DEPARTMENT OF TRANSPORTATION
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March 24, 2015

Mr. Greg Scoles
City Manager
City of Belmont
1 Twin Pines Lane, Suite 320
Belmont, CA 94002

Dear Mr. Scoles:

At the request of the California Department of Transportation (Caltrans), Audits and Investigations (A&I), the State Controller's Office (SCO) conducted an audit of the City of Belmont, Department of Public Works (City), Indirect Cost Rate Proposal (ICRP) for fiscal year (FY) 2010/2011 to determine whether the ICRP is presented in accordance with Title 2, Code of Federal Regulations (CFR), Part 225.

Based on audit work performed by the SCO, we determined the City's ICRP for FY 2010/2011 is presented in accordance with Title 2 CFR, Part 225. The approved indirect cost rate is 42.96% of the total direct salaries and wages plus benefits.

The rate of 42.96% supersedes the rate of 44.15% accepted in our letter to you dated April 11, 2012. Since the audited indirect cost rate is lower than the previously accepted rate, the City is required to reconcile all prior reimbursement claims using the lower audited rate. Any resulting overpayments should be repaid to Caltrans within 30 days or by the next billing cycle, whichever comes first.

The audit identified $30,522 in overstated indirect costs and $13,174 in overstated direct labor costs. Actual direct costs and indirect labor costs were segregated using an allocation process instead of personnel activity reports.

This report is intended solely for the information of the City, Caltrans Management, the California Transportation Commission, and the Federal Highway Administration (FHWA). However, this report is a matter of public record and its distribution is not limited.

Please retain a copy of this letter with your ICRP. Copies of this letter were sent to Caltrans' District 4, Caltrans' Division of Accounting, and FHWA. If you have any questions, please contact Alice Lee, Audit Manager, at (916) 323-7953.

Sincerely,

ZILAN CHEN
Chief, External Audits
Local Governments
Audits and Investigations

Enclosure:
City of Belmont, Department of Public Works, Audit Report, Indirect Cost Plan Audit, FY 2010/2011, Prepared by California State Controller's Office

c: Janice Richard, Director, Financial Services, Federal Highway Administration
Jermaine Hannon, Director, Planning and Air Quality, Federal Highway Administration
Kara Magdaleno, Administrative Program Assistant, Planning and Finance, Federal Highway Administration
C. Edward Philpot, Jr., Branch Chief, Grants/Public Engagement, Office of Community Planning, California Department of Transportation
Andrew Finlayson, Chief, State Agency Audit Bureau, California State Controller's Office
James Ogbonna, Chief, Rural Transit and Intercity Bus Branch, Division of Mass Transportation, California Department of Transportation
Thomas Fil, Director, Department of Finance, City of Belmont
Sylvia Fung, Chief, Office of Local Assistance, District 4, Division of Planning and Local Assistance, California Department of Transportation
Ezequiel Castro, Chief, Associate Transportation Planner, Division of Mass Transportation, California Department of Transportation
Erin Thompson, Senior Environmental Planner, Division of Transportation Planning, California Department of Transportation
Michael Mock, Audit Manager, State Agency Audit Bureau, State Controller's Office
Sean Tsao, Audit Manager, State Agency Audit Bureau, State Controller's Office
Leticia Alvarez, Assistant Director, Department of Public Works, City of Belmont
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Lai Huynh, Audits & Federal Performance Measures Analyst, Division of Local Assistance, California Department of Transportation
David Saia, LAPM/LAPG Coordinator, Division of Local Assistance, California Department of Transportation

P1590-0243

CITY OF BELMONT

Audit Report

INDIRECT COST RATE PROPOSAL AUDIT OF CALTRANS CONTRACT NO. 77A0034 (Audit Request No. P1590-0243)

July 1, 2010, through June 30, 2011

BETTY T. YEE

California State Controller

January 2015

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BETTY T. YEE
California State Controller

January 29, 2015

Zilan Chen, 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. Chen:

The State Controller's Office (SCO) audited the indirect cost rate proposal (ICRP) of the City of Belmont, Department of Public Works. The audit period included the ICRP for fiscal year 2010-11.

The purpose of the audit was to determine whether the ICRP was presented in accordance with in accordance with Title 2, *Code of Federal Regulations*, Part 225, Appendix A-F, and the California Department of Transportation's Local Program Procedures 04-10. The City's management is responsible for fair presentation of the ICRP.

