

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

**A FINANCIAL REVIEW OF
THE CITY OF IMPERIAL BEACH**



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Kurt R. Sjoberg
Acting Auditor General

March 28, 1990

C-959

Honorable Elihu M. Harris, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 2148
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents a report prepared under contract by Ernst & Young concerning the City of Imperial Beach's fiscal operations and financial condition.

Respectfully submitted,

A handwritten signature in black ink that reads "Kurt Sjoberg".

KURT R. SJOBERG
Acting Auditor General

**A Report to the State of California
Office of the Auditor General**

**Financial Review of the
City of Imperial Beach**

March 1990

**Ernst & Young
in association with
Macias and Pierini**

TABLE OF CONTENTS

	<u>Page</u>
EXECUTIVE SUMMARY	1
Background	1
Future Economic Condition	1
Recommendations	2
Financial Reporting Conditions	3
INTRODUCTION	4
General Information About the City of Imperial Beach	4
Background	4
Scope of Work	5
THE CITY OF IMPERIAL BEACH'S ECONOMIC CONDITION	7
The City of Imperial Beach's Current Financial Condition -- Scenario 1	7
The City's Plan To Transfer Its Tidelands to the San Diego Unified Port District -- Scenario 2	8
The City Has Requested a \$4.5 Million State Loan -- Scenario 3	9
The Impact of Transferring the Tidelands and Receiving a State Loan - Scenario 4	10
Other Plans for Revenue Enhancements	11
Cost Containment	13
Conclusions	14
Recommendations	15
FINANCIAL REPORTING CONDITIONS	16
Management Letters	16
Financial Reporting	17
Other Issues	18
Conclusions	19
THE CITY OF IMPERIAL BEACH'S RESPONSE TO THE REPORT	21

INDEX TO EXHIBITS

<u>Exhibit Number</u>		<u>Follows Page</u>
1	No Major Revenue Enhancements (Scenario 1)	8
2	Transfer of Tidelands (Scenario 2)	8
3A	State Loan -- Repayment in 3 Years (Scenario 3a)	9
3B	State Loan -- Repayment in 5 Years (Scenario 3b)	9
4A	Transfer of Tidelands and State Loan -- Repayment in 3 Years (Scenario 4a)	10
4B	Transfer of Tidelands and State Loan -- Repayment in 5 Years (Scenario 4b)	10

I. EXECUTIVE SUMMARY

This report presents the results of a review of the fiscal operations and financial condition of the City of Imperial Beach (City). The California Auditor General retained Ernst & Young and subcontractor Macias and Pierini to conduct the review.

A. BACKGROUND

During the past several years, the City has experienced financial difficulties. For example, general fund expenditures have exceeded general fund revenues -- in fiscal year 1987-88, general fund expenditures were \$6.8 million while general fund revenues amounted to only \$4 million. The City transferred monies from other funds and used reserves to make up for the shortfalls. In addition, the City's independent financial auditors identified several internal accounting control weaknesses.

B. FUTURE ECONOMIC CONDITION

To address the City's financial situation, the newly hired city manager developed a long-term financial plan which identified several revenue enhancement and cost containment measures. Also, the City prepared a 15-year financial forecast which included actions presented in the long-term plan. Using that forecast, we developed the following scenarios to estimate the City's financial situation:

- No major revenue enhancements;
- Transfer of the City's tidelands to the San Diego Unified Port District;
- \$4.5 million loan from the State of California with two different state loan repayment scenarios: repayment due by June 30, 1994 (a three-year payback schedule) and repayment due by June 30, 1996 (a five-year payback schedule);
- Transfer of the City's tidelands to the Port District and a \$4.5 million loan from the State.

Results of the scenarios were:

- Without significant additional revenue sources, the City's general fund will be in a deficit position at the end of fiscal year 1989-90 and will deplete its cash reserves around January 1992.

- Transfer of the tidelands would help the City avoid insolvency in the long-term. Under this scenario, which assumes transfer of the tidelands in fiscal year 1990-91, the City's general fund would experience a deficit through fiscal year 1991-92. In subsequent years, the general fund would show positive fund balances.
- A State loan, without other significant revenue enhancement measures, would exacerbate the city's financial situation. It is unlikely that the City would be able to repay the loan.
- The City's financial condition would improve substantially if the tidelands were transferred to the port district and the city received a loan from the state. Assuming the city would receive the loan at the beginning of fiscal year 1990-91, the city would experience large fund balances in 1990-91 and 1991-92. These fund balances would gradually decline to a modest positive fund balance at the end of the loan payback schedule.

C. RECOMMENDATIONS

The following presents our recommendations to the City to improve its economic situation:

- Continue to work towards transferring the tidelands to the Port District;
- Pursue revenue enhancements in areas such as user fees, development impact fees (AB 1600 fees), business license and transient occupancy taxes;
- Seek economic development and redevelopment opportunities to expand the City's tax base whenever possible;
- Work with federal agencies to obtain federal land for city use;
- Explore the possibility of obtaining sales tax revenue generated from military commissary operations within city limits;
- Continue to make improvements in financial reporting and budgeting and seek additional methods for containing expenditures.

D. FINANCIAL REPORTING CONDITIONS

From 1986 through 1988, the City's independent auditors identified several internal accounting control weaknesses. More specifically, these problems included:

- Improper preparation of budgets;
- Improper management of the self-insurance fund;
- Inconsistent account classification;
- Lack of timely bank reconcilations.

