



Local Programs Procedures

LPP 98-02 Preaward Audits

Reference: *Local Assistance Procedures Manual*, Chapter 10, "Consultant Selection"

Effective Date: August 28, 1998

Approved: _____
Assistant Program Manager
Design and Local Programs

This LPP presents a new procedure of how preaward audits are to be accomplished. The foregoing applies when there is participation of Federal-aid highway funds.

BACKGROUND

Title 23 of the Code of Federal Regulations (CFR), Part 172, Section 5 (c), requires the preparation of prenegotiation audits of consultant contracts expected to exceed \$250,000 and for contracts less than that amount as specified in the CFR. This is to provide the necessary data to assure that the consultant has an acceptable accounting system, adequate and proper justification of the various rates charged to perform work, and is aware of the FHWA's cost eligibility and documentation requirements.

EXISTING PROCEDURES

The Caltrans *Local Assistance Procedures Manual* (LAPM), Chapter 10, "Consultant Selection" contains detailed instructions pertaining to preaward audits, which suffices for the required prenegotiation audits. According to these procedures, Caltrans is to perform the required preaward audit. This is to occur before a consultant contract is executed.

NEW PROCEDURES

As part of Caltrans delegation authority, each local agency shall now perform their own consultant contract preaward audit in accordance with the following procedures:

On consultant agreements of \$250,000 or more, it is the responsibility of the local agency to perform (or contract to perform) a preaward audit. This is also applicable to subconsultant contracts with work over \$250,000. The preaward audit examines the consultant's accounting, estimating, and administrative systems; proposed costs; quantities; and financial condition. This preaward audit requirement may be waived by the local agency when sufficient audited consultant data is available to permit reasonable comparisons with the cost proposal. This waiver must be documented in the project files.

If the consultant agreement is for less than \$250,000, a preaward audit is required only when one of the following conditions exist:

- There is inadequate knowledge about the consultant's accounting procedures.
- There has been a previous, unfavorable experience with the consultant's estimating or accounting methods.
- The audit has been requested by Caltrans or the consultant.
- It is the first time a consultant has performed services for the local agency.
- Inadequate contract provisions.

The purpose of a preaward audit evaluation 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 agreement, cost/price proposal or cost accounting system.

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

- Determine if the consultant agreement provides for a three-year record retention period, identifies methods of payment, references the cost principles set forth in the Code of Federal Regulations, and determines the allowability of individual items of cost.
- Determine if the consultant's cost proposal contains a breakdown of the estimate for performing the work, indicates reasonable proposed costs, and shows that the estimating system and procedures are adequate.

- Determine if the cost accounting system is capable of accumulating reasonable, allocable, and allowable costs.
- Determine if the consultant is financially capable of performing the required services.
- Determine the administrative systems' adequacy and the availability of applicable key personnel to perform the contract.

See Sample Preaward Audit attached.

The agency needs to advise the applicable consultant (and subconsultant) that an audit needs to be performed in accordance with generally accepted government auditing standards and that cooperation with the auditors is expected.

Exhibit 10-A must be transmitted to the District Local Assistance Engineer (DLAE) prior to entering into a contract with a consultant(s). Failure to do this will result in loss of Federal funds for the consultant services. Remove and dispose of the existing Exhibit 10-A in the LAPM and replace it with the new Exhibit 10-A attached.

Negotiation may begin with the consultant while the audit is being prepared. Discussion should focus on technical aspects of the work and any discussion of costs should be limited until the audit results are received. 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 agency.

The existing Exhibit 3-A in the LAPM is to be replaced with the new Exhibit 3-A attached.

This new procedure will be included in the next manual change.

Attachment

ITEM NO.	Audit Program Contents	AUDITOR INIT/DATE
I	<p>Purpose</p> <p>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.</p>	
II	<p>SCOPE</p> <p>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.</p>	
III	<p>STANDARDS</p> <p>The audit is to be conducted in accordance with generally accepted governmental auditing standards.</p>	
IV	<p>APPLICABLE RULES AND REGULATIONS</p> <ol style="list-style-type: none"> 1. Contract Provisions 2. CFR 48, Part 31- Federal Cost Eligibility 3. CFR 49, Part 18- Uniform Administrative Requirements 	
V	<p>OBJECTIVES</p> <ol style="list-style-type: none"> 1. To determine if the consultant agreement specifically provides for the following: <ul style="list-style-type: none"> 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	<p>PRELIMINARY AUDIT STEPS</p> <ol style="list-style-type: none"> 1. Review the proposed contract. <ol style="list-style-type: none"> a. Document your review and note any exceptions needed to be included on the audit report. 	

