

SOUND TRANSIT AUDIT AND REPORTING COMMITTEE MEETING

Summary Minutes
December 20, 2012

CALL TO ORDER

The meeting was called to order at 11:04 a.m. by Committee Chair Dave Enslow, in the Ruth Fisher Boardroom, 401 South Jackson Street, Seattle, Washington.

ROLL CALL

Chair

(P) Dave Enslow, Sumner Mayor

Vice Chair

(A) Larry Phillips, King County Councilmember

Committee Members

(P) Fred Butler, Issaquah Deputy Council President

(P) Mary Moss, Lakewood Councilmember

(A) Dow Constantine, King County Executive

(P) Stuart Scheuerman, Citizen Oversight Panel Chair

(P) John Marchione, Redmond Mayor

Ms. Katie Flores, Board Coordinator, announced that a quorum of the Committee was present at roll call.

REPORT OF THE CHAIR

Chair Enslow asked Brian McCartan, CFO to review today's meeting agenda.

2012 Financial and Federal Audit Entrance-KPMG

Brian McCartan announced that KPMG will be auditing Sound Transit's financial statements again this year and normally meet with the full Audit and Reporting Committee to conduct an entrance conference and exit conference for the audit. This year the entrance conference with KPMG took place before today's meeting because of the full Committee agenda. The Chair of the Audit and Reporting Committee and Sound Transit's CEO were in attendance along with other staff. The audit will include review of the financial statements, conducting the single audit, and doing agreed upon procedures related to subarea equity. The audit will also look at the bond refunding that took place in 2012 and any changes in Sound Transit's fixed asset system.

Copies of the audit entrance documentation was included in Committee members packets.

BUSINESS ITEM

Minutes of the September 27, 2012 Audit and Reporting Committee Meeting

It was moved by Boardmember Butler, seconded by Boardmember Marchione, and carried by unanimous vote that the minutes of the September 27, 2012 Audit and Reporting Committee be approved as presented.

AUDITS

2011 State Auditor's Office Accountability Audit Report

Mr. McCartan noted that the State Auditor's office conducts an annual accountability audit of Sound Transit that looks at the agency's compliance with state laws and regulations and agency policy and procedures. Hong Nguyen, Lead Auditor, Carol Ehlinger, Audit Manager reviewed the accountability audit results for 2011. The audit reviewed six areas including compliance with transit security and police contracts; open public meeting minutes; fare enforcement; expenditures; change orders-public works and professional

services; and self-insurance programs. The audit found three exit items and one finding. The exit items were related to the safeguarding of citations, change order reviews and contract compliance documentation. The exit items were discussed in detail with Sound Transit management. The audit finding was Sound Transit's lack of adequate internal controls to ensure it properly monitors its security and police contracts, resulting in late fees and unallowable costs; and the payment of invoices without sufficient supporting documentation. The audit report included in Committee members packets contains the State Auditor's Office recommendation and Sound Transit's response to the finding. Kelly Priestley, Controller, noted that Sound Transit has since conducted a review of late payment reports in 2012 and did not find any additional late fees that were paid.

State Auditor's Office Performance Audit Report

Chris Cortines, Principal Auditor from the State Auditor's Office reviewed the performance audit of Sound Transit. The audit looked at four areas including how Sound Transit responded to Citizen Oversight Panel (COP) concerns and the relationship between the COP and the Board; the adjustments made to ST2 as a result of the economic downturn; Sound Transit's construction management area; and ridership forecasting.

In the COP area, the audit concluded that the COP is pleased with Sound Transit's efforts to respond to its concerns and efforts to respond to long-standing concerns. The audit recommends some additional communication between the Board and the COP on the status of long-standing concerns, efforts to maintain objectivity and improve focus, and establish equal representation on the COP among the subareas.

Key recommendations for Sound Transit's construction management include continue with implementation of life-cycle costing, and increasing project contingency for ST2 projects. The audit found that the Sound Transit's construction program is very strong and all 20 recommendations from the prior audit were implemented.

The audit found that the use of independent forecasters and the large contingency in the ST2 plan allowed Sound Transit to adjust well in part to the economic downturn. However, the audit recommends re-evaluating the current low level of contingency.

In ridership forecasting, the audit recommended that Sound Transit use range forecasting instead of fixed point forecast. Future investments should be evaluated using ridership forecasts. Sound Transit uses PSRC forecasts as part of the ridership forecast; using the updated PSRC numbers is recommended for future ridership forecasting.

