

**AUDIT OF FINANCIAL CONTROLS FOR
COST ACCOUNTING AND BILLING
PRACTICES, VOLPE NATIONAL
TRANSPORTATION SYSTEMS CENTER**

Research and Special Programs Administration

**Report Number: FI-2004-076
Date Issued: August 4, 2004**



Memorandum

U.S. Department of
Transportation

Office of the Secretary
of Transportation
Office of Inspector General

Subject: **ACTION:** Audit of Financial Controls for Cost
Accounting and Billing Practices, Volpe National
Transportation Systems Center
Research and Special Programs Administration
FI-2004-076

Date: August 4, 2004

From: Alexis M. Stefani 
Principal Assistant Inspector General
for Auditing and Evaluation

Reply to
Attn. of: JA-20

To: Deputy Administrator, Research and Special
Programs Administration

This report presents the results of our review of the John A. Volpe National Transportation Systems Center's (Volpe) system for tracking and reporting project costs. Volpe, located in Cambridge, MA, is part of the Department of Transportation's (DOT) Research and Special Programs Administration (RSPA). It was established in 1970 to provide analytical, scientific, and engineering support to DOT. Volpe currently employs approximately 550 Federal employees and 900 contractor employees, 450 of whom are on-site.

Volpe does not receive direct appropriations from Congress. Rather, Volpe receives funds from its customers on a fee-for-service basis. Federal customers advance spending authority through inter-service support agreements. For fiscal year (FY) 2003, Volpe received \$232 million in funding, with \$229 million coming from Federal customers, including \$149 million from DOT customers. The Federal Aviation Administration provided about half of the DOT funding.

Because Volpe operates on a fee-for-service basis and thereby charges all of its work to its customers, it is imperative that it have a cost accounting and financial reporting system to collect costs by project and charge them to customers accurately. Project cost accounting systems are used to accumulate actual total direct costs by cost element (e.g., labor, materials) for all work in an organization. The systems assign the costs to the appropriate time period and individual project and normally provide monthly cost summaries for use in billing customers. Cost accounting systems also distribute indirect costs (overhead) to projects based on

an acceptable allocation method. Indirect costs generally comprise normal operating expenses such as rent and utilities that benefit all projects but cannot be readily charged to any specific project. The allocation method should result in all projects receiving a fair share of indirect costs.

The objective of this review was to evaluate Volpe's FY 2002 operations to determine that the revenues and costs, accumulated by project and funded by various agencies, are accurately reflected in the accounting records. As part of this objective, we evaluated whether Volpe's overhead rate development and implementation, including its method of distributing overhead costs to projects, were in accordance with generally accepted accounting principles, which incorporate Federal accounting standards. O'Connor & Drew P.C. assisted us by performing agreed-upon procedures on Volpe's FY 2002 financial operations. Their findings are included in Appendix II of this report. We expanded the audit to cover FY 2003 financial operations because in May 2003, Volpe implemented DOT's new Delphi financial management system, which includes cost accounting. We performed this audit in accordance with Government Auditing Standards. Our audit objective, scope, and methodology are presented in Exhibit A.

RESULTS IN BRIEF

During FYs 2002 and 2003, Volpe recorded actual direct costs such as labor and acquisitions (contracts) and assigned them to projects appropriately. However, the treatment of indirect costs during both FYs 2002 and 2003 did not comply with generally accepted accounting principles. Volpe recorded \$2.31 million of FY 2003 overhead costs in the year obligated, FY 2002, rather than the year the costs were actually incurred, FY 2003. This resulted in an increase in FY 2002 overhead costs for all projects worked in FY 2002. Shifting these costs from FY 2003 to FY 2002 resulted in overcharging FY 2002 projects and undercharging FY 2003 projects. Volpe has also not implemented formal policies and procedures to guide staff in project cost accounting issues.

During FY 2002 and until May of 2003, Volpe's system provided four financial status reports to its customers' finance offices. The financial status reports provided reasonably detailed information on the status of authorizations, advances, commitments, obligations, accrued expenditures, and disbursements. They also provided actual costs of projects, but the reports did not identify the actual costs of individual cost elements such as labor and materials.

After converting to DOT's new Delphi financial management system in May 2003, Volpe's reporting capability was adversely affected. The financial status reports, which had been generated under the old financial management and cost accounting systems, are no longer available and accordingly cannot be given to

customers. Volpe and the Oklahoma City Delphi Team have been working to improve the reports being generated from Delphi. We recommend a series of actions to correct the accounting system deficiencies, improve reporting capabilities, and implement policies and procedures. RSPA agreed with the report recommendations and provided planned actions for implementing each recommendation.

FINDING AND RECOMMENDATIONS

Overhead Costs Were Not Assigned to the Proper Year

Prior to implementing Delphi in May of 2003, Volpe used the Financial Status of Programs (FSOP) cost accounting system, interfaced with the Departmental Accounting and Financial Information System financial management system, for cost accounting and related financial reporting. During this time, the cost accounting system properly assigned direct costs, such as labor and contract charges, to projects. After conversion to the Delphi system, Volpe continued to properly assign direct costs to projects.

In contrast, the treatment of overhead costs during both FYs 2002 and 2003 did not comply with generally accepted accounting principles. When FY 2002 actual overhead costs were lower than amounts charged to customers, Volpe assigned future (FY 2003) overhead costs related to service contracts as current year (FY 2002) actual costs. This resulted in customers being overcharged in FY 2002 by \$2.31 million (7 percent of the total FY 2003 overhead pool), the amount of FY 2003 service contracts costs included in FY 2002 overhead.

Volpe charged expected future costs to the current year by counting obligations as expenses. Obligations are liabilities to pay an amount at a future date, rather than costs that have actually been incurred. Generally accepted accounting principles require that managerial cost accounting systems not charge costs to a project until the costs have actually been incurred, a practice referred to as the accrual basis of accounting.

At the end of FY 2002, Volpe recognized expenses in the cost accounting system before they were incurred. Volpe shifted \$2.31 million of costs expected to be incurred in FY 2003 overhead to FY 2002 overhead. The \$2.31 million consisted mainly of obligations associated with various service contracts, including maintenance, delivery, mailroom, office supplies, accounting, and security services. Volpe representatives explained this practice is not done every year but is part of their fiscal year-end review process. If the actual overhead rates are significantly lower than the budgeted and billed rates, Volpe includes obligations in that year's overhead costs. Volpe officials stated that the decision to count

obligations as FY 2002 overhead costs was based on an informed management decision and is done to keep the actual overhead rate from fluctuating each year.

