



Florida Department of TRANSPORTATION

Office of Inspector General
Robert E. Clift, Inspector General

A handwritten signature in blue ink, reading "Robert E. Clift", is positioned to the right of the printed name.

Audit Report No. 17I-1001

December 15, 2016

CSX Transportation, Inc. 2014 Labor Additive and Indirect Cost Rates

What We Did

The Florida Department of Transportation's (department) Office of Inspector General (OIG) reviewed the 2014 surcharge, overhead and indirect construction cost rates (indirect rates) submitted by CSX Transportation, Inc. (CSXT) to determine if the rates are reasonable, allocable and allowable. We also reviewed CSXT's supporting records and procedures to determine whether they are transparent and readily understandable. We reviewed an independent audit prepared by Ernst & Young LLP (EY)¹ regarding the rates, inspected EY's audit workpapers, interviewed EY and CSXT staff members, and performed a walk-through of CSXT's rate preparation procedures.

What We Found

We observed CSXT has made substantial investments to update its accounting system, streamline its cost allocation procedures, and enhance the documentation supporting its rate calculation process. **We determined** CSXT's accounting procedures meet the visibility rule set forth in Title 48 Code of Federal Regulations (CFR) Part 9904 – Cost Accounting Standards (CAS) Section 9904.405-50², which requires transparent and readily understandable records and procedures regarding the classification of expenses as allowable or unallowable. **We also determined** the EY audit team possessed sufficient qualifications, performed sufficient test procedures, and prepared sufficient documentation to support EY's audit opinion regarding CSXT's 2014 indirect cost rates.

We determined the rates submitted by CSXT³ are reasonable, allocable, and allowable for use in billing railroad-highway projects.

What We Recommend

We recommend the department's Rail Office review and approve CSXT's 2014 indirect cost rates for use in billing costs for railroad-highway project and communicate this decision to the Federal Highway Administration (FHWA).

¹ Included as Appendix C.

² Only those portions of 48 CFR 9904 CAS incorporated by reference into the Federal Acquisition Regulation (FAR) apply to CSXT.

³ Included as Appendix B.

**Office of Inspector General
Florida Department of Transportation**

TABLE OF CONTENTS

BACKGROUND AND INTRODUCTION	3
RESULTS OF REVIEW	4
USE OF REVIEW AND INDEPENDENT AUDITOR’S OPINION	6
APPENDIX A – Purpose, Scope, and Methodology	7
APPENDIX B – Schedule of CSXT Rates by Craft	8
APPENDIX C – Report of Independent Certified Public Accountant (page 1 of 19)	9
APPENDIX D – Affected Entity Response	28
APPENDIX E – Management Response	29
DISTRIBUTION	30
PROJECT TEAM	31
STATEMENT OF ACCORDANCE	31

BACKGROUND AND INTRODUCTION

CSXT is the third-largest railroad operating in the United States, providing traditional freight and intermodal carrier services. Its service region spans 23 states, the District of Columbia, and two Canadian provinces, ranging from the Province of Quebec to the State of Louisiana. The service region covers the entire Eastern seaboard and most of the region east of the Mississippi River. Its rail network spans 21,000 route miles (the equivalent of 40,000 total track miles).

Both CSXT and its parent company, CSX Corporation (CSX), are headquartered in Jacksonville, Florida. CSX is a publicly traded corporation subject to Securities and Exchange Commission (SEC) reporting requirements.

Title 23, Part 646-Railroads, Subpart B-Railroad Highway Projects, allows federal participation in railroad/highway crossing projects. Title 23, Part 140-Reimbursement, Subpart I-Reimbursement for Railroad Work, provides guidance for reimbursable costs, including labor, materials, and equipment. Under 23 CFR 140.906, railroads may elect to apply labor surcharges to recover certain costs, such as fringe benefits and worker compensation insurance. However, the surcharge rates must be based on historical data, approved by the State Highway Agency (SHA) and Federal Highway Administration (FHWA), and adjusted annually to correct for variances between applied and actual costs from the previous year.

Under 23 CFR 140.907, SHAs may also elect to reimburse railroads for overhead and indirect construction costs. These costs are recovered by rates applied over an equitable base, such as direct labor hours. To be eligible for inclusion in the rates, costs must meet the requirements of the Federal Acquisition Regulation (FAR). In addition, rates must be approved by the SHA and FHWA and supported by records:

...readily available at a single location which adequately support the costs included in the distribution, the method used for distributing the costs, and the basis for determining additive rates. (23 CFR 140.907(b)(5))

The detail and depth of records required as backup support...shall be that which is adequate to establish and maintain visibility of identified unallowable costs (including directly associated costs), their accounting status in terms of their allocability to contract cost objectives, and the cost accounting treatment which has been accorded such costs. (48 CFR 9904.405-50(a))

RESULTS OF REVIEW

Based on our review of CSXT's rate calculation procedures and supporting documentation, we determined CSXT meets the 48 CFR 9904.405-50(a) visibility rule. Based on our walkthrough of CSXT's procedures and review of EY's workpapers, we determined the rates submitted by CSXT are reasonable, allocable, and allowable for use in billing railroad-highway projects.

