

AUDIT COMMITTEE

Thursday, June 3, 2010
4:00 PM

Conference Room 157
County Government Center
70 West Hedding Street
San Jose, CA

AGENDA

CALL TO ORDER

- 1. ROLL CALL**
- 2. PUBLIC PRESENTATIONS:**

This portion of the agenda is reserved for persons desiring to address the Committee on any matter not on the agenda. Speakers are **limited to 2 minutes**. The law does not permit Committee action or extended discussion on any item not on the agenda except under special circumstances. If Committee action is requested, the matter can be placed on a subsequent agenda. All statements that require a response will be referred to staff for reply in writing.

- 3. ORDERS OF THE DAY**

CONSENT AGENDA

4. Approve the Minutes of March 4, 2010.

REGULAR AGENDA

5. ACTION ITEM - Authorize the General Manager to execute one or more task orders with Deloitte & Touche LLP, to conduct the Fiscal Year 2011 internal audit work plan, in an amount not to exceed \$160,000, for a new total contract value of \$420,000.
6. INFORMATION ITEM - Receive a Report on the Investment Controls Internal Audit.

OTHER ITEMS

7. Items of Concern and Referral to Administration.
8. Review Committee Work Plan. (Burns)
9. Committee Staff Report. (Burns)
10. Chairperson's Report. (Gage)

11. Determine Consent Agenda for the August 5, 2010 Board Meeting.
12. ANNOUNCEMENTS
13. ADJOURN

NOTE COMMITTEE MEMBERS: In order to establish a quorum for this meeting, members are asked to call the Board Secretary's Office at (408) 321-5680 or E-mail: bd.sec.polling@vta.org before 5:00 p.m. on the day prior to the meeting. Thank you for your cooperation.

In compliance with the Americans with Disabilities Act (ADA), those requiring accommodations or accessible media for this meeting should notify the Board Secretary's Office 48 hours prior to the meeting at (408) 321-5680 or e-mail: board.secretary@vta.org, TDD (408) 321-2330. VTA's Homepage is located on the Web at: <http://www.vta.org>.

Disclosure of Campaign Contributions to Board Members (Government Code Section 84308) In accordance with Government Code Section 84308, no VTA Board Member shall accept, solicit, or direct a contribution of more than \$250 from any party, or his or her agent, or from any participant, or his or her agent, while a proceeding involving a license, permit, or other entitlement for use is pending before the agency. Any Board Member who has received a contribution within the preceding 12 months in an amount of more than \$250 from a party or from any agent or participant shall disclose that fact on the record of the proceeding and shall not make, participate in making, or in any way attempt to use his or her official position to influence the decision. A party to a proceeding before VTA shall disclose on the record of the proceeding any contribution in an amount of more than \$250 made within the preceding 12 months by the party, or his or her agent, to any Board Member. No party, or his or her agent, shall make a contribution of more than \$250 to any Board Member during the proceeding and for three months following the date a final decision is rendered by the agency in the proceeding. The foregoing statements are limited in their entirety by the provisions of Section 84308 and parties are urged to consult with their own legal counsel regarding the requirements of the law.

All reports for items on the open meeting agenda are available for review in the Board Secretary's Office, 3331 North First Street, San Jose, California, (408) 321-5680, the Monday, Tuesday, and Wednesday prior to the meeting. This information is available on VTA's website at <http://www.vta.org> and also at the meeting.

**NOTE: THE BOARD OF DIRECTORS MAY ACCEPT, REJECT OR MODIFY
ANY ACTION RECOMMENDED ON THIS AGENDA.**



Audit Committee

Thursday, March 4, 2010

MINUTES

CALL TO ORDER

The Regular Meeting of the Audit Committee was called to order at 4:08 p.m. by Chairperson Gage in Room 157, County Government Center, 70 West Hedding Street, San Jose, California.

1. ROLL CALL

Attendee Name	Title	Status
Don Gage	Chairperson	Present
Rose Herrera	Vice Chairperson	Present
Chuck Page	Member	Present
Nancy Pyle	Member	Absent

A quorum was present.

