



OFFICE OF THE CITY AUDITOR
Long Beach, California

LAURA L. DOUD, CPA
City Auditor

February 5, 2013

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, 2012.

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 monies 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 2012, the City received \$3,394,899 of Prop H revenues, a decrease of \$33,109 from the prior year;
- 2) Prop H expenditures during the fiscal year totaled \$3,072,940. Expenditures were made for eligible costs as defined in the Municipal Code;
- 3) The amount of unspent monies carried over into fiscal year 2013 increased to \$959,748. In an effort to reduce the carry-over balance, Management budgeted a total of \$800,000 of the \$959,748 into FY 2013's budget. Subsequent to the audit, Financial Management has developed a policy addressing how unspent Prop H funds are to be handled; 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 since the inception of Prop H in June 2007 through September 30, 2012, annual oil production in Long Beach has decreased by 13%, thereby reducing the amount of special oil tax revenues to the City by 8%.

HONORABLE MAYOR AND CITY COUNCIL

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During FY 2012, production fell 2% resulting in 1% less Prop H revenue received by the City when compared to the prior year.

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 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.

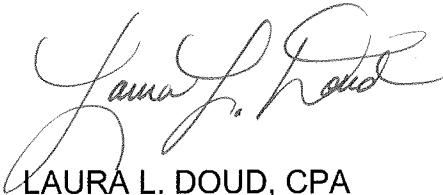
FISCAL IMPACT:

Approving this action would have no fiscal impact.

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Laura L. Doud".

LAURA L. DOUD, CPA
CITY AUDITOR

Attachment

Office of the City Auditor

Audit Report

**Proposition H
Police and Fire Public Safety Oil Production Act**

For Fiscal Year Ending September 30, 2012

January 31, 2013



Audit Staff

City Auditor: Laura L. Doud
Assistant City Auditor: Deborah K. Ellis
Deputy City Auditor: Terra Van Andel
Supervising Senior Auditor: Carolyn Phu
Staff Auditor: Jennifer Rethwisch
Staff Auditor: Damon Melfi

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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 has since been adjusted as follows:

**Table 1
Prop H Tax Rates
FY 2007-2012**

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

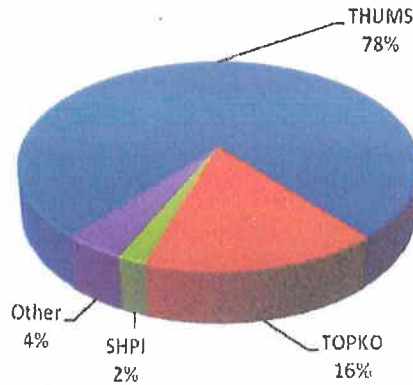
This special tax is in addition to the existing tax of 15 cents per barrel produced, and is a legally distinct tax to be used specifically to fund public safety. Specifically, these proceeds may only be used for police officers, firefighters, and related costs including, but not limited to, equipment, 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, 2012 was due to the City on or before September 30, 2012.

Oil Producers

In fiscal year (FY) 2012, oil operators in Long Beach reported a total of 12,426,399 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 2012. As illustrated in Chart 1, these three oil operators accounted for 96% of oil produced in FY 2012.

