CITY AND COUNTY OF SAN FRANCISCO

OFFICE OF THE CONTROLLER

SAN FRANCISCO COUNTY TRANSPORTATION AUTHORITY:

Management Letter for the Financial Statements Audit July 1, 2002, Through June 30, 2003

Audit Number 03018
March 23, 2004

CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ed Harrington
Controller

Monique Zmuda
Deputy Controller

March 23, 2004

Audit Number 03018

Chairperson and Members
Board of Commissioners
San Francisco County Transportation Authority
100 Van Ness Avenue, 25th Floor
San Francisco, CA 94102

Chairperson and Members:

The Office of the Controller presents its management letter issued in connection with the financial statements audit report of the San Francisco County Transportation Authority (Authority) of the City and County of San Francisco for the fiscal year ended June 30, 2003. Although we had requested the Authority to submit its response to us first, and follow standard audit protocol, the Authority instead submitted its response to us and the Board of Commissioners at the same time. The Authority's response is attached to this report. Unfortunately, the Authority's response contains a number of misstatements that could have been resolved if it had followed standard protocol and cooperated with us.

Respectfully submitted,

Ed Harrington
Controller

CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER
AUDITS DIVISION

Ed Harrington
Controller

Monique Zmuda
Deputy Controller

Audit for the Fiscal Year Ended June 30, 2003 - Management Letter

We have audited the financial statements of the San Francisco County Transportation Authority (Authority) for the fiscal year ended June 30, 2003, in accordance with auditing standards generally accepted in the United States of America.

In planning and performing our audit of the financial statements of the Authority, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve 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 Authority'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 of the internal control components does not reduce to a relatively low level the risk that errors 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.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we noted the following reportable conditions that we believe to be material weaknesses.

We identified material weaknesses in the internal control operations where the Authority:

- Did not provide formal monthly bank reconciliations for all bank accounts during our fieldwork. *(Finding 1)*
- Reconciliations for the last month of the fiscal year contained numerous errors. *(Finding 2)*
- Failed to keep its accounts payable correct or current. *(Finding 7)*

We also identified material weaknesses in management oversight where the Authority:

- Did not exercise due care in reviewing bank reconciliations. *(Finding 3)*
- Accepted errors and misstatements in its audited financial statements. *(Findings 15 and 16)*

We also noted the following reportable conditions that are not believed to be material weaknesses where the Authority:

- Understated grant revenue receivable by $56 million because it failed to understand and apply government accounting standards. *(Finding 4)*
- Improperly included sales tax revenues for the next fiscal year in its current fiscal year sales tax revenues. *(Finding 5)*
- Did not properly accrue as accounts payable those expenses it incurred in the current year, but for which it had not yet paid or received billings for the amounts. *(Finding 6)*
- Made an error in overbilling granting agencies because the Authority did not record different grants in different funds. *(Finding 9)*
- Failed to adequately manage its cash to maximize interest earnings. *(Finding 11)*
- Failed to invest all public funds with the City's Treasurer, according to its policy, and unnecessarily established additional bank accounts. *(Finding 12)*

Finally, we noted other conditions, which we believe should be addressed to improve the Authority's system of internal control:

- Did not maintain accurate records of capital expenditures in its internal accounting and financial management systems because it did not properly reconcile its systems. *(Finding 8)*
- Is slow in paying its capital expenditure bills to departments. *(Finding 10)*
- Does not maximize the flow of grant revenues. *(Finding 13)*
- Unnecessarily established additional bank accounts. *(Finding 14)*
- Lacks formal desk procedures for its accounting staff. *(Finding 17)*

Our fieldwork was completed on January 28, 2004.

THE SAN FRANCISCO COUNTY TRANSPORTATION AUTHORITY FAILED TO PERFORM OR PERFORMED POORLY MANY REQUIRED ACCOUNTING PROCEDURES

The San Francisco County Transportation Authority (Authority) has significant deficiencies in the design and the operation of internal controls over its financial operations that, in our judgment, could adversely affect the Authority's ability to initiate, record, process, and report consistent data in accordance with the assertions of management in the financial statements.

The Authority Has Significant Deficiencies in Accounting for Cash and Revenues

In conducting our audit, we noted that the Authority:

Finding 1
Material Weakness

- Could not provide formal monthly bank reconciliations of all its bank accounts by the end of our fieldwork, January 28, 2004. The Authority could only provide the June 30, 2003, bank reconciliations for its three bank accounts**.** The Authority eventually did show us the bank reconciliations after we had submitted to the Authority a draft of our report on March 11, 2004. At our exit conference on March 17, 2004, the Authority's manager of accounting and finance (accounting manager) stated that he was not aware that we had not been provided the bank reconciliations, and arranged for us to review the Authority's bank reconciliations on the next day. While the Authority's files did contain the bank reconciliations with original bank statements, we must note that the files the Authority provided to us during our fieldwork contained only the original bank statements. Further, the bank reconciliations subsequently provided to us did not have evidence of supervisory approval, although the June 30, 2003 bank reconciliations did have initials and dates of approvals.

  Furthermore, the Authority did not use check registers, which are listings of checks issued, to perform its bank reconciliation. In fact, it could not produce check registers from its accounting system until two weeks after the start of our audit. In one of its accounts, which the Authority uses to pay its personnel, operational and administrative costs, the Authority processes an average of $215,000 in disbursements each month. Bank reconciliations are an important internal control tool and should be performed on a monthly basis and reviewed by management.

Finding 2
Material Weakness

- For two of the three bank reconciliations it did provide for our review, we found that the reconciliations contained numerous errors. For example, the Authority, for one of its bank accounts, showed outstanding checks totaling more than $123,000. After we identified the errors and had the Authority correct its bank reconciliation, the amount of outstanding checks at year-end was actually about $50,000. Among the errors we identified, the Authority in its June 30, 2003 reconciliation of its bank account with the Bank of America:

  - Listed 17 old reconciling items totaling $30,710 that were not associated with the account being reconciled but with another bank account.
  - Failed to identify that 18 reconciling items totaling $42,642 had already cleared the bank through reissued checks or other payments. By reissuing checks, the Authority processed and recorded in its accounting system the same payments twice. However, the Authority had not voided the duplicate payments in the accounting system, resulting in the recording of duplicate expenditures.
  - Listed nine checks with obviously incorrect check numbers; therefore, we could not trace them to the bank statement. While the correct check numbers ranged from 9119 to 10222, the nine checks listed in the reconciliation had numbers such as 999999 or 1000000.
  - Made a $4,487 calculation error.

  The Authority, in its June 30, 2003 reconciliation of one of its two bank accounts with the Mission National Bank:

  - Listed $2,168 as deposits in transit that had already cleared the bank.
  - Listed 16 outstanding checks and reconciling items totaling $121,268 that had already cleared the bank.
  - Did not adequately administer its bank account and incurred overdraft charges totaling $441 for writing 28 checks with insufficient funds between July 1, 2002, and October 31, 2003.

  According to the accounting manager, the errors occurred because the Authority converted its accounting system from Quickbooks to Fundware in July 2002. However, at June 30, 2003, the Fundware system had already been in place for a year, and the Authority had run both systems in a parallel implementation process from January 2002, through December 2002.

