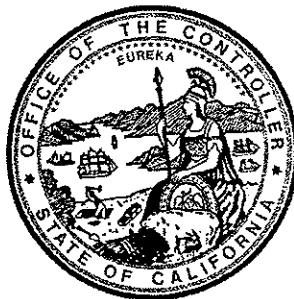


# **CITY OF MONTEBELLO**

Audit Report

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

*July 1, 2009, through June 30, 2010*



**JOHN CHIANG**  
California State Controller

September 2011



**JOHN CHIANG**  
California State Controller

September 22, 2011

Art Barajas  
Mayor of the City of Montebello  
1600 Beverly Boulevard  
Montebello, CA 90640

Dear Mayor Barajas:

The State Controller's Office audited the City of Montebello's Special Gas Tax Street Improvement Fund—highway users tax, Proposition 1B, and Traffic Congestion Relief Fund allocations—for the period of July 1, 2009, through June 30, 2010.

Our audit disclosed that the city accounted for and expended its Special Gas Tax Street Improvement Fund in compliance with requirements during Fiscal Year 2009-10, with the exception to the following:

- Impairment of Gas Tax Fund cash;
- Unsubstantiated loan to the Citywide Financing Entity Fund in the amount of \$500,000; and
- Improperly charged \$5,500 of ineligible costs.

If you have any questions, please contact Steven Mar, Chief, Local Government Audits Bureau, at (916) 324-7226.

Sincerely,

*Original signed by*

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

JVB/wm

cc: Frank Gomez, Mayor Pro Tem  
City of Montebello  
William M. Molinari, Councilmember  
Montebello City Council  
Alberto Perez, Councilmember  
Montebello City Council  
Christina Cortez, Councilmember  
Montebello City Council  
Larry Kosmont, Interim City Administrator  
City of Montebello  
David Biggs, Interim Assistant City Administrator  
City of Montebello  
Francesca Schuyler, Director of Finance  
City of Montebello

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# Audit Report

## Summary

The State Controller's Office audited the City of Montebello's Special Gas Tax Street Improvement Fund (Gas Tax Fund)—highway users tax, Proposition 1B, and Traffic Congestion Relief Fund (TCRF) allocations—for the period of July 1, 2009, through June 30, 2010.

Our audit disclosed that the city accounted for and expended its Gas Tax Fund in compliance with requirements, except that it understated the fund balance by \$5,500 as of June 30, 2010. The city understated the fund balance primarily because it improperly charged \$5,500 of ineligible costs to the Gas Tax Fund by transfers out to the Golf Fund. We also noted that Gas Tax Fund cash was impaired because the city was using it for the general operating costs of the city. Additionally, the Gas Tax Fund made a year-end transfer of \$500,000 to the Citywide Financing Entity Fund, which we deem as an unsubstantiated loan.

## 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 are derived 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.

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.

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 allocations in the Gas Tax Fund. A city also is required to expend its allocations within three years following the end of the fiscal year in which the allocation was made and to be expended 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 the Gas Tax Fund 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 determined whether the city:

- Properly deposited highway users tax apportionments 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, 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 disclosed that the City of Montebello 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, 2009, 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 \$5,500 to the city's accounting records. We also noted that the Gas Tax Fund cash was impaired because the city was using it for the general operating costs of the city. Additionally, the Gas Tax Fund made a year-end transfer of \$500,000 to the Citywide Financing Entity Fund, which we deem as an unsubstantiated loan.

Our audit also disclosed that the city accounted for and expended its Proposition 1B allocations recorded in the Special Gas Tax Street Improvement Fund in compliance with Article XIX of the California Constitution, the Streets and Highways Code, and Government Code section 8879.23, for the period of July 1, 2009, through June 30, 2010.

Our audit also disclosed that the city accounted for and expended its TCRF allocations recorded in 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 for the period of July 1, 2009, through June 30, 2010.

**Follow-Up on Prior Audit Findings**

Our prior audit report, issued on August 25, 2010, disclosed no findings.

