

City of Tracy Incurred Cost Audit



FINAL AUDIT REPORT

FEBRUARY 2019

PREPARED BY:

Independent Office of Audits and Investigations – MS 2

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P1575-0056

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

SUMMARY

The Independent Office of Audits and Investigations (IOAI), California Department of Transportation (Caltrans), audited three projects with costs reimbursed to the City of Tracy (City) totaling \$32,308,536. Our audit determined that the City's financial management system (FMS) is adequate to accumulate, segregate, and allocate reasonable and allowable project costs. However, we found that the City charged \$18,343 of unallowable costs and did not always comply with respective agreement provisions, and state and federal regulations.

OBJECTIVES

We performed our audit to determine whether:

- The project costs incurred and reimbursed to the City were in compliance with the respective agreement provisions and state and federal regulations.
- The City's FMS, which includes procurement and contract management, was adequate to accumulate, segregate, and allocate reasonable and allowable project costs.
- The costs billed and reimbursed were allowable, reasonable in nature and amount, and were adequately supported.

SCOPE

We conducted an incurred cost audit of the City's billed costs on the following projects:

- ▶ Mt. Diablo, Mt. Oso & C Street Sidewalks and Streetlights project, ATPSTPL-5192 (042)
- ▶ 11th Street – East Tracy Overhead Bridge Replacement project, BHLS-5192 (020)
- ▶ I-205 – Lammers Road/11th Street Interchange project, DEMO3LN-5192 (021)

The audit was limited to financial and compliance activities. The audit included costs incurred during the audit period of July 30, 2015, through December 22, 2017.

The audit comprised of transaction testing of reimbursed project costs to evaluate compliance with Title 2 Code of Federal Regulations (CFR) 200, 48 CFR 31, 23 CFR, California Government Code, California Public Contract Code, Caltrans Local Assistance Procedures Manual (LAPM), Caltrans Local Assistance Program Guidelines (LAPG), and any other applicable federal, state, or local laws and regulations or agreement provisions.

The City is responsible for the claimed costs and compliance with applicable agreement provisions and state and federal regulations. In addition, the City is responsible for the adequacy of their FMS to accumulate and segregate reasonable, allocable, and allowable costs. Considering the inherent limitations in any FMS, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the FMS to future periods are subject to the risk that the FMS may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate. We completed our field work on

October 19, 2018. Transactions occurring after this date were not tested and, accordingly, our conclusions do not include costs or credits arising after this date.

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. The audit was less in scope than an audit performed for the purpose of expressing an opinion on the financial statements of the City. Therefore, we did not audit, and are not expressing an opinion on, the City's financial statements.

The audit included interviews of City staff to obtain an understanding of the City's FMS, review of prior audit reports, and review of costs claimed. The audit also included examining, on a test basis, evidence supporting the amounts and disclosures in the data and records selected. Further, we assessed the accounting principles used and significant estimates made and evaluated the overall presentation of costs claimed.

CONCLUSION

Based on our audit, we determined the City's FMS is capable of accumulating, segregating, and allocating reasonable and allowable project costs. However, we identified disallowed costs totaling \$18,343 due to double billing Caltrans. In addition, we determined the following:

- The City did not always follow proper procedures related to grant management and contract management.
- The City's labor charging practices were not applied consistently.
- Some of the City's policies and procedures need to be updated.

VIEWS OF RESPONSIBLE OFFICIALS

Our findings and recommendations take into account the City's response dated January 23, 2019, to our January 15, 2019, draft audit report. Our findings and recommendations, the City's response, and our analysis of the response are set forth in the Findings and Recommendations section of this report.

This report is a matter of public record and will be placed on the Caltrans webpage, which can be viewed at <www.dot.ca.gov/audits/INC.html>.

