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Revised
EXECUTIVE MANAGEMENT AND AUDIT COMMITTEE
NOVEMBER 16, 2006

SUBJECT: MANAGEMENT AUDIT SERVICES FY 2007 FIRST QUARTER REPORT

ACTION: RECEIVE AND FILE

RECOMMENDATION

Receive and file the ~~year-end~~first quarter FY07 report of Management Audit Services for the period ending September 30, 2006.

ISSUE

At its January 2005 meeting, the Board designated the Executive Management and Audit Committee (EMAC) as their audit committee. The EMAC requested a quarterly report from Management Audit Services on its audit activities. This ~~year-end~~ report fulfills the requirement for first quarter of FY 2007.

DISCUSSION

Management Audit Services (MAS) provides audit support to the Chief Executive Officer (CEO) and his executive management. MAS provides audit services both internally reviewing agency processes, functions and systems, as well as externally reviewing compliance to contracts and memorandums of understanding (MOUs).

There are five audit groups in MAS, contract audit, grant audit, financial audit, information technology audit, and operational audit. Contract Audit audits contractor's proposals/claims to support the Office of Procurement and Material Management. Grant Audit audits compliance to MOUs for projects funded by Countywide Planning and Development. Financial Audit specializes in financial transaction reviews, Information Technology Audit audits the information technology (IT) systems, infrastructure, IT programs and activities, and Operational Audit focuses on agency operations and processes.

The summary of MAS audit activity for the quarter ending September 30, 2006 is as follows:

Contract Audit – six audits were completed reviewing a net value of \$15.4 million and questioning a net value of \$3.2 million. As of September 30, 2006, 20 audits are in process.

Grant Audit – three audits were completed reviewing \$8.1 million and identifying \$3.8 million of unused funds that can be reprogrammed through the Call-for-Projects. Thirty-four audits are in process with a total value of \$100 million.

Financial Audit, Information Technology Audit, and Operational Audit – 12 audits and two consulting engagements were completed during the first quarter.

Contractor Pre-Qualification – 101 applications and validations were processed and 94 were approved.

Audit Follow-up and Resolution – 22, or 25%, of all outstanding audit recommendations were completed and closed. Seventeen new audit recommendations were added.

MAS' FY 2007 First Quarter report is included as Attachment A.

NEXT STEPS

Management Audit Services will provide a second quarter summary of FY 2007 audit activity to the Board at the February 2007 Executive Management and Audit Committee meeting.

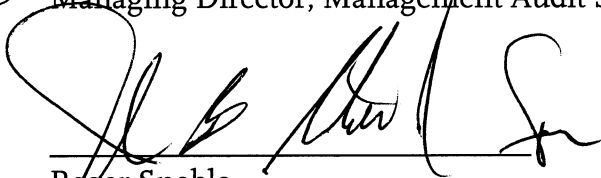
ATTACHMENT

- A. Quarterly Report on Management Audit Services activity for period ending September 30, 2006.

