



OFFICE OF INSPECTOR GENERAL

FLORIDA DEPARTMENT OF TRANSPORTATION

605 Suwannee Street • Tallahassee, FL 32399-0450
(850) 410-5800 • www.dot.state.fl.us/inspectorgeneral

Robert E. Clift
Inspector General

CSX Transportation Inc. 2009 Reimbursement Rates for Railroad Work Attestation Report No. 11T-1001

EXECUTIVE SUMMARY

The Florida Department of Transportation (department), Office of Inspector General (OIG) has conducted an examination of CSX Transportation Inc.'s (CSXT) proposed 2009 labor additive and material handling rates for the calendar year 2009.

The audited rates are to be used by CSXT to bill costs related to railroad-highway projects. The rates that are approved by the department Central Rail Office (Rail Office) and the Federal Highway Administration (FHWA) will remain in effect until new rates are examined and approved.

CSXT revised its overhead/indirect rate computation methodology for its 2009 overhead rate submission. The 2007 overhead/indirect rates were prepared using the 2007 CSXT Financial Report to the Surface Transportation Board. The 2007 rates were approved by the department on November 16, 2009. CSXT decided to generate its 2009 overhead/indirect rate submissions based on the CSXT General Ledger in an effort to improve efficiencies. CSXT also changed rate categories in the 2009 rate proposal. All the claimed categories are discussed in Attachment 2 of this report. Additionally, CSXT proposed a Materials Handling rate of five percent of the amounts billed for materials and supplies which are issued from CSXT stores and material yards.

We determined the rates submitted by CSXT were reasonable, allocable and allowable for use in billing railroad-highway projects.

CSXT has submitted their agreement (Appendix B) with the 2009 Labor Surcharge Rates, as audited (Attachment 1). The Rail Office and FHWA have also submitted concurrence (Appendix C and D) with the CSXT 2009 Labor Surcharge Rates, as audited.

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BACKGROUND AND INTRODUCTION

FHWA regulations state that railroads will be reimbursed at actual costs or rates representative of actual costs as submitted by the railroad and approved by the State Highway Agency (SHA) and FHWA. Historically, the Federal-Aid Programs were intended as a partnership with the railroads to address rail/highway crossing safety issues. Through this partnership, the railroads would be reimbursed for direct cost but not overhead or profit. Federal Acquisition Regulations (FAR) were later changed to allow SHAs the option of paying overhead and indirect construction costs which were unallowable before this change. Title 23, Section 140.906, Code of Federal Regulations (C.F.R.), requires railroads to annually submit labor charge rates to the SHA and FHWA for approval. In January 2008, the Florida Division of the FHWA approved the establishment of bi-annual audit requirements for CSXT's rate proposals. The OIG examines the rates and forwards the report to the Rail Office and FHWA for their approval prior to releasing a final report.

CSXT was created July 1, 1986, as a result of consolidation of the Chessie System and the Seaboard System Railroads. In June 1999, CSXT expanded its rail operations with the integration of portions of the Conrail system. CSXT operates in 23 states, the District of Columbia and the Canadian provinces of Ontario and Quebec.

USE OF EXAMINATION

This examination will not replace the need for the Rail Office and other SHAs to review direct costs incurred by CSXT to determine the allowability, allocability and reasonableness of the costs of rail projects as outlined in 23 C.F.R. Subpart I, Reimbursement for Railroad Work, and 48 C.F.R. Subpart 31.2, Contracts with Commercial Organizations. Summarized costs noted on CSXT's invoices are supported by computerized detail. The Rail Office and other SHAs are responsible for evaluating the accuracy of CSXT's invoices through independent inspection of project construction records prepared by the funding agency. Also, the Rail Office and other SHAs are responsible for evaluation of CSXT's project prices charged for direct labor, materials and equipment usage.

