Local Programs Procedures

LPP 00-03
Revised Preaward Audits Requirements

Reference: *Local Assistance Procedures Manual*, Chapters 3, "Project Authorization," and 10, "Consultant Selection"

Effective Date: April 3, 2000 Approved: _____

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Preaward audits are required for all engineering and design related service contracts, greater than $100,000, financed with State or Federal-aid highway funds. This LPP allows Caltrans or the local agency to perform the required preaward audit.

EXISTING PROCEDURES

LPP 99-01 entitled "Interim Preaward Audits Requirements" was issued April 1, 1999 and effective until a task force could resolve some processing problems and applicability issues. The task force has completed its assignment and has revised the LPP as presented herein.

NEW PROCEDURES

This LPP supercedes the preaward audit section in Chapter 10, "Consultant Selection," of the *Local Assistance Procedures Manual*. Other changes to this subject include revisions to Exhibits 3-A, 10-A, and 10-H, new Exhibits 10-K, 10-L, 10-M, 10-N, 10-O, and 10-P. Exhibit 10-J from LPP 99-01 has been deleted (to be replaced by a future DBE LPP).

PREAWARD AUDIT

The preaward audit requirement is placed on all consultant contracts when State or Federal-aid highway funds participate in the contract. See the *Transit Planning Procedures Manual* for audit requirements for transit projects. All contracts of this nature must go through the process described

below. The extent of audit work to be accomplished depends primarily on the dollar amount of the consultant contract. The following describes the preaward audit process for the particular case of the contract amount.

PROCESS

Case 1: Contracts less than $100,000: Exempt

Consultant contracts less than $100,000 are exempt from the preaward audit requirements. If your contract is less than $100,000, Cases 2 and 3 are not applicable.

Case 2: Contracts between $100,000 and $250,000: Risk Assessment

For consultant contracts between $100,000 and $250,000, Caltrans Audits and Investigations will perform a risk assessment to determine whether a preaward audit is required. In order to perform a risk assessment, Caltrans Audits and Investigations needs the following information:

- A copy of the draft agreement between the consultant and the local agency.
- A copy of the draft cost proposal for the prime consultant and all subconsultants. At a minimum, the draft cost proposal must include a breakdown of the proposed costs into categories of direct labor, indirect costs (overhead), other direct costs (travel, equipment, printing, etc.), and profit.
- Local agency contact person, including name, address, phone number and fax number.

The risk assessment will be completed within two working days of receipt of all the required items, at no cost to the local agency. If any of the required information is not provided, the External Audit Manager will notify the local agency contact person and the clock will stop until all required information is received. Once the risk assessment is complete, the External Audit Manager will notify the local agency contact person and the District Local Assistance Engineer (DLAE) of the results. If a preaward audit is not required, the local agency can execute the agreement. If a preaward audit is required, the local agency can choose to perform the preaward audit, contract with a CPA to perform the preaward audit or request Caltrans Audits and Investigations to perform the audit. Also, of a preaward audit is required, the procedures under Case 3 shall be followed.

To request Caltrans Audits and Investigations to perform a risk assessment, the local agency must send the above noted information/documents to:

Department of Transportation
Audits & Investigations, M.S. 2
Attention: External Audit Manager
P.O. Box 942874
Sacramento, CA 94274-0001

A sample risk assessment request letter is provided in Exhibit 10-L. A risk assessment checklist is provided in Exhibit 10-M. A copy of the risk assessment request shall be sent to the DLAE.

Case 3: Contracts in excess of $250,000: Preaward Audit Required

The purpose of a preaward audit is to provide professional advice on accounting and financial matters and to assist in the award and administration of proposed consultant contracts. A preaward audit also serves to alert both the consultant and the local agency of potential problems concerning the consultant's financial qualifications, basic contract, cost/price proposal or cost accounting system. The preaward audit examines the consultant's accounting, estimating, and administrative systems—as well as proposed costs, quantities, and financial condition.

The audit is as broad in scope as necessary to meet the following objectives:

- Determine if the consultant agreement specifically provides for the following:
  - Three year record retention period and right to audit
  - Method of payment
  - Reference to cost principles set forth in 48 CFR Chapter 1, Part 31 for allowability of individual items of cost; 49 CFR, Part 18 for administrative procedures; and OMB Circular A-110, which are administrative procedures for nonprofit subrecipients
- Determine if the Consultant's cost proposal contains a breakdown of the estimate for performing the work, and that the proposed costs are reasonable in relation to actual historical costs and estimating procedures
- Determine if the Consultant's cost accounting system is capable of accumulating reasonable, allocable, and allowable costs

Procedures to perform the preaward audit will depend on who the local agency elects to perform the audit.

