



July 21, 2010

To: Finance and Administration Committee

From: Will Kempton, Chief Executive Officer

Subject: Review of Revenue Agreements

Overview

The Internal Audit Department has completed a review of Orange County Transportation Authority agreements that include revenue components. The Internal Audit Department determined that there is no central database or record of revenue agreements, billed amounts, and outstanding balances. The Internal Audit Department made two recommendations to improve controls over revenue agreements and ensure all contractual revenue is collected.

Recommendation

Direct staff to implement recommendations in the Review of Revenue Agreements, Internal Audit Report No. 10-501.

Background

For all Orange County Transportation Authority (OCTA) agreements with revenue components, project managers request invoices from the Accounts Receivable Department (Accounts Receivable) during the term of the agreement and Accounts Receivable prepares invoices. Invoices may be based on an initial lump sum, a defined percentage of total costs, or a uniform amount over a stated period of time.

The Development and Rail Programs divisions rely on the Project Controls Department to assist project managers with the invoicing process. Requests for invoices are initiated by project managers and processed through the Project Controls Department, which assigns the revenue and project number account coding. The Project Controls Department maintains spreadsheets for these revenue agreements to track invoices and collections.

Discussion

The objective of the review was to determine that adequate controls exist to ensure collection of all revenue for agreements with revenue components. The Internal Audit Department (Internal Audit) reviewed a sample of revenue agreements managed by the Development, Rail Programs, and Transit divisions.

Internal Audit noted that OCTA does not maintain a centralized record of revenue agreements, related invoices, and outstanding balances. The current process relies solely on project managers to identify these amounts and either project managers or the Project Controls Department to track the amounts. Based on review of the number and amount of OCTA revenue agreements, Internal Audit considered these procedures inadequate to ensure that all revenue is ultimately invoiced. Internal Audit recommended that the Finance and Administration Division, with the input of user departments, consider and implement controls to ensure revenue agreements are centrally tracked and monitored. Management concurred with the recommendation and is in the process of creating a database to track revenue agreements.

Internal Audit reviewed an agreement with Riverside Transit Agency (RTA) that requires that RTA reimburse OCTA for a percentage of operating costs for bus route 794. When originally executed, the agreement required that RTA pay 30 percent of operating costs for short trips and 36 percent for long trips. In July 2009, OCTA began using another contractor to provide this service and the billing basis changed from revenue vehicle miles to revenue vehicle hours. As a result, OCTA changed its cost sharing with RTA to 32 and 34 percent for short and long trips, respectively. However, the agreement was not amended to reflect this change. Additionally, billing rates for July 2009 through March 2010 were not calculated correctly, resulting in a \$16,000 underbilling. Internal Audit recommended that the Transit Division initiate an amendment to the agreement reflecting the new cost-sharing terms and an invoice for underbilled amounts. Management included a revision to the cost-sharing terms and funding allocation rates for each agency in the most recent amendment. Management also submitted an invoice for the underbilled amount to RTA.

Summary

Based on a review of revenue agreements, Internal Audit offered two recommendations to ensure all revenue due OCTA is billed and collected. Management concurred with both recommendations and has initiated corrective action.

Attachment

- A. Review of Revenue Agreements, Internal Audit Report No. 10-501

Prepared by:

A handwritten signature in cursive script that reads "Kathleen M. O'Connell".

Kathleen M. O'Connell
Executive Director, Internal Audit
714-560-5669

ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



Review of Revenue Agreements

INTERNAL AUDIT REPORT NO. 10-501

June 18, 2010



Internal Audit Team:

Kathleen M. O'Connell, CPA, Executive Director
Serena Ng, CPA, Senior Internal Auditor

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT**

**Review of Revenue Agreements
June 18, 2010**

Contents

Conclusion 1
Background 1
Objectives, Scope and Methodology 3
Audit Comments, Recommendations and Management Responses 5
 Noteworthy Accomplishments 5
 Need for Additional Controls over Revenue Agreements 5
 Change in Cost Sharing Agreement 6

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT**

**Review of Revenue Agreements
June 18, 2010**

Conclusion

The Internal Audit Department (Internal Audit) has completed a review of revenue agreements. The objective was to determine that adequate controls exist at the Orange County Transportation Authority (OCTA) to ensure collection of all revenue under these types of agreements.

Internal Audit noted that there is no central database or record of revenue agreements, billed amounts, and outstanding balances. As such, Internal Audit was unable to quantify the number of revenue agreements or amounts due to OCTA.

