State of California

Business, Transportation and Housing Agency

Memorandum

To: TOM MCDONNELL, Chief
Division of Mass Transportation

Date: July 12, 2001

From: **DEPARTMENT OF TRANSPORTATION**
Audits and Investigations

Subject: Preaward Evaluation Requests – Revised Procedures as of July 2001

Audits and Investigations (Audits) has revised the procedures to be followed for requesting preaward evaluations of local agencies receiving Mass Transportation Program funding. The revised procedures are effective as of July 2001. Following are the revised procedures:

Master Agreements

All master agreements (MA) should be submitted to Audits for preaward evaluation prior to execution. In performing the preaward evaluation, Audits will review the draft MA for contract language and will perform a review of the Local Agency's accounting system to verify that it is adequate to accumulate and segregate reasonable, allocable, and allowable project costs. The preaward evaluation of the MA should be requested as soon as it is known that the local agency will be entering into a MA and should not be executed until Audits completes the evaluation.

Once Audits receives the request, a risk assessment will be performed to determine whether preaward evaluation work is required. Audits will attempt to place reliance on work performed on the Local Agency by our office within the last two years in order to reduce the scope of the evaluation. However, if material deficiencies were noted in the prior work, if the Recipient was designated as a high-risk auditee or if other concerns were noted in the prior audit work, then a preaward evaluation may be performed based on the discretion of the audit manager. A preaward evaluation is necessary if a local agency has not undergone a preaward evaluation within the last two years.

Preaward evaluation requests of MA's are to be submitted for preaward evaluation regardless of the dollar amount of current allocations expected to be issued under the MA. Although allocations under a MA could be of a minimal dollar amount, preaward evaluations of each MA is required prior to execution given that the MA will remain in effect for ten years and future allocations could be of a significant dollar amount.

Program Supplements

Program Supplements (PS) do not need to be forwarded to Audits for preaward evaluation prior to execution unless the following applies:

- PS includes special conditions not included in the Master Agreement.
- Prior audit work noted material deficiencies.
- Recipient has been designated a high-risk auditee.

If one or more of the above apply, regardless of the dollar amount, the PS should be submitted for evaluation prior to execution. Audits will perform a risk assessment to determine if preaward evaluation work is necessary. Based on the assessment, a preaward evaluation may be performed. However, if none of the above situations apply, the executed PS should be forwarded to Audits for our files.

Annual Lists

To assist Audits in performing annual risk assessments of future audit work the Division of Mass Transportation (DMT) is requested to submit annually (by May 1 of each year) the following:

- A listing of all Local Agencies that in the current fiscal year either:

  1. Executed a MA with the DMT.
  2. Received an allocation(s) (please provide amounts).

  Please differentiate in the listing the category under which each Local Agency is included. If a Local Agency is subject to both categories please list under both. Since the listing is requested by May 1 for each current year any additional MA's or allocations to be awarded through the end of that fiscal year should be estimated in order to be included in the listing.

- A separate listing that includes future allocations expected to be received by a Local Agency in the following fiscal year. It is understood that the listing cannot be all-inclusive but any known allocations will help our office develop our annual audit plan more accurately.

Audits will perform interim/post audits on an ongoing basis to assure that the Local Agency has an adequate accounting system and that costs reimbursed under the MA and PS' are reasonable, allocable, and allowable.

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Attached Memo

Please submit the attached memo with all preaward evaluation requests of MA's and PS's. Once the request is reviewed, Audits will return the memo indicating whether a preaward evaluation is necessary or if it will be waived. If a preaward evaluation is necessary, the memo will also serve to inform the requestor of the auditor's name and phone number.

Thank you for your assistance in the implementation of the revised procedures. If you have any questions, please contact Zilan Chen at 323-7915.

MAURA F. TWOMEY
Audit Manager

Attachment

State of California

Business, Transportation and Housing Agency

Memorandum

(Insert Name of Audit Requestor)
(Office and District of Requestor)
(Phone number of Requestor)
(Fax number of Requestor)

Date: (Current Date)

DEPARTMENT OF TRANSPORTATION
Audits and Investigations

Subject: Preaward Evaluation Request

---------- To be completed by Requestor ----

We have reviewed your request for a preaward evaluation of a:

(check one) **Master Agreement** **Program Supplement**

Recipient Name: _____
Master Agreement or Program Supplement No.:_____
Recipient's Contact Person: _____Phone No.:
Caltrans Project Mgr.:_____ Phone No.:_____

- **If request is for a <u>Program Supplement</u> please provide the following:**
  Project Description:_____
  Allocation Amount: _____
  Reason for request:
  _____ Program Supplement includes special conditions not included in the Master Agreement.
  Prior audit work noted material deficiencies.
  Recipient has been designated a high-risk auditee.
  Other (state reason) _____

