



Summary Minutes

Finance and Audit Committee Meeting June 20, 2019

Call to order

The meeting was called to order at 11:013 a.m. by Committee Chair Nancy Backus, in the Ruth Fisher Boardroom, 401 South Jackson Street, Seattle, Washington.

Roll call of members

Chair	Vice Chair
(P) Nancy Backus, Auburn Mayor	(P) Bruce Dammeier, Pierce County Executive

Board Members	
(A) Dow Constantine, King County Executive	(A) Roger Millar, WSDOT Secretary
(A) Jenny Durkan, Seattle Mayor	(P) Patty Rubstello, WSDOT Alternate
(A) John Marchione, Redmond Mayor	(P) Dave Somers, Snohomish County Executive
(P) Joe McDermott, King County Councilmember	

Paige Armstrong, Board Relations Specialist, announced that a quorum of the Committee was present at roll call.

Report of the Chair

Chair Backus announced that she approved a request from Boardmember Somers to participate via telephone.

Chair Backus continued that there was another request to participate by phone, but this would require the suspension of the Board's Rules and Operating Procedures to allow for the participation of more than 25 percent of the committee members via telephone.

It was moved by Boardmember McDermott, seconded by Boardmember Backus and carried by unanimous vote that rules be temporarily suspended to allow Boardmember Dammeier to participate in the meeting via teleconference.

CEO Report

Pride Month

CEO Peter Rogoff began his report by announcing that Sound Transit is joining with other public agencies and people around the globe to celebrate Pride month this June 2019. He thanked Boardmember McDermott for participating in the raising of the pride flag in front of Union Station earlier in the month, and invited the committee members to participate in a number of events being coordinated by the PRIDE Employee Resource Group. Additionally, Mr. Rogoff announced that Sound Transit will be walking in the 45th Annual Pride Parade, from Downtown to Seattle Center, which is taking place this year on June 30.

Public comment

Alex Tsimmerman
Marguerite Richard
Will Knedlik

Business Items

February 21, 2019, Finance and Audit Committee minutes

It was moved by Boardmember McDermott seconded by Boardmember Backus and carried by unanimous vote that the minutes of February 21, 2019, Finance and Audit Committee Meeting be approved as presented.

Annual Financial and Audit Report

2018 Annual Financial and Federal Audit Results

Tracy Butler, Chief Financial Officer, introduced the presenters from Moss Adams, the external auditing firm. The presenters from Moss Adams were Laurie Tish, Partner, Amy Sutherland, Senior Manager, and Sasha Correnti, Senior Manager. Ms. Butler announced the completion of a clean audit, and thanked Moss Adams for their thorough work this year.

Ms. Tish began the presentation by outlining the unmodified completed report, which indicates the clean audit. The audit report was issued on May 24, 2019. In addition to the audit on the financial statements of the agency, Moss Adams completed single audit report on compliance with other standards and regulations, which was also issued unmodified on May 24, 2019.

Ms. Sutherland presented the audit areas of emphasis included internal controls around financial systems including information technology systems, project controls and project budget controls, the agency's position as a joint fare system manager through the ORCA program, and unusual transactions which include the leasing of the rails for Sounder Commuter Rails.

The single audit was completed to ensure that the agency is in compliance with any federal regulations that are required for the receipt of federal funding both through grants and the TIFIA loans. There were no found exceptions or findings throughout the single audit. The single audit was issued on June 10, 2019.

Ms. Correnti continued that it is a requirement to report on any difficulties or disagreements with management, and there were no such encounters that require reporting. The audit progressed on time and in an orderly fashion, all requested schedules and draft financial statements were received on a timely basis from the agency. Ms. Tish commented that all Sound Transit personnel organization wide and across all departments were courteous, responsive and fulfilled all of our requests in a timely manner.

Ms. Butler thanked Moss Adams for their work, and commented that this work from independent auditors is critical for the agency to maintain transparency and the public trust.

