

Memorandum



To:

JEANNIE WARD-WALLER
DEPUTY DIRECTOR
Planning and Modal Programs

Date: April 14, 2020

File: P1580-0024

From:

MARSUE MORRILL, CPA
AUDIT CHIEF
Independent Office of Audits and Investigations

SUBJECT: INDIRECT COST ALLOCATION PLAN AUDIT – KERN COUNCIL OF GOVERNMENTS

At the request of the Independent Office of Audits and Investigations, the Department of Finance, Office of Audits and Evaluations (Finance) completed an audit of the Kern Council of Governments' (KCOG) Indirect Cost Allocation Plans (ICAPs) for fiscal years (FYs) 2017-18 and 2018-19. The purpose of the audit was to determine whether the ICAPs were presented in accordance with Title 2 Code of Federal Regulations (CFR) Part 200, and the California Department of Transportation's Local Assistance Procedures Manual (LAPM).

Based on the audit, Finance found \$13,561 of unallowable costs included in the indirect costs pool. These unallowable costs, however, did not result in a change to the accepted ICAP rates. Finance also found KCOG inappropriately billed \$5,767 prior to approval from the Caltrans' District Office.

Please provide our office with a corrective action plan addressing the recommendations in the audit report, including time lines, by June 13, 2020.

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

Jeannie Ward-Waller
April 14, 2020
Page 2

Attachment:

c: Ahron Hakimi, Executive Director, KCOG
Dee Lam, Acting Division Chief, Division of Local Assistance, California Department of Transportation
Marlon Flournoy, Division Chief, Division of Transportation Planning, California Department of Transportation
Kyle Gradinder, Division Chief, Division of Rail & Mass Transportation, California Department of Transportation
Rodney Whitfield, Director, Financial Services, Federal Highway Administration
Veneshia Smith, Financial Manager, Financial Services, Federal Highway Administration
Sharri Bender Ehlert, District Director, District 6, California Department of Transportation
Jim Perrault, District Local Assistance Engineer, District 6, California Department of Transportation
Gilbert Petrissans, Chief, Division of Accounting, California Department of Transportation
Luisa Ruvalcaba, Audit Manager, Independent Office of Audits and Investigations

P1580-0024



Kern Council of Governments

Indirect Cost Allocation Plan
Fiscal Years 2017-18 and 2018-19

Report No. 20-2660-014
April 2020

Team Members

Cheryl L. McCormick, CPA, Chief
Rebecca G. McAllister, CPA, Assistant Chief
Sherry Ma, CRP, Manager
Kylie L. Oltmann, CPA, Supervisor
Amanda Voie, Lead
Mathew Rios
Thong Thao

Final reports are available on our website at <http://www.dof.ca.gov>.

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

April 10, 2020

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

Final Report—Kern Council of Governments, Indirect Cost Allocation Plan Audit

The California Department of Finance, Office of State Audits and Evaluations, has completed its audit of the Kern Council of Governments' (KCOG) Indirect Cost Allocation Plans for fiscal years 2017-18 and 2018-19, Caltrans Audit Numbers P1580-0024 and P1580-0025.

The draft report was issued March 5, 2020, and KCOG's response to the draft report required a minor change to the Background section to reflect KCOG is governed by a 13-voting member Board of Directors. KCOG's response to the report findings and our evaluation of the response are incorporated into this final report. This report will be placed on our website.

If you have any questions regarding this report, please contact Sherry Ma, Manager, or Kylie Oltmann, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

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

cc: Luisa Ruvalcaba, Audit Manager, Planning and Modal Office, Independent Office of Audits and Investigations, California Department of Transportation
Yung Ryoo, Staff Management Auditor Specialist, 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) Division of Transportation Planning articulates a long-term vision for California's transportation system and implements statewide transportation policy through partnerships with state, regional, and local agencies. The Division provides quality planning products, services, and information to support and guide transportation investment decisions.¹

The Kern Council of Governments (KCOG) is an association of city and county governments created to address regional transportation issues. KCOG is governed by a 13-voting member Board of Directors. Its member agencies include the County of Kern and the 11 incorporated cities within Kern County. KCOG is responsible for developing and updating a variety of transportation plans and for allocating the federal and state funds to implement them.²

KCOG is both a Metropolitan Planning Organization (MPO) and a Regional Transportation Planning Agency (RTPA). As a MPO, KCOG is responsible for implementing the comprehensive transportation planning process for the urban Bakersfield area. An integral element of the planning process is the Overall Work Program's (OWP) annual adoption. As a RTPA, KCOG is responsible for developing and adopting several transportation planning documents and studies.³

At the discretion of local governmental agencies (LGA), including MPOs, indirect costs may be recovered when seeking reimbursement for federal-aid transportation projects and state funded projects. To recover indirect costs, LGAs and MPOs annually submit an Indirect Cost Allocation Plan (ICAP), 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 and MPOs 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 KCOG's ICAP for fiscal years 2017-18 and 2018-19.

