

Schedule of Federal Audit Findings and Questioned Costs

Island Transit Island County January 1, 2013 through December 31, 2013

1. The Transit's internal controls were inadequate to ensure compliance with the requirements of the State of Good Repair Grants Program.

CFDA Number and Title:	20.525 State of Good Repair Grants Program
Federal Grantor Name:	Federal Transit Administration, U.S. Department of Transportation
Federal Award/Contract Number:	WA-04-0073
Pass-through Entity Name:	NA
Pass-through Award/Contract Number:	NA
Known Questioned Costs:	\$94,517
Likely Questioned Costs:	\$36,704

Background

In 2013 the Transit spent \$10,217,511 from the State of Good Repair Grants Program, funded by the Department of Transportation, Federal Transit Administration.

The purpose of the federal program is to assist in financing the planning, acquisition, construction and improvement of facilities and equipment in public transportation services. Island Transit used the funds to build a new administration and operations building, maintenance facility, bus washing station and fueling facility.

Description of Condition

Allowable costs/cost principles

Our audit identified the Transit did not have adequate controls to ensure costs charged to the grant were allowable under program requirements. In order for the costs to be allowable, the Transit must take reasonable steps to ensure and document that costs serve the purpose of the grant, which is to construct the new transit facilities. Our audit found the following:

- The Transit spent federal funds on preventative maintenance items and grounds maintenance equipment, such as a tractor, tires and other maintenance supplies, which are unallowable, and two gazebos, which the Transit could not demonstrate were part of the building and should have been included in the project. These

items resulted in known questioned costs of \$69,692 and likely questioned costs of \$36,704 based on similar vendor purchases in 2013 and 2014.

- The Transit claimed more payroll than actually paid by the Transit by using hourly rates and not limiting the hourly rate charges to actual salaried payroll amounts. This resulted in known questioned costs of \$13,423.

Matching

The grant requires the Transit to provide a matching contribution of 20 percent, of which a minimum of 18 percent can be provided from cash contributions and a maximum of two percent can be for in-kind activities. Although the Transit may over match (pay more than the 20 percent), the Transit cannot substitute between cash contributions and in-kind activities. Our audit found the Transit substituted in-kind activities for cash contribution in the amount of \$24,825, which includes the \$13,423 in over claimed payroll noted above. The \$24,825 is reported as known questioned costs.

Equipment management

Grantees that purchase equipment with federal funds are required to keep equipment records that track the federal source of funding and demonstrate that equipment is used for grant purposes. If a grantee decides to transfer the equipment to another party or a different use or dispose of the asset, the grantee is required to follow specific procedures, including reimbursing the federal agency for its share. The Transit did not adequately track all equipment purchased with federal funds and could not provide a complete list of equipment purchased for the project when first requested. Through available records we were able to determine at least \$1.5 million in equipment purchases in 2013, which is material to the program.

Suspension and Debarment

When entering into contracts \$25,000 or greater governments are required to have processes in place to ensure it does not make payments to parties barred from participation in federally funded projects. Typically, this requirement is met by including a clause in the contract with the contractor and/or vendor, obtaining a stand-alone certification, or by checking the “Excluded Parties List System” (EPLS), prior to making any payments. The Transit could not demonstrate compliance with this requirement for two vendors that were paid a total of \$1,043,927 for the project in 2013. The Transit was not aware it had a responsibility to verify vendors paid through state contracts were not suspended or debarred. The Transit paid a vendor through a state contract \$772,682 for the project in 2013.

Davis-Bacon Act

For Federally funded construction projects that exceed \$2,000, the Davis-Bacon Act requires contractors to pay federally prescribed prevailing wages to laborers. In addition, contracts for these projects must contain language notifying the contractor and subcontractors must comply with the Davis-Bacon Act in construction contracts. The Act also requires recipients of federal funds to obtain weekly certified payrolls for all contractors and subcontractors to ensure prevailing wages are paid.

The Transit relied on the general contractor to provide weekly certified payroll reports and did not ensure all weekly certified payroll reports were obtained on a timely basis. We confirmed the Transit did not obtain all certified payroll reports for 20 subcontractors in a timely manner. While our auditors were onsite, the Transit was able to obtain the missing reports.

Cause of Condition

The Transit did not fully understand federal grant requirements or establish adequate controls and monitoring to ensure only allowable costs were charged to the grant, matching requirements did not exceed allowable limits, all equipment was adequately tracked, suspension and debarment requirements were met, and weekly certified payroll was obtained for all subcontractors on a timely basis. We consider the control deficiency over the Davis-Bacon Act to be a significant deficiency, and control deficiency over equipment management and suspension and debarment to be material weaknesses.