INDEPENDENT ACCOUNTANT'S REPORT

We have examined the 2009 CSXT Overhead Rate Proposal. CSXT's management is responsible for the accuracy of the proposal. Our responsibility is to express an opinion on CSXT's compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and standards applicable to Attestation Engagements contained in Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, this engagement included

examining, on a test basis, evidence of CSXT's compliance with those requirements and performing other procedures we considered necessary in the circumstances. Our examination does not provide a legal determination on CSXT's compliance with the specified requirements. Our examination relied on the unqualified opinion of Ernst & Young LLP's work on the 2009 CSXT Financial Statement Audit based on the CSXT General Ledger (GL). We believe our examination provides a reasonable basis for our opinion.

In our opinion, the 2009 CSXT Labor Additive Rate Proposal, as examined, is reasonable and supported by accounting records and the costs included in the rate computations are allowable, allocable and reasonable for use in billing costs for railroad-highway projects.

RESULTS OF EXAMINATION

CSXT revised its overhead rate computation methodology for its 2009 overhead rate submission. Previous overhead rate submissions were based on the Class I Railroad Report to the Surface Transportation Board (R1 Report), specifically Schedule 410.

In an effort to improve efficiencies, CSXT decided to generate its 2009 overhead rate proposal based on the CSXT GL. Using the GL enables CSXT to identify expenditures directly related to the rates and facilitates the identification of unallowable costs. The Oracle trial balance detail report is created from the GL and is the source of all data for the rates. This Oracle report ties back to the CSXT Financial Statements. Our audit processes for this examination relied on the unqualified opinion of Ernst & Young LLP's work on the 2009 CSXT Financial Statement Audit and related GL. CSXT has proposed new rate categories and these categories are discussed in Attachment 2 – Rate Category Notes.

Our examination revealed unallowable taxes included the Fixed Cost Pool in the original rate allocation submittal. After discussions with CSXT, they developed an allocation methodology which we determined to be reasonable. When CSXT revised the tax allocation they determined some charges needed to be removed from other rates. After incorporating these changes they resubmitted their proposal on June 25, 2012.

Additionally, CSXT proposed a Materials Handling rate of five percent of the amounts billed for materials and supplies which are issued from CSXT stores and material yards. This five percent rate is for the cost of handling, loading, and recovering of materials and supplies. 23 C.F.R. 140.908 (e), states, "At the option of the company, 5 percent of the amounts billed for the materials and supplies which are issued from company stores and material yards will be reimbursable in lieu of actual costs."

We determined the CSXT revised rates were reasonable, allocable and allowable. The revised labor surcharge rates are listed in Attachment 1 - Labor Surcharge Rates. We recommend the Rail Office and FHWA approve CSXT's 2009 rates as audited for use in billing costs for railroad-highway projects.

APPENDIX A – Purpose, Scope and Methodology

The **purpose** of this examination was to determine whether the costs included in CSXT's 2009 rate proposal were allowable, allocable and reasonable for use in billing Federal-Aid projects pursuant to 23 C.F.R. 140 and 23 C.F.R. 646.

The **scope** was the 2009 labor additive rate proposal submitted by CSXT and all associated records and documentation.

Our **methodology** consisted of:

- examining CSXT's accounting records and supporting documentation for the 2009 labor additive rate proposal;
- reviewing work papers from the 2007 Labor Additive Rate examination conducted by the OIG;
- conducting variance analysis which included comparing the proposed 2009 rates to the audited 2007 rates and to other railroad company rates;
- reviewing the 2009 CSXT Audited Financial Statements; and
- reviewing federal and state regulations pertaining to the rates.

