TheRide
Ann Arbor Area Transportation Authority

Agenda Item: 5.1.1

Monitoring Report:
Financial Planning / Budgeting (Policy 2.4)
Monitoring Period:

Finance Committee Meeting Review Date: September 12, 2023

Board of Directors Meeting Review Date: September 21, 2023

INFORMATION TYPE
Monitoring
RECOMMENDED ACTION(S)
That the Board review this monitoring report and consider accepting it as: (A) a reasonable interpretation for **all** policy items and that the evidence demonstrates compliance with the interpretations. (B) a reasonable interpretation for all policy items and that the evidence demonstrates compliance with the interpretations, except for the CEO's stated non-compliance with item(s) x .x, which the Board acknowledges and accepts the proposed dates for compliance.is making reasonable progress towards compliance. (C) 1. For policy items x.x.x – there is evidence of compliance with a reasonable interpretation 2. For policy items x.x.x – the interpretation is not reasonable 3. For policy items x.x.x – the interpretation is reasonable, but the evidence does not demonstrate compliance 4. For policy items x.x.x – the Board acknowledges and accepts the CEO's stated non-compliance and the proposed dates for compliance
PRIOR RELEVANT BOARD ACTIONS & POLICIES
Monitoring Reports are a key Policy Governance tool to assess organizational/CEO performance in achieving Ends (1.0) within Executive Limitations (2.0). A Policy-Governance-consistent Monitoring Process is: 1. CEO sends Monitoring Report to all board members 2. At Board meeting, board accepts Monitoring Report through majority vote (or if not acceptable, determines next steps)
ISSUE SUMMARY
TheRide's Board of Directors establish policies that define what methods are unacceptable to use to achieve expected results, called Executive Limitations. This monitoring report provides the CEO's interpretations of those policies,

evidence of achievement, and an assertion on compliance with the Board's written goals. As with other monitoring reports, the Board decides whether the interpretations are reasonable, and the evidence is convincing.

Per Appendix A of the Board Policy Manual, this report was scheduled for monitoring in September and was submitted in August.

I certify that the information is true and complete, and I request that the Board accept this as indicating an acceptable level of compliance.

CEO's Signature	**Date**
______________________	______8/29/2023_________

ATTACHMENTS
1. Monitoring report for Financial Planning / Budgeting (Policy 2.4)

Table of Contents

Fully Compliant   Partially Compliant   Non-Compliant

Preliminary CEO Interpretations and Evidence

POLICY 2.4 Financial planning for any fiscal year or the remaining part of any fiscal year shall not deviate from Board's Ends priorities, risk fiscal jeopardy, or fail to be derived from a strategic multi-year plan. Further, without limiting the scope of the foregoing by this enumeration, the CEO shall not cause, allow or fail to address budgeting that:
Degree of Compliance: Compliant
Interpretation
Measure/Standards & Level of Achievement Compliance with this policy will be demonstrated when there is compliance with all lower-level policies. Rationale This interpretation and degree of achievement is convincing because the board has fully interpreted this policy in lower level policies: A. Deviation from Board's Ends priorities (2.4.2), B. Derived from strategic multi-year plan (2,4,2, 2.4.4, 2.4.7), and C. Risk fiscal jeopardy (2.4.1, 2.4.3, 2.4.5, 2.4.6, 2.4.7, 2.4.8).
Evidence
Source of Data: Compliance of lower-level policies **Date of Data Review:** 8/29/2023 as verified by Chief Executive Officer **Data:** As demonstrated below, policies 2.4.1-2.4.8 are reported to be in compliance.

POLICY 2.4.1
Risks incurring those situations or conditions described as unacceptable in the Board policy "Financial Condition and Activities."

Degree of Compliance: Compliant

Interpretation

Policy *2.5: Financial Conditions and Activities* pertain to daily actions in managing the money *after a budget has been approved*. It is the monitoring report for policy 2.5 (not this one) that will assess the compliance with 2.5 in detail. I interpret that this policy and monitoring report are about elements in a recommended annual budget that could impact compliance with 2.5 in the future. Further, the Budget does not impact many elements of policy 2.5 directly, for example having policies and procedures, which are duties of staff. These issues will be addressed in the monitoring report for 2.5.

