State of California
DEPARTMENT OF TRANSPORTATION

California State Transportation Agency

Memorandum

Serious drought.
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To: COCO BRISENO
Deputy Director
Planning and Modal Programs

Date: March 4, 2016

File: P1575-0033

From: WILLIAM E. LEWIS
Assistant Director
Audits and Investigations

Subject: **INCURRED COST AUDIT – CITY OF RIVERSIDE**

We audited costs claimed by and reimbursed to the City of Riverside totaling $21,310,088 for work performed under projects TCIFL-5058(083), STPL-5058(086), and PNRSTCIPL-5058(082) with Caltrans. The audit was performed to determine whether the costs were supported and in compliance with the agreement provisions, and state and federal regulations. This audit was performed as a management service to assist Caltrans in fulfilling its fiduciary responsibilities to state and federal regulatory agencies. The final audit report, which includes the City's response, is attached.

Based on our audit, we determined that project costs totaling $2,625,835 did not comply with respective agreement provisions, and state and federal regulations. In addition, we determined that the City did not follow proper procurement, contract management, construction management, and grant management practices. The City also billed indirect costs without approval and did not maintain adequate documentation to support costs billed.

Please provide our office with a corrective action plan addressing the recommendations in the report including estimated timelines by April 18, 2016.

This report is a matter of public record and will be placed on Caltrans Audits and Investigation's website.

If you have questions or need additional information, please contact MarSue Morrill, External Audits - Local Governments, at (916) 323-7105.

Attachment

c: Kris Martinez, Public Works Director, City of Riverside
Brent A. Mason, Finance Director/Treasurer, City of Riverside
Michael Tritz, Deputy Secretary for Audits and Performance Improvement, Business, Transportation and Housing Agency
Janice Richard, Director of Financial Services, Federal Highway Administration
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AUDIT REPORT

City of Riverside
Incurred Cost Audit

P1575-0033

March 2016

Prepared By:

Audits and Investigations

California Department of Transportation

"Provide a safe, sustainable, integrated and efficient transportation system to enhance California's economy and livability"

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- **II. Procurement Findings**
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Executive Summary, Background, Scope, Methodology, and Conclusion

EXECUTIVE SUMMARY

The California Department of Transportation (Caltrans) Audits and Investigations (A&I) audited reimbursed project costs, totaling $21,310,088 to the City of Riverside (City) and found project costs totaling $2,625,835 did not comply with respective agreement provisions, and state and federal regulations.

BACKGROUND

Caltrans A&I performs incurred cost audits to ensure Caltrans is meeting its legal and fiduciary responsibilities, and that state and federal funds are properly expended by local government agencies. This audit was performed to determine whether project costs claimed by and reimbursed to the City were allowable, adequately supported, and in compliance with the respective agreement provisions, and state and federal regulations.

The audit included costs incurred on projects Magnolia Avenue Grade Separation TCIFL-5058(083); Streeter Avenue Grade Separation STPL-5058(086); and Iowa Avenue Grade Separation PNRSTCIPL-5058(082) during the period from July 1, 2010, through June 30, 2012.

SCOPE

The scope of the audit was limited to reviewing financial and compliance activities. The audit of the City's financial management system included interviews of City staff to obtain an understanding of the City's financial management system. The audit comprised transaction testing of reimbursed project costs to evaluate compliance with Title 2 Code of Federal Regulations (CFR) Part 225; 48 CFR Chapter 1 Part 31; 49 CFR Part 18; 23 CFR; Caltrans's Local Assistance Procedures Manual; and requirements stipulated in the City's agreements with Caltrans. Field work was completed on June 29, 2015, and transactions occurring subsequent to this date were not tested and, accordingly, our conclusion does not pertain to costs or credits arising after this date.

The City is responsible for claimed costs; compliance with applicable agreement provisions, and state and federal regulations; and the adequacy of its financial management system to accumulate and segregate reasonable, allocable and allowable costs. Because of inherent limitations in any financial management system, misstatements due to error or fraud may occur and not be detected. Also, any projection or evaluation of the financial management system in future periods using the results of this audit are subject to the risk that the financial management system may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

METHODOLOGY

We conducted this performance audit under generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit was less in scope than an audit performed to express an opinion on the financial statements of the City. Therefore, we did not audit and are not expressing an opinion on the City's financial statements.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the data and the records selected. An audit also includes assessing the accounting principles used and significant estimates made, and evaluating the overall presentation.

CONCLUSION

Based on our audit, we determined:

- Reimbursed project costs totaling $2,625,835 (see Attachment I) did not comply with respective agreement provisions, and state and federal regulations.
- The City approved questionable relocation costs.
- The City did not follow proper procurement, contract management, construction management, and grant management practices.
- The City billed indirect costs without approval.
- The City did not maintain adequate documentation to support costs billed, including labor costs.

VIEWS OF RESPONSIBLE OFFICIALS

Our findings and recommendations take into consideration the City's response dated December 29, 2015, and received January 21, 2016, to our November 10, 2015, draft report. Our findings and recommendations, the City's response, and our analysis of the response are set forth in the Findings and Recommendations of this report. A copy of the City's full written response is included as Attachment V.

This report is intended as information for Caltrans management, the California Transportation Commission, the Federal Highway Administration, and the City. This report is a matter of public record and will be placed on Caltrans A&I's website.

If you have any questions, please contact Barbara Nolan, Auditor, at (916) 323-7880 or Cliff Vose, Audit Manager, at (916) 323-7917.

MarSue Morrill

MARSUE MORRILL, CPA
Chief, External Audits – Local Governments
Audits and Investigations

March 4, 2016

FINDING 1 - Questioned Relocation Costs

The City of Riverside (City) could not support all of the $2,636,840 in relocation costs claimed for the relocation of a business tenant, Experienced Tractor Parts, on the Iowa Avenue Grade Separation project. Based on our review of the documents provided, the City could support $445,060 of the $2,636,840 in relocation costs incurred in August 2011. The $445,060 in supported relocation costs, however, exceeded the City's authorized federal-aid limit for relocation cost of $272,000.

In addition, the City recorded the relocation costs as acquisition costs in its accounting system. Regulations require relocation and acquisition costs to be separated and reported accordingly. The California Department of Transportation (Caltrans) Right of Way (ROW) Manual section 10.01.12.05 states, "Care must be taken to code the portion of relocation benefit payments appropriately because acquisition payment is subject to taxation and capital gains."

The City considered the $2,636,840 as payment to cover all costs including relocation, acquisition of fixtures and equipment, and loss of goodwill, otherwise known as a "global settlement." Such "global settlements" are not allowed. Per Federal Highway Administration (FHWA) Uniform Act Frequently Asked Questions under Title 49 Code of Federal Regulations (CFR) 24.102, "the use of Global Settlements on federal and federal-aid projects is not permitted."

The City claimed the payment included goodwill but provided no documentation to support a goodwill calculation. According to 49 CFR 24.301 (h), goodwill is not an eligible relocation cost. In addition, the City provided no evidence the settlement amount was approved by the City Council.

By exceeding the authorized relocation amount, entering a global settlement and not supporting or consistently accounting for the relocation costs claimed, $2,364,840 ($2,636,840 - $272,000) of relocation costs are questioned.

See Attachment IV for detailed criteria.

RECOMMENDATION

To ensure that its ROW activities meet the requirements of 49 CFR 24 and the Caltrans ROW Manual, the City should ensure that staff are trained and understand and implement 49 CFR 24 and the Caltrans ROW Manual. In addition, the City should provide a detailed report to Caltrans Division of Local Assistance (DLA) of the actual relocation, acquisition, and goodwill costs paid to Experienced Tractor Parts with supporting documentation. In addition, the City should provide evidence that the City Council approved the settlement amount.

The City should clearly identify, support, and separate the actual amount of relocation costs and acquisition costs incurred and billed to the project, and then work with Caltrans DLA to determine if additional funds allocated in April 2014 can be used to cover the relocation costs incurred in August 2011.

Caltrans DLA should determine how much of the remaining relocation costs above the current authorized limit reimbursed to the City are allowable, and if not allowable, seek reimbursement.

