

Office of the City Auditor

Audit Report

Oil Production Audit

June 2013



Audit Staff

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Executive Summary

The Office of the City Auditor (OCA) conducted an audit to determine if oil production reported to the City of Long Beach (City) by oil producers is complete and reliable for tax purposes. During the audit period of Fiscal Year (FY) 2012, there were 19 oil producers required to remit taxes to the City, totaling approximately \$5.3 million. Two of the largest oil producers, TOPKO and THUMS, comprise 94% of total oil production.

Our audit found that for the audit period of FY 2012, oil production levels reported to the City were reasonably complete and reliable for tax purposes. This is mainly due to the Department of Gas & Oil's (GO) monitoring practices of TOPKO and THUMS. GO staff observes the oil extraction process, independently calculates the barrels produced, and compares it to oil production reports submitted by the producers. In addition to our sampling testwork, the nature and extent of GO's onsite monitoring and independent calculations attributed to our confidence in the numbers reported.

Besides TOPKO and THUMS, 17 other oil producers account for the remaining 6% of oil production. According to GO, some review of this production was performed in the past, but a reduction in staff and limited revenue generated by these producers compared to TOPKO and THUMS did not make monitoring a Department priority. Our sample testwork from these producers found no material differences with reported production numbers. If the City wanted to increase its assurance that these producers were not underreporting production levels or taxes, then it should consider periodic monitoring to verify oil production.

Assurance levels could also be elevated by increasing the sharing of information between City departments. Financial Management (FM) receives oil tax payments and oil production reports similar to those monitored by GO. If GO forwarded its verified oil production reports to FM, then FM could reconcile GO report totals to the reports it receives and have additional assurance that tax payments were correct. In addition, Development Services (DV) maintains system information for oil permits and the status of active and abandoned wells. If this information were forwarded to GO, it would assist GO in the monitoring of oil producers other than TOPKO and THUMS. GO could target its monitoring efforts to those producers with active wells.

We want to thank the departmental staff of Gas & Oil, Development Services, and Financial Management for their cooperation and assistance during this audit. It was greatly appreciated.

Background

Oil Production Tax

Per Long Beach Municipal Code Section 3.80.221, oil producers pay a business license tax and a Police and Fire Public Safety tax on each barrel of oil produced in the City of Long Beach (City). The Police and Fire Public Safety tax is adjusted annually on June 1st based on the Consumer Price Index. At the time of our audit, the business license tax was 15 cents and the Police and Fire Public Safety tax was 28 cents per barrel, respectively. Taxes are remitted to the City on a quarterly basis.

Oil Producers

There were 19 oil producers that remitted oil production tax in Fiscal Year (FY) 2012, self reporting approximately 12.4 million barrels to the City's Department of Financial Management (FM), and generating just under \$5.3 million in tax revenue as shown in Table 1 below. Two oil producers, TOPKO and THUMS, comprise 94% of the total oil production and tax remitted to the City. The City has ownership rights over the Wilmington Oil Field, and serves as trustee over oil production on behalf of the State of California (State). The City contracts with TOPKO and THUMS to operate the Wilmington Oil Field, which encompasses what is referred to as Tidelands and Uplands properties. The remaining 6% of oil production and tax is derived from the remaining 17 oil producers, which are located in other parts of the City.