Prepared by: Ruthe Holden, Managing Director, MAS



Ruthe Holden
Managing Director, Management Audit Services



Roger Snoble
Chief Executive Officer

Los Angeles County Metropolitan Transportation Authority

**MANAGEMENT AUDIT SERVICES
QUARTERLY REPORT TO THE BOARD**

**FIRST QUARTER
FY 2007**



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EXECUTIVE SUMMARY

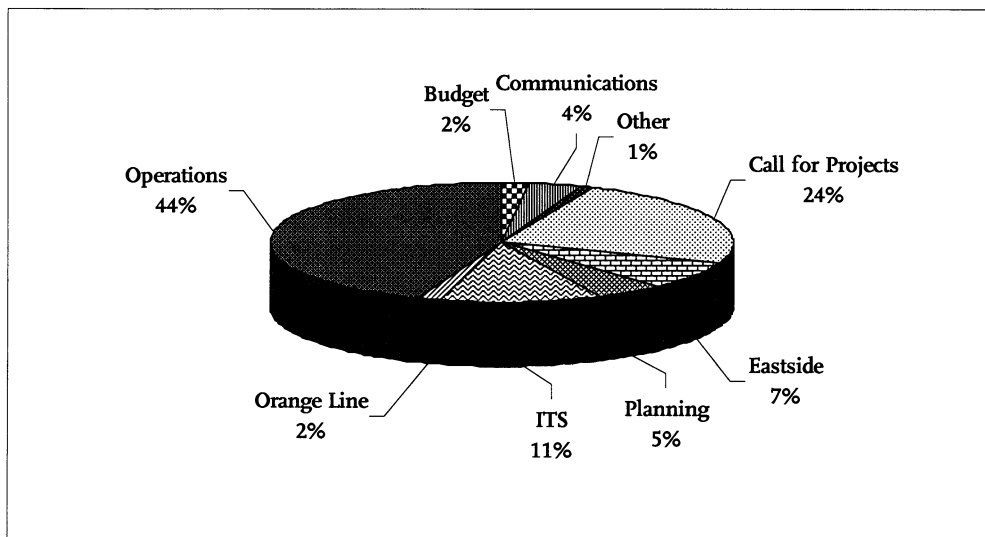
Introduction

During the first quarter of FY 2007, 12 audits and two consulting engagements were completed. Two audit memos were issued for audit projects that were stopped after the preliminary survey was completed because risk to the agency was deemed to be low.

The completed audits for first quarter include three internal audit reports, six contract audits, and three grant audits. The completed contract and grant audits are summarized on page three and completed internal audits begin on page four.

Eighty-six audits, three CSA reports and one consulting engagement were in process as of September 30, 2007. One of these audits is the forensic audit of the environmental and pre-construction process for the archeological excavation at the Los Angeles County Crematorium site. The Board requested this audit at the March 2006 Board Meeting and it was outsourced to Thompson, Cobb, Bazilio & Associates (TCBA) in July 2006. This audit will be finalized early in 3rd quarter 2007.

The following chart identifies the functional areas where Management Audit Services (MAS) focused staff time and efforts during first quarter FY 2007:



“Other” includes hours spent on projects for Administration and the Office of the CEO.

Work plans have been established for all auditors based upon the Board approved FY 2007 annual audit plan. Audits for the entire year have been scheduled to ensure smooth transition between audits and adequate planning and notification time for each department being audited.

EXECUTIVE SUMMARY

Audit Follow-up and Resolution has continued its more proactive approach to getting recommendations resolved. Twenty-two, or 25% of the recommendations were completed and closed during the quarter out of a total universe of 88. A total of 17 audit recommendations were added during the fiscal year.

The pre-qualification group processed 101 applications and validations during first quarter FY 2007, which were in support of 28 different procurement actions.

Highlight of the Quarter - Agency Wide Risk Assessment

In January 2005, the Board approved the Financial Standards requiring an annual risk assessment be completed for the agency. MAS has begun the process of updating last year's risk assessment completed by KPMG, LLP.

Risk assessments are a means of providing management with information needed to understand factors that can negatively influence operations and outcomes. The risk assessment is the process of identifying the possibility that events will occur that will be harmful to the agency, and/or will be detrimental to the achievement of the agency's strategic goals.

The methodology being used includes reviewing agency documents and interviewing management, staff and other interested parties to:

- Identify threats that could adversely affect critical operations and assets;
- Estimate the likelihood that such threats will materialize and their potential impact;
- Identify and rank the value, sensitivity, and criticality of the operations and assets that could be affected should a threat materialize.

The assessment of risk is an important planning step in developing the annual audit plan. The information gathered from this risk assessment will be used to develop the FY 2008 annual audit plan, which will be presented to the Board in 4th quarter FY 2007.

CONTRACTORS & OTHER AGENCY AUDITS

Contract Audit

Contract Audit provides support to the Office of Procurement and Material Management for a wide range of large-dollar procurements and projects in the area of financial and contract compliance. This support is given throughout the procurement cycle in the form of pre-award, interim, change order, and closeout audits.

During first quarter FY 2007, six audits were completed, reviewing a net value of \$15.4 million and questioning a net value of \$3.2 million. Four of these completed audits were for Operations projects and two were for the Eastside project. In addition, Contract Audit completed one special request for consulting services. As of September 30, 2006, 20 audits and one consulting engagement were in process.

For contract actions negotiated during first quarter FY 2007 (including open audit findings from prior quarters) the agency avoided \$284 thousand in cost based on questioned costs from audit findings, which resulted in a total sustention rate of 61%.

During the quarter, approximately 71% of Contract Audit's efforts went to support of Operations. The rest of the audit effort was split among Eastside, Orange Line, and Planning audit support.

Details on Contract Audits completed during first quarter FY 2007 are in Appendix A.

Grant Audit

Grant Audit conducts audits for Countywide Planning's Call-for-Projects program, federally funded transportation programs, and various other grantees for transportation related projects. These include the Alameda Corridor East and CalTrans. The purpose of the audits is to ensure that money is spent in accordance with the terms of the grants or contracts and Federal cost principles.