CITY'S RESPONSE

The City acknowledged the settlement was for business relocation, fixtures, equipment and loss of business goodwill, i.e., a "global settlement." The City stated that it acted in good faith and suggested the settlement amount would likely be less than a jury award had the case gone to trial. The City also claimed it relied upon consultation with Caltrans, and they believed the value of funds expended was fair and reasonable. The City received an increased relocation allotment in April 2014.

ANALYSIS OF RESPONSE

The City did not provide support that the funds expended were fair and reasonable. Also, Caltrans staff stated they had no recollection of settlement discussions with the City. The City's response provided no evidence that the City Council approved the settlement. No other recommendations were addressed in the City's response. The finding remains, but was clarified to identify the time relocation costs were incurred.

FINDING 2 - Improper Procurement Practices

The City did not procure professional services in accordance with state and federal laws and regulations.

The audit included testing the City's procurement of three professional service contracts, HDR Engineering (HDR), T.Y. Lin International (TY Lin), and Southstar Engineering (Southstar). We also reviewed the establishment of qualified panels for real property services and the procurement of a property appraisal contract from one of the panels. See Attachment II for a summarization of issues found.

The City could not provide procurement documentation for the awarding of the contracts with HDR and TY Lin as required by 49 CFR 18.36 (b) (9) and Chapter 10 of the Caltrans Local Assistance Procedures Manual (LAPM). Therefore, the City cannot support it procured the two consultants in accordance with state and federal regulations, and we cannot conclude that the procurements met state or federal regulations. Consequently, we question all costs billed under these two contracts.

The City did not have sufficient documentation to show that the Southstar procurement followed state and federal regulations. Documentation the City provided included a sample scoring sheet

and a partial log-in sheet showing the receipt of some proposals. The City could not provide a complete list of proposals received, when all proposals were received, proof of advertisement, actual evaluation score sheets, or evidence that the City prepared an estimate of costs as required by 49 CFR 18.36 and the LAPM. Therefore, the City could not show they procured this contract in accordance with state and federal regulations, and we cannot conclude that the procurements met state or federal regulations. Consequently, we question all costs billed under this contract.

The Request for Qualifications (RFQ) for the City's establishment of the real property services panels was not advertised as required by 49 CFR 18.36 and the LAPM; however, the City received 74 proposals. City records show that of the 74 proposals received, the City accepted 15 proposals (20 percent) after the stated final submission date, and the receipt dates of four other proposals (5 percent) were listed as unknown; therefore, over 25 percent (19 of 74) of all proposals submitted were late or had an unknown submission date. City records also showed that the City evaluated 9 of these 19 proposals with no documentation to show why the other 10 proposals were not evaluated. Any arbitrary action in the procurement process is considered restrictive of competition and is not allowed per 49 CFR 18.36 (c) (1) (vii). Also, LAPM Chapter 10.5 states that late submittals are considered nonresponsive and shall be rejected and that the submittal of additional information after the due date shall not be allowed.

The prequalified panels of real property services consultants created as a result of the RFQ were established for a five year period with no process in place to allow new consultants to be considered for inclusion into the panels, which is a restriction of competition. LAPM Chapter 10.5 states, "Lists of qualified consultants (prequalified lists) established through the RFQ process must be reestablished at least once every 12 months, to give new consultants the opportunity to qualify." The arbitrary actions taken by the City in creating the procurement panels and the extended life of the panel are a limitation to open and free competition and violates state and federal regulations.

The City's procurement of the property appraisal contract using the real properly services panel did not meet state and federal regulations. The City stated it issued a Request for Proposals (RFP) via email to panel members but had no evidence to support this statement. The RFP identified no selection criteria in violation of 49 CFR 18.36 (d) (3) (i). Documentation provided by the City appeared to show that cost and timeframe to complete the work were the criteria used by the single City staff member who reviewed the proposals. The consultant's proposal used to award the contract did not have the lowest price and did not identify the date(s) when the work would be completed; therefore, the City cannot justify the awarding of the contract. In addition, the City prepared no independent cost estimate or provide evidence that cost and profit were negotiated, both violations of 49 CFR 18.36.

Without proper procurement practices and procurement documentation, the City cannot support that open and fair competition occurred and cannot support that the most qualified contractors were selected at a fair and reasonable price.

See Attachment IV detailed criteria.

RECOMMENDATION

To ensure the City complies with state and federal laws and regulations, the City should implement procurement practices and maintain records sufficient to detail the significant history of the procurement process as required by 49 CFR 18.36 and the LAPM, Chapter 10.

Caltrans DLA should work with FHWA and the California Transportation Commission to determine if costs associated with these procurements are to be reimbursed to the state. Also, Caltrans DLA should take steps to ensure that the City is following state and federal procurement regulations and the LAPM prior to submitting consultant costs for reimbursement.

CITY'S RESPONSE

The City generally agreed that some procurement documentation could not be located. The City stated that new procurement policies and procedures are being drafted, and the City will work to get feedback and concurrence from DLA on the new policies and procedures.

ANALYSIS OF RESPONSE

The City is addressing the recommendation. The finding remains.

FINDING 3 - Contract Management Practices Need Improvement

The City did not manage its professional services contracts/agreements in accordance with 49 CFR 18.36 (b) (2), contract administration requirements, to ensure that consultants provide services and billings in accordance with the terms, conditions, and specifications of the contracts/agreements which resulted in questioned costs. Our audit testing included the review of costs claimed under seven consultant contracts. Specifically, we found these exceptions:

<u>Thomas Pike Associates – Streeter Avenue Grade Separation Project</u>
The Supplemental Agreement between Thomas Pike Associates (Pike) and the City was amended twice to increase the not-to-exceed amount of the Supplemental Agreement via change orders. The change orders, however, identified no change to the scope of work. For one of the change orders, Pike added hours and $1,600 to complete work with no justification why the additional hours were required; and the City had no documentation to justify the increase in hours or costs. Also, although the other change order identified no change in the scope of work, the City provided supplemental documentation justifying it by identifying the addition of one additional parcel to the contract. The lack of documentation to support change orders can result in the City overpaying for work.

In addition, we found that the Pike invoices were not itemized as required by paragraph 3.1 of the Master Agreement between Pike and the City. The invoices reviewed did not identify the parcels appraised or what additional work was being performed. The lack of documentation to support why additional work was needed and missing detail information on invoices are inconsistent with 2 CFR 225 Appendix A C.1. that states allowable costs must be reasonable, necessary, and

adequately documented, and increases the risk that unnecessary work is performed and unallowable costs are incurred. Therefore, we are questioning the $1,600.

Southstar - Magnolia Avenue Grade Separation Project

We reviewed four invoices from the Southstar contract. We noted and are questioning $731 of other direct costs for reproduction of plans which were not included as other direct costs in the contract's cost proposal. Billing for costs not included in the cost proposal increases the risk of the City paying for unnecessary or unallowable costs.

HDR - Magnolia Avenue Grade Separation Project

The HDR contract expired on December 31, 2008, but was amended March 18, 2009, which violates Caltrans LAPM (May 2006 version) Chapter 10.7, contract amendment requirements. An expired contract cannot be amended; therefore, any cost incurred from January 1, 2009, to March 17, 2009, is unallowable as the City did not have a contract in effect during this period. In addition, tested costs totaling $38,922 billed after the contract amended date of March 18, 2009, are questioned.

We also found that the contract used a cost plus percentage of cost fee structure, which violates 49 CFR 18.36 (f) (4) methods of contracting requirements. Further, we could not tie the labor costs billed to the contract amendments because the invoices listed personnel names without positions, and the contract amendments listed personnel positions without names and none of the hourly rates on the invoices tied to the rates in the amendments. Therefore, the City cannot support, and we cannot determine if the rates charged were reasonable and allowable.

The City also reimbursed HDR other direct costs for "technology charges," which were not included as eligible other direct costs in the contract cost proposal or amendments. In addition, technology charges are costs typically included in overhead. Billing for costs not included in the cost proposal increases the risk of the City paying for unnecessary or unallowable costs. Therefore, $1,155 in technology charges identified on the invoices tested and included in the $38,922 costs above are questioned.