Effect of Condition and Questioned Costs

Allowable costs/cost principles/matching

The Transit charged \$69,692 in unallowable costs and \$36,704 in projected questioned costs in 2013 and 2014. The Transit also over claimed payroll costs that resulted in \$13,423 questioned costs. We are also questioning the costs associated with the Transit substituting in-kind activities for cash contributions in the amount of \$24,825, which also includes the \$13,423 over-claimed payroll costs already noted.

Noncompliance with grant requirements may require the Transit to return all or a portion of this money to the grantor.

Equipment management

Failure to comply with federal property record requirements increases the risk that federally funded equipment may be lost, misappropriated or used for unallowable purposes.

Suspension and debarment

Without proper controls, the Transit increases the risk of spending funds with vendors that are suspended or debarred from participating in federal programs. Any payments made to an ineligible party are unallowable and would be subject to recovery by the funding agency. Failure to comply with federal requirements may jeopardize the Transit's eligibility for future federal assistance.

We were able to verify the vendors were not suspended or debarred; therefore, we will not question these costs.

Davis-Bacon Act

The Transit did not obtain certified weekly payrolls for all subcontractors on a timely basis. Without adequate internal controls, the Transit cannot ensure the subcontractors

paid workers prevailing wage. The Transit could be liable for paying additional wages if prevailing wage was not paid.

Recommendation

We recommend the Transit dedicate the necessary resources to:

- Ensure only allowable costs are charged to the grant and matching requirements are adequately tracked
- Establish a tracking method for all equipment purchased with federal funds that follows the federal guidelines
- Provide adequate training to staff to ensure they are aware of all applicable program requirements

We also recommend the Transit work with the Federal Transit Administration to determine whether any portion of these costs should be repaid.

Transit's Response

- 1. Island Transit acknowledges there was a misunderstanding regarding allowable costs and match percentage requirements of the State of Good Repair Grant. Island Transit will ensure staff will be properly trained so future grants are adequately tracked and managed. Island Transit is working with FTA for resolution of these items.*
- 2. Island Transit has developed an inventory of equipment purchased with federal funds. The necessary resources have been identified and a tracking method has been established to meet the requirements of the federal guidelines.*
- 3. When made aware of the suspension and debarment requirement for two vendors, Island Transit checked the Excluded Parties List System to verify these vendors had not been suspended or debarred to confirm that payments were not made to parties barred from participation in federally funded projects. Island Transit will ensure the necessary processes are in place and staff is properly trained to meet future grant requirements.*
- 4. During construction of the facilities project, Island Transit conducted random 'spot check' wage surveys of on-site laborers. Wages were documented and checked to verify prevailing wage requirements were met. Island Transit acknowledges some certified payroll reports were not received in a timely manner; however, these items were identified by Island Transit and obtained from the contractor. During the audit process, Island Transit conducted a spot check of the weekly certified payroll reports to verify that subcontractors paid workers prevailing wages.*

Auditor's Remarks

We appreciate the steps the Transit is taking to resolve the issues. We will review the condition during our next audit.

Applicable laws and Regulations

U.S. Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, Section 300, states in part:

The auditee shall:

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

(c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.

U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Section 500, states in part:

(a) The audit shall be conducted in accordance with GAGAS.

Government Auditing Standards, December 2011 Revision, paragraph 4.23 states:

4.23 When performing GAGAS financial audits, auditors should communicate in the report on internal control over financial reporting and compliance, based upon the work performed, (1) significant deficiencies and material weaknesses in internal control; (2) instances of fraud and noncompliance with provisions of laws or regulations that have a material effect on the audit and any other instances that warrant the attention of those charged with governance; (3) noncompliance with provisions of contracts or grant agreements that has a material effect on the audit; and (4) abuse that has a material effect on the audit.

The American Institute of Certified Public Accountants defines significant deficiencies and material weaknesses in its *Codification of Statements on Auditing Standards*, section 265, as follows:

.07 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Material weakness. A deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material

misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Significant deficiency. A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

U.S. Office of Management and Budget Circular A-87, 2 CFR 225, *Cost Principles for State, Local, and Indian Tribal Governments*, Appendix A, General Principles for Determining Allowable Costs, states in part:

C. Basic Guidelines

1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

b. Be allocable to Federal awards under the provisions of this Circular.

j. Be adequately documented.

