



Florida Department of TRANSPORTATION

Office of Inspector General
Kristofer B. Sullivan, Inspector General

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Audit Report No. 19I-1001
CSX Transportation, Inc. 2017 Fringe Indirect Rate

January 8, 2019

What We Did

The Florida Department of Transportation's (department) Office of Inspector General (OIG) audited the 2017 indirect rates submitted by CSX Transportation, Inc. (CSXT) to determine whether rates are reasonable, allocable, allowable, and supported by transparent and understandable records. We reviewed the Indirect Cost Rates Reporting Package (audit report) prepared by Ernst & Young, LLC (EY) and performed substantive testing at CSXT's headquarters.

What We Found

We determined the rates submitted by CSXT are reasonable, allocable, and allowable for use in billing railroad-highway projects. CSXT's accounting procedures, including supporting documentation, continue to meet the visibility rule set forth in Title 48 Code of Federal Regulations (CFR) Part 9904 – Cost Accounting Standards (CAS) Section 9904.405-50,¹ which requires transparent and readily understandable records and procedures to deem expense allowability.

During our review of the indirect rate process, we observed the following developments:

- A material increase (24 percent) in the Engineering craft rate due to CSXT's decision to recover additional cost categories previously not claimed. We determined these costs are allowable.
- The implementation of a change in presentation method for certain account balances that caused reported adjustments to significantly decline (without impacting the rate). We determined this change to be appropriate.

We also observed opportunities for CSXT to continue to improve its submission process as it evolves; additional details are provided under the results section of this report.

What We Recommend

We recommend the department's Rail Office review and approve CSXT's 2017 indirect cost rates for use in billing costs for railroad-highway projects and communicate this decision to the Federal Highway Administration (FHWA).

¹ Incorporated into the Federal Acquisition Regulation (FAR) by reference at 48 CFR 31.201-6(c).

**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	7
APPENDIX A – Purpose, Scope, and Methodology	8
APPENDIX B – 2017 Rate Schedule (As Submitted)	9
APPENDIX C – Affected Entity Response	10
APPENDIX D – Management Response	11
DISTRIBUTION	12
PROJECT TEAM	13
STATEMENT OF ACCORDANCE	13

BACKGROUND AND INTRODUCTION

CSX Transportation, Inc. (CSXT), a wholly-owned subsidiary of CSX Corporation (CSX), a publicly traded company, is a Class I railroad headquartered in the United States. It owns and operates 21,000 route miles of track in 23 states east of the Mississippi River, the District of Columbia, and two Canadian provinces. As of December 2017, CSXT employed approximately 24,000 individuals which included approximately 20,000 union employees. CSXT transports a variety of freight across the network servicing three primary lines of business including merchandise, coal, and intermodal.

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

Criteria

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 methods 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

Rate Calculation Procedures

CSXT calculates separate indirect cost rates for the Engineering and Transportation craft types. Department projects are most frequently billed using the Engineering rate.

CSXT uses two platforms in the development of the indirect rate:

- its financial management system, Oracle, where accounts' allowability are identified and labeled, and
- an Excel table referred to as the Overhead Rate Table where the recapturing of capitalized costs from the balance sheet occurs.

The OIG has identified and assessed the following risks as particularly relevant to the scope of its review:

- risks associated to changes made to the Oracle database;
- risks inherent to the Oracle extraction process; and
- risks inherent to the manual adjustment process recorded in Excel.

RESULTS OF REVIEW

Based on our review of the indirect rate development process, coupled with our assessment of EY’s indirect rate audit, **we determined** the rates (**Appendix B**) 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 to deem allowability.

During our review of the indirect rate, we observed the following new developments.

Engineering Rate Increase – 24 Percent

We noted an increase of approximately 24 percent in the Engineering craft for 2017, as compared to 2016 (as shown in Table 1).

Table 1: Rate Variance Analysis

Rate Level Variance Analysis			
Scope - Explain significant variances			
	2017 Submitted Rate	2016 Audited Rate	Rate Change 2016 vs. 2017
Engineering Cost Pools			
Collective Bargaining Agreement	12.0%	4.8%	7.2%
Department Support costs	20.7%	17.0%	3.7%
Fringe	39.2%	35.4%	3.8%
Payroll Taxes	25.4%	23.4%	2.0%
Project Management	24.3%	22.2%	2.1%
Small Tools, Safety & Supplies	2.8%	4.2%	-1.4%
Training	0.4%	0.5%	-0.1%
Vehicle & Equipment	29.8%	22.8%	7.0%
Engineering Subtotal	154.6%	130.3%	24.3%

Source: CSXT Indirect Cost Rates Reporting Packages for the fiscal years ending December 31, 2017, and December 30, 2016.

