

**City of Montebello
Transit System Fund
Financial Statements
Year ended June 30, 2012
with Report of Independent Auditors**

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Report of Independent Auditors

To the Honorable City Council Montebello, California

We have audited the accompanying basic financial statements of the Transit System Fund (Fund) of the City of Montebello (an enterprise fund of the City of Montebello) as of and for the year ended June 30, 2012, as listed in the table of contents. These basic financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Transit System Fund and do not purport to, and do not, present fairly the financial position of the City of Montebello, California, as of June 30, 2012, and the changes in its financial position, or where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Transit System Fund of the City of Montebello as of June 30, 2012, and the changes in its net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 30, 2012, on our consideration of the City of Montebello Transit System Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The supplementary information identified in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

The Fund has not presented a management's discussion and analysis that accounting principles generally accepted in the United States of America require to supplement, although not to be part of the basic financial statements.

Vargus + Company LLP

Los Angeles, California
December 30, 2012

City of Montebello
Transit System Fund
Statement of Net Assets
June 30, 2012

ASSETS

Current assets

Cash and investments	\$	247,806
Grants receivable		2,081,008
Inventories		914,524
		3,243,338
Total current assets		3,243,338

Noncurrent assets

Capital assets		84,512,428
Accumulated depreciation		(36,277,434)
		48,234,994
Net capital assets		48,234,994
		51,478,332
Total assets		51,478,332

LIABILITIES

Current liabilities

Accounts payable		1,583,068
Other accrued liabilities		573,980
Compensated absences		968,775
Unearned revenue		171,708
		3,297,531
Total current liabilities		3,297,531

Noncurrent liabilities

Compensated absences, net of current portion		254,384
		3,551,915
Total liabilities		3,551,915

NET ASSETS

Invested in capital assets		48,234,994
Unrestricted		(308,577)
		47,926,417
Total net assets	\$	47,926,417

See notes to financial statements.

City of Montebello
Transit System Fund
Statement of Revenues, Expenses, and Changes in Net Assets
Year ended June 30, 2012

Operating revenues		
Bus fares	\$	6,131,802
Special contracts		109,626
Other revenue		95,539
Total operating revenues		<u>6,336,967</u>
Operating expenses		
Labor and fringe benefits		15,350,274
Vehicle expenses		4,632,125
Administrative costs		1,582,964
Professional fees and other contracts		1,553,700
Utilities and other services		274,892
Other		900,954
Depreciation expense		3,569,840
Total operating expenses		<u>27,864,749</u>
Operating loss		<u>(21,527,782)</u>
Nonoperating revenues		
Proposition "A" discretionary		5,205,138
Proposition "A" local return		1,100,000
Proposition "C" discretionary		3,125,311
State grant - operating		5,720,288
State grant - capital/discretionary		384,330
Measure R		2,751,953
Federal grant - capital		4,640,087
Interest income		5,779
Total nonoperating revenues		<u>22,932,886</u>
Change in net assets		1,405,104
Net assets, beginning of year		<u>46,521,313</u>
Net assets, end of year	\$	<u><u>47,926,417</u></u>

See notes to financial statements.

**City of Montebello
Transit System Fund
Statement of Cash Flows
Year ended June 30, 2012**

Cash flows from operating activities	
Receipts from customers	\$ 6,131,802
Other receipts	205,165
Payments to suppliers	(8,524,263)
Payments to employees	<u>(14,698,527)</u>
Net cash used in operating activities	<u>(16,885,823)</u>
Cash flows from noncapital financing activities	
Noncapital grants received - federal and state	17,369,922
Interest received	<u>5,779</u>
Net cash provided by noncapital and related financing activities	<u>17,375,701</u>
Cash flows from capital and related financing activities	
Capital contributed by federal and state grants	3,619,743
Acquisition of capital assets	<u>(4,640,497)</u>
Net cash used in capital and related financing activities	<u>(1,020,754)</u>
Change in cash and cash equivalents	(530,876)
Cash and cash equivalents, beginning of year	<u>778,682</u>
Cash and cash equivalents, end of year	<u>\$ 247,806</u>
Reconciliation of operating loss to net cash used in operating activities	
Operating loss	\$ (21,527,782)
Depreciation	3,569,840
Changes in assets and liabilities:	
Increase in inventories	(914,523)
Increase in accounts payable	1,334,896
Increase in accrued liabilities	274,060
Increase in deposits	<u>377,686</u>
Net cash used in operating activities	<u>\$ (16,885,823)</u>

See notes to financial statements.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Transit Fund of the City of Montebello, California (Transit Fund), an enterprise fund, accounts for all revenues and expenses related to the operations of the City's transit service. The accounting policies of the Transit Fund conform to accounting principles generally accepted in the United States of America. The following is a summary of the significant policies applied to the preparation of the financial statements.

