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Agenda

MEETING OF THE METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

June 13, 2013

Executive Conference Room
 9:00 a.m.

ACTION RECOMMENDED

- | | | |
|----|---|--------------------|
| A. | 1. Roll Call | |
| | 2. Approval of the Minutes of November 8, 2012 | Approve |
| B. | COMMITTEE DISCUSSION ITEMS | |
| | 1. <u>Audit Engagement Letter (Tom Lynch)</u>
Action would review the audit engagement letter and provide comments. | Possible
Action |
| | 2. <u>Interim Audit (Tom Lynch)</u>
Action would receive a report on interim audit work (conducted by MTS's independent auditor Pun and McGeedy) and related observations. | Possible
Action |
| | 3. <u>Proposed Audit Schedule (Tom Lynch)</u>
Action would review the proposed audit schedule and provide comments. | Possible
Action |
| | 4. <u>Internal Audit Update (Daniel Madzellan)</u>
Action would receive a final status report on the fiscal year 2013 audit plan and a preliminary outline of the fiscal year 2014 audit plan. | Possible
Action |
| C. | COMMITTEE MEMBER COMMUNICATIONS AND OTHER BUSINESS | |
| D. | PUBLIC COMMENTS | |
| E. | NEXT MEETING DATE: To be determined. | |
| F. | ADJOURNMENT | |

Please SILENCE electronics
 during the meeting

1255 Imperial Avenue, Suite 1000, San Diego, CA 92101-7490 • (619) 231-1466 • www.sdmts.com

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)
1255 Imperial Avenue, Suite 1000
San Diego, CA 92101

November 8, 2012

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. Minto moved to approve the minutes of the June 14, 2012, Audit Oversight Committee meeting. Mr. Ovrom seconded the motion, and the vote was 6 to 0 in favor.

B. AUDIT OVERSIGHT COMMITTEE DISCUSSION ITEMS

1. Draft FY 2012 Comprehensive Annual Financial Report (CAFR)

Linda Musengo, MTS Finance Manager, gave an update on the Draft FY 2012 CAFR. Ms. Musengo reported that the CAFR is largely completed with a few outstanding items. She added that the Transportation Development Act (TDA) reporting, National Transit Database reporting, and the single audit will also be completed. Ms. Musengo stated that MTS staff working with an outside consultant has developed a new indirect-cost model. She reported that this year's audit went extremely smooth. Ms. Musengo reviewed some of the minor changes in the Draft CAFR. Mr. Ewin requested that the Audit Oversight Committee be provided with the exact changes within the CAFR before they go to the Board.

Mr. Ewin thanked Karen Landers, MTS General Counsel, for responding to the audit requirements within the time frame. Discussion ensued regarding reporting requirements and utilizing the information within the report.

Mr. Ewin stated that he read the report in its entirety and didn't have any concerns or find anything that he felt needed to be presented to the AOC other than how this process works. He added that after five or six years, he feels that the AOC's function has provided structure and gained knowledge of the auditing process.

Action Taken

Mr. Minto moved to receive a draft of the fiscal year (FY) 2012 CAFR for review and discussion. Mr. Ovrom seconded the motion, and the vote was 6 to 0 in favor.

2. New Government Accounting Standards Board (GASB) and Auditing Standards
Ken Pun of Pun & McGeady discussed the changed approach to testing (and auditing) MTS controls. Gary Caporicci (also of Pun & McGeady) added that Pun & McGeady followed all of MTS's major systems and spent a lot of time assessing risks, which sets the stage for what and how much they have to do. Mr. Caporicci stated that the end result was very good and complimented MTS staff.

Mr. Pun stated that there will be a lot of changes for next years' audit, and they want to prepare in advance. Mr. Caporicci added that Pun & McGeady will incorporate mock testing on MTS pension and financial plans. Mr. Pun clarified for the Committee that he conducted the first audit for MTS in 2005.

Mr. Caporicci gave a PowerPoint presentation regarding reporting of pension plans. He also covered assets, liabilities, outflows, and inflows. Mr. Caporicci stated that the preparation for this reporting will be time-consuming and difficult because this is the first year for these reporting-requirement changes. He discussed the work-plan time line and new format of the auditor's report. Mr. Caporicci reviewed Statement on Auditing Standards (SAS) No. 126, which addresses the auditor's responsibilities in an audit of financial statements. Discussion ensued regarding group-auditing responsibilities.

Mr. Ewin stated that it is very important that the AOC and MTS have the tools needed to be diligent in their auditing oversight responsibilities. Mr. Caporicci responded that MTS is very good in comparison to other agencies that he has audited. Mr. Caporicci complimented MTS on its tightened internal auditing controls and cited an example a couple of years ago wherein MTS reported a mistake in the inventory reporting to the auditors as soon as it was discovered.

Action Taken

Mr. Minto moved to receive a report from Pun & McGeady regarding upcoming reporting and auditing changes. Mr. Ovrom seconded the motion, and the vote was 5 to 0 with Mr. Young absent.

3. FY 13 Audit Plan Update

Daniel Madzelan, MTS Internal Auditor, gave a PowerPoint presentation on the FY 13 audit plan. Mr. Madzelan reviewed follow-up audits, audits in progress, and planned audits (not yet commenced). Mr. Madzelan also reviewed ongoing reviews of storeroom operations and contract compliance and administration. Ms. Landers clarified for Mr. Ewin that the CAFR reports presented to the AOC are also presented to the MTS Board.

Action Taken

Mr. Ewin moved to receive a status report on the fiscal year (FY) 13 audit plan. Mr. Ovrom seconded the motion, and the vote was 4 to 0 with Mr. Young and Mr. Roberts absent.

