



# Florida Department of TRANSPORTATION

Office of Inspector General  
Kristofer B. Sullivan, Inspector General

A handwritten signature in black ink that reads "KSullivan".

Audit Report No. 19I-1003  
CSXT 2018 Fringe/Indirect Rate

December 26, 2019

## What We Did

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The Florida Department of Transportation's (Department) Office of Inspector General (OIG) audited the 2018 indirect rates submitted by CSX Transportation, Inc. (CSXT) to determine whether rates are reasonable, based on allocable and allowable costs, and supported by transparent and understandable records. We also reviewed the Indirect Cost Rates Reporting Package (audit report) prepared by Ernst & Young, LLP and performed substantive testing as part of our evaluation.

## What We Found

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**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, Part 9904, Code of Federal Regulations (C.F.R.) – Cost Accounting Standards (CAS), 48 C.F.R. 9904.405-50,<sup>1</sup> which requires transparent and readily understandable records and procedures to deem expense allowability.

During our review, we observed CSXT made the following process improvements:

- simplification of the data export and presentation of the rate calculation to only include allowable values; and
- exclusion of certain immaterial cost pools after a cost/benefit analysis.

## What We Recommend

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**We recommend** the Department's Freight and Multimodal Operations Office review and approve CSXT's 2018 indirect cost rates for use in billing costs for railroad-highway projects and communicate this decision to the Federal Highway Administration.

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<sup>1</sup> Incorporated into the Federal Acquisition Regulation (FAR) by reference at 48 C.F.R. 31.201-6(c).

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## **BACKGROUND AND INTRODUCTION**

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CSX Transportation, Inc. (CSXT), a wholly-owned subsidiary of CSX Corporation, a publicly traded company, is a Class I railroad headquartered in Jacksonville, Florida. It owns and operates 20,500 route miles of track in 23 states east of the Mississippi River, the District of Columbia, and two Canadian provinces. As of December 2018, CSXT employed approximately 22,500 individuals which included 18,500 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 Florida Department of Transportation's (Department) 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, Code of Federal Regulations (C.F.R.), Subpart B-Railroad Highway Projects;
- 23 C.F.R. 140-Reimbursement, Subpart I-Reimbursement for Railroad Work;
- 48 C.F.R. 31-Federal Acquisition Regulation; and
- 48 C.F.R. 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 craft 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 additional adjustments are made.

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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

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Based on our review of the indirect rate development process, coupled with our assessment of Ernst & Young's, LLP (EY) indirect rate audit, **we determined** the costs associated with 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 C.F.R. 9904.405-50, which requires transparent and readily understandable records and procedures to deem allowability.

During our review of the indirect rate, we observed new developments. It is worth noting these changes did not impact the final rate value.

### ***Rate Export Change***

This change consists of filtering out all accounts identified as "not claimed in rate" prior to the rate schedule/calculation. This presentation change was completed to enhance clarity in the rate calculation, and to eliminate the need for manual filtering in the Excel spreadsheet used to complete the final rate calculation. The actual change to the overhead rate table was performed during the prior year because of a recommendation from the Department's Office of Inspector General (OIG). The exclusion of these accounts has been updated in the Oracle Rules table.

### ***Rate Calculation Presentation Change***

This presentation change was completed to allow Recapture of Capitalized Costs and Adjustments and Reclassifications columns in the rate schedule (Excel spreadsheet) to only present values related to accounts classified as allowable.

### ***Direct Cost Analysis***

CSXT completed a comprehensive analysis of direct-to-indirect cost project activity to better determine the inclusion/exclusion from the rate calculation. This analysis resulted in a change to the status of certain accounts within the overhead rate table. These changes did not have a significant impact on the rate calculation.

### ***Discontinued Cost Pools for the Transportation Craft***

While CSXT will continue to calculate, audit, and bill the transportation craft rate to government projects, it will no longer specifically identify and evaluate management code 4000 accounts which are not categorized as labor additive or project management costs. This change results in the removal of the Department Support Costs and Small Tools, and Safety and Supplies Costs from the audited transportation craft rate. This is due to a cost/benefit analysis which concluded the cost of time invested to prepare, calculate, and audit these cost pools within the rate schedule is significantly greater

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than the benefit of recovery. For fiscal year 2018, the net impact is less than \$5,000. The impact of this exclusion on the related cost pools, can be observed in table 1.

