

CITY OF LONG BEACH GAS ENTERPRISE FUND

Financial Statements

September 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

CITY OF LONG BEACH GAS ENTERPRISE FUND

Financial Statements
September 30, 2006 and 2005

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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
of the City of Long Beach, California
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), as of and for the years ended September 30, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the City of Long Beach (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 audits 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 City'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 to the financial statements, the financial statements of the Gas Enterprise Fund are intended to present the financial position and the changes in financial position and cash flows of only that portion of activities of the City of Long Beach that is attributable to the transactions of the City's 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, 2006 and 2005, 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 as of September 30, 2006 and 2005, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 26, 2007 on our consideration of the Gas Enterprise Funds' 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 audits.

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

KPMG LLP

June 8, 2007

CITY OF LONG BEACH GAS ENTERPRISE FUND

Statements of Revenues, Expenses, and Changes in Fund Net Assets
 Years ended September 30, 2006 and 2005
 (In thousands)

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Sale of gas (note 7)	\$ 100,305	\$ 92,103
Other service charges	<u>7,176</u>	<u>6,895</u>
Total operating revenues	<u>107,481</u>	<u>98,998</u>
Operating expenses:		
Purchase of gas (note 7)	69,643	62,673
Personal services	11,610	11,281
Customer service and general	15,166	9,813
Provision for doubtful accounts	366	341
Depreciation expense (note 4)	<u>3,242</u>	<u>3,007</u>
Total operating expenses	<u>100,027</u>	<u>87,115</u>
Operating income	<u>7,454</u>	<u>11,883</u>
Nonoperating income (expense):		
Interest income	674	562
Interest expense	(401)	(447)
Loss on disposition of property	(443)	(156)
Other income, net	<u>5,572</u>	<u>5,451</u>
Total nonoperating income	<u>5,402</u>	<u>5,410</u>
Net income before transfers	12,856	17,293
Transfers to other City departments (note 6)	<u>(17,001)</u>	<u>(15,497)</u>
Change in net assets	(4,145)	1,795
Total net assets, beginning of year	<u>67,855</u>	<u>66,060</u>
Total net assets, end of year	<u>\$ 63,710</u>	<u>\$ 67,855</u>

See accompanying notes to financial statements.

CITY OF LONG BEACH GAS ENTERPRISE FUND

Statements of Cash Flows
Years ended September 30, 2006 and 2005
(In thousands)

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Cash received from customers	\$ 107,558	\$ 97,598
Cash paid to employees	(11,385)	(11,112)
Cash paid to suppliers	<u>(83,631)</u>	<u>(68,266)</u>
Net cash provided by operating activities	<u>12,542</u>	<u>18,219</u>
Cash flows used in noncapital financing activities:		
Transfer to other City Departments	(17,001)	(15,497)
Other income	<u>5,572</u>	<u>5,451</u>
Net cash used in noncapital financing activities	<u>(11,429)</u>	<u>(10,046)</u>
Cash flows from capital and related financing activities:		
Payment of defeased bonds	-	(7,560)
Proceeds from other funds under capital lease receivable	663	633
Payments for capital acquisitions	(10,396)	(5,624)
Principal repayments of long term debt	(885)	(945)
Interest paid	(393)	(517)
Proceeds from issuance of long term obligation	<u>7,755</u>	<u>7,675</u>
Net cash used in capital and related financing activities	<u>(3,256)</u>	<u>(6,338)</u>
Cash flows from investing activities:		
Payments for investments	114	304
Interest income	<u>674</u>	<u>562</u>
Net cash provided by investing activities	<u>788</u>	<u>866</u>
Net decrease in cash and cash equivalents	(1,355)	2,701
Cash and cash equivalents, beginning of year	<u>16,260</u>	<u>13,559</u>
Cash and cash equivalents, end of year	<u>\$ 14,905</u>	<u>\$ 16,260</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	<u>\$ 7,454</u>	<u>\$ 11,883</u>
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	3,242	3,007
(Increase) decrease in customer accounts receivable, net	383	(1,247)
(Increase) decrease in inventory	(12)	179
Increase in accounts payable	1,336	4,175
Increase in accrued wages payable	47	20
Increase in due to City of Long Beach	32	16
Increase in deferred revenues	182	193
Decrease in customer deposits	<u>(122)</u>	<u>(7)</u>
Total adjustments	<u>5,088</u>	<u>6,336</u>
Net cash provided by operating activities	<u>\$ 12,542</u>	<u>\$ 18,219</u>

See accompanying notes to financial statements.