To justify its decision to include obligations in FY 2002 overhead costs, Volpe cited a procurement change in the Federal Acquisition Streamlining Act (FASA) that provided that annual service contracts crossing 2 fiscal years may be fully obligated in the first fiscal year. However, the FASA change did not address or change generally accepted accounting principles, which require that the cost accounting system charge costs to the proper project and cost element in the year the costs are actually incurred.

Volpe's practice of including obligations in the current fiscal year's overhead costs does not comply with generally accepted accounting principles, which include Statements of Federal Financial Accounting Standards (SFFAS). SFFAS Number 4, "Managerial Cost Accounting Standards," states that the cost of an output (project) is the cost of resources consumed. Resources are not consumed until the services are delivered (FY 2003 in this case). Similarly, SFFAS Number 1, "Accounting for Selected Assets and Liabilities," states that liabilities should be recorded when services are provided or goods are delivered, rather than when obligated. The Financial Accounting Standards Board Statement of Concepts Number 6, "Elements of Financial Statements," defines expense in a similar manner.

Volpe officials also told us that there is no material effect associated with its practice of counting obligations as expenses because most customers' projects cover more than 1 fiscal year. Essentially, by expensing obligations in FY 2002, Volpe is reducing expenses in FY 2003, the time period when the expense is actually expected to be incurred. Thus, Volpe believes that customers would benefit in FY 2003, since Volpe will not record any expense for the \$2.31 million in obligations when the services are delivered in FY 2003. We do not agree that this practice has no effect because individual customers could be materially overcharged if their projects were completed in FY 2002 or if the effort associated with their projects was greater in FY 2002 than FY 2003.

To account properly, Volpe should have reduced the amounts that it charged customers in FY 2002 due to the overestimated overhead rate and returned the funds to customers. Because this was not done, Volpe should adjust the FY 2002 and FY 2003 overhead rates to actual rates and adjust customers' accounts.

In the future, allocated overhead rates should be adjusted to actual rates, and customer accounts should be adjusted appropriately at the end of the year. Additionally, the allocated overhead rate should be adjusted before the end of the year if during the year Volpe determines that the actual rate will be significantly lower than the budgeted rate at the end of the year. Early adjustments would

provide certain customers with sufficient time to use freed-up funds for other operating needs.

Information Provided to Customers and Internal Users Is Inadequate

SFFAS Number 4 requires agencies to design managerial cost accounting reports to consider the needs of both external users, such as Volpe's customers, and internal users, such as Volpe project managers. SFFAS Number 4 also requires that agencies accumulate and report the actual costs of projects and activities and the composition of those costs.

During FY 2002, Volpe was able to satisfy most needs of customers and project managers. However, upon converting to Delphi (DOT's new financial management system) and the Oracle Projects cost accounting module in May 2003, much of the existing reporting capability was lost. Volpe is gradually regaining its reporting capability, but the process has been costly, requiring the assistance of the Oklahoma City Oracle Delphi consultants. Volpe still lacks much of the information available in financial reports issued routinely prior to converting to Delphi.

Efforts To Meet Customers' Information Needs

Volpe's customers are DOT and other Federal agencies. Volpe does not routinely send bills to customers because the Federal customers fund their projects in advance. Accordingly, Volpe's customers need financial reports that provide cost and budget information for individual projects and in total. Cost information needed includes cost incurred by project and by cost element such as labor, material, and travel. Budget information includes amounts authorized, committed, and obligated by project and appropriation. This cost and budget information helps customers understand how their funds are being used and identify remaining funds and obligations available to complete their projects.

Before converting to Delphi, Volpe used the FSOP cost accounting system and periodically provided four financial status reports to customer finance offices. These reports provided reasonably detailed information on the total costs of projects. The reports also provided detailed information on amounts funded, committed, and obligated by project and appropriation. However, customer reports could be confusing and were not user friendly. For example, customers needed to review separate reports to identify current year project costs and inception-to-date project costs. Also, none of the reports identified the cost elements making up the total project costs.

After Volpe converted to Delphi and Oracle Projects in May 2003, most reporting capability was lost, and customers' finance offices no longer receive regular financial status reports. The Volpe Financial Management staff worked with an Oracle consultant to develop an interim work-around to provide monthly reports for Volpe project managers that the project managers share with their customers. Prior to April 2004, these reports did not contain incurred cost information; they contained only budget information. Volpe was able to piece together through various data extracts a one-line summary per project of customer advances and Volpe revenue and accounts receivable at September 30, 2003. This information was sent to customers for use in preparing their annual financial statement.

Efforts To Meet Volpe Project Managers' Information Needs

Volpe project managers need access to a cost accounting system capable of identifying actual costs by project, both in total and by cost element. They also need access to the system to enable them to obtain information on individual transactions so they can analyze and control costs on their projects. Finally, they need budget information to help them identify remaining funds available to complete projects within budget.

Prior to converting to Delphi, Volpe project managers received monthly project status reports from the FSOP cost accounting system and had access to Volpe's Executive Information System (EIS) from their desktops. The EIS provided project managers with direct on-line access to the information available in the FSOP cost accounting system. The project status reports and EIS access provided information on budget, commitments, and obligations by project, task, and cost element. The EIS also gave project managers the capability to examine individual commitment and obligation transactions, such as contracts and requisitions. Volpe project managers, however, were not provided access to actual cost information.

After converting to Delphi, Volpe lost much of the capability to provide project information to its project managers. With the assistance of an Oracle consultant, Volpe did develop a work-around report for its project managers that shows budget, commitments, and obligations by project, task, and cost element. It did not show actual costs. Volpe developed the ability to report on actual project costs on a monthly basis in April 2004. However, Volpe project managers are no longer able to access any information from their desktops, and they lost the ability to obtain information on individual transactions.

Efforts to Generate Reporting Information in Delphi

With design input from Volpe and a cost to date of about \$300,000, the Delphi support staff in Oklahoma City is developing project status reports for Volpe that

are expected to replicate most of the information in the previous four FSOP reports that were provided to customers' finance offices and the previous reports that were provided to Volpe project managers. According to the Oklahoma City Delphi staff, development of these reports has been complicated and delayed by the effort to make Delphi reports look like the prior reports, rather than using the standard reporting capabilities built into the Delphi system. These Delphi reports are currently being tested by Volpe. Although progress is being made, the reports still contain errors.

