



SANTA CLARA VALLEY TRANSPORTATION AUTHORITY

ORGANIZATIONAL AND FINANCIAL ASSESSMENT

EXECUTIVE REPORT

March 2007

HayGroup®

Organizational and Financial Assessment
Executive Report

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Preface: Historical Context

Santa Clara Valley Transportation Authority (VTA) was formed in 1995 as a regional Agency, by combining Santa Clara County's Department of Transportation and Congestion Management Agency. The Agency's mission was to develop and execute plans and construct facilities designed to alleviate and manage congestion, and to operate and maintain the County's transit systems. VTA's performance since its formation needs to be considered in an appropriate context.

VTA's formation occurred at the beginning of a major economic boom that was fueled by the explosion of new technologies and technology companies within the Silicon Valley. The boom was followed by a severe and sustained downturn. Like many start up companies in the region, VTA endured the challenges of this boom and bust cycle. The economy required VTA to grow quickly and then, after five years of unprecedented growth, make draconian cuts to its services, expenses, and employee base. The VTA, its governance, employees, culture and performance are a byproduct of these experiences.

Having endured these swings, VTA faces difficult decisions. 2007 is a watershed year that will require VTA's Board of Directors (Board) to make meaningful changes to VTA's vision and mission, governance and organizational structure, and financial policies and practices, to enable VTA to become a mature and sustainable business. VTA must determine its priorities in the following areas:

- Transit Sustainability Policy
- Comprehensive Operational Analysis (COA)
- Measure A Revenue/Expenditure Plan

These efforts coincide with the results of this Organizational and Financial Assessment ("Assessment"), which include recommendations for embarking on a transformation initiative to redefine VTA's governance, realign its organization, and establish financial credibility.

The Board's decisions during 2007 will require policy, financial, and operating tradeoffs, and will have long term implications for VTA and the region.



I. Project Background and Approach

The RFP

VTA initiated the Assessment to improve its understanding of VTA's emerging requirements and opportunities for improvement. VTA designed the Assessment to emphasize critical analysis of VTA's flaws, weaknesses and gaps, rather than areas of strength and positive results (e.g., increases in tax revenues and ridership, Measure B). This reflected VTA's desire to ensure that it was on the right track strategically, independent of any favorable or unfavorable near term developments.

The Board approved this self initiated effort and, in April 2006, VTA issued its Request for Proposal 06-11: Organizational and Financial Assessment Consulting Services ("RFP"). The RFP called for a broad study to encompass a diverse range of subjects.

Hay's Engagement

In August 2006, VTA engaged Hay Group ("Hay") as its consultant for the project. At that time, Hay set out to develop and deliver the following:

- A fact based assessment of VTA's performance against goals and objectives.
- An assessment of future performance based on VTA's current strategy and plans.
- Recommendations for transitioning VTA to an organization that enjoys the confidence of the Board, public and customers through:
 - ✓ An inclusive and effective governance structure; and
 - ✓ An organization that operates transparently and is responsive to the public.
- Recommendations for building a sustainable organization that is structured to:
 - ✓ Promote efficiency, accountability and creativity; and
 - ✓ Successfully implement VTA's strategy at a predictable and reasonable cost.

Scope. Hay's deliverables are scoped to provide a "Strategic Review;" that is, preliminary, directional, strategic recommendations and (where appropriate) areas for further study.

Project Approach. Hay assembled a national team of consultants with the breadth and depth of capabilities to develop the promised deliverables. The team's members possess a unique mix of Board level experience, executive experience, and technical expertise in the areas encompassed by the RFP.

Project Methodology. Hay's project methodology focused on the following process:

Collect and Review Existing Documents. Hay collected, reviewed and analyzed a large volume of preexisting information about VTA. This included: Board governance documents; employee and stakeholder surveys; financial and budgeting



reports; organizational goals and objectives; organization charts and job descriptions; previous consulting reports; divisional policies and procedures; performance measures and reports; and newspaper articles.

Interviews. Hay conducted more than 80 interviews to validate the information obtained from the document review process, fill in gaps in the data, and further our understanding of VTA's environment. The interviews included a wide range of VTA Board members, Advisory Committee members, other stakeholders, VTA executives and select senior staff.

Preliminary Findings and Analysis. From the information gathered in the previous steps, the project team developed a series of internal work papers that articulated what we had learned. These papers summarized our understanding of VTA's current environment and preliminary recommendations about next steps for project completion and beyond.

Focus Areas. The Hay team then engaged in a series of small and large group discussions to validate, integrate and prioritize our preliminary findings and analysis. Based on this process, we identified three key recommended areas where VTA should focus its efforts: governance, fiscal resources, and organization structure.

Working Environment. Per our project plan, Hay conducted a series of employee focus groups. This enabled us to assess VTA's working environment.

Development of Findings and Recommendations. The Hay team worked together to review the preliminary outcomes from each subject area and develop an overall set of appropriately prioritized recommendations. This process allowed us to leverage the collective experiences and expertise of our diverse team. The findings and recommendations from this Assessment were reviewed with VTA's General Manager (GM) and Project Manager to confirm the factual basis for our conclusions.

Delivery. Hay's delivery process focused on preparing a Technical Memorandum and this Executive Report.

- The Technical Memorandum is a detailed document that includes Hay's findings and recommendations from the entire Assessment. It includes divisional and program specific findings and recommendations, as well as details about the project focus areas.
- This Executive Report provides a summary of Hay's most important findings and recommendations, with an emphasis on VTA performance and on the project focus areas as they apply across the organization. It is intended as a stand alone document for Board and executive use.

While Hay's divisional and program specific recommendations are important, they are not emphasized in the body of this Executive Report, since they are relatively narrow in scope. The Appendix provides a list of select divisional and program specific recommendations contained in the Technical Memorandum.



II. Hay's Findings: Why Is VTA Faced With Such Difficult Choices?

A. VTA has Lost its Regional Focus and Strayed from its Core Business

Funding Projects vs. Transit Programs. VTA's mission is to plan, build and operate transportation systems where needed, to improve mobility and help manage regional congestion. During the last decade, VTA has, in many cases, planned for and built capital projects that have not satisfied regional transportation needs. The organization's concern has been focused on the capital cost of funding construction, rather than funding for the future operations and maintenance requirements of the transportation system. VTA's fiduciary obligations and the Board's duty of care require that these transportation systems be built, operated and maintained within existing fiscal constraints.

Local vs. Regional Focus. Many of the Board's actions over the last decade have not supported VTA's core business or its mission. The Board has approved capital projects that were political solutions to address the needs of certain local neighborhoods at the expense of regional congestion management. As a result, VTA has built transportation systems that have low ridership and are also expensive to operate and maintain. In the past five years, total passenger miles served by VTA's transportation systems have declined by 25%, while VTA's transportation costs per hour have increased by 3%. VTA's financial performance measures for its transportation systems illustrate the result: VTA's fare box recovery ratio has not increased above 14%, a level regarded as low performance in the transit industry. VTA's 2003 Fare Policy, as approved by VTA's Board, specified that the overall goal was to achieve a fare box recovery ratio of 20 to 25% by FY 2007. The Board also mandated that if the fare box recovery ratio was less than 20%, VTA shall recommend fare changes to recover its costs. Increasing VTA's fares would not solve the problem (however, increases could aggravate the problem). The real issue is that VTA's existing service plan is not aligned with the demand for transit services.

Underutilized Transportation Systems. Examples of VTA's underutilized transportation infrastructure are evident in the Light Rail and Bus transit systems. Hay benchmarked VTA's performance against peer agencies and found that VTA's bus and light rail services are less productive than their peers (using passengers per revenue hour as a performance indicator). In addition, benchmark data related to costs indicates that VTA's costs for bus and light rail service are high while productivity is low. Hay's performance benchmarking demonstrates that VTA could improve how it utilizes Light Rail and Bus transit systems to address regional congestion concerns. We support VTA's initiative in conducting the COA and encourage the VTA to implement changes to address this issue.

Project Funding Has Not Been Definitively Secured. VTA's budgeting practices and operations indicate that VTA has been focused on funding for building projects, but not on post-build system operations and maintenance. Future funding of capital projects and their operations is primarily based on authorized sales tax revenue which is unstable, as it relies on sustaining strong regional economic conditions over the



next thirty years. In addition, as VTA is aware, the 30 Year Measure A Revenue/Expenditure Plan (“Measure A Plan”) is not fully funded. The current Measure A Plan includes approximately \$2.8 billion in revenue that has not been definitively secured. If the funding as set forth in the Measure A Plan is not obtained, VTA will be faced with significant issues deciding which projects should and can be built.

There are several reasons for VTA not having secured funding. First, the Measure A Plan includes federal agency funding of \$750 million that has been deferred until the financial viability analysis of the Silicon Valley Regional Transit (SVRT) project is completed and VTA’s fiscal practices are strengthened. Second, the Measure A Plan anticipated the authorization of a \$2 billion general revenue tax over a thirty year period (equivalent to a ¼ cent sale tax for the thirty year period), but this was not authorized by local county voters in a 2006 referendum. (It is important to note that this was a county general tax with no guarantee that funds would flow to VTA.) The Measure A Plan’s funding assumptions must be revisited to reflect a short and long term reduction of scheduled funds.

In addition, the Measure A Plan does not provide for realistic revenue assumptions and related cost increases for the operation of its planned capital projects. VTA’s need to adequately plan for maintenance as part of the total project costing is illustrated by the lack of a maintenance plan for the light rail infrastructure when its warranties expire. The current Measure A Plan assumes that fare box revenue will increase 5% every other year over the thirty year period. However, VTA has neither raised fares at this projected growth rate nor seen an increase in ridership that would drive this revenue growth.

