

**First Transit Contract Compliance Audit
August 2011
Internal Audit Report 11-08**



**Internal Audit
City of Sioux Falls, South Dakota**

FIRST TRANSIT CONTRACT COMPLIANCE AUDIT INTERNAL AUDIT REPORT 11-08

INTRODUCTION

The City of Sioux Falls City Council authorized this audit in the 2011 Annual Audit Program. This is the City's second internal audit of the Sioux Falls transit system. Internal Audit Report 08-02 was performed in 2008. The initial purpose of the 2008 audit was to evaluate compliance of Laidlaw Transit Services agreement to manage the transit system. The second purpose of the 2008 audit was to evaluate Laidlaw's performance in comparison to other transit operations. This current audit was performed primarily to determine compliance with contractual terms. The result of such an audit also helps to determine if City Funds are spent in an appropriate manner, good business policies and procedures are followed and adequate oversight is practiced. Opportunities to improve management control and reduce risk may be identified.

STATEMENT OF INDEPENDENCE

Internal Audit is administratively and operationally independent of the programs and departments it audits, both in appearance and in fact. The Lead Internal Auditor is accountable to an Audit Committee, appointed by the City Council, per City Ordinance 120-05.

BACKGROUND

The City of Sioux Falls (the City) acquired the local public transit system in 1979. While the City owns the buses, buildings and equipment, the day-to-day operations are contracted out to a transit management company.

In 2000, the City entered into an agreement with Laidlaw Transit Services to manage the public transit system. The agreement was amended several times and was subsequently extended through December, 2009. Agreement 09-0035 is the current contract with FT for the management and operation of the transit system. This is a five year agreement that is effective from January 1, 2010 to December 31, 2014. This agreement may be extended by mutual agreement of the parties for two additional one-year terms.

First Group Incorporated acquired Laidlaw International in the fall of 2007. First Group's transit entity in the United States is First Transit of America with corporate offices in Cincinnati, Ohio. According to their website, First Transit (FT) is the largest public sector provider of transit services in North America. It provides services for over 225 locations, which equates to approximately 300 million passengers per year.

The City of Sioux Falls owns the buses and the facilities. The City pays the operating and capital expenses not covered by other revenue sources. FT is paid a management fee to provide the General Manager who has the responsibility to actively manage the transit system. All other transit personnel are employed by SuTran, Incorporated, a wholly owned subsidiary of FT. The City Planning Department is the liaison with FT. The department employs a Transit Planner as the liaison to develop, implement and administer state and federal grants in regard to transit systems. The planner helps ensure that the City maintains eligibility for federal grants.

The Public Transit Advisory Board (PTAB) was established by Resolution Number 101-76 in 1976. The board's purpose is to advise the council, administration and transit management on public transportation issues. The PTAB consists of seven community members that are appointed by the Mayor. The appointments are subject to the review and approval of the City Council.

Sioux Area Metro (SAM) operates 12 regular fixed routes, four school tripper routes during the school year, paratransit services for the elderly and disabled, an evening demand response bus service and a seasonal trolley service for the downtown Sioux Falls area.

The funding for transit services comes from a mixture of fare revenues, advertising sales, City general fund contributions, in addition to state and federal grants. See page eight of this report for a breakdown of the funding sources.

OBJECTIVES

The City often hires professional management companies to operate City facilities. Internal Audit's objective is to review these contracts and agreements to verify that both the City and the management companies are complying with the contracts' stated terms and conditions.

The primary objectives of this contract compliance audit were to:

- 1) Determine if both parties to the management agreement are in compliance with the expressed terms and conditions as outlined in the contract.
- 2) Determine if the internal controls over all forms of revenue, to include cash receipts, grants, fares and bank deposits are appropriate and functioning properly.
- 3) Determine if cash receipts are deposited in a timely, secure and accurate manner.
- 4) Determine if an adequate separation of duties exists among transit employees and if security procedures are in place and being followed.
- 5) Determine if written policies and procedures are adequate, current, properly documented and being adhered to.
- 6) Determine if the transit fares, charges and related policies and procedures are consistent with the City ordinances, resolutions and executive orders.

AUDIT SCOPE

This audit evaluated the contract compliance related practices and procedures of FT from January, 2010 to July, 2011. Various administrative requirements, such as the insurance requirements of the vendor and revenue procedures were also reviewed.

