



**Government Relations & Public Affairs Committee**

May 31, 2016

**Caltrans Incurred Cost Audit**

**Issue:** SACOG has received a draft Incurred Cost Audit from Caltrans.

**Recommendation:** None; this item is for information only.

**Discussion:** In 2012, Caltrans Audits and Investigations (Audits) began an audit of SACOG focused on \$6.9 million in incurred costs from July 2011-April 2014, agreements with Caltrans and Placer County Transportation Planning Agency from fiscal year 2012, and consultant contracts procured prior to fiscal year 2012. SACOG has yet to receive a final audit report from Audits, but staff wanted to brief the committee on draft information shared with SACOG.

Audits has informed SACOG that it intends to submit a final audit report in June. Based on draft information shared by Audits in March, SACOG staff acknowledges that there were technical errors in some of its procurements and contract management, but it also has significant disagreements with the proposed findings and conclusions. Since that time, staff has worked to validate the audit findings. In April, SACOG hired Diane Eidam as a retired annuitant to assist with that effort, and to lead an internal compliance review of SACOG's policies and procedures. Ms. Eidam previously served as the Chief of Audits and Investigations at Caltrans. She has also worked as an executive at SACOG's peer agencies in San Diego and Monterey, and served as Executive Director of the California Transportation Commission.

With the assistance of Ms. Eidam and SACOG's outside counsel (Renne Sloan Holtzman Sakai), staff sent a response letter to Audits earlier this month. Staff hopes that Audits will reflect that response in its final report. As Audits has not issued its final report as of this writing, this staff report summarizes the issues raised by Audits and SACOG's response.

***Overview***

SACOG appreciates the important oversight role of Caltrans Audits and Investigations in ensuring that state and federal funds are used properly, and that state and federal regulations are followed. From the first arrival of the audit team at SACOG nearly five years ago, management expressed its commitment to work with the audit team to ensure the proper use of state and federal funds, to comply with state and federal regulations, and to improve SACOG's policies, procedures, and oversight. Management asked the audit team to communicate with it when the audit team identified areas for improvements. However, the audit stretched out over four years, and communication was less than ideal.

For example, Audits proposes to disallow approximately \$2.1 million in costs, much of it incurred after alleged defects were identified, but no effort was made to work with SACOG staff to immediately correct the alleged problems and thereby minimize the funds at risk. The recommendation to reimburse funds comes for the first time in 2016, over four years after the audit started and a year and a half after the audit field work ended. It is hard to reconcile a good faith belief that taxpayer dollars were being misspent with this course of

action.

In other instances, information presented by SACOG was simply disregarded and the proposed findings and conclusions are incorrect. Audits concludes that a SACOG employee had an impermissible conflict of interest in overseeing contracts with UC Davis, but there is no evidence that the employee ever received compensation from UC Davis. Another major proposed conclusion is that an engineering contract was improperly procured. That contract, although provided to an engineering firm, was not for engineering services, and outside legal counsel determined that these non-engineering consultant services are not subject to the federal law cited by Audits. The broad-brush implications of systemic issues, based on a sampling of procurements, is misleading and inaccurate.

Staff believes that SACOG complied with the intent of the law and oversight regulations; SACOG ensured that taxpayer dollars were expended fairly and that taxpayers received high value for the dollars expended. Nevertheless, staff acknowledges that SACOG can and must improve its processes—and many changes have been implemented since the audit began in 2012. A summary of the improvements that SACOG already has implemented is attached.

The audit findings are not unique to SACOG. Transportation agencies and cities and counties around the state have received similar findings. A recent Caltrans study of 29 local agencies found significant non-compliance across the agencies.

### *Summary of findings and staff responses*

The following summarizes the major issues raised and SACOG staff's response:

#### 1. Improper Procurement Practices

Audits sampled five consultant contracts and alleges that SACOG did not perform fair and open competition, or did not follow proper procedures. Audits further alleges that an engineering services contract improperly used price as an evaluation factor. Audits also questioned whether the Board approved certain contracts. Audits recommends several improvements be implemented by SACOG. Audits further recommends that SACOG reimburse \$1,289,888 incurred on these contracts.

Most importantly, SACOG already has implemented all of the procurement recommendations proposed by Audits, and more. Staff believes that most of the issues raised are technicalities, and that it is unfair and unreasonable to recommend repayment for the entirety of these contracts. Some of the specifics raised included that SACOG did not place legal notices in newspapers to advertise Requests for Proposals. Instead, RFPs were posted to SACOG's website and distributed to over 2,000 subscribers. Staff does not believe that there is a nexus between the technical errors identified and the issue of whether appropriate value was received for the funds expended. Staff has performed additional analyses to ensure that fair and reasonable compensation was paid for the products and services received. SACOG received independent legal advice that the finding regarding the engineering services contract is a misapplication of the law. Finally, with respect to Board action on contracts, SACOG board minutes show that four of the five contracts were approved by the Board. In the one case where it was not, the Board had expressly delegated approval to the CEO, in consultation with Board leadership.

