



OFFICE OF THE CITY AUDITOR
Long Beach, California

LAURA L. DOUD, CPA
City Auditor

February 7, 2012

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, 2011.

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 2011, the City received \$3,428,008 of Prop H revenues, a decrease of \$120,500 from the prior year;
- 2) Prop H expenditures during the fiscal year totaled \$2,988,357. Expenditures were made for eligible costs as defined in the Municipal Code;
- 3) The amount of unspent monies carried over into fiscal year 2012 was \$637,789. The carryover balances were not included in the annual budget amount provided to Police and Fire by Financial Management's Budget Office. The Budget Office would like to increase the Prop H fund balance to cover any possible future Prop H fund deficits. However, the City does not have a policy addressing how unspent monies are to be handled, resulting in the Prop H fund balance continuing to grow; 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 from June 1, 2007 through September 30, 2011, quarterly oil production in Long Beach has declined 12.2%, thereby reducing the amount of special oil tax revenues to the City. Given the volatility of oil, we encourage management to continue to monitor the revenue from this special tax and to implement a policy to determine how unspent Prop H monies should be applied.

Detailed information regarding the results discussed above 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,



LAURA L. DOUD, CPA
CITY AUDITOR

Dated: February 7, 2012

Attachment

Office of the City Auditor

Audit Report

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

For Fiscal Year Ending September 30, 2011

January 31, 2012



Audit Staff

City Auditor: Laura L. Doud
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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:

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

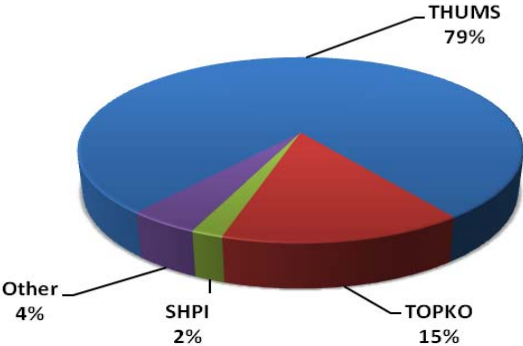
This special tax is in addition to the existing tax of 15 cents per barrel produced, and is a legally distinct tax to be used specifically to fund public safety. Specifically, these proceeds may only be used for police officers, firefighters, and related costs including, but not limited to, equipment, 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, 2011 was due to the City on or before September 30, 2011.

Oil Producers

In fiscal year (FY) 2011, oil operators in Long Beach reported a total of 12,664,476 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 2011. As illustrated below, these three oil operators accounted for 96% of oil produced in FY 2011.

Percentage of Barrels Produced in FY 2011 by Oil Producer

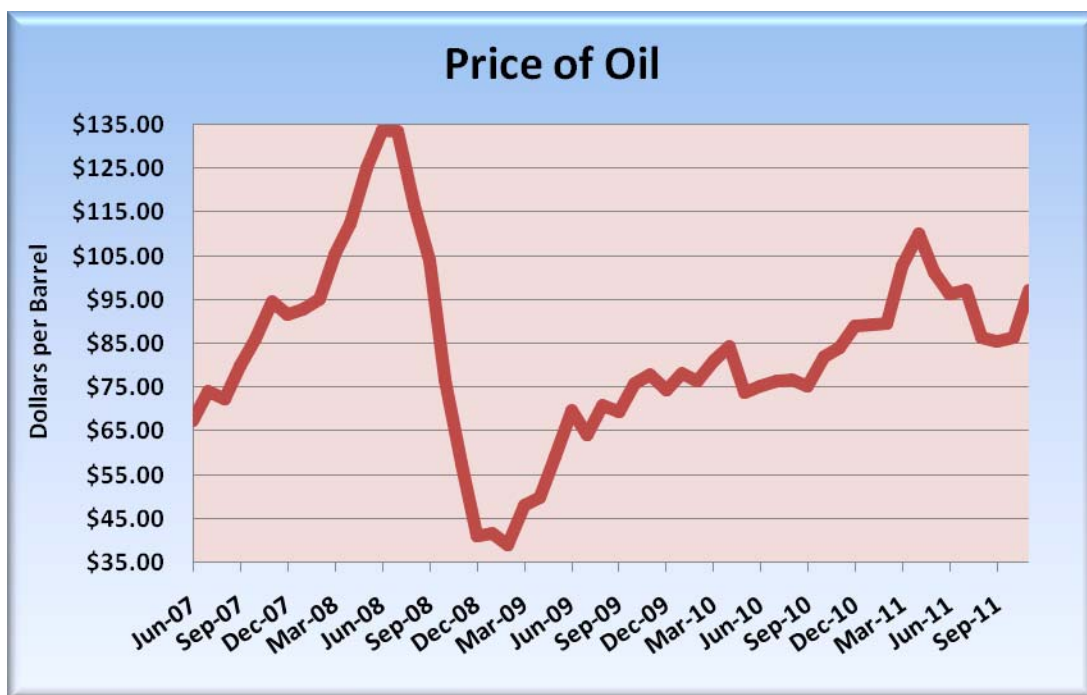


The source for the majority of the oil produced is the Wilmington Oil Field. The Wilmington Oil Field was discovered in Long Beach in 1932 and is 13 miles long, extending from San Pedro to Seal Beach. The field is divided into two sections: West and East. TOPKO serves as the field contractor for the western section of the oil field, and THUMS serves as the field contractor for the eastern section. In FY 2011, THUMS produced 9,970,289 barrels of oil, while TOPKO produced 1,890,534 barrels of oil.

