

SOUND TRANSIT AUDIT AND REPORTING COMMITTEE MEETING

Summary Minutes

March 17, 2016

CALL TO ORDER

The meeting was called to order at 11:06 a.m. by Chair Rob Johnson, in the Ruth Fisher Boardroom, 401 South Jackson Street, Seattle, Washington.

ROLL CALL

Chair

(P) Rob Johnson, Seattle Councilmember

Vice Chair

(A) Dave Enslow, Sumner Mayor

Committee Members

(P) Nancy Backus, Auburn Mayor

(A) Dave Somers, Snohomish County Executive

(A) Joe McDermott, King County Councilmember

(P) Philip Lovell, Citizen Oversight Panel Chair

(P) Mary Moss, Lakewood Councilmember

Ms. Linda Markey, Board Coordinator, announced that there is no quorum of the Committee present at roll call. Chair Johnson noted that the committee would hear reports first and move to Business Items after additional Boardmember(s) arrive and a quorum is established.

REPORT OF THE CHAIR

New Audit and Reporting Committee Chair Rob Johnson introduced Nancy Backus who also joined the Committee as a new member.

Chair Johnson noted that the committee would be working from a revised agenda. Staff will present item number 6, Annual External Reporting at a future meeting.

EXTERNAL AUDIT RESULTS

Summary of Historical External Audits Environment, Results and Findings

Chair Johnson asked Brian McCartan, Executive Director of Finance and IT to provide context on Sound Transit's audit environment and the role of the Audit and Reporting Committee (ARC). Mr. McCartan provided an overview of the agency audit environment. Sound Transit relies on both internal and external audits to ensure the appropriate spending of public funds and to review delivery and execution of core agency objectives. Sound Transit's audit environment focuses on three levels of controls including strong internal compliance and controls, active Board review and engagement and strong external assurances. Sound Transit established the ARC to consider the effectiveness of the agency's system of internal controls and evaluate how well the agency is set up structurally to achieve its mission and objectives. Sound Transit has had over 160 external audits to date with outstanding results overall and no major findings.

Chair Johnson recognized the arrival of Boardmember Moss and asked Boardmembers to share their thoughts on the future direction and focus for the Committee over the next several years. Areas of interest included opportunities in training and personnel development as Sound Transit expands service and operations as well as impediments to expanded small business participation.

In response to Boardmember inquiries, Mr. McCartan noted that staff could provide information about small business participation, goals and Sound Transit's use of small businesses compared to other organizations as well as impediments to increasing participation. Boardmembers expressed their belief in the value of both internal and external audits to identify and improve methods to improve service delivery.

BUSINESS ITEMS

Minutes from the December 17, 2015 Audit and Reporting Committee meeting minutes

It was moved by Boardmember Moss, seconded by Citizen Oversight Panel Chair Lovell, and carried by unanimous vote that the minutes of the December 17, 2015 Audit and Reporting Committee Meeting Minutes be approved as presented.

FINANCIAL REPORTING

Fourth Quarter Financial Report

Brian McCartan, Executive Director of Finance and IT presented the fourth quarter financial reports. The agency was at 112% of budget for revenues due to a strengthening economy. The agency also benefitted from a large settlement claim adding approximately \$28M. Expenditures for transit operations were under budget in almost all areas but noted a positive variance for fuel cost on Sounder commuter rail. Project delivery in 2015 reflected the ST2 program overtaking Sound Move in expenditures. The Northgate and East Link Extensions represented the two projects with the highest expenditures. Budget variances included overspending on the annual budget for the Northgate project due to timing of a right of way purchase but the project is still within the approved lifetime budget. The South 200th Link Extension was at 107% of budget for the year due to higher design expenditures and payments to the City of SeaTac. This project is also trending significantly under the approved lifetime budget. Mr. McCartan summarized the financial year as being solid on the revenue side and expenditures are tracking well as the agency moves into the heart of capital spending for ST2. Mr. McCartan reminded Boardmembers that the Positive Train Control (PTC) Project, which responds to a national federal mandate that all commuter rail programs implement a computerized system to prevent train collisions, should be complete by the end of this year. This is well ahead of the December 2019 deadline recently extended by Congress.

In response to Boardmember questions, Mr. McCartan explained that Sound Transit uses lessons learned from previous projects to ensure the most accurate forecasting possible, to meet target goals set to eliminate both under and overspending.

Fourth Quarter Asset Liability Management Report

The Asset Liability Management Report looks at both debt and investments. Sound Transit is one of the largest debt issuers for transit in the county. The agency closely coordinates debt issuance and investment strategies as outlined in established policies. The report uses stoplight indicators to assist the committee in identifying significant variances from quarter to quarter. Key indicators include investment performance, interest rate risk, credit risk and liquidity risk. The agency is ahead of interest earnings on a budget basis but there were some losses as interest rates fluctuated. Interest rate risk, credit risk and liquidity risk are all unchanged from prior periods.

