



Audit Report

Partner Cost Monitoring – Pierce Transit

Report Number: 2020 - 10 | Report Date: June 02, 2021

Executive Summary

Audit Report No.: 2020 - 10

June 02, 2021

WE AUDITED the current Partner Cost Monitoring processes to ensure that Sound Transit has effective controls over Pierce Transit (PT) Cost Allocation Model (CAM) related to reasonableness of shared costs for regional bus services.

Our **AUDIT OBJECTIVE** was to determine whether the agency has effective controls in place to ensure:

- PT costs allocated to ST are allowable and reasonable.
- PT costs allocated to ST are actual expenses based on actual performance.

The audit examined records from January 2018 through October 2020; along with processes and management controls in place as of October 2020.


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WHAT WE FOUND

Sound Transit (ST or the Agency) outsources the operations and maintenance of its multimodal system (i.e., Link Light Rail, Sounder, and ST Express) to key agency partners. Pursuant to Washington State Law, the agency and Pierce Transit have entered into key Interagency Agreements allowing PT to perform operation and maintenance for ST's Express Bus services.

Pierce Transit (PT) is one of the three partnering agencies (along with Community Transit & King County Metro) contracted to provide operating and maintenance (O&M) services for ST Express buses. The cost of O&M services from PT increased by \$9M (or 21%) from \$42M in 2017 to \$51M in 2019.

The agency and PT utilize the Cost Allocation Model (CAM) to allocate costs. This process sets the unit cost per hour for the annual baseline cost. PT invoices the monthly baseline cost (one-twelfth of the annual baseline cost) for the current year. At year-end, the agency performs reconciliation to true up between the baseline invoice payments and actual expense.

As part of our 2020 Audit Plan, we identified Partner Cost Monitoring-Pierce Transit as an area of risk due to the following:

- Increasing purchased transportation costs due to increasing bus service hours and operating partner rate.
- Issues from prior audits including, King County Metro Cost Monitoring audit completed in 2019.

While we observed continuous improvements towards the implementation of the current CAM model (e.g. variance and budgetary reviews), the audit concluded that monitoring controls in ensuring the appropriateness of PT allocation costs needs to be strengthened. Specifically, ensuring: 1) allowable costs are formally defined within the agreement; and 2) on-going periodic reviews are occurring to ensure the allocated costs are allowable and expensed based on actual performance. **See Finding #1**

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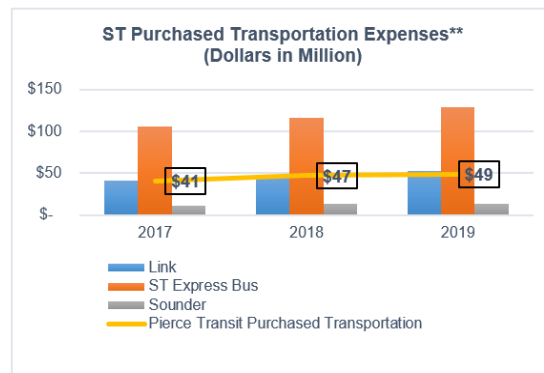
Background

Sound Transit (ST or the Agency) outsources the operations and maintenance of its multimodal system (i.e., Link Light Rail, Sounder, and ST Express) key agency partners. Pursuant to Washington State Law¹, the agency and Pierce Transit (PT)² have entered into key Interagency Agreements allowing PT to perform operation and maintenance for ST's express bus services. As of December 2019, PT provided Regional Express Bus services for 15 ST routes including; 132 ST owned vehicles and 11 PT leased vehicles.

ST Operations and Maintenance (O&M) expenses³ include purchased transportation expenses⁴. Those expenses increased to \$36.7million (M) (or 23%) from \$158M in 2017 to \$195M in 2019. The increase was attributed to additional bus service hours and operating partner rate increases. Specific to the purchased transportation costs for Sound Transit express bus increased by \$23M (or 11%) from \$105M in 2017 to \$129M in 2019. Of the \$129M, Pierce Transit costs increased by \$8M (or 20%) from \$41M in 2017 to \$49M in 2019.

