

Memorandum

*Serious drought.
Help Save Water!*

To: CLARK PAULSEN, Chief
Division of Accounting

Date: April 30, 2014

File: P4000-0393

From: WILLIAM E. LEWIS
Assistant Director
Audits & Investigations



Subject: **FINAL REPORT – PAYROLL RESERVE ASSESSMENT RATE**

Audits and Investigations (A&I) completed an Agreed Upon Procedures Engagement (engagement) of the Division of Accounting's (DofA) Payroll Reserve Assessment Rate (PRAR) process. We performed the engagement at the request of Los Angeles County Metropolitan Transportation Authority to determine if the PRAR was calculated in compliance with federal and state rules and regulations. The scope of the engagement covered the period of July 1, 2003, to June 30, 2010.

We thank you and your staff for its assistance during our review. If you have any questions or need additional information, please contact Juanita Baier, Internal Audit Manager, at (916) 323-7951 or Laurine Bohamera, Chief, Internal Audits, at (916) 323-7107.

Attachment

c: Lisa Kwong, Chief, Office of Financial Accounting and Analysis, DofA, Caltrans
Karen Louie-Tom, Chief, Financial Analysis Branch, DofA, Caltrans
Greg Magaziner, Deputy District Director, Program and Project Management, District 7, Caltrans
Tin Dinh, Senior Transportation Engineer, Program and Project Management, District 7, Caltrans
Laurine Bohamera, Chief, Internal Audits, A&I, Caltrans
Juanita F. Baier, Audit Manager, A&I, Caltrans

P4000-0393

**Division of Accounting
Payroll Reserve Assessment Rate**

April 2014

**William E. Lewis
Assistant Director
Audits and Investigations
California Department of Transportation**

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Summary

The California Department of Transportation's (Caltrans), Audits and Investigations (A&I) completed an Agreed Upon Procedures engagement (engagement) of the Division of Accounting (DofA) Payroll Reserve Assessment Rate (PRAR). We performed the engagement at the request of the Los Angeles County Metropolitan Transportation Authority (Metro) to determine if the methodology for calculating the PRAR was consistent; and the cost components were reasonable, allowable and supported.

Our engagement determined that the methodology used for calculating the PRAR was consistent for fiscal years 2009 and 2010, and that the cost components included in the fiscal year 2009 PRAR were reasonable, allowable and supported. However, we noted the following:

- Misabeled or incorrect cost components
- DofA not adhering to Caltrans' record retention policy
- Inconsistent communication between Caltrans and FHWA

Background

Caltrans enters into Memoranda of Understanding (MOU) with Metro to perform work for transportation projects. Metro reimburses Caltrans for project costs incurred based on the terms of the MOU. They conduct engagements to evaluate and validate the total project incurred costs by cost element billed to Metro and determine whether the costs are allowable and in compliance with the MOU.

As part of their engagement, Metro requested documentation to support whether the Federal Highway Administration (FHWA) reviewed and approved the PRAR for fiscal years 1999 through the current year. Caltrans was unable to provide this information because FHWA did not review and approve the PRAR annually. Since Metro could not verify whether the PRAR was approved by FHWA, it requested Caltrans' A&I to conduct an engagement to evaluate the methodology used for calculating the PRAR.

Caltrans' Division of Accounting (DofA) is responsible for calculating the PRAR. The PRAR is a labor fringe benefit rate that is calculated in accordance with the State Administrative Manual sections 8740 and 8752 to fully recover the cost of personnel services. The PRAR adds the cost of employer paid benefits to an employee's labor rate.

The PRAR includes the following categories of fringe benefits:

1. Salary Benefits – Paid leave such as vacation and sick leave.
2. Payroll Benefits – Contributions made to the State Controller's Office to pay other parties for benefits such as retirement, medical, and dental.
3. NonPayroll Benefits – Amounts paid by Caltrans to other parties for benefits such as unemployment compensation and survivor benefits.

**Background
(continued)**

The PRAR is calculated by totaling the actual cost of the benefit and dividing the total by the anticipated salaries for each benefit cost component. The rates for each benefit cost component are totaled to arrive at the PRAR.

