in the Air Quality Improvement Fund's financial position during the reporting period. Actual results could differ from those estimates.

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Notes to Financial Statements

September 30, 2007 and 2006

(h) Pooled Cash and Investments

In order to maximize investment return, the Air Quality Improvement Fund pools its available general cash with that of the City. The cash management pool is used essentially as a demand deposit account by the participating units; therefore, the Air Quality Improvement Fund has defined cash and cash equivalents as pooled cash and investments, including restricted pooled cash and investments. Investments decisions are made by the Treasurer of the City of Long Beach (City Treasurer) and approved by a general investment committee.

Interest income and realized gains and losses arising from pooled cash and investments are apportioned to each participation unit based on the relationship of an individual unit's respective daily cash balances to aggregate pooled cash and investments. The Air Quality Improvement Fund's share of pooled cash and investments as of September 30, 2007 and 2006 is stated at fair value (see note 2).

(i) Capital Assets

Capital assets are recorded in the governmentwide financial statements. Capital outlay is recorded as expenditures in the Fund's financial statements. Fund capital assets are recorded at historical cost and depreciated on a straight-line basis over their estimated useful lives as follows:

Automobiles	2 – 6 years
Machinery and equipment	5 – 20 years
Office furniture, fixtures, and equipment	3 – 20 years

(j) Fund Balance

The financial statements utilize a fund balance presentation, and are categorized as follows:

Reserve for Future Capital Projects/Transportation – This component of the fund balance consists of restrictions placed on cash and cash equivalents for use of future Fund-related projects.

(2) Pooled Cash and Investments

As of September 30, 2007 and 2006, the Fund's pooled cash and investments amounted to \$936,179 or 0.06% and \$784,527 or 0.05% of the City's pooled cash and investments, respectively. The City's pooled cash and investments as of September 30, 2007 and 2006 totaled \$1,686,441,000 and \$1,438,524,000, respectively.

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Notes to Financial Statements

September 30, 2007 and 2006

(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.

<u>Authorized investment type</u>	<u>Maximum maturity</u>	<u>Maximum percentage of portfolio</u>	<u>Maximum investment in one issuer</u>
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 (5) years unless a longer maturity is approved by the City Council, either specifically or as part of an investment program, at least (3) months prior to purchase.

(b) *Investments Authorized by Debt Agreement*

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

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Notes to Financial Statements

September 30, 2007 and 2006

(c) ***Interest Rate Risk***

Interest rate risk is the risk that changes in market interest rates that 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 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 investment, which includes the amount the Fund has invested with the City as of September 30 (in thousands):

	2007		2006	
Investment type		Weighted average maturity (in years)		Weighted average maturity (in years)
Interdepartment loan (Health Savrs)	\$ 3,098	11.60	\$ 3,297	12.60
U.S. Treasury notes	145,149	0.90	214,467	1.54
Federal agency securities	1,190,784	2.28	1,042,876	1.57
Medium-term notes	49,881	1.83	33,464	1.61
Short-term commercial paper	135,874	0.02	132,731	0.01
LAIF	139,156	0.01	2,921	0.01
Subtotal city pool	1,663,942		1,429,756	
Cash on hand	32,878		26,811	
Outstanding checks	(10,379)		(18,043)	
Total city pool	\$ 1,686,441		\$ 1,438,524	

(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, 2007 and 2006. 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.

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Notes to Financial Statements

September 30, 2007 and 2006

(e) 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 on the following page 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	Rating as of year-end 2007							
	Minimum legal rating	Not required to be rated	A-1+	A-1	AAA	AA-	Unrated	
Interdepartment loan (Health Savrs)	\$ 3,098	N/A	\$ 3,098	—	—	—	—	—
U.S. Treasury notes	145,149	N/A	145,149	—	—	—	—	—
Federal agency securities	1,190,784	N/A	—	—	1,190,784	—	—	
Medium-term notes	49,881	A	—	—	44,861	5,020	—	
Short-term commercial paper	135,874	N/A	—	54,350	81,524	—	—	
LAIF	139,156	N/A	139,156	—	—	—	—	
Subtotal city pool	1,663,942		287,403	54,350	81,524	1,235,645	5,020	—
Cash on hand	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	5,020	22,499

