

Audit Report Attachment I

Prequalification Audit of the North Coast Railroad Authority
Prepared by the Department of Transportation Audits & Investigations
August 22, 2006

PROCUREMENT CRITERIA:

- Procurement without competition must also meet the requirements of 49 CFR Part 18.36 (d) (4) which states, (i) Procurement by noncompetitive proposal may be used only when the award of a contract is infeasible under small purchase procedures, sealed bids or competitive proposals and one of the following circumstances applies: (A) The item is available only from a single source; (B) The public exigency or emergency for the requirement will not permit a delay resulting from competitive solicitation; (C) The awarding agency authorizes noncompetitive proposals; or (D) After solicitation of a number of sources, competition is determined inadequate. (ii) Cost analysis i.e. verifying the proposed cost data, the projections of the data, and the evaluation of the specific elements of costs and profits is required.
- OMB A-87 requires a proper contract: Attachment B. 32. Professional service costs. b. In determining the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However the following factors are relevant: (8) Adequacy of the contractual agreement for the services (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions).
- NCRA P&P: Chapter 1105 – Elements of a Valid Contract; Each contract must contain the following information:
 - Term for the performance or completion of the contract; dates or length of time
 - Consideration: The contract must clearly express the maximum amount to be paid and the basis of which payment is to be made.
 - Scope: Clear and concise language should be used.
 - Signature by a person for each party who is authorized to bind that party.
- NCRA P&P: Chapter 1106.3 Responsibilities of the Contract Manager. 1. Develop and write a clear, concise, detailed description of the work to be performed. 2. Review the draft contract for contract provisions, scope of work, technical requirements, completion dates, benchmarks, timelines, estimated quantities, dollar amounts and final product. 3. Ensure compliance with all federal or special regulations.
- NCRA P&P: Chapter 1212 Non-Competitive Contract Award Conditions. The Board of Directors shall approve all sole source contracts and shall cause to be entered into the official minutes the complete record of the Executive Director's justification for such award and the basis for determining the reasonableness of the award.
- NCRA P&P: Chapter 1215 – General Form of Contract. Consulting Services contracts shall be substantially in the form as Appendix I attached hereto and incorporated herein by this reference.

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TIMEKEEPING CRITERIA:

- NCRA's P&P: Chapter 0506 Payroll – states that time cards are to be prepared by each employee to reflect time spent on direct and indirect work.
- OMB A-87 Attachment B. 8. Compensation for personal services; h. (5) Personnel activity reports or equivalent documentation must meet the following standards; (b) They must account for the total activity for which each employee is compensated.
- OMB A-87 Attachment A. C. Basic Guidelines, 1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria: e. Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit. F. Be accorded consistent treatment.

Audit Report Attachment II

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POLICIES AND PROCEDURES

Below is a listing of our concerns pertaining to NCRA's Policy and Procedures Manual. Our comments pertain to areas identified in the P&P that were not followed in practice as well as procedures that may conflict with federal regulations or other compliance requirements. This listing is by Chapter Section with our comments below:

CHAPTER 0400: Travel Policy

- 0406 – Short Term Travel
The section explains that the 50 mile rule applies to headquarters. DPA policy states that no per diem expenses are allowable at any location within 50 miles of home or headquarters.
- 0408.2 Expense Verification
The policy does not require the Executive Directors travel expense claims be approved by a board member.

CHAPTER 0500: Accounting Procedures

- 0501.8 states that a general ledger and various subsidiary ledgers are prescribed and maintained by the County of Sonoma in accordance with their policies and procedures. We found that there were no subsidiary ledgers kept by Sonoma County for NCRA. At a minimum NCRA should have accounts receivable, accounts payable, inventory and property lease subsidiary ledgers.
- 0503.1 Monthly Reports. 1. Budget to Actual Report. This report compares the actual revenues received and expenses incurred.
This statement was not correct. Sonoma County does not record expenses as incurred; expenses are only recorded when paid. This can lead to inaccurate reports.
5. Trial Balance. This report summarizes the Assets, Liabilities, Net Assets (Equity) and the temporary accounts for each of NCRA's fund at the project level.
This statement is not entirely correct. The monthly trial balance only reflected the current position of NCRA on a cash basis of accounting. Both accounts receivable and accounts payable are not current during the year since neither record outstanding receivables nor payables.
- 0504.5 Labor Cost – One paragraph regarding the charging of labor. It did not reference the payroll section. This paragraph should reference 0506 – Payroll for details on proper time keeping.
- 0505 Internal Controls – Top of page 500-10, 4. Transactions are recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles on a timely basis.
NCRA was not recording transactions on a timely basis. Receivables were not recorded until payment was received and payables were not recorded unless payment was made. The balances are presented in accordance with generally accepted accounting principles only at year end by NCRA's independent auditor.

