



Board Report

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REVISED
FINANCE, BUDGET AND AUDIT COMMITTEE
MAY 18, 2016

SUBJECT: FY17 AUDIT PLAN

ACTION: APPROVE ADOPTION OF THE FY17 PROPOSED AUDIT PLAN

RECOMMENDATION

ADOPT the **FY17 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 FY17 Audit Plan was completion of the FY16 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 FY17 Proposed Audit Plan (Attachment A).

This is the twelfth 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's patrons or employees.

FINANCIAL IMPACT

Any funding for external consultants needed to complete the annual audit plan will be included in the FY17 budget in Management Audit's cost centers 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

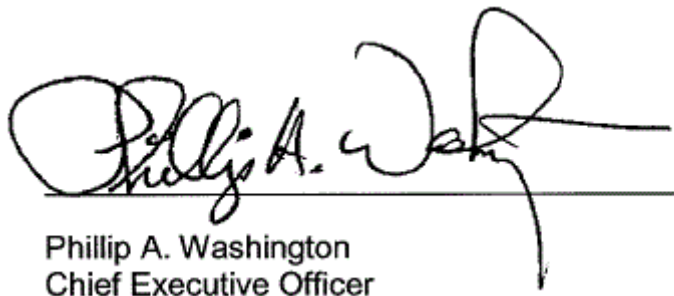
Once the Board adopts the annual audit plan, Management Audit will develop the audit schedule for FY17. Management Audit will report to the Board quarterly on its progress in completing the annual audit plan.

ATTACHMENTS

Attachment A - FY17 Annual Business Plan and Proposed Audit Plan

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MANAGEMENT AUDIT SERVICES

FISCAL YEAR 2017 ANNUAL BUSINESS PLAN AND PROPOSED AUDIT PLAN



Management Audit Services

Fiscal Year 2017 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 FY17 Audit Plan was completion of the FY16 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 eight CEO initiatives identified in the Budget document:

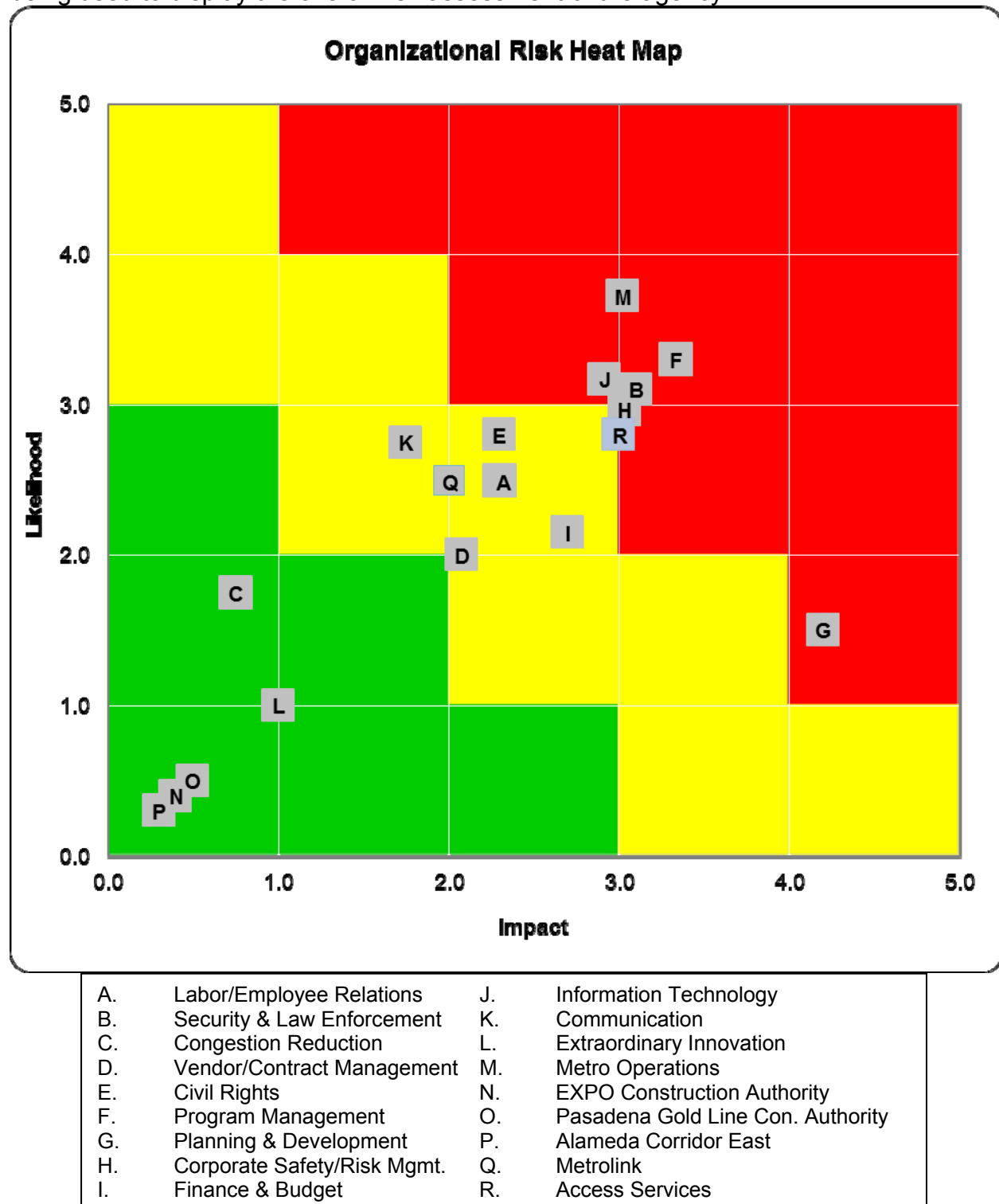
1. Advance safety and security for our customers, the public, and Metro employees
2. Exercise fiscal discipline to ensure financial stability
3. Plan and deliver capital projects on time and on budget while increasing opportunities for small business development and innovation.
4. Improve the customer 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.

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 the available funding and staffing.

The agency-wide risk assessment process began by reviewing and analyzing key documents such as the annual budget, the Basic Financial Statements, status reports on major projects, past audit reports, open and late corrective actions to prior audit findings, and the transportation plans. We then completed an extensive assessment of

the different areas within the agency. We supplemented this assessment by interviewing 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 MTA: Access Services, Metrolink, Exposition Authority (Expo), 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.



High Risk Areas

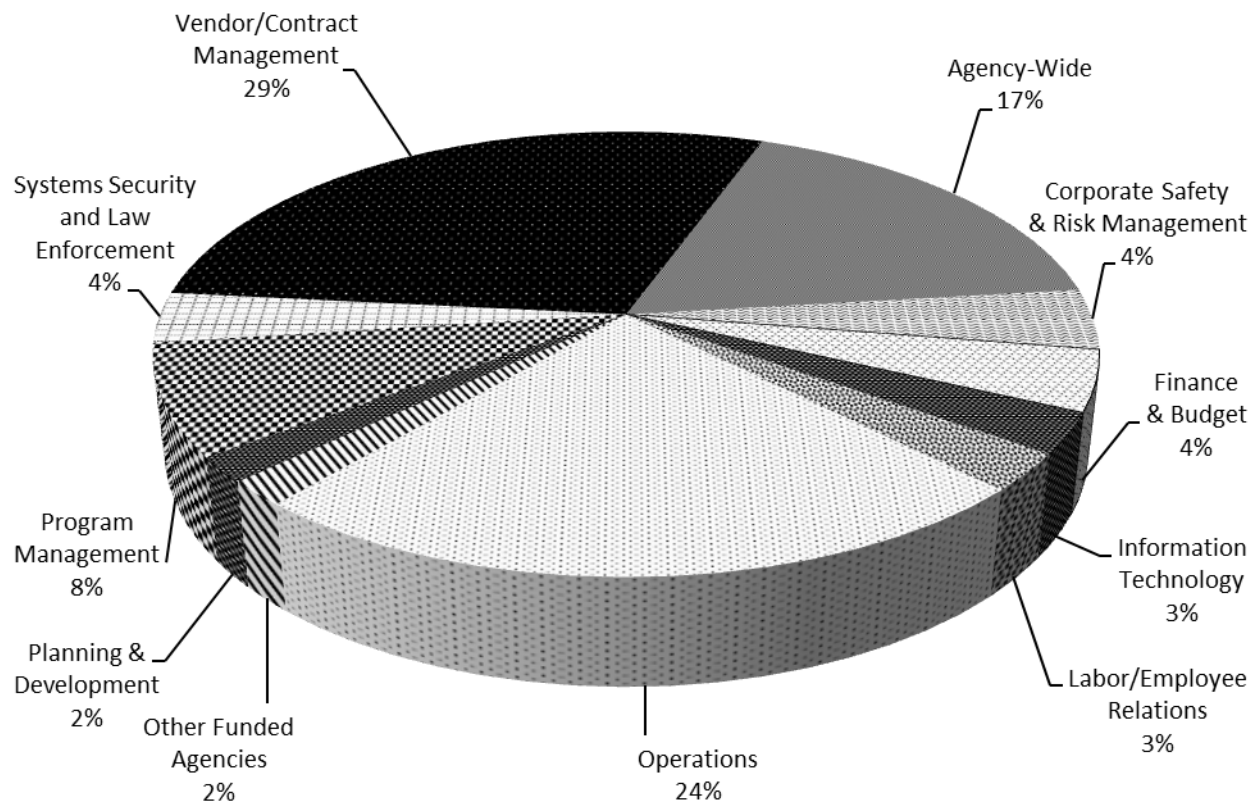
The top internal risks include safety and security, aging infrastructure, funding constraints, dated information systems and completion of multiple capital projects within the same timeframe with limited resources. Access Services continues to be an external risk.

- 1) The agency is facing heightened risk due to potential threats of terrorism and other crimes. Systems Security and Law Enforcement is exploring innovative ways to use technology and partner with the Sheriff's department and the community to secure high risk areas. In addition, Metro is planning to increase law enforcement visibility to improve safety and security and decrease fare evasion.
- 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. Operations and the Transit Asset Management department are now collaborating to formalize a process to assess the condition of their equipment, rolling stock, infrastructure, and facilities in order to comply with FTA's state of good repair regulation and upcoming MAP 21 certification.
- 3) Completion of multiple capital projects simultaneously with limited resources is still considered to be a risk. Apart from the inherent development/construction risks, there may be inadequate funding to complete all projects as planned within the projected timeframe. In addition, schedule delays, increased costs and the inability to hire qualified technical staff to provide oversight for major construction projects continue to be significant concerns. However, more emphasis has been placed on strategic planning, risk transference and risk sharing, particularly in the area of Third Party Utility relocations.
- 4) Metro continues to struggle with the projected operating deficit as well as limited resources to fully fund the capital expansion projects already in progress. The agency has recognized the need to be more fiscally flexible and innovative and responded by implementing the Risk Allocation Matrix (RAM) and an Internal Savings Account. In addition, we are assessing possible Public, Private Partnership (P3) opportunities and other strategic alternatives to ensure financial stability and mitigate projected budget shortfalls.
- 5) Increased reliance on system generated data and the need for comprehensive, integrated information systems continue to impact the overall technology risk scoring. Growing concern over cyber security vulnerabilities require more resources to be expended to preserve system reliability and data integrity. In addition, there is a need for a collaborative business continuity disaster recovery plan to facilitate the ability to resume operations in the aftermath of a catastrophic event.
- 6) The inability to hire qualified technical and support staff are pervasive concerns that surfaced in most of the risk assessment discussions. Senior 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, implementing a leadership academy and continuing the entry level trainee program.

- 7) Access Services has traditionally been funded using federal and local funds which have not been growing at the same rate as Americans with Disabilities Act (ADA) paratransit demand. ADA paratransit costs and demands are growing due to demographic shifts of an aging population of baby boomers and cuts in human services transportation funding. Metro is preparing for the increased costs by including funding for Access Services in the proposed ballot measure.

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 FY17 audit plan are distributed across the organizational structure as follows:



A detailed list of audits is included in Appendix A.

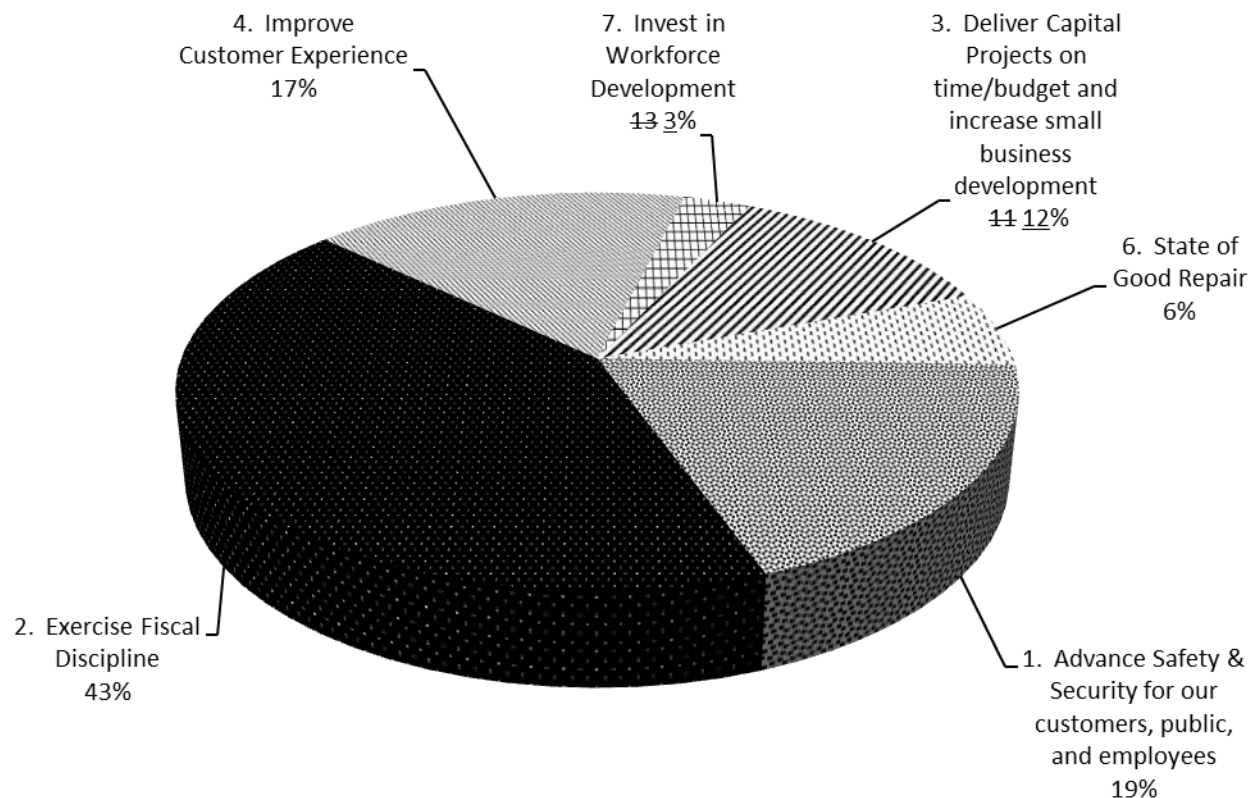
Audit Plan Strategy

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 correlate to the 8 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.

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



ALLOCATION OF AUDIT RESOURCES

Our FY17 plan is based on 27,300 direct audit hours to be provided by 13 budgeted audit professionals, 3 entry-level trainees and contracted subject matter experts. The audit hours for the Chief Auditor and her management team are not included in the direct audit hours. The direct audit hours are allocated as follows:

- 18,550 hours (68%) for new audits,
- 2,500 hours (9%) for CEO requested projects, and
- 6,250 hours (23%) 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 FY17 audit plan included in Appendix A attempts to provide a balanced and effective review of the entire agency constrained by Management Audit resource limitations.

This is the CEO's audit plan being presented to the Board for approval. 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 FY16 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 FY17 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 FY17 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 critical system's internal controls are adequate and working effectively.

Contract Pre-Award & Incurred Cost Audits

Incurred Cost Audits review costs associated with MOU's 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 FY17 proposed plan based on discussions with project managers and contract administration staff, analysis of Call for Project's audit universe and Financial Information Systems' (FIS) data for contract audits. The universe of audits was balanced against the associated budget authorized to complete the work. The grant audit work was completely outsourced in FY16 and will continue to be outsourced in FY17 due to a shortage of permanent staff.

The highest priority for FY17 is contract audits for large construction, corridor, and rolling stock regulatory projects followed by pre-award audits for all other projects. Incurred cost and closeout audits are the lowest priority. Because staffing in Management Audit is limited, 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 FY17 plan includes hours set aside to ensure that these audits are completed within the scope and schedule of the contracts.

Special Request Audits

The FY17 plan also includes 2,500 hours or approximately 9% 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 needs 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. The Standards require that internal audit 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 FY17.

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:

- Monitor and verify key regulatory and legislative compliance;
- Assess internal controls effectiveness and fiscal responsibility;
- Evaluate cost reasonableness of contracts and grants;
- Identify and recommend business process improvements;
- Evaluate and recommend efficiencies and effectiveness of programs and functions;
- Evaluate safety and security of agency systems, programs and initiatives; and
- Track and report 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

	Title	Objective	Area
1.	Audit of IT Project Management	Evaluate efficiency and effectiveness of IT project management.	Information Technology
2.	Audit of Rail Communication Systems	Evaluate efficiency and effectiveness of Rail Communication Systems.	Operations
3.	Audit of Transit Terrorism <u>System Security Plan</u>	Evaluate adequacy of Transit Terrorism Homeland Security efficiency and effectiveness on the process for the <u>development and updates for System Security Plan</u> .	Systems Security and Law Enforcement
4.	Audit of SCADA	Evaluate systemwide security of SCADA.	Operations
5.	Audit of Environmental Compliance	Evaluate effectiveness of agency's environmental compliance program.	Program Management

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

	Title	Objective	Area
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.	Performance Audit of Cash Counting Process	Evaluate Controls of Cash Counting Process.	Finance & Budget

	Title	Objective	Area
6.	Performance Audit of Farebox Revenue Process	Evaluate Controls of Farebox Revenue collection process.	Finance & Budget
7.	Performance Audit of P-card Purchases	Evaluate compliance to P-card purchase requirements.	Vendor/Contract Management
8.	Performance Audit of IT Asset Management	Evaluate the effectiveness of management over technology assets.	Information Technology
9.	Audit of Consultant Hours	Evaluate efficiency and effectiveness of the use of consultants.	Agency-Wide

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 Pre-Awards	Buy America pre-award audits	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 controls over Regional Connector Project.	Program Management
4.	Audit of EIS/EIR process	Evaluate the efficiency and effectiveness Environmental Impact Study / Environmental Impact Report (EIS/EIR) of the project management and oversight	Planning & Development / Program Management

Strategic Goal #4 – Improve the customer experience and expand access to transportation options

	Title	Objective	Area
1.	Audit of IT Controls over Access Services	Evaluate the reliability of Access Services information systems.	Other Funded Agencies
2.	Audit of HASTUS Daily Module	To evaluate the effectiveness of controls over the Hastus Daily Module.	Operations
3.	Audit of M3 System	Evaluate effectiveness of M3 system utilization.	Operations
4.	Audit of Power Maintenance & Usage	Evaluate efficiency and effectiveness of rail operations power maintenance and usage.	Operations
5.	Audit of Division Management Practices	Evaluate efficiency and effectiveness of Division management practices and processes.	Operations

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.	Corp. Safety & Risk Mgmt. / Operations

Strategic Goal #7 – Invest in workforce development

	Title	Objective	Area
1.	Audit of Oracle HR	Evaluate accuracy of Oracle HR position reconciliation process.	Labor/Employee Relations