California State Auditor

BUREAU OF STATE AUDITS

Department of Transportation:

Seismic Retrofit Expenditures Comply With the Bond Act

December 1998
98022

The first copy of each California State Auditor report is free.
Additional copies are $3 each. You can obtain reports by contacting
the Bureau of State Audits at the following address:

California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814
(916) 445-0255 or TDD (916) 445-0255 x 248

OR

This report may also be available
on the worldwide web
http://www.bsa.ca.gov/bsa/

CALIFORNIA STATE AUDITOR

KURT R. SJOBERG
STATE AUDITOR

MARIANNE P. EVASHENK
CHIEF DEPUTY STATE AUDITOR

December 1, 1998 98022

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by Chapter 310, Statutes of 1995, the Bureau of State Audits presents its audit report concerning the Department of Transportation's (department) revenues and expenditures authorized by the Seismic Retrofit Bond Act of 1996 (Bond Act). This report concludes that the department in general has ensured that seismic retrofit projects funded with bond proceeds are consistent with the purpose of the Bond Act. In the 1998-99 fiscal year, the department plans to begin reimbursing the State Highway Account and the Consolidated Toll Bridge Fund for expenditures incurred during fiscal years 1994-95 and 1995-96.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

BUREAU OF STATE AUDITS
660 J Street, Suite 300, Sacramento, California 95814 Telephone: (916) 445-0255 Fax: (916) 327-0019

CONTENTS

SUMMARY

RESULTS IN BRIEF

This is the third in a series of annual reports on Department of Transportation (department) revenues and expenditures authorized by the Seismic Retrofit Bond Act of 1996 (Bond Act). Chapter 310, Statutes of 1995, requires the California State Auditor to ensure that the seismic retrofit projects funded by the bond proceeds are consistent with the purpose of the Bond Act.

Seismic retrofit expenditures for seven toll bridges and approximately 1,155 bridges in Phase II of the retrofit program qualify for Bond Act funding. As of July 1998, the expenditures totaled $815 million, including approximately $114 million of expenditures and commitments incurred during fiscal years 1994-95 and 1995-96.

The State Highway Account (SHA), the Consolidated Toll Bridge Fund (CTBF), and other state funds provided interim funding for expenditures incurred during fiscal years 1994-95 and 1995-96. The Bond Act required that bond proceeds be used to reimburse the SHA and the CTBF for these prior year expenditures. For fiscal years 1996-97 and 1997-98, the State used loans from its Pooled Money Investment Account to cover expenditures until bonds could be sold. As of July 1998, the department had received three loans totaling $1.548 billion. General-obligation bonds related to the Bond Act were issued in March and October 1997, and in October 1998, totaling $694.8 million.

In general, the department has ensured that the seismic retrofit projects are consistent with the purpose of the Bond Act. In fiscal year 1996-97, the department encountered difficulties in complying with the Bond Act requirement to reimburse the SHA and the CTBF for the fiscal year 1994-95 and 1995-96 seismic retrofit expenditures. The State Treasurer's Office and the Department of Finance objected to the reimbursements because they would have resulted in the loss of the bonds' tax-exempt status; however, certain provisions of Chapter 327, Statutes of 1997, now allow the department to make the reimbursements without losing the bonds' tax-exempt status and without violating the terms of the loan. Thus, the department plans to begin the reimbursement process in fiscal year 1998-99.

