



1255 Imperial Avenue, #1000
San Diego, CA 92101-7490
619.231.1466 FAX 619.234.3407

04-07-14 A08:43

Agenda

MEETING OF THE SAN DIEGO METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

April 10, 2014

Executive Conference Room
9:00 a.m.

ACTION RECOMMENDED

- A. 1. Roll Call
2. Approval of the Minutes of October 17, 2013 Approve
- B. COMMITTEE DISCUSSION ITEMS
1. Appointment of Chairperson Appoint
Action would appoint a chairperson.
2. Pun & McGeady Engagement Letter for the FY2014 Audit (Erin Dunn) Possible
Action would review the audit engagement letter from Pun & McGeady. Action
3. Proposed FY2014 Audit Schedule (Erin Dunn) Possible
Action would review the proposed FY2014 audit schedule and provide Action
comments.
4. Report of New GASB Statements and Auditing Standards (Ken Pun of Pun & Receive
McGeady LLP & Gary Caporicci of Caporicci & Larson)
Action would receive a report from Pun & McGeady regarding upcoming
reporting and auditing changes.
5. Proposed Fiscal Year 2015 Internal Audit Plan (Toufic Tabshouri) Possible
Action would receive the proposed 2015 Internal Audit Plan. 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

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

MINUTES

October 17, 2013

A1. ROLL CALL

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

A2. APPROVAL OF MINUTES

It was moved and seconded to approve the minutes of the June 13, 2013, Audit Oversight Committee meeting. The vote was 6 to 0 in favor.

B. COMMITTEE DISCUSSION ITEMS

1. Draft of FY 2013 Comprehensive Annual Financial Report (CAFR)

Erin Dunn reported that the audit has gone very smoothly. Gary Caporicci of Pun & McGeady LLP added that there were only a few very minor issues, and everything went very well.

Mr. Ewin asked staff if there were any time lines for information needed from MTS Board members. Ms. Dunn responded that MTS received all confirmations from attorneys and Board members.

Mr. Cunningham asked if full access to any and all records and accountings was provided to the auditors for purposes of reviewing the report. Ken Pun responded affirmatively.

Mr. Cunningham asked if there were any barriers or problems with accessing records and how long it took. Mr. Pun responded that the turnaround time is quick—they were at MTS for about 3 weeks, and getting the information requested took about 2 days. He said they received all of the information needed. He added that he is really happy with the turnaround time.

Mr. Ovrom asked if there were any areas where the auditors needed to expand their sample size. Mr. Pun responded that they did a significant amount of internal-controls testing this year and over the last couple of years. He stated that they follow the CTA auditing standards for sampling size. He explained those procedures and added that MTS is low risk.

Mr. Ewin asked if there is a need to audit any information from the San Diego Association of Governments (SANDAG). Mr. Pun replied that they do review SANDAG pass sales and capital grant funds information. He added that this information has an impact on MTS's financial outcomes, and this information is audited at the MTS location.

Mr. Ewin noted that there is a citation about data needed for the National Transit Database in order to complete MTS's exhibits. Ms. Dunn responded that MTS has one question in regard to revenue hours but otherwise everything is complete.

Mr. Ewin stated that the purpose of this item is to gather comments, resolve any conflicts or typos, and answer any questions relating to the process. He stated that when the CAFR is presented in its final format to the Board, Mr. Ewin has 12 questions that he asks publicly for the minutes.

Mr. Ewin noted that under Taxicab in the CAFR, he saw all cities listed except La Mesa. Ms. Dunn responded that she will investigate. Ms. Landers responded (later in the meeting) that the CAFR incorrectly lists National City (MTS does not regulate its taxicabs), and it also left off La Mesa. She added that this will be corrected.

Mr. Ewin asked staff to highlight any additions or edits to the CAFR between now and the November Board meeting. Ms. Dunn added that the only subsequent-event finding was the purchase of the Pyramid Building.

Action Taken

It was moved and seconded to receive a draft of the FY 2013 CAFR for review and discussion. The vote was 6 to 0.

2. Report of New GASB Statements and Auditing Standards

Gary Caporicci of Pun & McGeady referred to a handout entitled "Presentation to San Diego Metropolitan Transit System" (attached). Mr. Caporicci reviewed updates to the GASB Statements 60-70. Ken Pun reviewed Government Auditing Standards and AICPA Clarified Standards.

Mr. Ewin asked who checks that Pun & McGeady's processes are in line. Mr. Pun explained that there is one partner in the field and another partner behind the scenes making sure that procedures are in place to ensure that responsibilities are being implemented on their end. Mr. Ewin asked if there is an outside firm overseeing processes. Mr. Caporicci responded that there is an outside firm that does a peer review of Pun & McGeady.

Mr. Caporicci summarized pension implications of the CAFR. He stated that MTS is in very good shape in comparison to other agencies.

Ms. Dunn asked if AOC members would like a copy of Pun & McGeady's peer review report to be made available at the Board meeting. Mr. Ewin responded that he would like a copy for the AOC, but that he would give a verbal report at the Board meeting and make the report available if anyone wished to see it.

Action Taken

Mr. Roberts moved to receive a report from Pun & McGeady regarding upcoming reporting and auditing changes. Mr. Ovrom seconded the motion, and the vote was 6 to 0.

3. Auditing Services Contract Award

Erin Dunn stated that the auditing services contract award selection committee for MTS included Claudine Aquino from the Procurement Department; Cliff Telfer, former CFO; Tom Lynch, former Controller; Daniel Madzellan, former Internal Auditor; and Linda Musengo, Finance Manager.

