



September 12, 2018

To: Finance and Administration Committee

From: Darrell E. Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit

Subject: Warranty Administration, Internal Audit Report No. 18-510

Overview

The Internal Audit Department has completed an audit of warranty administration. Based on the audit, controls over identification, processing, and reporting of warranty claims are adequate; however, one recommendation is being made to formalize and document procedures used to derive the value of warranty labor.

Recommendation

Direct staff to implement one recommendation provided in Warranty Administration, Internal Audit Report No. 18-510.

Background

Warranty claims include repairs performed by vendors at no cost to the Orange County Transportation Authority (OCTA), repairs performed by OCTA mechanics and reimbursed by vendors, claims for parts order inventory discrepancies, and claims for defective parts. Warranty Section staff within the Contracts Administration and Materials Management Department are responsible for processing warranty claims for the directly operated bus fleet.

To help ensure parts under warranty are identified, the Collective Bargaining Agreement with the Transportation Communications Union/International Association of Machinists and Aerospace Workers includes an incentive bonus of \$250 per employee, per year for equipment parts and stock room clerks when warranty recoveries total \$3,500 or more per vehicle, per year. An additional \$100 per employee may be earned when recoveries equal \$5,000 or more per vehicle.

Discussion

Labor rates and labor hour estimates used to calculate the value of warranty recoveries is not always consistent or adequately documented. To address this, the Internal Audit Department (Internal Audit) recommended management formalize procedures for developing warranty claim values and maintain documentation to support the labor rates and labor hour estimates used. Management agreed and indicated that a formal process will be developed and implemented.

Summary

Internal Audit has completed an audit of warranty administration and offered one recommendation for improvement.

Attachment

- A. Warranty Administration, Internal Audit Report No. 18-510

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ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



Warranty Administration

Internal Audit Report No. 18-510

August 22, 2018



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Conclusion

The Internal Audit Department (Internal Audit) has completed an audit of warranty administration. Based on the audit, controls over identification, processing, and reporting of warranty claims are adequate; however, one recommendation is being made to formalize and document procedures used to derive the value of warranty labor.

Background

The Contracts Administration and Materials Management Department (Camm) of the Finance and Administration (F&A) Division is responsible for the processing and reporting of all warranty claims related to the directly-operated bus fleet. The Warranty Section (Warranty) includes a warranty supervisor, a senior warranty coordinator, and an associate warranty coordinator. The directly-operated bus fleet consists of 283 buses.

Warranty claims include repairs performed by vendors at no cost to the Orange County Transportation Authority (OCTA), repairs performed by OCTA mechanics and reimbursed by vendors, claims for parts order inventory discrepancies, and claims for defective parts.

To help ensure parts under warranty are identified, the Collective Bargaining Agreement with the Transportation Communications Union/International Association of Machinists and Aerospace Workers includes an incentive bonus of \$250 per employee, per year for equipment parts and stock room clerks when warranty recoveries total \$3,500 or more per vehicle, per year. An additional \$100 per employee may be earned when recoveries equal \$5,000 or more per vehicle.

To determine the value of warranty recoveries, Warranty staff record the cost of parts per the parts inventory system or vendor work orders and calculate a value for warranty labor by multiplying the estimated labor hours by a labor rate. For work performed by OCTA mechanics, a fully burdened rate for a certified journeyman mechanic is developed by Financial Planning and Analysis Department staff. Warranty staff obtain labor hours from related work orders or they use their own estimates based on the work performed.

Warranty recovery values reported for the past three years, were as follows:

2015	2016	2017
\$1,757,671	\$1,590,497	\$3,522,403

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Objectives, Scope, and Methodology

The objectives were to assess the adequacy of controls in place over warranty claims identification, processing, and reporting.

The methodology consisted of interviews with the section manager and the section supervisor, testing of a haphazard sample of warranty monthly reports, testing of the warranty bonus calculation and testing of a judgmental sample of outstanding and/or rejected claims. Judgmental samples were selected to provide coverage of the various categories of warranty claims. For haphazard and judgmental samples, conclusions are limited to the sample items tested since sampling is non-statistical.

The scope was limited to warranty claims for the directly-operated bus fleet, monthly reports for 2017, bonus payments processed in November 2017, and warranty claims data for January 1, 2017 through July 26, 2018.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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Audit Comment, Recommendation, and Management Response

Determination of Warranty Recovery Amounts

Labor rates and labor hour estimates used to calculate the value of warranty work performed are not always consistent and adequately documented.

Warranty staff estimate, record, and report the value of warranty claims. These values are used to both measure performance and to calculate employee incentive payments. The value of warranty work, whether by a vendor or by OCTA staff, is determined using an estimate of the labor hours needed to perform the repair multiplied by a labor rate.

Documentation was not available to validate the labor rates and labor hour estimates used for most warranty claims.

Recommendation 1:

Internal Audit recommends management formalize procedures for developing warranty claim values. Documentation to support labor rates and labor hour estimates used should be maintained.

Management Response:

Management agrees that procedures for developing warranty claim values should be formalized. Management will establish a formal process for stating claim values on internal and external repairs and utilizing internal labor rates established by OCTA's F&A Division.