PT purchased Transportation cost and platform hours [*]			
Services	2017	2018	2019
Fixed Route	41,067,674	47,011,146	49,455,237
Depreciation	249,528	211,399	218,545
Total ST cost	\$41,317,202	\$47,222,545	\$49,673,782
ST Platform Hours	339,523	344,587	354,178
Cost per Platform Hour Growth		113%	102%

Source: ^{*}2017, 2018, 2019 costs and platform hours are based on Pierce Transit Actual CAM.
^{**}ST Purchased Transportation cost by mode obtained from ST Financial Planning, Analysis, & Budget Division.



Sound Transit and Pierce Transit utilize the Cost Allocation Model (CAM) to allocate costs⁵ that PT incurs operating and maintaining ST Express bus service, including general administration costs. This process sets the unit cost per hour for the annual baseline cost. Pierce Transit provides its baseline cost estimate for the upcoming year in October each

¹ Pierce Transit and Sound Transit are authorized to contract for public transportation services under the Revised Code of Washington (RCW) 36.57A.080 and RCW 39.33.050.

² Pierce Transit is one of the three major partnering agencies (Community Transit & King Country Metro) to provide the operating and maintenance services for ST Express buses.

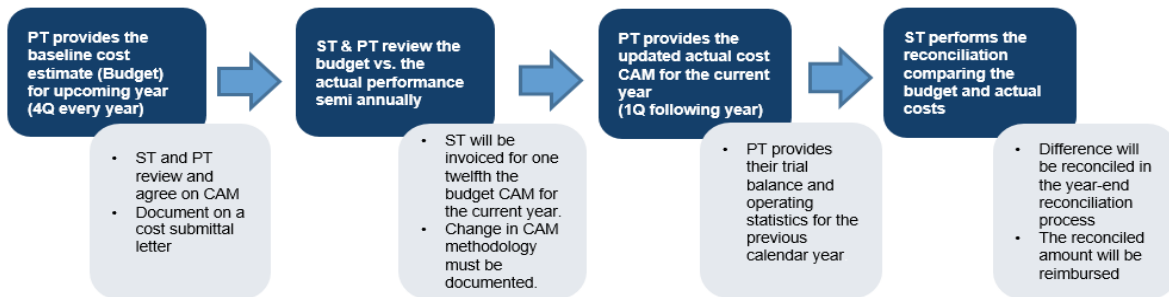
³ According to the 2019 ST financial statement, ST O&M expenses for 2019, totaled \$345M from \$271M in 2017, representing a significant increase by 74M (or 27%). Of the \$345M O&M expenses, \$195M purchased transportation expenses accounted for 56% of O&M expenses.

⁴ Purchased transportation includes amounts paid for the operation of Sound Transit's express bus service to Community Transit, King County Metro and Pierce Transit, for the operation of Link light rail and associated paratransit services to King County Metro and for the operation of Sounder commuter rail services to BNSF Railway Company (BNSF).

⁵ Allocated costs are based on the actual cost incurred in the provision of services to ST under the following two governing documents:

- Interagency Agreement between Pierce Transit and Sound Transit for ST Express Bus Service Operations & Maintenance (O&M) dated 2015 (Amended November 2018 & September 2019).
- Tacoma Dome Station (TDS) Garage and Bus Platform O&M Agreement 2015. There are accompanying Letters of Agreement regarding proportionate cost sharing for O&M of TDS Parking Garage and Bus Platform for each year. (Note: TDS O&M cost is not a part of ST purchased transportation expenses.)

year. Both parties agree on the baseline cost for the upcoming year by the year-end and Sound Transit provides a cost submittal letter to be countersigned by Pierce Transit.



Pierce Transit invoices the monthly baseline cost (one-twelfth of the annual baseline cost) for the current year. At year-end, Pierce Transit updates CAM based on total actual operating and certain non-operating expenses such as depreciation. Sound Transit performs the final year-end reconciliation to true up between the baseline invoice payments and actual expenses.

