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Agenda

JOINT MEETING OF THE AUDIT OVERSIGHT COMMITTEE

for the
Metropolitan Transit System
San Diego Transit Corporation, and
San Diego Trolley, Inc.

June 17, 2010

Executive Conference Room
9:00 a.m.

ACTION RECOMMENDED

- A. 1. ROLL CALL
- 2. APPROVAL OF THE MINUTES OF MARCH 4, 2010 Approve
- B. COMMITTEE DISCUSSION ITEMS
 - 1. MTS: Interim Audit (Tom Lynch) Receive
Action would receive a report on: (1) an interim audit conducted by Caporicci and Larson (MTS's independent auditor); (2) the exit conference held on May 24, 2010; and (3) related observations coupled with management's responses.
 - 2. MTS: Audit Schedule for FY 2010 (Linda Musengo) Receive
Action would receive a report on scheduling for the FY 2010 audit.
 - 3. MTS: Proposed 2010/2011 Internal Audit Plan (Mark Abbey) Approve
Action would approve the proposed 2010/2011 Internal Audit Plan Summary.
- C. COMMITTEE MEMBER COMMUNICATIONS AND OTHER BUSINESS
- D. PUBLIC COMMENTS
- E. NEXT MEETING DATE: To be determined.
- F. ADJOURNMENT

Please turn off cell phones and pagers
during the meeting

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Metropolitan Transit System (MTS) is a California public agency comprised of San Diego Transit Corp., San Diego Trolley, Inc., San Diego and Arizona Eastern Railway Company (nonprofit public benefit corporations), and San Diego Vintage Trolley, Inc., a 501(c)(3) nonprofit corporation, in cooperation with Chula Vista Transit. MTS is the taxicab administrator for seven cities. MTS member agencies include the cities of Chula Vista, Coronado, El Cajon, Imperial Beach, La Mesa, Lemon Grove, National City, Poway, San Diego, Santee, and the County of San Diego.

AUDIT OVERSIGHT COMMITTEE MEETING FOR THE
METROPOLITAN TRANSIT SYSTEM (MTS),
SAN DIEGO TRANSIT CORPORATION (SDTC),
AND SAN DIEGO TROLLEY, INC. (SDTI)

MARCH 4, 2010

MTS
1255 Imperial Avenue, Suite 1000, San Diego

MINUTES

A. ROLL CALL

1. Chairman Ewin called the meeting to order at 9:00 a.m. A roll call sheet listing Audit Oversight Committee member attendance is attached.

2. APPROVAL OF MINUTES

Mr. Mathis moved to approve the minutes of the November 5, 2009, Audit Oversight Committee meeting. Mr. Rindone seconded the motion, and the vote was 4 to 0 in favor.

B. AUDIT OVERSIGHT COMMITTEE DISCUSSION ITEMS

1. MTS: Appointment of Chairperson

Tiffany Lorenzen opened nominations for the chairperson of the Audit Oversight Committee. Mr. Mathis nominated Ernie Ewin. There were no other nominations. Mr. Ewin left the room.

Action Taken

Mr. Mathis nominated Mr. Ewin as Chairman of the Audit Oversight Committee. The vote was 3 to 0 in favor. Mr. Ewin was not present for the vote.

2. MTS: Statement of Auditing Standards (SAS) 114 Letter from Independent Auditors Caporicci & Larson

Kenneth Pun, Caporicci & Larson (C&L), reported that a requirement of the Statement of Auditing Standards (SAS) 114 letter was based on the 2009 audit. In the letter, the auditors communicate to those charged with governance:

1) the auditor's responsibilities under generally accepted auditing standards, 2) an overview of the planned scope and timing of the audit, and 3) significant findings from the audit.

Gary Caporicci of C&L referred to page 2 of the letter regarding management accounting estimates that will be audited. He also reviewed how sensitive disclosures, such as investments, workers' compensation, and claims liabilities, are audited.

