



# AUDITS OF CONSULTANTS

## Audit Office

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# PRE-AWARD EVALUATIONS

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## Pre-award reviews:

- *Performed for Qualifications based procurements as negotiation support to the Contract Manager*
- *Determine a fair and reasonable price in compliance with:*
  - » *40 USC §1101*
  - » *California Government Code 4526*
  - » *Contract provisions*
- *Evaluation of proposed rates:*
  - » *Labor*
  - » *Indirect Costs*
  - » *Other Direct Costs*
- **Pre-award is a review of proposed rates to determine if the rates are reasonable for billing purposes. It is not an audit of the rates proposed.**

# CONTRACT COMPLIANCE INTERIM/POST AUDITS

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Audits are performed in accordance with the Performance Standards set forth in the Government Auditing Standards issued by the Comptroller General of the United States of America, (generally accepted auditing standards), to ensure audit objectives are achieved.

## **Audit Objectives:**

- 1. Determine if the Consultant's financial management system is capable of accumulating and segregating reasonable, allocable, and allowable direct and indirect costs and maintains adequate cost records which segregate project costs from the costs of other operations as required by the cost principles of Code of Federal Regulations (CFR), 48 Chapter 1 Part 31 and 2 CFR Part 200 or 49 CFR Part 18.**
- 2. Determine if the Consultant and its subcontractors' cost billed are actual, supported and reflect only those costs allowable by the contract provisions and by CFR 48 Chapter 1 Part 31.**

# AUDIT PROCESS

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Auditors follow a prescribed audit program in performing contract compliance audits and preaward evaluations.

Auditors prepare workpapers to document the work performed, their analysis of the information provided, and conclusions reached.

Workpapers are reviewed at two levels. The first level is to determine if the objectives have been met. The second level is to determine if the issues identified are supported in the workpapers.

# CHALLENGES IN CONSISTENCY

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- Audits are performed by analyzing each firm individually
- Each consultant has a different level of sophistication in its financial management system.
- Variables include:
  - » *Timesheet hours recorded*
  - » *Salary, hourly, owner draws*
  - » *Type of business entity*
  - » *Segregation of direct and indirect costs*
  - » *Length of time in business*

# DIRECT VS INDIRECT COSTS

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- **Direct cost:** A cost that can be directly tied to the production of specific goods or services/project.
  - ❖ *Project Labor*
  - ❖ *Travel*
- **Indirect cost:** A cost that is not directly traceable to a specific department, product, activity, customer, or project.
  - ❖ *Indirect Labor – company-wide support staff*
  - ❖ *Rent & utilities*
  - ❖ *Insurance*
  - ❖ *Communications*

# BILLABLE VS. NON-BILLABLE COSTS

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**Billable expenses are costs your client agrees to be billed for.**

- » *Billable expenses are reimbursable if they are included in the terms of your contract and/or were approved by the client prior to incurring the cost.*
- » *Billable costs are recovered through invoices to the client.*

**Non-billable direct expenses are costs directly related to your work with the client that they are unwilling to reimburse.**

- *These costs are direct, unbillable costs.*
- *They are not indirect costs and cannot be part of the indirect cost rate.*

# AUDIT WORK

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**To ensure contract compliance audit objectives are achieved:**

- *Information and documentation is obtained throughout the audit.*
- *Consultants are updated regularly on audit progress, required information and any issues identified.*
- *Audit issues are also discussed with Consultants prior to issuing the audit report.*
- *Final audit report issued at the contract level and Prime consultant provides a consolidated response.*



# DOCUMENT CONSULTANT'S INTERNAL CONTROLS

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**Auditors obtain an understanding of the Consultant's financial management and information systems through:**

- **Review and analysis of Consultant's completed Internal Control Questionnaire;**
- **Interviews with key Consultant management;**
- **Walkthrough of the processes for:**
  - ❖ *Tracking, recording and maintaining accounting records;*
  - ❖ *Timekeeping and payroll;*
  - ❖ *Management of subconsultants (if applicable);*
  - ❖ *Invoice/billing process, including contract set up.*

