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Long Beach, California

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LAURA L. DOUD, CPA
City Auditor

March 12, 2019

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, 2018.

DISCUSSION:

Pursuant to Long Beach Municipal Code Section 3.80.227, the City Auditor's Office 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 2018, the City received \$3,357,702 of Prop H revenues, a decrease of \$40,282 or 1% from the prior year.
2. Prop H expenditures during FY 2018 totaled \$3,763,526. Expenditures were \$408,867 or 10% less compared to the prior year and were made for eligible costs as defined in the Municipal Code.
3. During FY 2018, the amount of unspent monies carried over decreased 65% from the prior fiscal year to \$221,062. 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 2019 is expected to decrease slightly to \$220,562.
4. In FY 2019, 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

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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,

A handwritten signature in cursive script, reading "Laura L. Doud".

Laura L. Doud, CPA
CITY AUDITOR

Proposition H

Police and Fire Public Safety Oil Production Act

*Generated nearly \$3.36 million in additional
revenue for public safety in FY 2018*



Independence you can rely on

January 2019

Laura L. Doud
City Auditor

Hannah Morgan
Performance Audit Manager

Brenda Auner
Senior Performance Auditor

Jennifer Lopez
Performance Auditor



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Audit Results

Finding 1. Prop H revenues received during FY 2018 were properly calculated based on oil producers' reports remitted to the City.

The City of Long Beach (City) received a total of \$3,357,702 of Proposition H (Prop H) oil tax revenue, including penalties and interest, during fiscal year (FY) 2018, as depicted in Table 1 below. This is a revenue decrease of 1% from the prior year. The oil tax revenue received was based on FY 2018 production reports totaling 11,158,706 barrels of oil.

Table 1
Total Tax Revenues Received
FY 2018

Oil Tax Revenue		Penalties and Interest		Total	
\$	3,347,612	\$	10,090	\$	3,357,702

We substantively tested 97% of the special tax revenues received in FY 2018 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 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 2018 expenditures of Prop H funds complied with the approved uses set forth in the City's Municipal Code.

Prop H expenditures during FY 2018 totaled \$3,763,526 and were made for eligible costs as defined in the City's Municipal Code.

Police Department

In FY 2018, Prop H expenses for the Police Department totaled \$1,741,754. Of that, \$1,327,677 (76% of department expenses) was spent on safety improvements to the City's Shooting Range. Payments were made to contractors, consultants, and departments that assisted with the project. Of that amount, \$1,305,288 was paid to contractors and consultants for work performed on the shooting range for items such as street repairs, side wall repairs, and concrete work. Additionally, the Police Department paid roughly \$22,000 to the City's Public Works Department for inspection and clerical work performed on the project. The Department also spent \$300,000 (17% of department expenses) on a new California Law Enforcement Telecommunication System

(CLETS) router installed by the Technology and Innovation Department. The new router allows for faster transfer of sensitive data through encrypted systems.

The remaining expenditures for the Department during FY 18 consisted primarily of fleet service charges (4% of department expenses), background investigation services for the Police Academy (1% of department expenses), and charges from other departments for services such as email, data center, web services, and audit charges (1% of department expenses). In total, we reviewed \$1,716,977 (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 2018 Prop H expenditures totaled \$2,021,772. Most of the expenditures, \$1,824,034, or 90% of all expenditures, were for salaries, benefits and workers' compensation charges for nine positions to staff Fire Truck 17. Additionally, \$175,000 (9% of department expenses) was used to help fund the Fire Academy. The remaining Prop H department expenses included additional costs for data center, email, web services, and audit charges (1% of department expenses). We reviewed \$1,999,034 (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 2018 that were carried over into the current fiscal year is \$221,062.

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 2018, the carryover amount decreased 65% from the prior fiscal year, from \$626,886 to \$221,062. This amount is within the allowed carryover range established by Financial Management's carryover policy. The budgeted carryover for FY 2019 is expected to be about \$220,562 which is a slight decrease from the FY 2018 carryover. See Table 2 on the next page.

Table 2
Prop H Funds Cash Flow
FY 2017-2019

	Police	Fire	Total	FY % Change
FY 2017 Carryover	\$ 415,227	\$ 211,659	\$ 626,886	
FY 2018 Actual Revenue	\$ 1,680,279	\$ 1,677,423	\$ 3,357,702	
FY 2018 Actual Expenditures	\$ 1,741,754	\$ 2,021,772	\$ 3,763,526	
FY 2018 Carryover	\$ 353,752	\$ (132,690)	\$ 221,062	-65%
FY 2019 Budgeted Revenue	\$ 1,657,956	\$ 1,657,956	\$ 3,315,912	
FY 2019 Budgeted Expenditures	\$ 1,658,456	\$ 1,657,956	\$ 3,316,412	
FY 2019 Projected Carryover	\$ 353,252	\$ (132,690)	\$ 220,562	0%

Finding 4: The anticipated projects and programs funded by Prop H revenue in FY 2019 comply with the approved uses set forth in the City's Municipal Code.