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- Top of page 500-11 – states, transactions should be initially recorded as promptly as practicable in order to maintain accountability for assets.
This is not done by NCRA. We point to accounts receivable and accounts payable as examples. Also, the details of the purchase of equipment and material with the FEMA dollars was not provided to Sonoma County's Auditor's Office and therefore inventory was not adequately reflected in the NCRA's accounting system.
- 3rd paragraph page 500-11 – states, "Actual assets should be compared with recorded accountability for such assets in order to determine the effectiveness of the system of safeguarding assets, as well as the effectiveness of procedures utilized in recording transactions."
NCRA has not performed this asset comparison for at least 5 years.
- 0505.3 Procedures for Processing Payables and Receivables. Item 5. Page 0500.13 Staff will manage payables by: 5. If the item is an invoice for a state or federal grant project, conduct a review of the invoice as outlined in the Chapter. Check documentation, math, justification to contract/task order, compliance with travel.
This should be a step for all invoiced costs and not just for state or federal grant projects.
- 0505.3 page 0500.14, top third of page discusses what the Sonoma County Auditor's office does, sentence states, "Vendor payments will then be input into the accounting system provided the authorized signatures are valid."
We found that Sonoma County does not check for valid authorized signatures other than whether the executive director approves the payment.

Bottom third of page, under 3. Process returned information by: third bullet states, "Filing the Journal Vouchers in the Journal Voucher File".

The policy should state that all journal vouchers are reviewed and authorized and then filed. We found during our review that NCRA does not review journal vouchers for allowability, reasonableness or other criteria.

- 0509 Capitalization Policy – To come.
Need to update this to reflect that the capitalization policy is in Chapter 0905.

CHAPTER 0600 Purchase of Supplies, Equipment and Services Procedure:

1. The NCRA purchase policy does not mention and is not in compliance with 49 CFR Part 18.
 - Master Agreement between NCRA and State of California – Section 2. Audits and Reports A. Cost Principles, (1) RECIPIENT agrees to comply with . . . 49 CFR, Part 18, Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments.
 - There is no mention or reference to 49 CFR Part 18 in the policy with only the following reference made to alert a reader of the possibility of other laws, "0602.1 Obtaining Bids, In the absence of other laws, the purchasing agent shall use the following guidelines to select the type of bidding process to be used."

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- 49 CFR 18.36 (b) procurement standards. (1) Grantees and subgrantees will use their own procurement procedures which reflect applicable State and local laws and regulations, provided that the procurement conforms to applicable Federal law, and the standards identified in this section.
 - There is no reference to Chapter 1200, NCRA's policy on the acquisition of professional services. 602.4 Exception to Competitive Bidding. 1. Contracts involving acquisition of professional or expert services, such as, but not limited to, services rendered by architects, attorneys, engineers, and other specialized consultants.
 - There is no requirement to perform cost or price analysis as required by 49 CFR, 18.36 f. (1) Grantees and subgrantees must perform a cost or price analysis in connection with every procurement action including contract modifications.
2. The NCRA policy does not require that price or rate quotes be obtained from an adequate number of qualified sources. It only states when quotes should be obtained in writing.
- 0602 – Bidding Procedures: 0602.1 – Obtaining Bids. In the absence of other laws, the purchasing agent shall use the following guidelines to select the type of bidding process to be used. For products with an estimated value of: 1. \$1,000 or less informal quotes may be obtained from vendors, but are not required. 2. \$1,000 to \$10,000 informal quotes shall be received in writing see chapter 0602.6. 3. \$10,001 to \$25,000 written quotes from vendors shall be obtained. It is up to the purchasing agent if a formal sealed bid procedure may be followed. 4. \$25,001 and over a formal sealed bid/proposal procedure shall be followed as described in 0602.3.
 - Federal regulations require price or rate quotes: 49 CFR 18.36 (d) (1) Procurement by small purchase procedures. If small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.
3. In the case where all bids were rejected, NCRA's policy is less restrictive than federal regulations.
- NCRA 0602.3 Competitive Bid Process – 7. At its discretion, the Board of Directors may reject all bids presented and re-advertise for bids.
 - Federal regulation: 49 CFR 18.36 (d) (2) (i) (e) Any or all bids may be rejected if there is a sound documented reason.
4. The NCRA policy guidelines for evaluating bids does not include price.
- 0602.5 Purchasing Award – Factors to be Considered. The factors listed do not include price. Although under the competitive bid process 0602.3, 8. contracts shall be awarded by NCRA to the lowest responsible bidder, except as otherwise provided herein.

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- Federal regulation: 49 CFR 18.36 (d) (2) Procurement by sealed bids (formal advertising). Bids are publicly solicited and a firm-fixed-price contract (lump sum or unit price) is awarded to the responsible bidder whose bid, conforming with all the material terms and conditions of the invitation for bids, is the lowest in price.
5. The policy does not refer to the other chapters that cover procurement by competitive proposals such as consultants, engineering services, etc.
6. 0602.7 Surplus Supplies and Equipment. This section states that the purchasing agent shall have the authority to sell, trade or exchange all supplies and equipment.
- The policy should state that such authority is applicable when not restricted by funding source used to purchase the supplies and equipment or otherwise restricted by contract provisions.

CHAPTER 0900: Administration of Property

The policy makes no statement regarding the reporting of property disposed of either through age, sale, donation, or lost and stolen to Sonoma County so that the property can be removed from the list of depreciable property.

CHAPTER 1100: Contracting Procedures

- The chapter makes no mention of federal regulations, 49 CFR Part 18.36 - Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments.
- 1105 Elements of a Valid Contract – States that the scope should use clear and concise language to describe the scope. It should also state that all deliverables should be clearly identified along with due dates. Record retention should be listed. Right to audit should be included.
- 1106 Contract Management – Should require that the contract manager be technically qualified to be the manager.
- The chapter does not mention the requirements of performing preaward or price verification audits as required by 49 CFR Part 18.36.

