

Memorandum

*Making Conservation
a California Way of Life.*

To: RIHUI ZHANG
Chief
Division of Local Assistance

Date: June 6, 2019

File: P1594-0097

From: MARSUE MORRILL, CPA *Marsue*
Chief
Planning and Modal Office
Independent office of Audits and Investigations

Subject: **INDIRECT COST RATE PROPOSAL AUDIT – CITY OF SANTA BARBARA, DEPARTMENT OF PUBLIC WORKS, DIVISION OF ENGINEERING**

At the request of the Independent Office of Audits and Investigations, the California State Department of Finance, Office of Audits and Evaluations (Finance) completed an audit of the City of Santa Barbara, Department of Public Works, Division of Engineering's (City) Indirect Cost Rate Proposal (ICRP) for fiscal year (FY) 2017/18. The purpose of the audit was to determine whether the FY 2017/18 ICRP was presented in accordance with Title 2 Code of Federal Regulations (CFR) Part 200 and Caltrans Local Assistance Procedures Manual (LAPM) Chapter 5. The complete audit report is attached.

Based on the audit, Finance determined the City's 2017/18 ICRP was not in compliance with 2 CFR 200 and the LAPM. Additionally, Finance identified weaknesses in the City's ability to adequately segregate allowable and allocable ICRP costs resulting in unallowable costs impacting the 2017/18 ICRP rate. The audited rate is as follows:

Applicable To	Fiscal Year	Proposed Rate	Audited Rate*
Engineering Division	2017/18	98.53%	55.56%

***Base: Total Direct Salaries and Wages plus Fringe Benefits**

Please provide our office with a corrective action plan, including time lines, by August 6, 2019.

If you have any questions, contact Luisa Ruvalcaba, Audit Manager, at luisa.ruvalcaba@dot.ca.gov

RIHUI ZHANG

June 6, 2019

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Attachment

City of Santa Barbara Audit

cc: Rebecca Bjork, Director, Public Works, City of Santa Barbara
Rodney Whitfield, Director of Financial Services, Federal Highway Administration
Veneshia Smith, Financial Program Manager, Federal Highway Administration
William Lewis, Assistant Director, Independent Office of Audits and Investigations
Tim Gubbins, District Director, District 5, California Department of Transportation
Aileen Loe, Deputy District Director, Planning and Local Assistance, District 5, California
Department of Transportation
Angel Pyle, Assistant Division Chief, Division of Rail and Mass Transportation, California
Department of Transportation
Ezequiel Castro, Chief, Capital South Branch, Division of Rail and Mass Transportation,
California Department of Transportation
Susie Beesley, Manager, Contract and Grant Compliance, Division of Rail and Mass
Transportation, California Department of Transportation
Erin Thompson, Chief, Office of Regional Planning, Division of Transportation Planning,
California Department of Transportation
Jacqueline Kahrs, Regional Coordination Branch Chief, Office of Regional Planning, Division
of Transportation Planning, California Department of Transportation
Kamal Sah, Chief, Office of Guidance and Oversight, Division of Local Assistance, California
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Paula Bersola, Audit Coordinator, Division of Local Assistance, California Department of
Transportation
Lisa Gore, Associate Accounting Analyst, Division of Accounting, California Department of
Transportation
Jacqueline Manohar, Audits Coordinator, Division of Rail and Mass Transportation, California
Department of Transportation
Luisa Ruvalcaba, Audit Manager, Planning and Modal Office, Independent Office of
Audits & Investigations
P1594-0097



City of Santa Barbara

Department of Public Works, Division of Engineering

Indirect Cost Rate Proposal

Fiscal Year 2017-18

Report No. 19-2660-006
June 2019

Team Members

Cheryl L. McCormick, CPA, Chief
Rebecca G. McAllister, CPA, Assistant Chief
Rick Cervantes, CPA, Manager
Jeremy Jackson, CPA, Supervisor
Nicole Hawkins

You can contact our office at:

California Department of Finance
Office of State Audits and Evaluations
915 L Street, 6th Floor
Sacramento, CA 95814
(916) 322-2985



DEPARTMENT OF
FINANCE

GAVIN NEWSOM • GOVERNOR

915 L STREET ■ SACRAMENTO CA ■ 95814-3706 ■ WWW.DOF.CA.GOV

Transmitted via e-mail

June 4, 2019

Ms. MarSue Morrill, Chief, Planning and Modal Office
Independent Office of Audits and Investigations
California Department of Transportation
1304 O Street, Suite 200
Sacramento, CA 95814

Dear Ms. Morrill:

Final Report—City of Santa Barbara, Department of Public Works Indirect Cost Rate Proposal Audit

The California Department of Finance, Office of State Audits and Evaluations, has completed its audit of the City of Santa Barbara, Department of Public Works, Division of Engineering's (City) Indirect Cost Rate Proposal for fiscal year 2017-18.

