MEMORANDUM

SUBJECT: Final Audit Report OIG No. 10-028
Audit of Fiscal Year 2009 Accruals and
Year-End Spending

DATE: July 12, 2010

FROM: OIG – Helen Lew /s/

TO: DGMA/CFO –Carol Kissal

This **Final Audit Report**, entitled *Audit of Fiscal Year 2009 Accruals and Year-End Spending*, presents the results of our audit. The audit was conducted at the request of the Board of Directors of the Washington Metropolitan Area Transit Authority (WMATA) Audits and Investigations Subcommittee (Subcommittee). The objectives of the audit were to determine whether: (1) WMATA recognized pension and other post-employment benefits (OPEB) costs in accordance with generally accepted accounting principles (GAAP); (2) fiscal year-end accruals recorded by WMATA were proper; and (3) year-end spending, including prepayments, was appropriate and recorded in the proper period.

BACKGROUND

In August 2009, the Subcommittee requested that the Office of Inspector General (OIG) conduct an audit of fiscal year (FY) 2009 accruals and year-end spending. Subcommittee members were concerned that some pension contributions may not necessarily need to be recognized in FY 2009, end-of-the-year journal entries were being used to accrue charges for goods and services not yet received, and unnecessary spending took place at the end of the fiscal year. One of the concerns brought to our attention was the budget subsidy variance. In May 2009, the subsidy variance reported to the Board's Finance, Administration and Oversight Committee was a favorable $16.6 million. At the end of the fiscal year (June 30, 2009), the favorable variance had dropped to $5.5 million. The Subcommittee was concerned that the decrease in favorable variance was due to cost overruns, especially in non-represented employees' pension contributions.

Washington
Metropolitan Area
Transit Authority

AUDIT RESULTS

We found that: (1) pensions and OPEB costs for non-represented employees were recognized in accordance with GAAP, although some of the transactions/economic events for OPEB were recorded outside the financial management system; (2) journal entries for year-end accruals were generally proper, but there were some exceptions; and (3) year-end spending was generally appropriate and recorded in the proper period. During our review, we also identified an incident in which WMATA did not properly safeguard and account for its assets. We discuss this internal control weakness in the "Other Matters of Concern" section of this report.

Based on the above findings, we made three recommendations to the Deputy General Manager Administration/Chief Financial Officer (DGMA/CFO).

In the DGMA/CFO's July 6, 2010, response to a draft of this report, she indicated general agreement/concurrence with our findings and recommendations. The complete text of the DGMA/CFO response is included as Attachment 1 of this report.

Finding 1 – Pension and OPEB Costs Were Recognized in Accordance with GAAP

WMATA recognized pension and OPEB costs for non-represented employees in accordance with Governmental Accounting Standards Board (GASB) Statement 27 (GASBS 27), GASBS 45, and the actuarial valuation reports of the actuaries. However, OPEB costs were not fully recorded in WMATA's financial management system.

The GASB promulgates GAAP for state and local governmental entities. GASBS 27, "Accounting for Pensions by State and Local Governmental Employers," states that the annual pension cost should be equal to the Annual Required Contribution (ARC), unless there is a net pension obligation (NPO) at the beginning of the year.[1] GASBS 27 further states that the ARC should be actuarially determined and include

[1] An NPO exists if there were a pension liability or asset at an employer's transition to GASBS 27 and if there is a cumulative difference between annual pension costs and the employer's contribution. If there is an NPO, annual pension cost should equal the ARC, one year's interest on the NPO, and an adjustment to the ARC.

the normal cost and a provision for amortization of the total unfunded actuarial accrued liability (UAAL). Normal cost is defined as the portion of the cost of projected benefits allocated to the current year or as the cost of benefits earned by employees during the current year. The maximum allowed period for amortizing the UAAL is 30 years. GASBS 27 additionally states that pension expense of proprietary funds should be recognized on an accrual basis and pension expense reported for the year should equal annual pension cost.

Similarly, GASBS 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions," states that the ARC for OPEB should include the normal cost and a provision for amortizing the UAAL. GASBS 45 additionally states that OPEB expense of a proprietary fund should be recognized on an accrual basis. OPEB expense for the year should be reported in relation to the ARC equal to annual OPEB cost.