#### 2. Inadequate Contract Management

Audits found various issues with contract administration. Audits recommends that SACOG reimburse \$828,895 for a single contract, and \$679,210 in contracts already identified above.

Again, SACOG has implemented all of the contract management recommendations and more. During the course of the audit, SACOG and Audits had a fundamental disagreement about the validity of a contract if it is amended after the initial contract date expires. SACOG was advised by counsel that it could amend the expired contracts, if both parties agreed, and establish new effective dates for the contracts. SACOG subsequently was made aware of a sentence in the Caltrans Local Assistance Program Manual that does not allow this. As with the prior finding, however, staff believes that the reimbursement recommendation is out of proportion to the error made. SACOG entered into legally binding and otherwise permissible amendments, received full and fair value for those contracts, and was able to deliver critical projects for the SACOG region by implementation of the contract amendment work.

### 3. Lack of Monitoring of Sub-Recipient Pass-Through Funds

Audits alleges that SACOG did not properly monitor funds passed through to five public agencies (subrecipients). Audits found that SACOG should have subrecipient agreements in place and policies and procedures on how to manage subrecipient agreements. Audits recommends that SACOG reimburse \$80,803.

During the period audited, SACOG was not adequately overseeing the monitoring of subrecipient agreements by project managers. However, SACOG can demonstrate that work was performed consistent with the intended purpose, and SACOG provided quarterly reports to Caltrans on this work as part of its regular OWP reporting. For these reasons, staff believes that the recommendation to reimburse all funds under these projects is inappropriate. Staff does agree that SACOG should reimburse \$26,591 in fees and charges on one subrecipient agreement.

### 4. Conflict of Interest

Audits alleges that SACOG did not enforce its Conflict of Interest Policy. Staff disagrees with the basis of this finding, that Gordon Garry, Director of Research and Analysis, had a conflict of interest under SACOG's Code of Conduct, which was adopted pursuant to state and federal requirements. Based on analysis by outside legal counsel, Mr. Garry was not employed by UC Davis, but rather remained solely employed by SACOG while on a temporary assignment to UC Davis performing SACOG work. Consequently, Mr. Garry's temporary assignment to UC Davis did not create an impermissible conflict of interest.

### 5. Unallowable Costs

Audits identified \$2,629 in costs for food and travel costs that were not eligible for state funding. Staff agrees that SACOG should reimburse \$1,225 in food costs, and SACOG has implemented new processes to ensure that costs are only billed to eligible funding sources. With regard to the travel costs, Audits improperly concludes that \$1,404 was for lobbying, which is not reimbursable, but the travel was related to an event hosted by the National Association of Development Organizations (NADO) to share the research SACOG conducted as part of its Rural-Urban Connections Strategy.

### 6. Inadequate Policies and Procedures

Audits recommends that SACOG develop and implement written policies and procedures, and train staff on: required supporting documentation on billed costs and local match; invoice review and approval; time sheet submittal and approval; and reimbursement of cell phone costs.

SACOG has implemented all of these recommendations. SACOG is following all recommendations for documenting incurred and billed costs and local match. Project managers are reviewing submitted invoices for compliance with all state and federal, as well as local match, requirements, including all supporting

documentation required by the grant/contract. In addition, accounting staff are reviewing these for compliance, and claims are reviewed and approved by the Finance Manager before submission for payment. In August 2014, SACOG implemented a new accounting system that requires staff to submit weekly electronic timesheets. Project managers review and approve the time on at least a monthly basis. This replaced SACOG's previous paper-based, monthly system. This new process was documented in a written August 2014 policy and is covered in new employee orientations and will be reviewed annually by SACOG management.

In January, SACOG implemented a formal cell phone policy. Prior to that, each employee who received reimbursement for cell phone use had an individual memo on file from a supervisor or the Board of Directors authorizing reimbursement for business purposes.

*Next steps*

Once Audits submits a final report to SACOG, any recommended reimbursements are subject to negotiation between SACOG and Caltrans at a future date.

Staff has made an organizational commitment to fully address all of the issues identified and has asked Audits to work with SACOG to conduct future trainings and to continually improve our practices. SACOG's organizational values include professional excellence and innovation, and we want to both comply with Audits' requirements and be a leader in delivering excellent value for the state and federal taxpayers who fund our work.

Approved by:

Mike McKeever  
Chief Executive Officer

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Attachment

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In 2011, SACOG identified the need to improve and strengthen its internal operations and controls. The result was the establishment of a new position and the hiring of a new Chief Operating Officer/General Counsel in April 2011. Not long after that, Audits and Investigations commenced its ICAP and, subsequently, incurred cost audits. Particularly because of the organizational changes and its desire to improve internal operations and controls, SACOG management met with the audit team and expressed SACOG's commitment to work with the audit team to improve our policies, procedures, and oversight. We specifically asked the audit team to communicate with us immediately when they identified areas for improvements.