<u>Measure/Standards & Level of Achievement</u>
Compliance with this policy will be demonstrated when:

1. Recommendations pertaining to decisions the Board has reserved for itself (i.e. authorization of unbudgeted contracts over $250,000, use of the Capital Reserve, adjustments to tax rates or fares, real estate transactions, or creation of debt) are clearly noted.
2. The recommended budget includes resources to hire an independent auditor.

Rationale

A. The Board has identified specific budget controls in policy 2.5. Ensuring these items are addressed in the budget maximizes compliance with 2.5.
B. Policy 2.5.4 requires the CEO must not compromise the Board's audit, so it is necessary to provide budgeted resources for an external auditor.

Evidence

Source of Data: Draft FY 2024 Operating and Capital Budget (the budget) and Corporate Business Plan FY2024 (the business plan)
Date of Data Review: 8/23/2023 as verified by the Deputy CEO, Finance and Administration
Data:

A. The following decisions reserved for the Board under Policy 2.5 are addressed in the budget as follows:
    a. 2.5.6 Budgeted Contracts – Contracts over $250,000 are illustrated on page 48.
    b. 2.5.7 Capital Reserve Funds – There is no use of capital reserve funds in the budget.
    c. 2.5.9 Tax Rates – There are no adjustments to tax rates affecting the budget.
    d. 2.5.10 Real Estate Transactions – The capital budget includes a budget for acquiring land for the Ypsilanti Transit Center (page 39). In accordance with Policy 2.5.10, approval by the Board will be requested prior to purchase. Approval of the budget

allocates the financial resources to acquire the land but does not provide approval of the purchase.

e. 2.5.11 Debt – As indicated in the capital plan (pages 38-39)_there is no debt funding planned in the budget.

B. Auditing Fees – As indicated in Figure 14: Contractual Services Summary (page 31), auditing fees consistent with historical spending plus inflation are included in the budget.

POLICY 2.4.2

Fails to place business decisions in a comprehensive, strategic context that illustrates progress towards Ends and compliance with Executive Limitations.

Degree of Compliance: Compliant

Interpretation

I interpret this policy to mean that each draft annual budget (and the expenditures therein) must be informed by a multi-year strategic planning plan that illustrates how the agency will align its resources to make progress towards achieving the expectations set by the Board (policies).

Measure/Standards & Level of Achievement

Compliance with this policy will be demonstrated when the CEO produces an annual Corporate Business Plan that together:

1. Uses the Board policies as the only goals/outcomes to be achieved. *All* efforts must be aligned towards these outcomes.
2. Provides a summation of the agency's current situation sufficient to establish a common understanding of the plan' starting point and key considerations.
3. Illustrate how activities (i.e. expenditures, initiatives, projects, Means, etc.) are A) aligned to meet the Board's Ends goals and/or advance compliance with Executive Limitations, and B) how staff, community and the Board participate to provide input on the activities before they are adopted in the budget for funding.
4. Provides a multi-year framework of 5 years for operational initiatives and 10 years for capital initiatives. Longer-term context can be provided, as necessary, in supplemental documents.

Rationale

This interpretation and degree of achievement is convincing because

A. The Board's written policy expectations are the strategic goals the agency is to achieve (the What's and Why's). No strategic planning process can afford to be unclear about the outcomes it is trying to achieve. Each initiatives should be clearly advancing one Board policy or another.

B. A summary of the agency's current situation establishes a common understanding of the starting point, clarifies background, provides situational awareness, and focuses on key issues.
C. Being able to articulate how activities advance the Board's goals (i.e. How) is a central part of any planning exercise. Providing staff, board and the public an opportunity to review activities before they are funded ensures transparency of the organization's work before they are finalized/ funded. Otherwise, under Policy Governance Means are delegated to the CEO who is responsible for proposing/enacting the most appropriate approach.
D. The 5 and 10 year timeframes are appropriate for the duration of the operating or capital activities anticipated and to illustrate progress towards goals. Longer timeframes (10-25 years) can be useful for long-range planning exercises. Shorter durations may not provide enough context. All business decisions are addressed, directly or indirectly, through the Business Plan and Budget documents. All expenditures are addressed in each annual budget.

