

California State Auditor

B U R E A U O F S T A T E A U D I T S

Department of Transportation:

*Seismic Retrofit Expenditures Are Generally
in Compliance With the Bond Act*



October 1999
99022

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CALIFORNIA STATE AUDITOR

KURT R. SJOBERG
STATE AUDITOR

MARIANNE P. EVASHENK
CHIEF DEPUTY STATE AUDITOR

October 7, 1999

99022

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 fiscal year 1999-2000, 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

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SUMMARY

RESULTS IN BRIEF

Legislation passed in 1995 requires the California State Auditor to ensure that projects funded by the Seismic Retrofit Bond Act of 1996 (Bond Act) are consistent with that measure's purposes, which are to reconstruct, replace, or retrofit state-owned highways and bridges, including toll bridges. This is the fourth in a series of annual reports on the Department of Transportation's (department) revenues and expenditures, authorized by the Bond Act, for retrofitting California's highways and bridges.

As of June 30, 1999, the department had spent \$1.14 billion for projects on more than 1,100 bridges and 7 state-owned toll bridges, completing 96 percent of the retrofitting for highway bridges and having all of the toll bridges either in retrofit design or under construction. In general, the department has done a good job of ensuring that seismic retrofit projects do meet the criteria for funding under the Bond Act. However, we found that not all expenditures charged to those projects were eligible for such funding. Through minor recording errors, the department incorrectly charged approximately \$38,000 for expenses not allowed under the Bond Act.

Also, the department has not resolved a long-standing issue of reimbursing other accounts for interim funding obtained during fiscal years 1994-95 and 1995-96. During those years, the State Highway Account (highway account) and the Consolidated Toll Bridge Fund (toll bridge fund) provided a total of \$114 million in expenditures and commitments for retrofitting California's bridges. The Bond Act requires that the department use bond proceeds to reimburse the highway account and the toll bridge fund for these prior expenditures.

In attempting to make the reimbursements, however, the department discovered two objections: one by the State Treasurer's Office, which pointed to a possible loss of the bonds' tax-exempt status; and a second by the Department of Finance, which objected that the department's source of reimbursement funds

could be used only for current expenditures. Although both of these objections were removed by provisions in 1997 legislation, the department had not taken any action as of June 30, 1999, to reimburse the expenses.

AGENCY COMMENTS

In their response, the department addressed the current status of reimbursing other accounts for interim funding obtained during fiscal years 1994-95 and 1995-96. The department acknowledged that it originally planned to reimburse the high-way account and toll bridge fund during fiscal year 1998-99. However, the department states that the criteria it developed to select the projects to facilitate this reimbursement process was complex and required additional time. Therefore, the department currently anticipates that it will accomplish this reimbursement in fiscal year 1999-2000. ■

INTRODUCTION

BACKGROUND

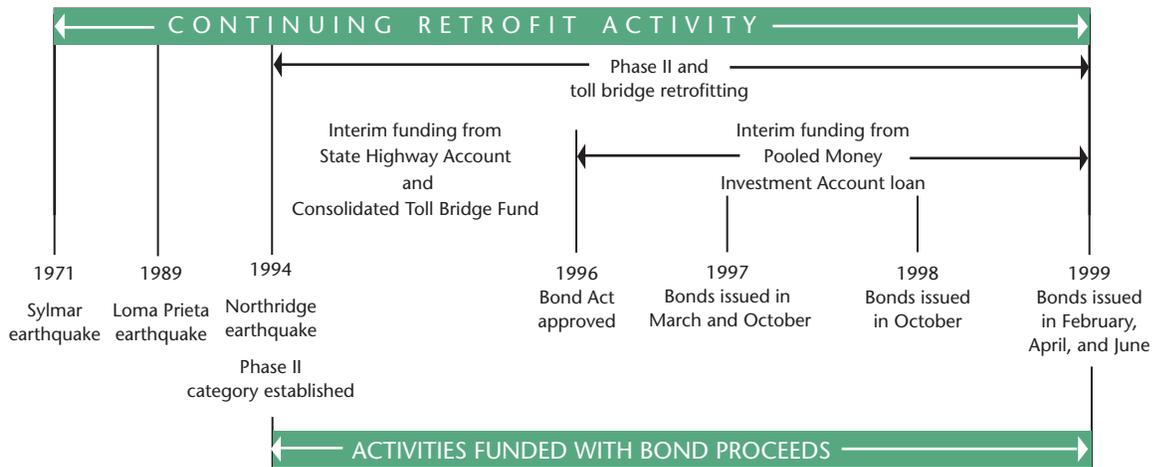
Since the 1971 Sylmar earthquake struck the Los Angeles area, the Department of Transportation (department) has been engaged in a statewide seismic retrofit program for bridges. Seismic retrofit involves structural analysis to determine a bridge's potential vulnerability during earthquakes and a strategy meeting with engineers to discuss the extent and nature of retrofit approaches and to determine the final retrofit design. Current retrofit work includes strengthening the columns of existing bridges by encircling them with a steel casing, enlarging and strengthening some of the bridge footings by placing additional pilings in the ground or by using steel tie-down rods to better anchor the footings to the ground, and enlarging the hinges that connect sections of bridge decks to help prevent them from separating during severe ground movement.