Ms. Dunn reported that the MTS selection committee is recommending a five-year contract with 3 one-year options with Pun & McGeady LLP for auditing services. She stated that Pun & McGeady LLP was ahead of the one other firm that was interviewed with both its cost proposal and Best and Final Offer. She added that MTS also already had confidence in Pun & McGeady LLP from its prior work with the agency. Ms. Dunn noted that 5 bids were received, but only 2 firms were interviewed. Discussion ensued about the cost differences between the two bidders and the bidding process. Mr. Ewin clarified that this request could go to the Board as a Consent item.

Action Taken

It was moved and seconded to forward a recommendation to the Board of Directors to authorize the MTS CEO to execute MTS Doc. No. G1513.0-13 for a five-year contract with 3 one-year options with Pun & McGeady LLP for auditing services. The vote was 6 to 0.

C. COMMITTEE MEMBER COMMUNICATIONS AND OTHER BUSINESS

Mr. Ewin requested that if anyone had any concerns to submit them as soon possible; otherwise, the CAFR will go to the next Board meeting in November.

D. PUBLIC COMMENTS


There were no public comments. Karen Landers, General Counsel, informed members that Daniel Madzelan, MTS's Internal Auditor, left the agency for another position.

E. NEXT MEETING DATE

The next meeting will be held as called.

F. ADJOURNMENT

Chairman Ewin adjourned the meeting at 9:57 a.m.


Chairman

Attachments: Roll Call Sheet
Pun & McGeady handout "Presentation to San Diego Metropolitan Transit System
"A New Look" by Gary M. Caporicci, CPA, CGFM, CFF

**AUDIT OVERSIGHT COMMITTEE
METROPOLITAN TRANSIT SYSTEM**

ROLL CALL

MEETING OF (DATE) October 17, 2013

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

RECESS N/A

RECONVENE N/A

CLOSED SESSION N/A

RECONVENE N/A

ADJOURN 9:57 a.m.

BOARD MEMBER (Alternate)	PRESENT (TIME ARRIVED)	ABSENT (TIME LEFT)
EWIN (Chair) <input checked="" type="checkbox"/>	9:00 a.m.	
GLORIA <input type="checkbox"/> (Emerald) <input checked="" type="checkbox"/>	9:03 a.m.	
MATHIS <input checked="" type="checkbox"/>	9:00 a.m.	
OVROM <input checked="" type="checkbox"/> (Bragg) <input type="checkbox"/>	9:00 a.m.	
ROBERTS <input checked="" type="checkbox"/> (Cox) <input type="checkbox"/>	9:04 a.m.	
CUNNINGHAM <input checked="" type="checkbox"/> (McClellan) <input type="checkbox"/>	9:00 a.m.	
Transportation Committee Rep Slot (Mathis)		

SIGNED BY THE CLERK OF THE BOARD:



CONFIRMED BY THE GENERAL COUNSEL:





Presentation to
San Diego Metropolitan Transit System
San Diego, California

Audit Oversight Committee
October 17, 2013

Presented by:

Gary M. Caporicci, CPA, CGFM, CFF

Kenneth H. Pun, CPA, CGMA

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- GASB Update

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- Government Auditing Standards Update

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- AICPA Clarified Standards

GASB UPDATE

Pun & McGeedy LLP

(3)

2013

- Statement 60 – *Service Concession Arrangements (SCAs)*
- Statement 61 – *The Financial Reporting Entity – Omnibus*
- Statement 62 – *Codification of Pre-November 30, 1989 FASB and AICPA Pronouncements*
- **Statement 63 – *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position***

2014

- Statement 65 – *Items Previously Reported as Assets and Liabilities*
- Statement 66 – *Technical Corrections – 2012*
- **Statement 67** – *Financial Reporting for Pension Plans*
- Statement 70 – *Non exchange Financial Guarantees*

2015

- **Statement 68** – *Accounting and Financial Reporting for Pensions*
- **Statement 69** – *Government Combinations and Disposals of Operations*

GASB STATEMENT

NO. 63 -

Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position

Highlights

- Now five elements make up a statement of financial position:
 - Assets
 - **Deferred Outflows of Resources**
 - Liabilities
 - **Deferred Inflows of Resources**
 - Net Position
- New title: *Net Investment in Capital Assets*

GASB STATEMENT
NO. 67-
Financial Reporting for Pension Plans

Highlights

- Pension Plans must present two financial statements:
 - A Statement of Fiduciary Net Position
 - A Statement of Changes in Fiduciary Net Position
- Pension Plan disclosures in the financial statements:
 - Total Pension Liability
 - The Plan's Fiduciary Net Position
 - Net Pension Liability
 - The Plan's Fiduciary Net Position as a percentage of the Total Pension Liability
 - Significant Assumptions to Calculate Total Pension Liability
 - Ten Years of Disclosures

Highlights

- Actuarial Valuation
 - At least biennially
 - Disclose all Major Actuarial Assumptions

GASB STATEMENT
NO. 68-
Accounting and Financial Reporting for
Pensions

Highlights

- Accounting-based versus funding-based
- The difference between Total Pension Obligation and Plan Assets would be reported as a **Net Pension Liability** in the financial statements.
- Actuarial Requirements:
 - Valuation at least biennially
 - Within 12 months of fiscal year-end (OK to “roll forward” from date within 30 months)
 - All assumption should conform to Actuarial Standards of Practice

PENSION EXPENSE T-ACCOUNT

1. Employer contributions.
Earnings on Plan
Investments.

2. Earnings on Plan
Investments.

Difference between actual and
projected earnings to be
recognized over a 5-year period.*

2. Earnings on Plan Investments.

Difference between actual and
projected earnings to be
recognized over a 5-year closed
period. *

* Report as deferred outflows or inflows of resources

PENSION EXPENSE

T-ACCOUNT (Continued)

- 3. Interest on the beginning Total Pension Liability.
- 4. Change in plan terms.
 - a) Changes for past service of inactive/retired employees to be recognized immediately.
 - b) Changes for past service of active employees to be recognized over the average expected remaining service lives of the employees. *

* Report as deferred outflows or inflows of resources

Highlights

- Note Disclosures
- Required Supplementary Information

Government Auditing Standards Update

Pun & McGeady LLP

(17)

Effective Date

- The effective date for financial audits and attestation engagements is for periods ending on or after December 15, 2012.

