

# **CITY OF ELK GROVE**

Audit Report

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

*July 1, 2007, through June 30, 2013*

## **TRAFFIC CONGESTION RELIEF FUND ALLOCATIONS**

*July 1, 2007, through June 30, 2013*

## **PROPOSITION 1B FUND ALLOCATIONS**

*July 1, 2007, through June 30, 2013*



**BETTY T. YEE**  
California State Controller

June 2016



**BETTY T. YEE**  
California State Controller

June 20, 2016

The Honorable Gary Davis  
Mayor of the City of Elk Grove  
8401 Laguna Palms Way  
Elk Grove, CA 95758

Dear Mr. Davis:

The State Controller's Office audited the City of Elk Grove's Special Gas Tax Street Improvement Fund for the period of July 1, 2007, through June 30, 2013. We also audited the Traffic Congestion Relief Fund allocations recorded in its Traffic Congestion Relief Fund for the period of July 1, 2007, through June 30, 2013, and the Proposition 1B Fund allocations recorded in its Proposition 1B Fund for the period of July 1, 2007, through June 30, 2013.

Our audit found that although the city accounted for and expended its Special Gas Tax Street Improvement Fund, Traffic Congestion Relief Fund allocations, and Proposition 1B Fund allocations in compliance with requirements, the city understated the fund balance in the Special Gas Tax Street Improvement Fund by \$2,015,685 as of June 30, 2013, because it had a deficit fund balance at June 30, 2008.

If you have any questions, please contact Christopher Lek Interim Chief, Local Government Audits Bureau by telephone at (916) 284-0120.

Sincerely,

*Original signed by*

**JEFFREY V. BROWNFIELD, CPA**  
Chief, Division of Audits

JVB/rg

cc: Brad Koehn, Finance Director  
City of Elk Grove

# Contents

## **Audit Report**

<b>Summary .....</b>	<b>1</b>
<b>Background .....</b>	<b>1</b>
<b>Objectives, Scope, and Methodology .....</b>	<b>2</b>
<b>Conclusion .....</b>	<b>3</b>
<b>Follow-Up on Prior Audit Findings .....</b>	<b>4</b>
<b>Views of Responsible Officials.....</b>	<b>4</b>
<b>Restricted Use .....</b>	<b>4</b>
<b>Schedule 1—Reconciliation of Fund Balance .....</b>	<b>5</b>
<b>Finding and Recommendation .....</b>	<b>6</b>
<b>Attachment—City of Elk Grove’s Response to Draft Audit Report</b>	

# Audit Report

## Summary

The State Controller's Office (SCO) audited the City of Elk Grove's:

- Special Gas Tax Street Improvement Fund for the period of July 1, 2007, through June 30, 2013;
- Traffic Congestion Relief Fund allocations recorded in its Traffic Congestion Relief Fund for the period of July 1, 2007, through June 30, 2013; and
- Proposition 1B Fund allocations recorded in its Proposition 1B Fund for the period of July 1, 2007, through June 30, 2013.

Our audit found that although the city accounted for and expended its Special Gas Tax Street Improvement Fund, Traffic Congestion Relief Fund allocations, and Proposition 1B Fund allocations in compliance with requirements, the city understated the fund balance in the Special Gas Tax Street Improvement Fund by \$2,015,685 as of June 30, 2013, because it had a deficit fund balance at June 30, 2008.

## 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 Traffic Congestion Relief Fund allocations in its Traffic Congestion Relief Fund. We conducted our audit of the city's Traffic Congestion Relief Fund 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 must 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 its Proposition 1B Fund. A city also

must 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 Fund allocations under the authority of Government Code section 12410.

## **Objectives, Scope, and Methodology**

Our audit objective was to determine whether the city accounted for and expended its Special Gas Tax Street Improvement Fund, Traffic Congestion Relief Fund allocations, and Proposition 1B Fund allocations 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 a sample of 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 Allocations**

- Reconciled the Traffic Congestion Relief Fund allocations recorded in the city ledger to confirm that the allocations received by the city agreed with the SCO's apportionment schedule.
- Judgmentally selected a sample of 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 requirement.

**Proposition 1B Fund Allocations**

- Reconciled the Proposition 1B Fund allocations recorded in the city ledger to confirm that the allocations received by the city agreed with the SCO's apportionment schedule.
- Judgmentally selected a sample of 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, Traffic Congestion Relief Fund allocations, and Proposition 1B Fund allocations, 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 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 Elk Grove 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, 2007, through June 30, 2013, except as noted in Schedule 1 and described in the Finding and Recommendation section of this report. The finding requires an adjustment of \$2,015,685 to the city's accounting records.
- Traffic Congestion Relief Fund allocations recorded in its Traffic Congestion Relief 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, 2007, through June 30, 2013.
- Proposition 1B Fund allocations recorded in its Proposition 1B 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 October 31, 2002, disclosed no findings.

