

CITY OF PORTERVILLE

Audit Report

SPECIAL GAS TAX STREET IMPROVEMENT FUND

July 1, 2001, through June 30, 2012

TRAFFIC CONGESTION RELIEF FUND ALLOCATIONS

July 1, 2001, through June 30, 2012

PROPOSITION 1B ALLOCATIONS

July 1, 2007, through June 30, 2012



JOHN CHIANG
California State Controller

June 2014



JOHN CHIANG
California State Controller

June 23, 2014

The Honorable Cameron J. Hamilton
Mayor of the City of Porterville
291 North Main Street
Portville, CA 93258

Dear Mayor Hamilton:

The State Controller's Office audited the City of Porterville's Special Gas Tax Street Improvement Fund for the period of July 1, 2001, through June 30, 2012. We also audited the Traffic Congestion Relief Fund (TCRF) allocations recorded in the Special Gas Tax Street Improvement Fund for the period of July 1, 2001, through June 30, 2012, as well as reviewed the Proposition 1B Fund allocations recorded in the Special Gas Tax Street Improvement Fund for the period of July 1, 2007, through June 30, 2012.

Our audit found that the city accounted for and expended its Special Gas Tax Street Improvement Fund—and TCRF allocations—in compliance with requirements, except that it understated the fund balance by \$4,474,497 as of June 30, 2012. The city understated the fund balance because it charged ineligible debt service payments to the Special Gas Tax Street Improvement Fund for its Certificates of Participation. In addition, our review found that the city accounted for and expended its Proposition 1B allocations recorded in the Special Gas Tax Street Improvement Fund in compliance with requirements for the period of July 1, 2007, through June 30, 2012.

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/mh

cc: Maria Bemis, Finance Director
City of Porterville
Steve 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 Porterville's Special Gas Tax Street Improvement Fund for the period of July 1, 2001, through June 30, 2012. We also audited the Traffic Congestion Relief Fund (TCRF) allocations recorded in the Special Gas Tax Street Improvement Fund for the period of July 1, 2001, through June 30, 2012, as well as reviewed the Proposition 1B Fund allocations recorded in the Special Gas Tax Street Improvement Fund for the period of July 1, 2007, through June 30, 2012.

Our audit found that the city accounted for and expended its Special Gas Tax Street Improvement Fund and TCRF allocations in compliance with requirements, except that the city understated the fund balance by \$4,474,497 as of June 30, 2012. The city understated the fund balance because it charged ineligible debt service payments to the Special Gas Tax Street Improvement Fund for its Certificate of Participation. In addition, our review found that the city accounted for and expended its Proposition 1B allocations recorded in the Special Gas Tax Street Improvement Fund in compliance with requirements for the period of July 1, 2007, through June 30, 2012.

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 Special Gas Tax Street Improvement 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 Special Gas Tax Street Improvement

Fund. A city also is required to expend its funds within three years following the end of the fiscal year in which the allocations were made and to expend the funds in compliance with Government Code section 8879.23. We conducted our review 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 in compliance with Article XIX of the California Constitution, the Streets and Highways Code, Government Code section 8879.23, and Revenue and Taxation Code section 7104. 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;
- 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 in accordance with the requirements of the Streets and Highways Code, Government Code section 8879.23, and Revenue and Taxation Code section 7104. 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 Porterville 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, 2001, through June 30, 2012, except as noted in Schedule 1 and described in the Finding and Recommendation section of this report. The finding requires an adjustment of \$4,474,497 to the city's accounting records.

Our audit also found that the city accounted for and expended its TCRF allocations recorded in the Special Gas Tax Street Improvement 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, 2001, through June 30, 2012

In addition, our review found that the city accounted for and expended its Proposition 1B Fund allocations recorded in the Special Gas Tax Street Improvement Fund in compliance with Government Code section 8879.23 for the period of July 1, 2007, through June 30, 2012.

Follow-Up on Prior Audit Findings

Our prior audit report, issued on September 30, 2002, disclosed no findings.

Views of Responsible Official

We issued a draft audit report on January 8, 2014. Maria Bemis, Finance Director, responded by letter dated January 13, 2014, agreeing with the audit results. The city also provided additional information for our review and consideration. 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 Porterville'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, 2011, through June 30, 2012**

	Special Gas Tax Street Improvement Fund		
	Highway Users Tax Allocations ^{1, 2}	Proposition 1B Allocations ³	Totals
Beginning fund balance per city	\$ 2,252,545	\$ —	\$ 2,252,545
Revenues	<u>2,034,027</u>	<u>765,126</u>	<u>2,799,153</u>
Total funds available	4,286,572	765,126	5,051,698
Expenditures	<u>(2,096,215)</u>	<u>—</u>	<u>(2,096,215)</u>
Ending fund balance per city	<u>2,190,357</u>	<u>765,126</u>	<u>2,955,483</u>
SCO adjustment: ⁴			
Finding—Ineligible COPS debt payments	<u>4,474,497</u>	<u>—</u>	<u>4,474,497</u>
Total SCO adjustment	<u>4,474,497</u>	<u>—</u>	<u>4,474,497</u>
Ending fund balance per audit	<u>\$ 6,664,854</u>	<u>\$ 765,126</u>	<u>\$ 7,429,980</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 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, 2001, through June 30, 2012; however, this schedule includes only the period of July 1, 2011, through June 30, 2012.