Our audit showed that WMATA recognized non-represented employees' pension costs and OPEB costs in accordance with applicable GAAP in FY 2009. WMATA only recorded OPEB costs funded in its financial management system. Based on our review of applicable GASBs and the actuary's report for the non-represented employee pension plan, we determined that the $16.1 million ARC recognized and recorded by WMATA for the non-represented employee pension plan was proper.

The $16.1 million ARC represented a nearly $5 million or approximately 42 percent increase from the $11.3 million recorded for FY 2008. According to a Department of Human Resource Benefits Manager, the increase could be attributed to the decrease in the Non-Represented Employees Pension Plan's assets and new smoothing method.[2] Also, as the actuarial present value of plan assets for non-represented employees decreased due to a decline of the stock market, the UAAL increases. As a result, the amortized amount of UAAL for FY 2009 increased. Additionally, according to the Benefits Manager, the new smoothing method employed for the unfunded liability added to the ARC.

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[2] This is an asset valuation method that minimizes the volatility of fluctuations in the stock market by spreading out gains and losses over several years.

In accordance with the actuary's assumptions, WMATA amortizes the UAAL over 15 years. We reviewed the financial statements of four other transit agencies to determine the amortization period of their UAALs. We found that these agencies all have more than one plan, and the amortization periods range from 10 years to 30 years. For example, the Los Angeles County Metro Transportation Authority has six pension plans—five plans are amortized over 15 years and one is over 30 years. The San Francisco Bay Area Rapid Transit District amortizes one plan over 13 years and one over 22 years. The Chicago Transit Authority amortizes two pension plans over 30 years, one over 20 years, and one over 12 years. The Metropolitan Transit Authority (New York City) amortizes one plan over 24 years and one over 10 years.

As we mentioned earlier, GASBS 27 allows the UAAL to be amortized up to a period of 30 years. The entity, however, should be consistent in the number of years in which the amortization takes place, unless the actuarial conditions indicate otherwise.

WMATA recognized FY 2009 OPEB expenses in accordance with GAAP in its financial statements. It only records OPEB expenses actually paid in its general ledger. The unfunded excess amount between the ARC and OPEB expenses paid is recorded on spreadsheets outside of the general ledger. WMATA only records OPEB amounts budgeted in the general ledger. Since the unfunded part of OPEB is not budgeted, it is not recorded in the general ledger. The total unfunded OPEB (for non-represented and union employees) for FY 2009 was about $59 million. The total accumulated unfunded OPEB was about $118 million as of June 30, 2009.

Given the sizeable amount of unfunded OPEB, WMATA should record the unfunded amounts. The general ledger is the collection of all accounts, including assets and liabilities, which support the financial statements. Sound accounting practices dictate that all transactions flow through the general ledger, including the unfunded OPEB transactions.

WMATA's Comptroller informed us that they are trying to determine how to record the unfunded OPEB in the general ledger without affecting the jurisdictional subsidy amounts.

Recommendation

We recommend that the DGMA/CFO:

1. Develop and implement a methodology for recording unfunded OPEB amounts in the general ledger.

Management Comment

Management did not agree with the finding title in an earlier draft of this report. Management felt that the use of the term "generally" was a qualifier. Management agreed with the sentence in the body of the finding which stated that pension and OPEB costs were recognized in accordance with GAAP.

Also, management concurred with the recommendation that OPEB costs be fully recorded in the financial management system. Management stated that this finding was noted in a financial system assessment project and is already part of the implementation of the project.

OIG's Comment

We deleted the word "generally" from the finding title in the final report.

Finding 2- Journal Entries for Accruals Were Generally Proper

We found that except for three journal entries, WMATA generally recorded year-end accruals properly in its financial management system.

According to National Council on Governmental Accounting Statement[3] (NCGAS) 1, in regards to the accrual basis of accounting for proprietary funds, revenues earned and expenses incurred are recognized in a government's proprietary funds in essentially the same manner as in commercial accounting.

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[3] The National Council on Governmental Accounting was the predecessor of the GASB. The GASB incorporates NCGA statements as GASB statements.