Chart 1
Percentage of Barrels Produced by Oil Producer
FY 2012

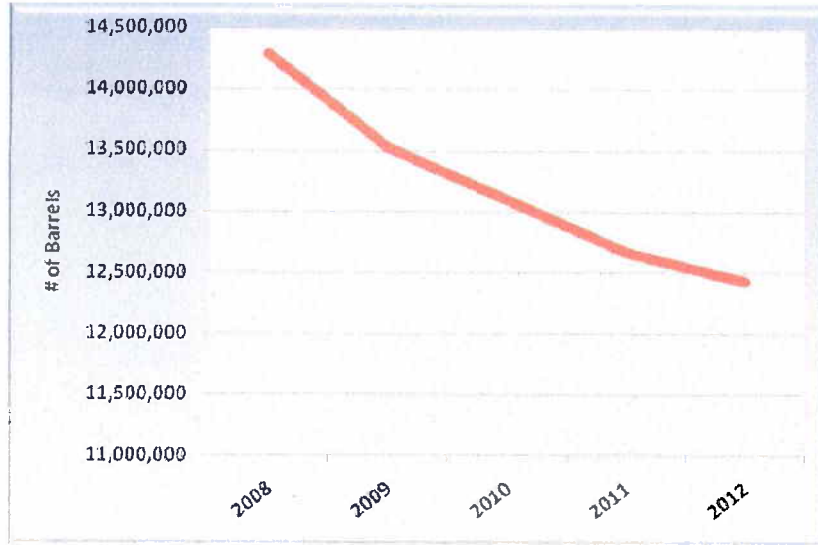


The source for the majority of the oil produced is the Wilmington Oil Field. The Wilmington Oil Field was discovered in Long Beach in 1932 and is 13 miles long, extending from San Pedro to Seal Beach. The field is divided into two sections: West and East. TOPKO serves as the field contractor for the western section of the oil field, and THUMS serves as the field contractor for the eastern section. In FY 2012, THUMS produced 9,659,272 barrels of oil, while TOPKO produced 1,991,912 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, and Signal Hill H&L Lease Oil Fields. The oil fields are located in both Long Beach and Signal Hill. In FY 2012, SHPI produced a total of 249,587 barrels of oil in Long Beach.

Since the inception of Prop H through September 30, 2012, annual oil production in Long Beach has decreased significantly, thereby reducing the amount of special oil tax revenues to the City. In FY 2008, Long Beach oil producers reported 14,291,942 barrels of oil produced. In FY 2012, 12,426,399 barrels of oil were reported, equating to a 13% reduction in annual oil production over five years. There was a 2% drop in production when compared to the prior year. Given the volatility of oil, we encourage management to continue considering the above potential impacts in their fiscal planning. See Chart 2 for additional details on the decline in annual oil production.

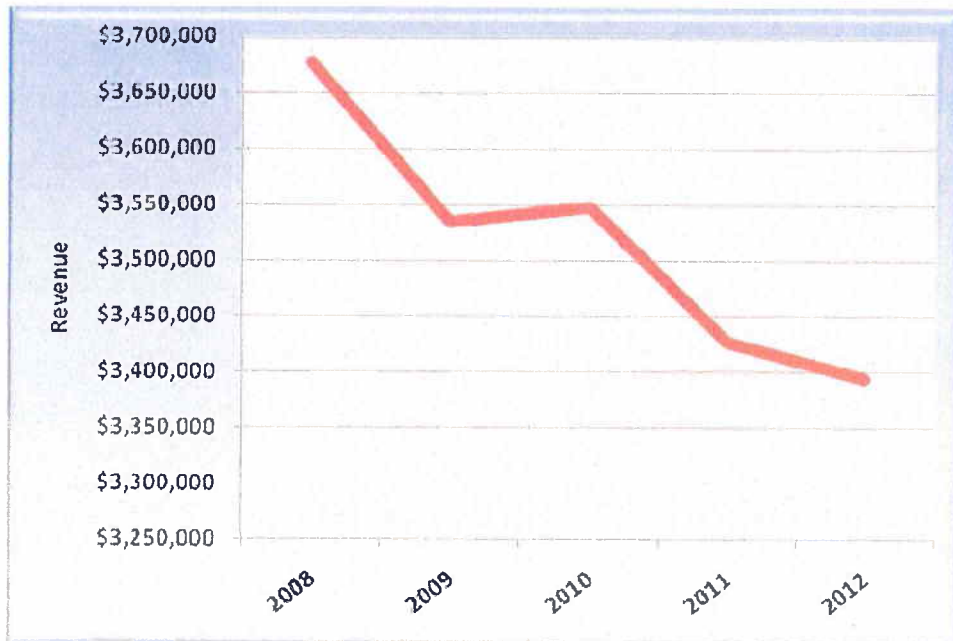
Chart 2
Annual Oil Production
FY 2008-2012



Prop H Revenues

Based on the level of production and price per barrel of oil, Prop H revenue received by the City has decreased 8% since FY 2008. There was a 1% decline in Prop H revenue from the prior year.

