State of California
DEPARTMENT OF TRANSPORTATION

Business, Transportation and Housing Agency

Memorandum

Flex your power!
Be energy efficient!

To: BOB FINNEY
Deputy District Director
Construction
District 4

MARK ZABANEH
Deputy District Director
Program Project Management
District 4

Date: June 17, 2013

File: P3000-401

From: for WILLIAM E. LEWIS
Assistant Director
Audits and Investigations

Subject: **FINAL AUDIT REPORT – PROJECT DELIVERY DISTRICT 4**

Attached is Audits and Investigations' final audit report of District 4's Construction and Project Management functions within Project Delivery, focusing on projects funded by the American Reinvestment and Recovery Act of 2009. Your response has been included as a part of the report.

Please provide our office with status reports on the implementation of audit finding recommendations 60, 180, and 360 days subsequent to the report date. If all findings have not been corrected within 360 days, please continue to provide status reports every 180 days until the audit findings are fully resolved.

We thank you and your staff for their assistance provided during the audit. If you have any questions or need additional information, please contact Laurine Bohamera, Chief, Internal Audits and Construction Claims, at (916) 323-7107, or me at (916) 323-7122.

Attachment

c: Bijian Sartipi, District Director, District 4
Premjit Rai, Deputy District Director, Administration, District 4
Laurine Bohamera, Chief, Internal Audits and Construction Claims, Audits and Investigations
Douglas Gibson, Internal Audit Manager, Audits and Investigations

P3000-401
Project Delivery Division of Construction Division of Program/Project Management
June 2013

WILLIAM E. LEWIS
Assistant Director
Audits and Investigations
California Department of Transportation

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District 4's Division of Program/Project Management's Response

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Summary

The California Department of Transportation (Caltrans), Audits and Investigations (A&I) performed an audit of District 4's (District) Division of Program/Project Management (Program/Project Management) and Division of Construction (Construction), to determine whether adequate controls exist for managing projects and meeting the requirements of the American Recovery and Reinvestment Act of 2009 (ARRA).

Our audit disclosed that the District's Program/Project Management and Construction have adequate controls in place to properly manage projects, and meet ARRA requirements except for the issues noted below:

- Improvement Needed in Monitoring of Construction Support Costs.
- Improvement Needed in Contract Change Order and Extra Work Bill Processes.
- Improvement Needed in Reviewing ARRA Monthly Employment Reports.
- Non Compliance with Labor and Equal Employment Opportunity Code.
- Missing Secondary Review of Quantity Calculation Sheets.

Background

Project Delivery is responsible for facilitating the delivery of capital projects on the State highway system in order to improve the movement of people, goods, and services across California. Capital projects go through four major phases of work: Phase 0- Environmental Document and Project Report; Phase 1- Plans, Specifications, and Estimates; Phase 2- Right of Way; and Phase 3- Construction. The following Divisions within D-4 help facilitate the delivery of capital projects: Environmental Analysis, Design, Engineering Services, Right of Way and Land Surveys, Project/Program Management, and Construction. Our evaluation focused on Project/Program Management and Construction.

The District's Program/Project Management consists of four Project Management sub-divisions (North, South, East, and Toll Bridge), and three supporting offices (Office of Consultant Services, Office of Program Management Support, and Office of Project Management Control/Support).

Program/Project Management develops and implements policies and procedures to direct Single Focal Point staff in the four sub-divisions for project management activities; and evaluates and recommends policies and procedures governing the Project Management Program. It works with the other District Divisions to set project priorities and coordinates development of the District's capital outlay programs and program amendment documents. Program/Project Management also manages the

Background (Continued)

allocation process and is responsible for on-going management of all capital outlay resources to support the District's commitment to deliver assigned capital outlay projects.

Construction's mission is to construct high-quality, cost-effective, and timely transportation solutions for Californians while maximizing safety, minimizing adverse impacts, and ensuring the public trust. It is a results driven engineering organization that prides itself on timely project completion.