Basic Composition of Rates

CSXT distributes costs by craft (Mechanical, Engineering, Transportation, and General Office) and management code (department). For the primary crafts (Mechanical, Engineering and Transportation), CSXT calculates separate rates using direct union labor and overtime charged to craft-specific departments as its base. For General Office costs, which include general administrative and fixed asset costs such as depreciation, CSXT uses direct union labor and overtime charged to all departments as its base. Finally, CSXT uses standard additive rates for the following costs:

- Material handling costs—flat rate of 5% (as permitted by 23 CFR 140.908(e).
- Force account (protective liability) insurance (as required by 23 CFR 646.107)—flat rate of 16%, based on actual cost.

The total rate applied will be the sum of the applicable primary craft rate (Mechanical, Engineering or Transportation), the standard additive rates, and (depending on SHA elections), the full General Office rate.

CSXT Accounting System

The backbone of CSXT's accounting system is a relational database that supports detailed project costing for both internally and externally funded projects. Multiple payroll feeder systems link into the centralized accounting system. Direct labor and overtime are charged by project number and task within the feeder systems before being posted to the parent system. To capitalize the full project cost, the parent system uses the project number and task to look up the corresponding indirect rate before moving the combined total to its final destination balance sheet account. These entries are identified by specific codes for transaction type, and can be reversed by query at year-end to re-compile total costs by income statement (operating expense) account for purposes of calculating next year's rate.

During a 2014 system update, CSXT added a new table to capture its classification of operating expense accounts as allowable, unallowable, or voluntarily excluded for purposes of its rate calculation. As confirmed by EY's testing, CSXT conducted extensive sampling and analysis to support its classification decisions.

Rate Calculation Procedures

CSXT applies a stepdown process from its total expenditures, reported as a separate column in its parent company's 10-K Report, to expenditures included in its rate calculation as follows:

1. CSXT itself serves as a parent company to multiple subsidiaries. The first step in its calculation process involves excluding subsidiary balances from total CSXT expenditures.
2. CSXT also excludes multiple departmental balances in their entirety. For example, it excludes the procurement department which would otherwise include the material handling costs covered by the corresponding standard additive rate.
3. Classify account balances for remaining departments as allowable, unallowable or voluntarily excluded (i.e., allowable types of costs incurred by an operational area which does not benefit chargeable projects either directly or indirectly).
4. Review allowable balances for additional adjustments.

Additional Observations

Equipment Rental

CSXT uses company-owned and rental equipment interchangeably on its projects. Typically, 23 CFR 140.910(b) requires rental equipment costs to be treated as direct costs, but allows for exceptions "where doing so would be impractical." Similarly, 48 CFR 31.202(b) FAR allows direct costs to be treated as indirect costs "for reasons of practicality" where amounts, as well as overall impact, are minor.

Based on the fact that CSXT's equipment rental costs accounted for 0.6% or less of total claimed costs between 2011 and 2014, CSXT includes them in its indirect rate (along with ownership/usage costs). Based on guidance received from FHWA in a letter dated January 5, 2016, we determined this treatment to be permissible.

Sampling Adjustments

During the calculation of its 2014 rates, CSXT applied sampling adjustments to revise some of its allowable account balances downwards. 48 CFR 31.201-6(c)(2) FAR states:

Statistical sampling is an acceptable practice for contractors to follow in accounting for and presenting unallowable costs provided...(i) The statistical sampling results in an unbiased sample that is a reasonable representation of the sampling universe...(ii) Any large dollar or high risk transaction is separately reviewed...(iii) The statistical sampling permits audit verification.

We determined CSXT's sampling procedures, as confirmed by EY's testing, met these requirements.

Independent Audit Report

For the year ended December 26, 2014, EY audited CSXT's financial statements, Single Audit (federal and State of Florida), and indirect rate audits in accordance with Generally Accepted Government Auditing Standards (GAGAS). We determined the EY engagement team members had sufficient training per GAGAS. We also determined EY's audit planning and testing supported its rate determination opinion.

USE OF REVIEW AND INDEPENDENT AUDITOR'S OPINION

Neither this review nor EY's audit opinion replace the need for the Rail Office and other SHAs to review direct costs incurred by CSXT for compliance with project plans, contracts, and applicable regulations. The Rail Office and other SHAs are responsible for evaluating the accuracy of CSXT's invoices through independent inspection of project construction records prepared by the funding agency.

APPENDIX A – Purpose, Scope, and Methodology

The **purpose** of this engagement was to determine whether CSXT's:

- fiscal year 2014 indirect rates are reasonable, allowable, and adequately supported.
- supporting records and procedures are transparent and readily understandable.

The **scope** of this audit consisted of the proposed 2014 indirect rates submitted by CSXT and associated records and supporting documentation, including EY's audit opinion.