Delphi has a number of standard reports that would provide project managers with much but not all of the information currently needed by customers and project managers. However, Volpe project managers do not have access to the standard reports. The Oklahoma City Delphi staff will allow access to the standard reports, as well as to other reports currently being developed, using report-generating software. After appropriate training, Volpe financial managers and individual project managers would be able to access reports via the internet to get the information they need when and in the format they need it. However, Volpe management has not approved providing this access to Volpe project managers. Volpe should approve access and provide the necessary training.

Written Policies and Procedures Needed

Volpe has informal processes that the staff follows to monitor and control overhead rates, year-end overhead rate development, and year-end adjustment of overhead rates from billed to actual. For example, indirect transactions and associated overhead rates are monitored, and analyses are performed by the assigned analysts after the close of every month. However, there is no formal financial policy and no procedures manual for the staff to use. According to Volpe's Financial Management Division manager, the staff position responsible for development of these policies and procedures has never been filled.

Federal cost accounting standards provide that all managerial cost accounting activities, processes, and procedures should be documented by a manual, handbook, or guidebook of applicable accounting operations. This reference should outline the applicable activities, provide instructions for procedures and practices, list cost accounts, and contain examples of forms and other documents used. Lack of such a reference makes it more time consuming and difficult to perform and support actions such as overhead rate development and adjustment and makes it more difficult for new or substitute employees to perform duties in case of turnover or absence. To operate as an efficient organization, Volpe should develop a policies and procedures manual for its cost accounting system.

RECOMMENDATIONS

We recommend that the Deputy Administrator of the Research and Special Programs Administration direct that the Acting Deputy Director of Volpe:

1. Implement a corrective action plan with milestones to:
 - a) Utilize the accrual basis of accounting for the cost accounting and financial management systems and discontinue including subsequent year's costs in the prior year's overhead pools.
 - b) Compute the effect of including obligations in overhead costs for FYs 2002 and 2003 on costs charged to customers. This includes removing the \$2.31 million from the FY 2002 indirect cost pools, including the actual costs incurred in FY 2003 in the FY 2003 indirect cost pools, and then re-computing overhead rates for both years. Volpe then must appropriately reimburse excess overhead charged to customers.
 - c) Develop and implement policies and a procedures manual for all managerial cost accounting activities, processes, and procedures.
2. Work with the Office of Financial Management, the Office of the Secretary of Transportation, and the Oklahoma City Delphi Team to implement a corrective action plan with milestones to:
 - a) Identify and develop reporting requirements that ensure that project status reports and financial status reports comply with SFFAS Number 4 and provide sufficient information so users can clearly understand the basis for the amounts charged. Customer reports should identify actual costs, in total and by cost element.
 - b) Determine whether standard or ad hoc Delphi reporting capabilities can meet these requirements and develop the appropriate reports.
 - c) Ensure Volpe's project managers, financial managers, and staff are provided the necessary training and granted appropriate access to Delphi so they can extract standard and ad hoc reports via the internet and obtain the financial status of projects when and in the format they need it.

MANAGEMENT COMMENTS AND OIG RESPONSE

A draft of this report was provided to the RSPA Deputy Administrator on June 10, 2004. The Deputy Administrator provided a written response on July 19, 2004, agreeing with our recommendations and providing the following comments. A copy of RSPA's reply is contained in Appendix I.

In response to our draft report, the Deputy Administrator expressed complete agreement with our opening observation "Because Volpe operates on a fee-for-service basis and thereby charges all of its work to its customers, it is imperative that it have a cost accounting and financial reporting system to collect costs by project and charge them to customers accurately." The Deputy Administrator is confident that implementation of the following actions in response to the Draft Report's recommendations will further assure Volpe customers and stakeholders alike that Volpe's overall financial practices are sound.

Specific comments by the Deputy Administrator and RSPA/Volpe planned actions on our recommendations are provided below.

Recommendation 1(a): RSPA concurred. Volpe's goal is to implement this recommendation and change from its prior practice of obligation-based accounting to accrual-based accounting in August 2004 for application to all FY 2004 and future transactions. Volpe Center financial staff has already initiated discussions with the Oklahoma City (OKC) Delphi Team. If the necessary changes in Delphi cannot be made by the end of August 2004, rather than jeopardize accurate fiscal year-end financial statements and a clean audit opinion for DOT, Volpe will defer the changes until FY 2005 and make any retroactive adjustments related to FY 2004 in FY 2005.

OIG Response: RSPA's planned actions are responsive to the intent of our recommendation.

Recommendation 1(b): RSPA concurred. Volpe has discussed this recommendation with the OKC Delphi Team and submitted a formal request for the necessary financial data from Delphi. When this request is prioritized in the next Delphi Reports User Group meeting in July and an estimated completion date is assigned, Volpe will prepare and supply to the OIG a corrective action plan to reallocate the identified indirect costs from FY 2002 to FY 2003.

OIG Response: Although Volpe agrees with the recommendation, their response does not indicate whether or not it intends to reimburse excess overhead charged to customers after it re-computes overhead rates for each year. Therefore we are requesting that RSPA provide more details on the specific actions Volpe will take to adjust customer's accounts or otherwise reimburse customers that were

overbilled. Additionally, we would appreciate receiving a copy of the corrective action plan for completing the recommended action.

OIG Recommendation 1(c): RSPA agrees that a procedures manual would be beneficial, and Volpe will develop one. Within 60 days of official issuance of the soon-to-be-released DOT Financial Management Policies Handbook, Volpe will begin developing a procedures manual that conforms to the DOT policies. In the interim, Volpe will begin formal documentation of the routines used to facilitate Delphi's calculation of FY 2004 indirect rates.

OIG Response: RSPA's planned actions are responsive to the intent of our recommendation.

OIG Recommendation 2(a): RSPA concurred. Volpe will continue to work with the OKC Delphi Team and OST's Office of Financial Management to complete the core financial status and project status reports currently under development. These reports will comply with SFFAS Number 4. On completion of the reports and Volpe remedial actions in response to the Draft Report, Volpe will hold customer information meetings in Washington, DC, on the Volpe Working Capital Fund, General Working Agreement, Reimbursable Agreement, cash advance processes, and customer reports. Volpe also plans to offer customers one-on-one meetings to review project data needs.

OIG Response: RSPA's planned actions are responsive to the intent of our recommendation. We request that RSPA provide us with a timeframe for completing the planned actions.

OIG Recommendation 2(b): RSPA concurred. Volpe informed the OKC Delphi Team of the complete information needed in the reports 3 years ago when Delphi was first introduced. Since then the OKC Delphi Team has intermittently worked on this challenge. RSPA/Volpe believe the OIG recommendation may help raise the OKC Delphi Team priority for completion of these reports.