3. MTS: Exercise of Options on Independent Auditor's Contract

Tom Lynch, Controller, gave a report on the Caporicci & Larson (C&L) contract. He stated that MTS currently has a contract with C&L to provide audit services of financial statements for five years (FY 2006 through FY 2010). There are 3 one-year options for the FY 2011 through FY 2013 audits. He stated if the options were not exercised, the contract would be over at the conclusion of the FY 2010 audit (approximately December 31, 2010). He stated that a Request for Proposals (RFP) and the contract award process would take approximately 12 months. He added that staff is seeking direction on whether the options should be exercised or if staff should begin the RFP process.

In response to Mr. Selby, Mr. Ewin stated that there has never been a question related to the integrity of the audit or professional standards of C&L. He added that that he is comfortable with forwarding the recommendation to the Board to exercise the three-year option. He stated that if ever a question arose about C&L's integrity or nonresponsiveness, he would expect staff to keep the Audit Oversight Committee apprised.

Mr. Lynch stated that C&L unilaterally reduced the contract amount in FY 2009 and FY 2010 to \$295,000, which is the amount of the first year of the contract. He reviewed a table that depicted the effect of this cost reduction, which would save MTS \$87,000 over the base contract and has the potential to save an additional \$235,000 if the three-year option is exercised.

Mr. Lynch stated that based upon the cost savings projected and the level of service provided by C&L, staff recommends that the Audit Oversight Committee forward a recommendation to the Board to exercise the three-year option in the contract.

Mr. Jablonski stated that even if the three-year option is exercised, the contract could be terminated at any time through the termination for convenience clause, and the procurement process could be started for the next year.

Mr. Rindone noted the cost savings that would be realized by exercising the three-year option; however, he stated that it is most important to ensure that the audit is conducted appropriately. He stated that he would support the three-year option with the caveat that the Audit Oversight Committee review the decision each year to determine whether to continue with C&L.

Mr. Ewin stated that it is important that the minutes reflect that members have considered the integrity of the audit.

Action Taken

Mr. Selby moved to forward the recommendation to the Board to exercise the three-year option of Caporicci & Larson's contract. The Audit Oversight Committee

will review and consider for approval the extension for the second and third years. Mr. Mathis seconded the motion, and the vote was 6 to 0 in favor.

4. MTS: Auditor Schedule for FY 2010

Linda Musengo, Finance Manager, reviewed the MTS proposed audit schedule for FY 2010.

MTS PROPOSED AUDIT SCHEDULE FY 2010

March 8-19	Interim work – documentation and testing of Compass Card system
May 2-4 weeks	Balance of interim work
August 23- September 30	Field work
October 7	Draft CAFR presented to Audit Oversight Committee
October 21	Final CAFR presented to Audit Oversight Committee
October 28	Final CAFR presented to Board

Mr. Lynch stated that staff will come back to the Audit Oversight Committee in June or July of 2010 after the results of the interim letter are received.

Action Taken

Mr. Rindone moved to receive the audit schedule. Mr. Selby seconded the motion, and the vote was 6 to 0 in favor.

C. COMMITTEE MEMBER COMMUNICATIONS AND OTHER BUSINESS

There were no committee member communications or other business.

D. PUBLIC COMMENTS

There were no public comments.

E. NEXT MEETING DATE

June 2010 (date to be determined)

F. ADJOURNMENT

Chairman Ewin adjourned the meeting at 9:19 a.m.

Chairman

vicki.rogers.minutes

Attachment: Roll Call Sheet

**AUDIT OVERSIGHT COMMITTEE
METROPOLITAN TRANSIT SYSTEM**

ROLL CALL

MEETING OF (DATE) MARCH 4, 2010

CALL TO ORDER (TIME) 9:00 a.m.

CLOSED SESSION none RECONVENE _____

ADJOURN 9:19 a.m.

BOARD MEMBER (Alternate)	PRESENT (TIME ARRIVED)	ABSENT (TIME LEFT)
EWIN (Chair) ☒		
LIGHTNER ☒ (Young) ☐		
MATHIS ☒		
Rotated to Chula Vista		
RINDONE (VC) ☒ (Young) (CPT) ☐		
ROBERTS ☒ (Cox) ☐	9:09 a.m.	
SELBY ☒ (Ryan) ☐	9:03 a.m.	