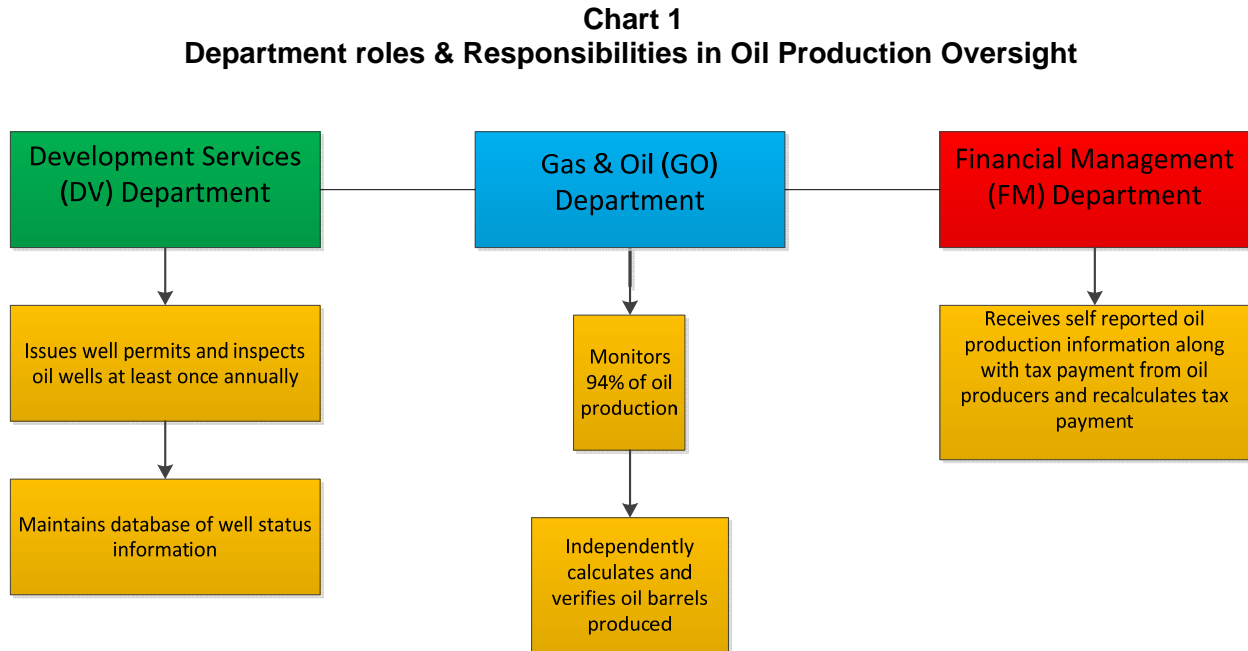
Table 1
Fiscal Year 2012 Oil Production & Revenue

Producer(s)	Barrels Produced	Tax Revenue
TOPKO and THUMS (94%)	11,651,184	\$4,922,881
Other oil producers (6%)	775,215	\$335,880
Total	12,426,399	\$5,258,761

Producers measure oil production in barrels, which is monitored through the use of controlled meters. Meters track beginning and ending values when oil is extracted for sale. Values are printed on a run ticket that is inserted into the meter at the time of extraction. These values are then used to calculate the number of oil barrels produced.

Department Oversight

As shown in Chart 1, three City departments generate or receive information related to oil operations:



Department of Development Services (DV)

DV is responsible for ensuring that oil well operators obtain an oil well permit in accordance with Long Beach Municipal Code 12.12.020. DV receives oil well permit applications and issues permits to oil producers in the City. In addition to issuing permits, DV also inspects oil wells for environmental aspects (oil leaks, gated well, etc.), whether wells are actively producing oil or are abandoned, and to determine if any new wells exist. Oil well permit data is entered manually into two systems, the Hewlett Packard (HP) system for tracking inspections, and the Billing and Collections (BC) system for annual billing. Currently, DV has one staff person assigned to conduct inspections along with other duties. Inspections are performed when the Department is notified that there is a change in an oil well's status (i.e. from active to abandoned) or potential environmental issues; however, wells in the surrounding area will also be inspected at the same time. As a result, some oil wells may only be inspected once a year, while others may be inspected more frequently.

Department of Gas & Oil (GO)

GO administers Wilmington Oil Field production activities including oversight of contracts, agreements, accounting and administrative functions. GO staff is present when run tickets are printed for all TOPKO and THUMS production. Values printed on the run tickets for TOPKO and THUMS production are reviewed by GO staff, the buyer of oil, and the producer before approved by all parties present. On occasion a representative from the State is also present. All run tickets are delivered to GO Accounting.

Accounting uses the run tickets for TOPKO and THUMS to independently calculate net oil barrels produced and compares the net barrel calculation to oil production reports submitted by TOPKO and THUMS to ensure production reported is accurate.

Besides TOPKO and THUMS, GO staff also verifies run tickets generated at three other oil producer sites. However, the run tickets for these producers are not reconciled by Accounting to production reports. There is no on-site monitoring or reconciliation of data for the remaining 14 oil producers.

