

Los Angeles – San Diego – San Luis Obispo Rail Corridor Agency
Incurred Cost Audit



Audit Report

May 2018



PREPARED BY:

California Department of Transportation
Independent Office of Audits and Investigations – MS 2
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ATTACHMENTS

- I. Audit Response from the Los Angeles – San Diego – San Luis Obispo Rail Corridor Agency**

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

SUMMARY

The California Department of Transportation (Caltrans), Independent Office of Audits and Investigations (A&I) audited contract costs totaling \$3,280,257 advanced to the Los Angeles – San Diego – San Luis Obispo Rail Corridor Agency (LOSSAN). We found that LOSSAN charged \$38,156 of disallowed costs, reported \$173,947 of questioned costs, and did not accurately report expenditures totaling \$273,831.

OBJECTIVES

This audit was performed to determine whether project costs claimed by LOSSAN were allowable, supported, and in compliance with respective agreement provisions, state and local regulations, and LOSSAN’s policies and procedures. The audit included costs incurred under Interagency Transfer Agreement (Agreement) number 75LOSSAN2015ITA between Caltrans and LOSSAN. Our audit period was from July 1, 2015 through March 31, 2017.

SCOPE

We conducted an incurred cost audit of LOSSAN’s costs charged to the Agreement between Caltrans and LOSSAN to determine if costs were in compliance with the Agreement, and applicable laws and regulations. Further, we assessed LOSSAN’s financial management system to determine if it is capable of accumulating, segregating, and allocating costs. The audit was limited to financial and compliance activities.

We limited our scope to requirements in the Agreement, applicable state laws and regulations, and LOSSAN’s policies and procedures. Due to the ambiguity of language included in the Agreement, we did not apply the cost principles set forth in 2 CFR 200. Recommendations to clarify the ambiguous language will be reported to Caltrans management in a separate management memorandum. Our field work was completed on September 15, 2017 and transactions occurring after this date were not tested and, accordingly, our conclusion does not include costs or credits arising after this date.

LOSSAN is responsible for the claimed costs, compliance with applicable agreement provisions, state and local laws and regulations. LOSSAN is also responsible for the adequacy of their financial management system to accumulate and segregate reasonable, allocable, and allowable costs. Because of inherent limitations in any financial management system, misstatements due to

error or fraud may occur and not be detected. Also, projections of any evaluation of the financial management system to future periods 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 or procedures may deteriorate.

METHODOLOGY

We conducted our 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. The audit was less in scope than an audit performed to express an opinion on the financial statements of LOSSAN. Therefore, we did not audit and are not expressing an opinion on LOSSAN's financial statements.

The audit of LOSSAN's financial management system included interviews of LOSSAN staff to obtain an understanding of LOSSAN's financial management system. The audit comprised transaction testing of costs to evaluate compliance requirements stipulated in LOSSAN's Agreement with Caltrans.

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

BACKGROUND

Caltrans has a legal and fiduciary responsibility to ensure that all state and federal funds are expended in compliance with state and federal laws, regulations, and agreements. Caltrans performs audits to ensure they are meeting their legal and fiduciary responsibilities and that state and federal funds are properly expended by local government agencies.

CONCLUSION

Based on our audit:

- LOSSAN reported or charged disallowed costs as follows:
 - Cost incurred prior to agreement execution totaling \$32,668.
 - Operation related costs charged as administration costs totaling \$2,081.
 - Travel costs totaling \$3,407 that were reimbursed by another organization.

These costs are disallowed.

- LOSSAN received services for positions billed contrary to contract terms. The billed costs totaled \$173,947 and these costs are questioned.
- LOSSAN reported expenditures totaling \$271,146 in the incorrect time period and overpaid a consultant by \$2,685 due to an overbilling. These costs need to be adjusted accordingly.

VIEWS OF RESPONSIBLE OFFICIALS

Our findings and recommendations consider LOSSAN's response dated March 13, 2018 to our February 9, 2018 draft report. Our findings and recommendations, LOSSAN's response, and our analysis of the response are set forth in the Findings and Recommendations section of this report. A copy of LOSSAN's full written response is included as Attachment I.