This increment is heavily associated with the Engineering craft’s inclusion of certain capitalized costs worth \$76.3 million not previously claimed. These expenses are:

- Corporate Lodging Costs (CLC) for a total of \$21 million were incorporated into the rate calculation. CLC is a lodging program whereby CSXT has negotiated special rates with hotel chains. CLC expenses have always been included in the rate calculation. However, for this period CSXT also claimed the portion of CLC costs allocated to capital projects. CSXT decided to recapture only those

capitalized expenses incurred using the CLC lodging program since it provides the lowest lodging costs, ensuring compliance with federal reimbursable thresholds.

- Additionally, travel and per diem payments made to union employees that are required by the Collective Bargaining Agreements for a total of \$32.8 million were also included in the 2017 indirect rate calculation.
- Equipment rental costs increased by \$21.7 million for the 2017 rate calculation.
- Lastly, \$850K in capitalized airfare costs associated with allowable travel.

An additional factor affecting the overall increase in the rate relates to a reduction of the labor base, comprised of union labor forces, of \$88.7 million. This decrease represents a six percent overall impact.

Change in Presentation Method

In 2014 and 2016's rate submissions, the OIG noted a positive addback of over \$80 million for the Engineering craft. This single adjustment reversed the negative total of all other adjustments to yield a large positive balance in the Adjustments column for the Engineering craft. To enhance visibility of the rate submission process, the OIG suggested enabling the flow of both debits and credits associated with the unrelated activities adjustment column, to present only its net effect in the final Excel rate calculation worksheet, avoiding the need for additional adjustment. The adaptation of this recommendation allows for a cleaner indirect rate presentation.

Opportunities to Improve Process

Updating Oracle Export to Include Status Field

As part of the indirect rate calculation process, the Government Compliance team extracts all the Oracle accounts to an Excel file for further analysis and to perform Balance Sheet recovery and other adjustments. CSXT then validates the integrity of the data by recording and comparing account balances and their status within Oracle to the data presented on the Excel table.

When we reviewed this process, we noted CSXT's process has evolved to include additional field values for the account classification status in Oracle, but its template for exporting data to Excel does not always reflect these changes. The export template includes a limited number of columns for certain field values, requiring additional information to be added manually.

Even though we determined the final spreadsheet values to be accurate, CSXT should consider exporting the account classification status field directly from Oracle to Excel.

Playbook Updates

During its transition to a new rate calculation process in 2014, CSXT developed a document referred to as the Playbook which served both as an explanatory brochure for stakeholders (broad overview) and a procedural guide (detailed description) for certain stages of the process, particularly those which had been recently upgraded. For their internal use, CSXT developed a procedural checklist outlining all required steps in the process.

At the OIG's recommendation, CSXT also shared the complete checklist with the department and FHWA in advance of the approval of the 2014 rate. CSXT now routinely includes an updated Playbook and checklist (as an exhibit to the Playbook) in its annual submission packet. We observed the dual-purpose format of the Playbook has become less useful as CSXT's processes have evolved.

Future auditors and regulators may find it more useful to start from the checklist to understand CSXT's process. To facilitate communication with future stakeholders, CSXT should consider replacing the Playbook with an explanatory narrative(s) which follows the structure of the checklist (whether in the form of a single manual/guide, series of modular procedures, or other alternate means).

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 2017 indirect rates are reasonable, allowable, and adequately supported, and
- supporting records and procedures are transparent and readily understandable.

The **scope** of this audit consisted of the proposed 2017 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 2016 and 2017;
- reperforming export of accounting data from system;
- recompiling data and reperforming rate calculations;
- performing comparative analysis on 2016 and 2017 rate data;
- reviewing changes in the adjustment structure for the 2017 rates;
- interviewing key management staff and reviewing selected workpapers prepared internally by CSXT; and
- reviewing EY audit plans and selected workpapers.

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

APPENDIX B – 2017 Rate Schedule (As Submitted)