TY Lin - Streeter Avenue Grade Separation Project

We reviewed three invoices from the TY Lin contract. In each invoice, we identified billings for staff whose names and/or positions were not listed on the contract cost proposal. As a result, the City cannot support, and we cannot determine if the charges for the unlisted staff are reasonable or necessary.

California Property Specialists, Incorporated (CPSI) – Iowa Street Grade Separation Project

We reviewed one invoice from the CPSI contract and noted that a key person on the CPSI contract was substituted without prior approval from the City in violation of section 8 of the CPSI agreement and LAPM Chapter 10.7 (May 2006), substitution of key personnel requirements. City staff stated that a signature approving the payment of services that included the substituted key personnel was sufficient. In these circumstances, however, approval of the payment would have occurred after the services had been rendered. Without documenting an approved change to key personnel, the City cannot support that the new personnel is qualified prior to work being performed.

Donna Desmond and Lea Associates – Iowa Street Grade Separation Project

The City did not enter into signed contracts with Donna Desmond or Lea Associates, which violates 49 CFR 18.20 (b) (6), contract documentation requirements. The City could not provide any documentation of the services agreed to for Donna Desmond, and the City provided an unsigned agreement for Lea Associates. City staff stated these services were procured through the City Attorney's office.

Without written agreements, the City cannot support that the services to be provided, qualifications of staff providing the services, and rates to be charged were allowable and reasonable; and it increases the risk of incurring unallowable, unreasonable or unnecessary costs. In addition, we cannot verify that the costs billed are allowable and reasonable. Without proper contract management, the City risks incurring and billing Caltrans for unallowable and unsupported costs.

In addition, we reviewed four consultants and two construction contracts to determine if certain required provisions were included in the contracts as required by state and federal master agreements and the LAPM Chapter 10 (May 2006). See Attachment III for a summarization of the missing required contract provisions and associated consultant/contractors.

See Attachment IV for detailed criteria.

RECOMMENDATION

To ensure that the City's consultants and contractors are following contact/agreement provisions and state and federal laws and regulations, the City should develop, document, and implement policies and procedures to ensure:

- Services provided and costs billed by third party consultants agree to contract provisions and terms.
- Contracts are amended timely and reflect the nature of all services being provided.
- Management and staff are trained in proper contract administration.
- Third party consultant contracts contain the required provisions and service terms.

Caltrans DLA should seek reimbursement for any costs reimbursed to the City during the time that the HDR contract was expired and determine if any of the questioned costs totaling $41,253 ($1,600 + $731 + $38,922) are to be reimbursed to Caltrans.

CITY'S RESPONSE

The City generally agreed with the contract management exception. The City indicated that the lack of documentation for the Donna Desmond contract procured through the City Attorney's Office was an isolated incident and acknowledged the need for improvement.

ANALYSIS OF RESPONSE

The City did not specifically address the recommendations, but in their response to Finding 8 below, the City stated they were developing policy and procedures to address the audit findings. The finding remains.

FINDING 4 - Construction Management Practices Need Improvement

The City did not adequately document construction activities as required by Chapter 16 of the LAPM, or show compliance with 49 CFR 18.36 (f) (1) and Chapter 16 of the LAPM. The LAPM requires that progress pay estimate (PPE) costs be supported by daily reports, and both 49 CFR 18.36 and the LAPM require contract change order (CCO) costs be supported by cost estimates. We tested four PPEs and one CCO submitted by the Riverside Construction Company for work on the Magnolia Avenue Grade Separation project and found these exceptions:

- Daily reports were not sufficiently detailed to identify the amount of work being performed or what materials were delivered.
- Daily reports were not signed by the person completing the reports despite having a section for signatures on the document.
- The billing period for the costs being billed was not identified.

Also, these exceptions were noted on CCO 1:

- There was no evidence that an independent cost estimate was prepared prior to work being performed.
- The CCO was not prepared and signed until five months after the work was performed.

Without adequate construction contract management, the City risks being overbilled for work, materials, or equipment.

See attachment IV for detailed criteria.

RECOMMENDATION

To ensure that the City's project documentation can support project costs the City should maintain accurate and complete daily inspection reports in the project files. In addition, the inspection reports should record all construction activities that occurred, such as what work is being performed and materials being delivered, stored, and/or used. The daily inspection reports should agree with calculation sheet information and weight certificates. Further, the City should prepare and document independent cost estimates prior to extra work being performed, and process CCO more timely.

Caltrans DLA should ensure that the City properly document construction activities in their construction files such as detailed daily construction reports, ensure CCOs are supported by estimates, and process CCOs timely.

CITY'S RESPONSE

The City disagreed with the finding. The City stated that documentation other than daily reports were provided to support the claimed PPE costs. The City acknowledged that it had no documentation to support CCO cost estimates and approvals, but stated that such documentation would be maintained in the future.

ANALYSIS OF RESPONSE

The City did not provide any new information or documentation to support its assertions. The finding and recommendation were edited for clarification.

FINDING 5 - Questioned Equipment, Central Stores, and Overhead Cost Rates

The City used unallowable equipment rates and could not support the Central Stores indirect cost rate billed. In addition, the City billed overhead without an approved indirect cost allocation plan (ICAP). Specifically, we found these exceptions:

Equipment

The City used Federal Emergency Management Agency (FEMA) equipment rates to bill for equipment usage on the Magnolia Avenue Grade Separation project. FEMA's schedule of rates states that the rates only apply in major disasters or emergency situations. Since there was no indication this project resulted from a disaster or an emergency, all equipment costs totaling $150,227 are questioned.

The City did not compare equipment usage against labor charged to a project at the time incurred; and as a result, risks overbilling for equipment not being utilized on a project. We noted two instances where the hours for equipment usage charged to the Magnolia Avenue Grade Separation project exceeded the hours the employees assigned to the equipment charged to the project. The excess costs for the equipment usage would not be allowable under 2 CFR 225 Appendix A C.1.b.; however, since we have already questioned all equipment costs above, there are no disallowed costs associated with this finding at this time.

Central Stores

The City recovered the cost of managing the Central Stores department by adding 20 percent to the cost of each item issued (indirect cost rate); however, the City could not provide a basis or approval for the 20 percent indirect cost rate as required by 2 CFR 225 and the LAPM Chapter 5 for costs allowable under state and federal awards. We reviewed the cost and revenue information for Central Stores provided by the City and found that from fiscal year 2007 to fiscal year 2011, the Central Stores recovered $1,079,707 more in revenue (profit) than it expended. An indirect cost rate is used to recover costs, and profit is not a recognized local government agency indirect cost. We also found no evidence showing that the City reconciled revenue and expenses to adjust the 20 percent rate between fiscal years. Per 2 CFR 225 Appendix A, an indirect cost rate is used to recover allowable and necessary costs, that costs must be of a type generally recognized as ordinary and necessary for the operations of the governmental unit, and is a cost allocated based

on benefits received. Since the City did not submit the Central Stores indirect cost rate for approval prior to billing and the rate includes profit, we question the $35,836 of unsupported central stores indirect costs charged to the Magnolia Avenue Grade Separation project.

In addition, we noted one instance where an employee received materials from Central Stores and charged the cost to the Magnolia Avenue Grade Separation project during a month when the employee charged no labor hours to the project. The City provided documentation that a portion of the materials was placed in the project. Because of these inconsistencies in charging, we cannot determine if all the materials were charged to the proper project, and we question $1,968 in materials cost.

General Fund Overhead and Other Indirect Costs

The City had no approved ICAP for the allocation of general fund overhead costs or other indirect costs as required by 2 CFR 225 Appendix E D.1.a. In fiscal years 2009, 2010, and 2011 the City used overhead rates to recover the costs of fringe benefits, general fund allocations, and other indirect costs including allocations of the Public Utilities Department. The City could support the fringe benefit rates used by the Public Works Department; however, without an approved ICAP, the City may not bill for any indirect costs. We cannot identify the exact amount of unsupported indirect costs based on the expenditure reports provided by the City.

See Attachment IV for detailed criteria.