This report is intended as information for Caltrans management, and LOSSAN. The report is a matter of public record and will be placed on Caltrans' webpage, which can be viewed at <www.dot.ca.gov/audits/INC.html>.

If you have questions, please contact Luisa Ruvalcaba, Audit Manager, at (916) 323-7888.



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Independent Office of Audits and Investigations

May 3, 2018

FINDINGS AND RECOMMENDATIONS

FINDING 1 – Unallowable Expenses Charged

The Los Angeles – San Diego – San Luis Obispo Rail Corridor Agency (LOSSAN) reported ineligible expenses as follows:

- LOSSAN included \$32,668 of administration expenses incurred in fiscal year (FY) 2014/15 which was prior to the execution of the Interagency Transfer Agreement (Agreement) with the California Department of Transportation (Caltrans). These costs were included in LOSSAN's FY 2015/16 expenditure report and are ineligible. Subsequent to our audit, LOSSAN resubmitted the expenditure reports and submitted them to Caltrans, Division of Rail and Mass Transportation (DRMT). DRMT is reviewing for accuracy.

Section 1.2.5 of Appendix D of the Agreement states in part, *“Only work performed during the term of, and consistent with, the work elements in the approved Annual Business Plan and executed MFTA [Master Fund Transfer Agreement] Supplement may be reimbursed.* Section 2.3.1 of Appendix D states in part, *“The LOSSAN Agency shall electronically submit MFTA Supplement closeout reports to Department no later than six months (December 31st) from the close of the fiscal year for administration, marketing expenditures, and operations expenditures...”*

- LOSSAN charged for services related to the operations of the Pacific Surfliner as administrative expenses in FY 2015/16. Specifically, LOSSAN charged \$2,081 for the cost of using Orange County Transportation Authority (OCTA) buses to transfer Pacific Surfliner passengers to Union Station on June 12, 2016. These costs are ineligible as administration expenses.

Per the Agreement Appendix C, Section 1A, *“The administrative budget includes administrative staffing, legal services, travel, insurance premiums and contracted services: audits, safety/security and planning budgets as itemized in the LOSSAN Agency's Initial Business Plan (Appendix B Table 11.7 LOSSAN Agency FY 2015/16 Budget).”*

- In FY 2016/17 LOSSAN received \$3,407 in reimbursement from a sponsoring agency for travel costs to attend conferences in Chicago and Washington, DC. LOSSAN also charged Caltrans for the same travel. The portion of travel costs billed to Caltrans and reimbursed by the sponsoring agency is unallowable.

Per Section 2.3.1 of Appendix D of the Agreement, *“...The closeout report shall show actual expenditures for administration, marketing and operations...”*

- In FY 2015/16 LOSSAN directly charged Caltrans for marketing staff whose costs were supposed to be recovered through an overhead rate. LOSSAN entered into an agreement with OCTA to act as LOSSAN's managing agency. The Managing Agency Services (MAS) agreement between LOSSAN and OCTA indicated that shared marketing staff would be billed through an overhead rate to be applied to the labor of dedicated LOSSAN staff, and that a Marketing Manager would be hired and billed directly to LOSSAN. Although some staff did perform general marketing duties and their time was appropriately included in the overhead, the hiring of the Marketing Manager was delayed. To try to remediate the situation, OCTA had a combination of five additional employees performing the Marketing Manager duties and billed this staff time directly to LOSSAN. There was no justification or advanced approval for the change in scope to the MAS agreement. The direct labor, and associated overhead costs, totaling \$174,341 are questioned. Note: This amount includes \$394 of labor and overhead costs incurred in FY 2014/15 and is included in the ineligible amount identified in the first bullet above. The net amount is \$173,947.