C. COMMITTEE MEMBER COMMUNICATIONS AND OTHER BUSINESS

Ms. Musengo clarified for Mr. Ewin that MTS will finalize the CAFR by the end of next week and submit it to Pun & McGeady for review. She confirmed that a summary will be created to identify any significant changes to the draft document. Mr. Ewin added that the AOC will be available to meet if any issues arise before the final CAFR is presented to the MTS Board.

D. PUBLIC COMMENTS

There were no public comments.

E. NEXT MEETING DATE

The next meeting will be held as called.

F. ADJOURNMENT

Chairman Ewin adjourned the meeting at 10:07 a.m.



Chairman

Attachment: Roll Call Sheet

**AUDIT OVERSIGHT COMMITTEE
METROPOLITAN TRANSIT SYSTEM**

ROLL CALL

MEETING OF (DATE) November 8, 2012

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

RECESS _____

RECONVENE _____

CLOSED SESSION n/a

RECONVENE _____

ADJOURN 10:07 am

BOARD MEMBER (Alternate)	PRESENT (TIME ARRIVED)	ABSENT (TIME LEFT)
EWIN (Chair) <input checked="" type="checkbox"/>		
YOUNG <input checked="" type="checkbox"/> (Gloria) <input type="checkbox"/>		approx 9:40 am
MATHIS <input checked="" type="checkbox"/>		
OVROM <input checked="" type="checkbox"/> (Bragg) <input type="checkbox"/>		
ROBERTS <input checked="" type="checkbox"/> (Cox) <input type="checkbox"/>		10:00 am
MINTO <input checked="" type="checkbox"/> (Cunningham) <input type="checkbox"/>		
Transportation Committee Rep Slot (Mathis)		

ACTING

SIGNED BY THE CLERK OF THE BOARD: Paula Cord

CONFIRMED BY THE GENERAL COUNSEL: Paula Cord



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Agenda Item No. B1

MEETING OF THE METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

June 13, 2013

SUBJECT:

AUDIT ENGAGEMENT LETTER (TOM LYNCH)

RECOMMENDATION:

That the MTS Audit Oversight Committee review the audit engagement letter (Attachment A) and provide comments.

Budget Impact

None at this time.

DISCUSSION:

Review and Approval of the Audit Engagement Letter

Auditing standards require the auditor to present a written engagement letter and obtain a signature from an officer of the company. Attachment A is the engagement letter from Pun & McGeady for the FY 2013 audit. A representative from Pun & McGeady will be available for questions.



Paul C. Jablonski
Chief Executive Officer

Key Staff Contact: Sharon Cooney, 619.557.4513, Sharon.Cooney@sdmts.com

Attachment: A. Audit engagement letter dated 5/13/13



Metropolitan Transit System (MTS) is comprised of the Metropolitan Transit Development Board (MTDB) a California public agency, San Diego Transit Corp., and San Diego Trolley, Inc., in cooperation with Chula Vista Transit and National City Transit. MTS is Taxicab Administrator for eight cities. MTDB is owner of the San Diego and Arizona Eastern Railway Company. MTDB Member Agencies include: City of Chula Vista, City of Coronado, City of El Cajon, City of Imperial Beach, City of La Mesa, City of Lemon Grove, City of National City, City of Poway, City of San Diego, City of Santee, and the County of San Diego.



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May 13, 2013

Board of Directors
San Diego Metropolitan Transit System
1255 Imperial Avenue, Suite 1000
San Diego, California 92101

RE: Engagement of Pun & McGeady LLP (the "Firm") as MTS' Independent Auditors

We are pleased to confirm our understanding of the services we are to provide to the San Diego Metropolitan Transit System ("MTS") for the year ending June 30, 2013. The Firm's services are provided pursuant to MTS Contract No. G1013.0-06, as modified by G1013.1-06 (exercise of extension options) ("Contract"). Nothing in this engagement letter is intended to modify or amend the terms and conditions set forth in the Contract. In the event a conflict arises between this letter and the Contract, the terms in the Contract shall prevail.

Fiscal Year 2012/13 Audit Assignment

We will audit the financial statements of the business-type activities which collectively comprise the basic financial statements of MTS as of and for the year ending June 30, 2013.

Accounting standards generally accepted in the United States of America provide for certain Required Supplementary Information (RSI), such as Management's Discussion and Analysis (MD&A), to supplement the MTS' basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. As part of our engagement, we will apply certain limited procedures to the MTS' RSI in accordance with auditing standards generally accepted in the United States of America. These limited procedures will consist of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We will not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance. The following RSI is required by generally accepted accounting principles and will be subjected to certain limited procedures, but will not be audited:

- 1) Management's Discussion and Analysis
- 2) Schedule of Funding Progress - Pensions
- 3) Schedule of Funding Progress - OPEB

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We have also been engaged to report on Supplementary Information other than RSI that accompanies the MTS' financial statements. We will subject the following Supplementary Information to the auditing procedures applied in our audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America and will provide an opinion on it in relation to the financial statements as a whole:

- 1) Schedule of Expenditures of Federal Awards
- 2) Combining Financial Statements
- 3) Individual Fund Financial Statements and Schedules

The following other information accompanying the financial statements will not be subjected to the auditing procedures applied in our audit of the financial statements, and our auditor's report will not provide an opinion or any assurance on that other information.