AGENCY COMMENTS

The agency chose not to respond. ■

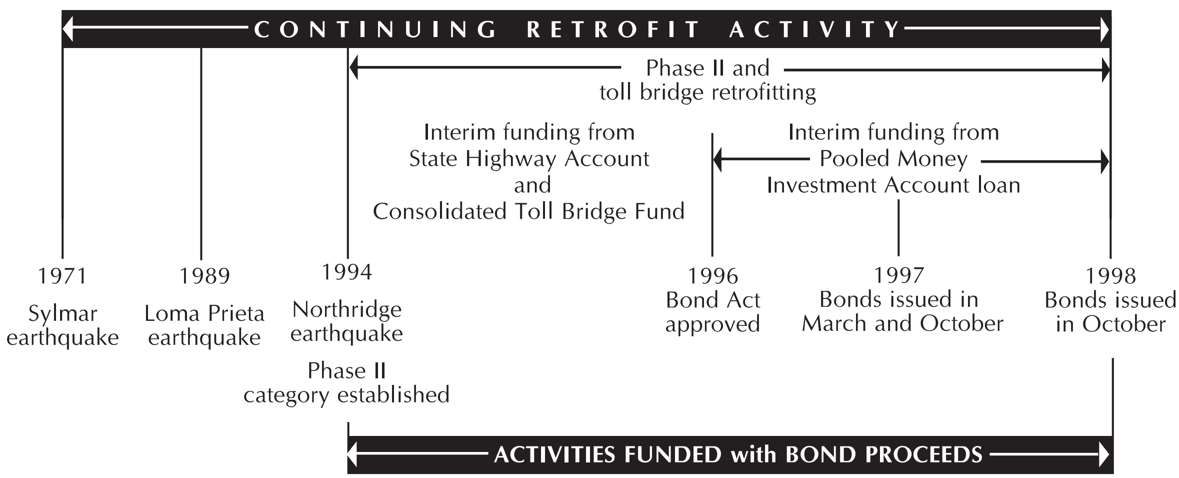
INTRODUCTION

BACKGROUND

Since the 1971 Sylmar earthquake struck the Los Angeles area, the Department of Transportation (department) has been engaged in a statewide seismic retrofit program for bridges. In March 1996, California voters approved the Seismic Retrofit Bond Act of 1996 (Bond Act), which authorized the State to sell $2 billion in general-obligation bonds to reconstruct, replace, or retrofit state-owned highways and bridges, including toll bridges. The Bond Act will remain in effect until all retrofits for state-owned toll bridges are complete, or until June 30, 2005, whichever is sooner. Figure 1 depicts the State's continuing seismic retrofit activity and its relationship to the Bond Act.

Figure 1

Retrofit Activity – 1971 to the Present



The Bond Act initially required the department to use $650 million of the bond proceeds for seismic retrofit of toll bridges and the remaining $1.35 billion for Phase II retrofits. However, on August 20, 1997, the governor signed into law Chapter 327, Statutes of 1997, that effectively shifted the allocation of funds in the Bond Act to $790 million for toll bridges and $1.21 billion for Phase II retrofits. Since the cost estimate to retrofit or replace the state-owned toll bridges approximates

$2.62 billion, Chapter 327, Statutes of 1997, also authorized additional funds from various state and toll bridge revenue accounts for retrofitting the seven state-owned toll bridges.

The Bond Act also requires the department to reimburse the State Highway Account (SHA) and the Consolidated Toll Bridge Fund (CTBF) which, along with other state funds, provided interim funding for fiscal year 1994-95 and 1995-96 expenditures for Phase II and toll bridge retrofits. Total Phase II and toll bridge seismic retrofit expenditures and commitments for fiscal years 1994-95 and 1995-96 are approximately $114 million. The Bond Act requires the department to reimburse the SHA and CTBF for these prior year expenditures with bond proceeds.

In fiscal year 1996-97, the Seismic Retrofit Bond Fund of 1996 was created to account for seismic retrofit expenditures and revenues. Before bonds could be issued, the State used loans from the Pooled Money Investment Account (PMIA) to cover expenditures of the seismic retrofit program. As Figure 2 on page 5 indicates, the funding of these expenditures is very complex, and it involves temporary funding until bonds are issued.

