



## Board Report

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### FINANCE, BUDGET AND AUDIT COMMITTEE JUNE 14, 2017

**SUBJECT: FY18 AUDIT PLAN**

**ACTION: ADOPT THE FY18 PROPOSED AUDIT PLAN**

#### **RECOMMENDATION**

ADOPT the FY18 Proposed Audit Plan.

#### **ISSUE**

At its January 2008 meeting, the Board adopted modifications to the FY07 Financial Stability Policy. The Financial Stability Policy requires Management Audit Services (Management Audit) to develop a risk assessment and an audit plan each year and present it to the Board. It also requires that the Finance, Budget and Audit Committee, as the audit committee for the agency, provide input and approval of the audit plan.

#### **DISCUSSION**

Instrumental to the development of the FY18 Audit Plan was completion of the FY17 agency-wide risk assessment. The agency-wide risk assessment is continually being refined and adjusted based upon events, issues identified during audits and agency priorities. The risk assessment continues to place a strong emphasis on the agency's internal control framework and vulnerability to fraud. We believe this year's risk assessment portrays the agency's risks in light of the changes to our risk environment and the challenges the agency faces in the next few years. The result is the FY18 Proposed Audit Plan (Attachment A).

This is the thirteenth year an audit plan has been developed and presented to the Board for input and adoption.

#### **Policy Implications**

An audit plan defines the work that will be completed or directed by Management Audit each fiscal year. It indicates both the depth and breadth of audit activities addressing financial, operational and compliance risks for the agency. The audit plan also identifies the extent to which controls are being assessed by routine audit activities, addressed proactively through advisory services, or as a result of

concerns from management.

The annual audit plan is driven by two key factors: (1) risk assessment results and (2) audit resources. The goal in drafting the audit plan is to address the highest risk areas at the agency given the resources available to complete the audits.

In developing the plan, the hours included for each audit are an estimate. There are occasions where some reviews may take longer and therefore absorb more hours than proposed and in other cases, the audit will be completed in fewer hours than estimated. In addition, urgent requests arise that need audit support. When this occurs, the plan must be reassessed and Management Audit may supplement internal resources with outside consultants as long as there is funding and consultants available for the task. Therefore, not all planned audit work may be completed and the audit plan may be reassessed and adjusted during the year for unanticipated risks and work.

### **DETERMINATION OF SAFETY IMPACT**

Approval of this item will not impact the safety of Metro patrons or employees.

### **FINANCIAL IMPACT**

Funding for the annual audit plan will be included in the FY18 budget in Management Audit and the appropriate projects throughout the agency.

### **ALTERNATIVES CONSIDERED**

One option would be not to complete an annual audit plan. This is not recommended since the audit plan is a management tool to systematically assign resources to areas that are a concern or high risk to the agency. Communicating the audit plan to the Board is required by audit standards.

### **NEXT STEPS**

Upon Board approval, Management Audit will develop the audit schedule for FY18. Management Audit will report to the Board quarterly on its progress in completing the annual audit plan.

### **ATTACHMENT**

A. FY18 Annual Business Plan and Proposed Audit Plan

Prepared by: Amanda Hall, Sr. Director, Audit, (213) 922-4554

Reviewed by: Diana Estrada, Chief Auditor, (213) 922-2161



Phillip A. Washington  
Chief Executive Officer

**FISCAL YEAR 2018  
ANNUAL BUSINESS PLAN  
AND  
PROPOSED AUDIT PLAN**



**Metro**

Management Audit Services

Fiscal Year 2018 Annual Business Plan  
And Proposed Audit Plan

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# Executive Summary

## OVERVIEW

Annually, the Board requires Management Audit Services (Management Audit) to complete an agency-wide risk assessment and submit an audit plan to the Board for its input and approval.

An agency-wide risk assessment is the process of understanding an organization's strategic, operational, compliance and financial objectives to identify and prioritize threats/risks that could inhibit successful completion of these objectives. Risk assessments provide management with meaningful information needed to understand factors that can negatively influence operations and outcomes.

An audit plan is driven by two key factors: 1) risk assessment results, and 2) audit resources. The goal of preparing an audit plan is to address the highest risk areas at the agency given the resources available to complete the audits.