- 1) Introductory Section
- 2) Statistical Section

Audit Objectives

The objective of our audit is the expression of opinions as to whether your basic financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles and to report on the fairness of the supplementary information referred to in the fourth paragraph when considered in relation to the financial statements as a whole. The objective also includes reporting on –

- Internal control related to the financial statements and compliance with laws, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements in accordance with *Government Auditing Standards*.
- Internal control related to major programs and an opinion (or disclaimer of opinion) on compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program in accordance with the Single Audit Act Amendments of 1996 and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

The reports on internal control and compliance will each include a paragraph that states that the purpose of the report is solely to describe (1) the scope of testing of internal control over financial reporting and compliance and the result of that testing and not to provide an opinion on the effectiveness of internal control over financial reporting or on compliance, (2) the scope of testing internal control over compliance for major programs and major program compliance and the result of that testing and to provide an opinion on compliance but not to provide an opinion on the effectiveness of internal control over compliance, and (3) that the report is an integral part of an audit performed in accordance with *government auditing Standards* in considering internal control over financial reporting and compliance and OMB Circular A-133 in considering internal control over compliance and major program compliance. The paragraph will also state that the report is not suitable for any other purpose.

Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America; the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; the Single Audit Act Amendments of 1996; and the provisions of OMB Circular A-133, and will include tests of accounting records, a determination of major program(s) in accordance with OMB Circular A-133, and other procedures we consider necessary to enable us to express such opinions and to render the required reports. We cannot provide assurance that unmodified opinions will be expressed. Circumstances may arise in which it is necessary for us to modify our opinions or add emphasis-of-matter or other-matter

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paragraphs. If our opinions on the financial statements or the Single Audit compliance opinions are other than unmodified, we will discuss the reasons with you in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed opinions, we may decline to express opinions or to issue a report as a result of this engagement.

Audit Procedures—General

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We will plan and perform the audit to obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the entity or to acts by management or employees acting on behalf of the entity. Because the determination of abuse is subjective, *Government Auditing Standards* do not expect auditors to provide reasonable assurance of detecting abuse.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, and because we will not performed a detailed examination of all transactions, there is a risk that material misstatements or noncompliance may exist and not be detected by us, even though the audit is properly planned and performed in accordance with U.S. generally accepted auditing standards and *Government Auditing Standards*. In addition, an audit is not designed to detect immaterial misstatements or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements or major programs. However, we will inform the appropriate level of management of any material errors, any fraudulent financial reporting, or misappropriation of assets that come to our attention. We will also inform the appropriate level of management of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential, and of any material abuse that comes to our attention. We will include such matters in the reports required for a Single Audit. Our responsibility as auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, and may include tests of the physical existence of inventories, and direct confirmation of receivables and certain other assets and liabilities by correspondence with selected individuals, funding sources, creditors, and financial institutions. We will request written representations from your attorneys as part of the engagement, and they may bill you for responding to this inquiry. At the conclusion of our audit, we will require certain written representations from you about the financial statements and related matters.

Audit Procedures—Internal Controls

Our audit will include obtaining an understanding of the entity and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Tests of controls may be performed to test the effectiveness of certain controls that we consider relevant to preventing and detecting errors and fraud that are material to the financial statements and to preventing and detecting misstatements resulting from illegal acts and other noncompliance matters that have a direct and material effect on the financial statements. Our tests, if performed, will be less in scope than would be necessary to render an opinion on internal control and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to *Government Auditing Standards*.

As required by OMB Circular A-133, we will perform tests of controls over compliance to evaluate the effectiveness of the design and operation of controls that we consider relevant to preventing or detecting material noncompliance with compliance requirements applicable to each major federal award program. However, our

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tests will be less in scope than would be necessary to render an opinion on those controls and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to OMB Circular A-133.

An audit is not designed to provide assurance on internal control or to identify significant deficiencies or material weaknesses. However, during the audit, we will communicate to management and those charged with governance internal control related matters that are required to be communicated under AICPA professional standards, *Government Auditing Standards*, and OMB Circular A-133.

Audit Procedures – Compliance

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of the MTS' compliance with the provisions of applicable laws, regulations, contracts, and agreements, including grant agreements. However, the objective of those procedures will not be to provide an opinion on overall compliance and we will not express such an opinion in our report on compliance issued pursuant to *Government Auditing Standards*.

OMB Circular A-133 requires that we also plan and perform the audit to obtain reasonable assurance about whether the auditee has complied with applicable laws and regulations and the provisions of contracts and grant agreements applicable to major programs. Our procedures will consist of tests of transactions and other applicable procedures described in the OMB Circular A-133 Compliance Supplement for the types of compliance requirements that could have a direct and material effect on each of the MTS' major programs. The purpose of these procedures will be to express an opinion on the MTS' compliance with requirements applicable to each of its major programs in our report on compliance issued pursuant to OMB Circular A-133.

Management Responsibilities

Management is responsible for the basic financial statements and all accompanying information as well as all representations contained therein. Management is also responsible for identifying government award programs and understanding and complying with the compliance requirements, and for preparation of the schedule of expenditures of federal awards in accordance with the requirements of OMB Circular A-133. As part of the audit, we will assist with preparation of your financial statements, schedule of expenditures of federal awards, and related notes. You will be required to acknowledge in the written representation letter our assistance with preparation of the financial statements and schedule of expenditures of federal awards and that you have reviewed and approved the financial statements and schedule of expenditures of federal awards and that you have reviewed and approved the financial statements, schedule of expenditures of federal awards, and related notes prior to their issuance and have accepted responsibility for them. You agree to assume all management responsibilities for any nonaudit services we provide; oversee the services by designating an individual, preferably from senior management, who possesses suitable skill, knowledge, or experience; evaluate the adequacy and results of the services; and accept responsibility for them.

