

**SOUND TRANSIT
AUDIT AND REPORTING SUBCOMMITTEE
January 22, 2009 Meeting Summary**

Subcommittee members in attendance: Fred Butler (Chair), Mary-Alyce Burleigh, Dave Enslow, Claudia Thomas, and J.D. Wessling (COP Vice Chair)

Chair Butler called the meeting to order at 11:38 a.m.

1. Introduction

Chief Financial Officer Brian McCartan reviewed today's agenda with the committee.

2. 2007 State Accountability Audit Report

Tony Martinez of the State Auditors Office presented the exit conference documents from the 2007 Accountability and Legal Compliance Audit of Sound Transit. The areas that were reviewed include lease and rental revenues, contracts and agreements, Board compensation, subarea equity, credit card use and community development fund expenditures.

Mr. Martinez reviewed the items included in the packets from the State Auditor's office (SAO). He noted that the draft accountability report is included; the report does not include any findings for Sound Transit. Exit items are also included in the committee's packets. Last year's exit items were resolved with the exception of two instances of construction contracts that did not have certificates of insurance. He noted that a report on an issue raised by the citizen hotline is also included in the packets. The issue is in regards to Sound Transit spending money on membership fees and sponsorships in charity organizations; the report determined that Sound Transit does have the authority to pay membership fees, but not sponsorships. A Sound Transit response on that issue is also in the packets.

Boardmember Enslow asked what the response from Sound Transit includes; Ms. Priestly noted that a team of managers is reviewing and clarifying the policy on that issue.

3. SAO Performance Audit – Entity-wide Risk Assessment

Harriet Richardson of the State Auditors office gave a presentation on the risk assessment done by the State Auditors office. The auditor's office has contracted with the auditing firm Talbot, Korvola & Warwick, LLP and their two sub consultants in order to perform the audit. She described the process and described how risks were rated. She noted that risks identified by the audit could be used by the state as possible future audit topics. Risks identified by the audit could also be used by Sound Transit in order to make changes or to audit. CFO Brian McCartan noted that Sound Transit has conducted eight performance audits on its own, and another performance audit was already conducted by the state. He noted that the ST2 financial policies commit the agency to conduct performance audits, topics can be selected from the list identified by this state audit to conduct audits in years when the state auditor is not conducting audits.

Chair Butler noted that the SAO compliance audit and the SAO performance audit will be done in conjunction with each other; he asked what interaction the audits will have with each other. Ms. Richardson noted that the state is working on integrating the compliance audits and performance audits. Risks identified by the risk assessment may be audited as a performance or compliance audit depending on the issues involved. Staff integration will also take place so that the process is more seamless.

Boardmember Enslow asked about the financial benefit in doing performance audits; Ms. Richardson noted since the SAO has been doing performance audits there has been a ratio of one dollar in cost for nine dollars in savings.

4. 2008 Financial and Federal Audit Plan

Tom Evert of KPMG introduced the auditors on the KPMG team and discussed the deliverables and objective of the audit. Mr. Evert listed the deliverables for this year's audit, including a financial statement audit, governmental audit, and meeting with Sound Transit to discuss any items that come out of the auditing process. Mr. Evert explained that a risk approach will be taken with the audit, more significant and higher likelihood items will be looked at when reviewing financial statements as well as claims litigation and intergovernmental transactions. Karl Erickson of KPMG explained that significant account transactions and estimates are looked at as part of the audit as well as fraud risks.

Boardmember Butler asked how the risks looked at in this audit relate to the Entity-wide risk assessment done by the State Auditors office. Ms. Richardson noted that the state auditor's office is still in the early work on the entity-wide risk assessment and the risks are still being developed. She noted that as the entity-wide risk assessment completes a risk map, they will be able to work with the KPMG auditors to identify any major differences.

Mr. Evert responded to a question from Boardmember Enslow about how Sound Transit's investment portfolio compares with other companies; he noted that Sound Transit's portfolio tends to be more conservative. J.D. Wessling, COP Vice Chair, asked why an audit of internal controls is not included in the list of deliverables; Mr. Evert noted that internal controls are considered, weaknesses or deficiencies in internal controls would be communicated in a management letter or in the audit report.

Jennifer Pearson of KPMG noted that the single audit will review the government funds received by the agency. Mr. Erickson showed the timeline and process for the audit. He explained that possible impacts to financial reporting such as Link start-up, the start-up of ORCA smart card, completion of Sound Move, and expansion related to ST2 were all being looked at as part of the audit. He noted that accounting procedures for pollution remediation will be included in audits starting this year along with some other accounting changes.