Annual Fare Revenue Reporting

Chair Backus introduced Lisa Wolterink, Director of Fares and Grants, and Chad Davis, Fares Manager, to provide the presentation. The purpose of the Fare Revenue Report is to show 2018 Sound Transit fare revenue, farebox recovery rates and the status of various fare-related programs as compared to prior years.

Ms Wolterink continued that Fare revenue in 2018 was 96 million dollars, up from 90 million dollars in 2017. Each mode contributed to the 5.6 million dollar year over year fare revenue increase, led by an

increase in Link light rail of 3.6 million dollars. Sounder fare revenue increased in 2018 by 10 percent, due in part to the addition of two new round trips that were implemented to the South Line in September 2017. ST Express boardings were down 1 percent in 2018, however, revenue increased by one percent primarily due to the full year impact of the March 2016 fare change now recognized in ORCA Business Passport contract renewals.

Mr. Davis continued the presentation, reporting that this region has successful programs for employers and institutions to provide transit passes to employees and students. Forty seven percent of Sound Transit fare revenue comes from ORCA Business Passport. The percent of fare revenue from the Business Passport has increased from 40 percent in 2016 and 43 percent in 2017.

Overall 84 percent of ST fare revenue comes from ORCA sources. Non-ORCA fare revenue, for example cash or tickets from Ticket Vending Machines, is 16 percent of fare revenue. Cash payments make up only five percent of fare revenues.

The agency measures farebox recovery rate as the percentage of operating costs paid for by fares. Per Sound Transit fare policy, minimum farebox recovery rates are as follows: 20 percent for ST Express bus, 23 percent for Sounder, and 40 percent for Link. In 2018 ST Express achieved 28 percent recovery and Sounder 33 percent recovery, both above policy minimum.

In 2018, Link had a farebox recovery rate of 38 percent, which is below the 40 percent policy threshold. While Link fare revenue increased in 2018, so did expenses as the agency ramps-up for Northgate and East Link Extensions. We forecast that Link farebox recovery will be above 40 percent in 2022, after the Northgate extension opening. As forecasts show Link farebox recovery above 40 percent once Northgate opens, staff is not proposing a fare change process at this time.

Ms. Wolterink then spoke to the ORCA Lift Program. The ORCA Lift (low-income fare) program continues to see growth. There have been more than 87,000 enrollments program to date with currently over 58,000 active cards. ORCA Lift boardings on Link were up six percent year over year and eight percent on ST Express. Contributing to this growth is the expansion of ORCA Lift enrollment to the Department of Social and Health Services (DSHS) locations in Pierce County (October 2018) and Snohomish County (July 2018) with Sound Transit funding those efforts. Sound Transit is also providing funding for ORCA Lift cards preloaded with \$10 as an incentive for people to register for ORCA Lift at DSHS offices in all 3 counties. Together, these efforts help ST expand ORCA Lift awareness and registration.

Ms. Rubstello asked if the funding for the pre-loaded ORCA cards being offered through DSHS are being provided by Sound Transit or by the department. Ms. Wolterink replied that the funding for those cards is being funded by Sound Transit, as was part of a Board approved action for incentivizing ORCA Lift.

Boardmember Dammeier asked if the farebox recovery is hitting the financial and budget predictions for the agency. Ms. Wolterink stated that the Farebox Recovery Report is a report of actuals reported year over year, and is used to generate the budget predictions for the following year. Ms. Butler commented that the first quarter financials will be presented later in the agenda, and will show the fare recovery versus the budgeted for 2019 so far.

Quarterly Financial Reports

Quarterly Financial Performance Report.

Ms. Butler began the presentation, outlining some highlights from financial performance including that tax revenues are tracking close to the budget, the capital spending is currently lower than budget due to weather impacts to construction, and slower than scheduled right of way acquisition. Capacity at this time remains sufficient to provide the voter-approved plan. However, long term capacity could be under

stress due to the continued hot construction and real estate markets, and high cost growth for system operations. Ms. Butler then introduced Ann Sheridan, Budget Director, to present the Quarterly Financial Performance Report.

