

SOUTHERN CALIFORNIA
RAPID TRANSIT DISTRICT

REPORT TO MANAGEMENT
For The Year Ended July 1, 1989

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Coopers
& Lybrand

Certified Public Accountants

Coopers
& Lybrand

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SOUTHERN CALIFORNIA
RAPID TRANSIT DISTRICT

REPORT TO MANAGEMENT
For The Year Ended July 1, 1989

October 31, 1989

To the Board of Directors
Southern California Rapid Transit District

Dear Board Members:

In planning and performing our audit of the financial statements of the Southern California Rapid Transit District (District) for the year ended July 1, 1989, we considered the District's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. Although our audit was not designed to provide assurance on the internal control structure, we noted certain matters involving the internal control structure and its operation, and are submitting for your consideration related recommendations designed to help the District make improvements and achieve operational efficiency. Our comments reflect our desire to be of continuing assistance to the District.

Certain of these matters may be considered reportable conditions, as defined by the American Institute of Certified Public Accountants, which involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

The accompanying comments and recommendations are intended solely for the information and use of the board of directors, management, and others within the organization.

Very truly yours,

Coopers & Lybrand

SOUTHERN CALIFORNIA RAPID TRANSIT DISTRICT

REPORT TO MANAGEMENT
For the Year Ended July 1, 1989

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ACCRUED LIABILITIES

1. Segregate Current And Long-Term Compensated Absences

The vacation, life insurance, and sick pay accrual are not classified between their current and long term portions. By not segregating these liabilities, the District is misstating the financial information presented in its financial statements as the District presents a classified balance sheet.

We recommend the District segregate the current and long term portions of these liabilities. This could be done using historical information of amounts used from prior years or some other systematic and rational approach.

District's Response

The District agrees with the auditor's recommendations. This recommendation will be implemented for the next fiscal year.

2. Perform Year End Adjustment Of Accrued Liabilities

Certain construction contracts in progress and other receipts of goods/services at year end were not accrued in the Districts financial statements. This resulted in the misstatement of assets and liabilities prior to making appropriate adjustments.

We recommend the District establish policies to ensure that all liabilities at year-end are properly recorded.

District's Response

Procedures will be implemented to ensure that all liabilities are properly recorded.

3. Calculate Self Insurance Reserves Utilizing Generally Accepted Actuarial Principles

Liabilities for self-insured workers' compensation and public liability/property damage claims are calculated by the Risk Management Department. In reviewing the methodology used by the Risk Management Department, Coopers & Lybrand's actuaries identified certain weaknesses which were communicated to the District in a correspondence dated October 2, 1989. The principle weaknesses identified related to the District's methodology not being in accordance with generally accepted actuarial principles. As a result Coopers & Lybrand's actuaries were engaged to calculate independent estimates of the self-insurance liabilities. These estimates were communicated to the District in draft form in a correspondence dated October 17, 1989. We understand the District is in the process of addressing the latter correspondence so that it may be issued in final form.

We recommend the District seek actuarial support to assist Risk Management in developing the capability to consistently calculate reserve and funding estimates and to test those estimates to assure that they are prudent and determined in accordance with generally accepted actuarial principles.

District's Response

Risk Management has incorporated Coopers & Lybrand's actuarial changes to the loss development formula. The changes primarily reflect the use of the current four years of claims paid and incurred data. The next step will be to review other methods to consistently calculate reserves and funding estimates.

Currently, the Los Angeles County Transportation Commission (LACTC) has hired the firm of Booz Allen and Hamilton, Inc. to review such methods to insure that the funding estimates are responsible and would be accepted by both the District's funding source (LACTC) and the certified public accountants. After receipt of this report, expected in April, 1990, the District will consider further action to insure that reserves are prudent and the determination of funding estimates are in accordance with generally accepted actuarial principles.

PAYROLL SYSTEM

4. Utilize An Automated Payroll System

The District currently manually distributes payroll checks to its employees but has had some accountability problems with these procedures. Accountability problems have been related to improperly handled payroll checks which may have resulted in loss or theft of individual employee checks. Undistributed checks originally distributed to each division for employee distribution are not being reported back to the cash office on a timely basis. This could result in misstatements or losses of cash.

We recommend that division supervisors list all undistributed checks. Undistributed checks and the lists should be returned to the cash office for subsequent distribution. Also, employees should sign for their checks and show picture I.D.s if the check distributor is not familiar with the employee.

District's Response

The District agrees with the auditors recommendation. Written procedures for the handling of distributed payroll checks will be prepared.

REVIEW PROCEDURES

5. Review Long Outstanding Unmatched Items In Accounts Payable System

At year end there were approximately 50 unmatched invoices in the accounts payable file. These invoices may represent commitments (or liabilities) for which no receiver or purchase order has been matched against it. As a result, it is possible the District may be paying for goods/services not received or not ordered or that liabilities may be understated for goods/services received and not recorded.

We recommend the District periodically monitor this file and perform follow-up procedures for unmatched invoices older than ninety days.

District's Response

Because of the controls inherent in the system which match dollar and receipts of the purchase order with the items invoiced, there will always be some amount of invoices unmatched at any given point in time.

Double billings, unposted receipts, pricing errors and unentered credits are only some of the reasons for this unmatched status. However, a new report will be generated so as to review and resolve all invoices over sixty days which will keep these unmatched invoices to a minimum.

