CITY OF BEAUMONT

Audit Report

SPECIAL GAS TAX STREET IMPROVEMENT FUND

July 1, 2004, through June 30, 2013

TRAFFIC CONGESTION RELIEF FUND ALLOCATIONS

July 1, 2004, through June 30, 2011

PROPOSITION 1B FUND ALLOCATIONS

July 1, 2007, through June 30, 2013

BETTY T. YEE

California State Controller

October 2015

BETTY T. YEE
California State Controller

October 26, 2015
The Honorable Brenda Knight
Mayor of the City of Beaumont
550 East Sixth Street
Beaumont, CA 92223

Dear Mayor Knight:

The State Controller's Office audited the City of Beaumont's Special Gas Tax Street Improvement Fund for the period of July 1, 2004, through June 30, 2013. 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, 2004, through June 30, 2011, and the Proposition 1B Fund allocations, recorded in the Special Gas Tax Street Improvement Fund, for the period of July 1, 2007, through June 30, 2013.

Our audit found that the city accounted for and expended its Special Gas Tax Street Improvement Fund in compliance with requirements, except that it understated the fund balance by $383,838 as of June 30, 2013. The city understated the fund balance because it charged unsupported overhead costs of $360,978 to the Special Gas Tax Street Improvement Fund. The city also transferred funds from the Special Gas Tax Street Improvement Fund to the General Fund in excess of the actual street maintenance expenditures incurred by $22,860.

In addition, we identified procedural findings.

If you have any questions, please contact Mike Spalj, Chief, Local Government Audits Bureau, at (916) 324-6984.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/ls

Attachment

cc: Onyx Jones, Interim Finance Director
City of Beaumont

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Audit Report

Summary

The State Controller's Office audited the City of Beaumont's:

- Special Gas Tax Street Improvement Fund for the period of July 1, 2004, through June 30, 2013.
- Traffic Congestion Relief Fund (TCRF) for the period of July 1, 2004, through June 30, 2011, and
- Proposition 1B Fund for the period of July 1, 2007, through June 30, 2013.

Our audit found that the city accounted for and expended its Special Gas Tax Street Improvement Fund in compliance with requirements, except that the city understated the fund balance by $383,838 as of June 30, 2013. The city understated the fund balance because it charged unsupported overhead costs of $360,978 to the Special Gas Tax Street Improvement Fund. The city also transferred funds from the Special Gas Tax Street Improvement Fund to the General Fund in excess of the actual street maintenance expenditures incurred by $22,860.

In addition, we identified procedural findings.

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.

Chapter 91, Statutes of 2000, (Assembly Bill 2928) as amended by Chapter 636, Statutes of 2000, (Senate Bill 1662) and 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 Fund allocations in the Special Gas Tax Street Improvement Fund. A city also is required to expend its allocations within four years following the end of the fiscal year in which the allocation was made and to expend the funds 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 its Special Gas Tax Street Improvement Fund, TCRF, and the Proposition 1B Fund in compliance with Article XIX of the California Constitution, the Streets and Highways Code, Revenue and Taxation Code section 7104, and Government Code section 8879.23.

To meet the audit objective, we performed the following procedures:

Special Gas Tax Street Improvement Fund

- Reconciled the fund revenue recorded in the city ledger to the balance reported in the SCO's apportionment schedule to determine whether Highway Users Tax Account (HUTA) funds received by the city were completely accounted for.
- Judgmentally selected sample expenditure transactions and verified proper documentation and eligibility to determine whether HUTA funds were expended in accordance with the criteria above.
- Analyzed and tested sample transactions to determine whether recoveries of prior HUTA fund expenditures were identified and credited to the Special Gas Tax Street Improvement Fund.
- Reviewed the fund cash and liabilities accounts for unauthorized borrowing to determine whether unexpended HUTA funds were available for future street-related expenditures.
- Interviewed city employees and reviewed policies and procedures to gain an understanding of the city's internal controls and accounting systems related to this audit.

Traffic Congestion Relief Fund (TCRF)

- Reconciled the TCRF revenue recorded in the city ledger to confirm that the TCRF allocations received by the city agreed with the SCO's apportionment schedule.

- Judgmentally selected sample expenditure transactions and verified proper documentation and eligibility to determine the city's compliance with the criteria above.