In addition, assumptions for unfunded pension and retiree health benefits and other employee benefits require upward adjustments. The financial impact of these changes has not been fully determined. Reported future funding requirements exceed \$200 million. This may require further funding in addition to the \$2.8 billion unsecured amount discussed above.

Good Governance Can Refocus VTA on Its Core Mission. VTA’s original governance structure and its mission are sound. However, since VTA has plans to build more than it can support based on its planned financial capacity and stakeholder authorization level, the Board has a responsibility to use its governance processes to realign VTA’s priorities and:

- Authorize capital projects that fulfill VTA’s regional mission;
- Make capital allocation decisions that avoid overbuilding in areas that cannot support the transportation infrastructure with sufficient ridership, based on origin and destination studies; and
- Make the necessary fiscal decisions to avoid expenditure deficits on projects and operations.



B. VTA Governance Does Not Operate as Designed

Current Board Structure. The Congestion Management Agency's ("CMA's") governance structure served as VTA's governance model. The structure was designed to provide Santa Clara County and the cities within the county with an opportunity to participate in VTA's governance. Enabling legislation establishes VTA's Board as "...the legislative body of the district" that "shall determine all questions of district policy." The Board has broad powers as a public transit agency and as the CMA. These include the power to construct, improve and/or operate transit and paratransit services, state and county highways, roads, streets, bicycle, and transportation facilities.

The Board consists of twelve voting members who are appointed for two year terms by their respective appointing agencies from the county and cities. The Chair and Vice Chair serve one year terms and are elected by VTA's Board.

Standing Committees. VTA has three Standing Committees that serve as Board advisors on policy matters within their assigned areas of responsibility and other matters referred to them by the GM or Board Chair. The Standing Committees are specified in its Administrative Code and can be changed by the Board as appropriate. VTA's Standing Committees are:

- Administration and Finance Committee: pertaining to VTA's financial management and general administration;
- Transit Planning and Operations Committee: pertaining to VTA's transit planning, capital projects, transit operations, and marketing; and
- CMP and Planning Committee: pertaining to congestion management program and development of countywide transportation plans.

Advisory Committees. The Board has also established five Advisory Committees that provide advice to the Board on policy issues referred to the Committee either by the Board or the GM. These Advisory Committees also facilitate communications between the community, other agencies, and VTA, to build necessary consensus for policy decisions. Like the Standing Committees, the Advisory Committees are specified in the Administrative Code and can be changed by the Board as appropriate. VTA's Advisory Committees are:

- Policy Advisory Committee: advise on policy issues (unlike the other Advisory Committees, members of this Committee are elected officials);
- Technical Advisory Committee: advise on major policy and technical issues related to VTA projects and programs;
- Citizens Advisory Committee: advise on policy issues from a citizen's perspective, including community interests, business and labor groups, and city and county groupings, and serves as Measure A watchdog;



- **Committee for Transit Accessibility:** advise on matters pertaining to paratransit services and accessibility to VTA transit services, facilities, and media, and on related state and federal laws; and
- **Bicycle and Pedestrian Advisory Committee:** advise on matters pertaining to bicycle and pedestrian related issues that affect the countywide transportation system.

Board Responsibilities. It is clear from a review of VTA's enabling legislation that the Board must exercise reasonable care in making decisions. This obligation requires that a Director be diligent and responsible in considering all relevant information when making judgments and decisions on behalf of VTA. Moreover, Board members should act with loyalty and avoid decisions where VTA would be in conflict with individual Board members. Conflicts would arise if VTA were to set policy or make other decisions for the sole benefit of a Director or a particular city or county, rather than for the benefit of its regional stakeholders. The duty of loyalty requires that VTA directors set policy and make decisions that are in the best interest of VTA and the region, subordinating the interests of their local jurisdictions.

The Board's responsibilities of care and loyalty are based on the members' fiduciary responsibilities to VTA. Fiduciary responsibilities require that Board members provide oversight to ensure that VTA's assets are protected, that its operations are conducted in a financially sound manner, and that it has appropriate internal controls in place.

VTA's Governance Challenges. Our assessment found that VTA's governance structure has served it well in the past. However, the Board has not consistently exercised its responsibilities of reasonable care and loyalty, and the Board is facing a number of operating and financial challenges that need to be addressed to satisfy its responsibilities.

Board Turnover and Training. Board members do not fully understand their responsibilities, partially due to significant Board turnover and lack of Board training programs. The enabling legislation provides for Directors to serve a two year term, and states that Directors should have knowledge in transportation (which could be gained in a number of ways, including orientation, training and workshops). This requirement, along with term limits associated with their elected positions, has increased the frequency of VTA Board turnover. In addition, VTA discontinued Board member orientation due to severe fiscal constraints, and some Board members do not regularly attend VTA workshops that provide opportunities for Board training and education. Taken together, turnover and the lack of orientation/training have created an environment where many Directors have not been provided with formal orientation/training about their policy role and fiduciary responsibilities.



Use Advisory Committees to Inform Board Decisions. While the duties of each Advisory Committee are described in the Administrative Code, Hay did not find that the Committees have clearly articulated missions, goals and objectives. As a result, the Advisory Committees are not well aligned with VTA's mission. There is also a significant degree of overlap in the Advisory Committees' activities and work plans.

Hay found that these Committees do not have an opportunity to consider policies and plans in the early stages of their development. Early stage participation by these Committees would enable them to provide meaningful input and could help facilitate the development of a consensus on issues, so that true regional solutions can evolve. More often than not, staff presentations are made to the Advisory Committees only when a proposal has been fully developed and is planned for recommendation to the Board in an upcoming meeting. In these cases, the Advisory Committee action is to report to the Board that the staff report was accepted. The Advisory Committees have generally not been in a position to provide meaningful, regionally based policy guidance to the Board based on their own input, agreements and discussions.

Need to Embrace Fiduciary Responsibilities and Obligations. VTA's Board has a fiduciary responsibility to ensure that VTA remains financially sound and that its assets are appropriately protected. It is the responsibility of each Board member to understand the complete financial consequences of policy proposals for VTA's mission, financial condition, expenditures, and reserves. While the Board's fiduciary responsibility is clear in principle, VTA has not consistently taken actions to adhere to this responsibility.

- Making decisions where local interests take priority over VTA and the region's needs. The Board has approved capital projects and transit service plans that were political solutions to address the needs of local jurisdictions at the expense of the region's transportation needs. As a result, VTA has built transportation systems and has transit service plans that have low ridership and are expensive to operate and maintain.
- Making Decisions Without Adequate Financial Information. The Board members have reported that they have made significant financial decisions without being fully informed of their short and long term consequences for VTA's financial condition, reserves, or expenditures. Board members repeatedly expressed frustration that reports, recommendations, and information provided by VTA staff have not clearly and concisely presented the full current and future financial impact of policy proposals and alternatives. Many Board members have also expressed that VTA's Board package is not designed for ease of use when preparing for upcoming meetings (this is particularly an issue for Directors who do not have full time staff support).

- Unfunded But Authorized Budget Expenditures. As previously mentioned, VTA's Measure A Plan includes approximately \$2.8 billion in revenue that has not been definitively secured and may require additional resources to cover maintenance costs. However, the Measure A Plan still received Board approval, as though it was fully funded.
- No Audit Committee. VTA's Board does not have an Audit Committee with an Independent Auditor General reporting to it. While public sector agencies are not required to implement Sarbanes-Oxley, most are modifying their committee structure to include an Audit Committee. An Audit Committee can assist in fulfilling the Board's fiduciary obligations for safeguarding VTA's financial integrity and ensuring internal controls. The Auditor General can assist the Board in fulfilling its fiduciary responsibilities by overseeing risks and controls in financial reporting, financial integrity, and program activities.
- Postponing Difficult Decisions. During VTA's history, the Board has postponed dealing with difficult issues that relate directly to the region's long-term interests. This appears to reflect a combination of: misunderstandings about (or lack of focus on) VTA's long-term financial capabilities; policy-making without complete financial information; and governance based on consensus through near-term, locally-oriented trade-offs rather than long-term regional interests. Several examples follow:
 - ✓ Measure A Plan: Plan includes \$2.8 billion for capital projects and maintenance that has not been definitively secured.
 - ✓ SVRT: VTA has not determined whether SVRT can or will be built. Federal funding of \$750 million has been deferred until the financial viability of the SVRT project is determined and VTA's financial practices are strengthened.
 - ✓ Need to Enforce Enterprise Capital Budgets: Hay's assessment found that, although enterprise capital budgeting was performed for internal VTA projects, these budgets were not adhered to. As a result, allocated project funds are rapidly shifted between projects as priorities are changed, causing projects to be delayed or not completed.
 - ✓ Insufficient Expenditure Allocations to Maintain Assets In a State of Good Repair: One of the principal considerations in funding a project is to determine whether adequate resources will be available to keep the constructed facility/asset in a state of good repair and able to operate on a day to day basis. Professional engineers within the organization are generally assigned to evaluate and determine whether a project has adequate funding to keep assets in such a state. Two examples for which this has not been adequately addressed are the SAP system upgrade and Light Rail asset maintenance.

1. *SAP System Upgrade:* Generally, organizations perform computer software maintenance to keep their financial systems fully functional and supported by the software manufacturer. VTA has delayed an upgrade to a major new release of SAP. VTA's current SAP software version is not completely supported by the manufacturer. This places VTA at risk if the system software fails.

Recovery of VTA's software may become difficult as SAP no longer fully supports the version that is in place at VTA. Moreover, the newer version of SAP provides VTA with additional modules that would help VTA improve its controls.

2. *Light Rail Asset Maintenance:* As previously indicated, VTA's light rail vehicles are coming out of warranty. Currently, VTA has no inventory management plan for this fleet, nor any related operating and capital budgets to support upcoming maintenance costs.

