



LAURA DOUD

February 20, 2018

HONORABLE MAYOR AND CITY COUNCIL  
City of Long Beach  
California

**RECOMMENDATION:**

Receive and file the Proposition H Audit Report for the fiscal year ending September 30, 2017.

**DISCUSSION**

Pursuant to Long Beach Municipal Code Section 3.80.227, the Office of the City Auditor is charged with conducting an annual independent financial audit of Proposition H (Prop H) funds and providing a written report to the City Council.

The City Auditor conducts annual audits of Prop H funds to identify the following: the amount of special tax revenues collected during the fiscal year (FY), the amount of special tax revenue expended on eligible costs during the fiscal year, the amount of unspent monies that were carried over into the current fiscal year, and the status of any projects and programs funded by the special tax revenues.

We determined the following as a result of our audit:

- 1) During FY 2017, the City received \$3,397,985 of Prop H revenues, a decrease of \$291,850 or 8% from the prior year;
- 2) Prop H expenditures during FY 2017 totaled \$4,172,393. Expenditures were \$645,073 or 18% more compared to the prior year, and were made for eligible costs as defined in the Municipal Code;

- 3) During FY 2017, the amount of unspent monies carried over decreased 55% from the prior fiscal year to \$626,886, which exceeds the top of the reserve policy range of \$400,000 for the fund. However, the projected carryover by the end of FY 2018 is expected to drop by 84% to (\$102,312), bringing it below the minimum of the reserve policy.
- 4) In FY 2018, the Fire Department intends to use their Prop H resources to continue funding public safety positions and Fire Academy costs. The Police Department will use funds to contribute to renovations of their pistol range and upgrades to their Telecommunication System.

Detailed information regarding these results is included in the attached report.

In conclusion, we express our appreciation to employees of the Police Department, Fire Department, and the Department of Financial Management for providing their time, information, and cooperation during the audit process.

#### TIMING CONSIDERATIONS

Action by the City Council is not time sensitive.


#### FISCAL IMPACT

Approving this action would have no fiscal impact.

#### SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,

  
LAURA L. DOUD, CPA  
CITY AUDITOR

Attachment

# Proposition H

## Police and Fire Public Safety Oil Production Act

*Generated nearly \$3.4 million in additional  
revenue for public safety in FY 2017*



*Independence you can rely on*

January 2018

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# Audit Results

**Finding 1. Prop H revenues received during FY 2017 were properly calculated based on oil producers' reports remitted to the City.**

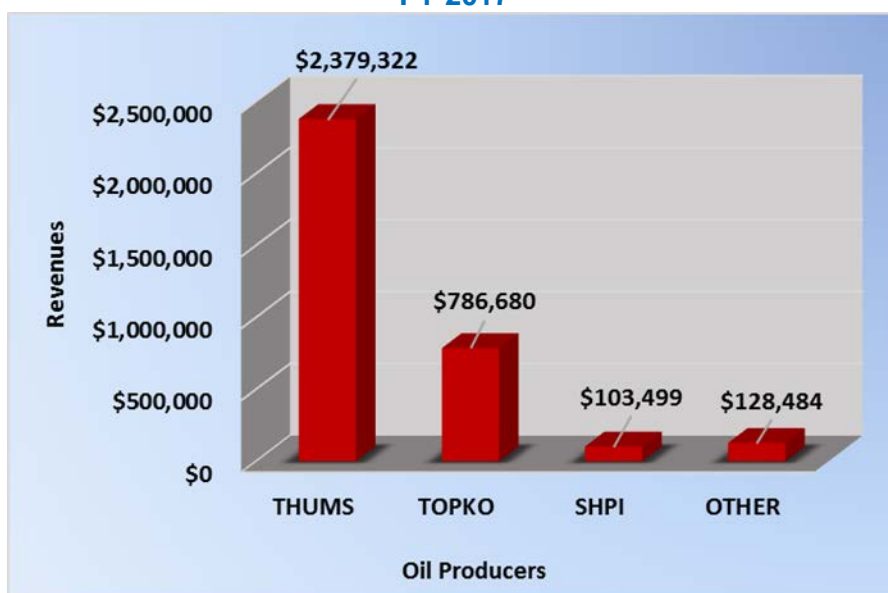
The City of Long Beach (City) received a total of \$3,397,985 of Proposition H (Prop H) oil tax revenue, including penalties and interest, during fiscal year (FY) 2017, as depicted in Table 1 below. This is a revenue decrease of 8% from the prior year. The oil tax revenue received was based on FY 2017 production reports totaling 11,588,168 barrels of oil.