2. PUBLIC PRESENTATIONS

There were no Public Presentations.

3. ORDERS OF THE DAY

Michael T. Burns, Staff Liaison and General Manager, provided background information on the formation of the VTA Audit Committee.

Mr. Burns reported in March 2007, the Organizational Financial Assessment recommended the formation of an Audit Committee of the VTA Board of Directors. The Assessment recommended that an Independent Auditor General assist the Board of Directors in fulfilling its fiduciary responsibilities by overseeing risks and controls, financial reporting and integrity, and program activities.

In May 2008, the Board of Directors formally amended VTA's Administrative Code to add the Audit Committee as one of its Standing Committees. The Committee was charged to review and recommend to the Board of Directors policy decisions required to fulfill the Board of Directors' oversight responsibilities for: 1) integrity of VTA financial statements; 2) compliance with legal and regulatory requirements; and 3) ensure effective system of internal management and financial controls.

Mr. Burns noted the Audit Committee meets quarterly and the Chairperson serves a two-year term.

In December 2008, the Audit Committee recommended that VTA contract for the Auditor General services. VTA conducted a competitive bid process and selected Deloitte & Touche, LLP, to provide services for a two-year period with three one-year options.

Mr. Burns noted that Pat Hagan of Deloitte & Touche was appointed to serve as the Auditor General. He has since retired and has been replaced by Mr. Greg Thomas, a Principal in the firm's Enterprise Risk Services Practice.

In May 2009, the Audit Committee reviewed and recommended that Deloitte & Touche conduct the Fiscal Year 2010 Internal Audit Work Plan, which was based on a risk assessment performed by the Auditor General. One internal audit has been completed and was presented to the Audit Committee and Board of Directors. The second internal audit will be presented to the Committee today under Agenda Item #11. SVRT Soft Cost Internal Audit.

The following persons introduced themselves: 1) Farah Faruqui, Partner; and Greg Thomas, Auditor General, Deloitte & Touche, LLP; and 2) Leonard Danna, Partner, Vavrinek, Trine, Day and Co., LLP.

The Agenda was taken out of order.

REGULAR AGENDA

5. Elect Standing Committee Vice Chairperson

Chairperson Gage opened the nominations from the floor for the position of Audit Committee Vice Chairperson for 2010.

Member Page nominated Member Herrera to serve as the Vice Chairperson for 2010.

M/S/C (Page/Gage) to close the nominations and elect Member Herrera as Audit Committee Vice Chairperson for 2010.

CONSENT AGENDA

4. Minutes of October 1, 2009

M/S/C (Herrera/Page) to approve the Minutes of October 1, 2009.

NOTE: M/S/C MEANS MOTION SECONDED AND CARRIED AND, UNLESS OTHERWISE INDICATED, THE MOTION PASSED UNANIMOUSLY.

REGULAR AGENDA (continued)

6. 2010 Audit Committee Meeting Schedule

Chairperson Gage reported the Audit Committee meets quarterly at 4:00 p.m., with the exception of the December 9, 2010 Committee meeting, which meets immediately following the VTA Board of Directors meeting scheduled at 9:00 a.m.

M/S/C (Herrera/Page) to approve the 2010 Audit Committee Meeting Schedule.

Agenda Items #7 and #8 were heard together.

Agenda Items #7 to #8

7. Fiscal Year 2009 Comprehensive Annual Financial Report for the Santa Clara Valley Transportation Authority, and the Santa Clara Valley Transportation Authority Amalgamated Transit Union Pension Plan Report

8. Audited Santa Clara Valley Transportation Authority Retirees' Other Post Employment Benefits (OPEB) Trust Financial Report for Fiscal Year 2009

Joseph T. Smith, Chief Financial Officer, reported VTA is required to have its financial statements audited by a certified public accounting firm pursuant to state law and VTA Administrative Code. An audit of VTA finances for fiscal year ended June 30, 2009 (FY 2009), was conducted by Vavrinek, Trine, Day & Company, LLP (VTD). The audited financial statements are required to be submitted to the State Controller, Metropolitan Transportation Commission (MTC), various Federal and State agencies, as well as other parties, such as bondholders.

