

## SOUND TRANSIT AUDIT AND REPORTING COMMITTEE MEETING

**Summary Minutes****April 20, 2017**

## CALL TO ORDER

The meeting was called to order at 11:05 a.m. by Committee Chair Rob Johnson, in the Ruth Fisher Boardroom, 401 South Jackson Street, Seattle, Washington.

## ROLL CALL

Chair*(P) Rob Johnson, Seattle Councilmember*Vice Chair*(A) Joe McDermott, King County Councilmember*Committee Members*(P) Nancy Backus, Auburn Mayor**(A) Dave Earling, Edmonds Mayor**(P) Claudia Balducci, King County Councilmember**(P) Phil Lovell, COP Chair**(P) Bruce Dammeier, Pierce County Executive*

Paige Armstrong, Board Coordinator, announced that there was a quorum of the Committee present at roll call.

## REPORT OF THE CHAIR

Committee Chair Johnson welcomed Pierce County Executive Bruce Dammeier as the new Vice Chair of the Committee, and King County Council Member Claudia Balducci as a new committee member.

## BUSINESS ITEMS

Minutes from the December 20, 2016 Audit and Reporting Committee meeting minutes

**It was moved by Board Member Backus, seconded by Board Member Dammeier, and carried by unanimous vote that the minutes of the December 15, 2016 Audit and Reporting Committee Meeting Minutes be approved as presented.**

## REVIEW OF THE 2017 AUDIT AND REPORTING COMMITTEE WORK PLAN

Committee Overview

Committee Chair Johnson introduced Brian McCartan, Executive Director of Finance and IT who provided the report.

Mr. McCartan introduced the presentation as an overview of the committee's potential 2017 work and founding charter, which was updated in 2010. The resolution that formed the committee was Resolution No. R2010-19, and it directs the committee to oversee financial reporting, audits, and internal controls of the agency.

Board Member Balducci asked whether the Audit and Reporting Committee would oversee the agency's relationships with partners in service providers and with jurisdictions. Mr. McCartan replied that the Board determines the purview and focus of each committee. The Executive committee has traditionally overseen issues of agency organization and policy structure; however, if relations with jurisdictions and partners was considered a risk to the agency accomplishing its mission, than that issue could fall within the ARC committee's purview.

Mike Harbour, Deputy CEO, added that the full Board will be undergoing discussion of project delivery and strategy, and at a point later on the agenda the committee will select a 2017 performance audit topic.

Committee Chair Johnson commented that the other committees such as the Capital Committee should be brought into any discussions on committee focus to make sure all the Board Members are copacetic and clear on their roles and how to participate in the Board's operations moving forward.

Mr. McCartan continued his presentation, mentioning that audit committees typically take a risk-based approach, and this committee has followed a uniform structure in the past, but there is currently direction from the Chair to diversify the agendas of the committee to offer deeper discussion on certain topic areas. The proposal would have the ARC committee focus on financial reporting more intensely at year-end, and less in the second and fourth quarters, and would have less emphasis on external auditing unless there are completed reports to discuss, as opposed to detailed status updates. There is also a proposal to cover a special topic at each meeting as an opportunity for feedback to staff.

Board Member Dammeier remarked that he is interested in the historical context of the committee and the internal audit function. His questions included asking when the internal audit function started, what audits were completed, and what areas of concern were identified. Committee Chair Johnson added that a historical recap could be prepared for the committee as a potential future special topic, and that his goal as Chair of the committee is to increase the amount of dialogue between committee members and staff.

Mr. McCartan then shared the potential special topics with the committee. Board Member Balducci asked about the inclusion of information from the Citizen Oversight Panel (COP) into the agency's assumption of risks, and if information about the COP's past inclusion with the committee could be tied in to the historical overview. Mr. McCartan said the COP has been informally involved with the ARC, but that more information would be provided at the second quarter ARC meeting.

COP Chair Phil Lovell added that the COP had just met, and they had heard a presentation about Information Technology Security, and this could be a potential special topic as it poses a large risk to the agency at large.

#### National Transit Database Peer Comparisons

David Huffaker, Deputy Executive Director of Operations and Support Services, provided the report. Sound Transit uses the National Transit Database for benchmarking, trend analysis, and peer comparison. The database is administered by the Federal Transit Administration, and started when Congress mandated data reporting for transit agencies nationwide. The data is broken out by modes of transportation, and self-reported by agencies. Sound Transit's data is audited by KPMG before being submitted to the FTA.