The enclosed report is for your information and use. The City's response to the report findings and our evaluation of the response are incorporated into the final report. If you have any questions regarding this report, please contact Rick Cervantes, Manager, or Jeremy Jackson, Supervisor, at (916) 322-2985.

Sincerely,

Cheryl L. McCormick, CPA
Chief, Office of State Audits and Evaluations

cc: Ms. Luisa Ruvalcaba, Audit Manager, Planning and Modal Office, Independent Office of Audits and Investigations, California Department of Transportation

BACKGROUND, SCOPE, AND METHODOLOGY

BACKGROUND

The California Department of Transportation's (Caltrans) Local Assistance Program oversees more than \$1 billion dollars annually available to over 600 cities, counties, and regional agencies for the purpose of improving their transportation infrastructure or providing transportation services. This funding comes from various Federal and State programs specifically designed to assist the transportation needs of local agencies.¹

The City of Santa Barbara, Department of Public Works, Division of Engineering (City), is responsible for land development, public Improvements including bridge projects and pavement maintenance, the Lower Mission Creek bridge projects, and outdoor dining licenses.²

At the discretion of local governmental agencies (LGA), indirect costs may be recovered when seeking reimbursement for federal-aid transportation projects and state funded projects. To recover indirect costs, LGAs submit an Indirect Cost Rate Proposal (ICRP), which may also include a fringe benefit rate to Caltrans' Independent Office of Audits and Investigations (IOAI). IOAI reviews the documentation supporting the rate(s) and issues an acceptance letter allowing the LGAs to bill Caltrans and seek reimbursement of indirect costs, which IOAI may audit for compliance with Title 2 Code of Federal Regulations Part 200 (2 CFR 200) and Caltrans' Local Assistance Procedures Manual Chapter 5 (LAPM).

SCOPE

At the request of IOAI, the California Department of Finance, Office of State Audits and Evaluations, audited the City's ICRP for fiscal year 2017-18.

The audit objectives were to:

1. Determine if the 2017-18 ICRP, including the fringe benefit rate, was in compliance with 2 CFR 200 and the LAPM.
2. Recalculate the proposed ICRP rate if unallowable costs impacting the ICRP rate by 1 percent or greater are identified.

The 2017-18 ICRP and fringe benefit rate include transactions related to actual costs incurred and billed to Caltrans in 2015-16.

The City has an accepted fringe benefit rate of 41.06 percent for 2017-18. However, the City did not use the accepted fringe benefit rate to bill Caltrans. Accordingly, we did not audit the accepted fringe benefit rate. Instead, we audited the actual fringe benefit costs included in the indirect costs pool and direct cost base used by the City to determine the accepted ICRP rate.

¹ Caltrans, Division of Local Assistance website <http://www.dot.ca.gov/localassistance/index.html>

² Excerpts obtained from City of Santa Barbara, Department of Public Works, Division of Engineering website <https://www.santabarbaraca.gov/gov/depts/pw/engineering/default.asp>

The City is responsible for preparing its 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.

METHODOLOGY

In planning the audit, we gained an understanding of the City's operations, and identified relevant ICRP requirements by reviewing 2 CFR 200, the LAPM, and applicable City policies and procedures, and interviewing IOAI and City personnel.

We conducted a risk assessment, including evaluating whether key internal controls relevant to our audit objectives, such as reviews and approvals, separation of duties, reconciliations, and separation of indirect and direct costs, were properly designed, implemented, and operating effectively. Our assessment included observing processes and testing transactions related to accounts payable, time keeping/payroll, billing, and cash disbursements for effectiveness of existing documented processes and procedures. Deficiencies in internal control that were identified during our audit and determined to be significant with the context of our audit objectives are included in this report.

Additionally we assessed the reliability of data from the City's financial management system, Munis, and the City's electronic time reporting system, Replicon. Our assessment included reviewing information process flows, testing transactions for completeness and accuracy, and determining if costs were separately categorized by tracing to accounting records. We determined the data were sufficiently reliable for the purpose of this audit.

