

CITY OF NEVADA CITY

Audit Report

SPECIAL GAS TAX STREET IMPROVEMENT FUND

July 1, 1998, through June 30, 2011

TRAFFIC CONGESTION RELIEF FUND

July 1, 2000, through June 30, 2011

PROPOSITION 1B FUND

July 1, 2007, through June 30, 2011



JOHN CHIANG
California State Controller

June 2014



JOHN CHIANG
California State Controller

June 23, 2014

The Honorable Sally Harris
Mayor of the City of Nevada City
317 Broad Street
Nevada City, CA 95959

Dear Mayor Harris:

The State Controller's Office audited the City of Nevada City's Special Gas Tax Street Improvement Fund for the period of July 1, 1998, through June 30, 2011. We also audited the Traffic Congestion Relief Fund for the period of July 1, 2000, through June 30, 2011, and reviewed the Proposition 1B funds, recorded in the Proposition 1B Fund, for the period of July 1, 2007, through June 30, 2011.

Our audit found that the city accounted for and expended its Special Gas Tax Street Improvement Fund, Traffic Congestion Relief Fund, and Proposition 1B Fund in compliance with requirements.

If you have any questions, please contact Steven Mar, Chief, Local Government Audits Bureau, at (916) 324-7226.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/sk

cc: Catrina Olson, Finance Director
Nevada City
Steven Mar, Bureau Chief
Division of Audits, State Controller's Office
Mike Spalj, Audit Manager
Division of Audits, State Controller's Office

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Audit Report

Summary

The State Controller's Office audited the City of Nevada City's Special Gas Tax Street Improvement Fund for the period of July 1, 1998, through June 30, 2011. We also audited the Traffic Congestion Relief Fund (TCRF) for the period of July 1, 2000, through June 30, 2011, and reviewed the Proposition 1B funds, recorded in the Proposition 1B Fund, for the period of July 1, 2007, through June 30, 2011.

Our audit found that the city accounted for and expended its Special Gas Tax Street Improvement Fund, Traffic Congestion Relief Fund, and Proposition 1B Fund in compliance with requirements.

Background

The State apportions funds monthly from the highway users tax account in the transportation tax fund to cities and counties for the construction, maintenance, and operation of local streets and roads. The highway users taxes derive from state taxes on the sale of motor vehicle fuels. In accordance with Article XIX of the California Constitution and Streets and Highways Code section 2101, a city must deposit all apportionments of highway users taxes in its Special Gas Tax Street Improvement Fund. A city must expend gas tax funds only for street-related purposes. We conducted our audit of the city's Special Gas Tax Street Improvement Fund under the authority of Government Code section 12410.

Government Code section 14556.5 created a Traffic Congestion Relief Fund in the State Treasury for allocating funds quarterly to cities and counties for street or road maintenance, reconstruction, and storm damage repair. Cities must deposit funds received into the city account designated for the receipt of state funds allocated for transportation purposes. The city recorded its TCRF allocations in the Traffic Congestion Relief Fund. We conducted our audit of the city's TCRF allocations under the authority of Revenue and Taxation Code section 7104.

Senate Bill 1266, Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006, was introduced as Proposition 1B and approved by the voters on November 7, 2006, for a variety of transportation priorities, including the maintenance and improvement of local transportation facilities. Proposition 1B funds transferred to cities and counties shall be deposited into an account that is designated for the receipt of state funds allocated for streets and roads. The city recorded its Proposition 1B allocations in the Proposition 1B Fund. A city also is required to expend its allocations within three years following the end of the fiscal year in which the allocation was made and to expend the allocations in compliance with Government Code section 8879.23. We conducted our audit of the city's Proposition 1B allocations under the authority of Government Code section 12410.

Objective, Scope, and Methodology

Our audit objective was to determine whether the city accounted for and expended the Special Gas Tax Street Improvement Fund, the Traffic Congestion Relief Fund, and the Proposition 1B Fund in compliance with Article XIX of the California Constitution, Streets and Highways Code, Revenue and Taxation Code section 7104, and Government Code section 8873.23. To meet the audit objective, we determined whether the city:

- Properly deposited highway users tax apportionments and other appropriate revenues in the Special Gas Tax Street Improvement Fund;
- Properly deposited TCRF allocations into an account designated for the receipt of state funds allocated for transportation purposes;
- Expended funds exclusively for authorized street-related purposes; and
- Made available unexpended funds for future 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We did not audit the city's financial statements. We limited our audit scope to planning and performing the audit procedures necessary to obtain reasonable assurance that the city accounted for and expended the Special Gas Tax Street Improvement Fund, Traffic Congestion Relief Fund, and Proposition 1B Fund in accordance with the requirements of the Streets and Highways Code, Revenue and Taxation Code section 7104, and Government Code section 8879.23. Accordingly, we examined transactions, on a test basis, to determine whether the city expended funds for street purposes. We considered the city's internal controls only to the extent necessary to plan the audit.

