



EXECUTIVE MANAGEMENT AND AUDIT COMMITTEE
February 15, 2007

SUBJECT: MANAGEMENT AUDIT SERVICES FY 2007 SECOND QUARTER REPORT

ACTION: RECEIVE AND FILE

RECOMMENDATION

Receive and file the second quarter FY 2007 report of Management Audit Services for the period ending December 31, 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 report fulfills the requirement for the second 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 December 31, 2006 is as follows:

Contract Audit – eight audits and a consulting engagement were completed, and as of December 31, 2006, 25 audits are in process.

Grant Audit – six audits were completed reviewing \$36 million and identifying \$419 thousand of unused funds that can be reprogrammed through the Call-for-Projects. Forty-two audits are in process with a total value of \$120 million.

Financial Audit, Information Technology Audit, and Operational Audit – 4 audits, one controlled self assessment, and one consulting engagement were completed during the second quarter.

Contractor Pre-Qualification – 145 applications and validations were processed and 108 were approved.

Audit Follow-up and Resolution – 28, or 34%, of all outstanding audit recommendations were completed and closed. Seventeen new audit recommendations were added.

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

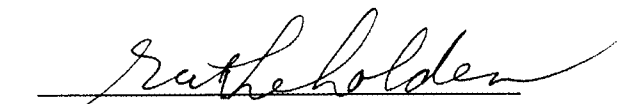
NEXT STEPS

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


ATTACHMENT

- A. Quarterly Report on Management Audit Services activity for period ending December 31, 2006.

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Roger Snoble
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Los Angeles County Metropolitan Transportation Authority

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

**SECOND QUARTER
FY 2007**



Metro

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EXECUTIVE SUMMARY

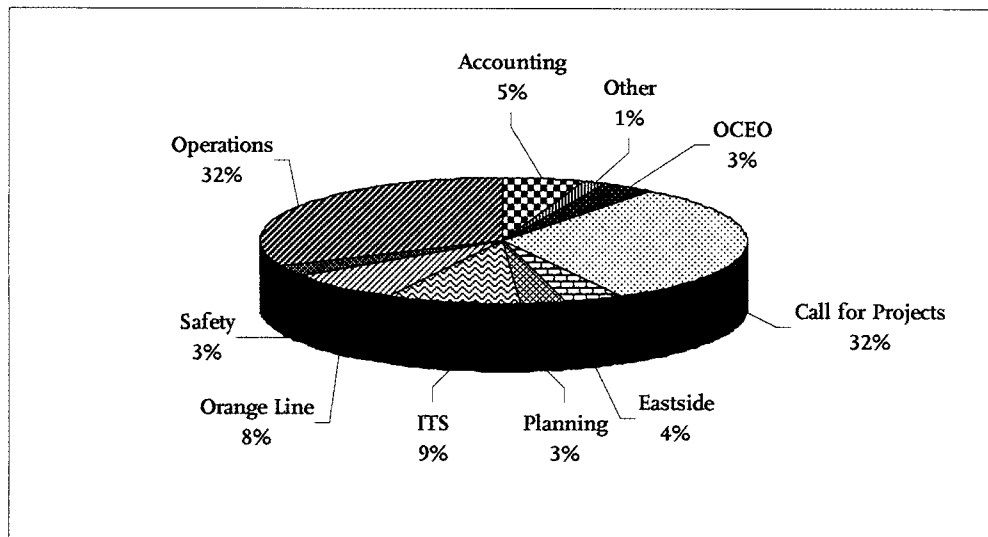
Overview

During the second quarter of FY 2007, 18 audits, one controlled self assessment (CSA), and two consulting engagements were completed.

The completed audits for second quarter include 4 internal audit reports, 8 contract audits, and 6 grant audits. The completed contract and grant audits are summarized on page three and completed internal audits begin on page four.

Ninety-five audits and three CSA reports were in process as of December 31, 2006.

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



“Other” includes hours spent on projects for Communications and Procurement.

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.

Audit Follow-up and Resolution has continued its more proactive approach to getting recommendations resolved. Twenty-eight, or 34% of the recommendations were completed and closed during the quarter out of a total universe of 83. A total of 17 audit recommendations were added during the second quarter.

The pre-qualification group processed 145 applications and validations during second quarter FY 2007, which were in support of 36 different procurement actions.