Evidence

Source of Data: Corporate Business Plan, Draft FY 2024 Budget, TheRide2045 (long-range plan)
Date of Data Review: 8/24/2023 as verified by Corporate Strategy & Performance Officer
Data:

A. The Board's Ends policies appear on page 3 of the Business Plan. All recommended initiatives are cross-referenced to illustrate which Board policy (Ends or Executive Limitation) they are intended to advance (pgs. 15-24).
B. The Business Plan provides historical background on ridership trends (pg. 5-7) in part to focus attention on this key output. It also provides SWOT (pgs. 32-33), PESTLE (p. 34) and GAP (p35) analyses.
C. The Business Plan provides a framework of cascading goals, objectives, and tactics to document alignment of activities with policy requirements (pgs. 8-14). The Business Plan provides an outline of key criteria staff use while vetting various Means (pgs. 36-37). It also provides project descriptions and references to which policies each initiative advances (pgs.15-24). Ways to provide input or feedback on the plan are provided (pgs. 2 & 32).
D. The Business Plan (v10a) provides 5- and 10-year plans in Gantt charts on pages 19 and 24. TheRide2045 provides a longer, 22-year perspective to help guide long term infrastructure investments.

POLICY 2.4.3

Omits credible projection of revenues and expenses, separation of capital and operational items, cash flow, and disclosure of planning assumptions.

Degree of Compliance: Compliant

Interpretation

Measure/Standards & Level of Achievement

Compliance with this policy will be demonstrated when the annual draft budget includes transparent estimates of future revenues and costs sufficient to; contextualize elements of the budget, illustrate how agency resources will be used (i.e. alignment with policy goals), and how longer-term financial considerations influence pending decisions. Specifically, this will include:

1. Cost estimates of 5-year operating and 10-year capital expenses by category or project as appropriate,
2. Revenue estimates for 5-year operating and 10-year capital revenues,
3. Assumptions that are based on historic financial evidence, identified risks, and future circumstances.
4. Cash Flow projections (annually) for the current year and the next five years that are based on operating and capital budget.

Compliance will be further illustrated when there is an adopted long-term service plan that provides illustrative capital and operation cost estimates beyond a 10-year horizon.

Rationale

This interpretation and degree of achievement is convincing because:

A. The budget and a long-term plan are the logical place to house financial projections,
B. Transparent estimates and assumptions speak to credibility, and allow accountability and learning,
C. 5-year operating projections are reasonable because longer-term estimates of operating costs add little value while a shorter horizon does not provide enough time to foresee potential shortfalls.
D. 10-year capital estimates are reasonable because every project has a 5-15 year development timeline, coordinating multiple large projects requires a longer timeframe to foresee cashflow requirements and potential conflicts between projects, and the high costs make the agency dependent on outside funding that cannot be guaranteed. A shorter horizon will not provide enough time to address the above considerations and could create unrealistic expectations for most construction projects.
E. Annual projections of Cash Flow illustrate the net budget position, and ability to meet expenses.

Evidence

Source of Data: Draft FY 2024 Operating and Capital Budget (the budget)
Date of Data Review: 8/23/2023 as verified by the Deputy CEO, Finance and Administration
Data:

A. Cost Estimates – Page 37 provides estimates of 5-year operating expenses by category and page 39 provides 10-year capital expenses by project.
B. Revenue Estimates – Page 37 provides estimates of 5-year operating expenses by category and page 39 provides 10-year capital expenses by project.
C. Assumptions – Pages 28 through 34 and 45 through 47 provide operating and capital budget assumptions, respectively.
D. Cash Flow Projections – Page 42 provides cash flow for the current year and the next five years. Cash flow is based on operating and capital budget revenue and expense projections as presented in the budget.