Anticipated Activities

In FY 2019, the Police Department plans to use all budgeted Prop H funds (\$1,658,456) to fund their Mental Health Evaluation Team. Funding will cover staffing costs for six Police Officers and one Sergeant 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 2019, 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, \$1,482,956 is expected to be spent on salaries and benefits in FY 2019. 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 2019 Budgeted Revenues and Expenditures

For FY 2019, budgeted Prop H revenues and expenditures are \$3,315,912 and \$3,316,412, 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 3.
Prop H Tax Rates
FY 2007-2018

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

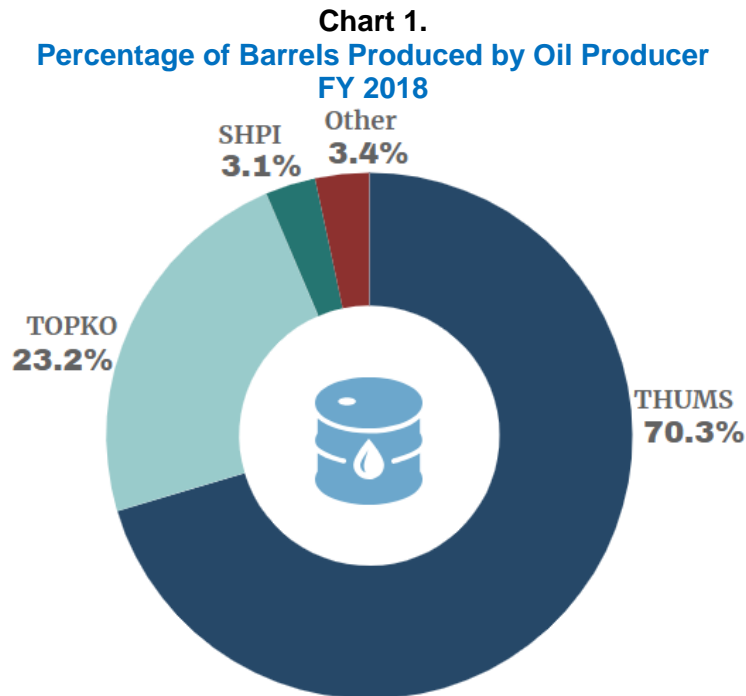
This special tax is in addition to the existing tax of 15 cents per barrel produced, and is a legally distinct tax to be used explicitly to fund public safety. Specifically, these tax proceeds may be used only for police officers, firefighters, and related costs, including but not limited to equipment, 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, 2018 was due to the City on or before September 30, 2018.

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) 2018, oil operators in Long Beach reported a total of 11,158,706 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 2018. As illustrated in Chart 1 below, these three oil operators accounted for approximately 97% of oil produced in FY 2018.

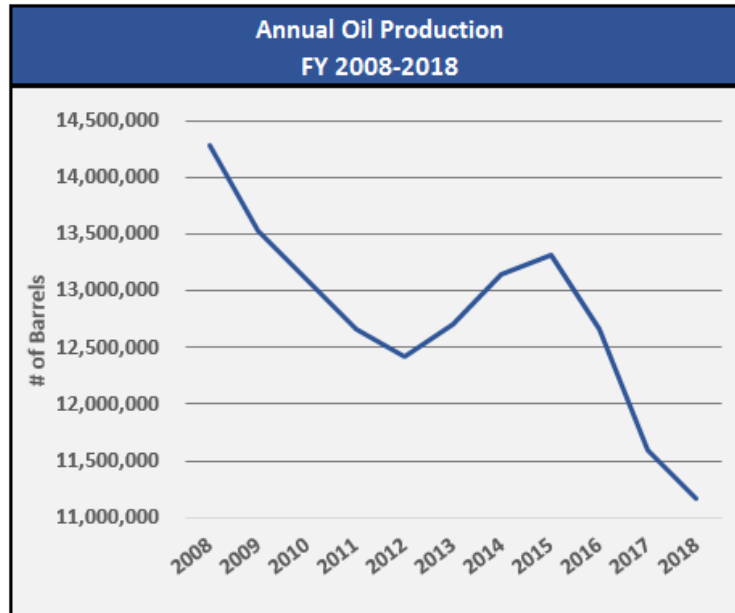


Most of the oil is produced in the Wilmington Oil Field. The Wilmington Oil Field was discovered in Long Beach in 1932 and is 13 miles long, extending from San Pedro to Seal Beach. The field is divided into two sections: West and East. TOPKO serves as the field contractor for the western section of the oil field, and THUMS serves as the field contractor for the eastern section. In FY 2018, THUMS produced 7,848,010 barrels of oil, while TOPKO produced 2,591,031 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 2018, SHPI produced a total of 346,744 barrels of oil in Long Beach.

Since the inception of Prop H through September 30, 2018, 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 16% since then. In FY 2018, there was a decline of 4% from the prior year. See Chart 2 on the next page for additional details on the fluctuation in annual oil production.