The **methodology** included:

- Reviewing relevant regulations, including (but not limited to) 23 CFR 140, 23 CFR 646, and 48 CFR 31 FAR;
- Reviewing CSXT's procedures and rate preparation checklists;
- Re-performing key steps in CSXT's rate preparation procedures;
- Analyzing rate preparation data;
- Reviewing the AASHTO Program for CPA Audits of Consulting Engineers' Indirect Cost Rates and comparing underlying requirements to those impacting railroad indirect cost rates;
- Reviewing EY engagement staff training records;
- Reviewing EY audit plans and workpapers.

Office of Inspector General
Florida Department of Transportation

APPENDIX B – Schedule of CSXT Rates by Craft

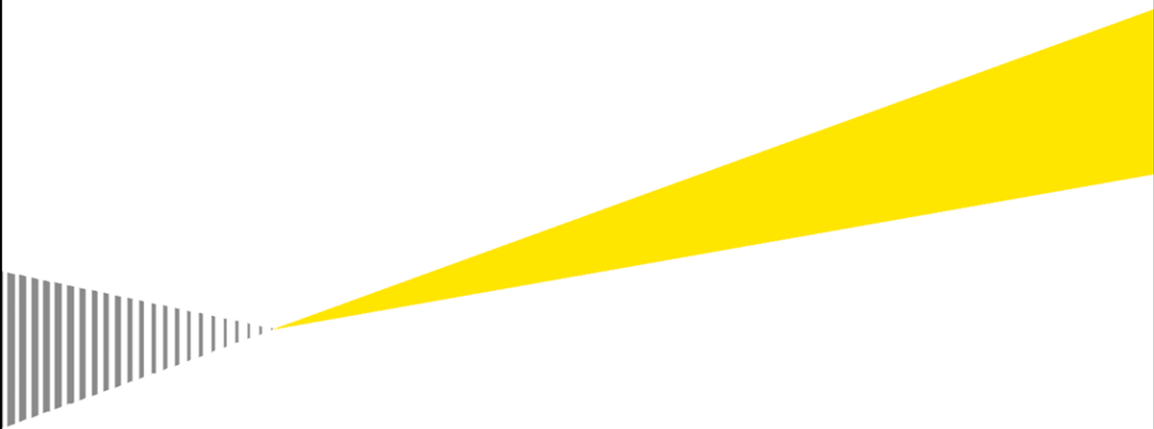
Component	Engineering	Transportation	Mechanical
Craft Cost Pool			
Fringe	32.3%	51.3%	33.0%
Payroll Taxes	22.3%	29.2%	22.7%
Project Management	18.1%	20.7%	17.2%
Department Support Costs	16.0%	13.8%	7.6%
Small Tools, Safety & Supplies	5.6%	3.2%	27.0%
Training	0.6%	8.2%	3.4%
Collective Bargaining Agreement	5.1%	22.0%	0.6%
Vehicle and Equipment	25.7%		
<i>Craft Subtotal</i>	125.7%	148.4%	111.5%
Standard Additives			
Force Account Insurance	16.0%	16.0%	16.0%
Materials Handling	5.0%	5.0%	5.0%
<i>Standard Additive Subtotal</i>	21.0%	21.0%	21.0%
General Office Cost Pool			
Fixed Costs	19.6%	19.6%	19.6%
General and Administration	19.1%	19.1%	19.1%
<i>General Office Subtotal</i>	38.7%	38.7%	38.7%
Total Rate	185.4%	208.1%	171.2%

Source: Internally compiled by OIG from CSXT's Schedule of Direct Labor and Indirect Cost Rates for Year Ended December 26, 2014 (as incorporated into EY audit report attached as Appendix C).

CSX Transportation

Schedule of Direct Labor and Indirect Cost Rates Package

June 24, 2016



Building a better
working world

Office of Inspector General
Florida Department of Transportation

APPENDIX C – Report of Independent Certified Public Accountants (page 2 of 19)

Table of contents

02	Report of Independent Certified Public Accountants
04	Schedule of Direct Labor and Indirect Cost Rates Calculated in Accordance with Part 31 of the Federal Acquisition Regulations and Section 112.061 of the Florida Statutes
05	Notes to Schedule of Direct Labor and Indirect Cost Rates Calculated in Accordance With Part 31 of the Federal Acquisition Regulation and Section 112.061 of the Florida Statutes
17	Report of Independent Certified Public Accountants on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

**Office of Inspector General
Florida Department of Transportation**

APPENDIX C – Report of Independent Certified Public Accountants (page 3 of 19)



Ernst & Young LLP
Suite 1701
One Independent Drive
Jacksonville, FL 32202

Tel: +1 904 358 2000
Fax: +1 904 358 4598
ey.com

Report of Independent Certified Public Accountants

Chief Executive Officer, Chief Financial Officer, and Audit Committee
CSX Corporation

Report on the Schedule

We have audited the accompanying Schedule of Direct Labor and Indirect Cost Rates (Schedule) of CSX Transportation (CSX) as of December 26, 2014 and for the year then ended.