Finding 3
Material Weakness

- Did not exercise any reasonable due care in reviewing the bank reconciliations. The initials of the accounting manager appear on the Bank of America June 30, 2003 reconciliation with a date of September 30, 2003, and the name of the accounting manager was shown by signature on the Mission National Bank June 30, 2003 reconciliation with a date of October 8, 2003. The accounting manager apparently approved the reconciliation for the Bank of America account with an ending balance of $4.36 million. However, after correcting the errors we identified, the correct balance is $60,000 more. Furthermore, the accounting manager apparently approved the Mission National Bank June 30, 2003, reconciliation with an ending balance of $27,000. However, after correcting the errors we identified, the correct balance is $119,000 more.

  Not only did the accounting manager approve bank reconciliations that were significantly in error, he was also late in conducting his reviews. Most financially prudent organizations prepare the bank reconciliation for a given month in the following month upon receiving the related bank statement, and it is expected that supervisory review occur soon after the reconciliation has been prepared to identify and correct any errors. Although we could not determine the dates the Authority prepared the June 30, 2003 reconciliations, the Authority was certainly lax in delaying its review for more than two months after the reconciliations should have been prepared.

Finding 4
Reportable Condition

- Understated a grant revenue receivable by $56 million at fiscal year-end because it failed to understand and apply government accounting standards that the Authority is required to follow. The Authority is required to accrue grant revenue for cost-reimbursement grants when the City departments performing the services incur the expenditures. A few days before we began our audit on December 12, 2003, the Authority recorded $39 million as a receivable for the Traffic Congestion Relief Program (TCRP), but it also reduced its capital project expenditures by the same amount. Instead of reducing its expenditures, it should have recorded $39 million as grant revenue. Further, it should have recorded an additional $17 million as grant revenue receivable and corresponding grant revenue.

Finding 5
Reportable Condition

- Improperly included sales tax revenues for the next fiscal year in its current fiscal year sales tax revenues. In making the final payment for the Authority's June sales tax revenues, the State also includes an advance payment for the July sales tax revenues. The Authority, instead of separately allocating the payment amount to the current fiscal year and to the next fiscal year, included the entire payment amount as the sales tax revenues for the current fiscal year. As a result, the Authority overstated the sales tax revenues for June by more than $4 million, which should have been recorded as sales tax revenue for July, the next fiscal year. However, because the Authority recognized July 2002 sales tax revenue as revenue for 2001-02, the net effect on its 2002-03 sales tax revenue was that it was understated by approximately $350,000.

RECOMMENDATIONS

To ensure that the Authority properly accounts for cash and revenues, the Authority should take the following actions:

Recommendation Number 1

Prepare monthly, accurate bank reconciliations on a timely basis. The Authority should require its accounting manager to review each month's reconciliation for accuracy and require the manager to attest to the Authority's Board of Commissioners each month that the bank reconciliations have been performed and are correct until the Board of Commissioners has confidence that the procedures are being carried out without its review.

Recommendation Number 2

Accrue grant revenue for cost-reimbursement grants when the City departments performing the services incur the expenditures, as required by the California Committee on Municipal Accounting guidelines on the application of revenue recognition criteria set forth in Government Accounting Standards Board Statement No. 33 to revenue sources significant to California cities.

Recommendation Number 3

Adhere to generally accepted accounting principles by recognizing revenues in the correct fiscal year in which they were earned.

The Authority Has Significant Deficiencies in Accounting for Payables and Expenditures

We also noted that the Authority in accounting for payables and expenditures:

Finding 6
Reportable Condition

- Failed to follow generally accepted accounting principles by not accruing as accounts payable those expenses it incurred in the current year, but for which it had not yet paid or received billings for the amounts. The Authority failed to record as accounts payable at least $671,000 in expenses. According to the accounting manager, he did not accrue these expenditures because he believed he did not incur them until he received the invoices. However, a liability is incurred when goods or services are received, not when an organization gets the invoice.

Finding 7
Material Weakness

- Failed to keep its accounts payable account correct or current. The Authority:
  - Did not eliminate until year-end $2.5 million of old, erroneous accounts payable entries that it should have cleared during the year.
  - Erroneously posted an adjusting entry of $588,765 that doubled its accounts payable for 13 of its funds, including its Congestion Management Agency (CMA), Transportation Fund for Clean Air (TFCA), and Traffic Congestion Relief Program (TCRP) funds.
  - Erroneously posted as accounts payable a $261,000 invoice not related to the current fiscal year.
  - Recorded more than $5 million as negative amounts for two funds. Any accounts payable should be a positive amount that would be reduced to zero when paid.

According to the accounting manager, inexperienced accounting staff and the consultant charged with the responsibility for implementing the Fundware system caused the errors in accounts payable. Nevertheless, the accounting manager should have identified these errors if he had properly reviewed the staff's work and Fundware reports.

Finding 8
Other Condition

- Did not maintain accurate records of capital project expenditures in its internal accounting and financial management systems because it did not properly reconcile its systems. When we started our audit, the amount of total capital expenditures recorded in the Authority's accounting system, Fundware, did not agree to the total capital expenditures recorded in the Authority's project information management system (PIMS) for the Proposition B and Transportation Congestion Relief Program (TCRP) projects. While the Authority's Fundware showed total capital expenditures of $85,130,350, its PIMS showed total capital expenditures of $101,759,777. However, these amounts should be the same since the Authority uses reports from the Controller's Financial and Management Information System (FAMIS) to post its transactions to Fundware and PIMS. The Controller's FAMIS showed the Authority had recorded total capital expenditures of $118,771,414.

  These problems would not be occurring if the Authority reconciles its internal accounting and financial management systems. Although the accounting manager stated that his staff reconciles the transactions and balances in the Authority's Fundware and PIMS each month, he could not provide us with any written documentation to show that the Authority had conducted any monthly reconciliations. During the course of our audit fieldwork, Authority and Controller staff worked toward reconciling the capital projects expenditures and appropriations on PIMS to FAMIS. However, the Authority should reconcile its capital project transactions in all three systems on a monthly basis to ensure that the Authority has correctly posted all transactions. By performing the reconciliations, errors or irregularities would be discovered on a timely basis.

Finding 9
Reportable Condition

- Made an error in billing a granting agency because the Authority does not adhere to basic grant accounting procedures. Instead of identifying each grant in a different fund, the Authority recorded all transactions from three different grants in one project fund. By doing so, it was unable to adequately separate the revenues and expenses that should be attributed to each grant separately. As a result, the Authority billed Caltrans $228,548 more than was available in the grant funds for the Doyle Drive project. In this case, Caltrans did not pay the invoices that billed it for amounts that exceeded the remaining grant funds, and therefore did not overpay the Authority. According to the accounting manager, the total grant amount changed and therefore, he was unaware at the time that he requested reimbursement for more expenditures than was available in the grant funds.

