



EXECUTIVE MANAGEMENT AND AUDIT COMMITTEE
MAY 19, 2005

SUBJECT: MANAGEMENT AUDIT SERVICES QUARTERLY REPORT

ACTION: RECEIVE AND FILE

RECOMMENDATION

Receive and file the quarterly report of Management Audit Services for the period ending March 31, 2005.

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.

DISCUSSION

The summary of Management Audit Services (MAS) audit activity for the quarter ending March 31, 2005 is as follows:

Contract Audit – 17 audits were completed reviewing \$24 million and questioning \$861 thousand. One of these completed audits was negotiated during third quarter resulting in a \$424 thousand savings to the agency. Nine of the completed audits were for Metro Orange Line. 32 audits are in process, most of which will be completed by 6/30/05.

Grant Audit – nine audits were completed reviewing \$7 million and identifying \$263 thousand of unspent funds that can be reprogrammed through the Call for Projects. 46 audits are in process, most of which will be completed by 6/30/05.

Internal Audit – 14 audits in process, most will be completed by 6/30/05. These include one for the Chief Communication Officer, one for the Chief of Planning, two for the Chief of Staff, three audits for the Chief Financial Officer and seven audits for the Deputy Chief Executive Officer. Six Control Self Assessment (CSA) projects are in process, which should be completed early in FY06. The CSA projects in process include two for the Chief Financial Officer, one for Deputy Chief Executive Officer, and three for Chief Planning Officer.

Information Technology Audit – six audits are in process and all but one should be completed by 6/30/05. These include three audits for the Chief Financial Officer, two audits for the Deputy Chief Executive Officer and one for the Chief Executive Officer.

Vendor Prequalification – 151 applications and validations were processed and approved this quarter. One firm was denied prequalification and the Prequalification review committee upheld the denial.

Audit Follow-up and Resolution – 30% of all open findings for internal and external audits were completed during this quarter.

Each quarter as part of the report's executive summary, MAS will highlight a group or one of its services with an in-depth discussion of the process and how it benefits the agency. The Audit Follow-up and Resolution group will be highlighted this quarter.

The details of our quarterly report are included in Attachment A.

BACKGROUND

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 currently four audit groups in MAS, contract audit, grant audit, internal audit, and information technology audit.

Contract Audit conducts attestation reviews of contractor's proposals/claims to support the Office of Procurement and Material Management. Contract audits include pre-awards, change orders, incurred costs, claims review, contract closeouts and buy-America reviews.

Grant Audit conducts attestation reviews of compliance to MOUs to support Countywide Planning and Development. Grant audits include interim and closeout audits of projects funded by the Call-for-Projects.

Internal Audit currently performs two functions, internal audit and control self-assessment projects. At the beginning of FY06, Internal Audit will be split into two groups. Operational Audit, which will perform internal control reviews, economy and efficiency audits, compliance audits and program effectiveness and results audits of the agency's core functions and processes. CSA will be a part of Operational Audit. CSA is responsible for assisting management in defining objectives; implementing self-assessment of risks, controls, and residual risks; and developing action plans to mitigate excessive risk. The other group, Financial Audit will perform internal control reviews and compliance audits of the agency's financial processes and transactions.

The Information Technology Audit Group performs compliance audits, internal controls audits, efficiency and effectiveness audits and program effectiveness and results audits of the information technology systems, infrastructure, programs and activities.

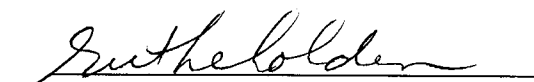
NEXT STEPS

Management Audit Services will provide a year-end summary of audit activity to the Board at the August 2005 Executive Management and Audit Committee meeting.

ATTACHMENT

- A. Quarterly Report on Management Audit Services activity for period ending March 31, 2005.