**Table 1**  
**Total Tax Revenues Received**  
**FY 2017**

Oil Tax Revenue	Penalties and Interest	Total
\$3,389,248	\$8,737	\$3,397,985

We substantively tested 96% of the special tax revenues received in FY 2017 through confirmations with the oil producers and determined that funds remitted by oil producers were properly calculated based on the reports presented to the City. We also verified that revenues were recorded into the City's financial system. In addition, we reviewed revenues received to ensure that penalties were assessed on late payments when appropriate. Chart 1 is a summary of the Prop H funds received by oil producer during FY 2017.

**Chart 1**  
**Prop H Revenues Received by Oil Producer**  
**FY 2017**



The special tax revenues and penalties received were deposited into Fund 121, the Police and Fire Public Safety Oil Production Act Special Revenue Fund, as required by §3.80.225 of the Municipal Code. The revenues were divided equally between two sub-funds, one for the Police Department and one for the Fire Department.

***Finding 2. FY 2017 expenditures of Prop H funds complied with the approved uses set forth in the City's Municipal Code.***

Prop H expenditures during FY 2017 totaled \$4,172,393 and were made for eligible costs as defined in the City's Municipal Code.

**Police Department**

In FY 2017, Prop H expenses for the Police Department totaled \$2,043,420. Salaries and benefits, including workers' compensation charges, for two officers totaled \$351,421, and accounted for 17% of total expenses. Expenditures aligned with the FY 2017 budget allocation of \$250,000 to be used to support homelessness rapid response. In addition, \$1,628,684 was used to help fund Police Academy costs related to staffing for background investigators and academy instructors. The remaining Prop H expenses consisted primarily of fleet services charges and some small additional costs for data center, email, web services, and audit charges. We reviewed \$2,019,188 (99%) of Prop H Police Department expenditures and found that they complied with the approved uses as set forth in the City's Municipal Code.

**Fire Department**

The Fire Department's FY 2017 Prop H expenditures totaled \$2,128,973. Most of the expenditures, \$1,929,628, or 91%, were for salaries, benefits and workers' compensation charges for 11 positions: two Firefighter Paramedics on the Fire Department's Homelessness Education and Response Team (HEART), and nine positions on Fire Truck 17, equal to constant staffing for two daily Firefighters and one daily Fire Engineer. In total, \$250,000 was allocated towards costs associated with the HEART team, as budgeted. Additionally, \$175,000 was used to help fund the Fire Academy. The remaining Prop H Fire expenses included some small additional costs for data center, email, web services, and audit charges. We reviewed \$2,104,628 (99%) of Prop H Fire Department expenditures and found that they complied with the approved uses as set forth in the City's Municipal Code.

***Finding 3. The amount of unspent Prop H monies at the end of FY 2017 that were carried over into the current fiscal year is \$626,886.***

The Department of Financial Management (Financial Management) has a Prop H reserve policy which establishes a range of \$150,000 to \$400,000 to be available should Prop H oil production revenues decline, or for any one-time needs. Financial Management has stated that this policy is used as a general guideline, and deviations from the policy are not necessarily causes for concern. In addition, they have stated that the Prop H Fund is part of a multi-fund and multi-year

budgeting strategy; therefore, decisions regarding reserves are not made based on any one particular year.

