



**OFFICE OF THE CITY AUDITOR**  
Long Beach, California

**C-9**

LAURA L. DOUD, CPA  
City Auditor

March 10, 2020

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, 2019.

**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 2019, the City received \$3,276,231 of Prop H revenues, a decrease of \$81,472 or 2% from the prior year.
- 2) Prop H expenditures during FY 2019 totaled \$3,316,641. Expenditures were \$446,885 or 12% less compared to the prior year and were made for eligible costs as defined in the Municipal Code.
- 3) During FY 2019, the amount of unspent monies carried over decreased 18% from the prior fiscal year to \$180,652. This amount aligns with the reserve policy's established reserve range of \$150,000 to \$400,000 for the fund. The projected carryover by the end of FY 2020 is expected remain the same.
- 4) In FY 2020, 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 its funds to support staffing of the Mental Health Evaluation Team.

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

HONORABLE MAYOR AND CITY COUNCIL

March 10, 2020

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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,

A handwritten signature in cursive script that reads "Laura L. Doud".

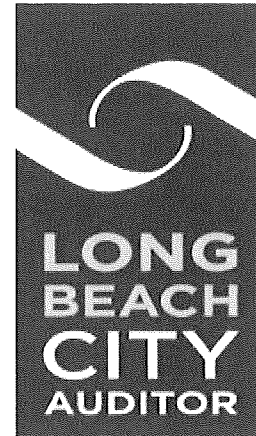
Laura L. Doud, CPA

CITY AUDITOR

attachment

# Proposition H Police and Fire Public Safety Oil Production Act

*Generated nearly \$3.28 million in additional  
revenue for public safety in FY 2019*



*Independence you can rely on*

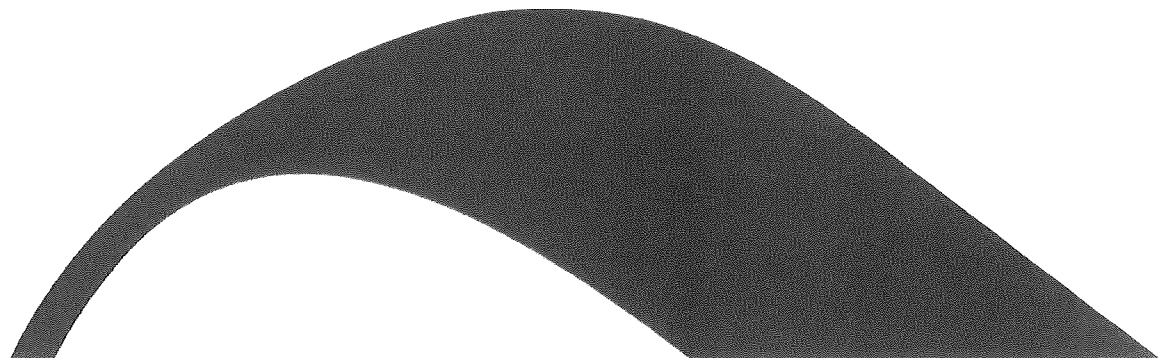
**January 2020**

**Laura L. Doud**  
*City Auditor*

**James Lam**  
*Assistant City Auditor*

**Hannah Morgan**  
*Performance Audit Manager*

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# Audit Results

***Finding 1: Prop H revenues received during FY 2019 were properly calculated based on oil producers' reports remitted to the City.***

The City of Long Beach (City) received a total of \$3,276,231 of Proposition H (Prop H) oil tax revenue, including penalties and interest, during fiscal year (FY) 2019, as depicted in Chart 1 below. This is a revenue decrease of 2% from the prior year. The oil tax revenue received was based on FY 2019 production reports totaling 10,640,973 barrels of oil.

**Chart 1**  
Total Tax Revenues Received  
FY 2019

| Oil Tax Revenue | Penalties and Interest | Total        |
|-----------------|------------------------|--------------|
| \$ 3,244,300    | \$ 31,931              | \$ 3,276,231 |

We substantively tested 97% of the special tax revenues received in FY 2019 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.

The special tax revenues and penalties received were deposited into Fund 2100, the Fire Public Safety Oil Production Tax Special Revenue Fund, and Fund 2150, the Police Public Safety Oil Production Tax Special Revenue Fund, as required by §3.80.225 of the Municipal Code.

***Finding 2: FY 2019 expenditures of Prop H funds complied with the approved uses set forth in the City's Municipal Code.***

Prop H expenditures during FY 2019 totaled \$3,316,641 and were made for eligible costs as defined in the City's Municipal Code.