Department of Financial Management (FM)

FM is responsible for collecting the business license and special tax applied to oil production. On a quarterly basis, producers remit tax along with an Oil Production Tax form and self reported production reports. FM staff enters this information into a tracking spreadsheet and recalculates the tax to ensure that the tax remitted is accurate based on the number of barrels reported by the producer. Tax payments received are also entered into the City's financial system, FAMIS.

Audit Objective, Scope and Methodology

The objective of our audit was to determine if oil production reported to the City by oil producers is complete and reliable for tax purposes. The scope of the audit covered October 1, 2011 through September 30, 2012 (Fiscal Year 2012).

During our audit, we performed the following procedures:

- Interviewed management and staff from Development Services, Gas & Oil, and Financial Management;
- Reviewed the Long Beach City Charter and Long Beach Municipal Codes related to oil production, as well as department policies and procedures;
- Reviewed and analyzed well permit reports from Development Services, oil production reports from Gas & Oil, and financial reports from Financial Management;
- Reconciled producers listed on Development Services' well permit reports against producers listed on Financial Management's Oil Production Tax Spreadsheet (OPT);
- Sampled a total of six oil producers and completed the following:
 - Reviewed and analyzed oil production reports, run tickets, and meter reports provided by the producers and/or Gas & Oil;
 - Recalculated net barrels produced;
 - Reconciled calculated net barrels to oil production reported on Financial Management's OPT.
- Evaluated key information systems used to track data related to oil production and taxes remitted.

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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Results

We reviewed oil production reports submitted by oil companies for Fiscal Year (FY) 2012 and found them to be reasonably complete and reliable for tax purposes. The Department of Gas & Oil (GO) has implemented an effective monitoring process covering the top two oil producers, TOPKO and THUMS, which represent 94% of oil production levels. The remaining 6% of oil production is generated from 17 companies. While GO performs limited monitoring of these 17 companies, our sample testwork of these producers found no material differences with reported production numbers. There are improvements the City could make in the monitoring of the 17 companies; however, the City would need to determine if the cost of the improvements outweigh the reduction in risk.

GO has an effective monitoring process for 94% of oil production

In 2012, GO monitored approximately 11.7 million barrels of oil production (94%) from TOPKO and THUMS, which produced nearly \$5 million in tax revenue. As part of GO's monitoring process, staff has considerable interaction with the two producers and does extensive onsite observations. In addition, staff reviews the generation of run tickets that indicate the amount of oil extracted through controlled meters and independently calculates oil production. These numbers are then compared to oil production reports submitted by the oil producers. To validate GO's process, we compared three months of oil production reports to the run tickets and found no material differences.

There is limited monitoring of 6% of oil production

Besides TOPKO and THUMS, 17 other oil producing companies represent 6% of total oil production and generate approximately \$336,000 in annual tax revenue for FY 2012. We sampled four of these oil producers, recalculated the oil production for three months, and compared the results to what oil producers reported to Financial Management (FM) for tax purposes. We found no material differences.

Monitoring by GO of these 17 producers is minimal. For three of the producers, verification of run tickets is done, but they are not reconciled to production reports. There is no monitoring of the remaining 14 producers. According to GO, some review was performed in the past, but reduced staffing and the limited revenue generated by these producers compared to TOPKO and THUMS does not make monitoring of these producers a priority for the Department. While periodic review with oil production verification would be ideal, the City needs to determine if the cost of monitoring these producers outweighs the risk of underreporting of production levels.

Increased communication within the City could benefit the monitoring process

Three departments within the City generate or receive information related to oil operations. However, sharing of the information between departments is limited. Increased communication could result in additional assurance that oil production levels are being accurately reported.

Currently, oil tax payments sent to Financial Management (FM) are accompanied by oil production reports, similar to those received by GO. However, FM has no way of verifying the production levels on the reports since they are not involved in the monitoring process. If FM were to receive copies of the production reports GO has verified, FM could reconcile the totals to increase assurance that tax payments are correct.

Development Services issues well permits and conducts well inspections to verify active (wells that produce oil) or abandoned status. This information is maintained in the Hewlett Packard system, with billing information also input into the City's Billing and Collection system. Both systems have information for active wells that could be shared with GO. This information would allow GO to know if all active wells were reported on oil production reports, and subsequently, FM would know if appropriate taxes are being paid. This information could also assist GO in balancing its limited resources by targeting monitoring efforts to those producers with active wells.

