

Audit Committee

Thursday, March 4, 2010
4:00 PM

Conference Room 157
County Government Center
70 West Hedding Street
San Jose, CA

AGENDA

CALL TO ORDER

1. ROLL CALL

2. PUBLIC PRESENTATIONS:

This portion of the agenda is reserved for persons desiring to address the Committee on any matter not on the agenda. Speakers are limited to 2 minutes. The law does not permit Committee action or extended discussion on any item not on the agenda except under special circumstances. If Committee action is requested, the matter can be placed on a subsequent agenda. All statements that require a response will be referred to staff for reply in writing.

3. ORDERS OF THE DAY

CONSENT AGENDA

- 4.** Approve the Minutes of October 1, 2009.

REGULAR AGENDA

- 5.** ACTION ITEM - Conduct voting to determine the Committee's vice chairperson for calendar year 2010.
- 6.** ACTION ITEM - Approve the 2010 Audit Committee Meeting Schedule.
- 7.** ACTION ITEM - Review and receive the audited Comprehensive Annual Financial Report for the Santa Clara Valley Transportation Authority, and the Santa Clara Valley Transportation Authority Amalgamated Transit Union Pension Plan Report for Fiscal Year 2009. (J. Smith)

8. ACTION ITEM - Review and receive the Audited Financial Report for Fiscal Year 2009 of the Santa Clara Valley Transportation Authority Retirees' Other Post Employment Benefits Trust (Trust). (J. Smith)
9. INFORMATION ITEM - Receive a report on the current financial audit service contract. (J. Smith)
10. INFORMATION ITEM - Review Status of Internal Audit Workplan. (Thomas)
11. INFORMATION ITEM - Receive a Report on the Silicon Valley Rapid Transit (SVRT) Soft Cost Internal Audit. (Thomas)

OTHER ITEMS

12. Items of Concern and Referral to Administration.
13. Review Committee Work Plan. (Burns)
14. Committee Staff Report. (Burns)
15. Chairperson's Report. (Gage)
16. Determine Consent Agenda for the April 1, 2010 Board Meeting.
17. ANNOUNCEMENTS
18. ADJOURN

NOTE COMMITTEE MEMBERS: In order to establish a quorum for this meeting, members are asked to call the Board Secretary's Office at (408) 321-5680 or E-mail: bd.sec.polling@vta.org before 5:00 p.m. on the day prior to the meeting. Thank you for your cooperation.

In compliance with the Americans with Disabilities Act (ADA), those requiring accommodations or accessible media for this meeting should notify the Board Secretary's Office 48 hours prior to the meeting at (408) 321-5680 or e-mail: board.secretary@vta.org, TDD (408) 321-2330. VTA's Homepage is located on the Web at: <http://www.vta.org>.

Disclosure of Campaign Contributions to Board Members (Government Code Section 84308) In accordance with Government Code Section 84308, no VTA Board Member shall accept, solicit, or direct a contribution of more than \$250 from any party, or his or her agent, or from any participant, or his or her agent, while a proceeding involving a

license, permit, or other entitlement for use is pending before the agency. Any Board Member who has received a contribution within the preceding 12 months in an amount of more than \$250 from a party or from any agent or participant shall disclose that fact on the record of the proceeding and shall not make, participate in making, or in any way attempt to use his or her official position to influence the decision. A party to a proceeding before VTA shall disclose on the record of the proceeding any contribution in an amount of more than \$250 made within the preceding 12 months by the party, or his or her agent, to any Board Member. No party, or his or her agent, shall make a contribution of more than \$250 to any Board Member during the proceeding and for three months following the date a final decision is rendered by the agency in the proceeding. The foregoing statements are limited in their entirety by the provisions of Section 84308 and parties are urged to consult with their own legal counsel regarding the requirements of the law.

All reports for items on the open meeting agenda are available for review in the Board Secretary's Office, 3331 North First Street, San Jose, California, (408) 321-5680, the Monday, Tuesday, and Wednesday prior to the meeting. This information is available on VTA's website at <http://www.vta.org> and also at the meeting.

**NOTE: THE BOARD OF DIRECTORS MAY ACCEPT, REJECT OR MODIFY
ANY ACTION RECOMMENDED ON THIS AGENDA.**



Audit Committee

Thursday, October 1, 2009

MINUTES

CALL TO ORDER

The Regular Meeting of the Audit Committee was called to order at 4:30 p.m. by Chairperson Gage in Room 157, County Government Center, 70 West Hedding Street, San Jose, California.

1. ROLL CALL

Attendee Name	Title	Status
David Casas	Vice Chairperson	Present
Don Gage	Chairperson	Present
Nancy Pyle	Member	Present
Greg Sellers	Member	Present

A quorum was present.

2. PUBLIC PRESENTATIONS

There were no Public Presentations.

3. ORDERS OF THE DAY

There were no Orders of the Day.

CONSENT AGENDA

4. Minutes of March 5, 2009

M/S/C (Casas/Sellers) to approve the Minutes of March 5, 2009.

5. Minutes of May 7, 2009

M/S/C (Casas/Sellers) to approve the Minutes of May 7, 2009.

NOTE: M/S/C MEANS MOTION SECONDED AND CARRIED AND, UNLESS OTHERWISE INDICATED, THE MOTION PASSED UNANIMOUSLY.

REGULAR AGENDA

6. Security Guard Qualification and Training Internal Audit

Michael T. Burns, General Manager, reported the Auditor General has completed its first audit as part of the Fiscal Year (FY) 2010 Internal Work Plan approved by the VTA Board of Directors. The audit conducted was on the security guard qualification and training due to VTA's transition from Securitas Security Services to AlliedBarton Security Services LP. Mr. Burns acknowledged Michael Hursh, Operations Deputy Director, and Captain Robert Schiller were in attendance, noting their availability to address any concerns/questions.

Pat Hagan, Auditor General, Deloitte & Touche, LLP, introduced team members Farah Faruqui, Partner, and Sandra Koning, Manager.

Member Pyle took her seat at 4:34 p.m.

Mr. Hagan provided a summary report on the Auditor General Report No. 2009-01, Security Guard Qualification and Training Internal Audit. He reported the Security Guard Qualification and Training Internal Audit was a compliance audit that related to the transition from Securitas to AlliedBarton. He noted it was a compliance audit of the contractual requirements between VTA and the contractor. The objectives of the internal audit were to: 1) Assess whether AlliedBarton security personnel serving VTA were in compliance with training and certification requirements specified in contract terms; and 2) Assess the effectiveness of VTA processes for monitoring contractor reports of compliance with training and certification requirements.

Mr. Hagan reported out of a total of 81 AlliedBarton security guards assigned to VTA, a sample of 25 armed and unarmed security guards was selected for the testing period of March 13, 2009 through June 30, 2009. Based upon the sample selected, it appeared AlliedBarton complied with the key training and certification requirements.

The Internal Audit determined VTA's informal monitoring process could be improved through formalization of the process and controls. The Internal Audit observed several lower relative risks and recommended VTA either amend the Agreement to reflect current practice and document exceptions to the Agreement, or comply with the training requirements in accordance with the Agreement.

Mr. Hagan reported on VTA's management response, noting VTA concurred with the Internal Audit findings. He thanked Mr. Burns and staff for their cooperation and support.

Mr. Hagan reported on the responsibilities of the AlliedBarton security guards. He reported VTA and AlliedBarton indicated the transition from Securitas to AlliedBarton went smoothly, noting a number of Securitas guards were retained by AlliedBarton.

Mr. Hagan reported on the scope of contract requirements assessed and VTA processes assessed. He noted the overall risk rating was “low.”

Chairperson Gage queried if the same number of personnel were involved from the previous contractor up till now. Mr. Hursh noted the scope of the security services were essentially the same level of protection as with the previous contractor. Upon query of Chairperson Gage, Mr. Hursh reported on the level of firearms training of AlliedBarton, noting it exceeded State requirements.

Upon query of Vice Chairperson Casas, Mr. Hursh indicated tasers were not issued to the security guards. Vice Chairperson Casas queried if AlliedBarton was responsible for the operation of surveillance video equipment. Mr. Hursh noted AlliedBarton was not responsible for the maintenance or upkeep of the Closed Circuit Television (CCTV) system. VTA has contracted personnel to maintain the surveillance video equipment.

Vice Chairperson Casas referenced the Auditor General Report No. 2009-01, Page 3 of 12, last bulleted item under the security guards responsibilities: “closed circuit television and other security services as required by VTA.” He indicated it is not specified whether testing is conducted. Vice Chairperson Casas commented in order to solve a crime from a security standpoint, one wants to make sure the assets are functional and also relevant from the image that is produced. Mr. Hagan indicated from an audit perspective, when testing some of the technology areas that could be part of the scope.

Vice Chairperson Casas queried if random checks were conducted for criminal backgrounds, liens, and bankruptcies. Mr. Hursh reported on the criminal background check procedures and Mr. Hagan noted civil record checks were also conducted.

Member Sellers queried if there was an opportunity to independently verify alcohol testing was being conducted on a quarterly basis. Mr. Hagan noted from an audit perspective, VTA has to request the reports and has not done so at this time. Mr. Hursh indicated from an operational perspective, if there are any issues, VTA operational staff is notified, noting there is plenty of data sharing between AlliedBarton and VTA.

Mr. Hagan referenced the Auditor General Report No. 2009-01, Security Guard Qualification and Training Internal Audit, Exhibits A.C.6, A.C.7, A.D.3, and A.H.1.C under Section 1.0 – Contract Compliance with Training and Qualification Requirements. He provided an overview of the internal audit observations, individual area’s risk rating, Auditor General’s recommendation, and management’s response.

In reference to management’s responses, Chairperson Gage requested a checklist be completed identifying areas covered.

Vice Chairperson Casas expressed concern regarding the chart formatting and requested each exhibit header have some type of connectivity.

On order of Chairperson Gage and there being no objection, the Committee reviewed the Security Guard Qualification and Training Internal Audit Report.

7. **External Financial Auditor Review FY2009 Audit Plan**

Joseph T. Smith, Chief Financial Officer, reported pursuant to state law and VTA's Administrative Code, VTA is required to have an annual audit conducted on its financial statements. He introduced Leonard Danna, Partner, Vavrinek, Trine, Day & Co., LLP (VTD), and noted Mr. Danna would be providing an overview of the Audit Plan.

Mr. Danna, VTD, directed attention to the presentation entitled, "Audit Plan for the Year Ended June 30, 2009," and provided an overview, highlighting: 1) Scope Changes for 2008-09; 2) 2008-09 Fee Analysis; 3) Significant New Accounting Pronouncements; 4) Timetable: Interim, Final and Completion; noting VTD received and was in the process of reviewing the first draft of the financial statements; and the National Transit Database (NTD) audit work was to be completed the week of October 5, 2009; 5) Interim Work Completed to Date; and 6) Final Audit Work Procedures. Mr. Danna noted VTD expects to meet all of its deadlines going forward.

Upon query of Chairperson Gage, Mr. Smith noted VTA staff has been reviewing the Audit reports.