**Views of Responsible Officials**

We issued a draft report on August 24, 2011. Larry Kosmont, Interim City Administrator, responded by letter dated September 8, 2011 (Attachment), disagreeing with the audit results. This final audit report includes the city's response.

**Restricted Use**

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

September 22, 2011

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

	Special Gas Tax Street Improvement Fund			
	Highway Users Tax Allocations <sup>1</sup>	Proposition 1B <sup>2</sup>	TCRF Allocations <sup>3</sup>	Totals
Beginning fund balance per city	\$ 82,971	\$ 148,005	\$ 407,661	\$ 638,637
Revenues	<u>1,152,930</u>	<u>976,510</u>	<u>594,119</u>	<u>2,723,559</u>
Total funds available	1,235,901	1,124,515	1,001,780	3,362,196
Expenditures	<u>(891,082)</u>	<u>(642,909)</u>	<u>(1,001,780)</u>	<u>(2,535,771)</u>
Ending fund balance per city	344,819	481,606	—	826,425
SCO adjustment: <sup>4</sup>				
Finding 1—Ineligible expenditures	<u>5,500</u>	<u>—</u>	<u>—</u>	<u>5,500</u>
Ending fund balance per audit	<u>\$ 350,319</u>	<u>\$ 481,606</u>	<u>\$ —</u>	<u>\$ 831,925</u>

<sup>1</sup> 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.

<sup>2</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.

<sup>3</sup> 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 Special Gas Tax Street Improvement Fund. The audit period was July 1, 2009, through June 30, 2010.

<sup>4</sup> See the Findings and Recommendations section.



## Findings and Recommendations

### FINDING 1— Gas Tax Fund cash was impaired

The Special Gas Tax Street Improvement Fund (Gas Tax Fund) cash was impaired because the city was using it for the general operating costs of the city. The General Fund cash balance was negative the entire Fiscal Year (FY) 2009-10. The only reason it was positive during June 2010 is that the city transferred funds into the General Fund to eliminate negative year-end balances in the financial statements. We also noted that the General Fund cash balances were negative for the entire FY 2010-11.

The General Fund is the main operating fund and its cash is maintained in an investment pool with cash from other funds, including restricted funds (such as the Gas Tax Fund, which includes highway users tax, traffic congestion relief, and Proposition 1B allocations). During our review, we noted that the General Fund was using funds from the city's investment pool, which includes the Gas Tax Fund, to fund city operating costs.

To date, the city's General Fund still is reporting negative cash balances. Therefore, this negative cash balance is affecting the integrity of the Gas Tax Fund which includes highway users tax, traffic congestion relief, and Proposition 1B allocations.

Based on our analysis of the General Fund and the Gas Tax Fund cash balances, the Gas Tax Fund cash was impaired. However, we could not determine the impact on the Gas Tax Fund or other funds' cash because the city's investment pool includes a majority of the city's funds. The table below shows cash balances for the General Fund and the Gas Tax Fund by month during FY 2009-10. Due to the fact that General Fund cash balances were negative, cash from other funds was used to pay for general city operating costs.

<u>Month/Year</u>	<u>Fund 1 General Fund</u>	<u>Fund 103 Gas Tax Fund</u>	<u>Cash Impairment</u>
July 2009	\$ (2,298,725)	\$ 460,789	Yes
August 2009	(3,896,375)	460,789	Yes
September 2009	(8,031,223)	460,664	Yes
October 2009	(11,545,496)	460,664	Yes
November 2009	(13,549,969)	536,608	Yes
December 2009	(13,520,144)	536,608	Yes
January 2010	(11,085,658)	536,498	Yes
February 2010	(11,846,667)	536,498	Yes
March 2010	(14,791,374)	536,389	Yes
April 2010	(16,286,313)	714,002	Yes
May 2010	(14,665,733)	2,187,772	Yes
June 2010	99,414	58,702	No

Streets and Highways Code section 2101 states:

All moneys in the Highway Users Tax Account in the Transportation Tax Fund and hereafter received in the account are appropriated for all of the following:

- (a) The research, planning, construction, improvement, maintenance, and operation of public streets and **highways** (and their related public facilities for nonmotorized traffic). . . .
- (b) The research and planning for exclusive public mass transit guideways (and their related fixed facilities). . . .
- (c) The construction and improvement of exclusive public mass transit guideways (and their related fixed facilities). . . .

