


Memorandum

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To: RAY ZHANG
Division Chief
Division of Local Assistance

Date: April 27, 2018

File: P2535-0073

From: ALICE M. LEE 
Chief
External Audits — Contracts
Independent Office of Audits and Investigations

Subject: **AUDIT OF THE CITY OF COSTA MESA, PROPOSITION 1B PROJECT**

Attached is the audit report pertaining to the audit performed on the following Proposition 1B (Prop 1B) project:

<u>Project Name</u>	<u>Project number</u>	<u>P Number</u>	<u>Amount Audited</u>
Red Hill Rehabilitation	1200020077	P2535-0073	\$992,000

The project's implementing agency is the City of Costa Mesa. The project was funded using Proposition 1B State-Local Partnership Program Funds.

As required by the Governor's Executive Order S-02-07 and SB88, the expenditures of bond proceeds and outcomes are subject to audit. The audit was performed by the Department of Finance on behalf of Caltrans. Deputy Directive 100-R 1, "Departmental Responses to Audit Reports" cites responsibilities of Division Chiefs relative to audits performed. The audit disclosed the following findings:

- The City claimed ineligible and unsupported construction and consultant expenditures totaling \$285,571.
- The City did not adhere to Caltrans requirements relating to the procurement of three consultant contracts.

Please provide the Independent Office of Audits and Investigations a corrective action resolution on the audit findings within 90 days of this memorandum's date and reference the P number identified above. If you have any questions, please contact Elena Guerrero, Acting Audit Manager, at (916) 323-7954.

Attachment

cc: Stephen Maller, Deputy Director, California Transportation Commission
Rick Guevel, Associate Deputy Director, California Transportation Commission
Teri Anderson, Assistant Deputy Director, California Transportation Commission
Coco Briseño, Deputy Director, Planning and Modal Programs
Bruce De Terra, Division Chief, Transportation Programming
Sharon Bertozzi, Sr. Transportation Engineer, Division of Local Assistance
Doris M. Alkebulan, Prop 1B Specialist, Transportation Programming
Daniel Burke, Audit Liaison, Division of Local Assistance
Elena Guerrero, Acting Audit Manager, Audits and Investigations



City of Costa Mesa

Proposition 1B Bond Program

Project Number 1200020077

Team Members

Jennifer Whitaker, Chief
Cheryl L. McCormick, CPA, Assistant Chief
Jon G. Chapple, CPA, Manager
Angie Williams, Supervisor
Jedediah S. Thompson, Lead
Stephen Franz

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



EDMUND G. BROWN JR. ■ GOVERNOR

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Transmitted via e-mail

April 25, 2018

Ms. Alice M. Lee, Chief
External Audits—Contracts, Audits and Investigations
California Department of Transportation
1304 O Street, Suite 200
Sacramento, CA 95814

Dear Ms. Lee:

Final Report—City of Costa Mesa, Proposition 1B Audit

The California Department of Finance, Office of State Audits and Evaluations, has completed its audit of the City of Costa Mesa's (City) Proposition 1B funded project listed below:

<u>Project Number</u>	<u>P Number</u>	<u>Project Name</u>
1200020077	P2535-0073	Red Hill Avenue Rehabilitation

The enclosed report is for your information and use. The City's response to the report findings are incorporated into this final report. The City agreed with our findings. We appreciate their assistance and cooperation during the engagement, and their willingness to implement corrective actions. This report will be placed on our website.

If you have any questions regarding this report, please contact Rick Cervantes, Manager, or Angie Williams, Supervisor, at (916) 322-2985.

Sincerely,

Jennifer Whitaker, Chief
Office of State Audits and Evaluations

Enclosure

cc: Ms. Elena Guerrero, Acting Audit Manager, External Audits—Contracts, Audits and Investigations, California Department of Transportation
Mr. Raja Sethuraman, Director, Public Services Department, City of Costa Mesa
Mr. Baltazar Mejia, City Engineer, Public Services Department, City of Costa Mesa
Ms. Irina Gurovich, Assistant Engineer, Public Services Department, City of Costs Mesa

BACKGROUND, SCOPE AND METHODOLOGY

BACKGROUND

California voters approved the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 (Proposition 1B) for \$19.925 billion. These bond proceeds finance a variety of transportation programs. Although the bond funds are made available to the California Transportation Commission (CTC) upon appropriation by the Legislature, CTC allocates these funds to the California Department of Transportation (Caltrans) to implement various programs.¹

CTC awarded \$922,000 of Proposition 1B State-Local Partnership Program Account (SLPP) funds to the City of Costa Mesa (City) for the Red Hill Avenue Rehabilitation project (1200020077). The project consisted of the rehabilitation of Red Hill Avenue from Bristol Street to Paularino Avenue, including the removal and reconstruction of asphalt concrete pavement, damaged curbs, gutters, and sidewalks, and roadway stripping. Construction for this project is complete.