Chairperson Gage queried if a summary of the audits were made available to the public. Mr. Smith indicated VTA provides the Comprehensive Annual Financial Report (CAFR), which is posted on VTA's Website.

Vice Chairperson Casas referenced the Audit Plan for the Year Ended June 30, 2009 presentation, Page 3, 2008-09 Fee Analysis, fourth bulleted item: "In addition, VTA staff proposed additional scope changes as noted in the previous slide which resulted in a further fee decrease." Vice Chairperson Casas noted the previous slide, Page 2, Scope Changes for 2008-09, showed there was no separate audit report for Measure A and CMP. He queried it was not that VTD was not conducting the work; VTD was just not sending out a separate report. Mr. Danna indicated that was correct. If a separate report was conducted of those two components, VTD would have the audit to a lower level of materiality, which means VTD would be conducting more work. Vice Chairperson Casas commented from a standpoint, you are talking millions of dollars and a savings of \$20,000. He queried if VTD sees any material risk on not going down to that level of detail. Mr. Danna indicated, "no."

Vice Chairperson Casas referenced Page 6, Interim Work Completed to Date, third bulleted item: "High risk areas noted include investments, capital grant accruals, sales tax, STA and TDA revenues and classification of restricted vs. unrestricted program resources including Measure A restricted funds." Vice Chairperson Casas focused on sales tax, and indicated Governor Arnold Schwarzenegger is trying to convene a new special session to address sales tax collection. He asked what impact this may have on VTA. Mr. Danna indicated whatever was proposed or to be proposed was not pertinent to the June 30th audit. He noted the reason sales tax is a risk, was because it is a significant revenue source.

On order of Chairperson Gage and there being no objection, the Committee reviewed the Scope of Work for Annual Financial Audit Services.

8. Internal Audit Work Plan

Pat Hagan, Auditor General, Deloitte & Touche, LLP, directed attention to the presentation entitled, "Review Status of Internal Audit Activities," and provided a summary, highlighting: 1) Audit Plan FY 2010 and FY 2011 (presented May 2009); 2) Timeline of Internal Audit Activities (presented May 2009); and 3) Silicon Valley Rapid Transit (SVRT) Project Status. In reference to SVRT, Mr. Hagan noted a report containing the risk ranking would be presented at the next scheduled Audit Committee meeting.

Vice Chairperson Casas queried if the next Audit Committee meeting was scheduled for December 10, 2009 at 1:00 p.m. Michael T. Burns, General Manager, indicated "yes."

On order of Chairperson Gage and there being no objection, the Committee received a verbal report on the Status of Internal Audit Work Plan.

OTHER ITEMS

9. Items of Concern and Referral to Administration

There were no Items of Concern and Referral to Administration.

10. Committee Work Plan

Michael T. Burns, General Manager, directed attention to the items to be presented at the Thursday, December 10, 2009, Audit Committee Meeting.

On order of Chairperson Gage and there being no objection, the Committee reviewed and approved the Committee Work Plan.

11. Committee Staff Report

There was no Committee Staff Report.

12. Chairperson's Report

There was no Chairperson's Report.

13. Determine Consent Agenda for the November 5, 2009 Board Meeting

CONSENT:

Agenda Item #6. Review the Security Guard Qualification and Training Internal Audit Report

REGULAR:

None

M/S/C (Pyle/Sellers) to approve placing Agenda Item #6. Review the Security Guard Qualification and Training Internal Audit Report, on the November 5, 2009 Board of Directors Consent Agenda.

14. Announcements

Vice Chairperson Casas referenced Attachment 6.a, Auditor General Report No. 2009-01, Security Guard Qualification and Training Internal Audit, charts summarizing the internal audit observations, individual area's risk rating, Auditor General's recommendation, and management's response. He requested the charts be formatted into an easy to read document prior to the November 5, 2009 Board of Directors Meeting.

Michael T. Burns, General Manager, acknowledged the accomplishments of the Audit Committee, including the appointment of the Auditor General and conclusion of the first Internal Audit Report.

15. Adjournment

On order of Chairperson Gage and there being no objection, the meeting was adjourned at 5:13 p.m.

Respectfully submitted,

Tracene Y. Crenshaw, Board Assistant
Office of the Board Secretary



Date: February 23, 2010
 Current Meeting: March 4, 2010
 Board Meeting: N/A

BOARD MEMORANDUM

TO: Santa Clara Valley Transportation Authority
 Audit Committee

THROUGH: General Manager, Michael T. Burns

FROM: Board Secretary Sandra Weymouth

SUBJECT: Elect Standing Committee Vice Chairperson

Policy-Related Action: No

Government Code Section 84308 Applies: No

ACTION ITEM

RECOMMENDATION:

Conduct voting to determine the Committee's vice chairperson for calendar year 2010.

BACKGROUND:

The VTA Administrative Code has established four board standing committees that review items and provide recommendations to the full board on matters within their respective assigned areas of responsibility. The four standing committees are: Administration and Finance (A&F); Transit Planning and Operations (TPO); Congestion Management Program and Planning (CMPP); and Audit, which was added in 2008.

The VTA Board Chairperson nominates, for Board approval, committee members for each standing committee chairperson position. The Board approves the appointment of the standing committee chairpersons at its first meeting of the calendar year, which is normally January. Standing committee chairpersons serve a one-year term, except for the Audit Committee chairperson, which serves for two years.

At the first meeting of the calendar year, each standing committee elects from its membership a vice chairperson. The vice chairperson performs the duties of the chairperson in the event of the chairperson's absence or inability to act, and while so acting, has all of the authority of the chairperson. The vice chairperson position serves a one-year term, which coincides with the calendar year and the Committee chairperson's term. The vice chairperson is eligible for election to successive terms and only members, not alternates, are eligible to serve. The affirmative vote of a majority of the total authorized committee membership, which is three members, is required to elect the vice chairperson. The term of office for the newly elected vice chairperson commences immediately following completion of the voting.

FISCAL IMPACT:

There is no financial impact.

Prepared by: Stephen Flynn, Sr. Management Analyst
Memo No. 2417



Date: January 6, 2010
 Current Meeting: March 4, 2010
 Board Meeting: N/A

BOARD MEMORANDUM

TO: Santa Clara Valley Transportation Authority
 Audit Committee

THROUGH: General Manager, Michael T. Burns

FROM: Board Secretary Sandra Weymouth

SUBJECT: 2010 Audit Committee Meeting Schedule

Policy-Related Action: No

Government Code Section 84308 Applies: No

ACTION ITEM

RECOMMENDATION:

Approve the 2010 Audit Committee Meeting Schedule.

BACKGROUND:

The VTA Board of Directors Audit Committee generally meets quarterly on the first Thursday of the month prior to the Board of Directors meeting. The following meeting dates are proposed for 2010. The Audit Committee meets at the County Government Center, 70 West Hedding Street, Room 157, at 4:00 p.m., or as otherwise posted.

Thursday, March 4, 2010	4:00 p.m.
Thursday, June 3, 2010	4:00 p.m.
Thursday, September 2, 2010	4:00 p.m.
Thursday, December 9, 2010	(immediately following the Regular Board/ Workshop Meeting)

FISCAL IMPACT:

There is no Fiscal Impact.

Prepared by: Tracene Y. Crenshaw
 Memo No. 1894



Date: February 17, 2010

Current Meeting: March 4, 2010

Board Meeting: April 1, 2010

BOARD MEMORANDUM

TO: Santa Clara Valley Transportation Authority
Audit Committee

THROUGH: General Manager, Michael T. Burns

FROM: Chief Financial Officer, Joseph T. Smith

SUBJECT: Fiscal Year 2009 Comprehensive Annual Financial Report for the Santa Clara Valley Transportation Authority, and the Santa Clara Valley Transportation Authority Amalgamated Transit Union Pension Plan Report

Policy-Related Action: No

Government Code Section 84308 Applies: No

ACTION ITEM

RECOMMENDATION:

Review and receive the audited Comprehensive Annual Financial Report for the Santa Clara Valley Transportation Authority, and the Santa Clara Valley Transportation Authority Amalgamated Transit Union Pension Plan Report for Fiscal Year 2009.

BACKGROUND:

Pursuant to state law and the Administrative Code of the Santa Clara Valley Transportation Authority (VTA), Vavrinek, Trine, Day & Company, LLP (VTD), a Certified Public Accounting Firm, conducted an audit of VTA finances for the fiscal year ended June 30, 2009 (FY 2009). The auditors are required by audit standards to obtain reasonable assurance about whether the financial statements are free of material misstatement as well as assess whether the accounting principles used and estimates made by management are reasonable. Audited financial statements are required to be submitted to the State Controller, Metropolitan Transportation Commission, Federal and State agencies, and other parties such as the bondholders and financial rating agencies.

DISCUSSION:

Audit Results

VTD rendered a “clean” or unqualified opinion on VTA’s financial statements. The audit report states that VTA’s Comprehensive Annual Financial Report (CAFR) presents fairly, in all material respects, the respective financial position of the business-type activity, the governmental activity, each major fund, the aggregate remaining fund information of VTA as of June 30, 2009, as well as the respective changes in financial position and cash flows. There were no material weaknesses noted in the internal controls over financial reporting and operations. The Independent Auditor’s opinion addressed to the Board is on pages 2-1 and 2-2 of the CAFR.

Auditor’s Management Letter

In planning and performing the audit of VTA’s financial statements, VTD considered VTA’s internal control system and procedures. Based on their consideration, they issued the Memorandum of Internal Controls or Management Letter addressed to the Board. This type of memo typically includes any audit findings or observations and recommendations to address the issue(s).

An audit finding denotes a serious violation of internal control procedures, such as a control deficiency, a significant deficiency or a material weakness, which must be addressed by the management. A control deficiency exists when the design or operation of control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects VTA’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the VTA’s financial statements that is more than inconsequential will not be prevented or detected by the entity’s internal control. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the VTA’s internal control. An observation reflects recommended improvements to existing internal controls or procedures. There were no audit findings as a result of the FY2009 audit.

Audited Financial Statements

VTA uses the fund accounting system for financial reporting to ensure and demonstrate compliance with finance-related legal requirements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. VTA’s funds can be divided into three categories: proprietary, governmental and fiduciary funds.

The financial statements, related footnotes, and Management Discussion and Analysis as presented in the CAFR were prepared in accordance with the reporting requirements recommended by the Government Finance Officer's Association (GFOA).

The GFOA awarded a Certificate of Achievement for Excellence in Financial Reporting to VTA for its CAFR for the fiscal year ended June 30, 2008. This was the 13th consecutive year that VTA achieved this coveted award. The award provides affirmation that VTA's Comprehensive Annual Financial Reports are prepared consistently in accordance with generally accepted accounting principles and applicable legal requirements.