Based on the results of our planning, we developed specific methods for gathering evidence to obtain reasonable assurance to address the audit objectives. Our methods are detailed in the Table of Methodologies on the following page.

Table of Methodologies

Audit Objective	Methods
<p>Objective 1: Determine whether the 2017-18 ICRP is in compliance with 2 CFR 200 and the LAPM.</p>	<ul style="list-style-type: none"> • Selected a non-generalizable sample of 2015-16 significant and high-risk cost categories to verify compliance with 2 CFR 200 and the LAPM. Specifically, costs were selected from direct and indirect salaries and wages, fringe benefits, and the indirect costs pool. <ul style="list-style-type: none"> ○ Sample selection for direct and indirect salaries and wages was based on quantitative factors such as total hours charged; and qualitative factors such as the type (i.e. description) of costs. ○ The most quantitatively significant fringe benefit costs were selected for testing. ○ Sample selection for indirect costs pool were based on quantitative factors such as costs with a potential impact to the ICRP rate by 1 percent or greater; and qualitative factors such as the timing and type (i.e. description) of costs. • Determined if direct and indirect salaries and wages were allowable, supported, segregated, and allocated, by tracing amounts and task coding to accounting and time reporting records, reviewing timesheets and payroll records, interviewing key staff, reviewing the City's organizational chart, and reviewing project description codes in the Replicon time reporting system. • Determined if fringe benefit costs were allowable, supported, segregated, and allocated, by interviewing key staff, tracing amounts to accounting records, and verifying fringe benefits were included in employee billable rates and not billed as a separate fringe benefit rate. • Determined if indirect costs pool were allowable, supported, segregated, and allocated, by interviewing key staff, reviewing invoices for accurate coding, comparing invoice descriptions to vendor websites for services and supplies provided, reviewing vendor contracts, tracing costs to cleared checks or bank statements, reviewing methodology for allocation of costs, and tracing allocated costs to the City's budget. • Verified the actual indirect costs recovered by the City were billed at the approved indirect cost rate by reviewing invoices, verifying support for direct labor hours, and recalculating the indirect cost billed to Caltrans.
<p>Objective 2: Recalculate the proposed ICRP rate if unallowable costs impacting the ICRP rate by 1 percent or greater are identified.</p>	<ul style="list-style-type: none"> • Recalculated the proposed ICRP rate as a result of indirect costs pool audit adjustments greater than 1 percent. <ul style="list-style-type: none"> ○ Adjusted salary and wages and fringe benefit costs for ineligible indirect costs and reclassified as direct costs. ○ Removed ineligible indirect costs from the indirect costs pool. ○ Recalculated the carry forward adjustment based on fiscal year 2015-16 audited actual amounts.

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.

CONCLUSION

Based on the procedures performed and evidence gathered, we determined the City’s 2017-18 ICRP is not in compliance with 2 CFR 200 and the LAPM. We identified weaknesses in the City’s ability to adequately segregate allowable and allocable ICRP costs resulting in unallowable costs impacting the 2017-18 ICRP rate, as described in Finding 1. We recommend a rate change decrease of 42.97 percent as identified in Table 1 below.

Table 1 –Accepted and Audited ICRP Rate for FY 2017-18³

Rate Type	Accepted Rate	Audited Rate	Difference
ICRP	98.53%	55.56%	(42.97%)

See Appendix A for a Summary of Accepted and Audited Costs and Rates for the Indirect Cost Rate Proposal.

FINDING AND RECOMMENDATIONS

Finding 1: Unallowable Costs Included in the Indirect Costs Pool

The City’s indirect costs pool included unallowable costs totaling \$426,375. As a result, the accepted 98.53 percent ICRP rate was overstated and should be reduced to 55.56 percent (see Appendix A for the audited rate and audit adjustments). The following unallowable costs were identified:

- Direct salaries and wage plus direct fringe benefits totaling \$284,208 and \$124,747, respectfully, were incorrectly included in the indirect costs pool. These costs should have been included in the direct cost base of the ICRP rate calculation. The City tracks its labor hours in a time reporting system and codes the hours as either billable or non-billable. Project codes 3001 to 3008 and 3010, totaling 5,755.25 hours, were classified as non-billable. The hours charged to these project codes can be specifically identified to a final cost objective and should have been classified as direct labor. However, the City did not perform a comprehensive review when preparing the ICRP and the 5,755.25 hours were incorrectly included in the indirect costs pool. 2 CFR 200.413 (a) states direct costs are costs that can be identified specifically with a particular final cost objective or, be directly assigned to such activities relatively easily with a high degree of accuracy.
- Pool car replacement and pool car maintenance costs totaling \$11,462 and \$2,090, respectfully, were incorrectly included in the indirect costs pool. These costs are contributions to accounts for future replacement and maintenance costs of the City’s pool cars. According to the City, these were new costs and it did not review 2 CFR 200 to determine compliance. 2 CFR 200.439 (b) (7) and 433 (c) state that capital expenditures and contingency reserves are unallowable.