POLICY 2.4.4

Is unclear about long-term funding needs and growth projections.

Degree of Compliance: Compliant

Interpretation

Measure/Standards & Level of Achievement

Compliance with this policy will be demonstrated when the annual budget clearly outlines 5-10 year financial assumptions for:

1. Maintaining operation of existing services,
2. Maintaining assets (per Board policy and FTA requirements),
3. Mitigating against foreseeable risk,
4. Implementing expansion plans (i.e. TheRide2045, the long-range plan), and
5. Changes in ridership (i.e. passenger demand).

Rationale

This interpretation and degree of achievement is convincing because it accounts for the main elements of funding needs (Maintaining existing services and equipment, risk, expansion, growing demand).

Evidence

Source of Data: Draft FY 2024 Operating and Capital Budget (the budget)
Date of Data Review: 8/23/2023 as verified by the Deputy CEO, Finance and Administration
Data:

1. Page 10 of the budget states that the budget includes operating full service levels and funding for millage service expansions. Page 37 demonstrates that there is no reduction in

funding for operations, and that there are increased levels of funding for expanded services through the projection period (6 additional years).
2. Page 39 of the budget demonstrates that there is funding for maintaining assets through capital funding in the "State of Good Repair" section for the projection period (10 years).
3. The projections included on page 37 and 39 of the budgets include average annual inflationary increases of at least 3% per year. There are some exceptions, such as union salary and wage increases, which are based on the current bargaining unit contract in the first few years, and then 3% annually after expiration of the current contract. Additionally, some areas of the budget include additional inflationary adjustments based on historical trends that may be higher than 3%, such as different types of insurance costs.
4. Expansion plans are included in the budget as follows:
    a. Millage services to be implemented in FY2024 and through the projection period are described in the operating budget on pages 8 through 10. Increased funding to support initiatives are demonstrated in the budget and projections on page 37. Operating costs supporting the longer-term service changes, such as Bus Rapid Transit (BRT) are beyond the current millage cycle and are not included in the projections as funding has not been approved and will not be implemented until funding becomes available.
    b. Longer term expansion plans are described in the capital plan on pages 11 through12. Increased funding to support capital initiatives are provided in the capital budget and projections on page 39.
5. Changes in ridership are described in the budget on pages 24 through 26.

POLICY 2.4.5

Causes deficit spending.

Degree of Compliance: Compliant

Interpretation

<u>Measure/Standards & Level of Achievement</u>

Compliance with this policy will be demonstrated when the draft annual budget demonstrates that:
1. Projected costs do not exceed reasonable forecasts of revenues,
2. Any unsecured revenue sources, such as aspirational or competitive capital grants, are clearly identified,
3. Operating and Capital reserves are maintained at appropriate levels, and
4. Maintenance is not deferred.

<u>Rationale</u>

This narrow interpretation and degree of achievement is convincing because,
A. While multi-year forecasts are included in the budget for context, the Board only approves one year of budget at a time. Projections of future deficits do not cause deficit spending. The CEO cannot recommend a budget that would cause immediate deficits. This is also

consistent with state law which says our annual budget must be balanced. Forecasting future deficits may be necessary to represent the agency's circumstances honestly and transparently.

B. Stipulating the reserves must be maintained eliminates the option of drawing down those reserves to temporarily increase spending beyond what revenues could support longer-term.
C. Stipulating that required maintenance be conducted eliminates the option of underfunding these important activities in order to temporarily increase spending beyond what revenues could support longer-term.

