OFFICE OF THE CITY AUDITOR
Long Beach, California

LAURA L. DOUD, CPA
City Auditor

February 10, 2009

HONORABLE MAYOR AND CITY COUNCIL
City of Long Beach
California

RECOMMENDATION:

Receive and file the Proposition H Audit Report for fiscal year ending September 30, 2008.

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 amount of tax revenues collected, determine whether funds were expended on purposes set forth in the Municipal Code, report on the status of any projects and programs funded by Prop H, and report the amount of unspent monies on deposit that were carried-over into the current fiscal year.

Our audit reveals that the City received $3,677,451 of Prop H revenues during FY 2008. Since the end of FY08, the price of oil has continued its dramatic fall, from a monthly average of $133.93 in July 2008 to a monthly average of $41.02 in December 2008. If the price of oil stagnates or continues to fall, future Prop H funds could decrease due to decreased production or cease for months in which the per barrel price falls below $20.

Our audit also notes that there was $3,401,137 in combined Prop H expenditures by the Police and Fire Departments during the fiscal year. Detailed information regarding these expenditures and planned future uses for Prop H funds are 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.

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FISCAL IMPACT:

Approving this action would have no fiscal impact.

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,

Laura L. Doud

LAURA L. DOUD, CPA
CITY AUDITOR

Dated: January 30, 2009

Attachment

Audit Report

Proposition H
Police and Fire Public Safety Oil Production Act

For Fiscal Year Ending September 30, 2008

January 30, 2009

Audit Staff

City Auditor: Laura L. Doud
Assistant City Auditor: James Johnson
Deputy City Auditor: Danica D. Rogers
Senior Auditor: Sotheary Hul
Audit Staff: Carolyn Phu

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BACKGROUND:

Proposition H

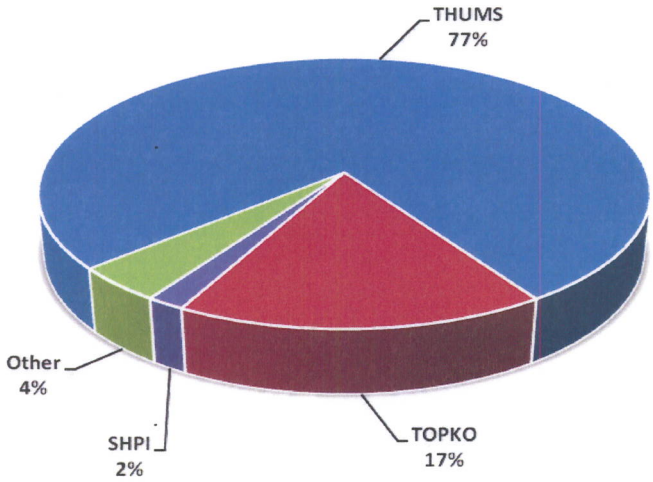
The citizens of Long Beach (City) approved Proposition H (Prop H), the Police and Fire Public Safety Oil Production Tax, on May 1, 2007. Prop H amended the Long Beach Municipal Code to assess an additional 25 cents per barrel special tax on oil producers in Long Beach, with the tax rate to be adjusted annually on June 1 based on the Consumer Price Index (CPI). The special tax became effective on June 1, 2007; 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. On June 1, 2008, the tax was adjusted to 26 cents per barrel to reflect the annual increase in CPI.

To date, the special tax revenues have been distributed equally between the Police and Fire Departments. 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.

Oil Producers

In fiscal year (FY) 2008, oil operators in Long Beach produced a total of 14,291,942 barrels of oil. 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 2008. As illustrated below, these three oil operators accounted for 96% of oil produced in FY 2008.

Percentage of Barrels Produced in FY 2008 by Oil Producer



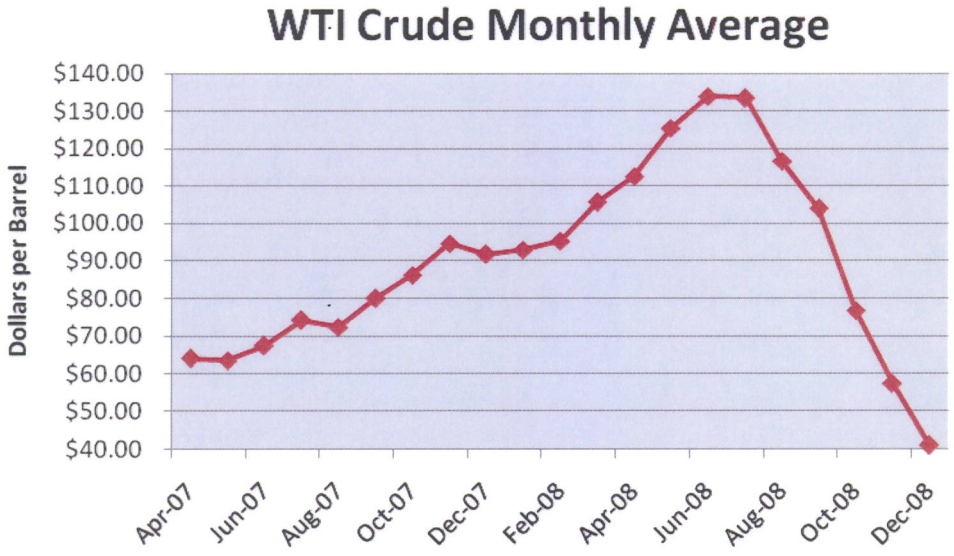
The source for the majority of the oil produced is the Wilmington Oil Field. The Wilmington Oil Field was discovered in Long Beach in 1932 and is 13 miles long, extending from San Pedro to Seal Beach. The field is divided into two sections: West and East. TOPKO serves as the field contractor for the western section of the oil field, and THUMS serves as the field contractor for the eastern section. In FY 2008, THUMS produced 11,016,073 barrels of oil, while TOPKO produced 2,422,405 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 2008, SHPI produced a total of 251,875 barrels of oil in Long Beach.