CHAPTER 1200: Independent Contractor Procedures

- No reference to federal regulations 49 CFR Part 18.36.
- No requirement to perform preaward or price audits as required by 49 CFR Part 18.36.

Audit Report Attachment III

Prequalification Audit of the North Coast Railroad Authority
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August 22, 2006

Below is our review comments of NCRA's December Quarterly Reports submitted to the CTC on February 14, 2006.

REVENUE ISSUES:

1. The narrative states that property revenue bookkeeping has undergone major refinement in FY03-04 and 04-05, that agency staff has internally reviewed each lease and built an Accounts Receivable list that will continue to be refined throughout FY05-06.
 - NCRA did not have a usable listing of leases. Based on our review and interviews, this statement is not correct. A prior NCRA employee reportedly had developed a listing of all leases using QuickBooks but at the time of our review no current employees of NCRA had a good operating knowledge of QuickBooks and the data base was not in use.
 - We asked for a listing of all leases. We were told that one was not available. We requested this information from NCRA, Sonoma County and NCRA's single auditor. We were provided with a listing of the leases used to develop the Accounts Receivable balance for the FY 05 balance sheet and NCRA provided a listing of the leases mailed in April 2006.
 - NCRA had no data base that is current showing all leases, balance due, lease type, status, CPI index used, etc. It appears that NCRA has not performed a physical inventory of property to leases, permits etc. for years. NCRA's policy and procedures requires a physical inventory every three years.
2. Narrative states that NCRA staff is committed to bringing the receivables up to date by invoicing delinquent leaseholders back to 2001.
 - At the end of FY 05, NCRA wrote off the complete Accounts Receivable balance, without Board Approval, because NCRA was unsure of the fairness of the account. If NCRA did not consider the Accounts Receivable account reliable it is questionable how NCRA could invoice delinquent leaseholders back to 2001.
3. Schedule A Note (1) for the Revenue report states that "Disciplined management control should enable increased collection for existing leases." We found little, if any, management of property leases performed by NCRA.
4. Comparison of property revenue reported in the financial statements and the property revenue/fee reported in the quarterly reports showed the following differences:
 - FY 05 Financial statement - \$318,068 vs. quarterly report of \$194,517
 - FY 04 Financial statement - \$222,426 vs. quarterly report of \$185,766
 - FY 03 Financial statement - \$222,693 vs. quarterly report of \$145,896
5. Quarterly financial report for FY 06 lists property revenues/fees at \$230,000. The monthly cash flow report provided to the NCRA Board reported the budget for leases and fees at \$206,600, through December at \$107,667, and through April 2006 at \$165,835.

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6. Quarterly report shows equipment lease revenue at \$161,000. The narrative states NCRA will receive approximately \$160,000, yet the actual revenue appears to be \$120,750. The inaccurate lease revenue information should have been known by NCRA by the time they submitted the December report. The narrative states that the monthly lease was approximately \$20,000 and the lease didn't start until January 2006, which means the maximum would be \$120,000 as of the December report.
7. Interest earned on pooled cash with Sonoma County is listed in the Quarterly report at \$5,000, the Monthly Cash Flow Report shows budget amount of \$3,000, and the April Cash Flow Report shows estimated actual at \$1,811. By the end of December the actual amount was \$287.
8. Revenue projections for rail operations list \$240,000 per year in rail lease payments starting in FY 08/09. It is unknown how this figure was arrived at. A review of the RFP for NCRA's next operator only required that the proposal include an estimate of likely payments to NCRA with the proposed method of calculation.

EXPENDITURES:

1. The December 2005 NCRA Board meeting minutes mention the consideration and adoption of a settlement with California Redwood. The FY 05 financial statements show as a subsequent event the termination of a passenger operation agreement with California Redwood Coast Company for \$134,937 with interest at 7%. This settlement is not listed in the quarterly reports.
2. Quarterly report shows FY 06 salary and benefits as \$209,000. Through December 2005 \$113,296 has been expended making the projected yearly expenditure over \$226,000 yet the quarterly report was not updated. As of April 30, 2006 the estimated salary and benefit expenditures is \$220,629.
3. Schedule A, Annual Expenditures – the notes do not correspond to the references above the notes.
4. Schedule A – Long Term Debt – fails to mention the settlement with California Redwood.
5. Quarterly statement lists only three known judgments, TXL for \$52,773, Caltrans for \$152,886 and Mass Electric for \$259,769 for a total of \$465,428. The FY 05 audit report lists judgments of \$512,772 and a difference of \$47,344. The reason for the difference between the financial report and the quarterly report is not explained.
6. In a letter from NCRA's attorney, Chris Neary, to NCRA's independent auditors, Mr. Neary states a settlement with Foss Environmental by stipulated judgment for \$54,308.82 on or about Sept. 5, 2004. This settlement does not show up in the quarterly reports.

