

CITY OF NEWMAN

Audit Report

SPECIAL GAS TAX STREET IMPROVEMENT FUND

July 1, 1999, through June 30, 2011

TRAFFIC CONGESTION RELIEF FUND ALLOCATIONS

July 1, 2000, through June 30, 2011

PROPOSITION 1B FUND ALLOCATIONS

July 1, 2007, through June 30, 2011



JOHN CHIANG
California State Controller

October 2014



JOHN CHIANG
California State Controller

October 6, 2014

The Honorable Ed Katen
Mayor of the City of Newman
P.O. Box 787
Newman, CA 95360

Dear Mayor Katen:

The State Controller's Office audited the City of Newman's Special Gas Tax Street Improvement Fund—highway users tax—for the period of July 1, 1999, through June 30, 2011. We also audited the Traffic Congestion Relief Fund allocations recorded in the State Grants Fund for the period of July 1, 2000, through June 30, 2011, as well as the Proposition 1B allocations, recorded in the Local Transportation 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—highway users tax—and Traffic Congestion Relief Fund allocations recorded in the State Grants Fund in compliance with requirements, except that the city understated the fund balance in the Special Gas Tax Street Improvement Fund by \$96,169 as of June 30, 2011, because it had an unexpended \$114,201 in Gas Tax Fund money in the General Fund and also recorded \$18,032 in excess revenue in error.

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

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/sk

cc: Lewis Humphries, Finance Director
City of Newman
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 Newman's Special Gas Tax Street Improvement Fund for the period of July 1, 1999, through June 30, 2011. We also audited the Traffic Congestion Relief Fund (TCRF) allocations recorded in the State Grants Fund for the period of July 1, 2000, through June 30, 2011, as well as the Proposition 1B allocations recorded in the Local Transportation 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 and TCRF allocations recorded in the State Grants Fund in compliance with requirements, except that the city understated the fund balance in the Special Gas Tax Street Improvement Fund by \$96,169 as of June 30, 2011, because it had an unexpended \$114,201 in Gas Tax Fund money in the General Fund and also recorded \$18,032 in excess revenue in error.

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

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 State Grants 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 Local Transportation 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 be expended 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 and the TCRF allocations, as well as the Proposition 1B Fund allocations, in compliance with Article XIX of the California Constitution, the Streets and Highways Code, and Government Code section 8879.23. 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, the TCRF allocations, and the Proposition 1B Fund allocations 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 Newman 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, 1999, through June 30, 2011, except as noted in Schedule 1 and described in the Findings and Recommendations section of this report. The findings required an adjustment of \$96,169 to the city's accounting records.

Our audit also found that the city accounted for and expended its TCRF allocations recorded in the State Grants 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 audit found that the city accounted for and expended its Proposition 1B allocations recorded in the Local Transportation 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 on September 29, 2000.

Views of Responsible Official

We issued a draft audit report on June 30, 2014. Lewis Humphries, Finance Director, responded by letter dated July 7, 2014, disagreeing with Findings 1 and 3 and agreeing with Finding 2. 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 Newman'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

October 6, 2014

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

	Special Gas Tax Street Improvement Fund	Proposition 1B Fund Allocations ³
	Highway Users Tax Allocation ^{1,2}	
Beginning fund balance per city	\$ —	\$ 7,214
Revenues	<u>258,369</u>	<u>—</u>
Total funds available	258,369	7,214
Expenditures	<u>(258,369)</u>	<u>—</u>
Ending fund balance per city	—	7,214
Timing adjustment:		
Accrual of June 2011 highway users tax apportionment (Governmental Accounting Standards Board Statement No. 34)	34,090	—
SCO adjustments: ⁴		
Finding 1—Unused balance in General Fund	113,772	—
Finding 2—Excess gas tax revenue	(18,032)	—
Finding 3—Unallocated interest	<u>429</u>	<u>—</u>
Total SCO adjustments	<u>96,169</u>	<u>—</u>
Ending fund balance per audit	<u>\$ 130,259</u>	<u>\$ 7,214</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, 1999, 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 State Grants Fund. The audit period was July 1, 2000, through June 30, 2011. The city did not receive any TCRF revenues and did not incur any TCRF expenditures during FY 2010-11; 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 Proposition 1B allocations were recorded in the Local Transportation Fund. The audit period was July 1, 2007, through June 30, 2011.

⁴ See the Findings and Recommendations section.

