



**November 9, 2022**

**To:** Finance and Administration Committee

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

Janet Sutter, Executive Director  
Internal Audit Department

**Subject:** Independent Cost Estimates, Internal Audit Report No. 22-513

### **Overview**

The Internal Audit Department of the Orange County Transportation Authority has completed an audit of independent cost estimates. Based on the audit, independent cost estimates are not always prepared in compliance with policy and procedures. In addition, the Internal Audit Department identified concerns to oversight and procurement activities related to one consultant. Two recommendations have been made to enhance controls over independent cost estimates and to implement additional controls related to contract management.

### **Recommendation**

Direct staff to implement two recommendations provided in Independent Cost Estimates, Internal Audit Report No. 22-513.

### **Background**

The Contracts Administration and Materials Management (CAMM) department is responsible for solicitations of all goods, inventory items, consultant and professional services, and public works projects. As part of this responsibility, CAMM staff serves as the primary point of contact with vendors and consultants with regard to procurement actions.

CAMM Policies and Procedures (Policies) require a cost or price analysis be performed for every procurement action, including, but not limited to, contract amendments, interagency agreements, and single bids. An Independent Cost Estimate (ICE) is the initial step in a cost or price analysis. The ICE serves as a benchmark for evaluating the reasonableness of the contractor's proposed cost or price and represents the project manager's (PM) independent assessment of

what OCTA would expect to pay for goods or services, based on reliable sources, such as paid historical prices, industry standard, or market surveys. The PM is responsible for developing the ICE and submitting it with the procurement requisition to CAMM.

### ***Discussion***

ICEs are not always prepared in accordance with Policies and are not always accompanied by adequate documentation to support the estimates provided. In addition, in some cases, pricing was obtained by PMs prior to preparing the ICE. The Internal Audit department (Internal Audit) recommends CAMM ensure that ICEs include adequate detail and are submitted in accordance with Policies. CAMM should also consider providing additional training to PMs on how and where to obtain independent data for proper development of ICEs. CAMM agrees and will provide training to PMs and ensure ICEs contain adequate detail to support estimates.

Internal Audit also identified an ICE that was submitted supporting a request to increase the maximum obligation on a one-person consultant contract by 15 percent, or \$132,288, and to extend the contract by 30 days. The ICE was based on an estimated 1,121 additional hours of work required. Review of payments made against the contract after execution of this amendment found that approximately \$64,725 of the amendment amount was utilized to pay the consultant for three months of work provided prior to obtaining contract authority for the services. Further review found evidence that management has consistently underestimated the level of work required by this consultant and twice executed amendments to cover work already provided. Following expiration of this contract, a new contract for these services was awarded on October 1, 2021, for \$238,960 for a one-year term. The new contract estimated consultant hours of approximately 32 hours per week, despite the fact that the consultant worked an average of 50 hours per week in the preceding one-year period. An amendment for \$158,380 (66 percent of the contract value) was then executed on October 3, 2022, after expiration of the contract, and extended the contract term for another six months. This amendment also included funding for two months of work that had already been provided by the consultant during the initial one-year term. Internal Audit recommended management develop tools to ensure proper oversight, including monitoring of contract burn rate and development of reasonable estimates, to ensure funding is sufficient to achieve objectives. Management agreed and indicated that oversight tools will be implemented and the PM will be provided training to facilitate improved contract management in the future.

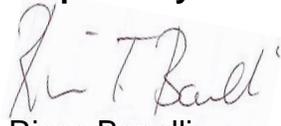
**Summary**

Internal Audit has completed an audit of independent cost estimates and has offered two recommendations, which management agreed to implement or otherwise address.

**Attachment**

- A. Independent Cost Estimates, Internal Audit Report No. 22-513

**Prepared by:**



Ricco Bonelli  
Principal Internal Auditor  
714-560-5591

**Approved by:**



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

# ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



## Independent Cost Estimates

### Internal Audit Report No. 22-513

October 25, 2022



**Audit Team:** Ricco Bonelli, CIA, Principal Internal Auditor *RTB*  
Janet Sutter, CIA, Executive Director

**Distributed to:** Andrew Oftelie, Chief Financial Officer, Finance and Administration  
Pia Veesapen, Meena Katakia, Georgia Martinez

**ORANGE COUNTY TRANSPORTATION AUTHORITY  
INTERNAL AUDIT DEPARTMENT  
Independent Cost Estimates  
October 25, 2022**

**Table of Contents**

Conclusion .....	1
Background .....	1
Objectives, Scope, and Methodology .....	2
Audit Comments, Recommendations, and Management Responses .....	3
Independent Cost Estimates.....	3
Contract Management .....	4

**ORANGE COUNTY TRANSPORTATION AUTHORITY**  
**INTERNAL AUDIT DEPARTMENT**  
**Independent Cost Estimates**  
**October 25, 2022**

## **Conclusion**

The Internal Audit Department (Internal Audit) of the Orange County Transportation Authority (OCTA) has completed an audit of independent cost estimates. Based on the audit, independent cost estimates are not always prepared in compliance with policy and procedures. In addition, Internal Audit identified concerns related to oversight and procurement activities related to one consultant. Two recommendations have been made to enhance controls over independent cost estimates and to implement additional controls related to contract management.

## **Background**

### Contracts Administration and Materials Management (CAMM) Department

CAMM is responsible for solicitations of all goods, inventory items, consultant and professional services, and public works projects. As part of this responsibility, CAMM staff serves as the primary point of contact with vendors and consultants. During fiscal year 2021-22, CAMM executed 339 contract agreements totaling \$665,864,761.42, and 3,036 purchase orders totaling \$17,579,036.49.

The CAMM intranet site includes a “Procurement Tools” page developed to provide key documents, user guides, and policies. The site includes an instructional video for project managers (PM) on how to develop an independent cost estimate (ICE) and provides examples of ICEs developed for services including architectural/engineering, professional, and construction services. CAMM has also developed and delivered procurement training modules that include guidelines on preparing an ICE.

### Independent Cost Estimate

The Federal Transit Administration requires that a cost or price analysis be performed in connection with every procurement action, including contract modifications. CAMM Policies and Procedures (Policies) incorporate this requirement for every procurement action, including, but not limited to, contract amendments, interagency agreements, and single bids.

An ICE is the initial step in a cost or price analysis. The ICE serves as a benchmark for evaluating the reasonableness of the contractor’s proposed cost or price and may range from a simple budgetary estimate to a complex estimate. The ICE should represent the PM’s independent assessment of what OCTA would expect to pay for goods or services based on reliable sources such as paid historical prices, industry standard, or market surveys. The PM is responsible for developing the ICE and submitting it with the procurement requisition to CAMM.

**ORANGE COUNTY TRANSPORTATION AUTHORITY**  
**INTERNAL AUDIT DEPARTMENT**  
**Independent Cost Estimates**  
**October 25, 2022**

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

The objectives were to determine whether ICEs are properly prepared in accordance with Policies and applicable regulations, as well as to assess the implementation and effectiveness of related internal controls.

According to Generally Accepted Government Auditing Standards (GAGAS), internal control is the system of processes that an entity's oversight body, management, and other personnel implement to provide reasonable assurance that the organization will achieve its operational, reporting, and compliance objectives. The five components are control environment, risk assessment, control activities, information and communication, and monitoring.<sup>1</sup> The components and principles that were evaluated as part of this audit are:

- Control Environment
  - OCTA demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
- Control Activities
  - OCTA selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.

The methodology consisted of testing a judgmental sample of ICEs developed for contracts, purchase orders, and amendments for compliance with Policies and applicable regulations.

The scope was limited to procurements over \$2,500 executed during fiscal year 2021-22, and amendments that increased the maximum obligation amount executed during fiscal years 2020-21 and 2021-22. The scope did not include cooperative agreements between OCTA and other local agencies. A judgmental sample was selected to ensure inclusion of high dollar and low dollar procurements while also ensuring representation of procurements using Invitation for Bids, Request for Proposals, and sole source solicitation methods. Since the samples were non-statistical, any conclusions are limited to the sample items tested.

We conducted this performance audit in accordance with GAGAS. 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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<sup>1</sup> See U.S. Government Accountability Office publication, "Standards for Internal Control in the Federal Government," available at <http://www.gao.gov/products/GAO-14-704G>, for more information.

**ORANGE COUNTY TRANSPORTATION AUTHORITY  
INTERNAL AUDIT DEPARTMENT  
Independent Cost Estimates  
October 25, 2022**

## **Audit Comments, Recommendations, and Management Responses**

### **Independent Cost Estimates**

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Independent Cost Estimates (ICEs) are not always prepared in accordance with Policies and are not always accompanied by adequate documentation to support the estimates provided. In addition, in some cases, pricing was obtained by project managers (PM) prior to preparing the ICE.