Audit Objectives

To determine whether the agency has effective controls to ensure:

- PT costs allocated to ST are allowable, and reasonable.
- PT costs allocated to ST are actual expenses based on actual performance.

Scope and Methodology

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusion based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusion based on our audit objectives.

We gained an understanding of Pierce Transit’s Cost Allocation Model through documentation reviews, data analysis, analytical procedures, walkthroughs, and personnel interviews. We identified risks in the processes and assessed management controls in place to mitigate those risks. Based on our assessment, we focused on management’s practices related to monitoring of allowable and reasonable PT costs incurred. Specific controls were reviewed to ensure PT costs allocated to ST were actual expenses based on actual performance.

We examined agreements, procedures, oversight documentation and records from January 2018 through October 2020 and processes and management controls in place as of October 2020.

Objective 1:

1. To determine whether the agency has the effective controls to ensure that costs allocated to ST are allowable and reasonable, we performed the following procedures:
 - a. Reviewed interagency agreements and associated amendments, Sound Transit (ST) internal procedures, best practices and supplemental guidance documents.
 - b. Interviewed ST Operations Business Support Services, ST Express Bus Operations, ST Risk Management, ST Financial Reporting & Grants Accounting staff and management to ensure agreements, ST internal procedures, or other financial oversight documents provide definitions for allowable costs and provide clear guidance to management.
 - c. Reviewed 2018 & 2019 depreciation allocated cost (including assets) from Pierce Transit (PT) to ST to determine whether the depreciation cost was allowable.
 - d. Reviewed 2019 Full Time Equivalent (FTE) charged for allocated baseline cost and the actual cost to ST for reasonableness.
 - e. Reviewed task order invoices to ensure the task order expenses were excluded from allocation to ST.

Objective 2:

2. To determine whether the agency has the effective controls to ensure that PT costs allocated to ST are actuals based on actual performance, we performed the following procedures:
 - a. Selected 16 out of 143 ST Express Buses that were operated and maintained by PT (or ~\$803K out of a total 3.7 million actual parts cost) and reviewed if the parts cost allocated to ST was based on actual repair costs.
 - b. Reviewed if ~\$2.8 million and ~\$2.6 million in 2018 & 2019 fuel costs allocated to ST to determine if costs were based on the actual costs.
 - c. Reviewed if PT transit police allocated costs of ~\$980K to ST were based on the actual performance.

Conclusion

The current partner cost monitoring controls have progressively improved since the Audit Division's previous review: King County Metro Cost Monitoring audit (dated, October 2019) - which identified control weaknesses in implementing the agency's Cost Allocation Model (CAM). Related to our current engagement, we observed areas of improvement as it pertains to on-going reviews performed by ST staff. These included checks over the accuracy of

CAM formulas, identification of major variances & budgetary review, and clarifying exceptions noted with key transit partners.

However, the audit found opportunities of improvement are still needed to provide a reasonable assurance over the monitoring of cost incurred by Pierce Transit (PT). Specifically, management controls need to be strengthened in two areas to include: 1) explicitly defined allowable costs within the agreement; and 2) enhancing periodic reviews to ensure the allocated costs were allowable and expensed based on actual performance.
See Finding #1

Findings and Recommendations

1. Agency controls over Pierce Transit allocation costs should be strengthened

Specific to Sound Transit (ST or the Agency) express bus services, Interagency Government Agreement (IGA)⁶ sections 12.1.1(a) & 12.1.2 requires Pierce Transit (PT) to maintain the financial books, records, documents, and other evidence directly pertinent to the performance of the work under this agreement. Section 12.6 states the parties agree to meet two times during the year to review the budget versus actual performance of Pierce Transit. Thus, the Cost Allocation Model (CAM) is utilized to allocate PT cost incurred related to the operations and maintenance of ST bus services and facilities.

