

CITY OF BELL

Audit Report

GAS TAX FUND

July 1, 2007, through June 30, 2010



JOHN CHIANG
California State Controller

October 2010



JOHN CHIANG
California State Controller

October 20, 2010

Pedro Carrillo
Interim City Administrator
City of Bell
6330 Pine Avenue
Bell, CA 90201

Dear Mr. Carrillo:

The State Controller's Office audited the City of Bell's Gas Tax Fund—highway users tax, Proposition 1B, and Traffic Congestion Relief Fund (TCRF) allocations—for the period of July 1, 2007, through June 30, 2010.

Our audit disclosed that the city accounted for and expended its Gas Tax Fund in compliance with requirements, except the city understated the fund balance in the Gas Tax Fund by \$521,086 as of June 30, 2010, primarily because it improperly charged the Gas Tax Fund for the following:

- Unsupported costs of \$301,810 for payment of engineering charges without a written contract.
- Unsupported general maintenance charges of \$129,600.
- Unsupported costs of \$76,992 for payment of street sweeping services without a written contract.
- Ineligible non-street-related costs of \$7,806 for painting house numbers on curbs.
- Unsupported costs of \$4,878 charged in excess of the contract amount.

Our audit also disclosed that the city did not meet its TCRF maintenance-of-effort (MOE) expenditure requirements of \$278,254 for Fiscal Year (FY) 2008-09. The city only had eligible TCRF MOE expenditures of \$136,162 for FY 2008-09. Therefore, the city's shortfall amount is \$142,092.

In addition, we noted significant internal control deficiencies and weaknesses related to the Gas Tax Fund and TCRF allocations. These deficiencies and weaknesses are described further in Finding 7 of this report.

Pedro Carrillo
October 20, 2010
Page 2

If you have any questions, please contact Jeffrey V. Brownfield, Chief, Division of Audits, at (916) 324-1696.

Sincerely,

JOHN CHIANG
California State Controller

cc: The Honorable Edmund G. Brown, California Attorney General
The Honorable Steve Cooley, Los Angeles County District Attorney
André Birotte Jr., U.S. Attorney, Central District of California
Lourdes Garcia, Director of Administrative Services
City of Bell

Contents

Audit Report

Summary	1
Background	2
Objective, Scope, and Methodology	2
Conclusion	3
Views of Responsible Officials.....	3
Restricted Use	3
Schedule 1—Reconciliation of Fund Balance	4
Findings and Recommendations.....	5

Audit Report

Summary

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Our audit also disclosed that the city did not meet its TCRF maintenance-of-effort (MOE) expenditure requirements of \$278,254 for Fiscal Year (FY) 2008-09. The city only had eligible TCRF MOE expenditures of \$136,162 for FY 2008-09. Therefore, the city's shortfall amount is \$142,092.

In addition, we noted significant internal control deficiencies and weaknesses related to the Gas Tax Fund and TCRF allocations. Internal control deficiencies and weaknesses noted were as follows:

- There is a potential conflict of interest because the contracted city engineer has performed all engineering services for the city including major projects. No consideration was given to other engineering firms. The lack of competitive bidding may not be cost-effective and lead to abuse.
- There is a lack of current written contracts for street services including engineering and street sweeping charges.
- There is a lack of internal administrative and accounting controls over gas tax expenditures.

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 Gas Tax Fund. A city must expend gas tax funds only for street-related purposes. We conducted our audit of the city's Gas Tax Fund under the authority of Government Code section 12410.

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. Proposition 1B provided \$19.925 billion in bond funds for a variety of transportation priorities, including \$2 billion for cities and counties to fund the maintenance and improvement of local transportation facilities. The 2007 Budget Act and Chapter 181, Statutes of 2007, (Senate Bill 88) appropriated a total of \$950 million of Proposition 1B in the FY 2007-08. Of this amount, Chapter 313, Statutes of 2007, (Assembly Bill 196) specified that \$550 million be allocated to cities and \$400 million be allocated to counties. We conducted our audit of city's Proposition 1B funds under the authority of Government Code section 12410.

