



Florida Department of TRANSPORTATION

Office of Inspector General
Robert E. Clift, Inspector General

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

Audit Report No. 18I-1001

January 5, 2018

CSX Transportation, Inc. 2016 Labor Additive and Indirect Cost Rates

What We Did

The Florida Department of Transportation's (department) Office of Inspector General (OIG) reviewed the 2016 surcharge, overhead, and indirect construction cost rates (indirect rates) submitted by CSX Transportation, Inc. (CSXT) to determine if the rates are reasonable, allocable, allowable, and supported by transparent and understandable records. We reviewed the Indirect Cost Rates Reporting Package for the fiscal year ending December 30, 2016 (audit report) prepared by Ernst and Young (EY) and performed additional testing at CSXT's headquarters in Jacksonville, Florida, as described in Appendix A.

What We Found

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

We also determined CSXT's accounting procedures continue to meet the visibility rule set forth in Title 48 Code of Federal Regulations (CFR) Part 9904 – Cost Accounting Standards (CAS) Section 9904.405-50 (incorporated into the Federal Acquisition Regulation [FAR] by reference at 48 CFR 31.201-6(c))¹, which requires transparent and readily understandable records and procedures regarding the classification of expenses as allowable or unallowable.

What We Recommend

We recommend the department's Rail Office review and approve CSXT's 2016 indirect cost rates for use in billing costs for railroad-highway projects and communicate this decision to the Federal Highway Administration (FHWA).

¹ Only those portions of 48 CFR 9904 CAS specifically incorporated by reference into the FAR apply to CSXT, per 48 CFR 31.201-2(b).

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BACKGROUND AND INTRODUCTION

CSXT is the wholly owned subsidiary of CSX Corporation (CSX), a large multimodal transportation supplier for which CSXT manages one of the largest rail networks in the United States. Its rail network spans approximately 21,000 route miles (the equivalent of 40,000 total track miles), passing through 23 states (including the entire Eastern seaboard), the District of Columbia, and two Canadian provinces. CSXT and its parent company CSX are both headquartered in Jacksonville, Florida. As a publicly traded company, CSX is subject to the regulatory requirements of the Securities and Exchange Commission (SEC), including the internal control requirements of the Sarbanes-Oxley Act of 2002.

CSXT completes railroad crossing and other types of projects that support the department's highway construction projects. The department reimburses CSXT for the costs of these projects, including direct union labor, labor surcharges (e.g., benefits), and indirect overhead costs (including supervisory labor). CSXT bills for labor surcharge and indirect overhead costs in the form of a percentage rate applied to direct union labor.

The following regulations authorize the department's payment of labor surcharge and indirect costs rates for highway-related railroad construction, define allowable costs for purposes of inclusion in the rates, and set minimum standards for calculation methodologies and supporting records:

- Title 23, Part 646-Railroads, Subpart B-Railroad Highway Projects
- Title 23, Part 140-Reimbursement, Subpart I-Reimbursement for Railroad Work
- Title 48 (Federal Acquisition Regulation) Part 31
- 48 CFR 9904.405-Cost Accounting Standards-Accounting for Unallowable Costs

In particular, 48 CFR 9904.405-50 requires CSXT to maintain support records:

...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.

In 2014, in response to concerns raised by the OIG, CSXT substantially improved the visibility of its recordkeeping system by:

- Updating the table structure of its accounting system;
- Simplifying its procedures and enhancing documentation;
- Creating summary narratives and process checklists to support better understanding of its procedures; and
- Engaging EY to independently audit its rates and issue a report.

RESULTS OF REVIEW

Based on our review of the EY audit report and additional testing described in Appendix A, we determined the rates submitted by CSXT are reasonable, allocable, and allowable for use in billing railroad-highway projects. We also determined CSXT's accounting procedures continue to meet the visibility rule set forth at 48 CFR 9904.405-50, which requires transparent and readily understandable records and procedures regarding the classification of expenses as allowable or unallowable.

Rate Calculation Procedures

CSXT's complex operations encompass multiple subsidiaries and operational crafts. The backbone of CSXT's centralized accounting system is a relational database that uses separate fields to track costs by company, department, craft, project, task and account number and accounting entries by transaction type. 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 destination balance sheet account.