Grant Audit completed three audits during first quarter FY 2007, reviewing in excess of \$8.1 million. We identified \$3.8 million of unused funds that can be reprogrammed by Countywide Planning for other projects. Thirty-four audits with a total value of \$100 million were in process as of September 30, 2006.

Details on Grant Audits completed during first quarter FY 2007 are in Appendix B.

INTERNAL AUDITS

Financial Audit

For the first quarter of FY 2007, two audits were completed, Compliance with the Investment Policy, and Compliance Audit of the FY 2005 Cost Allocation Plan. These audits are summarized below. In addition, Financial Audit is providing consulting services to PricewaterhouseCoopers.

Eight Financial audits were in process as of September 30, 2006. They are: Fixed Asset, Inventory Management, General Ledger, Accounts Payable, Encumbrances, Budget Process, Petty Cash, and Payroll Process. The eight audits in process are listed in Appendix C.

Compliance with the Investment Policy

The objective of the audit was to determine whether Treasury investment operations were in compliance with the Investment Policy and applicable sections of the Code. Based on our review of Treasury operations and testing of a sample of investment transactions, we noted no significant non-compliance issues. However, we noted that the Official Signatory Listing of individuals who can authorize electronic transfers should be updated to reflect current organizational changes.

We recommend that the Treasury revise its procedures so the Official Signatory Listing is updated and the changes transmitted to investment managers and custodial financial institutions immediately when changes to authorized persons occur.

Treasury concurred with our findings and agreed to implement the recommendation.

Compliance Audit of the FY 2005 Cost Allocation Plan

This audit was outsourced to Macias, Gini & O'Connell, LLP. The objective of this audit was to examine the agency's FY 2005 Cost Allocation Plan for adherence to Federal OMB A-87 requirements. Based on the results of the examination, all costs included in the Cost Allocation Plan are properly allocable to Federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements.

INTERNAL AUDITS

Information Technology Audit

Preliminary work was completed on Audit of CCC/Harvest Change Management, resulting in a memo to the auditee notifying them that the audit had been stopped because the overall risk to the agency was deemed to be low. Also, two consulting engagements were completed; Analysis of Overtime Payments, and Analysis of Normal Time and Overtime Budget Variances.

Twelve Information Technology (IT) audit projects are in process. Nine audits are in process from the FY 2006 audit plan: Financial Information System Environment, Advanced Transportation Management System Security, Oracle Human Resources, Budget Information and Accounting System, Supervisory Control & Data Acquisition Firewall, Payroll System Interfaces, Software Licensing Procedures, Compliance to Software License Agreements, and Physical Access Security for Rail Operations. Three audits in process from the FY 2007 audit plan include: Oracle Change Management, Wireless System, and Continuous Monitoring. The IT audits in process are listed in Appendix D.

INTERNAL AUDITS

Operational Audit

For the first quarter of FY 2007, one audit report was issued, Bus Operators OCB/VCB Assignments at San Fernando Valley Sector, and is summarized below. Preliminary work was completed on another audit project, Compliance with Funding Sources Regulations and Requirements, resulting in a memo to the auditee notifying them that the audit had been stopped because the overall risk to the agency was deemed to be low.

Eleven Operational audit projects are in process as of September 30, 2006. They include: Family and Medical Leave, Fare Media Controls, Accident Management Process, Program Management Business Process Improvement, Bus Maintenance Service, Bus Warranty Administration, Call for Projects Administration, Cell Phone Utilization, Rail Service Interruption and Contingency Planning, ADA Compliance, and Procurement Card. Three control self assessments are in process. They include: Equipment Maintenance, Warranty Process, and Facility Services Maintenance.

The eleven audits and three control self assessments in process are listed in Appendix E.

Audit of the Bus Operators OCB/VCB Assignments at San Fernando Valley Sector

The primary purpose of the audit was to evaluate mandatory call back (OCB) and voluntary call back (VCB) on-duty time data for the San Fernando Valley Service Sector from January 2005 to December 2005. The call back assignment procedure was developed to meet operator shortages. The audit found 144 (9%) out of 1,675 callbacks for the period reviewed resulted in 469 instances where 71 operators on-duty assignments exceeded the limitations set by the California Vehicle Code. A task force of Operations and ITS staff are developing an online tool that will allow mark-up staff to generate and review a report on an operator's time casting back seven days. Once implemented, Operations will develop guidelines and train appropriate personnel.

AUDIT SUPPORT SERVICES

Contractor Pre-Qualification

California Public Utilities Code §130051.21 and Ordinance #4-05 of the Administrative Code require firms to be pre-qualified prior to doing business with the agency.