Conclusion

Our audit found that the City of Nevada City accounted for and expended its Special Gas Tax Street Improvement Fund in compliance with Article XIX of the California Constitution and the Streets and Highways Code for the period of July 1, 1998, through June 30, 2011.

Our audit also found that the city accounted for and expended its Traffic Congestion Relief Fund in compliance with Article XIX of the California Constitution, the Streets and Highways Code, and Revenue and Taxation Code section 7104 for the period of July 1, 2000, through June 30, 2011.

In addition, our review found that the city accounted for and expended its Proposition 1B Fund in compliance with Government Code section 8879.23 for the period of July 1, 2007, through June 30, 2011.

Follow-Up on Prior Audit Findings

The city satisfactorily resolved the findings noted in our prior audit report, issued in October 1999.

Views of Responsible Official

We issued a draft audit report on February 26, 2014. Catrina Olson, Finance Director, responded by letter dated March 18, 2014, disagreeing with the audit results. The city's response is included in this final audit report as an attachment.

Restricted Use

This report is intended for the information and use of the City of Nevada City's management and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

June 23, 2014

**Schedule 1—
Reconciliation of Fund Balance
July 1, 2010, through June 30, 2011**

	Special Gas Tax Street Improvement Fund	Traffic Congestion Relief Fund ²
	Highway Users Tax Allocation ^{1,3}	
Beginning fund balance per city	\$ 72,762	\$ —
Revenues	<u>93,229</u>	<u>326</u>
Total funds available	165,991	326
Expenditures	<u>(79,882)</u>	<u>—</u>
Ending fund balance per city	86,109	326
Timing adjustment:		
Accrual of July 2011 highway users tax apportionment (Governmental Accounting Standards Board Statement No. 34)	<u>9,210</u>	<u>—</u>
Ending fund balance per audit	<u>\$ 95,319</u>	<u>\$ 326</u>

¹ The city receives apportionments from the State highway users tax account, pursuant to Streets and Highways Code sections 2103, 2105, 2106, 2107, and 2107.5. The basis of the apportionments for sections 2103, 2105, 2106, and 2107 varies, but the money may be used for any street purpose. Streets and Highways Code section 2107.5 restricts apportionments to administration and engineering expenditures, except for cities with populations of fewer than 10,000 inhabitants. Those cities may use the funds for rights-of-way and for the construction of street systems. The audit period was July 1, 1998, through June 30, 2011; however, this schedule includes only the period of July 1, 2010, through June 30, 2011.

² Government Code section 14556.5 created a Traffic Congestion Relief Fund (TCRF) in the State Treasury for allocating funds quarterly to cities and counties for street and road maintenance, reconstruction, and storm damage repair. The TCRF allocations were recorded in the Traffic Congestion Relief Fund. The audit period was July 1, 2010, through June 30, 2011.

³ Senate Bill 1266, Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006, introduced as Proposition 1B, provided funds for a variety of transportation priorities. The review period was July 1, 2007, through June 30, 2011. The city did not receive any Proposition 1B revenues and did not incur any Proposition 1B expenditures during FY 2010-11, therefore it is not included in this schedule.

Findings and Recommendations

FINDING 1— Unspent Traffic Congestion Relief Fund allocations

The city did not expend its Traffic Congestion Relief Fund (TCRF) allocations of \$125,929 and related interest of \$6,551, totaling \$132,479 within the required two-year period.

The Streets and Highways Code section 2182.1(g) and the Guidelines Relating to Traffic Congestion Relief Funds section 390, states:

Cities and counties must expend the allocations received from the TCRF (and any related interest income earned) no later than the end of the following fiscal year in which the allocation is received. Any allocations and related interest not expended within that period must be returned to the State Controller and reallocated to other cities and counties.