**Table 1: Rate Variance Analysis**

<b>Transportation Cost Pools</b>	<b>2018 Submitted Rate</b>	<b>2017 Audited Rate</b>	<b>Rate Change 2017 vs. 2018</b>
Collective Bargaining Agreement	23.4%	24.7%	-1.3%
Department Support Costs	0.0%	10.9%	-10.9%
Fringe	52.2%	55.6%	-3.4%
Payroll Taxes	30.9%	32.5%	-1.6%
Project Management	19.3%	20.3%	-1.0%
Small Tools, Safety & Supplies	0.0%	1.3%	-1.3%
Training	1.4%	2.8%	-1.4%
<b>Transportation Subtotal</b>	<b>127.2%</b>	<b>148.1%</b>	<b>-20.9%</b>

**Source:** CSXT Indirect Cost Rates Reporting Packages for the fiscal years ending December 31, 2018, and December 31, 2017.

***Immaterial Variance on the Engineering Craft***

The engineering craft had a slight increase of 5.5 percent during fiscal year 2018, see table 2. Some of the major contributors to the rate increase are costs associated with:

- Higher corporate lodging costs during 2018, which increased by \$9 million; and
- Higher repair expenses in comparison to 2017, as they increased by \$5 million.

**Table 2: Rate Variance Analysis**

<b>Engineering Cost Pools</b>	<b>2018 Submitted Rate</b>	<b>2017 Audited Rate</b>	<b>Rate Change 2017 vs. 2018</b>
Collective Bargaining Agreement	12.1%	12.0%	0.1%
Department Support Costs	25.5%	20.7%	4.8%
Fringe	35.1%	39.2%	-4.1%
Payroll Taxes	24.7%	25.4%	0.7%
Project Management	24.7%	24.3%	0.4%
Small Tools, Safety & Supplies	3.1%	2.8%	0.3%
Training	0.2%	0.4%	-0.2%
Vehicle & Equipment	34.7%	29.8%	4.9%
<b>Engineering Subtotal</b>	<b>160.1%</b>	<b>154.6%</b>	<b>5.5%</b>

**Source:** CSXT Indirect Cost Rates Reporting Packages for the fiscal years ending December 31, 2018, and December 31, 2017.

***Overhead Rate Manual Development***

During CSXT's transition to a new rate calculation process in 2014, they 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 Federal Highway Administration 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. During the 2017 rate review, the dual-purpose format of the Playbook had become less useful as CSXT's processes evolved. As a result, CSXT developed the Government Overhead Guide, which is a high-level overview of CSXT's accounting structure and its indirect cost rate calculation process and methodology. Procedural details are retained by CSXT during each year's calculation and they are provided to the OIG upon request.

**USE OF REVIEW AND INDEPENDENT AUDITOR'S OPINION**

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Neither this review nor EY's audit opinion replace the need for the Freight and Multimodal Operations Office or other state highway agencies to review direct costs incurred by CSXT for compliance with project plans, contracts, and applicable regulations. The Freight and Multimodal Operations 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**

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

- fiscal year 2018 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 2018 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 C.F.R. 140, 23 C.F.R. 646, and 48 C.F.R. 31;
- reviewing CSXT's procedures and rate preparation checklists;
- identifying and reviewing account classification differences between 2017 and 2018;
- reperforming export of accounting data from system;
- recompiling data and reperforming rate calculations;
- performing comparative analysis on 2017 and 2018 rate data;
- reviewing changes in the adjustment structure for the 2018 rates;
- interviewing key management staff and reviewing selected workpapers prepared internally by CSXT; and
- reviewing EY's audit plan and selected workpapers.

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**APPENDIX B – 2018 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
<b>Engineering Craft Direct Labor</b>	<b>\$ 259,436,346</b>	<b>\$ 211,338,602</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (25,625,377)</b>	<b>\$ 445,149,571</b>	<b>100.0%</b>
<b>Engineering Cost Pools</b>							
Collective Bargaining Agreement	20,199,584	30,644,615	(1,287,893)	(1,245)	4,387,162	53,942,223	12.1%
Department Support Costs	138,866,657	64,044,053	(317,091)	(71,738,052)	(17,187,137)	113,668,430	25.5%
Fringe	87,485,671	72,435,104	-	(3,600,764)	(288,712)	156,031,299	35.1%
Payroll Taxes	55,959,627	53,239,532	-	-	843,925	110,043,084	24.7%
Project Management	52,004,479	34,834,307	-	-	22,925,183	109,763,969	24.7%
Small Tools, Safety & Supplies	23,576,870	6,188,395	(8,768)	(15,930,970)	(96,572)	13,728,955	3.1%
Training	1,076,902	(11)	-	-	(7)	1,076,884	0.2%
Vehicle and Equipment	101,665,635	53,559,883	(309,665)	(2,986,010)	2,594,356	154,524,199	34.7%
<b>Subtotal Indirect Costs</b>	<b>\$ 480,835,425</b>	<b>\$ 314,945,878</b>	<b>\$ (1,923,417)</b>	<b>\$ (94,257,041)</b>	<b>\$ 13,178,198</b>	<b>\$ 712,779,043</b>	<b>160.1%</b>