Findings and Recommendations

**FINDING 1—
Unused balance in
General Fund**

For fiscal year (FY) 2008-09 through FY 2010-11, the city transferred Gas Tax funds of \$662,297 into its General Fund for street-related expenditures. However, the city did not expend \$113,772 of the total transferred funds, as follows:

	<u>FY 2008-09</u>	<u>FY 2009-10</u>	<u>FY 2010-11</u>	<u>TOTAL</u>
Transfers to General Fund	\$ 225,242	\$ 178,686	\$ 258,369	\$ 662,297
Expended amount	(224,570)	(120,829)	(203,126)	(548,525)
Unexpended amount	<u>\$ 672</u>	<u>\$ 57,857</u>	<u>\$ 55,243</u>	<u>\$ 113,772</u>

Streets and Highways Code section 2113 states that Gas Tax apportionments should be deposited in the “special gas tax street improvement fund.”

Recommendation

The city should transfer \$113,772 from its General Fund to the Gas Tax Fund to correct the understatement. Additionally, the city should establish policies and procedures to ensure that future Gas Tax Fund transfers to the General Fund are limited to the current fiscal year’s street-related expenditures.

City’s Response

Our main contention with this report has been the same since your staff ran its calculations back in 2012. Your office contends that HUTA funds of a current year cannot be used to pay for prior year streets and roads expenditures. We disagree with this conclusion and have found it unsubstantiated. California Streets and Highways Code Section 2101 (d) states that you can issue bonds, and use future HUTA revenues to pay for those prior year street costs. There, in the law, it is authorizing the use of future revenues to cover prior year’s street and road expenditures. I’ve asked your staff for any section of the Highways Code which would state that you cannot use revenues from future years to cover current year expenditures, since the law provides a method by where you can use future revenues to cover prior year expenditures.

SCO’s Comments

The city contends that the Gas Tax money was not left in the General Fund, but instead it was spent on prior-year expenditures. The city’s argument is that this is similar to using Gas Tax money to pay for bonds and, therefore, it should be allowable.

There is no direct provision in the Streets and Highways Code for prior-year expenditures, but voter-approved bonds may be eligible.

However, transfers for prior-year expenses are not the same as debt payments for voter-approved bonds. In fact, there are many differences. The Streets and Highways Code allows for Gas Tax funding of principal and interest only 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.

Streets and Highways Code section 2107.4 states:

Not more than one-quarter of the bonds 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 fulfill the requirements in order to use Gas Tax money for prior year expenditures, these transfers in excess of current expenses are unallowed.

In conclusion, the city made ineligible Gas Tax transfers to its General Fund to pay for prior year expenditures.

The finding remains as stated.

**FINDING 2—
Excess gas tax
revenue**

For FY 2003-04, the city made a posting error when it recorded Gas Tax revenues of \$18,032 twice for the July 2004 apportionment, causing the Gas Tax Fund balance to be overstated by that amount.

Recommendation

The city should reduce its Gas Tax Fund balance by \$18,032. In the future, the city should establish procedures to avoid recording errors.

City's Response

The city agrees with the finding and recommendation.

**FINDING 3—
Unallocated interest**

For FY 2009-10 and FY 2010-11, the City of Newman did not allocate interest income of \$429 to a portion of the Gas Tax Fund balance that was retained in the General Fund. As a result, the Gas Tax Fund balance is understated.

Streets and Highways Code section 2113 states:

Interest received by a city from the investment of money in its special gas tax street improvement fund shall be deposited in the fund and shall be used for street purposes.

Recommendation

The city should transfer \$429 from its General Fund to the Gas Tax Fund and establish policies and procedures to ensure that the Gas Tax Fund receives an equitable share of the interest generated from the investments.

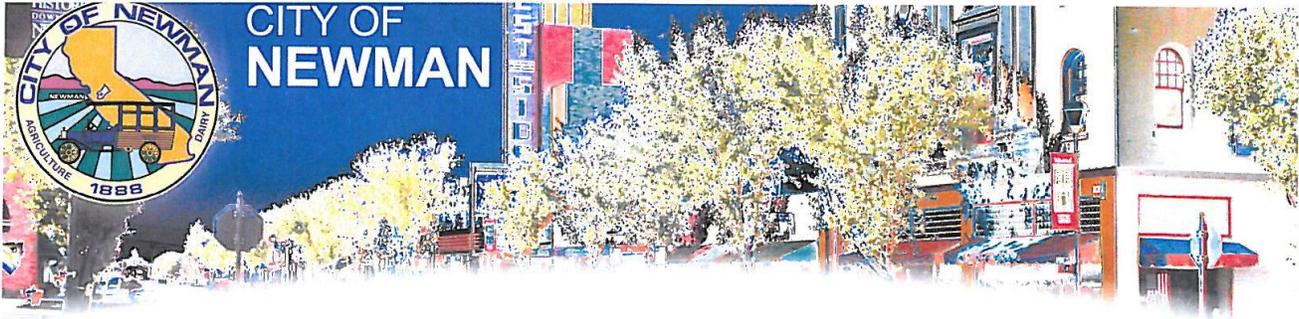
City's Response

This finding no longer applies. Since Finding 1 is not based on California Streets and Highway Code, any interest on the calculation is also unsubstantiated.

