



**METROPOLITAN TRANSIT AUTHORITY  
OF HARRIS COUNTY, TEXAS**

Single Audit

September 30, 2009

(With Independent Auditors' Reports Thereon)

**METROPOLITAN TRANSIT AUTHORITY  
OF HARRIS COUNTY, TEXAS**

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**Independent Auditors' Report on Internal Control over Financial  
Reporting and on Compliance and Other Matters Based on an Audit of  
Financial Statements Performed in Accordance with *Government Auditing Standards***

The Board of Directors  
Metropolitan Transit Authority of  
Harris County, Texas:

We have audited the basic financial statements of the Metropolitan Transit Authority of Harris County, Texas (the Authority) as of and for the years ended September 30, 2009 and 2008 and have issued our report thereon dated May 17, 2010, which included a paragraph concerning the adoption of the provisions of Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pension*, and GASB Statement No. 50, *Pension Disclosures*, as of September 30, 2008. In addition, our opinion stated that we did not audit the financial statements of the Metropolitan Transit Authority Transport Workers Union Pension Plan Local 260, the Metropolitan Transit Authority Non-Union Pension Plan and Trust, and the Transport Workers Union Metropolitan Transit Authority Health and Welfare Trust (the Retirement Plans) in 2009 or 2008. The financial information related to the Retirement Plans is included in footnote 4 of the notes to the basic financial statements. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control over Financial Reporting**

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over financial

reporting that we consider to be a significant deficiency which is described in the accompanying schedule of findings and questioned costs as item 09-01. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Authority in a separate letter dated May 17, 2010.

The Authority's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Authority's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

**KPMG LLP**

May 17, 2010



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**Independent Auditors' Report on Compliance with Requirements Applicable to Its Major Federal Program, Internal Control over Compliance in Accordance with OMB Circular A-133 and the Schedule of Expenditures of Federal Awards**

The Board of Directors  
Metropolitan Transit Authority of  
Harris County, Texas:

**Compliance**

We have audited the compliance of the Metropolitan Transit Authority of Harris County, Texas (the Authority) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal programs for the year ended September 30, 2009. The Authority's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Authority's compliance with those requirements.

In our opinion, the Authority complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended September 30, 2009. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 09-02, and 09-03.

**Internal Control over Compliance**

The management of the Authority is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance but

not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as described below, we identified a deficiency in internal control over compliance that we consider to be a significant deficiency.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 09-02 to be a significant deficiency.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did not consider the deficiency described in the accompanying schedule of findings and questioned costs to be a material weakness.

The Authority's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the Authority's responses, and accordingly we express no opinion on them.

#### **Schedule of Expenditures of Federal Awards**

We have audited the basic financial statements of the Authority as of and for the year ended September 30, 2009, and have issued our report thereon dated May 17, 2010 which included a paragraph concerning the adoption of the provision of Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employees for Postretirement Benefits Other than Pension and GASB Statement No. 50, Pension Disclosures*, as of September 30, 2008. In addition our opinion stated that we did not audit the financial statements of the Metropolitan Transit Authority Transport Workers Union Pension Plan Local 260, the Metropolitan Transit Authority Non-Union Pension Plan and Trust, and the Transport Workers Union Metropolitan Transit Authority Health and Welfare Trust (the Retirement Plans) in 2009 or 2008. The financial information related to the Retirement Plans is included in footnote 4 of the notes to the basic financial statements. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Board of Directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

June 23, 2010, (except as to the paragraph relating to the schedule of expenditures of federal awards, which is as of May 17, 2010).

**METROPOLITAN TRANSIT AUTHORITY  
OF HARRIS COUNTY, TEXAS**

Schedule of Expenditures of Federal Awards

Year ended September 30, 2009

(In thousands)

