
Pinal County Transportation Excise Tax



Performance Audit

June 28, 2001



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STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

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June 29, 2001

Members of the Arizona Legislature

The Honorable Jane Dee Hull, Governor

Pinal County Board of Supervisors

Transmitted herewith is the report A Performance Audit of the Pinal County Transportation Excise Tax. This audit was conducted by the consulting firm KPMG LLP under contract with the Auditor General and was in response to the requirements of A.R.S. §41-1279.03.

A response to the audit report was received from the Town of Kearny. The City of Apache Junction declined to provide a response. The Town of Kearny indicates that it will review its expenditure for a street plaque and review the appropriate financial reporting system for the transfer of HURF funds to the General Fund.

This report will be released to the public on July 2, 2001.

Sincerely,

A handwritten signature in black ink, appearing to read "Debbie Davenport".

Debbie Davenport
Auditor General

Enclosure

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Executive Summary

I. Project Scope, Approach, and Methodology

On February 2, 2001, Arizona’s Office of the Auditor General (OAG) contracted with KPMG LLP (KPMG) to conduct a performance audit of the Pinal County Transportation Excise Tax for the fiscal years 1998 through 2000. This audit was conducted under the authority vested in the Auditor General by Arizona Revised Statutes (A.R.S.) §41-1279.03 and pursuant to a June 16, 1999 resolution of the Joint Legislative Audit Committee.

In 1986, the residents of Pinal County voted to pass a half-cent sales tax to “*provide additional funding for the construction, reconstruction, maintenance, repair, and roadside development of County, city, and town roads, streets, and bridges.*” The twenty-year tax became effective January 1, 1987. From fiscal year 1998 through fiscal year 2000, the excise tax has generated \$17,750,079 in revenues for roads, highways, and bridges in the County. This revenue is shared between eight incorporated cities and towns and the County, which maintains responsibility for unincorporated roads. The tax is distributed to each entity according to a population-based formula. Currently, cities and towns receive 56 percent of the excise tax revenue, while the County receives the remaining 44 percent.

II. Results in Brief

During the conduct of this performance audit, KPMG identified several opportunities for improvement regarding the management of Pinal County’s transportation excise tax. In the section below, we summarize our performance audit findings.

III. Transportation Excise Tax Findings

This section summarizes the four findings associated with the management performance of Pinal County’s transportation excise tax during fiscal years 1998 through 2000.

3.1 The City of Apache Junction allocated an excessive portion of its debt service payments to its Highway User Revenue Fund (HURF), which includes transportation excise tax and HURF monies.

Recommendation: KPMG recommends that the City of Apache Junction recalculate the amount of money charged to its HURF account for debt service payments involving its issuance of Series 1998 bonds, and repay its HURF account \$173,115 representing unallowable costs charged to that road-related account during fiscal years 1999 and 2000.

Condition/Cause: In 1998, the City of Apache Junction issued a \$9,965,000 bond to use towards both street and non-street improvement activities. However, while the City earmarked \$6,000,000, or approximately 60 percent, of the bond for street improvement activities during fiscal years 1999 and 2000, the City allocated more than 60 percent of the bond’s debt service payments to its HURF account, which includes transportation excise tax and HURF monies.

Effect: Because the relevant statute restricts the use of transportation excise tax and HURF monies to highway, street, and/or transportation purposes, the City’s current allocation of debt service payments indicates that these monies are paying for non-street improvement activities.

3.2 The Town of Kearny transferred funds restricted for street purposes to its General Fund.

Recommendation: KPMG recommends that the Town of Kearny develop a methodology to allocate overhead costs to its HURF account. ***Condition:*** During fiscal years 1998, 1999, and 2000, the Town of Kearny transferred \$177,445, \$178,000, and \$180,000, respectively, from its HURF account to cover overhead expenditures, as well as salaries and benefits of Public Works employees incurred by the General Fund on behalf of the HURF. ***Cause:*** While it is not an

uncommon practice among Pinal County’s eight incorporated cities and towns to make similar transfers, Kearny estimates the transfer amounts and retains no documentation to support these transfers. **Effect:** Since the Town cannot substantiate the amounts it transfers from its HURF account to the General Fund, Kearny may potentially over allocate overhead costs to this fund.

3.3 Two municipalities used road-related monies to finance purchases which are not an allowable use of such funds.

Recommendation: KPMG recommends that the Town of Kearny and the City of Apache Junction repay borrowed road monies. **Condition:** KPMG found documentation that the Town of Kearny used HURF monies to purchase a street plaque. In addition, the City of Apache Junction allocated funds from its HURF account to pay for United States postage expenses.

Cause: While meeting minutes indicate that the town council of Kearny approved the aforementioned purchase, this approval violated the expenditure use of HURF revenues. The City of Apache Junction committed an error when it charged \$2,000 in postage to its HURF.

Effect: The aforementioned municipalities did not comply with statutes governing the use of road-related monies.

