



Summary Minutes

Finance and Audit Committee Meeting July 21, 2022

Call to order

The meeting was called to order at 12:35 p.m. by Committee Chair Nancy Backus.

The meeting was available in person and streamed on <https://soundtransit.webex.com/soundtransit/onstage/g.php?MTID=eb2b7bb444682695cb15303d6f7f8b906>

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) Joe McDermott, King County Councilmember
(P) Christine Frizzell, Lynnwood Mayor	(P) Ed Prince, Renton Councilmember
	(A) Kristina Walker, Tacoma Councilmember

Josephine Gamboa, Board Relations Specialist, announced that three members of the Committee were present at roll call.

Report of the Chair – None

CEO Report – None

Public comment

Chair Backus announced that public comment would be accepted via email to emailtheboard@soundtransit.org and would also be accepted virtually and in person.

There were no written or virtual public comments. The following person provided in person comment:

Alex Tsimerman

Business Items

Chair Backus noted a quorum of the committee was not present at this time. The committee moved forward with the Moss Adams report and would resume committee actions when a quorum was present.

Audit Update

2021 Financial Audit Report – Moss Adams

Laurie Tish, with Moss Adams, provided the presentation. She reviewed the various audit results and advised that there were unmodified, or clean, opinion on the financial statements and the financial statements with other information. The report on internal control over financial reporting and on

compliance and other matters reported no findings. The report on compliance for the major federal program and on internal control over compliance; report on schedule of expenditures of Federal awards required by the uniform guidance reported no findings.

Boardmember Frizzell asked how long Moss Adams had audited for Sound Transit. Ms. Tish responded there was one year left remaining on the contract.

Committee Vice Chair Dammeier asked if the auditors searched for specific areas that made representations to qualify for certain monies. Ms. Tish responded that the figures were not the sole reason of federal awards being given, there were various control hosts and requirements that play part. She noted each grant would take over 100 hours to audit. Most of the audit was focused on administrative and operational views rather than accounting.

Committee Vice Chair Dammeier asked if the Moss Adams team would examine processes on forward-looking projections such as debt pinch points, financial capacity, and future projects. Ms. Tish answered that they look at controls around budgeting and how it relates to financial statements. Appropriateness and quality of budgeting was not within Moss Adams' audit scope.

Committee Vice Chair Dammeier asked Ms. Tish her opinion of where Sound Transit's greatest vulnerability was in terms of risks. Ms. Tish noted her perspective was as a financial statement auditor; she responded some categories that they focused on were construction projects, operational activity, and Information Technology such as cybersecurity.

Committee Vice Chair Dammeier asked if the Moss Adams' closely audits cash transactions due to internal controls and vulnerabilities associated with it. Ms. Tish replied that the ORCA card had changed the audit process and therefore required less cash handling. The cash section covered cash investments and cash receipting functions.

(Boardmember Prince joined at this time.)

Chair Backus recognized leadership and Moss Adams for their work and acknowledged Boardmember Prince's attendance.

Business Items

Item for Final Committee Action

March 17, 2022, Finance and Audit Committee meeting minutes

It was moved by Committee Vice Chair Dammeier, seconded by Boardmember Prince, and carried by unanimous voice vote of the committee members present that the minutes of the March 17, 2022, Finance and Audit Committee meeting be approved as presented.

Internal Audit Update

Patrick Johnson, Audit Director, provided a summary of the 2021 year in review, 2021 performance audit close out of construction performance metrics management, and 2022 audit plan Q1 progress report. The performance audit completed six audits resulting in 11 findings. Mr. Johnson noted the use of construction contingency audit was deferred due to the similarity to the construction performance metrics management audit, which was requested by the Finance and Audit Committee and Community Oversight Panel in 2020 – due to COVID, it was put on hold until 2021 when Talson Solutions was hired to conduct the audit. The audit's objectives were to evaluate the execution of agency construction performance management metrics against industry best practices. It benchmarked the agency's performance against other similar transit agencies such as LA Metro and Chicago Transit. There were no findings, but nine improvement recommendations were identified.

Seven Compliance audits were completed in 2021 and resulted in eight findings. Four Capital Project Safety and Security Certification audits were completed over 2021, with one being deferred to late 2022 due to the shift of work to be audited on the East Link project in 2022 and 2023. There was one finding from this audit.

