

SOUND TRANSIT AUDIT AND REPORTING COMMITTEE MEETING

Summary Minutes

June 15, 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) *Bruce Dammeier, Pierce County Executive*

Committee Members

(A) *Nancy Backus, Auburn Mayor*

(P) *Dave Earling, Edmonds Mayor*

(A) *Claudia Balducci, King County Councilmember*

(P) *Phil Lovell, COP Chair*

(P) *Joe McDermott, King County Councilmember*

Paige Armstrong, Board Coordinator, announced that there was not a quorum of the Committee present at roll call.

REPORT OF THE CHAIR

Committee Chair Johnson announced that one agenda item had been removed, the Annual Fares Revenue Report, which will be presented at a later meeting.

FIRST QUARTER ARC MEETING FOLLOW UP

Brian McCartan, Executive Director of Finance and Information Technology, presented a memorandum of staff follow-up items that are in progress or completed in answer to questions raised at the first quarter ARC meeting.

ANNUAL EXTERNAL REPORTING

Kelly Priestley, Director of Accounting, introduced the auditing team from external auditor KPMG to present results of the Annual Federal and Financial audit. The auditing team consisted of Karissa Marker, Audit Partner, Michael Ortman, Audit Engagement Senior Manager, and Rachel Kehoe, Audit Engagement Manager.

Ms. Marker walked through the audit deliverables for this annual audit cycle, which included agreed upon procedures, audit reports on financial statements, and an attestation report related to the issued Green Bonds. The processes and controls used for the financial statements audit were all completed without issue, and the communications responsibilities were all met. Following the completion of the audit, an unmodified opinion dated May 19, 2017, was issued stating that Sound Transit's financial documents were all fairly presented and all in agreement with Generally Accepted Accounting Principles (GAAP).

There were no adjustments made by KPMG, and internal management judgements and accounting estimates were all found to be correct. There were no adjustments proposed by the auditor that were passed upon by management, and no disagreements with management that would warrant reporting to the Audit and Reporting Committee. Ms. Marker also reported there were no difficulties in completing the audit, and the Sound Transit was incredibly cooperative. In addition, there were no noted internal control deficiencies. Michael Ortman then presented the single audit, an audit of federal grants received by the agency. This audit is compliance based and in conjunction with the financial statement audit. The audit report from this audit was unmodified, issued May 19, 2017, and had no findings.

KPMG also issued agreed upon procedure reports, which reviewed National Transit Database (NTD) Reporting and the procedures set by the Federal Transit Administration (FTA). The report from these agreed upon procedures has not yet been issued, and should be complete in June 2017.

There was another agreed upon procedure report, which is in progress with cooperation from the Customer Oversight Panel (COP) and pertains to sub-area equity. No significant findings have been reported so far, and this report will be finalized in June 2017. Committee Member Phil Lovell, who is the Chair of the COP, commented that the COP is pleased that the agency is developing methodologies to ensure continued sub-area equity when dealing with large projects that will cross boundaries between the service areas.

Other completed reports by KPMG included the Attestation Report on the agency issued Green Bonds, which is the second Green Bond issuance for Sound Transit and resulted in an unmodified opinion, and an audit of ORCA financial statements, which also resulted in an unmodified opinion on April 14, 2017.

Committee Chair Johnson paused the presentation for questions from the Committee members, and Board Member Earling inquired about the referenced minor inaccuracies in the NTD reporting agreed upon procedures, and asked for an example of what they would entail. Ms. Priestley replied that the full report will be given at the September meeting, and that she would be happy to send more details to Board Member Earling following the meeting.

AUDIT RESULTS

Ms. Priestley then presented the Financial Statements Audit results, and the Single Audit Report, which included a schedule of federal grant dollars received and an overview of the federal grant program.

The financial statements for 2016 show a high level of variance throughout the year, largely attributable to the opening of the University Link station in March and the 200th Street station to Angle Lake in September. These openings affected revenue, ridership, and operating costs. For 2016, there were no reclassifications from the prior year, however there have been a number of accounting pronouncements from the accounting standards Board for governmental accounting. There were ten new pronouncements, nine of which were implemented with no impact. The tenth new pronouncement had an impact on disclosures in the accounting statements for fare revenue hierarchies, which is the system by which prices exist in an active market, and are quoted at market price.

