

SOUND TRANSIT AUDIT AND REPORTING COMMITTEE MEETING

**Summary Minutes
September 21, 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

(P) Claudia Balducci, King County Councilmember

(P) Phil Lovell, COP Chair

(P) Joe McDermott, King County Councilmember

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

REPORT OF THE CHAIR

Board Members Request to Participate via Teleconference

Committee Chair Johnson announced that Board Member Dammeier asked to participate in the meeting by phone. The Board's Rules and Operating Procedures allow members to attend meetings by teleconference with a two-thirds affirmative vote of those members in attendance.

It was moved by Board Member Earling, seconded by Board Member McDermott, and carried by unanimous vote that Board Member Dammeier be allowed to participate in the Board meeting by telephone.

BUSINESS ITEMS

Minutes of the June 15, 2017, Audit and Reporting Committee Meeting

Citizen Oversight Panel (COP) Chair Phil Lovell asked for a correction in the name of the COP in the June minutes.

It was moved by Board Member Lovell, seconded by Board Member Earling, and carried by unanimous vote that the minutes of the June 15, 2017 Audit and Reporting Committee Meeting minutes be approved as corrected.

ANNUAL EXTERNAL REPORTING

Kelly Priestley, Director of Accounting, and Brian McCartan, Executive Director of Finance and Information Technology, presented the report. Ms. Priestley began by walking through reports that were finalized in the third quarter.

National Transit Database Reporting

In June, KPMG presented the results of the audits of Sound Transit's financial statements, single audits, and also did a preliminary report on the National Transit Database (NTD) reporting. The full NTD report is included in the Board Members packets. The NTD is a compilation of data that is required by the Federal Transportation Administration (FTA) for any organization that is receiving federal funding. The data is collected by the FTA and used by congress in making funding decisions. It is also used by agencies such as Sound Transit to complete benchmarking and peer analysis work. The FTA requires audits on numbers submitted, and the auditors do inquiry management and validate the data. Validation work includes interviews with staff, source documentation, and verification of calculations.

Subarea Reporting

The agency is required by its financial policies to establish a system that on an annual basis reports the subarea revenues and expenditures, or sources and uses of funds. Policy also requires that Sound Transit appoint an advisory Citizen Oversight Panel. Included in the Sound Transit 2 (ST2) ballot measure was an adopted 15 year financial plan, and this plan is refreshed annually with annual subarea reports, so it monitors equity throughout the life of the plan.

Board Member Dammeier asked if subarea equity is required by statute or where the requirement comes from. Ms. Priestley responded that the requirements are embedded within the voter approved plans, and then built into agency policy. Mr. McCartan added that there is a reference in state law to subarea equity, but it is very broad in nature and only applies to disclosure of spending.

Ms. Priestley continued with outlining the agency's responsibilities to maintain internal controls that will create results in alignment with the voter approved plans. Two reports are prepared annually on subarea equity, the schedule of Sources and Uses of Funds by subarea for the single year, which is referred to as a single year report, and the Summary of Sources and Uses of Funds by Subarea for the fifteen year report from 2009 through 2023. It should be noted that this plan reports only on the final ST2 plan, and that in 2018 there will be a combined plan with the 15 year financial plan that was included in Sound Transit 3 (ST3).

The subarea report is completed on a modified cash bases, which is consistent with the agency financial plan. This means the report does not incorporate non-cash items such as depreciations and amortization, and that tax revenues are depicted on a cash basis. To validate the integrity of the subarea reporting, procedures have been developed by management, and have been reviewed with the COP, lastly in 2010, when the ST2 ballot measure was adopted.

Some highlights of this single year's report include that tax, grant, fare and interest sources were up in 2016, and sources from bond issuance were lower than in 2015. Sources overall were up, as not all of the 2016 bond issuance were utilized by subareas, and was allocated to system wide use. Tax revenue grew by 8 percent in South King County, and 10 percent in East King County, which is slightly ahead of the increases in the other three subareas.