SCOPE AND METHODOLOGY

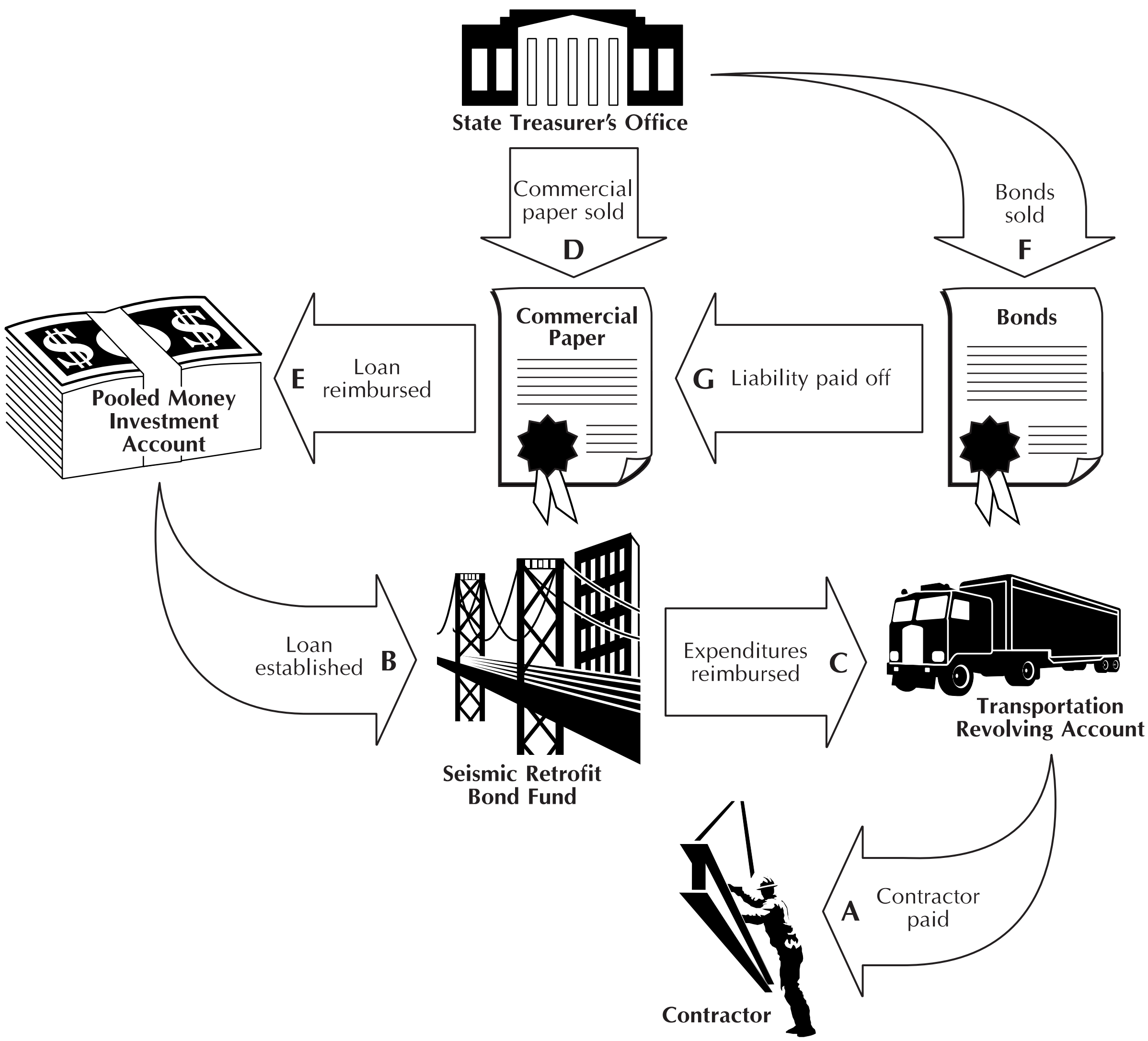
Chapter 310, Statutes of 1995, requires the California State Auditor to annually audit revenues and expenditures authorized by the Bond Act to ensure that projects are consistent with its purpose.