CFDA number	Grant number	Program/project description	Expenditures
		U.S. Department Transportation, Federal Transit Administration:	
		Federal transit capital improvement grants	
20.500	* TX-03-0207	FY 1998/9 Fixed Guideway Modernization	\$ 133
20.500	* TX-03-0232	FY 2001/2 New Starts (2025 Studies)	1
20.500	* TX-03-0233	FY 2001/2 Bus & Bus Facilities	87
20.500	* TX-03-0238	FY 2001 Fixed Guideway Modernization	1,036
20.500	* TX-03-0259	Cypress, Fuqua & Clear Lake P&R (Sect 5309 New Starts)	94
20.500	* TX-03-0268	North Corridor PE (Sect. 5309 New Starts)	10,985
20.500	* TX-03-0269	Southeast Corridor PE (Sect. 5309 New Starts)	11,835
20.500	* TX-03-0288	FY 2003-2004-2005 Fixed Guideway Modernization	1,091
20.500	* TX-04-0025	FY2006 and 2008 Bus & Bus Facilities	3,771
20.500	* TX-05-0138	Capitalized Rail Preventive Maintenance	3,086
		Total direct federal transit capital improvement grants	<u>32,119</u>
		Federal transit capital formula grants:	
20.507	* TX-90-0603	FY 2003 Urbanized Area POP – Purchase METROLIFT Vans, Administration Office Building Construction, MFRI, Smart Card, Shelter Enhancement, RCTSS and Small Business Develop Planning	9
20.507	* TX-90-0640	FY 2004 Urbanized Area POP – Administration Office Building Construction MFRI, Bus Shelters, SmartCard and RCTSS	5
20.507	* TX-90-0681	FY 2005 Urbanized Area POP – MFRI, Smart Card, RCTSS and Shelter Enhancement	4
20.507	* TX-90-0769	FY 2007 Urbanized Area POP – Smart Card and METRONet	15
20.507	* TX-90-0805	FY2008 Urbanized Area POP – 40' Bus Purchase, University DEIS & PE/FEIS, and Shelter Enhancement	752
20.507	* TX-96-0017	ARRA – HOT Lanes, 19 Light Rail Cars, and Shelters	9,399
20.507	* TX-95-0006	Bike Racks, Quickline Infrastructure, and New Service (Quickline, Cypress, & Katy Mills)	967
		Total direct federal transit capital formula grants	<u>11,151</u>
		Funds treated as cost recovery funds:	
20.507	* TX-90-0640	Capitalized Bus Preventive Maintenance	274
20.507	* TX-90-0681	Capitalized New Service – Cypress P&R	197
20.507	* TX-90-0708	Capitalized Bus Preventive Maintenance	477
20.507	* TX-90-0769	Capitalized Bus Preventive Maintenance	758
20.507	* TX-90-0805	Capitalized Bus Preventive Maintenance	1,908
20.507	* TX-90-0843	Capitalized Bus Preventive Maintenance, and Paratransit Support	45,677
20.507	* TX-95-0006	Capitalized New Service – Cypress P&R and Grand Parkway P&R	1,434
		Total direct funds treated as cost recovery	<u>50,725</u>
		Total direct federal transit capital formula and cost recovery grants	<u>61,876</u>
		Other federal funds:	
20.205	TX-17-0001	Intermodal Terminal – Land	492
20.516	TX-37-0059	FY2006 Job Access and Reverse Commute (JARC)	18
20.521	TX-57-0006	FY2006 New Freedom	7
97.036	N/A	FEMA – Hurricane Ike	1,406
		Total direct other federal funds	<u>1,923</u>
		Total Direct Funds from Federal Transit Administration Grants	<u>95,918</u>
		Funds passed through from Federal Highway Administration (FHWA) and treated as cost recovery funds:	
		U.S. Department of Transportation funds passed through the FHWA to The Texas Department of Transportation and the Houston-Galveston Area Council (HGAC) Regional Van Pool Program	5,508
20.205	HGAC		<u>5,508</u>
		Total Funds from Federal Highway Administration (FHWA)	<u>5,508</u>
		Total federal awards received and used by METRO	<u>101,426</u>
		Funds passed to subrecipients:	
20.516	TX-37-0059	FY2006 Job Access and Reverse Commute (JARC)	76
20.521	TX-57-0006	FY2006 New Freedom	276
		Total funds passed to subrecipients	<u>352</u>
		Total federal awards received by METRO	<u>\$ 101,778</u>

\* Major federal assistance program.

See accompanying auditors' report and notes to the schedule of expenditures of federal awards.



**METROPOLITAN TRANSIT AUTHORITY  
OF HARRIS COUNTY, TEXAS**

Notes to Schedule of Expenditures of Federal Awards

Year ended September 30, 2009

**(1) Reporting Entity**

The Schedule of Expenditures of Federal Awards presents the activity of all federal financial assistance programs of the Metropolitan Transit Authority of Harris County, Texas (the Authority).

**(2) Basis of Accounting**

The accompanying Schedule of Expenditures of Federal Awards is presented using the accrual basis of accounting, which is described in note 1 to the Authority's basic financial statements.

**(3) Relationship to the Basic Financial Statements**

Federal financial assistance revenue is reported in the Authority's financial statements as capital grant proceeds and nonoperating grant proceeds in the amount of approximately \$100.3 million.

