

Audit Committee

Meeting date: January 13, 2010

ADVISORY INFORMATION

Date:	January 13, 2010
Subject:	Risk Assessment and Audit Plan for 2010
District(s), Member(s):	All
Policy/Legal Reference:	Audit Charter, IIA Standard 2010, 2020
Staff Prepared/Presented:	Kathleen Shea, Director
Division/Department:	Program Evaluation and Audit

Proposed Action

That the Audit Committee accept the proposed Risk Assessment and Audit Plan for 2010 as the direction for the Program Evaluation and Audit Division.

Background

The Metropolitan Council's Audit Charter and the Institute of Internal Auditor's *Internal Standards for the Professional Practice of Internal Auditing* require that the Chief Audit Executive/Director develop, in consultation with organizational leadership, an annual assessment of risks to the organization and an audit plan for the review and approval by the Audit Committee.

Rationale

By using an inclusive and consultative process, the Risk Assessment provides a means for creating a risk profile for the Council and all of its diverse functions. By doing so, it enables the Director to develop an audit plan which targets audit resources to those areas where they can provide the greatest benefit to the Council.

Leadership teams from all areas of the Council, including Transportation, Community Development, Environmental Services, and Regional Administration, are involved in development of the risk assessment and audit plan, helping to ensure that the resulting plan represents a broad, but inclusive view of the organization.

The complete Risk Assessment/Audit Plan Document is attached for review and discussion.

Known Support / Opposition

None.

Program Evaluation and Audit RISK ASSESSMENT/AUDIT PLAN 2010 FOR CONSIDERATION OF THE AUDIT COMMITTEE January 13, 2010

Requirements of the Standards

In the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing*, standard 2010 deals with audit planning, and requires, in part:

- That the chief audit executive (Director) establish risk-based audit plans to prioritize internal audit activities consistent with the organization's goals.
- That the audit plan should be based on an annual risk assessment created with the input of senior management and the board.

This document represents the risk assessment for 2010, as well as the proposed audit plan based on that assessment.

Risk

Risks to the Council can take many forms. Perhaps the most obvious is financial risk, where funding or the use of funding involves some risk taking. However, there are other types of risk to the Council that should be considered in an organization-wide risk assessment.

- Reputational Risk in a public organization like the Council is crucial. Harm to the Council's reputation can affect availability of discretionary funding from local, state and federal governments, and can adversely impact the Council's relationship with taxpayers in the Region.
- Similarly, program risk can affect how the Council operates. If programs are ineffective or fail to achieve their objectives, that too can have adverse effects on the Council.

This Risk Assessment attempts to consider all relevant risks to the Council and assigns audit resources accordingly.

Organization of Report

This report is organized in three parts:

- The Council's Risk Environment and general risks anticipated in 2010 and beyond,
- Specific risks affecting programs or activities of the Council,
- Proposed Audit Plan for 2010, taking into account the risks and priorities of the Council.

Methodology of Assessment

Given the breadth of the activities of the Metropolitan Council, Program Evaluation and Audit takes an inclusive approach to Risk Assessment and Audit Planning. Meetings are held with the management team of each division to discuss their perspectives on risks to

the Council generally, and on risks specific to their activities. Divisional meetings were held with:

- Metro Transit,
- Metropolitan Transportation Services,
- Environmental Services,
- Community Development,
- Regional Administration.

A draft of this assessment was also provided to the Regional Administrator's Executive Team for review and discussion prior to the presentation to the Audit Committee.

GENERAL RISK ENVIRONMENT

The Metropolitan Council focuses on a number of policy areas:

- Environmental Services works to protect the public health and the environment by providing efficient and effective water resources management,
- Metro Transit provides bus and rail transit services in the region,
- The Central Corridor Project Office is focused on the development of the Central Corridor Light Rail Line, currently in preliminary engineering, and planning to move into construction during 2010 and operation in 2014.
- Metropolitan Transportation Services oversees transportation planning for the region, as well as contracted transit services, funding for suburban transit providers, and Metro Mobility.
- Community Development informs the land use planning activities of local governments as prescribed in the Land Planning Act; administers grants for the regional parks system, and the Livable Communities Act; and operates a Housing and Redevelopment Authority that administers rental assistance programs in communities throughout the metropolitan area.
- Regional Administration provides centralized support for all of the business units, including service areas like Finance, Human Resources and Risk Management.

In consulting with leadership across the Council, several risks emerged that are Council-wide in nature and could affect the Council as a whole, which are summarized here to provide a picture of the Council's general risk environment.

Recessionary Economy

The economy, nationwide and in Minnesota, continues to be troubling. Although many economists believe that the recession has "hit bottom," the recovery is expected to be the slowest on record. The national unemployment rate, already higher than initially anticipated, is expected to rise even further in 2010 before it begins to taper off in 2011, although the end of 2009 showed an unexpected decline in the unemployment rate in Minnesota. Wage declines and the lack of income growth make it difficult to generate the spending needed for a sustained economy, according to the State of Minnesota's November Forecast.