The City was required to provide dollar-for-dollar match funding for this project.

PROGRAM DESCRIPTION¹

SLPP: \$1 billion of bond proceeds made available to the SLPP to finance a variety of eligible transportation projects nominated by applicant transportation agencies. For an applicant transportation agency to receive bond funds, Proposition 1B requires a dollar-for-dollar match of local funds.

SCOPE

As requested by Caltrans, the California Department of Finance, Office of State Audits and Evaluations, audited the project described in the Background section of this report. The audit period for the project is identified in Appendix A.

The audit objectives were to determine whether:

- Proposition 1B expenditures were incurred and reimbursed in compliance with the executed project agreements, Caltrans/CTC's program guidelines, and applicable state and federal regulations cited in the executed agreements.
- Deliverables/outputs were consistent with the project scope and schedule.
- Benefits/outcomes, as described in the executed project agreements or approved amendments, were achieved and adequately reported in the Final Delivery Report.

We did not assess the efficiency or effectiveness of program operations.

The City's management is responsible for ensuring accurate financial reporting; compliance with project agreements, state and federal regulations, and applicable program guidelines; and the adequacy of its job cost system to accumulate and segregate reasonable, allocable, and allowable expenditures. CTC and Caltrans are responsible for the state-level administration of the program.

¹ Excerpts were obtained from the bond accountability website <https://bondaccountability.dot.ca.gov/>.

METHODOLOGY

To achieve the audit objectives, we performed the following procedures:

- Examined the project files, project agreements, program guidelines, and applicable policies and procedures to gain an understanding of the project and respective program.
- Reviewed procurement records to verify compliance with applicable local and state procurement requirements.
- Selected a sample of expenditures to determine if they were project-related, properly incurred, authorized, and supported by accounting records, progress payments, cancelled checks, and electronic fund transfer documents.
- Reviewed a sample of contract change orders to determine if they were within the scope of the project, properly approved, and supported.
- Evaluated whether other revenue sources were used to reimburse expenditures already reimbursed with bond funds.
- Verified the match requirement was met by reviewing a sample of supporting documentation.
- Evaluated whether project deliverables/outputs were met by reviewing supporting documentation and conducting a site visit to verify project existence.
- Evaluated whether project deliverables/outputs were completed on schedule by reviewing project files, project agreements or approved amendments, and the Final Delivery Report.
- Evaluated whether project benefits/outcomes were adequately reported in the Final Delivery Report by reviewing a sample of supporting documentation.
- Determined whether project benefits/outcomes were achieved by comparing actual project benefits/outcomes in the Final Delivery Report with the expected project benefits/outcomes described in the executed project agreements or approved amendments.

In conducting our audit, we obtained an understanding of internal control, including any information systems controls that we considered significant within the context of our audit objectives. We assessed whether those controls were properly designed, implemented, and operating effectively. Any 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.

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.

Except as noted below, Proposition 1B expenditures were incurred and reimbursed in compliance with the executed project agreements, Caltrans/CTC's program guidelines, and applicable state and federal regulations cited in the executed agreements. Additionally, the project deliverables/outputs were consistent with the project scope. Although the project was behind schedule, the City appropriately informed Caltrans and CTC of the delay.

Project benefits/outcomes were adequately reported in the Final Delivery Report and the City achieved the expected project benefits/outcomes as described in the executed project agreements or approved amendments. The *Summary of Projects Reviewed* is presented in Appendix A.

Finding 1: Questioned Construction and Consultant Expenditures

The City claimed ineligible and unsupported construction and consultant expenditures totaling \$285,571.²

Project Costs - Outside Scope of Red Hill Avenue

The City claimed \$284,451 in project costs that were outside the scope of the Red Hill Avenue Rehabilitation project ("Red Hill"). Specifically, the City claimed:

- \$100,000 in ineligible consultant costs. The City awarded a \$200,000 contract to a consultant to perform inspection and construction management services for eight city-wide capital improvement projects, and claimed the entire amount to the Red Hill project. Although the City contends the work performed was project related, numerous inconsistencies were noted, as follows:
 - The contract identified eight specific capital improvement projects, but did not include the Red Hill project.
 - The consultant identified the work as being performed on "various capital improvement projects" on invoices submitted to the City. The City's accounting unit coded the invoices to the various capital improvement accounts in the general ledger, and then after project completion posted a journal entry reclassifying \$200,000 to the Red Hill project. The City also provided invoices showing the coding was inexplicably changed to the Red Hill project. In addition, the City provided project reports where it appeared the Red Hill project name was subsequently added to the documents.
 - The consultant's daily field inspection reports included narrative describing locations that were not within the Red Hill project scope.

