A&E Consultant Contract Reviews and Indirect Cost Rate Audits and Reviews

Presented by Caltrans Audits & Investigations

Topics

- FAR Compliant Indirect Cost Rate
- CPA Indirect Cost Rate Audits
- Safe Harbor Indirect Cost Rate
- LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Standards that Apply

- 23 Code of Federal Regulation (CFR), Chapter 1, Part 172 – *Administration of Engineering and Design Related Service Contracts*
- 48 CFR, *Federal Acquisitions Regulation Systems*, Chapter 1 – *Federal Acquisition Regulation*, Part 31- *Contract Cost Principles and Procedures*
- 48 CFR – *Federal Acquisition Regulation* (FAR)
- 48 CFR, Chapter 99 – *Cost Accounting Standards*, Subpart 9900
- 49 CFR, Transportation, Subtitle A, Office of the Secretary of Transportation, Volume 1, Part 18, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Government*

Standards that Apply

- 49 CFR, Part 18.20 – *Standards for Financial Management Systems*
- 23 U.S.C. – *Letting of Contracts*
- United States Government Accountability Office, *Generally Accepted Government Auditing Standards* (GAGAS)
- American Institute of Certified Public Accountants, *Generally Accepted Auditing Standards (GAAS or GAS)*
- Caltrans' Local Assistance Procedures Manual (LAPM).
- Project Program Supplemental Agreements
- Contract terms and conditions
- Caltrans Contract Requirements and Specifications
- Federal Highway Administration, Safe Harbor Indirect Cost Rate Test & Evaluation Project Work Plan

Resources Available

- AASHTO Uniform Audit & Accounting Guide http://audit.transportation.org/Documents/UAAG-3%20FINAL.pdf
- DCAA (Defense Contract Audit Agency) Contract Audit Manual
- Internal audit and accounting staff
- Independent CPA
- FHWA Procurement, Management, and Administration of Engineering and Design Related Services - Questions and Answers - http://www.fhwa.dot.gov/programadmin/172qa.cfm#q01
- National Compensation Matrix - http://audit.transportation.org/Documents/2012_National_Compensation_Matrix(FINAL 5-7-12).xls
- National Highway Institute (NHI) Training

  http://www.nhi.fhwa.dot.gov/default.aspx

  - Using the AASHTO Audit Guide for the Procurement and Administration of A/E Contracts (FHWA-NHI-231028)
  - Using the AASHTO Audit Guide for the Development of A/E Consultant Indirect Cost Rates (FHWA-NHI-231029)
  - Using the AASHTO Audit Guide for the Auditing and Oversight of A/E Consultant Indirect Cost Rates (FHWA-NHI-231030)

FAR Compliant Indirect Cost Rate

FAR Compliant ICR

Purpose and Objective

Purpose: To highlight frequently identified issues encountered by A&E firms when developing an Indirect Cost Rate (ICR)

Objective: To help A&E firms be successful in developing a FAR compliant ICR

FAR Compliant ICR

Frequent Issues with A&E ICRs

- Some reasons why Accounting Systems fail - properly designed system should (not limited to):
  - Segregate direct, indirect, and unallowable costs
  - ID and accumulate direct costs by contract/project/cost objective
  - Accumulate costs under GL control
  - Periodically reconcile costs charged to contracts every 30-days
  - Exclude unallowable costs to contracts

Table 8-1, Common Unallowable Costs, p84, 2012 AASHTO Guide

FAR Compliant ICR

Frequent Issues with A&E ICRs

Example

- Inadequate (project) job cost system
  - No separate G/L acct. for direct, indirect, and unallowable costs
  - No ability to identify direct costs by contract
  - Inability to identify unallowable costs that should not be charged to contracts