During FY 2017, the carryover amount decreased 55% from the prior fiscal year, from \$1,401,294 to \$626,886. While this exceeds the top of the range stated in the policy, the budget for FY 2018 is set to reduce the reserve, bringing it under the range stated in the policy. The fund balance projected for the end of FY 2018 is estimated to decrease by 84% to \$102,312, as part of their multi-year budgeting plan. Lower revenue is budgeted by Financial Management based on available FY 2017 data combined with a projected decline in oil production. See Table 2 below.

**Table 2**  
**Prop H Funds Cash Flow**  
**FY 2016-2018**

	Police	Fire	Total	FY % Change
<b>FY 2016 Carryover</b>	<b>\$ 756,949</b>	<b>\$ 644,345</b>	<b>\$ 1,401,294</b>	
FY 2017 Actual Revenue	1,701,698	1,696,287	3,397,985	
FY 2017 Actual Expenditures	2,043,420	2,128,973	4,172,393	
<b>FY 2017 Carryover</b>	<b>415,227</b>	<b>211,659</b>	<b>626,886</b>	<b>-55%</b>
FY 2018 Budgeted Revenue	1,657,956	1,657,956	3,315,912	
FY 2018 Budgeted Expenditures	1,818,715	2,021,771	3,840,486	
<b>FY 2018 Projected Carryover</b>	<b>\$ 254,468</b>	<b>\$ (152,156)</b>	<b>\$ 102,312</b>	<b>-84%</b>

***Finding 4: The anticipated projects and programs funded by Prop H revenue in FY 2018 comply with the approved uses set forth in the City’s Municipal Code.***

**Anticipated Activities**

In FY 2018, the Police Department plans to contribute between \$800,000 and \$1,200,000 of Prop H revenues to fund renovations to the Police Academy’s pistol range. In addition, they will use funds to upgrade the Department’s California Law Enforcement Telecommunication System (CLETS) network, a federal and state mandated communications system used to share sensitive computerized police information through encrypted systems. The Department anticipates that the cost of the project will range from \$300,000 to \$400,000. The remaining expenses will consist of paying for interdepartmental service charges, such as data center, fleet services, and audit costs.

The Fire Department intends to continue to use Prop H revenues in FY 2018 to fund salaries and benefits, including workers’ compensation charges, to provide staffing for nine positions on Fire Truck 17. In addition, they will fund service charges from other departments as well as allocate \$175,000 to help fund Fire Academy costs.

The Departments’ anticipated activities for Prop H funds, as described above, comply with the approved uses as set forth in the City’s Municipal Code.

## **FY 2018 Budgeted Revenues and Expenditures**

For FY 2018, budgeted Prop H revenues and expenditures are \$3,315,912 and \$3,840,486, respectively, as shown in Table 2 above.



# Background

## Proposition H

The citizens of Long Beach (City) approved Proposition H (Prop H), the Police and Fire Public Safety Oil Production Act, on May 1, 2007. Prop H amended the City’s Municipal Code to assess an additional 25 cents per barrel special tax on oil producers in Long Beach, with the tax rate to be adjusted annually on June 1 based on the Consumer Price Index (CPI). The special tax became effective on June 1, 2007, and has since been adjusted as follows:

**Table 4.**  
**Prop H Tax Rates**  
**FY 2007-2017**

Effective Date	Adjustment for CPI	Amount of Special Tax
June 1, 2007	-	\$0.25
June 1, 2008	\$0.01	\$0.26
June 1, 2009	\$0.01	\$0.27
June 1, 2010	\$0.00	\$0.27
June 1, 2011	\$0.00	\$0.27
June 1, 2012	\$0.01	\$0.28
June 1, 2013	\$0.00	\$0.28
June 1, 2014	\$0.00	\$0.28
June 1, 2015	\$0.01	\$0.29
June 1, 2016	\$0.00	\$0.29
June 1, 2017	\$0.01	\$0.30

This special tax is in addition to the existing tax of 15 cents per barrel produced, and is a legally distinct tax to be used explicitly to fund public safety. Specifically, these tax proceeds may be used only for police officers, firefighters, and related costs, including but not limited to equipment, facilities, and training, to ensure responses to public safety needs.

