



**March 8, 2017**

**To:** Finance and Administration Committee

**From:** Darrell Johnson, Chief Executive Officer

Janet Sutter, Executive Director  
Internal Audit Department

**Subject:** Budget Development, Monitoring, and Reporting, Internal Audit Report No. 16-509

### **Overview**

The Internal Audit Department has completed an audit of budget development, monitoring, and reporting. Based on the audit, controls are generally adequate; however, recommendations were made to enhance and expand written procedures, to improve controls over salary grade changes, to adhere to the Position Control Policy, and to improve estimates and explanations included with the Sole Source List.

### **Recommendation**

Direct staff to implement four recommendations provided in Budget Development, Monitoring, and Reporting, Internal Audit Report No. 16-509.

### **Background**

Every year, the Orange County Transportation Authority develops its staffing, operating, and capital plans for the upcoming fiscal year (FY). The product of this effort is an approved FY budget. The Financial Planning and Analysis staff, within the Finance and Administration Division (F&A) is responsible for inputting budget assumptions, providing training and support to the user departments, meeting with project management and executive management, and addressing concerns from committees prior to the public hearing.

Also, as part of the budget, the Human Resources and Organizational Development Division (HROD) submits an annual Personnel and Salary Resolution (P&SR) for Board of Directors (Board) approval. The P&SR outlines general policies regarding employment practices, employee benefits,

compensation, and salary structure for administrative employees. The FY 2016-17 P&SR included changes in salary grades for multiple classifications, along with a statement that the changes resulted from a compensation study conducted by a consultant.

Also, in conjunction with approving the budget, the Board approves an annual Sole Source List developed by the Information Systems Department within F&A. The Sole Source List contains details of software and hardware licensing and maintenance agreements that have been executed with developers on a sole source basis.

Quarterly, F&A staff prepare and submit quarterly budget status reports to the Finance and Administration Committee and the Board.

### ***Discussion***

Budget policies, calendars, and forms are maintained; however, there are no written procedures on the development of salary and benefit budget assumptions and the budget transfer process. In addition, the Internal Audit Department (Internal Audit) identified some salary and benefit budget assumptions that appear to overstate budget expenditures. Finally, written procedures for budget to actual reporting include requirements to investigate variances in individual projects exceeding a set threshold; however, several projects with variances exceeding the threshold were not investigated. Internal Audit recommended that F&A develop certain procedures, including re-evaluating and documenting budget assumptions and requiring specific approvals for special budget transfers. Also, F&A should ensure that project variances are investigated as required by procedures. F&A agreed to re-evaluate and document salary and benefit budget assumptions and to outline approvals for budget transfers requiring explanation for special circumstances. Finally, F&A advised that investigation requirements will be clarified and adhered to.

The Board-approved P&SR included upgrades to job classifications which were attributed to a consultant-prepared compensation study; however, Internal Audit found that the consultant's final report did not include a listing of grade change recommendations. Rather, HROD staff asserted that the recommendations were based on schedules provided by the consultant outside of the final report and considered input from management; however, these schedules did not reconcile to either the final report or the P&SR, nor did documentation of management discussions support all recommendations. Internal Audit recommended that procedures be implemented to ensure that changes to salary grade levels are based on reasonable and consistent methodologies and that documentation is

maintained. Changes should also be communicated to management prior to seeking Board approval. HROD responded that they are in the process of obtaining a compensation and market salary data system, which will be utilized to enhance data collection, consistency, and documentation. HROD agreed to communicate P&SR changes to management prior to seeking Board approval.

The Sole Source List identifies the proposed budget for each software and hardware maintenance agreement; however, these proposed budget amounts exceeded the actual amounts budgeted for most items. In addition, one group's maintenance budget was not based on the estimated value of the agreements but on the prior year budget which was overrun. Finally, emergency malware support, which can be provided by multiple vendors, was included on the Sole Source List. Internal Audit recommended that actual budgeted amounts be reflected on the Sole Source List. For services that can be performed by multiple vendors, Internal Audit recommended that the budget package provide an explanation and justification for using the selected vendors. F&A agreed and will show the actual budgeted amount for software and hardware maintenance when the Sole Source List is presented to the Board for approval. F&A will also develop a budget justification for emergency malware support and include it in the budget package.