EXECUTIVE SUMMARY

Annual Audit Planning Process

The agency's financial standards require that MAS prepare an annual risk assessment and audit plan and present it to the Board for their input and approval. Therefore, during the second quarter, MAS began the process of updating the agency wide risk assessment, reviewing and updating the audit universe and preparing the audit plan to present to the CEO, Executive Management and the Board.

The risk assessment process drives the audit plan, determining the scope and nature of the audit work undertaken. The audit plan identifies how MAS will allocate its resources and defines the audit priorities for the next fiscal year. An annual audit plan is considered an industry best practice and is a requirement to comply with the Institute of Internal Auditors (IIA), and the Information Systems Audit and Control Association (ISACA) auditing standards.

To update the agency wide risk assessment, MAS has been meeting with Executive Officers and Directors to identify audit priorities and management concerns. The audit plan is currently being drafted. Once it is completed, MAS will then present the final audit plan to the CEO and the Board for their approval during the next quarter.

Changes to Auditing Standards

At the end of 2006, the Government Accountability Office (GAO) issued the final draft of the revised Generally Accepted Government Auditing Standards (GAGAS). This is the fifth revision since the standards were first issued in 1972. This revision emphasizes the critical role of high quality government audits in achieving credibility and accountability in government. The overall focus of the changes includes an increased emphasis on audit quality and ethics and an extensive update of the performance auditing standards to include a specified level of assurance within the context of risk and materiality.

In addition, this revision includes updates to bring GAGAS consistent with American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards (SAS) No. 102, *Defining Professional Requirements in Statements on Auditing Standards*, SAS No. 103, *Audit Documentation*, and SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit*.

The revised GAGAS standards will become effective for audits beginning on or after July 1, 2007. We will be holding training classes for staff before June 30, 2007 to ensure all audits comply with the changes in the standards. We will provide a more detailed update as soon as GAO issues the final version of the standards.

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 second quarter FY 2007, eight audits were completed. Three of the completed audits were compliance audits and three were incurred cost audits for the Eastside project, one was a Buy America audit for an Operations project, and the other was a forward pricing rates audit for an Environmental project. As of December 31, 2006, 25 audits were in process.

For contract actions negotiated during second quarter FY 2007 (including open audit findings from prior quarters) the agency avoided \$7 thousand in cost based on questioned costs from audit findings.

During the quarter, approximately 53% of Contract Audit's efforts were in 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 second 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 6 audits during second quarter FY 2007, reviewing in excess of \$36 million. We identified \$419 thousand of unused funds that can be reprogrammed by Countywide Planning for other projects. Forty-two audits with a total value of \$120 million were in process as of December 31, 2006.

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

INTERNAL AUDITS

Financial Audit

For the second quarter of FY 2007, one audit was completed. This audit is summarized below. In addition, the audit support services provided to PricewaterhouseCoopers ended this quarter.

Seven Financial audits were in process as of December 31, 2006. They are: Inventory Management, General Ledger, Accounts Payable, Encumbrances, Budget Process, Petty Cash, and Payroll Process.

The seven audits in process are listed in Appendix C.

Audit of Real Estate Procedures for Tracking of Real Property Fixed Assets

The objective of the audit was to determine the adequacy of internal controls for tracking real property fixed assets. The Real Estate Department (RED) manages agency-owned property and maintains real property inventory records.

Based on our audit, we found that significant internal control deficiencies identified in prior audits have still not been corrected. RED needs to verify completeness and accuracy of real property records, RED and Accounting need to strengthen the follow-up process to ensure an accurate recording of property additions, and the Real Property Management Information System (RPMIS) needs to be made operational.

RED has agreed to strengthen internal controls over real property and has started implementing the corrective actions. These include establishing procedures to reconcile records of new acquisitions with Accounting and Assessor records, taking steps to make RPMIS operational, and conducting a cost/benefit analysis to determine the added value of an overall reconciliation of properties and property titles from Assessor's records to RED records.

INTERNAL AUDITS

Information Technology Audit

For the second quarter FY 2007, one audit report was issued, Advanced Transit Management System Security, and is summarized below.