**METROPOLITAN TRANSIT AUTHORITY  
OF HARRIS COUNTY, TEXAS**

Schedule of Findings and Questioned Costs  
Year ended September 30, 2009

**Section I – Summary of Auditors’ Results**

***Financial Statements***

The type of auditors’ report issued:	<b>Unqualified</b>
Internal control over financial reporting:	
• Material weaknesses identified?	<b>No</b>
• Significant deficiency(ies) identified that are not considered to be material weakness(es)?	<b>Yes</b>
Noncompliance that is material to the financial statements noted?	<b>No</b>

***Federal Awards***

Internal control over major programs:	
• Material weaknesses identified?	<b>No</b>
• Significant deficiency(ies) identified that are not considered to be material weakness(es)?	<b>Yes</b>
The type of auditors’ report issued on compliance for major programs:	<b>Unqualified</b>
Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133?	<b>Yes</b>

Identification of Major Program:

Name of program or cluster	CFDA numbers
Federal Transit Cluster (ARRA and Non-ARRA)	20.500 and 20.507

Dollar threshold used to distinguish between Type A and Type B programs:	\$3,000,000
Auditee qualified as a low-risk auditee under Section 0.530 of OMB Circular A-133:	<b>Yes</b>

**METROPOLITAN TRANSIT AUTHORITY  
OF HARRIS COUNTY, TEXAS**

Schedule of Findings and Questioned Costs

Year ended September 30, 2009

**Section II – Financial Statements Findings**

**Reference No. 09-01**

**Capital Assets**

Per Governmental Standards Board Statement (GASB) No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, “capital assets should be reported at historical cost. The cost of a capital asset should include capitalized interest and ancillary charges necessary to place the asset into its intended location and condition for use. Ancillary charges include costs that are directly attributable to asset acquisition – such as freight and transportation charges, site preparation costs, and professional fees. The term capital asset includes land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.”

The Authority’s policy for capitalizing costs associated with its capital assets is not codified. Based on discussions with management and a review of the costs capitalized in fiscal year 2009, the Authority is employing an approach whereby it capitalizes not only the direct asset acquisition costs as described in GASB 34, but certain indirect costs as well. While the capitalization of direct costs is in accordance with generally accepted accounting principles, the capitalization of indirect costs is not completely consistent with generally accepted accounting principles. For example, the Authority capitalized the salary costs of certain procurement and IT personnel and the overhead costs (utilities, office supplies, etc.) it attributes to those procurement and IT personnel. Services such as the procurement or IT department are essential to the proper functioning of the organization and reflect the true cost of operations. However, due to the inherent nature of central service related costs, the activities are not directly attributable incremental costs that should be capitalized.

***Recommendation***

We recommend that management implement a formal policy for capitalizing costs that is more consistent with applicable GASB guidance. Implementation of such a policy would provide consistent guidance to Authority personnel regarding the appropriate types of costs to be capitalized.

***Management Response***

Management agrees the codification of the capitalization policy would be beneficial in providing consistent guidance regarding costs to be capitalized. In reviewing our capitalization policies and procedures, particular consideration will be given to consistency with generally accepted accounting principles. Management has developed a plan to accomplish the codification of the capitalization policy by September 30, 2010. The Finance Department, Accounting and OMB, will be working with METRO managers to fully implement METRO’s capitalization policy.

**METROPOLITAN TRANSIT AUTHORITY  
OF HARRIS COUNTY, TEXAS**

Schedule of Findings and Questioned Costs

Year ended September 30, 2009

**Section III – Federal Award Findings and Questioned Costs**

**Reference No. 09-02**

**Davis-Bacon Act**

**Federal Transit Cluster CFDA # 20.500 and 20.507**

**Award year – Various**

**Award number – Various**

**Type of finding – Significant Deficiency and Noncompliance**

Questioned Costs: None

When required by the Davis-Bacon Act, the Department of Labor's (DOL) government wide implementation of the Davis-Bacon Act, or by Federal program legislation, all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of \$2,000 financed by Federal assistance funds must be paid wages not less than those established for the locality of the project (prevailing wage rates) by the DOL (40 USC 3141-3144, 3146, and 3147 (formerly 40 USC 276a to 276a-7)).

Non-federal entities shall include in their construction contracts subject to the Davis-Bacon Act a requirement that the contractor or subcontractor comply with the requirements of the Davis-Bacon Act and the DOL regulations (29 CFR part 5, Labor Standards Provisions Applicable to Contracts Governing Federally Financed and Assisted Construction). This includes a requirement for the contractor or subcontractor to submit to the non-Federal entity weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls) (29 CFR Sections 5.5 and 5.6). This reporting is often done using Optional Form WH-347, which includes the required statement of compliance (OMB No. 1215-0149).

