

CITY OF ATWATER

Audit Report

SPECIAL GAS TAX STREET IMPROVEMENT FUND

July 1, 2002, through June 30, 2013

TRAFFIC CONGESTION RELIEF FUND ALLOCATIONS

July 1, 2002, through June 30, 2013

PROPOSITION 1B FUND ALLOCATIONS

July 1, 2007, through June 30, 2013



JOHN CHIANG
California State Controller

December 2014



JOHN CHIANG
California State Controller

December 3, 2014

The Honorable Joan Faul
Mayor of the City of Atwater
750 Bellevue Road
Atwater, CA 95301

Dear Mayor Faul:

The State Controller's Office audited the City of Atwater's Special Gas Tax Street Improvement Fund—highway users tax allocations—for the period of July 1, 2002, 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, 2002, through June 30, 2013, and the Proposition 1B Fund allocations recorded in the General Capital Fund for the period of July 1, 2007, through June 30, 2013.

Our audit found that the city did not account for and expend its Special Gas Tax Street Improvement Fund in compliance with requirements. It understated the fund balance by \$2,237,664 as of June 30, 2013. The city understated the fund balance because it charged inequitable overhead costs, ran a negative fund balance, made an ineligible interfund loan, and made a transfer for prior-year expenditures.

In addition, our audit found that the city accounted for and expended its Proposition 1B Fund allocations recorded in the General Capital Fund in compliance with Government Code section 8879.23 for the period of July 1, 2007, through June 30, 2013.

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/sk

cc: Frank Pietro, City Manager-Police Chief
City of Atwater
Lakhwinder Deol, Finance Operations Manager
City of Atwater
Bill Zenoni, Consultant
City of Atwater

Contents

Audit Report

Summary	1
Background	1
Objective, Scope, and Methodology	2
Conclusion	3
Follow-Up on Prior Audit Findings	3
Views of Responsible Officials	3
Restricted Use	3
Schedule 1—Reconciliation of Fund Balance	4
Findings and Recommendations	5
Attachment—City’s Response to Draft Audit Report	

Audit Report

Summary

The State Controller's Office audited the City of Atwater's Special Gas Tax Street Improvement Fund—highway users tax—for the period of July 1, 2002, 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, 2002, through June 30, 2013, and the Proposition 1B Fund allocations recorded in the General Capital Fund for the period of July 1, 2007, through June 30, 2013.

Our audit found that the city did not account for and expend its Special Gas Tax Street Improvement Fund in compliance with requirements. The city understated the fund balance by \$2,237,664 as of June 30, 2013. The city understated the fund balance because it charged ineligible overhead costs, ran a negative fund balance, made an ineligible interfund loan, and made a transfer for prior-year expenditures.

In addition, our audit found that the city accounted for and expended its Proposition 1B Fund allocations recorded in the General Capital Fund in compliance with Government Code section 8879.23 for the period of July 1, 2007, through June 30, 2013.

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 California 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.

Proposition 1B recipients are required to expend allocations within four years following the end of the fiscal year in which the allocations were made and to be expended 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 and Proposition 1B Fund allocations recorded in the General Capital 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 and Proposition 1B Fund allocations recorded in the General Capital 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 Atwater did not account for and expend its Special Gas Tax Street Improvement Fund—highway users tax and TCRF allocations—in compliance with Article XIX of the California Constitution and the Streets and Highways Code for the period of July 1, 2002, through June 30, 2013, as noted in Schedule 1 and described in the Findings and Recommendations section of this report. The findings required an adjustment of \$2,237,664 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, 2002, through June 30, 2013.

In addition, our audit found that the city accounted for and expended its Proposition 1B Fund allocations recorded in the General Capital 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**

The city satisfactorily resolved the findings noted in our prior audit report, issued on May 7, 2003.

**Views of
Responsible
Officials**

We issued a draft audit report on October 16, 2014. Lakhwinder Deol, Finance Operations Manager, responded by email on November 7, 2014, disagreeing with Findings 1 and 2, and agreeing with Finding 3. The city’s responses are included in this final audit report as an attachment.