The CAM process requires PT to provide its estimated budget (or baseline cost estimate) to ST for the upcoming year, and the total actual operating cost at the year-end. After both sides agree with the cost estimates for the upcoming year, PT invoices ST on a monthly-basis for the current year. Interagency Agreement Section 12.8 specifies the end of year requirements and reconciliation, necessitating PT to provide the cost allocation based on total actual operating and certain non-operating expenses (such as depreciation).

As part of the final year-end reconciliation, ST performs a comparison between the invoice payments and actual expense allocations. Section 12.8.3 states that PT will provide their trial balance and operating statistics for the previous calendar year. If there is any change, both parties must concur with the change in writing. Any division cost allocation which cannot be substantiated in this manner must be revised to meet the agreed-upon methodology.

In addition, section 12.8.4 of the IGA also states the total cost per the agreed-upon cost allocation model will be compared to the total actual payments and will result in a reconciling amount. The settlement of the annual reconciliation will be made by separate invoice.

It is imperative that ST effectively reviews whether the cost estimate from PT is allowable and reasonable when it reviews the cost estimate for the next year. In addition, ST's reconciliation process, comparing the baseline cost estimate agreed on cost allocation

⁶ Interagency Governmental Agreement (IGA) between Pierce Transit and Sound Transit for ST Express Bus Service Operations & Maintenance dated 2015 (Amended November 2018 & September 2019).

model to the total actual payments to PT at year-end, is crucial to determine the reconciling amount. This resulted in variances, estimating \$5.6M⁷ for the period of review.

Furthermore, we noted that absent an adequate review and reconciliation processes performed by ST increases the probability that:

- That monthly payments of baseline cost estimate to PT, may result in over/underpayment for the current year.
- A result of reimbursement for the difference between the baseline cost estimate and the actual cost may be inaccurate.

ST performs variance analysis when reviewing the baseline cost estimate and reconciliation processes at the end of the year for the true up of cost. In addition, ST reviews the monthly report from PT to ensure the reasonableness of actual cost (e.g., parts cost, fuel cost) throughout the year.

However, based on our review, we found that the agency did not execute reasonable financial oversight over cost incurred by PT. Specific control deficiencies included:

- (1) Lack of guidance required to supplement the proper treatment of specific cost line-items (e.g., depreciation, transit police, fuels & parts, etc.); and
- (2) Insufficient and untimely reviews related to the reasonableness of actual costs incurred.

The preceding deficiencies occurred due to: (1) inexplicitly defined allowable costs in the agreement; and 2) inadequate controls to ensure the allocated costs were allowable and actual.

Undefined allowable and allocable costs

a. Depreciation cost

Pierce Transit (PT) generated the baseline cost estimate for vehicle operations and maintenance, non-vehicle maintenance, and general administration costs using Cost Allocation Model (CAM). Additionally, PT added depreciation as the separate item⁸ to the total cost for upcoming year. At the year-end, ST performed the reconciliation between updated the actual total cost through CAM and the baseline cost estimate. In this reconciliation process, the depreciation cost should have been reviewed to determine whether the depreciation was allowable to ST.

For this audit, we reviewed PT's calculation for depreciation of assets related to non-revenue vehicles (NRV)⁹ between 2018 and 2019. Audit re-performed calculation of depreciation for 135 assets, 67 assets (in 2018) and 68 assets (in 2019), resulting in allocated depreciation costs to ST were ~\$211K and ~\$218K in 2018 and 2019, respectively. We have reviewed

⁷ As the result of the reconciliation, Sound Transit reimbursed Pierce Transit in the amount of \$3.2 million (M) in 2018, and Pierce Transit reimbursed Sound Transit in the amount of \$2.2M in 2019.

⁸ Interagency Agreement Exhibit G1: Rate Setting shows the depreciation is one of other items to allocate to the total allocated cost to ST.