Thirteen Information Technology (IT) audit projects are in process. Eight audits are in process from the FY 2006 audit plan: Financial Information System Environment, 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. Five audits in process from the FY 2007 audit plan include: Oracle Change Management, Wireless System, Continuous Monitoring, Procurement Card, and Vendor Master File.

The 13 audits in process are listed in Appendix D.

Audit of the Advanced Transportation Management System Security

The primary purpose of the audit was to evaluate the logical, physical and environmental security controls over the Advanced Transportation Management System (ATMS) from December 2005 to July 2006. ATMS is an advanced bus communication and fleet management system integrating data, voice, radio, telecom, wired networks and other related components. ATMS was implemented to integrate a number of communication systems under one global umbrella.

ATMS controls are inadequate. Both the logical and physical security standards and controls over the ATMS environment have significant weaknesses. There were 3 areas of significant weaknesses noted in our report: 1) Inadequate Account and Password Management Practices; 2) No Separate Test Environment; and 3) Inadequate Physical Security Controls.

Management will implement stricter account and password management procedures including reviewing all operating system and user accounts for proper authority and rights as well as establishing network monitoring devices. Management is investigating the implementation of an onsite test environment that will closely replicate the ATMS environment. Management will work with Facilities Maintenance to resolve the physical security issues.

INTERNAL AUDITS

Operational Audit

For the second quarter of FY 2007, four assignments were completed. Audit reports were issued for Fare Media Controls and Family and Medical Leave. In addition, the Program Management Business Process Improvement Consulting Engagement was finished, and the Bus Maintenance Control Self Assessment was completed. The Fare Media Controls report and the Family and Medical Leave report are summarized below.

Eight Operational audit projects were in process as of December 31, 2006. They include: Accident Management Process, Bus Maintenance Service, Bus Warranty Administration, Call for Projects Administration, Cell Phone Utilization, Rail Service Interruption and Contingency Planning, ADA Compliance, and the forensic audit of the Metro Gold Line Eastside Extension Los Angeles Crematorium Site. Three control self assessments are in process. They include: Equipment Maintenance, Warranty Process, and Facility Services Maintenance.

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

Fare Media Controls

The objective of the audit is to determine whether internal controls are adequate for safeguarding and controlling fare media distributed to LACMTA service centers and third parties, and to safeguard and control day passes at the divisions.

During the course of the audit, we found that physical controls are adequate for safeguarding and accounting for all fare media except day passes. Controls over assigning responsibility, safeguarding and controlling day passes once they have been issued to bus operators and vehicle officers are inadequate. Divisions do not consistently enforce procedures requiring operators to enter their badge numbers on the back of each day pass book issued, nor do they monitor whether the operators return unused day passes at the end of the shift, and there is no follow-up with operators to determine reasons for missing day pass books.

Operations responded quickly to the findings by establishing a task force to develop methods to strengthen and enforce day pass controls to create greater system accountability.

INTERNAL AUDITS

Operational Audit

Family and Medical Leave

The purpose of the audit was to evaluate the use of family and medical leave (FML) by the United Transportation Union (UTU) employees for the period July 1, 2003 through April 30, 2005.

There is inconsistent management of UTU employees on family and medical leave, and management of family and medical leave documentation needs improvement.

Operations will enforce the agency's Family and Medical Leave Policy (HR Policy 6-1) by providing a copy to each manager for their review. All Operations management staff will attend the next available training session provided by Office of Development & Training on Managing Leaves of Absence. In addition, Operations will coordinate a task force to identify the best method for monitoring employees on family and medical leave and request an HR representative to review all relevant paper work to determine whether files are in compliance with the policy.

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 second quarter FY 2007, 145 applications and validations were processed. This is a 30% increase from first quarter FY 2007. Ninety applications and 51 validations were submitted, and four applications were in process from the end of first quarter FY 2007. Of the 145 processed, 108 firms were approved to do business with LACMTA, five were closed as incomplete (applicants failed to respond to requests for information), and 32 applications were still in process as of December 31. The average processing time was 12 days for applications and three days for validations.

The applications processed during second quarter FY 2007 were in support of 36 different procurement actions, including contracts in construction, operations, and professional services.

Audit Follow-Up and Resolution

During the second quarter, 17 new audit recommendations were added to the outstanding audit recommendations list, and 28 additional recommendations were completed and closed out of a universe of 83 representing a 34% reduction in the total outstanding recommendations. Below is a table summarizing the second quarter activity.