Streets and Highways Code section 2118 states:

When the State Controller determines it to be necessary, he may require a county or city to deposit money received from the Highway Users Tax Fund in a separate bank account.

Recommendation

The city should develop and implement policies and procedures to ensure that it does not impair other funds' cash, especially the restricted funds, for general operating costs.

The city must establish a separate bank account for the Gas Tax Fund which includes gas tax, traffic congestion relief, and Proposition 1B allocations. This account shall be used to record all deposits and expenditures against these moneys. The city must provide the State Controller's Office with proof that a separate bank account has been established. The bank account shall remain open until the city provides evidence that it has restored the financial health of the General Fund.

City's Response

The City does not agree with the State Controller's finding that the Gas Tax Fund was cash impaired. This finding is misplaced because it overlooks the fundamental economic reality of Montebello spending levels on Gas Tax eligible activities, which is that the City through its General Fund spends more on Gas Tax eligible activities than Gas Tax funds the City receives. As a result the finding inadvertently penalizes Montebello, simply because the City reconciles general fund transfers on annual basis, which in and of itself is not improper. Further, the finding goes away in substance with monthly transfers instead of single year end transfers, because in Montebello's case, a separate Gas Tax account would have a negative balance for the 9 out of 12 months per the attached illustration developed for FY 2010/11 and for 11 of 12 months for FY 2011/12 (Exhibit A).

Recent actions taken by the City Council which include a balanced budget for FY 2011/12, approval of financial principles, approval of a General Fund Financial Recovery Plan, and a 2011/12 Tax Revenue Anticipation Note, have addressed all underlying issues which were present in the prior Fiscal Year. A separate account is not necessary and

will result in a doubling of transactions for which the City and State will have to account leading to increased possible problems in the future.

Ongoing Solution: The City will ensure monthly transfer of Gas Tax eligible expenditures to the Gas Tax fund to reflect actual activity.

The SCO should eliminate this finding.

SCO's Comment

During the entire 2009-10 fiscal year, the Gas Tax Fund had positive cash balances and at June 30, 2010, the cash balance was in excess of \$800,000, even after all the transfers were made by the city. Therefore, the city's argument that it is penalized because it reconciles annually instead of monthly is incorrect. Even if the transfers were made monthly, there still would have been a positive cash balance every month, and therefore the Gas Tax was impaired.

As to the argument that Gas Tax Fund would be negative 9 of the 12 months, it would not be possible. Gas Tax funds are not meant to provide 100% of the funding for street-related activities. Therefore, expenditures can only be claimed against available Gas Tax funds. Additionally, future Gas Tax funds cannot be used to pay for past expenditures.

The finding remains as stated.

**FINDING 2—  
Unsubstantiated loan**

Our review disclosed that the Gas Tax Fund included a “Due From” of \$500,000 in its assets balance for FY 2009-10. This was classified as a loan from the Gas Tax Fund (Fund 103) to the Citywide Financing Entity Fund (Fund 106). This was part of year-end adjustments the city made to rectify negative balances in other city funds. The documentation provided for our review did not have any description as to why this loan was made from the Gas Tax Fund. As a result, we deem this to be an unsubstantiated loan.

Article XIX of the California Constitution, section 1, states:

Revenues from taxes imposed by the state on motor vehicle fuels for use in motor vehicles upon public streets and highways, over and above the cost of collection and any refunds authorized by law, shall be used for the following purpose:

- (a) The research, planning, construction, improvement, maintenance, and operation of public streets and highways (and their related public facilities for nonmotorized traffic). . . .
- (b) The research, planning, construction, and improvement of exclusive public mass transit guideways (and their related fixed facilities). . . .