While Internal Audit found only one instance of under-collected revenue, there remains a deficiency in the design of controls to ensure all revenue is invoiced and collected. Internal Audit has offered two recommendations to improve controls over revenue agreements.

Background

Revenue Agreements with Government and Not-for-Profit Agencies

A cooperative agreement is a legally binding contract between OCTA and another government or not-for-profit agency setting forth terms and conditions upon which there is mutual agreement. They are contractual documents that often include cost-sharing arrangements or establish other roles and responsibilities.

Requisitions for cooperative agreements are entered by OCTA departments into Ellipse, OCTA's integrated maintenance, inventory, and purchasing software application. Contracts Administration and Materials Management Department (CAMP) management assigns a procurement or contract administrator to the requisition. These agreements and any amendments are subject to the same approval limits, signature authority, and process as all other agreements.

Revenue Collection Cycle

For cooperative agreements that generate revenue to OCTA, project managers (PM) must request invoices from Accounts Receivable (A/R) during the term of the agreement and A/R will prepare the invoices. Invoicing to a local agency is based on the specific reimbursements set forth in the agreement. Billing method may be based on an initial lump sum, a defined percentage of total costs, or a uniform billing amount over a certain period. PM's may request that an invoice be picked up by them for delivery or mailed by A/R.

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT**

**Review of Revenue Agreements
June 18, 2010**

In the Development and Rail Programs divisions, the Project Controls Department assists PM's in the invoicing process. Requests for invoices are initiated by the PM and processed through the Project Controls Department, which assigns the revenue and project number account coding. The Project Controls Department maintains spreadsheets for the revenue agreements to track invoices and collections.

Based on limited available sources of information, Internal Audit identified about forty revenue agreements with government and not-for-profit agencies totaling approximately \$30 million. Internal Audit compiled a list of revenue agreements using a listing of cooperative agreements provided by CAMM, OCTA's Contract Listing provided by CAMM, and recent staff reports requesting approval of revenue agreements. Because there is no reliable means of identifying revenue agreements and because dollar amounts are not consistently specified in the available contract listings, Internal Audit was unable to determine if all revenue agreements were captured. Internal Audit also estimated the related revenue and this amount may be inaccurate.

Revenue Agreements with Other Parties

OCTA also has revenue agreements with parties other than government and not-for-profit entities. OCTA has a revenue agreement with a consultant for the sale and administration of OCTA's bus advertising program. Since that agreement was recently audited, Internal Audit excluded the agreement from testing during this review. Other revenue agreements include agreements with relatively low dollar amounts such as recycling agreements.

Based on limited available sources of information, Internal Audit identified a few revenue agreements with other parties totaling approximately \$18 million, most of which is attributable to the bus advertising agreement. Internal Audit compiled a list of revenue agreements using OCTA's Contract Listing provided by CAMM and recent staff reports requesting approval of revenue agreements. Because there is no reliable means of identifying revenue agreements and because dollar amounts are not consistently specified in the available contract listings, Internal Audit was unable to determine if all revenue agreements were captured. Internal Audit also estimated the related revenue and this amount may be inaccurate.

Accounting

Every month, A/R reconciles a subledger report "A/R Aging by Funds" to Integrated Financial and Administrative Solution (IFAS), OCTA's accounting system. Every quarter, for departments other than Risk Management¹, the A/R specialist emails an outstanding receivables aging to PM's for review as to whether the receivable is

¹ The aging is sent to Risk Management every six months at the request of the department manager.

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT**

**Review of Revenue Agreements
June 18, 2010**

uncollectable, collectable, or being disputed. If the receivable is uncollectable, then the PM must complete a write off authorization form and obtain approval from the department manager².

The Accounting Department indicated that the accounts receivable module in IFAS records only invoiced receivables and is not capable of recording the terms of a revenue agreement. For example, if OCTA is party to a three-year revenue agreement at \$100,000 per year, once the first year is billed, the accounts receivable module will reflect a \$100,000 receivable. However, no amounts will be recorded or tracked for the second and third year of the agreement. Therefore, IFAS does not record revenue agreements, record receipt of revenue against the agreement, nor track agreement billed amounts and remaining balance.

Objectives, Scope and Methodology

The objective of the review was to determine that adequate controls exist to ensure collection of all revenue on revenue agreements.

In meeting this audit objective, Internal Audit employed the following methodologies:

- Reviewed OCTA Procurement Policies and Procedures Manual (September 2009);
- Interviewed CAMM and Accounting staff on revenue agreements;
- Discussed procedures and controls with PM's responsible for the sampled revenue agreements; and
- Reviewed a judgmentally selected sample of ten revenue agreements and a sample of the invoices and collections on those agreements³.