**Summary of MAS and External Audit Recommendations
As of December 31, 2006**

Executive Area	Closed or Completed in Oct.	Closed or Completed in Nov.	Closed or Completed in Dec.	Under Review	Extended	Not Yet Due	Total Open Recom.
EO Finance					2	1	3
EO Administration					4		4
EO Procurement & Material Management	1	2			7		7
Chief Executive Officer	1	1			3		3
EO Real Property Management & Development						4	4
Chief Comm. Officer		3	2	2		1	3
Chief Planning Officer		1				11	11
DCEO/COO	11	2	4		7	13	20
Totals	13	9	6	2	23	30	55

Appendix A

Contract Audit FY 2007 - Audits Completed During Second Quarter						
Area	Audit Number & Type	Contractor	Requirement	Date Completed		
Eastside	07-LRT-C02 - Change	Eastside LRT Constructors	Legal	10/2006		
Eastside	07-LRT-C03 - Change	Eastside LRT Constructors	Legal	10/2006		
Operations	06-ANS-01 - Interim Buy America	Ansaldobreda S.p.A.	Contractual	11/2006		
Eastside	07-LRT-C04 - Change	Eastside LRT Constructors	Legal	11/2006		
Eastside	Incurred Cost - FY05 reported costs and indirect expense rate	Barrio Planners	Contractual	11/2006		
Eastside	Incurred Cost - FY01 indirect expense rate	Barrio Planners	Contractual	11/2006		
Eastside	Incurred Cost - Revalidation of labor classification of certain employees for years 2002 and 2003	Barrio Planners	Contractual	11/2006		
Environmental	07-JAS-C01A - Forward Pricing	Jones and Stokes Associates, Inc.	Contractual	12/2006		

Appendix B

Grant Audit FY 2007 - Audits Completed During Second Quarter

Area	Audit Number & Type	Contractor	Requirement	Date Completed
Planning	MOU No. P0000349 - Closeout	Caltrans	Contractual	10/2006
Planning	06-KMI-01 - Closeout	Kinder Morgan, Inc.	Contractual	10/2006
Planning	06-FPL-01 - Closeout	FPL & Associates	Contractual	10/2006
Planning	07-CLA-G01 - Closeout	LADOT	Contractual	11/2006
Planning	07-CLA-G06 - Closeout	LADOT	Contractual	11/2006
Planning	STIP Regional Rideshare Program - Closeout	LACMTA	Contractual	12/2006

Appendix C

Financial Audit FY 2007 - Progress Toward Completing Audit Plan					
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion	
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	3/2007	
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	3/2007	
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	
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	

Appendix C

Financial Audit FY 2007 - Progress Toward Completing Audit Plan

Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
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	
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	3/2007	
Executive Officer Finance/ITS	06-ITS-004 Oracle Human Resources	Completion of FY06 audit in process. Assess Oracle HR security controls.	High	3/2007	
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	2/2007	
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	2/2007	
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	1/2007	
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	1/2007	
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	3/2007	

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-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	1/2007	
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	3/2007	
Agency-wide	07-ITS-I06 - Wireless System	Assess the confidentiality, integrity and availability of the wireless network.	High	1/2007	
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	
Financial	07-PMM-I10 - Procurement Card	Assess procurement card policies, procedures and controls and determine compliance with policies and procedures.	High	6/2007	
Financial	07-ACC-I08 - FIS - Vendor Master File	Validate internal controls of the vendor master file and that the data in the file are accurate, complete, and duplicate vendors do not exist.	High	6/2007	

Appendix E

Operational Audit FY 2007 - Progress Toward Completing Audit Plan				
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
Construction	07-MGLEE-001 - Forensic audit of the Metro Gold Line Eastside Extension Los Angeles Crematorium Site (outsourced to TCBA)	Investigate how Metro's environmental and pre-construction review process did not detect the mass grave prior to submission of the FEIR and Statement to the FTA.	High	1/2007
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	2/2007
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-O05 - Cell Phone Utilization	Conduct an internal control review to validate agency compliance to cell phone policy.	Low	2/2007

Appendix E

Operational Audit FY 2007 - Progress Toward Completing Audit Plan				
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
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