⁹ Those assets were non-revenue vehicles, purchased between 2003 and 2009.

the ‘useful life’ of the assets and the fund for purchasing assets for allowable costs to ST. Based on our review, we found the following exceptions:

- 31% (21 out of 67 total assets) in 2018 & 25% (17 out of 68 total assets) in 2019 assets were fully depreciated contrary to management’s assertion of an estimated useful life of 7 years. Thus, the depreciation cost for these assets was erroneously allocated to ST for 2018 & 2019 and should have been excluded from the calculation of depreciation.

Year	Total depreciated assets	Total fully depreciated assets	% of unallowable depreciation assets	Potential effect for over allocated cost to ST
2018	67	21	31%	~\$25K
2019	68	17	25%	~\$20K

Moreover, based on our testing, we noted that 52% (11 out of 21) in 2018 & 53% (9 out of 17) in 2019 of assets were purchased with grants. The cost of assets purchased with grants were not the actual cost that PT incurred during the year. Those assets should have not been included for allocated depreciation cost to ST.

The condition above occurred because the interagency agreement did not explicitly define what assets would be depreciated and how it would allocate the depreciation cost to ST. In addition, it was not clearly defined in the agreement whether the depreciation cost from assets purchased with grants could be allocated to ST. The operating expenses using grants should have been excluded from allocating cost to ST in the CAM. If not excluded, operating expenses could be considered as reimbursed from two different sources.

Furthermore, ST Management was not able to ensure validity of depreciation cost during the reconciliation at year-end due to undefined the depreciation costs. This could affect the actual depreciation amount, one of the reconciling items, which increased by \$25K in 2018 and \$20K in 2019.

b. Transit Police cost

Pierce Transit (PT) provides the security services for Tacoma Dome Station (TDS) and Lakewood Station (LWS) based on the agreement¹⁰. This transit police cost was one of the allocated costs, included as part of the baseline cost estimate. At year-end, Sound Transit (ST) performs a reconciliation between PT’s total actual cost and the baseline cost estimate

10 PT provides operational and maintenance services: (1) ST’s express bus services; and (2) Tacoma Dome Station Garage (TDS). ST and PT agreed on the services for TDS under Tacoma Dome Station Garage and Bus Platform Operations & Maintenance Agreement 2015 dated January 1, 2015. This is not a part of purchased transportation expenses. There are accompanying Letters of Agreement regarding proportionate cost sharing for Operations & Maintenance (O&M) of TDS Parking Garage and Bus Platform for each year. Sound Transit’s share is 75% and Pierce Transit’s share is 25% for O&M costs in 2019.

through CAM. In this reconciliation process, the transit police cost should be substantiated¹¹ to determine whether the cost allocations to ST were allowable and reasonable.

PT's actual cost for transit police was ~\$980K (ST share) of the total \$4.2 million (M) in 2019. Of the \$980K, costs associated consisted of \$900K for Pierce County Sheriff Department (PCSD); and \$80K for Lakewood Police Department (LPD).

For the purposes of our review, we consulted with management to ascertain PT's methodology in applying its cost allocation formula (absent documented criteria) and analyzed PT's supplemental cost analysis for accuracy. Discussions with ST management indicated that cost allocations were based on one cost driver, 'facility check hours' and did not consider other cost factors (e.g., 'number of facility checks').

'Total facility check hours' by PCSD and LPD were 11,656 & 4,079 in 2019, respectively. 'Total number of facility checks' were 56,266 & 33,804 in 2019. PCSD and LPD checked 20 and 12 PT facilities including TDS and LWS in 2019.

Transit Police	2019 Lakewood Station & Tacoma Dome Station Check hours	2019 # of Lakewood Station & Tacoma Dome Station checks	2019 Total Facility Check hours	2019 Total # of checks	% of Lakewood Station & Tacoma Dome Station Facility Checks
PCSD	3,739	6,954	11,656	56,266	32%
LPD	650	1,524	4,079	33,804	16%

- 32% (3,739 out of 11,656) and 16% (650 out of 4,079) were LWS & TDS Checks hours by PCSD and LPD. Only these percentages were used to calculate the allocated transit police cost to ST.