WMATA's Office of Accounting Procedures Manual, Procedure Number ACCT: 7.6, "Month-End Liability Accruals," states: In accordance with generally accepted accounting principles ... (WMATA) uses the accrual method of accounting. Under accrual accounting expenses are recorded in the period incurred rather than when paid. In order to achieve this objective, expenses incurred but not yet paid must be accrued at the end of each month.

Further, in a May 12, 2009, memorandum regarding WMATA's year-end closing process, Accounting requested WMATA departments to submit to it invoices dated June 30, 2009 or earlier by July 10, 2009. The memorandum additionally stated that "any 2009 expenses not received in Accounts Payable by noon on July 10" will require submittal of an accrual.

We judgmentally tested 16 line items from year-end accrual journal entries to determine whether or not the transactions were proper. Of the line items examined, 13 of the 16 items were properly accrued for FY 2009. However, two of the accruals appeared to be related to FY 2010 expenditures, and one accrual appeared to be excessive. These three items totaled approximately $574,133 or 4 percent of the $16. 9 million tested and are discussed below.

- WMATA issued a purchase order in June 2009 for information technology support services in the amount of $89,544. The purchase order stated that the period of performance was June 2009 through August 2009. However, our review of timesheets indicated that approximately $53,000 in services was rendered during July and August 2009. Services rendered after June 2009 should have been recognized as FY 2010 expenses.

- WMATA recorded an FY 2009 accrued expense of $254,709 for bolt and welding testing services. In July 2009, the vendor submitted an invoice for $127,354 covering the period June 26 through July 29, 2009. The invoice stated that 50 percent of the contract work had been completed. WMATA should have recognized services rendered after June 30, 2009, as FY 2010 expenses.

- WMATA accrued $900,000 for services rendered under a safety services contract for the period April 2009 through June 2009. However, the August

2009 invoice for that period was for $633,705 or nearly 30 percent less than the estimated accrual.

We found that the above problems were caused by (1) the program offices' failure to provide sufficient and appropriate documentation to Accounting to support the accrual, and/or (2) Accounting's failure to review the accrual request from the program office for appropriateness and to request, if necessary, sufficient and appropriate documentation. As an illustration, in the first example, the program office provided Accounting a purchase order in June 2009 for $89,544. The purchase order clearly stated the period of performance was for June through August 2009. The accrual, however, was set up for $89,545 based on a July 1, 2009, email between the Accounting staff. The email stated that a partial billing had been received from the vendor showing $36,414 for June 2009, but the billing did not include all hours worked. Accounting did not adequately review the documentation to determine the appropriateness of the accrual.

We also noted that neither the Accounting Manual nor the memorandum on year-end closing procedures adequately address the type of documentation required to be submitted to support for accruals.

Recommendation

We recommend that the DGMA/CFO:

2. Provide written guidance to the program offices on the type of documentation required to be submitted to Accounting to support accruals and that Accounting staff adequately review the documentation submitted to ensure that the accrual is recorded in the appropriate period.

Management Comment

Management agreed with the overall finding. However, management believed that inclusion of the accrual for the safety services contract was proper. Management stated that the estimate was based on previous quarter billings and that by the time the actual invoice came in August 2009, the general ledger had been closed and the difference between the accrual and the invoice (approximately $270,000) was considered immaterial.

Management agreed with Recommendation 2. Management indicated that the Financial System Implementation project will minimize the number of accruals requiring manual documentation.

OIG's Comment

We disagree with management's assertion that the accrual for the safety services contract was proper. The requesting program office is responsible for determining services rendered, and based on this information, letting Accounting know the amount that should be accrued.

Finding 3: Fiscal Year-end Operating Spending, Including Prepayments, was Generally Appropriate and Recorded in the Proper Period

WMATA generally spent operating funds evenly throughout the fiscal year. Our analysis of information retrieved from the financial management system revealed that during the fourth quarter of FY 2009, WMATA expended $478.6 million, or 26.7 percent, of nearly $1.8 billion of total operating expenses during the fiscal year. This pattern was relatively consistent with spending during the first through third quarters, which were 24.3 percent, 24.6 percent, and 24.4 percent, respectively.

