SOUNDTRANSIT

Internal Audit Report

Asset Disposals Audit

Report Number: 2018 - 06 | Report Date: December 14, 2018

Executive Summary

Audit Report No.: 2018 - 06 **December 14, 2018**

WE AUDITED the current asset disposal processes to ensure that the agency has effective controls in place over asset and spare parts' disposals.

AUDIT OBJECTIVE was to determine whether the agency has effective controls in place to ensure:

- Policies & procedures are comprehensive and provide clear guidance for asset disposals.
- Disposal decisions are timely and based on comprehensive support/methodology.
- Disposal records are complete and accurate.

The audit examined management controls in place as of September, 2018.

Jack Hutchinson, CPA, CIA, CISA
Internal Audit Director

WHAT DID WE FIND?

Asset disposal is a decentralized process at Sound Transit. According to Agency Policy 14, the CEO delegates the authority to department executive directors or their designee to make determinations of when assets are no longer needed for Sound Transit purposes.

Per policy, a surplus asset is any property owned by Sound Transit that is obsolete, not repairable, or not needed at present or for the foreseeable future.

The agency ERP system, EntepriseOne, tracks capital assets, and Enterprise Asset Management System (EAMS) tracks Transit Systems, Link, Tacoma Link, and Sounder Maintenance of Way (MOW) spare parts inventory.

Disposals were $286 million (before acc. depr) and $17 million for 2017 and 2016, respectively. In 2018, there were no recorded capital asset disposals as of 9/30/2018. For spare parts, there were 59 parts reported as disposed of for $28,902.

The audit concluded that agency lacks adequate asset and spare parts disposal procedures. See Finding #1.

Table of Contents

Background

Asset disposal is a decentralized process at Sound Transit. Typically, the organizational unit purchasing assets has the end-to-end responsibility from initial acquisition to disposal. According to Agency Policy 14, the CEO delegates the authority to departmental executive directors or their designee to make determinations of when assets are no longer needed for Sound Transit purposes.

Per policy, a surplus asset is any property owned by Sound Transit that is obsolete, not repairable, or not needed at present or for the foreseeable future. The mechanism to dispose surplus assets consists of:

1. Transfers or sales to another governmental agency
2. Sales to the public directly or through public auction
3. Trade-ins
4. Donations
5. Scrapping (i.e., no residual value).

Sound Transit serves the public with three modes of transportation: 1) Link Light Rail, 2) ST Express Buses, and 3) Sounder train. Currently, the agency outsources service delivery, as well as asset maintenance for most of our modes. For example, King County DOT Rail Division operates and maintains Link Light Rail. These external contractors also play a role in asset disposal, as assets (including spare parts) are held either at their own facilities or ST facilities attended to by the contractors. While agency staff is responsible for final disposition, the process of asset disposal typically begins with the contractor.

For the year ended December 31, 2017, capital assets were approx. $9 billion (net of acc. Depreciation) and represented 82% of total assets. Disposals were $286 million (before acc. depr) and $17 million for 2017 and 2016, respectively. In 2018, there were no recorded capital asset disposals as of 9/30/2018.

Capital Asset Disposals 2013 – 2017 (in thousands)						
	FS Line Items	**2013**	**2014**	**2015**	**2016**	**2017**
Non-depreciable Assets	Land	-	1,930	-	6	371
	Sound Transit - Tangible	1,908	-	-	6,602	4,440
	Other governments - tangible	64,217	27,872	12,997	400	274,282
	Subtotal	66,215	29,802	12,997	7,008	279,093
Depreciable Assets	Building & Leasehold Improvements	-	227	-	252	30
	Furniture, Equipment & Vehicles	1,061	401	297	151	24
	Revenue Vehicles	6,715	1,499	6,870	9,604	-
	Software	77	585	26	-	-
	Transit Facilities, Rail, & Heavy Equipment	10	318	3,740	10	6,832
	Subtotal	7,863	3,030	10,933	10,017	6,886
Total*		**74,078**	**32,832**	**23,930**	**17,025**	**285,979**

*Total before acc. Depreciation. Based on audited financial statements.

In addition to capital assets, the agency has inventories of parts and equipment at various locations primarily for maintenance purposes. The inventory has increased significantly in the last two years as system expansion places more assets into service. Specifically, there was an increase in 2017 related to mid-life overhaul of Light Rail Vehicles.