However, based on our re-performed calculations utilizing a combination of cost drivers (both 'number of checks' and 'facility check hours'), we found cost variances, totaling \$98K, for police services provided by PCSD and LPD.

Transit Police	2019 Actual Transit Police Costs	% of Lakewood Station & Tacoma Dome Station Facility Checks	2019 Cost allocated to ST (2019 Actual Cost X % of total facility checks)*	Avg. % of total facility check hours & # of checks	If Avg. % of total facility check hours & # of checks used for allocating cost to ST	Cost variance
PCSD	\$ 3,734,891	32%	\$ 898,446	22%	\$ 829,764.59	\$ 68,682
LPD	\$ 505,229	16%	\$ 80,525	10%	\$ 51,651	\$ 28,874
Total	\$ 4,240,120		\$ 978,971		\$ 881,416	\$ 97,555

*Proportionate cost sharing (75% for Sound Transit) for Operations & Maintenance of TDS Parking Garage and Bus Platform were applied.

The condition above occurred because the Interagency Agreement does not explicitly define how to allocate the transit police cost in the CAM. In addition, the service from the PT Transit Police division was not clearly described in the agreement or any supplemental guidance.

¹¹ Interagency section 12. 8. 3 states Pierce Transit will provide their trial balance and operating statistics for the previous calendar year. Any division allocation which cannot be substantiated in this manner must be revised to meet the agreed upon methodology.

Based on interviews with ST management (ST Public Safety-Operations), we were informed that it was not clear as to what services PT Transit Police division provided. In addition, it was stated that the calculation of allocation cost should be a combination of cost drivers, including 'the number of check hours' and 'the number of checks.' As a result, insufficient knowledge of the preceding process is indicative that management may have had inadequate validation of the accuracy of expenses as part of the variance analysis.

Inadequate controls over validity actual costs

a. Fuel and Parts Cost

Interagency Agreement section 8.5 states that Pierce Transit (PT) will provide fuel, lubricants, tires, repair parts, and supplies required for the operation, maintenance, and repair of the buses. PT will report the quantity and price of total fuel costs monthly. The fuel cost will be recorded at the year-end Cost Allocation Model (CAM) as actual cost.

We reviewed the following actual cost from the 2019 year-end actual cost CAM.

- 1) The fuel Compressed Natural Gas (CNG) and Diesel costs, totaling \$2.6 million (M) for the 2019 year-end actual cost CAM. Subsequent comparisons were performed on the (1) actual cost of fuel for 2019 and (2) the actual fuel cost to the monthly quantity.
- 2) The bus parts costs, \$803K out of \$3.7M (or 16 buses out of 143) for the 2019 year-end actual cost CAM. Subsequent comparisons were performed on the (1) actual parts cost (\$803K) from the work order repair report (PT provided) and (2) PT's work order repair report (ST provided) for 2019.

Based on our analysis, we found cost variances, totaling \$117K (or 3%) of the total \$3.4M related to fuel and parts cost.

Type	2019 PT Reporting	2019 Actual Cost CAM	Difference (Shown in Red to show overages)
CNG ^[1]	\$279,633	\$349,711	\$70,078
Diesel ^[1]	\$2,265,868	\$2,293,426	\$27,558
Total fuel cost	\$2,545,501	\$2,643,197	\$97,636
Total Parts^[2] sample selection	\$784,058	\$803,906	\$19,848
Total Fuel and Parts cost	\$3,329,559	\$3,447,043	\$117,484

Source: Derived from PT's 2019: [1] Monthly Fuel; and [2] Work Order Repair reporting.

Based on our analysis above, we noted the following exceptions:

- CNG fuel and diesel cost actual CAM (\$2.6M) were ~\$70K & ~\$27K higher than the monthly partner report-fuel cost (\$2.5M).
- Actual parts cost, totaling \$803K (or 16 buses) of \$3.7M (or 143 buses), resulted in variances of \$20K. Further review of 'PT's Work Repair Report' appeared to have only calculated 'parts issued' thereby excluding 'opened work orders' from the prior years (which was not defined in the agreement whether only 'parts issued' would be included for the cost of the actual parts).