Overall Changes

- Updated financial and audit standards which:
 - Reflect recent updates to the auditing standards issued by the AICPA, where applicable.
 - More clearly identifies the Yellow Book requirements and guidance that supplement AICPA requirements for financial audits.
- Consistency of the use of footnotes has been improved.

Highlights

- Concepts and ethical principles that serve as the foundation for the requirements and guidance for GAGAS.
- Legislators, Oversight Bodies, Those Charged with Governance, and the Public Need to Know Whether...
 - Entities manage government resources and use their authority properly and in compliance with laws and regulations
 - Government programs are achieving their objectives and desired outcomes
 - Government services are provided effectively, efficiently, economically, ethically, and equitably
- Purpose and Applicability of GAGAS

Highlights

- Non Audit Services
- Circular A-133 audits involve three layers of requirements:
 - OMB Circular A-133 requirements
 - Yellow Book requirements
 - GAAS requirements
- SAS 117, Compliance Audits
- Conceptual Framework for Independence

AICPA
Clarified Auditing Standards
(And How They Apply to Government Audits)

Purpose of Clarified Standards

- Implement ASB's clarity drafting conventions designed to make standards easier to read, understand and apply.
- Convergence of standards with International Standards on Auditing of the International Auditing and Assurance Standards Board.
- Not to create additional requirements, but some practices will need to be "adjusted".

AICPA

Clarified Auditing Standards

- Clarity project substantially completed with issuance of SAS 122-127
 - SAS 122 *Clarification and Recodification*
 - SAS 123 *Omnibus Statement on Auditing Standards – 2011*
 - SAS 124 *Financial Statements Prepared in Accordance with a Financial Reporting Framework Generally Accepted in Another Country*
 - SAS 125 *Alert that Restricts the Use of the Auditor's Written Communications*
 - SAS 126 *The Auditor's Consideration of An Entity's Ability to Continue as a Going Concern(Redrafted)*
 - SAS 127 *Omnibus Statement on Auditing Standards -2013*
- Effective for periods ending after 12/15/2012

Documentation

- Make sure impacts on various documents are incorporated:
 - Engagement letters
 - Representation letters
 - Auditors' reports
 - Restricted use reports (e.g. management letters)

Substantive Changes

- Consideration of Laws and Regulations
- Communicating Internal Control Related Matters
- Related Parties
- Group Audits
- Auditors' Reports

A New Look

New Elements in GASB Financial Statements

this article is intended to aid government officials and practitioners in the implementation of the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

- Concepts Statement No. 4, *Elements of Financial Statements*
- Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*

In June 2007, GASB completed Concepts Statement No. 4, *Elements of Financial Statements*, which discussed, explained and concluded about the elements of financial statements. Further, in 2011 GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This article presents the requirements and implementation of GASB Statement No. 63.

Concepts Statement No. 4, Elements of Financial Statements

This Concepts Statement is one of a series that has been issued or will be issued and are intended to provide a conceptual framework of inter-related objectives and fundamental concepts that can be used as a basis for establishing consistent financial reporting standards.

Concepts statements identify the objectives and fundamental principles of financial reporting that can be applied to address numerous financial accounting and reporting issues. They provide GASB with the basic conceptual foundation for considering the merits of alternative approaches to financial reporting and help GASB develop well-reasoned financial reporting standards.

Concepts Statement No. 4 established definitions for seven elements—or fundamental components—of financial statements of state and local governments. The elements of a statement of financial position are defined as:

- **Assets:** Resources with present service

capacity that the government presently controls.

- **Deferred Outflows of Resources:** Consumption of net assets by the government that is applicable to a future reporting period. Has a positive effect on net position similar to assets.
- **Liabilities:** Present obligations to sacrifice resources that the government has little or no discretion to avoid.
- **Deferred Inflows of Resources:** Acquisition of net assets by the government that is applicable to a future reporting period. Has a negative effect on net position similar to liabilities.
- **Net Position:** Residual of all elements presented in a statement of financial position (assets plus deferred outflows minus liabilities and deferred inflows equals net position)

The elements of the resource flows statements are defined as:

- **Outflow of Resources:** Consumption of net assets by the government that is applicable to the reporting period.
- **Inflow of Resources:** Acquisition of net assets by the government that is applicable to the reporting period.

Concepts Statement No. 4 improves financial reporting by defining some of the most central terms used in GASB pronouncements, which will enhance consistency in future standards setting. These defined terms include deferred outflows of resources and deferred inflows of resources, which will, for example, allow for better presentation of interperiod equity in certain financial statements.

This Concepts Statement also may benefit preparers and auditors when evaluating transactions, in certain cases, for which there are no existing standards. Financial statement users also may benefit from understanding these definitions that identify the items and events that should be reported as specific elements of financial statements.