CSXT uses a system table (the Overhead Rate Table) to classify each combination of company number, department, craft and account 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). The table also uses various fields to isolate certain activity costs by company/department/craft/account for removal from the rate calculation, or certain capitalized costs to add back. Each year, CSXT reviews and tests its classification of account balances, updating the system table as necessary.

The classifications in the Overhead Rate Table are applied as a reporting filter to CSXT's accounting data after it has been finalized for SEC reporting purposes. Additional adjustments are captured in an Excel spreadsheet before final compilation of the rate.

New Developments for 2016

Overhead Rate Table Updates

CSXT's programmers originally created the Overhead Rate Table to support the 2014 rate calculation. Due to time and resource constraints, the table did not originally capture all CSXT's accounting data. As of 2016, the Overhead Rate Table captures all CSXT's accounting data, and all amounts reported in the following columns of the rate schedule can be directly tied back to this data:

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- Operating Expense G/L Balance
- Unallowable Costs
- Voluntarily Excluded Costs

The following columns contain combinations of exported data and manual adjustments:

- *Recapture of Capitalized Costs*. This column contains a combination of field totals from the Overhead Rate Table, including costs directly capitalized through the project costing system, and additional exports of specialized transactions, including journal entries for direct-charged supervisory labor. Some of these adjustments may be automated in the future.
- *Adjustments*. As of 2016, CSXT has succeeded in automating capture of several large adjustments in the Overhead Rate Table.

Composition of Rates

As of 2016, CSXT opted not to calculate rates for its mechanical craft. Related costs have been excluded from current rates, except union labor continues to be included in the General Office base.

Large increases in manual adjustments to the Engineering and Transportation crafts were accompanied by a corresponding drop to the General Office craft. Per interviews with CSXT management, certain simplifying assumptions were made during the initial rollout of its new procedures for the 2014 rate calculation. Following additional analysis, CSXT now allocates management bonuses (previously charged in total to the General Office craft) among all crafts. Since it no longer calculates a rate for the Mechanical Craft, this results in the removal of certain bonus costs from the rate calculation altogether.

USE OF REVIEW AND INDEPENDENT AUDITOR'S OPINION

Neither this review nor EY's audit opinion replace the need for the Rail Office or other state highway agencies to review direct costs incurred by CSXT for compliance with project plans, contracts, and applicable regulations. The Rail Office and other state highway agencies 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 2016 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 2016 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;
- Identifying and reviewing account classification differences between 2014 and 2016 rate calculation procedures;
- Re-performing export of accounting data from system;
- Recompiling data and reperforming rate calculations;
- Performing comparative analysis on 2014 and 2016 rate data;
- Reviewing changes in the adjustment structure for the 2016 rates;
- Interviewing key management staff and reviewing selected workpapers prepared internally by CSXT; and
- Reviewing EY audit plans and selected workpapers.

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APPENDIX B – Affected Entity Response



How Tomorrow Moves

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

January 4, 2018

Kris Sullivan, Audit Director
Florida Department of Transportation's Office of Inspector General
605 Suwannee Street, MS 44
Tallahassee, FL 32399-0450

Dear Mr. Sullivan:

We have reviewed your draft audit report No. 181-1001 (CSX Transportation, Inc. 2016 Labor Additive and Indirect Cost Rates) received on December 26, 2017. We understand that we have up to 20 working days to provide a written response. This communication is our response to that draft report.

We agree with the conclusions presented by EY and FDOT OIG. We will implement these rates for billing upon receipt of the following:

1. The final audit report No. 181-1001 from Florida Department of Transportation's Office of Inspector General
2. Approval of the rates from the Florida Department of Transportation's Rail Office
3. Approval of the rates from the Federal Highway Administration

Sincerely,

A handwritten signature in black ink, appearing to read "Am 28", followed by a horizontal line.

Andrew L. Glassman
Vice President & Controller
CSX Transportation, Inc.

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

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Linsey Funston, CPA, Manager Government Compliance, CSXT
Natalie Rolle, Manager Government Billing Compliance, CSXT

PROJECT TEAM

Engagement was conducted by:

Nancy Shepherd, Intermodal Audit Manager; and
Melynda Childree, Senior Audit Supervisor

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.