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Roger Snoble
Chief Executive Officer

Los Angeles County Metropolitan Transportation Authority

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

**THIRD QUARTER
FY 2005**



Metro

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EXECUTIVE SUMMARY

Management Audit Services' (MAS) primary goal is to provide highly reliable, independent, objective assurance and consulting services to the Chief Executive Officer (CEO), Roger Snoble, and his management team.

MAS experienced several changes in the third quarter of FY05, beginning with the retirement of the prior Managing Director. The new Managing Director is reorganizing the department and shifting focus to provide the services necessary to meet the CEO's strategic vision and goals for the agency.

Los Angeles County Metropolitan Transportation Authority (LACMTA) is a complex and evolving entity. MAS resources and priorities were evaluated in January to assess whether the department was properly aligned to meet the CEO's priorities. Resources have been shifted from Internal and Contract Audit groups into Information Technology and Audit Follow-up and Resolution to meet the needs of the agency. In FY06, Internal Audit will be split into two groups, Operational Audit and Financial Audit to develop and focus core expertise in the key processes that impact the agency's ability to complete its mission.

MAS has completed 26 audits during third quarter FY05 in the Contract and Grant Audit groups. While Internal Audit and Information Technology Audit groups have not finalized any audits this quarter, there are 20 audits in process, of which six are in the review process.

Audit Support Services includes three groups, Administration, Contractor Pre-qualification and Audit Follow-up and Resolution. Administration provides administrative support to all MAS staff. Contractor Pre-qualification group has gone through several changes this quarter. The Pre-Qualification Manager retired and currently there is a person supervising the unit in a temporary position. In addition, during MAS' reorganization and downsizing efforts as part of the FY06 budget process, the Pre-qualification unit was consolidated into the MAS Support Services group. Other changes occurring within the Pre-Qualification unit relate to the Board adopted Pre-Qualification Ordinance. The pre-qualification questionnaires have been rewritten this quarter and posted to the Internet and the pre-qualification policies and procedures are being redrafted to reflect the changes in the Ordinance.

EXECUTIVE SUMMARY

Highlight of the Quarter: Audit Follow-up and Resolution group

Each quarter as part of MAS' report on the activities of its unit, a group will be highlighted and discussed in detail. Based on recent changes in the group and requests related to outstanding audit findings from the Executive Management and Audit Committee, the Audit Follow-up and Resolution group is highlighted this quarter.

Following up on audit findings is not only required by LACMTA policy (GEN 19) but also by Generally Accepted Government Auditing Standards (GAS). The Audit Follow-up and Resolution group not only tracks and clears all findings internal to MAS, they track and resolve all external findings as well. External audit reports include audits completed by the Office of Inspector General (OIG), California State Auditors, Federal Transit Administration Auditors, and other similar audit agencies. Status reports on the resolution of findings and recommendations are prepared monthly for the CEO and the Board.

MAS Internal and Information Technology audit reports and external audit reports are inventoried and maintained in a database management system. Recently MAS initiated a proactive process to follow up on these audit findings. A reminder memo is now sent out 30 days prior to the corrective action due date. Executive Management is copied on this reminder letter. Another memo is sent requesting status when the corrective action is due. Once the due date has passed and MAS has not received the documentation necessary to clear the finding, a series of memos are sent out escalating the issue to more senior management in the agency. This process was instrumental in reducing the total outstanding findings by 30% during the month of March.

Audit Follow-up and Resolution also track contract audit reports. Contract Audit reports typically question a portion of the contractor's proposal or claim and are used by the Contract Administrator when negotiating a contract action. The Office of Procurement and Material Management usually provides a record of negotiation once the contract action is finalized. The Audit Follow-up and Resolution group reviews the Records of Negotiation to determine whether the findings in the audit report were used to negotiate cost savings or cost avoidance. The amount of questioned cost that was used to negotiate the final contract amount is compared to the total cost questioned in the audit report to calculate the sustention rate. The goal of the Contract Audit group is to provide enough persuasive information to the Contract Administrator to increase the sustention rate calculated for that report. The sustention rate calculated for the third quarter is 34.89% (more information on this can be found in the section on Contract Audit).

