



City of Long Beach Office of the City Auditor



Proposition H, Police and Fire Public Safety Oil Production Tax Act
Providing vital funds for public safety since 2007

January 29, 2015

FY 2014 Prop H Audit Report For Fiscal Year Ending September 30, 2014

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Executive Summary

**FY 2014 Prop H
Annual Report:
Oct. 1, 2013
Through
Sep. 30, 2014**

The citizens of Long Beach approved *Proposition H: Police and Fire Public Safety Oil Production Tax* (Prop H) in May 2007. Prop H amended the City's Municipal Code and allowed for an additional 25 cents per barrel special tax to the existing tax of 15 cents per barrel, on oil producers operating in the City. Prop H funds have a restricted use and can only be used to pay 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.

For fiscal year (FY) 2014, oil operators in Long Beach reported over 13.1 million barrels of oil were produced, an increase of 3.4% over FY 2013. Also in FY 2014, Prop H revenues increased slightly to \$3.7 million from \$3.6 million, while expenditures decreased 23% to \$3.1 million from \$4.0 million the prior year.

The use of Prop H revenues by the Police and Fire Departments complied with the approved uses set out by City Code. In FY 2014, Prop H supported 9.5 motorcycle officers and 9 firefighters. Remaining Prop H funds were used for non-personnel related expenditures, including fleet services charges, a data center, email, and web services.

At over \$1.1 million, the Prop H carry-over fund balance at September 30, 2014 exceeds the reserve policy for this fund. However, the FY 2015 Adopted Budget for Prop H includes the use of close to \$843,000 in reserve funds, which should bring the reserve balance to within policy by the end of fiscal year 2015.

We want to thank the staff of the Financial Management, Police, and Fire Departments for their assistance during this audit.

Background

What is Prop H?



On May 1, 2007, the citizens of Long Beach approved the Long Beach Police and Fire Public Safety Oil Production Tax (Prop H). Prop H levied a 25 cents special tax per barrel on oil producers within Long Beach. The tax is annually adjusted every June 1st by the consumer price index (CPI). Table 1 depicts the applied annual CPI adjustments since inception of Prop H in 2007. For FY 2014 the Prop H tax is \$0.28, unchanged from the prior year.

Table 1
Prop H Tax Rates, FY 2007-2014

Effective Date	CPI Adjustment	Prop H Special Tax	Total OPT & Prop H Tax
June 1, 2007	-	\$0.25	\$0.40
June 1, 2008	\$0.01	\$0.26	\$0.41
June 1, 2009	\$0.01	\$0.27	\$0.42
June 1, 2010	\$0.00	\$0.27	\$0.42
June 1, 2011	\$0.00	\$0.27	\$0.42
June 1, 2012	\$0.01	\$0.28	\$0.43
June 1, 2013	\$0.00	\$0.28	\$0.43
June 1, 2014	\$0.00	\$0.28	\$0.43

This Prop H special tax, codified in Municipal Code Section 3.80.222, is a legally distinct tax used specifically to fund public safety. 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.

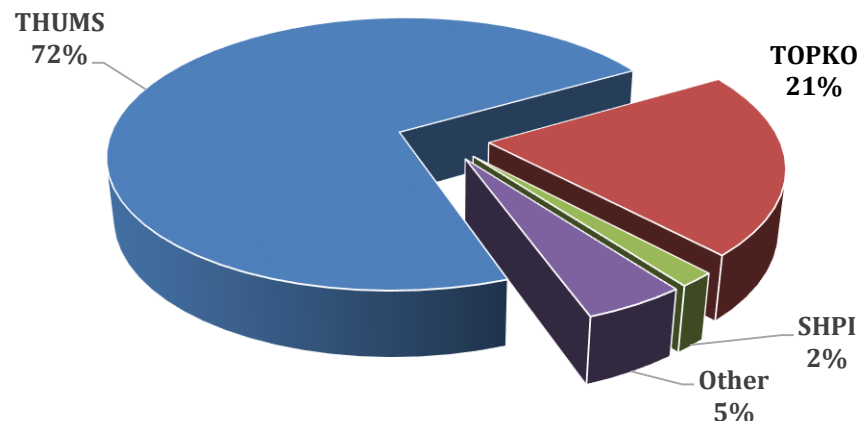
The oil taxes are due to the City on or before the last day of each calendar quarter, and the payments are based on a production quarter, which ends one month earlier than the calendar quarter. For example, the tax payments for the production quarter ending June 30, 2014 were due to the City on or before July 31, 2014.

