DEPARTMENT OF TRANSPORTATION
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March 27, 2015

Mr. Gary Antone
Executive Director
Department of Public Works
Tehama County
9380 San Benito Avenue Drive
Gerber, CA 96035 - 9701

Dear Mr. Antone:

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 Tehama County, Department of Public Works, Division of Engineering's (County) Indirect Cost Rate Proposal (ICRP) for fiscal year (FY) 2011/2012 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 County's ICRP for FY 2011/2012 is presented in accordance with Title 2 CFR, Part 225. The approved indirect cost rate is 122.79% of total direct salaries and fringe benefits.

The indirect cost rate of 122.79% supersedes the rate of 70.50% accepted on November 15, 2011. Since the audited indirect cost rate is higher than the previously accepted rate, the County may use the higher audited rate. If the county chooses to do this, it should notify A&I and reconcile all prior reimbursement claims using the higher audited rate.

The audit identified $1,636,283 in unallowable indirect costs that should have been excluded from the indirect cost pool and $2,697,803 in unallowable direct salaries and fringe benefits that should have been excluded from the base of the rate because they did not benefit from costs in the indirect cost pool. These changes predominantly affected the rate increase from 70.50% to 122.79%.

This report is intended solely for the information of the County, 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 2, 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:
County of Tehama Department of Public Works, Audit Report, Indirect Cost Plan Audit, FY 2011/2012, 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
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Tim Wood, Chief, Deputy Director, Department of Public Works, County of Tehama
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Ezequiel Castro, Chief, Associate Transportation Planner, Division of Mass Transportation, California Department of Transportation
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David Saia, LAPM/LAPG Coordinator, Division of Local Assistance, California Department of Transportation

P1590-0249

TEHAMA COUNTY

Audit Report

INDIRECT COST RATE PROPOSAL AUDIT OF CALTRANS CONTRACT NO. 770034 (Audit Request No. P1590-0249)

July 1, 2011, through June 30, 2012

BETTY T. YEE

California State Controller

February 2015

BETTY T. YEE
California State Controller

February 11, 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 completed an audit of the Tehama County, Department of Public Works' (DPW) indirect costs rate proposal (ICRP) for fiscal year (FY) 2011-12. The proposed rate was based on actual costs for FY 2009-10. The County proposed a department-wide indirect cost rate of 70.50%, based on indirect and direct costs of $3,601,634 and $2,539,175, respectively. Our audit was conducted to determine whether (1) the proposed rate was in compliance with the cost principles prescribed in Title 2, *Code of Federal Regulations*, Part 225; (2) the ICRP was in compliance with Caltrans Local Program Procedures Manual, 04-10; and (3) the cost accounting system was accumulating and segregating reasonable, allowable, and allocable costs.

Our audit determined an indirect cost rate of 122.79%, a difference of 52.29%, for FY 2011-12. The difference was primarily due to the DPW establishing a combined indirect cost rate for its engineering function and several other functions, including its maintenance, operations, and transportation functions. Furthermore, we noted an instance of unreported administration expenses.

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

Sincerely,

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/mh

cc: Andrew Finlayson, Bureau Chief
State Agency Audits bureau, Division of Audits, State Controller's Office
Chris Prasad, Audit Manager
Division of Audits, State Controller's Office
Payam Ameri, Auditor-in-Charge
Division of Audits, State Controller's Office

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Audit Report

Summary

The State Controller's Office (SCO) completed an audit of the Tehama County, Department of Public Works' (DPW) indirect costs rate proposal (ICRP) for fiscal year (FY) 2011-12. The proposed rate was based on actual costs of FY 2009-10. The County proposed a department-wide indirect cost rate of 70.50%, based on indirect and direct costs for $3,601,634 and $2,539,175, respectively. Our audit was conducted to determine whether (1) the proposed rate was in compliance with the cost principles prescribed in Title 2, *Code of Federal Regulations*, Part 225 (2 CFR 225); (2) the ICRP was in compliance with Caltrans Local Program Procedures Manual, 04-10; and (3) the cost accounting system was accumulating and segregating reasonable, allowable, and allocable costs.

Our audit determined an indirect cost rate of 122.79%, a difference of 52.29%, for FY 2011-12. The difference was primarily due to the DPW establishing a combined indirect cost rate for its engineering function and several other functions, including maintenance, operations, and transportation. Furthermore, we noted an instance of unreported administration expenses.

