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**EXECUTIVE MANAGEMENT AND AUDIT COMMITTEE
JUNE 18, 2009**

SUBJECT: MANAGEMENT AUDIT SERVICES FY 2009 THIRD QUARTER REPORT

ACTION: RECEIVE AND FILE

RECOMMENDATION

Receive and file the third quarter report of Management Audit Services (Management Audit) for the period ending March 31, 2009.

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 on its audit activities. This report fulfills the requirement for the third quarter of FY 2009.

DISCUSSION

Management Audit provides audit support to the Chief Executive Officer (CEO) and his executive management. Internal audit services include reviewing agency processes, functions and systems, and external audit services consist of reviewing compliance to contracts and memorandums of understanding (MOUs).

There are four groups in Management Audit: Operational and Financial Audit, Information Technology Audit, Compliance and Performance Audit, and Audit Support and Research Services.

Operational and Financial Audit is primarily responsible for all audits for Finance, Bus Operations, Rail Operations, and Communications. Compliance and Performance Audit is responsible for all audits in Administrative Services, Construction, Real Estate & Development, and Planning. Both of these units provide assurance to the public that internal processes are efficiently, economically, effectively, ethically, and equitably performed by conducting audits of program effectiveness and results, economy and efficiency, internal controls, and compliance. Compliance and Performance Audit is also responsible for the Contract Audit and Grant Audit functions.

Information Technology (IT) Audit has two focuses. One is to review IT Systems for adequate controls, effective performance and accuracy, and reliability of the data being processed. The other is to provide support services to other auditors to meet auditing standards requirements when reliance needs to be placed on IT systems. Audit Support and Research Services is responsible for administration, financial management, budget coordination, Pre-Qualification, audit follow-up and resolution tracking.

The summary of Management Audit activity for the quarter ending March 31, 2009 is as follows:

Internal Audits: Two internal audits, one Control Self Assessment (CSA), two audit memos and one consulting engagement were completed; 32 internal audits were in process.

External Audits: eight contract audits with a total value of \$19.2 million and three grant audits with a total value of \$22.5 million were completed; 16 contract audits and 25 grant audits were in process.

Contractor Pre-Qualification: 392 Pre-Qualification applications and validations were received and 192 were approved. This represents a 216% increase in activity since the same time frame last year.

Audit Follow-up and Resolution: 26, or 29%, of all outstanding audit recommendations were completed and closed; 24 new audit recommendations were added.

Management Audit's FY 2009 third quarter report is included as Attachment A.

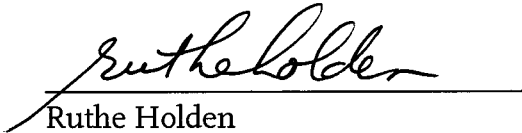
NEXT STEPS

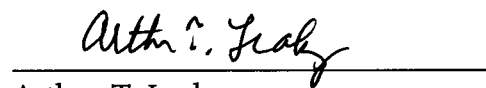
Management Audit will provide the FY2009 year-end summary of audit activity to the Board at the August 2009 Executive Management and Audit Committee meeting.

ATTACHMENT

- A. Management Audit Services Quarterly Report to the Board for the period ending March 31, 2009