We adjusted the indirect cost rate because the proposal originally submitted by the City allocated costs between direct and indirect cost pools using an allocation method that was based on employee interviews. Also, other costs were found to be unallowable due to lack of support or because they were from unallowable accounts, such as the capital account and fleet maintenance account.

Based on the adjustments, the City's rate decreased from the originally proposed amount of 44.15% to 42.96%.

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/sk

Audit Report

Summary

The State Controller's Office (SCO) audited the indirect cost rate proposal (ICRP) of the City of Belmont, Department of Public Works. The audit period included the ICRP for fiscal year (FY) 2010-11.

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

We adjusted the indirect cost rate as shown on Schedule 1 because the proposal originally submitted by the City allocated costs between direct and indirect cost pools using an allocation method that was based on employee interviews. Also, other costs were found to be unallowable due to lack of support or because they were from unallowable accounts, such as the capital account and the fleet maintenance account.

Based on the adjustments, the City's rate decreased from the originally proposed amount of 44.15% to 42.96%.

Background

The City of Belmont operates under the council-manager form of government. Policy-making and legislative authority are vested in a governing council consisting of the mayor and four other members. The City Manager is responsible for carrying out the policies and ordinances of the Council, for overseeing daily operations of the City, and for appointing the heads of the departments, one of which is the Public Works Department

The Public Works Department provides services to the public in two primary areas: Transportation and Environmental Services.

Transportation Services plans and maintains a safe and efficient transportation infrastructure to meet the community's mobility needs through the maintenance of the public right-of-way, traffic control devices and streets lights; maximizing traffic management strategies; managing pavement and infrastructure programs; designing and constructing transportation capital improvement projects; and participating in regional transportation discussions and projects.

Environmental Services safeguards the environment for the health, protection, and benefit of the community. Environmental Services ensures that the City complies with all applicable sewer, storm drain, and solid waste laws and regulations through increasing awareness and participation in environmental protection efforts; inspections of properties and enforcement for pollution control regulatory compliance; managing the collection, recycling, and disposal of solid waste; maintaining roads and storm drain systems to minimize pollutants; and the maintaining and constructing sewer and storm drain infrastructure.

The audit was performed by the SCO on behalf of Caltrans (Audit Request No. P1590-0243). The authority to conduct this audit is given by:

- Interagency Agreement No. 77A0034, dated March 31, 2011, between the SCO and Caltrans, which provides that the SCO will perform audits of proposed ICRPs submitted to Caltrans from local governmental 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 the disbursements of any money, for correctness, legality, and for sufficient provisions of law for payment."

The audit was performed by the SCO on behalf of Caltrans (Audit Request No. P150-0137). 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 2010-11. Changes to the financial management system subsequent to FY 2010-11 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 city's ICRP was presented in compliance with the cost principles prescribed in 2 CFR 225; (2) the ICRP was in compliance with the requirements for ICRP preparation and application identified in the Caltrans LPP 04-10;

(3) and accounting system is accumulating and segregating reasonable, allowable, and allocable costs.

We did not audit the City of Belmont'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

The City of Belmont, Department of Public Works' ICRP for FY 2010-2011 is in compliance with the cost principles prescribed in 2 CFR 225 and the requirements for ICRP preparation and application identified in Caltrans' LPP 04-10, and the Department's accounting system is accumulating and segregating reasonable, allocable, and allowable costs. We determined that the indirect cost rate of 42.96% for FY 2010-2011 is allowable.

Views of Responsible Officials

We conducted an exit conference on October 29, 2014, and discussed our audit results with Thomas Fil, Finance Director; Brooke Lazzari, Deputy Finance Director; and Leticia Alvarez, Assistant Public Works Director. Mr. Fil, Ms. Lazzari, and Ms. Alvarez did not agree with the audit results in their entirety but agreed that we could issue the audit report as final. Responses to the findings, submitted by email on July 2, 2013, will be included in the report.