Attachment A of the Managing Agency Administrative Support Agreement states in part, *"This position [Marketing Manager] will work closely with shared staff in OCTA's marketing department for all support services..."* It further states in part, *"In addition to the dedicated positions outlined above, OCTA proposes to use shared positions to provide services in key areas such as...marketing/communications... All shared positions necessary to support the JPA [Joint Powers Authority] are included in OCTA's overhead rate..."*

RECOMMENDATION

We recommend that LOSSAN:

- Resubmit the FY 2015/16 closeout report to exclude the \$32,668 and \$2,081 disallowed costs identified above.
- Exclude the \$3,407 disallowed costs associated with reimbursed travel when reporting the FY 2016/17 expenditures.
- Implement policies and procedures to ensure advanced justification and approval is obtained when changes are made to agreements.

We recommend that DRMT:

- Work with LOSSAN to determine if value was received for the positions billed directly in place of the marketing manager, and to determine if any of the \$173,947 needs to be repaid to Caltrans.

SUMMARY OF LOSSAN'S RESPONSE

- LOSSAN submitted to DRMT expense worksheets identifying the FY 2014/15 incurred expenses that were paid for in FY 2015/16 with member agency funds therefore the costs should not be labeled ineligible. DRMT and A&I were informed of these expenses and that LOSSAN had no intent to claim them. LOSSAN resubmitted FY 2015/16 excel templates to DRMT excluding the FY 2014/15 expenses funded by member agency surplus funds. A reconciliation

of FY 2015/16 expenses was provided to DRMT showing the reduction of the FY 2014/15 expenses paid in FY 2015/16, and in addition expenses incurred in FY 2015/16 but paid for in FY 2016/17.

- LOSSAN stated they follow OCTA’s administrative and human resources policies of allowing bereavement flowers to be purchased for staff members who lost an immediate member of their family.
- LOSSAN does not concur that the \$2,081 cost to transfer customers is unallowable. LOSSAN stated their responsibility to enter into an agreements for services like emergency bus bridge falls under Section 2.4 in Appendix K of the Agreement, which states the LOSSAN agrees to “negotiate and execute all necessary agreements for the administration, operations and maintenance of the Service.”
- LOSSAN noted the payment of \$1,087 for staff travel costs in December 2016 from the American Association of State Highway and Transportation Officials (AASHTO). LOSSAN acknowledged that initially that reimbursement was inadvertently not reported to DRMT. Additionally, LOSSAN received another reimbursement of \$2,320 from AASHTO again to reimburse for staff travel cost already billed to DRMT. However, as LOSSAN was unaware of the reimbursement amount they waited until reimbursement was received to report to DRMT but it was after our audit period. LOSSAN also stated that in future cases they will report expenses as incurred and reimbursement when received even if in different quarters to reduce the need of resubmitting prior quarter worksheets.
- LOSSAN does not concur that OCTA marketing costs billed in the amount of \$173,341 is an ineligible expense. This amount was billed directly by OCTA for five marketing positions that backfilled LOSSAN’s vacant Marketing Manager and Senior Marketing Specialist during FY 2016. The OCTA staff were in essence, filling the roles of the vacant LOSSAN positions, and performing duties that were over and above the normal shared support role (which is included in the overhead). These specific OCTA staff members spent significant time initiating LOSSAN marketing campaigns, representing LOSSAN at events, doing marketing presentations on behalf of LOSSAN, managing LOSSAN marketing projects and overseeing marketing contracts during FY 2016. At the same time, OCTA also provided limited marketing support staff for website work, graphic design, and other areas that was not billed for directly, as the overhead rate justifiably covered these shared support functions.

See Attachment 1 for LOSSAN’s complete response.

ANALYSIS OF LOSSAN’S RESPONSE

- We appreciate LOSSAN’s decision to resubmit a reconciled FY 2015/16 worksheet excluding and including the proper expenses. As a result of this submittal, the finding will be considered cleared when DRMT finishes reviewing the expenditure report and finds it accurate.
- We have removed the finding for the cost of flowers due to immateriality.
- The issue was not that there was not a contract for the expenditures. The issue is that the cost of transferring Pacific Surfliner passengers to another station due to a stoppage in service is an operation expense not an administrative expense, therefore, the \$2,081 finding remains.

