State of California
DEPARTMENT OF TRANSPORTATION

California State Transportation Agency

Memorandum

Serious drought.
Help Save Water!

To: RIHUI ZHANG, Chief
Division of Local Assistance

Date: September 16, 2015

File: P1590-0410

From: MARSUE MORRILL, CPA MarSue
Chief, External Audits – Local Governments
Audits & Investigations

Subject: **INDIRECT COST ALLOCATION PLAN AUDIT – COUNTY OF SAN JOAQUIN, DEPARTMENT OF PUBLIC WORKS, DIVISIONS OF ENGINEERING AND DEVELOPMENT SERVICES**

At the request of Caltrans, Audits and Investigations (A&I), the State Controller's Office (SCO) conducted an audit of the County of San Joaquin, Department of Public Works (County), Divisions of Engineering and Development Services' Indirect Cost Rate Proposal (ICRP) for fiscal year (FY) 2012/13 to determine if the ICRP was presented in accordance with Title 2 Code of Federal Regulations Part 225 (2 CFR Part 225). The audit report is attached.

The audited indirect cost rate of 58.01 percent is lower than the previously accepted rate of 85.23 percent for the Division of Engineering. As a result, the County is required to reconcile all prior reimbursement claims using the lower audited rate. Any resulting overpayment must be repaid to Caltrans within 30 days or by the next billing cycle, whichever occurs first. The audited indirect cost rate of 44 percent is higher than the accepted indirect cost rate of 31.85 percent for the Division of Development Services. As a result, the County should reconcile all prior reimbursement claims using the higher audited rate.

Please provide our office with a corrective action plan, including time lines, to address the County's reconciliations and repayment of overpaid costs by November 2, 2015.

If you have any questions, please contact Alice Lee, Audit Manager, at (916) 323-7953.

Attachment

c: Roger Janes, Business Administrator, Department of Public Works, County of San Joaquin
Jeri Wong, Accounting Manager, Department of Public Works, County of San Joaquin
Janice Richard, Director, Financial Services, Federal Highway Administration
Jack Lord, Director, Planning and Air Quality, Federal Highway Administration
Kara Magdaleno, Administrative Program Assistant Planning and Finance, Federal Highway Administration
Veneshia Smith, Transportation Financial Manager, Federal Highway Administration
Parminder Singh, Senior Transportation Engineer, Caltrans District 10
Annette Goudeau, Audits and Federal Performance Measures Analyst, Caltrans Division of Local Assistance
David Saia, LAPM/LAPG Coordinator, Caltrans Division of Local Assistance

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SAN JOAQUIN COUNTY

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Final Report

INDIRECT COST RATE PROPOSAL AUDIT OF CALTRANS CONTRACT NO. 77A0034 (Audit Request No. P1590-0410)

July 1, 2012, through June 30, 2013

C.1.PRG

BETTY T. YEE
California State Controller

July 2015

BETTY T. YEE
California State Controller

July 16, 2015

MarSue Morrill, Chief
External Audits-Local Governments
Audits and Investigations, MS 2
California Department of Transportation
1304 O Street, Suite 200, MS 2
Sacramento, CA 95814

Dear Ms. Morrill:

The State Controller's Office (SCO) audited the indirect cost rate proposals (ICRPs) of San Joaquin County, Department of Public Works, Engineering Division and Development Services Division. The audit period included ICRPs for fiscal year (FY) 2012-13.

The purpose of the audit was to determine whether the ICRPs were presented in accordance with Title 2, *Code of Federal Regulations*, Part 225, Appendices A–F, and the California Department of Transportation's (Caltrans) Local Program Procedures (LPP) 04-10. The county's management is responsible for fair presentation of the ICRPs.

The indirect cost rates were adjusted as shown on Schedule 1 because the county included unallowable indirect charges. The county's proposed rates were based on entire costs of the Department of Public Works' Engineering and Development Services Divisions. Our audit determined that some indirect costs were not allocated equitably or adequately supported. Thus, we excluded $1,441,512 for FY 2012-13, which included $947,112 of indirect costs from carry-forward FY 2010-11 for the Engineering Division. We included an additional $74,227 for FY 2012-13, which excluded $37,214 from carry-forward FY 2010-11 for the Development Services Division.

If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/ls

cc: Andrew Finlayson, Chief, State Agency Audits Bureau
Division of Audits, State Controller's Office
Michael Mock, Audit Manager
Division of Audits, State Controller's Office

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Audit Report

Summary

The State Controller's Office (SCO) audited the indirect cost rate proposals (ICRPs) of San Joaquin County, Department of Public Works Engineering, and Development Services Divisions. The audit period included ICRPs for fiscal year (FY) 2012-13.