Restricted Use

This report is solely for the information and use of the City of Belmont, Department of Public Works; 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

January 29, 2015

Schedule 1—
Summary of Proposed and Audited Rates
July 1, 2010, through June 30, 2011

Description of cost	Proposed Amounts	Audit Adjustments	Audited Amounts
Salaries and Fringe Benefits			
Direct costs			
Salaries	$ 1,362,642.42	$ (13,884.68)	$ 1,348,757.74
Benefits	720,616.16	710.21	721,326.37
Subtotal	2,083,258.58	(13,174.47)	2,070,084.11
Indirect costs			
Salaries	568,928.11	13,591.02	582,519.13
Benefits	314,655.38	(63,965.25)	250,690.13
Subtotal	883,583.49	(50,374.23)	833,209.26
Total direct and indirect costs	2,966,842.07		2,903,293.37
Unallowable costs			
Salaries	—	186,048.37	186,048.37
Benefits	—	159,238.81	159,238.81
Subtotal	—	345,287.18	345,287.18
Total Salaries and Fringe Benefits	2,966,842.07	281,738.48	3,248,580.55
Expenditures			
Indirect costs			
Other professional services	4,396.54	(3,640.54)	756.00
Computer software	1,083.32	2,990.92	4,074.24
Utilities (water and PG&E)	9,405.27	3,999.23	13,404.50
Repair and maintenance services	7.21	23.31	30.52
Equipment and vehicle rentals	392.19	(392.19)	—
Liability Insurance	943.15	(943.15)	—
Communications	7,561.86	6,956.19	14,518.05
Postage and delivery services	726.10	2,347.33	3,073.43
Printing and binding	76.69	20.55	97.24
Travel and training	1,676.82	2,234.81	3,911.63
Memberships and dues	1,292.43	1,779.57	3,072.00
Miscellaneous	4,777.86	1,393.74	6,171.60
General supplies	1,992.33	2,778.45	4,770.78
Fuel	1,386.35	(308.06)	1,078.29
Books manuals and subscriptions	459.53	612.05	1,071.58
Subtotal	36,177.65	19,852.21	56,029.86
Total, direct costs	65,984.26	1,101,079.69	1,167,063.95
Total, unallowable costs	5,215,344.32	(171,387.36)	5,043,956.96
Total expenditures	5,317,506.23	949,544.54	6,267,050.77

Schedule 1 (continued)

Description of cost	Proposed Amounts	Audit Adjustments	Audited Amounts
Total Expenditures Salaries and Fringe Benefits	8,284,348.30	1,231,283.02	9,515,631.32
Total Direct Costs	2,083,258.58	(13,174.47)	2,070,084.11
Total Indirect Costs	919,761.14	(30,522.02)	889,239.12
Total Unallowable Costs	$ 5,215,344.32	$ 173,899.82	$ 5,389,244.14
Indirect Cost Rate	44.15%		42.96%

Findings and Recommendations

FINDING 1—
Improper allocation methodology

The City calculated an Indirect Cost Rate Proposal (ICRP) that excluded several expense accounts and improperly distributed salaries. Our initial review revealed several instances that created the need for adjustments:

- The trial balance summary used in development of the ICRP included capital accounts and did not include expense accounts from Divisions 703 and 730, and did not include expense accounts from Fund Numbers 234, 334, 503, 505, and 507.
    - Capital accounts are all 9000 level accounts
    - Divisions 703 and 730, and Funds Numbers 234, 334, 503, 505, and 507 are not included in costs shown by Fund/Division, yet they appear on the complete Detailed Trial Balance
- Total benefit amounts did not agree with the net debit balance for benefit accounts. Total benefit amount included an additional $10,000 due to the addition of Account No. 501-3-710-8305
- Improper methodology was used for the distribution of salaries, benefits, and operating expenses between direct and indirect costs.
    - Percentage allocation between direct and indirect cost for salaries in the city's analysis was derived from staff interviews and not from actual employee activities supported by documentation
    - The indirect costs for salaries included Afshin Oskoui, the current Public Works Director, but Mr. Oskoui was not the director during FY 2010-2011.
    - The methodology used to distribute these costs between direct and indirect costs is a percentage distribution derived from the improper methodology used to allocate direct and indirect salaries. Additionally:

Title 2, *Code of Federal Regulations*, Part 225 (2 CFR section 225), Appendix B, 8.h.4 applies to the improper methodology used by the auditee to distribute salaries and benefits based on staff interviews instead of actual time supported by documentation. 2 CFR section 225, Appendix B.8.h.4 states in part: "Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation. . . ."

The distribution of operating costs, aside from salaries and benefits, were allocated to direct and indirect cost categories based on a percentage distribution derived from the allocation of salaries using a methodology that is not acceptable. The operating costs were not allocated to the direct or indirect cost base with respect to a specific service or function.

