



LAURA DOUD

February 14, 2017

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, 2016.

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 2016, the City received \$3,689,835 of Prop H revenues, a decrease of \$94,961 or 3% from the prior year;
- 2) Prop H expenditures during FY 2016 totaled \$3,527,320. Expenditures were \$197,582 or 5% less compared to the prior year, and were made for eligible costs as defined in the Municipal Code;

- 3) During FY 2016, the amount of unspent monies carried over increased 13% from the prior fiscal year to \$1,401,294, which exceeds the top of the reserve policy range of \$400,000 for the fund. However, the FY 2017 Adopted Budget for Prop H includes the use of over \$936,000 in reserve funds, which is expected to reduce the projected carryover by the end of FY 2017 by 67% to \$464,409, which is significantly closer to the reserve policy.
- 4) In FY 2017, both the Police Department and the Fire Department intend to use their Prop H resources to continue funding public safety positions. In addition, the Police Department will use funds to contribute to the cost of a new Police Academy facility and the Fire Department will help fund Fire Academy costs. Also, the City Council allocated \$250,000 from each department to be used on Homelessness Rapid Response.

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.

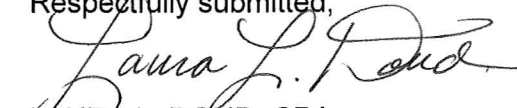
FISCAL IMPACT:

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 over \$3.6 million in additional
revenue for public safety in FY 2016*



Independence you can rely on

January 2017

Laura L. Doud
City Auditor

Deborah K. Ellis
Assistant City Auditor

Terra Van Andel
Deputy City Auditor

Hannah Morgan
Senior Performance Auditor

Kristen Clement
Performance Auditor

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Audit Results

Finding 1. Prop H revenues received during FY 2016 were properly calculated based on oil producers' reports remitted to the City.

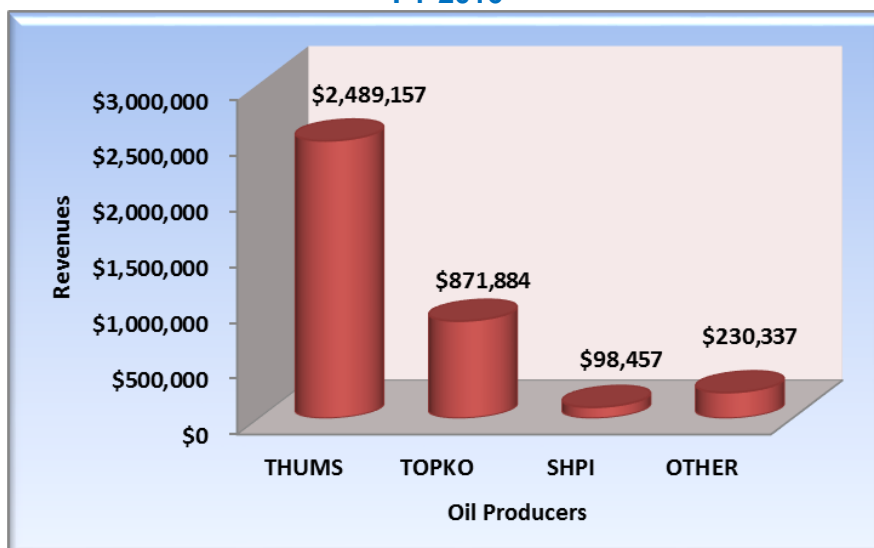
The City of Long Beach (City) received a total of \$3,689,835 of Proposition H (Prop H) oil tax revenue, including penalties and interest, during fiscal year (FY) 2016, as depicted in Table 1 below. This is a revenue decrease of 3% from the prior year. The oil tax revenue received was based on FY 2016 production reports totaling 12,656,148 barrels of oil.