The purpose of the audit was to determine whether the ICRPs were presented in accordance with in accordance with Title 2, *Code of Federal Regulations*, Part 225 (2 CFR 225), Appendices A–F, and the California Department of Transportation's (Caltrans) Local Program Procedures (LPP) 04-10. The county's management is responsible for fair presentation of the ICRPs.

The indirect cost rates were adjusted as shown on Schedule 1 because the county included unallowable indirect charges. The county's proposed rates were based on entire costs of the Department of Public Works' Engineering, and Development Services Divisions. Our audit determined that some indirect costs were not allocated equitably or adequately supported. Thus, we excluded $1,441,512 for FY 2012-13, which included $947,112 of indirect costs from carry-forward FY 2010-11 for the Engineering Division. We included an additional $74,227 for FY 2012-13, which excluded $37,214 from carry-forward FY 2010-11 for the Development Services Division.

Background

The San Joaquin County Department of Public Works, with a staff of 374 employees in 14 divisions, is charged with the responsibility to plan, design, construct, operate, and maintain the public roads, bridges, water, wastewater systems, flood control, and solid waste systems of the county, to protect the health and welfare of the public, and preserve the county's infrastructure investments. The San Joaquin County Department of Public Works is located in Stockton, California.

The following rates were reviewed for FY 2012-13:

	Engineering	Development Services	
FY 2012-13 budgeted indirect costs	$3,318,722	$224,445	A
Carry-forward FY 2010-11	1,194,576	(29,728)	B
Total indirect costs	4,513,298	194,717	C=A+B
FY 2012-13 budgeted direct salaries and benefits	5,295,127	611,273	D
FY 2012-13 indirect cost rate	85.23%	31.85%	E=C÷D

The San Joaquin County Department of Public Works proposed indirect cost rates of 85.23% for the Engineering Division and 31.85% for the Development Services Division for FY 2012-13. These rates also included a General and Administrative first-tier rate of 8.65%. The proposed rates are based on estimates of the costs for the period covered by the rate (FY 2012-13). Therefore, our audit included the current years' estimated costs and carry-forward adjustments from two years back (FY 2010-11).

The audit was performed by the SCO on behalf of Caltrans (Audit Request No. P1590-0410). The authority to conduct this audit is given by:

- Interagency Agreement No. 77A0034, dated March 31, 2010, between the SCO and Caltrans, which provides that the SCO will perform audits of proposed ICRPs submitted to Caltrans from local government agencies to ensure compliance with 2 CFR 225 (formerly Office of Management and Budget Circular A-87) and LPP 04-10.
- Government Code section 12410, which states, "The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state and may audit the disbursement of any money, for correctness, legality, and for sufficient provisions of law for payment."

Objectives, Scope, and Methodology

The scope of the audit was limited to the select financial and compliance activities. The audit consisted of recalculating the ICRP and making inquiries of department personnel. The audit also included tests of individual accounts in the general ledger and supporting documentation to assess allowability, allocability, and reasonableness of costs and an assessment of the internal control system related to the ICRP for FY 2012-13. Changes to the financial management system subsequent to FY 2012-13 were not tested and, accordingly, our conclusion does not pertain to changes arising after this fiscal year.

We conducted this performance audit in accordance with the 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.

Our audit was conducted to determine whether (1) the county's ICRPs were presented in compliance with the cost principles prescribed in 2 CFR 225; (2) the ICRPs were in compliance with the requirements for ICRP preparation and application identified in the Caltrans LPP 04-10; and (3) the county's accounting system is accumulating and segregating reasonable, allowable, and allocable costs.

To achieve our audit objectives, we performed the following audit procedures:

- Reviewed the agency's prior audit reports;
- Reviewed the agency's written policies and procedures relating to accounting systems, procurement, and project/contract management;
- Interviewed employees, completed the internal control questionnaire, and performed a system walk-through in order to gain an understanding of the agency's internal controls, accounting systems, timekeeping and payroll systems, procurement and billing processes;
- Performed limited test of controls on a haphazard sample of transactions to confirm and validate existing documented processes and procedures;
- Tested project costs accounting systems;
- Tested indirect cost and direct cost bases by validating amounts claimed to supporting evidential matter; and
- Tested the ICAP calculation by ensuring that only allowable costs were included within the rate.

We did not audit San Joaquin County's financial statements. We limited our audit scope to planning and performing audit procedures necessary to obtain reasonable assurance that the proposed ICRP was in accordance with the 2 CFR 225 and LLP 04-10. In addition to developing appropriate auditing procedures, our review of internal control was limited to gaining an understanding of the transaction flow, accounting system, and applicable controls to determine the department's ability to accumulate and segregate reasonable, allowable, and allocable indirect and direct costs.