To achieve our objective of determining whether WMATA spent year-end funds properly, we sampled and reviewed a total of 120 financial transactions, totaling $3.2 million, made between April 1, 2009, and July 31, 2009. Based upon our review of supporting documentation and inquiry of personnel, we found that WMATA's year-end spending was generally appropriate and recorded in the proper period.

However, we did identify one incident in which WMATA purchased an Apple desktop computer for $6,100 on June 17, 2009, which we considered to be in excess of the $3,997 that was initially approved and specified as needed. Specifically, the Department of Public Relations needed a computer, designed to create different web-based graphics and video editing. Our review indicated that WMATA purchased the computer at a higher cost and with greater specifications than needed in an effort to have the item delivered by June 30, 2009, the fiscal year-end cutoff date.

Excessive and wasteful year-end spending can occur when an organization rushes to use funds at the end of the fiscal year. This often is an attempt to spend funds that would otherwise expire, meaning they would no longer be available for new obligations after the fiscal year ends.

Because we only identified one incident out of 120 financial transactions in our sample review, we did not make a recommendation. Instead, we brought this incident to the attention of WMATA's Comptroller and encouraged her to reinforce the importance of avoiding excessive and wasteful year-end spending to all program offices.

Management Comment

Management agreed with the finding that year-end spending was appropriate. Management also agreed with the importance of avoiding excessive and wasteful spending.

Although the OIG did not make a specific recommendation to this finding, management noted that an area where excess costs might have been avoided is related to the timing of our audit. Specifically, the accounts and transactions selected for our audit were the same as those which had been audited by WMATA's external auditors under OIG's review.

OIG Comment

Although the period of our audit was the same, we disagree that our sample was precisely the same as that of the external auditors as implied in management's comments. We also disagree that complying with a Board request for information is a wasteful exercise. Furthermore, to avoid disruptions, we accommodated the Accounting staff during the audit.

Other Matters of Concern

During our audit of year-end spending and accruals, we identified a matter of concern. This concern involves an incident in which WMATA did not properly safeguard and account for its assets. Specifically, WMATA did not: (1) bar code all assets received at the Metro Supply Facility, and (2) record these assets in the Fixed Asset Management System (FAMS).

During our review of selected invoices, we found that WMATA purchased 10 Sharp LCD televisions on April 7, 2009. Each television had a purchase price of $1,709.95, including a three-year service contract, for a total price of $17,099.50. According to the invoice, the televisions were shipped to the Metro Supply Facility at 8201 Ardwick-Ardmore Road in Hyattsville, Maryland. However, according to the Program Budget Analyst, four of the televisions had not been bar-coded as of April 21, 2010, over a year after their delivery. Also, none of the 10 televisions had been entered in FAMS.[4]

The WMATA Property Accounting & Controls Procedures Manual (PACP Manual), chapter 2.1 states that "all reportable accountable property (...all expendable sensitive items costing $100 or more that are susceptible to theft or loss) acquired by the Authority through purchase...must be accounted for and charged to the appropriate property account." Chapter 2.2 of the PACP Manual further states that, "when the commercial vendor delivers property directly to the requisitioning office at field locations or the Jackson Graham Building, the Property Custodian shall perform bar-coding and prepare a Property Transaction Request. The Property Custodian must track the Property Transaction Request, using the FAMS, until (he/she) verifies that the property is entered, and appears on the Property Transaction Query Screen."

We asked the Program Budget Analyst why the televisions were not bar-coded and were told that there was uncertainty on who had responsibility for bar-coding these assets. She assumed incorrectly that receiving personnel in the Bus Divisions were bar-coding these items.

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[4] The WMATA property item must be bar-coded before it is to be recorded in FAMS.

Failure to bar-code assets increases the risk of loss, damage, or theft of WMATA capital assets. Furthermore, failure to enter these items in FAMS adversely affects the accuracy and completeness of WMATA financial information and management's use of the information for decision-making purposes.

