



Florida Department of TRANSPORTATION

Office of Inspector General
Kristofer B. Sullivan, Inspector General

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Audit Report No. 19I-6002

January 14, 2019

Florida Department of Transportation Fiscal Year (FY) 2019-2020 Indirect Rate

What We Did

As part of the Office of Inspector General's (OIG) annual audit plan, and at the request of the Office of Comptroller (OOC), the OIG conducted a review of the Florida Department of Transportation's (department) indirect cost rate (indirect rate) submission packet proposal for fiscal year 2019-2020.

The primary purpose of this project was to determine whether the indirect rate submission packet was complete, sufficient in detail, the process remained consistent in relation to the previous years, and calculations were accurate to allow for an adequate review by the Federal Highway Administration (FHWA). A secondary purpose, in response to FHWA inquiries, was to verify and disclose additional details regarding the department's processes for purposes of transparency.

Our assessment consisted of the following steps:

- review of prior indirect rate submission packages;
- walkthroughs to understand key stages of the process;
- evaluation of utilization of the rate for federal match purposes; and
- evaluation of the indirect rate submission packet as prescribed in FHWA's Cost Allocation and Indirect Cost Rate Review Guide (July 2016).

What We Found

We determined the indirect rate submission packet complied with the preliminary elements required by the FHWA Cost Allocation and Indirect Cost Rate Review Guide (Desk Guide). The information is complete, sufficient, consistent, and accurate.

Based on the following factors, the OIG continues to deem the department's indirect rates low risk:

- component rates have not substantially varied from year to year. The most prominent exception, emergency (ER) indirect rates, is attributed to the

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unpredictability of natural disasters because ER rates are based on actual historical costs;

- the OOC's underlying rate calculation methodology has remained constant;
- key personnel have not changed;
- the department rarely utilizes the indirect rate for billing purposes. In fiscal year 2017-2018, the state only billed \$326K (lowest amount billed since 2012) in indirect costs, yielding an effective rate of .0137 percent; and
- although the department may apply indirect costs to meet match requirements for certain federally funded projects, this practice is not used in all instances.

The OOC continues to make significant improvements to the annual indirect rate submission packet.

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BACKGROUND AND INTRODUCTION

The department receives federal grant funding from FHWA for a variety of projects. Federal regulations allow grantees (such as the department) to recover indirect (overhead) costs by means of an approved rate. The department uses the following information to compile its annual Indirect Cost Allocation Plan (ICAP):

- detailed historical cost data;
- projected changes to its Work Program; and
- projected disbursement amounts for the first year of the Cash Forecast prepared to support the final Work Program.

At the end of each fiscal year, the department calculates the difference between actual indirect costs incurred and those applied using the rate. Any variance is included in the calculation of the next year's rate. Applied costs will adjust to actual costs over time. Ideally, the rate calculation process will produce a stable and accurate rate, without wide variances from year to year.

Several factors affect the impact of any potential volatility introduced into the rate calculation by the use of cash forecasting data:

- the department applies a different rate calculation methodology, based solely on historical costs, to some projects;
- outside of these specific project types, the department rarely bills the federal government for indirect costs;
- the department limits its use of indirect costs for meeting applicable match requirements; and
- the department's cash forecasting data is based on multiple objective sources tied to its budget and finance activities.

Rate Calculation Methodology

Indirect Rate – Emergency Relief (ER)

For ER projects, the department calculates the indirect rate based on prior year's actual costs, without reference to the Work Program or Cash Forecast. It also consistently applies the rate when billing the federal government. However, total billings for ER have historically been small compared to the department's overall budget.

Indirect Rate – non-ER

For non-ER projects, the department contemplates its projected commitments for the next fiscal year's Work Program. These commitments are in turn influenced by the following information:

- statewide revenue projections provided to the department by the State Revenue Estimating Conference;
- projections of federal grant reimbursements based on disbursement projections for awarded grants (e.g., authorized under Federal Transportation Act or continuing resolutions);
- outstanding project commitments from prior years;
- new project commitments;
- cash forecasts of additional financing needs based on the difference between forecasted revenue and anticipated project obligations maintaining a statutory threshold;
- additional financing decisions (e.g., bond issuance);
- a balanced financial plan based on above;
- the final five-year Work Program based on above; and
- the disbursement projections for the first year of the Cash Forecast prepared to support the final Work Program.