Table 6-1, Labor Charging Checklist, p52, 2012 AASHTO Guide

FAR Compliant ICR

Frequent Issues with A&E ICRs

- Inadequate procedures over labor charging system. Proper procedures should include:
  - Requiring ALL employees to record ALL hours worked, paid or unpaid, even if over 8 hrs/day or 40 hrs/wk
  - Account for uncompensated OT
  - Ensure proper distribution of labor costs
  - Periodically reconcile Job Cost System to the GL, (i.e., every 30 days)

FAR Compliant ICR

Frequent Issues with A&E ICRs

Example

- No/Inadequate procedures over the labor charging system
  - Many salaried employees who do not receive OT pay (e.g. uncompensated OT) do not record their hours in excess of 8hrs/day or 40hrs/wk unless they work directly on a project
  - Even if OT is not paid, <u>all</u> time worked over 8hrs/day or 40hrs/wk (indirect & direct) must be recorded on time sheets

Frequent Issues with A&E ICRs

Salary Variance Method - Standard Rate Example

	Direct Hours	Indirect Hours	Hours Worked	Annual Salary	Standard Hourly Rate	Direct Labor	Indirect Labor	Labor Variance	Total Labor
Employee									
Smith	2,000	600	2,600	$ 72,800	$ 35	$ 70,000	$ 21,000	$(18,200)	$ 72,800

Ending Direct Labor: $ 70,000

Ending Indirect Labor: $ 2,800 ($21,000 - $18,200) (2,600 - 2,080 = 520 X $35 = $18,200) 2,080 = Std hrs/yr

~~~
~~~

FAR Compliant ICR

Frequent Issues with A&E ICRs

- No/Inadequate documented Executive Compensation Analysis. Proper documentation should include a description of work performed for using either:
  - Salary Surveys with Benchmarks

  Or
  - National Compensation Matrix
- Benchmark Compensation Amount - $952,308 for FY 2012
- Inadequate superior performance evaluation/documentation

  Ch. 7.6 – Criteria for Demonstrating Superior Performance, p58, 2012 AASHTO Guide

FAR Compliant ICR

Frequent Issues with A&E ICRs

- Using estimated in-house unit rates instead of creating cost centers and using actual costs

  Example: Vehicles, Printing, Computers, CADD

- If used, these unit rates s/b offset to indirect expense pool as credits or cost recoveries for direct costs as they are used on projects

- Direct Cost unit rates must be supported & audited

- Burden of proof is A/E firm's responsibility

Ch. 5.3, Cost Centers, p29, 2012 AASHTO Guide

FAR Compliant ICR

Frequent Issues with A&E ICRs

Example

- Using estimated rates instead of actual costs
  - Mileage rates s/b supported by vehicle/mileage logs, supporting any Direct usage charges
  - Vehicle/mileage logs should track
    - Allowable Indirect usage
    - Unallowable Indirect usage
    (i.e., Personal commute use)

FAR Compliant ICR

Frequent Issues with A&E ICRs

- Insufficient documentation for ODCs. Documentation should include:
  - Identification and accumulation by cost objective
  - Support that rates are based on actual costs w/o mark-ups or profit
  - Support that ODCs are treated consistently
  - Support that ODCs were not included in indirect expense pool
  - "Like-cost" category are consistently allocated in accounting system

- Not all rates proposed in contract are audited.
  - Every rate proposed (e.g. Field Office, Home Office) needs to be audited for contracts $3.5 M and above

FAR Compliant ICR

Frequent Issues with A&E ICRs

Classifying "Employee Morale" when costs are actually "Entertainment" in nature

- Examples of Employee Morale
  - Painting, new carpet to improve workplace
  - In-house health and wellness publications
  - Employee counseling services
- Examples of Entertainment
  - Gifts or prizes –not tied to performance based on <u>formal policies</u>
  - Food, Drinks, Snacks, etc.
  - Parties/Social Events, Shows/Sports Events, etc.