## RISK ASSESSMENT

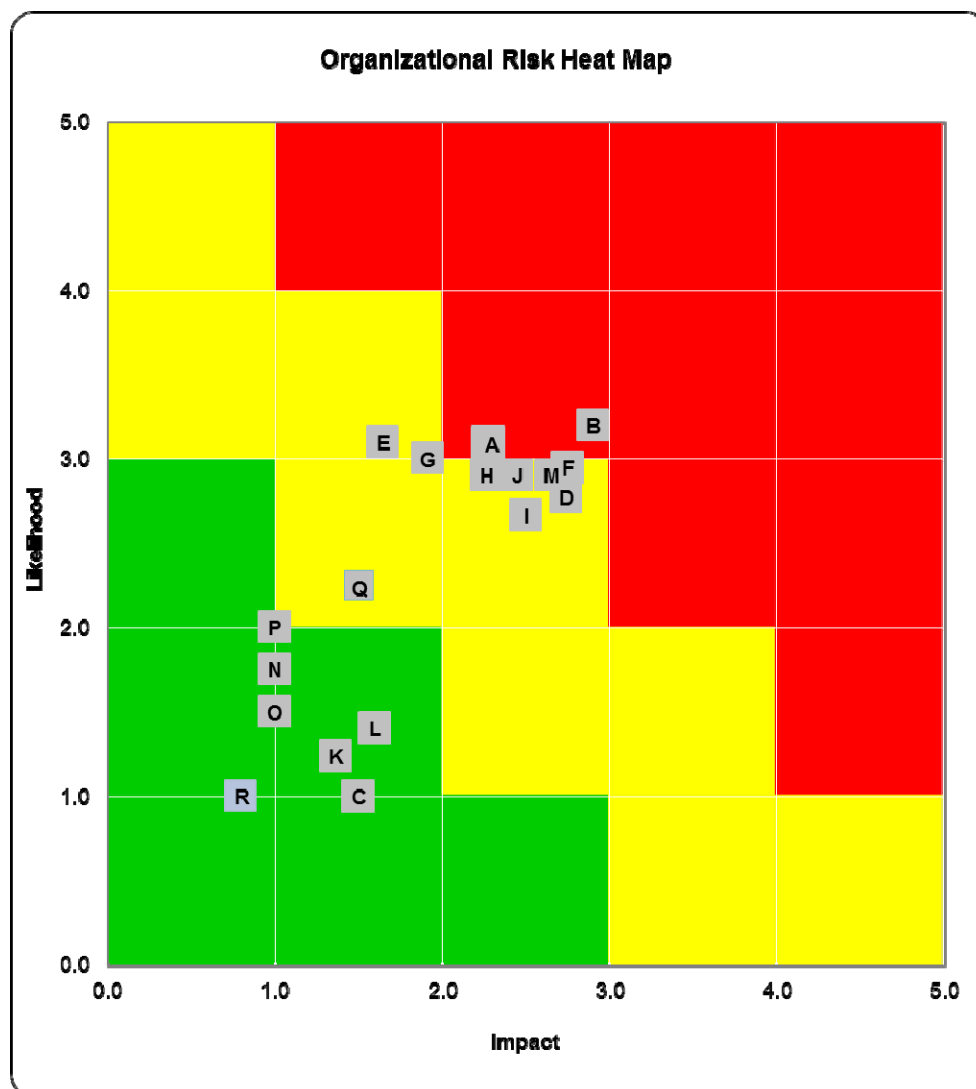
Instrumental to the development of the FY18 Audit Plan was completion of the FY17 agency-wide risk assessment. The agency-wide risk assessment is continually being refined and adjusted based upon events, issues identified during audits and agency priorities. The categorization of risks used corresponds with the current nine CEO initiatives identified in the Budget document:

1. Advance safety and security for our customers, the public, and Metro employees.
2. Exercise fiscal discipline to ensure financial stability.
3. Plan and deliver capital projects on time and on budget, while increasing opportunities for small business development and innovation.
4. Improve the customer experience and expand access to transportation options.
5. Increase transit use and ridership.
6. Implement an industry-leading state of good repair program.
7. Invest in workforce development.
8. Promote extraordinary innovation.
9. Contribute to the implementation of agencywide and departmental Affirmative Action and Equal Employment Opportunity (EEO) goals.