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements
September 30, 2006 and 2005

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

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

(a) *General*

The Long Beach Gas Department was established in 1924 under a provision of the City Charter of the City of Long Beach (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 approximately more than 140,000 commercial and residential customers. Natural gas rates are established by the City Council and are based on prevailing natural gas rates.

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 1,900 miles of gas pipeline infrastructure.

In October 1998, the Long Beach City Council approved the direct pass-through of 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 Long Beach Gas 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 & Oil.

(b) *Reporting Entity*

The Gas Enterprise Fund is part of the overall financial reporting entity of the City of Long Beach. 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.

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements
September 30, 2006 and 2005

(c) **Implementation of New Accounting Pronouncements**

For the fiscal year ended September 30, 2006, the Gas Enterprise Fund adopted new accounting standards in order to conform to the following Governmental Accounting Standards Board (GASB) Statements:

GASB Statement No. 42 Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This Statement also clarifies and establishes accounting requirements for insurance recoveries.

GASB Statement No. 46 Net Assets Restricted by Enabling Legislation addresses selected issues and amends GASB Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments. The Statement enhances the usefulness and comparability of net asset information and clarifies the meaning of legal enforceability. The Statement also specified accounting and financial reporting requirements for restricted net assets.

GASB Statement No. 47 Accounting for Termination Benefits provides accounting guidance for state and local governmental employers regarding benefits (such as early-retirement incentives and severance benefits) provided to employees that are terminated. The Statement requires recognition of the cost of involuntary termination benefits in the period in which a government becomes obligated to provide benefits to terminated employees.

(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 Governmental Accounting Standards Board. The City of Long Beach and, by consequence, the Gas Enterprise Fund also has 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 nonoperative 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 or virtually complete.

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements

September 30, 2006 and 2005

(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, 2006 and 2005, respectively, is stated at fair value. The value of each investment is based on independent third party pricing provided to the City of Long Beach (see note 2).

(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 refundable 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, which is reserved for capital projects, are likewise recorded as restricted assets.

(h) *Capital Assets*

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 (see note 4).

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements

September 30, 2006 and 2005

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 of Long Beach. 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*

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 act 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.

Contribution requirements of plan members and the City are established and maybe amended by CalPERS. Effective October 1, 2004, the City contribution payments to CalPERS Miscellaneous Plans are at 11.325% plus the employee rate of 9% and 8%. Miscellaneous employees paid 2% to CalPERS, that when added to the 6% paid by the City makes up the 8% employee rate, which was effective March 4, 2006. Management employees pay 1% of the 8% to CalPERS and the City pays 7%. Effective in fiscal year 2007, all miscellaneous employees in tier one and tier two will pay 2% of the 8%. Miscellaneous employees in tier three will pay 2% of the 7% employee rate.

In fiscal year 2006, the Gas Enterprise Fund's contributions to CalPERS were \$1,477,458, which were equal to the annual required contributions. Further information regarding the City's participation in PERS may be found in the City's Comprehensive Annual Financial Report (CAFR).

(k) *Use of Estimates*

The preparation of financial statements in conformity with United States 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.

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements

September 30, 2006 and 2005

(2) Pooled Cash and Cash Equivalents

As of September 30, 2006 and 2005, the Gas Enterprise Fund's pooled cash and cash equivalents amounted to \$14,905,000 and \$16,260,000, respectively, which represented 1.036% and 1.22%, respectively, of the City's cash management pool of \$1,438,522,000 and \$1,330,217,000, respectively. Cash and Investments as of September 30, 2006 are classified in the accompanying statements of net assets as follows (in thousands):

	(In thousands)	
	2006	2005
Pooled cash and cash equivalents	\$14,905	\$16,260
Non-pooled cash and investment	\$650	\$764
Total cash and investments	\$15,555	\$17,024

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 trustees that 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 *	None	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

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* Maximum maturity of five (5) years unless a longer maturity is approved by the City Council, either specifically or as part of an investment program, at least three (3) months prior to purchase.

