

Office of the City Auditor

Audit Report

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

For Fiscal Year Ending September 30, 2013

January 31, 2014



Audit Staff

City Auditor: Laura L. Doud
Assistant City Auditor: Deborah K. Ellis
Deputy City Auditor: Terra Van Andel
Staff Auditor: Katie Smith

TABLE OF CONTENTS

BACKGROUND 1

 Proposition H 1

 Oil Producers 1

 Prop H Revenues 3

 Price of Oil 3

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY 5

AUDIT RESULTS 6

MANAGEMENT’S COMMENTS 9

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 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 1
Prop H Tax Rates
FY 2007-2013**

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

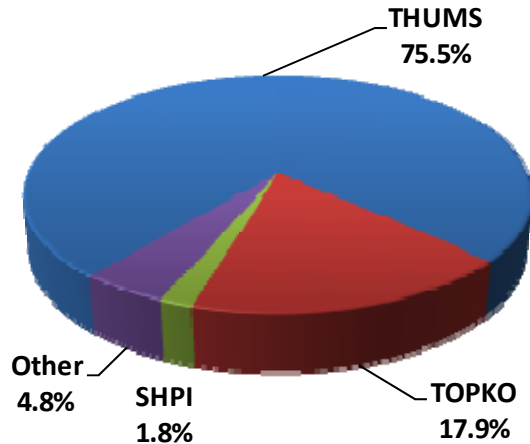
This special tax is in addition to the existing tax of 15 cents per barrel produced and is a legally distinct tax to be used specifically to fund public safety. Specifically, these proceeds may be used only for police officers, firefighters, and related costs, including but not limited to equipment, 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, 2013 was due to the City on or before September 30, 2013.

Oil Producers

In fiscal year (FY) 2013, oil operators in Long Beach reported a total of 12,703,962 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 2013. As illustrated in Chart 1, these three oil operators accounted for 95% of oil produced in FY 2013.

Chart 1
Percentage of Barrels Produced by Oil Producer
FY 2013

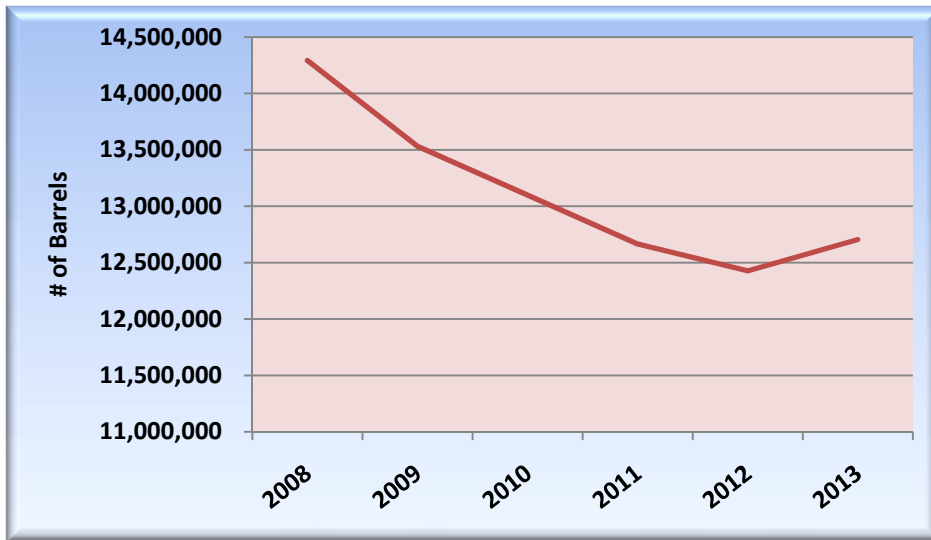


The source for the majority of the oil produced is the Wilmington Oil Field. The Wilmington Oil Field was discovered in Long Beach in 1932 and is 13 miles long, extending from San Pedro to Seal Beach. The field is divided into two sections: West and East. TOPKO serves as the field contractor for the western section of the oil field, and THUMS serves as the field contractor for the eastern section. In FY 2013, THUMS produced 9,595,607 barrels of oil, while TOPKO produced 2,276,267 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, and Signal Hill LBA-1 Lease Oil Fields. The oil fields are located in both Long Beach and Signal Hill. In FY 2013, SHPI produced a total of 227,303 barrels of oil in Long Beach.