Ms. Priestly noted that the audit work is going as scheduled. She noted that the two management letter items have been acted upon; changes to payroll were implemented at the end of the 3rd quarter and coordination for NTD reports has taken place. She explained that next year's challenges include Link operations and capitalization of those assets. The ORCA smartcard will also impact the agency and the treasury team. The agency will continue to use a project manager to work with the auditor. She noted that they will be returning with the results of the audit later this year.

5. Investment Policy

Treasurer Tracy Butler discussed the reasons behind revising the investment policy and highlighted the proposed changes. Revisions will allow the policy to deal with the new market and regulations, and will realign the policy with restrictions that exist. Major changes include adding definitions for the different investment pools currently in place, adding a compliance component, defining roles and responsibilities, adding limits on permitted investments, and increasing the collateralization requirement. She noted that she will be incorporating feedback received from Boardmembers. Joni Earl, CEO, noted that the changes are mostly administrative, but because of some uncertainty about the type of changes that can be made by staff, the recommendation is to bring the revised policy to the Finance Committee as an action item, it could then be forwarded by that committee to the Board.

Mr. Wessling noted that the Citizen Oversight Panel has an interest in the investment policies and have developed some suggestions and questions. One of the suggestions was to ensure that the investment managers at Sound Transit have a good understanding of where the money is being invested and are not relying solely on other investors.

Boardmember Enslow and Burleigh wanted to have further discussion on the proposed changes. Ms. Earl also suggested that the Finance Committee and Board look at adding policy language about the level of administrative changes that Sound Transit is authorized to make.

6. 3rd Quarter 2008 Asset/Liability Report

Assistant Treasurer Jim Block presented the third quarter Asset/Liability report. Mr. Block noted that a change has been made to the risk indicator for credit risk; it has been increased to medium because of the increase in counterparty credit risk. He noted that the debt service reserve fund previously invested with Lehman Brothers was reinvested into Triple A rated general obligation bonds which resulted in an increase in basis points as a result of managing the bonds directly.

Mr. Block described the overall yields for the agency's investments; the overall yield went up seven basis points. He also described the third quarter cash investment balance and interest earnings; interest earnings are trending below budget, from 16.1 million in interest earnings versus 17.3 million estimated. Interest rates have continued to decline, he explained that agency investments were made at better levels.

With the passage of ST2, an additional indicator will be added to the report that shows the ST2 debt in addition to the Sound Move debt. Ms. Butler noted that there was no liquidity in the borrowing market for a period of time in third quarter of 2008 after Lehman Brothers went out of business. She noted that bond sales would not have been possible at that time if Sound Transit had needed to go to the bond market; she suggested thinking about a strategy for going forward.

7. 3rd Quarter 2008 Financial Report

Budget Manager Pete Rogness gave a presentation on the third quarter financial report. He noted that two financial risk areas have been tracked throughout the year--tax revenues and fuel costs; updated numbers will be provided.

He compared the net assets from the third quarter to the third quarter of 2007; total net assets are up \$250 million and capital assets are up \$500 million, current assets are up \$227 million. He noted that the ratio of the agency's ability to pay its current liabilities and expenditures with cash is up from 2.4 last year to 3.8 at the end of the third quarter of 2008.

For the capitol program, the agency is at 73% of the year to date budget; he described the capital budget expenditure percentages for the Sounder, Link Light Rail, Regional Express, and Other capital programs.

Total revenues were at 109% of the year to date budget, and total expenses were 85% of the year to date budget; representing a positive variance for net income at around \$60 million. Revenue from federal, state and local grants and fare box recovery were all above the budget forecasts.

He reviewed 2008 tax revenues; total tax revenues are under budget by \$5.2 million dollars through the end of September. He broke down the tax revenues by source and by subarea; tax revenues for Snohomish County and Pierce county are 12% and 10% below budget respectively, South King and East King are around 2.9% below budget and North King remains above budget at 2.4%.

Transit operations costs are at 90% of the budget through the third quarter, and ridership was 13% ahead of forecast. Fuel costs have gone down, and as a result the bottom line budget for Regional Express and Sounder for the year will not be impacted. Staff operations are at 91% of the year to date budget. Mr. Rogness noted that disbursements for the year have been fairly constant and average around \$12.8 million a week.

Mr. Rogness responded to a question from Kathy Elias about the 2008 income statement.

8. Next Meeting – March 19, 2009

Chair Butler adjourned the meeting at 12:50 p.m.