EXECUTIVE SUMMARY

Audit Follow-up and Resolution does not track Grant audit reports. The measurement for this group on whether the findings are resolved is based on the issuance of the final audit report. MOUs include terms and conditions, which state that the final audit report is considered final, and the MOU will be closed out based on the findings noted in the final report. Therefore, Grant Audit tracks the time frame between draft and final report. It is important to this group to ensure the draft report is clear and concise and that the auditee understands the issues presented. This will ensure that the final report is issued in a timely manner.

Per Board direction, MAS has implemented a monthly Board Box to the Board on the status of all open audit findings. The original Board Box was issued by the OIG in February 2005. In March 2005 the Board requested they continue to receive status on open audit findings. MAS has taken over responsibility for issuing the Board Box and the first one is for the period ending March 31, 2005. MAS will continue to issue Board boxes reporting on the outstanding audit findings for each subsequent month.

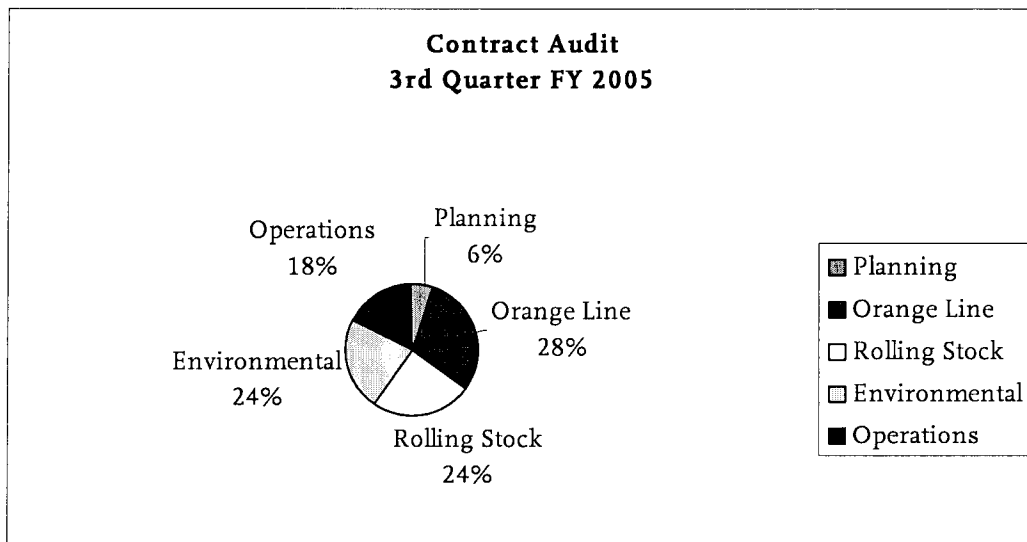
MAS is also currently drafting an audit finding protocol for the agency. This protocol will be approved by the CEO and will assign a risk ranking for each finding included in an audit report. Based on the finding's assigned risk, the auditee will be required to implement the recommendation within a maximum set period of time. The intent of the protocol is to ensure audit findings that pose a high risk to the agency will have the resources devoted to resolve them rapidly while resolution of lower risk issues will be allotted more time.

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. Currently, Contract Audit is heavily involved in supporting Rail & Bus Rapid Transit Projects.

- Contract Audit has completed 17 audits reviewing \$24,352,210 and questioning a total of \$861,354 for the quarter. One of these completed audits was negotiated during 3rd quarter resulting in a \$424,400 savings to the agency from the audit findings.
- Nine of these completed audits were for the Metro Orange Line project. Change orders totaling \$2,446,202 were reviewed, resulting in 7% of the proposed cost questioned. Contract Audit also notified the Contract Administrator that 2.5% of the proposed cost did not have adequate supporting documentation.
- 32 audits are in process as of March 31, seven are change-order audits, two are closeout audits, 10 are incurred cost audits, 11 are overhead audits, and two are pre-award audits.
- Contract Audit is currently implementing new audit requirements to comply with the Board adopted Change Order Ordinance. These new audit procedures are expected to save time and money for the agency by speeding up change order processing time.
- For all negotiations that were completed during 3rd quarter (including open audit findings from prior quarters) Contract Administrators were able to save \$1,451,778 based on questioned costs from audit reports, which results in a sustention rate of 34.89%.