Policies require an ICE be prepared for every procurement action, including amendments, and that it be prepared and submitted with the requisition for goods or services. The ICE should serve as a benchmark for evaluating the reasonableness of contractor bids or pricing. Policies also state that CAMM should be the primary point of contact with vendors and consultants with regard to procurement actions.

Testing of ICEs prepared for 40 procurements and 20 amendments identified one instance in which an ICE was not developed as required and six instances in which the ICE was prepared after the requisition date. In addition, ten ICEs were prepared after the PM received pricing and/or a cost proposal directly from the vendor and seven ICEs lacked adequate detail as to the methodology and resources used to develop the estimate.

#### **Recommendation 1:**

Internal Audit recommends CAMM ensure that ICEs include adequate detail to support the methodology used to estimate costs and are submitted in accordance with Policies. ICEs that do not reflect an independent estimate, or lack sufficient detail, should be returned. CAMM should also consider providing additional training to advise PMs that pricing and/or cost proposals should not be solicited directly from vendors and to provide additional guidance on how and where to obtain external and internal pricing data for proper development of ICEs.

#### **Management Response (CAMM):**

Management agrees with the recommendation and will ensure all ICEs include adequate detail to support the methodology used to estimate costs. In addition, CAMM will revise Policies to address the appropriate timeline for PMs to send ICEs. Furthermore, CAMM will conduct training to PMs to provide guidance on how to obtain pricing data and supporting information to assist them in preparing an ICE.

**ORANGE COUNTY TRANSPORTATION AUTHORITY  
INTERNAL AUDIT DEPARTMENT  
Independent Cost Estimates  
October 25, 2022**

**Contract Management**

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An ICE was submitted supporting a request to increase the maximum obligation on a one-person consultant contract by 15 percent, or \$132,288, and to extend the contract by 30 days. The ICE was based on an estimated 1,121 additional hours of work required. Review of payments against the contract, after execution of this amendment, found that approximately \$64,725 of the amendment amount was utilized to pay the consultant for three months of work provided prior to obtaining contract authority for the services.

Internal Audit expanded testing and found evidence that management has consistently underestimated the level of work required by this consultant and twice executed amendments to cover work already provided. While the original procurement, as well as the contract option term, were approved by the Board of Directors (Board), three amendments were executed to increase the maximum obligation by 15 percent, the maximum allowed under Policies without requiring Board approval. The ICEs for these amendments described essentially the same services but indicated additional hours were required. Following expiration of this contract, a new contract for these services was awarded on October 1, 2021, for \$238,960 for a one-year term. The amount was based on the PM's estimate that 32 hours per week would be required from the consultant, despite the fact that the consultant worked an average of 50 hours per week in the preceding one-year period. An amendment for \$158,380 (66 percent of the contract value) was then executed on October 3, 2022, after expiration of the contract, and extended the contract term for another six months. This amendment was approved by the Board; however, it included funding for two months of work that had already been provided by the consultant during the initial one-year term. The current contract is set to expire in March 2023, and a new procurement is in process for a two-year contract beginning in April 2023, with three, one-year option terms.

**Recommendation 2:**

Internal Audit recommends management develop tools to ensure proper oversight and management of these consulting services. This should include regular monitoring of the contract burn rate and development of reasonable estimates to ensure funding is sufficient to achieve objectives.

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

Management agrees with the development of tools to ensure proper oversight and management of these consulting services. Staff managing this contract will also be required to attend OCTA procurement training to improve understanding of OCTA's Policies and to facilitate improved contract management in the future.

**ORANGE COUNTY TRANSPORTATION AUTHORITY  
INTERNAL AUDIT DEPARTMENT  
Independent Cost Estimates  
October 25, 2022**

The 12-month contract executed on October 1, 2021, anticipated consultant workload of 32 hours per week due to a dedicated internal employee being trained to take over the consultant role. This plan would have resulted in less hours required of the consultant during the contract period. However, the internal full-time employee resigned during training which led to the work being completed by the consultant. The most recent amendment approved by the Board and executed on October 3, 2022, did take into consideration additional hours with an average workload of approximately 43 hours per week.