Management's Responsibility for the Schedule

Management is responsible for the preparation and fair presentation of the Schedule in conformity with the provisions prescribed in Part 31 of the Federal Acquisition Regulations and Section 112.061 of the *Florida Statutes*. Management also is responsible for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the Schedule that is free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the Schedule based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Schedule is free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Schedule. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Schedule in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates, made by management, as well as evaluating the overall presentation of the Schedule.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Office of Inspector General
Florida Department of Transportation**

APPENDIX C – Report of Independent Certified Public Accountants (page 4 of 19)



Opinion

In our opinion, the Schedule referred to above presents fairly, in all material respects, the direct labor and indirect cost rate calculations of CSX at December 26, 2014 and for the year then ended in conformity with the provisions prescribed in the Part 31 of the Federal Acquisition Regulations and Section 112.061 of the *Florida Statutes*.

Basis of Accounting

The Schedule was prepared by CSX in conformity with the provisions prescribed in the Part 31 of the Federal Acquisition Regulations and Section 112.061 of the *Florida Statutes*, which is a basis of accounting other than U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 11, 2015 on our consideration of CSX Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering CSX Corporation's internal control over financial reporting and compliance.

Restriction on Use

This report is intended solely for the information and use of the audit committee, management and various Federal agencies providing funding to the organization and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

June 24, 2016

**Office of Inspector General
Florida Department of Transportation**

APPENDIX C – Report of Independent Certified Public Accountants (page 5 of 19)

CSX Transportation, Inc.
Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal Acquisition
Regulation and Section 112.061 of the *Florida Statutes*
For Year Ended December 26, 2014

Component	Operating Expense G/L Balance	Recapture of Capitalized Costs	A Unallowable	B Voluntarily Excluded	C Adjustments	Claimed Costs	Indirect Rate
Engineering Direct Labor Base	\$280,064,299	\$230,510,951	-	-	(\$3,091,853)	\$507,483,397	100.0%
Engineering Cost Pools							
Fringe	87,732,304	79,661,630	-	(1,447,347)	(1,914,108)	164,032,479	32.3%
Payroll Taxes	63,697,284	49,503,153	-	-	-	113,200,437	22.3%
Project Management	72,127,537	19,706,172	-	-	(1,020)	91,832,989	18.1%
Department Support Costs	225,708,187	11,047,931	(10,851,828)	(161,484,227)	16,972,964	81,393,027	16.0%
Small Tools, Safety & Supplies	32,932,101	5,880,827	(24,050)	(10,090,040)	(513,871)	28,184,967	5.6%
Training	2,796,572	82,980	-	-	-	2,879,552	0.6%
Collective Bargaining Agreement	27,552,019	106,237	(1,199,138)	(607,486)	-	25,851,632	5.1%
Vehicle and Equipment	74,456,578	58,082,540	(324,335)	(3,796,033)	1,993,723	130,412,473	25.7%
Subtotal	\$587,002,882	\$224,071,470	(\$12,399,351)	(\$177,425,133)	\$16,537,688	\$637,787,556	125.7%
Transportation Direct Labor	\$743,324,219	\$5,862,821	-	-	(\$1,566,140)	\$747,620,900	100.0%
Transportation Cost Pools							
Fringe	397,279,701	1,837,322	(405)	(9,602,882)	(6,083,893)	383,429,843	51.3%
Payroll Taxes	216,768,655	1,254,865	-	-	-	218,023,520	29.2%
Project Management	152,085,082	2,333,636	-	-	(2,278)	154,416,440	20.7%
Department Support Costs	1,715,971,890	284,293	(3,597,792)	(1,607,589,345)	(1,583,119)	103,485,927	13.8%
Small Tools, Safety & Supplies	25,265,979	-	(33,458)	(1,412,339)	(115,005)	23,705,177	3.2%
Training	61,452,478	39,811	-	-	-	61,492,289	8.2%
Collective Bargaining Agreement	167,475,076	189,581	(3,068,007)	(56,214)	-	164,540,436	22.0%
Subtotal	\$2,736,298,861	\$5,939,508	(\$6,699,662)	(\$1,618,660,780)	(\$7,784,295)	\$1,109,093,632	148.4%
Mechanical Direct Labor	\$237,751,418	\$11,533,369	-	-	(\$311,422)	\$248,973,365	100.0%
Mechanical Cost Pools							
Fringe	81,904,468	2,924,397	-	(1,051,337)	(1,627,124)	82,140,404	33.0%
Payroll Taxes	54,222,981	2,262,238	-	-	-	56,485,219	22.7%
Project Management	9,033,512	1,421,992	-	32,302,045	(29)	42,757,320	17.2%
Department Support Costs	277,566,312	539,805	(872,872)	(256,681,901)	(1,629,043)	18,922,301	7.6%
Small Tools, Safety & Supplies	193,664,585	-	(63,679)	(152,631,498)	26,348,472	67,317,880	27.0%
Training	8,443,554	1,070	-	-	-	8,444,624	3.4%
Collective Bargaining Agreement	2,037,451	284	(307,329)	(297,313)	-	1,433,093	0.6%
Subtotal	\$626,872,663	\$7,149,786	(\$1,243,880)	(\$378,370,004)	\$23,092,276	\$277,500,841	111.5%
General Office Direct Labor	\$1,261,139,936	\$247,907,141	-	-	\$33,453,631	\$1,542,500,708	100.0%
General Office Cost Pools							
Fixed Costs	1,137,674,853	-	-	(938,249,747)	2,174,087	301,599,193	19.6%
General and Administration	1,661,481,598	-	(116,252,838)	(1,262,674,599)	12,311,443	294,865,604	19.1%
Subtotal	\$2,799,156,451	-	(\$116,252,838)	(\$2,100,924,346)	\$14,485,530	\$596,464,797	38.7%