Current Economic Events

§3.80.222A of the Municipal Code states, "In the event that the price per barrel on the monthly average of the daily WTI (West Texas Intermediate Crude index) is reported in an amount less than twenty dollars ($20.00) for any month, the rate of this special tax on oil production…shall be temporarily suspended only for that same month." The monthly average of the daily WTI was $63.97 when Prop H was approved by the voters.

The monthly average of the WTI steadily rose until July 2008, when, at its height, it averaged $133.93 per barrel. The price of oil then began to decline quickly, as illustrated in the graph below. The WTI monthly average for December 2008 was $41.02 per barrel.



This 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.
2) Given the low price of oil, oil producers might decrease production, thereby reducing Prop H revenues.

Unaudited oil production figures for the first fiscal quarter of 2009 show an approximate 3.6% decrease in reported oil production compared to the fourth fiscal quarter of 2008. This decline in production equates to a decrease of approximately $34,000 in Prop H revenues for the quarter. As such, we encourage management to continue to consider 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 2008 and determine if funds remitted by the oil producers were properly calculated;

2) Identify FY 2008 expenditures of Prop H funds and analyze whether such expenditures complied with the approved uses set forth in the Municipal Code;

3) Determine the amount of unspent Prop H monies on deposit at September 30, 2008 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, 2007 through September 30, 2008. We performed the following procedures during our audit:

- Obtained the Oil Production Taxes Schedule from the Department of Financial Management and recalculated FY 2008 Prop H revenues.

- Identified the largest Prop H revenue sources and traced those revenues to the checks received and supporting production reports from the oil producers, and verified that all revenues were recorded into the City's financial system.

- Independently confirmed the reported oil production amounts with the top three oil producers, accounting for 96% of oil production within the City.

- Identified the Prop H expenditures during FY 2008 and determined whether the expenditures were in accordance with the Municipal Code.

- Obtained 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 Municipal Code.

- Identified the amount of unspent Prop H monies on deposit at September 30, 2008 that were carried over into the current fiscal year.

- Reviewed all payments received from the oil producers and determined whether appropriate penalties were assessed on late payments.

- Interviewed City personnel in the Police Department, Fire Department and Department of Financial Management and obtained relevant documentation to obtain an understanding of internal control procedures related to Prop H revenues and expenditures.

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.

In addition to the results below, we have communicated to management internal control recommendations not significant to the objectives of our audit. Those recommendations were made in a separate management letter.

AUDIT RESULTS

Objective 1 - Identify Prop H revenues received during FY 2008 and determine if funds remitted by the oil producers were properly calculated.

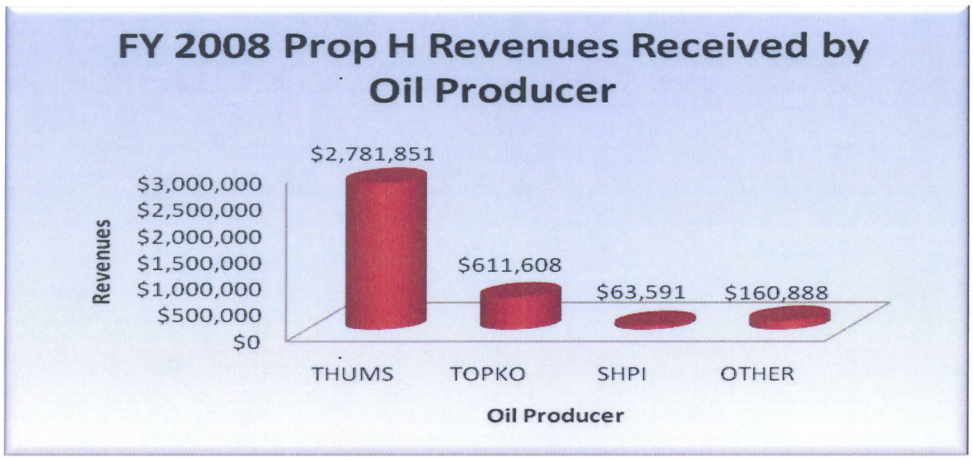
The City received a total of $3,677,451 of Prop H special tax revenue, including penalties and interest, during FY 2008.