Recommendation

The city should return \$132,479 to the State Controller's Office, Attention Rhodora Bravo, P.O. Box 942850, Sacramento, CA 94250.

City's Response

Beginning with the finding regarding the TCRF unspent allocations, the City does not agree with the balance that the State Controller's Office is recommending that the City return. Attached is a copy of the final audit for fiscal year 10/11 which shows the balance of TCRF at \$112,006 which includes \$6,877.04 of interest allocated to the account since fiscal year 01/02. This doesn't agree with the draft audit provided by the State Controller's Office which states a balance of \$125,929 and related interest of \$6,551.00.

Regarding the finding that the funds were unspent the City does not agree. The City did not have an accurate accounting of special funds, such as TCRF, that were being expended. The City went through a major reorganization from 2006-2008 which many funds were identified as expended however still "sitting in the City's financials" with unused balances. This matter was identified by the City's new auditors Smith and Newell beginning fiscal year 2006/2007. This fund clean-up task was a multi-year clean up which included TCRF funds. All citywide projects were being charged to the general fund and special transaction tax Measure "S" rather than being charged to the appropriate designated fund, as in the TCRF. It was the intent of the City that the revenues to support street improvement, maintenance, and repair, and reconstruction received from the State, were to be used to support the City streets ongoing projects. As you can see from the spreadsheet provided the City has expended a great deal of general fund and transaction tax revenue on the streets and roads in Nevada City because of their extremely poor conditions. Please refer to the attached documentation that provides support of the audited balance tied to the City's annual audit from Smith and Newell, as well as projects that were completed during the time frame the City was receiving the money, however was not charged appropriately at the completion of the projects to support the funding of the projects (Exhibits 1-8 which

includes Exhibit 1 – copy of audited financial reflecting TCRF balance, Exhibit 2 which is City financial system reports reflecting the City’s allocation of interest to the fund, Exhibit 3 – City financial system report also reflecting the audited financial balance, Exhibit 4 – a schedule from the City financial system that reflect revenues received with City street and road project expenditures for each of the fiscal years, Exhibit 5 – City’s asset schedule of street and road projects that were capitalized that are reflected on Exhibit 4, Exhibit 6 – City financial system report reflecting maintenance expenditures that are reflected on Exhibit 4, Exhibit 7 and Exhibit 8 – City financial system reports of major capital projects in which ONLY special transaction tax funds were used, and Exhibit 9 – the City’s capital assets schedule which also reflects all of the special district taxes that have been used for road reconstruction projects).

SCO’s Comment

Finding withdrawn.

Based on our review of additional documentation provided by the city, we determined that the city originally miscoded General Fund/Measure S projects that should have been charged to the Traffic Congestion Relief Fund. These miscoded projects were eligible as TCRF expenditures and would have enabled the city to meet the two-year rule requirement.

Therefore, the city did spend all of its TCRF allocations within the required time period.

FINDING 2— Cash impairment

The Special Gas Tax Street Improvement Fund (Gas Tax Fund) cash was impaired because the city was using it for the general operating costs of the city. The General Fund cash balance was negative for most of the second half of fiscal year (FY) 2010-11. We also noted that the General Fund cash balances were negative for the entire FY 2009-10. The General Fund is the main operating fund and its cash is maintained in an investment pool with cash from other funds, including restricted funds, such as the Gas Tax Fund. During our review, we noted that the General Fund was using funds from the city’s investment pool, which includes the Gas Tax Fund, to fund city operating costs. Therefore, for the years under audit, this negative cash balance is affecting the integrity of the Gas Tax Fund.

Streets and Highways Code section 2101 states:

All moneys in the Highway Users Tax Account in the Transportation Tax Fund and hereafter received in the account are appropriated for all of the following:

- (a) The research, planning, construction, improvement, maintenance, and operation of public streets and **highways** (and their related public facilities for nonmotorized traffic). . . .
- (b) The research and planning for exclusive public mass transit guideways (and their related fixed facilities). . . .
- (c) The construction and improvement of exclusive public mass transit guideways (and their related fixed facilities). . . .

Streets and Highways Code section 2118 states:

When the State Controller determines it to be necessary, he may require a county or city to deposit money received from the Highway Users Tax Fund in a separate bank account.