SUMMARY OF TOTAL RATES BY CRAFT

Component	Craft		
	Engineering	Transportation	Mechanical
Craft Cost Pool Subtotal	125.7%	148.4%	111.5%
Standard Additive- Force Account Insurance	16.0%	16.0%	16.0%
Standard Additive- Materials Handling	5.0%	5.0%	5.0%
General Office Cost Pool Subtotal	38.7%	38.7%	38.7%
	185.4%	208.1%	171.2%

Footnotes

- A Costs deemed unallowable per cost principles contained in FAR Part 31
 B GL account balances which are properly excluded from the rate calculation when determining reimbursable costs
 C Adjustments required to establish a proper pool of costs for allocation. See notes to the Schedule

CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014

1. Organization

CSX Transportation, Inc. (CSXT or the Company) is a wholly owned subsidiary of CSX Corporation, a company headquartered in Jacksonville, Florida. CSXT is one of five Class I railroads headquartered in the United States. CSXT owns and operates 21,000 miles of track in 23 states east of the Mississippi River, the District of Columbia, and two Canadian provinces.

2. Summary of Significant Accounting Policies

Basis of Accounting

In preparing the Schedule of Direct Labor and Indirect Cost Rates in Accordance With Part 31 of the Federal Acquisition Regulation and Section 112.061 of the Florida Statutes (Schedule), CSXT performed an analysis of the accounting and financial records to ensure that the Schedule is prepared in accordance with Part 31 of the Federal Acquisition Regulation (FAR) and the applicable state requirements. Accordingly, the above-mentioned Schedule is not intended to present the results of operations of CSXT in conformity with U.S. generally accepted accounting principles (GAAP).

CSXT calculates its indirect rates for three Labor Crafts as well as two General Office categories. Each craft may contain individual elements of cost (e.g Fringe, Payroll Taxes, Project Management, etc). These costs are accumulated within seven management codes (departments) established within the Company's books and records. Additive rates for Force Account Insurance and Materials Handling are also included. Any rate calculation for a specific agency begins with GAAP based costs with adjustments made for modifications to FAR-based amounts to arrive at claimed costs and specific rates.

CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014

Accounting System

CSXT uses the accrual basis for its financial accounting and reporting and maintains a job-order cost accounting system for the recording and accumulation of costs incurred under its contracts. Each project is assigned a job number such that costs may be segregated and accumulated within CSXT's job-order cost accounting system.

Estimates for Pricing Purposes

CSXT's method of estimating costs for pricing purposes during the proposal process is consistent with the accumulation and reporting of costs under its job-order cost accounting system.

Direct and Indirect Costs

Consistent with the FAR cost principles, CSXT defines a direct cost as a cost identified with a particular final cost objective (i.e., a contract or job charge). Direct costs associated with one or multiple projects are excluded from CSXT's overhead amounts. An indirect cost is identified with two or more final cost objectives and is included in CSXT's indirect rates to the extent allowable under the FAR cost principles.

**CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014**

Distribution of Labor Costs

CSXT distributes labor costs to direct and indirect projects for all employee classifications on an actual cost basis, including overtime premium.

Other Direct Costs

CSXT allocates final overhead on a direct labor basis, and as such, direct costs other than labor are excluded from the Schedule. CSXT's principal costs that are excluded include materials and subcontract costs. CSXT has separate expense accounts for subcontractors and other direct costs that are project related.

Any labor costs incurred by subcontractors or temporary agencies are billed as other direct costs and are not included in CSXT's direct labor cost.

Paid Overtime

Overtime costs are incurred in meeting certain deadlines or contract requirements (construction projects often require personnel to be on-site for extended hours during the actual construction of projects). If employees are eligible for overtime premium under the Fair Labor Standards Act or terms defined in Collective Bargaining Agreements (CBA), they are paid time and one-half (or another premium rate if required by law or agreement). If the premium portion or any other portions of labor costs cannot be billed to the project due to contract terms, it is transferred to a non-billable account as a non-reimbursable cost item. These costs are not included in the indirect cost pool for overhead.

CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014

Uncompensated Overtime

CSXT has professionals who are not paid for overtime worked. These salaried employees are management employees and are paid for 40 hours per week but may work more or less on a weekly basis.

Highly Compensated Employees/Officers

CSXT paid compensation to senior executives in excess of limitations set forth by FAR §31.205-6(p) or other applicable requirements. Effective June 24, 2014, the company adopted the compensation limit of \$487,000 as required by the Bipartisan Budget Act of 2013. The amounts in excess of this limitation are deemed unallowable and removed as part of adjustments; thus excluding them from the final overhead rate calculation for General Office.