The effects of the economy on the state's budget continue to be significant. The November forecast estimates a budget deficit of \$1.2 billion for FY2010-2011, 70% of which is due to lower than expected income tax receipts. One slight gain for transit is that there was a small uptick in revenues from the Motor Vehicle Sales Tax in this forecast.

Although the Council relies less on the State's General Fund than many other units of government, the impacts of the cuts that will likely be made in the 2010 Legislative Session will not be known until the session is over.

Population Changes

The overall population, in the region and across the country, is aging. Baby boomers are reaching retirement age and collecting social security and medicare, and demanding services that better meet the needs of a senior population. In the next ten years, one out of every 8 Minnesotan will contemplate retirement. Once they retire, most retirees see a significant decrease in income from what they made while they were working. Median household income for Americans begins to decline at age 55.

The combination of an aging population and a recessionary economy that will likely have a slow recovery could dramatically affect forecasts in the next 10 years and beyond.

The change in the population will affect many key aspects of life, according to State Demographer, Tom Gillaspay. Aged people require housing that can meet the needs of the disabled (without stairs, with accessible showers, etc.) and does not require driving, but has access to public transportation. The call is expected to be for smaller lots and smaller houses to meet goals of affordability and flexibility.

Also, the number of workers leaving the workforce will far exceed the number entering the workforce, leaving potential worker shortages in some areas and less potential for economic growth, which has been fueled by population growth for nearly a century. Moving ahead, growth will require productivity improvements, which can be difficult to achieve, or immigration.

Workforce Changes

At the Metropolitan Council, our workforce is aging and many are rapidly reaching retirement eligibility. The average age of an employee at the Council is currently 48, two years older than the average for even state employees. Many of the retiring employees have amassed critical knowledge and skills during their time at the Council. One area of concern expressed by many managers is how to retain some of the knowledge and skills retiring employees have so that it is not lost when they leave the Council.

Another area of concern is that as the Council's workforce has aged and advanced in skills and abilities, it has outgrown its entry level positions. The majority of current jobs at the Council require education and/or experience that entry level candidates do not possess. As a result, the workforce continues to be older than most. The largest number of hires at the Council are over 49 years of age. The next largest group is between 39 and 48. The smallest group is the youngest group, those just leaving college. To attract younger employees, fundamental changes need to be made to create more entry level positions and opportunities to mentor those employees to advance in their careers at the Council.

An additional challenge for Council staffing issues is the statewide hiring freeze. Most positions that are vacated for retirements, promotions or other departures cannot be replaced due to the nature of the current hiring freeze. Although Council managers clearly understand the current financial challenges, many are frustrated at their inability to staff their programs. One manager said, "We've maxed out on doing more with less. We're down to the bare bones already." Another stated that there were key areas in his division where only one staff member knew how to perform certain key functions. That individual was eligible to retire soon, and there was no one to replace him.

2010 Election

In November of 2010, Minnesota will elect a new Governor (Governor Pawlenty has announced that he is not running for re-election), as well as new legislators and other state offices.

The effects of the election cannot be anticipated until the results are known and the policy positions of winners are revealed. Nonetheless, some change, and some level of disruption, are inevitable during the transition. Current Council members are appointed to serve until replacements, if made, are named. However, generally during this period, the Council does necessary business, but very little policy making or direction setting, leaving key decisions to the new Council. Some initiatives may be on hold during this period and others may have only limited activity.

RISKS TO SPECIFIC COUNCIL OPERATIONS

Community Development

Unlike past years, and even unlike the past century, the growth of the Twin Cities Region will slow dramatically on the heels of the major recession and with an aging population. Although there was originally a growth of 210,000 jobs forecast for this decade, which was thought to be conservative, the revised number will probably be 0. The negative affects of this change would affect all of the Council's programs, particularly some transit programs where we are required to report population forecasts to the federal government to get funding for fixed transit ways.

To better deal with the rapidly changing environment, Community Development (CD) will be the first user of a new software package called Cubeland to aid in the forecasting process. Although there is risk in being the first adopter of any new product, CD believes strongly that this is a tool that will help to enhance the reliability of their forecasts, so that all of those who use the projections across the metro can count on the Council's forecasts and use them for their own local purposes.

The Housing and Redevelopment Authority recently converted the Council's 150 public housing sites to the Section 8 program. At the time of conversion, it appeared that the Section 8 program would better cover the Council's costs in operating and maintaining so many widely spread housing sites. Once a full year of the new program has been completed, it may be worthwhile to re-evaluate the finances of the program to determine if the change has benefitted the Council as intended.

More funding has been allocated to Parks recently than was the case in the past. A large share of it is for trails. However, experience has shown that many people who live in the areas where trails could be created object to having trails running near their property. Resolving these issues and still benefitting parks programs could be a thorny issue.

Transportation

The federal transportation bill is pending action in Congress. The bill contains policy provisions and funding for transit and Metropolitan Planning Organizations, both of which affect the Council. There is discussion about potentially working towards better coordination between transit and highway funding, which have been disconnected in the past, causing some project problems when needs conflict over a particular area.