2 CFR 225, Appendix A, D.2 states:

> There is no universal rule for classifying certain costs as either direct or indirect under every accounting system. A cost may be direct with respect to some specific service or function, but indirect with respect to the Federal award or other final cost objective. Therefore, it is essential that each item of cost be treated consistently in like circumstances either as a direct or an indirect cost. Guidelines for determining direct and indirect costs charged to Federal awards are provided in the sections that follow.

Recommendation

The City should adhere to acceptable allocation methods outlined in 2 CFR 225 and should ensure that proposals based on actual expenditures are supported by proper documentation.

Adjustments to the indirect cost rate must be made by the proper reallocation of costs based on personnel activity reports and classification of operating costs with respect to service or function.

City's Response (Email Response on July 2, 2013)

The City concurs with the finding and agrees with the adjustments.

FINDING 2—Compliance with Local Assistance Procedures Manual

The ICRP was not submitted in accordance with Section 5.14 of the Local Program Procedures Manual (LPP) and costs were not allocated according to 2 CFR 225. The ICRP does not include a subsidiary schedule showing cost categories by type as specified by Section 5.14 and as shown in exhibit 5-I of the LPP. Additionally, the methods used to allocate salaries, benefits, and other operating costs to direct and indirect are based on a method that is not accepted by 2 CFR 225.

The ICRP submission was not in accordance with Section 5.14 of the LPP as follows:

- No subsidiary worksheet was provided showing cost category type;
- No fringe benefit rate calculation was included with the proposal;
- No amount of direct base to be incurred was included with the proposal; and
- No functional statement was included.

LPP Section 5.14, Documentation of Proposal states:

> All local agencies desiring to claim their indirect cost for federal-aid and/or state funded projects must prepare an Indirect Cost Rate Proposal and Central Service Cost Allocation Plan and related documentation to support those costs. All documents related to the Indirect Cost Rate Proposal and Central Service Cost Allocation Plan must be retained for audit in accordance with the records retention

requirements in the "Common rule," Title 49, CFR, part 18. The following shall be included with each proposal as prescribed by OMB Circular A-87:

1. INDIRECT COST RATE PROPOSAL

   a. Schedule showing calculation of rates proposed including subsidiary worksheets and other relevant data, cross-referenced and reconciled to the financial data noted below. Unless a cognizant federal agency requires otherwise, the type of rate to be used is the "fixed rate" addressed in OMB Circular A-87, Attachment E, Section B, No.6.

   b. Subsidiary worksheets should include the following:

      - Schedule of actual direct / indirect costs incurred by cost category type (i.e., rent, utilities, etc...) as well as by department unit.

      - Schedule of budgeted direct costs and indirect costs by cost category type and department unit.

      - Schedule showing calculation of the over/under carry forward provision when "fixed rate" is used.

   c. A copy of the financial data (financial statements, comprehensive annual financial report, etc) on which the rate is based.

   d. The approximate amount of direct base costs to be incurred under federal-aid reimbursement. These costs should be broken out between salaries and wages and other direct costs.

   e. A chart showing the organization structure of the agency during the period for which the proposal applies along with a functional statement noting the duties and/or responsibilities of all units that comprises the agency.

   f. Certification that the Indirect Cost Rate Proposal was prepared in a manner consistent with the cost principles of OMB Circular A-87.

Recommendation

The City should submit its ICRPs in accordance with the guidelines and requirements of the LPP. The City should implement a review process that covers guidelines and requirements given in Section 5.14 of the LPP.

City's Response (Email Response on July 2, 2013)

The City concurs with the finding and will refer to the LPP when preparing future cost rate proposals to ensure that the proposal contains all required documents, worksheets, and calculations.

FINDING 3—
Improved internal controls

Our review of responses given by the City on an internal control questionnaire revealed indications of internal control weaknesses.

The following responses on the internal control questionnaire indicated weaknesses or possible weaknesses in internal control:

- New vendors can be set up in the financial system without approval.
- Financial information system users are not automatically logged out after a period of inactivity. Only some staff members have their computers set to automatically lock.
- Financial information system software does not periodically prompt the user to change password.
- While the financial information system can limit user abilities, the Deputy Finance Director has been given super-user rights and is also responsible for the maintenance of the General Ledger.
- Random unannounced checks are not performed. Checks are performed only when an anomaly is found during a reconciliation.
- No policy or guideline exists regarding the classification of costs as either direct or indirect.
- The ICRP includes only indirect and direct cost allocations for salaries from personnel working in management or supervisory roles.
- Neither the City nor its Public Works Department use a cost accounting system that employs the use of cost centers and cost codes.
- Management is not aware of Title 49 of the *Code of Federal Regulations*, Part 18.36 and how it applies to the ICRP.