Ms. Sheridan began the presentation with first quarter revenues, which are slightly below budget, primarily due to a delay in receipt of grant funding. There was an issue on the Federal Transit Administration's side that prevents the dispersal of some funds. Tax revenues are coming in at about one percent above budget. Due to the delays in the actual receipt of the funds, this budgeting is being completed on an accrual basis.

Ms. Sheridan continued that spending on capital projects is 25 percent below budget, but is anticipated to be at 96 percent by the end of 2019. The primary causes of this underspend is due to the snow storms in February, slower than planned right of way acquisition, and a deferred milestone of the procurement for the new light rail vehicles (LRVs).

Spending for the enhancement project portion of the budget was at 72 percent for the first quarter, with the vast majority of delays being due to delays in the procurement for completion of Elevator Modernization Program. The State of Good Repair Project budget performance was at 22 percent, significantly below budget, but the total budget for this sub-category is four million dollars. By year end, this category is anticipated to be 10 percent over budget, due to the early delivery of some replacement ST Express buses that have been purchased.

Ms. Sheridan then provided an overview of the ridership portion of the budget, stating that all modes are below the 2019 forecast, due in large part to the snow storms and the decision of many commuters not to work for those weeks.

Spending for the operations and agency budget category is at seven million dollars, eight percent under budget, due in part to lower than anticipated Securitas hours, lower spare parts consumption, and the delay of a rail grinding project for this quarter. Year over year total spending is up 12 percent, primarily due to an increase in staffing, and higher purchased transportation services spending. The main driver in the increased cost of purchased transportation is variance with agreements with King County Metro.

Agency Asset and Liability Management Report

Ms. Butler then presented the Agency Asset Liability Management Report. Ms. Butler spoke to the report at a high level, stating that there have been no changes to the four measures, which include investment performance, interest rate risk, credit risk, and liquidity risk.

Special Topics for Discussion

Financial Risk Assessment Presentation

Ms. Butler presented on the special topic of agency financial risk. Ms. Butler began by previewing the key points of the presentation, which are that revenues have been exceeding the projected revenues due to a robust economy, but these increases are outpaced by higher than expected capital construction costs and operating costs. These things have led to an increased in anticipated borrowing for the agency, absorbing financial capacity. There is a higher than previously predicted risk of reaching the legal debt limit, and there is increased pressure to maintain debt service coverage ratios.

Ms. Butler continued to explain the risk assessment model that has been developed for monitoring these issues. The model incorporates historical data, correlations, and thirty other major variables which include expenditure growth rates, tax revenue rates, capital cost estimates, among many others.

In 2016, ahead of the adoption of the Sound Transit 3 (ST3) plan, the agency engaged a consultant to develop a risk assessment report. This year, that report has been updated with a three year trajectory and to incorporate current market trends. Ms. Butler then presented a number of key scenarios showing

various outcomes of the agency's current risk situation, detailing the major variables of tax revenue, operating costs, and capital costs.

Ms. Butler then outlined the agency's financial capacity, which is driven by three measures. There is a legal debt capacity of 1.5 percent of Sound Transit's assessed property value. There is a Board adopted policy for the required net coverage ratio, and there are the requirements included in issued bond covenants. The program is affordable under current projections, however, all three measures of capacity are under more stress under the 2019 risk assessment.

Boardmember Dammeier asked if the projections of capital expenditures are based on the representative alignments for ST3 projects. Ms. Butler commented that the financial plan does not include any projections for increased scope without also assuming third party funding to make up for those increases in scope.

Boardmember Dammeier asked what the consequence is for breaching the bond covenants. Ms. Butler stated that it would depend on the responsive change in the agency's credit rating. However, if the legal limit is overcome, then the agency cannot borrow any further funds without 60 percent voter approval.

Ms. Butler continued her presentation, detailing the increased probability of the agency reaching each of the three capacity constraints. The key takeaways are that expenditures are the largest drivers of uncertainty for the debt capacity, and that these factors have a high amount of uncertainty. Further, any decrease in debt coverage or financial capacity, can have an impact on interest rates.