The Northstar Commuter Rail commenced operations in the fall of 2009. Northstar, like the Hiawatha Light Rail, uses a barrier free boarding system. Questions about ridership and fare enforcement on Northstar have already begun to arise, as they did for Hiawatha. Legislators and funders want to know how ridership numbers are calculated and how likely you are to be checked for a fare when aboard the train.

The Central Corridor Light Rail Project is proceeding toward final design and hopefully construction with a full funding grant agreement from the Federal Transit Administration in 2010. Although this will be the largest public works project ever in the State of Minnesota, it comes with significant risks, some of which have already surfaced. People and organizations along the line have concerns about the effects of construction and operation of a light rail line on their business/home. The University of Minnesota filed suit against the Council over the potential effects of having the trains run near sensitive

scientific equipment. Negotiations between the University and the Council continue in an effort to address the University's concerns and avoid significant delays to the line's construction and a potential loss in federal funding.

Minnesota Public Radio has raised concerns about the effects of vibration on its downtown studio. Businesses are concerned about access and parking during and after construction, and residents worry that CCLRT will divide their neighborhood like I94 did Rondo and that their transportation access will not be improved as promised with the Central Corridor Rail.

There are also compliance risks associated with a project of this complexity. State standards for state General Obligation Bonds must be met, as well as the requirements by the FTA, among which are the involvement of disadvantaged business enterprises, wage rate compliance and Title VI regulations. The surrounding community is well-versed on federal requirements, especially for disadvantaged business enterprises, which are a significant issue for them. This same community area sued the St. Paul HRA for having an inadequate representation from minority businesses.

Demand for additional rail transit continues to grow. As the Central Corridor Light Rail Project progresses toward its final design phase, planning discussions have begun for a new light rail line from the Southwest metro to downtown Minneapolis (project preliminary engineering slated to shift to Metro Transit within the next 6 months), and a third is under discussion for the northern suburbs (Bottineau Boulevard). To date, project staff has included many of the same people moving from one project to the next. However, given the rapid growth in the number of these complex, costly projects going on at the same time, there is a risk that existing staff who have experience with these New Starts projects will be spread too thin, and there will not be sufficient knowledgeable, experienced staff to work on New Starts project teams for the upcoming projects.

Similarly, "back office" functions like finance, human resources and IS, remain at their pre-light rail levels. In essence, the service and the complexity of that service continues to expand, but it does so without any change to the people who manage the funding, the staffing or the systems for such projects. With staff spread so thin, there is a higher risk of errors or things missed in internal control processes, creating a significant risk for Metro Transit, and the Council as a whole.

Environmental Services

The drop in the housing market and reduction in new development in the Twin Cities, due to housing market readjustment and the recession significantly impacted ES' Service Availability Charge (SAC), which is generally charged based on capacity used in new development or redevelopment. The decrease in the SAC reserve fund in 2009 was the largest in organizational history. A task force has been formed to study how to pay for reserve capacity in the system without fees.

ES gave communities Inflow and Infiltration grants to use for projects that would reduce or eliminate inflow or infiltration of storm water into the sanitary sewer system and exceeding its capacity. The grants were generally well received, though a full evaluation of the program is still needed.

ES is a subgrantee from the PFA to ARRA. The stimulus program requires frequent, detailed reports, the details of which are easily overlooked. That is a key concern for

administering these grants, making certain that the ARRA processes and procedures are fully compliant and timely.

AUDIT PROJECTS FOR 2010

Objective

This plan reflects activities where the risk assessment indicates a high priority and high risk for the Council. Approximately 70% of all auditors' time is allocated to this plan. The remaining 30% is left open to allow for consultations, client requests and investigations where needed.

This plan does not include a detailed list of projects for the Central Corridor Project Office. Due to the evolving nature of this project, audit needs are difficult to anticipate in advance and therefore, the plan is left flexible to meet project needs in this early phase. Projects generated through the ongoing risk assessment of CCLRT will be brought to the Audit Committee as they arise.

Given the risks discussed in the previous section and the established priorities of the Council, Program Evaluation and Audit proposes to audit the following topic areas during 2010.

Transportation

- Northstar fare compliance
- Northstar ridership
- Payroll direct deposit for transit employees – savings generated, issues arising
- Reconciliation of fuel with fuel contract
- Utility billings – reconciliation with Transit building records
- Snow removal/groundskeeping contracts

Environmental Services

- ARRA Compliance
- Evaluation of Inflow and Infiltration Grants
- Warehouse Operations

Community Development

- Impact of Conversion of Public Housing to Section 8 Program

Regional Administration

- Asset Management
- IS Outsourcing/Co-Sourcing and Contract Management

In addition, Program Evaluation and Audit performs the following recurring audits each year, at the request of the client organization.

Requested Projects (Recurring)

Transit Farebox Reviews (all garages within the year)

Transit Store Cash Counts (twice per year)

Transit stockroom inventories

Parks Operating and Maintenance Cost Reviews

Environmental Services Overhead Rate Verifications