The audit coverage for the Contract Audit group is reflected in the chart below.



The details on third quarter Contract Audits are in Appendix A.

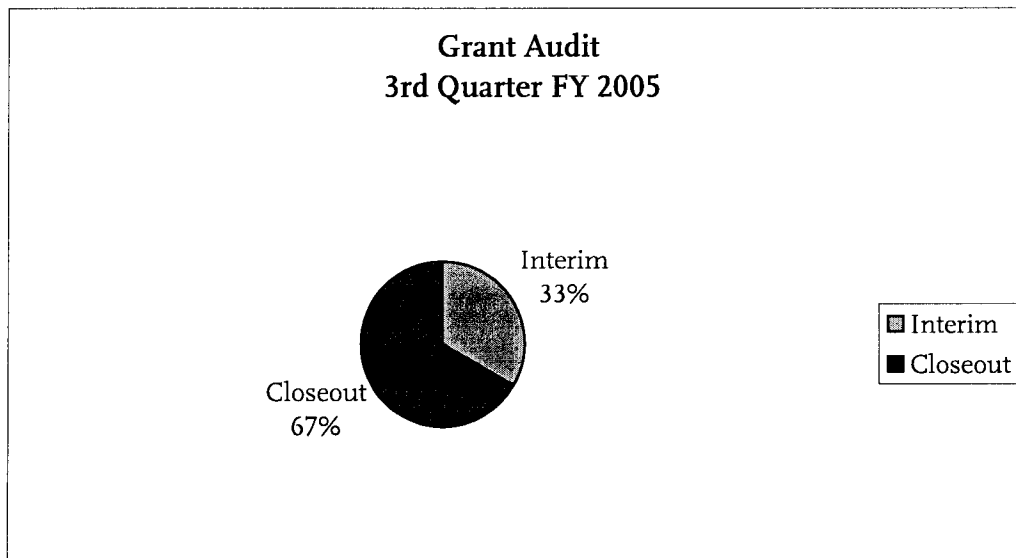
GRANT AUDIT

Grant Audit provides audit support to Countywide Planning and Development (Planning) and is responsible for determining whether funds provided through the Call-For-Project program are expended in accordance with the terms of the Memorandum of Understanding and applicable cost standards. The group also identifies whether any funds remain at project completion that may be reprogrammed by Planning for additional transportation improvement projects.

During the quarter, Grant Audit completed nine audits. Total funding audited was in excess of \$7 million. The audits identified \$263,126 of unspent funds that Planning will be able to reprogram through the Call for Projects and \$80,074 of questioned cost that is currently being resolved. As of March 31, 2005, 46 grant audits are in process with a total value in excess of \$115 million.

Grant Audit primarily completes either interim or closeout audits. Interim audits are done on a periodic basis for multi-year, multi-phase projects to identify whether funds are being expended in compliance with the Grant. Interim audits provide useful information to the Project Manager to manage the grantee and ensure the final audit to closeout the grant can be completed in a timely and efficient manner.

