



February 17, 2010

To: Finance and Administration Committee

From: Will Kempton, Chief Executive Officer

Subject: Review of Metrolink Audit Activities

Overview

The Internal Audit Department of the Orange County Transportation Authority has completed a review of the audit activities of the Southern California Regional Rail Authority. The review was conducted in response to a recommendation made during the Orange County Transportation Authority's fiscal year 2004-06 state triennial audit. Recommendations have been made to enhance the internal audit function at the Southern California Regional Rail Authority and management has indicated that they will be implemented.

Recommendation

Receive and file Review of Metrolink Audit Activities, Internal Audit Report No. 08-010.

Background

In September 2006, the Orange County Transportation Authority (OCTA) engaged an independent consultant to perform a state-mandated triennial performance review of OCTA, the Orange County Transit District, and the Laguna Beach Municipal Transit Lines. In April 2007, the consultant issued its review reports which included 38 recommendations for improvements to OCTA operations.

Among the recommendations was one that suggested that, as a member agency of the Southern California Regional Rail Authority (Metrolink), OCTA conduct periodic audits of Metrolink operations. In response, OCTA's Internal Audit Department (OCTA Internal Audit) proposed an initial evaluation of the audit activities of Metrolink.

Discussion

The purpose of conducting a review of the audit activities of Metrolink was to assess the level of audit activity, review the internal audit function's compliance with applicable professional standards, and evaluate the need for the inclusion of Metrolink operations in future OCTA annual internal audit plans.

In conducting this review, OCTA Internal Audit relied on publicly available audit reports, audit status reports, Board of Directors (Board) and Board committee agendas and minutes, and inquiries and discussions with Metrolink staff.

OCTA Internal Audit noted that the independence of Metrolink's internal audit function could be improved. Through inquiry with Metrolink staff and review of the results of audits performed by Metrolink's contract audit firm, OCTA Internal Audit observed that Metrolink staff have input into the scope and procedures performed by the contract audit firm. An outsourced audit function creates greater reliance by auditors on the expertise and knowledge of the staff who oversee the programs under audit. As such, OCTA Internal Audit recommended that the Safety and Operational Oversight Committee (Committee) of Metrolink's Board, acting as Metrolink's audit committee, create a stronger firewall between staff and auditors through revisions to Metrolink's audit charter. Metrolink agreed with the recommendation and will modify its audit charter and procedures accordingly.

OCTA Internal Audit also observed that audits performed by Metrolink's on-call audit firms are not provided to the Committee or Board. These audits generally consist of contract audits or price and cost reviews. Through review of these reports, OCTA Internal Audit noted that the reports include financial claims and recommendations for improvements to Metrolink operations. OCTA Internal Audit recommended that all audit reports, regardless of audit contractor, be provided to the Committee and Board. Metrolink agreed and will provide all audits, with the exception of price reviews, to the Committee and Board.

Through review of a 2003 Metrolink audit risk assessment, OCTA Internal Audit determined that the Metrolink's internal audit function was obtaining only limited coverage of business processes identified as high risk. Furthermore, professional audit standards require that the risk assessment be updated annually, which has not been the case. OCTA Internal Audit recommended that a comprehensive risk assessment be conducted annually and that limited internal audit resources be directed toward those operations considered high risk. Management agreed, indicating that a risk assessment and audit plan is under development and is expected to be completed by April 2010.

Metrolink staff is charged with monitoring the status of internal audit findings and recommendations and closing them out when implemented. Professional standards require that follow-up procedures be independently performed and include testing and documentation. OCTA Internal Audit recommended that follow-up procedures be performed by Metrolink's contract auditors and that they be performed according to professional standards. Management indicated that policies will be developed to establish the protocols for follow-up of audit recommendations.

The final three recommendations are related to improvements in Metrolink's audit charter, its internal audit quality assurance program, and its internal audit policies and procedures. OCTA Internal Audit recommended that the Committee periodically review and update its audit charter, that staff and the Committee evaluate their contract audit firm for compliance with professional audit standards, and that core policies and procedures related to Metrolink's internal audit function be developed. Metrolink management agreed with all the recommendations and will revise its audit charter and policies and procedures.

OCTA Internal Audit recognized that this review was conducted during a period of organizational changes and while Metrolink is launching numerous safety initiatives and programs that stretch staff resources and availability. As such, OCTA Internal Audit is appreciative of the cooperation of Metrolink management and staff, and their resolve to make improvements to Metrolink's internal audit function.

Summary

OCTA Internal Audit has completed a review of the audit activities of Metrolink. Based on the review, OCTA Internal Audit has offered recommendations for improving the internal audit function of Metrolink and ensuring its compliance with Government Auditing Standards. Metrolink management provided responses, indicating that all would be implemented.

Attachment

- A. Review of Metrolink Audit Activities, Internal Audit Report No. 08-010 dated February 5, 2010.

Approved by:

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

Kathleen M. O'Connell
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Orange County Transportation Authority Internal Audit Department



Review of Metrolink Audit Activities

INTERNAL AUDIT REPORT NO. 08-010

February 5, 2010



Internal Audit Team:

Kathleen M. O'Connell, CPA, Internal Audit Manager
Ricco Bonelli, Senior Internal Auditor

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Conclusion

The Internal Audit Department of the Orange County Transportation Authority (OCTA Internal Audit) has completed a review of audit activities of the Southern California Regional Rail Authority (Metrolink or SCRRA). The review was conducted in response to an OCTA state triennial audit recommendation that OCTA, as a member agency in a six county Joint Powers Agreement (JPA), audit Metrolink activities. Rather than conducting audits of Metrolink, OCTA Internal Audit proposed an initial evaluation of the audit function of Metrolink.

Based on this review, OCTA Internal Audit determined that Metrolink established an internal audit function in 1998. The Metrolink Board of Directors (Board) has adopted an internal audit charter, established an audit committee, contracted with an external firm to perform independent audits, and implemented procedures over reporting and communication of audit results.

Despite a formally established audit function, Metrolink's audit activities have been limited. OCTA Internal Audit noted only four audit engagements were completed by Metrolink's internal audit contractor between April 2004 and November 2009. Numerous other audits, primarily contract close out audits, have been performed by other on-call contract auditors at the direction of Metrolink staff; however, these audit reports have not been provided to the Board or audit committee.

In addition to the limited number of internal audits performed, it does not appear that Metrolink's audit function is obtaining adequate coverage of high-risk operations or business functions, as defined in a risk assessment conducted in November 2003. Furthermore, Metrolink's audit function requires improvement to be fully compliant with the International Standards for the Professional Practice of Internal Auditing (Standards) as required by its Internal Audit Charter (Charter).

During this review, OCTA Internal Audit observed areas where the audit function could be enhanced:

- Auditor Independence
- Audit Report Distribution
- Annual Risk Assessment and Audit Plan
- Audit Activity Monitoring and Follow-up Reviews
- Quality Assurance and Improvement Program
- Internal Audit Charter
- Policies and Procedures

As a party to the JPA establishing Metrolink, OCTA has no direct control over this separate and distinct legal entity. In addition, the JPA only requires that Metrolink

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provide for an annual independent audit.¹ However, as a result of this review, OCTA's Internal Audit Department has concluded that OCTA is exposed to financial risks that are not addressed by Metrolink's internal audit function. Consequently, during the development of OCTA's annual audit plan, OCTA Internal Audit will consider several audits as they relate to Metrolink. In particular, OCTA Internal Audit will include all OCTA cooperative agreements with Metrolink in the annual risk assessment, as well as a financial review of the revenue and expense allocations to OCTA by Metrolink.

OCTA Internal Audit has offered recommendations for Metrolink's consideration and Metrolink management has provided responses which are included herein. OCTA Internal Audit appreciates the assistance of Metrolink staff in conducting this review.