Caltrans Performs Preaward Audit

For situations where a local agency elects Caltrans to perform the audit, the local agency must transmit a preaward audit request (see Exhibit 10-A) to Caltrans Audits and Investigations with copies of the proposed consultant contract and cost proposal (and cover letter copy to the DLAE). It should be noted that the consultant's cost proposal (for the prime and subcontractors) must contain a breakdown of all components of cost including labor base rate, overhead, fee, and other direct costs. For sample cost proposals, see Exhibit 10-H. The agency needs to advise the consultant that an audit needs to be performed and that cooperation with the auditors is expected. A preaward audit checklist (the same as for a risk assessment) is provided in Exhibit 10-M. Thirty calendar days should be allowed for the average audit, from the date of receipt of a complete package (request, draft contract, and each proposal with cost breakdowns). Exhibit 10-K shall be completed.

Local Agency (or hired CPA) Performs Preaward Audit

If the local agency performs the preaward audit, Exhibit 10-K must be completed and transmitted to the DLAE. This is usually accomplished when the local agency submits the request for authorization to proceed with preliminary engineering (Exhibit 3-A for Federal-aid projects). The audit must be completed before the consultant contract is executed. Failure to do this will result in loss of funds for the consultant services. **The audit must be performed in accordance with generally accepted government auditing standards promulgated by the United States General Accounting Office.**

The local agency shall follow the information in Exhibit 10-P "Audit and Accounting Guidelines for Negotiated Contracts with Caltrans" to assure that the audit objectives are clear as to the basic elements of an accounting system. In addition, Exhibit 10-O "Standard Audit Program Procedures" shall be used as the minimum procedures to be performed for the preaward audit.

The local agency shall notify Caltrans Audits and Investigations of their decision to perform the preaward audit using its own forces or by contracting with a CPA firm. The notification will be in writing using the sample letter format of Exhibit 10-N. As a part of this notification process, the local agency shall also submit preaward audit procedures. Caltrans Audits and Investigations may perform a review of such procedures and express an opinion on them as needed.

Caltrans shall retain the right to audit or review the work of the local

agency or designee at any time.

Negotiation may begin with the consultant while the audit is being prepared. The contract shall not be executed until the audit report has been completed and the consultant's accounting system, rates charged, knowledge of FHWA's cost eligibility, and documentation requirements are found satisfactory by the auditors. The local agency shall be proactive to resolve any audit comments before execution of the consultant contract.

Exhibit 3-A, "Request for Authorization to Proceed with Preliminary Engineering," includes boxes that indicate compliance with the preaward audit requirement when there is Federal-aid participation.

Exhibit 10-A is a sample request for a preaward audit to be performed by Caltrans. Section 4.3 of the Caltrans' *Service Contracts Manual* provides additional details about the audit process.

If Caltrans' Audits and Investigations determines that a preaward audit for a contract over $100,000 is not required, Exhibit 10-K must still be completed. Exhibit 10-K must be signed by the local agency financial officer and submitted to the DLAE to document compliance with the preaward audit requirement.

A courtesy copy of preaward audits conducted by the local agency shall be mailed to Caltrans' Office of Audits and Investigations, P.O. Box 942874, Sacramento, CA 94274-0001. Exhibit 10-K will indicate that a courtesy copy was mailed to Caltrans.

The local agency is responsible for complying with these preaward audit procedures. In the event it is found by Caltrans or FHWA (or FTA) that the reimbursed consultant costs resulting from a lack of contract provisions, unallowable or unsupported activities, or an inadequate accounting system are the responsibility of the local agency—the local agency will be subject to the sanctions mentioned in Chapter 20 of this manual.

This new procedure will be included in the next manual change as well as on the Local Programs Home Page on the Internet at www.dot.ca.gov/hq/LocalPrograms.

Attachments

REQUEST FOR AUTHORIZATION
TO PROCEED WITH PRELIMINARY ENGINEERING (PE)

Local Agency Letterhead

To: (DLAE Name)
District Local Assistance Engineer
Caltrans, Office of Local Assistance
(District Address)

Date:_____
(Federal Number)
(Project Description)
_____

Dear (DLAE Name):

In order to begin reimbursable preliminary engineering for the above project, we request that you secure Federal authorization and obligate funds for this work. The amounts requested do not exceed the Federal funds provided to this agency in the approved Federal TIP/Federal Statewide TIP (FSTIP).

Attached are the following documents that are required to authorize this phase of work:

Request for Authorization Package

- ☐ Completed Project Prefix Checklist (Exhibit 3-E)
- ☐ Completed Finance Letter (Exhibit 3-F)
- ☐ Completed Data Sheets (Exhibit 3-G)

Field Review Form (Exhibit 7-B)

- ☐ Completed Field Review form, or
- ☐ I will not be preparing the final design at this time. I will transmit the Field Review Form at a later date.

Environmental Document

- ☐ Approved Environmental Document
  Type of Document _____
  Approval Date _____
- ☐ I have not completed the environmental process and will not be preparing the final design at this time. I will transmit the Environmental Document at a later date.