Mr. Johnson reviewed the Q1 progress report of the 2022 audit plan. He noted the Land and Airspace Lease consultation (JLARC) was not an audit his team performed, his team was used in a consultative role that provided advice and guidance to the agency's Real Property staff as they proceeded through the Joint Legislative Audit Review Committee's study. JLARC's work would continue throughout 2022 and Mr. Johnson would provide status reports every quarter as part of the division update report. JLARC would provide a tentative final report in January 2023 and would be presented to the Committee in Spring 2023. The Data Classification and Retention Audit and Vertical Conveyance Systems audit were being finalized. The contract deliverables for Transit Police were in progress. These audits would be finalized and briefed at the October 2022 Finance and Audit Committee meeting.

Committee Vice Chair Dammeier asked if the Vertical Conveyance Systems auditing reviewed vulnerabilities of past occurrences with limited evacuation mechanisms in certain stations and how to correct them. Mr. Johnson replied that was all included in the audit.

Mr. Johnson reviewed the single completed audit, Structure Oversight. This audit was determined as a significant potential risk for the agency for service delivery impacts, financial risk, and safety. The results of the audit found that key processes, roles, responsibilities, and accountability lack appropriate definition to ensure structural assets were maintained in a consistent objective and transparent manner. Mr. Johnson advised there were multiple opportunities to enhance and strengthen internal oversight processes and to further align to industry best practices. The two findings were 1) current oversight processes were not aligned and 2) some processes for structures oversight were missing or incomplete. The two findings note that while inspections were performed and assets were currently in sound condition, the agency lacked a systematic repository that captured all assets, their conditions, and prioritized repairs based on safety and financial considerations and could improve processes to further align to best practices as the agency transitioned new or acquired assets into operational service.

Paul Denison, Deputy Executive Director of Transportation and Maintenance, provided the agency's management response to this audit. For finding 1, Mr. Denison noted management partially agreed with the auditor's risk rating. The partial agreement did not disregard the finding but that the auditor had mentioned in their report that since structures were being inspected, and met or exceeded requirements, management presumed a lower rating. Operations staff was committed to further examine structure oversight requirements and ensure it aligns with regulatory and industry standards. A complete list of corrective actions was anticipated by Q1 2024. For finding 2, management agreed with the finding. Management felt there were too many assets not built by, nor commissioned by Sound Transit, had or would be transitioned into Operations without current required inspections, documentation, training, and asset condition assessments. Operations committed to ensure future asset transfers would be completed using a commissioning process prior to owner transfer. That would include the development of robust operational transition requirements and deliverables prior to transfer. A corrective action would be completed by Q1 2024.

Mr. Johnson informed the 2022 Performance Audit of Sound Transit's Secondary Control and Data Acquisition (SCADA) Systems were deferred. The Statement of Work was advertised for several months, however there were no solicitations received from qualified firms to take on the audit work. Mr. Johnson noted the audit would be moved to the 2023 Audit Plan and completed by his team.

ST Express Bus Annual Internal Safety and Environmental Management Systems (ESMS) Internal Audits were completed during the past quarter. Both yielded no findings and noted five total observations for improvement with management already taking corrective action on those observations.

Mr. Johnson proceed with Q3 audits and noted the progress of first integrated management systems internal audit of both Safety and Asset Management and moving forward into internal safety audit of the Sounder Commuter Rail service by the end of Q3. Those results would be briefed at the October 2022 committee meeting.

Four other Capital project Safety and Security Certification Audits were in the final stages of agency draft report. The final results would be shared at the October 2022 committee meeting.

Chair Backus thanked Mr. Johnson and staff for their presentation.

Committee Vice Chair Dammeier asked Mr. Johnson to explain how the findings and observations with recommendations were correlated with the ST Express Internal audit. Mr. Johnson replied that the observations were related to operational policy and procedures that were in development that were currently being worked on by the team. It was not noted as a finding due to operations needing sign off.

Chief Financial Officer Report

Mary Cummings, Deputy Chief Executive Officer and acting Chief Financial Officer, Ryan Fisher, Deputy Executive Director of Financial Planning, Analysis and Budget, and Jeff Clark, Deputy Executive Director of Financial Operations, provided the presentation.