Vice Chairperson Herrera expressed concern regarding the untimely receipt of the reports and requested that information be provided in a timely manner.

Leonard Danna, VTD, provided an overview of the audited Fiscal Year 2009 Comprehensive Annual Financial Report (CAFR) for VTA, highlighting: 1) Audit Results, noting VTD rendered an unqualified opinion on VTA's financial statements; 2) Auditor's Management Letter; and 3) Audited Financial Statements.

Mr. Danna also provided an overview of the audited VTA Amalgamated Transit Union Pension Plan Report for Fiscal Year 2009 and VTA Retiree's Other Post Employment Benefits (OPEB) Trust Financial Report for Fiscal Year 2009, highlighting: 1) Audit Results; and 2) Financial Highlights.

Upon query of Vice Chairperson Herrera, Mr. Smith reported on VTA's contributions to its employees' retirement funds.

M/S/C (Page/Herrera) to approve Agenda Items #7 through #8 as follows:

7. **M/S/C (Page/Herrera)** to approve submitting a recommendation to the Board of Directors to review and receive the audited Comprehensive Annual Financial Report for the Santa Clara Valley Transportation Authority, and the Santa Clara Valley Transportation Authority Amalgamated Transit Union Pension Plan Report for Fiscal Year 2009.
8. **M/S/C (Page/Herrera)** to approve submitting a recommendation to the Board of Directors to review and receive the Audited Financial Report for Fiscal Year 2009 of the Santa Clara Valley Transportation Authority Retirees' Other Post Employment Benefits Trust (Trust).

9. **Financial Audit Services Contract**

Joseph T. Smith, Chief Financial Officer, reported VTA's contract with Vavrinek, Trine, Day and Co., LLP is for a five-year term and expires at the end of Fiscal Year (FY) 2010. VTA will be issuing a Request for Proposal for financial audit services for FY 2011 and will bring forward a recommendation to award a contract in December 2010.

Michael T. Burns, Staff Liaison and General Manager, noted the Board of Directors could defer the award of the contract to the Audit Committee.

On order of Chairperson Gage and there being no objection, the Committee received a report on the Current Financial Audit Service Contract.

10. **Internal Audit Work Plan**

Greg Thomas, Auditor General, Deloitte & Touche, provided background information on his experience, noting he is the Enterprise Risk Services Leader for the State of California.

Mr. Thomas referenced the presentation entitled, "Review Status of Internal Audit Work Plan," and provided an overview, highlighting: 1) The Role of Internal Audit at VTA; 2) Overview of Internal Audit Process; 3) Background and Historical Timeline; 4) Risk Assessment Methodology; 5) Risk Assessment Results (from March 2009); 6) Revised Audit Plan FY 2010 and FY 2011, noting the FY 2011 Internal Audit Work Plan will be updated and presented at the June 3, 2010 Audit Committee meeting; 7) Revised Timeline of Internal Audit Activities; and 8) Security Guard Qualification and Training – Remediation, noting VTA Management completed remediation plans and the Auditor General has confirmed management remediation plans were completed and has considered the audit closed.

Vice Chairperson Herrera queried if cost savings was one of the goals associated with the audit. Mr. Thomas indicated one of the goals is to look for operational efficiencies. Farah Faruqui, Partner, Deloitte & Touche, noted some of their projects are compliance focused and some are operational efficiencies focused.

Member Page queried about the timeframe an internal audit is completed. Ms. Faruqui indicated the size of the project is dependent upon the scope to be covered, noting the

Silicon Valley Rapid Transit (SVRT) Soft Cost Internal Audit was one of the largest projects of the year. Deloitte & Touche works with VTA management to set the appropriate scope and makes sure the risks are addressed.