Pre-Award Audit

- ☐ Completed Audit Disposition (Exhibit 10-K), or
- ☐ Audit Disposition was not completed because Federal-aid highway funding will not participate in a consultant contract, or
- ☐ Preaward audit was not done because the consultant contract is for $100,000 or less, or
- ☐ I will not submit the Audit Disposition at this time. I will submit it to the DLAE prior to entering into a contract with the consultant(s).

I understand that invoice requests for payment will not be processed until a Program Supplement Agreement and Federal-aid Project Agreement (PR-2) have been executed.

(Check which of the following applies)

- ☐ I plan to request early reimbursement and invoicing for PE costs as incurred. As indicated a bove, I have included a completed Field Review Form. I am also including the "Agreements Checklist" (Exhibit 4-A) request forms with this transmittal and request that the agreements be prepared now.
- ☐ I do not plan to invoice for PE costs until this phase of the work is completed. I will transmit the "Agreements Checklist" at a later date.

I will not submit any invoice request until I receive notification that the Program Supplement Agreement and PR-2 have been executed.

CERTIFICATION

I certify that the facts and statements in this "Request for Authorization Package" are accurate and correct. This Agency agrees to comply with the applicable terms and conditions set forth in Title 23, U.S. Code, Highways, and the policies and procedures promulgated by the Federal Highway Administrator and the California Department of Transportation relative to the above designated project.

I understand that each succeeding phase of the project will require a separate authorization to be eligible for Federal reimbursement. I further understand that this Agency is responsible for costs in excess of the Federal funds obligated and all costs incurred before it has received FHWA "Authorization to Proceed" for that phase of the project.

Please advise us as soon as the authorization has been received. You may direct any questions to (Name_____) at (phone number).

Signed _____
Title _____
Agency _____

Attachments

EXAMPLE

PREAWARD AUDIT REQUEST LETTER

Local Agency Letterhead

Department of Transportation
Audits and Investigations, MS 2
Attention: External Audit Manager
P.O. Box 942874
Sacramento, CA 94274-0001

Date:_____
(Federal Number)
(Project Description)
_____

Dear External Audit Manager:

Attached is a copy of (Local Agency Name) proposed contract number _____ with (Consultant's Name). Please arrange a pre-award evaluation and forward a copy of the written report to us. Services to be performed under this contract are (describe work to be performed).

The (Local Agency Name) understands that any work with costs incurred prior to the approval of the "Authorization to Proceed" (E-76) is not eligible for Federal fund reimbursement.

Please notify us of the estimated completion date of the audit.

If you need further information, please contact (Name) at (Phone #).

Sincerely,

Signed _____
Title _____
Agency _____

Attachments: Proposed Contract
Draft Cost Proposal(s)

cc: DLAE

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SAMPLE COST PROPOSAL

Contract No._____ Date _____

Consultant _____

DIRECT LABOR

Classification	Name	Range	Hours	Initial Hourly Rate	Total
Project Manager	_____	_____	_____	@_____	$_____
Highway Engineer	_____	_____	_____	@_____	$_____
	_____	_____	_____	@_____	$_____
Bridge Engineer	_____	_____	_____	@_____	$_____
	_____	_____	_____	@_____	$_____
Technician	_____	_____	_____	@_____	$_____
Project Manager	_____	_____	_____	@_____	$_____
	_____	_____	_____	@_____	$_____
	_____	_____	_____	@_____	$_____
	_____	_____	_____	@_____	$_____

Subtotal Direct Labor Costs $_____
Anticipated Salary Increases $_____
Total Direct Labor Costs $_____

Fringe Benefits	Rate	Total
	_____%	$_____
Total Fringe Benefits		$_____

Indirect Costs		
Overhead	_____%	$_____
General and Administrative	_____%	$_____
Total Indirect Costs		$_____

FEE (Profit) $_____

OTHER COSTS

Travel Costs	$_____
Equipment and Supplies (Itemize)	$_____
Other Direct Costs (Itemize)	$_____
Total Other Costs	$_____

Subcontractor Costs (attach detailed cost estimate for each subcontractor) $_____

TOTAL COST $_____

	Fringe Benefit %		Overhead %		General Administration %		Combined %
NORMAL		+		+		=	
OVERTIME		+		+		=	

FEE %

BILLING INFORMATION — CALCULATION INFORMATION

Name/Classification [1]	Hourly Billing Rates			Effective date of hourly rate		Actual/ average hourly rate[2]	% or $ increase	Hourly range for class
	Straight	OT(1.5x)	OT(2x)	From	To			

1. Names and classifications of team members at a level of _____ must be listed. FOR ALL OTHER EMPLOYEES USE CLASSIFICATIONS ONLY.

2. For named employees enter the actual hourly rate. For classifications only, list the average hourly rate for that classification.

AUDIT DISPOSITION

Date: _____

Agency Name:_____

Federal Number: _____

The following information documents the disposition of the required preaward (prenegotiation) audit prescribed in 23 CFR 172.5 (c). This form shall be completed for each consultant contract greater than $100,000 with participating State or Federal-aid highway funds.