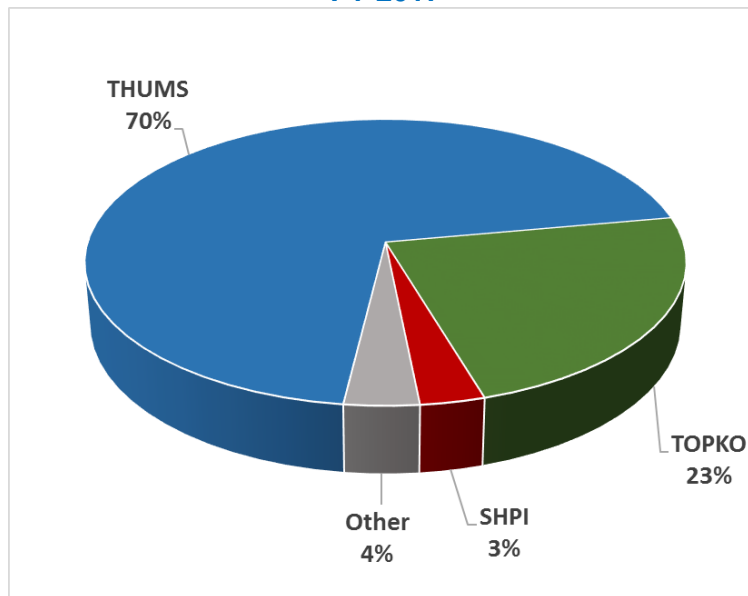
The special tax is due to the City on or before the last day of the calendar quarter. The payment is based on a production quarter, which ends one month earlier than the calendar quarter. For example, the special tax payment for the production quarter ending August 31, 2017 was due to the City on or before September 30, 2017.

Failure to pay the tax results in a penalty of 25% of the total tax on the first day of the month following the close of the calendar quarter. If the tax remains unpaid for each month thereafter, an additional 10% penalty is assessed, up to a maximum of 100% of the tax amount.

## Oil Producers

In fiscal year (FY) 2017, oil operators in Long Beach reported a total of 11,588,168 barrels of oil produced. THUMS Long Beach Company (THUMS), Tidelands Oil Production Company (TOPKO) and Signal Hill Petroleum, Inc. (SHPI) were the City's top oil producers in FY 2017. As illustrated in Chart 2, these three oil operators accounted for 96% of oil produced in FY 2017.