RECOMMENDATION

The City should take these corrective actions:

- Develop its own equipment rates and discontinue using FEMA rates to bill state and federal funds for equipment unless equipment is being used during major disasters or emergencies.
- Ensure Central Stores' indirect cost rate is supported and approved.
- Establish policies and procedures related to equipment usage and monitor equipment usage to ensure employees charge equipment costs to projects only when working on the project.
- Discontinue billing overhead costs and Public Utilities allocations, until the City submits and receives an approved ICAP from Caltrans A&I.

Caltrans DLA should work with the City to determine if any of questioned costs totaling $188,031 ($150,227 + $35,836 + $1,968) are to be reimbursed to Caltrans.

CITY'S RESPONSE

The City disagreed with the finding. The City made the following assertions:

- FEMA rates are used by other public agencies and are considered a national standard.
- It is likely that projects may be undercharged for equipment usage.
- The documents previously provided support a 20 percent Central Stores overhead rate.

- Previously provided documentation shows that questioned materials were used on the project.
- Fringe benefits should not be considered indirect costs.

The City acknowledged the use of a fringe benefit rate.

ANALYSIS OF RESPONSE

The City did not provide any new information or documentation to support its assertions. Based on the response, however, previously received documentation was re-reviewed, and as a result, the questioned materials cost identified in the finding and recommendation was reduced. Also, fringe benefit costs are considered indirect costs unless the fringe benefits are charged at the individual employee level, which the City does not do. No other recommendations were addressed in the City's response. The finding remains unchanged, except where the questioned dollars were reduced and additional criteria were added to Attachment IV to clarify the treatment of fringe benefits.

FINDING 6 - Unallowable and Questioned Costs

The City billed for unallowable and questioned costs to the Magnolia Avenue Grade Separation project as construction engineering costs in violation of 2 CFR 225 Appendix A C.1, requirements for allowable costs and adequate documentation; C.2, requirement for reasonableness; and C.3., requirement for allocability. Specifically, we found these exceptions:

- An encroachment permit for the University Wash project totaling $910 was incorrectly charged to the Magnolia Avenue Grade Separation project; therefore, the costs are unallowable.
- City staff could not reconcile $18,076 paid for a storm drain encroachment permit charged to the Magnolia Avenue Grade Separation project to the documents provided as support for the costs. Without a detailed and complete accounting of effort and costs, the City risks paying for unsupported and unallowable costs. Therefore, we question the $18,076 in permit costs.
- City staff could not provide documentation to show the delivery of cold mix and fill sand materials from a City storage location to the job site; therefore, the City cannot support that the quantity billed to the project was delivered and/or placed in the project. We further noted that City staff did not consistently sign the weight tags to show the materials were received at the storage location (1 of 5 signed) or delivered to the job site (0 of 1 signed). Therefore, the City could not support the quantity of materials delivered and placed in the project and questionable costs totaling $12,369.
- The cost for safety vests totaling $356 was charged directly to the project. This type of cost is typically an indirect cost recovered through the application of an indirect cost rate and not a direct cost; therefore, the costs are disallowed.
- We identified $1,207,253 in utility relocation costs and $67,590 in traffic equipment costs billed as construction engineering for the Magnolia Avenue Grade Separation project. The state master agreement, federal regulations, and the LAPM all consider utility relocation a

right of way activity. Traffic equipment placed in a transportation facility is typically a construction cost and not construction engineering. Also, the City billed $918,641 in utility relocation costs incurred prior to the amended "Begin Construction" date of February 1, 2010. If costs are charged to incorrect phase or before authorization, the City could incur unallowable costs, costs above the authorized phase limits, incorrectly bill Caltrans, and not accurately record or report its costs.

Finally, the City's Magnolia Avenue Grade Separation Water Facility Relocation final report, dated August 21, 2008, includes work that appears to be outside the project impact area, and possibly includes new services and betterments; for example, installation of pipe (item 3 in the final report), relocation of existing service (item 12 in the final report), and replacement of 4-inch cast iron pipe with 8-inch ductile iron pipe (item 1 in the final report).

See Attachment IV for detailed criteria.

RECOMMENDATION

The City should take these corrective actions:

- Reimburse Caltrans $1,266 for disallowed costs identified above ($910 + $356).
- Submit revised invoices to DLA that correctly report costs claimed to ensure that all costs claimed and reimbursed are in accordance with correct funding phase limits and regulations.
- Develop procedures to ensure that only allowable and direct project costs are adequately documented and billed to a project, under the correct phase.

Caltrans DLA should:

- Work with the City to collect the $1,266 in disallowed costs.
- Determine if the $30,445 of questioned costs are to be reimbursed to Caltrans ($18,076 + $12,369).
- Review the corrected invoices submitted by the City to ensure that costs claimed are allowable and in accordance with regulations.
- Review the utility relocation project to ensure that only allowable relocation activities were billed and that all betterment, salvage and depreciation credits were calculated and given where appropriate.

CITY'S RESPONSE

The City agreed that the University Wash encroachment permit was incorrectly charged to the Magnolia Avenue Grade Separation. The City stated that non-project costs being billed was an isolated instance, and that previously provided explanation clarified the permit costs. The City claimed that circumstances required the direct charge of orange safety vests to the project. The City stated that the utility relocation work is considered construction based on their agreement with the state and that utility work performed during the construction phase is considered

construction cost. The City also claimed that Caltrans did not support the basis for considering utility relocation costs as right of way costs.

ANALYSIS OF RESPONSE

The City provided no new information or documentation to support the storm drain permit costs and safety vest charges. In addition, the utility relocation work was charged as construction engineering and the majority of the work was performed prior to the start of construction. No other recommendations were addressed in the City's response. The finding remains.

FINDING 7 - Timekeeping Needs Improvement

Our review noted instances where the City's Public Utilities crews' time sheets were created and approved by office staff rather than the individual employee or crew leader with first-hand knowledge of the employee's daily activities as required by 2 CFR 225 Appendix B 8. h. (5) (a) and (d). We also noted instances where time sheets were completed prior to the work being performed and where time sheets were not approved by a supervisor which violates the City's Timekeeping User Guide for Public Utilities.

See Attachment IV for detailed criteria.

RECOMMENDATION

To ensure that the City can support labor costs claimed and reimbursed, the City should implement procedures and train staff to make sure that staff time sheets are completed after-the-fact and that they are completed by the employee or staff with first-hand knowledge of work performed, and that time sheets are approved by the employee's supervisor.

CITY'S RESPONSE

The City stated that instances where estimates are inputted prior to the end of the pay period is infrequent, happening only when holidays shorten the payroll processing timeline. The City stated that the estimates were provided by employees and/or supervisors, and cited 2 CFR 225 Appendix B 8. h. (5) (e) (iii).

ANALYSIS OF RESPONSE

Based on audit work, the exceptions were noted in regular pay periods, not just holiday pay periods. 2 CFR 225 Appendix B 8. h. (5) (e) states that budget estimates do not qualify as support for charges to Federal awards, but may be used for accounting purposes. The finding remains.

FINDING 8 - Policies and Procedures Need Improvement

The City's policies and procedures did not meet state and federal regulations in effect during our audit and subsequent to our audit. We noted the following violations of 49 CFR 18 and 23 CFR 172.

- There were no detailed written procedures on administering consultant contracts, such as verifying billing rates to the contract, verifying key personnel, and amending contracts prior to contract expiration date.
- There were no detailed procedures for managing construction contracts, such as what information should be recorded on the daily reports, and recording time period for progress pay estimates.
- There were no specific instructions that identify the need to sign receipts for goods delivered, such as construction material weight tags.
- The City's manual allowed for price to be used as a pre-screening factor for the procurement of professional services which is not allowed by 23 CFR 172 and California Government Code Section 4525 - 4529.

Without adequate policies and procedures in place and staff complying with them, the City's compliance with state and federal regulations may be compromised (see findings in this report), which will lead to questioned and disallowed costs as a result of our audit. In addition, the City may be identified as a high-risk recipient of federal funds. As a high-risk recipient of federal funds, the City could be subject to conditions, such as requiring additional project monitoring, establishing additional prior approvals, and withholding authority to proceed to the next phase until receipt of evidence of acceptable performance with in a given period of performance.

See Attachment IV for detailed criteria.