Failure to pay the tax results in a penalty of 25% of the total amount 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.

Three oil producers accounted for 95% of over 13.1 million barrels of oil produced in the City during FY 2014.

In fiscal year (FY) 2014, oil producers in Long Beach reported a total of 13,141,325 barrels of oil produced. THUMS Long Beach Company (THUMS), Tideland Oil Production Company (TOPKO) and Signal Hill Petroleum, Inc. (SHPI) were the City's top oil producers in FY 2014, as illustrated in Figure 1.

**Figure 1
FY 2014 Oil Production by Oil Producer**



The Wilmington Oil Field, which was discovered in 1932, is the major source of oil produced in the City. The field is 13 miles long and extends from San Pedro to Seal Beach; it is divided into two sections: East and West.

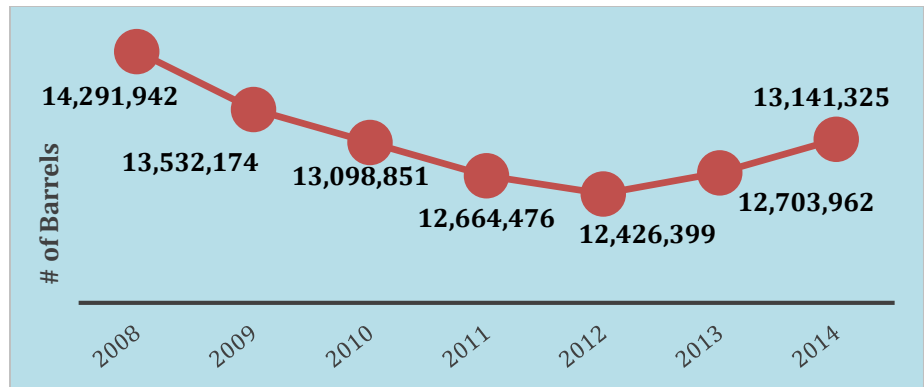
THUMS serves as the field contractor for the eastern section of the oil field and TOPKO serves as the field contractor for the western section. In FY 2014, THUMS produced 9,489,205 barrels of oil, while TOPKO produced 2,804,021 barrels of oil.

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 2014, SHPI produced a total of 223,226 barrels of oil in Long Beach.

Oil production has been trending upward for the past two years.

Since the inception of Prop H through fiscal year 2012, annual oil production in Long Beach has continually decreased. However, as shown in Figure 2, production for the past two fiscal years has moved upward almost 6%. Increased production during this two-year period correlates with the rising cost of fuel per barrel during the time, which averaged \$95.62 and \$99.22 in FYs 2013 and 2014, respectively.

Figure 2
Annual Oil Production in Long Beach
FYs 2008 – 2014



Price of Oil

As shown in Figure 3, when the special oil tax became effective in June 2007, the monthly average price of oil was steadily rising based on the West Texas Intermediate (WTI) crude index.

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 index falling to \$39.16 per barrel in February 2009, and as of the period ending September 2014, the WTI was \$93.35 per barrel.

Figure 3
Price of Crude Oil, WTI Index
June 2007 – September 2014





Following the end of FY 2014, it should be noted that the price of oil began to fall beginning in October 2014. As of January 2015, the price per barrel was at \$50.04, the lowest per barrel price since April 2009, with projections it could drop further.