Salary benefits are recorded when payroll is accounted for and a reserve account is recorded when the salary benefit is used. The DofA monitors the variance between the actual and reserve expenditures on a monthly basis to determine if the reserve amounts are adequate to cover the actual cost of the benefit. When the reserve varies significantly from the cost, the PRAR is revised.

**Objectives, Scope,
and Methodology**

We performed the engagement in accordance with Generally Accepted Governmental Auditing Standards; and performed the necessary procedures to satisfy the following objectives:

- To determine if the methodology used for calculating the PRAR was consistent for fiscal years 2009 and 2010.
- To evaluate the PRAR for fiscal year 2009 to determine the allowability of the cost components used in the rate calculations.
- To perform analytical procedures of significant rate changes for fiscal years 2004 to 2009 to determine if rate changes were supported and reasonable.

The scope of the engagement covered the PRAR for the period of July 1, 2003 to June 30, 2010. We interviewed DofA management and staff, reviewed policies and procedures, evaluated processes and tested the calculation methodology. We also analyzed each benefit cost component in the PRAR for fiscal year 2009 to determine if it was reasonable, allowable, and supported.

Conclusion

Our engagement determined that the methodology used for calculating the PRAR was consistent for fiscal years 2009 and 2010, and that the cost components included in the 2009 PRAR were reasonable, allowable and supported. However, we noted the following:

- Mislabeled or incorrect cost components
- DofA not adhering to Caltrans' record retention policy
- Inconsistent communication between Caltrans and FHWA

The above issues and recommendations are discussed in detail in the Engagement Results section of this report.

**View of
Responsible
Official**

We requested and received a response from the Chief of the Division of Accounting. This official agreed with our findings and recommendations and has implemented procedures accordingly. For a copy of DofA's complete response, please see Attachment 1.



WILLIAM E. LEWIS
Assistant Director
Audits and Investigations

April 11, 2014

ENGAGEMENT RESULTS

Finding 1 - Misabeled or Incorrect Cost Components

We reviewed the cost components used in the rate calculation and found some mislabeled and incorrect cost components. Specifically, we found:

- 1) Employee Assistance Program (EAP) benefit costs were mislabeled as Medical Care Administration until August 2012. This had no effect on the overall Payroll Reserve Assessment Rate (PRAR) because EAP is an allowable employee benefit cost.
- 2) Medicare Tax was not identified as a benefit cost component in the PRAR for the engagement period. We were provided documentation showing that the benefit cost was combined with Old-Age, Survivors, and Disability Insurance under one cost code, and therefore, had no effect on the overall PRAR. In August 2012, staff began recording this benefit under its own cost code.
- 3) Salary Bonus benefit cost component was identified as employee awards and premium pay. These costs are considered non-payroll benefits that are recorded under one cost code. The Division of Accounting (DofA) makes monthly salary adjustments to credit the salary expense and recognize the salary bonus as a benefit expense.

According to the State Controller's Office (SCO) Payroll Procedures Manual there are many types of awards and premium pay benefits. However, we could not determine which specific types were included in the cost being recorded. Caltrans' Information Technology (IT) organizes the payroll expenditure information provided by SCO and prepares summarized reports. We identified that the summarized reports combined the two benefit cost components under one object code which was recorded in the Transportation Accounting Management System (TRAMS). This did not affect the PRAR.

When TRAMS was replaced by Advantage, staff requested that Caltrans IT include the specific costs in the summarized reports. The specific costs for awards are now being recorded, but the specific costs for premium pay are not identified because SCO does not separate out those costs in the payroll expenditure reports. Based on the SCO Payroll Procedures Manual, we determined that both costs are allowable in the PRAR calculation as staff benefits and do not affect the overall PRAR.