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

MARSUE MORRILL, CPA

Chief

External Audits — Local Government Agency

Independent Office of Audits and Investigations

February 12, 2019

Findings and Recommendations

FINDING 1— Improper Procurement Practices

During our audit of the City of Tracy (City), we noted the following deficiencies with the City's grant management.

Double-Billed Costs

Drake Haglan & Associates' (DHA) invoice #09010-93, dated 9/20/2017 for \$18,343, was billed to the California Department of Transportation (Caltrans) twice, once in request for reimbursement (RFR) #22 and again in RFR #23A. The error was due to lack of project oversight. These costs are disallowed.

Title 48 Code of Federal Regulations (CFR) 31.204 states, in part, "Costs are allowable to the extent they are reasonable, allocable, and determined to be allowable under 31.201 and 31.202...." 48 CFR 31.201-3 further states, "A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business."

Late Submittal of Request for Reimbursements

The City did not submit the RFRs in a timely manner for two of the three projects reviewed. Specifically, we identified the deficiencies summarized below:

Project	RFR	Months Late
Mt. Diablo, Mt. Oso & C Street Sidewalks and Streetlights; ATPSTPL-5192 (042)	#2	6
I-205 Lammers Road/11th Street Interchange; DEMO3LN-5192 (021)	#14	10
I-205 Lammers Road/11th Street Interchange; DEMO3LN-5192 (021)	#15	8.5

Article IV, paragraph 4 of the federal Master Agreements No. 10-5192R and No. 10-5192F15 and Chapter 5 of the Local Assistance Procedures Manual (LAPM) require the administering agency to submit invoices at least once every six months to avoid the project from being classified as inactive.

The City's current Federal Grant Reimbursements, Claims and Drawdowns policy and procedure manual is silent on the submission of RFRs at a minimum of every six months. Based on our discussions with the project managers, they were aware of the requirement set forth in the Master Agreements and the LAPM, however, other workload and priorities impacted timely submission of RFRs. By not invoicing every six months, the project could potentially be placed on the

“inactive list” and be suspended, or it may lose project funding. Late invoices could also impact the timeliness of Caltrans’ oversight and increase the risk of billing for unallowable or unreasonable costs.

Recommendation

We recommend that the City:

- Refund Caltrans \$18,343 for the disallowed costs identified above.
- Ensure project managers review and track all invoices received to avoid future problems with double-billed invoices.
- Ensure billings to Caltrans occur at least once every six months.
- Update their Federal Grant Reimbursements, Claims and Drawdowns policy and procedure manual to include a requirement that at a minimum the RFRs be submitted to Caltrans every six months.

Summary of Auditee’s Response

The City concurs with the audit finding. The City has reduced Billing No. 24, Invoice No. 23, for Project No. BHLS-5192 (020) by \$18,343. According to the City’s Federal Grant Reimbursements, Claims and Drawdowns policy, all billings are now reviewed by the Finance Department before submittal to Caltrans to avoid errors. Also, the City will update the policy to include semi-annual RFRs submittal requirements. The Development Services Department will schedule all RFRs a month ahead of the six-month deadline to avoid late submittals.

Analysis of Auditee’s Response

We appreciate the City’s efforts to correct the disallowed costs. We have not reviewed or audited any new processes and procedures implemented subsequent to our fieldwork date.

FINDING 2 — Inconsistent Methodology Used in Billing the City’s Labor Costs

We found inconsistency in the methodology used when billing the City’s labor costs to Caltrans. Specifically, in our test sample of eight employees, the amount billed for five employees included fringe benefits and the amount billed for three other employees did not include fringe benefits.

2 CFR 200.34 (a) Expenditures states, “The charges may be reported on a cash or accrual basis, as long as the methodology is disclosed and is consistently applied.”

The City lacked oversight by not applying consistent methodology when billing labor costs to Caltrans. If costs are not consistently applied, Caltrans may pay for costs that are unallowable.

Recommendation

We recommend project managers be trained to apply consistent methodology when accounting for labor costs.