Background

The DPW provides County infrastructure services, products, and protection through design, construction, and maintenance. The DPW consists of seven divisions that are responsible for a variety of activities. The seven divisions are as follows:

- Administration / Accounting
- Engineering
- Flood Control
- Operations and Maintenance
- Transportation
- TRAX (Tehama Rural Area Express)
- Water Resources

The Engineering Division coordinates with various local, state, and federal agencies to acquire funding for projects, and to ensure compliance with regulations and environmental requirements. The Engineering Division performs mandated functions for individuals and organizations in Tehama County. These functions include reviewing construction plans, land development projects, and proposed projects to provide conditions of approval.

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 county'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 Tehama 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

The County proposed a department-wide indirect cost rate of 70.50% based on indirect and direct costs of $2,539,175 (including a $306,328 carry forward) and $3,601,634.

Our audit determined an indirect cost rate of 122.79%, a difference of 52.29%, for FY 2011-12. The difference was primarily due to the DPW establishing a combined indirect cost rate for its engineering function and other functions, including maintenance, operations, and transportation.

Unlike the engineering function, the other function groups had a significant amount of direct labor costs, but a lesser ratio of indirect costs. The combined rate, as a result, caused the indirect cost rate for the Engineering function to be understated. Furthermore, we noted an instance of unreported administration expenses.

Views of Responsible Officials

We discussed our audit results with the county's representatives during an exit conference conducted on September 24, 2014. Tim Wood, Chief Deputy Director and Ellen Junowitz, Accountant II, agreed with the audit results. Mr. Wood 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 Tehama County – 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

February 11, 2015

Schedule 1—
Summary of Proposed and Audited Rates
July 1, 2011, through June 30, 2012

Division Fiscal Year	Proposed Rate	Audited Rate	Difference	Reference
2011-12	70.50%	122.79%	52.29%	Schedule 1,2

Schedule 1—
Tehama County, PWD–Engineering Division
Summary of Proposed and Audited Direct Costs, Indirect Costs, and Indirect Cost Rate for Fiscal Year 2011-12

	Proposed	Excluded Costs - Non Engineering Division	Engineering Division	Adjustment
Direct costs:				
Salaries and Wages	$ 2,400,737	$ 1,851,996	$ 548,741	
Benefits	1,200,897	933,517	267,380	
Total direct salaries and benefits	3,601,634	2,785,513	816,121	$ —
Indirect costs:				
Salaries	1,004,564	774,949	229,615	
Benefits	502,503	390,621	111,882	
Total indirect salaries and benefits	1,507,067	1,165,570	341,497	—
Indirect services, supplies, and other expenses				
Clothing	12,000	11,600	400	
Communications	17,700	17,700	—	
Household expense	18,000	18,000	—	
Insurance (road, operations, and liability)	115,200	115,200	—	
Equipment maintenance	43,500	40,000	3,500	
Structural maintenance	9,600	9,600	—	
Medical or lab supplies	700	700	—	
Memberships or dues	3,500	3,500		
Office expense	27,800	27,800		
Professional and special services	107,000.00	104,000	3,000	
A-87	127,200	97,952	29,248	
Advertising	1,600	1,600		
Rent or lease - Equipment	18,000	18,000	—	
Rent or lease - Buildings	—	—	—	
Small tools	21,000	20,400	600	
Special department expense	108,000	106,000	2,000	
Travel	14,600	14,600	—	
Transit subsidy	1,080	1,080	—	
Utilities	56,900	56,900	—	
Administration Services	—	—		
Taxes and assessments	400	400	—	—
Total indirect services, supplies, and other expenses	703,780	665,032	38,748	—
Depreciation	22,000	13,887	8,113	—
Total indirect costs	2,232,847	$ 1,844,489	388,358	$ —
FY 2009-10 carry forward	306,328		613,723	
Estimated indirect costs	$ 2,539,175		$ 1,002,081	
Indirect cost rate	70.50%		122.79%	52.29%

Schedule 2—
Tehama County, PWD–Engineering Division
Carry Forward Calculation
Fiscal Year 2009-10 Actual for Use in Fiscal Year 2011-12