Management is responsible for establishing and maintaining effective internal controls, including internal controls over compliance, and for evaluating and monitoring ongoing activities, to help ensure that appropriate goals and objectives are met and that there is reasonable assurance that government programs are administered in compliance with compliance requirements. You are also responsible for the selection and application of accounting principles; for the preparation and fair presentation of the financial statements in conformity with U.S. generally accepted accounting principles; and for compliance with applicable laws and regulations and the provisions of contracts and grant agreements.

Management is also responsible for making all financial records and related information available to us and for ensuring that management is reliable and financial information is reliable and properly recorded. You are also responsible for providing us with (1) access to all information of which you are aware that is relevant to the

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preparation and fair presentation of the financial statements, (2) additional information that we may request for the purpose of the audit, and (3) unrestricted access to persons within the government from whom we determine it necessary to obtain audit evidence.

Your responsibilities also include identifying significant vendor relationships in which the vendor has responsibility for program compliance and for the accuracy and completeness of that information. Your responsibilities include adjusting the financial statements to correct material misstatements and confirming to us in the written representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

You are responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud affecting the government involving (1) management, (2) employees who have significant roles in internal control, and (3) others where the fraud could have a material effect on the financial statements. Your responsibilities include informing us of your knowledge of any allegations of fraud affecting the government received in communications from employees, former employees, grantors, regulators, or others. In addition, you are responsible for identifying and ensuring that the entity complies with applicable laws, regulations, contracts, agreements, and grants. Additionally, as required by OMB Circular A-133, it is management's responsibility to follow up and take corrective action on reported audit findings and to prepare a summary schedule of prior audit findings and a corrective action plan. The summary schedule of prior audit findings should be available for our review on June 30, 2013.

You are responsible for preparation of the schedule of expenditures of federal awards in conformity with OMB Circular A-133. You agree to include our report on the schedule of expenditures of federal awards in any document that contains and indicates that we have reported on the schedule of expenditures of federal awards. You also agree to include the audited financial statements with any presentation of the schedule of expenditures of federal awards that includes our report thereon. Your responsibilities include acknowledging to us in the written representation letter that (1) you are responsible for presentation of the schedule of expenditures of federal awards in accordance with OMB Circular A-133; (2) that you believe the schedule of expenditures of federal awards, including its form and content, is fairly presented in accordance with OMB Circular A-133; (3) that the methods of measurement or presentation have not changed from those used in the proper period (or, if they have changed, the reasons for such changes); and (4) you have disclosed to us any significant assumptions or interpretations underlying the measurement or presentation of the schedule of expenditures of federal awards.

You are responsible for the preparation of the supplementary information, which we have been engaged to report on, in conformity with U.S. generally accepted accounting principles. You agree to include our report on the supplementary information in any document that contains and indicates that we have reported on the supplementary information. You also agree to include the audited financial statements with any presentation of the supplementary information that includes our report thereon. Your responsibilities include acknowledging to us in the written representation letter that (1) you are responsible for presentation of the supplementary information in accordance with GAAP; (2) that you believe the supplementary information, including its form and content, is fairly presented in accordance with GAAP; (3) that the methods of measurement or presentation have not changed from those used in the prior period (of, if they have changed, the reasons for such changes); and (4) you have disclosed to us any significant assumptions or interpretations underlying the measurement or presentation of the supplementary information.

Management is responsible for establishing and maintaining a process for tracking the status of audit findings and recommendations. Management is also responsible for identifying for us previous financial audits, attestation engagements, performance audits, or other studies related to the objectives discussed in the Audit Objectives section of this letter. This responsibility includes relaying to us corrective actions taken to address significant findings and recommendations resulting from those audits, attestation engagements, performance audits, or

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studies. You are also responsible for providing management's views on our current findings, conclusions, and recommendations, as well as your planned corrective actions, for the report, and for the timing and format for providing that information.

Communication with Those Charged with Governance

As part of our engagement, we are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process as well as other matters we believe should be communicated to those charged with governance. Generally accepted auditing standards do not require the auditor to design procedures for the purpose of identifying other matters to communicate with those charged with governance. Such matters include, but are not limited to, (1) the initial selection of and changes in significant accounting policies and their application; (2) the process used by management in formulating particularly sensitive accounting estimates and the basis for our conclusions regarding the reasonableness of those estimates; (3) all passed audit adjustments; (4) any disagreements with management, whether or not satisfactorily resolved, about matters that individually or in the aggregate could be significant to the financial statements or our report; (5) our views about matters that were the subject of management's consultation with other accountants about auditing and accounting matters; (6) major issues that were discussed with management in connection with the retention of our services, including, among other matters, any discussions regarding the application of accounting principles and auditing standards; (7) serious difficulties that we encountered in dealing with management related to the performance of the audit; and (8) matters relating to our independence as your auditors.

Third-Party Service Providers

We may from time to time, and depending on the circumstances, use third-party service providers in serving your account. We may share confidential information about you with these service providers, but remain committed to maintaining the confidentiality and security of your information. Accordingly, we maintain internal policies, procedures, and safeguards to protect the confidentiality of your personal information. In addition, we will secure confidentiality agreements with all service providers to maintain the confidentiality of your information and we will take reasonable precautions to determine that they have appropriate procedures in place to prevent the unauthorized release of your confidential information to others. In the event that we are unable to secure an appropriate confidentiality agreement, you will be asked to provide your consent prior to the sharing of your confidential information with the third-party service provider. Furthermore, we will remain responsible for the work provided by any such third-party service providers.

Assistance By Your Personnel

We will ask that your personnel, to the extent possible, prepare required schedules and analyses, and make selected invoices and other required documents available to our staff. This assistance by your personnel will serve to facilitate the progress of our work and minimize our time requirements.