Summary Of Auditee's Response

The City concurs with the audit finding. The Finance Department has developed a standardized template that provides detailed breakdown of employee labor costs and separates direct labor costs and fringe benefits, and is used to provide labor and benefits costs for all grants.

Analysis of Auditee's Response

We appreciate the City's efforts to correct the audit finding. We have not reviewed or audited any new processes and procedures implemented subsequent to our fieldwork date.

FINDING 3 — Contract Management Needs Improvement

During our audit, we noted deficiencies with the City's compliance with contracts and contract provisions as follows.

Substitution of Subconsultant Without Written Approval

Rajappan & Meyer Consulting Engineers, Inc. (R&M Consulting) used the services of a subconsultant, MNS Engineers, Inc., that were not included in the contract cost proposal with the City.

2 CFR 200.318 (b) states, "Non-federal entities must maintain oversight to ensure that contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders."

The City indicated they verbally approved the change to use MNS Engineers, Inc. because the subconsultant listed in the contract was not available on the scheduled date. Without proper approval, however, the consultant could substitute a subconsultant with substandard qualifications.

Lack of Proper Contract Provisions

We reviewed the contract provisions for three contracts between the City and consultants and noted the following deficiencies:

- The DHA's contract and six amendments did not include end dates.

- The Hanna Group's contract lacked the following required provisions:
 - ▶ The performance period end date.
 - ▶ Rebates, kickbacks, or other unlawful consideration.

2 CFR 200.77 states, in part, "Period of performance means the time during which the non-federal entity may incur new obligations to carry out the work authorized under the federal award. The federal awarding agency or pass-through entity must include start and end dates of the period of performance in the federal award..."

LAPM Chapter 10, Exhibit 10-R, Article XIV requires mandatory fiscal provisions for Rebates, Kickbacks or other Unlawful Consideration.

The City's current purchasing policy and procedure manual does not address contract provisions. Contracts without end dates could result in misunderstanding between the City and consultants/contractors and may lead to disputes. Also, the consultants may not complete the work expeditiously. Without adequate contract provisions, the City risks billing Caltrans for costs that are not accurate or allowable for state or federal reimbursements.

Lack of Key Personnel and/or Classifications and Billing Rates Information

The City did not identify all key personnel and/or classifications in two of its executed consulting contracts, DHA and R&M Consulting. In addition, R&M Consulting's contract did not identify the billing rates of the prime consultant and subconsultants.

Article I, paragraph 9 of the federal Master Agreement No. 10-5192R states, in part, "Administering agency shall conform to all state statutes, regulations and procedures (including those set forth in the Local Assistance Procedures Manual and the Local Assistance Program Guidelines...) relating to the federal-aid program, all Title 23 federal requirements, and all applicable federal laws, regulations, and policy and procedural..."

LAPM Chapter 10 states, in part, "The proposed team - complete for prime consultant and all key subconsultants...key personnel names and classifications - key team members identified in the original proposal/cost proposal shall not change (be different than) in the executed contract..."

LAPM Exhibit 10-H Cost Proposal for lump sum contracts requires hourly rates be included for contract cost proposals.

A lack of oversight led to the omitting of key personnel and/or classification of employees and billing rates in the executed contracts. Failure to identify all key personnel and/or classifications and the respective billing rates puts Caltrans at risk of paying for unqualified consultants and unallowable costs.

Inadequate Support Documentation

In reviewing the project files of the three sampled projects, we found the City did not maintain adequate support documentation as required by applicable laws and regulations and agreement provisions as detailed below:

11th Street – East Tracy Overhead Bridge Replacement project, BHLS-5192 (020)

The project file was missing the following records:

- ▶ Reports of Investigation for Pacific Gas & Electric (PG&E) utility relocation costs.
- ▶ Independent cost estimate for contract change order (CCO) 14.2.
- ▶ CCO justifications for CCOs 14.2, 14.6, and 15.1.
- ▶ Daily reports for CCOs 14.2, 14.6, and 15.1.