Since 1988, the City has taken steps to significantly improve its financial management and operations. In 1989, the City hired a new city manager and director of administrative services. Changes implemented by the new staff include:

- Preparation of monthly financial management reports presented to the City Council;
- Conversion to a new accounting system;
- Simplification of the City's chart of accounts;
- Implementation of independent auditor's recommendations to improve internal accounting controls; and
- Development of realistic and restrained operating budgets.

II. INTRODUCTION

In the fall of 1989, the Joint Legislative Audit Committee approved a request for the California Auditor General to conduct a review of the fiscal operations and financial condition of the City of Imperial Beach (City). The requested audit was to review and evaluate the City's plans for revenue enhancements and cost containment. The Auditor General retained Ernst & Young and subcontractor Macias and Pierini, to perform the review of the city. This report represents the results of the review.

A. GENERAL INFORMATION ABOUT THE CITY OF IMPERIAL BEACH

Located in southwest San Diego County, the City of Imperial Beach is five miles from the Mexican border and eleven miles from downtown San Diego. It covers 4.4 square miles and its population is about 26,000. The City claims to have the last undeveloped beach in Southern California.

Imperial Beach is a general law city incorporated in 1956. It operates under a council/manager form of government. For the fiscal year 1989-90, the City's budget is \$10 million and includes 49 full-time positions. The largest City department is the fire department with 13 full-time positions.

The City contracts with other public and private sector organizations for most of its major services. Besides the city-run fire and sewer departments, the City contracts with the San Diego County Sheriff's Department for police services and with a private contractor for refuse collection.

B. BACKGROUND

The City has experienced financial difficulties during the past several years. In each fiscal year during the period 1985-86 through 1988-89, the general fund expenditures exceeded the general fund revenues. The largest annual general fund deficit occurred during the 1987-88 fiscal year where expenditures totalled approximately \$6.8 million and revenues amounted to about \$4 million. The City transferred monies from other funds and used reserves to compensate for the shortfall.

In addition, the City's independent financial auditors described several internal accounting control weaknesses in management letters issued for the fiscal years 1985-86 through 1987-88. The major weaknesses included budgetary procedures and miscoding of transactions.

In the first quarter of 1989, the City hired a new city

manager and a new director of administrative services. The new administration has developed and implemented various policies and procedures to correct many of the City's accounting control problems. The management letter for the fiscal year 1988-89 reflects a dramatic improvement in the City's accounting control and administrative practices. These improvements are demonstrated by a 70 percent reduction in auditing fees from fiscal year 1987-88 to fiscal year 1988-89.

The new city administration has developed a long-term strategic plan to remedy the city's financial difficulties. Several revenue enhancement and cost containment measures are identified in the plan. Additionally, the City has prepared a 15-year financial forecast that takes into account actions presented in the long-term strategic plan. The plan is a working document prepared by city staff and, currently, does not have official city council approval.

C. SCOPE OF WORK

The purpose of the review is to verify and develop information related to the fiscal operations and financial condition of the the City of Imperial Beach. In addition, we were asked to determine the potential fiscal impact of a \$4.5 million loan from the State and other revenue enhancement plans being pursued by the City. Our review included the following tasks:

- Reviewing the financial statements and management letters for the fiscal years 1985-86 through 1988-89;
- Reviewing the City's long-term strategic plan and financial forecasts;
- Evaluation of the City's short- and long-term plans and measures to improve the financial condition of Imperial Beach; and
- Determine the financial impact of the transfer of the City's tidelands to the Port of San Diego and a \$4.5 million state loan.

Our overall approach for conducting this review consisted of:

- Gathering data from meetings with various city representatives and the city's financial auditors;
- Reviewing the financial statements, budgets, staff reports, proposed legislation, and other pertinent documents;
- Analyzing historical financial data; and

- Reviewing the long-range revenue and expenditure forecasts prepared by the City.

III. THE CITY OF IMPERIAL BEACH'S ECONOMIC CONDITION

The new city management has developed a long-term plan to help the city improve its economic future. This plan includes revenue enhancement activities and cost reduction efforts. Many of the revenue enhancement activities are related to proposed development projects and are not certain to happen. Based on the major revenue activities that will most likely come to fruition, we developed a number of scenarios to illustrate the fiscal impact on the City's financial condition. These scenarios include:

- No major revenue enhancements;
- Transfer of the City's tidelands to the San Diego Unified Port District;
- \$4.5 million loan from the State of California;
- Two different state loan repayment scenarios: repayment due by June 30, 1994 (a three-year payback schedule), and repayment due by June 30, 1996 (a five-year payback schedule);
- Transfer of the City's tidelands to the San Diego Unified Port District and a \$4.5 million loan from the State of California with a three-year and five-year payback schedule.

As part of this review, we requested that the City prepare a 15-year financial forecast of its revenues and expenditures. We used the estimates included in the forecast to consider the impact on the City of the various scenarios over the next six fiscal years. Our analyses include the following assumptions: a loan from the State of California would be received in a lump sum at the beginning of fiscal year 1990-91; the interest rate on a state loan would be 8 percent; interest would accrue on monies held by the city at 6 percent; long-term development and other revenue enhancement plans would begin to be realized during the 1995-96 fiscal year and would provide an additional \$577,000 in revenues; and during the six-year period covered by the analyses, the City would maintain the existing level of services.

A. THE CITY OF IMPERIAL BEACH'S CURRENT FINANCIAL CONDITION -- SCENARIO 1

Under the City's current financial situation, the City's general fund will expend \$147,000 more than it will receive during the 1989-90 fiscal year and will end the year with an \$83,000 deficit. Moreover, the City projects that its combined cash balances will be exhausted by January 1992 unless the City obtains

significant revenue enhancements. Without cash in the city treasury, the city treasurer would have to register the City's warrants issued to pay its obligations during 1992. At this point, the City would be technically insolvent; that is, if the City was a business, it would be bankrupt. Further, the City has no reserves for economic uncertainty, has underfunded its self-insurance fund, and has transferred monies from other funds to meet its general fund obligations.