Fund Accounting

The Transit Fund accounts for two separate departments, the transit and the metro rail station activity. All transactions of the Transit Fund are included in the reporting entity of the City of Montebello (City) and are recorded in a separate fund of the City. A fund is defined as an independent fiscal and accounting entity with a self-balancing set of accounts recording resources, related liabilities, obligations, reserves, and equities segregated for the purpose of carrying out specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

Basis of Accounting

The Transit Fund uses the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recorded when the related liability is incurred.

Cash and Cash Equivalents

All cash and investments are held in a City pool. Therefore, all cash and investments in the Transit Fund are considered cash and cash equivalents, as they are available on demand.

Capital Assets

Capital assets are recorded at historical cost or estimated fair market value at the date of contribution. Generally, capital asset purchases in excess of \$5,000 are capitalized if they have an expected life of one or more years.

Depreciation has been provided over the estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Office equipment	5-10 years
Computer equipment	8 years
Electrical equipment	8-10 years
Machinery and equipment	5-15 years
Buildings	10-40 years

Interest Earned

The City's cash and investments are operated on a pooled basis. In accordance with the administrative policy of the City, interest on such pooled resources is accrued to each fund based on the equity of a particular fund in the pooled cash and investments.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Unearned Revenue

Grants received by the City for the acquisition of capital assets and certain operating expenses are recorded as unearned revenue until such time as expenditures are made.

NOTE 2 CASH AND CASH EQUIVALENTS

Cash and deposits of the Transit Fund are pooled with other City funds to improve investment opportunities and provide sufficient coverage for warrants as they are presented at the City's bank. State statutes and the City's investment policy authorize City officials to invest its pool funds in obligations of the United States Treasury or its agencies, bankers' acceptances, State Treasurer's investment pool, certificates of deposit, passbook savings account demand deposits, repurchase agreements, and money market funds. As of June 30, 2012, the cash and cash equivalents balance of the Transit Fund totaled \$247,806. Further information concerning the City's investment pool regarding custodial risk, concentrations of credit risk, and interest rate risk can be found in the City's Comprehensive Annual Financial Report.

NOTE 3 CAPITAL ASSETS

Capital assets of the Transit Fund at June 30, 2012 were as follows:

	<u>Balance</u> <u>July 1, 2011</u>	<u>Additions</u>	<u>Adjustments/ Deletions</u>	<u>Balance</u> <u>June 30, 2012</u>
Capital assets not being depreciated:				
Land	\$ 3,901,596	\$ -	\$ -	\$ 3,901,596
Construction in progress	111,372	-	-	111,372
	<u>4,012,968</u>	<u>-</u>	<u>-</u>	<u>4,012,968</u>
Capital assets being depreciated:				
Buildings and improvements	21,376,212	2,211,228	-	23,587,440
Machinery and equipment	54,482,751	2,429,269	-	56,912,020
Total capital assets being depreciated	<u>75,858,963</u>	<u>4,640,497</u>	<u>-</u>	<u>80,499,460</u>
Less accumulated depreciation:	<u>32,707,594</u>	<u>3,569,840</u>	<u>-</u>	<u>36,277,434</u>
Net capital assets, being depreciated	<u>43,151,369</u>	<u>1,070,657</u>	<u>-</u>	<u>44,222,026</u>
Net capital assets	<u>\$ 47,164,337</u>	<u>\$ 1,070,657</u>	<u>\$ -</u>	<u>\$ 48,234,994</u>

NOTE 4 PUBLIC TRANSPORTATION MODERNIZATION IMPROVEMENTS AND SERVICE ENHANCEMENT ACCOUNT

In November 2006, California voters passed a bond measure enacting the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006. Of the \$19.925 billion of State general obligation bonds authorized, \$4 billion was set aside by the State as instructed by the statute as the Public Transportation Modernization Improvement and Service Enhancement Account (PTMISEA). These funds are available to the California Department of Transportation for intercity rail projects and to transit operators in California for rehabilitation, safety or modernization improvements, capital service enhancements or expansions, new capital projects, bus rapid transit improvements, or for rolling stock procurement, rehabilitation, or replacement.