Background

Review Purpose

As a recipient of State Transportation Development Act funds, OCTA is required to have a performance audit conducted every three years. In the Fiscal Year 2004 through 2006 Triennial Performance Audit of OCTA, dated May 31, 2007, the consultant recommended "OCTA conduct periodic audits and reviews of Metrolink activities on a regular basis to assure integrity in the use of funds spent for rail services affecting Orange County." OCTA's management response indicated that OCTA Internal Audit would include a review of Metrolink's audit activities in its fiscal year 2007-08 Internal Audit Plan. The review would include an inventory of the audit activities of Metrolink and evaluate the reasonableness and comprehensiveness of those audit efforts.

Metrolink

In 1991, Metrolink, a Joint Powers Authority, consisting of five county transportation planning agencies, was formed to develop a regional transit service to reduce congestion on highways and improve mobility throughout the Southern California region. Metrolink's five-agency membership includes the Los Angeles County Metropolitan Transportation Authority, OCTA, the Riverside County Transportation Commission, the San Bernardino Associated Governments, and the Ventura County Transportation Commission. Metrolink operates an average of 149 weekday trains, serving 55 stations, and carries approximately 45,000 riders per day. OCTA's total operating contribution to Metrolink for fiscal year 2007-08 was \$14,176,000.

¹ Section 14.0 of the JPA states "The AUTHORITY shall provide for the accountability of all funds and shall provide for an annual independent audit."

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Metrolink Audits

Metrolink did not establish an internal audit function upon formation in 1991. On June 10, 1998, a Metrolink Peer Review Audit Group (Peer Group), consisting of financial officers and staff support from the five member agencies was established to perform a general review of Metrolink policies, practices, and procedures to ascertain whether the internal control environment and structure was appropriate for the evolving role of Metrolink. The Peer Group reviewed the following areas:

- a. Policies, Procedures and Internal Controls
- b. Personnel Management
- c. Finance/Treasury Functions
- d. Contracting Functions
- e. Risk Management Functions
- f. Performance Audit, Classification Study, and Management Study

In its report to Metrolink's Board, the Peer Group recommended the establishment of an internal audit function. In response to this recommendation, on June 11, 1999, the Metrolink Board awarded an internal audit contract to the public accounting firm of Ernst & Young, LLP. In December 1999, the Metrolink Board formally adopted Metrolink's Internal Audit Charter. The Charter defined the purpose, independence, authority, scope, and reporting of Metrolink's Internal Audit function. The Charter's purpose states "reviews performed by Internal Audit will comply with the *Code of Ethics* and the [International] *Standards for the Professional Practice of Internal Audit*." See Metrolink's Charter at Appendix A.

Since June 11, 1999, Metrolink's internal audit function has been out-sourced to an external firm (Internal Audit Firm). The Internal Audit Firm reports to the Safety and Operational Oversight Committee that serves as Metrolink's audit committee. Metrolink's Controller is designated as the day-to-day staff coordinator for internal audit matters. Metrolink's Internal Audit Firm submits audit reports to the Safety and Operational Oversight Committee and the Metrolink Board.

The Safety and Operational Oversight Committee is responsible for overseeing Metrolink's operational and financial performance. This includes review of internal and external audit reports and oversight of management's corrective action. Metrolink staff provides updates of the results of audits to members of the Safety and Operational Oversight Committee and Metrolink's Board using Audit Activity Status Reports (Status Reports).

In addition to the Internal Audit Firm, Metrolink has on-call contracts with audit firms for use on an ad-hoc basis. Staff has the ability to solicit assistance from these auditors to address emerging issues or problems staff has identified, to conduct audits of contracts or inventory, and to perform other routine audit activities like price and cost reviews.

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Metrolink Audit Status Reports

Status Reports are presented to the Safety and Operational Oversight Committee and the Board of Directors about once every three months and list unresolved findings of recent audits, including all externally mandated audits. In addition to the findings, the Status Reports document the Internal Audit Firm's recommendations, responses provided by Metrolink's management, and the implementation status of management's corrective actions. As findings are satisfactorily resolved and implemented, they are removed from the Status Report. The Status Report also provides notification of upcoming audits as well as the status of audits in progress.

Management Audit Committee

In addition to the audit committee responsibilities of the Safety and Operational Oversight Committee, Metrolink staff has established an Engineering & Construction Audit Committee to deal with contract audit issues. The committee meets quarterly and is comprised of the assistant executive officers, as well as staff from the capital programs, engineering, and procurement and accounting departments.

Risk Assessment

In November 2003, then Internal Audit Firm Thompson, Cobb, Bazilio and Associates, PC (TCBA) submitted a risk assessment of Metrolink's business processes/functions by major functional area to the Safety and Operational Oversight Committee. This risk assessment listed 17 business processes that were determined by TCBA to warrant high-level risk status. The following functions/processes were identified:

- Railroad Services
- Program Control
- Contract Administration & Procurement
- Materials Management
- Information Systems
- Signal & Communication Contract Management
- Maintenance of Way
- Public Projects
- Grants Development & Administration
- Accounts Payable/Invoice Processing
- Payroll & Timekeeping
- Fixed Asset & Inventory Control Management
- Grant Accounting
- Recollectables
- Financial Reporting
- Employee Relations
- Project Management

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This list, which was presented to Metrolink in no specific priority order, was utilized in the selection of audits to be performed by the Internal Audit Firm. According to Metrolink staff, the internal audits selected were based on this initial risk assessment along with input from Metrolink management and Board members. See Appendix B for the Risk Assessment of Significant Key Business Processes, prepared by TCBA.

Internal Audits

OCTA Internal Audit has identified the following audit reports submitted by Metrolink's Internal Audit Firm since April 2004:

<u>Title of Audit Report</u>	<u>Report Issued</u>	<u>Findings</u>
Fare Collection Services	July 2006	6
Grants Management & Administration	October 2005	2
Project and Program Controls	August 2005	6
Cash Receipts and Accounts Receivable	April 2004	4

Detailed information concerning each audit performed by Metrolink's Internal Audit Firm can be found at Appendix C. An inventory of Metrolink's on-call audits can be found at Appendix D: Summary of On-Call Audit Results.

Review Objectives, Scope and Methodology

The objective of this review was to evaluate Metrolink's internal audit activities including its annual audit planning process, the nature, frequency, and results of audits performed, and the reporting and follow-up of audit findings and recommendations.

The review scope considers Metrolink audit activities from April 2004 to November 2009.

The review methodology included obtaining an understanding of Metrolink's internal audit function and activities. Through interviews with Metrolink and OCTA staff and review of documents and reports, we gained an understanding of Metrolink's audit process, the selection and performance of internal audits, and the communication of audit results. OCTA Internal Audit also reviewed all Status Reports and Audit Reports submitted to Metrolink's Board and its Safety and Operational Oversight Committee since April of 2004.

This review was conducted in accordance with generally accepted government auditing standards, except for the triennial peer review requirement, which has not yet been fulfilled. Those standards require that OCTA Internal Audit plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on audit objectives. OCTA Internal Audit believes that the evidence obtained provides a reasonable basis for these findings and conclusions based on the audit objectives.

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Compliance with these standards relates to the work performed by OCTA Internal Audit in assessing the internal audit activities of Metrolink and does not intend to, and does not, constitute an audit of Metrolink's financial condition, results of operations, or system of internal controls. Furthermore, because OCTA has no governance responsibilities for Metrolink, management responses to recommendations provided herein will not be assessed for accuracy, adequacy, or implementation.

In performing this review, OCTA Internal Audit relied on Metrolink documents, reports, and Board and Committee minutes. As these records were unaudited, their accuracy or completeness could have a material effect on the findings and conclusions contained herein.

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Review Observations and Recommendations

Acknowledgements

OCTA Internal Audit recognizes that this review was conducted during a period of organizational change at Metrolink and while the organization was launching numerous safety initiatives and programs that stretched staff resources and availability. Some of the initiatives and programs cited by management include the installation of inward-facing cameras, grade crossing safety enhancements, and the implementation of a public safety program, including the establishment of an independent Commuter Rail Safety Review Panel. Metrolink is also moving forward with the installation of automatic train stop technology at speed sensitive locations and is operating under a strategy to accelerate the implementation of Positive Train Control three years ahead of a federal mandate.

