

## **M e m o r a n d u m**



**To:**

SABRINA WATTS-JEFFERSON  
Acting Assistant Director  
Office of Civil Rights Caltrans

**Date:** June 29, 2020

**File:** P3010-0654

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Chief  
Division of Accounting

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**From:**

RHONDA L. CRAFT  
Inspector General

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**Subject: Final Audit Report on Compliance with the California Prompt Payment Requirements**

Attached is the Independent Office of Audits and Investigations' final audit report on Compliance with the California Prompt Payment Requirements. Your response has been included as part of the final report. This report is intended for your information and for Caltrans Management.

Please provide our office with status reports on the implementation of your audit finding dispositions 60, 180, and 360 days subsequent to the transmittal date of this memorandum.

Senate Bill 1 requires the Inspector General to report at least annually, or upon request, to the Governor, the Legislature, and the California Transportation

Commission with a summary of audit findings and recommendations. The summary along with this report and the status reports will be posted on the Independent Office of Audits and Investigations' Internet Web site.

We thank you and your staff for their assistance provided during this audit. If you have any questions or need additional information, please contact Alice Lee, Chief, at (916) 639-6300, or me at (916) 952-5521.

## Attachment

c: Toks Omishakin, Director, Caltrans

James Davis, Chief Deputy Director, Caltrans

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## INDEPENDENT OFFICE OF AUDITS AND INVESTIGATIONS

Rhonda L. Craft, Inspector General

### **Caltrans - Compliance With The California Prompt Payment Requirements Audit**

#### **Background**

The Independent Office of Audits and Investigations (IOAI) completed an audit of the California Department of Transportation's (Caltrans) compliance with the California Prompt Payment Act (Act) and Caltrans prompt payment contract provisions that require contractors and subcontractors to be paid within established timeframes.

As a state agency, Caltrans is required to follow the Act, which requires contractor invoices to be paid within 45 days of invoice receipt or pay applicable late payment penalties. Caltrans has also established internal prompt payment policies requiring construction contractors to be paid within 30 days as required by the California Public Contract Code (PCC) 10261.5 for construction contracts. The Act does not establish a timeframe for contractors to pay its subcontractors but requires state agencies to encourage contractors to pay its subcontractors promptly, especially those that are small businesses. Caltrans, however, adopted PCC 10262 provisions that require construction contractors to pay their subcontractors within 7 calendar days. Additionally, for contracts with pass-through local government agencies (LGA), Caltrans requires LGAs to use boilerplate language in their agreements with contractors, which requires contractors to pay their subcontractors within established timeframes.

On an annual basis, the Act also requires state agencies to provide the California Department of General Services (DGS) with a report on late payment penalties paid, separately listing the number and total dollar amounts of all late payment penalties and refunds paid to small businesses and other businesses and make the information available to the public.

#### **Key Findings**

- Caltrans is generally in compliance with the Act and Caltrans prompt payment contract provisions as it relates to timely payments to contractors, except for the following:
- Caltrans is not reporting late penalty payments on major construction contract invoices to the Department of General Services as required by the Act.
- Caltrans requires local agencies to use boilerplate language in their contracts with construction and AE firms but for construction contracts the boilerplate does not include any language on how long local agencies have to pay contractors or how long prime contractors have to pay subcontractors.

#### **Key Recommendations**

1. Absent an exemption, Caltrans should report to DGS all interest for late payments on major construction contract invoices similar to how it reports interest for late payments on minor construction contract invoices.
2. Amend local agency boilerplate contract language for construction contracts to include the prompt pay requirement for local agencies to pay contractors within 30 calendar days and contractors to pay subcontractors within 7 calendar days.



# Compliance with California Prompt Payment Requirements

Audit Report  
P3010-0654  
June, 2020



**PREPARED BY:**

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P3010-0654

## TABLE OF CONTENTS

Summary .....	1
Background .....	1
Objective and Scope.....	2
Methodology .....	3
Views of Responsible Officials.....	4
Results, Findings, and Recommendations .....	5
Attachment A - Audit Response from Division of Accounting	
Attachment B - Audit Response from Division of Local Assistance	

## **Summary, Background, Objectives, Scope, and Methodology**

### **Summary**

The Independent Office of Audits and Investigations (IOAI) completed an audit of the California Department of Transportation's (Caltrans) compliance with the California Prompt Payment Act (Act) and Caltrans prompt payment contract provisions that require contractors and subcontractors to be paid within established timeframes.