Finding 10
Other Condition

- Is slow in paying its bills for capital expenditures. We tested a sample of payments for capital expenditures, and found that the Authority paid 7 of 28 (25 percent) requests late; the payment dates ranged from 40 to 69 days after it received the reimbursement requests. However, according to its accounting manager, the Authority has a policy to pay its bills within 21 days. As a result, the Municipal Railway, the Department of Parking and Traffic, and the Department of the Environment had to wait more than a month for reimbursement of their expenditures. Furthermore, the City's FAMIS drawdown procedure manual for the Authority states that the Authority's accounting manager must review and approve payments to city departments within 10-15 business days of the Authority's receipt of any encumbrance payment documents.

RECOMMENDATIONS

To ensure that the Authority properly accounts for payables and expenditures, the Authority should take the following actions:

Recommendation Number 4

Accurately record accounts payable transactions. The Authority should adhere to generally accepted accounting principles and standard government accounting practices by properly accruing expenses at year-end so that accounts payable is properly stated on the financial statements. The accounting manager should properly review the work performed by his staff to ensure that they are not making any errors.

Recommendation Number 5

Reconcile its accounting system, Fundware, to its capital project management system, PIMS, and to the Controller's FAMIS on a monthly basis.

Recommendation Number 6

Maintain separate fund accounts for each of its grants to enable it to accurately allocate the correct costs to each grant that may be funding a common project.

Recommendation Number 7

Promptly pay departments for its capital expenditures. The Authority should follow the written payment policy stated in the City's FAMIS drawdown procedure manual and inform those departments receiving capital expenditure payments of that policy.

THE TRANSPORTATION AUTHORITY POORLY MANAGES CASH

The Authority Failed to Maximize Interest Earnings

Finding 11
Reportable Condition

The Authority could have earned approximately $176,000 more in interest earnings if it had adequately managed its cash. Instead of investing the majority of its funds with the City's Office of the Treasurer/Tax Collector, the Authority maintained a significant amount of its funds in one of its commercial bank accounts. In doing so, it did not take advantage of the higher interest earnings of the Treasurer, but instead earned much lower interest with the commercial bank. The following table 1 shows the amount the Authority earned as interest on its deposits with the Treasurer and on its deposits with the commercial bank.

TABLE 1

Projected Lost Interest Earnings by the Authority

		Interest Earnings Commercial Bank			Projected Interest Earnings Treasurer		
	Month/Year	Average Collected Cash Balance	Bank Monthly Interest Rate	Interest Earned	Treasurer Monthly Interest Rate	Interest Projected	Interest Foregone
	Jul-02	$0		$0	0.2429%	$0	$0
	Aug-02	137,255	0.0489%	67	0.2598%	357	290
	Sep-02	350,092	0.0288%	101	0.2138%	748	648
	Oct-02	725,545	0.0297%	216	0.2205%	1,600	1,384
	Nov-02	751,194	0.0222%	167	0.2217%	1,665	1,499
	Dec-02	1,022,471	0.0212%	217	0.2197%	2,247	2,030
	Jan-03	1,771,228	0.0212%	376	0.2063%	3,654	3,278
	Feb-03	1,840,543	0.0192%	353	0.2213%	4,073	3,720
	Mar-03	7,761,932	0.0212%	1,648	0.1890%	14,668	13,020
	Apr-03	8,891,091	0.0205%	1,827	0.1469%	13,060	11,233
	May-03	5,873,813	0.0211%	1,241	0.1961%	11,521	10,280
	Jun-03	4,768,048	0.0186%	886	0.1752%	8,353	7,467
	Totals		0.2975%*	7,098	2.5132%**	$61,946	$54,848
	Jul-03	4,338,330	0.0085%	368	0.1407%	$6,105	$5,737
	Aug-03	12,966,140	0.0085%	1,101	0.1830%	23,732	22,630
	Sep-03	20,253,507	0.0082%	1,665	0.1713%	34,689	33,025
	Oct-03	20,119,208	0.0085%	1,709	0.1571%	31,608	29,899
	Nov-03	20,567,869	0.0082%	1,691	0.1562%	32,128	30,437
	Totals			6,534		$128,262	$121,728
	Grand Totals			$13,632		$190,208	$176,576

* Annual rate adjusted for 11 months of interest earnings.
**Annual rate

In fiscal year 2002-03, the Authority had on deposit with its commercial bank a monthly average of more than $2.8 million. From July 2003 through November 2003, the Authority increased the amount of its deposit with the commercial bank to a monthly average of $15.6 million. While the Authority received annualized interest of only 0.10 percent on its deposits with the commercial bank in November 2003, the Treasurer was earning almost twenty times that amount, or 1.94 percent in annualized interest, for departments investing in the Treasurer's pooled money investment account**.** On December 29, 2003, the Authority transferred $21 million from its commercial bank to the City Treasurer's pooled investment account.

The Authority also kept other funds throughout the year in certificates of deposit at its other commercial bank that earned interest ranging between 0.95 percent and 1.80 percent. The certificates at June 30, 2003 totaled $3,393,981 and $3,399,511 at June 30, 2002. However, during this period, the Authority could have earned approximately 2.5 percent on its funds if it had invested the funds with the Treasurer.

The Authority Is Not Complying With Its Policy to Invest All Public Funds With the City's Treasurer

Finding 12
Reportable Condition

On November 30, 2003, the Authority held over $20.5 million in its Bank of America account. Although the executive director had stated on February 24, 2004, before the Authority's finance committee meeting that it is the Authority's policy to deposit only sales tax revenues with the Treasurer, the Authority's written policy states that it is "to invest ***all public funds*** [emphasis added] in a manner which will provide the highest investment return with the maximum security …" The policy goes on to state that the Authority is "to use the Treasurer of the City and County of San Francisco as its Investment Officer." The Authority's policy does not distinguish sales tax revenues from other public funds received by the Authority, including grants received from other state or federal agencies. If the Authority's policy is to invest all public funds with the Treasurer, then the Authority has not been in compliance with its policy when it invested significant public funds with a commercial bank. While the policy appears to have been established more than 10 years ago when the Authority was receiving only sales tax revenues, it is now receiving funds from other government sources, and it may wish to clarify its policy.

The Authority Fails to Maximize the Flow of Grant Revenues

Finding 13
Other Condition

The Authority does not bill many of its grants until year-end, even though the expenses are incurred throughout the year. For fiscal year 2002-03, the Authority did not bill more than $2.4 million until after year-end. What is even more problematical is that the Authority failed to bill funding agencies $136,356 for expenses incurred in the prior fiscal year. To pay for work conducted under these grants, the Authority uses the sales tax fund during the year, and reimburses the fund when it receives payments from the funding agencies. By using the sales tax fund, and not reimbursing the fund periodically during the year from grant payments, the Authority loses the interest that the sales tax funds could have realized during the year.

Finding 14
Other Condition

The Authority Unnecessarily Established Additional Bank Accounts

The Authority, as of June 30, 2003, held three outside bank accounts and an account with the City's Office of the Treasurer/Tax Collector (Treasurer). In our opinion, the Authority needs only one outside bank account. The Authority initially opened a bank account at the Mission National Bank to process the Authority's operational and administrative expenses. According to the executive director, the Authority opened a second account at the Mission National Bank to process revenues for the Transportation Fund for Clean Air (TFCA) program because the program requires the Authority to establish a separate bank account to account for the use of the funds. However, the executive director has incorrectly interpreted the requirements for this fund. While the TFCA agreement requires the Authority to account for the transactions in a separate fund or sub-ledger, it does not require a separate bank account. We confirmed this with staff at the Bay Area Air Quality Management District, the agency providing the funds. Furthermore, in August 2002, the Authority opened a bank account at the Bank of America. According to the accounting manager, the bank account was to be used to process the Authority's administrative expenses. However, the Authority was already using its first bank account at Mission National Bank for these purposes. According to the accounting manager, this first bank account at Mission National Bank is no longer needed, but the Authority has not closed this account.