SIGNED BY OFFICE OF THE CLERK OF THE BOARD

Vicki Rogers

CONFIRMED BY OFFICE OF THE GENERAL COUNSEL:

Jeff Williams



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Agenda

Item No. B1

JOINT MEETING OF THE AUDIT OVERSIGHT COMMITTEE
for the
Metropolitan Transit System,
San Diego Transit Corporation, and
San Diego Trolley, Inc.

ADM 110.12

June 17, 2010

SUBJECT:

MTS: INTERIM AUDIT (TOM LYNCH)

RECOMMENDATION:

That the MTS Audit Oversight Committee receive a report on:

1. an interim audit conducted by Caporicci and Larson (MTS's independent auditor);
2. the exit conference held on May 24, 2010; and
3. related observations coupled with management's responses.

Budget Impact

None at this time.

DISCUSSION:

During the month of May, Caporicci and Larson conducted an interim audit and tested MTS's internal controls. Upon completion of this stage of the audit process, an exit conference was held with MTS management staff on May 24, 2010, to discuss the results and provide management with the report. Management has responded to the recommendations, and these responses are contained within the observations in Attachment A.

As noted on page 1 of the report, the audit risk assessment is low in all areas with the exception of Compass Cards, which indicates that MTS has successful internal controls. The Compass Card Program is a new area involving new technology and procedures that are still evolving. Without the longer track record of successful internal controls, there is a need for greater audit attention.

A representative from Caporicci and Larson will be available to discuss the audit observations.

A handwritten signature in black ink, appearing to read 'Paul C. Jablonski', is written over a horizontal line.

Paul C. Jablonski
Chief Executive Officer

Key Staff Contact: Tom Lynch, 619.557.4538, tom.lynch@sdmts.com

JUNE17-10.B1.CAP & LARSON INTERIM AUDIT.TLYNCH.doc

Attachment: A. Interim Audit Exit Conference Report

**San Diego Metropolitan Transit System
 For the Fiscal Year Ending June 30, 2010
 Interim Exit Conference
 May 24, 2010**

AUDIT PROCEDURES

**AUDIT
 RISK
 ASSESSMENT**

➤ Internal Control Evaluation

Overall	Low
Financial reporting	Low
Budget	Low
Cash	Low
Investments	Low
Revenue and Receivable	Low
Capital Assets	Low
Accounts Payable	Low
Payroll and Related Liabilities	Low
Long-Term Debt	Low
Risk Management	Low
Computer Controls	Low
Inventory	Low
Compass Cards	Moderate

- ❑ Identify Related Parties Transaction
- ❑ Considerate Fraud and Perform Brainstorming
- ❑ Review of Minutes of the Board of Directors

**San Diego Metropolitan Transit System
For the Fiscal Year Ending June 30, 2010
Interim Exit Conference
May 24, 2010**

CURRENT YEAR OBSERVATIONS

☐ Travel Expenses

Observation:

- **Approval of Monthly Transaction Log Sheet**

The monthly transaction log sheet for purchases made with Elizabeth Horn's purchasing credit card were not signed and approved by a Department Director. Per instructions on the log sheet, all log sheets must be approved by the Department Director.

- **Approval Authorization**

According to MTS' policies and procedures, expense reports are required to be approved by CFO, Cliff Telfer. During our review of the expense reports, we noted the followings:

- i. For September 2009, the expense report for Jerry Rindone was approved by the General Counsel, Tiffany Lorenzen.
- ii. For October 2009, the expense reports for Harry Mathis and Jerry Rindone were approved by CEO, Paul Jablonski.

Management Response:

Finance manager routinely approves office supplies purchased on Elizabeth's purchase card, provided the invoice total does not exceed \$500, in which case a director will approve. Approvals are provided on payment voucher form rather than the purchase card log sheet as a matter of efficiency. The board travel item on the card was not noted for special approval when the card payment was processed. Elizabeth's card was used rarely for this type of transaction and was due to the vacancy in the executive assistant position.

A revised MTS policy #44, MTS TRAVEL EXPENSE POLICY, will be presented to the board with a proposed change allowing the Chief Executive

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For the Fiscal Year Ending June 30, 2010
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May 24, 2010**

Officer (CEO) and General Counsel to sign Board of Directors expense reports as well as the Chief Financial Officer (CFO).