Evidence

Source of Data: Draft FY 2024 Operating and Capital Budget (the budget)
Date of Data Review: 8/23/2023 as verified by the Deputy CEO, Finance and Administration
Data:

1. On page 35 of the budget, Figure 17 demonstrates that the FY2024 Operating Budget is balanced. On page 38 of the budget, Figure 18 demonstrates that the FY2024 Capital Budget is balanced.
2. On page 39 of the budget, Figure 21 shows anticipated funding sources for aspirational projects, including some projects that are unfunded later in the projection period.
3. On pages 42 through 43, descriptions of required operating and planned capital reserves are provided, along with multi-year projections demonstrating reserve requirements are met through the projection period. Additional compliance with operating reserve requirements are described on pages 21 through 22.
4. On page 30 of the budget explanations of additional funding for maintenance are described under fuel, materials and supplies expenses and contractual services in the operating budget. Also, fleet and facilities maintenance staff are fully funded in the operating budget, including additional staff needed to support additional service hours due to the millage services. As described on page 39, the capital plan also includes "State of Good Repair" funding for equipment and existing facilities. All operating and capital items are fully funded through the projection periods.

POLICY 2.4.6

Does not provide for adequate reserves.

Degree of Compliance: Compliant

Interpretation

Measure/Standards & Level of Achievement

Compliance with this policy will be demonstrated when the draft annual budget provides for:

1. An operating reserve with funding equivalent to at least 2.5 months of operating costs and intended to ensure continuity of agency operations the event that regular revenues are disrupted.
2. A Worker's Compensation Insurance Reserve with at least $500,000 is available to pay for claims costs beyond what is anticipated in the budget in any given fiscal year.
3. A Capital Reserve (of whatever amount is available) intended to help pay for the local match in competitive federal grant applications, or for other capital expenses.

Rationale

This interpretation and degree of achievement is convincing because:

A. An **operating reserve** is prudent because it provides an easily-accessible amount of funding to ensure agency operations do not have to shut down in the event normal funding mechanisms were temporarily interrupted. Unpredictable circumstances beyond the agency's control such as cyberattacks, federal government shutdowns or paperwork errors can disrupt normal cash flow and impact paychecks and fuel purchases. A reserve provide an emergency buffer against such interruptions.

   The Government Finance Officers Association (GFOA) best practice recommends, *at a minimum*, that governments maintain at least two (2) months of regular operating expenditures in reserve. Given recent volatility, the CEO and CFO feel that a more conservative stance is warranted, and a target of 2.5 months is appropriate.

B. The **Worker's Compensation Insurance Reserve** is an important part of the agency's approach to being self-insured, which is more cost-effective than paying high insurance premiums. The level of $500,000 has been historically adequate.

C. A **capital reserve** is useful to sequester one-time surplus funds to help provide the local match for competitive federal grants. Presently, the agency has a board-approved long-range plan with numerous capital projects. Several grants will be needed, making a capital reserve a prudent tool.

   The adequacy of the amount of funding in the capital reserve is entirely dependent on available resources. Saving for future growth is the last priority after maintaining existing assets and services. Presently, the agency does not have a permanent funding source for the capital reserve.

D. There are no other reserves.

Evidence

Source of Data: Draft FY 2024 Operating and Capital Budget (the budget)
Date of Data Review: 8/23/2023 as verified by the Deputy CEO, Finance and Administration
Data:

1. Operating Reserves – As indicated on page 43, Figure 25 illustrates exceed the reserve through the projection period.
2. Worker's Compensation Insurance Reserve – As illustrated on page 22, the reserve is fully funded. There is no additional funding needed as part of the FY2024 Budget.
3. Capital Reserve – As illustrated on page 43 of the budget, while there is no anticipated contribution to the Capital Reserve in FY2024, the CEO expects the reserve balance to its highest amount ever.

POLICY 2.4.7

Provides less for Board prerogatives during the year than is set forth in the Cost of Governance policy.

Degree of Compliance: Compliant

Interpretation

Measure/Standards & Level of Achievement
Compliance with this policy will be demonstrated when the draft annual budget incorporates the budget for Board activities adopted by the Governance Committee.

Rationale
This interpretation and degree of achievement is convincing because the Governance Committee has been delegated "primary responsibility" for Costs of Governance (3.7.1[f]).

Evidence

Source of Data: Draft FY 2024 Operating and Capital Budget (the budget)
Date of Data Review: 8/23/2023 as verified by the Deputy CEO, Finance and Administration
Data:

Cost of Governance – As indicated on page 32 of the budget, per Board Policy 3.8.3, there is $50,000 budgeted in FY2024. This amount is recommended by the Governance Committee as documented in committee meeting minutes for August 24, 2023.

