



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

Agenda

JOINT MEETING OF THE AUDIT OVERSIGHT COMMITTEE

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

July 9, 2009

Executive Conference Room
9:00 a.m.

ACTION RECOMMENDED

- | | | | |
|----|--|---|---------|
| A. | 1. | ROLL CALL | |
| | 2. | APPROVAL OF THE MINUTES - June 4, 2009 | Approve |
| B. | COMMITTEE DISCUSSION ITEMS | | |
| | 1. | <u>MTS: FY 09 Audit Report</u>
That the MTS Audit Oversight Committee receive a report on: (1) the exit interview for the interim phase of the FY 09 audit; and (2) the audit engagement letter for the FY 09 audit. | Receive |
| C. | COMMITTEE MEMBER COMMUNICATIONS AND OTHER BUSINESS | | |
| D. | PUBLIC COMMENTS | | |
| E. | NEXT MEETING DATE: October 1, 2009 | | |
| F. | ADJOURNMENT | | |

Please turn off cell phones and pagers
during the meeting

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

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

DRAFT

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

June 4, 2009

MTS
1255 Imperial Avenue, Suite 1000, San Diego

MINUTES

A. ROLL CALL

1. Chairman Ewin called the meeting to order at 9:03 a.m. A roll call sheet listing Audit Oversight Committee member attendance is attached.

He asked everyone to introduce themselves.

2. APPROVAL OF MINUTES

Mr. Roberts moved approval of the minutes of the March 19, 2009, Audit Oversight Committee meeting. Mr. Mathis seconded the motion, and the vote was 5 to 0 in favor.

B. AUDIT OVERSIGHT COMMITTEE DISCUSSION ITEMS

1. MTS: Update on Audit Status (ADM 110.12)

Ms. Linda Musengo, Finance Manager, reported that MTS's external auditors, Caporicci & Larson, have completed their evaluation of internal controls in major accounting and financial areas, especially as they pertain to grants management, financial reporting and budget, and cash management of ticket vending machines (TVM's). She stated that their preliminary report indicated that there were no significant findings, just one minor issue in the SDTI storeroom. She also reported that the engagement letter should be received shortly. She advised Committee members that the auditors will begin their year-end work on August 24. She also reported that the auditors commended staff for responding quickly to their requests, which allowed them to complete their work ahead of schedule. She advised Committee members that the exit conference with Caporicci & Larson would take place later in the day and invited any Committee members who wished to attend.

Action Taken

No action was taken on this item.

2. MTS: Proposed 2009/2010 Internal Audit Plan (ADM 110.12)

Mr. Mark Abbey, Internal Auditor, reviewed the factors that were used to determine which areas should be audited next year and briefly discussed each of these areas. He advised Committee members that this list has been reviewed by the CEO, Chief Financial Officer (CFO), and General Counsel. In response to a question from Mr. Ewin, he reviewed the types of audits that he conducts upon request.

Chairman Ewin felt that the audit list was optimistic given that Mr. Abbey would be conducting all of these audits by himself. Mr. Paul Jablonski, CEO, stated that the plan is also optimistic because Mr. Abbey's services will be required during the implementation of the Compass Card program. He added that Mr. Cliff Telfer, CFO, has been doing advance work on this project. Mr. Abbey stated that he has been discussing this matter with other agencies that have implemented similar programs and will be making a site visit to the Metropolitan Transit Authority in Los Angeles to discuss their implementation of Smart Card technology.

In response to a question from Mr. Mathis, Mr. Abbey reported that the Compass Card relationship with Vons is under contract with SANDAG, not MTS, and he will therefore not be auditing that element of the program. Staff advised the Committee that SANDAG does not have an internal auditor.

In response to a question from Mr. Ewin, Mr. Abbey stated that he will provide information on the size of internal audit functions within similar-sized transit properties.

Action Taken

No action was taken on this item.

C. COMMITTEE MEMBER COMMUNICATIONS AND OTHER BUSINESS

There were no Committee communications.

D. PUBLIC COMMENTS

There were no public comments.