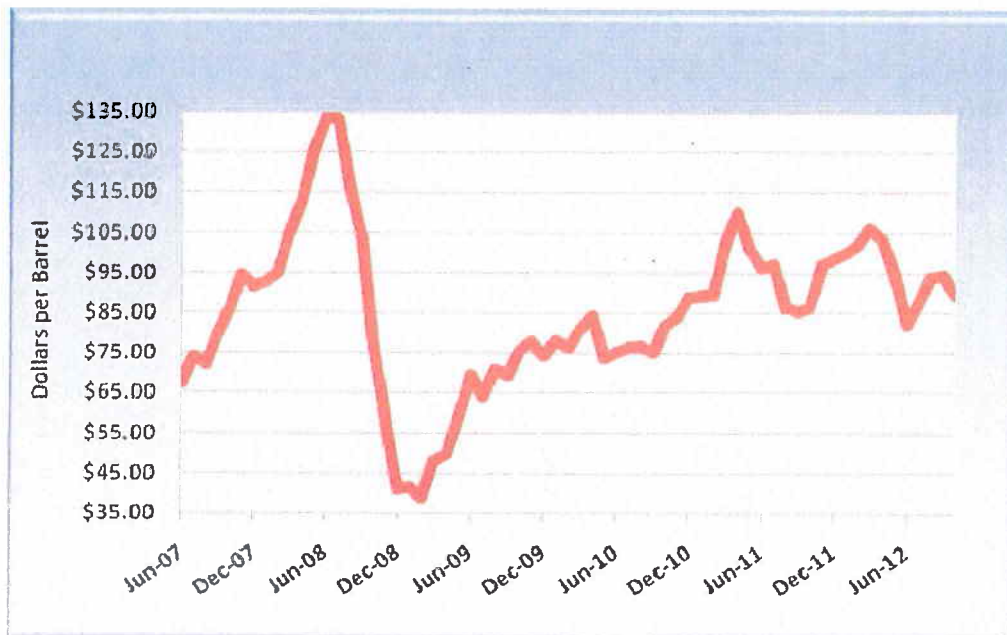
Chart 3
Prop H Annual Revenue
FY 2008-2012



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 Chart 4. 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.

Chart 4
Price of Oil
FY 2007-2012



As demonstrated in the chart above, oil prices rose steadily from February 2009 to April 2011. Since April 2011, oil prices have fluctuated, with the latest price at \$94.72 per barrel (as of September 2012). It is important to note that a decline in the price of oil could impact the City in the following two ways:

1. According to the Municipal Code, 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.

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 2012 and determine if funds remitted by the oil producers were properly calculated based on oil producers' reports remitted to the City;
2. Identify FY 2012 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, 2012 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, 2011 through September 30, 2012. 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 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 2012.
- Identified the Prop H expenditures during FY 2012 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, 2012 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 2012 and determine if funds remitted by the oil producers were properly calculated based on oil producers' reports remitted to the City.