Status Report on the Value Engineering Performance Audit

Ahmad Fazel, Executive Director of DECM and Aniekan Usoro, Deputy Executive Director Project Control and Value Engineering have the status report on Sound Transit's follow-up to the Value Engineering Performance Audit presented to the Audit and Reporting Committee in March. The audit had nine main recommendations. Sound Transit has completed implementation of six of the recommendations, another recommendation is in process and two are planned for 2014. The completed recommendations include: moving value engineering responsibility and management under project controls; creating a new value engineering program manager position; identifying all current projects that should receive value engineering; establishing a separate budget for the value engineering studies; strengthening value engineering requirements including development of a value engineering program; and training all Sound Transit staff in the value engineering process.

Implementing further training for additional project control staff and key managers will be completed in mid-2013. A new procurement strategy for value engineering will take place in mid-2014 because the agency already has an existing contract for value engineering. Refined value engineering reporting will be included in the scope of work for a new procurement for value engineering.

Mr. Fazel noted that the audit recommendations were improvements on Sound Transit's existing value engineering program. Value engineering was used for the Northgate Link Extension. The value engineering study for that project cost \$350 thousand and resulted in 125 recommendations. The projected savings from

the value engineering program for the Northgate Link Extension project is \$31 to \$51 million, a benefit to cost ratio of 90 to 1. Value engineering is conducted on all Sound Transit capital projects.

SELECTION OF A 2013 PERFORMANCE AUDIT TOPIC

David Hammond, Internal Auditor Director, reviewed the potential audit topics for the 2013 performance audit that will be conducted by Sound Transit. The Audit and Reporting Committee began its review of possible 2013 performance audit topics at the September meeting. The potential audit topics are evaluated based on the potential for cost savings, the potential to improve performance and efficiency, the potential to facilitate decision-making, the potential to contribute to public accountability, and the likely audit cost/scale. One possible topic reviewed in September was to review progress in implementing the recommendations from the 2009 Transit Operations Task Force Report. This will be handled as a management status update instead of an audit. One new topic has been added to look at managing goods and services contracts as a result of the finding from the accountability audit performed by the State Auditor's Office. The other three potential topics are transit operations planning-performance measurement; security program; and information technology project management.

Mr. Hammond reviewed each topic in more detail including the new topic on managing goods and services contracts. Mr. Hammond explained that Sound Transit has over 800 active purchase orders. The audit would look agency-wide and review the contracts structures and training that Sound Transit has. The topic is also timely because there is a project to automate some contracts processes later in 2013. The topic has a high potential to improve performance and efficiency, facilitate decision making, and contribute to public accountability because of the recent audit. The audit scale and cost are reasonable for the timeframe.

Committee members spoke in favor of a performance audit on managing goods and services contracts. The Committee also asked that Security be reviewed from a policy management standpoint in 2013. The evaluation of efficiency and effectiveness should look at pursuing benchmarking, reviewing whether the security and police program is at the right level, and whether improvements should be made. Joni Earl, CEO, noted that Sound Transit is beginning the procurement process for the security contracts. Security and the sheriff's group has also recently been moved into the Operations department.

It was moved by Boardmember Butler, seconded by Boardmember Marchione, and carried by unanimous vote that Managing Goods and Services Contracts be selected as the 2013 Performance Audit Topic and that an evaluation of the efficiency and effectiveness of the security and police program be added to the agency workplan in 2013.

INTERNAL AUDIT QUARTERLY UPDATE

David Hammond, Internal Audit Director, gave a quarterly update on current audit reports, audits in progress and audits that were deferred.

New Internal Audit Reports

Two reports were issued by the Internal Audit division over the last three months; the Small & Attractive Assets audit report and a Procurement Card Program audit report. The review of Sound Transit's small and attractive assets procedures was based on a 2009 state auditor's office recommendations for changes to the existing policy. The internal audit division reviewed whether Sound Transit has adequate control over assets with a value below \$5,000 that have a potential to be stolen. The report recommended formalizing some of the central controls. The audit of the Sound Transit procurement card program looked at purchase cards issued to agency employees. The audit evaluated whether the procedures are able to adequately control the program. The audit recommended additional monitoring and reporting controls.