There was a significant shift in the national rate environment when the Federal Reserve for the first time in a number of years tightened financial policies and increased interest rates. This has important impacts to Sound Transit's borrowing and investments. The agency has restricted cash investments of \$450M set aside as reserve. The unrestricted amount of \$795M pays for the capital program and is significantly higher than the previous report due to the recent issuance of \$640M in bonds. The agency will spend that money over 2016 as it enters peak spending for the ST2 program. The agency manages \$1.2B in cash investments.

Mr. McCartan summarized agency policies that ensure restricted reserves and the agency choice to issue green bonds. Adopted policies require that the agency maintain a two-month operating reserve, a reserve for capital replacements, an emergency loss reserve for unanticipated expenditures maintained for the life of the bonds and other miscellaneous reserves required under particular contractual obligations.

The agency chose to issue green bonds to advertise the focus on its sustainability program and that the nature of the investments themselves are green. This approach was effective in expanding the appeal of the bonds and reaching over two dozen new investors. The agency intends to include this as a permanent part of the bonding program.

Fourth Quarter Contract Reports

The contract report provides the Committee with information about the delegation of authority given to staff. The full report discloses information about the following:

- Competitive Contracts Awarded by the CEO up to \$200,000;
- Proprietary Contracts Awarded;
- Sole-Source Contracts Awarded, and
- A comprehensive list of all awarded contracts.

Mr. McCartan provided a brief summary of each report section to confirm that agency policies for execution of contracts is carried out as prescribed by the Board.

INTERNAL AUDIT UPDATE

Jack Hutchinson, Internal Audit Director summarized the six Internal Audit items on the agenda. The first two reports provide updates on response to findings within audit results previously reported to the Committee.

Management Update on the 2015 QA/QC Program Performance Audit

Mohammad Saleem, Senior Quality System Manager provided the update. Mr. Saleem noted that though results were largely positive, the audit did identify the processing of the Nonconformist Report as an area for improvement. Mr. Saleem summarized management actions to address the recommendation including the formation of a cross-functional team to conduct an in depth process improvement project specific to nonconformist reporting. The project goal is to simplify the reporting process, better define roles and responsibilities and increase effectiveness during construction. Following project completion, staff will provide additional training to construction managers, resident engineers and field inspectors.

Management Update A&E Contract Compliance Review

Ted Lucas, Director of Procurements and Contracts provided the update. Mr. Lucas reported that this audit looked at five of Sound Transit's architect engineer services contracts with Parson-Brinckerhoff. The focus of the review was on verification of amounts due with observations on Sound Transit's project management. The audit provided six recommendations. Mr. Lucas provided a summary of the recommendations and actions to address the recommendations.

The first two recommendations related to approval of personnel additions and direct labor rates. An update to contract language will ensure that contractors will not remove or change assignments of key personnel without Sound Transit's written approval. Sound Transit's approval extends to review of pricing and cost information related to any substitution or addition made during the course of the contract. Contractors must also provide notification of proposals for new key personnel changes with hourly labor rates and receive Sound Transit approval of direct labor rates.

Recommendations 2 and 3 related to strict management control of travel and overtime requests. Sufficient controls exist within the approval process and staff provided a training refresh to Sound Transit Project Managers and Consultants and will continue to monitor compliance in this area.

The audit looked at project cost tracking and total costs to date for Parson-Brinckerhoff within the scope of the audit and found the current accounting to be accurate. Recommendation 5 of the audit results suggested that Sound Transit vendors hold disputed amounts from future billings until the dispute is resolved. The auditors categorized this recommendation as a minor observation. Parson-Brinckerhoff has agreed to comply with this change.

Finally, recommendation 6 related to cost of lease vehicles. Sound Transit made a minor change to contract language to include leased equipment, material, supplies and vehicles as well as rented.

Internal Audits Completed

Jack Hutchinson provided a summary of results from two recently completed audits. The first audited the facilities condition assessment program and the second audited the annual testing of procurement card (P-Card) transactions.

The Facilities Condition Assessment Program audit reviewed compliance with internal and external requirements of the assessment program and the effective utilization of assessment data. The audit confirmed that the program is in compliance and that staff is utilizing assessment data to determine efficiency and effectiveness of asset management activities. This audit had no exceptions and issued a clean audit report.