Employee Benefits

CSXT has a defined-contribution 401(k) retirement and savings plan. Amounts paid, either as an employer matching contribution or as a year-end discretionary allocation, are included in the General Office cost pool.

CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014

Compensated Absences

CSXT accrues paid time off expense when it is earned. Holidays and sick leave are expensed as incurred.

Depreciation

Depreciation expense is the same that is used and included in CSXT's audited financial statements prepared in accordance with GAAP. In accordance with CFR guidance, the Company's primary method of calculating depreciation expense is covered under Group Life.

3. Recapture of Capitalized Costs

As required by GAAP, costs incurred by CSXT for internal capital projects and reimbursable Government projects are recorded in the Balance Sheet as an asset. For purposes of the annual indirect rate calculation, certain portions of these costs are included and identified within the column "Recapture of Capitalized Costs". Costs claimed in the calculation are as follows:

1. Direct labor charged to projects (for inclusion in the allocation base)
2. Indirect costs allocated to projects via the burdening or overhead allocation process

CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014

CSXT's cost accounting system does not incorporate dedicated contra accounts as part of the burdening process. As such, indirect costs associated with labor burdening are determined using unique identifiers within standardized general ledger reporting rules. CSXT believes that including the costs of labor incurred on all project types is both proper as well as conservative and that separately reporting these costs on the rate schedule assists with transparency.

4. Adjustments and Allocations

The claimed costs column of the Schedule reflects CSXT's general ledger costs after certain routine adjustments, intercompany allocations, and intermediate allocations. Specific adjustment amounts are contained in the Adjustments column of the Schedule.

Credit Amount Adjustments

CSXT investigates general ledger accounts with credit balances that may be applicable to claimed costs. Credits that are related to corresponding expense balances are included in the rate. Credit balances less than \$1 million are automatically included in the rate.

Coal Pier Adjustments

For financial reporting purposes, a specific component of operational costs (known as "Coal Piers") are included as part of General & Administrative costs. Since these costs are not typical General & Administrative costs, CSXT does not include them in the indirect rate calculation process.

CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014

Management Code Adjustments

The indirect cost rate calculation is primarily comprised of balances within seven management codes (departments). Vehicle insurance costs are coded to Operations Support (5600) and vehicle and equipment depreciation is coded to Fixed Costs (6000). Both of these expenses have Engineering (1000) components that should be included in the engineering indirect cost rate, which are allowable per 23 CFR 140.910. Therefore, these costs are transferred to the relevant Engineering cost pool through an adjustment.

CBA Arbitrary Adjustments

An arbitrary is an allowance/compensation paid to a union/contract employee based on terms outlined in the CBA. In some cases, arbitraries are charged to a labor base account initially based on the expenditure description. Since these costs are not actually labor, an adjustment is made to transfer balances from the labor base to the CBA cost pool as an indirect expense.

5. Calculation and Components of the Overhead Rate

The overhead rate is calculated for each cost pool by dividing total claimed costs by the applicable direct labor base associated with the Craft. For the General Office cost pool, the rate is calculated by dividing General & Administrative expense and Fixed Costs by the total of all CSXT direct labor. Additional information defining the labor base and cost pools follows.

**CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014**

Direct Labor Base

The direct labor base includes labor costs identified with a particular final cost objective (i.e., a contract or job charge).

Fringe

The fringe cost pool represents expenses for fringe benefits associated with direct labor in each craft-specific labor base. These compensation and benefits costs are evaluated for allowability in accordance with 48 CFR 31.205-6 and 31.205-13 and include vacation, sick leave, holiday pay, medical insurance, life insurance, bonuses and awards, tuition reimbursement, and retirement benefits.

Payroll Taxes

The payroll tax cost pool represents expenses related to the employer's portion of payroll taxes associated with direct-billed labor in each craft-specific labor base. These costs are evaluated in accordance with 48 CFR 31.205-6 and include railroad unemployment and retirement expense.

CBA Pay

The CBA cost pool represents costs of union CBA entitlements and incentives associated with direct-billed labor in each craft-specific labor base. These costs are evaluated for allowability in accordance with various CFR pronouncements and include those mandated by agreements negotiated between CSXT and the employee unions. Expenses in this cost pool include travel, meals, and other time paid for employees who direct bill their time to projects.

CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014

Project Management

The project management cost pool represents expenses related to project oversight and supervision associated with the direct-billed labor in each craft-specific labor base. These costs are evaluated for allowability in accordance with various CFR pronouncements and include compensation, benefits and travel costs of supervisory employees related to a number of tasks. Tasks include cost estimation, budget preparation, contract negotiation, and project administration.

Department Support

The department support pool represents expenses related to the operational activities associated with the direct-billed labor in each craft-specific labor base. These costs are evaluated for allowability in accordance with 23 CFR 140.907 and 48 CFR 31.203 and include utilities, materials, communications, field office equipment, security, and technology.

Small Tools and Safety Supplies

The small tools and safety supplies pool represents small tools and safety supplies associated with the direct-billed labor in each craft-specific labor base. These costs are evaluated for allowability in accordance with various CFR pronouncements and include materials, services, and safety equipment. This pool also contains costs incurred for attending routine, job-related, safety meetings.

CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014

Training

The training cost pool represents expenses incurred for training associated with the direct-billed labor in each craft-specific labor base. These costs are evaluated for allowability in accordance with CFR 48 CFR 31.205-44 and include expenses related to in-house and third party education and certification of employees.

Vehicle and Equipment

The vehicle and equipment cost pool contains expenses associated with both owned and rented vehicle and equipment costs associated with direct-billed labor in each craft-specific labor base. 23 CFR 140.910 allows CSXT to be reimbursed for the costs of depreciating, operating, repairing and renting equipment and vehicles through the indirect cost rates. Additionally, the inclusion of applicable vehicle insurance costs that support the engineering teams is added to the claimed costs in this cost pool.

General & Administrative

The General & Administrative cost pool represents costs associated with the overall operations of CSXT. This pool includes costs that support reimbursable projects (e.g., costs related to the Government Billing department) and the overall operation of the company, but which are not included in cost pools specific to Engineering, Transportation and Mechanical crafts. These costs are evaluated for allowability in accordance with applicable FAR cost principles and include accounting, finance and human resources expenditures.

CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014

Fixed Costs

The fixed costs cost pool represents costs of owned assets associated with the overall operations of CSXT. These costs are evaluated in accordance with FAR 31.205.11 & FAR 31.205.41 and include depreciation expenses for vehicles, owned equipment, computers, buildings and operating taxes.

Force Account Insurance

CSXT purchases force account insurance for liability claims covering property and medical costs of employees and subcontractors that occur on Operating Expense, Capital and Outside Party projects.

Requirements to purchase Insurance are outlined in 23 CFR 646.107. Guidance related to allowability of such costs is contained within 48 CFR 31.205-19 while guidance related to reimbursement of such costs is covered under 23 CFR 140.906 (b). The 16% charged represents CSXT's actual cost of coverage and is, therefore, the amount included for reimbursement in the indirect rate.

Materials Handling

Material handling is unlike other cost pools because it is not applied to labor. Rather than develop a specific material handling cost pool, CSXT utilizes a flat rate of 5% as prescribed by 23 CFR, 140.908 (e). CSXT direct bills third party freight charges and does not include these costs in any of the overhead pools. CSXT does not consider freight as part of the material handling rate.

CSX Transportation, Inc.
Notes to the Schedule of Direct Labor and Indirect Cost Rates
Calculated in Accordance With Part 31 of the Federal
Acquisition Regulation and Section 112.061 of the *Florida
Statutes* For Year Ended December 26, 2014

The 5% rate is applied to direct material cost transferred from CSX inventory. This rate is meant to encompass procurement, receiving, and other costs associated with the purchasing function. To prevent duplication of costs in the claimed indirect cost rates, CSXT excludes the management code expenses associated with this function (5300 - S&S Management). While expenses from management code 5300 are not included in any of the cost pools in CSXT's indirect cost rate structure, any direct labor associated with this management code is included in the General Office labor base allocation to provide for the consistent treatment of like expenses and prevent fragmentation of the labor base.



Ernst & Young LLP
Suite 1701
One Independent Drive
Jacksonville, FL 32202

Tel: +1 904 358 2000
Fax: +1 904 358 4598
ey.com

Report of Independent Certified Public Accountants on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Chief Executive Officer, Chief Financial Officer and Audit Committee
CSX Corporation

We have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the consolidated financial statements of CSX Corporation which comprise the consolidated balance sheet as of December 26, 2014, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the year ended, and the related notes to the consolidated financial statements. We have issued our report thereon dated February 11, 2015, and expressed an unqualified opinion thereon. We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of CSX Corporation's internal control over financial reporting as of December 26, 2014, based on criteria established in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) and our report dated February 11, 2015, expressed an unqualified opinion thereon.

Internal Control Over Financial Reporting

A *deficiency in internal control* over financial reporting (internal control) exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's annual or interim financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

In planning and performing our audits, we did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CSX Corporation's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

February 11, 2015

APPENDIX C – Report of Independent Certified Public Accountants (page 19 of 19)

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

About EY's Assurance Services

Our assurance services help our clients meet their reporting requirements by providing an objective and independent examination of the financial statements that are provided to investors and other stakeholders. Throughout the audit process, our teams provide timely and constructive challenge to management on accounting and reporting matters and a robust and clear perspective to audit committees charged with oversight.

The quality of our audit starts with our 60,000 assurance professionals, who have the breadth of experience and ongoing professional development that comes from auditing many of the world's leading companies.

For every client, we assemble the right multidisciplinary team with the sector knowledge and subject-matter expertise to address your specific issues. All teams use our Global Audit Methodology and latest audit tools to deliver consistent audits worldwide.

© 2015 Ernst & Young LLP.
All Rights Reserved.