Audits in progress, Deferred Audits, and Prior Audit Recommendations

Eight audits are currently in process including five new audits and follow up on three prior audits. Five audits were deferred into 2013 and one audit was deferred indefinitely because it was determined that an audit of Risk Management claims processing was not needed. Audit recommendations from prior audits are

reviewed by the internal audit division. Mr. Hammond provided information on the follow-up status of audits conducted in prior years.

FINANCIAL REPORTING

Overview of Third Quarter 2012 Financial Results and Reports

Pete Rogness, Budget Manager, presented the third quarter 2012 Financial Results and Reports. Third quarter revenues are just under budget; all categories except for miscellaneous revenues improved in the third quarter. The largest under-run was due to sales and use tax, it was below budget by 2%. Federal Grants were also under budget by \$4 million. Fare revenues were \$6.9 million above budget and investment income was \$4.5 million above budget. Based on tax revenues through November, the sales tax is below budget by 1.5%, Motor Vehicle Excise Tax is 4.2% below budget and the Rental Car Tax is at .3% ahead of budget, for a total of 2.1% below budget for overall tax revenues.

Boardings and fare revenues for the third quarter were ahead of 2011 and the 2012 budget for all modes. Transit operations expenses were at 95% of the year to date budget; Sounder was at 85% of budget because of savings in vehicle and facilities maintenance. ST Express is at 98% of the year to date budget, the largest variance was due to savings in facilities maintenance. Central Link is at 96% of its budget related to higher expenditures for materials and supplies for spare parts offset by savings in fare vending machine work being done in-house. Tacoma Link is at 86% of the year to date budget because discretionary expenditures for repairs were used more efficiently or projects were deferred.

All departments are within their year to date budget. Salaries and benefits and services make up 85% of the total agency administration budget. There average vacancy rate is at 8%.

ST Express is at 33% of the year to date budget due to under-spending on the ST Express bus base program that was placed on hold. Final design was \$3.4 million below budget as a result of under-spending on the I-90 stage two project. Invoices for that project are still being received from WSDOT. There were also delays on projects managed by other jurisdictions including the 85th street corridor in Kirkland, and the Rainier Avenue and Strander Boulevard projects in Renton. Sounder capital expenditures are at 73% of the year to date budget, due to project delays with the D Street to M Street Project and the Tukwila Sounder Station. Central Link is at 77% of the year to date capital budget. Under-spending is a result of the University Link and First Hill Streetcar projects. Money budgeted for tunneling contingency for University Link was not needed. The First Hill Streetcar will remain under budget for the rest of the year due to schedule changes. East Link is ahead of budget because of the acquisition of the Eastside Rail property that was not budgeted in 2012. Service delivery is at 40% of the year to date budget due to changes in vehicle procurements. Other agency projects were at 35% of the year to date budget, including administrative expenditures for office furniture and equipment, the research and technology program, STart program, and TOD surplus property and property disposition are below budget.

Third Quarter Asset Liability Management Report

Jim Block, Cash Investment Administrator, gave a presentation on the third quarter Asset Liability Management report.

There were no changes to the stoplight indicators. The federal government plans to keep the fed rate floating between 0 and 25 basis points for a considerable time after the economy recovers. In the third quarter, the average yield on total cash and investment holdings decreased by three basis points, from 1.01% basis points to 98. The state investment pool was at 18 basis points at the end of the third quarter and the King County investment pool was at 55 basis points. There was no change in the investment strategy. \$40 million in open market securities were purchased for the unrestricted portfolio at an average yield of 35 basis points. New purchases were all in Agency bonds. Interest earnings exceeded the budget by \$4.5 million, but without unrealized gains and losses, interest earnings were over budget by \$670,000 at the end of the third quarter. The investment portfolio is above benchmarks and all portfolios comply with policy limits and guidelines. Tax-exempt bonds are yielding higher than taxable bonds. The current borrowing rate for long-term debt is at 2.5%.

Contract Reports

Contract reports covering contracts opened during the third quarter of 2012, sole source and propriety contracts opened in the third quarter, third quarter contracts under \$10,000, and all contracts over five years old were included in Committee members packets.

EXECUTIVE SESSION

None.

NEXT MEETING

March 28, 2013
10:30 a.m. to 12:30 p.m.
Ruth Fisher Boardroom

ADJOURN

The meeting was adjourned at 12:42 p.m.



Dave Enslow
Audit and Reporting Committee Chair

ATTEST:



Katie Flores
Board Coordinator

APPROVED on March 28, 2013, KWF.