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7. NCRA's current P&P states that Medical insurance of up to \$200 per month will be paid by NCRA. Any balance is the responsibility of the employee. NCRA has two employees, yet the Cash Flow Report shows that NCRA is currently expending \$1,852 per month for health insurance.
8. Car hire cost under reported, quarterly report is \$1,724,814 for FY 05; however the FY 05 financial report is \$1,986,064.





North Coast Railroad Authority

419 Talmage Road, Suite M

Ukiah, CA 95482

July 25, 2006

Susan Bransen
Audit Manager, External Audits
Department of Transportation Audits and Investigations
PO Box 94283
Sacramento, Ca 94279-0001

Dear Ms. Bransen,

On July 12, 2006 the North Coast Railroad Authority (NCRA) Board of Directors adopted the attached Corrective Action Plan in response to your June 28, 2006 Draft Prequalification Audit. In addition, the NCRA Board of Directors adopted updated and revised policies and procedures consistent with the Corrective Action Plan.

While the Corrective Action Plan and updated policies and procedures address specific tasks in response to the draft audit, NCRA staff and its Board of Directors believe that it is even more important that we emphasize our commitment to integrating and implementing adequate management practices on an on-going basis. These practices, including training, sharing information and advice from other local agencies, internal controls, and requesting feedback from Caltrans District 1 staff, will ensure that NCRA adheres to the Board adopted policies and procedures, as well as the appropriate regulations, laws and processes required in the use of State and Federal funds.

NCRA does not disagree with any of the audit recommendations contained in the June 28, 2006 draft audit. The Corrective Action Plan provides a detailed approach to addressing all of the findings. To date, we believe we have completed the tasks necessary to satisfy 20 of the 29 findings and recommendations cited in the June 28, 2006 Draft Audit. We have a plan to address the remaining 9 issues in anticipation of a follow-up audit by your department in December, 2006.

To ensure an on-going commitment to the implementation of the Corrective Action Plan, the NCRA Board of Directors and executive management are considering the following "Management Implementation Plan". The plan is a work in progress, and is being discussed with Caltrans District 1 staff.

1. Attend training programs conducted by Caltrans Local Assistance.
2. Utilize contacts in equivalent agencies to gain feedback on options, procedures and draft documents.
3. Consult with the relevant grants manager responsible for the respective funding source, to gain feedback on scoping, applications, contracts, and processes.
4. Enforce the checks and balances as set forth in the Policies and Procedures Manual to ensure that the policies are followed.

5. Include an item on each month's NCRA Board agenda to report on progress made toward the completion of the Corrective Action Plan. Over time, this item will be utilized to address any updates or other issues related to the Policies and Procedures Manual.
6. Form an Ad-Hoc Policies and Procedures committee comprised of two NCRA Board Directors, legal counsel, all NCRA staff, and as necessary: NCRA's accountant - Sonoma County Auditor-Controller staff, NCRA's annual auditor - Aycock & Edgmon, and NCRA's project engineer and planning consultant - American Rail Consultants. Quarterly meetings of this committee will address an agenda that includes a status report and discussion of the Corrective Action Plan. This would include discussion of specific policies and procedures in order to gain an in-depth understanding of the purpose, necessity, and process associated with each Policy Manual chapter. The critical Procurement, Contracting, and Accounting chapters will be addressed first. The Executive Director will be responsible for preparing the agenda. The Board committee members are to report back to the full Board at the following meeting on the status of the Executive Director's progress, any issues or challenges, and make recommendations for improvement.
7. Conduct an annual workshop with the NCRA Board of Directors to provide a systematic overview of the policies and procedures applicable to recipients of state and federal funding. In addition, the status of the Corrective Action Plan will be discussed, and the Management Implementation Plan will be reviewed to ensure that its intent is being achieved. This annual workshop will be conducted prior to the December NCRA Board meeting.

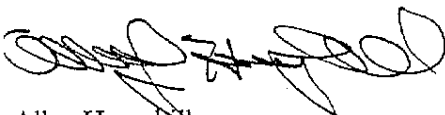
The June 28, 2006 Draft Audit highlights the need for NCRA to vigilantly and carefully follow state and federal laws and regulations governing the use of public dollars. It illustrates the importance of strict adherence to state and federal policies and procedures in the investment of public funds for capital repairs to the NWP rail line.

Through the adoption of the Corrective Action Plan and the Management Implementation Plan, it is NCRA's goal to fully comply with all of the aforementioned local, state, and federal requirements regarding the use of public funds.

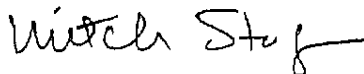
We look forward to continuing to work with the Department to resolve any outstanding issues as NCRA embarks upon its long-awaited plans to initiate rail infrastructure repairs this Fall. Please let us know as soon as possible whether our proposed Corrective Action Plan and Management Implementation Plan are responsive to the findings and recommendations outlined in your June 28, 2006 Draft Prequalification Audit. Thank you for your prompt attention to this request.