C. VTA's Financial Capacity and Future are Uncertain and Unstable

VTA's governance issues, particularly the inconsistent application of fiduciary responsibilities, have left VTA in a situation where it faces financial resource constraints that the Board will be compelled to address to ensure long term financial stability. Absent such governance activity, VTA's financial capacity and future will remain uncertain and unstable. Sustained financial uncertainty/instability could lead to further erosion in stakeholder credibility about VTA's governance and operating capabilities. Over time, this could create a self-fulfilling spiral of financial constraints that are designed to mitigate taxpayer/stakeholder financial risks, but also impair VTA's ability to meet the expectations of its stakeholders in the region.

VTA's Financial Statements Do Not Provide Complete Financial Information for Board Decision Making. VTA's uncertain and unstable financial picture is not clearly depicted in its financial statements, a fact that was repeatedly reported by Board members. VTA's financial statement only depicts historical accounting transactions. The CAFR does not provide an opinion on whether VTA's expenditure plans, capital plans, and other commitments will be covered on a short and long term basis by available, authorized funding sources. VTA's balance sheet is not required by generally accepted accounting principles to report all future obligations committed to by the Board's policy and project decisions. Furthermore, the CAFR does not clearly depict identified funding gaps that the Board will be expected to address, including future pension and retiree program liability gaps that could exceed \$200 million.

The Financial Future Is Uncertain and Unstable. VTA's uncertain financial future is evidenced by the following:

Current Underfunded Expenditure Plan and Inadequate Funding for Planned Capital Projects. VTA is beginning to recognize that it has over \$2.8 billion in unfunded commitments in the thirty year Measure A Plan that provides



for capital resources and maintenance expenditures. Prioritized decisions have not been made for achieving a balanced expenditure and financial stability plan, to include sound policies to ensure that capital projects can be realistically achieved, taking into account reasonable expectations for current and future funding. In making regional policy and project choices, VTA has not realistically considered what resources can reasonably be expected to fund these programs. The Board has not made the necessary trade-offs to avoid financial uncertainty and instability.

Underfunded Asset Maintenance. VTA's operational resources must be adequate to keep its constructed facilities and other assets in a state of good repair. The Measure A Plan does not provide for all operational cost increases resulting from its planned capital projects. The financial impact of these unfunded maintenance requirements have not been fully determined by VTA. As a result, further funding could be required - in addition to the \$2.8 billion that has not been secured. Absent secure funding, VTA has neither made the necessary choices to establish prioritized maintenance plans to live within its means nor invested in asset maintenance programs designed to reduce future spending on parts and maintenance not under warranty. In addition to making transportation decisions that did not maximize regional benefit from a congestion management perspective, VTA has not adequately provided for the maintenance and operation of its assets.

Underfunded Pension and Retiree Plans. VTA has two plans, an Amalgamated Transit Union Pension Plan and a Retiree Health Benefits Plan. Recent actuarial valuations for both plans indicate that VTA has an unfunded actuarial liability of over \$200 million for both. These forecasted plan obligations are yet to be funded, and VTA does not have definitive plans about how it will obtain the funds.

Further, there is no guarantee that the plans will achieve their assumed rates of return on plan assets in the future, which would cause a further increase in the unfunded actuarial liability.

Over-Reliance on Reserves to Support Operations. For three of the last five years, VTA has budgeted to draw on fund balance reserves, in order to meet its operating needs. As of June 30, 2006, VTA's audited financial statements reported that VTA's net operating reserves amounted to \$55 million. Another \$49 million is restricted for specific purposes, in whole or in part, by legal agreements or Board policies.

Unless additional financial controls are implemented and stronger governance by the Board is provided, this narrow margin for unplanned expenditures could greatly limit VTA's financial flexibility to address new transportation needs. To the extent that VTA continues to expend its resources to build, maintain and operate systems that do not satisfy its mission or meet its transportation needs, it will dig itself into a deeper hole and further reduce its financial margin of error.

Over-Reliance on Volatile Revenue Sources to Support Operations and Capital Projects. From 2004 to 2006, recurring revenue as a percentage of total revenue increased from 27% to 49%. VTA's most significant recurring revenue



source is sales tax, which is regarded as a volatile source since it depends on the economic success of the region. Sales tax revenues are also used to fund VTA's capital projects. VTA has not developed financial strategies or programs to diversify revenue sources and lower VTA's reliance on sales tax revenues.

Unrealistic Fare Box Recovery Expectations. VTA's fare box recovery ratio has not exceeded 14%, a level regarded as low performance in the industry. The current Measure A Plan assumes that fare box revenue will increase 5% every other year over the thirty year period. VTA has not raised fares to maintain this annual growth rate. Fare box recovery cannot be realistically improved until VTA's COA and Service Plans are aligned with ridership demands for service in congested areas.

It is Hay's finding that a fare box recovery ratio goal of 25% is not realistic. VTA has not seen an increase in ridership that would drive revenue growth. In addition, since VTA's experience is that increasing fares has a negative impact on ridership raising fares may or may not increase revenues.

D. VTA Must Consistently Avoid Conflicts

VTA's Board is obligated to have a regional focus in making policy decisions and choosing projects to resolve regional congestion. VTA's empty buses and light rail cars indicate that service is not being provided where traffic congestion exists. This may be due to cases where local priorities and requests were placed above regional interests.

Hay also found that appropriate disclosure controls have not been maintained at the executive level, to track and manage potential conflicts.

Finally, VTA lacks an Auditor General and an independent Audit Committee. Adding these to the structure would help mitigate the risk that decisions could be made while inherit conflicts exist among decision makers.

E. VTA's Organization Reflects a Lack of Focus on the Core Business, Which Presents Significant Weaknesses Relative to Future Needs

Misalignment at the C-Level

"C-Level" refers to VTA's GM, General Counsel, and executive positions that report directly to the GM. VTA appears to have opportunities for improving the C-Level team, from a structural and behavioral perspective.

Focus of the GM Role. Strategic leadership and external communications management are increasingly critical functions for the GM's role. Yet the GM has nine direct reports, which creates heavy oversight responsibilities at the expense of his long term thinking and external relationships. The GM is further stretched by his role as the de facto SVRT project manager (more on this below). The current role definition and structure does not set the GM up for success.



Misaligned C-Level Team. Although VTA executives were circumspect and professional in describing each other and their respective roles, the Hay team completed our interviews with a strong and clear impression that the executives are not well aligned. The GM has yet to develop a collaborative process with his executives to facilitate policy discussion and decision making. Weekly C-Level staff meetings are not productive beyond basic information exchange. The lack of a well aligned leadership team appears to have a cascading effect, resulting in functional silos in parts of VTA.

The Functional Structure Presents Many Opportunities for Improvement

Hay found numerous cases where VTA's functional structure appears to lack focus, accountability and alignment. Key functional accountabilities are dispersed throughout VTA, including accountabilities for Transit Services, Planning and Congestion Management, Engineering and Construction, capital projects, SVRT, finance, and External Affairs. Following are specific examples of opportunities for improving the functional structure:

- The current structure has SVRT accountabilities dispersed in several parts of the organization, leaving the GM to serve as the single point of accountability and de facto Project Manager for the SVRT.
- Engineering activities are managed in both the Development and Congestion Management Division and the Construction Division. The Construction Division manages engineering and construction for rail and facilities projects and construction of highway projects, while the Development and Construction Management Division manages highway engineering.
- The Construction Division is involved in accounting and payment processing relating to contract disbursements for project vendors.
- Transit Services includes inventory and materials management functions.
- Marketing and Public Affairs currently reports to the Development and Congestion Management Division, while its functional responsibilities relate to all of VTA - including External Affairs. This group includes a diverse range of loosely related functions, which may have been clustered together out of expediency rather than pursuant to sound organization design principles.
- The Fiscal Resources Division has a very narrowly focused accountability for monitoring its fiduciary responsibilities. Fiscal Resources focuses on accounting rather than VTA's business. The lack of CFO involvement in VTA's operations and strategy has impacted VTA's effectiveness in meeting its fiduciary obligations.
- Contracts and Materials Management is part of Fiscal Resources, which lends itself to potential conflicts (since Fiscal Resources both authorizes and disburses payments to third party contractors).



These cases indicate that VTA could use functional realignment to clarify accountabilities, strengthen internal controls (e.g., through segregation of duties), focus staff, and consolidate similar functions.

Systemic Weaknesses in Financial Management Processes and Policies. Hay found that financial management processes and policies are lacking or exceptionally weak. This has kept the Board and C-Level staff from properly exercising their fiduciary responsibilities. Hay regards this as a major systemic problem requiring immediate attention.

Lack of Internal Audit Function. Through discussions with the CFO and his direct reports, Hay learned that the CFO had eliminated VTA's Internal Audit function and substituted a contract compliance function in its place. Even though they are not required to implement Sarbanes-Oxley, most public sector agencies today have an Internal Audit function that reports to an Auditor General or Internal Auditor. This function helps meet the Board's fiduciary responsibilities, by evaluating risks and controls over financial reporting, financial integrity, and other assigned areas.

Weak Asset Management. "Build it and the money will appear" is not an effective fiduciary strategy for managing assets. VTA's weaknesses in the asset management area have appeared as follows:

- **Cash Management Is In Its Infancy.** VTA has managed its cash as if it was a petty cash fund. Requests are made for cash, and cash is disbursed under existing authorization controls. Rudimentary cash management tools are used to forecast cash requirements when concerns about covering project expenditures arise.

Since Construction processes its invoices and disbursements for various capital projects, there are internal control weaknesses related to segregation of duties.