Before the January 1994 Northridge earthquake, the department classified all state-owned highway bridges (except toll bridges) into two groups: single-column bridges and multiple-column bridges. After the Northridge earthquake, the department reclassified the bridges into Phase I and Phase II categories. Phase I includes bridges determined in the strategy process to have required retrofitting as of January 1, 1994; these bridges are thus not eligible for funding from the Seismic Retrofit Bond Act of 1996 (Bond Act). Phase II includes all of the remaining state-owned bridges (excluding toll bridges), for which no retrofit strategy was in place by January 1, 1994.

In March 1996, California voters approved the Bond Act, which authorized the State to sell \$2 billion in state general-obligation bonds to reconstruct, replace, or retrofit Phase II bridges and state-owned toll bridges. The Bond Act will remain in effect until all construction activities for the seismic retrofit of 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



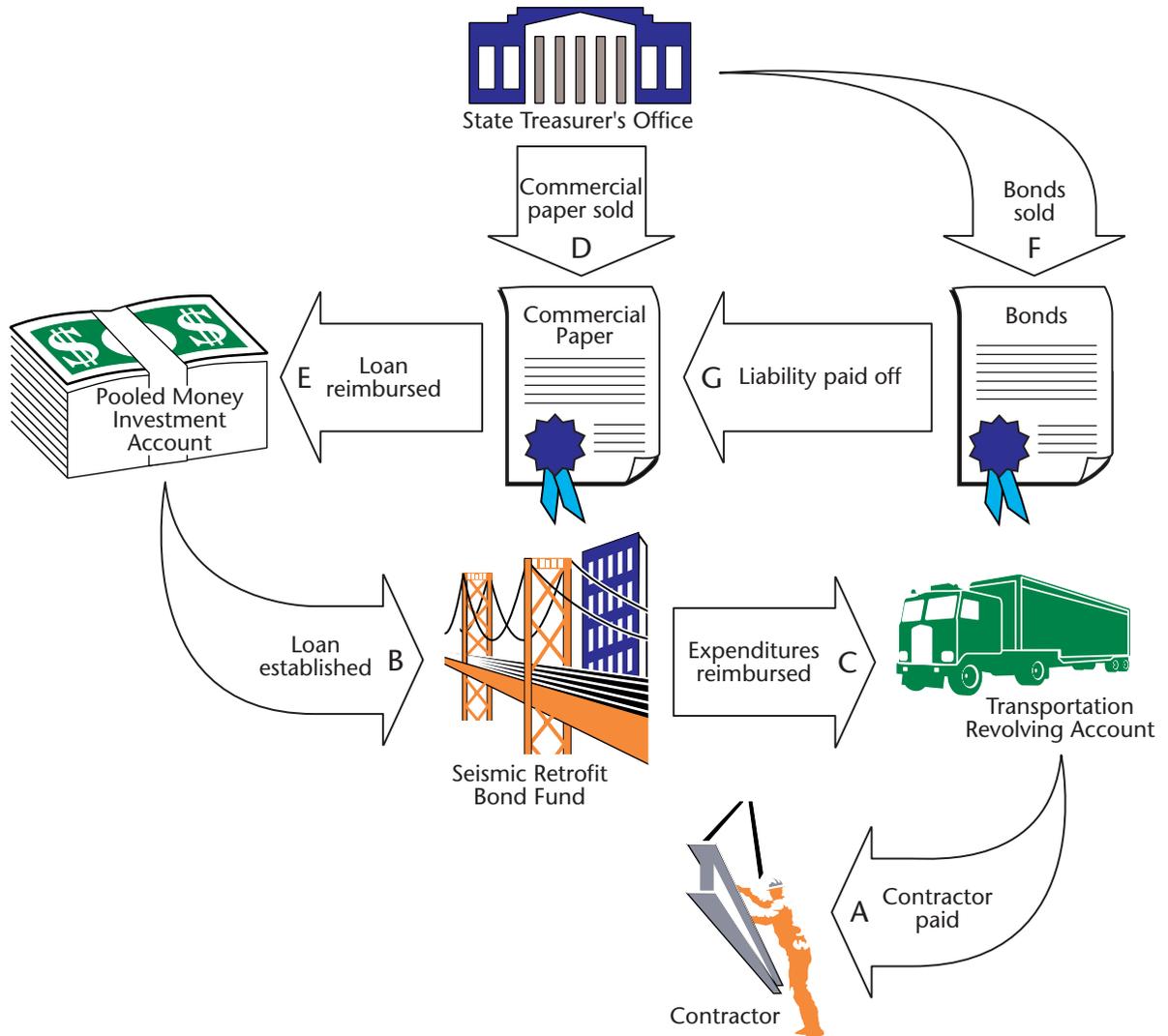
The Bond Act initially required the department to use \$650 million of the bond proceeds for seismic retrofit of toll bridges and the remaining \$1.35 billion for Phase II retrofits. However, on August 20, 1997, the governor signed into law Chapter 327, Statutes of 1997, which effectively shifted the allocation of expenditures in the Bond Act to \$790 million for toll bridges and \$1.21 billion for Phase II retrofits. Since the estimate to retrofit or replace the state-owned toll bridges is \$2.62 billion, the legislation also authorized additional funds from various state and toll bridge revenue accounts for retrofitting the seven toll bridges.