Each fiscal year District Directors submit a Contract for Delivery agreement to Caltrans' Director. The Contract for Delivery is a promise that their individual district will deliver a list of projects to the Ready to List (RTL) milestone date within that fiscal year. District Division Chiefs for Program/ Project Management have the overall responsibility for management of the capital program in their districts or regions. Project Managers in each district have full authority, delegated from the District Division Chief for Program/Project Management, to produce the intended results, meet schedules, and stay within budget. The project manager is responsible for planning, controlling, and closing a project, and retains these responsibilities over the life of the project. In addition, the project managers are responsible for the project's overall scope, risk management plan, cost, and schedule.

Objectives, Scope, and Methodology

Our audit focused on the Program/Project Management and Construction in District 4. We interviewed personnel and reviewed internal controls to determine whether policies, procedures, and processes are in place to adequately manage projects. We selected specific projects and tested them to:

- Assess compliance with applicable policies and procedures, with particular emphasis on ARRA requirements.
- Review and evaluate policies, procedures, and processes over the management of projects.
- Review and evaluate the processes for preparing and approving Contract Change Orders (CCOs).
- Assess compliance with other provisions in reference to ARRA requirements.

The audit was performed in accordance with the International Standards for the Professional Practice of Internal Auditing. It covered ARRA projects in the Ready to List (RTL) stage or in construction for the period April 1, 2009 to March 31, 2011. The audit field work was conducted between October 28, 2010 and March 31, 2011. Changes after March 31, 2011 were not tested, and accordingly, our conclusion

Objective (Continued)

does not pertain to changes arising after that date. We included tests as we considered necessary to achieve the above objectives.

Conclusion

Our audit disclosed that the District's Program/Project Management and Construction have adequate controls in place to properly manage projects and meet ARRA requirements, except for the issues noted below:

- Improvement Needed in Monitoring of Construction Support Costs.
- Improvement Needed in Contract Change Order and Extra Work Bill Processes.
- Improvement Needed in Reviewing ARRA Monthly Employment Reports.
- Non Compliance with Labor and Equal Employment Opportunity Code.
- Missing Secondary Review of Quantity Calculation Sheets.

View of Responsible Officials

We requested and received written responses to our findings from the Chiefs of the District's Divisions of Program/Project Management and Construction. These officials agreed with our findings. Please see the attachments for their complete response.

WILIAM E. LEWIS
Assistant Director
Audits and Investigations

April 13, 2013

FINDINGS AND RECOMMENDATIONS

Finding 1 - Improvement Needed in Monitoring of Construction Support Costs

Our review of construction support labor charges on eight projects identified the following:

- Seven of the projects had support Phases 0 and 1 open, although construction had already started on the projects.
- None of the project managers were aware of labor charges on the open support phases of the projects.

When project phases are not monitored and closed timely, labor charged to projects may be incorrect, labor errors may not be corrected timely, and budget overruns may occur on specific project phases.

According to project managers, this is due partly to lack of control over who charges to a project and lack of clear communication from senior management for closing project phases.

Deputy Directive (DD)-4,1 Departmental Charging Practices, states "All California Department of Transportation (Department) employees must accurately record time and expenses in performing their duties. Accurate charging practices are essential for providing financial information in a cost effective manner, maintaining financial control of budgets, effective project management, billings to the federal government and local agencies for reimbursable work, development of indirect cost rates, billing rates, and preparation of annual financial statements."

Managers, supervisors, and project managers are responsible for proper charging practices including monitoring expenditure reports to ensure accuracy of both the reports and source information; ensuring employees are trained in proper charging practices and conduct periodic evaluations of charging practices; and monitoring and ensuring compliance with proper charging practices.

District management stated that it established a formal process for scheduling project phase closure and allowing more control over the charging of labor costs.

Recommendation

We recommend that the District's Division of Program/Project Management ensure timely closure of project phases.

District's Response

The District's Division of Program/Project Management concurs with the finding and has implemented the Project Resource and Schedule Management system which is expected to improve project control by identifying unit assignments, restricting labor charges, and monitoring expenditures. For the District's complete response, please see Attachment 1.