The City received a total of \$2,370,983 of PTMISEA funds from 2008 to 2010. These funds were fully expended as of June 30, 2011. The City did not receive any PTMISEA funds during the fiscal year ended June 30, 2012.

NOTE 5 TRANSPORTATION DEVELOPMENT ACT

The State of California established the Transportation Development Act (TDA) to provide funds for public transportation. The funds are administered by the Los Angeles County Metropolitan Transportation Authority. The TDA created a Local Transportation Fund (LTF) in each county for the transportation purposes specified in the Transportation Development Act Statutes and Administrative Code. Revenues of the LTF are derived from a 1/4 of one percent sales tax rate levied in each county. To qualify for funding under TDA, the City of Montebello Transit Fund must maintain a ratio of fare revenues and local support to operating cost greater than 20%.

In accordance with the requirement of the TDA, the following information is presented (in thousands of dollars):

Operating revenues		
Bus fares	\$ 6,132	
Special fares	110	
Total operating revenues	<u>6,242</u>	<u>\$ 6,241</u>
Operating expenses		
Labor and fringe benefits	15,350	
Vehicle expenses	4,632	
Administrative costs	1,583	
Professional fees and other contracts	1,554	
Utilities and other services	275	
Other	901	
Depreciation expense	<u>3,570</u>	
Total operating expense		27,864
Less depreciation expense		<u>(3,570)</u>
Net operating expense		<u>\$ 24,295</u>
Fare Ratio		<u>26%</u>

NOTE 6 SUBSEQUENT EVENTS

The City has evaluated events subsequent to June 30, 2012 to assess the need for potential recognition or disclosure in the financial statements. Such events were evaluated through December 30, 2012, the date the financial statements were available to be issued. Based upon this evaluation, it was determined that no subsequent events occurred that require recognition or additional disclosure in the financial statements.

SUPPLEMENTARY INFORMATION

**City of Montebello
Transit System Fund**

**Combining Statement of Revenues, Expenses and Changes in Net Assets - Departmental
Year ended June 30, 2012**

	Transit	Metro Station	Total
Operating revenues			
Bus fares	\$ 6,131,802	\$ -	\$ 6,131,802
Special contracts	109,626	-	109,626
Other revenue	95,539	-	95,539
Total operating revenues	<u>6,336,967</u>	<u>-</u>	<u>6,336,967</u>
Operating expenses			
Labor and fringe benefits	15,329,655	20,619	15,350,274
Vehicle expenses	4,632,125	-	4,632,125
Administrative costs	1,553,804	29,160	1,582,964
Professional fees and other contracts	1,378,363	175,337	1,553,700
Utilities and other services	213,421	61,471	274,892
Other	790,571	110,383	900,954
Depreciation expense	3,569,840	-	3,569,840
Total operating expenses	<u>27,467,779</u>	<u>396,970</u>	<u>27,864,749</u>
Operating loss	<u>(21,130,812)</u>	<u>(396,970)</u>	<u>(21,527,782)</u>
Nonoperating revenues (expenses)			
Proposition "A" discretionary	5,205,138	-	5,205,138
Proposition "A" local return	1,100,000	-	1,100,000
Proposition "C" discretionary	3,125,311	-	3,125,311
State grant - operating	5,720,288	-	5,720,288
State grant - capital/discretionary	384,330	-	384,330
Measure R	2,751,953	-	2,751,953
Federal grant - capital	4,640,087	-	4,640,087
Interest income	5,779	-	5,779
Total nonoperating revenues	<u>22,932,886</u>	<u>-</u>	<u>22,932,886</u>
Change in net assets	1,802,074	(396,970)	1,405,104
Net assets, beginning of year	<u>47,003,215</u>	<u>(481,902)</u>	<u>46,521,313</u>
Net assets, end of year	<u>\$ 48,805,289</u>	<u>\$ (878,872)</u>	<u>\$ 47,926,417</u>

**Independent Auditors' Report on Internal Control Over
Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial Statements
Performed in Accordance With Government Auditing Standards**

**The Honorable Mayor and Members of City Council
City of Montebello
Montebello, California**

We have audited the financial statements of the Transit System Fund (Fund) of the City of Montebello, California (an enterprise fund of the City of Montebello), as of and for the year ended June 30, 2012, as listed in the table of contents, and have issued our report thereon dated December 30, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Transit System Fund of the City of Montebello is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over financial reporting, identified as Finding 2012-01 in the accompanying schedule of findings and recommendations, that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, contained in the *Transportation Development Act Conformance Auditing Guide* issued by the Los Angeles County Metropolitan Transportation Authority (LACMTA), and the *California Department of Transportation Public Transportation Modernization, Improvement and Service Enhancement Account (PTMISEA) Guidelines*, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the City Council, the City's management, the California Department of Transportation, and the LACMTA, and is not intended to be, and should not be, used by anyone other than these specified parties.