Chapter 1: Introduction and Methodology

Introduction

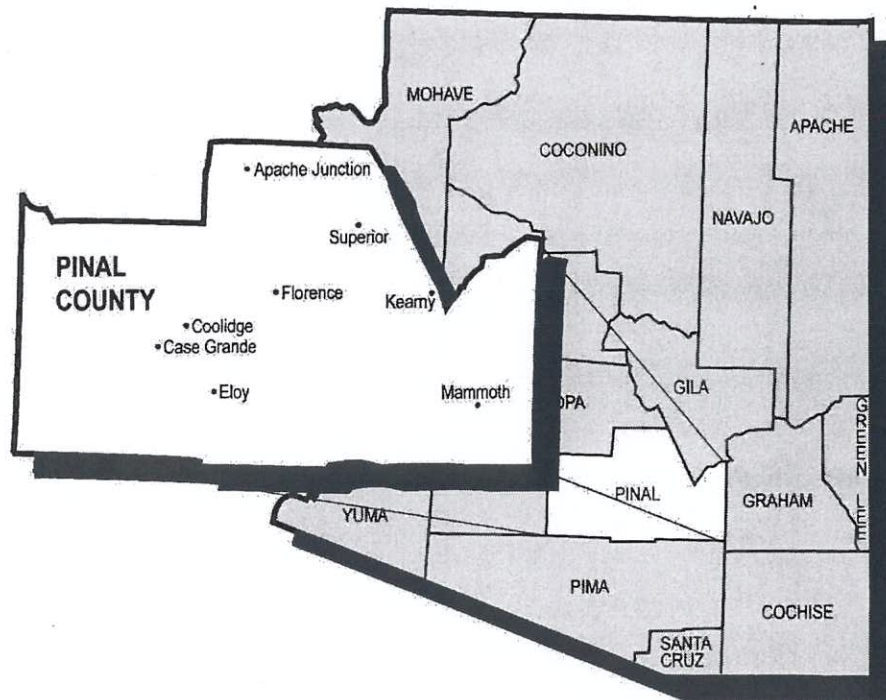
On February 2, 2001, Arizona’s Office of the Auditor General (OAG) contracted with KPMG LLP (KPMG) to conduct a performance audit of the Pinal County Transportation Excise Tax for the fiscal years 1998 through 2000. The purpose of this audit was to assess the management performance of Pinal County, and the eight incorporated cities and towns within the County, regarding the transportation excise tax, review specific areas identified through interviews with various interested parties, address statutorily mandated questions, and recommend any areas for improvement. The audit was conducted under the authority vested in the Auditor General by Arizona Revised Statutes (A.R.S.) §41-1279.03 and pursuant to a June 16, 1999 resolution of the Joint Legislative Audit Committee.

Project Background

In 1986, the residents of Pinal County voted to pass a half-cent sales tax to “provide additional funding for the construction, reconstruction, maintenance, repair, and roadside development of County, city, and town roads, streets, and bridges.” The twenty-year tax became effective January 1, 1987. From fiscal year 1998 through fiscal year 2000, the excise tax has generated \$17,750,079 in revenues for roads, highways, and bridges in the County. This revenue is shared between 8 incorporated cities and towns and Pinal County (see Figure 1), which maintains responsibility for

Figure 1

Pinal County and Incorporated Cities/Towns

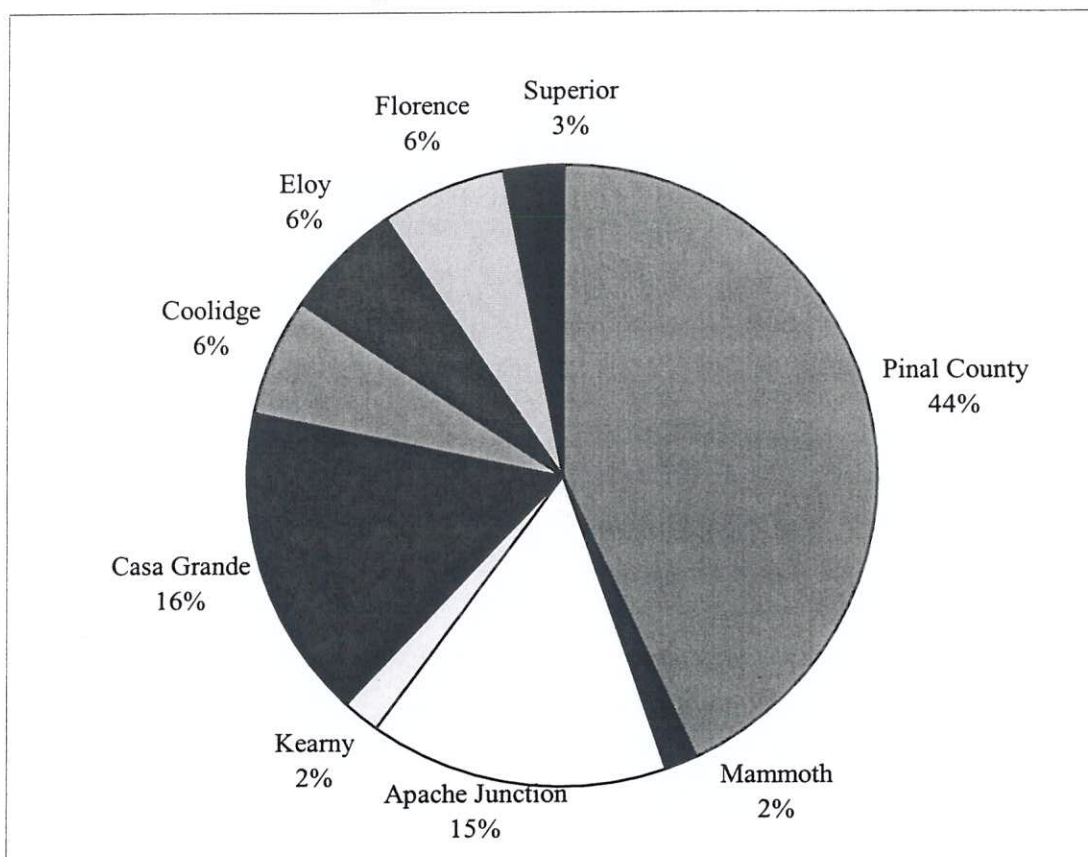


Source: Arizona Department of Commerce.

unincorporated roads. The tax is distributed to each entity according to a population-based formula. As noted in Figure 2 (page 8), cities and towns currently receive 56

percent of the excise tax revenue, while the County receives the remaining 44 percent.

Figure 2
Transportation Excise Tax Distributions



Source: Pinal County Treasurer’s Office.

During this engagement, KPMG devised an approach to facilitate the following:

- Identify opportunities for improvement related to management, use of resources, processes, and outcomes;
- Provide reasonable recommendations and a high-level action plan that outlines the steps necessary to implement the recommendations;
- Transfer knowledge from the KPMG team to the State, Pinal County, and its incorporated cities/towns to promote continuous improvements in their operations, and
- Work with management and other key leaders to ensure understanding, acceptance, and support of project recommendations.

To conduct the performance audit of Pinal County’s transportation excise tax, KPMG recommended, and employed, a three-phased approach. While the first phase consisted of strategies designed to establish a clear understanding of roles,

project objectives, and expectations, the second phase included techniques to evaluate the use of the transportation excise tax monies by Pinal County and its incorporated cities/towns. The final phase entailed the compilation of detailed findings and recommendations. In each phase, analytical techniques were selected (see Methodology section) to assess the management performance of Pinal County and its incorporated cities/towns regarding the transportation excise tax.