RECOMMENDATION

To ensure that the City's actions follow state and federal laws and regulations, the City should take these corrective actions:

- Expand its Administrative Manual to include more detailed procedures for procurement of professional services, contract and construction management, and grant requirements to comply with state and federal laws and regulations.
- Submit its written policies and procedures to Caltrans DLA for review and approval.

Caltrans DLA should review and approve the City's written policies and procedures to assess compliance with applicable state and federal regulations.

CITY'S RESPONSE

The City agrees with the finding. The City stated it is drafting policies and procedures to address issues noted in the audit.

ANALYSIS OF RESPONSE

The finding remains.

FINDING 9 - Grant Management Needs Improvement

The City did not adhere to state and federal master agreement reporting requirements for its state and federally funded projects. Specifically, the City did not submit invoices at least once every six months, as required by the master agreements. Seven of 11 invoices tested were submitted between 7 and 20 months after the date of the prior invoice. City staff informed us that one person was assigned to process invoices, and due to other workload, the processing of invoices was not a priority. Untimely submission of invoices can limit Caltrans' ability to monitor the progress of projects, the allowability of costs, and can jeopardize future funding.

See Attachment IV for detailed criteria.

RECOMMENDATION

To ensure that the City's actions follow state and federal laws and regulations, the City should train staff in the applicable manuals and grant requirements and take steps to make sure that staff are following the manuals and grant requirements, to include submitting invoices at least every six months.

CITY'S RESPONSE

The City agrees with the finding. The City is training additional staff in grant administration and monitoring, and commits to invoicing at least every six months.

ANALYSIS OF RESPONSE

The finding remains.

Audit Team

MarSue Morrill, Chief, External Audits – Local Governments

Cliff Vose, Audit Manager

Barbara Nolan, Auditor

Ashna Singh, Auditor

Fifie King, Auditor

ATTACHMENT I

AUDIT UNIVERSE AND DISALLOWED AND QUESTIONED COSTS

	Projects Audited (July 2010 – June 2012)			
	Magnolia	**Streeter**	**Iowa**	**Total Cost Audited**
Federal Project Number	**TCIFL-5058(083)**	**STPL-5058(086)**	**PNRSTCIL-5058(082)**	
Federal or State Funded	State	Federal	Federal	
Total State/Federal Funds Reimbursed	**$14,805,832**	**$4,170,311**	**$2,333,945**	**$21,310,088**
Questioned Cost (includes match)				
Finding 1 – Questioned Relocation Costs	-	-	$2,364,840	**$2,364,840**
Finding 3 – Contract Management Practices Need Improvement	$39,653	$1,600	-	**$41,253**
Finding 5 – Questioned Equipment, Central Stores, and Overhead Cost Rates	$188,031	-	-	**$188,031**
Finding 6 – Unallowable and Non-allocable Costs	$30,445	-	-	**$30,445**
Unallowable Cost				
Finding 6 – Disallowed and Non-allocable Costs	$1,266	-	-	**$1,266**
Grand Total	**$259,395**	**$1,600**	**$2,364,840**	**$2,625,835**

ATTACHMENT II

PROCUREMENT FINDINGS

	STPL-5058(086)			TCIFL-5058(083)		Total Exceptions
	STREETER PROJECT			MAGNOLIA PROJECT		
	RFQ/RFP	RFP	RFQ	RFQ	RFP	
Procurement Exceptions ↓ Contract Awardee →	**Real Property Consultant Panels**	**Pike**	**Ty Lin**	**HDR**	**Southstar**	
RFP/RFQ not Publicized in newspaper or trade journal	x		x	x	x	4
Selection criteria not identified in the RFP/RFQ		x				1
No weighted factor identified in RFP/RFQ to determine the relative importance			x	x		2
No evidence of independent cost estimate	n/a	x	x	x	x	4
No evidence of score sheets being manintained /inadequate & incomplete scoresheets provided		x	x	x	x	4
No evidence of cost analysis, including profit separately negotiated	n/a	x		x	x	3
No evidence of direct solicitation from qualified sources		x				1
Additional consultants were not allowed to participate during the solicitation period after a pre-qualified consultant list was established	x		n/a	n/a	n/a	1
Prequalified consultant panel established throught the RFQ process was not reestablished at least once every 12 months*	x		n/a	n/a	n/a	1
Proposals were not date stamped, or no evidence of receipt	x		x	x	x	4
Unable to determine whether sufficient repsonse time was given to bidders because there is no evidience showing the date the RFQ was issued			x	x	x	3

Note: City established the list for a 5 year period.*
x = exception noted
n/a = not applicable

ATTACHMENT III
MISSING CONTRACT PROVISONS

	STPL-5058(086)		TCIFL-5058(083)			
	STREETER PROJECT		MAGNOLIA PROJECT			
Contracts → Missing Contract Provisions ↓	**Pike**	**TY Lin**	**Southstar**	**HDR**	**Riverside Construction**	**J.Fletcher**
Contract end date clearly stated		x				
Termination for cause or convenience			x			
Record retention 3 years after final payment under the program supplement	x		x			
Right to audit by State, State Auditor or duly authorized representative	x		x	x	x	x
Agree to use 48 CFR, Chapter. 1, Part 31 to determine allowability of project costs	x		x	x	x	x
Comply with 49 CFR, Part 18	x		x	x	x	x
Travel and subsistence in accordance with Department of Personnel Administration regulations	x	x	x	x	x	x
Maintain an accounting system and records that properly accumulates and segregates incurred project costs	x		x	x	x	x
Accounting system shall conform to Generally Accepted Accounting Principles, enable the determination of incurred costs at interim points of completion	x		x	x	x	x

x = exception noted

ATTACHMENT IV
CRITERIA

Finding 1

1a. Federal Master Agreement 08-5058R Article I, Paragraph 9 states "ADMINISTERING AGENCY shall conform to all State statutes, regulations and procedures (including those set forth in the Local Assistance Procedures Manual and the Local Assistance Program Guidelines, hereafter collectively referred to as "LOCAL ASSISTANCE PROCEDURES") relating to the federal-aid program, all Title 23 federal requirements, and all applicable federal laws, regulations, and policy and procedural or instructional memoranda, unless otherwise specifically waived as designated in the executed project-specific PROGRAM SUPPLEMENT."

1b. Federal Master Agreement 08-5058R Article II, Paragraph 5 states in part, "Whether or not federal-aid is to be requested for right of way, should ADMINISTERING AGENCY, in acquiring right of way for PROJECT, displace an individual, family, business, farm operation, or non-profit organization, relocation payments and services will be provided as set forth in 49 CFR, Part 24..."

1c. Caltrans Local Assistance Procedures Manual (LAPM), Chapter 13 states in part, "The intent of this chapter is to provide local agencies with the basic understanding of Right of Way (R/W) procedures for locally sponsored federal-aid transportation projects. Local agencies, which will be actively involved in R/W acquisition and relocation, must comply with the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 as amended in 1987 (the Uniform Act). This law can be found in Chapter 10 of the Caltrans *Right of Way Manual*, the FHWA "*Project Development Guide"* (See Appendices A and B) and 49 of the Code of Federal Regulations (CFR), Part 24." "The Uniform Act also contains basic requirements when displacement occurs as a result of the transportation project. These requirements are found at 49 CFR 24 Subparts C, D and E. The relocation procedures are also discussed in detail in Chapter 10, "*Relocation Assistance*", of the Caltrans *Right of Way Manual*."

1d. Caltrans Right of Way Manual (ROWM) Section 10.05.08.01 of states in part, "The agreed-upon amount to be paid for a self-move should never include specialized moving costs that are performed by others…"

1e. ROWM Section 10.05.09.02 states in part, "If an item of personal property…is promptly replaced…the displacee is entitled to payment of the lesser of: The cost of the substitute item… OR the estimated cost of moving… the replaced item…"

1f. ROWM Section 10.01.05.00 states in part, "Global settlements are not consistent with the requirements if the Uniform Act or 49 CFR 24 in that relocation benefits must be determined in accordance with specific fact based criteria…"

1g. 49 CFR 24.102 (i) states, "The purchase price for the property may exceed the amount offered as just compensation when reasonable efforts to negotiate an agreement at that amount have failed and an authorized Agency official approves such administrative settlement as being reasonable, prudent, and in the public interest. When Federal funds pay for or participate in acquisition costs, a written justification shall be prepared, which states what available information, including trial risks, supports such a settlement."