SCO's Comments

As Finding 1 remains as stated, Finding 3 also remains unchanged.

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



July 7, 2014

Mike Spalj
Local Government Audits Bureau
State Controller's Office – Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874

Dear Mr. Spalj,

This letter is in reply to the State Controller's Office letter dated July 9, 2013 regarding the audit of our City Highway Users Tax Account (HUTA) audit. Firstly, I'd like to thank your office for the professionalism that was exhibited by your staff during his visit to our City. He audited an 11 year period. During that period your staff calculated that the City complied with its Prop 1B and TCRF requirements and that the City expended \$1.6M on Gas Tax expenditures while receiving \$1.1M in Gas Tax revenues. What caused the divide between us was the City believed that the law allows the use of future Gas Tax revenues to cover prior year expenditures while the State Controller's office believes otherwise.

Finding 1 – Our main contention with this report has been the same since your staff ran its calculations back in 2012. Your office contends that HUTA funds of a current year cannot be used to pay for prior year streets and roads expenditures. We disagree with this conclusion and have found it unsubstantiated. California Streets and Highways Code Section 2101 (d) states that you can issue bonds, and use future HUTA revenues to pay for those prior year street costs. There, in the law, it is authorizing the use of future revenues to cover prior year's street and road expenditures. I've asked your staff for any section of the Highways Code which would state that you cannot use revenues from future years to cover current year expenditures, since the law provides a method by where you can use future revenues to cover prior year expenditures. What I did receive from your staff was two documents: a letter from the controller's office dated July 11, 1975, and a photocopy of four pages of the Attorney General's Opinions from 1958. Neither one is from the California Streets and Highways Code and neither one applies in this situation.

The first document, the letter from 1975, written by Kenneth Cory, State Controller, does not apply to our situation. The second and third paragraphs of that letter state:

"We have found that some cities are not recording year end adjustments in the fiscal year to which they apply.

This results in Gas Tax Expenditures and Fund Balances reports on the Annual Report which are not reflected on the books of record as of June 30."

This letter was about Cities that were presenting their Annual Street Report to the SCO's office inclusive of Gas Tax Expenditures; but then, not recording the Gas Tax Expenditures on their books until the following year. This made the Annual Report and the City's books not tie out. So the letter from the SCO's office continued,

"It will be necessary, therefore, beginning 1974-75 fiscal year to approve only expenditures which have been recorded as of June 30."

What the State Controller, at that time, was trying to say was that if you report expenditures in the Annual Streets Report but don't record it in your books, they will be disallowed as expenditures in the report.

This has nothing to do with our situation. Our Annual Street Report and our books tie out.

The second document, the photocopy of the page from the Attorney General's Opinion, no longer applies as well. The sections of the law, that it refers to, no longer exist. That opinion refers to sections of the law that have been superseded or eliminated and therefore, the opinion, no longer applies.

To reiterate, we've not seen any sections from the California Streets and Highway Code that states we cannot use future revenues to cover prior year expenditures; but, just the opposite. Section 2101 (d) actually provides one way that it can be done and yet doesn't eliminate all other financing options.

When we were first notified of the audit, the letter from your office stated that the audit would be from July 1, 1999 to June 30, 2011. During the audit your staff determined that we received \$1.1M in Highway Users Tax Revenue and expended \$1.6M in highway maintenance and construction during that 11 year period. This final draft says nothing of this. It also only presents the last 3 years of the 11 year audit. We feel that the City has used the HUTA revenues that it has received on our Streets and Roads and that we have used it in a way that has allowed our residents to have streets in better condition sooner and has created more jobs sooner than if we were to follow these outdated and erroneous conclusions that we have been provided.

Finding 3 – This finding no longer applies. Since Finding 1 is not based on California Streets and Highway Code, any interest on the calculation is also unsubstantiated.

We respectfully request the State Controller's Office correct this report removing all findings with the exception of Finding 2.

Sincerely,



Lewis A. Humphries | Finance Director
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