**Views of Responsible Officials**

We issued a draft report on January 14, 2016. Brad Koehn, Finance Director, responded by letter dated May 16, 2016. The city's response is included in this final audit report.

**Restricted Use**

This report is intended for the information and use of the City of Elk Grove 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

June 20, 2016

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

	Special Gas Tax Street Improvement Fund <sup>1</sup>	Traffic Congestion Relief Fund Allocations <sup>2</sup>	Proposition 1B Fund Allocations <sup>3</sup>
Beginning fund balance per city	\$4,589,558	\$ 9,211	\$ 811
Revenues	<u>3,370,599</u>	<u>89</u>	<u>20</u>
Total funds available	7,960,157	9,300	831
Expenditures	<u>(2,066,033)</u>	<u>(9,300)</u>	<u>(831)</u>
Ending fund balance per city	<u>5,894,124</u>	<u>—</u>	<u>—</u>
Timing adjustment:			
Accrual of June 2013 Highway Users Tax apportionment (Governmental Accounting Standards Board Statement No. 34)	<u>301,293</u>	<u>—</u>	<u>—</u>
SCO adjustment: <sup>4</sup>			
Finding 1—Deficit fund balance at June 30, 2008	<u>2,015,685</u>	<u>—</u>	<u>—</u>
Ending fund balance per audit	<u>\$8,211,102</u>	<u>\$ —</u>	<u>\$ —</u>

<sup>1</sup> The city receives apportionments from the State Highway Users Tax Account (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 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 city must deposit its HUTA apportionments in its Special Gas Tax Street Improvement Fund. The audit period was July 1, 2007, through June 30, 2013; however, this schedule includes only the period of July 1, 2012, through June 30, 2013.

<sup>2</sup> 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 and road maintenance, reconstruction, and storm damage repair. The city recorded its Traffic Congestion Relief Fund allocations in its Traffic Congestion Relief Fund. The audit period was July 1, 2007, through June 30, 2013; however, this schedule includes only the period of July 1, 2012, through June 30, 2013.

<sup>3</sup> 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 city recorded its Proposition 1B Fund allocations in its Proposition 1B Fund. The audit period was July 1, 2007, through June 30, 2013; however, this schedule includes only the period of July 1, 2012, through June 30, 2013.

<sup>4</sup> See the Finding and Recommendation section.



# Finding and Recommendation

## **FINDING 1— Deficit fund balance at June 30, 2008**

At June 30, 2008, the city's Special Gas Tax Street Improvement Fund had a deficit fund balance of \$2,015,685. The deficit resulted from the city inadvertently charging more street expenditures to the Special Gas Tax Street Improvement Fund than there were funds available.

The practice of funding one fiscal year's activities with Highway User's Tax apportionments of the following fiscal year is in violation of Article 16, Section 18, of the California Constitution, and contrary to established municipal budgetary and accounting practice.

As a result, the deficit fund balance of \$2, 015,685 is unallowable.

### Recommendation

The city should transfer \$2,015,685 to the Special Gas Tax Street Improvement Fund to correct the deficit fund balance. In the future, the city should establish procedures to ensure that there are sufficient funds in the Special Gas Tax Street Improvement Fund prior to charging the expenditures.

### City's Response

In connection with your audit of the Special Gas Tax Street Improvement Fund for the fiscal years commencing July 1, 2007 and ending June 30, 2013, the City of Elk Grove received your email, dated May 5, 2016. In this email you presented the City with your current conclusion that the City has not sufficiently evidenced a concerted effort to reimburse the Gas Tax Fund's deficit.

The City believes that it has provided the necessary information and support to satisfy your request and that this conclusion may be due to a lack of communicating all of the events that have led to your audit findings and continued conclusion.

To review, the City Council approved a resolution, in which the City's Gas Tax Fund would borrow funds from the Elk Grove Roadway Fee Fund to pay for the costs of a road widening project. This resolution also created a formal loan between the Gas Tax Fund and the Elk Grove Roadway Fee Fund. This created an "advance from other funds" on the Gas Tax Fund's general ledger as well as a loan amortization schedule with regular monthly payments. The City then spent the advance on the road widening project, which caused the fund balance in the Gas Tax Fund to become negative; as noted in your email. In the last correspondence to your office, the City demonstrated when and how much each payment was made from the Gas Tax Fund to the Elk Grove Roadway Fund which reduced and eventually eliminated the advance from the Elk Grove Roadway Fund liability which was causing the negative fund balance. Final repayment of this advance was made on May 30, 2013; four and a half years before the final payment was to be made, per the loan amortization schedule.