We determined Caltrans is generally in compliance with the Act and Caltrans prompt payment contract provisions as it relates to timely payments to contractors. However, Caltrans did not have the data needed to determine if payments made from prime contractors to subcontractors complied with Caltrans contract clause requirements. Additionally, we found Caltrans' boilerplate language for contracts between local agencies and construction firms lack prompt payment clauses and Caltrans is not reporting late penalty payments for all late payments to the Department of General Services as required by the Act.

### **Background**

This audit was included in IOAI's fiscal year 2019-20 Audit Plan in response to the business community, legislative members, community leaders, and the California Business Chambers' concern of prime, small, disabled veteran, and disadvantaged businesses (DBE) being paid untimely.

As a state agency, Caltrans is required to follow the Act, which requires contractor invoices to be paid within 45 days of invoice receipt or pay applicable late payment penalties. Caltrans has also established internal prompt payment policies requiring construction contractors to be paid within 30 days as required by the California Public Contract Code (PCC) 10261.5 for construction contracts.

The Act does not establish a timeframe for contractors to pay its subcontractors but requires state agencies to encourage contractors to pay its subcontractors promptly, especially those that are small businesses. Caltrans, however, adopted PCC 10262 provisions that require construction contractors to pay their subcontractors within seven calendar days. Additionally, for contracts with pass-through local government agencies (LGA), Caltrans requires LGAs to use

boilerplate language in their agreements with contractors, which requires contractors to pay their subcontractors within established timeframes.

On an annual basis, the Act also requires state agencies to provide the California Department of General Services with a report on late payment penalties paid, separately listing the number and total dollar amounts of all late payment penalties and refunds paid to small businesses and other businesses and make the information available to the public.

### **Objective and Scope**

The objective of the audit was to determine if Caltrans is in compliance with the Act and Caltrans prompt payment contract provisions which require contractors and subcontractors to be paid within established timeframes.

For the audit period from July 1, 2018, to December 31, 2019, we focused on the below object codes and related contract invoices listed below.

**Table 1: Object Codes Included in Audit Population**

Object Code	Object Class Description	Object Description
232	Architecture & Engineering Contracts	Consultant and Professional Services – Project Delivery
332	Consultant (Special Projects)	Consultant and Professional Services – Hazardous Waste Related
832	Architecture & Engineering Contracts	Consultant and Professional Services by Government Agencies
432	Consultants Special Projects	Consultant and Professional Services – Land and Building
40, 40N	Construction	Payment to Contractors for Highway Construction and Maintenance

*Source: Caltrans' Division of Accounting*



We requested detail payment information for each of the object codes above and found Caltrans paid a total of \$5.7 billion in construction and Architecture and Engineering (AE) contractor invoices during the audit period.

We conducted our audit from December 30, 2019, through May 21, 2020. Changes after these dates were not tested, and accordingly, our conclusions do not pertain to changes arising after May 21, 2020.

### **Methodology**

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We interviewed Caltrans staff to gain an understanding of the applicable prompt payment regulations, policies, procedures, and practices.

In planning the audit, we reviewed the Act (Government Code Section 927) and the California Public Contract Code sections 10261.5, 10262 and 20104.50. We also reviewed the following Caltrans prompt payment related contract provisions and manuals:

- Caltrans Contract Requirements
  - Division of Procurement and Contracts agreements with AE consultants and construction contractors
  - Division of Local Assistance boilerplate contract language for local agency contracts with AE consultants and local agency contracts with construction contractors
  - Local Assistance Procedures Manual
- Caltrans Division of Construction 2018 Standard Specifications, Section 9-1.03
- Caltrans Accounting Prompt Payment Guide
- Caltrans Accounting Manual, Section 8.03.05, Expedite Payment and Section 8.07.06.02, Stop Payment Notices

To determine the length of time Caltrans took to pay its contractors we selected 146 invoices, comprised of 63 AE invoices and 83 construction invoices, representing 2 percent, or \$104 million of \$5.7 billion in total dollars paid during the audit period. See Table 2 below. For the samples selected, we accessed Caltrans' accounting system to review and compare invoice receipt dates to invoice payment dates.