GASB Statement No. 63

GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* in June 2011, addressing the various elements of financial statements:

Financial Reporting for Deferred Outflows of Resources and Deferred Inflows of Resources: Amounts that are required to be reported as deferred outflows of resources should be reported in a statement of financial position in a separate section following assets. Similarly, amounts that are required to be reported as deferred inflows of resources should be reported in a separate section following liabilities. The total for deferred outflows of resources may be added to the total for assets, and the total for deferred inflows of resources may be added to the total for liabilities to provide subtotals.

Statement of Net Position: Reports all assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position. The Statement of Net Position should report the residual amount as net position, which represents the difference between all other elements in a statement of financial position and should be displayed in three components:

- Net Investment in Capital Assets
- Restricted (by major categories)
- Unrestricted

Components of net position are defined as:

- **Net Investment in Capital Assets:** The net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes or other borrowings that are related to those assets.

Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction or improvement of those assets or related debt also should be included in this component of net position.

If there are significant unspent related debt proceeds or deferred inflows of resources

at the end of the reporting period, the portion of the debt or deferred inflows of resources attributable to the unspent amount should not be included in the calculation of net investment in capital assets. Instead, that portion of the debt or deferred inflows of resources should be included in the same net position component (restricted or unrestricted) as the unspent amount.

- **Restricted Component of Net**

Position: Consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets.

- **Unrestricted Component of Net**

Position: Includes the net amount of the assets, deferred outflows of resources, liabilities and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

- **Financial Reporting for**

Governmental Funds: Deferred outflows of resources and deferred inflows of resources that are required to be reported in a governmental fund balance sheet should be presented in a format that displays assets plus deferred outflows of resources, equals liabilities plus deferred inflows of resources, plus fund balance. Governmental funds

continue to report fund balance.

- **Disclosures:** Balances of deferred outflows of resources and deferred inflows of resources reported in a statement of net position or a governmental fund balance sheet may be presented in detail or as aggregations of different types of deferred amounts. Governments should provide details of the different types of deferred amounts in the notes to the financial statements if not separately presented.

Effective Date

Statement No. 63 is effective for financial statements for periods beginning after Dec. 15, 2011. Earlier application is encouraged.

How about Early Implementation of GASB 65?

GASB Statement No. 65, Items Previously Reported as Assets and Liabilities, is effective for financial statements for periods beginning after Dec. 15, 2012. In California, the effective dates are:

Year End	Effective Dates
Dec. 31	Dec. 31, 2013
June 30	June 30, 2014
Sept. 30	Sept. 30, 2014

Although early application is encouraged and GASB Statement No.65 seems clearly related to GASB Statement No.63, it's recommended not to early implement. The reasoning to not implement early is that government officials and practitioners need sufficient time to accurately reformat the financial statements for Statement No. 63.

In early 2014, an article will be published on GASB Statement No. 65 with a detail matrix of assets and liabilities to be classified as Deferred Outflows and Deferred Inflows and other amounts put into the resource flows statement.

Conclusion

Although it may seem that GASB No. 63 will make financial reporting more complicated, I believe by displaying the significant deferred elements separately, financial reporting will be improved and better positioned and consistent with new GASB standards being issued. [7]

Gary M. Caporicci, CPA, CGFM, CFF, is a partner with Pun & McGeady LLP and chair of the CalCPA California Municipal Accounting Committee. You can reach him at gcaporicci@pm-llp.com.

Ad



1255 Imperial Avenue, Suite 1000
San Diego, CA 92101-7490
(619) 231-1466 • FAX (619) 234-3407

Agenda Item No. B1

MEETING OF THE SAN DIEGO METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

April 10, 2014

SUBJECT:

APPOINTMENT OF CHAIRPERSON

RECOMMENDATION:

That the MTS Audit Oversight Committee appoint a chairperson.

Budget Impact

None at this time.

DISCUSSION:

Appointment of Chairperson of the MTS Audit Oversight Committee

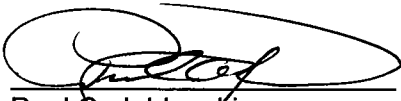
MTS Policy No. 22.9.1 states: *The Audit Oversight Committee shall be comprised of the same members that make up the Executive Committee. The Chairman of the Audit Oversight Committee shall be appointed from amongst its members at the first meeting held during each calendar year. The Chairman of the Audit Oversight Committee shall be another member other than the member who serves as the Executive Committee Chairman. Additional members of the MTS Board may be appointed on an annual basis at the first MTS Board meeting in January at the discretion of the MTS Board. The Board may appoint individuals who are not members of the Board to serve as nonvoting advisory members to the Audit Oversight Committee.*

The Chairman of the Audit Oversight Committee nomination procedures pursuant to Robert's Rules of Order are as follows:

1. The Chairman of the Board of Directors opens the agenda item.
2. The Chairman of the Board of Directors requests nominations from the floor.
Nominations do not require a second.



3. The Chairman of the Board of Directors closes the nominations.
4. The Chairman of the Board of Directors invites the candidate(s) to address the Committee for 3 minutes.
5. The Chairman of the Board of Directors asks for any Committee discussion.
6. The Chairman of the Board of Directors calls for the vote on each motion for each candidate.
7. The vote is taken on the motion until a candidate is elected.



Paul C. Jablonski
Chief Executive Officer

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



1255 Imperial Avenue, Suite 1000
San Diego, CA 92101-7490
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Agenda Item No. B2

MEETING OF THE SAN DIEGO METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

April 10, 2014

SUBJECT:

PUN & MCGEADY ENGAGEMENT LETTER FOR THE FY2014 AUDIT (ERIN DUNN)

RECOMMENDATION:

That the MTS Audit Oversight Committee (AOC) review the audit engagement letter from Pun & McGeady (Attachment A).