Check appropriate box:

Caltrans Performs Preaward Audit or Determines it is not Necessary

- ☐ Caltrans' Audits and Investigations performed the preaward audit and informed the local agency of its findings. The local agency resolved any outstanding issues and found the consultant satisfactory.

- ☐ Caltrans performed a risk assessment and found that a preaward audit is not necessary.

Local Agency (or hired CPA) Performs Preaward Audit

- ☐ Preaward audit completed. Consultant found satisfactory.

- ☐ A courtesy copy of the completed preaward audit was mailed to Caltrans' Audits and Investigations on _____(date)_____.

_____
Signature of local agency financial/auditing officer

Title_____

Distribution: 1) DLAE
2) Project Files

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EXAMPLE

RISK ASSESSMENT REQUEST LETTER

Local Agency Letterhead

To: (External Audit Manager Name)
External Audit Manager
Caltrans, Audits & Investigations, M.S. 2
P.O. Box 942874
Sacramento, CA 94274-0001

Date:
Federal Number:
Project Description:

Dear (External Audit Manager Name):

Attached is a copy of (Agency Name) proposed contract number _____ with (Consultant's Name). Please perform a risk assessment to determine if a preaward audit is required and notify us of the results. Services to be perfromed under this contract are (describe work to be performed).

If you need further information, please contact (Name) at (Phone #).

Sincerely,

Signed_____
Title _____
Agency_____

Attachments: Proposed Contract
Draft Cost Proposal(s)

cc: DLAE

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Risk Assessment/Preaward Audit Checklist

Documents/Information Required for Risk Assessment/Preaward Audit:

____ Cover letter requesting Risk Assessment/Preaward Audit

____ Proposed contract between the local agency and the consultant

____ Proposed cost proposal for prime consultant and all subconsultants

____ Name of local agency contact person, phone number and fax number

Send the Risk Assessment/Preaward Audit request and all required documents/information to:

Department of Transportation
Audits & Investigations, M.S. 2
Attention: External Audit Manager
P.O. Box 942874
Sacramento, CA 94274-0001

cc: Department of Transportation
Office of Local Assistance
Attention: District Local Assistance Engineer (Name)
District Address

EXAMPLE

PREAWARD AUDIT NOTIFICATION LETTER

Local Agency Letterhead

To: (External Audit Manager Name)
External Audit Manager
Caltrans, Audits & Investigations, M.S. 2
P.O. Box 942874
Sacramento, CA 94274-0001

Date:
Federal Number:
Project Description:

Dear (External Audit Manager Name):

We are executing the preaward audit based on Caltrans Audits and Investigations' risk assessment of ___(date)_____and have contracted with the CPA firm of _____ to perform the work. The audit will be conducted following Generally Accepted Government Auditing Standards. The audit procedures that the firm will be following are:

List or identify procedures (i.e., Caltrans Standard Audit Program Procedures in Exhibit 10-O of the *Local Assistance Procedures Manual*)

At the end of the preaward audit, a copy of the audit report will be forwarded to your offices for review. Should you have any questions, please call _____.

Sincerely,

Local Representative Name_____
Title _____
Agency_____

Attachments: Proposed Contract
Draft Cost Proposal(s)

cc: DLAE

Preaward Audit
(Name of Contractor)
Sample - Audit Program

W/P No:
Audit No:
Contract No:
Auditor:
Reviewer:

ITEM NO.	Audit Program Contents	AUDITOR INIT/DATE	WORKPAPER REF.
I	***Purpose*** The purpose of a preaward evaluation is to provide the approving authority with professional advice on accounting and financial matters and to assist in the award and administration of proposed consultant contracts. It also alerts both the consultant and the approving authority to potential problems relative to the Consultant's basic agreement, cost/price proposal, procurement procedures, or cost accounting system		
II	***SCOPE*** The examination shall include reviews of applicable laws and regulations, the contract requirements, and the Contractor's system of internal controls. Audit tests of accounting records and such other auditing procedures considered necessary to meet the objectives will be conducted. Applications of audit procedures will be governed by the individual contract under audit.		
III	***STANDARDS*** The audit is to be conducted in accordance with generally accepted governmental auditing standards.		
IV	***APPLICABLE RULES AND REGULATIONS*** 1. Contract Provisions 2. CFR 48, Part 31- Federal Cost Eligibilit 3. CFR 49, Part 18- Uniform Adminstrative Requirement		
V	***OBJECTIVES*** 1. To determine if the consultant agreement specifically provides for the following: o three-year record retention period and right to audit. o method of payment o references to cost principles set forth in CFR 48, Chapter 1, Part 31 for allowability of individual items of cost; CFR 49, Part 18, for administrative procedures; and OMB Circular A-110, for nonprofit subrecipients. 2. To determine if the Consultant's cost proposal contains a breakdown of the estimate for performing the work, and that the proposed costs are reasonable in relation to actual historic costs and estimating procedures. 3. To determine if the Consultant's cost accounting system is capable of accumulating reasonable, allocable, and allowable costs.		
VI	***PRELIMINARY AUDIT STEPS*** 1. Review the proposed contract. a. Document your review and note any exceptions needed to be included on the audit report.		