During your audit of our Gas Tax Fund, it was determined that the City should not have borrowed money from the Elk Grove Roadway Fee Fund in order to spend future Gas Tax funding. As a result, you requested that the City reverse the original loan and pay all of the funds borrowed back to the Gas Tax fund with a journal entry. We posted a journal entry that transferred funds from the Elk Grove Roadway Fee Fund to the Gas Tax Fund that had previously been used to repay the advance on March 13, 2015 in order to comply with this State Controller's auditor request. This entry was then provided to your office as evidence of compliance with your request.

The City acknowledges that the loan between the Elk Grove Roadway Fee Fund and the Gas Tax Funds was made not in accordance with the Gas Tax regulations and believes that it has provided all of the necessary documents to evidence that the funds have been repaid. Further, the City believes that it has provided all the documentation to evidence that both Funds are now whole and that the negative fund balance your office requested be reimbursed in the Gas Tax Fund has been provided. However, if your office requires further documentation, please let the City know what documentation you require and the City will be more than willing to do so.

#### SCO's Comment

The city acknowledges that the loan between the Elk Grove Roadway Fee Fund and the Special Gas Tax Street Improvement Fund, which created the deficit fund balance at June 30, 2008, was not made in accordance with the Gas Tax regulations. The city posted a journal entry adjustment on March 13, 2015. The SCO will follow up on the repayment during the next audit.

**Attachment—  
City of Elk Grove’s Response to  
Draft Audit Report**

---

FINANCE DEPARTMENT

8401 Laguna Palms Way  
Elk Grove, California 95758

Phone: 916.683.7111  
Fax: 916.691.3182

Web: [www.elkgrovecity.org](http://www.elkgrovecity.org)



May 16, 2016

Jason Fong  
Local Government Audits Bureau  
California State Controller's Office, Division of Audits  
P.O. Box 942850  
Sacramento, California 94250-5872

Dear Mr. Jason Fong:

In connection with your audit of the Special Gas Tax Street Improvement Fund for the fiscal years commencing July 1, 2007 and ending June 30, 2013, the City of Elk Grove received your email, dated May 5, 2016. In this email you presented the City with your current conclusion that the City has not sufficiently evidenced a concerted effort to reimburse the Gas Tax Fund's deficit.

The City believes that it has provided the necessary information and support to satisfy your request and that this conclusion may be due to a lack of communicating all of the events that have led to your audit findings and continued conclusion.


To review, the City Council approved a resolution, in which the City's Gas Tax Fund would borrow funds from the Elk Grove Roadway Fee Fund to pay for the costs of a road widening project. This resolution also created a formal loan between the Gas Tax Fund and the Elk Grove Roadway Fee Fund. This created an "advance from other funds" on the Gas Tax Fund's general ledger as well as a loan amortization schedule with regular monthly payments. The City then spent the advance on the road widening project, which caused the fund balance in the Gas Tax Fund to become negative; as noted in your email. In the last correspondence to your office, the City demonstrated when and how much each payment was made from the Gas Tax Fund to the Elk Grove Roadway Fund which reduced and eventually eliminated the advance from the Elk Grove Roadway Fund liability which was causing the negative fund balance. Final repayment of this advance was made on May 30, 2013; four and a half years before the final payment was to be made, per the loan amortization schedule.

During your audit of our Gas Tax Fund, it was determined that the City should not have borrowed money from the Elk Grove Roadway Fee Fund in order to spend future Gas Tax funding. As a result, you requested that the City reverse the original loan and pay all of the funds borrowed back to the Gas Tax fund with a journal entry. We posted a journal entry that transferred funds from the Elk Grove Roadway Fee Fund to the Gas

Tax Fund that had previously been used to repay the advance on March 13, 2015 in order to comply with this State Controller's auditor request. This entry was then provided to your office as evidence of compliance with your request.

The City acknowledges that the loan between the Elk Grove Roadway Fee Fund and the Gas Tax Funds was made not in accordance with the Gas Tax regulations and believes that it has provided all of the necessary documents to evidence that the funds have been repaid. Further, the City believes that it has provided all the documentation to evidence that both Funds are now whole and that the negative fund balance your office requested be reimbursed in the Gas Tax Fund has been provided. However, if your office requires further documentation, please let the City know what documentation you require and the City will be more than willing to do so.

Sincerely,



Brad Koehn  
City of Elk Grove  
Director of Finance and Administrative Services

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

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