



CHAIR

Dick Chapin

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Paul Wiesner

August 20, 2009

Sound Transit Board
Honorable Greg Nickels, Chair
Union Station
401 South Jackson Street
Seattle, WA 98104

Josh Benaloh

Aubrey Davis

Chris Elwell

RE: Report of the COP's Operating Cost Task Force

Bob Goldstein

Dear Chair Nickels and Board Members:

Miriam Helgeland

The Citizen Oversight Panel has written to you previously about concerns regarding the growth of Sound Transit's operating costs. This spring COP convened a task force of its members to delve more deeply into this important topic and today we write to communicate to you our findings in the attached report.

Karen Miller

Michael Murphy

We know that Board members and ST management have shared many of COP's concerns. The Board's Transit Operations Task Force concluded its work a few months ago with a number of strong recommendations relating to fundamental policies on transit service operations and maintenance. We applaud those efforts and encourage you to continue to play a forceful role in helping bring down long-term cost trends, not just at Sound Transit but also at the partner transit agencies.

Dave Russell

Stuart Scheuerman

The economic downturn hit the Puget Sound region in the middle of 2008 just as the ST2 plan was being adopted and there is a forecasted shortfall of \$2.1 to \$2.5 billion over the life of the 15-year ST2 financial plan. Therefore, the growth in operating costs is an even more urgent issue. Extraordinary diligence in identifying cost controls is essential to manage this situation. CEO Joni Earl has charged the new Deputy CEO Ron Tober to direct this effort. Mr. Tober met with COP's task force repeatedly to delineate plans to "scrub" the agency's budgets and to review its management reporting systems.

Bruce Seiber

Vic Sood

JD Wessling

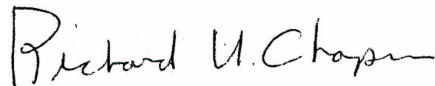
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The COP Task Force reviewed transit operations but primarily focused on broader topics such as the agency's budgeting and reporting practices, compensation structure and trends, and corporate staffing and non-staff costs. Believing that having valid systems for tracking trends over time is essential for cost control, we are pleased to report that Sound Transit management is in the process of addressing many of the questions and concerns we identified. We are hopeful that the plans will lead to results but the situation demands close monitoring by the Board. Improved reporting and management controls should help contain operating costs. But the proof must be based on data collected and reported in a manner that is transparent and comparable over time.

We wish to acknowledge COP's Task Force participants: Aubrey Davis, Miriam Helgeland, Mike Murphy, Dave Russell, Stuart Scheuerman, Vic Sood, Paul Wiesner and Task Force chair, JD Wessling, for their efforts in studying these issues and developing the comments and recommendations of the attached report.

Sincerely,
CITIZEN OVERSIGHT PANEL

Richard U. Chapin
Chair

A handwritten signature in black ink that reads "Richard U. Chapin". The signature is written in a cursive style with a large, prominent initial "R".

Cc: Sound Transit Board
Joni Earl

Citizen Oversight Panel

Report of the Operating Cost Task Force

This report of the COP's Operating Cost Task Force is organized into five broad topics: Organization, Budgeting Process, Management Reporting, Staff Compensation, and Financial Metrics. COP discussion and comments, within these broad topics, generally applies to all Sound Transit operations unless specifically stated otherwise. Following are a number of observations and findings we bring to your attention:

Organization

As Sound Transit has grown and evolved, management has introduced several major reorganizations to adapt to changing functional, skill and FTE requirements. Certain operational functions that were peripheral in the early days have become significant cost centers; other functions that primarily supported capital projects and were handled by consultants and contractors became day-to-day needs that were brought in house. These adaptations of project and corporate structure have represented a natural and appropriate evolution. However, the related budgeting and reporting mechanisms have not always kept pace. We have noted instances where organization charts, budgets and financial reports have not been aligned, leading to confusion about which positions and functional units were being tracked in which departments.