CITY OF LONG BEACH GAS ENTERPRISE FUND

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Investments Authorized by Debt Agreements

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

Disclosures Relating to 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 maturity evenly over time as necessary to provide cash flow and liquidity needed 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, 2006 (in thousands):

Investment Type	2006		2005	
		Weighted Average Maturity (in years)		Weighted Average Maturity (in years)
Inter-Department Loan (Health Savrs)	\$3,297	12.600	-	0.000
Bonds Issued by the City	-	0.000	\$3,502	13.570
U.S. Treasury Notes	214,467	1.542	275,731	1.990
U.S. Treasury Bonds	-	-	10,513	0.030
Federal agency securities	1,042,876	1.572	858,461	1.310
Medium-Term Notes	33,464	1.609	95,404	0.840
Money Market Funds	-	0.000	34	0.000
Short-term Commercial Paper	132,731	0.013	-	0.000
Local Agency Investment Fund (LAIF)	2,920	0.003	94,981	0.490
Subtotal City Pool	\$1,429,755		\$1,338,626	
Cash on Hand	26,811		11,499	
Outstanding Checks	(18,044)		(19,908)	
Total City Pool	\$1,438,522		\$1,330,217	

The Gas Enterprise Fund's non-pooled investments consists of guaranteed investment contracts held by the bond trustee and amounted to \$650,000 and \$764,000 at September 30, 2006 and 2005, respectively. These guaranteed investment contracts do not have stated maturity dates.

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, 2006.

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements

September 30, 2006 and 2005

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):

Rating as of Fiscal Year 2006								
City Pooled Investment		Minimum Legal Rating	Not Required To Be Rated	A-1+	A-1	AAA	AA-	Unrated
Inter-Department 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	N/A	-	-	-	28,445	5,019	-
Short-term Commercial Paper	132,731	A	-	75,773	56,958	-	-	-
Local Agency Investment Fund (LAIF)	2,920	N/A	2,920	-	-	-	-	-
Subtotal City Pool	1,429,755		220,684	75,773	56,958	1,071,321	5,019	-
Cash on Hand	26,811		-	-	-	-	-	26,811
Outstanding Checks	(18,044)		-	-	-	-	-	(18,044)
	<u>\$ 1,438,522</u>		<u>\$ 220,684</u>	<u>\$ 75,773</u>	<u>\$ 56,958</u>	<u>\$ 1,071,321</u>	<u>\$ 5,019</u>	<u>\$ 8,767</u>

Rating as of Fiscal Year 2006								
Non-Pooled Investment		Minimum Legal Rating	Not Required To Be Rated	AAA	Aa	Aa	A	Unrated
Guaranteed Investment Contracts	\$ 650	N/A	\$ 650	\$ -	\$ -	\$ -	\$ -	\$ -
Total held by Bond Trustees	<u>\$ 650</u>		<u>\$ 650</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Rating as of Fiscal Year 2005								
City Pooled Investment		Minimum Legal Rating	Not Required To Be Rated	AAA	Aa	A	Unrated	
Bonds issued by the City	\$ 3,502	N/A	\$ 3,502	\$ -	\$ -	\$ -	\$ -	-
U.S. Treasury Notes	275,731	N/A	275,731	-	-	-	-	-
U.S. Treasury Bonds	10,513	N/A	10,513	-	-	-	-	-
Federal agency securities	858,461	N/A	-	858,461	-	-	-	-
Medium-Term Notes	95,404	A	-	71,783	5,018	18,603	-	-
Money Market Funds	34	N/A	34	-	-	-	-	-
Local Agency Investment Fund (LAIF)	94,981	N/A	-	-	-	-	-	94,981
Subtotal City Pool	1,338,626		289,780	930,244	5,018	18,603	-	94,981
Cash on Hand	11,499		-	-	-	-	-	11,499
Outstanding Checks	(19,908)		-	-	-	-	-	(19,908)
	<u>\$ 1,330,217</u>		<u>\$ 289,780</u>	<u>\$ 930,244</u>	<u>\$ 5,018</u>	<u>\$ 18,603</u>	<u>\$ -</u>	<u>\$ 86,572</u>

Rating as of Fiscal Year 2005								
Non-Pooled Investment		Minimum Legal Rating	Not Required To Be Rated	AAA	Aa	A	Unrated	
Guaranteed Investment Contracts	\$ 764	N/A	\$ 764	\$ -	\$ -	\$ -	\$ -	-
Total held by Bond Trustees	<u>\$ 764</u>		<u>\$ 764</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