Prepared by: Ruthe Holden, Chief Auditor, Management Audit


Ruthe Holden
Chief Auditor, Management Audit Services


Arthur T. Leahy
Chief Executive Officer

Los Angeles County Metropolitan Transportation Authority

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

***THIRD QUARTER
FY 2009***



Metro

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EXECUTIVE SUMMARY

Summary of Audit Activity

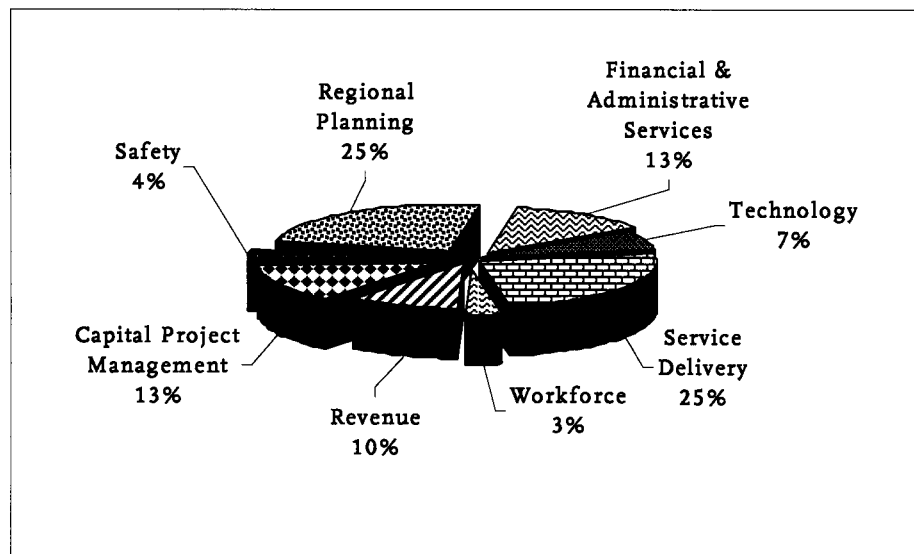
During the third quarter of FY 2009, 17 audit projects were completed. These include:

- Procurement Card Audit
- Health Care Benefit Eligibility Audit
- 2 audit memos on Budget Process and Real Estate Acquisitions Environmental Review Process
- 8 contract audits
- 3 grant audits
- 1 control self assessment (CSA) on the M3 Timekeeping Process, and
- 1 consulting assignment related to Bus Passed-up Complaints

The completed external audits are summarized on page three. Summaries of the internal audits begin on page four.

Seventy-three audits were in process as of March 31, 2009; these include 32 internal audits, 16 contract audits, and 25 grant audits.

The following chart identifies the functional areas where Management Audit focused audit staff time and efforts during third quarter FY 2009:



Results of activities managed by the Audit Support and Research Services group include:

- Twenty-six or 29% of the recommendations were completed and closed during the quarter out of a total universe of 90. Twenty-four recommendations were added during the third quarter; and
- 392 Pre-Qualification applications and validations were received and 192 were approved during the third quarter FY 2009.

EXECUTIVE SUMMARY

Annual Financial Audit Services

KPMG, LLP was engaged to audit Metro's Comprehensive Annual Financial Report (CAFR) beginning with fiscal year end June 30, 2008. As our CAFR auditors, KPMG is responsible for conducting an audit in accordance with auditing standards generally accepted in the United States of America and the standards for financial audits contained in *Government Auditing Standards*. In conducting the audit, the auditor is required to perform tests of Metro's accounting records and such other procedures, as they considered necessary in the circumstances, to provide a reasonable basis for their opinion on the financial statements. In carrying out this responsibility, the auditor must plan and perform the audit in accordance with professional standards. In addition, the auditor must also consider internal control over financial reporting for the purpose of expressing an opinion on the financial statements. Based on the results of the audit, the auditor then issues an opinion on the fair presentation of Metro's basic financial statements in conformity with U.S. generally accepted accounting principles.

Parts of KPMG's responsibilities include reporting to the Board of Directors on the following matters:

- Auditor's responsibilities under professional standards;
- Qualitative aspects of significant accounting practices, including:
 - Accounting policies,
 - Accounting estimates, and
 - Financial statement disclosures;
- Significant difficulties encountered during the audit;
- Uncorrected misstatements;
- Material corrected misstatements;
- Disagreements with management;
- Management representations;
- Management's consultation with other accountants;
- Significant issues discussed, or subject to correspondence, with management, and
- Independence.