E. NEXT MEETING DATE:

Mr. Jablonski reported that the June 18, 2009, Executive Committee meeting may be cancelled. He reported that the next Audit Oversight Committee meeting, originally scheduled for that same date, will be held on July 9 if the Executive Committee meeting is cancelled.

F. ADJOURNMENT

Chairman Ewin adjourned the meeting at 9:16 a.m.

Chairman

**AUDIT OVERSIGHT COMMITTEE
METROPOLITAN TRANSIT SYSTEM**

ROLL CALL

MEETING OF (DATE) 6/4/09

CALL TO ORDER (TIME) 9:03 a.m.

RECESS _____

RECONVENE _____

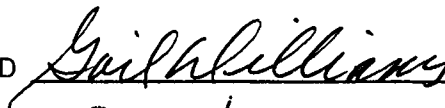
CLOSED SESSION _____

RECONVENE _____

ADJOURN 9:16 a.m.

BOARD MEMBER (Alternate)	PRESENT (TIME ARRIVED)	ABSENT (TIME LEFT)
EWIN (Chair) <input checked="" type="checkbox"/>		
LIGHTNER <input checked="" type="checkbox"/> (Young) <input type="checkbox"/>		
MATHIS <input checked="" type="checkbox"/>		
Rotated to Chula Vista		
RINDONE (VC) <input checked="" type="checkbox"/> (Young) (CPT) <input type="checkbox"/>	9:05 a.m. during AI B1	
ROBERTS <input checked="" type="checkbox"/> (Cox) <input type="checkbox"/>		
SELBY <input checked="" type="checkbox"/> (Ryan) <input type="checkbox"/>		

SIGNED BY OFFICE OF THE CLERK OF THE BOARD



CONFIRMED BY OFFICE OF THE GENERAL COUNSEL:





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

Agenda

Item No. B1

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

ADM 110.12

July 9, 2009

SUBJECT:

MTS: FY 09 AUDIT REPORT

RECOMMENDATION:

That the MTS Audit Oversight Committee receive a report on:

1. the exit interview (Attachment A) for the interim phase of the FY 09 audit; and
2. the audit engagement letter (Attachment B) for the FY 09 audit.

Budget Impact

None at this time.

DISCUSSION:

Exit Interview

Ken Pun from Caporicci & Larson will discuss the exit interview that was held on June 4, 2009. The attached letter (Attachment A) with management's response includes a brief overview of the remaining audit schedule.

Engagement Letter

Caporicci & Larson has submitted for signature its engagement letter for FY 09. (Attachment B is attached for committee review.)

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: Linda Musengo, 619.557.4531, linda.musengo@sdmts.com

JULY9-09.B1.FY 09 AUDIT REPORT.LMUSENGO.doc

Attachments: A. Interim Exit Conference
B. Letter from Caporicci & Larson

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

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



San Diego Metropolitan Transit System
Fiscal Year Ending June 30, 2009
Interim Exit Conference
May 29, 2009

AUDIT PROCEDURES

AUDIT
RISK
ASSESSMENT

➤ Internal Control Evaluation

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

- ☐ Review Internal Audit Function
- ☐ Fraud and Related Parties Checklists
- ☐ Review of Minutes of the Board of Directors

2009 FOCUS/HIGH PROFILE AREAS:

- ☐ Grant Management
- ☐ Financial Reporting
- ☐ Budget
- ☐ Cash Management (TVM machines)

**San Diego Metropolitan Transit System
 Fiscal Year Ending June 30, 2009
 Interim Exit Conference
 May 29, 2009**

OPEN ITEMS:

- ☐ Preparation of Confirmations
- ☐ Engagement Letter
- ☐ Year-end PBC list

CURRENT YEAR OBSERVATION

☐ **Inventory**

Observation: During our observation of the cycle count at SDTI, we noted that physical quantities of four (4) items out of twenty-nine (29) items counted did not match the amount recorded in the system. Per inquiry with the Storeroom Manager, quantities may be off for a variety of reasons such as (a) storekeepers may take out an item while dropping another one on the ground and not retrieve it due to immateriality and (b) items may be a credit in the system but items are physically not present in the storeroom due to timing differences.