Vargus + Company LLP

Los Angeles, California
December 30, 2012

2012-01 Year-end Adjustments

Finding

As part of the year-end closing process, there were more than 20 adjusting journal entries made to correct the account balances to arrive at more accurate financial statements. Some of these adjustments were significant and affected the Transit Fund.

Recommendation

To generate more accurate financial statements, we recommend the City perform monthly closing procedures by analyzing the accuracy of the month-end account balances and correcting errors found during this process. This procedure will substantially reduce the amount of adjusting journal entries at year-end, improve the reliability of interim financial statements and allow for more timely completion of the annual financial statements.

Management response

The Finance Department filled three key positions in March 2012, several of which had been vacant for nearly a year or longer, as a result of staff turnover. While Finance staff made great efforts to ensure that all closing entries were processed timely, challenges with resolving issues from the past, including system security and account set up, consumed a great deal of time and energy to ensure that the books were closed to begin the audit. Additionally, during May 2012, Finance staff implemented the City-wide cashiering module in order to ensure proper collection and accounting of cash receipts from all points of cash collections at various City facilities, including the Transit Department. The implementation of the cashiering module also took a great deal of time and effort to ensure that the books were closed to begin the audit. We concur with the recommendation and will continue to refine the month end and year end closing process.

2011-01 Bank reconciliations

Finding

Cash account was not properly reconciled to the bank statements on a timely basis.

Action taken by management

The Finance Department filled three key positions in March 2012, several of which had been vacant for nearly a year or longer, as a result staff of turnover. In addition to resolving the staffing issues, in May 2012, the City implemented a city-wide automated cashiering module for management and security of cash receipting at all points of cash collections, including the Transit Department. Additionally, issues from the past, such as system security and incorrect account set up have been resolved and as of the date of this management letter, Finance staff is able to reconcile cash receipts and disbursements on a daily basis.

2011-02 Capital assets

Finding

The City lacks sufficient internal control over the recording of capital assets resulting to material misstatement of the total cost and accumulated depreciation of capital assets, as well as in the depreciation expense included in the statement of revenues and expenses of the Transit Fund.

Action taken by management

The City has historically maintained an outside firm to assign and maintain its fixed assets as well as the annual depreciation calculations. The fixed asset module of the City's current financial system was never set up to record fixed assets as purchases were made, and depreciation calculations were not set up for automated calculations. For these reasons, the possibilities of delays and errors were greater than warranted. In response to this and other financial system needs, the City recently purchased a new financial system, New Worlds, which will be implemented for fiscal year 2012-2013. Included in the new financial software is a fixed asset component that will be utilized to capture the fixed asset purchases with appropriate depreciation calculations. This capability will enable the City, including its Transit Department, to better manage its fixed assets and depreciation calculations within the financial system rather than an outside firm. Efforts are being made to address this matter.

2011-03 Documentation of policies and procedures

Finding

The City's policies and procedures manual have not been updated in years and a complete manual was not readily available to all staff.

Action taken by management

Updating the policies and procedures manuals is an ongoing process. Given the fiscal constraints and reduction in staffing levels, while efforts are being made to review and update these manuals, it will continue to remain a work in progress. The Substance Abuse Policies were updated during the fiscal year and additional efforts are being made to address this matter. A soft copy of the manual policies and procedures is located within the City employees' public folder (the P: Drive) and is available for access by all City Employees. The City is "going green" and many of its documents are available electronically as opposed to paper.

2011-04 Cut-off procedures

Finding

The cut-off procedures for revenues received by the Transit Department are not designed to capture all revenues on a timely basis. Cash received at the Transit Department is not promptly posted in the general ledger in the proper accounting period.

Action taken by management

During May 2012, Finance staff implemented the City-wide cashiering module in order to ensure proper collection and accounting of cash receipts from all points of cash collections at various City facilities, including the Transit Department. The cashiering module is an automated system that enables staff to record daily receipts directly from the point of collection. While there were some system related and training issues, during the first few months of implementation, major issues have been resolved and recording of revenues are occurring timely. Additional training has also been provided to ensure that electronic revenue receipts are recorded promptly to the general ledger.

