

CITY OF WEST COVINA

Audit Report

SPECIAL GAS TAX STREET IMPROVEMENT FUND

July 1, 2008, through June 30, 2013

TRAFFIC CONGESTION RELIEF FUND

July 1, 2008, through June 30, 2011

PROPOSITION 1B FUND

July 1, 2007, through June 30, 2013



BETTY T. YEE
California State Controller

July 2015



BETTY T. YEE
California State Controller

July 9, 2015

The Honorable Fredrick Sykes
Mayor of the City of West Covina
1444 West Garvey Avenue South, Room 305
West Covina, CA 91790

Dear Mayor Sykes:

The State Controller's Office audited the City of West Covina's Special Gas Tax Street Improvement Fund for the period of July 1, 2008, through June 30, 2013. We also audited the Traffic Congestion Relief Fund for the period of July 1, 2008, through June 30, 2011, and the Proposition 1B Fund for the period of July 1, 2007, through June 30, 2013.

Our audit found that the city accounted for and expended its Special Gas Tax Street Improvement Fund, Traffic Congestion Relief Fund, and the Proposition 1B Fund in compliance with requirements, except that the city understated the fund balance in the Special Gas Tax Street Improvement Fund by \$270,255 as of June 30, 2013, because:

- The city charged \$50,904 in ineligible overhead costs and \$83,161 in unsupported overhead costs to the Special Gas Tax Street Improvement Fund.
- The city understated the fund balance in the Special Gas Tax Street Improvement by \$127,778 as of June 30, 2013, because the city expended in excess of available funds.
- The city transferred funds from the Special Gas Tax Street Improvement Fund to the General Fund in excess of actual street-related expenditures incurred by \$8,412.

The city's request for a two-year repayment schedule/plan for repaying the obligations should be submitted to:

Richard J. Chivaro, Chief Counsel
State Controller's Office
300 Capitol Mall, Suite 1850
Sacramento, CA 95814

It should be noted that the city agreed with the findings and the city's new staff has initiated correcting the many issues cited and has fully cooperated with our staff. We would like to express our thanks to city staff and management, who were extremely helpful throughout the audit process.

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/lis

cc: Thomas Mauk, Interim City Manager
City of West Covina
Chris Freeland, Assistant City Manager/CDC Director
City of West Covina
Christa Buhagiar, Finance Director
City of West Covina
Mike Spalj, Chief
State Controller's Office
Local Government Audits Bureau

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 —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 West Covina's Special Gas Tax Street Improvement Fund for the period of July 1, 2008, through June 30, 2013. We also audited the Traffic Congestion Relief Fund for the period of July 1, 2008, through June 30, 2011, and the Proposition 1B Fund for the period of July 1, 2007, through June 30, 2013.

Our audit found that the city accounted for and expended its Special Gas Tax Street Improvement Fund, Traffic Congestion Relief Fund, and Proposition 1B Fund in compliance with requirements, except that the city understated the fund balance in the Special Gas Tax Street Improvement Fund by \$270,255 as of June 30, 2013, because:

- The city charged \$50,904 in ineligible overhead costs and \$83,161 in unsupported overhead costs to the Special Gas Tax Street Improvement Fund.
- The city understated the fund balance in the Special Gas Tax Street Improvement by \$127,778 as of June 30, 2013, because the city expended in excess of available funds.
- The city transferred funds from the Special Gas Tax Street Improvement Fund to the General Fund in excess of actual street-related expenditures incurred by \$8,412.

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 (TCRF) allocations in the Traffic Congestion Relief 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 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 shall 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 allocation in the Proposition 1B Fund. A city also is required to 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 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 its Special Gas Tax Street Improvement Fund, Traffic Congestion Relief Fund, and Proposition 1B Fund in compliance with Article XIX of the California Constitution and the Streets and Highways Code. 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;
- Properly deposited TCRF allocations into an account designated for the receipt of State funds allocated for transportation purposes;
- Properly deposited Proposition 1B Fund allocations into an account designated for the receipt of State funds allocated for streets and roads purposes;
- 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 its Special Gas Tax Street Improvement Fund, Traffic Congestion Relief Fund, and Proposition 1B Fund 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 West Covina 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, 2008, through June 30, 2013, except as noted in the Schedule and described in the Findings and Recommendations section of this report. The findings required an adjustment of \$270,255 to the city's accounting records.

Our audit also found that the city accounted for and expended 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, 2008, through June 30, 2011.

In addition, our audit found that the city accounted for and expended its Proposition 1B Fund allocations recorded in the 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 May 19, 2010, disclosed no findings.