Management also expressed their commitment to improved internal controls, with plans to augment contractor oversight, safety and compliance staff. Management also indicated that it is conducting workshops with staff to train them on proper controls over contract management.

Despite competing priorities, Metrolink management committed valuable time and assistance to OCTA Internal Audit during this review. Furthermore, as demonstrated in management's responses to the recommendations below, Metrolink has committed to implementing all proposed recommendations for its internal audit function in a timely manner and concurrently with on-going safety enhancement initiatives.

Auditor Independence

As discussed in the Background section, Metrolink outsources its internal audit function to a contractor (Internal Audit Firm). According to Metrolink's Audit Charter, internal audit reports functionally to the Safety and Operational Oversight Committee (Committee) and the Board of Directors (Board). Presumably, this means that only administrative functions related to the contract with the Internal Audit Firm will be handled by Metrolink staff.

However, Metrolink staff is involved in directing the work of the Internal Audit Firm. This has resulted, in part, from staff's disappointment in the performance of the Internal Audit Firm. Staff indicated that the Internal Audit Firm required advice on program risks, audit scope, audit procedures, and findings and recommendations.

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While it appears that this direction from staff is well intentioned and resulted in increased scrutiny of the performance of the Internal Audit Firm, staff direction or involvement in audit scope and procedures jeopardizes the independence of the internal audit function.

Recommendation 1:

OCTA's Internal Audit Department recommends that the Metrolink Internal Audit Charter be revised to specifically address the administrative support that Metrolink staff may provide the Internal Audit Firm. Furthermore, the Audit Charter should incorporate a periodic evaluation of audit contractors by the Committee and Board. Such a mechanism would allow Metrolink staff, the Committee, and the Board to provide input into the performance of audit contractors, thus preserving auditor independence. A formalized performance evaluation process for the Internal Audit Firm would also ensure that performance issues with an audit contractor are elevated and addressed in a timely manner. The American Institute of Certified Public Accountants (AICPA) and the Government Finance Officers Association (GFOA) are two professional organizations that provide "best practice" tools and templates for a thorough evaluation of audit firms.

Some of the problems staff encountered with the Internal Audit Firm related to the audit firm's lack of familiarity with the industry, the Metrolink organization and its projects and programs. This leaves a contract audit firm heavily reliant on the very staff whose functions it audits. While it is strictly a matter of Board policy, OCTA's Internal Audit Department recommends that Metrolink consider an in-house internal auditor to improve the quality of internal audit work.

Management Response to Recommendation 1:

Metrolink management concurs with this recommendation. The involvement of Metrolink staff in the internal audit process, at times, has been required when staff has the knowledge necessary to assist and impart information to the auditors that they might find beneficial during their audit process; information they may not have been able to gain otherwise. While it was never staff's intent to hinder auditor independence, internal audit policies will incorporate proper follow up procedures when the results of an audit contradict what is known to staff or other parties regarding Agency's business processes or practices. As part of best practice recommendations, management will incorporate into internal audit policies and the auditor charter procedures for the receipt, retention or treatment of concerns regarding accounting, internal controls, or auditing matters. Such procedures will specifically provide for the confidential, anonymous submission by employees regarding questionable business practices and accounting or auditing matters. The audit committee also should monitor controls performed directly by senior management, as well as controls designed to prevent or detect senior management override of other controls. Metrolink's audit charter, to be revised no later

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than June 30, 2010, will help govern the internal audit process effectively and efficiently whether it's done in-house or by an external third party.

Audit Report Distribution

In addition to the Internal Audit Firm, Metrolink engages on-call audit firms for use on an ad-hoc basis. Management may solicit assistance from these auditors to address emerging issues or problems staff have identified, to conduct audits of contracts or inventory, or to perform other routine audit activities like pre-award price and cost reviews. A summary of audit reports reviewed by OCTA Internal Audit may be found at Appendix D.

OCTA Internal Audit noted that many of these audit reports include findings that result in financial claims against contractors. In fact, on-call auditors questioned costs of over \$2.6 million in the reports reviewed by OCTA Internal Audit. They also include findings related to contractors' compliance with other contract terms. For example, there were several instances where contractors had billed for unapproved subcontractors. OCTA Internal Audit also noted an instance where a contractor had not carried the appropriate amount of insurance, as required by the contract.

OCTA Internal Audit also noted findings and recommendations related to Metrolink's system of internal control. For example, an audit performed of Contract C3078-05 included recommendations related to Metrolink's approval of contract payment vouchers and compliance checklists. The same audit report suggested that Metrolink needs to improve controls over progress payment verifications.

Audit reports and communications from these on-call audit firms are not currently provided to the Committee or Board.

Recommendation 2:

OCTA's Internal Audit Department recommends that Metrolink's Audit Charter be revised to require that all audit or review reports or communications, regardless of auditor or audit contract, be provided to the Committee and Board, with the exception, perhaps, of reviews of price and cost proposals. This distribution will ensure that all audit recommendations are evaluated as to significance by the Committee and Board, that they are tracked, that corrective action is taken and that the implementation of recommendations is validated. Furthermore, OCTA Internal Audit recommends that Metrolink staff advise the Committee and Board of the status of each of the recommendations identified in Appendix D, and any other audits reports prepared during that period or since.

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Management Response to Recommendation 2:

Metrolink management concurs with this recommendation. All audits, with the exception of price reviews, will be presented to the Safety and Operational Oversight Committee for review and approval. Additionally, staff will advise the Committee and the Board of the status of each of the recommendations identified in Appendix D. In an effort to mitigate risk to the Agency and properly address any operational deficiencies, several years ago Metrolink staff formed an ad-hoc audit committee that is comprised of Directors, Managers and other staff of the Agency. The primary goal was to address audit issues as they arose from various on-call audit activities. On-call audit activities consist of contract close out audits, interim audits, and operational audits and other audits or reviews as deemed necessary or required. During the start-up phase of the audit committee, meetings were conducted monthly to assess the status of completed and pending audits and provide guidance and resolution to management and staff. Staff-conducted audit committee meetings continue to be held on a quarterly basis in order to address audit issues, mitigate risk to the Agency, and ensure compliance of staff with proper business practices.

Annual Risk Assessment, Audit Plan, and Audit Activities

Metrolink's Internal Audit Charter requires that all reviews be conducted in compliance with the [International] Standards for the Professional Practice of Internal Audits (Standards). These Standards, commonly referred to as the "Red Book," are issued by the Institute of Internal Auditors and are one of two sets of standards with which government auditors generally comply. The Standards require that the organization establish risk-based plans to determine the priorities of the internal audit function, consistent with the organization's goals. The internal audit function's plan of engagements must be based on a documented risk assessment, undertaken at least annually.

Metrolink does not develop an annual risk based audit plan. In November 2003, Metrolink's Internal Audit Firm submitted a "Risk Assessment of Significant Key Business Processes" (Risk Assessment) to Metrolink's Safety and Operational Oversight Committee. The Risk Assessment identified 17 business processes/functions assessed as high-risk. OCTA Internal Audit noted that the Risk Assessment did not adequately define or describe Metrolink's 48 business processes/functions or the 13 risk factors utilized and that it has not been updated since its development in 2003.

OCTA Internal Audit identified four audit reports issued by Metrolink's Internal Audit Firm between 2003 and 2009. Two of the audits performed relate to business processes/functions identified as high-risk in the Risk Assessment; however, the other two relate to business processes/functions identified as medium risk in the Risk Assessment. Furthermore, both the Fare Collection Services audit and the Grants

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Management & Administration audit appear to be repeats of prior audits performed three to six years earlier.

Based on OCTA Internal Audit's review of the Risk Assessment and the four audit reports issued since 2004, it appears that Metrolink's audit function is obtaining limited coverage of its operations or those business functions considered high-risk. It also appears that there is little correlation between the risk assessment and audits performed.

Recommendation 3:

Because Metrolink's Internal Audit Charter requires compliance with the Standards for the Professional Practice of Internal Audit, OCTA's Internal Audit Department recommends that Metrolink require an annual risk assessment and internal audit plan. The methodology used to conduct the risk assessment should be explained and the business processes or functions sufficiently detailed. Risk factors should also be defined.

