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EXECUTIVE MANAGEMENT AND AUDIT COMMITTEE
FEBRUARY 19, 2009

SUBJECT: MANAGEMENT AUDIT SERVICES FY 2009 SECOND QUARTER REPORT

ACTION: RECEIVE AND FILE

RECOMMENDATION

Receive and file the second quarter report of Management Audit Services (Management Audit) for the period ending December 31, 2008.

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 second 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 December 31, 2008 is as follows:

Internal Audits: Five internal audits were issued, and one consulting engagement was completed; 21 internal audits and one control self assessment (CSA) were in process.

External Audits: 47 contract audits with a total value of $59.6 million and three grant audits with a total value of $17.8 million were completed; 35 contract audits and 27 grant audits were in process.

Contractor Pre-Qualification: 290 Pre-Qualification applications and validations were received and 183 were approved. This represents a 91% increase in activity since the same time frame last year.

Audit Follow-up and Resolution: 20, or 23%, of all outstanding audit recommendations were completed and closed; 27 new audit recommendations were added.

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

NEXT STEPS

Management Audit will provide the third quarter summary of FY 2009 audit activity to the Board at the May 2009 Executive Management and Audit Committee meeting.

ATTACHMENT

A.   Management Audit Services Quarterly Report to the Board for the period ending December 31, 2008

Prepared by: Ruthe Holden, Chief Auditor, Management Audit

Ruthe Holden

Ruthe Holden
Chief Auditor, Management Audit Services

Roger Snoble
Chief Executive Officer

Los Angeles County Metropolitan Transportation Authority

MANAGEMENT AUDIT SERVICES QUARTERLY REPORT TO THE BOARD

SECOND QUARTER
FY 2009

Metro

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EXECUTIVE SUMMARY


Summary of Audit Activity

During the second quarter of FY 2009, 56 audit projects were completed. These include:
- 1 financial audit
- 1 IT audit
- 3 operational audits
- 47 contract audits
- 3 grant audits, and
- 1 consulting engagement

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

Eighty-three audits and one CSA were in process as of December 31, 2008; these include 21 internal audits, 35 contract audits, and 27 grant audits.

The following chart identifies the functional areas where Management Audit focused audit staff time and efforts during second quarter FY 2009:
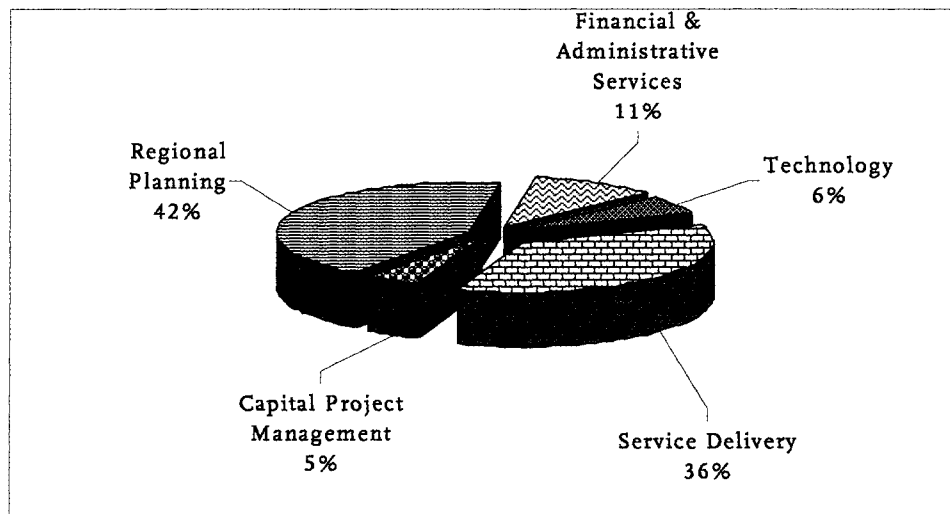
Results of activities managed by the Audit Support and Research Services group include:
- Twenty or 23% of the recommendations were completed and closed during the quarter out of a total universe of 86. Twenty-seven audit recommendations were added during the second quarter; and
- 290 Pre-Qualification applications and validations were received and 183 were approved during the second quarter FY 2009.

EXECUTIVE SUMMARY

Agency Wide Risk Assessment

In January 2007, the Board approved the Financial Stability Policy requiring an annual risk assessment be completed for the agency. Risk assessments are a means of providing management with information needed to understand factors that can negatively influence operations and outcomes. Management Audit has been completing agency wide risk assessments and reporting the results to the Board for the last three years.