Board Member Balducci asked about the changes in North and South King County. Ms. Priestley replied that bond proceeds are based on whether the accumulative revenues and expenditures to date are sufficient to meet the expenditures in the current year. In both 2015 and 2016, both North and South King needed bond proceeds allocated to meet their overall budget. Ms. Balducci asked if this is something that was anticipated. Ms. Priestley replied that the use of bond proceeds for

these two subareas was anticipated for that year, and that the 15 year plan will depict the overall schedule for the use of bond proceeds.

Board Member Dammeier asked about the system wide charges, and if they are reallocated to the subareas. Ms. Priestley answered that any bond proceeds not used in a given year, are kept at the system wide level, and then used when a subarea needs funds to meet their equity expectations.

Total capital outlays were down one percent from 2015, as University Link and Angle Lake stations opened for revenue service. Capital outlays increased in Snohomish, East King County, and Pierce County as work progressed on Lynnwood and East Link Extensions, the Tacoma Trestle, and Point Defiance projects. Operating and Maintenance expenses increased significantly, which was an anticipated increase with the increased service from University Link and the Angle Lake stations operating. There were an additional 44 weekday or mid-day trips for ST Express, an addition of three stations in operation for Link, and 4.7 miles of new light rail service.

Overall, for the 15 year Subarea Report update, the revenues are slightly higher, and accordingly, the debt service and the Operations and Maintenance have been adjusted. Generally, results are consistent with 2015, however, there is a notable increase of costs for the Lynnwood Link Extension.

There will be a new procedure developed and reviewed by the Citizen Oversight Panel in regards to the collection of property tax revenue. In addition, revenue procedures for the Motor Vehicle Excise Tax (MVET) will be updated as they will be reported based on location code.

Board Member Earling asked about ridership numbers, having seen that other transportation agencies are struggling with their ridership numbers, and if Sound Transit's steady ridership increases impact this financial report.

Deputy CEO, Mike Harbour, replied that a report about ridership impacts upon subarea reporting can be prepared for presentation at a later meeting.

Board Member Balducci asked for information that could more simply answer questions that Board Members receive from constituents regarding how subarea equity could possibly be maintained when large capital projects experience cost overruns, or when subareas see capital projects delivered at vastly different times. Mr. McCartan replied that staff will look into simplified ways to present generalized subarea equity information, and will share that with the Board. Mr. McCartan commented that the Board has given guidance throughout the formation of all the agency policies which regulate subarea equity, and that this discussion has raised the issue of how the reporting and tracking is done, but there should be no concerns about the accuracy of the subarea equity policies in place or their effectiveness.

FINANCIAL REPORTING

Mr. McCartan summarized the second quarter financial reports, beginning with annual revenue, which shows the agency ahead of expected revenues by approximately seven percent. The local economy is doing even better than initially expected when this forecasting was done, which explains this high revenue.

Mr. McCartan highlighted the agency's vacancy rate, with 744 positions filled of an authorized 843, a 12 percent vacancy rate. This is due to the ramp up for the ST3 projects, and continuing work on ST2. The agency has hired additional staff in Human Resources and recruiting, and is actively working at lowering the vacancy rate.

In modal budgets, all modes are around 90 percent of their allotted expenditures, which is as anticipated. Costs were slightly lower for fuel and maintenance, but overall nothing out of the ordinary has occurred this quarter.

The Capital budget is at 94 percent utilization, which is a good number, as the agency tries to stay above 85 percent. Northgate and the Tacoma Trestle are slightly under budget, but both are still projected as on schedule for delivery. East Link is currently over budget, but this is projected to even out over time as the project moves forward.

Committee Chair Johnson commented that it is important to think strategically about expenditures at this time, as improvements such as lighting and bike lockers will improve the rider experience and should be made ahead of the weather turning cold and the days getting shorter.