Finding 2 – Improvement Needed in Contract Change Order and Extra Work Bill Processes

We reviewed 15 Contract Change Orders (CCO) and 108 Extra Work Bills (EWB) and identified areas where internal processes could be improved. In addition, we determined that there was not always a time impact analyses prepared and a review of lump sum payments as required. Our review identified the following:

- Two of the EWBs reviewed were not supported by material invoices. The Construction Manual, Section 5-904B, requires that payment for material purchases for force account work be supported by a copy of the vendor's invoice, or if no invoice is available, that a statement explaining how the unit prices were verified be submitted.
- Six of the EWB's did not have support for labor and equipment costs on the Assistant Resident Engineer (Assistant RE) daily reports. The Construction Manual, Section 5-306C, requires the contractor's item cost records be verified by comparing labor and equipment charged to the item by the contractor to the labor and equipment shown on the daily reports.
- One EWB did not have the extra work referenced on the Assistant RE daily report as required by the Construction Manual, Section 5-005.
- Four of the CCOs's reviewed involved time adjustments; and one of the four did not have a time impact analysis to determine the effect of the time adjustment. The Construction Manual, Section 5-306D, requires that the calculations and other data used to determine adjustments of contract time be filed with the contract records.
- Two lump sum payments did not have supporting documents for the cost of the extra work. The Construction Manual, Section 5-306C, requires that the contract record file contain any calculations made to determine extra work at the agreed price.

Finding 2 – (Continued)

According to District staff, the deficiencies noted were the result of the following:

- A lack of project staff which created a backlog of Assistant RE daily reports.
- The unavailability of Assistant REs to be onsite for unscheduled extra work.
- Materials taken from the contractor's stock with no invoice or statement to substantiate materials charged.
- The construction manager's belief that extra work lump sum does not require monitoring because it is considered a fixed cost.

As a result, project completion timelines may be incorrect, project costs may be overcharged and unsubstantiated extra work may be completed under lump sum agreements.

Recommendation

We recommend D-4 Construction:

1. Enforce its policies and procedures including analyses for time adjustments cause by CCOs.
2. Ensure field inspections are adequate to monitor day-to-day operations.
3. Establish effective communication with contractors to ensure invoices are received timely.
4. Support extra work at lump sum payment with material invoices, Assistant RE daily reports, cost estimation calculations and cost proposals.

District's Response

The District's Division of Construction concurred with the finding. The Division of Construction stated that it will remind Resident Engineers of their responsibility for time analyses of CCOs, EWBs, and effective communication with the contractor regarding daily activities. For the complete response by the District, please see Attachment 2.

Finding 3 - Improvement Needed in Reviewing ARRA Monthly Employment Reports

Our examination of ARRA Monthly Employment Reports (CEM-1204) disclosed instances in which the processes are not being followed and reviews are not being performed. Specifically, we noted the following issues:

- Eight instances of CEM-1204s submitted late by the contractor.
- Nine instances of information entered late into Proposition 1B and ARRA Online Data Input System (FHWA 1587) by the contract administrator.
- Twenty-one instances of subcontractors working during the month, but not being included on the CEM 1204 reports.

Finding 3 (Continued)

- Eight instances of contract administrators not withholding two percent of administrative deductions from the Monthly Progress Estimates as required when contractors are late in submitting their CEM 1204 reports.
- Eleven instances in which the contract administrator did not retain the original CEM 1204 reports.
- One instance of non submission of a CEM 1204 report.

The Construction Policy Bulletin (CPB) 09-4: American Recovery and Reinvestment Act Monthly Employment Reporting Requirements – Federal Aid Contracts, provides reporting requirements for all contracts advertised after March 24, 2009, and funded with ARRA funds. Requirements include a specification that each contractor is to complete and certify a CEM-1204 report indicating the number of jobs created or sustained for that project, the total number of hours worked by these employees, and the total base wages paid to them by the fifth day of each month with information for the previous month. In addition, the resident engineer or contract administrator are responsible for reviewing the submitted CEM-1204 for reasonableness and transferring certain information to form FHWA-1587, Monthly Summary Employment Report, by the eight day of the month.