I-205 – Lammers Road/11th Street Interchange project, DEMO3LN-5192 (021)

Invoices #RM 33001-20, #RM 33001-21, and #RM 33001-22, billed by consultant R&M Consulting, were missing the engineering progress and performance reports that show the amounts invoiced and percentage of work completed by the consultant.

LAPM Chapter 14.2 requires the local agency to complete a Report of Investigation to determine the agency's liability for relocation costs. LAPM Chapter 16.13 requires change orders to be approved in advance of any work being done on the change. It further requires the administering agency to submit a letter explaining the change order and a revised detailed cost estimate. Chapter 16.13 references the Caltrans Construction Manual for additional information on change orders.

LAPM Chapter 16.7 states, in part, "The administering agency's resident engineer, assistant resident engineers, and construction inspectors shall keep daily reports to record work in progress...when there is an anticipated change in character of work...."

LAPM Chapter 10 states, in part, "...a lump sum contract can be negotiated with progress payment if feasible. The progress payment shall be based on percent of work complete or completion of clearly defined milestones...." In addition, paragraph 7.2 of the R&M Consulting's contract states, "Progress payment to consultant shall be made monthly in arrears based on the percentage of work completed by the consultant."

The City was unable to locate project records, therefore, we had to obtain them from either the District 10 Local Assistance Office or the consultant. Without the proper records, the City may not be able to justify costs billed to Caltrans. Also, lack of proper progress and performance reports makes it difficult for Caltrans to ensure adequate work is completed timely and according to contract terms.

Recommendation

We recommend that the City:

- Ensure all consultants justify and request written approval for any substitution of subconsultants.
- Update their purchasing policy and procedure manual to ensure the contract provisions are in accordance with the LAPM, including the clear identification of the start and end dates on all contracts and amendments.
- Identify all key personnel and/or classifications and the respective billing rates in all contracts.
- Require project managers overseeing contract management ensure contract requirements are met.
- Maintain documentation in the project files to allow for accountability and an audit trail.
- Develop policies and procedures to address utility relocations and construction contract administration in accordance to the LAPM guidance.

Summary Of Auditee's Response

The City concurs with the audit finding. The City has hired MGO CPAs and Advisors to assist in updating the purchasing policy, which is expected to be completed in June 2019. The update will ensure contract provisions are in accordance with the LAPM. The Development Services Department is working with the City Attorney's Office to incorporate contract requirements in all contracts, including identifying all key personnel and/or classification and the respective billing rates, and adding enforcement provisions to the Professional Service Agreements should the consultants fail to seek approval. The City's Federal Grant Reimbursement, Claims and Drawdowns policy requires all grant-related documents be stored electronically in the GRANTS folder on the Common (R Drive). The City's Utility Relocation and Construction Contract Administration policy requires adoption of the LAPM, and the Development Services Department will send out a reminder email to its Department staff regarding the policy.

Analysis of Auditee's Response

The City did not address the recommendation that all consultants require written approval from the City when substituting any subconsultant. The City's Federal Grant Reimbursement, Claims and Drawdowns policy does not address that all grant documents be stored as hardcopy or electronically in project files. These will still need to be addressed.

FINDING 4 — Inadequate Policies and Procedures

The City's purchasing policy and procedures manual, dated November 1, 2002, lacked the provisions required in contracts when using state and federal transportation funds. For example,

there is no requirements for preparing and documenting cost estimates, cost analysis, or profit negotiations.

In addition, the City's travel expense policy, dated March 3, 1992, does not reflect rates authorized to be paid under current State Department of Personnel Administration (DPA) rules.

2 CFR 200.318 states, "The non-federal entity must use its own documented procurement procedures which reflect applicable state, local, and tribal laws and regulations, provided that the procurements conform to applicable federal law and the standards identified in this part."

