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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Directors
Orange County Transportation Authority
Orange, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Orange County Transportation Authority (OCTA), as of and for the year ended June 30, 2021, and the related notes to the financial statements, which collectively comprise OCTA's basic financial statements, and have issued our report thereon dated November 22, 2021.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered OCTA's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of OCTA's internal control. Accordingly, we do not express an opinion on the effectiveness of OCTA's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as items 2021-001 and 2021-002 that we consider to be significant deficiencies.

(Continued)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether OCTA's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

OCTA's Response to Findings

OCTA's response to the findings identified in our audit is described in the accompanying Schedule of Findings and Responses. OCTA's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Crowe LLP

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Costa Mesa, California
November 22, 2021

Finding 2021-001 – Financial Accounting and Reporting for Expense Accruals (Significant Deficiency)

Criteria

Generally accepted accounting principles require entities to record liabilities and related expenses that result from exchange transactions when goods or services have been received in exchange for a promise to compensate the vendor or service provider. In addition, management should have internal controls to ensure that such liabilities and expenses are fairly stated.

Condition

During the fiscal year, management identified prior year errors in expense accruals related to the Local Transportation Authority (LTA) fund that were not previously corrected. Management inadvertently over accrued two invoices in the prior year for the same transaction. Conversely, management also identified utility construction costs that had been incurred in prior years but had not accrued because invoices had not been timely remitted by the utility companies. As a result of the delay in the receipt of the utility invoices, management estimated an amount to be accrued for utility costs for work performed in prior years. In addition, management updated their estimate for an amount to be accrued for the utility costs for work performed in the current year. The net impact of these transactions was under accruals of expense in the prior year for the LTA fund and governmental activities in the amounts of $14,433,346 and $22,249,243, respectively. Management elected to correct the prior year accruals in the current year.

Cause

Expense over accruals were caused by lack of controls surrounding the booking of estimates as project managers did not make accounting aware that actual invoices were subsequently posted related to items that were previously estimated. For the missed utility expense under accruals, management did not have internal controls in place to estimate the utility costs incurred relative to the progress of the utility construction projects given the delay between when the work is actually performed and the time the utility companies invoice OCTA for such costs.

Effect

The net impact of these transactions was under accruals of expenses in the prior year for the LTA fund and governmental activities in the amounts of $14,433,346 and $22,249,243, respectively

Recommendation

We recommend that management improve Project Managers' understanding of the accrual process and importance of notifying Accounting of the posting of invoices that are related to those already accrued for by management. We also recommend additional layers of review to accrual journal entries including recurring review of the entries for actual invoices up until the financial statements are issued. The review should include comparing all manually accrued invoices/estimates to the vouchers and retainage payable accounts to ensure there are no duplications. For the utility construction costs, Crowe recommends that management review their utility accrual analysis for all construction projects annually for completeness and accuracy, and adjust accordingly.

Management's Response

Management agrees and has implemented a control to review all AP accounts specifically looking for duplications between the manual accrual account and the voucher and retainage payable accounts. In addition, the Accounting department will provide training on a yearly basis to all staff involved in the expense accruals process to ensure expense accruals are submitted in compliance with all rules and requirements. The Accounting department will work with Project Managers on the utility accrual analysis on a yearly basis prior to the closing of the fiscal year.

Finding 2021-002 – Preparation of the Schedule of Expenditures of Federal Awards (Significant Deficiency)

Criteria

2 CFR 200.510 (b) requires "...the auditee to prepare a schedule of expenditures of federal awards (SEFA) for the period covered by the financial statements which must include the total federal awards expended. At a minimum, the schedule must .... provide total federal awards expended for each individual federal program and the [related] Assistance Listings Number." In addition, the auditee should ensure they have proper internal controls to ensure that the SEFA is fairly stated in relation to the financial statements.

Condition

During our review of the SEFA reconciliation to the OCTA financial statements, management underreported expenditures on the SEFA in the amount of $18.6M, related to the Federal Transit Cluster. Management inadvertently did not include an adjustment made to the general ledger on the SEFA which resulted in the amount underreported. Crowe proposed and management reflected an $18.6 million adjustment to increase the expenditures on the SEFA.

Cause

Management's review of the SEFA reconciliation did not properly resolve an $18.6 million reconciling item between the federal grant expenditures reported on the SEFA and federal grant revenues recorded in the general ledger.

Effect

As a result, the expenditures on the SEFA for the Federal Transit Cluster were understated by $18.6 million.

Recommendation

We recommend that management strengthen their review process over the SEFA to ensure that all expenditures are appropriately reflected and reconcile to the general ledger, which should include a detailed review and approval of any reconciling items.

Management's Response

Management agrees with the recommendation. An in-depth review of the SEFA schedule will be completed by the Accounting department in coordination with the Revenue department to ensure all expenditures are appropriately reflected in the schedule. This review will include a reconciliation of all expenditures reported on the SEFA schedule to the general ledger. Any differences will be resolved before the SEFA schedule is finalized.