Risk-based audit plans establish the priorities of an entity's internal audit function. To help ensure adequate audit coverage, the timing and results of prior audits should be considered when assessing risk. Additionally, priority of audits should be directed toward business functions/processes evaluated as high-risk to ensure efficient use of limited internal audit resources.

Management Response to Recommendation 3:

Metrolink management concurs with this recommendation. Metrolink's current internal auditors from Macias Consulting Group are in the process of developing a comprehensive risk assessment and internal audit plan. They anticipate completing this process and presenting their assessment to the Safety and Operational Oversight Committee April 2010. Upon review and approval by the Safety and Operational Oversight Committee the internal auditors will begin the internal audit process on Metrolink's highest risk areas. On an annual basis the internal auditors, in accordance with Standards for the Professional Practice of Internal Audit and the Metrolink Audit Charter, will update the risk assessment and audit plan to ensure that areas of high risk are constantly being reviewed and audited. This will enable Metrolink Board of Directors and management to mitigate areas of high risk through the development of new practices or enhanced policies and procedures.

Audit Activity Monitoring and Follow-up Reviews

Metrolink monitors the disposition of audit report findings and recommendations. On a quarterly basis, the Metrolink Board of Directors (Board) and its Safety and Operational Oversight Committee (Committee) members receive a Status Report, which includes

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unresolved findings of recent audits and the status of Metrolink management's corrective action. The report includes an estimated month of completion for each open item and notifies the Board and Committee of ongoing and upcoming audits, including external audits and state/federal mandated audits.

It does not appear, however, that specific follow-up procedures are performed to evaluate whether management's corrective action has been effectively implemented. Follow-up is a process by which internal auditors evaluate the adequacy, effectiveness, and timeliness of actions taken by management on reported observations and recommendations, including those made by external auditors. Follow-up procedures must be evidenced by documentation demonstrating the procedures performed, results of procedures, and conclusions reached.

Metrolink management provides the status updates for the corrective action plans noted in the Status Reports, but there does not appear to be independent evaluation performed by Metrolink's Internal Audit Firm to corroborate management's status update. OCTA Internal Audit observed that both the Fare Collection Services (2006) audit report and the Grants Management & Administration (2005) audit report, performed by Thompson, Cobb, Bazillo & Associates, included follow-up testing on previously reported audit findings; however, the time elapsed between the original audits and subsequent audits was approximately six years and three years, respectively.

Recommendation 4:

OCTA Internal Audit recommends that Metrolink conduct follow-up reviews in a timely manner and that these follow-ups be conducted in accordance with the same professional standards as other audit work. Specifically, follow-up procedures should be independently performed. Metrolink's Internal Audit Firm should conduct the follow up, rather than staff. Policies and procedures establishing when a follow-up must be initiated and the protocols, documentation, and close-out process should also be developed.

Management Response to Recommendation 4:

Metrolink management concurs with this recommendation. It is staff's goal to continue to update the audit status activity report given to the Committee on a monthly basis and the Board quarterly. Follow up audits, to be conducted six months after the issuance of an audit report, and every six months thereafter until all recommendations have been satisfactorily addressed, will include an update memo and periodic close out memorandums to management and the Safety and Operational Oversight Committee. An internal audit policy will be developed no later than June 30, 2010, that will establish protocols for audit procedures and appropriate follow up.

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Internal Audit Charter

In December 1999, the Metrolink Board of Directors formally adopted Metrolink's Charter. Metrolink's Charter defines the purpose, independence, authority, scope, and reporting requirements of Metrolink's internal audit function. During OCTA Internal Audit's review of Metrolink Board and Safety and Operational Oversight Committee agenda meetings, we noted that the Charter has not been reaffirmed. According to the Standards, the Charter should be periodically reviewed and presented to senior management and the Board for affirmation.

The Charter's purpose states, "All reviews comply with the Code of Ethics and the [International] Standards for the Professional Practice of Internal Audit;" however, none of the audit reports submitted by the Internal Audit Firm indicate compliance with either the Code of Ethics or the Standards. Compliance with the Standards should be disclosed in the audit report, if applicable. For non-compliant engagements, the audit report should disclose which Standard(s) was/were not met as well as the reason and impact of non-compliance on the engagement.

Recommendation 5:

OCTA Internal Audit recommends that Metrolink update its Audit Charter and provide it to the Committee and Board for approval. The Audit Charter itself should establish the requirement that it be periodically reviewed, updated and approved.

Metrolink's Internal Audit Firm should also be advised of the requirement that it conduct its audits or reviews in compliance with the Code of Ethics and Red Book Standards, and that it cite compliance therewith in its reports.

Management Response to Recommendation 5:

Metrolink management concurs with this recommendation. The audit charter, to be updated no later than June 30, 2010, will incorporate the requirement that Metrolink's internal audit firm conduct its audits or reviews in compliance with the applicable Government Auditing Standards and professional Code of Ethics, and that it cite compliance therewith in its reports. Metrolink will present the updated internal audit policies and charter to the Safety and Operational Oversight Committee and the Board of Directors and seek approval no later than June 30, 2010.

Quality Assurance and Improvement Program

Metrolink does not have a Quality Assurance and Improvement (QA) Program as required by the Standards. A QA Program is designed to evaluate the internal audit function's compliance with the Standards and the Code of Ethics. A QA Program also

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assesses the efficiency and effectiveness of internal audit activity and identifies opportunities for improvement.

Using an independent audit firm as the internal auditor for an organization relieves the organization of some, but not all, of the requirements of a QA Program. For example, the organization need not conduct an evaluation of the internal auditors' compliance with the Standards as long as the organization verifies that the audit firm has a QA Program in place and it is operating effectively. This is accomplished by obtaining and reviewing the results of the firm's periodic "peer review".

An organization that outsources its internal audit function must evaluate and document an assessment of the audit firm's independence periodically. Audit firms that become too reliant on fees from certain clients may compromise their independence and objectivity, in either fact or appearance.

Recommendation 6:

OCTA Internal Audit recommends that Metrolink establish policies and procedures for its Quality Assurance Program. Among other things, the policies and procedures should include a periodic review of the Internal Audit Firm's "peer review" report. The policies and procedures should include action Metrolink should take when peer review findings indicate a lack of compliance by the Internal Audit Firm to the Standards. Metrolink's policies and procedures for a Quality Assurance Program should also include a periodic evaluation of the Internal Audit Firm's independence.

Management Response to Recommendation 6:

Metrolink management concurs with this recommendation. Management will develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity. A quality assurance and improvement program is designed to enable an evaluation of the internal audit activity's conformance with the definition of Internal Auditing and the Standards and an evaluation of whether internal auditors apply the Code of Ethics. The program will also assesses the efficiency and effectiveness of the internal audit activity and identify opportunities for improvement. The quality assurance and improvement program will include both internal and external assessments. The quality assurance and improvement will be developed in conjunction with the internal audit policies and audit charter.

Policies and Procedures

The Standards require that organizations develop policies and procedures to guide the internal audit function. The form and content of written policies and procedures should

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be appropriate to the size and structure of the internal audit activity and the complexity of its work.

In situations where the internal audit function is out-sourced, detailed policies and procedures for the performance of audits and reviews are obviously unnecessary. However, several other considerations are relevant:

- Internal Audit Firm Selection, Evaluation, Retention and Dismissal
- Reporting and Communication Requirements
- Protocols and Requirements for Adjustments to the Annual Internal Audit Plan
- Audit Records - Access and Retention
- Evaluation of Impairments, Including Those Caused by Non-Audit Services
- Confidentiality Requirements
- Responsibilities with Regard to Fraud, Illegal Acts, and Violations of Provisions of Contracts, Grant Agreements, and Waste or Abuse Investigations

Recommendation 7:

OCTA Internal Audit recommends that Metrolink develop core policies and procedures to govern the Internal Audit function, including some of the considerations identified above.

