

SOUTHERN CALIFORNIA



**ASSOCIATION of  
GOVERNMENTS**

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Energy & Environment  
Margaret Clark, Rosemead

Transportation  
Paul Glaab, Laguna Niguel

## MEETING OF THE

# AUDIT COMMITTEE

**Wednesday, February 29, 2012  
10:00 a.m. – 11:00 a.m.**

**SCAG Offices  
818 W. 7<sup>th</sup> Street, 12<sup>th</sup> Floor  
Policy Committee A  
Los Angeles, CA 90017  
(213) 236-1800**

**Teleconference will also be available**

### **Video Conference is Available:**

Imperial County SCAG Office  
1405 N. Imperial Avenue, Suite 1  
El Centro, CA 92243

If members of the public wish to review the attachments or have any questions on any of the agenda items, please contact Carmen Summers at (213) 236-1984 or via email [summers@scag.ca.gov](mailto:summers@scag.ca.gov).

Agendas & Minutes for the Audit Committee are also available at:

[www.scag.ca.gov/committees.htm](http://www.scag.ca.gov/committees.htm)

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***Audit Committee Membership***  
*February 2012*

**Members**

1. Hon. Greg Pettis, Cathedral City (**Chair**)
2. Hon. Glen Becerra, Simi Valley,
3. Hon Glenn Duncan, Chino
4. Hon. Phil Luebben, Cypress, (**Vice Chair**)
5. Hon. Leroy Mills, Cypress
6. Hon Cheryl Viegas-Walker, El Centro
7. Hon. Edward H. J. Wilson, Signal Hill

**Representing**

**District 2 SCAG 2<sup>nd</sup> Vice-President**  
**District 46, SCAG 1<sup>st</sup> Vice-President**  
**District 10**  
**OCCOG**  
**District 18**  
**District 1**  
**Gateway Cities**

# AUDIT COMMITTEE AGENDA FEBRUARY 29, 2012

**TIME      PG#**

*The Audit Committee may consider and act upon any of the items listed on the agenda regardless of whether they are listed as information or action items.*

**CALL TO ORDER & PLEDGE OF ALLEGIANCE**

*(Hon. Greg Pettis, Chair)*

**PUBLIC COMMENT PERIOD** – Members of the public desiring to speak on items on the agenda, or items not on the agenda, but within the purview of the Audit Committee must fill out and present a speaker’s card to the Assistant prior to speaking. Comments will be limited to three (3) minutes per speaker provided that the Chair has the discretion to reduce this time limit based on the number of speakers. The Chair may limit the total time for all public comments to twenty (20) minutes.

**REVIEW and PRIORITIZE AGENDA ITEMS**

**CONSENT CALENDAR**

**Approval Items**

- |   |                   |  |          |
|---|-------------------|--|----------|
| 1. <u>Minutes of October 25, 2011 Meeting</u> | <b>Attachment</b> |  | <b>1</b> |
|---|-------------------|--|----------|

**INFORMATION ITEMS**

- |   |                   |               |           |
|---|-------------------|---------------|-----------|
| 2. <u>FY 2010/11 Information Technology Audit</u><br><i>(Wayne Moore, CFO)</i>                                  | <b>Attachment</b> | <b>20 min</b> | <b>7</b>  |
| 3. <u>Risk Management Evaluation</u><br><u>Action Report Update</u><br><i>(Basil Panas, Accounting Manager)</i> | <b>Attachment</b> | <b>10 min</b> | <b>19</b> |
| 4. <u>FY 2010/11 ICAP Audit Update</u><br><i>(Basil Panas, Accounting Manager)</i>                              | <b>Attachment</b> | <b>10 min</b> | <b>21</b> |
| 5. <u>Internal Audit Status Report</u><br><i>(Richard Howard, Internal Auditor)</i>                             | <b>Attachment</b> | <b>10 min</b> | <b>37</b> |

# AUDIT COMMITTEE AGENDA FEBRUARY 29, 2012

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*TIME*    *PG#*

## STAFF REPORT

## FUTURE AGENDA ITEMS

Any member or staff desiring to place items on a future agenda may make such a request.

## ANNOUNCEMENTS

## ADJOURNMENT

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Audit Committee  
of the  
Southern California Association of Governments

October 25, 2011

*Minutes*

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**THE FOLLOWING MINUTES ARE A SUMMARY OF ACTIONS TAKEN BY THE AUDIT COMMITTEE. AUDIO CASSETTE TAPE OF THE ACTUAL MEETING IS AVAILABLE FOR LISTENING IN SCAG'S OFFICE.**

The Audit Committee held its meeting at the SCAG offices in downtown Los Angeles. The meeting was called to order by Hon. Greg Pettis, Chair, Cathedral City. There was a quorum.

**Members Present**

Hon. Greg Pettis, Cathedral City (**Chair**)  
Hon. Phil Luebben, Cypress (**Vice Chair**)  
Hon. Leroy Mills, Cypress  
Hon. Cheryl Viegas-Walker, El Centro  
Hon. Edward H. J. Wilson, Signal Hill

**Representing**

District 2, SCAG 2<sup>nd</sup> Vice-President  
OCCOG (Via Teleconference)  
District 18  
District 1 (Via Videoconference)  
Gateway Cities (Via Teleconference)

**Members Not Present**

Hon. Glen Becerra, Simi Valley  
Hon. Glenn Duncan, Chino

District 26, SCAG 1st Vice-President  
District 10

**Other Attendees**

Hon. Pam O'Connor  
SCAG Staff Members

District 41, SCAG President

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Audit Committee  
of the  
Southern California Association of Governments

October 25, 2011

*Minutes*

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**CALL TO ORDER & PLEDGE OF ALLEGIANCE**

Hon. Greg Pettis, Chair, called the meeting to order at 9:05 a.m.

**PUBLIC COMMENT PERIOD**

None.

**REVIEW and PRIORITIZE AGENDA ITEMS**

None.

**CONSENT CALENDAR**

**Approval Items**

1. Minutes of June 20, 2011 Meeting

Motion was made (Luebben) to approve the Consent Calendar Approval Items. Motion was seconded (Mills). A roll call vote was taken. Motion passed.

**INFORMATION ITEMS**

2. Risk Management Evaluation

Basil Panas, Accounting Manager provided a brief summary of The California Joint Powers Insurance Authority's (JPIA) agency-wide Risk Management Program and Evaluation that was conducted in December, 2010. The evaluation is designed to minimize SCAG's loss exposure. The evaluation, which was primarily a review on SCAG's policies and procedures, resulted in fifteen recommendations, three of which have been completed. The recommendations are listed on the attached LossCAP Action Plan (Action Plan).

Several committee members expressed concern regarding: 1) the delay of implementation on the recurring items listed on the Action Plan and; 2) whether established target dates have been identified for completing all of the recommended tasks.

Staff explained that due to SCAG's limited resources, the primary focus has been on the issues that had a greater impact on SCAG's operations. However, there were several items that were not included in the report that were previously implemented; that list can be agendaized on the next Audit Committee agenda. In addition, a Risk Management Committee was formed to address, establish deadlines and implement the remaining action items by the June, 2012 target date. The committee will meet quarterly to monitor progress.

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Audit Committee  
of the  
Southern California Association of Governments

October 25, 2011

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*Minutes*

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The discussion concluded with the committee members requesting that staff, at each subsequent Audit Committee meeting, provide an updated status report of the action items listed on the Action Plan, and report until all action items have been implemented. Staff agreed.

3. FY 2010/11 ICAP Audit

Basil Panas, Accounting Manager, discussed SCAG's FY11 Indirect Cost Allocation Plan (ICAP) audit which was conducted by the State Controller's Office (SCO). The SCO report to Caltrans recommended adjusting SCAG's FY11 ICAP rate from 97.38% to 96.02%. The adjustment resulted from two disallowances: 1) Depreciation of \$46,087 for fixed assets; 2) Severance of \$109,835 made after the contract expiration date. At this time, Caltrans has not yet acted on the recommendations; however, SCAG did use the revised ICAP rate of 96.02% for its FY 2010/11 grant billings. The SCO audit findings were also reported at the September 1, 2011 EAC/RC meetings.

4. Internal Audit Status Report

Richard Howard, Internal Auditor, provided a brief summary of the Internal Audits that are currently in progress. In addition, to provide a better understanding of the types of audits that are usually performed, Mr. Howard provided an Audit Activity Report. This report detailed the types of audits performed during the past three years.

The committee members expressed their appreciation for the Audit Activity report.

5. FY 2010/11 Draft Financial Audit Report

Basil Panas, Accounting Manager, introduced SCAG's outside independent auditors, Vasquez & Company, LLC to the committee. Ms. Linda Narcisso, Manager, provided a brief presentation of SCAG's preliminary audit findings.

The following documents were part of the agenda packet and presentation:

- Comprehensive Annual Financial Report
- Single Audit
- Report on Internal Control over Financial Reporting  
And on Compliance and Other Matters
- Comments to Management

Ms. Narcisso noted that there were two recommendations to SCAG's management and those recommendations have since been implemented by the department. In addition, the audit team is currently working on the Information Technology (IT) systems audit. The IT audit findings will be presented at the next Audit Committee meeting.

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Audit Committee  
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*Minutes*

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Finally, Ms. Narcisso stated that there were no audit findings or any identified deficiencies associated with SCAG's FY 2010/11 Draft Financial Audit. The final Financial Audit report will go to the Executive/Administration Committee and Regional Council at the January 2012 meeting.

Hon. Cheryl Viegas-Walker, in compliance of best practices, requested that the audit team research and implement an automated testing procedure for preparing future audits. The audit team concurred.

Hasan Ikhata, Executive Director also expressed interest in automating the audit-testing software and asked if he and Hon. Viegas Walker could schedule some time to discuss software and other technological alternatives.

6. Actuarial Report For Other Post Employment Benefits (OPEB)

Basil Panas, Accounting Manager introduced SCAG's outside independent actuary, Doug Pryor from Bartel Associates, LLC. Mr. Pryor presented the June 30, 2011 Actuarial Report for SCAG's Other-Post Employment Benefits (OPEB) which is required biennially. The presentation included the following topics:

- Actuarial Assumptions Highlights
- Actuarial Obligations
- Annual Required Contribution (ARC)
- Funded Status

SCAG's management chose to assume a discount rate of 7% vs. 7.75% to last year's rate, for its valuation summary. The 7% assumption was used in the actuarial study to forecast SCAG's ARC to fully fund SCAG's retiree healthcare benefit obligations, and was for computation purposes only. The monthly benefit level of \$550 increasing 2% every three years was not changed. This is an assumption for computation purposes only. SCAG's actuarial computed contribution in FY13 will be \$589,000.

**ACTION ITEMS**

7. Audit Committee Charter Amendment

At the June 20, 2011 committee meeting, the committee directed staff to modify the Audit Committee Charter (Charter) as it pertains to the Committee's reporting responsibilities to the Regional Council (RC).

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Audit Committee  
of the  
Southern California Association of Governments

October 25, 2011

*Minutes*

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The modified reporting responsibilities section reads as follows:

“Report to the Regional Council on an as needed basis, no less than annually, about how the Audit Committee has discharged its duties and met its responsibilities.”

The Audit Committee Charter Amendment, once approved by the Audit Committee, will be forwarded to the Regional Council for approval.

Motion was made (Wilson) to approve staff’s recommendations and forward the Audit Committee Charter Amendment to the RC. Motion was seconded (Viegas-Walker). A roll call vote was taken. Motion passed UNANIMOUSLY.

**STAFF REPORT**

None.

**FUTURE AGENDA ITEMS**

Risk Management Action Plan Update  
Final IT Audit by Vasquez & Company, LLC.

**ANNOUNCEMENTS**

None.

**ADJOURNMENT**

Hon. Greg Pettis, Chair, adjourned the meeting at 11:10 a.m. The next meeting of the Audit Committee will be scheduled at a later date.

**Minutes Approved by:**

Wayne Moore, Chief Financial Officer  
Staff to the Audit Committee

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# REPORT

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**DATE:** February 29, 2012  
**TO:** Audit Committee  
**FROM:** Wayne Moore, CFO, 213-236-1804, moore@scag.ca.gov  
**SUBJECT:** FY 2010/11 Information Technology Audit

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**RECOMMENDED ACTION:**  
For Information Only-No Action Required.

**EXECUTIVE SUMMARY:**  
*SCAG's outside independent auditors, Vasquez and Company, LLC, will present the results of their audit of the Information Technology function.*

**STRATEGIC PLAN:**  
This item supports SCAG's Strategic Plan Goal 3: Enhance the Agency's Long Term Financial Stability and Fiscal Management.

**BACKGROUND:**  
SCAG's auditors, Vasquez and Company, LLC, completed the financial portion of their FY 2010/11 audit in December and recently completed their audit of SCAG's Information Technology (IT) function. The audit did not reveal any issues that could affect the integrity of SCAG's financial reporting but did identify nine recommendations that could reduce business and other control risks. Vasquez staff will present these findings. They will be referred to SCAG's IT Steering Committee for resolution.

**FISCAL IMPACT:**  
None.

**ATTACHMENT:**  
IT Audit Report issued by Vasquez and Company, LLC.

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**Letter of Comments to Management**  
**Southern California Association of Governments**  
*Year ended June 30, 2011*

**The Honorable Members of the Regional Council  
Southern California Association of Governments**

In planning and performing our audit of the financial statements of Southern California Association of Governments (SCAG) as of and for the year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered SCAG's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SCAG's internal control. Accordingly, we do not express an opinion on the effectiveness of SCAG's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses.

*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 combination of deficiencies in internal control, that there is a reasonable possibility that a material misstatement of SCAG's financial statements will not be prevented or detected and corrected on a timely basis. We did not identify any material weaknesses during the course of our audit.

However, during our audit, we became aware of certain matters that we believe represent opportunity for SCAG to further strengthen its internal controls over its information technology. These matters do not represent significant deficiencies, material weaknesses in internal control, or material instances of noncompliance.

This communication is intended to give our observations and suggestions about operational or administrative efficiencies, and other items that we perceive of benefit to SCAG that go beyond internal control related matters and are communicated only as information for the benefit of management. It includes items noted during the course of our audit, which in our judgment, are not considered significant deficiencies but are presented for management's consideration.

Our comments have been classified into two areas: Audit Concerns - controls issues which could impact the nature, timing and extent of our procedures at SCAG; and Business Risks and Other Controls which do not impact our audit approach.

## **I. AUDIT CONCERNS**

- None noted

## **II. BUSINESS RISKS AND OTHER CONTROL ISSUES**

### **1. Long-term Strategic Planning for Information Technology (IT)**

#### **Comments:**

SCAG's IT management currently has key projects planned out for future dates that will positively impact its IT operations. Regular reports about IT project status are presented to an internal SCAG IT Steering Committee on a quarterly basis for review and approval. The most current IT Strategic Plan is from 2007-2008. The overall SCAG Strategic Plan was published in 2008-2009. The IT Strategic Plan should be updated to reflect the key objectives in the SCAG Strategic Plan and current SCAG management directives. Effective long and short-term IT strategic planning on a continual basis is essential for an IT organization to ensure that its information resources will support established business goals and objectives. A strategic plan should be reliant on an overall organizational plan.

#### **Business risk:**

By not adequately updating the organization's IT strategic planning, SCAG faces the risk of inadequate project planning, limited personnel resources, and incorrect determination of required future resources and IT requirements.

#### **Recommendation:**

We recommend SCAG management should ensure the IT Strategic Plan is adequately updated with the current and future projects that are not included therein. The future IT objectives should be linked to the overall organizational strategic plan taking into account the industry, stakeholders and regional forces shaping SCAG's operations which will continue to serve as the foundation for all future IT projects. Management should ensure that the IT Strategic Plan is updated continuously to ensure that any enabling technologies that may provide a strategic advantage are considered for usage within the organization.

#### **Management response:**

SCAG staff will update the IT Strategic Plan by June 30, 2012 to obtain management consensus and approval of IT initiatives. This update will take into account the organizational objectives outlined in the SCAG 2009 Strategic Plan and more recent executive directives.

### **2. IT Capacity Planning**

#### **Comments:**

Formal capacity planning is not regularly performed to determine the effect of heavy traffic on SCAG systems. There was no evidence of the usage of automated tools to analyze system capacities on a scheduled basis. Instead, system administrators use system-based monitoring utilities to perform capacity troubleshooting and analysis on an ad hoc basis, and only when set thresholds are exceeded. As this process is reactive rather than proactive, serious capacity issues may go undetected until emergency action is required.

**Business risk:**

SCAG faces the risk of unforeseen production problems if it can't measure the current IT infrastructure's capacity. A consistent representative review and analysis of system activity and utilization is necessary to ensure that the system is capable of meeting future processing and capacity requirements.

**Recommendation:**

We recommend that management implement a process to generate and review system activity and utilization reports on a consistently scheduled basis. Special consideration should be given to the accounting system's related processes and infrastructure.

**Management response:**

SCAG increases capacity frequently to accommodate growth and avoid IT service disruption. SCAG has not suffered a critical capacity problem in financial or other systems for several years. However, SCAG concurs with the recommendation that regular capacity reports are needed. SCAG initiated a competitive bid process in late 2011 to select a new IT managed services provider, Allied Digital Services LLC (ADSL), whose contract is expected to begin in March 2012. ADSL's contract guarantees detailed, regular IT system capacity and performance reporting.

### 3. Information Security Independence

**Comments:**

In reviewing the organizational structure at the SCAG, we noted that the Information Security function is divided between certain key IT operations managers. Proper segregation of duties is a key aspect of a well managed IT function.

**Business risk:**

There are inherent segregation risks when an information security function reports to an operations function. This type of organizational structure does not allow for clear objectivity that will create confidence within the user communities that security related tasks are objective and free of bias. This creates an environment that lacks the independence needed to properly carry out its audit and oversight function. It is very easy for an operations function to bypass security related controls in this type of organizational structure.

**Recommendation:**

We understand that having an independent security function within a not-for-profit organization is difficult from a financial and resource perspective. However, we recommend that the Information Security function report to a party outside of IT, or to an IT-related party that is independent of Operations.

**Management response:**

SCAG uses a combination of external and internal resources to manage information security. SCAG does not have sufficient resources to create an Information Security function outside of IT. However, per audit recommendation, SCAG will create an information security oversight role that reports directly to IT management and is not involved in daily IT operations. IT security reporting will be presented on a quarterly basis to the IT Steering Committee, which is comprised of executive level management. This function is expected to be implemented within 90 days after the new selected IT outsource vendor contract is initiated.

#### 4. Security Violation Reporting

**Comments:**

A mechanism for reporting security violations on the local area network has not been initiated, such as the one utilized for the MS Dynamics accounting system. Audit logging mechanisms are available on network servers that could help management identify anomalous information that is unauthorized. Additionally, firewall and router logs are also available that could help identify other unauthorized activity at the network border points. The audit logging capabilities at the server level include security event logging, application event logging, operating system event logging, and web server logging. Logging can be enabled for security-related events only.

**Business risk:**

Without audit logging capabilities, SCAG is without a forensic capability that can help identify unauthorized activity within the IT environment. Currently, SCAG management would be unaware of unauthorized access to server and data resources if it were to occur.

**Recommendation:**

Although we understand that enabling the audit logging feature on the network servers can provide processing overhead, we recommend that management determine an acceptable framework for logging and follow-up of security-related events on the network. As a start, a risk-based approach can be considered where only those servers identified as high-risk have security event logging capabilities enabled. Processing overhead can be kept to a minimum if file-level activity logging is minimized to only important files and directories.

**Management response:**

SCAG concurs that event logging and correlation must be implemented to reduce security risks. At the network and server levels, the current outsource vendor does not provide log analysis service. However, ADSL, the new IT outsource vendor, will provide advanced security event monitoring using a network of global Network Operations Centers (NOCs) and Security Operations Centers (SOCs). Advanced incident correlation of server and router event logging will be used to determine the source of suspicious activity. The system will automatically block intrusion attempts so that protection is proactive rather than reactive. This service is expected to begin on June 2 and be fully tested and functional by August 2, 2012.

#### 5. Application System Parameters

**Comments:**

The system processing parameters to the MS Dynamics accounting application systems are not currently documented. In addition to this, we noted that key application control features, such as audit logging, user auditing, and security parameter settings were either not enabled and/or unknown. We also noted that password parameters are not optimally set, as required by internal policy. System processing parameters help determine an application's mode of operation and which functions and controls are enabled.

**Business risk:**

By not fully understanding the system processing parameters of the MS Dynamics accounting application system, management may not be taking advantage of certain processing and security controls that can have a positive impact on the control environment.

**Recommendation:**

We recommend that management identify the system parameter settings and review for potential control enhancement and optimization. If any weaknesses are identified, these should be immediately addressed. From a security perspective, management should consider enabling parameters related to audit logging at the application level to strengthen the forensic capabilities of the organization. Formal procedures should be implemented where the system parameters are reviewed on a periodic basis for unauthorized changes.

**Management response:**

SCAG will implement new password policies for the MS Dynamics system to match the Active Directory (AD) password policy planned for March 2012. This password policy will require complex passwords (as defined by Microsoft) and 90 day password expiration. Currently, the Human Resources and Payroll modules have audit trail enabled. Audit trail will be reviewed and expanded to all critical modules, especially those that affect disbursements, to the highest degree possible without compromising the application performance. SCAG staff will review, document and update MS Dynamics system processing parameters. The SCAG security oversight function will review these parameters periodically to ensure no unauthorized changes have occurred. The first cycle of documentation and review will be completed by May 31, 2012 and will occur quarterly in the future.

**6. Periodic Certification of User Profiles in Systems****Comments:**

Although IT liaisons throughout different departments maintain administrative oversight of departmental application systems, management has not performed a formal review of all user profiles on all key systems, except for the MS Dynamics accounting application system, to ensure employee access levels are appropriate. Ideally, this is performed once every 6 – 12 months to help ensure employee job responsibilities are aligned with their access to network and application systems.

**Business risk:**

Employee access levels to systems tend to grow over time, thereby providing employees with excessive access to key systems, which may pose a risk of unauthorized access and/or segregation of duty issues to key accounting processes.

**Recommendation:**

We recommend that management implement a formal access certification procedure where departmental managers are asked to certify their employee's access levels to key systems. Authorizations should be required on formalized documentation from departmental managers, and should be required every 6 – 12 months.

**Management response:**

SCAG IT staff establishes and reviews role-based security settings whenever systems or network folders are implemented or updated. As an additional security precaution, SCAG management will ensure that a formal, periodic access certification procedure be implemented. User access rights will be approved by department managers every 12 months. SCAG staff will schedule the first review to be completed by June 30, 2012. Findings will be reported to the IT Steering Committee.

## 7. Business Contingency Planning

### Comments:

During our review, we noted that an organization-wide business contingency plan has not been developed. However, it was noted that the IT network was designed with some redundancy measures and other disaster recovery measures in place that include varying levels of data backup for the MS Dynamics accounting application system.

### Business risk:

A lack of an organization-wide business contingency planning may hinder SCAG's ability to recover its operations during a disaster. Delays in its ability to recover its operations could have a significant impact on its operational performance and results.

### Recommendation:

To ensure prompt and proper reaction to service disruptions, we recommend that management document an organization-wide business contingency plan. The plan should be detailed and well organized to reflect the chosen strategies and activities for business resumption. The business contingency plan should address and/or include the following areas:

- Identification of key business processes internally and externally,
- identification and evaluation of both interim and long-term recovery strategies,
- identification and documentation of recovery teams and personnel,
- identification and development of resource requirements including supplies and equipment,
- identification and documentation of business recovery procedures including those related to IT and telecommunications,
- recovery procedures training,
- plan testing and maintenance,
- identification of critical business forms and supplies, and
- detailed backup restoration procedures for all key systems.

### Management response:

SCAG completed an organization-wide Business Impact Analysis (BIA) and technical recovery plan in 2008. The technical portions of this plan are complete or in progress, including server virtualization that increases IT system recovery and data center redundancy. However, SCAG recognizes that an organization-wide Business Recovery plan is required to expedite the resumption of critical SCAG business functions after a disaster. SCAG management will initiate a project to develop, approve, implement and test a Business Recovery plan by December 30, 2012. In addition, SCAG will be utilizing for its primary data center an offsite colocation facility by May 31, 2012 that will help enable its contingency capabilities. The secondary data center site will be located at the Los Angeles office until a permanent recovery site is identified.

## 8. Environmental Controls Within Data Operations Room

### Comments:

During our tour of SCAG's data operations room, we noted several key environmental control mechanisms that are ideal for protecting IT infrastructure assets. However, in observing the temperature control systems, we noted that non-dry air conditioning systems were being used to cool the data operations room. We also noted that condensed water from the air conditioning units was being gathered in trash bins

immediately next to server racks and other network equipment, and resting on the raised flooring, potentially just above network and electrical wiring.

**Business risk:**

By utilizing air conditioning units that provide humidity to the data operations room and storing condensated water, SCAG faces the risk of damage to key computing equipment and other infrastructure assets that may impact operations.

**Recommendation:**

We recommend SCAG make a formal determination as to the impact the humidity from the air conditioning units provides to the data servers and other network equipment, via formal discussion with vendor representatives, and identify a manner in which condensated water can be kept out of the data operations room.

**Management response:**

SCAG recognizes that the server rooms located in its headquarters office have inadequate environmental controls, including air conditioning, humidity control and fire suppression. In June 2011, SCAG obtained Board approval to relocate all production servers and related systems to an offsite colocation facility that provides industry-standard environmental and power controls and redundancy. The relocation has been scheduled for May 2012, after the new IT outsource vendor is onboard. SCAG will then have a single point of responsibility for the planning, execution and support of the new server and network (data center) facility. In the meantime, SCAG staff monitors the server room on a daily basis to ensure that the temporary, supplemental air conditioning unit is functioning properly.

## 9. Secure Server Build Standard

**Comments:**

A formally documented and management approved methodology for configuring all Windows servers has not been documented. Although all Windows servers appear to be relatively secure, which include automated patching and anti-virus mechanisms, a secure server standard helps ensure that all servers are consistently built and configured in a secure manner.

**Business risk:**

By not utilizing a checklist approach to security configuration of Windows servers, management faces the risk of misconfigured servers that may provide a security risk to the organization.

**Recommendation:**

Management should ensure that SigmaNet utilizes a secure server standard for all SCAG servers that is utilized for new server builds and existing server security assessment. This will help ensure consistency with respect to security control.

**Management response:**

SCAG management concurs. SCAG will work with its new IT managed services vendor, ADSL, to develop and implement a checklist for standardized, secure server builds. This checklist will be completed within 90 days of the commencement of the ADSL contract.

\* \* \* \* \*

This communication is intended solely for the information and use of the management and members of the Regional Council of Southern California Association of Governments and others within the entity, and is not intended to be and should not be used by anyone other than these specified parties.

**Los Angeles, California**  
**December 5, 2011**

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# REPORT

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**DATE:** February 29, 2012

**TO:** Audit Committee

**FROM:** Wayne Moore, CFO, 213-236-1804, moore@scag.ca.gov

**SUBJECT:** Risk Management Evaluation Action Report Update

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**RECOMMENDED ACTION:**

For Information Only-No Action Required.

**EXECUTIVE SUMMARY:**

*Staff will report progress on the action items recommended in the Risk Management Evaluation.*

**STRATEGIC PLAN:**

This item supports SCAG's Strategic Plan Goal 3: Enhance the Agency's Long Term Financial Stability and Fiscal Management.

**BACKGROUND:**

SCAG's insurer, the California Joint Powers Insurance Authority (JPIA), performed a risk management evaluation in December 2010 as part of its LossCAP Program. The JPIA assessed SCAG's policies, procedures and practices with respect to its risk exposures. The final report identified 15 action items aimed at reducing future losses. Attached is a summary of the progress made in executing the action items. All will be completed by June 30, 2012.

**FISCAL IMPACT:**

None.

**ATTACHMENT:**

LossCAP Action Plan

**IMPORTANT PRIORITY**

<b>RME No.</b>	<b>TYPE</b>	<b>ACTION ITEM</b>	<b>STATUS</b>
06-02	Concurrent	Revise the Injury & Illness Prevention Program	Revised IIPP but it still needs further revisions
06-05	Concurrent	Develop & implement a Hazard Communication Program (HCP)	Assessment determined that an HCP was not needed
06-06	Concurrent	Assess exposure to blood and infectious materials	Assessment determined there was no exposure
06-06	Concurrent	Develop & implement a written lockout/tagout program	Assessment determined that no program was needed
10-01	New	Website does not meet current accessibility standards	Website meets accessibility standards
10-02	New	Develop or revise the formal records retention policy to include retention of electronic data & media	SCAG's Records Management Policy now includes the E-Communications Policies & Procedures as Appendix A which lays out the retention policy for electronic data & media

**AVERAGE PRIORITY**

<b>RME No.</b>	<b>TYPE</b>	<b>ACTION ITEM</b>	<b>STATUS</b>
06-03	Concurrent	Develop & implement a centralized safety manual	Draft is being reviewed by Safety Committee
06-10	Concurrent	Establish a Transitional Return to Work Policy	Draft is under review
10-03	New	Develop & implement a Repetitive Motion Injury Control Program	Draft is in progress
10-04	New	Provide a pre-designated physician form to all employees	Completed
10-05	New	Maintain the log and summary of occupational injuries and illnesses	Completed
10-06	New	Include safety compliance when conducting employee performance evaluations	Completed
10-07	New	Instruct supervisors to notify CalOSHA of serious employee injury or illness, or death	Completed
10-08	New	Develop & implement an automatic external defibrillator program (AED)	Program is being developed by the Safety Committee
10-09	New	Report the number of agency volunteers to the CalJPIA	Completed

# REPORT

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**DATE:** February 29, 2012  
**TO:** Audit Committee  
**FROM:** Wayne Moore, CFO, 213-236-1804 [moore@scag.ca.gov](mailto:moore@scag.ca.gov)  
**SUBJECT:** FY 2010/11 ICAP Audit Update

---

**RECOMMENDED ACTION:**  
For Information Only-No Action Required.

**EXECUTIVE SUMMARY:**  
*Caltrans has accepted the results of the audit of SCAG's FY 2010/11 Indirect Cost Allocation Plan performed by the State Controller's Office.*

**STRATEGIC PLAN:**  
This item supports SCAG's Strategic Plan Goal 3: Enhance the Agency's Long Term Financial Stability and Fiscal Management.

**BACKGROUND:**  
SCAG submits its Indirect Cost Allocation Plan (ICAP) to Caltrans for approval annually after SCAG's budget has been approved by the General Assembly and RC. The ICAP is subject to audit by Caltrans but in the case of SCAG's FY 2010/11 ICAP, they engaged the State Controller's Office (SCO) to perform the audit. In July, 2011, the SCO submitted its audit report to Caltrans and Caltrans informed SCAG on February 11, 2012, that they had accepted the SCO's report and findings.

**FISCAL IMPACT:**  
The final audit report disallowed \$155,922 of indirect costs (\$109,835 in severance pay and \$46,087 in depreciation expense). This had the effect of reducing the ICAP rate from 97.38% (original submission) to 96.02% (final audit report). There is no need to reissue SCAG's FY 2010/11 Comprehensive Annual Financial Report because it was prepared using the final audited rate of 96.02%.

**ATTACHMENTS:**  
Letter from Zilan Chen, Caltrans, dated February 2, 2012  
Letter from Jeffrey Brownfield, State Controller's Office, dated October 31, 2011

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**DEPARTMENT OF TRANSPORTATION****AUDITS AND INVESTIGATIONS**

P.O. Box 942874, MS-2  
SACRAMENTO, CA 94274-0001  
PHONE (916) 323-7111  
FAX (916) 323-7123  
TTY 711  
www.dot.ca.gov



*Flex your power!  
Be energy efficient!*

February 2, 2012

Mr. Wayne Moore  
Chief Financial Officer  
Southern California Association of Governments  
818 West Seventh Street, 12<sup>th</sup> Floor  
Los Angeles, CA 90017-3435

Dear Mr. Moore:

At the request of the California Department of Transportation (Department), the State Controller's Office (SCO) conducted an audit of the Southern California Association of Governments (SCAG) Indirect Cost Allocation Plan (ICAP) for fiscal year (FY) 2010/2011 to determine whether the ICAP is presented in accordance with Title 2 Code of Federal Regulations (CFR) Part 225. The scope of the audit was limited as detailed tests of the FY 2008/2009 carry forward costs were not performed.

Based on audit work performed by the SCO, the SCAG's ICAP for the FY 2010/2011, is presented in accordance with Title 2 CFR Part 225. The approved indirect cost rate is 96.02 percent of total direct salaries and wages, plus fringe benefits.

This report is intended solely for the information of the SCAG, Department Management, the California Transportation Commission and the Federal Highway Administration (FHWA). However, this report is a matter of public record and its distribution is not limited.

Mr. Wayne Moore  
February 2, 2012  
Page 2

Please retain the approved ICAP for your files. Copies were sent to the Department's District 7, the Department's Division of Accounting and the FHWA. If you have questions, please contact Amada Maenpaa, Audit Manager at (916) 323-7868.



ZILAN CHEN  
Chief, External Audits – Local Governments  
Audits and Investigations

Enclosure:

FY 2010/2011 ICAP Certification  
Southern California Association of Governments, Audit Report, Indirect Cost Plan Audit,  
FY 2010/2011, Prepared by California State Controller's Office

- c: Janice Richard, Director, Financial Services, Federal Highway Administration
- Michael Avery, Financial Integrity Review and Evaluation (FIRE) Manager, Federal Highway Administration
- Gary Sweeten, Acting Director of Local Programs, Federal Highway Administration
- Kara Magdaleno, Administrative Program Assistant, Planning and Finance, Federal Highway Administration
- Andrew Finlayson, Chief, State Agency Audit Bureau, California State Controller's Office
- James Ogbonna, Chief, Rural Transit and Intercity Bus Branch, Division of Mass Transportation, California Department of Transportation
- Terry Farris, Branch Chief, Rural Transit and Intercity Bus Branch, Division of Mass Transportation, California Department of Transportation
- Tracey Frost, Senior Transportation Planner, Regional and Interagency Planning, Division of Transportation Planning, California Department of Transportation
- Kirk Cessna, Supervising Transportation Engineer, District 7, Division of Planning and Local Assistance, California Department of Transportation
- Karen Hunter, Rail Transportation Associate, Division of Rail, California Department of Transportation
- Lisa Gore, Associate Accounting Analyst, Local Program Accounting Branch, Local Assistance, California Department of Transportation
- Lai Huynh, Audits & Federal Performance Measures Analyst, Division of Local Assistance, California Department of Transportation
- David Saia, LAPM/LAPG Coordinator, Division of Local Assistance, California Department of Transportation
- Morteza Estebari, Associate Transportation Planner, District 7, Division of Planning and Local Assistance, California Department of Transportation

**SOUTHERN CALIFORNIA ASSOCIATION OF GOVERNMENTS**  
**Indirect Cost Plan**

The indirect cost rate contained herein is for use on grants, contracts and other agreements with the Federal Government and California Department of Transportation (Department), subject to the conditions in Section II. This plan was prepared by the Southern California Association of Governments (Grantee) and approved by the Department.

**SECTION I: Rates**

Rate Type	Effective Period	Rate*	Applicable To
Fixed rate w/carryforward	7/1/10-6/30/11	96.02%	All Programs

\*Base: Total Direct Salaries and fringe benefits

**SECTION II: General Provisions**

**A. Limitations:**

The rate(s) in this Agreement are subject to any statutory or administrative limitations and apply to a given grant, contract, or other agreement, only to the extent that funds are available. Acceptance of the rates is subject to the following conditions: (1) Only costs incurred by the organization are included in its indirect cost pool as finally accepted: such costs are legal obligations of the organization and are allowable under the governing cost principles; (2) The same costs that have been treated as indirect costs are not claimed as direct costs; (3) Similar types of costs have been accorded consistent accounting treatment; and (4) The information provided by the organization used to establish the rates is not later found to be materially incomplete or inaccurate by the Federal Government or the Department. In such situations, the rate(s) would be subject to renegotiation at the discretion of the Federal Government or the Department; (5) Prior actual costs used in the calculation of the approved Rate(s) are contained in the grantee's Single Audit, which was prepared in accordance with OMB Circular A-133. If a Single Audit is not required to be performed, then audited financial statements should be used to support the prior actual costs; and, (6) This rate is based on an estimate of the costs to be incurred during the period.

**B. Accounting Changes:**

This Agreement is based on the accounting system purported by the organization to be in effect during the Agreement period. Changes to the method of accounting for costs which affect the amount of reimbursement resulting from the use of this Agreement require prior approval of the authorized representative of the cognizant agency. Such changes include, but are not limited to, changes in the charging of a particular type of cost from indirect to direct. Failure to obtain approval may result in cost disallowances.

**C. Fixed Rate with Carry Forward:**

The fixed rate used in this Agreement is based on an estimate of the costs for the period covered by the rate. When the actual costs for this period are determined either by the grantee's Single Audit or if a Single Audit is not required, then by the grantee's audited financial statements any

differences between the application of the fixed rate and actual costs will result in an over or under recovery of costs. The over or under recovery will be carried forward, as an adjustment to the calculation of the indirect cost rate, to the second fiscal year subsequent to the fiscal year covered by this plan.

**D. Audit Adjustments:**

Immaterial adjustments resulting from the audit of information contained in this plan shall be compensated for in the subsequent indirect cost plan approved after the date of the audit adjustment. Material audit adjustments will require reimbursement from the grantee.

**E. Use by Other Federal Agencies:**

Authority to approve this agreement by the Department has been delegated by the Federal Highway Administration, California Division. The purpose of this approval is to permit subject local government to bill indirect costs to Title 23 funded projects administered by the Federal Department of Transportation (DOT). This approval does not apply to any grants, contracts, projects, or programs for which DOT is not the cognizant Federal agency.

The approval will also be used by the Department in State-only funded projects.

**F. Other:**

If any Federal contract, grant, or other agreement is reimbursing indirect costs by a means other than the approved rate(s) in this Agreement, the organization should (1) credit such costs to the affected programs, and (2) apply the approved rate(s) to the appropriate base to identify the proper amount of indirect costs allocable to these programs.

**G. Rate Calculation:**

FY10-11 Budgeted Indirect Costs:	
Salaries and fringe benefits	\$ 5,466,026
Indirect Non-Labor Budget	\$ 5,609,288
Indirect Cost Carry Forward from FY08-09	\$(73,178)
 Total FY10-11 Indirect Costs	 \$11,002,136
 FY10-11 Budgeted Salaries & fringe benefits	 \$11,458,345
 FY10-11 Indirect Cost Recovery Rate	 96.02%

**H. Vacancy Rate Analysis:**

As in FY09-10, the reduction for vacancies in FY10-11 was included in the salary budget. In both years, a 4% vacancy factor is incorporated into the indirect cost plan.

**CERTIFICATION OF INDIRECT COSTS**

This is to certify that I have reviewed the indirect cost rate proposal submitted herewith and to the best of my knowledge and belief:

- (1) All costs included in this proposal to establish billing or final indirect costs rates for fiscal year 2011 (July 1, 2010 to June 30, 2011) are allowable in accordance with the requirements of the Federal and State award(s) to which they apply and OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments." Unallowable costs have been adjusted for in allocating costs as indicated in the indirect cost plan and Attachments I-IV.
- (2) All costs included in this proposal are properly allocable to Federal and State awards on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently and the Federal Government and the Department will be notified of any accounting changes that would affect the fixed rate.

I declare that the foregoing is true and correct.

Governmental Unit: Southern California Association of Governments

Signature: Wayne Moore

Signature: Basil Panas

Reviewed, Approved and Submitted by:

Prepared by:

Name of Official: Wayne Moore  
Title: Chief Financial Officer  
Date: June 3, 2010  
Phone: (213) 236-1804

Name of Official: Basil Panas  
Title: Mgr., Accounting & Finance  
Date: June 3, 2010  
Phone: (213) 236-1817

Date of Execution:

**INDIRECT COST RATE APPROVAL**

Caltrans Audits and Investigations has reviewed this indirect cost plan and hereby approves the plan.

Zilan Chen  
Signature

Reviewed and Approved by: Zilan Chen

~~MARYANN CAMPBELL SMITH~~

Title: Chief of External Audits

Date:

Phone Number: 916-323-7105 7877

Max Chamberlain  
Signature

Reviewed and Approved by:

~~MAX CHAMBERLAIN~~

Auditor

Date:

Phone Number: 916-323-7950



JOHN CHIANG  
California State Controller

October 31, 2011

Mary Ann Campbell-Smith, Chief  
External Audits-Local Governments  
Audits and Investigations, MS 2  
California Department of Transportation  
P.O. Box 942874  
Sacramento, CA 94274-0001

Dear Ms. Campbell-Smith:

The State Controller's Office (SCO) audited the indirect cost rate proposal (ICRP) of the Southern California Association of Governments (SCAG). The audit period included the ICRP for fiscal year 2010-11.

The purpose of the audit was to determine whether (1) the ICRP was in compliance with the cost principles prescribed in Title 2, *Code of Federal Regulations*, Part 225 (2 CFR 225); (2) the ICRP was in compliance with the requirements for ICRP preparation and application identified in the California Department of Transportation's Local Program Procedures (LPP) 04-10; and (3) SCAG's cost accounting system was accumulating and segregating reasonable, allowable, and allocable costs.

Our audit determined an indirect cost rate of 96.02%, a difference of 1.36%. The rate was overstated because the indirect costs included \$155,922 (\$109,835 in severance pay and \$46,087 in depreciation costs) in ineligible and unallowable costs.

If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeffrey V. Brownfield", is written over a faint, larger version of the same signature.

JEFFREY V. BROWNFIELD  
Chief, Division of Audits

JVB/vb

# Audit Report

## Summary

The State Controller's Office (SCO) audited the indirect cost rate proposal (ICRP) of the Southern California Association of Governments. The audit period included the ICRP for fiscal year (FY) 2010-11.

The purpose of the audit was to determine whether (1) the ICRP was in compliance with the cost principles prescribed in Title 2, *Code of Federal Regulations*, Part 225 (2 CFR 225); (2) the ICRP was in compliance with the requirements for ICRP preparation and application identified in the California Department of Transportation's (Caltrans) Local Program Procedures (LPP) 04-10; and (3) SCAG's cost accounting system was accumulating and segregating reasonable, allowable, and allocable costs.

Our audit determined an indirect cost rate of 96.02%, a difference of 1.36%. The rate was overstated because the indirect costs included \$155,922 (\$109,835 in severance pay and \$46,087 in depreciation costs) in ineligible and unallowable costs.

## Background

The Southern California Association of Governments (SCAG) was formed in 1965 to provide a forum for elected officials from 56 cities and 5 counties to conduct growth forecasting and regional planning. Over the past four decades, SCAG has become the nation's largest federally designated Metropolitan Planning Organization (MPO), serving six Southern California counties, including Imperial, Los Angeles, Orange, Riverside, San Bernardino, and Ventura, as well as 189 cities in the greater Los Angeles area. SCAG is also legally organized as a Joint Powers Authority pursuant to California Government Code section 6500 et seq. Its primary responsibilities include the development of regional plans for transportation, growth management, housing development, air quality and other key issues facing the region.

SCAG develops an annual Overall Work Program (OWP) that describes proposed transportation planning activities for the upcoming fiscal year. The OWP also includes those transportation planning activities and studies required by federal and state law and authorized by the Regional Council. The OWP, which includes budgeted direct and indirect costs, is reviewed and approved by the Regional Council, Caltrans and Federal Highway Administration. Upon approval of the OWP, SCAG submits and seeks from Caltrans, a provisional approval of the proposed rate per ICRP. The provisional rate allows SCAG to recover project-related administrative indirect costs as costs are incurred, rather than deferring the reimbursement until Caltrans completes the required ICRP audit. Doing so is financially paramount to SCAG as there are no other revenue sources available to fund the project-related indirect activities.

The audit was performed by the SCO on behalf of Caltrans (Audit Request No. P1591-0072). The authority to conduct this audit is given by:

- Interagency Agreement No. 77A0034, dated March 31, 2011, between the SCO and Caltrans, which provides that the SCO will perform audits of proposed ICRPs submitted to Caltrans from local governmental agencies to ensure compliance with 2 CFR 225 (formerly Office of Management and Budget Circular A-87) and LPP 04-10.
- Government Code section 12410, which states, "The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state and may audit the disbursements of any money, for correctness, legality, and for sufficient provisions of law for payment."

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

The scope of the audit was limited to select financial and compliance activities. The audit was conducted from May 2, 2011, through July 26, 2011. The audit consisted of recalculating the ICRP and making inquiries of SCAG's personnel. The audit also included tests of individual accounts in the general ledger and supporting documentation to assess allowability, allocability, and reasonableness of costs, and an assessment of the internal control system applicable for FY 2010-11. Changes to the financial management system subsequent to these dates were not tested and, accordingly, our conclusion does not pertain to changes arising after these dates.

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 conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our audit objectives.

Our audit was conducted to determine whether (1) the ICRP was presented in compliance with the cost principles prescribed in 2 CFR 225; (2) the ICRP was in compliance with the requirements for ICRP preparation and application identified in the Caltrans' LPP 04-10; and (3) the accounting system was accumulating and segregating reasonable, allowable, and allocable costs.

We did not audit SCAG's financial statements. We limited our audit scope to planning and performing audit procedures necessary to obtain reasonable assurance that the proposed ICRP was in accordance with the 2 CFR 225 and LPP 04-10. In addition to developing appropriate auditing procedures, our review of internal control was limited to gaining an understanding of the transaction flow, accounting system and applicable controls to determine its ability to accumulate and segregate reasonable, allowable, and allocable indirect and direct costs.

**Conclusion**

Our audit determined an indirect cost rate of 96.02%, a difference of 1.36%. The rate was overstated, as it included \$155,922 (\$109,835 in ineligible severance pay and \$46,087 in depreciation costs on fixtures paid for by the landlord) in ineligible and unallowable costs.

**Views of  
Responsible  
Officials**

We conducted an exit conference on July 26, 2011, and discussed our audit results with Basil Panas, Manager of Accounting, and Richard Howard, Internal Auditor. Mr. Panas and Mr. Howard agreed with the audit results and requested that we proceed with the final report.

**Restricted Use**

This report is solely for the information and use of Southern California Association of Governments; the California Department of Transportation; and the SCO. It is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record. Parties interested in this report should go to Caltrans' Reporting Transparency in Government website or contact Caltrans.



JEFFREY V. BROWNFIELD  
Chief, Division of Audits

October 31, 2011

**Schedule 1—  
Summary of Proposed and Audited Direct Costs,  
Indirect Costs, and Indirect Costs Rate  
July 1, 2010, through June 30, 2011**

Description of Costs	Proposed	Adjustment	Audited
Direct costs:			
Salaries	\$ 7,158,559	\$ —	\$ 7,158,559
Benefits	4,299,786	—	4,299,786
Total direct costs	<u>\$ 11,458,345</u>	<u>\$ —</u>	<u>\$ 11,458,345</u>
Indirect costs:			
Salaries	\$ 3,414,880	\$ —	\$ 3,414,880
Benefits	2,051,146	—	2,051,146
Subtotal	<u>5,466,026</u>	<u>—</u>	<u>5,466,026</u>
Indirect service, supply, and other costs:			
SCAG consultant	518,905	—	518,905
Legal expense	150,000	—	150,000
Professional service	604,925	—	604,925
Internet access fees	—	—	—
Software support	373,924	—	373,924
Hardware support	270,584	—	270,584
Repair – maintenance	20,484	—	20,484
Office rent 818-offices	1,650,000	—	1,650,000
Office rent satellite	121,000	—	121,000
Equipment leases	115,000	—	115,000
Equipment repairs/maintenance	82,704	—	82,704
Insurance expenses	287,189	—	287,189
ADP and bank fees	14,850	—	14,850
Small office purchases	198,000	—	198,000
Office supplies	109,400	—	109,400
Graphic supplies	25,000	—	25,000
Telephone charges	141,700	—	141,700
Postage and delivery service	33,500	—	33,500
Delivery services	11,800	—	11,800
SCAG memberships	36,000	—	36,000
Professional memberships	1,060	—	1,060
Resource material/subscriber	51,350	—	51,350
Depreciation expense – furniture	42,000	—	42,000
Depreciation expense – computers	192,000	(46,087)	145,913
Recruitment notices	25,000	—	25,000
Public notices	5,000	—	5,000
Staff training	147,500	—	147,500
Conference/workshops	20,500	—	20,500
Other meeting expense	52,000	—	52,000
Miscellaneous other	85,000	—	85,000
Temporary help	25,000	—	25,000
Printing	126,500	—	126,500
Travel	52,600	—	52,600
Travel – local	2,325	—	2,325

## Schedule 1 (continued)

Description of Costs	Proposed	Adjustment	Audited
Mileage	36,450	—	36,450
Staff lodging expense	15,825	—	15,825
Travel-registration fees	1,500	—	1,500
Travel-lodging	—	—	—
Fleet vehicles	8,800	—	8,800
Subtotal	<u>5,655,375</u>	<u>(46,087)</u>	<u>5,609,288</u>
Indirect cost carry-forward	<u>36,657</u>	<u>(109,835)</u>	<u>(73,178)</u>
Total indirect costs	<u>\$ 11,158,058</u>	<u>\$ —</u>	<u>\$ 11,002,136</u>
Direct costs base, salaries and benefits	<u>÷ 11,458,345</u>	<u>÷ —</u>	<u>÷ 11,458,345</u>
Indirect cost rate	<u>97.38%</u>	<u>—</u>	<u>96.02%</u>

# Finding and Recommendation

**FINDING—  
Ineligible severance  
pay and unallowable  
depreciation expenses**

Our audit determined that the indirect cost rate was overstated by \$155,922 (\$109,835 in severance pay and \$46,087 in depreciation expenses) in unallowable costs. As a result, the proposed indirect cost rate of 97.38% was overstated by 1.36%.

During the prior year's audit, California Department of Transportation disallowed severance pay, as it was paid pursuant to expired employer and employee agreement. Subsequently, Southern California Association of Governments (SCAG) agreed with the audit finding and revised its prior year's ICRP with the revised costs and rate. SCAG failed, in its' accounting records, to reconcile the prior year's actual and estimated indirect costs in determining their carry forward adjustment for the current ICRP. As a result, the carry forward adjustment included \$109,835 in ineligible severance pay.

Our review of the depreciation expense revealed that SCAG charged \$46,087 for depreciation expenses for fixtures that were paid by SCAG's landlord, Downtown Properties, LLC, as refurbishment allowance. SCAG acquired the fixtures, and capitalized and recorded the purchase price as acquisition costs. However, SCAG failed to offset the purchase price with the refurbishment allowance to correctly value and record the the acquisition costs. As a result, the depreciable basis for the fixtures was overstated. Accordingly, depreciation expenses were overstated.

Title 2, *Code of Federal Regulations*, Part 225 (2 CFR 225), Appendix E, section B.6., states, in part, "Fixed rate' means an indirect cost rate [in] which... the difference between the estimated costs and the actual, allowable costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period." Section F.5. provides, in part, "Costs specifically identified as unallowable and charged to Federal awards either directly or indirectly will be refunded."

As stated, in part, in 2 CFR 225, Appendix A, section C.4.a., "Applicable credits refer to those receipts or reduction of expenditure type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are: . . . rebates or allowances, recoveries or indemnities on losses . . . they shall be credited to Federal award either as a cost reduction or cash refund, as appropriate." Further, Appendix B, section 11.a., provides, in part, "Depreciation and use allowances are means of allocating the cost of fixed assets to periods benefiting from asset use. Compensation for the use of fixed assets on hand may be made through depreciation of use allowances." Appendix B, section 11.b., provides, in part, "The computation of depreciation or use allowances shall be based on acquisition cost of the assets involved."

Recommendation

We recommend that SCAG exclude ineligible and unallowable costs, recalculate indirect costs, and resubmit its current ICRP. In addition, we recommend that SCAG implement policies and procedures to ensure that all prior and current ineligible and unallowable costs are identified and excluded from the allowable indirect and direct cost components.

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# REPORT

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**DATE:** February 29, 2012  
**TO:** Audit Committee  
**FROM:** Richard Howard, Internal Auditor, (213) 236-1905, [howard@scag.ca.gov](mailto:howard@scag.ca.gov)  
**SUBJECT:** Internal Audit Status Report

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**RECOMMENDED ACTION:**

For Information Only – No Action Required

**STRATEGIC PLAN:**

This item supports SCAG's Strategic Plan, Goal 3 - Enhance the Agency's Long Term Financial Stability and Fiscal Management.

**BACKGROUND:**

Since October 2011, three preaward audits of contract proposals over \$250,000 were performed. In addition, preaward audit work continues on the seven Federal Transportation Planning Grants that were awarded in July 2011. The total of the grant is \$1,243,465.

Work also continued on the review of the SCAG travel policy. Several suggested additions and/or revisions were received from SCAG managers and a final draft should be available within the next month.

A survey to select appropriate audit subjects is underway. At the same time, unannounced audits continue as directed by the Audit Committee.

**FISCAL IMPACT:**

There is no Fiscal Impact.