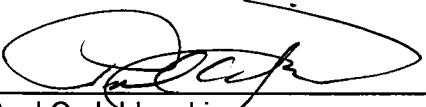
Budget Impact

None at this time.

DISCUSSION:

Auditing standards require the auditor to present a written engagement letter and obtain a signature from an officer. Attachment A is the engagement letter from Pun & McGeady for the FY 2014 audit. A representative from Pun and McGeady will be available for questions.

Pun & McGeady is required to submit their peer review (Attachment B) along with the MTS engagement letter. This peer review was previously provided to the AOC in November 2013.



Paul C. Jablonski
Chief Executive Officer

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

Attachment: A. Engagement Letter
B. Peer Review



6265 Greenwich Drive
Suite 220
San Diego, California 92122

Phone: (858) 242-5100
Fax: (858) 242-5150
www.pm-llp.com

April 10, 2014

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, 2014. The Firm's services are provided pursuant to MTS Contract No. G1513.0-13 ("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 2013/14 Audit Assignment

We will audit the financial statements of MTS, which comprises of statement of net position as of June 30, 2014, and the related statements of revenues, expenses, and changes in net positions, and cash flows for the year then ended, and the related notes to the financial statements.

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

San Diego Metropolitan Transit System
Engagement Letter
 April 10, 2014
 Page 2

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 third 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

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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 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 perform 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*.

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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 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 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.

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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 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, 2014.

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 prior 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 (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 supplementary information.

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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 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.

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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.

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

**San Diego Metropolitan Transit System
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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. 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 April 10, 2014 and to issue our reports no later than December 31, 2014.

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. Accordingly, our 2013 peer review report accompanies this letter.

San Diego Metropolitan Transit System
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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 & McGeedy LLP

Kenneth H. Pun, CPA
Partner

ACCEPTED

This letter correctly sets forth the management/auditor responsibilities and procedures for the FY 13/14 audit of the San Diego Metropolitan Transit System.

Authorized Signature:  _____

Title: CHIEF FINANCIAL OFFICER _____

Date signed: APRIL 1, 2014 _____



JOHN LERIAS, CPA
STEPHEN C. WILLIAMS, CPA
JOSEPH O. ROMERO, CPA

System Review Report

PUN & MCGEADY LLP

Irvine, California;
and the Peer Review Committee of the California Society of CPAs

We have reviewed the system of quality control for the accounting and auditing practice of Pun & McGeady LLP (the firm) in effect for the year ended March 31, 2013. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

As required by the standards, engagements selected for review included engagements performed under *Government Auditing Standards* and audits of employee benefit plans.

In our opinion, the system of quality control for the accounting and auditing practice of Pun & McGeady LLP in effect for the year ended March 31, 2013, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)* or *fail*. Pun & McGeady LLP has received a peer review rating of *pass*.

8577 Haven Avenue
Suite 306
Rancho Cucamonga
CA 91730

909.948.9990
800.644.0696
FAX 909.948.9633

gyld@gyldecauwer.com
www.gyldecauwer.com

Gyl Decauwer LLP

Ontario, California
May 31, 2013

your
Success
is our
DESTINATION



1255 Imperial Avenue, Suite 1000
San Diego, CA 92101-7490
(619) 231-1466 • FAX (619) 234-3407

Agenda Item No. B3

MEETING OF THE SAN DIEGO METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

April 10, 2014

SUBJECT:

PROPOSED FY2014 AUDIT SCHEDULE (ERIN DUNN)

RECOMMENDATION:

That the MTS Audit Oversight Committee review the proposed FY 2014 audit schedule and provide comments.

Budget Impact

None at this time.

DISCUSSION:

Staff and Pun & McGeedy propose the following schedule for completion of the FY 2014 Audit:

- | | |
|---|--|
| • April 7 th -April 25 th | Interim fieldwork |
| • June 12 th | AOC – Interim audit report |
| • August 18 th -September 12 th | Fieldwork |
| • October 6 th | Draft audit report completed |
| • October 23 rd | AOC – Present CAFR draft/discuss progress/issues |
| • November 13 th | AOC – Additional/Alternative date if needed |
| • November 20 th | Board of Directors – Present final CAFR |
| • December 11 th | Board of Directors – 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



1255 Imperial Avenue, Suite 1000
San Diego, CA 92101-7490
(619) 231-1466 • FAX (619) 234-3407

Agenda Item No. B4

MEETING OF THE SAN DIEGO METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

April 10, 2014

SUBJECT:

REPORT OF NEW GASB STATEMENTS AND AUDITING STANDARDS (KEN PUN OF
PUN & MCGEADY LLP & GARY CAPORICCI OF CAPORICCI & LARSON)

RECOMMENDATION:

That the Audit Oversight Committee receive a report from Pun & McGeady regarding
upcoming reporting and auditing changes.

Budget Impact

None at this time.

