

SOUND TRANSIT AUDIT AND REPORTING COMMITTEE MEETING

**Summary Minutes
September 26, 2013**

CALL TO ORDER

The meeting was called to order at 10:35 a.m. by Committee Chair Dave Enslow, in the Ruth Fisher Boardroom, 401 South Jackson Street, Seattle, Washington.

ROLL CALL

Chair
(P) Dave Enslow, Sumner Mayor

Vice Chair
(P) Larry Phillips, King County Councilmember

Committee Members

(P) Fred Butler, Issaquah Deputy Council President

(P) Mary Moss, Lakewood Councilmember

(A) Dow Constantine, King County Executive

(P) Stuart Scheuerman, Citizen Oversight Panel Chair

(A) John Marchione, Redmond Mayor

Ms. Katie Flores, Board Coordinator, announced that a quorum of the Committee was present at roll call.

REPORT OF THE CHAIR

Chair Enslow asked Brian McCartan, Executive Director of Finance and Information Technology to review today's agenda.

BUSINESS ITEM

Minutes of the June 27, 2013 Audit and Reporting Committee Meeting.

It was moved by Boardmember Moss, seconded by Boardmember Phillips, and carried by the unanimous vote of all members present that the minutes of the June 27, 2013 Audit and Reporting Committee be approved as presented.

EXTERNAL AUDITS

Subarea Report

Lacy Ferguson, Accounting Manager, gave the 2012 Subarea Report. Sound Transit is required to report on benefits and expenditures for each subarea on an annual basis. Subarea equity is measured based on 2023 when the ST2 plan is completed. The Board is responsible for reviewing and approving the agreed upon procedures performed by an independent auditor, currently KPMG. Source and use allocations are based on mode and are then broken down by subarea using established drivers. Operating expenses are based on where the service occurs, as service levels change allocations change as well. The report appendix includes all the drivers used by Sound Transit to allocate revenues and costs. If the scope changes for capital projects, drivers are adjusted.

New drivers were reviewed based on new projects beginning in 2012 and two corrections related to Ticket Vending Machine and Closed-Circuit Television allocations. The KPMG review of agreed upon procedures

found no exceptions for 2012. Sound Transit is on track to maintain subarea equity at the 15-year milestone.

2012 State Auditor's Office Accountability Audit

Kelly Priestly, Director of Accounting, provided an update on the status of the State Auditor's Office (SAO) accountability audit. Auditors are now on site conducting audit planning for the 2012 Accountability Audit. The audit entrance is scheduled for October 3, 2013. The audit will be completed before the end of 2013.

Procurement Status for Financial and Federal Audit Services

The financial and federal audit services contract expires at the end of 2013. Sound Transit is preparing a new procurement for future services in this area. An action will be brought to the Operations and Administration Committee to approve a new contract. KPMG was the successful candidate for that contract.

FINANCIAL REPORTING

Overview of 2Q 2013 Financial Results and Reports

Pete Rogness, Director of Budget and Financial Planning, gave a report on the second quarter 2013 Financial Results and Reports. He noted that there was a revision to the report; the updated second quarter report is marked "Revised."

Revenues through the second quarter are \$2.2 million over the budget. Sales tax was 3% above budget, Rental Car Tax was on budget, and Motor Vehicle Excise Tax was above budget by 2%. Fare revenues were 10% above budget, or \$2.5 million above budget. Sounder revenues were 11% above budget, ST Express was 10% above budget, and Central Link was 8% above budget. Investment income was 35% below budget due to the mark to market entry that will be discussed later in today's meeting. Miscellaneous revenues were 8% of budget. Miscellaneous revenues used to include state and local revenues, but that is now reported separately. Federal Grants were at 96% of the budget based on draw downs, but it represents an increase over the first quarter.