OIG Response: RSPA's planned actions are responsive to the intent of our recommendation. We request that RSPA provide us with an estimated date for completing the reports.

OIG Recommendation 2(c): RSPA concurred. Volpe is implementing a new business information system that will provide project managers with easy access to project financial and project management data. This system will use Delphi financial data, milestones, project deliverables, performance indicators and other critical data to support Earned Value Management and other tools for managing complex projects.

OIG Response: RSPA's planned actions are responsive to the intent of our recommendation. We request that RSPA provide us with an estimated date for completing the business information system.

The complete text of management comments is in Appendix I.

ACTION REQUIRED

Actions taken and planned for Recommendations 1(a) and 1(c) are reasonable and no further response to those recommendations is necessary, subject to follow up. In accordance with DOT Order 8000.1C, we request additional comments and completion date milestones for Recommendation 1(b) and completion target dates for Recommendations 2(a), 2(b), and 2(c) within 30 days.

We appreciate the cooperation and assistance of RSPA, Volpe, and O'Connor & Drew P.C. representatives. If you have any questions concerning this report, please call me at (202) 366-1992, or Theodore Alves, Assistant Inspector General for Financial and Information Technology Audits, at (202) 366-1496.

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EXHIBIT A. OBJECTIVE, SCOPE, AND METHODOLOGY

This audit was requested by Congressman Ernest J. Istook, Chairman, Subcommittee on Transportation, Treasury and Independent Agencies, House Committee on Appropriations. Congressman Istook requested that we determine: (1) how Volpe's role and functions have changed over the years and whether current Volpe activities meet DOT's needs, (2) if Volpe has the necessary financial controls in place to assure its service fees are appropriate, and (3) DOT's role in overseeing Volpe and whether that role is adequate to ensure that Volpe provides cost-effective services.

To address Congressman Istook's request, we plan to issue three reports. This report addresses whether Volpe has the necessary financial controls in place to assure its service fees are appropriate. Another report will be issued to cover Volpe's role and function in the Department. The third report, which will be issued later this year, will cover program management oversight.

The objective of this review was to evaluate Volpe's FY 2002 operations to determine whether the revenues and costs, accumulated by project and funded by various agencies, are accurately reflected in the accounting records. As part of this objective, we evaluated whether Volpe's overhead rate development and implementation, including its method of distributing overhead costs to projects, were in accordance with generally accepted accounting principles. We expanded the audit to cover FY 2003 financial operations because Volpe implemented a new financial management and cost accounting system (Delphi and Oracle Projects) in May 2003.

We contracted with O'Connor & Drew P.C. of Quincy, MA, to perform agreed-upon procedures on Volpe's controls, assets and liabilities, costs and revenues, overhead rate development, and project reporting process for the fiscal year that ended September 30, 2002. We reviewed the audit work to ensure that it complied with applicable Government Auditing Standards.

We conducted work at the Volpe Center in Cambridge, MA, and DOT Headquarters in Washington, DC. We conducted the audit from September 2003 through April 2004 and in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States.

EXHIBIT B. MAJOR CONTRIBUTORS TO THIS REPORT

THE FOLLOWING INDIVIDUALS CONTRIBUTED TO THIS REPORT.

<u>Name</u>	<u>Title</u>
Terrence J. Letko	Program Director
Michael Weisz	Project Manager
Robert Anderson	Senior Auditor
Kathleen Huycke	Editor



U.S. Department
of Transportation

Research and
Special Programs
Administration

Memorandum

Subject: ACTION: Draft Report on the Volpe National
Transportation Systems Center Project No.
04F3004F000

Date: July 19, 2004

From: Samuel G. Bonasso
Deputy Administrator

A handwritten signature in black ink, appearing to read "S. Bonasso".

Reply to DRP-1
Attn. Of:

To: Kenneth M. Mead
Inspector General

This memorandum responds to your Office's Draft Report on the RSPA/Volpe National Transportation Systems Center (financial management), Project No 04F3004F000, dated May 14, 2004. I agree completely with your opening observation, "Because Volpe operates on a fee-for-service basis and thereby charges all of its work to its customers, it is imperative that it have a cost accounting and financial reporting system to collect costs by project and charge them to customers accurately." I am confident that implementation of the following actions in response to the Draft Report's recommendations will further assure Volpe customers and stakeholders that the Volpe center's overall financial practices are sound. In this regard, I appreciate your inclusion, as an attachment, of the entire report submitted to you by O'Connor & Drew, Certified Public Accountants, which documents that Volpe's overall financial management practices are sound:

"Other than the issue raised in the "Cost Accounting System" section D (ii) regarding fiscal year 2003 expenditures in the fiscal year 2002 overhead pool, our review determined that the cost accounting system is capable of generating adequate and reliable financial data, reconciliations are performed periodically and provisional rates are adjusted to actual rates annually."

The Draft Report sets forth two sets of recommendations. One related to addressing Volpe's decision to record \$2.31 million of overhead costs in the year obligated, FY 2002, rather than in the year the costs were actually incurred, FY2003. The second related to continued Volpe cooperation with the Oklahoma City Delphi Team (OKC Delphi Team) to complete the core financial reports for Volpe project managers and

customers. I agree with both sets of recommendations. RSPA/Volpe's planned actions for each specific Office of Inspector General (OIG) recommendation follow:

OIG Recommendation 1(a)

Utilize the accrual basis of accounting for the cost accounting and financial management systems and discontinue including subsequent year's costs in the prior year's overhead pools.

Response:

Volpe's goal is to implement this recommendation and change from Volpe's 34-year practice of obligation-based accounting to accrual-based accounting by August 2004 for application to all FY 04 and future transactions. Volpe Center financial staff have already initiated discussions with the OKC Delphi Team. If the necessary changes in Delphi cannot be made by the end of August 2004, rather than jeopardize accurate fiscal-year-end financial statements and a clean audit opinion for DOT, Volpe will defer the changes until FY2005 and make any retroactive adjustments related to FY 2004 in FY 2005.

OIG Recommendation 1(b)

Compute the effect of including obligations in overhead costs for FYs 2002 and 2003 on costs charged to customers. This includes removing the \$2.31 million from the FY 2002 indirect cost pools, including the actual costs incurred in FY 2003 in the FY 2003 indirect cost pools, and then re-computing overhead rates for both years. Volpe then must appropriately reimburse excess overhead charged to customers.