Table 1
Total Tax Revenues Received
FY 2016

Oil Tax Revenue	Penalties and Interest	Total
\$3,673,919	\$15,916	\$3,689,835

We substantively tested 94% of the special tax revenues received in FY 2016 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 significant 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 2016.

Chart 1
Prop H Revenues Received by Oil Producer
FY 2016



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 2016 expenditures of Prop H funds complied with the approved uses set forth in the City's Municipal Code.

Prop H expenditures during FY 2016 totaled \$3,527,320 and were made for eligible costs as defined in the City's Municipal Code.

Police Department

In FY 2016, Prop H expenses for the Police Department totaled \$1,770,584. Salaries and benefits, including workers' compensation charges, for eight and one-half citywide motorcycle officers totaled \$1,391,394 and accounted for 79% of total expenses. In addition, \$308,604 of carryover from the prior year was used to help fund Police Academy costs. 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 \$1,747,398 (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 2016 Prop H expenditures totaled \$1,756,736. The majority of the expenditures, \$1,560,011, or 89%, were for salaries, benefits and workers' compensation charges for nine positions, which equates to constant staffing for two daily firefighters posts and one daily fire engineer post on Fire Truck 17 for the year. 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 \$1,735,011 (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 2016 that were carried over into the current fiscal year is \$1,401,294.

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 2016, the carryover amount increased 13% from the prior fiscal year, from \$1,238,779 to \$1,401,294. While this exceeds the top of the range stated in the policy, the budget for FY 2017 is set to bring the reserve significantly closer to the range stated in the policy. The fund

balance projected for the end of FY 2017 is estimated to decrease by 67% to \$464,409. More than one-half of the decrease can be attributed to City Council’s allocation of \$500,000 of the carryover to be spent on Homelessness Rapid Response. In addition, lower revenue is budgeted by Financial Management based on available FY 2016 data combined with a projected decline in oil production. See Table 2 below.

Table 2
Prop H Funds Cash Flow
FY 2015-2017

	Police	Fire	Total	FY % Change
FY 2015 Carryover	\$ 681,836	\$ 556,943	\$ 1,238,779	
FY 2016 Actual Revenue	1,845,697	1,844,138	3,689,835	
FY 2016 Actual Expenditures	(1,770,584)	(1,756,736)	(3,527,320)	
FY 2016 Carryover	756,949	644,345	1,401,294	13%
FY 2017 Budgeted Revenue	1,568,295	1,568,295	3,136,590	
FY 2017 Budgeted Expenditures	(2,002,931)	(2,070,544)	(4,073,475)	
FY 2017 Projected Carryover	322,313	142,096	464,409	-67%

Finding 4: The anticipated projects and programs funded by Prop H revenue in FY 2017 comply with the approved uses set forth in the City’s Municipal Code.

Anticipated Activities

In FY 2017, the Police Department intends to use Prop H revenues to fund labor costs for ten officers from the Patrol and Investigative Bureaus. In addition, they will contribute funds toward a new Police Academy facility.

The Fire Department intends to continue to use Prop H revenues in FY 2017 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.

Further, during the FY 2017 budget process, the City Council allocated \$250,000 from each department to be drawn from Prop H funds for Homelessness Rapid Response.

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 2017 Budgeted Revenues and Expenditures

For FY 2017, budgeted Prop H revenues and expenditures are \$3,136,590 and \$4,073,475, respectively.

Table 3
Budgeted Revenues and Expenditures
FY 2017

Revenues and Expenditures	Police	Fire	Total
FY 2017 Budgeted Revenues:			
Oil Production Tax	\$ 1,568,195	\$ 1,568,195	\$ 3,136,390
Interest-Pooled Cash	100	100	200
Total Budgeted Revenues:	1,568,295	1,568,295	3,136,590
FY 2017 Budgeted Expenditures:			
Salaries, Wages and Benefits	1,781,960	1,959,904	3,741,864
Workers' Compensation	90,984	88,767	179,751
Internal Support	129,987	16,470	146,457
Interfund Transfer	-	5,403	5,403
Total Budgeted Expenditures:	2,002,931	2,070,544	4,073,475
Revenues Less Expenditures at 9/30/2017 (Budgeted)	(434,636)	(502,249)	(936,885)
FY 2016 Carryover	756,949	644,345	1,401,294
FY 2017 Projected (FY 2016 Carryover Less FY 2017 Budgeted)	322,313	142,096	464,409