ATTACHMENT IV
CRITERIA

1h. ROWM Section 10.01.12.05 states in part, "... Care must be taken to code the portion of relocation benefits payments appropriately because acquisition payment is subject to taxation and capital gains."

1i. 2 CFR 225 Appendix A, C. 1. states in part, "To be allowable under Federal awards, costs must meet the following general criteria: …d. Conform to any limitations or exclusions set forth in…terms and condition of the Federal award…"

1j. 49 CFR 24.209 states in part, "No relocation payment received by a displaced person under this part shall be considered as income for the purpose of … determining the eligibility or the extent of eligibility of any person for assistance under … Federal law…"

1k. 49 CFR 24.301 (h) states in part, "A displaced person is not entitled to payment for: …Loss of goodwill…"

Finding 2

2a. 49 CFR 18.36 (b) (9) states, "Grantees and subgrantees will maintain records sufficient to detail the significant history of a procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price."

2b. LAPM Chapter 10 states in part, "Federal-Aid Highway Program funding recipients and sub-recipients must maintain adequate and readily accessible project performance and financial records, supporting documents, and other records considered pertinent to the grant agreement and in compliance with Federal laws and regulations (e.g. … 49 CFR 18.) These records shall be maintained for a minimum of three (3) years following issuance of the final voucher from FHWA (forwarded by Caltrans) … For audit purposes, project records and documentation shall be kept for three (3) years after payment of the final federal and/or state voucher. Among the records to be retained are as follows:

- Copies of RFPs and RFQs …
- Solicitation/advertisement records
- Identification of selection committee members
- Evaluation and ranking records
- Independent cost estimate
- Record of negotiations …
- Executed consultant contracts, cost proposals and amendments …"

2c. 49 CFR 18.36 (f) (1) states in part, "Grantees and subgrantees must perform a cost or price analysis in connection with every procurement action including contract modifications. The method and degree of analysis is dependent on the facts surrounding the particular

procurement situation, but as a starting point, grantees must make independent estimates before receiving bids or proposals…"

2d. LAPM Chapter 10 states in part, "…Local agency advertises the availability of the RFP in a major newspaper of general circulation or technical publication of widespread circulation…"

2e. 49 CFR 18.36 (c) (1) (vii) states in part, "All procurement transactions will be conducted in a manner providing full and open competition consistent with the standards of § 18.36. Some of the situations considered to be restrictive of competition include but are not limited to: … Any arbitrary action in the procurement process."

2f. LAPM Chapter 10 states in part, "… Late submittals … are considered nonresponsive and shall be rejected. Submittal of additional information after the due date shall not be allowed."

2g. LAPM Chapter 10 states in part, "Lists of qualified consultants (prequalified lists) established through the RFQ process must be reestablished at least once every 12 months, to give new consultants the opportunity to qualify."

2h. 49 CFR 18.36 (d) (3) (i) states, "Requests for proposals will be publicized and identify all evaluation factors and their relative importance."

Finding 3

3a. 49 CFR 18.36 (b) (2) states, "Grantees and subgrantees will maintain a contract administration system which ensures that contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders."

3b. LAPM Chapter 10 states in part, "All contract amendments must be fully executed before the ending date of the contract….and all contract amendments must be in writing and fully executed by the consultant and local agency before reimbursable work begins on the amendment."

3c. 225 CFR 2 Appendix A, C.1. states in part, "Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria: … a. Be necessary and reasonable… j. Be adequately documented."

3d. Pike Consultant Master Agreement Paragraph 3.1 states in part, "Consultant shall receive compensation… upon receipt and approval of an itemized invoice setting forth the services performed…"

3e. 49 CFR 18.20 (b) (6) states in part, "The financial management systems of other grantees and subgrantees must meet the following standards: … Accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc."

3f. 49 CFR 18.36 (f) (4) states, "The cost plus a percentage of cost and percentage of construction cost methods of contracting shall not be used."

3g. LAPM Chapter 10 states in part, "The consultant should not substitute key personnel (Project Manager and others listed by name in the cost proposal) or subcontractors without prior written approval from the local agency. The consultant must request and justify the need for the substitution and obtain approval from the local agency prior to use of different subcontractor on the contract. The proposed substituted person must be as qualified as the original, and at the same rate or lower cost."

3h. LAPM Chapter 10 states in part, "…Beginning and ending dates must be specified for work under the agreement…"

3i. 49 CFR 18.36 (i) (2) states in part, "Contract provisions. A grantee's and subgrantee's contracts must contain provisions in paragraph (i) of this section…Termination for cause and for convenience by the grantee or subgrantee including the manner by which it will be effected and the basis for settlement."

3j. Federal Master Agreement 08-5058R and State Master Agreement 00221S, Article V, Paragraph 7 state, "Any subcontract entered into by the ADMINISTERING AGENCY as a result of this AGREEMENT shall contain all of the provisions of Article IV, FISCAL PROVISIONS, and this Article V, AUDITS, THIRD-PARTY CONTRACTING RECORDS RETENTION AND REPORTS, shall mandate that travel and per-diem reimbursements and third-party contract reimbursements to subcontractors will be allowable as project costs only after those costs are incurred and paid for by the contractors."

3k. Federal Master Agreement 08-5058R and State Master Agreement 00221S, Article V, Paragraph 3 state in part, "…ADMINISTERING AGENCY, ADMINISTERING AGENCY's contractors and subcontractors, and STATE shall each maintain and make available for inspection and audit all books, documents, papers, accounting records, and other evidence pertaining to performance of such contracts, including, but not limited to, the costs of administering those various contracts. All of the above-reference parties shall make such AGREEMENT and PROGRAM SUPPLEMENT materials available at their respective offices at all reasonable times during the entire PROJECT period and for three (3) years from date of final payment to ADMINISTERING AGENCY under any PROGRAM SUPPLEMENT. STATE, the California State Auditor, or any duly authorized representative of STATE or the United States, shall each have access to any books, records, and documents that are pertinent to a PROJECT for audits, examinations, excerpts, and transactions and administering agency shall furnish copies thereof if requested."

3l. Federal Master Agreement 08-5058R, Article IV, Paragraph 19 and State Master Agreement 00221S, Article IV, Paragraph 18 state in part, "ADMINISTERING AGENCY agrees, and will assure that its contractors and subcontractors will be obligated to agree that (a) Contract Cost Principles and Procedures, 48 CFR, Federal Acquisition Regulations System, Chapter 1, Part 31, et seq., shall be used to determine the allowability of individual PROJECT cost items and (b) those parties shall comply with federal administrative

procedures in accordance with 49 CFR, Part 18, Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments…"

3m. Federal Master Agreement 08-5058R and State Master Agreement 00221S, Article IV, Paragraph 2 state in part, "ADMINISTERING AGENCY, its contractors and subcontractors shall establish and maintain an accounting system and records that properly accumulate and segregate incurred PROJECT costs … The accounting system of ADMINISTERING AGENCY, its contractors and all subcontractors shall conform to Generally Accepted Accounting Principles…"

Finding 4

4a. 49 CFR 18.36 (f) (1) states in part, "…a cost analysis will be necessary when adequate price competition is lacking, and for sole source procurements, including contract modifications or change orders."

4b. LAPM Chapter 16 states in part, "…The administering agency's Resident Engineer, Assistant Resident Engineers, and construction inspectors shall keep daily reports to record work in progress….The narrative portion of the report should include a description of the contractor's operation and the location where the work was performed. It should also include statements made by the contractor or agency personnel, which are pertinent to the work. The report must contain the name of the contractor or subcontractor performing the work…"

4c. LAPM Chapter 16 states in part, "…The calculations on source documents are to be checked in accordance with good engineering practice and the name of the checker included thereon…"

4d. LAPM Chapter 16 states in part, "…All change orders are to be approved by the administering agency in advance of any work being done on the change…"

Finding 5

5a. 2 CFR Part 225 Appendix B, 11. (a) states, "Depreciation and use allowances are means of allocating the cost of fixed assets to periods benefiting from the asset use. Compensation on the use of fixed assets on hand may be made through depreciation or use allowance."