Michael T. Burns, Staff Liaison and General Manager, noted the contracts are task order contracts, so each audit is an individual task order.

On order of Chairperson Gage and there being no objection, the Committee reviewed the status of the Internal Audit Work Plan.

11. SVRT Soft Cost Internal Audit

Denise Martini, Director, Deloitte & Touche, provided background information on her experience.

Ms. Martini referenced the presentation entitled, "SVRT Program Soft Costs Internal Audit," and provided an overview, highlighting: 1) Audit Objectives & Scope; 2) Internal audit team's observations (a. SVRT Soft Cost Trends; b. SVRT Root Cause; and c. SVRT Policies and Procedures); 3) Risk rating associated with each observation; 4) Recommendation for addressing each observation; and 5) VTA management's response to each observation.

Upon query of Chairperson Gage, Michael T. Burns, General Manager, reported that VTA staff would be developing policies and procedures to address the issues identified by the Internal Auditor.

Ms. Martini commented all of the recommendations were well received by VTA management and that many of the Internal Auditor's recommendations were already on the way to being implemented.

Ms. Martini also reported on the following observations, noting the recommendation for addressing each observation: 1) SVRT Ongoing Project Risks: a. Third Party Entities; b. Design Changes, and c. BART.

Upon query of Chairperson Gage, Carolyn Gonot, Chief SVRT Officer, reported on the value engineering efforts that have been undertaken. She also reported on the steps taken and that will be taken to address the Internal Auditor's observations and recommendations.

On order of Chairperson Gage and there being no objection, the Committee received a report on the Silicon Valley Rapid Transit (SVRT) Soft Cost Internal Audit.

OTHER ITEMS

12. Items of Concern and Referral to Administration

There were no Items of Concern and Referral to Administration.

13. **Committee Work Plan**

On order of Chairperson Gage and there being no objection, the Committee reviewed and accepted the Committee Work Plan.

14. **Committee Staff Report**

Michael T. Burns, Staff Liaison and General Manager, reported the following: 1) In July 2008, the California Bureau of State Audits released its report on VTA and VTA developed an action plan to address each of the findings/recommendations; and 2) In February 2010, the California Bureau of State Audits issued a special report confirming that VTA had adequately addressed their findings and recommendations.

On order of Chairperson Gage and there being no objection, the Committee Staff Report was received.

15. **Chairperson's Report**

There was no Chairperson's Report.

16. **Determine Consent Agenda for the April 1, 2010 Board Meeting**

CONSENT: **Agenda Item #7.** Review and receive the audited Comprehensive Annual Financial Report for the Santa Clara Valley Transportation Authority, and the Santa Clara Valley Transportation Authority Amalgamated Transit Union Pension Plan Report for Fiscal Year 2009; **Agenda Item #8.** Review and receive the Audited Financial Report for Fiscal Year 2009 of the Santa Clara Valley Transportation Authority Retirees' Other Post Employment Benefits Trust (Trust); and **Agenda Item #11.** Receive a report on the Silicon Valley Rapid Transit (SVRT) Soft Cost Internal Audit.

REGULAR: None

17. **Announcements**

There were no Announcements.

18. **Adjournment**

On order of Chairperson Gage and there being no objection, the meeting was adjourned at 5:16 p.m.

Respectfully submitted,

Tracene Y. Crenshaw, Board Assistant
VTA Office of the Board Secretary



Date: May 24, 2010
 Current Meeting: June 3, 2010
 Board Meeting: August 5, 2010

BOARD MEMORANDUM

TO: Santa Clara Valley Transportation Authority
 Audit Committee

THROUGH: General Manager, Michael T. Burns

FROM: Auditor General, Greg Thomas

SUBJECT: Review and Approve FY2011 Internal Audit Plan

Policy-Related Action: No

Government Code Section 84308 Applies: Yes

ACTION ITEM

RECOMMENDATION:

Authorize the General Manager to execute one or more task orders with Deloitte & Touche LLP, to conduct the Fiscal Year 2011 internal audit work plan, in an amount not to exceed \$160,000, for a new total contract value of \$420,000.