Methodology

Performance Audit Approach and Methodology

In the execution of the audit's work plan, KPMG employed the following methodologies:

- **Focus Interviews.** KPMG conducted over 25 focus interviews of State of Arizona, Pinal County, and city/town municipal leadership most familiar with the accrual and disposition of funds generated by the transportation excise tax, as well as those individuals involved in the municipal transportation planning process. These interviews allowed KPMG to gain an understanding of each municipality's business processes, organizational structure, operating policies, job responsibilities, and organizational climate.
- **Document Review.** KPMG reviewed numerous documents from fiscal year 1998 through fiscal year 2000 to assess each municipality's activities, processes, costs, and structure. Example documentation reviewed included the following: organizational charts, United States Census information, Pinal County Board of Supervisors/city/town council meeting minutes, budget reports, Comprehensive Annual Financial Reports (CAFRs), five-year transportation plans, street and capital improvement plans, transportation-related vendor contracts, and transportation excise tax revenue and expenditure data.
- **Population Figure Review.** KPMG documented the methodology associated with the population figures used to distribute the excise tax and verified the accuracy of those figures since the OAG's March, 1998 performance audit report.
- **Post Implementation Review.** KPMG examined the implementation status of recommendations from the OAG's March, 1998 performance audit report of Pinal County's transportation excise tax.
- **Excise Tax Revenue and Expenditure Assessment.** KPMG assessed excise tax revenue and expenditure data between fiscal years 1998 through 2000 to ensure that Pinal County and its eight incorporated cities/towns used excise tax monies for highway, street, and transportation-related purposes.
- **Functional Analysis.** KPMG examined the transportation planning process for Pinal County, as well as its incorporated cities and towns to identify and inventory the specific activities performed during this process. Specifically, KPMG mapped the operational relationship of Pinal County's transportation planning and competitive bidding processes.
- **Excise Tax Impact Analysis.** KPMG conducted an impact analysis to document the effect of the transportation excise tax on each entity's transportation-related activities since the OAG's March, 1998 performance

audit report.

- **Competitive Bidding Statute Review.** KPMG assessed the compliance of Pinal County to applicable State of Arizona statutes governing the competitive bidding process. KPMG reviewed all 12 transportation projects outsourced by Pinal County’s Public Works Department to private sector vendors using transportation excise tax monies between fiscal years 1998 through 2000.

Constraints and Limitations

Constraints and limitations present special factors that should be considered in the interpretation of the performance audit results. In the execution of the performance audit, KPMG followed generally accepted government audit standards as set forth in the General Accounting Office’s Government Auditing Standards or, the “Yellow Book.”

Report Organization

KPMG organized the report for the Performance Audit of the Pinal County Transportation Excise Tax in the following manner:

- **Executive Summary:** summarizes key findings and recommendations associated with the management performance of Pinal County, and its eight incorporated cities, regarding the transportation excise tax.
- **Introduction and Methodology:** describes the performance audit scope, approach, and methodology used to conduct fieldwork activities, as well as limitations and constraints pertinent to interpretations of the performance audit findings.
- **Transportation Excise Tax Update:** provides an overview of the transportation excise tax since the OAG’s March, 1998 performance audit report including an update on tax recipients, revenue projections, project selection processes, use of excise tax revenues, and impact of the tax.
- **Transportation Excise Tax Findings:** identifies the observations, findings, and recommendations associated with the review of the Pinal County transportation excise tax between fiscal years 1998 through 2000.
- **Appendices:** presents the engagement scope questions and responses, as well as responses to the final report received from Pinal County and its eight incorporated cities and towns.

Chapter 2: Transportation Excise Tax Update

Introduction

This chapter provides an update of the management performance of the transportation excise tax since the OAG’s March, 1998 report and highlights information learned during KPMG’s focus interviews, document review, population figure review, functional analysis, excise tax impact analysis, and competitive bidding statute review. As this chapter only provides an overview of the transportation excise tax’s performance, KPMG does not present any findings or recommendations in this chapter of the report.

Recipient Information

Population figures drive excise tax revenues

Pinal County and its eight incorporated cities and towns rely on revenue from several sources to fund their road projects. The primary, stable sources of road funding consistently received by the entities include monies from the transportation excise tax, the Highway User Revenue Fund (HURF), and the Local Transportation Assistance Fund (LTAF).¹ The HURF, which derives its revenue from a statewide gasoline tax and the Vehicle Licensing Tax, is the largest of these three sources of transportation funding. The state shared lottery revenue funds the LTAF, and it is the smallest stable source of transportation funding. Table 1 highlights the fiscal year 2000 distribution of primary, stable road funding for each entity.

Table 1
Pinal County Transportation Excise Tax Recipients
Year Ended June 30, 2000
(Unaudited)

Excise Tax Recipient	1990 Population	Miles Maintained	Excise Tax Distribution	Primary, Stable Road Funding
Pinal County (unincorporated)	50,143	2,192	\$ 2,815,883	\$ 13,427,386
Casa Grande	19,015	236	\$ 1,071,970	\$ 3,297,435
Apache Junction	17,931	185	\$ 1,007,259	\$ 3,175,398
Florence*	11,390	55	\$ 421,598	\$ 1,639,802
Coolidge	7,871	50	\$ 388,916	\$ 1,137,585
Eloy	7,211	117	\$ 405,257	\$ 1,316,862
Superior	3,468	19	\$ 194,785	\$ 561,151
Kearny	2,262	11	\$ 126,806	\$ 374,022
Mammoth	1,845	9	\$ 103,929	\$ 312,239
Total	121,136	2,874	\$ 6,536,403	\$ 25,241,880

* The population figure for Florence reflects the results of the special census commissioned by the Town in 1995.

Source: The mileage information was obtained from the Arizona Department of Transportation (ADOT). Excise tax distribution and population figures were obtained from the Pinal County Treasurer’s Office. Primary, stable road funding was determined through KPMG analysis of each entity’s financial statements and other financial information.

