



State of New Jersey

DEPARTMENT OF TRANSPORTATION
1035 PARKWAY AVENUE
P.O. Box 600
Trenton, NJ 08625-0600

JOHN S. CORZINE
Governor

KRIS KOLLURI, ESQ
Commissioner

November 14, 2006

Dear Sir or Madam:

SUBJECT: Disposition of Audit Findings for Cost Plus Fixed Fee Contracts

The New Jersey Department of Transportation (NJDOT) has recently initiated an effort to dispose of recommended audit adjustments from our CPA audit firms on Cost Plus Fixed Fee contracts. In many cases, these audits show that we owe a firm additional reimbursement on some contracts and the firm owes us a refund on other contracts. Since the Department has recently been invoicing consulting firms for audit adjustment amounts owed to us, a number of questions and issues have been raised by firms being billed. I would like to clarify the Department's position on the following issues that have been raised to date:

- 1. Offsetting Audit Adjustments Payable against Audit Adjustments Receivable.**
Some consulting firms have requested that audit adjustment amounts owed to NJDOT on one contract be deducted from audit adjustment amounts payable to the firm on another contract. In other cases firms have requested that audit adjustment amounts owed to NJDOT on one contract be offset against future bills for work on other unrelated contracts. These offsets would be applied in lieu of direct payments to NJDOT or to reduce the amount of such payments. In both of these cases, the offsetting is not permissible because NJDOT is required to maintain the integrity of its Federal Highway Administration (FHWA) and Transportation Trust Fund Authority (TTFA) appropriation funding records at the project level, not by vendor. Therefore, amounts owed to consultant firms by NJDOT for specific contracts must be invoiced separately by the prime consultant and not used as a credit against amounts owed. The only instance where NJDOT will allow offsets is when the firm proposes to apply the amount payable on a specific contract to future billings against that same contract (basic plus "additional work" modifications). If the audit adjustment impacts an "extra work" modification,

NJDOT will allow the firm to offset that amount against future costs billable to that specific extra work modification.

- 2. Direct Billing of Audit Adjustments to Subcontractors (Privity).** Since many consultant firms serve as both prime consultants and subconsultants, the simplest administrative procedure for addressing audit findings would be to handle all the adjustments for prime and subconsultant work directly with the firm being audited. The Department of Transportation, however, has no legal contractual relationship with subconsultants and, therefore, we have determined that it is problematic to be making or receiving payments directly from firms when they are acting as subconsultants. Accordingly, all NJDOT billing for overpayments will be directed to the appropriate prime consultant. Similarly, any reimbursement due to a subconsultant as a result of an audit adjustment should be invoiced to NJDOT by the appropriate prime consultant.
- 3. Impact of Audit Adjustments on Ceilings.** Audit adjustments do not have any direct effect on contract ceilings. If an audit adjustment results in additional reimbursement due to a company which is in excess of the contract ceiling, there is no automatic adjustment of the ceiling. If the consultant firm believes a ceiling adjustment is warranted, the justification should be submitted to NJDOT's project manager. The NJDOT project manager will evaluate the particular circumstances and determine whether an increase in the ceiling is warranted. If the ceiling is not raised, the consulting firm may only invoice NJDOT for audit adjustments up to the ceiling.
- 4. Costs in Excess of Contract Ceiling.** If an audit adjustment results in a refund due to NJDOT, the total contract cost on some projects will drop from the contract ceiling to some lesser amount. Some firms have reported that they have incurred costs on projects in excess of current ceilings but have not previously disclosed those costs in their billings to NJDOT. They are now seeking to bill those costs where an audit adjustment has left total contract costs under the ceiling. Where those situations currently exist, the Department will evaluate the previously undisclosed costs and documentation on a case-by-case basis to determine whether they are still billable. For future billing, the Department recommends that total costs incurred be displayed in each periodic billing and that any amounts in excess of the ceiling be deducted to generate a net payment due. This will eliminate the need to provide separate justification to bill these costs in the future if audit adjustments generate the ability to do so.
- 5. Arbitration of Audit Report Findings.** Federal Law 23 USC. 112 (b) (2) (c) requires that contracts for engineering services be performed and audited in compliance with the cost principles contained in the Federal Acquisition Regulations, Title 48, Chapter 1, Part 31-Contract Cost Principles and Procedures ("Part 31"). Part 31 contains cost principles and procedures for pricing contracts, subcontracts, and modifications to contracts. These guidelines are supplemented by the "Uniform Audit and Accounting Guide for Audits of Transportation Consultants Indirect Cost Rates," published by the American Association of State Highway and Transportation Officials (AASHTO). These guidelines are very specific and generally not subject to interpretation. They are meant to be applied consistently and uniformly by all auditors of federal contracts anywhere in the United States. Although not all NJDOT contracts are federally funded, we abide by federal audit standards on all our contracts. Firms that have questions or issues with any audit findings should first discuss their concerns with the independent CPA auditing firm. If the questions or issues raised are not satisfactorily addressed by the

independent CPA auditing firm, the consulting firm can contact the Manager, Bureau of Auditing, New Jersey Department of Transportation, for further discussion of the questions or issues. The Bureau of Auditing will be responsible for making the final determination regarding the application of FAR cost principles to any NJDOT consultant agreement. NJDOT does not intend to create any other level of administrative appeal regarding disputes over audit adjustments.

6. **Negotiation of Amounts Owed.** The NJDOT has no legal authority to negotiate lower amounts than have been found due by the independent CPA audit reports. In those instances, however, where a lump sum payment may represent an economic hardship on the company, NJDOT will allow periodic payments not to exceed one calendar year from date of billing.
7. **Interim versus Contract Completion Audits.** Currently, NJDOT audits and adjusts all active or closed contracts on a two to three year cycle. The concept of auditing and adjusting contracts only at contract completion would help the audit disposition process. Most NJDOT consultant agreements, however, include various types of additional work and extra work contract modifications which delay the final closing of agreements. Auditing these types of agreements at closing only would further extend the Department's current audit cycle. The Department does not currently have the authority from FHWA to take any actions which would extend the audit cycles beyond current time frames.
8. **Final Contract Release.** The Department does not currently issue a final release of contract certificate. The concept in issuing such a release is practical and would help consulting firms determine the need for records retention. Beginning immediately, the Department will issue a letter advising the consultant that the audit of cost is complete and the contract is considered closed. This will enable the firm to calculate the three year record retention date that is required by the FHWA and the NJDOT. It shall not, however, relieve the consultant of its obligation to indemnify and defend the NJDOT from claims resulting from the firm's negligence.

If you have any questions regarding these issues or others related to audit process, please contact Joseph J. Licari, Director, Division of Accounting and Auditing at (609) 530-2343.

Sincerely,



Steven B. Hanson
Chief Financial Officer

bcc: Deputy Commissioner Stephen Dilts
Assistant Commissioner Richard T. Hammer
Assistant Commissioner Mark L. Stout
DAG Richard J. Harcar
Joseph J. Licari, Director