Response:

Volpe has discussed this recommendation with the OKC Delphi Team and submitted a formal request for the necessary financial data from Delphi. When this request is prioritized in the next Delphi Reports User Group meeting in July and an estimated completion date is assigned, Volpe will prepare and supply to the OIG a corrective action plan to reallocate the identified indirect costs from FY 02 to FY 03. There will be no net change in the combined FY 02 and FY 03 total overhead charges.

OIG Recommendation 1(c)

Implement a corrective action plan with milestones to develop and implement policies and a procedures manual for all managerial cost accounting activities, processes, and procedures.

Response:

We agree that a procedures manual would be beneficial, and Volpe will develop one. In fact, the soon-to-be-released DOT Financial Management Policies Handbook has set aside Section 11 for Managerial Cost Accounting. Within 60 days of official issuance of this guidance, Volpe will begin developing a procedures manual that conforms to the DOT policies. In the interim, Volpe will begin formal documentation of the routines used to facilitate Delphi's calculation of FY 2004 indirect rates.

OIG Recommendation 2 (a)

Identify and develop reporting requirements that ensure that project status reports and financial status reports comply with SFFAS (Statements of Federal Financial Accounting Standards) Number 4, and provide sufficient information so users can clearly understand the basis for the amounts charged reports should identify actual costs, in total and by cost element.

Response:

Volpe will continue to work with OKC Delphi Team and OST's Office of Financial Management to complete the core financial status and project status reports currently under development, and will furnish these report formats to the OIG. These reports will continue to comply with SFFAS Number 4. On completion of the reports and our remedial actions in response to this Draft Report, Volpe will hold customer information meetings in DC on the Volpe Working Capital Fund, General Working Agreement, Reimbursable Agreement, cash advance processes, and customer reports. Volpe also plans to offer customers one-on-one meetings to review project data needs.

OIG Recommendation 2(b)

Determine whether standard or ad hoc Delphi reporting capabilities can meet these requirements and develop the appropriate reports.

Response: As noted in the Draft Report: "*Delphi has a number of standard reports that would provide project managers with much but not all of the information currently needed by customers and project managers.*" (bold emphasis added). Volpe informed the OKC Delphi Team of the complete information needed in the reports three years ago when Delphi was first introduced. Since then, the OKC Delphi Team has intermittently worked on this challenge. We think the OIG recommendation may help raise the OKC Delphi Team priority for completion of these reports.

OIG Recommendation 2(c)

Ensure Volpe's project managers, financial managers, and staff are provided the necessary training and granted appropriate access to DELPHI so they can extract standard and ad hoc reports via the internet and obtain the financial status of projects when and in the format they need it.

Response:

Volpe is implementing a new business information system that will provide project managers with easy access to project financial and project management data. This system will use Delphi financial data, milestones, project deliverables, performance indicators and other critical data to support Earned Value Management and other tools for managing complex projects.

cc:

Deputy Secretary

Chief of Staff

**UNITED STATES
DEPARTMENT OF TRANSPORTATION
OFFICE OF INSPECTOR GENERAL**

**AGREED-UPON PROCEDURES OF THE
VOLPE NATIONAL TRANSPORTATION SYSTEMS CENTER
INTERNAL CONTROLS, ASSETS AND LIABILITIES,
COSTS AND REVENUES, OVERHEAD RATE DEVELOPMENT AND
CUSTOMER BILLING PROCEDURES**



APPENDIX II. O'CONNOR & DREW REPORT 18

Agreed-Upon Procedures of the Volpe National Transportation System Center
Internal Controls, Assets and Liabilities, Costs and Revenues, Overhead Rate Development and Customer Billing Procedures

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Agreed-Upon Procedures of the Volpe National Transportation System Center
Internal Controls, Assets and Liabilities, Costs and Revenues, Overhead Rate Development and Customer Billing Procedures

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APPENDIX II. O'CONNOR & DREW REPORT 20

Agreed-Upon Procedures of the Volpe National Transportation System Center *Internal Controls, Assets and Liabilities, Costs and Revenues, Overhead Rate Development and Customer Billing Procedures*

I. INTRODUCTION

We have performed the procedures enumerated below, which were requested by the U.S. Department of Transportation Office of Inspector General, solely to assist the U.S. Department of Transportation Office of Inspector General in evaluating internal controls, assets and liabilities, costs and revenues, overhead rate development and customer billing procedures of the Volpe National Transportation System Center for fiscal year 2002. Management of the Volpe National Transportation System Center is responsible for internal controls, assets and liabilities, costs and revenues, overhead rate development and customer billing procedures. This agreed-upon procedures engagement was conducted in accordance with the attestation standards established by the American Institute of Certified Public Accountants and *Government Auditing Standards*, Revised 2003, issued by the Comptroller General of the United States. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below whether for the purpose for which the report has been requested or for any other purpose.

II. SUMMARY OF RESULTS

Volpe records direct costs such as labor and acquisitions and assigns them to projects appropriately, but has a flaw in its treatment of indirect costs (overhead), which do not meet cost accounting standards or Federal reporting requirements. Volpe included \$2,310,000 of fiscal year 2003 overhead costs within fiscal year 2002.

The \$2,310,000 of fiscal year 2003 costs included in fiscal year 2002 overhead consists mainly of various service contracts, including maintenance, delivery, mailroom, office supplies, accounting and security. Volpe finance management explained this practice is not done every year but is part of their review process at fiscal year-end if the actual overhead rates differ significantly from the advertised rates. Volpe officials stated the selection of certain costs is an informed management decision and helps to keep the actual rate from fluctuating each year. However, Volpe's practice of including the following year's expenses in the current fiscal year's overhead pool does not comply with generally accepted accounting principles. Statement of Federal Financial Accounting Standards (SFFAS) No. 4, paragraph seven, states the cost of an output (project) is the cost of resources consumed. Resources are not consumed until the cost is incurred, fiscal year 2003 in this case.

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III. BACKGROUND

The Department of Transportation's Volpe National Transportation Systems Center, located in Cambridge, MA, was established in 1970 to fulfill the need for an in-house systems research capability. Since then, the Center's research, analysis and project management expertise has been applied to a wide variety of transportation and logistics problems and serves numerous customers within the Department of Transportation (DOT); other Federal agencies; State, local and foreign governments; other public authorities; and private organizations. In 1979, the Secretary of Transportation delegated oversight and leadership responsibility for the Volpe Center to the Administrator of the DOT's Research and Special Programs Administration (RSPA). The Center operates under the policy guidance of the Administrator of RSPA and serves as DOT's Research and Development Center.