Highlights of the audit include total assets on the agency's balance sheet now exceeding 10 billion, while liabilities are approximately 2.8 billion. There are two significant items impacting the balance sheet; the Green Bond issuance, which resulted in significantly more cash available at the end of the year, and the continued progress of the agency's capital program, which continues to expand capital assets and capital expenditures.

Net non-operating revenue is the agency's primary revenue source, with most of these funds coming from taxes as well as contributions received from other parties. Operating revenue reflects the ridership increases from the opening of new stations, and this year being the first time Link ridership surpassed that of ST Express ridership. There will be additional detail available on these items available in September when the Fare Revenue report is presented.

The non-operating revenue and expenses reflect increased tax revenues in 2016, as the region continues to experience strong economic growth. Lower non-operating expenses reflect the completion of the First Hill Streetcar program, for which Sound Transit only has a small economic commitment to in years to come.

Capital spending, by project, shows spending increases around the Tacoma Trestle and Point Defiance Bypass projects, while spending on Light Rail has seen a shift of spending to the East Link project, and ST Express spending is largely focused on the I-90 two-way transit and HOV project which is necessary for the construction of East Link. There has been a major shift in capital spending away from facilities as the U-Link and S. 200th Street stations were put into operation.

Additionally, the ORCA financial statement audit was included in the Committee's materials, for information purposes, as the ORCA Joint Board will be receiving those audit materials.

GREEN BOND ANNUAL REPORT

Ms. Priestley then presented the Green Bonds Audit Report, and the 2016 Green Bonds Annual Report. This report provides narrative surrounding the Sound Transit sustainability plan and improving the agency's climate impacts. Sound Transit is one of the largest issuers of Green Bonds in the country, and the agency takes a lot of pride in providing accurate and positive reporting on this program. The bonds were issued in December of 2016, and there will be more substantive reports completed annually moving forward.

Committee Chair Johnson commented that after reviewing the report, he is very proud of the agency's commitment to remaining the country's greenest transit agency, and he is happy to see the report and hopes it gets attention from the public as well.

FINANCIAL REPORTING

Mr. McCartan ran through the spotlight indicators on the Asset and Liability Management report, which for the first time depicts all green ratings on the four measured areas of investment performance, interest rate risk, credit risk, and liquidity risk.

Committee Chair Johnson commented that he has reviewed all the financial reports in detail and saw nothing negative to note. He inquired about one of the sole-source contracts within the CEO's authority, which was with Community Attributes to do a workforce analysis, he asked if more information about that project could be provided and expressed interest in hearing the results of the analysis.

Mr. Rogoff commented that this report will be brought to the Board upon completion, as it addresses the possibility of workforce shortages in various construction fields, as well as some specific skilled trades.

INTERNAL AUDIT UPDATE

Jack Hutchinson, Director of Internal Audit, provided the report.

Internal Audits Completed

An audit of the dual-benefit reimbursement program has been completed, which was part of the management requested audits, and was requested by the Office of Small Business Development and Labor Compliance internally.

Mr. Hutchinson introduced Soon Kwon, Senior Internal Auditor, to present the results of the dual-benefit reimbursement audit. Under the Sound Transit Project Labor Agreement, all contractors, including union and non-union contractors are required to contribute benefits to a union fund for all craft employees. For non-union contractors, this is an additional cost that union contracts would not incur. Therefore, Sound Transit reimburses this contribution to provide fair pay to all contract employees.

The audit was conducted to insure that the agency has adequate controls in place to maintain fairness and accuracy when reimbursing contract employees and conducting this program and the audit results found that there are adequate controls in place. There was one finding that has been provided to management for improvement, which has been accepted by management and is currently being addressed.

Committee Chair Johnson commented that after review of the audit he found it to be very thorough, as nearly fifty percent of the programs invoices were reviewed. Mr. Hutchinson commented that it was important to get a good sense of the agencies controls of this program as moving forward with the capital program there will be many more contractors and the program will expand.