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 TCRF allocations in the Gas Tax Fund. We conducted our audit of the city's TCRF allocations under the authority of Revenue and Taxation Code section 7104.

Objective, Scope, and Methodology

Our audit objective was to determine whether the city accounted for and expended the Gas Tax Fund in compliance with Article XIX of the California Constitution, the Streets and Highways Code, and Revenue and Taxation Code section 7104. To meet the audit objective, we determined whether the city:

- Properly deposited highway users tax apportionments, Proposition 1B, TCRF, and other appropriate revenues in the Gas Tax Fund;
- 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 the Gas Tax Fund in accordance with the requirements of the Streets and Highways Code and Revenue and Taxation Code section 7104. 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 disclosed that the City of Bell accounted for and expended its Gas Tax Fund—highway users tax, Proposition 1B, and TCRF allocations—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, 2010, except as noted in Schedule 1 and described in the Findings and Recommendations section of this report. The findings required an adjustment of \$521,086 to the city's accounting records.

Views of Responsible Officials

We issued a draft audit report on October 13, 2010. We contacted the city's interim administrator and left messages on October 18 and 19, 2010, inquiring about the response to the draft audit report. We did not receive a verbal or written response to the draft audit report from the City of Bell.

Restricted Use

This report is intended for the information and use of the City of Bell 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
Chief, Division of Audits

October 20, 2010

**Schedule 1—
Reconciliation of Fund Balance
July 1, 2009, through June 30, 2010**

	Gas Tax Fund			Totals
	Highway Users Tax Allocation ¹	Prop 1B Allocation ²	TCRF Allocation ³	
Beginning fund balance per city	\$ 574,914	\$ 577,424	\$ —	\$ 1,152,338
Revenues	572,117	—	253,437	825,554
Total funds available	1,147,031	577,424	253,437	1,977,892
Expenditures	(730,597)	—	—	(730,597)
Ending fund balance per city	416,434	577,424	253,437	1,247,295
Timing adjustment:				
Accrual of June 2010 highway users tax and TCRF apportionment (Governmental Accounting Standards Board Statement No. 34)	60,426	—	97,335	157,761
SCO adjustments ⁴ :				
Finding 1—Unsupported engineering charges	301,810	—	—	301,810
Finding 2—Unsupported general maintenance charges	129,600	—	—	129,600
Finding 3—Unsupported street sweeping services	76,992	—	—	76,992
Finding 4—Ineligible house number painting charges	7,806	—	—	7,806
Finding 5—Unsupported excess contract charges	4,878	—	—	4,878
Total SCO adjustments	521,086	—	—	521,086
Ending fund balance per audit	<u>\$ 997,946</u>	<u>\$ 577,424</u>	<u>\$ 350,772</u>	<u>\$ 1,926,142</u>

¹ The city receives apportionments from the state highway users tax account, pursuant to Streets and Highways Code sections 2105, 2106, 2107, and 2107.5. The basis of the apportionments for Sections 2105, 2106, and 2107 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.

² The 2007 Budget Act and Chapter 181, Statutes of 2007, (Senate Bill 88) appropriated a total of \$950 million of Proposition 1B in the FY 2007-08. Of this amount, Chapter 313, Statutes of 2007, (Assembly Bill 196), specified that \$550 million be allocated to cities and \$400 million be allocated to counties. The Proposition 1B funds were recorded in the Gas Tax Fund. The city did not receive or expend any Proposition 1B funds during the FY 2009-10.

³ Government Code section 14556.5 created a Traffic Congestion Relief Fund (TCRF) 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 Gas Tax Fund.

⁴ See the Findings and Recommendations section.

Findings and Recommendations

**FINDING 1—
Unsupported costs—
Payment for
engineering charges
without a written
contract**

For more than 12 years, the City of Bell has been making payments to D&J Engineering for engineering services charged to the Gas Tax Fund without a written contract. D&J Engineering, owned by an individual who served as the city’s Director of Planning Services during our audit period, subcontracts with RSCC Engineering Inc., whose principal serves as the contracted “city engineer” for all engineering services including city streets. The City of Bell pays D&J Engineering for work performed by RSCC Engineering, Inc. D&J Engineering retains a 10% overhead charge as its profit billed to the city.