The following chart identifies the amount of effort expended on these two types of audits



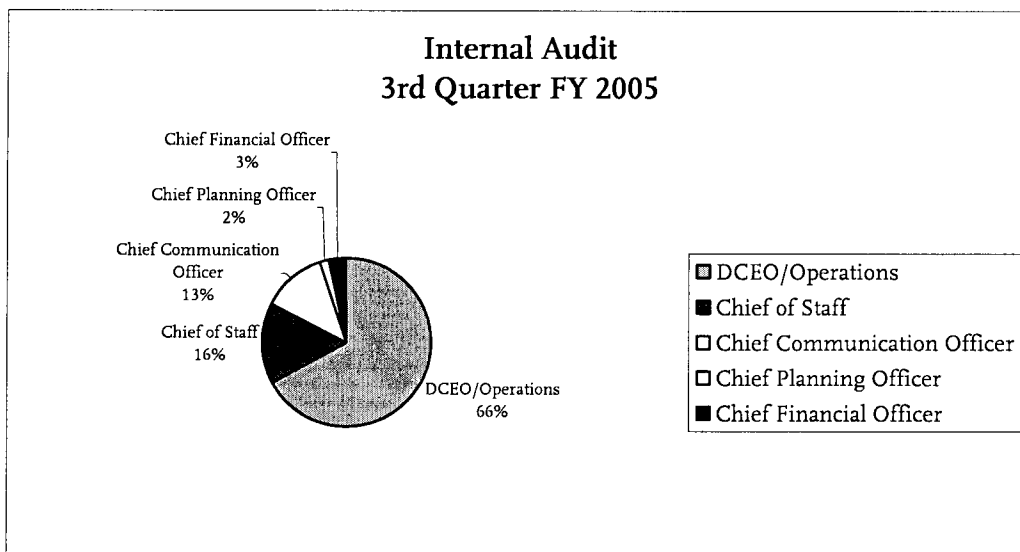
The details on third quarter Grant Audits are in Appendix B.

INTERNAL AUDIT

Internal Audit provides support to the Chief Executive Officer and his management team. The types of audits completed in this group are Compliance reviews, Internal Control reviews, Effectiveness and Efficiency audits, and Program Effectiveness and Results audits

Internal Audit is responsible for completing the audits identified in the FY05 audit plan as well as completing any special requests. Each audit is managed on schedule and within a budget to specific audit objectives. Some audits maybe expanded or reduced based upon the preliminary review. Therefore, the annual audit plan is developed to allow for some flexibility in the audit work completed for the year. During the third quarter, 14 audits are in progress and are described in Appendix C. The in process audits include one for the Chief Communication Officer, one for the Chief of Planning, two for the Chief of Staff, three audits for the Chief Financial Officer and seven audits for the Deputy Chief Executive Officer.

The following chart depicts the audit coverage for the internal audits in process during the third quarter:



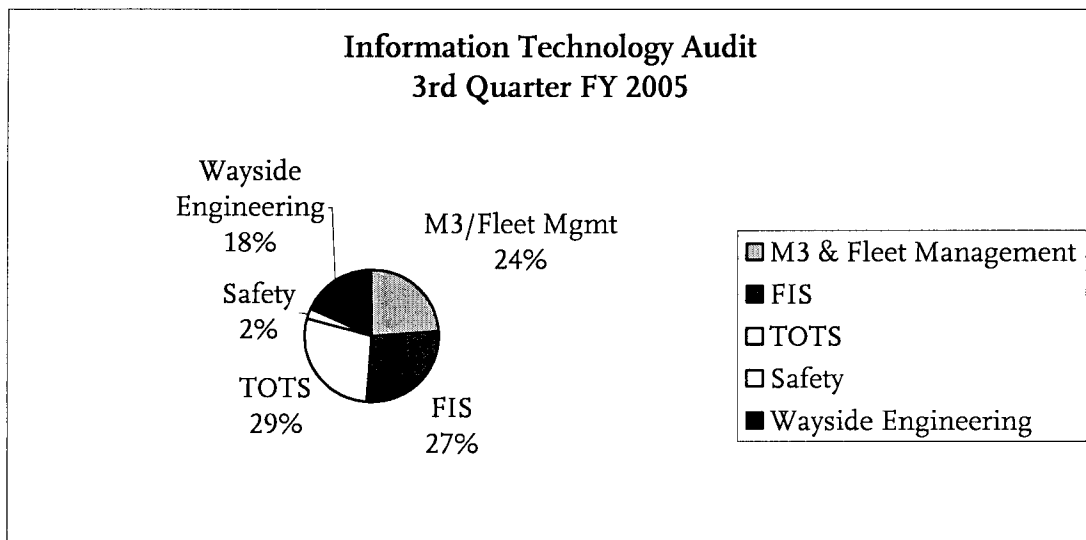
The CSA group is also part of Internal Audit. CSA's FY05 goal is to complete six more assessable business units and update existing documentation to conform to current organizational changes. All six CSA documents are in process and expect to be completed early in FY06. The CSAs in process include the areas of Pension and Benefits, Workers Compensation Claims, Bus Transportation Division 1, Transit Planning, Long Range Planning and Transportation Development and Implementation.