To gain an understanding of the seismic retrofit program, we reviewed the provisions of the Bond Act and related policies and procedures the department developed for expenditures charged to the Seismic Retrofit Bond Fund of 1996. We also interviewed administrators and staff to determine their responsibilities for implementing provisions of the Bond Act and their manner of meeting those responsibilities.

To determine how fully the department complies with the requirements of the Bond Act, we reviewed a sample of seismic retrofit projects for fiscal year 1997-98 and assessed whether the projects were eligible for funding under the Bond Act. In addition, we reviewed a sample of seismic retrofit expenditures that related to the $815 million in expenditures recorded as of June 30, 1998, for all years combined.

Figure 2

The Flow of Funds for Bond Fund Expenditures



A Seismic retrofit expenditures are first paid from the Transportation Revolving Account.

B The State's Pooled Money Investment Account (PMIA) loan program provides interim financing to Bond Act projects. As of June 30, 1998, the department had received three PMIA loans totaling $1.5 billion, all of which were approved by the Pooled Money Investment Board.

C The department uses PMIA loan funds and submits a monthly transfer letter, based on a Plan of Financial Adjustment to the State Controller's Office to reimburse the Transportation Revolving Account from the Seismic Retrofit Bond Fund for the month's expenditures.

D The State Treasurer's Office sells commercial paper in the amount of the previous period's expenditures recorded in the Seismic Retrofit Bond Fund. Commercial paper is simple, short-term promissory notes with maturities ranging from 1-270 days.

E The proceeds of these commercial paper sales are used to pay down the outstanding balance of the PMIA loan to the department.

F The State Treasurer's Office sells general obligation bonds when the market allows.

G The State Treasurer's Office uses the proceeds from bond sales to pay off the liability for the commercial paper.

We also followed up on the issues raised by the State Treasurer's Office and the Department of Finance regarding federal tax and fiscal implications of using bond proceeds to reimburse the 1994-95 and 1995-96 Phase II seismic retrofit expenditures. We reviewed the department's records and interviewed administrators to determine if any reimbursement has taken place.

Finally, we reviewed bond-issuance records available through October 1998 to determine the status of the bond issuances and their use. ■

AUDIT RESULTS

Seismic Retrofit Projects and Expenditures Were Valid and Appropriate

SUMMARY

We reviewed a sample of 45 seismic retrofit projects for fiscal year 1997-98. We found that the Department of Transportation (department) made appropriate charges to the Seismic Retrofit Bond Fund. In addition, the department has taken appropriate action to implement our fiscal year 1996-97 recommendations.

As we reported in our last audit, the department had encountered difficulties in complying with the Bond Act requirement to reimburse the State Highway Account (SHA) and Consolidated Toll Bridge Fund (CTBF) for fiscal year 1994-95 and 1995-96 seismic retrofit expenditures. The department had used funds from the SHA and CTBF to finance portions of these prior year expenditures, but the State Treasurer's Office and the Department of Finance had objected to the proposed reimbursements of the SHA and CTBF because they would result in the loss of the bonds' tax-exempt status. The DOF further opposed the use of Pooled Money Investment Account (PMIA) loans to provide interim reimbursement to the SHA and CTBF for fiscal reasons; however, certain provisions of Chapter 327, Statutes of 1997, now allow the department to reimburse the funds without losing the bonds' tax-exempt status and without violating the terms of the loan. We reviewed the department's records and determined that it had not reimbursed any funds as of June 30, 1998. However, the department plans to begin doing so in fiscal year 1998-99.

BACKGROUND

As of June 30, 1998, department records showed 900 seismic retrofit projects for 1,155 bridges with Phase II status and seven toll bridges eligible to use Bond Act revenues. The department has retrofitted 1,071 bridges, representing 93 percent of those in Phase II. The department has also begun construction on six of the seven state toll bridges. As of June 30, 1998, the department recorded over $815 million in expenditures for both types of projects funded with Bond Act proceeds. Appendix B shows the breakdown of these expenditures.