23 CRF 172.5 (c) addresses written policies and procedures for procurement, management, and administration of engineering and design-related consultant services. Caltrans Consultant Procurement Manual (CPM) provides procurement process guidance to local agencies.

Article IV, paragraph 17 of the federal Master Agreements No. 10-5192R and No. 10-5192F15 states, in part, "Payments to administering agency for project-related travel and subsistence (per diem) expenses of administering agency forces and its contractors and subcontractors claimed for reimbursement or as local match credit shall not exceed rates authorized to be paid rank and file state employees under current state Department of Personnel Administration (DPA) rules."

The City's reorganization of staff duties within the Finance department impacted workload and priorities, and therefore, updating current policies was not their highest priority. The City's outdated purchasing policy puts the City at risk for entering into contracts without fair and open competitive negotiations, demonstrated competence, and professional qualifications at a fair and reasonable price. In addition, outdated policies put the City at risk for non-compliance with applicable rules and regulations.

In addition, the City's travel and subsistence costs that are reimbursed with state and federal funds might not be in conformance with current travel and subsistence rates authorized by DPA rules, which may result in questioned or unallowable costs. The City's Finance department is currently reviewing and updating the policies and procedures.

Recommendations

We recommend the City:

- Update the current procurement policy and manual by adopting the CPM or the elements of the CPM. Please see <http://www.dot.ca.gov/hq/LocalPrograms/AE/2017/Consultant-Procurement-Manual.pdf>
- Revise the travel expense policy to be in conformance with the current Master Agreement and DPA rules.

Summarization of City's Response

The City concurs with the audit finding. The City is in the process of updating their procurement and travel policies, which is expected to be completed in June 2019. The policies are to include the auditor's recommendations.

Attachment 1
Audit Response from the City of Tracy



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January 23, 2019

California Department of Transportation

Independent Office of Audits and Investigations

Post Office Box 942874

Sacramento, California 94274-0001

RE: City of Tracy Response to Incurred Cost Audit

FINDING 1 — Deficiencies in Grant Management

Double-Billed Costs

Drake Haglan & Associates' (DHA) invoice #09010-93, dated 9/20/2017 for \$18,343, was billed to the California Department of Transportation (Caltrans) twice, once in request for reimbursement (RFR) #22 and again in RFR #23A. The error was due to lack of project oversight. These costs are disallowed.

Late Submittal of Request for Reimbursements

The City did not submit the RFRs in a timely manner for two of the three projects reviewed.

Recommendations

- Refund Caltrans \$18,343 for the disallowed costs identified above.
- Ensure project managers review and track all invoices received to avoid future problems with double-billed invoices.
- Ensure billings to Caltrans occur at least once every six months.
- Update their Federal Grant Reimbursements, Claims and Drawdowns policy and procedure manual to include a requirement that at a minimum the RFRs be submitted to Caltrans every six months.

City Response: The City concurs with the audit finding.

Corrective Action:

The City has reduced Bill No. 24, Invoice' No. 23 (CIP 73603) for Project No. BHLS-5192 (020) by \$18,343, therefore, correcting the finding.

With the implementation of the City's Federal Grant Reimbursements, Claims and Drawdowns policy on March 7, 2018, all billings are now reviewed by Finance before submittal to Caltrans to avoid errors including possible double billing.

The Development Services Department will keep schedule/calendar of all federal and state funded projects and put in a line item for reimbursement/invoicing schedule one month ahead of six month deadline to avoid late submittals.

The City will update the Federal Grant Reimbursements, Claims and Drawdowns policy to include required semi-annual RFRs submittal to Caltrans.

FINDING 2 — Inconsistent Methodology Used in Billing the City's Labor Costs

We found inconsistency in the methodology used when billing the City's labor costs to Caltrans. Specifically, in our test sample of eight employees, the amount billed for five employees included fringe benefits and the amount billed for three other employees did not include fringe benefits.