    Example: *Costs associated with mandatory Off-Site Staff Meetings requiring travel & lodging, food, prizes and entertainment will likely not be fully allowable. State Per Diem and Travel requirements and rates must be considered to determine allowability.*

FAR Compliant ICR

Frequent Issues with A&E ICRs

Documentation Requirements

- Adequate documentation must support FAR allowability
- Support for business purpose
- Who, what, when, where, why
- Receipts that are detailed/itemized
- Expense reports, company credit cards, and vendor invoices

FAR Compliant ICR

What to Look for When Selecting a CPA Firm to Perform an ICR Audit

- CPA should meet all GAGAS Requirements (including CPE requirements)
- CPA should be well versed in:
  - GAGAS
  - FAR Part 31
  - Cost Accounting Standards
  - 23 U.S.C. 112

FAR Compliant ICR

What to Look for When Selecting a CPA Firm to Perform an ICR Audit

- CPA should have working knowledge of the A&E industry.
- CPA should be well versed in job-cost accounting practices & systems used by A&E Firms

Prior experience conducting <u>ICR</u>

(e.g. not Construction, F/S, etc. audits)

Audits for A&E firms is important

FAR Compliant ICR

Resources

- 2012 American Association of State Highway and Transportation Officials (AASHTO) Uniform Audit and Accounting Guide.
  - For Audits of A&E Consulting Firms
  - Appendix A – Review Program for CPA Audits of Consulting Engineers' ICR
  - Appendix B – Internal Control Questionnaire

http://audit.transportation.org/Documents/UAAG-3%20FINAL.pdf

Resources

- FHWA's National Highway Institute (NHI) Training
  - FHWA-NHI-231028: *Using the AASHTO Audit Guide for the Procurement and Administration of A/E Contracts*
  - FHWA-NHI-231029: *Using the AASHTO Audit Guide for the Development of A/E Consultant Indirect Cost Rates*
  - FHWA-NHI-231030: *Using the AASHTO Audit Guide for the Auditing and Oversight of A/E Consultant Indirect Cost Rates*

http://www.nhi.fhwa.dot.gov/default.aspx

Contacts

Linda Laubinger
Audit Manager
Caltrans A&I
Linda.laubinger@dot.ca.gov
(916) 323-7957

MarSue Morrill
Audit Chief
Caltrans, A&I
Marsue.morrill@dot.ca.gov
(916) 323-7105

CPA Indirect Cost Rate Audits

What A&I is Looking for in a CPA Workpaper Review

Is the independent CPA's work sufficient to support their conclusions.

Key: Can a cold reader follow the independent CPA's work and come to the same conclusion.

Purpose and Objective

Purpose: To highlight frequently identified issues discovered during A&I's reviews of CPA's audits of Indirect Cost Rates (ICRs)

Objective: To help CPA firms be successful in auditing A&E firms' ICR

CPA Indirect Cost Rate Audits

Cognizant Audit

An audit to obtain reasonable assurance that claimed costs are accordance with the FAR Subpart 31.2 cost principles

Such audit work may be performed by:

- Home-state auditors
- Federal audit agency
- CPA firm
- Non-home state auditor designated by the home-state auditor

Cognizance

- Determines who conducts the Review to issue a cognizant approval
  - The cognizant state is determined by where financial records are maintained
- Review may involve transfer of Cognizance if Home State is not conducting a review

CFR, Ch. 1, Part 172 – Administration of Engineering & Design Related Service Contracts

CPA Indirect Cost Rate Audits

CPA Workpaper (WP) Review

- Performed by Caltrans Audits & Investigation (A&I)
- Full access to CPA's WP is required by contract provisions
- Review Independent CPA's WPs of ICR Audits
  - To ensure CPA's work performed in accordance with all applicable federal and state standards as well as, to verify the accuracy of the audited ICR

Goal of a CPA WP Review is to issue a Cognizant Letter of Approval

Cognizant Letter of Approval

- The "Cognizant Agency" issues a Cognizant Letter of Approval so that the ICR can be relied upon on future contracts with the consultant for a given year and for reliance by other state agencies using the same consultant
- If there are significant issues with the CPA's audit of a consultant's ICR, A&I will not be able to issue a Cognizant Letter of Approval