**Table 2: Total Contract Dollars Tested**

Invoice Type	Total Dollars Paid (a)	Total Dollars Tested (b)	Invoices Tested
Construction	\$5,444,373,139	\$98,700,895	83
AE	\$303,570,670	\$5,826,042	63
Total	\$5,747,943,809	\$104,526,937	146

Source: Caltrans' Division of Accounting

### **Views of Responsible Officials**

We received a written response from Caltrans to our findings on the draft report dated June 5, 2020. Our findings and recommendations, the Caltrans' responses, and our analysis of the responses are set forth in the Results, Findings and Recommendations section of this report.

## Results, Findings, and Recommendations

### Results

Based on procedures performed, we determined that in general Caltrans is in compliance with the California Prompt Payment Act (Act) which requires states to pay contractor invoices within 45 calendar days and Caltrans' contract requirements which require construction contractor invoices be paid within 30 calendar days pursuant to the California Public Contract Code (PCC) 10261.5.

**Table 3: Results of Architecture and Engineering (AE) and Construction Invoices Tested**

Type	AE Invoices Tested	Construction Invoices Tested
Paid Timely	51	83
Not paid Timely and Not Reportable *	9	0
Not paid Timely and Reported	3	0
Total Invoices	63	83

\* Late fees are not reportable if under thresholds set by Government Code section 927.6.

As noted in Table 3 above, 12 of 63 AE invoices tested, or 19 percent, did not meet the Act's requirements as the invoices were paid beyond the required timeframes. However, only three of the 12 late payments were reportable to the Department of General Services (DGS) as required by the Act. This section sets the threshold for reporting late payment penalties for small businesses at \$10 or more and other businesses at \$100 or more. Total penalties reported was \$410. For the other nine of 12, the interest incurred were below the threshold and therefore not reported to DGS.

For the 83 construction invoices sampled, we found no evidence of late payments. However, as detailed in Finding 1 below, Caltrans did not segregate the interest penalties paid from the invoiced amounts. Furthermore, Caltrans did not report the interest penalty amounts to DGS as required by the Act.

As shown in Table 4 below, for the two-year audit period, Caltrans reported a total of \$142,827 in late invoice payments in its annual report to DGS. The \$142,827 represented 0.0016% of \$9,189,180,069 in total invoice dollars paid in the 2-year period.

**Table 4: Invoice Dollars Paid Late**

Fiscal Year	Total Invoice Dollars Paid (a)	Invoice Dollars Paid Late (b)	% of Total Dollars Paid Late $c = (b/a)$
18/19	\$7,040,917,827	\$131,603	0.0019%
19/20	\$2,148,262,242	\$11,224	0.0005%
Total	\$9,189,180,069	\$142,827	0.0016%

Source: Caltrans' Division of Accounting

On a sample basis, we tested the detail that supports the above figures and found no exceptions. We also reviewed the detail to make sure it included the reportable late penalty payments for the three AE invoices in our sample and found they were properly included. However, as previously noted, these figures do not include late payment penalties for major construction contract invoices.

Additionally, we found that Caltrans is in compliance with the Act's requirement to encourage contractors to pay their subcontractors promptly by doing the following:

1. Includes language in contracts with construction companies and AE firms requiring contractors to pay subcontractors within seven calendar days for construction contracts and 15 calendar days for AE contracts.
2. Allows subcontractors to file a 'Stop Payment Notice' with Division Of Accounting (DOA) against funds that become due to the contractor when the subcontractor claims that the contractor has not paid for material delivered or work performed.
3. Uses an expedited payment process, when necessary, to help pay contractors within required timeframes.

However, we noted the following areas for improvement:

- Caltrans does not collect data on prime contractor payments to subcontractors or data on LGA payments to contractors to determine the extent of compliance with Caltrans established payment timeframe requirements. Additionally, Caltrans does not track the number of stop payment notices received and processed.
- Caltrans is not reporting late penalty payments on major construction contract invoices to DGS as required by the Act (see Finding 1).
- Caltrans requires local agencies to use boilerplate language in their contracts with construction and AE firms but for construction contracts the boilerplate does not include any language on how long local agencies have to pay contractors or how long prime contractors have to pay subcontractors (see Finding 2).