A good management system should have clear lines of authority and accountability. This authority and accountability is reflected in an organization chart which then is the basis for a structure of cost centers (in our view, the lowest logical level for charging operating expense is a cost center where there is assigned manager responsibility), departments, and divisions. From this structure, a system of budgeting and charging expenses is established. We believe it is important to have a direct alignment and easy tracking from the organization chart to management reports and recommend that ST management maintain this alignment in future budget reports, management reports and other reports.

Budgeting Process

We discussed with top management the budgeting approach used at Sound Transit. We were told managers throughout the organization are involved in preparing the budgets for their particular cost centers with review and consolidation performed by Finance. When we asked about documents used in communicating directives to managers, the answer was that the communication occurred verbally at meetings but there were no written guidelines, forms or memos. We wonder if this doesn't create opportunities for confusion and misunderstanding. To establish a culture of cost control it seems advisable for guidelines to be in writing.

In our previous reports and in our task force discussions with ST management, we have struggled to understand agency cost trends due to service growth versus increases due to base salary growth or some other factor. Missing from the discussion were budgeted (as well as actual) FTEs

(so-called full-time equivalent staff counts) by cost center or budgeting unit. COP recommends that ST management take a more rigorous approach to budgeting and reporting FTEs by cost center. We discuss this issue in greater depth below in the section on Management Reporting.

ST management has stated a commitment to provide a breakdown of increases to the base versus increases due to new projects and services in future reporting, beginning with the 2010 budget. Critical to this breakdown will be actual FTEs compared to budget. We welcome this change and believe it will facilitate both public understanding and internal management controls.

We understand the budgeting process begins in March and is generally concluded with Board adoption in December. Developing a budget for the following year requires utilization of available information to arrive at the best estimate of what expenses will be in the following year. Using the best available information means combining actual expense for the period(s) known, with current year budget for the remainder of the year (e.g. an operating budget for 2010, prepared in July of 2009 would utilize the first six months of actual 2009 plus the 2009 budget for the remainder of the year). This “Updated Budget” is also modified for any other known, material changes. The 2009 Updated Budget should be the base comparison when reviewing the 2010 proposed budget for reasonableness. We see little benefit of comparing to the original 2009 Budget.

We note the use of “contingencies” and “other miscellaneous expense” in ST’s 2009 budget. For example, in the Corporate Services Staff Operating Budget (p. 214 of the Adopted 2009 Budget) there is an amount of \$1,354,913 for Other Misc. Expenses, the largest budgeted line item other than salaries and benefits. Another example is a contingency of \$477,533 in the Executive Staff Operating Budget (p. 195 of the Adopted 2009 Budget). It is difficult for COP to understand why these line item amounts are not budgeted in more descriptive detail. No one can project with certainty what operating expenses will be in a future year, but the budgeting process should be used to determine as best as one can what the expenses should be by account, without using accounts such as “other miscellaneous” or “contingency” for large budget amounts. We recommend future ST budgets be more descriptive when budgeting for expenses and there be high level management approval of contingency budgets.

Management Reporting

As part of our discussions, COP members were provided sample reports used to manage operating expenses. These reports were not easy to use, did not include FTE counts and did not readily provide answers to our questions. We recommend that the management reporting process be strengthened by developing monthly management reports that compare to the adopted budget for the month and year-to-date. Included in such a report, we believe, should be the average number of FTEs for the month and year-to-date. The logical basic reporting level would be the cost center and managers of cost centers would receive the management reports for their review and further analysis. We understand this type of review currently occurs quarterly at an agency level.

One of the most significant operating expense categories at ST is purchased transportation services. This very significant amount is currently reported as a single line item. We suggest that

reporting of this expense area should be detailed by partner and that meaningful breakdown be provided for tracking purposes, for example, service hours provided to date compared to budget.