This year Management Audit reevaluated the methodology used in prior years to complete the risk assessment. We incorporated current industry best practices into the risk assessment process, as well as identifying and including elements that are more relevant to government agencies.

The agency wide risk assessment is the process of identifying the possibility that events will occur that will be harmful to Metro, and/or will be detrimental to the achievement of the strategic goals. Not all risks are equal. Some are more likely than others to occur, and some will have a greater impact than others if they occur. So, once risks are identified, their probability and significance must be assessed.

This year's process began with an initial list of risks that were identified using key documents, analysis and benchmarking. The risks were analyzed within the agency's functional areas. Functional areas are defined as groups with a common purpose that are necessary for the agency to complete its mission and strategic goals. Once the initial assessment was completed, questionnaires and checklists were developed that provided the additional information necessary to adequately assess and categorize the agency's risks. In recognition of the current economic climate, we also included procedures to evaluate fraud vulnerabilities and their related risks to the agency.

The assessment of risk is an important planning step in developing the annual audit plan. The information gathered from this risk assessment will be used to develop the FY 2010 annual audit plan, which will be presented to the Board in the fourth quarter of FY 2009.

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 second quarter FY 2009, 47 audits were completed, reviewing a net value of $59.6 million of which $6.6 million was questioned. Thirty-nine of these completed audits were pre-award audits and accounting system reviews for Planning in support of corridor projects, and eight were for Operations projects. As of December 31, 2008, 35 contract audits were in process.

Details on Contract Audits completed during second 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 second quarter FY 2009. They reviewed $17.8 million and identified $1.2 million of unused funds that may be reprogrammed by Countywide Planning for other projects. Twenty-seven grant audits were in process as of December 31, 2008.

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

INTERNAL AUDITS

For the second quarter of FY 2009, a total of five internal audit reports were issued and one consulting engagement was completed. The consulting engagement was a follow-up analysis of the ITS Overtime Validations for represented and non-contract employees.

Twenty-one internal audits and one CSA were in process as of December 31, 2008. The internal audits and CSA in process are listed in Appendix C.

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

Day Pass Internal Controls
The CEO requested this audit to determine whether controls over fare media distribution were adequate at the divisions to prevent theft of day passes. An audit in 2006 noted significant internal control deficiencies and Operations developed and implemented a new procedure for distribution and oversight of day passes. In the 2008 audit, Management Audit found a continued lack of accountability in spite of the procedures and controls implemented in 2006. The three major deficient areas were:
- Inadequate compliance to day pass book security procedures
- Ineffective controls for monitoring individual day passes, and
- Ineffective day pass security design features.

The Chief Operations Officer has directed the divisions to comply with day pass procedures and has drafted a centralized day pass monitoring process. Day pass book distribution has been reduced; day pass lock boxes and storage containers have been re-keyed, and key control is being enforced, and all day pass books issued to night owl runs will be reconciled 100 percent. In addition, reports are being developed to identify major discrepancies, and each month two divisions will be selected for evaluation.

The Chief Communications Officer will print day pass serial numbers in the middle of the day pass rather than at the top to prevent the removal of the serial numbers. Transit Access Pass (TAP) management has agreed to expedite TAP day pass implementation and eliminate paper day passes.

At the January 2009 Executive Management and Audit Committee meeting, the Board was updated on this audit and the day pass implementation schedule. Day Passes will be converted to the TAP product in March 2009.

Until the paper day pass has been converted to TAP, Management Audit staff will continue monthly follow up audits at all divisions to verify that Operations staff is complying with Day Pass procedures.

INTERNAL AUDITS

Fare Media Stockroom

The audit objective was to determine the adequacy and effectiveness of internal controls over fare media production, storage and distribution. Some controls designed to secure and account for fare media are not being enforced, and monitoring of controls are not sufficient to assure the protection and safeguarding of fare media. We found that stockroom alarms did not trigger during an intrusion test, unauthorized personnel had access to the stockroom, the printing contractor did not have documented security procedures for fare media as required by the contract, and fare media overruns and scrap were allowed to be shredded by the printer. In addition, security personnel could not locate in a timely manner a functional master key to manually open the stockroom door.