Sincerely,

North Coast Railroad Authority



Allan Hemphill
Chairman of the Board



Mitch Stogner
Executive Director

Copy: NCRA Board Members
Cheryl Willis, Caltrans District 1
Gregg Albright, Department of Transportation Audits and Investigations
John Barna, California Transportation Commission
Robert Chung, California Transportation Commission
State Senator Wes Chesbro



North Coast Railroad Authority
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July 25, 2006

Susan Bransen
Audit Manager, External Audits
Department of Transportation Audits and Investigations
PO Box 94283
Sacramento, Ca 94279-0001

RE: RESPONSE AND CORRECTIVE ACTION PLAN TO JUNE 28, 2006 DRAFT
PREQUALIFICATION AUDIT

The North Coast Railroad Authority respectfully submits the following corrective action plan and responses to the Draft Fourth Prequalification Follow-Up Audit dated June 28, 2006 prepared by the Department of Transportation Audits and Investigations.

Audit Period: November 1, 2003 through May 26, 2006

The findings from the June 28, 2006 Draft Prequalification Audit and related responses and corrective action plan are discussed below. The findings are numbered consistently with the numbers assigned in the audit results section of the report.

Finding 1 Project Manager Conflict of Interest

Audit Statement: "Based on interviews, NCRA's consultant project manager develops the scopes of work and estimates for NCRA and also provides the same scopes of work and estimates to the prime contractor, therefore creating a conflict of interest."

NCRA Response: The Audit Statement would more accurately be stated as, "NCRA's consultant project manager develops written scopes of work by coordinating with NCRA and Caltrans District 1 for consistency with Caltrans and NCRA methods and policies. NCRA's consultant project manager then provides HNTB with a scope and HNTB then develops estimates and negotiates hours based on NCRA's project manager's estimates. This could result in a perceived conflict of interest."

Audit Recommendation: "NCRA should hire a project manager or procure a project manager independent of the current on-call engineering consultant."

Action Taken or Planned: NCRA concurs with the recommendation, and completed implementation of this recommendation on July 12, 2006. The Policies and Procedures Manual Chapters 0600, 1100, 1200, and 1300 were updated to address procurement procedures when using federal and state proceeds by adding references to 49 CFR 18. The NCRA Board approved the revised Policies and Procedural Manual at its Board meeting held July 12, 2006.

A contract was prepared for the procurement of Project Engineering and Transportation Planning staff and approved by the NCRA Board on July 12, 2006. Documentation has been filed to reflect the procurement was conducted according to the requirements for small purchase procedures as found in 49 CFR 18 and the NCRA's Policies and Procedures Manual. The new contract has a term of six months and is for a contract amount of less than \$100,000. Within the next six months the Executive Director will proceed with a formal Request for Qualifications and subsequent evaluation in order to enter into a long-term contract for these services. The six month interim contract was secured to provide an immediate correction action and to provide for these services at a critical time in NCRA history.

Finding 2 Procurement

Audit Recommendation No. 1: "NCRA should terminate the consultant contracts identified above and procure the services in accordance with federal regulations and NCRA's P&P."

Audit Recommendation No. 2: "For all future procurements, NCRA should ensure that compliance with federal regulations and NCRA's P&P is achieved."

Action Taken or Planned Nos. 1 & 2: NCRA concurs with the recommendations. At the NCRA Board meeting held July 12, 2006, the Board recognized that of the three contracts, two had been fulfilled, completed and were no longer active, and one was on-going. The Board took action to terminate the two completed contracts as well as the current contract for transportation planning services. Going forward, the Executive Director and his staff will implement and comply with the Policies and Procedures Manual in the procurement process.

Finding 3 Contract Management

Audit Recommendation: "NCRA seek reimbursement from the contractor for the \$11,979.71 in overpaid interest."

Action Taken or Planned: The Policies and Procedures Manual has been updated to include a step-by-step process for paying contractors interest under the Prompt Payment Act (Chapter 0605). Attachment 1 to this corrective action plan documents the penalties (interest) paid to the contractor and the outstanding balance. The \$11,979.71 in overpaid interest referenced by the Auditors is not accurate as Attachment 1 shows. The highest level of overpayment at any given time was \$9,367.72 in November 2005, but the mistake was detected within the month, and by December 2005 the

within the month, and by December 2005 the overpayment was being used to credit new interest billings. The credit was entirely applied in March 2006, prior to the Caltrans audit, and no further interest payments have been made by NCRA to the contractor.

By using the Prompt Payment Act and the Budget Letter 05-15 detailing the daily interest factor to be charged (daily interest factor of 0.0000892 for FY 05-06), and taking into consideration the amounts and dates of invoices, OES payments, interest payments, and retention credits, the penalty owed to the contractor through June 30, 2006 is \$3,147.24. In summary, to date NCRA has paid the contractor \$10,268.35 and, per the Prompt Payment Act, owes the contractor an additional \$3,147.24 through June 30, 2006.

Finding 4 Financial Condition

Audit Recommendation No. 1: "NCRA provide the CTC and the Department as part of their quarterly reports, a report on their management activities regarding lease and rental income."

Action Taken or Planned No. 1: NCRA concurs with the recommended action. Beginning with the 2007 first quarterly report to the CTC, the NCRA will include in the report the activity for the quarter on the management of the property lease receivables and revenues (see P&P Chapters 0505.5 and 0802.9).

The database used to track the property lease receivables and revenue will be updated beginning the week of July 24, 2006. Heather Newell, NCRA Administrative Assistant, is scheduled to receive training in Quickbooks July 17-21, 2006. The training will result in the creation of a database to track the following: milepost location, date initiated, property owner, property address, outstanding amount billed, date billed, date paid, delinquency date, delinquency follow-up, and annual CPI adjustments. The training will also include instruction on how to prepare a report that can be run at any time to show the current status of lease income and quarterly activity. The database will be brought to a full accrual basis by the second quarter of the 2007 fiscal year.