Construction stated that untrained staff, unfamiliar with the requirements of the new grant, together with staff turnover, resulted in inadequate oversight of the CEM-1204 and submission of FHWA-1587 forms. As a result, the District did not always have accurate, complete, or timely payroll data as required by ARRA which could result in sanctions by federal funding agencies.

Recommendation

For those projects that are still subject to ARRA requirements, we recommend that District 4 Construction:

1. Provide training to construction staff on the requirements of ARRA reporting.
2. Re-emphasize the importance of receiving the CEM 1204 forms timely and reviewing them for accuracy and completeness.
3. Ensure that FHWA-1587 forms are submitted timely.
4. Ensure that construction staff maintain and retain original CEM 1204 reports.
5. Ensure that the contract administrator withhold the two percent administrative deductions from Monthly Progress Estimates whenever contractors are late in submitting the CEM 1204 reports.

District's Response

The District's Division of Construction concurred with the finding. The Division of Construction will distribute Memo CPB-09-04 regarding ARRA monthly reporting requirements and will provide reminders of the requirements at the quarterly senior meeting and at future Resident Engineers' annual meetings. For the complete response by the District, please see Attachment 2.

Finding 4 – Non Compliance with Labor and Equal Opportunity Employment Code

Our review of ARRA CEM 2504 reports on one project for the period January through July 2010, disclosed that the RE did not interview the contractors' employees in compliance with Labor and Equal Employment Opportunity (EEO) requirements. Examination of the RE's daily reports and discussion with the labor compliance officer confirmed the absence of interviews which could result in the following:

- Misclassification of contractor personnel on the contract.
- Incorrect charging of salary costs.
- Failure to pay full prevailing wages by the contractor, including fringe benefits, for all hours worked (including overtime hours).

Caltrans' Construction Manual, Section 8-102A requires:

- REs to conduct employee interviews in compliance with EEO requirements and transmit fully completed interview forms to the district labor compliance office. Interviews should be at the rate of three employees per contract, per month, including at least one interview from the prime contractor and each subcontractor until the contract is accepted or all employees on the project have been interviewed.
- Interviews with contractor personnel are recorded on Form CEM-2504, "Employee Interview: Labor Compliance/ EEO".

According to the RE, supporting documentation for some interviews was misfiled during an audit by Federal Highway Administration, and as a result, could not be located.

Recommendation

We recommend that District 4 Construction:

1. Ensure contractor employee interviews are performed monthly.
2. Emphasize the need to safeguard contractors' files and documents.

District's Response

The District's Division of Construction concurred with the response. The Division of Construction stated that it would remind Resident Engineers of their responsibility to conduct interviews of employees and

District's Response (Continued)

the need to store and secure all documents properly. For the complete District response, please see Attachment 2.

Finding 5 – Missing Secondary Review of Quantity Calculation Sheets

Our review found that four of nine contract items did not have secondary reviews on the Quantity Calculation Sheets.

The Construction Manual, Section 3-907A states, "…a source document (Quantity Calculation Sheet) must be on file showing the details of the quantity's determination." In addition, the Government Code, Section 13403 (a) states, "The elements of a satisfactory system of internal accounting and administrative control, shall include, but are not limited to, the following… (6) an effective system of internal review."

Without the control provided by secondary reviews, the District is less able to ensure accurate calculation of contract item quantities.

According to the Assistant RE, missing secondary reviews were due to an oversight by the RE and inadequate administrative support to perform the review of contract item quantity calculations.

Recommendation

We recommend District 4 Construction have processes in place to ensure that secondary reviews are properly documented on contract item quantity calculations.