The CAFR reports the results of operations for:

- Proprietary Funds
 - § VTA Enterprise - Transit Operating, 1996 Measure B Transit Rail Program, and 2000 Measure A Transit Improvement Program
 - § Internal Service Fund - Workers' Compensation, General Liability, and Compensated Absences programs
- Governmental Funds
 - § Special Revenue Fund - Congestion Management Program (CMP)
 - § Capital Projects Funds - Congestion Management & Highway Program and 1996 Measure B Highway Program
- Fiduciary Funds
 - § Trust Funds - VTA Amalgamated Transit Union (ATU) Pension Plan; ATU Spousal Medical and Vision/Dental Trust; and Retirees' Other Post Employment Benefits (OPEB) Trust
 - § Agency Funds - Bay Area Air Quality Management District and 1996 Measure B Ancillary Program

Financial Highlights

Proprietary Funds

The Proprietary Funds account for activities that are reported using the full accrual basis of accounting. VTA maintains two types of proprietary funds: Enterprise Funds and Internal Service Funds.

Enterprise Funds

Enterprise Funds are used to account for functions of VTA that are principally supported by user charges, sales tax and intergovernmental revenues. There are three types of activities that fall under this category: VTA Transit Operating, 1996 Measure B Transit Rail Program, and 2000 Measure A Transit Improvement Program.

Statement of Revenues, Expenses, and Changes in Fund Net Assets

For FY2009, operating revenues (mainly from transit service fares and advertisement income) were \$38.4 million, up \$386 thousand or 1% from the prior fiscal year as a result of higher ridership. VTA's largest revenue source for operating and capital funding - 1976 Half-Cent Sales Tax and 2000 Measure A Half-Cent Sales Tax, were \$25.4 million (15.6%) and \$23.3 million (14.5%) lower, respectively, compared to FY2008 reflecting a slowdown of taxable sales activity in the Santa Clara County. Operating grants which consist mainly of Federal Section 5307 grants, State Transit Development Act (TDA) and State Transit Assistance (STA) were also \$11.6 million or 9.1% below prior fiscal year mainly due to State slashing the STA funding and lower taxable sales activity in the County from where the TDA revenues are generated.

Operating expenses in FY2009 were \$0.9 million lower compared to prior fiscal year as VTA implemented various cost control measures in response to declining revenues. Although wages and benefit costs were \$6 million or 2.5% higher in FY2009, they were offset with lower spending in categories such as materials and supplies (mainly due to lower diesel fuel price drop), services and depreciation expenses. For non-operating expenses, the major change was in the Capital Contributions to/on-behalf of Other Agencies which increased \$23.3 million in FY2009 due primarily to Swap contributions to Congestion Management and Highway Program and other agencies.

Total Enterprise Fund net assets were \$2.7 billion, an increase of approximately \$96.6 million over the FY2008 balance. This can be seen on page 2-90 of CAFR. Of the total net asset increase, \$125.1 million belonged to the 2000 Measure A Transit Improvement Program as the VTA Transit Fund reported a \$35.1 million decline in its net assets because of lower revenues and disposal of assets. VTA accounts for the 2000 Measure A Transit Improvement Program as part of its Enterprise Fund. Even though the 2000 Measure A program revenues and related capital expenses are reported as part of Enterprise Fund financial statements, they are restricted for capital programs and operating activities included in the 2000 Measure A Ordinance.

Reserves

As of June 30, 2009, VTA Transit Fund reports a total operating reserve balance of \$46 million (Statistical Section, Table 7, page 3-7). VTA Board has adopted a policy to maintain a target reserve balance at 15% of its operating budget to meet emergency needs that cannot be funded from any other source. This is meant to ensure that funds are available in the event of unanticipated revenue shortfalls or if unavoidable expenditures may be required. For FY2009, the reported operating reserve balance is at 12% of VTA's operating budget.

In addition to operating reserve balance of \$46 million, the Enterprise Fund also has a restricted and unrestricted reserve balance of \$497.3 million. Restricted funds are intended for specific purposes, bound by legally contracted agreements or Board policies. Of this amount, \$284.9 million represents local share of approved capital funding that VTA must provide toward Board-approved capital projects, Measure A and B Transit Improvement Projects, and VTA Transit Fund capital projects. The remaining amount is restricted or designated for debt service payments (\$29.7 million), debt reduction fund (\$147.7 million), and Inventory, Prepaid Expenses, and Issuance Costs (\$34.9 million). Details of the reserve balances are shown in the

Financial Section of CAFR, page 2-23.

Budgetary Comparison

As shown on the Budgetary Comparison Schedule for the Enterprise Funds (page 2-93 & 94), the FY2009 actual results for Enterprise Fund revenues and expenses were unfavorable compared to both the Adopted and Final Budget. VTA was originally projecting a net budgetary surplus of approximately \$8 million. Subsequently, the surplus was revised upward to \$9.3 million. Based on the FY2009 actual results, VTA Enterprise Fund reported a net loss of \$8.6 million, a \$17.9 million unfavorable variance when compared to the Final Budget.

Internal Service Funds

Internal Service Funds are set up to account for services to other funds, departments or to other governments on a cost-reimbursement basis. General Liability, Workers' Compensation, and Compensated Absences programs are accounted for in the Internal Service Funds.

The Statement of Revenues, Expenses and Changes in Fund Net Assets (page 2-24) report an increase in net assets of \$5.5 million primarily due to a change in claims liability reserve requirement for workers' compensation program as determined by the actuarial valuation study. As reflected in the Statement of Fund Net Assets, page 2-23, Internal Service Fund column, total net assets amounted to \$15.4 million. Future contribution rates will be adjusted to address the increase in net assets

Governmental Funds

Governmental funds are reported using the modified accrual basis of accounting. This means that revenues are recognized in the accounting period in which they become "measurable and available." VTA's Governmental Funds are divided in two categories: Special Revenue Funds and Capital Projects Funds.

Special Revenue Funds are set up to account for revenues from specific taxes or other earmarked revenue sources which, by law, are designated to finance particular activities of government. The Congestion Management Program falls under the Special Revenue Fund category.

Capital Projects Funds are set up to account for resources used for acquisition or construction of major capital assets by a governmental unit. VTA reports the Congestion Management and Highway Program, and 1996 Measure B Highway Program under the Capital Projects Funds category.

Congestion Management Program (CMP)

The CMP Special Revenue Fund is used to account for the congestion management, planning, and programming and development services for Santa Clara County. The Statement of Revenues, Expenses and Changes in Fund Balances (page 2-28) reports a \$1.4 million decrease in fund balance due to expenditures exceeding revenues in the current fiscal year. Total fund

revenues, which mainly include member assessment and grants, were \$4.3 million in FY2009; \$0.6 million lower than the prior year due primarily to a decrease in Federal Technical Studies Operating Assistance Grants, and State Operating Assistance Grants. Total expenses were \$5.8 million, an increase of \$0.9 million due mainly to higher salaries and benefit costs. The CMP fund balance was \$52 thousand at the end of FY2009.

Congestion Management & Highway Program (CM&HP)

CM&HP Capital Projects Fund is used to account for the acquisition of capital assets and construction of highway projects administered on behalf of state and other local governments (other than those accounted for in the Measure B Highway Capital Projects Fund). The CM&HP administers highway projects on behalf of other agencies.

As reflected on page 2-28, the CM&HP expended approximately \$27.1 million on project costs during FY2009. The primary expenditures were for Highway 152/156 Interchange, I280/880 to Yerba Buena improvements, and I880 HOV Widening (SR237-US101) projects. The bulk of the funding for these three projects came from the State grants and Measure A Swap funds. In total CM&HP received approximately \$27.1 million in FY2009; \$5.2 million as reimbursement from the Federal Grants, \$4.3 million from the State Grants, \$11.3 million from the Measure A Swap funds, and \$6.3 million from other sources.

Measure B Highway Program

Measure B Highway Program Capital Projects Fund is used to account for acquisition of capital assets or construction of Measure B Highway projects. The 1996 Measure B Highway projects consist primarily of widening highways and improvements that become the property of the State.

As shown on page 2-28, VTA expended approximately \$2.4 million during FY2009 for Measure B Highway projects. Of this amount, Santa Clara County's (County) contribution was approximately \$2.2 million and the remaining balance was received from 1996 Measure B Swap fund sources.

Fiduciary Funds

The Fiduciary Funds are used to account for assets held by VTA as a trustee (in a trust fund) and as an agent for others (in an agency fund). These assets cannot be used to support VTA's programs. VTA's Fiduciary Funds consist of trust and agency funds. The trust funds include the VTA ATU Pension Plan, ATU Medical Trust, and the Retirees' Other Post Employment Benefits (OPEB) Trust. The VTA ATU Pension Plan Report is discussed on pages 7 and 8 of this report. Bay Area Air Quality Management District and the Measure B Ancillary Programs are reported as agency funds.

Retirees' Other Post Employment Benefits (OPEB) Trust

The Retirees' Other Post Employment Benefits (OPEB) Trust was established by VTA to implement the GASB Statement Number 45 in FY2008. In prior fiscal years, VTA reported the retiree medical program as part of its Internal Service Funds. The Statement of Changes in

Fiduciary Net Assets (page 2-96) shows a total decrease of \$4.1 million to the Trust in the current fiscal year. It includes the actuarial determined Annual Required Contribution of \$15.9 million from VTA to the Trust. Net investment income was negative \$12.6 million due primarily to mark-to-market investment losses of \$15.1 million on the Trust investments as of June 30, 2009. Total expenses of the Trust which mainly include the retiree medical premium payments were \$7.4 million. As of June 30, 2009, total net assets held in the OPEB Trust totaled \$100.3 million. As required by GASB, VTA has also published separate financial report for the OPEB Trust.

ATU Medical Trust

The ATU Medical Trust Fund accounts for the ATU Spousal Medical Trust, which is a medical insurance benefit for eligible pensioners' spouses, and the Vision/Dental Trust, which is a vision and dental benefit for eligible pensioners. This Plan is funded through employee contribution at a rate of 25 cents per hour paid to the Medical Trust Fund and 10 cents per hour to the Retiree's Vision/Dental Trust Fund.

As shown on the Combining Statement of Changes in Fiduciary Net Assets for Retiree Trust Funds (page 2-96), total employee contributions to Spousal Medical and Vision/Dental were approximately \$868 thousand and \$347 thousand, respectively. Total benefit payments made on behalf of Spousal Medical Trust Fund totaled \$1.4 million for FY2009. Total changes in net assets show a decline of \$1.7 million for the Total Medical Trust funds. Total net assets for Spousal Medical were \$7 million and \$3.5 million for Vision/Dental.

Bay Area Air Quality Management District (BAAQMD)

The BAAQMD Agency Fund accounts for the activities that relate to the Transportation Fund for Clean Air (TFCA) Program. The TFCA is generated by a \$4 surcharge on vehicle registrations. The BAAQMD administers these funds in the nine-county Bay Area. Funds are available for allocation to alternative fuels, arterial management, bicycle, and trip-reduction projects that reduce vehicle emissions. Assets in the BAAQMD fund are held by VTA in a custodial capacity; therefore, they are reported in the Agency Fund. As of June 30, 2009, BAAQMD's total assets were approximately \$3 million, as reflected on page 2-97.

Measure B Ancillary Program

The Measure B Ancillary Program was established to administer the 1996 Measure B funds. During FY2009, VTA received and expended County contributions for Ancillary Program projects such as highway and intersection improvements, signal synchronization, and bikeway paths. The County contribution represents funding received and passed on to other governments, commonly referred to as "pass-through" grants. As of June 30, 2009, the total assets of this program were \$8.3 million (page 2-97).