Since the inception of Prop H through September 30, 2013, 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 2013, 12,703,962 barrels of oil were reported, equating to an 11% reduction in annual oil production over six years. While production steadily declined from FY 2008 to FY 2012, there was a 2% increase in production from FY 2012 to FY 2013. 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 fluctuation in annual oil production.

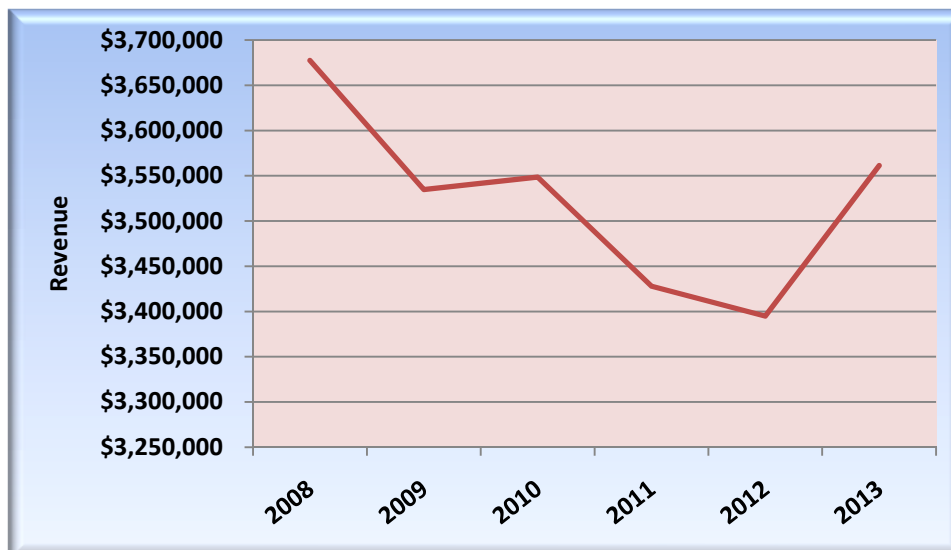
**Chart 2
Annual Oil Production
FY 2008-2013**



Prop H Revenues

Based on the level of production and price per barrel of oil, Prop H revenue received by the City has decreased 3% since FY 2008, with the lowest revenue received in FY 2012 of \$3,394,899. However, due to a slight increase in production in FY 2013 there was a 5% increase in Prop H revenue from FY 2012 to FY 2013. FY 2013 revenue was \$3,561,403.

**Chart 3
Prop H Annual Revenue
FY 2008-2013**



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 2007-2013**



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 \$106.31 per barrel (as of September 2013). 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 2013 and determine if funds remitted by the oil producers were properly calculated based on oil producers' reports remitted to the City;
2. Identify FY 2013 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, 2013 that were carried over into the current fiscal year, FY 2014; 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, 2012 through September 30, 2013. 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 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 95% of the reported oil production amounts with the oil producers for FY 2013.
- Identified the Prop H expenditures during FY 2013 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, 2013 that were carried over into the current fiscal year, FY 2014.
- 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.

AUDIT RESULTS

Objective 1 - Identify Prop H revenues received during FY 2013 and determine if funds remitted by the oil producers were properly calculated based on oil producers' reports remitted to the City.