Audit Recommendation No. 2: "NCRA aggressively seek funding support from their county members and property leases/rentals."

Action Taken or Planned No. 2: NCRA concurs with the recommended action and is making a concerted effort to determine and collect the property lease receivables due as well as conducting the additional training discussed in Action Taken or Planned No. 1 above. In addition, NCRA at its April 12, 2006 Board meeting took the following action:

3. *Approval of Letter Seeking Local Government Assistance for Rail Repairs*

Mitch Stogner said that NCRA is scheduled to return to the CTC on April 27 in Fresno to request \$4.9 million in funding to make public safety repairs to the line. Mr. Stogner said that he would like to solicit the support and help from various Public Works departments within the county where the work will be performed. He provided the Board with a draft letter for its consideration and approval.

Director Wagenet and Director Woolley directed staff to send a copy of the letter to the various Work Force Investment Boards and local COG's within each county. Director LaVallee motioned to approve the support letter seconded by Director Ollivier carried unanimously (6-0).

Subsequent to this Board action, on April 14, 2006 ten letters were sent to Public Works departments, Councils of Governments and Work Force Investment Boards in the format shown in Attachment 2 to this Corrective Action Plan. The Executive Director is in the process of following up with the letters, and will make every effort to build funding and in-kind services support.

Finding 5 Financial Management System

Internal Controls

Audit Recommendation No. 1: "NCRA establish in their P&P the approval authority thresholds for expenditures. This should include a requirement that all Executive Director expenditure claims be approved by an NCRA Board Member. Also, NCRA should implement controls to ensure that all payments are properly authorized and withhold payment if proper authorizations are missing."

Action Taken or Planned No. 1: NCRA concurs with the recommendation. The Board of Directors on July 12, 2006 amended its Policies and Procedures Manual to incorporate appropriate authorization thresholds for expenditures: less than or equal to \$10,000 to be approved by the Executive Director, and greater than \$10,000 to be approved by the Executive Director and one (1) Board member (Chapter 0505.3). In addition, a cash disbursement journal will be approved by the Board of Directors on a monthly basis on an after-the-fact basis (Chapter 0505.5).

The updated and approved Policies and Procedures Manual also provides for appropriate controls for the authorization and approval of the Executive Director's expenses (Chapter 0408.2).

Audit Recommendation No. 2: "All journal entries made by Sonoma County should be reviewed and approved by NCRA consistent with established authorization requirements within a set period, such as one week from the entry."

Action Taken or Planned No. 2: NCRA concurs with the recommendation, and effective July 3, 2006 all journal entries initiated by Sonoma County are reviewed and approved by NCRA consistent with the above authorization requirements stated in Action Plan No. 1. Journal entries less than or equal to \$10,000 will be approved within one week, and journal entries more than \$10,000 will be approved within two weeks in order to allow sufficient time to obtain a Board member's signature (Chapter 0505.4).

Accounting System

Audit Recommendation No. 1: "NCRA establish and properly use subsidiary ledgers on an accrual basis during the year."

Action Taken or Planned No. 1: NCRA concurs with this recommendation and established subsidiary ledgers on an accrual basis effective July 1, 2006 (P&P Chapter 0501.8, 0505.3, 0505.5, 0802.9, 0905.15). NCRA has sought a greater level of assistance from the Sonoma County Auditor-Controller's office (County Auditor) to address these recommendations. Scott Catania, Accountant, met with Heather Newell, NCRA Administrative Assistant, on July 7, 2006, to assist in the establishment of subsidiary ledgers to track accounts payables and receivables, and other current and long-term liabilities. These ledgers, to be implemented immediately, will be forwarded to the County Auditor monthly for inclusion within the County's general ledger system. These corrective actions, along with the stated action to Finding 4 – Financial Condition regarding lease and rental income, as well as Finding 5– Financial Management System – Inventory, will facilitate NCRA reporting its financial condition on a full accrual basis in accordance with GAAP. These corrective actions address recommendations 1 and 3.

Audit Recommendation No. 2: "NCRA make the necessary modifications to the chart of accounts to allow the segregation of allowable and unallowable expenditures."

Action Taken or Planned No. 2: NCRA concurs with this recommendation and the cost coding structure has been expanded to isolate all direct and indirect cost centers and the account structure to include codes for unallowed costs (Chapter 0504). NCRA staff will identify and record all time to the proper projects and subobjects effective July 1, 2006. Once implementation of the cost coding has been achieved and in use for a period of time, NCRA will request that the auditor return in December 2006 to verify that the correct procedures are being followed.

Audit Recommendation No. 3: "NCRA maintain accounting records on an accrual basis of accounting during the year to ensure that financial reports presented to funding agencies reflect an accurate presentation of NCRA's financial condition."

Action Taken or Planned No. 3: NCRA concurs with this recommendation. A search for unrecorded payables and receivables will be performed as detailed above and reported to the Sonoma County Auditor's Office to ensure that the NCRA's financial reporting is presented on an accrual basis in accordance with GAAP, and will train staff to prepare such accrual documentation. See action plan 1

documentation. See action plan 1 above.