Chair Backus asked about the considerations of a regional financial downturn. Ms. Butler commented that yes, the model does take into consideration historical properties and probability of a downturn. The difficulty with including that in the model is the timing of any economic slowdown has a much higher impact upon the year in which it begins.

Boardmember Somers asked about the implications of scope discipline and any necessary program changes, including just the lengthening of timelines for some projects, and asked for an opportunity in the future to discuss these issues. Mr. Rogoff commented that these issues still contain a high amount of uncertainty, and any program changes would be vastly dependent on the timing of any increase to risk or lowering of the debt capacity.

Internal Audit Update

Jack Hutchinson, Internal Audit Director, presented the Internal Audit Status Update.

Internal Audits Completed

Fare Enforcement Complaints Audit

Mr. Hutchinson introduced Gana Byambaa, Senior Internal Auditor, to present the audit results. The audit objective was to determine whether the agency has effective controls to ensure policies and procedures are comprehensive and provide clear guidance for handling customer complaints. Further, that a comprehensive training program has been developed, implemented, and continuously updated, and that complaint records are complete and accurate. The audit period covered 66 complaints, nine of which were determined to have merit. The complaints found to have merit prompt a personal response and adjustments to procedures.

The audit concluded that management controls over fare enforcement complaints are effective to reasonably ensure the implementation of applicable policies and procedures, a comprehensive training program, and complete and accurate complaint records.

Boardmember McDermott asked if this audit had any overlap with the work currently being done by the agency surrounding fare enforcement equity. Mr. Rogoff replied that this audit covered the procedures in place and the compliance with the current fare enforcement policy, and there was not any examination

of the current policy work being done to determine if an update to the fare enforcement policy is needed. The future policy update, if it is taken up by the Board, would likely be subject to a separate future audit.

Small and Attractive Assets Audit

Ms. Byambaa continued to present the results of this audit. The audit objective was to determine whether the agency has effective controls to ensure all organizational units submit a certified inventory to the Small and Attractive Assets (SAA) coordinator, that certified inventories of SAA are complete and accurate, and that processes for submittal and collection of annual documentation is efficient.

The audit found that the agency has effective controls to reasonably ensure that SAAs certifications are submitted, those certifications are complete and accurate, and that annual submittal and collection process of Small and Attractive Assets is effective.

Agency Project Labor Agreement Audit

Mr. Hutchinson introduced Soon Kwon, Senior Internal Auditor, to present the audit results. The objective of this audit was to determine whether the agency has effective controls to ensure proper administration of the workforce development initiatives. Additionally, to determine if the agency has proper monitoring of the substance abuse program in compliance with the agency Labor Compliance Manual, and the timely addressing of grievances in compliance with the agency Project Labor Agreement.

The audit concluded that the agency has effective controls to address grievances in compliance with the agency Project Labor Agreement. However, controls over the workforce development and the substance abuse program are not adequate. There was one finding for management, that the controls for the workforce development program and the substance abuse program should be strengthened, and management has responded with an approach for improvements.

The internal audits that are currently in progress are:

- Construction Progress Payment Process
- Customer Complaints Management
- Continuous Process Improvement (CPI)
- Partner Cost Monitoring – King County Metro

2019 Performance Audit Update

Mr. Hutchinson continued to provide an update on the Annual Performance Audits. The State Auditor's Office is completing an audit on the agency this year, focusing on the design and construction of voter-approved projects. The State Auditor's Office will be seeking to provide methods for improvement to project management and oversight. The results of this audit are projected to be published in early 2020.

In addition, the Internal Audit team is completing a performance audit on workforce management practices, and procurement of a consultant to complete this work is underway.

Executive session

None.

Other business

None.

Next meeting

Thursday, August 15, 2019
11:00 a.m. to 12:30 p.m.
Ruth Fisher Boardroom

Adjourn

The meeting adjourned at 12:42 p.m.

Nancy Backus
Finance and Audit Committee Chair

ATTEST:

Kathryn Flores
Board Administrator

APPROVED on _____. PIA.