Conclusion

We determined that the county included some indirect costs that were not allocated equitably or adequately supported. Thus, we excluded $1,441,512 for FY 2012-13, which included $947,112 of indirect costs from carry-forward FY 2010-11 for the Engineering Division. We included an additional $74,227 for FY 2012-13, which excluded $37,214 from carry-forward FY 2010-11 for the Development Services Division.

Views of Responsible Officials

We discussed our audit results with the county's representatives during an exit conference conducted on May 20, 2014. Roger Janes, Business Administrator; and Jerry Wong, Accounting Manager, agreed with the audit results. Mr. Janes declined a draft audit report and agreed that we could issue the audit report as final.

Restricted Use

This report is solely for the information and use of San Joaquin County; the California Department of Transportation; and the SCO. It is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

July 16, 2015

Schedule 1—
Summary of Proposed and Audited Indirect Cost Rates
Fiscal Year 2012-13

Description	Proposed rate FY 2012-13	Audited rate FY 2012-13	Difference	Schedule
Engineering Division	85.23%	58.01%	-27.22%	Schedule 1A
Development Services Division	31.85%	44.00%	12.15%	Schedule 1B

Schedule 1A—
Summary of Proposed and Audited Direct Costs, Indirect Costs, and Indirect Cost Rate
Engineering Division
Fiscal Year 2012-13

	Proposed rate FY 2012-13	Audited rate FY 2012-13	Difference	Reference
Direct costs:				
Direct salaries and benefits	5,295,127	5,295,127	-	
Indirect costs:			-	
Indirect salaries and benefits	946,806	946,806	-	
Services, supplies, and other:			-	
Office expense - general	900	900	-	
Office supplies - purchasing ISF	7,781	7,781	-	
Printing/duplicating	576	576	-	
General office supplies	748	748	-	
Postage	4,127	4,127	-	
Office expense - subscriptions/periodicals	3,792	3,792	-	
Books-electronic media	7,060	7,060	-	
Communications	35,775	35,775	-	
Communications - cell phones	5,600	5,600	-	
Memberships	250	250	-	
Membership-traffic	1,100	1,100	-	
Maintenance - equipment	6,250	6,250	-	
Maintenance - software	43,824	43,824	-	
Rents and leases - copy machines	500	500	-	
Transportation and travel	1,982	1,982	-	
Transportation and travel - training seminars, workshops	15,000	15,000	-	
Professional and special services - engineering	13,729	13,729	-	
Publications and legal notices	913	913	-	
Special departmental expense	150	150	-	
Licenses and permits	5,625	5,625	-	
Engineering supplies	5,000	5,000	-	
Survey monuments	750	750	-	
Software and related licenses	15,300	15,300	-	
Miscellaneous expense	52	52	-	
Household expense	800	800	-	
Utilities	850	850	-	
Small tools and instruments	7,500	7,500	-	
Radio maintenance - ISF	1,584	1,584	-	
Rents and leases - office automation equipment	34,792	34,792	-	
Insurance - workers' compensation	31,550	31,550	-	
Insurance - casualty	1,473,817	23,778	(1,450,039)	Finding 1
Subtotal	2,674,483	1,224,444	(1,450,039)	Finding 1

Schedule 1A (continued)

	Proposed rate FY 2012-13	Audited rate FY 2012-13	Difference	Reference
Materials from road maintenance	827	827	-	
Equipment usage	912	912	-	
Subtotal division indirect costs	1,739	1,739	1,450,639	Finding 1
First-tier Administration allocation	458,029	1,413,668	955,639	Finding 2
Division A-87 County costs	184,471	184,471	-	
Carry-forward from FY 2010-11	1,194,576	247,464	(947,112)	Note 1
Total Indirect Costs	4,513,298	3,071,786	(1,441,512)	
Total Direct Salaries and Benefits	5,295,127	5,295,127	-	
Indirect Cost Rate	**85.23%**	**58.01%**	-27.22%	

Note 1: The change in carry-forward amount is due to an audit finding related to indirect costs incurred during the SCO's FY 2010-11 audit. This finding caused the FY 2012-13 carry-forward amount to be overstated.

Schedule 1B—
Summary of Proposed and Audited Direct Costs, Indirect Costs, and Indirect Cost Rate
Development Services Division
Fiscal Year 2012-13