In addition, KPMG was also engaged to complete the following:

- Metro's Single Audit of federal grant activities;
- National Transit Database (NTD) agreed upon procedure engagements for Metro operating and capital activities and 45 transit operators' operating and capital activities funded by and reported to the NTD;
- Transportation Development Act (TDA) financial statement and compliance audit for Transit Operations and County-wide Planning;
- State Transit Assistance Funds financial statement and compliance audit;
- Benefit Assessment Districts A1 and A2 financial statement audit;
- Public Transportation Service Corporation (PTSC) financial statement audit;
- PTSC-Metro Risk Management Authority (PRMA) financial statement audit;

EXECUTIVE SUMMARY

- Exposition Metro Line Authority Construction (EXPO) financial statement audit;
- Metro leasing authority financial statement audit, and
- Service Authority for Freeway Emergency (SAFE) financial statement audit.

Metro also has certain responsibilities as part of the audits which are summarized as follows:

- Management is responsible for the fair presentation, in accordance with U.S generally accepted accounting principles, of the financial statements and all representations contained therein.
- Management is responsible for identifying and ensuring that Metro complies with laws, regulations, contracts, and grants applicable to its activities, and for informing us of any known material violations of such laws and regulations.
- Management is responsible for preventing and detecting fraud, including the design and implementation of programs and controls to prevent and detect fraud, for adopting sound accounting policies, and for establishing and maintaining effective internal controls and procedures for financial reporting to maintain the reliability of the financial statements and to provide reasonable assurance against the possibility of misstatements that are material to the financial statements.
- Management is responsible for informing the auditor, of which it has knowledge, of all significant deficiencies and material weaknesses in the design or operation of such controls.
- Management is responsible for making available to the auditor all records, documentation, and information the auditor requests in connection with the audit. Management is also responsible for disclosing all material information to the auditor and for providing the full cooperation of Metro's personnel to the auditor.
- Management is responsible for adjusting the financial statements to correct material misstatements and for affirming to us in the representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements being reported upon.
- In accordance with the requirements of OMB Circular A-133, management is required to prepare the following:
 - Schedule of expenditures for federal awards;
 - Summary schedule of prior audit findings;
 - Corrective action plan, and
 - Data collection form (Part I).
- Management is responsible for the distribution of the reports issued by KPMG. In accordance with *Government Auditing Standards*, the reports issued citing *Government Auditing Standards* are to be made available for public inspection.

EXECUTIVE SUMMARY

KPMG's audit plan for the June 30, 2009 audit includes the following significant areas:

- Cash, cash equivalents and investments;
- Receivables;
- Lease accounts;
- Capital assets;
- Self insurance reserves;
- Bonds and notes payable;
- Net assets, and
- Revenues and expenses.

KPMG's interim audit fieldwork began in May 2009, final fieldwork for the NTD engagements will begin in July 2009 and the final audit fieldwork for the financial statement audits will begin in September 2009. The deliverables and due dates for the 2009 audit are as follows:

- CAFR report complete on or before December 31;
- Component audit reports completed on or before December 31;
- A-133 audit report completed on or before December 31;
- NTD Report for #9154 (Metro Operations Report) completed on or before October 31;
- NTD Report for #9166 (Consolidated Small Operators Report and 45 individual reports consolidated by operator inclusive of all modes) completed on or before October 31, and
- TDA (Operations & Planning) and STA Compliance Reports completed on or before December 31.

EXTERNAL 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. This support is provided throughout the procurement cycle in the form of pre-award, interim, change order, and closeout audits, as well as assistance with contract negotiations.

During third quarter FY 2009, 8 audits were completed, reviewing a net value of \$19.2 million. \$2 million or 10.53% of the proposed cost was questioned by the auditors. The 8 audits supported procurements in the following areas:

- 3 Rail Operations procurements
- 3 Planning procurements
- 1 Bus Operations procurement
- 1 review of an Independent Cost Estimate for Metro Gold Line Eastside Extension project.

As of March 31, 2009, 16 contract audits were in process.

Details on Contract Audits completed during third quarter FY 2009 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 transportation related projects, including Alameda Corridor East and CalTrans projects. The purpose of the audits is to ensure that grantees spend funds in accordance with the terms of the grants and federal cost principles.

