

CITY OF KING CITY

Audit Report

SPECIAL GAS TAX STREET IMPROVEMENT FUND

July 1, 2016, through June 30, 2017



BETTY T. YEE
California State Controller

March 2019



BETTY T. YEE
California State Controller

March 26, 2019

Steven Adams, City Manager
City of King City
212 Vanderhurst Avenue
King City, CA 93930

Dear Mr. Adams:

The State Controller's Office audited the City of King City's Special Gas Tax Street Improvement Fund to determine whether the city accounted for and expended its Special Gas Tax Street Improvement Fund in compliance with requirements for the period of July 1, 2016, through June 30, 2017.

Our audit found an instance of non-compliance. The city understated the fund balance by \$310,124 as of June 30, 2017, because it over-expended its Special Gas Tax Street Improvement Fund. The city agreed with the finding and adjusted the Special Gas Tax Street Improvement Fund balance with a correcting journal entry.

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

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/as

cc: The Honorable Mike LaBarre, Mayor
City of King City
Mike Howard, Finance Director
City of King City

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Audit Report

Summary

The State Controller's Office (SCO) audited the City of King City's Special Gas Tax Street Improvement Fund to determine whether the city accounted for and expended its Special Gas Tax Street Improvement Fund in compliance with requirements for the period of July 1, 2016, through June 30, 2017.

Our audit found an instance of non-compliance. The city understated the fund balance by \$310,124 as of June 30, 2017, because it over-expended its Special Gas Tax Street Improvement Fund.

Background

The State apportions funds monthly from the Highway Users Tax Account (HUTA) in the Transportation Tax Fund to cities¹ 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 Streets and Highways Code, cities must establish individual Special Gas Tax Street Improvement Funds for the deposit of their HUTA fund apportionments. Additionally, cities must expend their HUTA fund apportionments only for street-related purposes in accordance with Article XIX of the California Constitution and Streets and Highways Code. We conducted our audit of the city's Special Gas Tax Street Improvement Fund under the authority of Government Code (GC) 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 in compliance with Article XIX of the California Constitution and Streets and Highways Code.

The audit period was July 1, 2016, through June 30, 2017.

To achieve our objective, we:

- Gained a limited understanding of internal controls that would have an effect on the reliability of the accounting records of the Special Gas Tax Street Improvement Fund by interviewing key personnel, completing an internal control questionnaire, and reviewing the city's organization chart;
- Conducted a risk assessment to determine the nature, timing, and extent of substantive testing;
- Performed analytical procedures to determine and explain the existence of unusual or unexpected account balances;
- Verified the accuracy of fund balances by performing a fund balance reconciliation for the period of July 1, 2007, through June 30, 2016,

¹Includes towns.

and by recalculating the trial balance for the period of July 1, 2016, through June 30, 2017;

- Verified that the components of and changes to fund balances were properly computed, described, classified, and disclosed by scheduling and analyzing the Special Gas Tax Street Improvement Fund account balances;
- Reconciled the fund revenue recorded in the city ledger to the balance reported in the SCO's apportionment schedule for fiscal year (FY) 2016-17 to determine whether HUTA apportionments received by the city were completely accounted for;
- Analyzed the system used to allocate interest and determined whether the interest revenue allocated to the Special Gas Tax Street Improvement Fund was fair and equitable, by interviewing key personnel and recalculating all interest allocations for the audit period;
- Reviewed the fund cash and receivables accounts for unauthorized borrowing to determine whether unexpended Special Gas Tax Street Improvement Funds were available for future street-related expenditures; and
- Verified that the expenditures incurred during the audit period were supported by proper documentation and eligible in accordance with the applicable criteria, by testing all expenditure transactions that were equal to or greater than the significant item amount (calculated based on materiality threshold), and judgmentally selecting non-statistical samples of other transactions for the following categories:
 - Services and Supplies – We tested \$170,550 of \$306,774.
 - Labor – We tested \$35,825 of \$64,572.
 - Construction/Engineering – We tested \$1,294,761 of \$1,670,288.

For the selected samples, errors found, if any, were not projected to the intended (total) population.

We did not audit the city's financial statements. We limited our audit scope to planning and performing 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 criteria. We considered the city's internal controls only to the extent necessary to plan the audit.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Conclusion	Our audit found an instance of non-compliance for the period of July 1, 2016, through June 30, 2017, as quantified in the Schedule and described in the Finding and Recommendation section of this report. The finding required an adjustment of \$310,124 to the city's accounting records.
Follow-up on Prior Audit Findings	The city satisfactorily resolved the findings noted in our prior audit report for the period of July 1, 2005, through June 30, 2006, issued on May 25, 2007.
Views of Responsible Officials	We discussed the audit results with city representatives during an exit conference on February 4, 2019. Steven Adams, City Manager, agreed with the audit results. Mr. Adams further agreed that a draft audit report was not necessary and that the audit report could be issued as final. During fieldwork, the city provided a journal entry to correct fund balance of the Special Gas Tax Street Improvement Fund.
Restricted Use	This audit report is solely for the information and use of the City of King City 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 the final audit report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov .

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

March 26, 2019

Schedule—
Reconciliation of Fund Balance
July 1, 2016, through June 30, 2017

	Special Gas Tax Street Improvement Fund ¹
Beginning fund balance per city	\$ (124,218)
Revenues	<u>1,855,727</u>
Total funds available	1,731,509
Expenditures	<u>(2,041,633)</u>
Ending fund balance per city	(310,124)
SCO adjustment: ²	
Finding — Deficit fund balance	<u>310,124</u>
Ending fund balance per audit	<u><u>\$ -</u></u>

¹Cities receive apportionments from the State HUTA, 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-related 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. Cities must establish individual Special Gas Tax Street Improvement Funds for the deposit of their HUTA fund apportionments.

²See the Finding and Recommendation section.

Finding and Recommendation

FINDING— Deficit Fund Balance

The city incurred costs in excess of available funds, resulting in a deficit fund balance of \$310,124 in the Special Gas Tax Street Improvement Fund as of June 30, 2017. We noted the issue while performing a fund balance reconciliation. We analyzed the revenues, expenditures, and beginning fund balance for FY 2016-17 and found that the city spent \$185,905 on street-related expenditures in excess of available funds for the fiscal year. Additionally, the Special Gas Tax Street Improvement Fund's beginning fund balance for the fiscal year was a deficit \$124,219.

The Special Gas Tax Street Improvement Fund was over-expended because the city lacks adequate procedures to ensure that funds are available prior to incurring costs.

The practice of funding one fiscal year's activities with HUTA apportionments from the following fiscal year is contrary to established municipal budgetary and accounting practice and in violation of Article XVI, section 18, of the California Constitution, which states, in part:

- (a) 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.

In addition, pursuant to GC section 12440, the Controller draws warrants on the Treasurer for the payment of money only where authorized by law and only where unexhausted specific appropriations provided by law are available to meet such obligations. No specific unexhausted appropriations exist for the purpose of reimbursing negative fund balances. Therefore, the city should not carry forward a deficit fund balance in its Special Gas Tax Street Improvement Fund in any given year, even if the city is expecting to reimburse the deficit fund balance with future revenues.

During our audit fieldwork, the city agreed with the finding and reimbursed the Special Gas Tax Street Improvement Fund \$310,124 through Journal Entry No. 407088, dated March 27, 2018.

Recommendation

We recommend that the city implement procedures to ensure that sufficient funds are available prior to incurring costs.

**State Controller's Office
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