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Notes to Financial Statements
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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	City Pooled Investment Type	Reported Amount	
		2006	2005
FFCB Total	Federal Agency Securities	\$ 181,052	\$ 194,999
FHLB Total	Federal Agency Securities	241,246	204,151
FHLMC Total	Federal Agency Securities	266,937	216,462
FNMA Total	Federal Agency Securities	353,641	237,814
U.S. Treasuries	U.S. Treasury Notes & Bonds	214,467	-
Commercial Paper	Unsecured Corporate Debt	132,731	-

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 governmental units by pledging securities in an undivided collateral pool held by a depository regulated under 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 City 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 Local Agency Investment Fund.

As of September 30, 2006, the City reports cash deposits of \$26,811,475, less \$18,043,998 for checks outstanding.

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements
September 30, 2006 and 2005

Investment in State Investment Pool

The City is a voluntary participant in the Local Agency Investment Fund (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 accompanying 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.

GASB 31

GASB 31 requires that certain investments and external investment pools be reported at fair value. At September 30, 2006 and 2005, the effect of valuating the City's investments at fair value did not have material impact on its financial position.

Securities Lending

The City did not engage in any securities lending programs for the fiscal year ended September 30, 2006. However, from time to time, the City engages in limited securities-lending activities. These activities are governed by formal agreements with the City's contract bank. These agreements limit the nature and amount of the transactions, and provide 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 Tidelands Enterprise Fund. Under 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 (see note 5).

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements

September 30, 2006 and 2005

(4) Capital Assets

Activity in capital assets for the years ended September 30, 2006 and 2005 are as follows (in thousands):

	Fiscal Year 2006			Balance, September 30, 2006
	Balance, October 1, 2005	Increase	Decrease	
Capital assets, not being depreciated:				
Land	\$ 203	\$ -	\$ -	\$ 203
Construction in progress	3,680	5,196	(3,680)	5,196
Total capital assets not being depreciated	<u>3,883</u>	<u>5,196</u>	<u>(3,680)</u>	<u>5,399</u>
Capital assets being depreciated:				
Buildings and improvements	5,676	-	(34)	5,642
Distribution systems	113,876	8,840	(2,745)	119,971
Storage structures	318	-	-	318
Machinery and equipment	2,019	39	(118)	1,940
Total capital assets being depreciated	<u>121,889</u>	<u>8,879</u>	<u>(2,897)</u>	<u>127,871</u>
Less accumulated depreciation:				
Buildings and improvements	(3,202)	(132)	6	(3,328)
Distribution systems	(62,322)	(3,007)	2,351	(62,978)
Storage structures	(223)	(7)	-	(230)
Machinery and equipment	(1,464)	(96)	100	(1,460)
Total accumulated depreciation	<u>(67,211)</u>	<u>(3,242)</u>	<u>2,457</u>	<u>(67,996)</u>
Total capital assets being depreciated, net	<u>54,678</u>	<u>5,637</u>	<u>(440)</u>	<u>59,875</u>
Total	<u>\$ 58,561</u>	<u>\$10,833</u>	<u>\$ (4,120)</u>	<u>\$ 65,274</u>

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements

September 30, 2006 and 2005

	Fiscal Year 2005			
	Balance, October 1, 2004	Increase	Decrease	Balance, September 30, 2005
Capital assets, not being depreciated:				
Land	\$ 203	\$ -	\$ -	\$ 203
Construction in progress	2,126	3,680	(2,126)	3,680
Total capital assets not being depreciated	<u>2,329</u>	<u>3,680</u>	<u>(2,126)</u>	<u>3,883</u>
Capital assets being depreciated:				
Buildings and improvements	5,551	125	-	5,676
Distribution systems	110,637	3,914	(675)	113,876
Storage structures	318	-	-	318
Machinery and equipment	1,998	31	(10)	2,019
Total capital assets being depreciated	<u>118,504</u>	<u>4,070</u>	<u>(685)</u>	<u>121,889</u>
Less accumulated depreciation:				
Buildings and improvements	(3,075)	(127)	-	(3,202)
Distribution systems	(60,134)	(2,713)	525	(62,322)
Storage structures	(217)	(6)	-	(223)
Machinery and equipment	(1,306)	(161)	3	(1,464)
Total accumulated depreciation	<u>(64,732)</u>	<u>(3,007)</u>	<u>528</u>	<u>(67,211)</u>
Total capital assets being depreciated, net	<u>53,772</u>	<u>1,063</u>	<u>(157)</u>	<u>54,678</u>
Total	<u>\$ 56,101</u>	<u>\$ 4,743</u>	<u>\$ (2,283)</u>	<u>\$ 58,561</u>