❑ Capital Assets

Observation:

- **Approval of Acquisition Form**

According to MTS' policies and procedures, acquisition forms must be approved by the Project Manager. During our testing of the internal control of Capital Assets, we noted 8 out of 30 additions did not have the proper approval on the acquisition form.

Management Response:

The 8 additions referenced above relate to multiple forms from a single project. One of the eight relates to a LRV rehabilitation project and serves as an example. 54 LRV cars were rehabilitated at cost of \$2.27 million. The overall project, contract, and purchase orders were properly approved. To properly assign costs to each LRV, 54 separate forms were generated. Only the first was approved by the project manager.

The purposes of the acquisition form are to advise accounting of the existence of a capital asset and properly record the asset in the accounting system. This occurs both in the general ledger as well as the capital asset detail records.

There are two purposes of the project manager's approval. The first is to verify that all of the project information that is to be recorded is correct. The second is to reinforce with the project manager their ongoing custodial responsibility for the capital asset.

In the above example, having the project manager sign all 54 forms adds additional work with no additional control value. All of the eight items contained within the observation above are similar transactions.

**San Diego Metropolitan Transit System
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The capital asset section of the financial procedures manual will be amended to note this distinction and provide an exception to the need for the project manager's signature for these types of transactions.

CURRENT YEAR OBSERVATIONS, Continued

❑ Compass Cards

Background:

The Compass Card is a form of electronic ticketing used on public transport services within San Diego County, California. It is administered by the San Diego Association of Governments and is valid on a number of different travel systems in San Diego County including MTS bus, the San Diego Trolley, North County Busses, the Coaster and the Sprinter.

Observation:

During our initial review of the internal control over the compass card process, we noted the followings:

- The initial batch of compass cards received from SANDAG was not in sequential, pre-numbered order, therefore it is difficult to track and reconcile compass cards issued.
- We noted that the TVM's cannot distinguish transactions between new cards issued and cards that are reloaded.
- Compass card validating stations on the trolley lines are not easily distinguishable to the public. Each trolley station has two validating stations, one on each end of the trolley line. We observed that some validating stations are not located in visible areas of the trolley station, and there are no signs to instruct the user to tap before boarding the trolley.
- We noted that the TOT machines cannot take more than one payment nor can they complete multiple tasks within the same transaction.

Management Response:

**San Diego Metropolitan Transit System
For the Fiscal Year Ending June 30, 2010
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May 24, 2010**

- The initial batch of compass cards received from SANDAG was not in sequential, pre-numbered order, therefore it is difficult to track and reconcile compass cards issued.

Current situation

Blanks cards are now provided to the Transit Store in predetermined quantities. The supervisor at the Transit Store counts cards and then issues them to sales clerks. Although they are not serialized, quantities sold are checked by the Transit Store Supervisor. Compass cards sent to other outlets such as Vons are billed for usage. Quantities are counted at SANDAG and confirmed by the recipient.

Future situation

The new card stock (sun burst design) is both pre numbered and consecutively numbered. As the new card stock replaces the old card stock, tracking and reconciliation will be easier and more effective.

- We noted that the TVM's cannot distinguish transactions between new cards issued and cards that are reloaded.

There are reports that can be run by staff that can tell the difference. These exist within the Hummingbird system. New cards show a three step process (initialize, issue, pass sale) and there is now a \$2.00 charge associated with them. Reloaded cards show a one step process (pass sale).

- Compass card validating stations on the trolley lines are not easily distinguishable to the public. Each trolley station has two validating stations, one on each end of the trolley line. We observed that some validating stations are not located in visible

**San Diego Metropolitan Transit System
For the Fiscal Year Ending June 30, 2010
Interim Exit Conference
May 24, 2010**

areas of the trolley station, and there are no signs to instruct the user to tap before boarding the trolley.

The locations of the validating stations will be reviewed periodically and changed if needed and feasible.

This issue has the most impact for our blind customers. Their dogs are trained to avoid obstacles and would naturally steer the customer away from the validating stations.