Restricted Use

This report is intended for the information and use of the City of Atwater’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

December 3, 2014

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

	Special Gas Tax Street Improvement Highway Users Tax Allocations ^{1,2}	General Capital Fund Proposition 1B Allocations ³
Beginning fund balance per city	\$ (16,983)	\$ 409,195
Revenues	933,881	—
Total funds available	916,898	409,195
Expenditures	(220,647)	—
Ending fund balance per city	696,251	409,195
SCO adjustments: ⁴		
Finding 1—Unsupported overhead costs allocations	1,563,493	—
Finding 2—Unallowable negative fund balance	639,270	—
Finding 3—Unallowable transfer for prior-year expenditures	34,901	—
Total SCO adjustments	2,237,664	—
Ending fund balance per audit	<u>\$ 2,933,915</u>	<u>\$ 409,195</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, 2002, 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, 2002, through June 30, 2013. 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, 2013.

⁴ See the Findings and Recommendations section.

Findings and Recommendations

**FINDING 1—
Unsupported overhead costs allocations**

From fiscal year (FY) 2006-07 through FY 2011-12, the City of Atwater charged \$1,563,493 to the Gas Tax Fund for overhead, including administrative fees, IT maintenance, risk management, and other post-employment benefits costs. Amounts charged to the Gas Tax Fund were as follows:

Fiscal Year	Admin Fees	IT	Risk Management	OPEB	Total
2006-07	173,807	—	—	—	173,807
2007-08	182,497	11,153	59,148	30,647	283,445
2008-09	170,150	17,427	54,882	40,863	283,322
2009-10	176,667	15,939	44,251	49,987	286,844
2010-11	168,580	17,871	40,724	60,320	287,495
2011-12	105,901	16,991	47,893	77,795	248,580
Total	977,602	79,381	246,898	259,612	1,563,493

The city calculated the amounts by taking the percentage charged in prior years and applying it to the total costs of the current year. The city was unable to provide documentation to describe the methodology used.

The Gas Tax Guidelines state that overhead will only be allowed 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.

Therefore, the \$1,563,493 in overhead costs are disallowed.

Recommendation

The city should reimburse the Gas Tax Fund for \$1,563,493 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

Management does not concur with the State Controller's Office recommendation. For FY 2006-07 through FY 2011-12 regarding Unsupported overhead costs allocations. City categorized city costs as direct service providers (Police, Fire, Water, Wastewater, Street Maintenance, etc.) or as indirect service providers (City Manager, Finance, Clerk, etc.) who's costs are not readily identifiable to a particular public service program but jointly benefit all direct service providers. The cost plan allocated the indirect service department costs across all departments that benefit from their services. The primary factors used to allocate the direct costs were budget and/or staffing. There may have been some weighting factors that were also included based on the direct services providers use of indirect cost services. Some direct service provider departments contained limited

administrative and analytical staffing resources because of the organizational structure. These departments used a higher degree of administrative and analytical support. Some departments such as Police and Fire were larger and more capable of providing administrative and analytical support. The Public Works Department was at the other end of the spectrum; they provided maintenance and direct supervision but had very little administrative or internal analytical capacity and therefore utilized the services of the direct cost departments at a much higher degree.

The cost plan was based on budget but adjusted it to actuals at year end. Also some changes in the organizational structure may have impacted the allocation of costs.

SCO's Comments

The city disagrees with this finding.

The city claimed that the Gas Tax Fund benefited from the indirect costs and should be charged. The finding is not whether the Gas Tax Fund benefitted from the indirect costs but is strictly based on the fact that the city failed to provide us with adequate supporting documentation for these indirect costs. The city did not have an approved cost allocation plan or an equitable and auditable distribution of overhead costs as required by the SCO's Guidelines Relating to Gas Tax Expenditures. Therefore, we could not determine how much of the indirect costs should have been charged to the Gas Tax Fund. The city should develop a cost allocation plan or a similar type of document based on an equitable and auditable distribution of overhead costs with adequate supporting documentation.

The finding remains as stated.

FINDING 2— Unallowable negative fund balance

The city ended FY 2008-09 with a negative fund balance of \$639,270 in the Gas Tax Fund. The negative fund balance was due to the city expending Gas Tax monies in excess of the available funds. Therefore, the city inappropriately funded FY 2008-09 activities with future Highway Users Tax apportionments.