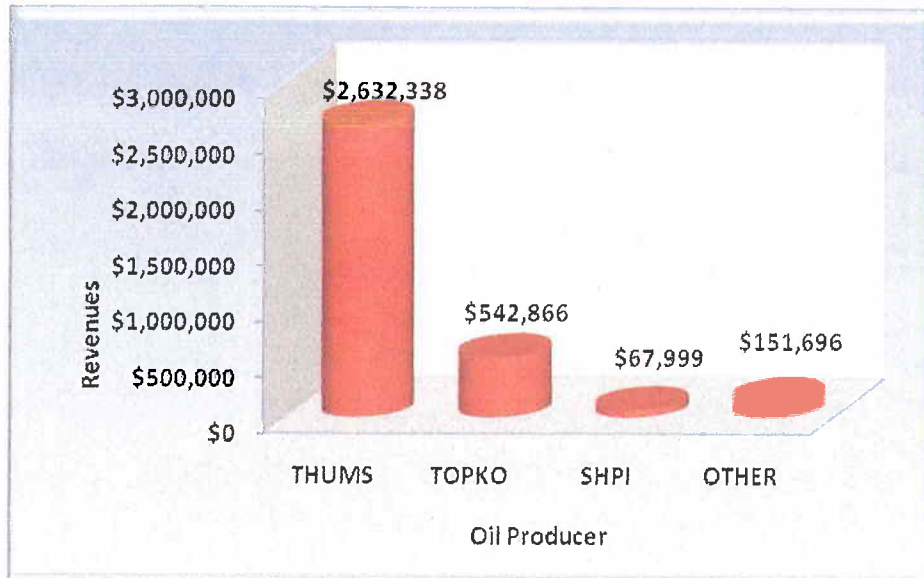
The City received a total of \$3,394,899 of Prop H special tax revenue, including penalties and interest, during FY 2012, as depicted in the table below.

**Table 2
Total Tax Revenues Received
FY 2012**

Oil Tax Revenue	Penalties and Interest	Total
\$3,386,472	\$8,427	\$3,394,899

The special tax revenue received was based on production reports totaling 12,426,399 barrels of oil. We substantively tested 96% or \$3,243,203 of the special tax revenues received in FY 2012 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. Chart 5 is a summary of the Prop H funds received from major oil producers during FY 2012:

Chart 5
Prop H Revenues Received by Oil Producer
FY 2012



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 2012 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 2012 totaled \$3,072,940 and were made for eligible costs as defined in the Long Beach Municipal Code.

Police Department

In FY 2012, Prop H expenditures for the Police Department totaled \$1,552,360. Salaries and benefits for nine and a half Prop H-funded citywide motorcycle officers totaled \$1,403,354 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 data center and email and web services. We reviewed \$1,532,947 (99% 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 2012 Prop H expenditures totaled \$1,520,580. Salaries and benefits for six Fire Truck 17 firefighters and three Fire Truck 17 fire engineers totaled

\$1,501,927 and accounted for 99% of total expenses. The remaining Prop H Fire expenses included data center, email, and web services charges, as well as audit costs. We reviewed \$1,501,927 (99% of total expenditures) of salaries and benefits expenses related to Truck 17 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 2012.

**Table 3
Prop H Carry-Over Fund Balances
FY 2010-2012**

	Amount Carried Over From FY 2010	Amount Carried Over From FY 2011	FY 2012 Revenues	FY 2012 Expenditures	Amount Carried Over To FY 2013
Police	\$110,952	\$372,589	\$1,698,042	(\$1,552,360)	\$518,271
Fire	\$87,185	\$265,200	\$1,696,857	(\$1,520,580)	\$441,477
Totals:	\$198,137	\$637,789	\$3,394,899	(\$3,072,940)	\$959,748

The expenditure amounts budgeted in the Prop H fund for Police and Fire are determined by the Financial Management's Budget Office during the preparation of the annual budget. Since FY 2010, carry-over balances have increased \$761,611, or 384%. In an effort to reduce the carry-over balance, Management budgeted a total of \$800,000 of the \$960,000 carry-over balance for FY 2013 expenditures. We verified that \$400,000 was budgeted for each the Police and Fire Department's FY 2013 expenditures. Although there are future plans to continue to budget carry-over balances, the City has yet to establish a formal written policy addressing how unspent Prop H funds are to be handled, as recommended in the FY 2011 Prop H audit report. Further, the Prop H ordinance is silent on this matter.

Prior Audit Recommendation from FY 2011 Audit: We recommend the City Manager, along with Financial Management, develop a policy determining how unspent Prop H monies should be applied, including consideration of the development of an on-going fund balance.