The Bond Act also requires the department to use bond proceeds to reimburse the State Highway Account and the Consolidated Toll Bridge Fund, which, along with other state funds, provided approximately \$114 million in interim funding for fiscal years 1994-95 and 1995-96 expenditures for Phase II and toll bridge retrofits.

In fiscal year 1996-97, the Seismic Retrofit Bond Fund of 1996 was created to account for seismic retrofit expenditures and revenues. Before bonds can be issued, this fund uses loans from the State Pooled Money Investment Account to cover expenditures made by the seismic retrofit program. As Figure 2 indicates, the funding of these expenditures is very complex, involving temporary funding until bonds are issued.

FIGURE 2

The Use of Funds for Bond Fund Expenditures



- A Seismic retrofit expenditures are originally 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, 1999, the department had received PMIA loans totaling \$1.3 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 to 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 is favorable.
- G The State Treasurer's Office uses the proceeds from bond sales to pay off the liability for the commercial paper.

STATUS OF THE BOND ISSUANCES

Since the inception of the seismic retrofit program, the State has issued six general obligation bonds under the Bond Act. Table 1 shows the date and amount of each issuance.

TABLE 1

Seismic Retrofit Bond Act: General Obligation Bond Issuances

Bond Series	Date Sold	Amount Sold
Series A	03/18/97	\$ 50,005,000
Series B	10/08/97	300,000,000
Series C	10/07/98	344,850,000
Series D	02/23/99	100,000,000
Series E	04/07/99	76,000,000
Series F	06/09/99	20,000,000
Total		\$890,855,000

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 the projects funded are consistent with the act's purpose.

To gain an understanding of the seismic retrofit program, we reviewed the Bond Act's provisions and the related policies and procedures developed by the department 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 complied with the requirements of the Bond Act, we reviewed a sample of seismic retrofit projects for fiscal year 1998-99 and assessed whether the projects were eligible for funding. In addition, we reviewed a sample of the \$1.14 billion in seismic retrofit expenditures recorded as of June 30, 1999, for all years combined.

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

Finally, we reviewed bond-issuance records available through August 1999 to determine their status and use. ■

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AUDIT RESULTS

Although Seismic Retrofit Projects Were Valid, Not All Expenditures Were Eligible for Bond Act Funding

SUMMARY

We reviewed a sample of 32 projects and 50 expenditures charged to these projects by the Department of Transportation (department) for fiscal year 1998-99. We found that while the projects and most of the expenditures were appropriate under the Seismic Retrofit Bond Act of 1996 (Bond Act), some expenditures were in error. Specifically, we found that the department erroneously charged approximately \$38,000 to Bond Act projects for expenses it should have recorded elsewhere.

