



Date: July 26, 2010
To: Honorable Mayor and City Councilmembers
From: Laura L. Doud, City Auditor *ld*
Subject: Tidelands Operating Fund Transfer – Recommended Charter Revision

In response to recent discussions of the Charter Amendment Committee regarding the annual transfer from the Harbor Department to the City's Tidelands Operating Fund (TOF), I would like to bring to your attention a provision of the City Charter that warrants change.

Currently, City Charter section 1209.c.4 states that the transfer "shall not exceed ten percent of the net income of the Harbor Department as shown on the most recent available independently audited financial statements..." As of 2002, resulting from an industry-wide accounting change, the term "Net Income" is no longer used in governmental accounting. Therefore, the Harbor began substituting "Increase in Net Assets" as the base for calculating the transfer.

Increase in Net Assets reflects all of the Harbor's revenues and expenses within any given year. As demonstrated in Attachment 1, items such as depreciation and amortization expense, non-operating income and expense, capital grants, and the prior year TOF transfer are included in Increase in Net Assets, thus impacting the transfer. As we have seen in recent discussions of the matter, this "all-inclusive" approach raises many questions and creates ambiguity surrounding the appropriateness of the transfer base.

A more straightforward approach would be to use gross revenues to calculate the transfer rather than Increase in Net Assets. Specifically, gross revenues would be defined as the Harbor's Gross Operating Revenues as shown on the independently audited financial statements. While Gross Operating Revenues is influenced by various economic factors, it does represent a more transparent view of the Harbor's performance and allows for the transfer to be calculated under objective and unambiguous terms. By employing Gross Operating Revenues in the calculation, discretionary costs that can vary widely from year-to-year are eliminated from the transaction. This would provide City staff with a more reliable base to forecast and project future transfers, thus resulting in a more effective budgeting process for the TOF.

Provided below are examples from two other cities that have non-reimbursement transfers based on a percentage of an operating result.

- City of Anaheim – The Electric and Water Utility Funds are required by the City Charter to transfer an amount equal to 4% of total operating revenues to the City's General Fund.

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- Los Angeles Department of Water and Power – The Water and Power Revenue Funds are required by the City Charter to transfer a percentage of the previous years operating revenues to the City's General Fund. In FY 2009, the transfer rate was 8%.

I recommend that you consider submitting to the voters, a revision in the Charter language that would require Gross Operating Revenues as the base used to calculate the Harbor's transfer to the TOF. I also recommend taking into consideration the fiscal needs of the TOF and modifying the percentage on which the transfer is calculated from 3% to 5% of Gross Operating Revenues. For comparison purposes, Attachment 2 illustrates a five-year trend analysis of the transfer calculated as 3%, 4%, and 5% of Gross Operating Revenues in addition to the transfer based on ten percent of the Increase in Net Assets, as is currently the case.

If the Increase in Net Assets is retained as the base for calculation of the transfer, I recommend revising the Charter language from Net Income to Increase in Net Assets and identify the specific non-operating items, as scheduled in Attachment 1, to be included or excluded from the calculation.

Please do not hesitate to contact me at (562) 570-6767 should you have any questions or concerns.

Cc: Patrick H. West, City Manager
Lori Ann Farrell, Director of Financial Management
Robert Shannon, City Attorney

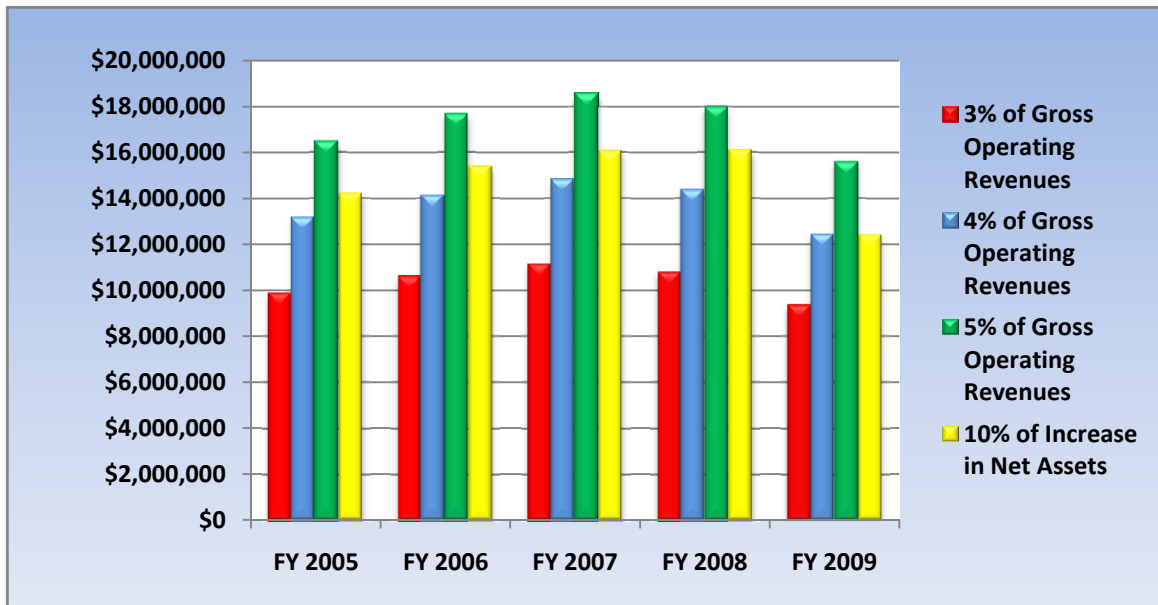
Attachments:

- (1) Components Currently Used in the Calculation to Arrive at the Base
- (2) Comparison of Transfer Based on Various Percentages

Attachment 1
Components Currently Used in the Calculation
to Arrive at the Base

Increase in Net Assets		FY 2009
Total Harbor operating revenues	\$	311,351,582
Operating expenses before depreciation and amortization		(97,880,226)
Depreciation and amortization		(85,857,712)
Nonoperating income (expense)		3,771,253
Capital grants		11,439,537
Operating transfers to City		(2,503,404)
Transfers to the TOF		<u>(16,083,972)</u>
Increase in Net Assets (Base)		124,237,058
Ten percent transfer rate		10%
Future transfer due to TOF	\$	12,423,706

Attachment 2
Comparison of Transfer Based on
Various Percentages
FY 2005 - FY 2009



FY	Total Gross Operating Revenue	3% of Gross Operating Revenues	4% of Gross Operating Revenues	5% of Gross Operating Revenues	10% of Increase in Net Assets
2005	\$ 329,207,462	\$ 9,876,224	\$ 13,168,298	\$ 16,460,373	\$ 14,222,184
2006	\$ 353,294,477	\$ 10,598,834	\$ 14,131,779	\$ 17,664,724	\$ 15,399,535
2007	\$ 370,831,933	\$ 11,124,958	\$ 14,833,277	\$ 18,541,597	\$ 16,059,464
2008	\$ 359,344,133	\$ 10,780,324	\$ 14,373,765	\$ 17,967,207	\$ 16,083,972
2009	\$ 311,351,582	\$ 9,340,547	\$ 12,454,063	\$ 15,567,579	\$ 12,423,706