Total fare revenue was 11% above budget for transit operations. Boardings on all transit modes were ahead of budget forecasts and 2012 boardings except for Tacoma Link. The fare box recovery rate exceeded the target for all the modes. Transit operations expenses were 94% of the annual budget. Sounder was 92% of budget because of vehicle maintenance with Amtrak that was budgeted but not needed this quarter. ST Express was at 96% of the budget due to lower partner rates than budgeted and facility maintenance that was budgeted but not needed. Tacoma Link was at 87% of the budget, due to services and facility maintenance that were not needed in the quarter. Central Link was at 93% of its budget because Sound Transit received payment for costs related to copper wire replacement.

All departments are within budget, salary and benefits were within their budgets, some savings were seen in software and hardware maintenance, auditing and temporary services. The agency had an 10% position vacancy rate, there were 69 vacancies in the first quarter. Ten positions were added in June related to work on the Long Range Plan and ST3 planning.

Capital expenditures for ST Express are at 82% of the budget because of slower work on I-90 Stage 3 and the Mountlake Terrace Freeway Station. The Rainier Avenue Arterial Improvement and Strander Boulevard projects are ahead of budget because of faster billing than anticipated. Sound Transit has fixed contributions for both of those projects. The ST Express bus base project is not proceeding as quickly as anticipated. Capital expenditures for Sounder are at 189% through the second quarter because Sound Transit paid for a BNSF easement in the second quarter that was scheduled for the third quarter. Without that payment, the Sounder capital budget is at 54% of the year to date budget due to savings in the

Layover and M to Lakewood projects and delays to the Positive Train Control project. Capital expenditures for Central Link are at 96% of the year to date budget. Under spending was due to anticipated right-of-way acquisition for the S 200th Link Extension and lower University Link spending.

The Service Delivery capital budget was at 38% of the year to date budget because of delays to enhancement and repair and replacement projects that will take place in 2014. Capital outlays were at 63% of the year to date budget because of slower expenditures for the South Corridor Alternatives Planning Study and the Ballard to downtown High Capacity Transit Study.

2Q Asset Liability Management Report

Jim Block, Cash Investment Administrator, gave a presentation on the second quarter report.

There were no changes to the stoplight indicators in the asset liability management report. The federal government will keep the Fed rate floating between 0 and 25 basis points for a significant period. In the second quarter 2013, the average yield on total cash and investment holdings decreased two basis points, to 88 basis points. The state investment pool was at 12 basis points at the end of the second quarter and the King County investment pool was at 47 basis points. There has been no change in investment strategy. During the second quarter, \$3 million in open-market securities were purchased for the unrestricted portfolio at an average yield of 75 basis points. New purchases were in agency bonds. Yields in longer term bonds rose dramatically after comments from the Federal Reserve Chair that the central bank may begin to reduce bond purchases to reduce quantitative easing. The rapid increase in yields caused some of the largest unrealized losses seen by bond investors in recent history. The increase in yields caused the value of Sound Transit's portfolio holdings to decrease by \$7.9 million. The losses do not truly affect Sound Transit so long as the investments are held to maturity. Actual interest earnings without the fair market value adjustment were \$4.1 million, or \$1.2 million over budget. Performance returns are above the benchmark for the unrestricted but below the benchmark for capital replacement portfolios due to the increase in longer term yields. All portfolios are in compliance with policy limits and guidelines. Tax exempt debt is higher than taxable debt because of a flight to quality in US Treasuries and the impact of the bankruptcy of the City of Detroit. The current borrowing rate for short-term debt is around 69 basis points and the current borrowing rate for long-term debt is around 4.4%.

Mr. McCartan noted that borrowing rates have gone from 3.69% in the first quarter to 4.41% in the second quarter. The financial plan assumes Sound Transit will borrow at 5.75%. As rates rise, Sound Transit will not be able to achieve as much savings when borrowing funds. Sound Transit still needs to borrow \$7.5 billion to complete the capital program. One strategy is to pursue a TIFIA loan. Sound Transit is investing agency funds, but investment returns have not increased much. The agency will continue to pursue somewhat earlier bonding to lock in lower interest rates and continue communicating with consultants and peers on strategies going forward.