## Police Department

In FY 2019, Prop H expenses for the Police Department totaled \$1,658,685. The majority of those expenditures, \$1,617,972 (98% of department expenses), was spent on salaries and benefits for Police Department employees. \$1,227,278 was spent on six employees assigned to the Police Department's Mental Health Evaluation Team and another \$390,694 was used to partially fund the Traffic Motors team. Additionally, the Police Department spent \$33,972 on costs relating to Email/Web Services and Data Center related charges. A one-time expense of \$6,040 was utilized to support critical technology infrastructure, such as Citywide fiber optics, the replacement of outdated technology, and items to prevent malicious system attacks, data loss and service outages.

In total, we reviewed \$1,657,985 (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 2019 Prop H expenditures totaled \$1,657,956. Most of the expenditures, \$1,477,144 (89% of department expenditures), were for salaries and benefits for nine positions to staff Fire Truck 17. Additionally, \$175,000 (11% of department expenses) was used to help fund the Fire Academy. The remaining Prop H department expenses included additional costs for data center, email, and web services (0.4% of department expenses).

We reviewed \$1,652,144 (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 2019 that were carried over into the current fiscal year is \$180,652.***

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 2019, the carryover amount decreased 18% from the prior fiscal year, from \$221,063 to \$180,652. This amount is within the allowed carryover range established by Financial Management's carryover policy. The budgeted carryover for FY 2020 is expected to be about \$180,652 which is equal to FY 2019 carryover. See Chart 2 on the next page.

**Chart 2**  
**Prop H Funds Cash Flow**  
**FY 2018-2020**

|                                    | Police         | Fire           | Total          | FY % Change |
|------------------------------------|----------------|----------------|----------------|-------------|
| <b>FY 2018 Carryover</b>           | \$ 353,752     | \$ (132,689)   | \$ 221,063     |             |
| FY 2019 Actual Revenue             | \$ 1,643,489   | \$ 1,632,742   | \$ 3,276,231   |             |
| FY 2019 Actual Expenditures        | \$ (1,658,685) | \$ (1,657,956) | \$ (3,316,641) |             |
| FY 2019 Intrafund Transfer*        | \$ (162,164)   | \$ 162,164     | -              |             |
| <b>FY 2019 Carryover</b>           | \$ 176,392     | \$ 4,260       | \$ 180,652     | -18%        |
| FY 2020 Budgeted Revenue           | \$ 1,577,254   | \$ 1,577,254   | \$ 3,154,508   |             |
| FY 2020 Budgeted Expenditures      | \$ (1,577,254) | \$ (1,577,254) | \$ (3,154,508) |             |
| <b>FY 2020 Projected Carryover</b> | \$ 176,392     | \$ 4,260       | \$ 180,652     | 0%          |

\*An intrafund transfer was made from the Police Department to the Fire Department to correct the Fire Department's negative cash balance. The transfer complies with §3.80.225 of the Municipal Code.

***Finding 4: The anticipated projects and programs funded by Prop H revenue in FY 2020 comply with the approved uses set forth in the City's Municipal Code.***

#### **Anticipated Activities**

In FY 2020, the Police Department plans to use all budgeted Prop H funds (\$1,577,254) to fund its Mental Health Evaluation Team (Team). Funding will cover staffing costs for six Police Officers on the Team. The Mental Health Evaluation Team responds to calls for service that involve individuals who may require mental health services. The Team partners with the Los Angeles County's Department of Mental Health when they respond to calls, allowing the Team to offer access to mental health services in an efficient manner.

In FY 2020, the Fire Department intends to use Prop H revenues to fund salaries and benefits, including workers' compensation charges, for nine positions on Fire Truck 17: three engineers and six firefighters. In total, \$1,402,254 is expected to be spent on salaries and benefits in FY 2020. In addition, the department plans to continue funding Fire Academy training costs and has allocated \$175,000 of Prop H funds towards those 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 2020 Budgeted Revenues and Expenditures**

For FY 2020, budgeted Prop H revenues and expenditures are \$3,154,508 and \$3,154,508 respectively, as shown in Chart 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:

**Chart 3**  
**Prop H Tax Rates**  
**FY 2007-2019**

| 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                |
| June 1, 2018   | \$0.00             | \$0.30                |
| June 1, 2019   | \$0.02             | \$0.32                |

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, 2019 was due to the City on or before September 30, 2019.