Streets and Highways Code section 2101 states:

All moneys in the Highway Users Tax Account in the Transportation Tax Fund and hereafter received in the account are appropriated for all of the following:

- (a) The research, planning, construction, improvement, maintenance, and operation of public streets and **highways** (and their related public facilities for nonmotorized traffic). . . .
- (b) The research and planning for exclusive public mass transit guideways (and their related fixed facilities). . . .
- (c) The construction and improvement of exclusive public mass transit guideways (and their related fixed facilities). . . .

The use of highway user’s tax apportionments is restricted to street-related purposes only. Further, costs are allowable under section 2101 only when they are supported by documentation.

Recommendation

The city should reverse this year-end adjustment of \$500,000. The city should only use Gas Tax Funds for street-related purposes and only when there is supporting documentation to justify the expenditure.

City’s Response

The City did make a short-term borrowing from the Gas Tax Fund in FY 2009/10 as reflected in the City’s financial records and the financial statements for that year. The City’s new Finance Director identified this issue and addressed this matter proactively in February, 2011, prior to the commencement of the State Controller’s Audit, with the full amount being reimbursed the Gas Tax Fund at that time.

Ongoing Solution: The City will ensure no future borrowings are made from the Gas Tax Fund.

Since this has been resolved prior to the SCO's audit, the SCO should eliminate this finding.

SCO's Comment

The SCO's auditor is well aware of the fact that the Gas Tax Fund has been repaid the amount that was loaned. But the fact remains, as noted above, that gas tax funds cannot be loaned out without specific approval by the legislature. Our finding addresses the ineligible loaning of the funds, and not that the amount is outstanding.

The finding remains as stated.

**FINDING 3—  
Ineligible expenditure**

Our review disclosed that the city improperly charged \$5,500 of ineligible costs to the Gas Tax Fund during the FY 2009-10. This was a \$5,500 transfer out from the Gas Tax Fund (Fund 103) to the Golf Fund (Fund 610).

Streets and Highways Code section 2101 states:

All moneys in the Highway Users Tax Account in the Transportation Tax Fund and hereafter received in the account are appropriated for all of the following:

- (a) The research, planning, construction, improvement, maintenance, and operation of public streets and **highways** (and their related public facilities for nonmotorized traffic). . . .
- (b) The research and planning for exclusive public mass transit guideways (and their related fixed facilities). . . .
- (c) The construction and improvement of exclusive public mass transit guideways (and their related fixed facilities). . . .

Recommendation

The city should reimburse the Gas Tax Fund \$5,500. In the future, the city should ensure that all costs charged to the Gas Tax Fund are street related.

City's Response

The \$5,500 annual transfer to the Golf Course Fund from the Gas Tax Fund is for gas tax eligible expenditures made by the Golf Course Fund related to the repair and maintenance of Via San Clemente Avenue, a gas tax eligible public street, which traverses through the Golf Course between Garfield Avenue and Findlay. Supporting documentation is attached as Exhibit B. The transfer did not take place in FY 2010/11 nor is a transfer planned or budgeted for FY 2011/12, though transfers may be made again in future years with appropriate documentation.

The SCO should eliminate this finding.

SCO's Comment

There was and is no documentation for the journal entry transfer. The documentation attached as Exhibit B does not support the journal entry made during FY 2009-10; it is created after the fact. The city has not provided any documentation to support that these changes were related to the repair and maintenance of an eligible street project.

The finding remains as stated.

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

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That portion of the city's response that relates to the Montebello Redevelopment Agency is not included here.



*City of Montebello*

September 8, 2011

Mr. Jeffrey V. Brownfield  
Chief, Audit Division  
California State Controller's Office  
PO Box 942850  
Sacramento, CA 94250-5874

Dear Mr. Brownfield:

The City of Montebello received the draft State Controller reports for Redevelopment and Gas Tax dated August 24, 2011, via certified mail on Monday, August 28, 2011. Per our discussion, our response is due on September 8, 2011, and is here with transmitted.