The Position Control Policy (Policy) and the annual budget indicate that the Board approves positions at the job family level; however, the Policy also allows positions to be filled outside of the job family, which appears to conflict with the former statement. In addition, the Policy allows positions to be dual-filled by two employees with Chief Executive Officer (CEO) approval; however, Internal Audit found that both instances of dual-filling lacked CEO approval. Further, the requirement to borrow a budgeted vacant position when allowing a dual-fill was eliminated, thereby creating the possibility that the total number of employees could exceed the Board-approved number. Finally, an allowed practice is to over-fill a position by borrowing an under-fill or vacancy of another position, but this practice appears contrary to the policy which states that positions must be filled at or below the budgeted level. Internal Audit recommended that management clarify the Policy with regard to Board-approved positions and develop procedures and controls to ensure compliance with the Policy. HROD responded that the Policy will be revised to clarify the approval process and require Board approval for any additions to Director-level executive headcount. Procedures will be reviewed to ensure the total number of employees does not exceed the Board-approved number. In addition, CEO approval will be obtained for recruitments that will result in a dual-fill.

***Summary***

Based on the audit, controls over the budget development, monitoring, and reporting processes are generally adequate; however, four recommendations were made to enhance and expand written procedures, to adhere to the Policy, and to improve estimates and explanations included with the Sole Source List.

***Attachment***

- A. Budget Development, Monitoring, and Reporting, Internal Audit Report No. 16-509

**Prepared by:**

*Serena K. Ng*

Serena Ng  
Senior Manager  
714-560-5938

**Approved by:**

*Janet Sutter*

Janet Sutter  
Executive Director, Internal Audit  
714-560-5591

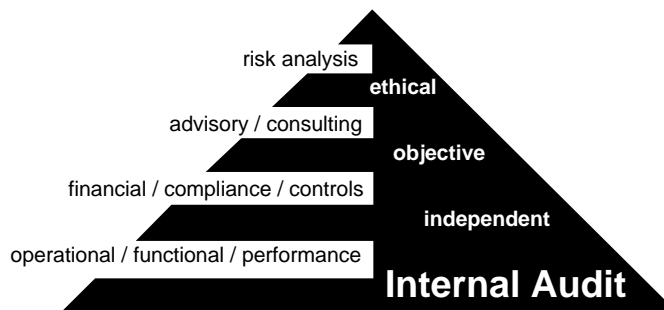
# ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



## Budget Development, Monitoring, and Reporting

### Internal Audit Report No. 16-509

February 15, 2017 (Revised)



**Performed by:** Serena Ng, CPA, Senior Manager  
Janet Sutter, CIA, Executive Director

**Distributed to:** Andrew Oftelie, Executive Director, Finance and Administration  
Maggie McJilton, Executive Director, Human Resources &  
Organizational Development  
Sean Murdock, Bill Mao, Victor Velasquez, Lloyd Sullivan

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## **Conclusion**

The Internal Audit Department (Internal Audit) has completed an audit of budget development, monitoring, and reporting. Based on the audit, controls are generally adequate; however, recommendations were made to enhance and expand written procedures, to improve controls over salary grade changes, to adhere to the Position Control Policy (Policy), and to improve estimates and explanations included with the Licensing and Maintenance Agreements Sole Source List (Sole Source List).

## **Background**

Every year, the Orange County Transportation Authority (OCTA) develops its staffing, operating, and capital plans for the upcoming fiscal year (FY). The product of this effort is an approved FY budget. The budget outlines the expected funding sources and expenditures that represent OCTA's year-long commitment to transportation projects and services. In FY 2016-17, the combination of revenues and planned use of prior year designations produced available funding of \$1,161.5 million, while expenditures and designations yielded use of funds for that same amount.