Data Collection Form

At the conclusion of the engagement, we will complete the appropriate sections of the Data Collection Form that summarizes our audit findings. It is management's responsibility to submit the reporting package (including financial statements, schedule of expenditures of federal awards, summary schedule of prior audit findings, auditors' reports, and corrective action plan) along with the Data Collection Form to the federal audit clearinghouse. We will coordinate with you the electronic submission and certification. If applicable, we will provide copies of our report for you to include with the reporting package you will submit to pass-through entities. The Data Collection Form and the reporting package must be submitted within the earlier of 30 days after receipt of the auditors' reports or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audits.

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Independence

Professional standards require that a firm and its members maintain independence throughout the duration of the professional relationship with a client. In order to preserve the integrity of our relationship, no offer of employment shall be discussed with any Pun & McGeady LLP professionals assigned to the audit, during the one year period prior to the commencement of the year end audit. Should such an offer of employment be made, or employment commences during the indicated time period, we will consider this an indication that our independence has been compromised. As such, we may be required to recall our auditors' report due to our lack of independence. In the event additional work is required to satisfy independence requirements, such work will be billed at our standard hourly rates. Furthermore, we strive to staff your engagement with quality, superbly trained professionals. In recognition of the extensive investment we have made to recruit and develop our personnel, we ask that you agree to the following. In the event that any of our employees accepts a position of employment with your Organization, or any of its related parties at any time while we are performing services for you or within one year thereafter, you agree to pay us a placement fee equal to the employee's annual compensation in effect on the date such employment was contracted. Such fee is payable when the employee accepts such a position.

Access to Working Papers

The audit documentation for this engagement is the property of Pun & McGeady LLP and constitutes confidential information. However, pursuant to authority given by law or regulation, we may be requested to make certain audit documentation available to the Oversight Agency for Audit or its designee, a federal agency providing direct or indirect funding, or the U.S. Government Accountability Office for purposes of a quality review of the audit, to resolve audit findings, or to carry out oversight responsibilities. We will notify you of any such request. If requested, access to such audit documentation will be provided under the supervision of Pun & McGeady LLP personnel. Furthermore, upon request, we may provide copies of selected audit documentation to the aforementioned parties. These parties may intend, or decide, to distribute the copies or information contained therein to others, including other governmental agencies.

The audit documentation for this engagement will be retained for a minimum of seven years after the report release or for any additional period requested by the Oversight Agency for Audit or Pass-through Entity. If we are aware that a federal awarding agency, pass-through entity, or auditee is contesting an audit finding, we will contact the party(ies) contesting the audit finding for guidance prior to destroying the audit documentation.

The Firm is required to undergo a "peer review" every three years. During the course of a Peer Review engagement, selected working papers and financial reports, on a sample basis, will be inspected by an outside party on a confidential basis. Consequently, the accounting and/or auditing work we performed for you may be selected. Your signing this letter represents your acknowledgement and permission to allow such access should your engagement be selected for review. As a result of our prior or future services to you, we may be required or requested to provide information or documents to you or a third-party in connection with a legal or administrative proceeding (including a grand jury investigation) in which we are not a party. If this occurs, our efforts in complying with such request or demands will be deemed a part of this engagement and we shall be entitled to compensation for our time and reimbursement for our reasonable out-of-pocket expenditures (including legal fees) in complying with such request or demand. This is not intended, however, to relieve us of our duty to observe the confidentiality requirements of our profession.

Other Services

We are always available to meet with you and/or other management personnel at various times throughout the year to discuss current business, operational, accounting and auditing matters affecting your Organization.

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Whenever you feel such meeting are desirable please let us know; we are prepared to provide services to assist you in **any** of these areas.

Timeline

We expect to begin our audit on approximately May 20, 2013 and to issue our reports no later than December 31, 2012.

Kenneth H. Pun, CPA is the engagement partner and is responsible for supervising the engagement and signing the reports or authorizing another individual to sign them.

Report Distribution and Other

We will provide copies of our reports to MTS; however, management is responsible for distribution of the reports and the financial statements. Unless restricted by law or regulation, or containing privileged and confidential information, copies of our reports are to be made available for public inspection.

Most Recent External Quality Control Review

Government Auditing Standards require that we provide you with a copy of our most recent external peer review report **and** any letter of comment, and any subsequent peer review reports and letters of comment received during the period of the contract.

Since the Firm is newly established, we have yet to have our first peer review conducted. However, the assigned engagement partner, Kenneth H. Pun, was the Partner of Caporicci & Larson, Inc. (C&L) who supervise its Southern California practice and heavily participated in the quality control process of C&L. In 2011, a quality review of the policies, practices, and procedures was conducted for Caporicci & Larson, Inc. (a subsidiary of Marcum LLP). The reviewers made an independent assessment of C&L's quality control policies and procedures and inspected the working papers and reports on a representative sample of accounting and auditing governmental clients. C&L's administrative files and records were also reviewed and our professional personnel interviewed.

After thorough study of C&L's procedures and work practices, the report had a peer review rating of pass which mean that the accounting and auditing practice of C&L has been suitably designed and complied with to provide the firm with reasonable assurance of performing and has an effective quality control system and that our accounting and auditing work conforms to professional standards.

We have scheduled our first peer review after our first anniversary and will review of the Firm's policies, practices, and procedures. The reviewers will make an independent assessment of the Firm's quality control policies **and** procedures and will inspect the working papers and reports on representative sample of accounting and auditing engagements. The Firm's administrative files and records will be reviewed and our professional personnel will be interviewed.

Upon completion of our first peer review, we will furnish you the independent peer reviewers' report and the recommendations, if any.

San Diego Metropolitan Transit System
Engagement Letter
May 13, 2013
Page 9

We appreciate the opportunity to be of service to San Diego Metropolitan Transit System and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know.