BACKGROUND:

In January 2009, the VTA Board of Directors authorized the General Manager to execute a task order contract with Deloitte & Touche LLP, to provide Auditor General Services. Under the initial task order (\$35,000), Deloitte & Touche LLP was charged with executing the first two tasks within the contracted scope-of-services: (1) develop and recommend goals and objectives for the internal audit program; and (2) develop and recommend an annual internal audit plan. The VTA Board approved the goals and objectives of the internal audit program on April 2, 2009.

To develop the internal audit plan, Deloitte & Touche LLP conducted a risk assessment of potential financial and business risks. They presented a summary of the risk assessment methodology and results to the Audit Committee in March 2009. The Audit Committee concurred with the risk prioritization and internal audit focus areas.

In May 2009, the Audit Committee reviewed a two-year plan and approved the FY10 internal audit work plan, which included five audit projects and Auditor General support services (task order six, value of \$225,000). Three out of the five audit projects have been completed and two were deferred and are now scheduled to be completed by November 2010.

DISCUSSION:

Based on direction from the Audit Committee, and in collaboration with the General Manager and VTA staff, Deloitte & Touche LLP has defined two new audit projects for FY11, as follows:

- **SVRT contract compliance**
Conduct an assessment of the contract between Hatch-Mott McDonald/Bechtel and VTA; evaluate how the contracts are organized and if there are clear deliverables and milestones enforced
- **Investment control design assessment**
Evaluate the existing investment controls by performing a design assessment on the adequacy and appropriateness of management's key controls

Both of these audits build on previous audits conducted as part of the FY10 work plan, and SVRT contract compliance was identified as an audit opportunity during interviews with VTA management to update the original risk assessment. In addition, the FY11 work plan includes a task order to follow up on VTA management's efforts to address the findings and implement the recommendations contained in the FY10 and FY11 audits, as they are completed. It is the Auditor General's responsibility to determine the adequacy, effectiveness, and timeliness of actions taken by VTA management on reported observations and recommendations. Finally, the FY11 work plan provides for continued Auditor General services, including quarterly status reports and attendance at Audit Committee meetings, periodic meetings with VTA management, and overall engagement and project management activities.

The FY11 work plan, including proposed internal audit topics and budget, is summarized below.

Internal Audit Project	Type	FY11	
		Est. hours	Est. \$000
SVRT contract compliance	Compliance audit/value-added	300	\$65
Investment controls	Annual compliance requirement	70	\$15
Follow-up to FY10 audits	NA	50	\$12
Follow-up to FY11 audits	NA	110	\$25
Auditor General Services support	NA	125	\$35
Related expenses	NA	0	\$8
	TOTAL	655	\$160

For the internal audit projects scheduled for FY11, the Auditor General conducted additional staff interviews and data collection in order to develop more detailed plans. Attachment B describes each project in more detail. Each description includes the objective(s) of the internal audit, the specific scope of operations to be included in the internal audit, the general approach or

methodology to be employed by the auditors, and the expected content of the internal audit report deliverables.

The internal audit projects will be executed according to the following schedule, with findings and recommendations presented at future Audit Committee meetings. The proposed timing of these projects, including those audits from FY10 not yet completed, is shown below:

Internal Audit	FY2011											
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
SAP SOD (FY10 plan)			AC mtg									
IT security (FY10 plan)						AC mtg						
SVRT contract compliance (FY11 plan)									AC mtg			
Investment controls (FY11 plan)									AC mtg			

ALTERNATIVES:

The Audit Committee could reject some or all of the specific projects and services included in the FY11 internal audit work plan, add additional projects to the work plan, and/or direct the Auditor General to develop a new work plan. Due to limited resources, not all the potential risk areas identified in the March 2009 risk assessment are addressed by the two-year internal audit plan.

