

# **CITY OF SOUTH GATE**

Audit Report

## **SPECIAL GAS TAX STREET IMPROVEMENT FUND**

*July 1, 2016, through June 30, 2017*



**BETTY T. YEE**  
California State Controller

April 2019



**BETTY T. YEE**  
California State Controller

April 23, 2019

Michael S. Flad, City Manager  
City of South Gate  
8650 California Avenue  
South Gate, CA 90280

Dear Mr. Flad:

The State Controller's Office audited the City of South Gate'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 instances of non-compliance. The city understated the fund balance by \$4,312 as of June 30, 2017, because it charged ineligible expenditures to the Special Gas Tax Street Improvement Fund. We also identified a deficiency in internal control that is not significant to the audit objective, but warrants the attention of management.

If you have any questions, please contact Efren Loste, 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: M. Belén Bernal, Mayor  
City of South Gate  
Kim Sao, Deputy Director of Administrative Services  
City of South Gate  
Jackie Acosta, Director of Administrative Services  
City of South Gate

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## **Audit Report**

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# Audit Report

## Summary

The State Controller's Office (SCO) audited the City of South Gate'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 instances of non-compliance. The city understated the fund balance by \$4,312 as of June 30, 2017, because it charged ineligible expenditures to the Special Gas Tax Street Improvement Fund. We also identified a deficiency in internal control that is not significant to the audit objective, but warrants the attention of management.

## Background

The State apportions funds monthly from the Highway Users Tax Account (HUTA) in the Transportation Tax Fund to cities<sup>1</sup> 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;

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<sup>1</sup>Includes towns.

- Verified the accuracy of fund balances by performing a fund balance reconciliation for the period of July 1, 2007, through June 30, 2016, 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;
- Reviewed city accruals and adjustments for validity and eligibility;
- 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 HUTA funds were available for future street-related expenditures and protected from impairment; 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 \$1,022,803 of \$1,612,694.
  - Labor – We tested \$32,658 of \$1,369,500.
  - Transfers – We tested \$309,294 of \$457,898.

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 instances 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 requires an adjustment of \$4,312 to the city’s accounting records.

We also identified a deficiency in internal control that is not significant to the audit objective, but warrants the attention of management. This deficiency is described in the Observation and Recommendation section of this audit report.

**Follow-up on Prior Audit Findings**

The city satisfactorily resolved the findings noted in our prior audit report for the period of July 1, 2006, through June 30, 2007, issued on December 31, 2008.

**Views of Responsible Officials**

We issued a draft report on February 12, 2019. Jackie Acosta, Director of Administrative Services, responded by letter dated March 7, 2019, agreeing with the audit results. The city’s response is included in this final report as an attachment.

**Restricted Use**

This audit report is solely for the information and use of the City of South Gate 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 audit report, which is a matter of public record and is available on the SCO website at [www.sco.ca.gov](http://www.sco.ca.gov).

*Original signed by*

JIM L. SPANO, CPA  
Chief, Division of Audits

April 23, 2019

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

	Special Gas Tax Street Improvement Fund <sup>1</sup>
Beginning fund balance per city	\$ 1,999,882
Revenues	<u>1,887,482</u>
Total funds available	3,887,364
Expenditures	<u>(3,440,092)</u>
Ending fund balance per city	447,272
SCO adjustment: <sup>2</sup>	
Finding—Ineligible expenditures	<u>4,312</u>
Ending fund balance per audit	<u><u>\$ 451,584</u></u>

<sup>1</sup>Cities 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.

<sup>2</sup>See the Finding and Recommendation section.

# Finding and Recommendation

## **FINDING— Ineligible Expenditures**

The city charged \$1,612,694 in services and supplies expenditures to the Special Gas Tax Street Improvement Fund. We tested \$1,022,803 of this total and identified \$4,312 in ineligible expenditures, which consisted of:

- \$2,024 for rental of barricades for a Christmas parade;
- \$1,969 for rental of barricades for a La Posada parade; and
- \$319 for purchase of sand for the city park.

We reviewed the remaining expenditures in the Special Gas Tax Street Improvement Fund's Expenditure Detail Report for FY 2016-17 to determine whether there were additional transactions for the identified ineligible expenditures. We did not identify additional ineligible expenditures.

The expenditures for barricades for the Christmas and La Posada parades and sand for the city park did not involve street maintenance, street construction, or street reconstruction.

Streets and Highways Code section 2101 states, in part:

all moneys in the Highway Users Tax Account in the Transportation Tax Fund and hereafter received in the account are appropriated for...(a) The research, planning, construction, improvement, maintenance, and operation of public streets and highways.

The city's non-compliance with these requirements resulted in an overstatement of street expenditures by \$4,312 and an understatement of the fund balance for the Special Gas Tax Street Improvement Fund by the same amount.

The city made ineligible expenditures because it does not have adequate procedures to ensure that all costs charged to the Special Gas Tax Street Improvement Fund are for street-related purposes.

### Recommendation

We recommend that the city:

- Reimburse the Special Gas Tax Street Improvement Fund by \$4,312; and
- Establish adequate procedures to ensure that all costs charged to the Special Gas Tax Improvement Fund are for street-related purposes in compliance with Streets and Highways Code section 2101.

### City's Response

The city agreed with the finding.



# Observation and Recommendation

**OBSERVATION—  
Non-compliance with  
GC section 41004**

The city did not comply with GC section 41004 for FY 2016-17. This section requires the city treasurer to submit to the city clerk a monthly written report and an accounting of all receipts, disbursements, and fund balances.

Compliance with GC section 41004 increases accountability for receipts, disbursements, and fund balances.

We identified the error when reviewing the city’s cash and fund balance controls. The city did not have internal controls in place to ensure compliance with the above requirement. The city’s non-compliance with this requirement does not affect the Special Gas Tax Street Improvement Fund compliance with Article XIX of the California Constitution and the Streets and Highways Code.

Recommendation

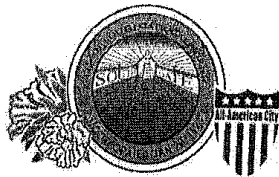
We recommend that the city establish internal controls to ensure compliance with GC section 41004.

City’s Response

The city agreed with the observation.

**Attachment—  
City of South Gate's Response to Draft Audit Report**

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**City of South Gate**  
8650 California Avenue, South Gate, CA 90280

March 7, 2019

Efren Loste, Chief  
Local Government Audits Bureau  
State Controller's Office  
Division of Audits  
Post Office Box 942850,  
Sacramento, California 94250

Mr. Loste,

This letter is in response to the letter dated February 12, 2019 in regards to the State Controller's Office's audit of the City of South Gate's Special Gas Tax Street Improvement Fund for the period of July 1, 2016 through June 30, 2017.

The City concurs with the finding of ineligible expenditures of \$4,312. The City will make the reimbursement to the Special Gas Tax Street Improvement Fund during fiscal year 2018-2019. Furthermore, the City's Public Works Department has been informed of the finding and will ensure that in the future, expenditures charged to the Special Gas Tax Street Improvement Fund are thoroughly reviewed and eligible under the Special Gas Tax Street Guidelines.

In regards to the non-compliance with GC section 41004, which requires the City Treasurer to submit to the City Clerk a monthly written report and an accounting of all receipts, disbursement, and fund balances, the City will review the code and determine a reasonable method to ensure compliance with the code.

Sincerely,

Jackie Acosta

Director of Administrative Services

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

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