



Internal Audit Report

Sounder Contract Management 2014-2015

Report Number: 2016-02 | Report Date: June 1, 2016

Executive Summary

Audit Report No.: 2016-02

June 1, 2016

WE AUDITED the Operations Department's management controls to monitor the Sounder Commuter Rail Program's contracts.

AUDIT OBJECTIVE was to determine whether Sound Transit has implemented effective management controls to provide reasonable assurance of accuracy over the Sounder partner cost billings.

The audit examined management controls in place as of November 2014, specifically for the periods November 2014 and March 2015.

WHAT DID WE FIND?

The Sounder Commuter Rail spans three counties, serving commuters and travelers from Lakewood on the south end and Everett on the north end of the central Puget Sound.

The Sounder has been operating since 2000 for the South line and 2003 for the North line. Currently, there are ten and four daily roundtrips for the South and North line, respectively.

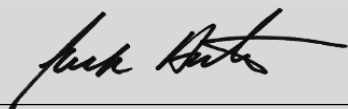
The Sounder Division in the Operations Department manages the Sounder Commuter Rail contracts with an annual budget of \$30 million and five FTEs.

The Sounder Program has five key contracts with four contractors:

- The BNSF Railway to operate the trains, perform train dispatching and right-of-way maintenance since 2000.
- Amtrak to maintain the Sounder vehicles at Amtrak Holgate Maintenance Yard and Facility since 2000.
- Stacy & Witbeck, Inc. (SWI) to maintain the right-of-way between, D Street in Tacoma, and Bridgeport Way in Lakewood since 2012.
- Electro Motive Diesel EMD) to perform locomotive overhaul work.

The audit concluded that management has implemented monitoring controls, and the controls are effective to reasonably ensure the accuracy of the billings for all but one area of the Amtrak contract, that of shared service facilities maintenance costs. The audit noted opportunities to improve controls.

The audit also discovered that Sound Transit was not taking advantage of a state tax deduction for Public Utility Taxes (PUT). The effect of not taking the deduction resulted in a tax overpayment of \$610,000 since 2011.



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Table of Contents

Executive Summary	i
Background	1
Audit Objectives	1
Scope and Methodology	1
Conclusion	2
Findings and Recommendations	3
1. Management Controls Over Invoice Review Should Be Strengthened	3
2. Management Controls Should Be Strengthened to Identify Duplicate Tax Payments	5

Background

The Sounder Commuter Rail spans three counties, serving commuters and travelers from Lakewood on the south end and Everett on the north end of the central Puget Sound.

The Sounder South line has been operating since 2000, and currently offers ten daily roundtrips between Seattle and Tacoma, with six of these trips extended to and from Lakewood. The Sounder North line has been operating since 2003, and currently offers four daily roundtrips between Everett and Seattle.

The Sounder fleet consists of fourteen locomotives, forty coaches and eighteen cab cars, and nine new passenger cab cars are expected in 2016. All vehicles are stored overnight in Everett and Lakewood for the North and the South line trains, respectively.

Much of the Sounder Commuter Rail program is outsourced. The program has five key contracts with four contractors:

- The BNSF Railway to operate the trains, perform train dispatching and right-of-way maintenance since 2000.
- Amtrak to maintain the Sounder vehicles at Amtrak Holgate Maintenance Yard and Facility since 2000.
- Stacy & Witbeck, Inc. (SWI) to maintain the right-of-way between from D Street in Tacoma, to Bridgeport Way in Lakewood since 2012.
- Electro Motive Diesel EMD) to perform locomotive overhaul work.

Annual Contract Payments for the last three calendar years are noted below.

(in millions)	2013	2014	2015*
BNSF – South	\$6.5	\$6.4	\$6.2
BNSF – North	2.8	3.1	2.5
Amtrak	14.2	15.8	14.1
Stacy & Witbeck	1.7	1.4	1.6
Electro Motive Diesel	0.0	3.5	5.0
Total	\$25.2	\$30.2	\$29.4

Source: Sound Transit Annual Budget Documents and GL Data

*Amounts are estimated as of April 2016

The Sounder Division in the Operations Department manages the Sounder Commuter Rail contracts with an annual budget of approximately \$30 million and five FTEs.

Audit Objectives

To determine whether Sound Transit has implemented effective management controls to provide reasonable assurance of accuracy over the Sounder partner cost billings.

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 conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

After reviewing documentation, interviewing personnel, and considering financial data and previous audit activity, we determined to focus our efforts on the four most significant (scope and contract value) Sounder contractors: BNSF, Amtrak, Stacy & Witbeck and Electro-Motive Diesel. Annual disbursements to the four contractors represent approximately 96% of the program's annual operating budget.

We examined management controls in place as of November 2014, specifically for the periods November 2014 and March 2015.