2. Review the permanent file.

   a. Ascertain the nature, timing, and extent of the last internal control and accounting system review.

3. Review the cost proposal.

   a. Determine if the Consultant's cost/price proposal contains a breakdown of the estimate for performing the work.

   b. Foot and extend cost data.

   c. Obtain missing cost proposal information, if necessary

   d. Compare data with permanent file. Obtain updated cost information, if necessary.

   e. Comment on unusual amounts, unfavorable trends or differences between current and past costs.

   f. Recalculate cost proposal in consideration of any audit exceptions.

4. Determine scope of audit.

   a. Omit audit step 2 (field work) if:

      - a recent audit found the accounting system adequate, and

      - the accounting system is adequate to accumulate and segregate additional contract costs.

   b. If the accounting system has not recently been reviewed or does not appear to be able to take on additional contract costs, discuss the nature, timing, and extent of audit procedures with supervisor.

5. Prepare preliminary Audit Plan and Time Budget

6. Contact the Contract Administrator to inform him/her of the following:
   a. Scheduled date of field work.
   b. Tentative completion date.
   c. Any anticipated problems, etc.

Note: The Contract Administrator should be kept abreast of all pertinent audit issues. Any problems in obtaining necessary information, etc., should be discussed with him/her immediately and documented in the work papers.

VII ***AUDIT STEPS - FIELD WORK***

1. Contact the Contractor and arrange a date for the audit.

   a. Inform the Contractor of the type of information, records, and personnel needed, and arrange for work space.

b. Request that the Contractor prepare schedules of the calculations of all billing rates such as overhead, fringe benefits, in-house direct cost billing rates and any other rates used in billing. If possible, have these schedules sent to the auditor for review before the date of field work.

c. Inquire whether the Contractor has been audited within the previous year by the DCAA or similar Federal agencies, or has had an independent CPA review overhead, internal controls or project costing systems. If so, obtain a copy of the audit report and/or review working papers for consideration when evaluating internal controls, overhead rates, etc.

d. Prepare and send an engagement letter to the Contractor to confirm the above discussion. Send a copy of the letter to the Contract Administrator.

2. Conduct an entrance conference with the Consultant to ensure coverage of the following:

- Purpose, scope and objective of the preaward evaluation.
- Anticipated time frame of audit field work.
- Whether the Consultant is familiar with CFR 48, Chapter 1, Part 31. If not, Consultant can call (202) 783-3238 to obtain a copy of these regulations.
- Records, etc. needed to perform the audit.
- Intention to keep Consultant updated on audit progress and to discuss all audit exceptions prior to issuance of an audit report.
- Documentation of the entrance conference in the work papers.

VIII ***Control Structure Survey***

1. Review and evaluate the Contractor's internal control structure.

a. Prepare or update a written narrative, flowchart and/or completed internal control questionnaire which adequately describes the accounting system including significant internal controls over contract costs in order to adequately plan the audit and test the various applications. This understanding should include knowledge of the Contractor's control environment, accounting system and control procedures. Generally, the relevant policies and procedures pertain to a Contractor's ability to record, process, summarize, and report contract and financial information and to ensure compliance with applicable laws and regulations.

b. Selectively examine (test) the accounting records and underlying source documents only to the extent necessary to determine if the system has the ability to accumulate and segregate reasonable, allocable and allowable costs through the use of a cost accounting system. The following are some of the attributes which should ideally be found in such a system:

Chart of accounts (direct and indirect accounts).

- Segregation of costs by contract, category of cost and milestones (if applicable).

- Proper recording of direct and indirect costs. For example, separate accounts should be used for direct labor, indirect labor, vacation, holiday, sick leave, etc.

- consistent accounting treatment of costs in recording and reporting.

- Ability to trace from invoices billed to job cost records and original, approved source documents to the general ledger.

2. Prepare a summary of the internal control structure and cost accounting system. The summary should include or reference to a control risk assessment. Finalize Audit Planning document

3. Evaluation of cost/price data.

   a. Obtain source documents and/or other criteria used to establish the cost/price proposal.

4. Evaluate the propriety of direct labor costs.

   a. Select a representative sample of employee timesheets (cards) and test the hourly extensions.

   b. Trace hours to the payroll journal and compare hourly rates paid to the rates submitted with the cost/price proposal.

   c. If applicable, compare proposed direct labor rates to prevailing wage and union labor rates.

   d. If overtime is proposed, does the Consultant have procedures to ensure and document equitable overtime charges to government and non-government contracts?

   e. Prepare a labor rate analysis and comment on variances.

