



OFFICE OF THE CITY AUDITOR
Long Beach, California

LAURA L. DOUD, CPA
City Auditor

February 8, 2011

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, 2010.

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, the amount of special tax revenue expended on eligible costs during the fiscal year, the amount of unspent moneys on deposit 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 fiscal year 2010, the City received \$3,548,514 of Prop H revenues;
- 2) Prop H expenditures during the fiscal year totaled \$3,883,571. Expenditures were made for eligible costs as defined in the Municipal Code. However, since Prop H expenditures exceeded revenues received, there was a transfer from the General Fund in the amount of \$382,915 to the Prop H Fund (SR 121);
- 3) The amount of unspent monies carried over into fiscal year 2011 was \$198,138; and
- 4) Both the Police Department and the Fire Department intend to use their Prop H resources to continue funding certain designated public safety positions.

We also noted that from June 1, 2007 through September 30, 2010, quarterly oil production in Long Beach has declined 8.5%, thereby reducing the amount of special oil tax revenues to the City. Given the volatility of oil, we encourage management to continue to monitor the revenue from this special tax.

Detailed information regarding the results discussed above is included in the attached report.

HONORABLE MAYOR AND CITY COUNCIL

February 8, 2011

Page 2

In conclusion, we express our appreciation to employees of the Police Department, Fire Department and 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,

A handwritten signature in blue ink that reads "Laura L. Doud". The signature is written in a cursive, flowing style.

LAURA L. DOUD, CPA
CITY AUDITOR

Dated: January 31, 2011

Attachment



**City of Long Beach
Office of the City Auditor**

**Proposition H
Police and Fire Public Safety Oil Production Tax**
For Fiscal Year Ending September 30, 2010

Audit Report
January 31, 2011

Laura L. Doud, CPA
City Auditor

Office of the City Auditor

Audit Report

Proposition H Police and Fire Public Safety Oil Production Act

For Fiscal Year Ending September 30, 2010

January 31, 2011



Audit Staff

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TABLE OF CONTENTS

BACKGROUND	1
Proposition H	1
Oil Producers	1
Price of Oil	2
AUDIT OBJECTIVES, SCOPE AND METHODOLOGY	3
AUDIT RESULTS	5
MANAGEMENT'S COMMENTS	7

BACKGROUND

Proposition H

The citizens of Long Beach (City) approved Proposition H (Prop H), the Police and Fire Public Safety Oil Production Tax, on May 1, 2007. Prop H amended the Long Beach 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 was increased to 26 cents per barrel on June 1, 2008 to reflect the change in CPI. The special tax was also increased on June 1, 2009 to 27 cents a barrel to reflect the change in CPI. Since there was no change in the annual average of the CPI, the rate remained at 27 cents per barrels on June 1, 2010.

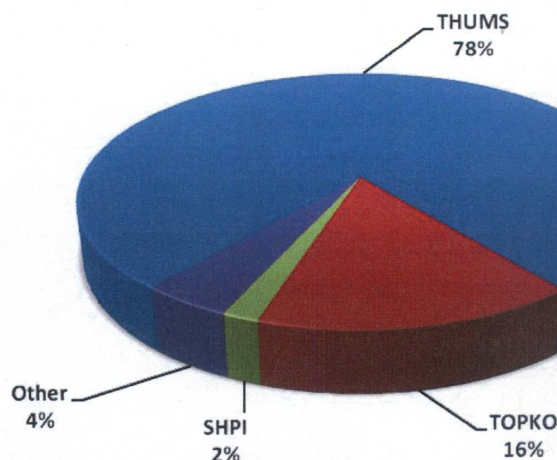
This special tax is in addition to the existing tax of 15 cents per barrel produced, and is a legally distinct tax to be used specifically to fund public safety. Specifically, these proceeds may only be used for police officers, firefighters, and related costs including, but not limited to, equipment,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

This 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, 2010 was due to the City on or before September 30, 2010.

Oil Producers

In fiscal year (FY) 2010, oil operators in Long Beach reported a total of 13,098,851 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 2010. As illustrated below, these three oil operators accounted for 96% of oil produced in FY 2010.