¹ Excerpts obtained from Caltrans Division of Transportation Planning website <http://www.dot.ca.gov/transplanning/>

² Excerpts obtained Kern Council of Governments <https://www.kerncog.org/category/who-we-are/about-kern-cog/>

³ Excerpts obtained Kern Council of Governments <https://www.kerncog.org/wpcontent/uploads/2009/10/ResponsibilitiesManual.pdf>

The audit objectives were to:

1. Determine if the 2017-18 and 2018-19 ICAPs are in compliance with 2 CFR 200 and the LAPM.
2. Recalculate the 2017-18 and 2018-19 ICAP rates if unallowable costs are identified.⁴

The 2017-18 and 2018-19 ICAPs include transactions related to actual costs incurred and billed to Caltrans in 2015-16 and 2016-17.

In performing our audit, we considered internal controls significant to the audit objectives. See Appendix A for a list of significant internal control components and the underlying principles.

KCOG is responsible for preparing its ICAP 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 KCOG's operations, and identified relevant ICAP requirements by interviewing Caltrans and KCOG personnel and reviewing 2 CFR 200, the LAPM, the Master Fund Transfer Agreement (MFTA), and applicable KCOG policies and procedures.

We conducted a risk assessment, including evaluating whether key internal controls relevant to our audit objectives were properly designed, implemented, and operating effectively. Key controls evaluated focused on separation of indirect and direct costs including labor, and preparation of the ICAP. Our assessment included observing processes and testing transactions related to accounts payable, time keeping/payroll, and ICAP preparation for effectiveness of existing documented processes and procedures. Deficiencies in internal control that were identified during our audit and determined to be significant within the context of our audit objectives are included in this report.

Additionally, we assessed the reliability of data from KCOG's financial management system, Financial Edge. Further, we reviewed KCOG's monthly cost allocation spreadsheets, which is a bridging document to the financial management system. Our assessment included reviewing information process flows, testing transactions for completeness and accuracy, and determining if costs were separately categorized by tracing to the accounting records. We determined the data related to tracking labor hours was sufficiently reliable to address the audit objectives.

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.

⁴ As noted in the Results section, adjustments to the indirect costs pool did not impact the rate; therefore, recalculation was not necessary.

Table of Methodologies

Audit Objective	Methods
<p>Objective 1: Determine if the 2017-18 and 2018-19 ICAPs are in compliance with 2 CFR 200 and the LAPM.</p>	<ul style="list-style-type: none"> • Selected 2015-16 and 2016-17 significant and high-risk cost categories to verify compliance with 2 CFR 200, MFTA, and the LAPM. Significant indirect costs pool categories were determined based on change analysis from the two prior year's actual costs and cost categories with ending balances that meet or exceed one percent of the current direct cost base. Further, direct and indirect salaries and fringe benefits were considered high-risk categories based on the impact to the rate. High-risk indirect costs pool categories were determined based on costs commonly identified for non-compliance with 2 CFR 200 and the LAPM. Specifically, costs were selected from direct and indirect salaries, fringe benefits, and the indirect costs pool. <ul style="list-style-type: none"> ◦ Selection of direct and indirect salaries and fringe benefits were based on quantitative and qualitative factors such as total hours charged, percentage of time charged to direct and indirect activities, and employee job classification. ◦ Selection of indirect costs pool costs were based on quantitative and qualitative factors such as dollar amount of transactions and the timing and type (i.e. description) of costs. • Determined if direct and indirect salaries and fringe benefits were allowable, supported, segregated, and allocated, by tracing payroll amounts from the payroll registers to the general ledger reports, verifying the task codes and hours on the cost allocation spreadsheets agreed to the timesheets, and interviewing key staff. • Determined if indirect costs pool costs were allowable, supported, authorized, segregated, and allocated, by interviewing staff; reviewing invoice descriptions, time periods, and account coding for eligibility and accuracy; comparing travel expense claims to the California Department of Human Resources (CalHR) per diem and lodging rates; agreeing costs to warrant vouchers for proof of payment; and reviewing general ledger reports. • Verified the actual indirect costs recovered by KCOG were billed at the IOAI approved indirect cost rate by reviewing invoices, verifying the support for direct labor hours, and recalculating the indirect costs billed to Caltrans.
<p>Objective 2: Recalculate the 2017-18 and 2018-19 ICAP rates if unallowable costs are identified.⁵</p>	<ul style="list-style-type: none"> • Determined the identified unallowable costs did not impact the rates by one percent or more when removing ineligible indirect costs from the indirect costs pool and recalculating the carry-forward adjustment based on 2015-16 and 2016-17 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.