The Transportation Excise Tax is a ½ cent sales tax levied in Pinal County. The Arizona Department of Revenue (ADOR) collects these revenues in conjunction with the monthly state sales tax filings. All of the revenues are then handed over to the Pinal County Treasurer’s Office, which is charged with distributing them to each

¹ As documented in the OAG’s March, 1998 report, “primary stable road funding is defined as revenue, excluding grants, that has been consistently received.”

municipality within the County based on the population figures per the most recent United States Census. The Pinal County Treasurer’s Office distributes excise tax monies monthly to each municipality.

Revenue Projections

Forecasts still falling short

Similar to information conveyed three years ago, transportation excise tax revenues continue to fall short of initial projections. Specifically, the OAG noted the following in its March, 1998 performance audit report on the Pinal County transportation excise tax:

The tax has not generated as much additional revenue as anticipated. While the tax was estimated to generate between \$125 million to \$200 million before it expires in 2006, actual revenues have fallen short of projected revenue by at least \$1 million each year since 1988 and over \$2 million each year since 1993. Consequently, to date, the tax has yielded only 65 percent of original projections.²

In fact, since the OAG’s March, 1998 report, the disparity between estimated revenue and actual revenue has increased. Table 2 illustrates the variance between estimated and actual transportation excise tax revenues generated between fiscal years 1998 through 2000.

Table 2
Estimated Versus Actual Transportation Excise Tax Revenues
Years Ended June 30, 1998 through 2000

Fiscal Year	Estimated Revenues	Actual Revenues
1998	\$9,275,000	\$5,215,841
1999	\$10,136,000	\$5,997,836
2000	<u>\$11,075,000</u>	<u>\$6,536,402</u>
Total	\$30,486,000	\$17,750,079

Source: Estimated figures per the Publicity Pamphlet compiled and issued by the Pinal County Board of Supervisors pursuant to the November 4, 1986 Special Election. Actual excise tax revenue figures per the Pinal County Treasurer’s Office.

As evidenced in Table 2, between fiscal years 1998 through 2000, actual transportation excise tax revenues fell short of the Pinal County Board of Supervisors’ 1986 projections by approximately 42 percent.

Project Selection Processes

Number of road miles within each community influences the processes used to identify, prioritize, and fund road projects

Although the transportation excise tax continues to generate less revenues than was originally anticipated in 1986, Pinal County and each of its eight incorporated cities and towns annually identify road projects for funding using excise tax monies.

² State of Arizona, Office of the Auditor General, Performance Audit report on the Pinal County Transportation Excise Tax, March, 1998.

Despite the existence of project selection processes within each tax recipient’s Public Works Department, the approaches used by the communities to identify street and highway projects vary significantly. For instance, as noted in Table 1 (page 12), the Town of Superior annually sustains a total of 19 road miles. While the Town itself currently maintains no formal mechanism to outline transportation project needs or priorities (i.e., transportation plans), the Town’s Public Works Director indicated that the Central Arizona Association of Government’s (CAAG) “Five Year Transportation Plan” identifies Superior’s road needs. Informally, much of the Town’s road work arises from public comment to the Public Works office. In addition to public comment regarding street needs, Superior’s Public Works Director also periodically surveys the Town’s roads, via town vehicle, to assess their quality. Although an informal methodology, the Town of Superior’s project planning process appears to successfully identify and prioritize road projects.

A somewhat larger municipality than the Town of Superior, the City of Apache Junction employs a more sophisticated, yet equally successful, project planning process to maintain its 185 road miles. Specifically, Apache Junction’s Public Works Department recently began using a computer software application that compiles a master-rating of every street within the City. According to the City’s Public Works Director, this program divides all of Apache Junction’s streets into sections (n=770, currently), outlines the classifications of each road (i.e., length of street section, curbs, sidewalks, etc.), and inventories such things as the date the section was last maintained and the type of activities performed, etc. Combined with other factors such as citizen input, the use of this computer program facilitates the City’s ability to track road improvements and also helps the City assess road needs.

The largest of all transportation excise tax recipients, Pinal County maintains over 2,000 road miles. The County’s Public Works Department prioritizes road projects according to a Five-Year Transportation Improvement Plan developed by citizen Transportation Advisory Committees (TACs) in each of the County’s three districts. Annually, the three TACs each produce a *recommended* Five-Year Transportation Improvement Plan that lists road project priorities based upon staff and public input, and a road tour of each particular district. Also, the TACs organize a series of public meetings throughout their districts to obtain additional community input regarding the area’s road needs. Finally, the County’s Board of Supervisors regularly review, revise and approve each TAC’s transportation improvement plan to authorize final road project funding.

Use of Excise Tax Revenues

Pinal County

Pinal County generally earmarks excise tax monies for new roadway construction and major road reconstruction projects

As part of its project selection process, Pinal County’s Public Works Director explained that the County typically allocates the revenue received via the transportation excise tax to road construction, or reconstruction, endeavors, while HURF monies generally fund road maintenance activities such as crack sealing. Although the Public Works Department employs staff to perform road construction/reconstruction in-house, according to the Public Works Director, the Department outsources some projects depending on their size. Table 3 (page 15) illustrates some of the road projects completed by Pinal County using transportation excise tax monies.

Table 3
Examples of Pinal County Road Projects
Funded with Transportation Excise Tax Monies
Years Ended June 30, 1998 through 2000

Project Location	Project Description	Project Cost
Battaglia Drive – SR 84 to Sunshine Blvd	Remove and reconstruct (widen) this existing stretch of Battaglia Drive.	\$267,435
Farrell Road – Warren Road to Ralston Road	New construction – Rip existing roadway eight inches and recompact subgrade 95 percent minimum.	\$198,321
Guinn Drive – SR 84 to Peters Road	New construction of an existing unpaved road.	\$315,366

Source: Pinal County, Department of Public Works' project records.

Pinal County spent a significant portion of its excise tax revenues during fiscal years 1998 through 2000

According to the Pinal County Treasurer's Office, between fiscal years 1998 through 2000, Pinal County received \$7,646,735 in transportation excise tax revenues. A review of road projects during that same time-frame revealed that the County completed 63 road-related endeavors using a total of \$7,262,139 or 95 percent of its excise tax revenues.