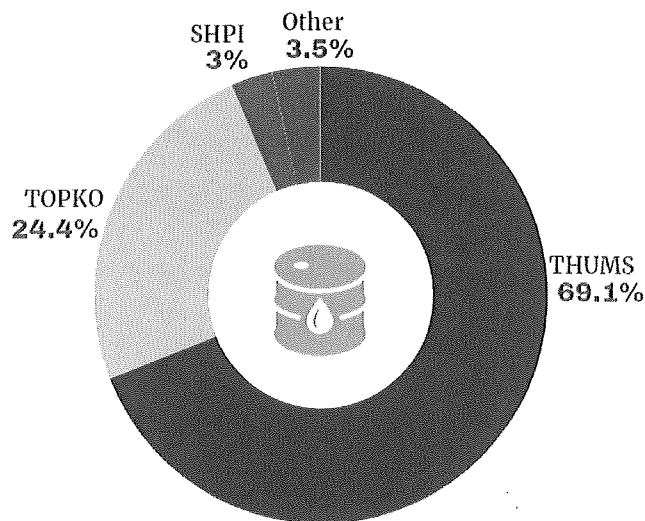
Failure to pay the tax results in a penalty of 25% of the total tax on the first day of the month following the close of the calendar quarter. If the tax remains unpaid for each month thereafter, an additional 10% penalty is assessed, up to a maximum of 100% of the tax amount.



## Oil Producers

In fiscal year (FY) 2019, oil operators in Long Beach reported a total of 10,640,973 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 2019. As illustrated in Chart 4 below, these three oil operators accounted for approximately 97% of oil produced in FY 2019.

**Chart 4**  
Percentage of Barrels Produced by Oil Producer  
FY 2019



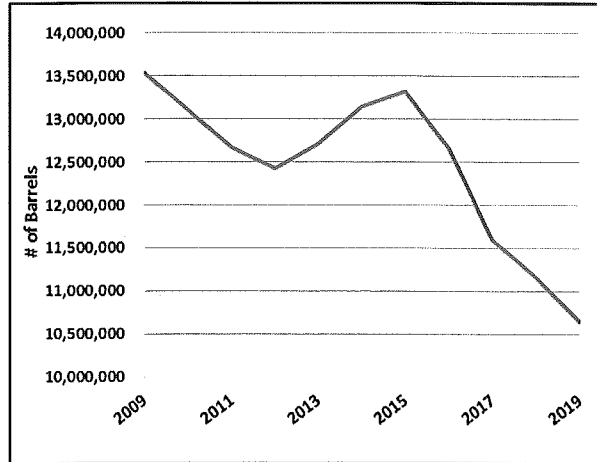
Most of the oil is produced in the Wilmington Oil Field. The Wilmington Oil Field was discovered in Long Beach in 1932 and is 13 miles long, extending from San Pedro to Seal Beach. The field is divided into two sections: West and East. TOPKO serves as the field contractor for the western section of the oil field, and THUMS serves as the field contractor for the eastern section. In FY 2019, THUMS produced 7,350,561 barrels of oil, while TOPKO produced 2,600,762 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 2019, SHPI produced a total of 320,083 barrels of oil in Long Beach.

Since the inception of Prop H through September 30, 2019, 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 but has declined by 20% since then. In FY 2019, there

was a decline of 4.6% from the prior year. See Chart 5 below for additional details on the fluctuation in annual oil production.

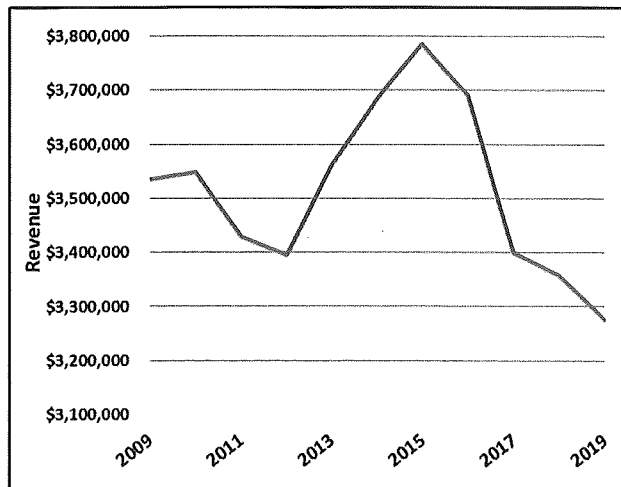
**Chart 5**  
Annual Oil Production  
FY 2009-2019



**Prop H Revenues**

Based on the level of production shown above, Prop H revenue received by the City shows the similar general fluctuations: overall decline from FY 2008 to FY 2012, increase from FY 2013 to FY 2015, and a decline in revenue of 13% between FY 2015 and FY 2019. In FY 2019, Prop H experienced a 2.4% decline from the revenue received the previous fiscal year. See Chart 6 below.