² Caltrans reimbursed the City 50 percent of claimed construction and construction engineering costs. The questioned costs reflect the amount reimbursed by Caltrans (i.e., questioned costs total \$571,143 X 50 percent = \$285,571 reimbursed to the City).

- \$184,001 in ineligible and unsupported construction costs. Specifically, the City claimed costs relating to asphalt material that were not project related. City inspectors documented 4,973 tons of material from a contract change order describing locations that were not within the Red Hill project scope. The City stated the amount of material needed for the Red Hill project was underestimated and additional material was needed to correct drainage issues at two intersections. However, the City could not provide documentation substantiating the material costs were project related.
- \$450 in ineligible materials testing expenditures. Specifically, documents supporting the consultant invoices show work was performed for various capital improvement projects extending onto Bristol Street, which is outside the scope of the Red Hill project. The City relied on the cover page of the consultant's invoice, and incorrectly coded the cost to the Red Hill project.

The Project Programming Request approved by CTC identifies the scope of work to include the rehabilitation of Red Hill Avenue, starting at Bristol Street and ending at Paularino Avenue. Additionally, Article V, section 2, of the Master Agreement requires the Administering agency to establish and maintain an accounting system and records that properly accumulate and segregate incurred project costs and matching funds by line item for the project.

Claimed Expenditures – In Excess of Contracted Rates

The City claimed \$1,120 for unsupported consultant inspection service expenditures. The hourly rate charged by the consultant was \$15 per hour higher than rates approved in the consultant's contract. Specifically, the rate schedule in the consultant's contract specified a rate of \$80 per hour, but the consultant billed at \$95 per hour, resulting in consultant expenditures paid in excess of the contracted amount. The City stated the rate increase was approved via email with the consultant; however, the City could not locate a copy of the email.

Exhibit C of the consultant contract states revisions to the contract fees must be approved via amendment prior to implementing higher rates. Also, the Caltrans Local Assistance Procedures Manual (LAPM) Chapter 10, Section 10.8, provides contract amendments are required to modify the terms of the original contract for changes such as extra time, added work, or increased costs.

Recommendations:

- A. Remit \$285,571 to Caltrans.
- B. Develop and implement adequate policies and procedures to ensure consultant and contractor invoices are properly reviewed, approved, project-related, and recorded in the appropriate project general ledger prior to submitting reimbursement invoices to Caltrans.
- C. Require contractor invoices and supporting documentation include the specific project name and location of work, especially for vendors that work on multiple projects in the same geographic area.
- D. Ensure contractor billing invoices agree to contracted rates, and obtain executed contract amendments prior to incurring expenditures related to changes in project scope and billing rates.

Finding 2: Improvements Needed in Procurement Process

The City did not adhere to Caltrans requirements relating to the procurement of three consultant contracts totaling \$285,000. Specifically, the City did not retain documentation supporting the evaluation of consultants, such as engineers' proposal evaluations and scoring sheets. The City stated it was unable to locate these documents due to a recent remodel of City Hall and the length of time since the contracts were awarded. Lacking cost estimates and price analysis, the City is unable to substantiate if they received the best price for the work performed.

The LAPM, Chapter 19, Section 19.2, requires agencies to retain project records for a period of three years from the state payment of the final voucher or four years from the date of the final payment under contract, whichever is longer. Section 10.2 requires an independent cost estimate or price analysis for all consultant contracts to ensure that consultant services are obtained at a fair and reasonable price. In addition, Section 10.4 requires the agency to retain all consultant selection documentation.

Recommendations:

- A. Retain all project documents for a period of three years from the state payment of the final voucher or four years from the date of the final payment under contract, whichever is longer.
- B. Ensure cost estimates and evaluations of proposals are prepared and retained for consultant contracts as required.

APPENDIX A

The following acronyms are used throughout Appendix A.

- California Department of Transportation: Caltrans
- California Transportation Commission: CTC
- City of Costa Mesa: City
- State Local Partnership Program Account: SLPP

Summary of Projects Reviewed

Project Number	Expenditures Reimbursed	Project Status	Expenditures In Compliance	Deliverables/ Outputs Consistent	Benefits/ Outcomes Achieved	Benefits/ Outcomes Adequately Reported	Page
1200020077	\$922,000	C	P	Y	Y	Y	A-1

Legend

C = Complete

Y = Yes

P = Partial

Project Number: 1200020077

Project Name: Red Hill Avenue Rehabilitation

Program Name: SLPP

Project Description: Rehabilitation of Red Hill Avenue from Bristol Street to Paularino Avenue, including the removal and reconstruction of asphalt pavement, damaged curbs, gutters, and sidewalks, and restriping of the roadway.