As reported in our last two audits, the department encountered difficulties with the Bond Act requirement to reimburse the State Highway Account (highway account) and the Consolidated Toll Bridge Fund (toll bridge fund) for funds the department used for seismic retrofit expenditures in fiscal years 1994-95 and 1995-96. Specifically, the State Treasurer's Office and the Department of Finance had raised valid objections to the department's method of reimbursement. In 1997, new legislation removed those objections, allowing the department to use Bond Act revenues to reimburse the highway account and the toll bridge fund, and the department indicated that it would begin payments in fiscal year 1998-99. However, our review of the department's records through June 30, 1999, found that it had not begun the reimbursement process.

BACKGROUND

As of June 30, 1999, department records showed that 559 active seismic retrofit projects related to 1,155 Phase II bridges and 7 toll bridges were eligible to use Bond Act revenues. The department has retrofitted 96 percent of the Phase II bridges. The department has also completed 2 of the 13 construction contracts that it currently has for retrofitting 6 of the state-owned

toll bridges. In addition, the department projects that it will award all contracts for the San Francisco-Oakland Bay Bridge, the seventh state-owned toll bridge, by 2001. Appendix A shows the status of the seismic retrofit program. As of June 30, 1999, the department had recorded over \$1.14 billion in expenditures for both types of projects funded with Bond Act revenues. Appendix B shows the breakdown of these expenditures.

NOT ALL EXPENDITURES WERE ELIGIBLE FOR BOND ACT FUNDING

Although most of the expenditures we reviewed were properly charged to the Seismic Retrofit Bond Fund of 1996, we found allocation and coding errors that caused inappropriate charges. For one of the 50 expenditure transactions we reviewed, the department incorrectly charged approximately \$6,700 to a Phase II project that should have been charged to a Phase I project. This error occurred because the department failed to identify that, unlike most of its contracts, this contract for professional services benefited several projects, thus requiring the department to allocate the \$392,262 that it paid for these services to a combination of Phase I, Phase II, and toll bridge seismic retrofit projects. After we discussed this allocation with the department, it corrected its mistake by transferring approximately \$6,700 from Phase II to Phase I projects.

In addition, we found that the department erroneously charged to a seismic retrofit project a total of \$31,066 for legal services to defend the department in a right-of-way lawsuit related to a nonseismic project. This mistake occurred because the department made a keying error when entering the project code. The department did not identify the error because it failed to follow its review procedures for right-of-way capital outlay expenditures. After we discussed this coding error with the department, it made an adjusting entry to charge the expenditure to the correct project.

These two errors seem to be the result of isolated breakdowns in the department's system of ensuring that only eligible expenditures are charged to the Bond Act and are not pervasive throughout the seismic retrofit expenditures.

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 highway account and the toll bridge fund for seismic retrofit expenditures during fiscal years 1994-95 and 1995-96. Department records show approximately \$114 million in expenditures and commitments for seismic retrofit during these two fiscal years. This total included \$103 million from the highway account and \$11 million from the toll bridge fund. However, as we stated in previous reports, the department found two problems that prevented it from complying with this requirement.

First, the State Treasurer's Office raised the concern that reimbursing these past expenditures with bond proceeds would jeopardize the bonds' federal tax-exempt status, potentially obligating the State, if the tax-exempt status were lost, to pay bond purchasers a higher interest rate to compensate them for paying federal taxes on interest earnings. According to the State's bond counsel, under treasury regulation, an issuer wanting to use the proceeds of tax-exempt bonds to reimburse expenditures 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. Because the 60-day window for the early retrofit expenditures has long since passed without the required official resolution, the reimbursement of expenditures does not meet the requirements for tax exemption.

Further, because of fiscal considerations, the Department of Finance objected to using Pooled Money Investment Account loans to provide interim reimbursement to the highway account and the toll bridge fund for fiscal years 1994-95 and 1995-96 seismic retrofit expenditures. Loan provisions require that this possible source of reimbursement be used for current expenditures only.