Mr. McCartan continued that the agency is at 115 percent of spending on State of Good Repair, which includes capital projects that are for maintenance and repairs. This overage is due to some one-off circumstances related to the timing and purchase of additional buses. There are also administrative projects, which are primarily improvements to Union Station at this time, which are currently at 20 percent of expenditure utilization, but that is expected to get closer to full budget by the end of the year.

QUARTERLY CONTRACT REPORTS

Ted Lucas, Director of Procurements and Contracts, provided the report. Mr. Lucas highlighted four sole-source contracts that were authorized by the CEO, all under one hundred thousand. All sole-source contracts above one hundred thousand must be approved by the Board. The two other reports include proprietary and competitive contracts authorized by the CEO. Lastly, Mr. Lucas covered open contracts, which have not been signed or completed.

Board Member Dammeier asked about a specific competitive procurement for artwork cleaning, and asked if this is mostly graffiti repair or if this is maintenance for exposure. Mr. Lucas replied that this is mainly for maintenance due to exposure, and also for cleaning the surrounding areas of litter and debris.

Mr. Lucas prefaced that staff is reworking the contract reports to better specify categories of contracts, specifically change orders, which is currently an umbrella term for all phase changes and contract options, not necessarily change orders which effect the scope of a contract.

Board Member Lovell commented that as the capital program moves forward, it will be increasingly important that the differences mentioned by Mr. Lucas be made explicit. Members of the public will be interested to know final figures of contingency allocated and used, if projects are being completed on budget, and if contracting procedures are being maintained at a high standard.

Board Member Dammeier commented that the Audit and Reporting Committee has a responsibility to be examining all the budget actions and one-off decisions made by the Board Committees and Board at a high level to ensure that the big picture is on target.

Committee Chair Johnson commented that as the agenda is moving along, it appears there will not be time for the scheduled special topic report, which was planned to be about the Small and Minority Owned Business Program.

ASSET AND LIABILITY MANAGEMENT REPORT

Mr. McCartan presented the Asset and Liability Management report, commenting that there have been no significant changes to the report since the last meeting.

ASSET AND LIABILITY MANAGEMENT POLICY

Mr. McCartan then introduced Tracy Butler, Director of Treasury Financial Planning and Risk Management, to present the progress on the agency's update to the Asset and Liability Management (ALM) Policy. Ms. Butler introduced the current ALM policy that was adopted in 2004, and was amended in both 2005 and 2009. The goal of this policy is to manage the agency's assets and liabilities on a consolidated basis, so that the agency can achieve the lowest possible cost of capital, and the lowest possible risk exposure.

There are three components to the policy, the investment policy, the swap policy, and the debt policy. To illustrate these three subject areas, Ms. Butler summarized that the ending balance of investments for the agency after the second quarter was 1.75 billion dollars, with 1.26 billion dollars being unrestricted funds, and 497 million as reserved funds. Also at the end of the second quarter, the agency had 2.3 billion dollars in debt, in addition to a secured 3.3 billion dollar TIFIA loan. There are currently no swap agreements outstanding for the agency.

Committee Chair Johnson commented that Sound Transit is one of the largest holders of TIFIA loan funds, and Ms. Butler clarified that in addition to holding one of the largest loans ever granted by the US Department of Transportation, Sound Transit was also the first agency to close a TIFIA Master Credit Agreement. Mr. Johnson asked about the benefits of this to the agency, and Ms. Butler replied that there are several benefits, some more tangible than others. The first is the low interest rates, as compared to using bonds or other sources of funding. In addition, the loans are highly flexible, offering graduated pay back rates, and funds from TIFIA are rated very low in terms of risk, and allow the agency to maintain its very high credit rating even with high debt.

Mr. Johnson asked about the TIFIA interest rates, as compared to the agency's projected financial plan. Ms. Butler replied that the financial plan projected a 5.3 percent interest rates based on historical averages, and that the rate provided by the TIFIA loans as closed so far, is 2.7 percent.

