

CITY OF WHEATLAND

Audit Report

SPECIAL GAS TAX STREET IMPROVEMENT FUND

July 1, 2016, through June 30, 2017



BETTY T. YEE
California State Controller

May 2019



BETTY T. YEE
California State Controller

May 20, 2019

Susan Mahoney, Finance Director
City of Wheatland
111 C Street
Wheatland, CA 95692

Dear Ms. Mahoney:

The State Controller's Office (SCO) audited the City of Wheatland'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. The SCO also reviewed the city's Annual Street Report (ASR) for the period of July 1, 2016, through June 30, 2017 to determine whether the report was adequate and accurate.

Our audit found instances of non-compliance. The city understated the fund balance by \$8,277 as of June 30, 2017, because it incurred duplicate charges totaling \$4,851 and charged negative interest totaling \$3,426.

Our review of the city's ASR found that the city did not report accurate fund balances and did not include all street-related activities in its ASR.

We identified a deficiency in internal control that is significant to the audit objective. 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 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 Joseph Henderson, Mayor
City of Wheatland
Jim Goodwin, City Manager
City of Wheatland

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Audit Report

Summary

The State Controller's Office (SCO) audited the City of Wheatland'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. The SCO also reviewed the city's Annual Street Report (ASR) for the period of July 1, 2016, through June 30, 2017 to determine whether the report was adequate and accurate.

Our audit found instances of non-compliance. The city understated the fund balance by \$8,277 as of June 30, 2017, because it incurred duplicate charges totaling \$4,851 and charged negative interest totaling \$3,426.

Our review of the city's ASR found that the city did not report accurate fund balances and did not include all street-related activities in its ASR.

We identified a deficiency in internal control that is significant to the audit objective. 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 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 section 12410.

Cities are also required to file a report with the SCO, on or before October 1 of each year, detailing the revenues and expenditures for street-related purposes during the preceding fiscal year. We performed our review of the city's ASR under the authority of Streets and Highways Code section 2153.

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; and whether the city's ASR was adequate and accurate.

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

¹Includes towns.

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 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, 2006, 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;
- 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;
- 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 \$26,153 of \$71,196.
 - Labor – We tested \$35,546 of \$86,625.
 - Indirect – We tested \$20,770 of \$20,770.
 - Acquisitions – We tested \$1,500 of \$2,694.

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

- Interviewed key personnel to gain an understanding of citywide street-related funds and activities and the ASR reporting process and verify that the city accounted for all of its HUTA apportionments; reported and properly classified all of its street-related expenditures and revenues, and year-end fund balances; and that the ASR was filed in a timely manner.

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 Findings and Recommendations section of this report. Findings 1 and 2 required an adjustment of \$8,277 to the city's accounting records.

Our review of the city's ASR found that the city did not report accurate fund balances and did not include all street-related activities in its ASR.

We identified a deficiency in internal control that is significant to the audit objective. This deficiency is described in the Findings and Recommendations section.

In addition, we 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, 2004, through June 30, 2005, issued on August 30, 2006.

Views of Responsible Officials

We discussed the audit results with city representatives during an exit conference on April 10, 2019. Susan Mahoney, Finance Director, agreed with the audit results. Ms. Mahoney further agreed that a draft audit report was not necessary and that the audit report could be issued as final.

Restricted Use

This audit report is solely for the information and use of the City of Wheatland 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.

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

May 20, 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	\$ (82)
Highway Users Tax revenues	78,487
General Fund transfer in	<u>143,000</u>
Total funds available	221,405
Expenditures	<u>(181,286)</u>
Ending fund balance per city	<u>40,119</u>
SCO adjustments: ²	
Finding 1 – Duplicate charges	4,851
Finding 2 – Negative interest	<u>3,426</u>
Total SCO adjustments	<u>8,277</u>
Ending fund balance per audit	<u><u>\$ 48,396</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 Findings and Recommendations section.

Findings and Recommendations

FINDING 1— Duplicate charges

The city inadvertently posted \$4,851 of administrative salary costs to the Special Gas Tax Street Improvement Fund twice in FY 2016-17. During testing of expenditures, we noted that city included salaries for administrative services division staff members as direct charges to the Special Gas Tax Street Improvement Fund. We also noted that the city's indirect cost rate included salary costs for the same three out of four administrative staff members. By including the same salary costs as direct charges and as indirect costs, the city incurred \$4,851 in duplicate charges.

The city made duplicate charges because it lacked adequate policies and procedures to ensure that costs included in the indirect cost pool were not also directly billed to the Special Gas Tax Street Improvement Fund.

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 (and their related public facilities for nonmotorized traffic), including the mitigation of their environmental effects, the payment for property taken or damaged for such purposes, and the administrative costs necessarily incurred in the foregoing purposes.

During our audit fieldwork, the city agreed with the finding and provided Journal Entry No. 208555 dated June 21, 2018, to reimburse the Special Gas Tax Street Improvement Fund for the double-posting of salaries. In addition, the city updated its policies and procedures to prevent duplicate charges from occurring in the future.

Recommendation

We recommend that the city:

- Follow the transaction review procedures in its policy and procedures manual prior to posting transactions to the Special Gas Tax Street Improvement Fund in order to prevent double posting of costs; and
- Monitor compliance with updated policies and procedures to ensure that expenditures included in the calculation of indirect costs are not also directly billed to the Special Gas Tax Street Improvement Fund.