Committee Member Lovell asked about the total payout from the program, which is reported as \$1,650,000. Mr. Kwon replied that was correct. Mr. Lovell asked about the requirements for program participation, which

include either health insurance or a pension benefit provided by the contractor, and asked if this requirement excludes a large number of contractors. Mr. Hutchinson replied that he is unaware of how many contractors do not meet these criteria, but he would be happy to look further into the issue.

Internal Audits In-Progress

Mr. Hutchinson then presented the list of audits still in progress:

- Indirect Costs for Co-located Consultants
- Non-regular Wages
- Federal Grant Drawdown
- Follow-Up of the Partner Cost Monitoring Audit (Community Transit)
- Payment Accuracy
- U830 Construction management Close-Out Audits

2017 Performance Audit Update

The Request for Proposals (RFP) to bring a contractor on for this audit closed on June 14, 2017, and the audit will begin within several weeks of that date. The audit is scheduled to be completed by the December 2017 Audit and Reporting Committee Meeting.

BUSINESS ITEMS

Board Member McDermott arrived at 11:51 a.m., at which time a quorum of the committee was recorded to be present.

Minutes from the April 20, 2017 Audit and Reporting Committee meeting minutes

It was moved by Board Member McDermott, seconded by Board Member Earling, and carried by unanimous vote that the minutes of the April 20, 2017, Audit and Reporting Committee Meeting Minutes be approved as presented.

SPECIAL TOPIC: AGENCY INSURANCE PROGRAM

Mr. McCartan introduced Mike Anastasi, Senior Risk and Insurance Manager, to provide the presentation of the agency's insurance program. Mr. Anastasi first clarified that Sound Transit does use commercial insurance as opposed to self-insuring.

There are three insurance programs that Sound Transit uses the first is a rail operations insurance program, which encompasses the heavy rail service, light rail service, and property rolling stock. The second program is agency operation insurance, which provides coverage for all non-revenue vehicles, various types of liability, crime, and pollution. The third is capital development insurance, which the agency uses an Owner Controlled Insurance Program (OCIP). Some projects use a traditional risk transfer, wherein contractors provide their own insurance until Sound Transit accepts the completion of the project and then accepts the risk.

Mr. Anastasi then ran through the specific amounts of coverage for example projects, and emergency insurances which include 400 million dollar property insurance, 150 million dollar earthquake coverage, and 100 million dollars of flood coverage. These emergency insurances have a \$100,000 deductible.

Committee Chair Johnson inquired if the agency's decision to use commercial insurance instead of to self-insure is common of transit agencies of comparable size, and why that decision has been made. Mr. Anastasi replied that the agency frequently analyzes the feasibility and the cost-benefit of transferring risk versus retaining it. He stated that there is a possible size of the agency, as it continues to grow, that would lead to it being more affordable to self-insure. Mr. McCartan added that it is fairly common for transit agencies to use commercial insurance, especially as it pertains to Sound Transit meeting specific required

Committee Chair Johnson asked about the rolling property stock insurance and if these are common amounts or individually determined. Mr. Anastasi replied that there were multiple factors; there is low risk of all stock being damaged at once as they are not housed in the same locations, and in addition to that, they used benchmarks from similar agencies and determined the amounts of risk that made sense.

Board Member McDermott asked about the amounts of coverage, which have been remarked to be higher than similar agencies, and if the agency's risk is higher, due to emergency risk specifically in our region. Mr. Anastasi answered that there are many sophisticated modeling approaches taken, especially considering earthquake modeling and assumed damages amounts, and there are also certain requirements mandated by jurisdictions that the agency works with, even as specifically as the University of Washington.

Committee Chair Johnson asked for any further questions, and upon hearing none, thanked staff for the presentation and commented that these discussions are part of the new Audit and Reporting Committee structure that allows for more dialogue and review of a special topic at every meeting.

EXECUTIVE SESSION

None.

NEXT MEETING

December 21, 2017
11:00 a.m. to 12:30 p.m.
Ruth Fisher Boardroom

ADJOURN

The meeting adjourned at 11:51 a.m.

ATTEST:



Kathryn Flores
Board Administrator



Rob Johnson
Audit and Reporting Committee Chair

APPROVED 9/21/17, PIA.