⁵ Ibid

CONCLUSION

Based on the procedures performed and evidence gathered, we determined KCOG's 2017-18 and 2018-19 ICAPs are not in compliance with 2 CFR 200 and the LAPM. We identified unallowable costs as described in Findings 1 and 2; however, the proposed 2017-18 and 2018-19 ICAP rates were not impacted. Therefore, there were no changes to KCOG's accepted rates.

Table 1 – Accepted and Audited 2017-18 and 2018-19 ICAP Rates⁶

Fiscal Year	Rate Type	Accepted Rate (a)	Audited Rate (b)	Rate Difference (a-b)
2017-18	ICAP	89.7%	89.7%	0.00%
2018-19	ICAP	106.3%	106.3%	0.00%

FINDINGS AND RECOMMENDATIONS

Finding 1: Unallowable Costs in the Indirect Costs Pool

KCOG included \$13,561 of unallowable costs within the Office and Transportation and Travel Expense categories. Specifically, the unallowable costs were related to food purchased for board members, award dinners, and meetings; service awards for employees such as engraved clocks and frames; gift cards for contests and raffle prizes; and kitchen supplies such as napkins and paper plates. KCOG was not aware these costs were prohibited.

Further, KCOG included costs for hotels and meals in excess of per diem rates allowed by CalHR. KCOG was not aware it had to adhere to CalHR travel policies; therefore, KCOG followed its own internal travel policies. Although these unallowable costs did not result in a change to the accepted ICAP rates, the costs should be excluded from future calculations of the ICAP submission to reduce the risk of overstating ICAP rates and overbilling indirect costs. For details of the disallowed costs, see Table 2.

Table 2 – Unallowable Indirect Costs Pool Costs

Fiscal Year ⁷	Costs Categories	Unallowable Costs
2015-16	Office Expense	\$ 108
2015-16	Transportation and Travel	12,053
2016-17	Transportation and Travel	1,400
Total Unallowable Costs		\$ 13,561

⁶ The ICAPs submitted by KCOG were accepted by IOAI on October 6, 2017 and June 21, 2018, respectively.

⁷ The respective fiscal year actual costs incurred were used to calculate the 2017-18 and 2018-19 ICAP rates, respectively.

2 CFR 200.445 (a) states that goods or services for personal use are unallowable. Additionally, Article II, section 2, A, of the MFTA, effective January 1, 2015, states that payments for travel expenses are not to exceed rates under current CalHR policies.

Recommendations:

- A. Review all ICAP indirect costs pool accounts to ensure costs are in compliance with 2 CFR 200 and applicable CalHR policies.

Finding 2: Unallowable Direct Labor Costs Billed to Caltrans

KCOG inappropriately billed \$5,767 prior to Caltrans' District Office approval. Specifically, February 2016 and March 2016 costs within the 2015-16 OWP Development and Monitoring Work Element were billed and reimbursed. The Caltrans District Office approved an amendment for the 2015-16 OWP Agreement in April 2016, which is the effective date of reimbursable costs. However, KCOG was not informed of the approval. As a result, KCOG relied on its Board's January 2016 approval of the amendment and billed February 2016 and March 2016 costs. See Table 3 for details of the disallowed costs.

Per the Caltrans 2015 Regional Planning Handbook, OWP amendment packages are reviewed by the Caltrans District Office and the amendment, i.e. the OWP Agreement document, is considered approved the date the Caltrans Deputy District Director signs the completed OWP Agreement.

Table 3 – Unallowable Direct Costs

Billing Number	Billing Period	Amount Billed	Unallowable Costs
7	February 2016	\$2,728	\$ 2,728
8	March 2016	3,039	3,039
Total Unallowable Costs			\$ 5,767

Recommendations:

- A. Remit \$5,767 to Caltrans.
- B. Work with the Caltrans District Office to improve communication regarding amendment approval notification.
- C. Ensure all billed costs are eligible for reimbursement.

APPENDIX A

We considered the following internal control components and underlying principles significant to the audit objectives:

Internal Control Component	Internal Control Principle
Control Activities	<ul style="list-style-type: none">• Management designs control activities to achieve objectives and respond to risks.• Management designs the entity's information system and related control activities to achieve objectives and respond to risks.• Management implements control activities through policies.