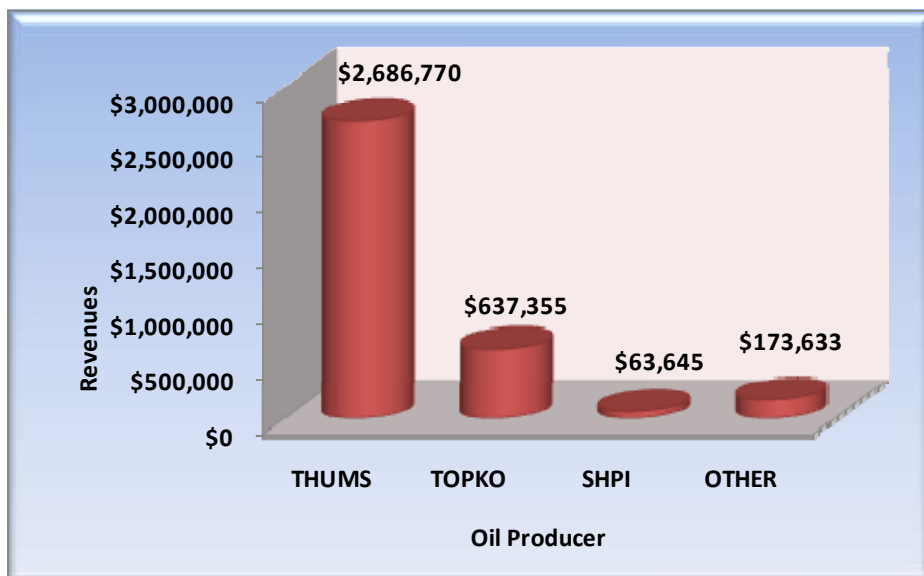
The City received a total of \$3,561,403 of Prop H oil tax revenue, including penalties and interest, during FY 2013, as depicted in the table below. The oil tax revenue received was based on production reports totaling 12,703,962 barrels of oil.

**Table 2
Total Tax Revenues Received
FY 2013**

Oil Tax Revenue	Penalties and Interest	Total
\$3,557,052	\$4,351	\$3,561,403

We substantively tested 95% or \$3,387,770 of the special tax revenues received in FY 2013 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 during FY 2013 totaling \$3,561,403:

**Chart 5
Prop H Revenues Received by Oil Producer
FY 2013**



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 2013 expenditures of Prop H funds and analyze whether such expenditures complied with the approved uses set forth in the City's Municipal Code.

Prop H expenditures during FY 2013 totaled \$3,961,731 and were made for eligible costs as defined in the City's Municipal Code.

Police Department

In FY 2013, Prop H expenses for the Police Department totaled \$1,977,507. Salaries and benefits for nine and a half Prop H-funded citywide motorcycle officers totaled \$1,449,348 and accounted for 73% of total expenses. Additionally, \$400,000 of the FY 2012 carry-over balance was used in FY 2013 to fund the Police Academy. The remaining Prop H Police Department expenses consisted primarily of fleet services charges and some small additional costs for data center, email, and web services. We reviewed \$1,956,805 (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 2013 Prop H expenditures totaled \$1,984,224. Salaries and benefits to provide constant staffing for two daily firefighter positions and one daily fire engineer position on Fire Truck 17 totaled \$1,564,288 and accounted for 79% of total expenses. Additionally, a portion of the FY 2012 carry-over balance was used in FY 2013 to offset \$400,000 of Fire Department labor cost typically funded by the General Fund. The remaining Prop H Fire expenditures included data center, email, and web services, as well as audit costs. We reviewed \$1,964,288 (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.

Objective 3 - Determine the amount of unspent Prop H monies on deposit that were carried over into the current fiscal year.

Table 3 depicts the cash flow of Prop H funds during FY 2013.

**Table 3
Prop H Funds Cash Flow
FY 2013**

	Amount Carried Over From FY 2012	FY 2013 Revenues	FY 2013 Expenditures	Amount Carried Over To FY 2014
Police	\$518,272	\$1,781,146	(\$1,977,507)	\$321,911
Fire	\$441,477	\$1,780,257	(\$1,984,224)	\$237,510
Totals	\$959,749	\$3,561,403	(\$3,961,731)	\$559,421

The expenditure amounts budgeted in the Prop H fund for Police and Fire are determined by the Department of Financial Management's Budget Office during the preparation of the annual budget.

In response to the FY 2012 Prop H Audit, management developed a policy to address the development of the growing fund balance. The policy states that the City shall maintain a fund balance of at least \$150,000, but not more than \$400,000. At the end of FY 2013, the fund balance was \$559,421. Management has opted to not use any of the FY 2013 carry-over fund balance in FY 2014. However, they did state that they plan to use a portion of the fund balance carry-over when budgeting for FY 2015. Since FY 2009, the carry-over fund balance has increased \$409,141 or 272%.