To be completed by Audits & Investigations ----------

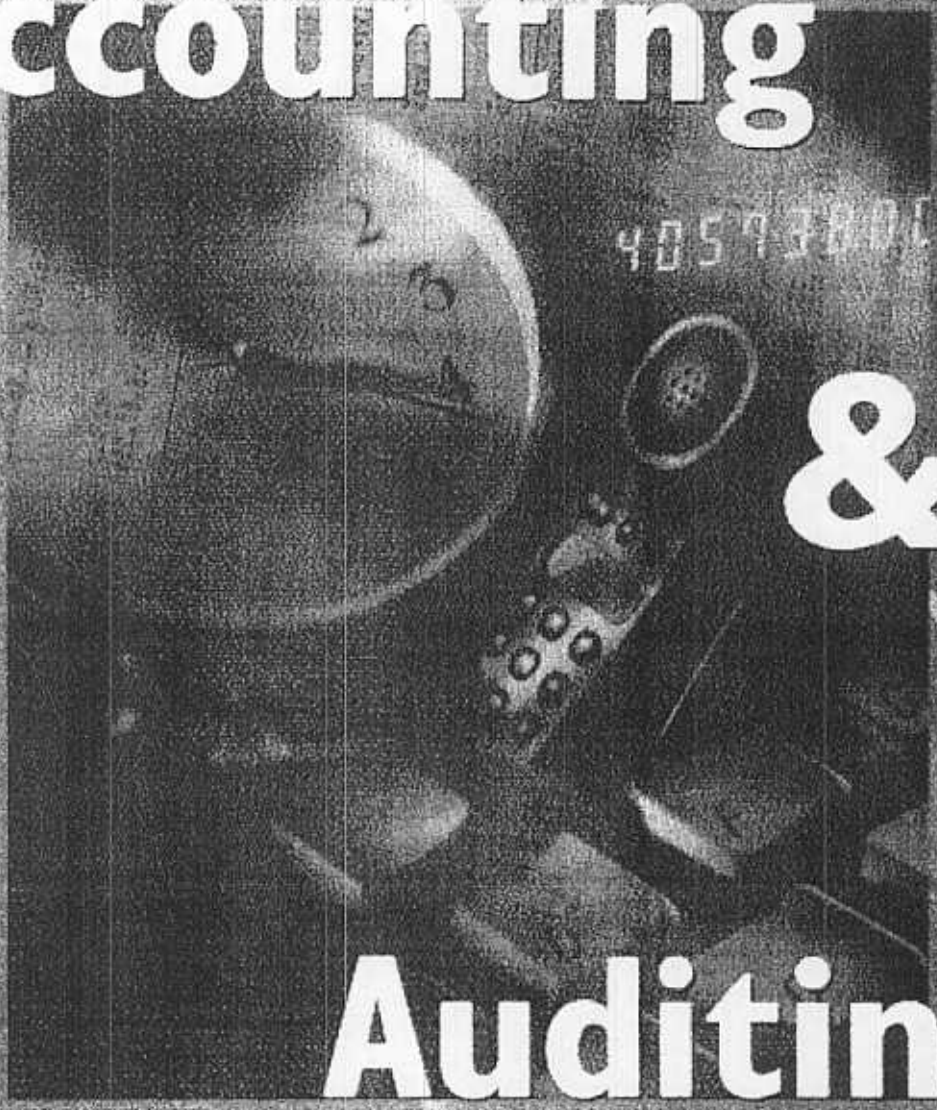
Based on our review we have determined the following

☐ **Preaward Evaluation Not Required.**
Comments if any: _____

☐ **Preaward Evaluation Required.**
Any questions concerning the preaward evaluation should be referred to the following auditor.
Auditor Assigned: _____Phone No.:_____
Comments if any: _____