DISCUSSION:

1. Pun & McGeady will present information regarding the following statements of
accounting standards as issued by the Government Accounting Standards Board
(GASB) that have become effective or will become effective during the next few
years.
 - a. No. 65 – Items Previously Reported as Assets and Liabilities
 - b. No. 67 – Financial Reporting for Pension Plans - an amendment of GASB
Statement No. 25
 - c. No. 68 – Accounting and Financial Reporting for Pensions - an
amendment of GASB Statement No. 27
 - d. No. 69 – Government Combinations and Disposals of Government
Operations
 - e. No. 70 – Accounting and Financial Reporting for Nonexchange Financial
Guarantees
 - f. No. 71 – Pension Transition for Contributions Made Subsequent to the
Measurement Date - an amendment of GASB Statement No. 68



2. Pun & McGeady will present information regarding changes in auditing standards as provided in the American Institute of Certified Public Accountants (AICPA) Clarity Standards.
 - a. Statements on Auditing Standards (SAS) No. 128 – Using the Work of Internal Auditors
 - b. SAS Clarity – Group Audits
3. Pun & McGeady will present information regarding Single Audit Reform



Paul C. Jablonski
Chief Executive Officer

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



Presentation to
San Diego Metropolitan Transit System
San Diego, California

Audit Oversight Committee
April 10, 2014

Presented by:
Gary M. Caporicci, CPA, CGFM, CFF

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GASB UPDATE

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- Statement 65 – *Items Previously Reported as Assets and Liabilities*
- Statement 67 – *Financial Reporting for Pension Plans***
- Statement 70 – *Non exchange Financial Guarantees*

** To be discussed in detail at the June 12, 2014 AOC Meeting

[4]

2015

- Statement 68 – *Accounting and Financial Reporting for Pensions***
- Statement 69 – *Government Combinations and Disposals of Operations*
- Statement 71 – *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment to GASB Statement No. 68* **

** To be discussed in detail at the June 12, 2014 AOC Meeting

[5]

GASB STATEMENT

No. 65 -

Items Previously Reported as Assets and Liabilities

[6]

Highlights Deferred Inflows of Resources

- Grants received in advance of meeting timing requirement
- Deferred amounts (credits) from refunding of debt
- Proceeds from sales of future revenues
- Deferred gain from sale-leaseback
- “Regulatory” credits

[7]

Highlights Deferred Outflows of Resources

- Grant paid in advance of meeting timing requirement
- Deferred amounts (debits) from refunding of debt
- Cost to acquire rights to future revenues (intra-entity)
- Deferred loss from sale-leaseback

[8]

Highlights Outflows of Resources (Expense)

- Debt issuance costs (other than insurance)
- Initial costs incurred by lessor in an operating lease
- Acquisition costs for risk pools
- Loan origination costs

[9]

Highlights Inflows of Resources (Revenue)

- Loan origination fees
- Commitment fees (after exercise or expiration)

[10]

GASB STATEMENT
No. 67 -
Financial Reporting for Pension Plans

[11]

Highlights

- Pension Plans must present two financial statements:
 - A Statement of Fiduciary Net Position
 - A Statement of Changes in Fiduciary Net Position
- Pension Plan disclosures in the financial statements:
 - Total Pension Liability
 - The Plan's Fiduciary Net Position
Net Pension Liability
 - The Plan's Fiduciary Net Position as a percentage of the Total
Pension Liability
 - Significant Assumptions to Calculate Total Pension Liability
 - Ten Years of Disclosures

[12]

Highlights

- Actuarial Valuation
 - At least biennially
 - Disclose all Major Actuarial Assumptions

[13]

GASB STATEMENT

No. 70 -

Nonexchange Financial Guarantees

[14]

Highlights

- Nonexchange financial guarantees
 - A transaction that is classified as nonexchange is based the same definition of nonexchange that is found in Statement 33
 - Excludes exchange and exchange-like transactions
- Entities addressed
 - Providers of financial guarantees
 - Recipients of financial guarantees

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Recognition

- Provider of financial guarantee
 - When qualitative factors and historical data, if any, indicate that it is more likely than not that a government will make a payment on nonexchange financial guarantees it extended, the government should recognize a liability
- Recipient of financial guarantee
 - When nonexchange financial guarantee is legally released as an obligor from the obligation and from any liability to the guarantor, the government should recognize revenue

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Qualitative Factors

- Examples of qualitative factors relevant to the entity or individual that has issued the guaranteed obligation include:
 - Initiation of the process of entering into bankruptcy or financial reorganization
 - Breach of a debt contract, such as failure to meet covenants or delinquency in interest or principal payments
 - Indicators of significant financial difficulty, such as drawing on a reserve fund to make debt service payments, debt holder concessions, or loss of a major source of revenue

[17]

Measurement

- Provider of financial guarantee
 - Amount equal to the discounted present value of the best estimate of the future outflows expected to be incurred as a result of the guarantee
 - If there is no best estimate, the discounted present value of the minimum amount in a range should be recognized
- Recipient of financial guarantee
 - Amount equal to the reduction of the guaranteed liability should be recognized

[18]

Disclosures

- Provider of financial guarantee
 - Description of the guarantee, including length
 - Total amount of all guarantees extended that are outstanding at the reporting date.
 - Description of liabilities recorded and payments made
- Recipient of financial guarantee
 - Description of the guarantee, including amount and length
 - Outstanding amounts, if any, required to repay the entity providing the guarantee.