THE DEPARTMENT MADE APPROPRIATE CHARGES TO THE SEISMIC RETROFIT BOND FUND

Since the inception of the seismic retrofit program, to finance its expenditures, the State issued three general-obligation bonds under the Bond Act: one for $50 million in March 1997, the second for $300 million in October 1997, and the third for $344.8 million in October 1998. Both Phase II and toll bridge projects are eligible for funding with Bond Act proceeds. We reviewed 45 seismic retrofit projects of both types for fiscal year 1997-98 and found that they were all eligible for bond funding. In addition, we found that the expenditures charged to the Seismic Retrofit Bond Fund met the intended purpose of the program.

THE DEPARTMENT HAS IMPLEMENTED LAST YEAR'S RECOMMENDATIONS

In the 1996-97 fiscal year, we reported that the department erroneously charged expenditures to the Seismic Retrofit Bond Fund because it incorrectly coded some projects and used an incorrect funding allocation for an expenditure authorization. We followed up on these issues and found that the department has taken appropriate actions to correct the problems. For example, the department has reclassified projects that it inappropriately coded as Phase II projects in prior years. These errors occurred because of an apparent breakdown in communicating project status changes to various units. As we recommended, the department has established procedures to better communicate and implement changes in seismic retrofit projects.

THE DEPARTMENT HAS NOT YET REIMBURSED EARLY SEISMIC RETROFIT EXPENDITURES

Article 2 of the Bond Act requires that bond proceeds be used to reimburse the SHA and the CTBF for fiscal year 1994-95 and 1995-96 seismic retrofit expenditures. Department records show approximately $114 million in expenditures and commitments attributable to seismic retrofit in fiscal years 1994-95 and

1995-96. Included in this total is $103 million from the SHA and $11 million from the CTBF. However, as we previously reported, the department encountered two difficulties in complying with this requirement.

First, the State Treasurer's Office raised the concern that reimbursing expenditures incurred during fiscal years 1994-95 and 1995-96 with bond proceeds would jeopardize the bonds' tax-exempt status. According to the State's bond counsel, under Treasury Regulation, sections 1.150-2(d) and (e), to use tax-exempt bond proceeds to reimburse expenditures, an issuer must adopt a resolution of official intent, no later than 60 days after the payment of the original expenditures, indicating that it expects to reimburse the expenditures with bond proceeds. The department made its early seismic expenditures long before the 60-day window and without the required official resolution; therefore, these expenditures do not meet requirements for tax exemption. If the State loses the bond's federal tax-exempt status, it will be obligated to pay higher interest to bond purchasers to compensate for taxes they will pay on interest earnings.

Further, because of fiscal considerations, the Department of Finance objected to the use of Pooled Money Investment Account (PMIA) loans to provide interim reimbursement to the SHA and CTBF for fiscal year 1994-95 and 1995-96 seismic retrofit expenditures. Loan provisions require that the loan be used for current expenditures only.

Chapter 327, Statutes of 1997, signed in August 1997, offers a solution to the problem of both meeting the legal reimbursement requirements and preserving the tax-exempt status of the bonds. The new statute authorizes the use of $745 million from the SHA to finance seismic retrofit projects for toll bridges. According to the chief of the department's Office of Finance and Capital Budgets, because the new legislation requires SHA contributions for toll bridge retrofits, the department plans to use $103 million of bond proceeds to pay for future costs of this type. In addition, the department intends to fund $11 million of future CTBF projects with Bond Act proceeds. This allows the department to reimburse the SHA and CTBF for the $114 million in seismic retrofit expenditures incurred during fiscal years 1994-95 and 1995-96 using Bond Act proceeds.

The Seismic Retrofit Finance Committee generally approved the department's use of these moneys on November 19, 1997. Furthermore, Chapter 327, Statutes of 1997, also addresses the Department of Finance's concerns because it allows PMIA loans to temporarily fund future seismic retrofit projects until bonds are issued.

