



EXECUTIVE MANAGEMENT AND AUDIT COMMITTEE
May 20, 2004

**OFFICE OF THE
INSPECTOR GENERAL**

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**SUBJECT: OFFICE OF INSPECTOR GENERAL (OIG) AUDIT
ACTIVITIES REPORT**

ACTION: RECEIVE AND FILE

RECOMMENDATION

Receive and file subject report.

ISSUE

The MTA Board of Directors requested the OIG to report on audit activities.

BACKGROUND

The OIG Charter mandated the creation of a unit to report directly to the MTA Board of Directors. The OIG has numerous responsibilities as defined in the Charter, and the OIG Audit Unit has a broad responsibility for oversight in a cooperative support mode with MTA management for increased accountability and improvement of MTA organizational performance.

A large measure of the OIG audit focus is to provide the MTA Board of Directors and MTA management with independent analyses, evaluations, and appraisals of performance effectiveness, accuracy of information, efficient use of resources, and adequacy of internal controls. In addition, the Audit Unit is charged with the detection and analysis of those items indicative of fraud, waste, or abuse.

DISCUSSION

In January 2004, we issued our Annual Report for 2003. This report reflects the efforts of our audit and investigative departments, and provides additional information regarding other programs and activities within our office to ensure high quality work products at reduced costs.

The OIG recently issued the following audit reports:

1. *Advisory Report on Prior OIG Findings Involving Construction Contracts and Related Contract Changes*
2. *Report on Emerging Issues Involving the Processing of Construction Contract Changes*
3. *Audit of Controls Over Equipment Items*
4. *Audit of MTA Miscellaneous Expenses, July 1, 2003 to September 30, 2003*

The above audit reports were previously submitted to the Board and MTA management in their entirety.

Advisory Report on Prior OIG Findings Involving Construction Contracts and Related Contract Changes. This report was issued to provide information to the MTA Board of Directors and Executive Management on issues noted during prior OIG reviews of construction contracts and related contract changes. Prior OIG audits showed a number of reasons for cost overruns on construction projects including problems with processing contract changes.

Under the leadership of the current Chief Executive Officer and direction from the Board, the MTA has taken actions to correct many of the past problems. However, to avoid repeating past mistakes on the current construction projects, the MTA is encouraged to follow Public Utility Code requirements and exercise strong internal controls and sound procurement practices to safeguard limited construction dollars.

Report on Emerging Issues Involving the Processing of Construction Contract Changes. During our review of the Orange Line construction project, we noted several issues regarding the processing of contract changes. Our review of Management Audit Services Department (MASD) contract audit reports found that the contractor's price proposals for changes were inadequate, and the MASD audits questioned a high percentage (67%) of the contractor's proposed costs. The contractor's price proposals contained costs that were invalid or not allowed by the terms of the contract, and costs that were inadequately supported. The issues noted with the current construction project are a cause for concern because historically the inadequate processing of change orders has caused cost overruns on past projects.

On March 31, 2004, at the request of the OIG, an initial meeting was held with MTA Senior Management from Construction, County Counsel, Procurement, and Management Audit Services Department to discuss issues concerning the contract change process. At this meeting, it was recognized that design-build contracts are unique, which necessitates different procedures for processing changes.

On April 8, 2004, at the request of the OIG, a follow-up meeting was held to discuss methods for streamlining the contract change process to meet the unique requirements of design-build

contracts while meeting regulatory requirements and maintaining adequate safeguards. An approach was agreed upon. The County Counsel will prepare an ordinance that addresses the unique requirements of design-build contracts and streamlines the change process for these types of contracts. Additional working group meetings will be held to develop implementing procedures.

Audit of Controls Over Equipment Items. We found that the program to inventory and track MTA equipment (such as computer, office, and maintenance items) was ineffective and did not ensure that these assets were accounted for and safeguarded. This occurred because MTA policies and procedures had not been established to provide guidance for the accounting of assets, maintaining and updating the BarScan System, and conducting physical inventories. As a result, 10,518, or over half of the 20,500 equipment items on the BarScan System, were not located during the past inventory cycles. Some of these items had not been located for the past five annual inventory cycles. In addition, our physical inventories of assets at three MTA cost centers found many items that were on hand but not recorded on the BarScan System, items that belonged to other cost centers, and items that did not have asset bar code tags.

The equipment management program only consisted of Material Management staff performing annual physical inventories of accountable assets. This practice only provided limited safeguards over assets because other key controls were not in place. We found that:

- Responsibility and accountability was not assigned for equipment at the cost centers.
- Sound inventory practices were not followed and all applicable items were not accurately counted and accounted for.
- Inventory results were not reconciled and discrepancies were not resolved.
- Equipment transfers were not reported to Material Management.
- Some information on the BarScan System was not complete, accurate, and current.

MTA Management agreed with the findings and recommendations discussed in this report and initiated the recommended corrective actions.

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WILLIAM WATERS
Inspector General