**FINDING 1: Total Late Payment Penalties Are Not Reported to the Department of General Services as Required by the Act**

We tested a total of 83 minor and major construction invoices that represented \$98.7 million out of \$5.4 billion in total construction contract payments (Table 2) and found no evidence of late payments. However, upon further testing we determined the \$5.4 billion included interest penalty amounts that were not segregated from the invoiced amounts. Furthermore, Caltrans did not report the interest penalty amounts to DGS as required by the Act.

The Division of Construction (DOC) processes and approves major construction contract invoices (contracts > \$314,000) prior to submitting to DOA for payment. When DOC uploads invoice detail into Caltrans' accounting system for DOA payment processing, DOC does not segregate the invoiced amounts from the interest penalty amounts for late payments. IOAI requested the total interest penalties for major construction contracts payments during our audit period. DOC provided a report from its Contract Administration System showing \$47,315 in late payment penalties were paid. This amount represents approximately .001% of \$5.4 billion in total major and minor construction contract invoices paid.

While the interest penalties incurred during the audit period were minimal, future interest penalty amounts may be material and should be monitored and reported to DGS.

Additionally, Caltrans does not believe late payment penalties paid on construction contracts is reportable to DGS because it follows PCC 10261.5 and

not the Act. However, Caltrans does report late payment penalties for minor construction contract invoices which also follow PCC 10261.5. Additionally, based on DOA's inquiry to DGS in March 2020, DGS informed DOA they were not aware of any reporting exemptions, but stated this did not mean that such an exemption did not exist and if DOA chose to, it could work with Caltrans' legal counsel and send justification along with statutory citation(s) to DGS for review.

Absent an exemption, \$47,315 in interest penalties should have been reported to DGS as they were all above established thresholds reportable thresholds.

California Government Code, Chapter 4.5 Prompt Payment of Claims, Section 927.9(a)(b) states, in part, "(a) On an annual basis, within 90 calendar days following the end of each fiscal year, state agencies shall provide the Director of General Services with a report on late payment penalties that were paid by the state agency in accordance with this chapter during the preceding fiscal year. (b) The report shall separately identify the total number and dollar amount of late payment penalties paid to small businesses, other businesses, and refunds or other payments to individuals. State agencies may, at their own initiative, provide the director with other relevant performance measures. The director shall prepare a report separately listing the number and total dollar amount of all late payment penalties paid to small businesses, other businesses, and refunds and other payments to individuals by each state agency during the preceding fiscal year, together with other relevant performance measures, and shall make the information available to the public."

Caltrans Division of Accounting Prompt Payment Guide, Reporting Requirement Section states, in part, "State Agencies shall annually report to Department of General Services by September 30th, the amount of late payment penalties paid during the preceding fiscal year. At a minimum, the report shall identify the total number and dollar amount of late payment penalties paid. State agencies may, at their own initiative, provide the DGS with other relevant performance measures."

### **Recommendation**

Absent an exemption, Caltrans should accurately segregate and report all late payment penalties for major construction contracts to DGS.

### **Caltrans' Division of Accounting Response**

Caltrans does not agree with IOAI's finding. Per Caltrans' Legal Division, the California Prompt Payment Act (Act) only requires the annual reporting of late payment penalties to DGS when payments are made in accordance with the Act. Caltrans states that late payment penalties on major construction invoices are paid using a different interest rate and penalty regimen (PCC 10261.5) than that stated in the Act and, therefore, these payments are not required to be reported to DGS. See Attachment A for Caltrans' detailed response.

### **Analysis of Caltrans' Division of Accounting Response**

Caltrans' position that it is not required to report late payment penalties on major construction invoices is inconsistent with how it treats minor construction invoices that also follow PCC 10261.5 and for which it does report late payment penalties to DGS. Additionally, based on Caltrans's inquiry with DGS on March 2020, DGS informed Caltrans that they were not aware of any reporting exemptions, but stated this did not mean that such an exemption did not exist and if Caltrans chose to, it could work with Caltrans legal counsel and send justification along with statutory citation(s) to DGS for review. On April 1, 2020, Caltrans stated in an e-mail response to the above issue that they would pursue a clearer interpretation of GCC 927 and PCC 10261.5 from its Legal Division. IOAI followed up with Caltrans multiple times prior to issuing its draft audit report. Caltrans responded each time that they had not yet received feedback from its Legal Division. As a result, and consistent with the direction Caltrans received from DGS, Caltrans should forward its legal justification to DGS for review.