FISCAL IMPACT:

This action will authorize up to \$160,000 for internal audit services through June 30, 2011. Appropriation for this expenditure is included in the FY11 Adopted VTA Transit Enterprise Fund Operating Budget.

Prepared by: Greg Thomas, Auditor General
Memo No. 2376

Attachment AListing of Consultants
FY 2011 Internal Audit Work Plan

FIRM	ADDRESS	CONTACT	TITLE
Deloitte & Touche, LLP	50 Fremont Street San Francisco, CA, 94105	Greg Thomas Denise Martini	Principal Director
Deloitte & Touche, LLP	225 West Santa Clara Street Suite 600 San Jose, CA 95113	Farah Faruqui Emily Kwan	Partner Manager

Attachment B

Internal Audit Project Descriptions

SVRT Contract Compliance

Objective

1. Evaluate contract compliance of one of the large consultant contracts to evaluate and assess how the contract is structured and whether there are clear deliverables and milestones enforced.
2. Conduct some sample transactional testing of the payment applications and any associated change orders to determine if the consultant team is reporting cost information in accordance with contract requirements.

Scope

The scope of the SVRT Contract Compliance Audit will include an evaluation and assessment of the consultant contract between Hatch-Mott McDonald/Bechtel and the VTA organization.

Approach

Evaluate the consultant contract between Hatch-Mott McDonald/Bechtel and VTA to understand the requirements and terms and conditions included in the contract.

Interview key VTA and consultant personnel who are involved in either managing the consultant work or providing the services to VTA to gain an understanding of the contract and the work associated with it including how the contract is organized, contract terms and conditions, contract deliverables, contract milestones and how payment applications and any associated change orders are processed by the team.

Conduct sample testing of reports or tools used to manage and monitor contract deliverables and milestones and a sample of payment applications and change orders.

Assess contract compliance related to contract deliverables, milestones and costs and identify potential areas of improvement in managing and monitoring the services provided under the consultant contract.

Deliverables

A report describing our scope, methodology and observations and recommendations focused on contract compliance issues related to contract deliverables, contract milestones and incurred costs and change orders. As part of the recommendations, the report will identify potential areas of improvement in managing and monitoring the services provided under the consultant contract.

Investment Controls

Objective

Perform a design assessment of processes and controls related to investment management activities. Current processes will be evaluated for compliance with VTA's investment policy and compared to leading practices to identify opportunities to improve internal controls design effectiveness.

Scope

The scope of controls audited will include:

- Key internal controls over investment transactions as identified by management (e.g., proper approvals, compliance with investment policy restrictions) and included in documentation modeled after Sarbanes Oxley Act compliance.

Out of Scope - the following items are out of scope for this audit:

- Sample testing for operating effectiveness
- Externally managed investments (third party money managers)
- Pension investments

Approach

- Review existing investment policy, procedures and reporting.
- Conduct process interviews with relevant personnel involved in executing, confirming, approving, managing, and monitoring VTA's internally managed investments.
- Gain an understanding of management's practices for monitoring investment quality and risk.
- Compare VTA's existing processes to leading industry practices and recommend changes, if any, to improve internal controls effectiveness or operational efficiency.

Deliverables

A memorandum summarizing our overall design assessment of the processes and controls and enhancement opportunities, if any.

Follow-up to FY10 and FY11 Audits

Objective

Determine the adequacy, effectiveness and timeliness of actions taken by management on reported observations and recommendations from previous internal audits. Evaluate and assess VTA management's progress on implementing management responses to audit observations.

Scope

A follow up on VTA management's efforts to address the findings and implement the recommendations contained in the issued FY10 and FY11 audit reports. An evaluation and assessment of management responses and implementation tasks included in the audit reports for the following projects:

- SVRT Soft Cost Audit
- IT Security
- SAP SOD Review
- SVRT Contract Compliance Audit

Approach

Interview key VTA personnel involved in developing the management responses to discuss and understand what implementation tasks have been completed in addressing the issues identified in the audit reports. Gather evidence or corroborate management's responses to assess if the remediation plans have been adopted and address the findings and recommendations noted.