The ALM policy is being reworked primarily to adapt to new Revised Code of Washington (RCW) requirements, and to keep the language current and updated with ST3. Highlights of the update for investment policy include adjusting restrictions, allocation limits, adding security lending to diversify portfolios, and allowing more flexibility. These changes are consistent with RCW 39.58, 39.59, 43.250. Other highlights include tightening the rating requirements for short-term investments, adding maturity requirements, and clarifying and strengthening guidance for investments.

Highlights of the debt policy are updates to stay consistent with ST3, which updated debt coverage requirements from a 1.3 to 1.5 coverage ratio. The update also adds more specific requirements, and a timeline, for savings and bond refunds.

The swap policy update will preserve flexibility and bring the policy into alignment with current regulations.

Board Member Balducci asked if there will be a written report at the time that this policy comes before the Board for approval, and if it will also be reviewed by a committee. Ms. Butler replied that it will be discussed by the Executive Committee prior to going before the Board, and Mr. McCartan

commented that staff will ensure the staff report is detailed and comprehensive to detail the changes.

INTERNAL AUDIT UPDATE

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

Internal Audits Completed

Four engagements have been completed since the last ARC meeting:

- Indirect cost for co-located consultants
- Non-regular wages
- Federal grant drawdown process
- Follow-up of the 2013 partner cost monitoring audit of Community Transit.

The audit on indirect costs for co-located consultants concluded that management has not implemented effective controls to ensure firms with co-located staff are not billing for indirect costs related to home office expenses. Management has responded to the audit and has begun implementing procedures so that going forward the correct rate will be billed.

Committee Chair Johnson clarified that the audit found about a half of a percent of charges that should not be billed, but this number can add up over multiple contracts. Mr. Johnson asked Deputy CEO Mike Harbour to speak to the management response to this audit. Mr. Harbour commented that staff is looking at how to better manage co-located consultants, including ensuring that security and IT staff to know who are the co-located consultants are, setting up an ongoing tracking of this to ensure the correct rate is charged, and working to ensure that office space provided to consultants is being used to maximum efficiency.

The indirect costs for consultants was the only audit that had a finding of the audits reviewed. The results of the non-regular wages audit, Federal grant drawdown process, and the follow-up to the 2013 Community Transit audit were that management has implemented adequate controls.

Board Member Dammeier asked if any of the auditing work done for Community Transit was done on other partner agencies. Mr. Hutchinson replied that the initial audit, done in 2013, did cover all of the partner agencies, including Pierce Transit. Mr. Hutchinson also commented that future follow-up audits will be done in 2018 or 2019 for Pierce Transit.

Internal Audits In-Progress

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

- Miscellaneous revenues
- Non-revenue vehicle program
- Non-construction change orders
- Payment accuracy
- Electrical Contract/contraction management (EC/CM) specifically on University Link systems work

Internal Audits Activity Update

Mr. Hutchinson reviewed that the internal audit division activities include assurance for management that all processes are working correctly, and reporting to the Board that staff's processes and management is working as intended.

Internal audit also provides consultation services, the department is currently working on the legal department's public disclosure processes as a consultation.

Board Member Balducci commented her appreciation for the internal audit program, and commented that the reports provided are clear and easy to understand.

2017 Performance Audit Update

The procurement process for a contractor for the 2017 performance audit of real property acquisitions has been completed. The contractor is at work, meetings are being held with management and staff, and the audit should be completed in advance of the December committee meeting.

The Internal Audit team is working on potential 2018 performance audit topics, and topic proposals will be shared with the committee in December.

EXECUTIVE SESSION

None.

NEXT MEETING

Will be rescheduled per the request of Committee Chair Johnson.

ADJOURN

The meeting adjourned at 11:51 a.m.

ATTEST:

Rob Johnson
Audit and Reporting Committee Chair

Kathryn Flores
Board Administrator

APPROVED _____, PIA.