### **FINDING 2: Local Agency Construction Contracts Lack a Prompt Payment Requirement Clause**

Caltrans requires local government agencies (LGA) to use boilerplate language in their contracts with construction and AE firms. However, for construction contracts, Caltrans boilerplate language does not include prompt payment clauses specifically requiring that contractors must be paid within 30 calendar days or that contractors must pay their subcontractors within seven calendar days as required by the PCC.

Caltrans' Division of Local Assistance (DLA) develops the Local Assistance Procedures Manual (LAPM) for LGAs, which contains the requirement to follow boilerplate language. DLA was unable to provide an explanation for the absence of the contract language. According to DLA, they will include this requirement in their annual revisions to the LAPM. Without the contract

payment clause, contractors may not fully comply with California prompt payment requirements. Further, Caltrans is unable to perform proper oversight responsibilities of LGAs as pass-through fund recipients.

PCC 20104.50 states in part, "The Legislature finds and declares that all government officials, including those in local government, must set a standard of prompt payment that any business in the private sector which may contract for services should look towards for guidance. Any local agency which fails to make any progress payment within 30 days after receipt of an undisputed and properly submitted payment request from a contractor on a construction contract shall pay interest to the contractor equivalent to the legal rate set forth in subdivision (a) of Section 685.010 of the Code of Civil Procedure.

PCC 10262 states, "The contractor shall pay to his or her subcontractors, within seven days of receipt of each progress payment, the respective amounts allowed the contractor on account of the work performed by his or her subcontractors, to the extent of each subcontractor's interest therein."

Caltrans Standard Specifications, Section 9-1.03 states, in part, "Pay your subcontractors within 7 days of receipt of each progress payment under Pub Cont. Code §§ 10262 and 10262.5."

### **Recommendation**

Amend local agency boilerplate contract language for construction contracts to include the prompt pay requirement for local agencies to pay contractors within 30 calendar days and contractors to pay subcontractors within seven calendar days.

### **Caltrans' Division of Local Assistance Response**

Caltrans concurs with IOAI's finding and recommendation. Please see Attachment B for detailed response.



## **Attachment A Part - 1**

## Memorandum

**To:**  
RHONDA L. CRAFT  
Inspector General  
**Independent Office of Audits and Investigations**

**Date:** June 19, 2020

**File:** P3010-0654

**From:**  
GILBERT PETRISSANS  
Chief  
Division of Accounting

**Subject: Compliance with the California Prompt Payment - P3010-0654**

The Division of Accounting (Accounting) received the Draft Audit Report, Compliance with California Prompt Payment Requirements – P3010-0654, dated June 4, 2020. As discussed in the exit conference held June 5, 2020, the following is our response to the findings:

**Finding 1 - Total Late Payment Penalties are not Reported to the Department of General Services as Required by the Act**

We do not concur with the recommendation. It is the Department's position that the Prompt Payment Act, Government Code Section 927 et seq. does not require interest penalties for Construction contracts to be reported annually to the Department of General Services. Construction interest penalties are mandated by Public Contract Code (PCC) 10261.5 and therefore is not required to be reported under the Prompt Payment Act. Attached is the Department's legal opinion supporting the Department's position. Should you have any questions regarding this response, please contact Lisa Kwong at (916)227-9279.

c: SKeck, Chief Financial Officer  
LKwong, Chief – Office of Commodities and Contract Payables, Division of Accounting  
SSI, Chief – Service Payable Branch, Division of Accounting  
NFelcher, Audit Coordinator - Division of Accounting

## **Attachment A Part - 2**

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**California State Transportation Agency**

*Making Conservation a California  
Way of Life*

**Date:** June 19, 2020

**File:** P3010-0654

June 18, 2020

RHONDA L. CRAFT  
Inspector General  
P.O. Box 942874  
Sacramento, CA 94274

**Re: Response to audit number - P3010-0654**

Dear Ms. Craft,

Question Presented:

Does the Prompt Payment Act, Government Code (GC) Section 927 et seq., require Caltrans to report interest penalties paid pursuant to Public Contract Code (PCC) Section 10261.5 for late payments on construction contracts?