City's pooled investments investment type	Rating as of year-end 2006							
	Minimum legal rating	Not required to be rated	A-1+	A-1	AAA	AA-	Unrated	
Interdepartment loan (Health Savrs)	\$ 3,297	N/A	\$ 3,297	—	—	—	—	—
U.S. Treasury notes	214,467	N/A	214,467	—	—	—	—	—
Federal agency securities	1,042,876	N/A	—	—	1,042,876	—	—	
Medium-term notes	33,464	A	—	—	28,445	5,019	—	
Short-term commercial paper	132,731	N/A	—	75,773	56,958	—	—	
LAIF	2,921	N/A	2,921	—	—	—	—	
Subtotal city pool	1,429,756		220,685	75,773	56,958	1,071,321	5,019	—
Cash on hand	26,811		—	—	—	—	—	26,811
Outstanding checks	(18,043)		—	—	—	—	—	(18,043)
Total city pool	\$ 1,438,524		\$ 220,685	75,773	56,958	1,071,321	5,019	8,768

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Notes to Financial Statements

September 30, 2007 and 2006

(f) 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):

<u>Issuer</u>	<u>Investment type</u>	<u>Reported amount</u>	
		<u>2007</u>	<u>2006</u>
Federal Farm Credit Bank	Federal agency securities	\$ 89,334	181,052
Federal Home Loan Bank Federal Home Loan Mortgage Association	Federal agency securities	354,763	241,246
Federal National Mortgage Association	Federal agency securities	307,865	266,937
U.S. Treasury	Federal agency securities	438,822	353,641
Commercial paper	U.S. Treasury notes and bonds	145,149	214,467
LAIF	Unsecured corporate debt	135,874	132,731
	State pool investment	139,156	—

(g) 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, 2007, the City reported deposits of \$32,878,000 less \$10,379,000 for checks outstanding. As of September 30, 2006, the City's deposits were \$26,811,000 less \$18,043,000 for checks outstanding.

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Notes to Financial Statements

September 30, 2007 and 2006

(h) 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.

(i) Reverse Repurchase Agreements

There were no transactions involving reverse repurchase agreements during the fiscal years ended September 30, 2007 and 2006.

(j) 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, 2007 and 2006, the effect of valuating the City's investments at fair value did not have a material impact on the City's and agency's financial position.

(k) Securities Lending

The City did not engage in any securities lending programs for the fiscal years ended September 30, 2007 and 2006. Accordingly, 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) Capital Assets

Capital asset activity for the year ended September 30, 2007 was as follows:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending balance</u>
Automotive	\$ —	185,207	(103,784)	81,423
Machinery and equipment	—	256,483	(256,483)	—
Less accumulated depreciation for:				
Automotive	—	(7,475)	—	(7,475)
Total capital assets, net	<u>\$ —</u>	<u>434,215</u>	<u>(360,267)</u>	<u>73,948</u>

AIR QUALITY IMPROVEMENT FUND

City of Long Beach, California

Notes to Financial Statements

September 30, 2007 and 2006

In 2007, \$256,483 was expended for the purchase and installation of an electric charging station at the Long Beach Airport. This was later transferred to the City's Airport Fund. Also in 2007, several hybrid vehicles were purchased for \$100,000 and transferred to the City's Fleet Services Fund.

Depreciation was charged to functions/programs as follows:

Air quality mitigation	\$	7,475
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There was no capital asset activity during the year ended September 30, 2006.

(4) Due from Other Governments

The Fund receives quarterly payments from the State Department of Motor Vehicles, which represent the majority of the fund's revenue. They fluctuate depending on the amounts collected by the State Department of Motor Vehicles and the City's population. In fiscal years 2007 and 2006, the fund received between \$133,000 and \$154,000, respectively, per quarter. The final payment for fiscal year 2007 of \$150,000 was received in December 2007.

(5) Commitments and Contingencies

At September 30, 2007, commitments for the purchase of goods and services totaled \$32,000.



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**Report on Internal Control over Financial Reporting and on
Compliance with Assembly Bill 2766 (AB2766) Chapter 1705 (Health and Safety Code
Sections 44220 through 44247) and Other Matters Based on an Audit of Financial
Statements Performed in Accordance with *Government Auditing Standards***

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 governmental activities and major fund of the Air Quality Improvement Fund (the Fund), a component financial reporting unit of the City of Long Beach, California, as of and for the year ended September 30, 2007, which collectively comprise the Fund's basic financial statements and have issued our report thereon dated July 18, 2008. We conducted our audit 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing opinions on the financial statements, but not for the purpose of expressing opinions on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control over financial reporting. We consider the deficiencies described in the accompanying schedule of findings and responses as findings FS-07-01 to FS-07-03 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, including applicable provisions of Assembly Bill 2766 (AB2766) Chapter 1705 (Health and Safety Code Sections 44220 through 44247), noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and that are described in the accompanying schedule of findings and responses as finding S-07-01.