**Chart 2.**  
**Percentage of Barrels Produced by Oil Producer**  
**FY 2017**

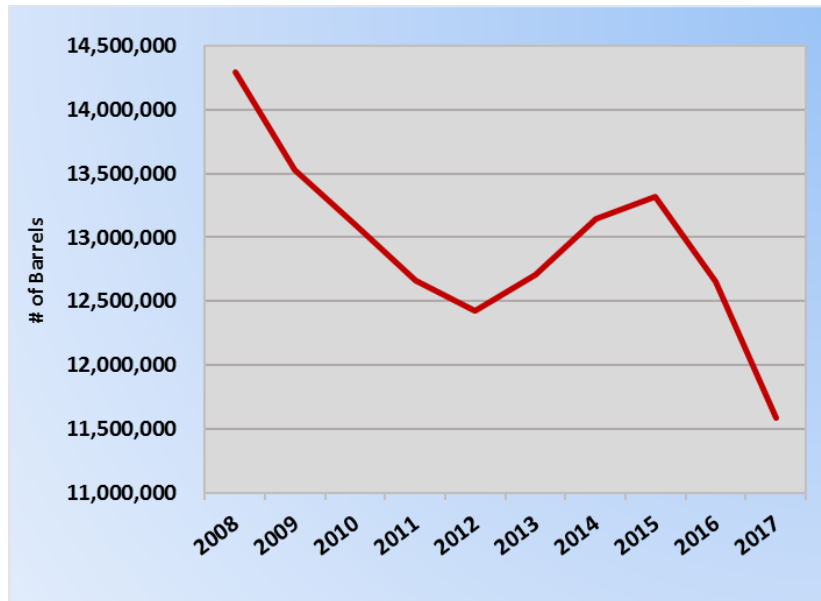


The majority of oil is produced in the Wilmington Oil Field. The Wilmington Oil Field was discovered in Long Beach in 1932 and is 13 miles long, extending from San Pedro to Seal Beach. The field is divided into two sections: West and East. TOPKO serves as the field contractor for the western section of the oil field, and THUMS serves as the field contractor for the eastern section. In FY 2017, THUMS produced 8,135,310 barrels of oil, while TOPKO produced 2,689,637 barrels of oil.

SHPI, the third largest oil producer in Long Beach, is the operator for the Signal Hill West Unit, Signal Hill East Unit, Signal Hill Bryant Lease, Signal Hill H&L Lease, Signal Hill B-302, Signal Hill LBA-1, and Signal Hill Graner Lease Oil Fields. These oil fields are located in both Long Beach and Signal Hill. In FY 2017, SHPI produced a total of 353,848 barrels of oil in Long Beach.

Since the inception of Prop H through September 30, 2017, annual oil production in Long Beach has fluctuated. Production steadily declined from FY 2008 to FY 2012, and then experienced a growth period from FY 2013 to FY 2015. In FY 2017, there was a decline of 8% from the prior year. See Chart 3 on the next page for additional details on the fluctuation in annual oil production.

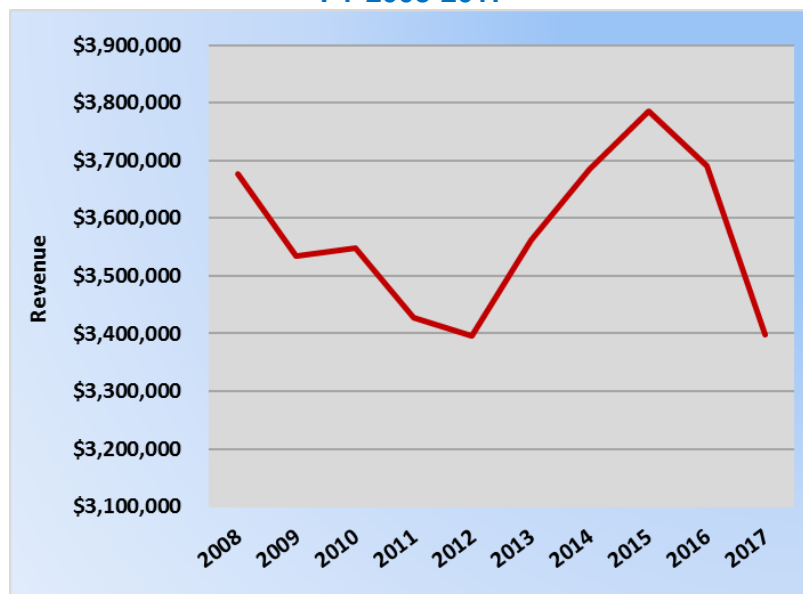
**Chart 3.**  
**Annual Oil Production**  
**FY 2008-2017**



**Prop H Revenues**

Based on the level of production shown above, Prop H revenue received by the City shows the same general fluctuations: overall decline from FY 2008 to FY 2012, increase from FY 2013 to FY 2015, and an 8% decline in FY 2017. See Chart 4 below.