The practice of funding one fiscal year's activities with Highway Users Tax apportionments of the following fiscal year is in violation of Article 16, Section 18, of the California Constitution and is contrary to established municipal budgetary and accounting practice. Expenditures exceeding what is available are therefore unallowable expenditures because it pledges future revenues.

Article 16, Section 18(a), of the California Constitution states

No county, city, town, township, board of education, or school district, shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the voters of the public

entity voting at an election to be held for that purpose, except that with respect to any such public entity which is authorized to incur indebtedness for public school purposes, any proposition for the incurrence of indebtedness in the form of general obligation bonds for the purpose of repairing, reconstructing or replacing public school buildings determined, in the manner prescribed by law, to be structurally unsafe for school use, shall be adopted upon the approval of a majority of the voters of the public entity voting on the proposition at such election; nor unless before or at the time of incurring such indebtedness provision shall be made for the collection of an annual tax sufficient to pay the interest on such indebtedness as it falls due, and to provide for a sinking fund for the payment of the principal thereof, on or before maturity, which shall not exceed forty years from the time of contracting the indebtedness.

Therefore, the \$639,270 negative fund balance in the Gas Tax Fund for FY 2008-09 is disallowed.

Recommendation

The city should transfer \$639,270 to the Gas Tax Fund and establish policies and procedures to ensure that future expenditures of Gas Tax monies do not exceed available balances.

City's Response

Management concurs with the State Controller's Office recommendation that future expenditures of Gas Tax monies should not exceed available balances. However, Management does not concur with the recommendation to transfer \$639,270 to the Gas Tax Fund due to the unique circumstance which caused this situation. The City anticipated the receipt of \$1.2 million in Gas Tax funds in Fiscal Year 2008-09 which was consistent with the prior fiscal years actual Gas Tax receipts. As a result of the unanticipated economic downturn, Fiscal Year 2008-09 Gas Tax revenue was reduced from \$1.2 million to \$0.6 million. At the same time, the City was experiencing significant reductions in other revenues and was working diligently to identify areas for cost reductions. Cost saving measures were identified and implemented as soon as feasible. The following year (Fiscal Year 2009-10) a reduced Gas Tax expenditure program was implemented and the fund was returned to a positive balance. It has remained positive since that time.

SCO's Comments

The city agreed with the finding, but disagreed with the recommendation for a transfer of \$639,270 to Gas Tax Fund.

The fact remains that for FY 2008-09, expenditures exceeded what was available by \$639,270 and therefore resulted in unallowable expenditures.

In addition, the city never received \$1.2 million of Gas Tax revenue. The \$1.2 million figure cited by the city for FY 2007-08 includes only \$481,408 of Gas Tax revenues. The remaining amounts consist of

\$444,217 in Proposition 1B revenues and \$230,148 in STP reimbursement. Since these revenue sources are not recurring allocations they should not be budgeted in this manner.

It should also be noted that in FY 2009-10, the Gas Tax Fund had a negative ending fund balance of \$293,808. It was not until FY 2012-13 that the Gas Tax Fund reflected a positive ending fund balance.

The finding remains as stated.

**FINDING 3—
Unallowable transfer
for prior-year
expenditures**

In FY 2012-13, the city made an unallowable transfer of \$34,901 from the Gas Tax Fund to the General Capital Fund for expenditures related to a crosswalk project incurred and paid in FY 2010-11.

In general, current-year expenditures should be matched with current-year revenues. Therefore, expenditures incurred in FY 2010-11 should be paid for with 2010-11, not 2012-13 revenues.

Recommendation

The city should transfer \$34,901 to the Gas Tax Fund for the unallowable prior-year expenditures and establish policies and procedures to ensure that transfers out of the Gas Tax Fund are for current-year expenditures only.

City's Response

Management concurs with the State Controller's Office recommendation.

SCO's Comments

The city agrees with the finding.

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

Spalj, Mike

From: Lakhwinder Deol <ldeol@atwater.org>
Sent: Friday, November 07, 2014 2:02 PM
To: Spalj, Mike; Cheng, Michael; Lek, Christopher
Cc: Frank Pietro; Bill Zenoni; Lakhwinder Deol
Subject: Gas Tax Draft Audit Report Response - City of Atwater
Attachments: Response Gas Tax - Findings and Recommendations.docx

Importance: High

Michael,

Please see attached response for the draft Gas Tax Audit Report from the City of Atwater.