5b. Per Federal Emergency Management Agency, 2008 Schedule of Equipment Rates: "The rates on this schedule are applicable to major disasters and emergencies declared by the president..."

5c. 2 CFR 225 Appendix A, C. 1. states in part, "…To be allowable under Federal awards, costs must meet the following general criteria: … b. Be allocable to Federal awards under the provisions of 2 CFR part 225…"

5d. 2 CFR 225 Appendix A, F. 1. states in part, "…Indirect costs are those: Incurred for a common or joint purpose benefiting more than one cost objective, and not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved…"

5e. 2 CFR 225, Appendix E, D. 1. (a) states "All departments or agencies of the governmental unit desiring to claim indirect costs under Federal awards must prepare an indirect cost rate proposal and related documentation to support those costs. The proposal and related documentation must be retained for audit in accordance with the records retention requirements contained in the Common Rule."

5f. LAPM Chapter 5 states in part, "A local agency without an assigned cognizant federal agency and/or who have not been required by their cognizant federal agency to submit their Indirect Cost Rate Proposal and Central Service Cost Allocation Plan for review and approval, will submit their proposals to Caltrans Audits and Investigation for their review and approval under delegation from the FHWA, California Division."

5g. 2 CFR 200.431(d) states in part, "Fringe benefits may be assigned to cost objectives by identifying specific benefits to specific individual employees or by allocating on the basis of entity-wide salaries and wages of the employees receiving the benefits…"

5h. 2 CFR 200, Appendix VII, F states in part, "If overall fringe benefit rates are not approved for the governmental unit as part of the central service cost allocation plan, these rates will be reviewed, negotiated and approved … during the indirect cost negotiation process…"

Finding 6

6a. 2 CFR 225 Appendix A, C.1. states in part, "… To be allowable under Federal awards, costs must meet the following general criteria: … b. Be allocable to Federal awards under the provisions of 2 CFR Part 225… c. Be authorized and not prohibited under State or local laws or regulations… j. Be adequately documented"

6b. 2 CFR 225 Appendix A, C. 2. states in part, "…A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when governmental units or components are predominately federally-funded..."

6c. 2 CFR 225 Appendix A, C. 3. (a) states, "A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received."

6d. State Master Agreement 00221S Article II, Paragraph 2 states in part, "The furnishing of rights of way…as provided herein includes, and is limited to, the following, unless the program supplement provides otherwise…(e) The cost of all unavoidable utility relocation, protection or removal."

6e. Resolution TCIF-P-0708-01, Paragraph 2.5 states in part, "… the Commission's approval of individual project TCIF funding is only for the cost of Construction (and construction support)…"

6f. 2 CFR Part 225 Appendix A, E.1. states in part, "…Direct costs are those that can be identified specifically with a particular final cost objective."

6g. State Master Agreement 00221S Article VI, Paragraph 2 states, "ADMINISTERING AGENCY shall conform to all applicable State and Federal statutes and regulations, and the Local Assistance Program Guidelines and Local Assistance Procedures Manual as published by STATE and incorporated herein, including all subsequent approved revisions thereto applicable to PROJECT unless otherwise designated in the project-specific executed PROJECT SUPPLEMENT."

6h. LAPM Chapter 13 states in part, "…Project Engineer and Utility Coordinator shall make sure the owner provides credit when applicable, for salvage value, betterment, and all supporting documents are attached to the invoice…"

Finding 7

7a. 2 CFR 225 Appendix B, 8. h. (5) (a) states in part, "Personnel activity reports or equivalent documentation must … reflect an after-the-fact distribution of the actual activity of each employee."

7b. 2 CFR 225 Appendix B, 8. h. (5) (d) states, "Personnel activity reports … must be signed by the employee."

7c. 2 CFR 225 Appendix B, 8. h. (5) (e) states, "Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards but may be used for interim accounting purposes,"

7d. City's Timekeeping User Guide for Public Utilities states in part "…Timesheets will be approved..."

Finding 8

8a. 49 CFR 18.36 (b) (1) states, "Grantees and subgrantees will use their own procurement procedures which reflect applicable State and local laws and regulations, provided that the procurement conform to applicable Federal law and the standards identified in this section."

8b. 49 CFR 18.36 (b) (2) states, "Grantees and subgrantees will maintain a contract administration system which ensures that contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders."

8c. 49 CFR 18.20 (b) (3) states in part, "Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets.

Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes."

8d. 23 CFR 172.5 (c) states in part, "The contracting agency shall prepare and maintain written policies and procedures for the procurement, management, and administration of engineering and design related consultant services. … These policies and procedures shall… as appropriate for each method of procurement… ensure compliance with Federal and State laws, regulations, and the requirements of this part…

8e. 23 CFR 172.9 (d) states in part, "A full-time, public employee of the contracting agency qualified to ensure that the work delivered under contract is complete, accurate, and consistent with the terms, conditions, and specifications of the contract shall be in responsible charge of each contract or project… The public employee's responsibilities shall include: … (ii) Being familiar with the contract requirements, scope of services to be performed… (iii) Being familiar with the qualifications and responsibilities of the consultant's staff and evaluating any requested changes in key personnel… (v) Ensuring consultant costs billed are allowable in accordance with the Federal cost principles and consistent with the contract terms as well as the acceptability and progress of the consultant's work…"

Finding 9

9a. Federal Master Agreement 08-5058R, Article IV, Paragraph 4 states in part, "ADMINISTERING AGENCY agrees, as a minimum, to submit invoices at least once every six (6) months commencing after the funds are encumbered on either the project-specific PROGRAM SUPPLEMENT or through a project-specific finance letter approved by STATE. STATE reserves the right to suspend future authorizations/obligations, and invoice payments for any on-going or future federal-aid project by ADMINISTERING AGENCY if PROJECT costs have not been invoiced by ADMINISTERING AGENCY for a six (6) month period"

9b. State Master Agreement 00221S, Article IV, Paragraph 4 states, "ADMINISTERING AGENCY agrees, as a minimum, to submit invoices at least once every six months commencing after the STATE FUNDS are encumbered on either the project-specific PROGRAM SUPPLEMENT or through a project-specific finance letter approved by STATE. STATE reserves the right to suspend future allocations and invoice payments for any on-going or future STATE FUNDED project performed by ADMINISTERING AGENCY if PROJECT costs have not been invoiced by ADMINISTERING AGENCY for a six-month period."

ATTACHMENT V

Public Works
Department

City of Arts & Innovation

December 29, 2015

Marsue Morrill, CPA
Chief, External Audits – Local Governments
State of California
Audits & Investigations
Department of Transportation

RE: RESPONSE TO DRAFT AUDIT REPORT

Ms. Morrill:

Overview

The City takes the State and Federal requirements for the use of its funds seriously and has always worked closely with the Caltrans District Local Assistance office to comply with the intent of the law and oversight regulations. We believe that we have complied with the various guidelines governing the expenditure of these funds and that taxpayer dollars were expended fairly on eligible expenses. That said, we acknowledge that there are some areas for improvement and are in the process of making the appropriate procedural changes to address certain documentation issues and other procedural matters. However, there are several findings that we dispute, particularly with regards to Finding Nos. 1 and 6 related to business relocation expenses and utility relocations.

It is important to note that any amounts listed in the draft report as unallowable or questioned costs are the total costs. The City of Riverside was only reimbursed a percentage of those amounts based on the applicable reimbursement ratio for the project, phase of work, and funding source.

1. Questioned Relocation Costs

Experienced Tractor Parts (ETP) was a tenant at 670 Iowa Avenue in which a portion of the property was acquired by the City as part of the Iowa Grade Separation Project. The acquisition required relocation of ETP. The City paid ETP $2.8 million as part of a settlement for compensation of business relocation, fixtures and equipment and loss of business goodwill. The City believed the settlement was fair given that ETP had previously requested $4.3 million and given the possibility of this going to trial a jury award would likely result in an amount much greater than what was negotiated with ETP.