Grant Audit completed three audits during third quarter FY 2009. They reviewed \$22.5 million and identified \$3 million of unused funds that may be reprogrammed by Countywide Planning for other projects. Twenty-five grant audits were in process as of March 31, 2009.

Details on Grant Audits completed during third quarter FY 2009 are in Appendix B.

INTERNAL AUDITS

For the third quarter of FY 2009, two internal audit reports, two audit memos and one CSA were issued, and one consulting engagement was completed. The CSA was on the M3 Timekeeping Process. The memos were issued for the Budget Process and for Real Estate Acquisitions Environmental Review Process. For both of these audits projects, after initial planning we determined that the risk to the agency was low. Therefore, per policy, the audits were stopped and memos were issued cancelling the audits. The Chief Executive Officer requested that MAS complete a consulting engagement analyzing Bus Passed-up Complaints. He was briefed on the results at the end of March.

Thirty-two internal audits were in process as of March 31, 2009. The internal audits and CSA in process are listed in Appendix C.

The following internal audits were issued in the third quarter FY 2009. The completed reports are listed in order of the magnitude of risks that their findings represent to the agency.

Procurement Card Program

The audit objective was to assess procurement card policies, procedures and controls, and determine compliance with policies and procedures. While no evidence of inappropriate personal purchases for any of the PCard transactions reviewed, numerous instances of non-compliance with PCard policies and procedures were identified. Many of the non-compliance issues were related to ineffective monitoring and oversight. In addition, there was a disconnect between what the PCard program was measuring to report the success of the program and the CEO's measure of success. The PCard program measured its success by the increase in volume and dollar amount of the transactions purchased using PCard. However, the CEO's measure of success was 100% compliance to the PCard Rules and Guidelines. The level of compliance was not being tracked or reported to the CEO. The CEO has requested that this criteria be added to the quarterly report as a measurement of the success of the PCard program. The audit also recommended that management over the PCard Program be strengthened to lessen the risk of PCard misuse.

Health Care Benefit Eligibility

The audit objective was to evaluate the process for updating health care contract providers with eligible employees, retirees and their dependents, and to verify the accuracy of payments. Pension and Benefits is responsible for the maintainance of the employees' and retirees' data base, Oracle Advance Benefits, and the proper remittance of medical premiums to the various trustees and insurance carriers. The monthly premiums are approximately \$13 million for 14,095 participants. This audit was part of the FY09 annual audit plan.

There were no audit issues identified in this audit report. The health care benefit eligibility determinations for employees, retirees and dependents, premiums paid to trustees and insurers, premiums deducted from payroll, and billing adjustments are valid and accurate.

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 third quarter FY 2009, 392 applications and validations were submitted, and 203 applications were in process from the end of second quarter FY 2009. Of the 595 active files, 192 firms were approved to do business with Metro, 79 were closed and 324 applications were still in process as of March 31.

The applications and validations processed during third quarter FY 2009 were in support of 76 different procurement actions, including contracts in construction, operations, and professional services.

Audit Follow-Up and Resolution

During the third quarter, 24 new audit recommendations were added to the outstanding audit recommendations list, and 26 recommendations were completed and closed out of a total universe of 90 representing a 29% reduction in the total outstanding recommendations. The table below summarizes the third quarter activity.

**Summary of MAS and External Audit Recommendations
As of March 31, 2009**

Executive Area	Closed or Completed in Jan.	Closed or Completed in Feb.	Closed or Completed in Mar.	Under Review	Extended	Not Yet Due	Total Open Recom.
Chief Financial Services Officer	2		1			6	6
Chief Administrative Services Officer		6	4	1	8	26	35
Chief Real Property Management & Development						4	4
Chief Planning Officer	2				2		2
Chief Communications Officer	1		1			9	9
General Mgr. Rail Operations		1					
Chief Operations Officer		3	1	3	2	3	8
Chief Capital Management Officer			4				
Totals	5	10	11	4	12	48	64

