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## Agenda

### MEETING OF THE SAN DIEGO METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

June 12, 2014

Executive Conference Room  
9:00 a.m.

#### ACTION RECOMMENDED

- A. 1. Roll Call
- 2. Approval of the Minutes of April 10, 2014 Approve
- B. COMMITTEE DISCUSSION ITEMS
  - 1. Interim Audit (Erin Dunn) Receive  
Action would receive a report on: (1) Interim audit work conducted by Pun & McGeady; and (2) Related observations.
  - 2. Report of GASB 67, GASB 68, and GASB 71 (Erin Dunn & Gary Caporicci of Pun & McGeady) Receive  
Action would receive a report from Pun & McGeady regarding upcoming reporting and auditing changes.
- C. COMMITTEE MEMBER COMMUNICATIONS AND OTHER BUSINESS
- D. PUBLIC COMMENTS
- E. NEXT MEETING DATE: To be determined.
- F. ADJOURNMENT



# DRAFT

MEETING OF THE SAN DIEGO METROPOLITAN TRANSIT SYSTEM  
AUDIT OVERSIGHT COMMITTEE  
1255 Imperial Avenue, Suite 1000  
San Diego, CA 92101

## MINUTES

April 10, 2014

### A1. ROLL CALL

Mr. 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

Mr. Ewin moved for approval of the minutes of the October 17, 2013, Audit Oversight Committee meeting. Mr. McClellan seconded the motion, and the vote was 4 to 0 in favor, with Mr. Gloria and Mr. Roberts absent.

### B. COMMITTEE DISCUSSION ITEMS

#### 1. Appointment of Chairperson

Mr. Mathis moved to nominate Mr. Ewin as Committee Chairman. Mr. McClellan seconded the motion.

#### Action Taken

The vote for Mr. Ewin as Committee Chairman was 3 to 0 in favor, with Mr. Ewin abstaining, and Mr. Gloria and Mr. Roberts absent.

#### 2. Pun & McGeady Engagement Letter for the FY2014 Audit

Erin Dunn, Controller, explained to the Audit Oversight Committee that Pun & McGeady were awarded a new contract with MTS in November 2013. She stated that the Pun & McGeady engagement letter for the FY2014 audit had been received and reviewed by MTS staff.

#### Action Taken

Chairman Ewin noted that the agenda item was accepted for review. No action taken.

#### 3. Proposed FY2014 Audit Schedule

Erin Dunn stated that fieldwork for the audit began on Monday, April 7, 2014. She then reviewed the entire proposed FY2014 audit schedule.

#### Action Taken

Chairman Ewin noted that the agenda item was accepted for review. No action taken.

4. 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 GASB Statements 65 and 67-71. Mr. Caporicci reviewed Statement on Auditing Standards and the American Institute of Certified Public Accountants (AICPA) Clarified Standards. He also presented information regarding the Single Audit Reform. Chairman Ewin requested that Pun & McGeady provide the Audit Oversight Committee a new definition sheet for clarification in future reports.

Action Taken

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

5. Proposed Fiscal Year 2015 Internal Audit Plan

Karen Landers, General Counsel, introduced Toufic Tabshouri, MTS's new Internal Auditor. Mr. Tabshouri provided a brief introduction of himself and reviewed the proposed fiscal year 2015 internal audit plan. He explained that the plan will consist of eight audits and an estimated 1,680 hours. Mr. Tabshouri provided an overview of the planned audits and the factors and processes used to select those audits.

Action Taken

Mr. Gloria moved to receive the proposed fiscal year 2015 Internal Audit Plan. Mr. Roberts seconded the motion, and the vote was 6 to 0 in favor.

C. COMMITTEE MEMBER COMMUNICATIONS AND OTHER BUSINESS

Chairman Ewin asked Erin Dunn when the confirmation letters will be sent to the attorneys regarding the audit. Ms. Dunn stated that the letters will be sent out at the end of the fiscal year.

D. PUBLIC COMMENTS

There were no public comments.

E. NEXT MEETING DATE

The next Audit Oversight Committee meeting is scheduled for June 12, 2014.

F. ADJOURNMENT

Chairman Ewin adjourned the meeting at 9:34 a.m.

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Chairman

Attachments: Roll Call Sheet  
                  Pun & McGeady handout "Presentation to San Diego Metropolitan Transit System"

**AUDIT OVERSIGHT COMMITTEE  
METROPOLITAN TRANSIT SYSTEM**

ROLL CALL

MEETING OF (DATE) April 10, 2014

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

RECESS N/A

RECONVENE \_\_\_\_\_

CLOSED SESSION N/A

RECONVENE \_\_\_\_\_

ADJOURN 9:33a.m.

BOARD MEMBER (Alternate)	PRESENT (TIME ARRIVED)	ABSENT (TIME LEFT)
EWIN (Chair) <input checked="" type="checkbox"/>	9:00a.m.	9:33a.m.
GLORIA <input checked="" type="checkbox"/> (Emerald) <input type="checkbox"/>	9:05a.m.	9:33a.m.
MATHIS <input checked="" type="checkbox"/>	9:00a.m.	9:33a.m.
OVROM <input checked="" type="checkbox"/> (Bragg) <input type="checkbox"/>	9:00a.m.	9:33a.m.
ROBERTS <input checked="" type="checkbox"/> (Cox) <input type="checkbox"/>	9:03a.m.	9:33a.m.
CUNNINGHAM <input type="checkbox"/> (McClellan) <input checked="" type="checkbox"/>	9:00a.m.	9:33a.m.
Transportation Committee Rep Slot (Mathis)		

SIGNED BY THE CLERK OF THE BOARD:

Julia Johnson (interim C.O.B.)