APPENDIX B – CSXT Response



Valerie Yeager
Director Government Billing & Property
6735 Southpoint Drive South, J695
Jacksonville, FL 32216

October 19, 2012

Joe Gilboy, Audit Manager
Florida Department of Transportation
Office of Inspector General
605 Suwannee Streets, MS 44
Tallahassee, Florida 32399-0450

RE: Draft Report 11T-1001, CSXT 2009 Reimbursement Rates for Railroad Work

Dear Mr. Gilboy:

This letter is in response to the Draft Report 11T-1001, CSXT 2009 Reimbursement Rates for Railroad Work. CSX Transportation (CSXT) agrees with the audited rates contained in the report. The overhead categories were developed in accordance with Federal Acquisition Regulation, part 31 and are reimbursable for the following reasons:

- **Vehicles & Equipment:** This overhead cost pool captures company owned and leased vehicle and equipment costs incurred by CSXT for government, railroad operating and capital projects. 23 CFR 140.910 allows CSXT to be reimbursed for the costs of depreciating, operating and repairing equipment. State DOTs currently reimburse CSXT for these costs. These costs will not be billed as a direct cost in the future.
- **Construction Equipment:** This overhead category recovers depreciation of company owned equipment used on large construction projects. This category will only be applied to construction projects. The new overhead methodology increased visibility to allow CSXT to create this overhead category. 23 CFR 140.910 allows CSXT to be reimbursed for the costs of operating and repairing equipment and for the depreciation expense on owned equipment.
- **Project Management:** This overhead category includes management labor costs associated with work performed on government, capital and railroad operating projects. The labor activities include managing, initiating and negotiating projects. State DOTs currently reimburse CSXT for these costs. These costs will not be billed as a direct cost in the future.
- **Training:** This overhead cost pool captures training costs for training conducted by CSXT or outside vendors. 48 CFR 31.205-6 allows CSXT to be reimbursed for training costs related to the field in which the employee is working.
- **Small Tools, Safety & Supplies:** This overhead category recovers costs associated with supplies, services and safety equipment necessary for completing



government, railroad operating and capital projects. State DOTs currently reimburse CSXT for these costs. These costs will not be billed as a direct cost in the future.

- **Department Support Costs:** This overhead category includes material, communications and other general support costs. These costs benefit government, railroad operating and capital projects. These costs were formerly included in the General & Administrative costs; however, the new overhead methodology provided increased visibility to create a new overhead cost pool. 23 CFR 140.907 and 48 CFR 31.203 allows CSXT to be reimbursed for overhead costs that are directly and indirectly allocable to projects.
- **General & Administration:** The general administration intermediate cost pool includes expenses of the accounting, auditing, finance, legal, secretarial, management services and data procurement personnel and for the overall operation of the company. 48 CFR 31.201-4 allows CSXT to be reimbursed for activities and costs necessary for the overall operation of the business.
- **Fixed Costs:** The fixed cost pool includes taxes (personal property, franchise, etc.), rent and depreciation that are part of the general operating expenses for CSXT. These costs were formerly included in the General & Administrative costs; however, the new overhead methodology provided increased visibility to create a new overhead cost pool.

Additionally, the 2009 overhead rate submission is computed and compliant with all 23 CFR 140.907 regulations:

- (1) The costs are distributed to all applicable work orders and other functions on an equitable and uniform basis in accordance with generally accepted accounting principles: CSXT's 2009 overhead rate was equitably distributed across all project types including government, railroad operating and capital projects.
- (2) The costs included in the distribution are limited to costs actually incurred by the railroad: The CSXT overhead rate is based on the general ledger and ties to the Form 10-K. The costs claimed in the overhead tie back to the CSXT Financial Statements. As a result, all costs are limited to costs incurred by CSXT during the 2009 fiscal year.
- (3) The costs are eligible in accordance with the Federal Acquisition Regulation (48 CFR), part 31, Contract Cost Principles and Procedures, relating to contracts with commercial organizations: CSXT's 2009 overhead rate was developed in accordance with the Federal Acquisition Regulation (48 CFR), part 31.
- (4) The costs are considered reasonable: As stated in the draft audit report, all costs are considered reasonable.
- (5) Records are readily available at a single location which adequately support the costs included in the distribution, the method used for distributing the costs, and the



basis for determining additive rates: All records and supporting documentation are available at CSXT offices located in Jacksonville, Florida.