Subsequent to our inquiry, all 10 televisions were bar-coded, and a Property Transaction Request was completed, listing each television. The request was then forwarded to Accounting so that the items could be recorded in FAMS. These items were not entered in FAMS as of June 17, 2010.

The above problem is not new. The lack of safeguarding and accounting for WMATA assets was cited in a previous OIG audit entitled, *Review of Capital Projects: Internal Controls,* issued December 4, 2008. In that report, we identified property which was not bar-coded nor entered timely in FAMS.

Recommendation

We recommend that the CFO working with other members of the Executive Leadership Team to:

3. Ensure that personnel, specifically those that have been designated as Property Custodians, have a clear understanding of their roles and responsibilities, as it pertains to safeguarding WMATA assets and proper accounting for these items, and follow applicable policies and procedures.

Management Comment

Management agreed with the finding and recommendation.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objectives were to determine whether: (1) WMATA recognized pension and OPEB costs in accordance with GAAP; (2) fiscal year-end accruals recorded by WMATA were proper; and, (3) year-end spending was generally appropriate and recorded in the proper period.

This audit focuses on the processes and controls surrounding year-end spending and accruals for FY 2009. Audit methodology included: (1) reviewing the Office of Accounting's year-end closing procedures; (2) determining applicable GAAP, such as GASBS 25, 27, 43, and 45 and NCGA Statement 1; (3) obtaining year-end accrual journal entries and tracing them to the financial management system; (4) testing expenditures for supplies, materials, and services for the fourth quarter; (5) examining vouchers, invoices, and other supporting documentation to determine the propriety of tested transactions; (6) interviewing Accounting, Office of Management and Budget Services (OMBS), Human Resources, and program personnel, as appropriate; and (7) reviewing actuarial valuation reports (pensions and OPEB) of the actuaries. The audit was conducted from January 2010 through June 2010.

The scope of our testing related to year-end operating expenditures for the period April 1, 2009, through July 31, 2009. We applied American Institute of Certified Public Accountants standards in testing significant controls with high inherent risk. (The suggested minimum sample size is 60, with zero deviations expected.) We obtained two samples, one random and one judgmental, both with a sample size of 60, which gave us a total of 120 transactions, totaling $2.1 million.

For the random sample, we reviewed operating accounts that had an increase in spending greater than or equal to $100,000 and greater than or equal to 10 percent from month-to-month during the period April 1, 2009, through July 31, 2009. We randomly selected a sample of financial transactions for each month-to-month period. Using IDEA Data Analysis Software, we selected 60 transactions totaling $1.1 million or 1.8 percent out of 10,776 transactions, totaling $62.5 million for review.

Regarding the judgmental sample, we selected transactions from the *Services* and *Materials & Supplies* operating expense accounts, as these accounts were deemed to have a greater risk for excessive and wasteful spending. Services accounts are deemed high risk based on the fact that many of the service expenditures require payment prior to being rendered, such as training and information technology service agreements. Materials & Supplies accounts are deemed as high risk based on the fact that many of the items charged to this code can be pilferated. We selected 60 transactions from this population, 30 from each account code group.

The amount of these transactions totaled $2.1 million or 1.0 percent of the total population of 48,323 transactions with a value of $203.5 million.

We obtained and reviewed the supporting documents for each transaction in our sample, including the invoice, contract, request for payments, memorandums, and email correspondences. We determined whether (1) the payments were supported by documentation, including proper sign off/approval, (2) the goods and/or services were rendered prior to year-end and or was there adequate justification for placing the inventory in stock, and (3) the goods and/or services were properly included or excluded in year-end expenses/expenditures.

Regarding the testing of year-end accrual journal entries, a judgmental sample of 16 line items, totaling $16.9 million, was sampled from a population of 120 line items, comprising 14 journal entries totaling $24.6 million. The sample was selected based on types of supplies or services accrued. We considered consultant services to be more susceptible to improper accruals.

We conducted our audit in accordance with *Government Auditing Standards*, appropriate to the scope. Those standards require that we plan and perform the audit to afford a reasonable basis for our judgments and conclusions regarding the functions under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy our audit objectives.