COP noted in its previous letters and reports to the Board that total salaries, benefits and staff costs have risen dramatically in recent years. We were unable to determine what portions of these increases were the result of base increases versus growth in staff resulting from new projects and services. ST staff provided task force members with information showing staff budgets since 2000 and indicating that cost increases have been about 50% driven by staff additions. New positions were added since 2000 in several key areas: 40 FTEs in Operations, 30 FTEs in Link and 19 FTEs in Information Technology. Capital Projects on the other hand was down by 22 FTEs as projects were completed and put in service. It is estimated that the remaining 50% of total staff budget growth is due to salary increases and awards while non-staff costs were flat between 2000 and 2009. Inclusion of budgeted and actual FTEs on management reports would make it much easier to understand at a glance how added staff is driving cost growth.

We recognize that at Sound Transit, reporting FTEs by cost center has been difficult for several reasons: Reorganizations have repeatedly changed lines of accountability and reporting in the middle of budget cycles; hiring has sometimes been deferred or delayed for various reasons; and employees are sometimes shared across reporting units. These factors complicate the identification of FTEs by area and therefore the analysis and understanding of management performance. We recommended to management that actual staffing levels be updated and reported monthly and that organizational tracking align with budgets and management reports.

As noted above, ST does not update its actual FTEs, by reporting unit, more than quarterly. We believe that Sound Transit needs to develop and employ a better FTE reporting system for its management reporting. One approach is to calculate an average FTE count for each month. The goal is to have FTEs relate to salaries and benefits for ease of analysis and understanding. The FTEs should be reported for both actual and budgeted expenses each month and year-to-date. To accomplish this type of reporting is not easy and will take some major effort by management but we believe it is an important element for better understanding and communication.

ST management stated to our task force members that management reports are in fact being revamped and will address some of our comments. We welcome this new level of detail. We believe that management reporting should be an effort to control operating expense by having managers accountable for specific cost centers. For management reporting purposes there should be a clear segregation of expenses such as depreciation and allocated expenses from manager-controllable expenses. This can be accomplished by having management reports identify controllable management expenses and then, below this total, report depreciation and allocated expenses. Managers should not be held accountable for allocated expense from other cost centers or for depreciation. Managers should be held accountable for expenses where they have some control and where they have developed the budgeted amounts or at least contributed to the budgeted amounts.

Staff Compensation

Unlike most governments which use cost of living and “step” increases based on annual inflation rates and employee seniority, Sound Transit uses a system of annual base increases and lump sum bonus awards based on performance evaluations. We applaud this approach and believe it provides incentives for retention of the best employees and fosters a culture of merit and quality. However, ST does not appear to have a good ongoing analysis tool to determine how many FTEs at which salary levels are receiving bonus awards and what the impact on cost growth is. ST staff report that about 80% of employees receive a performance evaluation of “proficient” which can result in 2009/2010 in a maximum total compensation increase of 6% over the previous year’s total salary. In prior years it could yield a maximum 8% increase. We recognize that base increases and awards have been curtailed this year as a result of the economic downturn and believe that this is prudent. The cumulative agency-wide impact of these increases on the agency’s expense trend however was not available.

We believe that operating budgets need a formula for determining how much money is available for these total base increases and bonus awards, for example, a percent increase over prior year total payroll. Each year’s budget guidelines to managers should include specific instructions on increases for base salary and awards.

Financial Metrics

ST management explained to COP that performance objectives and scorecards are developed by managers each year and used for performance evaluation. Financial metrics in particular are still evolving. One metric that has been listed in ST’s agency scorecard for several years is the goal of keeping cost growth limited to a ten-year average inflation rate. This goal has never been met and has now been found to be unrealistic, given that the agency continues to be on a growth trajectory and that 80% of ST employees appear to earn base and bonus awards well in excess of inflation. We encourage Sound Transit to develop realistic metrics for cost control over time and to monitor and fine tune them as needed.

As a result of the COP’s task force, we have outlined some broad concerns and areas for improvement. The questions that COP task force members asked of staff often required considerable research and time spent to develop explanations, tables, charts, and presentations and COP members appreciate the effort expended by staff.