SHPI, the third largest oil producer in Long Beach, is the operator for the Signal Hill West Unit and the Signal Hill East Unit Oil Fields. The oil fields are located in both Long Beach and Signal Hill. In FY 2011, SHPI produced a total of 249,523 barrels of oil in Long Beach.

Price of Oil

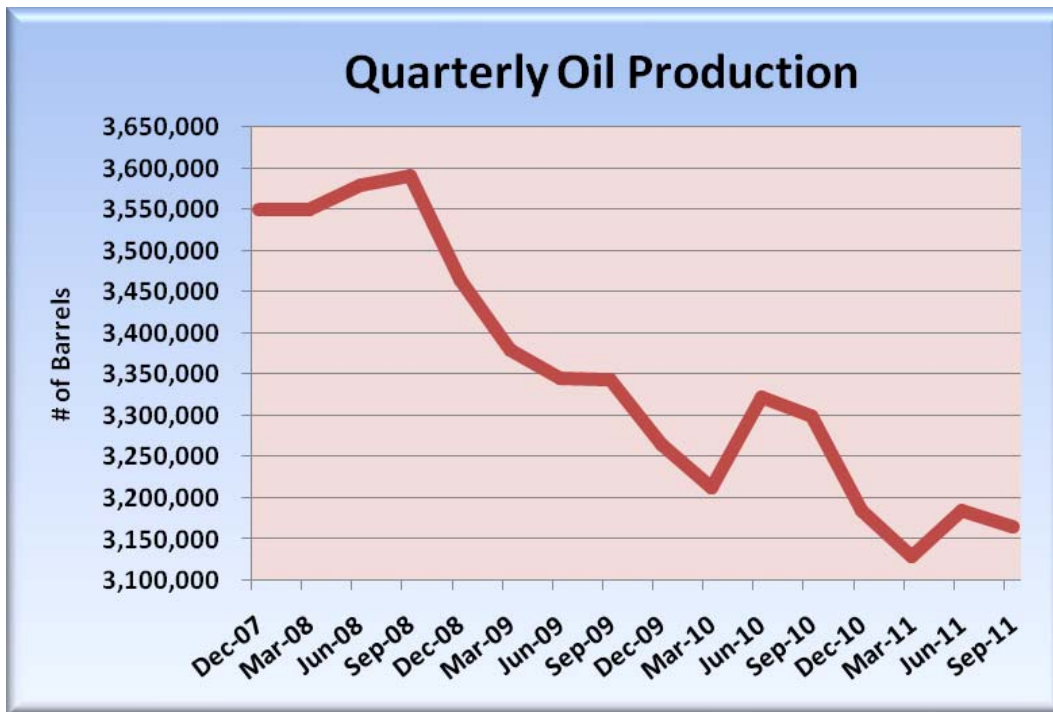
When the special oil tax became effective in June 2007, the monthly average price of oil based on the WTI (West Texas Intermediate) crude index was steadily rising. In June 2008, the monthly WTI average reached a high of \$133.93 per barrel, as shown in the chart below. However, oil prices began to decrease significantly shortly thereafter. In February 2009, the monthly WTI average fell to \$39.16 per barrel, a low not seen since June 2004.



As demonstrated in the graph above, oil prices have steadily risen since February 2009. However, it is important to note that a decline in the price of oil could impact the City in the following two ways:

1. 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.

Since the inception of Prop H through September 30, 2011, quarterly oil production in Long Beach has decreased significantly, thereby reducing the amount of special oil tax revenues to the City. See the below chart for additional details on the decline in oil production in recent years.



As depicted in the graph above, oil production in the City has notably decreased. For the fourth quarter of 2007, Long Beach oil producers reported 3,605,516 barrels of oil produced. For the fourth quarter of 2011, 3,164,832 barrels of oil were reported, equating to 12.2% reduction in quarterly oil production over four years. Given the volatility of oil, we encourage management to continue considering the above potential impacts in their fiscal planning.

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 2011 and determine if funds remitted by the oil producers were properly calculated;
2. Identify FY 2011 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, 2011 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, 2010 through September 30, 2011. 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 2011.
- Identified the Prop H expenditures during FY 2011 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, 2011 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 2011 and determine if funds remitted by the oil producers were properly calculated.