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

Recommendation: We recommend Storeroom Managers should ensure that all employees follow the policies and procedures manual.

Management Response:

The store room manager will ensure that all employees follow the policies and procedures manual.

**San Diego Metropolitan Transit System
Fiscal Year Ending June 30, 2009
Interim Exit Conference
May 29, 2009**

CURRENT YEAR OBSERVATION, Continued

☐ Inventory, Continued

Management Response, Continued:

The total value of the adjustments (discrepancies) for the items in the cycle count was less than 1/10 of one percent of the dollar value of the items counted that day (\$25 difference on \$36,200 worth of items counted).

Item (a) in the observation refers to storekeepers occasionally losing small inexpensive items such as screws, washers, nuts, etc. and it is not always cost effective to pursue further investigation when the quantity discrepancy is small such as one item.

Item (b) in the observation can occur in the following situations. When an item leaves stock but is expected to be returned to stock, the item is issued and a pick ticket created. The pick ticket isn't acquitted so as not to charge the department in question and require a credit when the item is returned. An example would be shipping a part to a vendor as a sample while trying to obtain a quote. A copy of the pick ticket is put into the bin with the remaining parts and is suppose to be counted along with the parts that are still on the shelf. Sometimes the storekeeper who's performing the count misses the pick ticket and doesn't count it. This can create a discrepancy.

San Diego Metropolitan Transit System
Fiscal Year Ending June 30, 2009
Interim Exit Conference
May 29, 2009

PRIOR YEAR OBSERVATIONS

☐ Payroll and Related Liabilities

Observation: During the testing of payroll, it was noted that two (2) I-9 forms, seven (7) W-4 forms and one (1) employment application were missing from twenty (20) personnel files selected.

Status: In process. A memorandum was sent out to all employees to collect I-9 and W-4 forms. Human Resources created a checklist of documents necessary to be filed in employee files.

☐ Capital Asset

Observation: During the review of internal controls for capital assets, it was noted that two (2) of the fifteen (15) assets tested are not tagged.

Status: In process. MTS is in the process of tagging all capital assets.

**San Diego Metropolitan Transit System
Fiscal Year Ending June 30, 2009
Interim Exit Conference
May 29, 2009**

NEW PRONOUNCEMENTS AND ISSUES:

- ❑ **To be implemented in 2009**
 - GASB 49 – Accounting and Financial Reporting for Pollution remediation obligation
 - GASB 52 – Land and Other Real Estates Held as Investments by Endowments
 - GASB 55 – The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments
 - GASB 56 – Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards

- ❑ **To be implemented in 2010**
 - GASB 51 – Accounting and Financial Reporting for Intangible Assets
 - GASB 53 – Accounting and Financial Reporting for Derivative Instruments
 - GASB 54 – Fund Balance Reporting and Governmental Fund Type Definitions

**San Diego Metropolitan Transit System
 Fiscal Year Ending June 30, 2009
 Interim Exit Conference
 May 29, 2009**

SCHEDULE

Audit Committee meeting: July 9, 2009
 Year-end: August 24, 2009 to September 18, 2009

REPORTS TO BE ISSUED

**DEADLINE /
 DUE DATES**

- | | |
|--|----------|
| <input type="checkbox"/> Audited Financial Statements – MTS prepares | 12/31/09 |
| <input type="checkbox"/> SAS 112 Letter – if applicable | 12/31/09 |
| <input type="checkbox"/> Single Audit | 12/31/09 |
| <input type="checkbox"/> San Diego Transit Corp Retirement Plan | 12/31/09 |
| <input type="checkbox"/> Agreed Upon Procedures | |
| ♦ NTD for MTS, SDTC, SDTI | 12/31/09 |
| ♦ TDA for MTS, SDTC, SDTI | 12/31/09 |
| ♦ Indirect Costs | 12/31/09 |
| ♦ TransNet | 12/31/09 |
| <input type="checkbox"/> SAS 114 Letter | |



May 11, 2009

Mr. Cliff Telfer
 Chief Financial Officer
 San Diego Metropolitan Transit System
 1255 Imperial Avenue, Suite 1000
 San Diego, CA 92101-7490

Dear Mr. Telfer:

We are pleased to confirm our understanding of the services we are to provide for San Diego Metropolitan Transit System (MTS) for the year ending June 30, 2009.