VTA does not budget completely for minimum maintenance of operational and technology assets, causing maintenance expense shortfalls that also affect VTA's ability to effectively manage its cash requirements.

- **Weak Capital Budget Controls.** Hay's assessment found that, while budgeting was performed for VTA capital projects, they were always not adhered to. As a result, allocated project funds are rapidly and informally shifted between projects as priorities change, causing projects to be delayed or not completed.
- **Weak Budget and Expenditure Controls.** Hay found deficiencies in VTA's budgeting processes, as evidenced in the need for clearly documented and updated assumptions relating to the Measure A Plan and other expenditure budgets as provided by Fiscal Resources. Basic technology tools have been used to prepare and update planning/budget assumptions, which



limits VTA's capability to compute iterative scenarios or conduct sensitivity analysis. Changes are made to budgets and forecasts without updating assumptions or obtaining consensus about the changes. While Hay recognizes that VTA's budget process is dynamic, its budget procedures are not designed to control, prioritize, and provide alternative scenarios for planned expenditures in a rapidly changing environment.

- Weak Controls. Since the elimination of Internal Audit by the CFO, little attention has been given to internal controls. For example, the Fiscal Resources organization presents a control weakness by having procurement in the same division that issues checks. Similar concerns arise in Construction, where division staff perform accounts payable functions on vendor invoices that they approve (and that are generally processed by Fiscal Resources).
- Incomplete Financial Analysis of Policy Decisions and Recommended Options. In Hay's review of policy decision requests made to the Board and during our interviews with Board members, we found that VTA's reports, recommendations, and information have not clearly and fully presented the current and future financial impact of policy proposals and their alternatives. Fiscal Resources has not provided sufficient disclosure of assumptions and impacts with respect to future capital expenditures or other program initiatives. In addition, Fiscal Resources has not established a framework for coordinating VTA financial analysis. Consequently each Division selects its own manner of presenting financial analysis.
- Short Term Operational and Financial Focus. Fiscal Resources focuses disproportionately on short term requirements. For example, the biennial operating budget is balanced without taking into account the total future impact of capital expenditures (including capital asset operating and maintenance costs after these assets are placed into service). In fiscal year 2007, forecasted Measure A capital expenditures were materially changed by approximately \$200 million within two months of the adoption of the plan. Initially, accelerated SVRT capital expenditures were proposed to the GM without realistic consideration of the impact on VTA's cash flows.
- Lack of Timely and Usable Financial Information from Which to Make Decisions. In Hay's review of VTA's financial information and during our interviews with Board members, we noted that Board members have made significant financial decisions without being fully informed of the short and long term consequences on VTA's financial conditions, reserves or expenditures.

Opportunities for Improving Accountability Based Management

Accountability based management encompasses the basics of organizational leadership. It involves translating an organization's business priorities into specific job accountabilities, establishing performance measures and goals to track job performance, and holding people accountable for results. VTA has opportunities for improvement in each aspect of accountability based management.

Roles Have Not Been Effectively Communicated. VTA's structure of functional leadership jobs lacks clarity, focused accountability, and fiscal responsibility. As discussed earlier in this section, this applies to all major functional areas. Since role accountabilities have not been clearly defined and communicated, VTA staff have tended to self-define their roles. This has (inevitably) led to role conflicts and to a lack of alignment between individual roles, VTA's mission, and the Board and executives' fiduciary responsibilities.

Performance Measures are Not Outcome Based. VTA has a wide range of goals and objectives within its 5 broad goal areas, including 28 agency level performance measures. Hay determined that the measures associated with the goals and objectives are largely qualitative. More importantly, VTA's numerous performance and operational measures are not tightly linked to VTA's overall goals and objectives. This means that VTA's robust set of measures do not always provide a clear indication of VTA's actual implementation of its overall mission and strategy.

Poor Performers are Not Held Accountable. Even though VTA has established performance measures, these measures are not tracked, reported or actively used to improve divisional or VTA performance. As a result, these performance measures bring limited value to the organization.



III. Top Nine Recommendations

This section describes nine recommendations that Hay developed, based on our analysis of issues considered to be essential to VTA's viability and success. Implementing these recommendations and the associated organizational and governance transformation will represent a significant effort for VTA, and will require a strong commitment, effective planning and execution, and appropriate funding. VTA should approach its funding decisions from a strategic investment perspective, to ensure that the costs associated with change are worthwhile and more than offset by long term benefits.

Hay is confident that, with effective planning and leadership, pursuing these recommendations will provide a superior return on investment for VTA. The ultimate benefit to VTA and the residents of Santa Clara County will be an operationally efficient and financially viable VTA that can plan, construct and operate transportation facilities to relieve congestion, increase mobility and support the economic vitality of the region.

In addition to the top nine recommendations presented below, Hay recommends that VTA consider the other recommendations set forth in the Technical Memorandum. The Appendix lists divisional and program specific recommendations from the Technical Memorandum. Upon adopting any of these recommendations, VTA should assign it to the relevant staff for planning and execution, with appropriate oversight by the transitional leadership team.

A. Implement Governance Processes and Practices to Enable Transformation

VTA's Board should implement governance processes and practices that will address the challenges currently facing VTA, with the objective of improving VTA's effectiveness as a regional policy board that satisfies its responsibilities.

Adopt the Spirit of Sarbanes-Oxley Practices, Where Applicable. Most public sector agencies today, while not required to implement Sarbanes-Oxley, are modifying their practices to incorporate the spirit of this legislation as follows:

Establish an Audit Committee. VTA should establish an Audit Committee as a Standing Committee of the Board. The Audit Committee can be chartered to:

- Approve and provide policy oversight for VTA's Audit Program;
- Approve the Independent Auditors;
- Provide oversight for compliance activities and risk management; and
- Establish and provide oversight for a VTA "Whistleblower" Program.

The Audit Committee can also assist in fulfilling the Board's fiduciary obligations for safeguarding VTA's financial integrity, including its internal controls.

Implement an Auditor General Function. VTA should also establish an Auditor General position that reports directly to the Audit Committee of the



Board and that has a dotted line responsibility to the GM. The Auditor General will be responsible for assisting the Board in fulfilling its fiduciary responsibilities, including overseeing risks and controls in financial reporting, financial integrity, program activities, and other assigned responsibilities.

Establish Board Training on Duties and Responsibilities. The Board should develop and require attendance at a Director Orientation Program that acquaints Directors with the Board's policy role, governance structure, and decision making process. In addition, training should be provided to Directors to provide them with a full understanding of their fiduciary responsibilities. VTA should also develop and require attendance at ongoing programs and workshops designed to educate Directors on relevant planning and development, construction, transit and transportation issues, as needed to inform the Board's policy discussions.

Focus the Board on its Fiduciary Responsibilities. The GM should work with the Board to improve its focus on its fiduciary responsibilities for ensuring that VTA remains financially sound and that its assets are appropriately protected. Each Board member should be trained to review the complete financial consequences of policy alternatives on VTA's financial condition, expenditures, and reserves.

Conduct Annual Board Self Evaluations. The Board should annually assess its performance against VTA's mission and the Board's responsibilities in relation to VTA's charter. This self assessment should also encompass the effectiveness of Board meetings and of Board relationships with VTA staff and external stakeholders. The GM and Board Chair should study the results, identify areas that need improvement, and plan and implement resolutions.

Make the Board Structure Function Effectively. Hay recommends that VTA adopt the following recommendations to improve the functioning of its Board:

Make the GM a Board Member. The Board should appoint the GM as an ex-officio, non voting member of the Board. This model, which has proven very effective in not-for-profit organizations and in private industry, will elevate and empower the GM as he works with regional stakeholders to represent VTA's interests and VTA's Board. Given the organizational and financial challenges facing VTA, this recommendation, together with the balance of the recommendations in this report, is essential to VTA's transformation into a mature and financially sustainable organization.

Develop an Annual Board Work Plan. The GM should develop a work plan for the Board Chair, to focus the Board on its policy role and fiduciary responsibilities. Given VTA's current financial challenges and the need to make meaningful changes to its service plans and capital program priorities, the Board should:

- Review and approve VTA's Vision, Mission and Goals;



- Review and adopt business policy at VTA (near term policy issues include the Transit Sustainability Policy, COA, Financial Policy to assure sustainability, Policy for Measure A Revenue/Expenditure Planning and Project Prioritization, and the Commercial Development Program);
- Review and approve changes to the Administrative Code to reflect changes in governance structure such as appointment of the GM to the Board, changes in Standing and Advisory Committees, changes in oath of office, etc.; and
- Provide oversight of VTA's financial management, policies, controls, practices, and financial statement disclosures.

Revalidate the Board's Role in VTA Policy Making. It is imperative that the Board engage its Standing and Advisory Committees to provide input into policy decisions for the benefit of regional stakeholders. The Board should remain focused on establishing general policies and charge the GM with responsibilities for developing initiatives and actions consistent with Board policy. The Board, in turn, will be able to evaluate whether the organization's programs are consistent with Board policy and whether the desired outcomes were achieved.

Revisit the Board Standing Committee Structure in 2008. As previously noted, Hay believes that the Standing Committee structure could be effective under good governance practices. However, we recommend that the Board revisit the Standing Committees' effectiveness during fiscal year 2008 as part of the annual Board self evaluation, and make any adjustments deemed necessary.

Reduce the Number of Advisory Committees. VTA should develop and evaluate a plan to incorporate the duties of the Technical Advisory Committee into the mission and responsibilities of the Policy Advisory Committee. VTA should also consider revising the membership so that elected officials would continue to serve as Committee members but designate the alternate position to be filled by the senior professional in the jurisdiction (City Manager). This approach would help ensure that the Policy Advisory Committee members have the benefit of business and/or technical analysis conducted by professional staff in their jurisdiction for the policy matters that they consider.