Very truly yours,
Pun & McGeady LLP

Kenneth H. Pun, CPA
Partner

ACCEPTED

This letter correctly sets forth the management/auditor responsibilities and procedures for the FY 12/13 audit of the San Diego Metropolitan Transit System.

Authorized Signature: _____

Title: _____

Date signed: _____



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Agenda Item No. B2

MEETING OF THE METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

June 13, 2013

SUBJECT:

INTERIM AUDIT (TOM LYNCH)

RECOMMENDATION:

That the MTS Audit Oversight Committee receive a report (Attachment A) on interim audit work (conducted by MTS's independent auditor Pun and McGeady) and related observations.

Budget Impact

None at this time.

DISCUSSION:

During the month of May, Pun & McGeady conducted an interim audit and tested MTS's internal controls. Upon completion of this stage of the audit process, Pun & McGeady issued an interim status report (Attachment A). Staff will discuss the issues raised in the report, and a representative from Pun & McGeady will be available as well.

Paul C. Jablonski
Chief Executive Officer

Key Staff Contact: Sharon Cooney, 619.557.4513, Sharon.Cooney@sdmts.com

Attachment: A. Interim Status Report dated 5/30/13

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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.



San Diego Metropolitan Transit System (MTS)
For the Fiscal Year Ending June 30, 2013
Interim Status Report
May 30, 2013

INTERIM AUDIT PROCEDURES:

The purpose of our interim audit was to ~~gain an understanding~~ of how MTS' internal control systems are designed and implemented in ~~order to prevent~~ and detect material misstatements, to evaluate the effectiveness of those controls ~~designed and implemented~~ in order to achieve these goals, and to determine if opportunities for strengthening internal controls existed. To accomplish these objectives, we interviewed ~~management~~ and staff regarding policies and procedures, performed walkthroughs of significant transaction cycles, identified key controls, and, in certain instances, designed tests to ~~evaluate the operating effectiveness~~ of key internal controls over the following significant transaction cycles:

- Financial Reporting
- Revenues and Cash Receipts for SDTI and SDTC
- Expenditures and Cash Disbursements
- Payroll and Related Liabilities
- Inventory
- Capital Assets

In addition to updating our understanding of MTS' internal control systems, we also performed procedures to evaluate MTS' Information Technology (IT) system, performed a surprise cash count on SDTI TVM revenue, performed ~~fraud risk~~ inquiries with management and staff, and discussed results of 2012/2013 internal audit with Daniel Madzelan, Internal Auditor.

CURRENT YEAR INTERIM RESULTS AND DISCUSSION ITEMS:

Based on the interim procedures performed, ~~internal controls~~ for the selected transaction cycles appeared to be both properly designed and ~~effectively operating~~ in order to prevent and detect material misstatements. We found one instance ~~based our testing~~ that indicated key internal controls were not operating effectively.

During our test of controls for ~~Expenditures and~~ Cash Disbursements, we noted an inappropriate signatory approval on a request for ~~payment/~~ payment voucher. The finding was a payment for \$5,700 made to San Diego Gas and Electric that was approved by a SDTC director. According to MTS's policies and ~~procedures # 41~~, the approver for the payment voucher should have also included the COO or CFO. Although this was not considered material, the finding was brought to the attention of the Finance Department for correction. We will continue to test approval limits during our year end procedures.

San Diego Metropolitan Transit System
Interim Exit Memo
For the year ending June 30, 2013
Page 3

During our review of audit reports from the internal auditor, we noted Contract Compliance and Administration as an area of concern. This was an area brought to the attention of the internal auditor based on discussions with Legal and Finance departments. Based on a report provided to the Board of Directors on January 17, 2013 regarding one contract (sample size was 12) the following issues were identified:

- Out of scope work being performed, resulted from contracts being rolled over and not updated from previous contract.
- Total costs of contract exceeding amount awarded.
- Contractor not submitting material invoices from vendor for reimbursement or invoice of actual hours worked (using estimated hours).

Based on our discussion with Internal Audit, these findings were result of project managers not reviewing details of newer contracts and monitoring invoices and project costs. To correct this deficiency, starting in November 2012 Finance and Procurement began developing new internal control procedures to govern contract compliance operations. Further, Finance, Procurement and the training division of Human Resources developed a five (5) hour training course designed to educate and inform project managers and members from Finance and Procurement departments of the new procedures. The training courses were administered beginning April 2013. Also, a Contract Administrator position was created in November 2012 and was filled January 2013. The position's primary role is higher risk contracts to assist in compliance. Lastly, before new projects commence, there are kickoff meetings with project managers and staff to go over details of the project and discuss best practices.

We believe these responses to be appropriate to address the deficiency noted.

REPORTS TO BE ISSUED

We will perform the following audits and agreed upon procedures enumerated below for the year ended June 30, 2013. Our audit will be conducted in accordance with U.S. generally accepted auditing standards, the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

1. Comprehensive Annual Financial Report
2. Single Audit
3. SDTC Employees' Retirement Plan
4. Transportation Development Act (TDA)
5. National Transit Database (NTD)
6. Prop 1B PTMISEA
7. Indirect Cost

YEAR END FIELDWORK DATE

We are scheduled to begin fieldwork August 19, 2013.



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Agenda Item No. B3

MEETING OF THE METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

June 13, 2013

SUBJECT:

PROPOSED AUDIT SCHEDULE (TOM LYNCH)

RECOMMENDATION:

That the MTS Audit Oversight Committee review the proposed audit schedule and provide comments.

Budget Impact

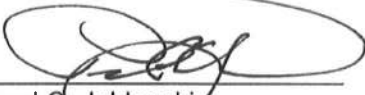
None at this time.