Additionally, of the 63 road projects completed by Pinal County during fiscal years 1998 through 2000, 18 involved pavement preservation and maintenance-type activities, while 45 involved new construction or reconstruction activities. In fact, the 45 new construction/reconstruction projects accounted for \$5,295,723, or 73 percent, of the \$7,262,139 Pinal County spent of its transportation excise tax during fiscal years 1998 through 2000.

Cities and towns use transportation revenues for a variety of road-related projects

Cities and Towns

While Pinal County spent more than 70 percent of its excise tax revenues on new road construction or reconstruction, the eight incorporated cities and towns tend to disperse their road monies on a array of transportation-related matters. Table 4 (page 16) highlights the chief use of transportation-related monies by each of Pinal County's eight incorporated cities and towns.

Some cities and towns commingle their road monies

As noted in the OAG's March, 1998 report, and as previously explained in Table 1 (page 12), the eight incorporated cities and towns within Pinal County receive three primary, stable sources of road revenue statutorily restricted for highway, street, and/or transportation purposes. While we were able to physically track the separate revenues received by each entity, several of the cities and towns commingle at least two of the three aforementioned revenue sources. Only the City of Coolidge and the

Table 4
Major City and Town Activities
Funded with Transportation-Related Monies
Years Ended June 30, 1998 through 2000

Municipality	Major Road-Related Activities
Apache Junction	Road paving.
Casa Grande	Widening and reconstruction of roads.
Coolidge	Road repairs and purchases of road-related vehicles (i.e., front-end loaders, dump trucks, etc.).
Eloy	Road paving (rejuvenate).
Florence	Road reconstruction and resurfacing and installation of curbs, gutters, sidewalks, and street lights/signs. Purchases of road-related vehicles.
Kearny	Sealing road cracks, filling potholes, replacing street/stop signs, and speed hump installations.
Mammoth	Road maintenance and purchases of road-related equipment.
Superior	Road maintenance (i.e., sealing road cracks, filling potholes, etc.).

Source: KPMG analysis of interviews with city and town Public Works Directors, city and town road project data, and city and town council meeting minutes.

Town of Superior maintain distinct funds for each road revenue source. The other six municipalities combine their excise tax monies with at least one other revenue source. Similar to the OAG's March, 1998 report, our expenditure review included all three sources of road revenue since it was not possible to determine exactly what expenditures were paid with excise tax monies versus HURF or LTAF dollars.

Cities and towns are expending a significant portion of their road-related revenues

During fiscal years 1998 through 2000, the eight incorporated cities and towns within Pinal County expended large portions of road-related revenues derived from transportation excise tax, HURF, and LTAF monies. Specifically, as noted in Table 5 (page 17), the eight municipalities expended between 62 and 149 percent of the road-related revenues received. The cities and towns which had expended lower percentages of their transportation related budgets indicated that they were in the process of accumulating their resources over a period of time in order to be able to complete larger construction projects than they would be able to undertake using their annual road related revenues alone. KPMG noted that some municipalities had expended more than 100 percent of their transportation related revenues during the three-year period under audit. These municipalities had previously accumulated resources and were in the process of spending down those fund balances on large road-related construction projects during the three-year period ended June 30, 2000. In some cases, as noted in Table 5 (page 17), it was impossible to determine whether transportation excise tax monies had remained unspent since the accounting practice of pooling all road related monies in one fund restricted the analysis to a higher level.

Table 5
Comparison of City and Town Road-Related Expenditures
As a Percent of Road-Related Revenues
Years Ended June 30, 1998 through 2000

Municipality	Road-Related Revenues	Road-Related Expenditures ^a	Percent of Road-Related Revenues Expended
Apache Junction	\$8,063,367 ^b	\$9,849,410 ^b	122%
Casa Grande	\$8,924,913 ^c	\$8,481,565 ^c	95%
Coolidge	\$1,086,814 ^d	\$687,915 ^d	63%
Eloy	\$3,678,799 ^c	\$2,480,448 ^c	67%
Florence	\$4,394,298 ^e	\$5,793,358 ^e	132%
Kearny	\$998,556 ^b	\$1,486,806 ^b	149%
Mammoth	\$860,530 ^c	\$536,654 ^c	62%
Superior	\$529,460 ^d	\$669,836 ^d	127%

- a Includes road-related expenditures, transfers out (i.e., transfers made from one fund to another fund for such things as transportation-related debt service payments on public bonds, etc.), and capital outlay (i.e., large transportation-related projects often involving construction over more than one financial reporting period).
- b Includes transportation excise tax and HURF monies.
- c Includes transportation excise tax, HURF, and LTAF monies.
- d Includes transportation excise tax monies.
- e Includes transportation excise tax, HURF, and LTAF monies in fiscal years 1998 and 1999, and transportation excise tax and HURF monies in fiscal year 2000.

Source: KPMG analysis of each municipalities' comprehensive annual financial reports.

Impact of Excise Tax

Road improvements would suffer or cease without excise tax revenues

Although the transportation excise tax revenues have fallen short of original projections, they have been a valuable source of road-related monies for Pinal County and each of its eight incorporated cities and towns. Specifically, Public Works Directors commented on the fact that transportation excise tax revenues have served as important supplements to their street budgets during the last thirteen years. In addition, several Public Works Directors from the smaller municipalities indicated that they would be unable to continue street improvements in the absence of transportation excise tax monies. For example, the City of Apache Junction's Public Works Department indicated that prior to the passage of the transportation excise tax in 1987, the City promised voters that it would use excise tax dollars to pave at least one mile of unpaved road in the City each year. While Apache Junction has used the excise tax money to accomplish this task, the City's Public Works Director indicated that without the excise tax such annual road paving endeavors might cease. In addition, Pinal County's Public Works Director furthered this sentiment by suggesting that the County could not afford to build new roads without the transportation excise tax.

Table 6 (page 18) shows the percentage transportation excise tax revenues represented of the total road related revenue available to the County and each

municipality during the year ended June 30, 2000.

Table 6
Transportation Excise Tax Revenues
As a Percent of Road-Related Revenues
Year Ended June 30, 2000

Municipality	Excise Tax as a Percentage of Total Road Revenue
Pinal County	22%
Apache Junction	34%
Casa Grande	34%
Coolidge	35%
Eloy	31%
Florence	27%
Kearny	34%
Mammoth	34%
Superior	36%

Source: Excise Tax revenue data obtained from the Pinal County Treasurer's Office. Highway User Revenue Fund and Local Transportation Assistance Fund data obtained from the Arizona State Treasurer's Office.