Change the Oath of Office to Require a Regional Focus. The GM and Board Chair should reach out to appointing authorities to educate them about the requirements of enabling legislation for their respective appointments to the Board. To serve the region and the jurisdiction effectively, VTA should consider changing its Oath of Office for the Board to include commitments to: (1) avoid the appearance of conflict; and (2) take a regional perspective when making policy decisions.

Conduct of Board and Committee Meetings. VTA's Board meetings need to be conducted in a collegial and professional manner, with a focus on pre-established agenda items set forth in Committee work plans that are mutually



developed by the Board and Committee Chairs. Items for Board action should first be reviewed and recommended by the appropriate Advisory Committee and then by the appropriate Standing Committee. The practice of having all items reviewed by all committees should be discontinued. Items that are recommended for approval to the Board by a Standing Committee should be reported out and a motion made by the Chair of the Standing Committee. The item should not be presented at the Board meeting. The Board should continue to use the Consent Agenda for appropriate items. Board members should be able to request that individual items be removed from the Consent Agenda and considered by the Board. Items on the Consent Agenda should not be presented at the Board meeting.

Improve the Quality of Information that the Board Receives. VTA staff should revise the structure and content of the Board Package of materials. Staff should also develop a format and a review process that ensures meaningful, actionable policy recommendations and clear, concise supporting information, including short and long term impacts on VTA's financial condition, expenditures, and reserves. The Board package should be designed to serve the needs of all Board members, including those Board members who do not have full time staff support.

B. Operate VTA Like a Business

VTA needs to operate more like a for profit business with a focus on financial viability and stability, while fulfilling its non profit regional transportation mission. In this way, VTA will enhance its ability to deliver the quantity and quality of regional transportation services in the most financially effective manner.

Establish Goals, Objectives and Performance Management Processes for the Executive Management Team. VTA should update the accountabilities for C-Level staff, taking special care to clearly define accountabilities for core leadership processes such as strategic planning, capital budgeting, and operations budgeting. In addition, interdependencies between the GM's role and the C-Level roles should be clearly defined. The GM and executive management team need to develop a new strategic business plan for the Agency. This new strategic business plan should be accompanied by goals that can be quantified and measured while at the same time tied to VTA's mission. Once the performance measures are established, a system should be developed which will allow for the integration of the organization's activities with the measures used to gauge their performance. These activities need to be managed to drive the results to the highest levels of performance.

VTA should ensure that it updates its executive performance management program to include communicating about performance, providing feedback, and holding executives accountable for their individual and collective impact. Performance metrics should consider measures that engage the interrelationships between VTA's strategy and its business/operational component.

Delegate Appropriate Authority, and Accountability. Hay recommends that VTA make substantial changes to its organizational structure to support the revised mission



and vision. VTA executive leadership must provide more clarity, focused accountability, and fiduciary responsibility for VTA's lines of business and key functions, including transit services, planning and congestion management, engineering and construction, and capital project management.

Require That All Decisions Be Made Within Financial Constraints. VTA needs to ensure that all decisions with financial implications are properly evaluated.

Initiate A Program to Identify and Implement Required Controls. VTA's program should use technology based approaches to implement controls, analysis and reporting.

C. Align VTA's Mission With Its Operating Practices

VTA's regional focus on transportation solutions that help manage congestion and improve mobility should be the benchmark used to evaluate programs, processes and operating practices within VTA, as follows:

Revise VTA's Mission to Focus on Transportation as a Core Business. VTA's vision and mission are very broad and seemingly expensive to achieve. Hay recommends that the Board gain a thorough understanding of the current and projected financial constraints and challenges facing VTA, and develop and adopt a new Vision and Mission that is more focused and financially achievable. The COA effort that is underway provides an opportunity for VTA to reinvent itself as a transit service provider. An updated vision and mission will also provide a framework within which VTA can establish and implement a transformational strategy that moves the organization towards sustainability.

Develop a Comprehensive Transformational Strategy and Plan. The "business transformation" strategy and transitional organizational structure must be put in place to support VTA in making the transition to a mature and sustainable business. This transformation strategy should encompass decisions about appointments or contracts for the three key transition officers (Chief Transformation Officer, Chief Financial Officer, and Chief Administrative Officer). Specific recommendations for cash management, budgeting, financial controls and changes to key financial management positions need to be implemented. A change management program that proactively provides training and assistance to the staff at VTA to help them make the transition to the new organization needs to be procured and implemented. As VTA begins its business transformation, it should have a clear idea of the end-game organizational structure that it is evolving towards.



D. Align the Organization Structure and Executive Team with the New Strategy

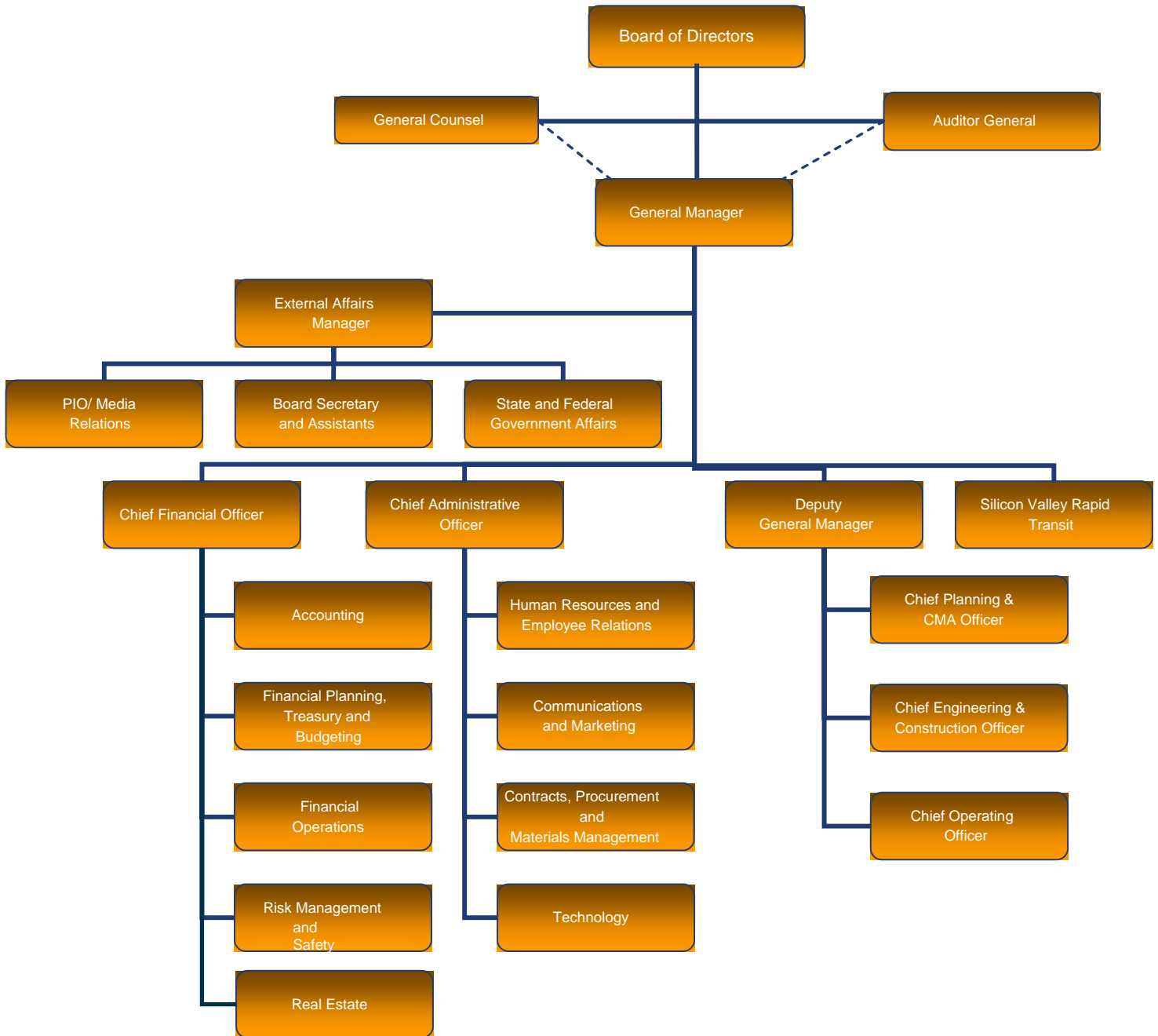
Hay recommends that VTA make substantial changes to its organization structure to support VTA's new direction. The most important and overarching requirement of the new structure is that it must enable VTA executive leadership to work with the Board to establish and implement an appropriate forward looking mission, vision and strategy. The structure must also:

- Support VTA's ability to address the increasing criticality of strategic leadership, external communications and external relationship management;
- Provide more clarity, focused accountability, and fiduciary responsibility for VTA's lines of business and key functions, including transit services, planning and congestion management, engineering and construction, and capital project management (including SVRT); and
- Help put VTA management and staff in a position to address the many issues identified throughout the Technical Memorandum.