The OOC uses projected disbursements for the first year of the current authorized Work Plan (per the Cash Forecast), along with detailed historical cost data (including trend data), to estimate allowable costs for the coming fiscal year for purposes of the rate calculation. During the year, the Cash Forecast is reviewed monthly to ensure the underlying financial assumptions supporting the Work Program remain sound. However, the indirect rate remains based on the Cash Forecast in effect at the time of the rate calculation.

Utilization of Rate

Utilization of Indirect Rate for Reimbursement

Indirect rates are used by the department to account for total project costs. However, the department rarely utilizes indirect rates when billing for non-ER projects, since it applies most of its federal allotment for highway construction to direct costs before the allotment is exhausted. Generally, state funds are used to pay for indirect costs.

Utilization of Indirect Rate for Match

When determining whether a project's match requirements have been met, the department may consider the following resources:

1. *Allowable state-funded direct costs.*
2. *Qualifying locally-funded direct costs.* The department limits the use of local funds as a match source for Federal Highway Administration funds to only those budgeted local funds that have been:
 - received from the local agency as revenue on deposit, and
 - subsequently expended by the department as a participating cost.

If the local expenditure cannot be easily documented through the state's accounting system, the department considers it high-risk and disqualifies it as a potential source of match.

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3. *Indirect costs*, allocated to projects by means of the approved rate. These are state-funded.
4. *Soft match*, provided by toll-road credits. The department elects to use soft match as a more readily available and easily documented non-federal matching source than alternative (non-qualifying) local sources.

If a project’s match requirements have not been obviously met from sources 1 and 2, the department calculates total available “hard match” by adding together source 1, 2, and 3 amounts. If this total does not equal or exceed the required match amount for the project, the department utilizes “soft match” provided by toll-road credits to fill the gap (even though additional local match funds may also be available).

However, often there are enough direct expenditures to meet the minimum non-federal match without having to consider indirect costs or soft match.

Overall Risk

As shown in Table 1, the effective rate (based on actual federal reimbursement for indirect costs) continues to be lower than the submitted rate, even though ER projects are included in the totals.

Table 1 - Effective (Utilized) Indirect Rate vs. Approved by State Fiscal Year

Fiscal Year	Total Billings	Total Indirect Billed	Total Direct	Effective Indirect %	Submitted Indirect
SFY12	\$1,863,300,141	\$36,546,559	\$1,826,753,583	2.0006%	7.50%
SFY13	\$1,864,285,813	\$6,370,852	\$1,857,914,961	0.3429%	4.53%
SFY14	\$2,322,013,336	\$825,390	\$2,321,187,945	0.0356%	4.11%
SFY15	\$2,092,647,395	\$1,564,189	\$2,091,083,207	0.0748%	4.17%
SFY16	\$2,356,605,868	\$467,294	\$2,356,138,575	0.0198%	4.05%
SFY17	\$2,154,231,061	\$682,467	\$2,153,548,594	0.0317%	4.03%
SFY18	\$2,383,363,177	\$326,214	\$2,383,036,963	0.0137%	3.58%

The following factors lessen the department’s risk of billing for unallowable indirect costs:

- the department’s practice to limit the use of the rate for billing (versus internal project costing) purposes;
- the methodology for calculating the indirect rates had predominantly remained constant for the last two years;
- prior reports issued by the OIG for Indirect Cost Rates indicated there were no significant deficiencies or material errors; and
- overall, the actual indirect rates declined or stayed stable (i.e., increased less than 10 percent), with the exceptions of the Tolls In-House and the ER In-House.

RESULTS OF REVIEW

Based on our review of the indirect rate calculation and its development process, **we determined** the rates (Appendix B) submitted are reasonable, allocable, and allowable. **We also determined** the indirect packet submission process has become more transparent with the utilization of the One Note platform which includes explanations of the files it contains.

As part of our review, we assessed any potential risk in the utilization of the indirect rate for federal match purposes. As of the present time, the department does not designate which specific costs are used to meet the federal match requirement. Instead, it designates all available sources (state-funded direct costs, qualifying locally-funded direct costs, and indirect costs) as match in its project costing system even after the requirement has been met and exceeded. If the department does not meet the match requirement for a project from these sources, it fills the gap with toll credits.

Therefore, we can conclude the department does not consistently utilize the indirect rate for match purposes, although we cannot quantify the exact effective match rate.