³ The ICRP submitted by the City was accepted by IOAI on October 18, 2017.

- A fine totaling \$3,868 was incorrectly included in the indirect costs pool. According to the City, this was a new cost and it did not review the 2 CFR 200 to determine compliance. 2 CFR 200.441 states fines, penalties, damages, and other settlements are unallowable.

Recommendations:

- A. Adjust the 2015-16 actual indirect costs pool by \$426,375 for the unallowable costs and ensure these costs are not included in future indirect costs pools (See Appendix A).
- B. Adjust the 2015-16 actual direct cost base by \$408,955 and ensure these costs are included in future direct cost bases (See Appendix A).
- C. Adjust the 2015-16 carry forward by \$687,125 based on the adjustments in Recommendations A and B (See Appendix A).
- D. Review all indirect accounts to ensure costs are in compliance with 2 CFR 200 and properly segregated between direct, indirect, and unallowable costs.
- E. Reconcile the 2017-18 billings using the audited rate of 55.56 percent and reimburse Caltrans any over payments.

APPENDIX A

**Summary of Accepted and Audited Costs and Rates
Indirect Cost Rate Proposal
City of Santa Barbara, Department of Public Works
Division of Engineering
2017-18**

Description	Accepted Amounts ⁴	Audit Adjustments	Audited Amounts	Finding No.
Direct Costs				
Salaries and Wages	\$ 2,217,528	\$ 284,208	\$ 2,501,736	1
Fringe Benefits	902,496	124,747	1,027,243	1
Total Direct Salaries and Wages plus Fringe Benefits	\$ 3,120,024	\$ 408,955	\$ 3,528,979	1
Indirect Costs Pool				
Salaries and Wages	\$ 1,315,499	\$ (284,208)	\$ 1,031,291	1
Fringe Benefits	548,208	(124,747)	423,461	1
Alloc-Vacation Cashout	17,614		17,614	
Alloc-Sick Leave Cashout	25,531		25,531	
Alloc-Retiree Medical	27,528		27,528	
Network/Infrastructure	173,892		173,892	
GIS Support	19,399		19,399	
Building Maintenance	35,879		35,879	
Planned Maintenance Program	13,903		13,903	
Vehicle Maintenance	19,431		19,431	
Alt. Transportation	8,273		8,273	
Telephone Allocated	5,545		5,545	
Custodial	48,251		48,251	
Communications	15,261		15,261	
Energy Conservation	14,584		14,584	
Liability Insurance	45,608		45,608	
Office Supplies and Expenses	5,096		5,096	
Uniform Allowance and Maintenance	4,149		4,149	
Minor Tools	93		93	
Special Supplies and Expenses	9,974		9,974	
Facilities Maintenance	1,621		1,621	
Equipment Repair	11,807		11,807	
Professional Services Contracts	76,569		76,569	
Non-Contractual Services	180		180	
Pool Car Maintenance	2,090	(2,090)	0	1
Pool Car Replacement	11,462	(11,462)	0	1
Publications	1,205		1,205	
Training	11,672		11,672	
Printing and Binding	1,363		1,363	
Postage/Delivery	2,277		2,277	
Telephone	8,938		8,938	
Pooled Vehicle Fuel	1,306		1,306	
Vehicle Fuel	7,340		7,340	
Equipment Rental	3,334		3,334	

⁴ The ICRP submitted by the City was accepted by IOAI on October 18, 2017.