ENGAGEMENT RESULTS

**Finding 1 -
(continued)**

- 4) State Disability Insurance (SDI) is a program administered by the Employment Development Department. It is funded through employee payroll withholdings and no employer contribution is required. A reserve account was established for SDI and .80 percent was included in the PRAR calculated February 15, 2006, until the rate was revised in August 1, 2006. We determined this was not an allowable benefit because there was no employer contribution required. We calculated revised labor costs for all outstanding projects in the Los Angeles County Metropolitan Transportation Authority's (Metro) Schedule of Fringe Benefits Charged to Caltrans, by deducting the .80 percent from the PRAR established February 15, 2006, and we noted overstated costs of approximately \$2,119. The finding amount was immaterial and warranted no further review.
- 5) Furlough Leave was a mandatory unpaid leave established by the state in 2009 and ended in 2010. A benefit reserve account was established for furlough leave and the leave usage costs were included in the October 29, 2009, PRAR calculation. DofA management realized this was not a proper benefit and the cost was removed when the PRAR was revised in April 8, 2010. We calculated revised labor costs for all outstanding projects in Metro's Schedule of Fringe Benefits Charged to Caltrans, by deducting the furlough rate of 5.21 percent from the PRAR. The total amount overstated was approximately \$13,455 which is considered immaterial.

As noted in the table below, we reviewed all the variances in the PRAR rate for the years 2003 through 2010 and noted slight changes. We revised the PRAR by deducting the salary bonus, SDI and furlough benefit cost components and found that the effect was less than one percent with the exception of the furlough leave. None of the noted changes had a significant effect in the PRAR.

Date	Billed PRAR	Potentially Disallowed Benefit Costs				Revised PRAR
		SDI	Salary Bonus	Furlough	Total	
8/1/2003	54.45%	-	0.38%	-	0.38%	54.07%
2/1/2004	58.47%	-	0.27%	-	0.27%	58.20%
7/22/2004	60.62%	-	0.27%	-	0.27%	60.35%
7/1/2005	63.63%	-	0.25%	-	0.25%	63.38%
7/28/2005	61.74%	-	0.19%	-	0.19%	61.55%
2/15/2006	62.54%	0.80%	0.19%	-	0.99%	61.55%
8/1/2006	61.30%	-	0.13%	-	0.13%	61.17%
5/1/2008	54.31%	-	0.13%	-	0.13%	54.18%
11/1/2008	60.78%	-	0.13%	-	0.13%	60.65%
3/18/2009	69.48%	-	0.22%	-	0.22%	69.26%
5/15/2009	63.06%	-	0.16%	-	0.16%	62.90%
10/29/2009	59.91%	-	0.60%	5.21%	5.81%	54.10%
4/8/2010	56.16%	-	1.53%	-	1.53%	54.63%

ENGAGEMENT RESULTS

Recommendations

We recommend that DofA ensure:

1. Payroll benefit cost components are identified and properly labeled.
2. Payroll expenses in the PRAR meet the criteria as noted in the State Administrative Manual (SAM), and the Department of Finance's Uniform Code Manual.
3. Documentation is maintained to indicate the reason a benefit is added or removed from the PRAR.

DofA Response

The DofA agreed with the finding and has already taken corrective action. For a copy of the complete response, please see Attachment 1.

Finding 2 - Division of Accounting not Adhering to Caltrans' Record Retention Policy

Our engagement found that DofA is not complying with Caltrans' record retention policy. We were not able to determine DofA's policy for retaining the PRAR records because the PRAR records are not included as part of the records retention schedule.

Caltrans' Deputy Directive - 101 requires the retention of records, including electronic records based on a retention schedule. This Deputy Directive was developed based on Government Code section 14750 and SAM section 1600. It mandates that no departmental record shall be destroyed or disposed of by any state agency, without a record retention schedule unless the record was determined inappropriate for preservation in the state archives.

Although we found that documents to support the rate calculation for fiscal years 2004 to 2006 were not retained, we analyzed the PRAR for each cost component for fiscal years 2004 to 2009, and noted no significant changes to the rates. It is unclear why PRAR records were not part of the record retention schedule. However, during the time of our review, DofA stated that PRAR records will now be part of a revised record retention schedule.

Recommendation

We recommended that the DofA:

1. Revise the record retention schedule to include the PRAR records.
2. Retain PRAR records in accordance with Caltrans' Record Retention Policy.

DofA Response

The DofA agreed with the finding and has already revised the record retention schedule to include PRAR records. For a copy of the complete response, please see Attachment 1.

