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April 6, 2010

TO: All Architectural and Engineering Consultants
Doing Business with California Department of Transportation

RE: Revised Uniform Audit and Accounting Guide
Audits and Investigation

The American Association of State Highway Transportation Officials (AASHTO) has revised the Uniform Audit and Accounting Guide (Guide) for Audits of Architecture and Engineering (A&E) consulting firms. The Guide applies to all firms contracting with the California Department of Transportation (Caltrans) as a prime consultant or sub-consultant for engineering and engineering-related services under the Caltrans Division of Procurement and Contracts (DPAC) Request for Qualifications (RFQ) process. The purpose of this letter is to provide clarification and additional information related to the Guide. The Guide was originally published in December 2001 and then updated in September 2005; a major revision occurred with the most recent update which was published in February 2010.

The impetus for the current revision was from USDOT (US Department of Transportation) Office of Inspector General's (OIG) Audit on Oversight of A&E consulting firms' indirect cost claimed on federal-aid grants.

Among the OIG's audit findings were:

- Certified Public Accountants (CPAs) did not perform sufficient transaction testing.
- Unallowable costs and unallowable executive compensation were included in A&E consulting firms' overhead.
- Audit services were not effectively acquired.
- CPAs did not have relevant training.
- Oversight of CPAs' audits was not effective.

The OIG's audit recommended:

- Revision of Federal Highway Administration (FHWA) 23 Code of Federal Regulations (CFR) 172 to:
  1. Require A&E consulting firms to certify cost allowability.
  2. Provide states penalty assessment authority.
  3. Assign responsibility and accountability for overseeing CPA audits of A&E firms.
- Issue guidance for the A&E consulting firms' procurement of CPAs.
- Establish a process for monitoring and ensuring state implementation of National Highway System (NHS) 307.

As a result of OIG's audit and recommendations, AASHTO formed a task force made up of representatives from 14 State DOT audit agencies and FHWA to revise the Guide. Input for the Guide was solicited and provided by American Council of Engineering Companies (ACEC), public accounting firms, A&E consulting firms, American Institute of Certified Public Accountants (AICPA), and AASHTO's audit subcommittee members.

The purpose of the update is to ensure audits are conducted in accordance with the Federal Acquisition Regulations (FAR) and other applicable laws and regulations, improve audit consistency and quality, promote the recognition of a single cognizant audit, and improve government oversight and overall guidance.

The Guide is designed to be used as a tool by A&E firms, in addition to CPAs and State DOT auditors who perform audits and attestations engagements of A&E consulting firms. The revised Guide is a more comprehensive and effective tool that focuses on auditing and reporting procedures. The techniques discussed in the Guide were designed to be applied to audits performed in connection with A&E Consultants' Statement of Direct Labor, Fringe Benefits and General Overhead, as well as the related accounting systems, job-costing systems, and labor-charging systems that serve as the basis for the overhead schedule(s).

The Guide was published in February 2010. With the exception of the National Compensation Matrix (NCM), which FHWA is developing, all the information and procedures in the Guide are based on current regulations; thus the effective date of the Guide will be the date published. FHWA intends to have the Guide made part of the federal regulation by reference once the federal rule making process is completed.

Some of the key points and clarifications regarding the Guide are:

- The Guide includes improved guidance in the determination of reasonable compensation costs. It provides a process for demonstrating reasonableness that A&E consulting firms should follow to prepare their own independent compensation analysis. This process is outlined in Chapter 7 of the Guide. It is

the firm's responsibility to prepare an analysis to support the reasonableness of claimed compensation costs in accordance with FAR 31.205-6. Typically, this analysis focuses on executive positions because those positions comprise the highest compensation levels and are a significant area of audit risk. In the case where an A&E consulting firm does not do its own independent compensation analysis, a National Compensation Matrix (NCM), which is being developed by FHWA, will provide parameters for reasonableness of executive compensation.

- The Guide discusses A&E consulting firms' management and CPAs' roles and responsibilities. The A&E consulting firms' management is responsible for representations of the firm's accounting records, including identifying, segregating, and removing unallowable cost from all billings to Government contracts. The selection of a CPA for an overhead audit is also discussed.

- AASHTO's approval of the Guide solidifies the agreement between states to follow the Guide's common interpretations of a "FAR Compliant" audit, thus eliminating state-specific overhead policies, except in cases where state-specific rules are supported by statute or state law.

- Caltrans will perform cognizant audits of in-state firms based on risks and as audit resources allow. However, nationally and regionally, there will be a greater reliance on CPA audits. Larger national A&E consulting firms may involve team-cognizant approvals with multi-states involved in the review of the CPA's work papers. For in-state firms that contract in multiple states, there may be a need for some firms to have a CPA audit to meet requirements for other State DOTs.

- Other highlights of the Guide include a definition and guidance on what a cognizant audit is, minimum audit requirements to be considered for a "FAR Compliant" audit, a CPA work paper review program, cost accounting and field rate development, detailed discussion on select areas of costs, a standardized internal control questionnaire (for all DOTs to use), detailed guidance and tools to assist in determining allowable or unallowable costs, and audit reports and minimum disclosure requirements.

Benefits of the revised guide are:

- The revised Guide is more comprehensive and a more effective tool for DOTs, A&E firms, and CPAs to use.

- The revised Guide provides clarifying guidance on complex or confusing areas of the FAR to promote a consistent interpretation in producing a FAR compliant audit.

- The revised Guide allows cognizance to move forward by providing guidance and clarity. Firms should be able to produce one single audit using a FAR-based audit approach and receive a cognizant letter that will be accepted by all states.

A copy of the Guide may be reviewed on AASHTO's website at:

http://www.transportation.org.

The Caltrans Audits and Investigations Office will comply fully with the interpretation and guidance included in the revised Guide. We intend to work closely with all A&E consulting firms and CPAs as the Guide is implemented.

Thank you for your cooperation in working with Caltrans as the Guide is put into effect.

Sincerely,

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