DEPARTMENT OF TRANSPORTATION
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August 31, 2012

Mr. Michael Jewell
Chief
U.S. Army Corps of Engineers
Regulatory Division
1325 J Street
Sacramento, CA 95814

Dear Mr. Jewell:

The California Department of Transportation (Caltrans) Audits and Investigations (A&I) audited the U.S. Army Corps of Engineers' (USACE) incurred costs of $791,462 under Agreement Number 43A0275 (Agreement) between Caltrans and USACE to determine if costs are reasonable, allowable, allocable and supported in accordance with:

- Agreement Provisions.
- Department of Defense Financial Management Regulation 7000.14-R.
- Section 214 of the Water Resources Development Act of 2000 (WRDA).

The Agreement period is March 8, 2010, through September 30, 2012, and includes three Task Orders with USACE district offices in Los Angeles, Sacramento, and San Francisco. Our audit also included a review of USACE's internal controls and contract management processes to determine if they are in compliance with state and federal regulations.

OBJECTIVES

The audit was performed as a management service to Caltrans to assist in its fiduciary responsibility to state and federal regulatory agencies. The audit was performed to determine whether costs incurred by USACE are allowable, supported and in compliance with the Agreement provisions, and state and federal regulations.

USACE is responsible for the fair presentation of costs incurred, ensuring compliance with Agreement provisions and state and federal regulations, and the adequacy of its financial management system to accumulate and segregate reasonable, allowable, and allocable costs.

METHODOLOGY

A&I conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that A&I 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. A&I believes that the evidence obtained provides 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 USACE. Therefore, A&I did not audit and are not expressing an opinion on USACE's financial statements.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the data and the records selected. An audit also includes assessing the accounting principles used and significant estimates made by USACE, as well as evaluating the overall presentation.

SCOPE

The scope of the audit was limited to financial and compliance activities related to the above referenced Agreement. The audit consisted of a review of the Agreement provisions, an assessment of USACE's financial management system related to its ability to accumulate and segregate project costs, a review of costs incurred by each USACE district office, a review of USACE's invoicing and billing process, a review of USACE's performance measures, interviews of applicable personnel, and tests of transactions supporting costs incurred through September 30, 2011. Transactions arising subsequent to this date were not tested and, accordingly, A&I did not express an opinion on costs or credits arising after this date. As a result, conclusions expressed in this report pertain solely to USACE's compliance with state and federal regulations and Agreement provisions.

Due to inherent limitations in any financial management system, misstatements caused by error or fraud may occur and not be detected. Also, projections of any audit of the financial management system to future periods are subject to the risk that the financial management system may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

BACKGROUND

Caltrans partners with regulatory agencies for priority review of transportation projects, beyond what the agencies existing financial resources permit. Under agreement with these partner agencies, environmental technical assistance, consultation, and coordination services are provided to enable Caltrans and the regulatory agencies to address issues timely and more effectively, therefore, accelerating the environmental review and permit process.

One of the partner agencies is USACE. USACE provides environmental technical assistance, oversight and coordination services to Caltrans regarding projects subject to its jurisdiction in California.

CONCLUSION

Based on our audit, A&I determined that USACE's financial management system is capable of accumulating and segregating costs in accordance with provisions of Agreement 43A0275, and

costs incurred are reasonable, allowable, allocable and supported. A&I found that USACE's charges were only for services prescribed by the Agreement; and its contract management process is adequate to perform expedited permit processing services under the Agreement, except for deficiencies detailed in the Findings and Recommendations section of this report.

Our findings and recommendations were discussed with officials from each USACE district office their comments were taken into consideration when finalizing the report. The results of the audit were discussed with the following USACE staff:

- Mark Cohen, Deputy Chief, Regulatory Division of the USACE Los Angeles District on June 4, 2012. Mr. Cohen agreed with the findings and recommendations and submitted a written response. The response can be found as Attachment II, which is enclosed.
- Paul Maniccia, Branch Chief, Regulatory Division of the USACE Sacramento District on May 21, 2012. Mr. Maniccia agreed with the findings and recommendations as presented by A&I auditors. He did not submit a written response to the audit results.
- Jane Hicks, Chief, Regulatory Division of the USACE San Francisco District on June 8, 2012. Ms. Hicks disagreed with some of the findings but did not submit a written response to the audit results. Detailed information on the findings and recommendations Ms. Hicks disagreed with can be found in the enclosed Attachment I.