IV. DETAILS OF RESULTS

Internal Controls

A) Determine whether internal controls provide reasonable assurance that amounts are properly recorded and summarized to permit the preparation of reliable financial information included in the Report to Customers.

- i) Expense accounts are segregated in the cost accounting system between direct and indirect expenses and proper internal controls and supporting documentation exist to support transactions.

Direct Costs

Our testing of 78 Volpe direct costs transactions consisted of randomly selecting four Project Plan Agreements (PPA) from the Direct Cost Reports (DCR). The detail for each PPA, by Work Plan Budget (WPB/task) and cost element, was provided. Volpe's management provided us supporting documentation to test the following attributes:

- *Charges were properly supported and approved* - We determined that the PPA, WPB, object class code and any other applicable documents and references were uniform throughout the support provided. We also determined that the appropriate authorization signatures were documented and justified.
- *Charges were properly classified and posted on a timely basis* – We determined that object class codes were applicable based on posting criteria utilized by the

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finance management division within fiscal year 2002 and postings were made on a timely basis.

- *Charges were properly calculated* – We determined that the amounts charged agreed to the supporting documentation provided.
- *Charges were identified with a specific project*. We determined that the PPA, WPB, and description corresponded to a direct project and task and the charge was not subsidizing other Volpe services.
- *Traced and Agreed to Job Cost Detail* - Our ultimate PPA sample selection was derived from the highest dollar amounts of the four random PPA's we chose from the direct cost summary. We "drilled down" to specific charges within WPB's and their applicable cost elements; therefore, the charges were inevitably traced and agreed to the direct cost summary.

Indirect Costs

Our testing of 29 Volpe indirect costs first consisted of randomly selecting 40 Project Plan Agreements from the Indirect Cost Summary (ICS). Our methodology was to select 40 items within the ICS from a total population of 353.

We reviewed the charges by WPB and cost element. Under the cost elements, we observed numerous transactions that cumulatively made-up the total amount of indirect charges for each PPA. Volpe's management provided us supporting documentation to test the following attributes:

- *Charges were properly supported and approved* - We determined the PPA, WPB, object class code and any other applicable documents and references were uniform throughout the support provided. We also determined that the appropriate authorization signatures were documented and justified.
- *Charges were properly classified and posted on a timely basis* – We determined that object class codes were applicable based on posting criteria utilized by the finance management division within fiscal year 2002 and postings were made on a timely basis.
- *Charges were properly calculated* – We determined that the amounts charged agreed to the supporting documentation provided.
- *Charges were not identified with a specific project* – We reviewed that the PPA, WPB, and description did not correspond to a direct project or task and the charge was not subsidizing other Volpe activities.

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- *Traced and Agreed to Job Cost Detail* - Our ultimate PPA sample selection was derived from the highest dollar amounts of the 40 random PPA's we chose from the indirect cost summary. We "drilled down" to specific charges within WPB's and their applicable cost elements; therefore, the charges were inevitably traced and agreed to the indirect cost summary.
- ii) Labor Charges are properly identified by project, recorded in the cost accounting system in a reasonable manner and proper internal controls and supporting documentation exist to support the transaction.

Our review of source documents determined that labor charges were properly identified and recorded within the cost accounting system in a reasonable and accurate manner at the WPB and PPA levels for both direct and indirect charges.

Direct Labor

Our direct labor test consisted of randomly selecting 40 Project Plan Agreements (PPA) from the Direct Cost Summary (DCS) and utilizing four random pay periods from fiscal year 2002.

Our direct labor test of 40 transactions covered the following attributes:

- *Timesheets existed and were properly completed* – We determined that the employee and the supervisor properly signed the timesheets.
- *Timesheets agreed with other reports throughout the Cost Accounting System* - We determined that each individual's timesheet for the respective pay period agreed with the labor distribution report and job cost report.
- *WPB (Tasks) were properly identified* - We determined that the hours were traced and charged to the correct task on each timesheet for each pay period.
- *Overtime was paid properly* - If an employee worked overtime, we determined that the overtime was paid and properly authorized.
- *Agreed that Volpe personnel received proper payment* – We examined cancelled checks and/or direct deposits authorization and agreed the pay rate with human resources by viewing the Employee Master Record (EMR) for the appropriate pay period, which shows a very detailed synopsis of the employee's work record including hours worked (regular, overtime, leave and compensatory), along with regular rates and overtime rates.

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Indirect Labor

Our indirect labor test consisted of randomly selecting four Project Plan Agreements (PPA) from the Indirect Cost Summary (ICS).

We received each of the 56-sampled individuals' timesheets for the four selected pay periods along with each employee's master record. Consistent with our direct labor test, the indirect labor test tested the following attributes:

- *Timesheets existed and were properly completed* – We determined that the employee and the supervisor properly signed the timesheets.
- *Timesheets agreed with other reports throughout the Cost Accounting System* - We determined that each individual's timesheet for the respective pay period agreed with the labor distribution report and job cost report.
- *WPB (Tasks) were properly identified* – We determined that the hours were traced and charged to the correct task on each timesheet for each pay period.
- *Overtime was paid properly* - If an employee worked overtime, we determined that the overtime was paid and properly authorized.
- *Agreed that Volpe personnel received proper payment* – We examined cancelled checks or direct deposit authorization and agreed the pay rate with human resources by viewing the Employee Master Record (EMR) for the appropriate pay period, which shows a very detailed synopsis of the employee's work record including hours worked (regular, overtime, leave and compensatory), along with regular rate and overtime rate.

Conclusion

Expenditures are properly segregated within the cost accounting system between direct and indirect expense accounts.

Labor changes are properly identified by project and recorded in the cost accounting system in an accurate manner.

Source documentation exists that supports the individual charges.

Proper internal controls exist to support the respective transactions. The cost accounting system is capable of segregating and accumulating costs by project.

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Laws and Regulations

B) *Determine whether executed transactions are in accordance with laws and regulations governing the use of Volpe budget authority.*

Obligations

i) Obligations were available to support cost accounting charges and were in compliance with OMB Circulars A-11 and A-34.

We sampled four PPA's and tested the following attributes:

- *Obligated* - We determined that the revenues for the current and prior years did not exceed the General Working Agreement for DOT customers and Reimbursable Agreements for non-DOT customers.
- *Limitation of Revenues* - We determined that the revenue for the current and prior years did not exceed the respective obligated amount.