The agency did its first benchmarking in 2005, and since then the commuter bus mode was added in 2011 with the criteria of longer trips, less passenger turnover, and routes connecting outlying areas to a central city. Sound Transit Express Service falls into the category of commuter bus, and is differentiated from 'motor bus' which is an urban, slower moving, higher stop frequency mode. Peers for the ST Express service include Houston Metro, Capital Metro, Utah Transit Authority, Maryland Transit Administration, Georgia Regional Transit Agency, and the Los Angeles Department of Transportation. Mr. Huffaker then walked through a comparison of Sound Transit to the peer agencies in four key metrics, cost per boarding, cost per revenue hour, boardings per revenue hour, and farebox recovery.

Committee Chair Johnson asked for clarification regarding Sound Transit's lower costs per boarding in comparison to the peer agencies, but also lower farebox recovery. Mr. Huffaker commented that this is attributable to the higher fares charged by other agencies, because they have much longer average trip lengths, and the average number of passengers per trip for Sound Transit is much higher.

Board Member Dammeier asked if these metrics include the capital costs of operating the vehicles, and if they include depreciation of vehicles. Mr. Huffaker replied that the metrics do not include those factors; however, Sound Transit does have an integrated cost allocation number, which removes agency overhead.

Over the last five years, there have been fluctuations in the peer index and uncontrollable variables such as fuel price, but Sound Transit has compared favorably in the measures of cost per rider and farebox recovery.

Mr. McCartan also interjected that the increase in ridership has been unique to Sound Transit, compared to nationwide trends, bus ridership and overall transit use is down.

Committee Chair Johnson asked if Sound Transit had any fare changes during the five-year measure. Mr. Huffaker answered that in 2015, there was a general ridership fare increase, and a fare decrease for low-income individuals, but the data does not reflect much of that change.

Mr. Lovell asked about ST Express service as ST3 brings a massive expansion in light rail service. Mr. Huffaker replied that the agency is focusing on the next 5-6 years, wherein there will not be an expansive amount of Link stations opening. However, when looking ahead at the service horizon and considering those additions in service, service planning will begin looking at how to successfully integrate ST Express service to feed the expanding light rail system.

Mr. Huffaker then went on to discuss Sounder service, which has peer agencies chosen for comparable size fleets and age of service – the larger cities systems are not used as peers due to the fleet size difference. When looking at cost and productivity, Sounder compares very favorably. In farebox recovery, the operation is right at the peer index average, this is attributable to peer agencies having higher fares as compared to cost per rider.

Mr. Lovell inquired if these numbers include the special events ridership numbers, which provide huge spikes in service provided. Mr. Huffaker replied that those events are included in the data.

Board Member Balducci asked why the decision was made to exclude large cities as peer agencies, Mr. Huffaker replied that the magnitude of comparing 60 vehicles in operations per day to over 1,000 per day, it becomes difficult to create valuable comparisons.

Ms. Balducci also asked how these numbers would change if you divided Sounder Service by the North and South lines. Mr. Huffaker replied that because a vast majority of service provided is provided by the South line, that the numbers for the North line, which tend to be higher cost per boarding, are included but are not an impactful factor.

Mr. Huffaker then moved on to Link data, which uses peer agencies previously chosen in collaboration with partner service providers. These peers are of similar size and age, and used by the agency and King County Metro for all comparison work. In 2016, Sound Transit will begin its participation in the Group of North American Light Rail agencies (GOAL) which is facilitated by the Royal College of London, an industry leader in benchmarking work. There will be eleven agencies across the country, including TriMet in Portland as the closest neighbor to Sound Transit, and three Canadian agencies.

Link tends to have a higher cost of operation than the agencies in Sound Transit's peer group, and comparatively successful boardings per revenue vehicle hour. This data is from 2015, and therefore is prior to the extension of UW and Angle Lake Service. There will be improvements in these comparisons when the data catches up to the current level of service.

Committee Chair Johnson asked why TriMet is so far below Sound Transit in cost per vehicle hour and cost per boarding. Mr. Huffaker replied that because they have all surface running track they face much lower costs of operation compared to Sound Transit, which has bridges, and tunnels, which includes the Downtown Seattle Transit Tunnel which is a mixed-use bus and train tunnel, elevating the cost.

Mr. Huffaker continued that the trends over the past five years have been favorable, and in 2015, the agency saw the first year with farebox recovery higher than the peer index, and that is expected to continue.

Board Member Dammeier asked about the costs overall and why the age of our fleet has not made our costs of operation much lower. Mr. Huffaker replied that vehicle maintenance is not a large cost driver in the comparison, and the voltage that is used by our system is quite different from any other system in the country. The agency is always looking for ways to drive the cost of operations lower. Mr. Dammeier directed staff to provide follow-up information about Sound Transit's use of a different power voltage than other agencies.