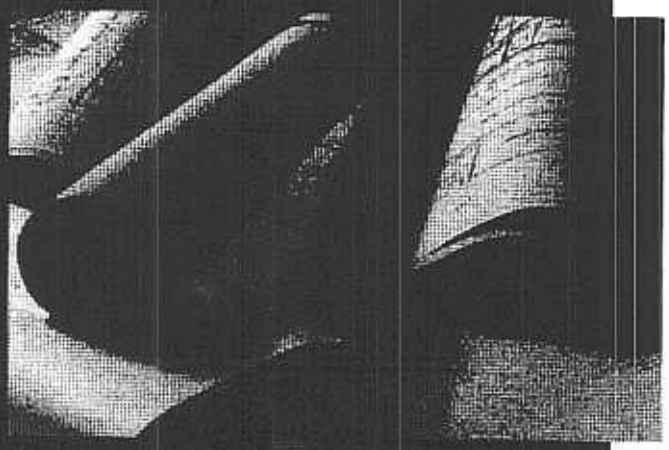
Authorized by:_____ Phone Number:_____

Accounting & Auditing



GUIDELINES FOR CONTRACTS WITH CALTRANS

Caltrans



INTRODUCTION

The purpose of this brochure is to outline for you, a potential contractor with the California State Department of Transportation (Caltrans), the basic elements of an adequate accounting system, and the types and objectives of audits that will be performed in relation to your contract. In order to successfully compete for a contract and meet the audit requirements, a contractor (whether a prime or subcontractor) must have a system of record keeping and internal control. Although a specific cost accounting system is not required, a contractor needs a system which will assure compliance with the terms of the agreement. A preaward audit will be preformed to assure you meet these requirements prior to contract execution. If your system is deficient, the contract will not be executed.

Caltrans reimburses, through your overhead rate, the costs attributable to establishing and maintaining a cost accounting system.

Staff time and other costs related to an audit performed of your contract are normally reimbursed through your overhead rate.

ACCOUNTING SYSTEM

Contractors (whether a prime or subcontractor) planning to contract with Caltrans must have an accounting system which meets the following objectives:

- The ability to record and report financial data in accordance with generally accepted accounting principles.
- A system of record keeping to ensure that costs billed to Caltrans are:
  - **a.** Supported by adequate documentation.
  - **b.** In compliance with the terms of the contract and applicable Federal and State regulations specified in the contract.
- A system of record keeping ideally includes the following:
  - **a. General ledger**
  - **b. Job cost ledger**
  - **c. Labor distributions**
  - **d. Time records**
  - **e. Subsidiary journals**
  - **f. Chart of accounts**
  - **g. Financial statements**
- The ability to accumulate and segregate reasonable, allocable (incurred solely for a project) and allowable (per terms of the contract) costs through the use of a cost accounting system. The following are some of the attributes which would ideally be found in such a system:
  - **a.** A chart of accounts which includes indirect and direct general ledger accounts. Indirect costs are not specifically identified to a project, for example, rent and/or utilities. Direct costs are specifically identified with a project, for example, drafting hours and/or design hours.
  - **b.** Segregation of costs by contract, category of cost and milestones (if applicable).
  - **c.** Proper recording of direct and indirect costs. For example, recording of labor costs should provide that non-project indirect hours be recorded on a time sheet and in the accounting records to an administration, vacation, sick leave or other indirect cost account/code. Direct project hours should be recorded on a time sheet and in the accounting records to a direct project cost account/code.

d. Consistent accounting treatment of costs in recording and reporting. For example, if travel expense is charged directly to a project, all travel expense incurred on any project should be considered a direct costs. As a result, project-related travel, whether reimbursable per the contract terms or not, should be included as a direct cost.

e. Ability to trace from invoices submitted to Caltrans to job cost records and original, approved source documents, for example, time sheets, vendor invoices, cancelled checks.

f. Ability to reconcile job cost records to the accounting records.

- Compliance with cost principles described in the Code of Federal Regulations 48, Federal Acquisition Regulations System (FAR), Chapter 1, Part 31. Information on how to obtain this regulation is described under "Audit Criteria" on the following page.
- Procedures to monitor and adjust projected overhead rates to actual rates.
- Controls to ensure that written approval is obtained prior to any changes to the contract.
- Procedures to retain accounting records and source documentation as required by the terms of the contract.
- A system of internal control which provides reasonable assurance that assets are protected; financial data, records and statements are reliable; and errors and irregularities are promptly discovered, reported and corrected. The elements of a system of internal control should include, but not be limited to, the following:

a. Separation of duties for proper protection of assets. Incompatible duties are those that place any person in a position to both perpetrate and conceal errors or irregularities in the normal course of business. For example, the person who writes checks should be different from the person who reconciles bank statements and the person who purchases goods should be different from the person who receives goods.

b. Limiting access to assets to only authorized personnel who require these assets in the performance of their assigned duties. For example, blank check stock should be locked in a safe when not in use.