We will audit the financial statements of MTS as of June 30, 2009. In addition, the audit reports we submit to you will include the Schedule of Expenditures of Federal Awards that will be subjected to the auditing procedures applied in our audit of the financial statements.

Audit Objectives

The objective of our audit is the expression of an opinion as to whether your 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 additional information referred to in the second paragraph when considered in relation to the financial statements taken as a whole. The objective also includes reporting on:

- Internal control related to the financial statements and compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements in accordance with *Government Auditing Standards*.
- Internal control related to the 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, "Audit of States, Local Governments, and Non-Profit Organizations."

The reports on internal control and compliance will each include a statement that the report is intended for the information and use of management, specific legislative or regulatory bodies, federal awarding agencies, and if applicable, pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Toll Free Ph: (877) 862-2200

Toll Free Fax: (866) 436-0927

Oakland
 180 Grand Ave., Suite 1365
 Oakland, California 94612

Orange County
 9 Corporate Park, Suite 100
 Irvine, California 92606

Sacramento
 777 Campus Commons Rd., Suite 200
 Sacramento, California 95825

San Diego
 4858 Mercury, Suite 106
 San Diego, California 92111

Our audit will be conducted in accordance with generally accepted auditing standards in the United States; 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 an opinion and to render the required reports. If our opinion on the financial statements or the Single Audit compliance opinion is other than unqualified, we will discuss the reasons with management in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed an opinion, we may decline to express an opinion or to issue a report as a result of this engagement.

Management Responsibilities

Management is responsible for establishing and maintaining internal control and for compliance with the provisions of contracts, agreements, and grants. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of the controls. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that federal award programs are managed in compliance with applicable laws and regulations and the provisions of contracts and grant agreements.

Management is responsible for making all financial records and related information available to us and for the accuracy and completeness of that information. We will advise management about appropriate accounting principles and their application and will assist in the preparation of MTS's financial statements, including the schedule of expenditures of federal awards, but the responsibility for the financial statements remains with management. This responsibility includes the establishment and maintenance of adequate records and effective internal controls over financial reporting and compliance, the selection and application of accounting principles, and the safeguarding of assets. Management is responsible for adjusting the financial statements to correct material misstatements and for confirming to us in the management 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. 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.

With regard to the electronic dissemination of audited financial statements, including financial statements published electronically on MTS's Internet website, management understands that electronic sites are a means to distribute information and, therefore, we are not required to read the information contained in these sites or to consider the consistency of other information in the electronic site with the original document.

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. We will plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether from errors, fraudulent financial reporting, misappropriation of assets, or violations of laws or governmental regulations that are attributable to MTS or to acts by management or employees acting on behalf of MTS. As required by the Single Audit Act Amendments of 1996 and OMB Circular A-133, our audit will include tests of transactions related to major federal award programs for compliance with applicable laws and regulations and the provisions of contracts and agreements. Because an audit is designed to provide reasonable, but not absolute, assurance 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. 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 to major programs. However, we will inform you of any material errors and any fraudulent financial reporting or misappropriation of assets that come to our attention. We will also inform you of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential. 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, tests of the physical existence of inventories, and direct confirmation of receivables and certain other assets and liabilities by correspondence with selected funding sources, creditors, and financial institutions. We will also request written representations from MTS's attorneys as part of the engagement, and they may bill MTS for responding to this inquiry. At the conclusion of our audit, we will require certain written representations from management about the financial statements and related matters.

Audit Procedures – Internal Control

In planning and performing our audit, we will consider the internal control sufficient to plan the audit in order to determine the nature, timing, and extent of our auditing procedures for the purpose of expressing our opinions on MTS's financial statements and on its compliance with requirements applicable to major programs.