To determine whether Sound Transit has implemented effective management controls to provide reasonable assurance of accuracy over the Sounder partner cost billings, we conducted the following procedures:

1. Examined management reports, meeting documentation and audits performed by Sound Transit staff and outside agencies to determine whether contract monitoring controls had been implemented.
2. To test control effectiveness, we selected 42 invoices, totaling approximately \$8 million from the four contractors, from the period November 2014 to March 2015 to determine the following:
 - a. Was the work within the scope of the contract?
 - b. Were the charges allowable under the terms of the contract?
 - c. Were allocated amounts appropriate and reasonable?
 - d. Was the invoice supported with proper and complete documentation?
 - e. Was the invoice accurately calculated?
 - f. Was the invoice properly reviewed and approved by the Operations Department?

Conclusion

Management has implemented monitoring controls, and the controls are effective to reasonably ensure the accuracy of the billings for all but Amtrak shared service facilities costs. See Finding 1.

In addition, Sound Transit did not take an available deduction to public utilities tax, resulting in overpayments. See Finding 2.

Findings and Recommendations

1. Management Controls Over Invoice Review Should Be Strengthened

Sound Transit reimburses Amtrak for various services in support of Sounder vehicle maintenance. Under the terms of amendment number three, Section 3.2.D.iii, effective January 2013, Sound Transit is responsible for one-third (1/3) of Amtrak's costs of operating and maintaining the Service Facilities. The original contract, Section 1.2 defines "Service Facilities" as:

"...the tracks, land, structures, and other facilities owned or leased and controlled by Amtrak at the King Street Yard that are or may be used by Amtrak to provide the Maintenance and Repair Services. The term "Service Facilities" does not include any structures, land, or other facilities owned or controlled by Sound Transit."

And Section 3.2.D of amendment number three provides for the types of eligible facility expenses for reimbursement, as follows:

"...compensation shall be based on the expenses for the Service Facilities incurred by Amtrak for utilities, security, janitorial services, dispatching, track and signal maintenance, and routine building repairs."

We noted the following 20 exceptions from a test sample of 103 items totaling \$132,002 on 9 shared service facilities invoices.

		No. of Items	Amount in Question*
Billing Error	Overbilled	1	\$4,991
	Incorrectly Billed	3	\$778
	Duplicate Billing	1	\$2,430
Deemed Ineligible Items	New Replacement Rolling Steel Door	1	\$8,392
	Demolition Work for Rolling Steel Door Replacement	1	\$689
	New Compressor System	1	\$1,562
	Storage Unit for Compressor System	1	\$2,250
	Shipping for Compressor System	1	\$953
	Custom Build and Install of Catch Basin	1	\$1,940
	Install of Dual Slope Ramp	1	\$1,629
	Repair Exercise Equipment	1	\$872
	Carwash Chemical	1	\$5,598
	Conceptual Yard Map Design	1	\$243
	Train Wash Maintenance	4	\$4,102
	Waste Water Treatment	1	\$5,690
		20	\$42,119

*Amounts include Amtrak's 16.54% management and G&A fees.

In addition to billing errors, several items in the test sample were deemed ineligible for reimbursement. The current contract language under Section 3.2.D is specific about the expense types for reimbursable operating and maintenance costs of the Service Facilities. The items noted above were deemed to be ineligible expenses.

In early 2014, the Operations Department and Amtrak jointly agreed that Amtrak would no longer provide detailed receipts for the shared facility invoice items. Instead, the parties agreed that Amtrak would provide a spreadsheet listing all of the shared facilities expenses. Following Sound Transit management review, Amtrak would provide copies of supporting documentation when an expense was deemed questionable. It was noted that this spreadsheet did not contain a description of the expenses being billed, an attribute that if included, may increase the effectiveness of this tool in management monitoring. The change was in response to the volume of supporting documentation and its impact on timely review and approval for payment. For the nine service facilities invoices tested, management questioned 3% of the items billed, which was equivalent to 10% of the total value of the invoices. We believe this change has contributed to the exceptions noted above.

Recommendations:

We recommend the Operations Department consider the following recommendations:

1. Obtain credits for the billing errors identified in this audit.
2. Increase oversight for the Amtrak invoices to ensure Sound Transit is billed accurately in compliance with the contract.
3. Revise the Amtrak contract to include costs not specifically allowed under the current contract's Section 3.2.D.

Management Response (Operations Department)

Finding – Management controls over Amtrak invoice review should be strengthened.

Management Response – We concur with this recommendation.

There are two types of exceptions presented in the audit report; billing errors and items deemed ineligible for reimbursement by the auditors. Billing errors in this case refer to Amtrak invoice errors that staff did not recognize and question at the time of processing. Ineligible expense items are those expenses that the auditors felt were not related to routine facility repairs.

Billing Errors – Operations agrees with most of the billing errors identified by Internal Audit and has corrected each with credits issued by Amtrak. We've researched the three Amtrak purchase card (P-Card) purchases that Internal Audit believed were "incorrectly billed" and have determined they were not. Under separate cover we are providing information on the status and disposition of items questioned in the Internal Audit Report.

