



Board Report

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EXECUTIVE MANAGEMENT COMMITTEE
SEPTEMBER 21, 2017

SUBJECT: STREAMLINING AUDITS FOR SMALL BUSINESSES

ACTION: RECEIVE AND FILE

RECOMMENDATION

RECEIVE AND FILE report on streamlining audits for small businesses.

ISSUE

Audits are necessary to provide accountability and transparency on the utilization of Metro’s financial resources. However, at the June 2017 Board meeting Director Dupont-Walker, it was noted that the audit of small businesses should not be too burdensome to the point of negatively impacting small business operations and Metro’s Management Audit Services (MAS) Department was requested to report back on the policies and practices for auditing small businesses.

DISCUSSION

As stewards of taxpayers’ money, Metro’s MAS department completed a total of 222 contract audits in the last five fiscal years covering FY 2013 to FY 2017. The audits identified questioned costs of \$76,261,508. Audit costs for these 222 audits is estimated at \$4.4 million. Eighty-eight of the 222 audits were audits of small business enterprise (SBE) or disadvantaged business enterprise (DBE) contracts. Below is a summary of the contract audits completed and resulting questioned costs:

	Completed Audits*	Amount Questioned**
SBE/DBE	88	\$14,497,894
Other Contractors	134	\$61,763,614
Total*	222	\$76,261,508

*Completed Audits include the following types of audits: Pre-Award, Incurred Cost, Change Orders, Buy America Compliance, Indirect Cost Rates and Labor Rates.

**The amount questioned excludes the amounts for indirect cost rates, labor rates, and Buy America

Compliance because these audits only report questioned rates or compliance.

MAS completed these 222 audits in response to requests made by Vendor/Contract Management (V/CM) department based on V/CM's policy requirements. The V/CM's policy requirements are designed to comply with the audits required by funders, such as Federal Transit Administration, Federal Highway Administration, and the State, for each type of buying activity. (See Attachment A for VCM's audit request requirements). At V/CM's request, MAS initiates the audit and uses the terms and conditions provided in either the Request for Proposal (RFP), or the executed contract, whichever is applicable, as the audit criteria. (See Attachment B for MAS Audit Practices.) Metro's RFP and the contract include provisions for the contractors to comply with the Federal Acquisition Regulation (FAR) Part 31, Contract Cost Principles and Procedures either due to Federal requirements or best practice. The FAR Part 31 is also included in the flow-down provision from the Prime Contract agreement to the Subcontractor agreement.

The increasing number of audits over the last five years correlates with the increased contracts awarded to SBE/DBE contractors. From FY 2013 through FY 2017, Metro has awarded \$587.7 million in contracts to small and disadvantaged businesses; 939 prime contracts totaling \$179.6 million, and 1,191 subcontracts totaling \$408.1 million.

A. Audit Challenges for SBE/DBE Contractors

Metro's contracts require contractors to account for and bill costs in accordance with FAR Part 31. Contractors are also required to develop indirect cost rates in accordance with FAR on an annual basis for cost reimbursable contracts. However, complying with these requirements may be challenging for SBE/DBE contractors because they may lack resources to fully comply with FAR Part 31 requirements. The development of an indirect cost rate compliant with FAR Part 31 is an area that generates discussion because many SBE/DBE contractors do not hire a Certified Public Accountant (CPA) to conduct an audit of their (1) financial statements and/or (2) indirect cost rate proposal to provide assurances in compliance with FAR Part 31. As a result, many SBE/DBE contractors are unfamiliar with the audit process and the required level of documentation to support the incurred costs. Some SBE/DBE contractors also experience difficulty pulling the supporting documents for incurred costs due to the timing difference between when the audit is initiated versus the timing when the SBE/DBE contractors incurred the expenditures. V/CM's practice is to request MAS to initiate the audit once the contractor reaches the contract incurred costs of \$750,000. For some SBE/DBE contractors, it may take a few years before this threshold amount is reached, resulting in the timing difference between audit initiation and costs incurrence.

In addition, some of the SBE/DBE contractors do not sufficiently provide evidence that costs proposed or incurred comply to Metro comply with the contract requirements. For example, incentive compensation or bonuses may have a contract requirement in addition to the FAR requirement, i.e. Bonus Plan/Policy must be in place 12 months prior to contract award. Also, due to lack of resources, some SBE/DBEs do not comply with the subcontract flow down requirements from the prime contract to the subcontract agreements. As a result, complying with their contract terms proves to be difficult and challenging to many SBE/DBEs.

B. V/CM and MAS' continuing efforts with audit of SBE/DBE

Staff have identified the following improvement opportunities:

- a. Indirect Cost Rates - As part of V/CM's procurement streamlining initiative, V/CM will research options/programs to simplify the establishment of indirect cost rates for SBE/DBE contractors. Since indirect cost rates are a topic of interest to SBE/DBEs, staff will report back on this strategy at the December Board meeting.
- b. Flow-Down - V/CM will work on minimizing the call for audits and the "flow-down" of certain provisions to the SBE/DBE community when those contractors are subcontractors to larger primes.
- c. Tracking - Measures are being put in place to improve the request process that will help monitor frequency and impacts of audits with Metro's contractors.
- d. Training - At the March 2016 Transportation Business Advisory Council meeting, MAS presented an overview of the audit process and typical audit findings. In October 2017, MAS and V/CM are also partnering to educate the SBE/DBE community on the audit process, as well as, how to adequately interpret the audit provisions of their contracts. This will be an ongoing activity initiated and coordinated by V/CM.
- e. Database of Audited Indirect Cost Rates - MAS is in the process of developing a database of all contractors' audited indirect cost rates based on completed audits from the past five years. This will allow both V/CM and MAS to quickly review whether the audited indirect cost rates can be applied to other contracts before requesting/initiating another future audit. The database will be ready for use by September 15, 2017.

NEXT STEPS

In six months, V/CM and MAS will report back to the Board on the status of all improvement opportunities.

ATTACHMENT

- A. V/CM Audit Requirements
- B. MAS Audit Practices

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