AUDIT METHODOLOGY

We performed detailed audit procedures upon the relevant data for the audit period. Management and staff were interviewed to better understand their roles and responsibilities as related to the various revenues, fares, funds and grants. We reviewed applicable laws, regulations, agreements, ordinances and resolutions pertaining to the transit operation. Internal Audit verified source documents and performed transaction testing to ensure that the fare revenues collected, reported and deposited were accurate, timely and complete. The required types and amounts of insurance were reviewed and verified. Similar studies and audits pertaining to transit operations were identified and reviewed.

RESULTS INCLUDING AUDIT FINDINGS, RECOMMENDATIONS AND OPPORTUNITIES FOR IMPROVEMENT

If an audit finding is identified, it will be addressed either through a Recommendation or an Opportunity for Improvement. Material findings result in Recommendations. Less serious internal procedural matters result in Opportunities for Improvement.

The objectives of this audit were achieved with the following exceptions:

Audit Finding One

The City has a current agreement, # 09-0023, with the Center for Active Generations (the Center), to provide paratransit transportation services to and from the Center, for \$1.00 per one-way ride.

All fares must be authorized by ordinance and not modified by agreement. The authorized current paratransit fares, per trip, are either \$2.00 or \$4.00, depending upon Americans with Disabilities Act (ADA) eligibility. The paratransit rates are already a heavily subsidized fare. According to SAM records, the net expense, per paratransit ride, in July, 2011 is \$23.72 per passenger.¹

Recommendation One

Only the Center is being afforded this special paratransit rate, above and beyond an already heavily subsidized fare. This agreement should be null and void since all transit fares may only be authorized and set by ordinance and may not be modified by agreement. Since this special fare is not set in ordinance, we recommend that the Center be charged the current authorized fares, effective no later than November 1, 2011. We further recommend that the City not enter into any future agreements that attempt to modify fare rates that have already been authorized and set by ordinance.

First Transit Response

Audit Finding One is in regard to a contract the City currently holds with Active Generations to provide Paratransit transportation services to and from the Active Generations facility at a rate of \$1.00 per one-way ride. The usual fare is \$2.00 per one-way ride. Nothing exists in the current ordinance authorizing this special rate. The auditor recommends not entering into a future agreement with Active Generations and to charge the Center the regular rate of fare.

In the current contract for the *Management and Operation of Sioux Falls Transit*, Point 9 states, "The City shall retain exclusive authority to establish and determine routes and the scheduling of services for the public transit system and the authority to fix and alter fares and other charges to be collected in connection with the operation of the transit system. First Transit will make recommendations as to the rates of fare required and any deletions, additions, or changes in the service and routing of the transit system."

The contract the City has with Active Generations was in place long before First Transit became the holder of the management contract. It was a decision of the City's to enter into it and therefore, completely out of the hands of First Transit. The paratransit system is a heavily subsidized system so First Transit would recommend an increase up to the normal fare to help offset the costs of this service.

¹ Sioux Area Metro, Paratransit Operational Report, July 2011

City of Sioux Falls Response

The City of Sioux Falls is currently under contract with Active Generations to provide Paratransit transportation services to and from the Active Generations facility for the Daybreak Program participants at a rate of \$1.00 per one-way ride. The usual fare is \$2.00 per one-way ride. The Auditor has determined that there is nothing in the ordinance allowing this reduced rate for Active Generations and would like to see the contract made null and void by November 1, 2011. The City will follow through with this request and will no longer offer reduced fares not listed in the transit fare ordinance other than what is allowable under special promotions/marketing.

Audit Finding Two

The fixed route fares have not increased since 1995. The paratransit fares have not changed since 1997. One of transit's major sources of revenue is the City's contribution from the general fund. The City's general fund contribution to the transit system was slightly over \$1 million in 1995 and has increased to an approved budget request of \$4.6 million in 2011. From the chart and tables on pages seven and eight, it's evident that the City's general fund contribution to the transit system has increased dramatically, while the fares have remained the same for 14 to 16 years.

According to the Sioux Falls Transit Development Plan 2011-2015, the percent of expenses recovered through passenger revenue has decreased from 14.6% in 2000 to 11.1% in 2010. The operating deficit has increased from \$3.3 million in 2000 to \$6.3 million in 2010.

Recommendation Two

We recommend that the transit system conduct a formal analysis every three years to establish and update the fare criteria and then make a recommendation as to the appropriate passenger fares. We further recommend that the initial study and recommendation, in conjunction with a proposed route analysis, be completed by July 1, 2012 and presented to the Council by October 1, 2012.