  Ch. 10.7, Failure To Meet Minimum Audit Procedures, p104, 2012 AASHTO Guide

CPA Indirect Cost Rate Audits

Differences in ICR and F/S Audits

- ICR Audits Cover
  - Statement of Direct Labor, Fringe Benefits, and General Overhead
  - Report on Internal Control
- ICR Audits require 3 additional audit assertions
  - Allowability (FAR 31.201-2)
  - Reasonableness (FAR 31.201-3)
  - Allocability (FAR 31.201.4)

CPA Indirect Cost Rate Audits

Definitions

- Allowability (FAR 31.201-2)
  - A cost is allowable only when the cost complies with all of the following requirements:
    - *Reasonableness.*
    - Allocability.
    - Cost Accounting Standards, GAAP, or other acceptable accounting methods.
    - Terms of the contract.
    - Other limitations of FAR subpart 31.2.
- Reasonableness (FAR 31.201-3)
  - "A cost is reasonable if, in its nature and amounts, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business."

CPA Indirect Cost Rate Audits

Definitions

- Allocability (FAR 31.201.4)
  - A cost is allocable if it is assignable/chargeable to one or more cost objectives or cost centers on the basis of either the relative benefits received or some other equitable relationship.
- Directly Associated Costs
  - A cost incurred as a result of incurring another related cost and typically associated with unallowable costs.

    Example: Unallowable advertising costs and the labor directly associated

CPA Indirect Cost Rate Audits

Important to Note:

When Federal and/or State Funds are Involved:

- There is more scrutiny
- Materiality levels should be lower
- More testing is required
- Should <u>not</u> be approached like a Financial Statement Audit

CPA Indirect Cost Rate Audits

Frequent Issues with CPA ICR Audits

- Difficulty getting full access to CPA and/or their WPs
- Overall lack of documentation
  - Why steps were excluded
  - Clear and complete description of analysis
  - How conclusions were reached
- No Audit Program or Audit Program is not designed for an ICR Audit

Ch. 10 , 2012 AASHTO Guide - guidance for developing audit procedures

CPA Indirect Cost Rate Audits

Frequent Issues with CPA ICR Audits

Internal Control Testing

- Labor Charging Controls – most critical area
  - Examine P&Ps
  - Timesheet testing
  - Reconciliation between payroll system, job cost system, and general ledger
- Cash Disbursement Controls – key internal control area
  - Examine P&Ps
  - Test controls over purchasing and vendor payment

CPA Indirect Cost Rate Audits

Frequent Issues with CPA ICR Audits

Internal Control Testing

- Accounting System
  - Proper segregation of Direct & Indirect costs
  - Accumulation of Direct costs by cost objective
  - Interface with timekeeping system?
  - Periodic determination of costs charged to contracts through routine posting of costs?
  - Are there controls to identify and exclude from costs charged to Government contracts unallowable amounts?

CPA Indirect Cost Rate Audits

Frequent Issues with CPA ICR Audits

- Insufficient timesheet testing
- Insufficient support consultants performed Executive Compensation analysis
- Insufficient indirect expense testing
  - No support for compliance with allowability, reasonableness, allocability
  - No assurance on general F/S assertions
  - No support for large dollar or sensitive (LDS) transactions testing
  - Non-high risk accounts not tested

Ch. 9.9 & 10.4, 2012 AASHTO Guide - information on LDS testing & materiality levels

CPA Indirect Cost Rate Audits

Frequent Issues with CPA ICR Audits

- Lack of documentation/explanation:
  - Consultant's accounting treatment of Uncompensated & Premium Overtime
  - Consultant's system accounts for all direct costs
  - If direct costs were audited for consistency
  - If "directly associated costs" were considered
  - Why In-House direct cost rates were not audited

- Insufficient disclosure of a complete review of Minimum Audit Report disclosure notes