Committee Chair Johnson asked if a big picture takeaway that the citizens of the Sound Transit service district are getting a good deal in terms of costs compared to our peers is a correct summary. Mr. Huffaker replied that the question of fare policy and decisions regarding the value of services being provided is very much in the purview of the Board and not for staff to drive, but that farebox recovery falling at all would trigger a discussion of fare policies. Mr. McCartan added that the levers of adjusting fares, service, and revenue are at the discretion of the Board and of this committee, in terms of prioritizing agency objectives.

## FINANCIAL REPORTING

### Fourth Quarter Financial Report

Brian McCartan, Executive Director of Finance and IT, provided the report. Mr. McCartan reported that 2016 was a strong year financially for the agency. Revenue was strong in every category the actual revenues were higher than those projected in the financial plan. All three modes of service were below their allocated budget for operations, and lower than forecasted fuel costs also assisted in keeping operations costs down. Eighty two percent of the allocated capital budget was spent; three projects largely caused this variance, including the Lynnwood Link Extension, Link Operations and Maintenance Facility, and the Tacoma Track and Signal project.

Committee Chair Johnson asked how the strong fiscal performance of this year would be captured in future long and short term financial planning. Mr. McCartan replied that the capital budget is different year over year, but Operations budgets remain static, meaning these numbers will be used in creating future financial plans. Any surplus versus the forecast is used the following year to minimize agency debt and to plan for future expenditures. Mr. Johnson inquired about the ridership numbers and farebox recovery, if those new high performance numbers become the expectation, or how those numbers are adjusted for the next year. Mr. McCartan answered that forecasting is updated annually, and all over performances are factored into the update, but among a number of other factors that create the financial plan.

Committee Chair Johnson asked about the Tacoma Track and Trestle project, which has had a large amount of variance in cost projections and realities, and what has led to that result. Mr. McCartan replied that the variance is attributable to difficult forecasting due to projects being one-offs and out of the ordinary, and staffing variance on the projects due to the nature of the budget allocations to Sounder being smaller scale capital projects. Deputy CEO Mike Harbour interjected that it is also important to look at these cost over and under runs for more than a one-year on certain projects, as they sometimes have funds remaining from a prior budget that contribute to the underspending against the budget.

Board Member Balducci requested that the Sounder data be separated into North and South lines for budgeting purposes. Ms. Balducci also requested that it might be helpful for staff to consider ways to show budget performance against the predicted in a different way than a list, perhaps utilizing a scatter gram or a visual description. Mr. McCartan replied that staff could look into visual representations of information for future presentations.

Committee Chair Johnson raised the issue of ridership at the University of Washington Link Station, and that it might be improved by the installation of a bike cage or bike lockers at the station, so there is more room on trains and less reports of theft.

### Fourth Quarter Asset Liability Management Report

Committee Chair Johnson opened the floor for questions regarding the Asset Liability Management Report, and none was raised.

### Fourth Quarter Contract Reports

Board Member Dammeier asked about the large expenditure for long distance phone service found on the report for contracts within the CEO's authority. Ted Lucas, Director of Procurements and Contracts, replied that he would provide some follow-up information regarding the contract.

## INTERNAL AUDIT UPDATE

Jack Hutchinson, Director of Internal Audit, provided the report. Mr. Hutchinson outlined his section of the agenda for the benefit of the new committee members. The internal audit update always includes a list of completed internal audits, and a presentation of the audit results, in addition to updates on audits currently underway, and annual and semi-annual performance audits that are completed.

In 2016, ten audits were completed, four of which had individual findings. The 2016 work plan had 12 audits planned, and two of these were not completed due to staff constraints. Also in 2016, the Internal Audit Division has implemented an Audit Management System, which was procured in 2016 and has just finished implementation in early 2017. This system will make it easier to track audits and management responses, and will be useful to increasing the efficiency of audits.

Board Member Dammeier asked about institutional changes that Mr. Hutchinson has made since he began in his position last year. Mr. Hutchinson replied that he has improved procedures for the department.

Committee Chair Johnson inquired about staffing in the department, Mr. Hutchinson began one calendar year ago, there was only one full time employee (FTE) in the department, and now there are two occupied positions and a third open position for the department.

### Internal Audits Completed

Three engagement were completed in the fourth quarter of 2016. The first is an ongoing audit of payments within the agency, which in 2016 focused on security related contracting and payments to the King County Sheriff's Office and Securitas. There were no reportable conditions from this audit, so no audit report was included in Board member packets.