3. Allocable costs.

a. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received

b. All activities which benefit from the governmental unit's indirect cost, including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of indirect costs.

d. Where an accumulation of indirect costs will ultimately result in charges to a Federal award, a cost allocation plan will be required as described in Attachments C, D, and E.

U.S. Office of Management and Budget Circular A-102, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments* [Title 49 CFR 18.32 Equipment], states in part:

d. Management requirements. Procedures for managing equipment (including replacement equipment), whether acquired in whole or in part with grant funds, until disposition takes place will, as a minimum, meet the following requirements:

(1) Property records must be maintained that include a description of the property, a serial number or other identification number, the source of property, who holds title, the acquisition date and cost of

the property, percentage of federal participation in the cost of the property, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sales price of the property.

(2) A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years.

(3) A control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property. Any loss, damage, or theft shall be investigated.

(4) Adequate maintenance procedures must be developed to keep the property in good condition.

(5) If the grantee or subgrantee is authorized or required to sell the property, proper sales procedures must be established to ensure the highest possible return.

e. Disposition. When original or replacement equipment acquired under a grant or subgrant is no longer needed for the original project or program or for other activities currently or previously supported by a federal agency, disposition of the equipment will be made as follows:

(1) Items of equipment with a current per-unit fair market value of less than \$5,000 may be retained, sold or otherwise disposed of with no further obligation to the awarding agency.

(2) Items of equipment with a current per-unit fair market value in excess of \$5,000 may be retained or sold and the awarding agency shall have a right to an amount calculated by multiplying the current market value or proceeds from sale by the awarding agency share of the equipment.

(3) In cases where a grantee or subgrantee fails to take appropriate disposition actions, the awarding agency may direct the grantee or subgrantee to take excess and disposition actions.

Title 2, Code of Federal Regulations, Section 180.300 – What must I do before I enter into a covered transaction with another person at the next lower tier?

When you enter into a covered transaction with another person at the next lower tier, you must verify that the person with whom you intend to do business is not excluded or disqualified. You do this by:

(a) Checking the EPLS; or

- (b) Collecting a certification from that person if allowed by this rule; or
- (c) Adding a clause or condition to the covered transaction with that person.

Title 29, Code of Federal Regulations, Section 5.5, *Contract provisions and related matters*, states in part:

(a) The Agency head shall cause or require the contracting officer to insert in full in any contract in excess of \$2,000 which is entered into for the actual construction, alteration and/or repair, including painting and decorating, of a public building or public work, or building or work financed in whole or in part from Federal funds or in accordance with guarantees of a Federal agency or financed from funds obtained by pledge of any contract of a Federal agency to make a loan, grant or annual contribution (except where a different meaning is expressly indicated), and which is subject to the labor standards provisions of any of the acts listed in §5.1, the following clauses (or any modifications thereof to meet the particular needs of the agency, *Provided*, That such modifications are first approved by the Department of Labor) . . .

(8) *Compliance with Davis-Bacon and Related Act requirements.*
All rulings and interpretations of the Davis-Bacon and Related Acts contained in 29 CFR parts 1, 3, and 5 are herein incorporated by reference in this contract.

Title 29, Code of Federal Regulations, Section 3.3, *Weekly statement with respect to payment of wages*, states in part:

(b) Each contractor or subcontractor engaged in the construction, prosecution, completion, or repair of any public building or public work, or building or work financed in whole or in part by loans or grants from the United States, shall furnish each week a statement with respect to the wages paid each of its employees engaged on work covered by this part 3 and part 5 of this title during the preceding weekly payroll period. This statement shall be executed by the contractor or subcontractor or by an authorized officer or employee of the contractor or subcontractor who supervises the payment of wages, and shall be on the back of Form WH 347, "Payroll (For Contractors Optional Use)" or on any form with identical wording. Copies of Form WH 347 may be obtained from the Government contracting or sponsoring agency or from the Wage and Hour Division Web site at <http://www.dol.gov/esa/whd/forms/wh347instr.htm> or its successor site.

United States of America, Department of Transportation, Federal Transit Administration, Grant Agreement, Project No: WA-04-0073-00 states in part:

Percentage of Federal participation are based on amounts included in the Approved Project Budget.