A continued decline in the price of oil could impact the City in two ways:

- Prop H revenue is suspended by Municipal Code for any months in which the WTI average falls below \$20 per barrel; and
- A decision by oil producers to decrease production in line with a decrease in oil prices, thereby reducing Prop H revenue.

Audit Objectives, Scope and Methodology

Long Beach Municipal Code §3.80.227 requires annual independent financial audits of Proposition H (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 2014 and determine if funds remitted by the oil producers were properly calculated based on oil producers' reports remitted to the City;
2. Identify FY 2014 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, 2014 that were carried over into the current fiscal year, FY 2015; 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, 2013 through September 30, 2014. 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 Financial Management Department (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 2014.
- Identified the Prop H expenditures during FY 2014 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, 2014 that were carried over into the current fiscal year, FY 2015.
- 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

REVENUES

Objective 1: Identify Prop H revenues received during FY 2014 and determine if funds remitted by the oil producers were properly calculated based on oil producers' reports remitted to the City.

\$3.7 million in Prop H revenues were collected in FY 2014.

Since Prop H was enacted on June 1, 2007, the City has collected more than \$25.7 million in Prop H oil tax revenues, including penalties and interest, as depicted in Table 2, based on production of nearly 95.5 million barrels of crude oil.

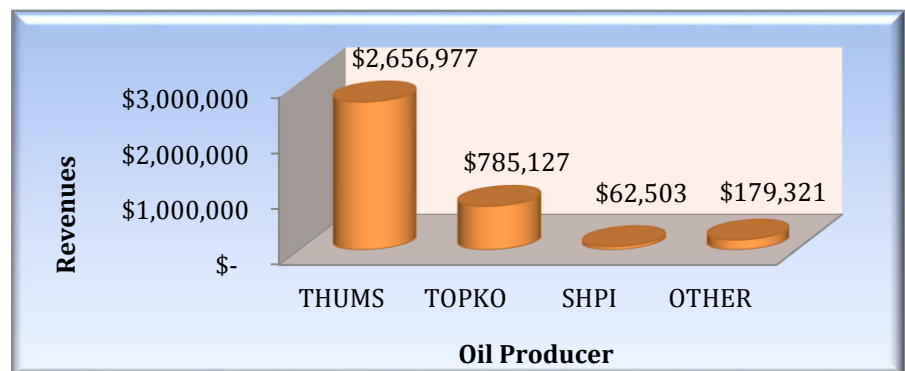
Table 2
Prop H Annual Revenues
FYs 2007 - 2014

Fiscal Year	Oil Tax Revenue	Penalties	Interest	Total
2007*	\$ 903,093	\$ -	\$ -	\$ 903,093
2008	3,609,806	8,132	59,513	3,677,451
2009	3,511,007	2,991	20,808	3,534,806
2010	3,540,929	7,953	(368)	3,548,514
2011	3,419,409	7,243	1,356	3,428,008
2012	3,386,472	5,411	3,017	3,394,899
2013	3,557,052	5,437	(1,086)	3,561,403
2014	3,679,571	1,806	2,551	3,683,928
Total	\$ 25,607,339	\$ 38,973	\$ 85,791	\$ 25,732,102

*FY 2007 is a partial year as Prop H was initiated on June 1, 2007.

For FY 2014, the City received \$3.7 million, an increase of 3.4% over the prior year. This revenue is shown by oil producer in Figure 4. This was based on 13.1 million barrels of oil produced.

Figure 4
Prop H Revenues by Producer



We substantively tested 95% or \$3.5 million of the special tax revenues received in FY 2014 through confirmations from oil producers, and we 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, and that penalties were assessed on late payments, where required.

We verified that the special tax revenues and penalties received have been deposited into the Police and Fire Public Safety Oil Production Act Special Revenue Fund (Fund 121), as required by Section 3.80.225 of the Municipal Code; and that the revenues were divided equally between two sub-funds, one for the Police Department and the other for the Fire Department.