RECOMMENDATIONS

To ensure that the Authority manages cash effectively and efficiently, the Authority should take the following actions:

Recommendation Number 8

Clarify its policy on investing public funds with the Office of the Treasurer/Tax Collector. The Authority should conduct sufficient analyses to decide whether depositing its funds with the Treasurer, rather than a commercial bank, will maximize interest earnings on its funds.

Recommendation Number 9

Bill granting agencies as the Authority incurs substantial grant costs. The Authority should bill on a regular basis, or according to schedules stated in the grant agreements. At no time should the Authority wait until the end of the fiscal year to bill granting agencies for funds that may be recovered sooner.

Recommendation Number 10

Comply with Authority's investment policy, which states that it shall use the Treasurer of the City and County of San Francisco as its investment officer.

Recommendation Number 11

The Authority should maintain only one outside bank account to process its operational and administrative expenses. The Authority should consider keeping the majority of its funds in the account at the City's Office of the Treasurer/Tax Collector.

THE TRANSPORTATION AUTHORITY DID NOT EXERCISE DUE CARE IN ACCEPTING THE WORK OF ITS INDEPENDENT AUDITORS

The Authority Accepted Errors and Misstatements in Its Audited Financial Statements

Finding 15
Material Weakness

Because of errors and irregularities identified by the Controller in the financial statements audit reports by the Authority's independent auditors for the fiscal year ended June 30, 2003, the Controller requested his Audits Division to re-conduct a full financial audit of the Authority for the year. Our audit of the Authority's 2003 financial statements resulted in markedly different results from the Authority's independent auditors' 2003 revised financial statement audit report dated December 10, 2003. The following table 2 highlights some of the more significant differences.

TABLE 2

Comparison of Financial Statement Amounts Identified by the Controller's Audits Division and the Authority's Independent Auditors

Account	Controller's Audit Division	Authority's Independent Auditors	Over (Under) Stated
Deposits with City Treasurer	$131 Million	$64 Million	($67 Million)
Program Receivables	$68 Million	$51 Million	($17 Million)
Due to City	$69 Million	$2 Million	($67 Million)
Net Assets (Unrestricted)	$35 Million	$14 Million	($21 Million)
Traffic Congestion Relief Program Revenues	$71 Million	$15 Million	($56 Million)
Capital Project Expenditures	$124 Million	$86 Million	($38 Million)

Not only did we find errors in the financial statement audit for the current year, but we also identified errors by the independent auditors for their prior year audit. During the course of our audit, we identified four prior period adjustments totaling $4,162,070, which affected the June 30, 2002 balance of technical consulting expenditures, program receivables, unrealized gain on investments, sales tax receivable, and accounts payable. The Authority's independent auditors also misreported accounts payable as accrued salaries and taxes of $1.2 million on their prior year audit.

For the fieldwork conducted by the Authority's independent auditors for fiscal year 2002-03, the Authority's accounting manager stated to us that he did not know what the auditors were doing and that he did not understand some of the adjustments made by the auditors. Our work did not substantiate much of the work of the Authority's auditors, and the financial statements prepared by the Authority and attested to by its independent auditors contain errors and misstated amounts.

Furthermore, the executive director improperly approved issuing financial statements audit reports that contained other misstatements regarding the Authority's compliance with state law. The Authority's independent auditors had reported in the financial statement notes for both fiscal years 2001-02 and 2002-03, "In accordance with enabling legislation and adopted principles, the authorized budget amount for the Authority's ***staff salaries and fringe benefits averaged over three years***, [emphasis added] shall not exceed one percent of the annual revenues averaged over three years." Based on this interpretation, the auditors concluded that for fiscal year 2001-02, the Authority's expenditures were within the Authority's Expenditure Plan, although for the year, the Authority had exceeded by 0.09 percent the one percent limit set by the State.

State law, however, does not describe averaging as a method to calculate whether the Authority is in compliance with the salaries and benefits requirement. According to the California Public Utilities Code, Section 131107:

"In an adopted county transportation expenditure plan that provides for the imposition of a retail transaction and use tax, ***not more than 1 percent of the annual net amount of revenues raised by the tax may be used to fund the salaries and benefits of the staff*** [emphasis added] of the commission or the county transportation authority, as the case may be, in administering the plan and the retail transactions and use tax ordinance."

When we discussed this issue with the Authority's executive director, he stated that he did not know where the auditors had come up with this policy. In reviewing the Authority's *Fiscal Policies and Goals,* however, we did find a reference to how the Authority apparently planned to comply with state law. According to the Authority's *Fiscal Policies and Goals,*

"Under the Authority's enabling legislation (Section 131107 of the Public Utilities Code), the adopted expenditure plan was precluded from using more than 1 percent of the annual net amount of revenues raised by the tax for salaries and benefits. Thus the Expenditure Plan programmed $902 million for programs and projects, even though the projected revenues were $911 million, with the remaining $9 million reserved for salaries and benefits. In order to ensure that actual expenditures do not exceed the 1 percent limitation over time, every three years staff compensation shall be compared to actual revenues received to date and appropriate adjustments to staff compensation will be made at that time, if required."

Notwithstanding the executive director's comment, the Authority's management has ultimate responsibility for its financial statements, and should not have approved issuing the audit reports with inaccurate interpretation of state law.

RECOMMENDATION

To ensure that the Authority properly oversees the work of its independent auditors, the Authority should take the following action:

Recommendation Number 12

Make sure that it reviews and understands the work of its independent auditors before it makes adjustments proposed by the auditors.

THE AUTHORITY'S INDEPENDENT AUDITORS DID NOT EXERCISE DUE PROFESSIONAL CARE IN PERFORMING THE AUTHORITY'S FINANCIAL STATEMENT AUDITS FOR 2002 AND 2003

Finding 16
Material Weakness

Audit organizations are required by the American Institute of Certified Public Accountants to exercise due professional care in the performance of financial statement audits. Due professional care is defined as the application of the care and skill expected of a reasonably prudent and competent auditor in the same or similar circumstances. In our opinion, the Authority's independent auditors failed to demonstrate due care when it submitted a signed audit report for fiscal year ended June 30, 2003 on November 26, 2003, and then submitted a revised audit report 15 days later on December 10, 2003, after the Controller questioned some of the reported results. In its revised report, the Authority's independent auditors' revised statements included millions of dollars in adjustments. Table 3 on the following page compares the statement of net assets accounts contained in the first draft of the Authority's financial statements, dated October 31, 2003, the Authority's independent auditors' two audit reports, dated November 26, 2003, and December 10, 2003, and the Controller's Audits Division audit report dated January 28, 2003. The table also shows the differences between the Authority's December 10 audit report and the Controller's January 28 audit report.