The budget preparation is a seven month-process. Financial Planning and Analysis (FP&A) staff inputs budget assumptions for sales tax, salaries, and benefits, as well as information on grants and non-project related revenues into the BUDBAR system. FP&A hosts six budget user training classes and provides support to user departments during the budget line item entry process. Analysts review all budget requests and host various meetings with project managers as necessary. FP&A staff meets with the Budget Review Committee (BRC), comprised of the Deputy Chief Executive Officer, Executive Director (ED) of Finance and Administration, and ED of Human Resources and Organizational Development, on approximately 12 different occasions to present the proposed budget. Meetings are conducted with the BRC and ED's of each division as necessary. The BRC's recommendations are presented to the Chief Executive Officer (CEO) and workshops are held with executive management and the Board of Directors (Board). FP&A staff attends all OCTA committee meetings between the time of the Board budget workshop and the public hearing to ensure that all questions and concerns are addressed.

During budget development, the Board approves staff positions at the job family level, such as Accountant, which includes Associate, Senior, and Principal Accountant levels. Positions can be filled at or below the salary grade reflected in the budget, following analysis by Human Resources (HR). In addition, according to the Policy, positions listed in the budget can also be filled outside of the job family as long as the filled position is at or below the salary grade budgeted.

In conjunction with approving the budget, the Board approves the Sole Source List and the Personnel and Salary Resolution (P&SR). The Sole Source List contains software

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and hardware licensing and maintenance agreements that are executed with developers on a sole source basis. The P&SR provides the general policies regarding employment practices, employee benefits, compensation, and salary structure for administrative employees. The FY 2016-17 P&SR included changes in salary grades for multiple classifications, along with a statement that the changes resulted from a compensation study conducted by consultants (Arthur J. Gallagher & Company).

On a quarterly basis, FP&A staff reviews OCTA's budget in order to ensure that the budget is being expensed as dictated by the annual budget. FP&A prepares and submits quarterly budget status reports to the Finance and Administration (F&A) Committee and the Board. The reporting is presented by programs: General Fund; Measure M2; Transit; 91 Express Lanes; and Commuter and Urban Rail Endowment.



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## **Objectives, Scope, and Methodology**

The objectives were to assess the adequacy and effectiveness of controls over the development, monitoring, and reporting of the annual OCTA budget.

The scope included review of the budget development, transfer, and monitoring functions and position controls. The scope also included review of the Sole Source List and the P&SR presented in the Board budget package for FY 2016-17.

The methodology included review of controls over preparation of the annual budget, with testing of selected key budget assumptions for FY 2016-17. Controls over monitoring and quarterly reporting of the annual budget were also reviewed, with testing to ensure that all quarterly budget status reports were submitted to the Board for FY 2014-15 and FY 2015-16. Internal Audit reviewed budget transfers, including testing of a judgmental sample of 25 budget transfers for proper approval and posting. The sample was selected to ensure even coverage throughout the period with an emphasis toward higher-dollar budget transfers. Controls over position control were also reviewed, with testing of a judgmental sample of ten employees hired from July 1, 2015 through September 30, 2016, with a bias toward employees that were hired under a dual-fill arrangement. Internal Audit also reviewed controls over the preparation of the Sole Source List, including a comparison of Sole Source List amounts to budgeted amounts for FY 2016-17. Finally, controls over the preparation of the P&SR were reviewed, with reconciliation of grade changes in the FY 2016-17 P&SR to the compensation classification study report and supporting schedules. For all judgmental samples, any conclusions are limited to the sample items tested since sampling is non-statistical.