# RISK ASSESSMENT

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**Auditor tests internal controls by reviewing selected accounting records and supporting documents to determine if the Consultant's system is capable of accumulating and segregating reasonable, allocable and allowable costs:**

- ❖ Identify and document instances of internal control deficiencies that may affect the Consultant's ability to support billed costs.*
- ❖ Update transactions to be tested based on identified risks.*

# TESTING OF ELEMENTS OF COST

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- Auditor verifies the elements of cost during the testing phase of the audit:
  - ❖ *Direct labor*
  - ❖ *Indirect Costs*
  - ❖ *Other Direct Costs*
  - ❖ *Subconsultant Costs*

# TESTING OF ELEMENTS OF COST –DIRECT LABOR

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- Auditor verifies billed hours and rates are supported by:
  - ❖ *Consultant timesheets;*
  - ❖ *Consultant payroll registers;*
  - ❖ *Application of escalation;*
  - ❖ *Job cost records;*
  - ❖ *Master Resource Pool; and/or*
  - ❖ *Evidence of Authority approval of staff and labor rates*

# TESTING OF ELEMENTS OF COST –INDIRECT COSTS

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- Auditors verify billed indirect cost rates (overhead) are supported.
- For all indirect rates, audited by a CPA or self-prepared
  - ❖ *Consultant or independent accountant's schedules and explanation of methodologies*
  - ❖ *Fluctuation analysis between years to identify significant variances*
  - ❖ *Trace indirect cost schedule to trial balance*
  - ❖ *Trace labor costs to federal payroll tax return (940 or 941)*
- For self-prepared, compiled or reviewed indirect rate schedules
  - ❖ *Consultant's general ledger accounts*
  - ❖ *Additional supporting documentation, as applicable*
- Auditors verify the billed indirect cost accounts:
  - ❖ *Comply with the cost principles for allowable costs, CFR 48 Part 31*
  - ❖ *Exclude any direct project costs*

# ELEMENTS OF COST –EXECUTIVE COMPENSATION

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Auditors review total executive compensation, including salary and bonuses:

- **Salary:** Verify wages were paid for work in the billed year.
- **Bonus:** Verify the incentive compensation plan is objective, performance based and communicated to all staff.
- **Bonus:** Verify the bonus does not constitute distribution of profits.
- **Assess reasonableness of total compensation:**
  - ❖ *Compare executive compensation to the National Compensation Matrix.*
  - ❖ *Identify any excess compensation and exclude from the overhead calculation.*

## TESTING OF ELEMENTS OF COST – OTHER DIRECT COST

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- **Auditors verify billed other direct costs are:**
  - ❖ *Supported by source documents (invoices, receipts, usage logs)*
  - ❖ *Costs were approved in advance, as applicable (travel)*
  - ❖ *Costs are recorded in the job cost system as direct costs and not as overhead (indirect cost)*

## TESTING OF ELEMENTS OF COST – SUBCONSULTANT COST

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- Auditors verify billed subconsultant costs (includes second-tier subs and independent consultants) are supported by:
  - ❖ *Subconsultant invoices (including direct labor, indirect costs, and other direct costs)*
  - ❖ *Subconsultant rates invoiced agree to rates in subconsultant agreements*
  - ❖ *Subconsultant payments agree to Prime agreement terms*



# LESSONS LEARNED AND HELPFUL RESOURCES

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- Escalation passed along to employees
  - Related-party transactions (rent)
  - Meetings should be documented (agendas, minutes, etc.)
  - Selected provisions from the Prime agreement flow down to the subconsultant agreements
  - Prime agreement – if incorporated then understand effect
  - Record retention – documents and methodologies (including when there is a change in system or provider)
  - Record retention period – three years from date of final payment to the Prime.
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- AASHTO Audit Guide

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# Questions?

# THANK YOU

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