5. Analyze indirect costs (fringe benefits, overhead, general and administrative).

   a. Request written verification of an approved overhead rate, if available (DCAA or other qualified entity).

   b. Obtain a written breakdown/schedule of costs included in the rates.

      - Trace the indirect rate schedule to the general ledger.

      - Scan the indirect cost accounts in the general ledger for unallowable costs.

- Test the Consultant's proposed rate by comparing the individual items of cost for allowability and fair presentation with CFR 48, Ch 1, subpart 31.203.

c. Schedule all disallowed costs.

d. Recalculate the overhead rate and comment on variances.

6. Evaluate the propriety of other direct costs (materials, transportation, equipment, per diem, etc.) and Subcontractors.

a. Determine the methods used to establish the cost materials, transportation, and per diem, etc.

b. Compare proposed rates or costs with prevailing rates or past experiences.

c. Determine if direct costs are independent from the indirect cost pool.

d. Schedule all costs which do not appear to meet the criteria established in CFR 48, Chapter 1, Subpart 31.2.

7. Evaluate the proposed fixed fee.

As field work progresses, keep the Controller or other contact person aware of the findings or problems as they arise. Resolve the matters if possible. Document these conversations in the work papers.

8. Evaluate the Contractor's financial capability - Ratio Analysis

9. Prior to completion of field work, discuss all exceptions with the consultant ensuring coverage of:

- Scope and objectives of the preaward audit.
- The condition, criteria, cause, effect, and recommendation for each exception noted.
- Caltrans' review process and reporting procedures.
- Any questions the Consultant may have.

IX COMPLETION

1. Complete work papers to assure that they are properly headed, indexed, signed, dated, and cross referenced. In addition, each work paper should include, or be reference to, a statement of purpose, source, analysis and conclusion.

2. Prepare an audit summary which documents the purpose, objectives, procedures, results/conclusions and recommendations.

3. Cross reference all exceptions to the appropriate work papers.

4. Prepare draft audit report.

	5.	If necessary, schedule a close out conference with the Consultant to discuss any exceptions not discussed or resolved as of completion of fieldwork. Also, if material findings are identified, the Contract Administrator should also be contacted. Document these conversation/conferences.		
	6.	Complete audit assignment card.		
	7.	Update the permanent file.		
	8.	Submit completed work papers and draft audit report to supervisor for final review.		
	9.	Prepare final report and distribute as follows: * Original - Requester * If Requester is headquarters than: 1 copy - Headquarters Contract Office * If Requester is District than: 1 copy - District Contract Officer or District Consultant Services * 1 copy - Audit file (Section B) * 1 copy - Chronological File (Audit Reports Binder) * 1 copy - P# File (Audit Reports Binder) * 1 copy - Audit Office * 1 copy - Supervisor NOTE: A "cc" notation is needed on the final report for reports distributed outside of the audits office.		