(6) The rates are adjusted at least annually taking into consideration any over-recovery or under-recovery of costs: Beginning with the 2009 submission, CSXT has submitted annual overhead submissions to FDOT.

(7) The railroad maintains written procedures which assure proper control and distribution of the overhead and indirect construction costs: CSXT maintains written methodology documentation to ensure proper control and distribution of overhead costs.

As a result, these overhead categories will ensure simplified invoices that are compliant with government rules and regulations. Please feel free to contact me if you have any questions or concerns regarding our response to Draft Report 11T-1001, CSXT 2009 Reimbursement Rates for Railroad Work.

Sincerely,

A handwritten signature in cursive script that reads 'Valerie Yeager'.

Valerie Yeager
Director Government Billing & Property
904-279-6681
Val_Yeager@csx.com

APPENDIX C – Department Rail Office Response



Florida Department of Transportation

RICK SCOTT
GOVERNOR

605 Suwannee Street
Tallahassee, FL 32399-0450

ANANTH PRASAD, P.E.
SECRETARY

November 30, 2012

Joe Gilboy, CIA, CGAP
Audit Manager, Intermodal Audit
Office of Inspector General
Florida Department of Transportation

Dear Mr. Gilboy:

The Florida Department of Transportation Rail Office has completed the review of your CSXT 2009 Reimbursement Rates for Railroad Work Attestation Report No. 11T-1001 dated October 24, 2012. The rates contained in Attachment 1 denote CSX Transportation, Inc. (CSXT) labor surcharge rates, labor additive and material handling rates for the calendar year 2009. We concur with your findings regarding the audited CSXT rates.

Rate category notes in Attachment 2 represent various elements that pertain to the designated labor surcharge rates. After reviewing Attachment 2, we approve for reimbursement the following rate categories: Fringe, Collective Bargaining Agreement Pool, Project Management, Payroll Taxes, Small Tool & Safety, Vehicles & Roadway, and Force Account Insurance. However, we do not approve the following rate categories: Training, Construction Equipment, Department Support, G&A, and Fixed Costs.

As we discussed earlier, based upon your review of the audited rates provided in the report, we concur that these rates are supported by the approved categories above. The specified rates are acceptable and are to remain in effect until subsequent rate proposals are submitted by CSXT, audited by your office, and approved by the Federal Highway Administration.

Sincerely,

A handwritten signature in black ink, appearing to read "Fred Wise".

Fred Wise
Rail Office Manager

www.dot.state.fl.us

APPENDIX D – FHWA Response



U.S. Department
of Transportation
**Federal Highway
Administration**

Florida Division

November 7, 2012

545 John Knox Road, Suite 200
Tallahassee, Florida 32303
Phone: (850) 553-2200
Fax: (850) 942-9691 / 942-8308
www.fhwa.dot.gov/fldiv

In Reply Refer To:
HDA-FL

Mr. Robert E. Clift
Inspector General
Florida Department of Transportation
605 Suwannee Street
Tallahassee, FL 32399-0450

Dear Mr. Clift:

This Office has completed review of your October 25, 2012 request for approval of the audited CSX Transportation, Inc. (CSXT) labor surcharge rates for each of three (3) labor categories and additional rates and cost treatments for the period ending December 31, 2009. The rates and treatments displayed in Appendix 1 to the Office of Inspector General's draft audit report include audit adjustments from the initial 2009 CSXT Rate Proposal.

Based on the information provided in the draft audit report, the audited rates displayed in Appendix 1, Labor Surcharge Rates and related notes, are approved and are to remain in effect until subsequent rate proposals are submitted by CSXT, audited by your Office, and approved by the Federal Highway Administration.