Component	Operating Expense G/L Balance	Recapture of Capitalized Costs	Unallowable Costs	Voluntarily Excluded Costs	Adjustments and Reclassifications	Final Claimed Costs	Indirect Rate
Engineering Direct Labor Base	\$ 254,412,320	\$ 219,824,055	\$ -	\$ -	\$ (23,167,106)	\$ 451,069,269	100.0%
Engineering Cost Pools							
Collective Bargaining Agreement	34,373,198	33,735,991	(746,146)	(476,439)	(12,741,213)	54,145,391	12.0%
Department Support Costs	129,716,312	47,974,827	(193,056)	(70,541,574)	(13,377,372)	93,579,136	20.7%
Fringe	94,775,744	82,950,872		(837,017)	(73,474)	176,816,126	39.2%
Payroll Taxes	59,033,302	54,025,773			1,289,866	114,348,941	25.4%
Project Management	50,758,575	38,541,951			20,422,924	109,723,450	24.3%
Small Tools, Safety & Supplies	23,315,549	3,871,364	(12,755)	(14,599,539)	(63,749)	12,510,870	2.8%
Training	1,674,402	125,252			(130)	1,799,523	0.4%
Vehicle and Equipment	78,191,892	57,244,021	(420,329)	(3,289,043)	2,822,230	134,548,770	29.8%
Subtotal	\$ 471,838,974	\$ 318,470,052	\$ (1,372,286)	\$ (89,743,612)	\$ (1,720,918)	\$ 697,472,208	154.6%
Transportation Direct Labor	\$ 608,257,111	\$ 4,295,327	\$ -	\$ (3,649,674)	\$ (866,264)	\$ 608,036,500	100.0%
Transportation Cost Pools							
Collective Bargaining Agreement	171,130,715	66,185	(1,272,539)	(31,256)	(19,614,194)	150,278,911	24.7%
Department Support Costs	966,641,241	246,615	(967,336)	(898,114,541)	(1,469,519)	66,336,460	10.9%
Fringe	350,324,456	1,356,505	(163,425)	(14,391,181)	743,890	337,870,245	55.6%
Payroll Taxes	193,738,289	906,770	-	-	2,709,158	197,354,217	32.5%
Project Management	115,630,251	307,366	-	(14,413,976)	21,750,994	123,274,635	20.3%
Small Tools, Safety & Supplies	9,943,905	-	-	(2,134,924)	(93,426)	7,715,555	1.3%
Training	16,831,369	17,027	-	-	-	16,848,396	2.8%
Subtotal	\$ 1,824,240,226	\$ 2,900,468	\$ (2,403,300)	\$ (929,085,878)	\$ 4,026,903	\$ 899,678,419	148.1%
General Office Direct Labor	\$ 1,097,876,424	\$ 228,468,382	\$ -	\$ (3,649,674)	\$ (22,197,852)	\$ 1,300,497,280	100.0%
General Office Cost Pools							
Fixed Costs	1,157,783,844	2,920,204		(791,999,050)	-	368,704,998	28.4%
General and Administration	1,498,544,654	13,789,147	(193,981,724)	(1,032,939,387)	(106,460,912)	178,951,778	13.8%
Subtotal	\$ 2,656,328,498	\$ 16,709,351	\$ (193,981,724)	\$ (1,824,938,437)	\$ (106,460,912)	\$ 547,656,777	42.2%
Total Labor-Based Rates by Craft							
Component	Engineering		Transportation				
Craft Cost Pool Subtotal	154.6%		148.1%				
Standard Additive - Force Account Insurance	16.0%		16.0%				
General Office Cost Pool Subtotal	42.2%		42.2%				
	212.8%		206.3%				
Additional Rates							
Standard Additive - Materials Handling	5.0%		5.0%				

See accompanying Notes to Schedule

Source: CSX Transportation Indirect Cost Rates Reporting Package for the fiscal year ending December 31, 2017

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

APPENDIX C – Affected Entity Response



November 29, 2018

Nancy Shepherd, Deputy Audit Director of Intermodal
Florida Department of Transportation's Office of Inspector General
605 Suwannee Street, MS 44
Tallahassee, FL 32399-0450

Dear Ms. Shepherd:

We have reviewed the draft audit report No. 191-1001 (CSX Transportation, Inc. 2017 Fringe Indirect Rates) received on November 20, 2018. We understand that we have the opportunity to provide a response within 20 working days. This communication is our response to that draft report.

We agree with the conclusions presented by Ernst & Young and Florida Department of Transportation's Office of Inspector General (FDOT OIG). We will implement these rates for billing upon receipt of the following:

1. The final audit report No. 191-1001 from FDOT OIG
2. Approval of the rates from 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 "awilliams", is written over the typed name.

Angela C. Williams
Vice President & Controller
CSX Transportation, Inc.

CSX Corporation, 500 Water Street, Jacksonville, FL 32202

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

APPENDIX D – Management Response

From: Fitzgerald, Rickey
Sent: Friday, January 4, 2019 12:44 PM
To: Shepherd, Nancy
Cc: Sullivan, Kristofer; Allbritton, Scott; Gilboy, Joseph; Allbritton, Scott
Subject: RE: OIG Assignment 19I-1001, CSX Transportation, Inc. 2017 Fringe Indirect Rate, Response Request

Nancy/Joe/Kris,
I've reviewed the Audit Report No. 19I-1001 and I concur with the findings and have no additional inputs or comments.

Respectfully,

Rickey Fitzgerald

Success = Teamwork + Efficiency

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

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Amanda Hightower, Director SEC Reporting & Compliance, CSX Transportation, Inc.
Linsey Funston, Manager Government Compliance, CSX Transportation, Inc.

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PROJECT TEAM

Engagement was conducted by:
Luis Camejo, Senior Audit Supervisor

Under the supervision of:
Nancy Shepherd, Deputy Audit Director for Intermodal
Joseph W. Gilboy, Director of Audit

Approved by:
Kristofer B. Sullivan, 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.