AMALGAMATED TRANSIT UNION (ATU) PENSION PLAN REPORT

The Santa Clara Valley Transportation Authority ATU Pension Plan Fund reports on the activities of the pension benefit plan covering VTA employees who are represented by the Amalgamated Transit Union (ATU). The ATU Pension Plan is 100% funded by VTA's contribution.

Audit Results

VTD rendered a "clean" or unqualified opinion on the ATU Pension Plan Report, a component unit report of VTA's CAFR. The audit report states that it presents fairly, in all material respects, the activities of the ATU Pension Plan for the year ended June 30, 2009, in conformity the accounting principles generally accepted in the United States of America. The Independent Auditor's opinion addressed to the Board is on page 1 of the component unit report.

Financial Highlights

As shown on the Statement of Changes in the Plan Net Assets of ATU Pension Plan Report (page 6), net assets decreased \$40.4 million for the year ended June 30, 2009. The major factor for the decrease was \$33.6 million in net investment losses during the fiscal year including mark-to-market valuation loss of \$19.3 million. VTA contributions to the Plan were \$14.8 million and the benefit payments to retirees and administration expenses were \$21.6 million during FY2009. As of June 30, 2009, net assets amounted to \$282.8 million. Report details are shown on pages 5 & 6 of the ATU Pension Plan component unit report.

These financial statements can be viewed online at <http://www.vta.org/inside/investor/index.html>. A hard copy may be requested by writing to Santa Clara Valley Transportation Authority, Fiscal Resources Division, 3331 North First Street, San Jose, CA 95134-1927.

FISCAL IMPACT:

There is no fiscal impact as a result of this action.

Reviewed and Verified by: Grace Ragni, Fiscal Resources Manager

Reviewed and Verified by: Ali Hudda, Deputy Director of Accounting

Prepared by: Tony Sandhu, Financial Accounting Manager

Memo No. 1891

**Santa Clara Valley Transportation Authority
Comprehensive Annual Financial Report**

(J. Smith)

**ATTACHMENT TO THIS BOARD MEMORANDUM
WILL BE FORWARDED UNDER SEPARATE COVER**

**Independent Auditor's Report and the Amalgamated
Transit Union Pension Plan Report**

(J. Smith)

**ATTACHMENT TO THIS BOARD MEMORANDUM
WILL BE FORWARDED UNDER SEPARATE COVER**



Date: February 17, 2010

Current Meeting: March 4, 2010

Board Meeting: April 1, 2010

BOARD MEMORANDUM

TO: Santa Clara Valley Transportation Authority
Audit Committee

THROUGH: General Manager, Michael T. Burns

FROM: Chief Financial Officer, Joseph T. Smith

SUBJECT: Audited Santa Clara Valley Transportation Authority Retirees' Other Post Employment Benefits (OPEB) Trust Financial Report for Fiscal Year 2009

Policy-Related Action: No

Government Code Section 84308 Applies: No

ACTION ITEM

RECOMMENDATION:

Review and receive the Audited Financial Report for Fiscal Year 2009 of the Santa Clara Valley Transportation Authority Retirees' Other Post Employment Benefits Trust (Trust).

BACKGROUND:

Pursuant to the provisions of the Trust, Vavrinek, Trine, Day & Company, LLP (VTD), a Certified Public Accounting Firm, conducted an audit of the Trust's finances for the fiscal year ended June 30, 2009 (FY2009). The auditors are required by audit standards to obtain reasonable assurance about whether the financial statements are free of material misstatement as well as assess whether the accounting principles used and estimates made by management are reasonable.

The Trust was established by VTA Board of Directors in May 2008 to comply with the accounting pronouncement promulgated by the Government Accounting Standards Board (GASB) - the accounting standard making body for the state and local governments, and special districts such as VTA. The Trust financial statements report on the activities of the retiree medical benefit program for Santa Clara Valley Transportation Authority employees who meet certain age and service criteria and retire directly from VTA. The Trust is 100% funded by VTA's contributions.

DISCUSSION:**Audit Results**

VTD rendered a “clean” or unqualified opinion on the Trust Financial Report, a component unit of VTA’s Consolidated Annual Financial Report (CAFR). The audit report states that it presents fairly, in all material respects, the activities of the Trust for the year ended June 30, 2009, in conformity with the accounting principles generally accepted in the United States of America. The Independent Auditor’s opinion addressed to the Board is on page 1 of the Audited Financial Report.

Financial Highlights

The Statement of Changes in Trust Net Assets (page 6) shows a total decrease of \$4.1 million in Trust net assets for the year ended June 30, 2009. It includes the actuarially-determined Annual Required Contribution amount of \$15.9 million from VTA to the Trust. Net investment income was negative \$12.6 million due primarily to mark-to-market investment losses of \$15.1 million on the Trust investments as of June 30, 2009. Total expenses of the Trust, which mainly include the retiree medical premium payments, were \$7.4 million. As of June 30, 2009, total net assets held by the Trust totaled \$100.3 million. Report details are shown on pages 5 & 6 of the Audited Financial Report.

These financial statements can be viewed online at <http://www.vta.org/inside/investor/index.html>. A hard copy may be requested by writing to Santa Clara Valley Transportation Authority, Fiscal Resources Division, 3331 North First Street, San Jose, CA 95134-1927.

FISCAL IMPACT:

There is no fiscal impact as a result of this action.

Reviewed and Verified by: Grace Ragni, Fiscal Resources Manager

Reviewed and Verified by: Ali Hudda, Deputy Director of Accounting

Prepared by: Tony Sandhu, Financial Accounting Manager
Memo No. 1892

**Independent Auditor's Report and the
Santa Clara Valley Transportation Authority
Retirees' Other Post Employment Benefits (OPEB) Trust
Report**

(J. Smith)

**ATTACHMENT TO THIS BOARD MEMORANDUM
WILL BE FORWARDED UNDER SEPARATE COVER**



Date: February 17, 2010
 Current Meeting: March 4, 2010
 Board Meeting: N/A

BOARD MEMORANDUM

TO: Santa Clara Valley Transportation Authority
 Audit Committee

THROUGH: General Manager, Michael T. Burns

FROM: Chief Financial Officer, Joseph T. Smith

SUBJECT: Financial Audit Services Contract

FOR INFORMATION ONLY

BACKGROUND:

VTA is currently in contract with Vavrinek, Trine, Day and Co. (VTD) to provide financial audit services for three years, with the option to extend the agreement for two additional one-year terms; VTA has exercised the two one-year options. VTD audited VTA's financial statements for the Fiscal Years (FY) 2006 through 2009 and will continue to perform audit services for the FY 2010 financial statements, for a total of five years.

DISCUSSION:

Section 11-7 of the Administrative Code requires an independent audit of VTAs' finances at the close of each fiscal year by a certified public accountant. Additionally, the state and federal agencies, as well as the bond counsel require independent audit reports. The following is the list of the audited reports that are needed to meet these requirements:

- VTA General Purpose Financial Statements
- VTA/Amalgamated Transit Union Pension Plan Report
- Retirees' Other Post Employment Benefits Trust
- VTA Single Audit Report
- Transportation Development Act Compliance Report
- Federal Transit Administration Agreed-Upon Procedures Report relating to the National Transit Database
- Compliance Report required by certain grants such as the Public Transportation for Modernization Improvement and Service Enhancement Account

Due to the upcoming expiration of the contract with VTD including the two one-year option periods, staff plans to issue a Request for Proposal for financial audit services for the period starting FY 2011 and bring forward a recommendation to award a contract in December 2010.

ALTERNATIVES:

The committee could choose to defer the competitive selection of a new financial auditor and extend the existing contract.

Prepared By: Grace Salandanan, Fiscal Resources Manager
Memo No. 2483



Date: February 17, 2010

Current Meeting: March 4, 2010

Board Meeting: April 1, 2010

BOARD MEMORANDUM

TO: Santa Clara Valley Transportation Authority
Audit Committee

THROUGH: General Manager, Michael T. Burns

FROM: Auditor General, Greg Thomas

SUBJECT: SVRT Soft Cost Internal Audit

FOR INFORMATION ONLY

BACKGROUND:

At the June 4, 2009, meeting, the VTA Board of Directors approved the FY 2010 internal audit work plan and authorized the General Manager to execute task orders with Deloitte & Touche LLP to conduct the internal audit projects identified in the plan. In July 2009, Deloitte & Touche initiated the second audit in the work plan, which was an internal audit of the Silicon Valley Rapid Transit (SVRT) project soft costs. The audit was performed in accordance with the Standards for Consulting Services issued by the American Institute for Certified Public Accountants. The results of this audit are presented in Auditor General Report No. 2009-02 (see Attachment A).

DISCUSSION:

The purpose of this audit was to review the estimated and actual-to-date soft costs associated with the SVRT project, identify factors driving those costs, and recommend potential improvements to projecting and managing soft costs over the remainder of the project.

The attached report describes the objectives established for this audit, the scope of soft costs evaluated as part of the audit, and the approach used by the internal audit team. The report presents the internal audit team's observations, the risk rating associated with each observation, and the Auditor General's recommendation for addressing each observation. The report also includes VTA management's response to each observation, and steps that have been or will be taken to address the Auditor General's recommendations.

Prepared By: Greg Thomas, Auditor General
Memo No. 2088



AUDITOR GENERAL REPORT No. 2009-02

TO: Chair Audit Committee, Don Gage
Santa Clara Valley Transportation Authority

THROUGH: General Manager, Michael Burns

FROM: Auditor General, Greg Thomas

DATE: February 11, 2010

SUBJECT: Silicon Valley Rapid Transit Program Soft Costs Internal Audit

Enclosed is our report for the Silicon Valley Rapid Transit Program Soft Cost internal audit.

Our internal audit was performed in accordance with the terms of our engagement letter between Santa Clara Valley Transportation Authority and Deloitte & Touche LLP for Auditor General Services, Contract No. SO9022 dated January 9, 2009, and in accordance with the Standards for Consulting Services issued by the American Institute of Certified Public Accountants. This report is intended solely for the information and use of Management and the Audit Committee of the Santa Clara Valley Transportation Authority (VTA) and is not intended to be used by anyone other than these specified parties. Recommendations for improvement are presented for Management's consideration. Management is responsible for the effective implementation of corrective action plans.

Please contact Greg Thomas, Principal, in the VTA Auditor General's office if you have any questions.

This report is intended solely for the information and internal use of Santa Clara Valley Transportation Authority, and should not be used or relied upon by any other person or entity.

AUDITOR GENERAL REPORT No. 2009-02

Silicon Valley Rapid Transit Program Soft Costs Internal Audit

February 11, 2010

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I. EXECUTIVE SUMMARY

The Santa Clara Valley Transportation Authority's ("VTA") Silicon Valley Rapid Transit ("SVRT" or "SVRT Program") Project comprises a 16-mile extension of the Bay Area Rapid Transit District system ("BART") from a future Warm Springs station in Fremont to San Jose.