The Fund's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the Fund's responses, and accordingly, we express no opinion on them.

This report is intended solely for the information and use of management and others within the entity, and the South Coast Air Quality Management District and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

July 18, 2008

AIR QUALITY IMPROVEMENT FUND

Schedule of Findings and Responses

Year ended September 30, 2007

(1) **Findings Relating to the Financial Statements Reported in Accordance with *Government Auditing Standards***

Finding FS 07-01: Financial Reporting

Criteria

A significant deficiency in internal control is the result of a deficiency in internal control, or combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles (GAAP) such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. We believe the control deficiency described below represents a significant deficiency in internal control.

Condition and Context

The Air Quality Improvement Fund (the Fund) does not have an effective process or control in place to determine that transactions are recorded and disclosed in accordance with GAAP. During our audit and review of the financial statements of the Fund, we noted several errors in the presentation of the financial statements, which management subsequently corrected. We also noted a \$4,000 entry to properly accrue unrecorded liabilities at September 30, 2007, which management opted not to record as they deemed the error not to be material to the financial statements.

Furthermore, we identified certain non-GAAP policies currently in place. The Fund concluded that all non-GAAP policies are immaterial to the financial statements; however, management does not perform a formal evaluation on a regular basis to ensure that all non-GAAP policies are identified and do not materially misstate the financial statements.

Cause

The Fund's fiscal year 2006 financial statements were compiled and audited by an outside auditing firm. The 2006 annual reports incorrectly presented the Fund as a proprietary fund, inclusive of note disclosures describing the Fund as such. In fiscal year 2007, financial management assumed responsibility for and compiled the Fund's annual report. Financial management produced financial statements correctly presenting the Fund as a governmental fund, in accordance with applicable accounting standards. However, certain presentation errors were inadvertently made.

Effect or Potential Effect

The lack of effective control in place over the accurate reporting of transactions and evaluation of non-GAAP policies may lead to management producing financial information that does not adhere to GAAP.

AIR QUALITY IMPROVEMENT FUND

Schedule of Findings and Responses

Year ended September 30, 2007

Recommendation

We recommend that management evaluate the current process in place over the preparation of the year-end financial statements, as well as recommend that management consider the skill set, training, and time availability of the individuals performing this function. We also recommend that management consider additional levels of accountability and reviews for the timely and accurate preparation of the year-end financial statements. Furthermore, we recommend that the Fund implement formal policies and procedures to document their consideration of all non-GAAP policies at least annually to ensure that the non-GAAP policies do not materially misstate their financial statements.

Views of Responsible Officials

Financial management will continue to compile the Fund's financial statements using the format in fiscal year 2007, which include governmental fund statements (under the modified accrual basis of accounting) and entitywide statements (under the accrual basis of accounting). Financial management will review new GAAP requirements to ensure financial integrity.

Findings FS-07-02 – Lack of Information Technology Policies and Procedures

Criteria

A significant deficiency in internal control is the result of a deficiency in internal control, or combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. We believe the control deficiency described above represents a significant deficiency in internal control.

Condition and Context

The City of Long Beach, California (the City) does not have formal Information Technology (IT) security and safeguarding policies and procedures. During our audit, we noted that the City has implemented procedures to address the issues surrounding information security, such as signing a confidentiality agreement upon commencing of employment. However, policies and procedures, while in existence and in practice for many years, are not formally documented.

Additionally, the City does not have formally documented policies and procedures related to systems and application change control. Based on our audit of the Human Resources System (Tesseract), we note that the system changes do follow an informal process and programming changes are documented into the program itself; however, formal documentation of appropriate approval, testing, and user acceptance is not always obtained. Based on our audit of Financial Accounting Management Information System (FAMIS), the Fixed Asset Accounting System (FAACS), and the Advanced Purchasing and Inventory Control System (ADPICS), we note that system patches and bug fixes performed by the Financial Systems Officer in the Department of Financial Management do follow a formal process, and programming changes are documented. However, changes made by the Technology Services programmers for other changes, such as modifying custom reports, follow an informal documentation process, and appropriate approval, testing, and user acceptance are not always obtained.

AIR QUALITY IMPROVEMENT FUND

Schedule of Findings and Responses

Year ended September 30, 2007

Cause

The City has policies and procedures over its information technology security, systems, and application change management. These policies and procedures were in full practice, however, were not consolidated into formal written manual until fiscal year 2008.

Effect or Potential Effect

Lack of documented information security policies and procedures weaken the IT general control environment. With regards to change management, once a system is operational, further changes to the system are usually required to meet the business developing needs. Such changes should be subjected to control as stringent as those used in the development or implementation of a new system. If there is little or no control over system changes, the benefits originally gained by controlling the system's implementation may be lost as subsequent changes are made.

