



September 13, 2023

To: Finance and Administration Committee

From: Darrell Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit

Subject: Review of Oversight Controls and Contract Compliance Related to the Anaheim Canyon Improvements Project, Internal Audit Report No. 23-515

Overview

The Internal Audit Department of the Orange County Transportation Authority has completed an audit of oversight controls and contract compliance related to the Anaheim Canyon Station Improvements Project. Based on the audit, project oversight and monitoring controls are in place and operating effectively. However, recommendations have been made to comply with policy on the presentation of procurement actions at committees, to ensure contracted work is not performed prior to issuance of an authorizing change directive or amendment, and to maintain complete files of contract change orders, contract amendments, and invoice support.

Recommendation

Direct staff to implement three recommendations provided in Review of Oversight Controls and Contract Compliance Related to the Anaheim Canyon Station Improvements Project, Internal Audit Report No. 23-515.

Background

The Orange County Transportation Authority (OCTA), the City of Anaheim, and the Southern California Regional Rail Authority mutually agreed to implement improvements at the Anaheim Canyon Metrolink rail station that included the addition of approximately 3,400 linear feet of secondary track, a second station platform, extending the existing station platform, improvements for two at-grade railroad crossings located on Tustin Street and La Palma Avenue, and the installation of shade structures, benches, and ticket vending machines.

OCTA entered into contracts for design services, construction management (CM) services, and construction services. CM services include notifying the construction contractor of changes to the construction contract through issuance of a change directive. Change directives are used to increase or decrease the quantity of contract items, to process a lump sum deduction for deleted work, to provide a price increase for items added or changed, and for force account work. Once these changes are negotiated and agreed-upon, a contract change order is processed. For construction billing, the CM performs review of the draft payment application against what work was done in the field, using quantity sheets that show quantities they have determined by measurement and calculation.

Discussion

The design and CM contract awards were not presented as regular items at the respective Board of Directors' committee meetings, as required by policy. The Internal Audit Department (Internal Audit) recommended management enhance controls to ensure compliance. Management agreed to send out communications reiterating the policy and to identify items that must be placed on the regular calendar during weekly agenda setting meetings.

Extra work was performed by the construction contractor prior to a change directive being issued and approved. In addition, the contract change order back-up files did not always contain documents required to fully validate pricing and confirm quantities. Internal Audit also noted a few instances in which the design and CM contract files did not include all documentation to support amendments. Internal Audit recommended management withhold work authorization until a change directive has been issued and ensure all back-up documentation is on file. Management agreed to remind CM teams that extra work shall not begin until a change directive has been issued and asserted that project staff will review contract change order files to ensure all relevant documentation to validate pricing is included. Management also agreed to ensure contract files include all supporting documentation.

The design consultant invoiced OCTA three times for additional work that was performed prior to obtaining authority through a contract amendment. In addition, CM invoices did not consistently include payroll registers to substantiate labor rates, and one sub-consultant billed for other direct costs not listed in the contract schedule. Also, construction applications did not include quantity sheets for one original bid item and several contract change order items. Internal Audit recommended management withhold work authorization until contract authority has been obtained and require the CM to prepare quantity sheets to support all

billed contract change order items. Internal Audit also recommended management consistently obtain payroll registers to support labor classification rates billed and obtain cost or price support for other direct costs not listed in the contract schedule. Management agreed to remind project and CM teams to ensure vendors do not submit invoices for work not yet authorized and to confirm that all documentation requirements for payments are met.

Summary

Internal Audit has completed an audit of the Anaheim Canyon Station Improvements Project and has offered three recommendations for improvement.

Attachment

- A. Review of Oversight Controls and Contract Compliance Related to the Anaheim Canyon Station Improvements Project, Internal Audit Report No. 23-515

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Review of Oversight Controls and Contract Compliance Related to the Anaheim Canyon Station Improvements Project

Internal Audit Report No. 23-515

August 31, 2023



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Conclusion

The Internal Audit Department (Internal Audit) of the Orange County Transportation Authority (OCTA) has completed an audit of oversight controls and contract compliance related to the Anaheim Canyon Station Improvements Project. Based on the audit, project oversight and monitoring controls are in place and operating effectively. However, recommendations have been made to comply with policy on the presentation of procurement actions at committees to ensure contracted work is not performed prior to issuance of an authorizing change directive or amendment, and to maintain complete files of contract change orders, contract amendments, and invoice support.