TABLE 3

Comparison of Statement of Net Assets Accounts in the Financial Statements by the Authority, Its Independent Auditors, and the Controller's Audits Division

	Authority October 31, 2003* (Column A)	Authority Auditors November 26, 2003** (Column B)	Authority Auditors December 10, 2003 (Column C)	Controller's Audits January 28, 2003 (Column D)	Differences (Col C vs. Col D)
ASSETS					
Cash in Bank	$5,722,029	$4,522,886	$4,522,886	$4,706,363	$183,477
Deposits-Treasurer	65,176,080	64,322,859	64,322,859	131,327,394	67,004,535
Other Investments	5,899,511	3,410,564	3,410,564	3,393,981	(16,583)
Receivables					
Sales Tax Receivable	18,964,636	15,664,636	11,273,236	10,873,863	(399,373)
Interest Receivable from the City	826,770	826,770	826,770	826,770	
Other Interest Receivables		324,937	324,937	324,937	
Other Program Receivables	9,196,148	8,294,292	8,294,292		(8,294,292)
Other Receivables	4,301,901	7,488,246	42,828,462		(42,828,462)
Program Receivables *(Total)*				68,099,307	68,099,307
Due From Other Programs	8,748,635	7,777,826	7,777,826	17,335,166	9,557,340
Other Assets	7,487	12,799	12,799		(12,799)
Net Capital Assets		125,075	125,075	125,075	
Total Assets	118,843,197	112,770,890	143,719,706	237,012,856	93,293,150
LIABILITIES					
Accounts Payable	4,741,606	738,627	738,627	757,985	(19,358)
Due to the City		2,246,642	2,246,642	68,718,556	(66,471,914)
Accrued Salaries and Taxes	26,995	29,564	29,564	29,564	
Accrued Vacation	12,080	68,167	68,167	55,367	(12,800)
Deferred Revenue	69,971	69,971	69,971		(69,971)
Due to Other Programs	10,182,835	12,048,266	12,048,266	17,335,166	(5,286,900)
Total Liabilities	15,033,487	15,201,237	15,201,237	86,896,638	71,695,401
NET ASSETS					
Invested in Capital Assets		125,075	125,075	$125,075	
Restricted for Appropriation	134,730,315	85,442,085	114,650,320	115,099,137	448,817
Unrestricted	(30,920,605)	12,002,493	13,743,074	34,892,006	21,148,932
Total Net Assets	103,809,710	97,569,653	128,518,469	150,116,218	21,597,749
Total Liabilities and Net Assets	$118,843,197	$112,770,890	$143,719,706	$237,012,856	$93,293,150

* Based on Governmental Funds Balance Sheet
******Signed audit report

Furthermore, we do not understand how the Authority's independent auditors were able to issue either a signed audit report or a revised audit report when we found the Authority's accounting records in disarray when we started our fieldwork on December 15, 2003. We seriously question whether the Authority's independent auditors met the requirement for exercising due professional care. The Authority's independent auditors failed to identify the various errors made by the Authority in recording accounts payable and capital project expenditures, sales tax revenue, program revenues and accounts receivable, in preparing monthly bank reconciliations, and in billing granting agencies. This resulted in the Authority's independent auditors issuing financial statements audit reports that are misstated and misleading.

RECOMMENDATION

To ensure that the Authority meets its contract and fiduciary obligation to accurately report the results of its financial operations, the Authority should take the following action:

Recommendation Number 13

Retain the services of a qualified, independent audit firm.

THE AUTHORITY NEEDS TO MAKE OTHER IMPROVEMENTS IN ITS FINANCIAL OPERATIONS

The Authority Lacks Formal Desk Procedures For Its Accounting Activities

Finding 17
Other Condition

In conducting our audit, we identified numerous errors in the Authority's Fundware accounting records because accounting staff did not perform their tasks correctly or accurately and because the accounting manager does not adequately or sufficiently supervise accounting staff. The errors we identified could have been reduced if the Authority had adequately trained its staff, including providing complete, detailed desk procedures to guide employees in performing their tasks. However, the Authority has taken corrective action, and is currently preparing formal desk procedures for its accounting staff.

RECOMMENDATION

To ensure that the Authority improves its financial operations, the Authority should take the following actions:

Recommendation Number 14

Complete the formal, detailed desk procedures for its accounting staff. The supervision and review responsibilities of the Authority's accounting manager should also be detailed as part of the procedures.

This letter is intended solely for the information and use of the Authority, management, and others within the organization. This restriction is not intended to limit the distribution of this letter, which is a matter of public record.

Sincerely,

Noriaki Hirasuna
Director, Audits Division

Staff: Elisa Sullivan, Audit Manager
Deborah Gordon
Leon Valle, Jr.
Helen Vo

SAN FRANCISCO TRANSPORTATION AUTHORITY RESPONSE TO THE AUDIT:

San Francisco County Transportation Authority

Memorandum

Date: 03.22.04

To: Authority Board: Commissioners McGoldrick (Chair), Alioto-Pier (Vice-Chair), Ammiano, Daly, Dufty, Gonzalez, Hall, Ma, Maxwell, Peskin and Sandoval

From: José Luis Moscovich – Executive Director

Subject: **Management Response** – Controller's Management Letter of 03.22.04

This letter constitutes the Authority's response to the management letter dated March 22, 2004, which was issued by the Audit Division of the Office of the Controller of the City and County of San Francisco in connection with the audit of the Authority's financial records, conducted by that Division for the fiscal year ending June 30, 2003.

The management letter lists a large number of findings. The summary on page 2 of that letter shows that the material weaknesses (i.e., those involving amounts large enough to be considered significant) are in 3 areas, involving only 6 of the 17 findings in the letter. Of those 6 findings, 3 have to do with the same issue: bank reconciliations. The remaining 11 findings, as the letter states "are not believed to be material....". Of the 11 non-material findings, 6 are presented as reportable conditions, and the remaining 5 are neither material weaknesses nor reportable conditions, but they are nevertheless offered as suggestions for improvements. We find it troubling that the detailed discussion of each of the findings does not distinguish, for the benefit of the reader, which findings are material or reportable, and which are not. *

The material weaknesses involve 3 issues, the bank reconciliations, accounts payable and shortcomings of the auditing firm. The bank reconciliation issues are limited to the Authority's overhead operations, effectively about 1% of the Authority total annual budget. The one material item regarding accounts payable (Finding 7) involved an error (negative amounts) introduced by the auditing firm that was not in the pre-audit books of the Authority. This was not noted in the management letter. Characterizing the auditing firm's shortcomings as a failure of management oversight is somewhat akin to criticizing our finance staff for not auditing the auditors.

Some of the material weakness findings, in our view, are provided without an appropriate context for the reader to form an opinion as to their significance. Indeed, the findings vary widely in their degree of significance. Some of the findings, in our view, do not have a full and fair foundation established in the management letter, particularly in instances where errors resulted from failures of communication or misunderstandings involving not just the Authority but the Controller's office or other departments. We address this further elsewhere in this letter. Ultimately, however, an important function of an audit should be to identify problems so that they can be addressed and corrected. The management letter does report several categories of issues that we believe should be addressed, and which we are taking immediate steps to address. We also find the recommendations in the management letter essentially reasonable and consistent with the actions we are proposing to undertake to address the findings.