Mr. Fisher reviewed the May YTD Financial Performance Report. Other revenues including federal grants were \$10 million, or 9 percent, above budget and Investment income was \$36 million below budget. Passenger Fare revenue was above budget by \$2.7 million due to continued increase in UW passport usage along with the return in Link ridership in downtown and Northgate stations. Within Transit operations, purchased transportation was \$7 million under budget due to prior year partner reconciliations. Services was \$6 million under budget due to various delays in facility maintenance work, which was expected to catch up in Q3, and prior year partner reconciliations and security and safety were understaffed. Cost transfers were \$5 million under budget due to lower agency overhead and timing of operating projects were expected to catch up in Q3. Insurance was \$3 million under budget due to a softening insurance carrier market and later than planned Downtown Seattle Transit Tunnel turnover. Within debt service, refinancing resulted in lower than budgeted actuals all in January 2022. Other expense such as tax collection and fees were underspent by \$4.4 million driven by savings from DOL amendment of fees and lower sales and tax offset fee driven by less construction costs associated with Rule 171.

Chair Backus asked if there were any updates on state legislatures expenditures. Mr. Fisher had no current updates but noted staff was actively working on recovery.

Jenny Stephens, Director of Financial Planning, Analysis and Budget, provided the May YTD revenue performance. Total revenues were \$5 million below budget due to negative fair market value adjustments to investment income and lower MVET revenue. Mr. Fisher noted Asset and Liability Management would be spoken to later in the meeting. Total taxes were \$19 million above budget. The continued economic recovery and inflation was driving sales tax revenues. The year end forecast was expected to exceed budget, however MVET revenue was \$10.7 million below budget. This was due to a decrease in vehicle registrations in 2022. There was a negative fair market value adjustment to date of \$37 million which was not budgeted and was non cash. Federal grants were \$10 million above budget due to \$71.6 million higher than budgeted project costs for ARP grants for FTA Preventative Maintenance. This was offset by \$25.7 million lower than budgeted projected costs for Federal Way Link Extension due to lack of funds to draw from as well as \$41.3 million lower than budgeted project costs for Lynnwood Link Extension due to lack of funds. Year End expectation was for Federal Grants to be near budget.

Performance was \$23 million below budget due to services being \$6 million, purchased transportation at \$7 million, modal overheads at \$5 million and insurance at \$3 million, all under budget.

The concrete drivers' strike which occurred from November 2021 through April 2022 had a negative effect on projects in construction which largely rely on concrete deliveries to meet schedule and financial milestones. All System Expansion projects were \$205 million under budget. Link was \$154 million under, Stride was \$26 million under, Sound was at \$8 million under, and Regional Express was at \$5 million under budget.

Non-System Expansion projects were \$5 million under budget. Enhancements were \$11 million under due to digital passenger information system vendor delivery being delayed due to software defects, installation and testing delays, and fare paid zone late procurement of final design due to the complexity of the project. State of good repair was \$7 million under budget largely due to Issaquah garage repairs pending confirmation of required work, delay in Auburn Plaza lighting project, restriping lots and garages pending pricing with vendor, and IT Network redesign phase 2 supply chain delays of hardware which were also impacting the timing of implementation activities. Administrative was \$12 million over budget primarily due to timing of budget which would be adjusted in June 2023.

Committee Vice Chair Dammeier asked if there were concerns of trends with revenue projections for the remainder of the year. Ms. Stephens responded that with revenues and other financing sources, it was expected to continue on trend with reaching just below 100%. Committee Vice Chair Dammeier asked about projections regarding recession rates. Mr. Fisher replied that a process was beginning to capture that forecast within the upcoming years.

Jeff Clark, Deputy Executive Director of Financial Operations, provided the Asset and Liability Management highlights. Highlights included interest rate increases which presented both challenges and opportunities. The agency's fixed income investments would lose value with interest rate increases. The agency sought to hold most investments to maturity to avoid realizing losses. Interest earnings on investments would increase. Another highlight was continuing to monitor market volatility and adjust the portfolio to minimize risk and maximize returns.

Lisa Wolterink, Deputy Executive Director of Grants and Fares, provided highlights of the annual fare report. Ridership was slightly increased in 2021 compared to 2020, while fare revenue was down. Revenue declined from \$30 million in 2020 to \$28 million in 2021. The agency experienced a lower level of fare payment compliance, primarily on Link. All modes, farebox recovery rates were below minimum policy thresholds. She reviewed a few mitigation steps the agency was taking to increase fare revenue.