Recommendation

We recommend project managers be trained to apply consistent methodology when accounting

for labor costs.

City Response: The City concurs with the audit finding.

Corrective Action: The Finance Department has developed a standardized template that provides detailed breakdown of employee labor costs and separates direct labor costs and fringe benefits. This new template has been in use since 2018 and will be used to provide labor and benefits costs for all grants.

FINDING 3 — Contract Management Needs Improvement

During our audit, we noted deficiencies with the City's compliance with contracts and contract provisions as follows: Rajappan & Meyer Consulting Engineers, Inc. (R&M Consulting) used the services of a subconsultant, MNS Engineers, Inc., that were not included in the contract cost proposal with the City.

Lack of Proper Contract Provisions

We reviewed the contract provisions for three contracts between the City and consultants and

noted the following deficiencies:

- The DNA's contract and six amendments did not include end dates.
- The Hanna Group's contract lacked the following required provisions:
 - The performance period end date.
 - Rebates, kickbacks, or other unlawful consideration.

Lack of Key Personnel and/or Classifications and Billing Rates Information

The City did not identify all key personnel and/or classifications in two of its executed consulting contracts, DHA and R&M Consulting. In addition, R&M Consulting's contract did not identify the billing rates of the prime consultant and sub-consultants.

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Invoices #RM 33001-20, #RM 33001-21, and #RM 33001-22, billed by consultant R&M Consulting, were missing the engineering progress and performance reports that show the amounts invoiced and percentage of work completed by the consultant.

Recommendations

- Ensure all consultants justify and request written approval for any substitution of subconsultants.
- Update their purchasing policy and procedure manual to ensure the contract provisions are in accordance with the LAPM, including the clear identification of the start and end dates on all contracts and amendments.
- Identify all key personnel and/or classifications and the respective billing rates in all contracts.
- Require project managers overseeing contract management ensure contract requirements are met.
- Maintain documentation in the project files to allow for accountability and an audit trail.
- Develop policies and procedures to address utility relocations and construction contract administration in accordance to the LAPM guidance

City Response: The City concurs with the audit finding.

Corrective Action:

The City has hired MGO CPAs and Advisors to assist with the update of the purchasing policy and will ensure policy includes contract provisions with LAPM are included. Expected time of completion June 2019.

The Development Services Department is working with the City Attorney's Office to incorporate contract requirements in all contracts moving forward including identifying all key personnel and/or classifications and the respective billing rates and by adding additional enforcement provisions to the Professional Service Agreements should consultants fail to seek approval.

With the implementation of the City's Federal Grant Reimbursements, Claims and Drawdowns policy on March 7, 2018, all grant related documents must be stored electronically in the GRANTS folder on the Common (R Drive).

The City's Utility Relocation and Construction Contract Administration policy is to follow the LAPM guidance found online. The Development Services Department will send out an email to its Departments' staff to remind them of the City's policy.

FINDING 4 — Inadequate Policies and Procedures

The City's purchasing policy and procedures manual, dated November 1, 2002, lacked the provisions required in contracts when using state and federal transportation funds. For example, there is no requirements for preparing and documenting cost estimates, cost analysis, or profit negotiations.

In addition, the City's travel expense policy, dated March 3, 1992, does not reflect rates authorized to be paid under current State Department of Personnel Administration (DPA) rules.

Recommendations

- Update the current procurement policy and manual by adopting the CPM or the elements of the CPM. Please see <http://www.dot.ca.gov/hq/LocalPrograms/AE/2017/Consultant-Procurement-Manual.pdf>
- Revise the travel expense policy to be in conformance with the current Master Agreement and DPA rules.

City Response: The City concurs with the audit finding.

Corrective Action:

The City is currently in the process of updated its procurement policy & travel policy. The City will ensure auditor recommendation is included in the City's updated policies. Expected time of completion June 2019.

Martha Garcia

Finance Manager