Ch. 5.3, Cost Centers, p29, 2012 AASHTO Guide

CPA Indirect Cost Rate Audits

Contacts

Linda Laubinger
Audit Manager
Caltrans A&I
Linda.laubinger@dot.ca.gov
(916) 323-7957

MarSue Morrill
Audit Chief
Caltrans, A&I
Marsue.morrill@dot.ca.gov
(916) 323-7105

Safe Harbor
Indirect Cost Rate

Purpose and Objective

Purpose: To describe the utilization and requirements for using the safe harbor indirect cost rate (SHR)

Objective: To help eligible A&E firms understand the requirements for utilizing the SHR

Safe Harbor ICR

SHR Background

The Federal Highway Administration (FHWA) developed a national SHR of **110%** for eligible consulting firms to use on a test-evaluation basis. The testing period is from July 1, 2013 to June 30, 2016

Purpose

- To remove financial management barriers that may prevent or inhibit new, small, disadvantaged or otherwise eligible A&E firms from entering into federal or state contracts
- To provide a framework for A&E firms to establish an adequate cost history to eventually develop a FAR compliant ICR

Safe Harbor ICR

SHR Implementation

- Caltrans DPAC instructions for state A&E contracts:
  - DPAC Website http://caltrans-opac.ca.gov/aeinfo.htm
- Caltrans DLA instructions for LGA A&E contracts via bulletin:
  - DLA Website http://www.dot.ca.gov/hq/LocalPrograms/DLA_OB/DLA_OB.htm
- Caltrans A&I certification and questionnaire:
  - A&I Website http://www.dot.ca.gov/hq/audits/

Safe Harbor ICR

SHR Eligibility Requirements

- Firms that do not have a previously accepted ICR by a cognizant agency, or with an audited/accepted actual ICR within the established test period
- Firms that do not have relevant contract cost history to use as a base for developing its own indirect cost rate (consistent contract workload over consecutive years)

Safe Harbor ICR

Additional SHR Requirements

- All firms must have a project/cost accounting system capable of accumulating and tracking direct labor and other direct costs by contract, segregating indirect costs, and removing unallowable costs
- Fixed hourly labor rates need to be established for calculation of the direct labor portion of contracts
- SHR is not adjustable for the term of the contract
- No retroactive adjustment to indirect costs will be allowed for contracts utilizing the SHR

Safe Harbor ICR

Additional SHR Requirements

The SHR impacts the Indirect Cost Rate Only!

All other FAR Cost Principles must still be followed

Safe Harbor ICR

What Eligible Firms Need to Do

Eligible firms must complete and submit the following with their cost proposals:

- Consultant Certification of Eligibility; and Contract Costs and Financial Management System
- Questionnaire for Evaluating Consultant's Financial Management System

Upon satisfactory review, Caltrans A&I will issue an acceptance/approval

A rejection letter will be issued by A&I if the consultant cannot use the SHR

Safe Harbor ICR

Contacts

Linda Laubinger
Audit Manager
Caltrans A&I
Linda.laubinger@dot.ca.gov
(916) 323-7957

Nancy Shaul
Audit Manager
Caltrans A&I
Nancy.shaul@dot.ca.gov
(916) 323-7940

MarSue Morrill
Audit Chief
Caltrans, A&I
Marsue.morrill@dot.ca.gov
(916) 323-7105

LAPM Chapter 10.3
A&E Consultant Audit and Review Process

Purpose and Objective

Purpose: To highlight the changes in LAPM Chapter 10.3, "A&E Consultant Audit and Review Process"

Objective: To help Local Government Agencies (LGA). the consultant community, and independent CPAs be successful in submitting and auditing federal and state compliant A&E contracts

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Contracts/Consultants Selected for Audit or Review

Risk based approach dictated by dollar amount and other risk factors such as:

- History of satisfactory performance
- Prior FAR compliant history and audit frequency
- Financial stability
- Conformance to terms and conditions of previous contracts
- General responsiveness and responsibility
- The approximate dollar amount of all A&E contracts awarded to the consultant by Caltrans or a local agency in California within the last three calendar years.
- The number of states in which the consultant does business
- The type and complexity of the consultant's accounting system
- The relevant professional experience of any certified public accountant (CPA) performing audits of the consultant's ICR(s)
- Responses to internal control questionnaire (ICQ), see AASHTO Audit Guide, Appendix B
- Changes in the organizational structure

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Contracts/Consultants Selected for Audit or Review

- If audited or reviewed, contracts, cost proposals, and ICRs <u>are required to be modified to conform to the audit or review recommendations</u>
- LGAs are responsible for ensuring recommendations are implemented
- LGAs are subject to sanctions outlined in LAPM, Ch 10, http://www.dot.ca.gov/hq/LocalPrograms/lam/lapm.htm
- If provisions, unallowable charges, unsupported activities, or f reimbursement is a result of a lack of proper contract an inadequate financial management system

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Why are Subconsultants Included?

- 23 U.S.C. (b) (2) (B) – *Letting of Contracts states:*

  Any contract or subcontract awarded in accordance with subparagraph (A), whether funded in whole or in part with Federal-aid highway funds, shall be performed and audited in compliance with cost principles contained in the Federal Acquisitions Regulations of part 31 of title 48, Code of Federal Regulations.

- Proposed federal requirements to review subconsultants (23 CFR, Part 172)

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

How are Subconsultants Impacted?

Subconsultants are required to:

- Certify their contract costs and financial management system when ***total*** contract is $150,000 or greater – not just their portion. (LAPM Exhibit 10-K)
- Use the accrual basis of accounting when developing their ICR
- Have an adequate job cost system to identify and segregate project costs
- Submit their cost proposals with the Prime's request for audit process (LAPM Exhibit 10-A) when the ***total*** contract is $1 million or greater

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Types of Audits and Reviews Performed

While Caltrans reserves the right to audit or review any contract described in this chapter typical audits and reviews are as follows:

For Contracts less than $1 Million (Case 1)

- *Contract Audits*
- *Risk Assessments*
- *Incurred Cost Audits*
- *Financial Management System Reviews*

Case 1 contracts require a certification of contract and financial management systems cost,
(LAPM Exhibit 10-K)

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Types of Audits and Reviews Performed

For Contracts great than or equal to $1 Million (Case 2)

- Indirect Cost Rate (ICR)Audits.

  Includes examination of the consultant's proposed ICR for the applicable one-year accounting period to ensure it is in compliance with FAR cost principles

  If in compliance with FAR cost principles, a Cognizant Letter of Approval will be issued

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Case 2 Contracts Require:

- All requirements in Case 1 above – certification of contract costs and financial management system (LAPM Exhibit 10-K)

AND

- A&E consultant audit request letter and checklist, (LAPM Exhibit 10-A):
  - Proposed contract
  - Cost proposals – Prime and Subs
  - Contacts
  - ICR Schedule
  - Internal Control Questionnaire (AASHTO Audit Guide, Appendix B)
  - Prior year cognizant approved or audited ICR if available

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Types of Audits and Reviews Performed

For Contracts equal to/greater than $3.5 Million (Case 3)

- CPA Audited ICR Workpaper Review

  Includes a review of the CPA's workpapers to determine whether:

  - The audit was conducted in accordance with GAGAS
  - The CPA adequately considered the consultant's compliance with FAR
  - The audit report format, notes, and disclosures are acceptable

If in compliance with FAR cost principles, a Cognizant Letter of Approval will be issued.