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

Anticipated Activities

In FY 2013, the Police Department intends to use Prop H revenues to fund salaries, benefits, and fleet maintenance expenses for nine and a half Prop H-funded motorcycle officers, and the Policy Academy.

In FY 2013, the Fire Department intends to use Prop H revenues to fund labor costs for six Prop H-funded firefighters and three Prop-H funded fire engineers that will staff Fire Truck 17 and other fire suppression operations, as well as small technology charges from other City departments.

The above anticipated activities for Prop H funds by the Police and Fire Departments comply with the approved uses as set forth in the Long Beach Municipal Code.

FY 2013 Budgeted Revenues and Expenditures

For FY 2013, budgeted Prop H revenues, including carry-over fund balances, and expenditures were \$4,017,522 and \$3,989,820, respectively. Approximately, 84% of total expenditures were budgeted for Salaries, Wages and Benefits.

**Table 4
Budgeted Revenues and Expenditures
FY 2013**

Revenues and Expenditures	Police	Fire	Total
Carry Over (Fund Balance):	\$400,000	\$400,000	\$800,000
FY 2013 Budgeted Revenues:			
Oil Production Tax	\$1,608,661	\$1,608,661	\$3,217,322
Interest-Pooled Cash	\$100	\$100	\$200
Total Budgeted Revenues:	\$1,608,761	\$1,608,761	\$3,217,522
FY 2013 Budgeted Expenditures:			
Salaries, Wages and Benefits	\$1,323,743	\$1,870,423 ⁽²⁾	\$3,194,166
Worker's Compensation	\$74,983	\$99,370	\$174,353
Materials, Supplies and Services	\$400,000 ⁽¹⁾	-	\$400,000
Internal Support	\$206,870	\$14,431	\$221,301
Total Budgeted Expenditures:	\$2,005,596	\$1,984,224	\$3,989,820
Revenues (including Carry-Over) Less Expenditures at 9/30/2013 (Budgeted)	\$3,165	\$24,537	\$27,702 ⁽³⁾

⁽¹⁾ \$400,000 of the Police Department's carry-over fund balance was budgeted to Materials, Supplies and Services for the Police Academy.

⁽²⁾ \$400,000 of the Fire Department's carry-over fund balance was included in budgeted Salaries, Wages and Benefits.

⁽³⁾ Total Revenues Less Expenditures at 9/30/2013 does not include the remaining carry-over amount from FY 2012.

MANAGEMENT'S COMMENTS

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

The Department of Financial Management provided comments, which can be found on the following page.



Date: January 17, 2013
To: Laura Doud, City Auditor
From: John Gross, Director of Financial Management
Subject: **Response to Fiscal Year 2012 Prop H Audit Report**

Thank you for an opportunity to comment on the draft audit of Proposition H for Fiscal Year (FY) 2012. Please find below our Management Response.

Management concurs with conclusions reached by the Office of City Auditor in its audit of the disposition of Proposition H funds for FY 12, which found that those funds were properly recorded and spent in accordance with the Police and Fire Public Safety Oil Production Act. Moreover, Management affirms that it budgeted \$800,000 for FY 13 expenditures to reduce the carryover balance from one fiscal year to the next.

In addition, Management concurs with the audit recommendation that it "develop a policy determining how unspent Prop H monies should be applied, including the consideration of the development of an ongoing fund balance." To that end, Financial Management developed the following policy:

To the extent possible within the practical limits of budget estimates of available Prop H funding for the ensuing fiscal year, the City will budget each year all estimated Prop H funds, including any excess funds available for purposes legally permitted under Police and Fire Public Safety Oil Production Act except that the City shall maintain fund available of at least \$150,000, but no more than \$400,000, for use in emergency purposes should Prop H oil production revenues decline in any one year to allow the City to transition to alternative funding or reduced services financed with Prop H dollars.

The above policy will go into effect with the City's FY 14 budget. Management welcomes City Auditor's recommendation and appreciates the opportunity to review the draft report and formulate a policy in response