[19]

GASB STATEMENT

No. 68 -

***Accounting and Financial Reporting for
Pensions***

[20]

Highlights

- Accounting-based versus funding-based
- The difference between Total Pension Obligation and Plan Assets would be reported as a **Net Pension Liability** in the financial statements.
- Actuarial Requirements:
 - Valuation at least biennially
 - Within 12 months of fiscal year-end (OK to “roll forward” from date within 30 months)
 - All assumption should conform to Actuarial Standards of Practice

[21]

Highlights

- Note Disclosures
- Required Supplementary Information

[22]

GASB STATEMENT
No. 69 -
*Government Combinations and Disposals
of Operations*

{ 23 }

Highlights

- Combinations in which no consideration is provided
 - Government mergers
 - Transfers of operations
- Combinations in which consideration is provided
 - Government acquisitions
- Disposal of government operations reporting

{ 24 }

Mergers and Transfers of Operations

- Assets and liabilities at carrying values
 - Presumption of GAAP
- Reporting
 - Mergers
 - New entity
 - Continuing entity
 - Transfers of operations
- Adjustments
 - Accounting principles, policies, and estimates
 - Capital asset impairment
 - Transaction eliminations

[25]

Acquisitions

- Assets (and liabilities) at *acquisition value*
 - GAAP applicable to state and local governments is used for recognition
 - Market-based entry price measurements
 - Exceptions
- Accounting for the difference
 - Goodwill—deferred outflow of resources
 - Contribution received or reduction of non-current assets
- Reporting period

[26]

Disposals of Government Operations

- Governments would report disposals of operations for all disposals of operations (transfers or sales).
 - Gains and losses reported as special items
- Costs associated with disposals of government operations
 - Should consider all costs associated with disposals of operations
- Disclosures
 - Description of the circumstances leading to the discontinuation
 - Operations revenues, expense, and non-operating items

[27]

Additional Note Disclosures

- General information about ALL government combinations
 - Brief description of the combination and identification of the entities involved
 - Date of the combination
 - Primary reasons for the combination
- Additional information about specific combinations
 - Government mergers and transfers of operations
 - Carrying values recognized as of the merger date
 - Description of significant adjustments
 - Amounts recognized

[28]

Disclosures - Government Acquisition

- Brief description of consideration provided
- Total amount of net position acquired
- Brief description of contingent consideration arrangements

[29]

GASB STATEMENT No. 71-

Pension Transition for Contributions Made Subsequent to the Measurement Date

The provisions of this statement should be applied simultaneously with the provisions of GASB Statement No. 68 (For years ended June 30, 2015 or later)

[30]

Highlights

- Statement affects transition provisions related to certain pension contributions made to defined benefit pension plans prior to implementation of GASB Statement No. 68

[31]

Highlights

- At the beginning of the period that GASB Statement No. 68 is adopted, it may not be practical for a government to determine the amounts of ALL applicable Deferred Outflows of Resources and Deferred Inflows of Resources related to pensions

[32]

Highlights

- The government should recognize a beginning Deferred Outflows of Resources only for its pension contributions, if any, made subsequent to the measurement date of the beginning Net Pension Liability, but before the start of the Government's fiscal year.

Highlights

- No other beginning balances for the Deferred Outflows of Resources and Deferred Inflows of Resources relate to pensions should be recognized.

AUDITING STANDARDS UPDATE

[35]

Statement on Auditing Standards No. 128, *Using the Work of Internal Auditors*

- **Issue Date:** February 2014
- **Effective Date:** This Statement on Auditing Standards is effective for audits of financial statements for periods ending on or after December 15, 2014.

[36]

Statement on Auditing Standards No. 128,
Using the Work of Internal Auditors

- SAS No. 128 addresses the external auditor's responsibilities if using the work of internal auditors. Using the work of internal auditors includes (a) using the work of the internal audit function in obtaining audit evidence and (b) using Internal auditors to provide direct assistance under the direction, supervision, and review of the external auditor.

[37]

Statement on Auditing Standards No. 128,
Using the Work of Internal Auditors

- SAS No. 128 does not apply if the entity does not have an internal audit function.
- Nothing in SAS No. 128 requires the external auditor to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor; it remains the external auditor's decision to establish the overall audit strategy.

[38]

Statement on Auditing Standards No. 128, *Using the Work of Internal Auditors*

- Consistent with International Standard on Auditing (ISA) 610 (Revised 013), *Using the Work of Internal Auditors*, SAS No. 128 Introduces the concept of a *systematic and disciplined approach* and would require, among other things, as a prerequisite to being able to use the work of the internal audit function, that the external auditor evaluate the application by the internal audit function of a *systematic and disciplined approach, including quality control*.

[39]

Group and Component Audits

- Updates guidance when Other Auditors involved to reflect risk assessment standards
- Changes terminology
 - “Principal Auditor” replaced with “Group Engagement Partner or Team”
 - “Other Auditor” replaced with “Component Auditor”

[40]

Responsibility of Group Engagement Partner

- Emphasizes Group Engagement Partner responsibility to assess whether sufficient appropriate evidence obtained to provide basis for opinion on Group Financial Statements

[41]

SINGLE AUDIT REFORM

[42]

Objectives

- Targeting Audit Requirements on Risk of Waste, Fraud, and Abuse
 - Right-sizes the footprint of oversight
 - Improves transparency and accountability by making single audit reports available to the public online

[43]

Revisions Focus Audit on Risk

- Increases audit threshold
- Strengthens risk-based approach to determine Major Programs
- Provides for greater transparency of audit results
- Strengthens agency use of the single audit process
- Provide public outreach to focus Compliance Supplement on requirements of highest risk

[44]

Audit Threshold

- Increases audit threshold from \$500,000 to \$750,000
- Programs are grouped based on dollars
 - Type A/B Programs
 - Less Than or Equal to \$25 Million
 - Increase from \$300,000 to \$750,000
 - Between \$25 Million to \$100 Million
 - Total FAE times 3%
 - Exceed \$100 Million to \$1 Billion
 - \$3,000,000

(45)

High Risk Type A Program

- Not audited as major program in 1 of 2 most recent audit periods
- Modified Opinion on Major Program
- Material Weakness in Internal Control Over Compliance Requirements Identified
- Known or likely questioned cost exceeding 5% of total program expenditures
- Other – Auditor Judgment

(46)