The City began fiscal year 1989-90 with approximately \$64,000 of unreserved monies in the general fund. Although it plans to transfer \$350,000 into the general fund from other funds during the year, the transfer will not compensate for its deficit spending and the City estimates it will end the year with a negative balance of \$84,000. If this pattern of spending more revenue than it receives continues, the general fund deficit would grow, as indicated in Exhibit 1 on the next page.

While it is not sound fiscal practice to transfer in monies from solvent funds to compensate funds operating with a deficit, the City has been supplementing the general fund with monies from the enterprise funds. (At the end of 1988-89, the enterprise funds had unreserved balances of over \$1.6 million.) In addition, the general fund has been reimbursed from capital projects funds for capital project expenditures made through the general fund.

Furthermore, the City's self-insurance reserves are underfunded and it has not funded its equity reserve account for insurance claims. The City plans to contribute \$500,000 to a Joint Powers Authority for self-insurance during fiscal year 1990-91. This contribution will further deteriorate their general fund position.

B. THE CITY'S PLAN TO TRANSFER ITS TIDELANDS TO THE SAN DIEGO UNIFIED PORT DISTRICT -- SCENARIO 2

Over the past several years, the City has considered transferring tidelands along its beach to the San Diego Unified Port District (Port District). Recently, the City of Imperial Beach City Council approved, in principle, the transfer of the tidelands to the Port District. If the Legislature passes Senate Bill 1796, and if it is signed into law, the City will transfer its tidelands to the Port District.

According to City estimates, the transfer of the tidelands would provide additional revenues to the City equal to its expenses in support of the pier, beach, and public services. The City estimates that for the fiscal year 1990-91, the Port District would reimburse the City approximately \$850,000 for expenses related to the tidelands. Currently, these services are provided by the City and are paid through the general fund.

CITY OF IMPERIAL BEACH
REVENUE AND EXPENDITURE ESTIMATES

EXHIBIT 1: NO MAJOR REVENUE ENHANCEMENTS

	FISCAL YEARS						
	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
General Fund							
Beginning Balance	64,000	(83,000)	(1,399,000)	(2,391,000)	(3,525,000)	(4,948,000)	(6,452,000)
Revenues:							
Basic	4,558,000	4,656,000	4,796,000	4,988,000	5,237,000	5,499,000	5,774,000
Port District	0	0	0	0	0	0	0
Development	0	0	0	0	0	0	577,000
State Loan	0	0	0	0	0	0	0
Transfer - Other Funds	350,000	0	0	0	0	0	0
Interst Earnings	0	0	0	0	0	0	0
Total Revenues	4,908,000	4,656,000	4,796,000	4,988,000	5,237,000	5,499,000	6,351,000
Total Available	4,972,000	4,573,000	3,397,000	2,597,000	1,712,000	551,000	(101,000)
Expenditures:							
Basic	3,973,000	4,211,000	4,464,000	4,732,000	5,200,000	5,470,000	5,798,000
Port District	1,082,000	1,261,000	1,324,000	1,390,000	1,460,000	1,533,000	1,610,000
Self-Insurance Fund	0	500,000	0	0	0	0	0
State Loan Payment	0	0	0	0	0	0	0
Principal	0	0	0	0	0	0	0
Interest	0	0	0	0	0	0	0
Inc. in Svc Level	0	0	0	0	0	0	0
Total Expenditures	5,055,000	5,972,000	5,788,000	6,122,000	6,660,000	7,003,000	7,408,000
Ending Balance	(83,000)	(1,399,000)	(2,391,000)	(3,525,000)	(4,948,000)	(6,452,000)	(7,509,000)

Notes: Interest earnings is estimated using a 6% annual interest rate.
The City would be required to register warrants during fiscal year 1991-92 due to a cash shortage.

CITY OF IMPERIAL BEACH
REVENUE AND EXPENDITURE ESTIMATES

EXHIBIT 2: TRANSFER OF TIDELANDS

	FISCAL YEARS						
	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
General Fund							
Beginning Balance	64,000	(83,000)	(138,000)	194,000	451,680	508,050	565,842
Revenues:							
Basic	4,558,000	4,656,000	4,796,000	4,988,000	5,237,000	5,499,000	5,774,000
Port District	0	1,261,000	1,324,000	1,390,000	1,460,000	1,533,000	1,610,000
Development	0	0	0	0	0	0	577,000
State Loan	0	0	0	0	0	0	0
Transfer - Other Funds	350,000	0	0	0	0	0	0
Interest Earnings	0	0	0	1,680	19,370	28,792	32,217
Total Revenues	4,908,000	5,917,000	6,120,000	6,379,680	6,716,370	7,060,792	7,993,217
Total Available	4,972,000	5,834,000	5,982,000	6,573,680	7,168,050	7,568,842	8,559,059
Expenditures:							
Basic	3,973,000	4,211,000	4,464,000	4,732,000	5,200,000	5,470,000	5,798,000
Port District	1,082,000	1,261,000	1,324,000	1,390,000	1,460,000	1,533,000	1,610,000
Self-Insurance Fund	0	500,000	0	0	0	0	0
State Loan Payment	0	0	0	0	0	0	0
Principal	0	0	0	0	0	0	0
Interest	0	0	0	0	0	0	0
Inc. in Svc Level	0	0	0	0	0	0	0
Total Expenditures	5,055,000	5,972,000	5,788,000	6,122,000	6,660,000	7,003,000	7,408,000
Ending Balance	(83,000)	(138,000)	194,000	451,680	508,050	565,842	1,151,059

Note: Interest earnings is estimated using a 6% annual interest rate.