Background

Anaheim Canyon Station Improvements Project

OCTA, the City of Anaheim (City), and the Southern California Regional Rail Authority (SCRRA) mutually agreed to implement improvements at the Anaheim Canyon Metrolink rail station that included the addition of approximately 3,400 linear feet of secondary track, a second station platform, extending the existing station platform, improvements for two at-grade railroad crossings located on Tustin Street and La Palma Avenue, and the installation of shade structures, benches, and ticket vending machines. The project is substantially complete and currently in the close out process. OCTA served as the lead agency for the design and construction phases. SCRRA provided the design and construction of signals, communication systems, and positive train control. The City provided general design review. The project was funded with Congestion Mitigation and Air Quality Improvement (CMAQ), Federal Highway Administration, Measure M2, and other local funds. The forecasted project cost at completion is \$34,246,000.

Contracts

OCTA entered into Agreement No. C-7-1609 with HNTB Corporation to prepare the plans, specifications, and estimates (i.e., design services) for the project for a firm-fixed price of \$1,835,196.34, commencing March 1, 2018, continuing through December 30, 2020. Through Amendment No. 9, the firm-fixed price had increased to \$2,309,517.15, and the term had been extended to December 31, 2023.

OCTA entered into Agreement No. C-8-1760 with Berg & Associates, Inc. to provide construction management (CM) services for the project on a time-and-expense basis with a maximum obligation of \$1,720,824.00, commencing March 1, 2018, continuing through November 30, 2021. Through Amendment No. 5, the firm-fixed price had increased to \$2,108,702.54, and the term had been extended to November 30, 2023.

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OCTA entered into Agreement No. C-0-2193 with Stacy and Witbeck, Inc. to provide construction services for the project for a firm-fixed price of \$13,480,000. Eight contract change orders have been executed, with a net increase to the price of \$560,313.21.

Change Directives and Contract Change Orders

The CM may notify the construction contractor of changes to the construction contract by issuing a change directive to the contractor. Change directives are used for an increase or decrease in the quantity of contract items, a negotiated lump sum deduction on lump sum contract items for deleted work, a negotiated lump sum price increase for items added or changed, and for force account work. Within 15 calendar days after receipt of a change directive, the construction contractor provides a cost and schedule proposal. The CM reviews the proposal and negotiates with the construction contractor, and then a contract change order is processed.

Policies and Procedures

The Contracts Administration and Materials Management (CAMM) Policies and Procedures (procurement policy) set forth the general procurement policy and standards that govern the conduct of OCTA procurement activities. The Rail Programs department Program Management Procedures serves as a set of procedures to effectively manage and monitor projects and develop strategies for delivering rail projects. The Rail Programs Department Construction Management Procedures Manual (CM Procedures Manual) establishes policies and procedures for contract administration and construction management of OCTA Rail Program projects and describes the duties of field and administrative personnel.

Project Status Controls

Weekly construction progress meetings were held during the construction phase, with minutes prepared by CM and filed in the project files. The Capital Programs Division prepares quarterly progress reports on capital project delivery and submits them to the Board of Directors (Board).

Invoice Review

The project manager (PM) validates the percentage of completion in the design invoices and the work done in the CM invoices. These invoices are also reviewed by Project Controls for comparison with the contracts. For construction billing, CM performs the first review and checks the draft payment application against what work was done in the field, using quantity sheets that show quantities they have determined by measurement and calculation. Once CM and the construction contractor agree, the PM reviews the final application (e.g., invoice) and certificate for payment by looking at the quantity sheets and

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checking what is being charged against what CM has told them about construction progress.

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Objectives, Scope, and Methodology

The objectives were to evaluate contract compliance and assess and test internal controls related to procurement, project oversight, and invoicing.

According to Generally Accepted Government Auditing Standards (GAGAS), internal control is the system of processes that an entity's oversight body, management, and other personnel implement to provide reasonable assurance that the organization will achieve its operational, reporting, and compliance objectives. The five components are control environment, risk assessment, control activities, information and communication, and monitoring.¹ The components and principles that were evaluated as part of this audit are:

- Control Environment
 - OCTA demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
- Risk Assessment
 - OCTA identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.
- Control Activities
 - OCTA selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- Information and Communication
 - OCTA obtains or generates and uses relevant, quality information to support the functioning of internal control.
- Monitoring
 - OCTA evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the Board, as appropriate.

The methodology consisted of testing compliance with selected CAMM policies and procedures, testing compliance with construction contract bond and recovery schedule requirements, confirming if a risk register and other project documentation were prepared, testing contract change orders and amendments for compliance with contracts and procedures, assessing invoice review procedures and testing invoices for compliance with policies and contract provisions, confirming all weekly construction progress meetings were held through review of minutes, testing a judgmental sample of monthly status reports, and testing a judgmental sample of the quarterly capital project status reports to the Board and assessing the timeliness and sufficiency of such reports.

¹ See U.S. Government Accountability Office publication, "Standards for Internal Control in the Federal Government," available at <http://www.gao.gov/products/GAO-14-704G>, for more information.