The risk assessment continues to place a strong emphasis on the agency's internal control framework and vulnerability to fraud. We believe this year's risk assessment portrays the agency's risks in light of the changes to our risk environment and the challenges the agency faces in the next few years.

The risk environment continues to evolve with the focus this year on safety and security, state of good repair, capital projects delivery, strategic financing alternatives, key information systems, and the agency's ability to achieve all of its goals successfully with available funding and staffing.

The agency-wide risk assessment process began by reviewing and analyzing key documents such as the annual budget, the Comprehensive Annual Financial Report (financial statements), Annual State of the Agency Address, Program Management Plan, Board/Committee Reports, status reports on major construction projects, and past audit reports. We conducted interviews with key personnel to obtain additional information. All of this information was used to identify risks and concerns specific to individual cost centers as well as risks impacting the entire agency. In addition, similar to last year we evaluated risks related to five outside agencies that receive significant funding from Metro: Access Services, Metrolink, High Speed Rail, Pasadena Foothill Extension Authority (Foothill), and Alameda Corridor East (ACE). Risks were then scored using two factors, magnitude of impact and likelihood of occurrence. As in prior years, a heat map is still being used to display the overall risk assessment of the agency.



A.	Labor/Employee Relations	J.	Information Technology
B.	Security & Law Enforcement	K.	Communications
C.	Congestion Reduction	L.	Extraordinary Innovation
D.	Vendor/Contract Management	M.	Metro Operations
E.	Civil Rights & EEO	O.	Alameda Corridor East
F.	Program Management	P.	Metrolink
G.	Planning & Development	Q.	Access Services
H.	Risk, Safety & Asset Mgmt.	R.	High Speed Rail
I.	Finance & Budget		

## High Risk Areas

The top internal risks include acquisition of qualified talent, aging infrastructure, safety and security, completion of multiple capital projects, lengthy procurement process, dated information systems, emergency preparedness, and fiscal discipline and fiscal responsibility and Access Services continues to be an external risk.

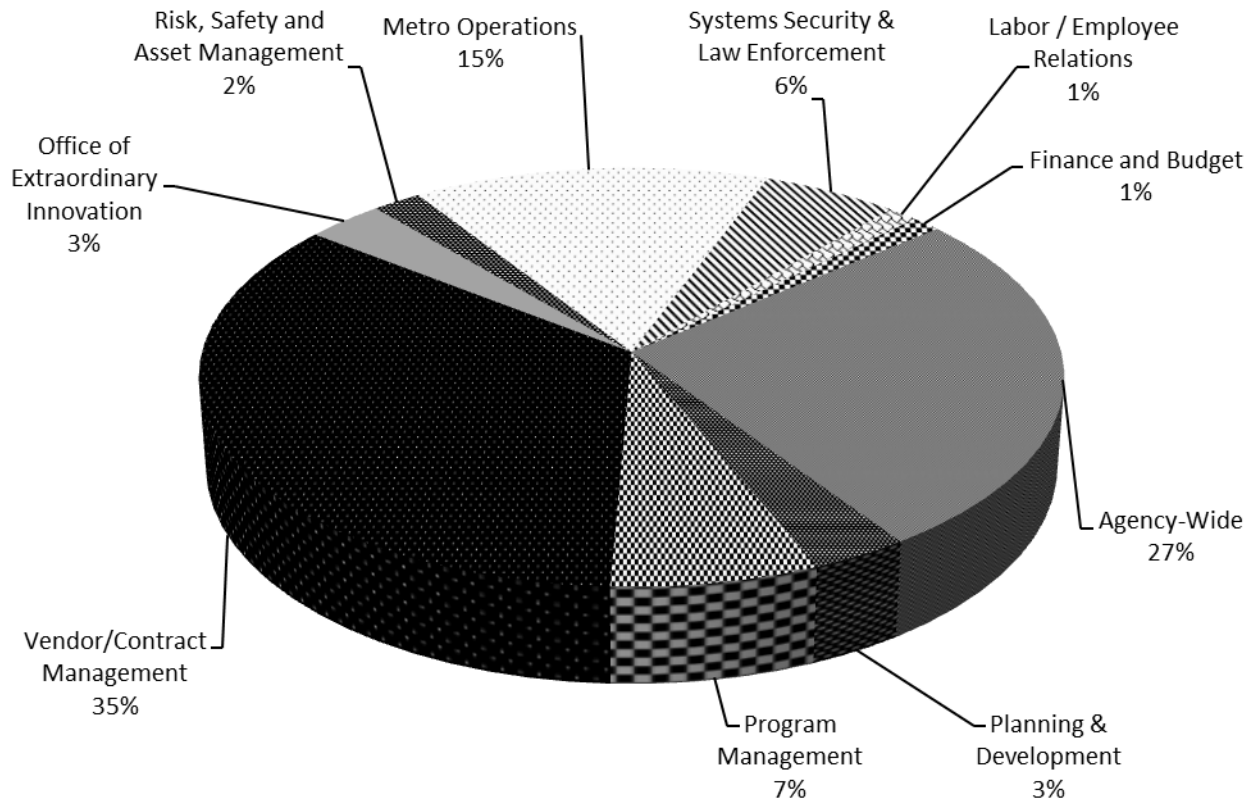
- 1) The ability to hire qualified technical and support staff and maintaining adequate staffing levels to complete projects, while improving overall performance, continues to be a pervasive concern throughout the Agency. The right number of staff with the right skillset is critical given the aging workforce and passage of Measure M. Management is addressing these concerns by shifting available resources to key risk areas, partnering with local institutions to provide specialized training, expanding the veteran hiring initiative, promoting internal and external leadership training opportunities, implementing the Workforce Initiative Now (WIN-LA) Program and continuing the entry level trainee program. Talent Acquisition is partnering with the various business units to come up with improvements to the overall hiring process.
- 2) Operations' overall risk score is impacted by aging infrastructure coupled with a significant amount of deferred maintenance that is being addressed but is still considered a risk to achieving some of the agency's key goals. Additionally, increased revenue service levels and other competing priorities such as technological upgrades and short and long-term maintenance work pose a challenge to operations' resources. Operations and the Transit Asset Management Department are now collaborating to assess the condition of equipment, rolling stock, infrastructure, and facilities in order to comply with FTA's state of good repair and MAP 21 certification.
- 3) Terrorism and other crimes continue to be potential threats to the Agency. Systems Security and Law Enforcement has started to implement innovative ways to use technology and partner with the Sheriff's Department, Los Angeles Police Department, Long Beach Police Department, and the community to secure high risk areas. In addition, Metro has begun to increase law enforcement visibility to improve safety and security and decrease fare evasion by hiring 77 additional Transit Security Officers.
- 4) Completion of multiple capital projects simultaneously on time within budget is still considered to be a risk due to various high inter-dependencies internally and externally. Effective planning and collaboration with external stakeholders is necessary to mitigate risks of delays and increased costs. Timely delivery of projects becomes even more critical if the 2024 Olympics take place in Los Angeles. Management acknowledges this risk and has already taken initiatives including the development of the Agency's Strategic Plan, Shovel Ready Projects, and Program Management Plan.
- 5) Procurement of goods and services is expected to increase due to the passage of Measure M. Management has prioritized streamlining the procurement process to improve the timely awarding of contracts to meet agency needs.



- 6) Information Technology risk continues to be driven by the need to integrate specialized legacy systems and upgrade and replace aging management systems. Having reliable, complete and timely information is becoming more critical in order to improve accountability and transparency. Management has developed a plan to upgrade and/or replace legacy and aging management systems. Concerns over cyber security vulnerabilities require a more robust approach to monitor and keep up with our security strategy in ensuring system reliability and data integrity. Management has implemented mandatory Cyber Security training for all employees to increase awareness. Risk, Safety and Asset Management is leading the effort for a collaborative business continuity disaster recovery plan to resume operations in the aftermath of a catastrophic event.
- 7) Fostering a culture of financial discipline and fiscal responsibility is imperative, even more so with the passage of Measure M. There is also financial uncertainty regarding federal/state funding levels due to new Federal leadership and State financial position. There is an increased need for transparency and to effectively manage, monitor, track, and report expenditures. Management is exploring Public, Private Partnership (P3) opportunities and other strategic alternatives to ensure financial stability.
- 8) Paratransit demand continues to grow due to demographic shifts that are driving ridership demand and reductions in other human services transportation funding. Access Services has traditionally been funded utilizing a mix of federal and local funds. While demand has grown an average of 6.5% over the last 10 years, federal funds allocated by Metro have grown less than two percent (2%) per year over the same period resulting in increased usage of Proposition C sales tax dollars. To that end, Metro has sought alternative sources of funding from other federal programs, and more recently, inclusion of ADA paratransit funding in Measure M.

## AUDIT PLAN

For purposes of the audit plan, the agency has been organized into 13 departmental functions and 5 other agencies funded by MTA. The audits in the FY18 proposed audit plan are distributed across the organizational structure as follows:



A detailed list of audits is included in Appendix A.

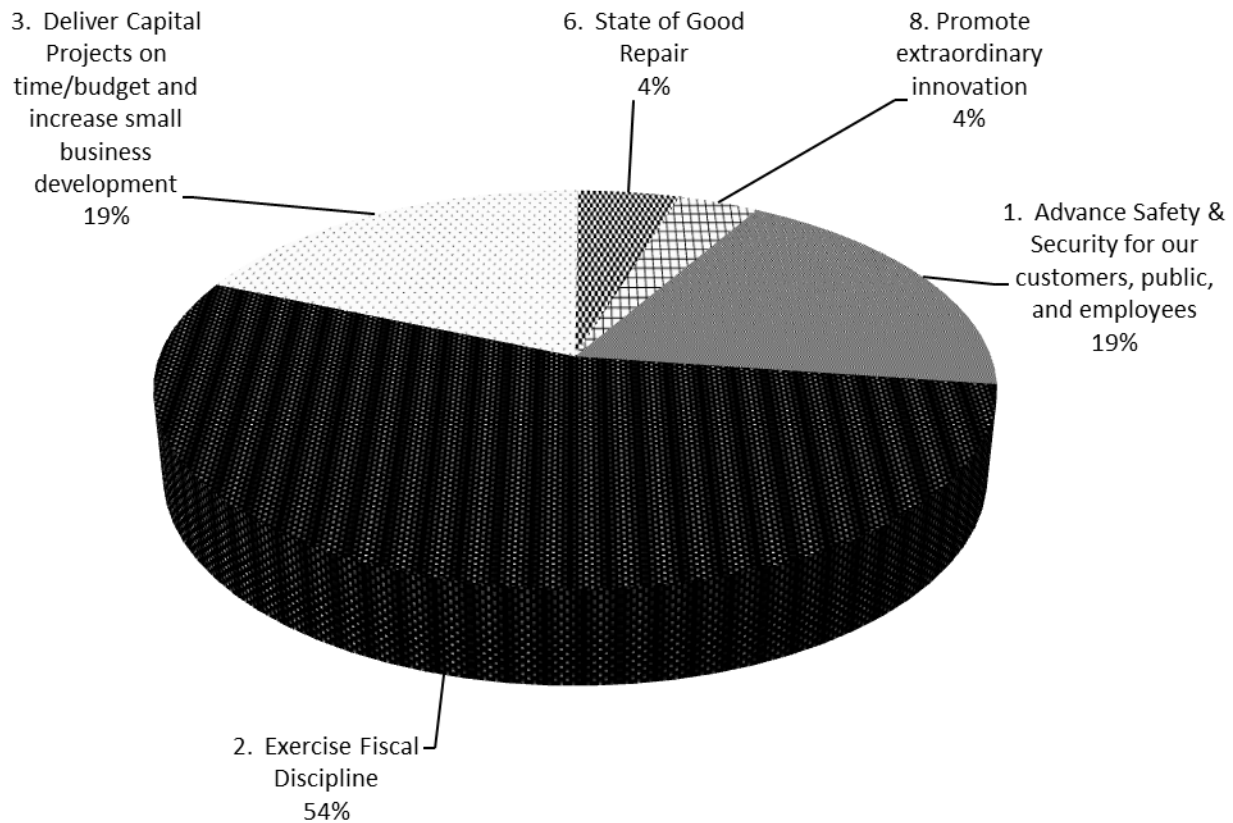
### Audit Plan Strategy

The audit plan is based on the information obtained during the agency-wide risk assessment process and includes audits in those areas identified as high risk to the agency.

The projects proposed in the audit plan directly or indirectly support the nine CEO Goals for the agency:

1. Advance safety and security for our customers, the public and Metro employees.
2. Exercise fiscal discipline to ensure financial stability.
3. Plan and deliver capital projects on time and on budget, while increasing opportunities for small business development and innovation.
4. Improve the customer experience and expand access to transportation options.
5. Increase transit use and ridership.
6. Implement an industry-leading state of good repair program.
7. Invest in workforce development.
8. Promote extraordinary innovation.
9. Contribute to the implementation of agency-wide and departmental Affirmative Action and Equal Employment Opportunity (EEO) goals.

The following chart summarizes the audits by the primary agency strategic goal.



## ALLOCATION OF AUDIT RESOURCES

Our FY18 proposed audit plan is based on 24,450 direct audit hours to be provided by 18 audit professionals and contracted subject matter experts. The direct audit hours are allocated as follows:

- 20,300 hours (83%) for new audits,
- 2,500 hours (10%) for CEO requested projects, and
- 1,650 hours (7%) for audits which are still in progress.

In developing the plan, the hours included for each audit are an estimate. There are occasions where some audits may take more or fewer hours than estimated. In addition, urgent requests from the CEO or Executive Management may arise that require audit support. When this occurs, Management Audit will reassess the plan and may supplement internal resources with outside consultants, pending available funding. Management Audit may also use external consultants to provide subject matter expertise when necessary.

The FY18 proposed audit plan included in Appendix A attempts to provide a balanced and effective review of the entire agency constrained by Management Audit resource limitations.

The CEO has the discretion based on agency need or Board direction to reprioritize audit resources. We are dedicated to completing our audit plan while continuing to be flexible and responsive to the agency's needs.

## **AUDIT PLAN AREAS**

### Internal Audits

The internal audits were selected based on the results of the FY17 agency-wide risk assessment. Areas identified as critical or high risk during the agency-wide risk assessment were given priority when identifying potential audits for the FY18 proposed audit plan. Since there are more risks than available resources, resources were the key factor in selecting the number of risks and areas to audit. The audits identified for the FY18 proposed audit plan were selected based on one of the following four strategic audit objectives:

1. Support agency-wide goals and objectives
2. Evaluate governance, risk and internal control environment
3. Review efficiency and effectiveness of operations
4. Validate compliance to regulatory requirements

The majority of Management Audit's projects are focused on identifying business process improvements and innovative ways to support the agency's strategic initiatives. This is in addition to our traditional assurance work on "hard controls", such as segregation of duties, safeguarding agency assets, reliability of financial and operational information, and compliance with regulations, contracts, and memorandums of understanding (MOUs). Since the agency is currently undertaking numerous major IT system enhancements and development, audit resources will also provide assurance that the internal controls of critical systems are adequate and working effectively.

### Contract Pre-Award & Incurred Cost Audits

Incurred Cost Audits review costs associated with MOUs issued under the Call for Projects program or contract incurred costs. Contract Pre-award Audits review costs proposed for contracts and change orders issued by Vendor/Contract Management. We identified the audits in the FY18 proposed plan based on discussions with project managers and contract administration staff. The universe of audits was balanced against the associated budget authorized to complete the work. The grant audit work was completely outsourced in FY17 and will continue to be outsourced in FY18 due to a shortage of permanent staff.

The highest priority for FY18 is contract audits for large construction, corridor, and rolling stock regulatory projects followed by pre-award audits for all other projects. This is followed by incurred cost and closeout audits in the priority list. External resources will be used if there are available funds to meet critical project deadlines.

### External Financial and Compliance Audits

In 2009, Management Audit assumed the responsibility for managing the agency's planned audits by external auditors. The FY18 proposed audit plan includes hours to ensure that these audits are completed within the scope and schedule of the contracts.

### Special Request Audits

The FY18 proposed audit plan also includes 2,500 hours or approximately 10% of available hours for special projects requested by the CEO. These hours provide some

flexibility in the audit plan to respond to emerging issues where the CEO may need audit resources to address an unanticipated issue or heightened concern.