The detailed findings and recommendations can be found in Attachment I of this report titled Findings and Recommendations.

This report is intended for USACE's and Caltrans' management. However, this report is a matter of public record and its distribution is not limited.

If you have any questions, please contact Juanita Baier, Audit Manager, at (916) 323-7951, or Teresa Greisen, Audit Manager, at (916) 323-7910, or Laurine Bohamera, Audit Chief, at (916) 323-7107.

Sincerely,

WILLIAM E. LEWIS
Acting Assistant Director
Audits and Investigations

Enclosures

c: William Leady, Colonel, District Commander, USACE, Sacramento District
R. Mark Toy, Colonel, District Commander, USACE, Los Angeles District
John K. Baker, P.E. District Commander, USACE, San Francisco District
David Castanon, Chief, Regulatory Division, USACE, Los Angeles District
Mark Cohen, Deputy Chief, Regulatory Division, USACE, Los Angeles District
Paul Maniccia, Branch Chief, Regulatory Division, USACE, Sacramento District
Jane Hicks, Chief, Regulatory Division, USACE, San Francisco District
Robert Pieplow, Acting Deputy Director, Project Delivery, Caltrans
Jay Norvell, Chief, Division of Environmental Analysis, Caltrans
Laurine Bohamera, Audit Chief, Audits and Investigations, Caltrans
Teresa Greisen, Audit Manager, Audits and Investigations, Caltrans
Juanita Baier, Audit Manager, Audits and Investigations, Caltrans

FINDINGS AND RECOMMENDATIONS

FINDING No. 1 – Cost Estimates Need More Accuracy

We found that the USACE requested and received more funding than what was reasonable or necessary. Caltrans advanced $405,013 more than necessary for two USACE offices during federal fiscal year 2011. The cost estimates for the two offices were significantly greater than actual costs as noted below:

	Estimate	Actual	Difference
Sacramento Office	$419,336	$139,296	$280,040
San Francisco Office	$200,796	$ 75,823	$124,973
Total			**$405,013**

There was no documented reason for the large difference between the estimated workload and the actual workload. Either Caltrans did not have enough work for these offices or the offices did not assign sufficient staff to complete the workload originally estimated. Because the terms of the agreement allow for advance funding, it is critical that estimates be reasonable and as accurate as possible. The Agreement also has a provision requiring the USACE to return unspent funds to Caltrans at the conclusion of the Agreement. However, because the provision does not require that unspent funds be returned to Caltrans at the end of the fiscal year, the USACE has the benefit of keeping the advanced funds and any accumulated interest not spent during the fiscal year.

Criteria: USACE Agreement Exhibit B, Paragraph 4. A. states "*Allowable costs issued under this Agreement must be necessary, reasonable, and allocable. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.*"

Recommendation: We recommend that USACE management:

- Develop an accurate cost estimate for each office by requesting input from the Caltrans' district offices.
- Assign sufficient staff in order to provide Caltrans with expedited services as described in the Agreement.

USACE Response to Finding No. 1 – The Sacramento office agreed with this finding and recommendation and did not provide a written response. The San Francisco office disagreed with the finding and stated that they lost the staff person assigned to work on this Agreement and it took the office several months to hire another one. The San Francisco office did not provide a written response.

Auditor's Analysis of Response: The finding and recommendation remain unchanged. Each USACE office is responsible for complying with the terms of the Agreement by assigning sufficient staff to provide the expedited services as described in the Agreement.

FINDINGS AND RECOMMENDATIONS

FINDING No. 2 – Annual Advance Payments

The Agreement with the USACE allows for large annual advance payments to be made prior to the performance of work which is contrary to the State Contracting Manual (SCM). Each USACE office invoices Caltrans annually for the advance payments based on the estimated workload for the fiscal year. According to USACE, advance funds are necessary in order for each office to staff their office accordingly and avoid interruption in services to Caltrans. USACE staff also stated that in the past Caltrans has taken a long time in processing the advance and the advance goes to their Finance Center in Millington, Tennessee. As a result, it takes longer for each district office to receive the funds. During the course of our audit, we determined that each USACE district office could request advances via Electronic Funds Transfers (EFT) which would expedite the USACE receiving the funds. EFT would allow each USACE office to have the advance funds in a timely manner.