During first quarter FY 2007, 101 applications and validations were processed. Sixty-nine applications and 27 validations were submitted, and five applications were in process from the end of FY 2006. Of the 101 processed, 94 firms were approved to do business with LACMTA, three were closed as incomplete (applicants failed to respond to requests for information), and four applications were still in process as of September 30. The average processing time was six days for applications and one day for validations.

The applications processed during first quarter FY 2007 were in support of 28 different procurement actions, including contracts in construction, operations, and professional services.

Audit Follow-Up and Resolution

During the first quarter, 17 new audit recommendations were added to the outstanding audit recommendations list, and 22 additional recommendations were completed and closed out of a total universe of 88 representing a 25% reduction in the total outstanding recommendations. Below is a table summarizing the first quarter activity.

**Summary of MAS and External Audit Recommendations
As of September 30, 2006**

Executive Area	Closed or Completed in July	Closed or Completed in Aug.	Closed or Completed in Sept.	Under Review	Extended	Not Yet Due	Total Open Recom.
EO Finance	1	1				3	3
EO Administration						4	4
EO Procurement & Material Management	1		2		7	3	10
Chief Executive Officer					1	4	5
Chief Comm. Officer			4	7		1	8
Chief Planning Officer						12	12
DCEO/COO		6	7	1	8	15	24
Totals	1	7	13	8	16	42	66

Appendix A

Contract Audit FY 2007 - Audits Completed During First Quarter					
Area	Audit Number & Type	Contractor	Requirement	Date Completed	
Eastside	07-LRT-C01 - Change	Eastside LRT Constructors	Legal	8/2006	
Operations	06-CTS-01 - Change	Cubic Transportation Systems, Inc.	Contractual	8/2006	
Operations	07-TMD-C01 - Cost Proposal	Transporation Management & Design, Inc.	Contractual	8/2006	
Eastside	06-LRT-07 - Change	Lenax Construction Services, Inc.	Legal	8/2006	
Operations	06-GIR-01 - Cost Proposal	Giro, Inc.	Contractual	9/2006	
Operations	06-SMT-C01 - Cost Proposal	Simmons Machine Tool Corp.	Contractual	9/2006	

Appendix B

Grant Audit FY 2007 - Audits Completed During First Quarter					
Area	Audit Number & Type	Contractor	Requirement	Date Completed	
Planning	06-ACT-01 - Closeout	ACT Consulting	Contractual	7/2006	
Planning	06-COH-01 - Closeout	South Bay Council of Government	Contractual	7/2006	
Planning	06-CCC-01 - Closeout	Culver City	Contractual	9/2006	

Appendix C

Financial Audit FY 2007 - Progress Toward Completing Audit Plan				
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
Executive Officer of Real Property Management & Development	06-ACC-004 - Real Estate Controls	Completion of FY06 audit in process. Review the agency fixed assets report to determine accuracy and completeness. Follow-up on prior audit findings.	High	12/2006
Executive Officer Finance	06-ACC-007 - Account Reconciliation	Completion of FY06 audit in process. Performance audit to review internal controls over the periodic reconciliation of the agency's bank accounts.	High	12/2006
Executive Officer Finance	06-ACC-009 - Accounts Payable	Completion of FY06 audit in process. Performance audit to test sample transactions for compliance to policies and procedures, and accuracy of payments.	High	12/2006
Executive Officer Procurement and Material Management	06-PMM-003 - Inventory Management	Completion of FY06 audit in process. Performance audit to verify adequacy of internal controls over inventory purchasing, receiving, and disbursement.	High	3/2007
Executive Officer Finance	07-ACC-F03 - Petty Cash	Performance audit to review internal controls over the handling of petty cash funds.	High	3/2007

Appendix C

Financial Audit FY 2007 - Progress Toward Completing Audit Plan					
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion	
Executive Officer Finance	05IA-P17-00 - Encumbrances	Audit to determine whether encumbrances are being closed out in compliance with agency policy and in a timely fashion.	High	6/2007	
Executive Officer Finance	06-OMB-006 - Budget Process	Performance audit to evaluate the effectiveness and efficiency of the processes used in developing the agency's annual operational budget.	High	6/2007	
Executive Officer Finance	06-ACC-008 - Payroll Process	Completion of FY06 audit in process. Integrated audit to assess the adequacy of effectiveness of internal controls in Payroll Central.	High	6/2007	