EXPENDITURES

Objective 2: Identify FY 2014 expenditures of Prop H funds and analyze whether such expenditures complied with the approved uses set forth in the City's Municipal Code.

\$3.1 million in Prop H funds were expended in FY 2014 for Police and Fire.

As shown in Table 3, since Prop H tax was enacted, a cumulative total of \$25 million has been spent on approved public safety uses as set forth in the City's Municipal Code. Prop H expenditures for FY 2014 totaled \$3.1 million, almost \$0.9 million or 23% less than the prior year.

Table 3
Prop H Annual Expenditures
FYs 2007 – 2014

Fiscal Year	Salaries, Wages & Benefits	Materials, Supplies & Services	Internal Support	Capital Purchases	Total
2007	-	-	-	-	-
2008	\$2,927,000	\$296,190	\$161,524	\$16,423	\$3,401,137
2009	3,479,737	36,157	1,077,474	0	4,593,368
2010	3,571,158	8,588	303,825	0	3,883,571
2011	2,778,615	17,860	191,881	0	2,988,356
2012	2,905,281	39	167,620	0	3,072,940
2013	3,413,635	23	548,073	0	3,961,731
2014	2,970,203	4	94,379	0	3,064,586
Total	\$22,045,629	\$358,861	\$2,544,776	\$16,423	\$24,965,689
% of Total	88.3%	1.4%	10.2%	0.1%	

Prop H taxes are payable on a quarterly basis, contingent upon reported oil production levels from the prior three months. Yearly expenditure amounts and uses budgeted in the Prop H fund are determined by the Department of Financial Management's Budget Office (Financial Management) during the preparation of the annual budget, based on projected available Prop H funds plus any excess funds available. For these reasons, Prop H expenditures in a particular year are not equivalent to that year's actual Prop H tax proceeds.

Over the years, Prop H helped support critical services, such as traffic safety, crime prevention, fire suppression, and emergency medical response and, in FY 2014, supported 9.5 police officers and 9 firefighters, as shown in Table 4.

Table 4
Positions Funded by Prop H
FYs 2008 - 2014

Fiscal Year	Police	Fire
2008	14 Motorcycle Officers	12 Firefighters
2009	14 Motorcycle Officers	12 Firefighters
2010	14 Motorcycle Officers	12 Firefighters
2011	12 Motorcycle Officers	9 Firefighters
2012	9.5 Motorcycle Officers	9 Firefighters
2013	9.5 Motorcycle Officers	9 Firefighters
2014	9.5 Motorcycle Officers	9 Firefighters
Average	11.8 Positions	10.3 Positions

During our testwork, we verified 99% of the \$3.1 million of expenditures made during FY 2014 by the Police and Fire Departments. We determined that the funds were used for eligible costs and complied with the approved uses as set forth in the City's Municipal Code, as further described below.

Police Department

In FY 2014, Prop H expenditures for the Police Department totaled \$1.5 million. The majority of funds, 95%, were used for the salaries and benefits of 9.5 motorcycle officers. Other expenditures consisted primarily of fleet services charges and some small additional costs for a data center, email, and web services. We reviewed \$1.46 million, or 99%, of total Police expenditures and found no exceptions.

Fire Department

In FY 2014, Prop H expenditures for the Fire Department totaled \$1.6 million. The majority of funds, 99%, were used for the salaries and benefits to support staffing of six firefighters and three fire engineers. The remaining funds funded the costs for a data center, email, and web services. Based on our review of these expenditures, we found no exceptions.

CARRY-OVER FUNDS

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

Carryover funds at the end of FY 2014 continue to exceed City policy.

In order to not overspend available Prop H fund balances, some funds are reserved for carry-over for the next fiscal year. As shown in Table 5, the carry-over from FY 2014 into FY 2015 is over \$1.18 million, an increase of \$0.6 million, or almost 111%, over FY 2013.