Because of the low risks identified in previous years, the focus of our engagement has shifted from reviewing and recalculating rates to enhancing the understandability of the review and approval process. We used the July 2016 FHWA Desk Guide to identify components important to FHWA's review and approval of the department's indirect rates. As stated in the Desk Guide, the proposal package should include the following elements:

Element 1: The proposal itself, including detailed schedules for the composition and allocation of all allocated, billed, or indirect cost centers.

Element 2: A transmittal letter from the non-federal entity requesting approval of the indirect cost allocation plan for the specified fiscal year and the proposed rate(s).

Element 3: A detailed and understandable reconciliation of the costs included in the proposal to the non-federal entity's accounting records.

Element 4: An explanation of any significant increases in individual cost centers or rate components (i.e., direct costs or significant indirect cost rate component that is more than 10 percent higher than the level negotiated for the prior year).

Element 5: A computation of the actual/estimated federal financial assistance for each applicable agency with federal funds.

Element 6: Any other information specifically requested by the FHWA as a condition of prior negotiation agreements.

Element 7: A signed Certificate of Cost Allocation Plan or Certificate of Indirect Costs as required by the OMB Uniform Guidance (*Ref 2 CFR 200.415*).

Element 8: Justification for any deviations from the standard allocation bases prescribed by the Uniform Guidance.

We found all elements to be compliant in this year's submission packets (Elements 5 and 6 are not applicable).

Variance Analysis

We identified the following instances of significant variances within indirect rate components. In both cases, large positive variances in the 2018-2019 rates reversed large negative variances in 2017-2018, which produced negative rates for that year:

- **Tolls In-House:** Increased by 56 percent (from negative 55.94 percent to positive 0.39 percent), due to a \$47M adjustment made by the Cash Forecast Team coupled by forecasted direct rates for the current year which are \$34.5M higher than last year's; and
- **ER In-House:** Increased by 43 percent (from negative 8.25 percent to positive 34.91 percent). As confirmed with the OOC, these cost pools can be unstable in nature; therefore, forecasting is not feasible. Thus, actual indirect costs are used to determine rates. Natural disasters will increase the number of ER projects in one year, increasing the rate for the following year. If the following year entails a low number of ER projects, the variance between costs incurred and costs applied will be higher for that year, but its effect will reverse the following year.

APPENDIX A – Purpose, Scope, and Methodology

The **purpose** of this review was to determine whether the fringe and indirect rates submission packets were complete, sufficient in detail, the process remained consistent in relation to previous years, and that calculations were accurate to allow for an adequate review by the Federal Highway Administration (FHWA).

The **scope** of this review entailed evaluating compliance of the fringe and indirect rates submission packets with elements of the FHWA Desk Guide.

The **methodology** included:

- review of the Indirect Handbooks, Indirect Cost Allocation Plan, and FHWA Desk Guide, to gain an understanding of rates proposal submission requirements;
- analytical review through the development of trend analysis to observe significant rate fluctuations;
- inquiries to understand significant rate increases/decreases;
- reconciliation of proposed rates to underlying support to ensure accuracy in rate calculation process; and
- review of prior year's indirect rates audit reports to ensure methodology has remained consistent.

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APPENDIX B – 2019 Rate Schedule (As Submitted)

Direct Program Pools	Indirect Rates 2019-2020
61 Preliminary Engineering Product	7.06%
62 Preliminary Engineering In-House	4.60%
63 Construction Engineering Inspection Product	3.47%
64 Construction Engineering Inspection Inhouse	2.22%
65 Construction Product	3.38%
66 Right Of Way Product	8.89%
67 Right Of Way Inhouse	5.48%
68 Public Transportation Product	2.56%
69 Public Transportation Inhouse	2.71%
70 Turnpike Product	2.89%
71 Turnpike Inhouse	2.63%
72 Tolls Product	4.33%
73 Tolls Inhouse	0.39%
74 Maintenance Product	6.61%
75 Maintenance Inhouse	6.68%
76 Traffic Operations Product	3.03%
77 Motor Carrier Size & Weight	0.00%
78 Planning Product	9.91%
79 Planning Inhouse	3.04%
80 E R Inhouse	34.91%
81 E R Product	-24.48%
TOTALS	3.58%

Source: OOC Indirect Rate Packet Submission

APPENDIX C – Management Response

On Friday, January 11, 2019, the Office of Comptroller responded with no comments to Audit Report No. 19I-6002 regarding the Florida Department of Transportation Fiscal Year (FY) 2019-2020 Indirect Rate, and thanked the OIG for its work.

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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*.

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