District's Response

The District's Division of Construction concurred with the response. It stated that it would distribute Memo CPD 09-14 that deals with the requirements regarding Resident Engineers' daily reports and monthly pay quantity verification. The Division will also follow up on this issue at the quarterly Seniors' meeting and the annual Resident engineers' meeting. For the complete District response, please see Attachment 2.

Audit Team

Laurine Bohamera, Chief, Internal Audits and Construction Claims
Douglas Gibson, Audit Manager
Judith Mason, Auditor
Herbert Chan, Auditor

ATTACHMENT 1

DISTRICT 4'S DIVISION OF PROGRAM/PROJECT MANAGEMENT'S RESPONSE TO THE DRAFT REPORT

State of California
DEPARTMENT OF TRANSPORTATION

Business, Transportation and Housing Agency

Memorandum

Flex your power!
Be energy efficient!

To: LAURINE BOHAMERA
Chief, Internal Audits
Audits and Investigations

Date: May 30, 2013

From: MARK ZABANEH
Deputy District Director
Division of Program/Project Management

Subject: **RESPONSE TO 2013 DRAFT AUDIT REPORT FOCUSING ON THE AMERICAN REINVESTMENT & RECOVERY ACT OF 2009 (ARRA)**

Upon reviewing the draft audit report that disclosed that the Division of Program/Project Management and the Division of Construction have adequate controls for managing projects and meeting the requirements of the American Recovery and Reinvestment Act of 2009 (ARRA), the Department acknowledges the five (5) items of opportunity for improvement as noted in the audit. District 4 will take the following steps to address your findings.

District 4 Work Plan:

ITEM	STEPS	COMPLETION DATE	RESPONSIBILITY OF
Finding #1: Improvement Needed in Monitoring of Construction Support Costs	Replace various District 4 tools (i.e., Project Focus, WPS, XPM) with a new project management system--Project Resource and Schedule Management (PRSM). PRSM interfaces with the Department's accounting system (EFIS) and timekeeping system (Staff Central) to improve project control by identifying unit assignments, restricting labor charges, and monitoring expenditures.	January, 2013	Division of Program/Project Management's Office of Project Management Support
	Provide PRSM training to Project Managers, Task Managers, and other District 4 employees.	October, 2012, to May, 2013	Division of Program/Project Management's Office of Project Management Support
	Monitor expenditures in PRSM to ensure accurate recording of employee time and expenses in performance of said duties on project(s) and task(s).	Ongoing	Project Managers and Task Managers
	Identify the units in PRSM that can charge to a project/task. By doing so, Staff Central uses the PRSM data and implements edits which controls labor/charges to only those on the project team and task.	Ongoing	Project Managers and Task Managers
	Use PRSM to monitor which project phases are currently open in EFIS and ensure timely closure of project phases.	Ongoing	Project Managers

ITEM	STEPS	COMPLETION DATE	RESPONSIBILITY OF
Finding #1 (Continued): Improvement Needed in Monitoring of Construction Support Costs	Remind Project Managers of responsibility to ensure timely closure of project phase once deliverable is completed.	PM Workshop July 16, 2013	Division of Program/Project Management's Office of Project Management Support
Finding #2: Improvement Needed in Contract Change Order (CCO) and Extra Work Bill (EWB) Processes.	Remind Resident Engineers (R.E.'s) of responsibility for time analysis of CCO and EWB invoices.	Quarterly Senior Meeting in June, 2013 and Annual R.E. Meeting in March, 2014	Division of Construction's Office of Functional Support
Finding #3: Improvement Needed in Reviewing Monthly Employment Reports	Distribute and discuss Construction Policy Bulletin (CPB 09-4), "American Recovery Act Monthly Employment Reporting Requirement".	Quarterly Senior Meeting in June, 2013 and Annual R.E. Meeting in March, 2014	Division of Construction's Office of Functional Support
Finding #4: Non-Compliance with Labor and Equal Employment Opportunity (EEO) Code.	Remind R.E.'s of responsibility to conduct employee interviews monthly. In addition, R.E.'s will be reminded that all documents must be stored and secured properly.	Quarterly Senior Meeting in June, 2013 and Annual R.E. Meeting in March, 2014	Division of Construction's Office of Functional Support
Finding #5: Missing Secondary Review of Quantity Calculation Sheets	Distribute and discuss Construction Procedure Directive (CPD 09-14), "Resident Engineer Daily Reports and Monthly Pay Quantity Verification".	Quarterly Senior Meeting in June, 2013 and Annual R.E. Meeting in March, 2014	Division of Construction's Office of Functional Support

Progress reports providing feedback on the status of the work plan items will be provided for the 60-, 180-, and 360-day milestones.