Inventory

Audit Recommendation No. 1: "That NCRA implements an inventory system to track the purchases and withdrawals of materials and equipment to and from inventory."

Action Taken or Planned No. 1: NCRA concurs with the recommendation. The NCRA on July 11 implemented an adequate inventory system to account for the inventory of the signal equipment acquired with FEMA and OES funds. The Policies and Procedures Manual approved by the Board on July 12, 2006 includes policies and procedures to ensure that the inventory will be safeguarded and properly reported in the NCRA's financial reporting (Chapters 0505.3 and 0905.15).

Timekeeping

Audit Recommendation No. 1: "NCRA change the current policy to require that the Executive Director's timesheet be reviewed and approved by an NCRA Board Member."

Action Taken or Planned No. 1: NCRA will concur with this recommendation, but would like to point out its shortcomings. The purpose of this control is for a person in an oversight position to verify that the employee worked the hours included on the time sheet presented for payment and to verify that the employee performed the given tasks. The Board of Directors is not in such a position to verify the Executive Director's daily tasks. In addition, with the NCRA contracting directly for a Project Manager, it is not expected that the Executive Director will be charging any direct project time. That said, NCRA is willing to add this step to its procedures, and the Administrative Assistant will continue to check the timecard for arithmetic accuracy and completeness.

Audit Recommendation No. 2: "NCRA implement the written P&P on timekeeping to include the use of one timesheet to record all hours worked on all projects and indirect activities."

Audit Recommendation No. 3: "NCRA record all labor hours worked on all projects on the same timesheet and ensure that labor costs are recorded in the accounting system."

Action Taken or Planned No. 2 & 3: NCRA concurs with this recommendation, and began implementing the Policies and Procedure Manual approach to timekeeping effective July 1, 2006. One time sheet is maintained on a biweekly basis by both the Executive Director and the Administrative Assistant that accounts for all hours worked and all tasks performed, whether direct or indirect. This in combination with Action Plan Nos. 1 & 2 under "Accounting System" will be used to record the labor costs into the accounting system.

Property Management

Audit Recommendation No. 1: "NCRA implement the established P&P's on property management and dedicate staff time and resources to the proper management of property and the associated leases and rents."

Audit Recommendation No. 2: "NCRA should maintain a system of record keeping and internal control to account for lease/rent revenue and write offs of receivables."

Action Taken or Planned Nos. 1 & 2: NCRA concurs with these recommendations, and as detailed in Finding 4 Action Taken or Planned No. 1, intends to commit time, funds, and substantial resources into optimizing this revenue-generating aspect of the Authority. As a possible alternative, NCRA is currently negotiating a contract in which a private firm with real estate expertise would assume management of NCRA's Crossing Lease Program in return for a sum specific annual guarantee of income. In that the Crossing Lease Program is NCRA's only source of unrestricted income for funding NCRA administrative services, a guaranteed income with CPI increases would stabilize NCRA's administrative funding so that market fluctuations would not impact NCRA's provision of administrative services.

Capital Assets

Audit Recommendation No. 1: "NCRA fully implement their P&P on capital assets; perform a physical inventory documenting location, condition and identifying features of each piece of equipment and all material listed as capital assets."

Audit Recommendation No. 2: "NCRA provide a report to the CTC and Department that identifies all pieces of equipment purchased with state and federal funds and the disposition of that equipment, whether it is still usable, and whether it is still in the possession of NCRA. Any amounts due should be reimbursed to the Department."

Audit Recommendation No. 3: "NCRA ensure that the Independent Auditor observe the physical inventory taken prior to expressing an opinion on the financial statements."

Audit Recommendation No. 4: "NCRA properly account for all capital assets and properly report depreciation expense in accordance with the NCRA P&P requirements and the results of the capital asset inventory results."

Action Taken or Planned Nos. 1-4: The audit contract for the fiscal year ended June 30, 2006 was awarded by the Board at the July 12, 2006 Board of Directors' meeting. A mid-year inventory with observation by the auditors will be conducted during the 2007 fiscal year for financial reporting purposes for the fiscal year ended June 30, 2006.

An inventory of equipment and rolling stock will be conducted once every two years beginning with the fiscal year 2007. The inventory will be reconciled to the property records and adjusted, if needed. Impairments will be recorded based on the inventory every two years. Depreciation expense will be recorded on an annual basis.

The NCRA will report annually beginning with the fiscal year 2007 to the CTC the status of property and equipment acquired with federal and state funds.

Policies and Procedures

Audit Recommendation No. 1: "NCRA make all necessary changes to the P&P to ensure compliance with state and federal regulations."

Audit Recommendation No. 2: "NCRA implement the P&P as approved by NCRA's Board of Directors."

Audit Recommendation No. 3: "NCRA certify to the CTC and the Department when the two recommendations above have been met and NCRA has operated under the implemented P&P for a minimum of six months before another follow-up audit is performed."

Audit Recommendation No. 4: "NCRA submit an indirect cost allocation plan that meets the requirements of OMB A-87."