Management Response to Recommendation 7:

Metrolink management concurs with this recommendation. Since Metrolink outsources its internal audit function, management will incorporate the relevant considerations listed as they relate to the outsourced internal audit function. A complete set of internal audit policies and procedures, updated audit charter, and quality assurance program will be available no later than June 30, 2010.

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Appendix A: Metrolink's Internal Audit Charter

ITEM 6

DECEMBER 3, 1999

TO: MEMBERS AND ALTERNATES - 12/10 MEETING

FROM: CHIEF EXECUTIVE OFFICER

SUBJECT: INTERNAL AUDIT CHARTER

Member Agencies:
Los Angeles County
Metropolitan Transportation
Authority
Orange County
Transportation Authority
Riverside County
Transportation Commission
San Bernardino
Associated Governments
Ventura County
Transportation Commission
Ex Officio Members:
Southern California
Association of Governments
San Diego Association
of Governments
State of California

ISSUE

The Audit Committee (Committee), at its September 24, 1999 meeting, formally adopted an Internal Audit Charter, which must be approved by the SCRRA Board.

RECOMMENDATION

The Committee recommends the SCRRA Board approve the adoption of the Internal Audit Charter.

BACKGROUND

As a result of the Audit Peer Group report issued in September 1998, the Committee recommended (to the Board) the establishment of an internal audit function within SCRRA. On June 11, 1999, the Board awarded the Internal Audit contract to Ernst & Young LLP, which signified the official start of the internal audit function within SCRRA.

To assist both the Audit Committee and the Internal Auditor in discharging their respective duties, at its September 24, 1999 meeting the Committee adopted an Internal Audit Charter. At its November 19, 1999 meeting, the Committee revised the original Internal Audit Charter to include recommendations of legal counsel (See Attachment A).

Highlights of the Internal Audit Charter are:

1. Purpose - The Charter defines the purpose of Internal Audit to review the Authority's operations as a service to management and the Board of Directors.
2. Independence - The Charter specifies that Internal Audit is an independent appraisal function that examines and evaluates activities within the Authority. Internal Audit must maintain an independent and objective mental attitude and therefore, cannot have direct authority over any operation or activity it may review.

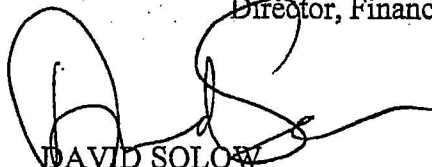
3. Authority – Except for confidential files or files that are attorney/client work product, privileged, the Charter gives Internal Audit unlimited access to all authority activities, records, property and employees.
4. Scope - The Charter defines the scope of Internal Audit as examining and evaluating the adequacy and effectiveness of the Authority's system of internal control and the quality of performance in carrying out assigned responsibilities.
5. Reporting - The Charter specifies that the Internal Auditor reports functionally to the Committee and to the Board. The Charter requires reporting of significant findings to Senior Management and the Audit Committee. Management is responsible for taking action on audit recommendations, and internal audit will report quarterly to the Audit Committee on the status of these actions.

In summary, the Internal Audit Charter gives the Internal Audit function the authority necessary to carryout its responsibilities to the Committee and to the Board.

BUDGET IMPACT

There is no budget impact.

Prepared by: Paul Sakamoto
Director, Finance


DAVID SOLOW
Chief Executive Officer

ATTACHMENT A

SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY INTERNAL AUDIT CHARTER

This Charter defines the purpose, authority, scope and reporting requirements of Internal Audit.

Purpose

Internal Audit independently reviews the SCRRA's operations as a service to Management and the Audit Committee on behalf of the Board of Directors. All reviews comply with the *Code of Ethics* and the *Standards for the Professional Practice of Internal Audit*.

AUTHORITY and SCOPE

The Internal Audit is an independent appraisal function established by the SCRRA Board of Directors to examine and evaluate the activities within the organization. It reports functionally to the Audit Committee and to the SCRRA Board of Directors. This reporting relationship ensures independence, promotes comprehensive audits and assures audit recommendations get proper consideration. The Internal Auditor has a duty to the Board of Directors to notify the Audit Committee regarding any irregularity or suspicion of irregularity.

Except for confidential personnel files or files that are attorney/client work product privileged, Internal Auditors will have unlimited access to all authority activities, records, property, and employees. Access may be considered and approved upon written justification or be determined by recommendation of the Committee and directions from the Board with advice of counsel. Limitations of scope must be reported immediately to the Audit Committee and the Chief Executive Officer.

The scope of internal auditing will encompass the examination and evaluation of the adequacy and effectiveness of the authority's system of internal control and the quality of performance in carrying out assigned responsibilities. Internal Audit will:

- Review the reliability and integrity of financial and operation information and the means used to identify, measure, classify and report such information.
- Review the established systems to ensure compliance with policies, plans, procedures, laws, regulations, and contracts.
- Review the means of safeguarding assets and verify existence of such assets, as appropriate.
- Appraise the economy and efficiency with which resources are employed.
- Review operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried as planned.

Internal Audit must maintain an independent and objective mental attitude. Therefore, it cannot have direct authority over any operation or activity it may review. Designing, installing, or operating systems, policies, procedures, and standards are not audit functions. Performing such activities impairs objectivity and independence. However, reviewing procedures and controls as they are designed into manual or automated systems is appropriate.

Reviews by Internal Audit do not relieve Management of their responsibilities. It is the responsibility of management to ensure that proper controls are in place and policies and procedures are being followed.

REPORTING

Internal auditors will meet with Audit Committee at least quarterly. Management will respond, in writing, to Internal Audit's finding and recommendations within 10 working days of being presented with them. Such responses must include the actions Management will take to comply with the findings and a timetable for completing them. When Management disagrees with a recommendation, an explanation must be given regarding the disagreement by Management, and a description of the compensating controls must be provided. An alternative recommendation may be proposed by management. Internal Audit will issue a draft report, including Management's responses to the Management of the area reviewed. If Internal Audit does not receive a response from Management within the 10 working day period, the draft report will be issued indicating Management did not respond. A final report will be issued after appropriate Management review.

Internal Audit will report significant outstanding findings to Senior Management and to the Audit Committee. Management must update Internal Audit, in writing, on the status of any outstanding findings. Management is responsible for taking action on audit recommendations. Internal Audit will report quarterly to the audit committee on the status of these actions.

All findings are issued to Senior Management and the Audit Committee.

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Appendix B: Risk Assessment of Significant Key Business Processes

THOMPSON, COBB, BAZILIO & ASSOCIATES, PC
Certified Public Accountants and Management, Systems and Financial Consultants

Main Office:

1101 15th Street, N.W.
 Suite 400
 Washington, DC 20005
 (202) 737-3300
 (202) 737-2684 Fax

Regional Office:

100 Pearl Street
 14th Floor
 Hartford, CT 06103
 (860) 249-7246
 (860) 275-6504 Fax

Regional Office:

21250 Hawthorne Boulevard
 5th Floor
 Torrance, CA 90503
 (310) 792-7001
 (310) 792-7004 Fax

November 4, 2003

Mr. Ron Roberts, Chairman, Operational Oversight Committee
 Southern California Regional Railroad Authority
 700 South Flower Street, Suite 2600
 Los Angeles, CA 90017-4101

Re: Risk Assessment of SCRRA Business Processes/Functions

Dear Mr. Roberts:

Thompson, Cobb, Bazilio & Associates, PC (TCBA) is pleased to present the attached risk assessment of SCRRA's business processes/functions by major functional area. Please note that a high-level risk designation should not be construed as an indication that specific problems or internal control weaknesses have been identified, but rather that a potential for high-level risk exists. A high-level risk assessment means that the potential of a significant loss in terms of dollars, productivity and/or efficiency are high if the business process is not adequately controlled or designed.