*The Controller's Audits Division's comments on the Authority's response to the audit begins on page 27.

All findings can be summarized into 3 broad conclusions: a) the Authority's financial statements contained departures from generally accepted government accounting standards; b) the Authority's internal accounting control structure needs improvement; and c) the independent audit firm engaged by the Authority lacks depth of expertise in government accounting and/or did not exercise proper professional care in performing its audit of the Authority for the period in question. Importantly, the management letter confirms, albeit tacitly, what we have maintained all along, that the audit found no malfeasance, and identified no funds unaccounted for or misspent.

From the perspective of management and Board oversight, the most critical of these areas is the choice of auditing firms. The current auditing firm, Vargas and Company, has performed the Authority's audits since 1996. The FY 2002/03 audit was the last one in the scope of the Vargas contract. The standards for reportable conditions that are outlined in the Audit Division's management letter were extant during the June 30, 2003 and previous audits of the Authority by Vargas. Vargas may have believed that these matters did not rise to the level of reportable conditions, or may simply have failed to identify them. In any event, the conditions were not reported by Vargas, either formally in a management letter, or informally in any other manner. Consequently, their exact nature or magnitude was not brought to our attention until the issuance of the Audit Division's draft management on March 11.

One issue identified as a reportable condition in the management letter, but which is not a material weakness, (Findings 11 and 12) was the potential loss of interest resulting from a failure to invest all funds in the City's pooled accounts. As the Controller's management letter correctly states, the Authority's investment policy is more than 10 years old, and it was adopted at a time when the Authority only had sales tax revenues. It has been our understanding that this policy applies to the sales tax funds, but we also acknowledge it needs to be updated to reflect the Authority's evolution and increased responsibilities over the past decade. In December, after passage of Prop K, I informed the Board that all of our operating policies were being reviewed, and that new policies would be proposed as part of our transition plan.

Sales tax funds are deposited directly by the State Board of Equalization into the City's pooled accounts. The funds in question were non-sales tax funds (state or federal reimbursements) received by the Authority in the form of checks, which we deposited in our bank account as a normal procedure. In our experience, if the checks had been forwarded to the City, these funds would not have been included in the City's pooled accounts, and would instead have been placed in dedicated accounts yielding significantly less than the pooled accounts. The Authority's policy is to invest "in a manner which will provide the highest investment return with the maximum security." We believe that the aggregate rate of return on these funds, including waived bank charges, exceeded the amount we could have earned in a dedicated account with the City. Table 1 in the management letter uses the pooled account rates, rather than the much lower dedicated account rates. We think the comparison is not appropriate under the circumstances.

The Authority is in the midst of a very significant transition, moving from the old Proposition B to the new Proposition K transportation sales tax expenditure plan, approved by the voters in November. That transition includes a sweeping review of all procedures, policies, systems, and staffing and other resources, to ensure that the organization is well equipped to handle its increased responsibilities. In that context, in December 2003, following our own recommendation, the Authority Board approved a reorganization of our financial staff. The reorganized section will include a Director of Administration and Finance. This position will be filled with an individual who will be required to have a higher level of accounting, financial and administrative management expertise than what is required for the current position of Manager of Accounting, which is being phased out. The Board also created another new position of Senior Accountant, so that there would be two accountants providing support to the Director. When the reorganization is complete, in the next 90 days, we will have three positions instead of the current two. We have advertised the Director of Administration and Finance position for over a month. On March 19, we interviewed several well-qualified finalists, with the help of a panel comprised of well respected CFOs from transportation agencies in the Bay Area. We expect to have the new director on board within 15 days. The new structure, including a very well qualified Director of Administration and Finance, will allow us to keep records up to date, correct problems as they arise, and account for transactions fully in accordance with government accounting standards. This effectively constitutes our first step in addressing the audit's findings.

As a second step, we will be engaging a reputable accounting firm with experience in internal control consulting, to help us strengthen our internal control structure. The scope of work is being finalized. It will include, at a minimum, checking and correcting the current accounting records for any errors; and strengthening the foundation for internal controls, including improvements to the discipline and procedures applied to accounting activities, so as to ensure a control environment that provides better information and timely communications on an ongoing basis.

As a third step, we will be issuing a request for proposals to major auditing firms with proven credentials in government auditing, to complete the independent audit of the Authority for the period ending June 30, 2004.

We believe that there are certain items in the Audit Division's management letter that require additional information and clarification. A brief review of some of the matters that came to our attention follows. Other issues may arise on further review, and we may wish to supplement these comments at a later date.

- All of the findings about accounting mistakes involved just that—mistakes. No malfeasance was identified, and no funds were lost or misspent.
- We are taking steps to improve our accounting, including bank reconciliations. However, with respect to findings regarding bank reconciliations, it must be understood that we only use the bank accounts to deal with day-to-day operating expenses (which are really small, since we only have a staff of 12 people), and that the amounts involved in actual reconciliation errors add up to only one tenth of 1% of our annual budget. More specifically to Finding 1 (a material weakness), the management letter asserts that monthly bank reconciliations were not provided. The fact is that the field audit staff did not request bank reconciliations other than for June. Upon reading the finding in the draft management letter of March 11, the Manager of Accounting provided the monthly statements, which were reviewed by the Manager of Audits. This clarifies the fact that the Authority did indeed prepare monthly bank reconciliations every month. The clarification notwithstanding, we will work to ensure that our bank reconciliations are performed in a timely and highly competent manner.
- The method of calculation of the amount of staff salaries and benefits (Finding 15, a material weakness referring to the acceptance of financial statements from the auditors) for purposes of compliance with the annual cap of one percent of total net sales tax revenues was reasonable, complied with the law and was consistent with past practice. The Audit Division's interpretation of the Authority's fiscal policies in this respect is incorrect. The Authority's adopted policy calls for a *review* of trends every three years, when "staff compensation shall be compared to actual revenues received to date, and appropriate adjustments to staff compensation will be made at that time, if required." This obviously refers to revenues since the inception of the program in

1990, and it is exactly the methodology we have followed, consistent with the 2003 Prop B Strategic Plan. Nowhere is the calculation of a 3-year average required. We did mention this issue to Vargas, as a matter of course, but it was not considered a significant issue at the time, since Vargas found the Authority in compliance. In any event, salaries and benefits are budgeted on an annual basis, using estimates of expected sales tax revenues, not final collection figures. The Authority has been able to stay below the 1% cap while sales tax revenues have fluctuated and our volume of administrative transactions has increased substantially over the past couple of years.

- The June 30 period, covered by the audit, coincided with a major conversion of our accounting systems from QuickBooks, which was put in place by prior management, to AmericanFundware, a fund accounting package much better suited to an organization of our size and complexity. The changeover was accomplished largely with in-house staff. A number of the issues identified with bank reconciliations (though admittedly not all of them) stem from this changeover period.
- Also during that period, we agreed to the Controller's request that we move from a paper-based to a paperless system to process requests for Prop B reimbursements from City departments. The conversion which was also accomplished with no outside help, involved computer interconnections with the Controller's office and other system changes and was fraught with logistical problems, ultimately creating a significant backup of drawdown requests. We worked through the conversion issues and have achieved an improved degree of efficiency in processing drawdowns. This same period also coincided with the start of construction of the 3rd Street Light Rail project, which resulted in a doubling of our workload in processing drawdown requests.

