



U.S. Department
of Transportation
Federal Highway
Administration

Memorandum

Subject: **ACTION:** Request for approval of TE-045 Proposal for Construction Oversight of Local Agencies' Federal-aid Projects off the State Highway System

Date: November 28, 2011

From: Vincent P. Mammano
Division Administrator
Sacramento, California

In Reply Refer To:
HDA-CA

To: Mr. Mark Sullivan
Senior Advisor, Innovative Program
Delivery
1200 New Jersey Avenue, SE,
Washington DC 20590

Please find attached a signed copy of the TE-045 proposal for Construction Oversight of Local Agencies' Federal-aid Projects off the State Highway System. This TE-045 proposal has been coordinated between FHWA HQ, FHWA Division, and Caltrans. This proposal would enable Caltrans to more efficiently execute the delivery of the Federal-aid program to local public agencies. Based on the foreseeable benefits, we recommend approval of this TE-045 proposal.

If you have any questions, please contact David Tedrick, Local Agency Programs – Team Leader (South), at (916) 498-5024 or david.tedrick@dot.gov.

Attachments

cc: (via e-mail)

Gary Sweeten, FHWA
Michael Avery, FHWA
David Tedrick, FHWA

CALIFORNIA DEPARTMENT OF TRANSPORTATION (CALTRANS)



**TE-045 – INNOVATIVE FINANCE TEST AND EVALUATION PROGRAM
PROPOSAL FOR CONSTRUCTION OVERSIGHT OF LOCAL
AGENCIES’ FEDERAL-AID PROJECTS OFF THE STATE HIGHWAY
SYSTEM**

This proposal details a Caltrans request for authority to conduct an innovative finance research project to fund construction oversight activities Caltrans will perform on Federal-aid projects off the State Highway System during a three-year trial period (July 1, 2012 through June 30, 2015). This research project would entail reimbursement of the Federal share of costs identified in this proposal through the employment of a narrative cost allocation methodology under FHWA’s Test and Evaluation (TE - 045) process. Included in this request is a description of the reporting and monitoring requirements to be carried out by Caltrans in order to evaluate the effectiveness of construction oversight activities.

PROPOSED BY:

A handwritten signature in black ink, appearing to read 'Denix D. Anbiah', written over a horizontal line.

**DENIX D. ANBIAH
Chief
Division of Local Assistance**

11/22/11

Date

NOVEMBER 2011

Introduction

The purpose of this proposal is to request a waiver from FHWA's policy on indirect cost allocation (<http://www.fhwa.dot.gov/legregs/directives/policy/indirectcost.htm>), to test development and application of a narrative cost allocation methodology (NCAM) that would reimburse Caltrans for the Federal share of costs of specifically identified construction activities related to locally-administered Federal-aid projects, as described in this proposal. These oversight activities will be performed by Caltrans on local agencies' Federal-aid projects off the State Highway System. Caltrans would be reimbursed the Federal share of the oversight cost using any eligible available Federal funds via an innovative finance research project under the auspices of FHWA's Test and Evaluation (TE-045) process. This request for approval to employ a NCAM cost reimbursement work plan will be limited to a three-year trial to fund certain defined local agency oversight activities and document, measure, evaluate and report on the effectiveness of this oversight work plan and related funding process on these Federal-aid projects. Caltrans intends to use Toll Credits for the state match. It is noted that other subrecipient monitoring activities as required under 23 USC 106(g)(4), 49 CFR 18.37 and 18.40, OMB Circular A-133 § _____.400(d), and 2 CFR 225 Appendix E (D)(1)(b), remain the responsibility of Caltrans, without regard to the scope of this proposed funding plan.

This request for use of experimental testing under TE-045 stems from findings from recent audits and reviews of California's local public agency Federal-aid projects, including the Office of Inspector General's audit report, "Federal Highway Administration's Oversight of Federal-Aid and Recovery Act Projects Administered by Local Public Agencies Needs Strengthening," dated July 15, 2011.

Background

California has over 600 local agencies administering transportation construction projects involving a variety of funding sources, including Federal-aid funds. Caltrans' Local Assistance Program (LAP) has the responsibility to ensure that Federal and State requirements are being met on these projects. LAP has compiled extensive guidelines for local agencies to utilize in meeting both Federal and State requirements, two of which are the Local Assistance Procedures Manual (LAPM) and Local Assistance Program Guidelines (LAPG). LAP also provides training to local agencies for assistance in meeting Federal and State requirements. Since the mid-1990s, LAP has maximized delegations to local agencies in an effort to minimize resource expenditures. In the construction phase of projects, LAP has utilized local agency self-certifications with limited verification procedures to validate that requirements are being met.

Results from recent audits and reviews performed by Office and Inspector General (OIG), Federal Highway Administration (FHWA), and Caltrans' own Audits and Investigations (A&I) found that there is a significant rate of non-compliance with Federal and State requirements by local agencies and that LAP is not fulfilling its oversight responsibilities. These findings generally show adequate guidelines exist in the form of LAPM and LAPG policies and procedures, but that local agencies are not following the guidelines and LAP is not verifying local agencies compliance to a satisfactory degree.