Preaward Audit
 (Name of Contractor)
 Sample - Audit Program

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

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	<p>2. Review the permanent file.</p> <p>a. Ascertain the nature, timing, and extent of the last internal control and accounting system review.</p> <p>3. Review the cost proposal.</p> <p>a. Determine if the Consultant's cost/price proposal contains a breakdown of the estimate for performing the work.</p> <p>b. Foot and extend cost data.</p> <p>c. Obtain missing cost proposal information, if necessary.</p> <p>d. Compare data with permanent file. Obtain updated cost information, if necessary.</p> <p>e. Comment on unusual amounts, unfavorable trends or differences between current and past costs.</p> <p>f. Recalculate cost proposal in consideration of any audit exceptions.</p> <p>4. Determine scope of audit.</p> <p>a. Omit audit step 2 (field work) if:</p> <ul style="list-style-type: none"> - a recent audit found the accounting system adequate, and - the accounting system is adequate to accumulate and segregate additional contract costs. <p>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.</p> <p>5. Prepare preliminary Audit Plan and Time Budget</p> <p>6. Contact the Contract Administrator to inform him/her of the following:</p> <p>a. Scheduled date of field work.</p> <p>b. Tentative completion date.</p> <p>c. Any anticipated problems, etc.</p> <p>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.</p>	
VII	<p>AUDIT STEPS - FIELD WORK</p> <p>1. Contact the Contractor and arrange a date for the audit.</p> <p>a. Inform the Contractor of the type of information, records, and personnel needed, and arrange for work space.</p>	

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	<p>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.</p> <p>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.</p> <p>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.</p> <p>2. Conduct an entrance conference with the Consultant to ensure coverage of the following:</p> <ul style="list-style-type: none"> - 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	<p>Control Structure Survey</p> <p>1. Review and evaluate the Contractor's internal control structure.</p> <p>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.</p> <p>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:</p>	

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
	<p>Chart of accounts (direct and indirect accounts).</p> <ul style="list-style-type: none"> - 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. <p>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</p> <p>3. Evaluation of cost/price data.</p> <ul style="list-style-type: none"> a. Obtain source documents and/or other criteria used to establish the cost/price proposal. <p>4. Evaluate the propriety of direct labor costs.</p> <ul style="list-style-type: none"> 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. <p>5. Analyze indirect costs (fringe benefits, overhead, general and administrative).</p> <ul style="list-style-type: none"> 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. <ul style="list-style-type: none"> - Trace the indirect rate schedule to the general ledger. - Scan the indirect cost accounts in the general ledger for unallowable costs. 	

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	<ul style="list-style-type: none"> - 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.	<p>Evaluate the propriety of other direct costs (materials, transportation, equipment, per diem, etc.) and Subcontractors.</p> <ul style="list-style-type: none"> 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.	<p>Evaluate the proposed fixed fee.</p> <p>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.</p>	
8.	Evaluate the Contractor's financial capability - Ratio Analysis	
9.	<p>Prior to completion of field work, discuss all exceptions with the consultant ensuring coverage of:</p> <ul style="list-style-type: none"> - 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.	

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	<p>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.</p> <p>6. Complete audit assignment card.</p> <p>7. Update the permanent file.</p> <p>8. Submit completed work papers and draft audit report to supervisor for final review.</p> <p>9. Prepare final report and distribute as follows:</p> <ul style="list-style-type: none"> * 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 <p>NOTE: A "cc" notation is needed on the final report for reports distributed outside of the audits office.</p>	

**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-A), or
- Audit Disposition was not completed because Federal-aid highway funding will not participate in a consultant contract, or
- I will not submit the Audit Disposition at this time. I will submit it 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 above, 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

AUDIT DISPOSITION

Date: _____

Agency Name: _____

Federal Number: _____

The following information documents the disposition of the pre-award (prenegotiation) audit prescribed in 23 CFR 172.5 (c). This form shall be completed for each consultant contract with participating Federal-aid highway funds. Similarly, it shall be completed for each subconsultant contract with work over \$250,000.

Contract \$250,000 or more

- Pre-award audit completed
- Pre-award audit was not done because sufficient audited consultant data was available to permit reasonable comparisons with the cost proposal.

Contract less than \$250,000

- Pre-award audit completed
- Pre-award audit was not done because there was sufficient knowledge of the consultants accounting system and there was no previous unfavorable experiences regarding the reliability of the consultant's accounting system.

Signature of local agency accounting officer

Title _____

Distribution: 1) DLAE
2) Project Files

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