Views of Responsible Officials

We issued a draft report on May 22, 2015. Thomas Mauk, Interim City Manager, responded by a letter dated June 2, 2015. The city agreed with the findings and is in the process of implementing our recommendations. The city's response is included in this final review report as an attachment.

Restricted Use

This report is intended for the information and use of the City of West Covina'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

July 9, 2015

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

	Special Gas Tax Street Improvement Fund Highway Users Tax Allocations ^{1,2}	Proposition 1B Fund ³
Beginning fund balance per city	\$2,316,785	\$ 9,076
Revenues	<u>2,656,048</u>	<u>24</u>
Total funds available	4,972,833	9,100
Expenditures	<u>(4,217,740)</u>	<u>—</u>
Ending fund balance per city	<u>755,093</u>	<u>9,100</u>
SCO adjustments: ⁴		—
Finding 1—Ineligible and Unsupported Overhead Costs	134,065	—
Finding 2—Deficit Fund Balance	127,778	—
Finding 3—Transfer in excess of Actual	<u>8,412</u>	<u>—</u>
Total SCO adjustments	<u>270,255</u>	<u>—</u>
Ending fund balance per audit	<u>\$1,025,348</u>	<u>\$ 9,100</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, 2008, 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 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 Traffic Congestion Relief Fund. The audit period was July 1, 2008, through June 30, 2011. The city did not receive any TCRF revenues and did not incur any TCRF expenditures during FY 2012-13; 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—
Ineligible and unsupported overhead costs**

During the audit period, the city included \$50,904 in ineligible Civic Center debt service payments in the overhead costs to the Special Gas Tax Street Improvement Fund. The debt relates to redevelopment of the Civic Center.

The ineligible overhead costs charged to the Special Gas Tax Street Improvement Fund are as follows:

<u>Fiscal Year</u>	<u>Overhead Costs</u>
2008-09	\$ 21,374
2009-10	6,265
2010-11	7,728
2011-12	7,702
2012-13	<u>7,835</u>
Total	<u>\$ 50,904</u>

In addition, in fiscal year (FY) 2008-09, the city charged \$83,161 in unsupported overhead costs to the Special Gas Tax Street Improvement Fund.

Debt service payments whether charged directly or indirectly via overhead costs, are not eligible charges to the Special Gas Tax Street Improvement Fund. The Streets and Highways Code does not allow for debt service payments, except for voter-approved bonds.

Streets and Highways Code section 2107.4 states:

Not more than one-quarter of funds allocated to a city or county from the Highway Users Tax Account in the Transportation Tax Fund for the construction of Streets therein may be used to make principal and interest payments on bonds issued for such construction, if the issuance of such bonds is authorized by a proposition approved by a majority of the votes cast thereon. The term of any such bonds shall not exceed 25 years.

The State Controller’s Office *Guidelines Relating to Gas Tax Expenditures for Cities and Counties* provides a definition of overhead and section 440 specifically states:

Overhead will only be allowed via an approved cost allocation plan or an equitable and auditable distribution of overhead to all departments.

As the overhead costs were not supported, we could not substantiate whether the Special Gas Tax Street Improvement Fund money was expended in compliance with the Streets and Highways Code section 2101.

As a result, overhead costs totaling \$134,065 are disallowed (\$50,904 in ineligible debt service payments, and \$83,161 in unsupported overhead costs).

Recommendation

The city should reimburse the Special Gas Tax Street Improvement Fund by \$134,065. The city should develop an equitable and auditable distribution of overhead payments to all departments. The cost allocation plan should not include the Civic Center debt service payments; it should include only eligible and supported overhead costs to ensure compliance with Streets and Highways Code section 2101.

City's Response

The City of West Covina acknowledges the disallowed costs and will reimburse the Special Gas Tax Street Improvement Fund by \$134,065. City staff will engage a consultant to develop a new cost allocation plan for the City during Fiscal Year 2015-16 that will accurately recover only allowable administrative costs.

SCO's Comment

The city agrees with the SCO and is in the process of implementing our recommendation.

**FINDING 2—
Understated Fund
Balance**

The City of West Covina understated its Special Gas Tax Street Improvement Fund balance by \$127,778, as of June 30, 2013. The understatement was due to the city's negative fund balance of \$181,913, as of June 30, 2008. The city transferred \$54,135 during FY 2008-09 from its General Fund to the Special Gas Tax Street Improvement Fund. The city has not made any other transfers; therefore, the Special Gas Tax Street Improvement Fund balance is understated by \$127,778.