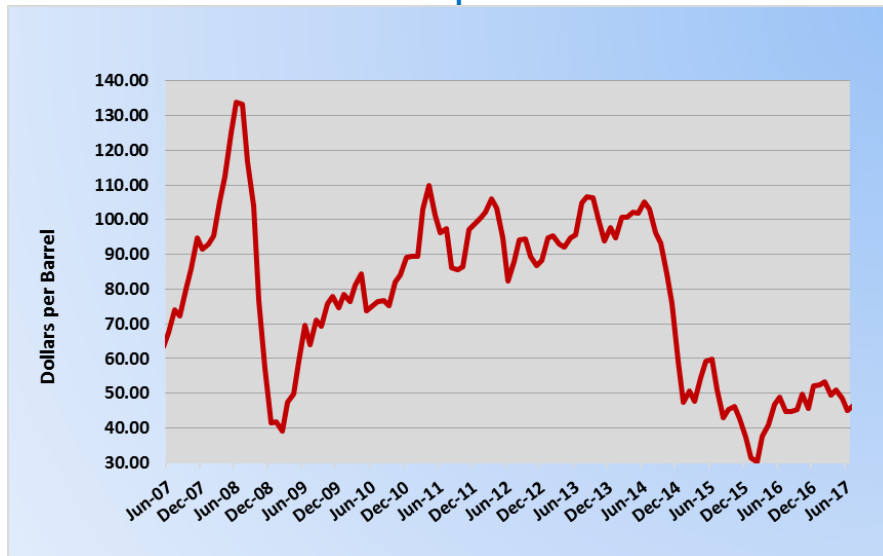
**Chart 4.**  
**Prop H Annual Revenue**  
**FY 2008-2017**



## Price of Oil

As shown in Chart 5 below, when the special oil tax became effective in June 2007, the monthly average price of oil, based on the West Texas Intermediate (WTI) crude index, was steadily rising. In June 2008, the monthly WTI average reached a high of \$133.93 per barrel. The price of crude oil declined significantly shortly thereafter with the average monthly WTI price falling to \$39.15 per barrel in February 2009, but it increased steadily thereafter. For a four-year period, between October 2010 and September 2014, the WTI monthly average price never dipped below \$80.00 per barrel, averaging \$95.81 per barrel.

**Chart 5.**  
**Price of Oil**  
**June 2007- September 2017**



However, the oil price began dropping significantly after October 2014. According to the Municipal Code, Prop H revenue will be suspended for any month in which the average WTI index is below \$20.00 per barrel. FY 2017 began with the average monthly oil price of \$49.89. The price fluctuated and dipped to a low of \$45.17 in June 2017, before rising back up to end the fiscal year at \$49.83.

## Objective, Scope & Methodology

Long Beach Municipal Code §3.80.227 requires annual independent financial audits of Prop H revenues and expenditures during each fiscal year. The four primary objectives of this audit were as follows:

1. Identify Prop H revenues received during FY 2017 and determine if funds remitted by the oil producers were properly calculated based on oil producers' reports remitted to the City;
2. Identify FY 2017 expenditures of Prop H funds and analyze whether such expenditures complied with the approved uses set forth in the Long Beach Municipal Code;
3. Determine the amount of unspent Prop H monies on deposit at September 30, 2017 that were carried over into the current fiscal year, FY 2018; and
4. Determine the status of any projects and programs funded by Prop H revenue.

The scope of our audit covers the period October 1, 2016 through September 30, 2017. We performed the following procedures during our audit:

- Obtained an understanding of internal controls surrounding the collection and recording of Prop H funds and calculated the annual change in the special tax rate based on the change in the annual average CPI.
- Obtained the Oil Production Taxes Schedule from the Financial Management Department and recalculated Prop H revenues, verified that appropriate amounts of penalties were assessed, and traced payments from checks to the City's financial system. Independently confirmed 96% of the reported oil production amounts with the oil producers for FY 2017.
- Identified the Prop H expenditures during FY 2017 and determined whether the expenditures were in accordance with the City's Municipal Code and identified the amount of unspent Prop H monies on deposit at September 30, 2017 that were carried over into the current fiscal year, FY 2018.
- Identified the Police and Fire Departments' plans to use Prop H monies in the future, and determined whether those plans are in accordance with §3.80.224 of the City's Municipal Code.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

# **Management Comments**

The Financial Management, Fire, and Police departments were in agreement with the information contained in the report and had no further comments.