Compliance

ii) Transactions tested, as noted in B(i), are in compliance with various Federal laws.

- All of our transactions selected for testing appeared to be in compliance with various Federal laws.

Conclusion

Executed transactions were made in accordance with laws and regulations governing the Volpe National Transportation System Center.

Financial Reporting

C) *Determine whether amounts for assets, liabilities and capital accounts are generated from the accounting system and are in compliance with Treasury regulations.*

Reconciliation

i) Reconciliation of trial balance to balance sheet and statement of net cost.

We traced and agreed the supporting components of the Balance Sheet and Statement of Net Cost to the cost accounting system. This support also included all manual adjusting journal entries that were made to reconcile the cost accounting system to the financial reporting system.

U.S. Standard General Ledger Accounts

ii) Use of U.S. Standard General Ledger Accounts

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We obtained the Volpe Center's consolidated balance sheet and their "pre" and "post" closing trial balances and traced 24 account balances associated with Volpe assets, liabilities and capital accounts from the balance sheet to the trial balance. The parent accounts located within the trial balance clearly state the United States Standard General Ledger Accounts (USSGL) accounts. We traced and agreed the 24 accounts to the USSGL without exception. The sub-accounts of the USSGL are not accounted for in the trial balance. Volpe finance management stated they are not in compliance with this requirement because of the utilization of the Department of Transportation's Accounting and Finance Information System (DAFIS) software. However the DELPHI accounting system, installed in May, 2003, incorporated for the sub-accounts.

Conclusion

Amounts contained on the balance sheet and statement of net cost are supported by the Volpe trial balance.

The Volpe Center's accounting system is utilizing USSGL for parent accounts within their accounting system.

Cost Accounting System

D) Determine whether systems for cost accounting are reliable, including overhead development and implementation. Additionally, the accuracy of costs and revenue amounts reported for Volpe's business practices and service activities appears reasonable.

Indirect Expenses

i) Indirect expenses are reasonable and accumulated in homogenous overhead pools.

Beginning in fiscal year 1997, Volpe adapted a policy of allocating indirect costs into two pools. Volpe officials wanted to isolate acquisition costs because in their view, they were starting to observe more contracted costs associated with projects and felt segregating these costs would assist in keeping costs closer to this acquisition activity.

The dual-pool approach provides for a fairer means by which to recover costs from projects. The acquisition overhead pool rate specifically helps to recover acquisition-related indirect costs and the project overhead pool rate helps to recover all other indirect costs in proportion to each project's direct labor. Prior to 1997, various methods were used, including a sole project overhead rate from 1992

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through 1996 and from 1993 through 1996, a general and administrative model was utilized.

According to DOT Order 2300.6D, Section 6(c)(2), "Combination Allocation Bases," if a combination allocation base is utilized, one of the cost pools must be a General and Administrative (G&A) pool. Volpe management officials used the (G&A) methodology prior to 1997 and believe the implementation of the acquisition overhead pool, in conjunction with the project overhead pool, addresses overhead costs more closely and accurately and complies with the provisions of the Order.

Additionally, according to DOT Order 2300.6D, Section 7(d), "The Volpe Center shall submit to the RSPA Administrator a quarterly report of actual indirect costs incurred compared with the approved budget." Based upon the specific request of the former RSPA Administrator, Volpe management officials were informed it was not necessary to complete the quarterly reporting requirement required by Section 7(d). Though non-compliant with the requirement, this request was adhered to through fiscal year 2002 by Volpe finance management. Subsequently, during fiscal year 2003, the current RSPA Administrator re-instituted the reporting requirement starting with the first quarter of fiscal year 2004. In addition to the DOT quarterly reporting requirement, a request was made by the RSPA Administrator to provide a monthly written report of the same information to the Volpe Deputy Director. Our review did not ascertain whether the first report was completed but were informed by Volpe finance management its production was underway.

Financial Statement and Overhead Pool Adjustments

- ii) Appropriate financial statement and overhead pool adjustments are reflected in the cost accounting system.

We reviewed adjustments made to the financial statements and the overhead pool. A \$2.3 million financial adjustment for fiscal year 2003 expenditures was included in the fiscal year 2002 overhead pool. Based upon our testing of both direct and indirect costs we determined the transactions compiling the \$2.3 million were the only fiscal year 2003 expenditures classified by management for funding in fiscal year 2002.

Volpe finance management explained that this practice is not done every year but is part of their review process at fiscal year-end if the actual overhead rates are significantly different from the advertised rates. The effect of including fiscal year

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2003 expenditures in the fiscal year 2002 overhead pool is that customers were overcharged by \$2.3 million in fiscal year 2002 and undercharged by \$2.3 million in fiscal year 2003.

Statement of Federal Financial Accounting Standard (SFFAS), Number 1 states, in part, "The Board (Federal Accounting Standards Advisory Board) does not believe that recognizing a liability prior to an actual receipt or constructive receipt of goods or services should be adopted as a financial accounting standard." Additionally, "until goods or services are received or work progress is made, the Board does not believe that an obligation should be recognized as a liability. When goods or services are received or work progress is made under either a short or long-term contract, a liability for unpaid amounts should be recognized."

Statement of Federal Financial Accounting Standard (SFFAS), Number 4, states that "Managerial cost accounting should provide cost information using a basis of accounting and recognition/measurement standards that are appropriate for the intended use of the information." Since these customers reimburse Volpe for direct costs plus a portion of the indirect costs, the accrual basis of accounting should be utilized. A situation can occur where a contract ends in the current fiscal year but a customer is reimbursing Volpe for expenditures for the next fiscal year. SFFAS 4 also states that cost accounting should be consistent from year to year to "help the user determine the costs of providing specific programs and activities." Specifically, SFFAS 4, paragraph seven states, in part, "reporting entities should report the full costs of outputs in general purpose financial reports. The full cost of an output produced by a responsibility segment is the sum of the costs of resources consumed by the segment that directly or indirectly contribute to the output and identifiable supporting services." In this case, the resources were consumed in fiscal year 2003, not fiscal year 2002.

Unallowable Contract Costs

iii) Identification of unallowable contract costs.

Our review determined that the cost accounting system does not include unallowable contract costs. On the direct cost side, program managers and customers build their budgets and this ensures the customer is advancing funds for allowable and legitimate costs to complete the project. Both (direct and indirect budgets and costs) are reviewed by the finance management division. Direct and indirect budgets and costs are built on estimated costs. Therefore, unallowable costs would not be reported in the system because they are not part of the budget process.