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements
September 30, 2006 and 2005

(5) Long-Term Debt

Long-term debt activities for the 2006 and 2005 fiscal years is as follows (in thousands):

	Fiscal Year 2006			Balance, September 30, 2006
	Balance, October 1, 2005	Increase	Decrease	
Long-term debt:				
2005 Commercial Paper	\$ -	\$ 7,755	\$ -	\$ 7,755
2005 Gas Utility Revenue Bonds	7,385	-	(885)	6,500
Current portion of long-term debt, due within one year	(885)	(905)	885	(905)
Unamortized discount	(35)	-	4	(31)
Unamortized issuance cost	(83)	-	7	(76)
Net long-term debt	<u>\$ 6,382</u>	<u>\$ 6,850</u>	<u>\$ 11</u>	<u>\$ 13,243</u>

	Fiscal Year 2005			Balance, September 30, 2005
	Balance, October 1, 2004	Increase	Decrease	
Long-term debt:				
1993 Gas Utility Revenue Bonds	\$ 8,215	\$ -	\$ (8,215)	\$ -
2005 Gas Utility Revenue Bonds	-	7,675	(290)	7,385
Current portion of long-term debt, due within one year	(655)	(885)	655	(885)
Unamortized discount	(104)	(35)	104	(35)
Unamortized issuance cost	(83)	(83)	83	(83)
Net long-term debt	<u>\$ 7,373</u>	<u>\$ 6,672</u>	<u>\$ (7,663)</u>	<u>6,382</u>

In December 2005, the Gas Enterprise Fund initially issued \$3,945,000 of City's subordinate Gas Utility Revenue Commercial Paper Notes. As of September 30, 2006, \$7,755,000 in commercial paper notes has been issued and has had interest rates ranging from 3.01% to 3.60% since its issuance. The Commercial Paper Notes, Series A and B (taxable) was authorized in an aggregate principal amount not to exceed \$35,000,000. The program termination date is July 1, 2020 unless earlier terminated 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 refinance the Commercial Paper Notes on a long-term basis by renewal of the Commercial Paper Notes and future issuance of revenue bonds.

The Gas Utility Revenue Bond, Series 2005 bonds are payable through August 1, 2013 with a total debt service in the amount of \$7,196,010. The 2005 Bonds have interest rates ranging from 2.0% to 3.125%.

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements
September 30, 2006 and 2005

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

	<u>Annual debt service requirements</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Fiscal year ending September 30:			
2007	\$905,000	\$169,329	\$1,074,329
2008	925,000	149,192	1,074,192
2009	940,000	127,546	1,067,546
2010	970,000	103,719	1,073,719
2011	990,000	77,756	1,067,756
2012 - 2013	1,770,000	68,469	1,838,469
Totals	<u>\$ 6,500,000</u>	<u>\$ 696,010</u>	<u>\$ 7,196,010</u>

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 year ended September 30, 2006 and 2005.

(6) Transfers to Other City Departments

Transfers consist of the following as of September 30, 2006 and 2005 (in thousands):

	<u>2006</u>	<u>2005</u>
Transfers to:		
General Fund	<u>\$ 17,001</u>	<u>\$ 15,497</u>
Total transfers	<u>\$ 17,001</u>	<u>\$ 15,497</u>

(7) Gas Rates

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

The contract for full gas supply requirements was renewed with Coral Energy effective April 1, 2006 through March 31, 2009, which provides gas for a price that is competitive with surrounding utilities. This contract has a price ceiling cap of \$10.50 per decatherm, which offers protection against swings in market prices during the winter months of November through February. There is a price floor cap of \$5.50 per decatherm during all months of the year. Additionally, the price paid to local gas supplies is equal to the Southern California Gas Company's Core Procurement Price.

CITY OF LONG BEACH GAS ENTERPRISE FUND

Notes to Financial Statements
September 30, 2006 and 2005

(8) 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.