Expenses Deemed Ineligible – The remaining items listed in the audit were presented as facility related repair expenses to Sound Transit that Internal Audit has identified as not appropriate based on their interpretation of Section 3.2.D of the agreement. Section 3.2.D states that:

*"Monthly Compensation for Costs of Operating and Maintaining Service Facilities.
"...compensation shall be based on the expenses for the Service Facilities incurred by Amtrak for utilities, security, janitorial services, dispatching, track and signal maintenance, and routine building repairs."*

When the agreement was amended in 2012 (January 2013 implementation), the parties agreed to continue including the cost of routine maintenance and repairs to Amtrak service facilities in Section 3.2.D under the “routine building repairs” category, a practice that began with the original agreement in 2000. The inclusion of facilities maintenance repairs and regulatory inspections (fire alarm, fire extinguishers, environmental waste disposal, etc.) under “routine building repairs” has also been a standing practice since the original agreement was implemented in 2000. Sound Transit directly benefits from Amtrak facilities, equipment and systems being in a state of good repair and compliant with regulatory requirements that ensure timely and efficient maintenance and care of our trains used in daily passenger service.

Amtrak has tentatively agreed to discuss a revision of Section 3.2.D to clarify our mutual understanding in light of the facility maintenance and repair costs deemed ineligible by Internal Audit. The proposed changes would reflect the original intent and standing practice of sharing facility maintenance repair costs and will require local representatives and legal involvement from each agency to accomplish. We are also taking the following immediate steps to further improve the contract management process:

- 1. A shared facility cost invoice review has been added to monthly Sounder-Amtrak contract review meetings. Each shared expense item will be reviewed and a determination made as to whether it is a valid or ineligible expense. The first expanded meeting agenda occurred on May 17, 2016.*
- 2. ST and Amtrak will meet to discuss potential changes to the agreement that match the intent and longstanding practice of sharing the cost of facility maintenance expenses on or before June 30, 2016. Negotiations and final agreement are expected to take up to 6 months to accomplish.*
- 3. Amtrak has agreed to pursue the inclusion of a description of each shared facilities cost in the monthly invoice. This action will provide Sounder staff with a more thorough understanding of the expenses and will assist in the monthly expense review outlined in item 1 above.*

2. Management Controls Should Be Strengthened to Identify Duplicate Tax Payments

The Washington State Public Utility Tax (PUT) is a tax on public service businesses based on gross income (fare revenue) derived from operation. The Sounder Program, as a business engaged in public transportation is subject to the tax. Accordingly the agency has been remitting a PUT payment as part of monthly excise tax filings.

The audit noted a duplication of PUT payments to the state:

1. Direct Payments - The Accounting Division has been remitting a PUT payment to WA Department of Revenue as a percentage of Sounder revenues on a monthly basis.
2. Indirect Payments - The Operations Department, as part of its regular reimbursements to BNSF, has been paying for the PUT as a percentage of all costs invoiced.

Under WAC 458-20-179 and RCW 82.16.050, a deduction is available for payments made from one utility provider to another. Reimbursement payments to BNSF qualify as an inter-utility provider payment, but the agency was not aware of the deduction. This lack of awareness contributed to the overpayment of \$610,000 from 2011 to 2014.

Recommendations:

We recommend the Accounting Division consider the following recommendations:

1. Obtain a credit from the Washington State Department of Revenue for previous years' deductions not taken, and take advantage of the eligible deduction going forward.
2. Implement controls to identify potential tax deductions.

Management Response (Accounting Division)*Recommendation 1:*

Obtain a credit from the Washington State Department of Revenue for previous years' deductions not taken, and take advantage of the eligible deduction going forward.

Steps Taken:

- *Amended B&O tax returns were filed with the Washington State Department of Revenue in January, 2016 to take maximum allowable deduction for Public Utilities Tax (PUT) paid to BNSF during years 2011-2014. The state approved the returns and a tax refund of \$610,993 plus interest was received from the state in March 2016.*
- *All 2015 allowable PUT deductions were reported and deducted on the 4th quarter, 2015 B&O tax return.*
- *The B&O tax preparation process was modified to account for BNSF PUT payments as they are made. Accounts payable now codes all BNSF PUT payments to tax liability account (as a reduction) to insure deductions are picked up on future B&O tax returns.*

Recommendation 2

Implement controls to identify potential tax deductions.

Steps to be taken in near future:

- *Improve tax awareness by AP staff. Accountants preparing returns need to be aware of all taxes being paid by the agency so that potential tax deductions can be considered. Accounts payable staff are in best position to review returns and highlight taxes being paid.*
- *Increase training and tools for the accounting staff that prepare and review excise and B&O tax returns.*
- *Periodically review major contracts for potential tax savings. Consider procuring professional tax consultant for potential tax saving strategies.*