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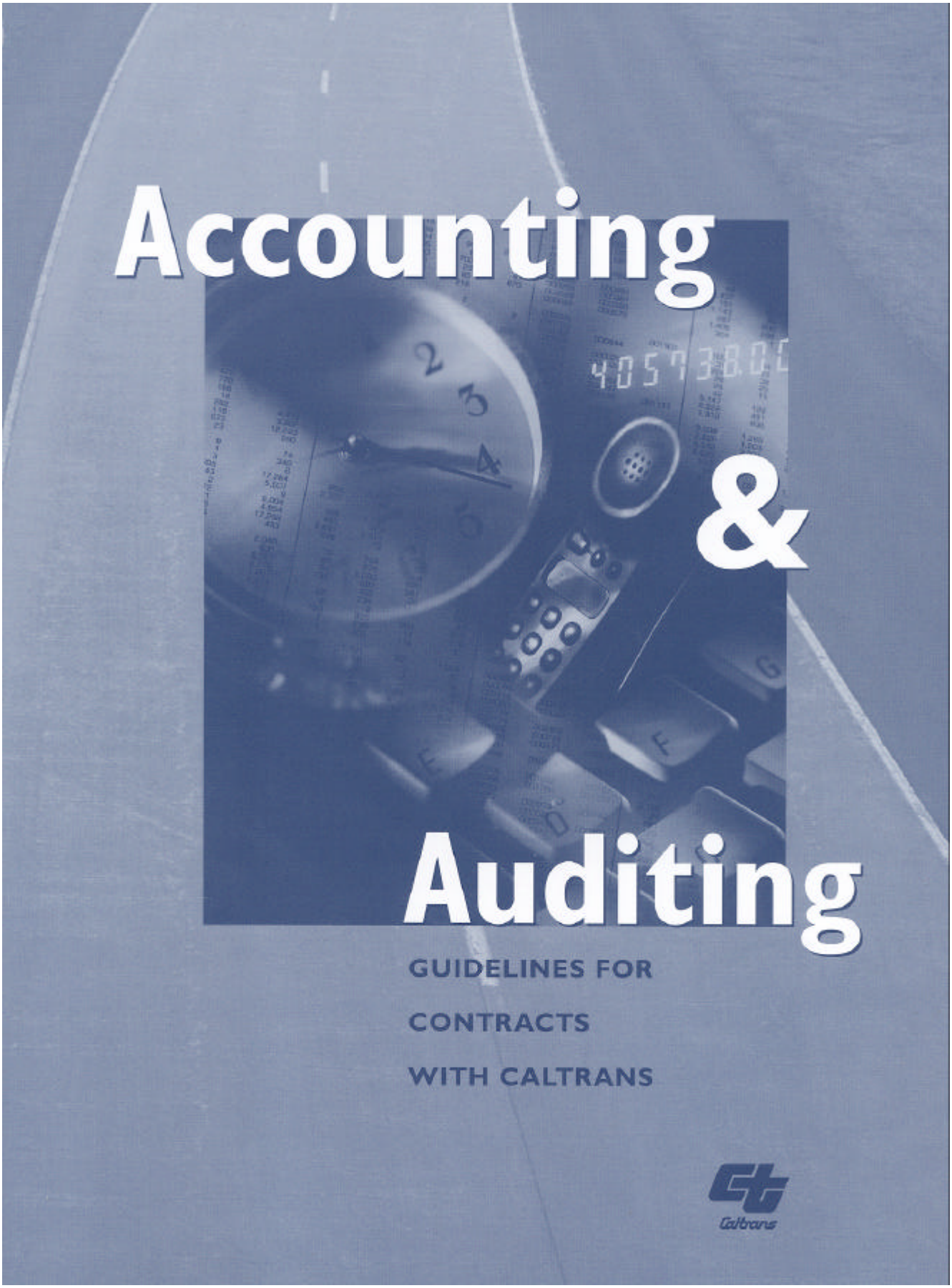
Accounting
&
Auditing
GUIDELINES FOR
CONTRACTS
WITH CALTRANS
Caltrans

INTRODUCTION

The purpose of this brochure is to outline for you, a potential contractor with the California State Department of Transportation (Caltrans), the basic elements of an adequate accounting system, and the types and objectives of audits that will be performed in relation to your contract. In order to successfully compete for a contract and meet the audit requirements, a contractor (whether a prime or subcontractor) must have a system of record keeping and internal control. Although a specific cost accounting system is not required, a contractor needs a system which will assure compliance with the terms of the agreement. A preaward audit will be preformed to assure you meet these requirements prior to contract execution. If your system is deficient, the contract will not be executed.

Caltrans reimburses, through your overhead rate, the costs attributable to establishing and maintaining a cost accounting system.

Staff time and other costs related to an audit performed of your contract are normally reimbursed through your overhead rate.

ACCOUNTING SYSTEM

Contractors (whether a prime or subcontractor) planning to contract with Caltrans must have an accounting system which meets the following objectives:

- The ability to record and report financial data in accordance with generally accepted accounting principles.
- A system of record keeping to ensure that costs billed to Caltrans are:

a. Supported by adequate documentation

b. In compliance with the terms of the contract and applicable Federal and State regulations specified in the contract.

- A system of record keeping ideally includes the following:

  a. A general ledger

  b. Job cost ledger

  c. Labor distributions

  d. Time records

  e. Subsidiary journals

  f. Chart of accounts

  g. Financial statements

- The ability to accumulate and segregate reasonable, allocable (incurred solely for a project) and allowable (per terms of the contract) costs through the use of a cost accounting system. The following are some of the attributes which would ideally be found in such a system:

  a. A chart of accounts which includes indirect and direct general ledger accounts. Indirect costs are not specifically identified to a project, for example, rent and/or utilities. Direct costs are specifically identified with a project, for example, drafting hours and /or design hours.

  b. Segregation of costs by contract, category of cost and milestones (if applicable).

  c. Proper recording of direct and indirect costs. For example, recording of labor costs should provide that non-project indirect hours be recorded on a time sheet and in the accounting records to an administration, vacation, sick leave or other indirect cost account/code. Direct project hours should be recorded on a timesheet and in the accounting records to a direct project cost account/code.

d. Consistent accounting treatment of costs in recording and reporting. For example, if travel expense is charged directly to a project, all travel expense incurred on any project should be considered a direct cost. As a result, project-related travel, whether reimbursable per the contract terms or not, should be included as a direct cost.

e. Ability to trace from invoices submitted to Caltrans to job cost records and original, approved source documents, for example, time sheets, vendor invoices, cancelled checks.

f. Ability to reconcile job cost records to the accounting records.

- Compliance with cost principles described in the Code of Federal Regulations 48, Federal Acquisition Regulations System (FAR), Chapter 1, Part 31. Information on how to obtain this regulation is described under "Audit Criteria" on the following page.