Background

Proposition H

The City Auditor worked closely with City officials, the Long Beach Firefighters and Police Officers Associations, and many other local influential organizations to garner public support for Prop H, the Police and Fire Public Safety Oil Production Act. The citizens of Long Beach approved Prop H 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 1st 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 2007-2016

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

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. These proceeds may be used only for police officers, firefighters, and related costs, including but not limited to equipment, facilities, and training in order to ensure responses to public safety needs.

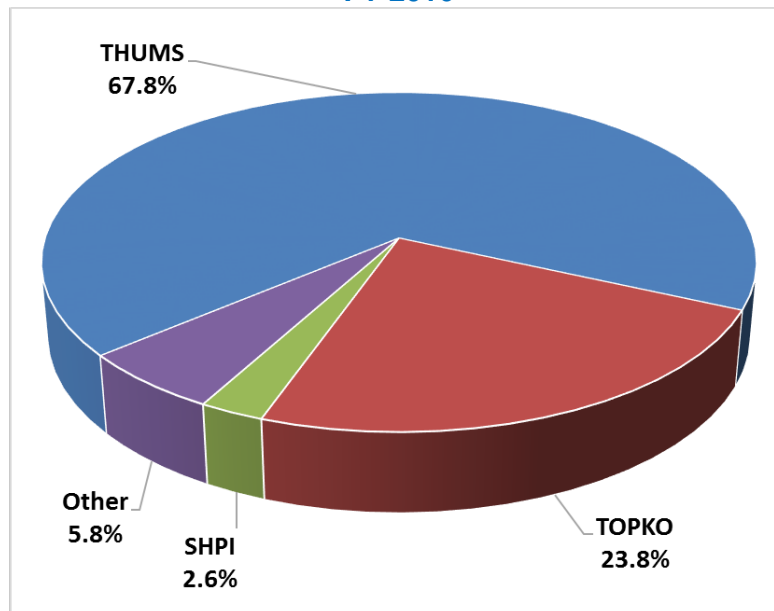
This special tax is due to the City on or before the last day of the calendar quarter. The payment is based on a production quarter, which ends one month earlier than the calendar quarter. For example, the special tax payment for the production quarter ending August 31, 2016 was due to the City on or before September 30, 2016.

Failure to pay the tax results in a penalty of 25% of the total tax amount 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 FY 2016, oil operators in Long Beach reported a total of 12,656,148 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 2016. As illustrated in Chart 2, these three oil operators accounted for 94% of oil produced in FY 2016.

Chart 2
Percentage of Barrels Produced by Oil Producer
FY 2016



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 2016, THUMS produced 8,583,301 barrels of oil, while TOPKO produced 3,006,497 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, and Signal Hill LBA-1 Lease Oil Fields. The oil fields are located in both Long Beach and Signal Hill. In FY 2016, SHPI produced a total of 327,114 barrels of oil in Long Beach.

Since the inception of Prop H through September 30, 2016, annual oil production in Long Beach has fluctuated; production steadily declined from FY 2008 to FY 2012, then there was a growth period from FY 2013 to FY 2015. In FY 2016 there was a decline of 5% from the prior year. See Chart 3 below for additional details on the fluctuation in annual oil production.