Chapter 3: Transportation Excise Tax Findings

Chapter Overview

This chapter outlines KPMG’s analysis of the management performance of Pinal County and the eight incorporated cities and towns within the County regarding the transportation excise tax. This chapter highlights key findings and recommendations learned during KPMG’s focus interviews, document review, post-implementation review, excise tax revenue and expenditure assessment, and functional analysis.

Finding 3.1 The City of Apache Junction allocated an excessive portion of its debt service payments to its HURF account, which includes transportation excise tax and HURF monies.

Current Condition 3.1

While the City of Apache Junction issued a bond in 1998 to pay for street and non-street improvements, during fiscal years 1999 and 2000, the City disproportionately charged its HURF account to pay the bond’s debt service payments. Specifically, the City issued a Series 1998 Municipal Property Corporation Municipal Facilities Revenue Bond for \$9,965,000 to pay costs associated with street, and non-street, enhancements. According to the bond’s official issue statement, \$6,000,000 (or approximately 60 percent) of the bond’s \$9,965,000 proceeds were earmarked to construct new streets and make street improvements.

In order to make the debt service payments on the \$6,000,000 allocated for street construction/improvements, the City uses monies from its HURF account. While Apache Junction’s HURF account consists of transportation excise tax and HURF revenues, Arizona’s Constitution specifies the authorized uses of road-related monies like the excise tax and HURF. As noted in the OAG’s March, 1998 report, “A.R.S. §28-6533 stipulates that HURF monies may only be expended for highway and street purposes as prescribed in Article IX, §14 of the Constitution of Arizona, which include *“costs of rights-of-way acquisitions and expenses related thereto, construction, reconstruction, maintenance, repair, roadside development, of county, city, and town roads, streets, and bridges and payment of principal and interest on highway and street bonds.”*³

Although Arizona’s Constitution permits use of road-related revenues to make debt service payments on highway and street bonds, the City improperly applied the ratio to make these payments from streets and non-streets related funds during fiscal years 1999 and 2000. As previously noted, the street-related portion of the 1998 Series bond accounted for 60 percent of the bond, while the remaining 40 percent of the bond was earmarked for non-street purposes. Instead of using a similar 60:40 ratio to apply the percent of debt service payments required to receive funding from the City’s street-related versus non-street related accounts, the City charged the HURF account upwards of 78 percent of the bond’s debt service payments. Had the City allocated its debt service payments between street-related and non-street-related funds using the 60:40 ratio to raise the Series 1998 bond monies, approximately 60 percent of the debt service payments should have been charged to the HURF account, while the other 40 percent should be charged to other funds.

³ State of Arizona, Office of the Auditor General, Performance Audit report on the Pinal County Transportation Excise Tax, March, 1998.

Impact of Current Condition 3.1

Given the allocation of debt service payments on the 1998 Series bond for street and non-street related activities, the City of Apache Junction appears to have violated Arizona statutes regarding the use of road-related monies. While revenues from the transportation excise tax and HURF comprise the City's HURF account, and statute restricts the use of such road-related monies to highway, street, and/or transportation purposes, the City's current allocation of debt service payments indicates that these monies are paying for non-street improvement activities.

Improperly applying the 1998 Series bond's debt service payments resulted in \$173,115 in overcharges to the City's HURF account during fiscal years 1999 and 2000. An actual 60:40 ratio of streets to non-streets debt service payments would result in a charge of \$1,487,592 to City's HURF account. However, in actuality the City's 78:22 ratio of debt service payments resulted in the a \$1,660,707 charge to the HURF account, a difference of \$173,115 across fiscal years 1999 and 2000.

Recommendation 3.1

KPMG recommends that the City of Apache Junction recalculate the amount of money charged to the HURF account for debt service payments for the Series 1998 bonds in a manner reflecting the ratio in which the money raised from the issuance of those bonds was used.

In addition, the City should repay its HURF account \$173,115, the amount of money that was disproportionately charged to it during fiscal years 1999 and 2000.

Finding 3.2 The Town of Kearny transferred funds restricted for street purposes to its General Fund.***Current Condition 3.2***

The Town of Kearny recorded 'Operating Transfers Out' of its HURF account in the amount of \$180,000 in fiscal year 2000, \$178,000 in fiscal year 1999 and \$177,445 in fiscal year 1998. The HURF account includes Transportation Excise Tax monies. Per Kearny's Town Manager, these transfers cover overhead expenditures, and salaries and benefits of Public Works employees incurred by the General Fund on behalf of the HURF. The Town's management estimates the amounts of these transfers annually, and retains no supporting documentation for them.

Impact of Current Condition 3.2

Since the Town cannot substantiate the amounts charged to its HURF account for the expenses previously listed, KPMG could not determine whether such expenses appear reasonable. Consequently, the Town may potentially be over-allocating such costs to this account.

Recommendation 3.2

KPMG recommends that the Town of Kearny develop a reasonable methodology to appropriately allocate costs to its HURF account and apply that methodology consistently during future fiscal years.

Finding 3.3 Two municipalities used road-related monies to finance purchases which is not an allowable use of such funds.

Current Condition 3.3

Two of Pinal County’s municipalities used road-related monies for purchases which is not an allowable use of such funds. While reviewing the expenditure of transportation excise tax dollars, KPMG found that the Town of Kearny used HURF monies to purchase a street plaque. In addition, the City of Apache Junction allocated \$2,000 from its HURF account for United States postage.

Town of Kearny

The Town of Kearny inappropriately expended HURF monies. As previously noted in Finding 3.2, HURF monies may only be expended for highway and street purposes as prescribed in Article IX, §14 of the Constitution of Arizona, which include “*costs of rights-of-way acquisitions and expenses related thereto, construction, reconstruction, maintenance, repair, roadside development, of county, city, and town roads, streets, and bridges and payment of principal and interest on highway and street bonds.*”⁴ According to the Town of Kearny’s August 9, 1999 Town Council meeting minutes, the Town Council approved a HURF expenditure of \$1,000 for a street plaque dedicating a town street. The street plaque simply recognized a change in an existing road’s name and did not include any road construction, reconstruction, maintenance, repair, or roadside development. Consequently, this purchase does not meet the HURF requirements set forth by Arizona’s statute or Constitution.