DISCUSSION:

Staff and outside auditors propose the following schedule for completion of the FY 2013 audit:

- | | |
|--|---|
| • August 19-September 13 | Audit field work |
| • October 7 | Draft audit report completed |
| • October 17 – AOC | Present CAFR ¹ draft/discuss progress/issues |
| • November 7 – AOC
December 5 – AOC | Present completed CAFR
Alternative date if needed |
| • November 14 – Board Meeting
December 12 – Board Meeting | Present completed CAFR
Alternative date if needed |

As always, adherence to the schedule will depend in part on the timeliness of information from other agencies and confirmations from financial institutions and law firms. Any changes in the proposed schedule will be communicated to the Audit Oversight Committee.



Paul C. Jablonski
Chief Executive Officer

Key Staff Contact: Sharon Cooney, 619.557.4513, Sharon.Cooney@sdmts.com

¹ Comprehensive Annual Financial Report





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Agenda Item No. B4

MEETING OF THE METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

June 13, 2013

SUBJECT:

INTERNAL AUDIT UPDATE (DANIEL MADZELAN)

RECOMMENDATION:

That the Audit Oversight Committee receive a final status report on the fiscal year 2013 audit plan and preliminary outline of the fiscal year 2014 audit plan.

Budget Impact

None.

DISCUSSION:

MTS Internal Auditor will provide a final summary on the fiscal year 2013 approved audit plan and preview the preliminary audit plan for fiscal year 2014.



Paul C. Jablonski
Chief Executive Officer

Key Staff Contact: Sharon Cooney, 619.557.4513, Sharon.Cooney@sdmts.com

MTS Internal Audit

FY13 Audit Plan Summary & Preliminary Outline of FY14 Plan

Daniel Madzellan
6/13/2013



①

Approved FY13 Audit Plan & Time Budget

Audit	Primary Business Unit	Audit Type	Risk Impact	Risk Likelihood	Budgeted Hours
Follow Up Audits – FY12 Audits	Multiple Business Units	Follow Up/Assurance	Medium	Possible	220.0
Contract Compliance and Administration	Multiple Business Units	External Business Relationships/Operational/Performance	High	Probable	400.0
Storeroom Operations	Finance	Consultative/Operational	High	Possible	280.0
IT – Business Continuity Management	IT/Finance	Operational	High	Possible	160.0
Token Management Operations	SDTI	Business Process Review	High	Possible	104.0
Special Event Revenue Management	SDTI	Consultative/Operational	High	Probable	96.0
Establish Continuous Monitoring Program	Finance/Accounting	Operational/Finance	High	Possible	88.0
Totals – Planned Engagements					1,348.0
Unscheduled Projects/Management Requests					200.0
Total Audit Hours – FY13					1,548.00



②

Actual Results - FY13 Audit Plan

Audit	Primary Business Unit	Status	Budgeted Hours	Actual Hours	Difference
Follow Up Audits – FY12 Audits	Multiple Business Units	Nearly Completed	220.0	154.0	66.0
Contract Compliance and Administration	Multiple Business Units	Complete	400.0	760.0	(360.0)
Storeroom Operations	Finance	Complete	280.0	263.0	17.0
IT – Business Continuity Management	IT/Finance	Planning Phase Only	160.0	35.0	125.0
Token Management Operations	SDTI	Complete	104.0	55.0	49.0
Special Event Revenue Management	SDTI	Complete	96.0	92.0	4.0
Establish Continuous Monitoring Program	Finance/Accounting	Complete	88.0	86.0	2.0
FY12 Carry Forward Audits: Compass Cards Follow Up / SDTI Warranty Operations			0.0	34.0	(34.0)
Buy America: Pre and Post Award Reviews			0.0	20.0	(20.0)
Mgmt. Request – Gillespie Claim Invoice Review			0.0	27.0	(27.0)
Total Audit Hours – FY13			1,548.0	1,526.0	22.0



3

Contract Compliance and Administration

- Population Potentially Subject to Review: 1,671
 - Contracts Executed between May 2007 and June 2012.
- Creating Risk Profile for Contracts
 - Dollar value of the contract,
 - Duration of the contract,
 - Type of contract (service, goods, construction, etc.),
 - Capital vs. operating expenditures;
 - Organization responsible for administration (MTS, SDTI, or SDTC), which determines the system used for procuring the related goods or services (IFAS or Ellipse),
 - Internal policies and procedures; and
 - Regulatory requirements.
- Contractual Agreements Reviewed - 12.
 - Six Operating Expenditures
 - Six Capital Expenditures



4

Contract Compliance and Administration

- Significant Findings Summary: Primarily Operating/Service Contracts
 - Scopes of work:
 - All material and services required not reflected in scopes of work.
 - Unrealistic estimates used in developing the scopes of work.
 - Cost management controls needing improvement:
 - Actual costs incurred exceeding authorized spend authority of contract.
 - Red flags associated with costs overruns not identified or addressed timely.
 - Over reliance on vendor for preparing and submitting accurate invoices:
 - Vendor invoices approved for payment inconsistent with contractual terms and conditions.
 - Vendor invoices approved for payment where evidence indicated non-compliance or performance with stated contractual terms.
 - Vendors not providing required documentation supporting cost reimbursement as required by contractual terms.



5

Contract Compliance and Administration

- Probable Root Causes of Findings:
 - **Scopes of Work/Cost Estimates not always re-examined for new contract procurements.**
 - **Emphasis on managing department costs against budget, not against actual contractual terms.**
 - Need for better tools to assist Project Managers in tracking contract costs effectively and efficiently.
 - **Purchase Order dates and amounts not in alignment with Contract dates/amounts.**
 - Creates difficulty managing/monitoring contract spend rates
 - **"Silo" Effect**
 - Communication or coordination between Contract Officer, Project Manager, and Finance Department after execution of contract.
 - **Missing "Trust but Verify" mentality with respect to vendor invoices.**
 - Assume the money you are spending is your own.