Based on our analysis of the General Fund and the Gas Tax Fund cash balances, the Gas Tax Fund cash was impaired. However, we could not determine the impact on the Gas Tax Fund or other funds' cash because the city's investment pool includes a majority of the city's funds. The table below shows cash balances for the General Fund and the Gas Tax Fund by month during FY 2009-10 and FY 2010-11. Due to the fact that General Fund cash balances were negative, cash from other funds was used to pay for general city operating costs.

Month	Fund #100 General Fund	Fund #210 Gas Tax	Impairment
July 09	(54,864.31)	155,674.37	No
Aug 09	(133,760.80)	155,674.37	No
Sept 09	(295,729.65)	155,871.30	Yes
Oct 09	(431,150.73)	149,536.81	Yes
Nov 09	(730,626.01)	146,805.09	Yes
Dec 09	(905,024.84)	145,891.74	Yes
Jan 10	(312,846.84)	145,891.74	Yes
Feb 10	(401,573.75)	146,047.67	Yes
Mar 10	(495,848.67)	91,355.21	Yes
April 10	(598,022.14)	91,475.12	Yes
May 10	(121,885.59)	123,727.03	No
June 10	(117,791.50)	73,724.03	Yes
July 10	549,064.55	72,761.01	No
Aug 10	425,104.90	79,571.44	No
Sept 10	375,703.46	79,571.44	No
Oct 10	259,441.17	84,309.69	No
Nov 10	31,733.38	97,483.26	No
Dec 10	(145,564.48)	94,573.18	Yes
Jan 11	(7,696.82)	104,793.48	No
Feb 11	(126,159.80)	104,793.48	Yes
Mar 11	(276,059.98)	109,497.46	Yes
April 11	(396,199.39)	114,227.16	Yes
May 11	(395,498.07)	119,318.91	Yes
June 11	109,138.48	83,717.48	No

Recommendation

The city's General Fund cash balances were at times negative, which caused the operating costs of the city to be absorbed by other funds within the pooled cash, including but not limited to the Gas Tax Fund.

The city should develop and implement policies and procedures to ensure that it does not impair other funds' cash, especially the restricted funds, for general operating costs.

The city must establish a separate bank account to account for Gas Tax cash. This account shall be used to record all deposits and expenditures against these moneys. The city must provide the State Controller's Office with proof that a separate bank account has been established. The bank account shall remain open until the city provides evidence that it has restored the financial health of the General Fund.

City's Response

Regarding the Special Gas Tax Street Improvement Fund cash impairment find, the City does not agree with the finding that the City was using Gas Tax Funds for general operating costs of the City. The attached spreadsheet shows the subtotals of each of the classifications of funds and the corresponding balances during the impaired months documented in the draft audit. The funds included within the subtotal of the general fund are all sub-funds that are reported within the General Fund for the purposes of financial reporting and audited financials. During the Gas Tax Audit only fund 100 was reviewed against the Gas Tax Fund which isn't an accurate view of the City's General Fund. I have highlighted the 6 months in red that the General Fund was actually running a negative fund balance. As outlined the City had plenty of funds available in the subtotal of the Enterprise Funds to borrow from the Sewer Fund. The City, through any negative General Fund cash flow times, has borrowed funds from the Sewer Fund. Also, at times expenditures during the fiscal year are recorded to the General Fund, and transfers from other Restricted/Special Funds are made at the end of the fiscal year for applicable expenditures. Finally as show through the City's cash totals at the bottom of the spreadsheet, the City at all times had plenty of cash on deposit to maintain the full balance of the Gas Tax Fund's cash (shown below the cash total line). The City maintains, based on the information provided, that the City did not use Gas Tax Funds for general operating costs of the City, and disagrees with establishing a separate bank account for the sole purpose of Gas Tax cash (for deposits and expenditures), on the basis provided, (as well as, opines that this is what fund accounting is set to accommodate, and would create a added burden to the City's Finance and Administration's department "bookkeeping" with no added value. Exhibit 10 – City financial system schedule reflecting the cash balances of the City in question of cash impairing gas tax funds.

SCO's Comment

Finding withdrawn.

Based on our review of the additional documentation provided by the city, we determined that the city did not impair the Gas Tax Fund.