If you have any questions or concerns, please feel free to contact me at below listed information.

Please confirm receipt!

Thank you,

Lakhwinder Deol
City of Atwater
Finance Operations Manager
Office: (209) 357-6347
Fax: (209) 357-6364



Please note that due to on-going financial constraints, City employees (non-safety) are on mandatory unpaid time off. Employees are also on a "compressed work schedule." City offices are subsequently closed every Friday.

Office hours for the City Finance Department are Monday through Thursday 7:30 AM to 5:30 PM.

Save a Tree: We're doing our part and we urge you to please think twice before printing this email. Thank you.

Confidentiality Notice:

This message is for the named person's use only. It may contain confidential, proprietary or legally privileged information. No confidentiality or privilege is waived or lost by any mistransmission. If you receive this message in error, please immediately delete it and all copies of it from your system, destroy any hard copies of it and notify the sender. You must not, directly or indirectly, use, disclose, distribute, print, or copy any part of this message if you are not the intended recipient. We and any of our subsidiaries each reserve the right to monitor all e-mail communications through its networks.

Any views expressed in this message are those of the individual sender, except where the message states otherwise and the sender is authorized to state them to be the views of any such entity.

City of Atwater



Special Gas Tax Street Improvement Fund

July 1, 2002, through June 30, 2013

Traffic Congestion Relief Fund Allocations

July 1, 2002, through June 30, 2013

Proposition 1B Fund Allocations

July 1, 2007, through June 30, 2013

Findings and Recommendations:

Findings

Finding 1 Recommendation:

The city should reimburse the Gas Tax Fund for \$1,563,493 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.

Management Response:

Management does not concur with the State Controller's Office recommendation. For FY 2006-07 through FY 2011-12 regarding Unsupported overhead costs allocations. City categorized city costs as direct service providers (Police, Fire, Water, Wastewater, Street Maintenance, etc.) or as indirect service providers (City Manager, Finance, Clerk, etc.) who's costs are not readily identifiable to a particular public service program but jointly benefit all direct service providers. The cost plan allocated the indirect service department costs across all departments that benefit from their services. The primary factors used to allocate the direct costs were budget and/or staffing. There may have been some weighting factors that were also included based on the direct services providers use of indirect cost services. Some direct service provider departments contained limited administrative and analytical staffing resources because of the organizational structure. These departments used a higher degree of administrative and analytical support. Some departments such as Police and Fire were larger and more capable of providing administrative and analytical support. The Public Works Department was at the other end of the spectrum; they provided maintenance and direct supervision but had very little administrative or internal analytical capacity and therefore utilized the services of the direct cost departments at a much higher degree.

City of Atwater



The cost plan was based on budget but adjusted it to actuals at year end. Also some changes in the organizational structure may have impacted the allocation of costs.

Finding 2 Recommendation:

The city should transfer \$639,270 to the Gas Tax Fund and establish policies and procedures to ensure that future expenditures of Gas Tax monies do not exceed available balances.

Management Response:

Management concurs with the State Controller's Office recommendation that future expenditures of Gas Tax monies should not exceed available balances. However, Management does not concur with the recommendation to transfer \$639,270 to the Gas Tax Fund due to the unique circumstance which caused this situation. The City anticipated the receipt of \$1.2 million in Gas Tax funds in Fiscal Year 2008-09 which was consistent with the prior fiscal years actual Gas Tax receipts. As a result of the unanticipated economic downturn, Fiscal Year 2008-09 Gas Tax revenue was reduced from \$1.2 million to \$0.6 million. At the same time, the City was experiencing significant reductions in other revenues and was working diligently to identify areas for cost reductions. Cost saving measures were identified and implemented as soon as feasible. The following year (Fiscal Year 2009-10) a reduced Gas Tax expenditure program was implemented and the fund was returned to a positive balance. It has remained positive since that time.

Finding 3 Recommendation:

The city should transfer \$34,901 to the Gas Tax Fund for the unallowable prior-year expenditures and establish policies and procedures to ensure that transfers out of the Gas Tax Fund are for current-year expenditures only.

Management Response:

Management concurs with the State Controller's Office recommendation.

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

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