We will obtain an understanding of the design of the relevant controls and whether they have been placed in operation, and we will assess control risk. 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. Tests of controls relative to the financial statements are required only if control risk is assessed below the maximum level. Our tests, if

performed, will be less in scope than would be necessary to render an opinion on internal control and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to *Government Auditing Standards*.

As required by OMB Circular A-133, we will perform tests of controls 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, we will inform the governing body of any matters involving internal control and its operation that we consider to be significant deficiencies or material weaknesses under standards established by the American Institute of Certified Public Accountants. Any matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. We will also inform management of any control deficiencies or other matters involving internal control, if any, as required by OMB Circular A-133.

Audit Procedures – Compliance

Our audit will be conducted in accordance with the standards referred to in the section titled Audit Objectives. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of MTS's compliance with applicable laws and regulations and the provisions of 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 agreements applicable to major programs. Our procedures will consist of the 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 MTS's major programs. The purpose of these procedures will be to express an opinion on MTS's compliance with requirements applicable to major programs in our report on compliance issued pursuant to OMB Circular A-133.

Audit Administration, Fees, and Other

We understand that your employees will prepare all cash, accounts receivable, and other confirmations we request and will locate any documents selected by us for testing.

At the conclusion of the engagement, we will complete the appropriate sections of and sign the Data Collection Form that summarizes our audit findings. We will provide copies of our reports to MTS; however, 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, auditor's reports, and corrective action plan) along with the Data Collection Form to the designated federal clearinghouse and, if appropriate, 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 auditor's 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 audit. At the conclusion of the engagement, we will provide information to management as to where the reporting packages should be submitted and the number to submit.

The workpapers for this engagement are the property of Caporicci & Larson and constitute confidential information. However, we may be requested to make certain workpapers available to a cognizant or grantor agency pursuant to authority given to it by law or regulation. If requested, access to such workpapers will be provided under the supervision of Caporicci & Larson personnel. Furthermore, upon request, we may provide photocopies of selected workpapers to the cognizant or grantor agency. The cognizant or grantor agencies may intend, or decide, to distribute the photocopies or information contained therein to others, including other governmental agencies.

The workpapers for this engagement will be retained for a minimum of seven years after the date the auditor's report is issued or for any additional period requested by the cognizant agencies, oversight agencies for audit, or pass-through entities. 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 workpapers.

Our fee for these services will be \$295,000. The fee is based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered during the audit. If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs.

Should MTS records not be in an auditable condition, we will notify you in writing and include suggested alternative procedures. If MTS is unable to provide records necessary to perform the audit or refuses to respond to auditors' request, we will communicate to the Audit Oversight Committee and issue a report to that effect and bill you for the time incurred to date.

Any claim or controversy arising out of the rendering of professional accounting services by Caporicci & Larson, under the terms of this agreement shall be settled by arbitration in accordance with the Rules of Practice and Procedure of Judicial Arbitration and Mediation Services, Inc. ("JAMS"). Any claim for nonpayment of amount due to Caporicci & Larson for services rendered in accordance with this agreement, however, shall be determined by a court

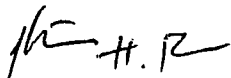
Mr. Cliff Telfer
San Diego Metropolitan Transit System
Page 6 of 6

of law, as opposed to arbitration. The agreed place of venue for any proceeding, arbitration or court, shall be San Diego, California.

We will submit our bill for services on a progress basis, and billings are due upon submission. Interest is charged on balances not paid within 30 days at the rate of 1.5 percent per month. We reserve the right to suspend work and withdraw from the engagement if fees are not paid in a timely manner. It is our policy to require the fees be paid to date prior to issuing our report. If the account is not paid in full when due, you agree to pay all expenses of collection, including legal fees.

We appreciate the opportunity to be of service to you and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us.

Sincerely,



Kenneth Pun
Partner

RESPONSE:

This letter correctly sets forth the understanding of the San Diego Metropolitan Transit System.

Officer Signature: _____

Name: _____

Title: _____

Date: _____