OCTA

April 13, 2016

To: Finance and Administration Committee

From: Darrell Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit Department

Subject: Oversight Controls, Contract Compliance, and Billings Related to the Bristol Street Widening Project

Overview

The Internal Audit Department of the Orange County Transportation Authority has completed an audit of oversight controls, contract compliance, and billings related to the Bristol Street Widening Project, led by the City of Santa Ana and funded through various agreements with the Orange County Transportation Authority. Internal Audit identified overbillings from inaccurate calculation of labor rates, duplicated charges, and weaknesses in timekeeping practices by the City of Santa Ana. Also, the Orange County Transportation Authority project management staff does not review supporting documentation for costs charged to Agreement No. C-6-0069 or reconcile funding amounts.

The Internal Audit Department recommended that management obtain a credit of $261,764 for labor overbillings, reduce final payment under a Measure M2 Comprehensive Transportation Funding Program project by $58,371, and either obtain a credit of $443,078 for the value of excess property or implement controls to ensure proceeds on the sale of excess property are applied to eligible project costs. The Internal Audit Department also recommended that management implement controls to ensure costs claimed comply with Agreement No. C-6-0069, are valid and supported, and are not duplicated under another agreement.

Recommendation

Direct staff to implement six recommendations offered in the audit of Oversight Controls, Contract Compliance, and Billings Related to the Bristol Street Widening Project, Internal Audit Report No. 15-515.

Background

The Bristol Street Widening Project (Project) will widen Bristol Street from two to three lanes in each direction between 17th Street and Warner Avenue, and will be completed in four phases.

Recognizing Bristol Street as a major arterial with countywide significance, on June 12, 2006, the Orange County Transportation Authority (OCTA) and the City of Santa Ana (City) entered into Agreement No. C-6-0069 (gas tax agreement), whereby OCTA made available funding through the gas tax subvention funds in the not-to-exceed amount of $125,000,000. The City acts as the lead agency in the right-of-way acquisition, design, construction, and construction management, and OCTA provides funding through the gas tax agreement and multiple Comprehensive Transportation Funding Program (CTFP) project awards under Measure M and Measure M2.

Discussion

The Internal Audit Department (Internal Audit) identified $261,764 in overbillings resulting from the City's use of inflated labor billing rates. Specifically, to calculate billing rates, the City used unreasonable estimates, accounted for the costs of indirect labor time twice, and used the highest-paid employee in each classification as a basis for the rate. Internal Audit recommended that management obtain a credit of $261,764 to the gas tax agreement, ensure labor billing rates are corrected, and implement monitoring controls going forward. Management agreed to obtain the credit and require the City to utilize revised rates going forward. Management also agreed to amend the gas tax agreement to require the City to certify that reports of actual expenses versus monthly payment requests, including labor billing rates charged, are true and correct.

Internal Audit also recommended that the City's final claim under CTFP Project No. 11-SNTA-ACE-9003 be reduced by $58,371 to eliminate duplicate charges. The CTFP project funds 65 percent of eligible project costs with a 35 percent required local match. The match is comprised of costs charged to the gas tax agreement. Review of the City's final claim identified labor and materials costs that had already been fully charged to the gas tax agreement. Conversely, matching funds identified for construction contract costs had not all been charged to the gas tax agreement. After revising amounts allocated to the CTFP and to the match, Internal Audit recommended that the final payment be reduced by $58,371. Internal Audit also recommended management implement controls to ensure that costs charged to the gas tax agreement and CTFP projects are not duplicated. Management agreed to reduce the CTFP final payment and to ensure reviews are coordinated to identify any duplicate cost claims.

In addition, Internal Audit identified $443,078 in excess right-of-way property that was charged to the agreement. While the gas tax agreement does not obligate the City to sell excess property, it does require that sale proceeds be applied to Project costs. Currently, there is no mechanism to ensure sale proceeds are applied to Project costs before agreement expiration. To address this, Internal Audit recommended management either request credit to the gas tax agreement for $443,078, or implement controls to ensure that sales proceeds from excess property are applied to eligible Project costs prior to close-out of the agreement. Management agreed to both obtain a credit from the City and to amend the gas tax agreement to strengthen requirements for the disposition of excess property.

Weaknesses in City employee timekeeping and mark-ups of sub-consultant costs were also identified during review of costs charged to the gas tax agreement. Specifically, labor hours charged to the Project did not always agree to the timesheets on file. Also, several invoices charged to the agreement reflected sub-consultant mark-ups, a practice not typically allowed by OCTA. Internal Audit recommended management request the City strengthen controls over timekeeping and consider disallowing sub-consultant markups through update of the agreement language. Management agreed to review a sample of supporting documentation from quarterly reports to verify expenses and to ensure labor hours billed are supported by timesheets on file. Management also indicated that the gas tax agreement will be amended to specifically disallow sub-consultant markups.

OCTA staff does not reconcile quarterly reports to OCTA records of payments or review supporting documentation for costs charged. Internal Audit recommended that management reconcile quarterly reports and implement a cost review process to ensure that costs charged to the gas tax agreement are Project-related, supported, and reasonable. Management agreed to reconcile quarterly reports to OCTA's records of payments and to periodically sample and review supporting documentation.

Finally, Internal Audit found that amounts paid under the gas tax agreement are inconsistent with the terms and amounts specified in the agreement. The agreement allows the City to request payments monthly based on a pro-rated portion of amounts specified in an exhibit to the agreement. When actual expenses are less than payments to date, excess payment amounts are to be withheld from the City's next monthly payment request. Rather than using this specified methodology, the City invoices based on its cash flow forecasting and spending plan, and OCTA pays these invoiced amounts. Internal Audit recommended that management amend the gas tax agreement to update the payment schedule and enforce payment provisions. Management agreed to amend the gas tax agreement to reflect the reconciliation of the pro-rated invoicing and to update the payment schedule accordingly.

Summary

Internal Audit has completed an audit of oversight controls, contract compliance, and billings related to the Bristol Street Widening Project. The audit identified overbillings from inaccurate calculation of labor rates, duplicated charges, and weaknesses in timekeeping practices by the City. Internal Audit also noted that OCTA staff does not review supporting documentation for costs charged to the gas tax agreement or reconcile funding amounts. Six recommendations were offered.

Attachment

A. Oversight Controls, Contract Compliance, and Billings Related to the Bristol Street Widening Project, Internal Audit Report No. 15-515

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ATTACHMENT A

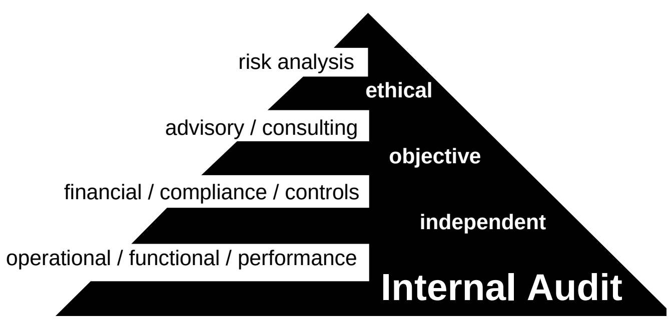
ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT

OCTA

Oversight Controls, Contract Compliance, and Billings Related to the Bristol Street Widening Project

Internal Audit Report No. 15-515

February 29, 2016



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Conclusion

The Internal Audit Department (Internal Audit) of the Orange County Transportation Authority (OCTA) has completed an audit of oversight controls, contract compliance, and billings related to the Bristol Street Widening Project (Project), led by the City of Santa Ana (City) and funded through various agreements with OCTA. Internal Audit identified overbillings from inaccurate calculation of labor rates, duplicated charges, and weaknesses in timekeeping practices by the City. Also, OCTA project management staff does not review supporting documentation for costs charged to Agreement No. C-6-0069 (gas tax agreement) or reconcile funding amounts.

Internal Audit is recommending that management obtain credit of $261,764 for labor overbillings charged to the gas tax agreement. Management should also reduce final payment to the City under Measure M2 Comprehensive Transportation Funding Program (CTFP) Project No. 11-SNTA-ACE-9003 by $58,371 to adjust for duplicated charges. OCTA management should strengthen language regarding excess right-of-way property, and obtain a $443,078 credit to the gas tax agreement for the value of excess property or implement monitoring controls to ensure that sales proceeds of excess property sold are applied to eligible Project costs. OCTA management should also implement controls to ensure costs claimed comply with the gas tax agreement, are valid and supported, and are not duplicated under another agreement. Finally, management should consider including eligible cost guidelines in future agreements.

Background

Project

The Project will widen Bristol Street from two to three lanes in each direction between 17th Street and Warner Avenue. The Project will be completed in four phases:

- Phase I - centerline of McFadden to 300’ north of Pine Street;
- Phase II - 200’ south of Third Street to Centerline of Civic Center Drive;
- Phase III - centerline of Civic Center Drive to 17th Street; and
- Phase IV - centerline of Warner Avenue to St. Andrew Place.

The City acts as the lead agency in the right-of-way acquisition, design, construction, and construction management, and OCTA provides funding through the gas tax agreement and multiple CTFP project awards.

Sources of Funding

The sources of funding for the Project, by phase, are:

	Gas Tax Agreement	Measure M-through CTFP	State-Local Partnership Program-through CTFP	Federal funds
Phase I	X			
Phase II	X	X	X	
Phase IIIA	X	X		X
Phase IIIB	X	X		
Phase IV	X	X		X

Agreement No. C-6-0069

On June 12, 2006, OCTA and the City entered into the gas tax agreement, whereby OCTA makes available funding through the gas tax subvention funds in the not-to-exceed amount of $125,000,000.

Under the original gas tax agreement, OCTA was responsible for paying the City upon receipt of an acceptable invoice; the invoice format included billings of City personnel with names, billing rates, hours, and amounts, as well as billing from consultants/contractors, and reimbursable costs. Amendment No. 2 changed the payment provision, to allow the City to request payments on a monthly basis according to a pro-rated portion of amounts specified in Exhibit D "Semi-Annual Maximum Obligation for Bristol Street Widening." On a quarterly basis, the City is required to reconcile actual expenses versus payments from OCTA for the Project; if actual expenses are less than payments OCTA should withhold such excess payment amounts from the City's next monthly payment request, and if actual expenses exceed payments then the City should submit a written request for payment to OCTA.

CTFP Projects

Under Measure M2, OCTA has awarded the City multiple CTFP projects with allocation amounts totaling $44.4 million.

Under the prior Measure M, OCTA had awarded several CTFP's for the Bristol Street/Warner Avenue intersection widening and the Bristol Street/17th Street intersection widening, with payment amounts over $5.6 million.

Objectives, Scope, and Methodology

The objectives were to assess the adequacy of oversight controls and contract compliance and to determine whether payments made to the City are in accordance with agreements and are based on valid, accurate Project costs.

The methodology consisted of identification and testing of controls to monitor project status and costs, review of payments to the City for compliance with the gas tax agreement, review of the City's quarterly reconciliations of actual costs versus payments to determine contract compliance and appropriate OCTA oversight, and review of costs on selected quarterly reconciliations to determine if costs are for the Project and allowable and are not also billed under CTFP projects.

The scope is limited to the Project. The scope included monthly progress reports and quarterly reconciliation reports available for fiscal year (FY) 2013-14 and FY 2014-15. The scope included payments made by OCTA to the City after Amendment No. 2 to the gas tax agreement. The scope also included review of Project costs shown on the quarterly reconciliation reports from the second quarter in calendar year 2013 through the first quarter in calendar year 2015, including a review of timesheets for all labor report items greater than $10,000. Since the labor sample is non-statistical, any conclusions are limited to the sample items tested. The scope included review of costs charged to CTFP projects only when those costs may have overlapped with the reviewed costs under the gas tax agreement; further, for the closed-out CTFP projects, Internal Audit did not have the detailed labor reports for those periods and therefore could not determine if those labor costs overlapped with the costs charged to the gas tax agreement.