As part of the American Recovery and Reinvestment Act of 2009 (ARRA), LAP was able to secure additional limited-term resources for performing construction oversight of local agency ARRA funded projects off the SHS. These resources consisted of seven senior level engineers (six construction oversight engineers and one construction oversight program coordinator) located across the state. In the approximately 21 months these resources have been in place, they have performed more than 1050 ARRA project reviews. These reviews have utilized a three-part review system consisting of preconstruction, mid-project and after acceptance type of reviews. By sharing results from these reviews with the local agencies, contract administration deficiencies can usually be corrected without loss of funding. In addition, results from the reviews are evaluated for common problem areas where further policy, procedure and training efforts have been focused to aid the local agency program on the whole. On a quarterly basis, results from these reviews are presented to both FHWA and OIG. The construction oversight process utilized on the ARRA projects has been identified as a successful practice by auditing agencies and has improved local agencies compliance with Federal-aid requirements within the high-risk construction phase. Unfortunately, the construction oversight positions, created in response to the ARRA program and isolated to ARRA projects, will expire on June 30, 2012. Due to California's budget crisis, Caltrans will not be able to extend these positions beyond this date, unless the cost is directly reimbursed by FHWA.

Results from audits and reviews indicate that local agencies compliance issues with Federal-aid requirements are not isolated to the ARRA program. The OIG report dated July 15, 2011 actually indicates a significantly higher rate of non-compliance with Federal-aid requirements on the non-ARRA Federal-aid projects (reference Exhibit B of the OIG report).

Caltrans does not use its existing indirect cost allocation plan to assess indirect costs to Local Programs projects due to structural limitations in the methods and systems used to charge costs directly to Local Program projects and the methods used to assess indirect costs to projects. As is the case with most entities, Caltrans uses personnel service costs (from employee timesheets) charged directly to a project as the "driver" on which indirect costs are added to the project. The indirect costs are assessed to the project as a percentage of the personnel service costs charged directly to the project. Example: Direct personnel service costs of \$3,000 are charged directly to a project, indirect costs of \$900 would be added to the project if Caltrans indirect cost rate plan rate is 30 percent.

However, Caltrans Local Assistance engineers work on such a large volume of Local Program projects with very small increments of work, it is not reasonable or feasible for the Local Assistance engineer to record the project details on his/her timesheet. Consequently, Caltrans has no direct personnel service costs being charged to the specific Local Program project. The "driver" which Caltrans uses to add indirect costs to Local Program projects does not exist and Caltrans indirect cost allocation plan cannot be used in this scenario.

Caltrans seek to address these problems, with FHWA support, through employment of an NCAM- funded work plan that would provide direct reimbursement from Federal funds for the Federal share of costs of specifically identified construction activities related to locally-administered Federal-aid projects modeled after those provided during the ARRA program.

This will be a three-year trial period to evaluate the effectiveness of the oversight on local agency Federal-aid projects off the SHS. Evaluations shall occur on a yearly basis independently by Caltrans and FHWA and shared with each party. Based on these annual evaluations, the NCAM funding mechanism could be amended to add or otherwise modify the scope of oversight activities to be funded. As previously noted, other subrecipient monitoring activities as required under 23 USC 106(g)(4), 49 CFR 18.37 and 18.40, OMB Circular A-133 § _____.400(d), and 2 CFR 225 Appendix E (D)(1)(b), remain the responsibility of Caltrans, without regard to the scope of this proposed funding plan.

Responsibilities

Outlined in this proposal are the responsibilities of Caltrans Division of Local Assistance (DLA) for performance of construction oversight activities and reporting on said activities. Also included are the responsibilities of FHWA to review and approve (as necessary) the annual NCAM work plan, including the necessary personnel and operating costs specifically related to said activities. The request for use of the NCAM funding mechanism covers the period of July 1, 2012 through June 30, 2015.

Caltrans Responsibilities:

Project Level Construction Oversight (DLA responsibilities):

- DLA will establish the roles, responsibilities and authorities of the construction oversight engineers within a policy document and distribute to affected parties. Construction oversight engineers shall be empowered to enforce project findings and initiate appropriate sanctions when local agencies fail to resolve significant deficiencies. Local agencies will be allotted 30 calendar days to propose corrective actions to resolve significant deficiencies. An additional 30 calendar days will be allotted for local agencies to implement their corrective actions once an acceptable plan has been received by Caltrans. Failure on the local agency's part to meet the corrective action proposal and implementation timelines may result in project sanctions initiated by the construction oversight engineer and implemented by the District Local Assistance Engineering. Certain significant deficiencies may not be correctable and may result in project sanctions.
- Provide nine senior level engineers with appropriate backgrounds and knowledge to perform the construction oversight duties as envisioned within this proposal.
- Project reviews (mid project reviews and preconstruction reviews) will be performed by the construction oversight engineer utilizing a standard questionnaire. These reviews will be performed in the local agency's construction office where project records are located. The report form will be completed by the construction oversight engineer through discussions with the local agencies contract administrators and verified through examination of project records. These reviews may also include a field visit to the construction site depending on the specifics of the project. Upon completion of the review, the construction oversight engineer shall provide a verbal report of their findings to the local agency that identifies their observations and any significant deficiencies that will require follow-up action (e.g. corrective action). A written report of the review will