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 Special Gas Tax Street Improvement Fund. The audit period was July 1, 2001, through June 30, 2012. The city did not receive any TCRF revenues and did not incur any TCRF expenditures during the 2011-12 fiscal year, therefore it is not included in this schedule.

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 audit period was July 1, 2007, through June 30, 2012.

⁴ See the Finding and Recommendation section.

Finding and Recommendation

**FINDING—
Ineligible debt service
payments**

The city improperly charged the Special Gas Tax Street Improvement Fund \$4,474,497 for debt service payments (principal and interest) for the period of July 1, 2001, through June 30, 2012. The principal and interest was for \$20,000,000 in Certificates of Participation (COPS) (1998 Infrastructure Financing Project) with a 30-year term issued on June 30, 1998 by the City of Porterville. The proceeds were used to finance long-term capital improvements. The COPS were secured in part by future gas tax revenue.

There is no direct provision in the Streets and Highways Code for debt service payments relating to the issuance of COPS, but voter-approved bonds may be eligible.

COPS are similar to bonds, and as such, principal and interest cost may be eligible for Gas Tax funding. The Streets and Highways Code allows for Gas Tax funding of principal and interest when the following three criteria are met:

1. bonds are voter approved,
2. the terms of the bonds do not exceed 25 years, and
3. the bonds are limited to 25% of the annual Gas Tax fund.

Street and Highways Code section 2107.4 states:

Not more than one-quarter of the funds allocated to a city or county from the Highway Users Tax Account in the Transportation Tax Fund for the construction of streets therein may be used to make principal and interest payments on bonds issued for such construction, if the issuance of such bonds is authorized by a proposition approved by a majority of the votes cast thereon. The term of any such bonds shall not exceed 25 years.

As the city did not obtain voter approval for the COPS, these debt service payments are not eligible gas tax expenditures.

As a result, the following debt service charges to the gas tax fund are unallowable:

Debt service payments	Principal	Interest	Total
FY 2011-12	395,000	5,000	400,000
FY 2010-11	380,000	20,000	400,000
FY 2009-10	370,000	30,000	400,000
FY 2008-09	360,000	40,000	400,000
FY 2007-08	345,000	55,000	400,000
FY 2006-07	400,000	—	400,000
FY 2005-06	400,000	—	400,000
FY 2004-05	400,000	—	400,000
FY 2003-04	385,000	44,594	429,594
FY 2002-03	369,500	—	369,500
FY 2001-02	345,000	130,403	475,403
Audit Adjustments	4,149,500	324,997	4,474,497

Recommendation

The city should reimburse the Special Gas Tax Street Improvement Fund for the ineligible debt service payments totaling \$4,474,497 from FY 2001-02, through FY 2011-12.

In the future, the city should ensure that all debt service payments charged to the Special Gas Tax Street Improvement Fund are for voter-approved bonds and not COPs, and the term of the bonds is for not more than 25 years. In addition, the city should ensure that the proceeds from the bonds are used for street activities and that the debt service payments do not exceed 25% of the annual gas tax funds.

City’s Response

In response to the audit finding and recommendation, the City of Porterville respectfully requests the State Controller’s Office to allow us to replace the ineligible debt service charges with other streets and storm drain maintenance expenditures that was paid for by the City’s General Fund during the same audit period. We have prepared a spreadsheet showing the total street maintenance and operation expenditures and the amounts charged to the Gas Tax Fund and the General Fund. As presented, the City had spent General Fund monies more than the amount of the debt service payments charged to the Gas Tax Fund from July 1, 2001 to June 30, 2012.

SCO’s Comments

The City requested the SCO to allow it to replace the ineligible debt service charges with other street expenditures paid for by its General Fund during the same audit period.

We reviewed the additional information provided and determined that these were eligible gas tax expenditures.

The city provided a copy of Journal Entry #95-25, dated March 27, 2014, replacing the ineligible debt service charges with eligible street-related expenditures incurred during the same period. Therefore, no further adjustments are required to be made by the city.

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



Maria Bemis
Finance Director
(559) 782-7435

January 13, 2014

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

Re: Audit Finding – Special Gas Tax Street Improvement Fund

Dear Mr. Mar:

We received the State Controller's Office draft Audit Report of the City of Porterville's Special Gas Tax Street Improvement Fund for the period July 1, 2001 through June 30, 2012. We acknowledge our mistake in using \$4,474,497 of Gas Tax Funds to pay for debt service on Certificates of Participation issued by the City to finance several street projects.

In response to the audit finding and recommendation, the City of Porterville respectfully requests the State Controller's Office to allow us to replace the ineligible debt service charges with other streets and storm drain maintenance expenditures that was paid for by the City's General Fund during the same audit period. We have prepared a spreadsheet showing the total street maintenance and operation expenditures and the amounts charged to the Gas Tax Fund and the General Fund. As presented, the City had spent General Fund monies more than the amount of the debt service payments charged to the Gas Tax Fund from July 1, 2001 to June 30, 2012.

Attached are our comment and the aforementioned spreadsheet. We look forward to your favorable consideration. If you need any other information or documentation, please contact me at (559) 782-7435.

Sincerely,

Maria Bemis
Finance Director

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>