Description	Proposed rate FY 2012-13	Audited rate FY 2012-13	Difference	Reference
Direct Costs:				
Direct salaries and benefits	611,273	611,273	-	
Indirect Costs:			-	
Indirect salaries and benefits	116,869	116,869	-	
Services, Supplies, and Other:			-	
Office expenses - general	500	500	-	
Office expenses - purchasing ISF	1,000	1,000	-	
Printing			-	
Postage	1,781	1,781	-	
Office expenses - subscriptions/periodicals	500	500	-	
Communications	5,500	5,500	-	
Transportation and travel - training seminars workshops	1,000	1,000	-	
Software and related licenses	4,700	4,700	-	
Small tools and instruments	200	200	-	
Rents and leases - office automation equip	5,018	5,018	-	
Insurance - workers' compensation	1,379	1,379	-	
Insurance - casualty	11,654	12,775	1,121	Finding 1
Subtotal Division Indirect Costs	**150,102**	**151,223**	1,121	Finding 1
First-tier Administration allocation	52,875	163,195	110,320	Finding 2
Division A-87 County costs	21,468	21,468	-	
Carry-forward from FY 2010-11	(29,729)	(66,943)	(37,214)	Note 1
Total Indirect Costs	**194,716**	**268,943**	74,227	
Total Direct Salaries and Benefits	611,273	611,273	-	
Indirect Cost Rate	31.85%	44.00%	12.15%	

Note 1: The change in carry-forward amount is due to an audit finding related to indirect costs incurred during the SCO's FY 2010-11 audit. This finding caused the FY 2012-13 carry-forward amount to be overstated.

Finding and Recommendation

FINDING—
Unallowable costs included in the indirect cost proposal

For FY 2012-13, San Joaquin County (County) proposed an 85.23% indirect cost rate for the Department of Public Works' Engineering Division and a 31.85% rate for the Development Services Division. Our audit determined the rates of 58.01% and 44.00%, a difference of 27.22% and 12.14% for Engineering, and Development Services Divisions, respectively. The difference, as discussed below, was due to unallowable costs being included in the indirect cost rate proposal (ICRP).

- The county included unallowable casualty insurance charges of $1,450,039 and $1,121 for the Engineering Division and Development Services Division, respectively, during fiscal year (FY) 2012-13. Our audit found that the casualty insurance charges were for general liability, auto, and crime insurance. The allocation methodology was based on each division's 10-year loss history and an allocation plan based on a fixed percentage of the overall general liability amount. The part that was based on a fixed percentage had been excluded from ICRP submittals in previous years because the amounts were very high and the Department of Public Works did not feel it would be appropriate to include it. During our prior audit of the ICRPs for 2009-10 through 2011-12, we advised the Department to include it in the ICRP because casualty insurance is an eligible indirect cost. However, during our current audit, we found that the part that represented the fixed percentage was not adequately supported. Therefore, we recalculated an allowable amount based on the Engineering and Development Services Divisions' percentages of the 10-year loss history compared with the county's calculation of 10-year loss history total. Subsequently, we multiplied those percentages by the total allocation amount.

- Furthermore, the county submitted its FY 2012-13 ICRP and excluded from the cost base the Trades and Labor bargaining unit because the county felt that this unit did not benefit from first-tier costs. The county was advised by Caltrans to include the unit and to resubmit its ICRP. Therefore, the county used an incorrect cost base to calculate the first-tier rate. The cost base used included the salaries and benefits of the Trades and Labor bargaining unit staff of the Department of Public Works (DPW). However, the Trades and Labor staff did not fully benefit from DPW administration. We recalculated the cost base using the percentage representing payroll staff applied to the Trades and Labor bargaining unit salaries. The change in the methodology resulted in the first-tier rate being understated by 18.05%. The understated first-tier rate caused the Engineering Division indirect costs to be understated by $955,639 and the Development Services Division indirect costs to be understated by $110,320.

Title 2 of the *Code of Federal Regulations*, Part 225 (2 CFR 225), Appendix B, section 22d(3) states in part that, "Contributions to reserves must be based on sound actuarial principles using historical experience and reasonable assumptions. Reserve levels must be analyzed and updated at least biennially for each major risk being insured and take into account any reinsurance, coinsurance, etc."

Also, 2 CFR 225, Appendix B, section 22d(4), states in part that, "If individual departments or agencies of the governmental unit experience significantly different levels of claims for a particular risk, those differences are to be recognized by the use of separate allocations or other techniques resulting in an equitable allocation."

Finally, 2 CFR 225, Appendix A, section F(1), states in part that, "To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs...Indirect cost pools should be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived."

The Engineering Division's proposed rate for FY 2012-13 was overstated by 27.22%, and the Development Services Division's proposed rate for FY 2012-13 was understated by 12.14%. The understatement and overstatement affected the carry-forward amount.

The percentages used to allocate charges to the Engineering and Development Services Divisions did not represent an equitable allocation and was not supported with adequate documentation. Also, the first-tier rate was calculated using an incorrect cost base.

Recommendation

San Joaquin County should develop and implement an equitable casualty insurance allocation methodology to ensure that unallowable charges are excluded from future ICRPs.

The county should implement the agreed-upon first-tier rate cost base methodology regarding Trades and Labor bargaining unit salaries and benefits.

The county should make the necessary adjustment to the carry-forward amount because of the disallowed costs.