Deliverables

A memorandum describing our methodology and approach, and the results of the follow-up work.

Auditor General Services Support

Overall internal audit engagement management activities, project management activities including periodic meetings with management and the preparation for and attendance at the quarterly audit committee meetings.

Deliverables

Status reports and memoranda delivered at quarterly Audit Committee meetings.



Date: May 25, 2010
Current Meeting: June 3, 2010
Board Meeting: August 5, 2010

BOARD MEMORANDUM

TO: Santa Clara Valley Transportation Authority
Audit Committee

THROUGH: General Manager, Michael T. Burns

FROM: Auditor General, Greg Thomas

SUBJECT: Investment Controls Internal Audit

FOR INFORMATION ONLY

BACKGROUND:

At the June 4, 2009, meeting, the VTA Board of Directors approved the FY 2010 internal audit work plan and authorized the General Manager to execute task orders with Deloitte & Touche LLP to conduct the internal audit projects identified in the plan. In January 2010, Deloitte & Touche initiated the third audit in the work plan, which was an audit of VTA's internal controls for investments. The audit was performed in accordance with the Standards for Consulting Services issued by the American Institute for Certified Public Accountants. The results of this audit are presented in Auditor General Report No. 2009-03 (see Attachment A).

DISCUSSION:

The purpose of this internal audit was to assess the operating effectiveness of the internal controls for investment of restricted and unrestricted funds. Internal controls are required by VTA's investment policy (FRS-PL-07-01, dated 2/5/2009); the policy also requires an annual review of the controls by the internal auditor.

The attached report describes the objectives established for this audit, the scope of internal controls reviewed, and the approach for testing those controls. The report presents the test results, and internal audit team's observations and recommendation for addressing each observation. The report also includes VTA management's response to each observation, and steps that have been or will be taken to address the Auditor General's recommendations.

Prepared By: Greg Thomas, Auditor General's Office
Memo No. 2379



AUDITOR GENERAL REPORT No. 2009-03

TO: Audit Committee Chair, Don Gage
Santa Clara Valley Transportation Authority

THROUGH: Michael T. Burns, General Manager

CC: Joseph T. Smith, Chief Financial Officer

FROM: Greg Thomas, Principal, Deloitte & Touche LLP
Office of the Auditor General

DATE: April 12, 2010

SUBJECT: Investment Internal Controls Testing

Enclosed is our summary report for the Investment Transaction Controls Testing.

Our testing was performed in accordance with the terms of the agreement between Santa Clara Valley Transportation Authority and Deloitte & Touche LLP for Auditor General Services, Contract No. SO9022, dated January 9, 2009, and in accordance with the Standards for Consulting Services issued by the American Institute of Certified Public Accountants. This summary report is intended solely for the information and use of management and the Audit Committee of the Santa Clara Valley Transportation Authority and is not intended to be used by anyone other than these specified parties. Recommendations for improvement are presented for management's consideration. Management is responsible for the effective implementation of corrective action plans.

Please contact Greg Thomas at the VTA Auditor General's office, if you have any questions.

BACKGROUND, OBJECTIVE, SCOPE AND APPROACH:

Santa Clara Valley Transportation Authority (VTA) has a Treasury function which is responsible for managing VTA's investment portfolio in unrestricted and restricted funds. VTA currently invests in four separate funds: three funds managed by Payden & Rygel and one with the State of California Local Agency Investment Funds (LAIF). The investment program is required to comply with the California Government Section 53601 et seq. and VTA's internal policy entitled 'Investment of Unrestricted and Restricted funds' (the Policy) to help ensure successful and prudent management of public funds.

The Policy, Section 7 – 'Internal Controls,' states that 'The internal controls shall be reviewed with the Auditor General and the independent external auditor. The internal auditor shall perform a review of the internal controls at least on an annual basis.' Management documented the key internal controls over the investment transactions in a risk and controls matrix modeled after the requirements for Sarbanes Oxley Act Section 404 compliance.