The P-Card transaction audit scope of work included testing of procurement card transactions across the agency with the goal of identifying any systemic weaknesses in management controls and to ensure that transactions are proper and in compliance with applicable agency policies and procedures. Staff uses the P-Card to procure high volume, low cost supplies such as paper and pens. Staff provided management with a memo stating that this audit found no exceptions. The audit was not included in committee members' packets based on a proposal by Mr. Hutchinson to not include regular annual audit findings in Committee packets unless significant issues are identified that require committee discussion. Boardmember discussion confirmed the continuance of this practice.

Internal Audits in Progress

Mr. Hutchinson presented a summary of audits in progress. The Sounder contract compliance monitoring audit looked at management monitoring controls to ensure that Sounder program partner billing was in compliance with contract terms and conditions. The results of this audit will be presented to the Committee in June.

The project labor accounting audit focuses on Sound Transit employee time sheets and allocation of hours to specific projects. The audit found that employees accurately allocated and reported times. Mr. Hutchinson noted that this also has implications related to Grant reimbursement funds and this audit helps to mitigate those funding risks.

Finally, staff is performing a follow up procedure on a previous audit of the wireless device program performed in 2013. The audit identified a process area related to management monitoring for improvement. This follow up examines the actions management has or is in the process of taking to mitigate the issue identified in the audit report. Staff will present results of this follow up audit to the Committee in June.

2015-2016 Biennial Internal Audit Work Plan Update

Mr. Hutchinson reported that the agency's 2015 biennial plan included 30 individual engagements and 23 individual engagements for 2016. With only 3 employees and a 67% recent turnover, the Internal Audit Division was able to complete 16 audits or 53% of scheduled audits in 2015. Mr. Hutchinson recommended that the agency adjust future work plans to accurately reflect the division size. As a peer example, the Port of Seattle employees 67 professional internal auditors and includes an average of 25 engagements in their annual plan.

Mr. Hutchinson reviewed remaining open audits for 2015 and the 23 individual audits currently in the 2016 work plan and selected 10 individual audits. In addition, two additional engagements would be included in the work plan. The first being the performance audit topic which the committee will select today and an Information Technology Risk Assessment. Information Technology (IT) is an area with a number of risks for every organization. Mr. Hutchinson stated that as technology evolves, engaging with qualified consultants to identify areas of significant risks specifically within the IT space and systematic review of the management controls over IT infrastructure to mitigate identified risks would greatly benefit the agency.

Mr. Hutchinson concluded this report by providing information about utilization of internships in the Internal Audit Division. The previous intern has left the agency but the intent is to continue the program with a

replacement. Mr. McCartan noted that staffing levels are reviewed annually to determine if they are sufficient to perform audits necessary to mitigate agency risk.

2016 Performance Audit Topic Selection

Mr. Hutchinson explained that Sound Transit conducts annual performance audits as established and required in ST2. Performance audits are an oversight and management tool to realize cost savings, improve performance and to facilitate the decision making process. There is an added benefit of providing public accountability to taxpayers funding the agency. Mr. Hutchinson provided an overview of the success of past audits and explained the process of selecting a performance audit topic. The process includes gathering management concerns and potential risks to the agency. Staff then compiles a list of potential audit topics for Committee discussion and review.

Mr. Hutchinson provided a brief overview of each of the potential performance audit topics and noted that several of the topics are included entirely or correspond closely with scheduled engagements for 2016. After removing those projects, the four remaining potential performance audit topics are Configuration Control Board, Community Outreach, Performance Management and Job Order Contracting (JOC). Mr. Hutchinson recommended Job Order Contracting as the topic for 2016 stating that JOC is an area with a very specific scope and specific requirements and elements that are of interest to the Committee including diversity and subcontracting requirements.

Chair Johnson noted that the Committee is under no obligation to select JOC as the performance audit topic but agreed that it is an appropriate project for the 2016 topic. Boardmembers agreed that a specific scope of work would provide the largest benefit and most valuable work product. Boardmember Lovell added that whether or not JOC is good for the agency is worth the effort and exploration and could potentially benefit the State as well. Staff concluded by noting that one element of the audit could include review of how widely JOC is used across the state and what opportunities are available for benchmarking.

With consensus of Boardmembers, Chair Johnson asked for ask for a motion to select Job Order Contracting as the Performance Audit topic for 2016.

It was moved by Boardmember Moss, seconded by Boardmember Backus, and carried by unanimous vote that Job Order Contracting be the topic of the 2016 Performance Audit.

EXECUTIVE SESSION

None

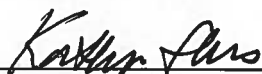
NEXT MEETING


June 16, 2016
11:00 a.m. to 12:30 p.m.
Ruth Fisher Boardroom

ADJOURN

The meeting adjourned at 12:34 p.m.

ATTEST:


Kathryn Flores
Board Administrator


Rob Johnson
Audit and Reporting Committee Chair

APPROVED on June 16, 2016, LM