Long Range Financial Planning Process Update

Mary Cummings, Deputy Chief Executive Officer and acting Chief Financial Officer, Ryan Fisher, Deputy Executive Director of Financial Planning, Analysis and Budget, and Stephanie Ball, Deputy Executive Director of Financial Planning and Analysis, provided an update to the budget process for 2023 and a few macroeconomic factors that would be included in the Fall long-range financial plan projections.

Mr. Fisher reviewed the new and improved processes for the year. Workforce planning process included single agency staffing plan, 2023 headcount requests and forecast through 2028, and headcount target guidance provided before department budgeting. The Non-System Expansion project (NSEP) request process included unified prioritization process for all requests, incorporation of Total Cost of Ownership (TCO) view into NSEP decisions, and multi-year spending targets through 2028. New budgeting system, Prophix, would replace the existing budget system and planning, forecasting, and the reporting tool would provide better visibility.

NSEP process improvements included the agency goal to achieve 100% of NSEP requests analyzed for TCO by 2024. The goal would be to provide objective comparisons between requests for decision

making process and ensure resource alignment to work force planning. Other process improvements included identifying material changes in long-term operating costs and staffing data available for resource planning conversations.

Ms. Ball reviewed the independent inflation forecasts that were received from third party experts. Sound Transit received inflation indices from independent economists and consultants. These include consumer price index (CPI) forecast, construction cost index (CCI), and an assessed value (AV) forecast. The assessed value forecast was currently used to inform a right of way index and to forecast property tax revenues. It was also an input of debt capacity calculation which was the requirement that Sound Transit could only issue debt of up to 1.5 percent of assessed value within the Sound Transit district. Sound Transit also received independent forecasts for sales tax and MVET. Ms. Ball reviewed the inflation indices. She noted Sound Transit's Long-Range financial plan forecasted all revenues and expenditures through 2060 in year of expenditure dollars. The expenditure forecasts for the long-range plan were first developed in a constant year basis. Then inflation was applied to these constant year forecasts by expenditure type based on when the agency planned to spend the dollars to convert it to year-of-expenditure dollars prior to it being entered in the financial plan.

The CPI measured the change in prices for consumer goods and services in the Seattle area. This index was applied to operations and maintenance expenses and soft capital costs. The CCI measured the change in prices of construction and applied to the capital construction and contingencies. The AV measured the change in assessed value of property within the Sound Transit district and applied to property tax revenue and right-of-way property acquisition.

Ms. Ball reviewed a chart that displayed the compound annual growth rate from 2017 to 2046 in the ST3 plan versus the Spring 2022 update and the variance. The variance, which was in the range of 20 to 40 basis points for each index, caused a large change in expenditure forecasts. The index change caused an increase of \$4.2 billion in expenditures through 2046, which was a decrease of 21.5 percent in debt capacity in 2042. Additionally, Sound Transit has changed operating cost forecasting methodology, which included changing internal wage growth from CPI expect higher inflation growth in Fall 2022 projects, to CPI + 1, as well as changing purchased transportation growth to 5 percent short term rate and CPI + 1.5 in the long-term. This had added an additional \$2.8 billion in operating costs. Ms. Ball noted the period of historically high inflation and expect increases in the forecasts made in fall 2021 and spring 2022. Every 0.1 percent increase in the compound annual growth rate caused an overall increase of \$2 billion in capital and operating costs through 2046.

Ms. Ball provided a few challenges the agency would face in forecasting. The agency currently received only one CCI and AV forecast per year, long-term forecasts may not predict near-term volatility cycles, AV forecast may lag the market, and contractor margins and bid-prices were difficult to capture and quantify in CCI.

Next steps and process updates included new CPI, CCI, and AV forecasts would be received in summer 2022 and would be shared with the agency and the Board in October 2022. The financial plan was updated in spring 2022 which would provide another chance to include the latest trends in the long-range projections. Inflation forecasts and trends were included in the bi-annual cost drivers report. The forecasting contract was currently out to bid, with a 2023 start date, and would be brought to the Board for approval. Ms. Ball noted the changes staff are hoping to make include a spring and fall update to report inflation indices and AV. Staff also hope to receive an independent forecast of right-of-way acquisition separate from AV to more accurately project property acquisition costs.

Executive session – None

Other business – None

Next meeting

Thursday, October 20, 2022
12:30 to 2:00 p.m.
Virtually via WebEx

Adjourn

The meeting adjourned at 1:58 p.m.

ATTEST:

Nancy Backus
Finance and Audit Committee Chair

Kathryn Flores
Board Administrator

APPROVED on _____ . JG.