The aforementioned contractors under agency supervision and monitoring utilize inventoried parts to maintain agency assets, as follows:

Parts Inventory				
	Contractor/Location	**Inventory****	**2017 Financial Statement Balance (000)***	**2018 Disposal Count/Amount*****
ST Express	King County Metro / Seattle	Just In Time	0	N/A
	Pierce Transit / Tacoma	Just In Time	0	N/A
	Community Transit / Everett	Just In Time	0	N/A
Sounder	Amtrak - Seattle	On-site	$2,898	-
	Stacy-Whitbeck / Lakewood	On-site	$941	-
Link Light Rail	ST Light Rail Maint. Facility and Snoqualmie site / Seattle	On-site	$12,412	56/$28,902
Tacoma Link Streetcar	ST Tacoma Link	On-site	$985	3/$0
IT	Transit Systems	On-site	$986	-
		Total	$18,222	59/$28,902

* per Agency Audited 2017 Financial Statement and excludes inventory allowance account.
** JIT - spare parts are invoiced as part of interagency agreement billings. There is no spare parts inventory for ST buses.
***Spare parts disposals are based on “Parts by Location” reporting from EAMS as of 10/26/2018.

The agency utilizes EntepriseOne to record all asset balances including spare parts and utilizes its Fixed Assets module for tracking of capital assets. Since 2015, Enterprise Asset Management System (EAMS) has been incrementally implemented by various asset owner groups. Currently, the system is used to track Transit Systems, Link, Tacoma Link, and Sounder Maintenance of Way (MOW) spare parts inventory.

Audit Objectives

To determine whether the agency has effective controls in place to ensure:

- Policies & procedures are comprehensive and provide clear guidance for asset disposals.
- Disposal decisions are timely and based on comprehensive support/methodology.
- Disposal records are complete and accurate.

Scope and Methodology

We conducted this performance audit in accordance with 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.

We gained an understanding of disposal processes through data analysis, documentation reviews, and personnel interviews. We identified risks in the processes and assessed management controls in place to mitigate those risks. Based on the assessment, we determined to focus on management practices related to asset disposal policies & procedures, timeliness of disposal decisions and comprehensive support/methodology, and completeness and accuracy of disposal records for the three modes of transportation and their associated spare parts' inventory.

We examined policies, procedures, and process documentation and records as of September, 2018. In certain instances, however, the most recent reporting was utilized.

1. To determine whether the agency has the effective controls to ensure that policies & procedures are comprehensive and provide clear guidance for asset disposals, we performed the following procedures:

    a. Conducted management interviews to identify all stakeholders.
    b. Reviewed all relevant policies/procedures including industry standards and applicable FTA requirements.
    c. Reviewed applicable agency policies, as well as contractors' policies related to asset disposal.

2. To determine whether the agency has the effective controls to ensure disposal decisions are timely and based on comprehensive support/methodology, we performed the following procedures:

    a. Conducted management interviews to identify stakeholders related to disposal which included partner agencies.
    b. Conducted facility and disposal process walkthroughs.
    c. Tested a selection of 20 and 107 capital asset disposals representing 65% and 95% of the total disposal population for 2016 & 2017, respectively.
    d. Tested all known 2018 disposals for timely disposal and comprehensive methodology.
    e. Tested a selection of 35 spare parts (64% of the total disposal) at Central Link Location and 3 spare parts (100% of the total disposal) marked as disposed of at Tacoma Link location.
    f. Reviewed spare parts obsolescence related to Sounder trains.

3. To determine whether the agency has the effective controls to ensure that disposal records are complete and accurate, we performed the following procedures:

    a. Performed management interviews with agency EAMS administrators and accounting staff.
    b. Reviewed capital asset disposal records for completeness and accuracy.
    c. Reviewed cycle inventory counts at Central and Tacoma Link for completeness.
    d. Reviewed adjustments in EAMS for propriety and record completeness.
    e. Tested a selection of spare parts based on usage analysis at the following locations for timely disposals and completeness & accuracy of disposals' reporting.
        1. Central Link – 12 parts
        2. Tacoma Link – 11 parts
        3. Sounder tracks – 5 parts
        4. Sounder signals – 10 parts

Conclusion

The audit concluded that agency lacks adequate asset and spare parts' disposal procedures. See Finding #1.

Findings and Recommendations

1. Asset and Spare Parts Disposal Procedures Are Inadequate

The agency utilizes public funds to invest in maintenance spare parts to provide safe transportation services to the public. Timely maintenance while avoiding high operating costs is among essential responsibilities of the agency. Maintaining a proper level of spare parts while timely surplusing unnecessary items is an ongoing challenge to management. Thus, effective management controls over disposal are an integral part of an asset lifecycle management to ensure accountability that surplus property is disposed in a manner reasonable and fair to the agency and the public.