Action Taken or Planned Plan Nos. 1-4: NCRA concurs with these recommendations and incorporated the applicable provisions of 49 CFR and OMB A-87 in the Policies and Procedures Manual. The necessary changes to the Policies and Procedures Manual for compliance to state and federal regulations were adopted at the Board's July 12, 2006 meeting (Chapters 0600, 1100, 1200, 1300). NCRA has implemented the updated Policies and Procedures Manual as approved by the Board.

As discussed in the Action Taken or Planned under "Timekeeping" and "Accounting System" the structure for an indirect cost allocation plan has been implemented and was initiated as of July 1, 2006. NCRA will request a follow-up audit by December 2006 to review the implementation of the Policies and Procedures Manual and cost coding structure. Once a follow-up audit has been completed, NCRA expects to be in a position to certify that these recommendations have been met, and will have an indirect cost allocation plan prepared in accordance with the requirements of OMB A-87 for review and approval by Caltrans indirect cost allocation plan audit staff.

Audit Recommendation No. 5: "NCRA obtain approval from the required authorities for the DBE program once developed."

Action Taken or Planned No. 5: NCRA received approval from the required authorities for its DBE program on June 14, 2006 (Chapter 1700).

Finding 6 Quarterly Reports to the California Transportation Commission

On June 9, 2006 Cliff Vose sent 12 comments to NCRA and District 1 staff regarding the quarterly reports to the CTC. On June 27, 2006 NCRA responded to these comments and subsequently Mr. Vose responded on July 10. NCRA believes that the Actions Taken and Planned for this Finding 6 and for Finding 4 address Mr. Vose's comments. By bringing the property database to a full accrual basis by the second quarter of the 2007 fiscal year and by instituting the full accrual accounting method, NCRA will ensure that future CTC reports contain accurate and complete data, and information presented in the CTC reports will agree with NCRA's records.

Audit Recommendation No. 1: "That NCRA's Board of Directors is responsible for the reports submitted to the CTC to ensure that the reports contain the most up-to-date and correct data and information."

Audit Recommendation No. 2: "All financial data presented to the CTC should be reported in accordance with GAAP."

Action Taken or Planned Nos. 1-2: With the implementation of the Actions Taken or Planned in the prior 5 Audit Recommendations, NCRA will be able to submit quarterly reports to the CTC that are based on full accrual accounting in accordance with GAAP beginning with the 4th quarter 2005-06 report. Sonoma County will post to the subsidiary ledgers for Accounts Payable, Accounts Receivable, Judgments, and Long-Term Debt on a monthly basis to ensure that the financial reporting produced by Sonoma County's financial system and NCRA's financial reports to the CTC agree. By instituting the full accrual accounting method, NCRA will ensure that reports contain accurate and complete data, and information presented in all future CTC reports agree with NCRA's records. Notes to the reports provided to CTC will be prepared where required to facilitate the understanding of third party users of these financial reports.

Audit Recommendation No. 3: "The CTC should withhold all decisions regarding project approvals and allocation of funding until NCRA provides the CTC with corrected quarterly reports. The reports should be attached to a letter signed by the Executive Director and the Chairman of the NCRA Board of Directors certifying to the correctness and completeness of the reports submitted."

Action Taken or Planned No. 3 – This recommendation is directed to the CTC. While the NCRA takes the recommendations made by the Department of Transportation, Audits and Investigations very seriously, and has taken action to comply fully with its intent, the conclusion that the CTC should withhold project approval and funding is not commensurate with the findings of the June 28, 2006 Fourth Prequalification Follow-up Audit. By the time of this letter, NCRA has implemented more than two-thirds (20 of 29) of the recommendations, including complete resolution of

resolution of Finding 1 which the auditors stated was the most significant finding. The management and Board of the NCRA encourage the CTC and the Department to consider the NCRA's positive actions to implement the recommendations, and to take action, if any, commensurate with the nature and effect of the findings.

Conclusion

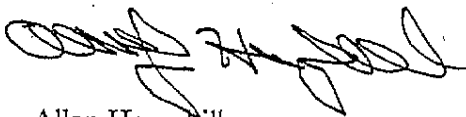
The NCRA Board of Directors and NCRA executive management are fully committed to the timely and orderly implementation of the findings and recommendations detailed above. To this end, NCRA intends to enact a management implementation plan, in concert with the Corrective Action Plan, which will ensure these problems do not arise in the future.

Several approaches are being considered and discussed with District 1 staff to ensure that best management practices become a part of NCRA's daily operations. Items being discussed include: 1) attendance at Caltrans Local Assistance Training, 2) increasing the level of interaction with equivalent agencies such as MCOG, HCAOG, MTC, SMART, and SCTA to seek advice and guidance, 3) consulting with the appropriate grants manager prior to finalizing applications, contracts and other key milestones, 4) implementing an internal check and balance system as outlined in NCRA's Policies and Procedures Manual to ensure correct procedures are followed, and 5) scheduling regular training from NCRA's contract accountant, the Sonoma County Auditor-Controller's office.

If you have any questions regarding this plan, please call Mitch Stogner, NCRA's Executive Director at (707) 463-3280.

Sincerely,

North Coast Railroad Authority



Allan Hemphill
Chairman of the Board

ATTACHMENT 1
Prompt Payment Penalty Computation

Following is a detailed analysis of the prompt payment penalty due to Dutra and referenced in Finding 3 – Contract Management.