The scope of the review was limited to revenue agreements, defined as agreements that generate revenue to OCTA. Grants were excluded from this review as they were included in the Grants Management and Accounting Review, Internal Audit Report No. 08-018. The sampled revenue agreements consisted of agreements managed by the Development Division, the Rail Programs Division, and the Transit Division.

The sample that Internal Audit tested is as follows:

² For July 2009 through April 2010, write-offs were \$ 51,569.52 for Risk Management claims-related receivables and \$1.69 for pass-related receivables.

³ Of the total \$30 million of identified revenue agreements, Internal Audit tested approximately \$19.9 million, including \$13.0 million of agreements managed by Development Division, \$3.7 million managed by Rail Programs Division, and \$3.2 million managed by the Transit Division.

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT**

**Review of Revenue Agreements
June 18, 2010**

No.	City/Agency	Terms	Estimated Revenue ⁴
C-8-0861	San Juan Capistrano	Cost sharing formula, with OCTA absorbing 88%, cities 12%, for rail-highway grade crossing safety enhancements.	\$ 837,771
C-8-0859	Orange	Same as above.	2,871,974
C-7-1312	Foothill/Eastern Transportation Corridor Agency (TCA)	Feasibility study and micro-simulation analysis for solutions to alleviate traffic delays and provide additional transportation capacity between the 91 Express Lanes and SR-241. TCA funds one-half of the cost with a maximum obligation of \$350,000.	350,000
C-9-0631	Seal Beach	Widening of the Seal Beach Boulevard bridge in the West County Connectors project. Seal Beach funds its cost-share with \$5,304,983 in funds provided by OCTA and \$1,869,017 in city funds.	1,869,017
C-9-0307	Fullerton	Step Two service planning for Go Local Program. Fullerton provides 10% of actual service planning costs.	100,000
C-6-0589	Riverside Transit Agency (RTA)	Express bus service from Riverside County to Orange County, Bus Route 794. RTA provides a percentage of operating costs.	579,000
C-8-0426	Regional Center of Orange County (RCOC)	Specialized paratransit services to RCOC customers attending programs funded by RCOC. RCOC pays OCTA for service provided on a monthly basis at a per trip rate.	2,154,720
C-8-0092	Southern California Association of Governments (SCAG)	Consultant services for the Central County Corridor Major Investment Study. SCAG provides 88.53% of eligible expenses for work related to Task 2, 3, and 4 of the Scope of Work up to \$200,000.	200,000
C-8-0244	County of Orange	Transportation to selected centers within cities participating in the congregate meal program. OCTA contracts out the services. OCTA invoices the Office of Aging based on vehicle hours.	334,060
C-4-0597	Garden Grove	As part of a settlement agreement, Garden Grove contributes \$4,000,000 in Measure M Turnback funds and pays OCTA \$1,400,000 in federal funds for the design and construction of Harbor Boulevard improvements. Based on review of the agreement, project summaries, and OCTA staff reports, there also appears to be estimated revenue of \$5,200,000 for the replacement of the Magnolia Street bridge.	10,600,000
<i>Total</i>			\$19,896,542

This review was conducted in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁴ Revenue is estimated based on agreement terms and/or staff estimates identified in staff reports. Estimated revenue for Agreement No. C-8-0426 is based on the budgeted revenue for FY09/10.

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT**

**Review of Revenue Agreements
June 18, 2010**

Audit Comments, Recommendations and Management Responses

Noteworthy Accomplishments

A/R has procedures in place to notify PM's of uncollected invoices. Every quarter, A/R emails an outstanding receivables aging to PM's. This control ensures that invoiced amounts are properly monitored. A/R also requires that appropriate approval is obtained prior to any write-offs of accounts receivable.

For revenue agreements in the Development and Rail Programs divisions, the Project Controls Department monitors invoiced and collected amounts on these agreements.

Need for Additional Controls over Revenue Agreements

As discussed in the Background material on page 3 of this report, OCTA does not maintain a centralized record of revenue agreements, related invoices, and outstanding balances. While Internal Audit identified only one instance of under-invoiced revenue, a lack of suitable controls puts OCTA at risk of not collecting all revenue under these types of agreements.

When an agreement with revenue components is executed, all aspects of contract administration fall to a PM. Among these administrative responsibilities is the determination of when invoices should be prepared and for what amount. The PM requests that A/R prepare an invoice to be mailed to the counterparty or to be picked up by the PM for delivery to the counterparty.