High Risk Type B Program

- Perform risk assessments on Type B Programs until high-risk Type B programs have been identified UPTO at least 25% of number of low risk Type A programs

[47]

Coverage Rule

- **Not low-risk Auditee**
 - 40%
- **Low-Risk Auditee**
 - 20%

[48]

Low Risk Auditee

- Annual Single Audits
- Unmodified opinions on financial statements in accordance with GAAP or basis of accounting required by state law
- Unmodified SEFA in relation to opinion
- No GAGAS material weaknesses
- In either of preceding two years, none of Type A program had:
 - Material Weaknesses
 - Material Noncompliance
 - Questioned Costs that exceed 5%
- Timely filing with FAC
- No Auditing Reporting of Going Concern
- No Waivers

[49]



1255 Imperial Avenue, Suite 1000
San Diego, CA 92101-7490
(619) 231-1466 • FAX (619) 234-3407

Agenda Item No. B5

MEETING OF THE SAN DIEGO METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

April 10, 2014

SUBJECT:

PROPOSED FISCAL YEAR 2015 INTERNAL AUDIT PLAN (TOUFIC TABSHOURI)

RECOMMENDATION:

That the Audit Oversight Committee receive the proposed fiscal year 2015 Internal Audit Plan.

Budget Impact

None.

DISCUSSION:

The MTS Internal Auditor has proposed a work plan commencing in April 2014 and continuing through the end of fiscal year 2015. The plan consists of eight audits estimated to consume 1,680 hours, with an additional 333 hours budgeted for consulting and management-requested projects.

The presentation will provide an overview of audit resources and a listing of the planned audits. It will also explain the process of selecting audits, which is based on an assessment of risk and other factors such as prior audit findings and management input.

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: Sharon Cooney, 619.557.4513, Sharon.Cooney@sdmts.com



Internal Audit Plan

Presentation for the MTS Board of Directors
Audit Oversight Committee
April 10, 2014



Internal Audit Plan

- Internal Auditor Toufic Tabshouri started at MTS on December 30, 2013
- Held prior audit positions with the California State Auditor, the UC Davis Medical Center, and the City of San Diego
- Spent January-February learning about MTS, meeting with management and staff, and developing the Internal Audit Plan



Internal Audit Plan

This presentation covers the content and development of the Internal Audit Plan, which entails:

- Determining available audit resources and developing a time budget
- Selecting areas for audit



Internal Audit Plan

Audit Time Budget		
	April 2014 - June 2014	Fiscal Year 2014/15
Total Work Hours	520	2,080
Less:		
Holidays	(16)	(72)
Annual Leave	(44)	(176)
Training	(16)	(60)
Audit Administration	(26)	(177)
Consultations	(67)	(266)
Available Audit Hours	351	1,329



Internal Audit Plan

The selection of audits is primarily driven by three factors:

1. Auditor assessment of organizational risks
2. Prior audit work
3. Management input



Internal Audit Plan

1. Risk

- Risk assessments provide a way to systematically select audits.
- The risk of an adverse event is evaluated in terms of its *likelihood* of occurrence (remote, possible, probable) and the *impact* (low, moderate, high) on the organization.



Internal Audit Plan

1. Risk (*continued*)

Common types of risk include:

- Non-compliance with federal or state laws and regulations
- Non-compliance with grant provisions or contractual agreements
- Adverse changes in economic conditions



Internal Audit Plan

1. Risk (*continued*)

Common types of risk also include:

- Employee fraud
- Damage to the MTS brand and reputation
- Physical injury to employees or others
- Information technology systems failures



Internal Audit Plan

2. Prior Audits

Two factors from prior audits were used to adjust the assessed risk of various functional areas:

1. Significance and resolution of findings
2. Recency of audits



Internal Audit Plan

3. Management Input

- MTS directors and managers provided feedback about the organization, risk areas, and suggestions for audits.
- They also identified known problem areas.



Internal Audit Plan

Planned Audits			
#	Audit Area	Estimated Hours	Timeframe
1	Procurement: Vendor Oversight and Monitoring	320	April 2014 - June 2014
2	Information Technology: Governance and Planning	240	June 2014 - August 2014
3	Worker's Compensation	160	September 2014 - October 2014
4	SDTC Revenue	160	November 2014 - December 2015



Internal Audit Plan

Planned Audits			
#	Audit Area	Estimated Hours	Timeframe
5	Procurement: Compliance and Management	320	January 2015 - March 2015
6	Information Technology: Business Continuity and Security	160	March 2015 - April 2015
7	MTS Security	160	May 2015
8	MTS Performance Goals	160	June 2015



Internal Audit Plan

Audit Budget Summary:

- Available audit hours: $351 + 1,329 = 1,680$
- Hours allocated to plan audits: 1,680
- Hours available for consultations: $67 + 266 = 333$



Internal Audit Plan

Focuses on areas that impact crucial functions at MTS.

- Examples include Procurement and Information Technology.

Does not focus on known problems that are receiving sufficient attention from management.

- An example is the transition of the Compass Card from SANDAG.



Internal Audit Plan

Planned non-audit projects:

- Organizational fraud risk assessment
- Review of MTS Audit Charter and Internal Audit policies and procedures
- Review of audit quality control process
- Report on the status of implementation of audit recommendations



Internal Audit Plan

- The Internal Audit Plan will be revised as necessary.
- Depending on the progress of the audits, additional audits may be proposed.
- The MTS Board and Audit Oversight Committee will be informed of all revisions to the Internal Audit Plan.



Internal Audit Plan

Questions?

Toufic.Tabshouri@sdmts.com
(619)595-4920