We conducted this performance audit 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 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**

### **Budget Guidelines and Procedures**

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FP&A maintains written budget policies and a budget calendar; however, procedures outlining how salary and benefit budget assumptions are developed have not been documented. In addition, Internal Audit identified some salary and benefit budget assumptions that appear to overstate budget expenditures. For example, the budget assumed a 12 percent increase in health care for administrative and Transportation Communications International Union (TCU) employees in 2017 based on a health care broker's estimate, however, costs actually increased only 2.1 percent in 2017, 6.5 percent in 2016, and 0.1 percent in 2015. Likewise, the 3 percent budgeted vacancy for administrative, maintenance, and TCU employees is lower than the 4.5 to 6.5 percent actually experienced over the last few years. Finally, the budget was not adjusted to reflect actual coach operator salary rates, which were finalized before the budget was presented to the Board for adoption.

In addition, FP&A utilizes a budget transfer form that identifies required approval levels; however, there are no written procedures for budget transfers. Internal Audit identified one transfer approved by an individual below the required authority level, as well as two atypical transfers (e.g. a correction to account coding and the establishment of a new fund) that lacked required approvals.

Finally, written procedures for budget to actual reporting include requirements to investigate variances in individual projects exceeding a set threshold; however, Internal Audit identified several projects where variances exceeded the threshold and there was no evidence of investigation. For a few projects with overall expense underruns, the underrun was not investigated while a few minor off-setting overruns were analyzed. In addition, Internal Audit identified a few errors in the project analysis reports, as well as in the quarterly budget status reports where management summarizes significant variances at the program-level and reports them to the Board.

#### **Recommendation 1:**

Internal Audit recommends that procedures be developed and documented for the budget development and transfer processes. Such procedures should include requirements to re-evaluate and document salary and benefit budget assumptions and establish specific approvals for different budget transfer types. Management should also ensure project variances exceeding the threshold are investigated in accordance with the budget to actual reporting procedures, or alternatively clarify the investigation requirements in such procedures.

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**Management Response (Finance and Administration):**

As part of the annual budget development process, management maintains a detailed calendar and re-evaluates and documents all salary and benefit budget assumptions. These assumptions are documented in the budget system, BUDBAR, and summarized at an object level. Management agrees with the recommendation and will re-evaluate and document all salary and benefit budget assumptions at a lower level of detail. The assumptions will continue to be documented within BUDBAR and will be written in a manner that can be easily followed without the need of a budget team member's explanation.

The budget transfer process is handled via a module within the BUDBAR system and provides automated warning messages to obtain manager verification for all proposed budget transfers. The intent of the warning messages is to ensure all proposed budget transfers have the proper authorization. In addition, all budget transfer forms require specific approvals dependent on the type of transfer being requested, i.e. internal to a department within a major object category or cross-divisional/department transfer, etc. These specific approvals are outlined on the bottom of all transfer forms. All budget transfers require the signature of the budget manager and grant manager when grant funds are impacted. Management agrees with the recommendation and has already added an additional approval requiring an explanation for special circumstances as well as the approval of the Director of Finance and Administration. This addition will enhance the already established specific approvals for different budget transfer types.

Budget-to-actual reporting procedures are also reviewed on an annual basis to ensure important programmatic variances are reported to the Board. Management agrees with the recommendation and will ensure project variances exceeding the threshold continue to be investigated in accordance with the budget to actual reporting procedures, and will clarify investigation requirements in such procedures.

### **Inconsistent and Unsupported Salary Grade Changes**

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As part of the budget package, the Board approved the P&SR for FY 2016-17, which included upgrades to 53 job classifications that were attributed to a consultant-prepared compensation study issued in January 2015. Following concerns expressed by executive management and the CEO, most of the planned actions were suspended pending further review and analysis.

The consultant's final report, referred to with the P&SR changes, did not include a listing of grade change recommendations, as indicated in the Board package. Rather, upon inquiry, HR staff asserted that the recommendations were based on schedules provided by the consultant outside of the final report; however, these schedules did not reconcile to either the final report or the recommendations made in the P&SR. HR staff then

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indicated that final recommendations also considered input from discussions with management; however, documentation of these discussions also did not support all recommendations.