INFORMATION TECHNOLOGY AUDIT

Information Technology (IT) Audit also provides support to the CEO and his executive management. IT audit focuses on the technology systems and infrastructure that process data for the agency's key business areas. The types of audits completed in this group are similar to Internal Audit and include Compliance reviews, Internal Control reviews, and some Program Effectiveness and Results audits.

At the end of the 3rd quarter, six IT audits were in-progress. They ranged from evaluating internal controls for an M3 module that automates fueling and tracking of fuel consumption, to determining the adequacy of controls to prevent unauthorized access to rail activities and the safeguarding of driver's license data to ensure compliance with the State of California DMV system. The audit of the M3 system was requested by the CEO to review the system requirements and project management. The M3 system audit should be completed by the end of first quarter FY06. More detailed information is reflected in Appendix D.

The following chart depicts the audit coverage for IT audit in the third quarter:



AUDIT SUPPORT SERVICES

Contractor Pre-Qualification

California Public Utilities Code §130051.21 and Ordinance #4-05 of LACMTA's Administrative Code require firms to be pre-qualified prior to doing business with the agency. LACMTA's ordinance #4-05 specifically exempts certain firms from the pre-qualification process. Firms not exempt from the process must be pre-qualified if their bid or proposal exceeds \$100,000.

Two new streamlined applications were implemented in March to comply with the Pre-Qualification Ordinance adopted by the Board in 2004. Pre-Qualification Policies and Procedures are being re-drafted to conform to the new applications and the ordinance.

During the third quarter of FY 05, 106 applications and 48 validations were submitted, and 22 applications and validations were in process from the second quarter. Of the 176 applications and validations, 151 firms were approved to do business with LACMTA, ten were closed as incomplete (applicants failed to respond to requests for information), one was denied, and 14 applications were still in process as of March 31. An appeal hearing was held for the one firm that was denied, and the review committee upheld the denial. The average processing time was 17 days for applications and 4 days for validations.

Audit Follow-Up and Resolution

This group's activities are covered in detail in the Executive Summary Highlight of the Quarter.

Appendix A

Contract Audit 3rd Quarter FY 05 Completed Audits						
Area	Audit Number & Type	Contractor	Contract	Requirement	Date Completed	
Planning	F-002-05F - Pre-Award	PBF, Div. Of PBQD, Inc.	PS-4360-1580	Contractual Requirement	1/2005	
Orange Line	G-011-05F - Change	Washington Group International	C0675	Legal	2/2005	
Orange Line	G-015-05F - Change	Shimmick/Obayashi, JV	C0675	Legal	2/2005	
Orange Line	G-019-05F - Change	Shimmick/Obayashi, JV	C0675	Legal	2/2005	
Orange Line	G-022-05F - Change	Shimmick/Obayashi, JV	C0675	Legal	2/2005	
Orange Line	G-024-05F MEU - Compliance	LACMTA Estimating Unit Shimmick/Obayashi, JV	C0675	Legal	3/2005	
Rolling Stock	I-006-05F - Buy America	North American Bus Industries, Inc.	OP-33200634	Legal	2/2005	
Rolling Stock	I-001-05F - Buy America	Siemens Transportation Systems, Inc.	P2000	Legal	3/2005	
Rolling Stock	K-004-05F - Closeout	Virginkar And Associates	E0350	Contractual Requirement	3/2005	
Rolling Stock	K-002-05FS1 - Closeout	LTK Engineering	E0001	Contractual Requirement	3/2005	
Environmental	I-008-05F - Change	CH2M Hill Constructors	EN069	Legal	2/2005	
Environmental	I-007-05F - Change	CH2M Hill Constructors	EN069	Legal	2/2005	