Agency Policy #14 and Policy #44 together define a structure to guide management in its disposal decision making process. Specifically, Policy #14, Section 5.2 has an implicit requirement to proceduralize management processes, as management is "to determine the best method of disposal, follow the appropriate procedures, and report the disposal to Accounting." Formal (i.e., written) procedures establish clear performance expectations and provide consistency in the performance of duties. Further, procedures institutionalize staff expertise and are an efficient way to demonstrate due diligence and accountability.

Currently, agency disposal controls are at two levels: 1) contractors who perform day-to-day responsibilities and 2) ST management that monitors contractor performance. Some contractors have shown evidence of their own policies & procedures. However, the Agency disposal procedures haven't been formally established for both capital assets and spare parts, as follows:

	Contractor	Sound Transit Disposal Procedures	
		Capital Assets	Spare Parts
ST Express	Community Transit King County Metro Pierce Transit	Surplus Bus Disposal Ops Procedure*	N/A**
Sounder	Amtrak Stacy & Witbeck	Informal/ad hoc	Informal/ad hoc
Light Rail	King County Metro	Informal/ad hoc	Informal/ad hoc

*different versions of the procedure exist
**N/A – partner agencies use their spare parts on an as-needed basis for ST buses

Management has regular and informal meetings with the contractor to discuss various business items including obsolete/surplus parts, but there are no formal processes to monitor disposal activities. With numerous stakeholders, it is critical to set clear expectations through procedures in order to avoid miscommunication, inconsistent and ineffective processes. Due to a lack of procedures, disposal processes have become an ad-hoc practice. Ad-hoc practices can cause inaccurate asset inventory and unnecessary storage of surplus-able parts, as evidenced by the following audit exceptions:

- There are approximately 8,100 distinctive new spare parts in EAMS. Roughly, 4,300 or 53% of the parts have never been used, dating as far back as 6 years. Although a

high level of never-been-used parts is necessary given the unique nature of agency assets (e.g., link trains) and unpredictable parts availability, there should be reviews at regular intervals either to affirm the continued high level or to surplus those determined to be unnecessary. However, no such reviews have been observed.

- EAMS records are inaccurate or incomplete.
  - There is an inconsistent understanding of what assets (including spare parts) should or should not be in EAMS, which could result in incomplete records.
  - 17 out of 35 (48%) samples of disposed spare parts stored at Central Link have no record (e.g., document attachments or comments) of the reason for disposal.
  - 3 out of 3 (100%) samples of disposed spare parts stored at Tacoma Link are incorrectly labeled as “disposed” although they are usable/active parts.
  - There are over 700 ‘subtract’ or ‘change’ adjustments in the system. Of 700, 29 were noted as obsolete or damaged. All 29 should have been coded with a part suffix 99 which is a category reserved for disposed/obsolete/scrapped items. Adjustments were used, instead, because of a lack of certain system functionalities. Adjustments as a workaround have been implemented to address the weakness but in so doing, visibility to disposed/obsolete items has been obscured. As a result, an accurate listing of disposed/obsolete parts is not readily available.
  - Approximately 105 spare parts (valued at $355,000) have not been recorded in the system from Point Defiance Bypass and Tacoma Trestle project.
  - Adjustments from physical inventory counts of spare parts at a Tacoma Link location have not been input into EAMS. Example, a cycle count with the report date of 7/18/2018 had 14 adjustments, but the adjustments have not been reflected in the system, thereby making system balances incorrect.

- Disposal of obsolete parts is not timely.
  - As of September 2018, the Sounder contractor estimates that 1,500 (46%) spare parts have no use, which represents about $1.5million of the total $3.3 million spare parts. The contractor claims to have been communicating the obsolescence to management for a number of years. As of this report, a level of true obsolescence has not been determined.
  - 2 out of 13 (15%) samples of spare parts stored at Sounder track & signals are obsolete and should be scrapped.
  - 54 out of 347 (16%) of spare parts at Sounder signals are identified as salvaged, obsolete or retired; however, none has been removed.
  - 1 of 12 (8%) samples of spare parts stored at Central Link is obsolete.

Overstocked and/or obsolete parts, if not timely controlled through established procedures, could result in a high inventory cost: management costs - More efforts would be necessary to manage., 2) financing costs - The longer overstocked/obsolete parts are retained, the less likely it is to realize maximum salvage value., and 3) storage costs - Unnecessary parts are taking space that could otherwise be available for other uses.