<b>Transportation Craft Direct Labor</b>	<b>\$ 592,598,860</b>	<b>\$ 2,836,789</b>	<b>\$ -</b>	<b>\$ (2,256,122)</b>	<b>\$ (1,129,048)</b>	<b>\$ 592,050,488</b>	<b>100.0%</b>
<b>Transportation Cost Pools</b>							
Collective Bargaining Agreement	139,462,902	61,157	(2,175,481)	(35,930)	1,222,576	138,535,224	23.4%
Department Support Costs	1,134,388,037	-	-	(1,134,388,037)	-	-	0.0%
Fringe	322,515,455	907,304	-	(13,961,050)	(462,789)	308,998,920	52.2%
Payroll Taxes	181,265,624	591,698	-	-	1,318,611	183,175,933	30.9%
Project Management	108,136,460	294,883	-	(16,744,207)	22,678,371	114,367,507	19.3%
Small Tools, Safety & Supplies	8,356,007	-	-	(8,356,007)	-	-	0.0%
Training	8,175,641	7,563	-	-	-	8,183,204	1.4%
<b>Subtotal Indirect Costs</b>	<b>\$ 1,902,802,126</b>	<b>\$ 1,862,605</b>	<b>\$ (2,175,481)</b>	<b>\$ (1,173,485,231)</b>	<b>\$ 24,756,769</b>	<b>\$ 753,260,788</b>	<b>127.2%</b>

<b>General Office Direct Labor</b>	<b>\$ 1,039,883,523</b>	<b>\$ 217,492,069</b>	<b>\$ -</b>	<b>\$ (2,101,049)</b>	<b>\$ (25,413,987)</b>	<b>\$ 1,229,860,556</b>	<b>100.0%</b>
<b>General Office Cost Pools</b>							
Fixed Costs	1,253,660,247	3,826,942	(118)	(870,454,045)	(8,266,607)	378,766,419	30.8%
General and Administration	1,330,376,764	19,247,848	(85,708,517)	(946,819,435)	(130,468,533)	186,628,127	15.2%
<b>Subtotal Indirect Costs</b>	<b>\$ 2,584,037,011</b>	<b>\$ 23,074,790</b>	<b>\$ (85,708,635)</b>	<b>\$ (1,817,273,480)</b>	<b>\$ (138,735,140)</b>	<b>\$ 565,394,546</b>	<b>46.0%</b>

<b>Total Indirect Costs</b>	<b>\$ 4,967,174,562</b>	<b>\$ 339,883,273</b>	<b>\$ (89,807,533)</b>	<b>\$ (3,085,015,752)</b>	<b>\$ (100,800,173)</b>	<b>\$ 2,031,434,377</b>	
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<b>Total Labor-Based Rates by Craft</b>		
Component	Engineering	Transportation
Craft Cost Pool Subtotal	160.1%	127.2%
General Office Cost Pool Subtotal	46.0%	46.0%
Standard Additive - Force Account Insurance	16.0%	16.0%
<b>Total</b>	<b>222.1%</b>	<b>189.2%</b>

<b>Additional Rates</b>		
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, 2018

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APPENDIX C – Affected Entity Response



November 20, 2019

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. 191-1003 (CSXT 2018 Fringe/Indirect Rate) received originally on November 4, 2019 with a revised version received on November 18, 2019. We understand that we have the opportunity to provide a response within 20 working days. This communication is our response to that revised 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. 191-1003 from FDOT OIG
2. Approval of the rates from Florida Department of Transportation's Freight and Multimodal Operations Office
3. Approval of the rates from the Federal Highway Administration

Sincerely,

A handwritten signature in blue ink, appearing to read 'Angela Williams', written over a light blue horizontal line.

Angela C. Williams  
Vice President & Chief Accounting Officer  
CSX Transportation, Inc.

CSX Corporation, 500 Water Street, Jacksonville, FL 32202

**APPENDIX D – Management Response**

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On December 19, 2019, the OIG received an e-mail from Rickey Fitzgerald, Manager of the Department’s Freight and Multimodal Operations Office, stating, “After reviewing the report and our meeting with CSX, I have no additional questions/responses at this time.”

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Rickey Fitzgerald, Manager, Freight and Multimodal Operations

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Sean Craig, Assistant General Counsel, CSX Transportation, Inc.

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**PROJECT TEAM**

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Engagement was conducted by:

Luis Camejo, Senior Audit Supervisor  
Mervat Bebawy, Auditor in Charge

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**

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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.