To assist our blind customers and provide an additional validating station, SANDAG (project manager for the compass card) is investigating the cost of getting the TVMs to function as a validating station.

- We noted that the TOT machines cannot take more than one payment nor can they complete multiple tasks within the same transaction.

The software application controlling the retail (customer) functions of the TOT machines lack many of the features traditionally found in most retail environments. These include those mentioned above along with a number of others. SANDAG is issuing an RFP to address these shortcomings.

CURRENT YEAR OBSERVATIONS, Continued

☐ Risk Management

Observation:

- **Consistency of Claim Processing between MTS, SDTC and SDTI**
Prior to sending worker's compensation claims to the Third Party Administrator, TriStar, the Risk Management department performs preliminary work which includes entering information into the

**San Diego Metropolitan Transit System
For the Fiscal Year Ending June 30, 2010
Interim Exit Conference
May 24, 2010**

TriStar system. The current procedures for entering information into the system for SDTC, SDTI, and MTS are not consistent.

- o For SDTC claims, the Claim Adjuster has to input information into the TriStar system and the Ellipse system;
- o For SDTI and MTS claims, information is only entered into the TriStar system.

Management Response:

Upon discussion with the Risk department and SDTC management, the information required for SDTC can be obtained elsewhere. As such the data will not now be entered into Ellipse eliminating this duplication.

PRIOR YEAR OBSERVATIONS

☐ Accounts Payable

Observation:

During the review of internal controls for Purchase/Credit Card, it was noted that there were no policies and procedures implemented for cards issued to the Executive Assistant. The procedures for this employee differ from the procedures established in the MTS Purchase/Credit Card policies and procedures.

Status:

Implemented.

☐ Inventory

Observation:

During our observation of the cycle count at SDTI, it was noted that physical quantities of four (4) items out of twenty-nine (29) items counted did not match the amount recorded in the system. Per inquiry with the Storeroom Manager, quantities may be off for a variety of reasons such as

**San Diego Metropolitan Transit System
 For the Fiscal Year Ending June 30, 2010
 Interim Exit Conference
 May 24, 2010**

(a) storekeepers may take out an item while dropping another one on the ground and not retrieve it due to immateriality and (b) items may be a credit in the system but items are physically not present in the storeroom due to timing differences.

<u>STOCK NO</u>	<u>STOCK DESCRIPTION</u>	<u>QUANTITY PER COUNT</u>	<u>QUANTITY PER SYSTEM</u>	<u>VARIANCE</u>
98368	Brush	501	502	(1)
120162	Screw	12	11	1
100032	Gasket	10	11	(1)
145946	Battery	9	8	1

Status:

Implemented.

NEW PRONOUNCEMENTS AND ISSUES:

- ☐ **To be implemented in 2010**
 - o GASB 51 – Accounting and Financial Reporting for Intangible Assets
 - o GASB 53 – Accounting and Financial Reporting for Derivative Instruments

REPORTS TO BE ISSUED

**DEADLINE /
DUE DATES**

- | | |
|--|----------|
| ☐ Audited Financial Statements – MTS prepares | 12/31/10 |
| ☐ SAS 115 Letter – if applicable | 12/31/10 |
| ☐ Single Audit and Data Collection Form | 03/31/11 |
| ☐ San Diego Transit Corp Retirement Plan | 12/31/10 |
| ☐ Agreed Upon Procedures | |
| ♦ NTD for MTS, SDTC, SDTI | 12/31/10 |
| ♦ TDA for MTS, SDTC, SDTI | 12/31/10 |
| ♦ Indirect Costs | 12/31/10 |
| ☐ SAS 114 Letter | 12/31/10 |



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Agenda

Item No. B2

JOINT MEETING OF THE AUDIT OVERSIGHT COMMITTEE
for the
Metropolitan Transit System,
San Diego Transit Corporation, and
San Diego Trolley, Inc.

ADM 110.12

June 17, 2010

SUBJECT:

MTS: AUDIT SCHEDULE FOR FY 2010 (LINDA MUSENGO)

RECOMMENDATION:

That the MTS Audit Oversight Committee receive a report on scheduling for the FY 2010 audit.