We reviewed the department's records and determined that no actual reimbursement has taken place as of June 30, 1998. However, the department plans to begin the reimbursement process in fiscal year 1998-99.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

Date: December 1, 1998

Staff: Denise L. Vose, CPA
Nasir A. Ahmadi, CPA
Douglas J. K. Gibson, CPA
Christiana Mbome, CPA

APPENDIX A

Seismic Retrofit Program Status

According to the July 1, 1998, Seismic Retrofit Program—Summary Status, issued by the Department of Transportation (department), of the 1,155 total bridges in Phase II, 1,071 were complete, 56 were under construction, and 28 were still being planned and designed. The department has retrofitted 93 percent of the Phase II bridges. Table 1 shows the Phase II program status, based on the department's report.

TABLE 1

Status of Phase II Bridges as of July 1, 1998

District	Construction Complete	Under Construction	Advertised for Bids	Planning and Design	Total
1	58	6	0	5	69
2	12	0	0	0	12
3	34	2	0	0	36
4	123	16	0	12	151
5	97	7	0	3	107
6	77	0	0	0	77
7	279	11	0	3	293
8	113	12	0	5	130
9	7	0	0	0	7
10	40	0	0	0	40
11	172	0	0	0	172
12	59	2	0	0	61
Totals	**1,071**	**56**	**0**	**28**	**1,155**

As of July 1998, the department had planned 13 construction contracts in order to complete the retrofits needed on six of the seven state toll facilities. Six of these 13 projects were under construction, and the other 7 were at various stages of design, with construction scheduled to begin in 1998 or early 1999. Part of the cost of retrofitting the following toll bridges is included in the Bond Act funding:

1. San Francisco-Oakland Bay Bridge
2. Benicia-Martinez Bridge
3. San Mateo-Hayward Bridge
4. Richmond-San Rafael Bridge
5. Carquinez Bridge, Eastbound
6. Vincent Thomas Bridge
7. San Diego-Coronado Bridge

APPENDIX B

Bond Act Expenditures as of June 30, 1998

Table 2 shows the breakdown of seismic retrofit expenditures by fiscal year as of June 30, 1998.

TABLE 2

Breakdown of Seismic Retrofit Expenditures (In Thousands)

Expenditures			Fiscal Year 1994-95	Fiscal Year 1995-96	Fiscal Year 1996-97	Fiscal Year 1997-98	Total (All Years)
Phase II	State Operations	Administration	$ 0	$ 0	$ 7,248	$ 18,314	$ 25,562
		Legal	0	0	0	0	0
		Operations	0	0	0	0	0
		Capital Outlay—Support	12,452	19,248	70,609	80,542	182,851
		Subtotal	12,452	19,248	77,857	98,856	208,413
	Capital Outlay	Major Construction	0	0	0	0	0
		Major Contracts	4,085	1,880	185,215	172,184	363,364
		Minor Construction	0	0	0	0	0
		Minor Contracts	1,043	1,961	4,615	1,718	9,337
		Rights-of-Way	57	259	562	1,118	1,996
		Subtotal	5,185	4,100	190,392	175,020	374,697
		Total Phase II	17,637	23,348	268,249	273,876	583,110
Toll Bridges	State Operations	Administration	0	0	3,490	11,789	15,279
		Legal	0	0	0	0	0
		Operations	0	0	0	0	0
		Capital Outlay—Support	14,978	48,447	44,548	47,511	155,484
		Subtotal	14,978	48,447	48,038	59,300	170,763
	Capital Outlay	Major Construction	0	0	0	0	0
		Major Contracts	877	7,285	5,938	39,572	53,672
		Minor Construction	0	0	0	0	0
		Minor Contracts	0	0	0	0	0
		Rights-of-Way	2	0	492	7,334	7,828
		Subtotal	879	7,285	6,430	46,906	61,500
		Total Toll Bridges	15,857	55,732	54,468	106,206	232,263
		Grand Total	**$33,494**	**$79,080**	**$322,717**	**$380,082**	**$815,373**

Blank page inserted for reproduction purposes only.