Variances identified were due to the following:

- The cost of the fuel (\$2.6M) was from the 'annual average fuel price'. The monthly quantity and fuel price was reported to ST in compliance with the agreement; however, the actual fuel cost was calculated based on the annual average of fuel price for the 2019 year-end actual cost CAM.
- The cost of the actual parts (\$803K) was from the work order repair report including all work order closed in 2019 (e.g. repair work order opened in 2018 and closed in 2019), however, 2019 PT's work order repair report included only parts issued during 2019.
- As with the fuel and parts cost issue, the Inter-Agency Agreement (IGA) did not define which cost reports would be used for the year-end actual cost to allocate ST. The adjustment for the difference amounts were not part of the result of reconciled amount at the year-end.

We noted that ST Operations Business Service division continues to perform variance analysis – comparing the baseline estimate cost and the year-end actual cost – for reasonableness throughout the year. However, the sufficiency of independent reviews to ensure allowable and reasonableness of PT cost incurred (e.g., substantiated variances) were not adequately performed. Auditor's note that if variances are not traceable to supporting documentation, this is an increase in the financial risk that ST will not receive full reimbursement (as intended).

b. Full Time Equivalent

IGA section 2.1.2 states that under National Transit Database guidelines, Pierce Transit (PT) will provide to Sound Transit (ST) financial data (monthly and annual). Among the many requirement, data submission shall include the annual Full Time Equivalent (FTE) and hours. Furthermore, those FTE numbers will be used to allocate FTE budget/actual cost incurred to ST (via CAM model).

In 2019, PT allocated 'FTE budget cost' of \$5.2M (incurred cost) of the total \$20M to Sound Transit. Per the 2019 budget CAM, the \$5.2M was linked to 816 FTEs as derived from 58 PT divisions.

For the purposes of our audit, we compared budgeted FTE numbers from each 58 PT divisions against 'PT's position control report' (year-end FTE count) to determine if any adjustments were made to correctly reflect actual FTE figures. Based on our analysis, we found the following:

- The 2019 total actual FTE in PT's position control report was 72 less than '2019 budgeted FTE' in the 2019 budget CAM, resulting in an overstatement in the '2019 actual FTE in CAM' at year-end.
- The PT's relief transit operator had the most variance of 56 FTE. It was budgeted 91 FTE and actual filled 35 FTE at the year-end according to 'PT position control report'.

Variance between '2019 Budget FTE' and '2019 Actual FTE' *			
Position Title	Budget FTE	Actual FTE (Filled position))	Variance
JOURNEY LEVEL MECHANIC	46	42	-4
RELIEF TRANSIT OPERATOR	91	35	-56
SERVICE SUPERVISOR	46	34	-12
Other position	633	633	-
Total	816	744	-72

*PT Position Control Report was as of November 26 2019

The conditions above occurred due to a lack of reconciliation between budgeted FTE and actual FTE at year-end. The budgeted FTE used for the baseline estimate cost to allocate cost to ST was used as the actual FTE at the year-end. If the FTE is not adjusted to the year-end actual cost CAM, ST will reimburse the additional unsupported FTE overhead costs, and this will increase the burden of ST's finances.

Recommendations:

We recommend the following specific procedures are suggested for management consideration:

- Develop policy defining the appropriate level of review and allocation for major cost drivers. Specific examples include prescribing methodologies for the following (not an all-inclusive list):
 - **Depreciation:** Define assets subject to depreciation and proper valuation (e.g., 'useful life of the assets and assets purchased with grants). This also entails defining the methodology for calculation when allocating depreciation costs to ST.
 - **Police Services:** Define methodology and calculation for allocating transit police cost to ST.
 - **Fuel, Parts and FTE:** Determine appropriate level of reporting for fuel and parts costs and the number of FTE to substantiate actual costs at year-end.
- Management to enhance its information and communication control (e.g., recurring meetings) with key transit partners – PT, KCM, CM – to enhance:
 - Periodic reconciliations and interim reviews (as opposed to deferred year-end reconciliation). The process may be supplemented by an exceptions list (audit trail) identifying calculations errors and variances that do not conform to cost principles – allowable and reasonableness.