In August 1997, new legislation offered a solution to the problem of preserving the tax-exempt status of the bonds, while meeting the legal reimbursement requirements. Chapter 327, Statutes of 1997, authorizes the use of \$745 million from the highway account 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 highway account 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 toll bridge fund projects with Bond Act revenues. This allows the department to use Bond Act proceeds to reimburse the highway account and the toll bridge fund for the \$114 million in seismic retrofit expenditures incurred during fiscal years 1994-95 and 1995-96. Furthermore, the 1997 legislation also addresses the Department of Finance's concerns because it allows Pooled Money Investment Account loans to temporarily fund future seismic retrofit projects until bonds are issued.

The Seismic Retrofit Finance Committee, which is responsible for the administration of Bond Act financing programs, approved the department's use of these funds on November 19, 1997. Yet, when we reviewed the department's records, we determined that no actual reimbursement had taken place as of June 30, 1999. According to the department, it has not begun the reimbursement because selecting the best possible projects to facilitate this reimbursement is a complex process. More specifically, the department is currently reviewing its project inventory to select only projects that are scheduled for construction and completion within the life of the Bond Act, which ends on June 30, 2005. The department intends to complete the selection of projects by the end of fiscal year 1999-2000.

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 government 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: October 7, 1999

Staff: Denise L. Vose, CPA
Nasir Ahmadi, CPA
Anna Escudro

APPENDIX A

Status of the Seismic Retrofit Program

Tables 2 and 3 depict the status of the seismic retrofit program for both Phase II bridges and toll bridges as of July 1, 1999.

TABLE 2

Status of Phase II Bridges as of July 1, 1999

District	Retrofit Complete	Under Construction	Design	Total
1	63	1	5	69
2	12	0	0	12
3	34	2	0	36
4	131	11	9	151
5	100	4	3	107
6	77	0	0	77
7	288	3	2	293
8	124	1	5	130
9	7	0	0	7
10	40	0	0	40
11	172	0	0	172
12	61	0	0	61
Totals	1,109	22	24	1,155

Source: Seismic Retrofit Program: Summary Status, issued by the Department of Transportation.

TABLE 3**Status of Toll Bridges as of July 1, 1999**

Toll Facility	Number of Projects	Current Status	Current Retrofit Completion Date
San Francisco-Oakland Bay Bridge:			
East Bay span	To be determined	Design	Spring 2005
West Bay span	7	Construction/design	Summer 2005
Benicia-Martinez Bridge	2	Under construction	Summer 2001
San Mateo-Hayward Bridge	4	Under construction/design	Spring 2001
Richmond-San Rafael Bridge	1	Design	Winter 2004
Carquinez Bridge (eastbound)	1	Under construction	Summer 2000
Vincent Thomas Bridge	1	Under construction	Winter 2000
San Diego-Coronado Bridge	4	Under construction/design	Winter 2002

Source: Seismic Retrofit Program: Summary Status, issued by the Department of Transportation.

APPENDIX B

Bond Act Expenditures as of June 30, 1999

Table 4 shows the breakdown of seismic retrofit expenditures by fiscal year as of June 30, 1999.

TABLE 4

**Breakdown of Seismic Retrofit Expenditures as of June 30, 1999
(in Thousands)**

Expenditures	Fiscal Year 1994-95	Fiscal Year 1995-96	Fiscal Year 1996-97	Fiscal Year 1997-98	Fiscal Year 1998-99	Total (All Years)
Phase II bridges						
State operations						
Administration	\$ 0	\$ 0	\$ 7,248	\$ 18,314	\$ 24,038	\$ 49,600
Legal	0	0	0	0	0	0
Operations	0	0	0	0	1	1
Capital outlay—support	12,452	19,248	70,609	80,542	34,928	217,779
Subtotal	12,452	19,248	77,857	98,856	58,967	267,380
Capital outlay						
Major construction	0	0	0	0	0	0
Major contracts	4,085	1,880	185,215	172,184	65,256	428,620
Minor construction (A&B)	0	0	0	0	0	0
Minor contracts (A&B)	1,043	1,961	4,615	1,718	219	9,556
Right-of-way	57	259	562	1,118	443	2,439
Subtotal	5,185	4,100	190,392	175,020	65,918	440,615
Total Phase II	17,637	23,348	268,249	273,876	124,885	707,995
Toll bridges						
State operations						
Administration	0	0	3,490	11,789	15,694	30,973
Legal	0	0	0	0	0	0
Operations	0	0	0	0	0	0
Capital outlay—support	14,978	48,447	44,548	47,511	7,339	162,823
Subtotal	14,978	48,447	48,038	59,300	23,033	193,796
Capital outlay						
Major construction	0	0	0	0	0	0
Major contracts	877	7,285	5,938	39,572	161,658	215,330
Minor construction (A&B)	0	0	0	0	0	0
Minor contracts (A&B)	0	0	0	0	0	0
Right-of-way	2	0	492	7,334	15,512	23,340
Subtotal	879	7,285	6,430	46,906	177,170	238,670
Total toll bridges	15,857	55,732	54,468	106,206	200,203	432,466
Grand Total	\$33,494	\$79,080	\$322,717	\$380,082	\$325,088	\$1,140,461