1507-1588711

Office of Inspector General
Florida Department of Transportation

APPENDIX D – Affected Entity Response



How Tomorrow Moves

Controller's Group
500 Water Street
Second Floor, C729
Jacksonville, FL 32202

November 23, 2016

Mr. Robert E. Clift
605 Suwannee Street
Tallahassee, FL 32399

Dear Mr. Clift:

We have reviewed Audit Report No. 17I-1001(CSXT 2014 Labor Additive and Indirect Cost Rates) and concur with the rates audited by EY and FDOT OIG. We will implement the new rates upon receipt of the following:

1. The final rate report incorporating approval from the Florida Department of Transportation Rail Office
2. Approval from the Federal Highway Administration

Sincerely,

A handwritten signature in black ink, reading "Carolyn T. Sizemore". The signature is written in a cursive, flowing style.

Carolyn T. Sizemore

**Office of Inspector General
Florida Department of Transportation**

APPENDIX E – Management Response

On December 13, 2016, Rickey Fitzgerald, Manager of Freight and Multimodal Operations, submitted the following response to our audit.

From: Fitzgerald, Rickey
Sent: Tuesday, December 13, 2016 3:37 PM
To: Shepherd, Nancy
Cc: Goins, Andre; Lee, Robert E; Sullivan, Kristofer; Clark, Ashley; Matthews, Javaughn; Clift, Robert; O'Rourke, Gerard
Subject: RE: OIG Assignment 17I-1001, CSXT 2014 Rates, Response Request

Nancy,

In response to the final report on OIG Assignment 17I-1001, CSXT 2014 Rates, we concur with the finding(s) and recommendation(s). However, I'd like to provide some additional observations. We noted an increase in rates between 2009 and 2014 and requested additional information regarding these variances. At a meeting held at the OIG's office on November 30th between the Rail Office, CSXT and the OIG, CSXT disclosed the following reasons for the rate increases:

- Reclassifying certain costs from direct to indirect as part of simplifying overall billing processes.
- Increases in the cost of overhead salaries and company provided benefits that occurred between 2009 and 2014.
- Inclusion of allowable, recoverable costs paid in accordance with Collective Bargaining Agreements that were previously excluded.

Also, by changing the classification of some costs from direct to indirect, these changes will result in lower direct billings at the same time indirect rates go up. According to CSXT, it conducted a comparison of its total billings (to all States) for its fiscal year ended December 25, 2015 as originally billed and as recalculated using the new procedures and rates. The two methods were comparable; in fact, the recalculated amount (using the new procedures and rates) was slightly less than actual.

Respectfully,

Rickey Fitzgerald

Success = Teamwork + Efficiency

Manager, Freight & Multimodal Operations (Rail Office)
Florida Department of Transportation
605 Suwannee Street, MS 25, Tallahassee, Florida 32399-0450
(w) 850.414.4702 rickey.fitzgerald@dot.state.fl.us

**Office of Inspector General
Florida Department of Transportation**

DISTRIBUTION

Responsible Manager:

Rickey Fitzgerald, Rail and Motor Carrier Manager

Internal Distribution:

Jim Boxold, Secretary, Department of Transportation
Mike Dew, Chief of Staff and Legislative Programs
Brian Blanchard, P.E., Assistant Secretary of Engineering and Operations
Rachel Cone, Assistant Secretary of Finance and Administration
Robin Naitove, Comptroller
Tom Byron, P.E., Assistant Secretary of Intermodal Systems Development
Gerard O'Rourke, State Freight and Logistics Administrator
L.K. Nandam, P.E., District One Secretary
Greg Evans, P.E., District Two Secretary
Phillip Gainer, P.E., District Three Secretary
Gerry O'Reilly, P.E., District Four Secretary
Noranne Downs, P.E., District Five Secretary
Jim Wolfe, P.E., District Six Secretary
Paul Steinman, P.E., District Seven Secretary
Diane Gutierrez-Scaccetti, Executive Director, Turnpike Enterprise

External Distribution:

Melinda Miguel, Chief Inspector General, Executive Office of the Governor
Sherrill Norman, Auditor General, State of Florida
James Christian, Florida Division Administrator, Federal Highway Administration
Matt Ubben, Executive Director, Florida Transportation Commission
Carolyn Sizemore, Vice President and Controller, CSXT
Valerie Yeager, Director Asset Accounting, CSXT
J. Ryan Cole, Director Property Accounting, CSXT

**Office of Inspector General
Florida Department of Transportation**

PROJECT TEAM

Engagement was conducted by:
Nancy Shepherd, Intermodal Audit Manager;
Ashley Clark, Senior Audit Supervisor; and
Javaughn Matthews, Auditor

Under the supervision of: Kristofer B. Sullivan, Director of Audit

Approved by: Robert E. Clift, Inspector General

STATEMENT OF ACCORDANCE

The department's mission is to provide a safe transportation system that ensures the mobility of people and goods, enhances economic prosperity, and preserves the quality of our environment and communities.

The Office of Inspector General's mission is to promote integrity, accountability, and process improvement in the Department of Transportation by providing objective, fact-based assessments to the DOT team.

This work product was prepared pursuant to section 20.055, Florida Statutes, in accordance with the Association of Inspectors General *Principles and Standards for Offices of Inspector General*, and conforms with The Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

Please address inquiries regarding this report to the department's Office of Inspector General at (850) 410-5800.