Table 5
Prop H Carry-Over Fund Balance
FY 2009 – 2014

Fiscal Year	Carry-Over at FY End
2009	\$ 150,280
2010	\$ 198,137
2011	\$ 637,789
2012	\$ 959,749
2013	\$ 559,421
2014	\$ 1,178,884

Based on an audit recommendation in the Office of the City Auditor's FY 2012 report, Financial Management developed a reserve policy to address the growing fund balance and to reduce the risk of unexpected revenue drops. The new policy establishes a goal to maintain a fund balance in the range of \$150,000 to \$400,000 to provide a cushion should Prop H revenues decline or to fund large one-time expenditures.

Although the policy was written in FY 2013, it was not completed prior to the finalization of the FY 2014 Budget, and Financial Management elected not to adjust the Police and Fire Departments' budgets for FY 2014. Therefore, the fund balance continued to increase during FY 2014. However, almost \$843,000 of carry-over funds has been programmed in the FY 2015 Adopted Budget. Based on revenue and expenditure budget forecasts, the fund balance is estimated at just above \$335,000 for the end of FY 2015, which will conform to recent fund policy.

STATUS OF PROJECTS & PROGRAMS

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

Anticipated Activities

Anticipated activities for Prop H by the Police and Fire Departments for FY 2015 comply with the approved uses as set forth in the City's Municipal Code, as described below.

Police Department

The Police Department intends to continue their use of Prop H revenues to fund salaries, benefits, and fleet maintenance expenditures for 9.5 motorcycle officers. The department will spend \$400,000 to fund the construction of a new East Patrol Division substation at Schroeder Hall. Also, a small portion of funds, about \$190,000, will pay for additional Police Recruit salaries at the Police Academy.

Fire Department

The Fire Department will continue to use Prop H revenues to fund salaries and benefits to provide staffing for six firefighter positions and three fire engineers. Also, \$400,000 will be used to purchase equipment and emergency generators for department facilities. The balance of budgeted funds will be used towards other fire suppression and training operations, as well as associated internal services charges.

FY 2015 Budgeted Revenues & Expenditures

The Adopted Budget for FY 2015, shown in Table 6, includes revenues and expenditures of \$3.6 million and \$4.4 million, respectively. The majority of Prop H funds, about 73%, are budgeted for salaries, wages and benefits of Police and Fire personnel. As discussed earlier, the Budget in FY 2015 includes almost \$843,000 in carry-over funds.

Table 6
FY 2015 Prop H Budget

Revenues and Expenditures	Police	Fire	Total
FY 2014 Carry-Over Funds:			\$ 1,178,884
FY 2015 Budgeted Revenues:			
Oil Production Tax	\$ 1,805,865	\$ 1,784,103	\$ 3,589,968
Interest-Pooled Cash	100	100	200
Total	\$ 1,805,965	\$ 1,784,203	\$ 3,590,168
FY 2015 Budgeted Expenditures:			
Salaries, Wages and Benefits	\$ 1,551,930	\$ 1,688,206	3,240,136
Worker's Compensation	113,116	123,345	236,461
Internal Support	136,057	20,507	156,564
Materials, Supplies, and Services		400,000	400,000
Transfers between funds	400,000		400,000
Total	\$ 2,201,103	\$ 2,232,058	\$ 4,433,161
Carry-Over Plus Revenues	\$ (395,138)	\$ (447,855)	\$ 335,891
Less Expenditures At 09.30.2015			


Management Comments



City of Long Beach
Working Together to Serve

Memorandum

Date: January 30, 2015
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) 2014.

The Departments of Financial Management and Police have reviewed the audit report and thank the City Auditor for the thoroughness of the report and for providing a history of the funding and its status. Both Departments concur with the report findings.

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

JG
K:\EXEC\JOHN GROSS\01-30-15 MEMO TO DOUD RE FY 14 PROP H AUDIT MANAGEMENT RESPONSE.DOC

CC: PATRICK WEST, CITY MANAGER
TOM MODICA, ASSISTANT CITY MANAGER
JOHN KEISLER, CFO, POLICE DEPARTMENT