In addition, the transfer of the tidelands would relieve the City of the approximately \$350,000 in annual debt service payments for certificates of participation supporting the pier reconstruction. The final payments on the certificates are due in 2008. Further, the transfer would remove the operating liability of the pier from the City's general fund. The City estimates that it would realize approximately \$1.2 million during the 1990-91 fiscal year if SB 1796 is signed into law.

As reflected in the fiscal impact analysis in Exhibit 2 (presented on the prior page), if the tidelands are transferred and the City receives the expected reimbursements from the Port District, the City's financial situation would change drastically. Although the City predicts unbalanced budgets through the fiscal year 1990-91, the City projects that it would end its deficit spending in the years following and would be operating with a positive general fund balance. Given that the general fund balances will grow at a slow rate, the City may be able to improve or increase its service level gradually over the following years.

**C. THE CITY HAS REQUESTED A \$4.5 MILLION STATE LOAN --
SCENARIO 3**

The City has requested a \$4.5 million loan from the State of California. Senate Bill 1864 has been introduced and provides for a \$4.5 million loan to the city at the Pooled Money Investment Account interest rate. Provisions of the bill require that the City repay the loan by June 30, 1994.

The City plans to use the loan to fund its operating deficit and to enter into a Joint Powers Authority self-insurance pool. Exhibit 3a (see following page) provides general fund revenues and expenditure estimates assuming the City receives the State loan in fiscal year 1990-91 at an eight percent interest rate. With loan repayment due by June 30, 1994, the City proposes to make the first of three principal payments in fiscal year 1991-92 (three-year repayment schedule). Interest would accrue from the date the City receives the loan and would be paid annually.

As a result of this state loan, the City would experience positive ending general fund balances for the fiscal years 1990-91 and 1991-92. However, in the years following, the general fund balance would fall into a deficit position, estimated at \$2.5 million for 1992-93, and the deficit would continue to grow each year. The deficit at the end of fiscal year 1995-96 is estimated at \$8 million.

Exhibit 3b, which is presented on the page following Exhibit 3a, shows a scenario which assumes loan repayment by June 30, 1996 (a five-year loan repayment schedule). The first of five principal payments would be made during the fiscal year 1991-92 and the

CITY OF IMPERIAL BEACH
REVENUE AND EXPENDITURE ESTIMATES

EXHIBIT 3A: STATE LOAN (REPAYMENT IN 3 YEARS)

	FISCAL YEARS						
	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
General Fund							
Beginning Balance	64,000	(83,000)	2,741,000	193,481	(2,478,873)	(5,518,679)	(7,022,679)
Revenues:							
Basic	4,558,000	4,656,000	4,796,000	4,988,000	5,237,000	5,499,000	5,774,000
Port District	0	0	0	0	0	0	0
Development	0	0	0	0	0	0	577,000
State Loan	0	4,500,000	0	0	0	0	0
Transfer - Other Funds	350,000	0	0	0	0	0	0
Interest Earnings	0	0	79,740	88,034	0	0	0
Total Revenues	4,908,000	9,156,000	4,875,740	5,076,034	5,237,000	5,499,000	6,351,000
Total Available	4,972,000	9,073,000	7,616,740	5,269,515	2,758,127	(19,679)	(671,679)
Expenditures:							
Basic	3,973,000	4,211,000	4,464,000	4,732,000	5,200,000	5,470,000	5,798,000
Port District	1,082,000	1,261,000	1,324,000	1,390,000	1,460,000	1,533,000	1,610,000
Self-Insurance Fund	0	500,000	0	0	0	0	0
State Loan Payment							
Principal	0	0	1,386,151	1,497,043	1,616,806	0	0
Interest	0	360,000	249,108	129,345	0	0	0
Inc. in Svc Level	0	0	0	0	0	0	0
Total Expenditures	5,055,000	6,332,000	7,423,259	7,748,388	8,276,806	7,003,000	7,408,000
Ending Balance	(83,000)	2,741,000	193,481	(2,478,873)	(5,518,679)	(7,022,679)	(8,079,679)

Notes: Interest earnings is estimated using a 6% annual interest rate.
 Entire amount of State loan proceeds is assumed to be received by the City in 1990-91.
 Given that the City's first priority would be to provide a basic level of service, the negative ending balance in 1992-93 indicates that the City would be unable to repay the loan in that year.

CITY OF IMPERIAL BEACH
REVENUE AND EXPENDITURE ESTIMATES

EXHIBIT 38: STATE LOAN (REPAYMENT IN 5 YEARS)

	FISCAL YEARS						
	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
General Fund							
Beginning Balance	64,000	(83,000)	2,741,000	640,740	(1,507,808)	(3,974,808)	(6,450,808)
Revenues:							
Basic	4,558,000	4,656,000	4,796,000	4,988,000	5,237,000	5,499,000	5,774,000
Port District	0	0	0	0	0	0	0
Development	0	0	0	0	0	0	577,000
State Loan	0	4,500,000	0	0	0	0	0
Transfer - Other Funds	350,000	0	0	0	0	0	0
Interest Earnings	0	0	79,740	101,452	0	0	0
Total Revenues	4,908,000	9,156,000	4,875,740	5,089,452	5,237,000	5,499,000	6,351,000
Total Available	4,972,000	9,073,000	7,616,740	5,730,192	3,729,192	1,524,192	(99,808)
Expenditures:							
Basic	3,973,000	4,211,000	4,464,000	4,732,000	5,200,000	5,470,000	5,798,000
Port District	1,082,000	1,261,000	1,324,000	1,390,000	1,460,000	1,533,000	1,610,000
Self-Insurance Fund	0	500,000	0	0	0	0	0
State Loan Payment							
Principal	0	0	900,000	900,000	900,000	900,000	900,000
Interest	0	360,000	288,000	216,000	144,000	72,000	0
Inc. in Svc Level	0	0	0	0	0	0	0
Total Expenditures	5,055,000	6,332,000	6,976,000	7,238,000	7,704,000	7,975,000	8,308,000
Ending Balance	(83,000)	2,741,000	640,740	(1,507,808)	(3,974,808)	(6,450,808)	(8,407,808)