  Findings about the Authority's problems with timeliness in processing drawdowns and payments seem to disregard the above conditions, and the fact that they were extraordinary circumstances generated by system changeover, not normal operating conditions. Furthermore, the Authority has had to deal with errors in the drawdown requests from City departments, often necessitating re-submittal of requests, sometimes multiple times. Measurement of processing time from the time of receipt of acceptable invoices or drawdowns would yield a more accurate picture. Notwithstanding the foregoing circumstances, we acknowledge that there have been problems with timely payment of invoices and with invoicing outside agencies for grant reimbursements, and we will endeavor to correct these promptly.
- Regarding our bank accounts (Finding 14, neither a material weakness nor a reportable condition), the Mission National Bank account was opened in 1992, under the interpretation that a separate bank account is required to administer the Air District's TFCA funds. This requirement is still valid. We have to separately account for the interest earned on these funds, and the separate bank account greatly facilitates that. The Bank of America account was opened for non-TFCA funds, because Mission National could not provide some expanded services that we anticipated would be needed, particularly in order to deal with commercial paper transactions. We could close our Mission National account, and open a separate Bank of America account for TFCA funds, but we have felt it was important, and consistent with Authority policy, to support a local, minority-owned bank.
- Regarding sales tax revenue recognition (Finding 5, a reportable condition but not a material weakness) there was indeed an error in the method used to estimate the last quarter's amount. It should be clarified, however, that the method used had been in place since the inception of the Authority in 1990; and that although the required method was changed in 2001, when GFOA promulgated GASB 33 and 36, dealing with sales tax revenue recognition, the Controller's office did not object to our revenue recognition method in 2002, even though the new rules were

already in place. We would also note the change in accounting rule does not materially affect the actual amount of sales tax revenue the Authority receives. We are now aware of the new revenue recognition requirements and will apply them to our future statements.

- With respect to the issue of management of our capital project records (Finding 8 – neither a material weakness nor a reportable condition), the Authority keeps a Project Information Management System (PIMS) database. PIMS was set up well before current management was in place, and it was not dynamically connected to the accounting system because the computerized accounting system was not compatible. We are well aware of the advantages of integrating capital grants and accounting records. We have been working for some time on a database design that would accomplish integration and be more user-friendly. Part of our transition plan to Prop K is to consolidate PIMS with Fundware (our new accounting software).

  We also must reconcile to the records kept by the Controller's office. During the audit period we spent significant effort ensuring that our records did reconcile with the Controller's. That process identified 99 capital grant items that were incorrectly entered in the City's system, and enabled us to work collaboratively with the Controller's staff to correct them. Among other issues, there were a number of capital grants in the City's system, amounting to $85 million, which were not properly set up to distinguish between sales tax-funded and TCRP (state)-funded Authority resolutions. This created confusion about how to track, recognize and present information about revenues and expenses in the financial statements. Now that the Authoirty and the City are more focused on these distinctions, we should be able to avoid these problems in the future. As a result of the reconciliation of records, the Authority has emerged with a significantly higher unrestricted fund balance available for allocation to projects.

  Obtaining the State's agreement to advance $140 million in TCRP funds to the 3rd Street project, was a major joint success by the Authority and MUNI. It saved the Authority and MUNI several million dollars in interest by delaying the time when borrowing would be necessary in order to meet the project's cash flow needs. If we had waited, it is also almost certain that the funds would have been lost to the governor's budget ax. Although the TCRP grant turned out to be more of a challenge to administer than either MUNI, the Controller's office or the Authority had anticipated, the benefits clearly outweigh the problems.

The Authority boasts a proud record of accomplishments on a number of counts, as evidenced in the voters' strong support for reauthorizing the local transportation sales tax by a 75% landslide vote. As an organization, the Authority has become a catalyst for change and an advocate for good government and sound policymaking. We have done this with a lean and dedicated staff of 12 people, and we have often had to stretch in order to keep everything moving forward. It should not be surprising, therefore, that some problems were identified. In the accounting area we have been chronically understaffed, although we are now turning that around. We welcome the opportunity to learn from some of the findings identified in the management letter, and we are taking decisive steps to correct and remedy problems as appropriate. With a new Director of Administration and Finance, tighter internal controls, completed system conversions and a new outside audit firm, the organization is emerging even stronger from the experience of this audit. This, after all, should be the goal of an audit. Our target now is to present to the Board by November 2004, a clean audit of the FY 2003/04 books, performed by a reputable audit firm with strong credentials in government auditing. I predict that we will accomplish this with distinction.

cc: E. Harrington

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CONTROLLER'S AUDITS DIVISION COMMENTS ON THE RESPONSE FROM THE AUTHORITY:

To provide clarity and perspective, we are commenting on the response to our audit report from the San Francisco Transportation Authority. The following numbered responses correspond to the numbers we have placed in the Authority's response.

Pages 1 and 2 of the report clearly identifies the classification of the findings. However, we have also added the classifications to the report text.

The finding of a material weakness is warranted by the lack of evidence that the Authority performed monthly bank reconciliations, and further that the reconciliations it did perform contained numerous errors. Because of this, the Authority has little assurance that it is properly accounting for some of its funds. The Authority increases the risk of fraud and abuse without proper conduct of this important internal control. We find it surprising that a government official appears to be dismissing fiduciary responsibility for more than $16 million that the Authority deposited into its three bank accounts during the fiscal year.

The executive director continues to demonstrate his lack of understanding of basic financial management practices. As stated in the Authority's financial statements audit report, the financial statements are the responsibility of the Authority's management; the auditor's responsibility is to express an opinion on these basic financial statements based on its audit. The executive director states that the error involving accounts payable was introduced by the Authority's independent auditors. The auditors cannot introduce any errors into the Authority's accounting system since the auditors can only present their results to the Authority with suggested audit adjustments. The Authority either rejects or concurs with the adjustments. Any errors introduced into the Authority's accounting system were made by its staff when it concurred with the adjustments presented by its independent auditors. The Authority has ultimate responsibility for all the transactions in its accounting system.

The executive director apparently refuses to recognize or acknowledge that the Authority's poor financial management practices significantly increases the risk of errors, fraud, and abuse. Further, as stated in our opinion in the financial statements audit report, the audit was planned and performed to obtain reasonable assurance whether the basic financial statements are free of material misstatements. The audit was not conducted to identify specifically instances of fraud or abuse. We have not given any assurances that fraud or abuse has not occurred, only that we did not identify any instances of fraud or abuse in conducting our financial audit. The Authority must be cognizant of the fact that it increases the Authority's exposure to fraud and abuse when it does not engage in basic financial accounting practices that protects against these risks.