The major functional areas and applicable managerial responsibility are as follows:

DivisionDirector/Manager

Equipment	Bill Lydon
Support Services	Steve Wylie
Engineering & Construction	Mike McGinley
Communications & Development	Steve Lantz
Finance	Mark Dubeau
Operations	John Kerins
Human Resources	Irene Shapiro

This risk assessment is based in part upon interviews with the seven SCRRA Directors/Managers listed above. We also interviewed the following six SCRRA Directors/Managers to obtain their input and views on SCRRA's business processes/functions that they believe are of high risk:

<u>Division</u>	<u>Director/Manager</u>
Grants Administration	Joanna Capelle
Railroad Services	Bruce Ferguson
Safety	Fred Jackson
Contracts Admin. & Procurement	Cheryl Johns
Public Projects	Ron Mathieu
Engineering & Construction	Harold Watson

Coupled with the input we received from the interviews with the 13 SCRRA Directors/Managers above, we also assessed each business process/function using the 13 risk factors listed in the attached risk assessment analysis. Each of the 13 risk factors was rated as low, medium, or high for each business process/function. An overall risk assessment of low, medium or high was then assigned to each business process/function based on the majority of the ratings assigned to the 13 risk factors assessed.

Based on TCBA's risk assessment approach discussed above, we have identified the following 17 SCRRA business processes/functions that we believe warrant a high-level risk assessment at this time. The listing below is in no specific priority order.

1. Railroad Services
2. Program Control
3. Contract Administration & Procurement
4. Materials Management
5. Information Systems
6. Signal & Communication Contract Management
7. Maintenance of Way
8. Public Projects
9. Grants Development & Administration
10. Accounts Payable/Invoice Processing
11. Payroll & Timekeeping
12. Fixed Asset & Inventory Control Management
13. Grant Accounting
14. Recollectables
15. Financial Reporting
16. Employee Relations
17. Project Management

The matrices by functional area detailing the 17 high-level risk processes and the factors or reasons contributing to this high-risk assessment are attached.

Mr. Ron Roberts
November 4, 2003
Page 3

After SCRRA management's review and concurrence of this risk assessment, TCBA will then prepare an internal audit work plan that will identify the internal audits to be performed over the next 18 months.

If you have any questions, please feel free to contact me at 310-792-7001.

Respectfully,

A handwritten signature in black ink, appearing to read "Michael J. de Castro", written over a horizontal line.

Michael J. de Castro
Principal

Cc: Mr. Bill Alexander, Chairman, Board of Directors

RISK ASSESSMENT OF SIGNIFICANT KEY BUSINESS PROCESSES

Prepared by Thompson, Cobb, Bazilio, and Associates

[illegible]

RISK ASSESSMENT OF SIGNIFICANT KEY BUSINESS PROCESSES

Prepared by Thompson, Cobb, Bazilio, and Associates

[illegible]

RISK ASSESSMENT OF SIGNIFICANT KEY BUSINESS PROCESSES

Prepared by Thompson, Cobb, Bazilio, and Associates

[illegible]

RISK ASSESSMENT OF SIGNIFICANT KEY BUSINESS PROCESSES

Prepared by Thompson, Cobb, Bazilio, and Associates

[illegible]

RISK ASSESSMENT OF SIGNIFICANT KEY BUSINESS PROCESSES

Prepared by Thompson, Cobb, Bazilio, and Associates

Risk Factors		Overall Risk Assessment												
SCRRRA Business Processes/ Functions (DUBEAU) FINANCE	Size of Unit or Resources Affected/Controlled	Known Internal Control Weaknesses	Management's Concerns and Attitudes About Process	Elapsed Time Since Last Audit or Review	Outdated and/or Unwritten Procedures	Complexity of Operation on Decision-making	Vacant positions or Known Staffing Shortages	Poor Alignment of Organization responsibilities	Dependence on Or by Others for Information or Outputs	Recent or Pending Changes in systems or procedures	Extent of reliance on Computerized Data	Visibility and Effect on Reputation	Extent Regulated and Impact of Non-compliance	
Cash & Fund Management	H	L	M	M	H	M	H	L	H	L	H	M	L	Medium
Accounts Payable/Invoice Processing	H	L	H	L	H	H	H	M	H	H	H	H	M	HIGH
Accounts Receivable	H	L	M	L	M	M	H	L	H	H	H	M	L	Medium
Payroll & Timekeeping	H	L	H	M	M	M	M	L	H	H	H	H	H	HIGH
Fixed Asset & Inventory Control Management	H	M	H	M	H	H	M	L	H	H	H	M	H	HIGH
Fare Collection Services Administration	H	L	H	L	M	M	M	M	M	H	M	H	L	Medium
Grant Accounting	H	M	H	L	H	M	M	M	H	H	H	H	H	HIGH
Recollectables	H	M	H	M	H	M	M	M	H	H	H	H	M	HIGH
Financial Reporting	H	L	H	L	H	H	M	L	H	H	H	H	H	HIGH
Budgets	H	L	M	L	M	M	L	L	H	H	H	H	M	Medium

RISK ASSESSMENT OF SIGNIFICANT KEY BUSINESS PROCESSES

Prepared by Thompson, Cobb, Bazilio, and Associates

[illegible]

RISK ASSESSMENT OF SIGNIFICANT KEY BUSINESS PROCESSES

Prepared by Thompson, Cobb, Bazilio, and Associates

[illegible]

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Review of Metrolink Audit Activities
February 5, 2010**

Appendix C: Summary of Internal Audit Findings and Recommendations

Review of Metrolink Audit Activities **Summary of Internal Audit Findings and Recommendations** **April 2004 - August 2008**

Audit (Date)	Audit Firm	Findings/Observations	Recommendation
Fare Collection Services (July 2006)	TCBA	SCRRRA lacks a comprehensive set of policies and procedures for the Fare Collection Services (FCS) area.	FCS management should complete the documentation of their management processes and procedures in formal written format. The development of policies and procedures has been, and continues to be, an important activity of SCRRRA.
		Annual physical inventory records did not include an inventory of cash boxes, bill vaults, bucos, and coin drums maintained at their site. This equipment is not inventoried and reconciled on a periodic basis.	Implementation of the new Fare Collection inventory system should be accompanied by a thorough inventory recount of all Fare Collection equipment. Procedures should be developed to corroborate the inventory information.
		The credit card refund process would be strengthened if the Passenger Services Department required a supervisory signature for approval of refunds. Also, we found that Passenger Services does not research transaction numbers of all refund requests.	Refund decisions by Passenger Services require review and approval by an additional official within that Department and 2) Transaction numbers for all refund requests should be researched and matched to data found in the CMS database.
		Controls over cash at Union Station were generally adequate, but could be improved by ensuring that cash deposits are made on a daily basis. We also found that security procedures governing the dual combination safes located at the Union Station ticket offices could be improved.	Ticket agents should prepare and submit cash deposits daily as part of the comprehensive cash collection control procedures. Additionally, dual combination locks on safes located at the Union Station ticket offices should be changed to ensure that the safes could be opened only with a SCRRRA representative's combination and L.A. Federal guard combination.
		L.A. Federal prepares reports daily for FCS and the Finance Department. The accuracy over information contained in the reports prepared by L. A. Federal could be improved if that information was periodically verified to system-generated data.	We recommend that SCRRRA verify on a periodic basis the amount of currency and coin that should have been collected as shown in the Deposit by TVM Report and the BUCOs Installed/Removed Report to the source data on the Money and Change Cards Reports.
		Controls over the charge-back process could be strengthened if the investigator's findings required a second or supervisory review before they are sent to the credit card company. Additionally, since credit card refund and charge-back processes are performed by separate departments, there exists the risk that both a refund and charge-back could be issued for the same transaction.	We recommend that 1) investigation decisions by FCS should require review and approval by an additional official within that Department to assure that decisions are reasonable and consistent, and 2) the Passenger Services Department and FCS should develop formal procedures for exchanging credit card refund and charge back data to reduce or eliminate the risk of refunding an individual twice for the same transaction.
		Project control policies and procedures for Railroad Services and the procedures for the review of engineering and construction management invoices within the Engineering & Construction Department are not documented, nor do any written manuals or desk procedures exist.	Recommend that SCRRRA management complete the development of written policies and procedures for project control functions.