Recommendations

Although the City does not monitor the production levels of all oil producers, our audit did not find any material shortages in production reporting. If the City desires additional assurance that oil producers are not underreporting production levels or payment of taxes, the following recommendations should be considered:

1. The Department of Gas & Oil (GO) should periodically monitor oil producers other than TOPKO and THUMS to gain confidence that all producers are accurately reporting production levels.
2. GO should forward verified oil production reports to Financial Management (FM). FM can then reconcile GO report totals to the production reports it receives to assure reporting is consistent and tax payments are reasonable and accurate.

3. Development Services (DV) should forward information for active wells to GO so it can then use this information to assist in the monitoring of oil producers other than TOPKO and THUMS.

Appendix A

Management's Response

Department of Gas & Oil



Date: July 29, 2013
 To: Laura Doud, City Auditor
 From: Christopher Garner, Director of Long Beach Gas and Oil
 Subject: REVISED - Management Response to Oil Production Audit

The Long Beach Gas and Oil Department (LBGO) have reviewed the "Oil Production Audit" prepared by your Office. We support its recommendations and have added some additional information below. While I cannot speak for Financial Management or Development Services, please accept this memo as management's response for items associated with LBGO.

- 1) ***The Department of Gas & Oil (GO) should periodically monitor oil producers other than TOPKO and THUMS to gain confidence that all producers are accurately reporting production levels.***

RESPONSE

LBGO regularly monitors what represents about 96 percent of all oil produced in Long Beach. This includes the two largest producers TOPKO and THUMS (representing 94 percent); as well as, three smaller producers Signal Hill Petroleum, Recreation Park and City Wasem lease (representing about 2 percent). Besides the operators mentioned above, as identified by the audit, there are another 14 oil producing companies in Long Beach that represent varying levels of production activity. LBGO will consider periodic monitoring of additional production companies where the City has that production monitoring authority; and, where the reduction in risk outweighs the additional monitoring cost.

- 2) ***GO should forward verified oil production reports to Financial Management (FM). FM can then reconcile GO report totals to the production reports it receives to assure reporting is consistent and tax payments are reasonable and accurate.***

RESPONSE

LBGO will begin providing FM with the verified oil production reports that FM deems beneficial in verifying accuracy of barrel tax payments. In some instances the production reports may not be relevant. For example, the City has working interest on the entire East and West Fields controlled by Signal Hill Petroleum, but the City only receives barrel tax on the wells located within the City of Long Beach boundaries. So, Signal Hill Petroleum production data used for evaluation of financial interests wouldn't match production reports provided for calculation of barrel tax.

Laura Doud, City Auditor
July 29, 2013
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- 3) ***Development Services (DV) should forward information for active wells to GO so it can then use this information to assist in the monitoring of oil producers other than TOPKO and THUMS.***

R E S P O N S E

LBGO will work with DV to determine what information they can provide on active wells to assist in the monitoring of oil companies' production data.


cc: John Gross, Director of Financial Management
Kevin Tougas, Manager of Oil Operations

Appendix B

Management's Response

Development Services Department



Date: July 12, 2013
To: Laura L. Doud, City Auditor and Rachel Snell, Deputy City Auditor
From: Angela Reynolds, Deputy Director of Development 
Subject: Response to Recommendation Number 3 of the Oil Production Audit

Response to recommendation number 3 of the Oil Production Audit:

Development Services requires an annual permit for active oil well inspections as well as a permit for the action of abandoning an oil well.

Information regarding these permits was historically logged into the HP system. This information has been migrated to the City's Land Management Resource (LMR) system. All current and future permit information will be located in the LMR system. In addition the City is undergoing a technology effort to use the LMR system for billing and collections.

In the short term, a report can be generated that indicates the location of active and abandoned oil wells and then e-mailed to Gas and Oil Department. Ultimately, the Gas and Oil Department will be able to access all reports created in the LMR system.

Attachment

CC: Amy J. Bodek, Director of Development Services
Truong Huynh, Superintendent of Building and Safety