In order to comply with Government Accountability Office's Generally Accepted Government Auditing Standards and the Institute of Internal Auditor's (IIA) International Standards for the Professional Practice of Internal Auditing Standards, internal audit must adopt a process to monitor and assess the overall effectiveness of the audit quality process. This self-assessment measures compliance to the Standards and to Management Audit's Charter, mission statement, objectives, audit policy manual, supervision, and staff development. In addition, the internal quality assurance review assesses our effectiveness and promotes continuous improvement within Management Audit. This internal review will also help us prepare for the external quality assurance review scheduled for FY18.

## **OTHER PLANNED ACTIVITIES**

### Audit Tracking and Follow-up

In compliance with the Standards, Management Audit tracks and follows up on the implementation of all audit recommendations from both internal and external audit groups including OIG, State of California, FTA, etc. Management Audit also reports all outstanding audit issues to the CEO and Board of Directors on a quarterly basis to ensure that any significant risks to the agency are addressed in a timely manner.

## **MANAGEMENT AUDIT SERVICES FRAMEWORK**

Metro's vision is excellence in service and support. Management Audit is committed to providing essential support to achieve this vision. To do this we have developed our department vision which is to deliver value by driving positive change through partnership and trust. In order to ensure our work is consistently reliable, independent and objective, Management Audit completes work under the framework of our Board approved Audit Charter. The Audit Charter includes Management Audit's mission, the standards we must comply with, and our department's objectives and core function.

### Mission

Our mission is to provide highly reliable, independent, objective assurance and consulting services designed to add value and improve operations. The department accomplishes this by bringing a systematic, disciplined approach to evaluating and recommending improvements to the effectiveness of risk management, controls and governance processes.

### Standards

The Institute of Internal Auditors (IIA) defines internal auditing as:

"...an independent, objective, assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes."

To meet our client's expectations and for us to function with reliability and credibility, Management Audit must ensure our audits are independent, objective and accurate. Therefore, Management Audit follows the ethical and professional standards

promulgated by the Government Accountability Office, Generally Accepted Government Auditing Standards (GAGAS) and the Institute of Internal Auditors International Professional Practices Framework. Depending on the type of audit being done, Management Audit also follows the standards promulgated by the American Institute of Certified Public Accountants (AICPA) and by the Information Systems Audit and Control Association (ISACA).

### Objectives and Core Functions

As summarized in our Audit Charter, the primary objective of Management Audit is to assist the CEO and his management team with their important business and financial decisions by:

- Monitoring and verifying key regulatory and legislative compliance;
- Assessing internal controls effectiveness and fiscal responsibility;
- Evaluating cost reasonableness of contracts and grants;
- Identifying and recommending business process improvements;
- Evaluating and recommending efficiencies and effectiveness of programs and functions;
- Evaluating safety and security of agency systems, programs and initiatives; and
- Tracking and reporting on all outstanding external and internal audit findings.

In addition, Management Audit's objective is to foster a system and environment that supports the highest level of integrity and ethical conduct and provides assurance of an acceptable level of risk to management for all key business processes.

## APPENDIX A

### DETAILED LISTING OF AUDITS

**CEO Goal #1 – Advance safety and security for our customers, the public and Metro employees**

	<b>Title</b>	<b>Objective</b>	<b>Area</b>
1.	Audit of Rail Communications Network System	Evaluate Security of Rail Communications Network System	Metro Operations
2.	Audit of Business Continuity Plan	Evaluate Adequacy of Business Continuity Plan	Systems Security and Law Enforcement
3.	Audit of SCADA System	Evaluate IT General Controls of SCADA System	Metro Operations
4.	Audit of Accident Prevention Practices	Evaluate the Efficiency and Effectiveness of Operations' Accident Prevention Practices	Metro Operations