The objective of the investment controls testing is to assess whether key treasury controls over investment transactions are operating as intended. Internal Audit performed an assessment of the operating effectiveness of the key internal controls over investments, as identified by management, for the period February 1, 2009 through February 1, 2010. Internal Audit obtained management's control matrix which included 12 key treasury controls mapped to risks. Eight controls were selected for testing to obtain appropriate coverage for each risk identified by management. Testing was performed by conducting interviews and obtaining supporting evidence.

RESULTS:

Based on the work performed and the samples selected, the key controls tested appeared to be operating effectively as designed. However, there were two documentation lapses that should be addressed to provide better evidence of the control execution and one instance where approved entries were posted by an unauthorized individual. More information is provided below:

Risk Description*	Key Control Description*	Observation	Recommendation	Management Response
<p>Insufficient liquid funds are available to meet cash requirements, resulting in the need to sell a security at a loss.</p>	<p>Monthly and Semi-Annual Review of cash flow needs are conducted.</p> <p>(Control implemented October, 2009)</p>	<p>Although the control appears to be performed based on our interviews, no evidence is available that a review of the monthly and semi-annual review of cash flow needs spreadsheets was conducted.</p>	<p>We recommend that the monthly and semi-annual cash flow needs spreadsheets be reviewed by appropriate individuals and the review be evidenced by sign-off.</p>	<p>VTA concurs with the recommendation. Effective April 2010, the monthly and semiannual cash flow needs worksheets will be signed by a Fiscal Resources Manager or higher level manager in Fiscal Resources as evidence of the review.</p>
<p>Investment portfolios are not monitored regularly leading to potential loss due to risky investments and/or underperforming portfolios.</p> <p>Money Managers make investment decisions that are inconsistent with VTA Investment Policy and/or lead to loss on portfolio/ change in management that affects investment portfolio management or other risk associated with fund manager.</p> <p>Management does not receive timely and detailed reports regarding investment portfolios, performance, asset allocation and market risks, leading to underperformance of portfolios and/or loss of investments due to market risk and exposure.</p>	<p>Memo and Monthly Investment Report are reviewed and signed by GM and submitted to Admin & Finance Committee for review.</p>	<p>Although the control appears to be performed based on our interviews, no evidence is available that General Manager reviewed the Memo and Monthly Investment Report prior to submission to the Administration & Finance Committee for review.</p>	<p>We recommend that the General Manager evidence his review and approval of the Memo and the Monthly Investment Report.</p>	<p>VTA concurs with the recommendation. Effective April 2010, the monthly investment report will be signed by the General Manager as evidence of the review.</p>

Risk Description*	Key Control Description*	Observation	Recommendation	Management Response
<p>Deposits or withdrawals are not recorded to general ledger account, resulting in inaccurate Fund financial statements.</p> <p>Duties within function are not segregated leading to potential fraud and loss of investments.</p> <p>Entries related to investment gain/loss and interest are not reviewed by Management leading to inaccurate reporting of investments.</p>	<p>All journal entries prepared during month-end are reviewed and approved by Investment Manager prior to posting by Sr. Accountant.</p>	<p>Although the Investment Manager did approve the 15 journal entries we tested, 3 of the 15 journal entries selected were posted by the Accountant III instead of the Senior Accountant. An Accountant III is a lower level position than the Senior Accountant.</p>	<p>Given that the key control point is the review and approval of the journal entry by the Investment Manager, we recommend that management consider rewording the control to remove specific reference to posting of the entries by the Senior Accountant.</p>	<p>VTA concurs with the recommendation. Given that the Investment Manager reviews and approves the journal entries which is a key control already in place, VTA will reword the control description to remove "Senior" allowing any level accountant to post the journal entries consistent with current practice.</p>

* Source - VTA's risk and controls matrix

The Internal Audit team will assess the completion of management's remedial actions as part of next year's annual testing, and will report its findings at a subsequent Audit Committee meeting.