- We agree with the process LOSSAN intends to follow on reporting reimbursement's received.
- Relative to the questioned marketing costs of \$173,947, we are unable to assess the value received. We modified our finding and recommendation, however, LOSSAN did not obtain justification or advanced approval for the change of scope to the MAS agreement. Additionally, our audit did not access the value of the marketing effort received from OCTA. Our finding recommends DRMT staff work with LOSSAN to determine the value of any marketing services received.

FINDING 2 – Misreported Expenditures

LOSSAN misreported expenditures for FY 2015/16 because the expenses were originally reported on a cash basis rather than on an accrual basis. LOSSAN incurred expenditures in FY 2015/16, but paid for and reported them to Caltrans as FY 2016/17 expenses. LOSSAN did not provide a closeout report showing all FY 2015/16 expenditures compared against the FY 2015/16 advanced payments. Based on our testing and analysis, for FY 2015/16 LOSSAN excluded \$223,014 and \$48,132 for administration and marketing, respectively.

LOSSAN overpaid a consultant by \$2,685 due to a doubling of billed costs in FY 2016/17, which was not identified by staff reviewing the invoice. We informed LOSSAN of the overpayment and they corrected the error by reducing a subsequent consultant invoice, but in FY 2017/18.

Section 2.3.1 of Appendix D of the Agreement states in part, “...*The closeout report shall show actual expenditures for administration, marketing and operations as compared to advance payments received by the LOSSAN Agency...*”

RECOMMENDATION

We recommend that LOSSAN resubmit their FY 2015/16 closeout report to move the \$271,146 expenditures identified above from FY 2016/17 to FY 2015/16. We also recommend that the over and under payments of \$2,685 be correctly reflected in the FY 2016/17 and FY 2017/18 closeout reports.

SUMMARY OF LOSSAN’S RESPONSE

Caltrans DRMT provided LOSSAN close-out financial reporting templates which LOSSAN completed and submitted to Caltrans DRMT. The reports identified total administration and marketing activities for FY 2015/16 and FY 2016/17.

LOSSAN is in agreement of overpaying a consultant by \$2,685 in FY 2016/17. LOSSAN states they have reimbursed Caltrans by short-paying an invoice, they will ensure that the FY 2017/18 close-out report reflects the reimbursement received from the consultant, and that they have established an invoice review procedure to ensure all invoices are accurate and properly supported.

See Attachment 1 for LOSSAN’s complete response.

ANALYSIS OF LOSSAN'S RESPONSE

- We appreciate LOSSAN's decision to submit the close-out financial reports for FY 2015/16 and FY 2016/17. As a result of this submittal, the finding will be cleared when DRMT finishes reviewing the expenditure report and finds it accurate.
- LOSSAN is in agreement of overpaying the \$2,685 and is taking appropriate corrective action.
- We appreciate LOSSAN establishing an invoice review process.

Any new procedures implemented subsequent to our fieldwork have not been audited.

Attachment I

LOSSAN's REPOSE

RESPONSE TO FINDING 1 – Ineligible Expenses Charged

- The scope and purpose of this audit as provided by Caltrans Audits and Investigations, was to determine whether the costs reported are in compliance with applicable state and federal rules and regulations, agreement provisions, and *conform with generally accepted accounting principles*. The LOSSAN Rail Corridor Agency was provided excel templates by Caltrans DRMT to record and report administrative and marketing related line item expenses on a quarterly basis. The worksheets were completed by the LOSSAN Agency using the cash basis of accounting, which shows expenses when the payment is made, and conforms with generally accepted accounting principles (GAAP).

The worksheets completed by the LOSSAN Agency and submitted to Caltrans DRMT clearly identified the individual administrative expenses that were incurred in fiscal year (FY) 2015 prior to the start of the Interagency Transfer Agreement (ITA), but paid for in FY 2016. These expenses were funded by member agency funds prior to the start of the ITA, and are not funded by the State, therefore they should not be labeled as ineligible expenses. It was communicated to both Caltrans DRMT and Caltrans Audits and Investigations the method used in reporting the expenses on the templates, as well as the intent of the LOSSAN Agency to not claim for these 2015 expenses.