Summary Conclusion:

No, the Prompt Payment Act does not require Caltrans to report interest penalties paid pursuant to PCC 10261.5 for late payments on construction contracts because the Prompt Payment Act itself is clear on this point: The only late penalty payments reportable to the Director of General Services pursuant to the Prompt Payment Act are *"...late payment penalties that were paid by the state agency in accordance with this chapter..."* (Emphasis added.) (GC 927.9 (a). "This chapter" is the "Prompt Payment Act, GC 927 et seq., which is "Chapter 4.5" entitled "Prompt Payment of Claims," the first sentence of which is GC 927(a) which provides: "This chapter shall be known as California Prompt Payment Act."

Background:

In "Finding 1" of the Auditor's "Draft report on Compliance with the California Prompt Payment Requirements" dated June 4, 2020 (hereinafter referred to as "the Prompt Payment Act Report"), the Auditor concludes that

"Provide a safe, sustainable, integrated and efficient transportation system to enhance California's economy and livability"

Caltrans is not in compliance with the Prompt Payment Act reporting requirements by not including in its annual Prompt Payment Act Report to the Director of DGS the interest paid by Caltrans in accordance with Public Contract Code (PCC) 10261. To wit, the Auditor's draft conclusion in this regard, as set forth in Finding 1 of that Draft Audit Report, is as follows:

**FINDING 1: Total Late Payment Penalties Are Not Reported to the Department of General Services as Required by the Act**

We tested a total of 83 minor and major construction invoices that represented \$98.7 million out of \$5.4 billion in total construction contract payments (Table 2) and found no evidence of late payments. However, upon further testing we determined the \$5.4 billion included interest penalty amounts that were not segregated from the invoiced amounts. Furthermore, Caltrans did not report the interest penalty amounts to DGS as required by the Act.

The Division of Construction (DOC) processes and approves major construction contract invoices (contracts > \$314,000) prior to submitting to DOA for payment. When DOC uploads invoice detail into Caltrans' accounting system for DOA payment processing, DOC does not segregate the invoiced amounts from the interest penalty amounts for late payments. IOAI requested the total interest penalties for major construction contracts payments during our audit period. DOC provided a report from its Contract Administration System showing \$47,315 in late payment penalties were paid. This amount represents approximately .001% of \$5.4 billion in total major and minor construction contract invoices paid.

While the interest penalties incurred during the audit period were minimal, future interest penalty amounts may be material and should be monitored and reported to DGS.

Additionally, Caltrans does not believe late payment penalties paid on construction contracts is reportable to DGS because it follows PCC10261.5 and not the Act. However, Caltrans does report late payment penalties for minor construction contract invoices which also follow PCC 10261.5. Additionally, based on the DOA's inquiry with DGS in March 2020, DGS informed DOA they were not aware of any reporting exemptions, but stated this did not mean that such an exemption did not exist and if DOA chose to, it could work with Caltrans legal counsel and send justification along with statutory citation(s) to DGS for review.

"Absent an exemption, the \$47,315 in interest penalties should have been reported to DGS as they were all above the established reportable thresholds.

"California Government Case, Chapter 4.5 Prompt Payment of Claims Section 927.9 (a)(b) states, in part, *"(a) On an annual basis, within 90 calendar days following the end of each fiscal year, state agencies shall provide the Director of General Services with a report on late payment penalties that were paid by the state agency in accordance with this chapter during the preceding fiscal year. (b) The report shall separately identify the total number and dollar amount of late payment penalties paid to small businesses, other businesses, and refunds or other payments to individuals. State agencies may, at their own initiative, provide the director with other relevant performance measures. The director shall prepare a report separately listing the number and total dollar amount of all late payment penalties paid to small businesses, other businesses, and refunds and other payments to individuals by each state agency during the preceding fiscal year, together with other relevant performance measures, and shall make the information available to the public. "*