Appendix A

Contract Audit 3rd Quarter FY 05 Completed Audits						
Area	Audit Number & Type	Contractor	Contract	Requirement	Date Completed	
Environmental	I-009-05F – Change	CH2M Hill Constructors	EN069	Legal	2/2005	
Environmental	05CA-G04-00 - Change	CH2M Hill Constructors	EN070	Legal	3/2005	
Operations	G-018-05F - Change	Cubic Transportation Systems, Inc.	OP-02-4610-10	Legal	3/2005	
Operations	G-020-05F – Change	Cubic Transportation Systems, Inc.	OP-02-4610-10	Legal	3/2005	
Operations	05CA-G05-00 - Change	Cubic Transportation Systems, Inc.	OP-02-4610-10	Legal	3/2005	

Appendix B

Grant Audit 3rd Quarter FY 05 Completed Audits						
Area	Audit Number & Type	Memorandum of Understanding	MOU Number	Requirement	Date Completed	
Planning	B-013-04 – Closeout	Transportation Foundation - Adventure In Mass Transit	P0004038	Contractual Requirement	2/2005	
Planning	B-016-05 – Interim	Alameda Corridor East - Siemens Energy & Automation	P0004367	Contractual Requirement	2/2005	
Planning	B-032-05 - Closeout	Alameda Corridor East --Automated Switching Controls	P0004367	Contractual Requirement	2/2005	
Planning	B-041-04 – Closeout	UCLA Transportation Service - UCLA Bruin Go! Transit Pass Demonstration	P0008311	Contractual Requirement	2/2005	
Planning	B-019-05 – Closeout	City of LA - San Diego Freeway Corridor - Phase 1 ATSAAC Project	P0004234	Contractual Requirement	2/2005	
Planning	B-022-05 – Closeout	Caltrans - HOV Lanes on Rte 14 from I-5 to Rte 126/San Fernando Rd	P0002201	Contractual Requirement	2/2005	
Planning	B-030-05 – Closeout	Beverly Hills - Sunset Blvd Signal Synchronization	P0004253	Contractual Requirement	3/2005	
Planning	B-039-04 – Interim	Transportation Foundation - Real Time Transit Tech Program	P0004012	Contractual Requirement	3/2005	
Planning	B-013-05 - Interim	Alameda Corridor East - Padilla & Assoc	P0004367	Contractual Requirement	3/2005	