The Authority includes the applicable Davis-Bacon provisions for contracts that are subject to the Davis-Bacon Act to allow for the contractor or subcontractor to comply with the requirements of the Davis-Bacon Act and the DOL regulations. We selected a sample of 4 out of 8 contracts from open constructions contracts over \$2,000 and reviewed the contract documentation noting whether management approved the contract for compliance with the Davis-Bacon provision. However, due to management oversight in the awarding of a new contract, we noted that one vendor contract did not include the applicable Davis-Bacon language.

***Recommendation***

The Authority should ensure that all constructions contracts subject to applicable Davis-Bacon requirements incorporate the appropriate language to comply with grant related guidelines.

***Management Response and Corrective Action Plan***

Modifications to include the Davis-Bacon and Copeland Anti-Kickback Act clause in the aforementioned contract have been completed. To prevent future occurrences, management implemented a process where the Program Specialist will review contract files subject to Davis-Bacon prior to routing to ensure that the required Davis-Bacon clauses and Wage Decisions are entered into the contract.

*Implementation Date:* November 13, 2009

*Responsible Person:* Gunther Schieb

**METROPOLITAN TRANSIT AUTHORITY  
OF HARRIS COUNTY, TEXAS**

Schedule of Findings and Questioned Costs

Year ended September 30, 2009

**Reference No. 09-03**

**Procurement Suspension and Debarment**

**Federal Transit Cluster CFDA # 20.500 and 20.507**

**Award year – Various (ARRA Funds)**

**Award number – TX-96-0017 (ARRA)**

**Type of finding – Noncompliance**

Questioned Costs: None

The Authority has been working with Federal Transit Authority (FTA) to resolve potential issues related to its compliance with Buy America requirements. Specifically, the Authority must comply with Buy America requirements as noted below:

All steel, iron, and manufactured products used in the project must be manufactured in the U.S., as demonstrated by a Buy America certificate, or, in the case of rolling stock, the cost of components produced in the United States is more than 60 percent of the cost of all components and final assembly of the vehicle takes place in the U.S. (49 CFR part 661).

- a. The FTA Administrator may grant specific waivers following case-by-case determinations that: (1) applying the requirement would be inconsistent with the public interest; (2) the goods are not produced in the U.S. in a sufficient and reasonably available quantity and of satisfactory quality; or (3) the inclusion of the domestically produced material will increase the overall project cost by more than 25 percent (49 CFR sections 661.7(b) through (d)).
- b. Appendix A to 49 CFR section 661.7 provides general waivers for the following items:
  - (1) Those articles, materials, and supplies exempted that are listed in 48 CFR section 25.104;
  - (2) Microprocessors, computers, microcomputers, or software, or other such devices, which are used solely for the purpose of processing or storing data; and
  - (3) All “small purchases” (under \$100,000) made by FTA recipients with capital, planning, or operating assistance.
- c. Appendix A to 49 CFR section 661.11 provides a general Buy America waiver when foreign-sourced spare parts for buses and other rolling stock (including train control, communication, and traction power equipment) whose total cost is 10 percent or less of the overall project contract cost are being procured as part of the same contract for the major capital item.
- d. A recipient that purchases rolling stock for transportation of fare-paying passengers must conduct, or cause to be conducted, a pre-award audit before entering into a formal contract for the purchase of rolling stock, and certify that a post-delivery audit is complete before title to the rolling stock is transferred to the recipient. Pre-award and post-delivery audits verify the accuracy of the Buy America certification, purchaser’s requirements certification, and certification of compliance with or inapplicability of Federal motor vehicle safety standards (49 CFR part 663).

**METROPOLITAN TRANSIT AUTHORITY  
OF HARRIS COUNTY, TEXAS**

Schedule of Findings and Questioned Costs

Year ended September 30, 2009

We tested 8 of 40 procurement contracts. For one of the contracts tested, the FTA has issued a formal investigation related to the Authority's compliance with Buy America requirements. The vendor involved is CAF, USA, Inc. (CAF), a light rail vehicle supplier. As of September 30, 2009, the Authority has paid \$4,292,750 in federal funds to CAF, of which \$2,992,720 was funded by the ARRA. The Authority and FTA have been and are currently addressing the concerns that FTA has raised. The Authority's management has responded to FTA's concerns and management is working on settling the matter with FTA.

***Recommendation***

The Authority should continue to work with FTA to address its concerns and potential Buy America noncompliance matters.

***Management Response and Corrective Action Plan***

*Implementation Date:* July 30, 2010

*Responsible Person:* Lloyd Welch

METRO agrees with KPMG's recommendation and will continue to work diligently with the FTA to resolve their concerns on the Buy America matters.