First Transit Response

This finding relates to the current fares for fixed-route and paratransit services. It has been several years since the rates have been evaluated so the Auditor would like to see a formal analysis conducted with recommendations for future fares. Again, the contract for the *Management and Operation of Sioux Falls Transit*, Point 9 states "The City shall retain exclusive authority to establish and determine routes and the scheduling of services for the public transit system and the authority to fix and alter fares and other charges to be collected in connection with the operation of the transit system. First Transit will make recommendations as to the rates of fare required and any deletions, additions, or changes in the service and routing of the transit system."

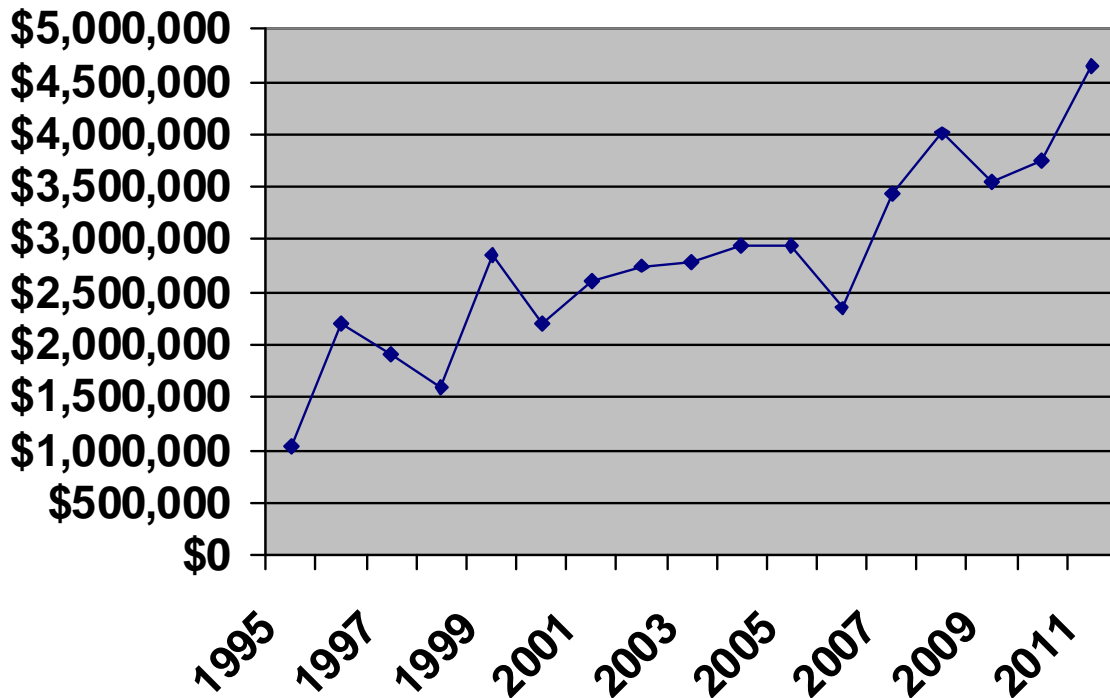
First Transit is available to offer its services as needed in moving forward with a rate analysis when the City has the funds appropriated in the budget for the study.

City of Sioux Falls Response

Per the request of the Auditor, the City of Sioux Falls will have a transit fare analysis completed. Since it has been several years since the fares were last increased, the City will compare its

current fares with the current fares of other comparable-sized communities. If a rate increase appears to be in order, the proper procedures as outline in Executive Order 11-09 will be followed to move toward implementation.

TRANSIT GENERAL FUND CONTRIBUTIONS, 1995-2011*



*From City of Sioux Falls financial records, General Ledger # 268-6801-391-1000

<u>YEAR</u>	<u>AMOUNT</u>
1995	\$1,032,429
1996	\$2,212,848
1997	\$1,908,827
1998	\$1,600,000
1999	\$2,862,010
2000	\$2,205,214
2001	\$2,609,357
2002	\$2,752,630
2003	\$2,791,086
2004	\$2,935,991
2005	\$2,936,015
2006	\$2,350,000
2007	\$3,437,785
2008	\$4,008,774
2009	\$3,549,915
2010	\$3,750,000
2011**	\$4,653,650

**Approved budget amount

**SIOUX FALLS TRANSIT
REVENUE, EXPENSES AND FUNDING SOURCES²**

Transit System Characteristics All Services Combined	Year		
	2000	2005	2010
Service Expenses and Revenue			
Operating Expenses			
Total Expenses	\$3,866,694	\$5,021,198	\$7,134,223
Cost per Total Vehicle Hour	\$40.33	\$49.46	\$65.09
Cost per Total Vehicle Mile	\$3.21	\$4.02	\$5.17
Cost per Passenger	\$5.33	\$6.00	\$6.66
Passenger Revenue (no fare increase during this time frame)	\$563,081	\$578,730	\$789,220
Revenue per Passenger	\$0.78	\$0.69	\$0.69
Percent of Expenses Recovered through Passenger Revenue	14.6%	11.5%	11.1%
Operating Deficit			
Total Deficit	\$3,303,613	\$4,442,468	\$6,345,003
Deficit per Passenger	\$4.55	\$5.31	\$6.77