Recommendation

We recommend that management formalize the current procedures into policies and develop standard IT security and safeguarding policies, such as:

- Information Security Infrastructure Requirements
- Password-Based Access Control
- Password Protection
- Virus Protection
- Internet Web Site Control
- Standard Network System Configuration
- Network System Administration
- Application Security Administration
- Firewall and Router Security
- Transmission of Data/Encryption
- Physical/Perimeter Security and Data Center Protection

Additionally, we recommend that management develop and implement formal IT change management policies, standards, and related procedures associated with system (e.g., infrastructure and configuration change) and application change control. Management should ensure that the new developments are understood and communicated to all IT and supporting City personnel. Adequate formal change management procedures should be designed and implemented to ensure that changes to the key financial systems are made in a controlled manner. Specifically, we recommend that the following control be implemented and enforced:

- All change requests should be formally authorized and documented by appropriate management and business owner;

AIR QUALITY IMPROVEMENT FUND

Schedule of Findings and Responses

Year ended September 30, 2007

- Appropriate change management software should be utilized for the Tesseract application to support the migration of programming changes to the live environment;
- Changes that are made to the IT systems are tested, validated, and approved prior to implementation into the production environment. Test criteria should be documented and applied for all testing. This is to ensure that the changes will meet the user requirements and that the changes will not have a negative impact on any of the existing;
- User acceptance sign-off should be obtained and maintained before changes are migrated to the production environment;
- Changes made to IT systems should be validated after promotion to production to confirm that the change did not impact the system functionality or data integrity and that unauthorized changes were not inadvertently or intentionally promoted;
- Access to migrate changes into production should be segregated from the responsibilities of program development. Only a limited number of personnel should have access to migrate changes to the production environment to ensure that this process is well controlled and only tested, authorized, and properly approved changes are migrated into production;
- Change procedures also be applied to both system and application configuration settings (e.g., tolerance setting such as check authorization limits; three-way match; work flow flags to escalate for approval; and system configuration on hardware). Configuration settings are a key component of many information systems. Configuration settings frequently can impact the design and/or operating effectiveness of internal control over financial reporting;
- Emergency change provisions and control are outlined to ensure that changes requiring immediate implementation are properly handled, allowing for timely change and no impact to systems and applications related to the financial reporting process; and
- Finally, we recommend that documentation of the activities above be maintained to strengthen the overall IT general control environment.

We recommend that these policies be formally communicated throughout the organization to users supporting and maintaining information systems and technology and are accessible and understandable to all persons. This ensures that management sets a clear direction and demonstrates support and commitment to information security through the issuance and maintenance of an information security policy. We recommend an annual review and update of the IT policies and procedures occur to integrate any new system, technology, and process improvements.

Views of Responsible Officials

In fiscal year 2008, the City's Technology Services Department formalized its various security procedures in a comprehensive information technology security policy to guide those supporting and maintaining information systems, as well as those using the systems. This security policy was approved by the City Manager on April 22, 2008. Also in fiscal year 2008, the City's Technology Services department formalized its various change management policies in a comprehensive information technology change management policy to guide those supporting and maintaining the City's software applications.

AIR QUALITY IMPROVEMENT FUND

Schedule of Findings and Responses

Year ended September 30, 2007

The City's formal policies and procedures ensure the proper safeguarding of:

- Information Security Infrastructure Requirements
- Password-Based Access Control
- Password Protection
- Virus Protection
- Internet Web Site Control
- Standard Network System Configuration
- Network System Administration
- Application Security Administration
- Firewall and Router Security
- Transmission of Data/Encryption
- Physical/Perimeter Security and Data Center Protection

Findings FS-07-03 – Administrative Access – Inappropriate Administrative Access and Lack of Review over Appropriateness of User Access and Segregation of Duties within Certain Applications

Criteria

A significant deficiency in internal control is the result of a deficiency in internal control, or combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. We believe the control deficiency described above represents a significant deficiency in internal control.

Condition and Context

We noted several programmers have SCLM access to promote changes to production causing a segregation of duties conflict. Access to SCLM should be limited to two to three individuals independent of any programming responsibilities. Furthermore, management does not currently have control in place to periodically review and document the appropriateness of user access to the related applications, administrative access to Active Directory, Resource Access Control Facility (RACF), and SCLM.