Internal Audit (IA) performed an internal audit of SVRT's controls related to soft cost¹ estimating, management and monitoring with the following objectives:

- ❖ Gain an understanding of the VTA soft cost policies and procedures used to develop estimates and manage and monitor performance
- ❖ Evaluate soft cost budgets vs. actual incurred costs and plot variances over time in the following areas:
 - VTA Labor
 - Environmental Consultants
 - Design Consultants
 - Non-Technical Services
 - Public Outreach
 - Professional Consultants
 - Specialty Services
 - Appraisal Consultants
 - Acquisition Consultants
 - Other Real Estate Consultants
 - VTA Overhead Allocation
- ❖ Evaluate soft costs to complete ("Estimate to Complete" or "ETC") and variances between budget and costs at completion ("Estimate at Complete" or "EAC")
- ❖ Understand, at a summary level, the factors, root causes, and/or trends, where possible, that have been the drivers behind the SVRT soft costs
- ❖ Assess the processes used to develop estimates and manage and monitor performance and identify potential improvements to process efficiency and effectiveness

Relevant project documents and policies and procedures were read and analyzed and VTA personnel were interviewed during the field work between August 2009 and September 2009. Cost data analyzed was through May 2009.

Detailed observations and recommendations are provided in the main body of the report in the sections entitled SVRT Soft Cost Trends, SVRT Root Cause, SVRT Policies and Procedures, and SVRT Ongoing Project Risks. Provided below is a summary of the observations and recommendations in these four areas.

- ❖ SVRT Soft Cost Trends – The trending analysis conducted shows a capital program that has experienced recurring soft cost overruns when compared to estimates throughout the life of the project. Additionally, trending efforts conducted during the course of this internal audit show that SVRT monthly cost reporting does not always include the most current estimate information and,

¹ For the purposes of our work, soft costs include the professional, technical and management services related to the design and construction of fixed infrastructure during the preliminary engineering, final design and construction phases of a project as described in the Federal Transit Administration's Standard Cost Categories Worksheet SCC 80 – Professional Services.

as a result, inaccurately reflects Project status. Therefore, Management should consider the following recommendations, as briefly described below.

- Management should take action to assess the validity of current estimates.
 - Management should develop a controls program that results in meaningful monthly, quarterly and/or periodic forecasting efforts to understand current SVRT Program status and any ongoing cost exposures.
 - Management should assign responsibility to a team to develop strategies for mitigating identified cost exposures.
- ❖ SVRT Root Cause - An evaluation of the soft costs incurred over the life of the SVRT Program was conducted to identify the root causes and/or highlight those actions and occurrences that may have had the most significant impact on the overall soft cost budget and incurred costs. Based upon our analysis of the project documents, both the project schedule and the staffing organization have, and are the most likely factors that will continue to impact and affect soft cost budgets and incurred costs.
- Schedule – Most of the SVRT Program original milestones have slipped significantly from the original baselines due to the developing project definition, the entry and re-entry into the Federal Transit Administration (FTA) New Starts program and key environmental decisions (see SVRT Baseline vs. Actual Schedule, page 11). The SVRT Program was not “schedule driven” in that no hard construction start date or revenue service date was in place to help confine the level of effort expended on design and other professional services efforts. With the underground scope of work now to be implemented in a later phase of the Project, SVRT Management should closely evaluate how to update the Project schedule and the soft cost estimates associated with the implementation of the later phased work.
 - Staffing - A new organizational structure was established over the past 12 months in an effort to improve SVRT project organizational hierarchy and increase management and integration efficiency. During field work and in interviews, our team learned that a general design coordination role had been absent in the past, and as a result coordination and integration had been inefficient. This inefficiency will likely continue if the new organizational structure does not help to mitigate this issue. Going forward, a more centralized and coordinated management team will be necessary during final design and construction phases. This project-wide management team should be able to act as a link between the design teams to better manage coordination and integration issues and address risks.
- ❖ SVRT Policies and Procedures – The SVRT Program policies and procedures appear deficient in certain areas. As a result, Management should consider the following recommendations as briefly described below.
- Management should formalize policies related to the evaluation of soft cost estimates provided by design consultants prior to inclusion in the SVRT Program soft cost estimates.
 - Management should develop formal policies to monitor and manage the forecasting of soft costs.
 - Management should develop a formal set of policies and procedures for the evaluation and approval of all soft cost consultant invoices as well as the procedures and guidelines for the recurring and contemporaneous internal audits of consultant invoices and/or individual SVRT Program contracts.

- Management should develop policies and procedures for the timely update of SVRT Program reports to allow the monthly report to be more of an effective project management tool for the SVRT team.
- ❖ SVRT Ongoing Project Risks – Three areas of ongoing project risk were identified during our work efforts that may warrant attention from the project team going forward.
 - Third Party Entities - One of the more significant ongoing risks to the Project includes the unresolved design issues and finalizing and executing agreements with the various public and private third party agencies affected by the Project. As soon as practical, the project team should begin working and negotiating with third parties that are critical to the SVRT Program moving forward.
 - Design Changes – Changes in the project definition and schedule as well as uncertainty in the overall project scope and phasing have resulted in designs being carried out without having finalized decisions on critical Project elements. This has resulted in re-work in the past and risks of re-work in the future once the Project implementation of later phased work is finalized and third party/agency agreements are in hand for all planned segments of the project. The project team should limit the ongoing design efforts until the project definition is completely revised and approved.
 - BART – The BART organization has not been intimately involved with the Project planning and design to date as the Project is not fully funded and resources have not been completely dedicated to the SVRT Program. The project team should consider ways to incorporate BART personnel into the SVRT Program to better inform the design teams on how their design requirements and any needed changes might affect the overall Project.

Management Response

VTA Management agrees with the overall audit findings. Many of the management steps taken over the last one to two years, initiating with the development of the SVRT Program Office, have already addressed some of the findings. VTA will need to take additional steps to address others, particularly in formalizing policies and procedures and following through with the implementation of the procedures. The specific actions are noted in each section of the report, and will be completed prior to VTA's final submission to the Federal Transit Administration to enter into final engineering, which is anticipated in September 2010.

The SVRT Program is now in the “engineering readiness” phase, prior to entering final engineering. During this time, the SVRT Program Office is establishing processes and procedures to control and better assess the Program's soft costs. In addition, the Program Office will mitigate ongoing risks by:

- 1. Working to resolve third party issues and reaching agreements prior to final engineering.*
- 2. Focusing activities on the candidate project for federal funding, required by FTA and its Program oversight consultant, to minimize design changes; and*
- 3. Developing a management structure that includes BART as a partner in delivering BART to Silicon Valley.*

The internal audit team will assess the remedial actions identified by VTA Management, and will report its findings at a future Audit Committee meeting.

II. BACKGROUND

The Santa Clara Valley Transportation Authority's ("VTA") Silicon Valley Rapid Transit ("SVRT" or "SVRT Program") Project comprises a 16-mile extension of the Bay Area Rapid Transit District system ("BART") from a future Warm Springs station in Fremont, CA to San Jose, CA. The full SVRT Project ("Project") comprises six stations from Fremont, CA through Milpitas, CA and downtown San Jose, CA and into the City of Santa Clara, CA near the San Jose International Airport. Roughly five miles of the alignment will be underground in a twin bored tunnel.

Through May 2009, contract commitments for expenditures on the Project related to soft costs² included over \$625 million. These included \$106 million for conceptual engineering (CE), \$190 million for preliminary engineering (PE) and approximately \$330 million for engineering through the 65% level of design. The May 2009, cost reports place the cost of the Project in excess of \$6.1 billion at year of expenditure ("YOE"). It should be noted that SVRT Management is working with several federal, state and local government organizations to revise the definition of the Project being submitted for the New Starts program by developing a plan to separate the above ground and at grade phases of the Project from the below ground phases. After the revised definition of the phased Project is approved into the New Starts program and final design progresses forward, the current estimate of the Project may change.

The focus of this internal audit was to gain an understanding of how soft costs are estimated and tracked over the lifecycle of the Project and to identify areas for improvement in estimating, monitoring and controlling the soft costs. Specifically, the internal audit focused on identifying past trends in soft costs, and any associated root causes for these trends that may point to possible areas of exposure to increased costs in the future.

III. OBJECTIVE, SCOPE & APPROACH

A. Objective

The objectives of this internal audit of internal controls over soft cost estimating, management and monitoring were to:

- ❖ Gain an understanding of the VTA soft cost policies and procedures used to develop estimates and manage and monitor performance
- ❖ Evaluate soft cost budgets vs. actual incurred costs and plot variances over time
- ❖ Evaluate soft costs to complete ("Estimate to Complete" or "ETC") and variances between budget and costs at complete ("Estimate at Complete" or "EAC")
- ❖ Understand, at a summary level, the factors, root causes, and/or trends, where possible, that have been the drivers behind the SVRT soft costs
- ❖ Assess the processes used to develop estimates and manage and monitor performance and identify potential improvements in process efficiency and effectiveness

² For the purposes of our work, soft costs include the professional, technical and management services related to the design and construction of fixed infrastructure during the preliminary engineering, final design and construction phases of a project as described in the Federal Transit Administration's Standard Cost Categories Worksheet SCC 80 – Professional Services.

B. Scope

The soft cost categories evaluated included:³

- VTA Labor
- Environmental Consultants
- Design Consultants
- Non-Technical Services
- Public Outreach
- Professional Consultants
- Specialty Services
- Appraisal Consultants
- Acquisition Consultants
- Other Real Estate Consultants
- VTA Overhead Allocation

The following VTA processes were evaluated:

- Soft Cost Estimating
- Soft Cost Monitoring
- Soft Cost Forecasting
- Soft Cost Invoice Review

In performing our evaluation, our team read and evaluated the following:

- SVRT Program Executive Summary Reports (May 2004 – May 2009)
- SVRT Project Construction Cost Estimate Peer Review Summary Report (September 2008)
- SVRT Project Wide Trended Project Cost Estimate (December 31, 2007)
- SVRT Project Cost Overview PE Cost Estimate (June 23, 2006)
- SVRT Project Wide Monthly Cost Reports (May 2004 – May 2009)
- SVRT Project Wide Draft 65% Design Cost Estimate (January 12, 2009)
- SVRT Project Guideline: Capital Cost Estimate Guideline (Effective: March 1, 2005)
- SVRT Project Management Plan (April 10, 2009)

C. Approach

Our team initially conducted interviews with key VTA personnel. Once these interviews were completed, our team evaluated policies and procedures and other Project documents related to SVRT soft costs from March 2003 through May 2009. Thereafter, the team conducted follow-up interviews as needed to confirm assumptions, and discussed observations with VTA Management prior to issuing a draft report. Once follow-up was complete with VTA Management, we solicited Management Responses from VTA and finalized the report.

IV. RATINGS:

Risk ratings have been assigned to each observation to provide VTA Management with a better understanding of the risk and potential impact of each observation. In addition, an Overall Risk Rating and a Fiscal Impact Rating have been provided herein to help Management understand the overall risk and impacts of the observations.

³ Note these soft cost categories have been further developed from those defined in the planning memorandum to more closely align with the SVRT cost reporting and tracking.