In the subsequent years, both on its own and in response to issues raised by Caltrans Audits and Investigations, SACOG undertook a series of actions designed to improve our policies, procedures, oversight, and training. The following is an outline of some of these actions.

- In late December 2012, SACOG implemented a new organizational teaming plan, a principal component of which was strengthening the role of the project managers in the organization. As a result, a series of training sessions and regular meetings with project managers focused on improving project management and oversight skills.
- In December 2012, when notified of the omission, SACOG commenced publishing all procurements in a local newspaper.
- In July 2013, SACOG updated its Purchasing Policies and Procedures to provide staff direction and tools to conduct proper procurements. The update included, among other things, requirements for cost/price analysis, documentation of the history of each procurement, documentation of telephone quotes, guidelines for interview criteria, and Board approval of RFPs.
- In July 2013, SACOG added scoring weights and values to its RFP templates.
- In January 2014, SACOG created a position of Manager of Policy and Administration, whose responsibilities include development, evaluation, and implementation of policies and procedures.
- In April 2014, SACOG conducted a mandatory, all-staff contracts training.
- In August 2014, SACOG replaced its legacy accounting system with a new web-based accounting system, Ajera, which provides detailed information and reports to project managers to assist them in managing their projects.
- In August 2014, SACOG hired an accountant with extensive state and federal grants experience to replace the incumbent, who retired.
- In November 2014, SACOG introduced a new Travel Policy and Procedures that fully complies with state and federal requirements. SACOG also joined the Statewide Travel Program, offered through the Department of General Services, which provides detailed expenditure tracking and assists with adhering to state travel requirements. SACOG also

identified a staff person to be the travel coordinator to assist with policy compliance. SACOG staff also received training, and new staff receive training when hired.

- In June 2015, continuing its focus on improving project management and oversight, SACOG created a Project Management Office and assigned a management employee to assist project managers with training and resources to more effectively manage projects. This included a toolkit of uniform tools and reports that allowed project managers to provide status reports to management and identify clear roles and responsibilities for projects and tasks within projects. SACOG also began holding monthly team/project manager meetings to provide training and assistance to team/project managers, and to communicate about policies and procedures related to project management.
- In September 2015, SACOG took additional steps to improve its procurement processes. SACOG hired new staff specifically dedicated to procurement, contract, and grant administration. SACOG also hired an experienced accountant who was working for Caltrans to join the Finance Team. SACOG revised its contract templates to include requirements specified in the Local Assistance Program Manual, the Master Fund Transfer Agreement, and 2 CFR, Part 200. The format and example of a cost proposal was added to the RFP template at that time.
- In January 2016, SACOG adopted a new Cellphone Policy.
- In February 2016, SACOG migrated its RFP/RFQ notification system to Public Purchase, a national platform for vendor management used by over 10,000 government agencies. Public Purchase provides a larger pool of potential bidders with notice of bid opportunities with SACOG. It also provides SACOG with more detailed reports on bids.
- In March 2016, upon receipt of the draft audit report, SACOG hired Diane Eidam as a retired annuitant to lead a further internal compliance review. Ms. Eidam has extensive experience as the former Chief of Audits and Investigations at Caltrans, former Executive Director of the California Transportation Commission, and has served in several executive roles at other regional transportation agencies in California.
- In April 2016, SACOG held a mandatory training for all staff on procurement and contracts led by Jack Pelligrino, a statewide expert on procurement and the Director of Procurement for San Diego County. Mr. Pelligrino teaches procurement and contracts for San Diego State University and for the California State Association of Counties Institute.
- Continuing its commitment to ensuring that its procurement processes and procedures are compliant with state and federal regulations, SACOG staff have prepared another revision to its contract policies and procedures, including subrecipient agreements, which will be brought to the SACOG Board for approval in August 2016. The policies and procedures will include appendices that will ensure that procurements are performed and documented correctly.

## Summary of Organizational Improvements Implemented

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- A team of SACOG staff is conducting a process improvement mapping exercise for all contracting and procurements to provide better tools and training for all staff, and to identify potential organizational changes to ensure compliance. Going forward, SACOG staff will receive an annual refresher on policies and procedures, and new project managers will receive one-on-one assistance.
  
- In addition to the trainings mentioned above, SACOG has the following ongoing training programs planned for 2016:
  - Contracts management for all team managers, which includes a review of state and federal requirements related to contracts and grant funds (Summer 2016);
  - Subrecipient requirements and monitoring (Summer 2016);
  - New purchasing policies and procedures, as soon as they are approved by the SACOG Board (Summer 2016);
  - Project status reporting, including budget reporting (Summer 2016);
  - Accounting for project time and management of staff time budgets (Fall 2016); and
  - Supervisor training (Summer/Fall 2016).