Outside Funding Sources			
Year	Federal Grant	State Grant	Medicaid Reimbursement
2000	\$780,417	\$46,575	\$26,461
2005	\$1,507,000	\$46,575	\$26,434
2010	\$2,116,781	\$46,575	\$38,027

Local Funding Sources					
Year	Fixed Route Fare	Paratransit Fare	Advertising	Charter	General Fund
2000	\$319,344	\$243,737	\$26,030	\$0	\$2,205,014
2005	\$377,470	\$201,260	\$38,200	\$10,781	\$2,936,015
2010	\$550,031	\$245,854	\$83,618	\$0	\$3,750,000

² Sioux Falls Transit Development Plan 2011-2015, page 6

Audit Finding Three

SAM has a current coin machine lease agreement that authorizes Premier Vending to operate pop and snack vending machines at various City owned SAM locations. This agreement provides 10% gross sales commissions on the total sales. These commissions are used by SAM for employee related expenses such as providing flowers or memorials for funerals.

This contract is between SAM and Premier Vending, with no formal input from the City. The contract was signed by the FT general manager.

Recommendation Three

Any agreement that involves the City should be approved, in advance, in writing, by the department that is acting as the liaison between the vendor and the City. In this case, a SAM agreement involving vending machines on City property should be prepared, bid and approved by the City. All such agreements need to go through the appropriate City departments to ensure that proper legal issues are addressed, risk related insurance requirements are met and state mandated bid laws are followed. The commissions from the sale of vending items should be used by SAM to offset transit related expenses, just as advertising and fare revenue is used.

First Transit Response

The vending machine arrangement between Sioux Area Metro (previously Sioux Falls Transit) and Premier Vending has been in existence for approximately 20 years. Traditionally, management has retained 10% of the profits from the machines and deposited it in an Employee Morale and Welfare fund. The revenue generates approximately \$200 a month which has been used for things such as flowers for funerals, expenses for retirement parties, and items to extend our Safety Program. Sioux Area Metro employees are not city employees and are not included in the City of Sioux Falls' morale and award programs (i.e. Excellence in Municipal Government Award, Wellness programs, employee art shows, Jeanne Fullenkamp Management Excellence Award, and the V.L. Crusinberry Award, to name a few) so this was a way of making some special events happen to improve morale. Sioux Area Metro will comply with however the City of Sioux Falls wants us to handle this.

OPPORTUNITY FOR IMPROVEMENT

- 1) Transit fares may be purchased at a customer service station at The Bus Stop, (TBS), 120 East 11th Street. The transit employees operate the station where fares are purchased and customers' questions and concerns are addressed. The employees currently operate out of a cash box and a lockable safe. We recommend that a cash register be used for added security and to provide customers with a machine generated receipt. A cash register generated report of the day's sales would also provide an additional management tool in accounting for fare revenue.

First Transit Response

The Auditor has suggested that a cash register be installed in the Customer Service area at The Bus Stop (TBS). First Transit is a little hesitant to place a cash register at this location. TBS is not manned at night and if there is a cash register there, it would be a focus for robbery. With the current cash box being kept below in a desk drawer, money is not in the customer's line of sight and so it is not a visual focal point. Approximately \$500 changes hands at TBS daily through the purchase of fare cards. Cash on hand is taken to the main Transit facility at the end of the day by the Road Supervisor on duty. The fare card purchased acts as a receipt and, not having paper receipts has not been an issue with the customers. If

a receipt is requested, a hand written receipt is completed for them. Balancing the day's receipts is a relatively easy procedure done by balancing the number of fares cards sold with the amount of cash on hand. The existing Printer Encoding Machine already generates a report. I recommend that we do not purchase a cash register for TBS because 1) space is extremely limited, 2) the visual appearance of a cash register could lead to security issues, and 3) there is a system of checks and balances in place.

OPPORTUNITY FOR IMPROVEMENT

- 2) The daily sales revenue from TBS is returned, by a supervisor, to the SAM office at the end of each business day. We recommend that the transit supervisor prepare the deposit and then do a night bank drop, rather than return the funds to the SAM office. Having someone other than the cashier prepare the deposit provides a greater segregation of duties involving cash transactions. The daily bank drop would deliver the funds to the bank in a more direct and timely manner.