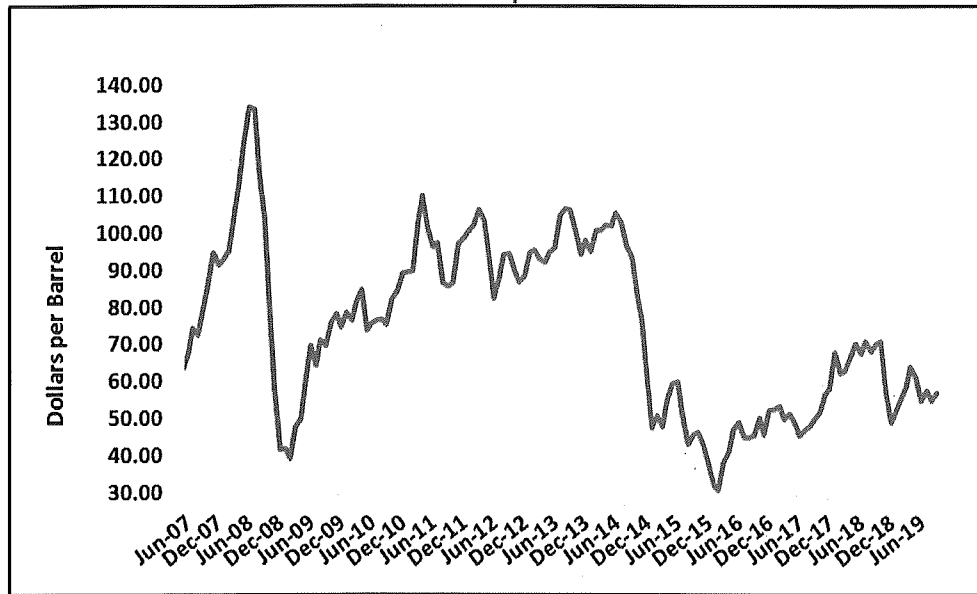
**Chart 6**  
Prop H Annual Revenue  
FY 2009-2019



## Price of Oil

As shown in Chart 7 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 was higher than \$80.00 per barrel, averaging \$95.81 per barrel.

**Chart 7**  
Price of Oil  
June 2007 – September 2019



However, the oil price began decreasing significantly after October 2014, reaching a low of \$30.39 average cost per barrel in February 2016. Per the Municipal Code, Prop H revenue will be suspended for any month in which the average WTI index is below \$20.00 per barrel. The average monthly WTI cost per barrel began to rise in March 2016. Between February 2016 and the end of FY 2019, the average cost per barrel increased by roughly \$26.56. FY 2019 began with the average monthly oil price of \$70.75. The price fluctuated throughout the year, but experienced a general decrease in comparison to the beginning of the Fiscal Year. At the end of the Fiscal Year, September 2019, the average monthly oil price was \$56.95.

# 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 2019 and determine if funds remitted by the oil producers were properly calculated based on oil producers' reports remitted to the City;
2. Identify FY 2019 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, 2019 that were carried over into the current fiscal year, FY 2020; and
4. Determine the status of any projects and programs funded by Prop H revenue.
  - Remediate identified internal control deficiencies on a timely basis.

The scope of our audit covers the period October 1, 2018 through September 30, 2019. 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. The following are the internal control components and underlying principles that are significant to the audit objectives. Management is responsible for all of these activities.
  - Risk Assessment
    - Define objective clearly to enable the identification of risks and define risk tolerances.
    - Identify, analyze, and respond to risks related to achieving the defined objectives.
    - Consider potential fraud when identifying, analyzing, and responding to risks.
    - Identify, analyze, and respond to significant changes that could impact the internal control system.
  - Control Activities
    - Design control activities to achieve objectives and respond to risks.
    - Design the entity's information system and related control activities to achieve objectives and respond to risks.
    - Implement control activities through policies.
  - Information and Communication
    - Use quality information to achieve the entity's objectives.

- Internally communicate the necessary quality information to achieve objectives.
  - Externally communicate the necessary quality information to achieve objectives.
- Monitoring
  - Establish and operate monitoring activities to monitor the internal control system and evaluate the results.
  - Remediate identified internal control deficiencies on a timely basis.
- 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 approximately 97% of the reported oil production amounts with the oil producers for FY 2019.
- Identified the Prop H expenditures during FY 2019 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, 2019 that were carried over into the current fiscal year, FY 2020.
- 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 Department of Financial Management agreed with the information contained in the report and had no further comments.

The Police Department and Fire Department management comments are pending.



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