**Table 4
Prop H Carry-Over Fund Balance
FY 2009-2013**

Fiscal Year	Prop H Carry-Over at Fiscal Year End
FY 2009	\$150,280
FY 2010	\$198,137
FY 2011	\$637,789
FY 2012	\$959,749
FY 2013	\$559,421

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

Anticipated Activities

In FY 2014, the Police Department intends to continue to use Prop H revenues to fund salaries, benefits, and fleet maintenance expenses for nine and a half Prop H-funded motorcycle officers.

In FY 2014, the Fire Department intends to continue to use Prop H revenues to fund salaries and benefits to provide constant staffing for two daily firefighter positions and one daily fire engineer position on 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 City’s Municipal Code.

FY 2014 Budgeted Revenues and Expenditures

For FY 2014, budgeted Prop H revenues and expenditures were \$3,217,522 and \$3,194,892 respectively. Approximately 88% of total expenditures were budgeted for salaries, wages and benefits.

**Table 5
Budgeted Revenues and Expenditures
FY 2014**

Revenues and Expenditures	Police	Fire	Total
FY 2014 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 2014 Budgeted Expenditures:			
Salaries, Wages and Benefits	\$1,352,717	\$1,455,731	\$2,808,448
Worker's Compensation	\$107,649	\$105,949	\$213,598
Internal Support	\$151,997	\$20,849	\$172,846
Total Budgeted Expenditures:	\$1,612,363	\$1,582,529	\$3,194,892
Revenues Less Expenditures at 9/30/2014 (Budgeted)	(\$3,602)	\$26,232	\$22,630 ⁽¹⁾


⁽¹⁾ Total Revenues Less Expenditures at 9/30/2014 does not include the carry-over amount from FY 2013.

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 8, 2014
To: Laura Doud, City Auditor
From: John Gross, Director of Financial Management 
Subject: **Response to Fiscal Year 2013 Proposition H Audit Report**

Thank you for an opportunity to comment on the draft audit of Proposition H (Prop H) for Fiscal Year (FY) 2013. Please find below our Management Response.

Management concurs with conclusions reached by the Office of City Auditor in its audit of the disposition of Prop H funds for FY 13, which found that those funds were properly recorded and spent in accordance with the Police and Fire Public Safety Oil Production Act and that the fund ended FY 13 with a \$559,421 balance.

The \$559,421 was somewhat more than the policy maximum on funds available due to unexpectedly high oil revenues in FY 13. Because of timing of the revenues, the additional revenues were not able to be budgeted in FY 14. It is likely that the fund balance will remain at that level and perhaps somewhat higher by the end of FY 14. The Budget Office will propose a budget for FY 15 that is projected to draw down that balance to within target levels by the end of FY 15.

Financial Management revised its policy on the fund balance to better state the difficulty of projecting oil revenues and to take into account the timing of budget decisions.

The revised Financial Management policy, effective with the FY 15 budget is:

To the extent feasible, within the practical limits of revenue projection of available Prop H funding, the City will budget each year projected available Prop H funds plus any excess funds available, for purposes legally permitted under the Police and Fire Public Safety Oil Production Act. This budget practice has a primary goal of not drawing funds available below zero. The secondary goal is maintaining funds available in the range of \$150,000 to \$400,000 for use in transition purposes should Prop H oil production revenues decline or for use for any one-time needs.

Management welcomes City Auditor's recommendation and appreciates the opportunity to review the draft report and formulate a policy in response.

JG
K:\EXEC\JOHN GROSS\01-08-14 MEMO TO DOUD RE FY 13 PROP H AUDIT MANAGEMENT RESPONSE DOC

CC: PAT WEST, CITY MANAGER
SUZANNE FRICK, ASSISTANT CITY MANAGER
GRACE YOON, BUDGET OFFICER
JULISSA JOSE MURRAY, BUDGET OFFICER
JOHN KEISLER, CFO, POLICE DEPARTMENT