City of Apache Junction

The City of Apache Junction allocated, and spent, \$2,000 from its HURF for U.S Postage during fiscal year 1999. The City’s Finance Director indicated that this expenditure had been charged to the HURF in error. Although some postage charges may be considered an appropriate part of an overhead allocation to the HURF, the City does not currently have an overhead allocation methodology governing such charges.

Impact of Current Condition 3.3

Arizona statutes explicitly limit expenditures of HURF monies for highway, street, and transportation purposes. However, the purchases noted previously by the Town of Kearny and the City of Apache Junction did not meet the State’s expenditure standards. As a result, the aforementioned municipalities did not comply with statutes governing the use of road-related monies.

Recommendation 3.3

To comply with statutory requirements, KPMG recommends that the Town of Kearny and the City of Apache Junction repay inappropriately used road monies.

⁴ Ibid.

Chapter 4: Appendices

Appendix A: Engagement Scope Questions & Responses

Engagement Scope Questions & Responses

To assess the management performance of Pinal County (and its eight incorporated cities and towns) regarding the transportation excise tax, the OAG directed KPMG to address the following 13 specific questions and issues of concern:

1. **As required by state statute A.R.S. §41-1279.03(A)(6)(a): review “past expenditures and future planned expenditures of the transportation excise tax and determine the impact of the expenditures in solving transportation problems within the county.”**

Please see “Engagement Scope Questions and Responses” number 8, pages 27 and 28.

2. **As required by state statute A.R.S. §41-1279.03(A)(6)(b): review “projects completed to date and projects to be completed during the remaining years in which the transportation excise tax is in effect.”**

KPMG reviewed the projects completed to-date, and the projects to-be-completed, during the remaining years of the transportation excise tax for Pinal County and its eight incorporated municipalities. To accomplish this, KPMG performed the following tasks:

- Obtained and reviewed projects completed from fiscal year 1998 through 2000 for the County and each city/town;
- Requested and reviewed future project information (i.e., Five-year transportation plans, etc.) from the County and each city/town, and
- Interviewed County/city/town transportation officials about additional planned projects not included in transportation plans.

KPMG noted that the County tends to allocate the revenues received via the transportation excise tax to road construction and reconstruction projects (see pages 14 and 15, Table 3, page 15). On the other hand, the County’s eight incorporated cities and towns tend to disperse road monies on an array of transportation-related matters, including road paving, road maintenance, and purchases of road-related vehicles (i.e., dump trucks, front-end loaders, etc.) (see pages 15 and 16, Table 4, page 16).

In addition to the aforementioned completed projects involving transportation excise tax revenues, Pinal County and its eight incorporated municipalities have earmarked several future projects for transportation excise tax monies. For example, the City of Apache Junction plans on using excise tax monies to continue paving at least one mile of road each year. In addition, the Town of Florence anticipates using its excise tax revenue to continue the reconstruction of roads to remedy drainage issues in several residential neighborhoods.

3. **Review and comment on the status of implementing the recommendations contained in the 1998 audit report.**

During the previous audit in March 1998, the OAG found that the City of Eloy and the Town of Mammoth established inter-fund loans to funds with non-road purposes, despite statutory restrictions regarding the use of transportation excise tax, HURF,

and LTAF monies. In its report, the OAG noted that Eloy owed \$419,150 and Mammoth owed \$24,429 to their respective HURFs. To remedy these transgressions, the OAG's March, 1998 performance audit report recommended that the two municipalities repay inappropriately borrowed road monies.

In an attempt to verify the repayment of the borrowed monies, KPMG interviewed officials from both municipalities, consulted with Eloy's current, and Mammoth's current and former external auditors, examined General Ledger journal entries, and reviewed each entity's annually audited financial statements. The following provides an overview of this review:

Town of Mammoth - KPMG determined that, for financial reporting purposes, a journal entry was prepared to report a loan from the HURF in the amount of \$24,429 to eliminate other funds' cash deficits. At the time the loan was booked, however, ample monies were available in other Town funds, thereby making a loan from the HURF unnecessary. This practice was discontinued in subsequent years and accordingly HURF monies were no longer reported as being lent to other funds.

City of Eloy - Similar to the Town of Mammoth's circumstance, a journal entry was prepared for financial reporting purposes to reflect a loan from the HURF to other funds. In the case of the City of Eloy, however, other monies were not available and as such road monies were expended by other funds for other than road-related purposes. By June 30, 2000, however, sufficient monies were available to finance the activities of other city funds and road monies were no longer used for non-road purposes. Accordingly no further amounts are owed to the HURF from other funds.

4. Review and report on the accuracy of the population figures used to distribute the excise tax.

KPMG noted that the population figures used to distribute Pinal County's transportation excise tax revenues have not changed since the OAG's March, 1998 report, except for the figures representing the Town of Florence's population. Florence's figures increased from 7,510 in the OAG's March, 1998 report to 11,390 as a result of a 1995 special census.

5. Determine how much money the excise tax generated since the OAG's 1998 report (Report Number 98-8) and how accurate the excise tax revenue estimates have been since the 1998 report.

From fiscal year 1998 through fiscal year 2000, Pinal County's transportation excise tax has generated \$17,750,079 in revenues for roads, highways, and bridges in the County. However, similar to information conveyed in the OAG's March, 1998 report, transportation excise tax revenues continue to fall short of initial projections. Specifically, while the excise tax was estimated to generate \$30,486,000 between fiscal years 1998 and 2000, the actual revenue generated during this time period only totaled \$17,750,079 (see Table 2, page 13).

6. Review and report on the process used to recommend and select transportation projects for funding and identify any recommendations for improvement.