ADMINSITRATIVE MATTERS

Corrective actions proposed (resolution phase) and implemented (closure phase) by Accounting will be monitored and tracked through the OIG's audit Accountability and Resolution Tracking system. Department policy requires that you develop a final corrective action plan (CAP) for our review in the automated system within 30 days of the issuance of this report. The CAP should set forth specific action items and targeted completion dates necessary to implement final corrective actions on the findings and recommendations contained in this report.

We appreciate the cooperation and assistance extended by OMBS and Accounting representatives during the audit.

Should you have any questions, please call Andrew Clemmons, Assistant Inspector General – Audits, on (202) 962-1014 or me at (202) 962-2515.

/s/
Helen Lew
Inspector General

cc: CHOS –Shiva Pant
COUN –Carol O'Keeffe

MEMORANDUM

SUBJECT: Draft Audit Report OIG No. 10-028 Audit of Fiscal Year 2009 Accruals and Year-End Spending

DATE: July 6, 2010

Stephanie Audette for

FROM: DGMA/CFO – Carol Dillon Kissal

TO: IG/OIG – Helen Lew

This is in response to the Office of Inspector General's (OIG) Draft Audit Report, entitled "Audit of Fiscal Year 2009 Accruals and Year-End Spending", dated June 22, 2010. We offer the following comments for your consideration prior to finalizing the audit report.

Finding 1 – Pension and OPEB Costs Were Generally Recognized in Accordance with GAAP

We agree with the first sentence of the report under this finding that states that pension and the unfunded OPEB amounts were recognized in accordance with generally accepted accounting principles (GAAP). We do not agree with the overall finding which adds the qualification that these costs were "generally" recognized in accordance with GAAP.

Recommendation

We recommend that the Chief Financial Officer (CFO):

1. Develop and implement a methodology for recording unfunded OPEB amounts in the general ledger.

We concur with the recommendation of recording the unfunded OPEB amount in the general ledger. This same finding was noted in the Financial System Assessment project and is therefore already part of the Financial System Implementation project.

Finding 2 – Journal Entries for Accruals Were Generally Proper

We agree with the overall finding that Journal Entries for Accruals Were Generally Proper. We also agree that two of the three items noted in the report were exceptions and that they totaled approximately $308,000 or 1.8% of the sample. However, we believe that the third accrual made for the safety services contract was proper and relayed that to the OIG staff at two separate meetings. The amount of

Washington Metropolitan Area Transit Authority this accrual was based on the best known information at year end; the prior quarterly invoices. The actual invoice was not received until August after the General Ledger was closed. Although the actual invoice was for a lower amount than the estimate, the difference was not considered material for adjustment. We respectfully request that our views on this accrual be reflected in this finding.

Recommendation

We recommend that the CFO:

2. Provide written guidance to the program offices on the type of documentation required to be submitted to Accounting to support accruals and that Accounting staff adequately review the documentation submitted to ensure that the accrual is recorded in the appropriate period.

We agree with the recommendation. In addition, the automation of many of our current accruals is part of the Financial System Implementation project which will minimize the number of accruals which require manual documentation.

Finding 3 – Fiscal Year-end Operating Spending, including Prepayments, was Generally Appropriate and Recorded in the Proper Period

We agree with the finding that Fiscal Year-end Operating Spending, including Prepayments, was Generally Appropriate and Recorded in the Proper Period. We also agree with the importance of avoiding excessive and wasteful spending as noted in the report.

No Recommendation

Although there was no specific recommendation related to this finding an example where excess spending might have been avoided was cited in the report. Another example of an area where excess costs might have been avoided is related to the timing of this OIG audit of Fiscal Year 2009 Accruals and Year-End Spending. The accounts and transactions selected for this audit were the same as those which had just been audited by WMATA's external auditors under the review of the OIG. In the future our recommendation is that this type of audit be performed concurrent and as part of the external financial audit not separate and subsequent as was the case for this audit.

Other Matters of Concern

We agree with this finding.

Recommendation

3. Ensure that personnel, specifically those that have been designated as Property Custodians, have a clear understanding of their roles and responsibilities, as it pertains to safeguarding WMATA assets and proper accounting for these items, and follow applicable policies and procedures.

We agree with this recommendation.