DATA PROCESSING

6. Improve Documentation Of Programs Placed Into Production

Currently, the District has well designed procedures to control the implementation of programs placed into production. These procedures include the signature of user and programming and computer operations personnel. Once received by the operation analysts, it is logged, a control number assigned, and the program placed into production. The documentation is then filed by the operation analysts. During our review, we were not able to find sign-off documentation on programs placed into production during the audit period. We were able to obtain satisfaction that procedures were complied with, and the sign-off documentation was simply not filed in an organized manner. If documentation used for control purposes cannot be retrieved, management cannot gain reasonable assurance that control procedures are being complied with.

We recommend the control number assigned by the operations analyst be placed on the change control form, and all forms be filed in an organized manner.

District's Response

We agree with the recommendation. We are enhancing the implementation procedure to include: a) a modified change control form which accommodates the change control number and b) the establishment of a new file where complete copies of executed implementation packages with associated change control forms will be stored. For practical reasons, the original implementation packages will continue to be filed separately (in computer operations) from the original change control forms (in quality control). However, the original documents will be linked by change control number and complete copies of all relevant documentation will be housed in the new file referenced previously.

7. Formalize Procedures Over The Implementation And Maintenance Of Systems Software

The District does not have formalized policies and procedures over the implementation or maintenance of system software (e.g. CA-7). System software is recommended and discussed with the Technical Support Group. There are no required sign-offs to document understandings between the main user of the software and technical support as to parameters used during the system software implementation process. System software should be controlled in the same manner as implementation of modifications to application programs. The controls should help ensure that system software is appropriate to control the function desired by the organization, and that the system software is implemented properly. If system software is not controlled, other general computer controls dependent upon the system software may not function correctly.

We recommend that policies and procedures for the implementation and maintenance of system software be developed and formalized.

District's Response

We agree with the recommendation. Routine systems software implementations conducted on a by-weekly basis follow the standard change control procedure. We are developing an appropriate change control procedure to cover special systems software implementations, such as those which result from IPO processes.

8. Improve Protection Over District's Data Sets

The District utilizes IBM's RACF access software to provide security over critical data files and programs. During our review, we noted that the "ORG" group was authorized to alter files in the CA-7 scheduling libraries. This group is outside the computer operations and should not be involved in the modification or maintenance of the CA-7 scheduling libraries. If authorization levels over data sets are not set at the proper levels, there is an exposure to the intentional or unintentional modification of data.

While there appears to be no log-on ID's associated with the "ORG" group, we recommend RACF authorization over CA-7 scheduling libraries be reviewed and altered as necessary to provide the proper level of protection.

District's Response

We agree with the recommendation. Since there are no user ID's associated with the "ORG" group, unauthorized access to CA-7 data sets is not a concern in this case. However, we intend to delete the "ORG" group as a housekeeping measure once all technical ramifications of that action are considered and resolved.

9. Document Deviations From Standard Program Implementation Procedures

The District has well designed and formalized procedures over the modification and/or implementation of application programs. Our testing revealed that there were several program changes implemented that were not properly authorized as per the District's standard procedures. If procedures are not followed in the modification and/or implementation of application programs, unauthorized or untested programs may be placed into production.

We recommend the District adhere to their formalized procedures relating to the modification and/or implementation of application programs

District's Response

We agree with the recommendation. Proper documentation for nearly all program changes checked in the audit were found on file. The few cases where the paperwork could not be located involved changes that took place as long as 3 or 4 years ago. Since then, we have strengthened our change control procedures to improve their effectiveness. We have every intention of making further refinements where indicated to ensure that our controls are as reliable as possible..

10. Plan For Continuance Of Data Processing In Case Of Emergency

We understand the District is currently working with SunGard in implementing a disaster recover plan. Such a plan would allow the District to experience minimum processing downtime in the event of a disaster. Given the reliance of the District on its EDP operations, a loss of this resource for any significant amount of time could have a major negative impact on the District.

We concur with the direction the District is taking in its disaster recovery planning and urge that a disaster recovery plan be implemented on a timely basis.

District's Response

We appreciate the comment. We agree with the recommendation. A contract with a specialized consulting firm for assistance in the development of a disaster recovery plan has been executed by the District. Work on that project has already commenced.

FEDERAL FINANCIAL ASSISTANCE AUDIT

11. Improve Procedures For Monitoring Davis-Bacon Act Compliance For Metro Rail Construction Projects

The District uses an outside agency for monitoring contract performance including Davis-Bacon compliance. Up to December 1988 the District required the outside agency to forward certified payrolls to the District after the outside agency completed its compliance monitoring review on those payrolls. The District then performed its own review on the payrolls. Subsequent to December 1988 the District is no longer receiving certified payrolls from the outside agency. The District does receive a monthly Contract Performance Report from the outside agency which identifies contracts monitored, equal opportunity information, project sites visited and employee interviews performed. The Contract Performance Report does not include certified payrolls, therefore, the District is unable to gain absolute assurance that contractors are complying with all aspects of the Davis-Bacon Act.

We recommend the District reinstitute its practice of receiving and reviewing certified payrolls from contractors and perform sampling test procedures to ensure, among other Davis-Bacon Act compliance requirements, that prevailing wage and fringe benefit rates are being paid to the contractor employees. This is particularly crucial as the District is the grantee and may have the ultimate liability for non-compliance with the Davis-Bacon Act.

District's Response

The Districts Board of Directors approved the transfer of the outside agency's contract monitoring function to the District's contract compliance department effective January 1, 1990.