**FINDING 2—
Negative interest**

The city posted negative interest totaling \$3,426 to the Special Gas Tax Street Improvement Fund. While preparing a reconciliation of the fund balance for FY 2016-17, we noted that the city posted \$228 in negative interest to the fund in FY 2016-17. As a result, we expanded our review of the interest transactions posted to the fund to include all prior unaudited periods of FY 2005-06 through FY 2015-16. We found that the city posted negative interest to the Special Gas Tax Street Improvement Fund totaling \$3,426, as illustrated in the table below:

Fiscal Year	Interest Income
2005-06	\$ -
2006-07	-
2007-08	(1,250)
2008-09	(1,195)
2009-10	(106)
2010-11	(155)
2011-12	-
2012-13	(51)
2013-14	(30)
2014-15	(109)
2015-16	(302)
2016-17	<u>(228)</u>
 Total	 <u>\$ (3,426)</u>

The city posted negative interest because it lacked adequate cash management policies and procedures to ensure that the Special Gas Tax Street Improvement Fund cash balance remains positive at all times. The city computed allocable interest at a point in time without verifying sufficient cash balances in various funds.

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.

During our audit fieldwork, the city agreed with the finding and provided Journal Entry No. 208554 dated June 21, 2018, to reimburse the Special Gas Tax Street Improvement Fund for the negative interest. In addition, the city developed new procedures and communicated them to city staff to prevent negative cash balances and negative interest calculations from occurring in the future.

Recommendation

We recommend that the city:

- Monitor compliance with newly developed cash management policies and procedures to prevent negative cash balances from occurring in the Special Gas Tax Street Improvement Fund; and
- Eliminate the practice of computing negative interest.

**FINDING 3—
Unallowable cost
allocation methodology**

During our testing of expenditures for FY 2016-17, we noted that the city used unallowable allocation methodology when posting various administrative and operating costs to the Special Gas Tax Street Improvement Fund. The Public Works Department did not use the approved indirect cost allocation percentage of 4.58% when posting operating expenditures to the Special Gas Tax Street Improvement Fund. Specifically, the city posted miscellaneous expenditures such as supplies, clothing allowances, fuel and telephone charges, and other expenses at 25% rather than using the approved indirect cost rate.

The city did not provide an approved resolution or other documentation supporting the allocation percentages used as opposed to the approved indirect cost allocation percentages. By using unallowable allocation methodology, the city inadvertently charged expenditures that might have been unallowable to the Special Gas Tax Street Improvement Fund.

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.

Streets and Highways Code Section 2150 states, in part:

All money received by a county from the Highway Users Tax Fund and all money deposited by a county in its road fund shall be expended by the county exclusively for county roads for the purposes specified in section 2101 or for other public street and highway purposes as provided by law.

The city used an unallowable cost allocation methodology because it lacked adequate policies and procedures to verify that expenditures were allocated to the Special Gas Tax Street Improvement Fund based on approved indirect cost allocation percentages.

During our audit fieldwork, the city developed new procedures and communicated them to city staff to eliminate the use of unallowable cost allocation methodologies.

Recommendation

We recommend that the city monitor compliance with newly developed policies and procedures to ensure that the city uses only approved indirect cost allocation percentages when allocating expenditures to city funds.

**FINDING 4—
Annual Street Report
not accurate**

During our review of the city's ASR for FY 2016-17, we noted that it reported inaccurate fund balances. The city did not reconcile the Special Gas Tax Street Improvement Fund balance stated in its ASR to the city's accounting records. In addition, the city included only approximately 30% of its street-related activity noted in the general ledger, and did not document which cost centers were excluded and why. As a result, the city's ASR included inaccurate information. The city lacked policies and procedures to ensure that it reported accurate street-related activity in its ASR by reconciling the ASR to the city's accounting records.

Streets and Highways Code section 2151 states, in part:

On or before the first day of October of each year, the governing body of each county and city shall cause to be made and filed with the Controller a complete report of the expenditures for street or road purposes during the preceding fiscal year ending on the 30th day of June.

Streets and Highways Code section 2152 states, in part:

The report shall contain ... a detailed statement of all expenditures during the fiscal year covered by the report for street or road purposes, including obligations incurred but not yet paid. The statement shall be broken down into expenditure categories ...

The State Controller, with the advice of the department, may prescribe any other expenditure categories and may require any detail that may be deemed necessary by him or her fully to disclose the nature and extent of all financial transactions by the county or city relating to streets or roads.

Streets and Highways Code section 2153 states:

The State Controller shall take such steps as he may deem necessary to ensure that such reports are adequate and accurate.

During our audit fieldwork, the city hired a consultant to prepare future ASR reports and to ensure that ASRs comply with applicable laws and regulations.

Recommendation

We recommend that the city implement policies and procedures to ensure that amounts reported in its ASR are accurate by reconciling the ASR to the city's accounting records.

Observation and Recommendation

**OBSERVATION—
Lack of management
review and approval**

During our testing of revenues and expenditures, we noted the lack of management review and approvals for the following items:

- Journal entries prior to posting to the accounting records;
- Management timesheets; and
- Bank reconciliations.

Management review and approval is an essential element of an effective system of internal control. Lacking management review and approval puts the city at risk of having potential errors in its accounting records.

During our audit fieldwork, the city communicated to city staff its requiring that managers review and approve entries prior to posting them to the accounting records.

Recommendation

We recommend that the city monitor compliance with updated policies and procedures to ensure that managers review and approve all bank reconciliations, timesheets, and journal entries prior to posting them to the accounting records.

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

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