"Caltrans Division of Accounting Prompt Payment Guide, Reporting Requirement Section states, in part, *"State Agencies shall annually report to Department of General Services by September 30th, the amount of late payment penalties paid during the preceding fiscal year. At a minimum, the report shall identify the total number and dollar amount value late payment penalties paid. State agencies may, at their own initiative, provide the DGS with other relevant performance measures.*

Analysis:

It is clear that the Prompt Payment Act applies to all state agencies including Caltrans. GC 927(b) and (c) provide:

(b) it is the intent of the Legislature that state agencies pay properly submitted, undisputed invoices, refunds, or other undisputed payments due to individuals within 45 days of receipt or notification thereof, **or** automatically calculate and pay the appropriate late payment penalties as specified in this chapter.

(c) Notwithstanding any other provision of law, this chapter shall apply to all state agencies, including, but not limited to, the Public Employees' Retirement System, the Treasurer, and the Department of General Services." (Emphasis added).

However, the section of the Prompt Payment Act that specifies which penalties are to be reported to the Director of General Services, pursuant to Prompt Payment Act (in the Prompt Payment Act Report), is GC 927.9 which provides:

"(a) Except as provided in subdivision (c), on an annual basis, within 90 calendar days following the end of each fiscal year, state agencies shall provide the Director of General Services with a report on late payment penalties that were paid by the state agency in accordance with this chapter during the preceding fiscal year.

(b) The report shall separately identify the total number and dollar amount of late payment penalties paid to small businesses, other businesses, and refunds or other payments to individuals. State agencies may, at their own initiative, provide the director with other relevant performance measures. The director shall prepare a report separately listing the number and total dollar amount of all late payments to individuals by each state agency during the preceding fiscal year, together with other relevant performance measures, and shall make the information available to the public.

(c) The reporting requirements of subdivisions (a) and (b) are not applicable to the Department of Forestry and Fire Protection.” (Emphasis added.)

In other words, every state agency, including Caltrans, is required to annually report to the Director of General Services, in its annual Prompt Payment Act Report, only those penalties that were paid by that state agency “*in accordance with this chapter*”, i.e., the Prompt Payment Act, and *not* penalties paid to pursuant to any other statute.

The Auditor’s position is that, absent some *exemption* from the Prompt Payment Act, interest penalties paid pursuant to Public Contract Code (PCC) Section 10261.5 for late payments on construction contracts must be reported pursuant to GC 927.9. But Caltrans is not claiming any exemption from the Prompt Payment Act; Caltrans is merely saying that the Prompt Payment Act *itself*, by its own clear wording, does not require either Caltrans, *or any other state agency*, to include in its annual Prompt Payment Act Report any late payment penalties paid by that state agency other than penalties paid by that state agency *in accordance with this chapter...*, i.e., the Prompt Payment Act. The Prompt Payment Act does not require penalties paid pursuant to any other statute other than the Prompt Payment Act itself to be included in a state agency’s Prompt Payment Act Report.

Stated another way, while it is true GC 927(c) provides that “Notwithstanding any other provision of law, this chapter *shall apply to all state agencies*, including but not limited to, the Public Employees Retirement System, the State Teachers’ Retirement System, the Treasurer, and the Department of General Services” (emphasis added), GC 927(c) does not say the Prompt Payment shall apply *to all penalties* paid by all state agencies, even penalties paid other than” ...in accordance with this chapter...” i.e., according to a completely different interest rate and penalty regimen, such as PCC 10261.5.

Interest payments payable under PCC 10261.5 are clearly not “paid in accordance with this chapter [i.e., the Prompt Payment Act, GC 927 et seq.]” because the Prompt Payment Act provides for an interest rate that varies, depending on the circumstances, but can be as low as “1 percent above the Pooled Money Investment Account [PMIA] Daily Rate on June 30 of the prior fiscal year” (GC 927.6) (which I estimate was only about 3.5% as of June 2019, i.e., 1% above PMIA yield of about 2.5% in June 2019 (see <https://www.treasurer.ca.gov/pmia/index.asp>)) while PCC 10261.5, which sets the interest rate for late progress payments on construction contracts.