The VTA risk rating definitions are:

- ❖ High – Significant control weakness presents a high likelihood of the event occurring potentially exposing VTA to significant financial loss, unauthorized access to key data, business or service interruption, and/or an impact to the VTA brand or public perception. This control weakness should be addressed promptly. If not addressed or corrected, it could expose VTA to significant financial or other loss, or otherwise significantly impair its reputation.
- ❖ Medium – Significant control weakness presents a possibility the event will occur potentially exposing VTA to moderate levels of financial loss, short term disruption to operations, short term impact to VTA brand or public perception and/or not making full use of human or system resources. This control weakness should be addressed in the near term.
- ❖ Low – Control weakness, if corrected or mitigated, will further strengthen the system of internal control. Likelihood of occurrence and impact if the event did occur are rated as low.
- ❖ Other Opportunities (No Rating) – Opportunity to improve efficiency or profitability of operations, but does not indicate an internal control weakness.

The risk ratings resulting from the work performed are provided below as an estimate to help Management understand the overall risk and impacts of the observations.

Overall Risk Rating: Medium

Fiscal Impact Rating: Medium

V. RESULTS:

The following sections summarize the internal audit observations, each individual area's risk rating, recommendations from the Auditor General's office, and Management's Response. The results of our field work have been reported in alignment with the internal audit scope and are delineated below in the sections entitled SVRT Soft Cost Trends, SVRT Root Cause, SVRT Policies and Procedures, and SVRT Ongoing Project Risks.

A. SVRT Soft Cost Trends

An evaluation of the soft costs estimated and incurred over the life of the SVRT Program was conducted to identify any trends, both historical and forward looking. In conducting the evaluation, we relied on the May 2009 monthly report data and performed an analysis of the soft costs. However, when SVRT Management reviewed our evaluation, it became clear that the monthly reports were inaccurate. The monthly reports included the actual costs incurred, but had not been updated with the revised cost estimates showing the current Program estimate or budget information. Therefore, much of the evaluation could not be used. However, there is at least one trend that can be gleaned from a summary level evaluation of the revised cost estimate data, as described below.

Observation

In looking at the overall soft costs from the CE Estimate (\$2005) to PE Estimate (\$2006) to the Draft 65% Design Cost (\$2008), the soft costs are trending substantially higher than initially estimated, which is shown in Figure 1 below. For example, the total capital cost increased from approximately \$4.5 billion to \$6.1 billion while at the same time soft costs increased from approximately \$755 million to \$1.4 billion or from 17% to 23.6% as a percentage of the total capital cost. Even though some of these estimates are adjusted for year of expenditure and completed at different points in time, it does show significant increases over time.

Figure 1 - Summary of Historical Soft Cost Estimates⁴

Description ⁵	CE Estimate (\$2005)	PE Estimate (\$2006)	Draft 65% Design Cost Estimate (\$2008)		Variance Between CE Estimate and Draft 65% ⁶
VTA Labor	85,000,000	98,280,000	VTA Labor (incl OH)	179,250,000	(94,250,500)
Design Consultants	234,820,000	395,940,000	Engineering	660,652,000	(425,832,000)
Professional Consultants	335,732,000	255,826,000	Professional Services	436,701,000	(100,968,000)
BART Design/Support	99,170,000	99,150,000	BART Design/Support	152,375,000	(53,205,000)
Total Soft Costs	754,722,500	849,196,000		1,428,978,500	
Capital Cost	4,451,420,000	5,227,460,000		6,052,000,000	
Soft Cost as % of Capital	17.0%	16.2%		23.6%	

Based on the extended timeline that the SVRT Program has experienced, it appears that failure to complete the ongoing design efforts and establish a hard construction start date may continue to cause the Project estimates to increase, based on past trends.

Comments/Recommendations

The simple analysis above depicts a capital program that has experienced estimate escalation at each major milestone and, with the ongoing risks and challenges facing the Project, these escalations represent an issue Management should continue to monitor very closely.

⁴ Trend data in the table was provided by SVRT Management at the request of the internal audit team and has not been formally published in the soft costs categories shown in the table. The source of the data is the SVRT Program 65% Design Estimate issued in January 2009. We understand management is working to update this data into future monthly SVRT reports.

⁵ The categories of costs have remained the same from CE Estimate to Draft 65% Design Cost Estimate but the titles are slightly changed in the most recent estimate information. However, based on information provided by the SVRT Management team, the categories have comparable elements of cost included in them.

⁶ Variance includes cost escalation.

In addition, Management should take action to assess the validity of current estimates and develop a controls program that results in more meaningful monthly, quarterly and/or periodic forecasting efforts to understand ongoing cost exposures. Additionally, Management should assign responsibility to a team to develop strategies for mitigating these exposures. Failure to do so will increase the likelihood of cost overruns and reduce the ability to bring about positive change on the SVRT Program.

Risk Rating: High

Management Response

The soft cost estimates were initially estimated assuming that the project development went from conceptual design to preliminary engineering at a 35% design level and then into final engineering. VTA subsequently undertook a 65% design development phase, which added an additional 18 months to two years of engineering to the schedule. The estimates had consultant efforts and VTA labor at roughly a “constant” level throughout the engineering phases, so that as the project engineering schedule lengthened, so did the cost of design and support services.

After concluding the 65% engineering phase, soft cost expenditures have been reduced substantially by reducing the level-of-effort committed from engineering consultant staff and other soft cost resources. The reduced team has entered an “engineering readiness” mode that is primarily focused on satisfying qualifying criteria for FTA New Starts funding. This concentrated effort will minimize the time required to gain FTA permission to proceed with final design and will optimize efficiencies through this period. Final design activities will not begin until full funding plans and firm schedules for construction, testing, and start-up are established with FTA.

To better manage and monitor work activities, a Work Directive process has been implemented that authorizes discrete elements of work as needed to achieve specific Management objectives. The SVRT Program now provides direction as to what tasks and services are needed and the level of effort that is authorized to complete each activity. The SVRT Program has implemented the Work Directive Process for the design and program management services during the past 10 months and has begun to distribute monthly Work Directive Reports to assist in monitoring the efforts.

The SVRT Program agrees with the recommendation to develop a controls program that results in more meaningful monthly, quarterly and/or periodic forecasting efforts to understand ongoing cost exposures. The Program is in the process of restructuring the monthly costs reports to provide more meaningful metrics in measuring soft cost, as well as other cost, exposures. VTA is also developing a risk-based management process that will be used to manage and monitor project progress and performance with FTA oversight on a monthly basis.

B. SVRT Root Cause

An evaluation of the soft costs incurred over the life of the SVRT Program was conducted to identify the root causes and/or highlight those actions and occurrences that may have had the most significant impact to the overall soft cost budget and incurred costs. As presented above, the Project has experienced cost overruns at previous milestones and it is important to understand what causes have driven these results so that they may be managed in the future. Based upon our analysis of the project documents, both the project schedule and the staffing organization have impacted, and are the most likely factors to continue to impact and affect, soft cost budgets and incurred costs.

1. SVRT Root Cause – Schedule

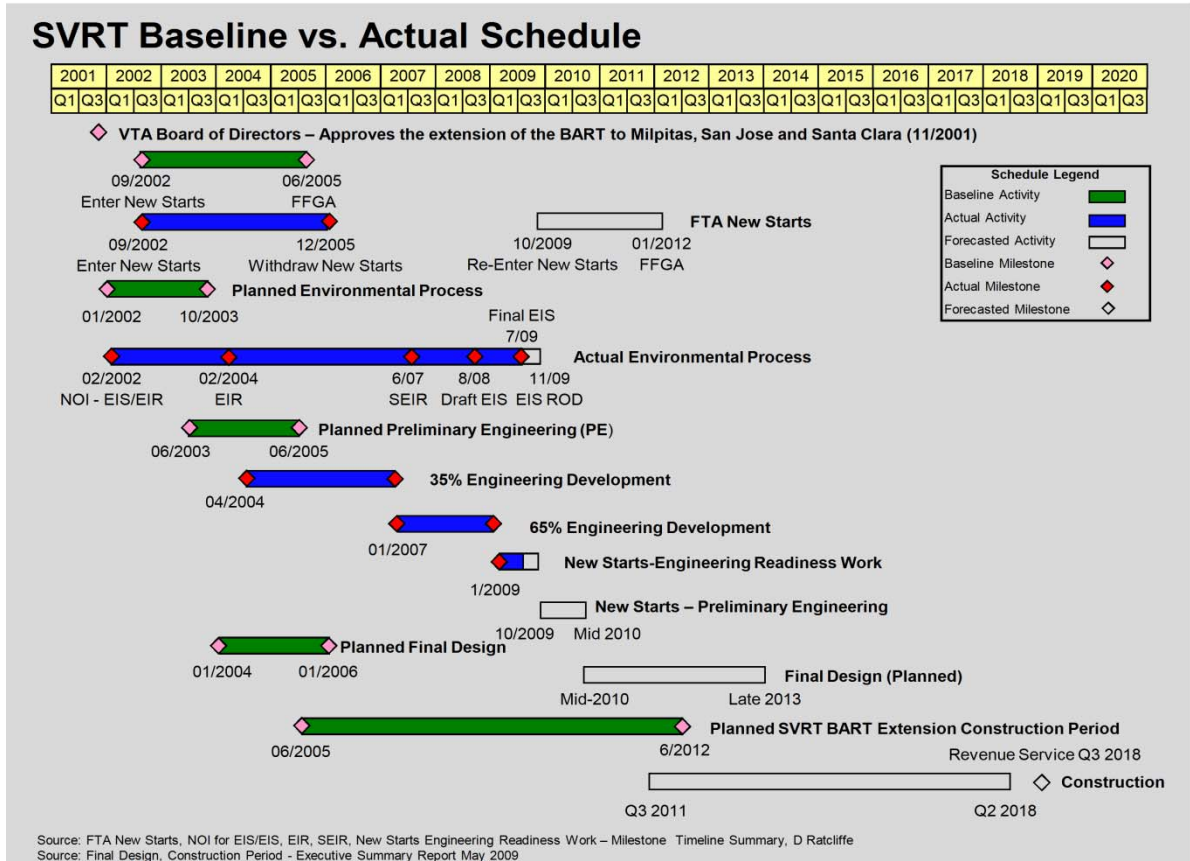
Observation

There are several reasons behind the Project soft cost escalation throughout the life of the Project, but perhaps the issue with the most likelihood to continue to affect soft costs is the extension of the overall program schedule. Throughout the report, we discuss the evolving and changing project definition, the entry and re-entry into the FTA New Starts program and key environmental decisions. As a result of these issues and others, most of the SVRT Program original milestones have slipped significantly from the original baselines.

In the evaluation of Project documents, it was apparent that the SVRT Program was not “schedule driven” in that no hard construction start date or revenue service date was in place to help confine the level of effort expended on design and other professional services efforts. While the delays to the Project schedule are primarily regulatory and/or outside the control of the project team, the effect of these delays is that the decision making process may have been less effective. Consequently, in some instances, delays may have resulted in reduced productivity or the value added not being in line with the cost of the efforts. In addition, based on discussions with the SVRT project team, decisions were made over time to retain staff and consultants to keep the project team together and the project moving forward.