	Proposed	Excluded Costs-Non Engineering Division	Engineering Division	Adjustment
Direct costs:				
Salaries	$ 2,120,084	$ 1,804,366	$ 315,718	
Benefits	1,049,765	893,437	156,328	
Total direct salaries and benefits	3,169,849	2,697,803	472,046	
Indirect costs:				
Salaries	956,813	677,179	279,634	
Benefits	473,769	335,308	138,461	
Total indirect salaries and benefits	1,430,582	1,012,487	418,095	
Indirect services, supplies, and other expenses				
Clothing	18,410	18,031	379	
Communications	21,701	16,887	4,814	
Household expense	35,589	35,589	—	
Insurance (road, operations, and liability)	155,271	155,271	—	
Equipment maintenance	45,701	33,628	12,073	
Structural maintenance	17,415	17,415	—	
Medical or lab supplies	842	842	—	
Memberships or dues	2,886	2,626	260	
Office expense	40,460	38,778	1,682	
Professional and special services	31,778.85	31,347	432	
A-87	183,191	144,721	38,470	
Advertising	999	517	482	
Rent or lease - Equipment	11,670	11,670	—	
Rent or lease - Buildings		—	—	
Small tools	23,664	23,348	316	
Special department expense	33,520	30,828	2,693	
Travel	12,196	7,955	4,241	
Transit subsidy	318	318	—	
Utilities	59,451	53,745	5,706	
Administration Services	—	—	122,660	122,660
Taxes and assessments	280	280		
Total indirect services, supplies, and other expenses	695,342	623,796	194,206	122,660
Indirect costs from approved carry forward	320,052		320,052	—
Total indirect costs	2,445,976	$ 1,636,283	932,354	122,660
Total direct salaries and benefits	3,169,849		472,046	
Approved ICAP rate for fiscal year 2009-10	67.50%		67.50%	
Recovered indirect costs	2,139,648		318,631	
Carry forward used for fiscal year 2011-12	$ 306,328		$ 613,723	$ 307,394

Finding and Recommendation

FINDING—
Combined functions understated the DPW indirect cost rate

The Tehama County Department of Public Works (DPW) proposed a department-wide indirect cost rate of 70.50%, based on indirect costs and direct salaries and fringe benefit costs of $2,232,847 and $3,601,634, respectively, and a carry-forward rate of $306,328. Our audit determined an indirect costs rate of 122.79%, an increase of 52.29%. The difference, as noted below, was due to the DPW establishing a combined indirect cost rate for its engineering function and several functions, including maintenance, operations, and transportation. Unlike the engineering function, other function groups had a significant amount of direct labor costs, but a lesser ratio of indirect costs. The combined rate, as a result, caused the indirect cost rate for the Engineering function to be understated. In addition, we noted an instance of unreported administration expenses.

The DPW's proposed rate was based on department-wide combined costs of its Administration, Engineering, Maintenance and Operations, and Transportation divisions. The DPW maintains separate sets of accounts and records for these divisions. In fact, the direct and indirect labor forces, along with the services, supplies, and materials, are provided by distinct and dedicated resources for each of these divisions. Furthermore, the resources and level of indirect activities for each division significantly varied.

The DPW understood that the individualized department rates (tier rate) for each division would yield better cost recovery than the department - wide rate. Tier rates would have identified the specific labor and indirect costs of the emergency function. Thus, the DPW suggested including only the Engineering Division's indirect and direct costs and excluding the remainder of the indirect and direct costs from the indirect cost rate proposal (ICRP). Accordingly, we identified the recorded non-engineering function costs from the DPW's financial statements and excluded $1,636,283 of indirect costs and $2,697,803 of direct salaries and fringe benefits costs from the ICRP. The cost that remained was the indirect and direct costs for the Engineering Division. As a result, our examination of account balances was limited to the engineering function.

Our review of the Engineering Division's indirect and direct labor costs revealed additional indirect costs, $122,660, of the department-wide administration costs for the Engineering Division. The DPW estimated, but erroneously excluded, the administration expenses from the ICRP.

We recomputed the indirect costs and direct salaries and fringe benefit costs for the Engineering Division of $1,002,081 and $816,121, respectively, and a carry-forward rate of $613,723. We determined an indirect cost rate of 122.79%, an increase of 52.29%.

Title 2, *Code of Federal Regulations* Part 225 (2 CFR 225), Appendix A, Section F (1) states, in part, that indirect cost pools should be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.

2 CFR 225, Appendix A, Section C.3.b states "All activities which benefit from the governmental unit's indirect cost, including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of indirect costs."

2 CFR 225, Chapter II, Appendix E, Section C. 3., Multiple allocation base method, states "Where a grantee agency's indirect costs benefit its major functions in varying degrees, such costs shall be accumulated into separate cost groupings. Each grouping shall then be allocated individually to benefitted functions by means of a base which best measures the relative benefits."

Recommendation

We recommend that the county revise and resubmit the ICRP including only the direct costs, indirect costs, and indirect cost rate for the Engineering Division. We further recommend that the county implement policies and procedures to ensure that only reasonable, allowable, and allocable costs are included in the indirect cost pool and that these indirect costs are distributed to all benefitted direct costs objectives. For instances where each of the major functions, such as engineering and transportation, require varying degrees of indirect costs, such costs and indirect cost rates should be accumulated separately.