Budget Impact

None at this time.

DISCUSSION:

The following is the remaining schedule for the FY 2010 audit:

August 23 – September 30, 2010	Field work
October 7, 2010	Draft Comprehensive Annual Financial Report (CAFR) submitted to Audit Oversight Committee
October 21, 2010	Final CAFR submitted to Audit Oversight Committee
October 28, 2010	Final CAFR submitted to Board of Directors

The largest variable in achieving this schedule is the receipt of capital asset information from the San Diego Association of Governments (SANDAG).

Paul C. Jablonski
Chief Executive Officer

Key Staff Contact: Linda Musengo, 619.557.4531, linda.musengo@sdmts.com

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Agenda

Item No. B3

JOINT MEETING OF THE AUDIT OVERSIGHT COMMITTEE
for the
Metropolitan Transit System,
San Diego Transit Corporation, and
San Diego Trolley, Inc.

ADM 110.12

June 17, 2010

SUBJECT:

MTS: PROPOSED 2010/2011 INTERNAL AUDIT PLAN (MARK ABBEY)

RECOMMENDATION:

That the Audit Oversight Committee approve the proposed 2010/2011 Internal Audit Plan.

Budget Impact

None.

DISCUSSION:

The MTS Internal Auditor has proposed a 2010/2011 work plan consisting of 9 internal audit projects plus an allowance of 400 hours for completion of various management and Board requests. The estimated time required to complete each project is shown on the attached audit plan (Attachment A). Each agency process to be reviewed is listed as well as the estimated business risks associated with each process. It should be noted that the projects were selected based on risk factors as follows:

- Date last audited
- Liquidity of assets; e.g. cash
- Recent changes in processes; e.g. Compass Cards
- Recent changes in key personnel
- Size and materiality of the process
- Previous control findings

A handwritten signature in black ink, appearing to read 'Paul C. Jablonski', is written over a horizontal line.

Paul C. Jablonski
Chief Executive Officer

Key Staff Contact: Mark Abbey, 619.557.4573, mark.abbey@sdmts.com

Attachment: A. Proposed 2010/2011 Internal Audit Plan Summary

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Proposed 2010/2011 Internal Audit Plan Summary

GOALS, OBJECTIVES, AND ACTIVITIES

GOAL 1: Strengthen the Board's and its subsidiaries' performance and accountability to the public in managing resources and achieving outcomes

Objective 1: Improve performance levels and outcomes for the Board and its subsidiaries

Risk:

Misappropriation, waste, or loss (evaluate controls)

Misappropriation, waste, or loss (evaluate controls)

Bodily harm to customers or employees

Regulatory noncompliance and possible loss of funding.

Misappropriation, waste, or loss (evaluate controls)

Misappropriation, waste, or loss (evaluate controls)

Misappropriation, waste or loss of collected revenue (evaluate controls)

Misappropriation, waste or loss of collected revenue (evaluate controls)

Misappropriation, waste, or loss (evaluate controls)

AGENCY - PROCESS	GROSS RISK ASSESSMENT	NUMBER TASK HOURS
---------------------	--------------------------	----------------------

Risk Management - TPA Disbursements	Medium	80
SDTI - Storeroom	High	160
SDTC - Training	Medium	120
California Air Resources Board Follow-up Review	Medium	40
Compass Card Controls	High	240
Transit Store Controls	High	120
SDTI - Revenue Collection	Extreme	160
SDTC - Revenue Collection	Extreme	160
Absenteeism-Sick Leave Review	High	120

Total: 1,200

Objective 2: Improve the public's ability to hold the Board and its subsidiaries accountable

Follow-up on all MTS and subsidiary audit and audit-related projects conducted in
FY 10 and evaluate the quality and timeliness of action

160

Total: 160

GOAL 2: Improve the auditing and consulting capabilities of the internal audit function

Objective 1: Improve staff knowledge and skills

Identify opportunities for improvement and obtain appropriate training

80

Objective 2: Improve customer satisfaction and internal audit reputation through delivering high-quality and timely services

Prioritize special requests and conduct special projects

400

TOTAL AUDIT HOURS: 1,840