Sincerely,

For: Martin C. Knopp, P.E.
Division Administrator

DISTRIBUTION, PROJECT TEAM AND STATEMENT OF ACCORDANCE

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Brian Blanchard, Assistant Secretary for Engineering and Operations
David Hawk, Division Administrator (Acting), Federal Highway Administration
Ken Harvey, Office of Finance Director, Federal Highway Administration
Valerie Yeager, Director Expenditure Recovery, CSXT

Project Team:

Engagement was conducted by Carlos Mistry, Audit Team Leader

Under the supervision of:

Joe Gilboy, Audit Manager; and

Kristofer Sullivan, Director of Audit

Approved by: Robert E. Clift, Inspector General

Statement of Accordance

The mission of the department is to provide a safe transportation system that ensures the mobility of people and goods, enhances economic prosperity, and preserves the quality of our environment and communities.

The mission of the Office of Inspector General is to promote integrity, accountability and process improvement in the Department of Transportation by providing objective fact-based assessments to the DOT team.

This work product was prepared pursuant to Section 20.055, Florida Statutes, in accordance with the applicable Principles and Standards for Offices of Inspectors General as published by the Association of Inspectors General and the American Institute of Certified Public Accountants and standards contained in Government Auditing Standards issued by the Comptroller General of the United States.

This report is intended for the use of the agency to which it was disseminated and may contain information that is exempt from disclosure under applicable law. Do not release without prior coordination with the Office of Inspector General.

Please address inquiries regarding this report to the department's Office of Inspector General at (850) 410-5800.

ATTACHMENT 1 - Labor Surcharge Rates

	<u>Proposed</u>	<u>Audited</u>
A. Engineering		
Fringe	32.16%	32.16%
Collective Bargaining Agreement Pay	0.30%	0.30%
Project Management ¹	12.97%	12.97%
Training ¹	0.47%	0.47%
Payroll Taxes	21.92%	21.92%
Small Tools, Safety and Supplies ¹	4.85%	4.85%
Vehicles & Roadway Equipment ¹	30.19%	30.19%
Construction Equipment ¹	4.47%	4.47%
Department Support Costs ¹	10.76%	10.76%
G&A ¹	14.51%	14.51%
Fixed Costs ¹	18.96%	18.96%
Force Account Insurance	<u>16.00%</u>	<u>16.00%</u>
TOTAL	<u>167.56%</u>	<u>167.56%</u>
B. Mechanical		
Fringe	35.62%	35.62%
Collective Bargaining Agreement Pay	0.05%	0.05%
Project Management ¹	15.80%	15.80%
Training ¹	1.81%	1.81%
Payroll Taxes	23.15%	23.15%
Small Tools, Safety and Supplies ¹	4.85%	4.85%
Department Support Costs ¹	5.03%	5.03%
G&A ¹	14.51%	14.51%
Fixed Costs ¹	18.96%	18.96%
Force Account Insurance	<u>16.00%</u>	<u>16.00%</u>
TOTAL	<u>135.78%</u>	<u>135.78%</u>
C. Transportation		
Fringe	41.70%	41.70%
Collective Bargaining Agreement Pay	14.44%	14.44%
Project Management ¹	12.70%	12.70%
Training ¹	3.41%	3.41%
Payroll Taxes	26.23%	26.23%
Small Tools, Safety and Supplies ¹	2.91%	2.91%
Department Support Costs ¹	2.27%	2.27%
G&A ¹	14.51%	14.51%
Fixed Costs ¹	18.96%	18.96%
Force Account Insurance	<u>16.00%</u>	<u>16.00%</u>
TOTAL	<u>153.13%</u>	<u>153.13%</u>

¹ In accordance with 23 C.F.R. 140.907(a), a SHA "... may elect to reimburse the railroad company for its overhead and indirect construction costs". If the SHA does not elect to use the rates they will then need to determine allowability and allocability of those costs as a direct billing to the project.

ATTACHMENT 2 – Rate Category Notes

The following rate category notes pertain to the surcharge rates in Attachment 1.