Management Response:

The internal audit had one finding that concluded “agency controls over Pierce Transit allocation costs should be strengthened.”

Management concurs that adequate agency controls can be improved and refined to ensure the most accurate and fair cost share between the respective agencies. As mentioned in the audit report, Management has made progress over the years to improve controls over cost allocation model (CAM) oversight, including recalculating the CAM model received from partner to ensure all formulas are correct, updated process documentation and incorporating internal audit recommendations when practical. Overall, Management is confident the overall CAM review process prevents material or significant

cost allocation errors that would result in an unfair cost absorption by our agency or our partner agencies. We employ historical trend analysis with and without fuel, compare detailed cost center variances to budget and research major variances with our partner before CAM is approved and payment finalized.

We do appreciate Internal Audit's support and deep detailed reviews of the CAM models to identify areas for improvement. Currently staffing resources have limited the very detailed examination on financial and operational data. We rely heavily on the assumption that our partners are providing accurate financial and operating metric data used in the CAM model. Below is the action we will take for audit exceptions identified through the detailed audit:

Fuel costs – We will work with Pierce Transit to determine which report to use for the final fuel cost allocation, either the monthly reports summed for total annual cost or year-end fuel report that has slightly different means to calculate the final cost.

Parts costs – Like fuel, we will work with Pierce Transit to identify which parts report is best to use for the final parts charge to Sound Transit.

Depreciation expense – Depreciation cost share with Pierce Transit is going to be more significant in future years. We have incorporated language in the new IGA regarding depreciation cost share and will work with Pierce Transit to review the details for depreciation allocations.

Police expense – We will engage our Sound Transit Public Safety division with Pierce Transit to identify best metrics to allocate these costs between the agencies.

FTE counts – Pierce Transit FTE counts are used as a means to allocate or share overhead costs between the agencies. Budgeted FTE counts or actual FTE counts will result in approximately same allocation of costs, but we do prefer that Pierce Transit use the actual FTE count at year end and will request they do so going forward.

Internal Audit provided two recommendations provided below. Management response is provided under each recommendation.

Develop policy defining the appropriate level of review and allocation for major cost drivers.

Management commits to reviewing and updating our 'ST Express Operations Oversight Plan' which includes processes to review the invoicing and reconciliation across all STX partners.

Cost Allocation Models need to be adaptive, dynamic and flexible to changing business or organizational changes. All costs have cost allocation drivers assigned and agreed to by both agencies, nevertheless, management will work with Pierce Transit to ensure better consistency in reports used for certain CAM cost centers. Both agencies will continue to work together to consider other alternatives, metrics, and new or emerging technology to document the cost of Sound Transit services provided by Pierce Transit.

Management believes the current CAM oversight or review process is adequate and efficient to ensure significant or material costs aren't unfairly allocated to the respective agencies. More resources at both Sound Transit and Pierce Transit would be required for the next level of detailed review process.

Management to enhance its information and communication control (e.g., recurring meetings) with key transit partners – PT, KCM, CT – to enhance:

- Periodic reconciliations and interim reviews (as opposed to deferred year-end reconciliation). The process may be supplemented by an exceptions list (audit trail) identifying calculations errors and variances that do not conform to cost principles – allowable and reasonableness.

Management does not concur with periodic reconciliations. Our partners will only run the CAM once the year is finalized. The CAM development process is very complex pulling data from many source systems and requires significant time for our partners to produce. We can, however, check in with our partner agencies mid-year to go over their financial and operating trends relative to budget, which may help us better understand what the cost allocation to Sound Transit might be relative to our budget when the year-end reconciliation is completed.