



Date: March 26, 2007
 Committee Meeting Date: April 11, 2007
 Board Meeting Date: N/A
 ACTION DISCUSSION INFO X

BOARD MEMORANDUM

TO: 2000 Measure A Watchdog Committee (Citizens Advisory Committee)
 Santa Clara Valley Transportation Authority
 Board of Directors

THROUGH: Michael T. Burns *Michael T. Burns*
 General Manager

FROM: Susan Stark *S. M. Stark*
 Controller

SUBJECT: VTA June 30, 2006 Audit Management Letter

INFORMATIONAL ONLY
BACKGROUND

At the conclusion of an annual audit, auditors prepare a brief report to the Board regarding managerial items related to internal control and other operational items. This report is often referred to as the Management Letter. The Management Letter is written considering the agency as a whole and not meant to be specific to one program or project such as Measure A.

A management letter is dated the ending date of audit field work to indicate the last date of any possible observations. It is subsequently written and sent to the Board of Directors. In this case, the last day of field work was November 16, 2006 while the letter itself was not written until February 2007.

The attached Management Letter is submitted to the Committee as requested.

DISCUSSION

In planning and performing the audit of VTA's financial statements, Vavrinek, Trine, Day & Company, LLP tested our internal control system and procedures. Based on their tests, they issued a Memorandum of Internal Controls or Management Letter addressed to the Board. This

type of memo typically includes either an audit finding or an observation and a recommendation to address the issue. As indicated in the attached FY2006 Management Letter (Attachment A), there were no audit findings issued to VTA.

- An audit finding denotes a serious violation of internal control procedures, such as a Reportable Condition or a Material Weakness, which must be addressed by the management.
 - Reportable Conditions are matters coming to the auditors attention, that in their judgment, represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements.
 - A material weakness is a reportable condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

There were five observations brought to our attention. An observation reflects proposed but not required improvements to existing internal controls or procedures. Nevertheless, VTA staff concurs with those observations and has already taken steps to implement them during FY2007.

As the 2000 Measure A Watchdog Committee, the pertinent items in the attached Management Letter include:

- Indirect Cost Allocation Plan (ICAP)
Management Letter, Page 4
 - This would be of interest to the Committee as the majority of Measure A funds are spent on capital projects. Implementation of the most recent Federal Transit Administration (FTA) approved ICAP means increased costs to capital projects.

- ICAP Background

In order for a public agency to get reimbursed for administrative and overhead costs associated with a capital project, they must have an Indirect Cost Allocation Plan that has been approved by their cognizant agency. In VTA's case the cognizant agency is the FTA. The FTA generally reviews the ICAP on an annual basis.

VTA's approved rate for capital projects increased effective with Fiscal Year 2006 from 3% to 8%. This rate was not immediately implemented due to the necessary budget evaluations required to accommodate the additional cost.

- Journal Entry Processing
Management Letter, Page 3
 - This would be of interest to the Committee as internal control measures are meant to ensure appropriate and accurate charges get posted to each program. In this observation the Committee would look for management's response to include some measure taken to tighten controls.

If you have any questions or desire further information on any of the Management Letter items, please contact Susan Stark (408-321-5595 or susan.stark@vta.org). Staff will also be available to respond at the April 11, 2007 Committee meeting.

Attachment: 1
Prepared by: Susan M. Stark, Controller



Vavrinek, Trine, Day & Co., LLP
Certified Public Accountants

VALUE THE DIFFERENCE

November 16, 2006

The Board of Directors
Santa Clara Valley Transportation Authority
San Jose, California

We have audited the basic financial statements of the Santa Clara Valley Transportation Authority (VTA) as of June 30, 2006, and have issued our report thereon dated November 16, 2006. In planning and performing our audit of the financial statements of the VTA, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

AUTOMATED PASSENGER COUNT REPORTING

OBSERVATION

During our procedures over the National Transit Database (NTD) reporting forms, it was noted that VTA utilizes an automated passenger count (APC) system from a third party vendor in order to capture the passenger miles and ridership statistics. In addition to the APC system, VTA has internally developed database applications for the motorbus mode which downloads raw data from the APC system, correlates the data, computes and summarizes results. It was noted that the development of the database application and knowledge of the programming resides with one individual. The development standards and programming of the application have not been formally documented. Accordingly, there is an increased risk of business discontinuity in the NTD data gathering procedures for the motorbus mode of transportation.

RECOMMENDATION

It was noted that VTA has developed a user guide to provide detailed instructions to the user in the routine processing of NTD statistics. However, we recommend that VTA formally document the development standards and programming used in the internal motorbus database application. Further, we recommend that other employees be cross-trained in the programming of the database application to reduce the risk of business discontinuity.