ENGAGEMENT RESULTS

Finding 3 - Inconsistent Communication Between Caltrans and FHWA

We noted that there was inconsistent communication between Caltrans' DofA and the Federal Highway Administration (FHWA) during the engagement period regarding their respective roles in the PRAR process.

FHWA conducted an audit in May 2006. The audit concluded that documentation was not maintained to support that FHWA's California Division approved the process and methodology used to develop the PRAR. Caltrans responded to the finding in a letter dated August 14, 2006, which included an attachment that described the methodology for calculating and applying the PRAR, and FHWA approved it.

According to DofA management, FHWA approved the methodology for calculating and applying the PRAR in August 2006 and they were not required to provide supporting documentation or advise FHWA when the PRAR changed, until 2009.

FHWA's June 2009 Federal-Aid Billing Review found that FHWA's California Division had not reviewed and approved the payroll additive rates adjusted periodically by Caltrans. FHWA recommended that:

1. Caltrans submit the current PRAR to FHWA's California Division, along with documentation supporting its history and methodology for review and approval.
2. Caltrans formally advise FHWA when the rate methodology is revised and FHWA's California Division review the methodology for cost eligibility compliance and grant approval as appropriate.

Caltrans implemented FHWA's recommendations and the DofA now has a process in place to advise FHWA when the PRAR is revised. As part of the process, DofA communicates with FHWA to discuss the proposed change to the PRAR and provides supporting documentation.

Recommendations

We recommend that DofA include steps in the PRAR's desk manual to notify FHWA when the PRAR is revised and to provide documentation to support the revised rate.

DofA Response

DofA's current desk procedures include steps to notify and obtain approval from FHWA. For a copy of DofA's complete response, please see Attachment 1.

Audit Team

Laurine Bohamera, Chief, Internal Audits
Juanita Baier, Audit Manager
Amy Norwood, Auditor

ATTACHMENT No. 1

Division of Accounting Response to Draft Report

Memorandum

*Serious drought.
Help Save Water!*

To: WILLIAM E. LEWIS
Assistant Director
Audits & Investigations

Date: April 22, 2014

From: CLARK PAULSEN
Chief
Division of Accounting



Subject: **DIVISION OF ACCOUNTING (DofA) RESPONSE- PAYROLL RESERVE ASSESSMENT RATE (PRAR)**

The Payroll Reserve Assessment Rate Engagement (Draft Report, File P4000-0393) included the following findings and recommendations from the scope of engagement period of July 1, 2003, to June 30, 2010:

Finding 1: Mislabeled or Incorrect Cost Components

Recommendation:

1. Payroll benefit cost components are identified and properly labeled.
2. Payroll expenses in the PRAR meet the criteria as noted in the State Administrative Manual (SAM), and the Department of Finance's Uniform Code Manual.
3. Documentation is maintained to indicate the reason a benefit is added or removed from the PRAR.

Response:

1. The mislabeled or incorrect cost components have been identified and corrected in the system.
2. The procedures have been updated to ensure the payroll expense in the PRAR meets the criteria as noted in the State Administrative Manual (SAM), and the Department of Finance's Uniform Code Manual (UCM).
3. The procedures have been updated to include the requirement to maintain supporting documentation indicating the reason a benefit is added to or removed from the PRAR.

Finding 2: DofA not Adhering to Caltrans' Record Retention Policy

Recommendation:

1. Revise the record retention schedule to include the PRAR records.
2. Retain PRAR records in accordance with Caltrans' Record Retention Policy.

Response:

1. DofA has revised the record retention schedule to include the PRAR records.
2. DofA will retain PRAR records in accordance with Caltrans' Record Retention Policy.

Finding 3: Inconsistent Communication Between Caltrans and FHWA

Recommendation:

Include steps in the PRAR's desk manual to notify FHWA when the PRAR is revised and to provide documentation to support revised rate.

Response:

The current PRAR desk procedure manual includes steps to notify and obtain approval from FHWA when there is a proposed PRAR revision and to provide documentation to support the revised rate.

If you have any questions or need additional information, please contact Lisa Kwong at (916) 227-9259.

- c: Laurine Bohamera, Chief, Internal Audits, A&I, Caltrans
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