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The scope is limited to the Anaheim Canyon Station Improvements Project and included the design, CM, and construction contracts, and all amendments and contract change orders executed or issued through May 2023. The scope excluded cooperative agreements with the City and SCRRA. The scope included invoices paid through May 2023. The scope also included monthly status reports from April 2021 through March 2023, and quarterly capital status reports to the Board from the third quarter of fiscal year 2020-21 through the second quarter of fiscal year 2022-23. The judgmental samples of the status reports were made with a bias for more coverage during the construction phase. Since the samples are non-statistical, any conclusions are limited to the sample items tested.

We conducted this performance audit in accordance with GAGAS. 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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Audit Comments, Recommendations, and Management Responses

Policy Requirements for Approval of Contract Awards

Procurement policy requires all architectural and engineering contract awards that exceed \$250,000 be presented as regular items at the respective Boards' committee meeting. Procurement of the design and CM service contracts exceeded the stated thresholds but were not presented as regular items at the respective committee meetings.

Recommendation 1:

Internal Audit recommends management enhance controls to ensure all procurements exceeding the stated thresholds are presented as regular calendar items, as required.

Management Response (Finance and Administration):

Management agrees with the recommendation. The CAMM Director will send out a communication to all the executive directors reiterating the procurement policy as it relates to procurement items that need to be discussed as regular items at the Board Committee level.

Additionally, the weekly updates that the CAMM Director submits to the Chief Financial Officer (CFO) on upcoming procurement-related staff reports will identify those items that need to be discussed as regular items at the Board Committees as applicable. The CFO or the CAMM Director will share this information at the weekly agenda setting meetings accordingly.

Contract Change Orders (CCO) and Contract Amendments

Extra work was performed by the construction contractor prior to a change directive (CD) being issued and approved by the OCTA PM, as required. In addition, CCO back-up files did not always contain all documents required to fully validate pricing and confirm quantities, such as material tickets, backup for daily traffic support rates, invoices, detail of a subcontractor's labor and materials costs, and PM approval of a supervision rate.

Internal Audit also noted a few instances in which the contract file did not include the final amendment proposal and/or all supporting documents to validate labor rates and other direct costs proposed. In addition, amendment proposals by the design consultant regularly included efforts by labor classification categories, that are not validated to employee payroll registers.

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Recommendation 2:

Internal Audit recommends that extra work not be authorized until a CD has been issued to the construction contractor. Management should also ensure all documentation to validate pricing is included in CCO back-up files.

Internal Audit also recommends management ensure contract files include final amendment proposals and support for other direct costs. In addition, management should develop procedures to validate labor rates of sole proprietors and consider requiring consultants to name employees, rather than using labor classifications in amendment proposals for fixed-price contracts.

Management Response (Capital Programs):

Management agrees with the recommendation. Typically, time is of the essence during construction and work must proceed so as not to impact scheduled critical path construction activities. Management will remind the CM teams that extra work shall not begin until a CD has been documented and issued to the contractor. Also, project staff will review construction CCOs to ensure backups include all relevant documentation to validate pricing.

Management Response (Finance and Administration):

Management agrees with the recommendation. CAMM believes that this was an anomaly. As part of due diligence, CAMM currently does have a practice to ensure that the final negotiated cost proposal is signed and on file and validated with adequate supporting documentation before placing amendments in signature cycle for execution.

CAMM will develop written procedures to be included in the Procurement Procedures Manual to validate rates for sole proprietors. Currently CAMM's practice is to validate a sole proprietor's hourly rate either by using invoices charged to prime consultants or contracts from other government agencies showing an hourly billing rate. This validation is documented in the memo-to-file and retained in the contract file. CAMM will conduct training to review the process related to validating labor rates of sole proprietors.

For firm-fixed price contract amendments, moving forward, CAMM will encourage consultants to identify named personnel in their cost proposal.

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Invoice Review Controls

The design consultant invoiced OCTA three times for additional work performed before obtaining authority through a contract amendment.

CM invoices did not consistently include payroll registers needed to substantiate the base labor rate for employees billed under labor classifications, and one sub-consultant billed for other direct costs not listed in the contract schedule.

Quantity sheets were not included in the construction payment applications for one original bid item, and several CCO items.

Recommendation 3:

Internal Audit recommends management not authorize work until contract authority has been obtained.

Management should also consistently obtain payroll registers for all consultant staff billed under labor classifications and cost or price support for any billed other direct costs not listed in the contract schedule. Management should also consider requiring CM to prepare quantity sheets to support all billed CCO items.

Management Response (Capital Programs):

Management agrees with the recommendations and will remind project and CM teams to ensure that vendors do not submit invoices for work not yet authorized, and that all documentation requirements for payment are met. Should a deviation be required, pre-approval from the OCTA PM and CAMM contract manager will be documented and included in the invoice or payment application before being processed.