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Case 3 Contracts Require:

- All requirements in Case 2 above

AND

- **One** of the following:
  - Another state DOT's approved ICR schedule **AND** Cognizant Letter of Approval

  OR
  - CPA Audited ICR (Required) **AND** Audited F/S (if any)

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Conformance Letter

A&I will review all Case 2 and 3 audit requests for the following in order to issue a Conformance Letter:

- If all elements are included with LAPM Exhibit 10-A (i.e. Complete Packet)
- If cost proposal(s) are in the correct format (see LAPM 10.2 *Determine Method of Payment* and Exhibit 10-H)
- Internal Control Questionnaire (AASHTO Audit Guide, Appendix B) – and all required attachments
  - Must have a job-cost accounting system
  - Must have prepared the overhead schedule on accrual basis

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Conformance Letter

A&I will review all Case 2 and 3 requests for the following (cont.):

- If all required fiscal provisions are included in the proposed contract (LAPM Exhibit 10-R):
  - Performance Period, begin and end date (Article IV);
  - Allowable Costs and Payments (Article V);
  - Termination (Article VI);
  - Cost Principles and Administrative Requirements (Article X);
  - Retention of Records/Audit (Article XII);
  - Audit Review Procedures, AUDIT CLAUSE (Article XIV. D.) **must be verbatim**;
  - Subcontracting (Article XV);
  - Equipment Purchase (Article XVI);
  - State Prevailing Wage Rates (Article XXVII);
  - Conflict of Interest (Article XXVIII);
  - Rebates, Kickbacks or other Unlawful Consideration (Article XXIX);
  - Prohibition of Expending State or Federal Funds for Lobbying (Article XXX).

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Conformance Letter

- Conformance Letter will identify any deficiencies
- Deficiencies addressing *requirements* must be corrected before contract can be executed but do not need to be cleared through A&I before doing so
- Deficiencies addressing *suggestions* are to be corrected as necessary before contract can be executed but do not need to be cleared through A&I before doing so
- Executed contract must be submitted to A&I
- Contracts cannot be executed until A&I issues a Conformance Letter
- Conformance Letters will be issued within 30 business days of receipt of a complete request packet

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Frequent Issues with Conformance Letter

- Contract payment method is not clear
- Cost proposals are not in the correct format

LAPM, Chapter 10.2

"DETERMINE METHOD OF PAYMENT

The method of payment of contract must be specified. Four methods are permitted depending on the scope of services to be performed:

- Actual Cost-Plus-Fixed Fee (see LAPM Exhibit 10-H, Example #1);
- Cost Per Unit of Work (see LAPM Exhibit 10-H, Example #3);
- Specific Rates of Compensation (see LAPM Exhibit 10-H, Example #2);
- Lump Sum (see LAPM Exhibit 10-H, Example #1)."

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Frequent Issues with Conformance Letter cont.

- Cost proposals for all subconsultants are missing
- Certifications (Exhibit 10-K) are not submitted for subconsultants
- ODCs are not itemized on cost proposals
- Key personnel are not named on cost proposals
- Not all required fiscal provisions are included

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Frequent Issues with Conformance Letter cont.

- Beginning and end dates of Agreement are missing
- AUDIT CLAUSE is not included – **must be verbatim (LAPM** Audit Review Procedures Article XIV. D)
- Outdated versions are used (e.g. LAPM Exhibits 10-A, 10-K)
- "Fiscal Period Covered" on Certification (LAPM Exhibit 10-K) should be the fiscal period the Indirect Cost Rate was developed