March 13, 2020

Cheryl L. McCormick, CPA
Chief, Office of State Audits and Evaluations
California Department of Finance
915 L Street
Sacramento, CA 95814-3706

Dear Ms. McCormack:

Please accept this letter as the written response to the Confidential Draft Report – Kern Council of Governments, Indirect Cost Allocation Plan Audit. Kern Council of Governments (COG) has the following comments:

Comment 1:

Page 1, Paragraph 2 states “KCOG is governed by an 11-voting member Board of Directors.”

Please correct this to read “KCOG is governed by a 13-voting member Board of Directors.”

Comment 2:

CONCLUSION

The conclusion states:

“Based on the procedures performed and evidence gathered, we determined KCOG’s 2017-18 and 2018-19 ICAPs are not in compliance with 2 CFR 200 and the LAPM. We identified unallowable costs as described in Findings 1 and 2; however, the proposed 2017-18 and 2018-19 ICAP rates were not impacted. Therefore, there were no changes to KCOG’s accepted rates.”

Kern COG respectfully requests that this language be altered. As stated at the end of this paragraph “the proposed 2017-18 and 2018-19 ICAP rates were not impacted”. Kern COG contends that it was in **substantial** compliance with 2 CFR 200 and the LAPM, otherwise the rates would have been impacted. Please alter the language to read as follows:

“Based on the procedures performed and evidence gathered, we determined KCOG’s 2017-18 and 2018-19 ICAPs were in substantial compliance with 2CFR 200 and LAPM. We did although identify unallowable costs as described in Findings 1 and 2...”

Comment 3:

Finding 1: Unallowable Costs in the Indirect Costs Pool

Kern COG agrees that it was not aware that office and travel expenses could not be included in the indirect rate. To correct this issue, the FY 2019/2020 OWP was amended to move these expenses to Work Element No. 1001.1 – Local Reimbursement funded by Local Funds.

Kern COG agrees that costs for hotels and meals were in excess of per diem rates allowed by CalHR. As stated, Kern COG was not aware it had to adhere to CalHR travel policies; therefore, Kern COG followed its own internal travel policies.

Kern COG agrees to bill for travel costs in compliance with CalHR. Any overage amount will be paid for with local funds.

Kern COG agrees to comply with the recommendation to review all ICAP indirect costs pool accounts to ensure costs are in compliance with 2 CFR 200 and applicable CalHR policies.

Comment 4:

Finding 2: Unallowable Direct Labor Costs Billed to Caltrans

While this finding may be technically correct, Kern COG maintains that Caltrans should not have paid invoices if there was not an approved amendment by Headquarters. It is Kern COG's understanding that Caltrans Local Assistance forwards amendments to Headquarters, but there hasn't been a procedure in place for Kern COG to know if the amendment is ultimately approved. Kern COG must then assume that if the District approves the invoicing based on amendments, that Headquarters has approved the amendment.

As a correction, for FY 2019-20, Caltrans sent Kern COG an email stating FY 2019-20 OWP Amendment No. 2 was approved and we invoiced for the expenses after the approval.

Kern COG agrees with the recommendation to work with Caltrans District Office to improve communication regarding amendment approval notification and to ensure all billed costs are eligible for reimbursement.

Kern COG requests that due to mutual miscommunication on this matter that the \$5,767 be waived. As an alternative, Kern COG requests that the \$5,767 be reimbursed over a 5 year period so as not to impact Kern's disadvantaged communities.

Kern COG appreciates the opportunity to respond to the Kern Council of Governments, Indirect Cost Allocation Plan Audit.

Original signed by:

Ahron Hakimi
Executive Director

EVALUATION OF RESPONSE

KCOG's response to the draft report has been reviewed and incorporated into the final report. We acknowledge KCOG's willingness to implement our recommendations specific to Finding 1. Additionally, the Background section of the report has been updated to reflect the current number of voting members on the KCOG Board. In evaluating KCOG's response, we provide the following comments:

Conclusion

KCOG requested the conclusion paragraph in the Results section be changed to state that KCOG was in substantial compliance with the requirements. However, due to the unallowable costs identified in the findings, Finance maintains that KCOG was not in compliance with 2 CFR 200 and the LAPM regardless of whether the 2017-18 and 2018-19 ICAP rates were impacted. Therefore, the language will remain unchanged.

Finding 2: Unallowable Direct Labor Costs Billed to Caltrans

KCOG agrees the finding is correct; however, KCOG asserts Caltrans should not have paid the invoices without an approved amendment. Due to the miscommunication between KCOG and Caltrans, KCOG requests that the repayment of funds be waived or payments be made over a five-year period. KCOG should work with Caltrans to discuss waiving repayment or repayment terms. The finding and recommendations will remain unchanged.