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(Agency's response provided as text only:)

Business, Transportation and Housing Agency
980 9th Street, Suite 2450
Sacramento, California 95814-2719

September 29, 1999

Kurt R. Sjoberg, State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

Attached is the Department of Transportation's (Caltrans) response to your report entitled "*Department of Transportation: Seismic Retrofit Expenditures Are Generally in Compliance with the Bond Act,*" report #99022. As identified in your report, I am pleased to report that Caltrans has done a good job of ensuring that seismic retrofit projects are meeting the criteria for funding under the Seismic Retrofit Bond Act of 1996.

While the report also identified that Caltrans has not yet reimbursed the State Highway Account (SHA) and the Toll Bridge Fund for temporarily providing \$114 million for seismic retrofit expenditures to California bridges from Proposition 192 funds, Caltrans will accomplish the reimbursement in fiscal year 1999-2000. Caltrans has chosen to select specific projects consistent with Bond Act timeframes and also projects which are 100% SHA or Toll Bridge funded to reduce the complexities of cost allocation. This process requires additional time to select specific projects meeting these criteria.

If you have any questions, please let me know.

Sincerely,

(Signed by: Maria Contreras-Sweet)

MARIA CONTRERAS-SWEET
Secretary

Attachment

Department of Transportation
Office of the Director
1120 N Street
P. O. Box 942873
Sacramento, CA 94273-0001

September 29, 1999

MARIA CONTRERAS-SWEET, Secretary
Business, Transportation and Housing Agency
980 - 9th Street, Suite 2450
Sacramento, CA 95814

Dear Secretary Contreras-Sweet:

I am pleased to provide our response to the State Auditor's report on Seismic Retrofit Expenditures for fiscal year 1998/99. The audit report noted that seismic retrofit expenditures were generally in compliance with the Bond Act. Two minor recording errors totaling approximately \$38,000 were noted, which amount was immaterial when compared to total seismic retrofit expenditures of \$1.14 billion.

The State Auditor also reported on the status of the reimbursement of fiscal year 1994/95 and 1995/96 expenditures to the State Highway Account and Consolidated Toll Bridge Fund. The reimbursement issue was originally reported by the State Auditor in December 1997, in their audit report on seismic retrofit expenditures. Caltrans would like to provide the following clarifying information on the current status of these reimbursements.

Caltrans intended to accomplish the reimbursement of State Highway Account (SHA) and Toll Bridge Accounts from Proposition 192 funds during fiscal year 1998-99. However, in developing the criteria for choosing projects to be funded with Proposition 192 funds, it became apparent that selecting very specific types of projects would greatly benefit the management of the reimbursement process. Two key criteria for selecting SHA and Toll Bridge projects for funding with Proposition 192 funds are:

Construction complete by June 30, 2005, the sunset date of Proposition 192 funds

Initially, large projects were considered to reduce the number of non-seismic retrofit projects funded with Proposition 192 funds. However, many of the large projects that were considered are not scheduled to begin construction until close to the sunset date of Proposition 192.

Projects initially programmed as 100% SHA or Toll Bridge funded

Projects with a combination of funding sources such as state, federal and reimbursement funds create a more complex process for monitoring the Proposition 192 “share” of expenditures. Projects that include federal and reimbursement funding often require expenditure adjustments at the time of completion. This is attributable to the project close out process when final eligibility of expenditures for reimbursement by either the federal government or local entities is determined.

The above selection criteria made it more difficult than anticipated to develop the candidate list of projects for funding with Proposition 192 funds. However, Caltrans has nearly completed development of an inventory of SHA and Toll Bridge projects and will accomplish the reimbursement in fiscal year 1999-00.

If we can provide any further information, or if you have any questions, please do not hesitate to contact me.

Sincerely,

(Signed by: Tony V. Harris for Jose Medina)

JOSE MEDINA

Director

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps