



Report of Independent Auditors
and Single Audit Reports for

**Southern California Regional
Rail Authority**

June 30, 2016

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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* Incorporated by reference only

**REPORT OF INDEPENDENT AUDITORS 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**

The Board of Directors
Southern California Regional Rail Authority
Los Angeles, California

We have audited, in accordance with 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 basic financial statements of Southern California Regional Rail Authority (SCRRA or the Authority), which comprise the statement of net position as of June 30, 2016, the related statements of revenues, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the basic financial statements, and have issued our report thereon dated December 30, 2016.

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 2016-001 and 2016-002 to be material weaknesses.

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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. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 2016-003 and 2016-004 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SCRRA'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 determination of financial statement amounts. 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*.

Southern California Regional Rail Authority's Responses to Findings

Southern California Regional Rail Authority's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Southern California Regional Rail Authority'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 result 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.



Los Angeles, California
December 30, 2016

**REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE FOR THE MAJOR FEDERAL PROGRAM;
REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON THE SCHEDULE OF
EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE**

The Board of Directors
Southern California Regional Rail Authority
Los Angeles, California

Report on Compliance for the Major Federal Program

We have audited Southern California Regional Rail Authority's (SCRRA or the Authority) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on SCRRA's major federal program for the year ended June 30, 2016. SCRRA's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for SCRRA's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about SCRRA's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of SCRRA's compliance.

Opinion on the Major Federal Program

In our opinion, SCRRA complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2016.



Report on Internal Control Over Compliance

Management of SCRRA is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered SCRRA's internal control over compliance with the types of requirements that could have a direct and material effect on its major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of SCRRA's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified a deficiency in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as item 2016-005 that we consider to be a significant deficiency.

SCRRA's response to the internal control over compliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. SCRRA's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the basic financial statements of SCRRA as of and for the year ended June 30, 2016, and have issued our report thereon dated December 30, 2016, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Moss Adams LLP

Los Angeles, California

January 17, 2017, except for our report on the Schedule of Expenditures of Federal Awards, for which the date is December 30, 2016

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2016**

Federal Grantor/Pass Through Grantor/ Program or Cluster Title	CFDA Number	Pass Through Entity Identifying Number	Federal Expenditures	Passed through to Subrecipients
FEDERAL TRANSIT CLUSTER				
<u>U.S. Department of Transportation</u>				
Direct Programs				
Federal Transit, Capital Investment Grants	20.500		\$ 10,810,323	\$ -
Federal Transit, Formula Grants	20.507		6,136,590	-
ARRA-Federal Transit, Formula Grants	ARRA - 20.507		1,574	-
State of Good Repairs	20.525		14,854,011	-
Pass Through Programs From				
Riverside County Transportation Commission				
Federal Transit, Capital Investment Grants	20.500	CA050268	3,148,041	-
Orange County Transportation Authority				
Federal Transit, Formula Grants	20.507	CA902016/CA90Y942/CA 95X180/CA95X286	995,907	-
Federal Transit, Capital Investment Grants	20.500	CA050269	26,595	-
Total Federal Transit Cluster			<u>35,973,041</u>	<u>-</u>
<u>Public Transportation Research, National Research Programs</u>				
Direct Programs	20.514		<u>20,000</u>	<u>-</u>
Total Public Transportation Research, Nation Research Programs			<u>20,000</u>	<u>-</u>
Total U.S. Department of Transportation			<u>35,993,041</u>	<u>-</u>
Total Expenditures of Federal Awards			<u>\$ 35,993,041</u>	<u>\$ -</u>

SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Note 1 - Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (Schedule) presents the expenditures of federal awards of the Southern California Regional Rail Authority (SCRRA) for the year ended June 30, 2016. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of SCRRA, it is not intended to and does not present the net position, changes in net position, or cash flows of SCRRA.

SCRRA's reporting entity is defined in Note 1 of SCRRA's financial statements. All federal awards from federal agencies are included in the Schedule.

Note 2 - Summary of Significant Accounting Policies

The accompanying Schedule is presented using the accrual basis of accounting, whereby eligible grant expenditures are recorded when incurred (i.e., when goods are received or services provided). Such expenditures are recognized following the cost principles in the Uniform Guidance wherein certain types of expenditures are not allowable or limited as to reimbursement. Expenditures reported include any property or equipment acquisitions incurred under federal programs. Pass-through identifying numbers are presented where available.

SCRRA has not elected to use the 10 percent de minimis indirect cost rate as described in 2 CFR 200.414.

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2016**

Section I – Summary of Auditor’s Results

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? Yes No
- Significant deficiency(ies) identified? Yes None reported
- Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major federal programs:

- Material weakness(es) identified? Yes No
- Significant deficiency(ies) identified? Yes None reported

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? Yes No

Identification of major federal programs and type of auditor’s report issued on compliance for major federal programs:

<i>CFDA Number(s)</i>	<i>Name of Federal Program or Cluster</i>	<i>Type of Auditor’s Report Issued on Compliance for Major Federal Programs</i>
20.500, 20.507, 20.507ARRA, 20.525	Federal Transit Cluster	Unmodified

Dollar threshold used to distinguish between type A and type B programs: \$ 1,079,791

Auditee qualified as low-risk auditee? Yes No

Section II – Financial Statement Findings

FINDING 2016-001 – Annual Financial Reporting (Material Weakness in Internal Control Over Financial Reporting)

Criteria – A well established and documented year end close process serves to detect errors and prevent them from accumulating within a particular period. The strength of this process also helps to ensure that the monthly and annual financial information reported to management and the Board of Directors, from which key decisions are made, is as meaningful and reliable as possible.

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FOR THE YEAR ENDED JUNE 30, 2016**

FINDING 2016-001 – Annual Financial Reporting (Material Weakness in Internal Control Over Financial Reporting) (continued)

Condition/Context – During the year and at year end, many existing reconciliation processes lacked documentation of the appropriate level of review and approval. Subsequent to completion of the financial close, audit adjustments or discrepancies were identified in the following accounts:

- Prepaid expenses
- Due from other agencies
- Inventory (see finding 2016-003)
- Capital assets (see finding 2016-002)
- Advances for construction
- Unearned revenue
- Claims and judgments payable (see finding 2016-004)
- Other postemployment benefits liability
- Classification of certain revenues and expenses

Cause – In discussions with management, these exceptions occurred as a result of 1) significant staff turnover within the finance department during the year, which resulted in loss of historical knowledge; 2) incorrect accounting treatment for transactions in prior years which subsequently impacted the current year; 3) lack of timely and or effective review; and 4) the initial setup of historical projects has made it challenging to reconcile certain accounts such as accounts receivable and advance deposits which are reconciled by customer.

Effect –

- During the year, management identified an escrow account held with a financial institution for approximately \$718,000 which was not recorded appropriately in the general ledger and not reflected in the financial statements. Based on further investigation it was determined that a prepaid asset should have been recorded at the time the escrow deposit was made, but the amount was expensed instead.
- Substantial amounts due from other agencies were reclassified from current assets to long-term as they represent revenue accruals for reimbursable costs for long-term projects that may not have yet been invoiced at year end and are likely to not be collected within the next fiscal year. In addition, reserves of approximately \$2.6 million were recorded to comply with the Authority's accounting policy on collectability of accounts greater than 180 days old.
- The Authority regularly receives deposits in advance of any construction projects it performs for other agencies. During the audit, it was identified that several projects had advance deposits that were collected from the agency that were not applied in estimating the accrual for work performed in relation to that project. An adjusting entry for approximately \$1.7 million was proposed to reduce accruals for amounts due from other agencies and advance deposits for construction because they were included within both populations.
- We noted inconsistencies in the revenue recognition applied to member subsidies: for example, written policies and procedures do not define what expenses should be applied to prepaid member subsidies and when recognition of these revenues should be recorded.

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FOR THE YEAR ENDED JUNE 30, 2016**

FINDING 2016-001 – Annual Financial Reporting (Material Weakness in Internal Control Over Financial Reporting) (continued)

- Management recorded an audit adjusting entry to update the liability for other post-employment benefits based on the actuarial valuation for the current year.
- Management recorded reclassification entries identified during the audit of expenses between functional categories based on the nature of the expenses within.

Recommendation –

- We recommend that management establish a well-designed and efficient annual and month-end closing process that would entail timely preparation and review of monthly reconciliations between general ledgers to sub-ledgers for all significant accounts. In addition, well-documented roles and responsibilities would help when staff transitions or departures occur and should be used for cross-training of employees.
- In addition, we recommend formally documenting current policies for the opening and creation of new projects. Review of the setup should be approved by all departments within Finance to ensure that funding patterns and classification is categorized in a way that the detail will be meaningful and enhance the financial close process.
- Management should work towards taking advantage of financial reporting components of the financial system to streamline reporting and reduce the risk of classification errors and other manual entries required for financial reporting in the comprehensive annual financial report.
- We recommend that management clearly outline revenue recognition policies related to member subsidies. This policy should specifically address what authorization by the members is necessary to trigger revenue recognition for losses related to claims and judgments and reserves recorded against accrued receivables and inventory.

Views of responsible officials and planned corrective actions – See response within management’s corrective action plan.

FINDING 2016-002 – Capital Assets and Project Management (Material Weakness in Internal Control Over Financial Reporting)

Criteria –

- a) Additions to construction in progress should only be recorded as an addition to capital assets once. Project costs should be reconciled between the general ledger and project accounting module.
- b) In accordance with the Authority’s accounting policies and procedures FIN-4.1, section 1.2, useful lives have been established for various capital asset categories and which depreciation is to be recorded annually on a straight-line basis.
- c) In accordance with the Authority’s accounting policies and procedures FIN-4.1 section 1.4, all physical property should be tagged and tracked by a unique asset ID number. Additionally, section 1.8 requires dispositions of capital assets are required to be communicated to the Authority’s Fixed Asset Accountant within the finance department by the Division Manager that oversees the custodian responsible for each asset.

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FOR THE YEAR ENDED JUNE 30, 2016**

FINDING 2016-002 – Capital Assets and Project Management (Material Weakness in Internal Control Over Financial Reporting) (Continued)

- d) The Authority should have a written policies and practical procedures for evaluating the capitalization of certain costs.

Condition/Context –

- a) An accrual for work in progress that was recorded as an addition to construction in progress for the year ended June 30, 2015 was accrued for again and recorded as an addition to construction in progress again during the year ended June 30, 2016 resulting in an audit adjustment of approximately \$6.3 million.
- b) At the end of fiscal year June 30, 2015, the Authority placed elements of the Positive Train Control (PTC) system into service. PTC is a multifaceted asset with various technical infrastructure and equipment components.
- c) The finance department identified certain ticket vending machines (TVMs) which had been disposed of in a prior year had not been appropriately communicated by the fare collections department to ensure that the dispositions were appropriately recorded. We also observed that the finance department does not have a central depository to track disposition forms received during the year to be used for updating assets during the year. The disposition was identified as a result of a reconciliation performed by management that occurred during the Authority's annual inventory observation.
- d) Certain interest expenditures and accruals were presented in the financial statements as both capitalized and expensed in the current year. Management concluded that the amount capitalized was appropriate and the presentation of expense should have been classified within rehab and construction. As a result the adjustment had no impact to the change in net position. There were also inconsistencies on when indirect and overhead costs were captured and capitalized.

Cause –

- a) Although a new capital asset module was implemented at the end of fiscal year June 30, 2015, it was not used consistently throughout the fiscal year ended June 30, 2016. Capital assets were mostly summarized and tracked manually in a spreadsheet outside of the module, making it prone to human and formula errors.
- b) Internal tracking of expenditures related to the PTC project were coded similarly to that of other infrastructure owned and operated by the Authority. Because most of the Authority's infrastructure is accounted for under the Modified Approach, the PTC related assets were initially classified as non-depreciable assets. At the end of 2015, management concluded that the project is depreciable; however, detail of its components had not been tracked in a method to evaluate their respective useful lives.
- c) Although a policy with outline procedures have been set in place, due to turnover in staffing and lapsed training, these procedures were not adhered to appropriately. Historically, TVMs were tracked by location instead of by an asset ID number as required by policy. Due to replacements at locations the dispositions were not immediately detected as part of past inventory counts.

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FOR THE YEAR ENDED JUNE 30, 2016**

FINDING 2016-002 – Capital Assets and Project Management (Material Weakness in Internal Control Over Financial Reporting) (Continued)

- d) The Authority does have a written policy to assist staff in determining when to capitalize interest expense on debt; however, the policy is limited to capitalizing interest on the construction of buildings. The Authority has other unique construction in progress type assets that qualify for interest capitalization. Current capitalization policies do not detail the types of overhead and indirect costs allowed to be capitalized or instances within the Authority's operations that may be appropriate.

Effect –

- a) An audit entry was proposed and recorded for approximately \$6.3 million to reduce construction in progress for the year ended June 30, 2016.
- b) Evaluation of the useful life of each component of the PTC project was not made in the current year. All capitalized costs were depreciated over a singly useful life of 10 years.
- c) Losses on the disposition of the TVMs were recorded in the current year rather than in a prior year.
- d) An entry was proposed to reclassify interest expenditures that were inconsistently capitalized and/or expensed. Although no adjustments were proposed related to the capitalization of indirect costs, there were inconsistencies between projects in how indirect costs were capitalized.

Recommendation –

- a) We recommend that management evaluate the use of the capital asset module as a tool to track activity to prevent future duplication of assets being capitalized.
- b) We recommend that management perform timely review of newly constructed capital assets as either depreciable or non-depreciable and ensure that all depreciable assets are being depreciated based on the useful lives assigned. For large and unique projects such as PTC, management should evaluate whether components of the overall project should be depreciated over different useful lives. For example, certain hardware components, such as an antenna used to broadcast signals may have a different useful life than software components used to ensure the technology is working appropriately. During a project's planning phase, expenditures of each component should be tracked in a method to allow management the ability to accurately establish an estimate for each component's useful life.
- c) We recommend that all Authority departments continue to receive training on the policies and procedures surrounding capital assets. The annual inventory process of assets continues to operate effectively in detecting errors when established procedures are not followed.
- d) We recommend that the Authority revise its capitalization policies to provide specific guidance on the capitalization of interest and overhead and indirect costs.

Views of responsible officials and planned corrective actions – See response within management's corrective action plan.

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FOR THE YEAR ENDED JUNE 30, 2016**

FINDING 2016-003 – Reconciliation and Valuation of Inventory (Significant Deficiency in Internal Control Over Financial Reporting)

Criteria – In accordance with the Authority’s Finance Policies and Procedures Manual FIN 4.5 and as promulgated by Government Accounting Standards Board (GASB) Statement No. 62, inventory should be valued at the lower of average cost or market. In addition, FIN 4.5 states that at fiscal year end, a physical inventory is to be conducted on all railroad parts and materials and that adjustments be recorded for discrepancies noted. Parts and materials that are utilized minimally and have outlived their useful life or subject to technological obsolescence are to be evaluated annually during the fiscal year end close.

Condition/Context –

- a) The Authority maintains a number of slow-moving inventory items which include replacement parts and tools for rolling stock, vehicles, communication signals, and other capital assets. Some of these inventory items have become obsolete because they no longer can be used for these assets, or they are retained on hand in excessive quantities compared to the need for these assets. Based on audit testing performed and inquiries with Authority staff, we tested if the assets they supported still exist or whether the number of items on hand exceeded the likely use in the future. We projected an overstatement of the inventory balance at June 30, 2016 is approximately \$2.3 million as an inventory obsolescence reserve was not recorded by management.
- b) We selected a sample of additions to inventory during the year to determine if values assigned and used for financial reporting agreed to underlying invoices and other purchasing records. We noted an error for one selection in which the unit price assigned and used for valuation did not agree to the underlying invoice. We projected that the inventory balance at June 30, 2016 was likely overstated by approximately \$213,000.

Cause –

- a) Staff turnover within the Authority’s department for monitoring inventory has made it so that the evaluation of obsolescence in great detail was not possible due to lack of personnel time and historic knowledge of inventory items on hand.
- b) Staff other than those that process disbursements were responsible for entering inventory values into the subledger for tracking individual inventory costs.

Effect – Inventory at June 30, 2016 was likely misstated; however, the cumulative financial impact was not projected to be material to overall financial statements. This misstatement did not result in any known questioned costs related to federal awards.

Recommendation –

- a) We recommend that management continue to prioritize the evaluation of obsolete inventory items and in coordination with field operations staff develop a well-defined methodology for identifying obsolete inventory items and calculating amount of reserve at least on an annual basis. In recent years the procurement of new rolling stock to replace existing rail cars and locomotives will result in more significant obsolescence which should be evaluated and reflected in financial reports of the entity.

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FOR THE YEAR ENDED JUNE 30, 2016**

FINDING 2016-003 – Reconciliation and Valuation of Inventory (Significant Deficiency in Internal Control Over Financial Reporting)

- b) We recommend that the finance department perform a final reconciliation to agree total disbursements on inventory acquisitions to total costs entered into Asset Works on a periodic basis.

Views of responsible officials and planned corrective actions – See response within management’s corrective action plan.

2016-004 – Claims and Judgments Valuation (Significant Deficiency in Internal Control Over Financial Reporting)

Criteria – Claims and judgments payable is a critical estimate that should be evaluated at year end in order to be properly reflected in accounting records in accordance with generally accepted accounting policies (GAAP). A liability should be reported if information available before the financial statements are issued indicates that 1) a loss is probable and 2) the amount of the loss can be reasonably estimated.

Condition/Context – An analysis is prepared annually by legal counsel summarizing activity of potential claims along with the maximum risk exposure the Authority has in each case which includes legal costs to represent the Authority.

Cause –

- a) Legal costs incurred and any settlements paid on claims activity is not tracked throughout the year or matched against prior year accruals.
- b) Management has historically recorded claims and judgment liabilities based on the maximum exposure of legal defense costs and loss even if those costs are only reasonably possible rather than probable.

Effect – Adjustments to estimates and payments were not tracked against individual claims from the prior year. Accruals for claims at June 30, 2016 were not individually evaluated to differentiate between claims that were probable or simply possible.

Recommendation – Management should establish a policy that follows GAAP for estimating contingent liability and risk exposure to the entity. In addition, periodic reconciliations throughout the year should be performed in finance to monitor claims and judgment activity so that as estimates change based on known events, accruals can be updated accordingly. As part of this reconciliation procedure, management should discuss the activity with legal counsel to ensure that the reconciliations are complete and accurate. Disbursements recorded within the period should be reviewed so that payments can be appropriately applied against accruals.

Views of responsible officials and planned corrective actions – See response within management’s corrective action plan.

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FOR THE YEAR ENDED JUNE 30, 2016**

Section III – Federal Award Findings and Questioned Costs

FINDING 2016-005 – Equipment Management (Significant Deficiency in Internal Control Over Compliance)

<i>CFDA Number(s)</i>	<i>Federal Agency / Pass-through Entity – Program Name</i>	<i>Pass-through Entity Identifying Number</i>	<i>Award Year</i>	<i>Questioned Costs</i>
20.500, 20.507, 20.507 ARRA, 20.525	U.S. Department of Transportation /Federal Transit Cluster	CA050268/CA902016 CA90Y942/CA95X180 CA95X286/CA050269	Various	\$0

Criteria – Southern California Regional Rail Authority is required to comply with Title 49 U.S. Code of Federal Regulations (CFR) Part 18, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments* for federal awards made prior to December 26, 2014 and to comply with Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* for federal awards made subsequent to December 26, 2014. Both of these regulations require property records be maintained that include a description of the property, a serial number or other identification number, the source of property, who holds title, the acquisition date, and cost of the property, percentage of Federal participation in the cost of the property, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property.

Condition/Context –

- a) In connection with our audit, we obtained a detail listing of all equipment acquired with federal funds by SCRRA. We reviewed the listing and observed certain assets were not identified with who holds title; the percentage of federal participation in the cost of the property; or use and condition of the property.
- b) We selected a sample of equipment purchased with federal funds for testing. We identified one asset was missing its asset ID tag as required by the Authority’s policy. However, we were able to identify that the asset matched the inventory listing based on the serial number. We also identified one asset that did not match the equipment listing because the original was replaced by the vendor due to a defect in the original asset acquired. We noted that the asset listing was not updated to reflect serial number and other identification information unique to the replaced asset.

Cause – During fiscal year 2016, the Authority did not effectively use its module for tracking capital assets and equipment. Management has not yet been able to update detail listings to include all of the characteristics required under the Code of Federal Regulations.

Effect – The Authority’s records have not been accurately maintained in accordance with federal requirements.

Repeat finding – Elements of this finding have been repeated from the prior audit finding 2015-004.

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FOR THE YEAR ENDED JUNE 30, 2016**

FINDING 2016-005 – Equipment Management (Significant Deficiency in Internal Control Over Compliance) (Continued)

Recommendation – We recommend that management evaluate methods to include all required information for tracking in accordance with applicable award regulations. Management should incorporate results of inventories performed for updating the condition of each asset.

Views of responsible officials and planned corrective actions – See response within management’s corrective action plan.