The normal experience of other departments in the City is that the department identifies whether its funds are to be deposited to a non-pooled dedicated account or to the pooled account. It is usually the department's responsibility to identify how its funds should be deposited. Furthermore, according to the Treasurer's chief investment officer, it was the accounting manager who made the decision to deposit some of the Authority's funds into a non-pooled dedicated account. Finally, the executive director fails to acknowledge that in December 2003 the Authority transferred $21 million from its commercial bank account to the Treasurer, and the Treasurer deposited the amount into the City's pooled money account. The comparisons we made are appropriate and correct.

We disagree. The audit staff did request the reconciliations during the fieldwork from December 15, 2003, through January 28, 2004. Further, during the course of our fieldwork, the audit manager noted that the Authority files did not contain the monthly bank reconciliations that were eventually shown to us in March 2004. When we were given access to the bank reconciliations in March 2004, we noted that many of the monthly bank reconciliations did not show review or approval by the accounting manager. For example, the April 2003 and May 2003 bank reconciliations showed some of the same errors we identified in the June 2003 bank reconciliation, and did not show any evidence of supervisory review. Examples of the bank reconciliations are shown in the following pages.

Furthermore, when we examined the bank reconciliation for the following months in the next fiscal year, we also observed that the Authority did not perform the bank reconciliations correctly or timely. In the July 2003 bank reconciliation, the accounting manager noted that he performed his review in March 2004, or more than six months late.

We stand by our conclusion that the Authority has not timely or correctly performed monthly bank reconciliations.

The executive director fails to identify that in the Authority's fiscal year 2001-02 audited financial statements, the Authority is shown as spending more than the 1 percent limit for salaries and benefits. According to the audit report by Vargas and Company (Vargas), the Authority's auditors, the Authority spent 0.09 percent more than the limit in fiscal year 2001-02. Furthermore, Vargas reported in its signed audit report dated November 26, 2003, that the Authority spent 0.39 percent more than the limit in fiscal year 2002-03. In both reports, Vargas concluded that the Authority complied with the 1 percent requirement because the Authority used a three-year average. Based on the assertions of the accounting manager that he had misclassified some salaries and benefits, our audit for fiscal year 2003-03 found that the Authority did not exceed the 1 percent limit.

The executive director again fails to demonstrate knowledge of basic principles of fund accounting and misreads the requirement by the Bay Area Air Quality Management District. As we have previously explained to the accounting manager, accounting for the funds separately does not require establishing separate bank accounts for each fund. If this were true, the City would have to establish hundreds of separate bank accounts to account for all the different grant funds it receives.

- We are pleased that the Authority recognizes that it made the error related to revenue recognition and is taking steps to apply proper revenue recognition rules in the future. In fiscal year 2002, the Controller relied on the Authority's certified audited financial statements, including the balance reported for sale tax receivables. The Controller had every reason to believe that the Authority and its independent auditors were correctly applying all accounting principles. It was only after we were involved in the audit for fiscal year 2003 that it became apparent that the Authority was not correctly applying the revenue recognition rules of GASB 33 and 36. In fact, one reason for the Controller to conduct its own audit, was that in November 2003, Controller staff identified that the reported sales tax receivable balance was being reported incorrectly.

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SAN FRANCISCO COUNTY TRANSPORTATION AUTHORITY
BANK RECONCILIATION (Bank of America)
June 30, 2003

Balance per bank statement, June 30, 2003 — $ 4,482,954.94

Amounts in books not recorded by Bank (Less)

Add: Deposit in transit

	Date of Check	Check #	Ck Amount
Less: Outstanding checks	11/15/2002	10001	1,290.24
	11/19/2002	1	-
	11/21/2002	10026	834.93
	11/21/2002	10027	2,000.00
	11/21/2002	10023	205.03
	11/21/2002	10025	289.00
	12/4/2002	10035	6,122.71
	12/4/2002	2	-
	12/4/2002	3	-
	12/5/2002	10065	9,000.00
	12/5/2002	10063	3,252.40
	12/5/2002	10062	40.68
	12/5/2002	10074	600.00
	12/5/2002	10071	938.64
	12/5/2002	10077	2,317.69
	12/5/2002	10078	558.00
	12/5/2002	10070	1,240.00
	12/5/2002	10081	174.80
	12/5/2002	10080	8,691.18
	12/5/2002	10060	4,282.77
	12/5/2002	10079	216.00
	1/29/2003	10118	75.75
	1/30/2003	10064	443.57
	2/24/2003	9119	51.20
	3/18/2003	9153	2,512.24
	3/24/2003	9191	10,080.13
	3/31/2003	999999	47.43
	3/31/2003	1000000	4,894.51
	3/31/2003	999998	289.00
	3/31/2003	1000002	3,330.87
	3/31/2003	1000001	85.52
	4/9/2003	9224	50.00
	4/30/2003	1000003	408.33
	4/30/2003	1000002	2,480.00
	4/30/2003	1000000	3,458.48
	4/30/2003	999999	1,875.00
	5/5/2003	9304	1,090.88
	5/5/2003	9305	125.00
	6/1/2003	10137	100.00
	6/10/2003	10181	561.00
	6/17/2003	10193	96.60
	6/19/2003	10213	43,002.91
	6/19/2003	10209	100.00
	6/19/2003	10203	300.00
	6/19/2003	10217	200.00
	6/19/2003	10207	200.00
	6/19/2003	10210	200.00
	6/19/2003	10218	200.00
	6/19/2003	10206	100.00
	6/19/2003	10204	200.00
	6/19/2003	10202	200.00
	6/19/2003	10219	901.50
	6/19/2003	10216	2,914.03
	6/27/2003	10220	227.00
	6/27/2003	10221	281.50
	6/27/2003	10222	412.00

Incorrect check numbers

Incorrect check numbers

		$ (123,546.52)
Amounts in books not recorded by Bank (Add)		$ -
Payment shown in July Bank Statement (Timing)	4,486.74	$ 4,486.74
Adjusted Balance, June 30, 2003		4,363,893.16
General ledger Balance as at June 30, 2003		$ 4,363,893.16
Difference		$ -

SAN FRANCISCO COUNTY TRANSPORTATION AUTHORITY
BANK RECONCILIATION (Misson National Bank)
June 30, 2003

Balance per Mission National Bank				$	146,142.69
Add: Deposit in transit					
	June		1818.86		
	June		349.55		
				$	2,168.41
Less: Outstanding Checks					
	June	2	-19,079.11 are not recorded in FW		
	June	3	-57,520.00		
		7009	-826.92		
		7108	-465.00		
		7267	-1,873.57		
		7292	-727.50		
		7587	-746.34		
		7754	-448.00		
		7843	-150.00		
		PY	-1,330.00		
		Genjrnl	-11,555.77		
		7916	-1,742.62		
		Gnjrl	-198.56		
		8267	-4,389.91		
			-1,818.85		
		Unreconciled	-18,395.92		
				$	(121,268.07)
				$	-
				$	-
Adjusted Balance, June 30, 2003					27,043.03
General ledger Balance as at June 30, 2003 (Fundware)				$	27,043.03
Difference				$	-

All the entries are incorrect. There are no deposits in transit and no outstanding checks.

The actual corrected book balance is $146,142.69.

cc: Mayor
Board of Supervisor
Civil Grand Jury
Budget Analyst
Public Library
KPMG LLP