The contract between the City of Bell and D&J Engineering was only in effect for the period from January 8, 1996, through June 30, 1997. The city did not negotiate a new contract or amend the existing contract. Without a valid contract, all engineering services charged to the Gas Tax Fund are ineligible to be paid with gas tax funds. Moreover, other than being a conduit between the city and RSCC Engineering Inc. for processing of invoices and payments, there is no evidence that D&J Engineering provided any services to justify the 10% overhead charge.

The unallowable charges for the audit period are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2007-08	\$ 71,465
2008-09	149,925
2009-10	80,420
Total	<u>\$ 301,810</u>

California Streets and Highways Code section 2101 specifies that highway users tax apportionments are to be expended only for 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 for the foregoing purposes. Additionally, costs are allowable under this section only when they are properly documented and supported.

Recommendation

The city must reimburse \$301,810 to the Gas Tax Fund for payments for engineering services without a written contract. Additionally, the city should ensure that it has written contracts for engineering services charged to the Gas Tax Fund.

**FINDING 2—
Unsupported costs—
General maintenance
charges**

The City of Bell has a written contract with Medina Construction for general maintenance services including streets and was billed \$18,000 a month for the audit period of July 1, 2007, through June 30, 2010. The city allocated 90% or \$16,200 of the monthly billings to the Gas Tax Fund. However, based on our review, of the written contract as well as our discussion with the principal of Medina Construction, only 70% or \$12,600 was street related. Therefore, the Gas Tax Fund was overcharged by 20% or \$3,600 a month over the three-year period, totaling \$129,600.

The California Streets and Highways Code, section 2101, specifies that Highway Users Tax apportionments are to be expended only for: 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. Additionally, costs are allowable under this section only when they are properly documented and supported.

Recommendation

The city must reimburse the Gas Tax Fund \$129,600 for costs charged in excess of general maintenance services relating to streets. Additionally, the city should ensure that only street-related costs are charged to the Gas Tax Fund.

**FINDING 3—
Unsupported costs—
Payment for street
sweeping services
without a written
contract**

Since January 2009, the City of Bell has been making payments for street sweeping services without a written contract. The city had a written contract with Graffiti Protective Coatings that expired on December 31, 2008. This contract was for \$10,000 a month of which 33.33% was charged to the Gas Tax Fund. Starting in February 2009, Graffiti Protective Coatings billed the city \$13,000 a month, 33.33% of which was charged to the Gas Tax Fund. The monthly fee was increased without entering into a new contract or amending the expired contract. Without a valid contract, all payments are ineligible charges against the Gas Tax Fund. For the audit period, the ineligible amount is \$76,992 (1 mo. @ \$10,000 × 33.33% = \$3,333 + 17 mos. @ \$13,000 × 33.33% = \$73,659).

California Streets and Highways Code section 2101 specifies that Highway Users Tax apportionments are to be expended only for: 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. Additionally, costs are allowable under this section only when they are properly documented and supported.

Recommendation

The city must reimburse the Gas Tax Fund \$76,992 for payments for street sweeping services without a written contract. Additionally, the city should ensure that expired contracts are renewed and/or amended.

**FINDING 4—
Ineligible non-street
related expenditures—
Painting of house
numbers on curb**

In Fiscal Year (FY) 2008-09, the city improperly charged \$7,806 to its Gas Tax Fund for painting house numbers on curbs. The painting of house numbers is a non-street-related expenditure and benefits the property owner and not the general public.

California Streets and Highways Code section 2101 specifies that highway users tax apportionments are to be expended only for: 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. Additionally, costs are allowable under this section only when they are properly documented and supported.

Recommendation

The city must reimburse the Gas Tax Fund for non-street-related expenditures totaling \$7,806. Additionally, the city should ensure that all costs charged to the Gas Tax Fund are street-related.