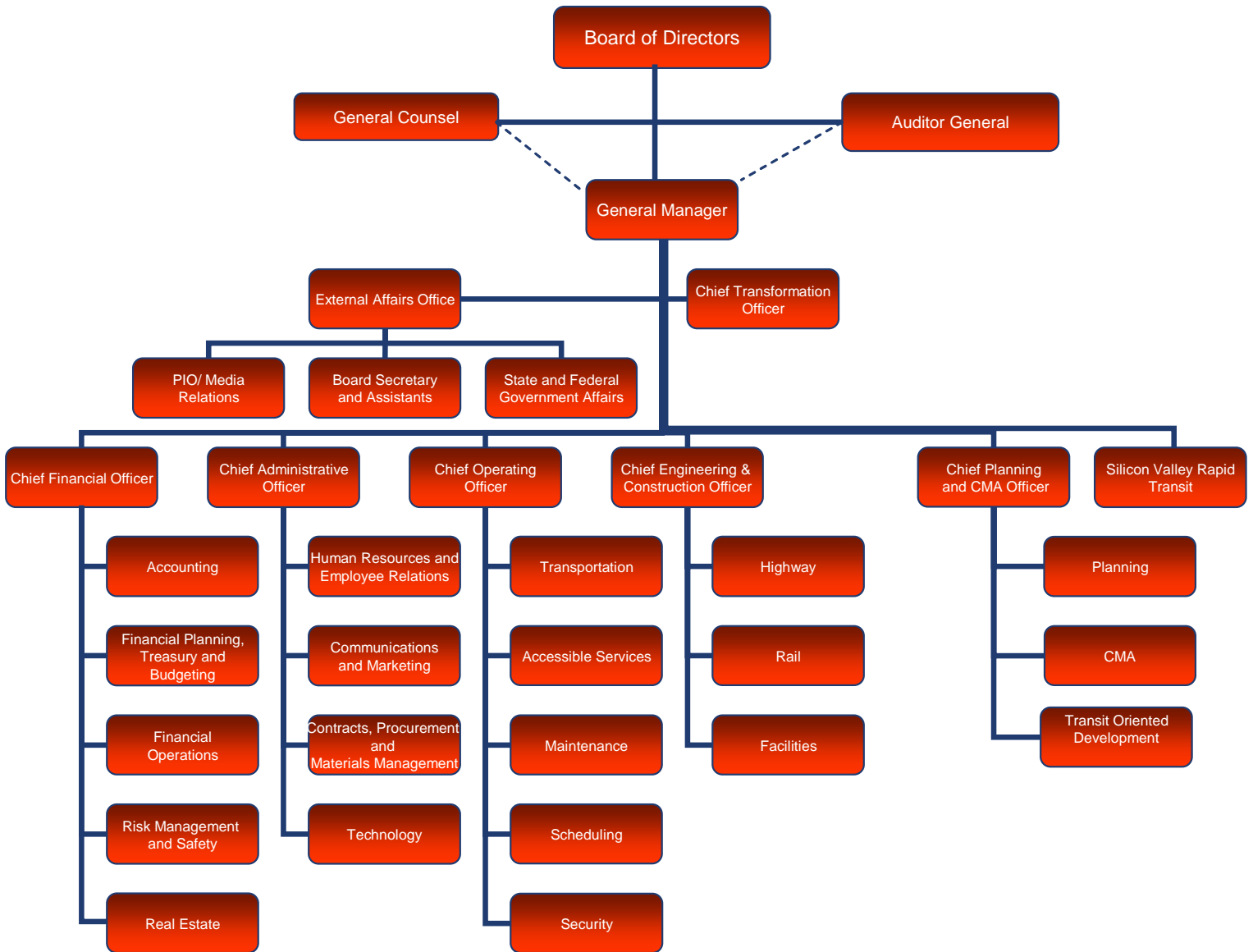
Hay developed two recommended organization structures, which are shown on the following pages:

- *Longer Term Structure:* As VTA begins its business transformation, it should have a clear idea of the end-game organizational structure toward which it is evolving. The Long Term Structure depicts this longer term vision.
- *Transitional Structure:* In line with our recommendation that VTA move quickly to define and initiate a strategic business transformation, we developed a recommended transitional structure that VTA can implement in the near term to support rapid change.

Model Longer Term Structure



Model Transitional Structure



Following are key near term steps VTA should take to implement the transitional structure and align the executive team with VTA's strategic business transformation.

- **GM Define and Communicate the Vision and Near Term Structural Changes.** Hay believes that our structural recommendations reflect a correct framework for organizational change at VTA. That said, the GM is clearly the ultimate arbiter of specific structural changes (and other strategic and organizational changes). The GM will need to define and communicate the new structure, as part of his effort to convey his ownership of the overall change agenda to the organization.
- **Appoint or Hire a Chief Transformation Officer.** The GM should select a Chief Transformation Officer who would be accountable for providing daily leadership in transforming the organization, its culture, and business processes.
- **Create the Office of External Affairs.** Hay recommends that VTA implement an Office of External Affairs with a single overall manager, to consolidate external communications to stakeholders and facilitate clear and consistent messages to external parties.
- **Select and Appoint the New Executive Management Team.** Create a true executive team to support the GM's decision making and establish the team's direction, structure, composition, norms, support and development requirements.

E. Improve VTA's Financial Condition and Stability

VTA must focus on improving its financial condition and stability through the implementation of proper financial planning, budgeting and controls. Hay recommends the following actions:

Balance VTA's 30 Year Revenue and Expenditure Plans. VTA must face its financial challenges early, by Fund, in order to have the lead time necessary to plan for and resolve these challenges. This includes balancing VTA's 30 Year Revenue and Expenditure Plans for Measure A and Enterprise Funds. VTA should identify short term and long term strategies to operate and build transportation systems within VTA's financial constraints. Recognizing that balancing and managing a 30 Year Revenue and Expenditure Plan is dynamic, VTA needs to perform its financial projections, planning, and operations in a realistic manner.

In a controlled financial environment, the CFO and the Fiscal Resources Division should proactively manage and oversee VTA's 30 Year Revenue and Expenditure Plan. The CFO should be engaged in the operational aspects of the organization and act and communicate concerns to the GM, the Board, and division managers to protect VTA's assets.



Develop an Effective Asset Management System. Hay provides the following recommendations with regard to effective asset management:

Cash. VTA must enhance its controls over cash and establish cash flow budgeting, cash flow expenditures and actual vs. budget reporting. VTA should review the investment returns on its fiduciary cash and investment accounts.

Real Estate. VTA needs to implement processes to properly identify and inventory its real estate holdings. Upon completion of the inventory, VTA should develop strategies to maximize its financial returns on its real estate, where appropriate.

Capital Project Planning and Maintenance. VTA should establish a long term capital asset planning process, which should include adequately planning for maintenance programs, future replacement, or renovation of assets. VTA should also actively manage funding related to enterprise information technology project commitments.

Strengthen Financial Reporting for VTA Decision Making. VTA's financial stability projections, models, and financial reporting capabilities should be strengthened to provide a capability for stress testing and contingency scenarios. VTA's financial reporting should be straight forward and provide the Board with a clear picture of its financial condition on a short and long term basis.

Provide the True Picture of VTA's Financial Condition and Liquidity. VTA must present a true picture of financial performance, which can only be displayed and understood by short term, medium term and long term budgeting. VTA also needs to separate, analyze and manage cash flows and budgets for its various Funds, to isolate and manage the finances for different parts of VTA's operations and capital asset additions. VTA's financial statements should depict the VTA's true performance, financial condition, and ability by Fund, to meet its mission, goals and objectives. This would enable the Board to identify and understand structural deficits, face financial challenges and shortfalls, and facilitate timely and appropriate action.

Institutionalize Full Disclosure about the Short and Long Term Financial Consequences of Proposals. The CFO should establish a format, training agenda, and communications forum with the GM, the Board, and division managers, to provide meaningful financial analysis.

Include Financial Policy as a Prominent Part of Board Fiduciary Duty. In the Director Orientation Program, the Board should include appropriate training about fiduciary responsibilities to protect VTA's assets, which includes an appropriate internal control structure. This training should also provide the Board with the tools necessary for analyzing future policy decisions and conducting well informed policy deliberations. This will facilitate the exchange of information and enable the Board to make difficult decisions about regional transit policies while avoiding decisions that are in conflict with VTA's mission.



Identify and Promote Financial Strategies within VTA. The CFO should be a proactive leader in developing financial strategies to address VTA's fiscal challenges. Hay recommends that these issues be given priority attention.

Explore Measures to Reduce Unfunded Pension and Retiree Healthcare Obligations. VTA should develop alternatives to mitigate the impacts of increasing levels of unfunded obligations, including the restructuring of pension and healthcare benefits under existing labor agreements. In addition, the CFO and Fiscal Resources organization should take an active role in monitoring investment strategies and performance to increase the yield of pension and retiree healthcare plan assets. Moreover, the actuarial assumptions of each plan should be challenged in light of current economic circumstances to ensure that a realistic picture of VTA's unfunded actuarial liability is understood and appropriately incorporated into its 30 Year Revenue and Expenditure Plan.

Create New Revenue Sources for VTA. The CFO should drive VTA's development of alternative revenue sources and implementation of action plans that pursue additional funding. This should include consideration of the full range of potential sources (state or federal, additional grants, endowments by private sector individuals or organizations, public debt, etc.). VTA should consider forming partnerships with other government agencies, not-for-profits and private companies to promote VTA's financial stability. VTA's Administration and Finance Committee should approve and monitor the CFO's progress in achieving its new revenue sources.

Close the Gap Between Capital Project Demands and Funding. VTA needs to make difficult choices in order to live within its existing financial constraints, and in making these choices it needs to ensure adequate funding for maintenance and operations. VTA will need to close the gap by prioritizing its capital project demands to align with financial funding commitments that have been obtained. This prioritization will remain dynamic given that project requirements and funding availability will change. VTA should prepare and present several realistic short and long term funding and capital project scenarios, and provide them to the Board for their consideration and action. These analyses will help inform the Board as it establishes capital project priorities that benefit the region.

Reduce Reliance on Operating Reserves. VTA has continued to draw on its operating reserves to fund its financial shortfalls. VTA needs to manage its finances conservatively to build up its reserves, so that the reserve can serve as a cushion for emergencies (as originally designed).