Because of the significance of the slippage of soft costs-related milestones to date and projected going forward, our team used available data from the original project baseline milestones to compare “as-planned” activities to the corresponding “as-built” dates. As can be seen below, most of the overall program milestones have been delayed and continued schedule slippage represents a significant risk to the SVRT Program soft costs.

Figure 2 – Baseline vs. Actual Schedule Comparison



Comments/Recommendations

The schedule slippage to date shows the critical need to complete the revision of the project definition and establish completion dates for key soft cost activities. With the implementation of a phased approach⁷ for the underground scope of work, SVRT Program managers should closely evaluate and carefully consider how to update the Project schedule and the soft cost estimates associated with those schedule activities and the new implementation plan.

Risk Rating: High

⁷ According to the Draft Environmental Impact Statement (EIS) and Draft Section 4(f) Evaluation, dated March 2009, published on VTA’s website, three alternative projects are included in the EIS: the No Build Project, the Silicon Valley Rapid Transit Project (SVRTP), which is similar to the project included in the previously prepared EIR and SEIR, and the Berryessa Extension Project (BEP). According to our discussions with VTA staff, the BEP is the current focus on the preliminary engineering efforts for the FTA New Starts application. The BEP Alternative, as described in the EIS report, “would consist of a 9.9 mile extension of the BART system,” beginning “at the approved BART Warm Springs Station in Fremont and proceed on the former Union Pacific Railroad right-of-way through Milpitas to near Las Plumas Avenue in San Jose. Two stations are proposed: Milpitas and Berryessa.” Alternative would start in 2018, assuming funding is available. Ridership is projected to be approximately 46,450 in 2030.

Management Response

VTA agrees with the report's observations about the schedule. The SVRT Program's current focus is the New Starts Candidate Project for federal funding, the Silicon Valley Berryessa Extension (SVBX). Activities are being closely monitored to ensure that they directly relate to SVBX and the goal of receiving a Full Funding Grant Agreement on the project. The 65% design work on the segment of the project through a tunnel in the downtown and to Diridon Station and then terminating at the Santa Clara Station was completed in 2008. The phase will proceed into final engineering only when funding is identified for the construction of this segment.

2. SVRT Root Cause - Staffing Organization

Observation

An overall organizational plan is necessary to help define the roles and responsibilities of those involved in the Project. During field work we learned that a general design coordination role has been absent, and coordination and integration has been inefficient. At times, design teams felt that there was a lack of integration between the design segments and many experienced the feeling of 'working in a silo.' We observed that the segmented organization structure resulted in design teams not working at the same pace, and integration issues related to interdependent design development schedules not being addressed. Therefore, the risk exists for future integration issues during the final design and construction phases. We understand that a new organization plan has been proposed to improve Project organizational hierarchy and increase management and integration efficiency.

Additionally, at the time of our field work, we understand there were 129 consultant/vendor contracts in place. The sheer volume of contracts in place presents challenges to project team members who may not have experience in managing a project the size and scale of the SVRT Program.

Comments/Recommendations

Going forward, a more centralized and coordinated management team is necessary during final design and construction phases. This project-wide management team should be able to act as a link between the design teams and coordinate efforts to address integration issues and risks.

Risk Rating: Medium

Management Response

The Project Management Plan (PMP) submitted to FTA in September 2009 describes a new organizational structure for implementing the project. An important feature of the organization is to place all design activities under a single Engineering Manager. This allows for a coordinated effort among the various engineering disciplines that was lacking previously. VTA is in the process of filling key positions to deliver the project, including a Project Director.

In addition, the SVRT Program has expanded the scope of the program management services to include design coordination and management to support the Engineering Manager.

C. SVRT Policies and Procedures

Our evaluation of the policies and procedures that are in place to manage the SVRT Program soft costs initially focused on the overall program controls to gain an understanding of the policies in place and utilized by the SVRT Management team. Thereafter, our evaluation focused on the key controls related to estimating, forecasting, invoicing and reporting that are used for managing the Program soft costs.

The Project Management Plan (PMP) provides guidelines for the SVRT Program cost and schedule reporting. This document requires the project team to provide frequent and consistent reporting and at various levels of detail to evaluate Project cost at the program level, by phase, and by category.⁸

For projects funded through FTA's Major Capital Investment ("New Starts")⁹ program, FTA and its Project Management Oversight Contractors ("PMOCs") use a risk-informed assessment process to assess and validate a project sponsor's budget and schedule. This risk-informed evaluation and assessment process is a tool for analyzing project development and management at a point in time under the conditions known at that same point in time.

According to members of the SVRT Project team, the PMOC held work sessions and made suggestions to the team that an SVRT organizational chart, resource plans, and a means of evaluating contracting strategy methods be included as part of the PMP. The SVRT team indicated that many of the PMOC suggestions are being implemented; for example, an SVRT organizational chart was developed and resource plans have been developed and provided by consultants for estimating and planning purposes over the past year or so. As a result, as the project moves forward the project team appears to have refined some policies and procedures to help manage the ongoing Project design. Listed below are more specific observations and accompanying recommendations related to the key controls for soft cost reporting, estimating, forecasting, and invoicing.

1. SVRT Policies and Procedures - *Soft Cost Reporting*

Observation

Monthly cost reports evaluated during our field work did not reflect the most current SVRT Program estimates. Specifically, the Program Estimate in the May 2009 cost report does not reflect the 65% design estimate issued in January 2009. The data included in the Program Estimate category was incorrect. Failure to update the monthly cost reports portrays an inaccurate picture of the project

⁸ Monthly SVRT cost reports are prepared and published to show the current budgets, commitments to date, incurred costs to date and remaining budget balance. Further drill down details into specific Project elements and phases is also provided in these reports.

⁹ The Federal Transit Administration's (FTA) discretionary New Starts program is the federal government's primary financial resource for supporting locally-planned, implemented, and operated transit "guideway" capital investments. There are three key phases in the New Starts process:

- 1) Alternatives Analysis - local officials evaluate appropriate options for addressing mobility needs in a given corridor and determine the benefits, costs, and impacts of alternative transportation. When a locally preferred alternative (LPA) is selected by local and regional decision makers, alternatives analysis is considered complete and the local project sponsor may submit to FTA the LPA's New Starts project.
- 2) Preliminary Engineering - local project sponsors refine the design of the proposal and determine cost estimates, benefits, and impacts at a level of detail necessary to complete the National Environmental Policy Act of 1969 (NEPA) processes. At this stage, FTA typically assigns PMOC to ensure that the engineering effort progresses in accordance with FTA requirements. Preliminary engineering is considered complete when FTA has issued a Record of Decision (ROD).
- 3) Final design - the last phase of project development and includes right-of-way acquisition, utility relocation, and the preparation of final construction plans (including construction management plans), detailed specifications, construction cost estimates, and bid documents.

(source: http://www.fta.dot.gov/planning/newstarts/planning_environment_2608.html)

status and does not allow the SVRT project management team to utilize the monthly report as an effective project management tool.

In discussions with the SVRT team, we learned that the monthly report is currently undergoing revisions to more accurately reflect the project cost status. However, in the meantime, the SVRT team can only monitor the overall Program soft costs at a summary level since the monthly report does not provide data to monitor at a more detailed level or by sub-components or categories of cost that make up the SVRT soft costs. As a result, the SVRT team is not able to effectively use the monthly report as a project management tool to monitor costs as they are incurred and committed. From our discussions, it appears any detailed monitoring of soft costs occurs by individual project managers outside of the monthly reporting process. Monitoring of costs in this manner could lead to a lack of transparency and may make it difficult for the SVRT team to accurately and/or quickly report budget versus actual costs to SVRT Management.

Comments/Recommendations

Management should develop policies and procedures for the timely update of SVRT Program reports to ensure the most accurate data available is distributed internally and externally to allow the monthly report to be more of an effective project management tool for the SVRT team.

Risk Rating: High

Management Response

VTA recognizes that the monthly cost reports over the past several years were not updated with the preliminary engineering cost estimates and therefore did not provide as much insight or usefulness as monitoring tools. As noted above, the SVRT Program Office has embarked on revising the monthly report and expects the new format to be completed for the January 2010 reporting period. The revised format will reorganize the charging activities to be more project-based than discipline-based. Previously, project costs were tracked by project feature, e.g. stations, guideway, systems. The current tracking of chargeable areas will include the individual freight railroad relocation projects, the Berryessa extension project elements, and other related projects to the BART extension. Budgets are being defined for each of these projects, and actual cost performance will be tracked against authorized budgets.

2. SVRT Policies and Procedures - *Estimate Development*

Observation

The SVRT Capital Cost Estimate Guideline (“CCEG”) outlines methodologies and procedures for project team members responsible for preparing and evaluating capital program estimates. The guidelines were developed in accordance with the Association for the Advancement of Cost Engineering (“AACE”) – a leading organization in design and construction estimating. The document outlines the roles and responsibilities of the various members of the project team and also provides process diagrams showing the flow of estimate development and approval for the Project.

Most soft cost estimates were originally developed by the SVRT team as a percent of construction, but the project team has more recently used additional data available to further refine the various soft cost aspects of the Project at major design milestones. A detailed description of the method of estimate development for significant soft cost areas is discussed below.

Design Services

During our evaluation of the various soft cost estimates beginning with the “Conceptual Engineering” (“CE”) estimate in March 2003 through the “Draft 65% Estimate” in January 2009, we noted that the common practice for developing design services estimates was to rely on preliminary estimates provided by the consultant that would be performing these services. In documents we evaluated and confirmed in interviews with project team members responsible for managing design service contracts, there are no specific requirements or procedures for reviewing the design consultant estimates or comparing the estimate to an engineer’s estimate or historical data.

Professional Services/VTA Labor

Professional services, defined on the Project as Construction Management (“CM”) and Program Management (“PM”) services, are estimated based on conceptual staffing plans, the proposed construction implementation plan, and a draft construction schedule. These estimates include current consultant billing rates and VTA Labor rates.

VTA Overhead Allocation

VTA’s overhead allocation changed during the course of the project, from a percentage of SVRT Program costs to a percentage of VTA labor only. This change has resulted in current estimates that no longer include costs associated with VTA overhead allocation. As a result, the VTA overhead allocation is no longer a separate line item in the overall estimate but included in the VTA labor estimate.¹⁰

Auditing and Legal Services

Based on discussions with VTA personnel, there is no specific estimate or budget line item for the cost of legal services to support the SVRT Program. Currently, legal services are provided as needed. In addition, there is no specific estimate or budget line item for the cost of auditing services to support the SVRT Program. Any specific audit work that is conducted is planned to be part of the Measure A or B sales tax increases for specified public transit capital improvement projects and/or operations & maintenance of the SVRT Project.

Real Estate/Right of Way

Right of Way (“ROW”) estimates are developed for the Project and include those costs necessary to acquire land temporarily or permanently in conjunction with construction, utility relocation, hazardous material remediation, and construction lay down. These costs are estimated in coordination with the Project real estate team which conducts appraisals and market research, and includes costs for easements, goodwill, relocation, and severance. To complete this work, VTA incurs soft costs in utilizing internal resources and real estate consultants.