Appendix A

Contract Audit FY 2009 - Audits Completed During Third Quarter

Area	Audit Number & Type	Contractor	Requirement	Date Completed
Rail Operations	09-SCA-C01A - Pre-Award	SYSTRA Consulting Inc.	Contractual	1/2009
Rail Operations	09-SCA-C01B - Pre-Award	Booz Allen Hamilton	Contractual	1/2009
Planning	09-COR-C06 - Pre-Award	Arellano and Associates	Contractual	1/2009
Planning	09-CMF-C01 - Pre-Award	Cambridge Systematics, Inc.	Contractual	1/2009
Rail Operations	09-ROR-C01 - Pre-Award	Modern Track Machinery, Inc.	Contractual	1/2009
Capital Management	08-LRT-C01 - Independent Cost Estimate	Lenax Construction Services, Inc.	Legal	2/2009
Bus Operations	09-OPS-C05 - Pre-Award	Trillium USA	Contractual	3/2009
Planning	09-PLN-C01 - Pre-Award	NuStats, LLC	Contractual	3/2009

Appendix B

Grant Audit FY 2009 - Audits Completed During Third Quarter

Area	Audit Number & Type	Grantee	Requirement	Date Completed
Planning	09-CAL-G11 - Closeout	State of California, Department of Transportation	Contractual	3/2009
Planning	08-COH-G01 - Closeout	City of Hawthorne	Contractual	3/2009
Planning	08-DOT-G04 - Closeout	City of Los Angeles, Department of Transportation	Contractual	1/2009

Appendix C

Internal Audit FY 2009 - Progress Toward Completing Audit Plan

Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
Service Delivery	09-COM-I01 - Audit of Passenger Comments Management Systems	Evaluate internal controls in tracking passenger complaints.	High	4/2009
Service Delivery	09-OPS-O03 - Day Pass	Follow-up on prior audit issues regarding Day Pass internal controls.	High	4/2009
Technology	07-ACC-I04 - Audit of Change Management System	Validate the formal change management process and assess the adequacy of controls in managing changes to applications.	High	4/2009
Service Delivery	09-OPS-O05 - Bus Preventive Maintenance Program	Evaluate preventative maintenance compliance with state and federal requirements. Review efficiency and effectiveness of process.	High	5/2009
Safety	07-OPS-O02 - Disaster: Response & Recovery	Validate existence, currency and adequacy of disaster recovery planning.	High	5/2009
Service Delivery	08-CBO-K03 - Follow-up Audit Bus Operator 8/80 Requirement	Follow-up on prior audit issues regarding the 8/80 bus operator work time requirements.	High	5/2009
Service Delivery	09-OPS-O01 - M3 Warranty Management	Validate whether key business process impacted by M3 system are effective and efficiently. Evaluate effectiveness of input controls.	High	5/2009

Appendix C

Internal Audit FY 2009 - Progress Toward Completing Audit Plan					
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion	
Service Delivery	09-OPS-O06 - Purchased Transportation	Review contract performance and contract terms. Determine accuracy of billing and conformance to contract terms and conditions.	High	5/2009	
Financial & Administrative Management	08-TAP-F01 - Human Resources Badging/Transit Access Pass Interface	Determine whether the HR badging processes effectively provide employees, dependents and retirees with UFS TAP enabled smart card identification badges/transportation passes.	High	5/2009	
Financial & Administrative Management	09-OPS-O02 - Solar Energy Projects	Sustainability Audit - Evaluate return on investment of solar energy project. Verify utility rebates received.	High	5/2009	
Service Delivery	08-OPS-O02 - Payroll Code Usage	Review actual usage of payroll codes in comparison with contract bargaining agreements, regulatory requirements and policy.	Critical	5/2009	
Governance	09-RSK-F01 - Compliance to State Workers Compensation Law	Evaluate effectiveness of Risk Management procedures and practices to ensure compliance to state workers compensation laws.	High	6/2009	