6

Contract Compliance and Administration

- Management Corrective Action Plans

- Internally developed training course (5 hours) for Project Managers and Contract Officers conducted during April and May 2013.
 - Positive feedback received from approximately 36 attendees of the course.
- Management tools for tracking contractual terms and conditions developed and made available on Internal Network Drive.
- Revisions to Request for Payment Voucher Forms.
 - Stricter controls for processing payments of vendor invoices.
- New process for issuing Purchase Orders in relation to Contracts.
- New Contracts Administration position in Procurement.
 - Position to act as an independent review and oversight of contract and invoices.
- Recurring meetings between Project Managers and Contract Officers to improve communication throughout contract lifecycle.



7

Storerooms - Trolley and Bus Consultative Review

- Notable Risks Identified

- Business Continuity Risks - Lack of formal process and procedural narratives (SOPs).
- Review had Scope Limitations.

- Secondary Risks Identified

- Overall, Internal controls are well designed, however, testing did identify events lacking evidence to support compliance with control procedures.



8

Follow Up Reviews

- Follow Up Reviews Performed:
 - Transit Store
 - SDTC Revenue
 - SDTI Revenue
 - Customer Services - Classroom Day Trip Program
 - Payroll
 - IT System Access/Security
- Follow Up Reviews not Performed
 - Procurement - FTA Compliance



(9)

Follow Up Review Results

- Total Issued Followed Up: 38
 - 12 medium priority and 26 low priority
- Total Issued Remediated: 34
 - Open - 1 Medium and 3 Low Priority Findings
- Remediation Percentage of those findings reviewed: **89%**

General Benchmark Performance Metric: All critical (high) recommendations and at least 75% of significant (Medium/Low) recommendations should be implemented by their target dates.

- Procurement FTA Compliance: 6 medium priority and 2 low priority findings not followed up to date.



(10)

Token Management Operations

No Reportable Findings:

- Evidence reviewed indicated Management implemented internal controls for receiving and transferring universal tokens. Those controls were working as designed and intended.
- Any residual risks are considered at acceptable levels.



(11)

Special Events Revenue Operations

No Reportable Findings:

- Evidence reviewed indicated Management implemented their action plans to address previous loss events and those controls were working as designed and intended.
- Any residual risks are considered at acceptable levels.



(12)

Continuous Monitoring Program

Continuous monitoring is review methodology in which key business process transactions and controls are constantly assessed. This permits ongoing insight into the effectiveness of controls and the integrity of transactions running within them.

Operations Included in Initial Rollout of Program:

- Procurement - FTA Compliance
- Accounts Payable
- Payroll Operations
- SDTC Revenue
- SDTI Revenue

Other operations (such as storerooms) might be incorporated into the program in subsequent fiscal years.



(13)

IT - Business Continuity Management (Disaster Recovery Plan)

- Planning Phase Completed

IT Management informed Audit that the Disaster Recovery Plan was in the process of being re-written. Accordingly, Audit elected to postpone review until new plan is finalized.

- Scheduled as part of FY14 Audit Plan.



(14)

Fraud/Waste/Abuse Hotline Summary

- **FY 13 Total Communications - 24**
 - Total Telephone - 24
 - Total Electronic - 0
- **FY 12 Total Communications - 31**
 - Total Telephone - 19
 - Total Electronic - 12
- **Department Summary**
 - SDTC - 10
 - Security - 5
 - SDTI - 4
 - Accounting/Finance - 3
 - Legal - 2
- Two (2) communications involved stolen credit cards used to purchase transit fares.
- One communication was a warning that an individual was planning to file a false injury claim against MTS.
- No communications received involved potential fraudulent activities or actions undertaken by MTS employees or related parties.



(15)

Time Budget For FY14 Audit Plan

	FY 2014	FY 2013
Total Available Hours – Annual Basis	2,080.0	2,080.0
Less:		
Company Holidays	72.0	72.0
Total Annual Leave Available	176.0	176.0
Training (Maintain Professional Certifications)	40.0	40.0
Est. Available Audit Hours	<u>1,792.0</u>	<u>1,792.0</u>
Less		
Audit Department Administration ~ 13%	240.0	240.0
FY2015 Planning, Risk Assessments, Policies Reviews, etc.		
Annual Internal Audit Quality Assessment Reviews		
General Meetings		
Fraud Hotline Administration		
Unscheduled Projects/Mgmt Requests/Budget Overruns	160.0	200.0
Est. Available Hours to Perform Scheduled Audits	1,392.0	1,352.0



(16)

FY14 Audit Plan - Plan to Date

Audit	Primary Business Unit	Audit Type	Risk Impact	Risk Likelihood	Estimated Hours
Compass Card Operations – Transition Support	Marketing/Finance	Consultative/ Business Process Review	High	Probable	320.0
Continuous Monitoring Program	Finance/Accounting/ Revenue Mgmt.	Operational/Assurance	High	Possible	280.0
Contract Compliance and Administration	Multiple Business Units	Operational/Performance	High	Probable	200.0
IT – Business Continuity Management	IT/Finance	Operational	High	Possible	100.0
Follow Up Reviews	Finance/IT	Follow Up/Assurance	Medium	Possible	88.0
Planned Engagements					988.0
Est. Time Budget Planned Engagements					1,392.0
Hours to Allocate to Projects					(404.0)



(17)