**Summary of Accepted and Audited Costs and Rates
Indirect Cost Rate Proposal
City of Santa Barbara, Department of Public Works
Division of Engineering
2017-18**

Description	Accepted Amounts ⁴	Audit Adjustments	Audited Amounts	Finding No.
Fines and Penalties	3,868	(3,868)	0	1
619 Garden St. Rent	11,341		11,341	
GASB 45 Actuarial Study	6		6	
Map Vault Archival Project	1,805		1,805	
Special Projects	100,768		100,768	
Computer Software Under \$5,000	5,282		5,282	
Upgrade Doc/Agenda Mgmt. Sys.	6,447		6,447	
City-Wide Cost Allocation Plan	182,743		182,743	
Total Indirect Costs Pool	\$ 2,807,142	\$ (426,375)	\$ 2,380,767	
Carry Forward (2015-16)	\$ 266,913	\$ (687,125)	\$ (420,212)	1
Adjustments to Indirect Costs	\$ 0	\$ (426,375)	\$ (426,375)	1
Total Carry Forward Adjustment	\$ 266,913	\$ (1,113,500)	\$ (846,587)	
Budgeted Indirect Costs	\$ 2,807,142	\$ (426,375)	\$ 2,380,767	
Total Indirect Costs*	\$ 3,074,055	\$ (1,113,500)	\$ 1,960,555	1
Total Direct Salaries and Wages plus Fringe Benefits	\$ 3,120,024	\$ 408,955	\$ 3,528,979	
Indirect Cost Rate**	98.53%	(42.97%)	55.56%	1
* Total Indirect Costs is the sum of Total Carry Forward Adjustments and Budgeted Indirect Costs				
** Indirect Cost Rate is the quotient of Total Indirect Costs divided by Total Direct Salaries and Wages plus Fringe Benefits				

RESPONSE



City of Santa Barbara

Public Works Department

SantaBarbaraCA.gov

May 9, 2019

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California Department of Finance
Office of State Audits and Evaluations
915 L Street, 6th Floor
Sacramento, CA 95814

To Whom It May Concern:

Response to Draft Report – City of Santa Barbara Indirect Cost Rate Proposal Audit

Thank you for the opportunity to review and respond to the confidential draft report dated April 25, 2019. Enclosed is the City's response to the report.

If you have any questions regarding the City's response or require additional information, please contact Christi Velasquez at (805) 897-1915.

Sincerely,

Rebecca J. Bjork
Public Works Director

RJB/cv

Enclosure: City of Santa Barbara's Response to Confidential Draft Report

c: Mr. Robert Samario, Finance Director
Mr. Brian D'Amour, City Engineer
Mr. Michael Pease, Public Works Business Manager
Ms. Christi Velasquez, Administrative Analyst II

City of Santa Barbara's Response to Confidential Draft Report

FINDINGS

Finding 1 – Unallowable Costs Included in the Indirect Costs Pool

The City's indirect costs pool included unallowable costs totaling \$426,375. As a result, the accepted 98.53 percent ICRP rate was overstated and should be reduced to 55.56 percent (see Appendix A for the audited rate and audit adjustments). The following unallowable costs were identified:

- *Direct salaries and wage plus direct fringe benefits totaling \$284,208 and \$124,747, respectfully, were incorrectly included in the indirect costs pool. These costs should have been included in the direct cost base of the ICRP rate calculation. The City tracks its labor hours in a time reporting system and codes the hours as either billable or non-billable. Project codes 3001 to 3008 and 3010, totaling 5,755.25 hours, were classified as non-billable. The hours charged to these project codes can be specifically identified to a final cost objective and should have been classified as direct labor. However, the City did not perform a comprehensive review when preparing the ICRP and the 5,755.25 hours were incorrectly included in the indirect costs pool. 2 CFR 200.413 (a) states direct costs are costs that can be identified specifically with a particular final cost objective or, be directly assigned to such activities relatively easily with a high degree of accuracy.*
- *Pool car replacement and pool car maintenance costs totaling \$11,462 and \$2,090, respectfully, were incorrectly included in the indirect costs pool. These costs are contributions to accounts for future replacement and maintenance costs of the City's pool cars. According to the City, these were new costs and it did not review 2 CFR 200 to determine compliance. 2 CFR 200.439 (b) (7) and 433 (c) state that capital expenditures and contingency reserves are unallowable.*
- *A fine totaling \$3,868 was incorrectly included in the indirect costs pool. According to the City, this was a new cost and it did not review the 2 CFR 200 to determine compliance. 2 CFR 200.441 states fines, penalties, damages, and other settlements are unallowable.*

City Response

City of Santa Barbara management agrees that the above costs were incorrectly included in the indirect costs pool, but the direct salaries (\$284,208) and benefits (\$124,747) costs for project codes 3001 to 3008 and 3010 were fee-supported so they should have been excluded from both the direct and indirect costs in the ICRP rate calculation. The City respectfully requests that Appendix A and the audited rate of 55.56% be updated to appropriately reflect the exclusion of the \$408,955 from the direct cost base.