- Reconciled the City's "Schedule of Expenditures as Reported in the Streets and Roads Annual Report" with the SCO's "Average Annual Expenditures Computation of Discretionary Funds" to determine compliance with the maintenance-of-effort (MOE) requirement.

Proposition 1B Fund

- Reconciled the Proposition 1B revenue recorded in the city ledger to confirm that the Proposition 1B allocations received by the city agreed with the SCO's apportionment schedule.

- Judgmentally selected sample expenditure transactions and verified proper documentation and eligibility to determine the city's compliance with the criteria above.

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 its Special Gas Tax Street Improvement 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-related 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 Beaumont 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, 2004, through June 30, 2013, except as noted in Schedule 1 and described in the Findings and Recommendations section of this report. The findings required an adjustment of $383,838 to the city's accounting records.

- 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, 2004, through June 30, 2011.

- 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, 2013.

Follow-Up on Prior Audit Findings

Our prior audit report, issued on September 9, 2004, disclosed no findings.

Views of Responsible Officials

We issued a draft audit report on April 8, 2015. Alan C. Kapanicas, City Manager, responded by letter dated April 30, 2015, agreeing 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 Beaumont'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

_____, 2015

Schedule 1—
Reconciliation of Fund Balance
July 1, 2012, through June 30, 2013

	Special Gas Tax Street Improvement Fund Highway Users Tax Allocations [1,2,3]
Beginning fund balance per city	$ 110,745
Revenues	875,736
Total funds available	986,481
Expenditures	(850,889)
Ending fund balance per city	135,592
SCO adjustments: [4]	
Finding 1—Unsupported Overhead Costs	360,978
Finding 2—Transfer in excess of Actual Expenditures	22,860
Total SCO adjustments	383,838
Ending fund balance per audit	$ 519,430

[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, 2004, through June 30, 2013; however, this schedule includes only the period of July 1, 2012, through June 30, 2013.

[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, 2004, through June 30, 2011. The city did not receive any TCRF revenues and did not incur any TCRF expenditures during FY 2012-13; 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, 2004, through June 30, 2013. The city did not receive any Proposition 1B revenues and did not incur any Proposition 1B expenditures during FY 2012-13; therefore, it is not included in this schedule.

[4] See the Findings and Recommendations section.

Findings and Recommendations

FINDING 1—Unsupported Overhead Costs Allocations

During the audit period, the city charged $360,978 in overhead costs to the Special Gas Tax Street Improvement Fund that it could not support with documentation.

The overhead costs charged to the Special Gas Tax Street Improvement Fund are as follows:

Fiscal Year	Overhead Charges
2004-05	$ 38,981
2005-06	40,000
2006-07	40,000
2007-08	40,000
2008-09	40,000
2009-10	39,997
2010-11	40,000
2011-12	40,000
2012-13	42,000
Total	$ 360,978

The city's overhead charge allocations were not supported by a valid cost allocation plan. The city's allocations were based on estimated percentages that were not supported by auditable evidence.

The State Controller's Office Guidelines Relating to Gas Tax Expenditures state that overhead will be allowed only via an approved cost allocation plan or an equitable and auditable distribution of overhead to substantiate that gas tax funds were expended in compliance with the Streets and Highways Code section 2101.

The $360,978 in overhead costs is disallowed. As a result, the Special Gas Tax Street Improvement Fund balance is understated by $360,978.

Recommendation:

The city should reimburse the Special Gas Tax Street Improvement Fund $360,978 and recalculate the costs with an equitable cost allocation plan to ensure that charges to the Gas Tax Fund are properly supported and in compliance with the Streets and Highways Code section 2101.

City's Response

> The City agrees to the transfer of $360,978. Please note that the same methodology to allocate costs to the Special Gas Tax Street Improvement Fund has been used since 1993. The City of Beaumont has had two audits done by the State Controller's Office between 1993 and 2003 and your office accepted the methodology twice, as there were no findings concerning this item in those previous audits.

SCO's Comment

The city agrees with our finding and will transfer $360,978 to the Special Tax Street Improvement Fund. The City's assertion that we accepted their methodology for allocating overhead costs is not correct. We performed the audits in accordance with generally accepted government auditing standards and, as such, we selected a sample, not 100%, of expenditures to review and analyze. The samples selected did not include overhead costs; therefore, the issue of unsupported overhead costs did not arise in those particular audits.