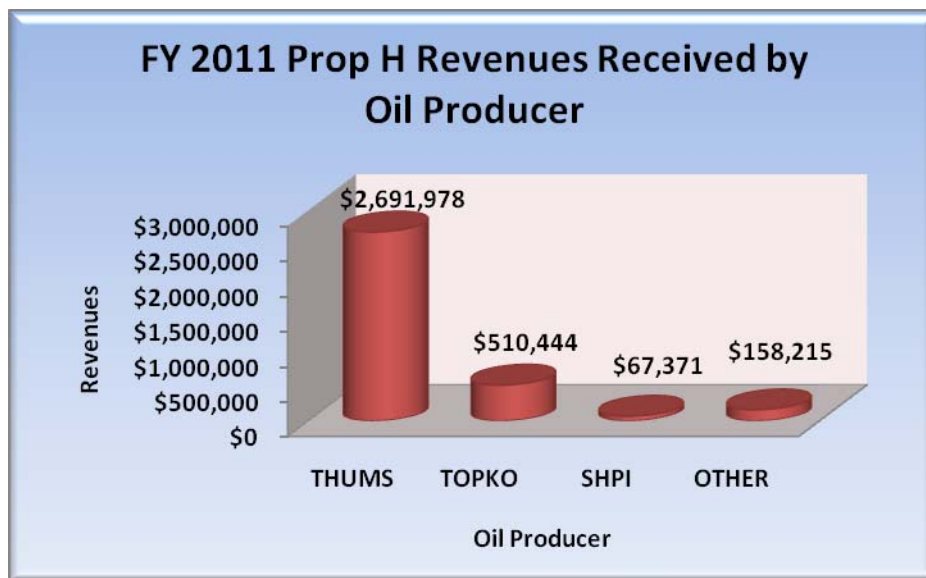
The City received a total of \$3,428,008 of Prop H special tax revenue, including penalties and interest, during FY 2011, as depicted in the table below.

Total Tax Revenues Received in FY 2011

Oil Tax Revenue	Penalties and Interest	Total
\$3,419,409	\$8,599	\$3,428,008

The special tax revenue received was based on production reports totaling 12,664,476 barrels of oil. We substantively tested 95% or \$3,269,793 of the special tax revenues received in FY 2011 through confirmations with the oil producers and determined that funds remitted by oil producers were properly calculated. 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.

Below is a summary of the Prop H funds received from major oil producers during FY 2011:



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 2011 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 2011 totaled \$2,988,357 and were made for eligible costs as defined in the Long Beach Municipal Code.

Police Department

In FY 2011, Prop H expenditures for the Police Department totaled \$1,452,804. Salaries and benefits for the twelve Prop H-funded citywide motorcycle officers totaled \$1,267,340 and accounted for 87% 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 \$1,426,216 (98% 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 2011 Prop H expenditures totaled \$1,535,553. Salaries and benefits for six Fire Truck 14 firefighters and three Fire Truck 14 fire captains totaled \$1,511,275 and accounted for 98% of total expenses. The remaining Prop H Fire expenses consisted of data center, email, and web services charges, as well as audit costs. We reviewed \$1,511,275 (98% of total expenditures) of salaries and benefits expenses related to Truck 14 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 2011.

	Amount Carried Over			Amount Carried Over
Sub-fund	From FY 2010	FY 2011 Revenues	FY 2011 Expenditures	To FY 2012
Police	\$110,953	\$1,714,441	(\$1,452,804)	\$372,590
Fire	\$87,185	\$1,713,567	(\$1,535,553)	\$265,199
Totals:	\$198,138	\$3,428,008	(\$2,988,357)	\$637,789

The expenditure amounts charged to the Prop H fund by Police and Fire are determined by the Financial Management’s Budget Office during the preparation of the annual budget. The carryover balances were not included in the amounts provided to Police and Fire as Financial Management would like to increase the Prop H fund balance to cover any deficits that may occur in a given year. However, the City does not have a policy addressing how unspent Prop H funds are to be handled, and the Prop H ordinance is silent on the matter. Therefore, the fund balance continues to grow.

We recommend the City Manager, along with Financial Management, develop a policy determining how unspent Prop H monies should be applied, including the development of an on-going fund balance or reimbursement to the General Fund for eligible Prop H expenditures.

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

Anticipated Activities

In FY 2012, the Police Department intends to use Prop H revenues to fund salaries, benefits, and fleet maintenance expenses for twelve Prop H-funded motorcycle officers.

In FY 2012, 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, 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 2012 Budgeted Revenues and Expenditures

For FY 2012, budgeted Prop H revenues and expenditures were \$3,190,166 and \$3,135,304, respectively. Approximately, 94% of total expenditures were budgeted for Salaries, Wages and Benefits.

Revenues and Expenditures	Police	Fire	Total
FY 2012 Budgeted Revenues:			
Oil Production Tax	\$1,594,983	\$1,594,983	\$3,189,966
Interest-Pooled Cash	\$100	\$100	\$200
Total Budgeted Revenues:	\$1,595,083	\$1,595,083	\$3,190,166
FY 2012 Budgeted Expenditures:			
Salaries, Wages and Benefits	\$1,311,643	\$1,475,807	\$2,787,450
Worker's Compensation	\$73,163	\$93,927	\$167,090
Internal Support	\$167,537	\$13,227	\$180,764
Total Budgeted Expenditures:	\$1,552,343	\$1,582,961	\$3,135,304
Revenues Less Expenditures at 9/30/2012 (Budgeted)	\$42,740	\$12,122	\$54,862

MANAGEMENT'S COMMENTS

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