Criteria: The SCM Section 7.32 states "*Contracts or agreements containing provisions for advance payments should preferably provide for small periodic payments rather than the total contract price or lump-sum advances (California Government Code Sections 11256-11263, 11019, and 12425).*"

Recommendation: We recommend that future agreements with USACE include provisions requiring that advances be paid on a quarterly basis via EFT.

USACE Response to Finding No. 2 – The Sacramento and Los Angeles offices agreed with this finding and recommendation. The San Francisco office expressed concerns regarding quarterly advances but agreed that EFT would be beneficial and did not provide a written response. The Los Angeles office provided a written response. For the complete response, please see Attachment II.

FINDING No. 3 – Not all Quarterly Expense Reports Received as Required

The USACE offices in Los Angeles and San Francisco did not always provide expense reports to the Caltrans contract manager as required. According to staff from the Los Angeles office, expense reports were submitted to the Caltrans contract manager via email. However, there was no evidence that these quarterly reports were submitted to Caltrans. The Caltrans contract manager's files only contained annual reports. The San Francisco office believed that annual expense reports by individual would be sufficient. Expense reports are critical to verify that services were provided and to support the annual advance payments.

Criteria: Agreement Exhibit B 3. C states in part, "... *USACE shall provide the Contract Manager with a quarterly statement of expenditures for each MOA that details expenditures for the quarter, and cumulatively for both the current federal fiscal year and for the life of the Agreement. The Quarterly statement for each MOA shall identify actual costs for salaries, travel, other direct costs and indirect costs by individual.*" Also, Exhibit B 3. J states, "*All invoices with attached budget estimates, quarterly statements, and final statements of expenditures shall be itemized in accordance with Attachment 2, USACE Estimated Salary Rates, and shall include dates of service, Agreement number, MOA date classifications of employees and hours of work, fringe benefit charges, and itemized travel, supply and equipment expenses.*"

FINDINGS AND RECOMMENDATIONS

Recommendation: We recommend that all USACE offices provide the quarterly expense reports to the Caltrans contract manager as required by the Agreement.

USACE Response to Finding No. 3 – The Sacramento and San Francisco offices agreed with the finding and recommendation and did not provide a written response. The Los Angeles office also agreed with the finding and recommendation and provided a written response. For the complete response, please see Attachment II.

FINDING No. 4 – Performance Measures Not Met for Nationwide Permits and Not Established for Other Permit Actions

We reviewed the annual reports the USACE offices submitted to their Headquarters for federal fiscal year 2011. These annual reports indicate that the Los Angeles and San Francisco offices are not meeting the established performance measures for the nationwide permits. The Los Angeles office reported processing nationwide permits within 45 days and the Agreement specifies 20 working days. The San Francisco office reported averaging 75 days to process nationwide permits and the Agreement specifies 45 working days. The USACE Sacramento office reported performance measures that were not consistent with the performance measures stated in the Agreement.

USACE district offices use calendar days to calculate the number of days it takes them to issue the nationwide and standard individual permits because their database tracks permit actions by calendar days. However, the Caltrans Agreement specifies the number of days as "working days." We determined that counting working days for each permit action is not practical for tracking purposes.

Criteria: Appendix B. II. B of each Task Order specifies that the target turnaround time for reaching a decision on Nationwide and Standard Individual Permits will be as follows:

<u>Task Order No. 1 - Los Angeles and Task Order No. 2 - Sacramento</u>

Nationwide Permits - 20 working days upon receipt of federally complete pre-construction notification package.

Standard Individual permits - 120 working days upon receipt of federally complete application package.

<u>Task Order No. 3 - San Francisco</u>

Nationwide Permits - 45 working days upon receipt of federally complete pre-construction notification package.

Standard Individual permits - 120 working days upon receipt of federally complete application package.

FINDINGS AND RECOMMENDATIONS

However, Appendix B. II. B of each Task Order also states that if conditions relating to Endangered Species Act, National Historic Preservation Act, and/or other stated conditions apply, those permit actions are excluded from performance measurement. In addition, the Agreement lacks performance measures for permit actions such as regional permits, letters of permission, and jurisdiction determinations. As a result, we were not able to assess whether the USACE is providing "expedited services" for those permit actions.