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POLICY 2.4.8

Funds ongoing operations via debt or creates unfunded future obligations.

Degree of Compliance: Compliant

Interpretation

I interpret this policy to be about not compromising the agency's future viability to increase short-term spending.

Measure/Standards & Level of Achievement
Compliance with this policy will be demonstrated when:

1. The draft annual budget does not require the Board to approve debt to maintain existing levels of public services or assets for the upcoming year,
2. Any one-time revenues are not used to create permanent ongoing expenses, and
3. The draft annual budget does not forecast operating deficits.

Rationale
This interpretation and degree of achievement is convincing because:

A. It covers both operating and capital expenses,
B. The absence of an request to authorize debt is evidence of spending discipline,
C. Creating ongoing expenses with temporary funding would create a future obligation, and
D. The credible projections required in earlier policies illustrate the future implications of immediate spending decisions.
E. This interpretation still allows the CEO to recommend that the Board approve debt as long as there is a revenue source to pay for it, for example revenue bonds paid for by a supplemental millage.

Evidence

Source of Data: Draft FY 2024 Budget and compliance of noted policies
Date of Data Review: 8/23/2023 as verified by the Deputy CEO, Finance and Administration
Data:

1. Debt – As indicated on page 9 of the FY2023 audited financial statements, liabilities, AAATA has no debt.
2. One-Time Revenues – As indicated on page 37 of the budget, the CEO has not caused new obligations for the AAATA that cannot be funded with reasonably foreseeable revenues. All increased expenses related to service expansions are funded with the August 2022 millage beginning in FY2024.
3. Operating Deficits – As indicated on page 35 of the budget, there is no projected deficit in FY2024.

Policy Trendlines

Policies	FY 21	FY 22	FY 23
2.4	3	3	3
2.4.1	3	3	3
2.4.2	3	3	3
2.4.3	3	3	3
2.4.4	3	3	3
2.4.5	3	3	3
2.4.6	3	3	3
2.4.7	3	3	3
2.4.8	3	3	3

LEGEND	
(red)	Policy is not compliant
(orange)	Policy is partially compliant
(green)	Policy is compliant

Guidance on Determining “Reasonableness” of CEO Interpretations

Are the interpretations reasonable?
An interpretation is reasonable if the following are provided,
1. a measure or standard,
2. a defensible rationale for the measure or standard,
3. a level of achievement necessary to achieve compliance and
4. a rationale for the level of achievement.

Is evidence verifiable?
Evidence is verifiable if there is
1. actual measurement/data,
2. the source of data and
3. the date when data was collected is provided.

CEO Notes: (If Applicable)

The flow of the monitoring report may make more sense if policies 2.4.1 and 2.4.7 are moved to the end of 2.4. They are very specific about budget content and disrupt the strategic narrative of the other policies.

Board's Conclusion on Monitoring Report

Board's conclusion after monitoring the report.
Following the Board's review and discussion with the CEO, the Board finds that the CEO:

(A) a reasonable interpretation for **all** policy items and that the evidence demonstrates compliance with the interpretations.

(B) a reasonable interpretation for all policy items and that the evidence demonstrates compliance with the interpretations, except for the CEO's stated non-compliance with item(s) x .x, which the Board acknowledges and accepts the proposed dates for compliance.is making reasonable progress towards compliance.

(C) 1. For policy items x.x.x – there is evidence of compliance with a reasonable interpretation
2. For policy items x.x.x – the interpretation is not reasonable
3. For policy items x.x.x – the interpretation is reasonable, but the evidence does not demonstrate compliance
4. For policy items x.x.x – the Board acknowledges and accepts the CEO's stated non-compliance and the proposed dates for compliance

Board Notes: (If Applicable)

Board accepted the policy as (A) a reasonable interpretation for all policy items and that the evidence demonstrates compliance with the interpretations.