Appendix C

Internal Audit FY 2009 - Progress Toward Completing Audit Plan

Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
Financial & Administrative Management	09-ACC-F03 - Accounts Payable	Evaluate accounts payable process controls.	High	6/2009
Revenue	09-COM-F01 - Customer Service Centers	Evaluate effectiveness of procedures at customer service center regarding the receipt and handling of funds.	High	6/2009
Revenue	09-REV-F01 - Cash Counting Facility	Evaluate process of collecting fare boxes at divisions and cash counting facility procedures.	High	6/2009
Safety	09-ROP-O02 - Hearing Conservation	Evaluate adequacy of hearing conservation processes, policies and procedures.	High	6/2009
Safety	09-ROP - 001 Mechanics Training	Evaluate adequacy of mechanics training processes, policies and procedures.	High	6/2009
Technology	09-OPS-008 - HASTUS - Transit Scheduling	Review HASTUS program functionality and evaluate current use.	High	6/2009

Appendix C

Internal Audit FY 2009 - Progress Toward Completing Audit Plan					
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion	
Technology	09-OPS-102 - Audit of HASTUS	Evaluate information technology internal controls within HASTUS (Horaires et Assignations pour Systeme de Transport Urbain et Semi-urbain) bus schedules and transmission to M3 via ATMS.	High	6/2009	
Technology	08-ITS-101 - Audit of Backup and Recovery Management	Evaluate backup procedures and controls for critical information.	High	6/2009	
Technology	08-CEO-101 - Audit of Information Privacy	Evaluate internal controls over systems, databases and processes that collect data subject to privacy acts.	High	6/2009	
Capital Project Management	08-CLK-04 - Compliance to Environmental Laws	Evaluate agency's compliance with environmental laws, and validate whether a portfolio of applicable environmental laws have been captured, and are current, accurate and complete.	High	6/2009	
Financial & Administrative Management	09-ADM-02 - Compliance to FTA 4220.1e	Evaluate whether contracts contain required federal clauses, evaluate whether procurement files contain 4220.1e required documentation.	High	6/2009	

Appendix C

Internal Audit FY 2009 - Progress Toward Completing Audit Plan					
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion	
Financial & Administrative Management	09-ADM-03 - Compliance with Contract Requirements	Validate waste management contractor performance is in compliance with contract provisions and requirements.	High	6/2009	
Financial & Administrative Management	09-ADM-04 - Sole Source Procurements	Evaluate whether sole source procurements comply with State laws and Federal requirements.	High	6/2009	
Financial & Administrative Management	09-ADM-05 - Technology Support of Agency Goals	Evaluate effectiveness and timeliness of technology support to agency's mission critical goals.	High	6/2009	
Governance	09-ADM-06 - Compliance to Davis-Bacon Act	Evaluate compliance with Davis-Bacon Act, whether contractors are being monitored for compliance with Davis-Bacon Act, and evaluate the efficiency and effectiveness of the monitoring process.	High	6/2009	
Revenue	09-ADM-07 - Cafeteria and Vending Machine Contracts	Review contract terms, determine accuracy of revenue received and conformance to contract terms.	High	6/2009	
Workforce	09-ADM-08 - Compliance to EEO/HR Policies	Evaluate hires/promotions to verify compliance to policy, and that new positions are properly budgeted.	High	6/2009	

Appendix C

Internal Audit FY 2009 - Progress Toward Completing Audit Plan

Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
Workforce	09-RSK-F02 - Workers Compensation Subsequent Injury Fund	Review procedures for filing claims to the California Subsequent Injury Trust Fund.	High	6/2009
Technology	08-OPS-I02 - Audit of TOAST	Evaluate system design for internal controls for Transit Operator activity Scheduling and Tracking (TOAST).	High	7/2009
Revenue	09-ED-I01 - Audit of Universal Fare System	Evaluate IT general controls for UFS to ensure systems are safeguarded from unauthorized access and changes and minimize unwarranted disruption of operation.	High	9/2009