Notes: Interest earnings is estimated using a 6% annual interest rate.
 Entire amount of State loan proceeds is assumed to be received by the City in 1990-91.
 Given that the City's first priority would be to provide a basic level of service, the negative ending balances beginning in 1992-93 indicates that the City would be unable to repay the loan.

interest payments would begin in 1990-91. Similar to the results presented in Exhibit 3a, the general fund would have a positive fund balance for the fiscal years 1990-91 and 1991-92. In the following years, the general fund would reflect a negative fund balance which would continually increase and the deficit at the end of the 1995-96 fiscal year would be greater than under a three-year repayment schedule.

Under the above two scenarios, by fiscal year 1992-93 the City would experience a negative fund balance of \$1.5 million under a five-year repayment schedule and \$2.5 million under a three-year payment schedule. Without substantial revenue enhancements from other sources (not considered in this analysis), the City would be technically insolvent and may default on the loan.

D. THE IMPACT OF TRANSFERRING THE TIDELANDS AND RECEIVING A STATE LOAN -- SCENARIO 4

Based on City financial information, we have determined that without any revenue enhancements the City may be out of combined cash reserves by January 1992. The City would also have a general fund deficit exceeding \$1 million by the end of the 1990-91 fiscal year. We determined that if the city transfers its tidelands to the San Diego Unified Port District its financial situation would greatly improve, the general fund balance would be positive and would grow at a slow rate. Further, we found that a state loan without any other revenue enhancements would put the City's general fund in a deficit position ranging from \$1.5 million to \$2.5 million, depending upon the term of the loan, by fiscal year 1991-92 and the deficit would continue to grow in subsequent years.

If the City were to transfer the tidelands to the Port District and obtain a loan from the State of California, the City would experience positive fund balances in the general fund beginning in fiscal year 1990-91. In meeting the legislatively proposed repayment date of June 30, 1994, the City's general fund would reflect a \$4 million positive fund balance in fiscal year 1990-91, decreasing to approximately \$275,000 in 1994-95. Once the loan is repaid the fund balance would modestly increase in subsequent years. If the loan were to be repaid by June 30, 1996, the City would experience a \$4 million general fund balance in fiscal year 1990-91, which would decrease at a slower rate than with the three-year repayment schedule, ending with a positive fund balance of approximately \$700,000 in fiscal year 1995-96. This year is the last year of the loan payback and the City's general fund balance would modestly increase in the years thereafter. The details of these scenarios are presented as Exhibits 4a and 4b on the next two pages.

CITY OF IMPERIAL BEACH
REVENUE AND EXPENDITURE ESTIMATES
EXHIBIT 4A: TRANSFER OF TIDELANDS AND
STATE LOAN (REPAY IN 3 YEARS)

	FISCAL YEARS						
	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
General Fund							
Beginning Balance	64,000	(83,000)	4,002,000	2,702,462	1,530,251	194,232	274,967
Revenues:							
Basic	4,558,000	4,656,000	4,796,000	4,988,000	5,237,000	5,499,000	5,774,000
Port District	0	1,261,000	1,324,000	1,390,000	1,460,000	1,533,000	1,610,000
Development	0	0	0	0	0	0	577,000
State Loan		4,500,000					
Transfer - Other Funds	350,000	0	0	0	0	0	0
Interest Earnings	0	0	117,570	201,134	126,981	51,734	14,076
Total Revenues	4,908,000	10,417,000	6,237,570	6,579,134	6,823,981	7,083,734	7,975,076
Total Available	4,972,000	10,334,000	10,239,570	9,281,596	8,354,232	7,277,967	8,250,043
Expenditures:							
Basic	3,973,000	4,211,000	4,464,000	4,732,000	5,200,000	5,470,000	5,798,000
Port District	1,082,000	1,261,000	1,324,000	1,390,000	1,460,000	1,533,000	1,610,000
Self-Insurance Fund	0	500,000	0	0	0	0	0
State Loan Payment							
Principal	0	0	1,500,000	1,500,000	1,500,000	0	0
Interest	0	360,000	249,108	129,345	0	0	0
Inc. in Svc Level	0	0	0	0	0	0	0
Total Expenditures	5,055,000	6,332,000	7,537,108	7,751,345	8,160,000	7,003,000	7,408,000
Ending Balance	(83,000)	4,002,000	2,702,462	1,530,251	194,232	274,967	842,043

Notes: Interest earnings is estimated using a 6% annual interest rate.
 Entire amount of State loan proceeds is assumed to be received by the City in 1990-91.
 Given that the City's first priority would be to provide a basic level of service, the modest ending balances in 1993-94 and 1994-95 indicates that the City may have difficulty repaying the loan in those years.