Communications management will commence regular testing of the stockroom alarm system and develop a security checklist that will include a secure location for a functional master key. Departmental access reports will be reviewed every quarter, updated as necessary and a separate report will be reviewed whenever Customer Service Agents bid in or out of the permanent stockroom position. The printing contractor will document security control measures over fare media and has agreed to install a secondary locked door to store fare media. Fare media overruns and scrap will be delivered to the fare media stockroom and stockroom personnel will be responsible for storing and disposing of overruns and scrap. In addition, Safety & Security will implement an Electronic Cabinet System to ensure keys are organized and easily accessible.

M3 Payroll Interface

The internal controls for the Maintenance and Materiel Management (M3) System Payroll Interface were audited to evaluate their adequacy and effectiveness in protecting the interface data from unauthorized access and ensue the accuracy and completeness of the data transmitted for Payroll processing. The audit evaluated 100% of the data transmitted for two pay periods.

The internal controls for the transmission of data are adequate and effective. However, we found that most M3 users (3,983 users) were granted unnecessary access privileges that exceed the requirements of their job function. This level of access privileges could be used to edit or delete payroll information and was not required at the job level that was granted the authority. Management concurred with the finding and took action to mitigate the risk by reducing the access privilege level for all 3,983 users to a level necessary for their job function.

INTERNAL AUDITS

Balanced Scorecard
A balanced scorecard is a strategic management system which uses measures to assess organizational success. The instrument is balanced between financial and non-financial measures; internal and external organizational constituents; and lag and lead performance indicators. Executive management uses the Balanced Scorecard to track significant key performance indicators for critical areas. The audit evaluated the FY08 Balanced Scorecard to determine whether it was aligned with the agency-wide FY08 goals and strategies.

We found of the eight strategic organizational goals which should be tracked, the current Balanced Scorecard has metrics for only four of the strategic goals: 1) Exercise fiscal responsibility; 2) Develop an effective and efficient workforce; 3) Provide leadership for the region's mobility agenda; and 4) Enhance a safety conscious culture.

The four remaining goals do not have any metrics: 1) Improve transit service: 2) Deliver quality capital projects on time and within budget; 3) Secure local, state and federal funding; and 4) Maintain open lines of communication.

Executive Management agrees to develop additional performance measures and to investigate options for replacing the current Balanced Scorecard. To enhance strategic management for the "Deliver quality capital projects on time and within budget goal," management introduced a reporting process to ensure greater capital project accountability.

Audit of Internal Controls for SAS 70 Reports
Statement on Auditing Standards (SAS) 70 reports are issued by independent accounting firms that have examined organizations providing financial services. The reports provide assurance that the financial services organizations' internal controls are adequate. We audited the receipt and review of SAS 70 reports for seven current service provider contracts that were executed on or before the year 2007. Although the appropriate reports were received from our financial service providers, the contracts for six of the seven service providers do not contain language requiring that they provide SAS 70 reports. We also noted that contract language for these types of services should be enhanced based on industry best practices to provide increased oversight of the financial service providers.

The Chief Financial Services Officer and Treasurer will identify contracts requiring SAS 70 clauses and notify the Contract Administration group in Procurement. Contract Administration will develop standard boilerplate language that can be included in applicable contracts. This issue will also be discussed during the procurement planning process, and it will be documented in the procurement file whether the clause needs to be included in the contract.

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 2009, 290 applications and validations were submitted, and 116 applications and four validations were in process from the end of first quarter FY 2009. Of the 410 active files, 183 firms were approved to do business with Metro, 25 were closed and 202 applications were still in process as of December 31.

The applications processed during second quarter FY 2009 were in support of 48 different procurement actions, including contracts in construction, operations, and professional services.

Audit Follow-Up and Resolution

During the second quarter, 27 new audit recommendations were added to the outstanding audit recommendations list, and 20 recommendations were completed and closed out of a total universe of 86 representing a 23% reduction in the total outstanding recommendations. The table below summarizes the second quarter activity.