The LOSSAN Agency also provided a reconciliation of FY 2015-16 expenses to Caltrans DRMT showing the reduction of these FY 2015 expenses that were paid in FY 2016, and the addition of expenses that were incurred in FY 2016, but paid in FY 2017. This reconciliation tied to LOSSAN's audited financial statements for FY 2015-16, for which LOSSAN received a clean audit opinion.

Based on Caltrans Audits and Investigations recommendation, the LOSSAN Agency has re-submitted the FY 2015-16 excel templates to Caltrans DRMT, excluding the FY 2015 expenses that are funded by member agency surplus funds.

- The LOSSAN Rail Corridor Agency has an agreement with the Orange County Transportation Authority (OCTA) to provide administrative management services and support. In absence of their own policy, the LOSSAN Agency follows the administrative and human resources related policies of OCTA. The OCTA business expenses policy allows for bereavement flowers to be purchased for staff members who lost an immediate member of their family. This line item expense is consistent with OCTA policy and had been reported to Caltrans DRMT along with supporting backup. There was no indication or communication to the LOSSAN Agency from Caltrans DRMT prior to the audit, that this line item expense had been reviewed and deemed unallowable.

- The LOSSAN Agency does not concur that the charge of \$2,081 for the cost of using the OCTA to transfer Pacific Surfliner customers to Union Station on June 12, 2016 should be charged to operating surplus funds. The service provided by OCTA was an emergency bus bridge service to help transport Pacific Surfliner customers that were stranded during a train service interruption. This type of emergency service provided by OCTA is not included under the current Amtrak operations agreement. The operations funds the LOSSAN Agency receives from the State of California are to fund the direct Amtrak operating cost. In addition, the ITA states in section 7.3, the operating reserve/surplus funds are to be used “solely to fund future variability in operating costs such as fuel, host railroad incentives and other operating costs that may vary from the budgeted amount established at the start of each passenger rail service provider contract year.” In the future, the LOSSAN Agency can look at funding this type of service using operating funds if this service is negotiated between Amtrak and OCTA or other bus service providers.

The LOSSAN Agency requests that the \$2,081 not be included in the \$34,749 referenced as ineligible, as this is an eligible expense, however Caltrans Audits and Investigations is recommending it should be funded by operating surplus funds rather than administrative funds.

The section of the ITA that is referenced, Section 3, of Appendix K, specifically 3.13, “Plan for and implement improvements in connectivity with local transit providers...” relates to the Transit Transfer Program that the LOSSAN Agency has initiated. This program allows for Pacific Surfliner customers to seamlessly transfer to a local transit provider bus route with a paid Pacific Surfliner ticket at no cost to the customer. This Section of the ITA is not applicable to emergency bus bridge service. The LOSSAN Agency’s responsibility to enter into agreements for services like an emergency bus bridge falls under Section 2.4 in Appendix K of the ITA, which states the LOSSAN Agency agrees to “negotiate and execute all necessary agreements for the administration, operations and maintenance of the Service.”

- The LOSSAN Agency received \$1,086.90 in December 2016 for reimbursement from the American Association of State Highway and Transportation Officials (AASHTO) for staff travel costs to attend the quarterly State-Amtrak Intercity Rail Passenger Committee meeting in Chicago in October 2016. The LOSSAN Agency acknowledges that this reimbursement was inadvertently not reported on the original expense worksheet, but a revised worksheet reflecting this reimbursement was submitted in October 2017.

An AASHTO reimbursement of \$2,319.92 was received in the fourth quarter of FY 2017, outside of the timeframe of the audit. The reimbursement was to partially reimburse staff travel costs to attend the quarterly SAIPRC meeting in Washington D.C. during the third quarter. The LOSSAN Agency did not know the exact amount of the reimbursement during the third quarter, and therefore waited until the reimbursement was received in the fourth quarter to show it on the fourth quarter worksheet. The LOSSAN Agency has submitted

the FY 2017 fourth quarter expense worksheet to Caltrans DRMT, properly reflecting the reimbursement, which offsets the expenses reported during the third quarter.