Shelli Applegate, Senior Internal Auditor, presented the second audit on Facilities Services Contract Management. Ms. Applegate discussed the findings from the audit, which had the objective of determining if contract controls are adequate to maintain adequate oversight over service based and on-call work. It was found that contract controls of on-call work need to be strengthened, and management has concurred with the finding and has begun to take steps to improve on-call contract management. Board Member Dammeier asked if this audit covered procurement practices, or only the contract management of a firm post-procurement. Ms. Applegate replied that this particular audit only examined contract management after the contract had been awarded. Mr. Hutchinson added that this audit did examine if work fulfillment matched the contract scope and order of work, and it examined what documents are required to substantiate payment and controls on processing payment to vendors.

Ms. Applegate then presented the indirect cost rate audit, which was the third internal audit completed in quarter four of 2016. Ms. Applegate explained that indirect costs are what is commonly referred to as agency overhead, including a number of expenses that are difficult to attribute to a specific project or business need. An indirect cost rate is a way for the agency to divide these overhead costs to different projects and divisions. This audit was a follow-up audit, with indirect costs being audits in 2011 and 2013 respectively. The objective of this year's audit was to identify if management had addressed the finding of the previous audit, which was that management did not have adequate controls in place to manage indirect costs, and that there was a lack of a written policy in assigning indirect costs. The finding of this audit was that management has not adequately addressed the finding of the 2013 audit, and internal audit has recommended that further action is needed, which management is now addressing.

Committee Chair Johnson asked for clarification about the management response to the audit, which declares that certain actions are feasible and already underway, while others may be delayed or difficult to implement. Deputy CEO Mike Harbour replied that the annual update of the indirect cost rates has led to the difficulty in managing indirect cost rate billing from contractors, and certain long-term contracts used a fixed-rate of indirect cost assessment, and that practice has been amended.

## Internal Audits In-Progress

Mr. Hutchinson then briefed the committee about audits that are currently in progress, which include indirect costs for co-located consultants, payment accuracy, and non-regular wages.

## 2016 PERFORMANCE AUDIT RESULTS

Mr. Hutchinson introduced the annual performance audit program, which began as a part of Sound Transit 2 and has been continued by Sound Transit 3. The implementation of this program has included a stipulation that if the State Auditor's Office is performing a performance audit, then the agency's internal audit staff will not complete a performance audit. For the years that the State Auditor's Office is not performing a performance audit, the internal audit division will come to the Audit and Reporting Committee with potential topics for committee selection.

The ARC selected Job Order Contracting (JOC) as the 2016 performance audit topic and a contractor was brought onboard to complete the audit. The contractor selected, RSM US LLP, finished the work in December of 2016. Mr. Hutchinson then invited a representative from RSM US LLP to present the audit results.

The scope of the audit included assessing controls to ensure compliance with all relevant Revised Codes of Washington (RCW's); ensure the program is effective in realizing the intended benefits as compared to other forms on contracting; and to provide improvement opportunities. Key highlights from the audit included the financial benefits of the JOC program, as a result of fewer change orders than when invitations to bid are used for all contracting. It was also found that the agency is tracking metrics and measuring performance adequately. There were reportable observations from the audit, but it should be noted that the controls are well designed and operating effectively, so the reportable conditions are process improvement opportunities.

The audit identified several opportunities for improvement including data tracking methods, through consolidating systems and creating better policies and procedures surrounding training new staff. There were also risks identified by the audit, one of which was that the process used to evaluate if JOC is the most effective procurement method for the project is not adequately documented. There is a lack of definition in the policies and procedures for what constitutes a project, and this can lead to confusion in about contracts qualifying.

COP Chair Lovell asked for some further information, and Committee Chair Johnson requested that that information be provided after the meeting due to time constraints.

## SELECTION OF A 2017 PERFORMANCE AUDIT TOPIC

Mr. Hutchinson reviewed the potential topics, including real property acquisitions, construction budgets, construction scheduling, and consultant co-location. Mr. Hutchinson clarified that staff is recommending the topic of real property acquisitions.

Committee Chair Johnson commented that he is in favor of selecting the topic of real property acquisitions, as they have been receiving a large amount of attention from outside the agency, and the audit would be timely.

COP Chair Phil Lovell asked if this proposed topic would cover the disposition of surplus property, and Mr. Hutchinson replied that surplus properties are not included in the current planned scope of the audit.

**It was moved by Board Member Backus, seconded by Board Member Dammeier, and carried by unanimous vote that real property acquisitions be selected as the performance audit topic for 2017.**

## EXECUTIVE SESSION

None.

NEXT MEETING

June 15, 2017  
11:00 a.m. to 12:30 p.m.  
Ruth Fisher Boardroom

ADJOURN

The meeting adjourned at 1:00 p.m.

ATTEST:

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Rob Johnson  
Audit and Reporting Committee Chair

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Kathryn Flores  
Board Administrator

APPROVED \_\_\_\_\_, PIA.