RECOMMENDATIONS

Recommendation A

Adjust the 2015-16 actual indirect costs pool by \$426,375 for the unallowable costs and ensure these costs are not included in future indirect costs pools (See Appendix A).

Response

City of Santa Barbara management agrees with this recommendation, and understands the importance of ensuring that costs are in compliance with 2 CFR 200 and properly distinguishing between direct, indirect, and unallowable costs. The development of an indirect cost rate proposal involves the analysis of all relevant costs by City staff, consultants with specialized knowledge, and Caltrans' IOAI staff. While there were a few items that made it through the various levels of review, City of Santa Barbara management believes these items represent limited and isolated cases. The City is utilizing a subject matter expert to ensure compliance going forward.

Recommendation B

Adjust the 2015-16 actual direct cost base by \$408,955 and ensure these costs are included in future direct cost bases (See Appendix A).

Response

City of Santa Barbara management disagrees with this recommendation and respectfully requests that Appendix A and the audited rate of 55.56% be updated to appropriately reflect the exclusion of the \$408,955 from the direct cost base. The costs in project codes 3001 to 3008 and 3010, totaling \$408,955, were incorrectly included in the indirect costs pool; however, they are supported by fee revenue so they should be excluded from both the indirect and direct costs in the ICRP rate calculation rather than being added to the direct costs.

Recommendation C

Adjust the 2015-16 carry forward by \$687,125 based on the adjustments in Recommendations A and B (See Appendix A).

Response

City of Santa Barbara management disagrees with this recommendation and respectfully requests that Appendix A and the audited rate of 55.56% be updated to appropriately reflect the exclusion of the \$408,955 from the direct cost base. The costs in project codes 3001 to 3008 and 3010, totaling \$408,955, were incorrectly included in the indirect costs pool; however, they are supported by fee revenue so they should be excluded from both the indirect and direct costs in the ICRP rate calculation rather than being added to the direct costs. City management believes the carry forward adjustment should be revised to reflect the exclusion.

Recommendation D

Review all indirect accounts to ensure costs are in compliance with 2 CFR 200 and properly segregated between direct, indirect, and unallowable costs.

Response

City of Santa Barbara management agrees with this recommendation, and understands the importance of ensuring that costs are in compliance with 2 CFR 200 and properly distinguishing between direct, indirect, and unallowable costs. The development of an indirect cost rate proposal involves the analysis of all relevant costs by City staff, consultants with specialized knowledge, and Caltrans' IOAI staff. While there were a few items that made it through the various levels of review, City of Santa Barbara management believes these items represent limited and isolated cases. The City is utilizing a subject matter expert to ensure compliance going forward.

Recommendation E

Reconcile the 2017-18 billings using the audited rate of 55.56 percent and reimburse Caltrans any over payments.

Response

City of Santa Barbara management disagrees with this recommendation and respectfully requests that Appendix A and the audited rate of 55.56% be updated to appropriately reflect the exclusion of the \$408,955 from the direct cost base. The City disagrees with the audited rate of 55.56% and would rather calculate the Caltrans overpayments once the rate is adjusted as requested.

EVALUATION OF RESPONSE

The City's response to the draft report has been reviewed and incorporated into the final report. We acknowledge the City's willingness to implement our recommendations. The City agreed to Finding 1 Recommendations A and D. We provide the following comments for Recommendations B, C, and E.

Finding 1: Unallowable Costs Included in the Indirect Cost Pool

The City agrees unallowable costs totaling \$426,375 were incorrectly included in the indirect costs pool (Recommendations A and D). However, the City disagrees the direct salaries and wages plus fringe benefits totaling \$408,955 should be included in the direct cost base of the ICRP rate calculation because these were fee supported costs (Recommendations B, C, and E). 2 CFR 200.413 (a) specifically states direct costs are costs that can be identified with a particular final cost objective, such as an internally or externally funded activity. Although the \$408,955 is supported by fee revenue, these costs were externally funded activities and are required by 2 CFR 200 to be included in the direct costs of the ICRP rate calculation. Because the City did not provide additional criteria or supporting documentation, the finding and recommendations will remain unchanged.