F. Build Commitment to the Commercial Development Program

The revenue potential for VTA through its Commercial Development Program is extremely high, as indicated by its first solicitation (which could garner as much as \$22 million for the West San Carlos site). Consummating the deals is difficult at best, as evidenced by VTA's recent experiences with the previously mentioned transaction as well as the Capital LRT joint development project. For VTA's Commercial



Development Program to succeed, VTA leadership needs to understand basic development principles, commit to the program's goals and objectives, and adhere to the policies and procedures set forth by VTA's development experts. This commitment should include establishing an account for the revenue generated by the Commercial Development Program, and developing a philosophy about how program revenues will be used. Without these initiatives, the program will not succeed.

G. Make VTA a Better Place to Work

VTA should implement the following recommendations to improve its work environment.

Establish Norms for the Conduct of Business. VTA should review its 1995 Code of Conduct. Among other things, this review should encompass whether it is current, given some of the momentous events that have taken place in the last 12 years (internet proliferation in the work environment, Sarbanes-Oxley and the related focus on fiduciary responsibilities, physical safety threats and concerns, etc.).

Communicate the Need for and Purpose of VTA's New Mission, Strategy, and Structure. Effective, interactive internal communications methods and strategies are the responsibility of the entire organization, starting at the top. While marketing and communications staff should be charged with facilitating and managing the process, every executive and manager in the organization has the responsibility to communicate effectively with staff. This concept is crucial to the successful implementation of VTA's new mission, strategy, and structure and the other recommended changes contained in this report. Creating a work culture where staff know what is happening and have access to feedback mechanisms will greatly enhance employee morale and create a healthier organizational climate.

Establish and Communicate Roles and Responsibilities on a Broad Basis. VTA should update the accountabilities for all positions within the Agency, taking special care to clearly define accountabilities and interdependencies for core business processes. These expectations should be communicated with individual personnel on a consistent basis to promote successful implementation of new responsibilities and performance and behavioral expectations.

Establish and Implement a Performance Management System. The current methods used to evaluate employee performance do not appear to be consistently applied, well understood, or effectively utilized. We recommend a comprehensive review of VTA's performance management system to ensure that it is aligned to support the business transition and can be effectively communicated and applied, to enable sound personnel planning, recruitment, and retention decisions.

Create and Implement an Organizational Development Plan. VTA should implement an Organizational Development Plan to build organizational capacity throughout the Agency. Human Resources should lead the development and assessment of core competencies required to achieve organizational priorities at all levels. VTA should assess its current capabilities relative to these core competencies



and design recruiting/selection, development, performance management, promotional and compensation approaches that support their development.

Make Training a Priority. An important aspect of VTA's organizational development is ensuring that sufficient financial and staff resources are allocated to training opportunities that reinforce competencies, skills and behaviors (as identified by the Organizational Development Plan). This investment in training will pay off in the form of skilled workers that are knowledgeable about VTA and able to perform their assigned responsibilities effectively during and after the business transformation.

H. Upgrade the SAP System

VTA needs to immediately initiate a project for the implementation of the latest upgrades available for its SAP software, to avoid future unsupported maintenance problems. VTA made a \$40 million investment in this technology platform, which supports many of VTA's core business activities. The upgrade, which was originally planned for the 2005 to 2006 timeframe and subsequently delayed until 2007 to 2008, is required to keep this infrastructure investment in a state of good repair. VTA also needs to consider implementing new modules that support VTA's operational and financial transformation initiatives.

I. Develop a Labor Negotiation Strategy that is Aligned with VTA's Financial Capabilities

VTA should develop a labor contract negotiation strategy that reflects the context of its existing expenditure constraints. This strategy should encompass changes in pay, the benefits structure, and retirement provisions. The Chief Administrative Officer should research recent labor contract negotiating results for model approaches to addressing similar issues. VTA should extend its labor – management partnership to contract negotiations.

J. Recap of Top Nine Recommendations

The table on the following pages provides a recap of the nine top level recommendations and their major subcomponents (where applicable).



Recap of Top Nine Recommendations

Recommendation	Elements Described in Section IV
<p><i>Implement Governance Processes and Practices to Enable Transformation</i></p>	<ul style="list-style-type: none"> • Adopt the Spirit of Sarbanes-Oxley Practices, where applicable <ul style="list-style-type: none"> ✓ Establish an Audit Committee ✓ Implement an Auditor General function ✓ Establish Board training on duties and responsibilities ✓ Focus the Board on its fiduciary responsibilities ✓ Conduct annual Board self evaluations • Make the Board Structure Function Effectively <ul style="list-style-type: none"> ✓ Make the GM a Board member ✓ Develop an annual Board Work Plan ✓ Revalidate the Board's role in VTA policy making ✓ Revisit the Board Standing Committee structure in 2008 ✓ Reduce the number of Advisory Committees ✓ Change the Oath of Office to require a regional focus ✓ Improve the conduct of Board and Committee meetings • Improve the quality of information that the Board receives
<p><i>Operate VTA Like a Business</i></p>	<ul style="list-style-type: none"> • Establish goals, objectives and performance management processes for the executive management team • Delegate appropriate authority and accountability • Require that all decisions be made within financial constraints • Initiate a program to identify and implement required controls
<p><i>Align VTA's Mission With Its Operating Practices</i></p>	<ul style="list-style-type: none"> • Revise VTA's mission to focus on transportation as a core business • Develop a comprehensive transformational strategy and plan
<p><i>Align the Organization Structure and Executive Team with the New Strategy</i></p>	<ul style="list-style-type: none"> • GM define and communicate the vision and near term structural changes • Appoint or hire a Chief Transformation Officer • Create the Office of External Affairs • Select and appoint the new executive management team



Recap of Top Nine Recommendations

Recommendation	Elements Described in Section IV
<i>Improve VTA's Financial Condition and Stability</i>	<ul style="list-style-type: none"> • Balance VTA's 30 Year Revenue and Expenditure Plan • Develop an effective asset management system <ul style="list-style-type: none"> ✓ Cash ✓ Real estate ✓ Capital project planning and maintenance • Strengthen financial reporting for VTA decision making <ul style="list-style-type: none"> ✓ Provide the true picture of VTA's Financial Condition and Liquidity ✓ Institutionalize full disclosure about the short and long term financial consequences of proposals • Include financial policy as a prominent part of Board fiduciary duty • Identify and promote financial strategies within VTA <ul style="list-style-type: none"> ✓ Explore measures to reduce unfunded pension and retiree healthcare obligations ✓ Develop new revenue sources for VTA ✓ Close the gap between capital project demands and funding ✓ Reduce reliance on operating reserves
<i>Build VTA Commitments to the Commercial Development Program</i>	<ul style="list-style-type: none"> • Commit to the Commercial Development Program's goals and objectives • Adhere to the policies and procedures set forth by VTA's development experts • Establish an account for the revenues generated by the Program, and develop a philosophy about how these revenues will be used
<i>Make VTA a Better Place to Work</i>	<ul style="list-style-type: none"> • Establish norms for the conduct of business • Communicate the need for and purpose of VTA's new mission, strategy, and structure • Establish and communicate roles and responsibilities on a broad basis • Establish and implement a performance management system • Create and implement an Organizational Development Plan, making training a priority
<i>Upgrade the SAP System</i>	<ul style="list-style-type: none"> • Immediately initiate a project for implementing the latest upgrades for the SAP software • Consider implementing new modules that support VTA's operational and financial transformation initiatives
<i>Develop a Labor Negotiation Strategy that is Aligned with VTA's Financial Capabilities</i>	<ul style="list-style-type: none"> • Develop a labor contract negotiation strategy that reflects the context of the existing expenditure constraints • Extend VTA's labor – management partnership to contract negotiations



IV. Implementation Considerations

The timetable depicts the effort that will be required to complete the key recommendations outlined in this Report:

<u>Days</u>	Transformation Planning	Transformation Implementation	Governance	Financials	Program	Organization
30						
60						
90						
120						
180						
360						

Hay’s conclusion is that VTA does not have sufficient resources of experienced personnel to effectively address all of the nine key recommendations in a one year timeframe, as requested by the General Manager. Implementing these recommendations in one year is an ambitious objective, yet critical to VTA’s success.

Hay recommends that a Transition Plan be developed in the next thirty (30) days which will include Board members and management staff as participants in the process. A Transition Team of experienced external professionals should be considered, to establish and complete a detailed action plans with VTA staff participation. This will enable knowledge transfer to VTA staff during the transformation and retention of Agency processes upon completion.



Appendix: Summary of Divisional and Program Specific Recommendations

- Summary of Divisional Recommendations
- Summary of Program Specific Recommendations



**Appendix: Summary of
Divisional and Program Specific Recommendations**
*Summary of Divisional Recommendations
(from Technical Memorandum Part II)*

Division	Reference Section	Recommendations
Operations	TM Part II.I	<ul style="list-style-type: none"> • Refocus on transit as a core business function at VTA and reexamine staffing levels. • Move materials management functions out of Operations and consolidate Q/A and warranty functions in the Maintenance Engineering group. • Continue to monitor and analyze key performance indicators for service reliability. • Consolidate operations planning functions under one department and elevate the level of responsibility. • Consider operating smaller trains and/or increasing the number of single cars operating during off peak periods. • Review the role and functionality of the Operations Manager position. • Absenteeism: <ul style="list-style-type: none"> ✓ Analyze the current ATU attendance program in preparation for the next negotiations. ✓ Consider revising the points based system to include missed work days instead of occurrences. Revise program definitions of lateness and remove these incidents from the occurrence definition. • Service Planning: <ul style="list-style-type: none"> ✓ While the TSP and COA efforts continue, consolidate the service planning functions under one department and revitalize and elevate the service planning function. ✓ While the COA process is underway, service planning should produce regular updates regarding the Service Management Plan, to coincide with the quarterly Transit Operations Performance Reports. ✓ Set productivity standards for light rail service and include these performance measures, by line, in the quarterly reports. ✓ Consider adjusting service standards less frequently.
Construction	TM Part II.II	<ul style="list-style-type: none"> • Consolidate all Engineering and Construction functions into a new Engineering and Construction Division. This Division should be responsible for all engineering and construction activities (except SVRT), beginning with preliminary engineering through construction to turnover of the facility to VTA Operations, City or State Agencies. • Create a SVRT Project Office reporting directly to the GM. This Office should have complete responsibility for delivery of the SVRT Project, and should also be responsible for working with federal, state and local officials to satisfy requirements to secure approvals and a full funding grant for the project. • Transfer all construction accounting activities to Fiscal Resources. • Formalize, document and implement a Project Delivery Model that requires collaboration between the Development and Congestion Management, Construction, Operations, Fiscal and Administration divisions. • Update the Construction Division Administration manual to include current organization structure, roles, responsibilities, policies and procedures.