Review of Metrolink Audit Activities **Summary of Internal Audit Findings and Recommendations** **April 2004 - August 2008**

Audit (Date)	Audit Firm	Findings/Observations	Recommendation
Project and Program Controls (August 2005)	TCBA	<p>Expenditure data for SCRRRA's operating and capital project activity is not being entered into the Oracle System until after review and approval of contractor invoices, resulting in a delay of up to one month or more in recording the expenditure Despite an established contractual requirement requiring that all contractors submit invoices directly to Accounts Payable, we found that this requirement is neither being adhered to nor enforced by SCRRRA management.</p> <p>Only one individual is responsible for the recording, review, and approval of invoice coding for various SCRRRA contracts under the control of the Railroad Services Division. The current flow of the invoice review process results in the coding of invoices after the project manager's review. This internal control weakness could result in the charging of project costs to the wrong funding source going undetected, resulting in the potential of disallowed costs or loss of State and Federal funding.</p> <p>We found that not all project managers were notified or aware of costs charged against their respective project budgets. We also noted certain project managers have found that retroactive cost adjustments were made to their project budgets without their prior knowledge and/or approval.</p> <p>Noted that the Request for Proposal form was used infrequently to initiate an Engineering CTO. Not using the RFP form is a violation of internal procurement policy as outlined in the Engineering Department's own Design Procedures Manual. Without this documentation on file, Federal and State auditors could question and disallow all costs associated with a CTO.</p> <p>There are no formal criteria or detailed procedures in existence detailing how Estimates-at-Completion for SCRRRA capital projects should be prepared. Consequently, in the absence of formal procedures, the resulting effect is Estimates-at-Completion that do not accurately include all costs and the expected time projection for those costs.</p>	<p>Recommend that SCRRRA management enforce the requirement that all contractors submit invoices directly to Accounts Payable. Also recommend that upon receipt of an invoice by Accounts Payable, expenditure data should be entered into the Oracle System and established as an accrual.</p> <p>We recommend that contractors be instructed as to the proper coding of invoices and forward coded invoices directly to Accounts Payable for prompt recording (accrual) into the Oracle financial system. When a contract, purchase order, CTO or other authorization to perform work is issued, detailed invoice coding instructions should be provided to the contractors. Project managers should then be responsible for review and approval of the invoices as to both proper coding and authorized costs.</p> <p>We recommend that the approval of the project manager responsible for funding and budget oversight of a project be required prior to processing CTO's. Procedures should also be implemented to ensure that all cost transfers and/or retroactive cost adjustments are made only after the written approval of the project manager whose project will be incurring the cost. In addition, journal entries for these project changes should only be processed with the appropriate supporting documentation such as an adjusted invoice.</p> <p>We recommend that engineering CTO's not be processed unless the Request for Proposal form has been properly prepared, reviewed, and authorized by the appropriate project manager.</p> <p>Since the time of our audit fieldwork, the Engineering Department has made improvements to the Estimates-at-Completion procedures by modifying their project management report summary format. We recommend that this report format be further improved by adding a column showing the anticipated value of future work to be authorized.</p>

Review of Metrolink Audit Activities
Summary of Internal Audit Findings and Recommendations
April 2004 - August 2008

Audit (Date)	Audit Firm	Findings/Observations	Recommendation
Grant Management & Administration (October 2005)	TCBA	Contracts Administration & Procurement (CA&P) department has difficulty obtaining timely grant information for use in procurements and contracting. This is particularly pertinent in cases where one contract might be necessary for more than one project. Since information on the Grant Summary Report is arranged by specific project titles, it is often difficult to obtain in these cases. Alternatively, CA&P must obtain required grant information details from project managers, and/or individuals in GRANTS and the Budget Division via e-mail and/or phone contact often resulting in conflicting information being disseminated.	We recommend that departments such as CA&P and others communicate their specific grant information needs to GRANTS for incorporation in the current report format or provide suggestions for development in alternative formats. We also recommend that GRANTS continue its outreach efforts throughout the organization to increase awareness as to the type of information available on the current report and how it can be more effectively utilized.
		During Invoice testing , Auditors noted the following: Supporting documentation (invoices) amounts did not match reimbursement billings to grantor agency; no evidence of payment authorization for invoices which exceeded authorized Contract Task Order (CTO) amounts; and lack of an audit trail for certain adjustments made to invoice payments.	We recommend that Finance should establish the practice of maintaining duplicate copies of the supporting documentation for State invoices for a period of at least one year. Also, in cases where an estimated invoice from a contractor is issued for purpose of verifying the actual quantities, the original invoice should always be adjusted to reflect the adjustments/changes that have occurred after review and approval of the invoice by Construction management. Furthermore, Finance should always ensure that all invoices are within the authorized CTO limits before processing for payment.
Cash Receipts and Accounts Receivable (April 2004)	TCBA	SCRRA should prepare and analyze the accounts aging report on a consistent basis.	Account receivables aging reports should be consistently prepared and generated on a monthly basis for management review and analysis and the appropriate follow-up of all past due receivables.
		SCRRA should document past due receivable follow-up and analysis	Follow-up action on all outstanding past due receivables should be adequately documented.
		SCRRA does not have formal procedures for writing off uncollectible accounts receivable.	SCRRA should establish procedures and approval requirements for the write-off of uncollectible receivables.
		SCRRA should establish a reserve for bad debt and write-off uncollectible receivables.	The June 30, 2003 account receivables balance for all categories needs to be reviewed for potential collection. Accounts deemed to be uncollectible should be reserved for bad debt and eventually written-off after all collection efforts are exhausted.

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Appendix D: Summary of On-Call Audit Results

**Review of Metrolink Audit Activities
Summary of On-Call Audit Results
January 2005 - April 2009**

Audit	Audit Type	Date	Audit Firm	Findings/Observations	Recommendations
Close-out Audit of Costs Claimed - Contract No. E0720C (STV, Inc.)	Close-out Audit	1/24/05	MHM	Contractor billed SCRRA excess overhead, excess subcontractor overhead, unauthorized subcontractor premium time, and other direct costs were not adequately supported.	Recover questioned costs of \$8,711.
Close-out Audit of Costs Claimed - Contract No. E0720B (Hanson-Wilson, Inc.)	Close-out Audit	2/1/05	MHM	Contractor billed SCRRA excess labor costs, excess labor overhead, unsupported subcontractor costs, and unapproved fixed fees.	Recover questioned costs of \$21,083.
Close-out Audit of Costs Claimed - Contract Number EO720A (Commuter Rail Engineering Team)	Close-out Audit	12/15/05	MHM	Questioned costs relate to excess labor costs, excess labor overhead, unsupported subcontractor costs, unsupported other direct costs, and unapproved fixed fees.	Recover questioned costs of \$96,971.
Close-out Audit of invoiced costs under Contract No. JO101-05. (Herzog Contracting Corporation, Inc.)	Close-out Audit	4/16/06	TCBA	Finding 1: Contractor did not meet all insurance requirements. Herzog could not provide an insurance certificate for Transportation Management Systems, Inc., a subcontractor responsible for miscellaneous trucking and hauling. Finding 2: Certified payroll records were not always attached to invoice. Five invoices totaling \$1,115,782 did not have certified payroll records attached as required by the contract.	Auditor provided no recommendations.
Review and recalculation of equipment rates and charges under Contract No. MS196-03. (Mass Electric Construction Company)	Contract Compliance Review	5/17/06	TCBA	Contractor was paid \$384,089 more than the amount allowed for equipment charges under the contract's equipment rental provisions.	Recover \$384,089 of overpaid equipment charges. SCRRA should establish, through a contract amendment, equitable overtime rates for certain specialty equipment items.
Review of Change Order No. 13, 14 and 15 under Contract No. C3079 (J.S. Meek Company)	Change Order Review	6/19/06	TCBA	Price negotiated for change orders No. 13, 14 and 15 was found to be fair and reasonable and adequately supported.	No recommendations provided.
Contract Compliance Review of Invoiced Costs (J. L. Patterson & Associates)	Contract Compliance Review	8/9/06	TCBA	Contractor's invoiced costs were reasonable, adequately supported, and in compliance with the terms of the Contract, except for \$64,848 in vehicle costs.	Seek reimbursement from the Contractor the amount of \$64,848 for over-billed vehicle costs.
Review of Change Order # 2 for Contract No. C3084-06 (Johnson Western Gunitite Company)	Change Order Review	8/17/06	TCBA	Contractor's proposed grout rate increase for quantities in excess of 25% of the contract schedule was not supported.	Grout costs should be paid at the stipulated contract rate of \$15.20 per bag resulting in a reduction of \$54,135 for Change Order # 2.
Review of Change Orders 16, 17 and 19 under Contract No. C3079 (J.S Meek Company, Inc.)	Change Order Review	8/31/06	TCBA	Review of supporting documents for three change orders resulted in questioned total of \$23,595.	Auditor provided no recommendations.