By definition, each fund is a separate fiscal and accounting entity with a self-balancing set of accounts. As the Special Gas Tax Street Improvement Fund did not have sufficient funds to pay for expenditures, it became insolvent. This resulted in encumbering future Highway Users Tax allocations to finance prior-period expenditures, which is contrary to generally accepted accounting principles.

The practice of funding one fiscal year's activities with Highway Users Tax apportionments of the following year is in violation of the California Constitution, and is contrary to established budgetary and accounting practices.

Article 16, Section 18 of the California Constitution states, in part:

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....

Recommendation

The city should transfer \$127,778 to the Special Gas Tax Street Improvement Fund to cover the prior period deficit fund balance. In the future, the city should adopt a budget that limits expenditures to the amount of funds available. The city should also establish procedures to ensure that expenditures do not exceed available funds and ensure that future Highway Users Tax allocations are not encumbered to finance prior-period expenditures.

City's Response

The City acknowledges this past mistake and will transfer the \$127,778 to the Special Gas Tax Street Improvement Fund to cover the prior period deficit fund balance. City staff will be sure to adopt a budget that limits expenditures to the amount of funds available as well as procedures to monitor expenditures to ensure the budget is not exceeded.

SCO's Comment

The city agrees with the SCO and is in the process of implementing our recommendation.

**FINDING 3—
Transfer in excess of
actual street
expenditures**

In FY 2012-13, the city transferred funds from the Special Gas Tax Street Improvement Fund to the General Fund to reimburse it for general street maintenance expenditures. Based on our review, we determined that the total transfer exceeded the street expenditures recorded in the General Fund by \$8,412. The city was unable to provide documentation to validate the transfer of this excess amount.

Streets and Highways Code section 2101 requires that the Special Gas Tax Street Improvement Fund be spent on allowable and verifiable street expenditures.

As a result, the unsupported transfer of \$8,412 is disallowed.

Recommendation

The city should reimburse the Special Gas Tax Street Improvement Fund by \$8,412. In addition, the city should establish policies and procedures to ensure that funds transferred out of the Special Gas Tax Street Improvement Fund are for actual costs incurred in accordance with the Streets and Highways Code section 2101.

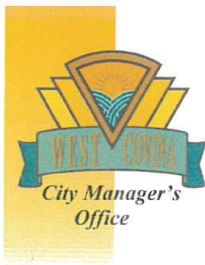
City's Response

The City acknowledges the lack of supporting documentation and will reimburse the Special Gas Tax Street Improvement Fund by \$8,412. City staff is currently implementing internal policies and procedures to ensure that special revenue funds are spent only on allowable costs.

SCO's Comment

The city agrees with the SCO and is in the process of implementing our recommendation.

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



June 2, 2015

Mike Spalj, Chief
Local Government Audits Bureau
Division of Audits
California State Controller
P.O. Box 942850
Sacramento, CA 94250-5874

SUBJECT: RESPONSES TO THE GAS TAX AUDIT REPORT

Dear Chief Spalj:

Below are management's responses to the draft report findings.

Finding # 1 – Management's Response

The City of West Covina acknowledges the disallowed costs and will reimburse the Special Gas Tax Street Improvement Fund by \$134,065. City staff will engage a consultant to develop a new cost allocation plan for the City during Fiscal Year 2015-16 that will accurately recover only allowable administrative costs.

Finding # 2 – Management's Response

The City acknowledges this past mistake and will transfer the \$127,778 to the Special Gas Tax Street Improvement Fund to cover the prior period deficit fund balance. City staff will be sure to adopt a budget that limits expenditures to the amount of funds available as well as procedures to monitor expenditures to ensure the budget is not exceeded.

Finding # 3 – Management's Response

The City acknowledges the lack of supporting documentation and will reimburse the Special Gas Tax Street Improvement Fund by \$8,412. City staff is currently implementing internal policies and procedures to ensure that special revenue funds are spent only on allowable costs.

Mike Spalj, Chief
Local Government Audits Bureau
California State Controller
Page 2

Please let the Final Report show that new staff has initiated correcting the many issues cited and has cooperated fully with the Gas Tax audit team.

The City requests a two-year repayment schedule/plan for repaying these obligations.

Thank you for your audit effort and its significant findings as well as the opportunity for the City to comment.

Sincerely,

A handwritten signature in blue ink that reads "Tom Mauk". The signature is fluid and cursive, with a large initial "T" and "M".

Tom Mauk
Interim City Manager

cc: Chris Freeland, Assistant City Manager
Christa Buhagiar, Finance Director

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

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