Percentage of Barrels Produced in FY 2010 by Oil Producer

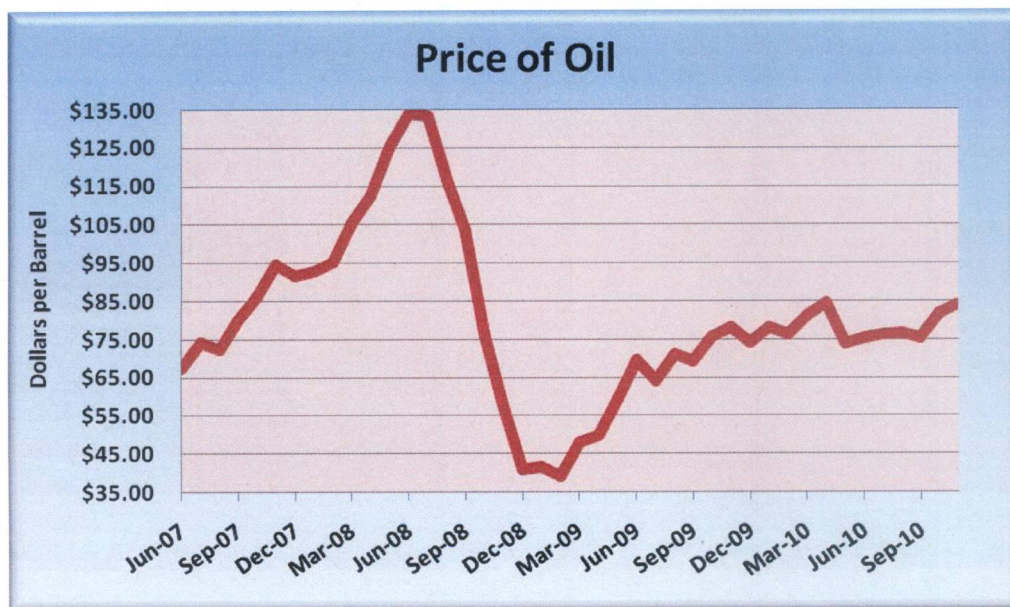


The source for the majority of the oil produced is the Wilmington Oil Field. The Wilmington Oil Field was discovered in Long Beach in 1932 and is 13 miles long, extending from San Pedro to Seal Beach. The field is divided into two sections: West and East. TOPKO serves as the field contractor for the western section of the oil field, and THUMS serves as the field contractor for the eastern section. In FY 2010, THUMS produced 10,258,529 barrels of oil, while TOPKO produced 2,027,348 barrels of oil.

SHPI, the third largest oil producer in Long Beach, is the operator for the Signal Hill West Unit and the Signal Hill East Unit Oil Fields. The oil fields are located in both Long Beach and Signal Hill. In FY 2010, SHPI produced a total of 230,941 barrels of oil in Long Beach.

Price of Oil

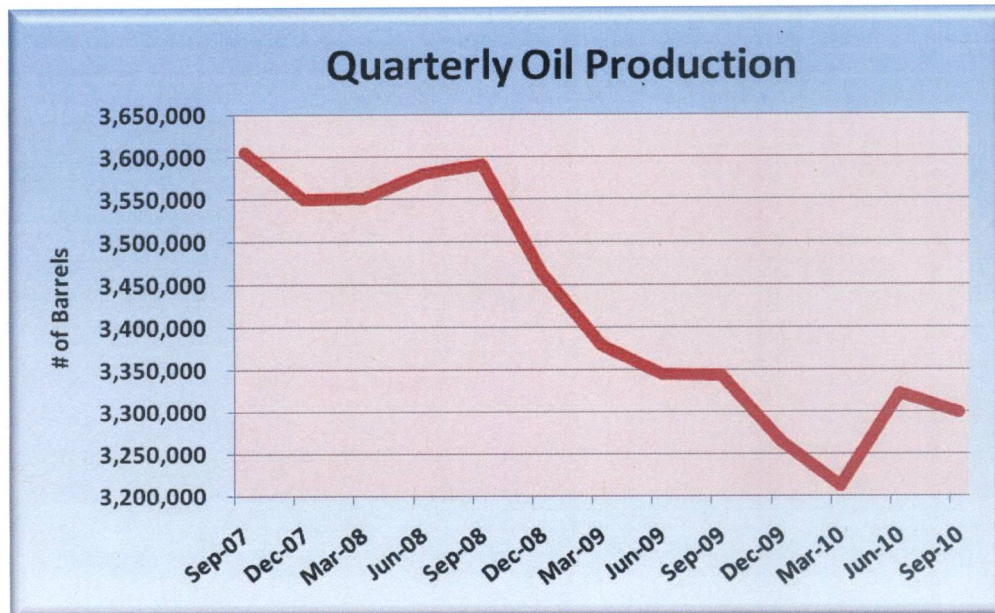
When the special oil tax became effective in June 2007, the monthly average price of oil based on the WTI (West Texas Intermediate) crude index was steadily rising. In June 2008, the monthly WTI average reached a high of \$133.93 per barrel, as shown in the chart below. However, oil prices began to decrease significantly shortly thereafter. In February 2009, the monthly WTI average fell to \$39.16 per barrel, a low not seen since June 2004.