KPMG's review of the project selection processes employed by each community determined that the approaches used vary significantly between the informal to the

formal. The following examples illustrate the differences among entities:

- **Town of Superior** – While the Town itself currently maintains no formal mechanism to outline transportation project needs or priorities (i.e., transportation plans), the Town’s Public Works Director indicated that the Central Arizona Association of Government’s (CAAG) “Five Year Transportation Plan” identifies Superior’s road needs. Public comment to the Town’s Public Works office augments the CAAG plan. In addition to public comment regarding street needs, Superior’s Public Works Director also periodically surveys the Town’s roads, via town vehicle, to assesses their quality. Although an informal methodology, the Town of Superior’s project planning process appears to successfully identify and prioritize road projects.
- **City of Apache Junction** – The City’s Public Works Department recently began using a software application that compiles a master-rating of every street within the City. According to the City’s Public Works Director, this program divides all of Apache Junction’s streets into sections (n=770, currently), outlines the classifications of each road (i.e., length of street section, curbs, sidewalks, etc.), and inventories such actions as the date the section was last maintained and the type of activities performed, etc. Combined with other factors such as citizen input, the use of this computer program facilitates the City’s ability to track road improvements and also helps the City assess road needs.
- **Pinal County** –The County’s Public Works Department prioritizes road projects according to a Five-Year Transportation Improvement Plan developed by citizen Transportation Advisory Committees (TACs) in each of the County’s three districts. Annually, the three TACs each produce a *recommended* Five-Year Transportation Improvement Plan that lists road project priorities based upon staff and public input, and a road tour of each particular district. Also, the TACs organize a series of public meetings throughout their districts to obtain additional community input regarding the area’s road needs. Finally, the County’s Board of Supervisors regularly review, revise and approve each TAC’s transportation improvement plan to authorize final road project funding (see pages 13 and 14).

7. Determine how the excise tax revenues have been used by the county and the cities/towns.

As part of its project selection process, Pinal County’s Public Works Director explained that the County typically allocated the revenue received via the transportation excise tax to road construction, or reconstruction, endeavors during fiscal years 1998 through 2000 (see page 14, and Table 3, page 15).

On the other hand, Pinal County’s eight incorporated cities and towns tended to expend their road monies on a array of transportation-related matters, such as road paving, purchases of road-related vehicles (i.e., front-end loaders, dump trucks, etc.), and road maintenance (see page 15, and Table 4, page 16).

8. Determine how the excise tax has impacted the funding of road projects.

The transportation excise tax revenues have been a valuable source of road-related monies for Pinal County and each of its eight incorporated cities and towns. Specifically, Public Works Directors commented on the fact that transportation

excise tax revenues have served as important supplements to their street budgets during the last thirteen years. In addition, several Public Works Directors from the smaller municipalities indicated that they would be unable to continue street improvements in the absence of transportation excise tax monies. For example, the City of Apache Junction's Public Works Department indicated that prior to the passage of the transportation excise tax in 1987, the City promised voters that it would use excise tax dollars to pave at least one mile of unpaved road in the City each year. While Apache Junction has used the excise tax money to accomplish this task, the City's Public Works Director indicated that without the excise tax such annual road paving endeavors might cease. In addition, Pinal County's Public Works Director furthered this sentiment by suggesting that the County could not afford to build new roads without the transportation excise tax (see page 17).

9. Consistent with the 1998 report, calculate the percentage of additional monies expended.

KPMG analyzed the annual financial reports of each auditee in order to determine the percentage of transportation excise tax revenues expended during the three fiscal years ended June 30, 2000. Due to the common accounting practice of pooling transportation related revenues from various sources into one fund, KPMG was unable to restrict this analysis to only transportation excise tax monies. KPMG included all road related revenues in this analysis for Towns and Cities which pool their transportation revenues into one fund (see Table 5, page 17).

10. Determine whether the excise tax monies have been used appropriately.

KPMG noted that a couple of purchases made by the Town of Kearny and the City of Apache Junction did not meet the State's expenditure standards (see Finding 3.3, page 22). While reviewing the expenditure of transportation excise tax dollars, KPMG found that the Town of Kearny used \$1,000 of HURF monies to purchase a street plaque. In addition, the City of Apache allocated \$2,000 from its HURF account for United States postage. Arizona statutes explicitly limit expenditure of HURF monies for highway, street, and transportation purposes only. To comply with statutory requirements, KPMG recommends that the Town of Kearny and the City of Apache Junction repay inappropriately used road monies.

11. Determine what transportation needs have been identified and to what extent the tax has allowed the county and cities/towns to meet those needs.

Please see "Engagement Scope Questions and Responses" number 8, pages 27 and 28.

12. Update the Excise Tax Recipient information identified in the 1998 performance audit report to June 30, 2000.

KPMG updated the Pinal County transportation excise tax information identified in the OAG's March, 1998 report to June 30, 2000 (see Table 1, page 12).

13. Determine if Pinal County is in compliance with Arizona's competitive bidding statutes as it relates to public works projects.

KPMG's review determined that Pinal County complies with Arizona's competitive bidding statutes as it relates to public works projects. To assess the County's

compliance, KPMG reviewed contractual information for those transportation projects outsourced by the County’s Public Works Department to private sector vendors that were funded by transportation excise tax money during fiscal years 1998 through 2000. This review included an examination of the following information: requests for proposals (RFP) data, vendor bid sheets, County Board of Supervisor meeting minutes, and contractual agreement information (i.e., signed contracts between the County and vendors, etc.).

Appendix B: Municipality Response

TOWN OF KEARNY

BOX 639, KEARNY, AZ 85237

PHONE (520) 363-5547

FAX (520) 363-7527

June 25, 2001



KPMG

Attn: David Gmelich

One Arizona Center

400 E. Van Buren Street, Suite 1100

Phoenix, AZ 85004

Re: KPMG Audit of Pinal County Excise Tax

Dear Mr. Gmelich:

The Town of Kearny, Arizona, acknowledges the audit report that KPMG has completed regarding the Pinal County Excise Tax. It is the position of the Town of Kearny, Arizona, supported by statute and qualified interpretations thereof, that the use of HURF funds for the purchase of a street designation plaque or sign is appropriate; however, the Town will review the expenditure. It is also the Town's position that the transfer of HURF funds to the General Fund to cover expenses related to HURF is reasonable; however, the Town will review the appropriate financial reporting system.

Sincerely yours,

Margaret Gaston, Town Clerk