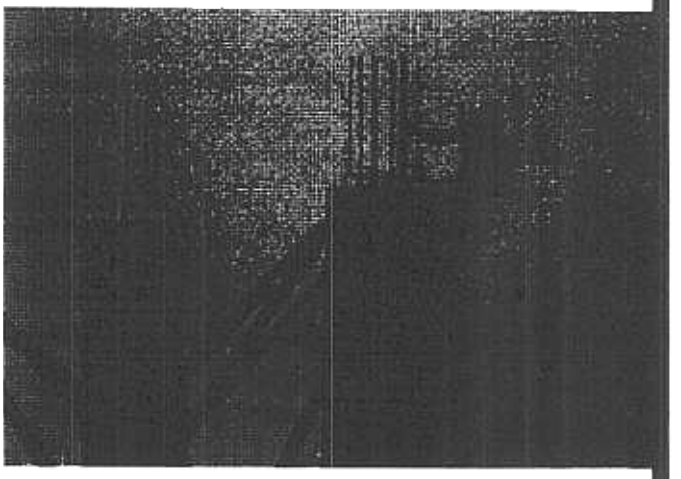
c. Authorization and record keeping procedures which provide effective accounting control over assets, liabilities, revenues, and expenditures.

d. A system of practices to be followed in the performance of duties and functions. Such a system normally includes policies and procedures which establish the purpose and requirements of the accounting system. For example, timekeeping practices should ideally provide for the following:

- Time sheets be prepared, signed and dated by all employees.
- Time sheets be completed in non-erasable ink.
- Time sheet corrections be crossed out and initialed by the employee.
- Time sheets be signed by a supervisor as reviewed and retained on file as required by the contract.

e. Personnel with skills and training commensurate with their responsibilities.

f. A system of internal review. For example, bank reconciliations and travel expense claims should be reviewed, approved, and signed by a supervisor.



AUDITS

Contractors, whether a prime or subcontractor, performing under a negotiated contract with Caltrans are subject to the following audits.

- **Preaward Audits:** Prior to the award of a contract, Caltrans Audits and Investigations will conduct a preaward audit to determine if the contractor's accounting system is adequate to accumulate and segregate costs as detailed in the previous section and to determine if the proposed costs are reasonable. The audit alerts both the contractor and Caltrans management to problems relative to the contractor's cost proposal and cost accounting system. Due to time constraints in the award process, your cooperation in scheduling the preaward audit with short notice will expedite the execution of your contract.

- **Interim Audits:** Interim audits are performed on an as needed basis. During the preaward audit, if it is determined that the contractor's accounting system is new or minor deficiencies are noted, an interim audit is scheduled to determine that the system is functioning adequately to ensure that billed costs are supported and that any deficiencies were corrected. An interim audit may be requested by the contract administrator or by Caltrans management to address concerns during the course of the contract. Also, an audit manager may initiate an interim audit of a multi-year contract to ensure that costs reimbursed to date are allowable.

- **Post Audits:** Post audits of contracts are performed routinely after project completion. Post audits are performed to determine whether the costs claimed are allowable, allocable, reasonable, and in compliance with the Federal and State laws and regulations as well as the fiscal provisions stipulated in the contract. The examination includes reviews of applicable laws and regulations, the contract requirements and the contractor's internal control system. Audit tests of the contractor's accounting records and other auditing procedures considered necessary will also be performed. Applications of all audit procedures would also be governed by the individual contract under audit. Unsupported or unallowable costs are normally the result of weaknesses in the accounting system and will be reimbursed to Caltrans.

To provide contractors with a procedure for obtaining prompt and equitable resolution to a dispute arising from a post audit of a non-highway construction cost reimbursement contract, Caltrans has established an Audit Review Committee (ARC). Information explaining the ARC should be found in your contract and/or as an attachment to the post audit report.

AUDIT CRITERIA

For specific information regarding basic cost accounting systems and applicable State and Federal regulations, please see the following:

- **Code of Federal Regulations 48, Federal Acquisition Regulations System, Chapter 1, Part 31:** This regulation contains cost principles and procedures for the pricing of contracts/subcontracts and the determination, negotiation, or allowance of costs. Contact:

  Superintendent of Documents
  Government Printing Office
  Washington, DC 20402

Washington, D.C.	**(202) 512-1800**
San Francisco	**(415) 512-2770**
Los Angeles	**(213) 239-9844**

- **California State Administrative Manual:** A reference source for statewide policies, procedures, regulations and information. Contact:

  Office of State Publishing,
  Department of General Services.
  Call for order form: (916) 445-2295.

For review of the above references, contact your local library or the California State Library.

California State Library
Library and Courts Building
914 Capitol Mall, P.O. Box 942837
Sacramento, CA 94237-0001

Information: (916) 654-0261

For assistance in establishing an accounting system which will meet the objectives outlined in this brochure, you should contact an accountant and/or bookkeeper who is familiar with cost accounting systems.

Caltrans is an affirmative action employer. Equal opportunity is offered to all regardless of race, color, creed, national origin, ancestry, sex, marital status, disability, religious or political affiliation, age or sexual orientation. Contractors that contract with Caltrans are responsible for taking necessary and reasonable steps to achieve these same goals.