be transmitted to the local agency and construction oversight program coordinator within two-business days that identifies observations and any significant deficiencies. When significant deficiencies have been identified, the written report will require the local agency's response within 30 calendar days. Depending on the significant deficiency and local agency response, a follow-up site visit may or may not be required. Unresolved significant deficiencies will result in the construction oversight engineer completing a sanction request to the DLAE for their action. The sanction request shall identify the deficiency and provide necessary details for the DLAE to take action. In the event an internal disagreement arises over the sanction request, the issue shall be elevated to DLA headquarters for resolution.

- Perform mid project reviews on each Federal-aid project to verify local agencies compliance with Federal-aid requirements (reference mid project review form) [estimate 550 mid project reviews per year].
- Perform preconstruction reviews on higher-risk projects to proactively aid agencies in meeting Federal-aid requirements and examine higher-risk project for fatal flaws (reference preconstruction project review form) [estimate 165 preconstruction reviews per year].
- Determination of higher-risk projects shall be made through a risk assessment form that measures the local agency's previous performance and experience with contract administration of Federal-aid projects (see attached draft risk assessment form). FHWA will be consulted in the process for identification of higher-risk projects.
- Participate in and respond to project audits and reviews by others (e.g. FHWA, OIG, GAO, SCO, A&I, etc.) [estimate 108 audits and reviews by others per year].
- Review and evaluation of complex contract change orders and claims [estimate a total of 72 evaluations per year].
- Provide knowledge transfer to DLAE staff during mid project reviews so that completed project documentation may be reviewed during final review process.
- Apply existing financial controls to these positions and their expenses to create an audit trail.

Programmatic Level Construction Oversight (DLA responsibilities):

- Quarterly reporting on construction activities similar to ARRA quarterly reports, including effectiveness of construction oversight (e.g. review metrics, common problem areas, recommendations for improvements, programmatic actions taken, trend analysis, at risk funds, "saved" funds, sanctions, corrective actions, etc.) [estimate four quarterly reports per year].
- Quarterly reporting on project specific findings (e.g. project identification [e.g. Federal-aid number, district, local agency, etc.], observations made, significant deficiencies requiring follow-up identified, corrective actions taken, status of significant deficiencies [e.g. resolved, on-going], quantification of at risk funds, "saved" funds, sanctions initiated and sanctions taken). Report will consist of a brief narrative section followed by project specific findings in a list format (e.g. electronic spreadsheet) segregated by district and agency. A database such as FileMaker Pro© or Microsoft Access© shall be utilized to collect, monitor and report on data. Access to the database information shall be granted to FHWA upon request [estimate four reports per year].

- Quarterly reports shall be issued directly to FHWA California Division Local Programs Director.
- Other subrecipient monitoring activities identified in this proposal will be carried out by Caltrans, without regard to inclusion in the NCAM work plan for one year and beyond.
- Establish a single project number and allow that number to capture labor and other charges for the work these resources perform on federally funded projects.
- Assurance that the NCAM will contain sufficient detail and be supported by adequate documentation to ensure only eligible and allowable costs related to the scope of activities identified herein are included in billings for reimbursement.
- Submission of an annual evaluation of the effectiveness of the NCAM funding mechanism and related work plan for providing effective monitoring of locally administered projects. Annual reports will include any recommendations for modifying or improving the NCAM.

FHWA Responsibilities:

- Work with appropriate Caltrans staff to ensure and NCAM is developed that complies with the Federal cost principles and aligns with the annual work plan agreed to with Caltrans.
- Provide review and approval of the annual work plan and related NCAM in order to authorize STP program funds for cost reimbursement of construction oversight personnel service dollars and operating expenses during the three-year trial period (estimates of present year annual personnel service dollars and annual operating expenses are \$1,299,000 and \$110,000 respectively).
- Allow Caltrans to program the Local Agency Oversight Activities as a line item in the Federal Statewide Transportation Improvement Program (FSTIP).
- As part of the FHWA Division Office risk assessment process, evaluate the effectiveness of this work plan to ensure that it is working as intended, in mitigating risks associated with adequate subrecipient monitoring by Caltrans.
- Review Caltrans' annual evaluation report for comment, and separately provide an independent assessment on the effectiveness of the NCAM funding mechanism for providing adequate local agency oversight in California, and for potential broader program application.