Summary of MAS and External Audit Recommendations
As of December 31, 2008

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.
Chief Financial Services Officer	2	4				9	9
Chief Administrative Services Officer			7	5	8	15	28
Chief Real Property Management & Development	1		1			4	4
Chief Planning Officer	1			1	2	1	4
Chief Communications Officer						6	6
General Mgr. Rail Operations						1	1
Chief Operations Officer	3					10	10
Chief Capital Management Officer			1			4	4
Totals	7	4	9	6	10	50	66

Appendix A

	Contract Audit FY 2009 - Audits Completed During Second Quarter		
Area	Audit Number & Type	Contractor	Requirement	Date Completed
Planning	09-COR-C03A - Pre-Award	D'Leon Consulting Engineers	Contractual	12/2008
Planning	09-COR-C03D - Pre-Award	Terry A. Hayes Associates LLC	Contractual	12/2008
Planning	09-COR-C03E - Pre-Award	IBI Group	Contractual	12/2008
Planning	09-COR-C02F - Pre-Award	ICF Jones & Stokes	Contractual	12/2008
Planning	09-COR-C02H - Pre-Award	Wagner Engineering & Survey, Inc.	Contractual	12/2008
Planning	09-COR-C02I - Pre-Award	D'Leon Consulting Engineers	Contractual	12/2008
Planning	09-COR-C03G - Pre-Award	MACTEC Engineering & Consulting Services, Inc.	Contractual	12/2008
Planning	09-COR-C03C - Pre-Award	LKG-CMC, Inc.	Contractual	12/2008
Planning	09-COR-C03B - Pre-Award	Intueor Consulting, Inc.	Contractual	12/2008
Planning	09-COR-C03F - Pre-Award	SWCA Environmental Consultants	Contractual	12/2008
Planning	09-COR-C02J - Pre-Award	LKG-CMC, Inc.	Contractual	12/2008
Planning	09-COR-C01N - Accounting System Review	Pacific Drilling Company	Contractual	12/2008

Appendix A

Contract Audit FY 2009 - Audits Completed During Second Quarter

Planning	09-COR-C03I - Pre-Award	Camp, Dresser and McKee, Inc.	Contractual	12/2008
Planning	09-COR-C02J - Pre-Award	Morgner Construction Management	Contractual	12/2008
Planning	09-COR-C03K - Pre-Award	Ted Tokio Tanaka Architects	Contractual	12/2008
Planning	09-COR-C02M - Pre-Award	Barrio Planners, Inc.	Contractual	12/2008
Planning	09-COR-C02L - Pre-Award	AECOM Consult, Inc.	Contractual	12/2008
Planning	09-COR-C02D - Accounting System Review	Barrio Planners, Inc.	Contractual	12/2008
Planning	09-COR-C03H - Pre-Award	PB Americas, Inc.	Contractual	12/2008
Planning	09-COR-C03J - Pre-Award	Sharon Greene and Associates	Contractual	12/2008
Planning	09-COR-C02K - Pre-Award	DMJM-Harris	Contractual	12/2008
Planning	09-COR-C05 - Pre-award	The Robert Group	Contractual	12/2008
Rail Operations	09-SCA-C02 - Pre-Award	SYSTRA Consulting, Inc.	Contractual	12/2008
Planning	09-COR-C02A - Pre-Award	Camp, Dresser and McKee, Inc.	Contractual	12/2008
Planning	09-COR-C01I - Pre-Award	PB Americas, Inc.	Contractual	11/2008

Appendix A

Contract Audit FY 2009 - Audits Completed During Second Quarter

Planning	09-COR-C01H - Pre-Award	MACTEC Engineering & Consulting Services, Inc.	Contractual	11/2008
Planning	09-COR-C01G - Pre-Award	LKG-CMC, Inc.	Contractual	11/2008
Planning	09-COR-C01B - Pre-Award	Kal Krishnan Consulting Services, Inc.	Contractual	11/2008
Planning	09-COR-C01E - Pre-Award	Terry A. Hayes Associates LLC	Contractual	11/2008
Planning	09-COR-C01J - Pre-Award	Fehr and Peers Associates, Inc.	Contractual	11/2008
Planning	09-COR-C01F - Pre-Award	Torti Gallas and Partners	Contractual	11/2008
Planning	09-COR-C01L - Pre-Award	Jenkins, Gales & Martinez, Inc.	Contractual	11/2008
Planning	09-COR-C01K - Pre-Award	Intueor Consulting, Inc.	Contractual	11/2008
Planning	09-COR-C01M - Pre-Award	Pacific Drilling Company	Contractual	11/2008
Planning	09-COR-C04B - Pre-Award	Iteris, Inc.	Contractual	11/2008
Planning	09-COR-C04A - Pre-Award	The Robert Group	Contractual	11/2008
Planning	09-COR-C02E - Pre-Award	EDAW, Inc.	Contractual	11/2008
Planning	09-COR-C02B - Pre-Award	HDR Engineering, Inc.	Contractual	11/2008