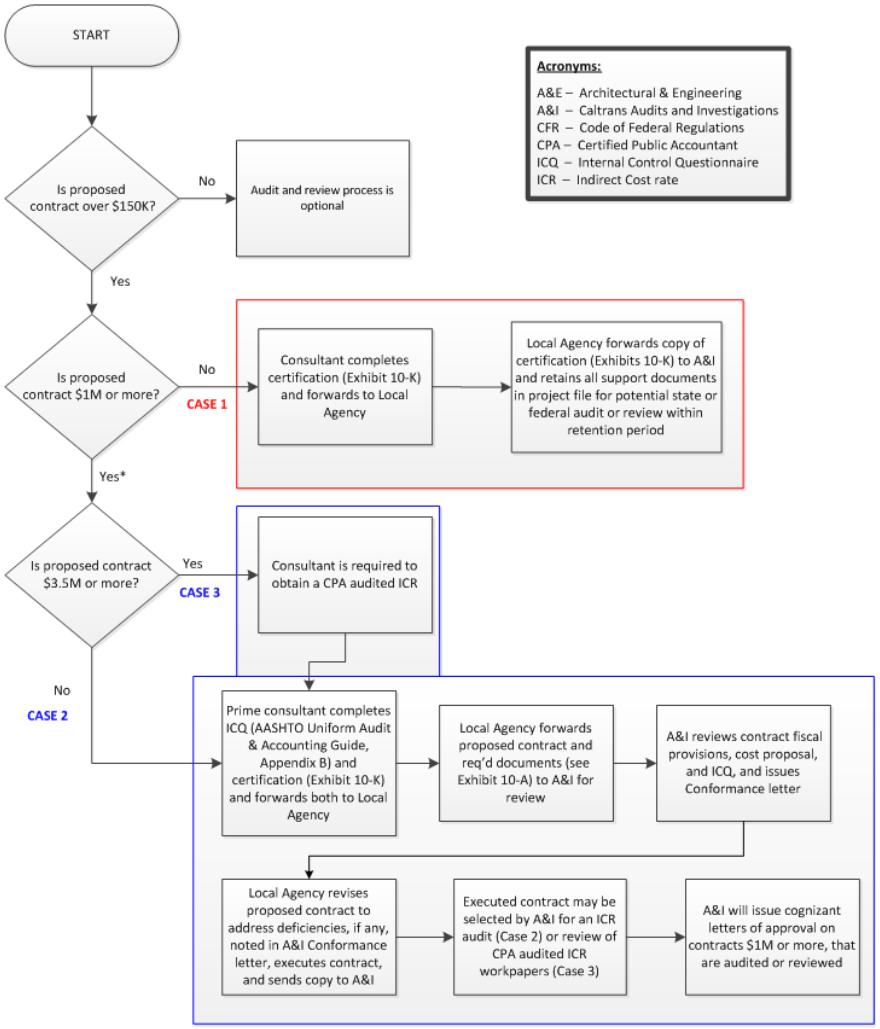
LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Summary of Contracts to be Audited or Reviewed

Proposed Contract Amount	***Documents Required***	***Conformance Letter Issued?***	***Audit/Review***	***If Audited or Reviewed will Cognizant Letter of Approval be Issued?***
Less than $150K	None	No	Audit/review optional	N/A
Between $150K and $1M **Case 1.**	Certifications by Consultants, including subs (Exhibit 10-K)	No	May be selected for Audit or Review.	***If*** Indirect Cost Rate (ICR) Audit is performed.
Between $1M and $3.5M **Case 2.**	Proposed contract, certifications, Internal Control Questionnaire, etc. (Exhibit 10-A.)	Yes	May be selected for ICR Audit.	Yes
$3.5M or greater **Case 3.**	Proposed contract, certifications, Internal Control Questionnaire, etc. **AND** CPA Audited ICR. (Exhibit 10-A)	Yes	May be selected for Review of CPA's workpapers of audited ICR	Yes

LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process

Audit Process Flowchart



Acronyms:

A&E – Architectural & Engineering
A&I – Caltrans Audits and Investigations
CFR – Code of Federal Regulations
CPA – Certified Public Accountant
ICQ – Internal Control Questionnaire
ICR – Indirect Cost rate

* Note: For A&E consultant contracts of $1M or more, local agency may begin, but not conclude cost negotiations with the best qualified firm until a Conformance Letter is received from A&I.

Contacts

Nancy Shaul
Audit Manager
Caltrans A&I
Nancy.shaul@dot.ca.gov
(916) 323-7940

MarSue Morrill
Audit Chief
Caltrans, A&I
Marsue.morrill@dot.ca.gov
(916) 323-7105