As demonstrated in the graph above, oil prices have steadily risen since February 2009. However, it is important to note that a decline in the price of oil could impact the City in the following two ways:

1. Prop H revenue will be suspended for any months in which the WTI average is below \$20 per barrel; and
2. Oil producers might decrease production in line with a decrease in oil prices, thereby reducing Prop H revenues.

Since the inception of Prop H through September 30, 2010, quarterly oil production in Long Beach has decreased significantly, thereby reducing the amount of special oil tax revenues to the City. See the below chart for additional details on the decline in oil production in recent years.



As depicted in the graph above, oil production in the City has notably decreased. For the fourth quarter of 2007, Long Beach oil producers reported 3,605,516 barrels of oil produced. For the fourth quarter of 2010, 3,299,927 barrels of oil were reported, equating to 8.5% reduction in quarterly oil production over three years. Although oil production appeared to be on an upward trend during third fiscal quarter of 2010, production began to decline again in the subsequent quarter. Given the volatility of oil, we encourage management to continue considering the above potential impacts in their fiscal planning.

AUDIT OBJECTIVES, SCOPE AND 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 2010 and determine if funds remitted by the oil producers were properly calculated;

2. Identify FY 2010 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, 2010 that were carried-over into the current fiscal year; 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, 2009 through September 30, 2010. We performed the following procedures during our audit:

- Obtained an understanding of internal controls surrounding the collection and recording of Prop H funds.
- Calculated the annual change in the special tax rate based on the change in the annual average of CPI.
- Obtained the Oil Production Taxes Schedule from the Department of Financial Management and recalculated FY 2010 Prop H revenues.
- Identified the largest Prop H revenue sources and traced those revenues to the checks received and supporting production reports from the oil producers, and verified that all revenues were recorded into the City's financial system.
- Independently confirmed 96% of the reported oil production amounts with the oil producers for FY 2010.
- Reviewed certain significant payments received from the oil producers and determined whether appropriate penalties were assessed on late payments.
- Confirmed that the FY 2009 underpayments of revenues resulting from not increasing the oil production tax on June 1, 2009 to reflect the change in CPI were received during FY 2010.
- Identified the Prop H expenditures during FY 2010 and determined whether the expenditures were in accordance with the Long Beach Municipal Code.
- Identified the amount of unspent Prop H monies on deposit at September 30, 2010 that were carried over into the current fiscal year.
- 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 Long Beach 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.

AUDIT RESULTS

Objective 1 - Identify Prop H revenues received during FY 2010 and determine if funds remitted by the oil producers were properly calculated.

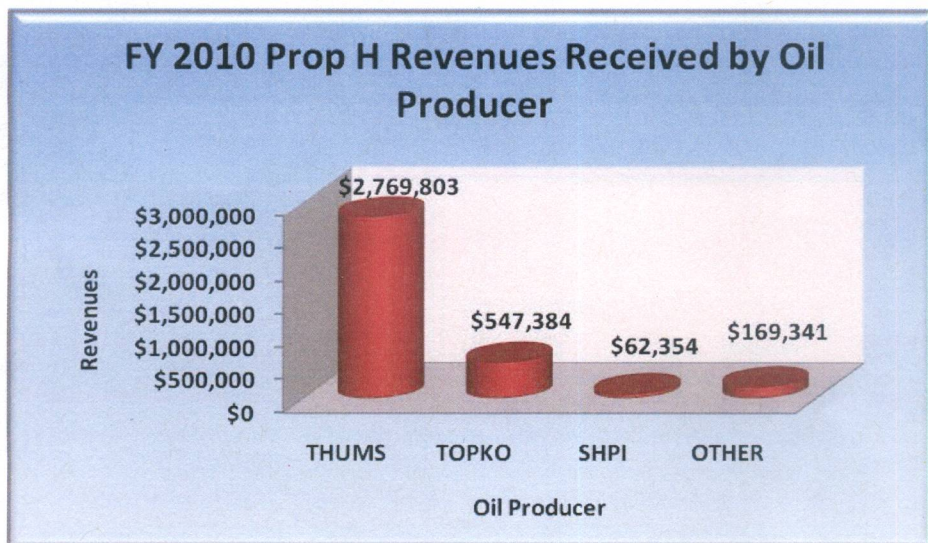
The City received a total of \$3,548,514 of Prop H special tax revenue, including penalties and interest, during FY 2010, as depicted in the table below.