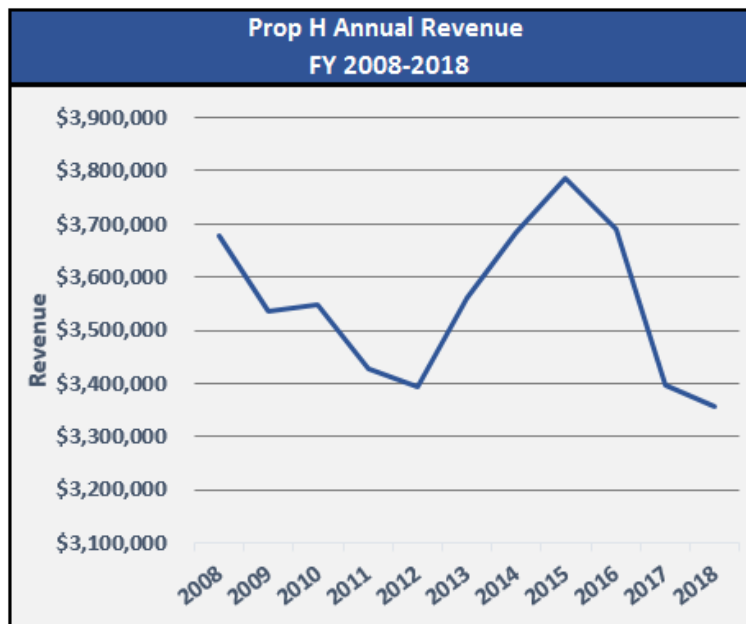
Chart 2.



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 11% between FY 2015 and FY 2018. In FY 2018, Prop H experienced a 1% decline from the revenue received the previous fiscal year. See Chart 3 below.

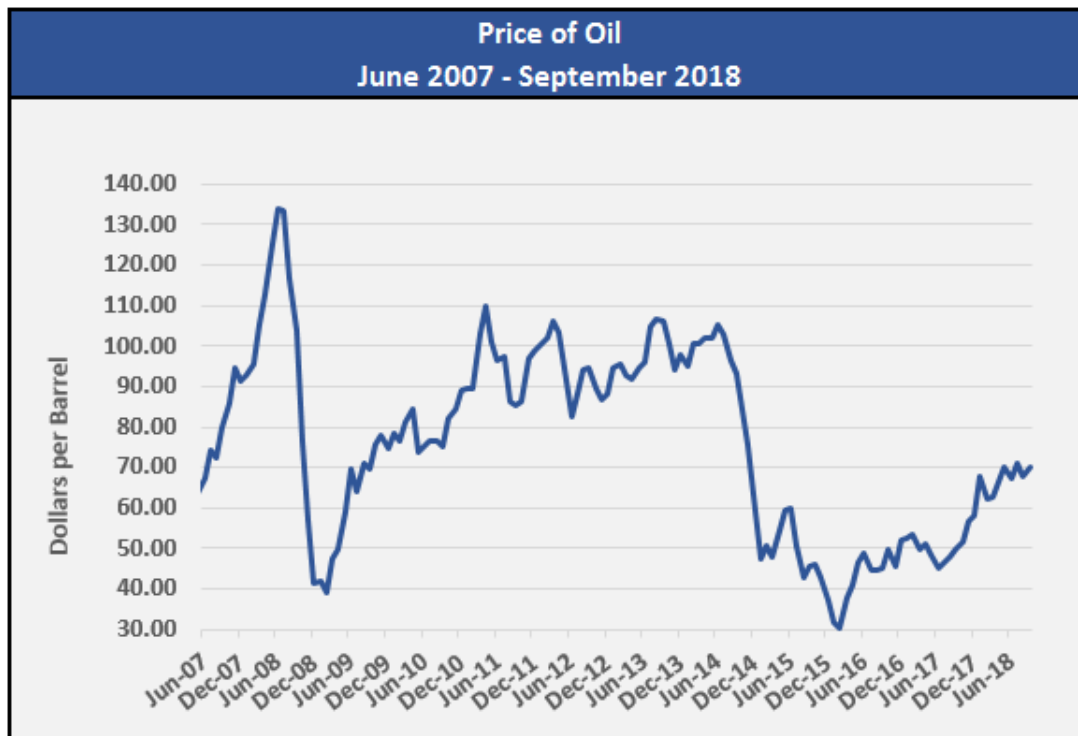
Chart 3.



Price of Oil

As shown in Chart 4 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 4.



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 2018, the average cost per barrel increased by \$39.82. FY 2018 began with the average monthly oil price of \$51.56. The price fluctuated throughout the year, but experienced a general increase in comparison to the beginning of the Fiscal Year. At the end of the Fiscal Year, September 2018, the average monthly oil price was \$70.21.

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 2018 and determine if funds remitted by the oil producers were properly calculated based on oil producers' reports remitted to the City;
2. Identify FY 2018 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, 2018 that were carried over into the current fiscal year, FY 2019; 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, 2017 through September 30, 2018. 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 approximately 97% of the reported oil production amounts with the oil producers for FY 2018.
- Identified the Prop H expenditures during FY 2018 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, 2018 that were carried over into the current fiscal year, FY 2019.
- 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.



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