BART Costs

BART estimated cost elements were developed by BART personnel based on previous project experience, historical cost data and/or detailed BART estimates when necessary.

¹⁰ VTA Labor (Incl OH) is approximately 190% of the estimated VTA Labor only. See Figure 1, Summary of Historical Soft Cost Estimates in Section V.A. SVRT Soft Cost Trends.

The process for estimating a large capital project like the SVRT Program is dynamic in nature and must be maintained and updated to provide value adding metrics to the project team and key stakeholders. Failure to maintain and update estimates in line with industry practices and on a recurring basis may result in significant cost overruns. The SVRT Program is at a pivotal stage of development and attaining several key milestones may require significant updates and reformatting to the current Project estimate. These upcoming milestones include:

- Project Definition (ongoing) – the SVRT Program team is currently working with several federal, state and local government organizations to revise the definition of the Project being submitted for the New Starts program by developing a plan to separate the above ground and at grade phases of the Project from the below ground phases. As a result, the SVRT team is phasing the project with the 9.8 mile at/above grade portion being included in the New Starts Candidate Project definition.
- Re-Entry Into Preliminary Engineering (planned October 2009) – Upon successful re-entry into the FTA New Starts program, the Project will be directed by the federal agency to re-enter PE and begin to produce design documents for further evaluation and approval.
- Receipt of Record of Decision (planned April 2010) – The ROD is the culmination of the environmental approval process, FTA approvals and is tied closely to the Project Definition.

Comments/Recommendations

With the uncertain start dates and durations of the activities described above, the project team should carefully monitor and trend the soft costs being expended. Soft cost estimates may vary with any delay in these planned milestones and could result in soft cost overruns when compared to current estimates.

Management should strengthen and formalize the process to evaluate estimates provided by third party design consultants prior to inclusion in the overall soft costs estimate. It is also necessary to create a process for establishing an estimate basis for specific audit and legal costs that will be incurred in supporting the SVRT Program.

At a minimum, design services estimates/proposals should be evaluated for reasonableness based on historical data or industry aligned cost estimating databases.¹¹ This will help assess if the estimates/budgets from design service providers accurately reflect scope and costs of the various design elements and if the SVRT Program is receiving value for the design dollars spent.

Risk Rating: Medium

Management Response

Through the new organizational structure, the SVRT Program Office has brought in experienced design managers to review scope and costs of the various design activities and consultant efforts. The Work Directive process that has been implemented over the last year allows the Program to initiate design, engineering, and support services when appropriate and manage each of the consultant efforts into a coordinated set of activities that achieve specific management objectives. We have tightened the scopes of work to better define deliverables which will lead to better estimates.

¹¹ The Project Guideline – Capital Cost Estimate Guideline, effective Date 3/1/2005, Paragraph – “Procedures”, discusses the requirement for an Engineer’s Estimate “to evaluate bids for individual contract packages prior to award”, but similar evaluations are not being performed on estimates/proposals prior to contract award to design consultants.

3. SVRT Policies and Procedures – *Forecasting and Estimate to Complete*

Observation

From various Project estimates and other Project documents, we noted that Project soft cost forecasts have changed as the Project definition has been developed, environmental decisions have been pursued, and as involvement in the FTA New Starts program was resolved. In the monthly cost reports, the project controls team members present SVRT Program cost summaries by program, category, and phase. Within these various presentations of the Project cost data, variances to budget are highlighted and included in the estimated total cost for project line items. The frequency of updates and accuracy of the ETCs is not clear based on the monthly reports.

In our evaluation of SVRT Program policies and procedures, we did not find formal policies in place to manage the forecasting of soft costs. In discussions with project team members responsible for managing consultant contracts, we understand that they often assess the accuracy of the services provided versus the amount invoiced, but there is not a common effort to evaluate the forecasted amount to be expended on the contract. In many cases forecasts are simply assumed to be the committed budget amount for the contract. Failure to assess the reasonableness of forecasted soft costs reduces the accuracy of the overall soft costs estimates and can lead to costs being incurred that are not in line with the value added to the Project.

Comments/Recommendations

A formalized policy and procedure requiring project controls team members to meet with consultant management team members when completing monthly forecasting efforts would be expected on a program like the SVRT. Variances from earlier estimates would be brought to the fore and allow VTA Management and consultants to make more timely and informed decisions. Additionally, cost reports should include a narrative to describe the root cause of any project line item variances at defined thresholds above or below the working authorized budget. Highlighting and describing the reasons behind project line item variances will allow for early discussions around cost overruns/underruns.

Risk Rating: Medium

Management Response

VTA agrees with the recommendations. We believe that the work directive process will assist us in formalizing our procedures. The SVRT Program Office will establish a formal policy with regards to monthly forecasts and objectives of the forecasts before the project enters final design.

4. SVRT Policies and Procedures - *Invoice Review and Cost Assessment Audit*

Observation

Based on our evaluation of the SVRT policies and procedures provided, there are currently no formal guidelines in place for evaluating soft cost consultant invoices. An evaluation (and additional second level evaluation) of consultant invoices by the project team responsible for management of a consultant contract may be performed by some teams. However, there is not a standard evaluation policy.

Additionally, we understand there is no formal process for recurring cost assessments or audit work to be performed on soft cost consultant invoices. Due to resource constraints, VTA currently does not have resources dedicated to evaluating or auditing SVRT payments, which in the past was accomplished within the accounts payable function and referred to by VTA personnel as audit or attest review of invoices.

VTA is in the process of developing formal guidelines for recurring cost assessments or internal audits based on Project risk and available VTA resources. In addition, we understand that certain tax measures¹² allow for and require recurring audits.

Comments/Recommendations

The SVRT should develop a formal set of procedures and guidelines for the evaluation and approval of soft cost consultant invoices. This formal standard should be followed by the functional areas and can be used as the basis for the development of a similar procedure for the evaluation and approval of construction invoices.

The project team should also develop a process for the recurring and contemporaneous audit of consultant invoices. The frequency and rigor of the internal audits should be based on the risk to the owner of inaccurate applications for payment. Failure to clearly define the requirements for invoice review and cost assessments/audits can increase the risk of inaccurate or fraudulent billing and payments on the Project. The execution of these assessments can be done with internal or external resources, but the assessment team should not be made up of those individuals working closely to manage the consultant whose invoice is being evaluated.

Additionally, going forward, the SVRT Program should monitor the focus and frequency of the Measure A and B related audits to verify they meet industry leading practices and are conducted to provide value to the SVRT Program.

Risk Rating: Medium

Management Response

VTA agrees with the recommendations. Although VTA Accounts Payable has an invoice review process which requires that each and every project invoice be reviewed and approved by the Project Manager and the Project Controls staff, there is no formal document delineating what each approval signifies. The SVRT Program Office will develop a formal document that lays out the scope of review of each function in conjunction with Accounts Payable which will be applied across VTA.

¹² Measure A, a 1/2-cent sales tax devoted to specified public transit capital improvement projects and operations and Measure B that allows for a 1/8-cent sales tax increase to provide for the operations & maintenance of the SVRT Project.

D. Ongoing Project Risks

Aside from the previously documented risks to the SVRT Program, and as the involvement in the FTA New Starts program is resolved, our team noted some areas of ongoing project risk that may warrant attention from the project team going forward. These risks appear to be issues that are being tracked by the SVRT Management team, but stood out as issues that have the potential to significantly impact future soft costs and the SVRT Program as a whole. Risk related observations and comments are provided below as opportunities for the SVRT Management team to consider for assistance in evaluating and handling the risks. As a result, they do not require Management Responses.

1. SVRT Ongoing Risk – *Third Party Entities*

Observation

One of the more significant ongoing risks known to the Project team includes the unresolved design issues and agreements with the various public and private third party agencies affected by the Project. Examples of these risks relating to third party agencies are varied but may include limited third party resources, uncooperative third parties, and/or third parties hoping to use the Project to better their community by insisting on additional scope, which could lead to design parameters for some potentially significant elements of the Project remaining unresolved. Further, due to the stakeholder pressure to continue to move forward with Project design, some sections of the design affected by third parties may ultimately change and result in re-work, additional soft costs, and potentially additional schedule slippage.

Moreover, the project team has recently been asked to start paying for some third party costs associated with the Project (mainly third party employee time). The Project controls personnel have included some third party cost in the estimates for some private third parties like Union Pacific, but currently have not considered the magnitude of third party costs from other public sector entities outside of BART.

Comments/Recommendations

As soon as practical, the project team should begin working and negotiating with third parties that are critical to the SVRT Program moving forward. Obtaining cooperative agreements or getting signed MOUs for key decisions are critical to the success of the project. And as additional cost exposures are identified (e.g., costs for third party personnel), the project team should work to track and estimate the potential exposure to the overall Project soft costs.

2. SVRT Ongoing Risk – *Design Changes*

Observation

Design changes and uncertainty have resulted in designs being carried out without having finalized decisions on critical Project elements and have resulted in re-work in the past and risks of re-work in the future. Additionally, due to the complications with entry and re-entry into the FTA New Starts program, design consultants have underestimated the amount of work required to complete scopes of work and hence the current budgets appear insufficient. Also some of the work accomplished to date may have to be revised and re-worked once the Project definition is finalized and third party/agency agreements are in hand for the planned segments of the project.

The Project is currently in what is being called the Engineering Readiness Work (“ERW”) phase, which includes only those staff kept in place for continuity and to answer questions that may arise

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while the FTA process is ongoing. The team will focus on environmental and regulatory issues, FTA New Starts application, and resolution of major issues in preparation for the next phases of design and construction of the Project. While the consultant staff and even the VTA staff have been greatly reduced since the 65% design was completed, based on discussions there is still a perception by some members of the SVRT team that the ERW phase may be inefficient.

In addition, in discussions with the SVRT Project team we understand that the FTA New Starts team has also expressed concerns with VTA's optimistic design schedule and the limited amount of re-work forecasted to meet FTA design stage gate requirements. Delays and changes in the FTA New Starts application have led to additional design costs that will certainly continue to accrue until re-acceptance into the program and finalized Project definition.

Comments/Recommendations

The project team should continue to evaluate the ongoing efforts of team members and forecasted efforts planned before more definite decisions are made. The cost of maintaining the project team at the current level may exceed the benefits. The project team should consider an independent evaluation of the reasonableness of the team remaining for ERW.

3. SVRT Ongoing Risk - BART

Observation

A critical element to the success of the Project is the integration with the existing BART system and continuing and/or engaging in productive dialogue with the BART team. We understand that BART has not been intimately involved with the Project planning and design to date. Because the Project is not fully funded, BART resources have not been completely dedicated to the SVRT Program. As a result, decisions are often made without formal BART agreement or concurrence. In many cases design has progressed without BART as it was slow to approve or did not respond. These issues represent a risk to increased future soft costs due to re-work or non conforming designs.

It is also possible that some of the BART design requirements have already changed or may change prior to the completion of the Project design. As a result, additional design and construction costs could be incurred in the future as BART standards or technology change.

Comments/Recommendations

The project team should consider ways to incorporate BART personnel into the SVRT Program and allow them to better inform the design teams on how their design requirements might affect the Project.