First Transit Response

As listed in Opportunities for Improvement #1, the Road Supervisor brings any cash from TBS to the main facility at the end of each day. It is placed in a vault and the Administrative Supervisor conducts a reconciliation of the transactions the next morning to ensure an accurate accounting of the funds. The Auditor is suggesting that the cash be taken directly to a bank drop box instead. The Road Supervisor could do this but Transit would need to have another FTE supervisor on duty while the one supervisor is absent making the drop. Currently, there are typically no more than two supervisors on duty in the evening and sometimes there is only one. The Road Supervisor's job is safety and security of the buses and the three transit facilities. The supervisor is also responsible for the movement of revenue vehicles and the checking in and out of drivers. Additionally, if there is a bus accident, the Road Supervisor needs to immediately go to the scene. It would difficult for Transit to absorb this additional duty of making the bank drop at the end of the day.

OPPORTUNITY FOR IMPROVEMENT

- 3) The entry door at TBS, to the driver room and the customer service station, is currently closed, but unlocked during business hours. The general public is able to access this area. An employee card-activated locked entry door would provide the necessary security while permitting access for authorized transit personnel.

First Transit Response

The Auditor is requesting a card-activated entry system to the Customer Service and Driver Lounge area. There is currently a lock on both the drivers lounge door and on the interior door to the Customer Service area. The buses arrive at TBS pretty much at the same time so many of the drivers come into the Driver's Lounge together. Because of this, the door will frequently be unlocked to accommodate them. There is a lot of activity during the day but there is also a strong Road Supervisor presence. The fact that the expense of a card-activated locking system is not in the Transit budget for this year or next year may make it cost-prohibitive to accomplish.

City of Sioux Falls Response

The improvement request related to the card-activated locking system at The Bus Stop will be addressed first by researching the costs for this type of system. If there are funds to purchase the system in the 2012 budget, it will be purchased and installed within that calendar year. If the funds are not available in 2012, it will be included in the budget for 2013.

OPPORTUNITY FOR IMPROVEMENT

- 4) Transit payroll is funded through an account at a local bank. Transit receives the monthly bank statements and the City Finance Department transfers the appropriate funds to this account. It is recommended that a transit employee perform a monthly bank reconciliation on this account, a practice that is not currently being followed. The employee that completes the bank reconciliation should be someone other than the employee(s) responsible for preparing the deposits. This will provide for a greater segregation of duties involving cash and other revenue.

First Transit Response

The Auditor is recommending that the Finance Officer conduct a monthly reconciliation of the payroll bank account. The bank account is used solely for employee payroll. When payroll is complete, the Sioux Area Metro Finance Officer requests a transfer into the account from the City to cover payroll expenses. The reconciliation process will begin immediately.

OPPORTUNITY FOR IMPROVEMENT

- 5) SAM provides approximately 40,000 free bus passes to certain social services agencies, who issue the passes to their clients. This program is provided for in ordinance³ and is referred to as the Pass-It-On bus pass program. The ordinance does not establish the number of passes that SAM provides on an annual basis. We recommend that the City initiate a formal agreement with the involved social agencies with the primary purpose of establishing the criteria for the Pass-It-On program and then review annually the number of proposed passes.

First Transit Response

The City currently donates 40,000 transit passes through the Pass-it-on Program. Several local human service agencies distribute the passes to those experiencing a financial hardship. The Auditor would like to see a contract in place with each of the participating agencies. There is no formal contract at this time. Since this is a program initiated by the City and any formal agreement would be between the City of Sioux Falls and the human service agency participating in the program, this is not a task to be carried out by First Transit.

City of Sioux Falls Response

The Pass-it-on Program was initiated by the City several years ago. There are currently 13 human service agencies receiving transit passes for distribution to their clients. The City will draw up a contract for the agencies outlining the guidelines of the program and their obligations as participants of the program.

Internal Audit recommends that the Opportunities for Improvement be completed by December 1, 2011.

³ City of Sioux Falls Revised Ordinance Number 47-10, effective date 5/27/10.

CONCLUSION

We thank the management and staff of First Transit, its subsidiary SuTran and the City Transit Planner for their cooperation and assistance throughout the course of this audit.

PERFORMED BY

The audit and report was completed by Jeff Weber, Internal Auditor and reviewed by Rich Oksol, CPA, CGAP, Lead Internal Auditor.