Caltrans has asserted that the payment to ETP for business relocation and loss of goodwill were not documented properly and equate to a global settlement and, therefore, it is not in compliance with the Uniform Act.

The City strongly believes that it complied with the intent of the law and oversight regulations since the City, in good faith, relied-upon consultations with Caltrans to handle this in a way that was acceptable to the State and in accordance with the rules and regulations. For instance, the City's former (and now retired) Real Property Agent, Ruben Duran, discussed the settlement and claim with David Chavez and Mike Romo at Caltrans in July/August 2011 to ensure that this was done in a manner consistent with the rules and regulations. Most importantly, the City also believes that the value of the funds expended, which were critical to the delivery and development of the project, were fair and reasonable.

In addition, in April 2014 a revised Finance Letter from the Department of Finance was received that increased federal relocation funding from $272,000 to $2,271,051. Given the additional funding, staff will continue to work with the Caltrans Division of Local Assistance to validate and support the costs we believe to be valid and accurate.

2. Improper Procurement Practices

While the City *generally* agrees with the procurement-related exceptions noted in the report, in that some procurement documentation could not be located. This is due in part to a relocation of Public Works' offices and turn over in key project manager staff.

Additionally, the City is in the process of drafting new procurement policies and procedures to ensure compliance with state and federal laws and regulations. These new policies and procedures align City practices with federal regulations and guidelines. We will work with Caltrans Division of Local Assistance for feedback and concurrence with the newly drafted policies and procedures once we are ready to implement.

3. Contract Management Practices Need improvement

While the City *generally* agrees with the contract management exceptions noted in the report, the City disagrees with the item regarding Donna Desmond and Lea Associates.

The report implies that the City Attorney's Office does not formalize its agreements for services, which is not accurate. The exception involved an isolated incident in which the City was unable to locate the agreement for a particular consultant. While the City agrees that there is room for improvement with respect to maintaining documentation, it is important to note that this was an isolated incident.

4. Construction Management Practices Need improvement

The City disagrees with and/or would like to provide some context for exceptions for daily reports and the contract change order (CCO) cited.

The construction files contain other supporting documentation besides the daily reports used for preparation of the progress pay estimates (PPE) such as calculation sheets and weigh certificates. These other supporting documents were also provided to the auditors on December 3, 2013.

The report indicates that an independent cost estimate and cost analysis was not done prior to work being performed on a contract change order. This is not accurate. However, the City acknowledges that it failed to obtain the related documentation showing that the engineer's cost estimate was performed prior to the work being performed and will work to maintain this type of documentation moving forward.

The report suggests that prior approval was not obtained for the execution of a contract change order and instead it was approved after all work was completed. This is not accurate. However, the City acknowledges that it failed to obtain the related documentation showing that the change order was approved prior to the work being performed and will work to maintain this type of documentation moving forward.

5. Questioned Equipment, Central Stores, and Overhead Cost Rates

The City disagrees with and/or would like to provide some context for questioned equipment, central stores, and overhead cost rates.

The report indicated that the City used equipment rates prepared by FEMA rather than preparing its own rate. While we agree with this statement, it is important to note that the FEMA rates are considered the national standard for equipment rates which is used by thousands of public agencies nationwide.

As clarification, the two instances cited of equipment usage exceeding the hours the assigned employees charged to the project were for particular pay periods. Over the life of the project both employees charged more hours to the project than equipment hours. It is more likely that the project was undercharged than overcharged for applicable equipment costs. This documentation was provided to the auditors on July 19, 2013.

The report indicated that the Central Stores overhead rate (20%) is unsupported and unallowed. The City disagrees with this statement since the City provided Caltrans with various documents supporting the overhead rate, which is used to cover the operating expenses (personnel and non-personnel) of Central Stores.

An explanation was provided to the auditors on March 3, 2014, regarding the employee who ordered materials from Central Stores during a month the employee charged no labor hours to the project. The employee was anticipated to work on the project on the date the ordered materials were to be used on the project, but ended up being re-assigned after the Monday holiday. Documentation was provided with the explanation showing that the materials were used for the project.

The report indicated that indirect labor overhead costs, including fringe benefits, were not submitted to Caltrans Audits and Investigations for review/acceptance

or approval prior to billing for such costs. However, the City does not consider fringe benefits to be an indirect cost since amounts charged to the project and requested for reimbursement only included costs directly attributable to the project. The City records employee benefit costs by charging them to each project using a conservative estimated fringe benefit rate that is applied to actual salaries that were charged directly to the program. These rates were approved by the City in accordance with CFR 225 (Appendix E, Section F.1).

6. <u>Unallowable and Questioned Costs</u>

Caltrans indicated in item 6(a) that non-project related costs were billed to a project. However, it is important to note that this involved an isolated incident in which a flood control invoice for $910.47 was mistakenly charged to the wrong TCIF project.

For Item 6(b), County Flood Control staff provided additional clarification for how to read the back up for their invoices to the auditors on July 22, 2013. While the invoices are a little confusing, containing current charges and additional deposit amounts, the explanation made it clear how the invoice amount was derived.

For Item 6(d), the circumstances make it appropriate to charge the cost of safety vests directly to the project. The railroad required orange safety vests to be worn in the railroad right-of-way when city employees normally use lime green vests. The average life in the field of a safety vest is approximately six months and railroad grade separation construction projects typically take longer than 18 months.

Item 6(e) questions $1.2 million of utility relocation work that was performed during the construction phase of the Magnolia Avenue grade separation project. Caltrans indicated that utility relocation work is considered Right-of-Way work. However, Caltrans did not provide a basis for their determination.

The utility relocation work performed during the construction phase is considered construction costs based on our agreements with the State for the Magnolia project. The Project Supplement Agreement Article 4, page 3, indicates that the project will be administered in accordance with the TCIF Guidelines, the Project-specific Baseline Agreement, and the Project Supplement Agreement. Historically, utility relocation work performed during the

construction phase is considered construction cost, not right-of-way cost. Although the TCIF Guidelines are silent regarding what is included as construction costs, other Caltrans documents offer more detail supporting this historical treatment. For example, Caltrans Local Assistance Procedures Manual Chapter 3, page 10, indicates that "eligible construction costs include" among other items, "utility or railroad work that is a part of the physical construction of the project".

Therefore, we disagree with this finding.

7. Timekeeping Needs Improvement

Item 7 indicated that timesheets were filled out prior to the end of the shift/pay period. While this may be partially true, it is important to note that this only occurs on pay periods that involve a holiday which impacts the payroll processing timeline. In order to meet payroll deadlines, during these shortened pay cycles, office staff would assist in the completion of field staff timesheets in order to ensure proper inclusion in the payroll run. Staff only entered time that was given to them as estimates and in no instance entered time without the employees or supervisor's approval and knowledge. It is also important to note that timecard corrections are posted after-the-fact to adjust any differences between actual time entries and estimates that may have been made. In accordance with 2 CFR 225 Appendix B 8.h(5)(e)(iii) this is acceptable. In addition, the timesheets submittals were approved by supervisory staff directly responsible for the project activity and any issues in time keeping would have been addressed prior to final approval. Ideally, all staff would complete their own timesheets; however, due to the nature of fieldwork involved it is at times impractical for staff to leave field operations and access the City's timekeeping software. As such, it may still be necessary for office staff to assist in the preparation of timesheets during shortened pay cycles. While the practice is not the norm for the City the mitigating factor for these infrequent occasions is the timesheet approval by supervisors' and the subsequent timecard corrections posted after-the-fact to adjust differences between estimates and actual time incurred.

8. Policies and Procedures Need Improvement

Management concurs with the recommendation. As part of a continual process improvement to align with best practices in proper grant administration and monitoring a policy is currently being drafted that addresses the issues noted in the audit. The draft policy and procedures manual will set forth the requirements that the City must adhere to in the solicitation, selection and administration of federally funded contracts.

9. Grant Management Needs Improvement

Management concurs with the recommendation. The resource issue is currently being addressed. Additional staff is currently being trained in grant administration and monitoring to assist in the timely invoice submittal process. To ensure the timely submittal of invoices for reimbursement we will commit to invoicing at least every six months.