**Review of Metrolink Audit Activities
Summary of On-Call Audit Results
January 2005 - April 2009**

Audit	Audit Type	Date	Audit Firm	Findings/Observations	Recommendations
Close-out Audit of Invoiced Costs under Contract No. CM 100-01, Contract Task Orders 13, 15, 17, 20 and 26. (The Culver Group)	Close-out Audit	12/21/06	TCBA	Invoiced amounts included costs beyond the authorized period of performance, some invoiced labor charges were not supported by employee timesheets, amounts billed for 4 labor categories were not included in the contract, and 5% of the timesheets reviewed did not have supervisor approval.	Auditor questioned costs of \$68,500, representing work performed beyond the authorized task order period, unsupported labor, and labor categories and rates not stipulated in the contract.
Contract No. E730-05 Report on Agreed-Upon Procedures - Review of Direct Labor Rates	Cost/Price Analysis	3/6/07	MHM	Various adjustments to contractor and subcontractors relating to escalation and billing rates.	Recommendations are for contract negotiation only.
Analysis of Overhead Rates Contract No. E730-05	Cost/Price Analysis	4/17/07	MHM	Various adjustments to contractor and subcontractors relating to escalation and billing rates.	Recommendations are for contract negotiation only.
Closeout audit of invoiced costs under Contract No. C3086-06. (John S. Meek Company, Inc.)	Close-out Audit	6/18/07	TCBA	Invoiced costs were reasonable, allowable, allocable and in compliance with the terms of the contract.	SCRRA should comply with appropriate procedures in closing out the contract using the \$379,130 as the final contract value and releasing the retention amount of \$18,956 to the contractor.
Review of direct labor rates and equipment rate increases applicable to Contract Number MS148 for the period July 1, 2007 through June 30, 2008	Cost/Price Analysis	6/27/07	MHM	Various adjustments to Contractor's proposed labor and equipment rate increases.	Recommendations are for contract negotiation only.
Close-out audit of invoiced costs under Contract No. C3079-04. (John S. Meek Company, Inc.)	Close-out Audit	6/28/07	TCBA	<p>Finding 1: The retention portion, in an amount of \$220,322, remains to be paid. The Contractor did not invoice SCRRA for Change Order 12, but the Contractor did perform the work. Therefore, SCRRA owes the contractor \$9,897 for Change Order 12.</p> <p>Finding 2: Twelve of sixteen subcontractors used were not in accordance with the approved list in the contract. Seven of these twelve unapproved subcontractors had subcontract values that exceeded 1/2 % of the contract value and therefore required approval by SCRRA.</p>	<p>Recommendation 1: SCRRA should comply with appropriate procedures in closing out the contract using the \$4,416,339 as the final contract value and releasing the retention amount of \$220,322 plus \$9,897 for Change Order 12 for a total amount of \$230,219 to the contractor.</p> <p>Recommendation 2: SCRRA should improve its oversight of the contractor's use of subcontractors to ensure that subcontractors not on the approved list in the contract are properly approved prior to the subcontractor beginning work.</p>

**Review of Metrolink Audit Activities
Summary of On-Call Audit Results
January 2005 - April 2009**

Audit	Audit Type	Date	Audit Firm	Findings/Observations	Recommendations
Close-out Audit of Costs Claimed under Contract Number C3078-05. (J.A. Placek Construction Company, Inc.)	Close-out Audit	6/29/07	MHM	<p>Finding 1: Failure to properly complete and approve contract payment vouchers, invoice review and compliance checklists, and progress payment applications in accordance with SCRRA policies.</p> <p>Finding 2: Failure to complete and approve progress payment verification logs.</p>	<p>Recommendation 1: SCRRA should instruct all individuals in the processing of vendor invoices to comply with Policy Number 8.1, Invoice Processing and Accounts Payable Policy.</p> <p>Recommendation 2: The contractor serving in the capacity of Construction Manager on behalf of the SCRRA should ensure that all progress payment verification logs are completed and approved to properly support the percentage of completed tasks.</p>
Review of Change Order No. 16 (CN-87) under Contract No. C3074-6. (FCI Constructors, Inc.)	Change Order Review	10/26/07	TCBA	The Resident Engineer's Fair Cost Estimate of \$515,600 was reasonable, adequately supported and priced in accordance with contract terms.	Auditor recommended approval of the global settlement at \$550,000.
Close-out audit of invoiced costs under Contract No. C3074-06. (FCI Constructors, Inc.)	Close-out Audit	12/3/07	TCBA	A railroad crossing at Fairhaven and Lincoln Ave, as designed and constructed, creates a safety hazard for large trucks in the 18 wheeler 55 ton category, resulting in a temporarily closure of the railroad crossing.	SCRRA should assess whether or not the design contractor was at fault for the safety hazard at the Fairhaven railroad crossing and whether SCRRA should seek recovery of damages through the errors and omissions provisions of the design contractor's contract with SCRRA.
Pre-award cost / price analysis of RAM Industrial Services, Inc.	Cost/Price Analysis	2/22/08	KNL Support Services	Auditor recommended adjustments to contractor and subcontractor rates for direct labor, escalation, material costs, etc.	Recommendations are for contract negotiation only.
Close-out audit of invoiced costs under Job Orders 103-6 and 104-6. (Herzog Contracting Corp's)	Close-out Audit	3/5/08	TCBA	Invoiced fees under No. 103-6 and No. 104-6 were found reasonable, allowable, allocable and in compliance with the terms of the contract and the Federal Acquisition Regulations.	No recommendations provided
Interim close-out audit of costs invoiced under Contract No. OP120-03. (Bombardier Transportation)	Close-out Audit	5/28/08	TCBA	Audited overhead rates for years 2 through 5, computed in accordance with FAR 31.2, were less than the overhead rates billed to SCRRA by the contractor, resulting in an over-billing of \$798,131.	<p>Recommendation 1: SCRRA should seek reimbursement of the \$798,131 of overhead and G&A costs billed in excess of audited overhead and G&A rates for years 2 through 5 of the contract.</p> <p>Recommendation 2: SCRRA should establish a lower provisional overhead and G&A rate below the 14.2% contract ceiling percentage. The provisional rate should be the average of the audited overhead and G&A rates for years 1 through 5, which is approximately 11%.</p>

**Review of Metrolink Audit Activities
Summary of On-Call Audit Results
January 2005 - April 2009**

Audit	Audit Type	Date	Audit Firm	Findings/Observations	Recommendations
Contract close-out audit of invoiced fees under Contract No. MS146-00. (Herzog Contracting Corporation, Inc.)	Close-out Audit	2/9/09	TCBA	Invoiced fees were found reasonable, allowable, allocable and in compliance with the terms of the contract, except for \$2,357 of equipment rental costs overcharged.	SCRRA should seek reimbursement from the contractor in the amount of \$2,357 for the overcharged equipment rental charges on invoice number. 85.
Cost and price analysis of Change Order No. 005 under Contract No. C3092-08. (Lim & Nascimento Engineering Corp's)	Cost/Price Analysis	4/6/09	KNL Support Services	Based on the analysis, we took no exceptions to the increase to the original quantities and total contract price.	No recommendations provided.