Total Tax Revenues Received in FY 2010

Oil Tax Revenue	Penalties and Interest	Total
\$3,540,929	\$7,585	\$3,548,514

The special tax revenue received was based on production reports totaling 13,098,851 barrels of oil. We substantively tested 95% or \$3,379,541 of the special tax revenues received in FY 2010 through confirmations with the oil producers and determined that funds remitted by oil producers were properly calculated. We also verified that revenues were recorded into the City's financial system. In addition, we reviewed significant revenues received to ensure that penalties were assessed on late payments.

Below is a summary of the Prop H funds received from major oil producers during FY 2010.



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.

Objective 2 - Identify FY 2010 expenditures of Prop H funds and analyze whether such expenditures complied with the approved uses set forth in the Long Beach Municipal Code.

Prop H expenditures during FY 2010 totaled \$3,883,571 and were made for eligible costs as defined in the Long Beach Municipal Code. As recommended in the Prop H FY 2009 audit report and depicted in the table below, a transfer from the General Fund totaling \$382,915 was made to the Prop H fund to cover expenditures in FY 2010.

Police Department

In FY 2010, Prop H expenditures for the Police Department totaled \$1,805,068. Salaries and benefits for the fourteen¹ Prop H-funded citywide motorcycle officers totaled \$1,626,846 and accounted for 90% of total expenses. The remaining Prop H Police expenses consisted primarily of fleet services charges and some small additional costs for uniforms and equipment. We reviewed \$1,777,155 (98% of total expenditures), of salaries, benefits, and fleet expenses for the motorcycle officers and found that they complied with the approved uses as set forth in the Long Beach Municipal Code.

Fire Department

The Fire Department's FY 2010 Prop H expenditures totaled \$2,078,503. Salaries and benefits for twelve Fire Station 14 firefighters totaled \$1,944,312 and accounted for 94% of total expenses. The remaining Prop H Fire expenses consisted primarily of fleet services charges and charges from other City departments. We reviewed \$2,043,151 (98% of total expenditures), of salaries, benefits, and fleet expenses related to Truck 14 and found that they complied with the approved uses as set forth in the Long Beach Municipal Code.

Objective 3 - Determine the amount of unspent Prop H monies on deposit that were carried-over into the current fiscal year.

The table below depicts the cash flow of Prop H funds during FY 2010.

Subfund	Amount Carried Over From FY 2009	Amount Transferred In From General Fund	FY 2010 Revenues	FY 2010 Expenditures	Amount Carried Over To FY 2011
Police	\$65,877	\$75,540	\$1,774,604	(\$1,805,068)	\$110,953
Fire	\$84,403	\$307,375	\$1,773,910	(\$2,078,503)	\$87,185
Totals:	\$150,280	\$382,915	\$3,548,514	(\$3,883,571)	\$198,138

¹ In April 2010, the number of Prop H funded motorcycle officers was reduced to eleven.

Objective 4 - Determine the status of any projects and programs funded by Prop H revenue.

Anticipated Activities

In FY 2011, the Police Department intends to use Prop H revenues to fund salaries, benefits, uniforms, and fleet maintenance expenses for ten Prop H-funded motorcycle officers.

In FY 2011, the Fire Department intends to use Prop H revenues to fund labor costs for nine Prop H-funded firefighters that staff Fire Truck 14 and small charges from other City departments.

FY 2011 Budgeted Revenues and Expenditures

For FY 2011, budgeted Prop H revenues and expenditures were \$3,255,268 and \$3,193,883, respectively. Approximately, 93% of total expenditures were budgeted for Salaries, Wages and Benefits.

Revenues and Expenditures	Police	Fire	Total
FY 2011 Budgeted Revenues:			
Oil Production Tax	\$ 1,627,534	\$ 1,627,534	\$ 3,255,068
Interest-Pooled Cash	100	100	200
Total Budgeted Revenues:	\$ 1,627,634	\$ 1,627,634	\$ 3,255,268
FY 2011 Budgeted Expenditures:			
Salaries, Wages and Benefits	\$ 1,320,117	\$ 1,476,730	\$ 2,796,847
Worker's Compensation	72,590	91,851	164,441
Internal Support	217,251	15,344	232,595
Total Budgeted Expenditures:	\$ 1,609,958	\$ 1,583,925	\$ 3,193,883
Revenue Less Expenditures at 9/30/2011 (Budgeted)	\$ 17,676	\$ 43,709	\$ 61,385

MANAGEMENT'S COMMENTS

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