If you have any questions or need additional information, please call me at (510) 286-6293.

c: Bijan Sartipi, District Director
Bob Finney, Deputy District Director, Division of Construction
Bill Schmidt, Chief, Functional Support, Division of Construction
Bipin R. Patel, Division of Construction
Lorne Benne, Division of Construction
Harlan Woo, Chief, D4 Office of Project Management Support
Nicholas Mraovich, Branch Chief, PPM Administration & Personnel
Kevin Strough, Chief, D4 Office of Budgets
Douglas Gibson, Manager, Internal Audits, Audits & Investigations
William E. Lewis, Assistant Director, Audits and Investigations

ATTACHMENT 2

DISTRICT 4'S DIVISION OF CONSTRUCTION'S RESPONSE TO THE DRAFT REPORT

State of California
DEPARTMENT OF TRANSPORTATION

Business, Transportation and Housing Agency

Memorandum

Flex your power!
Be energy efficient!

To: LAURINE BOHAMERA
Chief, Internal Audits
Audits and Investigations

Date: May 03, 2013

BWSCHMIDT FOR

From: BOB FINNEY
Deputy District Director, Construction
District 4

Subject: Response to March 2013 Draft Audit Report of American Reinvestment and Recovery Act of 2009 (ARRA) funded projects.

As a result of reviewing the draft audit report, District 4 will take the following steps to address the findings of the audit.

District 4 Work Plan:

Item	Steps	Completion Date	Person(s) Responsible
Finding #1: Improvement Needed in Monitoring of Construction support Costs			D4 Division of Program/Project Management
Finding #2: Improvement Needed in Contract Change Order (CCO) and Extra Work Bill (EWB) Process	Remind Resident Engineers (R.E.) of responsibility for Time analysis for CCO; EWB invoices and effective communication with contractor for daily activities.	6/21/13 Provide follow up reminders at Quarterly Senior Meeting. Provide follow up reminder at future annual R.E. Meeting.	D4 Construction, Office of Functional Support.

Finding #3: Improvement Needed in Reviewing the Monthly Employment Reports.	Distribute Memo (CPB 09-4) regarding ARRA Monthly Employment Reporting	6/21/13 Provide follow up reminder at Quarterly Senior Meeting. Provide follow up reminder at future annual R.E. Meeting.	D4 Construction, Office of Functional Support.
Finding #4: Non-Compliance with Labor and Equal Employment Opportunity (EEO) Code	Remind Resident Engineers (R.E.) of responsibility to conduct employee interviews monthly. In addition, R.E.'s will be reminded that all documents must be stored and secured properly.	5/31/13 Post information on D4CON Labor Compliance Webpage. 6/21/13 Provide follow up reminder at Quarterly Senior Meeting. Provide follow up reminder at future annual R.E. Meeting.	D4 Construction, Office of Functional Support. Labor Compliance Unit.
Finding #5: Missing Secondary Review of Quantity Calculation Sheets.	Distribute Memo (CPD 09-14) regarding Resident Engineer Daily Reports and Monthly Pay Quantity Verification.	6/21/13 Provide follow up reminder at Quarterly Senior Meeting. Provide follow up reminder at future annual R.E. Meeting.	D4 Construction, Office of Functional Support.

Progress reports providing feedback on the status of the work plan items will be provided for the 60, 180, and 360 day milestones.

If you have any questions or need additional information, please contact me at (510) 286-5896, or Bill Schmidt at (510) 286-6048.