Appendix D

Information Technology Audit FY 2007 - Progress Toward Completing Audit Plan				
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
Chief Operations Officer	06-MRL-002 - ATMS Security	Completion of FY06 audit in process. Assess the adequacy of controls for safeguarding ATMS resources.	High	11/2006
Executive Officer Finance/ITS	06-ITS-003 - Audit of Financial Information System Environment	Completion of FY06 audit in process. Assess the adequacy of controls for safeguarding the FIS environment.	High	12/2006
Executive Officer Finance/ITS	06-ITS-004 Oracle Human Resources	Completion of FY06 audit in process. Assess Oracle HR security controls.	High	11/2006
Executive Officer Finance/ITS	06-OMB-005 - Budget Information Accounting System	Completion of FY06 audit in process. Assess the adequacy of controls for processing budget information.	Medium	12/2006
Executive Officer Procurement & Material Management/ITS	06-MRL-I07 - SCADA Firewall	Completion of FY06 audit in process. Assess the internal controls implemented in the firewall system for the SCADA network.	High	1/2007
Executive Officer Finance/ITS	06-ACC-008 - Payroll System Interfaces	Completion of FY06 audit in process. Assess the internal controls implemented in the payroll system interfaces.	High	11/2006
Agency-wide	06-ITS-009 - Software Licensing Procedures	Completion of FY06 audit in process. Determine if policies and procedures for software purchases are adequate.	High	11/2006

Appendix D

Information Technology Audit FY 2007 - Progress Toward Completing Audit Plan					
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion	
Agency-wide	06-ITS-012 - Compliance to Software License Agreements	Completion of FY06 audit in process. Assess compliance with vendor licensing agreements and copyright laws.	High	11/2006	
Chief Operations Officer	06-ITS-018 - Physical Access to SCADA Communication Resources	Completion of FY06 audit in process. Assess physical access controls for safeguarding the SCADA computers and related communication resources.	High	11/2006	
Executive Officer Procurement & Material Management/ITS	07-ACC-I04 - Oracle Change Management	Validate the formal change management process and assess the adequacy of controls in managing changes to Oracle applications.	High	12/2006	
Agency-wide	07-ITS-I06 - Wireless System	Assess the confidentiality, integrity and availability of the wireless network.	High	11/2006	
Agency-wide	07-ITS-I09 - Continuous Monitoring	Independent mechanism to automatically monitor internal control effectiveness embedding audit "best practices" in the business operations .	High	6/2007	

Appendix E

Operational Audit FY 2007 - Progress Toward Completing Audit Plan				
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
Chief Operations Officer	05IA-V13-00 - Family and Medical Leave	Completion of FY05 audit in process. Assess compliance to the Family and Medical Leave Policy.	High	10/2006
Financial	06-CVS-008 - Fare Media Controls	Completion of FY06 audit in process. Performance Audit to evaluate the security and controls in place to protect fare media from the time it is printed until the asset is no longer the responsibility of the agency.	High	12/2006
Agency-wide	06-PPM-002 - Program Management Business Process Improvement	Completion of FY06 project in process. Perform Consulting engagement reviewing current Agency program management process and determining business improvements.	High	12/2006
Planning	06-TDI-004 - Call for Projects Administration	Completion of FY06 audit in process. Evaluate the adequacy of internal controls and project management process of periodic call for projects.	Medium	12/2006
Agency-wide	07-PMM-I10 - Procurement Card	Performance audit to identify policies, procedures and controls.	High	2/2007

Appendix E

Operational Audit FY 2007 - Progress Toward Completing Audit Plan					
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion	
Safety	07-OPS-001 - Accident Management Process	Validate the process for monitoring and reviewing bus driver accidents and determine that system performance continues to meet transportation safety requirements.	Critical	3/2007	
Operating	07-OPS-O13 - Bus Warranty Administration	Perform an internal control review validating that bus facilities maintenance program requirements are being met.	High	3/2007	
Operating	07-OPS-005 - Cell Phone Utilization	Conduct an internal control review to validate agency compliance to cell phone policy.	Low	3/2007	
Operating	07-OPS-003 - ADA Compliance	Validate that Metro complies with ADA requirements. Review the requirements of the contract with Access Services, and validate that Access Services is complying with contract requirements.	High	3/2007	
Operating	07-OPS-007 - Bus Maintenance Service	Perform an internal control review validating that warranty program requirements are being met.	High	6/2007	
Operating	07-OPS-003 - Rail Service Interruption and Contingency Planning	Validate adherence to policies for serving and assisting rail ridership when there is a service interruption.	Critical	6/2007	