At the time of submitting the quarterly expense worksheets to Caltrans DRMT, the LOSSAN Agency may not know the exact amount of a reimbursement that we may receive in a subsequent quarter. Therefore, the LOSSAN Agency will report these expenses as incurred, and if a reimbursement is received in a subsequent quarter, we will reflect the credit in the quarter received. This will reduce the need to have to re-submit prior quarter worksheets.

- The LOSSAN Agency does not concur that OCTA marketing costs billed in the amount of \$173,341 is an ineligible expense. This amount was billed directly by OCTA for five marketing positions that backfilled LOSSAN's vacant Marketing Manager and Senior Marketing Specialist during FY 2016. The OCTA staff were in essence, filling the roles of the vacant LOSSAN positions, and performing duties that were over and above the normal shared support role (which is included in the overhead). These specific OCTA staff members spent significant time initiating LOSSAN marketing campaigns, representing LOSSAN at events, doing marketing presentations on behalf of LOSSAN, managing LOSSAN marketing projects and overseeing marketing contracts during FY 2016. At the same time, OCTA also provided limited marketing support staff for website work, graphic design, and other areas that was not billed for directly, as the overhead rate justifiably covered these shared support functions.

The managing agency services agreement with OCTA includes an overhead rate that covers all shared positions, facilities and equipment necessary to support the LOSSAN Agency. The detailed cost proposal submitted by OCTA specified that the OCTA External Affairs/Marketing division will provide support to the LOSSAN Agency Marketing Manager in media relations, collateral development and printing, ad buys and new media. Paying directly for OCTA marketing staff resources (including overhead) while they were backfilling the vacant LOSSAN marketing positions, is no different than if we had filled the LOSSAN marketing positions and were paying for those positions (including overhead). The LOSSAN Agency marketing positions are currently filled with an annual cost of \$491,321, including managing agency overhead.

In billing for the direct marketing costs, OCTA inadvertently included two days from June 2015. This is due to OCTA billing on a pay period basis, and these two days in June fell into the first pay period of July 2015. The LOSSAN Agency agrees to pay back the \$394.

In October 2017, the LOSSAN Agency provided OCTA's cost allocation spreadsheets to Caltrans Audits and Investigations for fiscal year 2016 and 2017, as well as the worksheets that OCTA used to come up with the contracted overhead rate in the administrative services agreement.

RESPONSE TO FINDING 2 – Misreported Expenditures

As previously stated, the LOSSAN Agency completed the expense worksheets using the cash basis of accounting, which is a valid method under generally accepted accounting principles. The LOSSAN Agency also provided to Caltrans DRMT a reconciliation of FY 2015/16 expenses to the audited financial statements, which served as the close-out report. This reconciliation clearly showed the expenses that were incurred in FY 2015/16 but paid for in FY 2016/17. The amounts referenced as misreported for administration and marketing expenses are simply expense accruals (expenses incurred and recorded in one period, but paid in another) that were clearly identified in the information provided to both Caltrans DRMT and Audits and Investigations. At no time before the audit process did Caltrans DRMT communicate to the LOSSAN Agency that the expense worksheets or the year end reconciliation provided were unacceptable, or needed to be re-submitted on a different accounting basis.

Based on Caltrans Audits and Investigations recommendation, the LOSSAN Agency has re-submitted updated FY 2015/16 and FY 2016/17 expense worksheets to Caltrans DRMT which shows the administration and marketing expenses reported in the FY incurred rather than when the check was issued.

In October 2017, Caltrans DRMT provided close-out financial reporting templates for administration and marketing activity to the LOSSAN Agency. The LOSSAN Agency has completed these templates and submitted them to Caltrans DRMT, which identifies total administration and marketing activity for both FY 2015/16 and FY 2016/17.

The LOSSAN Agency is in agreement of inadvertently overpaying a consultant by \$2,685 in FY 2016-17 due to a math error in the invoice provided by the consultant. This amount has been reimbursed in FY 2017/18 by short paying an invoice. The LOSSAN Agency will ensure that the FY 2017/18 close-out report will reflect the reimbursement received from the consultant. In addition, the LOSSAN Agency has also established an invoice review procedure checklist which specifies steps and review procedures be taken on all invoices to ensure all invoices are accurate and properly supported.