provides an interest rate "equivalent" to the legal rate set forth in subdivision (a) of Section 685.010 of the Code of Civil Procedure", and CCP 685.010(a) provides: "Interest accrues at the rate of 10 percent per annum on the principal amount of a money judgment remaining unsatisfied." (Emphasis Added.) In addition, penalties accrue according to different timetables under these two different penalty regimens, i.e., progress payments on construction contracts must be paid "...within 30 days after receipt of the payment request from a contractor on a construction contract for an undisputed payment request..." (emphasis added) (PCC 10261.5(a)), while the Prompt Payment Act, GC927 et seq., requires a penalty to be paid if "...payment is not issued within 45 calendar days from the state agency receipt of an undisputed invoice." (Emphasis added.) GC 927.6(a).

Additionally, interpreting GC 927.9 to require the reporting of penalties paid under GC 10261.5 necessitates, in effect, ignoring a key clause of GC 927.9(a). giving no effect to its inclusion in the Prompt Pay Act, to wit, the following clause "...late payment penalties *that were paid by the state agency in accordance with this chapter...*" (Emphasis added.) The Legislature, obviously, not need not have included the words "in accordance with this chapter" in this statute, but it did, and if those words are ignored, then a fundamental rule of statutory interpretation is effectively violated. That rule of statutory interpretation is: "*Give significance, if possible, to every word or part, and harmonize the parts by considering a particular clause or section in the context of the whole. (See Moyer v. Work. Comp. App. Bd. (1973) 10C.3d 222, 232, 110 C.R. 144, 514 P.2d 1224 [word susceptible of different meanings construed in conformity with general purpose of statute]; California Assn. of Psychology Providers v. Rank (1990) 51 C.3d 1, 18, 270 C.R. 796, 793 P.2d; 18 Pepperdine L. Rev. 77 [California Assn. of Psychology].)*" (Emphasis in original.) 7 Witkin, Summary 11th Const Law §130 (2019).

Conclusion

The Prompt Payment Act does not require Caltrans report interest penalties paid pursuant to PCC 10261.5 for late payments on construction contracts because the Prompt Payment Act itself explicitly provides that the only late penalty payments reportable to the Director of General Services pursuant to the Prompt Payment Act are "...late payment penalties that were *paid by the state agency in accordance with this chapter...*" (emphasis added) (GC 927.9 (a)), i.e., the Prompt Payment Act itself, and interest penalties paid pursuant to PCC 10261.5 for late payments on construction contract contracts are not paid "in accordance with" the Prompt Payment Act.

Sincerely,

Jon Oldenburg  
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Richard J. Mitchell,  
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California Department of Transportation  
HQ Legal Division  
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## **Attachment B**

## Memorandum

**To**  
RHONDA L. CRAFT  
Inspector General  
**Independent Office of Audits and Investigations**

**Date:** June 25, 2020

**File:** P3010-0654

**From:**  
DEE LAM  
Acting Chief  
Division of Local Assistance

**Subject: THE DIVISION OF LOCAL ASSISTANCE RESPONSE TO FINDING 2 OF  
THE AUDIT REPORT - COMPLIANCE WITH THE CALIFORNIA PROMPT PAYMENT  
REQUIREMENTS**

In response to the draft report, this memorandum serves as the California Department of Transportation's (Caltrans) Division of Local Assistance (DLA) concurrence with the finding and recommendation for Finding 2: Local Agency Construction Contracts Lack of a Prompt Payment Requirement Clause as described in the June 2020 Program audit of the DLA for compliance with the California Prompt Payment requirements. We thank you and your staff for the efforts in coordinating this audit.

The DLA has added necessary language into our construction contract boilerplate Exhibit 12-G: Required Federal-Aid Contract Language and the contract boilerplate documents for Professional Service contracts Exhibit 10-R: A&E Boilerplate Agreement Language and will include these changes in the annual LAPM update scheduled to be published January 2021. If you have any questions, please contact Wenyi Long at (916) 654-6832, or <wenyi.long@dot.ca.gov>.

c: Felicia Haslem, Acting Chief, Office of Guidance and Oversight, Division of Local Assistance, Caltrans

Alice Lee, Chief, Independent Office of Audits and Investigations, Caltrans