**CEO Goal #2 – Exercise fiscal discipline to ensure financial stability**

	<b>Title</b>	<b>Objective</b>	<b>Area</b>
1.	Pre-Award Audits	Pre-Award audits for Procurements and Modifications	Vendor/Contract Management
2.	Incurred Cost Contract Audits	Verify Costs are Reasonable, Allowable and Allocable on Cost Reimbursable Contracts for Contractors	Vendor/Contract Management
3.	Incurred Cost Grant Audits	Verify Costs are Reasonable, Allowable and Allocable on Cost Reimbursable Contracts for Caltrans, Cities & County MOUs	Planning & Development / Program Management
4.	Financial and Compliance External Audits	Complete Legally Mandated Financial and Compliance Audits	Agency-Wide
5.	Audit of Consultant Hours	Evaluate Efficiency and Effectiveness of the Use of Consultants	Agency-Wide



## FY18 Proposed Audit Plan

## Appendix A

	<b>Title</b>	<b>Objective</b>	<b>Area</b>
<b>6.</b>	Audit of Change Orders	Evaluate the adequacy and effectiveness of internal controls over the Contract Change Order Process, and evaluate the utilization of key information (e.g. statement of work, technical evaluations, and independent cost estimates) by Vendor/Contract Management during the Contract Change Order Process.	Vendor/Contract Management
<b>7.</b>	Audit of Key Information	Evaluate the adequacy and effectiveness of the internal controls over the preparation of Key Information	Vendor/Contract Management
<b>8.</b>	Audit of Pre-Award Process	Evaluate the Adequacy and Effectiveness of Internal Controls over the Pre-Award Process, and Evaluate the Utilization of Key Information (e.g. Statement of Work, Technical Evaluations, and Independent Cost Estimates) by Vendor/Contract Management during the Pre-Award Process.	Vendor/Contract Management
<b>9.</b>	Audit of Internal Controls Over Overtime Payments	Evaluate adequacy of internal controls over overtime payments.	Agency-Wide
<b>10.</b>	Audit of HASTUS - Confirmation of Collective Bargaining Agreement Changes	Evaluate whether changes from the Collective Bargaining Agreements were effectively integrated into the HASTUS System.	Metro Operations
<b>11.</b>	Follow-up on FY17 Triennial Review Findings	Evaluate the extent of corrective actions for findings identified in the FTA Triennial Review.	Agency-Wide
<b>12.</b>	Audit of Position Reconciliation Process	Evaluate efficiency and effectiveness of position reconciliation process for Full-time equivalents (FTE).	Labor/Employee Relations / Finance & Budget

**Strategic Goal #3 – Plan and deliver capital projects on time and on budget while increasing opportunities for small business development and innovation**

	Title	Objective	Area
1.	Buy America Post-Award and Post-Delivery	Conduct Buy America Post-Award / Post- Delivery Audits for Rolling Stock Procurements	Vendor/Contract Management
2.	Annual Audit of Business Interruption Fund	Evaluate Business Interruption Fund Program	Vendor/Contract Management
3.	Audit of Regional Connector Project	Evaluate the Adequacy and Effectiveness of Project Management Controls for Regional Connector Project	Program Management
4.	Audit of Environmental Impact Report / Environmental Impact Statement (EIR/EIS) Process	Evaluate the Efficiency and Effectiveness of the EIR/EIS Process	Planning & Development / Program Management
5.	Audit of Quality Assurance Processes	Evaluate the Efficiency and Effectiveness of the Agency’s Construction Quality Assurance Program over Minor Construction Projects (Less than \$100 Million) and To Follow-Up on the Implementation of Recommendations from Prior Performance Audit of Quality Assurance, No. 11-CON-K02, Dated December 4, 2013.	Program Management
7.	Audit of Tracking of SBE/DBE Goals	Evaluate the Adequacy and Effectiveness of Process Used by the Diversity and Economic Opportunity Department to Monitor Contractors for Compliance with DBE/SBE Requirements	Vendor / Contract Management

**Strategic Goal #6 – Implement an industry-leading state of good repair program**

	Title	Objective	Area
1.	Audit of State of Good Repair Plan	Evaluate efficiency and effectiveness of readiness to Comply with State of Good Repair.	Risk, Safety & Asset Mgmt. / Metro Operations

**Strategic Goal #8 – Promote extraordinary innovation**

	<b>Title</b>	<b>Objective</b>	<b>Area</b>
1.	Audit of P3 Unsolicited Proposal Process	Evaluate the compliance of P3 Unsolicited Proposal Process with the policy.	Office of Extraordinary Innovation