Recommendation: We recommend that USACE and Caltrans Management:

- Agree on performance measures based on calendar days for all permit actions, including jurisdiction determinations, regional permits, and letters of permission. Once, the performance measures are agreed to, they should be included in future Agreements.
- Discuss the status of each permit application at quarterly meetings and identify technical issues and/or incomplete applications in a timely manner.
- Identify "priorities" at the quarterly meetings for each permit action in progress.
- Document the level of satisfaction from the Caltrans district offices on an annual basis.

USACE Response to Finding No. 4 - The finding and recommendations were discussed with the three district offices during the exit conferences. The Sacramento office agreed with the finding and recommendation and did not provide a written response. The San Francisco office expressed concerns with the recommendation requesting that performance measures be established for all permit actions. Even though this office expressed concerns, it did not provide a written response. The Los Angeles office agreed with the finding and recommendation and provided a written response. For the complete response, please see Attachment II.

Auditor's Analysis of Response: The finding and recommendation remain unchanged. In order for the Caltrans contract manager to evaluate whether the USACE is providing the expedited services, performance measures need to be established for all permit actions.

Finding 5 – Work Started Before the Task Orders Were Executed

Our audit found that two USACE district offices began providing services before the effective date of the task orders. Work for Task Order No. 2 began on July 17, 2010, but the effective date was September 9, 2010. Similarly, work for Task Order No. 3 began on September 7, 2010, but the effective date was December 30, 2010. According to USACE staff for the two district offices, a former Caltrans contract manager gave them instructions to begin work. Performing work before the effective date of a task order puts the USACE at risk of not getting paid since there is no legal authority to pay for services before the effective date.

Criteria: The State Contracting Manual Section 9.09 A. 4, states, "*Work cannot begin before contract execution and the effective date of the contract.*" In addition, Article XI of Task Orders 002 and 003 both state *"This MOA will become effective on the date of signature by the last Party, and approval by Department of General Services."*

FINDINGS AND RECOMMENDATIONS

Recommendation: We recommend that USACE and Caltrans negotiate future Agreements earlier in the contracting process so services are not provided before the effective date of the Agreement.

USACE Response to Finding No. 5 – This finding was discussed with the Sacramento and San Francisco offices during the exit conferences. The Sacramento office agreed with the finding and recommendation and did not provide a written response. The San Francisco office stated that services began at the direction of a former Caltrans contract manager but agreed that services should not start before an executed Agreement.

DEPARTMENT OF THE ARMY
Los Angeles District, Corps of Engineers
P.O. Box 532711
Los Angeles, California 90053-2325

June 11, 2012

REPLY TO
ATTENTION OF:
Office of the Chief
Regulatory Division

Tim Pasco, Auditor
California Department of Transportation-HQ
MS-2
P.O. Box 942874
Sacramento, California 94274

Dear Mr. Pasco:

As you know, the U.S. Army Corps of Engineers, Los Angeles District, Regulatory Division (USACE-LA) participated in an on-site financial audit of the State of California Department of Transportation Audit Investigation Team (Team) 13-15 March 2012, per the terms of Agreement 43A0275-TO-001. The results of this on-site audit were provided to us via email enclosure titled "Formal Audit Exit Conference", on 18 April 2012.

We participated in the "Formal Audit Exit Conference" with your Team on 04 June 2012. You then invited us 6to review the written findings and submit a formal response within 5 business days, 11 June 2012. In consideration of the written findings and the "Formal Audit Exit Conference", our response is as follows:

1. USACE-LA did not fully comply with reporting quarterly costs to the Department contract manager in accordance w/SA Exhibit B 3.C. and J.
Recommendation: USACE-LA should quarterly report the detail for all costs in accordance with SA Exhibit B 3.C. and J.
Response: We accept the Audit recommendation and have submitted quarterly reports detailing all costs in accordance w/SA Exhibit B 3.C. and J. for FY-2012, including the 1st and 2nd quarter cost detail reports, and will continue to do so.

2. State Contracting Manual states "Contracts of agreements containing provisions for advance payments should preferably provide for small periodic payments rather than the total contract price or lump-sum advances.
Recommendation: Caltrans should make advance payments on a quarterly basis through electronic fund transfers.