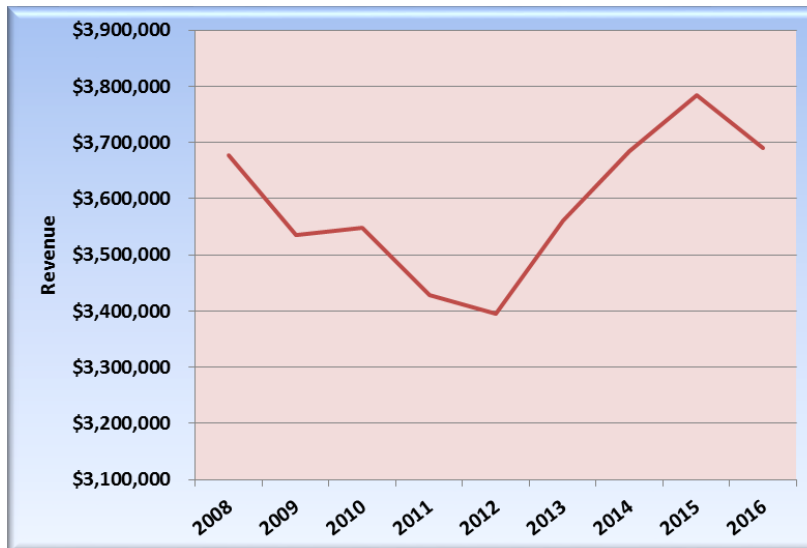
Chart 3
Annual Oil Production
FY 2008-2016



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 a slight 3% decline in FY 2016. See Chart 4 below.

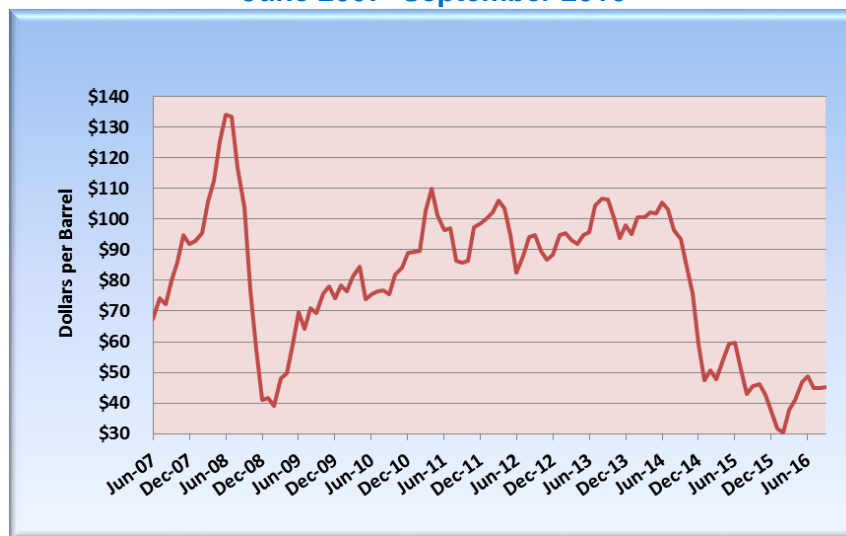
Chart 4
Prop H Annual Revenue
FY 2008-2016



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 \$39.16 per barrel in February 2009, but it increased steadily thereafter. For a four-year period, between October 2010 and October 2014, the WTI monthly average price never dipped below \$80.00 per barrel, averaging \$95.60 per barrel.

Chart 5
Price of Oil
June 2007- September 2016



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 2016 began with the average monthly oil price of \$46.20. Throughout the fiscal year, the price fluctuated and dipped to a low of \$30.35 in February 2016 before rising back up to end the fiscal year at \$45.17.

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 2016 and determine if funds remitted by the oil producers were properly calculated based on oil producers' reports remitted to the City;
2. Identify FY 2016 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, 2016 that were carried over into the current fiscal year, FY 2017; 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, 2015 through September 30, 2016. 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 of 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 94% of the reported oil production amounts with the oil producers for FY 2016.
- Identified the Prop H expenditures during FY 2016 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, 2016 that were carried over into the current fiscal year, FY 2017.
- 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.