The lack of supporting documentation justifying final recommendations raises issues of consistency and equity. For example, some surveyed positions that appear below market were not recommended for upgrade, while other positions that did not appear below market, or were not surveyed, were included in the P&SR upgrade recommendations.

**Recommendation 2:**

Internal Audit recommends that HR implement procedures to ensure that changes to salary grade levels are based on reasonable and consistent methodologies and that documentation is maintained. Changes should also be communicated to management prior to seeking Board approval.

**Management Response (Human Resources & Organizational Development):**

HR management will ensure that P&SR changes are communicated to management prior to seeking Board approval. During the budget process, salary grade level changes to the P&SR will be presented to the Executive Steering Committee prior to Board approval.

Current documentation methods for classification salary grade changes will be reviewed to determine the best practice for documenting these actions.

HR is in the process of obtaining a compensation and market salary data system. This system will be utilized to enhance data collection, consistency, and documentation.

**Position Control and Dual Filling of Positions**

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The Policy, as well as the annual budget document, includes procedures that appear to conflict. The Policy and the budget document indicate that the Board "...approves positions at the job family level..." however, the same Policy allows those positions to be "...filled outside of the job family..." In practice, staff can be promoted prior to the annual budget approval of the promoted position by using a vacant position in another job family with the same grade level. In addition, positions that are no longer needed can be converted, rather than eliminated, and used to add staff in other areas without requiring Board approval. Typically, additional positions and eliminated positions are highlighted in the Board package; however, because the Policy allows positions to be filled outside the Board-approved job family, a converted position would not be reflected.

In addition, under the Policy, a position may be filled by two employees (i.e. dual-filled) under extreme circumstances or to address impending employee retirements, with

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approval of the CEO. In the past, a budgeted vacant position would have to be borrowed; however, this requirement was eliminated in FY 2016-17. The ability to dual-fill a position without borrowing another budgeted position increases the risk that the total number of employees at a certain time can exceed the Board-approved number. Further, Internal Audit noted that both instances of a position being dual-filled lacked evidence of CEO approval, as required.

Internal Audit also identified instances whereby positions were over-filled (i.e. filled above the budgeted salary grade level) by borrowing an under-fill or vacancy of another position; however, this practice appears contrary to the Policy which states that positions must be filled "...at or below the budgeted level."

**Recommendation 3:**

Internal Audit recommends that management clarify the Policy with regard to Board-approved positions, develop procedures to ensure that the total number of employees does not exceed the Board-approved number, and obtain CEO approval for dual-filled positions. Additionally, Internal Audit recommends that management develop controls to ensure compliance with the Policy.

**Management Response (Human Resources & Organizational Development):**

The Policy will be revised to clarify the approval process by the Board, including authorization of the total employee headcount and associated salary and benefit costs. In addition, the Policy will require Board approval for any additions to Director-level executive headcount.

Procedures will be reviewed to ensure the total number of employees does not exceed the Board-approved number. In addition, CEO approval will be obtained for recruitments that will result in a dual-fill.

**Sole Source List**

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As part of the budget package, the Board approves software and hardware licensing and maintenance agreements which are executed on a sole source basis. The budget package includes a Sole Source List that identifies the vendor, software/hardware product, and proposed budget; however, the proposed budget amounts on the Sole Source List exceed the actual amounts budgeted for most items. In addition, Information Systems Technical Services' maintenance budget is not based on the estimated value of the agreements but on the prior year budget that was overrun. Finally, emergency malware support, which can be provided by multiple vendors, is included on the Sole Source List.

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**Recommendation 4:**

Internal Audit recommends that actual budgeted amounts be shown on the Sole Source List. For services that could be performed by multiple vendors, Internal Audit recommends that the budget package provide an explanation and justification for using the selected vendors.

**Management Response (Finance and Administration):**

Management agrees with Internal Audit's recommendation and will show the actual budgeted amount for software and hardware maintenance when the Sole Source List is presented to the Board for approval. Management will also develop a budget justification for emergency malware support in the budget package.