Project Budget:

	Local Amount	FTA Amount	Total Eligible Costs
Construct-Admin/Main Facility	3,776,447	16,784,209	20,560,656
Project Administration	448,000	0	448,000
Construct- Misc. Equipment	255,553	1,135,791	1,391,344

Schedule of Audit Findings and Responses

Island Transit Island County January 1, 2013 through December 31, 2013

2. The Transit’s financial condition has impacted current service levels and puts it at risk of not being able to meet financial obligations.

Description of Condition

The Transit’s expenditures have exceeded revenues, requiring the Transit to reduce staff and service to the public, and obtain debt to cover obligations. The table below shows operating expenses exceeding revenue related to operations for the past three years, and through July 2014.

	2011	2012	2013	July 30, 2014*
Total Revenue Related to Operations	9,641,466	10,194,009	10,756,237	6,644,203
Total Operating Expenses without Depreciation	10,614,847	11,153,469	11,878,527	6,811,497
Excess/(Deficit)	(973,381)	(959,460)	(1,122,290)	(167,294)

*2014 figures were not audited and were obtained from the Transit’s general ledger.

The Transit also has had significant capital expenses over this time period. The Transit was awarded approximately \$17.92 million in federal funding to build a new transit facility, which required the Transit to match approximately \$4.48 million in local funds.

The Transit’s operational deficits, combined with its \$4.48 million contribution for the new transit facility to meet the federal requirement, have depleted cash and investments balances and required the Transit to obtain a \$1.5 million bond in 2013 and an \$850,000 tax and revenue anticipation note in 2014 to cover operations. The Transit’s ending cash and investment balances since 2009 were:

<u>Fiscal Year</u>	<u>Ending Cash and Investments</u>
2009	\$ 6,227,053
2010	\$ 5,744,075
2011	\$ 4,785,101
2012	\$ 2,241,822
2013	\$ 123,072
July 30, 2014	\$ 247,123

Cause of Condition

The Board and management did not effectively monitor the financial activity of the Transit to ensure revenues were adequate to cover increased operational and capital expenditures.

The Board relied on the financial information the Executive Director presented to them. Although the Board received several monthly reports, such as budget-to-actual revenues and expenditures; the Board did not receive comprehensive reports that compared monthly, or year-to-date, revenues to expenditures or monthly cash and investment balances.

Effect of Condition

The Transit's financial condition has resulted in it reducing staffing levels and bus service. Additionally the Transit had to obtain debt financing to meet its financial obligations.

Although the Transit is taking steps to improve its financial condition, repayment of debt will continue to have an effect on the District's future cash flow and may inhibit the Transit's ability to continue funding general operating expenses, bus replacement, and restoring service to its former level.

Recommendation

We recommend the Transit Board and management take an active role to:

- Establish a formal financial plan to address cash flow issues and monitor and evaluate actual results compared to the plan to ensure its financial condition improves.
- Closely monitor and evaluate the financial activities to ensure the plan is being followed and the desired results achieved, and revise the plan if expected improvements are not achieved.
- Ensure timely and accurate financial information is provided to the Board in order to facilitate informed decision making.
- Take prompt action to manage operations within available resources.

Transit's Response

1. *Island Transit has created a formal financial plan to schedule and monitor the cash flow of the organization by creating a seven year plan detailing expected revenues, expenses, and cash balances during this term. We have hired a CPA to act as our Financial Analyst, who, with the guidance of our Finance Committee and Executive Director, will review monthly financial results to verify that actual*

results match our formal financial plan. The agency's current actual results show our planned improvement in financial condition.

- 2. Island Transit has taken steps to ensure that our financial activities are monitored and evaluated. The Executive Director reviews and signs the agency's monthly cash flow analysis and reconciliation. Island Transit's Board of Directors has created a finance committee, composed of two Board members and the Financial Analyst, who will now review cash flow, disbursements, and budget-actual performance on a monthly basis. The Island Transit Board will make any necessary changes to its formal financial plan through the budgeting process to maintain the health and stability of the organization.*
- 3. Island Transit's financial reporting has been enhanced to facilitate informed decision-making. The Island Transit's Board members now receive a monthly reconciled cash statement and a budget actual report to assess monthly and yearly financial progress. The Board also receives related, monthly operational and economic information to guide decision-making.*
- 4. Island Transit has taken swift action to operate within available resources. The agency reduced service during July, August, and September of 2014 so that we are now in a financial position where monthly revenues exceed monthly expenses in alignment with our financial plan.*

Auditor's Remarks

We appreciate the steps the Board is taking to increase its oversight and monitoring of the Transit's financial operations. The State Auditor's Office will review the corrective action taken during our next audit.