Contract Reports

Ted Lucas, Director of Procurements and Contracts introduced himself and reviewed the four contract reports included in Boardmember packets:

- A report covering 2nd quarter contracts awarded by the CEO that are between \$100,000 and \$200,000;
- A report covering 2nd Quarter sole source and propriety contracts awarded by the CEO that are between \$10,000 and \$100,000;
- A report covering 2nd Quarter proprietary contracts awarded by the CEO that exceed \$100,000; and
- All open contracts in excess of \$10,000 that were still current in the 2nd Quarter.

The first three reports are required under the Board's procurement policy, Resolution No. R78-2. The report showing contracts that are longer than 5 years will no longer be included in the quarterly contracts reports because they are included in the all open contracts report.

Real Estate Report

A real estate report showing properties where Sound Transit is the lessor or the lessee were included in Boardmember packets.

INTERNAL AUDIT UPDATE

2013 Performance Audit Report presentation

Mark Steranka and Colleen Rozillis from Moss Adams, LLP reviewed the audit conducted on Post-Award Goods and Services Contract Management. Sound Transit contracts for many goods and services; during the audit period there were 581 active goods and services contracts with a total commitment value of \$326 million. The audit focused on economy, efficiency and effectiveness instead of on compliance. Standard performance audit methodology was used for the audit, including conducting interviews with Sound Transit personnel, reviewing documents and conducting research and analysis on a sample of 40 active goods and services contracts.

The primary finding of the audit was that goods and services contract management practices are inconsistent across Sound Transit. The audit recommendation is to minimize risk by maximizing consistency across goods and services contract management practices. Seven areas were identified for better efficiency, including centralizing the contracting function, formalizing roles and responsibilities, formalizing policies and procedures, improving training, utilizing agency systems for contract administration, improving documentation, and developing tools to improve accountability.

A three-phase action plan was suggested including looking at organizational structure, workforce and resource allocation to begin implementing recommendations, followed by implementing changes that were dependent on changes to Sound Transit's structure, and adding resources as needed.

Mr. Steranka noted that Sound Transit is already working to address some of the audit findings; including the start of a formal training program, a regular review of goods and services contracts by the Facilities Division, and the hiring of a business manager in the Information Technology Division.

David Hammond, Internal Audit Director, noted that the management response is being prepared and will be included in the final performance audit report. A steering committee comprised of Sound Transit staff has also been established to provide follow-up on the audit.

Contract Cost Audit Report presentation

Steve Miller, of Miller & Miller, P.S., conducted an audit of Sound Transit architectural and engineering contracts' overhead costs. The audit evaluated Sound Transit's procedures in managing architectural and engineering (A&E) contract overhead costs to prevent inappropriate charges for indirect costs or higher overhead rates. The audit was based on previous findings in 2011 where overhead rates were increased on some contracts without adequate documentation to support the increase. The earlier audit recommended a formal policy for rate reviews; this audit follows up on the previous audit and looked at systemic issues. Sound Transit has implemented substantial procedures since the original audit.

The audit sought to establish three objectives; to protect Sound Transit's rights in contracts, that Sound Transit only pay for approved and supported rates, and that there be a regular inspection and monitoring program to ensure the rates are kept current and approved. The audit found a high compliance with contract provisions that protect Sound Transit's interests. The only exceptions found were limited to on-call contracts where the total contract amount was not known. There were also some exceptions with supporting documentation. The audit also found that policies regarding review and approval of overhead rates should be strengthened.

The audit recommendations include the definition and adoption of an overhead review policy that establishes contract limits where formal documentation or cognizant review through an independent audit or another agency is required, and lower contract limits where formal internal review is required. The audit also suggested establishing parameters for the frequency of review and documentation guidelines. The

policy should apply to all prime contractors for A&E contracts and should be updated annually. The reporting would also be enhanced by having a centralized database to record approved overhead rates.

Next steps include finalizing the audit report and receiving the management response to the audit for inclusion in the final report.

2014 Performance Audit topic selection

There are four potential audit topics for the 2014 performance audit. The Audit and Reporting Committee is scheduled to select the topic at its December meeting. Sound Transit's Performance Audit program requires one performance audit in years the State Auditor's office does not perform an audit. The topic is selected by the Audit and Reporting Committee and the audit is managed by the Internal Audit division.