CITY OF IMPERIAL BEACH
REVENUE AND EXPENDITURE ESTIMATES

EXHIBIT 48: TRANSFER OF TIDELANDS AND
STATE LOAN (REPAY IN 5 YEARS)

	FISCAL YEARS						
	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
General Fund	64,000	(83,000)	4,002,000	3,263,570	2,621,537	1,791,090	980,469
Beginning Balance	4,558,000	4,656,000	4,796,000	4,988,000	5,237,000	5,499,000	5,774,000
Revenues:	0	1,261,000	1,324,000	1,390,000	1,460,000	1,533,000	1,610,000
Basic	0	0	0	0	0	0	577,000
Port District	0	4,500,000	0	0	0	0	0
Development	350,000	0	0	0	0	0	0
State Loan	0	0	117,570	217,967	176,553	132,379	83,147
Transfer - Other Funds	0	0	0	0	0	0	0
Interest Earnings	4,908,000	10,417,000	6,237,570	6,595,967	6,873,553	7,164,379	8,044,147
Total Revenues	4,972,000	10,334,000	10,239,570	9,859,537	9,495,090	8,955,469	9,024,616
Total Available	3,973,000	4,211,000	4,464,000	4,732,000	5,200,000	5,470,000	5,798,000
Expenditures:	1,082,000	1,261,000	1,324,000	1,390,000	1,460,000	1,533,000	1,610,000
Basic	0	500,000	0	0	0	0	0
Port District	0	0	900,000	900,000	900,000	900,000	900,000
Self-Insurance Fund	0	360,000	288,000	216,000	144,000	72,000	0
State Loan Payment	0	0	0	0	0	0	0
Principal	0	0	0	0	0	0	0
Interest	0	0	0	0	0	0	0
Inc. in Svc Level	5,055,000	6,332,000	6,976,000	7,238,000	7,704,000	7,975,000	8,308,000
Total Expenditures	(83,000)	4,002,000	3,263,570	2,621,537	1,791,090	980,469	716,616
Ending Balance							

Notes: Interest earnings is estimated using a 6% annual interest rate.
 Entire amount of State loan proceeds is assumed to be received by the City in 1990-91.
 Given that the City's first priority would be to provide a basic level of service, the modest ending balances in 1993-94 and 1994-95 indicates that the City may have difficulty repaying the loan in those years.

E. OTHER PLANS FOR REVENUE ENHANCEMENTS

In addition to potential revenues from the tidelands transfer and the state loan, the City's long-term strategic plan includes several other revenue enhancement measures. If implemented, these sources could generate substantial revenue for the City. The following describes the significant revenue enhancement measures and estimates the fiscal impact to the City.

1. Economic Development

The long-term strategic plan states that the City needs to take steps to strengthen its current relationship with the business community and needs to develop a plan to attract more businesses into the City. The plan indicates that the City should focus its economic development efforts on areas that have received little attention in the past. For example, the City should concentrate its efforts on developing the 13th Street corridor as a business corridor to generate additional sales and property tax revenues. The plan also suggests revamping current ordinances that tend to force business out of Imperial Beach.

However, the City's long-term plan does not specifically identify economic development plans for the beach area. The fifteen-year financial forecast prepared by the City assumes that 500 new hotel/motel units would be developed along the beach and in other parts of the city by the fiscal year 1999-2000. The City estimates that the projected development would generate significant new property, sales, and transient occupancy tax revenues from \$575,000 in 1996-97 to \$1.75 million in 1999-2000.

2. Tax Increases

The City plans to propose business license and transient occupancy tax increases to the voters in June 1990. If approved, the City estimates additional annual revenues of approximately \$90,000, at the current level of businesses and hotel/motel rooms. If the City implements the economic development plans as described above, tax revenues would increase accordingly. In November 1989, the voters defeated the City's proposed utility tax increase. Based on consumption, this utility users tax would have yielded additional revenues of \$450,000 annually.

3. Fees

The City believes that the current user fees do not cover

the full cost of providing certain city services. It estimates that the current fees cover only about half of the cost of providing these services and believes that the fees should cover the entire cost. However, the City lacks a cost accounting system and indicates that it would require outside assistance in conducting the cost allocation/user fee study necessary to determine the total costs of providing the services and determining the new fee levels. The City indicates that it does not have the resources available to pay for the study.

In an effort to increase user fee revenues, the City has recently implemented a fire inspection fee, generating approximately \$9,000 per year. The City has also created a system for collecting developer fees, providing approximately \$40,000 annual revenue.

Over the past several years, a growing trend has developed among local governments to levy fees on development in order to fund capital facilities related to growth. State legislation governs the calculation and levy of these fees. For example, the agency levying the fees must identify the purpose and use, that is, the specific facilities or improvements, to be funded with these fees. In addition, the City must segregate the fee revenue from other city revenues and can use the fees only for the identified improvements. Furthermore, the fees can only be used for expansion and upgrades of facilities and not for replacement of worn out facilities.

The City has recently adopted a sewer connection fee for improvements to the existing collection system to meet the demands placed on the system by new development. The City estimates that it will collect approximately in \$561,600 in sewer connection fees annually.

4. Other Revenue Enhancement/Cost Reduction Activities

At the time of this report, the City is attempting a number of other revenue enhancement activities. While some are confidential and not reportable at this time, others include:

- Continued efforts to establish redevelopment projects in areas throughout the city;
- Obtaining a settlement from the federal government for \$700,000 lost in a court suit over the breakwater project;

- Working with adjoining cities in development activities; and
- Joining a municipal self-insurance pool to reduce insurance costs.

F. COST CONTAINMENT

The City implemented several cost containment measures during the fiscal year. For example, it converted to a new automated financial system operated by the City of Chula Vista. The system follows Generally Accepted Accounting Principles. In addition, the City has simplified its financial statements by reducing the number of funds from 55 to 14, making the City's accounting and financial reporting less complex and easier to understand.