1. Fringe:

48 C.F.R. 31.205-6 and 31.205-13, allow CSXT to be reimbursed for costs associated with compensated personal absences, health, welfare and the morale of its employees. The 2009 methodology for this category included four separate cost pools:

- Vacation and other
- Holiday
- Supplemental Sickness Insurance
- Health & Welfare

2. Collective Bargaining Agreement Pay:

CSXT has policies and work rules associated with union agreements and is bound by legal requirements to pay employees for various negotiated benefits and functions. The Collective Bargaining Agreement pool consists of the costs associated with these union agreements and applies only to contract labor. The labor related costs are required to be paid regardless of whether an employee is working on a capital, railroad operating or outside party project. The Collective Bargaining Agreement pool is allocated across outside party, capital and railroad operating labor for each respective craft.

3. Project Management:

Project management consists of labor costs associated with work performed on outside party, capital and railroad operating projects. The labor activities include tasks such as initiating projects, negotiating contracts, estimating project costs and overseeing project construction and budgets. It also includes non-management contract labor used in a supervisory or management role. Contracts with parties outside of CSXT for project management will be directly billed to the applicable project which contains the specific contractual requirement.

4. Training:

48 C.F.R. 31.205-44, allows CSXT to be reimbursed for training costs related to the field in which the employee is working or may be reasonably expected to work. The training cost pool captures training costs for training conducted by CSXT or outside vendors. Labor charged by CSXT employees to perform training is also included in the training pool.

5. Payroll Taxes:

48 C.F.R. 31.205-6, allows CSXT to be reimbursed for the employer's portion of federal retirement taxes. This pool is distributed across outside party, capital and railroad operating labor for each respective craft.

6. Small Tools, Safety and Supplies:

The small tools and safety category consists of costs associated with supplies, services and safety equipment utilized to complete outside party, railroad operating and capital projects. This pool also contains labor costs associated with attending

routine safety meetings. The small tools and safety category is used for reimbursement of supplies, services and safety equipment used on multiple projects which cannot be traced to a single project. Sales, marketing and advertising expenses are excluded from this category.

7. Vehicles & Roadway Equipment:

23 C.F.R. 140.910(a), states “Cost of company-owned equipment may be reimbursed for the average or actual cost of operation, light and running repairs, and depreciation, or at industry rates representative of actual costs as agreed to by the railroad, SHA, and FHWA.”

For 2009, CSXT has developed company-owned equipment and vehicle rates based on actual costs. In the past prior to 2007, CSXT directly invoiced for equipment and vehicles used on projects whether leased or company-owned. CSXT intends to phase out all direct charges to projects and use the vehicles and roadway rate except for agreed to specialty equipment.

8. Construction Equipment:

23 C.F.R. 140.910, allows CSXT to be reimbursed for depreciation expenses and the costs of operating and repairing company owned equipment. The construction equipment is utilized by engineering on railroad operating, outside party and capital projects and is allocated across these labor bases.

9. Department Support Costs:

The CSXT department support cost pool consists of overhead support costs for the engineering, mechanical and transportation crafts. Costs in this category include expenses for material, communications and other general support. Outside party, railroad operating and capital project expenses are included in this pool. This category is intended for expenses that cover multiple projects which cannot be traced to a specific project.

10. G&A:

48 C.F.R. 31.201-4, allows CSXT to be reimbursed for activities and costs necessary for the overall operation of the business. The general administration cost pool includes expenses of the accounting, auditing, finance, legal, secretarial, management services and data procurement personnel for the overall operation of the company.

11. Fixed Costs:

The fixed cost pool includes taxes (personal property, franchise, etc.), rent and depreciation that are part of the general operating expenses for CSXT. CSXT developed an allocation methodology to determine the personal property tax expenses based on only government projects.

12. Force Account Insurance:

Force Account Insurance provides liability, physical damage and medical coverage for the Maintenance of Way/Signal, Mechanical and Transportation categories. When CSXT works on non-company projects, they are reimbursed at a rate of 16% of labor cost for this insurance. This premium cost is paid to an external insurance company.