- Procedures to monitor and adjust projected overhead rates to actual rates.

- Controls to ensure that written approval is obtained prior to any changes to the contract.

- Procedures to retain accounting records and source documentation as required by the terms of the contract.

- A system of internal control which provides reasonable assurance that assets are protected; financial data, records and statements are reliable; and errors and irregularities are promptly discovered, reported and corrected. The elements of a system of internal control should include, but not be limited to, the following:

a. Separation of duties for proper protection of assets. Incompatible duties are those that place any person in a position to both perpetrate and conceal errors or irregularities in the normal course of business. For example, the person who writes checks should be different from the person who reconciles bank statements and the person who purchases goods should be different from the person who receives goods.

b. Limiting access to assets to only authorized personnel who requires these assets in the performance of their assigned duties. For example, blank check stock should be locked in a safe when not in use.

c. Authorization and record keeping procedures which provide effective accounting control over assets, liabilities, revenues, and expenditures.

d. A system of practices to be followed in the performance of duties and functions. Such a system normally includes policies and procedures which establish the purpose and requirements of the accounting system. For example, timekeeping practices should ideally provide for the following:

   - Time sheets be prepared, signed and dated by all employees.
   - Time sheets be completed in non-erasable ink.
   - Time sheet corrections be crossed out and initialed by the employee.
   - Time sheets by signed by a supervisor as reviewed and retained on file as required by the contract.

e. Personnel with skills and training commensurate with their responsibilities.

f. A system of internal review. For example, bank reconciliations and travel expense claims should be reviewed, approved, and signed by a supervisor.

AUDITS

Contractors, whether a prime or subcontractor, performing under a negotiated contract with Caltrans are subject to the following audits.

- **Preaward Audits**: Prior to the award of a contract, Caltrans Audits and Investigations will conduct a preaward audit to determine if the contractor's accounting system is adequate to accumulate and segregate costs as detailed in the previous section and to determine if the proposed costs are reasonable. The audit alerts both the contractor and Caltrans' management to problems relative to the contractor's cost proposal and cost accounting system. Due to time constraints in the award process, your cooperation in scheduling the preaward audit with short notice will expedite the execution of your contract.

- **Interim Audits:** Interim audits are performed on an as-needed basis. During the preaward audit, if it is determined that the contractor's accounting system is new or minor deficiencies are noted, an interim audit is scheduled to determine that the system is functioning adequately to ensure that billed costs are supported and that any deficiencies were corrected. An interim audit may be requested by the contract administrator or by Caltrans' management to address concerns during the course of the contract. Also, an audit manager may initiate an interim audit of a multi-year contract to ensure that costs reimbursed to date are allowable.

- **Post Audits:** Post audits of contracts are performed routinely after project completion. Post audits are performed to determine whether the costs claimed are allowable, allocable, reasonable, and in compliance with the Federal and State laws and regulations as well as the fiscal provisions stipulated in the contract. The examination includes reviews of applicable laws and regulations, the contract requirements and the contractor's internal control system. Audit tests of the contractor's accounting records and other auditing procedures considered necessary will also be performed. Applications of all audit procedures would also be governed by the individual contract under audit. Unsupported or unallowable costs are normally the result of weaknesses in the accounting system and will be reimbursed to Caltrans.

To provide contractors with a procedure for obtaining prompt and equitable resolution to a dispute arising from a post audit of a non-highway construction cost reimbursement contract, Caltrans has established an Audit Review Committee (ARC). Information explaining the ARC should be found in your contract and/or as an attachment to the post audit report.

AUDIT CRITERIA

For specific information regarding basic cost accounting systems and applicable State and Federal regulations, please see the following:

- **Code of Federal Regulations 48, Federal Acquisition Regulations System, Chapter 1, Part 31:**
  This regulation contains cost principles and procedures for the pricing of contracts/subcontracts and the determination, negotiation, or allowance of costs. Contact:

  Superintendent of Documents
  Government Printing Office
  Washington, DC 20402

  Washington, DC (202) 512-1800
  San Francisco (415) 512-2770
  Los Angeles (213) 239-9844

- **California State Administrative Manual:**
  A reference source for statewide policies, procedures, regulations and information. Contact:

  Office of State Publishing
  Department of General Services
  Call for order form: (916) 445-2295

For review of the above references, contact your local library or the California State Library.

California State Library
Library and Courts Building
914 Capitol Mall
P.O. Box 942837
Sacramento, CA 94237-0001

Information: (916) 654-0261

For assistance in establishing an accounting system which will meet the objectives outlined in this brochure, you should contact an accountant and/or bookkeeper who is familiar with cost accounting systems.

Caltrans is an affirmative action employer. Equal opportunity is offered to all regardless of race, color, creed, national origin, ancestry, sex, marital status, disability, religious or political affiliation, age or sexual orientation. Contractors that contract with Caltrans are responsible for taking necessary and reasonable steps to achieve these same goals.