Further, during the fiscal year, the City has implemented a "base budget" system as their primary budget program. In order for a department to receive a larger budget than in the previous year, it must submit a supplemental request clearly justifying the increase. Both the city manager and the director of administrative services review the request. In addition, schedules within the structure of the budget have significantly improved so that the city council, city manager, and department heads can track actual revenue and expenditures in conjunction with the approved budget. This eliminates many of the past problems with the City's budgets and reporting. Now the department of administrative services presents the city council with a monthly budget to actual expenditure reports. This report along with supporting detail is provided to each city department head.

The city has suspended filling many of its vacant positions to reduce its operating costs. Salary and benefit cost savings realized by not filling these positions total about \$90,000. However, some of the salary savings are negated by the need to pay overtime and to hire contract employees to perform city services. The City also conducted a review of its service contracts and decided to reduce services related to police, ambulance, and sanitation services which results in savings of \$160,000.

Additionally, the City utilizes state prison work program inmates to perform park and right-away maintenance. By using this program, the City saves approximately \$5,000 per year. Similarly, the City uses work release and job corps volunteers for some maintenance activities; these measures achieve minor cost savings. Currently, the City has requested federal assistance through work programs to alleviate other city expenditures. It estimates that the total fiscal impact of these measures decrease costs to the city of between \$165,000 and \$255,000 per year.

G. CONCLUSIONS

Based on our review of financial and managerial information provided by the City, it appears that unless the city can obtain or generate substantial amounts of additional revenues for general fund operations, the general fund will be in a deficit position at the end of fiscal year 1989-90. Further, the City will deplete its combined cash reserves by January 1992. At this point, the City of Imperial Beach would be technically insolvent. In the short-term, the City may continue to transfer unrestricted monies from its enterprise funds for emergencies or contingent liabilities.

The City's proposal that is currently before the California Legislature which would allow the city to transfer its tidelands to the San Diego Unified Port District would greatly assist the City avoid insolvency. However, the transfer of tidelands would not remove the City from having a deficit in the general fund until the fiscal year 1991-92. In subsequent years, if the City maintains its present expenditure containment policies and does not increase its service levels, the City would experience slow growth in its general fund reserves.

It is unlikely that the City would be able to repay a \$4.5 million loan from the State of California, unless the City also transferred its tidelands to the Port District or implemented some other significant revenue enhancement measures. Our evaluation indicates, under either of the two loan repayment schedules, that the \$4.5 million loan without any other coinciding revenue enhancements, would exacerbate the City's financial difficulties once the the City began repaying the loan. It is unlikely that the City would be able to make the principal payments under this set of circumstances.

The City's immediate financial condition would dramatically improve if the City was to transfer its tidelands to the Port District and take out the loan from the State. However, the transfer of the tidelands alone would improve the City's financial condition to such an extent that it would mitigate the need for an emergency loan in the near term. The City would use the \$4.5 million loan and the Port District reimbursement revenue to fund its investment in the self-insurance pool, cover its budgeted deficit spending, finance tidelands operations and pay the principal and interest on the state loan. Under either loan repayment schedule, the City would experience large positive fund balances beginning in the 1990-91 fiscal year which would gradually decrease to a modest fund balance in fiscal year 1995-96. Once the loan is repaid, the general fund balance would slowly grow. While the City would temporarily experience large fund balances with a State loan, it would be unable to significantly increase its current service levels or make additional capital improvements because the fund balance will be needed to repay the principal and interest on the loan.

H. RECOMMENDATIONS

Presented below are recommendations for the City related to revenue enhancement and cost containment measures.

- Continue to work towards transferring the tidelands to the Port District;
- Pursue revenue enhancements in areas such as user fees, development impact fees (AB 1600 fees), business license and transient occupancy taxes;
- Seek economic development and redevelopment opportunities to expand the City's tax base whenever possible;
- Work with federal agencies to obtain federal land for city use;
- Explore the possibility of obtaining sales tax revenue generated from military commissary operations within city limits;
- Continue to seek additional methods for containing expenditures.

IV. FINANCIAL REPORTING CONDITIONS

From the mid-1980s to 1988, the City experienced significant problems in financial reporting, internal accounting controls, and budget reporting practices. These problems, in conjunction with annual losses, helped create the City's present financial hardships and conditions. We have summarized these problems into three areas:

- Management letters;
- Financial reporting; and
- Other findings.

A. MANAGEMENT LETTERS

From 1986-1988, the independent auditor's management letters to the City contained several common issues. The auditors pointed out various weaknesses within the accounting system that need to be rectified. Although none of the management comments be deemed "material" internal accounting control weaknesses, they were weaknesses that were never addressed and contributed to the City's current economic problems. Some of these problems included:

- Improper preparation of budgets;
- Improper management of the self-insurance fund;
- Inconsistent account classification;
- Lack of timely bank reconciliations;
- Lack of a purchase ordering system;
- Out-of-balance journal entries;
- Lack of standardized systems for journal entries; and
- Lack of detailed records for the general fixed asset; group of accounts.

However, the 1989 management letter showed a dramatic improvement reflecting a change in accounting management and system controls. Many of the basic internal accounting control weaknesses were eliminated. Other changes included the preparation of a practical budget and better accounting practices which is reflected in the reduced auditing fees.

B. FINANCIAL REPORTING

The annual independent financial audits show increasing operating losses since 1987. The losses were the result of the reconstruction of the pier, increased costs for services, and poor fiscal management.

Most of the increased costs result from the reconstruction of the City's pier. The construction and interest costs of the pier were not covered by grant revenues. In addition, certificates of participation for the project totalled \$2.7 million, with a twenty-year annual debt service cost of approximately \$350,000.