**FINDING 5—
Unsupported costs—
Amounts charged in
excess of contract
amount**

The City of Bell had a written contract with All American Asphalt in the amount of \$229,229 for a street overlay project during FY 2008-09. However, the city was billed and paid All American Asphalt \$234,107 without a change-order to increase the contract amount. This resulted in an overcharge of \$4,878 to the Gas Tax Fund.

The California Streets and Highways Code, section 2101, specifies that Highway Users Tax apportionments are to be expended only for: 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. Additionally, costs are allowable under this section only when they are properly documented and supported.

Recommendation

The city must reimburse the Gas Tax Fund \$4,878 for charges in excess of the written contract amount for the street overlay project. Additionally, the city should ensure that payments do not exceed the contract amount without an approved change-order.

**FINDING 6—
Traffic Congestion
Relief Fund (TCRF)—
Shortfall in the
maintenance-of-effort
requirements**

The city did not meet its TCRF maintenance-of-effort (MOE) requirements of \$278,254 for FY 2008-09. The city only had eligible TCRF MOE expenditures of \$136,162 for FY 2008-09. Therefore, the city's shortfall amount is \$142,092. The city received \$327,968 in TCRF allocations in FY 2008-09.

Pursuant to California Revenue and Taxation Code section 7104, if a city or county fails to comply with the Three-Year Average (MOE) requirement in a particular fiscal year, the city or county must expend in the following fiscal year, an amount that is not less than twice the three-year average, less the previous year's expenditures combined, in order to meet the requirement.

If the city fails to meet the MOE expenditure requirement for FY 2008-09 it must return \$327,968 of TCRF moneys received to the State Controller's Office for reallocation to other cities and counties whose expenditures are in compliance.

Recommendation

The city must meet the MOE expenditure requirement for FY 2008-09 or return the TCRF allocations received in FY 2008-09 in the amount of \$327,968. In order to meet the MOE expenditure requirement, the city must transfer \$142,092 of discretionary funds to the Gas Tax Fund to make up for the shortfall amount. Additionally, the city should review future discretionary street-related expenditures to ensure that the MOE expenditure requirements are met.

**FINDING 7—
Internal control
deficiencies**

We noted significant internal control deficiencies and weaknesses related to the Gas Tax Fund and the TCRF. Therefore, we did not place any reliance on the city's internal controls, systems, and processes. We performed substantive tests as necessary to determine compliance with Gas Tax Fund and TCRF program requirements. Internal control deficiencies and weaknesses noted were as follows:

1. Potential conflict of interest—For over 12 years, the contracted city engineer has performed all street-related engineering services for the city including major projects. No consideration has been given to other engineering firms. The lack of competition may not be cost-effective and may lead to abuse.
2. There is a lack of current written contracts for street services, including engineering and street sweeping, charged to the Gas Tax Fund.
3. There is a lack of internal administrative and accounting controls over gas tax expenditures. For example:
 - The Department of Administrative Services-Procedures Manual was not approved by the city council.

- The requirement of a written contract and/or a purchase order for payments was not followed.
 - Invoices were paid solely with an approval signature, no matching of invoices to the supporting contracts and/or purchase order.
 - Some invoices lack sufficient detail and description for services provided.
 - The requisition process for materials and supplies was not consistently followed.
4. There is a lack of monitoring discretionary street-related expenditures to ensure compliance with MOE expenditure requirements relating to the TCRF.

Recommendation

The city should immediately implement the following:

1. Consider other contractors and the competitive bidding process for all street-related engineering services, especially when undertaking major projects. This will ensure competition, lower costs, and will minimize potential conflicts of interest.
2. Obtain written contracts for all the street-related services it receives from outside contractors/vendors. Ensure that contracts are updated or amended when necessary.
3. Improve internal administrative and accounting controls over gas tax expenditures by:
 - Updating the Department of Administrative Services-Procedures Manual and obtaining approval by the city council.
 - When appropriate, obtaining written contracts and/or a purchase order.
 - Invoices should be matched against supporting contracts and/or purchase orders, prior to making payments.
 - The requisition process for materials and supplies should be consistently followed.
4. Establish a process for monitoring discretionary street-related expenditures to ensure compliance with MOE expenditure requirements relating to the TCRF.

**State Controller's Office
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