CONFIRMED BY THE GENERAL COUNSEL:

Karen Conde



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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# **GASB UPDATE**

# 2014

- 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

# 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

# **GASB STATEMENT**

**No. 65 -**

***Items Previously Reported as Assets and  
Liabilities***

# 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

# 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

# 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

# Highlights

## Inflows of Resources (Revenue)

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

# **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. 70 -**  
*Nonexchange Financial Guarantees*

# 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

# 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

# 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

# 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

# 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.

**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

# Highlights

- Note Disclosures
- Required Supplementary Information

# **GASB STATEMENT**

**No. 69 -**

*Government Combinations and Disposals  
of Operations*

# 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

# 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

# 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

# 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

# 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

# Disclosures - Government Acquisition

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

# **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)

# Highlights

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

# 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

# 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.



# 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.

# 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.

# 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.

# 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*.

# 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”

# 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

# SINGLE AUDIT REFORM

# 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

# 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

# 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

# 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

# High Risk Type B Program

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

# Coverage Rule

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

# 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



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## Agenda Item No. B1

### MEETING OF THE SAN DIEGO METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

June 12, 2014

#### SUBJECT:

INTERIM AUDIT (ERIN DUNN)

#### RECOMMENDATION:

That the Audit Oversight Committee receive a report on:

1. Interim audit work conducted by Pun & McGeedy
2. Related observations


#### Budget Impact

None at this time.

#### DISCUSSION:

During the month of April 2014, Pun & McGeedy conducted an interim audit and tested MTS's internal controls. Upon completion of the testing, they issued the attached interim exit memo. Management will discuss the observations noted in the report.

Representatives from Pun & McGeedy will be present for questions and discussion.



Paul C. Jablonski  
Chief Executive Officer

Key Staff Contact: Sharon Cooney, 619.557.4513, [Sharon.Cooney@sdmts.com](mailto:Sharon.Cooney@sdmts.com)

Attachment: A. Interim Exit Memo



**San Diego Metropolitan Transit System (MTS)**  
**For the Fiscal Year Ending June 30, 2014**  
**Interim Exit Memo**  
**April 18, 2014**

**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, 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
- Expenses and Cash Disbursements
- Payroll and Related Liabilities
- Inventory
- Capital Assets

In addition to updating our understanding of MTS' internal control systems, we also performed a surprise cash count on SDTI TVM revenue, performed fraud risk inquiries with management and staff, and reviewed and discussed the internal audit plan and issued internal audit reports with Toufic Tabshouri, 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. However the following observations were made:

**Observations:**

- **Expenses / Cash Disbursement:**
  - Several check Registers from October 2013 and February 2014 were not initialed by management indicating they were reviewed and approved. This was explained as the result of the transition from the former finance manger to the new controller and new procedures being established.
  - For 3 purchase orders out of 40 selected for testing the CFO signed / approved purchase orders over \$50,000, which according to MTS's policy requires CEO approval; however after discussion with Ernest DeGuzman he indicated that the CEO can designate anyone in his absence to sign for him. We noted that there was no support or proof that the CEO made such a designation. We recommend that on the documents being signed on behalf of the CEO a notation of the person signing on his behalf be made.

- **Management Response:** As of 4/21/14 MTS updated their procurement policy to include when a designee does sign on behalf of the CEO a notation of that will be made on the document.
  - For 10 purchase orders out of 40 selected for testing we noted that they were approved by a Buyer or a Procurement Specialist and not by a Supervisor / Manager as dictated in MTS's policy. 5 of which were "stock" purchase and 5 were approvals made when the Procurement Manager was unavailable. After discussion with Mike Fitz-Gerald and Ernest DeGuzman they said that it is MTS's policy that "stock" purchases can be made by a Buyer. We recommend that this policy be formally adopted and included in MTS's procurement of goods policy.
- **Management Response:** As of 4/21/14 MTS updated their procurement policy to include that only the CFO, General Counsel, the Director of Financial Planning and Analysis, or the Controller can signed for the Procurement Manager in his absence.
- **SDTC Farebox Revenue Testing:** 4 of 40 Daily Farebox reconciliation were missing review from reviewer. Per Revenue Admin (Israel Maldonado), The August 2013 files were missing when they looked for them. Based purely on speculation, he believes it is likely that his predecessor misplaced the August files during an office relocation that took place sometime during the fall of 2013.
- **Payroll / Pension Disbursement:** 1 of the 20 pension disbursements tested did not have a signed copy of the pension calculation in the personnel file. We did test 60 payroll disbursements and noted no finding observation and both payroll and pension payments are processed in the same manner.

#### **OPEN ITEMS:**

1. OPEB census testing selections. Brendan Shannon is in the process of uploading the documents to our portal this week.
2. Inventory observation dates: July 1, 2014

#### **REPORTS TO BE ISSUED:**

We will perform the following audits and agreed upon procedures enumerated below for the year ended June 30, 2014. 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



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## Agenda Item No. B2

### MEETING OF THE SAN DIEGO METROPOLITAN TRANSIT SYSTEM AUDIT OVERSIGHT COMMITTEE

June 12, 2014

#### SUBJECT:

REPORT OF GASB 67, GASB 68, AND GASB 71 (ERIN DUNN & GARY CAPORICCI  
OF PUN & MCGEADY)

#### 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:

Pun & McGeady will present detailed 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. 67 – Financial Reporting for Pension Plans - an amendment of GASB  
Statement No. 25
- b. No. 68 – Accounting and Financial Reporting for Pensions - an amendment of  
GASB Statement No. 27
- c. No. 71 – Pension Transition for Contributions Made Subsequent to the  
Measurement Date - an amendment of GASB Statement No. 68

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](mailto:Sharon.Cooney@sdmts.com)