MANAGEMENT'S RESPONSE

VTA is in the process of elaborating on these steps to further explain their function and programming. By expanding on the documentation and adding technical notes, this will remediate the observation. In addition, VTA is in the process of developing and examining other data extraction methods for ridership that use newer and simpler methodologies. VTA Service & Operations Planning is also exploring the possibility of replacing the present bus APC program with the INIT APC program that has been proven very efficient for light rail ridership.

GASB STATEMENTS NO. 43 AND 45

OBSERVATION

Governmental Accounting Standards Board (GASB) Statements 43 and 45 are effective for VTA for the fiscal years ending June 30, 2007 and June 30, 2008, respectively. These standards provide reporting requirements, standards for measurement, display of employers' other post-employment benefit (OPEB) liabilities and required supplementary information (RSI). The requirements of GASB 43 are applicable to OPEB trust funds included in the financial report of employers and the stand-alone reports of OPEB plans. GASB 45 addresses how the employer accounts for and reports the costs and obligations related to the OPEB.

RECOMMENDATION

It was noted that VTA has commenced the implementation of these standards by retaining an actuary to assist in the development of OPEB cost models. We recommend that the VTA continue these efforts and consider developing policies for other pertinent aspects of the standards. Such items may include, but not be limited to, the following:

- Determining whether the OPEB trust currently reported meets the "trust" criteria of GASB 43 and
- Funding of the annual required contributions, based on the OPEB actuarial study

MANAGEMENT'S RESPONSE

Staff concurs with the observation. As included in the auditor's observation, both GASB Statements 43 & 45 were not due to be implemented until FY2007 & FY2008, respectively. VTA is in the process of implementing the provisions of both GASB Statements. Fiscal Resource staff is working with General Counsel's Office in determining if the current trust arrangements of the VTA's Medical Trust Funds meet the provisions of GASB 43. For GASB 45, VTA has already initiated actuarial valuations studies to determine the OPEB costs and will determine the course of action for reporting those costs in the FY2008 CAFR.

PAYROLL CHECKING ACCOUNT -- OUTSTANDING CHECKS

OBSERVATION

During our audit procedures for cash and investments, it was noted that there were checks outstanding from fiscal years 2000-01 through 2004-05. While the aggregate amount of these outstanding checks was immaterial, stale dated payments could indicate a problem with the payment or error in the reconciliation process.

RECOMMENDATION

We recommend that the stale dated payments be investigated on a periodic basis and adjusted to cash, if appropriate.

MANAGEMENT'S RESPONSE

Disbursement Department staff is in the process of reviewing all outstanding checks to determine if they need to be re-issued or cancelled. In addition, staff will ensure that VTA follows the rules and regulations of the State related to stale-dated or outstanding checks. Staff will resolve all of the outstanding check backlog during FY2007.

JOURNAL ENTRY PROCESSING

OBSERVATION

During our audit procedures for general journal processing, we noted that seven of the 40 journals that we tested did not evidence approval prior to posting, consistent with VTA policies and procedures.

RECOMMENDATION

We recommend that VTA ensure that journal entry processing procedures and internal controls are consistently followed.

MANAGEMENT'S RESPONSE

Staff concurs with the observation by auditors and recognizes the need to be more diligent in complying with its internal control policies related to general journal processing and approval. Department managers have already discussed this issue with staff and provided them written guidelines directing them to ensure that general journal processing procedures are strictly followed. In addition, all Section Supervisors have been directed to perform a quarterly review of each others respective area to ensure that these policies are followed. They will also be required to submit a report to the Controller summarizing the results of their quarterly review.

INDIRECT COST ALLOCATION PLAN

OBSERVATION

During our testing of federal programs, it was noted that VTA allocated costs to capital projects using an indirect cost rate of 3%. VTA prepares an annual indirect cost allocation plan to estimate the indirect cost rate for major functions of the organization. It was noted that the calculated cost rate for fiscal year 2005-06 was 8.03% or approximately 5% more than the amount actually allocated.

RECOMMENDATION

We recommend that VTA consider reviewing the results of its indirect cost allocation plan in relation to the rates actually charged. Federal and state grants allow for the allocation of indirect costs based on prescribed guidelines and therefore, VTA may strengthen its cost recovery in relation to these activities.

MANAGEMENT'S RESPONSE

Staff concurs with the observation and recommendation by the auditors. The General Manager authorized and staff implemented the above referenced indirect cost rate effective November 1, 2006.

Our audit procedures are designed primarily to enable us to form an opinion on the basic financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the Santa Clara Valley Transportation Authority gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the Board of Directors, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Vavrinek Trine Day & Co. LLP

Vavrinek, Trine, Day & Co., LLP
Palo Alto, California