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2016**

The following were reported as findings in the audit of Southern California Regional Rail Authority for the year ended June 30, 2015.

FINDING 2015-001 – Monthly Close and Review Process and Annual Financial reporting (Significant Deficiency in Internal Control Over Financial Reporting)

Federal Program(s) / Federal Agency – n/a

Recommendation – It was recommend that management establish a well-designed and efficient process for month-end closing that would entail timely preparation and review of monthly reconciliations between general ledgers to sub-ledgers for all significant accounts. In addition, well-documented roles and responsibilities would help when staff transitions or departures occur and should be used for cross-training of employees. Finally, timely reporting to the Board of Directors would allow in decision making and proper oversight.

Status of Finding – Elements of the prior audit finding were repeated within finding 2016-001 due to turnover within management and the finance department which made it difficult to implement the planned corrective action.

FINDING 2015-002 – Reconciliation and Valuation of Inventory (Significant Deficiency in Internal Control Over Financial Reporting)

Federal Program(s) / Federal Agency – n/a

Recommendations –

- Management should revise procedures to instruct staff in the process of valuing significant categories of inventory. This may be performed on a sample basis rotated over a certain number of years to obtain full coverage. For significant variances identified, management should apply appropriate reserves between the average cost and market values.
- The finance department should periodically perform reconciliations to agree total disbursements on inventory acquisitions to total costs entered into Asset Works.
- Project managers should communicate to the Finance Department all equipment and materials acquired in connection with capital projects that were not used. The Finance Department should ensure that the original cost of any unused materials is removed from capital projects so that they are not capitalized and instead recorded as inventory. Project managers should work with materials management to ensure that assets are appropriately tagged and added to Asset Works so that they are subject to future inventory counts and other controls such as work orders when the items are placed into service. Management should also ensure that if any of these items were acquired with assistance from a third party (i.e. a grantor or member agency) that all excess inventory items are communicated in accordance with applicable laws and regulations.

Status of Finding –Elements of the prior audit finding were repeated within finding 2016-003 due to turnover within management and the finance department which made it difficult to implement the planned corrective action.

**SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2016**

FINDING 2015-003 – Capital Assets and Project Management (Significant Deficiency in Internal Control Over Financial Reporting)

Federal Program(s) / Federal Agency – n/a

Recommendation –

- It was recommend that a formal process be established for status review and communication between project management and the Finance Department to ensure accurate tracking and review of construction projects and disposed or impaired assets.
- In cases where a project manager is also a department supervisor, it was recommend that segregations of duties be established so that at least two individuals knowledgeable of the project are involved in the review and approval of purchase orders and/or invoices and tracking of the remaining project budget. This will allow for stronger controls in the prevention and detection of errors and/or fraud.
- As project managers are responsible for reviewing that disbursements are properly coded to the appropriate project and classified as either an expense (i.e. for maintenance of infrastructure) or as a capital project, the finance department should arrange for more frequent and substantial training related to the Authority’s accounting policies and how to use the new FIS. In addition, the finance department should review classifications periodically throughout the year to capture data more timely and reduce the time required to follow up at year end.

Status of Finding –Elements of the prior audit finding were repeated within finding 2016-002 due to turnover within management and the finance department which made it difficult to implement the planned corrective action.

FINDING 2015-004 – Equipment Management (Significant Deficiency in Internal Control Over Compliance)

Federal Program(s) – 20.500, 20.507, 20.507 ARRA, 20.525

Federal Agency – U.S. Department of Transportation

Recommendation – It was recommended that as management implements the capital asset module that equipment acquired with federal funds be tracked to include all parameters required by the federal regulations.

Status of Finding – Partially corrected. Elements of the prior audit finding were repeated within finding 2016-005. As noted in the corrective action in the prior year, management implemented a capital asset module which identifies many of the characteristics required, but has not yet found a way to incorporate information such as the federal participation or condition of the asset. Management’s planned corrective action is described in detail in the corrective action plan accompanying this document.

December 30, 2016

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CORRECTIVE ACTION PLAN

Finding 2016-001 Annual Financial Reporting

Management response:

We agree with this finding.

While some progress was made in revising the Schedules for both the annual and month-end close this fiscal year, further expansion of those documents one of the highest priorities for the newly hired Manager, General Accounting. The revised schedules will include a very detailed timeline for task completion as well as clearly defined roles and responsibilities of the varied staff involved. Standard operating procedures are being developed to complement each task identified to help with cross training of staff and both planned and unplanned staff transitions.