Appendix C

Internal Audit 3 rd Quarter Progress Toward Completing Audit Plan				
Area	Audit No. & Title	Audit Subject	Risk	Estimated Date of Completion
Deputy Chief Executive Officer/ Operations Chief of Staff	03IA-017 - Operator Overtime	An internal control review over bus operator overtime.	High	06/2005
	04IA-001 - Diversity & Equal Opportunity Contract Compliance	An internal control review on the establishment of Disadvantaged Business Entities (DBE) goals in contracting, the monitoring of goals, and the reporting of the results.	High	04/2005
Deputy Chief Executive Officer/ Operations	04IA-002 - Westside/Central Sector Maintenance	Assess bus reliability as measured by the Preventive Maintenance Program.	High	04/2005
Chief Communications Officer	04IA-003 - Fare Media Stockroom Security	Determine the adequacy of security over passes and stamps in the Fare Media Stockroom and over Day Passes in the Bus Divisions.	High	04/2005
Deputy Chief Executive Officer/ Operations	04IA-005 - ADA Paratransit Services	Evaluate the efficiency and effectiveness of the ADA Paratransit Program run by Access Services, Inc.	High	04/2005
Deputy Chief Executive Officer/ Operations	04IA-008 - Rail Maintenance of Way	A preliminary survey to evaluate residual risks and weaknesses in the Rail Sector's Maintenance of Way area.	High	06/2005
Deputy Chief Executive Officer/ Operations	05IA-001 - Fleet Management	Determine the adequacy of internal controls related to the preparation of the Fleet Deployment Plan.	High	05/2005
Chief Planning Officer	05IA-004 - Santa Monica Big Blue Bus TDA/STA Claim	An internal control review of the processing of the TDA/STA claim.	Medium	05/2005

Appendix C

Internal Audit 3 rd Quarter Progress Toward Completing Audit Plan					
Area	Audit No. & Title	Audit Subject	Risk	Estimated Date of Completion	
Deputy Chief Executive Officer/ Operations	05IA-005 - BDOF Operator Analysis	Analyze the BDOF operator classification.	High	04/2005	
Chief of Staff/ General Services	05IA-007 - Gateway Pool Vehicles	Determine whether the Gateway pool vehicle records are complete and accurate and vehicles are available for employees' use.	Medium	04/2005	
Chief Financial Officer/ Procurement	05IA-009 - Procurement System Review	Determine compliance with selected Federal and State procurement requirements.	High	05/2005	
Chief Financial Officer/ Risk Management	05IA-010 - Workers' Compensation Claims Management	Evaluate the internal controls over the in-house claims management of worker's compensation.	High	06/2005	
Deputy Chief Executive Officer/ Operations	05IA-011 - South Bay Sector Performance Measures	A preliminary survey to review reporting mechanisms established for sector performance indicators.	High	06/2005	
Chief Financial Officer/ Accounting	05IA-012 - Financial Reporting	A preliminary survey to determine a manageable approach and testing program for the evaluation of internal controls over financial reporting.	High	06/2005	

Appendix D

Information Technology Audit 3 rd Quarter Progress Toward Completing Audit Plan					
Area	Audit No. & Title	Audit Subject	Risk	Estimated Date of Completion	
Fleet Management Support Services & ITS	04IT-006 – M3 Fuel Management	Evaluate the internal controls established for the Fleet Watch System, which automates fueling and tracking of bus and non-revenue fuel consumption.	Medium	04/2005	
Financial Information Systems-ITS	04IT-001 – Financial Information Systems Environment	Assess the adequacy and effectiveness of internal controls established for safeguarding the Financial Information System and the related data against unauthorized use, disclosure, modification, damage or loss	High	05/2005	
Transit Operations & Trends Systems-ITS	03IT-008 – Transit Operations & Trends System Environment	Assess the adequacy and effectiveness of internal controls established against unauthorized use, disclosure, modification, damage or loss. This system is responsible for timekeeping and scheduling of the bus and rail operators at divisions.	High	06/2005	
Safety	05IT-002 – Drivers License Monitoring System	Determine whether adequate and effective internal controls are established for safeguarding data against disclosure, unauthorized use, or modification and to ensure compliance with the terms of the contract with the State of California DMV system.	Medium	05/2005	

Appendix D

Information Technology Audit 3 rd Quarter Progress Toward Completing Audit Plan				
Wayside Engineering	05IT-001 – Supervisory Control & Data Acquisition (SCADA)	Determine the adequacy and effectiveness of internal controls for the SCADA System. We are particularly concerned with unauthorized access and unwarranted disruption of rail activities and functions the system support.	Medium	06/2005
Operations, Material Management & ITS	05IT-003	Audit outsourced at request of CEO to review system requirements, project management and system development life cycle.	High	09/2005