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.

Audit Comments, Recommendations and Management Responses

Gas Tax Agreement Should be Credited $261,764 for Overbillings due to Inflated Labor Billing Rates

The City's calculation of inflated labor billing rates resulted in overbillings to the gas tax agreement in the amount of $261,764.

To calculate billing rates, the City used unreasonable estimates, accounted for the costs of indirect labor time twice in the rate calculation, used the highest-paid employee in each classification as a basis for the rate, and used outdated rate calculations for charges to the gas tax agreement.

Internal Audit recalculated labor billing rates after removing duplicated indirect labor costs and using average employee hourly rates by classification.

Recommendation 1:

Internal Audit recommends that management obtain credit of $261,764 to the gas tax agreement and ensure labor billing rates are corrected. Monitoring controls should be implemented to ensure reasonable and accurate labor charges going forward.

Management Response (Capital Programs):

Management agrees with the finding and will take the following actions.

- The gas tax agreement will be credited $261,764 and the City will be required to utilize revised rates going forward.
- The gas tax agreement will be amended to require the City to certify with signature that the quarterly City reconciliation report of actual expenses versus monthly payment requests, including labor billing rates charged, are true and correct.

CTFP Payment Should be Reduced by $58,371 to Remove Duplicated and Overstated Costs

CTFP Project No. 11-SNTA-ACE-9003 provides for payment of 65 percent of eligible project costs, with a 35 percent required local match. The City's 35 percent match is comprised of costs charged to the gas tax agreement. At the time of the audit, Planning Division staff was in the process of reviewing the City's claim for final payment under the CTFP project. Internal Audit asked management to withhold final payment pending completion of Internal Audit's review of the claimed costs.

Internal Audit identified labor and material costs included in the CTFP cost claim that had already been fully charged to the gas tax agreement at the inflated labor billing rates. Conversely, matching funds identified for construction contract costs had not all been charged to the gas tax agreement. After revising the amounts allocated to CTFP costs and the match, Internal Audit determined that the claimed final payment should be reduced by $58,371.

Recommendation 2:

Internal Audit recommends management require the City to revise its claim for final payment downward by $58,371. Management should also implement controls to ensure that costs charged to the gas tax agreement and CTFP projects are not duplicated.

Management Response (Planning and Capital Programs):

Management agrees with the finding and will take the following actions.

- The Planning Division will reduce the CTFP final payment by $58,371.
- All future gas tax agreement invoices processed by the Capital Programs Division will be coordinated and reviewed with the Planning Division. The Capital Programs and Planning Division will explore organizational changes to improve grant management activities.

Gas Tax Agreement Should be Credited $443,078 for Value of Excess Right-of-Way Property or Monitoring Controls for Excess Property Should be Implemented

Internal Audit noted that the Planning Division disallowed payment of the CTFP share of excess right-of-way property. In response, the City charged the disallowed costs to the gas tax agreement resulting in a total of $443,078 of excess property charged to the agreement.

The gas tax agreement states that nothing obligates the City to sell excess property. However, if the City sells excess property, all sale proceeds are required to be applied to excess costs of the first two phases of the Project and any remaining balance applied to the last two phases.

Currently, there is no system in place to ensure that when excess property is sold that all sales proceeds are applied to eligible Project costs.

Recommendation 3:

Internal Audit recommends that the gas tax agreement be amended to strengthen requirements regarding excess right-of-way property including the addition of a requirement to sell or credit the value of excess property to the agreement. Also, Internal Audit recommends management either request the City credit the gas tax agreement for $443,078 or implement controls to ensure that sales proceeds of excess property sold are applied to eligible Project costs.

Management Response (Capital Programs):

Management agrees with the finding and will take the following actions.

- The gas tax agreement will be amended to strengthen requirements for compliance with applicable gas tax use statutes with respect to the disposition and disposal of excess property acquired with gas tax funding.
- The gas tax agreement will be credited for $443,078.
- The gas tax agreement will be amended to require the quarterly City reconciliation report to include tracking and accounting of excess property remnants that were originally acquired with gas tax funding. Upon disposal, the value of these remnant properties will be credited to the gas tax agreement.

Management Should Request the City Strengthen Timekeeping Controls and Consider Disallowing Markup of Sub-Consultant Costs

Internal Audit found that City employee timesheets are not submitted timely and/or are often revised in future time periods. These conditions increase the potential for errors in timekeeping and, ultimately, labor costs charged to the Project. Several instances were observed where labor hours charged to the Project did not agree to the timesheets on file.

Internal Audit also identified mark-ups of sub-consultant costs on several invoices, a practice not typically allowed by OCTA.

Recommendation 4:

Internal Audit recommends management request the City strengthen controls over timekeeping and periodically review supporting documentation to ensure accuracy of labor charges to the Project.

Management should also consider disallowing sub-consultant markups through update of contract language in cooperative agreements.

Management Response (Capital Programs):

Management agrees with the finding and will take the following actions.

- The gas tax agreement will be amended to require the City to certify with signature that the quarterly City reconciliation report of actual expenses versus monthly payment requests, including labor hours charged, are true and correct.
- Staff will review a sample of supporting documentation from the City quarterly reconciliation report to verify actual expenses and that labor hours billed are supported by time sheets on file.
- The gas tax agreement will be amended to specifically disallow sub-consultant markups.

Management Should Validate Charges and Reconcile Funding Amounts

The City provides quarterly reconciliation reports that reflect funding received and costs charged; however, OCTA staff does not review costs charged against supporting documentation (i.e. consultant invoices, labor reports, and purchase and sale agreements for acquisitions of real property).

OCTA staff also does not reconcile these reports to its own records of payments made under the gas tax agreement. Internal Audit's review found that the City is overstating funding received by $203,584[1]. Periodic reconciliation is necessary to ensure the City is reflecting an accurate amount of funding, since the amount is capped by the gas tax agreement.

Recommendation 5:

Internal Audit recommends that management design and implement a cost review process that includes review of a sample of City costs charged to the gas tax agreement to ensure that such costs are Project-related, supported, and reasonable.

Internal Audit also recommends management instruct the City to correct its quarterly reconciliation reports and implement procedures to reconcile City reports with OCTA records.

[1] The City did not include three $500.00 refund checks from First America resulting in an overstatement of $1,500.00. Also, the City reflected a wire in the amount of $1,988,397.27 rather than $1,786,313.54, resulting in an overstatement of $202,083.73.

Management Response (Capital Programs):

Management agrees with the finding and will take the following actions.

- Staff will periodically sample supporting documentation for costs charged to verify the charges are project-related, supported, and reasonable.
- The City will be instructed to correct quarterly reconciliation reports based on these audit findings and staff will reconcile each quarterly report with records of payments made under the gas tax agreement.

Management Should Enforce Payment Terms of the Gas Tax Agreement

Amounts paid under the gas tax agreement are inconsistent with the terms and amounts specified in the agreement. The agreement allows the City to request payments monthly based on a pro-rated portion of amounts specified in an exhibit to the agreement. When actual expenses are less than payments to date, excess payment amounts are to be withheld from the City's next monthly payment request. Rather than using this specified methodology, the City invoices based on its cash flow forecasting and spending plan and OCTA pays these invoiced amounts.

Recommendation 6:

Internal Audit recommends that management amend the gas tax agreement to update the payment schedule and implement controls to enforce the payment provisions.

Management Response (Capital Programs):

Management agrees with the finding and will take the following actions.

- The gas tax agreement will be amended to reflect the reconciliation of the pro-rated invoicing and the payment schedule will be updated accordingly.