Good internal control helps prevent or detect errors and fraud in a timely manner.

With finance staff able to enter new vendors into the financial system without approval, the City's ability to prevent unauthorized payments to individuals and vendors is further eroded.

The system does not time out and/or staff are not setting their computers to lock after a period of inactivity; therefore, the financial information system is at risk of unauthorized access. The financial information is at further risk of unauthorized access when the computer system does not prompt users to change passwords periodically.

The lack of unannounced and random checks of processed transactions and accounting records may allow errors or possible fraud to go undetected in a timely manner and/or never be detected at all.

The Deputy Finance Director supervises the finance staff and maintains the General Ledger, while also having super-user rights to the financial system. This gives the Deputy Finance Director the ability to circumvent internal controls.

Recommendation

The City should implement procedures for the entry of new vendors or payees that include a review and approval of management.

The City should set the "time-out" feature on its financial information system to automatically log users off after a period of no more than 30 minutes of inactivity, and staff should be encouraged to set password protection on their PCs and laptops.

Management or supervisory staff should conduct random unannounced checks of accounting work to ensure completeness and accuracy.

The Deputy Director of Finance's access in the financial system should be limited to review and approval functions. The Deputy Director of Finance should not be able to add new users or change current level user access. This function should be performed by Information Services.

The Finance Department should evaluate its internal controls to determine ways in which they can be improved.

City's Response (Email Response on July 2, 2013)

> With regard to new vendor set-up, a system of internal control includes in its design proper segregation of duties. As it applies here, vendor set-up is segregated between the departments and Finance. Departments propose new vendors, and Finance disposes those actions by their establishment. An additional control exists during the payment process where a supervisor, not involved in either of the previous two functions, approves disbursements to vendors.
>
> With regard to computers and information systems timing-out and/or locking, the financial system utilizes a master log-in protocol with the network and periodic password changes are required.
>
> With regard to random checks or review of work, random, unannounced checks are superseded by other compensation controls, including requirement for 100% verification and review of cash disbursements by an individual who is not part of the vendor submission process.
>
> General Ledger maintenance is the responsibility of the Accountant. The Deputy Finance Director supervises the work of the Accountant. The Finance Director performs monthly reviews of all published, authoritative financial statements and authorizes their release.
>
> Overall, the city does not concur with the assessment of conditions over internal control.

FINDING 4—
Need for improved timekeeping

The City does not use an electronic time keeping system for its time keeping or tracking of direct labor hours. The City maintains a manual system that consists of a spreadsheet that compiles all of the employee direct labor hours from employee timesheets (CIP Charge Back Report).

Our testing for direct labor involved a tracing the CIP Charge Back Report to employee timesheets. The CIP Charge Back Report tracks direct labor hours and groups them into Fund/Project numbers for each quarter of the fiscal year. Over the four quarters, the CIP Charge Back Report contains a total of 38 Fund/Projects. We selected three employees from each Fund/Project over the four quarters, for a total of 114 instances to test for direct labor tracking.

We found 20 instances of variances between the CIP report and employee time sheets. The variances equated to approximately 11% of the total time on the CIP report. Four timesheets were lacking a supervisor's signature.

The local agency must be able to accurately track and report direct labor costs and properly support those costs for ICRP development and invoicing purposes to ensure that any claims made are accurate and properly supported.

Recommendation

The City should implement an improved tracking system for direct labor and produce reports for time usage on projects on a weekly, bi-weekly, bi-monthly, or a monthly basis. The tracking of direct labor should be part of a job costing system that not only tracks direct costs but specifically identifies indirect costs as well.

A review process should be implemented to ensure that timesheets are signed by both the employee and the employee's supervisor. The supervisor should review employee timesheets for accuracy of time charged to projects for proper entry into a job costing system.

City's Response

> The City concurs with the finding. The City has implemented an integrated, on-line time keeping effective January 2012. Prior to that date, the City deployed a spreadsheet based time keeping system which interfaced to the financial system. The internal control for payroll was segregated between Finance and various departments, with departments proposing time with review and processing performed by Finance. Under this system, the lack of a supervisor's signature does not equate to a failure in the tracking of the hours.

State Controller's Office
Division of Audits
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