Cause

Technology Services' current level of application support staff has precluded segregation of duties between the test and production environments within the SCLM application. Since SCLM is a tool that is not utilized for the City's primary financial systems (FAMIS, ADPICS, BPREP, FAACS), the lack of segregation of duties within the SCLM does not pose a significant internal control risk.

AIR QUALITY IMPROVEMENT FUND

Schedule of Findings and Responses

Year ended September 30, 2007

Effect or Potential Effect

Weaknesses in user access control may lead to situations where an employee has the ability to perpetrate an error or irregularity and to conceal the error or irregularity. Additionally, a lack of adequate security over user access in the business systems and improper segregation of duties can potentially expose the City to a variety of risks resulting from unauthorized manipulation of data as well as an unauthorized exercise of system functions.

Recommendation

We recommend that administrative access be restricted to users within the IT Department with a specific job need. Users with administrative access, making programming changes, and promoting those changes into production should be segregated. Periodic review of users with access to certain applications helps prevent unauthorized access. We recommend that the City implement a formal review, similar to the established procedures performed on the FAMIS system of administrative access to supporting applications, including Active Directory, SCLM, and RACF. Additionally, management should include the Data Center as part of the annual review or review data center access more frequently based on the rate of turnover. This review should be performed at least annually to ensure that inappropriate system access is detected and remediated. Similar to the FAMIS procedures, this review should be performed in conjunction with the IT Department and business owners. Evidence of review by business owners and the IT department should be documented, signed and dated, and maintained for audit purposes.

Views of Responsible Officials

The Technology Services Department applications support programming staff that have administrative access to systems use the access so they can move programming changes into the production environment. A policy change has been made to this process to require the Technology Services Operation's staff to make all moves into Production. New procedures for the operations organization have been developed. This is part of a larger change management control process that is being developed, which, at a high level, will include the following:

- Procedures that define the type of documentation needed for system changes;
- Approval required to process system changes;
- Appropriate testing (QA and User), and proof of testing;
- Appropriate signoff for each change prior to putting into production;
- Requirements for an internal TSD system that will track all change requests;
- Communication plan to business partners within the City notifying them of the internal change management system; and
- Deployment of the Process to all systems maintained by TSD.

AIR QUALITY IMPROVEMENT FUND

Schedule of Findings and Responses

Year ended September 30, 2007

(2) Summary of Current Year Findings and Responses Relating to AB2766 Subvention Fund

Finding S 07-01: Reporting Requirements

Criteria

California Assembly Bill No. 2766, Section 1. Chapter 7 District Fees to Implement The California Clean Air Act, Section 44244.1 requires (a) any agency which receives fee revenues pursuant to Section 44243 or 44244 shall, at least once every two years, be subject to an audit of each program or project funded. The audit shall be conducted by an independent auditor selected by the south coast district in accordance with Division 2 (commencing with Section 1100) of the Public Contract Code. The district shall deduct any audit costs which will be incurred pursuant to this section prior to distributing fee revenues to cities, counties, or other agencies pursuant to Sections 44243 and 44244.

Implementation of AB2766 Subvention Fund Projects: A Resource Guide for Local Government Recipients of Motor Vehicle Registration Fee Revenues Fiscal Year 2007/2008. Financial Administration. 12. Audit of AB2766 Fee Revenues. The Audit Guidelines describe the financial and program reporting requirements for local governments. The AB2766 program legislation requires that each agency receiving motor vehicle registration fee revenues must submit:

- an annual program progress report
- an annual audited financial statement of AB2766 funds

These reports must be received by the Air Quality Management District (AQMD) no later than the first Friday in February of each year.

Condition and Context

During our procedures performed over the reporting requirement, the annual program progress report and audited financial statement of AB2766 funds were not filed with South Coast Air Quality Management District (SCAQMD) by February 1, 2008. No extension was filed.

Cause

Prior to fiscal year 2006, financial management did the lead sheet for the Fund's financial statement, which rolled into the City's CAFR. Historically, the City Auditor compiled and audited the financial statements. For fiscal year 2007, the responsibility of the Fund's financials became the responsibility of financial management. AB2776's requirements were not communicated to financial management until after the filing deadline.

Effect or Potential Effect

There does not appear to be adequate monitoring control in place to ensure that the required reports are submitted within the specified deadline to SCAQMD.

AIR QUALITY IMPROVEMENT FUND

Schedule of Findings and Responses

Year ended September 30, 2007

Recommendation

We recommend the City strengthen control to ensure that the annual program progress report and annual audited financial statement of AB2766 funds are submitted by first Friday in February of each year.

Views of Responsible Officials

For fiscal year 2008, financial management will comply with the AB2776 filing deadline.