At the time an invoice is created, and consistent with government accounting principles, a record of the invoiced receivable is created in the accounting system. The balance of the amount due under the agreement, however, is not tracked. In fact, there is no central record of the total amount due when the agreement is executed, or at any time during its term, until an invoice is generated. Amounts due under an agreement can only be established through review of the agreement and the project files.

The process as currently constructed lacks adequate controls to ensure that all revenue is ultimately invoiced. First, there is no control to ensure that PM's initiate timely invoices for the correct amount. Secondly, if a PM were to leave OCTA, there is no control to ensure that those assuming responsibility for the contract's administration are aware of remaining balances due from, or that they continue to invoice, counterparties. Third, there is no control that all amounts due under the agreement have been received upon expiration of the agreement.

The Project Controls Department assists in the monitoring of revenue contracts within the Development and Rail Programs divisions if, and only if, the Project Controls

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT**

**Review of Revenue Agreements
June 18, 2010**

Department is made aware of them. However, there are no similar independent controls within other divisions.

Recommendation 1: Internal Audit recommends that the Finance and Administration Division, with the input of user departments, consider and implement controls to ensure revenue agreements are tracked and monitored adequately. Some of the controls that should be considered are a central database or summary of revenue contracts, prepared at the time agreements are executed, that indicates total revenue due OCTA. These agreements should be monitored to ensure invoices are prepared timely and in the correct amounts.

Management Response (Finance and Administration Division): Management concurs with the recommendation and is in the process of creating a line item database to track revenue agreements. While management is not aware of any instance in which a project manager failed to seek reimbursement under a revenue agreement, and controls for revenue agreements do exist within various divisions at the Authority, a centralized database will certainly strengthen these controls and allow greater visibility and oversight. Initial line item creation will be the responsibility of the Financial Planning and Analysis Department during the budget process. The Contracts Administration and Materials Management Department will be involved in creating revenue agreements in Ellipse where appropriate, and when a revenue is due, Accounting will invoice the vendor and record the receivable in IFAS.

Change in Cost Sharing Agreement

As indicated on page 4, Agreement No. C-6-0589 (Agreement) between OCTA and the Riverside Transit Agency (RTA) requires that RTA reimburse OCTA for a percentage of operating costs for bus route 794 which provides express bus service between Riverside and Orange counties. When originally executed, the Agreement required that RTA pay 30 percent of operating costs for short trips and 36 percent for long trips.

In July 2009, OCTA began using another contractor to provide this service. The billing basis for the contract was changed from revenue vehicle miles to revenue vehicle hours. As a result of this change, OCTA changed its cost sharing with RTA from 30 and 36 percent for short and long trips, respectively, to 32 and 34 percent. However, the Agreement was not amended to reflect this change.

Additionally, billing rates for July 2009 through March 2010 were not calculated correctly. Based on the Agreement cost-sharing percentages, OCTA underbilled RTA approximately \$18,000. Had the Agreement been amended to reflect the revised percentages of 32 percent for short trips and 34 percent for long trips, the underbilled amount would have been approximately \$16,000.

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT**

**Review of Revenue Agreements
June 18, 2010**

Recommendation 2: Internal Audit recommends that the Transit Division initiate an amendment to the Agreement reflecting the new cost-sharing terms. Internal Audit also recommends that the Transit Division initiate an invoice for underbilled amounts.

Management has proposed a secondary review of future rate calculations under the Agreement and Internal Audit recommends that this control be implemented as planned. However, the Transit Division should also participate with the Finance and Administration Division to devise agency-wide controls over all revenue agreements.

Management Response (Transit Division): The Board of Directors approved Amendment No. 4 to Cooperative Agreement No. C-6-0589 on June 14, 2010, exercising the fourth option term and extending the agreement through August 30, 2011. The amendment included a revision to the cost sharing terms and funding allocation rates for each agency. RTA was notified of the calculation error on the July 2009 through April 2010 invoices and has agreed to pay the underbilled amount. An invoice was prepared in June and submitted to RTA for payment.

The funding allocation rates for each agency are developed by the Community Transportation Services (CTS) and Operations Analysis staff at the beginning of each fiscal year. Once the agency funding allocation rates have been determined, a schedule of anticipated monthly invoice totals for the fiscal year is prepared by the CTS project manager. To ensure improved accuracy, the invoice schedule will be reviewed by Operations Analysis staff to verify the use of appropriate rate calculations.

The report also included a recommendation for the Finance and Administration Division to establish agency-wide controls and procedures for all revenue agreements. The Transit Division agrees with this recommendation and will participate in all procedures when established by the Finance and Administration Division.

No further action is required.