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Conclusion

Indirect expenses are reasonably accumulated into project overhead and acquisition overhead pools.

We recommend that Volpe discontinue the use of including subsequent year's costs in the overhead pool. Volpe should not finalize the current year overhead pool until all reasonably known expenditures are recognized. After the overhead rate is finalized, the difference between the provisional rate and final rate should be debited/credited back to the respective customer's account.

Budget review procedures are in place amongst project managers, customers and Volpe finance management to ensure unallowable costs are not included in project budgets and subsequently, the cost accounting system.

We also recommend that Volpe management comply with all Department of Transportation reporting requirements to ensure proper oversight of indirect cost policies. Additionally, follow up inquiries should be conducted to make certain all reporting requirements have been completed.

Allocation Methodology

E) Evaluate the allocation methodology for Volpe Overhead Costs to determine whether costs are appropriately charged to lines of business.

Indirect Cost Allocation

i) Allocation of indirect costs to intermediate and final cost objectives and different pools are reasonable and accurately recorded.

The project overhead provisional rate for 2002 was 67% and the actual was 65.14%. The actual rate was calculated by dividing the net indirect project overhead (\$24.4 million) by the direct labor base, of (\$37.4 million).

The acquisition overhead advertised and actual rate for 2002 was 3.88%. The rate was calculated by dividing the net indirect acquisition overhead (\$6.4 million) by the direct acquisitions base, was of (\$167 million). Direct acquisitions are actual obligations on direct purchases, except for the cost of labor, travel and communications.

All intermediate and final cost objectives are charged the project overhead rate. Only costs incurred for the performance of the acquisition overhead staff are

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charged acquisition overhead. Examples of the tasks performed by the acquisition overhead staff are strategy and evaluations of proposals, legal reviews, contract administration, awarding and closeouts and accounts payable.

Indirect Cost Accumulation

ii) Accumulation of "indirect cost elements."

The cost accounting system is separated by many cost elements. During our testing of indirect costs, items tested were properly classified by "indirect cost elements."

Indirect Cost – Bases

iii) Indirect bases are appropriate for allocating costs.

We traced and agreed the direct labor used for the overhead pool to the direct labor cost report.

Conclusion

A logical and consistent methodology of allocating indirect costs exists for intermediate and final cost objectives and various overhead pools used are reasonable and accurately recorded.

Overhead costs are appropriately and consistently charged to lines of businesses based upon our evaluation of the allocation methodology.

The bases for allocating indirect costs were appropriate.

Billings

F) *Determine whether billings to customers are reasonable and provided sufficient information to clearly understand the basis for the amounts billed.*

Basis for Billings

i) Volpe's cost accounting system is used as the basis for billing projects/customers.

Customers and the Volpe Project Manager agree-upon budgets for Project Plan Agreements (PPA) for Department of Transportation (DOT) customers, Reimbursable Agreements (RA) for non-DOT customers and Agreements, for non-Federal customers. The funding authority and transfer of funds must precede any work that is done. Consequently, the Volpe Center does not send out formal bills to customers. Volpe project managers utilize the cost accounting system to provide information to customers on an "as needed" basis. On a monthly basis,

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project managers receive and review copies of the Direct Cost Summary of cost elements applicable to their projects. In addition to the direct cost summaries, project managers can access Volpe's Executive Information System (EIS) to obtain project accounting and finance information. EIS disseminates the same information available from the cost accounting system, but only Volpe finance management personnel can access the cost accounting system.

On a monthly basis the Volpe finance management division provides four reports to the customer's finance office, or designee. These reports explain the status of project funding authorizations, advances, commitments, obligations, accrued expenditures and disbursements. The information provided also includes financial data back to the project's inception.

Basis of Revenues

- i) Revenues are reasonable based on the cost accounting system.

Volpe's cost accounting system is used as the basis for billing projects/customers.

Conclusion

Although the Volpe Center does not produce a bill or statement of account for customers who hold contracts for services, Volpe provides sufficient reports and information to allow the customers to compare actual costs and budgeted costs. However, our review determined the reports were not easily discernable without proper instruction from Volpe accounting staff. Volpe finance management should revisit the format and amount of information being supplied to customers to ensure their needs are being met.

Subsidizing of Services

- G) *Determine whether Volpe services are subsidizing other Volpe activities.*

From our indirect cost testing referred to in Section A, we did not observe any indirect costs that relate to a specific project.

The overhead pools are properly segregated to ensure that the acquisition overhead pool is not charged for any non-acquisition customers.

Conclusion

Volpe services and direct and indirect costs are not subsidizing other activities based on project testing results. However, based on Volpe finance management's decision to include fiscal year 2003 indirect costs in the fiscal year 2002 overhead

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pool, it is possible fiscal year 2002 projects incurred costs belonging in fiscal year 2003. As mentioned previously, Volpe finance management should discontinue the use of including subsequent year's costs in the overhead pool.

Revenues and Costs

H) Determine whether revenues and costs are properly accounted for in the financial and cost accounting records.

Cost Accounting System and Reconciliations

i) Cost accounting system is capable of generating adequate and reliable data. Reconciliations are performed periodically and provisional rates are adjusted to actual rates annually.

Reconciliations of the cost accounting system are done on a daily basis. The Volpe accounting branch posts daily transactions to the cost accounting system. The system is updated overnight and also posts the transactions to the Executive Information System (EIS). Information regarding appropriations, advances, commitments, obligations, accrued expenditures and disbursements can be accessed on EIS. If there are unexplained variances, the cost accounting system gives Volpe finance staff the option of creating an exception report to research variances and, "drill down" to individual transactions.

Provisional (advertised) rates are adjusted at the fiscal year end and automatically adjusted by the cost accounting system. At the request of finance management, the actual rate is entered in the system and the calculations and adjustments are automatically made to the cost accounting and labor distribution systems. The Volpe labor distribution system applied the advertised rate (67%) for fiscal year 2002 throughout fiscal year 2003 and reported the actual rate (65.14%) for fiscal year 2003 at year-end reports.

Conclusion

Other than the issue raised in the "Cost Accounting System" section D(ii) regarding fiscal year 2003 expenditures in the fiscal year 2002 overhead pool, our review determined that the cost accounting system is capable of generating adequate and reliable financial data, reconciliations are performed periodically and provisional rates are adjusted to actual rates annually.

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We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Volpe National Transportation Systems Center management and the U.S. Department of Transportation, Office of Inspector General and is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit the distribution of this report if this report is a matter of public record.

Certified Public Accountants

December 3, 2003