Audit Period: January 8, 2013 through July 15, 2014¹

Project Status: Construction is complete.

Schedule of Proposition 1B Expenditures

Proposition 1B Expenditures	Reimbursed	Questioned Expenditures
Construction	\$785,764	\$184,001
Construction Engineering	136,236	101,570
Total Proposition 1B Expenditures	\$922,000	\$285,571

Audit Results:

Compliance–Proposition 1B Expenditures

Proposition 1B expenditures were incurred and reimbursed in compliance with the executed project agreements. Caltrans/CTC's program guidelines, and applicable state and federal regulations cited in the executed agreements, except for the \$184,001 of construction expenditures and \$101,570 of construction engineering expenditures. In addition, the match requirement was met.

Deliverables/Outputs

The construction phase for the project was completed in May 2014. At the time of our site visit in June 2017, project deliverables/outputs were consistent with the project scope. However, the project was behind schedule and completed nine months late. The City appropriately informed Caltrans and CTC of the delay.

Benefits/Outcomes

Actual project benefits/outcomes were adequately reported in the Final Delivery Report. Additionally, the City achieved the expected project benefits/outcomes as described in the executed project agreements or approved amendments.

Expected Benefits/Outcomes	Actual Benefits/Outcomes	Benefits/Outcomes Achieved
Extend the useful life of the pavement by at least 15 years.	Constructed to meet 15 year lifespan.	Yes
Provide a smoother and safer commute.	The resurfacing of the roadway resulted in a smoother and safer commute.	Yes

¹ The audit period end date reflects the billing period end date of the last reimbursement claim submitted to Caltrans.



CITY OF COSTA MESA

CALIFORNIA 92628-1200

P. O. BOX 1200

FROM THE OFFICE OF THE DIRECTOR, DEPARTMENT OF PUBLIC SERVICES

April 9, 2018

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

Subject: Response to Draft Report—City of Costa Mesa, Proposition 1B Audit

Dear Ms. Whitaker,

The City of Costa Mesa has received the Department of Finance's Draft Report, dated March 20, 2018, regarding a Proposition 1B audit performed for the Red Hill Avenue Rehabilitation Project ("Project") for an audit period of January 2013 to July 2014. The City appreciates the State's audit and feedback on its internal processes, as well as the opportunity to review and respond to the Draft Report. After thorough review of the Draft Report, the City of Costa Mesa concurs with the audit findings and accepts all recommendations outlined, including an acknowledgment of the \$285,571 in ineligible expenditures.

Although the City concurs with the audit findings, it has a few comments relating to each finding, which are set forth below.

Comments Regarding Finding 1:

By way of additional background, the total construction cost for the Project was \$1,376,938.75. The City received \$922,000 in funding from the State Proposition 1B account. A portion of the ineligible expenditures noted in the report were a result of an increase in the scope of the Project in order to achieve economies of scale and maximize use of Project funding. However, the City recognizes that written approval from Caltrans is required prior to changing the scope of work, and in the future will ensure that it obtains Caltrans' approval for any work outside of the approved scope of work. The City plans to attempt to submit additional documentation to Caltrans regarding Project expenditures that were outside the original scope of work, which the City believes would mitigate a portion of the recommended remittance to Caltrans.

The City would like to note that between the time the Project was completed in May 2014 and the State's audit in 2017, City staff had already implemented measures towards meeting all of the recommendations noted in the Draft Report. For example, one factor the City believes contributed to some of the State's findings was lack of adequate staffing, which led to an inability to appropriately manage and track Project expenditures. Since that time, the City has added additional personnel, and has taken steps to train staff regarding state and federal regulations as well as applicable program guidelines. It should also be noted that at the time the State conducted its audit regarding this Project, the staff members who had worked on the Project were no longer with the City. In addition, the City now meets with Caltrans' Local Assistance representatives on a regular basis. Finally, the City recently implemented an internal audit procedure in order to improve its internal controls. Accordingly, the City is confident that its current procedures are in compliance with all applicable agreements, regulations, and guidelines. However, the City will continue to monitor its internal processes to ensure that they adhere to state and federal requirements for projects receiving state and/or federal assistance.

Comments Regarding Finding 2:

The City concurs with the State's finding that improvements are needed in the procurement process. However, the City assures the State that it is improving its processes. Going forward, the City will ensure that the both the procurement process as well as document retention relating to such process will comply with all applicable requirements.

Thank you again for your audit and feedback, and please keep us informed on development of the final report. If you have any questions or need any further information, please contact me at (714) 754-5032 or at raja.sethuraman@costamesaca.gov.

Sincerely,



Raja Sethuraman
Public Services Director

c: Baltazar Mejia, P.E., City Engineer
Brittany Roberto, Assistant City Attorney
Irina Gurovich, Assistant Engineer