**Appendix: Summary of
Divisional and Program Specific Recommendations**
*Summary of Divisional Recommendations
(from Technical Memorandum Part II)*

Division	Reference Section	Recommendations
Administrative Services	TM Part II.III	<ul style="list-style-type: none"> • Reconfigure the Human Resources functions to support VTA's core organizational requirements. • Develop a labor contract renegotiation strategy in the context of expenditure constraints. • Strengthen recruitment and retention processes to respond to organizational needs in an effective and timely manner. • Lead processes for assessing and developing core competencies required to achieve VTA's organizational priorities at all levels. Review the Executive Management Succession Planning Program to determine its match with competency requirements at the executive level. • Institute workforce planning processes that reflect current and projected workforce needs at all levels of the organization. • Develop an integrated performance management and compensation strategy linked to the VTA's core business goals. • Review policies and procedures to ensure that they are current.
Development & Congestion Management	TM Part II.IV	<ul style="list-style-type: none"> ▪ Attain Board commitment to the Commercial Development Program. ▪ Delineate Congestion Management Agency (CMA) functions and consolidate into a single, identifiable department. ▪ Create a Public Information Officer position. ▪ Integrate Operations staff more fully into the COA. ▪ Appoint a Deputy Director of Planning. ▪ Move Real Estate functions to Financial Resources. ▪ Investigate Ways to Create a Profit Center within the DCMD. ▪ Reposition Marketing & Public Relations: <ul style="list-style-type: none"> ✓ Merge policy & Community Relations functions with Government Affairs ✓ Pursue technology based customer service support mechanisms ✓ Assess Call Center staffing structure and needs ✓ Embrace internal organizational communications strategies and methods ✓ Decentralize Budget Authority

**Appendix: Summary of
Divisional and Program Specific Recommendations**
*Summary of Divisional Recommendations
(from Technical Memorandum Part II)*

Division	Reference Section	Recommendations
Fiscal Resources	TM Part II.V	<ul style="list-style-type: none"> ▪ Fiscal Resources, and the CFO in particular, should become more integrated into VTA's governance and operations and become more influential throughout the organization, to ensure that VTA decisions are informed by appropriate financial information/advice and that projects and programs are fiscally sound. ▪ Improve the functional policies and related processes and systems: <ul style="list-style-type: none"> ✓ Establish strong budgeting, planning and cash management controls. ✓ Use the budget process to proactively identify financial stability issues. ✓ Establish a framework for coordinating financial analysis for projects/initiatives, using a standard methodology and uniform set of assumptions; simplify and standardize methods for presenting the financial impact of initiatives. ✓ Improve the technology/tools that the Division uses, e.g., for managing controls and financial reporting. ▪ Reorganize/realign the Division's leadership and functional structure: <ul style="list-style-type: none"> ✓ Restructure the CFO and Controller roles, requirements and desired capabilities, and ensure that Division leadership can fulfill its role in VTA's strategic transformation. ✓ Move the following <i>out of</i> Fiscal Resources: procurement and pension benefits functions (Administrative Services); and contracts compliance (to the Auditor General). ✓ Move the following <i>into</i> Fiscal Resources: Construction's contract accounting and payment processing functions; Congestion Management's real estate function; and Administrative Services' Risk Management and Safety functions.

**Appendix: Summary of
Divisional and Program Specific Recommendations**
*Summary of Program Specific Recommendations
(from Technical Memorandum Part IV)*

Topic	Reference Section	Recommendations
Employee Benefits	TM Part IV.A	<ul style="list-style-type: none"> • To enhance benefits, consider (1) providing a death benefit plan that is based on a multiple of salary; and/or (2) revising dental coverage to the most common coverage (100/80/50). • Consider the following to reduce costs: <ul style="list-style-type: none"> ✓ Increase the employee contribution for medical coverage. ✓ Focus on the needs of chronically ill employees in the work force, through disease management programs aimed at increasing self care efforts. ✓ Research a consumer driven medical coverage option. ✓ Continue to be vigilant in monitoring increases in health care costs and keep deductibles, co-payments and out of pocket allowances competitive with market practice on an ongoing basis.
Workers' Compensation	TM Part IV.B	<ul style="list-style-type: none"> • Continue to focus loss control initiatives on employees as the primary parties responsible for risk control. Continue the loss control initiatives that are currently in place, including weekly tailgate sessions, monthly facilities inspections, monthly Joint Safety Committees with unions and management, and monthly operations meetings to review claims and identify areas for improvement. • Continue to require management to stay in frequent contact with their injured workers. • Continue the transitional work program and the use of a medical provider network. • Design a cost allocation system to motivate participation in risk control programs. Revive the back injury prevention training program. Pursue a wellness program for bus drivers. • Keep interest earned on workers' compensation funds in the funds, instead of letting it revert to the general fund. Move the funds associated with the workers' compensation program to the Risk Management Department, which is responsible for the program. Evaluate and reorganize the Department's cost center codes to ensure that they will be more effective going forward. • Ensure the accuracy of statements in future CAFRs regarding VTA's retentions for workers' compensation program. Ensure accurate completion of future Self Insurer's Annual Reports. <p><i>Vendor Use, Selection and Management</i></p> <ul style="list-style-type: none"> • Test the market for excess insurance to determine if the cost is currently worth the risk transfer. • Work with an outside consultant to retool the vendor hiring process and requirements for claim administration, actuary and medical management. • Direct the claim administrator to implement changes recommended in the claim administration audit report. • Direct the current actuary to revise the actuarial report to correct the problems outlined in Hay's full report. Pending that, VTA should consider using the limited loss estimates provided in Hay's full report to revise its budget for fiscal '07. • Pursue appropriate reductions in the cost of claim administration services. Remedy overcharging for medical management services, retroactively and going forward.
ATU Pension Plan	TM Part IV.C	<ul style="list-style-type: none"> • Assign the functionality for administration of the plan to Human Resources. • Renegotiate the plan's benefit programs when the ATU collective bargaining agreement is brought up. • Examine investment alternatives, including the mix of timeframes. • Examine and assess risks and controls within a comprehensive framework.



**Appendix: Summary of
Divisional and Program Specific Recommendations**
*Summary of Program Specific Recommendations
(from Technical Memorandum Part IV)*

Topic	Reference Section	Recommendations
Paratransit	TM Part IV.D	<ul style="list-style-type: none"> • Develop a general plan for improving the information flow and working relationship between VTA and OUTREACH (VTA's paratransit contractor). • Audit financial records and databases to ensure that resources are being used efficiently, as allowed by the Agreement between VTA and OUTREACH. VTA does not appear to have conducted such an audit since 2002. • Work with OUTREACH to ensure that OUTREACH's current reporting and invoicing processes are providing VTA with the information it needs when it needs it. • Revisit the Paratransit Business Practice Improvement Plan to identify opportunities for further expense reductions.
Contracted Services	TM Part IV.E	<ul style="list-style-type: none"> • Perform a comprehensive review of all contracted services and assess the impact of these agreements on internal staff, funding and daily operations. • Review negotiating procedures and set goals/standards for similar contracts. Ensure that appropriate contractual obligations for data collection, reporting, meeting attendance etc. are in place and being monitored and fulfilled.
Security	TM Part IV.F	<ul style="list-style-type: none"> • Fill the Chief of Protective Services position. • Move responsibility for grant application and grant management out of the protective services department. • Revisit security contracts with Santa Clara County Sheriff's and Securitas, and revisit protective services staffing and deployment.
Procurement	TH Part IV.G	<ul style="list-style-type: none"> • Review and modify evaluation processes, to assure that the numerical scoring system results in sound business decisions. • Create cross functional teams for complex purchases. • Implement vendor scorecards to help staff monitor suppliers and communicate issues to suppliers.
Information Technology	TM Part IV.H	<ul style="list-style-type: none"> • Upgrade the current SAP application and migrate to Public Sector Solution. • For IT governance, assign separate TWG and TSC leadership, and combine the TSC and CPOC. Revisit the evaluation criteria used to approve projects to limit the number of projects that are approved each fiscal year. Prioritize internal IT projects and ensure that they are aligned with major capital projects. • Study resource allocation to align existing resources with ongoing projects and to acquire additional resources where necessary. Hire candidates with experience in the Agency's key operational applications, such as Trapeze, SCADA, or train existing staff on those applications. • Design a career progression path for technology professionals and establish succession path for key employees. Design incentives to retain SAP professionals. Conduct cross functional training for SAP professionals to support regular application in case of absences or emergency. • IT should conduct a cross functional session with client departments to develop SLAs, and develop key performance indicators and metrics in line with departmental goals and objectives.