Appendix A

	Contract Audit FY 2009 - Audits Completed During Second Quarter			
Bus Operations	09-UFS-C02B - Pre-award	Robnett Electric, Inc.	Contractual	11/2008
Bus Operations	09-GSA-C01 - Pre-Award	Gonzales, Suarez & Associates, Inc.	Contractual	10/2008
Operations	09-STI-C01 - Incurred Cost	Stevens Technology LLC	Legal	10/2008
Bus Operations	09-MDG-C01 - Pre-Award	Maintenance Design Group LLC	Contractual	10/2008
Bus Operations	09-RNL-C01 - Pre-Award	RNL Design, Inc.	Contractual	10/2008
Bus Operations	09-CJT-C01 - Pre-Award	C&J Techinical Solutions and Services , Inc	Contractual	10/2008
Bus Operations	09-UFS-C02A - Pre-Award	Cubic Transportation Systems, Inc.	Contractual	10/2008
Planning	09-COR-C01A - Pre-Award	SYSTRA Consulting, Inc.	Contractual	10/2008
Planning	09-COR-C01C - Pre-Award	URS Corporation	Contractual	10/2008

Appendix B

Grant Audit FY 2009 - Audits Completed During Second Quarter

Area	Audit Number & Type	Grantee	Requirement	Date Completed
Planning	08-CAL-G02 - Interim	CalTrans	Contractual	12/2008
Planning	08-CAL-G04 - Interim	CalTrans	Contractual	12/2008
Planning	09-STIP-G01 - Closeout	LACMTA	Contractual	12/2008

Appendix C

	Internal Audit FY 2009 - Progress Toward Completing Audit Plan		
Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
Financial & Administrative Management	06-OMB-O05 - Budgeting Process	Evaluate effectiveness and efficiency of of budgeting processes.	High	2/2009
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	2/2009
Financial & Administrative Management	07-PMM-I10 - Procurement Card	Assess preocurement card policies, procedures and controls and determine compliance with policies and procedures.	High	2/2009
Safety	07-OPS-O02 - Disaster: Response & Recovery	Validate existence, currency and adequacy of disaster recovery planning.	High	2/2009
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	2/2009
Service Delivery	08-OPS-O10 - Bus Passby Complaint Study	Consulting assignment that is reviewing the impact of signage changes on bus passby complaints.	High	2/2009

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-O01 - M3 Warranty Management	Validate whether key business process impacted by M3 system are effective and efficiently. Evaluate effectiveness of input controls.	High	2/2009
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	2/2009
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	3/2009
Financial & Administrative Management	09-TRS-F01 - Health Care Eligibility	Business proces Improvement Audit - Evaluate process of updating health care contract provider with eligible individuals/dependents. Verify accuracy of payments.	High	3/2009

Appendix C

Internal Audit FY 2009 - Progress Toward Completing Audit Plan

Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
Technology	09-OPS-I02 - 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	3/2009
Service Delivery	08-CSA-O04 - M3 Time Keeping	Control Self Assessment to document the business objectives, risks, controls, residual risks and action plans to mitigate any unacceptable residual risks identified for this area.	High	3/2009
Financial & Administrative Management	09-OPS-O02 - Solar Energy Projects	Sustainability Audit - Evaluate return on investment of solar energy project. Verify utility rebates received.	High	3/2009
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	3/2009
Service Delivery	09-COM-I01 - Audit of Passenger Comments Management Systems	Evaluate internal controls in tracking passenger complaints.	High	4/2009

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-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
Technology	08-OPS-I02 - Audit of TOAST	Evalute system design for internal controls for Transit Operator activity Scheduling and Tracking (TOAST).	High	4/2009
Technology	08-ITS-101 - Audit of Backup and Recovery Management	Evalute backup procedures and controls for crtical information.	High	5/2009
Technology	08-CEO-I01 - Audit of Information Privacy	Evaluate internal controls over systems, databases and processes that collect data subject to privacy acts.	High	6/2009
Governance	09-ECD-01 - Real Estate Acquisition Environmental Review Process	Evaluate whether procedures used to acquire real estate provides the agency with adequate protection for potential environmental issues.	High	6/2009

Appendix C

Internal Audit FY 2009 - Progress Toward Completing Audit Plan

Area	Audit Number & Title	Description	Risk	Estimated Date of Completion
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