First, I would like to thank the staff of the State Controller's Office for their professionalism and commitment to identifying issues which may need to be addressed here in Montebello. The City has been in a period of significant financial strain and we have welcomed the assistance and advice of your staff as we address a multiplicity of issues.

As you are aware, a new Interim City Administration team was specifically selected to guide the City through its current financial difficulties and started on May 12, 2011. Since that time, a number of steps have been taken to address the City's financial difficulties. On June 22, 2011, the City Council adopted a balanced budget for FY 2011/12 which provides for a reserve of \$1 million ending a multi-year period of deficit spending. In addition, the City Council adopted a Statement of Financial Goal, Principles, and Guidelines at that same (Attachment 1), which will guide our future financial management including grants funds. As a third action on that evening, the City Council approved a General Fund Financial Recovery Plan, which has been subsequently updated (Attachment 2). All of these actions set the stage for a Tax and Revenue Anticipation Note sale by mid-September to bridge the normal timing issues associated with matching expenditures to revenues within the single fiscal year.

We also want to assure the State Controller's Office that the City is not in risk of insolvency or of having to pursue bankruptcy as an option to address its current financial difficulties. Any prior press reports or other statements to that end were grossly exaggerated in our opinions. Certainly, the most recent actions taken by the City Council as articulated in this letter have further reinforced that the City's difficulties can be addressed. It is our understanding that many of the State Controller's concerns were

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**CITY OF MONTEBELLO**

**Responses to August 24, 2011 State Controller Draft Review Reports**

**Gas Tax, Proposition 1B, and Traffic Congestion Funds**

**Finding 1**

The City does not agree with the State Controller's finding that the Gas Tax Fund was cash impaired. This finding is misplaced because it overlooks the fundamental economic reality of Montebello spending levels on Gas Tax eligible activities, which is that the City through its General Fund spends more on Gas Tax eligible activities than Gas Tax funds the City receives. As a result the finding inadvertently penalizes Montebello, simply because the City reconciles general fund transfers on annual basis, which in and of itself is not improper. Further, the finding goes away in substance with monthly transfers instead of single year end transfers, because in Montebello's case, a separate Gas Tax account would have a negative balance for the 9 out of 12 months per the attached illustration developed for FY 2010/11 and for 11 of 12 months for FY 2011/12 (Exhibit A).

Recent actions taken by the City Council which include a balanced budget for FY 2011/12, approval of financial principles, approval of a General Fund Financial Recovery Plan, and a 2011/12 Tax Revenue Anticipation Note, have addressed all underlying issues which were present in the prior Fiscal Year. A separate account is not necessary and will result in a doubling of transactions for which the City and State will have to account leading to increased possible problems in the future.

**Ongoing Solution:** The City will ensure monthly transfer of Gas Tax eligible expenditures to the Gas Tax fund to reflect actual activity.

The SCO should eliminate this finding.

**Finding 2**

The City did make a short-term borrowing from the Gas Tax Fund in FY 2009/10 as reflected in the City's financial records and the financial statements for that year. The City's new Finance Director identified this issue and addressed this matter proactively in February, 2011, prior to the commencement of the State Controller's Audit, with the full amount being reimbursed the Gas Tax Fund at that time.

**Ongoing Solution:** The City will ensure no future borrowings are made from the Gas Tax Fund.

Since this has been resolved prior to the SCO's audit, the SCO should eliminate this finding.

**Finding 3**

The \$5,500 annual transfer to the Golf Course Fund from the Gas Tax Fund is for gas tax eligible expenditures made by the Golf Course Fund related to the repair and maintenance of Via San Clemente Avenue, a gas tax eligible public street, which traverses through the Golf Course between Garfield Avenue and Findlay. Supporting documentation is attached as Exhibit B. The transfer did not take place in FY 2010/11 nor is a transfer planned or budgeted for FY 2011/12, though transfers may be made again in future years with appropriate documentation.

**The SCO should eliminate this finding.**

**State Controller's Office  
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