Response: In part, we have concerns regarding this recommendation for the following reasons:

- We accept the recommendation to work with Caltrans to set-up the electronic funds transfer. We agree to work with Caltrans to improve the timeliness of payments made under the contract.
- The internal processes of both organizations are fairly slow, and a disruption in funding could affect performance under the contract.
- Lack of funds availability could affect work efficiency and end-products since the Corps is mandated not to work on projects in the absence of funding. The continual work start and stoppage would greatly hamper efficiency, thus affecting our ability to meet the terms and conditions of our WRDA section 214 Agreement and Contract.
- The USACE-LA makes staffing decisions annually based on the availability of funds under the agreement. If funds are not received, we would need to attempt to redirect Caltrans -funded project managers to other projects and funding sources. This would adversely affect our overall budget and staffing plans.
- Other WRDA section 214 agreements make advance payments annually, and this facilitates a smooth operation of the programs and lowers administrative costs.

3. The performance measures of Agreement 43A0275-TO-001 is based on working days, however, all USACE districts use the ORM database to tract permit actions and the ORM database uses calendar days. In addition, ORM data does not identify if permit actions require consultation related to ESA, SHPO, and/or other stated conditions to exclude permit actions from the target turnaround time. It was not determined whether USACE-LA met the performance measures stated in the contract, however the 2011 annual report to USACE HQ indicates that the performance measures may not be met.

Recommendation: In the future, Caltrans and USACE-LA should agree on performance measures based on calendar days. In quarterly meetings between USACE and Caltrans, communication must improve to discuss the status of each permit application for technical issues, etc. Performance measurement factors should be identified and Caltrans district representatives should document performance measurement factors in Caltrans STEVE database for tracking purposes. In addition to NWP and SIP's, USACE and Caltrans should agree on performance measures for other permit actions. Finally, Caltrans Districts should annually participate in detailing Caltrans level of satisfaction with USACE office's performance under the agreement.

Response: USACE-LA accepts the recommendation to change tracking of actions from working days to calendar days. In addition, we accept the recommendation to address performance measures, etc. in the future long-term Caltrans/USACE-LA Contract. However, with regard to LA District, most delays in permit processing are associated with incomplete applications submitted by Caltrans, not ESA or SHPO, which typically are coordinated by Caltrans in advance of permit application submittal, and are not in themselves the source of delays. We already coordinate with our Caltrans counterparts on outstanding additional information required through "additional information requests" (via letters, e-mails, and telephone discussions), and we also update the status on some projects during our quarterly meetings with Caltrans. Regarding annual reviews of performance, Jennifer Gillies does contact USACE-LA each year before sending us a performance appraisal letter. We can also

include performance appraisal as an agenda item to discuss during our last quarterly meeting with Caltrans each year.

4. Administrative support costs were directly charged to Agreement 43A0275-TO-001 for administrative support employees. "Allowable costs must be accorded consistent treatment. A cost may not be assigned a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated as an indirect cost." If the administrative support services are usually charged as indirect cost in either the G&A overhead or Regulatory overhead, then there is inconsistent treatment of costs which results in an inequitable allocation of indirect costs."
Recommendation: If administrative support staff usually charge time to indirect cost, administrative support staff costs should not be directly charged to the Agreement
Response: The USACE-LA support staff services usually charge time to direct costs. Charges to indirect/overhead by administrative and other Corps Regulatory Division staff (including project managers) are limited, and include meetings, training, and other mandated District activities for all USACE-LA staff. Indirect costs usually comprise less than 10% of a staff member's total costs. Administrative staff, who are generally graded lower than project managers, can accomplish certain project or program related activities that benefit Caltrans through cost savings. We will include a line-item for estimated administrative staff costs in our future cost/budget estimates made under our Contract with Caltrans.

The USACE-LA would like to take this opportunity to thank you and the team for providing constructive recommendations to enhance existing processes. This benefits present and future agreements. We look forward to our continued long-term partnership and collaborative efforts in responsible environmental stewardship through our joint transportation planning process.

If you have any questions, please contact Stephanie Hall of my staff at 213-452-3410 or via e-mail at Stephanie.J.Hall@usace.army.mil. Please refer to this letter and SPL-2010-00616-SJH in your reply.

Sincerely,

Mark D. Cohen
Deputy Chief, Regulatory Division

"Building Strong and Taking Care of People!"