FINDING 2—Transfer in excess of actual street expenditures

In fiscal year (FY) 2009-10, the city transferred funds from the Special Gas Tax Street Improvement Fund to the General Fund to reimburse it for general street maintenance expenditures. Based on our review, we determined that the total transfer amount exceeded the street expenditures recorded in the General Fund by $22,860. The city was unable to provide documentation to validate the transfer of this excess amount.

Street and Highways Code section 2101 requires that gas tax funds be spent on allowable and verifiable expenditures.

Recommendation

The city should reimburse the Gas Tax Fund $22,860 for the excess transfer made to the General Fund in FY 2009-10 for unsupported expenditures.

The city should also establish policies and procedures to ensure that funds transferred out of the Special Gas Tax Street Improvement Fund are for actual costs incurred in accordance with the Streets and Highways Code section 2101.

City's Response

The City agrees to the transfer of $22,860.

SCO's Comment

The city agrees with our findings and will transfer $22,860 to the Special Gas Tax Street Improvement Fund.

FINDING 3—Independent Auditor's report indicated a qualified opinion and emphasis of a matter

The city's Independent Auditor's report for FY 2012-13 indicated a qualified opinion and an emphasis of a matter regarding the city having substantial doubt and going concern issues. The CPAs stated that they prepared the city's financial statements assuming that the city would continue as a going concern. The CPAs stated in Note 19 of the financial statements that the City's governmental activities had a deficit in unrestricted net position of $32,707,527 and the General Fund had a deficit in unassigned fund balance of $6,866,481 at June 30, 2013. It is uncertain whether the $21,500,000 in advances to the Beaumont Successor Agency

will be collectible due to the dissolution of the Redevelopment Agency. It is uncertain if the city will be able to reduce the deficit without additional revenue sources or expenditure cuts. In addition, the city does not currently have the financial resources to pay the Western Riverside Council of Governments Transportation Uniform Mitigation Fee settlement in the amount of $42,994,879 plus interest and fees.

In the Management Report and the Auditor's Communication letter for FY 2012-13, the CPAs indicated a material weakness relating to the deficit unassigned fund balance in the General Fund and significant deficiencies relating to the deficit cash balance in the General Fund. Furthermore, the CPAs indicated that during the review of the city's trial balance, they noted that the General Fund had a deficit cash balance, which the city reduced by legally borrowing cash from the Community Facilities Capital Project Fund on June 30, 2013.

These conditions raise substantial doubt about the city's ability to continue as a going concern. This raises serious concerns about risks to the Highway User Tax money.

Recommendation

We recommend that the city develop a management action plan to eliminate or reduce deficit unassigned fund balances and deficit spending.

City's Response

> The City will develop a management action plan to eliminate or reduce deficit unassigned fund balances and deficit spending during the 2015-16 budget process.

SCO's Comment

The city agrees with the finding.

FINDING 4—Impairment of cash

The city's Special Gas Tax Street Improvement Fund was impaired by the deficit in the General Fund during FY 2012-13 and continued into FY 2013-14, subsequent to our audit period. 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 reporting negative cash balances every month in both fiscal years. The negative cash balances were impairing and affecting the integrity of the Gas Tax Fund.

Streets and Highways Code section 2101 specifies that highway users tax apportionments are to be expended only for the construction, maintenance, and operation of public streets and roads, construction of exclusive mass transit guide ways, and related administrative costs.

California 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 allocations in a separate bank account."

Recommendation

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

The city should establish a separate bank account for the Gas Tax Fund. This account will be used to record all deposits and expenditures against this money. The city should 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 over a reasonable period of time it has restored the financial health of the General Fund.

City's Response

A separate bank account for the Gas Tax Fund will be opened.

SCO's Comment

The City agrees with the finding.

FINDING 5—Questionable procurement of professional services

The City entered into a professional services contract with Urban Logic on March 23, 1993, for consulting services. The agreement provided for day-to-day planning and economic development services. The City amended the contract on September 27, 1993, to provide a comprehensive day-to-day public works services. The contract was again amended on April 11, 1994, to include the plan-checking and construction-inspection services.

The original contract and subsequent amendments do not include a specific time frame for the duration of the contract. The contract states that the duration of the agreement shall be until such time as the agreement is terminated by either party, or both.

The City has used Urban Logic for these professional services since the original contract of March 1993. We were not able to find any evidence that the city has evaluated the contract for critical factors, including costs, for over 20 years and, most importantly, the city has not prepared a Request for Proposal to solicit bids from other qualified companies for professional services. These actions are not good business practices and do not comply with the city's Municipal Code.