Costs for services have also increased because of inflation. To control these costs, the City has reduced ambulance service levels and eliminated two patrol units from its contract with the County Sheriff's Department. Additionally, tax revenues are steadily increasing, however, not as fast as rates for the City's services and its debt service obligations. Revenues from other governments have remained roughly the same over the last three years. Enterprise fund revenues have remained around \$2 million.

In many situations, annual losses could have been avoided if identified early in the fiscal year. Prompt identification could have given city management necessary reaction time to make appropriate decisions to avoid or at least mitigate some losses. Unfortunately, the auditor's management report points out that many internal accounting control weaknesses prevented the accounting department from providing important financial information in a timely fashion to the city management.

Most of the City's budgets were substantially off because the previous accounting staff prepared unrealistic budgets. The previous accounting staff also incorrectly prepared the budgets in terms of consistency and assumptions for projections. Moreover, they did not follow Generally Accepted Accounting Principles.

The City transferred large amounts of monies to the general fund from other "reserve funds" from 1986 through 1989. All were legal transfers within the laws, rules, and regulations of the City and the State of California. These transfers, primarily from the Sewer and Solid Waste Funds, provided the general fund with the additional monies necessary to enable it to remain solvent. However, the general fund received more transfers in than it transferred out which is an unsound fiscal management practice. Further, equity transfers established fund balances for the residential construction and the debt service funds.

In addition, the City did not consistently account for its transactions. Significant changes among financial statement revenue and expenditure accounts were the result of the city's inconsistent treatment when recording major transactions. These

transactions related to the reconstruction of the city pier, the recording of grants, the recording of self-insurance, and errors in posting to the accounts.

C. OTHER ISSUES

During our review we identified other issues that may affect the City's financial condition. These issues relate to the City's insurance potential reimbursements and capital improvement programs.

1. Self-Insurance Reserve

The City's self-insurance reserves are underfunded. The director of finance has indicated that the self-insurance liability may be understated as a result of recent information regarding litigation against the City. In addition, we noted that the city has not contributed to an equity reserve account for self-insurance claims. As a result, the City has no cash set aside to pay settled claims when they become due. The financial scenarios presented earlier in the report assume that the City will transfer \$500,000 from the general fund to finance this reserve or to participate in a Joint Powers Authority self-insurance pool.

2. Breakwater

The City planned to construct a breakwater which was to be funded jointly by the City and State of California. The City's contribution of \$1.3 million was matched by the State. The Army Corps of Engineers performed the engineering and design phase of the breakwater. However, the breakwater was scrapped prior to the construction phase because an improper environmental impact report of the project was prepared. In 1989, the Army Corps of Engineers reimbursed the City \$635,000 of unexpended project funds.

3. Timely Billings for Funds Owed

The City does not always bill funding sources on a timely basis and, therefore, may not receive the funds due to it as soon as these monies are available. For example, in 1987, the grant receivable balances were higher than in other years because the City did not bill the appropriate agencies on a timely basis. Specifically, the City was due to receive approximately \$284,000 from a state agency for work performed by the City on the pier plaza and \$120,000 from Housing and Urban Development for drainage work it performed on the

Seacoast Project.

4. Capital Improvement Programs

A five-year capital improvement program was presented with its 1989-90 budget. The City estimates that the total cost for the program would be \$5.5 million. The long-range plan shows the funding source for each capital project.

The Public Works Department has initiated a program for infrastructure/street maintenance. The program involves regularly scheduled inspections and maintenance.

D. CONCLUSIONS

Under the City's current financial situation, the general fund will end fiscal year 1989-90 with an \$83,000 deficit. Moreover, the city projects that its combined cash balances will be exhausted by January 1992 unless the city obtains significant revenue enhancements. Without cash in the treasury, the City would be unable to pay its obligations during 1992. At this point, the City would be technically insolvent.

We have identified four major reasons for the City's current fiscal position: weak fiscal management before 1989; reconstruction of the pier; lack of a growing tax base; and the City's practice of consistently reducing its available fund balances.

However, the City has taken positive steps which have significantly improved its management and operations. In 1989 the City hired a new city manager and director of administrative services who have implemented many changes in the fiscal operations of the city. For example, the City Council receives monthly financial management reports comparing budgeted expenditures to actual expenditures. In addition, the City has converted to a new automated accounting system, simplified its chart of accounts and implemented the independent auditor's recommendations to improve its internal accounting controls. Further, the City is projecting more realistic operating budgets and is identifying critical operating costs.



CITY OF
IMPERIAL BEACH
OFFICE OF THE CITY MANAGER
RONALD C. JACK

March 21, 1990

Mr. Kurt R. Sjoberg
Acting Auditor General
State of California
Office of the Auditor General
660 J Street - Suite 300
Sacramento, CA 95814

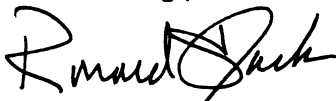
Dear Mr. Sjoberg:

Thank you for your draft copy of the report entitled "Financial Review of the City of Imperial Beach" for my review and comment. After careful review of this document, I feel that the draft report conscientiously documents the current financial problems facing the City of Imperial Beach. It is also my professional opinion that the recommendations contained on page 2 very succinctly state the options available to the City for long-term economic stability.

On behalf of the City of Imperial Beach I would like to compliment you and your staff, as well as the representatives for Ernst & Young, for the professional manner with which the study was conducted.

Please be advised that this document will be kept in confidence until such time as you have officially released the report to us.

Sincerely,



Ronald C. Jack

RCJ:plh

cc: Mayor and City Council

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps