Audit Plan

July 1, 2019 - June 30, 2020

Report of the Inspector General

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Audits

The Road Repair and Accountability Act, Chapter 5, Statutes of 2017 (SB 1), created the Independent Office of Audits and Investigations (IOAI) and the position of Inspector General to ensure the California Department of Transportation (Caltrans) and external entities that receive state and federal transportation funds from Caltrans are spending those funds efficiently, effectively, economically, and in compliance with applicable state and federal requirements. SB 1 requires the Inspector General to report a summary of investigation and audit findings and recommendations at least annually to the Governor, the Legislature, and the California Transportation Commission (CTC).

Following the passage of SB 1, SB 103 (Chapter 95, Statues of 2017) was approved in July 2017 and requires Caltrans to undertake several activities to increase procurement opportunities for small/micro enterprises, disabled veteran-owned, and new and limited contracting small businesses, as well as underrepresented, disadvantaged, formerly incarcerated, and LGBT business enterprises or individuals. In addition, it requires Caltrans to prepare a plan that includes steps Caltrans will take to prevent discrimination or preferences in its employment and contracting practices. SB 103 also requires a detailed outreach plan that focuses on partnerships, sponsorships, training, workshops, prime supplier engagement, pre-bid meetings, mentorship programs, apprenticeships, and relevant disparity study findings. It directs the Inspector General to review, audit, and report on Caltrans' outreach efforts.

Pursuant to SB 1, IOAI provides a full scope, independent, and objective audit and investigation program. The 2019-20 Audit Plan is a guiding document that outlines audit and investigative priorities and identifies specific engagements to be performed during the coming year.

Key SB 1 audits detailed in this plan include:

- Evaluation of new efficiency measures instituted to achieve $100 million in savings.
- Progress of Caltrans towards meeting mandated SB 1 performance outcomes.
- Program oversight and accountability for various programs identified in SB 1.
- Effectiveness and accuracy of Caltrans Project Cost Estimates.
- Review of District Director's Orders.
- Verification of SB 1 project costs for appropriateness.
- Caltrans efforts to enhance employee safety.

The Audit Plan also includes audits and reviews of financial documents of architectural and engineering firms that contract with Caltrans and local entities. In accordance with Caltrans' stewardship and oversight role over federal funds, Local Government Indirect Cost Rate proposals, Indirect Cost Allocation Plans, and Incurred Costs will be reviewed and audited as appropriate.

Key SB 103 audits detailed in this plan include compliance with:

- Application of the Federal Commercial Useful function (CUF) requirement as well as related Caltrans policies/directives.
- Implementation of the Caltrans OBEO Outreach Plan.
- The Federal Good Faith Effort Program requirements.
- The Prompt Pay Act (timely payments made to all suppliers, including subcontractors).
- Federal and state program denial requirements for small DVBE and DBE businesses.

Investigations and Ethics Program

Confidential administrative investigations are conducted when allegations of employee misconduct are identified. Examples of allegations of employee misconduct are: misuse of state resources, incompatible activities, conflict of interest, document falsification and ethics policy violations. Information about the investigations derived from and management of the Caltrans' Ethics Hotline is also included in the Audit Plan.

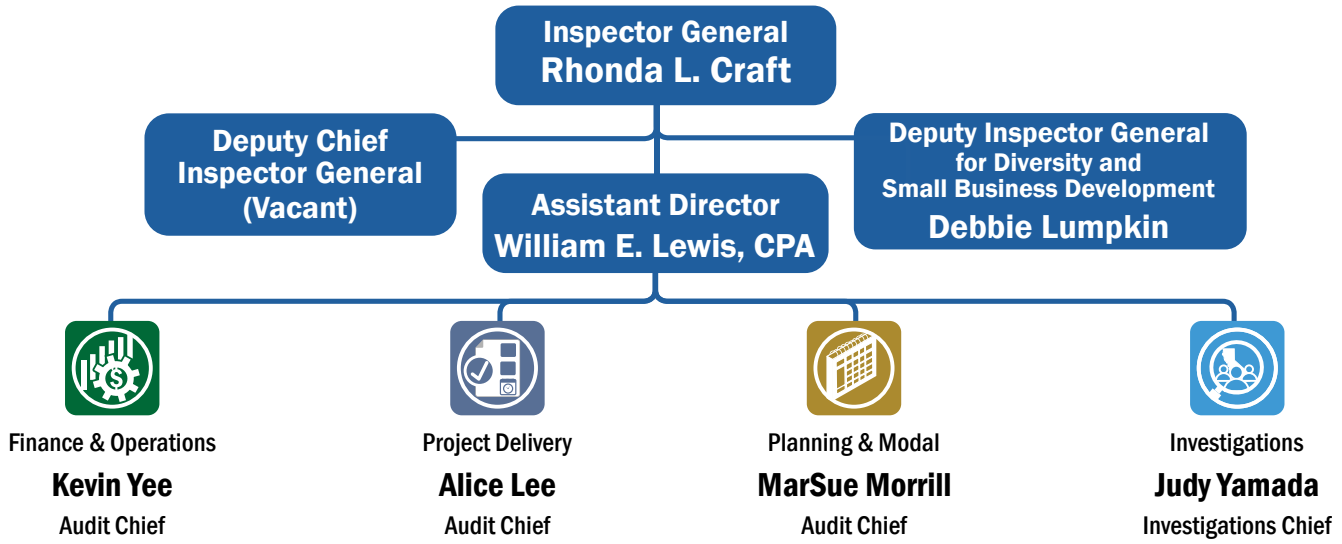
The 2019-20 Audit Plan identifies assignments and sets direction for the IOAI for July 1, 2019, through June 30, 2020. The Audit Plan is a guiding document that is subject to change based on the availability of resources and the need to set new priorities or initiate different projects over the course of the year.

The Audit Plan proposes audits, investigations, reviews, and consulting engagements that are 1) selected after an assessment of the risk factors or conditions that, absent effective management, could adversely affect the ability of Caltrans and external entities to accomplish stated SB 1 goals and priorities, 2) determined necessary to comply with state or federal reporting requirements, and/or 3) mandated by state or federal law or policy.

As part of the assessment of risk within Caltrans, IOAI staff considered the following risk factors: asset management; effective coordination of SB 1 programs; ability to recruit, hire, train, and retain well-qualified staff; shift to multi-modal transportation planning and policy; need to modernize technology systems; and ability to achieve performance targets. The financial impact of these factors, specific directives in law, recent or past audit experience, and employee disciplinary information were also considered. The selection of audits and reviews of external entities is also risk-based. An external entities risk was assessed using a number of factors including, but not limited to: little or no audit history, poor prior performance, past whistleblower or ethics complaints received, and financial impact. Much of the external audit work is mandated by law or policy, requested by Caltrans, and/or by agreement with the Federal Highway Administration.

The California Legislature designated the California State Auditor (CSA) as the responsible agency to perform the annual audit of the state's financial statements and compliance with the Single Audit Act. This Audit Plan does not provide for an independent audit of the Caltrans financial management system; however, CSA may rely on certain audits performed by IAOI when performing the Single Audit.

Caltrans, as a pass-through entity of federal funds, must ensure local government agencies, universities, and non-profit entities comply with single audit requirements. IOAI assists the department in this effort.



Inspector General

SB 1 requires the Governor to appoint an Inspector General to lead the IOAI and upon confirmation by the California State Senate, the Inspector General shall serve a six-year term. The Inspector General is vested with the authority to exercise all responsibility for maintaining a full scope, independent, and objective audit and investigation program as prescribed by law. The Inspector General has a duty to review policies, practices, and procedures and conduct audits and investigations of activities involving state transportation funds administered by the department and to report findings and recommendations to the Secretary of Transportation and the director and chief deputy director of Caltrans on an ongoing and current basis.

At least annually, or upon request, the Inspector General is required to report to the Governor, the Legislature, and the California Transportation Commission (CTC) with a summary of investigation and audit findings and recommendations.

Deputy Inspector General

To administer the statutory requirements of SB 103, Governor Edmund G. Brown, Jr. appointed a Deputy Inspector General for Diversity and Small Business Development in 2018. The Deputy Inspector General (DIG) is responsible for the review of programs, policies, and procedures related to diversity and small business development efforts by Caltrans. The DIG works with the Inspector General, auditors, and investigators to identify risks and appropriate audits and investigations to assist Caltrans in preparing for and executing SB 103 requirements. In addition, the DIG is tasked with providing recommendations and sharing best practices that assist Caltrans in expanding its diversity efforts and small business development opportunities. The DIG is a resource within Caltrans and works with external partners to identify and resolve issues.

SB 1 Performance Outcomes

Efficiency Measures to Achieve $100 Million in Savings

SB 1 requires Caltrans to implement efficiency measures with the goal to achieve at least $100 million per year in savings to invest in maintenance and rehabilitation of the state highway system. Caltrans is required to report the savings to the California Transportation Commission (CTC).

In last year's 2018-19 Audit Plan, the IOAI performed an audit to determine if Caltrans had internal controls in place to ensure the program areas identified can achieve the estimated savings. The audit was issued in July 2019, and audit objectives included:

- The estimated efficiency savings reported were supported.
- Caltrans has developed a methodology to determine whether savings related to Value Analysis and CMGC will result in actual savings in the future.

The 2019-20 Audit Plan will include an audit which will be initiated after Caltrans submits its annual Efficiency Report to the CTC in October 2019. IOAI will perform an audit of the new efficiency measures with significant savings identified to determine whether the savings reported by Caltrans are supported and available for reinvestment in the maintenance and rehabilitation of the state highway system.

Progress Toward Achieving SB 1 Performance Outcomes

SB 1 establishes performance outcomes for five state highway assets:

- Not less than 98 percent of pavement in good or fair condition.
- Not less than 90 percent level of service achieved for maintenance of potholes, spalls, and cracks.
- Not less than 90 percent of culverts in good or fair condition.
- Fix at least an additional 500 bridges.
- Not less than 90 percent of transportation management system (TMS) units in good condition.

Pavement Program Audit

In accordance with the 2018-19 Audit Plan, IOAI initiated an audit of the pavement program. The final audit report will be released in the first quarter of this fiscal year. Based on the information obtained during this audit, IOAI will perform additional audit work of the pavement program and performance outcomes. In fiscal year 2019-20, the focus of the audit will include audit work in additional Districts to determine if the findings are similar statewide. Additionally, we will review the Automated Pavement Condition Survey (APCS) procurement process to ensure adequate procedures are established and the process is timely to obtain the APCS on an annual basis.

Bridges

An audit will be performed on Caltrans efforts to meet the performance outcome for bridges to ensure policies, procedures, and metrics exist to adequately track, assess, monitor, and report on bridge improvements. Additionally, we will assess the progress Caltrans is making on meeting the performance objective of fixing at least 500 bridges.

Follow-Up on Prior SB 1 Audits Findings

In fiscal year 2019-20, three audits are planned that will follow up on each of the findings noted in the Baseline for Senate Bill 1 Performance Outcome audit, dated April 2018. That audit determined whether Caltrans had established an appropriate baseline to measure future progress toward achieving the performance goals. The planned work for the three audits will include evaluating the corrective actions taken by Caltrans in the following areas:

- Level of service performance outcomes - policies and procedures to ensure compliance with SB 1.
- Complete inventory of culverts.
- Accuracy of inventory in relation to the Transportation Management System Elements.

Independent Office of Audits and Investigations Oversight Responsibilities

Accuracy of Project Costs Estimates

The purpose of this audit is to determine if the process for estimating project costs can be improved to reduce Caltrans' risk of having insufficient funds to complete projects with over run. This audit will review a history of projects comparing the initial project estimate to the final project estimate at the time of the bid opening to determine how close the original engineers estimate was. Additionally, the audit would evaluate the causes for estimate changes to determine if operational improvements can be made to the estimate process.

District Director's Orders

A District Director's Order is a formal document approving the waiver of normal procedures for advertising, bidding, and awarding certain contracts when an emergency or other extenuating circumstance exists. The District Director's Orders process was identified as a high risk that should be reviewed to ensure controls are established to safeguard state resources. The objectives of the audit are to determine if:

- There are adequate and consistent policies, procedures, and guidelines in place over the District Director's Order process, and they are clearly communicated to those who are responsible.
- The use of Director's Orders is in compliance with the criteria specified in the State Contract Act.
- District Director's Orders are properly monitored and administered to ensure they are: 1) supported by proper justification and documentation and 2) the project cost and scope on District Director Orders agree with contract agreements, contractor invoices, and internal support documentation.
- Small businesses are considered for opportunities to participate in emergency work.

Contract Change Orders

A contract change order is used as a legally authorizing document to modify the terms of the original contract. The purpose of this audit is to determine if contract change orders are being used in accordance with Caltrans policies and procedures and if the justifications are reasonable.

Employee Safety

Caltrans' number one goal is to provide safety to its employees and the public who use the transportation system. This audit plan includes an audit of Caltrans' efforts to increase the safety of its employees. The audit will include a review of programs within Caltrans that have responsibility for safety policy and procedures. Additionally, the audit will evaluate if employees have the tools necessary to perform their duties safely and if not, what tools are needed to enhance safety.

Increasing Accountability for Local Assistance Programs

SB 1 states the intent of the Legislature to hold Caltrans and local governments accountable for the efficient investment of transportation funds including through performance goals that are tracked and reported. The California Transportation Commission (CTC) is responsible for identifying and reporting to the Legislature and public the expected and actual benefits of projects and whether projects are delivered within their approved scope, cost, and schedule. To fulfill this obligation, the CTC adopted SB 1 Accountability and Transparency Guidelines that apply to all specified SB 1 programs. Additionally, individual program guidelines, such as Active Transportation Program Guidelines or Trade Corridor Enhancement Program Guidelines, were adopted and define specific program-level requirements.

Pursuant to CTC guidelines, Caltrans provides the administrative oversight for SB 1 programs and ensures the terms and conditions of the CTC guidelines and subsequent programming, allocation, reporting, and other actions are followed. The 2018-19 Audit Plan included a consulting engagement of the Active Transportation Program with Caltrans' Division of Local Assistance to provide recommendations for effectively implementing the actions required by the CTC guidelines.

The 2019-20 Audit Plan includes audits of local recipients of funding under the Active Transportation Program (ATP). The objective of these audits is to determine if project costs claimed and reimbursed are supported and in compliance with agreement provisions and state and federal laws and regulations, and if expected performance outcomes and outputs were met. Additionally, audits will be performed to determine if the local entities have a financial management system capable of accumulating and segregating costs that are reasonable, allowable, and can be allocated to projects.

Addressing Information Technology Risks

In its December 2017 State Leadership Accountability Act report to the Department of Finance (DOF), Caltrans identified the need to modernize technology systems that do not meet current business needs. Caltrans received additional funding in the 2018-19 Budget Act to develop an Information Technology Roadmap that—once approved by DOF and the California Department of Technology—will guide replacement of technology that is at the end of its useful life.

The 2019-20 Audit Plan includes an audit to determine whether Caltrans is in compliance with State Administrative Manual (SAM) and Statewide Information Management Manual (SIMM) requirements to establish and maintain appropriate computer software management practices and ensure that computer software used and/or purchased with state funds is legally procured and is used in compliance with licenses, contract terms, and applicable copyright laws.

A second audit will document and evaluate Caltrans' information technology governance process and incorporate findings into the ongoing risk assessment process. These two audits will assist the department as it moves forward to address information technology risks.

Reviewing Architectural & Engineering Consultant Bid Proposal Documents

As a service to the Caltrans Division of Procurement and Contracts (DPAC), the IOAI reviews financial documents from Architectural and Engineering (A&E) firms submitted to Caltrans as part of a bid proposal. In addition, IOAI performs audits of the Indirect Cost Rates of A&E consultants contracting with Caltrans to determine if the Indirect Cost Rate and direct costs in a bid proposal are supported, reasonable, and in compliance with the cost principles set forth by Federal Highway Administration (FHWA) in 48 CFR Part 31 and 23 CFR Part 172.

The selection of documents for review is based on risk factors that include total consultant participation amount, results of previous reviews, and risks identified by DPAC. Recommendations are made to DPAC to adjust costs as needed prior to contract execution.

Completing Independent Audits of A&E Consultants Indirect Cost Rates

The IOAI performs audits of the Indirect Cost Rates of A&E consultants contracting with Caltrans. Audits are performed under Government Auditing Standards to ensure the proposed rates are in compliance with the cost principles set forth by FHWA in 48 CFR Part 31.

Audits of Local Governments A&E Contract Procurements

This service expands similar reviews and audits of A&E bid proposals submitted to local agencies as required of all state transportation agencies by the FHWA.

In addition to reviewing A&E firms bid proposal documents, the 2019-20 Audit Plan includes audits of local governments' procurements to ensure they are complying with applicable state and federal procurement requirements. The objective of these audits is to determine whether contracts are procured with fair and open competition and at fair and reasonable cost.

Audits of Extra Work-at-Force Account Change Orders on Highway Construction Projects

The 2019-20 Audit Plan includes audits of payments to construction contractors for “Extra Work-at-Force Account” change orders that allow for payment for time and material work (labor, materials, equipment, and markup) added to the original scope of a contract. This method of payment is only allowed when strictly necessary such as when the extent of work is unknown or is of such character that a price cannot be determined to a reasonable degree of accuracy. Audits are performed to determine if billed costs are in compliance with Caltrans Standard Specifications, consistent with contract provisions, and the contractor’s financial management system is adequate to accumulate and segregate allowable project costs. Contracts selected for audit are based on funding type, funding amount, number of previous construction contracts, input from Division of Construction, issues with Division of Labor Compliance, and past audit results.

Special Request Audits

At the request of the Caltrans Division of Construction, audits are conducted of construction contractors’ claims of financial damages resulting from projects delayed and/or terminated by Caltrans. Audits are performed to determine if claimed costs are allowable, allocable, reasonable, and in compliance with federal and state laws and regulations and contract provisions.

Providing Oversight of Federal Funds Received by Local Entities

The Stewardship and Oversight Agreement between the Federal Highway Administration and Caltrans establishes roles and responsibilities for oversight activities and requires Caltrans assess subrecipient accounting controls of local entities through various monitoring activities described in Caltrans' Local Assistance Procedures Manual (LAPM), including: Indirect Cost Allocation Plan (ICAP) acceptance and audit process, Incurred Cost Audits, Pre-award Agency Audits, and Single Audits. The 2019-20 Audit Plan includes the actions described below to comply with these requirements.

Submission Reviews and Audits of Local Governments Indirect Cost Rate Proposals and Indirect Cost Allocation Plans (ICRP/ICAP)

ICRP/ICAP submitted by local governments are accepted or reviewed for compliance with the requirements of 2 CFR Part 200. Once IOAI determined that the ICRP/ICAP meets the submission requirements, the IOAI issues acceptance letters to allow local governments to bill Caltrans for indirect costs. A risk assessment is performed by IOAI to identify the ICRP/ICAPs that will be subject to an audit. The audit work is performed by either the IOAI and/or the Department of Finance through an inter-agency agreement.

Other objectives of the audits are to determine whether the local government entities are in compliance with required procedures and have a financial management system capable of accumulating and segregating costs that are reasonable, allowable, and can be allocated to projects or specific cost objectives.

Audits of Incurred Costs

Audits of Incurred Costs of local governments determine if project costs claimed and reimbursed are supported and in compliance with agreement provisions and state and federal laws and regulations; and if the local entities have a financial management system capable of accumulating and segregating costs that are reasonable, allowable, and can be allocated to projects or specific cost objectives. Financial management systems include accounting, procurement, and contract management. In line with SB 1 allocations and other risk criteria, IOAI will perform audits of projects costs in areas such as ATP, Congested Corridor, Trade Corridor, and Local Partnership Program.

Incorporating Review of Diversity, Equity, and Inclusion Practices in All Applicable Audits

SB 103 expressed concerns about complex regulation, fair practices, process barriers, insufficient outreach, and development with over burdensome requirements. A review will be conducted to determine when questions of diversity, equity and inclusion should be considered as part of the scope of work on routine audit work to assist in making recommendations consistent with the intent of SB 103 to increase procurement opportunities for small, disabled veteran, and disadvantaged business owners; and to prevent discrimination in hiring and contracting practices.

Application of the Federal Commercial Useful Function (CUF) Requirement

This audit will be performed in response to several concerns raised by small disadvantaged business owners and non-diverse prime suppliers/contractors regarding process barriers within the administration and the application of Commercial Useful Function requirements. The audit will assess compliance with federal regulation and program administration as well as the adequacy of related Caltrans supporting policies and procedures.

Implementation of the Caltrans OBEO Outreach Plan

In January 2019, Caltrans submitted a report to the Legislature detailing an outreach plan to increase procurement opportunities for new and limited contracting small business enterprises, including, but not limited to, those owned by women, minorities, disabled veterans, LGBT individuals, and other disadvantaged groups. Per SB 103, the Office of the Inspector General reviewed and provided an assessment of the outreach plan in fiscal year 2018-19. Outreach is a critical component to achieving diversity, equity, and inclusion. Therefore, the IOAI will review plan progress and accomplishments made by Caltrans through implementation of this plan.

Application of the Federal Good Faith Effort Requirement

IOAI will perform an audit to evaluate Caltrans and its prime suppliers compliance with the Federal Good Faith Effort requirement. Given the project size of Caltrans contracting opportunities, it is imperative that disadvantaged businesses participate as a subcontractor for many reasons. For example, the anticipated shortfall of developed, experienced suppliers to execute the additional $5.4 billion annually due to the passage of SB 1.

Compliance with The Prompt Pay Act and Subcontractor Impacts

IOAI will perform an audit of Caltrans ability to meet the prompt payment requirements in response to concerns that have been raised by the business community, legislative members, community leaders, and the California Business Chambers. The concern is focused on receiving the required payment for services timely so that the primes and small, disabled veteran, and disadvantaged businesses will have the operating capital to avoid cash flow issues which could result in financial strains to their business resulting in bankruptcy.

Federal and State Program Participation Denials for Small DVBE and DBE Businesses

An audit of cases where small, disabled veteran, or disadvantaged businesses have been denied an opportunity to participate in Caltrans' federal and state contracting programs as a prime, subcontractor, or bidding party will be conducted. An audit will be performed to verify fair practices with consistent application. The results of this audit will provide critical information to Caltrans that they can use to help ensure their policies are not resulting in inappropriately denying small, DVBE, or DBE businesses from participating in the bidding and procurement process as a prime or subcontractor.

Discrimination Prevention Efforts Report

SB 103 requires Caltrans to prepare a detailed plan that includes the steps that Caltrans will take to prevent discrimination or preferences in its employing practices or practices in bidding and awarding public contracts to provide equal access to opportunities for all qualified applicants and shall report the plan to the Legislature and shall provide updates to the plan, as necessary. Once Caltrans finalizes the report and provides it to the Legislature, an audit will be performed to determine if actions outlined in the report are in place and are being monitored to ensure they are reasonable and equitable.

Mandated audits are required by statute, policy, standards or agreement. The 2019-20 Audit Plan includes the following mandated audits and assignments.

Proposition 1B Bond Audits

The California Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 (Proposition 1B) dedicated $19.925 billion over a ten-year period for transportation projects. Under Government Codes 8879.2(c) and 8879.50, audits are required of bond project expenditures and outcomes. The IOAI is responsible for mandated performance audits to determine if Proposition 1B bond fund recipients complied with federal and state procurement requirements, project costs reimbursed were allowable, and to ensure project deliverables and outcomes were met. IOAI contracts with the Department of Finance to perform the majority of these audits, however, IOAI staff may conduct Proposition 1B audits in order to maintain knowledge and awareness in this field.

Quality Control Review

IOAI will perform a quality control review of the audits it performs of the Caltrans internal programs starting in fiscal year 2019-20 and every two years thereafter.

The GAO Government Auditing Standards, General Standards 3.82 requires each audit organization performing audits in accordance with GAGAS to establish and maintain a system of quality control that is designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements. Section 3.93 requires audit organizations to establish policies and procedures for monitoring of quality in the audit organization. Section 3.94 requires audit organizations to perform monitoring procedures that enable it to assess compliance with applicable professional standards and quality control policies and procedures for GAGAS audits. Section 3.95 requires the audit organization to analyze and summarize the results of its monitoring process at least annually.

Business Continuity & Technology Recovery

With the recent rise in the number of natural disasters (fires, floods, earthquakes, etc.), there is an increased need to respond to emergency needs and resume business operations in a prompt manner. SAM 5325 requires state entities to identify and document all business functions and critical infrastructure; conduct a business impact assessment; develop recovery strategies to ensure systems, functions, and infrastructure can be brought online quickly; develop a Business Continuity Plan; conduct regular training; conduct regular tests and exercises to identify deficiencies; and develop steps to ensure the Business Continuity Plan is maintained and updated regularly. The Business Continuity Plan must also address the Office of Emergency Services' continuity planning requirements. The audit will determine compliance with SAM 5325 requirements.

DGS Contract Delegation

The Department of General Services (DGS) provided Caltrans an exemption from their approval of contracts under $150,000 as set forth in Public Contract Code section 10351. As part of this exemption, Caltrans' procurement process and policies and procedures are required to be audited in accordance with DGS' audit guide and the audit report submitted to DGS by April 30, 2020. This audit is performed by IOAI to fulfill the exemption requirements.

Conducting Investigations

The Investigations Unit of the IOAI conducts independent, confidential administrative investigations involving allegations of employee misconduct. Investigations can result from: complaints from Caltrans management and/or employees, Caltrans' Ethics Hotline, audit findings, and/or direct contact from a member of the public. Investigative staff works collaboratively with Caltrans management at all levels (districts, programs, and divisions) to investigate and report on allegations of employee misconduct. The Investigations Unit also assists external entities, including the California State Auditor and law enforcement agencies, with investigations involving Caltrans employees.

Managing the Caltrans Ethics Program and Ethics Hotline

In January 2018, the Ethics Program and the Ethics Hotline was transferred to IOAI within the Investigations Unit. The Ethics Program is responsible for fostering a culture of ethical conduct and integrity throughout Caltrans. This includes promoting, communicating, and monitoring ethics statewide and providing ethical training. The Ethics Hotline is a phone- and internet based, multi-lingual site managed by a third-party vendor 24 hours a day, seven days a week. Examples of complaints received include allegations of abuse of state resources (i.e. time, vehicle, equipment), conflict of interest, falsification of documents, discrimination, health and safety violations, and hostile work environment. The ethics staff conducts the first level review of complaints from the Ethics Hotline. The complaints are analyzed and triaged to determine the appropriate course of action, which may include inquiry from Caltrans management, formal investigations by IOAI and/or referral to law enforcement.