The city's Municipal Code regarding procurement of professional services states:

> **Section 3.01.010 Purpose and Policy.** It shall be the policy of the City that the procurement of professional architectural, landscape architectural, engineering, environmental, land surveying and

construction project management services shall be on the basis of demonstrated competence and on the professional qualifications necessary for the satisfactory performance of the services required. (Ord. No. 815, § 1, 11-20-01)

Section 3.01.040 Competitive Procurement Procedures. The Procurement Officer shall comply with the following procedure for the procurement of professional services:

A. Request for Proposal: Prepare a request for proposal that identifies all significant evaluation factors, including price or costs when required, and their relative importance.

B. Solicitation of Proposal: Proposals shall be solicited from an adequate number of qualified sources. The request for proposals should be publicized and reasonable requests by other sources to compete should be honored to the maximum extent practicable.

C. Evaluation: The Procurement Officer shall develop mechanisms for the technical evaluation of the proposals received, and shall conduct discussions with the proposers regarding anticipated concepts and the relative utility of alternative methods of approach for furnishing the required services.

D. Award: The Procurement Officer shall select, in order of preference and based upon criteria developed under Paragraph C above, the firm or individual deemed to be the most highly qualified to provide the services required. (Ord. No. 815, § I, 11-20-01)

Section 3.01.050 Exemptions to Competitive Procurement Procedure. The Procurement Officer is authorized to engage the services of a professional firm or individual without complying with the Competitive Procurement Procedures in the following circumstances:

A. The services are available only from a single source; or

B. Public exigency or emergency will not permit a delay; or

C. State or federal grant or loan requirements authorize noncompetitive procurement of such services; or

D. After solicitation of a number of sources, competition is determined inadequate. (Ord. No.815, § I, 11-20-01)

Recommendation

We recommend that the city comply with its Municipal Code by:

- Developing and implementing policies and procedures to ensure that city officials perform a detailed review and gain full understanding of

the professional services to be provided before entering into an agreement.

- Reviewing the professional services contract with Urban Logic and determining whether or not the services provided are adequate and cost effective.

- Preparing and issuing a Request for Proposal that identifies all significant evaluation factors, including price or costs when required, and their relative importance.

We also recommend that the city include a specific timeframe, and beginning and ending dates, in the terms of the agreement.

City's Response

> The City has entered into agreements with three separate engineering firms. When engineering services are required, each firm is given the opportunity to provide a cost proposal for the requested service.
>
> The firms are HR Green, Urban Logic Consultants and Munifinancial. Each agreement has a four year term.

SCO's Comment

The city agrees with the finding.

Attachment—
City's Response to
Draft Audit Report

City of Beaumont

550 E. 6th Street
Beaumont, CA 92223

Phone: (951) 769-8520 · Fax: (951) 769-8526

April 30, 2015

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

Re: Special Gas Tax Street Improvement Fund Audit

Dear Mr. Spalj,

The City of Beaumont is in receipt of the above referenced audit for the period ended June 30, 2013. We are responding to the findings as follows:

Finding 1-Unsupported Overhead Cost Allocations

The City agrees to the transfer of $360,978. Please note that the same methodology to allocate costs to the Special Gas Tax Street Improvement Fund has been used since 1993. The City of Beaumont has had two audits done by the State Controller's Office between 1993 and 2003 and your office accepted the methodology twice, as there were no findings concerning this item in those previous audits.

Finding 2-Transfer in excess of actual street expenditures.

The City agrees to the transfer of $22,860.

Finding 3-Independent Auditor's report indicated a qualified opinion and emphasis of a matter

The City will develop a management action plan to eliminate or reduce deficit unassigned fund balances and deficit spending during the 2015-16 budget process.

Finding 4-Impairment of cash

A separate bank account for the Gas Tax fund will be opened.

Finding 5-Questionable procurement of professional services

The City has entered into agreements with three separate engineering firms. When engineering services are required, each firm is given the opportunity to provide a cost proposal for the requested service.

The firms are HR Green, Urban Logic Consultants and MuniFinancial. Each agreement has a four year term.

Sincerely,

Alan C. Kapanicas
City Manager

State Controller's Office
Division of Audits
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http://www.sco.ca.gov

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