

# Memorandum

*Making Conservation  
A California Way of Life.*

**To:** RIHUI ZHANG  
Chief  
Division of Local Assistance

**Date:** February 27, 2018

**File:** P1594-0075  
P1594-0076  
P1594-0077

**From:** MARSUE MORRILL, CPA *Marsue*  
Chief  
External Audits – Local Governments  
Independent Office of Audits & Investigations

**Subject:** **INDIRECT COST RATE PROPOSAL AUDIT – COUNTY OF SACRAMENTO,  
DEPARTMENS OF GENERAL SERVICES AND TRANSPORTATION**

We performed an audit of the County of Sacramento (County), Department of General Services, Construction Management Inspection Division (CMID) for fiscal years (FY) 2014/15 and 2015/16 and Department of Transportation (DOT) for FY 2015/16 to determine whether the CMID and DOT's Indirect Cost Rate Proposals (ICRP) were presented in accordance with Title 2 Code of Federal Regulations (CFR) Part 225 or 2 CFR 200, and Caltrans Local Assistance Procedure Manual (LAPM) Chapter 5. The final audit report including the County's response is attached.

Based on our audit we determined CMID's and DOT's ICRPs for FYs ended June 30, 2015 and June 30, 2016, were presented in accordance with 2 CFR Part 225 or 2 CFR Part 200, and LAPM Chapter 5 except for the findings identified as follows:

- Both CMID and DOT did not reconcile estimated labor to actual labor costs.
- CMID included unallowable costs in the indirect cost pool for FY 2015/16.

The audited rates are as follows.

Fiscal Year	Proposed Rate	Audited Rate	Applicable To
FY 2014/15	55.02%	55.02%	Construction Management Inspection Division
FY 2015/16	37.94%	34.37%	Construction Management Inspection Division
FY 2015/16	65.13%	65.13%	Transportation

Please provide our office with a corrective action plan addressing the recommendations in the attached report, including time lines, by April 6, 2018.

If you have any questions, please contact Tami Gill, Audit Manager, at (916) 323-7899.

Attachments

- c: Joyce Renison, Assistant Auditor Controller, County of Sacramento,  
Department of Finance  
Rodney Whitfield, Director of Financial Services, Federal Highway Administration  
Tashia Clemons, Director, Program Development, Federal Highway Administration  
Veneshia Smith, Financial Manager, Financial Services, Federal Highway  
Administration  
Kara Magdaleno, Administrative Program Assistant Planning and Finance,  
Federal Highway Administration  
Roberto Rodrigues, F.I.R.E & Program Review Coordinator, Federal Highway  
Administration  
Chris Schmidt, Chief, Division of Transportation Planning, Caltrans  
Mark Codey, Branch Chief, State Transit Grants, Division of Rail and Mass  
Transportation, Caltrans  
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Office Chron  
P1594-0075  
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# County of Sacramento Indirect Cost Rate Proposal Audit



**Audit Report**  
**February 2018**

## PREPARED BY:

California Department of Transportation  
Independent Office of Audits and Investigations – MS 2  
Post Office Box 942874  
Sacramento, California 94274-0001  
[www.dot.ca.gov/hq/audits](http://www.dot.ca.gov/hq/audits)

## AUDIT TEAM

MarSue Morrill, Chief, External Audits  
Tami Gill, Audit Manager  
Lisa Moreno, Auditor-in-Charge  
Sheron Dikousman, Auditor

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# **SUMMARY, OBJECTIVES, SCOPE, METHODOLOGY, BACKGROUND, AND CONCLUSION**

## **SUMMARY**

The California Department of Transportation (Caltrans), Independent Office of Audits and Investigations (A&I) completed an Indirect Cost Rate Proposal (ICRP) audit of the County of Sacramento (County), Department of General Services, Construction Management Inspection Division (CMID) for fiscal years (FY) 2014/15 and 2015/16, and the Department of Transportation (DOT) for FY 2015/16. We found direct labor is not reconciled between estimated labor costs, and actual costs and unallowable costs were included in the indirect cost pool for CMID for FY 2015/16.

## **OBJECTIVES**

The audit was performed to determine whether the CMID and DOT ICRPs were presented in accordance with Title 2 Code of Federal Regulations (CFR) Part 225 (superseded by 2 CFR 200), 2 CFR 200, and Caltrans Local Assistance Procedure Manual (LAPM) Chapter 5. It was also performed to determine whether the County had a financial management system capable of accumulating and segregating costs that are reasonable, allowable, and can be allocated to projects.

## **SCOPE**

The scope of the audit was limited to select financial and compliance activities. The audit consisted of a recalculation of the ICRP, a review of the County's Single Audit Report for FYs ended June 30, 2016, and inquiries of County personnel. The audit also included tests of individual accounts to the general ledger and supporting documentation to assess allowability, allocability, and reasonableness of costs based on a risk assessment, as well as an assessment of the internal control system as related to the ICRP as of November 16, 2017. Financial management changes subsequent to this date were not tested and, accordingly, our conclusion does not pertain to changes arising after this date. We believe that our audit provides a reasonable basis for our conclusion.

The County is responsible for preparing their ICRP in accordance with state and federal requirements which includes implementing internal controls and maintaining an adequate financial management system to accumulate and segregate reasonable, allowable, and allocable costs. Because of inherent limitations in any financial management system, misstatements due to error or fraud may occur and not be detected. Also, any projection or evaluation of the financial management system in future periods using the results of this audit are subject to the risk that the financial management system may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

## **METHODOLOGY**

We conducted this performance audit in accordance with 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. The audit was less in scope than an audit performed for the purpose of expressing an opinion on the financial statements of the County. Therefore, we did not audit and are not expressing an opinion on the County's financial statements.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the data and records selected. An audit also includes assessing the accounting principles used and significant estimates made by the County, as well as evaluating the overall presentation of the ICRP costs.

## **BACKGROUND**

At the discretion of local agencies, indirect costs may be recovered when seeking reimbursement for their federal-aid transportation projects, as well as State Transportation Improvement Plan (STIP) and state funded projects. Specifically, this applies to federally authorized work, as well as STIP projects and state funded projects, with costs incurred after June 9, 1998. Completed projects with a Final Report of Expenditures prior to June 9, 1998 will not be eligible for retroactive indirect cost reimbursement.

Computation of Indirect Cost Rates are based on:

- 2 CFR 225 (superseded by 2 CFR 200), 2 CFR 200, Cost Principles for State, Local and Indian Tribal Government; and
- Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government (ASMB C-10), issued by the United States Department of Health and Human Services.

## **CONCLUSION**

We determined CMID FY's ending June 30, 2015 and June 30, 2016, and DOT's ICRPs for FY June 30, 2016 were presented in accordance with 2 CFR 225, 2 CFR 200, and LAPM except for the findings identified as follows:

- Both CMID and DOT did not reconcile estimated labor to actual labor costs.
- CMID included unallowable costs in the indirect cost pool for FY 2015/16.

The audited rates are listed below:

Fiscal Year	Proposed Rate	Audited Rate	Applicable To
FY 2014/15	55.02%	55.02%	Construction Management Inspection Division
FY 2015/16	37.94%	34.37%*	Construction Management Inspection Division
FY 2015/16	65.13%	65.13%	Transportation

\*See Attachment I for adjustments to the audited rate.

DOT's findings did not impact the proposed indirect cost rates, therefore, no changes were made to DOT's rates.

### VIEWS OF RESPONSIBLE OFFICIALS

Our findings and recommendations took into consideration the County's response submitted on February 7, 2018, to our January 23, 2018 draft report. Our findings and recommendations, the County's response, and our analysis of the response are set forth in the Findings and Recommendations section of this report. A copy of the County's full written response is included as Attachment II.

This report is intended as information for Caltrans management, the Federal Highway Administration, and the County. This report is a matter of public record and will be placed on Caltrans website which can be viewed at: [www.dot.ca.gov/hq/audits/reports\\_issued.html](http://www.dot.ca.gov/hq/audits/reports_issued.html).

If you have any questions, please contact Tami Gill, Audit Manager, at (916) 323-7899.



MARSUE MORRILL, CPA  
Chief  
External Audits – Local Government Agency  
Independent Office of Audits and Investigations

February 27, 2018



## FINDINGS AND RECOMMENDATIONS

### **FINDING 1 – The County of Sacramento Departments of General Services and Transportation Do Not Bill Actual Costs.**

The County of Sacramento (County) Department of General Services, Construction Management Division (CMID) and Department of Transportation (DOT) did not bill actual labor costs. CMID and DOT billed Caltrans using an average labor rate (rate) for each job classification within a division. The rate is applied to each employee by classification to their actual productive hours, which is the total estimated labor costs. CMID and DOT did not reconcile estimated labor costs to actual costs which is necessary to ensure labor costs are actual and allowable. Two prior California Department of Transportation (Caltrans) audits also identified this same finding for DOT and it has not been resolved.

The County's practices have been to use estimated labor costs for billing and did not perform reconciliations. Since, there are no written policy and procedures for actual labor billings, the County did not understand a reconciliation is required when estimated costs are used for billing.

Without reconciling the estimated labor costs to actual labor costs Caltrans may reimburse the County more direct labor costs than allowed. Additionally, when applying the indirect cost rate to estimated labor costs, the County may be recovering more indirect costs than allowed.

Article IV Section 7 in the Federal Master agreement 03-5924R states in part, *"Payments to Administering Agency can only be released by the State as reimbursements to actual allowable project costs already incurred and paid by administering agency."*

Local Assistance Procedure Manual (LAPM), Chapter 5, Section 5.2, Requirements for reimbursement states in part, *"The local agency may submit monthly invoices for reimbursement of participating costs (costs eligible for state and/or federal reimbursement). Amounts claimed must reflect the cost of completed work, which has been paid for."*

### **RECOMMENDATION**

We recommend the County bill actual labor costs and adhere to LAPM Section 5.2. Alternatively, if the County continues to bill Caltrans using an average labor rate, the County is required to develop and implement written procedures and reconcile the billings by comparing what was billed to the actual labor costs annually and at project completion. In addition, the County will not be eligible for any project reimbursement until the reconciliation process and procedures have been developed and implemented.

**SUMMARY OF AUDITEE'S RESPONSE**

The County indicated they have implemented a process to reconcile average labor rates to actual labor costs. In addition, the County indicated they will adjust for variances in project billings. See Attachment II for the County's complete response.

**ANALYSIS OF AUDITEE'S RESPONSE**

We appreciate the County's implementation of corrective action. The County's corrections were implemented after our fieldwork and have not been audited or reviewed.

**FINDING 2 – Unallowable Costs Were Included in the Indirect Cost Pool**

CMID included unallowable costs in the indirect cost pool for fiscal year (FY) 2015/16. The Construction Contract costs of \$373,788 (See Attachment I) are directly related to a final cost objective and should be identified as a direct cost and not be included in the indirect cost pool.

The County staff included Construction Contract costs in the indirect cost pool for recovery purposes because the costs were not a direct reimbursable cost from Caltrans. The CMID's indirect costs were impacted, resulting in the overstating of the Division Overhead Rate. If unallowable costs are included in the Indirect Cost Rate Proposal (ICRP), Caltrans may reimburse the County more than allowed.

2 Code of Federal Regulation (CFR) 200.413 Direct Costs (a) General states in part, "*Direct costs are those costs that can be identified specifically with a particular final cost objective, such as a Federal award, or other internally or externally funded activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy. Costs incurred for the same purpose in like circumstances must be treated consistently as either direct or indirect (F&A) costs.*"

**RECOMMENDATION**

We recommend the County exclude the Construction Contract cost from the indirect cost pool on future ICRP. The County is required to review all billings using the FY 2015/16 accepted rate to Caltrans and reimburse the difference between the accepted and audited rate.

**SUMMARY OF AUDITEE'S RESPONSE**

The County agrees with the finding and indicated that they have revised their rate calculation. In addition, the County indicated they would adjust future invoices for amounts due to Caltrans. See Attachment II for the County's response.

**ANALYSIS OF AUDITEE'S RESPONSE**

We appreciate the County's implementation of corrective action. The County's corrections were implemented after our fieldwork and have not been audited or reviewed.

**ATTACHMENT I**

**Audit Adjustment for  
Construction Management Inspection Division  
FY 2015/16**

	<b>Proposed Costs FY 2015/16</b>	<b>Audited Costs FY 2015/16</b>	<b>Change</b>
Direct Salaries	\$7,065,716	\$7,065,716	\$ -
Direct Fringe Benefits*	\$4,043,673	\$4,043,673	\$ -
<b>Total Direct Salaries and Fringe Benefits</b>	<b>\$11,109,389</b>	<b>\$11,109,389</b>	<b>\$ -</b>

\*Includes Pension Obligation Bond (POB) of \$632,932

<b>Indirect Costs</b>			\$ -
Indirect Salaries	\$343,855	\$343,855	\$ -
Indirect Fringe Benefits*	\$156,814	\$156,814	\$ -
Construction Contracts	\$373,788		\$ (373,788)
Department Overhead Allocation	\$365,660	\$365,660	\$ -
Division Overhead Allocation	\$526,668	\$526,668	\$ -
County Equipment Rental	\$551,850	\$551,850	\$ -
Other Costs	\$1,655,710	\$1,655,710	\$ -
<b>Total Indirect Costs</b>	<b>\$3,974,345</b>	<b>\$3,600,557</b>	<b>\$ (373,788)</b>

<b>Total Indirect Cost</b>	<b>\$3,974,345</b>	<b>\$3,600,557</b>	<b>\$ (373,788)</b>
<b>Total Direct Salaries and Fringe Benefits (less POB)</b>	<b>\$10,476,397</b>	<b>\$10,476,397</b>	<b>\$ -</b>
<b>Rate</b>	<b>37.94%</b>	<b>34.37%</b>	<b>-3.57%</b>

## Department of Finance

Ben Lamera  
Director



## Auditor-Controller Division

Joyce Renison  
Assistant Auditor-Controller

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**County of Sacramento**

January 30, 2018

MarSue Morrill, CPA  
Chief External Audits – Local Government Agency  
Independent Office of Audits and Investigations  
PO Box 942874  
Sacramento, CA 94274-0001

**Subject: Response to County of Sacramento Incurred Cost Audit Draft Report  
P1594-0075, P1594-0076, P1594-0077**

Dear Ms. Morrill:

On January 24, 2018, the County of Sacramento Department of Finance (Finance) and the California Department of Transportation Independent Office of Investigations Unit (Caltrans) conducted a formal exit conference to discuss the County of Sacramento's Indirect Cost Rate Proposal (ICRP) Audit draft report, findings and recommendations.

Attached is Finance's response to the Caltrans Indirect Cost Rate Proposal Audit findings. The attached document provides responses to both of the following two findings identified in the draft audit report:

1. The County of Sacramento Departments of General Services and Transportation Do Not Bill Actual Costs
2. Unallowable Costs Included in the Indirect Cost Pool

We understand that the attached Finance response will be incorporated into Caltrans' final audit report. If you have any questions or need additional information, please contact Mark Aspesi or Herman T. Williams at (916)874-6701.

Sincerely,

A handwritten signature in cursive script that reads "Joyce Renison".

Joyce Renison  
Assistant Auditor-Controller

Attachment: County of Sacramento Responses to the Caltrans Indirect Cost Rate Proposal Audit Findings

Cc: Ron Vicari, Director of Transportation  
Thor Lude, Chief of Construction Management and Inspection Division  
Mike Guiver, Department of Transportation  
Alan Matre, Chief of Audits

## **County of Sacramento Responses to the Caltrans Indirect Cost Rate Proposal Audit Findings January 2018**

### **FINDING 1 – The County of Sacramento Departments of General Services and Transportation Do Not Bill Actual Costs.**

The County of Sacramento (County) Departments of General Services and Transportation (Department) do not bill actual labor costs. The Departments bill Caltrans using an average labor rate (rate) for each job classification within a division. The rate is applied to each employee by classification to their actual productive hours, which are the total estimated labor costs. The Departments do not reconcile estimated labor cost to actual costs which are necessary to ensure labor costs are actual and allowable. Two prior California Department of Transportation (Caltrans) audits also identified this same finding for County Department of Transportation and it has not been resolved.

The County has always used estimated labor costs for billing and did not perform reconciliations. Since, there is no written policy and procedures for actual labor billings, the County did not understand reconciliation is required when estimated costs are used for billing.

Without reconciling the estimated labor costs to actual labor costs, Caltrans may reimburse the County more direct labor costs than allowed. Additionally, when applying the indirect cost rate to estimated labor costs, the County may be recovering more indirect costs than allowed.

Article IV Section 7 in the Federal Master agreement 03-5924R states in part, "Payments to Administering Agency can only be released by the State as reimbursements to actual allowable project costs already incurred and paid by administering agency."

Local Assistance Procedure Manual (LAPM), Chapter 5, Section 5.2, Requirements for reimbursement states in part, "The local agency may submit monthly invoices for reimbursement of participating costs (costs eligible for state and/or federal reimbursement). Amounts claimed must reflect the cost of completed work, which has been paid for."

### **RECOMMENDATION**

We recommend the County bill actual labor costs and adhere to LAPM Section 5.2. Alternatively, if the County continues to bill Caltrans using an average labor rate, the County is required to develop and implement written procedures and reconcile the billings by comparing what was billed to the actual labor costs annually and at project completion. In addition, the County will not be eligible for any project reimbursement until the reconciliation process and procedures have been developed and implemented.

### **AUDITEE'S RESPONSE**

The County has implemented reconciliation processes beginning July 1, 2016 whereas, labor costs billed to Caltrans using average labor rates will be reconciled with actual labor costs incurred annually and at project completion. We will also adjust project billings for any variances identified between the average labor costs and actual labor costs calculations annually and at project completion.

**FINDING 2--Unallowable Costs Included in the Indirect Cost Pool**

The County, Department of General Services, Construction Management Inspection Division (CMID) included unallowable costs in the indirect cost pool for fiscal year (FY) 2015/16. The Construction Contract costs of \$373,788 (See Attachment I) are directly related to a final cost objective and should be identified as a direct cost and not be included in the indirect cost pool.

The County staff included Construction Contract costs in the indirect cost pool for recovery purposes because the costs were not a direct reimbursable cost from Caltrans. The CMID's indirect costs were impacted, resulting in the overstating of the Division Overhead Rate. If unallowable costs are included in the Indirect Cost Rate Proposal (ICRP), Caltrans may reimburse the County more than allowed.

**2 Code of Federal Regulation (CFR) 200.413 Direct Costs:**

(a) *General.* Direct costs are those costs that can be identified specifically with a particular final cost objective, such as a Federal award, or other internally or externally funded activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy. Costs incurred for the same purpose in like circumstances must be treated consistently as either direct or indirect (F&A) costs.

**RECOMMENDATION**

We recommend the County exclude the Construction Contract cost from the indirect cost pool on future ICRP. The County is required to review all billings using the FY 2015/16 accepted rate to Caltrans and reimburse the difference between the accepted and audited rate.

**AUDITEE'S RESPONSE**

We agree with the finding and have revised the rate calculation to exclude the construction contract cost identified and all direct cost line items from the indirect cost pool on the County's ICRP calculation. The County has reviewed and recalculated all Caltrans billings using the FY 2015/16 accepted rate and has determined that the charged difference between the accepted rate and audited rate to be an immaterial amount. The County will adjust its future invoices to account for the amount due back to Caltrans.