Recommendations:

We recommend the agency:

1. Develop and implement disposal procedures unique to each asset group.

   The following should be considered when designing procedures.
   - Relevant stakeholders should be identified.
   - Responsibility and authority by title should be identified.
   - Disposal/obsolescence reasoning and decisions should be documented in the system either at the item- or batch-level, whichever is more efficient.
   - Specific processes for sharing disposal and obsolescence information with the contractor should be defined and performed at reasonable intervals.

2. Perform a complete physical inventory count at year end for all inventory locations, except 24/7/365 operations (e.g., Central Link maintenance).

3. Update Policy #14
   - Provide a definition for spare parts.
   - Provide policy expectations related to a level of spare parts inventory and their disposal.
   - Revisit IT equipment disposal responsibility in consideration of Ops Technology group in Operations.
   - Clarify when “Declaration of Surplus and Disposal form” is to be used. Currently, the policy is written to require the form for all personal assets including spare parts. Given the size of spare parts, requiring the form for such assets appears inefficient.

4. Asses Enterprise Asset Management System

   The following should be considered for the assessment.
   - System administrative ownership.
   - System effectiveness
     - Are certain critical functionalities missing?
   - System efficiency
     - Are there numerous workarounds requiring additional staff resources?
   - Support staffing level
   - All stakeholders for the system. Certain asset groups have opted out of the system. An enterprise system should account for all relevant enterprise assets.
   - Potential need for a separate system solely dedicated to maintenance operation.
   - Universal set of asset metadata applicable to all EAMS assets including spare parts.
   - Unique set of required asset metadata for each EAMS asset group.
   - Procedure for initial data upload of asset information to ensure completeness and accuracy at an appropriate level of detail.
   - Procedure for data migration in case system upgrade or replacement to avoid legacy data challenges.

Management Response:

Management concurs with the finding. Operations welcomes the subject audit and appreciates the points made about strengthening asset disposal procedures. Our review of the audit report provided actionable examples to demonstrate the need for an agency policy update, procedure development and increased management oversight of the process. It also identified the absence of Enterprise Asset Management System (EAMS) functionality as a contributing factor to the finding. EAMS changes will require a long term agency commitment, funding, and a third party contract to assist in developing effective and efficient disposal program processes.

Working with our Sound Transit partner departments and contractors, Operations will review and recommend changes to Agency Policy 14 and develop procedures to support disposal processes effectively. The following actions will be taken to address audit recommendations.

1. *Develop and implement disposal procedures unique to each asset group.*
   Management concurs with the recommendation. The timely and thoughtful disposal of assets and spare parts when no longer needed is an important function in inventory management and cost control. Obsolete parts in inventory shelves take up space that otherwise could be used for active parts. While the report recognized disposals of $17M for 2017 and 2017 respectively, Operations management agrees that there are additional spare parts that require a closer review and consideration for disposal. Development of formal disposal procedures covering each business unit will set clear expectations in order to avoid miscommunication and inconsistent procedures.

2. *Perform a complete physical inventory count each year for all inventory locations, except 24/7/365 operations (e.g. Central Link maintenance).*
   Inventory procedures are determined by Finance/Accounting and passed along to Operations for implementation. Any proposed changes to the current schedule and process will need to be supported by Finance. Operations staff will collaborate with Finance on the recommendation to identify the most appropriate inventory management practices to ensure accuracy and identify discrepancies.

3. *Update Policy #14*
   Management concurs with the recommendation. Operations will work closely with Finance and the Executive Department to develop and propose an update.

4. *Assess Enterprise Asset Management System*
   Management concurs with this recommendation. Management recognizes that standardized procedures and criteria prescribing how asset disposals are managed and coded within the EAMS system are not documented and managed consistently across all modal assets groups. Development of business processes and subsequent adopted governance for asset disposal management within EAMS is necessary to utilize the system effectively and consistently. Documented modal business processes should also include notification and review of changes in asset inventory status. This is in part a consequence of the phased Information Technology Department implementation of EAMS, since inception, performed without fully defined or holistic user business

processes, EAMS governance principles nor system requirements fully established. Completion of the EAMS system occurred in August 2017, and the modal groups have begun evaluating the system and documenting shortcomings. Operations is standing up a governance team for EAMS to address system challenges and drive key decisions, actions, priorities, and resulting resource demands which will address this recommendation and begin evaluation of the EAMS system suitability in its current state to meet operational asset management needs as an enterprise system.