**Attachment—
City's Response to
Draft Audit Report**



City of Nevada City

March 18, 2014,

Mr. Steven Mar
Chief Local Government Audits Bureau
State Controller's Office, Division of Audits
PO Box 942850
Sacramento, CA 94250-5874

Mr. Steven Mar,

I am in receipt of the City of Nevada City Draft Audit Report for the Special Gas Tax Street Improvement Fund, Traffic Congestion Relief Fund (TCRF), and Proposition IB Fund. It is noted in the introduction letter that if there are any comments regarding the draft report a response must be submitted within 15 days of the receipt of the report.

There are several findings documented in the draft audit report that the City is not in agreement with and have attached backup documentation to support the inaccuracy of findings regarding the TCRF unspent allocations, and also the finding of gas tax cash impairment.

Beginning with the finding regarding the TCRF unspent allocations, the City does not agree with the balance that the State Controller's Office is recommending that the City return. Attached is a copy of the final audit for fiscal year 10/11 which shows the balance of TCRF at \$112,006 which includes \$6,877.04 of interest allocated to the account since fiscal year 01/02. This doesn't agree with the draft audit provided by the State Controller's Office which states a balance of \$125,929 and related interest of \$6,551.00.

Regarding the finding that the funds were unspent the City does not agree. The City did not have an accurate accounting of special funds, such as TCRF, that were being expended. The City went through a major reorganization from 2006-2008 which many funds were identified as expended however still "sitting in the City's financials" with unused balances. This matter was identified by the City's new auditors Smith and Newell beginning fiscal year 2006/2007. This fund clean-up task was a multi-year clean up which included TCRF funds. All citywide projects were being charged to the general fund and special transaction tax Measure "S" rather than being charged to the appropriate designated fund, as in the TCRF. It was the intent of the City that the revenues to support street improvement, maintenance, and repair, and reconstruction received from the State, were to be used to support the City streets ongoing projects. As you can see from the spreadsheet provided the City has expended a great deal of general fund and transaction tax revenue on the streets and roads in Nevada City because of their extremely poor conditions. Please refer to the attached documentation that provides support of the audited balance tied to the City's annual audit from Smith and Newell, as well as projects that were completed during the time frame the City was receiving the money, however was not charged appropriately at the completion of the projects to support the funding of the projects. (Exhibits 1-8

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As stated earlier, especially with the passing of the special district tax (Measure “S”) in November of 2006 for a 1/2 cent which revenues are restricted to street and road repair and reconstruction ONLY by the voters, it was always the intent of the City, and understanding of the City voters that all state provided funds would be allocated to these major street and road project expenditures.

Regarding the Special Gas Tax Street Improvement Fund cash impairment find, the City does not agree with the finding that the City was using Gas Tax Funds for general operating costs of the City. The attached spreadsheet shows the subtotals of each of the classifications of funds and the corresponding balances during the impaired months documented in the draft audit. The funds included within the subtotal of the general fund are all sub-funds that are reported within the General Fund for the purposes of financial reporting and audited financials. During the Gas Tax Audit only fund 100 was reviewed against the Gas Tax Fund which isn’t an accurate view of the City’s General Fund. I have highlighted the 6 months in red that the General Fund was actually running a negative fund balance. As outlined the City had plenty of funds available in the subtotal of the Enterprise Funds to borrow from the Sewer Fund. The City, through any negative General Fund cash flow times, has borrowed funds from the Sewer Fund. Also, at times expenditures during the fiscal year are recorded to the General Fund, and transfers from other Restricted/Special Funds are made at the end of the fiscal year for applicable expenditures. Finally as show through the City’s cash totals at the bottom of the spreadsheet, the City at all times had plenty of cash on deposit to maintain the full balance of the Gas Tax Fund’s cash (shown below the cash total line). The City maintains, based on the information provided, that the City did not use Gas Tax Funds for general operating costs of the City, and disagrees with establishing a separate bank account for the sole purpose of Gas Tax cash (for deposits and expenditures), on the basis provided, (as well as, opines that this is what fund accounting is set to accommodate, and would create a added burden to the City’s Finance and Administration’s department “bookkeeping” with no added value. Exhibit 10 – City financial system schedule reflecting the cash balances of the City in question of cash impairing gas tax funds).

The City appreciates your time in carefully reviewing all of the documents provided supporting the City’s opinion disagreeing with the findings presented in the draft audit. If you have any questions please contact Catrina Olson at 530-265-2496 x134 or email catrina.olson@co.nevada.ca.us.



Catrina Olson
Assistant City Manager
City of Nevada City

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Division of Audits
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