Total Revenues Received in FY 2008

Special Tax Revenue	Penalties	Interest	Total
$3,609,806	$8,132	$59,513	$3,677,451

The special tax revenue received was based on production reports totaling 14,291,942 barrels of oil. We substantively tested 96% or $3,457,050 of the total special tax revenues received, including penalties, through confirmations with the oil producers. We also verified that all revenues were recorded into the City's financial system. In addition, we reviewed all revenues received to ensure that penalties were assessed on late payments, and we re-calculated the interest earned on Prop H revenues for reasonableness. All revenues received appear to be calculated correctly, and penalties were reasonably assessed on late payments. Further, interest earned on Prop H revenues was reasonable.

Below is a summary of the Prop H funds received from major oil producers during FY 2008.



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 funds were divided equally between two sub-funds, one for the Police Department and one for the Fire Department. Additionally, each department earned interest on its respective fund balance.

Objective 2 - Identify FY 2008 expenditures of Prop H funds and analyze whether such expenditures complied with the approved uses set forth in the Municipal Code.

Police Department

In FY 2008, Prop H expenditures for the Police Department totaled $1,771,703. Expenditures were incurred for the addition of 14 new Citywide motorcycle officers and 14 new police officer recruits. The expenses for the 14 motorcycle officers included salaries and benefits, overtime pay, uniforms, safety equipment, and fleet charges for their motorcycles. The expenses for the 14 police officer recruits were police academy costs, such as salaries and benefits, uniforms, and ammunition.

Salary and benefit expenses for the 14 motorcycle officers and 14 police officer recruits were $1,499,571, or 85% of the total expenditures. We performed a detailed review of these expenditures and found that they complied with the approved uses as set forth in the Municipal Code.

Fire Department

In FY 2008, as a part of its Prop H fiscal plan, the Fire Department reconditioned a spare fire truck, placed it into service at Fire Station 14, and in December 2007, transferred 12 firefighters from other locations to staff the fire truck (Truck 14). The Fire Department's FY 2008 Prop H expenditures totaled $1,629,434. Expenditures included approximately $1,387,000 of salaries and benefits for the 12 firefighters. Other significant expenditures included equipment and fire station modifications, as well as the purchase of capital equipment. We reviewed 98%, or $1,588,830, of the total expenditures and found that these expenditures complied with the approved uses as set forth in the Municipal Code.

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

The chart below depicts the cash flow of Prop H funds during FY 2008.

Subfund	Amount Carried Over From FY 2007	FY 2008 Revenues	FY 2008 Expenditures	Amount Carried Over to FY 2009
Police	$451,880	$1,837,044	($1,771,703)	$517,221
Fire	$451,880	$1,840,407	($1,629,434)	$662,853

As earmarked by the City Council during FY 2008 budget adoption, Prop H funds will be used to support the purchase of a new fire truck. Although the Police subfund shows $517,221 of cash to carry over into the next fiscal year, approximately $450,000 of those funds will be transferred in FY 2009 to the Fire Prop H subfund to partially pay for the new fire truck (see Objective 4 below for additional information).

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

Police Department

In FY 2009 and going forward, the Police Department intends to use Prop H revenues to continue funding the expenses incurred for the 14 motorcycle officers added in FY 2008. Eligible expenses will include the officers' salaries, benefits, uniforms, and equipment, as well as charges for the maintenance of their motorcycles.

Additionally, as stated above, a significant portion of the Police subfund's Prop H cash carryover balance will be used to help fund the purchase of a new fire truck in FY 2009. The Prop H funds were earmarked for this purpose shortly after the passage of Prop H.

Fire Department

It is anticipated that in February or March 2009, the Fire Department will take delivery of a new $900,000 fire truck. That fire truck will replace the reconditioned truck currently used at Fire Station 14. Additionally, the Fire Department intends to use its Prop H revenues to continue funding expenses relating to the operation of Fire Truck 14, including salaries and benefits of its firefighters and maintenance charges for the equipment.

MANAGEMENT'S COMMENTS

Department of Financial Management

The Department of Gas and Oil constantly monitors oil production to ensure rapid and timely management responses to projected declines in oil production. In addition, both the Department of Gas and Oil and the Department of Financial Management monitor oil prices on a daily basis to ensure proper fiscal planning, cashflow monitoring and budgetary stability. These efforts will help the City proactively address revenue shortfalls related to both the price of oil, and oil production.

It is important to note that on January 26, 2008, the Department of Gas and Oil submitted a report to the Budget Oversight Committee (BOC) identifying current and projected declines in oil production and the potential impact on Prop H and General Fund revenue for FY 09 and FY 10. The Department of Financial Management will work closely with the Fire and Police Departments to make sure expenditures in the fund do not exceed available revenue.

Fire and Police Departments

The Departments were in agreement with the information contained in the report and had no further comments.