The Finance management team (i.e. General Accounting, Budgets, and Grants Management) has initiated discussions to develop standard operating procedures for setting up new projects. This will ensure that all interested parties have input on project setup before they are created.

Utilization of the financial accounting system to its fullest capacity is currently being evaluated cooperatively between Finance and IT staff. Projects that will provide additional automation, controls and efficiencies are being identified and prioritized. A work plan will be developed and implemented.

The Finance management team will work to clearly outline revenue recognition policies as relates to member subsidies. This policy will address amongst other related issues, claims and judgments and reserves recorded against accrued receivables and inventory.

Efforts to address this finding have already begun, but estimating a timeline for full implementation of a corrective action will require additional assessment. We are committed to making steady and significant process each fiscal year.

Responsible staff member(s): Tom Schamber, Manager, General Accounting



Finding 2016-002 Capital Assets and Project Management

Management response:

We agree with this finding.

The Manager, General Accounting has dedicated a member of the general accounting team to become the subject matter expert on capital assets accounting and reporting. This team member will work to develop policies and standard operating procedures to address capital asset classification criteria, useful life designations, treatment of capitalized interest, treatment of overhead and indirect costs, and asset addition and disposal procedures. All Authority Staff will be trained on these related policies and procedures to ensure compliance.

Training has been scheduled with IT staff to gain a deeper understanding of the fixed asset module within the financial accounting system. With this, a plan to maximize the capabilities of the module will be created and implemented.

The PTC system will be specifically evaluated to determine correct treatment for capitalization and depreciation purposes.

Efforts to address this finding have already begun, but estimating a timeline for full implementation of a corrective action will require additional assessment. We are committed to making steady and significant process each fiscal year.

Responsible staff member(s): Tom Schamber, Manager, General Accounting

Finding 2016-003 Reconciliation and Valuation of Inventory

Management response:

We agree with this finding.

The Manager, General Accounting has dedicated a member of the general accounting team to become the subject matter expert on inventory accounting and reporting. This team member will work to will develop policies and standard operating procedures to address the identification and valuation of obsolete or over-valued inventory. Included in these standard operating procedures would be an annual coordination with field operations staff to develop a method for not only identifying, valuing but also disposing of obsolete inventory identified, if appropriate. This coordinated effort with field operations will help to enhance controls and monitoring of this area.

Training has been scheduled with IT staff to gain a deeper understanding of the unintegrated inventory system to enable Finance to better monitor the activity processed through that software.

Efforts to address this finding have already begun, but estimating a timeline for full implementation of a corrective action will require additional assessment. We are committed to making steady and significant process each fiscal year.

Responsible staff member(s): Tom Schamber, Manager, General Accounting

Finding 2016-004 Claims and Judgments Valuation

Management response:

We agree with this finding.

Policies and standard operating procedures will be developed to guide legal staff in preparing claims estimates according to accounting standards. In addition, staff will engage in discussions during the year-end close process to fully vet that the estimates provided are according to policy and consistent with prior experience in like situations.

As a part of the new process, payments on claims related to existing reserves will be tracked against those reserves to aid in evaluation of the reasonableness of ongoing and future estimates.

Efforts to address this finding have already begun. We expect to fully implement corrective action in fiscal year 2016-17.

Responsible staff member(s): Tom Schamber, Manager, General Accounting

Finding 2016-005 Equipment Management

Management response:

We agree with this finding.

The Manager, General Accounting has dedicated a member of the general accounting team to become the subject matter expert on capital assets accounting and reporting. This team member will work to develop policies and procedures to address asset addition and disposal procedures and will work with operations staff to ensure complete and timely communication of capital asset activity.

Training has been scheduled with IT staff to gain a deeper understanding of the fixed asset module within the financial accounting system. With this, a plan to maximize the capabilities of the module will be created and implemented. This will include designating a field for the identification of federal participation in the acquisition of capital asset, title information and asset condition.

All existing assets will be reviewed on a systematic basis to determine the completeness of information stored in the asset record. Missing components will be researched and filled in.

Efforts to address this finding have already begun, but estimating a timeline for full implementation of a corrective action will require additional assessment. We are committed to making steady and significant process each fiscal year.

Responsible staff member(s): Tom Schamber, Manager, General Accounting