The topics are based on the Internal Audit Division's assessment of risk based on interviews with stakeholders and management. The selection criteria includes an assessment of the potential for cost savings, the potential to improve performance and efficiency, the potential to facilitate decision-making, the potential to contribute to public accountability, and whether the topic has a manageable audit cost and scale.

The potential topics are Central Link Operating Costs, Sound Transit's Security Program, the Sound Transit Phase Gate Program and Information Technology Project Management. Mr. Hammond reviewed the audit objectives, audit history and cost and budget history for each of the topics.

The Central Link Operating Costs audit would evaluate factors driving costs and identify opportunities to reduce costs within the existing business model. Audit history includes FTA Triennial audits and an operations audit conducted by the Washington State Department of Transportation (WSDOT) that had positive results. The internal audit division is also conducting a cost audit in this area. The 2014 Central Link operating budget is 6% higher than the 2013 budget amount.

The Sound Transit Security Program audit would look at efficiencies, economy, effectiveness. This area was also audited in the operations audit conducted by WSDOT. The Department of Homeland Security also conducted an audit of Sound Transit Security last year that had very good results. A state auditor's compliance audit had a finding related to contract monitoring that has since been resolved. Last year, the Audit and Reporting Committee requested internal analysis of the efficiency and effectiveness of the program. That work is underway and benchmarking information will be presented to the Operations and Administration Committee in December. The annual budget for Sound Transit security is around \$18 million.

An audit of the Sound Transit Phase Gate Program would look at increasing efficiency and effectiveness. The Phase Gate program is Sound Transit's internal management and budget approval process for capital programs. There is no audit history, but the topic is on the list for the Internal Audit Division as a potential internal audit. The program has been beneficial to Sound Transit improving coordination, the audit would look for any efficiencies.

The Information Technology (IT) Project Management topic would identify process improvements and identify cost savings. A performance audit was conducted on IT procurement in 2010, and the Internal Audit division conducted a follow-up on that audit earlier this year. The Internal Audit Division also plans to conduct an audit on IT Project Management if this topic is not selected for the 2014 Performance Audit topic. The program budget is over \$6 million a year in capital projects.

Internal Audit reports issued

Shelli Applegate, Senior Internal Auditor, reviewed the audit of the Non-Revenue Vehicle Program issued in August. The audit was a follow-up to the 2010 fuel card audit and also looked at internal controls around the non-revenue vehicle program and parking garage usage. The Sound Transit non-revenue fleet includes 181 vehicles and heavy equipment machinery. A third of the fleet is managed by King County in support of Central Link operations. Over the past two years, the facilities division has made significant changes to the non-revenue vehicle program including installing a fleet management and reservation system, revising the non-revenue vehicle policy and establishing new procedures. The audit found that internal controls and oversight should still be improved. The specific recommendations include improving

monitoring of fuel cards, parking passes, and the assignment and usage of vehicles. Formal processes and procedures should be established for preventative maintenance, assignment of vehicles to individuals, and use of parking passes, and mitigating risk by separating duties. Management developed a corrective action plan that includes an additional employee in the 2014 budget. An audit follow-up is scheduled for 2014.

Prior Recommendation Status

Mr. Hammond reviewed the follow-up status for prior internal audits.

Internal Audits in progress

Mr. Hammond reviewed seven audits currently in progress; the Value Engineering Follow-up, Construction Change Orders, Partner Costs, Paratransit Follow-up, Wireless Device Program, Motor Vehicle Excise Tax Phase Two, and Fuel Purchasing Follow-up.

NEXT MEETING

December 19, 2013
10:30 a.m. to 12:30 p.m.
Ruth Fisher Boardroom

ADJOURN

The meeting was adjourned at 12:28 p.m.



Dave Enslow
Audit and Reporting Committee Chair

ATTEST:



Katie Flores
Board Coordinator

APPROVED on January 23, 2014, KWF